Directorate of
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Philippine Economic Decision Making: The System and the Players [redacted]

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An Intelligence Assessment

~~Secret~~

EA 83-10037
March 1983

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Philippine Economic Decision Making: The System and the Players [redacted]

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An Intelligence Assessment

This assessment was prepared by [redacted] the Southeast Asia Division, Office of East Asian Analysis. Comments and queries are welcome and may be addressed to the Chief, Malaysia, Singapore, Islands Branch, OEA, [redacted]

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This paper was coordinated with the Directorate of Operations and with the National Intelligence Council. [redacted]

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Philippine Economic Decision Making: The System and the Players

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Key Judgments

Information available as of 18 February 1983 was used in this report.

The Philippine economy faces a difficult decade. The outlook for foreign-exchange-earning agricultural crops is poor, and the country faces a rapid rise in the labor force at a time when increasing obligations on its foreign debt—which now exceeds $17 billion—will make it difficult to provide investment funds to create jobs. 25X1

The ability of the Philippines to weather these economic challenges will depend in large measure on the efficacy of the economic decision making structure. The strengths of Manila's decisionmaking system include:

- President Marcos's willingness to consult an honest and generally competent staff of technocrats when the economy is under stress.
- Marcos's strong political skills and relatively secure short-term political position, which permit him considerable latitude in formulating economic policy.
- Manila's recognition of its dependence on foreign capital and a good long-term relationship with the international financial institutions.

At the same time, the system has weaknesses that could prove troublesome in the years ahead. These include:

- The nonconfrontational style of Philippine policymaking, which permits more assertive ministries undue influence in the design of policy and produces a weak chain of command in long-term policy planning.
- Insufficient policy coordination, which produces internal inconsistencies in balance-of-payments management.
- Nationalism among the technocrats, which compromises financial planning by limiting foreign investment.
- The prominence of business interests close to the President, which compromises financial and industrial policy by undercutting the decisions of the technocrats. 25X1

On balance, Manila's management is unlikely either to improve the performance of the economy dramatically or to produce economic crisis. This judgment could change, however, if Manila fails to follow up on plans to curb the growth of public-sector equity capital contributions to the private sector—thus expanding the government's portfolio of financially troubled firms. Over the short term, the technocrats' approach to exchange rate policy will be the key to avoiding financial crisis. Failure to allow sufficient depreciation of the peso could produce even more severe balance-of-payments strains than the country now faces. 25X1

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Philippine Economic Decision Making: The System and the Players[1] [redacted]

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The Economic Decision Making Apparatus

Question: "What three parties run the Philippines?"
Answer: "Ferdinand Marcos, Imelda Marcos, and the International Monetary Fund."

(Joke making the rounds in Manila)

Balance-of-payments strains and sluggish growth since 1980 have rapidly shifted the process of economic policy formulation in the Philippines in favor of two groups: the technocrats—led by Prime Minister (and Finance Minister) Cesar Virata—who collectively run the key government policymaking agencies, and international financial institutions—headed by the International Monetary Fund and the World Bank—that require changes in economic policy in exchange for continuing balance-of-payments support.[2] The sponsorship of the Fund and the Bank and the advocacy of the technocrats account almost exclusively for recent trends in economic policy. [redacted]

Three other institutional interests influence economic policy. The most important are the politically well-connected—especially business interests close to President Marcos—who collectively manage most processing industries for primary commodities. Government ministries and state enterprises outside the control of key technocrats also have numerous policy responsibilities and comprise the rest of the government decisionmaking patchwork. Outside of government, several private think tanks and lobbying groups are prominent advocates of various approaches to economic strategy. Although they have been especially active during the past few years stimulating a lively public intellectual debate about policy, they hold widely divergent views and do not present a united front. [redacted] 25X1

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How the Marcos System Works

Manila's actual policymaking is the product of interaction among the individual players. US Embassy and intelligence reporting since the early 1970s shows that Marcos favors a collegial style of decisionmaking in which he reads numerous position papers prepared by his staff. Though it is often difficult to tell how actively he is involved in the economic policy process, we are certain that all major decisions require his approval. Less critical decisions are determined by the relative influence Marcos awards key coordinating agencies in the decisionmaking system. [redacted] 25X1

The current decisionmaking framework is the product of constitutional amendments of Marcos's own design that closely followed the dismantling of martial law in January 1981. The executive branch was reorganized along the lines of the French-style strong presidential system. Marcos's choice of Virata as Prime Minister was dictated, we believe, largely by economic events at the time—especially the ongoing financial crisis. 25X1

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Assessing the Technocrats' Performance. Aside from its managerial competence, the gang of four's chief strength is its reputation for being apolitical and

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Table 1
The Philippines: Institutional Interests in Economic Policy Formulation

