Philippines Confronts 'Argentine' Crisis

by Martin Chew Wooi Keat

The denial of economic reality is paving the way for an Argentina-style economic crisis to come to the Philippines—the result of years of looting by the International Monetary Fund.

The Philippines' public-sector deficit hit $3.40 billion for the first ten months of 2002, while the target for the entire year was only $2.45 billion. Both the London-based Fitch rating service, and the U.S.-based Standard and Poor's, downgraded the outlook for the Philippines to negative, and are expected to lower their sovereign credit rating in the near future. This "thumbs down" by the international financial oligarchy will make it even more expensive for the government to obtain loans to cover the deficit.

In late November, Rep. Rolando Andaya, chairman of the Philippine House of Representatives committee on appropriations, declared the Philippines to be in a state of a "de facto or undeclared unmanageable national government deficit."

A blowout was somewhat delayed by the expected proceeds (at least $500 million) from Malampaya, the country's first natural gas project—southwest of the main island of Luzon—which began commercial production a year ago. The Philippine government holds a 10% stake in the Malampaya Gas Project. Other stakeholders include Shell and Texaco, each owning 45% of the project.

However, the budget deficit, which was induced by the 1997-98 currency crisis (see **Figure 1**), not only ensured that the Filipino people would not see any larger benefit from the nation's first gas project, but also that the nation will have to borrow just to survive from day to day, as well as to repay old debts.

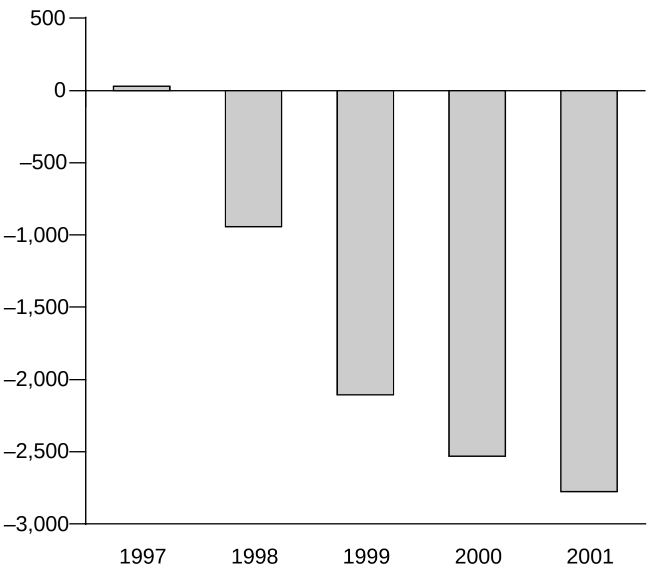
In April 2002, the Philippine central bank announced its intention to sell $500 million of five-year bonds to repay $700 million of debts that will mature next year. In July 2002, the central bank—taking advantage of historically low interest rates due to the U.S. Federal Reserve's "Wall of Money" policy—closed a deal for a $675 million five-year loan facility—the largest Asian sovereign loan in 2002, as well as the largest dollar-denominated loan in Asia to date, excluding Japan. The exercise was arranged by 22 syndicate members comprising various European, Asian, Middle Eastern, North American, as well as local financial institutions. The Philippines had originally wanted to borrow $740 million, but only $675 million was successfully closed.

In August 2002, the Philippine government announced that foreign borrowing accounted for one-third of total government financing. For 2003, by some estimates, 85% of total government financing may come from foreign lenders. It must be noted that the 1997-98 crisis caused the debt load of the Philippines, measured in dollars, to nearly double (see **Figure 2**)—but due to the devaluation, by half, of the peso, the debt has actually *quadrupled* when measured in pesos!

Personal finances are not in any better shape. A binge of credit-card buying sent loan defaults soaring in the first quarter of 2002, prompting the government to think about banning the issue of new plastic, said central bank deputy governor Alberto Reyes. Almost half of credit card loans were overdue in the January-March quarter, up from about a fifth in the previous quarter. Credit card interest rates run as high as 40% a year. These personal bankruptcies are a direct result of the unemployment crisis.

