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Japan and the Philippines' Lost Decade:
Foreign Direct Investments and International Relations

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Abbreviations

ASEAN	Association of Southeast Asian Nations
BOP	Balance of Payments
CA	Current Account
CDCP	Construction Development Corporation of the Philippines
DBP	Development Bank of the Philippines
ESB	Eastern Seaboard
FA	Capital and Financial Accounts
FDI	Foreign Direct Investments
FRB	Federal Reserve Board
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
HPAE	High Performing Asian Economy
IMF	International Monetary Fund
J-FDI	Japanese foreign direct investments
J-ODA	Japanese official development assistance
LOI	Letter of Instruction
MIP	Major Industrial Projects
ODA	Official Development Assistance
SAL	Structural Adjustment Loan
SDR	Special Drawing Rights
UNICOM	United Coconut Mills
WB	World Bank

Abstract

The 1980s witnessed the economic transformation of many Southeast Asian economies but for the Philippines they were a lost decade in terms of economic growth. Arguably, external finance played a major differential role especially after the 1985 Plaza Accord when vast sums of foreign direct investments (FDI) flowed to Southeast Asia. In the case of the Philippines, external finance had been critical; to a large extent, her economic performance depended on funds from abroad.

This dependence raises the importance of international relations to the country's economic growth and sustenance. This study explores how international relations have affected financial flows, including Japanese FDI, to the Philippines during the1980s. It examines the period 1979-83 as a decisive period for the later distribution pattern of FDI flows. The argument is that FDI avoided the Philippines because 1) the domestic investment climate under the Marcos regime increasingly became inhospitable since 1979 and 2) Japan's foreign policy and relations with other countries created a basis for Japanese FDI locational preferences later in the decade.

The study revisits the 1983 balance-of-payments (BOP) crisis, which was a critical juncture in Philippine economic performance of the 1980s, if not of her long-term performance record. It proposes that the crisis represented the loss of international support to the Marcos regime. This loss of support produced serious complications that later resulted in the steep decline of the Philippine economy. The periods surrounding the 1983 crisis reflected conditions that made the country less attractive to FDI.

Japan's active involvement in Southeast Asia also became notable in the early 1980s. Japan's foreign policy has been shaped by economic security considerations, which around 1980 included the economic and political stability of Southeast Asian countries. Particularly, world and regional events raised the strategic importance of countries along the Malacca Straits. The comprehensive security policy adopted meant that the "trilogy" of aid, trade, and FDI be stepped up in favour of these countries. Initial investments placed made these countries more attractive to Japanese FDI, particularly after the 1985 Plaza Accord.

Introduction

The Philippine economy has been always sensitive to external financing. Since gaining sovereignty on July 4, 1946 economic progress has relied much on inflows of foreign capital, both official and private. Much of these flows have depended on the country's international relations, especially those with the United States.

Official inflows are based on the recipient country's relationship with donor countries. Private inflows not only depend on business transactions with the domestic economy; host country conditions and relationships with the host government are also major considerations. The sudden and remarkable change in the pattern of inflows reflects not only changes in foreign economic preferences but also in international political decisions. Changes in foreign economic and political preferences are not necessarily reactions to the domestic situation; they could also be part of the broader strategies of external actors. International relations bear important economic consequences.

The 1980s were a period of remarkable change in the economic structures and performances of other Southeast Asian countries like Indonesia, Malaysia, and Thailand based on massive FDI flows. But this was not the case for the Philippines. In the 1970s capital inflows spurred the country's economic growth. However, in the early 1980s it suffered a serious setback when external finance became scarce. After the 1985 Plaza Accord, when massive amounts of foreign direct investments (FDI), notably from Japan, flowed to other parts of East Asia, the Philippines was virtually bypassed. Long dependent on foreign financing both in terms of official aid as well as private loans and investments, the Philippines suffered its first "lost decade" in the 1980s.

Why external finance and particularly, Japanese FDI, shied away from the Philippines in the early 1980s is the topic of this study. In the literature, differences in the ability of countries to attract private foreign investment could be partly explained by factors that determine a country's attractiveness. Host country conditions like FDI policy, market size, degree of industrial agglomeration, infrastructure, and costs of doing business are among the factors underscored. As well, among multinationals, prior experience and private information flows have been found to be influential in locational decisions (Belderbos and Sleuwaegen, 1996; Mody et al, 1999). An emerging stream in the literature also suggests the role of foreign policy in catalysing or directing FDI (Harms and Lutz, 2006; Kimura and Todo, 2009; Blaise, 2009). Government and private sector cooperation or consultations have been part of the process (Arase, 1994).

The goal of this study is to explore how international relations during the period 1978-1983 have affected Japanese FDI (J-FDI) flows to the Philippines and Southeast Asia. As suggested above, international relations here cover not only inter-state relations but also relations with the foreign private sector. The period of study belongs to a geopolitical era known as the Cold War. The Cold War is the global struggle that commenced after the Second World War between the communist bloc and the non-communist bloc (led by the United States). The region, then known as the Far East, is one of the important battle fronts of this struggle.

In the Philippines, the period was part of the authoritarian rule of President Ferdinand Marcos. Marcos declared martial law on September 21, 1972. The regime was initially dubbed as the New Society but was later changed to the New Republic when presidential elections were "restored" in 1981. In 1983, the Philippines suffered a balance of payments (BOP) crisis. The BOP crisis evolved into a full-pledged political and economic crisis for more than two years, which led to the ouster of the dictatorship.

The hypotheses of the study are 1) that the Philippine investment climate since 1979 increasingly became inhospitable for foreign investments and 2) Japan's foreign policy and relations with other countries created a basis for J-FDI locational preferences later in the decade. To support the first hypothesis, the study reviews the events leading to the 1983 BOP crisis. For the second, the study points to events that shaped J-FDI flows to Southeast Asia.

There are a number of reasons why a re-examination of that period is conducted from an international relations perspective. First, the period is seen as an important phase in the Philippines "lost decade." The significance of the "lost decade" itself has been lost in many studies that seek to answer why the Philippines was left behind in the region. Instead, they tend to explain long-term economic performance in terms of the particular characteristics of the country's politics and policymaking as well as of its culture and institutions. Yet performance should also take account of other elements like agency and critical episodes occurring within the country and without.

Second, a review of that period of the Philippines offers potential insights and lessons for the present. As the Philippine economy continues to depend on external finance, it is important to highlight the role of international relations in its provision.

The third reason goes beyond the Philippines but stresses the relevance of international relations to external finance in the present era. The current trend of forging free trade agreements (FTAs) between developed and developing countries reflects the recognition that

capital flows are determined not only by private sector interests but also by inter-state relations.

The study is organized into three chapters. Chapter 1 discusses the lost decade and issues about Philippine long-term economic performance. It also lays down the framework of the study. Chapter 2 focuses on the events leading to the 1983 BOP crisis. A comparative analysis of the BOP performances in three countries is conducted in order to show variations in foreign responses to the Philippine condition. Chapter 3 discusses the effects of Japan's changing policy preferences on capital flows in the region.

１．The Lost Decade

In 1993, the World Bank published a report entitled, “The East Asian Miracle: Public Policy and Economic Growth.” The report identified eight high performing Asian economies (HPAEs) which succeeded in terms of sustaining rapid growth and reducing income inequality. The Philippines did not belong to this list of HPAEs.

Since then, some confusion has prevailed over the causes of the Philippines’ long-term economic performance. Despite initial human capital and natural resource advantages, why did the Philippine economy lag behind those of other economies in the region? This question about the country’s long-term economic performance record has been called a “puzzle” (Balisacan and Hill, 2003) or “something of an enigma” (Fitzgerald, 1994). For Balisacan and Hill (2003), henceforth BH, a major segment of this puzzle is the “lost decade” of the 1980s. Accordingly, it was the 1980s that separated the Philippines from East Asia. This observation could be validated in Table 1.1, in which the growth in real per capita GDP averaged -0.6 a year in the 1980s.

1.1 Structure, Agency, and Chance

Several attempts to explain the puzzle have not provided convincing answers and the reason, BH argue, lies in the usual complexity of phenomena. Their survey of the literature on the Philippines’ lagging performance yielded three perspectives, to wit: 1) conventional growth explanations, 2) bad luck, and 3) structuralist-institutionalist explanations.

Table 1.1
Annual Average Growth Rate of Real Per Capita GDP,
Selected Asian Countries, 1950-2006

Period	Rep. Korea	Philippines	Thailand	Indonesia	Malaysia	Singapore
1951-1960	5.1	3.3	5.7	4.0	3.6	5.4
1961-1970	5.8	1.8	4.8	2.0	3.4	7.4
1971-1980	5.4	3.1	4.3	5.3	5.3	7.1
1981-1990	7.7	-0.6	6.3	4.3	3.2	5.0
1991-2000	5.2	0.9	2.4	2.9	4.6	4.7
2001-2006	4.2	2.7	4.0	3.3	2.7	3.2

Source: Table 2.2, ADB (2007:6). *Philippines: Critical Development Constraints. Country Diagnostics Studies*. Mandaluyong: Asian Development Bank.

Accordingly, each of these explanations suffered from consistency in either comparative or historical terms.

For instance, in the case of conventional growth explanations, they argued that the Philippine trade regime has not been as open as that of Singapore, Malaysia, and Hong Kong but it did not differ from that of Indonesia and Thailand (BH, 2003: 38). Also, they said that the Philippine macroeconomic record such as the inflation rate "has not matched that of Singapore, Malaysia, and Thailand but was similar to that of Korea and Indonesia for as much of the period since 1970" (ibid.). Further, the two authors maintained that the use of the growth determinants framework would be irrelevant given the "episodic" nature of Philippine growth. The observed episodic nature of Philippine growth suggests the economy's sensitiveness to external factors including flows of foreign capital.

BH criticized the argument that the Philippines had had a string of unfortunate events. Bad luck alone ignored the fact that other countries in the region and elsewhere were also suffering from the oil price increases, natural calamities, terms of trade deterioration, international credit tightening and interest rate appreciation. How these misfortunes were dealt with would suggest the quality of administration and economic management.

Structural and institutionalist explanations have been limited by the inability to explain deviations in agency behaviour and performance. BH cited the administration of President Fidel Ramos, which was able to institute drastic reforms even in the face of resistance from vested oligarchic interests and the Catholic Church. Noting the inconsistency of the different strands of structural and institutionalist explanations, BH (2003:40) remarked, "It might be tempting simply to assign the ills of the country to the 20-year Marcos rule. Obviously personalities do matter, but can one advance the argument in a somewhat more analytical manner?"

Although each of the three perspectives was deemed inadequate to explain economic performance, BH contended that they are all part of the story and could be treated "as elements of a case." As such, they offered the following narrative:

> *The Philippines failed to grow as quickly as several of its neighbours in the 1960s and 1970s for the reasons adumbrated above. In the second half of the Marcos administration, the development strategy changed to one of adventurous overseas borrowing. This came unstuck owing to a combination of reckless investments, ever-increasing cronyism and corruption, rising community disaffection (especially in the wake of the 1983 Aquino assassination), and external misfortune. The culmination was a serious political impasse and a deep and prolonged economic crisis that set the country back more than a decade, and from which recovery has been slow and painful." (BH, 2003:41).*

At least two suggestions emanate from BH's work. The first one points to the complex relationship between structure, agency, and luck (or chance) in critical episodes. Structural rigidities imply regularity of behaviour and performance. Thus, what would account for the rapid decline (or change for that matter) are elements of agency and chance.

Scholars have identified structural factors underlying the nature of the state (McCoy, 1993; Timberman, 1991; Hutchcroft, 1989; Fabella, 1999; Bello, 2004) and society (Timberman, 1991; Fallows, 1987; Sionil-Jose, 2005). The frequent reference is the political system or society's culture. Timberman (1991:385) cites political culture as one of the major reasons behind the absence of change in the Philippines. Accordingly, traditional political culture is characterized by the dominance of 1) kinship ties ("kamag-anak"), 2) patron-client relations and reciprocity (utang na loob), 3) smooth interpersonal relationships ("pakikisama"), and 4) a culture of poverty. These characteristics of Philippine political culture suggest a highly personalistic political system. From this setting could be understood the Philippines as a weak or soft state. McCoy (1993) demonstrates how strong oligarchic families operating in local and national settings have resulted in the weakening of the state for private ends.

Hutchcroft (1998) supports the weak state hypothesis in his study of the history of the Central Bank. He reveals a spoils system in which vested interests dominated Central Bank policies and extracted favours from the State. He argues that the Philippines is a patrimonial-oligarchic or "booty-capitalist" state, a type of weak state vis-à-vis strong family business interests.

Fabella (1999) takes Gunnar Myrdal's notion of the soft state, which is marked by various forms of "social undiscipline." However, he presents a powerful argument that links the soft state to economic performance. Accordingly, the Philippines as a soft state is characterized by the "marketization" of rules by state actors and the "gamble for rule changes" among investors. Such a preoccupation among state and business actors adversely affects the quality of investments and over time results in the misallocation of resources. He argues that the allocation of resources is the heart of long-term economic performance.

Bello (2004) introduces the thesis of an "anti-developmental state" in the Philippines. He notes that some streams in the literature associate corruption with the weak state, which in his perception is "barking on the wrong tree." His argument is that the economy's relative stagnation is based on the state's inability to control competing elite factions and to harness them and their resources for development.

It has also been argued that a deficient kind of nationalism underlies slow Philippine progress (Fallows, 1987; Sionil-Jose, 2005). Fallows (1987) has coined the term, "damaged culture," to refer to this kind of Filipino nationalism, which accordingly was tha product of colonial history. Damaged culture is reflected in the tradition of political corruption and cronyism, extremes of wealth and poverty, tribal fragmentation, the local elite's willingness

to make a separate profitable peace with colonial powers, and public abuse. Sionil-Jose (2005) adds that an inward-looking nationalism has resulted in inefficient industries and monopolies. Moreover, he argues that the loss of Filipinos' "ethical moorings" has led to the condonation of corruption and cronyism, crimes that should have led to ostracization and punishment but did not.

Economists studying the Philippines also demonstrate various economic structural and institutional constraints including perennial resource gaps (Montes and Lim, 1996; Power, 1983; Lamberte et al, 1992), protectionist trade and investment policies (Bautista and Power, 1979; Power, 1983), capital flight (Beja, 2005) as well as oligopolistic markets and weak public institutions (Vos and Yap, 1996; Lamberte et al, 1992). Of these structural constraints, protectionism based on a prolonged import-substitution regime has been frequently cited as a major source of the country's poor trade and growth performance (e.g., Bautista and Power, 1979). It also has an adverse effect on foreign capital flows. In Chapter 2, the government's economic protectionism beneath the mantle of liberalization shall be discussed.

The political, cultural, and economic factors identified in the literature reveal the structural weaknesses of the Philippine political economy, past and present. However, these structural features tend to be overemphasized in the analysis of long-term economic performance. Consequently, agency decisions in particular periods tend to be brought to the background.

Structural factors are important in the sense that they provide the setting for agency behaviour. However, there are episodes in which agents figure prominently. Particularly, decisions made during such periods, however apparently remote, create paths that constrain future policy choices. This has been referred to in the economics, political science and sociological literature as *path dependence* (Pierson, 2000; Mahoney, 2000; David, 1985). Historical accidents and credible commitments create sequences that provide relatively increasing benefits and are therefore hard or costly to reverse.

Critical incidents can also be identified in which agents appear not to have any control. This could be likened to a fire on uninsured property that translates to uncompensated wealth destruction for the property owner. It may be the case that the fire was due to the owner's neglect or actions. It may also be the case that the fire arose from other people's actions or from natural causes. Either way, the destruction of wealth due to this incident should merit an investigation.

The suggestion is that structure, agency, and chance interacting dynamically through time should be incorporated in the analysis of long-term national economic performance. In this regard, the study of critical episodes becomes relevant. A critical episode represents a culmination of structural, agential, and chance factors.

This leads to the second suggestion that emanates from the reading of BH's work, i.e., to examine crucial episodes during the 1980s. One of these local episodes is the 1983 BOP crisis. The impact of the crisis adversely affects any measurement of Philippine long-term economic performance between 1950 and the current period. Another episode, which is external to the Philippines, relates to the shaping of Japan's foreign policy in the region. This has a bearing on the direction of FDI and other financial flows from that country.

1.2 Framework

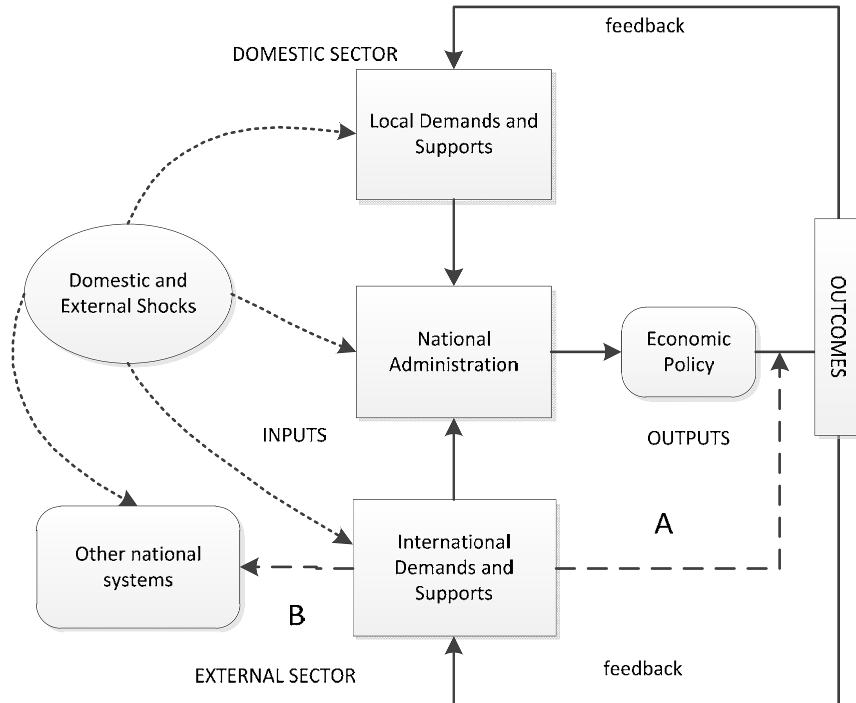
The relationship between external finance (including FDI) and international relations can be depicted in Figure 1. The framework is derived from the basic Eastonian systems approach familiar to political scientists studying domestic policy processes, comparative politics and international relations. The basic framework breaks down the policy process into 1) policy inputs based on demands and supports coming from the environment, 2) the *decision structures* (or the government), 3) *policy outputs* in terms of authoritative decisions and actions, and 4) based on these outputs are *outcomes* and *feedback* that in turn serve as new inputs to the policy process. Existing modifications have allowed for analysis in an open system such that politics and conditions elsewhere affect the local system (e.g., Almond, et al 2008; Kopstein and Lichbach, 2009).

