DRAWING LESSONS TO PUT IN PLACE POVERTY-SENSITIVE RESPONSES TO MACRO SHOCKS

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Especially in this age of globalization, the world market economy is prone to crises, some of which could not be accurately predicted. Thus, even if the Philippine economy could hurdle the structural obstacles to sound and sustained growth, it would nevertheless remain vulnerable to systemic external shocks. The 1997 global financial crisis has demonstrated clearly that economies with strong fundamentals are not spared from the volatility and risks of the globally integrated market economy.

But the Philippine economy faces greater internal risks, underscoring the need for economic policy to be sensitive to crisis prevention or mitigation. We cite two factors why this is so. The first factor is the history of the boom-and-bust cycle, a decisive end to which has become the main challenge for economic policy-makers. It can be easily observed over the decades that the economy has taken a roller-coaster ride, so to speak. Note that once growth rate peaks at around 6 percent, the strains in the economy become visible, leading to a slowdown if not a recession. The second factor is the regrettable fact that the Philippines is calamity-stricken--perennially visited by devastating typhoons, powerful earthquakes, severe droughts, and the like. These natural calamities contribute to a macro shock, recently exemplified by the impact of the El Niño drought on agriculture output in 1998.

In brief, the proneness of the global market system to shocks, the historical boom-and-bust episodes in the economy, and the regularity of natural calamities all combine to make the Philippines quite susceptible to macro shocks. To be sure, the best strategy is to minimize the occurrence of a crisis, but if this cannot be avoided, then the next-best option is to mitigate the impact, with emphasis on the protection of the poor.

Hence, based on lessons drawn from past crises, this paper attempts to develop a guide for policy-making that is sensitive and responsive to the welfare and interests of the poor.

Revisiting the Past

Undoubtedly, a macroeconomic shock--resulting in an economic slowdown or worse, a recession--aggravates poverty. It is the slow rate of growth (if not the failure of growth in critical periods) that mainly explains the persistence of high poverty incidence in the Philippines. In turn, the low average annual growth rate (from 1992 to 1999, the average growth rate was 3.12 percent) has been the product of the economy's boom-and-bust cycle. Below is a description of crisis episodes since the 1980s. It must be noted though that the country went through several economic crises in earlier years. Fabella (1995) notes that the crises occurred on the heels of presidential elections in 1949, 1957 and 1968, with the wide gap in the balance of trade as the underlying cause.

In 1983 to 1985, the economy collapsed, as a result of the political upheaval and instability in the aftermath of the assassination of Benigno Aquino, the foreign debt crisis, and the failure of an expansionary, counter-cyclical policy that was marred with cronyism and corruption (Lim 1998). GNP (gross domestic product) growth rate plunged to -7.32 percent and -7.31

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percent in 1984 and 1985, respectively. The economic and political crisis that erupted in the twilight years of the Marcos regime led to a huge drop in per capita income and in the sharp increase in poverty incidence. From a GDP per capita (1985 price) of PhP12, 869 in 1982, so far the highest per capita posted in Philippine economic history, GDP per capita fell to PhP10, 461 in 1985. Before the end of its term, the Ramos administration was poised to recover the level of GDP per capita attained in 1982. Sadly, a new crisis hit the economy and eroded the initial gains in economic growth and poverty reduction.

The next episode of the economic bust, though quite moderate if compared to the 1983-85 crisis, occurred in 1990 to 1992. The GDP registered growth rates of -0.58 percent and 0.34 percent in 1991 and 1992, respectively. One main cause of the crisis was again the debt overhang (at various points, debt servicing ate up more than half of the national budget, and foreign debt servicing was equivalent to more than a third of merchandise export earnings). The growing import requirements of the booming economy during the period 1986 to 1989 (though the decline in the growth rate began in 1989) also contributed to the widened gap in the external balance. The energy crisis, due to the under-investment in the power sector, was an internal factor, while an external development, the Iraq-Kuwait war, triggered the peso devaluation.

