A Review of the Government Response to the Balance-of-Payments Crisis

PIDS
Monograph Series
No. 8

A Review and Appraisal of the Government Response to the 1983-84 Balance-of-Payments Crisis

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ISSN 0115-9194

Printed in the Philippines by SBA Enterprises

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List of Abbreviations

ACDFOBN	—	Average cost of daily food and other basic necessities
BOI	—	Board of Investment
BOE	—	Board of Energy
BOP	—	Balance of Payments
CB	—	Central Bank
CPI	—	Consumer Price Index
DBP	—	Development Bank of the Philippines
EO	—	Executive Order
GDP	—	Gross Domestic Product
GNP	—	Gross National Product
IMF	—	International Monetary Fund
LRTA	—	Light Rail Transit Authority
MERALCO	—	Manila Electric Company
MOLE	—	Ministry of Labor and Employment
MPWH/MTC	—	Ministry of Public Works and Highways/Ministry of Transportation and Communications
MWSS	—	Manila Waterworks and Sewerage System
NCSO	—	National Census and Statistics Office
NDC	—	National Development Corporation
NEDA-NAS	—	National Economic and Development Authority-National Accounts Staff
NEDA-SCO	—	National Economic and Development Authority-Statistical Coordination Office
NIA	—	National Irrigation Administration
NPC	—	National Power Corporation
NWC	—	National Wages Council
OECD	—	Organization for Economic Cooperation and Development
PD	—	Presidential Decree
PNB	—	Philippine National Bank
PNOC	—	Philippine National Oil Company
PSC	—	Price Stabilization Council
WO	—	Wage Order
WPI	—	Wholesale Price Index

FOREWORD

The 1983-84 Philippine balance-of-payments crisis affected all sectors of the economy and all segments of society as it manifested itself in the growing unemployment and underemployment problems, in the all-time high inflation rates, and in the unprecedented contraction of the economy.

Many studies have been conducted and published about the underlying causes of the economic crisis, but few have looked into the government's response to it, as well as into the impact of this response on such concerns as growth, employment and inflation.

This study attempts to document and critically evaluate the various stabilization measures adopted by the Philippine Government in response to the 1983-84 balance-of-payments crisis. A number of research fellows and consultants at the Philippine Institute for Development Studies have combined their efforts and expertise, and put together this comprehensive and objective examination of the measures adopted by the Government as a direct reaction to the crisis and of their effects on the growth prospects of the economy in the short and medium term.

It is hoped that this Monograph will provide useful insights into Philippine economic planning and policy making.

FILOLOGO PANTE, JR.
President

ACKNOWLEDGMENTS

The authors are grateful to Dr. Ponciano Intal of the College of Development Economics and Management (CDEM) of the University of the Philippines at Los Baños; Dr. Florian Alburo of the University of the Philippines School of Economics; Mr. Romeo de Vera of the Office of Budget and Management; and Ms. Purita Neri of the Central Bank for their very useful and insightful comments on the earlier draft.

The authors are likewise grateful to Aleli de la Paz, Anicia Sayos, Emilynn Lorenzo and Evangeline Yu for their research assistance, Lilia Santiago for editorial assistance and Victoria Doctora for typing the manuscript.

SUMMARY AND CONCLUSIONS

The balance-of-payments (BOP) difficulties of the country have long historical roots. The economy has been characterized by persistent and increasing current account deficits since 1975. Although external factors, such as the rapid deterioration in the terms of trade and the slowdown in the demand for exports could be cited as contributory factors, domestic policies played a significant role in creating the 1983 economic crisis. The exchange rate, which was to a large extent influenced by Central Bank (CB) intervention, was inconsistent with movements in relative prices, thus encouraging more imports and discouraging exports. Both fiscal and monetary policies were decidedly expansionary since 1981. External borrowings at high interest rates were resorted to in order to finance the growing savings-investment gap. This strategy was sensible in the 70s when conditions in the international financial markets were relatively favorable, but not in the 80s when OECD countries started to pursue a tight monetary policy and major international banks became more cautious in lending as a result of defaults experienced by a number of less developed countries.

Interestingly, against the background of persistent and growing current account and bulging budget deficits, the Philippines embarked on a liberalization program in the early part of the 1980s. In 1981, a tariff reform program which aims at eventually reaching a more uniform tariff system in the range of 20 to 30 percent was instituted. Financial reforms were likewise introduced about the same time. Deregulation of interest rates, narrowing functional distinctions among different types of financial institutions, and reduction of reserve requirement ratio were among the significant financial reforms. However, a development that runs counter to the liberalization program was the phenomenal growth of the government corporate sector, particularly in the early 80s. This took two forms. One was in the massive investments undertaken by existing government corporations. Another was the takeover by government through its various instrumentalities of the so-called "vital industries" and the rescue of several big distressed corporations. Thus, government corporations, particularly the thirteen non-financial and three financial corporations, incurred huge deficits which exerted pressures on the national budget. These were reflected as transfers and contributions of the national government to the public corporate sector. In the final analysis, this resulted in rising government spending, causing rising real deficits and real excess demand.

The balance-of-payments difficulties became clearly unmanageable in the first half of 1983. The eroding confidence in the economy and the political system further aggravated the problems. The Aquino assassination and the CB disclosures on the international reserves were two major market surprises that resulted in greater dislocation since they were not predicted and properly discounted by the market. Thus, when international lending institutions ceased further lending to the Philippines and called in their maturing loans in the second half of 1983, the Philippines was catapulted into its worst balance-of-payments crisis unprecedented in its post-war history. This clearly called for an immediate response from the government.

The various stabilization measures adopted by government in response to the BOP crisis were not introduced at the same time. Rather, they were spread throughout the period 1983-84. It is believed that all the necessary stabilization measures were already in place by December 1984. This does not, however, mean that the crisis period is already over.

This study has attempted to document and critically evaluate the various stabilization measures adopted by government in response to the 1983-84 BOP crisis. Specifically, it has examined the measures adopted by government to improve the balance of payments, to manage budget deficits and growth of reserve money, as well as the price and wage adjustments effected throughout the period 1983-84. Their effects on the overall balance of payments, inflation, output and employment have also been investigated. The major findings are summarized below.

Measures Adopted to Improve the Balance of Payments

The immediate policy responses of government were directed at the external sector. To discourage imports and arrest further capital flight, the peso was devalued three times between June 1983 and June 1984. Finally, a free float was declared in October 1984.

The adjustments in the exchange rate were accompanied by severe foreign exchange restrictions and wide ranging import controls which include, among others, the creation of a foreign exchange pool for priority import payments by requiring banks to sell 100 percent of their foreign exchange receipts to the Central Bank and the setting up of priorities in the allocation of foreign exchange. However, towards the last quarter of 1984, the Central Bank abolished the foreign exchange priority allocations program for imports and allowed banks to hold 30 percent of their outstanding regular letters of credit.

New trade taxes were also imposed, effectively raising the prices of importables. Ad valorem duty on all importations was raised by 10 percent in June 1984. In addition, a special excise tax of 10 percent was imposed on foreign exchange sold by the Central Bank and its agents in June 1984. This was subsequently replaced by the foreign exchange transaction tax of 1 percent in October 1984. The economic stabilization tax of 30 percent was imposed on all exports in June 1984 but was later suspended in September 1984.

These measures have immediate effects on the real price of foreign exchange. The series of *de facto* devaluations have raised the real effective exchange rate from an index of 97.74 in 1982 to 112.90 in 1984 (1973=100). Correcting the appreciation of the dollar for the additional import tariff and export taxes and comparing the resulting net effective change in the exchange rate with the changes in domestic costs, represented by GDP deflator and wage index show that it was not until June 1984, when the peso was devaluated to ₱18 to a dollar, that net advantage for traditional and non-traditional exports could be discerned. The lifting of the stabilization tax and the floating of the peso could have considerably improved the net effective change in the exchange rate for both traditional and non-traditional exports, had GDP deflator not risen more sharply, eroding some of the benefits from net devaluation. For importables, the net effective change in the exchange rate has been generally favorable, implying that producers of import substitutes have benefitted from the peso devaluation. Overall, the recent *de facto* devaluations should have favorable effects on trade balance.

Additional tariffs and export taxes have virtually reversed the trade liberalization process initiated in 1981. Interestingly, the commodity groups included in the CB list of priorities are also the ones previously enjoying low import tariffs and priority in foreign exchange allocations. Since foreign exchange allocation by government effectively acts as quantitative restrictions on imports, then the measures adopted by government in response to the crisis give more protection to heavily protected import substitutes while penalizing less protected sectors (e.g., exports).

Clearly, the emergency measures taken to manage the BOP are contrary to the long-run goal of rationalizing the protection structure which would have eliminated the unjustified penalties against non-traditional exports and efficient import substitutes. Further, the measures, although effective in curing balance-of-payments difficulties, have widened the variation of effective rate of protection that could increase the cost of balancing the foreign exchange budget in the long-run.

Measures Adopted to Manage the Budget Deficits

The efforts to manage budget deficits consist of raising government revenues and controlling the growth of expenditures. Between June 1983 and July 1984, the additional revenues were mainly sourced from the external sector by increasing the specific tax on petroleum products, tariff duties, export duties and by imposing economic stabilization tax on exports. As the need to raise more revenues was felt, another set of revenue raising measures was put in place between August and October 1984. The new measures have two distinguishing features. One is that the additional tax burden has been shifted from the external sector to the internal sector. The other is that exemptions previously enjoyed by certain industries and some individual entities, including government corporations like National Power Corporation, have been withdrawn. Thus, the efforts to raise revenues consist of increasing tax rates and widening the tax base. The estimated revenues from the new tax measures constitute 0.5, 1.3 and 2.7 percent of GNP in 1983, 1984 and 1985, respectively.

Cash disbursements of the national government fell slightly short of the original cash disbursement program in 1983, but they went beyond by 21.5 percent in 1984. Actual cash disbursements in nominal terms increased by 1 percent in 1983 and 28.9 percent in 1984. Capital outlays, specifically the MPWH/MTC capital outlay and corporate equity, suffered huge cutbacks in 1983 and 1984. Net lending is a problem area in both years in terms of resistance to cutbacks, mainly because of pressures from the financially-strapped government corporate sector. The thirteen major non-financial government corporations posted combined deficits of ₱15.7B and ₱12.3B in 1983 and 1984, respectively. Likewise, government financial corporations, particularly DBP, PNB and Philguarantee incurred huge deficits, reaching ₱12.7B in 1984.

Taken as a whole, the efforts initiated by the national government to manage its budget deficits produced some favorable results. Total budget deficits as a percent of GNP went down from a high 4.28 in 1982 to 1.69 and 1.58 in 1983 and 1984, respectively. While these cuts in budget deficits are impressive by international standards, the accompanying adjustment costs have however produced some perverse redistribution effects as may be shown later.

Response to the Crisis in the Monetary Sector

In contrast to 1982, monetary policy during the period 1983-84

shifted in the direction of disinflation and credit restraint. The effort was focused mainly on reducing the money multiplier and putting a cap on the growth of reserve money. Reserve requirements on deposit liabilities of banks were increased from 18 to 24 percent. The Central Bank has practically closed the subsidized rediscounting windows since the crisis began. Further, by pegging the rediscount rates on the Manila Reference Rate, which is in turn based on actual transactions, rediscount accommodation has been made more an instrument of short-run stabilization and less an instrument for development financing. The Central Bank also introduced the CB bills to help mop up excess liquidity. Although the unprecedentedly high rates offered on these bills seemed to have arrested capital outflows that might have put pressure on the peso, they induced high interest rates in the whole system, resulting in massive decline in trade and inventory financing. Finally, policies to restrict the use of foreign loans were instituted.

The high growth rate in reserve money during the period of analysis seems to indicate inflationary monetary policy. Revaluation effects that bloated net domestic assets were mainly responsible for the massive increase in reserve money. It is reasonable to view the revaluation effect as non-discretionary within the immediate crisis period. After removing the revaluation effect, the net domestic assets component of monetary base actually increased by only 5 percent between June 1983 and June 1984 and only 8 percent in the first nine months of 1984. The inescapable conclusion is that in the period when inflation exceeded 40 percent, discretionary monetary policy has been disinflationary, especially on net domestic credit. It is the distribution of the burden of adjustment of these discretionary actions that is important. In this regard, the bias toward placing a greater burden on the private financial sector becomes obvious. In the twelve-month period between June 1983 and June 1984, net credit to the public sector grew by 88.5 percent while that to the financial system fell by 34.4 percent. The latter recovered to the December 1982 level only in September 1984.

The increase in net credits to the public sector took the form of budgetary loans and overdrafts which were resorted to in the wake of government revenue shortfalls. On the other hand, the reduction in net lending to deposit money banks took the form of a reduction in rediscounting and the effect of open market operations when the Central Bank issued reverse repurchase instruments.

There was an increase in net lending by the Central Bank to "other financial entities," a category that includes private thrift banks as well as government specialized banks. But the increase was

mainly due to the emergency loans provided thrift banks in response to massive withdrawals by depositors and the effort to keep DBP functional.

Price and Wage Adjustments

For the past decade, socialized pricing has been used extensively in basic commodities — such as rice, corn, chicken, eggs, sugar, etc.— petroleum products, electricity and apartment rental. In view of the series of *de facto* devaluations effected between 1983 and 1984, prices of these commodities were adjusted upwards. For example, support price for palay went up by 97.1 percent from June 1983 to December 1984. Domestic price of petroleum products rose by 129.7 percent on the average for the same period.

The long-standing policy of price control, however, was reversed during the last quarter of 1984. As of November 1984, rice is the only item that has remained in the PSC list of controlled commodities. In addition, subsidies to low-income consumers are going to be reduced gradually over a period of time. The current policy of deregulation is to remove distortions that have been created by previous price controls and to assure efficient allocation of scarce resources. It is expected that in the long-run, supply of basic commodities will be adequate, thereby stabilizing their prices.

The inflationary pressures due to the recent peso devaluations and increased tax rates have prompted government to adjust legislated money wages (which include basic pay and allowances) upwards five times between June 1983 and November 1984. Between July 1983 and June 1984, increases in legislated money wages were commensurate to the increase in prices for the same period. This development seems to indicate that government's wages policy was directed towards protecting real wages of minimum wage workers. However, starting in July 1984, real wages started to decline. This trend was reversed in November 1984 when a new wage order was introduced. However, the increase was not enough to compensate for the loss in purchasing power due to inflation since the last wage adjustment effected in June 1984. Workers not covered by wage legislation could have been worse off. The results of NEDA-SCO's Survey of Key Manufacturing Enterprises show that the rate of increase in the compensation of employees in 1984 was less than one-half of the inflation rate for the same year, indicating that employees of key enterprises suffered a substantial cut in their real wages.

One related policy concern is the sufficiency of wages. When legislated money wages are compared with the National Wages

Council's estimates of the average cost of daily food and other basic necessities, it appears that for a household with two minimum wage workers, the basic food needs can be met but not all the other basic needs.

Coverage and compliance of legislated money wages are other areas of concern. Available information shows that only 23 percent of those employed in 1983 are minimum wage workers. In addition, violation of wage orders is observed to be prevalent, an unfortunate situation aggravated by the lack of inspection teams from the Ministry of Labor and Employment.

A related concern is the relative impact of wage legislation on different firms. While these laws are introduced to improve the welfare of low-income earners, they may prove to be inequitable in the sense that efficient firms, which are not exempted from, and really follow strictly, the wage orders, are the ones penalized.

Effects of the Various Measures on Balance of Payments, Inflation, Output and Employment

Although it is too early to assess the full effects of the different policy measures on the overall balance of payments, some indications can already be gleaned from available information. Looking at the trade balance, some amount of success seemed to have been achieved. The deficit in the current account was reduced drastically by 43.8 percent during the first three quarters of 1984 as compared to the same period in 1983. This was mainly due to the large cutback in imports since exports achieved only a modest growth in the same period.

While traditional exports fell, non-traditional exports increased, netting an 8.5 percent growth rate for the total value of exports during the first three quarters of 1984. A qualification must be made here, however. Electronics and garments, which are the main non-traditional exports, have very low value added so that the benefits of devaluation could not be fully exploited by these industries.

Total imports, on the other hand, declined by 20 percent from the first three quarters of 1983 to the first three quarters of 1984. As expected, imports of capital goods suffered the biggest cutback. The cutback on total imports could be attributed mainly to the exchange controls, the series of *de facto* devaluations and tight monetary and fiscal policies which effectively dampened demand.

The present crisis has produced an inflation problem more severe than that caused by the oil shocks in 1974 and 1978. The

CPI started to climb in June 1983, when the peso was devalued to ₱18 to a dollar, reaching a peak at 63.8 percent in October 1984.

Various factors have contributed to the upward movement of the CPI. Using an inflation model, the additional tax on petroleum products added 0.1 percentage point to the inflation rate in 1983 and 4.8 percentage points in 1984. Import surcharge had a very minimal effect on inflation rate, 0.01 percentage point in 1983 and 0.47 percentage point in 1984. The increases in the price ceiling of basic commodities contributed 0.05 percentage point to the 1983 inflation rate and 0.65 percentage point to the 1984 inflation rate. The 5-step adjustments in the prices of petroleum products since June 1983 resulted in an additional increase of 1.46 percentage points in the 1983 inflation rate and 13.61 percentage points in the 1984 inflation rate. The series of wage adjustments since June 1983 contributed 0.47 percentage point to the increase in the 1983 inflation rate and 3.75 percentage points in the 1984 inflation rate.

The credit crunch sent interest rates up high, especially in 1984 when the Central Bank introduced the high yielding CB bills. The 91-day Treasury bill rate (which was used as a proxy for all the rates) added 1.04 percentage points to the 1983 inflation rate and 7.81 percentage points to the 1984 inflation rate. Total liquidity contributed 0.19 percentage point to the 1983 inflation rate and 6.66 percentage points to the 1984 inflation rate. Among the explanatory variables in the inflation model, total liquidity obtains the highest long-run elasticity of 0.76.

As discussed above, both fiscal and monetary policies generally tended to be deflationary, especially towards the second half of 1984. This development has certainly produced unfavorable effects on output and employment.

The agricultural sector posted negative growth rates starting the second quarter of 1983 up to the first quarter of 1984. The industrial sector started to yield negative growth after the first *de facto* devaluation in 1983 and has never recovered since then. The service sector suffered the same fate. While the economies of other ASEAN countries grew at an enviable rate in 1984, the Philippine economy shrank by 4.0 percent (GDP) in the same year, given the same international environment.

The general slowdown of the economy has indeed posed a great problem to labor absorption. The number of workers terminated as a result of shutdown/retrenchment increased from 75,428 in 1983 to 86,186 in 1984. Massive layoffs occurred in the manufac-

turing sector. Unemployment rate went up from 4.6 percent during the third quarter of 1983 to 6.2 percent during the third quarter of 1984, while underemployment rate rose from 30.1 percent to 36.5 percent for the same period. The view taken in this study is that the increase in unemployment and underemployment rates is not the direct result of increases in legislated money wages. Instead, other factors, specifically lack of raw materials resulting from import controls, tight monetary and fiscal policies and a slump in demand, weigh more heavily in the decision of employers to lay off some of their workers. Since the adjustment measures need some time to produce favorable effects on output and prices, sectors heavily dependent on government expenditures and imported raw materials as well as the labor sector will continue to feel the pain brought about by the measures.

Several conclusions can be drawn from the results of the study. These are discussed below not necessarily in the order of their importance.

1. When the crisis struck, policy measures taken by government became very restrictive and mostly oriented towards putting more control on the external sector. But as the need to obtain the standby credit agreement with the IMF became more pressing, the government began using the orthodox policy instruments, which include, among others, greater control of reserve money, reduction of budget deficits, fully flexible exchange rates, freeing of prices, reduction of newly introduced import and tariff duties, allowing real wages to decline, and withdrawal of tax exemptions and subsidies. The latest package of stabilization measures has at least two distinguishing features. One is that it includes measures such as freeing of prices and doing away with subsidies that might not have been introduced had the crisis not cropped up. The other is that it has strong long-term components, relying more on the free market system. Both features suggest that the government is moving towards restructuring the economy.

2. The measures adopted were aimed at restricting aggregate demand to curb the rate of price increases and reduce the balance-of-payments deficits. So far, modest success has been achieved with regard to the latter. Admittedly, direct exchange controls were considered a critical factor in improving the balance-of-payments position during the period considered. But with regard to moderating the inflation rate, all indications seem to show otherwise. It should be noted that during this high inflationary period, the government made a series of *de facto* devaluations and pursued a tight monetary policy which was responsible for the sharp rise

in interest rates. These can be reasonably viewed as supply shocks that eventually affected prices of final output within the immediate crisis period. In this regard, one might be tempted to claim that the inflation is of the cost-push type, and policies restricting demand may not be appropriate. However, the reading that one can get from the package of policies is that inflation seems to be regarded as a symptom of the improper working of the economy. The restructuring of the economy sought by the policy measures will, in the long-run, provide a stronger economy with more stable price movements. The presence of "effect lag," that is, the time that elapses between the variation of the instrument of control and its actual effect on any one of the targets, explains why inflation rate was not moderated during the time that the measures were introduced.

3. One controversial aspect of the monetary policy response to the crisis had to do with the raising of domestic interest rates. This policy was carried out through the role of government securities which paid high interests. The effectiveness of this strategy in defending the exchange rate cannot be questioned. What can be questioned is its place in the current recovery program. The policy instrument used induced high domestic interest rates which put at risk the survival of companies whose difficulties endanger the adjustment effort itself. Moreover, resources would not flow into new real investment unless rates of return are at least as high as those prevailing in the financial markets. The old exchange rate system and government budget deficits were important contributory factors to the crisis. That the constraints in the removal of these sources of trouble might have caused further permanent damage during the recovery period is a matter of concern.

4. There seems to be some rigidity in the budget process. Specifically, net lending by the government is found to be resistant to cutbacks. This is so because the government regards this item as endogenous; that is, whenever the public corporate sector incurs some deficits, the government will likely absorb them. This in effect allows the public corporate sector to proceed with their expenditure program without undergoing the normal processes that ordinary government agencies are subjected to whenever a budget allocation is requested from the national government. Better management of budget deficits, therefore, requires firmer control of net lending provided to the government corporate sector. Perhaps, together with the stabilization measures, efforts to develop the private capital market might be exerted. Initial funds will have to come from the government, perhaps using the proceeds from the sale of corpora-

tions and the funds that might have been needed for net lending, and from the Central Bank. Once instituted, government corporations, under a policy of self-financing, may be required to borrow from the capital market to finance their requirements, instead of going to the government. This program will achieve three objectives. First, it will help develop the moribund capital market. Second, it will force government corporations to be efficient to be able to compete with the private sector. Third, it will give government greater control over its budget since the net lending item will virtually disappear from its budget program.

5. It is to be noted that the stabilization measures have a profound effect on output and employment. Although in the long run they promise high sustained growth in output and greater employment, in the short-run however, the economy has to content itself with reduced output and employment. Indeed, the distributive effects of reduced output and employment are very unsettling issues.

