LEVERAGING AUSTRALIA'S DEBT RELIEF TO THE PHILIPPINES THROUGH DEBT-FOR-INVESTMENT PROJECTS

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I INTRODUCTION

This article proposes and analyses a 'debt-for-investment' project between the Australian and Philippine Governments as a means for Australia to enhance greatly the effectiveness of its debt relief and aid efforts for the Philippines. Debt-for-investment can serve the interests of the Australian and Philippine Governments and the poorest Filipino communities. This project would reduce the risk of transnational threats including terrorism and an avian flu epidemic and help the Philippines achieve the Millennium Development Goals ('MDGs')[1] by 2015. It would also strengthen the existing relationship between Australia and the Philippines, and allow Australia to join the ranks of developed nations engaging in debt swaps with developing nations.

This paper is in five parts. Part II analyses different types of debt relief and debt swap projects. Part III analyses the Philippines' current economic and social environment and the factors that threaten its efforts to achieve the MDGs by the target date of 2015. Part IV contains our 'debt-for-investment' proposal. The suggested projects have been chosen to reduce the terrorism and pandemic risks for Australia and to create a stable environment conducive to long-term growth in the Philippines. Part V is the conclusion.

II DEBT RELIEF AND DEBT-FOR-INVESTMENT PROJECTS

In the 1990s debt relief for poor countries was the subject of a campaign by a broad coalition of church and aid groups called Jubilee 2000. The campaign pushed debt

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[1] For more, see United Nations, *UN Millennium Development Goals* ('MDGs') <http://www.un.org/millenniumgoals/> at 28 November 2006.

relief for developing nations onto the agenda of Western governments and organizations such as the International Monetary Fund ('IMF') and the World Bank. The highly indebted poor country ('HIPC') initiative was launched by the World Bank in 1996 and enhanced in 1999 to provide debt relief for the world's poorest countries. The record of this initiative was very mixed, and so it was greatly enhanced, last year, by the Multilateral Debt Relief Initiative. Under this initiative the IMF, the concessional finance arm of the World Bank, and the African Development Fund agreed to cancel all of the debt owed to them by countries that are eligible for, and have completed, or do complete, the HIPC Initiative process.[2]

However, many countries like the Philippines, with regions of extreme poverty within them, fall short of qualifying as a HIPC, and have therefore not benefited at all from these initiatives. Nonetheless, the debt burden on the Philippines is severe. Just how severe can be seen from government expenditure in 2006: over 32 per cent of government spending went to servicing interest on debt alone, compared to less than 14 per cent on education, less than 5 per cent on defence and only 1.3 per cent on health.[3] When one factors in principal repayments as well, the situation becomes utterly intolerable, with total debt service in 2005 consuming almost 60 per cent of total government expenditures, a proportion projected to rise to 68.5 per cent in 2006.[4] In 2006, therefore, over two-thirds of every peso spent by the Philippines government will have been spent on paying interest or repaying principal on its debts. In the words of Habito and Beja Jr, '[u]ltimately the debt penalty compromises the country's long term human development and economic growth.'[5]

Because it does not qualify as a HIPC, the Philippines has had to rely for debt relief on the initiatives of individual developed countries, which, in turn, enables these nations to develop special relationships with the Philippines. In general terms, debt relief can take many forms. These include partial or complete debt cancellation, debt buybacks and debt-swap agreements.

A debt buyback refers to the purchase of debt by the debtor country from its creditors or through the secondary market.[6] Debt buyback schemes raise moral hazard issues because the purchase price of the debt on the secondary market is influenced by the actions of the debtor country. For example, Brazil defaulting on its interest payments from 1989 to 1991 deflated the price of its debt substantially

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2 For more information, see International Monetary Fund, *Factsheet: The Multilateral Debt Relief Initiative* (2006) <http://www.imf.org/external/np/exr/facts/mdri.htm> at 27 August 2006.

3 Cielito F Habito and Edsel L Beja Jr, 'Beating the Odds?: The Continuing Saga of a Crisis-Prone Economy', part of the *Civil Society Monitoring of the Medium Term Philippine Development Plan (MTPDP)* (2006) 11.

4 Ibid 9.

5 Ibid 10.

6 Ross P Buckley, 'Debt Exchanges Revisited: Lessons from Latin America for Eastern Europe' (1998) 18 *Northwestern Journal of International Law and Business* 655, 675-83.

as well as liberating the funds to purchase it.[7] Moral hazard arises whenever financial actors do not have to bear, or do not anticipate having to bear, the full risks of their actions.[8]

Debt-swap agreements have come to prominence in the past decade. The name debt-swap is a misnomer because no swap or exchange actually takes place. Put simply, under a debt-for-development swap, for example, instead of repaying the creditor nation, the debtor country uses the money that it owes the creditor nation, or an agreed proportion thereof, in development projects in its own territory agreed upon by the two countries.

Debt-swaps can benefit the international financial community, the governments that are party to the agreement, and the communities affected by the agreement. For the international financial community debt-swaps can reduce debt levels and increase debt prices in the secondary market. For creditor governments debt swaps allow control over the uses to which the funds liberated by debt they cancel are put. For debtor governments debt swaps can promote development, attract investment into critical areas and reduce debt.[9] For local communities, swaps can substantially reduce poverty levels and support much needed local projects. Debt-swaps can be used to achieve many different objectives depending on their specific terms.