The 1997-99 economic slowdown, magnified by the Asian financial crisis in July 1997, was the latest round of the economic bust following the vibrant growth rates (peaking at 5.48 percent GDP growth in 1996) in the middle of Ramos's term. The Philippine crisis, in relative terms, was mild. However, comparing the mildness of the Philippine crisis with the intensity of the crisis in other East or Southeast Asian countries is a contentious point. The Philippine economy, in the first place, was not a high-growth economy like its neighbors; hence it did not absorb massive amounts of voluntary private capital that poured into the NICs (newly industrialized countries), which suddenly and swiftly moved out amidst the regional contagion.

Many economists are in agreement that the 1997 crisis in the Philippines was mainly a problem of economic fundamentals (specifically, the widening current account deficit and the slowdown of the growth in the productive sectors). The Asian contagion that began in Thailand only served to precipitate or accelerate the eruption of what essentially was a crisis of fundamentals.

Nevertheless, the El Niño drought also had a great impact on poverty. The negative repercussions of the financial crisis were mainly felt in the industry and services sectors. But the drought was the principal culprit in the decline of agriculture output. The GDP posted a -0.5 percent growth rate in 1998. The industrial sector growth rate dropped to -1.8 percent, while the agriculture sector growth rate decelerated to -6.6 percent.

All told, Reyes (1999) concludes that the economic downturn that began in the second semester of 1997 reduced real incomes for all income groups, but the poorest decile suffered the largest cut in real income. The 1998 Annual Poverty Indicator Survey (APIS) also suggested the rise of poverty incidence in the aftermath of the crisis (official poverty incidence rate was 32 percent in 1997). Moreover, simulations done by the Micro Impacts of Macroeconomic Adjustment Policies (MIMAP) under the Philippine Institute for Development Studies (PIDS) showed a rise in income inequality. The GINI coefficient increased from .45 in 1994 to .49 in 1997.[1] Further, said Reyes, the ratio of the income share of the richest quintile to that of the poorest quintile increased from to 12.7 in 1997 to 16.4 in the following year. (This argument is reinforced by the MIMAP estimate that the poorest income decile group suffered the largest reduction of real income.)

[1] A Gini coefficent that approximates 0 means that the income distribution is close to equal; a Gini coefficent that approximates 1 means that the income distribution is highly inequal.

Sound Macroeconomy

The different episodes of economic busts that the country went through from the 1980s until the close of the 20th century have a common lesson. That is, the prevention of major macroeconomic crises makes sound fundamentals in macroeconomic policies and management absolutely necessary.

De Dios (1999) sums up the main structural problems that explain the "low and unchanged maximal rate of growth," namely low productivity[2], low saving rate[3], and a backward, uncompetitive agriculture sector[4]."

Sound macroeconomics towards decisively resolving the main problems mentioned above has to include the following features:

- A low consolidated public sector deficit (CPSD) combined with high public investments (Fabella [1995] suggests a public investments equivalent to 8-10 percent of GNP (gross national product).

- Better tax collection and administration, leading to the generation of more revenues to serve the twin goals of financing basic social services and infrastructure and keeping the budget deficit low.

- Greater mobilization of national savings to check the rise of domestic interest rates and reduce dependence on foreign debt and short-term foreign financing.

- Sustained growth in durable equipment investments hand in hand with an increasing share of manufacturing, including exports, in total output.

- Alignment of the nominal exchange rate with the real exchange rate and preventing an overvaluation of the currency to have a healthy trade and current account balance.

Along this line, Montes (1996) offers a macroeconomic policy framework that he calls "compositional preferences," to wit:

- Preference for investment growth over consumption growth.

- Preference for steady export growth, with the rate of export growth outpacing the rate of import growth.

- Preference for improving the ability to service foreign liabilities.

- Preference for long-term foreign direct investments over short-term portfolio flows.

