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of the Philippine Economy in the Neoliberal Regime

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Abstract

Capital flight, measured as net unrecorded capital outflows, is the movement of capital from a resource-scarce developing country in order to avoid social controls. Capital flight from the Philippines was \$16 billion in the 1970s, \$36 billion in the 1980s, and \$43 billion in the 1990s, which are large amounts of resources that could have been utilized in the country to generate additional output and jobs. Capital flight from the Philippines followed a revolving door process—that is, capital inflows financed the capital outflows—and this process became more pronounced with financial liberalization in the 1990s. It is argued that capital flight contributed to the hollowing out of the Philippine economy and, more importantly, neoliberal policies underpinned the process.

1. Introduction

Proponents of neoliberalism argue that the neoliberal regime guarantees an economic environment that is stable, rapidly growing and developing, and so globalization, or even the freer reign of markets, will take care of basic human needs, including human development.¹ Moreover, it is argued that in a neoliberal environment, everyone benefits rather than only an influential segment in society. Furthermore, proponents of neoliberal economic policies argue that this idea is self-evident and it will be realized if, for example, the market is allowed to operate freely, if capital is allowed to move freely, and so on, unfettered by government controls and social regulations. After all, the market can effectively and efficiently mediate the actions of rational individuals on where to put and how to use their funds. Countries that fail to grow or are facing problems in realizing growth are therefore only to blame for their misfortunes because they are not instituting neoliberal policies. If they are implementing them, perhaps they are not doing it the right way. In which case, these countries must maintain their resolve in pursuing neoliberal policies.

Recent developments in the Philippines ushered by neoliberal reforms since the 1980s, including recent domestic adjustments to globalization and global economic

¹ “Neoliberalism” refers to the contemporary application of the (classical) free-market doctrines. It is characterized by the emphasis of markets over economic affairs, an enhancement of private sector’s role and scope, thus a reduction of the public sector involvement in various affairs, and the promotion of an understanding of what constitutes “sound” economic policies (that includes, among others, balanced budget, inflation targeting, and labor market flexibility). This approach is commonly referred to as “Washington Consensus”. Thus a “neoliberal regime” promotes neoliberalism in economic and social affairs, with the underlying idea that it leads to an economic environment that efficient, transparent, and less prone to crises. Although, in recent years, there have been modifications to the “Washington Consensus”, it can still be argued that the core elements have remained the same.

integration, might lead one to think that capital flight is not anymore an issue.² In fact, the contention is that with deregulation and financial liberalization, there should be no more capital flight because there will be no more incentives to avoid social controls.³ At the same time, economic reforms will provide the discipline mechanisms on macroeconomic policy, make foreign savings available to domestic entrepreneurs, etc., and so resources are put into building businesses and creating jobs and other infrastructures necessary for growth and development.

We found that capital flight remains a problem to the Philippines today.⁴ In fact, we found that in recent periods, capital flight increased. Moreover, we found that capital flight and external borrowing followed a revolving door process in which both types of flows are directly linked and reinforce each other. Of course, the economic and political crises reinforced the whole process, too. But, in the neoliberal regime, we argue that latest surges of capital flight are closely linked to deregulation and financial liberalization. That is, there are more opportunities for capital flight and external borrowing. With these findings, we point out that capital flight and external borrowing resulted in the hollowing out of the Philippine economy, thus undermining growth and development. We in turn elaborate how we arrived at these conclusions.

In the following section, we discuss the concept of capital flight and the methodology. Next, we present the results and analysis. We conclude the paper with a policy discussion.

² “Capital flight” is the movement of capital from a resource-scarce developing country to avoid social controls. Basically, we are measuring the net unrecorded capital outflows. “Social controls” refer to the actual or potential, as well as the formal and informal, controls on capital, which includes societal norms and expectations on the use of foreign exchange, the legal, extra-legal or non-governmental exactions on the use or allocation of resources, including taxation, the government’s capacity to direct resources into productive endeavors, among others, thus engendering growth, and consequently, realizing development. The degree and scope of social control can be extended or reduced if the economic and political circumstances warrant a change. See related discussions in Bowles and Gintis (1988).

³ “Deregulation” refers to decontrols on the interest rates, credit allocation, exchange rate, among others, and “financial liberalization” refers to decontrols on capital movements. In other words, the former is principally internally-oriented reforms, while the latter is principally externally-oriented reforms. On the debates, see for example McKinnon (1991), Caprio et al. (1994; 2001), Eatwell (1997), and Williamson and Mahar (1998); on the role of financial liberalization in the Asian Crisis, see for example Jomo (1998) and Chang et al. (2001), and in the context of capital flight, see for example Gibson and Tsakalotos (1993), Lensink et al. (1998), and Demir (2004). In the Philippines, deregulation started in the early 1980s, but only in the mid-1990s that wide-scale and aggressive financial liberalization was implemented, among others, opening of the capital account in 1993 (thus liberalizing capital flows) and deregulating the domestic banking sector. Deregulation of interest rate and foreign exchange rate were introduced much earlier in the 1980s.

⁴ Earlier studies on capital flight from the Philippines are Boyce and Zarsky (1988), Boyce (1992, 1993), Vos (1992), Lamberte et al. (1992), and Vos and Yap (1996).

