Excerpts from advance reviews

"Reading this manuscript reminded me much of my days as a graduate student at the UP School of Economics where I completed both my MA and Ph.D. in Economics. At that time, lunch (not free) was served by Aling Ingga in a room where Friday seminars were also held. There were two rows of tables; the one farther from the door was where my professors sat, ate, and, with sufficiently loud voices for most to hear, debated many things economic, whether theory or policy. On occasion, there were conversations about sports, religion, movies, arts, and of course, politics. The vibe of this book is the same as those conversations - as if I was once again overhearing those interesting conversations. It was as if de Dios, Fabella, Paderanga – all former professors at UPSE – had invited over good friends – Bernardo and Chikiamco – to lunch. And over a good meal, with some wine and cheese, these intellectuals chatted about the most natural topic to them: where is *cara patria* heading? I imagine them proposing a toast: *In vino veritas*."

Stella Quimbo
Member, House of Representatives
and former Professor, UP School of Economics

"A choice selection of illuminating columns from *BusinessWorld* written in the last decade by five of our country's most distinguished economists whose counsel I seek before providing advice to Presidents or House Speakers, or more so when I push legislation in Congress."

Jose Ma. Clemente Sarte Salceda
Member, House of Representatives

"This book might just be the big push the government needs to act on urgent economic reforms to set off real and meaningful change, unlock the country's full potential, and attain more inclusive growth and development."

Margarito B. Teves
Former Secretary of Finance

“The nation is grateful to the talented economists who are the authors of this book. Their thoughts and writings in the last decade have helped form an intellectual consensus that paved the way for reforms to address the root cause why this country is among the least developed in this part of the world.”

Jose T. Almonte
Former National Security Adviser

“Over the years, *BusinessWorld's* “Introspective” column has rightfully earned a reputation as one of the most insightful and erudite business and economics columns out there. This comes from a unique brain trust that combines in one column perspectives from academe, business, and government. A paragon of smart opinion writing in economics, the column's high standards are something I aspire to in my own work. This book, a compilation of the best of “Introspective,” is required reading for serious observers and participants in Philippine economic and public policy discussions.”

J.C. Punongbayan
Ph.D. Candidate, UP School of Economics and Rappler *columnist*

“Post-war Philippine economic history has experienced economic growth – but in spurts. Sustainable economic growth has been elusive. It requires decisive yet visionary leadership, longer-term perspective, and honest pro-poor agenda in aid of meaningful legislation rather than political pandering in aid of re-election or dynastic perpetuation. The writers have addressed these issues time and again in a concise, deeply analytical, yet easily understandable manner even while occasionally seeming like lone voices in a wilderness of political expediency or proverbial unrecognized prophets in their own land. The book thus is beyond a must-read. It is a must-be-seriously-considered compendium if we wish to attain sustainable growth rather than sustainable envy of other nations' progress or sustainable regret over what should have beens.”

Roberto de Ocampo
Former Secretary of Finance

MOMENTUM

Economic Reforms for Sustaining Growth

Romeo Bernardo
Calixto Chikiamco
Emmanuel de Dios
Raul Fabella
and Cayetano Paderanga, Jr.

Edited by **Roel Landingin**
with a Foreword by **Felipe Medalla**

COPYRIGHT PAGE

Contents

2 **Foreword**

8 **Preface**

11 **Acknowledgments**

14 **List of Abbreviations**

366 **Index**

Romeo Bernardo

20 **National leadership and our collective future**
January 11, 2010
Future Philippine leaders can learn a trick or two from former President Fidel Ramos on winning broad support for well-timed reforms

23 **The good, bad, and somewhat stupid**
March 15, 2010
Conditional cash transfers are good, rice subsidies are bad and value added tax exemptions for the elderly are unwise

27 **Renewable energy — reality check**
January 11, 2011
Renewable energy is welcome but we should prioritize hydro and geothermal for now. Let the rich countries develop solar, wind and biomass technologies until costs become affordable for the rest of us

30 **De-monopolizing telecommunications**
September 9, 2011
An early warning against reducing the number of major telco players from three to just two

33 **The way forward for the power industry**
January 26, 2014
Suspending payments to Meralco and the power companies is the wrong way to address glitches in the power trading system that caused a temporary spike in electricity rates

38 **Plumbing the Manila Water story for corporate lessons**
June 29, 2014
Backed by 160 years of experience, the Ayala touch could be the secret sauce behind Manila Water's success in improving water service in the eastern half of the MWSS service area