The 1997 financial meltdown also unraveled new insights into policy formulation on crisis prevention and crisis mitigation. There is consensus on building a new international financial

[2] De Dios enumerates the many factors that hamper productivity: poor infrastructure, microeconomic inefficiency, weak competition, declining quality of education, weak inflow of foreign direct investments.
[3] De Dios estimates that the investment rate of 25 percent in the Philippines would translate to a yearly growth rate of no more than four to five percent.
[4] The agriculture sector is hobbled by the lack of infrastructure support, the delayed resolution of property rights in relation to agrarian reform, and the relatively high prices of food and agriculture products.

architecture and strengthening prudential regulation. A strong case has been argued for developing countries to have a cautious stance in liberalizing the capital account. Moreover, the advocacy for judicious capital controls has gained ground; even the International Monetary Fund (IMF) no longer considers capital control a taboo subject. Various efforts at the international and national levels are being undertaken to set up models and modes of "affordable" and "feasible" safety nets that effectively target the poor.

And since the poor are the most adversely hit by an economic crisis (and a crisis is, frankly, unavoidable), it is an imperative that their voices be heard and reflected in public policy.

Stabilization Measures

The preceding section has dealt with the macroeconomic policies towards crisis prevention. In this section, we face the issues relating to the formulation and implementation of stabilization policies once the crisis explodes.

In past crises (the prime negative example being the 1983-85 economic crisis), the stabilization policies aggravated the quality of life and led to further impoverishment. Orthodox stabilization policies such as high interest rates and sharp cuts in public spending resulted in high unemployment and underemployment rates, shrinkage of real incomes, and the deterioration in the provision of basic social services, among other things.

The interest rate cure (i.e., skyrocketing interest rates, even exceeding 40 percent in 1984) led to stagflation--a deep contraction in output combined with galloping inflation. In 1984, the average Treasury bill (91-days) rate was 28.24 percent; GDP contracted by 7.32 percent, and the inflation rate was 47.06 percent. The following year, the same variables exhibited a similar pattern: Treasury bill (91 days) averaged 25.87 percent; GDP declined by 7.31 percent, and the inflation rate was still a high 23.45 percent.

In the recent economic downturn precipitated by the 1997 financial crisis, the Bangko Sentral ng Pilipinas (BSP) ultimately abandoned the policy bias for high interest rates to arrest the peso devaluation. The BSP relented in light of the pressure exerted by government reformers (including members of the Monetary Board), academics, and civil society organizations. This move arguably had a moderating effect on the crisis. Furthermore, the newly installed Estrada administration adopted the strategy of fiscal stimulus, even if it meant allowing a higher though still reasonable level of deficit spending, towards facilitating the economic recovery.

The government policy in dealing with the recent shock was hence a significant departure from orthodox responses to macroeconomic shocks.[5] The distributional question with regard to the adjustment or stabilization policies thus leaned towards stimulating economic recovery and protecting social development.[6]

[5] Both the Ramos and Estrada administrations deserve to be credited for this.
[6] The distributional impact of adjustment policies has likewise become a burning international issue: On one side are those who defend orthodox stabilization policies as the means to restore confidence in the economy and on the other side are those who promote a heterodox approach, with a bias for jumpstarting growth at the soonest and protecting human development spending. An attention-grabbing incident that typified the intense debate was the acrid rejoinder of R. Dornbusch to J. Stiglitz's severe criticism against the IMF orthodoxy.

Responsiveness to Specific Conditions

The handling of the 1997 financial crisis and the subsequent mild recession also reaffirms the significance of putting in place the most appropriate policy responses to poverty by identifying and distinguishing specific causes.

For example, the response to shock-induced poverty is quite different from that of chronic poverty. Structural adjustment reform (such as trade liberalization and privatization) is arguably an important though insufficient condition to attack chronic poverty. But structural adjustment, which entails transitional costs, would be difficult to implement in the midst of shocks arising from a financial crisis or a devastating natural calamity. At the conjuncture, the responses to shock-induced poverty must be given priority.

Suffice it to say, too, that the negative effects of shock-induced poverty could lead to irreversible effects on capabilities of the poor. For instance, children dropping out of elementary school or children becoming undernourished as coping mechanisms to a shock could have longer-term adverse effects on their skills, health, and productivity, thereby consigning them to a permanent state of poverty. Reyes (1999) noted an increase in malnutrition rates among children and a reduction of immunization coverage in some regions. The 1998 APIS also revealed that the enrolment rate at the elementary level was lower than the recent trend and that a decline in enrolment was observed at the secondary level. In addition, a greater percentage of children from the poor families than that of the non-poor dropped out of school.