2. Capital Flight: Concepts

Capital flight is the net unrecorded capital outflow, or the residual of officially recorded sources and uses of funds.⁵ Recorded sources of funds are net additions to external debt (CDET) and net non-debt creating capital inflows (NKI), where NKI is the net direct foreign investments (FDI), net portfolio investment equities (PORT), and other investment assets (OTH), while recorded uses of funds are the current account deficits (CAD) and accumulation of international reserves, including central bank sanctioned uses of foreign exchange (CRES). Thus we obtain a baseline measure of capital flight (KF) as follows:

$$(1a) \quad KF = CDET + NKI - CAD - CRES.$$

Note that data used in Equation 1a contain errors, we need some adjustments.⁶ In particular, we include an adjustment for the impact of exchange rate fluctuations on long term external debts (i.e., $CDET_{ADJ}$), trade misinvoicing (MIS), and unrecorded remittances (UNREMIT):

$$(1b) \quad KF = CDET_{ADJ} + NKI - CAD - CRES + MIS + UNREMIT.$$

To analyze the results from Equation 1b, we utilize a model first employed by Boyce (1992), also used to analyze the Philippine data. Boyce (1992) was an attempt to find out the determinants (or causes) of capital flight and external borrowing. It is, however, not a model on the mechanisms of capital flight and external borrowing (i.e., the ways or means that individuals or firms use to carry out capital flight). In other words, the model we use is an attempt to answer the question: “Why there was capital flight?” but it cannot answer: “How was capital flight undertaken?” and neither can it answer: “Where did the capital go?”

The revolving door model posits some indirect and direct explanations of capital flight and external borrowing. In the indirect explanation, exogenous factors separately determine capital flight and external borrowing; that is, both are not directly linked to one another. For instance, capital flight occurs not because of capital inflows or external borrowing per se, but rather because of, say, macroeconomic mismanagement. As such, poor economic performance scares away capital. In parallel fashion, a country becomes highly indebted not because of capital flight but because of, again, macroeconomic mismanagement. Along this line of argumentation, it can be said that policy mistakes, corruption, rent-seeking behavior, among others, induce capital flight and lead to external indebtedness. A related point is that capital inflows (especially during surges of capital

⁵ See Beja (2005) for a longer discussion of procedures to estimate capital flight. In this paper, we use a modified residual method because our objective is to account for all types of capital and foreign exchange flows. What we obtain as a result is an estimate of capital flight that is merely indicative of the actual size of capital flight yet *prima facie* evidence of capital flight. There are other transactions like illegal capital flight that we cannot measure because they remain unrecorded. But we note that capital flight can take place within normal processes, which therefore makes the estimation of capital flight more challenging.

⁶ Obviously, the number of adjustment that can be done depends on the available data, including alternative sources of data. Here, we could not make an adjustment for the impact of foreign exchange fluctuations on short-term capital flows because information on their composition is not available.

flows) lead to economic instabilities, and eventually, a financial crisis (see, e.g., Palma 2004), and thus capital flight (see, e.g., Beja et al. 2005). Another argument is that capital inflows lead to risky and/or unsound investment behavior, resulting in overborrowing, and so problems with country external indebtedness (see, e.g., McKinnon and Pill 1996, 1998).

In this paper, we extend the conventional (indirect) explanations above for the neoliberal regime in the context of the Philippines. Neoliberal analysis posits that when such programs are pursued, there will be less or no more capital flight because there will be no more incentives to avoid social controls. Also, the expectation is that financial liberalization will make foreign funds available to domestic entrepreneurs, who in turn will put the funds to proper use; that is, utilize the funds for building businesses, creating jobs, and setting up infrastructures, and so on, in the country, which are needed for growth and development. Yet, despite following neoliberal policies—indeed the Philippines is a good example of a country that closely followed neoliberal prescriptions (see, e.g., Pritchett 2003; Bello 2004)—we find that capital flight and external borrowing have increased with deregulation and financial liberalization.

Such felicitous outcomes promised by the neoliberal regime are only possible when economic reforms are pursued with the requisite governance structures and the administrative capacity to carry out the reforms. Indeed, it is paradoxical that while deregulation and financial liberalization involve the loosening of direct government controls over economic decisions and processes, the successful management of the economy requires enhanced regulatory institutions and prudent policies to effectively respond to economic challenges and to thus make the reforms work properly (see also Vogel 1996). But often when neoliberal policies are adopted, or in some cases forced upon developing countries, the requisite structures, institutions, mechanisms for administrative capacity, and so on, are not in place or they have been removed. In consequence, while deregulation and financial liberalization facilitated greater capital flows, including external debts, the funds were increasingly utilized to finance capital outflows. In addition, we have an economic environment that is more vulnerable to financial swings, crashes, contagions, crises, and economic stagnation, as well as an environment that actually encourages external borrowing and facilitates capital flight.