Institution	Remarks
Decisionmakers within government	
Key ministries	
Central Bank	Most powerful institution in influencing the direction of the economy. Generally favors conservative monetary policies and exchange rates that somewhat overvalue the peso. Philippine equivalent to the US Federal Reserve. Along with other ministries, advocates free market policies with selected price-distorting mechanisms that favor domestic entrepreneurs.
Ministry of Finance	Has supported expansionary spending policies. Equivalent to the US Treasury.
Ministry of Energy	Among the most favored ministries in the budget.
Ministry of Agriculture	Least influential ministry.
Ministry of Labor and Employment	Manages overseas employment programs and domestic industrial relations. Industrial relations policy debated by tripartite government, business, and labor groups in a highly publicized manner atypical of other policy issues.
Ministry of Human Settlements	Run by Imelda Marcos. The Philippine equivalent to the US Department of Health and Human Services.
Ministry of Trade and Industry	Functions sharply expanded in recent years.
Selected state enterprises	
National Power Corp.	Handicapped by artificially low electricity rates.
Philippine National Oil Company	Charged with refining and distributing petroleum, mostly imported.
Philippine Air Lines	Among the least sound financially of the state firms.
NASUTRA (National Sugar Trading Corp.)	Responsible for export marketing.
PHILSUCOM (Philippine Sugar Commission)	Responsible for domestic management of sugar industry; among better run of state firms. Administered by Roberto Benedicto, a close associate of President Marcos.
UNICOM (United Coconut Oil Mills)	Semiprivate, controls processing of raw coconut. Run by Eduardo Cojuangco, a close associate of Marcos, and Defense Minister Juan Ponce Enrile.
PCA (Philippine Coconut Authority)	Oversees enormous coconut industry, including research, marketing, finance.
State financial organizations	
United Coconut Planters Bank	Finances coconut trade and price stabilization scheme administered by the PCA.
Philippine National Bank	Largest bank in the Philippines. Provides corporate finance and equity. Headed by Gerardo Sicat, formerly director of NEDA and longtime advocate of economic policy reform.
National Development Company	Holds equity stakes in 40 private firms. Expanding rapidly.
Development Bank of the Philippines	Holds equity stakes in 122 private firms. Recently referred to by one US banker as the "financial junk heap of the Philippines," as a result of the poor financial condition of the firms it has acquired.
Coordinating bodies	
The Monetary Board	Financial coordination: foreign and domestic government borrowing, monetary and exchange rate policy. Chaired by Virata.
NEDA (National Economic Development Authority)	Coordinates long-term planning. Weaker institution than several years ago. Advocate of high interest rates and small budget deficits as a technique of balance-of-payments management. World Bank and IMF restructuring program advocated for a decade by NEDA before implemented as policy in 1980.
Overall policy design	
Office of the President	Decides all matters of consequence, channels issues to other institutions via Executive Committee.
Office of the Prime Minister	Has acquired much of palace's decision-making machinery since 1981. Incumbent an advocate of market-oriented economic policies, but strongly nationalistic.
The Executive Committee	Considers largely technical matters according to agenda forwarded from President through Prime Minister.
The National Assembly	Essentially a rubberstamp, completely dominated by ruling party apparatus. Nonetheless plays more active role in discussion of policy than several years ago.
Influential interests outside government	
International institutions	

Table 1 (continued)

Institution	Remarks
The IMF	Provides short-term balance-of-payments support, requiring suitable monetary, fiscal, and exchange rate policy as precondition. Despite occasional criticism, the Fund and other official lenders have few fundamental disagreements with Manila over policy design. With other official creditors, advocates market-oriented economic policy.
The World Bank	Provides long-run development finance generally without preconditions on domestic economic policy. An exception is the $650 million balance-of-payments structural adjustment program.
The Consultative Group	The Philippines' consortium of foreign aid donors; examines the economy in detail at annual meetings while coordinating aid flows.
Domestic think tanks and lobbying groups	
The Center for Research and Communications	A privately funded policy analysis and forecasting group without formal ties to the government. Exercises some influence on government through its ties to private investors and informal links to the technocrats, but under political pressure has reportedly tailored some of its judgments to what the government wants to hear. Headed by Harvard-trained economist Bernardo Villegas.
SGV Accounting (SyCip, Gorres, and Verrano)	A financial consulting and accounting firm; trained Laya, Virata, Ongpin, and other technocrats in the practicalities of financial management. Not an active advocate of a particular economic strategy, we believe its alumni nonetheless are imbued with a bias against multinational corporations.
The Makati Business Club	A loose conglomeration of business interests, including several opposed to Marcos. During the summer of 1982, conducted a public reexamination of economic policy, calling for far-reaching changes amid charges of a "crisis of confidence" in government. Headed by Enrique Ayala-Zobel, an oligarch whose wealth predates the Marcos era.
The Philippine Chamber of Commerce and Industry	Key lobbying group of local business interests. Vigorously opposed to economic restructuring program. Advocates discretionary assistance to the private sector. Headed by Fred Elizalde, an industrial oligarch with ties to the President.

