

James K. Boyce
Department of Economics
University of Massachusetts at Amherst

*The Political Economy
of External Indebtedness*

A Case Study of the Philippines

CONTENTS

List of Tables.....	vi
List of Figures.....	vii
Acknowledgements.....	ix
1. Introduction	1
2. The Balance of Payments, 1962-1986	5
Reading the Balance of Payments.....	6
The Aftermath of Decontrol, 1962-1970	8
Debt-driven Growth, 1970-1983	10
The Long Crisis, 1983-1986.....	15
3. The External Debt: Magnitude and Composition.....	19
Definitional Problems	19
Total External Debt Outstanding by Borrowing Sector	21
Distribution of External Debt by Creditor	27
Term Structure of External Debt	30
4. Capital Flight: The Missing Billions	35
The Concept of 'Capital Flight'	37
Mechanisms for Capital Flight	39
The Measurement of Capital Flight.....	43
5. The Kiss of Debt.....	55
Debt and the Current Account Deficit.....	55
Debt, Savings, Investment, and Growth.....	59
Debt and Capital Flight: The Revolving Door	62
Debt and the Aggrandizement of the State	80
6. Conclusions	83
Debt for Development?	83
Policy Alternatives	84
Who Should Forgive Whom?.....	91
Bibliography	93

List of Tables

Table 1 : The Philippine Balance of Payments, 1962-1986	7
Table 2 : Exchange Rates of the Philippine Peso, 1962-1986	12
Table 3 : Alternative Estimates of Total Philippine External Debt Outstanding, 1961-1986	22
Table 4 : External Debt of the Philippines by Borrowing Sector, 1961-1986: A Constructed Time Series	23
Table 5 : Net Flow and Net Transfer, 1962-1986	28
Table 6 : Public External Debt by Creditor, 1963-1983	29
Table 7 : Term Structure of External Debt, 1965-1986	31
Table 8 : Ratio of Capital Flight to External Debt, Selected Countries.....	36
Table 9 : Change in External Debt and Non-flight Uses of Foreign Exchange, 1962-1986	44
Table 10: Capital Flight: Residual and Hot Money Measures (without adjustments).....	46
Table 11: Trade Invoicing Discrepancies, 1962-1986	49
Table 12: Summary Estimates of Philippine Capital Flight, 1962-1986	51
Table 13: Savings, Investment, and Growth, 1971-1983	61
Table 14: Foreign Savings Correlations	61
Table 15: Predicted Effects of Independent Variables in Debt-Capital Flight Regressions	75
Table 16: Independent Variables for Analysis of Determinants of Philippine Capital Flight.....	76

Fig. 1:	The Net Transfer Cycle	2
Fig. 2:	External Debt Inflows and Capital Flight, 1962-1986	52
Fig. 3:	Linkages Between Debt Disbursements and Capital Flight.....	64

Acknowledgements

This monograph is part of a larger work in progress, a book on the Philippine economy from 1962 to 1986 commissioned by the Development Center of the Organization for Economic Cooperation and Development as a component of its Research Program on Economic Choices before the Developing Countries. I am grateful for the support from the Development Center and for the encouragement from Dr. Keith Griffin.

I am also grateful for the research facilities generously extended to me by the Philippine Institute for Development Studies (PIDS) and for the opportunity to publish this volume as a PIDS Monograph.

A number of individuals assisted in my research on the Philippine external debt, and it is a pleasure to acknowledge them. Benito Legarda, Manuel Montes, Keith Griffin and Jose E.R. Ledesma read the manuscript and provided many helpful criticisms. In carrying out the econometric analysis of the relationship between debt and capital flight, I benefitted from the suggestions of Gerald Epstein, Martin Ravallion, and the participants in the January 1989 seminar sponsored by the PIDS where I presented an earlier version. Walden Bello, John Cavanagh, and Robin Broad provided access to a number of crucial documents. Annette Balaoing, Linda Balaoing, Lynn Duggan, Lester Henry, Tom Hutcheson, Tania Meisner, Beng Tan of IBON Databank, and Lyuba Zarsky provided valuable research assistance. In addition, I am thankful to the many individuals in the Philippines and elsewhere who agreed to be interviewed in the course of my research.

None of the above-named institutions or individuals bear any responsibility for the views expressed here, nor for any errors.

To all of them I owe a debt of gratitude - the best kind.

J.K.B.

June 1990

Introduction

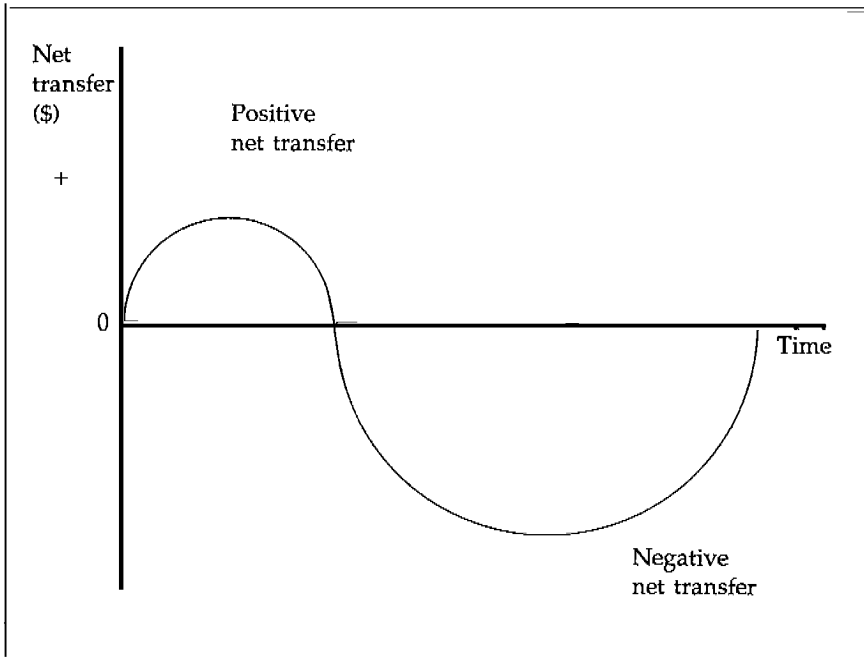
Foreign borrowing was a key element in Philippine development strategy under the Marcos government. The primary rationale advanced by the government and the external creditors was "development": borrowed money would speed up the growth of the Philippine economy, improving the well-being of present and future generations of Filipinos. If this was the goal, the strategy must be judged a historic failure.

The most evident legacy of the debt-for-development strategy is the \$28 billion external debt bequeathed by the Marcos regime to the new government of Mrs. Corazon Aquino in 1986. Payments on this debt today absorb some US\$3.5 billion per year, or about 10 percent of the country's gross national product. The legacy of the debt runs deeper, however, for the borrowed funds were put into uses which have had profound consequences for the Philippine economy.

Debt service does not pose a serious burden as long as enough new money can be borrowed to pay for it. The Philippines' mounting debt service obligations were met in precisely this fashion until 1983. It is in the nature of debt, however, that new money sufficient to service past loans cannot be borrowed forever. The reason, of course, is that loans must be repaid with interest. Ever larger sums must be borrowed to repay prior debts, until the creditors are eventually unable or unwilling to lend enough new money to meet debt service requirements. At that point, the *net transfer* - new money minus interest and principal repayment on past loans - turns negative.

This inexorable course of events is depicted in Figure 1. Starting with no debt and zero net transfer, the borrowing country initially receives a positive net transfer: the credit inflow comes first, the debt service outflow follows. As debt service rises over time, more and more new money is needed to maintain the positive net transfer. Sooner or later, assuming that the loans are repaid with interest, the country reaches the critical breaking point wherein debt service payments surpass the inflow of new money. This stage the beginning of negative net transfers.¹

Figure 1
THE NET TRANSFER CYCLE



The total amount of the negative net transfer is represented by the area above the curve and below the horizontal axis. It is, of course, much larger than the earlier positive net transfer (the area below the curve and above the axis). The difference between the two is total interest payments.

The net transfer cycle depicted in Figure 1 is not merely a theoretical possibility: it is a logical necessity. Creditors cannot increase lending

1. The precise shape of the net transfer curve depends, of course, on loan timing and interest rates. For a depiction of the net transfer cycle assuming 'World Bank-type terms' of seven percent interest, 25-year maturity, and a five-year grace period, see Frank (1972, p. 31).

indefinitely. The only question is timing, which depends on the interest rate and on the willingness of creditors to supply new money. The question is not *if* the breaking point will come at all, but *when*. For the Philippines, it came in 1983.

Consider the circumstances under which a country, once it reaches the stage of negative net transfers, could be deemed 'better off' than it would have been had it never borrowed at all.

If the borrowed money was invested productively and generated a rate of return greater than the interest rate, then the country would be better off in the aggregate sense that national income, net of external transfers, would be higher than it would have been without the loans. This rate of return must, of course, be calculated in hard currency. If inadequate foreign exchange earnings force a devaluation of the local currency, the required rate of return is pushed correspondingly higher.

What if part of the borrowed money is not invested, but rather is spent on consumption items such as imports of food or arms? What if part leaks out of the country as capital flight? What if part of that capital invested domestically fails to yield the necessary rate of return? In all these cases, the necessary condition for the country to be judged "better off" becomes still more stringent: the rate of return on the remaining capital must be high enough to cover not only its own repayment with interest (in foreign exchange), but also interest and principal repayment for that portion of borrowed money which was consumed, lost in capital flight, or invested at inadequate rates of return.

In theory, these stringent conditions could be met. If, for example, money was borrowed at eight percent interest, and five percent of this borrowed money was channelled into consumption, five percent into capital flight, and five percent into domestic investment yielding an average rate of return of only four percent, the country could still emerge better off — if the remaining 85 percent of foreign borrowings yielded a rate of return of at least 21 percent, calculated in hard currency. In theory, then, a debt-for-development strategy could succeed in raising aggregate income net of external transfers during the stage of negative net transfers.

In practice, however, these conditions are seldom fulfilled. The share of loans invested productively and the rate of return on that investment are typically insufficient to provide a net income gain once the inevitable negative net transfer occurs. Instead, net income during the era of negative net transfers is *lower than it would have been if no money had ever been borrowed*.²

External borrowing for unproductive (or insufficiently productive) purposes becomes addictive. At first, small doses of foreign funds may

2. For expositions of the net transfer cycle, see also Griffin (1978, Ch. 3) and Payer (1990, Ch. 25).

offer temporary relief from various economic woes. But in the end, the woes remain unsolved, sending the borrower back for more of the financial narcotic in ever larger doses. Over time, dependence upon the lender grows.

The term 'cold turkey' refers to the intensely painful withdrawal symptoms suffered by a narcotics addict when deprived of the drug. It is also used by economists to describe sharply recessionary anti-inflation strategies.³ This economic analogy is even more apposite in the case of a heavily indebted country facing the inevitability of a negative net transfer, and desperate for new money to ease the pain of debt service.

Why, then, do countries embark upon the perilous road of large-scale external debt? There are two reasons: myopia, and social heterogeneity.

Individuals tend to be myopic, or short-sighted: they value the present more than the future. Standing at time zero in Figure 1, they see the alluring mountain of the positive net transfer but lose sight of the deep valley of the negative net transfer which lies beyond it.

One may hope that governments will resist this short-sightedness and pursue a longer-term vision of the public interest. Alas, this often proves not to be the case as governments succumb to a myopia of their own.

Social heterogeneity helps to explain governmental myopia. A country comprises many individuals, groups, and classes, who have diverse and often contradictory interests. In general, the costs of the negative net transfer are not distributed across this population in proportion to the benefits of the positive net transfer. The distribution of benefits and costs is shaped, among other things, by the exercise of political power as individuals, groups, and classes seek to appropriate the benefits for themselves and to impose the costs on others. While debt is a doubtful route to long-term gains in aggregate income, it can lead to handsome income gains for particular individuals or groups.

This monograph traces the political economy of external indebtedness in the Philippines for the period 1962-1986. Chapter 2 reviews the balance-of-payments context within which the external debt was accumulated. Chapter 3 documents the growth of the debt and its changing composition by type of borrower, type of lender, and maturity length. Chapter 4 investigates the mechanisms and magnitude of capital flight from the Philippines. Chapter 5 analyzes the impact of external borrowing upon the current account deficit, investment and growth, capital flight, and the role of the Philippine state. Chapter 6 concludes this monograph with some implications of the analysis for future debt management strategy.

3. See, for example, Dornbush and Fischer (1990, p. 536).

The Balance of Payments

1962-1986

The build-up of the Philippine external debt began well before the oil price increases of the 1970s. It can be traced to the foreign exchange decontrol and trade liberalization announced by President Macapagal in 1962. In subsequent years, lending by international financial institutions, Western governments, and private commercial banks grew steadily. New loans ensured the means to service prior loans.

A balance of payments crisis in 1970 foreshadowed the inevitable turning point at which debt service payments surpass the inflow of new money and the net transfer turns negative. This turning point was temporarily deferred, however, by means of fresh lending, which was unlocked by an IMF adjustment program. External borrowing accelerated greatly in the 1970s, as the country pursued a development strategy of "debt-led growth." For a time, the country - or more accurately, some of its citizens - was able to live "beyond its means," thanks to a positive net transfer of external resources.

The day of reckoning arrived in October 1983. Private international lending, already in short supply following the Mexican near-default of August 1982, virtually dried up after the August 1983 assassination of Benigno Aquino precipitated the worst balance of payments crisis in the Philippines' postwar history. The net transfer turned negative.

This history is reflected in the Philippine balance of payments from the years 1962 to 1986 as summarized in Table 1. Before reviewing the chronology, it may be useful to discuss briefly the categories in which

Table 1
THE PHILIPPINE BALANCE OF PAYMENTS, 1962-1986
(US\$ Million)

9

Year	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Current Account:	30	182	85	137	161	-25	-250	-253	-48	2	7	474	-207	-924	-1102	-755	-1093	-1496	-1901	-2089	-3198	-2753	-1257	-26	991
Exports	556	727	742	769	828	821	858	855	1064	1136	1136	1871	2695	2263	2520	3151	3419	4600	5791	5711	5019	5008	5396	4632	4836
Imports	-587	-618	-780	-808	-853	-1062	-1150	-1132	-1090	-1186	-1261	-1596	-3145	-3459	-3634	-3916	-4725	-6141	-7727	-7957	-7664	-7492	-6074	-5118	-5045
Investment Income	-17	-17	-26	-31	-37	-76	-97	-78	-130	-101	-126	-113	-54	-126	-253	-333	-406	-565	-832	-1042	-1826	-1776	-2104	-2002	-1950
Others	78	90	149	207	223	292	139	102	108	148	257	312	297	398	265	343	618	610	867	1199	1273	1506	1526	2460	3150
Capital Account:	-28	0	-18	-4	-117	72	375	299	242	242	283	212	867	1094	1194	513	1855	1627	2739	2244	2868	1056	1424	-755	215
Direct Investment	-3	-4	-4	-10	-15	-9	-3	6	-29	-4	-22	64	-40	124	142	215	100	21	-103	176	17	111	6	20	140
Long-term Loans:	9	-53	56	119	-3	18	225	152	159	-5	137	68	267	393	998	661	886	1151	1080	1332	1553	1349	291	3096	1652
Official	6	-27	18	127	-5	-6	40	36	54	13	104	73	72	255	599	391	630	987	536	836	1305	965	400	1677	1798
Private	3	-26	38	-8	2	24	185	116	105	-18	33	-5	195	138	398	270	257	164	493	496	248	384	-109	1419	-147
Short-term Loans:	-34	57	-70	-106	-99	63	153	141	112	251	168	80	640	577	54	-363	869	455	1812	736	1298	-404	1126	-3871	-1577
Official	NA	NA	NA	NA	NA	106	-33	62	4	42	-60	-129	132	297	64	-530	19	422	781	248	699	617	821	-1222	-5
Deposit money banks	-7	28	39	12	-82	-55	8	12	32	117	173	134	277	177	89	335	930	628	712	478	505	-376	-240	-940	-759
Other private	-27	29	-109	-118	-17	12	178	67	76	91	55	75	231	102	-98	-167	-79	-596	319	11	95	-646	545	-1709	-813
Reserves & Related Items	-21	-23	-16	-67	12	25	74	81	-46	-97	-184	-668	-591	16	57	30	-876	-376	-960	349	703	2044	-263	122	-1111
Net Errors and Omissions	19	-159	-51	-73	-56	-72	-199	-127	-148	-142	-106	-19	-70	-186	-148	210	115	245	122	-503	-373	-347	97	659	-94

NA = not available.

Sources: International Monetary Fund, *Balance of Payments Statistics Yearbook*, various issues (in cases of conflict, data from more recent issues are used) and *International Financial Statistics* (SDRs/\$ exchange rate).

Notes: 'Direct investment' includes portfolio investment.
'Reserves and related items' includes counterpart items.

international financial transactions are grouped for the purposes of the table.

Reading the Balance of Payments

The *current account*, consisting of payments for goods and services and unrequited transfers, is subdivided into three components:

1. *Exports and imports.* These refer to merchandise trade. When their sum was negative, as in every year shown except for 1963 and 1973, the Philippines experienced a trade deficit. Export and import value estimates are based upon Philippine government data, which do not necessarily agree with data of trading partners (a problem discussed in Chapter 4).
2. *Investment income.* This refers to interest on international loans and profits on foreign direct investment. The loans and investments are themselves recorded in the capital account, but their returns are classified as payments for the "services" this capital renders and hence recorded in the current account — an accounting practice which effectively prohibits countries from placing controls upon interest payments and profit repatriation under the International Monetary Fund (IMF) Articles of Agreement.¹ Investment income is reported here in net form, subtracting outflows from the smaller inflows generated by Philippine investment abroad. In the Philippines, as in many third world countries, net investment income is consistently negative; hence, as Payer (1974, p. 8) remarks, this item could more accurately be termed "investment payments."²
3. *Other current account transactions.* This is a residual category which includes freight and insurance services, travel, earnings of non-resident Filipino workers overseas, and unrequited transfers (including remittances from Filipinos who are classified as residents of other countries).

The *capital account* consists of loans and investments which will give rise to future "service" payments. These are reported net of amor-

1. The IMF Articles of Agreement prohibit restrictions on payments on the current account, but allow controls on the capital account. Evans (1968, p. 34, cited by Payer, 1974, p. 8) remarks that this "may indicate why the drafters of the Fund Agreement specifically included interest and net income as payments for current transactions."

2. Following the Philippines government's declaration of a debt repayment moratorium, interest payments fell into arrears in 1983 and 1984. These payments were nevertheless recorded in the balance of payments as if they had been made, with corresponding short-term capital inflows (a form of 'exceptional financing'); the reverse occurred in 1985, when negative payments arrears represent outflows not reported on the investment income line.

tization payments and recorded capital outflows. The capital account is subdivided into the following categories:

1. *Direct investment.* This refers to the acquisition by foreigners of productive land or physical capital, or of securities issued by Philippine firms (distinguished in recent volumes of the *Balance of Payments Yearbooks* as "portfolio investment"). In theory, this includes reinvested profits, which are entered as a debit on the investment income line of the current account and again as a credit on this line. In the Philippines, net flows of direct investment have been small relative to loans.
2. *Long-term loans.* These are loans with maturities of more than one year. These are subdivided into *official* and *private* loans depending on whether the borrower is the government or a private firm.
3. *Short-term loans.* These are loans with maturities of less than one year. *Official* short-term loans include net drawings by the Central Bank (CB). *Deposit money banks* refer to foreign exchange assets and liabilities of commercial banks. *Private* short-term loans include trade credits and other non-bank assets and liabilities.

The *reserves and related items* line refers to changes in the country's official foreign exchange reserves, including "counterpart items" such as monetization of gold and valuation changes in reserves. These represent "accommodating" foreign exchange movements undertaken by Philippine monetary authorities so as to effect a balance between the current and capital accounts. In the absence of statistical discrepancies, the sum of the current account, the capital account, and changes in reserves and related items would be zero. Net reductions in reserves are recorded with a positive sign (in effect, foreign exchange is being provided to the economy by the change in reserves); net additions to reserves are recorded with a negative sign.

Net errors and omissions arise from data imperfections, when the above categories do not, in fact, sum to zero. Unrecorded capital flows are believed to be major sources of these discrepancies, and hence errors and omissions are often incorporated in measures of capital flight.

In 1970 and 1983, the Philippines experienced balance-of-payments crises. Shortages of foreign exchange forced the government to turn to the IMF and undertake longer-term "adjustments" ostensibly designed to remedy the problems which led to the crises. These crises serve as convenient points for demarcating the 1962-86 period into three segments, which are discussed below.

The Aftermath of Decontrol, 1962-1970

The year 1962 saw the abrupt abandonment of foreign exchange

controls by the newly elected government of President Diosdado Macapagal. These controls, which had been imposed in the wake of a balance-of-payments crisis in 1949, restricted the access of private firms to foreign credits, and required that any foreign payments be approved by the CB. Their effect, in particular, was to curtail imports of consumption goods, thus setting the stage for import substitution. As Power and Sicat (1971, pp. 33-4) remarked: "What began as an emergency tactic in balance of payments policy became the principal policy instrument for promoting industrialization over the decade of the 1950s."

The abandonment of controls is sometimes attributed to the influence of the United States (US) and the IMF³, but domestic politics appear to have played the decisive role. A foreign exchange crisis in 1958 had been resolved, in defiance of US and IMF pressures for decontrol and devaluation, through the imposition of a foreign exchange tax and with the help of short-term commercial borrowing rather than IMF drawings. Corruption and political favoritism in the rationing of foreign exchange and import licenses, however, fueled growing anti-control pressure, resulting in the passage in 1959 of legislation requiring a gradual decontrol. In the event, decontrol came quite precipitously upon Macapagal's assumption of the Presidency.⁴ Albuero and Canlas (1986, p. 9) conclude that "it is doubtful that the IMF had earlier been consulted or participated in [the decontrol] policy analysis and decision." Decontrol and the *de facto* devaluation of almost 100 percent (from 2.0 to 3.9 pesos per US dollar) which accompanied the freeing of the foreign exchange market did, however, quickly win backing from the US government and the IMF in the form of a US \$300 million stabilization loan package commitment.⁵

Despite the devaluation and imposition of higher tariffs which accompanied decontrol, imports climbed rapidly in the following years. By 1969 the dollar value of imports had risen to nearly twice the 1962 level, while the value of exports had grown by little more than 50 percent. The resulting trade deficits were financed in large part by foreign borrowings, the magnitude of which will be more fully revealed in the next chapter.⁶

3. For example, Bello *et al.* (1982, p. 131) state: "Pressured by US investors seeking freer repatriation of their profits and US exporters frustrated by protectionist obstacles, the US government forced President Diosdado Macapagal to abolish import and exchange controls." Montes (1987, p. 3) refers to the dismantling of controls as part of an "IMF adjustment program" imposed in connection with the "1962 crisis".

4. For an account of these events, see Payer (1974, pp. 59-66).

5. The stabilization package included a US\$40 million stand-by agreement with the IMF, credits from the USAID and the US Export-Import Bank, a loan (against gold) from the US Federal Reserve, and stand-by financing and refinancing from private banks (Albuero and Canlas 1986, p. 6; Broad 1983, p. 85; Broad 1988, p. 33).

6. The growth of the Philippine external debt is not fully captured by the data in Table 1, primarily because the balance of payments data are net of recorded capital outflows. In addition, differences between debt and balance-of-payments reporting procedures, involving the adjustment for late reporting for borrowers, valuation adjustments for

The growing trade deficit and repayment obligations for the loans which financed it set the stage for the balance-of-payments crisis which culminated in further devaluation of the peso in February 1970. Massive spending in Marcos' 1969 re-election campaign, financed by further external borrowing and an increase in the domestic money supply, provided "simply the spark that ignited the crisis."⁷ The International Labor Organization (ILO) mission (1974, p. 280) remarked that a sharp rise in debt service payments (amortization and interest) "was a major factor in the balance-of-payments crisis of 1970." The event was described by at least one observer (Wellons 1977, p. 161) as a "debt crisis" well before that phrase acquired its current popularity. The 1970 crisis thus underscored the likelihood of an eventual balance-of-payments crisis whenever external borrowing is used for purposes which do not generate sufficient foreign exchange for their ultimate repayment with interest. It was a lesson soon forgotten.

Debt-driven Growth, 1970-1983

The balance-of-payments crisis of 1970 and the associated adjustment measures began what several analysts characterize as "the period of debt-driven growth."⁸ The Philippine government turned to the IMF since, as Payer (1974, p. 71) observed: it "had virtually no alternative to the acceptance of the IMF programme other than repudiation of its debts, and it did not have the social backing or political courage to face the consequences of a cut-off of aid and trading credits which that course would involve." A US\$27.5 million IMF stand-by credit was arranged in February.

Three important developments occurred in connection with the 1970 crisis: (1) the floating of the peso and devaluation, the centerpieces of a stabilization package "dictated by the IMF;"⁹ (2) the adoption of policies to promote "non-traditional" exports; and (3) the formation of a consortium of aid donors chaired by the World Bank (WB).

The day after the stand-by agreement took effect, the Philippine government announced that henceforth the value of the peso would be allowed to float.¹⁰ The devaluation was swift and sharp. The peso rate

exchange rate movements, and the classification of short-term capital movements, give rise to discrepancies (World Bank 1984, p. 44).

7. Power and Sicat (1971, p. 50). See also Payer (1974, pp. 70-1); Bello *et al.* (1982, p. 136); and Montes (1987, p. 3).

8. Montes (1987, p. 6). Ranis (1984, p. 6) has also referred to the Philippines' "debt-driven growth of the 70s."

9. Broad (1988, p.34), quoting Benito Legarda, Jr., who was Assistant Director of the CB's Department of Economic Research at the time.

10. Alburo and Canlas (1986, p. 9). A CB circular stated: "The free market rate shall not be administratively fixed but shall be determined through transactions in the foreign exchange market on a day-to-day basis. The authorities shall not intervene in the market

to the dollar fell from 3.9 before the float to 6.4 by the end of the year. The extent of the devaluation surprised even the IMF, which had predicted that a rate of 5.0 to 5.2 pesos to the dollar would emerge (Broad 1988, p. 35).

The inflationary consequences of the devaluation were severe: the consumer price index for low-income families in Manila jumped from 116.4 in 1970 (with 1966 = 100) to 155.5 in 1971 and to 296.6 in 1974 (National Economic Development Authority 1976, Table 14.4, p. 470). "Floating rate" entered the Filipino vocabulary as a synonym for inflation (Payer 1974, p. 72). A number of private firms were unable to service their external debts at the new exchange rate, and many of their obligations passed to the government's Development Bank of the Philippines, which had liberally dispensed loan guarantees in the months preceding the 1969 election.¹¹

Philippine inflation eroded the impact of the devaluation upon real (as opposed to nominal) exchange rates. After a 34 percent drop in 1970, the peso actually appreciated in real terms in the 1970s, and by the end of the decade the real peso/dollar rate had returned to its pre-float level (see Table 2). The Philippine trade deficit meanwhile grew from US\$26 million in 1970 to US\$2.2 billion in 1981 (see Table 1). The co-existence of an appreciating real effective exchange rate with this growing trade imbalance was made possible by a concomitant influx of foreign borrowing, the extent of which is documented in the next section.

Export promotion was a second important policy response to the 1970 crisis. The Export Incentive Act of 1970 provided for tax exemptions on imported capital equipment and tax credits for domestic capital equipment (Ofreneo 1985, pp. 171-2).

The Consultative Group for the Philippines, an international consortium of official development assistance donors chaired by the WB, met

except to the extent necessary to compensate for excessive fluctuations but shall not operate against the trend in the market." (Quoted in ILO 1974, p. 128.) In practice, a fairly stable dollar exchange rate was maintained in the 1970s (see Table 2)—an accomplishment made possible by massive foreign exchange inflows on the capital account, as discussed below. As a result, the exchange rate regime during this period has been variously described as "fixed" and "on a managed float" (Canlas 1985, pp. 3, 4); as a policy of "limited flexibility in contrast to a policy of full flexibility" (Panganiban 1983, p. 10); as a "flexible" policy which "was not used effectively to adjust to the imbalances in the country's external accounts" (Remolona, Mangahas, and Pante 1985, p. 10); by the IMF in 1980 as a "policy of keeping the exchange rate of the peso closely in line with the dollar" (quoted by Thompson and Slayton 1985, p. 72); and as a "dirty float" policy, "wherein, although the peso was technically free to float, the CB intervened in foreign exchange markets to maintain the peso's value against the dollar" (Broad 1988, p. 94). The float became "cleaner" in the early 1980s, a change which Broad attributes to WB pressure.