A Debt-Equity Swaps

Debt-equity swaps were the initial form of debt swap but of late have lost favour to debt-for-development and debt-for-environment swaps. Debt-equity agreements involve the sale by an investor of external debt to the debtor government in return for a discounted amount of local currency which must then be invested locally in shares in a local company or otherwise.[10] Debt-equity swaps offer investors a preferential exchange rate for their investments.[11] The discount rate at which the debt will be converted into equity is set by agreement between the investor and the debtor government or at an auction at which potential investors bid.[12] Debt-equity schemes can increase investment and permit debtor nations to recapture part of the secondary market discount in the value of their loans. However, their potential disadvantages, more often than not, have out-weighted their advantages.[13] With the exception of Chile's quite extraordinary experience, debt-equity schemes have

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7 Lee C Buchheit, 'Moral Hazards and Other Delights', *International Financial Law Review* 10 (April 1991) note 130 at 10-11; George Anayiotos and Jaime de Piniés, 'The Secondary Market and the International Debt Problem' (1990) 18 *World Development* 1655; Buckley, above n 6, 679.

8 See generally, Buchheit, above n 7.

9 Joel Bergsman and Wayne Edisis, 'Debt-Equity Swaps and Foreign Direct Investment in Latin America' (Discussion Paper No 2, International Financial Corporation, 1989) 2.

10 Paris Club, *Debt Swap Reporting: Rules and Principles* (2006) <http://www.clubdeparis.org/en/public_debt.html> at 20 April 2006; Buckley, above n 6, 658.

11 Buckley, above n 6, 658f.

12 Ibid.

13 Ibid.

typically resulted in strong inflationary pressures, a loss of foreign currency, substantial budgetary burdens, and a misallocation of resources. To use Professor Rudy Dornbusch's word, the advocacy of debt-equity schemes by the IMF, World Bank and US Treasury has been 'obscene'.[14]

Chile was the first country to implement a debt-equity swap, in 1985, and it remains the most successful debt-equity scheme to date. Within the first 3 years, Chile had reduced its external debt by some US$3.8 billion, or 19 per cent.[15] Chile's ability to operate the debt-swap program consistently over a prolonged period encouraged foreign investment in addition to that which otherwise would have been made. Strict limitations on the repatriation of principal and the remission of dividends abroad restricted the drain on Chile's foreign exchange reserves. Chile's economy had a remarkable capacity to absorb credit without leading to inflation. These factors allowed the program to be opened to local investors which promoted its acceptance by the Chilean people.[16] Despite its apparent success it has been suggested that the rapid decline in foreign direct investment (FDI) that occurred upon the scheme's termination resulted from market saturation and the inferior quality of remaining investment opportunities.[17]

Mexico's debt-equity swap that commenced in April 1986 had retired US$3 billion of Mexico's US$107 billion foreign debt when it was suspended in November 1987.[18] The scheme was highly inflationary. Rather than issuing bonds, as Chile had done, Mexico printed pesos which led to inflation. The exchange rate afforded, in effect, was highly preferential and the scheme was, in the main, only financed investments that would have been made anyway (as will virtually always be the case in schemes of short duration due to the long lead times of international investment decisions).[19]

Debt-equity swaps have had a chequered past, and are unlikely to serve the Philippines in a long-term sustainable way. However, the fact that debt-for-development swaps grew out of debt-equity swaps, should not prejudice the assessment of what debt-for-development has to offer. Our proposed debt-for-investment agreement will benefit both countries on several different levels. We use the term 'debt-for-investment projects' because of the misleading effect of

14 The full quotation is: 'Washington has been obscene in advocating debt-equity swaps and in insisting that they be part of the debt strategy. The US Treasury has made this dogma, and the IMF and the World Bank, against their staff's professional advice and judgment, have simply caved in': Ruby Dornbusch, 'Panel Discussion on Latin American Adjustment: The Record and Next Steps' in John Williamson (ed), *Latin American Adjustment: How Much Has Happened* (1990) 312, 324.

15 Buckley, above n 6, 666.

16 Ibid.

17 Ibid.

18 Melanie Tammen, *Energizing Third World Economies: The Role of Debt-Equity Swaps* (1989) The Heritage Foundation, 7 <www.heritage.org/Research/TradeandForeignAid/bg736.cfm> at 10 April 2006.

19 Ibid.

describing these arrangements as swaps. 'Debt-for-investment' can encompass a range of projects, including debt-for-development, debt-for-nature and debt-for-education agreements.

B DEBT-FOR-INVESTMENT PROJECTS

Debt-for-investment projects are preferable to debt-equity swaps because they are not inflationary and promote poverty relief and sustainable economic development.

Debt-for-investment projects on even a small scale can offer substantial benefits to the economy and environment of the debtor country. For example, while Costa Rica's debt-for-nature agreement reduced its total external debt by less than 1 per cent, it was described by the Costa Rican Minister of Natural Resources, Energy and Mines as 'absolutely essential….[because otherwise] [t]here would have been no money to purchase land bridges between parks, to start tree nurseries for farmers, or even fight forest fires'.[20] Debt-for-investment projects have also been implemented successfully in the Philippines, the Dominican Republic, Madagascar, Mexico, Poland, Indonesia, Uganda and Zambia.[21]