41 **The life and times of our only Prime Minister**
September 1, 2014
Former Prime Minister Cesar Virata remains a widely respected figure even after the fall of the Marcos regime. Gerardo Sicat goes to great lengths to explain why

44 **Bangsamoro is a gamechanger**
September 28, 2014
The MILF leadership is better prepared than its predecessors to oversee the development of the expanded Muslim autonomous region in Mindanao

48 **On the Philippines joining the AIIB — What's to wait and see?**
July 3, 2015
Given the country's huge infrastructure needs, the Philippines should immediately join the AIIB

52 **Tribute to Francis Varela**
September 14, 2015
The untimely death of a young and well-loved civil servant is a timely occasion to reflect on what makes an effective advocate of good governance: passion, patriotism and strong intellect

56 **The way forward — The path to inclusive growth**
November 8, 2015
Preview of a book compiling selected columns written by one of the country's leading economic thinkers and president of the Foundation for Economic Freedom (FEF)

60 **Corporate governance in the digital age**
June 12, 2017
By taking good corporate governance more seriously than usual, the Bank of the Philippine Islands was well-placed to minimize public backlash from a computer glitch that disrupted online and ATM services

65 **The great infrastructure debate**
August 7, 2017
Rather than switch from PPP to ODA as the primary mode for doing infrastructure projects, the Duterte administration should pursue both, reserving PPP for projects with clear commercial value for the private sector

69 **It ain't Uber till it's Uber**
September 4, 2017
Amending the Public Services Act to limit the scope of economic activities deemed a public utility is a good start to modernizing regulations to accommodate innovative businesses

72 **On globalization, inequality, and inclusive growth**
November 6, 2017
The Philippines, like most of developing Asian countries, has benefitted from globalization through lower poverty rates. The sluggish decline in the ranks of the poor compared to our neighbors should be blamed on policies that hindered investments and job creation

76 **The gravy TRAIN is leaving and common sense isn't in it**
December 4, 2017
The imposition of higher excise tax on coal is a bad idea unworthy of inclusion in the tax reform law. It will just make power rates, already one of the highest in Asia, costlier

80 **Legislation that matters**
August 5, 2018
President Duterte's legislative priorities in his 2018 State of the Nation Address are welcome, especially the Bangsamoro Organic Law, rice tariffication and further tax reforms. The attention to land use is also good news but the proposed bill needs to shed its restrictive provisions

84 **Capitalism and inclusion under weak institutions**
October 21, 2018
Key takeaways from a new book by country's only national scientist in economics, Raul Fabella, who explains, among others, why and how large conglomerates can be good for inclusive growth

88 **Better a good neighbor than a distant cousin?**
January 13, 2019
The Philippines and China are set to deepen economic relations through a bevy of trade, investments and funding deals. We should make sure the benefits are mutual.

91 **Never let a good crisis go to waste**
April 1, 2019
The sudden interruption in 24/7 water supply in the eastern half of Metro Manila should prompt government to resolve the regulatory stumbling blocks to building new water sources

Calixto Chikiamco

100 **Five arrows for the next President**
June 21, 2015
To kill the beast that is widespread poverty, the next Philippine president must be armed with five policy weapons: open up the economy to more foreign investments, modernize labor laws, boost agricultural productivity, adopt a competitive exchange rate, and undertake institutional reform

104 **Labor rigidities as a first-order problem**
November 2, 2015
Raising taxes and improving infrastructure aren't the keys to industrialization. Removing labor rigidities — high entry-level wages and unreasonable labor security regulations — are the keys to growth of labor-intensive manufacturing and higher-paying manufacturing jobs

107 **The constricted rural land market**
November 30, 2015
Farmers, whether agricultural patent or agrarian reform beneficiaries, are "unfree" to mortgage, sell, or lease their lands. Property rights reform in the agricultural land market is the key to inclusive growth in the countryside.