Over the past two years, half a million Filipinos joined the ranks of the unemployed, swelling the number to nearly 5 million (**Figure 3**). If we include the underemployed, the number of Filipinos looking for gainful employment as of April 2002 stood at 9.5 million, out of a labor force of 35 million (Filipinos over 15 years of age).

FIGURE 1
Philippines Budget Deficit
($ Millions)



Source: Philippines National Statistical Coordination Board.

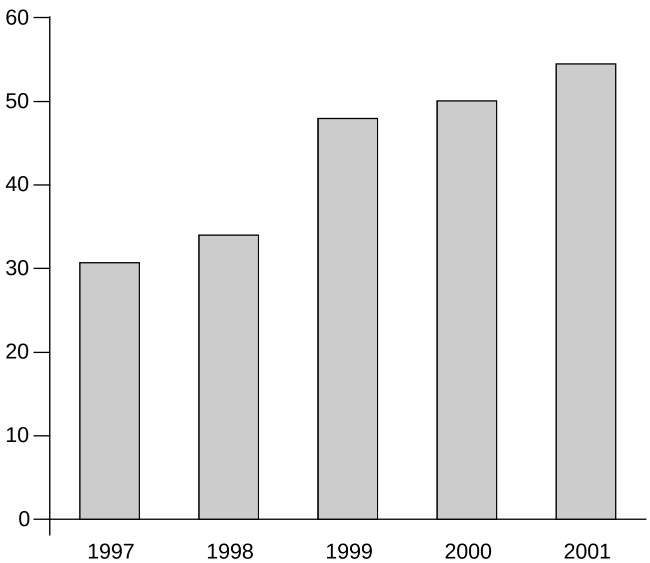
No 'Recovery' in Sight

New investments registered with the Philippine Board of Investments (BoI) dropped 82.48% in the first quarter of 2002, to $93 million, from $530 million in the same period last year.

FIGURE 2

Philippine Debt (Domestic and Foreign)

($ Billions)

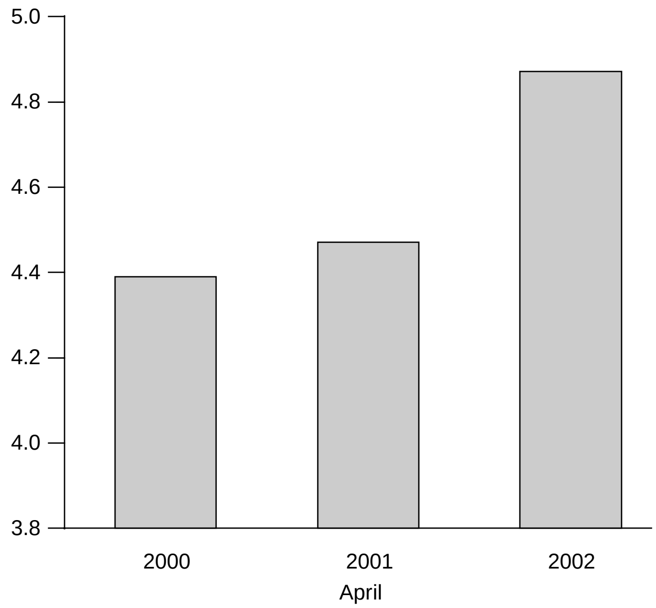


Source: Philippines National Statistical Coordination Board.

FIGURE 3

Philippines Unemployed

(Millions)



Source: Philippines National Statistical Coordination Board.

Furthermore, only 55% of projects registered with the BoI from 1993 to 1998 were actually pushed through.