In the basic systems framework, inputs are demands and supports based on feedback from policy outputs and outcomes. The framework as used here recognizes random events (as external and domestic shocks) as part of the inputs to the decision-making process. These events are not necessarily derived from a country's domestic political processes. In addition, inputs are broken down into local and foreign demands on and supports to the national administration.

Demands and supports of external actors (governments, foreign creditors, and foreign investors) are taken into account in terms of external financing/investment decisions. The decisions are reflected in the dotted lines (A) and (B). As such reactions to shocks are given importance in policy decisions of internal and external actors. This framework is applied to the understanding of the relationship between external finance and international relations in the two episodes earlier mentioned. For the purposes of this study, local demands and supports will be left out in the analysis.

Figure 1.1

A Systems Framework



1.3 1983 BOP Analysis

In the analysis of the 1983 BOP crisis, the external actor decisions are reflected in the capital and financial accounts of the Philippines. The capital and financial account (FA) shows the receipts and outflows of capital and indicates how the current account transactions might be financed (or not).

The current account (CA) reflects receipts and payments for goods, services, and income transactions as well as current transfers (CT). Thus, CA = (X-M) + CT, where X - M represent net exports of goods, services, and income. Current transfers include such items as official development assistance and workers' remittances. The income account includes employees' compensation and investment income (e.g., dividends, reinvested profits, interest income).

The capital and financial accounts have been traditionally called the *capital account*. However, in the Balance of Payments Manual 5 (BPM5), the International Monetary Fund (IMF) defines the capital account more narrowly than standard economics by limiting its

coverage to international transactions in non-produced, non-financial assets (e.g., patents, copyrights) and capital transfers. On the other hand, the IMF treatment of the financial account covers four major components, to wit: direct investment, portfolio investment, other investment, and reserve assets.[1] The term *financial account* (FA) shall be used in the text for purposes of convenience and consistency to refer to the capital and financial accounts of the BOP.

Based on the double-entry accounting system, the current account (CA) balance should be equal to the financial account (FA) balance. In other words, all of the country's transactions with the rest of the world should equal the financial flows. When the CA has a deficit, the items in the FA would show how that deficit might be financed. Suppose a country enjoys positive current transfers (e.g., workers' remittances and foreign aid) but has a CA deficit due to higher negative trade values. Unless the country has sufficient international reserves and foreign assets, or through a mix of fiscal and monetary policies adjusts its current account, then the foreign exchange requirements arising from the deficit has to be covered by a variety of external financing options. These options include additional foreign investments, loans, and other financial transfers. Thus, the shortfall in domestic savings for a particular period is financed by foreign savings, which is treated as a financial liability (or obligation).

A BOP crisis occurs when ready financing (local or external) becomes unavailable for a variety of reasons. A country with a serious foreign exchange constraint (which may be exacerbated by external debt payments) and foreseeing an impending BOP deficit may seek economic assistance from foreign banks and governments of other countries. It may also attract multinational corporations to invest and relieve the economy of its foreign exchange constraint. In more serious cases, it may opt for IMF intervention.

The IMF is known as the international "bank of last resort." Its intervention is deemed necessary not only in terms of providing short-term financing but also in terms of issuing its "seal of good housekeeping" which is essential to maintaining a country's commercial credit lines.[2] The loss of commercial credit lines risks the permanent disruption of trade (Cohen, 1992), which is naturally disadvantageous to the domestic economy unless an autarkic policy is adopted. The loss of trade credit would make it hard for most countries to import

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1 See Chapter VIII of Balance of Payments Manual 5 for classification of BOP transactions.

2 Aside from IMF intervention, a country may approach the Paris Club, which is an informal group represented by financial officials of the top lending countries. Certain countries as well as multilateral institutions like the World Bank, Asian Development Bank (ADB), and the IMF are invited as observers. Since the informal group is composed of government officials, Paris Club decisions such as debt provision and forgiveness bear on developing country BOP and debt situation.

oil, capital goods, and other essential commodities needed for both production and consumption.

A BOP crisis, or expectations of it, therefore raises the economic risks for most kinds of business including FDI. In Chapter 2, the relationship between Marcos government and the IMF and international creditors is discussed. To strengthen the observation, a comparison of BOP performances of the Republic of Korea (henceforth Korea), Thailand, and the Philippines is made.

1.4 Japanese FDI Flows in the Region

The framework described could also be applied to the second episode, which is a set of events that shaped Japan's foreign policy in the 1970s and early 1980s. These events necessitated the strengthening of regional security as well as Japan's own need to relocate production facilities abroad. The appreciation of the yen in the early 1970s exerted pressure on the international competitiveness of Japan's export-oriented manufacturing firms. Because of its proximity, cheap labour costs, and abundant supply of raw materials, Southeast Asia was an attractive region for such investments. In the framework above, this would favour J-FDI flows to the Philippines as well as other members of the Association of Southeast Asian Nations (ASEAN).

However, Japanese responses to international events including the oil crises and the conflict in Indochina in the late 1970s have an effect on the pattern of FDI flows to ASEAN. The episode, which is the development of Japan's comprehensive security policy, has had an indirect effect on the Philippines' lost decade but is significant by way of path dependence. Resource flows, such as FDI, to some countries tend to produce a bandwagon effect but could create a backwash effect on other countries. In establishing the relationship between J-FDI and international relations, a comparison of four ASEAN countries is made. The four countries are Indonesia, Malaysia, Thailand, and the Philippines.

2. The 1983 Philippine BOP Crisis

In September 1983, the Philippines' international reserves fell to US$680 million, or an equivalent of 0.7 months of imports.[3] The trend in financial outflows was such that the remaining reserves would be quickly wiped out and the Philippines would default on its credit obligations. Huge financial outflows were especially experienced in the wake of the August 21 assassination of opposition leader, Benigno Aquino, Jr. The normal 90-day short-term credits were reduced to shorter-term credits ranging from 24 hours to two weeks.[4] As well, the country witnessed massive capital flight.

On October 17, 1983 the Philippines declared a 90-day moratorium on principal repayments of its foreign debt in order to prevent a major credit default. Accordingly, payments on principal on foreign obligations maturing between October 17, 1983 and January 16, 1984 would be suspended. The government also imposed severe foreign exchange restrictions.

The moratorium signified that the country could no longer finance its BOP deficit.[5] Within the 90-day period the government was hoping for a bailout package, based on earlier consultations with its bank advisory group led by Manufacturers Hanover Trust and the Bank of Tokyo. However, the bailout was contingent on the IMF's approval of a standby credit program. The IMF's seal of good housekeeping would signal to foreign banks its confidence in the economy.

The IMF approval did not come as quickly as expected. Further, negotiations were complicated in December 1983 with the revelation of overstated reserves at the Central Bank. Consequently, the Philippine government had to declare an extension of the 90-day moratorium several times until the December 14, 1984 approval of the IMF Executive Board for a new standby arrangement.

The 1983 foreign exchange and payments crisis had turned into a serious debt crisis for the Philippines. The result was a serious economic decline for two years. The damage was akin to losing a big war, leaving the country with a heavy debt burden, loss of capital, the destruction of productive capacity, and the instabilities associated with exacerbated

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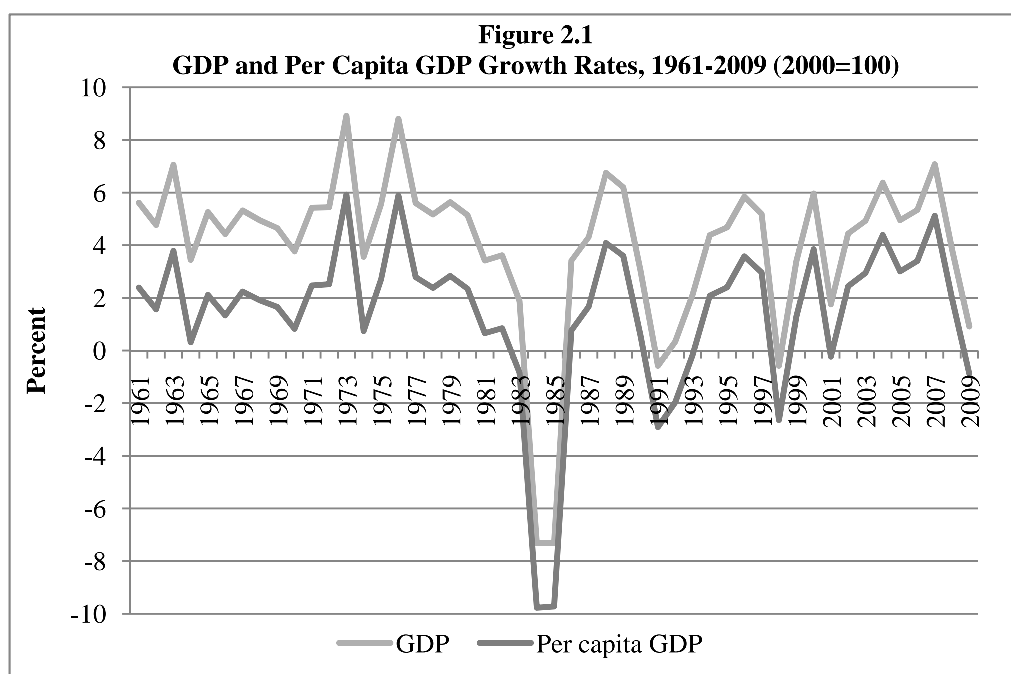
[3] See Table 6.12, Dohner and Intal (1989:521).

[4] G. Sacerdoti (1983) "Buying some time," *Far Eastern Economic Review (FEER)*, October 27. See also Kajiwara (1994) and Lindsey (1984). According to Kajiwara (1994:497), a group of foreign banks refused to renew short-term debt and transformed all long-term debt to short-term debt. He also reported that the reserves fell to US$430 million in October 1983.

[5] Sacerdoti, "Buying some time…". Asked about the standstill request, the then Central Bank Governor, Jaime Laya, said, "We can no longer finance the balance of payments deficit, it is as simple as that."

macroeconomic vulnerability. Moreover, the economic decline had social and political consequences that would later affect local and international perceptions of the Philippine capacity for economic change and progress.

As a direct result of the crisis, the country's gross domestic product (GDP) plunged during the two-year period 1984-85(see Figure 2.1). Double-digit inflation and interest rates as well as continued capital flight arrested the economy's growth. The economic plunge had the effect of balancing out whatever economic gains there were during the decade. Table 2.1 shows the dive in Philippine per capita GDP in 1984 and suggests slow recovery up to the 2000s.



Source: World Development Indicators, World Bank

Table 2.1.
Per Capita GDP in 2000$, Selected ASEAN countries

Economy	*1960*	*1983*	*1984*	*2006*
Philippines	612	1004	908	1175
Thailand	329	897	933	2549
Malaysia	784	2059	2161	4623
Singapore	2251	10386	11042	27685
Indonesia	196	444	467	983

Source: Table 2.1. ADB. 2007. Critical Constraints: Country Diagnostics Studies, p. 5.

2.1 Issues on the BOP crisis

Since external debt was a key element in the BOP crisis, criticisms on the debt policy pursued by the Marcos government are understandable. However, in hindsight, the BOP crisis would not have occurred at that time despite the rapid accumulation of foreign debt. It seems that the difficulties in external payments could have been relieved if only the Marcos government had the support of the international community in the third quarter of 1983. The support was withheld, if not withdrawn, as a consequence of the international outcry over the Aquino assassination.

Previous studies have regarded the crisis as an eventuality because of the economy's ailing circumstances and the magnitude of its external debt; the Aquino shock simply hastened it (Dohner and Haggard, 1994:13; De Dios et al, 1984:2; Lindsey, 1984: 1186). In their classic study of the Philippine economic crisis, De Dios et al (1984) contended that external shocks (e.g., oil crises, tightening of international credit, and the deterioration in terms of trade) affected other developing countries but highly indebted countries like Korea and Indonesia did not encounter a debt crisis. They maintained that the major explanation lies in the character of economic policies and of policymaking under the Marcos regime. The Aquino assassination simply "tore through" the already ailing economy.

Dohner and Intal (1989) argued that the "debt crisis" was not basically the result of a series of unfortunate external events. The external shocks simply accelerated an eventuality. Accordingly, the crisis was rooted in the economic and political structures built since independence but modified after Marcos declared martial law in 1972. The new structures relied on foreign loans but later ran into difficulties under the harsh environment of the 1980s.

The high levels of debt were due to expansionary fiscal programs and failed public investment programs (De Dios et al, 1984; Montes 1987; Dohner and Intal, 1989). The countercyclical policy adopted by the Marcos government at a time of the global recession led to the widening of fiscal deficits that were financed by foreign borrowing, particularly short-term loans (Montes 1987; James, Naya, and Meier, 1987:103). The fiscal deficits translated to current account deficits (Montes, 1987:12).

Montes (1987:4) said that the crisis could be blamed on both the failed investment strategy of the Marcos regime as well as the drying up of cheap international loans, which affected all countries. He also believed that the International Monetary Fund (IMF) and the World Bank should share in the responsibility of imprudent lending.

Power (1983) suggested that debt accumulation was not necessarily a problem based on a comparison of 1970s Korea and the Philippines—two countries with high levels of external indebtedness. The crisis arose not because huge stocks of external debt were

accumulated; the reasons had to be found elsewhere, particularly in the market distortions that developed from country's trade and industrial policies leading to chronic trade deficits.

Along this line, Remolona, Mangahas and Pante (1986) investigated the relationship between external shocks and domestic policy responses and the effects of this relationship on the current account from 1979 to 1983. Their study showed that both external shocks and domestic policy responses played a major part in the 1983 BOP crisis. From 1979 to 1980, domestic policy responses particularly the countercyclical policies weighed down on the current account. However, in succeeding years, the current account was seriously affected by an import bias as well as external shocks like the terms of trade deterioration, interest rates, increased borrowing, etc. By August and September 1983, the economy was already highly vulnerable to internal and external shocks. They argued that the economy could have been managed better.

Despite differences in locating the roots of the crisis, the majority of the above studies share the view that, instead of reliance on external finance, proper adjustments should have been made in response to the external shocks of the 1980s. This view is based on the observation that the period of easy finance during the 1970s ended and that external finance had dried up in the early 1980s. Yet other country experiences also reveal the availability of external finance, however limited, during those difficult years. Further, Naya and Imada (1990) observed that external funds were generally available to Asian countries.

2.2 Comparative Experiences

Based on the discussion above, unresolved issues remain regarding the 1983 BOP crisis. Given that an externally indebted country might face difficulties in its fiscal position and current accounts, does it have to experience a BOP crisis like that of the Philippines in 1983? How did the domestic situation affect FDI flows to the Philippines? What was the role of the country's international relations to the BOP crisis? To address the first question, a comparison of the Philippines to Korea and Thailand is made during the period 1979-83. Particularly, the study compares the fiscal balances, external indebtedness, and BOP accounts of the three countries. Data represented in some statistical tables and figures have been extended from 1978 to 1985 for illustrative rather than analytical purposes. The second and third questions would be addressed through a historical review that follows the comparative analysis.

The three countries have been selected based on varying levels of external indebtedness and also based on their strategic importance to the United States during the Cold War. During the period of study, Korea, Thailand, and the Philippines underwent similar experiences of external shocks, to wit: the second oil price shock of 1979-80, the tightening

of monetary policy in the United States (also called the Volcker shock),[6] the terms of trade deterioration and decline in export trade during the ensuring global recession, and the tightening of international credit. The rise in world interest rates following the Volcker shock signalled the squeeze on international lending and the end of cheap foreign loans. The situation had the inadvertent effect of increasing the Third World debt burden. Along with the negative trade effects of the global recession, the tightened flow of foreign credit led many countries to default on external payments, starting with Mexico in August 1982. An international debt crisis ensued.

The three countries had their share of financial scandals that rocked their respective financial systems. Thailand's Rajah Finance scandal caused a near crash of stock exchange in 1979. The 1981 Dewey Dee scandal in the Philippines caused a financial crisis. The Yi-chang kerb market scandal necessitated an infusion of fresh credit to Korea (Suh, 1983; Park, 1986).

Similarities in economic features could also be observed (see Tables 2.2 to 2.4). In 1980, gross domestic savings in the three countries were 22-24% of GDP. Emerging from predominantly agricultural backgrounds, the industrialization attempts of the three countries have succeeded in raising manufacturing shares to GDP, which were not far off from each other. In 1980, the manufacturing sector's share of GDP ranged from 21.5% to 25.7%. All of the countries sustained substantial current account deficits. International reserves were kept at around US$3 billion from 1979 to 1981. Government expenditures ranged from 8.3% to 13.1% of GDP, with the Philippines typically having the lowest government expenditure to GDP ratio. In 1980-81, inflation had been unusually rapid in the three countries but was somehow tamed in 1982.

Some differences may be also observed during the period, which point to Thailand's increasing attractiveness to FDI in the early 1980s. First, Thailand stands out in terms of maintaining positive real interest rates. Interest rates have been more volatile in Korea and the Philippines. Second, net FDI flows into Thailand (as % of GDP) have been greater than in the Korea and the Philippines. In contrast to the fluctuating pattern in Korea and the Philippines, the trend in FDI flows to Thailand is that of consistent increase. Both Korea and the Philippines have histories of colonial subjugation, which has been regarded as a factor to their preference for foreign loans rather than FDI.[7] Nevertheless, the Philippines under President Marcos have attempted to attract FDI in the 1970s.

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[6] The Volcker shock is the policy of monetary contraction by the Federal Reserve Board in the United States headed by Paul Volcker. The policy was adopted in 1979 by the FRB to address stagflation and the effects of the second oil-price shock effects in the United States. The policy had the effect of raising world interest rates, suddenly making international credit and debt service expensive.

[7] See for instance Park (1986) in the case of Korea.

Third, there were marked political and economic instabilities in certain years. Korea witnessed the assassination of President Park Chung Hee in October 1979 while as earlier mentioned, the Philippines saw the murder of an opposition leader in August 1983. Two years of economic instability followed these domestic political events. In April 1981, a coup d'état was attempted against the government of Prem Tinsulanonda but failed. In the 1980s, Thailand had a more stable system under Prem's leadership as the government moved toward democratization.

