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WHAT REAL WORLD?

Philippine Debt, Interest and Exchange Rate Policy - and Its Price*

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Those who will not understand history
Are doomed to repeat it.

George Santayana

The negotiation is concluded,
The boom is fading,
And we are not saved.

- Jeremiah 8:20 adapted to 1992 Philippines

The Real Worlds of Economic Policy

Secretary Jesus Estanislao has been wont to attack critics of his economic policies - especially his external debt policy - of being *balasubas* who did not live in the real world. He has also challenged them to look at history and shown a penchant for citing economic policy and performance in Chile under General Pinochet in support of his contentions.

It is but proper to ask: "What real world?" and "What lessons from the recent economic history of

This paper was written in the last days of the Aquino administration. Many of the points discussed however, remain applicable now. Reginald Green presents provocative and, at times, controversial insights into the nature and causes of the current recession and outlines both short- and long-term policy alternatives for sustained growth. Green is a professorial fellow in political economy at the Institute of Development Studies, University of Sussex. He is Senior Social Policy Advisor to the Government of Mozambique and an advisor to UNICEF.

Chile?" The real world is subject to both normative and technical interpretations while Chilean economic history must be appreciated in light of the "Southern Cone" economic strategy.[1] Said strategy was operated by the so-called ultra Chicago economic policy school (less politely termed "the Chicago Cowboys") and where it led is of direct relevance to these questions.

"Should We Starve Our Children to Pay Our Debts?"

Economic policy is in a very real sense a branch of applied moral philosophy. Adam Smith was a Professor of Moral Philosophy who asserted the primacy of "moral economy" on basic issues. In particular, he held that no nation could be great and prosperous when the majority of its people were poor and miserable. He believed that the state had a duty to create a facilitating environment so that the poor and miserable could win their way out of their condition of absolute poverty. He saw efficient, competitive enterprise as crucial to that process but also saw the *latifundistas*, the domestic monopolies and the transnational corporations of his day, as enemies of the moral economy. His comment was that they rarely met, even for socialisation and conviviality, without conspiring against the common good. He was particularly concerned when such groups influenced and interacted with the state so that policy was used to further their aims. It is interesting to consider the applications of this perspective to the Makati-Malacanang alliance on macroeconomic policy and to the landlord majority in the House of Representatives.

On how to handle external debt, one must conclude that Adam Smith would have also made Mwalimu Julius K. Nyerere's famous query to the notables of British finance and business. The question was whether Tanzania should starve its children to pay its external creditors. No one was in any doubt that it was intended as a rhetorical question. But, under the Secretaries and Governors of the Aquino administration, the Philippine government has not merely failed to view the question as rhetorical; it has regularly answered it "yes". No other country in the world has, over this period, done so as regularly and even enthusiastically as the Philippines. What real world of moral economy is this?

Debt Reduction - What Is The Current Context?

Secretary Estanislao asserts that the Philippine external debt management and renegotiation strategy over 1986-91 has been prudent and successful. He accuses critics - notably the Senate, the House of Representatives, the Freedom from Debt Coalition (FDC), and eminent members of the UP School of Economics - of being out of touch with realities.

The strategy and the bargaining have somewhat delayed debt principal repayment. They have never resulted in deferring interest though. The only substantial write-offs (50 percent reductions on two tranches of commercial bank debt) were pushed by the World Bank and IMF on an initially unenthusiastic Philippine Treasury and Central Bank. Even then, the Fund and Bank had to intervene to block the Philippine's accepting a 30 percent write-down instead of holding out for a 50 percent one. Now that the Secretary and Governor view the exercise as completed, it is clear that the Philippines has, at best, secured a 15 percent reduction in the real present value of future debt service payments (interest and principal). Is that a good result?

The Philippines is a lower middle income, debt-distressed economy in World Bank categorisation. At about $650 per capita national output, it is barely above the poor/lower middle breakpoint (and the IDA-World Bank soft loan window eligibility line). At a realistic peso-dollar exchange rate, it would be lower income. The idea that the Philippines is a slightly misplaced Latin American middle income economy or a slightly lagging Asian high growth economy may be flattering, but such classification is wrong. Structurally, the Philippines resembles poorly performing African `low/lower middle income,

debt weighted-down economies such as the Cote d'Ivoire more than it does any other category.