Boyce (1992, 1993) notes that the indirect linkages cannot explain why often there is a close year-to-year correlation between capital inflows and capital flight. Thus the direct linkages highlight direct causal explanations, holding for example that external debt itself provides the fuel and/or driver for capital flight, and vice versa. Briefly, the process can be described as follows: external debt is transformed from a capital inflow to capital flight (i.e., “fuel” effect), which ultimately ends up in private foreign bank accounts. And as external debts accumulate, the mounting burden of debt servicing, plus there is the possibility of a default on debt, provide signals for increased risks (i.e., “drive” effect), and so provide a motivation for capital flight. The causality can run in the reverse direction, too. In the case of flight-fueled external borrowing, the money sent abroad is borrowed back, a deal known as “back-to-back” loan. And as capital flight occurs, it creates a financial vacuum and the country is forced, in a way, to obtain external resources to fill the void and to fuel economic activities (i.e., “drive” effect).

The result of the direct and indirect linkages is a revolving process of capital flight and debt accumulation. Pincus and Ramli (2005), extending on their earlier work on Pincus and Ramli (1998), and also that of Rosser (2002, 2005), suggest that the strength of the direct linkages between capital flight and external borrowing would in part depend on the dynamics of interest coalitions in society. In similar fashion, we point out that the intensity of the linkages depends on the extent the neoliberal regime has entrenched itself in society.⁷ Putting together the indirect and direct linkages described above, the revolving door model can thus be expressed as:

$$(2) \quad \begin{aligned} \text{KF} &= \alpha_0 + \alpha_1 \text{CDET} + \alpha_2 \text{DEBT} + \alpha_i \mathbf{X} + e_1 \\ \text{CDET} &= \beta_0 + \beta_1 \text{KF} + \beta_2 \text{RES}_{-1} + \beta_i \mathbf{X} + e_2, \end{aligned}$$

where, as before, KF is capital flight and CDET is net additions to external debt (Equation 1a), DEBT is the stock of external debt, RES₋₁ is lagged international reserves, and \mathbf{X} is a set of the indirect linkages and other exogenous variables. CDET in the KF-equation and KF in the CDET-equation represent the debt-fuel and the flight-fuel linkages, respectively. DEBT in the KF-equation and RES₋₁ in the CDET-equation represent the debt-driven and the flight-driven linkages, respectively. For fuel linkages, we hypothesize that additions to external debt and capital flight have positive impacts, respectively, in Equation 2. For the drive linkages, we hypothesize that external debt stock and the lagged to international reserves have positive impacts, respectively, in Equation 2, as well. The model, however, leaves open what specific indicators to include in \mathbf{X} , and hence the impact on Equation 2 will depend on the actual indicator used.

3. Capital Flight from the Philippines

Sources of Data

We used the World Bank's Global Development Finance for external debt data (DEBT), and the IMF's International Financial Statistics for data on net direct foreign investments (FDI), net portfolio investment equities (PORT), other investment assets (OTH), current account deficits (CAD), and accumulation of international reserves, plus central bank sanctioned uses of foreign exchange (CRES). Missing data were compiled from the Bangko Sentral ng Pilipinas (BSP). We used the World Bank's World Development Indicators for other economic indicators, especially for Equation 2. In addition, we also conducted a review of recent Philippine economic history, interviewed political economy specialists, and met with BSP staff to discuss our findings.

⁷ An extension of our work deals with the class dimension of capital, trade and human flows. We hope to pursue this as a long term research agenda.

*The Philippines: Capital Flight 2000*⁸

In this section, we discuss the results. With Equation 1a, we obtained total capital flight (TKF) as follows: USD 16 billion for the 1970s, USD 36 billion for the 1990s, and USD 43 billion for the 1990s. Between 2000 and 2002, TKF was USD 36 billion. For the whole period, the Philippines lost a total of USD 131 billion to capital flight, or 2.8 times the country's total external debt in 2002. By any yardstick, these are large amounts of "lost" resources that could have been used to, for example, generate additional output and/or create more jobs in the country.

Figure 1 shows the trend of TKF. We observe that the figure follows a cyclical pattern, which reflects the economic boom-bust cycle that characterized the Philippine economy in the post-World War II period. During an economic bust, TKF was in a boom; and vice versa. But the TKF cycle tapers off in the latter stage of a crisis, when arguably most of the capital had left.

The frequency of the TKF cycle is also consistent with the Philippines economic history, in which the economic boom spans a brief period (usually, three years) then cut abruptly by an external or internal crisis. The events in the 1980s and earlier are already well documented (see, e.g., Boyce and Zarsky 1988; Vos 1992; Boyce 1993; Vos and Yap 1996); but we argue that what seems to be a different trend since the early 1990s is basically part of the overall boom-bust cycle that continues to characterize the Philippine economy. In other words, the trends since the 1990s reflect only a structural break in levels. In fact, the cycles in the 1990s are, in part, driven by financial liberalization and the resurgence of foreign capital inflows to the country, which is very similar to early surges of capital to the country.

Figure 2 illustrates that high levels of capital flight occurred during periods of domestic economic crises. The Latin American debt crisis in the early 1980s was an important trigger of the balance of payments crises in the Philippines. In the years before the crises, the country was experiencing a rapid slowdown in growth as debt burdens and global economic slowdown took their toll on the economy. Adding to this problem was the collapse of the capital and commodity markets and related events, including the Dewey Dee loans default. Then in 1983, Senator Benigno Aquino was assassinated. With the ensuing political and social unrest, the economic insecurities and uncertainties in the country worsened. In 1984-1985, the situation reached a lowest point when the Philippines had its worst recession in the post World War II period. And because of the debt crisis and the overall economic instability, the Philippines was cutoff from external funds. Thus capital flight for the most part of the 1980s could only be fueled by domestic resources.