111 **Government is the problem**
March 21, 2016
Given the Philippine government's proven record of corruptibility and incompetence, let's rely instead on the private sector and the markets to deliver essential economic goods and services. But promote competition to guard against market failures

115 **Uberized!**
April 18, 2016
Updating bankruptcy laws to ease entry and exit of firms, doing away with rigid labor laws and modernizing education to encourage life-long learning will go a long way in helping the Philippines survive technological disruption

119 **What agriculture needs is property-rights reform**
July 11, 2016
The Duterte administration's agriculture agenda belies the president's promise that change is coming. It merely resurrects failed and graft-prone programs of past regimes

123 **Labor rigidities are binding constraints to growth**
August 8, 2016
A new World Bank report confirms what eminent Filipino economists have been saying all along about the country's misguided labor policies

127 **Change and uncertainty under Duterte**
September 5, 2016
Risk is measurable; uncertainty is not. Risk is the "known unknown" while uncertainty is the "unknown unknown." Uncertainty under President Duterte can deter investments

131 **Poverty is a bigger threat to society and the state**
October 10, 2016
With only three million drug users and 50 million poor and near-poor Filipinos, President Duterte should be waging all-out war against poverty rather than on drugs

135 **Ending "Endo" and the logic of collective action**
November 7, 2016
Though we're ostensibly a democracy, many government policies, from feed-in-tariffs to ending "Endo," are driven by a tiny minority who stand to gain much

139 **The economic revolution the Philippines really needs**
February 20, 2017
Only a productivity revolution in agriculture will solve the problem of widespread poverty in the countryside. Only a productivity revolution in agriculture will lay the foundation for long-term sustainable growth and for the takeoff into industrialization

145 **Where's the human resource strategy?**
May 22, 2017
Though many of President Duterte's early appointees were disappointing, he seems to be learning from his mistakes. More than plans or strategy, correct appointments will spell his eventual success or failure

149 **Business model, disrupted**
October 9, 2017
Rapid technological advances are about to disrupt overseas jobs and BPOs, the two main drivers of Philippine economic growth

154 **Is growth sustainable?**
March 26, 2018
The widening current account deficits looks worrying amid slowing global economic expansion but a greater concern is the government's pursuit of flawed agricultural policies

158 **The structural weaknesses of the Philippine economy**
September 8, 2018
Rising inflation, slowing GDP growth and widening current account deficits in the middle of 2018 aren't mere economic hiccups but are signs of systemic weaknesses that are holding back sustained expansion

163 **Agriculture, agriculture, agriculture**
November 18, 2018
Not "build, build, build" should be the mantra of the Duterte administration, but "agriculture, agriculture, agriculture" if it's serious about inclusive, sustainable growth

167 **The main trends in the world today**
January 27, 2019
The rivalry between China and US, demographic shifts and rapid technological disruption are the main global trends shaping major economic and political events today, presenting both challenges and opportunities for countries like the Philippines

171 **Duterte's unfinished revolution**
March 10, 2019
For President Duterte to redeem his promise of real change, he must dismantle the twin pillars of the post-EDSA economic order: foreign ownership limits in the 1987 Constitution, and the agrarian reform law with its emphasis on distribution, but not on productivity

Emmanuel de Dios

180 **A development puzzle**
January 24, 2011
Rather than a sign of economic dynamism, the services sector's outsized share of output and employment is a hallmark of stagnation in the country's farms and factories. Unable to find formal work, people are creating their own

183 **You cannot legislate morality**
March 21, 2011
The Catholic Church stands against legislating morality but gives in to the temptation when it opposes the Reproductive Health bill, prohibiting the government from providing contraceptive methods Catholics consider sinful

186 **Libertádes ó preocupaciónes**
August 8, 2011
Jose Rizal's thoughts on the wealth or poverty of nations would have pleased Adam Smith and Douglass North

189 **Political dynasties: cause or consequence?**
October 8, 2012
The dismal state of Philippine politics is blamed on the dominance of political dynasties amid weak parties. A paradoxical solution: make it tougher for political parties by setting up a higher bar for them to take part in elections

192 **The Twain meeting**
November 12, 2012
The creator of Tom Sawyer and Huckleberry Finn was an ardent opponent of American colonization of the Philippines at the turn of the 20th century. Mark Twain's writings should be read by Americans, Filipinos and the Chinese as they redefine their roles and relationships today

195 **What is a public utility? Defense and opulence**
July 22, 2013
We don't need to amend the Constitution to free up wide swaths of economic activities to more foreign investments. Limiting the definition and scope of public utilities, which are subject to nationality restrictions, could be a faster way to do it

200 **Unemployment has no welfare significance**
September 30, 2013
In the battle against widespread poverty, it's not the quantity but quality of jobs that matters. While the proportion of poor people among the fully-employed is virtually the same as among the unemployed, that figure almost doubles among the underemployed