In the mid-1980s, it came to be accepted that both moral and applied political economy called for debt burden reduction for low-income economies. By 1989, it appeared realistic to seek a 30 percent to 50 percent effective debt reduction which, on the then trends, looked just negotiable. Such would have reduced net debt service (interest and principal repayment less new loans plus grants) to just 10 percent of visible and invisible exports plus workers remittances. That 10 percent level was the basic objective of the FDC and of the Senate and House debt cap bills, passed in 1989 by the Senate and 1990 by the House, but vetoed.

What is the picture as of the first half of 1992 as far as other countries are concerned?

Costa Rica in 1990 received about 67 percent write-off in both government (Paris Club) and commercial bank (London Club) debt. **Poland** and **Egypt** are in the process of receiving 60 percent write-downs agreed to in 1991. Late 1991 negotiations have led to a reduction estimated at up to 78 percent for Nicaragua. Argentine and Brazilian talks focus on 30 percent to 40 percent reductions which seem likely to be agreed in 1992.

All of these (with the exception of Nicaragua) are lower-middle income economies with higher output per person than the Philippines. For Philippine-type economies, the going rate appears to be at least 60 percent effective reduction by partial write-off of principal, longer duration at lower interest rates and/or, provision of new grants *de facto* to service old loans.

If the going rate is 60 percent in the real world of early 1990s lower-middle income and debt-distressed economy negotiations, what is one to make of a strategy concluding with 10 percent to 15 percent reductions? Prudent? For whom? For foreign banks, perhaps. For other foreign enterprises and economies interested in exports and investment, probably not. For the Philippines, surely not!

To claim the policy as having led to a high secondary market value on Philippine loans - over 50 percent compared to under 15 percent for the Cote d'Ivoire - is true. But why? To whose benefit? In order to maintain external debt service the Philippines has crippled the budget, ran down public services and infrastructure, and allowed absolute poverty to increase. The Philippine negotiators may live in a real world but it is the real world of conservative, short-term oriented creditors, not of debtors. It is indeed true that in the real world, if a country's own negotiators in fact argue the other side's case, they will get a poor deal.

History, General Pinochet and the Cowboys

In the late 1970s and early 1980s, Chile had a distinctive economic strategy. It was deliberately designed by the so-called ultra-Chicago sub-school of economists. While it lasted, it served foreign and domestic economic financial institution's interests very well. It appeared for a time to generate growth, end import capacity constraints and underwrite rising consumption (especially for the upper and middle classes). Also practiced under the authoritarian military regimes of Argentina and Uruguay, it became known as the Southern Cone strategy. The Chile of General Pinochet and the "Chicago Cowboys" was its *locus classicus*. It is, as should soon become evident, important for the Philippines to understand the nature of that strategy and its history.

The main objectives, instruments and results of the strategy can be schematised briefly:

- a fixed, or even slightly appreciating, nominal exchange rate with no foreign exchange or foreign transactions controls;

- a high (in world terms) real interest rate to pull

in short term foreign capital via the domestic banking system and the enterprise sector in general;

- growth and high imports fuelled by capital account inflows;
- a relatively conservative fiscal policy (3 percent to 5 percent of gross domestic output accounted for by government borrowing, basically to cover capital spending on infrastructure and to underwrite low personal income and enterprise profits taxes);
- consumer, real estate and financial market booms;
- moderate but rising inflation (say 6 percent creeping up to 15 to 20 percent);
- as another result, rising real overvaluation of the currency;
- hampered export growth and competition by domestic producers with imports;
- high and rising domestic interest rates to claw in foreign funds to cover the rising current account deficit and to try to damp down inflation;
- falling long-term productive investment masked for a time by property and financial market speculative bubbles;
- in four to six years, a rapidly escalating external loss of confidence, a reversal of capital flows (with no exchange control instruments to limit it), a collapse of import capacity, drastic falls in production and rises in unemployment, spiralling devaluation and inflation;
- collapse of the real estate/financial bubbles, bankruptcy of about 90 percent of domestic banks and associated company empires and of many other large enterprises which had borrowed abroad; and
- three to five years of depression.