Identifying the principal cause of poverty aggravation during the recent crisis was likewise complex and problematic. Was the principal problem the drought or the financial crisis? The long drought had the strongest impact on the rural poor, while the financial crisis affected most the workers in the industrial and services sectors. Nevertheless, researches and academics had difficulty in distinguishing the effects brought about by the drought on the one hand and the financial crisis on the other hand. In the end, it was irrelevant to belabor the problem of exactly which between the two (drought or financial crisis) was principally responsible for welfare losses. The important thing to grasp was that the financial crisis and the drought required a different set of policy menus even as some responses do intersect.

Another set of issues had to distinguish between the effects of policies put in place even before the crisis struck and the effects of actions undertaken immediately after the explosion of the crisis. Examples of the former would include the comparatively higher domestic interest rates and the overvaluation of the peso, which resulted in the slowdown of the productive sectors and subsequent retrenchment of workers. The latter would cover the initial orthodox stabilization measures espoused by the BSP and the more recent controversies that tend to reinforce the low level of investor confidence in the economy.

We cannot ignore either the transitional problems and other risks linked to the globalization process. In this context, we finely differentiate globalization (defined in broader terms to include cross-border flows, trade, technology and ideas) from the financial crisis (a subset within globalization's domain). The adjustment problems arising from trade liberalization and their particular effects on vulnerable groups should be treated distinctly from the impact of the financial crisis. To put it another way, a more sophisticated analysis is required to differentiate the problematic factors (e.g., capital account liberalization and misaligned exchange rate) directly linked to the financial crisis from the painful adjustments associated with locational competition and related issues of competitiveness.

Information Requirements

The specific responses to the different sets of problems discussed above all require good information. Correct and detailed information is a necessary condition to develop the policies and programs most appropriate and most responsive to alleviating poverty in the midst of a crisis. Moreover, information assumes a crucial role towards a better understanding of the causes of poverty and sources of welfare losses; enriching the discourse and debate on policy options or alternatives; and enhancing transparency and accountability, especially when the required policies entail tradeoffs or sacrifices.

Yet, it is in times of crisis that the extraction of information becomes more difficult.

The nuances and specificity of the economic crisis's impact on poverty are best obtained through on-the-ground studies and surveys. The government has a wealth of experience in obtaining information towards identifying poverty-sensitive responses.

The minimum basic needs (MBN) approach is considered a major breakthrough in operationalizing a research and survey methodology that ensures grassroots participation and promotes community empowerment. Through the meaningful participation of local communities, the MBN approach is able to generate concrete, informative, and reliable data, thereby establishing solid ground for the most appropriate policy intervention.

Worth citing, too, is the Annual Poverty Indicators Survey (APIS). Introduced in 1998, the APIS is designed to help policy-makers monitor and assess poverty indicators and establish benchmarks for anti-poverty programs. The APIS also complements the more comprehensive Family Income and Expenditure Survey (FIES), which is done every four years.

The 1998 APIS had its weakness, though not significant to undermine the survey outcome. The initial survey design could have incorporated more variables with regard to the people's minimum basic needs. Also, it could have classified respondents into income decile groups, to be consistent with the FIES, instead of limiting the income classification to the highest 60 percent of families and the bottom 40 percent. These deficiencies mainly arose from the funding constraint.

Nevertheless, the 1998 survey was able to draw out rich, if not peculiar, information and insights. For example, it validated the proposition that it was difficult to principally attribute the fall in the standard of living to the financial crisis. The 1998 survey showed that a majority of families stated they were affected by the drought. Another interesting result was that a bigger percentage of families belonging to the income group composed of the highest 60 percent (in other words, the upper and middle classes) reported loss of jobs or reduced wages.

