

2. Brady and the Philippines: What Progress?

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'Pacta Sunt Servanda' ('The Contract Must be Honoured')
Medieval Domestic Private Commercial Law Doctrine

Overview

The Philippine public sector medium and long-term commercial bank debt renegotiations concluding in September-October 1989 were intended to be the centre piece of closing a 1989 external resource gap of \$1.3 to 1.5 bn and a 1990 gap of \$0.1 to 0.4 bn. They took place in the context of a reaffirmation by President Aquino and her Central Bank Governor and Secretary of Finance that the whole external debt could, should and would be paid.

The outcome of the negotiations was two agreed targets:

- \$1 bn of 'new money' either as medium and long-term (MLT) loans or as 15 year non-reschedulable bonds at 13/16 per cent over Libor to be taken up by June 30, 1991;
- \$1.3 bn buyback of public sector MLT (20 per cent of outstanding) at 50 per cent discount financed by the IMF, the World Bank and the Ex-Im Bank of Japan to take place during the course of 1990.

Background

Philippine external debt is in the \$27.5 to \$29 bn range as of early 1990. Of this \$13 bn is commercial bank including \$10 bn MLT of which \$6.6 bn is public sector debt.

Over 1986-88 annual net transfers of debt interest and principal averaged \$1.7 bn or 5 per cent of GDP — after a variety of partial commercial bank (CB) and Paris Club rescheduling negotiations. 1989-92 projections are for \$1.5 bn annually assuming no new borrowings or renegotiations.

The 1988 growth rate was 6.5 per cent. Official 1989 projections were: with closing of the finance gap 6 per cent and without 4.6 per cent. In the event total Paris Club and regular rollover CB savings on outflow and limited increases in trade credit may have totalled \$0.3 to \$0.4 bn implying growth of about 5.0 per cent. However growth in tourism and direct foreign investment (likely to be reversed in 1990 following the November 1989 nearly successful coup attempt) plus some use of reserves allowed 5.8 per cent (tentative first estimate) growth.

The 'pay at all costs and borrow/get ODA/bargain on US payments for bases in order to do so' strategy of the President, Secretaries of Finance and Central Bank Governors (including those appointed in the January 1990 reshuffle) has kept Philippine external debt's secondary market value to 50 per cent of face and been welcomed by creditors — commercial, bilateral and official. It has probably played some role in mobilising ODA and encouraging direct investment inflows, both of which are significant. It has not secured new funds in the sense of net inflows of overall external resources nor has it closed the financing gap.

The strategy and the negotiations have been the object of sustained, widely based criticism in the press and by an umbrella Freedom from Debt Coalition, which groups academics, business organisations, church groups, labour and peasant bodies and support groups. Their main proposals have turned on gross debt service capping (at 10 per cent to 20 per cent of gross visible exports or one quarter to one half of 1986-88 average gross payments), selective repudiation (of up to \$6 bn of loans inherently flawed by corruption the lenders knew of or should have known of), bond swaps or secondary market purchases at a high discount and Paris Club renegotiations on a multi year, long grace period (interest and principal) plus long payback basis. Legislation on debt service capping as a means to force satisfactory debt renegotiation terms was passed by an overwhelming majority in the Senate and has majority support in the House, but the President has made clear she would veto it. Some Cabinet Ministers (now largely ex-Ministers) favour debt capping and going into selective partial arrears on debt service.

A Debt Council including some critics of the 1986-89 strategy has been appointed by the President, but has few powers and exhibits something very close to a built in 'pacta sunt servanda' majority. Some fairly imaginative but small debt buybacks (nominally by government owned financial institutions, not by the State) have been carried out. Beyond that pre-1989 approaches and results were very much like early post-1982 Latin American London and Paris Club models.

Financing Requirement and Timing

The initial National Economic Development Authority estimate of the 1989-90 external resource gap was

\$2.2 bn. The reduction to \$1.7 bn accepted in the 1989 IMF 'Letter of Intent' was on assumptions as to trade deficits and growth rates inconsistent with the NEDA model (and on trade, at least, with reality). That figure was cut to \$1.4 bn by Paris Club reschedulings \$0.1 bn above estimate (100 per cent not 70 per cent of interest rescheduled) and by £0.2 bn on CB rescheduling of 1990 principal payments. The division — on the IMF estimate — was \$1.3 bn in 1989 and \$0.14 bn in 1990.