The series of *de facto* devaluations and the eventual freeing of the foreign exchange market have certainly improved the relative price of tradables vis-a-vis non-tradables, thus favoring the export sector and the import-substituting activities. However, during the period of tight exchange controls, the measures adopted were such that the heavily protected import-substituting activities got more protection while the export sector was penalized even more. Thus, even between the two economic activities, distributive effects of exchange rate adjustments were uneven in view of the various exchange controls.

The imposition of additional import tariffs and export duties has certainly shifted resources to the government sector. While the additional import tariffs and duties were subsequently reduced towards the last quarter of 1984, still the amount that went to the government in absolute terms was substantial in view of the exchange rate adjustments. To the extent that government has a very low savings propensity, the shift of resources towards the government sector could be inflationary.

The discretionary actions of the monetary authorities were disinflationary during the crisis period. However, monetary policies seem to have been directed at maintaining failing government corporations (such as DBP) and making up for the sudden revenue shortfalls of the government. Indeed the massive increase in lending to the public sector and to government financial institutions during the same period required an equally massive withdrawal of credit to the private sector. There is no doubt that this credit withdrawal

reduced domestic spending, a goal of the stabilization program. The question of whether this reduction should have been borne more by the government can however be raised. Were the purposes to which government applied the credit truly crucial? If the credit went to non-productive or non-viable projects, then monetary policy could have further led to a reduction in output and employment than it otherwise would have been.

The way in which budget deficits are reduced determines to a large extent the distributive effects of fiscal adjustments introduced during the crisis period. The government opted to increase tax revenues and moderate the growth of expenditures to reduce budget deficits. To increase tax revenues, the government increased the tax rates and broadened the tax base. The distribution of the burden of the new tax measures indeed raises great concern. The observed pattern of changes in the specific tax on petroleum products seems to indicate that low income earners are penalized more heavily than high income earners. The withdrawal of tax exemptions and subsidies from utilities have also regressive distributive effects. Thus, the increase in taxes, together with the inflation tax, definitely hurts the low income earners.

The way in which government disposes its funds has also distributive effects. The government opted to reduce capital outlays, particularly public investment in infrastructure. This added more unemployment, mostly among unskilled and semi-skilled workers, since this sector is labor-intensive. On the other hand, the government increased net lending. This benefitted the government corporate sector which is relatively more capital-intensive. Thus, the expenditure pattern of government also tends to have regressive distributive effects.

One final conclusion that can be drawn from the results of the study is that the crisis has occasioned the huge shift of real and financial resources towards the government sector. Both monetary and fiscal policies adopted have facilitated such shift. This development has definitely made the size of the government sector in the economy even bigger. However, consistency with the long-run bias of the stabilization measures requires a smaller public sector relative to the private sector. This means that the government will eventually have to return the so-called "vital industries" and distressed corporations recently taken over by government to the private sector. But divestment of these assets would not be an easy task during this period. In fact, the government is caught in a real dilemma. By taking over capital-intensive industries and by infusing additional capital to rehabilitate distressed corporations, the govern-

ment has in effect increased the value of these firms. Indeed, the size of the capital alone can serve as an effective deterrent for the financially-starved private sector to buy back the said corporations. This is further complicated by the prevailing high interest rates on borrowed funds which would make re-acquisition of those corporations unnecessarily expensive. Unless these corporations will be grossly undervalued, the private sector will not be attracted to buy back these corporations. This, of course, would result in huge losses for the government, a development hardly acceptable in view of the current efforts to streamline government's budget deficits.

Chapter I

INTRODUCTION

The 1983-84 balance-of-payments crisis has, thus far, been the worst in Philippine post-war history. Forced to make do with severely limited foreign exchange, vital both for consumption and industry, the economy suffered a negative GDP growth rate of 4 percent in 1984, record high inflation rates in the order of 50 percent and massive unemployment. Although few people doubt that the Philippines will survive the crisis, there are differing views regarding how a real recovery could be achieved and when. In the meantime, the government has had to initiate emergency measures to alleviate the effects of the crisis as well as institute plans for recovery. On the other hand, the International Monetary Fund, representing the Philippines' major lenders, has been on the government's heels, imposing strict requirements regarding major government policies -- most notably on exchange rate, money supply, government expenditure and taxation. Although it may still be too early for the full effects of these measures to become visible, enough time has passed to discern what they possibly are. Now is the opportune time to pause and examine how beneficial these measures have really been.

It is the main objective of this study to review and evaluate the measures which have been instituted by the government during the period 1983-84 in response to the 1983 balance-of-payments crisis. It attempts to shed light on the following questions:

1. What was the rationale for the institution of specific measures?
2. How consistent were these measures with one another? With long-run growth objectives?
3. What are the likely impacts of these measures on output, employment and prices?
4. Who bears the burden of adjustments?

The study does not claim to be comprehensive nor strictly rigorous. The availability of recent and pertinent data imposes a severe limitation.

The next chapter of this study provides a brief background on the Philippine economic performance during the period 1975-1982. This aims to help in understanding the context of the various policy measures. Chapter III gives an overview of government response to the economic crisis. Chapters IV and V contain the body of study. Chapter IV gives a critical analysis of the policy measures

in the 5 major areas – (a) balance-of-payments management, (b) budget deficit management, (c) monetary policy, (d) price adjustments, and (e) wage adjustments. Chapter V then attempts to examine the effects of these measures on (a) balance-of-payments, (b) inflation, and (c) output and employment.

Chapter II

PHILIPPINE ECONOMIC PERFORMANCE, 1975-82

This chapter briefly reviews the major economic developments that took place during the period 1975-82. Hopefully, this will lead to a better understanding of the measures adopted by government authorities in response to the 1983-84 BOP crisis. A more detailed analysis of the balance-of-payments difficulties experienced by the Philippines can be found in Pante (1983), Power (1983), Remolona, Mangahas and Pante (1984), and Intal (1984).

Table II.1 presents selected economic indicators for the Philippines from 1975 to 1982. The economy was characterized by persistent and increasing current account deficits, rising from US$892M in 1975 to a high US$3,200M in 1982. A significant contributory factor to the current account imbalance was the rapid deterioration in the terms of trade. The net terms of trade index fell from 100 in 1972 to 58.7 in 1982. Demand for exports also slowed down considerably during the same period, especially after the second oil shock when most major trading partners underwent a prolonged recessionary period. Power (1983) estimated that during the period 1973-82 about 78 percent of the total external shocks can be attributed to the deterioration in the terms of trade and the remaining, to the effects of world recession.

Since net inflow of direct foreign investments was very minimal during the period, the current account deficits were financed mainly by foreign borrowings. External debt outstanding increased from US$3,799M in 1975 to a staggering level of US$17,469M in 1982. As a share of GNP, total external debt outstanding converted into pesos rose from 24.1 percent in 1975 to 47.7 percent in 1982. During the period 1975-80, total external debts were almost equally shared by the private sector and the public sector, but the latter's share increased dramatically to 58 percent in 1981 and stayed at 57 percent in 1982.

The relatively favorable conditions in the international financial markets after the first oil shock made the use of external borrowings possible to cushion the impact of current account imbalance on the overall BOP position. With easy international credit, the share of medium and long term loans rose from 78 percent in 1975 to 84.6 percent in 1977, and stayed above 80 percent until 1979. Government authorities took this opportunity to beef up international reserves. But after the second oil shock, OECD countries pursued a tight monetary policy. This dried up the loanable funds in the

international market, pushed interest rates upwards and shortened the period for loan maturity. This has a perceptible effect on the external debts outstanding of the Philippines. The share of medium and long term loans in total external debts went down to 74.5 percent in 1982 as the share of short term loans went up to 25.5 percent in the same year. The growing share of short term loans together with the sharp increase in the interest rate further aggravated the BOP problems in the later years.

The chronic current account deficits since 1974 clearly called for prudent management of both the external and internal sectors. Apparently, this was not pursued by government authorities. Adjustment of the nominal exchange rate allowed by the Central Bank was very minimal during the period despite adverse developments in the current account balance and accelerating domestic inflation rate. This can be gleaned from the moderate increase in the official effective exchange rate index from 100 in 1973 to 115.68 in 1982. With the Philippines experiencing a higher inflation rate than its major trading partners, the real effective rate index consequently went down to 87.74 in the same period, indicating a real appreciation of the peso. The overvalued domestic currency definitely encouraged imports and discouraged exports.

Rather than pursuing a deflationary policy to correct the chronic current account imbalance, government authorities opted for a fiscal and monetary expansionary posture. The acceleration of the investment rate, combined with a sluggish growth in the savings ratio, which was partly due to the unfavorable interest rate policy and cheap rediscounting policy of the Central Bank, further widened the savings-investment gap from -7.1 percent in 1975 of GNP to -8.7 percent in 1982. Indeed, the rapid increase in government capital expenditures during the same period contributed significantly to the savings-investment gap.

The national government has been running huge deficits since 1975. Interestingly, the deficit was kept below 2 percent of GNP up to 1980. However, it shot up to 4.0 percent and 4.3 percent in 1981 and 1982, respectively, as a result of the downward trend in government revenues and an increasing government expenditure program. Although national government revenues were growing in absolute terms, they exhibited a perceptible and worrisome downhill movement when expressed as a proportion of GNP in the period 1975-1982 (see Tables II.2 and II.3). From a high 14.7 percent of GNP in 1975, national government revenues averaged 13.4 percent of GNP in 1976-1980 and fell to an average of 11.6 percent of GNP in 1981 and 1982. As a percentage of GNP, non-

Table II.1

SELECTED ECONOMIC INDICATORS, PHILIPPINES
1975-1982

	1975	1976	1977	1978	1979	1980	1981	1982
1. Real GDP Growth Rate (%)	6.6	6.7	6.0	6.2	6.7	4.9	3.8	3.0
2. Inflation Rate (1978=100)								
Consumer Price Index (%)	6.9	9.7	9.4	7.5	17.5	18.2	13.1	10.2
GDP Deflator (%)	8.0	9.6	9.4	7.4	15.2	15.5	11.1	8.4
3. BOP Indicators (US$M)								
Current Account Balance	-892	-1,050	-752	-1,102	-1,497	-1,904	-2,061	-3,200
Overall BOP Position	-521	-161	164	-54	-570	-381	-560	-1,621
4. Trade and Exchange Market								
Net Terms of Trade (1972=100)	87.8	77.7	71.0	78.8	81.6	68.6	60.4	58.7
Exchange Rate								
Official Nominal (₱/US$)	7.25	7.44	7.40	7.37	7.38	7.51	7.90	9.17
Real Rate (₱/US$)	8.13	7.16	6.65	6.70	7.04	7.04	6.68	6.53
Official Effective (1973=100)	104.87	103.48	101.68	103.60	105.46	109.31	111.05	115.68
Real Effective	92.34	89.03	86.86	88.31	85.84	87.16	87.17	87.74
5. External Debts								
Total (US$M)	3,799	5,517	6,563	8,195	9,778	12,700	14,826	17,469
Short Term (%) [a/]	22.0	20.5	15.4	16.6	19.0	24.1	24.0	25.5
Medium- and Long-Term (%)	78.0	79.5	84.6	83.4	81.0	75.9	76.0	74.5
Total/GNP (%)	24.1	31.2	31.1	33.9	32.5	36.0	38.7	47.7

Table II.1 (Con't . . . . .)

	1975	1976	1977	1978	1979	1980	1981	1982
6. Public Finance Indicators								
Government Surplus/Deficits	-1,360	-2,138	-2,852	-2,167	-342	-3,387	-12,146	-14,405
Deficits/GNP (%)	1.2	1.6	1.8	1.2	0.2	1.3	4.0	4.3
7. Monetary Aggregates (Growth Rates)								
Money Supply (M1)	14.5	17.1	23.7	13.4	11.2	19.6	3.5	0.8
M1-GNP	8.7	11.0	16.7	6.6	4.4	15.2	-0.3	-2.0
Total Liquidity (M3)	19.2	24.3	22.4	18.0	10.6	18.2	15.8	21.3
M3-GNP	13.4	18.2	15.4	11.2	3.8	13.8	12.0	18.5
8. Unemployment Indicators								
Unemployment Rate (%)	4.2	5.2	4.5	4.0	4.3	4.3	5.2	4.4
Underemployment Rate (%)		25.5	20.0	21.7	21.9	21.8	28.8	33.1
9. Legislated Nominal Wages (P/day)								
Non-agricultural, NCR[b/]	10.65	12.61	15.19	16.28	23.20	29.85	31.82	31.82
Non-agricultural, Outside NCR	10.65	11.73	14.11	15.19	22.12	28.76	30.74	30.74
Agricultural, Plantation	7.13	9.56	11.94	13.03	19.15	24.70	26.18	26.18
Agricultural, Non-Plantation	7.13	8.48	10.86	11.94	14.90	18.67	19.65	19.65

[a/] Includes revolving credits.

[b/] NCR – National Capital Region.

Sources: *NCSO, NEDA-NAS, CB and Pante (1982).*

Table II.2

FISCAL POSITION OF THE NATIONAL GOVERNMENT CASH BASIS, 1975-1984
(GROWTH RATES)

	1975-1976	1976-1977	1977-1978	1978-1979	1979-1980	1980-1981	1981-1982	1982-1983	1983-1984
A. REVENUES	8.72	9.06	20.61	22.42	17.85	3.86	6.32	22.08	25.30
Tax	11.14	10.92	20.58	26.96	17.62	2.92	7.55	17.82	29.31
Non-Tax	(2.11)	(0.36)	20.77	(3.14)	19.55	7.36	(2.22)	54.78	1.92
B. CURRENT OPERATING EXPENDITURES	16.41	11.45	8.53	7.16	27.49	7.64	17.39	11.43	29.21
C.SURPLUS ON CURRENT OPERATIONS	(24.37)	(6.74)	116.20	82.98	15.27	(6.58)	(24.29)	67.75	14.17
D. CAPITAL OUTLAYS	56.71	11.17	34.18	23.32	54.80	60.59	(6.49)	(16.82)	(18.11)
MPWH/MTC	73.14	(12.47)	54.75	17.13	71.88	35.76	(24.42)	(7.88)	(18.56)
Corporate Equity Investment	–	20.48	9.62	39.38	33.08	78.70	15.93	(38.75)	(38.71)
Other Capital Outlays	–	–	47.31	(0.88)	55.96	155.52	(7.39)	38.23	(16.92)
E. NET LENDING	–	–	428.89	258.40	(20.87)	37.63	138.75	7.94	280.45
F. TOTAL DISBURSEMENTS	12.34	11.61	15.03	13.61	27.86	26.13	9.42	0.86	26.15

Table II.3

FISCAL POSITION OF THE NATIONAL GOVERNMENT CASH BASIS, 1975-1984
Percent of GNP

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
A. REVENUES	14.71	13.64	13.02	13.60	13.52	13.13	11.83	11.36	12.28	10.91
Tax	12.02	11.39	11.06	11.55	11.90	11.54	10.35	10.05	10.48	9.61
Non-Tax	2.69	2.22	1.96	2.05	1.61	1.59	1.48	1.31	1.80	1.30
B. CURRENT OPERATING EXPENDITURES	11.93	11.85	11.56	10.86	9.45	9.27	8.69	9.21	9.08	8.32
C. SURPLUS ON CURRENT OPERATIONS	2.78	1.79	1.46	2.74	4.06	3.86	3.14	2.15	3.19	2.58
D. CAPITAL OUTLAYS	2.53	3.38	3.29	3.82	3.83	4.89	6.84	5.77	4.25	2.47
MPWH/MTC	1.36	2.01	1.54	2.06	1.96	2.78	3.28	2.24	1.83	1.06
Corporate Equity Investment	–	1.38	1.45	1.38	1.56	1.71	2.66	2.78	1.51	0.66
Other Capital Outlays	1.17	–	0.30	0.39	0.31	0.40	0.89	0.74	0.91	0.76
E. NET LENDING	1.43	–	0.03	0.13	0.39	0.26	0.30	0.66	0.63	1.70
F. TOTAL DISBURSEMENTS	15.90	15.23	14.88	14.81	13.67	14.42	15.83	15.64	13.96	12.50
G. BUDGET DEFICIT	1.19	1.59	1.86	1.22	0.16	1.28	4.0	4.28	1.69	1.58

tax revenues were highest in 1975 at 2.7 percent, averaged at 1.9 percent in 1976-1980, and averaged at 1.4 percent in 1981-1982. Tax revenues, again in proportion to GNP, were at their best at 12 percent in 1975, averaged 11.5 percent in 1976-1980, and dipped to an all-time low of 10.0 percent in 1982. The decline in the tax to GNP ratio in 1981-82 was partly due to the implementation of the Tariff Reform Program in those years. However, a greater proportion of the revenue short fall could be attributed to factors that are not related to the said program. [1/]

On the other hand, national government expenditures as a proportion of GNP were fairly stable in 1975-1978, averaging 15.2 percent, dipped to 13.7 percent in 1979, consistently rose to 14.4 percent in 1980, 15.8 percent in 1981 and levelled at 15.6 percent in 1982. Current operating expenditures as a percentage of GNP were fairly stable at 11.6 percent average for 1975-1978 and 9.2 percent average for 1979-1982. Their share in total expenditures was 75.1 percent in 1975, peaked at 77.7 percent in 1976-1977 and continuously dropped to 58.9 percent in 1982. Capital outlays grew from an average rate of 3.4 percent of GNP (3.8 percent of GNP if net lending is included) in 1975-1979 to an average rate of 4.9 percent of GNP (5.2 percent if net lending is included) in 1980, and to an average of 6.3 percent of GNP (6.8 percent with net lending) in 1981 and 1982.

The share of the traditional infrastructure sectors (MPWH/MTC) in total capital outlay inclusive of net lending averaged 48 percent in 1975-1978, 48.6 percent in 1979-1981, and declined dramatically to 34.8 percent in 1982. Other capital outlays increased their share from an average of 5.9 percent in 1975-1979 to 27 percent in 1982. Corporate equity plus net lending captured an average of 41.8 percent of total capital outlays for 1975-1982 with its peak at 53.5 percent in 1982.

Three major trends then stand out in the national government's cash budget between 1975-1982. First, government revenues as a percentage of GNP followed a downward movement. Second, this was accompanied by a corresponding decline in current operating expenditures relative to GNP so that the national government's surplus on current operations as a percentage of GNP was relatively stable during the period. Third, capital outlays consistently grew relative to GNP after 1975.

[1/] The buoyancy of taxes and tariffs on imports with respect to GNP is estimated to be 0.85 while that of all other taxes lumped together is 1.10 in 1975-1980. If these parameters based on historical data were carried forward to 1981 then the revenue short fall for tariffs and taxes on imports is ₱1,539M while that for all other taxes is ₱2,949 M.

National government expenditures, on an obligation basis, averaged 15.3 percent of GNP in 1975-1982 (lowest in 1980 at 13.9 percent of GNP and highest in 1976 at 16.8 percent of GNP). Current operating expenditures were 10.1 percent of GNP on the average in 1975-1978, and was 9 percent of GNP on the average in 1979-1982. In terms of total expenditures, current operating expenditures accounted for 62.4 percent in the period (lowest in 1975 and 1981 at 55 percent and highest in 1976 at 67.6 percent). Capital outlays averaged 5.4 percent of GNP in 1975-1982. The highest recorded were in 1975 and 1981 with 7.2 and 6.4 percent of GNP, respectively. The years 1977, 1978, 1980 and 1982 were low in government investment with less than 5 percent of GNP going to capital outlays. The share of MPWH/MTC in total capital outlays was 48 percent in 1975-1980 but went down to 32.6 percent in 1981-1982. About 35 percent of capital outlays was allocated to corporate equity contribution in 1975-1980. In 1981 and 1982, its share rose to 54.5 percent.

The government corporate sector experienced tremendous growth in numbers in the last decade particularly in the early 1980s when the government, through its various instrumentalities, undertook the rescue of several distressed corporations. Public corporations in the Philippines, however, are not financially self-sufficient. In 1981, the deficit of the 13 major non-financial government corporations stood at ₱13.5B which is 4.5 percent of GNP (see Annex I for the list). NPC accounted for 37.9 percent of this figure followed by PNOC with 23.8 percent. NIA and NDC had an 8.9 percent share each. This was trimmed down to ₱11.1B (or 3.3 percent of GNP) in 1982. NPC again had the biggest deficit, 48.6 percent of the total. NDC deficit constituted 16.4 percent while NIA had 13.3 percent of the total. These deficits exerted pressures on the national government budget as reflected in the transfers and contribution of the national government to the public corporate sector. In 1981 the sum total of national government transfers to government corporations amounted to ₱9.4B which represents 3.1 percent of GNP and 19.5 percent of the former's total cash disbursements. This took any one of three forms: equity contributions, subsidies or net lending. National government contributions to government corporations increased by 37.3 percent nominally in 1982 reaching ₱12.9B (3.8 percent of GNP and 24.5 percent of the national government's total cash disbursements).

Partly pressured to finance government's budget deficits, the monetary authorities also pursued an expansionary monetary policy. Annual total liquidity (M3) growth rates averaged 18.7 percent

during the period 1975-82 (see Table II.1). Except for 1979, the difference between M3 growth rate and real GNP growth rate exceeded 10 percent each year during the same period, indicating more pressure on prices coming from excessive monetary expansion. Money supply (M1) growth rate even went beyond the statutory annual growth rate of 15 percent in three occasions, i.e., 1976, 1977 and 1980. It went down to 3.5 percent and 0.8 percent in 1981 and 1982, respectively, as a result of the depressed external sector developments.

These major economic developments have a profound effect on the labor sector. The problem of maintaining a decent wage for workers and at the same time keeping a manageable unemployment rate became more difficult, especially in an economy with surplus labor. The authorities instituted minimum wages for four labor sectors in the economy (see Table II.1). These were periodically adjusted in accordance with movements of the general price level. However, it is not clear how the minimum wage rate is obtained; that is, whether it is based on the daily nutritional requirements of a certain family size or on something else. Further, it is not clear at all whether government authorities want to effect a real increase in the minimum wage rate or maintain a certain real minimum wage rate whenever an adjustment is made. As may be observed, real minimum wage rates were increasing during the period 1978-80, but started to decline steadily in 1981 and 1982.

The historical unemployment rate was relatively low, averaging 4.5 percent during the period 1975-82. But this conceals the greater problem confronting the labor sector. Underemployment rate has been admittedly high, posting 20 to 29 percent between 1975 and 1981 and reaching 33.1 percent in 1982.

The analysis above has shown that the balance of payments crisis currently experienced by the Philippines already took shape a long time ago until it became clearly unmanageable in the recent period. Deterioration in the terms of trade, unfavorable exchange rate policy, and the expansionary monetary and fiscal policies were among the main contributory factors to the current balance of payments crisis. The subsequent chapters will discuss government's responses to the BOP crisis during the period 1983-84. Their impact on balance of payments position, prices, output and employment will also be analyzed.