In 1986, Mrs. Corazon Aquino was installed President. A difficult recovery characterized the following years. A series of coup d'états between 1986 and 1989

⁸ In order to transform the Philippine economy from its dismal status as the "sick man" of Asia, the Ramos administration embarked on an economic program to make the country take off to NIC-hood at the turn of the 21st Century. Thus the slogan: "Philippines 2000!" From 1992/3, wide scale and aggressive deregulation and financial liberation programs were undertaken but without instituting or (even) neglecting the requisite governance reforms and administrative capacity. We follow the Ramos administration slogan and say: "Capital Flight 2000!"

undermined economic and political stability. Then an economic recession and electricity power supply crisis in 1991 to 1992 stalled any economic recovery, which again induced capital flight. With the Ramos government quickly addressing the electricity crisis in 1992, investor confidence recovered. And from 1993, the Philippines appeared on track for an economic turnaround, experiencing its longest economic expansion since the mid-1980s. But, with the 1997-98 Asian financial and economic crises, economic recovery was once again interrupted — although this time, the crisis was induced by an external shock. Like in the previous decades, economic slowdown appears to have resulted in capital flight. Perhaps because there had been a shorter period of capital accumulation in the country, capital flight in the late 1990s was not as large as the other affected countries in the Asian region.

After 1998, when the Asian crises subsided and strong economic recoveries in the affected Asian economies were taking place, concerns about the Philippine economy reemerged, especially after the election of Mr. Joseph Ejercito Estrada to the presidency. What happened in the late 1990s seems similar to the 1980s: domestic economic and political instability induced capital flight. Mr. Estrada's impeachment in 2000, the social unrest in 2001, plus the insecurity that haunts the successor government of Mrs. Gloria Macapagal-Arroyo, converged to reinforce doubts on the country's economic sustainability, and we find that since 1998, capital flight had been large and generally rising. The upsurge of capital flight in 2002 appears to reflect the continued concerns on the Arroyo government and, in particular, the political instability and the government's indecisiveness to institute sound reforms. Recent development in the country would lead us to argue that there might again be an upsurge of capital flight, as there appears to be a repeat of the conditions in 2000 and 2001.

Revolving Door?

In the regression model, (real values of) KF, CDET, DEBT, CAD and RES are expressed as shares of real GDP. GROW is real GDP growth rate, also expressed in percentage. In the regression model (Equation 2), dummy variables are introduced for periods covering the mid-1980s for the deregulation period (D_1) and from the early 1990s for financial liberalization period (D_2). The dummy variables are interacted with external borrowing and capital flight, respectively, to capture the impact of neoliberal policies on capital flight and external borrowing. It is difficult to isolate the impact of policies over time, but we argue that the overlap in the dummy variables and interaction terms is one (though rudimentary) way of capturing the continued application, and eventual entrenchment, of neoliberal policies in the Philippines.⁹

⁹ Deregulation was introduced much earlier in the 1980s, but we argue that only after the mid-1980s that economic reforms were systematically pursued. Financial liberalization was pursued in the late 1980s but like deregulation systematic implementation happened only in the early 1990s. In fact, only in the Ramos administration that financial liberalization was comprehensive and completed. In the regressions, we argue that if deregulation and financial liberalization are effective (say, as disciplining mechanisms on the use of funds that neoliberal policies are supposed to achieve, among others), such policies will result in proper utilization of external borrowing. In the regression, we expect that the interaction terms of D_1 and D_2 with CDET will indicate lower coefficients for the latter.

Table 1 summarizes the results. Before we discuss the results, we note that the number of observations is small. The capital flight figures (Equation 1b) are constrained by the nature of the external debt data, which are available in annual figures. Researchers have to apply prudence in making generalizations from the results, especially for policy prescriptions and designing government interventions. Still the results are useful for analysis because they corroborate exiting studies on Philippines capital flight (see, e.g., Boyce 1992, 1993; Vos 1992; Vos and Yap 1996); the results also give us some directions on the key variables for advocacy work.

Thus, in the case of the Philippines, the results in Table 1 confirm a revolving door process of capital flight and external borrowing: we found evidence of both debt-fuel and debt-driven capital flight (KF-equations), as well as both flight-fuel and flight-driven external borrowing (CDET-equations). In particular, we found that for each dollar of external borrowing, from 33 to 47 cents ended up as capital flight each year (CDET on KF-equations) from 1970 to 2002. On top of that, there was a further 13 to 14 cents that went off as capital flight each year because of debt accumulation (SDET on KF-equations). From an economic point-of-view, these numbers indicate that for each dollar of external debt, the Philippines lost from 47 to 60 cents to capital flight every year in the last three decades.

In addition, we found that for each dollar of capital flight, about 68 to 71 cents of external borrowing was acquired to replenish the lost funds (KF on CDET-equations). So with sustained capital flight over the period 1970 to 2002, there was a further 5 to 59 cents of external borrowing each year (RES₁ on CDET-equations). From an economic point-of-view, these results mean that for each dollar of capital flight, the Philippines acquired from 76 cents to \$1.27 of external debt in the past three decades.