11. Interview with Benito Legarda, Jr., CB representative at the Embassy of the Republic of the Philippines, Washington, D.C., May 11, 1988. Legarda suggests that the Development Bank of the Philippines's demand for foreign exchange to service these debts "drove the market" after the float, causing the devaluation to be more substantial than it otherwise would have been.

Table 2
EXCHANGE RATES OF THE PHILIPPINE PESO, 1962-1986.

Year	Pesos per US dollar ¹		Dollar/ peso index (official rate	Real exchange rate ²	Real effective exchange rate ³
	Official rate	Black market rate			
1962	3.92	3.97	100.0	100.0	100.0
1963	3.91	3.92	100.3	107.1	104.5
1964	3.91	3.91	100.3	115.0	110.7
1965	3.91	4.00	100.3	116.7	110.3
1966	3.90	3.97	100.5	119.0	111.7
1967	3.93	4.20	99.7	121.4	113.6
1968	3.93	5.00	99.7	118.9	110.4
1969	3.93	5.00	99.7	118.9	105.8
1970	6.44	7.10	60.9	75.9	69.9
1971	6.44	6.88	60.9	75.9	76.3
1972	6.78	6.85	57.8	97.2	74.2
1973	6.73	6.85	58.2	97.2	77.7
1974	7.06	7.45	55.5	112.0	88.2
1975	7.50	8.50	52.3	103.2	81.6
1976	7.43	8.10	52.8	107.5	82.6
1977	7.37	7.57	53.2	111.8	80.6
1978	7.38	8.10	53.1	111.8	76.5
1979	7.42	7.90	52.8	117.0	86.1
1980	7.60	7.85	51.6	119.0	86.1
1981	8.20	8.70	47.8	113.0	85.8
1982	9.17	9.85	42.7	104.9	82.4
1983	14.00	21.00	28.0	73.3	58.2
1984	19.76	20.00	19.8	74.9	62.3
1985	19.03	16.60	20.6	92.4	70.7
1986	20.53		19.1	84.7	60.2

- Notes
1. End-of-year rates.
 2. Official dollar/peso rate multiplied by ratio of U.S. consumer price index to Philippine consumer price index (increase indicates appreciation).
 3. Average of real exchange rates against the US dollar, Japanese yen, and Deutsche mark, weighted by average trade shares in the period (increase indicates appreciation).

Sources: IMF, *International Financial Statistics Yearbook 1987*, lines ae and 64. Black market rates from *Pick's Currency Yearbook 1968* (p. 419), 1975-76 (p. 469), and 1985 *World Currency Yearbook* (p. 675).

for the first time in April 1971.¹² The formation of the consultative group was important for two reasons. First, it served to mobilize substantially larger official financial flows. As the WB (1976, p. 467) observed, "the importance of foreign aid increased dramatically" after the formation of the consultative group, with the total committed in 1971-74 exceeding that in the previous 20 years. The Philippines was designated a "country of concentration" by the WB itself, and received lending from the Bank "somewhat higher than average for countries of similar size and income."¹³ Second, the consultative group increased the leverage and influence of the WB, providing a vehicle for its "attempts to rally other donors around its recommendations" (Bello *et al.* 1982, p. 137, quoting a 1981 US Treasury Department report).

The 1974 ILO mission was optimistic about Philippine balance-of-payments prospects in the wake of the floating of the peso. Notwithstanding the faster inflation since the devaluation, the mission observed (p. 127) that "the prices of many goods and services, and especially money wage rates, have risen by much less than the devaluation," and "consequently, much of the competitive gain still remains." In other words, lower real wages would help to put the Philippine economy on a sounder international footing. The report noted that "the balance-of-payments has gone into surplus and foreign exchange reserves have reached their highest levels since the Second World War. " A substantial trade surplus was achieved in 1973. This was, however, primarily attributable to the world-wide commodity boom of that year which brought about a 50 percent jump in Philippine export prices (Wellons 1977, p. 174), and the experience has yet to be repeated.

The WB (1976, pp. 469-72) was similarly sanguine about the post-1970 growth of the Philippine external debt, remarking that "it would be unfortunate for the Philippines to curb its potential for rapid development unnecessarily" by failing to borrow on commercial markets in the years ahead. Hence the Bank called for "sustained and vigorous efforts ... to ensure that the volume of funds available is sufficient for the needs of the Philippines." Anticipating a rise in the shares of official and medium and long-term debt, the Bank predicted: "The present careful control over external borrowings will undoubtedly continue, and, provided that the composition of inflows is along the lines already indicated, the projected increase in external debt and debt service, though large, is not expected to present serious difficulties."

12. Wellons (1977, p. 187, n. 27); Ofreneo (1985, p. 173). In addition to the WB, its members included bilateral donor countries (among them the US and Japan), the IMF, the United Nations Development Program, the ADB, and the OECD. The first aid coordination group had been organized by the Bank for India in 1958; by May 1971 the Bank chaired 15 such groups (WB, 1971, p. 42).

13. Gould (1976, pp. 2, 17), cited by Bello *et al.* (1982, p. 24).

These optimistic prognoses contrasted with Cheryl Payer's (1974, pp. 72, 74) remarkably prescient conclusion that the Philippines was already facing "crippling debt obligations," and that the reliance of the Marcos government on fresh loans to service external debt "will only create more and larger obligations in the future." Similarly, commenting upon the influx of new lending which followed the imposition of martial law in 1972, the editors of *Pick's Currency Yearbook* noted wryly: "Despite the excellent chance of these debts possibly never being repaid, certain banks or bankers considered dictator Marcos an excellent credit risk" (Steve and Cowitt 1976, p. 466).

It would be misleading, therefore, to date the origins of the Philippine debt problem from the oil price shock of 1973-74. The oil price boom did, however, contribute to an acceleration in the build-up of external debt: the Philippine demand for foreign exchange to pay for more expensive oil imports rose, and more importantly, the supply of external finance increased as international banks sought to "recycle" the surpluses of the oil exporters. The direct, demand-side impact of the higher oil prices was limited by the fact that crude oil and petroleum products constituted only 12 percent of the value of Philippine imports in 1973, rising to 21 percent in 1974 (calculated from WB 1986, Vol. III, Tables 3.8 and 3.10, pp. 26, 28). Moreover, the Philippines had some success in substituting part of its oil imports: the quantum index of crude petroleum imports fell from 100 in 1973 to 92 in 1974, rose gradually to 108 in 1978, and thereafter declined to 71 in 1985. And the growing demand for Philippine labor in the Middle East partially offset the current account impact of the higher oil prices.¹⁴

The more serious impacts on the Philippine demand for external finance arose from the deterioration in Philippine terms of trade, in which the oil price shock played an indirect role by contributing to the recession in the industrialized countries.¹⁵ At the same time, Philippine efforts to develop non-oil energy sources led to increased imports of capital goods, the prices of which rose sharply in the mid-1970s, contributing almost as much as oil itself to the deterioration of the trade balance (Remolona, Mangahas and Pante 1985, pp. 12-13).

The infusion of "petrodollars" into world financial markets caused a dramatic shift in the supply of foreign lending, evidenced not only by the growth in the volume of debt but also by a marked shift in its

14. Personal income remittances from overseas contract workers, included in the 'other' line of the current account in Table 1, rose from US \$103 million in 1975 to a peak of US\$944 million in 1983, with workers in the Middle East accounting for roughly half of the total in the 1980s (Tabora 1986, Table 3, p. 24). The Philippine import bill for crude oil and petroleum products in 1983 stood at US\$1,752 million (WB 1986, Vol. III, Table 3.10, p. 28).

15. Power (1983, p. 9) reports that with 1971-73= 100, the terms-of-trade index (that is, the ratio of export prices to import prices) for the Philippines in 1982 was 52.

composition, with a growing proportion of the loans originating from private commercial banks (see Chapter 3). These banks found themselves with a large volume of cash to lend, at a time when investment demand was slack in the industrialized countries themselves. Their response was to increase dramatically their lending to Third World countries. The Philippine debt accumulation in the 1970s hence was part of this larger picture which included its counterparts in many other Asian, Latin American and African countries.

The relative importance of demand-side and supply-side factors in the post-1973 debt accumulation in the Third World is open to debate.¹⁶ But two items of evidence suggest that the increased supply of foreign loans played the dominant role. First, the debt build-up was not limited to oil-importing nations like the Philippines, whose demand for foreign exchange was directly and indirectly increased by the oil price rises. Oil-exporting nations, including Mexico, Venezuela, Indonesia, and Nigeria also saw a rapid accumulation of debt.¹⁷ Second, real interest rates were low and even negative in the 1970s, implying that at the international level supply shifts dominated.

In the Philippine case, the combination of increased lending from official sources and increased lending from private commercial banks led to massive capital account surpluses in the 1970s.

Following the second round of oil price increases in 1979-80, the Philippine external position grew still more precarious. Fresh borrowing now had to cover the rising burden of debt service on old money. At the same time, tight monetary policies in the industrialized countries pushed up real interest rates and plunged the world into the worst recession since the 1930s. Moreover, as commercial banks grew worried about their Third World loans, they shifted their new lending to shorter maturities. The stage was set for a new and deeper crisis.

The Long Crisis, 1983 -1986

On October 17, 1983, the Philippine government was forced by the depletion of its foreign exchange reserves to declare a 90-day moratorium on the amortization of its external debt, marking the onset of the

16. For discussion, see Taylor (1985), Darity (1986), and Darity and Horn (1988).

17. Oil wealth made such countries appear to be good credit risks; in the words of the Mexican official who managed that country's external debt in the late 1970s, "Mexico was really sexy then. We were contracting on terms as fine as Sweden's." (Quoted by Moffett and Truell 1988.) Oil was not essential to rouse the animal spirits of foreign bankers, however. Regarding the Philippines, the President of Bancor Development Corporation observed in 1976: "[I]n banking, like anything else, there are fads. There will be fads for a particular country. This means all of a sudden the credit of a particular country becomes hot in the market, a situation wherein everybody tries to push financing to that country. I think the Philippines is very much in this position now." (Quoted in Thompson and Slayton 1985, p. 77.) One indicator of lender perceptions of risk is the interest rate spread

worst balance-of-payments crisis in postwar Philippine history. The economic and political impacts of the ensuing "adjustment" measures were so severe that the period up to the overthrow of the Marcos government in February 1986 can be characterized as one long, protracted crisis.

The accumulation of external debt, analogous in many ways to a "Ponzi scheme" in which ever-increasing quantities of new money are borrowed to service past borrowing of dubious productive value, made a crisis inevitable.¹⁸ The growing proportion of short-term debt, the "interest rate shock" of the early 1980s, the sharp deterioration of the "country's term of trade, and the Mexican quasi-default of August 1982" brought the Philippine debt bubble close to the bursting point. According to Philippine Prime Minister and Finance Secretary Cesar Virata, "our credit lines were already being cut towards the end of 1982" and by early 1983 foreign banks had withdrawn US\$709 million in credit facilities (Peagam 1984, p. 53).

The final rupture was precipitated by the assassination of Benigno Aquino as he stepped from a plane at Manila airport on August 21, 1983. This event "triggered a torrent of closures of commercial credit lines to the country" (Montes 1987, p. 18). In addition, political unrest in the wake of the murder is said to have accelerated capital flight, which "significantly contributed to the dwindling of international reserves" (Remolona and Lamberte 1986, p. 113).¹⁹

The government's debt moratorium was accompanied by further devaluation of the peso (to P14: \$1 after having been devalued from P9 to P11 in June), and by an announcement that it was negotiating a new agreement with the IMF. Negotiations with the IMF and with commercial banks collapsed, however, when it was revealed in November that the CB had been systematically overstating its foreign exchange reserves, to the tune of US\$600 to US\$800 million, by double-counting dollars cycled through overseas branches of the government-owned Philippine

above LIBOR charged on public and publicly-guaranteed loans. The average spread for the Philippines from 1979 through 1982 was 0.9, while for Mexico it was 0.6; in 1983, however, it fell to 0.7 in the Philippines, while it rose to 1.9 in Mexico (Folkerts-Landau 1985). Alternative measures, based on the ratio of interest payments to total external debt, show the Philippines to have paid a substantially *lower* risk premium than Mexico throughout the 1978-83 period (Dooley 1986, p. 9).

18. Charles Ponzi, the "Boston swindler," was an early 20th century entrepreneur who offered high interest rates in a fraudulent investment scheme (based on ostensible profits to be made in exchange rate arbitrage using international postal reply coupons) which depended upon new depositors' money to pay dividends to earlier investors. Payer (1985, p. 17; 1990, Chapter 3) draws the analogy with international commercial bank lending in the 1970s.

19. This widely accepted version of the timing of capital flight has been disputed; for example, Weiner (1987) states that capital flight out of the Philippines peaked "in the months before, and not after, the murder of Benigno Aquino." Statistical evidence reviewed in Chapter 4 suggests that capital flight in fact peaked in 1981.

National Bank (PNB). This deception, later described by Virata as a "window-dressing effort" (Peagam 1984, p. 54), led to the resignation of the CB governor, and provoked further disenchantment in international financial circles. As a result, no new money was forthcoming, and the debt moratorium had to be repeatedly extended. A US\$608 million standby agreement with the IMF was finally concluded in December 1984 and a rescheduling agreement with the country's 483 foreign bank creditors followed in May 1985.²⁰

In "prior action commitments" preceding the signing of the IMF accord, the Philippine government implemented a number of "classic IMF adjustment measures," including the devaluation and floating of the peso (which fell to P20: \$1 by the end of 1984), tight monetary policies, interest rate increases as high as 40 percent, reduction of the government budget deficit, and the lifting of price controls (Montes 1987, pp. 23-24; Lamberte *et al.* 1985, pp. xvi-xx). These measures had a severe contractionary impact: GDP declined and real wages plummeted. In terms of fulfillment of the targets set forth in the IMF agreement, including balance-of-payments targets, the "adjustment" program was a great success. The current account deficit was virtually eliminated in 1985, and a substantial current account surplus was achieved in 1986.

Whether this adjustment provides the basis for a longer-term recovery is, however, open to serious doubt. As Montes (1987, pp. 46-8) observed, exports declined in 1985 and 1986 (and would have declined in 1984, too, but for a boom in commodity prices), leaving the adjustment to be achieved primarily through precipitous declines in imports, particularly of capital goods and industrial inputs. Noting the further deterioration in ratios of the country's debt burden to GDP and exports, the WB (1986, Vol. II, p. 6) warned that rescheduling alone "is not a sustainable strategy for the medium term." Alternatives to compressed consumption and rescheduling are considered in the final chapter of this monograph.

20. For details of the reserve overstatement scandal, see Peagam (1984) and Henry (1989). Subsequent negotiations are described in Montes (1987, pp. 19-24) and Remolona and Lamberte (1986, p. 23).

21. In addition, the balance of payments record a notable increase in net "other" payments, the reasons for which are unclear.

The External Debt: Magnitude and Composition

Between 1962 and 1986 the external debt of the Philippines grew from US\$355 million to US\$28.3 billion. In absolute terms, the Philippines became the ninth most indebted nation in Asia, Africa, and Latin America. In terms of the ratio of external debt to gross domestic product, the Philippines ranks second among the top 10 Third World debtor countries.¹

This chapter reviews the available data on growth of the Philippine external debt and its composition in terms of type of borrower (public or private sector), type of lender (official or commercial), and maturity (long, medium, or short term).

Definitional Problems

The Philippine Central Bank's statistical system established in 1971 to monitor the country's external debt is "one of the best in Asia and the Far East," according to the WB (1984, p. 43). Even so, substantial discrepancies exist among Philippine external debt estimates reported by different sources. One reason for these discrepancies is that many estimates rely on incomplete data on the volume of debt. This justifies a

1. The debt/GDP ratio for the Philippines was 0.88. Among the top 10 debtors, this was surpassed only by Egypt, with a ratio of 1.05, and was equal to that of Venezuela. The average ratio for the other seven countries was 0.54. Based on 1985 data from OECD (1987, Table 2) and WB (1987, Table 3).

general presumption in favor of larger rather than smaller estimates; as David (1984, pp. 4-5) observes, "in matters of debtor reporting, errors of omission are more likely than double counting."²

Different definitions of external debt also contribute to apparent discrepancies. One distinction is between loan *commitments* and loan *disbursements*. In the case of official development assistance (ODA) project loans, for example, funds committed at the start of the project are typically disbursed over a number of years as construction or other project activities proceed. More generally, the opening of a credit line represents a commitment, while drawings upon that credit line represent disbursements. The data presented here pertain to actual disbursements.³

A second distinction is between gross and net external liabilities of the CB and commercial banks. The CB has both external liabilities and international reserves; similarly, Philippine commercial banks have cross-border deposits which constitute external liabilities, but at the same time they hold external assets including deposits in foreign banks. Net external liabilities of the banking system are gross external liabilities minus gross external assets. In keeping with the general practice, the Philippine external debt is here defined to include gross external liabilities of the banking system.⁴ The augmentation of the banking system's international reserves is thus one possible use of foreign borrowing. One rationale for including gross rather than net external liabilities of the CB in the measure of the external debt is "the assumption that Central Bank assets should be available to cover imports" (WB, 1984, p. 8).⁵

A final definitional problem concerns the distinction between public sector and private sector debt. This distinction is blurred in the Philip-

2. This is reflected in the fact that total world lending of banks to non-banks reported by creditors exceeds that ascribed to individual borrowers; in 1983 US\$98 billion (of a total of US\$679 billion) remained unaccounted for in the IMF's international financial statistics (David 1984, p. 5).

3. Similarly, in the case of the monetary sector (the Central Banks and commercial banks), credit lines may be drawn down gradually; indeed, sometimes they are never drawn at all (as, for example, in the case of the country's first stand-by credits from the IMF in the 1960s; see Alburo and Canlas 1986, p. 6).

4. Annual data on changes in official reserves and commercial banking system external assets for the period under review are provided in Table 9; debt flows net of these can thus be readily calculated.

5. A further definitional point relates to the treatment of the assets and liabilities of offshore banking units (OBUs), whose establishment in the Philippines was permitted by a 1976 Presidential Decree. Some 28 foreign banks had set up OBU's in the Philippines as of 1984; they borrow and lend in foreign currencies "outside the regulatory framework of banks operating in the Philippines" (IMF 1984, pp. 69-70). Contrary to standard practice in many countries, the Philippine statistical authorities treat OBUs as overseas banks. Thus OBU lending to Philippine residents is included in the country's external debt statistics, while OBU external liabilities are not. As of June 1986, Philippine debt to OBUs stood at US\$2.5 billion, while the OBUs owed US\$3.7 billion to other foreign entities. The net effect was to understate the Philippine external debt (compared with that which would result from the conventional treatment of OBUs) by US\$1.2 billion. The debt statistics reported here were provided by Philippine authorities, and hence follow their practice in this regard.

panies, as in many countries, by two common practices. The first is external borrowing by government agencies for on-lending to the private sector. The government-owned PNB, for example, provided "the chief conduit for private external debt" in the early 1970s (Wellons 1977, p. 163). Similarly, under the Consolidated Foreign Borrowing Program (CFBP) established in 1978, the CB of the Philippines borrows (primarily from foreign commercial banks) in its own name and on-lends the proceeds to private and public sector borrowers by way of Philippine banks. By the end of 1982, total CFBP on-lending stood at US\$2.0 billion, more than half of which represented refinancing of prior foreign obligations (IMF 1984, p. 65; WB 1984, p. 39). In theory, foreign funds on-lent to the private sector are recorded by official record-keepers as private external debt, together with direct borrowing by the private sector. In practice, classifications vary.

A second practice which blurs the public-private debt distinction is the Philippine government's issuance of guarantees for repayment of most private debt. "The creditors, in general, considered the Philippines to be a very high risk country," former Finance Minister Cesar Virata testified before a Congressional hearing in 1987, "and they would not like to lend to the private sector without government guarantee."⁶ Considerable amounts of publicly guaranteed private obligations were assumed in the end by the public sector, as private borrowers defaulted, but the classification of such debt prior to default differs among data sources (see Wellons 1977, pp. 164, 186).

Total External Debt Outstanding by Borrowing Sector

Table 3 summarizes data on the Philippine external debt from several sources. These provide the basis for the constructed time series reported in Table 4.

Data sources

After the Philippine debt moratorium was declared in October 1983, the Philippine government revealed that the country's total indebtedness as of October 17 was US\$24.6 billion, a sharp jump from the previously accepted figure of US\$18 billion.⁷ The discrepancy was primarily due to the exclusion of monetary sector debt and revolving (as opposed to fixed

6. Official minutes of the testimony of Cesar Virata before the House of Representatives Subcommittee on Monetary, Credit and Financial Matters, August 26, 1987, p. IV-1. The WB (1984, p. 20) reports that 34 percent of private medium and long-term debt was publicly guaranteed in 1975, and that this share fell to 20 percent in 1980 and rose to 29 percent in 1982. These appear to be underestimates.

7. Rafferty (1983, p. 101); Peagam (1984, p. 57); IBON (1984, p. 32).

short-term) credits from prior estimates issued by the CB. These turned out to be much higher than had been previously known. The CB subsequently came up with more comprehensive debt estimates to cover the earlier years.

The CB's Financial Plan Data Center has compiled the official data on external debt from 1983 onwards. The CB's Department of Economic Research (International) has prepared comparable estimates for the years

Table 3
ALTERNATIVE ESTIMATES OF TOTAL PHILIPPINE EXTERNAL DEBT
OUTSTANDING, 1961-1986¹
(US\$ million)

Year	Central Bank ²	IMF	Alfiler	World Bank	Jurado	Wellons/NEDA ³
1961	—	—	—	—	355	278
1962	—	—	—	—	358	271
1963	—	—	—	—	376	252
1964	—	—	—	—	—	304
1965	—	—	—	—	—	481
1966	—	—	—	—	—	516
1967	—	—	—	—	—	680
1968	—	—	—	—	—	737
1969	—	—	—	—	—	840
1970	2297	2297	—	1613	—	956
1971	2393	2368	—	1777	—	1009
1972	2732	2663	—	1962	—	1171
1973	2886	2846	—	2029	—	1225
1974	3755	3538	3900	2465	—	1519
1975	4939	4392	5200	3053	—	2234
1976	6768	6345	7200	4471	—	3323
1977	8069	8035	8600	8221	—	3889
1978	10694	10608	11200	10817	—	5281
1979	13352	13192	13900	13307	—	6528
1980	17252	17122	18100	17390	—	8522
1981	20893	20291	21800	20750	—	11304
1982	24677	23797	25000	24299	—	13887
1983	24816	24972	26200	24124	—	14482
1984	25418	—	25900	24358	—	—
1985	26252	—	—	26190	—	—
1986	28256	—	—	28853	—	—

- Notes: 1. End-of-year estimates.
2. Unpublished data provided by the Central Bank of the Philippines, Department of Economic Research (International) and Financial Plan Data Center.
3. 'Public sector' debt only; see text for discussion.

Sources: IMF (1984, Table 12, p. 72); Alfiler (1986, Table 1, p. 23); World Bank (1989, Vol. II, p. 310; Vol. III, p. 180); Jurado (1966, Table 4, p. 373); Wellons (1977, Table 1 (1), p. 162); NEDA (1976, Table II.8, pp. 398-9; 1986, Table 15.12, pp. 606-7).

1970 through 1982. The annual totals reported in Table 3 include the monetary sector (that is, gross external liabilities of the CB and commercial banks) as well as the nonmonetary sector.

The CB estimates for the nonmonetary sector are broken down into public and private sector debt, and into short versus medium and long-term debt. The estimates for the monetary sector for 1983-86 are classi-

Table 4
EXTERNAL DEBT OF THE PHILIPPINES BY BORROWING SECTOR, 1961-1986:
A CONSTRUCTED TIME SERIES¹
 (US\$ billion)

Year	Total Outstanding	Borrowing Sector		Real Total (1986 \$) ²
		Public	Private	
1961	0.36	0.17	0.19	1.14
1962	0.36	0.19	0.17	1.14
1963	0.38	0.23	0.15	1.21
1964	0.48	0.28	0.20	1.52
1965	0.80	0.46	0.34	2.48
1966	0.91	0.50	0.41	2.73
1967	1.28	0.68	0.60	3.84
1968	1.49	0.76	0.73	4.36
1969	1.83	0.90	0.93	5.15
1970	2.30	1.10	1.20	6.25
1971	2.39	0.92	1.47	6.28
1972	2.73	1.11	1.62	6.87
1973	2.89	1.15	1.74	6.43
1974	3.76	1.57	2.19	7.04
1975	4.94	2.33	2.61	8.47
1976	6.77	3.52	3.25	11.09
1977	8.07	4.03	4.04	12.46
1978	10.69	5.69	5.00	15.31
1979	13.35	7.65	5.70	16.99
1980	17.25	10.25	7.00	19.24
1981	20.89	12.80	8.09	21.35
1982	24.68	15.43	9.25	24.72
1983	24.82	16.73	8.09	24.55
1984	25.42	17.55	7.87	24.56
1985	26.25	19.12	7.13	25.49
1986	28.26	21.83	6.43	28.26

Notes: 1. End-of-year estimates of external debt outstanding, including gross banking system liabilities.

2. US wholesale price index (from IMF, 1987, pp. 698-9) used as proxy for inflation rate.

Sources: 1961-63: Jurado (1966, p. 373).

1964-69: Wellons (1977, p. 162); original estimates scaled up to adjust for incompleteness.

1970-86: Unpublished data provided by Central Bank of the Philippines, Department of Economic Research (International) and Financial Plan Data Center.

For details, see text.

fied into liabilities of the CB, government commercial banks, and private commercial banks, again permitting a public/private breakdown. Commercial bank liabilities for 1970-82 are not subdivided into government and private banks, and the public and private sector debt estimates in Table 4 are based upon the assumption that government banks accounted for 20 percent of total commercial bank liabilities in those years.

The IMF (1984) and Alfiler (1986) present estimates which accord fairly closely with the Central Bank data. The OECD (1985, 1987) presents estimates for the years 1983-1986 which also are reasonably consistent with those presented above.⁸

The WB, in the 1988-89 edition of its *World Debt Tables*, also presents revised figures on external debt extending back to 1970. Past editions of the *World Debt Tables*, which were often used for international comparisons, woefully understated the Philippine external debt. The 1984-85 edition, for example, reported total Philippine external debt in 1983 to have been US\$13.7 billion.⁹ The Bank's revised figures redress this problem from 1977 onwards, but the estimates for 1970-1976 remain well below those reported by the CB, Alfiler, and the IMF, apparently owing to continued under-reporting.

Debt estimates for the 1960s must be drawn from other sources. Jurado (1966) presents data on Philippine foreign loans from 1906 to 1963; only his 1961-1963 figures are reported here. His estimates, sourced from the CB's Department of Economic Research, appear to be quite comprehensive. Data on both public and private sector debt are reported, and from the notes to the table it appears that monetary sector debt is included.

Wellons (1977) presents figures on Philippine external debt for the years 1960-1973. These correspond to the estimates of external debt classified by institutional source reported in various issues of the *Philippine Statistical Yearbook* published by the government's NEDA. The CB is stated to be the source of these data. Wellons reports, on the basis of a 1975 interview, that the data for the 1960s are "incomplete." The data refer only to "public sector" debt, although as Wellons notes, the categories of public and private debt overlap since: (1) the government-owned

8. The OECD (1985) reports estimated Philippine indebtedness at the end of 1983 to be US\$28.4 billion (including US\$5.3 billion in "other liabilities", representing cross-border deposits of non-banks in Philippine banks); and US\$29.0 billion (including \$5.2 billion in other liabilities) at the end of 1984. The OECD (1987) estimates for 1985 and 1986 (presented in a different format, which may not be entirely comparable with those of the 1985 report) are US\$28.6 billion and US\$27.2 billion, respectively. Earlier data published by the OECD were much less complete; see David and Lee (1986) for a comparison of the old and new OECD series.