Chapter III

OVERVIEW OF GOVERNMENT'S RESPONSE TO THE 1983-84 BALANCE-OF-PAYMENTS CRISIS

Given the major economic developments during the period 1975-82, it was not entirely surprising that when international banks ceased further lending to the Philippines and called their maturing loans in the second half of 1983, the Philippines was propelled into its worst balance-of-payments crisis in its post war history. Suddenly faced with a severe foreign exchange constraint, the Philippines had to drastically cut back its imports which were mostly intermediate and capital goods. Precious foreign exchange earnings from exports were allocated mainly for interest payments and crude oil imports. With the economy unable to pay for its much needed imports, production fell, shortages resulted, massive lay-offs occurred and inflation soared to record high levels. Drastically reduced real income, high inflation rate and high unemployment rate are ultimately the manifestations of the crisis which the government had, and still has to deal with. From these key problem areas stemmed most of the government policy responses.

The efforts focus on reducing the BOP deficit. As an immediate measure, severe foreign exchange restrictions and other controls were imposed. Foreign exchange was strictly allocated resulting in wide ranging prohibition of imports deemed unnecessary by government. To further discourage imports and capital flight and to bring the foreign exchange price at a more realistic level, the peso was adjusted upwards first on 23 June 1983 from ₱10 per dollar to ₱11 per dollar, then on 5 October 1983 to ₱14 per dollar, then on 6 June 1984 to ₱18 per dollar. Finally, a floating rate policy was declared in October 1984 to fully reflect supply and demand conditions in the market. Additional ad valorem import duty was raised from 3 percent to 5 percent in November 1983, then to 8 percent in April 1984 and finally to 10 percent on 6 June 1984. The objective was both to discourage imports and raise revenues.

The government allowed "no-dollar" importations for commodities not included in the priority list. Under the "no-dollar" importation scheme, payments for imports of these commodities had to be sourced instead from the curb market. In effect, a multiple exchange rate system was established.

The ₱18 to a dollar devaluation was accompanied by a 30 percent windfall tax on all exports (except for semi-conductors

and exports bonded warehouses) and a 10 percent excise tax on non-merchandise sale of foreign exchange. Furthermore, additional export taxes were imposed. The windfall tax and the 10 percent excise tax were, however, suspended last September 1984. The 10 percent ad valorem import duty was also recently reduced to 5 percent for crude oil imports and for all imports effective 1 January 1985. Other various CB circulars to manage the BOP were effected. One of the most important is the requirement by CB on the amount of foreign exchange that can be held by banks. The CB circular issued in November 1983 required banks to sell 100 percent of their foreign exchange receipts to the Central Bank. The latest circular allows banks to hold, in addition to 100 percent of the value of their cash letters of credit 100 percent of export bills purchased, 30 percent of outstanding regular letters of credit inclusive of cash letters of credits, and 10 percent of foreign exchange receipts based on the two-month moving average of the immediately preceding 12 months.

Besides devaluation, the orthodox prescription for chronic balance of payment deficits is to pursue a program of fiscal and monetary restraint. According to the traditional theory, contractionary fiscal and monetary policies are necessary to counteract the expansionary/inflationary effects of devaluation.

To reduce the budget deficit, several measures were passed to raise revenues. These included raising export taxes and additional ad valorem import duties, and increasing taxes particularly on petroleum. Several other specific taxes, e.g. on liquor, cigarettes, etc. were increased. On the other hand, the proposed budget for 1984 to 1985 intended to reduce government expenditures, particularly capital outlays.

The set of rules and regulation promulgated in the area of monetary policy since June 1983 was directed mainly on reserve requirements and rediscounting facilities. Reserve requirement was increased by 1 percentage point each in September and October 1983, 1.5 percentage points each in November and December 1983. Another one percentage point increase effective 25 April 1984 was imposed the following year. The reserve requirement on deposit and deposit substitutes increased from 18 to 24 percent. The reserve requirement on margin deposit on import letters of credit was increased from 50 percent to 100 percent in November 1983. Rediscounting windows, on the other hand, were virtually closed. Instead of quoting fixed discount rates, the Central Bank pegged these discounts on the 90 day Manila Reference Rate

(MRR90). The effective interest that is charged is MRR90 minus 3 to 9 percentage points depending on the nature of the paper.

High inflation rate is one of the major problems attendant to the crisis. The inflation problem has been more severe than the effects of the 1974 and 1978 oil shocks. The Consumer Price Index (CPI) started to climb in June 1983, reaching double digit year-on-year inflation rate by October of the same year. It still continued to increase rapidly so that by August 1984, the inflation rate has gone up to 60.4 percent. Price controls were used to mitigate somewhat the inflation effect. However, direct price controls cannot be resorted to indefinitely without seriously distorting the market system. Price ceilings of PSC-covered commodities increased on 15 occasions since June 1983.

To protect workers against erosion of their incomes due to inflation, six wage orders have been implemented since June 1983. The sufficiency of wage adjustments and their possible inflationary effects are two important questions which need to be examined.

Annex II summarizes in chronological order and by policy area the main government policy responses to the crisis.

Chapter IV

CRITICAL ANALYSIS OF THE VARIOUS MEASURES

This chapter critically evaluates the various stabilization measures adopted by government during the period 1983-84 in response to the balance-of-payments difficulties. It is firmly believed that most of the necessary measures were already in place by December 1984, hence the choice for the cut-off period.

This chapter consists of five major sections. The first section discusses the measures adopted to improve the balance of payments; the second, the measures adopted to manage the budget deficits; the third, the responses in the monetary sector; the fourth, the price adjustments; and the last, the wage adjustments effected during the period 1983-84.

IV.1 MEASURES ADOPTED TO IMPROVE THE BALANCE OF PAYMENTS

A. The Measures

Cognizant of the deteriorating balance of payments, the Central Bank (CB) allowed the peso to gradually depreciate starting January 1983. This development led to strong speculations on the exchange rate which largely contributed to the huge capital flight. To discourage further speculation and, at the same time, to encourage exports and curb imports, the Central Bank depreciated the peso more sharply on 23 June 1983 by 7.8 percent, ₱11 to $1. The avowed policy of the government then was to defend this exchange rate. However, unfavorable developments in the balance of payments, the continued strength of the US dollar and the rapid erosion of international reserves in the succeeding months prodded the CB to further depreciate the peso. The second sharp adjustment in the exchange rate occurred on 5 October 1983, ₱14 to $1 and the third on 6 June 1984, ₱18 to $1. Finally, a free float was declared in October 1984.

The adjustments of the exchange rate were accompanied by a number of exchange controls, the purposes of which were to discourage imports and to assure the optimum use of the dwindling foreign exchange reserves. Among the notable exchange controls were those found in CB Circular No. 970, dated 4 November 1983 (see Annex II). In particular, the circular: (1) created a foreign exchange pool for priority import payments by requiring all banks

to sell 100 percent of their foreign exchange receipts (this was revised on 6 June 1984 under CB Circular No. 1010 allowing banks to hold 20 percent of their foreign exchange receipts); (2) set priorities in the allocation of foreign exchange to the following: (a) crude oil imports, (b) raw materials, supplies, and other inputs of export products, (c) essential grain imports, and (d) raw materials of vital domestic industries; and (3) set ceilings for payments and new import letters of credit. However, import licenses were required to import these goods. It may be said that the foreign exchange controls actually acted as quantitative restrictions on imports.

Furthermore, the priority system for foreign exchange allocation together with the "no dollar" importation scheme for other imports not included in the priority list created a multiple exchange rate system. Imports included in the priority list obtained foreign exchange at the official rate, while other imports were financed from the black market at a higher rate (see Table IV.1).

On 15 October 1984, CB abolished the foreign exchange priority allocation program for imports. Furthermore, under CB Circular No. 1034 dated 10 December 1984, CB has increased the amount of foreign exchange commercial banks may hold to 30 percent of their outstanding regular letters of credit.

To help these measures further reduce importations, new trade taxes were imposed. An additional ad valorem duty on all importations was raised from 3 percent to 5 percent on 3 November 1983, to 8 percent on 29 April 1984, and finally to 10 percent on 6 June 1984. [1/] In addition, a special excise tax of 10 percent was imposed of foreign exchange sold by CB and its agents on 6 June 1984. This was subsequently replaced by the foreign exchange transaction tax of 1 percent on 15 October 1984. The required reserve on margin deposits on import letters of credit (L/Cs) for banned items was likewise increased to 100 percent on 2 November 1983.

To redistribute gains generated by adjustments in the exchange rate in the export sector, additional export duties on traditional export products and on certain non-traditional products were imposed starting 3 November 1984. Earlier, on 6 June 1984, an economic stabilization tax of 30 percent was imposed on all exports in addition to existing export duties. However, this was suspended on 22 September 1984.

[1/] Exempted are those importations of government agencies with existing obligations requiring exemptions of the diplomatic corps, personal effects of returning Filipino diplomats, those of bonded manufacturing and bonded smelting warehouses.

TABLE IV.1

BLACKMARKET (BM) TO OFFICIAL EXCHANGE RATE (OER) RATIO, MONTHLY 1983-1984

PERIOD	BM/OER
1983	
Jan.	1.001
Feb.	1.027
Mar.	1.074
April	1.046
May	1.027
June	1.070
July	1.009
Aug.	1.095
Sept.	1.168
Oct.	1.111
Nov.	1.345
Dec.	1.350
1984	
Jan.	1.484
Feb.	1.262
Mar.	1.094
April	1.277
May	1.370
June	1.195
July	1.092
Aug.	1.082
Sept.	1.077
Oct.	.999
Nov.	.967
Dec.	.984

Sources:

Blackmarket Rate: (Hongkong Banknote Rate)
Far Eastern Economic Review
Official Rate: Central Bank

B. Effects of the Measures on the Real Price of Foreign Exchange and on the Structure of Protection

After discussing the measures adopted by government to improve the balance of payments, it is now worthy to examine the immediate effects of these measures on the real price of foreign exchange and on the structure of protection. Their effects on the trade balance will be discussed in a later chapter.

1. The Real Price of Foreign Exchange

Even with a 50 percent average annual inflation rate, the recent devaluations have effectively raised the real (composite) exchange rate from an index of 100 in 1973 (even falling to as low as 85.84 in 1979) to 112.9 in 1984 (see Table IV.2). This means that domestic product in terms of prices are now relatively more attractive than foreign products, thus, benefitting exportables and import substitutes. The net effect of devaluation should therefore be favorable on the trade balance. Indeed, recent data support this (see Section 1 of Chapter V).

However, additional import tariff and export taxes were also imposed during the period when a series of *de facto* devaluations were effected. Increases in import tariff and export taxes somewhat reduced the effect of devaluation on prices received by producers of exports and import substitutes. In Table IV.3, the nominal and net appreciation of the dollar is computed out of the changes in import tariffs and export taxes to get the net effective change in the exchange rate for the following specific commodity groups: traditional exports, non-traditional exports, and importables. This gives the combined effects of tariff and tax changes and devaluation on prices received by producers of the specific commodity groups. The net effective change in the specific exchange rate are then compared with the change in CPI index or GDP deflator and wage index to see how much of the gains from the "net" devaluation is eroded by changes in domestic costs (as indicated by GDP deflator and wage index).

For traditional exports, it was not until June 1984, when the peso was devalued to ₱18 per dollar, that net advantage for traditional exporters could be discerned. There was a 50.9 percent net effective change in exchange rate for traditional exports, as compared to a GDP deflator change of 46.7 percent and 23.4 percent change in compensation rate index. Non-

Table IV.2
NOMINAL AND REAL EFFECTIVE EXCHANGE RATES:
PHILIPPINES, 1970-1984

(1973 = 100)

Year	Nominal Effective Exchange Rate Index	Real Effective Exchange Rate Index
1970	85.94	98.89
1971	92.44	103.64
1972	97.09	107.18
1973	100.00	100.00
1974	99.82	83.79
1975	104.87	92.34
1976	103.48	89.03
1977	101.68	86.86
1978	103.60	88.31
1979	105.46	85.84
1980	109.31	87.16
1981	111.05	87.17
1982	115.68	87.74
1983	145.95	92.66
1984*	196.20*	96.85*
	229.88**	112.90**

* Using the exchange rates data for 2nd quarter of 1984 and assuming a 50% change in Philippine GDP deflator and a 5% change in the GDP deflator of US, Australia, Japan, France, Germany, Canada, United Kingdom.

** Using the exchange rates data as of August 23, 1984.

Source: *OECD Quarterly National Accounts, No. 1, March 1984. International Financial Statistics, August 1984.*

Table IV.3

PERCENTAGE CHANGE IN PESOS PER DOLLAR:
NOMINAL AND INCLUSIVE OF CHANGES IN IMPLICIT TARIFF/TAXES

	Nominal Exchange Rate (r)	Nominal Appreciation of Foreign Exchange	1 + Implicit Tariff/Export Tax (1 + T)	% Change in (1 + T)	Net Effective Change in Specific Exchange Rate (2) + (4)	CPI (NCR) 1978= 100	% Change in CPI	GDP Deflator[a/] 1978= 100	% Change in GDP	Compensation Rate Index (NCR) 1978 = 100	% Change
TRADITIONAL EXPORTS											
December 1982	9.0593		.960			178.8		351.05		195.4	
June 1983	11.0020	21.4	.960	0	21.4	187.2	4.7	365.89	4.2	258.4	32.2
December 1983	14.0020	27.3	.943	−1.8	25.5	236.6	26.4	427.28	16.8	258.4	–
June 1984	16.8000	20.0	.943	0	20.0	285.7	12.1	536.85	25.6	318.9	23.4
October 1984	19.9900	19.0	.939	−0.4	18.6	318.3	11.4	615.56[b/]	14.7		
% Change June 1983-June 1984		52.7		−1.8	50.9		52.6		46.7		23.4
% Change June 1983-Oct. 1984		81.7		−2.2	79.5		70.0		68.2		
NON-TRADITIONAL EXPORTS											
December 1982	9.0593		.997			178.8		351.05		195.4	
June 1983	11.0020	21.4	.997	0	21.4	187.2	4.7	365.89	4.2	258.4	32.2
December 1983	14.0020	27.3	.996	−0.1	27.2	236.6	26.4	427.28	16.8	258.4	
June 1984	16.8000	20.0	.996	0	20.0	285.7	12.1	536.85	25.6	318.9	23.1
October 1984	19.9900	19.0	.996	0	19.0	318.3	11.4	615.56[b/]	14.7		
% Change June 1983-June 1984		52.7		−0.1	52.6		52.6		46.7		23.4
% Change June 1983-Oct. 1984		81.7		−0.1	81.6		70.0		68.2		
IMPORTABLES											
December 1982	9.0593		1.48			178.8		351.05		195.4	
June 1983	11.0020	21.4	1.51	2.03	23.43	187.2	4.7	365.89	4.2	258.4	32.2
December 1983	14.0020	71.8	1.53	1.3	73.1	236.6	26.4	427.28	16.8	258.4	
June 1984	16.8000	10.0	1.58	3.3	13.3	285.7	12.1	536.85	25.6	318.9	23.4
October 1984	19.9900	−3.8	1.58	0	−3.8	318.3	11.4	615.56	14.7		
% Change June 1983-June 1984		89.0		4.6	93.6		52.6		46.7		23.4
% Change June 1983-Oct. 1984		81.7		4.6	86.3		70.0		68.2		

[a/] Based on Quarterly Estimate of Gross Domestic Product.

[b/] For 3rd Quarter or September 1984.

Source: *Central Bank of the Philippines: Department of Economic Research (International); NEDA: National Accounts Staff.*

traditional exports fared only slightly better with a net effective change in the exchange rate of 52.6 percent. Those exempted from the stabilization tax gained most with 81.6 percent change.

By September 1984, the 30 percent stabilization tax was suspended for all exports and the peso was allowed to "float," yielding a 79.5 percent net effective change in exchange rate for traditional exports and 81.6 percent change for non-traditional exports. Simultaneously, however, there was a rise in the GDP deflator (and CPI index) amounting to a total change (for the same period – June 1983 to October 1984) of 68.2 percent, thus again almost eroding the benefits from "net" devaluation.

For importables, the net effective change in the exchange rate is most favorable up to June 1984. This development is clearly beneficial to producers of import substitutes.[2/] The figure went down slightly from 93.6 percent in June 1984 to 86.3 percent in October 1984 when the peso was allowed to "float" and the gap between the blackmarket and the official exchange rate narrowed down significantly.

In sum, the rise in domestic costs does not totally negate the effects of net devaluation. The recent devaluations, net of changes in import tariffs and export taxes after considering the rise in domestic costs, should have a favorable effect on the trade balance. The tight monetary and fiscal policies further reinforced this favorable effect on BOP.

2. Effects on Incentive/Protection Structure

Norma Tan's (1979) study on the structure of protection for 1984 shows effective protection rates (EPRs) greatly varying across sectors from 49 to 200 percent. In particular, the results of the study show a structure of protection heavily favoring the manufacturing sector with an EPR index of 489 as against that of agriculture equal to 100 (see Table IV.4). Within the manufacturing sector, the final consumption products were heavily favored with an EPR index of 481 versus 100 for inputs to construction. The export sector is heavily penalized with an EPR index of 100 as compared to a very high EPR index of 1525 for non-exportables.

[2/] Considering that during the period very restrictive and discriminatory (against final consumer products in general) exchange controls were in effect, 93.6 percent is probably an underestimate although the blackmarket rate was used in our computation.

Table IV.4

STRUCTURE OF PROTECTION, PHILIPPINES

Sector	EPR Index
Agriculture and primary	100
Manufacturing	489
All sectors	400
Manufacturing	275
Intermediate	144
Capital	112
Inputs into Construction	100
Consumption	481
Exportables	100
Non-exportables	1,525
All sectors	900

Source: Norma Tan, *The Structure of Protection and Resource Flows in the Philippines (1979).*

Table IV.5

AVERAGE EPRs ACCORDING TO MAJOR INDUSTRY GROUP: 1974 AND POST-TRP

(In Percent)

Industry Group	EPR 1974	EPR Post-TRP
Agriculture and Primary	9	3
Manufacturing	44	36
Exports	4	12
Non-exportables	61	–
Import, competing	37	35
Import, non-competing	148	67
Over all Average	36	28

Source: *Tariff Commission Status Report on the Recalculation and Analysis of EPRs Using 1979 I-O Table (1984).*

In 1981, a tariff reform program (TRP) was instituted. Very high import tariffs were scheduled to be gradually reduced, while some very low tariffs were increased to eventually reach a more uniform tariff level. Furthermore, quantitative restrictions were gradually lifted. The Tariff Commission calculated the EPR using post-TRP (Tariff Reform Program) tariff rates. The results show that the average EPR went down from 36 percent to 28 percent (see Table IV.5). However, there is no significant change in the rankings of the sector according to the level of protection received, i.e., the structure of protection remains relatively the same even after the TRP. The average EPR for agriculture and primary sector is still much lower than the average EPR for manufacturing. Furthermore, the exports sector is still relatively being penalized by the protection structure adopted.

The purpose of the Tariff Reform Program (TRP) is to eventually reach a more uniform tariff system (in the range of 20 to 30 percent). This would narrow down the EPR variation across industries and thus substantially eliminate inefficiencies from allocative biases of a highly uneven EPR structure. Hence, tariffs, which would be applied uniformly, would mainly be for revenue purposes and could even be justified on terms-of-trade grounds. The reform of the tariff system should, of course, be accompanied by liberalization of imports licensing and other exchange controls. (Exchange controls have differential tariff effects without the government revenue.)

In response to the BOP crisis, the trade liberalization efforts initiated in 1981 were suspended. As mentioned above, additional tariffs and export taxes were imposed. Furthermore, foreign exchange was brought under stricter control. Only those in the priority list may obtain foreign exchange allocation from official sources. These emergency measures have obvious effects on the protection structure.

The additional ad valorem import duty is uniform for all imports. [3/] The additional export taxes are specific to commodities already subject to export taxes (except for tuna and coffee) and the rates are all at 2 percent for logs (5 percent – from 20 percent to 25 percent) and copra (3 percent – from 7 percent to 10 percent until June 1984) which are incidentally also the most heavily taxed among exports. Foreign exchange allocation by government effectively acts as quantitative restrictions (QRs). Thus, its effects are similar to those of tariff and taxes. However, the

[3/] See footnote 1 of this chapter for a list of exemptions.

commodity groups included in the CB list of priorities are also the ones previously enjoying low tariffs and easier foreign exchange allocations. Thus, while the structure of protection is maintained, the EPR variation has widened. Heavily protected import substitutes get more protection and the less protected sectors (e.g. exports) are even more penalized.

In sum, the emergency measures taken to manage the BOP are contrary to the long-run goal of rationalizing the protection structure, which includes the system of uniform tariff, liberal import licensing and real protection via tax credit or direct subsidies to deserving industries inhibited by genuine market failures. Such rational protection would eliminate the unjustified penalties against nontraditional exports and efficient import substitutes and encourage greater economic efficiency. Further, these emergency measures which widen the EPR variation, although they can improve the balance-of-payments position in the short run, increase the cost of balancing the foreign exchange budget in the long run. A highly uneven EPR structure induces, at the margin, the use of resources to save a unit of foreign exchange more than what it costs to earn a unit from exports.

IV.2 MEASURES ADOPTED TO MANAGE BUDGET DEFICITS

This section discusses the measures adopted by government to manage its budget deficits. The first part of this section deals with the revenue raising measures and the distribution of the burden of these measures. Their effects on the general price level will be examined in a later section. The second part looks at the effects of government measures to cut expenditures.

A. Additional Sources of Government Revenue

1. The New Tax Measures

As part of the government deficit management program new tax measures were imposed in 1983 and 1984. The one year period ending 30 June 1984 witnessed the introduction of the following tax changes: (1) an increase in the specific tax on petroleum products, distilled spirits, wines, liquor, cinematographic films and cigarettes; (2) an across-the board increase in tariff duties; (3) an increase in export duties of selected export commodities; and (4) an economic stabilization tax on exports. The specific tax rates on petroleum products were increased four times (on 1 July 1983, 3 November 1983, 18 May 1984 and 7

June 1984) during the period. The specific tax on petroleum products expressed in pesos per liter rose by an average of 110 percent while at the other extreme, the specific tax on fuel oil increased by an astounding 650 percent. It was not only the peso rates of tax on petroleum products that went up but also the equivalent ad valorem rates which increased from 9.5 percent to 10.2 percent. [4/] The specific tax on distilled spirits, wines, liquor, cigarettes and cinematographic films were also increased in November 1983. The 3 percent additional duty on imports imposed effective December 1982 was increased to 5 percent on 11 November 1983, then to 8 percent on 29 April 1984 and finally to 10 percent on 6 June 1984. Additional export duties ranging from 2 to 5 percent were imposed on traditional export products effective 3 November 1983 to 31 December 1984. The economic stabilization tax (a tax based on the difference between the FOB value of exports at the prevailing exchange rate at the date of shipment and the FOB value of exports at the rate of ₱14 to US$1) was imposed on 6 June 1984 at 30 percent and will gradually be reduced by 5 percentage points every quarter thereafter.