Germany and Indonesia have conducted several successful debt-for-development projects. The first was a debt-for-education swap in December 2000 under which, in return for the cancellation of some 25.6 million euros of debt, Indonesia agreed to spend the equivalent of 12.8 million euros to build and equip 511 learning resource centers in 17 provinces to enhance the quality of teacher training in the basic sciences. In the second agreement, in October 2002, some 23 million euros of debt was cancelled in return for Indonesia's undertaking to put the equivalent of 11.5 million euros into building 100 new schools. In 2004 Germany and Indonesia entered into a debt for-environment agreement under which some US$29.25 million of debt was cancelled.[22]

The Philippines and the United States signed a debt for-development agreement in September 2002 in which the US agreed to cancel US$5.5million of the Philippines' debt to it. In return the Philippine Government agreed to fund tropical forest conservation activities through local NGOs in the Philippines.[23] The

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20 Lincoln C Wee, 'Debt-for-Nature Swaps, A Reassessment of Their Significance in International Environmental Law' (1994) 6 *Journal of Environmental Law* 57, 63.

21 See, eg, Facundo Gómez Minujín, 'Debt-for-Nature Swaps - A Financial Mechanism to Reduce Debt and Preserve the Environment' (1991) 21 *Environmental Policy and Law* 146, 147.

22 Tony Hotland, 'RI, Germany Agree US$29.25m Debt Swap Deal', *The Jakarta Post* (Jakarta, Indonesia), 15 May 2004, 13; 'Indonesia, Germany to Sign US$60m Debt Swap Deal', *The Jakarta Post* (Jakarta, Indonesia), 8 November 2004; Embassy of the Republic of Indonesia, *Indonesian – German Bilateral Relations* <www.indonesian-embassy.de/en/about_indonesia/bilateral_relations.htm> at 3 June 2006.

23 US Department of the Treasury Office of Public Affairs, 'Factsheet: US-Philippines Debt-Reduction Agreement Under the Tropical Forest Conservation Act (TFCA)', *TFCA Debt Swap Signing Ceremony with Philippines,* 19 September 2002 <http://www.treas.gov/press/releases/reports/philippines.pdf> at 29 November 2006.

Philippines agreed to apply in local currency the amount it will save in debt service repayments over the next 14 years to conservation activities over that period.[24]

Two small, successful debt-for-development projects were implemented recently between Egypt and Italy, and Egypt and Switzerland. These two projects combined amounted to only 1.6 per cent of Egypt's total external debt but the benefits received were significant.[25] Despite the fact that Egypt is a middle-income country, the Egyptian experience is a valuable reference point for debt-for-investment projects in the Philippines. Egypt's experience shows the benefit of debt-for-development swaps focusing on projects that yield immediate returns to communities. In Egypt, information and communications technology projects were chosen because of the impact of such technology in enhancing human resources and global competitiveness.[26] The goals included making the technology available to every segment of the population and providing the training and education required to use it. Egypt's projects created new economic and social opportunities for underprivileged groups such as women, rural communities, and low waged and low skilled workers.[27]

In summary, debt-for-investment projects are not new. It is a technique that has been applied by numerous developed countries in numerous developing countries and has consistently served the interests of both.

III THE PHILIPPINES

The Philippines' economic situation is quite bleak. Its total external debt was US$55.5 billion in September 2005, up from US$51.2 billion in 2000.[28] Poverty has increased in the last 30 years, with 34 per cent of the population below the national poverty line in 2000.[29] Nonetheless, President Arroyo has implemented ambitious economic reforms in the last 18 months.

As of April 2006, it is estimated that the Philippines owes Australia A$235 million[30] (approximately US$168.7 million),[31] down significantly from A$493 million in 2003.[32] Most of this debt was incurred over 10 years ago as a result of the Development Import Finance Facility ('DIFF') scheme. DIFF was a soft loan

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24 Ibid.

25 Sherif Kamel and Eskandar Tooma, 'Exchanging Debt for Development: Lessons from the Egyptian Debt-for-Development Swap Experience', Economic Research Forum and Ministry for Communication and Information Technology (MCIT), Egypt, September 2005, 15.

26 Ibid 54.

27 Ibid.

28 Doris Chung, *Philippines: Bi-Annual Report* (Report for the World Bank, 24 March 2006)

29 Commonwealth, Philippines Australia Development Cooperation Strategy 2004-2008, Australian Government and AusAID (2004) 8.

30 Public sector debt (loans and export finance guarantee only) owed to EFIC (National Interest and Commercial Account), as at 10 April 2006.

31 Based on an exchange rate of 0.7177 as of 3 April 2006 advertised by the Federal Reserve Bank of New York <http://www.federalreserve.gov> at 4 June 2006.

32 Ibid.

scheme to fund purchases from Australian companies by recipient governments and has been criticised by Treasurer Peter Costello as a 'subsidy paid to domestic businesses'.[33] The Australian economy has thus already benefited from the enhanced exports.[34]

A *Recent Developments in the Philippines*

Recently the Philippines has taken substantial steps to reduce its external sovereign debt. President Arroyo has implemented responsible fiscal and monetary policies that have helped to control inflation and lift the nation's debt rating. These include increasing Value Added Tax (VAT) from 10 per cent to 12 per cent in February 2006, which is expected to bring in additional revenue of PHP 75 billion in 2006,[35] and extending VAT to energy products in November 2005.[36] The Philippine government also sold US$2.1 billion in sovereign debt in January 2006.[37]

Standard & Poor's and Fitch's findings cited President Arroyo's expansion and increase of the VAT regime as the reason for upgrading the Philippines' debt rating.[38] Nonetheless, the Philippines continues to struggle with limited budgetary resources and a rapidly growing population.[39] Although remittances from abroad do assist,[40] it is clear that without further assistance Filipinos have a long road ahead of them before they see material benefits from the sacrifices they have made.