Concerning the outcome of the CB negotiation, two points stand out:

- a. \$1.0 bn of 'new money' (if achieved) and \$0.078 bn of net interest saving (for one year as no funds were drawable in 1989) on buyback does not add up to \$1.4 bn (much less \$1.9 bn on the NEDA estimate adjusted for other reschedulings);
- b. the timing of flows is inconsistent with that of the projected gap. On reasonable projections, as of October, \$0 would come in 1989; \$250 mn might come in the first half of 1990; \$400 mn in the second half of 1990 and \$425 mn in the first half of 1991.

'New Money'

The 'new money' component of the negotiated targets is \$0.9 bn for major banks and \$0.1 bn for those with smaller exposures. This can be in normal MLTs or in 15 year non-rescheduled bonds at the option of the banks. Each bank can pick the form it prefers and the amount of its additional exposure, i.e. the target is a ceiling with no guarantee it will be met or even approximated.

As of mid-January 1990, only \$0.62 bn had been pledged or semi pledged. The new Secretary of Finance was on a four nation tour to try to drum up the balance by a deadline extended from January to the end of February.

As the 'new money' is significantly less than principal repayments on old debt, is too late for 1989, at 13/16 per cent over Libor is not concessional and under the bond option would bar rescheduling, it is hard to see this leg of the arrangements as a great success even if \$1.0 bn is raised.

Secondary Market Purchases

It appears that a 50 per cent discount has been agreed with the banks (under pressure from the IMF and World Bank who indicated their reluctance to finance buybacks at the 30 per cent discount proposed by the CBs). Voluntary offers of the order of \$1.5 bn face value, exceeded the purchasing power of the \$0.650 bn raised from a Fund-Bank-Bilateral consortium of lenders who financed the January 1990 repurchase.

World Bank approval of \$0.2 bn exclusively for repurchase is the first tranche of what the outgoing

Central Bank Governor described as a pledged package of \$1.55 bn to retire \$3 bn more of debt at 50 per cent of face value by the end of 1991.

The problem with this approach — which does mark a breakthrough in using IFI and bilateral loans to a government to repurchase its own debt at a discount — is that it does little for the short term financing gap. In that respect the debate on the relative merits of discounted debt buybacks versus collateralised, discounted bond swaps is very much secondary to the point that the main gains come primarily on future obligations — especially for repayment of principal — rather than on present interest payments, so they cannot be the main source of plugging the short run financing gap. Further if these approaches are limited to CB channelled MLT loans to the public sector they would cover only about a fifth of total debt. At a 50 per cent discount they would therefore reduce the debt burden only by 10 per cent plus the amount by which interest on Fund-Bank-Bilateral loans used was below that on the retired debt — perhaps 12 per cent in total.

Where Next?

In including debt reduction (apparently only because it was stressed in the Brady Plan), the Philippines has altered its macro renegotiation strategy in a way which increases potential long-term gains. However the amount is marginal and the short-term gains almost negligible when set against the financing gap.

It is hard to avoid concluding that the present Philippine strategy is unlikely to be adequate. The basic target should be to reduce net debt service either to zero (treating grants as well as new loans as offsets) or at worst to 10 per cent of visible exports. That would free 5 per cent of GDP and 20 per cent of the recurrent budget for investment, would extinguish the financing gap and be roughly consistent with 6 per cent growth. This in turn would allow 1980 GNP/capita levels to be restored in the first half of the 1990s. It would also give some stability to debt service net outflow projections and force longer term, more realistic negotiations.

'Pacta nul servanda sunt' might — as the Freedom From Debt Coalition and Congress believe — be a better approach than the present one. It would force negotiations aimed at reducing present gross debt service by an average of 50 per cent and *de facto* put the focus on debt reduction, as it would be clear that present debts could not be fully serviced within a 10 per cent of visible export earnings net service ceiling. CB debt burden would need to go down by 50 per cent, i.e. substitution of 50 per cent reduced principal amount of loans (whether by collateralised swap or buyback) at interest rates no higher than the present ones. Action analogous in results, albeit not necessarily form, would be needed on the Paris Club

front. Conversion of all IMF drawings to ESAF (which is beginning) and agreements with the World Bank and ADB to lend at least as much as repayments plus interest are a third component with selective debt repudiation of loans in which corruption went to the heart of the transaction a fourth.

The 1989 CB agreement does not represent significant movement in that direction, as well as not meeting the immediate need for closing the external resource gap. It is more likely to act as a further impediment to sustained rapid growth and to require further rounds of interminable negotiations with the prospect of further delays in debt service payments but no adequate reduction in the overall burden of external debt.

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