203 **Manufacturing renaissance?**
March 2, 2015
Despite the recent pick-up in manufacturing growth, the sector is unlikely to power the Philippines' industrial resurgence. The peso's overvaluation, inflexible labor regulations and the rise of robots seem insurmountable stumbling blocks

206 **Working for peanuts**
June 16, 2015
Big business' efforts to help address rural poverty by integrating poor farmers in their supply chains are commendable. But the jury is still out on whether they are sustainable or scalable

209 **The truth about the economy under the Marcos regime**
November 16, 2015
The economic troubles of the Marcos regime didn't suddenly erupt just because of the Aquino assassination in 1983 but were due to massive debts that fueled growth in the early years of martial law

213 **Not human**
December 19, 2016
The idea that drug addicts are beyond all help, often cited by President Duterte when he threatens to kill them all, is based on flawed science. Latest studies discover new options and alternatives in treating addiction

217 **A law that produces criminals**
January 30, 2017
The rising costs of the unsuccessful global war on drugs have led many world leaders to call for a rethink of prohibition and punishment approach to substance abuse

221 **Arrow**
March 6, 2017
Tribute to probably the greatest economist in the second half of the 20th century whose insights informed a wide range of fields from economics of welfare to insurance

224 **Charisma and its limits**
April 24, 2017
Max Weber's insights on charismatic leadership helps explain President Duterte's rise and continuing popularity despite saying the wrong things

229 **What, me worry?**
May 29, 2017
Apathy towards the plight of victims of extrajudicial killings and other human rights abuses opens a door into a known abyss where we deny the humanity of others unlike us

233 **Just take it, it's good for you**
July 10, 2017
The proposed tax on sugary drinks, which also aims to curb rising obesity, may be another case of policy over-reach. With only 17% of the poorest considered overweight or obese (compared to 44% of the richest), it may just cut off the needy from cheap sources of calories

238 **Vox populi vox Dei?**
September 19, 2017
With his vast popularity that gives him control of Congress, President Duterte is risking denting business confidence by attacking autonomous institutions and introducing unsound constitutional changes

Raul Fabella

246 **CARPER: Time to let go**
October 28, 2013
Despite the likelihood of meeting 99% of its land redistribution target, the comprehensive agrarian reform program failed to cut widespread poverty and boost productivity among its beneficiaries. It shouldn't be extended again when it expires in 2014

249 **Rules, overlords and hope**
January 6, 2014
There are still too many instances of overlords running roughshod over rules in the Philippines. But they don't always get away with it

252 **Fighting yesterday's war**
April 7, 2014
It's time to update the law governing the Bangko Sentral ng Pilipinas. While it protected against bankruptcy, it also hampered the central bank from doing more for the country's growth

255 **Poverty, inequality and growth**
May 6, 2014
Sustained rapid growth is still the Philippines' best bet to reduce widespread poverty. Policies that promote greater equality also help but should not undermine the market

258 **Power and the pursuit of equity**
June 9, 2014
It's possible to promote equity without crimping markets or hurting efficiency. If you want to help the poor, give cash transfers to the targeted poor; don't artificially keep prices of commodities low

261 **Grains and Gilas: Geography, genes, dashed dreams**
September 8, 2014
Whether it's sports or agricultural policy, we ignore comparative advantage to our peril

264 **Hunger, inequality and saying Grace**
November 12, 2014
Ending undernourishment that afflicts 15 million Filipino kids is a worthy endeavor. Government can start by shifting funds from the loss-making National Food Authority

267 **Widodo, the Danes, and lessons from the little match girl**
May 25, 2015
Uncritically adopting rich-country standards, whether in matters of law, health or environment, may hurt our prospects for catching up with them

270 **Of CALAx, industrial policy and the nature of the State**
June 29, 2015
An excessively high premium offered by a bidder for a government infrastructure project is not necessarily the boon it appears to be

273 **Dado, flight of tradables and innovation**
April 11, 2016
No wonder the Philippines is lagging behind its Asian neighbors in innovation. Large companies selling to global markets, which have the most incentive to innovate, are leaving the country because of hostile policies

276 **Math Olympiad gold medals and brain parity**
November 28, 2016
We should do more to celebrate the rare feat of two Filipino high schoolers winning gold medals at the 2016 International Math Olympiad

279 **Manufacturing, quality of growth, and poverty reduction**
January 16, 2017
For the first time in decades, manufacturing grew faster than services during the term of the Aquino administration. If Duterte continues the trend, assuming he ditches his Maoist appointees in the Cabinet, we might see a sharp drop in poverty in his term