B *Threats to Economic Development*

Current poverty levels in the Philippines will cause long-term damage to the nation's human capital and make economic reform significantly more difficult in the future.[41] For this reason it is imperative that the economic turnaround currently underway continue. The Philippines is facing a number of serious threats to its continued progress including poverty, political instability, security concerns, natural disasters and avian flu.

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33 NSW Legislative Assembly Hansard, *Development Import Finance Facility Abolition,* 30 October 1996 <http://www.parliament.nsw.gov.au/prod/PARLIAMENT/hansArt.nsf/V3Key/LA19961030034> at 25 April 2006.

34 Ibid.

35 'Philippines: Market Strategy - Improving Local Debt Outlook' (2006) 11(44) *Emerging Markets Monitor* 9, 9.

36 IMF, 'IMF Executive Board Concludes 2005 Article IV Consultation with the Philippines' Public Information Notice (PIN) No 06/25, 6 March 2006.

37 Ibid.

38 Pia Lee-Brago, 'Washington Watching RP Economic Reforms', *Philippine Headline News Online* (Manila, Philippines), 15 February 2006 <www.newsflash.org/2004/02/be/be003351.htm> at 13 April 2006.

39 Ibid.

40 Ibid.

41 Commonwealth*,* above n 29, 2.

1 *Poverty*

Poverty is a major threat to stability in the Philippines. For poverty levels to be reduced, the Philippines must achieve sustainable broad-based economic growth. If the current poverty levels are allowed to continue, the long-term effects on health and education will frustrate economic development in the future.[42] The Philippines has one of the highest levels of income inequality in Asia.[43] The poorest 20 per cent of the population account for only 4 per cent of the total income.[44] Poverty is most severe in the rural communities and specifically on the island of Mindanao. More than half the islanders live on less than US$0.60 a day (well below the global level for extreme poverty); 30 per cent of children under 5 are stunted as a result of chronic malnutrition and only one-third of children finish primary school.[45] Decades of conflict on the island have contributed to poor agricultural productivity, a lack of investment in infrastructure, unequal land and income distribution, and poor social services.[46]

Mindanao receives food contributions from the World Food Programme and in March 2006 the Japanese government announced it would donate US$1.2 million to the island's poor communities.[47] Australia's current government has shown its concern for poverty in the Philippines though the Medium-Term Philippines Development Plan for 2001-2004 and 2004-2010, and the 2002 Ministerial Statement, Australian Aid: Investing in Growth, Stability and Prosperity.[48]

Poverty in the Philippines is a complex problem that deserves more of Australia's attention. Because poverty reduction efforts are already funded by several different sources, Australia's role in alleviating poverty must be precise and calculated not to interfere or overlap with other projects. It should target the root of the problem through programs that encourage self-sufficient, long-term economic and social development in the poorest communities.

2 *Political Stability*

President Arroyo's economic reforms have made her unpopular among her own people.[49] In 2005, the VAT expansion was temporarily suspended when the opposition challenged the charter change, claiming it was a diversion timed to coincide with impeachment proceedings against President Arroyo for her alleged

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42 Ibid.
43 Ibid 17.
44 Ibid 9.
45 United Nations News Service, 'UN Food Agency Supports Peace Effort in Philippines' Island of Mindanao', *UN Daily News*, 6 April 2006.
46 *Philippines Australia Development Cooperation Strategy,* above n 29, 1.
47 UN News Service, above n 45.
48 Commonwealth, *Medium-Term Philippines Development Plan* (MTPDP) for 2001-2004; Commonwealth, *Medium-Term Philippines Development Plan* (MTPDP) for 2004-2010; Alexander Downer, 'Australian Aid: Investing in Growth, Stability and Prosperity', Eleventh Statement to Parliament on Australia's Development Cooperation Program (2002).
49 Lee-Brago, above n 38.

cheating during the May 2004 elections.[50] In 2006 the opposition has again demanded President Arroyo step down due to allegations of vote-rigging.[51] According to Fitch, another impeachment attempt against President Arroyo could derail the administration's efforts to stabilise the country's fiscal standing and affect its creditworthiness.[52]

3 *Security*

The rule of law is essential to good governance and development. In the words of Alexander Downer, Australia's Minister for Foreign Affairs, '[s]ustainable broad-based [economic] growth is impossible in countries which cannot guarantee public safety. … In violent or insecure environments, inevitably the poor pay the highest price.'[53]

Civil conflict has being going on for five centuries in Mindanao and it is now the second oldest conflict in the world.[54] This insecurity encourages people to join vigilante groups while discouraging them from investing in their future through agriculture, education, infrastructure and resource protection.[55]

Conflict in Mindanao is a complex problem. It is concentrated in rural Muslim-majority communities and originated from the Moro clans' resentment of the increasing number of Christian settlers and Christian central control. The Moro National Liberation Front ('MNLF') emerged in the 1960s and Muslim resistance developed into armed conflict. More recently, the Moro Islamic Liberation Front ('MILF') has also emerged. The MNLF is the government's main opponent and the MILF is a more religiously focused resistance group. Although religious differences have shaped the conflict, its roots lie in the clans conflicting interests regarding control over land and the resentment felt by the Moros about their inferior status. The situation is further convoluted by the existence of several indigenous clans. They have been dominated and relocated by each of the settling colonisers and are regularly looked down upon by both the Christians and the Moros.[56]