Another difference is in economic growth. The Philippines was the slowest performer among the three countries. Korea was the fastest growing economy followed by Thailand. Thus, economic indicators related to GDP would naturally bring the Philippines at the lowest level in the comparison.

Table 2.2. Selected Economic Indicators, Korea, 1978-85

Indicator	1978	1979	1980	1981	1982	1983	1984	1985
Trade (% of GDP)	60.6	60.2	72.0	73.9	69.0	67.0	67.0	63.4
Exports of goods and services (% of GDP)	28.4	26.6	32.1	34.3	33.2	33.0	33.4	32.0
Exports of goods and services (annual % growth)	14.2	2.0	8.2	16.0	8.2	14.3	8.2	4.2
External balance on goods and services (% of GDP)	(3.7)	(7.1)	(7.9)	(5.4)	(2.5)	(1.1)	(0.3)	0.6
Current account balance (% of GDP)	(2.1)	(6.3)	(8.3)	(6.4)	(3.3)	(1.8)	(1.4)	(0.8)
Current account balance (BoP, current US$ million)	(1,085.00)	(4,151.00)	(5,312.20)	(4,606.60)	(2,550.50)	(1,524.10)	(1,293.10)	(795.10)
Foreign direct investment, net inflows (% of GDP)	0.2	0.1	0.0	0.1	0.1	0.1	0.1	0.2
Foreign direct investment, net inflows (BoP, current US$ million)	89.0	35.0	6.0	102.0	69.0	68.5	110.2	233.5
GDP growth (annual %)	9.3	6.8	(1.5)	6.2	7.3	10.8	8.1	6.8
General government final consumption expenditure (% of GDP)	10.5	10.4	12.4	12.5	12.4	11.8	11.1	11.2
Gross domestic savings (% of GDP)	29.3	29.0	23.9	24.2	26.2	27.9	30.0	30.6
Money and quasi money (M2) as % of GDP	27.9	28.1	28.9	29.0	31.9	32.7	31.7	31.7
Money and quasi money growth (annual %)	35.0	24.6	26.9	25.0	27.0	15.2	7.7	15.6
Population, millions	37.0	37.5	38.1	38.7	39.3	39.9	40.4	40.8
Total reserves in months of imports	1.8	1.5	1.3	1.1	1.1	0.9	1.0	1.0
Inflation, consumer prices (annual %)	14.5	18.3	28.7	21.3	7.2	3.4	2.3	2.5
Real interest rate (%)			(4.9)	(0.7)	4.8	3.6	3.8	5.0
Agriculture, value added (annual % growth)	(10.7)	10.6	(19.4)	18.4	5.3	6.0	(2.1)	4.5
Industry, value added (annual % growth)	22.4	6.8	(1.4)	4.7	8.4	17.3	12.8	6.0
Services, etc., value added (annual % growth)	7.6	5.7	3.4	4.8	7.0	7.8	7.4	7.9
Agriculture, value added (% of GDP)	22.4	20.9	16.2	17.0	15.9	14.6	13.7	13.5
Industry, value added (% of GDP)	34.6	36.0	36.6	36.4	37.0	38.5	39.8	39.1
Manufacturing, value added (% of GDP)	24.0	24.3	24.4	25.1	25.3	26.4	27.7	27.3
Services, etc., value added (% of GDP)	43.0	43.0	47.3	46.7	47.0	46.9	46.6	47.4

Source: World Bank Databank.

Table 2.3 Selected Economic Indicators, Philippines, 1978-85

Indicator	1978	1979	1980	1981	1982	1983	1984	1985
Trade (% of GDP)	45.6	48.2	52.0	51.0	46.5	49.4	49.1	45.9
Exports of goods and services (% of GDP)	20.7	21.6	23.6	23.8	20.3	21.3	24.0	24.0
Exports of goods and services (annual % growth)	6.1	4.3	39.8	9.5	(10.7)	3.4	4.5	(16.1)
External balance on goods and services (% of GDP)	(4.3)	(5.1)	(4.9)	(3.3)	(5.8)	(6.7)	(1.0)	2.1
Current account balance (% of GDP)	(4.8)	(5.4)	(5.9)	(5.8)	(8.6)	(8.3)	(4.1)	(0.1)
Current account balance (BoP, current US$ million)	(1,094.0)	(1,496.0)	(1,904.0)	(2,061.0)	(3,200.0)	(2,771.0)	(1,294.0)	(36.0)
Foreign direct investment, net inflows (% of GDP)	0.4	0.0	(0.3)	0.5	0.0	0.3	0.0	0.0
Foreign direct investment, net inflows (BoP, current US$ million)	101.0	7.0	(106.0)	172.0	16.0	105.0	9.0	12.0
GDP growth (annual %)	5.2	5.6	5.1	3.4	3.6	1.9	(7.3)	(7.3)
General government final consumption expenditure (% of GDP)	10.1	9.4	9.1	8.8	9.1	8.3	7.0	7.6
Gross domestic savings (% of GDP)	26.5	25.8	24.2	24.1	22.1	22.9	19.3	16.5
Money and quasi money (M2) as % of GDP	23.3	22.6	22.0	22.6	23.7	27.9	25.9	27.3
Money and quasi money growth (annual %)	24.2	12.4	20.6	17.4	18.5	53.0	17.9	12.5
Population, millions	45.6	46.8	48.1	49.4	50.8	52.2	53.6	55.0
Total reserves in months of imports	4.0	4.6	4.6	2.9	1.8	0.9	1.0	1.6
Inflation, consumer prices (annual %)	7.3	17.5	18.2	13.1	10.2	10.0	50.3	23.1
Real interest rate (%)	2.4	(0.7)	(0.2)	3.3	8.7	4.4	(16.4)	9.3
Agriculture, value added (annual % growth)	3.7	3.2	4.0	3.6	0.8	(3.4)	(0.9)	(1.9)
Industry, value added (annual % growth)	5.6	7.3	5.0	4.6	2.5	1.5	(11.5)	(15.7)
Services, etc., value added (annual % growth)	5.7	5.5	6.1	1.9	6.8	5.6	(6.5)	(2.1)
Agriculture, value added (% of GDP)	28.2	27.4	25.1	24.9	23.3	22.4	24.8	24.6
Industry, value added (% of GDP)	36.9	37.5	38.8	39.2	38.8	39.2	37.9	35.1
Manufacturing, value added (% of GDP)	26.0	25.1	25.7	25.5	25.1	24.2	24.6	25.2
Services, etc., value added (% of GDP)	34.9	35.1	36.1	35.9	37.8	38.4	37.3	40.4

Source: World Bank Databank

Table 2.4 Selected Economic Indicators, Thailand, 1979-85

Indicator	1978	1979	1980	1981	1982	1983	1984	1985
Trade (% of GDP)	44.0	51.9	54.5	54.0	47.5	47.4	48.1	49.2
Exports of goods and services (% of GDP)	19.9	22.6	24.1	23.8	22.9	20.1	21.9	23.2
Exports of goods and services (annual % growth)	12.4	10.4	7.7	9.2	11.7	(6.0)	17.3	9.8
External balance on goods and services (% of GDP)	(4.2)	(6.7)	(6.3)	(6.3)	(1.7)	(7.2)	(4.3)	(2.7)
Current account balance (% of GDP)	(4.8)	(7.6)	(6.4)	(7.4)	(2.7)	(7.2)	(5.0)	(4.0)
Current account balance (BoP, current US$ million)	(1,152.7)	(2,086.7)	(2,076.3)	(2,571.1)	(1,003.1)	(2,873.5)	(2,108.6)	(1,537.3)
Foreign direct investment, net inflows (% of GDP)	0.2	0.2	0.6	0.8	0.5	0.9	1.0	0.4
Foreign direct investment, net inflows (BoP, current US$ million)	55.7	55.3	189.9	290.6	190.9	349.6	401.0	163.2
GDP growth (annual %)	10.3	5.4	5.2	5.9	5.4	5.6	5.8	4.6
General government final consumption expenditure (% of GDP)	11.2	12.0	12.3	12.8	13.1	12.9	13.2	13.5
Gross domestic savings (% of GDP)	23.9	20.5	22.9	23.4	24.8	22.8	25.2	25.5
Money and quasi money (M2) as % of GDP	37.5	38.2	38.2	39.5	42.7	48.3	54.7	58.9
Money and quasi money growth (annual %)	19.1	14.4	22.3	15.8	23.3	23.8	19.7	11.5
Population, millions	45.2	46.2	47.3	48.3	49.4	50.5	51.6	52.5
Total reserves in months of imports	4.9	4.2	3.3	2.7	3.0	2.5	2.5	3.0
Inflation, consumer prices (annual %)	7.9	9.9	19.7	12.7	5.3	3.7	0.9	2.4
Real interest rate (%)	1.2	4.0	3.1	8.2	11.3	11.2	15.1	13.6
Agriculture, value added (annual % growth)	12.5	(1.9)	1.8	6.9	2.5	4.8	4.4	4.5
Industry, value added (annual % growth)	10.6	6.7	3.6	7.1	5.1	10.5	8.2	1.4
Services, etc., value added (annual % growth)	9.1	7.9	7.6	4.8	6.6	2.9	4.7	6.9
Agriculture, value added (% of GDP)	24.5	24.0	23.2	21.4	18.5	20.1	17.6	15.8
Industry, value added (% of GDP)	29.6	30.3	28.7	30.1	29.5	30.6	32.0	31.8
Manufacturing, value added (% of GDP)	20.0	21.0	21.5	22.6	21.3	22.1	22.9	21.9
Services, etc., value added (% of GDP)	45.9	45.7	48.1	48.5	51.9	49.4	50.5	52.3

Source: World Bank Databank.

Fiscal Deficits

Table 2.5 shows the government budget deficits of the three countries. The widening of the Philippines' fiscal deficit began in 1980 reaching a peak level in 1982. The 1982 deficit amounted to US$1.69 billion. In Table 2.6, this fiscal deficit constituted 4.5% of GDP, a situation similar only to its 1981 performance. The deficit was substantially trimmed down in 1983 by about US$1 billion.

From a comparative standpoint, the Philippine fiscal deficits both in absolute and relative terms were comparable to situations in Korea and Thailand during the period. As the tables show, the two countries even sustained larger deficits than the Philippines in 1982 and 1983. The ostensible difference was in the financing of the Philippines' fiscal deficits based on external borrowing. The next section compares aspects of external indebtedness.

Table 2.5
Government Deficits (US$ billions), 1978-85

Year	Korea	Philippines	Thailand
1978	-0.62	-0.29	-0.64
1979	-1.13	-0.05	-0.64
1980	-1.40	-0.45	-1.25
1981	-2.33	-1.54	-0.98
1982	-2.27	-1.69	-1.79
1983	-0.85	-0.67	-0.99
1984	-1.04	-0.60	-1.40
1985	-1.08	-0.60	-1.44

Source: IMF International Financial Statistics

Table 2.6
Fiscal Deficit to GDP (%)

Year	Korea	Philippines	Thailand
1978	-1.24	-1.22	-2.68
1979	-1.76	-0.16	-2.35
1980	-2.25	-1.39	-3.87
1981	-3.35	-4.32	-2.81
1982	-3.04	-4.54	-4.89
1983	-1.04	-2.02	-2.48
1984	-1.15	-1.90	-3.36
1985	-1.16	-1.95	-3.69

Source of basic data: IFS

External Indebtedness

Table 2.7 shows comparative debt indicators. Of the three countries during the period 1970-83, Korea had the largest stock of external debt (at US$40 billion) and the

Table 2.7 Selected Debt Indicators (Billion US$ Dollars), 1975-83

Country/Indicators	1970	1975	1979	1980	1981	1982	1983
Korea							
Total External Debt	2.25	8.46	20.50	27.37	32.49	37.31	40.10
As % of GNP/GNI	28.17	40.57	32.87	44.72	48.35	52.70	53.39
Short Term Debt	0.37	2.41	6.60	10.61	11.76	14.22	14.50
Total External Debt Service (TDS)	n.a.	n.a.	3.10	4.10	5.60	6.00	5.80
TDS to Total External Debt	n.a.	n.a.	0.15	0.15	0.17	0.16	0.14
TDS as % of GNI/GNP	n.a.	n.a.	5.00	6.70	8.30	8.50	7.70
TDS as % of exports of goods, services and income	n.a.	n.a.	16.30	18.50	20.70	21.00	19.30
Total reserves (includes gold, current US$ billion)		0.80	3.11	3.10	2.80	2.95	2.46
Total reserves in months of imports	n.a.	n.a.	1.55	1.34	1.06	1.14	0.92
Philippines							
Total External Debt	2.20	4.17	13.28	17.42	20.79	24.41	24.21
As % of GNP/GNI	33.44	28.09	48.32	54.04	58.72	66.99	74.52
Short Term Debt	0.58	1.11	5.32	7.56	9.42	11.33	9.42
Total External Debt Service (TDS)	0.31	0.46	1.58	2.18	2.97	3.51	3.03
TDS to Total External Debt	0.14	0.11	0.12	0.13	0.14	0.14	0.13
TDS as % of GNI/GNP	4.69	3.08	5.76	6.77	8.39	9.64	9.32
TDS as % of exports of goods, services and income	n.a.	n.a.	24.57	26.61	33.61	42.62	36.43
Total reserves (includes gold, current US$ billion)	n.a.	1.46	3.12	3.98	2.73	1.74	0.86
Total reserves in months of imports	n.a.	n.a.	4.62	4.61	2.93	1.79	0.90
Thailand							
Total External Debt	1.00	1.87	6.64	8.30	10.85	12.24	13.89
As % of GNP/GNI	14.10	12.53	24.55	25.86	31.64	33.96	34.94
Short Term Debt	0.28	0.51	2.34	2.30	2.88	3.04	3.31
Total External Debt Service (TDS)	0.16	0.36	1.31	1.62	1.88	1.94	2.21
TDS to Total External Debt	0.16	0.19	0.20	0.19	0.17	0.16	0.16
TDS as % of GNI/GNP	2.30	2.40	4.84	5.04	5.47	5.38	5.57
TDS as % of exports of goods, services and income	n.a.	n.a.	19.67	18.86	20.26	20.60	23.99
Total reserves (includes gold, current US$ billion)	n.a.	2.01	3.10	3.03	2.72	2.67	2.56
Total reserves in months of imports	n.a.	6.55	4.22	3.34	2.72	3.03	2.48

Sources: WDI; Park (1986).

compounded rate of debt accumulation (at 27% per year) was the most rapid among the three countries. Thailand had the lowest stock of external debt but its rate of debt accumulation (at 24.5% a year) was next to Korea. The Philippines has the second largest debt stock at US$24.5 billion. Its external debt level was at par to Korea in 1970 but its debt stock accumulation was slower at 22% a year.

It has been said that since the second oil price shock, one of the errors in Philippine economic policy was increased short-term external borrowing, which was more expensive. From a comparative perspective however Korea had a more rapid rate of accumulation averaging 22% a year during the period 1979-83. The Philippine average rate of short-term external debt during the period was only 11.4% a year while Thailand's average was 9% a year. The increased short-term loans in the Philippines were used to pay for oil imports, which became expedient when international oil companies began demanding accelerated payments after the second oil price shock (Dohner and Intal, 1989: 517).

Differences in external debt service could be expected to correspond to the level of external indebtedness in each country. In 1982, Korea paid US$6 billion from its external debt. In the following year, its external debt service was US$5.8 billion. The Philippines' external debt service payments amounted to US$3.5 and US$3 billion in 1982 and 1983, respectively. Finally, Thailand's external debt service rose from US$1.9 in 1982 to US$2.2 billion in 1983. Of the three countries, the ratio of external debt service to total external debt stocks was highest in Thailand at 0.18:1 on average during the period 1979-83. The average ratios for South Korea and the Philippines were 0.16:1 and 0.13:1, respectively.

When compared to GNP/GNI and to exports, the picture of external indebtedness changes. Since of the three countries the Philippines was the slowest growth performer, it appeared to shoulder the heaviest burden of external debt. In 1982-83, the Philippines' total debt service was 9.48% of GNI average while that of Thailand was 5.48% (see Table 2.7). Korea's average total debt service was 8.1% of GNP. Korea had the highest debt service but had the fastest economic growth rate of all (see Table 2.2). Following a financial run in 1981, the Philippines' economic growth decelerated and the rate of growth slipped below 5% a year (see Table 2.3). Thailand's economic growth likewise decelerated but the annual rate of growth was in the region of 5% to 6% since 1979 (Table 2.4).

Trade and Adjustments to External Shocks

As could be gleaned from Tables 2.2 to 2.4, Korea's export performance record was superior to those of the Philippines and Thailand. The dependence of that economy on trade was heavier than the two Southeast Asian economies. During the period 1979-83, Korea's debt burden ranged from 16.3% to 21% of exports of goods, services, and income (i.e., merchandise trade plus invisible trade receipts). Thailand's debt burden ranged from 18.9% to 24%. The Philippines' debt burden as a share of export receipts was high, ranging from

24.6% to 42.6% during the period. From this perspective, it was apparent that the Philippines had a fundamental problem with respect to foreign trade.

Power (1983) compared the Philippines and Korea and analyzed their responses to BOP crises in the 1970s. He observed that both had high levels of external indebtedness and undertook similar immediate policy responses to BOP crises. But because of the Philippines' earlier bias for import-substitution industrialization, market distortions occurred that eventually hampered the growth of non-traditional exports and undermined the translation of its high investment level into growth (Power, 1983:27). Because of the Philippines' excessive dependence on traditional primary exports, the country suffered from the rapid deterioration of the terms of trade after the second oil price shock. As Power (1983:9) observed, "Few countries in the world have suffered as much from the movements in international prices." Using 1971-73 as the base year, the Philippine terms of trade declined to 52 in 1982 while that of Korea was only 75.

Remolona, Mangahas and Pante (1986) also recognized the damaging effects of the terms of trade but argued that it was only in 1982 that its impact on the current account, along with other external shocks (interest rates, increased borrowing) became significant. They point to government stimulation of investment and importations other than oil and capital goods that were "doing the damage at the onset of the oil shock." Others like De Dios et al (1984) point out that the problem did not simply emanate from trade and industrial policies; their assertion lay in the nature of the investment transmission problem during the period immediately preceding 1983. Nevertheless, it is important to stress Power (1983) who argued that external indebtedness is not a sufficient condition to explain BOP crises.