[redacted] 25X1

honest. Several are extremely wealthy, but none has vested interests that compromise policymaking. Marcos has even claimed he is grooming Virata for a possible role as successor, though most astute political observers doubt the Prime Minister's political acumen. [redacted] 25X1

Their record indicates that the technocrats bring to policymaking a healthy pragmatism and the will to resist tailoring their judgments to what the President would like to hear. Virata and Ongpin, unlike many other presidential advisers, are candid with Marcos, [redacted] 25X1 They are also willing to confront entrenched economic interests when they believe the integrity of policy is at stake and are thus ideally suited to the role of engineers of economic and social policy reform. They have long been advocates of overhauling government trade and industrial policy, for example. [redacted] 25X1

The technocrats are adept at using their excellent international reputations to bolster confidence in the government's policies. Laya, for example, is credited by international bankers with saving the country from financial calamity with ad hoc measures in 1981. We believe the lynchpin of his strategy was successfully shifting blame for the crisis onto a financier who had fled the country, while Manila defended the peso in the face of an estimated $800 million in capital flight. As a result, the government's international credit rating remained unblemished, and Manila bought valuable time in which to implement a financial rescue operation. [redacted] 25X1

Though their prominence has unquestionably improved policymaking, in our judgment the gang of four has weaknesses that prevent them from living up to the image Manila has created in the eyes of private foreign bankers. We believe the formulation and execution of policy are slow, so the policy response lags changes in international economic trends. In addition, uneven administrative performances impair policy coordination. Even though he heads the technocracy, Virata's record suggests that he is among the least dynamic of its members. Meanwhile, Ongpin in our judgment has developed into an empire builder, reflecting his training as a manager rather than as an

A Profile of Interest Groups

The Technocrats

Manila's present staff of technocrats rose to positions of prominence during the financial crisis of 1981, when the collapse of the domestic commercial paper market left the private sector without short-term financing and the existing government decisionmaking apparatus with severely damaged credibility both at home and abroad. Best known among them is a group respectfully referred to within government as "the gang of four"—Prime Minister and Minister of Finance Virata, Central Bank Governor Jaime Laya, Minister of Trade and Industry Roberto Ongpin, and Planning Minister Placido Mapa (see appendix A for personal profiles). Through their individual ministries, they are jointly responsible for budget management and fiscal policy, exchange rate and trade policy, investment regulation and industrial policy, money supply control and financial regulation, development planning, and economic policy coordination. Except for Virata, the technocrats are young and less tradition bound than their predecessors.

A background of training in US graduate schools and a strong inclination towards nationalism mark the technocrats' intellectual makeup. We believe all recognize the strength of market forces in designing policy, but all are essentially Keynesian in philosophical outlook. Thus, fiscal policy designed to boost domestic spending is consistently an element in their policy design along with a preference for prices set by market forces. According to many Philippine government officials, the technocrats see this approach as a way of reducing the role of influence and corruption in the daily running of the economy, thereby increasing economic efficiency.

In our judgment, nationalism rather than laissez faire, however, rules the technocrats' decisions on financial planning. We believe Manila's current corporate rescue program is designed largely to keep management in Filipino hands while improving corporate efficiency, because the technocrats regard foreign investment as competition for indigenous entrepreneurs. When the investment treaty governing US investments expired in 1974, for example, Virata as Minister of Finance successfully lobbied for a foreign borrowing program to fuel development rather than to liberalize foreign investment regulations. The country's foreign investment procedures remain among the most complicated in Southeast Asia, as a result, according to US Embassy officials. 25X1

The Official Creditors

Though executed by the technocrats, the most far-reaching changes in domestic economic policy since 1979 have been undertaken at the insistence of the International Monetary Fund and the World Bank, the country's two leading creditors. The Philippines is among several developing countries engaged in a jointly sponsored IMF–World Bank industrial restructuring program requiring adjustments in tariffs, interest rates, foreign exchange controls, and exchange rate policy—combined with limits on growth of the money supply and on foreign borrowing. Professional journal articles and academic treatises by technocrats less influential than the current group 25X1 *show that they advocated similar measures during the early 1970s. In exchange for policy reform, initially resisted by the government because of anticipated objections from the politically powerful private sector, Manila is receiving credits from the Fund and up to $850 million in World Bank loans covering 1981-85 to modernize key industries.* 25X1

The Well Connected

Economic oligarchs have run key sectors of the economy—ensuring operational control and policy influence for the well connected. Through control of state enterprises, personal associates of Marcos set policy in two critical agricultural sectors, the sugar 25X1 *and coconut industries, which provide income for an estimated half the population. Sugar production, processing, financing, and marketing are controlled by former Ambassador to Japan Roberto Benedicto, and similar activities in the enormous coconut industry are controlled by National Assemblyman Eduardo Cojuangco and Defense Minister Juan Ponce-Enrile. The Ministry of Agriculture has no role, even as a coordinating agency.* 25X1

Marcos has relied on other political allies to develop the domestic construction, finance, and heavy industries, thereby constraining, in our judgment, the latitude of important government ministries in setting financial and industrial policy. This intensifies the charges by political opponents of cronyism and corruption. Manila's decision to provide up to $650 million in financial assistance to failing private firms in early 1981 was criticized by less influential businessmen who claimed that financial policy was compromised to bail out friends of the President. Most businessmen, however, according to US Embassy officials, believed Manila had little choice but to intervene to prevent the economic dislocation that would have resulted from a string of corporate bankruptcies. Moreover, the government required streamlining and management reorganizations as preconditions for financial assistance and injections of public-sector equity capital. As a result, one prominent US banker told US Embassy officials in July 1982 that cronyism had been reduced. [redacted]