283 **The punisher's dilemma: Helicopter drop or exoneration by due process**
February 6, 2017
Punishment for rogue cops should be 10 — a hundred — times harsher than on ordinary citizens they are supposed to serve and protect

286 **Which way will Duterte turn?**
April 3, 2017
The Duterte administration's economic program is both bold and balanced but it remains to be seen if the president is solidly behind it

290 **Conglomerates and inclusion**
May 15, 2017
Conglomerates dominate the country's business landscape because adverse economic and political conditions have selected them for survival

294 **"Endo" and manufacturing**
April 30, 2018
The Duterte administration's policies against temporary employment contracts undermine its plans to trigger a manufacturing resurgence to sustain growth and cut poverty

297 **Twilight of the rule of law**
April 28, 2019
If MWSS' lack of foresight is to blame for the water shortage that struck Metro Manila in March and April of 2019, as admitted by the agency's chief regulator himself, why is Manila Water being penalized with a heavy fine?

Cayetano Paderanga, Jr.

304 **Juggling mandates**
August 25, 2008
It may be time for another US government agency to handle bailouts to give the Fed room to focus on monetary policy

307 **Patching the investment hole**
September 15, 2008
Given the Philippines' low savings and investments ratios, policy makers should support the passage of the long-delayed Private Equity and Retirement Account (PERA) law

310 **Financial crisis: Genesis, evolution**
October 27, 2008
While credit-driven overconsumption by Americans lie at the heart of the crisis, it was helped along by extended period of low interest rates

314 **Credit ratings and financial meltdown**
December 15, 2008
Reforms in the regulation of credit ratings agencies are in order in the wake of their role in abetting the conditions that led to the global financial crisis

317 **Economics and leadership**
December 22, 2008
In fostering development, a leader's role is to create a common purpose by brokering compromise among the many valid but competing claims of communities that make up the nation

320 **Business rationality, market myopia**
February 23, 2009
Tougher disclosure regulations could be the way forward in ensuring that credit ratings agencies do not become complicit in the creation of asset bubbles

323 **The four-pronged strategy**
April 6, 2009
Global leaders have agreed to measures to address the global financial crisis but it will take some time for them to work

327 **Dreams from my father**
June 22, 2009
Youthful expectations on the inevitability of progress give way to mature realization that something important seems missing in our attempts to uplift the nation

330 **Working with President Cory**
July 27, 2009
The presidency of Corazon Aquino didn't just restore civil liberties and democracy but also laid down the ground for key economic reforms that next administrations built on

334 **Accounting lessons from the crisis**
September 28, 2009
The excessive risk-taking and collapse of large financial institutions that triggered the crisis could be traced to outdated accounting practices that lagged behind a changing business and financial landscape

338 **Too big to fail**
October 26, 2009
The solution to the "too big to fail" syndrome is to strike fear in the hearts of managers of large companies that they will be punished for bad behavior even as their firms may be bailed out

342 **Smugglers' dreams come true**
November 30, 2009
A proposed government order to control gasoline prices was averted just in time but we need to realize the grave disastrous consequences of such a move

345 **Dilemmas in bank regulation**
December 21, 2009
Proposals to limit the powers and functions of the Fed in the US should serve as an occasion to reflect on the role of the central bank in the economy

348 **Fiscal discipline in history**
June 8, 2010
Then as now, there are limits to a government's ability to issue or borrow money to pay for expenditures if tax resources are limited. States ignore these limits at their peril

351 **Why PPP?**
August 6, 2012
The advantages of public-private partnerships (PPP) are not limited to financial savings for government but include the efficiencies and relative speed of the private enterprises vis-à-vis the public sector

Foreword

"The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist." **—*John Maynard Keynes***, General Theory of Employment, Interest and Money

WHICH DOES MORE HARM to the economy? Powerful vested interests or bad but widely-accepted economic ideas? To Keynes, both cause a lot of harm to society, but the damage done by the latter is not well understood. Moreover, the power of vested interests becomes magnified and entrenched over many decades when they are supported by popular but defunct theories about how markets and governments work or fail. In other words, vested interests earn a lot of rent, generate deadweight losses and do a lot of harm because they are able to mislead a large part of the public or remain unscrutinized for a very long time. A good example is the NFA's rice importation monopoly which, thankfully, has been ended by the Duterte administration. The monopoly was created by government long before the authors of this book started to study economics.