Between August and October 1984, another set of revenue raising measures was put in place. This includes the following: (1) an increase in the specific tax on distilled spirits, cinematographic films, saccharine and its derivative, (2) imposition of an ad valorem tax of 20 percent on fermented liquors in addition to the existing specific tax, (3) imposition of an ad valorem tax of 10 percent on matches in lieu of the specific tax, (4) an increase in the percentage tax on services rendered by millers, proprietors of dockyards, hotels, caterers, carriers, brokers, dealers in securities ranging from 1 to 5 percentage points, (5) an increase in the documentary stamp tax rates on certain documents by 50 percent, (6) imposition of an additional 1 percent tax on all foreign exchange and user transactions, (7) an increase in the tax on insurance premiums, (8) an increase in amusement taxes and taxes on winnings, (9) simplifications of and abolition of exemptions from the final withholding tax on interest income, (10) imposition of an ad valorem tax on petroleum products ranging from 7 to 25 percent in addition to the specific tax rates which has been reduced, (11) an increase in the ad valorem tax on domestic crude oil by 11 percent, (12) an increase in specific tax on imported coal and coke, (13) rationalization of customs duties on

[4/] The equivalent ad valorem rates include both the specific tax and the special fund levy on petroleum products.

corn, coal and coke, (14) imposition of ad valorem tax on cigarettes (2-4 percent) while the specific tax on the same has been increased by 25 percent, (15) an increase in tax rates on private motor vehicles, (16) a doubling of airport passenger terminal fees, (17) withdrawal of all exemptions from payment of duties, taxes, fees, imports and other charges enjoyed by government entities like the National Power Corporation, National Food Authority, etc., (18) withdrawal of exemptions and other preferential treatment in the payment of duties and taxes previously granted to private business enterprises except those registered with the Board of Investment under BP 391, with the Export Processing Zone Authority, under LOI 1416 (copper mining) etc., (19) a modification of inventory valuation methodology for corporate tax purposes, and (20) improvements in sales tax and administration. At the same time, the economic stabilization tax was rescinded while the 10 percent import surcharge was reduced to 5 percent effective 15 October 1984 for oil imports and effective 1 January 1985 for non-oil imports.

2. Revenue Impact of the New Tax Measures

The estimated yield from the revenue raising measures discussed above are summarized in Table IV.6. The estimated revenues from the new tax measures constitute 0.5 percent of GNP in 1983, 1.3 percent in 1984 and 2.7 percent in 1985.

3. Distribution of the Burden of the New Tax Measures

The increased specific tax on petroleum products, distilled spirits, wines, liquors, cinematographic films and cigarettes as well as the import surcharge are indirect taxes and as such are regressive in nature and impose a heavier burden on the poorer segments of the population. The impact of the change in the specific tax on petroleum products on different income groups in particular is shown in the *Meta Systems* study on petroleum product pricing. This is a summary of the percentage change in cost of living index (CLI) of different income groups resulting in a 10 percent increase in the price of each fuel.

Table IV.7 indicates that gasoline taxes are quite progressive, kerosene and LPG taxes are regressive, while diesel and fuel oil taxes are relatively neutral.

Note that the change in the wholesale price due to the change in the specific tax is low for gasoline at approximately 4.0 per-

Table IV.6

REVENUE IMPACT OF THE NEW TAX MEASURES

(Million ₱)

		1983	1984	1985
1.	Increase in Specific Tax on Petroleum Products Based on July 1983 to June 1984 Measures	90.6	753.7	
2.	Additional Export Duty	44.9	433.0	
3.	Economic Stabilization Tax		282.0	
4.	Additional Import Duty	1,732.9	2,635.5	3,298.0
5.	Increase in Specific Tax on Alcoholic Beverages		276.0	655.0
6.	Increase in Specific Tax on Distilled Spirits			111.0
7.	Imposition of Ad valorem Tax on Fermented Liquors		100.0	1,034.0
8.	Increase in Percentage Tax on Services			515.0
9.	Increase in Documentary Stamp Tax		100.0	640.0
10.	1 Percent Tax on Foreign Exchange		450.0	2,900.0
11.	Removal of Exemptions on Interest Income		294.0	2,014.0
12.	Shifting of Some Elements of Specific Tax to an Ad Valorem Basis on Petroleum Products		209.0	2,131.0
13.	Increase in Ad Valorem Tax on Domestic Crude Oil		107.0	209.0
14.	Increase in Specific Tax on Imported Coal and Coke		16.0	16.0
15.	Rationalization of Customs Duties on Corn, Coal and Coke		31.0	36.0
16.	Imposition of Ad Valorem Tax on Cigarettes and Increase in Specific Tax on the Same		250.0	881.0
17.	Increase in Tax Rates on Private Motor Vehicles		45.0	457.0
18.	Increase in Airport Passenger Fees		30.00	150.0
19.	Withdrawal of Tax Exemptions on Government Corporations		383.0	1,100.0
20.	Withdrawal of Preferential Tax Treatment of Certain Business Enterprises		200.0	1,590.0
21.	Change in Inventory Valuation Procedures		40.0	120.0
22.	Improvement in Sales Tax Administration		100.0	
	TOTAL	1,868.4	6,935.2	17,857.0

centage points but high for fuel oil, diesel, LPG and kerosene at 15.8, 11.4, 11.3 and 8.4 percentage points, respectively. Given these, it may be concluded that the pattern of changes in the specific tax on petroleum products brought about by the stabilization measures is actually more regressive than it otherwise could have been.

As demonstrated earlier, the additional export duties and the economic stabilization tax have eroded some of the gains accruing to exporters following the devaluation of the domestic currency. Consequently, this is borne by the export sector.

B. Government Expenditure Cutbacks

Cash disbursements of the national government (net of debt amortization) amounted to ₱53.06B in 1983 and is projected to be ₱68.40B in 1984.[5/] These figures represent 97.3 and 121.5 percent of the original cash disbursement programs in 1983 and 1984, respectively.[6/]

In 1983, both current operating expenditures and capital outlays were reduced by 3.9 percent relative to their original program. Actual MPWH/MTC capital outlays and corporate equity were 3.5

Table IV.7

AN IMPACT OF THE CHANGE IN THE SPECIFIC TAX ON PETROLEUM PRODUCTS ON DIFFERENT INCOME GROUPS

	LPG & Kerosene	Gasoline	Diesel	Fuel Oil
lowest income	.55	.15	.21	.10
national average	.40	.22	.22	.11
highest income	.22	.39	.22	.13

Source: *Meta Systems, "Philippine Petroleum Product Pricing Study" (June, 1984).*

[5/] The 1984 figure is the sum of the estimates of the actual level, first semester, and the programmed level in the second semester.

[6/] Note, however, that the original cash budget program for 1984 has been adjusted upwards for the peso devaluations and unanticipated inflation so the 21.5 percent increase cited above is rather illusory considering that the inflation rate for the year is predicted to be 50 percent.

and 9 percent higher than their corresponding programmed levels while actual other capital outlay was 28.3 percent less than the planned amount. However, actual net lending was 33 percent higher than the programmed amount.

For 1984, the current operating expenditures and net lending were both above their original program levels by 14.4 and 264.3 percent, respectively. Capital outlay was 2.4 percent less than the planned amount. Corporate equity received the biggest cutback with 22.6 percent reduction relative to the scheduled level. MPWH/MTC capital outlays and other capital outlays were 12 and 1 percent higher than their corresponding programmed levels, respectively.

In nominal terms, total cash disbursements of the national government increased by 1 percent in 1983 and 28.9 percent in 1984. In 1983, other capital outlays grew the most with 38.2 percent rate of growth while corporate equity was reduced by 38.7 percent compared to their 1982 levels. Capital outlay as a whole declined by 16.8 percent while current operating expenditures increased by 11.4 percent in 1983. For 1984, capital outlay and all its components declined, again with corporate equity suffering the biggest proportional cutback. However, current operating expenditures increased by 33.7 percent while net lending grew by 280.5 percent in 1984.

Adjusting the above figures for inflation, (12 and 50 percent in 1983 and 1984, respectively) total disbursements declined by 11 percent in 1983 and further decreased by 21 percent in 1984. In 1983, the only expenditure component that grew in real terms was other capital outlays, while in 1984 it was net lending.

As a percentage of GNP, total disbursements declined to 13.9 percent in 1983 and 12.4 percent in 1984 from a high of 15.6 percent in 1982.

The general observation is that despite efforts to reduce other capital outlay relative to the programmed level in 1983, this expenditure component exhibited the highest nominal growth rate and the only one to realize a positive real growth rate. Net lending is a problem area in both 1983 and 1984 in terms of resistance to cutbacks, primarily because of pressures from the financially-starved public corporate sector, particularly the government financial institutions (GFIs). In view of this,net lending is likely to continue to be a problem in the near future as foreign creditors call on the loan guarantees extended in the past by the national government and GFIs and have defaults in the past with the private sector and GFIs following the economic crisis.

The public corporate sector continued to be financially-strapped.

The 13 major nonfinancial corporations posted a combined deficit of ₱15.7B in 1983 and ₱12.3B in 1984. Their deficit is expected to be ₱9.5B in 1985. NPC, NIA, LRTA, MWSS and PNOC are the top five deficit public corporations in 1983 and 1984. The government financial institutions particularly DBP, PNB, and Philguarantee also incurred huge deficits in these years. Their combined deficits reached ₱12.7B in 1984. Again, these deficits are translated into national government transfers despite national government efforts to trim down its budget. In 1983, national government contributions to government corporations were reduced by 32.3 percent nominally from the previous year's level but still constituted 16.4 percent of total cash disbursement of the national government and 2.3 percent of GNP. In 1984, this figure increased by 49 percent amounting to a total of ₱13B, which was 19.4 percent of total cash disbursement of national government, and 2.4 percent of GNP. Net lending's share was 70 percent or ₱9.1B. DBP obtained 68.6 percent or ₱6.25 B of total net lending of the national government.

Taken as a whole, the efforts initiated by the national government to raise additional revenues and control the growth of expenditures produced some favorable results. The ratio of government budget deficits to GNP declined from a high 4.28 in 1982 to 1.69 and 1.58 in 1983 and 1984, respectively.

While these cuts in the budget deficits are impressive by international standards, i.e., when compared with those achieved by other countries with debt problems similar to ours, the accompanying adjustment costs have however produced some perverse redistributive effect. First, to reduce the budget deficit the government raised additional revenues. The new tax measures are in general regressive, thus, favoring high income earners relative to low income earners (see IV. 2A.3). Second, the drastic reduction in government infrastructure expenditure as part of the cut-back on capital outlays has contributed to unemployment especially to the unskilled and semi-skilled labor force sector. On the other hand, the increase in net lending tends to favor the capital-intensive corporate sector. This expenditure pattern thus has regressive tendencies.

IV.3 RESPONSE TO THE CRISIS IN THE MONETARY SECTOR

The set of rules and regulations promulgated in the area of monetary policy since June 1983 can be characterized as restrictive and deflationary. In the absence of other factors, these policies would have reduced the money supply, increased interest rates, and reduced domestic absorption. That these rules have not resulted

in drastic reductions in liquidity must be attributed to actions by the government that contradicted these rules. The combination of tight rules and relatively loose credit to government operations has placed a heavy burden of adjustment on the private sector.

This analysis is divided into three parts. In the first part, the test of new monetary rules and regulations is described and analyzed. The second part attempts to document the actual developments in the monetary sector. The third part is a discussion of the overall effects of these policies and their implications for economic recovery.

A. Rules and Regulations in Response to the Crisis

The Central Bank, the Monetary Board, and the President have responded to the exigencies of the crisis by instituting new rules applicable to the monetary system. In contrast to 1982, monetary policy shifted in the direction of disinflation and credit restraint. In 1982, for example, reserve requirements were being reduced, net credit to the public sector grew by 62 percent, and the rediscount window provided a 10 percent increase of credits to deposit money banks. In 1983, reserve requirements were actually made more restrictive and the rediscount windows virtually closed.

1. Reserve Requirements

Reserve requirements were increased by 1 percentage point each in September and October, 1.5 percentage points each in November and December 1983 (CB Circular 961). Another one percentage point increase effective 25 April 1984 was imposed the following year. The reserve requirements on deposits and deposit substitutes increased from 18 to 24 percent. These policies effected a reduction of the money multiplier (the M3 multiplier fell from 6.2 times in June 1983 — which was a peak since the banking and monetary reform program started — to 4.7 in March 1984). The reserve requirement on margin deposits on import letters of credit (LCs) was increased from 50 percent to 100 percent (CB Circular 968 dated November 1983). The Central Bank also increased the interest it paid on reserve deposits with the Central Bank from 3 to 4 percent in June (CB Circular 1007) after attempting to rely on moral suasion in a Circular letter dated 9 May 1984. This policy contradicted earlier moves to remove interest paid on deposits with the CB in line with interest deregulation.

2. Rediscounting

The Central Bank has practically closed the subsidized rediscounting windows since the crisis began. Instead of quoting fixed discount rates it started to peg these discounts on the 90 day Manila Reference Rate (MRR90). The effective interest that is charged is MRR 90 minus 3 to 9 percentage points (see Table IV.8) depending on the nature of the paper. Bills on traditional exports get the lowest discount while medium and long-term papers are charged the highest discount. (The policies were implemented by CB Circular 991 dated January 1984, and CB Circular 994 dated March 1984.) The innovation here is that since the MRR is based on actual transactions, rediscount accommodation has been made more an instrument of short-run stabilization and less an instrument for development financing. Tighter eligibility rules for instruments that could be discounted were also imposed in March 1984.

3. Open Market Operations

In 1981, the Central Bank started replacing Central Bank Certificates of Indebtedness (CBCIs) with Treasury bills with the latter eventually serving as primary government securities in the securities market. This trend was reversed in the second semester of 1983 when new CBCI series were issued to help mop up excess liquidity. But the new CBCI series were cooly received by the public because their return was not attractive enough in the light of prevailing high inflation rates, rising levels of interest rate, and the rapid depreciation of the peso vis-à-vis the dollar. This prompted the Central Bank to introduce the CB bills under MB Resolution No. 416 dated March 16, 1984. Unlike the CBCIs, these CB bills (popularly known as "Jobo bills") are short-term debt instruments and cannot be used to satisfy the statutory reserves. CB bills are designed primarily to attract big savers since a minimum of ₱0.5M for firms and ₱1M for individuals is required. Above all, the coupon rates are flexible and highly competitive with those of other financial instruments.

The Central Bank began to earnestly sell the CB bills in September 1984 at about the time when the necessity of evolving a freer exchange rate regime and reducing domestic liquidity became inescapable. The unprecedentedly high rates offered on the bills (40 percent on 30-60 bills in September) seemed

Table IV.8

INTEREST RATES ON REDISCOUNT FACILITIES
(In Percent per Annum)

	1982 December	1983 December	1984 March
Medium and Long-Term Loans	11	MRR90-3	MRR90-3
Short-Term, General Purpose	8	MRR90-6	MRR90-6
Traditional Exports	8	MRR90-6	MRR90-6
Non-Traditional Exports	3	MRR90-7	MRR90-9
Food Production	8	MRR90-8	MRR90-9

MRR90 – 90-day Manila Reference Ratio

Source: *Central Bank*

to have arrested capital outflows that might have put pressure on the peso.

This policy instrument induced high interest rates in the whole system (see Table IV.9). The Manila Reference Rate jumped to 25-¾ percent and bank lending rates jumped to 30 percent in September 1984 which further induced a massive decline in trade and inventory financing.

4. Guaranteeing and Foreign Borrowing

Policies to restrict the use of foreign loans were also instituted. Letter of Instruction 1366 dated 25 November 1983 prohibits all government financial institutions from extending any guarantee to secure foreign loans or obligations. The approval of the President on all direct borrowing by all government owned or controlled corporations was imposed by P.D. 1930 (5 June 1984).

B. Actions in Response to the Crisis

The other aspect of policy response to the economic crisis is the set of actual measures undertaken by monetary and fiscal author-

Table IV.9

INTEREST RATES

(Average for the Month, in Percent Per Year)

	Manila Reference Rate= 90 a/	Time Deposit b/	Bank Lending Rate c/
March 1983	14-9/16	14.03	18.56
June 1983	14-1/2	12.81	18.31
September 1983	15-1/4	13.47	17.05
December 1983	17-1/16	14.96	20.88
March 1984	16-15/16	15.31	21.46
June 1984	22-1/4	20.83	25.44
September 1984	25-3/4	23.36	29.67

a/ 90-day Manila Reference Rate

b/ 61-90 days

c/ 60 days and less for secured loans.

Source: *Central Bank*

ities during the period. In a financial system such as that prevailing in the Philippines, government authorities have a larger scope for discretionary action because of the non-existence of a full set of financial markets (a reliable official foreign exchange market is an important missing market) and because of the relative dominance of government banks in the financial markets that exist.

Unlike the case of rules, there are no direct information on the actual actions by the monetary authorities. Only an analysis of the movement of monetary indicators and their components can be done to review their actions. These indicators reflect the effect of both the rules and actions and some effort must be applied to disentangle the two.

Reserve money grew by 49 percent for the whole year of 1983 and by 69 percent for the period June 1983 to June 1984 (see Table IV.10). By any yardstick, these numbers cannot reflect a disinflationary monetary policy. The quantum jump apparently

occurred in the last quarter of 1983 because in the nine-month period between December 1983 and September 1984, the growth rate had fallen to 3.4 percent. The apparently expansionary monetary development is compounded by the fact that the contribution of net foreign assets during the period was decidedly negative: net foreign assets fell by 145 percent through the year of 1983 and by 146 percent for the year beginning June 1, 1983 and ending June 1984. The massive increase in the monetary base can only be traced to increases in net domestic credits.

1. Revaluation Effects

Net domestic assets increased by 155 percent in the year 1983 and by 61 percent in the year ending June 1984. What were the sources of this growth? Revaluation effects generated the biggest source of growth in the period of three discrete devaluations. These revaluations come from three sources: stock revaluation, swap losses, and forward losses. These increases arose mainly from the cover provided by the Central Bank against foreign exchange losses. When the losses actually occurred, the Central Bank effectively lent more in the amount of the loss. The revaluation effect alone was larger than the increase in net domestic assets in 1983. Net domestic credit arising from revaluation increased by 745 percent in the year 1983 and by 324 percent from June 1983 to June 1984.

It is reasonable to view the revaluation effect as non-discretionary within the immediate crisis period. These were commitments arising from the previous regime of aggressive borrowing. Their adverse effects were reaped on the day of reckoning when devaluation became inescapable.

The Central Bank compounded the increase in liquidity in the last quarter of 1984 by failing to collect all the peso equivalent of foreign obligations of the financial system.

It must also be pointed out that huge liquidity advantages which the revaluation differentials might have afforded commercial banks did not materialize because the Central Bank blocked the deposits created by the liability.

After removing the revaluation effect (see the last line of Table IV.10), net domestic assets actually declined by 9 percent in the year 1983. Net domestic assets excluding revaluation increased by 5 percent in the year ending June 1984 and 8 percent in the first nine months of 1984. The inescapable con-

clusion is that in the period when inflation exceeded 40 percent, discretionary monetary policy has been disinflationary on net domestic credit. It is the distribution of the burden of adjustment of these discretionary actions that is important. In this regard, the bias toward placing a greater burden on the private financial sector becomes very obvious. In 1983, net credits to the public sector increased by 55 percent while net credits to the financial system (which includes credits to the Philippine National Bank and other government financial institutions) declined by 8 percent (see Table IV.10). In the twelve-month period from June 1983 to June 1984, net credits to the public sector grew by 88.5 percent while those to the financial system fell by 34.4 percent. The latter recovered to the December 1982 level only in September 1984.

The blocking of the revaluation, which induced deposits with the Central Bank, shut off a potential source of credit to the private banking system in the midst of the crisis. The previous government policy of maintaining an overvalued exchange rate, low domestic interest rates and generous forward cover made it profitable for the private banking system to aggressively increase its foreign exchange exposure. (It also permitted a greater rate of increase in the overall inflow of short-term credit to the country.) The action of the monetary authorities to block the overvaluation gains of the private banking system can be seen as an act of management control to limit the unfavorable effects of bad policy in the past.

2. Public Sector Lending

The increase in net credits to the public sector took the form of budgetary loans and overdrafts which were resorted to in the wake of government revenue shortfalls. (There was actually an overall drop of government securities held by the Central Bank in the period.) The budgetary loans portion increased by 85.2 percent in 1983, by 113.6 percent in the twelve-month period ending March 1984, and by 82.3 percent in the nine-month period from June 1983 to March 1984. In the fourth quarter of 1983 alone, budgetary loans increased by 44.7 percent. Overdrafts by the public sector on the Central Bank were negligible before the fourth quarter of 1983 when a jump to ₱1,946 million was recorded. At the end of the first quarter of 1984 a doubling of the figure to ₱3,952 million was recorded.

The reduction in net lending to deposit money banks took

Table IV·10

RESERVE MONEY, MAIN COMPONENTS

(In Million Pesos)

	1982		1983		1984	
	June	December	June	December	June	September
Reserve Money	15,675	18,664	16,064	27,723	27,082	28,664
Net Foreign Assets	–6,168	–14,953	–23,837	–36,683	–58,691	–53,124
Net International Reserve	–966	–9,067	–16,035	–23,989	–35,565	–37,190
Medium and Long-Term Foreign Liabilities	–5,202	–5,885	–802	–10,641	–15,226	n.d.a.
Blocked Peso Deposits	–	–	–	–2,053	–7,900	–10,930
Net Domestic Assets	21,843	33,617	39,901	64,406	85,773	81,788
Net Credits to the Public Sector	7,438	7,505	7,465	11,621	14,068	11,945
Net Credits to the Financial Sector*	15,142	16,262	14,480	14,895	9,502	16,314
of which						
CB Bills	–	–	–	–	–3,040	–5,709
Emergency Advances	3,142	3,137	3,051	3,787	3,431	4,044
Other Items	–737	9,850	17,956	59,257	40,836	53,529
of which						
Revaluation	2,373	4,525	13,737	38,241	58,199	65,297
Net Domestic Assets Without Revaluation	19,470	29,092	26,164	26,165	27,574	28,259

*Net credits to deposit money banks plus net credits to other financial entities.

n.d.a. — not directly available.

the form mainly of a reduction in rediscounting (a 52.0 percent drop between March 1983 and March 1984) and the effect of open market operations when the Central Bank issued reverse repurchase instruments (a ten-fold increase in these liabilities of the Central Bank between March 1983 and March 1984).

There was an increase in net lending by the Central Bank to "other financial entities," a category that includes thrift banks, but mainly includes the government banks — the Development Bank of the Philippines (DBP) and the Land Bank. The increase in this item was registered mainly in the fourth quarter of 1983 when an increase of 24.5 percent was recorded. The principal reasons for this increase were two: (1) the increase in emergency loans to thrift banks in the same quarter in response to massive withdrawals by depositors and (2) the effort to keep the DBP functional.