We need to understand that history is very simple. Philippine macroeconomic policy over 1989-92 has looked increasingly "Southern Cone" in nature. That this appears to be instinctive and unconsidered is not of much consolation as 1990 to 1991 Philippines appears to be characterized by (a) rising exchange rate overvaluation, (b) rising real interest rates, (c) growing depression of long-term directly productive fixed investment in favour of property and financial market speculative booms, (d) rising external account deficits plugged by foreign fund inflows not appearing on official external debt balance sheets, and (e) faltering growth. These can only have been exacerbated by the 1992 election boom with public works slush funds, campaign vote buying, and foreign campaign support bolstering import capacity and propping up the increasingly overvalued peso. Consumption is up, the exchange rate has appreciated even nominally from substantial late 1991 overvaluation, the property and financial bubbles expand further. But where next?

Overvaluation, Trade Liberalisation and Export-Led Growth?

Over 1986-89 the Philippine peso moved from moderately large to moderately small overvaluation. When it stood at P30 = $1 (after the Middle East war oil price, world economic slowdown and remittance shocks), it was probably 10 to 15 percent overvalued, i.e. P33 to P35 would have been sounder in terms of export profitability and import competitiveness. Since then, Philippine inflation has averaged over 15 percent - rising to 20 percent, supposedly falling to 10 percent and in the past few months accelerating again under drought and election spending stimuli. But instead of declining to P40 to P45 to $1 at the end of 1991 and perhaps P50 = $1 as of mid-1992 it appreciated to under P25 = $1 and then

remained in the 25 to 27 peso to the dollar range. That is approaching 100 percent overvaluation, quite possibly the worst in Philippine history. Certainly 100 percent or even 60 percent overvaluation is a crippling deterrent both to export production and to domestic market production competing with imports.

Philippine economic strategy is keyed to reducing barriers to imports (and especially prohibitions or quotas) and to export-led growth. It is clear that overvaluation is inconsistent with both. This contradiction (very literally antagonistic contradiction) is only worsened by the high real interest rates needed to suck in external funds to bridge the growing trade gap (and interest bill) and to attempt to choke down inflation. Fifteen (15) to 20 percent real interest rates to enterprises are neither consistent with present profitability nor with the long-term investment needed in production and infrastructure capacity. The 1986-90 growth generated largely by recovery and re-utilization of existing capacity idled during the 1983-85 slump cannot possibly be sustained.

Overvaluation, high real interest rates, trade liberalisation and export-led growth do not constitute a paradoxical strategy. They add up to simple nonsense. That, too, is the real world.

Walking on Water - For How Long?

The evident answer to this critique is that the strategy does work - output has risen, the overall external account is positive judging by exchange rate and reserve movements. To the first, the answer is that it all depends on what one means. Beginning in 1983 before the economic crises of the terminal years of the Marcos regime, average annual growth through 1991 has been under 2.5 percent (but with negative per person real growth). The period from 1986 to 1989 in retrospect was a simple recovery fuelled by higher private and public spending and made possible by less unsatisfactory capital account flows. It was not a genuine investment-underpinned development process start-up. The construction/property speculation boom (especially in Metro Manila, Cebu City and Davao) plus the standard pre-election boom have masked what may well be a 1991-92 decline - at best stagnation - in more basic sectors of the economy.

The external balance dynamics are more interesting intellectually, but no less alarming practically. From 1989 the actual external balance position has increasingly out-performed the projected but also what can be accounted for on known magnitudes. By 1991, the discrepancy seems to have been in the order of $5,000 million. The official explanation has been the very high growth of invisible exports and that remittances of overseas workers rose 75 to 100 percent after 1989. Is that plausible?

Tourism actually fell in real terms in 1990-91 as a result of the Gulf War and Northern recession. Base purchases and employment assuredly did not grow rapidly even pre-Pinatubo; it fell afterward even before the Senate's decision to reject the continued occupation agreement. The Gulf War, (particularly Iraq's occupation of Kuwait) and the continuing slump in the world maritime industry certainly reduced total Filipino overseas workers in 1990-91. Inflation offset the real contractions in nominal dollar terms but there is no way it could have led to a 75 to 100 percent increase in any of the three key categories, let alone in all three.