The current situation in Mindanao is much more complicated than can be seen from its history. Among the Christians there is tension between the elite and the majority. Within the Muslim clans there is constant conflict which often elicits military

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50 Ibid.
51 Ibid.
52 Ibid.
53 AusAID, *Australian Aid: Approaches to Peace, Conflict and Development* (November 2005) 1 <http://www.ausaid.gov.au/publications/pdf/ausaid_peace.pdf> at 21 August 2006.
54 Salvatore Schiavo-Campo and Mary Judd, 'The Mindanao Conflict in the Philippines: Roots, Costs, and Potential Peace Dividend' Paper No 24, *The World Bank Social Development Papers Conflict Prevention & Reconstruction* (February 2005) 1.
55 Alexander Downer, *Australia's Overseas Aid Program 2005-06* (10 May 2005) <http://www.budget.gov.au/2005-06/ministerial/html/ausaid.htm> at 13 April 2006.
56 Schiavo-Campo and Judd, above n 54, 2.

intervention. This is aggravated by widespread banditry including violence, extortion and kidnapping for ransom.

Numerous attempts have been made to bring the violence under control. Most recently efforts have involved the creation of the Government-MILF Joint Ceasefire Coordinating Committee on the Cessation of Hostilities ('JCCCH') which is charged with monitoring any violation of the ceasefire agreement. Additionally an agreement has been made to establish an International Monitoring Team to be led by Malaysia for the purpose of strengthening the peace process. Formal peace talks are expected to resume soon. In the past a major hurdle to negotiations has been the Moro's desire for a geographical area where they can promote their culture, religion and way of life.[57]

Conflict in Mindanao has killed 120 000 people and displaced a further 2 million since 1970[58] and has severely repressed economic and social development.[59] In addition to being a deterrent to FDI in the Philippines, conflict in Mindanao discourages any worthwhile investment by local farmers and reduces the profitability of crops in conflict- afflicted regions.[60] On a social level, extended conflict reduces levels of education and health, increases the level of poverty and causes a collective loss of hope.

Recently the World Bank has pledged US$50 million to rehabilitate 5000 villages in conflict-affected areas in Mindanao and in the South.[61] Japan and the United States have also made separate agreements to assist in post-conflict development.[62] In addition to improving the international image of the Philippines, resolving the conflict will facilitate enormous gains in economic and social development for the conflict-affected areas and subsequently allow the poorest Filipinos to improve their quality of life. According to a 2005 UN development report, additional economic opportunities may exist in Mindanao rebel controlled areas which are believed to be rich in oil, gas, copper and gold.[63]

Security and poverty in Mindanao are complex and overlapping problems. A comprehensive approach is necessary for peace to be achieved in Mindanao. Peace initiatives must include the unresolved issues from the 1996 Peace Agreement and

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57 Ibid 3.

58 Michael Vatikiotis, 'Resolving Internal Conflicts in Southeast Asia: Domestic Challenges and Regional Perspectives' (2006) 28(1) *Contemporary Southeast Asia* 27, 31.

59 Downer, above n 55; Schiavo-Campo and Judd, above n 54, 2.

60 Schiavo-Campo and Judd, above n 54, 7.

61 Mogato, above n 58.

62 The Ministry of Foreign Affairs of Japan, *Dispatch of Senior Advisor for Reconstruction and Development of Mindanao to International Monitoring and Support Team in Philippines* (2006) <http://www.mofa.go.jp/announce/announce/2006/10/1010.html> at 13 February 2007; The United States Ministry of Foreign Affairs, *Foreign Operations, Export Financing, and Related Programs (Foreign Operations)* (2007) 19 <http://www.state.gov/documents/organization/60300.pdf> at 13 February 2007

63 Mindanao Economic Development Council, *Mindanao* (2004) < http://www.medco.gov.ph/medcoweb/mindanao.asp> at 19 April 2007.

the concerns of the indigenous people.[64] A non-inclusive approach could be counter-productive in the long term by creating new tensions between clans. Post-conflict assistance programs must target Muslim and indigenous communities equally to provide the needed facilities, resources and training.[65] Care must be taken to prevent new economic and social tensions, to restore the trust of the people and break the cycle of violence.[66]

4 *Natural Disasters*

Natural disasters are an increasingly significant threat to the Philippines' growth. In the Philippines the risk of volcanic eruptions, earthquakes, floods, droughts, cyclones, tidal waves and landslides has increased dramatically in the last generation.[67] Disasters inflict costs on developing countries twenty times greater than industrialised countries due to poor planning and infrastructure. More than 95 per cent of deaths caused by disaster occur in developing countries.[68] In addition to death and destruction, disasters in developing countries frequently cause widespread disease and food shortages that drive up food prices.

5 *Avian Flu*

The Philippines' poultry industry is valued at about A$4 billion a year. In July 2005 a low-risk strain of bird flu was discovered in ducks in a region north of the capital Manila.[69] This was an isolated case and to date the Philippines has remained the only Asian country with large-scale poultry farming to have avoided the effects of the deadly H5N1 strain of bird flu.[70] The Philippines is particularly vulnerable to the threat of bird flu due to bird smuggling, the illegal trade of endangered birds, cock-fighting, and duck farmers who graze their foul in wetlands that are frequented by migratory birds. Any outbreak of the H5N1 strain in the Philippines would be difficult to contain despite the preventative measures in place, due to the

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64 Schiavo-Campo and Judd, above n 54, 9.