Analysts have asserted that the adoption of timely and appropriate exchange rate policies could avert a BOP crisis. Accordingly, the necessary exchange rate adjustments should reflect the current account deficits and the rise in domestic inflation. This would also avoid speculative attacks on the currency. However, the devaluation of the currency is a politically sensitive issue because of the short-term economic pain it induces. The strong political resistance has been noted in the three countries (Park, 1986; Dohner and Intal, 1989; Jansen, 1997:133). In contrast to the earlier views, the three countries have been observed to adopt similar measures of currency devaluation following BOP difficulties.

The Philippines instituted financial liberalization (1980) and adopted a managed floating rate system earlier than the two countries.[8] During the period 1979-83, the peso was devalued several times and the nominal rate rose from P7.4 to P14 to the US dollar. Foreign payments problems were foreseen in 1982 hence negotiations for an IMF standby agreement were initiated. In 1983, the peso was devalued twice. The first was done in June, in which

[8] See Kaminsky and Reinhart for comparative dates of financial liberalization for Philippines and Thailand. Korea's financial liberalization in the 1980s was largely domestic (Lindner, 1994).

the peso climbed from P9 to P11 per US dollar. The second devaluation, which saw the peso rise from P11 to P14 per US dollar, occurred in October prior to the announcement of the debt moratorium. The sharp devaluations came after complications with the IMF program in the Philippines during the year.

Korea suffered a financial crisis in 1979/80. Prior to 1980, the won was pegged to the US dollar. Devaluations of the won occurred a year after BOP crises. Since the 1974/75 crisis, the value was kept at ₩480 to a US dollar under a single-currency peg (SCP) system. Then, at the height of the 1979/1980 Korean financial crisis, exchange rate reforms were introduced. During the first quarter of 1980, the won was devalued by 20% to ₩580. The government also adopted a managed floating exchange rate system based on a basket of currencies. By 1983, the Korean won was ₩797.5 to a US dollar.

Financial system problems in Thailand resulted in the devaluations of the baht in 1981 and 1984. Coinciding with the SET crash were BOP difficulties in 1978 and early 1979.[9] The baht was finally devalued twice in 1981. From B20.4 the price of the baht was lowered to B21 in May and to B23 per US dollar in July. In November 1984, Thailand suffered a BOP crisis, resulting in the devaluation of the baht from B23 to B27.15 per US dollar.

Balance of Payments

One could gather a family resemblance in the economic circumstances of the three countries. The Philippines' poor export performance and the deterioration in its terms of trade have been noted in the 1983 BOP crisis (Power, 1983; Remolona, Mangahas, and Pante, 1986). However, Thailand and Korea were also suffering from the same problems because of the global recession of the early 1980s. Whatever differences in export performance and terms of trade, these should ultimately be reflected in the current account. Before going to an examination of CA performances, a comparative discussion of the international reserves is necessary.

As earlier mentioned, from 1979 to 1981, the level of international reserves of the three countries was around US$3 billion. During the three-year period, the Thailand and the Philippines maintained reserves at an average 3.5 to 4 months of imports. Korea's reserve level was lower averaging 1.3 months of imports. In 1983, the import equivalent of Korea's reserves fell to less than 1 month. The Philippines had the same experience of international reserves dropping below a month's worth of imports.

From 1982 to 1983, the decline in the amount of Philippine foreign exchange reserves was dramatic. Since 1981, it was experiencing an annual drop of close to US$1 billion. Korea and Thailand had similar experiences of pressure to use their official reserve assets in

9 See K. Jansen (1997: 138-39) and Pananond and Pongsudhirak (2010).

order to plug BOP deficits. But for the Philippines, the use of foreign exchange reserves reached a point of exhaustion in the second semester of 1983.

Because of the rapid drain in international reserves, one is led to examine the current account deficits in the Philippines. Table 2.8 and Figure 2.2 show the annual current account performances of Korea, Thailand, and the Philippines. The deficits exhibit a wave-like pattern in each country such that in certain years, the deficits in one country are higher than the others. This suggests the importance of "timing" in covering the deficits (Figure 2.2).

Table 2.8 shows the yearly and cumulative amounts of CA deficit for each country for the period 1978-85. During this period, the three countries experienced serious deficits that roughly totalled US$50 billion. Korea accounted for 42% of the total amount of deficit, Thailand 31%, and Philippines 27%.

The years 1982 and 1983 were extremely difficult for all of the countries because of the prolonged global recession. Reeling from huge deficits since 1979, Korea incurred another US$4 billion deficit during this period. It was only in 1983 that Korea was able to bring down its current account deficit to 3% of GDP (Table 2.2). Thailand's 1983 deficit was US$3.8 billion after successfully narrowing down its 1982 deficit to US$1 billion. The Philippines sustained the largest cumulative deficit of close to US$6 billion in 1982-83.

Table 2.8 Current Account Deficits, Cumulative, 1978-85
(US$ billions)

Year/Period	Korea	Philippines	Thailand
1978	-1.085	-1.094	-1.153
1979	-4.151	-1.496	-2.087
1980	-5.312	-1.904	-2.076
1981	-4.607	-2.061	-2.571
1982	-2.551	-3.200	-1.003
1983	-1.524	-2.771	-2.873
1984	-1.293	-1.294	-2.109
1985	-0.795	-0.036	-1.537
Total, 1978-85	-21.318	-13.856	-15.409
Total 1979-83	-18.144	-11.432	-10.611
Total 1979-81	-14.070	-5.461	-6.734
Total 1982-83	-4.075	-5.971	-3.877

Note: Annualized figures from quarterly data.

Source: CEIC Data

Quarterly data do not provide a neater picture than the annual figures (Figure 2.3). The trend from the 1st quarter of 1980 to the 1st quarter of 1984 may appear that the Philippines was in neither better nor worse condition than Korea and Thailand. However, the data reveal a consistent trend since the second quarter of 1981: the quarterly deficits were frequently between $600 and $900 million. The deficits have been linked to profligate spending by the Marcos administration, which raised imports at a time when foreign demand for Philippine exports was depressed. Despite improvements in the current account exhibited in the second and third quarters of 1983, the cumulative effects proved to be overwhelming. How were the deficits financed?

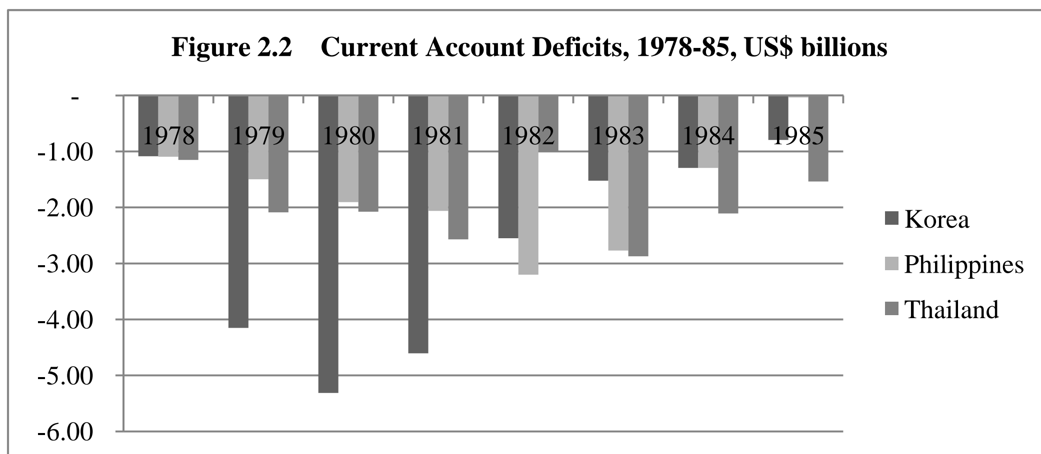


Figure 2.2 Current Account Deficits, 1978-85, US$ billions

Note: Annualized figures from quarterly data.
Source: CEIC Data

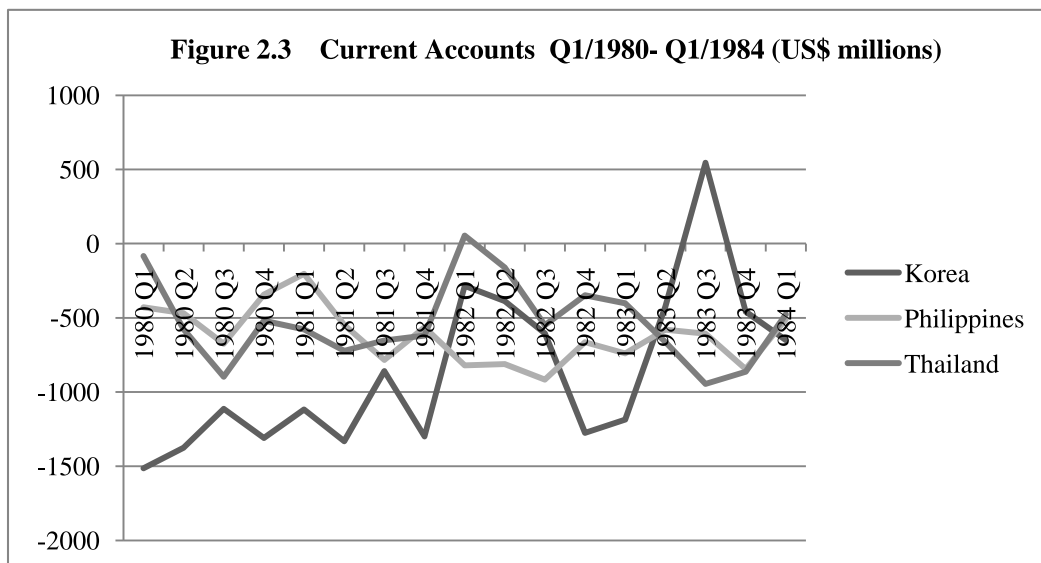


Figure 2.3 Current Accounts Q1/1980- Q1/1984 (US$ millions)

Source: CEIC Data

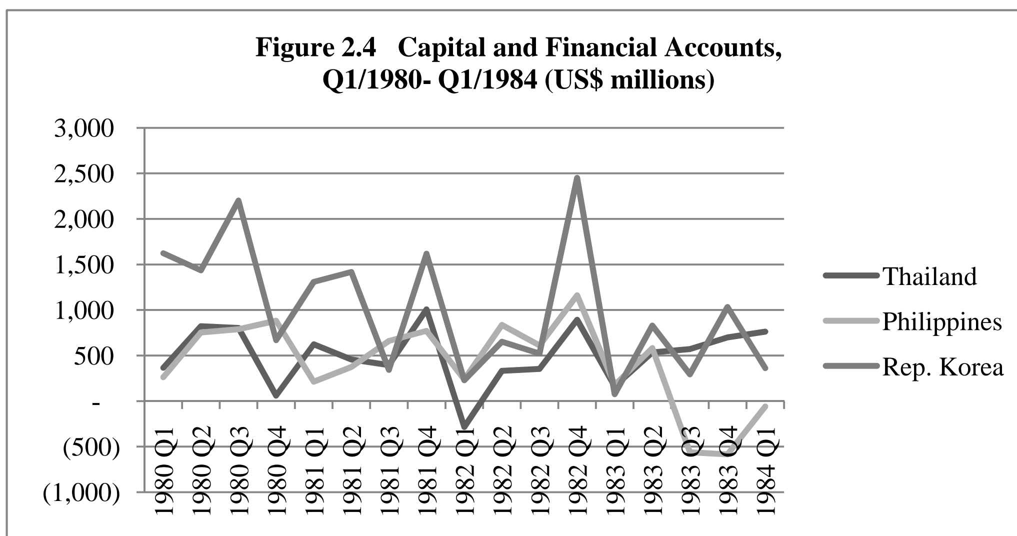
Financial Inflows and Capital Flight

Some US$55.6 billion flowed into the three countries during the period 1978-85. The shares of financial flows are broken down into Korea, 52%; Thailand, 27%; and the Philippines, 21%. The pattern of distribution among the three countries is consistent in all sub-periods (Table 2.9).

Table 2.9
Financial Account Performances 1978-85 (US$ billions)

Year/Period	Korea	Philippines	Thailand
1978	2.13	1.74	1.36
1979	5.35	1.56	1.98
1980	5.93	2.68	2.05
1981	4.69	2.02	2.48
1982	3.85	2.85	1.29
1983	2.23	(0.39)	1.97
1984	2.74	0.78	2.57
1985	1.87	0.33	1.54
Total, 1978-85	28.79	11.57	15.23
Total, 1979-83	22.05	8.72	9.77
Total, 1979-81	15.97	6.27	6.51
Total, 1982-83	6.08	2.46	3.26

Note: Annualized figures from quarterly data.
Source: CEIC Data



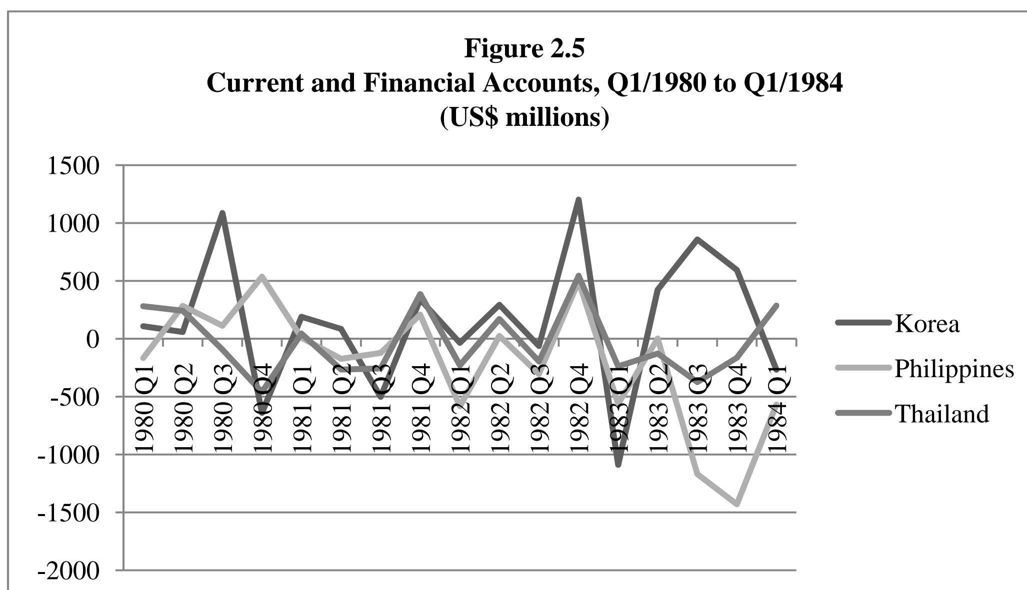
Source: CEIC

Figure 2.4 shows quarterly data on the capital and financial accounts from 1980 to 1984. During the period Korea never experienced a net outflow in a single quarter. The external financing helped to support Korea's large quarterly CA deficits. Thailand sustained a net outflow during the 1st quarter of 1982.

Table 2.10
Financial Account, Major Components, Philippines, March 1982 – March 1984 (US$ millions)

Quarter	Financial Account	Direct Investment	Portfolio Investment	Other Investments			
				Monetary Author-ities	General Govern-ment	Banks	Other Sectors
Mar, 1982	238	17	-1	197	520	-640	143
Jun, 1982	836	-12	0	263	285	4	296
Sep, 1982	612	15	0	-287	457	141	286
Dec, 1982	1,161	-4	0	-115	695	955	-370
Mar, 1983	176	49	-4	-295	109	-507	816
Jun, 1983	582	0	-2	148	34	585	-186
Sep, 1983	-562	34	-1	-16	-52	-289	-240
Dec, 1983	-585	23	0	94	85	-164	-623
Mar, 1984	-59	-13	0	-46	157	-162	5

Source: CEIC



Source: CEIC

Generally, the three countries maintained positive balances until the Philippine deviation in the 3rd quarter of 1983. The Philippine financial account turned red and stayed there for two quarters more. Not only did foreign financing stop but massive withdrawals were made as well. Both the banks and firms were pulling out of the country during that semester. Moreover, some liabilities in the general government account were pulled between June and September 1983 (Table 2.10). The pattern of withdrawals suggests a panic before and after a financial crash.

The joint effect of the quarterly performances in both current and financial accounts could be seen in Figure 2.5. [10] Interestingly, starting in 1981, the payments balance (excluding errors and omissions, reserve assets, and IMF credits) of the three countries assumed a synchronized wave-like pattern, which is unlike that in the current account. It was as if an invisible hand was guiding the flows of external finance to the three countries. All three suffered negative balances in the first quarter of 1983 and were recovering in the next quarter until the Philippine 3rd quarter crash. The crash could be attributed to the Aquino assassination shock.

Economic prospects for the Philippines appeared bright until 1979 when the second oil crisis struck and the United States Federal Reserve Board raised its interest rates. As others have pointed out, the Philippines was not the only one hit by higher interest payments, higher oil prices, and the global recession. As such, it has been argued that the economic policies adopted in response to the situation worsened the current account (e.g., Montes, 1987; Remolona, Mangahas, and Pante, 1986; De Dios et al, 1984). Because of rapid debt accumulation, inefficient investments and profligate spending, the BOP crisis was therefore bound to happen.

As most accounts of the 1983 crisis see it, the Aquino assassination was the triggering event. Returning from exile on August 21 and accompanied by international reporters, soldiers escorted former Senator Aquino out of the plane and closed its door. Instantly, shouts were heard, followed by gunfire. The media photo coverage showed the body of the late senator lying on the airport tarmac. The incident caused international and local outrage. More importantly, it triggered a financial panic.

Based on the analysis of quarterly BOP data it appears that the significance of the Aquino shock should go beyond its current treatment as an accelerator of the crisis. As suggested above, the timing of the crisis depended on the decisions of external actors. What could be gathered is that the assassination led to the loss of international support to Marcos regime. The underlying basis for this loss of support is rooted in the relations between the Marcos government and the international community since 1979. This is discussed in the following section.

[10] More detailed data on the Philippines' BOP could be found in Appendix 1.

2.3 Underlying Instabilities, Resentments, and Anxieties

From a historical perspective, there were several worrisome developments for external finance from 1979 up to the 1983 Aquino assassination shock. Government policy and behaviour since then have built underlying instabilities as well as foreign resentments and anxieties toward the Marcos regime.