9. The WB's figure comprised US\$10.4 billion public or publicly guaranteed debt and US\$3.3 billion private debt. Power (1983, p. 8) notes that the *World Debt Table* figures do not fully capture non-guaranteed private debt; in this instance they also appear to understate public debt.

PNB was the "chief conduit for private external debt;" and (2) the government's DBP "guaranteed substantial private foreign debt." The extent to which these are included in the Wellons/NEDA series is "unclear," but Wellons suggests that the inclusion of some publicly guaranteed private debt may help to account for the "astonishing" discrepancy between these figures and (lower) estimates reported at the time by the WB.¹⁰

A constructed time series

The time series on total, public, and private external debt reported in Table 4 is constructed on the basis of these data. For the years 1970-1986, the time series uses CB data. Estimates for 1961-1963 are taken directly from Jurado. For the intervening years, 1964-1969, estimates are derived from the data presented by Wellons and NEDA. Owing to their incompleteness, however, these are scaled up to make them comparable to the earlier and later data.¹¹ These estimates should therefore be regarded as rougher approximations than those for other years.

The total external debt at the end of 1961 stood at US\$355 million, of which slightly more than half represented private external debt. A review of the country's external debt up to the early 1960s concluded that most loans had been "channeled to economically productive enterprises," and that the volume of foreign loans had been "relatively light" (Jurado 1966, p. 378). The foreign debt was equivalent to approximately five percent of GNP, valued at the pre-devaluation exchange rate of P2 to the dollar, or 10 percent when valued at the post-devaluation rate of P3.9 (calculated from GNP data in NEDA 1976, p. 114).

By 1970, the debt had increased more than six-fold to US\$2.30 billion, equivalent (at the new post-devaluation exchange rate of P6.4 per dollar) to 36 percent of the country's GNP. Private sector debt registered the strongest increase in the 1960s, a period marked by the relaxation of government control over private foreign transactions, as noted in the

10. Wellons (1977, pp. 163-4, 186).

11. The ratio of the Wellons/NEDA estimate to Jurado's estimate for 1963 is 0.67; the ratio of the Wellons/NEDA estimates to the Central Bank estimates for 1970-73 is 0.425. Accordingly, the Wellons/NEDA figures for the intervening years were scaled up on the assumption that they represent a proportion of total external debt which declined linearly between these points (that is, 0.635 in 1964, 0.60 in 1965, . . . , 0.46 in 1969). The resulting estimates are partitioned into public and private debt in a similar fashion, interpolating the trend in their relative shares from the observation that the public share of total debt declined from 0.61 in 1963 to 0.48 in 1970. These trends are consistent with other evidence: NEDA (1976, pp. 400-1), in an alternative debt series (which includes private debt but is apparently less comprehensive with respect to public debt than the series cited here), indicates that the public share of total external debt declined in the late 1960s. The WB (1976, p. 472) similarly reports that the share of the public sector in total medium and long-term debt declined from 48 percent in 1964 to 29 percent in 1969. Both sources indicate that the public share then rose in the early 1970s.

preceding chapter. The rapid growth of debt in the late 1960s, the service requirements of which played a key role in the 1970 balance-of-payments crisis, led to the implementation of the control system administered by the CB (IMF, 1984, p. 73). The tasks of debt monitoring and management were entrusted to the CB's Management of External Debt and Investment Accounts Department (MEDIAD), which must approve all public and private nonmonetary sector borrowing (WB, 1984, pp. 37-42).

In the period 1970-74 the external debt "grew moderately", in the words of the IMF (1984, p. 73), "reflecting the improved balance of payments position and the close monitoring of approvals." Although the growth can be termed "moderate" relative to that in preceding and subsequent years, the external debt, already large enough to precipitate a crisis in 1970, continued to rise. Rapid world price inflation in 1973 and 1974 eroded the real value of the external debt outstanding in those years. Nevertheless new borrowing left total real debt at the end of 1974 above what it had been at the end of 1970. Outstanding external debt now stood at 26 percent of GNP.¹²

The external debt build-up again accelerated in the mid-1970s, rising from US\$3.8 billion in 1974 to US\$17.3 billion in 1980, and to US\$24.8 billion in 1983. New borrowing far outpaced the erosion of the real value of the accumulated debt by world price inflation, and by 1980 the real debt was three times its level in the early 1970s, and 16 times higher than in the early 1960s. When the Philippine debt crisis broke out in 1983, the external debt had swollen to 114 percent of GNP.¹³ The WB (1984, p. 12) nevertheless characterizes the growth rate of real Philippine debt during the 1970s as "quite modest," suggesting that modesty, like beauty, lies in the eye of the beholder.¹⁴

In contrast to the debt build-up which preceded the 1970 crisis, the debt accumulation of the 1970s and early 1980s was marked by a generally rising share of the public sector in total debt. Indeed, the "leading role" of the public sector is understated by the figures in Table 4 insofar

12. The apparent decline in the debt/GNP ratio in the early 1970s is quite sensitive to the exchange rate. Real Philippine GNP rose between 1970 and 1974 by 29 percent; the implicit Philippine GNP deflator (1970=100) was 192.1 (calculated from NEDA, 1976, pp. 115, 119). At the same time the real value of the external debt rose by only 13 percent (using the US wholesale price index, which rose by 45 percent, as the debt deflator). Despite the differences in inflation rates, the peso/dollar exchange rate rose by only 10 percent, from 6.435 to 7.065 (see Table 2). More rapid depreciation of the peso would have resulted in a higher debt/GNP ratio in 1974, by lowering the dollar value of GNP.

13. Converting the 304,876 million peso GNP (NEDA, 1986, p. 163) at the end-of-the-year exchange rate of P14 pesos/dollar; if the 1984 exchange rate of P19.76: \$1 is used on the grounds that the peso remained overvalued at the end of 1983, the debt/GNP ratio rises to 161 percent.

14. As evidence, the WB (p. 68) cites data indicating that real outstanding medium and long-term debt grew at "only" 5.0 to 9.7 percent per annum from 1970-79, depending upon the price index used. Short-term debt grew even faster, as discussed below.

as private debt was publicly guaranteed. After 1983, the "socialization" of private debt is evident in the decline of outstanding private external debt and the concomitant rise in outstanding public external debt.

The WB (1984, p. 24) interprets the declining share of private debt in the late 1970s and early 1980s as an indication of weakening private demand for foreign funds, which "perhaps reflected the combined effect of domestic recession, increased government use of foreign funds, take-over of private concerns by public enterprises, and the private sector's response to hardening of loan terms." In this context, WB continues, it would be useful "to further investigate if the private sector was really responsive to the changed economic and financial conditions and whether the public sector failed to do so." The rapid expansion of external debt after 1978, according to the WB (1984, p. 6) "suggests that the Philippine authorities were not sufficiently responsive to the sharp rise in real interest rates in international markets."

This analysis is flawed in three respects. First, it rests on the questionable premise that Philippine government borrowing was based on cost-benefit comparisons of expected internal rates of return with real interest rates, rather than an increasingly desperate effort to service past debt by means of new money and thereby forestall the inevitable crisis. Second, the inability of the private borrowers to service their debt, much of which was then assumed by the public sector, is transmuted into evidence of greater private sector responsiveness to market conditions, in a rather heroic effort to find virtue in private enterprise. And finally, the analysis conveniently omits mention of the active encouragement provided by international financial institutions, not least among them the World Bank itself, to the government's strategy of debt-driven growth.

The year 1983 marked the breaking point of the debt cycle in the Philippines, in which the net transfer turned negative. The net flow (that is, new lending minus amortization payments) shrank to US\$140 million, and this was far exceeded by an outflow of US\$2.0 billion in interest payments (see Table 5).¹⁵ The net transfer remained negative in subsequent years; even in 1986, with the influx of new credits following the February revolution, interest payments exceeded the net flow of lending.

Distribution of External Debt by Creditor

The distribution of the Philippine public external debt among creditors is reported in Table 6. Most private sector loans were received from

15. The "net transfer" estimates reported in Table 5 are inexact insofar as changes in the dollar value of external debt outstanding arose not from new money inflows but from exchange rate effects (notably changes in the yen/dollar rate). These effects were substantial in 1985 and 1986 (see Table 8), and as a result Table 5 understates the net transfer in those years. A further complication is that in 1983 the Philippine balance-of-payments accounts record US\$1.2 billion in "payments arrears" as a short-term official capital inflow

Table 5
NET FLOW AND NET TRANSFER, 1962-1986
(US\$ million)

Year	Change in external debt outstanding ¹	Interest payments ²	Net Transfer
1962	0	10	-10
1963	20	9	11
1964	100	25	75
1965	320	33	287
1966	110	29	81
1967	370	36	334
1968	210	33	177
1969	340	38	302
1970	470	116	354
1971	90	91	-1
1972	340	115	225
1973	160	119	41
1974	870	146	724
1975	1180	223	957
1976	1830	246	1584
1977	1300	236	1064
1978	2620	439	2181
1979	2660	625	2035
1980	3900	975	2925
1981	3640	1378	2262
1982	3790	1993	1797
1983	140	1988	-1848
1984	600	2328	-1728
1985	830	2219	-1389
1986	2010	2048	-38
Total	27900	15499	12401

Notes:

1. Including gross external liabilities of the banking system.
2. Investment income debits other than earnings on direct investment.

Sources: Change in external debt outstanding from Table 4; interest payments from IMF, *Balance of Payments Statistics Yearbook*, various issues.

private creditors, although the Philippine government channelled concessional funds from bilateral and multilateral donors and long-term export credits to private entrepreneurs "from time to time" (WB 1984, p. 21). The available data indicating the breakdown by creditor refer only to public external debt.

which financed corresponding debt service outflows. Alternative data for the 1980s presented by the WB (1990, p. 310) indicate that the negative net transfer from the Philippines commenced two years earlier, in 1981.

Table 6
PUBLIC EXTERNAL DEBT BY CREDITOR, 1963-1983
 (percentage distribution)

Year	Official Creditors					Private Creditors	
	World Bank	IMF	US	Japan	Others	Commercial banks	Suppliers' credits
1963	13.9	21.2	20.3	0	0	34.9	9.7
1964	14.8	15.4	16.6	0	11.8	34.6	6.6
1965	12.9	14.0	14.6	0	3.1	49.5	5.8
1966	13.6	17.5	11.5	0	2.7	49.1	5.5
1967	12.4	17.4	8.7	0	2.0	53.5	6.0
1968	12.9	23.3	8.8	0	2.9	43.2	8.9
1969	13.6	20.8	8.8	0	1.6	45.8	9.2
1970	13.4	24.2	8.9	0	1.7	45.2	6.5
1971	14.8	25.6	9.7	0	1.7	36.4	11.7
1972	13.6	28.7	10.0	0.2	4.7	27.3	15.5
1973	13.6	30.5	11.4	1.8	5.5	20.0	17.2
1974	11.4	23.6	10.3	5.3	5.6	28.5	15.0
1975	11.6	21.0	10.8	8.0	7.7	36.1	4.8
1976	10.0	18.4	9.0	6.8	17.0	34.3	4.5
1977	10.7	18.3	9.3	6.6	20.7	25.9	8.5
1978	10.2	17.3	9.0	8.3	20.4	25.5	9.3
1979	10.4	16.7	9.2	5.8	18.9	29.0	9.0
1980	10.2	17.4	8.0	5.6	18.8	33.3	6.6
1981	11.0	17.8	6.5	6.1	18.4	35.5	4.7
1982	11.4	14.1	4.8	5.4	12.5	49.6	2.3
1983	14.4	12.3	5.1	5.6	14.5	45.6	2.6

Sources: NEDA (1974, pp. 280-1), (1976, pp. 398-9), (1986, pp. 606-7).

Perhaps the most notable feature of the data is the fairly consistent percentage distribution of the rapidly growing debt among different types of creditors. Thus the private creditors' share of total public external debt was 44 percent in 1963 and 48 percent in 1983, with an intervening peak of 58 percent in 1967 and low of 34 percent in 1977. The WB accounted for 10 to 15 percent of total public external debt throughout the period. The growth of the Philippine debt hence cannot be attributed to lending by one or a few groups of creditors: it was a broadly-based process. The creditor structure of the debt did, however, show some variation over time. For example, in the 1970s lending from Japan and other official creditors (including European governments and the ADB) came to play an important role, whereas in the 1960s official lending came almost entirely from the US, the WB and the IMF.

The change in the composition of official creditors was accompanied by a parallel shift towards greater Japanese and European involve-

ment in commercial bank lending. The early 1970s saw the formation of separate syndicates of Japanese, US, and European banks which established revolving eurocurrency credit lines (Wellons 1977, p. 167). In 1983, outstanding public external debt to non-US commercial banks surpassed that to US banks for the first time.¹⁶

Term Structure of External Debt

The distribution of total external debt by maturity type is reported in Table 7.

Nonmonetary sector debt (public and private) is broken down into two categories: (a) medium and long-term (MLT) debt, with maturities of one year or more; and (b) short-term debt, with maturities of less than one year. Medium-term debt (with 1-5 year maturities) comprised a small fraction of the former, at least towards the end of the period. In 1982, for example, medium-term debt represented only 1.4 percent of all medium and long-term debt, while 51.6 percent carried maturities of 5-12 years, and 47.0 percent carried maturities over 12 years (WB 1984, p. 72). Short-term nonmonetary sector debt includes revolving credits, some of which are trade-related; a relatively small amount of fixed-term debt, primarily bridging finance for development projects that will subsequently be financed with MLT loans; and trade financing, which usually carries maturities of 30-60 days following the shipment of goods to the Philippines and comes in the forms of documents against acceptance (D/A's) provided by foreign banks, and open accounts (O/A's) provided by foreign suppliers. The latter method has been used primarily for oil imports and by subsidiaries of transnational corporations (IMF 1984, pp. 67, 76).

Monetary sector debt - the gross external liabilities of the CB and commercial banks - is reported separately in the table. This is not broken down by term structure owing to the inadequacy of available data, but most of it is probably short-term.¹⁷

16. As of 1985, the four commercial banks with the greatest exposure in the Philippines were US-based: Citibank (US\$1.8 billion), Manufacturers Hanover Trust Co. (US\$489 million), Bank of America (US\$487 million), and Chase Manhattan Bank (US\$427 million). They were followed by the Bank of Tokyo (US\$404 million), Barclays Bank (US\$386 million), Bank of Montreal (US\$362 million), Banque Nationale de Paris (US\$284 million), Credit Lyonnais (US\$267 million), Morgan Guaranty Trust Co. (US\$252 million), and the Fuji Bank (US\$251 million). Data reported in *The Manila Chronicle*, November 4, 1986, p. 5; see Lind (1984) for further details.

17. Unpublished CB data indicate that 64 percent of monetary sector liabilities in 1983 were short-term. For the next two years, the corresponding figures were 63 percent and 56 percent; in 1986 it fell to 26 percent, presumably as a result of rescheduling. Maturity breakdowns of monetary sector liabilities for earlier years are not available, but the CB data indicate that commercial bank liabilities, a higher proportion of which are short-term, constituted a larger fraction of total monetary sector liabilities from 1972 to 1982 than they did thereafter.

Table 7
 TERM STRUCTURE OF EXTERNAL DEBT, 1965-1986
 (percentage distribution)

Year	Nonmonetary Sector		Monetary Sector ³
	Medium and long-term ¹	Short-term ²	
1965-69 (average) ⁴	47	53	
1970	65	13	21
1971	64	13	23
1972	61	11	28
1973	60	10	30
1974	55	9	36
1975	53	9	38
1976	60	11	30
1977	65	12	23
1978	58	12	31
1979	53	14	33
1980	50	15	36
1981	47	18	35
1982	45	18	37
1983	50	16	33
1984	51	17	32
1985	52	14	34
1986	55	10	35

- Notes: 1. Debt with maturities of one year or more.
 2. Debt with maturities less than one year.
 3. Gross external liabilities of the banking system (Central Bank and commercial banks).
 4. Public debt only.

Sources: 1965-69: Wellons (177, p. 163).

1970-86: Unpublished data provided by Central Bank of the Philippines, Department of Economic Research (International) and Financial Plan Data Center.

The rapid growth of short-term debt in the late 1960s played an important role in precipitating the 1970 balance-of-payments crisis. Among the responses to the crisis (others of which were discussed in the preceding chapter) was a restructuring of this debt: "In early 1970, faced with a large volume of maturing debt during the year, the authorities negotiated longer maturities for a sizable proportion of outstanding debt and obtained new medium-term credits to replace maturing short-term loans." (IMF 1984, p. 76).

In the late 1970s, however, the share of short-term debt again began to rise, even as the total volume of debt grew rapidly. The share of short-term nonmonetary debt and gross monetary sector liabilities rose from

35 percent in 1977 to 55 percent in 1982. In absolute terms, such debt grew during in this period from US\$3 billion to US\$14 billion.

As the volume of short-term debt mounted, its composition shifted. The share owed to banks and other financial institutions (as opposed to suppliers' credits) registered a "phenomenal rise" from 45 percent in 1979 to 77 percent in 1982 (WB 1984, p. 13). Two developments played key roles in this shift: credits from major oil suppliers dried up, forcing importers to turn to financial intermediaries; and short-term credit was increasingly used not only to finance trade, but also "to replace maturing longer term debts" and "to continually finance their working capital needs" by some producers in both the public and private sector (WB 1984, pp. 13-14). Public sector enterprises - such as the Philippine National Oil Company, Philippine Airlines, the National Power Corporation, the DBP, the National Sugar Trading Corporation, the National Food Authority, and the National Steel Corporation - accounted for about two-thirds of the increase in short-term debt in the early 1980s (IMF 1984, p. 76).

Discussing this period, the WB (1984, p. 12) remarks: "In general, the financial markets interpret a sudden accretion of short-term debt as a sign of reduced creditworthiness." This initiates a vicious circle:

At this stage, a debtor is often faced with restrictions on the type of credits available, with creditors showing a preference for short-term rather than medium-term commitments. Thus, a country with an increasing share of short-term borrowings in its debt portfolio faces a serious dilemma: lenders' perceptions of its creditworthiness erode as the weight of short-term borrowings increases; on the other hand, in order to service the debt and thereby maintain credit-worthiness, the borrowing country's dependence on short-term rollovers continues to grow. (WB 1984, pp. 12-13.)

This was the predicament of the Philippine economy as it approached the crisis of 1983.

By the end of 1986, restructuring had reduced the share of short-term debt in total external liabilities. In this respect, the pattern following the 1970 crisis was repeated. In other respects, however, the aftermaths of the two crises were profoundly different. In the early 1970s, the reduction in short-term debt had been achieved in a context of growing availability of external finance. The exercise of restraint by Philippine authorities (notably in the CB), anxious not to repeat the 1970 experience, acted for a time as a check upon new borrowing in general, and upon short-term borrowing in particular. In the mid-1980s, by contrast, the Philippines faced much tighter supplies of external finance, both from

official sources and, most drastically, from private lenders. A resumption of the "Ponzi scheme" in this changed international financial environment seems quite unlikely. Rather than an infusion of new external finance, the country now faces the prospect of protracted negative net transfers.

Capital Flight: The Missing Billions

This chapter presents evidence that a substantial fraction of Philippine external borrowing abroad was “recycled” out from the country via capital flight, or what Filipinos often refer to as “dollar salting.”

The best-publicized instances of capital flight from the Philippines involve the assets of ex-President Marcos, his family, and his close associates.¹ But Philippine capital flight was not restricted to members of the ruling family and their friends. The first Finance Minister of the Aquino government, the late Jaime Ongpin, told a group of bankers in 1986 that “every successful businessman, lawyer, accountant, doctor, and dentist I know has some form of cash or assets which he began to squirrel abroad after Marcos declared martial law in 1972 and, in the process, frightened every Filipino who had anything to lose” (Shaplen 1986, p. 61).

The Philippines was not unusual in this respect. Many Asian, Latin American, and African countries experienced large-scale capital flight in the 1970s and 1980s even as they accumulated large external debts. Morgan Guaranty Trust Company (1986) estimates that capital flight from 18 major Third World countries totalled US\$198 billion from 1976 to

1. Estimates of the amount of capital exported by Marcos and his associates vary widely. Press reports in July 1988 indicated that Marcos had offered to repatriate US\$5 billion to the Philippines in return for the right to return to the country and be exempt from criminal prosecution (‘Marcos Bids \$5 Billion to Return to Philippines’, *Los Angeles Times*, July 26, 1988). On the search for Marcos’s hidden wealth, see, for example, WGBH Educational Foundation (1987).

Table 8
RATIO OF CAPITAL FLIGHT TO EXTERNAL DEBT, SELECTED COUNTRIES

Country	Ratio of capital flight to external debt ^a			External debt outstanding, end-1986 ^b (US\$ billion)
	Morgan Guaranty (1976-85)	Dooley (to 1983)	Khan & Ul Haque (1974-82)	
Argentina	0.62	0.61	0.72	55.2
Brazil	0.12	0.08	0.04	115.4
Mexico	0.71	0.44	0.34	109.6
Venezuela	1.15	0.77	0.49	42.5
Indonesia	0.19	NA	NA	42.2
Korea	0.30	0.27	0.22	54.4
Malaysia	0.63	NA	NA	22.9
Philippines	0.39	0.30	0.36	27.2

NA = Not available.

- Notes: 1. Ratios differ due to differences in time periods covered and in measures employed; see original sources for details. All are likely to be underestimates in that they omit interest earnings on flight capital.
2. OECD estimates.

Sources: Morgan Guaranty Trust Company (1986, p. 13); Dooley (1986, p. 17); Khan and Ul Haque (1987, p. 4); OECD (1987, Table 1).

1985. During the same period the total external indebtedness of these countries rose by US\$451 billion.²

Several estimates of the ratio of cumulative capital flight to external debt for major Latin American and Asian debtor countries are reported in Table 8. As a fraction of external debt, Philippine capital flight appears to have exceeded that of Brazil, Korea, and Indonesia, but it was less than that of Argentina, Venezuela, Malaysia, and possibly Mexico.

A noteworthy feature of the estimates in Table 8, and virtually all commonly-cited estimates of capital flight, is that the reported cumula-

2. The countries included were Argentina, Bolivia, Brazil, Chile, Columbia, Ecuador, India, Indonesia, Malaysia, Mexico, Nigeria, Peru, Philippines, South Africa, South Korea, Thailand, Uruguay, and Venezuela. For other estimates, see Dooley *et al.* (1986), Dooley (1986), Cumby and Levich (1987), Khan and ul Haque (1987), and Pastor (1990).

tive totals are simply the summation of *nominal* annual flows, with no adjustment for inflation or interest earnings on externally held assets. That is, a dollar that left the Philippines or Mexico in, say, 1975, is valued the same as a dollar that left in 1986. Such cumulative totals substantially understate the real value of flight capital, imparting a downward bias to the ratios reported in the table. This bias and others are corrected in measures of Philippine capital flight derived in this chapter.

The chapter is organized as follows. The first part discusses the concept of capital flight. This is followed by an enumeration of some mechanisms by which capital fled the Philippines. Annual measures of capital flight are then presented. These indicate that the cumulative flight in the 1962-86 period totalled to US\$13.5 billion in 1986 dollars. With imputed interest earnings, the stock of Philippine flight capital amounted to US\$19.9 billion, equivalent to 70 percent of the country's external debt outstanding. The causes of this capital flight are explored in Chapter 5.

The Concept of 'Capital Flight'

Capital is mobile, albeit not perfectly so. As a whole, cumulated gross external liabilities worldwide from 1977 to 1983 amounted to US\$2621 billion.³ What portion of these liabilities should be considered "capital flight" is a matter of debate.

Capital flight is here defined as the movement of private capital from one jurisdiction to another *in order to reduce the actual or potential level of social control over that capital*. Within a country, capital can flee a particular province or region to escape legal or other social constraints. International capital flight, the object of this study, refers to such movements of capital from one sovereign nation to another.

This definition is close to that advanced by several contributors to the recent literature on the subject. Dooley (1986, p. 15), for example, defines capital flight as those capital outflows which are "motivated by the desire of residents to obtain financial assets and earnings on those assets which remain outside the control of the domestic authorities." Similarly, Deppler and Williamson (1987, pp. 41) write that the "problem with capital flight is that resources escape those who seek to exercise some degree of control over how the funds may be used."

This concept of capital flight rests upon the proposition that private control over capital is seldom absolute. Rather, it is circumscribed by a

3. IMF (1987b, Table 3, p. 13). At the same time, the reported increase in cumulated external assets was US\$2324 billion. In other words, nearly US\$300 billion of recorded inflows (liabilities) were unmatched by recorded outflows (assets).

range of social controls. Some of these social controls are codified in existing laws. Examples include taxation; exchange controls which restrict the free exit of capital from the country; and regulations on the uses of capital. Social controls also include societal norms and expectations which, though not formalized in law, constrain individual control over capital, as well as extra-legal exactions by governmental or non-governmental authorities. Moreover, there is always a *potential* for further social controls to be extended should economic or political circumstances change. This risk itself constitutes a further dimension of social control over private capital.

The phenomenon of capital flight thus arises from the fact that control over capital is contested.⁴ Absolute private control, unfettered by social control, is the exception rather than the rule. The degree and nature of social control differs among nations, and it is this differential which triggers capital flight.⁵

Capital flight is sometimes contrasted to "normal" capital outflows motivated by higher expected returns or portfolio diversification (see Cumby and Levich 1987, pp. 30-1). But while capital flight may be a response to abnormal circumstances, it is not an abnormal activity. As Lessard and Williamson (1987, p. 201) remark, capital flight is "the result of individual agents reacting in the way that is posited as rational by economic theory and accepted as normal in industrial countries."

Whether capital flight is regarded as socially beneficial or harmful depends, of course, on one's notion of social welfare. Judgments are likely to vary from case to case according to the specific circumstances. One may, for example, laud the flight of capital from Nazi Germany, but deplore the export of capital by a dictator in anticipation of his future retirement.

In theory, efforts by private owners of capital to reduce social control over their assets can be distinguished from efforts to increase the rate of return on those assets.⁶ Indeed, as Walter (1987, p. 105) observes, one cost of the confidentiality obtained through capital flight may be a lower

4. This phenomenon of "contested endowments" is akin to "contested exchange" (on which see Bowles and Gintis 1988).

5. In recent years international competition for funds among "haven" countries has contributed to further loosening of taxation on nonresident investment income. See Lessard and Williamson (1987, pp. 240-1).

6. Consider the difference between a shift from local currency into domestically-held dollars in anticipation of a devaluation and the export of capital out of the country. Dollarization could protect the asset owner's rate of return, without the loss of social control involved in capital flight. This was the Philippine government's rationale for permitting commercial and foreign banks to set up Foreign Currency Deposit Units operating under CB Circular Nos. 343 and 547. The difficulties inherent in such a distinction were demonstrated in Mexico when dollar-indexed financial instruments ('Mex-dollars') were declared inconvertible at the free market rate when that country's debt crisis broke in August 1982 (Zedillo 1987, p. 182).

expected rate of return. In practice, the two motives are often conflated, thus making it difficult to distinguish capital flight from the broader concept of "resident capital outflow", which comprises all private, non-banking system capital exports. Moreover, the flight and non-flight motives for capital outflows may be mutually reinforcing. For example, capital flight contributes to pressure on the exchange rate, which in turn may spark efforts to increase the rate of return on assets via dollarization. This would add pressure on the peso-dollar rate, and if this in turn increases the probability of greater social controls on private capital, further capital flight could result.

The export of capital from the Philippines occurred for the most part in violation of Philippine law. The boundary between legal and illegal transfers is fuzzy, however, since a number of "laws" were made and modified by secret presidential decrees.⁷ As a US congressional staffer told journalists, "Marcos could have exempted his friends from any one of the regulations, and you'd never be able to tell" (Carey and Ellison 1985).

In such a setting, the problem of distinguishing capital flight from other capital movements is simplified: virtually all resident capital outflows can be classified as capital flight by virtue of their illegality. The diminution of social control over capital may not have been the sole motivation for capital flight, but it was one intended effect.