65 Ibid.

66 Ibid.

67 See generally, Population Reference Bureau, *Making the Link in the Philippines: Population, Health, and the Environment* (2006).

68 The World Bank Group, *Hazard Risk Management* (2006) <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTURBANDEVELOPMENT/EXTDISMGMT/0,,menuPK:341021~pagePK:149018~piPK:149093~theSitePK:341015,00.html> at 19 April 2006.

69 Prime Sarmiento, 'Wild Bird Smugglers Pose Avian-Flu Threat', *Manila Standard Today*, 3 April 2006 <http://www.manilastandardtoday.com/?page=news05_april03_2006> at 26 April 2006; Dino Balabo, '270 Ducks Culled in Calumpit; Measures against Bird Flu Planned', *Manila Times*, 10 July 2005 <http://ecologyasia.com/news-archives/2005/jul-05/mt_050710_1.htm> at 1 January 2007.

70 Ibid.

poor control over bird farming and trading.[71] The potential for a bird flu pandemic one of the major threats facing the global community.[72]

Avian flu can be quickly carried around the world by migrating birds.[73] The first case of bird flu occurred in 2004 and infections remained predominately in Southeast Asia until June 2005. Since then the virus has spread to Siberia, the Baltics, Turkey and Romania. The most efficient way for developed countries like Australia to protect themselves from the H5N1 virus is to minimise the risk of outbreak in the most vulnerable countries. There are several projects that can be undertaken cooperatively between the Philippines and Australia that will either significantly reduce the risk of an outbreak in the Philippines or, in the event of an outbreak, reduce the risk of the virus spreading to Australia. One such project is the re-establishment and improvement of mangrove habitats in the Philippines which will promote a greater separation between domestic fowl and migratory birds.

Poverty, political instability, security problems, natural disasters and avian flu are all serious threats to the Philippines and the entire region. A debt-for-investment agreement between Australia and the Philippines could address some of these issues to the benefit of both governments and of some poor Filipino communities.

IV SUGGESTED DEBT-FOR-INVESTMENT PROJECTS

The Philippine government is open to entering into debt-for-investment agreements with Australia and Australia has much to gain and little to lose from such agreements.

The threat of a bird flu epidemic in the Philippines is a serious concern for Australia. The persistence of security problems in Mindanao is another serious concern due to alleged links to transnational crime and terrorism.[74] Australia's future security is inevitably linked to the stability and security of our region. It is difficult to be a secure and prosperous nation in an insecure unstable region.
No outlays would be required from the Australian Government because all funding would come from the conversion of existing debt into Philippine pesos. Initially, only a small portion of the Philippines' debt to Australia would be converted into pesos for use in the debt-for-investment projects, but the effects of these projects could nonetheless be far reaching.

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71 Ibid.

72 See Ross Buckley, 'Executive Summary of the Australia 21 Roundtable', Sydney, March 2006, Security & Prosperity Program <http://www.australia21.org.au/ssp_progress.htm> at 13 February 2007; World Economic Forum et al, 'Global Risks 2006' <http://www.weforum.org/pdf/CSI/Global_Risk_Report.pdf> at 1 September 2006.

73 'UN Bird Flu Coordinator Advocates Multi-Prong Effort to Control Deadly Virus' (9 February 2006) *UN News Service,* 8.

74 Commonwealth, above n 29, 2, 13.

The negotiation, implementation and supervision of the debt-for-investment projects will also provide the opportunity to strengthen the relationship between the two governments.

Other leading developed nations including Canada,[75] France,[76] Germany,[77] Italy,[78] Switzerland,[79] and the USA,[80] have all taken part in debt swap agreements to benefit developing nations. The Philippines is in Australia's backyard, and we in theirs. We rank among the top six bilateral aid donors to the country and have shown our continued concern through the Medium-Term Philippines Development Plan.

It is in the interests of the Australian and the Philippines governments to agree to convert some part of the bilateral debt owed by the Philippines to Australia into funding for debt-for-investment projects. An initial sum of A$30 million could be made available with further sums to become available upon the successful implementations of the initial project. Both governments would have an active role in structuring the transaction and selecting the projects. The structure of the transaction would afford complete transparency and accountability and the implementation of the projects would be closely monitored by both governments.

The primary objectives of a debt-for-investment project would be to reduce poverty and improve economic development, and thus serve to assist the Philippines in achieving its Millennium Development Goals.[81]

The choice of debt-for-investment projects must be a joint decision of the debtor and creditor governments. Recent research suggests that donors overlook at their

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75 Canada offered a debt-swap for outstanding Official Development Assistance ('ODA') loans of C$447 million to the Government of Pakistan for education and teachers' training in December 2005. This has been Canada's largest debt-swap agreement to date: Khalid Saeed, Government of Pakistan Economic Affairs Division Islamabad, *Year Book* 2004-5 (October 2005), 28.

76 In March 2002 France signed its 4th debt swap agreement with the Kingdom of Jordan for approximately US$33million which is to be converted into investments. This debt swap is part of France's ongoing effort to help Jordan alleviate its US$6.9billion external debt: Rana Awwad, 'France Signs Debt-Swap Agreement with Jordan', *Jordan Times,* 7 March 2002 <www.jordanembassyus.org/03072002008.htm> at 6 June 2006.