The large increase in black market activities in the economy starting the fourth quarter of 1983 caused a rise in the currency-deposit ratio (see Table IV.11) and caused further reductions in the private financial system's resources. This ratio continued to increase in 1984 so that by September, the ratio had increased by 61.7 percent over that of the previous twelve-

Table IV.11

MULTIPLIER, VELOCITY AND CURRENCY DEPOSIT RATIO

	M3 Multiplier a/	Velocity b/	Currency Deposit Ratio c/
March 1983	5.63	0.91	118.6
June 1983	6.21	0.95	98.6
September 1983	5.71	0.89	111.1
December 1983	4.07	0.96	151.9
March 1984	4.68	1.18	138.6
June 1984	1.14	1.23	148.3
September 1984	3.78	n.a.	179.7

a/ Ratio of M3 to reserve money.

b/ Nominal GNP divided by M3.

c/ Ratio of Currency in circulation to demand deposit.

Source of Basic Data: *Central Bank*

month period.

C. Evaluation of the Monetary Policies

The overall effect of these actions by the monetary authorities can be seen in Table IV.11. Since June 1983, the M3 multiplier, which reflects the overall ability of the financial system to convert reserve money for credit to the economy was cut almost by half from 6.21 to 3.78 by September 1984. The combination of increases in reserve requirements and the Central Bank's restriction of credit to the financial system proved effective. During the same period velocity increased from 0.89 to 1.23 as the nominal money stock lagged behind the price increases contained in nominal GNP.

After all the policy actions, the monetary system had a sharply reduced credit expansion capability. The current policy is to maintain reserve money at its present level.

As has been suggested in the previous analysis, monetary policies had been directed at maintaining failing government corporations (such as the DBP) and making up for the sudden revenue shorfalls of the government. Overall, the discretionary actions of the monetary authorities were disinflationary. However, the massive increase in lending to the public sector and to government financial institutions during the same period required an equally massive withdrawal of credit to the private sector as has been previously documented.

There is no doubt that this credit withdrawal reduced domestic spending, a goal of the stabilization program. The question of whether this reduction should have been borne more by the government can however be raised. Were the purposes to which government applied the credit that it used truly crucial?[7/] To fully discuss all the other aspects of this issue raises all the other questions about the government's role in the making of the crisis itself. At this point, it is sufficient to point out that when the crisis struck, the government's immediate response was to consider its requirements first and then the requirements of all other sectors.

The most controversial aspect of the monetary policy response to the crisis had to do with the raising of domestic interest rates.

[7/] For a related study, see Lamberte (1984). The said study has analyzed the financial status of DBP in relation to the 1983-84 financial crisis. DBP borrowed heavily from the Central Bank, national government and from external sources to finance "priority" projects. It is saddled with non-performing assets however. Its efforts to bail out many ailing corporations did not produce the desired results.

As has been pointed out, this policy was carried out through the role of CB bills which paid high interest rates.

The effectiveness of the strategy in defending the exchange rate cannot be questioned. What must be questioned is its place in the current recovery program. The policy instrument used induced high domestic interest rates which put at risk the survival of companies whose difficulties endanger the adjustment effort itself. The old exchange rate system and government budget deficits were important contributory factors to the crisis. That the constraints in the removal of these sources of trouble might have caused further permanent damage during the recovery period is a matter of concern.

IV.4 PRICE ADJUSTMENTS

This section deals with the price intervention policies exercised by the government during the crisis. The inflationary effects of the upward price adjustments of certain key commodities will be examined in a later section.

A. Objectives of the Price Intervention Policies

There have been price intervention policies long before the present crisis. These have been used mainly to protect consumers, particularly the urban low income groups, against unreasonable price increases. The government merely continued to wield these policies during the crisis period. However, starting October 1984, there seems to be an apparent shift towards deregulation.

For the past decade, socialized pricing has been used extensively in basic commodities, petroleum products, electricity and house rent. About thirteen commodities have been in the list of the Price Stabilization Council. The list includes rice, corn grits, chicken, eggs, pork, sugar, milk, canned fish and some school supplies. In addition, prices of petroleum products have been regulated. For instance, diesel, kerosene and LPG which are commodities used by lower income groups, are priced lower than gasoline and other pertoleum products. Electricity rates are also varied to favor the smaller users. These measures are all intended to lessen the impact of price increases on the lower income groups.

Moreover, apartments whose rentals were less than ₱300 a month were allowed only a 10 percent increase in rent annually. Transport fares are also regulated and the prices are set by the Board of Transportation after consultations with the operators and con-

sumers in public hearings.

The various price intervention policies often have conflicting objectives. For example, the price of rice is controlled so as to assure stable and low price for low-income consumers. At the same time, the government has to defend a farm floor price to give higher incomes to farmers and encourage them to produce more to achieve food self-sufficiency. Another example of a conflict in objectives is evident in petroleum product pricing. Considering their importance as factor inputs, minimal increase in the prices of petroleum products commensurate to the rate of depreciation of the peso are desirable. But the government imposed higher taxes on these products in an effort to raise revenues, thus, effecting higher price increases. The examples help demonstrate the conflicting objectives of the price intervention policies of government, objectives such as: 1) low prices, 2) stable prices, 3) higher farm income, 4) more government revenues, and 5) food self-sufficiency.

B. Price Adjustments

In view of the series of *de facto* devaluations that took place between 1983 and 1984, prices of basic commodities were adjusted upwards. The support price for palay went up by 97.1 percent from June 1983 to December 1984 to cover increased production costs due to the series of exchange rate adjustments. Consequently, the real price of rice went up by 72.6 percent. The price adjustments for corn were almost simultaneous with those for rice. The support price increased by 92.3 percent and the retail price by 79.1 percent over the same period. Table IV.12 shows the changes in the support prices and the price ceilings for rice and corn.

Price ceilings of other PSC-controlled commodities were also adjusted upwards to account for higher production costs. Price ceilings of food items were increased on 16 occasions since June 1983. Table IV.13 shows the percentage increases of the eight food items covered by the PSC. The prices of non-food PSC-controlled items were also adjusted during the period.

The long-standing policy of price control, however, was reversed during the last quarter of 1984. A series of delisting actions were effected starting with chicken, pork and eggs on 12 October 1984. A few days later, corn grits was also taken off from the price control list. On 22 November 1984, the market prices of sugar, canned fish and canned liquid milk were allowed to prevail. At present, rice is the only item being controlled. There are indications, however, that this will also be taken off the list. This deregulation is part

Table IV.12

PRICE OF RICE AND CORN

Date of Effectivity	Support Prices		Retail Prices	
	Palay (₱/kg)	Corn (₱/kg)	Rice (₱/kg.)	Corn Grit (₱/kg)
October 1, 1983	1.80	1.40 [a/]	3.30	2.30
November 27, 1983	2.10	1.65		
December 1, 1983			3.30	2.70
May 25, 1984	2.35	2.00		
May 26, 1984			4.25	3.25
June 9, 1984	2.65	2.30	4.85	3.85
October 20, 1984	2.90	2.50	5.35	delisted

[a/] 1 September 1983 for Corn.

Sources: *Price Stabilization Council and NFA.*

Table IV.13

PERCENTAGE INCREASES OF PRICE CEILINGS

(As of 11 October 1984)

Commodities	Percent Increases Relative to June 1, 1983
Rice	72.58
Sugar	88.43
Corn Grits	79.07
Pork	120.81
Chicken	93.20
Eggs	104.44
Canned Fish	131.11
School Pads	73.64
Canned Liquid Milk	133.67
Composition Notebook	73.13
Spiral Notebook	75.76
Pencil	121.43

Source: *Price Stabilization Council.*

of the strategy to encourage greater production of these commodities.

Table IV.14 shows the changes in the domestic prices of petroleum products since July 1983. For the last eighteen months, their prices rose by 129.7 percent on the average. [8/] This is in response to the *de facto* devaluations as well as the additional taxes imposed. The *de facto* devaluations on 23 June 1983, 5 October 1983 and 6 June 1984, and the floating of the peso starting in October 1984 increased the peso cost of fuel imports. Additional ad valorem tax on imports of petroleum products, through Executive Order Nos. 918 (3 November 1983), 946 (29 April 1984) and 955 (6 June 1984), further increased the domestic prices of petroleum products. Moreover, the government took these occasions to increase the specific tax components of the petroleum products. As mentioned earlier, these measures were adopted to meet the government's requirements of higher revenues.

On 20 October 1984, the price structure of petroleum products was revised to reflect current developments. [9/] Presidential Decree No. 1956 created the Oil Price Stabilization Fund (OPSF) to be used to refund losses of oil companies as a result of future depreciations of the peso or a rise in the world price of oil. The OPSF levy was set at 10 centavos per liter by the Board of Energy.

The decree also abolished the Oil Industry Special Fund which was used on oil products. It set this levy as a percentage of the oil companies' share of the price, averaging ₱0.99 per liter.

The additional levies have increased the government's take by ₱0.427 per liter. The oil companies have been given an increase of ₱0.292 per liter to cover the higher peso costs of imported crude oil. The BOE has also granted an increase in the dealer's margin of ₱0.04 per liter for gasoline and diesel, and ₱0.01 per liter for LPG.

Being committed to ensuring stable and low prices for low-income consumers and industrial users, the socialized pricing scheme for petroleum products has been retained. Thus, although the prices of petroleum products were adjusted upwards, the prices of those petroleum products usually used by the lower income groups and

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[8/] The volume of sales for each of the different petroleum products were used as weights to get the average wholesale posted price (WPP). The increase indicated above was obtained by getting the percentage change in the WPP.

[9/] Executive Order No. 988 which took effect October 15, has reduced the import surcharge on crude oil from 10 percent to 5 percent, thereby reducing the rate on import duty on crude oil from 30 percent to 25 percent.

the industrial sector are still priced relatively lower than the rest.[10/]

Transport fares have increased on eight occasions as a consequence of the fuel price adjustments (see Table IV.15). For ordinary buses and jeepneys, the minimum rate went up by an average of 84.6 percent over the period while the rate for each additional kilometer increased by 117.9 percent on the average. This has directly affected the consumers in the form of higher bus, jeepney and taxi fares and indirectly through higher transport costs for producers and traders.

Table IV.14

DOMESTIC PRICES OF PETROLEUM PRODUCTS, (₱/LITER) JULY 1983 – JUNE 1984

Petroleum Product	July 1, 1983 (₱)	Nov. 3, 1983 (₱)	May 18, 1984 (₱)	June 7, 1984 (₱)	Oct. 20, 1984 (₱)
Premium gasoline	5.470	6.470	6.890	8.280	9.24
Regular gasoline	5.270	6.270	6.690	8.030	8.81
Diesel	3.430	4.430	4.890	7.724	7.26
Kerosene	3.440	4.440	4.890	6.210	7.17
Fuel Oil	2.404	3.404	3.664	4.645	5.1933
LPG	2.877	3.827	4.139	5.337	6.065
Avturbo	4.901	5.901	6.294	7.724	9.049
Solvents	4.626	5.626	5.816	7.186	8.6646
Asphalts	2.877	3.878	4.157	5.168	5.5723

Note: For gasoline, diesel and kerosene, the retail prices are used while the wholesale posted prices are used for the other products.

Source: *Board of Energy.*

The import surcharge instituted in December 1982 applies to both fuel and non-fuel imports. Executive Order No. 918 raised the surcharge from 3 percent to 5 percent on 3 November 1983. This was further raised to 8 percent on 29 March 1984 through

[10/] See Section IV.2 for the impact of the change in the specific tax of petroleum products on different income groups.

Executive Order No. 946. In an effort to raise more revenues and dampen imports at the same time, this was again revised upwards to 10 percent effective 6 June 1984 as provided for by EO No. 955. Consequently, this provided additional upward pressure on prices.

Utility rates have also gone up considerably during the period covered by the study. Average water tariff increased by 50 percent, while average power tariff rose by 64 percent.

MERALCO increased its rates to cover the added peso costs of its foreign exchange expenditures due to the series of *de facto* devaluations and the higher operation costs due to inflation. The new rate structure was adopted starting July 1984.

In line with the policy of removing price distortions, MERALCO will reduce the amount of subsidized electrical consumption starting 1985. The six year program allows for the reduction of the subsidized electricity consumption of individual consumers from 200 kwh to 150 kwh while the 90 kwh subsidized consumption of small commercial customers will be lessened to 75 kwh. In the next five years, subsidized residential consumption will be further reduced by 20 kwh every year and commercial establishments by 5 kwh yearly.

In another effort to ease the burden of rising prices on the low income groups, particularly those in the urban sectors, Presidential Decree No. 1912 was issued which extended Batas Pambansa Blg. 125 up to December 1984. BP Blg. 25, which provided for a maximum 10 percent annual increase for apartments covered by PD 20, would have ended last April 1984. While this legislation serves to control the increase in rents, this may also have adverse effects since apartment owners will be discouraged from doing repairs and maintaining their units in good condition considering the increases in the cost of repair over the period.

In line with the current thrust on deregulation, Parliamentary Bill No. 2587 was approved by the Batasan which provides for the lifting of rent control on 1 July 1986. The law also allows for graduated increases in rentals between 1 January 1985 to 1 July 1986.

C. The Desirability of Price Controls

Price controls are desirable only if they are used in the short-run to effect gradual adjustments in prices brought about by severe supply disturbances. In this case, consumers will be spared of unreasonable price increases as they correspondingly adjust the allocation of their resources. With inflation already very high either due

to disruptions in supply or speculation, some price controls may exist to arrest further increases in prices and to discourage further speculations on commodity prices. However, some of the price controls, which were really intended to be temporary, have become regular features of the economic system.

While price controls may benefit the consumers in the short-run in terms of lower prices, they may be detrimental in the long-run. Setting the price artificially low may drive away existing producers and prevent entry of new producers (which could lead to a more competitive market), thereby causing acute shortages. These may also cause producers to reduce the quality of their products in an attempt to cut costs. Moreover, price controls give incorrect price signals, thus preventing the efficient allocation of resources. For instance, the socialized pricing scheme for petroleum products has favored the low income groups, but it also has some negative effects. Due to the significant difference between gasoline and diesel prices, there was a significant shift in demand from gasoline to diesel. The resulting demand for these two products was inconsistent with the refineries' output of the same products. Thus, a demand-supply imbalance has been created. In this case, the price interventions prevented prices from performing their critical role of signals to direct the allocation of resources to their most efficient use.

As observed, price controls are directed at fixing the prices of commodities and making the products available to all income groups. This may be an inefficient way of helping the low income groups. Taking diesel prices as an example, if subsidies for public transport users are so desired, then other mechanisms should be considered

Table IV.15

TRANSPORTATION FARES IN METRO MANILA

Date of Effectivity	Transport Mode	Rate
before 11 July 1983	Bus and Jeepney	₱0.65 for the first 5 kms. and ₱0.14 for every additional km.
	Taxi	₱0.65 for the first 500 m. and ₱0.50 for every 300 m.
11 July 1983	Bus and Jeepney	₱0.65 for the first 4 kms. and ₱0.165 for every additional km; later raised to ₱0.70 for the first 4 kms. for jeepney only

6 November 1983	Bus	₱0.80 for the first 4 kms. and ₱0.21 for every additional km
	Jeepney	₱0.85 for the first 4 kms. and ₱0.21 for every additional km
15 November 1983	Taxi	₱2.50 flagdown for the first 500 m. and ₱0.60 for every 250 km thereafter
28 May 1984	Bus and Jeepney	₱0.90 for the first 4 kms. and ₱0.22 for every additional km
12 June 1984	Bus and Jeepney	₱1.00 for the first 4 kms. and ₱0.265 for every additional km
18 June 1984	Taxi	₱2.50 flagdown for the first 500 m. and ₱1.00 for every succeeding 325 m
25 October 1984	Bus	₱1.20 for the first 4 kms. and ₱0.305 for every additional km
12 November 1984	Taxi	₱2.50 for flagdown and ₱1.00 for every 250 m.

Source: *Board of Transportation*

because only a small fraction (about 5 to 10 percent) of total diesel use occurs in public transportation according to the Meta System's study on Petroleum Products Pricing (1984).

IV.5 WAGE ADJUSTMENTS

The government's policy statement on workers' income has been to relate wage adjustments to changes in productivity, increases in the cost of living, and the economy's capacity to absorb these changes. The inflationary pressures due to the recent peso devaluations and increased tax rates have necessitated government intervention to improve the level of minimum wages. The higher costs of living, rather than productivity increases, prompted the government to adjust wages upwards.

This section discusses the wage adjustments effected by the government during the period January 1983 to December 1984 and wage setting; sufficiency of the legislated wages to meet the basic needs of the worker and his/her family; the coverage of the minimum wage laws; and, degree of compliance by employer with the legislations of wage. The impact of wage adjustments on employment and prices will be considered in later chapters.

A. Scope of Wage-Setting

Minimum wage legislation in the Philippines started on 4 August 1951 with the passage of Republic Act No. 602, otherwise known as the Minimum Wage Law. This provided for a ₱4.00 daily minimum wage for non-agricultural workers and ₱2.00 for agricultural workers. Since then, a total of twenty-seven laws in the form of legislative acts, presidential decrees and wage orders have been effected. Four bills were enacted in the sixties while twelve were passed in the seventies. Eleven laws have already been issued in the present decade. The increasing trend in the number of laws issued reflects the increasing dependence on minimum wage legislation in improving the welfare of labor, particularly low income workers, in the form of higher minimum wage and/or increased allowances.

Wage-setting in the Philippines underwent a significant change beginning 1974, when wage legislation went beyond fixing the minimum wage and included the payment of allowances and thirteenth month pay. This tended to favor the workers in terms of higher pay and wider coverage. The latter is brought about by laws which provided for additional allowances even to those workers receiving more than the minimum wage. On the other hand, this also brought several problems. The increased scope of wage legislation has made it more difficult to enforce them. Moreover, the complex wage structure makes it more difficult on the part of the workers to know what is due them. The change also brought to attention the seemingly wavering stance of the government with regard to workers' income. While the broader scope of wage legislation seeks to increase workers' income, the increasing incidence of exemptions of certain sectors and/or "distressed" companies only serve to emphasize the uneven application of these laws.

Although wage adjustments have been tied up with increases in prices, there has been no explicit policy on the adjustments themselves. In some cases, the magnitude of the increases in legislated wages have compensated fully for the loss in purchasing power since the last adjustment. The more recent trends, however, show that the

increases in wages have not really brought back real wages to their former levels. Is our wage policy such that a benchmark real wage is maintained? Or that percentage changes in minimum wage should only be a certain proportion (less than one) of the inflation rate?

B. Wage Adjustments

The present crisis has induced record-high inflation. With the year-on-year inflation rates steadily increasing from 16.8 percent in November 1983 and peaking to 63.8 in October 1984, the purchasing power of the peso has been continuously decreasing.

To protect the workers against the erosion of their incomes due to inflation, five wage orders have been implemented since June 1983. Wage Order No. 2 provided for increases in the minimum and living allowance rates on two occasions: 6 July 1983 and 1 October 1983. Wage Order No. 3 which was issued on 1 November 1983 further increased the living allowance in two steps, implemented one month apart.

On 1 May 1984, Wage Order No. 4 was issued which led to the integration of the allowances provided for by P.D. Nos. 1614, 1634, 1678 and 1713 into the basic minimum wage. This benefitted the workers in two ways: 1) the amount integrated into the basic wage was slightly more than the sum of the allowances previously granted by the P.D.s, and 2) the overtime pay, 13th month pay and social security benefits, which are all based on the basic wage, have correspondingly increased. However, the integration also meant higher taxes and social security contributions for workers.

Effective 16 June 1984, the basic minimum wage and cost of living allowance was again increased through Wage Order No. 5.

The most recent increase in the legislated minimum wage was through Wage Order No. 6, effective 1 November 1984. It increased the minimum wage by ₱1.50 to ₱2.00 per day and the cost of living allowance by ₱1.50 to ₱3.00 per day .

Tables IV.16 to IV.19 show the changes in the legislated minimum wages of agricultural and non-agricultural workers resulting from the five wage orders. The effective daily minimum wage (EMW)of workers consists of the basic minimum wages, the cost of living allowance (COLA) and the daily equivalent of the mandated thirteenth month pay. The EMW has increased by five times since 1972. However, a closer look at the EMW reveals that before 1984, a substantial portion of the increase in the EMW was due to significant increases in its COLA component. In fact, in December 1983, the COLA and 13th-month pay components were even slight-

Table IV.16

LEGISLATED WAGES IN THE NON-AGRICULTURAL SECTOR, NATIONAL CAPITAL REGION, 1983-1984

Wage Order No.	Date of Effectivity	Minimum Wage (₱)	Cost of Living Allowance (₱)	13th Month Pay (₱)	Effective Minimum Wage Rate (₱)
2	1983 July 6	19.00	13.82	1.58	34.40
	October 1	19.00	14.82	1.58	35.40
3	November 1	20.00	17.82	1.67	39.49
	December 1	21.00	19.32	1.75	42.07
4	1984 May 1	32.00	9.00	2.67	43.67
5	June 16	35.00	14.00	2.92	51.92
6	November 1	37.00	17.00	3.00	57.00

Source: *National Wages Council, Ministry of Labor and Employment.*

Table IV.17

LEGISLATED WAGES IN THE NON-AGRICULTURAL SECTOR, AREAS OUTSIDE THE NATIONAL CAPITAL REGION, 1983-1984

Wage Order No.	Date of Effectivity	Minimum Wage (₱)	Cost of Living Allowance (₱)	13th Month Pay (₱)	Effective Minimum Wage Rate (₱)
2	1983 July 6	18.00	13.82	1.50	33.32
	October 1	18.00	14.82	1.58	34.32
3	November 1	19.00	17.82	1.58	38.40
	December 1	20.00	18.33	1.67	40.99
4	1984 May 1	31.00	9.00	2.58	42.58
5	June 16	34.00	14.00	2.83	50.83
6	November 1	36.00	17.00	3.00	56.00

Source: *National Wages Council, Ministry of Labor and Employment.*

Table IV.18

LEGISLATED WAGES IN THE AGRICULTURAL SECTOR, PLANTATION, 1983-1984

Wage Order No.	Date of Effectivity	Minimum Wage (₱)	Cost of Living Allowance (₱)	13th Month Pay (₱)	Effective Minimum Wage Rate (₱)
2	1983 July 6	16.00	10.42	1.33	27.75
	October 1	16.00	11.42	1.33	28.75
3	November 1	17.00	13.92	1.42	32.34
	December 1	18.00	14.92	1.50	34.42
4	1984 May 1	27.00	6.50	2.25	35.75
5	June 16	30.00	10.00	2.50	42.50
6	November 1	32.00	12.00	2.65	46.65

Source: *National Wages Council, Ministry of Labor and Employment.*

Table IV.19

LEGISLATED WAGES IN THE AGRICULTURAL SECTOR, NON-PLANTATION, 1983-1984

Wage Order No.	Date of Effectivity	Minimum Wage (₱)	Cost of Living Allowance (₱)	13th Month Pay (₱)	Effective Minimum Wage Rate (₱)
2	1983 July 6	15.00	5.48	1.25	20.73
	October 1	15.00	6.48	1.25	21.73
3	November 1	16.00	6.48	1.33	23.81
	December 1	17.00	7.48	1.42	25.90
4	1984 May 1	21.00	4.00	1.75	26.75
5	June 16	24.00	6.00	2.00	32.00
6	November 1	26.00	7.50	2.15	35.65

Source: *National Wages Council, Ministry of Labor and Employment.*

ly higher than the basic minimum wage rate for non-agricultural workers, almost the same for plantation workers and about half for non-plantation workers. It was only through Wage Order No. 4, which provided for the integration of most of the allowances previously granted, that this trend was reversed.