The dominant true explanation is fairly evident - unrecorded, largely short- to medium-term external financial flows largely of a debt nature but not recorded on official external debt accounts. By the end of 1991, these probably were of the cumulative order of $20,000 to $25,000 million - comparable to the recorded external debt. The main components appear to be:

- short-term net external liabilities of domestic banks - $1,000 to $3,000 million;

- dollar-denominated domestic bank accounts - $3,000 million;
- peso-denominated foreign-owned accounts attracted by high interest rates plus *de facto* free convertibility - $5,000 million or more;
- real estate speculative external investment - $5,000 million (probably largely equity but invested on the premise that the property boom will continue and the proceeds will be freely exchangeable);
- short-term commercial credit (including direct company book debts and short-term loans not intermediated via a bank) - $5,000 million; and
- loans raised offshore and in foreign currency by domestic companies to benefit from lower interest rates and the stable peso - $2,000 to $4,000 million.

Certainly, some of this total pre-dates 1989 and perhaps $8,000 to $10,000 million is normal and stable - until there is a crisis of confidence. But even a hiccup in confidence would cut net inflows leading to a payment crisis, rapid downward float (or sink) of the peso, increasingly frantic attempts to claw back existing loans/property investments and full scale external account, exchange rate, property and financial sector crises.

The near inevitability of such a hiccup sooner or later - and probably sooner, e.g. late 1992 or 1993 - is hard to deny. The property boom appears to be well into the speculative bubble/overbuilding stage (like its late lamented relatives in the USA, UK, Japan and Australia). Up to $500 million a year of labour, goods and services sales to US bases will be gone by the end of 1993. There are few signs that conversion of Subic will immediately generate substantial manufacturing or of John Hay, substantial tourist export earnings. Remittances are unlikely to continue to rise fast and may fall. The maritime trades are in secular decline. Whatever else it may be, 1997 is a death sentence date for non-Chinese household help in Hong Kong. The Middle East employment totals (especially in Kuwait) are unlikely to regain 1990 levels. Increasing permanent emigration to the USA, Australia and Canada will generate lower remittances (and *balikbayan* tourist earnings) than single, contract workers. Tourism and exports of goods (traditional or non-traditional) are hampered by high levels of currency overvaluation while investment in domestic market-oriented production no longer protected by quantitative restrictions will be rendered unattractive by low growth and high overvaluation. Sky-high real interest rates may delay the external flow of funds crisis. But by structurally weakening the domestic economy (and possibly precipitating real estate and financial sector crises) such will also deepen the crisis when it comes.

The present policies in the present context add up to walking on thin ice (more accurately tepid water) on Manila Bay. One need not be overly devout nor particularly skeptical to doubt whether Secretary Jesus Estanislao, his colleagues and his successors will be able to duplicate his namesake's miracle of walking on the storm-tossed waters of the Sea of Galilee. That conclusion is very much of the real world and of the history of comparable efforts.

Who Has Benefited (and Paid)? Who Will Be Hurt?

Actual economic strategies are rarely adopted and still more rarely pursued for long unless some key economic interests believe they benefit from them and the losers either do not recognise the costs or are powerless to reverse the strategy.

The Makati financial and property development community clearly believed - correctly in the short run - that high stable exchange rates, high real interest rates plus high spreads between deposit and lending rates with profits underwritten by high Treasury bill rates are good for them. They can be

said to be myopic but bankers and property developers very often are.

The Philippine manufacturing/landlord sector has a historic aversion to devaluation. It also appears to have an implicit understanding that in return for industry opposing meaningful land reform, the landlord influence will be delivered for high protection. It therefore appears to have - with limited exceptions - failed to note that overvaluation and high real interest rates plus trade liberalisation are very bad for exporters, producers competing with imports and net borrowers. Furthermore, manufacturers were not able to prevent massive dismantling of protection.

Organised (and even more the unorganised) labour and peasants have lost out under the present economic strategy - no real land reform, falling real wages, and reversal of 1986-87 moves to 'level the playing field' between workers and employers. They have been well aware of this. But since the departure from office of Secretary Sanchez and the Mendiola massacre, the Malacanang's hardline stance against worker and peasant interests has been both evident and consistent. Therefore, there was little they could do to reverse the strategy or even secure significant cushioning from its worst effects on them.