77 See above n 22.

78 Ibid.

79 As discussed in Part II: Kamel and Tooma, above n 25.

80 The US has participated in numerous debt swap agreements one of which was with the Philippines in September 2002 to cancel US$5.5 million in return for the funding of tropical forest conservation activities through non-governmental organizations (NGOs) in the Philippines (Distributed by the Office of International Information Programs, US Department of State <http://usinfo.state.gov> at 6 June 2006).

81 The World Bank Group, *Millennium Development Goals for the Philippines* <http://ddp-ext.worldbank.org> at 28 April 2006.

peril the expertise resident in developing countries about what their country needs.[82] In other words, if the Australian government wishes to get the most bang for its debt-relief buck, it needs to give careful attention to the projects suggested by the Philippines government.

Two projects that we suggest may be highly effective in achieving some of these goals are projects to re-establish and protect mangroves and projects to support the peace process in Mindanao.

A *Mangroves*

Mangrove forests protect coastlines, improve fish yields and provide forest resources. Mangroves provide protection from storms, hurricanes and tsunamis by absorbing the energy of wind and waves and stabilizing the shoreline, thus protecting villages from tidal surges.[83] They trap sediment, filter pollution, improve the supply of nutrients and provide habitat for marine life. Rural Filipino communities use mangrove trees for timber, to thatch roofs and to make medicines.

Intensive shrimp farming has been largely responsible for the destruction of mangrove forests in the Philippines. Shrimp farms require the complete removal of mangroves yet only have a productive life of about 5 years. After that time, yields decline dramatically and pollution and disease rise. At this point shrimp-farm investors move on, to clear another mangrove forest.[84] Estimates are that by 1997 the Philippines had lost 60 per cent of its mangrove forests, Thailand 55 per cent, Vietnam 37 per cent, and Malaysia 12 per cent.[85] One hectare of mangroves in the Philippines can yield 400 kilos of local fish and seafood annually, and help feed a further 400 kilos of fish and 75 kilos of seafood that mature elsewhere.[86] The removal of one hectare of mangroves thus costs fisheries between US$200 and US$700 per annum. The cost of restoring mangroves is therefore recoverable from the value generated for local fisheries within a few years.[87]

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82 See Ross Buckley, 'Why the Policy Development Capacity of Some Developing Countries Exceeds That of the International Monetary Fund', forthcoming *Tulane Journal of International and Comparative Law* (2006).

83 According to the Harbor Department of the Ministry of Communications and Transport there is severe erosion of the shoreline in several areas where there are no mangroves. The cost of construction breakwaters to prevent such erosion is estimated to be around US$875 per meter of coastline. Suthawan Sathirathai and Edward Barbier, 'Valuing Mangrove Conservation in Southern Thailand' (2001) 19 *Western Economic Association International* 109, 116.

84 Ibid 110.

85 Roy R Lewis III, 'Mangrove Restoration and Benefits of Successful Ecological Restoration' (Paper presented at the Mangrove Valuation Workshop, Beijer International Institute of Ecological Economics, Stockholm, Sweden, 8 April 2001) 1, 4.

86 Ibid, 4-5.

87 Edward Barbier, 'Valuing the Environment as an Input: Review of Applications to Mangrove-Fishery Linkages' (2000) 35 *Ecological Economics* 47; Edward Barbier, Ivan Strand and Suthawan Sathirathai, 'Do Open Access Conditions Affect the Valuation of an Externality? Estimating the Welfare Effect of Mangrove-Fishery Linkages in Thailand' (2002) 21 *Environmental and Resource Economics* 343.

Shrimp farming is a lucrative business and has been actively promoted by the Philippines' government for economic reasons. However, intensive shrimp farming is not economically beneficial once all of its costs are factored in, including declines in fishing revenue and loss of coastline protection.[88] This would remain true, even if shrimp farmers were required to reinstate the mangroves, and did so successfully, after the 5 year life span of their farms.

Local rural communities often see little returns from shrimp farms in their region. Intensive shrimp farming is capital intensive and thus beyond the capacity of local small-scale farmers. The loss of mangroves is thus detrimental to the lifestyle and livelihoods of local communities. Furthermore, mangroves in the Philippines are considered public property and thus communities must rely on the Royal Forestry Department ('RFD') to enforce mangrove protection.[89]

Recently, some communities have drafted local rules to protect mangroves and reserve their use for local communities.[90] Since 2005, Yadfon, an NGO, has worked to assist 20 communities to manage their own mangroves.[91]

Internationally several different types of programs have been undertaken to restore and protect mangrove forests. Bangladesh currently employs villagers to plant mangroves on coastal mudflats. More than 100 000 hectares have been planted for relatively little expense. Ecuador has discouraged the further destruction of its mangroves by giving shrimp farmers incentives to restore mangroves.[92]

The cost of successfully restoring mangrove forests varies widely and depends upon whether excavation or fill are required before planting. Many mangrove restoration projects have failed because they have moved directly into the planting phase without first re-establishing a suitable environment for the mangroves. Mangroves are a naturally recovering species therefore if natural recovery is not occurring there is generally a reason. In the Philippines large scale mangrove planting projects have had success rates that vary from 0 to 66 per cent.[93]

The debt-for-investment project proposed could financially support local projects to restore and protect mangroves. These local projects could provide employment and training for local communities, reduce the risk of conflict between communities and limit damage from natural disasters. This project could also support government efforts to give communities control over local mangrove forests.

