

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

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Statement by Mr. Legarda on the Philippines
Executive Board Meeting 82/61
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The basic strength and resiliency of the Philippine economy were tested by the prolonged and severe world recession and by a crisis of confidence in the domestic financial system in 1981.

Economic growth remained positive in both aggregative and per capita terms at 3.8 per cent (compared to 4.4 per cent the previous year and the 4 per cent target in the mid-term review of the 1981 stand-by). Continued growth in both manufacturing and domestic agriculture, despite some deceleration, was partly offset by adverse trends in mining and in agricultural exports under the impact of depressed world prices. It was calculated that the prices being received for metallic mineral exports no longer sufficed to cover extraction costs, and rather than see a closure of major and efficient producing entities for cyclical reasons, the authorities opted to set up a support fund for copper, one of the country's major exports.

Export prices for major primary exports experienced substantial setbacks, and with a slight decrease in quantum led to a 1.1 per cent decrease in overall exports. (Average prices tend to understate the extent of the fall, as the year-end levels were considerably lower than at the start of the year; see the attached table.) This occurred despite continued growth in non-traditional manufactured exports which, although slower than in the previous year, remained vigorous at 19% especially when projected against a background of stagnating world trade. It will be recalled from the WEO-Main Issues paper (ID/82/1) that imports by industrial countries actually declined for two consecutive years in 1980 and 1981, while the terms of trade for non-oil developing countries declined for four consecutive years from 1978.

Imports on the other hand rose by 2.9 per cent solely on account of higher prices, as import quantum actually dropped by 5.5 per cent. Nearly three-fourths of the increase in imports was traceable to oil, which accounted for 28 per cent of total imports, reflecting not so much the influence of demand on the oil bill but rather a fulfillment of contractual obligations to supplying countries. The terms of trade deteriorated by 5.4 per cent, accounting for virtually all of the current account deficit.

As to the external debt, while it is substantial, its servicing has not, even in the tightest periods, been an exceptional problem for the country since a monitoring system was set up in the early 1970s. It may be recalled that the Philippines is one of the few countries that monitors and publishes both its public and private external debt, whose maturities are well staggered over time, and that sets a self-imposed statutory limit on the debt service ratio, which will of course also be affected by factors beyond the authorities' control, such as low world demand for exports and high international interest rates.

Domestically, consumer demand was held down by the low prices for agricultural exports, in particular coconut products, with consequential effects on domestically oriented industries. Combined with the disturbances arising from the financial crisis, this led to a slowdown in private investment. For example, the combined net sales and/or revenue of the top 1,000 corporations dropped 12.2 per cent between 1980 and 1981, and the top 10 companies registered a combined loss of pesos 697.7 million in 1981 as compared to their combined profit of pesos 143.9 million in 1980.

Therefore, in order to keep up the momentum of growth, the authorities consciously adopted a compensatory fiscal policy. This policy had two aspects. One was to compensate for the under-performance of the year 1980, when growth projects were held back by unfamiliarity with budget processes of the newly-established Parliamentary system. Much of the lag was made up for in the following year. The other aspect of this policy is the normal one of offsetting recessionary trends by activating more public sector outlays. Expenditures were stepped up in the face of sluggish revenues, and the budget deficit went up to 4 per cent of GNP from its more usual levels in the previous four years of between 0.1 and 1.7 per cent of GNP. This is similar in magnitude to the average deficits of selected industrial countries since 1975 cited by the Managing Director in his March 16 speech to the American Enterprise Institute, except that in the Philippine case this figure clearly represents a counter-cyclical movement operative in the relevant phase of the business cycle. It is not slippage in the sense of expenditures inadvertently getting out of hand but rather, as reported in the staff paper, of a conscious policy decision, although it might be termed a slippage in the narrow context of a program that could not foresee all possible exogenous contingencies. The Philippine authorities consider this the appropriate stance to take in the cyclical context, and as the world pulls out of recession and revenues revive this figure is expected to decline.

The weak prices of major exports, the depression in domestic demand and investment, a prudent monetary policy and supply stabilization measures made possible a reduction in the inflation rate from 17.6 per cent to 12.4 per cent (countrywide indices) in the face of a continuous gradual depreciation of the Philippine peso.