As pointed out in previous studies, domestic policies in response to shocks since 1979 made the economy more vulnerable to adverse changes in the international and local settings (e.g., Remolona, Mangahas, and Pante, 1986; Montes, 1987; Lamberte et al, 1992; Yap and Vos, 1997). The panic that happened during the 3rd quarter of 1983 had been building up from a series of prior events.

In the economic front, the worrisome developments were the mounting trade and fiscal deficits being externally financed, the government's decision to pursue a structural adjustment program with the World Bank, the financial crisis following the Dewey Dee scandal, and the change in IMF attitude toward the Marcos government. In the political front, the issue of presidential succession and the associated political competition produced some uncertainty about the regime's future. Finally, state regulatory and investment behaviour since 1979 was an important source of resentment and anxiety.

The Twin Deficits and Mounting Foreign Debt

It was earlier pointed out that government deficit spending and trade deficits had been largely financed by foreign loans. Philippine external borrowings, particularly short-term debt, rapidly increased between 1979 and 1982. In a span of four years, US$11.2 billion was added to the country's external debt stock. Half of this amount consisted of short-term loans.

The government countercyclical policy after the second oil price shock did not produce its desired result of revitalizing economic activity. Since 1979, capital outlays represented between 34 and 43% of national government expenditures. Infrastructure comprised between 32 to 45% of the total amount of capital outlays while the bulk went to equity investments in government corporations and construction activities of government ministries other than the Ministry of Public Highways and the Ministry of Public Works, Transportation, and Communication (De Dios et al, 1984).

Expensive short-term loans from foreign commercial banks were obtained in order to finance many losing government corporations and to take over private firms. As the country experienced a serious recession, extravagant projects and activities such as the Manila Film Festival and the University of Life were criticized as having little to do to address more pressing concerns such as poverty alleviation. Government spending and mounting debt

amidst difficulties in generating income were serious concerns for providers of external finance.

Structural Adjustment Program

Following the IMF-WB Annual Meeting of September 1979, the World Bank introduced an aid package called the Structural Adjustment Loan (SAL). The SAL was approved by the WB Board in February 1980, was designed to maintain growth while facilitating balance of payments adjustments in Third World countries with mounting levels of debt (Easterly, 2005: 2). Moreover, the SAL was targeted toward market-oriented and export-oriented economic reforms.

In anticipation of the SAL's prior action requirements, Marcos issued a decree on August 1, 1980 to initiate a tariff reform program in four phases. Phase I would reduce peak nominal tariff rates (previously ranging from 100 to 70 percent) to 50 percent by January 1, 1982. Phases 2 to 3 would reduce average EPRs in 14 industries to 30 percent and 18 percent. Among the industries to be affected in Phase 2 were textile and garments, food processing, pulp and paper, as well as leather and footwear. Phase 4 would revise tariffs in industries and items not covered in the previous phases.

Later in the month, the government sent a letter to the WB signifying its intent to lower tariffs, liberalize import restrictions, promote exports and investment in export-oriented industries, adopt a flexible exchange rate policy, and restructure specific industries for integration in the export-oriented industrialization (Montes, 1988). In September 1980, the WB approved the Philippine SAL of US$200 million to be released in two tranches and recognized a three-phase tariff reform in the Philippines.

Structural adjustment adversely affected import-substituting and other firms in industries that long enjoyed the protection of tariff barriers. Moreover, the liberalization program would have the effect of discouraging FDI that sought advantages from import-substituting regimes. It will be noted that only after the 1985 Plaza Accord that most export-oriented manufacturing FDI especially from Japan fled to Southeast Asia and other parts of the world.

Financial Crisis After Dewey Dee Scandal

The 1991 Dewey Dee scandal had an effect on financial flows to the Philippines.[11] On January 9, 1981 the Filipino-Chinese industrialist Dewey Dee fled the country, leaving behind substantial debts obtained from 40 financial firms and banks. It was later estimated

[11] Bello (1982:170-171) links the flight of Dewey Dee to the World Bank's 1980 Structural Adjustment Loan (SAL) geared towards investment and trade liberalization, which affected among others "inefficient" textile and garment firms. Accordingly, Dee saw that his firms would be doomed and left "while the getting was good." Unfortunately, his departure triggered a financial panic.

that the debts amounted to approximately US$80 million.[12] Dee was a textile magnate with a diversified business empire. His flagship company was Continental Manufacturing Corp. (CMC) which was a joint venture with Mitsubishi Rayon (25%), Mitsubishi Corp. (7%), and Marubeni Corp. (7.5%). Dee also had joint venture partnerships with Japanese firms in subsidiary companies of several textile firms.[13]

The Dewey Dee scandal caused a panic and many of the investment houses suddenly found themselves illiquid. Domestic credit tightened and many highly-leveraged firms went under. Others shouldered the costs of tight credit. According to Alburo and Sicat (1983: 111), the incident caused losses to a number of Japanese multinationals that invested in local manufacturing, which "might have dampened their enthusiasm somewhat."

The financial crisis of 1981 and its associated uncertainties triggered massive capital flight. In one calculation, whereas capital outflows amounted to $695 million in 1980, in the following year outflows jumped up to US$2.15 billion (Dohner and Intal, 1989). The economy had yet to fully recover but the financial haemorrhage continued in 1982 with an estimated capital outflows of US$1.5 billion.

The financial scandal in 1981 produced recessionary effects and government responded with massive public spending financed by foreign borrowing. The situation worried the country's Japanese lenders. Unlike U.S. banks, they were more reluctant on lending to the Philippines since that time. In the second semester of 1983, U.S. banks, nervous but willing to extend credit to the Marcos government, were afraid of a withdrawal of support by the Japanese banks.[14]

Government Relations with the IMF

In contrast to previous years, the IMF began tightening its grip on the Philippines in 1982. Particularly, in April, IMF officials recommended that the government cut its borrowings, investments and growth targets if it were to be granted access to standby credit. It deemed that the government's 1982 growth rate target of 5.1% was too high.[15] The IMF based its recommendations from the country's 1981 economic performance, in which they estimated that GNP grew by only 2.5%.

Prime Minister Cesar Virata (also the Finance Minister) argued that the recommendations were based on mistaken assumptions on economic performance. Accordingly, the 1981 performance was due to private financial sector problems and not to

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[12] Dohner and Haggard (1994:37).

[13] Guy Sacerdoti (1983) "Dee-day in Vancouver," *FEER*, June 16.

[14] Guy Sacerdoti (1983) "Sounding the alarm," *FEER*, October 13.

[15] In October 1982, Korea predicted a 6% GNP growth as the current account deficit was expected to be reduced from US$4.5 to US$2 billion (see FEER October 8, 1982).

increased public investments. Nevertheless, Virata admitted the need to take painful measures in order to improve the country's payments position.[16] The dispute on economic performance targets dragged negotiations for a standby credit. In view of the slowdown in capital inflows from abroad, the delay necessitated the use of precious foreign exchange reserves. Later in the year, the World Bank also advised the government to earn more revenues and to rationalize spending. It warned of a future drying up of private foreign capital for Manila if government deficit spending continued.

In October and November, reports from the Finance Ministry, the Central Bank, and the Budget Ministry informed Marcos that the economy had reached its spending limits. The Central Bank reported that public sector borrowings had exceeded prescribed limits while the Budget Ministry issued a memorandum stating problems in the government revenue side. In effect, the economic managers recommended an austerity program as earlier advised by the IMF and WB. Furthermore, commercial creditors had informed Virata in November that new loans depended on the IMF program.[17] Thus pressured, Marcos agreed to reduce government spending including those intended for the government's 11 major investment projects (MIPs).

Following the government's expressed commitment to curb spending and fulfil IMF conditions, the multilateral institutions granted loans to alleviate the country's current account and BOP difficulties. In February 1983 the IMF approved a one-year credit programme for the Philippines in the amount of SDR 503 (equivalent to US$548 million), equally split in four quarterly tranches. In March, the Philippines received its second SAL from the World Bank amounting to US$302.3 million as well as club loans from New York banks (Lindsey, 1984: 1188-89).[18]

In March, an IMF official returned to the Philippines to seek reassurances from the government that the IMF conditions would be met.[19] After the IMF mid-year review in June, it was found out that the Philippine government had exceeded IMF conditions on domestic credit ceilings and BOP targets. Consequently, in the summer of 1983, the IMF cancelled the remaining two remaining tranches that the Philippines could draw from the Fund (Thompson and Slayton, 1985; Dohner and Intal, 1989: 524). What transpired later was a period of delayed external financing to rescue the Philippine economy following the Aquino assassination.

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[16] G. Sacerdoti (1982) "Virata fights back," *FEER*, May 21.

[17] R. Nations (1983) "The lengthening shadow of short-term debt," *FEER*, June 9.

[18] The "club" loans were said to be a confidence trick as these were not new exposures but a roll-over of loans. See footnote 26, R. Nations.

[19] G. Sacerdoti (1983) "Manila put on standby," *FEER*, April 7.

Renegotiations with the IMF resumed in September 1983. After a peso devaluation and the declaration of a debt moratorium in October, the Philippines submitted a letter of intent (LOI) to the IMF in November. The LOI was said to have been approved in principle by the IMF managing director, Jacques de Larosiere and was elevated to its Executive Board for approval. The Philippines had to wait for the release based on the Fund's disbursement schedule. Then, in early December 1983, news leaked regarding the overstatement of international reserves by the Central Bank. According to Montes (1987: 13), the leak of this information to foreign banks discouraged the latter from increasing their Philippine exposure. It was the "final straw."

The situation further complicated relations between the IMF and the Marcos government. An IMF team was immediately dispatched to Manila to review Philippine performance against the government's earlier LOI.[20] On January 9, 1984 the IMF team leader in Manila indicated that "if the Philippine program were to continue, Central Bank governor, Jaime Laya, would have to go." Marcos complied with Governor Laya leaving a week later although the latter had offered his resignation in December 1983, which Marcos declined (Lindsey, 1984: 1195). It was only in December 1984 that a new agreement for an IMF standby credit was reached.

The Presidential Succession Issue

The year 1979 was significant to the Philippines not only because of the second oil crisis and the Volcker shock. On the one hand, the year sent clear signals of the rise of crony monopoly capitalism. This shall be discussed later. On the other hand, questions regarding the health of President Marcos arose during the year (Neher, 1980). Particularly, he was ailing from a kidney disease. The associated issue of presidential succession raised the level of uncertainty for the Philippine political economy. It might have also led to acts of desperation among people associated with the regime.

At that time, Ferdinand Marcos was both President and Prime Minister of government. Because of Marcos health condition, members of the government party Kilusang Bagong Lipunan (KBL) urged him to resolve the issue of succession by naming his wife Imelda Marcos as Deputy Prime Minister. By Marcos's own decree (Presidential Decree No. 1514) the Deputy Prime Minister shall act as Prime Minister in the event of death, resignation, permanent incapacity or removal from office of the Prime Minister (Neher, 1980:156).

Marcos however refused to publicly name Imelda as his successor even if the latter tried to enhance her position in government, first as an international diplomat and later as Metro Manila governor and Minister of Human Settlements. Doing so might break the coalition of interests supporting his regime, which according to Neher (1980) included the

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[20] J. Galang (1983) "Waiting on the IMF," *FEER*, December 29.

army, bureaucracy, business elites, and the U.S. government. An equally important support group was the country's foreign creditors and it seemed that some bankers were not comfortable with the choice of the First Lady as presidential successor because of the potential instability that would entail.[21] The controversial First Lady was known for her grandiose projects as well as for excessive public spending.

Marcos's refusal to address the succession issue created insecurities or fissures within government. It also opened up possibilities for succession by allies outside of the Marcos family, an idea opposed by family supporters. The decision also gave the political opposition possibilities for gaining power through the electoral exercise. The resumption of legislative elections in 1978 was seen as only the start because of continued international pressures on the government to restore Philippine democracy.

Martial law was lifted on January 21, 1981 and presidential elections were called in the middle of the year to usher a "new" regime called the New Republic. Marcos's landslide victory indicated his intention to remain in power. The New Republic saw major political realignments in 1981. Marcos appointed General Fabian Ver as Chief of Staff of the Armed Forces. The move effectively dislocated Defense Minister Juan Ponce Enrile; it also bypassed Philippine Constabulary head Fidel Ramos. Enrile was regarded as contender to the throne but was suspected of disloyalty (Blitz, 2000:140). The disenfranchisement of key allies in the New Society represented major cracks in the establishment. This would later prove fatal to the Marcos government.

At any rate, speculations were ripe in 1982 that Imelda Marcos would eventually succeed the ailing dictator.[22] In September, the Marcoses visited the U.S., which was described as successful as the Reagan administration pledged fresh economic assistance to the Philippines. However, by mid-1983, there were indications from the U.S. State Department that other political alternatives beyond Marcos were being sought. For instance, an aide of State Secretary George Schultz was quoted in June as saying that since the Marcos regime was entering its twilight, they [the State Department] would not like to find themselves in the same position as when the Shah of Iran was overthrown.[23] Aquino believed that the First Lady would succeed Marcos and decided to present himself as an alternative amidst economically and politically fragile conditions. His return from exile in August 1983 stopped this bid.

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[21] Richard Nations (1982) "Debt squeeze in Asia," *FEER*, November 5.

[22] Rodney Tasker (1982) "Nothing succeeds like succession," *FEER*, October 29.

[23] Sheila Ocampo-Kalfors (1983) "Nor more Irans," *FEER*, July 21.

Crony Capitalism and Changes in State Regulatory Behaviour toward FDI

When the United States granted independence to the Philippines in 1946, a free trade agreement was reached, allowing parity rights to Americans and Filipinos investing in either country. The Philippine Trade Agreement (otherwise called as the Bell Trade Act) did not sit well with Filipino nationalists who regarded it as unequal and a symbol of the country's continued colonial status. The agreement, which was signed so that the country could gain favourable terms for war damage payments, contained provisions that restricted entry into the United States of Philippine manufactured goods that competed directly with American products.[24] The agreement was replaced by the Laurel-Langley Agreement of 1954 which essentially revised tariffs schedules. This agreement expired in 1974.

During the early independence period, the prevailing sentiment toward foreign investments was such that they were associated with economic colonization/imperialism. In the mid-1950s, in the backdrop of the rising economic nationalism, discriminatory policies against foreign capital (e.g. the 1957 Retail Trade Nationalization Act) were instituted. With the rise of xenophobic nationalism and anti-Americanism in the 1960s, many American businesses divested from the Philippines. This allowed members of the local economic elite to acquire their businesses in the country. The discriminatory environment toward foreign investments was distinct in the Philippines than in other Southeast Asian countries (Yoshihara, 1978; Thomsen, 1999).

Yamagata (1998) demonstrates the effect of discrimination on FDI entry and eventual performance of the textile industry in the 1960s. Accordingly, despite higher tariffs that would encourage import-substituting FDI, the Philippines missed out on FDI inflows because of its foreign ownership restrictions. While both countries did not allow more than 50% foreign ownership, restrictions were less strict in Thailand than in the Philippines.

President Marcos declared martial law in September 1972 and the new regime was dubbed as the New Society to distinguish his rule from governments of the old regime. The New Society government projected a more receptive attitude towards foreign investments and loans. This policy attitude was enthusiastically welcomed by the foreign business community. Consequently, massive amounts of foreign investments and loans were infused into the economy. It later became apparent that foreign loans became the government's external financing of choice. Nevertheless, the great spurt in foreign investments was from 1972 to 1978, with cumulative net flows amounting to US$772 million.

While the attraction of foreign investments and loans in the 1970s initially succeeded, the success proved to be short-lived owing to government favouritism and arbitrariness. Foreign firms affiliated to crony businesses were generally shielded from the increasingly

[24] See Jenkins, Shirley (1954:66) *American Policy Towards the Philippines*, Stanford University Press.

discretionary regulatory environment. Those attached to non-crony firms became vulnerable especially after the martial law era was coming to a close.

A glaring example was the monopolization of the coconut export industry in 1979.[25] In the mid-1970s foreign and joint venture firms dominated the industry. In the coconut oil milling industry were Southern Oil Mills (joint venture of Aboitiz, San Miguel Corporation, and Fuji Oil Company and C. Itoh), Iligan Coconut Industries (joint venture of Lu Do Development Corporation, Jardine Davies, Michimen and the Private Development Corporation of the Philippines), and Legaspi Oil (Ayala Corp. and Mitsubishi). Copra export was dominated by foreign firms particularly American Cargill-owned Granexport Corporation, the largest in Southeast Asia.

In 1979, firms were forced to sell to the government and allied business interests. Starting in January, the Ayala-Mitsubishi firm, Legaspi Oil Company, sold out apparently because of an October 1978 memorandum from the Philippine Coconut Authority (PCA) raising the export duty from approximately US$1.75 to US$35 per metric ton. A month after the sale of Legaspi Oil, the PCA lowered the duty to US$17.95.[26]

In September 1979, the President issued Letter of Instruction No. 926 creating the United Coconut Mills (UNICOM), which placed all private firms under its management and control. UNICOM was a private firm controlled by Defense Minister Enrile and Assemblyman Eduardo Cojuangco, who also owned the United Coconut Planters Bank (UCPB). In November, UCPB bought Granexport Corporation and its oil-milling subsidiary. These moves manifested the powerlessness of ordinary private sector firms against crony and State encroachments.

Other industries were affected by arbitrariness in government policy that ultimately favoured crony firms. In the automotive industry, foreign firms like GM and Ford had been stung by changes in component export manufacturing policy to offset local content requirements.[27] These and other adversely affected firms would eventually pull out from the Philippines.

Favouritism was also manifested in the bailout of firms. When the 1981 financial crisis erupted, the weaknesses of highly leveraged crony businesses and state companies were exposed. Prominent among the private firms were those owned or controlled by Marcos cronies like Herminio Disini's Herdis Group, Roberto Cuenca's Construction Development

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[25] See Bello (1982) and Salgado (1985).

[26] Salgado, P. (1985: 102).

[27] Bello (1982: 189) reports that GM and Ford were led to invest in export parts manufacturing as a way of offsetting the local content requirement for cars assembled and sold in the Philippines. After making the investments, a decree was issued providing that component export would only offset 15% of local content requirement.