Focusing next on the indirect linkages, we found evidence that deregulation (D_1) and/or financial liberalization (D_2) reinforced both types of fuel linkages. On both the KF-equations, for example, the results for the interaction between deregulation and financial liberalization with net additions to external debt (i.e., $D_1 \cdot \text{CDET}$ and $D_2 \cdot \text{CDET}$, respectively) indicate that there were 72 cents of additional capital flight, respectively. But the more interesting result is that they appear to be robust and stable, therefore, suggesting that capital flight was a constant feature when the neoliberal reforms were introduced in the Philippines.

Furthermore, since the two results refer to the fuel linkages as well, we can combine them with the results on the CDET earlier. Thus we can conclude that for each dollar of external debt, \$1.07 ended up as capital flight during the deregulation period. The amount is about \$1.19 during the financial liberalization period. If we exclude both neoliberal policies, the Philippines would still experience 33 to 47 cents of capital flight for each dollar of external debt (as discussed in above) but would only be due to external borrowing. We can therefore conclude that, in the case of the Philippines, neoliberal policies increased capital flight.

Now, on both the CDET-equations, we found that the results for the interactions between deregulation and financial liberalization with capital flight (i.e., $D_1 \cdot \text{KF}$ and $D_2 \cdot \text{KF}$, respectively) likewise reveal further borrowing from 82 cents to \$1.03 for each dollar of capital flight, with deregulation and financial liberalization, respectively. These

results are fuel-type processes, too, and so we can combine them with the earlier results, too. Thus, during the neoliberal regime, the impact of capital flight on external borrowing increased from \$1.50 to \$1.71. Also, if we exclude the neoliberal policies, the Philippines would still acquire 68 to 70 cents of external debt due to capital flight alone. We can therefore conclude that, in the case of the Philippines, neoliberal policies increased external borrowing.

We further examine the results in Table 1. In particular, we calculated the elasticities of both capital flight and external borrowing to determine how their respective intensities changed as neoliberal policies were pursued over time. The results are shown in Table 2.

From the table, we found that a 1% increase in external borrowing during the deregulation period resulted (in a total of) 0.67% increase in capital flight (CDET plus $D_1 \cdot \text{CDET}$ in Table 2), whereas during the financial liberalization period, about 0.64% (CDET plus $D_2 \cdot \text{CDET}$ in Table 2). That is, regardless of the type of policy, these results suggest that the overall responsiveness of capital flight remained relatively the same (although we note that specific results for $D_1 \cdot \text{CDET}$ and $D_2 \cdot \text{CDET}$ indicate that financial liberalization had a lower elasticity than deregulation). We argue that this result indicates is that despite the neoliberal policies, some of the external debts might have been used to expand economic activities in the country. Having said this, we further argue that because the overall elasticity for the fuel linkages remained the same over time, it means that external borrowings were ultimately taken out as capital flight. We can therefore infer from Table 2 that capital flight would be a constant feature under a neoliberal regime, at least, in the case of the Philippines.

Moreover, there were also other interesting results obtained on the elasticities of external borrowing (Table 3). We found that a 1% increase in capital flight during the deregulation period resulted in 1% increase in external debt (KF plus $D_1 \cdot \text{KF}$ in Table 3), while for the financial liberalization period, the figure was lower, at 0.85% (KF plus $D_1 \cdot \text{KF}$ in Table 3). What these results suggest is that neoliberal policies can have some benefits to the country, in particular, by lowering the overall tendency to acquire external debts or willingness of lenders to extend credit when their macroeconomic expectations are not met, among others. But we argue that this result can be due to the fact that the Philippines was largely cutoff from the international debt markets until around the mid-1990s.

Perhaps, too, neoliberal policies have shifted the dynamics for external borrowing. For instance, financial liberalization (and similar developments elsewhere) facilitated capital flow surges. When Philippine authorities received these flows, the authorities accommodated them by sterilizing the excess supply of foreign exchange, resulting in an accumulation of international reserves. With large reserves, it meant a decrease in the probability of debt default, and so, there was more external borrowing. As shown in Table 3, the elasticity of lagged total reserves (RES_{-1}) is consistent with this view. At the same time, there was a decline in the external sector's foreign exchange generation capacity, which is a direct result of financial liberalization (see e.g., Lim 2004). As such, external borrowing (albeit short-term external debt) was acquired to finance the country's external imbalance. The elasticity of the lagged of current account deficits (i.e., CAD_{-1}) shown in Table 3 is consistent with this argument. In fact, the

overall elasticity of lagged total international reserves (RES.₁) plus that of lagged of current account deficit (CAD.₁) was 12 times higher in the financial liberalization period than in the deregulation period.

Finally, we discuss the results for the other indirect linkages shown in Table 1. We found that higher levels of economic performance are negatively correlated with capital flight (KF-equations); that is, robust growth would lower capital flight. The converse is also true, and in fact, more pertinent given the Philippines' economic history. The results on international reserves (KF-equations) indicate a negative correlation with capital flight; that is, more international reserves would lower capital flight as it suggests a lower probability of a balance of payments crisis. Lastly, large current account deficits (CDET-equations) mean more external borrowing (CDET-equations). The results indicate (as in Table 3) that with financial liberalization, more external borrowing was undertaken to finance the current account deficits.