Mechanisms of Capital Flight

The process of capital flight involves two necessary steps: the acquisition of hard currency; and the exit of capital from the country. These can be accomplished by a number of mechanisms, including the following:

Cash transfers

The physical transfer of cash or other monetary instruments payable to the bearer (such as traveller's checks or cashier's checks) is one mechanism of capital flight. In the case of the Philippines, the main currency transferred is reportedly US dollars, which are exchanged for pesos on the black market by tourists, visiting businessmen, US military personnel, and Philippine residents working abroad.⁸ At least until the

7. Presidential decrees in the early 1970s and again in 1983 made it illegal to export large amounts of cash or to hold foreign exchange accounts without CB approval. For details regarding currency transferability restrictions, see Cowitt (1985, pp. 669-70). The legal situation was different in the mid-1960s, when Philippine residents lived "under a nearly liberal currency control system" (Pick 1968, p.417).

8. Exports of pesos are less common, although there is a market for Philippine currency in Hong Kong.

early 1980s, dollars were reportedly also sold on the Binondo black market by the government-owned PNB. "The primary motivation behind such action," according to Thompson and Slayton (1985, p. 72), "was to hurt black market traders and to facilitate their 'financial cooperation' with certain highly-placed government officials."

Having acquired dollars in the Philippines, the physical transfer can be achieved in three principal ways: 1) via personal smuggling; 2) via the use of hired couriers who charge a fee - Carey and Ellison (1985) report a figure of five percent - for guiding the money past customs officials; and 3) via the mails.⁹ Newspaper reports indicated that following the Aquino assassination in 1983 as much as US\$3 million per day was leaving the Philippines through the Manila airport (Carey and Ellison 1985).

A variant on the cash transfer mechanism is the wire transmission services provided by the black marketeers based in Manila's Binondo district, who are known collectively as the "Binondo Central Bank." The Binondo bankers acquire dollars on the black market and smuggle them to Hong Kong for deposit in major banks. An individual can provide pesos to a Binondo intermediary, who instructs a Hong Kong bank to wire dollars to the customer's overseas account. The customer then confirms that the deposit was made by contacting his or her overseas bank.¹⁰

False invoicing of exports and imports

Manipulation of trade invoices provides another important mechanism of capital flight. Exporters of goods from the Philippines are required by law to surrender their foreign currency earnings to the government for conversion into pesos. To circumvent this requirement and accumulate foreign currency abroad, the exporter can understate the true price or quantity of the goods in question on the invoice. The difference between the invoice value and the actual value is then deposited abroad. In the case of imports, the same objective can be achieved through overinvoicing: the importer takes an invoice with an inflated value to the Central Bank to obtain the necessary foreign exchange, which is then transferred to the supplier, who in turn deposits the difference in accordance with the importer's instructions.

False invoicing is widely believed to have been a major avenue for Philippine capital flight. Cowitt (1985, p. 675) reports that "underinvo-

9. Carey and Ellison (1985) report a case in which Deak & Company's San Francisco office received US\$11 million sent from the Philippines in envelopes marked "documents"; the company was convicted of banking law violations by US federal court for failing to report the transaction.

10. This process is described by Carey and Ellison (1985), who report that former Defense Minister Juan Ponce Enrile was among those who used the Binondo transmitters.

icing of exports and overinvoicing of imports represented a major part of the trade [in the foreign currency black market], while banknote smuggling accounted for less than 10 percent."

Kickbacks

The provision of kickbacks on import contracts, referred to in polite company as "commissions," is similar in effect to import overinvoicing. In this case, the foreign supplier pays an individual a portion of its proceeds from the sale of goods or services to the Philippines. The exchange occurs abroad, but the ultimate source of the hard currency is the payment for the imports in question. Perhaps the most famous example of this in the Philippines is the US\$80 million paid to Herminio Disini by Westinghouse Corporation "for assistance in obtaining the contract and for implementation services" in the sale of a nuclear power plant to the Philippine government. A lawyer who worked on the contract for the supply of the power plant told *The New York Times*:

There was nothing illegal about this contract. But if you look at the terms closely, you will see that the price of the equipment being sold to the Philippines was inflated, as a way to cover the cost of the fees to Disini.

In a memo to President Marcos, the Secretary of Industry of the Philippines described the transaction as "one reactor for the price of two."¹¹

Another documented example is the purchase of telecommunications equipment, financed by the US government's Foreign Military Sales program, from shell companies which in turn obtained "sham marketing contracts" with the actual producers "in order to kick back between 35 percent and 50 percent of their proceeds" (Pasztor 1987).¹²

Inter-bank transfers

The role of inter-bank transfers in capital flight is among the most controversial aspects of the phenomenon, particularly in countries such as the Philippines which have capital controls aimed at limiting outflows

11. The *Times* reported that 95 percent of Disini's fees were then transferred to Marcos (Butterfield 1986). Criminal investigations of the payments by the US Justice Department were dropped without bringing charges (Pasztor 1987). Further details on the financial negotiations leading to the reactor sale are reported by Bello, Hayes, and Zarsky (1979, pp. 9 -10), and Dumaine (1986).

12. Former Philippine armed forces commander General Fabian Ver is reported to be "a principal subject" of continuing grand jury investigations into this case. See also Ellison and Carey (1985).

of foreign exchange. Local banks, or local affiliates of foreign banks, have the ability both to provide foreign exchange and to transfer it to designated recipients abroad; the only problem is that this is often illegal.

Walter (1987, p. 115) asserts that "banks of international standing tend to avoid direct involvement in the capital flight process itself." More precisely, they seek to preserve what in the US political lexicon is termed "deniability":

They generally have multiple domestic and foreign relationships with governments, public- and private-sector entities, individuals and multinational firms, and exposure, especially of illegal capital flight activities, is likely to lead to business losses greater than prospective gains.

Subject to this constraint, however, the banks are by no means averse to flight capital:

[A]ll such institutions will actively solicit fiduciary and other business from individuals and institutions engaged in capital flight once the assets are safely offshore. They will also assiduously cultivate the various clients involved. In that sense they may help to reduce information and transaction costs.

While the first-tier banks "will tend to stay well clear of illegal acts," Walter notes that "among the foreign-based financial institutions there are plenty of second-tier players and shady operators who have far fewer long-term stakes in the game, and are more than willing to turn a fast profit at the edge of the law or ethical behavior."¹³

One variant of the inter-bank transfer mechanism is the "hidden deposit" placed by a Philippine resident in the local branch of a domestic or international bank with overseas branches:

He or she deposits US\$115 in the Philippine branch and makes a private agreement with the bank never to withdraw that money. The bank then provides the depositor with a US\$100 loan from an overseas branch of the bank.

13. Among such "second-tier" institutions was the Australia-based Nugan Hand Bank, whose Manila representative was General LeRoy Manor, the former commander of US military bases in the Philippines, who negotiated their renewal with the Philippine government in 1979. Nugan Hand's known clients included Elizabeth Marcos (sister of the President) and her husband Ludwig Rocka, who deposited US\$3.5 million with the bank according to records found after its collapse in 1980. See Kwitny (1987, pp. 34-7, 186-93). Affidavits filed with the Philippine Presidential Commission on Good Government indicate that President Marcos himself deposited US\$51.8 million in Hong Kong between 1981 and 1985 via inter-bank transfers by the Security Bank & Trust Company; and documents found in Malacañang Palace indicate that Marcos funds were also transferred abroad via the Traders Royal Bank (Malone 1987, pp. 29, 31).

The bank profits by the difference between the amount deposited and the amount "loaned," and through "tax advantages it gains by having an outstanding loan in its overseas branch" (Carey and Ellison 1985).

The Measurement of Capital Flight

The measurement of capital flight requires statistical detective work, for as Lessard and Williamson (1987, p. 205) remark, the individuals involved "are unlikely to make a point of informing the compilers of balance of payments statistics of their actions."

The capital flight estimates reported below differ from previous estimates in several respects: they span a longer period of time; they are based upon more complete estimates of the country's external debt outstanding; they include adjustments for changes in debt outstanding arising from fluctuations in the yen/dollar exchange rate; they incorporate the net effect of misinvoicing of exports and imports; and they calculate the cumulative stock of flight capital in real terms and with imputed interest earnings.

The residual and 'hot money' measures

Most of the recent literature on capital flight employs one of two measurement techniques.

The residual measure. The most widely used measure begins with annual changes in the country's total external debt outstanding, including gross banking system liabilities. Various non-flight uses of this external finance are then deducted, and the residual is taken as a measure of capital flight. In most cases, this measure is calculated as changes in gross foreign debt minus the net direct investment outflow, the current account deficit, and increases in official reserves.¹⁴ The relevant data for the Philippines are reported in Table 9.

One problem with residual measures of capital flight is that the dollar value of external debt outstanding is affected by exchange rate variations among the currencies in which the debt is denominated. In the case of the Philippines, where a substantial fraction of the debt is owed in Japanese yen, the dollar value of the external debt rises as the yen appreciates against the dollar, and declines as it depreciates. Such variations contribute to the year-to-year changes in external debt outstanding reported in Table 4.

14. See, for example, Diaz-Alejandro (1984, pp. 362-3), Sachs (1984, p. 397), the Bank for International Settlements (1984, p. 101), Erbe (1985), and the WB (1985a, p. 64). In keeping with the usual practice in the literature, direct investment outflows from the Philippines are treated here as non-flight capital. The definition of capital flight proposed above does not, however, necessarily exclude direct investment outflows. In the present instance, the quantities involved are so small that their treatment makes little difference.

Table 9
CHANGE IN EXTERNAL DEBT AND NON-FLIGHT USES
OF FOREIGN EXCHANGE, 1962-1986
(US\$ million)

Year	Change in external debt outstanding	Yen/dollar adjustment ²	Foreign exchange outflows ³					
			Current account deficit			Net direct investment	Increase in official reserves	Increase in commercial banks' external assets
			Total	Non-investment income	Net investment income			
1962	0	0	-30	-47	17	3	21	-19
1963	20	0	-182	-199	17	4	23	17
1964	100	0	-85	-111	26	4	16	-7
1965	320	0	-137	-168	31	10	67	37
1966	110	0	-161	-198	37	15	-12	45
1967	370	0	25	-51	76	9	-25	4
1968	210	0	250	153	97	3	-74	24
1969	340	0	253	175	78	-6	-81	-26
1970	470	0	48	-82	130	29	46	-9
1971	90	27	2	-99	101	4	97	25
1972	340	5	-7	-132	126	22	184	168
1973	160	22	-474	-588	113	-64	668	320
1974	870	-29	207	153	54	40	591	329
1975	1180	-10	924	798	126	-124	-16	117
1976	1830	27	1102	849	253	-142	-57	-405
1977	1300	146	755	422	333	-215	-30	-77
1978	2620	185	1093	687	406	-100	876	394
1979	2660	-300	1496	932	565	-21	376	403
1980	3900	357	1901	1069	832	103	960	816
1981	3640	-164	2089	1047	1042	-176	-349	-29
1982	3790	-176	3198	1372	1826	-17	-703	207
1983	140	38	2753	977	1776	-111	-2044	-710
1984	600	-325	1257	-848	2104	-6	263	122
1985	830	1155	26	-1975	2002	-20	-123	-68
1986	2010	1298	-991	-2941	1950	-140	1111	39
Cumulative totals:								
1962-69	1470	0	-67	-446	379	42	-65	75
1970-75	3110	15	700	49	651	-94	1569	950
1976-80	12310	415	6346	3958	2388	-375	2125	1131
1981-86	11010	1826	8332	-2367	10699	-469	-1845	-439
1962-86	27900	2255	15311	1194	14117	-896	1784	1717

- Notes: 1. Including gross external liabilities of the banking system.
2. Adjustment for appreciation (+) or depreciation (-) of yen-denominated debt.
3. Outflows positive, inflows negative (opposite of balance of payments sign convention).

Sources: Change in external debt outstanding from Table 4.

Yen/dollar adjustment based upon percentage share of Japanese in total liabilities from NEDA (1976, pp. 400-1; 1986, pp. 606-7) and unpublished Central Bank data, and exchange rates reported in IFS (1987, pp. 424-5).

Current account deficit, net direct investment, and change in reserves from Table 7.1; commercial banks' external assets from IMF, *International Financial Statistics*, 1987, pp. 558-9, line 7a.d.

Precise data on the currency composition of the Philippine external debt are not available, but NEDA data permit the calculation of the share of debt to Japanese private and official creditors.¹⁵ Multiplying this percentage by total external debt yields an estimate of the dollar value of yen-denominated debt at the end of each year. The yen/dollar adjustment factor reported in Table 9 is the change in the dollar value of the previous year's yen-denominated debt when revalued at the end-of-year exchange rate. The adjustment was zero in the 1960s, when the yen share of total debt was relatively low and the yen/dollar rate relatively stable, and largest in 1985 and 1986, when the yen appreciated strongly.

The residual measure of capital flight reported in Table 10 incorporates this yen/dollar adjustment. The arithmetic by which this measure is derived can be traced in Table 9. The total increase in external debt outstanding in this period was US\$27.9 billion; of this, US\$2.3 billion was attributable to the rise in the dollar value of yen-denominated debt, for an adjusted inflow of US\$25.6 billion. In addition, direct investment contributed a net inflow of US\$0.9 billion. The adjusted 'gross capital inflow' was thus US\$26.5 billion. Of this amount, US\$1.2 billion covered the cumulative deficit on the non-investment income portion of the current account. A further US\$14.1 billion covered net investment income payments, primarily interest payments on the external debt itself. Net additions to the country's official reserves amounted to US\$1.8 billion. The remainder - US\$9.4 billion - is the residual estimate of capital flight.¹⁶

A more restrictive variant of the residual measure excludes the external assets accumulated by the country's commercial banks.¹⁷ Philippine commercial banks accumulated US\$1.7 billion in external assets over the 1962-86 period; deducting these the total capital flight estimate would be US\$7.7 billion. There is no convincing reason, however, to assume that banks cannot engage in capital flight, and hence following

15. NEDA (1974, pp. 280-1; 1976, pp. 398-9; 1986, pp. 606-7). This share averaged approximately 10 percent in the period as a whole, and rose over time. Unpublished data furnished by the Central Bank indicate that 25.7 percent of foreign exchange liabilities, excluding liabilities to multilateral agencies, were to Japan at end of 1985; this is equivalent to 20 percent of total liabilities.

16. This estimate is reasonably consistent with those reported for the Philippines by other sources; for a review, see Boyce and Zarsky (1988, Appendix B).

17. This is the measure used by the Morgan Guaranty Trust Company of New York (1986) in its widely reported capital flight estimates. The Morgan Guaranty estimates for the Philippines are US\$7 billion in the period 1976-82 and a further US\$2 billion in 1983-85; these are somewhat higher than the corresponding estimates of US\$6.2 billion and US\$0.6 billion reported in Table 10. The reason for the discrepancy is not clear, but it may be due to different debt estimates used by Morgan Guaranty and/or to a slightly different definition of banking system external assets. Cumby and Levich (1987, pp. 60-1) and Lessard and Williamson (1987, p. 206) report an estimate of US\$3.7 billion by this method for the years 1976-84 (versus US\$5.7 billion reported here); their lower figure arises from an error (amounting to US\$639 million) in their recording of banking system foreign assets for the year 1983, and to their lower debt estimates.

Table 10
CAPITAL FLIGHT: RESIDUAL AND HOT MONEY MEASURES
(WITHOUT ADJUSTMENTS)
(US\$ million)

Year	Residual measure ¹		Hot money ²
	Inclusive	Non-bank	
1962	6	25	8
1963	175	158	130
1964	165	172	160
1965	380	343	191
1966	268	223	73
1967	361	357	60
1968	31	7	129
1969	174	200	117
1970	347	356	158
1971	-41	-66	99
1972	136	-32	104
1973	10	-310	25
1974	62	-267	120
1975	406	289	220
1976	900	1305	460
1977	645	722	127
1978	566	172	227
1979	1108	705	643
1980	579	-237	267
1981	2240	2269	1205
1982	1487	1280	734
1983	-495	215	248
1984	-589	-711	-197
1985	-208	-140	-248
1986	732	693	506
Cumulative			
Totals:			
1962-69	1560	1485	868
1970-75	920	-30	727
1976-80	3798	2667	1724
1981-86	3167	3606	2248
1962-86	9446	7729	5567

- Notes: 1. Residual measures calculated from data in Table 9:
 "Inclusive" = Increase in external debt outstanding minus yen/dollar adjustment minus current account deficit minus net direct investment outflow minus increase in official reserves.
 "Non-bank" = Inclusive measure minus increase in commercial banks' external assets.
2. Hot money = Sum of 'other short-term capital of other sectors: other assets' (or equivalent entries in earlier years) plus 'net errors and omissions', as reported in IMF, *Balance of Payments Statistics Yearbooks*.

the usual practice, their external assets are included in the residual measure developed here.¹⁸

The residual measures in Table 10 are incomplete in that they exclude capital flight through false trade invoicing and the interest earnings of flight capital. Adjustments for these are considered below.

The 'hot money' measure. The second measure of capital flight is relatively narrow: the sum of net errors and omissions plus certain private, non-bank short-term capital movements as recorded in the balance of payments. The aim is to capture only highly liquid "speculative" capital outflows; errors and omissions are included "because of the widespread belief that [they] largely reflect unrecorded short-term capital flows."¹⁹

This measure is excessively restrictive since, as Deppler and Williamson (1987, p. 43) observe, long-term assets such as equities and real estate "may be relatively close substitutes" for short-term assets. Even if the aim is to focus only upon the "hot" component of flight capital, which moves most quickly in response to changing economic and political conditions, the measure may be too narrow. As Cumby and Levich (1987, p. 35) remark: "In today's international financial markets there is very little loss of liquidity associated with acquiring long-term bonds (especially US government bonds, corporate bonds traded on US markets, or Eurobonds) or equities." The hot money measure can thus be regarded as an estimate of the lower bound on total capital flight.

The application of this measure to the Philippines yields the "hot money" estimate reported in the final column of Table 10.²⁰ Net outflows (here bearing a positive sign) were recorded every year except 1984 and

18. Cumby and Levich (1987, pp. 32-33) question whether there is sound "justification for treating the banking system differently from other firms and individuals." Cuddington (1986, p. 4, n. 2) offers the rationale that "the central bank directly or indirectly controls a large fraction of commercial banks' foreign assets in many developing countries." In the Philippines, government financial institutions (such as the PNB and DBP) and "political banks" enjoying a "special relationship with the group in government" accounted for more than half of the total assets of the commercial banking system in 1982 (De Dios *et al.* 1984, p. 38). The degree of social control over the external assets of the commercial banking system is hence open to doubt. As Patrick and Moreno (1985, p. 363) observe, the political power of major financial groups implies that "they do not have to take as given the rules of the economic game as determined by government." In the Philippine case, the more inclusive measure of capital flight thus seems preferable to the non-bank measure.

19. Cuddington (1986, pp. 2-3). Indeed, "net errors and omissions" are reported as a subheading under 'Short-Term Capital' in the "analytic presentation" for the Philippines in some issues of the IMF *Balance of Payments Yearbook*; see, for example, Vol. 28 (1977), p. 489. The IMF (1977, p. 51) states that this practice is followed when "there is evidence to suggest that the variations reflect mostly unrecorded short-term movements of capital." Dornbusch (1985, pp. 227-9) employs a similar definition of capital flight.

20. This measure includes, in addition to net errors and omissions, those short-term, non-bank private capital movements recorded as "other assets" or "other liabilities" in the balance of payments. Entries under the heading 'other loans received' (which correspond to entries under the heading 'trade credits' in earlier volumes) are excluded, since these

1985, with a peak of US\$1.2 billion in 1981. The cumulative (nominal) outflow by this measure, with no adjustment for inflation or interest earnings on externally held assets, was US\$5.6 billion, of which US\$4.0 billion fled from 1976 to 1986. Notwithstanding the narrowness of this measure, the volume of capital flight it captures is thus quite substantial.

Misinvoicing adjustment

A problem with both of the usual capital flight measures is that they fail to incorporate the effects of false trade invoicing. The underinvoicing of exports and overinvoicing of imports are widely believed to be important vehicles for capital flight. Such practices would inflate the trade and current account deficits, leading to underestimation of capital flight by the residual and "hot money" measures.

At the same time, however, "technical smuggling" via *underinvoicing* of imports, and "pure smuggling" in which legal import channels are bypassed completely, are also reported to have been widespread in the Philippines. The motive in this case is the evasion of tariff and other import barriers. Smuggling has the opposite effect: understatement of the trade and current account deficits, and overstatement of capital flight, as funds which appear to have fled the country are in fact used to finance unrecorded imports.

The net impact of trade misinvoicing on estimated capital flight is the sum of these two contradictory effects. Its direction and magnitude cannot be judged on *a priori* grounds, but the net effect can be estimated by means of trading partner data comparisons.

Table 11 presents annual estimates of the net impact of misinvoicing for the period under review. These are based on comparisons of trade flows as recorded by the Philippines and its industrial country trading partners, as reported in the IMF's *Direction of Trade Yearbooks*. In 1986, for example, the Philippines reported exports to the US as having a total value of US\$1.71 billion, while the US reported imports from the Philippines with a total value of US\$2.15 billion. Adjusting for freight and insurance costs (using the Philippine fob/cif ratio reported annually in the IMF's *International Financial Statistics*), the comparison indicates that Philippine exports to the US were underinvoiced by US\$320 million in that year. Total discrepancies for industrial country trading partners are scaled upwards (by their ratios to total Philippine exports and imports in a given year) to generate the global estimates reported in the table.²¹

primarily refer to trade financing. The same technique is used by Cumby and Levich (1987, pp. 60-1) in their calculation of the Cuddington measure for the Philippines for the years 1976-1984.

21. This methodology relies on the assumption that the trade data reported by the industrial countries are reasonably accurate. Gulati (1987, p. 70), who employs the same technique, reports that trade data comparisons among the industrial countries indicate that this assumption is "for the most part realistic."

Table 11
TRADE INVOICING DISCREPANCIES, 1962-1986
 (US\$ million)

Year	Export discrepancy ¹	Import discrepancy ²	Capital flight misinvoicing adjustment ³
1962	81	51	30
1963	-3	209	-212
1964	37	161	-124
1965	29	183	-155
1966	72	184	-111
1967	144	223	-79
1968	178	305	-127
1969	305	312	-7
1970	129	319	-190
1971	112	286	-174
1972	101	248	-147
1973	-46	298	-344
1974	63	-32	96
1975	458	203	255
1976	133	253	-121
1977	250	266	-16
1978	438	659	-221
1979	593	640	-47
1980	949	623	326
1981	1071	593	477
1982	1181	541	640
1983	870	1194	-324
1984	1395	803	592
1985	1516	886	630
1986	1223	923	300
Total	11277	10332	945

- Notes: 1. Export discrepancy = Trading partners' imports from the Philippines - (recorded Philippine exports x cif/fob factor).
 2. Import discrepancy = (Trading partners' exports to the Philippines x cif/fob factor) - recorded Philippine imports.
 3. Misinvoicing adjustment = Export discrepancy - import discrepancy.

Sources: IMF, *Direction of Trade Yearbooks*; cif/fob factors from IMF, *International Financial Statistics* 1987, pp. 126-7.

(For method of calculation, see text.)

On the export side, the data reveal a consistent pattern of underinvoicing. In all but two of the 25 years, the value of imports from the Philippines recorded by its trading partners exceeded the value of exports (adjusted for shipping costs) recorded by the Philippines. As a whole, the average discrepancy during the period was equivalent to 13 percent of the recorded value of exports; in the 1980s it rose to 24 percent, or nearly US\$1.2 billion per year.²²

22. Exports to the Philippines top three trading partners - the United States, Japan, and West Germany - were underinvoiced by averages of seven percent, 20 percent, and

On the import side, the data reveal consistent under- rather than overinvoicing. This indicates that capital flight through import overinvoicing was exceeded in magnitude by smuggling through underinvoicing or non-reporting of imports. The average net discrepancy was equivalent to 15 percent of the recorded value of imports; in the 1980s it fell to 11 percent.²³

In the 1960s, the misinvoicing adjustment to capital flight estimates is downward: the impact of smuggling swamped not only import overinvoicing but export underinvoicing as well. In the 1970s, the picture is mixed, with export underinvoicing exceeding the net import underinvoicing in two years and almost equalling it in two others. In the 1980s, the capital flight effect generally overwhelmed the smuggling effect, necessitating upward adjustments of our previous capital flight estimates. The misinvoicing adjustment consequently has a noticeable impact upon the time trend of capital flight. Its net effect upon total estimated nominal capital flight in 1962-86 is an additional US\$945 million.

It should be emphasized that this fairly modest total does not imply that trade invoice manipulation has been a relatively unimportant mechanism of capital flight. On the contrary, in the period as a whole, export underinvoicing alone amounted to US\$11 billion. The misinvoicing adjustment captures the *net* effect of: (1) capital flight via false trade invoicing; and (2) the use of unrecorded capital outflows to finance the undeclared portion of Philippine imports.²⁴ It is quite possible that cash and wire transfers were major mechanisms for undeclared import finance, while export underinvoicing and import overinvoicing were significant vehicles of capital flight.

Inflation and interest adjustments

Table 12 presents two alternative summary estimates of capital flight from the Philippines. Measure A is the residual measure reported in Table 10 plus the misinvoicing adjustment reported in Table 11. Measure B is the 'hot money' measure reported in Table 10 plus the misinvoicing adjustment. Measure A is the more comprehensive of the two. Measure B is reported as a minimal alternative estimate. In nominal terms, total capital flight from the Philippines from 1962 to 1986 amounted

71 percent, respectively. The extraordinarily high figure for West Germany may be partly attributable to misidentification of the final export destination as the Netherlands; trade data comparisons reveal consistent "overinvoicing" of Philippine exports to the latter.

23. Imports by the Philippines from the U.S., Japan, and West Germany were under-reported by averages of 12 percent, 25 percent, and four percent, respectively in the period as a whole.

24. A notion of the scale of the latter can be derived from Alano's (1984, pp. 185-7) estimate that in the period 1965-1978 smuggled imports represented 29 percent of the value of exports to the Philippines as recorded by its trading partners.

Table 12
SUMMARY ESTIMATES OF PHILIPPINE CAPITAL FLIGHT, 1962-1986
(US\$ million)

Year	Annual Flow				Cumulative stock (with interest adjustment) ²	
	Nominal (current \$)		Real (1986 \$) ¹		A	B
	A	B	A	B		
1962	36	38	115	121	37	39
1963	-37	-82	-116	-260	1	-43
1964	41	36	130	115	42	-8
1965	226	36	700	113	274	29
1966	157	-38	471	-115	448	-9
1967	282	-19	846	-56	756	-29
1968	-96	2	-280	6	698	-28
1969	167	110	470	309	917	84
1970	157	-32	425	-88	1138	56
1971	-215	-75	-565	-197	967	-18
1972	-12	-43	-29	-109	995	-63
1973	-334	-319	-744	-710	719	-398
1974	158	216	295	404	939	-205
1975	661	474	1133	814	1674	272
1976	779	339	1277	556	2556	633
1977	628	111	970	171	3336	780
1978	345	6	494	8	3934	842
1979	1061	596	1351	759	5444	1553
1980	905	593	1010	661	7035	2361
1981	2717	1682	2777	1719	10934	4494
1982	2127	1374	2130	1376	14347	6423
1983	-820	-76	-810	-75	14728	6898
1984	3	395	3	381	16141	7971
1985	422	382	409	371	17787	8965
1986	1032	806	1032	806	19912	10329
Total	10391	6512	13492	7080	(19912)	(10329)

Key: A = Residual measure plus misinvoicing adjustment.

B = Hot money measure plus misinvoicing adjustment.

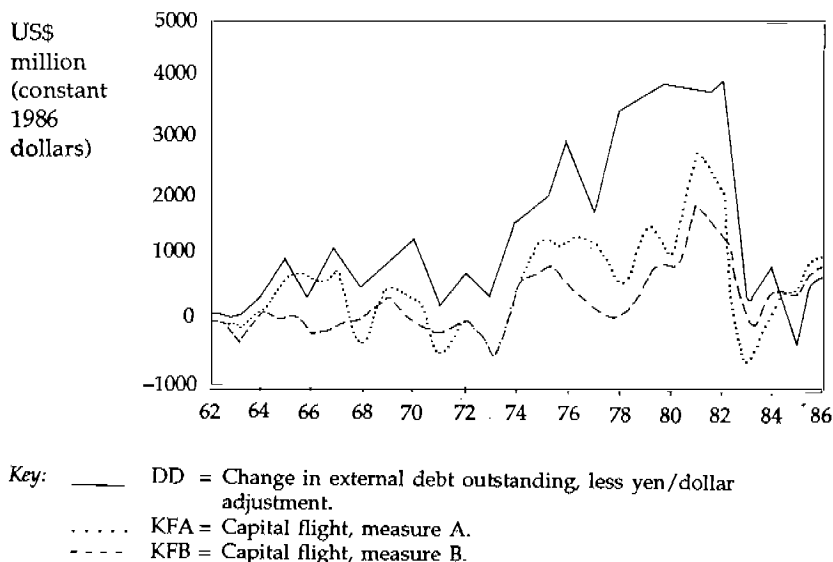
Notes: 1. Converted to 1986 dollars using US wholesale price index as reported in IMF (1987, pp. 698-9).