Corporation of the Philippines (CDCP) and Ricardo Silverio's Delta Motors (assembler and distributor of Toyota vehicles). Among several government firms in distress were the Philippine Airlines (PAL) and the Development Bank of the Philippines (DBP). As a matter of policy, government stepped in to rescue distressed firms but the more remarkable bailout cases were those owned by Marcos favourites. The massive bailout of CDCP alone cost the government about US$660 million as of early 1983. The DBP, along with the Central Bank, tried to bail out crony firms but in the process also fell into trouble.[28]

By 1983, a document from the U.S. embassy reported a "creeping state capitalism" in which the Marcos government controlled the steel, mining, and banking industries. The report also indicated that some 300 government corporations some of which formerly private (and crony) companies were bailed out by the government (Blitz, 2000).

Some government regulatory policies did not necessarily favour crony firms but were nevertheless arbitrary and inconvenient for foreign investment. For instance, when Prime Minister Yasuhiro Nakasone visited Manila in May 1983, ten Japanese trading firms issued a petition to the Philippine government requesting the relaxation of the policy Filipinizing the management of foreign firms. The ten firms were C. Itoh, Kanematsu Gosho, Kawatetsu Bussan Co., Marubeni Corp., Mitsubishi Corp., Mitsui and Co., Sumitomo Corp., Nichimen Co., Nissho-Iwai Co., and Toyo Menka Kaisha. The policy, as contained in the Labor Code, was aimed at saving on payroll costs (as well as foreign exchange) but in effect discouraged the hiring of expatriates.[29] The government policy on the employment of foreign nationals translated to the practice of issuing alien employment permits and visas valid for only three months. The policy clearly inconvenienced the 140 Japanese branch office managers in the *sogo shosha* operating in the Philippines. Therefore, they appealed for the relaxation of the foreign employment policy so that they could stay for two years without having to renew their employment permits. The petition of the *sogo shosha* was not taken up during talks between Nakasone and Marcos.[30]

Such government policies support claims that the Philippines discriminated foreign investors (Yamagata, 1998; Yoshihara, 1978). It was not until the 1990s that the country generally welcomed foreign investors (Thomsen, 1999:4).

[28] Guy Sacerdoti (1983) "A bailed-out case, FEER, *March 24*; Guy Sacerdoti. 1983. "Rescuer needs rescue," *FEER*, February 17; Guy Sacerdoti (1983) "Favouritism still in favour," *FEER*, June 30.

[29] The hiring of expatriates and other foreign professionals such as teachers depended on the graces of the Bureau of Local Employment and Bureau of Immigration.

[30] Leo Gonzaga (1983) "Refusing to bow," *FEER*, June 16.

2.4 International Support to the Regime

Official Assistance

ODA to the Philippines appeared indifferent to the resentments and anxieties that foreign lenders and investors bore toward the Marcos government. As long as the United States maintained its support to the Philippines, substantial amounts of allied ODA flowed.

The administration of U.S. President James Carter (1976-80) exerted pressure on Marcos to restore democracy and improve its human rights record. Marcos restored "democracy" by calling legislative elections in February 1978. However, the Philippine president also used the military bases in order to secure additional assistance even from the critical Carter administration. The 1979 agreement allowed the United States the use of the military bases in the Philippines up to 1991 in exchange for aid amounting to US$500 million over a period of five years. The Carter administration also approved support for World Bank loans to the Philippines (Blitz, 2000). It is interesting to note that in 1980 the Carter administration was able to persuade Marcos to let go of an incarcerated Aquino to undergo heart surgery in the U.S.

Ronald Reagan succeeded Carter to the U.S. presidency. He was more supportive and was an "uncritical ally" of Marcos, who it is believed strongly supported the former's presidential campaign. Official assistance to the ailing Philippine economy increased in 1981 but dropped in 1982 due to global economic difficulties (see Figure 2.6). In June 1982, during its annual meeting in Tokyo, the consultative group of 12 donor countries pledged to the Philippines US$1.2 billion in ODA and a foreign borrowing program amounting to US$2.3 billion for 1983. Included in the ODA package were grants and loans from the WB and the ADB totalling US$870 million. Japan committed bilateral assistance of US$250 million.[31]

In September 1982 Marcos went to Washington for an official state visit. The visit was a success and Marcos returned with a pledge from Reagan of US$900 million over a five-year period 1984-89. The amounts were of course subject to U.S. legislative constraints (Blitz, 2000: 143).

Things looked bright and encouraging for the Philippines up to July 1983 with pledges of official support particularly from the U.S. and Japanese governments. An IMF loan was approved in February though subject to unusually tough conditions. In May, Prime Minister Yasuhiro Nakasone visited Manila pledging at least US$325 million in yen credits, special loans, and technical aid.

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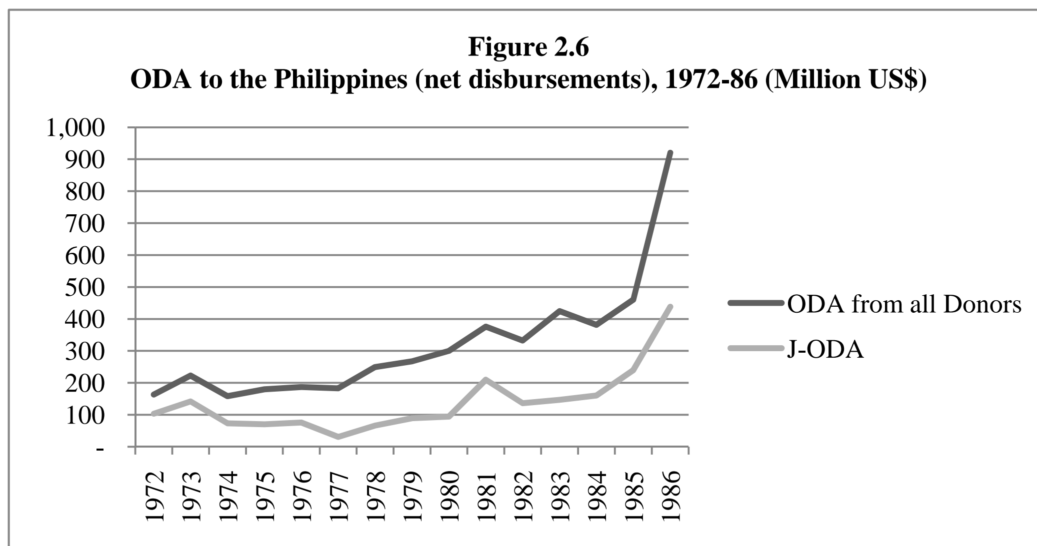
[31] These commitments to support the financially-strapped Philippine economy changed afterward, especially when the repercussions of the Mexican default came to be felt by international lenders.

Figure 2.6
ODA to the Philippines (net disbursements), 1972-86 (Million US$)



Source: OECD DAC

In July 1983, a World Bank-sponsored consultative group of aid donors aimed a higher level of support than the US$1.2 billion promised for the year. The economic assistance would enable the Philippines to reduce its BOP deficits to US$598 million and US$269 million in 1983 and 1984, respectively. Realizing that the country would not be able to meet targets under the IMF programme, the donors were nevertheless encouraged by measures taken by the Philippine government including the peso devaluation in June, the raising of oil prices, and the suspension of some MIPs. It was said that during the consultative group meeting of aid donors, the U.S., Japan, and Germany threw their unreserved support for the Philippines.[32]

Then, to paraphrase Blitz (2000: 144), the political winds shifted. The IMF programme was cancelled when the mid-year review revealed economic targets were not strictly met. Then, the international stir from the Aquino assassination prevented unqualified support of the Marcos government by the Reagan administration. The media reports on the Aquino assassination created a public outcry and official resentment in Japan. On board the plane and accompanying the former senator were three Japanese media representatives, who shared their accounts to the Japanese public.[33] Japanese public interest in the Philippines increased afterward. According to Wurfel (1986), prior to the assassination, Asahi Shimbun's coverage of the Philippines averaged only 12 column centimeters per day. After the assassination, the coverage increased to 67.5 column centimeters.

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[32] G. Sacerdoti and M. Subhan (1983) "Keeping faith in Manila," *FEER*, July 21.

[33] The three were Togo Tajika (Tokyo Broadcasting System), Katsuo Ueda (Kyodo news agency), and Kiyoshi Wakamiya, free lance journalist. See Blitz (2000)

In December 1983, while waiting for the IMF seal of approval, the Philippines turned to the United States and Japanese governments for bridge financing until such time that the IMF decided to resume loans to the country. The application was declined in the United States and it was suggested that the Philippines wait for IMF action (Dohner and Intal, 1989: 532). As Blitz (2000) argued, after the Aquino assassination, the Reagan administration tried to publicly distance itself from supporting Marcos in view of the upcoming U.S. elections.

On the other hand, upon the request of the Philippine government, the Japanese government indicated that it would certainly help ease the former's debt problems. However, it could not ascertain the amount, kind, and timing of the assistance, which depends on the agreements between international agencies and commercial banks. [34] Moreover, the government's Philippine policy appeared to hinge also on Japanese public sentiments. The Japanese government had to cautiously divide the issue of economic cooperation from the Aquino assassination, which had received some public sympathy. In a March 1984 press interview in Tokyo, Aquino's brother appealed to the Japanese government not to sustain Marcos (Atarashi, 1985:124). Thus, in light of external and internal factors, it took some time for the Japanese government to provide fresh official support to the Philippines other than those previously pledged. Eventually however, a loan from Japan came. Aquino's brother and his anti-Marcos allies demonstrated outside of the Japanese embassy burning effigies of Nakasone, Reagan and Marcos (Wurfel, 1986).

International Publicity

The Marcos government faced several economic and political trials during the period 1979-83. However, it could not overcome the negative publicity it generally received from the international media. For instance, in May 1983 banks were already jittery because of the debt crises that had spread from Mexico to Latin America and Eastern Europe.

Interviews conducted by the *Far Eastern Economic Review* among bankers revealed worries about the erosion of export performances in South Korea, Indonesia, the Philippines, and Malaysia. Of the four countries, it was believed that the credit lines to Korea and the Philippines had been badly strained. Bankers thought that the Philippines was more reasonable than Korea in accepting stiffer terms for loans received. However, many banks accordingly shied away from Philippine deals because of negative publicity. As one banker said, "Head offices in New York and London have become frightened by adverse—and, in my opinion, alarmist—press publicity about Manila. They do not want involvement in the Philippines."[35]

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[34] Mike Tharp (1983) "Japan will extend a helping hand, but slowly," *FEER*, December 15.
[35] C.C. Hye (1983) "Banks are now jumpy about lending anywhere," *FEER*, May 5.

Third World dictators were natural targets of the liberal members of the international mass media. During the Carter years, the latter reported on poverty, insurgency, and human rights in countries like Nicaragua, the Philippines, and Iran. The Philippine opposition in the United States frequently sought the media as an alternative channel to express its views and shape policy (Blitz, 2000: 185, cf26).

2.5 Debt, FDI, and the Marcos Regime

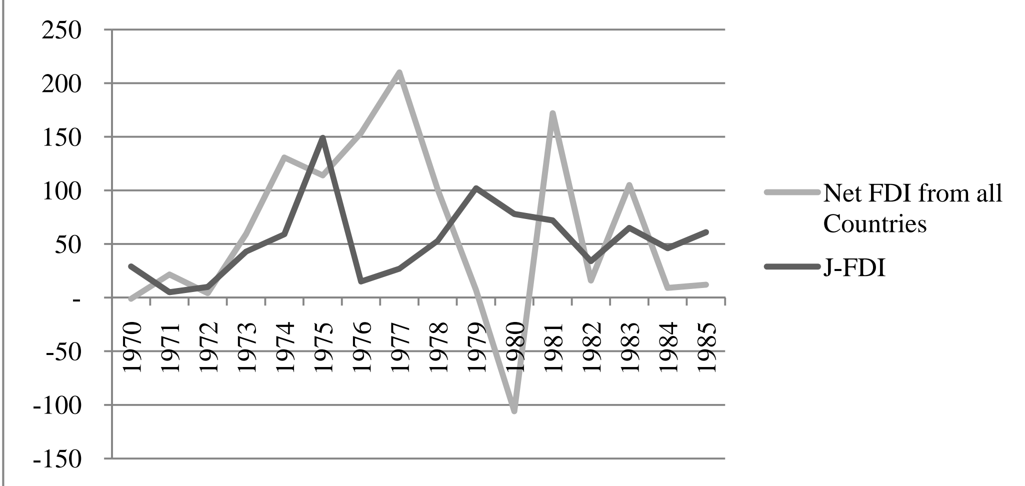
Since the late 1970s, several factors discouraged external financing of the ailing Philippine economy under the Marcos government. These included the state of Marcos's health and the succession issue, arbitrary state regulation and crony capitalism, as well as the growing strain between with the government and the IMF. Previous studies have taken as given that external finance has simply dried up in the early 1980s. However, other country experiences (as shown here Korea and Thailand) reveal the availability of external finance, however limited, during those difficult years. As Naya and Imada (1990:33) observed, debt was a limited problem in Asia and funds were generally available; however, they noted that only the Philippines had been subject to really strong pressure from the international banking community.

Despite this pressure, the Marcos government managed to recover official support based on the results of the July 1983 meeting of the consultative group of donor countries. The renewed pledge of financial support to the Philippine economy, assuming continued reduction in government spending, was projected to alleviate external payments difficulties in the next two years.

In 1983, the strength of multilateral support to the Marcos regime might have drawn a few millions of US dollars in FDI to the Philippines (Figure 2.7). FDI from Japan provided the bulk of support in 1983. Part of this came from Japanese car companies like Nissan and Toyota. Toyota Corporation infused a 10% equity share into its Philippine licensee Delta Motors, a crony firm that became insolvent after sustaining losses and accumulating debt in the early1980s. Following rescue attempts, the government took over the company and Toyota also earned two seats.

Whereas FDI in 1983 went up, the events since August 21 overcame whatever goodwill was planned for the Philippines. Note in Figure 2.7 that J-FDI flows to the Philippines from 1979 to 1982 assumed a sluggish pattern. That trend is consistent to problems suggesting the inhospitableness of the Philippine investment environment since 1979. In 1984, in the midst of foreign exchange shortages, firms like US carmaker Ford and Japanese textile giant Teijin withdrew from the Philippines. The pull-out occurred despite the policy issued by the Marcos government on December 6, 1983 allowing foreign investors up to 100% foreign ownership in non-pioneer industries.

Figure 2.7
FDI flows to the Philippines (net), 1970-85 (US$ millons)



Note: Japanese FDI data are notifications to the government and may be overstated.
Source: World Bank for net FDI flows; J-FDI data from Japan Ministry of Finance.

3. Japanese FDI to the ASEAN and Regional Security

A piece of the puzzle of why the Philippines was left behind in the region has been brought up by Bello (2004). Accordingly, Japanese investments spelled the difference in economic performance between the Philippines and her neighbours since 1985. Why the Japanese avoided the Philippines, Bello (2004: 20) said that neither foreign investment legislation nor corruption figured out in J-FDI locational preferences. High-growth countries like South Korea, Indonesia, and Thailand were as corrupt as the Philippines. Moreover, like the Philippines, Thailand discriminated against investments. So his argument was that the Philippines represented a “strategically-depressed” market.

In the previous chapter, it has been pointed out that Japanese multinationals encountered difficulties relating to the investment climate under the Marcos regime. The investment climate thus discouraged further investment and in the aftermath of the Aquino assassination, even capital withdrawals from the country.

As set out in the Introduction, government suasion has been also instrumental to directing FDI locational decisions. This chapter explores this possibility in Southeast Asia during the late 1970s to the early 1980s. Evidence is provided suggesting path dependence.

3.1 The Stock and Flow of Japanese FDI in the ASEAN-4

The 1985 Plaza Accord realigned the US dollar to other major currencies of the world. For Japan, the result was the steep appreciation of the yen (*endaka*). One of the effects of the yen appreciation was the remarkable spike in the trend of moving export-oriented manufacturing firms to cheaper production platforms abroad. East Asian countries were major hosts of J- FDI. By 1996, the stock of J-FDI in the region was more than US$78.4 billion, with US$8 billion placed in China. In the same year, the ASEAN-4 countries, comprising Indonesia, Malaysia, Thailand, and the Philippines, accounted for more than half of the J-FDI stock in East Asia (US$41.6 billion). Figure 3.1 shows the FDI stock in the ASEAN-4 countries in 1996. The chart suggests the relative attractiveness to FDI of each of the four countries.

Figure 3.2 shows the yearly flows of FDI to the ASEAN from 1976 to 1996. Flows to Indonesia and Malaysia have been remarkable. Flows to the Philippines increased around the mid-1990s during the Ramos administration following the resolution of the 1989-93 power crisis. Still, the flows to the Philippines paled in comparison to the other three ASEAN countries.

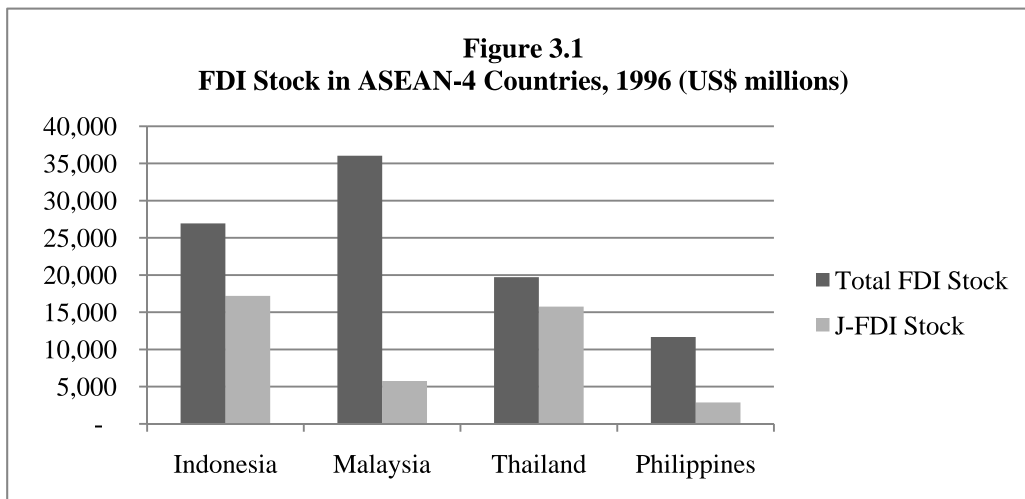


Figure 3.1
FDI Stock in ASEAN-4 Countries, 1996 (US$ millions)

Sources: World Investment Report for total FDI stock and Ministry of Finance for J-FDI.