Key Players in the Public Debate Over Economic Policy

Best known of the research groups is the privately funded Center for Research and Communications (CRC). Largely a consultant to investors, the CRC nevertheless publishes widely on national policy matters and economic trends, providing the government an informal indicator of the private sector's expectations and preferences on policy. The CRC's publications show that it has been supportive of the technocrats and their policies and has occasionally criticized Marcos. It has advocated limiting the role of government and avoiding the development of an industrial policy it refers to as "lemon socialism"—keeping inefficient firms afloat with public funds. The CRC has told US Embassy officials that the role of cronyism in diluting policy formulation is on the wane. [redacted]

The CRC's only direct ties to the government are informal contacts with presidential assistant Alejandro Melchor. Some US Embassy officials believe, moreover, that the CRC has succumbed to political pressures recently by altering the conclusions of its research to make them more acceptable to the government. For this reason, we believe the CRC's value in the policy debate is declining. [redacted] 25X1

A group of leading businessmen known as The Makati Business Club has tried to develop its own dialogue with the government. Established in mid-1982, the club's chief purpose is to persuade Manila to improve the integration of the private sector in national development as a way of defusing political instability and halting the country's economic slide. Its plan calls for the adoption of a labor-intensive growth strategy, deregulation of key industries, accelerated land reform, and a halt to state capitalism. The club, which includes businessmen with ties to Marcos's political opposition, has been critical of government corruption and inefficiency, cronyism, limits to free expression in the media, and even the technocrats because of the current trend toward larger government. US Embassy reports and press 25X1 *coverage reveal that the government has been tolerant—if not always receptive—to the club's views, which have been repeated with increasing frequency as the economy performs poorly and the rural Communist insurgency expands.* [redacted] 25X1

Among several persuasive lobbying organizations is the Philippine Chamber of Commerce and Industry (PCCI), a group of manufacturing interests heavily oriented toward the domestic market. The PCCI takes positions reflecting its own interests on a wide variety of issues, ranging from domestic energy prices to interest rate policy. Most of its recent energies have been focused on opposing the IMF– and World Bank–sponsored economic liberalization program. It has taken its case aggressively and persuasively to the press, and we believe it is taken seriously by government officials. [redacted] 25X1
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Table 2
Assignment of Policy Responsibility to Leading Economic Problems

Economic Problem	Policy Instrument	Responsibility
Short-run balance-of-payments instability	Exchange rate	Central Bank
Long-run balance-of-payments instability	Exchange rate and industrial policy	Central Bank and Ministry of Trade and Industry
Foreign debt service	Ceiling on new loans, refinancing	Central Bank via Monetary Board and debt management office
Central government dissaving	Spending and revenue management	Ministry of Finance
Short-run growth instability	Short-term credit to the private sector, pump priming	Central Bank via state banks, Ministry of Finance
Slow long-run growth and lagging productivity in:		
Agriculture	Exchange rate policy, land reform, input subsidies, credit to farmers	Central Bank, Ministry of Agriculture, Ministry of Human Settlements
Manufacturing	Exchange rate policy, commercial policy, investment regulations	Central Bank, Ministry of Trade and Industry
Low return investment bias	Interest rate	Central Bank via money supply growth and capital controls
Low risk investment bias	Capital market development, public-sector investment	Central Bank, Ministry of Trade and Industry via NDC
Capital-intensive investment bias, unemployment, and skewed income distribution	Exchange rate, capital equipment subsidies	Central Bank, Ministry of Trade and Industry
High population growth rate	Family planning	National Economic Development Authority
Inefficient land utilization	Land reform, infrastructure investment	Ministry of Agriculture
Energy import dependence	Investment in hydro, geothermal, and nuclear power. Pricing of gasoline, electricity. Promotion of oil exploration.	Ministry of Energy, National Power Corp.

[redacted]

economist. A "doer" rather than a designer of policy, many government officials say that Ongpin's Americanized style is out of place in the traditionally nonconfrontational environment of Filipino policymaking. [redacted] 25X1

Policy planning and coordinating mechanisms headed by the technocrats perform inconsistently, in our judgment. The Monetary Board, chaired by Virata with representation from most ministries, independent agencies, state enterprises, and financial organizations, meets weekly to plan financial policy. We believe its management of the foreign borrowing program is well above Third World standards, but the expansion of foreign borrowing since 1980 has sometimes placed too many loans in the international capital market at once, making potential lenders nervous and occasionally aborting the borrowing plans of state agencies. The board's efforts to develop local capital markets by reforming financial regulations have sometimes been at odds with growing government deficits, which have soaked up an increasing share of national savings even as reforms in financial regulations were implemented to stimulate savings. Last year, for example, the public-sector deficit reached 4.2 percent of GNP, and the sector accounted for over half the economy's net credit creation. In our judgment, economic nationalism has also compromised financial planning by limiting the role of foreign investment in tapping new sources of capital. [redacted] 25X1