Even then, great care has to be exercised in the interpretation of the data. A debatable point is how to interpret the respondents' sensitivity to high prices (inflation). Indeed, at that time, prices increased as a result of the steep peso devaluation and the reduction of food supply. The challenge for policy-makers is how to problematize and contextualize the inflation problem. A standard textbook response would have been to tighten monetary policy (restriction of monetary supply and higher interest rates). However, this would have meant sacrificing investments, output, and jobs. A more balanced and sophisticated analysis would acknowledge inflation as a problem but would weigh inflation vis-à-vis growth and employment. During the 1997-99 economic downturn, and even during the previous episode (1990-92), stagnation and unemployment were the more pernicious problems, although from the perception of the common person, they were not as visible as high prices.[7]

This invariably brings to the fore the tradeoffs involved in making policy preferences. But the dilemma facing the policy-makers with regard to the tradeoffs as well as opportunity costs cannot easily be appreciated by the layperson or by a non-economist. The political mobilization, dictated by the dynamics of the political economy, also has a tremendous impact on the shaping of policy. In the short run at least, what is sound economics oftentimes is bad politics. Politicians--who have the final say--would be tempted to compromise sound but controversial economics to maintain popularity and score political points.[8]

Consolidating the Framework

The public officials are given no quarters to commit mistakes during times of crisis. And there are no hard-and-fast rules, no magic formulas to depend on in the crafting of pro-poor policies.

At best, they have to construct a framework upon which key issues are identified and policies are made.

In this regard, the policy-makers must first have an idea of how macro-wide shocks are transmitted to communities, households, and individuals. With such appreciation or understanding, they are better equipped to design the appropriate poverty-sensitive measures.

The transmission mechanisms are: 1) the reduced demand for labor, 2) higher prices, 3) cuts on public spending, and 4) changes in the valuation of assets.

The reduction of labor demand is expressed though mass layoffs, the restriction of employment opportunities, and the lack of demand for goods produced by low-income households, etc.

Higher prices are determined by the steepness of the devaluation, the sharp contraction of supply, surge of commodity prices, changes in the prices of public goods, and the like.

Cuts in government spending may arise from a tight fiscal policy to balance the budget, weak revenue collection in the absence of growth, higher interest payments on both foreign and domestic debts, etc. Significant changes in the value of assets are principally a result of high inflation. Natural calamities are likewise a determinant of asset changes; in particular, they devastate the meager physical assets owned by the poor. And if one treats human capital and social capital as assets, then the longer-term effects of asset deterioration are more insidious.

Apart from coming to grips with these transmission mechanisms and their links, the policy-makers must anticipate the core questions whenever tensions and tradeoffs emerge in the selection of the policy menu. Among the key questions to be resolved, with due regard to specific contexts, are the following:

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[7] On the whole, Philippine inflation is a result of structural problems such as supply bottlenecks and higher transaction costs. Hence, restrictive monetary policy should not be treated as the typical response to the problem.

[8] Observe how politicians drumbeat populist but economically unsound positions whenever the election period approaches.

- The distributional impact of adjustment policies--whether the policy will principally serve stabilization goals to restore private sector confidence, even if this means pushing the economy into a recession.

- The classic intertemporal tradeoff--sacrificing present consumption to achieve longer-term growth and stability.

- The tensions between and among monetary, exchange-rate and fiscal policies; which policy objective is central and which policy instrument is the most pivotal.

- The timing, pacing and sequencing of structural reforms, taking into consideration the transitional social costs and the resistance of vested interests to the reforms.

- The ranking of budget items that have the greatest positive impact on poverty reduction and the identification of budget lines that can be sacrificed to protect public spending for the poor.

- The weighing of pros and cons regarding on the one hand, the provision of subsidies strictly limited to the absolute poor and on the other hand, the accommodation of a segment of the non-poor to minimize resistance and build a pro-poor alliance.

- The consolidation of simple and clear indicators towards tracking and targeting beneficiaries, in particular the absolute poor.

In conclusion, the Philippines by now should have learned many lessons in dealing with economic crises and putting in place poverty-sensitive responses to economy-wide shocks. Hopefully, this paper has contributed to highlighting the main lessons, issues and questions.

It remains to be seen whether we have indeed firmly grasped the lessons, especially the painful ones. It is everyone's wish to keep our economy insulated from economy-wide shocks. But this is wishful thinking. The acid test will come when we face the next crisis.