2. End-of-year cumulative totals, including interest calculated on mid-year cumulated stock (using short-term US Treasury bill rate as reported in IMF, 1987, pp. 698-9).

to US\$10.4 billion by the former measure, and US\$6.5 billion by the latter.

The magnitude of capital flight (relative, for example, to the country's US\$28.3 billion external debt outstanding at the end of 1986) can be better appreciated by imputing interest earnings to derive the cumulative stock of flight capital, or alternatively by converting the annual flows

Figure 2
EXTERNAL DEBT INFLOWS AND CAPITAL FLIGHT, 1962-1986



Sources: See Tables 12 and 16

into real terms. Both adjustments are reported in Table 12. The interest adjustment is made using the short-term US Treasury bill rate²⁵ while the inflation adjustment is made using the US wholesale price index. Capital flight by measure A in the 1962-1986 period, calculated with the inflation adjustment, totalled US\$13.5 billion in 1986 dollars, equivalent to almost half of the Philippines' external debt outstanding. This is a conservative estimate in that it assumes that externally held assets earned zero real interest. With the interest adjustment the total stock of flight capital amounted to US\$19.9 billion, equivalent to 70 percent of the external debt outstanding.

Concluding remarks

Capital flight from the Philippines, like the country's external debt problem, did not commence in the mid-1970s. In the eight years preceding the 1970 foreign exchange crisis, capital flight (by measure A)

25. The actual interest rate earned by flight capital is an open question; de Vries (1987, p. 188) considered the current Treasury bill rate of six percent to be a "low" proxy for the rate of return on overseas assets, while a European banker stated that most foreign depositors in Swiss banks received *negative* interest, "implying that they were willing to pay a substantial premium for security" (Lessard and Williamson, eds., 1987, p. 83). Nor

amounted to US\$776 million, equivalent to US\$2.3 billion in 1986 dollars. The outflow of flight capital in real terms appears to have peaked in 1975-76 and again in 1981-82 (see Figure 12). At the end of 1986 the cumulative stock of flight capital was equivalent to a sizeable fraction of the country's external debt. A key difference, of course, is that the external debt was largely public, while the external assets were strictly private.

The apparent net inflow of flight capital in 1983 and the relatively small outflow in 1984 are at variance with the conventional wisdom that massive capital flight followed the August 1983 Aquino assassination. One possible explanation is that with the collapse of foreign lending to the Philippines, an important source of financing for capital flight dried up. Another is that speculative capital was drawn back to the country by the very high-interest "Jobo bills" issued by the CB in 1984.

If anything, the capital flight estimates reported here may err on the conservative side. None of the measures captures capital flight which occurred through "commissions" or kickbacks paid abroad on import contracts. Unlike false invoicing, these cannot be detected by trading partner data comparisons since the kickbacks form part of the purchase price reported by both parties. If capital flight by this mechanism was substantial, the estimates reported here may be too low. Similarly, the practice of export "re-invoicing", whereby Philippine exporters "sell" goods at a low price to a foreign-based company which in turn resells them at a higher price to the final buyer, escapes detection.²⁶ Moreover, insofar as dollars supplied to the black market are unrecorded in the Philippine balance of payments, their re-export also escapes detection.²⁷ In each of these cases, the current account deficit is in effect overstated, and capital flight is correspondingly understated.

One measure of the cost of capital flight to the Philippine economy would be the productive investment which could have been financed within the country with the same resources. The extent to which individual flight capitalists would have undertaken such investments, had capital flight been blocked as an alternative with all else unchanged, is

is it necessarily the case that all capital sent abroad was saved; some may well have been used to finance consumption overseas. The interest imputation in Table 12 thus should be regarded as a measure of the opportunity cost of capital flight, rather than of actual accumulated external assets.

26. Carey and Ellison (1985) report that some exporters established front companies in Hong Kong for this purpose.

27. A further avenue for non-detectable capital flight may be transactions between Philippine residents working abroad who wish to obtain pesos at the black market rate, and those in the Philippines who wish to acquire dollars for transfer abroad. Rather than smuggling dollars to their families in the Philippines via "network of couriers" (as reported by Cowitt 1985, p. 671), overseas workers could sell dollars abroad for pesos at home, eliminating the costs and risks of currency smuggling in both directions. I have found no reference to such transactions in the literature, but it is unlikely that the opportunities for intermediation have escaped the notice of the Binondo bankers.

an open question. It is quite possible that much of the money instead would have been channeled into unproductive, speculative investment or the consumption of imported goods. But it is difficult to imagine that capital flight could have been eliminated while the rest of the country's political economy remained the same. Hence there are as many answers to the question of what would have happened in a different setting as there are varied conceivable settings. No doubt many Filipinos would have preferred other uses of the missing billions.

The Kiss of Debt

Philippine policy makers embraced the debt-for-development strategy whose attraction lay in the positive net transfer. Perhaps they realized that the stage of negative net transfers would eventually dawn. Perhaps some even anticipated the bitter, morning-after sensation of debt regret. But the lure of the positive net transfer proved irresistible.

How sweet was the "kiss of debt?" Did the inflows of borrowed capital allow the people of the Philippines to live, for a time, "beyond their means," reaping short-term benefits at the price of long-term indebtedness? What impact did external borrowing have upon savings, investment, and growth? Were debt-creating capital inflows a cause of capital flight, or was it mere coincidence that the two occurred in the same time period? How did external borrowing affect the character and role of the Philippine state?

This chapter explores these questions.

Debt and the Current Account Deficit

The usual view of the external debt of Third World countries is that borrowing on the capital account is a result of current account deficits, particularly trade deficits. Transactions in goods and services lead, and capital movements follow.

In discussing the Philippine experience in the 1960s, for example, Baldwin (1975, p. 14) states that imports were "stimulated by the

government's easy credit policies and expanded development-oriented expenditure programs," and that the resulting balance-of-payments problems "were held off for a few years by extensive foreign borrowing from official and private sources."

Similarly, referring to the experience of the late 1970s and early 1980s, the WB (1984, pp. i, ii) states that "adverse exogenous developments ... combined with expansionary demand policies, led to an increase in the country's current account deficit and a rapid accumulation of external debt." In particular, declining terms of trade and rising interest payments "were mainly responsible for the increase in the current account deficit (and *consequent* debt accumulation) in recent years" (emphasis added). In the same vein, Power (1983, p. 12) models external financing as an "accommodation" to current account deficits resulting from the gap between external shocks and other adjustments.

Yet it is evident that without capital account surpluses, the current account deficits which they financed could not have endured for long. Indeed, an explicit objective of some lending, such as official export credits and much bilateral aid, was the promotion of exports from the creditor countries.

The relationship between current account deficits and capital account surpluses can thus be interpreted such that causality does not run in a unilinear fashion from the former to the latter.

Remolona, Mangahas and Pante (1985, p. 1), for example, state: "The worsening of the current account was due in part to a severe deterioration in the country's terms of trade and in part to a policy response that relied heavily on foreign borrowing to the neglect of other adjustment measures." They observe (p. 11) that "easy external financing led to the postponement of required adjustments in the exchange rates" (or, it might be added, of other non-exchange rate measures to redress the imbalance).

Montes (1987, p. 4) states that the "foreign exchange bonanza" of the 1970s resulted in the appreciation of the real effective exchange rate by 18 percent between 1970 and 1982. He remarks: "This was a period of increasing overvaluation of the peso, which was made possible, ironically, by the consistent support of the IMF and the WB to the country's economic management."

An examination of trends in the real effective exchange rate of the peso (or the nominal exchange rates adjusted for inter-country differences in inflation and weighted among countries by trade share) reveals that significant real devaluations occurred in 1970 and in 1983 (see Table 2). The extent of overall real devaluation in the 1962-86 period was far less, however, than that of the nominal exchange rate. Moreover, between 1970 and 1983 the real effective exchange rate actually appreciated, as Montes observes, notwithstanding growing current account

deficits. In the 1970s the country's official foreign exchange reserves grew even as the current account deficit widened.¹ The increase in the supply of external finance thus exceeded the increase in demand for it during much of the period of debt-driven growth.

The relationship between forces of supply and demand in post-1973 international lending to Third World countries was considered briefly in Chapter 2. In the case of the Philippines, Ranis (1984, pp. 6-7) refers to an "unholy alliance between foreign banks eager to lend and public and private Filipinos eager to borrow - without much regard to the allocative efficiency of the projects." He concludes: "While the Government has generally responded rather well to the OPEC impact via higher oil prices, i.e., in terms of its energy policies, the OPEC impact via petro-dollars seeking an outlet in the "good investment climate" of the Philippines has thus had much more serious consequences."

It is thus possible to view the Philippine current account deficits as a *result* of the country's external borrowing, not only because interest payments on the debt eventually became a major component of current account deficits, but also because capital inflows increased the demand for imports via income and price effects.

In other words, a strong case can be made that in the Philippines the capital-account tail wagged the current-account dog.² While the apportionment of responsibility for capital flows between the Philippine borrowers and the foreign lenders is a matter which need not be judged here, it should suffice to note that the transactions occurred between mutually consenting adults. On the one hand, there can be little doubt that "the willingness, and in some cases, the eagerness of commercial banks to lend to dubious projects after all is one of the root causes of the debt crisis" (Albuero *et al.* 1986, pp. 46-7). On the other hand, as Remolona, Mangahas and Pante (1985, p. 24) remark, "the public sector

1. See Table 1, recalling the balance-of-payments convention that a negative sign indicates additions to reserves.

2. Wallich (1984) uses this phrase in a discussion of the United States balance of payments. A number of writers have put forward variants of this capital account-led view of the US trade deficit in the 1980s. One variant is the "safe-haven" model developed by Dooley and Isard (1986, 1987), in which capital flows from developing countries in response to variations in relative after-"tax" rates of return. Branson (1985, p. 50) notes that the safe-haven explanation for the rise in the US dollar is based upon a shift in the supply of funds to the US and adduces from the rise in real interest rates in the 1980s that "the dominant effect must have come from the demand side." In the case of the Third World debt in the 1970s, by contrast, the behavior of real interest rates supports the view that the supply side dominated. See also Marris (1985, pp. 28-9), and Hooper and Mann (1987, pp 9-11). The potential (if not inevitable) leading role of capital movements was quite clearly recognized in an earlier era, when US economists argued against European repayment of postwar capital inflows from the US on the grounds that, as "the balance of trade and service transactions adjusted to accommodate the change in investment items" (Lary 1946, p. 678), domestic production and full employment would be undermined; for discussion, see Payer (1990, Ch. 4). For an analysis of the role of capital account movements in the behavior of current accounts in Latin America, see Pastor (1989).

could have exercised more restraint in incurring such debt."³ Why borrowers, both public and private, did not exercise more restraint will be more apparent when we examine the relationship between external debt and capital flight.

Whatever the relative strength of the causal threads linking external debt to current account deficits, the extent to which the debt accumulation can be attributed to excessive spending on imports by Philippine firms and consumers remains a question. The Philippines ran merchandise trade deficits throughout the 1962-86 period (the only exceptions being the years 1963 and 1973; see Table 1). When all non-investment income current account transactions (*i.e.*, including payments for services) are considered, however, the picture is more mixed, with surpluses in the mid-1960s, early 1970s and mid-1980s (see Table 9). The cumulative merchandise trade deficit of the Philippines in the years 1962-86 was US\$17.8 billion, and the cumulative non-investment income current account deficit was US\$1.2 billion. Both are well below the US\$27.9 billion debt accumulation in the period. Substantial non-investment income current account deficits were run only from 1975 to 1983, and even then, these amounted to only one-third of the debt inflow.

It is not possible to say which imports would and would not have been imported in the absence of foreign loans. Given the balance of political power and the distribution of effective demand in the country, it is readily conceivable that in the absence of external finance some necessities would have been foregone while luxury imports continued. The important role of the import demand of well-to-do consumers is evident, however, from a comparison of the growth in numbers of buses and private automobiles in the country. Between 1962 and 1985, the number of registered private passenger cars rose from 55,693 to 332,473, an increase of 500 percent. At the same time the number of buses *declined* from 14,055 to 11,641, a 17 percent drop.⁴ The WB (1976, pp. 80-83) observed that the "large growth in private passenger vehicles" exacerbated Manila's chronic traffic congestion, and cited a survey which found that while private cars accounted for two-thirds of vehicular traffic and buses for less than five percent, buses carried almost as many passengers. Morrell (1979, p. 6) estimated the cost of the allocation of resources for cars instead of buses in the 1970s at US\$3.25 billion.

3. The duality is nicely captured by Finance Minister Cesar Virata (1984, pp. 272-3), who first asserts that "the problem of external indebtedness has arisen largely from the desires and plans of the developing countries to move ahead" by boosting investment, but then concedes: "It is probably true that things got out of hand in a number of instances because of the relative ease of obtaining finance from the commercial market."

4. Jeepneys, which seat 15-20 passengers, accounted for a rising share of public transportation; their number grew from 22,556 in 1962 to 57,961 in 1985 (NEDA 1976, p. 298; 1986, p. 508).

To a limited extent, then, one can say that the Philippine external debt was used to finance imports. Yet an analogy between the Philippines and a spendthrift individual, who buys now and pays later, would be misleading for at least four reasons. First, borrowing caused spending rather than vice versa, as imports were artificially stimulated by the income and exchange rate effects of the loan influx. Second, the non-investment income current account deficit accounted for only a small fraction of the debt - less than five percent of the cumulative total in the 1962-86 period. Third, a country differs from an individual in that it comprises many people with some benefitting considerably from the spending of the borrowed money and others who did not. It can be safely asserted, for example, that owners of private automobiles benefited more than bus passengers. And finally, those who do the borrowing are not necessarily those from whom repayment is demanded - a point to which we shall return in the concluding chapter.

Debt, Savings, Investment, and Growth

A primary rationale of the debt-for-development strategy is the belief that external capital can and will be used to finance investment and growth. "Sure, we're up to our eyeballs in debt," a Finance Ministry official admitted in 1980, "but to 'take off' you have to spend."⁵

The impact of foreign capital on growth in Third World countries has long been a matter of debate. The simplest view is that foreign capital (or more precisely, that fraction of foreign capital which finances investment rather than consumption) is entirely additional to domestic savings, and that its impact upon growth can be calculated simply by dividing its volume by the incremental capital output ratio (ICOR), which measures the efficiency with which capital is used to generate additional output. Even allowing for the possibility of diminishing returns to capital (rising ICORs), the impact on growth is necessarily positive.

This simple view was widely held by development economists in the 1950s and 1960s (see, for example, Chenery and Strout 1966). Griffin and Enos (1970) challenged this conventional wisdom, suggesting that the positive impact of foreign savings on growth could be partially or even fully offset by two phenomena: a decline in domestic savings, for which foreign savings act as a substitute; and a decline in the efficiency of capital owing to specific attributes of foreign capital. These include a bias towards the purchase of capital-intensive technology, long gestation periods for infrastructure investments, the hindering of local entrepre-

5. Quoted in Broad (1988, p. 197). "To paraphrase top Philippine technocrats," Broad adds, "the dollar amount of the debt was irrelevant, for the loans were being channeled into productive export-oriented industrialization."

neurship, and the strengthening of internal political forces which resist needed institutional reforms. The resulting inefficiencies may also affect domestically-financed investment, particularly if much of it is tied up in counterpart funding for foreign-assisted projects.

The subsequent debate has been conducted primarily by means of international cross-country comparisons.⁶ Yet the impact of foreign capital inflows can be expected to vary from country to country, depending upon their specific economic and political circumstances. Time-series analyses may help to illuminate the relationships within particular countries.

An examination of data on foreign capital inflows, domestic savings, investment, and output growth in the Philippines from 1971 to 1983 (the only years for which the necessary data are available) suggests that while foreign capital did not depress domestic savings, it had a negative short-run impact upon both investment efficiency and the rate of growth of output. The relevant data are presented in Table 13. Correlations between foreign savings and domestic savings, investment, the incremental capital output ratio, and the GNP growth rate are reported in Table 14. (The crisis year 1983 is omitted from these correlations because of the exceptionally high ICOR in that year.)

The results indicate that a one percent increase in foreign savings (as a percentage of GNP) was associated with a slight increase in domestic savings (not significantly different from zero), such that investment rose by slightly more than one percentage point. The incremental capital output ratio also rose with foreign savings, however, indicating that the efficiency with which capital was utilized was inversely related to the influx of foreign savings. This may help to explain the strong negative correlation between foreign savings and output growth: a one percentage point increase in foreign savings was associated with a 0.36 percent *decrease* in the GNP growth rate. Such correlations cannot conclusively establish cause and effect, but they are consistent with the Griffin-Enos hypothesis that foreign capital inflows lower the efficiency of investment.

The WB (1984, p. 35), remarking on the rising ICOR's of the late 1970s and early 1980s, expressed concern that "the investment pattern was not especially geared to expanding the DSC [debt servicing capacity]." The WB stated that this "was partly a result of the large weight of public sector infrastructure projects in total investment with relatively long gestation periods," but noted that "the relatively high ICOR has also been interpreted to reflect investment inefficiency in the economy."

6. The results have been mixed. See, for example, Papanek (1972), Weisskopf (1972), Chenery and Carter (1973), Bornschieer, Chase-Dunn and Rübinson (1978), Mosley (1980), and, for a survey, Riddell (1987, Ch. 10).

Table 13
SAVINGS, INVESTMENT, AND GROWTH, 1971-1983

Year	Foreign saving (% of GNP)	Domestic saving (% of GNP)	Investment (% of GNP)	Incremental capital output ratio	Real GNP growth rate (%)
1971	1.9	19.2	21.1	3.46	5.8
1972	1.8	19.0	20.8	3.46	4.9
1973	-3.3	24.9	21.6	1.87	9.6
1974	2.8	24.0	26.8	3.55	6.3
1975	7.1	24.1	31.2	3.56	5.9
1976	7.4	23.5	30.9	3.54	6.1
1977	4.3	25.2	29.5	3.35	6.9
1978	6.0	23.5	29.5	4.31	6.2
1979	5.3	25.9	31.2	3.87	7.5
1980	5.9	24.8	30.7	5.22	4.4
1981	6.0	24.7	30.7	6.72	3.7
1982	8.2	20.7	28.9	8.24	2.8
1983	7.4	19.5	26.9	22.55	1.4

Source: Remolona, Mangahas and Pante (1985, Table 2.6, p. 33).

Table 14
FOREIGN SAVINGS CORRELATIONS

Variable	Simple correlation coefficient (Pearson's r)	Simple regression	
		Constant	Coefficient (t-ratio in parentheses)
Domestic savings	0.09	23.0	0.07 (0.3)
Investment	0.83	23.0	1.07 (4.7)
Incremental capital output ratio	0.66	2.7	0.35 (2.8)
Real GNP growth rate	-0.65	7.5	-0.36 (-2.7)

Note: Number of observations = 12 (1971-1982). Variables as reported in Table 13.

Other analysts have been more blunt. Remolona and Lamberte (1986, p. 117), for example, interpret the rising ICOR as a result of "wasteful investment." Oshima (1983, p. 42) cites "rampant misallocation of funds borrowed abroad" as a cause of the country's disappointing economic performance. And Ranis (1987, p. 117) writes of the "many parastatals which have come to rest in government hands as a consequence of the inflow of foreign capital, its misallocation, and the exercise of government guarantees."

In discussing the potential contribution of foreign capital to investment in the Philippines, the ILO mission (1974, p. 279) observed that "the qualitative significance of foreign capital ... in affecting the orientation of the total effort, both foreign and domestic, may be quite substantial." This prediction appears to have withstood the test of time, albeit in retrospect with an unintended irony.

Debt and Capital Flight: The Revolving Door

In addition to financing the current account deficit (much of which was attributable to interest payments on previous borrowings) and investment, a substantial fraction of foreign borrowing appears to have financed capital flight from the Philippines.

The relationship between the timing of debt-creating external capital inflows and of capital flight is depicted in Figure 2 (p. 52). The solid line represents the annual change in the outstanding Philippine external debt (adjusted for yen/dollar exchange rate effects), and the broken lines represent alternative measures of capital flight derived in the preceding chapter. All are expressed in constant 1986 dollars to eliminate the effect of inflation. It is apparent from the figure that the two phenomena are positively correlated.⁷

Linkages between debt and capital flight: A classification

In a textbook world in which "capital is capital," money would move across borders in response to international differences in rates of return and risk. Favorable conditions in any given country would attract foreign and domestic investment alike; unfavorable conditions would repel foreign investment and trigger resident capital outflows. The result would be a negative correlation between debt-creating inflows and resident outflows: capital flight would be lowest in those years in which foreign lending was greatest, and vice versa.

7. The correlation between debt inflows and capital flight by "measure A" (from Table 12) is 0.77, when both variables are expressed in constant 1986 dollars to eliminate the effects of inflation. The correlation between debt inflows and capital flight by 'measure B' is 0.69.

In the Philippines and other real-world settings the opposite occurs: capital flight is larger in years of greater lending. How is this to be explained? Answers to this question can be grouped into five categories:

1. *Indirect linkages.*

The explanation favored by bankers, at least in their public statements, is that debt disbursements and capital flight bear no direct causal relation to each other. Rather, both are results of a common set of exogenous factors, notably poor economic management by the debtor government. The Morgan Guaranty Trust Company (1986, p. 15) declares, for example, that the simultaneous occurrence of debt accumulation and capital flight in Third World countries "was no coincidence," since "the policies and track records that engendered capital flight also generated demands for foreign credit."

This line of reasoning seems plausible as an explanation for a positive cross-sectional correlation between external borrowing and cumulative capital flight, both measured over an appropriately long interval. Over a decade or two, irresponsibly-governed country A may witness more public-sector demand for external credit, and more private-sector propensity for capital flight, than prudently-governed country B. It is far less convincing, however, as an explanation for a positive time-series correlation between annual debt disbursements and capital outflows in a given country, since the time frame for the relevant "policies and track records" is clearly longer than a single year.

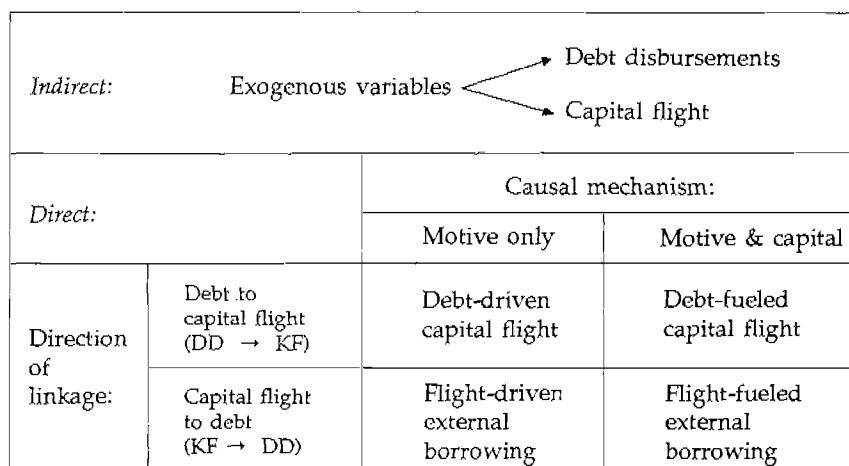
Moreover, while this line of reasoning may help to explain the *demand* for external borrowing, it leaves open the question of why foreign creditors were willing to *supply* large sums of money to governments whose own residents were shifting their capital abroad. As Pastor (1990, p. 7) remarks, "If the 'investment climate' in a country is negative enough to push out local capital, why would savvy international bankers extend their own capital in the form of loans?" Either the creditors were not so savvy, or they faced risks and returns systematically different from those perceived by residents.

2. *Debt-driven capital flight*

The latter possibility lies at the heart of explanations which posit *direct* causal linkages between debt and capital flight. Direct linkages can be classified into four groups on the basis of (a) whether the direction of causality runs from debt to capital flight, or vice versa, and (b) whether one simply provided the *motive* for the other, or whether it provided the *means* as well.

Figure 3 summarizes these linkages. Explanations in which the

Figure 3
LINKAGES BETWEEN DEBT DISBURSEMENTS
AND CAPITAL FLIGHT



causality runs from debt to capital flight can be divided into those in which external borrowing motivates residents to shift their own capital abroad (for example, by generating expectations of exchange rate devaluation or fiscal crisis), and those in which the borrowed funds are themselves transferred abroad. I shall term these "debt-driven" and "debt-fueled" capital flight, respectively. Similarly, explanations in which the causality runs from capital flight to debt can be divided into "flight-driven external borrowing," in which the export of capital generates an economy-wide demand for replacement funds, and "flight-fueled external borrowing", in which residents who exported capital then "borrow" their own money back.

In each of these direct linkages, capital flows in both directions as if through a revolving door. Pursuing this analogy, we can think of *debt-driven* capital flight as a case in which Mr. Dollar arrives through the revolving door, and Mr. Peso upon seeing him anticipates trouble and decides to leave. In *debt-fueled* capital flight, by contrast, Mr. Dollar enters, attends to a few formalities discussed below, and then slips out again. In *flight-driven* external borrowing, Mr. Peso leaves and Mr. Dollar is invited to take his place. And in *flight-fueled* external borrowing, Mr. Peso steps out and then comes back dressed as Mr. Dollar. Let us examine each scenario more closely.

"Debt-driven" capital flight refers to capital which flees a country in response to the economic circumstances attributable to the external debt itself.

Consider the impact of external borrowing upon the exchange rate. In the short run, the capital inflow increases the supply of foreign exchange, applying upward pressure to local currency. If, however, this debt is incurred for purposes which are unlikely to generate adequate foreign exchange for repayment, then in the long-run an opposite pressure will result. When the net transfer (new borrowing minus amortization and interest payments on past loans) turns negative, increased demand for foreign currency (compared to the no-borrowing counterfactual) will depress the value of the local currency. The rational response for any asset holder who can do so at reasonable cost is to dollarize when the local currency is artificially inflated in the expectation of its eventual decline.⁸ Since this dollarization further increases demand for foreign exchange, the pressure for devaluation gets an additional boost from self-fulfilling expectations.

Similarly, external borrowing temporarily eases the pressure upon government to tax residents either overtly or through the "inflation tax." Further down the road, however, domestic asset holders may expect exceptionally onerous taxes in the wake of an eventual debt crisis. "Taxes" can here be considered as a broad range of regulations which reduce the value of domestic financial assets (Dooley 1987, p. 79). The desire to avoid such taxes in the future provides a further motivational link between debt inflows and capital flight.

External funds may also preempt favorable investment opportunities, or drive down the domestic rate of return, "crowding out" domestic capital and pushing it overseas.⁹

Note, however, that debt-driven capital flight need not be hasty, particularly if the major impetus comes from anticipation of future consequences of the debt accumulation. The net transfer seldom alternates sign in successive years. Rather, a number of years of positive net transfers typically precedes a number of years of negative ones. In the Philippines, for example, the net transfer was positive from 1963 through 1970, briefly dipped below zero in 1971 in the wake of a balance-of-payments crisis, and then remained positive until crisis struck again in 1983. In such a setting one would expect debt-driven capital flight only when the warning signs of the negative net transfer appear in the form of diminishing official reserves, increasing reliance upon short-term finance, and so on. Lacking perfect foresight, some residents may even wait too long, and export whatever capital they can only after the crisis

8. Conesa (1987, p.55) advances this explanation for his finding of a positive association between capital flight and debt disbursements in Argentina and Mexico: "The excessive supply of credit to a country without an adequate and efficiently implemented growth strategy only overvalues national currency and acts as a provider of counterpart funds for local citizens who then deposit their money abroad."