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88 Ibid.

89 See, eg, Barbier, Strand and Sathirathai, above n 87.

90 Sathirathai and Barbier, above n 83.

91 John Parr, 'Natural Coastal Defence Barriers: Ecosystems can benefit from public participation', *Bangkok Post* (Thailand), 21 February 2005.

92 American Association for the Advancement of Science, 'Mangroves and Estuaries', *Atlas of Population & Environment* <http://atlas.aaas.org> at 29 April 2006.

93 Lewis, above n 85, 4-5.

B *Conflict in Mindanao*

In September 1996 the Final Peace Agreement ('FPA') was signed by the Government of the Republic of the Philippines ('GRP') and the MNLF under the auspices of the Organization of the Islamic Conference under the leadership of Indonesia.[94] The FPA seeks to address the political, social, cultural and religious foundations of the conflict in the southern Philippines. The signing of the FPA shows a commitment to peace. The FPA is, however, only the first step in achieving lasting peace in Mindanao. The next step is its effective implementation.[95]

The FPA's best chance for success will likely involve community-based initiatives. Avoiding future outbreaks of violence will depend on a fair social structure that gives all clans an equal opportunity to participate in the governance of the community. Efforts must also be made to overcome feelings of mistrust and resentment between clans. Specifically, it has been suggested that the implementation of the FPA focus on three goals:

1. The peace process in Mindanao must be community based and reflect the basic values of all Filipino communities.
2. The peace process must create a fair social structure where all individuals are free to engage in peaceful competition for the success of their political programs based on an electoral system.
3. The peace process must seek a peaceful resolution to the armed conflict without blame or surrender and which restores dignity to all people.[96]

Community level peace initiatives have been designed by communities to fit with their own image of peace. These have included projects promoting peace advocacy and education, community-based peace-building, peace centres and secretariats, mediation initiatives and inter-religious dialogues. An example of a community level peace initiative is the Mindanao Peace and Development Initiative ('MAPD'). MAPD is a joint government and community effort to respond to the increased level of violence and tension of the 1990s. MAPD's achievements include affirming the shared desire for peace, placing concerns about religion and community-related issues on the table for discussion, and proposing courses of action to address these concerns.

MAPD has also encouraged the formation of other peace initiatives such as the Mindanao Peaceweavers. The Peaceweavers are a broad-based network whose goal

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94 Nieves Confesor, 'The Philippines: In Search of a 'Transformed' Society – Building Peaceful Social Relations' (Expert Group Meeting, UN Division of Social Policy and Development, UN HQ, New York, 21-23 November 2005) 6; Mindanao Peaceweavers, 'Is the Philippines at War with the US?' (30 November 2005) <http://www.mindanaopeaceweavers.org/index.php?option=com_content&task=view&id=214&Itemid=1 > at 28 May 2006.

95 Confesor, above n 94.

96 Ibid 8.

is to engage communities in support of the peace initiative. The Peaceweavers believe, given the extended period of conflict and the damage it has done, that peace can only be achieved by starting at the local level.

The Mindanao Peaceweavers have investigated the factors that led to the wars in Sulu between the MNLF and the military in February and November of 2005. These conflicts alone displaced 70 000 civilians and have caused persisting fear and insecurity among the people. Since then there have been an alarming number of incidents in Sulu implicating Filipino marines. There are accusations of rape, murder and kidnapping, and the release from custody of marines suspected of killing innocent civilians without investigation. US soldiers in Mindanao are allegedly taking part in these attacks along side Filipino marines.[97]

The Peaceweavers have called on the police to assert supremacy over the military, to conduct formal independent investigations into allegations against marines and take the appropriate action to bring about justice for the victims.[98]

Programs like the MAPD and Peaceweavers that engage communities in initiatives to create a sustainable peaceful environment have a fundamental role to play in the implementation of the FPA. Local programs like these may be better placed than international organizations or government organizations to achieve these ends.

There are currently more than 40 successfully established peace zones in Mindanao. They are supported by local community conflict avoidance activities and local government. To achieve this there has been a joint effort made by the Lumads, the Christians and the Moros to share these territories. The result has been joint control over the community and improved communication. Social cohesion can only be achieved in the absence of conflict – so peace zones are indispensable. Leadership is fundamental to the sustainability of these peace zones. Community leaders must agree to support and work towards achieving peace for a better future.

Achieving peace in Mindanao will stop the cycle of violence, mistrust and fear that is preventing social and economic development. Once the violence has ended, new social structures can be established to facilitate continued communication and allow shared or fairly distributed ownership of resources and shared community governance.

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97 Mindanao Peaceweavers, above n 94.

98 Mindanao Peaceweavers, 'A Call for an Impartial Probe on Marines Involvement in the Killings, Bombings in Sulu' (29 March 2006) <http://www.mindanaopeaceweavers.org/index.php?option=com_content&task=view&id=316&Itemid=1 > at 28 May 2006.

V CONCLUSION

Australia can do more than it is today to assist the Philippines' development. A debt-for-investment program with the Philippines has much to offer both countries, at a very small cost to Australia.

A debt-for-investment project along the lines we have suggested will reduce the risks of avian flu and terrorism in our region and enhance the stability of the Philippines through economic growth, reduced internal conflict, and improved resistance to marine natural disasters. In addition, working together to structure and implement such projects will strengthen the bilateral relationship between Australia and the Philippines at the political and administrative levels.