C. Sufficiency of Wage Adjustments

The five wage legislations mentioned above have increased the effective daily minimum wage by an average of ₱25.22 for non-agricultural workers and ₱18.24 for agricultural workers. As of June 1984, these measures have brought back the real wages for both types of workers to their 1982 levels, even higher than the June 1983 levels (see Tables IV.20 to IV.23). This indicates that the increases in legislated money wages from July 1983 to June 1984 were commensurate to the increase in prices for the same period, as measured by the Consumer Price Index. In July 1984, however, real wage started to decline due to the big jump in prices without any corresponding increase in legislated wages. The declining trend in real wages was reversed only in November of the same year when the legislated wage was increased through Wage Order No. 6. The increase, however, was not enough to compensate for the loss in purchasing power due to inflation since the last wage adjustment in June 1984. Continuing price rises, however, are expected to quickly erode the gains in real wages over the next months, unless legislated money wages are again increased or counter-inflationary measures are successful.

The present income package has to be compared with the minimum income required to meet the basic needs of an average family. Several researchers have come up with their own estimates of subsistence income, and these can be used to evaluate the government-determined minimum wage levels. The more notable of these studies are those done by Abrera (1974), Tan and Holazo (1975), the World Bank (1975) and the Center for Research and Communication (1982).

The National Wages Council (NWC), the advisory body to the President on wage-related matters estimated the average cost of daily food and other basic necessities (ACDFOBN) to be ₱52.13 as of June 1981. This figure was based on the average cost of daily nutritional requirements for the reference family of six, computed to be ₱32.32 The total figure of ₱52.13 for ACDFOBN was derived by assuming that food items constitute 62 percent of total expenditure.

Using the growth rate of CPI for food items in Metro Manila, the average costs of daily nutritional requirement were estimated

Table IV.20

LEGISLATED MONEY AND REAL WAGES IN THE NON-AGRICULTURAL SECTOR, NATIONAL CAPITAL REGION, 1981 – JULY 1984

Period	Legislated Money Wage (₱)	Consumer Price index (1978=100) (₱)	Legislated Real Wage Rate (₱)
1981	31.82	156.9	20.28
1982	31.82	176.1	18.07
1983			
June	31.82	187.2	17.00
July	34.40	193.3	17.80
August	34.40	195.4	17.60
September	34.40	195.8	17.57
October	35.40	200.7	17.64
November	39.49	219.4	18.00
December	42.07	236.6	17.78
1984			
January	42.07	250.3	16.81
February	42.07	255.4	16.47
March	42.07	256.4	16.41
April	42.07	258.5	16.27
May	43.67	264.0	16.54
June	51.92	285.7	18.18
July	51.92	306.5	16.94
August	51.92	313.6	16.56
September	51.92	319.0	16.28
October	51.92	318.3	16.31
November	57.00	332.7	17.13

Source: *National Wages Council, Ministry of Labor and Employment.*

Table IV.21

LEGISLATED MONEY AND REAL WAGES IN THE NON-AGRICULTURAL SECTOR, AREAS OUTSIDE NATIONAL CAPITAL REGION, 1981 – JULY 1984

Period	Legislated Money Wage (₱)	Consumer Price index (1978=100) (₱)	Legislated Real Wage Rate (₱)
1981	30.74	153.6	20.01
1982	30.74	172.6	17.81
1983			
June	30.74	183.9	16.72
July	33.32	188.0	17.72
August	33.32	191.6	17.39
September	34.32	192.4	17.84
October	34.32	194.4	17.65
November	38.40	204.9	18.74
December	40.99	221.5	18.51
1984			
January	40.99	235.9	17.38
February	40.99	243.5	16.83
March	40.99	249.7	16.42
April	40.99	253.9	16.14
May	42.58	257.9	16.51
June	50.83	273.2	18.60
July	50.83	298.5	17.07
August	50.83	307.1	16.55
September	50.33	315.1	16.13
October	50.83	320.4	15.86
November	56.00	332.6	16.84

Source: *National Wages Council, Ministry of Labor and Employment.*

Table IV.22

LEGISLATED MONEY AND REAL WAGES IN THE NON-AGRICULTURAL SECTOR, PLANTATION, 1981 – JULY 1984

Period	Legislated Money Wage (₱)	Consumer Price index (1978=100) (₱)	Legislated Real Wage Rate (₱)
1981	26.18	153.6	17.04
1982	26.18	172.6	15.17
1983			
June	26.18	183.9	14.24
July	27.75	188.0	14.76
August	27.75	191.6	14.48
September	27.75	192.4	14.42
October	28.75	194.4	14.79
November	32.34	204.9	15.78
December	34.42	221.5	15.54
1984			
January	34.42	235.9	14.59
February	34.42	243.5	14.14
March	34.42	249.7	13.78
April	34.42	253.9	13.56
May	35.75	257.9	13.86
June	35.75	273.2	15.57
July	42.50	298.5	14.24
August	42.50	307.1	13.84
September	42.50	315.1	13.49
October	42.50	320.4	13.26
November	46.65	332.6	14.03

Source: *National Wages Council, Ministry of Labor and Employment.*

Table IV.23

LEGISLATED MONEY AND REAL WAGES IN THE NON-AGRICULTURAL SECTOR, NON-PLANTATION, 1981 – JULY 1984

Period	Legislated Money Wage (₱)	Consumer Price index (1978=100) (₱)	Legislated Real Wage Rate (₱)
1981	19.65	153.6	12.79
1982	19.65	172.6	11.38
1983			
June	19.65	183.9	10.68
July	20.73	188.0	11.03
August	20.73	191.6	10.82
September	20.73	192.4	10.77
October	21.73	194.4	11.18
November	23.81	204.9	11.62
December	25.90	221.5	11.69
1984			
January	25.90	235.9	10.98
February	25.90	243.5	10.64
March	25.90	249.7	10.37
April	25.90	253.9	10.20
May	26.75	257.9	10.37
June	32.00	273.2	11.71
July	32.00	298.5	10.72
August	32.00	307.1	10.42
September	32.00	315.1	10.16
October	32.00	320.4	9.99
November	35.65	332.6	10.72

Source: *National Wages Council, Ministry of Labor and Employment.*

for July 1983 to November 1984. The average cost of daily food and other basic necessities were derived, using the overall CPI for Metro Manila. The results are shown in Table IV.24.

Relating these figures with the take-home pay of minimum wage workers shown in Table IV.25, it is clear that an average household with only one minimum wage worker will not be able to meet its basic nutritional requirements. However, with two full-time workers in the family, the basic food needs could be met but not the other needs. According to the NCSO, the average number of employed workers per family is about 2.0.

The NWC estimates, as compared to the results of the other studies shown in Table IV.26, more or less lie in the middle of the scale. If we use the Tan-Holazo study, which gives the lowest estimates, a family with two employed members receiving the legislated minimum pay would be more than able to support their basic needs.

D. Coverage

The next issue relates to the coverage of these wage legislations. In general, the legislated wages would apply to those workers in the formal private sectors. Excluded are individuals working in the informal sector and government employees. Regarding the latter group, several laws have been issued which provided for increased salary and/or allowances. In November 1983, an additional ₱100 cost-of-living allowance was granted to government workers. Executive Order No. 951-A provided for a 10 percent across the board salary increase to officials and employees of government owned/or controlled corporations and financial institutions, effective 1 May 1984. In June 1984, President Marcos approved a Cabinet recommendation granting additional ₱100 to ₱150 cost-of-living to the 1.2 million national government employees. Notwithstanding all these adjustments, the actual minimum wage rate in the government sector is less than the legislated effective minimum wage rate in the private sector. Thus, how many are actually benefitted by the minimum wage legislation? How effective are these minimum wage legislations in helping the average Filipino worker?

According to the National Wages Council, about 23 percent of those employed in 1983 are minimum wage workers. These would be the workers directly affected by the minimum wage laws. In addition, workers who are earning less than ₱1,800.00 a month are also benefitted in terms of increased allowances. These adjustments may also tend to push up the incomes of the other workers in order

Table IV.24

AVERAGE COST OF BASIC NEEDS[a/]

(Pesos)

Period	Average Cost of Daily Food Needs (₱)	Average Cost of Daily Basic Needs (₱)	Average Cost of Monthly Food Needs (₱)	Average Cost of Monthly Basic Needs (₱)
1983				
June	36.94	62.48	1,108.20	1,874.40
July	37.70	64.51	1,131.00	1,938.30
August	38.26	65.21	1,147.80	1,956.30
September	38.16	65.35	1,144.80	1,960.50
October	39.56	66.98	1,186.80	2,009.40
November	44.17	73.22	1,325.10	2,196.60
December	48.49	78.96	1,454.70	2,368.80
1984				
January	50.69	83.53	1,520.70	2,505.93
February	52.15	85.24	1,564.50	2,557.20
March	51.82	85.57	1,554.60	2,567.10
April	52.06	86.27	1,561.80	2,588.10
May	53.92	88.11	1,617.60	2,643.30
June	59.02	95.35	1,770.60	2,860.50
July	63.92	102.29	1,917.60	3,068.70
August	66.39	104.66	1,991.70	3,139.80
September	68.03	106.46	2,040.90	3,193.80
October	67.00	106.23	2,010.00	3,186.90
November	70.60	111.03	2,118.00	3,330.90

[a/] For a family of six living in Metro Manila

Table IV.25

AVERAGE DAILY AND MONTHLY TAKE-HOME PAY OF MINIMUM WAGE EARNERS, NATIONAL CAPITAL REGION

Period	Daily Take-Home Pay (₱)	Monthly Take-Home Pay a/ (₱)
1983		
June	28.96	731.38
July	31.46	794.50
August	31.46	794.50
September	31.46	794.50
October	32.46	819.76
November	36.20	914.76
December	38.70	977.28
1984		
January	38.70	977.28
February	38.70	977.28
March	38.70	977.28
April	38.70	977.28
May	39.38	944.45
June	47.38	1,196.45
July	47.38	1,196.45
August	47.38	1,196.45
September	47.38	1,196.45
October	47.38	1,196.45
November	49.50	1,249.87
December	49.50	1,249.87

a/ This assumes an average of 25.25 working days per month.

Table IV.26

POVERTY THRESHOLDS
FEBRUARY 1984

1. Tan-Holazo (1975): With Food Variety 6-member household	
a. Metro Manila	1,306.36
b. Philippines	1,082.43
2. World Bank (1975): 6-member household "Least Cost" Consumption Basket	
a. Urban	3,469.92
b. Rural	2,613.12
C. Philippines	2,784.48
3. Abrera (1974): 6-member household	
a. Manila and Suburb	2,997.85
b. Other Urban Areas	2,487.76
c. Rural	2,171.74
4. Center for Research and Communication (January 1982): 5-member household	
a. Metro Manila	3,515.12

Source: Table taken from UPSE's *"An Analysis of the Philippine Economic Crisis," (1984).*

to correct the resulting distortions in the wage structure within the firms. The actual adjustments in the wage structure would depend, of course, on the strength of the workers' groups in negotiating their collective bargaining agreements.

E. Degree of Compliance

Another important aspect of the wage legislations is the degree of compliance. The absence of government inspection teams makes the enforcement of the various laws difficult. Employers have means of circumventing these laws, such as hiring workers on casual basis and keeping employees on an apprentice status beyond the period allowed by law. The so-called distressed firms may even apply for

exemption from these laws. Further, the workers themselves may agree to lower wages in view of the high unemployment and underemployment rates.

An increasing number of applications for exemptions from the wage orders have been filed since the first wage order was issued. Three hundred forty applications were received by MOLE in connection with W.O. No. 1, of which 57 percent were approved. For W.O. No. 2, 590 firms applied for exemption and 37 percent were granted. Out of 1,083 applications filed in connection with W.O. No. 3, only 32 percent were approved. The fourth wage order provided for mandatory increase and consequently no exemptions were possible. For W.O. No. 5, 911 applications were received and 32 percent have been granted. The rise in the number of applications for exemptions indicate that more and more firms find it harder to comply with the wage increases.

Available information shows that for the period 1976 to 1979, about 9 percent of the establishments inspected were found violating minimum wage legislation, 19 percent violating laws on cost of living allowances and 12 percent not following the rule of 13th-month pay. For 1980 to 1981, based on an inspection of establishments with complaints from workers, the percentages were much higher – 25 percent, 48 percent, and 21 percent, respectively. Moreover, from January to June 1984, about 28 percent of the actual strikes declared were due to violations of minimum wage legislation. In the absence of inspection teams from the Ministry of Labor and Employment, it is likely that there could be more firms not complying with the legislated wages.

A related concern is the relative impact of wage legislation on different firms. While these laws are intended to improve the welfare of the low-income workers, it may also prove to be inequitable in the sense that "efficient" firms are the ones penalized. The firms, who follow the laws strictly, will incur higher production costs due to increased labor costs, and this may render them less competitive in the market.

To summarize, this section has focused on the wage adjustments which have been instituted since June 1983. The sufficiency and coverage of the adjustments have been examined. The analysis, however, dealt with the legislated wages only. An examination of the impact of the present crisis on the actual incomes of the different household groups would have been more desirable. The lack of current information on this area, however, precludes any analysis of this sort. Not only is there lack of data on actual incomes of different income groups nor on changes in income distribution, but also on

actual wages received. The Central Bank used to publish a series on nominal and real wages received by different types of workers. However, the CB stopped generating the series in 1980 and the slack was not taken up by any other agency. In view of the importance of data series on nominal and real wages, NEDA-NCSO should make this undertaking a top priority project.

Chapter V

EFFECTS OF THE VARIOUS MEASURES ON THE BALANCE OF PAYMENTS, INFLATION, OUTPUT AND EMPLOYMENT

This chapter examines the effects of the various stabilization measures adopted by government on the balance of payments, inflation, output and employment. It is divided into three sections. The first section deals with the effects of the measures on the balance of payments; the second, on inflation; and the last, on output and employment.

V.1 EFFECTS OF THE VARIOUS MEASURES ON THE BALANCE OF PAYMENTS

It is still early to determine the full effects of the different policy measures on the balance of payments although some indications can be gleaned from recent data. Looking at the trade balance, moderate success seems to have been achieved so far. The deficit in the current account was reduced drastically by 43.8 percent during the first three quarters of 1984 as compared to the same period in 1983. This is mainly due to the large cutback in imports since exports achieved only a modest growth in the same period (see Table V.1).

The value of exports increased by 8.5 percent during the first three quarters of 1984. The leading exports for 1984 are coconut products, electronics and semi-conductors, and garments (see Table V.2). Exports of coconut products rose by 44.5 percent in the first semester of 1984 compared to the same period in 1983, electronics by 17.7 percent and garments by 17.9 percent. Although export taxes on coconut products were increased (plus initially the 30 percent stabilization tax), these products enjoyed very favorable world market prices. A number of traditional exports, notably sugar and mineral products, suffered a substantial decline due mainly to the depressed world market. On the whole, traditional exports fell by around 12 percent in the first three quarters of 1984 compared to the same period in 1982.

On the other hand, non-traditional exports, particularly electronics and garments, which even at the start, were exempted from the 30 percent stabilization tax, clearly benefitted from the recent devaluation and other trade policies (e.g., the various export incentives). Total non-traditional exports grew by a healthy 21 percent during the first three quarters of 1984. Optimism should, however, be guarded. Electronics and garments, which are the main non-tradi-

Table V.1

BALANCE OF PAYMENTS, 1983-1984

(Million US$)

	1st Sem. 1983 (Actual)	1st-3rd Quarter 1983 (Actual)	2nd Sem. 1983 (Actual)	2nd Sem. 1983 (adjusted for arrears)	1st Sem. 1984 (Actual)	1st Sem. 1984 (adjusted for arrears)	1st-3rd Quarter 1984 (Actual)	1st-3rd Quarter 1984 (adjusted for arrears)	1st-3rd Quarter 1983 to 1st-3rd Quarter 1984 (Actual)	1st-3rd Quarter 1983 to 1st-3rd Quarter 1984 (adjusted for arrears)
I. Current Transactions										
A. Merchandise Trade	−1,305	−1,923	−1,177	−1,177	−286	−286	−491	−491	−74.5	74.5
Exports	2,430	3,688	2,575	2,575	2,583	2,583	4,002	4,002	8.5	8.5
Imports	3,735	5,611	3,752	3,752	2,869	2,869	4,493	4,493	−19.9	−19.9
B. Non-Merchandise Trade	−221	−345	−233	−519	−432	−599	−518	−761	50.1	120.6
Inflow	1,701	2,522	1,426	1,426	1,110	1,110	1,746	1,746	−30.8	−30.8
Personal Income	484	743	460	460	1,329	329			−32.0[a/]	−32.0[a/]
Outflow	1,922	2,867	1,659	1,945	1,542	1,709	2,264	2,507	−21.0	−12.5
C. Transfers	219	360	253	253	118	118	180	180	−50.0	−50.0
Inflow	225	370	258	258	118	118	180	180	−51.4	−51.4
Outflow	6	10	5	5	–	–			−100.0	−100.0
Current Transactions, Total	−1,307	−1,908	−1,157	−1,443	−600	−767	−829	−1,072	−56.6	−43.8

II. Non-Monetary Capital										
A. Long-Term Loans	611	1,018	939	781	333	141	408	198	−59.9	−80.6
Inflow	1,102	1,735	1,234	1,234	621	621	818	818	−52.8	−52.8
Outflow	491	717	295	453	288	480	410	620	−42.8	−13.5
B. Direct Investments	54	89	68	58	12	22	52	62	−41.6	−30.3
Inflow	133	210	122	122	48	48	92	92	−56.2	−56.2
Outflow	79	121	54	64	36	26	40	30	−66.9	−75.2
C. Short-Term Capital (net)	315	−117	−499	−1,152	26	141	93	357	*	*
D. Errors & Omissions	−489	−152	321	321	210	210	303	303	*	*
Non-Monetary Capital Total	491	838	829	8	581	514	856	920	2.1	9.8
E. Monetization of Gold	135	173	48	48	89	89	118	118	−31.8	−31.8
F. Allocation of SDRs	–	–	–	–	–	–				
III. Overall BOP Position	−681	−897	−280	−1,387	70	−164	145	−34	*	−96.2

*Meaningful growth rates cannot be computed using the standard formula due to shifts in sign from negative to positive.

a/ For first semester 1983 to first semester 1984 only.

Source: *Central Bank of the Philippines: Department of Economic Research I.*

Table V.2

VALUES AND GROWTH OF EXPORTS, 1983-1984

(Values in million US$, growth in percent)

	1st Sem. 1983	% Share	2nd Sem. 1983	% Share	1st Sem. 1984[a/]	% Share	3rd Quarter, 1984[a/]	% Share	1st Sem. 1983 to 1st Sem. 1984	3rd Quarter 1983 to 3rd Quarter 1984	1st-3rd Quarter 1983 to 1st-3rd Quarter 1984
TOTAL EXPORTS	2,430	100.0	2,575	100.0	2,583	100.0	1,419	100.0	6.3	12.8	8.5
I. Traditional Exports	1,037	42.7	1,031	40.0	943	36.5	434	30.6	−9.1	−17.5	−11.9
A. Coconut Products	262	10.8	418	16.2	379	14.7	196	13.8	44.6	17.4	
B. Sugar & Products	213	8.8	103	4.0	152	5.9	41	2.9	−28.6	−50.0	
C. Forest Products	143	5.9	188	7.3	134	5.2	62	4.4	−6.3	−37.4	
D. Mineral Products	259	10.6	181	7.2	129	5.0	75	5.3	−50.2	−22.7	
E. Fruits & Vegetables	60	2.5	47	1.8	64	2.5	32	2.2	6.6	33.3	
F. Abaca Fibers	11	.4	7	.3	12	.4	10	.7	9.1	150.0	
G. Tobacco (unmanufactured)	27	1.1	7	.3	20	.8	5	.4	−25.9	9.8	
H. Petroleum Products	62	2.6	80	3.1	53	2.0	13	.9	−14.5	−72.9	
II. Non-Traditional Exports	1,358	55.9	1,488	57.8	1,573	60.9	930	65.5	15.8	29.9	20.7
A. Non-Traditional Manufactures	1,120	46.1	1,266	49.2	1,356	52.5	824	58.1	21.1	34.4	
Electrical & Electrical Equip.	502	20.6	551	21.4	591	22.9	391	27.6	17.7	39.1	
Garments	234	9.6	310	12.0	276	10.7	164	4.5	17.9	16.3	
Others	384	15.8	405	15.7	489	18.9	369	26.0	27.3	93.2	
B. Non-Traditional Unmanufacture	238	9.8	222	8.6	217	8.4	106	7.5	−8.8	2.9	
III. Special Transactions	9	.4	48	1.9	4	.1	12	.8	−55.5	−3.6	
IV. Re-Exports	26	1.1	8	.3	63	2.4	44	3.1	142.3	100.0	

[a/] Totals may not add up due to rounding.

Source: *Central Bank of the Philippines: Department of Economic Research (International).*

tional exports (comprising more than 30 percent of non-traditional exports) have very low value added.[1/] It is well to note that quotas are imposed on garment exports. In general, there is a rising protectionism in the West. Future developments with regard to trade policies of trading partners would certainly have an effect on export prospects.

Total imports, on the other hand, went down sharply by around 20 percent from the first three quarters of 1983 to the first three quarters of 1984. This compares well with the 10.3 percent average annual growth rate of total imports during the period 1975-1983. The biggest cutback was for capital goods imports which fell by around 35 percent during the period (see Table V.3).[2/] There was hardly any foreign exchange available for import of capital goods. Moreover, foreign investors as well as domestic entrepreneurs were hesitant to invest under the current economic and political uncertainty. Imports of raw materials and intermediate goods declined by only 13 percent during the same period since they are given priority in foreign exchange allocation. Finally, as expected, import of consumer goods went down substantially by around 28 percent.

The cutback on imports could be attributed to three main factors, namely: (1) exchange control (as manifested in priority list for imports by the CB), (2) the series of *de facto* devaluations culminating in the free float of the peso which raised the price of foreign goods, and (3) tight monetary and fiscal policies which effectively reduced the economy's expenditure, particularly on imports, both private and public.