9. For a model incorporating this possibility, see Diwan (1989).

has broken. In other words, the timing of debt-driven capital flight would not be expected to generate a terribly strong positive year-to-year correlation between net debt disbursements and capital flight.

In addition to economic impacts, it is worthwhile to consider possible 'extra-economic' impacts of external borrowing. These too could spur capital flight. Imagine, for example, that external borrowing increases the leverage of an avaricious tyrant and his greedy cronies, who control the borrower government. Imagine, further, that they employ this leverage to wrest control of assets and markets from their rivals in the national economy, using a combination of legal, quasi-legal and illegal methods. The resulting increase in "expropriation risk" may well propel further capital flight. These hypothetical circumstances, similar to those faced by Filipino capitalists under the Marcos regime, might strengthen the phenomenon of debt-driven capital flight. But again the relevant time frame would extend well beyond a single year. A strong year-to-year correlation implies that other, tighter linkages were at work.

3. *Debt-fueled capital flight*

In "debt-fueled" capital flight, the inflow of external resources provides the resources as well as a possible motive for capital flight. The same individual borrows external resources and then transfers part or all of his assets abroad. Debt directly fuels capital flight. In some cases the fuel is fungible, as in Pastor's (1990, p. 7) example in which "an investor could draw a publicly-guaranteed external loan cheaply and ship his/her own resources abroad to acquire foreign assets." In other cases the capital never enters the country: the money is borrowed and immediately deposited in a foreign bank, possibly the same one making the loan, so that "the entire cycle is completed with a few bookkeeping entries in New York" (Henry 1986, p. 20).

To differentiate between debt-driven and debt-fueled capital flight, it is useful to contrast two scenarios. In the first, the government borrows dollars (or any other hard currency) and then sells them to its own residents. Some of the buyers then legally or illegally transfer these dollars abroad. In this case, external borrowing merely furnishes foreign exchange; it does not provide the *resources* transferred abroad since residents must purchase the dollars with resources acquired in some other way. In the second scenario, the government again borrows dollars but on-lends these funds to private borrowers through a national development bank. The borrowers then transfer part or all of this capital abroad. In this case, unlike the first, external borrowing provides the resources - the fuel - for capital flight.

Debt-fueled capital flight typically involves a process of "layering" between the external creditor and the private resident in whose name

external assets are acquired. On the creditor's books, the debt is owed by the government or by a corporate entity, typically with a government guarantee of repayment in case of default. The external assets, by contrast, are in the names of individuals: government officials who siphoned part of the proceeds of the loan, or private residents who borrowed in the name of a firm. The holder of the external asset thus is not identical to the holder of the external liability. Yet in practice the same individual is engaged in both transactions.

This legal discrepancy is by no means coincidental. Public guarantees posed a "moral hazard" for creditors and borrowers alike. Insured against the risk of default, neither party had an incentive to minimize it. Creditors might have been more reluctant to finance capital flight if repayment were the sole responsibility of the individual flight capitalist. With the debt in the name of the government, or secured by government guarantee, the creditors could draw comfort from their faith that "governments do not go bankrupt."

For the flight capitalist, the evasion of responsibility for eventual repayment of the external loan was often a key element in the transaction's rationale. It is not likely that the capitalist could turn a profit by borrowing money from a bank and then redepositing it there or in another bank, for banks derive their own profit from the opposite spread between interest rates. It is conceivable that some borrowers were astute enough to identify lucrative overseas investment opportunities which permitted retention of a profit spread after repayment, but it is doubtful that all flight capitalists possessed such acumen. In many cases, the principal motive for debt-fueled capital flight was the opportunity to exploit the legal dichotomy between the holder of the liability and the holder of the asset. Whenever there are opportunities for the acquisition of private assets by means of public debts, "rational" profit maximizers can be expected to seize them.

Debt-fueled capital flight could generate a rather strong year-to-year correlation between net debt inflows and capital flight. Unlike debt-driven capital flight, the causal relation is not mediated by changing perceptions of the economic and political environment. Nor are the lags between borrowing and flight likely to extend over a period of several years. Rather the loan is obtained for the intended purpose of capital flight, and the borrower may well be anxious to consummate the circuit expeditiously, while the window of opportunity is open. Mr. Dollar's round trip through the revolving door is likely to be quick.

4. *Flight-driven external borrowing*

We now turn to causal linkages running in the opposite direction, from capital flight to external borrowing. Here too we can distinguish

between the case in which the link is solely motivational ('flight-driven' external borrowing) and that in which flight capital directly provides the resources which re-enter the country ('flight-fueled' external borrowing). Let us start with the former.

The demand-side of flight-driven external borrowing is straightforward: the drain of domestic resources through capital flight generates demand for replacement funds on the part of the government and private sectors.

Why are external creditors willing to meet this demand, when local residents are not? The answer is likely to be found in different risks and returns facing resident and non-resident capital, rather than in different perceptions of the same risks and returns. An inflation tax, for example, will erode the returns to holders of fixed-interest domestic-currency liabilities, whereas non-residents who hold claims denominated in foreign currency are unaffected.¹⁰ Foreign creditors may also enjoy a "comparative advantage" in risk mitigation thanks to the "direct or indirect sanctions" they can bring to bear upon the borrower (Lessard 1986, p. 16). If so, they may believe that "domestic assets held by residents are effectively subordinated to sovereign external obligations in the case of a fiscal crisis" (Lessard 1987, p. 99). Systematic differences in the risk-adjusted financial returns to domestic and external capital could also arise from disparities in taxation, interest-rate ceilings, and risk-pooling capabilities (Lessard and Williamson 1987, pp. 215-8).

Such differences can be expected to lead to "offshore financial intermediation," by which foreign creditors provide fresh loans as domestic capital is exported, in effect transforming resident capital into non-resident capital. This in turn can intensify debt-driven capital flight, since "the substitution of foreign funds backed by international leverage for resident savings may increase the likelihood of crises and the relative exposure of (the remaining) resident holdings of domestic assets" (Lessard 1987, p. 98). A vicious circle is set in motion, in which debt and capital flight feed upon each other.

5. *Flight-fueled external borrowing*

In flight-fueled external borrowing, Mr. Peso flees and then re-enters the country in the guise of Mr. Dollar. The flight capitalist seeks to arbitrage the yield and risk differentials between resident and external capital, by engaging in a series of transactions sometimes known as

10. In some cases, residents are permitted to hold dollar-denominated assets domestically. The protection against inflation afforded by dollar-indexed instruments is often incomplete, however, as demonstrated for example in Mexico in 1982 (see Zedillo 1987, p. 182). Moreover, other risks such as internal debt repudiation are not mitigated by mere dollarization.

"round-tripping" or "back-to-back loans." Resident capital is dollarized and deposited in an overseas bank, and the depositor then takes a "loan" from the same bank (for which the deposit may serve as collateral).

As in the case of offshore financial intermediation, government guarantees provide a crucial part of the rationale for back-to-back loans. As Khan and Ul Haque (1985, p. 625) remark:

To the extent that the investor believed that foreign debt implicitly carried a government guarantee, he was assured that, if the domestic firm or enterprise went bankrupt or was expropriated, the foreign lender's claim would be assumed by the government. Savings held abroad would obviously not be at risk, so that the investor was protected if he relied as much as possible on foreign borrowing. Given this scenario, the domestic investor was behaving in a completely rational fashion.

In many cases, of course, the government guarantees have been explicit.

A further motive for flight-fueled external borrowing is the concealment of the sources of funds from present or prospective government authorities. This was the main objective of the pioneer of back-to-back loans, US organized crime financier Meyer Lansky, who developed the technique in the 1930s as a means to launder funds in Switzerland.¹¹ In this respect back-to-back loans have a motivational dimension beyond more general offshore financial intermediation: the laundry service not only bleaches out systematic yield differentials, but also removes the stain of the money's origins.¹²

Which of the two causal linkages from capital flight to external borrowing is more likely to generate a strong positive correlation between their year-to-year variations? It seems reasonable to hypothesize that flight-fueled external borrowing generates the tighter link, since the causal relation is again not mediated by other economic variables, and accordingly the interval between the flight and borrowing may be shorter.

Discussion: The distinctions drawn above have been often blurred in the recent literature on Third World debt and capital flight. The debt-to-flight linkage has been described, for example, as a "liquidity effect," in which "the availability of foreign exchange enables capital flight to

11. Lansky's clients also reaped a fringe benefit: interest payments on the "loans" from Swiss banks were tax-deductible (Naylor 1987, pp. 21-22).

12. In practice, financial laundry services can be costly. For discussion, see Walter (1987, pp. 105-9, 119-20). One European banker estimates that much of the US\$600 billion deposited by foreigners in Swiss banks receives negative interest returns, implying that depositors "were willing to pay a substantial premium for security" (Lessard and Williamson, eds., 1987, p. 83).

take place" (Lessard 1987, p. 99). This formulation could encompass both *debt-fueled* and *debt-driven* capital flight.¹³ Yet the two have quite different implications.

The "fuel" linkages - debt-fueled capital flight and flight-fueled external borrowing - imply that international creditors bear a particularly heavy responsibility for the debt crisis. Knowingly or unknowingly, they colluded in transactions whereby public debts were transformed into private assets, and vice versa, transactions which come perilously close to what is commonly understood as fraud. The "drive" linkages place the creditors in a relatively favorable light: they may have lent unwisely, but they did not act unethically.

The assignment of blame for the debt crisis is politically connected to the apportionment of the costs of dealing with the crisis. Not surprisingly, therefore, bankers distinguish carefully between debt-driven and debt-fueled capital flight:

It is ... a gross distortion to claim, as some have done, that the "private banking" departments of some lending banks were deliberately seeking the money that their loan departments were putting out; rather, the point is that easy money contributed to lax policies, especially exchange overvaluation, which provided the incentive for private capital outflows.¹⁴

Bankers, it seems, would rather be viewed as slightly soft-headed providers of "easy money" than as operators of a toll booth at the revolving door.¹⁵

13. Similar ambiguity surrounds the use of the verb "finance," as, for example, in the statement that "large external debt increases have been used to finance the private accumulation of foreign assets" (Gulati 1988, p. 168). In domestic contexts the verb "finance" means providing resources, usually on credit, as when an individual obtains a mortgage to finance the purchase of a house. The above passage therefore may appear to refer to debt-fueled capital flight. In this instance, however, the author means something else: "Central banks have been borrowing abroad and *selling* foreign currency to domestic residents who simply purchase external assets with the obtained foreign exchange" (Gulati 1988, p. 169; emphasis added). This scenario may represent debt-driven capital flight (if motivated by economic and political circumstances attributable to the debt itself), but it is not debt-fueled by our definition since domestic resources are exchanged for the hard currency.

14. Pedro-Pablo Kuczynski, Co-Chairman of First Boston International, in Lessard and Williamson, eds. (1987, p. 192).

15. Note that debt-fueled capital flight is not necessarily redeposited in the same bank which lent the money. Moreover, it is conceivable that officers in a bank's lending division could operate in ignorance of the deposit-taking activities of the same bank's "international private banking" division. Thus, in reply to the allegation that his bank facilitated capital flight through the provision of "private banking" services to residents of major debtor countries, a senior international lending officer of Morgan Guaranty Trust Company "protested his ignorance of the actions of other parts of the bank and averred that Morgan

In the Philippines, however, the revolving door was very much in evidence. Guarantees and on-lending by government institutions were the major avenues for external borrowing by the Philippine private sector. Many of these guarantees were what Rosendo Bondoc, the former president of the Philippine Export and Foreign Loan Guarantee Corporation, termed "behest guarantees," issued at the express instructions of President or Mrs. Marcos.¹⁶ Asked whether he considered rescinding a guarantee on a loan he knew to have been diverted into capital flight, Bondoc explained: "In the light of the instructions being given, it was either follow or You know it was an autocratic rule."

Similarly, much of the external credit on-lent to the private sector by the DBP and the PNB were "behest loans," issued on the instructions of the Marcoses. In an extraordinary 1983 memorandum to President Marcos and Prime Minister Virata, Jose Tengco, Jr., the Acting Chairman of the DBP, listed of that institution's exposure to "behest accounts" amounting to P28.2 billion (equivalent to US\$2.54 billion at the average 1983 official exchange rate). Nearly a quarter of this exposure (P6.6 billion) was in the form of guarantees; the remainder was DBP loans, much of which represented on-lending of external borrowings.¹⁷

A DBP governor recounted the following example of debt-fueled capital flight to a journalist:

Persons seeking the loan would just come around here and say that we need US\$100-200 million for this project which looks viable. It's not viable but Marcos says it is viable. When he says that then it better be viable. For instance, we were recently sent an account for US\$65 million that we are supposed to pay. Now, apparently this money was supposed to have put up a steel mill, a factory.... So we asked to see where the factory is, and to this day, after several months, nobody has found it. In short, this factory does not exist.¹⁸

In other cases, a portion of the borrowed funds was invested, but the underlying motive for the loan was the diversion of the remainder into capital flight. "Kickbacks are apparently the name of the game in the expansion of the sugar industry here," the *Far Eastern Economic Review* reported in 1976:

would compete in whatever banking field it was legal to do so" (Lessard and Williamson, eds., 1987, pp. 198-9).

16. Official minutes of the testimony of Rosendo Bondoc before the House of Representatives Subcommittee on Monetary, Credit and Financial Matters, 2 October 1987, pp. VII-1, VIII-4, and IX-1.

17. J. R. Tengco, Jr., "Memorandum for His Excellency, President Ferdinand E. Marcos, Thru Prime Minister Cesar E. A. Virata, Subject: Action Program for the Rehabilitation of DBP," November 25, 1983.

18. Jose Mari Velez, quoted in WGBH Educational Foundation (1987).

Whether or not the new [sugar mill] centrals make any money may be of little consequence to the owners. The investors who are favoured generally have to put up only about P2.5 million (US\$333,330) for centrals costing US\$65 million. The remainder is loan money from or guaranteed by the Government-owned Philippine National Bank (Wideman 1976).

The requirement that loans be approved by the CB did not provide effective oversight:

Say there is an application for a loan to set up a new sugar mill. What is the right price for a sugar mill? It is hard to say. Likewise, it was hard for MEDIAD [the Central Bank's Management of External Debt and Investment Accounts Department] to evaluate the soundness of the particular project. So, for example, a mill was built in a very rainy region which produces only poor quality, watery cane. Or mills were installed close to existing mills, creating excess milling capacity and raising unit costs. We know why these things were done. The profit was not in the mill. *The profit was in the procurement of the mill equipment.*¹⁹

According to a senior Japanese government official, kickbacks averaged 12 percent of contract prices, or US\$7.8 million on a US\$65 million sugar mill.²⁰

The extent to which creditors knowingly lent money to fuel capital flight is an open question. The case of the largest single loan to the Philippines - the US\$900 million in direct loans and loan guarantees provided by the US Export-Import Bank for the Bataan nuclear plant - may be instructive in this regard. When asked in 1978 why the Bank had financed the plant despite the fact that its cost was roughly double that of a comparable reactor being built in South Korea, also by Westinghouse with Export-Import Bank backing, the Bank's general counsel replied with a rhetorical question: "The Ex-Im Bank is going to say the price is wrong when the two big boys have agreed to it?" The then chairman of the Export-Import Bank, William J. Casey, clarified where the buck stops:

19. Interview with a senior CB official, May 1988, anonymity requested.

20. Quoted by Wideman (1976). McCoy (1984, pp. 27-8) similarly reported that "the Japanese contractors pay a minimum 10 percent kickback on their machinery." In some cases, the CB may have deliberately looked the other way. McCoy (1984, p. 31) reports that a governor of the CB resigned "when it was discovered that his office had been accepting 'commissions' from borrowers for approving their loans."

You couldn't tell Westinghouse what to charge. If they charge too much, the Philippines has to pay it. It's their government; they have to protect themselves from getting fleeced.²¹

Many creditors apparently shared Mr. Casey's view that what happened to the money they lent was not their problem. The international debt crisis of the 1980s may have altered that perception.

The statistical analysis reported in the following section strongly supports the hypothesis that direct linkages existed between external borrowing and capital flight in the Philippines.

A model of Philippine capital flight

There are plausible *a priori* grounds to expect the positive correlation between capital flight and debt-creating capital inflows depicted in Figure 2: external borrowing can both drive and fuel capital flight, and capital flight can drive and fuel external borrowing. Since the causality may run in either or both directions, the relationship between the two must be modelled to permit simultaneity.

1. *The model*

A complete model of the relationship between capital flight and debt disbursements must incorporate other variables. Other possible determinants of capital flight include:

- (a) *The level of the country's official foreign exchange reserves.* Higher reserves, as an indicator of a lower likelihood of a balance-of-payments crisis, are expected to lead to less capital flight.²²
- (b) *The rate of growth of gross domestic product.* Higher growth, and the associated opportunities for investment, could be expected to result in less capital flight.
- (c) *The difference between international and domestic real interest rates.* A larger real interest rate gap would be expected to induce more capital flight.
- (d) *The government budget surplus or deficit.* As a signal of the likelihood of a fiscal crisis, a higher surplus (or lower deficit) would be expected to result in less capital flight.

21. Quoted by Crittenden (1978). The Philippine nuclear plant was the largest deal the Export-Import Bank had backed anywhere in the world; Casey personally approved it after a visit to Manila, despite a US Embassy report to Washington cautioning that the price was inflated and that there were reports of payoffs (Butterfield 1986).

22. See, for example, Conesa (1987). Note that this expectation is unambiguous only for private owners of capital. In the hypothetical case in which public officials engage in capital flight by diverting resources from government coffers, higher reserves might permit *more* capital flight.

Each of these variables could also affect the level of debt disbursements. Higher foreign exchange reserves, interest rate differences, and budget surpluses could be expected to lead to lower demand for external capital and to greater supply. The direction of the net effects, if any, would hence depend on the relative importance of supply and demand in determining the amount of external borrowing. The net effect of GDP growth is also uncertain: Higher growth would presumably boost private investment demand (and perhaps supply), but public sector demand for external credit could be counter-cyclical.

In addition, the Mexican near-default of August 1982 had a drastic effect on the supply of external credit from commercial banks in subsequent years. In the Philippine case, this was followed by the assassination of Senator Benigno Aquino in August 1983. As new lending dried up and the net transfer (new lending minus debt service payments) turned negative, the country was plunged into its worst balance-of-payments crisis in its postwar history.

A general model incorporating these variables is:

$$KF = f(DD, RES, GDPGR, INT, BS, MEXD) \quad (1A)$$

$$DD = f(KF, RES, GDPGR, INT, BS, MEXD) \quad (1B)$$

where KF = annual capital flight (in 1986 dollars); DD = net debt disbursements (in 1986 dollars); RES = the level of the country's official foreign exchange reserves (in 1986 dollars); $GDPGR$ = the percentage growth rate of gross domestic product; INT = the real US Treasury bill rate minus the real time deposit rate in the Philippines (in both cases, the real interest rate is calculated as the nominal rate minus the relevant consumer price index inflation rate); BS = the government budget surplus as a percentage of gross domestic product; and $MEXD$ = a dummy variable to allow for the impact of the Mexican debt crisis, taking the value 0 prior to 1983 and 1 thereafter. The predicted effects of each of these variables are summarized in Table 15.

A fairly general initial dynamic specification of this model is:

$$KF = a_0 + a_1KF_{-1} + b_0DD + b_1DD_{-1} + cRES_{-1} + dGDPGR_{-1} \\ + e_0INT + e_1INT_{-1} + f_0BS + f_1BS_{-1} + gMEXD + v_t \quad (2A)$$

$$DD = a'_0 + a'_1DD_{-1} + b'_0KF + b'_1KF_{-1} + c'RES_{-1} + d'GDPGR_{-1} \\ + e'_0INT + e'_1INT_{-1} + f'BS_{-1} + g'MEXD + v'_t \quad (2B)$$

Table 15
PREDICTED EFFECTS OF INDEPENDENT VARIABLES
IN DEBT-CAPITAL FLIGHT REGRESSIONS

Independent variable	Dependent variable		
	KF	DD	
		Demand	Supply
KF		+	+
DD	+		
RES	—	—	+
GDPGR	—	?	+
INT	+	—	+
BS	—	—	+
MEXD	+	+	—

Owing to possible simultaneity, only lagged values of *RES* and *GDPGR* are included in the equations, and for the same reason only the lagged value of *BS* appears in equation (2B). Simultaneity between *KF* and *DD* is addressed below by the use of instrumental variables.

Both of the capital flight measures derived in Chapter 4 are used in the following analysis: *KFA* = the broad measure A, and *KFB* = the narrow measure B (see Table 12). Although measure B is less comprehensive, it has the advantage that it is calculated independently of the external debt.²³ The other variables used in the analysis are presented in Table 16.

2. Estimation of the determinants of capital flight

Ordinary least-squares estimation of equation (2A), using each of our two measures of capital flight as the dependent variable, gave the following results (absolute values of t-ratios in parentheses):

$$\begin{aligned}
 KFA = & -15 - 0.12KFA_{-1} + 0.54DD + 0.07DD_{-1} - 0.25RES_{-1} \\
 & (0.4) \quad (2.7) \quad (0.3) \quad (0.6) \\
 & - 35.8GDPGR_{-1} - 6.7INT + 14.4INT_{-1} - 228BS \\
 & (0.3) \quad (0.4) \quad (0.6) \quad (1.6)
 \end{aligned}$$

23. Measure A, derived by the residual method, has the potential drawback that any measurement errors in the debt variable would be passed on to the capital flight variable, potentially giving rise to a spurious correlation. The results obtained using measure B can thus be regarded as a check upon those obtained using the broader measure.

Table 16
INDEPENDENT VARIABLES FOR ANALYSIS OF DETERMINANTS
OF PHILIPPINE CAPITAL FLIGHT

Year	DD	RES	GDPGR	INT	BS
1962	0.00	237.21	4.820	0.106	0.31
1963	64.45	345.82	7.100	5.292	-0.58
1964	315.54	389.35	3.214	6.345	0.14
1965	993.82	583.52	5.228	0.394	-1.29
1966	330.75	868.25	4.571	0.574	-0.59
1967	1109.10	896.36	5.366	1.104	-0.81
1968	614.01	763.35	5.268	-2.954	-0.62
1969	957.44	551.83	5.126	-3.877	-2.82
1970	1277.02	1208.93	5.021	9.013	0.14
1971	164.88	1798.20	5.104	14.611	-0.37
1972	842.57	1382.35	4.843	2.176	-1.96
1973	308.11	2307.85	9.307	10.548	-1.17
1974	1683.96	2815.16	5.020	21.814	0.45
1975	2040.80	2385.06	6.433	-5.806	-1.19
1976	2954.13	2688.47	7.985	-1.448	-1.74
1977	1781.29	2354.21	6.217	-1.226	-1.82
1978	3488.51	2697.05	5.381	-2.920	-1.22
1979	3766.92	3083.92	6.302	6.215	-0.16
1980	3950.63	3518.46	5.233	3.595	-1.28
1981	3887.89	2630.37	3.915	2.070	-3.98
1982	3972.52	1713.92	2.953	-0.649	-4.23
1983	101.11	855.72	1.014	0.069	-1.94
1984	894.22	856.14	-6.122	33.365	-1.84
1985	-315.20	1030.15	-4.183	5.058	-1.83
1986	712.00	2459.00	0.999	-9.460	-4.48

- Key: DD = net debt disbursements (1986 \$ million) with an adjustment for yen/dollar exchange rate effects as reported in Table 9.
- RES = level of official foreign exchange reserves. Source: IMF (1987, pp. 558-9).
- GDPGR = percentage growth rate of gross domestic product. Source: Calculated from IMF (1987, pp. 562-3).
- INT = real US Treasury bill rate minus real time deposit rate in the Philippines. Sources: US Treasury bill rate, US and Philippines consumer price indexes from IMF (1987, pp. 560-1, 698-9). Time deposit rate in the Philippines from unpublished Central Bank of the Philippines data provided to the author.
- BS = government budget surplus as percentage of gross domestic product. Source: Calculated from IMF (1987, pp. 562-3).

$$+ 22.5BS_{-1} - 433MEXD \tag{3A}$$

(0.1) (0.6)

$\bar{R}^2 = 0.59$; DW = 2.19; n = 24.
 LM test of residual serial correlation: $\chi^2(1) = 1.32$.

$$KFB = -708 - 0.13KFB_{-1} + 0.39DD + 0.11DD_{-1} - 0.31RES_{-1}$$

(0.4) (3.1) (0.9) (1.3)

$$+ 62.9GDPGR_{-1} + 2.8INT + 27.3INT_{-1} - 243BS$$

(1.0) (0.3) (1.8) (2.5)

$$+ 617BS_{-1} + 590MEXD \tag{3B}$$

(0.7) (1.2)

$\bar{R}^2 = 0.63$; DW = 2.31; n = 24.
 LM test of residual serial correlation: $\chi^2(1) = 2.87$.

On elimination of the less significant variables, we obtain the following estimates:

$$KFA = -303 + 0.62DD - 0.30RES_{-1} + 21.0INT_{-1} - 218BS \tag{4A}$$

(4.5) (1.6) (1.7) (2.8)

$\bar{R}^2 = 0.69$; DW = 2.20; n = 24.
 LM test of residual serial correlation: $\chi^2(1) = 0.29$.

$$KFB = -412 + 0.25DD + 16.3INT_{-1} - 176BS \tag{4B}$$

(5.3) (2.2) (3.6)

$\bar{R}^2 = 0.70$; DW = 2.05; n = 24.
 LM test of residual serial correlation: $\chi^2(1) = 0.04$.

The models performed well on various diagnostic tests.²⁴ To check for simultaneity bias, an instrumental variables estimator (DD^*) was tested. Using the lagged variables and the Mexican crisis dummy variable as instruments, a similar result was obtained:

$$KFA = -218 + 0.87DD^* - 0.57RES_{-1} + 31.9INT_{-1} - 167BS \tag{5A}$$

(2.9) (1.6) (1.7) (1.7)

24. Lagrange multiplier tests for second- and third-order residual serial correlation, Ramsey's RESET test for functional form mis-specification, and LM tests for normality and heteroscedasticity (see Pesaran and Pesaran 1987) were also performed. Details on test results available from the author.

$$\bar{R}^2 = 0.56; DW = 1.67; n = 24.$$

LM test of residual serial correlation: $\chi^2(1) = 0.76$.

$$KFB = -360 + 0.22DD^* + 15.2INT_{-1} - 170BS \quad (5B)$$

(3.3) (1.7) (2.7)

$$\bar{R}^2 = 0.54; DW = 1.75; n = 24.$$

LM test of residual serial correlation: $\chi^2(1) = 0.45$.

To summarize, the results indicate that debt disbursements were a highly significant determinant of Philippine capital flight in the 1962-1986 period. Greater borrowing led to greater capital flight, implying the existence of what are here termed "debt-fueled" and "debt-driven" capital flight. In addition, the real interest rate differential, government budget surplus or deficit, and, in the case of the broad capital flight measure, the level of official reserves, had moderately significant effects with the expected signs.

3. *Estimation of the determinants of net debt disbursements*

What of the reverse linkages, from capital flight to debt? Estimation of equation (2B), using each of our measures of capital flight, yields the following results:

$$DD = 529 - 0.03DD_{-1} + 0.57KFA + 0.14KFA_{-1} + 0.94RES_{-1} \\ (0.1) \quad (2.4) \quad (0.4) \quad (3.2)$$

$$- 118GDPGR_{-1} + 24.9INT - 46.3INT_{-1} + 32.3BS_{-1} - 1190MEXD \quad (6A)$$

(1.1) (1.3) (2.2) (0.2) (1.5)

$$\bar{R}^2 = 0.81; DW = 2.47; n = 24.$$

LM test of residual serial correlation: $\chi^2(1) = 6.06$.

$$DD = 960 - 0.02DD_{-1} + 0.81KFB + 0.08KFB_{-1} + 0.96RES_{-1} \\ (0.1) \quad (2.2) \quad (0.2) \quad (3.4)$$

$$- 166GDPGR_{-1} + 18.6INT - 56.4INT_{-1} - 10.6BS_{-1} \\ (1.7) \quad (1.0) \quad (2.8) \quad (0.1)$$

$$- 1885MEXD \quad (6B)$$

(2.6)

$$\bar{R}^2 = 0.81; DW = 2.40; n = 24.$$

LM test of residual serial correlation: $\chi^2(1) = 5.52$.