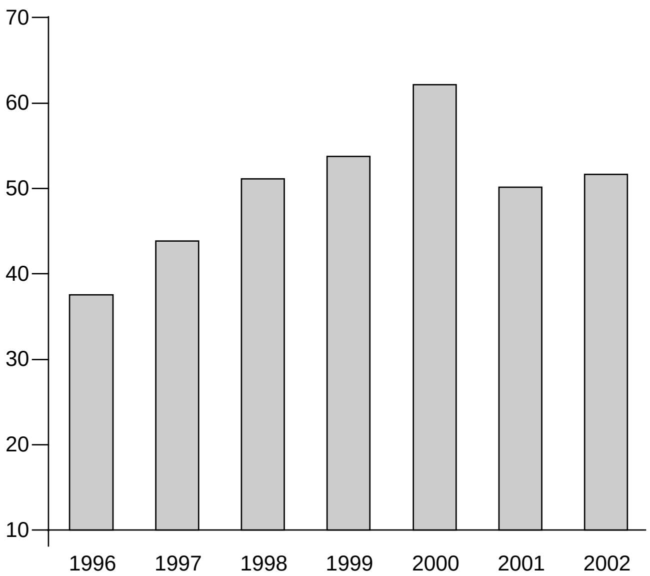
Japanese and Western businessmen cautioned the Philippines in May 2002, against mandating a rise of the daily minimum wage from $5 to $7. (Similar warnings were made in Indonesia, the other Southeast Asian nation facing possible financial collapse.) They threatened that China's wage rate is less than $1 per day, and should Manila jack up its daily minimum wage, it would price itself out of the foreign investment market. Toshiba shifted its personal computer manufacturing plant to Hangzhou, China to cut costs in the wake of plunging profits. NEC shut down its production of hard disk drives and laid off its entire 1,400-strong workforce, moving to Shanghai.

The unemployment crisis is threatening to dislocate the pension system. A state-run pension fund for millions of private-sector employees said in August 2002, that it could run out of money within ten years, because of low contributions and anemic returns on its investments. Social Security System (SSS) President Corazón de la Paz urged President Gloria Arroyo to authorize an increase in member contributions, which is now at 8.4% of a private employee's monthly income. "Right now, we are playing safe," said de la Paz. "We are sticking to business loans. At the stock market, we cannot sell, because we don't want to register a loss." The fund has more than 150 billion pesos (almost $3 billion) under management, of which 27% is locked in equities. The fund has also been pummelled by the underperforming Philippine Stock Exchange, as well as the low-interest regime now prevailing in the Philippines, driven by Federal Reserve Chairman Alan Greenspan's cuts in the United States.

Perhaps the most shocking fact, is that the current unemployment situation comes *despite* the departure every day of at least 2,000 Filipinos, seeking employment overseas. The Middle East alone hosts 1.3 million Filipino workers. Overseas workers pump close to $10 billion annually into the Philippine economy, a major chunk of which comes from those employed in the Arab countries. In the first half of 2002 alone, foreign exchange remittances surged 43.2% to $4.14 billion, enabling the Philippines to boost its reserves and stabilize the peso-dollar exchange rate. In August, Finance Secretary Jose Isidro Camacho admitted that a war in the Middle East could spell disaster for the Philippine economy, because of its dependence on the money the workers send back home. Massive dislocation of the workers and a disruption of remittances will lead to soaring unemployment. Reserves would plunge, and the peso would plummet against the U.S. dollar—which, in turn, would trigger hyperinflation.