In one sense everyone - or almost everyone - will lose if the bubble bursts without either preliminary partial deflation or a clear-cut, practicable damage-containment and revival-promotion strategy. Rapidly falling exchange rates fuel inflation and rising interest rates promptly feedback to create a vicious and possibly accelerating downward spiral.

Debtors - especially non-property or financial enterprises and landlords - will benefit or lose depending on whether their debts are peso or external currency denominated. If the former, they will gain from inflation; if the latter, they may well be crushed by devaluation. Exporters, not least landlords, should benefit unambiguously. Unless the economy goes into sustained hyperinflation, they will gain more on the devaluation boost to peso earnings than they will lose on inflationary boosting of peso costs. For domestic market competition with imports, the results are more ambiguous. General economic depression and loss of confidence may well hurt them more than the enhanced protection provided by devaluation.

Property developers - especially if they have borrowed in foreign currency - will be hard hit by the end of the real estate boom. On the record elsewhere over 1989-91, many will go bankrupt with chain effects on linked companies including banks. Banks will be in danger of collapse if they have significant net foreign liabilities or domestic property sector loan assets. Otherwise they will probably enter a sticky patch but no worse.

Peasants and workers will lose for three reasons:

- with the present tilted negotiating field, high inflation will lead to falling real wages;
- government efforts to reduce the fiscal deficit - an ineffective means of damping inflation generated by spiralling devaluation and a horrific step to take in the context of a probably severe depression will further erode the already eroding levels of real public services, rural infrastructure and funding for land reform; and
- the political economy of power in the Philippines is skewed against workers and peasants (both of whom have had falling real income trends for thirty years) so that any shock is likely (almost certain) to worsen their position.

A Fiscal Aside

One school of thought blames problems on unsound fiscal policy and argues that until taxes are raised, high real interest rates are the only way to avert spiralling inflation.

This line of argument is basically ill-conceived for six reasons:

1. Treasury bill rates are often 5 percent above inflation plus deposit rates, underwriting both bank profits and the attractiveness of lending to Filipino borrowers for any enterprise whose own inflation rates and capital costs are much lower;

2. A 3 to 5 percent of GDP government borrowing requirement is neither unsound nor unsustainable if adequate human and infrastructural investment is taking place - vide Malaysia and, until the late 1980s, Korea;

3. High interest rates and failure to secure 'going terms' external debt servicing burden reductions are the basic cause of the present deficit;

4. Tax collection (which is arguably only 50 percent of amounts actually due across a wide range of direct and indirect taxes) and the absence of meaningful progressive land taxes - not low tax rates - is the basic constraint on revenue. Increasing complexity of rates and broadened coverage for VAT (in itself an ill-chosen general indirect tax as opposed to a reformed - and enforced - single point of entry or manufacture sales tax) are a misdirection of energy and will do far less for revenue than enhanced collection;

5. Expenditure - notably on health, education, infrastructure and rural transformation (including but not limited to land reform) - is far too low. The Philippines over 30 years has gone from near the top of the Asian league table in terms of percent of GDP allocated via the budget on health and education, in quality and quantity of infrastructure (and on real wages and labour productivity) to near the bottom. Its present peers are not Korea-Taiwan nor Thailand-Malaysia but Vietnam-Cambodia-Afghanistan;

6. To cure 5 above requires more expenditure. To finance it requires both more effective tax collection (and reforming indirect taxes with a view to collectability) and reducing interest payments through external debt service reductions and lower domestic interest rates. To sustain such a transformation trend, GDP growth must be pushed to 4 to 5 percent a year concentrated on tradables.

The neo-Southern Cone strategy contributes nothing to such a transformation. High interest rates and currency overvaluation deter investment, reduce manufacturing and agricultural sector profits, further depress real wages (and labour productivity; thus, quite possibly raising even real peso labour cost per unit of output) and choke off growth. They are one of the basic causes of the fiscal crisis (the other being the administrative ineptitude and political power barriers to effective tax collection) and no part of its solution.

But... Inflation?

Inflation is a problem. However, the question is what is fuelling it in the conditions of near stagnation of basic domestic earned purchasing power which have characterised the last 24 months.

High interest rates' direct effect is to reinforce inflation. They are entered into markup price cost structures. Only if they also constrict total spending will their net effect be to reduce it and then usually at the price of substantial and sustained recession - as in Australia and the United Kingdom.