We believe the budget process has become unwieldy under Virata and Budget Minister Manuel Alba, who have yet to adapt the process to the recent growth of public-sector investment spending.[3] Last year implementing ministries and state corporations prepared individual capital budgets that exceeded available resources by over 65 percent, according to reports published by the World Bank. As for the long-term planning process, we believe the National Economic

[3] In the early 1970s capital expenditures constituted only 10 percent of the national budget and the role of the state enterprise sector was relatively small; capital spending took 30 percent of total government outlays in 1981, according to the World Bank. [redacted] 25X1

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Development Authority (NEDA), which resets development priorities every five years, and Planning Minister Mapa, who is the only formally trained economist among the technocrats, have lost influence recently to the Ministry of Trade and Industry because of Ongpin's aggressiveness. NEDA's chief role is that of coordinator between the Central Bank and key ministries. The coordination process is described by NEDA officials as "consensus seeking" and nonconfrontational, and, for this reason, we believe the chain of planning authority is weak. [redacted]

Recent Developments. Even at the height of Virata's authority, economic policy has emerged only after continued battles between the technocrats and well-connected interests that control key sectors of the economy. [redacted] The outcome of recent policy battles, however, suggests to us that the technocrats are prevailing over crony interests more frequently than they did during the 1970s. [redacted]

The most widely reported and controversial contest over the past several years has concerned the coconut levy—a tax on processed coconut that finances a price stabilization scheme for farmers. Several financial institutions run by Eduardo Cojuangco administer the program, and the scheme has financed industry consolidation under an umbrella organization controlled by Cojuangco and Enrile. Worried by the rapid growth of the Communist insurgency in the coconut-growing regions in late 1981, Virata persuaded Marcos to drop the levy in favor of higher prices for farmers. Industry management prevailed several months later to have the levy reinstated, however, [redacted] Virata threatened to resign. In January 1982 he persuaded Marcos to "float" the levy on a sliding scale dictated by international prices, and later in the year succeeded in suspending the levy completely when prices fell further.[4] [redacted]

The President has also allowed the technocrats to have their way recently on a variety of other matters. The business empires of Marcos allies Herminio Disini, Rodolfo Cuenca, and Ricardo Silverio have been reorganized, despite their objections, under technocrat management to achieve economic efficiency. Ongpin was also successful in 1981 in a bid to scale back the controversial and publicly financed gasahol program to be directed by Roberto Benedicto. There remain limits to the technocrats' power, however. For example, Virata's $2.4 billion ceiling on the country's foreign borrowing for 1982 was breached by government guaranteed foreign loans secured by private corporations receiving government financial assistance. [redacted]

On balance, we believe the strength of Virata's political position—and perhaps eventually his ability to make economic policy independently of political pressure—has eroded since early 1982. His relationship to Imelda Marcos, a political power in her own right, is tenuous. [redacted] When Marcos appointed his wife to the Executive Committee in August 1982, against his pledge to Virata that he would not do so, Virata's prestige suffered considerably, [redacted] The Executive Committee under Virata's leadership, moreover, has yet to consider its first sensitive political or economic issue. [redacted]

The Decade Ahead: A Notional View of Economic Policy

The Necessity for Choosing Wisely. In our judgment, Manila's economic policy making during the coming decade will depend critically on the degree of urgency Marcos attaches to the economy's problems and the potential political fallout they may produce. We believe that the outlook for the economy over the next several years is poor and that the most formidable tests of Marcos's economic decision making system are just beginning. As a result, the technocrats are

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[4] The suspension is temporary, and we believe the debate is certain to be rekindled when international prices again rise. In the meantime Marcos has chosen to help the severely depressed coconut industry with other policies, including a privately administered but publicly funded investment program. [redacted]

likely to continue as prominent actors in the policy arena during the next several years, and official creditors such as the IMF are likely to continue exercising substantial leverage on Manila's decisions. [redacted]

Most pressing among the economy's problems are those caused by a factor beyond Manila's control—the global recession. Manila's rescue program for the private sector has succeeded so far in sparing the economy the worst of the slowdown in international growth, although some sectors, especially the mining industry, have been hit very hard. Two long-term problems, in our judgment, may turn out to be more serious than the recession: demographics assure extremely rapid labor force growth during the 1980s while the maturity structure of the foreign debt assures continuing balance-of-payments strains. Furthermore, the outlook for several agricultural crops, and thus rural incomes, is very dim, according to commodity forecasts (see box). [redacted]

The Broad Objectives of Policy. The World Bank believes the economic policy strategy embodied in the government's 1983-87 Development Plan is broadly appropriate to face these challenges. The plan identifies five key elements of economic policy for the 1980s:

- Effective exploitation of development potential in agriculture, including food production, agro-energy crops, and export crops.

- Industrial development to exploit industries in which the country enjoys a competitive advantage, particularly labor-intensive enterprises, accompanied by the development of capital-intensive intermediate-good industries, such as steel and machinery, with investment risk born by the public sector.

- Continued development of supporting infrastructure for both agriculture and industry. NEDA is firmly committed to what its director refers to as "human infrastructure development," meaning the development of labor force skills and public health systems.

