Board Meeting of March 24, 1998
Statement by Juanita D. Amatong

PHILIPPINES -- Country Assistance Strategy Progress Report

The Philippines is at a critical juncture. As the economy continues to ride out the financial turmoil in East Asia, political activity is gaining momentum with the upcoming elections in May 1998. Indeed, what we have here is a timely and responsive CAS Progress Report. I would like to commend Management and staff for a well-written CAS update. It provides a good snapshot of the country’s key political developments and a sound assessment of the economic impact of the prevailing regional crisis. We also congratulate OED for the Philippines Country Assistance Review. The staff did an excellent job of evaluating the Bank’s program of assistance since 1986 -- the year which marked the beginning of a fundamentally changed political framework and economic and social policy environment in the country.

I would like to begin by briefly taking you through the pre-crisis situation in the Philippines. I hope that this provides the necessary context to better understand and appreciate the Government’s medium-term strategy to ensure that a stronger and more stable economy emerges out of this financial turbulence.

What was the state of the Philippine economy before the financial crisis? In recent years, the Philippines has taken major steps to create a stable and liberalized economy to facilitate its integration in a globalized economic environment. Reform measures were adopted on trade and investment liberalization, foreign exchange deregulation, privatization and opening up of key sectors of banking, insurance, shipping and telecommunications. Monetary and fiscal policies were pursued to achieve economic growth within the framework of a stable financial environment.

Given these policy changes, the country witnessed the onset of an economic turnaround. By 1996, GNP growth, driven by exports and private investment, accelerated from an average of 2 percent in 1990-93 to 6.9 percent in 1996; inflation was down from 18.7 percent in 1991 to 4.6 percent in June, 1997; exports have been growing 16-18 percent since 1992-93 and was up to around 23 percent in 1997; and total debt burden as a share of exports has reduced steadily from above 24 percent in 1992 to about 11 percent in mid-1997.

Economic reforms were seen as essential, though not necessarily sufficient ingredients, for a broad-based socially sustainable development path. Poverty, largely a rural problem in the Philippines, had to be addressed much more directly and substantially. This required the implementation of well-targeted poverty reduction programs. In 1994, the Government launched the Social Reform Agenda
targeted to 20 of the poorest provinces, providing social sector assistance in health, education and shelter services. This is a program led not only by Government but is a consensus-driven initiative of local government units, NGOs and civil society representatives, partnering as active participants rather than passive recipients of development.

While the Government has taken serious efforts at reducing poverty and enhancing human development, the Philippines’ social indicators still lag behind comparator countries in the region. Clearly, much more needs to be done and the Government is committed to press ahead, despite the difficult circumstances brought about by the regional crisis.

Has the Philippines achieved any breakthroughs in resolving pockets of internal conflict? Recognizing the deleterious effect of internal conflict on the country’s economic recovery, the Government took vigorous steps to fight communist insurgency and a hostile secessionist movement in the south. I am proud to share with you today the news of a historic breakthrough. After four years of negotiations, a peace accord was signed on March 17 between the Government and the National Democratic Front, representing the Communist Party of the New People’s Army. This marks the end of almost 30 years of insurgency, which spawned armed hostilities and the lack of respect for human rights.

In Mindanao, significant efforts to accelerate the peace process also brought to an end the long-standing pocket of civil conflict. The protracted conflict situation resulted in the profound neglect of mostly Muslim communities in terms of access to basic economic and social infrastructure and services, sources of livelihood and employment and opportunities to improve much-needed institutional capacity. And I am deeply gratified to see the Social Fund Project for the Special Zone for Peace and Development (SZOPAD) presented today for the Board’s approval. Bank assistance for this project is a historic opportunity to improve the quality of life in these marginalized communities, consisting of some 10 million people in 14 provinces, and will help pave the way for Mindanao’s economic integration.

How is the Philippines responding to the regional crisis? The Philippines is considered to have fared better than most of its neighbors, having been affected less severely than others. Both the CAS Progress Report (para 4, page 2) and the OED Philippines CAR (para 1.34, page 12, Vol I) clearly point this out. In particular, I fully appreciate the staff’s analysis and their efforts in highlighting the important differences between the Philippines and the other affected countries, citing country-specific conditions that have led to a more moderate impact of the crisis on the Philippine economy. While such an assessment might give some sense of comfort, the urgency in dealing with the effects of the crisis does not allow any room for complacency, neither for a momentary pause. Constant vigilance and decisive action are required. For as long as the financial crisis in the region persists, the vulnerability of the Philippine economy remains.

In response, the Philippine Government has taken swift action to further strengthen macroeconomic stability and rebuild investor
confidence. The floating of the peso was made in July, 1997 and fiscal and monetary policies were tightened considerably. Measures to strengthen the banking system were made. And the private sector was called upon to forge a common front in mitigating the effects of the crisis. For example, the Bankers’ Association of the Philippines, following another wave of currency turmoil in October, set a volatility band for currency trading to minimize wild fluctuations, while private manufacturers agreed to absorb some of the costs of the peso’s depreciation through increased efficiency and smaller margins to maintain price stability.