Massive short term foreign credit or speculative investment receipts - sucked in by the high interest rates - blunt the macroeconomic inflation-reducing impact of high real interest rates but not their recessionary impact on basic fixed investment and output.

External shocks - e.g. oil in 1989/90, drought in 1991/92 - and **bottlenecks** - e.g. electric power in 1991/92 - are both inflationary and output damag-

ing. In no conceivable way can high real interest rates be central to mitigating either impact.

Mini booms (or bubbles?) - notably in construction - are highly inflationary, e.g. the UK and Japan in the late 1980s. So long as the belief in ever-rising property prices and rents persists, they are self-generating despite high real interest rates especially when *de facto* (now *de jure*) free currency convertibility at a rate expected to be stable makes them attractive to external finance.

Fiscal management (as noted above) does result in some government borrowing pressure on prices although by itself this is clearly secondary and manageable at 3 to 5 percent of GDP borrowing requirements especially if a substantial portion are soft external loan financed.

In short, much of the inflation is **caused** by the strategy and little, if any, can be cured within the neo-Southern Cone parameters. A squeeze hard enough to lower inflation to 5 percent would destroy investor - and speculator - confidence, burst the building bubble - littering the three largest cities with mini-Canary Wharfs - and trigger a rush out of the peso.

What Is To Be Done?

The basic question to be addressed is how to get the Philippine economy and people out of the economic coffin which the Makati-Malacanang-Luisita axis of power has so elegantly, even if absentmindedly, crafted. That is a matter both of urgency and of difficulty - bubbles are hard to deflate softly, they tend to burst at the first prick.

To limit damage, initial action needs to be across the board, prompt and adequate to give some assurance it will stick. Long hesitation, minor piecemeal changes and growing uncertainty will trigger a cut off of new inflows, a withdrawal of new normal 90- to 180-day commercial credit and quite possibly substantial demands for cutting inter-company and other open book balance claims while the remitting is still good. The first two could exhaust reserves in two to three months. At its most extreme, all three could do it in two to three days.

The key elements and alternatives are evident:

1. **devaluation** - either by at least 50 percent (to peso 39-40 to the dollar) followed by a free float with only limited smoothing or successive 10 percent monthly devaluations to peso 40 to 50 to the dollar backed by exchange controls.

- o The first would have a faster positive effect on output of tradables and of manufacturing and agricultural enterprise profits but would run greater risk of deteriorating into a devaluation/price rise downward spiral. That risk would be even greater if 25 percent were the initial devaluation which, as on sober re-examination, few analysts would expect it to stick;

- o The second might or might not reduce unintended side effects. However, as the end goal of peso 40 to peso 50 to the dollar could be intuited and cutting off continued commercial credit will swamp exchange control dykes in a few months, caution may no longer be prudent. The basic lesson is to avoid inadvertently moving to 100 percent overvaluation.

2. Further, **reduction of tariffs** is needed to mitigate the inflationary impact. Import-substitution industries can afford to make such a contribution at much more favourable exchange rates anyway. For revenue purposes, taxes broadly equivalent to tariffs might be imposed on both domestic producers and on importers - perhaps as the first step to a multiple (perhaps five plus alcohol, tobacco and fuel) rate, semi-progressive single point sales tax to replace VAT.

3. Possible use of the balance in the **petroleum** stabilization fund to phase the impact of higher fuel costs. However, this might not work as it would be expected to be temporary, (or might be the road to

permanent fuel subsidies) so requires reflection.

4. Immediate inauguration of across the board re-negotiations aimed at a Brady plus **60 percent reduction in government-to-government and commercial external debt service** (with flexibility as to means of achieving it).

- o Suspension of payments on principal for the negotiating period would probably be prudent **except** for revolving commercial credit;

- o Repudiation of the Bataan agreement on the basis that the lenders knew or ought to have known that fraud went to the heart of the basic contract (especially as completing a nuclear reactor beneath the ash plume of Pinatubo in an active volcanic zone is an act of madness and a gratuitous waste of resources).

- o The debt cap bill should be reviewed, re-passed and signed to bolster the Philippine negotiators' position. However, exclusion of revolving commercial credits, making the 10 percent cap net, not gross, and applying it to all foreign exchange earnings would be prudent.