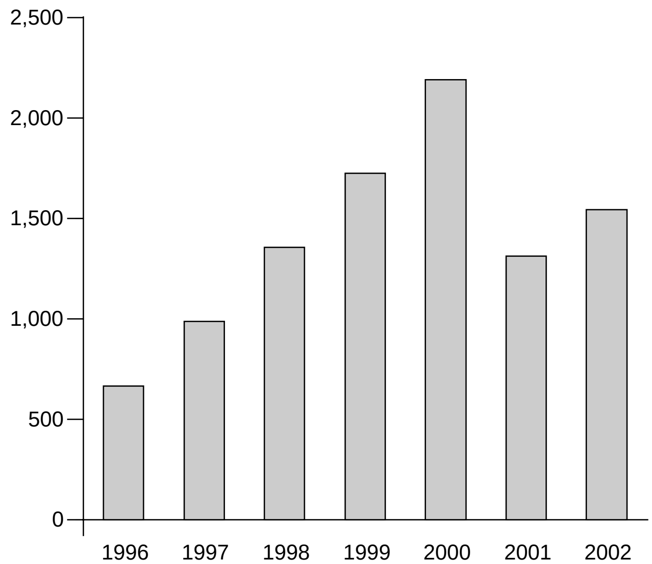
A side-effect of this foreign deployment of labor is the growth of HIV infection. Filipino workers returning from overseas account for as much as 30% of HIV cases in the Philippines. Meanwhile, the country faces a drastic shortage of nurses, since the relatively excellent nursing schools see their graduates recruited in huge numbers to work in the United States and other foreign locations.

FIGURE 4a
Philippines Electronics Exports
(% of Total Exports, August to August)



Source: National Statistics Office of the Philippines.

FIGURE 4b
Philippines Electronics Exports
($ Millions, August to August)



Source: National Statistics Office of the Philippines.

However, the Philippines is facing increasingly stiff competition in the business of "people exports." In April, Indonesia announced plans to set up a special agency to help export workers abroad, in an effort to earn up to $5 billion in foreign exchange annually. Last year, the foreign exchange earned from sending 738,000 Indonesian workers abroad amounted to $1.1 billion. The target for 2005 is $5 billion. Indonesia has a population of 215 million. There are currently 35-40 million unemployed, with an additional 2 million joining the labor force annually.

Banks and Industry Declining

The state of the banking system reflects the state of the Philippine economy. Philippine banks have the worst returns among the five major Southeast Asian economies (the other four being Thailand, Malaysia, Singapore, and Indonesia). Philippine banks reported an average return on assets of 0.1%, or one-fifth the regional average of 0.5%. The prevailing low-interest-rate regime has been bearing down on the net margins of banks. But in spite of the lower rates, loan growth in the Philippines remained problematic, with businesses making only selective new investments, given the patchy economic conditions. The Philippines also has Southeast Asia's worst acknowledged level of non-performing loans—at 18.4% of total outstanding loans as of September 2002. In the second quarter of 2002, the Philippine Central Bank posted a loss of over $60 million. Revenues slipped as interest income from international reserves declined by $750 million, or 51.2%.

Another casualty of the current economic crisis is the infrastructure system. A huge power outage hit the Philippine heartland in May 2002—the third in six months—leaving some 40 million people (half the population) without electricity for nearly five hours. The outage inflicted maximum damage on the commercial life of the nation, halting business at the Philippine Stock Exchange. Metro Manila was plunged into darkness, and factory work disrupted across the metropolis and nearby provinces. The capital's two overhead light rail transit systems were brought to a halt for more than five hours, stranding thousands of passengers.

Perhaps the biggest shoe waiting to drop is the Philippines' export of electronics (**Figures 4a** and **4b**). The Philippines' trade surplus for 2001 declined 61.1% to $2.6 billion, from $6.691 billion in 2000, as export revenues plunged, suffering from the global economic downturn.

Wishful thinking—that improved revenue collection would somehow solve the budget crisis—is as rampant in the government and in the press, as are fanciful stories of GDP growth, sounding very much like the faked picture presented in the United States of "economic recovery," while the bottom is falling out. As the global economic crisis worsens, the Philippines is set to be hit on *multiple fronts*—a deficit blowout, a debt blowout, an unemployment explosion, a banking meltdown, and a massive loss of its export revenue. There is no holding back the shockwave—except with a new international financial architecture, coupled with physical economic reconstruction.