As pointed out in the earlier chapters, exchange controls have been mainly in the form of various CB measures which regulate foreign asset holdings of banks and impose a priority list for foreign exchange allocation. Importations require prior CB approval, usually upon recommendation or endorsement by the BOI or other government agencies. Many other commodities are banned outright. Interestingly, before the crisis, the Philippines was moving toward liberalizing import licensing. Under such program, a number of commodities were already deleted from import bans. However, when BOP imbalance became more acute during the latter half of 1983, all attempts at liberalization were stopped and exchange controls be-

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[1/] Furthermore, a high growth rate recorded for electronics may have been partly due to better reporting.

[2/] Note that capital goods import was growing at an average annual rate of 6 percent from 1975 to 1983.

Table V.3

VALUES AND GROWTH OF IMPORTS, 1983-1984
(Values in million US$, growth in percent)

	1st Sem., 1983	% Share	2nd Sem., 1983	% Share	1st Sem., 1984*	% Share	3rd Qtr., 1984*	% Share[1/]	1st Sem., 1983 to 1st Sem., 1984	3rd Qtr., 1983 to 3rd Qtr., 1984	1st-3rd Qtr., 1983 to 1st-3rd Qtr., 1984
TOTAL IMPORTS	3,735	100.0	3,751	100.0	2,868	100.0	1,625	100.0	–23.2	–13.4	–19.9
I. Capital Goods	840	22.5	858	22.9	538	18.8	292	18.0	–36.0	–34.2	–35.4
II. Raw Materials and Intermediate Goods	1,459	39.1	1,559	41.6	1,263	44.0	708	43.6	–13.4	–13.3	–13.4
Wheat	70	1.9	64	1.7	54	1.9	41	2.5	–22.8	10.8	–12.0
Crude materials	90	2.4	94	2.5	61	2.1	40	2.5	–32.2	–25.9	–29.2
Chemicals	367	9.8	140	3.7	267	9.3	196	12.1	–27.2	–9.2	–20.4
Others	932	25.0	1,261	33.6	881	30.7	431	26.5	–5.4	–84.5	–9.1
III. Mineral Fuels and Lubricants	1,135	30.4	997	26.6	830	28.9	472	29.0	–26.9	7.3	–17.3
IV. Consumer Goods	302	8.1	337	9	237	8.3	106	6.5	–21.5	–39.4	–27.9

*Totals may not add up due to rounding.

1/The balance is under the special transactions account.

Source: Central Bank of the Philippines: Department of Economic Research (International).

came very restrictive. At the start, foreign exchange earnings were allocated only for interest and oil payments. The series of *de facto* devaluations that resulted helped ease the need for more controls. In October 1984, more liberal measures were initiated. The CB deregulation on the bank's allowable foreign exchange retention may be cited here as an example. Although the series of *de facto* devaluations helped curb imports in the last one and a half years, direct exchange controls were considered a critical factor in bringing down imports.

The present crisis has produced an inflation problem more severe than that caused by the oil shocks in 1974 and 1978. The successive devaluations since June 1983 and the imposition of additional taxes sparked a series of price adjustments. Just when the year-on-year inflation rate has been reduced to a one-digit rate during the first half of 1983, developments thereafter gave way to unprecedented inflation rates since the 1950s.

The Consumer Price Index started to climb in June 1983, reaching double digit year-on-year inflation rate by October of the same year (see Table V.4). It continued to increase rapidly reaching a peak at 63.8 percent in October 1984. The CPI level continued to go up till the end of the year although the year-on-vear inflation rate started to go down. The decline in the inflation rate is due to the high CPI levels in November and December of 1983.

This section discusses the effects of the various measures adopted by government during the crisis period on inflation.

Under fixed exchange rate, balance-of-payments deficits, by accommodating excess demand, reflect part of the inflationary pressure that is not translated in actual price increases. When the balance-of-payments deficits become unsustainable, the economy could either (a) resort to more import controls including quantitative restrictions (QRs) and other exchange controls, or (b) devalue its currency. If more QRs are imposed to arrest growing deficits, excess demand (now unaccommodated) would result. As a consequence, the price level would rise giving way to the inflationary pressure. Devaluation, on the other hand, would directly raise the price of tradables, thereby curbing demand for these products and relieving the excess demand pressure. In both cases, the price level rises. In the former case, however, the increase in price is a premium to producers of commodities affected by the QRs (and importers given the license to import these commodities), whereas in the latter case, exporters and producers of import substitutes are uniformly rewarded.

In response to the balance of payments crisis, the government used both measures. More exchange controls were imposed while at

Table V.4

YEAR-ON-YEAR INFLATION RATES, PHILIPPINES

Month	Inflation Rate
1983	
January	6.9
February	6.7
March	6.4
April	6.2
May	6.7
June	7.3
July	7.9
August	9.1
September	9.1
October	10.3
November	16.8
December	26.1
1984	
January	33.3
February	36.6
March	39.3
April	40.7
May	42.1
June	49.0
July	58.0
August	60.4
September	63.6
October	63.8
November	60.6

Source: *National Census and Statistics Office.*

the same time the peso was devalued. As discussed above, both measures are necessarily inflationary. It is, however, difficult to say how much is due to devaluation and how much is caused by more controls.

From June 1983 to October 1984, the peso was depreciated from ₱11 per dollar to around ₱20 per dollar. This converts to a nominal appreciation of the dollar by around 82 percent. Inflation during the same period was around 68 percent (this is the percentage change in the GDP deflator). It is difficult to determine how much of this was due to devaluation since other factors worked simultaneously – e.g., exchange controls, monetary and fiscal policies. What is more important to note is that the increase in the price level does not necessarily offset the effects of devaluation.

To assess the effects of the various measures on inflation, Mariano's (1984) inflation model is used. The said model regressed the consumer price index (CPI) against the following variables: (1) the average wholesale posted price of petroleum products (PMOILDP); (2) Hongkong blackmarket to official exchange rate ratio (ERMBMERP); (3) total domestic liquidity as a percent of GNP (TOTTGQ3); (4) annual import price index for non-fuels multiplied by (1+T) / (1+T 1972)[3/] and the ratio between the current exchange and the exchange rate in 1972 (PMPES); (5) natural logarithm of the average percentage increase in the price ceilings for food items controlled by the Price Stabilization Council (PCFOOD-3L); (6) average yield of 91-day Treasury Bill (91-DAY); (7) legislated effective minimum wage rate (WLNANCR); (8) peso-denominated export price index for all commodities (PXPEXP); and (9) lagged values of CPI. Annex III gives the full description of the said model.

The average wholesale price of petroleum products rose by 130 percent in the 18-month period covering June 30, 1983 to October 30, 1984. Over a quarter of this (or 34.1 percentage points) is attributable to the imposition of additional taxes on petroleum products. The tax on petroleum products expressed in pesos per liter ballooned by 270 percent on the average for the same reference period.

Using actual values of the independent variables, Mariano's (1984) inflation model predicted the inflation rate to be 10.23 and 48.91 percent, respectively for 1983 and 1984. However, had there been no change in petroleum product taxes the simulated inflation rate is 10.1 percent for 1983 and 44.1 percent for 1984. This indicates that 0.1 percentage point (or 1 percent in proportional terms) of the inflation rate in 1983 was due to the increased tax on

[3/] Where T = tariff.

petroleum products. In 1984, additional petroleum product taxes accounted for 4.8 percentage points (or 9.8 percent) of the inflation rate for the year.

The same inflation model predicted the inflation rate in 1983 to be 10.22 and that in 1984 to be 48.44 percent had there been no additional import surcharge on non-fuel imports. This implies that a minimal 0.01 percentage point in 1983 and 0.47 percentage point in 1984 of the inflation rate is due to the import surcharge.

Price ceilings of PSC-covered commodities have increased on 16 occasions since June 1983. The adjustments in the price ceilings of these food items caused the CPI to move up. Rice, the single most important item in the consumer basket, has a weight of 11.6 percent while corn constitutes 3.2 percent of the CPI basket. Together with pork, chicken, eggs, sugar, milk and canned fish, these items constitute about 25 percent of the basket. For the last 18 months, these items have increased by 96 percent on the average. Using the inflation model, these price increases have contributed 0.05 percentage point to the annualized inflation rate for 1983 and 0.65 percentage point to the 1984 inflation rate.

Another group of commodities which have been severely affected by the present crisis are the petroleum products. For the last eighteen months, the average wholesale price of these products has risen by 129.7 percent. This is in response to the devaluations as well as to the additional tax impositions. The devaluations on 23 June 1983, 5 October 1983 and 6 June 1984 and the floating of the peso since October 1984 increased the peso cost of fuel imports. Additional ad valorem tax on imports of petroleum products through Executive Order Nos. 918, 946, and 955, further increased the domestic prices of petroleum products. Moreover, the government took these occasions to increase the specific tax components of the petroleum products. These measures were adopted to meet the government's requirements of higher revenues. However, being committed to ensuring stable and low prices to low-income consumers and industrial users, the socialized pricing scheme has been retained. Thus, petroleum products usually used by the lower income groups and the industrial sector are still priced relatively lower than the rest.

Looking at the composition of the CPI basket, it is apparent that the average household would be most sensitive to increases in the prices of diesel, kerosene and LPG. Using the inflation model, the elasticity of inflation with respect to petroleum prices is .155 in the short-run and .687 in the long-run. Translated in terms of impact on the CPI, the 5-step adjustment in the prices of petroleum

products since June 1983 have resulted in an additional increase of 1.46 percentage points in the annualized inflation rate in 1983 and 13.61 percentage points in 1984.

Upward adjustments in wages have been implemented to help workers cope with increases in prices of commodities and services. But one may ask if these wage increases have led to more price increases. The issue, therefore, is to what extent these wage adjustments are inflationary.

According to the inflation model, a one-percent change in the legislated wages will lead to a 0.24 percent increase in the inflation rate. The low elasticity would seem to indicate that increases in wage rate would not lead to inflation rates as high as can be expected from similar increases in prices of petroleum products. Specifically, the five recent wage orders have resulted in 0.47 percentage point increase in the inflation rate in 1983 and 3.75 percentage points in 1984.

The relatively weak effects of minimum wage increases could be attributed to two factors: 1) the weak enforcement of the legislation, and 2) the policy with regard to wage adjustments. Looking at the historically legislated wage series, it seems that wages have been adjusted as a reaction to increases in the cost of living.

In the monetary sector, there were three major policy instruments used by the government – reserve requirements, rediscounting and open market operations. As discussed in the previous chapter, these measures affected total liquidity and interest rates – two variables which proved to be very important in Mariano's inflation model. Indeed, regression results for the model show that inflation is most sensitive to changes in total liquidity as a percentage of GNP (TL/GNP), having the highest long-run (inflation) elasticity of 0.760 while the 91-day Treasury Bill rate ranks third with long-run elasticity of 0.353.

As a result of the various measures, total liquidity (as measured by M3) rose from ₱99.8B in June 1983 to ₱110.9B in November 1984, with very minimal fluctuations in between (see Table V.5). As a percent of GNP, this represents a change from a rate of 1.97 in June 1983 to 2.44 in November 1984.

Fixing the TL/GNP rates at June 1983 level, simulation of the model shows that these changes in TL/GNP accounted for additional percentage points in annualized inflation rate of 0.19 in 1983 and 6.66 in 1984. For 1984, this represented around 14 percent of total inflation in 1984.

The 91-day Treasury Bills rate (91-day T-B) was used in the model to serve as proxy for interest rate. Table V.6 gives the rates

Table V.5

TOTAL LIQUIDITY AND TOTAL LIQUIDITY/GNP, 1983 AND 1984

	Total Liquidity[a/]		TL/GNP[b/]	
	1983	1984	1983	1984
January	94,730.5	112,153.0	1.870	2.342
February	95,476.0	112,497.0	1.885	2.349
March	96,774.6	116,259.0	1.911	2.428
April	97,418.2	116,248.0	1.923	2.427
May	98,710.2	114,928.0	1.949	2.400
June	99,789.1	112,036.0	1,970	2.339
July	99,249.8	111,303.0	2,060	2.447
August	99,548.6	110,349.0	2.067	2.426
September	100,722.8	108,266.0	2.091	2.380
October	103,607.3	108,160.0	2.151	2.378
November	107,850.6	110,911.0	2.239	2.438
December	112,962.0		2.345	

[a/] In million ₱.

[b/] Computed using the semestral values of GNP (at constant 1972 prices).

Source: *Central Bank, Department of Economic Research-Domestic, National Accounts Staff, NEDA.*

Table V.6

ANNUAL YIELD ON 91-DAY TREASURY BILL RATES, 1983-1984

(In Percent)

	1983	1984
January	14.04	15.63
February	14.05	16.32
March	14.04	16.54
April	14.03	16.86
May	13.99	19.78
June	13.56	26.63
July	13.70	31.62
August	14.06	33.54
September	14.30	37.78
October	14.58	42.04
November	15.04	43.00
December	15.38	42.22

Source: *Central Bank, Department of Economic Research-Domestic.*

during the period 1983 to 1984. It shows a sharp and steady increase from 13.6 percent in June 1983 to 44.2 percent in December 1984.

Again, fixing the 91-day T-B rate at its June 1983 level and simulating what would have been the inflation rate using the inflation model, results show that these changes brought about additional percentage points in the annualized inflation rate of 1.04 in 1983 and 7.81 in 1984. For 1984, this contributed around 16 percent to the total inflation rate.

These are not insignificant results. They show a combined effect of around 30 percent on inflation, arising from policy actions in the monetary sector alone. There may have been trade-offs between inflation and unemployment (and output). Still, it is important to note how sensitive prices are to the monetary policy measures.

V.2 OUTPUT AND EMPLOYMENT EFFECTS

The various measures adopted by government to improve the balance of payments position have inevitably impinged on output and employment. As discussed above, both fiscal and monetary policies generally tended to be deflationary, especially towards the second semester of 1984. This came at a time when prices of exportables, notably sugar and metal products, were still depressed and natural calamities affected the harvest of key agricultural regions in the country. The series of *de facto* devaluations effected during the period raised the cost of imported raw materials badly needed by import-dependent industries. The foreign exchange squeeze coupled with the tight credit policy of the Central Bank prompted producers to slow down production.

Table V.7 presents the quarterly growth rates of output for major industrial sectors. Agriculture, fishery and forestry posted negative growth rates starting the second quarter of 1983 up to the first quarter of 1984. This was due to the combined effect of bad weather conditions, low international price for sugar, and high prices of inputs, notably fertilizer and pesticides. Although a positive growth rate was registered in the second and third quarters of 1984, a huge drop in agricultural output is expected towards the last quarter of 1984 due to the two typhoons that devastated the crops in the Visayas and Mindanao and to disappointingly high interest rates on borrowed funds.

The industrial sector as a whole started to post a negative growth after the first *de facto* devaluation in 1983 and has never recovered

Table V.7

ANNUALIZED QUARTERLY GROWTH RATES OF OUTPUT, BY INDUSTRIAL ORIGIN

(At Constant Prices)

	1983				1984		
	I	II	III	IV	I	II	III
Agriculture, Fishery and Forestry	4.6	–4.6	–4.1	–1.5	–4.4	5.8	1.0
Industrial Sector	4.2	9.8	–2.0	–8.8	–6.5	–11.4	–2.6
Mining and Quarrying	4.1	10.8	5.7	–26.5	–21.4	–18.6	–43.9
Manufacturing	4.4	9.3	11.5	–7.5	–6.0	–6.6	–1.8
Construction	3.5	11.0	–24.8	–6.1	–5.7	–24.8	7.5
Electricity, Gas and Water	7.2	10.6	10.0	15.0	4.5	4.8	4.7
Service Sector	3.7	4.2	4.0	2.5	–2.2	–1.9	–4.3
Transport, Communication and Storage	4.2	4.5	1.4	–2.1	–4.3	–6.3	–4.9
Trade	2.5	2.5	8.6	11.4	–2.5	6.8	5.3
Finance and Housing	–0.5	3.4	–2.9	–5.6	–3.2	–5.2	–6.0
GDP	4.1	3.1	0.0	–2.6	–4.3	–2.8	–2.8
GNP	3.0	4.8	1.6	–3.9	–5.8	–4.8	–4.9

Source of Basic Data: *NEDA Statistical Coordinating Office.*

since then. Among the industrial groups, mining and quarrying suffered most. Aside from depressed metal and mineral prices in the world market, high cost of energy and prohibitive interest rates on working capital contributed to the decline of its output. Several mining firms simply ceased operation during this period.

One seeming bright spot that can be gleaned from Table V.7 is the positive growth rate registered by the construction industry group for the third quarter of 1984. But this was mainly due to the 42.6 percent increase in government expenditure on construction during the same period. The electricity, gas and water industry group also showed a consistent positive growth rate during the period under study. The government's policy to give priority to this industry group helps explain its positive growth. Note, however, that the quarterly growth rates of this sector in 1984 were considerably lower than those in 1983 for the comparable period, suggesting that this sector was also severely affected by the economic crisis.

The service sector supporting the agricultural and industrial sectors suffered the same fate. The output of finance and housing industry group dropped precipituously in the third quarter of 1984 as a result of a series of bank runs, high default rates, high yields for competing government financial instruments, specifically Central Bank and treasury bills, and high interest rate that practically ravaged the housing industry. Only trade performed well during the period. Heavy drawdown on inventories made possible the positive growth rate for this industry group during the period of analysis.

The economy as a whole performed miserably. GDP growth rate continued to slide down starting from the second quarter of 1983 up to the fourth quarter of 1984. While the economies of other ASEAN countries grew at an enviable rate in 1984, the Philippine economy shrank by 4.0 percent in the same year (according to NEDA's advanced estimate) given the same international environment (see Table V.8).

The general slowdown of the economy has indeed posed a great problem to labor absorption. There is no doubt that government favors high employment. In fact, one of the reasons often cited for taking over ailing corporations especially during this crisis period is to save jobs. At the same time, it is government's avowed policy to protect worker's wages from being eroded in times of escalating prices, hence the minimum wage law. What have been the effects of the series of minimum wage adjustments and tight monetary and fiscal measures adopted by government during the crisis period on employment?

Table V.9 gives information on the establishments and workers

Table V.8

REAL GDP GROWTH RATES FOR ASEAN COUNTRIES

	1982	1983	1984
Philippines	2.4	1.1	– 4.0
Indonesia	5.0	3.0	4.2
Malaysia	4.6	5.6	5.5
Singapore	6.3	6.1	8.6
Thailand	4.5	5.8	5.6

Sources: NEDA, *The National Income Accounts* (various issues) for the Philippines and Villegas, *"Brightening Up the Philippine Road Show,"* (1984) for other countries

terminated/affected due to economic conditions reported by the Ministry of Labor and Employment (MOLE).[4/] The number of establishments resorting to shutdown/retrenchment for economic reasons went up from 1,267 in 1983 to 2,134 in 1984. Consequently, the number of workers terminated as a result of shutdown/retrenchment also increased from 75,428 in 1983 to 86,186 in 1984. Moreover, the number of establishments resorting to reduced working time rose from 152 in 1983 to 310 in 1984, thereby adversely affecting 15,057 workers in 1983 and 29,910 workers in 1984. Massive layoffs occurred in the manufacturing sector which was affected mainly by lack of raw materials and a slump in demand.

Data from the National Census and Statistics Office (NCSO) reveal that the unemployment rate has gone up from 4.6 percent during the third quarter of 1983 to 6.2 percent during the third quarter of 1984 (see Table V.10). The figures may seem low considering the massive layoffs that took place during this period. The NCSO and MOLE data could be reconciled by noting the significant increase in the underemployment rate from 30.1 percent during the third quarter of 1983 to 36.5 percent during the first quarter of 1984. It is likely that workers who were laid off are now

[4/] The MOLE data are taken only from business establishments that reported layoffs voluntarily. Thus, the figures reported above may understate the actual figures if all establishments affected were included.

Table V.9

ESTABLISHMENTS AND WORKERS TERMINATED/AFFECTED
January to December 1983 and 1984

	Jan.-Dec. 1983	Jan.-Dec. p/ 1984	% Increase (Decrease)
I. A. Establishments resorting to shutdown/retrenchment for economic reasons	1,267	2,134	68.4
Permanent	115	195	69.6
Temporary	1,152	1,939	68.3
B. Workers terminated due to shutdown/retrenchment for economic reasons a/	75,428	86,186	14.3
Permanent	18,047	36,795	103.9
Temporarily	48,862	27,391	(41.5)
Average duration (weeks)	8.96	10.6	18.3
Indefinite	–	7,301	–
Not stated	10,519	14,699	39.7
II. A. Establishments resorting to reduced working because of economic reasons	152	310	103.9
B. Workers affected by reduced worktime because of economic reasons	15,057	29,910	98.6
III. Industry			
Agriculture, fishery, forestry	7,218	2,555	(64.6)
Manufacturing	55,613	54,834	(1.4)
Mining and Quarrying	1,685	5,957	253.5
Electrical, gas and water	16	138	762.5
Construction	2,814	5,957	110.7
Wholesale/Retail Trade	3,545	6,171	74.1
Transportation, storage and communication	1,745	3,911	124.1
Financing, insurance, real estate and business services	–	3,432	–
Community, social and personal services	2,792	3,258	16.7

p/preliminary (up to December 20, 1984)

a/Includes termination of indefinite duration.

Source of data: *Ministry of Labor and Employment.*

Table V.10

UNEMPLOYMENT AND UNDEREMPLOYMENT RATES, PHILIPPINES

Period	Unemployment Rate	Underemployment Rate
1983: I	5.9	30.9
1983: III	4.6	30.1
1983: IV	4.1	31.8
1984: I	6.3	36.5
1984: III a/	6.2	n.a.

a/Preliminary estimate.

Source: *National Census and Statistics Office.*

taking on even odd and irregular jobs to be able to earn any amount to meet their most basic needs.

Considering that higher wages imply higher costs of production, then this could possibly have been a major factor in the decision of employers to lay off some of their workers. However, the decline in employment could not be attributed mainly to the increase in wages. The looseness in the implementation of wage legislations seems to indicate a slight bias of government legislation towards greater employment over higher incomes for workers. The government's industrial relations policy shows the same bias so that restrictions on work stoppage are justified if they are inimical to the interests of business owners. Finally, the limited extent of union organization, together with the high rates of unemployment and underemployment has not bolstered the potential of labor unions as enforcers of labor legislation. On these bases, Tidalgo and Esguerra (1982) conclude that labor legislation cannot be considered a factor militating against the fuller employment of the country's labor resources. Instead, other factors, specifically lack of raw materials resulting from import controls, tight credit and a slump in demand, weigh more heavily in the decision of employers to lay off some of their workers.