- Import substitution coupled with conservation measures in the energy sector to release foreign exchange for use elsewhere.

Long-Term Constraints on Economic Policy

Roughly half the population of 51 million is under 16 years of age, and this group will provide the bulk of labor force entrants during the next 10 years. On the basis of likely trends in labor force participation rates, the World Bank projects that labor force growth will reach 3.7 percent annually—Asia's highest. The economy will thus have to create at least 700,000 jobs annually to prevent growing unemployment and further deterioration in real wages. This would require that the rate of job creation be nearly doubled. [redacted]

At the same time, our calculations show that interest payments on the foreign debt will consume about 5 percent of GNP over the next several years without a dramatic drop in global interest rates. Furthermore, without a sharp and immediate decrease in the trade deficit, we estimate that annual debt service is likely to almost triple to about $6 billion by the end of Marcos's current term in 1987. Thus foreign resources for job creation will be available only to the extent that new loans exceed these levels, and the new loans will produce a further debt service burden later in the decade. [redacted]

In agriculture, the price outlook for sugar and coconut is dim. Sugar faces new competition from high fructose corn sweeteners, and commodity specialists believe that international tropical cane sugar prices have seen their peak. Coconut oil faces competition from LDC suppliers of other edible oils that entered the market in the late 1970s. In our judgment, weak prices for both commodities are promoting the steady growth of the Communist insurgency which has occurred during the last several years—a trend Manila will eventually have to reverse. [redacted]

- Greater mobilization of domestic savings through financial reform and more efficient use of funds available for investment. [redacted]

The Plan has drawn three basic criticisms. Official creditors, and even the Philippine National Assembly, have criticized it for ignoring the need for population

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planning. This, however, is unlikely to change while Planning Minister Mapa—a staunch Roman Catholic opposed to birth control—runs NEDA.[5] The Plan also contains few specifics regarding the use of individual policy instruments, according to the World Bank. The Bank has also suggested that the Plan does not adequately consider the costs of the expanding role of the public sector, as investment in state enterprises consumes a growing share of scarce investable resources. [redacted]

Key Philosophical Choices. With the specifics of policy yet to be laid out, the fundamental decisions facing Philippine policymakers over the next decade will concern the choice between "crony capitalism," "lemon socialism," and a more realistic approach to economic policy. No one, we believe, including high officials of the Philippine Government, knows how this dilemma will be resolved. [redacted]

The technocrats' suggestions have yet to slow the momentum to larger government, however. Government investment in state enterprises, according to government data, reached 5 percent of GNP last year, up from 3 percent in 1978. At the same time, the public sector has significantly expanded its holdings of equity in the private sector because of the technocrats' rescue program. Manila thus faces the task in the 1980s of divesting itself of inefficient enterprises if expertise provided by government financial organizations proves insufficient to sort out their problems. [redacted]

A more awkward choice financially, in our judgment—and one more fundamental philosophically—may turn out to be whether to divest the public portfolio of sound enterprises, thus resisting the trend to state capitalism. We believe the technocrats' nationalism and professional expertise as managers rather than economists may work against divestiture. Foreign investors are unlikely to be given a prominent role providing capital and expertise in sectors in which Manila holds substantial equity, according to US Embassy officials. At the same time, Ongpin's ministerial track record suggests he believes that turning the financial corner for these firms will award the government a mandate to run them permanently. 25X1
This, we believe, would virtually assure continuing economic problems by stifling private-sector investment. [redacted] 25X1

In our judgment, Marcos's decisionmaking system must also find ways to revitalize the deteriorating rural economy, which will not be able to capitalize on the full effects of recovery in industrialized countries without substantial restructuring.[6] The shift out of 25X1
sugar and coconut production—a stated objective of 25X1
government agricultural experts—promises to be retarded by vested interests close to the President. Moreover, the Ministry of Agriculture is not sufficiently influential to force the adjustment over entrenched interests. A rural investment program begun in 1981, the $125 million National Livelihood Movement sponsored by Imelda Marcos, appears to be the decisionmaking system's primary response, and we believe it is not sufficient to offset the effects of otherwise weak agricultural policy. [redacted] 25X1

We believe the key indicator of the decisionmaking system's ability to deal with economic and financial strains during the next several years will be management of its most powerful policy instrument—the foreign exchange rate. We believe rising debt service obligations and a weak balance of trade, however, will demand more rapid depreciation of the peso than Manila has permitted in the past. The country's 25X1
estimated $1.1 billion balance-of-payments deficit for 1982 and the simultaneous failure of the peso to depreciate rapidly against currencies other than the

[redacted] 25X1 25X1

[5] Marcos is also believed by US Embassy officials to use the threat of family planning as a trump card in his efforts to neutralize the politically powerful Catholic Church. [redacted]

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US dollar are evidence of vigorous Central Bank defense of the exchange rate. We believe failure to allow sufficient depreciation for any reason could produce serious foreign debt management problems by expanding the trade deficit and thus the demand for new foreign loans beyond a sustainable level of financing. This would also delay the development of labor-intensive export manufacturing at a time when political stability requires rapid creation of jobs. 25X1

Appendix A

The "Gang of Four" Technocrats

Cesar Virata

Prime Minister;
Minister of Finance

Cesar Virata earned a Masters' degree in Business at the Wharton School at the University of Pennsylvania in 1953. He has championed the view, with limited success, that the Philippine economy should be subject to less political manipulation than it has been in the past. He is still learning the art of politics and has sometimes supported politically untenable, but otherwise proper and logical, economic positions. An advocate of conventional fiscal and monetary policies, he believes that the country must expand local control over its natural resources. Virata subscribes to a free market approach to problems of resource allocation, and he opposes subsidies for inefficient domestic firms.