Using instrumental variables estimators (KFA^* and KFB^*), again based upon the lagged variables and $MEXD$, and eliminating variables the estimated coefficients of which are not significantly different from zero, the serial correlation is eliminated and the equations collapse to:²⁵

$$DD = 108 + 0.84KFA^* + 0.71RES_{-1} - 34.6INT_{-1} - 361MEXD \quad (7A)$$

(2.6) (3.4) (2.2) (1.0)

$$\bar{R}^2 = 0.79; DW = 2.23; n = 24.$$

$$LM \text{ test of residual serial correlation: } \chi^2(1) = 0.49.$$

$$DD = 557 + 1.74KFB^* + 0.50RES_{-1} - 41.5INT_{-1} - 1011MEXD \quad (7B)$$

(2.4) (1.7) (2.6) (2.3)

$$\bar{R}^2 = 0.78; DW = 2.21; n = 24.$$

$$LM \text{ test of residual serial correlation: } \chi^2(1) = 0.48.$$

These results indicate that debt disbursements were significantly and positively affected by capital flight. Taken with the results reported in equations (5A) and (5B), this supports the hypothesis that the causal linkages between debt and capital flight did in fact run in both directions. In addition, debt disbursements were positively related to the (lagged) level of official reserves, suggesting that, at least in this respect, supply-side factors drove the credit market, since higher reserves were presumably associated with a greater willingness to lend but with a lesser need to borrow. Similarly, the negative impact of the Mexican debt crisis upon subsequent disbursements is clearly a supply-side phenomenon.²⁶ The negative sign on the lagged interest rate differential suggests, however, that demand-side considerations also influenced the level of external borrowing.

In sum, statistical analysis of the relationship between net debt disbursements and capital flight in the Philippines in the 1962-1986 period indicates that the two were strongly linked: Larger debt disbursements led to greater capital flight, and more capital flight led to larger debt disbursements.

While neither capital flight nor debt can be completely explained in terms of the other, the foregoing analysis indicates that this vicious circle was an important feature of the financial interactions between the Philippines and the world economy in recent decades, interactions which

25. Third-order autoregressive error models, estimated by the Cochrane-Orcutt method, gave similar results with the difference that the estimated coefficient on $GDPGR_{-1}$ remained moderately significant (and negative).

26. For a discussion of the importance of supply-side factors in commercial bank lending to the Third World, see Darity (1986). See also pp. 14-15, 55-57 above.

culminated in the country's continuing debt crisis. The Philippines was probably not unique in this respect.²⁷

The fact that debt disbursements and capital flight are most strongly correlated with each other's values *in the same year* suggests that they not only *drove* each other by providing motives, but also *fueled* each other by providing capital for the reverse flow. In other words, external resources did not simply 'crowd out' or scare off domestic capital, nor did capital flight simply create a vacuum into which external capital was pulled; rather, the same capital circuited in both directions through the revolving door.

Debt and the Aggrandizement of the State

External finance flows to specific institutions and individuals within countries. In the Philippines, much foreign borrowing was channelled to the state. Some 75 percent of the country's US\$28.3 billion external debt outstanding at the end of 1986 was public sector debt (see Table 4). Even this understates the state's role in foreign borrowing, since much private debt was on-lent by public sector financial institutions or was publicly guaranteed, and even direct, non-guaranteed private borrowings required CB approval. Control over the allocation of billions of dollars in borrowed money provided the financial basis for the aggrandizement of the Philippine state.²⁸

"The most durable support of the Marcos regime," according to political scientist William Overholt, "came from its own senior military officers and from the United States government." In light of the political predilections of these supporters, it is rather surprising to find that regime described by the same author as "socialist in the strict sense of radically increasing the state's ownership of the means of production" (Overholt, 1987, pp. 100-1). Similarly, Kwitny (1984, p. 307), wrote that "socialism is certainly not the name that the US embassy gives to it; but socialism is a fairly apt term for what Marcos has done to Philippine industry."

27. Conesa (1987) and Cuddington (1987) report a positive correlation between debt disbursements and capital flight in Mexico, Argentina, and Uruguay. Pastor (1990), in a pooled analysis of eight Latin American countries, finds that "capital availability" (defined as the ratio of net long-term capital flows to GDP) bore a significant positive correlation to capital flight in countries without capital controls (Argentina, Mexico, Uruguay, and Venezuela), but not in countries with capital controls (Brazil, Chile, Colombia, and Peru). Our findings for the Philippines, which had capital controls for much of the period under review, suggest that controls are not an either-or proposition but rather extend along a continuum in terms of their strictness and efficacy. The Philippines appears to have been situated near the low end of this scale.

28. The link between foreign borrowing and the growth of the state sector was a characteristic feature of the "indebted industrialization" policies pursued by a number of Third World countries in this period; see Frieden (1981).

The US embassy did have a different name for it: "creeping state capitalism."²⁹

External financial backing, in the form of lending from official institutions and private banks, unquestionably played a crucial role in this process. During his first administration (1965-69), President Marcos relied on external and internal borrowing to expand the direct role of the government in the economy, notably through rural infrastructure investments. In so doing, he built "an extensive patronage machine of a scale unmatched in postwar years," laying the basis for an unprecedented centralization of political authority (Doronila 1985, pp. 111-4).

When Marcos declared martial law in 1972, the WB and IMF "looked forward to funding another of the series of Pacific Basin economic miracles" (Overholt 1987, p. 92). At the end of the decade, the WB (1979, pp. 5, 14) applauded "the Government's remarkable success in raising the level of public investment," and claimed that while the efficiency of private investment had been damaged by import substitution policies, "public investment projects have generally been well selected." Foreign-assisted projects accounted for 75 percent of the public investment program, a ratio which WB conceded was "probably undesirably high" because it limited "the Government's room for maneuver" (pp. ii, 17). Nevertheless the Bank called for an increase in official development assistance from the Consultative Group to "at least US\$1 billion" in the following year (p. iv). At the same time, WB actively encouraged lending by commercial banks. Overholt (p. 99) reports: "The authority of the WB greatly weakened Marcos's critics inside private banks and greatly strengthened advocates of increased lending."

During the Marcos era, government involvement in both agriculture and industry grew substantially. As Overholt (p. 108) remarks, the regime "not only seized the commanding heights of the economy but also a good many of the minor foothills." In some cases the takeovers were hostile, as in the establishment of the predatory coconut and sugar monopolies. In others they were friendly, as the liabilities of private firms whose assets had been stripped to finance capital flight were handed over to the state.

A panel of Filipino economists described the situation in 1984:

The most damaging economic consequence of political monopoly is the potential abuse of the state machinery and its functions to dispense economic privileges and positions to certain private entities.... Hence it might be a mistake to view

29. This is the title of a 1983 embassy cable dealing with the DBP, the PNB, the National Development Company, and their client companies. "Creeping State Capitalism in the Philippines", Airgram from the US embassy to the Department of State, 83 Manila A-008, April 6, 1983 (declassified). The author is grateful to the National Security Archive (1775 Massachusetts Avenue, Washington, DC 20036) for providing this document.

the expansion of the government's role in recent years as an instance of "creeping socialism," or to regard the essence of the economic debate as being about the virtues of public intervention versus private enterprise. On the contrary, it could well be a conflict between different groups in society, being distinguished only in that one group has obtained exclusive access to the government. (De Dios *et al.*, 1984, pp. 61-2.)

In such a setting, the economists observed, it would be natural to expect the expanded government role to be attended by inefficiency, for "what might appear from the public viewpoint as government waste and inefficiency might in reality be gain and profit for private interests." (De Dios *et al.* 1984, p. 62.) This reality conforms to the ideal versions of neither socialism nor capitalism.

Administrative power in the Philippines was exercised by a coalition of two groups known in the country as "cronies" and "technocrats." The economists explained: "Most major economic decisions were formulated and approved by a rather small circle of people - consisting of so-called technocrats as well as political and business allies - gathered around a powerful chief executive" (De Dios *et al.* p. 59). Notwithstanding conflicts among them, the technocrats and cronies shared a common belief in the virtues of the authoritarian state.³⁰

Is there an irony in the support extended by foreign official and private lenders to this state apparatus? Not, if one superimposes upon the traditional dichotomy between capitalism and socialism another equally overarching one: that between technocracy, in which power is concentrated at the "top" in the hands of self-proclaimed leaders and experts, and democracy, in which power resides in the hands of the citizenry. The Philippines from 1962 to 1986, and particularly after the declaration of martial law, pursued a technocratic development strategy, in which the aggrandizement of state power was legitimated by an ideology of disinterested expertise. That in reality private interests enriched themselves behind this official veneer is, sadly, not an experience unique to the Philippines.

30. On the alliance between Marcos and the technocrats against nationalists, see Stauffer (1979, pp. 189-91). Referring to the conflicts between technocrats and "the so-called crony business empires," Bowring and Sacerdoti (1983, p. 63) observe:

Foreign banks' willingness to lend to DBP (Development Bank of the Philippines) for on-lending and to lend to public-sector operations without much regard for project viability, meant that resources tended to be distributed by reference to political influence. Technocrats may have deplored the results, but their preference for large centralised institutions probably exacerbated the problem.

On tensions between cronies and technocrats, see also Bello *et al.* (1982, Ch. 7).

Conclusions

The Philippines, like many Asian, African, and Latin American countries, accumulated a massive external debt in recent decades. Until 1983 the country received positive net transfers: Inflows of new money exceeded amortization and interest payments on past debt. Since then, however, the net transfer has turned negative, forcing the country to live "below its means" in order to service the accumulated debt.

Debt for Development?

The extent to which the majority of Filipinos benefitted from the country's foreign borrowing is open to serious question. During the era of positive net transfers, the borrowing helped to finance a persistent current account deficit, but interest payments on the debt itself were an important component of the deficit, and luxury imports absorbed part of the remainder. The borrowing financed some investment, but much of it was so inefficient that the short-run impact on output growth appears to have been negative. Foreign borrowing also financed large-scale capital flight, and by 1986 the cumulative stock of externally held assets was equivalent to 70 percent of the country's outstanding external debt. The borrowing also helped sustain the political regime which presided over this state of affairs.

Although national income per capita rose during the stage of positive net transfers, the real incomes of millions of Filipinos declined. The

Philippines experienced growth with impoverishment.¹ Real wages for agricultural workers in the country's principal food grain crops, rice and corn, fell to 65 percent of their 1962 level by 1980.² Urban wages for unskilled labor fell even more sharply to 50 percent of their 1962 level.³ The proportion of Philippine households living in poverty rose from an estimated 41 percent in 1965 to 59 percent in 1985.⁴

At the same time, the real incomes of wealthy Filipinos rose. Much of this increased wealth flowed abroad, either to escape the political and economic climate engendered by the Marcos regime or, in the case of crony capital, to ensure a pleasant retirement should the climate change.

While the benefits of the positive net transfer proved illusory for many Filipinos, the costs of the negative net transfer have been all too apparent.

In the first three years of the Aquino administration, the net transfer from the Philippines - that is, payments of debt service in excess of new lending - amounted to US\$4.7 billion. By 1988 the net transfer had risen to US\$2 billion, equivalent to six percent of the country's gross national product (WB 1990, p. 310). This required what are euphemistically termed "adjustments." Domestic consumption and investment had to be curtailed to free resources for debt service. The payments were not sufficient to make a dent in the total principal owed; on the contrary, external debt outstanding crept upwards to US\$29.4 billion by the end of 1988.

The negative net transfer can be expected to continue indefinitely, unless temporary relief arrives in the form of a massive infusion of new lending (implying in turn still larger debt service obligations in the future) or a more permanent solution is achieved by means of an alternative debt management strategy.

Policy Alternatives

Four policy options for the era of negative net transfers are considered below: (1) dutiful debt service; (2) debt buy-backs; (3) selective disengagement; and (4) outright default.

Option # 1: Dutiful debt service

The policy option most popular among debtor governments (if not their citizens) in the 1980s was dutiful debt service. To be sure, most

1. For details, see Boyce (forthcoming).

2. Calculated from data furnished by the Bureau of Agricultural Economics.

3. Calculated from CB data. This data series was discontinued by order of President Marcos in 1980 (WB 1985, p. 64), a step attributed by Lande and Hooley (1986, p. 1089) to the embarrassment the data caused the Marcos government.

4. Estimate for 1965 from Tan and Holazo (1979, pp. 473-4); estimate for 1985 from NEDA Technical Working Group on Poverty (1988, Table 3).

governments failed to meet the repayment schedules set forth in the original loan documents. They negotiated with their creditors to re-schedule debt payments, and some who failed to make scheduled payments on time slipped into the vast intermediate terrain between zero and total default. By and large, however, the debtor country governments have accepted the obligation to eventually repay their debts with interest, and they have demonstrated their willingness to extract remarkably large negative net transfers from their populations in order to do so.

The Philippines has not been an exception, notwithstanding the historic rupture between the government which accumulated the debt and that from which repayment is now demanded. In her September 1986 address to a joint session of the United States Congress, President Corazon Aquino described the foreign debt as a form of "slavery" and denounced "the previous government that stole this debt," but she pledged to repay it "if only for honor."

Dutiful debt service is clearly desirable from the standpoint of the creditors, but its attractions from the debtors' standpoint are less evident. As inducements creditors have deployed the carrot of new money and the stick of threatened reprisals.

The carrot is proffered in a recent World Bank country report on the Philippines, for example, which holds forth the "restoration of creditworthiness" as a critical goal for the country's future.⁵ Dutiful behavior will surely be rewarded: One day the country can re-enter the enchanted world of positive net transfers. This prospect does not seem imminent, however. Private creditors are seeking to reduce their Third World exposure, not to increase it, and official creditors have limited funds and other competing priorities. Moreover, borrowers may be less enamored of the lure of "creditworthiness" in light of their recent experience of its consequences.

Hence the importance of the stick. A month after the February revolution, CB Governor Jose Fernandez (1986, p. 1) warned of the risk of "economic retaliation against the country" should it take unilateral actions in defiance of its creditors. Trade credit lines could be withheld "paralyzing foreign trade," and foreign assistance could be terminated. In July 1986 Citibank President John Reed visited Manila to deliver the same message. If the Philippines were to repudiate its debts, he warned in an address to the American Chamber of Commerce and the Rotary Club of Manila, "it would produce immense suffering and difficulty for the people" (Andrei 1986, p. 76).

The credibility of these threats is, however, open to serious doubt. Brazil defied its commercial creditors for 18 months, beginning with the

5. WB (1989a, p. iii). The WB (1984, p. 47) emphasized this prospect from the outset of the Philippine debt crisis: "One of the main objectives of the Government's adjustment efforts will have to be to improve the country's credit worthiness."

unilateral suspension of debt service announced in February 1987. Its defiance provoked much posturing by the banks, but little genuine retaliation.⁶ The holders of paper assets proved to be paper tigers. Similarly, the well-publicized but less drastic debt service ceiling imposed by Peruvian President Alan Garcia did not bring grievous penalties; the Garcia government's heterodox economic program ultimately failed *despite* the debt policy, not because of it.⁷ More quietly, Bolivia halted most debt service payments in 1984, and three years later won the very favorable debt buy-back deal described below.

The credibility of creditor threats was carefully dissected by London *Financial Times* correspondent Anatole Kaletsky in his slim book *The Costs of Default*, published in 1985. Kaletsky's central conclusion is that debtor countries have relatively little to fear from their private creditors. A more serious concern is the reaction of the governments of creditor countries to alternative debtor government policies.⁸ Kaletsky argues persuasively that creditor country governments are unlikely to impose punitive sanctions against debtor governments which adopt a policy of "conciliatory default."

Indeed, there are important interests within creditor countries who stand to gain from the reduction or elimination of the negative net transfer from debtor countries. These include the management, shareholders, and workers of firms which have seen their export markets wither as indebted countries slash imports to meet debt service obligations; farmers whose export markets have met the same fate; and producers of goods for domestic markets who face stiff competition from countries obliged to run large trade surpluses to service their debts. To date, Third World debt policy in creditor countries, notably the US, has favored financial interests over industrial and farm interests, but the political equilibrium on this issue is not necessarily stable.⁹

6. Short-term credit lines (trade credits and inter-bank deposits) slipped from US\$15 billion at the outset of the moratorium to US\$13.5 billion near the end. In addition, interest rate spreads on these credits may have risen somewhat above their pre-moratorium level. These costs pale when compared to the benefit of US\$6 billion per year in suspended interest payments alone.

7. Griffith-Jones (1988, p. 360) observes: "The Peruvian experience has shown that after two years of unilateral action no legal response has come from the creditor banks to confiscate assets or other drastic measures; the only 'cost' of the unilateral action, as regards creditor banks, has been their curtailment of short-term credit lines."

8. The terms "creditor country" and "debtor country" here refer to the bilateral relationship between a borrower government and its private and official external creditors. The US for example, is a "creditor country" vis-a-vis the Philippines despite being the world's largest debtor country.

9. For a view from General Motors Corporation, see Whitman (1987). Berg (1988) presents an empirical analysis indicating that 11 percent of the US trade deficit in 1985 was attributable to debt-related austerity measures in five major Third World countries, including the Philippines, and that these caused a 0.5 percent decrease in US GNP. For a discussion of the so-called Bradley Plan, a debt initiative sponsored by a US Senator representing a heavily industrial state, see Dornbusch (1986).

Option # 2: Debt buy-backs

The widely held belief that much Third World debt will never be repaid, however long it lingers in the purgatory of rescheduling, drives a wedge between the face value of the debt and its real value. The emergence of a secondary market in which Third World debt is traded at a discount provides a market-based assessment of the latter. In recent years a variety of debt-management mechanisms have been fashioned to trade on the difference between the two.

Debt-equity swaps are one such mechanism, but they have a number of drawbacks from the debtor country's standpoint. Something real must be exchanged for the debt such as ownership rights in domestic enterprises. This transfer often generates fears of some loss of national economic sovereignty. This loss may not be more onerous than that arising from indebtedness, but it is more visible and hence politically suspect. In addition, the country sacrifices part of the resources and foreign exchange which would have entered as direct foreign investment anyway in the absence of the swaps. And if domestic currency is printed to finance swaps on a large scale, it can fuel inflation.

Direct debt buy-backs on the secondary market avoid these shortcomings. If debt is trading at 36 cents on the dollar, for example - as was Philippine debt in March 1989 - then a dollar devoted to repurchase of debt would clearly reduce future obligations more than a dollar devoted to debt service. The creditor banks have attempted to block such buy-backs for obvious "moral-hazard" reasons. If countries can buy their own debt at a discount, they have an incentive to withhold debt service so as to drive down its value. For this reason, clauses are inserted into rescheduling agreements prohibiting debt repurchases and requiring *pro rata* sharing of any debt payments among all the creditor banks.

This curious arrangement - whereby one party is excluded from participating in an otherwise open market - invites creative responses. One possibility is for debtor countries to buy each other's debt on the secondary market and then swap it.¹⁰ But even direct buy-backs are possible, as the Bolivian government demonstrated in 1987-88 when it repurchased roughly half of its commercial bank debt at an average price of 11 cents on the dollar. Sixty of the country's 130 creditor banks accepted the terms of the buy-back, including the Bank of America, which chaired Bolivia's bank advisory committee.¹¹

The banks sought to depict the Bolivian buy-back as a one-time-

10. In May 1990 Brazil and Bolivia agreed that Bolivia would buy Brazilian debt with US\$300 million face value on the secondary market (at 25.5 to 27.5 cents on the dollar) to exchange for Bolivian debt held by Brazil (Truell 1990).

11. For details, see Whitelaw (1987), Truell (1988), Sachs (1988), and 'Bolivia Buys Back \$334 Million of Debt', *The Wall Street Journal*, August 11, 1988.

only special deal, but in retrospect it looks more like a precedent. In 1989, reports *The Economist* of London, Third World countries quietly repurchased some US\$30 billion of their foreign debt in secondary markets.¹²

Option # 3: Selective disengagement

A third option is selective disengagement: a decision to honor some debts, but to repudiate others. The primary political and legal basis for selectivity lies in the uses to which the loans in question were put.

As documented in preceding chapters, upper-class Filipinos accumulated large-scale private external assets in the same decades in which the country accumulated its public external debt. Econometric as well as anecdotal evidence indicates that the two phenomena in many cases were causally linked through a financial revolving door. As Diaz-Alejandro (1984, p. 379) observed in Latin America, "this situation reduces the political legitimacy of efforts to service the external debt." It also raises the possibility of legal challenges to continued debt service.

Debtor country governments and their citizens might well ask why they should bear the cost of repayment of debts not of their making, from which they derived no benefit. Rather than continue to service the entire debt, debtor countries might instruct the creditors to seek repayment from the owners of the private external assets which are the real counterpart of a substantial component of the public external debt.

The compulsory mobilization of foreign private assets for debt service has been proposed by Felix (1985), who argues that creditor banks and governments might collaborate in this unorthodox endeavor so as to collateralize otherwise uncollectible debts. Pastor (1990) notes the practical problems of implementing such a plan: the identification of assets; the banks' reluctance to damage relations with private clients; and the political resistance from holders of foreign assets. In addition, unless such a plan were implemented on a world-wide scale, it could be evaded by shifting assets to safe-haven countries.

Debtor nations could, however, capitalize on the debt-flight connection in another way. Rather than seeking to recapture the flown capital, either by luring it home (which, as Pastor notes, amounts to ceding veto power over national economic policy to wealthy elites) or by impounding it abroad, governments could tell their creditors: "Resources permitting, we will scrupulously repay all loans or portions thereof which were used for *bona fide* investment or consumption in our country. However, until such time as you furnish proof of such use, we shall assume no obligation to repay."

12. "Brady's Bazaar," *The Economist*, May 12, 1990, p. 77.

Such a move could claim a legal basis in the "doctrine of odious debt," which holds that:

An interest which a creditor possesses in a debt must, in order to constitute an acquired right protected by international law, be an interest in funds utilized for the needs and interests of the State. Any debts contracted for other purposes is a debt intrinsically "hostile to the interests of the territory" (O'Connell 1967, p. 459).

The landmark application of this doctrine occurred nearly a century ago, in 1898, when the US seized control of the Philippines and Cuba in the Spanish-American War. At issue was the Cuban external debt accumulated under Spanish rule. At the Paris peace conference, the US authorities contended that this debt had not been incurred for the benefit of the Cuban people, that it had been contracted without their consent, that the creditors must have appreciated that the purpose of the loans was to finance "the continuous effort to put down a people struggling for freedom from the Spanish rule," and that "the creditors, from the beginning, took the chances of the investment."¹³

The legal circumstances under which the doctrine of odious debt can be applied are far from unambiguous. In particular, there is considerable room for different interpretations as to whether and to what extent its application requires proof that the creditor was aware of the ultimate use of the loan proceeds.¹⁴ "On this topic politics assume dominance over legal analysis," O'Connell (1967, p. 460) concludes, "and for this reason the only exact test of whether or not a debt is odious is the extent to which it is unbeneficial to the population of the territory it burdens."

The debts foisted upon the Philippine government via debt-fueled capital flight and flight-fueled external borrowing were unquestionably "unbeneficial to the population." The same argument could be advanced regarding some debts incurred for other purposes, for example, the construction of the Bataan nuclear power plant. Hence there is considerable scope for legal and political challenges to the legitimacy of a significant fraction of the country's external debt.

13. Quoted in O'Connell(1967, pp. 459-60) and Hoeflich (1982, pp. 53-55).

14. O'Connell (1967, p. 459) states that this is a "dangerous" doctrine, which if not limited "tends to be expanded as States seek a pretext for avoiding obligations which otherwise would be imposed upon them", and notes that one legal authority suggests that to justify its invocation a successor state "should be required to prove, first, that the debt was contrary to the interests of the population of all or part of the absorbed territory and, secondly, that the creditors were aware of this. Once these two things have been proved, . . . the onus is upon the creditors to show that the funds have in fact been utilized for the benefit of the territory." Citing the same authority, however, Frankenberg and Knieper (1984, p. 434) argue that the burden of proof should fall upon the creditor: "[T]he creditor (or supplier) would first have to show evidence that the credit (or supply) was used or was supposed to be used in the debtor country's national (developmental) interest."

Option # 4: Outright default

A final option is outright default. In its most naked form, this means informing creditors that debts will not be repaid. The attraction of such a policy is that it would immediately halt the hemorrhage of national income and foreign exchange in the negative net transfer. The drawback is the possibility of retaliation, not so much from private commercial creditors as from their governments.

Kaletsky (1985, p. 45) points out the important differences between such naked repudiation and more conciliatory forms of default, in which the country ceases or curtails debt payments without announcing that it never intends to repay:

A conciliatory default would be like a slow leak in the banks' balance sheets; it could be patched up with profit retentions and reserve additions for long enough to keep the banking system afloat. A repudiation, by contrast, would be like an explosion below decks: it would blow a hole right through the center of the banks' capital structure.

In terms of minimizing the likelihood of retaliation, the former is the more prudent course of action.

There is also room here for selectivity. Although the net transfer has turned negative in the aggregate, some individual (official) creditors continue to provide new money in excess of the interest and amortization payments they receive. In other respects as well, the retaliatory capabilities of some official creditors exceed those of private commercial banks. Hence a country may choose to default upon only the private subset of its total external debt.

There is ample historical precedent for one or another variant of the default option. "For at least five hundred years," Kaletsky remarks, "governments and nations have regularly defaulted on their foreign debts."¹⁵ Yet it has not been exercised in the current international debt crisis. A number of reasons for this have been advanced. MacEwan (1990, pp. 113-5) cites the availability of rescheduling alternatives, the benefits which ruling elites derive from the imposition of austerity measures upon the working classes (while themselves evading the consequences by holding foreign assets), and the integration of these elites as "junior partners" in the international economic power structure.

Magee and Brock (1986, p. 190) argue that ruling elites accede to creditor demands in order to safeguard their own external assets, and that this helps to explain the banks' collaboration in capital flight:

15. Kaletsky (1985, p. 1). For reviews of historical default experiences, see Fishlow (1985), Eichengreen and Portes (1986), and Felix (1987).

The strategy of all banks is not to lend to projects that have the highest expected return, but to individuals or groups with the greatest likelihood of repaying. This practice encourages redistributive loans to "flight capitalists" rather than to LDC [less developed country] capital development: collateral outside of the LDC is safer than capital inside it.

Magee and Brock (p. 186) maintain that even though private external assets cannot be seized by the banks in the event of a public sector default, they can be "tied up legally so that their owners cannot use them." The validity of this claim is rather doubtful, however.¹⁶

More plausibly, Sachs (1988, p. 710), like Kaletsky, emphasizes "fear of a foreign policy rupture with the United States." This again brings politics - within the debtor and creditor countries and between them - to center stage. The Reagan administration's debt policy, Sachs remarks, was built around the single goal of preventing write-downs which "might threaten the survival of the current management of even one or two of the most heavily exposed banks." Other conceptions of the US national interest are readily conceivable, however, as evidenced by the earlier example of President Franklin D. Roosevelt who in 1943 not only accepted a Bolivian default, but also apologized to the President of Bolivia for "some Americans [who] sold to the Bolivian government through supersalesmanship the idea that it needed a loan."¹⁷

Who Should Forgive Whom?

The case for a tougher debt strategy, including selective repudiation of debts in which "the creditor was negligent or was not acting in good faith when the loan was granted," was considered in the "Yellow Paper" prepared by a team of leading Filipino economists immediately after the February revolution (Alburo *et al.* 1986, pp. 46-9). Concerning the possibility of reprisals, such as a cut-off of trade credits, in response to such a strategy, they noted that "public opinion, both local and global, may be the critical determinant," and may provide "the best deterrent against lethal retaliation."

The analysis of the Philippine external debt presented above suggests that a compelling case for disengagement could be put before the court of world opinion.

In a lawsuit filed against ex-president Marcos in US District Court in California, the Aquino government's Presidential Commission on Good

16. As an example the authors cite the freezing of Iranian assets by the US in 1979. But this exceptional action applied only to Iranian *government* assets, not to the private assets of Iranian nationals (for details, see Gwetzman 1979).

17. Cited by Kaletsky (1985, p. 90), quoting an account which appeared in *The New York Times* on May 8, 1943.

Government characterizes the former government under Marcos as a "RICO [Racketeer Influenced and Corrupt Organizations] enterprise" as defined in the US criminal code.¹⁸ If this is a tenable characterization of the Marcos regime, then it is reasonable to ask whether the repayment of loans contracted or guaranteed by that regime should now be the responsibility of the Filipino people.