Implication: A Hollowing Out Process?

The documented large amounts of capital flight from the Philippines reveal large amounts of resources beyond social control. The figures are lost resources that are not being utilized to benefit the country. Since capital flight is typically undertaken by elites, or the dominant classes in society, we infer from the results that the majority of Filipinos bear a disproportionate burden of the adverse impacts of capital flight and external indebtedness. The documented revolving door process of capital flight and external borrowing means that resources (both domestic and foreign) ultimately fled the country. Further analysis on the revolving door revealed that capital flight actually increased, especially in 1990s during the financial liberalization period. Arguably, as the neoliberal regime deepened, expanded, and thus entrenched, in the country there was also intensified capital flight and external borrowing. Given the empirical evidence, we thus argue that the neoliberal regime (including the socio-economic and political dynamics that come with it), underpinned capital flight and external borrowing, ultimately resulted in the hollowing out of the Philippine economy. Further juxtaposing the results and the Philippines' economic performance over the years, it can be argued that capital flight played an important factor in derailing the country's takeoff to higher stages of development. Perhaps because of capital flight the country lost the opportunity to become an Asian economic tiger.

4. Conclusions

Using a measure of capital flight, we documented large amounts of lost resources from the Philippines. Capital flight was \$16 billion in the 1970s, \$36 billion in the 1980s, and \$43 billion in the 1990s. Between 1970 and 2002, total capital flight was estimated at USD 131 billion (in 1995 constant prices). Such resources would have been available to generate more output, create additional jobs, thus bringing about a better quality of growth, and in the process, raise the social welfare of many Filipinos.

Also, using a model of analyzing capital flight, we found that the upsurge of capital flight coincided with the application (and the consequent entrenchment) of the neoliberal regime in the Philippines. We thus put to question the conventional wisdom that when neoliberal policies are implemented there would be no more capital flight and there would be efficient use of external borrowing. That is to say, the untrammelled access to external capital would encourage domestic entrepreneurs to generate economic activities or facilitate the building of businesses and the creation of jobs and productive infrastructures in the country. In fact, we found that deregulation and financial liberalization only facilitated the inflows of external capital and it was increasingly used to fuel capital flight. Of course, economic and political crises, as well as the external shocks, play important roles in inducing capital flight, but under the neoliberal regime, such crises only meant greater levels of capital flight because there are more avenues for undertaking flight.

The fact that capital flight means large lost opportunities to the Philippines means that there are likewise large unaccounted adverse effects on Philippines society. When there are large externalities, government intervention is necessary and in fact justified. Therefore the government must and should explore progressive ways or mechanisms to manage capital flows and to restrict capital flight. We further argue that this goal is best achieved through the application of capital management techniques (see also Crotty and Epstein 1996, 1999; Epstein et al. 2003). Using such and related policy tools would enable the Philippines to retain and attract capital to sustain growth and development (see also Nembhard 1996; Montiel and Reinhart 1999; Chang and Grabel 2004). Such policy tools would enable the Philippines to regain control over policy making and allow the government to pursue more sensible policies. For example, as a way to manage capital flows, capital controls can be utilized to affect both the volume and composition of capital formation, especially in directing funds to the tradable or productive sectors in order to push the country toward sustainable industrialization. In a similar fashion, with macroeconomic regulation, the Philippines would be able to facilitate financial intermediation, including financial deepening, generate additional tax revenues and funds for public infrastructure and services, among others. During times of crises, capital controls can also be utilized, too, particularly to stem massive capital outflows, to hold at bay panic and speculation, and more importantly, rehabilitate the financial system and allow the government to work on economic recovery. Obviously, the goal of capital management techniques is not to return or re-impose financial repression; but rather, the goal is for the government to regain control, and to have sufficient space, over macroeconomic policies and the direction of development.

It is therefore critical to rethink government intervention. Indeed a more substantive role of the government is needed. Accepting, and in turn, pursuing a minimum government policy is only counter-productive to the economic and development goals. At the minimum, we argue that the Philippine government must ensure and prioritize domestic responsibility, especially in setting economic targets and articulating a vision of development that is realistic to the country's context. It must pursue policies that reflect and are sensitive to the domestic characteristics and strengths. We argue further that the government must embed itself in society so that it can constructively engage with and respond to various domestic demands and withstand external challenges. On one level, it must permit and encourage constructive relationships

(e.g., cooperative arrangements with the private sector, a meaningful involvement of civil society, etc.) but then, on another level, it must also regulate economic and social processes that are counter-productive to realizing a robust economy and domestic development (e.g., putting restraints on speculative capital, checking unsound environmental practices, etc.), as well as address attempts to undermine its capacity (i.e., controlling elites' dominance in policy-making, neoliberal thinking, etc.).

Finally, it should be stressed that when external debts are squandered by elites or they are inappropriately used to benefit only a few in society, it is the rest of society that suffers. More importantly, the nontrivial economic costs of external indebtedness and capital flight are imposed on the majority. Thus from an economic justice point-of-view, these provide basis to question the legitimacy of external debt itself the rationale for continuing to honor such debts.