According to a senior official of the US Embassy in Manila, Virata is dogged in his pursuit of Philippine national interests. He supports a policy of nondiscrimination toward all foreign investors, and he has been instrumental in establishing tax advantages for large foreign (including US) concerns. Virata is one of the principal architects of the 1983-87 Development Plan, which includes as priorities increased food and energy production and improving telecommunications.

Virata concurrently heads the Executive Committee, which is composed of top administration officials and handles many governing details that formerly devolved on the President. The committee is also constitutionally authorized to manage the transition period if the presidency becomes vacant. 25X1

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Jaime C. Laya

Governor, Central
Bank of the Philippines

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Jaime Laya is regarded by US Embassy officials and many foreign businessmen as one of the most competent, motivated, and honest technocrats in the Philippine Government. US officials have also commented that he is very perceptive politically and works very effectively within the constraints of the Philippine system. A member of President Ferdinand Marcos's inner circle of economic advisers, he assumed the

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governorship of the Central Bank during the 1981 financial crisis when many of the country's largest firms were suffering from liquidity problems. He acted promptly to rebuild public and international confidence in the Philippine financial system by initiating reforms in both the credit system and the money market, two problems that had contributed to the crisis. [redacted] Laya's decisive and courageous actions added to his already solid reputation as a skilled and resourceful technocrat. US bankers regard the Central Bank, under him, as a well-managed institution, but Laya has been less forthcoming with Central Bank foreign debt data than his predecessor. [redacted]

Laya is a magna cum laude graduate of the University of the Philippines. He also has an M.S. degree from the Georgia Institute of Technology and earned a Ph.D. in finance from Stanford University in 1965. During the late 1960s and early 1970s, he was dean of the College of Business Administration at his alma mater in Manila, as well as a consultant to various government agencies and private companies. Laya joined the government in 1974 as deputy governor of the Central Bank and then served as Budget Minister from 1978 to January 1981. [redacted]

Roberto V. Ongpin

Minister of Industry and Trade

Roberto Ongpin (M.B.A. Harvard, 1961) has an outstanding reputation in the international banking community, and he is respected by professionals both within and outside the Philippine Government. He is well known for his integrity and for his strong opposition to government corruption. According to US Embassy officials and a US businessman who has known him for many years, Ongpin is loyal to President Marcos and is one of his closest and most trusted advisers. US Embassy officers state that Ongpin has been an effective supporter of Marcos's development programs since he joined the Cabinet in 1979 as Minister of Industry. Ongpin believes that the Philippines missed the chance to develop export manufacturing in the early 1960s and, unlike Virata, advocates public-sector development of heavy industry in the style of Korean development. Extremely nationalistic, he nevertheless generally supports US goals that are aimed at continued liberalization of world trade. [redacted]

Ongpin is not afraid to disagree with the President or challenge the politicians if he believes a proposal or policy is misguided. [redacted] the Minister is a determined, opinionated, yet extraordinarily capable manager who "steps on a lot of toes." US Embassy officials agree that Ongpin is aggressive, often abrasive, and lacks patience with those less well informed and astute than himself. They also state that Ongpin may be involved in too many activities to be completely effective at all times. [redacted]

Placido L. Mapa, Jr.

Director General, National Economic and Development Authority

A competent and energetic economist and banker whose 20-year career has included positions both inside and outside the government, Placido Mapa is serving in his first cabinet post. In addition to directing the operations of the country's top economic

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planning organization, he also serves as Minister of State for Finance, a position he has held since 1965. According to a senior official of the US Embassy in Manila, Mapa lacks administrative ability and would probably be more effective in a financial, rather than a planning, position; he has, however, surrounded himself with some very capable deputies. US Embassy officers emphasize that Mapa's cooperation is crucial in the implementation of many bilateral aid programs. [redacted] 25X1

Mapa advocates that foreign aid should build on a developing country's socioeconomic base rather than to try to change or eliminate that base. A staunch Roman Catholic and active member of the conservative religious group Opus Dei, Mapa is well known for his rabid opposition to family planning programs. In May 1982 he and the Archbishop of Manila were successful in getting a contraceptive-oriented family planning program deleted from the country's draft economic plan for 1983-87. He earned a Ph.D. in Economics with specialties in development and international finance at Harvard in 1962. He believes government budget policy is the key to balance-of-payments management. [redacted] 25X1