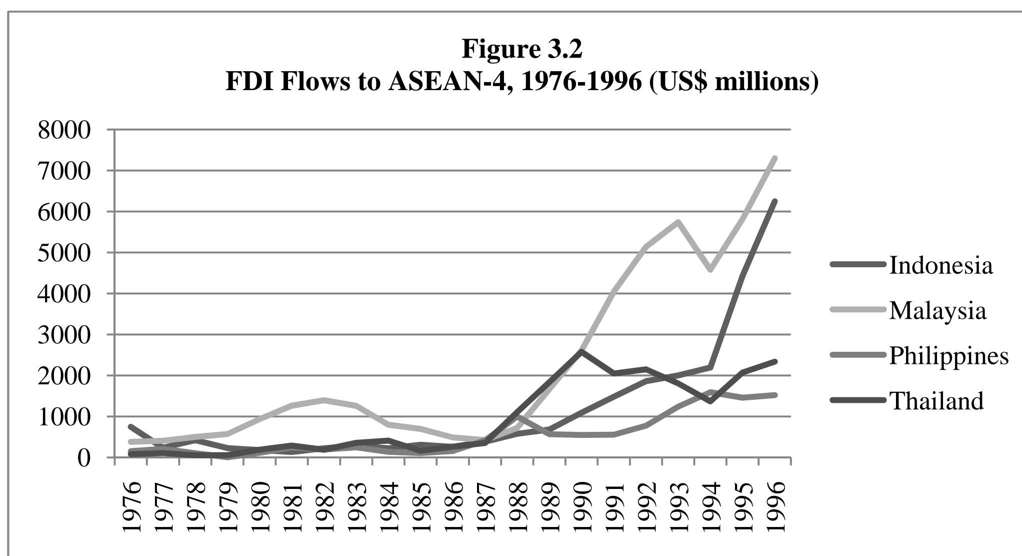


Figure 3.2
FDI Flows to ASEAN-4, 1976-1996 (US$ millions)

Source: UNCTAD

The available historical data on J-FDI flows to the ASEAN-4 have been compiled by JETRO from Japan Ministry of Finance data. The data are based on reports/notifications to and approvals of the Ministry of Finance. Based on Phongpaichit (1990:108), the data may tend to be overstated since some projects may not take place in the year reported and in other cases, the projects are not be realized. Thus, the data have to be treated with caution and could be used to indicate trends rather than actual investments.

Tables 3.1 to 3.2 show the amounts and number of cases of J-FDI flowing to the ASEAN-4 countries from 1965 to 2000. The data have been further subdivided into five-year periods. Up to the year 2000, Indonesia was the largest recipient of J-FDI flows, with a cumulative amount of US$25 billion. Thailand followed with close to US$14 billion and Malaysia with US$9 billion. The Philippines was the least recipient with US$5 billion during the 35-year period. The trend in the number of reported cases of FDI follows the same order as that of the amounts of flows. Indonesia led the pack with the Philippines at the tail end (Table 3.2).

The Philippines was generally the least favoured site but as shown in Table 3.1 a great spurt in J-FDI flows occurred in the 1970s. During the period 1975-79, the amounts of J-FDI flows to the Philippines were greater than those going to Malaysia and Thailand. There were also more cases that headed toward the Philippines during the period.

During the period 1980-84, a drastic fall in J-FDI flows and cases to the Philippines could be observed. From 259 cases in 1975-79, only 115 cases registered going to the country in 1980-84. A similar occurrence happened to Malaysia and Thailand during the period 1970-74. However, afterward they experienced a rising trend in J-FDI cases.

Table 3.1
Cumulative Amounts and Shares of Japanese FDI in ASEAN-4, 1965-2004
(US$ million)

Period Totals	Indonesia	Malaysia	Philippines	Thailand	Total	Period Share of Total Cumulative JFDI (%)
1965-1969	159	22	20	45	246	0.5%
1970-1974	996	213	146	117	1,718	3.2%
1975-1979	2,705	254	346	169	4,946	9.1%
1980-1984	4,121	541	295	348	8,779	16.1%
1985-1989	2,420	1,461	491	2,557	12,234	22.5%
1990-1994	6,546	3,850	1,496	3,916	22,736	41.8%
1995-2000	8,608	2,986	2,818	6,752	36,972	68.0%
Cumulative Total	25,555	9,327	5,611	13,904	54,398	100.0%
Share of Cumulative JFDI (%)	47%	17%	10%	26%	100%	

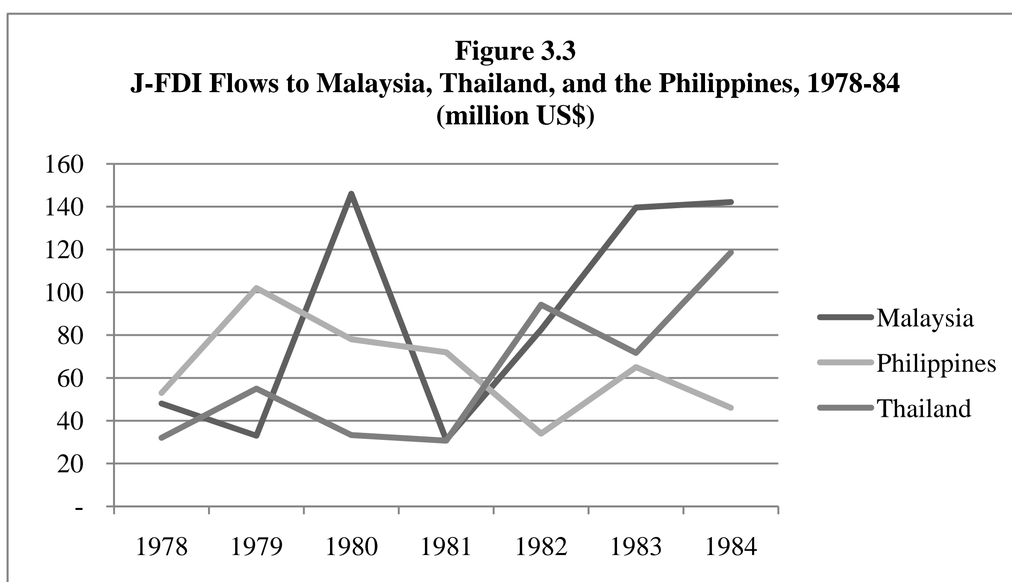
Source: JETRO compiled from MOF data.

Table 3.2
Cumulative No. of Cases and Shares of Japanese FDI in ASEAN-4, 1965-2004

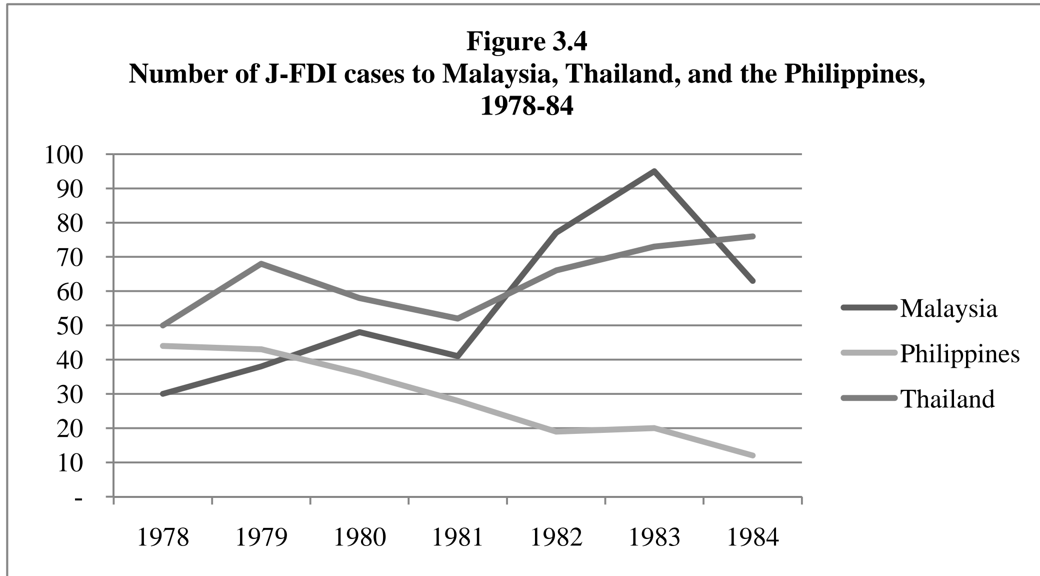
Period Totals	Indonesia	Malaysia	Philippines	Thailand	Total	Period Share (%)
1965-1969	35	40	44	110	229	2%
1970-1974	399	289	180	253	1,350	13%
1975-1979	437	180	259	209	2,206	22%
1980-1984	439	324	115	325	2,288	23%
1985-1989	399	461	177	1,086	3,326	33%
1990-1994	656	559	276	1,018	4,632	46%
1995-2000	622	286	318	642	4,377	43%
Cum. Total	2987	2139	1369	3643	10138	100%
Country Share (%)	29%	21%	14%	36%	100%	

Source: JETRO compiled from MOF data.

A closer comparative snapshot of the period 1978-84 is shown in Figure 3.3 presenting flows to Malaysia, Thailand, and the Philippines. What the chart indicates for the Philippines is that beginning in 1979, there was declining pattern in the amount of J-FDI flows. A similar pattern is also evident in the number of J-FDI cases to the three countries during the period (Figure 3.4). Indonesia was not included in the charts but the amounts and cases are highest among the three.



Source: JETRO, Ministry of Finance



Source: JETRO, Ministry of Finance

What might account for this sudden variation in the pattern of J-FDI flows to the ASEAN-4? On the one hand, as pointed out in the previous chapter, the Philippine investment climate increasingly became inhospitable, discouraging Japanese and other foreign businesses. Alburo and Sicat (1983) observed that the Dewey Dee incident might have dampened the enthusiasm of Japanese multinationals. Bello (1982:188) argued that while foreign investors were generally alarmed over competition from the Marcos cronies, there were also favoured multinationals including Japanese ones by virtue of their affiliation to crony capitalism.

On the other hand, the pattern of J-FDI flows may not necessarily be connected to the Philippines at all. From a review of major historical events since 1978, what emerges is the rise of uncertainty in the region due to the second oil crisis, the Vietnamese invasion of Cambodia, and the shift in Japan's foreign policy toward the ASEAN countries.

3.2 Shifts in Strategic Importance

Since 1951, Japan's regional security policy had been tied to its security treaty with the United States. However, Japan's rise as an economic power since the late 1960s led to regional strategic concerns independent of the United States. Thus Japan's regional policy could be seen as both shaped by its treaty with the United States as well as its own strategic preferences.

US-Japan Security Treaty and the Indochina Problem

The 1960 United States-Japan Security Treaty required that both countries be involved, "at the request of either party, whenever the security of Japan or international peace and security in the Far East is concerned" (Article IV). This treaty nonetheless Japan was constitutionally constrained to extend military assistance in defense of the Far East. Article IX of Japan's Constitution prohibited threats and use of force in settling international disputes. Therefore, Japan's contributions to regional peace and security were limited to diplomatic, economic, and cultural activities. When Japan established itself as an economic power, the United States increasingly sought positive non-military contributions from her for the maintenance of regional stability.

The tensions of the Cold War in East Asia subsided for a while after the end of the Vietnam War in 1975. However, the region was essentially divided by alliances to the three superpowers—United States, China, and the Soviet Union—even if some countries expressed non-alignment. Vietnam broke off ties with China in 1968 after reaffirming its allegiance to the Soviet Union during the Sino-Soviet rift. Tensions resumed with the Soviet Union military build-up and the Vietnamese invasion of Cambodia (Akaha, 1991).

On Christmas day 1978, Vietnam invaded Cambodia (called Kampuchea after the communist victory there). The invasion signalled the start of Vietnamese hegemony in Indochina and tensions heightened on the Thai-Kampuchean borders. In January 1979, China retaliated with attacks on Vietnam. Concerns on the Indochinese situation heightened when large numbers of refugees fled Indochina. Refugees from Vietnam for instance fled took to the South China Sea by boats.

Thailand suddenly became a "frontline state" in the Southeast Asian theatre of the Cold War. The U.S. response was to increase military and economic support. It also tried to convince Japan, which had been assuming a "low-profile" to raise its economic assistance to Thailand (Morrison, 1988; Akrasanee and Prasert, 2003). This was also revealed in the testimony of former Ambassador John Gunther Dean (2000:314):

> *"I realized during my tenure from 1981-85 that, while the United States still had a great deal of influence in Thailand resulting from our constructive role in the past, the time had come for Thailand also to work with other countries, and to reduce the American predominance. We encouraged the Japanese to be generous in their economic development aid to Thailand. More and more U.S.-Thai relations turned around military and security considerations, with the U.S. giving them top priority, while the Thai preferred projects, which developed their economic/social potential."*

Incidentally, Japan's intention to expand assistance to Thailand and countries along the Malacca Straits developed as part of the comprehensive security policy that it adopted in the early 1980s. As such, Japanese economic assistance to Thailand increased dramatically during the period. (Table 3.3). In Morrison's (1998: 426) observation, "The articulation in

Table 3.3
Comparative figures for U.S. and Japanese Aid to the ASEAN countries, 1970-84

ASEAN Country	Source of Aid	Total ODA gross (millions US$ and percent of DAC bilateral total)							
		1970		1975		1980		1984	
Indonesia	Japan	128.8	27%	209.6	37%	426.1	42%	286.3	37%
	US	195.0	42%	98.0	17%	146.0	14%	114.0	15%
Total ODA gross		461.0		563.5		993.4		764.6	
Malaysia	Japan	2.2	7%	64.6	64%	81.2	62%	270.5	82%
	US	3.0	10%	2.0	2%	1.0	1%	0.0	
Total ODA gross		28.2		100.5		129.0		330.6	
Philippines	Japan	19.2	44%	72.1	44%	109.6	48%	190.1	48%
	US	21.0	48%	65.0	39%	53.0	23%	137.0	35%
Total ODA gross		43.6		163.7		226.3		396.0	
Singapore	Japan	5.8	21%	7.6	67%	8.0	47%	32.5	72%
	US	0.0		0.0		0.0		0.0	
Total ODA gross		27.2		11.2		16.9		42.5	
Thailand	Japan	16.9	23%	44.4	52%	196.9	61%	260.0	66%
	US	37.0	50%	14.0	16%	17.0	5%	36.0	9%
Total ODA gross		73.2		84.0		319.6		390.6	
5 ASEAN country total	Japan	172.9	27%	398.3	43%	821.8	49%	1039.4	54%
	US	256.0	40%	179.0	19%	217.0	13%	287.0	15%
Total ODA Gross to ASEAN		633.2		99.9		1685.2		1927.0	

Source: Charles E. Morrison (1988: 440). "Japan and the ASEAN Countries: The Evolution of Japan's Regional Role," in Inoguchi, Takashi and Okimoto, Daniel, eds. *The Political Economy of Japan*, Vol. 2: The Changing International Context. Stanford: Stanford University Press.

1980 of the concept of a Japanese role in promoting comprehensive security, including that of the ASEAN region, does provide for expanding assistance based on security considerations, as noted in the case of Thailand." Table 3.3 shows the increasing trend in Japanese and U.S. aid to Thailand, as the latter's strategic importance to regional stability grew. Similarly, the increased flows of J-FDI to Thailand since the early 1980s could be seen as resulting initially from the latter's increased strategic importance to Japan. U.S. ODA to the Philippines went down and up during the Carter and Reagan administrations.

Japan's Economic Security

With the end of the Vietnam War in 1975 and the withdrawal of United States' troops from Indochina, Japan was poised to expand diplomatic and economic ties in Southeast Asia. It had already opened ties with China by recognizing it in 1972. While realizing its vulnerability to external shocks, it also felt "alienated from some of its neighbours, whose importance as raw material providers had just been highlighted by the oil embargo" of 1973 (Morrison, 1988: 420).

Thus, amidst the then prevailing Southeast Asian distrust toward the Japanese, in August 1977, Prime Minister Takeo Fukuda toured the region bearing a mission of friendship. Only a few years earlier, Prime Minister Kakuei Tanaka's visit of Southeast Asia was greeted by vehement demonstrations in Jakarta and Bangkok. Fukuda was more successful than Tanaka.

In Manila, he laid down what came to be known as the Fukuda Doctrine. Fukuda expressed that Japan's 1) commitment to peace and her rejection of military power; 2) desire to build "heart to heart" relationships with Southeast Asian countries based on mutual confidence and trust, and 3) intent to maintain peace and prosperity in Southeast Asia through positive cooperation with ASEAN and fostering mutual understanding with countries of Indochina. During this tour, Fukuda also expressed increased Japanese aid and investments to Southeast Asia. This meant the expansion of economic ties through increased trade, ODA (loans and grants), and FDI.

In 1980, Japan adopted a comprehensive security policy (*sogō anzen hoshō*) in view of the heightened instabilities that it faced (Sudo, 2002; Akao, 1983; Akaha, 1991). The policy was officially endorsed in 1981 by Prime Minister Zenko Suzuki (Akaha, 1991) but its informal adoption dated earlier with the dramatic increase in aid to Turkey, Pakistan, and Thailand following the Soviet invasion of Afghanistan (Akaha, 1991; Sudo, 2002).

The oil crises of the 1970s led to the realization that it was not only the politics of the Cold War but also others that potentially threatened Japan's economic security. As Inoguchi (1988:40) observes, "The first oil crisis brought home to the Japanese that Japan's survival depended virtually on every corner of the world and forced Japan to plan for emergencies

with such economic security programs as energy and resource diversification, energy conservation, and self-sufficiency in food.”

The oil crises were in fact politically instigated. The first crisis was triggered by the 1973 embargo imposed by the Organization of Arab Petroleum Exporting Countries (OAPEC) in reaction to U.S. support of Israel during the Yom Kippur War. The second crisis, occurring in 1979-1980, was brought about by Iran’s revolution and the subsequent Iraq-Iran war the year later. Oil production in these two countries was disrupted and prices were jacked up.

Japan’s economic security depended heavily on energy and oil supplies. In this regard, the shipping lanes from the Straits of Hormuz through the Malacca Straits to Japan were considered as strategic (Akao, 1983; Atarashi, 1985). According to Akao (1983:16), over 70% of oil bound for Japan passed through the Straits of Hormuz; one third of Japan’s trade, including 80 percent of oil imports passed through the Malacca straits. The passage of Japanese vessels along the Malacca straits had to be secured. As such, the political and economic stability in the Malacca Straits was vital (Atarashi, 1985; Akao, 1983).