The exchange rate was managed flexibly with a view to maintaining competitiveness, forestalling speculation, and avoiding undue pressure on the inflation rate. The continued growth of non-traditional exports, the reduction in the inflation rate, and the virtual absence of any black market premium on the exchange rate attest to the success of this management. The authorities are of the view that where a delicate balance must be struck among competing policy objectives, it would be prudent to maintain flexibility, especially in view of the questionable nature of some of the econometric contrivances purporting to measure competitiveness. In any event, these computations are of little relevance so long as other countries testify to the competitiveness of exports by protectionist restrictions.

The combination of exchange depreciation and a falling inflation rate may be more difficult to achieve in the future if the expected revival of world trade and primary prices materialize, as the staff appraisal recognizes the role of recession in bringing down the inflation rate. On the other hand, if they do, there would be more buoyant exports and less external constraints on growth, but also higher import demand reflecting the revival of private investment.

Growth remains the main objective of Philippines' economic policy. The widely anticipated recovery in the world economy should have favorable effects on exports, investment and economic activity, and should lessen the need for counter-recessionary action. Under these conditions adjustment would take the form of a gradual cutback in the budget deficit, a reduction in the balance of payments current account deficit, and a reduction in the inflation rate (provided this is not subverted by exchange rate developments). This adjustment is regarded as a medium-term effort, and requires a balancing of elements to make up a coherent and consistent program. Obviously the pace and timing of adjustment measures depend in large part on the international economic environment.

Everyone will agree that it is desirable to improve the balance of payments and growth performance, and to ensure that inflation continues to decline. The question is within what time period and with what combination of policies.

The staff appraisal correctly identifies the domestic financial crisis and severe international recession as the main factors behind the weaker aspects of economic performance in 1981.

What however is not always easy to follow is the recommended policy mix. With private investment sluggish, the recommendation is made to restrain public investment. This would appear to aim for higher growth with lower investment. It also seems to display a bias against public investment especially during a period of recession and slow private investment. The relative merits of public and private investment in different phases of the business cycle, and in various types of economies, might be argued, but in the end this would appear to be a socio-political decision to be made solely by the national authorities.

Likewise, having recognized that recession may have contributed to the marked decline of the inflation rate, no account seems to be taken of what might happen to this decline by following during an international cyclical upturn another recommendation in effect to continue the progressive devaluation of the currency. The various policy elements at best lie in uneasy juxtaposition and at worst might be said to be inconsistent.

Finally, little account seems to be taken of cyclical phases of economic activity. The last two lines of the second paragraph on page 19 speak of compensating "for the impact on government revenue of the sluggish economy". This would appear to be advocating a deepening of the recession by increasing taxes at the bottom of the business cycle. The implicit theory underlying this remark bespeaks a peculiar concept of compensatory policy. One would have thought that the situation should be judged the other way around, by how effectively programs could be mounted to compensate for a cyclical downturn.

The Philippine authorities recognize that adjustment will come willy nilly, and they are determined that it should be growth-oriented adjustment for, has been observed in another context, there can be no adjustment without growth. For those of us who lived through the war and occupation years, the stationary state was not a textbook construct; it was an existential reality. This kind of unilateral no-growth adjustment can be undertaken at any time by any country, with stagnationist consequences that no one seriously advocates.

But adjustment with growth needs multilateral action and international cooperation. It needs a revival internationally of economic activity and trade, a rational interest rate policy, and more stable exchange rates. With the fundamentals present, economies like those of the Philippines can perform well. And even without them, they will perform somehow: since the Second World War there has not been any year in which Philippine economic growth was negative. But it is quite clear that an economy can perform best if it is given a good international environment. The Philippines is doing its part in this environmental effort. Despite the present inauspicious phase of the business cycle, it is continuing its program of liberalizing trade and reducing tariffs. It can only hope that the leading economies of the world likewise turn away from protectionism and trade barriers, and give freer play to competitive commercial currents.

Attachment

PHILIPPINES: Export Unit Values, Selected Primary Products

1981 (Quarterly)
(U.S. Dollars per metric ton)

	<u>Copra</u>	<u>Sugar</u>	<u>Copper Concentrates</u>	<u>Abaca</u>
I	363.12	495.10	409.42	662.98
II	300.95	464.06	396.50	643.98
III	319.40	459.16	367.46	561.13
IV	226.70	394.97	341.47	565.06

SOURCE: Department of Economic Research, Central Bank of the
Philippines

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