It is not a question of debt "forgiveness," but of the legitimacy of the debt itself. Indeed, those Filipinos who saw their real incomes decline in the years of debt-driven growth and their aftermath may well ask who should forgive whom.

Selective disengagement is, by its very nature, a flexible debt-management strategy which does not exclude dutiful debt service in some cases, debt buy-backs in others, or outright default as a last resort. An advantage of selective disengagement over other options is that it focuses political and public attention upon the uses to which loans were put, and thereby fosters a broader awareness of the pitfalls of a debt-for-development strategy. If this awareness enables the country to resist the temptations of a positive net transfer at some future date when the present crisis has passed, then the debt tragedy will have had at least one redeeming feature.

18. *The Republic of the Philippines vs. Ferdinand E. Marcos et al.*, Case No. CIV 86-3859, filed before the US District Court, Central District of California, June 16, 1986, p. 13.

BIBLIOGRAPHY

- Alano, B.P., Jr. "Import Smuggling in the Philippines: An Economic Analysis." *Journal of Philippine Development* Vol. 11, No. 2 (1984): 157-90.
- Alburo, F. et al. *Economic Recovery and Long Run Growth: Agenda for Reforms*. Volume I: Main Report (the 'Yellow Paper'). Makati: Philippine Institute for Development Studies, 1 May 1986.
- _____ and D. Canlas. "Balance of Payments, Output, and the IMF." Paper presented at the Conference on Development Alternatives and Prospects, 5-6 December 1986 in Manila.
- Alfiler, F.R. "An Analysis of the Onset of the Philippine Debt Crisis." *Central Bank Review* Vol. 38, Nos. 1 & 2 (1986): 22-2444.
- Andrei, M.T. "Awaiting the Renaissance." *Asiabanking*, September 1986, pp. 75-80.
- Baldwin, R.E. *Foreign Trade Regimes and Economic Development: The Philippines*. New York: Columbia University Press for the National Bureau of Economic Research, 1975.
- Bank for International Settlements. *Fifty-Fourth Annual Report*. Basle: Bank for International Systems, 18 June 1984.
- Bello, W. et al. *Development Debacle: The World Bank in the Philippines*. San Francisco: Institute for Food and Development Policy, 1982.
- _____, P. Hayes, and L. Zarsky, "500 Mile Island: The Philippine Nuclear Reactor Deal." *Pacific Research* Vol. 10, No. 1 (1979): 1-29.
- Berg, G.C. "The Effects of the External Debts of Mexico, Brazil, Argentina, Venezuela, and the Philippines on the United States." *Applied Economics* 20 (1988): 939-56.
- Bornschier, V., C. Chase-Dunn and R. Rubinson "Cross-national Evidence of the Effects of Foreign Investment and Aid on Economic Growth and Inequality: A Survey of Findings and a Reanalysis." *American Journal of Sociology* Vol. 84, No. 3 (1978): 651-83.
- Bowles, S. and H. Gintis "Contested Exchange: Political Economy and Modern Economic Theory." *American Economic Review* Vol. 78, No. 2 (1988): 145-50.
- Bowring, P. and G. Sacerdoti. "Time for a Real Debate," *Far Eastern Economic Review*, 9 June 1983, pp. 54-66.
- Boyce, J.K. *The Philippines: The Political Economy of Growth and Impoverishment*. London: Macmillan, forthcoming.
- _____ and L. Zarsky. "Capital Flight from the Philippines, 1962-1986." *The Journal of Philippine Development* Vol. 15 No. 2 (1988): 191-222.
- Branson, W.H. "Causes of Appreciation and Volatility of the Dollar." In *The U.S. Dollar - Recent Developments, Outlook, and Policy Options*, a symposium sponsored by the Federal Reserve Bank of Kansas City,

- pp. 33-52, 1988.
- Broad, R. "Beyond Philippine Policy Making: The Role of the World Bank and the International Monetary Fund." Ph.D. dissertation, Woodrow Wilson School of Public and International Affairs, Princeton University, June 1983.
- _____. *Unequal Alliance, 1979-1986: The World Bank, the International Monetary Fund, and the Philippines*. Quezon City: Ateneo de Manila University Press; and Berkeley: University of California Press, 1988.
- Butterfield, F. "Filipinos Say Marcos Was Given Millions for '76 Nuclear Contract." *The New York Times*, 7 March 1986.
- Canlas, D.B. "The Balance of Payments Crisis and the Economy," *PIDS Development Research News*, Vol. 3, No. 2, March-April 1985, pp. 1-5.
- Carey, P. and K. Ellison. "How Smugglers Drain the Philippines," *San Jose Mercury News*, 27 October 1985.
- Chenery, H.B. and N.G. Carter. "Foreign Assistance and Development Performance, 1960-1970." *American Economic Review* Vol. 63, No. 2 (1973): 459-68.
- Chenery, H.B. and A.M. Strout. "Foreign Assistance and Economic Development." *American Economic Review*, September 1966.
- Conesa, E.R. "The Flight of Capital from Latin America." Mimeographed. Washington: Inter-American Development Bank, 1987
- Cowitt, P.P. *1985 World Currency Yearbook*. Brooklyn, N.Y.: International Currency Analysis, Inc., 1985.
- Crittenden, A. "Behind the Philippine Loan." *The New York Times*, 12 February 1978.
- Cuddington, J.T. *Capital Flight: Estimates, Issues, and Explanations*. Princeton: Princeton University, Department of Economics, Princeton Studies in International Finance No. 58, December 1986.
- _____. "Macroeconomic Determinants of Capital Flight: An Econometric Investigation," In *Capital Flight and Third World Debt*, edited by D.R. Lessard and Williamson, pp. 85-100. Washington, D.C.: Institute for International Economics, 1987.
- Cumby, R. and R. Levich. "On the Definition and Magnitude of Recent Capital Flight." In *Capital Flight and Third World Debt*, edited by D.R. Lessard and Williamson, pp. 27-67. Washington, D.C.: Institute for International Economics, 1987.
- Darity, W., Jr. "Did Commercial Banks Push Loans on the LDCs?" In *World Debt Crisis: International Lending on Trial*, edited by M.P. Claudon. Cambridge, Mass.: Ballinger, 1986.
- _____. and B. Horn. *The Loan Pushers: The Role of Commercial Banks in the International Debt Crisis*. Cambridge, Mass.: Ballinger, 1988.

- David, I.P. "Estimates of the Total External Debt of the Developing Member Countries of ADB: 1981-1983." *Statistical Report Series No. 1*. Manila: Asian Development Bank Economics Office, September, 1984.
- _____ and J. Lee. "External Debt Situation in Asian Developing Countries." *Statistical Report Series No. 6*. Manila: Asian Development Bank Economics Office, March 1986.
- De Dios, E.S. et al. *An Analysis of the Philippine Economic Crisis: A Workshop Report*. Quezon City: University of the Philippines Press, 1984.
- De Vries, R. "LDC Debt: Debt Relief or Market Solutions?" *World Financial Markets*. New York: Morgan Guaranty Trust Company, September 1986.
- _____. "Panel on Policy Issues." In *Capital Flight and Third World Debt*, edited by D.R. Lessard and J. Williamson. Washington, D.C.: Institute for International Economics, 1987.
- Deppler, M. and M. Williamson. "Capital Flight: Concepts, Measurement, and Issues." *IMF Staff Studies for the World Economic Outlook*. Washington, D.C.: IMF, August 1987.
- Diaz-Alejandro, C.F. "Latin American Debt: I Don't Think We Are in Kansas Anymore." *Brookings Papers on Economic Activity 2*: (1984): 335-89.
- Diwan, I. "Foreign Debt, Crowding Out and Capital Flight." *Journal of International Money and Finance* 8 (1989): 121-36.
- Dooley, M.P. "Country-Specific Risk Premiums, Capital Flight and Net Investment Income Payments in Selected Developing Countries." International Monetary Fund Research Department Memorandum DM/86/17, March 1986.
- _____. "Comment." In *Capital Flight and Third World Debt*, edited by D.R. Lessard and J. Williamson, pp. 79-81. Washington, D.C.: Institute for International Economics, 1987.
- _____, W. Helkie, R. Tyron and J. Underwood. "An Analysis of External Debt Positions of Eight Developing Countries Through 1990." *Journal of Development Economics* Vol. 21, No. 3 (1986): 283-318.
- _____ and P. Isard. "Tax Avoidance and Exchange Rate Determination." International Monetary Fund Research Department Memorandum DM/86/1, 2 January 1986.
- _____. "Country Preferences, Currency Values and Policy Issues." *Journal of Policy Modelling* Vol. 9, No. 1 (1987): 65-81.
- Dornbusch, R. "External Debt, Budget Deficits, and Disequilibrium Exchange Rates." In *International Debt and the Developing Countries*, edited by G.W. Smith and J.T. Cuddington, pp. 213-35. Washington, D.C.: World Bank, 1985.
- _____. "The Bradley Plan: A Way Out of the Latin Debt Mess."

The Washington Post, 27 August 1986, p. A19.

- _____ and S. Fischer. *Macroeconomics*. 5th ed. New York: McGraw-Hill, 1990.
- Doronila, A. "The Transformation of Patron-Client Relations and its Political Consequences in Postwar Philippines." *Journal of Southeast Asian Studies* Vol. 16, No. 1 (1985): 99-116.
- Dumaine, B. "The \$2.2 Billion Nuclear Fiasco." *Fortune*, 1 September 1986, pp. 39-46.
- Eichengreen, B. and R. Portes. "Debt and Default in the 1930s: Causes and Consequences." *European Economic Review* 30 (1986): 599-640.
- Ellison, K. and P. Carey. "Military Aid and Manila: Pentagon Probes U.S. Contractors for Links to Top Philippine Officials." *San Jose Mercury News*, 28 June 1985.
- Erbe, S. "The Flight of Capital from Developing Countries." *Intereconomics* 20 (November/December 1985): 268-75.
- Evans, J.G. "Current and Capital Transactions: How the Fund Defines Them." *Finance and Development* Vol. 5, No. 3 (September 1968): 30-35.
- Felix, D. "How to Resolve Latin America's Debt Crisis." *Challenge* Vol. 28, No. 5 (1985): 44-51.
- _____. "Alternative Outcomes of the Latin American Debt Crisis: Lessons from the Past." *Latin American Research Review* Vol. 22, No. 2 (1987): 3-46.
- Fernandez, J. "Honoring an International Commitment." *Central Bank Review* Vol. 38, No. 3 (1986): 1.
- Fishlow, A. "Lessons from the Past: Capital Markets during the 19th Century and the Interwar Period." *International Organization* Vol. 39, No. 3 (1985): 383-439.
- Folkerts-Landau, D. "The Changing Role of International Bank Lending in Development Finance." *IMF Staff Papers*, Vol. 32, June 1985.
- Frank, C.R., Jr. "Debt and Terms of Aid." In *Assisting Developing Countries: Problems of Debts, Burden-Sharing, Jobs, and Trade*, edited by C.R. Frank, et al. pp. 3-68. New York: Praeger, 1972.
- Frankenberg, G. and R. Knieper, "Legal Problems of the Overindebtedness of Developing Countries: The Current Relevance of the Doctrine of Odious Debts." *International Journal of the Sociology of Law* 12 (1984): 415-38.
- Frieden, J. "Third World Indebted Industrialization: International Finance and State Capitalism in Mexico, Brazil, Algeria, and South Korea." *International Organization* Vol. 35, No. 3 (1981): 407-32.
- Gould, M. "Philippines: Country Program Paper." World Bank Office Memorandum, 26 March 1976.
- Griffin, K.B. *International Inequality and National Poverty*. London: Macmillan, 1978.

- _____ and J.L. Enos, "Foreign Assistance: Objectives and Consequences." *Economic Development and Cultural Change* Vol. 18, No. 3 (1970): 313-27.
- _____ and A.K. Ghose, "Growth and Impoverishment in Rural Areas of Asia." *World Development* Vol. 7, No. 4/5 (1979): 361-83.
- Griffith-Jones, S. "Conclusions and Policy Recommendations." In *Managing World Debt*, edited by S. Griffith-Jones. New York: St. Martin's, 1988.
- Gulati, S.K. "A Note on Trade Misinvoicing." In *Capital Flight and Third World Debt*, edited by D.R. Lessard and J. Williamson, pp. 68-78. Washington, D.C.: Institute for International Economics, 1987.
- _____. "Capital Flight: Causes, Consequences and Cures." *Journal of International Affairs* Vol. 42, No. 1 (1988): 165-85.
- Gwertzman, B. "Carter Freezes Billions in Iranian Assets as Khomeini Regime Tries to Withdraw Them." *The New York Times*, 15 November 1979.
- Henry, J. "Where the Money Went: Third World Debt Hoax." *The New Republic*, 14 April 1986, pp. 20-23.
- _____. "The New Philippines: Revolution, Recovery and Reality." *International Development Review* (New York) Vol. 2, No. 1 (1989): 64-85.
- Hoeflich, M.E. "Through a Glass Darkly: Reflections Upon the History of the International Law of Public Debt in Connection with State Succession." *University of Illinois Law Review* No. 1 (1982): 39-70.
- Hooper, P. and C.L. Mann, "The U.S. External Deficit: Its Causes and Persistence." Board of Governors of the Federal Reserve System, International Finance Discussion Paper No. 316, November 1987.
- IBON Databank Phils., Inc. *What Crisis? Highlights on the Philippine Economy 1983*. Manila: IBON, 1984.
- International Labour Office. *Sharing in Development: A Programme of Employment, Equity and Growth for the Philippines*. Geneva: ILO, 1974.
- International Monetary Fund (IMF). *Balance of Payments Manual*. 4th ed. Washington: IMF, 1977.
- _____. *Philippines: Recent Economic Developments*. 8 June 1984. Mimeographed.
- _____. *International Financial Statistics Yearbook 1987*. Washington: IMF, 1987a.
- _____. *Report on the World Current Account Discrepancy*. Final Report of the Working Party on the Statistical Discrepancy in World Current Account Balances. Washington, D.C.: IMF, September 1987b.
- Jurado, G.M. "Philippine Foreign Loans: 1906-1963." *Philippine Economic Journal* Vol. 5, No. 2 (1966): 362-79.
- Kaletsky, A. *The Costs of Default*. New York: Priority Press, 1985.

- Khan, M.S. and N. Ul Haque. "Foreign Borrowing and Capital Flight: A Formal Analysis." *IMF Staff Papers* Vol. 32, No. 4 (1985): 606-628.
- _____. "Capital Flight from Developing Countries." *Finance and Development*, 24 (March 1987): 2-5.
- Kwitny, J. *The Crimes of Patriots: A True Tale of Dope, Dirty Money, and the CIA*. New York: Norton, 1987.
- Lamberte, M.B. et al. *A Review and Appraisal of the Government Response to the 1983-84 Balance-of-Payments Crisis*. PIDS Monograph Series No. 8. Makati: Philippine Institute for Development Studies, October 1985.
- Lande, C.H. and R. Hooley. "Aquino Takes Charge." *Foreign Affairs* 64 (1986): 1087-1107.
- Lary, H. B. "The Domestic Effects of Foreign Investment." *American Economic Review Papers and Proceedings* Vol. 36, No. 2 (1946): 672-86.
- Lessard, D.R. "Country Risk and the Structure of International Financial Intermediation." Paper presented at the Federal Reserve Bank of St. Louis Conference on Financial Risk, 14-15 November 1986.
- _____. "Comment" [on Cuddington's 'Macroeconomic Determinants of Capital Flight']. In *Capital Flight and Third World Debt*, edited by D.R. Lessard and J. Williamson, pp. 97-100. Washington, D.C.: Institute for International Economics, 1987.
- _____ and J. Williamson. "The Problem and Policy Responses." In *Capital Flight and Third World Debt*, edited by Lessard and Williamson, pp. 201-54. Washington D.C.: Institute for International Economics, 1987.
- _____, eds. *Capital Flight and Third World Debt*. Washington, D.C.: Institute for International Economics, 1987.
- Lind, J.E. *Philippine Debt to Foreign Banks*. San Francisco: Northern California Interfaith Committee for Corporate Responsibility, November 1984.
- MacEwan, A. *Debt and Disorder: International Economic Instability and U.S. Imperial Decline*. New York: Monthly Review, 1990.
- Magee, S.P. and W.A. Brock. "Third World Debt and International Capital Market Failure as a Consequence of Redistributive Political Risk Sharing." In *World Debt Crisis: International Lending on Trial*, edited by M.P. Claudon, pp. 173-198. Cambridge, Mass.: Ballinger, 1986.
- Malone, W.S. "Ferdinand E. Marcos: A Trail of Corruption." Investigative report for the Public Broadcasting System/WGBH Television, Boston, Massachusetts, 1987.
- Marris, S. *Deficits and the Dollar: The World Economy at Risk*. Washington, D.C.: Institute for International Economics, 1985.
- McCoy, A.W. *Priests on Trial*. New York: Penguin, 1984.
- Moffett, M. and P. Trucll, "The Man Who Did Mexico's Borrowing Now

- Works on a Possible Solution..." *The Wall Street Journal*, 25 January 1988.
- Montes, M.F. "Macroeconomic Adjustment in the Philippines, 1983-85." *PIDS Working Paper No. 8701*. Makati: Philippine Institute for Development Studies, February 1987.
- Morgan Guaranty Trust Company of New York. "LDC Capital Flight." *World Financial Markets*, pp. 13-15, March 1986.
- Morrell, J. "Aid to the Philippines: Who Benefits?" *International Policy Report* (Washington, D.C.: Center for International Policy), Vol. 5, No. 2 (October 1979).
- Mosley, P. "Aid, Savings and Growth Revisited." *Oxford Bulletin of Economics and Statistics* Vol. 42, No. 2 (1980).
- National Economic and Development Authority (NEDA), *Statistical Yearbook 1974*. Manila: NEDA, 1974.
- _____. *Statistical Yearbook of the Philippines 1976*. Manila: NEDA, 1976.
- _____. *1986 Philippine Statistical Yearbook*. Manila: NEDA, 1986.
- NEDA Technical Working Group on Poverty. "A Monograph for the Estimation of the 1985 Poverty and Subsistence Thresholds and Incidences." Typescript. Manila, 1988.
- Naylor, R.T. *Hot Money and the Politics of Debt*. New York: Simon and Schuster, 1987.
- O'Connell, D.P. *State Succession in Municipal Law and International Law. Vol. I: Internal Relations*. Cambridge: Cambridge University Press, 1967.
- Ofreneo, R.E. "Philippine Industrial Debacle and the Debt Crisis." *Economic and Industrial Democracy* 6 (1985): 161-84.
- Organisation for Economic Cooperation and Development (OECD), *Statistics on External Indebtedness: The Debt and Other External Liabilities of Developing, CMEA and Certain Other Countries and Territories at End-December 1983 and End-December 1984*. Paris: OECD, 1985.
- _____. *External Debt Statistics: The Debt and Other External Liabilities of Developing, CMEA and Certain Other Countries and Territories at End-December 1985 and End-December 1986*. Paris: OECD, 1987.
- Oshima, H.T. "Sources of Philippine Postwar Economic Growth: The Overall Record in Comparative Perspective." *Journal of Philippine Development* Vol. 10, No. 1 (1983): 1-44.
- Overholt, W.H. "Pressures and Policies: Prospects for Cory Aquino's Philippines." In *Rebuilding a Nation: Philippine Challenges and American Policy*, edited by C.H. Lande, pp. 89-110. Washington, D.C.: Washington Institute Press, 1987.
- Panganiban, L.R. "Exchange Rate Adjustment: The Philippine Experience." *Central Bank Review* Vol. 35, No. 9 (September 1983): 8-11.

- Papanek, G.F. "The Effect of Aid and Other Resource Transfers on Savings and Growth in Less Developed Countries." *Economic Journal* 82 (1972): 934-50.
- Pastor, M. "Current Account Deficits and Debt Accumulation in Latin America." *Journal of Development Economics* Vol. 31, No. 1 (1989): 77-97.
- _____. "Capital Flight from Latin America." *World Development* Vol. 18, No. 1 (1990): 1-13.
- Pasztor, A. "Inquiry Into Payments by Westinghouse to Marcos Aide Expected to be Dropped." *The Wall Street Journal*, 15 December 1987.
- Patrick, H. and H.A. Moreno. "Philippine Private Domestic Commercial Banking, 1946-80, in the Light of Japanese Experience." In *Japan and the Developing Countries*, edited by K. Ohkawa and G. Ranis, pp. 311-65. Oxford: Basil Blackwell, 1985.
- Payer, C. *The Debt Trap: The International Monetary Fund and the Third World*. New York: Monthly Review, 1974.
- _____. "Repudiating the Past." *NACLA Report on the Americas* Vol. 19, No. 2 (1985): 14-24.
- _____. *Lent and Lost* (tentative title). London: Zed Books, 1990, forthcoming.
- Peagam, N. "The Spectre that Haunts Marcos." *Euromoney*, April 1984, pp. 46-63.
- Pesaran, M.H. and B. Pesaran, *Data-FIT: An Interactive Econometric Software Package*. Oxford: Oxford University Press, 1987.
- Pick, F. *Pick's Currency Yearbook 1968*. New York: Pick Publishing, 1968.
- Power, J.H. "Response to Balance of Payments Crises in the 1970s: Korea and the Philippines." *PIDS Staff Paper Series No. 83-05*. Makati: Philippine Institute for Development Studies, 1983
- _____. and G.P. Sicat, *The Philippines: Industrialization and Trade Policies*. London: Oxford University Press, for the Development Centre of the OECD, 1971.
- Rafferty, K. "Thrills in Manila." *Institutional Investor*, December 1983, pp. 98-104.
- Ranis, G. "Brief Reflections on the Philippine Economy: Summer, 1984." Prepared statement read before the Subcommittee on Asian and International Affairs, Committee on Foreign Affairs, U.S. House of Representatives, 20 September 1984.
- _____. "Marcos' Economic Legacy: Problems, Policies, and Prospects for President Aquino and How the United States Can Help." In *Rebuilding a Nation: Philippine Challenges and American Policy*, edited by C.H. Lande, pp. 111-21. Washington D.C.: Washington Institute Press, 1987.
- Remolona, E.M. and M.B. Lamberte. "Financial Reforms and Balance-of-Payments Crisis: The Case of the Philippines: 1980-83." *Philippine*

- Review of Economics and Business* Vol. 23, Nos. 1 & 2 (1986): 101-41.
- Remolona, E.M., M. Mangahas, and F. Pante Jr. "Foreign Debt, Balance-of-Payments and the Economic Crisis of the Philippines in 1983-84." Report to the Group of Twenty-Four, UNDP/UNCTAD Project INT/84/021: Studies on International Monetary and Financial Issues for Developing Countries, 1985.
- Riddell, R.C. *Foreign Aid Reconsidered*. Baltimore: Johns Hopkins University Press, and London: James Currey, 1987.
- Sachs, J.D. "Comments" [on Diaz-Alejandro's "Latin American Debt"] *Brookings Papers on Economic Activity* 2 (1984): 393-401.
- _____. "Comprehensive Debt Retirement: The Bolivian Example." *Brookings Papers on Economic Activity* 2 (1988): 705-13.
- Shaplen, R. "The Philippines - Part II." *The New Yorker*, 1 September 1986.
- Stauffer, R.B. "The Political Economy of Refeudalization." In *Marcos and Martial Law in the Philippines*, edited by D.A. Rosenberg, pp. 180-219. Ithaca: Cornell University Press, 1979.
- Steve, G.T. and P.P. Cowitt. *Pick's Currency Yearbook 1975-1976*. New York: Pick Publishing, 1976.
- Tabora, M.C.D. "Overseas Workers: An Important Dollar Earner." *Central Bank Review* Vol. 38, No. 4 (April 1986) 21-25.
- Tan, E.A. and V. Holazo. "Measuring Poverty Incidence in a Segmented Market: The Philippine Case." *Philippine Economic Journal* Vol. 18, No. 4 (1979): 450-90.
- Taylor, L. "The Theory and Practice of Developing Country Debt: An Informal Guide for the Perplexed." *Journal of Development Planning* No. 16 (1985): 195-227.
- Thompson, M. and G.W. Slayton, "An Essay on Credit Arrangements Between the IMF and the Republic of the Philippines: 1970-1983." *Philippine Review of Economics and Business* Vol. 22, Nos. 1 & 2 (1985): 59-80.
- Truell, P. "Bolivia Buys Back Nearly Half of Its Debt to Banks at a Fraction of the Face Value." *The Wall Street Journal*, 18 March 1988.
- _____. "Bolivia and Brazil Reach Accord on Plan to Cut \$300 Million of Each Other's Debt." *The Wall Street Journal*, 11 May 1990.
- Virata, C. "North-South Dialogue" [Interview with Cesar Virata], *Third World Quarterly* Vol. 6, No. 2 (1986): 272-81.
- Wallich, H.C. "Capital Movements - The Tail That Wags the Dog." In *The International Monetary System: Forty Years After Bretton Woods*. Conference Series No. 28, pp. 179-87. Boston: Federal Reserve Bank of Boston, 1984.
- Walter, I. "The Mechanisms of Capital Flight." In *Capital Flight and Third World Debt*, edited by D.R. Lessard and J. Williamson, pp. 103-128. Washington, D.C.: Institute for International Economics, 1987.
- Weiner, B. "Advice for Mrs. Aquino: Get Business on the Government's

- Side." *The New York Times*, 11 January 1987.
- Weisskopf, T.E. "The Impact of Foreign Capital Inflow on Domestic Savings in Underdeveloped Countries." *Journal of International Economics* 2 (1972): 25-38.
- Wellons, P.A. *Borrowing by Developing Countries on the Eurocurrency Market*. Paris: OECD Development Centre, 1977.
- WGBH Educational Foundation. "In Search of the Marcos Millions." Transcript of *Frontline* No. 511, broadcast by the Public Broadcasting System on May 26, 1987. Available from: WGBH Transcripts, 125 Western Avenue, Boston, MA 02134, U.S.A.
- Whitelaw, J. "Bolivia Crafts Buyback Plan for Bank Debt." *American Banker*, 11 May 1987.
- Whitman, M.V.N. "The Impact of the Debt Problem on International Trade." In *The Export-Import Bank at Fifty* edited by R.M. Rodriguez, pp. 87-96. Lexington, Mass.: Lexington Books, 1987.
- Wideman, B. "The Dizzying Pace of Expansion." *Far Eastern Economic Review*, 26 November 1976, pp. 54-55.
- World Bank, *Policies and Operations: The World Bank, IDA and IFC*. Washington, D.C.: World Bank, June 1971.
- _____. *The Philippines: Priorities and Prospects for Development*. Washington, D.C.: World Bank, 1976.
- _____. *The Philippines: Domestic and External Resources for Development*. Report No. 2674-PH, 12 November 1979.
- _____. *The Philippines: A Review of External Debt*. Report No. 4912-PH, 2 November 1984.
- _____. *World Development Report 1985*. New York: Oxford University Press, 1985a.
- _____. *World Debt Tables: External Debt of Developing Countries. 1984-1985 Edition*. Washington: World Bank, 1985b.
- _____. *The Philippines: A Framework for Economic Recovery*. 3 vols. Report No. 6350-PH, 5 November 1986.
- _____. *World Development Report 1987*. New York: Oxford University Press, 1987.
- _____. *Philippines: Toward Sustaining the Economic Recovery. Country Economic Memorandum*. Report No. 7438-PH, 30 January 1989a.
- _____. *World Debt Tables: External Debt of Developing Countries, 1988-89 Edition*. Washington, D.C.: World Bank, 1989b.
- _____. *World Debt Tables, 1989-90: External Debt of Developing Countries. Volume 2: Country Tables*. Washington, D.C.: World Bank, 1990.
- Zedillo, E. "Mexico." In *Capital Flight and Third World Debt*, edited by D.R. Lessard and J. Williamson, pp. 174-85. Washington, D.C.: Institute for International Economics, 1987.



This work is licensed under a
Creative Commons
Attribution – NonCommercial - NoDerivs 3.0 License.

To view a copy of the license please see:
<http://creativecommons.org/licenses/by-nc-nd/3.0/>