The results of NEDA-SCO's Survey of Key Manufacturing Enterprises are quite instructive (see Table V.11). The monthly

Table V.11

ANNUALIZED MONTHLY GROWTH RATES OF VALUE OF PRODUCTION, COMPENSATION, EMPLOYMENT, CONSUMER PRICE INDEX AND WHOLESALE PRICE INDEX

(1981 = 100)

Month	Value of Production	Compen-sation	Employ-ment	CPI	WPI
1983	17.2	8.4	–2.8	10.9	18.0
January	4.1	3.5	–5.5	4.7	10.5
February	13.6	3.0	–6.0	6.5	11.6
March	16.9	5.8	–8.1	6.3	9.7
April	12.5	6.6	–2.3	6.2	9.7
May	15.4	6.5	–1.4	6.0	9.5
June	19.0	6.0	–1.4	7.5	10.9
July	12.8	5.4	–0.9	8.4	14.3
August	18.3	10.9	–1.5	8.7	14.2
September	25.3	10.3	–0.8	8.7	13.4
October	24.5	12.0	–1.6	11.7	23.3
November	19.2	11.1	–1.8	22.4	34.9
December	25.1	18.0	–2.3	32.3	50.4
1984					
January	35.4	17.8	–3.1	37.5	52.7
February	37.2	18.5	–2.4	40.0	54.2
March	28.7	18.4	–3.2	40.6	54.0
April	39.5	19.1	–4.4	40.7	55.8
May	42.9	21.3	–6.3	43.3	60.2
June	42.1	23.9	–7.8	52.5	77.0
July	57.8	34.8	–7.6	58.3	78.2
August	48.4	26.6	–6.1	60.5	78.2
September	40.7	21.9	–7.2	62.9	86.9

Source: *SKEM Industry Trends, NEDA Statistical Coordination Office (September, 1984).*

inflation rate based either on CPI or WPI outstripped the monthly growth rate of the value of production starting November 1983, a month after the first debt moratorium was declared, up to September 1984. This implies that the real output of the 200 manufacturing enterprises included in the sample markedly declined during that period. At the same time, the rate at which enterprises reduced their labor force also jumped up, especially in 1984. Although compensation of employees also increased during this period, the rate of increase was less than one-half of the inflation rate, indicating that employees of the 200 key enterprises suffered a substantial cut in their real wage.

In summary, the tight monetary and fiscal measures initiated by government to improve the balance of payments position, accompanied by the foreign exchange squeeze, have immediate and profound effects on output, employment and wages of laborers. Their favorable effect on prices will take some time. So, during the adjustment period, sectors dependent on government expenditures and imported raw materials as well as the labor sector will continue to feel the pain brought about by the tight monetary and fiscal measures.

ANNEXES

Annex I

SURPLUS (DEFICITS) OF THIRTEEN NON-FINANCIAL GOVERNMENT CORPORATIONS

(In Million Pesos)

Corporation	1981	1982	1983	1984
National Power Corporation (NPC)	–5,134	–5,387	–7,080	–6,126
Philippine National Oil Company (PNOC)	–3,226	617	–1,187	967
Metropolitan Waterworks and Sewerage System (MWSS)	–602	–797	–1,252	–1,229
National Irrigation Administration (NIA)	–1,206	–1,469	–1,649	–2,087
National Development Corporation (NDC)	–1,200	–1,815	–1,027	–323
Export Processing Zone Authority (EPZA)	–90	–91	–77	–78
Light Rail Transit Authority (LRTA)	–6	–437	–1,665	–1,327
Local Water Utilities Administration (LWUA)	–223	–167	–189	–149
Metro Manila Transit Corporation (MMTC)	–125	–36	29	–3
National Electrification Administration (NEA)	–487	–653	–782	–774
National Housing Authority (NHA)	–559	–536	–667	–392
Philippine National Railways (PNR)	–131	–119	–57	–140
Philippine Ports Authority (PPA)	–557	–190	–69	–658
TOTAL	–13,546	–11,080	–15,672	–12,319

Annex II

LIST OF MAJOR POLICY MEASURES IN RESPONSE TO THE BOP CRISIS: JUNE 1983 – DECEMBER 1984

	Instrument	Effectivity	Provision
I.	*BOP MANAGEMENT POLICY*		
		June 23, 1983	Devalues the peso by 7.8% to a new guiding rate of ₱11 to $1.
		October 5, 1983	Devalues the peso by 27.13% to ₱14 to $1.
	CB Circular 963	October 25, 1983	Allows no-dollar imports and/or imports on consignment basis of raw materials for re-exports.
	CB Circular 964	October 25, 1983	Allows no-dollar imports of certain commodities which are for domestic use.
	CB Circular 966	October 25, 1983	Creates a foreign exchange pool for priority import payments by requiring banks to sell to the CB 88% of their foreign exchange receipts.
	MAAB 53	November 2, 1983	Restricts importations of meat and canned sardines.
	EO 918	November 3, 1983	Imposes an additional import duty of 5% (up from 3%).
	EO 920	November 3, 1983	Imposes additional export duties on traditional export products; reimposes basic duties which have been suspended; imposes export duties on certain non-traditional products as follows.

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	Basic Rate	Add'l. Duty
Logs	2%	5
Lumber	4	2
Veneer	4	2
Plywood	4	2
Bananas	2	2
Copra	7	3
Coconut oil	4	5
Copra meal/cake	4	4
Desiccated coconut	4	4
Pineapple, sliced/crushed	4	2
Pineapple juice/concentrates	4	2
Shrimps and prawns	4	2
Coffee	–	2
Tuna	–	2

CB Circular 970	November 4, 1983	Amends CB Circular 966 by requiring all banks to sell 100% of their foreign exchange receipts.
CB Circular 970 Operating Guideline No. 1	November 8, 1983	Provides the priority system in the use of the foreign exchange pool; priority shall be given to the following: a) payments to assure crude oil imports; b) raw material, supplies, spare parts and other inputs of export products; c) essential grain imports; and d) raw materials of vital domestic industries.
CB Circular 970	November 8, 1983	1. Specifies the items covering inputs for export products

and raw materials of vital industries per Circular 970 Operating Guideline No. 1; First priority shall be given to:

a. export producers for imports necessary for their export production and indirect export producers for their import requirements to service exporters;

b. domestic producers/importers requiring imported raw materials, spare parts and supplies (EP and EC) for (i) petroleum and petrochemical based products, (ii) food grains and food products (milk and frozen beef for processing), (iii) fertilizers and pesticides. (iv) medicinal and pharmaceutical products, (v) textile fibers for basic clothing, (vi) livestock (breeding stock, soy–, fish– and bone–meal), (vii) iron and steel products, and (viii) paper products for newsprint, printing and writing paper, industrial packaging, sanitary paper and paper boards (box, kraft, chip).

2. Second priority shall be given to domestic producers/importers requiring imported raw materials, spare parts and supplies (EP and SEP category) for the manufacture of products other than those listed under *b* above.
3. Third priority shall be given to domestic producers requiring raw materials, spare parts and supplies (NEP, NEC, SEC, SEP, SUP, UP) necessary to complete the manufacture of products in priority *b* and 2 above.

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EO 920-A	November 14, 1983	Consolidates basic export duties and additional duties provided under EO 920 for coconut products, effective until June 30, 1984. For the period July 1, 1984 until December 31, 1985, the following additional duties are applied:

	Nov. '83-June '84	July '84-December '85	
		Basic	Add'l.
Copra	3	7½	7½
Coconut oil	2	4	4
Copra meal	2	4	4
Desiccated coconut	2	4	4

LOI 1367 MAAB 53	November 25, 1983	Suspends indefinitely the importations of fresh fruits and banned items previously allowed to be imported by NFA, AFP Commissary, FTI.
CB Circular 999	April 10, 1984	Establishes that the Foreign Exchange spot buying and selling rates of Authorized Agent Banks shall be under the jurisdiction of the Banker's Association of the Philippines.
EO 946	April 29, 1984	Increases the import duty to 8%.
CB Circular 1008	May 25, 1984	Amends CB Circular 992 which establishes a Foreign Exchange Working Capital Fund to finance the importation of inputs for exports to include:

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CB Circular 1009	May 30, 1984	1. Allowing exports to avail simultaneously of both the Export Deduction Scheme and the FEWCF; 2. Inclusion of C.I.F. and other expenses necessary for delivery as eligible for financing. Provides that some Essential Consumer (EC) items listed may not be important under prepaid L/C basis without limitation to amount. Provides that some other EC items may likewise be imported but subject to $50,000.00 limit and prior approval from the CB – Banker's Association of the Philippines Joint Committee on Foreign Exchange Priorities.
PD 1928	June 5, 1984	Devalues the peso by 28.5% to ₱18 to $1.
EO 955	June 6, 1984	Increases the import duty to 10%.
CB Circular 1010	June 6, 1984	Amends CB Circular 970 by requiring banks to sell 88% of their foreign exchange receipts.
PD 1928	June 6, 1984	Imposes a special excise tax of 10% on foreign exchange sold by CB and its agents.
PD 1929	June 6, 1964 until December 31, 1985.	Imposes an economic stabilization tax of 30% on all exports.
CB Circular 1011	June 18, 1984	Extends until further notice the availability of the no-dollar import facility including those on consignment basis to exporters.
CB Circular 1012	June 19, 1984	Provides for revisions of the rules governing the grant by the Central Bank of foreign exchange cover for specified foreign exchange obligations.
CB Circular 1014	July 29, 1984	Provides the rules and regulations on the imposition of a special excise tax on foreign exchange sold by the CB to

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		its agents pursuant to MB Resolution No. 821 implementing PD 1928.
CB Circular 1015	June 29, 1984	Authorizes exporters to import equipment in an amount not exceeding 5% of their recorded receipts from exports for the base year July 1, 1983 to June 30, 1984.
CB Circular 1020	July 31, 1984	Terminates the Foreign Exchange Incentive Raffle Program "Swerte sa Bangko."
CB Circular 1023	September 6, 1984	Authorizes commercial banks to retain one half of one percent of their total foreign exchange receipts which previously, banks were authorized to purchase from the pool under Operating Guideline No. 1 of Circular 970 to meet small payments in accordance with established priorities or which are allowable under existing rules and regulations.
LOI 1429	September 22, 1984	Suspends the economic stabilization tax.
EO 988	October 10, 1984	Lowers the import surcharge to 5%; to take effect October 15 for petroleum product imports and January 1, 1985 for all other imports.
CB Circulars 1028, 1029, 1038	October 15, 1984	Allows a full retention scheme on foreign exchange receipts; abolished the foreign exchange priority allocation program for imports; requires commercial banks to hold foreign exchange only equivalent to 10% of their outstanding L/Cs + 10% of their foreign exchange receipts.
PD 1959	October 15, 1984	Abolishes the 10% excise tax and imposes a foreign exchange transaction tax of 1%.
MAAB 31	October 15, 1984	Provides that spot foreign exchange transactions between the CB and the commercial banks under Operating Guideline No. 1 of Circular 970 shall be at the prevailing guiding rate at the delivery date.

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MAAB 41	October 29, 1984	Provides that remittances of interest and other charges due to international financial institutions shall continue to be referred to the CB Management of External Debt and Investment Account Department for prior approval. These include remittances and amortization on suppliers credits, multilateral and bilateral credits and credits to international financial institutions.
CB – MEMO TO ALL COMMERCIAL BANKS (unnumbered)	October 31, 1984	Allows commercial banks to hold 100% of the value of their cash letters of credit. Requires that for such L/C, the importer pays the bank 100% of the peso cost of the import and the bank sells the foreign exchange to the importer at the same time at the opening of the L/C.
MAAB 43	November 26, 1984	Requires that all dollars in special foreign exchange accounts of participants in the government's five progressive manufacturing programs be sold immediately to banks. Stipulates that firms' import obligations from October 15, 1984 onwards may be settled only to the extent of their net export proceeds.
CB Circular 1034	December 10, 1984	Allows commercial banks to hold, in addition to 100% of the value of their cash letters of credit; 100 % of export bills purchased (maximum of 15 days), 38% of outstanding regular letters of credit inclusive of cash letters of credit, and 10% of foreign exchange receipts (two-month moving average of the immediately preceding 12 months).

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II. *MONETARY POLICY*

CB Circular 961	November 1, 1983	Increases the reserve requirement (rr) on deposits and deposit substitutes by 1.5% effective November 1, 1983 and by another 1.5% one month thereafter (from 20%).
CB Circular 981	November 18, 1983	Amends loan values, rediscount rates and lending rates of eligible papers; loan values vary from 80 to 100% for the different preferential areas; rediscount rates range from 3 to 10% while the maximum bank lending rate varies from 6% to MRR (90) + 3.
CB Circular 991	January 23, 1984	Adjusts the maximum bank lending rates on non-traditional exports and general purpose loans under the CB rediscounting window based on floating MRR 90.
	March, 1984	Provides for the issuance of CB bills called "Jobo Bills."
CB Circular 994	March 9, 1984	Amends loan values, rediscounting and lending rates of eligible papers under the preferential rediscount window; loan values now shall be 80 and 90% for respective areas; rediscount rates vary between MRR (90) less 3 to MRR (90) less 12 for all the areas; lending rates range from MRR (90) less 6 to MRR (90) plus 3.
CB Circular 1082	April 25, 1984	Increases the rr by 1%.
CB Circular 1007	June 1, 1984	Increases the interest on reserve deposits with CB from 3% to 4% p.a.
CB Circular 1033	November 23, 1984	Suspends the establishment of new bank branches in most sections of Metro Manila and other major cities classified as Overbranched.
CB Circular 1005	May 15, 1984	Establishes a 5-day banking week.

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III. *FISCAL POLICY*

EO 918 — November 2, 1983

Increases specific taxes on petroleum products as follows:

	July 1983	Nov. 1983	May 1984	June 1984	Oct. 1984
Premium gasoline	1.38	1.5425	1.5425	1.6625	
Regular gasoline	1.34	1.5025	1.6625	1.7425	
Diesel	.1275	.96	1.23	1.31	
LPG	.117	.0675	.3275	.3775	
Kerosene	.045	.19	.575	.655	
Fuel oil	.05	.075	.335	.375	
Avturbo	.64	.1755	.475	.545	
Asphalts	.12	.18	.46	.53	
Solvents	.61	.915	.915	1.025	

PD 1917

EO 957 — June 7, 1984

PD 1931 — June 11, 1984

Abolishes duty and tax and tax exemptions granted to government-owned or controlled corporations and all other units.

EO 978 — October 1, 1984

Imposes additional ad valorem tax on cigarettes.

PD 1955 as implemented by Revenue Memorandum Circular 25-84 — October 12, 1984

Withdraws the duty and tax privileges granted to private business enterprises except those registered with BOI, the Export Processing Zone and a number of industries covered by international agreements.

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PD 1956	October 15, 1984	Imposes additional ad valorem taxes on petroleum products.
	October 15, 1984	Imposes additional ad valorem tax: on fermented liquors and matches; increases tax rate on insurance premiums and amusement places, documentary stamp tax on certain documents; also imposes additional one percent tax on gross value received by banks.
Revenue Memorandum Circular 26-84 under PD 1959		Increases the tax rates on insurance premiums, amusement places and winnings on horse-racings and jai-alai.
Revenue Memorandum Circular 27-84 under PD 1959		Increases the documentary stamp tax charges on certain documents.
EO 990		Allows sales tax credits on raw material purchases against quarterly sales taxes without taking into account raw materials, goods in process and finished goods inventory.
LOI 1430		Restores the full tax exemption privileges of the Philippine Amusement and Gaming Corporation.
LOI 1427		Exempts the Philippine Airlines from PD 1931 which abolishes tax and duty exemptions of government corporations.
BOI Memorandum Circular 002		Rescinds tax exemption privileges under PD 218 given to regional headquarters of multinational corporations.
PD 1959 as disclosed by Revenue Memorandum Circular 31-84	October 15, 1984	Imposes a final withholding tax of 15% on interest income from Philippine currency bank deposits and yield or any other monetary benefit from deposit substitutes and from trust funds and similar arrangements. Abolishes exemption from withholding tax if the aggregate amount of interest does not exceed ₱1,000.00.

Abolishes exemption from withholding tax of recipients of interest income who are exempted from income taxes.

Abolishes the imposition of preferential tax rates of recipients who are enjoying preferential tax treatment.

Appropriations Act

Signs the Appropriations Act for the ₱58.329 billion National Budget for 1985.

IV. *PRICING POLICY*

Increase in retail prices of petroleum products as follows: (₱/liter)

	Nov. 1983	May 1984	June 1984	Oct. 1984
Premium gasoline	6.47	6.89	8.28	9.24
Regular gasoline	6.27	6.69	8.03	8.81
Diesel	4.43	4.89	6.20	7.26
LPG	4.346	4.658	5.841	6.46
Kerosene	4.44	4.89	6.21	7.17
Fuel oil	4.901	6.294	7.7724	9.05
Avturbo	2.404	3.664	4.645	5.19
Asphalts	2.877	4.157	5.168	5.57
Solvents	4.626	5.816	7.185	8.66

November 2, 1983 –)
May 17, 1984 –)
June 7, 1984 –)
October 19, 1984 –)

Increases the retail prices of petroleum products by an average of ₱1.00, 8.6 centavos, ₱1.15 and 71.8 centavos, respectively on said dates.

WO 2	October 3, 1983
WO 2	October 3, 1983
WO 3	November 1, 1983 December 1, 1983
WO 4	May 1, 1984
WO 5	June 11, 1984
BOT Order	October 25, 1984

Increases in the price ceilings of basic commodities at various dates between October 1, 1983 and October 20, 1984.

	July 7, 1984	October 20, 1984
Rice	4.85	5.35
Corn grits	3.85	
Canned fish	4.40	4.96
Canned liquid milk	7.02	8.41
Sugar	6.92	8.00
Detergent bar		8.50

	WO 2		WO 3	WO 4	WO 5
	Oct.	Nov.	Dec.	—	—
Non-agriculture					
Metro Manila	35.40	39.49	42.07	43.67	51.92
Outside MM	34.32	38.40	40.99	42.58	50.83
Agriculture					
Plantation	28.75	32.34	34.42	35.75	42.50
Non-Plantation	21.73	22.81	25.90	26.75	32.00

Increases transport fares in all parts of the country by an average of 16.83%.

Provisions include:

Metro Manila Buses and Jeepneys: a 20% increase in minimum from ₱1.00 to ₱1.20 for the first 4 km. The per km rate was raised by 15.1% (from ₱0.265 to ₱0.305).

Luzon Buses: From ₱1.00 to ₱1.20 for first 5 km (20%). Per km from ₱0.24 to ₱0.285 per km.

Luzon Jeepneys: From ₱1.00 to ₱1.20 for first 5 km. Per km. from P0.24 to P0.285 per km.

Visayas and Mindanao Buses: From ₱1.05 to ₱1.30 for the first 5 km. Per km. rate from ₱0.245 to ₱0.29 (18.4%).

Visayas and Mindanao Jeepneys: From ₱1.00 to ₱1.20 for the first 5 km. Per km. rate from ₱0.24 to ₱0.285 (18.8%).

Special Provincial bus services:

First class: Luzon, ₱0.29 per km.
Visayas and Mindanao, ₱0.305 per km.

Premier: Luzon, ₱0.38 per km.
Visayas and Mindanao, ₱0.305 per km.

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		Air-con: ₱0.335 per km. De-Luxe Air-con: ₱0.345 per km. Super de Luxe: P0.335 per km.
WO 6	November 1, 1984	Increases the price of alcogas from ₱7.81 per liter to ₱8.49 per liter. Raises minimum effective pay (minimum wage, COLA, and daily equivalent of thirteenth month pay). a. Private employees of non-agricultural sector in Metro Manila – from ₱51.92/day to ₱57.08/day. b. Non-agricultural workers outside Metro Manila – from ₱50.83 to ₱56.00. c. Plantation workers – from ₱42.50 to ₱46.67. d. Non-Plantation workers – from ₱32.00 to ₱35.67.
BOE Regulation	December, 1984	Authorizes Meralco to increase its power sale rate by 7 centavos per kwh and the increases will be reflected in the electricity distribution charge.
NFA		Lifts the price controls on the byproducts of rice, corn and wheat which are used as inputs for animal feed.
NFA	December 1, 1984	Raises flour prices to a uniform ₱205.65 per 25 kg. bag from P195 for hard flour and ₱188 for soft flour.
PD		Abolishes all price controls in all basic commodities except rice with the condition that they be reimposed if the prices increase beyond reasonable levels.

Annex III

DESCRIPTION OF MARIANO'S INFLATION MODEL

A. **Estimated Equation:**

$$
\begin{aligned}
CPI = {} & -13.504 + .13401\ ERBMERP \\
& + 1.3881\ CPI\ (-1) \\
& - .61373\ CPI\ (-2) + .027695\ PXPEXP \\
& + .061682\ PMOILDP + 4.7833\ TOTTGQ3 \\
& + 1.9392\ PMPES + .564\ \ 91\text{-}DAY \\
& + .25202\ WLNANCR + .43344\ PCFOOD3L
\end{aligned}
$$

B. **Definition of Variables:**

CPI	=	Monthly consumer price index for the Philippines, in percent (base year: 1972).
ERBMERP	=	100*Hongkong Banknote Rate (₱ / $) / Official (₱ / $) Exchange Rate.
PXPEXP	=	Peso-denominated export price index for all commodities (base year: 1972).
PMOILDP	=	Average wholesale posted price of petroleum products, in centavos per liter.
TOTTGQ3	=	TLG + TLG (–1) + TLG (–2) + TLG (–3).
TLG	=	TL/GNPSEM
TL	=	Total domestic liquidity, in billion pesos.
GNPSEM	=	Semestral real GNP, in 1972 billion pesos.
PMPES	=	PMUSNF2* (1 + TARIFF) / (1 + TARIFF (1972))* ER (month) /ER (1972).
PMAUSNF2	=	Linear interpolation of the ($ denominated) annual import price index for non-fuels (in decimal; base year: 1972).
TARIFF	=	Simple average (across items) of tariffs on imports plus additional ad valorem duties on imports, in decimal.
ER (month)	=	Average exchange rate for the month, in ₱/ $1.
TARIFF (1972)	=	.45
ER (1972)	=	₱6.671/$1.

91–DAY	=	Average yield of 91-DAY Treasury Bill, in percent.
WLNANCR	=	Legislated effective minimum wage rate for non-agricultural workers in Metro Manila (₱/day).
PCFOOD3L	=	Natural Logarithm of PCFOOD3.
PCFOOD3	=	Average percentage increase (relative to the price ceilings in February 1980) in the price ceilings for food items controlled by the Price Stabilization Council.

C. Methodology of Estimating Inflationary Effects:

The inflation model was used to determine the inflationary effects of the various measures adopted during the 18-month period covered by the study. The impact of these measures were reflected on the variables included in the model.

To get the individual contribution of each of the measures (e.g. wage adjustments), the June 1983 value for the variable was retained throughout the simulation period from July 1983 to December 1984, while the actual values were used for the other independent variables. The annualized inflation rates for 1983 and 1984 were computed using the estimated monthly CPIs. This was compared with the annualized inflation rates derived from the simulation exercise using the actual values for all the explanatory variables. The difference between the two sets of rates was interpreted as the increase in the inflation rate due to the change in the variable whose value was held constant at its June 1983 level.

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