Our findings therefore provide compelling support to demand for a better management of external debts by debtors and creditors alike. The Philippine government is responsible in making sure that external debts benefit all Filipinos and not used to enrich a few. Thus a government that misuses funds is itself liable for the external debt itself and must not impose this burden on the public. Creditors must also share responsibility in the prudent management of the Philippines' external debts. Such a role can be achieved either through an application of sound lending policies or some involvement in the effective use or disbursement of funds. In cases, where external borrowings were actually misused, or proof cannot be presented to demonstrate that the funds were actually used to improve the social conditions of Filipinos, or the borrowed funds could not be traced where they went, we can conclude that they were diverted into private pockets, and more likely as capital flight. If creditors ignore or pretend not to see that the borrowed funds were used to benefit only a few, or they do not act to redress the situation, they too are accountable for the Philippines' indebtedness. In these cases, Filipinos must question the legitimacy of the external debt itself and the rationale for continuing to honor external debts that Philippine society, on the whole, did not benefit from. Accordingly, alternative debt relief programs should to be explored by both the government and creditors like interest rate payment cancellations (but still paying the principal, except when the borrowed funds are odious in nature) and rescheduling of debt principal. Debt relief should be demanded from the creditors so that the Philippines will not continue to bear the consequences of external indebtedness.

TABLE 1: Determinants of Capital Flight and External Borrowing of the Philippines

Variable	Run 1: Deregulation		Run 2: Financial Liberalization	
	KF-equation	CDET-equation	KF-equation	CDET-equation
Constant	-6.01 (0.24) ^{ws}	4.82 (0.05) ^s	-9.51 (0.02) ^s	-1.54 (0.48) ^{ns}
KF		0.71 (0.01) ^{hs}		0.68 (0.00) ^{hs}
CDET	0.33 (0.20) ^{ws}		0.47 (0.02) ^s	
DEBT	0.14 (0.01) ^{hs}		0.13 (0.00) ^{hs}	
RES ₋₁	-0.61 (0.00) ^{hs}	0.05 (0.74) ^{ns}	-0.78 (0.00) ^{hs}	0.59 (0.00) ^{hs}
GROW ₋₁	-0.63 (0.05) ^s		-0.50 (0.05) ^s	
CAD ₋₁		0.05 (0.84) ^{ns}		0.33 (0.06) ^s
D ₁ *KF		0.82 (0.00) ^{hs}		
D ₂ *KF				1.03 (0.00) ^{hs}
D ₁ *CDET	0.74 (0.03) ^s			
D ₂ *CDET			0.72 (0.01) ^{hs}	
n	33	33	33	33
Adj. R ²	0.33	0.17	0.68	0.55
Durbin-Watson	2.00	1.53	1.96	1.76

Notes:

[1] KF = capital flight; CDET = net additions to external debt; DEBT = stock of external debt; RES = total international reserves; GROW = country GDP growth rate; CAD = country current account deficit; D₁ = dummy variable for period of deregulation: value of 1 in 1986 onwards and 0 otherwise; D₂ = dummy variable for period of financial liberalization (which includes deregulation): value of 1 in 1993 onwards and 0 otherwise.

[2] KF, CDET, SDET and RES₋₁ (on the CDET-equations) represent the direct linkages. GROW₋₁, CAD₋₁, RES₋₁ (on the KF-equations), D₁*CDET, D₂*CDET, D₁*KF and D₂*KF are the indirect linkages. [3] Deregulation and financial liberation in the Philippines started in the mid-1980s, but it was only in the 1990s, during the Ramos administration (1992-1998), that wide-scale and aggressive financial liberalization was implemented: opening the capital account in 1993, deregulating the domestic banking sector in 1995 and others. [4] Results are from the Three Stage Least Squares procedure. [5] Numbers in the parentheses are the p-values from EViews 5: hs = highly significant; s = significant, ws = weakly significant; ns = not significant.

TABLE 2: Comparative Elasticities of Capital Flight Given Neoliberal Economic Policies

Dependent: KF	Run 1: Deregulation		Run 2: Financial Liberalization	
Variable	Coefficient	Elasticity	Coefficient	Elasticity
CDET	0.33	0.35	0.47	0.49
DEBT	0.14	1.32	0.13	1.22
RES ₋₁	-0.61	-0.96	-0.78	-1.23
GROW ₋₁	-0.63	-0.36	-0.50	-0.28
D₁*CDET	0.74	0.32		
D₂*CDET			0.72	0.15

Notes:

[1] KF = capital flight; CDET = net additions to external debt; DEBT = stock of external debt; RES = total international reserves; GROW = country GDP growth rate; CAD = country current account deficit; D₁ = dummy variable for period of deregulation: value of 1 in 1986 onwards and 0 otherwise; D₂ = dummy variable for period of financial liberalization (which includes deregulation): value of 1 in 1993 onwards and 0 otherwise.
 [2] Elasticity measures the degree of responsiveness of KF due to a 1% change in X (variables).