Early attempts to provide social safety nets involved the exercise of wage and price restraints to temper the inflationary impact of the crisis. Government policy will allow wage adjustments in response to market operating through regional wage boards rather than legislation. For our returning overseas workers affected by the crisis, the Government has in place an expanded reintegration program which will provide them with training programs on livelihood projects, entrepreneurship and business skills.

In recent weeks, the following significant developments took place:

* The IMF recently concluded its mission to the Philippines for a final review of the Extended Financing Facility (EFF) which expires on March 31, 1998 and to discuss with the authorities a request for a two-year stand-by arrangement in the amount of SDR 1,021 million to support the economic program for 1998-99. This new arrangement is intended to be treated as “precautionary”, to be used only in the event of adverse external circumstances.

* The Government has fulfilled the remaining elements of structural reforms covered under the IMF extended fund arrangement. These are: (i) the final component of the Comprehensive Tax Reform Package, dealing specifically with income tax; and (ii) the revised Oil Deregulation Law passed on February 10, which authorizes the President to accelerate deregulation for a 5-month period of all oil products, except kerosene, LPG, and regular gasoline, which are considered to be most socially sensitive. On March 15, President Ramos signed Executive Order 471, moving ahead of the time given him by law to fully deregulate the prices of petroleum products such as unleaded gasoline, aviation turbo, fuel oil and diesel and lifted the profit margin of oil companies. The Oil Deregulation Law opens up the oil industry to competition and sets the stage for a level playing field.

* The Government has firmed up its economic program for 1998-99, the objectives of which are discussed in para 12 page 4 of the CAS Progress Report. In order to achieve the medium-term macroeconomic targets, the Government will implement a strong policy package covering prudent macroeconomic policies, accelerated banking sector reform and other structural reforms.

Most recently, the Monetary Board raised further the minimum capitalization requirements of the different categories of banks by 10 percent to 30 percent, for compliance starting on December 31, 1998. In addition, the mandatory general loan loss provisioning is accelerated by 2 years, i.e. to be fully implemented by October 1,
1999 instead of October 1, 2000. Stricter bank entry qualification and competency criteria in the processing of licenses have also been issued. These moves are all part of the general thrust to strengthen the banking system and make it more resistant to shocks.

Other reforms will focus on ensuring fiscal sustainability through revenue and expenditure measures, both aimed at increasing public savings while allowing some leeway for higher public investment in infrastructure and human capital. Expected public savings will come from expenditure cuts now being implemented. In doing so, however, the Government is committed to provide safety nets to cushion the impact of the regional crisis on the poor, and to make the best possible effort to protect the social programs, especially those directly addressing poverty.

The three projects presented today for Board approval form part of these direct interventions to reduce poverty and support the country’s human development goals. These are the Early Childhood Development, Community Based Resource Management and the SZOPAD Social Fund Project. I take this opportunity to commend the Bank’s highly capable staff in the preparation of these three very important investment operations.

We are in full agreement with the Bank strategy, particularly with respect to the proposed adjustment lending to support financial and public sector reforms. My Philippine authorities attach critical importance to the timeliness and the quick-disbursing nature of these loans. I am pleased to see that these are proceeding on a fast track, and I would strongly urge Management to consider an early, single-tranche adjustment operation. I believe that a proactive and urgent response is required, even in a so-called “non-emergency” situation in the Philippines. First, we are still faced with the uncertainty of the duration and severity of the regional turmoil. In my view, the trickle-effect of gradual and measured interventions characterized by a multi-tranche operation, is not necessarily the best way to prevent deep crisis from creeping in the Philippine economy. I would argue for a more proactive assistance rather than a gradual, wait-and-see approach. Second, if the situation in the region deteriorates, and severe financial crisis hits the Philippines, an emergency bail-out in the end could be far more painful, complex and costly.

Will the anticipated political transition pose a major risk to the full implementation of the medium-term reforms? Understandably, concerns have been raised over the upcoming elections and the uncertainties of any major policy reversal by the incoming government. I see no reason to doubt that structural reforms enjoy broad political support. The highly participatory nature of our policy-making environment best illustrates the Philippines’ new brand of democracy. More importantly, reforms are enshrined in domestic laws which cannot simply be removed, neither at the desired will nor political whim of any incoming administration.

The current regional turmoil is but another test of our resiliency and capacity to deal squarely with challenges that confront us. And I believe that our success in managing this economic adversity lies in our ability to view this challenge as a stepping
stone rather than a stumbling block to our long-term development objective of sustained rapid growth and reduced poverty.

As one tries to contemplate what lies ahead, I can only offer a very important reminder: that the Philippines now has a strong and truly functioning democracy. I would consider it instructive to bring to mind the country’s much heralded triumph in gaining back political stability after the Marcos regime. Our broad-based democratic processes have empowered the Filipino people. And we consider ourselves fortunate to have a civil society that is strongly committed to preserve its hard-earned right to economic freedom and political stability.