Appendix B

The Last Decade in Economic Decision Making: A Report Card

Manila's Most Astute Decisions

The Decision To Monitor the Foreign Debt. Manila began to track the maturity profile of the country's foreign debt soon after rescheduling of the public-sector foreign debt was required in 1969. As a result, Manila has been able to avoid abrupt increases in the country's repayment obligations, and thus the need for sudden fluctuations in the exchange value of the peso. We believe it is precisely the recognition of Manila's competence in debt management on the part of private foreign bankers that has enabled the country to continue commercial borrowing on relatively favorable terms even as the debt grew rapidly. [redacted]

The Energy Program. Manila's domestic energy program, a response to the OPEC oil price hikes of 1973-74 and 1978-80, has two objectives: to reduce domestic oil consumption through conservation measures and to develop domestic supplies of nonoil energy—chiefly hydroelectric, geothermal, and nuclear power. We believe the government is unlikely to reach its goal of reducing the Philippines' energy dependence on imported oil from 84 percent currently to 44 percent in 1987, and outlays on imported capital equipment will probably exceed savings in the oil import bill during the next three or four years. Nonetheless, we believe the program is likely to provide large foreign exchange savings by the end of this decade. It has already succeeded in making the Philippines the world's second-largest producer of geothermal power, behind the United States. [redacted]

The Decision To Begin Diversifying Exports. Export earnings are still vulnerable to sharp fluctations in international primary commodity prices, but less so than in the early 1970s. Manufactured exports constituted 23 percent of merchandise export earnings in 1982, up substantially from 16 percent in 1975. The government's structural adjustment program is designed to remove the remaining weakness in the manufactured export sector, such as heavy reliance on imported inputs, which, according to World Bank data, currently limits the domestic income generated by each dollar of foreign exchange earned to about 25 cents. [redacted] 25X1

Manila's Mistakes

The Decision To Borrow at the Expense of Foreign Investment. When the bilateral treaty giving preferential treatment to US investments expired in 1974, Manila chose to develop industry through foreign borrowing rather than to open the economy to foreign investors, as many other LDCs—such as Brazil, Taiwan, and South Korea—have done to develop their industrial base. 25X1 The borrowed funds generated relatively little repayment capacity, however, while saddling the Philippines with a foreign debt that exceeded $17 billion by the end of 1982. In our judgment, Manila still regards foreign investors as a threat to indigenous entrepreneurs, despite lipservice to the contrary. We believe protection of indigenous entrepreneurs at the expense of wage earners, moreover, has contributed substantially to the country's skewed income distribution. [redacted] 25X1

The Decision To Prolong Import Substitution. Manila pursued exchange rate and trade policies that subsidized importers of capital goods and manufacturing for the domestic market beginning after World War II. This strategy produced rapid postwar growth, but the manufacturing sector never became internationally competitive and began to stagnate in the early 1970s. Rather than reform domestic manufacturing, 25X1 Manila confined support for manufactured exports to export processing industries, and local manufacturing interests required further protection to remain financially viable. Under pressure from official creditors, this strategy has started to change gradually, but the balance of payments remains weak, and the domestic economy is under great stress from the adjustment. [redacted]

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Table 3
The Philippines: Growth and Debt Performance in Perspective

	Growth Rate, 1970-80		Public Foreign Debt, Share of GNP		
	GDP	Manufactures	1970	1980	Increase
Philippines	6.3	7.2	9.0	18.2	9.2
Middle-income LDCs					
Oil exporters	5.5	8.0	14.0	21.3	7.3
Oil importers	5.6	6.2	10.7	15.4	4.7
Asian LDCs					
Thailand	7.2	10.6	5.0	12.4	7.4
Indonesia	7.6	12.8	27.1	22.5	−4.6
Singapore	8.5	9.6	7.9	12.8	2.9
Malaysia	7.8	11.8	10.0	13.7	3.7
South Korea	9.5	16.6	20.9	28.8	7.8
Hong Kong	9.3	9.3	0.1	1.9	1.8

[redacted] 25X1

The Decision To Rely on the Well Connected To Develop Industry and Finance. President Marcos relied on personal associates to develop certain heavy industries, food processing activities, and financial services beginning in the early 1970s. Philippine economists say his strategy was to develop key sectors of the economy by building Philippine versions of the "zaibatsu," the Japanese pattern of vertical industrial integration. Several associates proved inept businessmen, however, leading to near financial collapse in early 1981, when the international economic slowdown first hit the Philippines and short-term local financing dried up. Government rescue operations have saved several large firms, but saddled the public sector with ultimate financial responsibility should the firms still prove unsalvageable. [redacted] 25X1

The Economic Track Record

Grading Philippine economic performance depends critically on a choice of criteria. The country has done better than most of Africa and much of Latin America, but has almost entirely missed East Asia's economic success. Real wages in manufacturing are no higher than they were in 1970, and, on a per capita basis, exports are among the lowest in East Asia. [redacted] 25X1

Real economic growth is slightly above average by middle-income, oil-importing LDC standards. Philippine financial performance has been weak, however, with a doubling of the foreign debt as a share of GNP since 1970—worse by half than the middle-income, oil-importing LDC average. [redacted] 25X1

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