TABLE 3: Comparative Elasticities of External Borrowing Given Neoliberal Economic Policies

Dependent: CDET	Run 1: Deregulation		Run 2: Financial Liberalization	
	Variable	Coefficient	Elasticity	Coefficient
KF	0.71	0.66	0.68	0.64
RES ₋₁	0.05	0.07	0.59	0.87
CAD ₋₁	0.05	0.01	0.33	0.09
D₁*KF	0.82	0.34		
D₂*KF			1.03	0.21

Notes:

[1] KF = capital flight; CDET = net additions to external debt; DEBT = stock of external debt; RES = total international reserves; GROW = country GDP growth rate; CAD = country current account deficit; D₁ = dummy variable for period of deregulation: value of 1 in 1986 onwards and 0 otherwise; D₂ = dummy variable for period of financial liberalization (which includes deregulation): value of 1 in 1993 onwards and 0 otherwise.

[2] Elasticity measures the degree of responsiveness of CDET due to a 1% change in Y (variables).

FIGURE 1: Total Capital Flight, 1970-2002 (USD millions; 1995 constant prices)

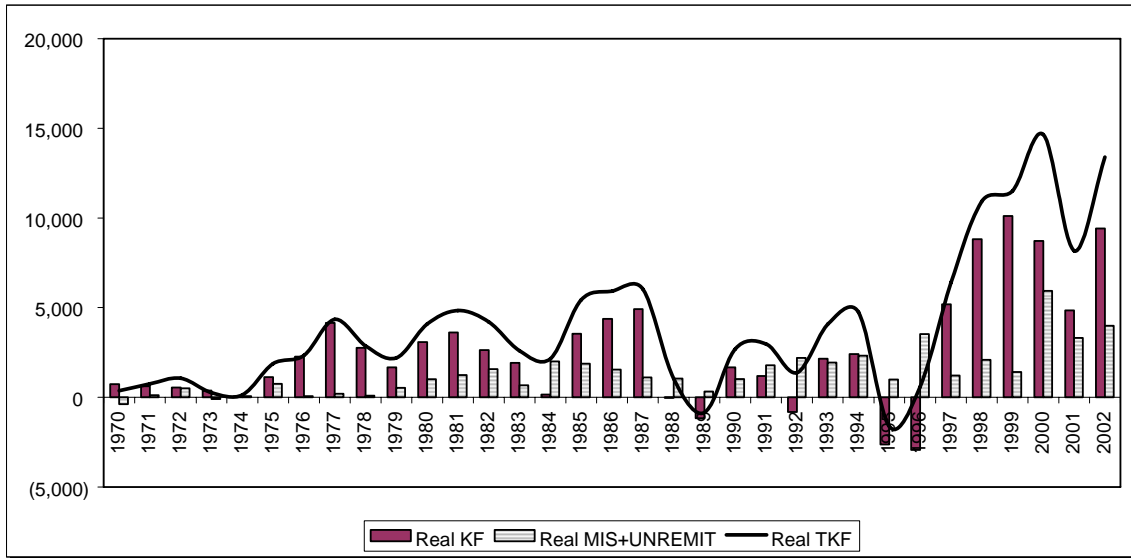
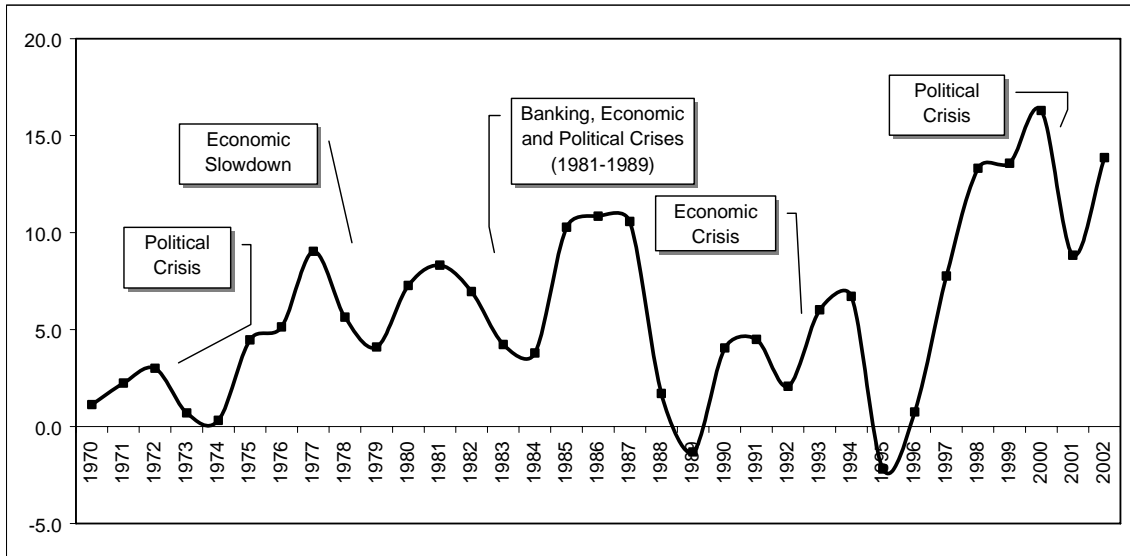


FIGURE 2: Share of Total Capital Flight to GDP, 1970-2002 (1995 constant prices)



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