Behest Loans, Non-performing Assets, Low Growth - Deja Vu

Contributed by Edita A. Tan

The economic crisis that ended with the ouster of Ferdinand E. Marcos in the 1980s and that which led to the resignation of Estrada were both largely caused by the financial abuses that resulted in largescale wastes of investment resources. After a brief overview of the two crises, bad banking practices that led to the insolvency and high non-performing loan ratios of troubled financial institutions are described. They reveal the vulnerability of the financial system to political pressure and personalized banking, and cases of abuse of political power. The dismal national savings rate of the country is likewise discussed. Policy directions are suggested to correct such malpractices and proscribe their comeback.

The 1983-85 economic crisis had its main root in the grave misuse of financial institutions by Marcos and his cronies. We see a repeat of corruption of some financial institutions in recent years. In the 1970s and 1980s, the GFIs, particularly the Development Bank of the Philippines, the Philippine National Bank, the Philippine Veterans Bank and the Government Service Insurance System, were used

to funnel funds to crony hands ostensibly for investment. The practice was to front-end the loans, i.e., propose a project with little or no collateral, pocket the loan proceeds and invest a small fraction for show. The funds financed capital flight and other investments. Cronies raided their own banks. At the time the Central Bank was heavily involved in development financing allowing it to supply loanable

funds to banks and GFIs. The 1970s was also a time for large scale foreign borrowing and the Central Bank used this source to add to the funds that Marcos and his cronies could appropriate. The practice created the terms behest loans and front-ending.

The 1983-85 economic crisis that ended with the ouster of Marcos was largely caused by the financial abuses that resulted in large scale wastes of investment resources. The financial abuses have documented consequences. So many crony projects were left uncompleted or bankrupt, all the GFIs excepting for the Social Security System were left with a large stock of non-performing assets. The Philippine Veteran Bank was bankrupted and had to close down and the DBP, PNB and GSIS became insolvent and left with high NPL ratios of 65%, 35% and 50%, respectively. The Cory government was faced the choice of closing down the GFIs or restructuring their portfolios to their present worth. The latter was chosen with a proviso that they had to mobilize their own funds and no longer rely on central bank loans. The Asset Privatization Trust was created to manage the NPAs of the GFIs. The bad assets of DBP and PNB were taken over by the Trust, which meant reducing their resource level. The private banks including numerous small unit rural banks and some crony banks that became insolvent were allowed to close down.

Read full text (.pdf, 142kb, 15pp.)