By virtue of their location and under conditions obtaining during that period, Thailand, Singapore, Malaysia, and Indonesia were strategic to Japan’s security (see Figure 3.5). Thailand was also important because of its position in the Indian Ocean and Indochina. In the 1970s, Japan considered the construction of a canal or pipeline across Thailand’s Kra Isthmus as an alternative to the Malacca Straits (Akao, 1983: 19).

These security considerations plus the search for cheaper production sites for Japanese factories in the 1970s raised the strategic importance of the ASEAN countries, especially those along the oil shipping lanes to Japan. The concept of comprehensive security thus dictates that Japanese economic assistance be stepped up in favour of these strategically important areas. Economic assistance comprises the “trilogy” of aid, trade and investments (Sudo, 2002: 66).

Figure 3.5 Map of Southeast Asia

Source: MapCruzin.com. Retrieved on November 6, 2010 from <http://www.mapcruzin.com/free-world-maps/free-southeast-asia-map.htm>

3.3 Suggestion of Path Dependence?

Both historical accidents and strategic responses created a path that was self-reinforcing to ASEAN countries whose relative strategic importance to Japan increased in the late 1970s and early 1980s. Benefits from earlier investments placed on these countries created a positive feedback process that paved the way for future additional investments.

Southeast Asian countries, including Thailand, were not aware of the financial tsunami headed their way following the 1985 Plaza Accord. They were all having serious economic difficulties during the first half of the 1980s. According to Montes (1997) several Southeast Asian countries were struck by financial and economic crises in the first half of the 1980s. Indonesia was hit in 1983, Thailand in 1984, and Malaysia in 1984-85 while Singapore experienced a serious economic slowdown. The Philippines suffered the most from the crisis of 1983-85.

Up to the first half of the 1980s, J-FDI to Southeast Asia was mostly oriented towards import-substituting markets and natural resource development. There was however an awareness of the increasing trend in relocations of Japanese factories to Southeast Asia. For instance, in the early 1980s, Chinwanno and Tambunlertchai (1983: 218) wrote:

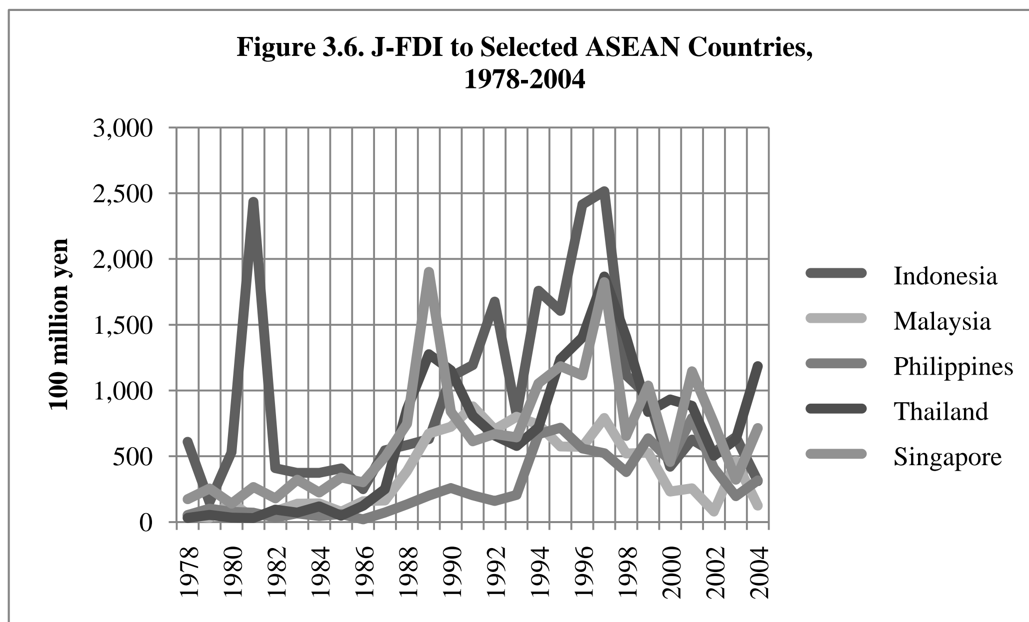
> *"How much of the Japanese investment will go to each ASEAN country will again largely depend on market and resource conditions, as well as on the investment policy and environment there. Among the ASEAN countries, Thailand is not likely to get a significant share of Japanese investment. Nevertheless, the types of industry in Thailand which would most likely attract Japanese investment participation will be those related to natural gas. Thailand may also obtain some Japanese investment in labour-intensive industries, or the labour-intensive part of assembly-type industries."*

After the yen appreciation set off by the Plaza Accord, export-oriented manufacturing FDI characterized most Japanese investments in Southeast Asia (Watanabe, 2003: 159cf1). Host country conditions became important considerations for such efficiency-seeking FDI since they sought cost-savings and high productivity for export-oriented manufacturing. In terms of investment policies and issues like corruption, crime, and political instability, there appeared to be no big differences among the ASEAN in the second half of the 1980s. However, those factors directly affecting production were critical to FDI locational preferences.

Montes (1997) argued that 1988 is the appropriate starting point to date the growth spurt in Southeast Asia. Accordingly, it was the year that Japanese companies extensively began relocating labour-intensive operations. Indeed, the MOF's data show that J-FDI

outflows were gradually picking up as early as 1987 (Figure 3.6). The flows of FDI were significant for all the ASEAN economies. In countries like the Philippines and Indonesia, the FDI (as well as ODA) helped provide foreign exchange and employment opportunities. In other countries, the effects were transformative. Thailand, for instance, eventually became the largest automotive manufacturer in the ASEAN (Watanabe, 2003). Accordingly, in 1996, it had 1,095 automotive-related companies against Malaysia's 297, Indonesia's 279 and the Philippines' 184. Employment from the automotive industry was 107,000 in Thailand versus 18,000 in the Philippines.

The amount of Japanese ODA to the ASEAN-4 was also substantial, amounting nearly US$36 billion from 1965 to 2004 (Table 3.4). Of the four countries, Malaysia was the least recipient with less than US$2 billion during the forty-year period. Indonesia was the top recipient with US$16.6 billion. The Philippines and Thailand received a cumulative amount of less than US$9 billion. However, in the 1980s, J-ODA utilization seemed to be more purposive in Thailand than in the Philippines. In other words, J-ODA appeared to fit a national development plan that was intended to produce a clearer development impact in Thailand.



Note: FDI flows based on notifications and reports to the Ministry of Finance
Source: JETRO based on Ministry of Finance reports.

Table 3.4. Cumulative Amounts and Shares of Japanese ODA (Net Disbursements) in ASEAN-4, 1965-2004 (In $ millions)

Period Totals	Indonesia	Malaysia	Philippines	Thailand	Total	Period Share (%)
1965-1969	335	15	204	31	585	2%
1970-1974	705	79	367	83	1,820	5%
1975-1979	1,001	249	332	420	3,237	9%
1980-1984	1,348	543	748	1,054	5,695	16%
1985-1989	3,160	544	1,996	1,676	11,069	31%
1990-1994	5,325	713	3,487	1,971	18,872	53%
1995-2000	4,789	(375)	1,860	3,238	21,009	59%
Cumulative Total	16,662	1,769	8,995	8,475	35,900	100%
Country Share (%)	46%	5%	25%	24%	100%	

Source: OECD Development Assistance Committee

Figure 3.7 Partial Map of Thailand

Source: mapCruzin.com. Retrieved on November 6, 2010 from <http://www.mapcruzin.com/free-maps-thailand/thailand_admin_2002.jpg>

The story of how Thailand became the largest automotive manufacturing site in ASEAN had its roots in Japan's regional strategic policy discussed earlier. Credible official and private commitments were made arising from this strategy. Watanabe (2003) shows how ODA in Thailand acted as a catalyst for FDI and industrial agglomeration. Her account relates to the development of the Eastern Seaboard (ESB). The ESB area, which lies 80 to 200 kilometers southeast of Bangkok into the Gulf Thailand, consists of three provinces. These provinces are, namely: Chachoengsao, Chonburi, and Rayong (see Figure 3.7). Since the 1970s, Thailand has expressed its intention to develop the area in order to decongest Bangkok.

The ESB has emerged as an important industrial site, especially for automotive parts manufacturing. From 22 during the period 1980-89, the number of parts suppliers' subsidiaries increased to 50 in 1996-99. The choice of location has been conditioned by the considerable development of infrastructure financed by Japan's ODA since 1982.

Japan's ODA in the ESB started with two loans in 1982 from the Japan Bank for International Cooperation (JBIC) for the development of a gas separation plant and water pipeline project. Then, in September 1983 a loan was provided for the conduct of a Development Plan and Engineering Study. Between 1982 and 2000, ODA loans from Japan Bank for International Cooperation (JBIC) financed 16 ESB projects to develop industrial estates, water pipelines, railways, roads, gas separation plants, reservoirs, and ports (Ichikawa, Cusumano, Polenske, 1991; Watanabe, 2003). Loan commitments amounted to a total of US$894 million, or 10% of Japan's cumulative loan commitments to Thailand (Watanabe, 2003: 142).

In the 1990s, automotive industry locators in Thailand were not merely the import-substituting assemblers that concentrated in Bangkok. The assemblers, like Toyota and Honda, decided to establish new factories in the area. General Motors and Ford followed the Japanese manufacturers in the mid-1990s. They have joined the FDI bandwagon to Thailand, making it their regional export hub (Watanabe, 2003: 146).

Going back to the Philippines, from 1994 to 2001, the country experienced a J-FDI rush although the amounts of investment still paled in comparison to the other ASEAN countries. This rush came at the heels of a prolonged power crisis that gripped the country since 1989. An economic region similar to Thailand's ESB was conceived and started in the late 1980s. This was the CALABARZON, which is an area comprising the provinces of Cavite, Laguna, Batangas, Rizal and Quezon in the Southern Tagalog region (or Region 4). Substantial improvements were still required for infrastructure supporting large-scale and heavy manufacturing activities in the area. Nevertheless, export manufacturing-oriented FDI located here during the Philippine economic boom of the mid-1990s. The increased exports along with rising overseas worker remittances of that period relieved the country of the severe foreign exchange difficulties experienced during the previous decade.

To end what would be a longer story, when efficiency-seeking FDI from Japan were ready to flood Southeast Asia in the second half of the 1980s, the Philippines was the least prepared to host foreign investors. Despite the tremendous worldwide appeal and pledges of assistance generated by President Corazon Aquino, high levels of insecurity marked her presidency. Yet as suggested by Figure 3.4, crime, coups d'état, policy uncertainty based on the contentious politics of various interest groups, high interest rates and inflation, and the huge debt service burden did not prevent FDI from coming in. It was the prolonged power crisis characterized by 12-hour brownouts that made the climate for export-oriented manufacturing once again inhospitable in 1989. That part of the story might easily be forgotten while the excesses of the dictatorship take a special place in our understanding of the Philippines' lost decade.

Conclusion

An approach to the question of why the Philippines was left behind by the HPAEs may necessitate the use of comparative and historical methods that consider conditions and events affecting not only the Philippines but other countries as well. This monograph has tried to examine certain domestic and international events that appeared pertinent to the narrative of the Philippines' lost decade of the 1980s. It finds that changes in domestic economic management as well as changes in the region's security landscape affected financial flows away from the Philippines.

In the 1970s, the Marcos government raised the country's dependence on external finance. It tried to attract FDI by providing investment incentives. It also borrowed heavily from abroad. For much of this period, the government enjoyed favourable relations with foreign governments, investors, and creditors.

Relations soured starting in the late 1970s as the excesses of the regime became apparent. Cases of multinationals being edged out of the competition in 1979, the arbitrary and discriminatory policies as well as the unevenness in the application of policies contributed to the underlying general resentments of foreign investors toward the regime. By 1982, crony capitalism was an established fact of Philippine economic life. Corporate bailouts of favoured firms as well as excessive public spending were major irritations for international creditors. In addition, the regime's human rights abuses were grave issues taken up by the Carter administration and the international press.

Given these underlying resentments, it was not surprising to find unfavourable foreign private sector responses to the shocks that occurred in the early 1980s, responses that seriously undermined the economy. Granted that foreign firms and banks operated under fixed investment budgets, it is not hard to imagine that the Philippines was not in their priority lists. Thus, when the shocks came, the economy experienced capital flight and the deceleration of fresh capital inflows from abroad.

Consequently, the Marcos government had to rely on official economic support, which though initially favourable, changed after the August 1983 Aquino assassination. The prolonged BOP crisis that ensued, signified by the October declaration of a debt moratorium and the delayed economic rescue, reflected the loss of international confidence in the Marcos regime.

Thus, during the period under study, the Philippines under the Marcos regime lost international favour. Despite investment incentives, government policies practically discouraged efficient business operations. International creditors were disappointed with how loans were

spent. Then, foreign governments had to distance themselves from the Marcos government because of international outrage over the Aquino assassination. J-ODA to the Philippines increased after Marcos as a consequence of the Japanese government's political support to the Aquino administration and the appreciation of the yen (Blaise, 2009:8).

At the same time, for strategic reasons not necessarily associated with the Philippines, other countries that were of top priority during 1979-83 seemed to gain international favour. Some of the initial commitments made in the region were path dependent. In Southeast Asia, expanded trade, investments and aid offered benefits not only to the recipient country but also to the investing parties. Japan's ODA in particular have been strategically provided to supporting economic goals and J-FDI has been found to follow in areas where J-ODA was high (Blaise, 2009; Kimura and Todo, 2009). An important linking mechanism is the public-private sector consultations in the formulation of development assistance programs (Arase, 1994).

The benefits from these activities and arrangements increased the attractiveness of ASEAN countries to foreign investment especially after the 1985 Plaza Accord when Japanese multinational corporations aggressively sought low-cost sites for their plant relocation strategies. Less FDI flowed to the Philippines because at that time it was the least attractive owing to its dark experience.

Granted that the main finding is valid, at least two policy lessons could be drawn from the study. First, the sequence of events based on domestic and foreign responses to shocks has considerable effects on national economic performance. This suggests that government should be able to craft its own responses carefully in relation to the shocks as well as to the foreign responses to these shocks. In this study, the Marcos government was initially somewhat oblivious to the effects of the shocks on foreign capital until the problem reached a precarious level in 1982-83.

The second point is that a policy of attracting FDI should be matched by governance improvements rather than by simple articulation of investment promotion policies, which was demonstrated in the Philippine experience. This point has an implication to contemporary developments. Since the 1990s, waves of bilateral and pluri-lateral FTAs have hit several parts of the world. FTAs may be construed as an opportunity for economic partners. Each partner may expect certain gains following an agreement. In 2008, the Philippines and Japan signed an economic partnership agreement (EPA). One of the expected benefits for the Philippines arising from this agreement is the infusion of J-FDI. While some inflows might be experienced, it is not certain whether the increase in FDI flows could be sustained. The review of the period 1979-83 suggests that domestic governance matters in sustaining capital inflows from abroad. But it matters more in order to unleash the potentials of domestic capital and human resources.

Appendix 1
Balance of Payments, Philippines, 1979-84 (million US$)

Quarter	Current Account	Capital Account	Financial Account	Current plus Capital and Financial Accounts	Net Errors and Omissions	Current, Capital, Financial Accounts and Net Errors and Omissions	Reserves and Related Items	Official Reserve Assets	Use of Fund Credit and Loans from the Fund	Exceptional Financing Transactions
Mar, 1979	-309		70	-239	62.901	-176.1	176.1	158.24	17.859	
Jun, 1979	-412		693	281	-94.63	186.37	-186.4	-184	-2.375	
Sep, 1979	-487		316	-171	156.97	-14.03	14.033	-64	78.036	
Dec, 1979	-288		484	196	123.71	319.71	-319.7	-372.4	52.721	
Mar, 1980	-429		262	-167	96.184	-70.82	70.816	-53.49	124.3	
Jun, 1980	-469		753	284	-34.56	249.44	-249.4	-199.8	-62.6	13
Sep, 1980	-675		788	113	-122.2	-9.201	9.2006	-140.1	149.35	
Dec, 1980	-344		881	537	184.72	721.72	-721.7	-769.9	48.203	
Mar, 1981	-203		212	9	42.587	51.587	-51.59	-185	50.447	83
Jun, 1981	-547		374	-173	-102	-275	275.03	161.28	46.744	67
Sep, 1981	-783		660	-123	-150.2	-273.2	273.25	151.87	46.381	75
Dec, 1981	-563		772	209	-276.9	-67.88	67.88	22.736	38.145	7
Mar, 1982	-820		238	-582	16.256	-565.7	565.74	576.53	-10.79	
Jun, 1982	-812		836	24	-123.9	-99.87	99.869	118.45	-20.58	2
Sep, 1982	-916		612	-304	491.42	187.42	-187.4	-180.3	-17.14	10
Dec, 1982	-664		1161	497	-747.7	-250.7	250.71	277.39	-26.67	
Mar, 1983	-739		176	-563	-57.32	-620.3	620.32	385.51	234.8	
Jun, 1983	-580		582	2	-517.8	-515.8	515.84	430.84	10	75
Sep, 1983	-607		-562	-1169	310.35	-858.6	858.65	777.26	-41.62	123
Dec, 1983	-845		-585	-1430	-71.28	-1501	1501.3	292.87	-48.59	1257
Mar, 1984	-509		-59	-568	22.903	-545.1	545.1	88.293	-62.2	519
Jun, 1984	-338		90	-248	11.521	-236.5	236.48	394.62	-62.15	-96
Sep, 1984	-385		540	155	14.529	169.53	-169.5	-102.4	-51.14	-16
Dec, 1984	-62		210	148	15.912	163.91	-163.9	-430	26.085	240
Mar, 1985	-15		-147	-162	-33.86	-195.9	195.86	162.35	-45.49	79
Jun, 1985	-22		617.99	595.99	533.1	1129.1	-1129	-193.4	-43.73	-892
Sep, 1985	-153	1	327	175	326.62	501.62	-501.6	-288	65.329	-279
Dec, 1985	154		-470	-316	-281.3	-597.3	597.28	417.3	187.98	-8

Source: CEIC Data

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3. Maps

Maps of Southeast Asia and Thailand were obtained from mapCruzin.com, downloadable.

4. Databases

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International Monetary Fund, International Financial Statistics

OECDStat

UNCTADStat and World Investment Reports (WIR), United Nations Center for Trade and Development (UNCTAD)

World Bank, World dataBank (World Development Indicators and Global Development Finance)

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