5. **Nominal interest rates** should be held constant (even if initial inflation after devaluation makes them negative in real terms) and reduced after inflation falls with a target of not over 5 percent real on basic commercial bank lending rates.

6. The government should not take the employer's side in **wage negotiations**. Philippine real wages are already too low in terms of achieving a dynamic of rising labour productivity and falling labour cost per unit of output. Certainly the initial results of policy change will be a further fall but the government should not seek to maximise it. Compulsory, binding, independent arbitration might be a useful interim initiative although whether it could be pushed through Congress promptly is problematic.

7. **Viable enterprises** caught by devaluation losses and/or loss of external credit should be given access to short-term emergency finance (at normal interest rates) while financial stabilisation or reconstruction is sorted out. This is especially true if main line financial institutions are heavily compromised (as may not be the case). This is not a case for bailing out shareholders but large-scale collapses (e.g. of groups with heavy property and construction exposure) could lead to a deeply damaging downward spiral. In no case should the government "nationalise" unserviceable private sector obligations - let the external lenders share the losses.

These measures will neither be popular nor avoid very considerable pain. But the pain involved in allowing the bubble to expand further, desperately trying to sustain it and ending with an unplanned collapse when external confidence vanishes, would be far worse. Nor would that route provide any clear base for reconstruction.

Longer-term strategic measures needing immediate canvassing for early initiation and medium-term payoff include:

1. Fiscal reform concentrating on restoring health, education and infrastructure budgets to adequate levels relative to present coverage and to GDP over a 5- to 7-year period;

2. Financing of 1 above by improving revenue collection (administration, probity, resistance to special interests), simplifying indirect taxes and introducing progressive property taxes on independent (not taxpayer provided) valuation as well as by external debt service reduction and lower real interest rates;

3. Focussing policy on means to creating an enabling environment for sustained, rapid growth of labour productivity including but not necessarily limited to more adequate human and infrastructural investment (not least breaking the power bottleneck) and a trend rise in real wages per day;

4. Substantial genuine land reform backed by enabling measures (not including crippling re-

payment burdens) for new family farming households and paralleled by serious attempts to achieve reforestation of some and conversion to agriculture of other substantial hectarages of present nominal forest lands (which are in fact slash-and-burn or abandoned bush disaster zones); and

5. Strengthening the domestic market growth base for economic expansion - including but not limited to the broad base purchasing power expansion resulting from higher real wages and land reform.

These measures - contrary to popular misperception - are all consonant with much of 1960s and 1970s Korean and Taiwanese economic policy that the 1986-91 - and *a fortiori* 1989-91 - economic policy of the Philippines. While not cast as an absolute poverty reduction strategy, these would - if successful - be much more effective than marginal, small 'target' group poverty palliation projects. They would raise wage and small farm real incomes and - by enhanced growth and lower unit labour costs from productivity growth - employment opportunities. When 40 to 60 percent of households are absolutely poor, it is only by enabling poor people to produce and to earn more can there be substantial, sustained transformation to decent incomes for (almost) all.

One aspect of Korean and Taiwanese policy is deliberately not proposed - detailed state involvement in credit, licence and other allocations flowing from an economic strategy framework. The Philippines public service does not have the experience, the skills, nor the independent professional judgment and probity to make that a prudent 1992 Philippine prescription.

The initial steps may in large measure be attainable if the case for them is made out promptly and pushed at all levels from advice to decision-makers to popular organisations. While many senators and representatives are holdovers, Congress had little impact on broad economic policy, and while the incoming President was certainly prominent in President Aquino's administration, he had no known involvement in economic policy.

The medium-term measures are more problematic. Each will clearly be opposed by particular interest groups well represented in the House and in traditional advisers and advice-bearers to Malacanang. As a whole, they could make progress only with full Presidential (and key Secretary) commitment and willingness to confront most landlords, a large fraction of industrialists, property developers, Makati, external creditors and a majority in the House and probably in the Senate as well.

Such a political transformation at the top is possible and could make some progress - especially if it proved electorally popular. It would be entirely consistent with the Cry of Balintawak and the spirit of EDSA so prominently featured in the President-elect's launching manifesto. To that extent it may be in the real world.

Notes

[1]"Southern Cone" refers to the following countries forming the southern part of South America: Argentina, Chile and Uruguay.