This collection of columns deals with a very wide range of topics, from motorcycles to Rizal. It is interesting to speculate on what Rizal might have thought about contemporary economic policy issues. (It was very clear that he would have given high priority to strengthening institutions, learning from other countries and investing in people.) But let me highlight a common theme that runs across the different authors' writings: certain government policies do much more harm than good. As already mentioned, all of the authors think that the creation of a government agency that enjoys a monopoly on rice importation has harmed consumers and taxpayers a lot more than it has benefited rice farmers. After all, if private owners of monopolies will use monopoly power to make themselves wealthy at the expense of everyone else, why should we expect the people who run government–owned monopolies to behave differently? Private ownership of monopolies could result in abuse of market power, but society might suffer even more if the monopolies are put under state control or ownership. It could intensify principal-agent problems (i.e., the people running the monopoly would be driven by objectives very different from the agency's remit). The problem is even more pronounced in countries where it is difficult to make politicians and government officials accountable.

Another mistaken and harmful idea is the romantic notion of making land-to-the-tiller the main pillar of agrarian reform and agricultural policies. It looks attractive and sustainable if one believes that the bureaucracy (e.g., DA and DAR), with the support of well-meaning NGOs, will be successful in managing and allocating public subsidies to help raise the productivity and incomes of small farmers. The romantics expect the government and NGOs to help farmers use better seeds and higher-yielding varieties by enabling cooperatives that will support farmers who cultivate very small farms use labor-saving machines and invest in facilities that will reduce post-harvest losses. Instead, bureaucratic inefficiency, patronage and corruption made it difficult for these government agencies to help increase the income and productivity of small farmers. It is clear that getting rid of laws that prevent land consolidation is a good idea.

In short, it is easy to accept the overarching view common among all the authors: the two main enemies of good public policy are myopia and wishful thinking. Many of our country's current problems are the result of policies that gave little or no importance to questions that are "too hard or distant for a society" whose capacity for careful thought "rarely extends beyond the next deadline [or] headline." A good of example of wishful thinking, or "insanity" as Einstein supposedly defined it, is that we are smart enough to produce a long list of government policies, projects and programs that failed because of incompetence, conflict of interest, greed, and lack of accountability, and yet we keep on creating new government mandates, programs or even departments, to address market failures. (It is hoped that the creation of DICT will be a shining counter-example.)

Fortunately, Keynes was right when he said that ideas of economists and pundits can be powerful both when they are right and when they are wrong. And even more fortunately, the authors of this book are very seldom off the mark when they put their thoughts down in writing. This is not an accident. Coherent essays are the best way to expose bad ideas and policies. And fortunately, the authors of this book are good essayists and pamphleteers. Like Adam Smith, they believe that people are capable of benevolence, but are largely driven by self-interest. Thus, if some resources or goods must be collectively owned and managed or there is too much market power in some markets or sectors, a well-functioning state can make the economy both more efficient and more inclusive. However, since people are self-interested whether they are in the private or the public sector, government intervention could make things worse if our institutions and the political and justice system cannot make politicians and bureaucrats accountable. Or worse, if elections are expensive and dirty, the competition for the power to control the state's mandate to regulate and redistribute can result in a kakistocracy.

In such a situation, the easiest thing to do is give up and stop writing columns on matters related to public policy since discussing what is good or bad public policy would be both difficult and frustrating. Thankfully, the authors did not shy away from this challenge.

There are two types of reforms that can make the Philippine economy more efficient and equitable. One is to improve the capacity of the State to do things that only governments can do. Perhaps, because of its complexity, none of the columns address this problem even as the authors clearly understand that it is at the core of economic development. Indeed, many of the columns have noted the contribution of the manufacturing sector and foreign direct investments to economic growth in more successful developing economies. Still, not much is said as to how our country can do better.

The other way is for the government to stop doing things that do more harm than good because their unintended negative effects outweigh their intended effects. This is where this collection of newspaper columns is a very valuable reference. The Philippines' over-regulated labor market is a good example. Employers' can abuse workers because some skills are firm-specific and job search is costly (e.g., no income while searching for a better job). But restrictions on firing of workers and minimum wages that are too high could result in lower employment in the formal sector and higher disguised unemployment (employment is higher with very little increase in output) in agriculture and the informal sector where the productivity and income of workers is much lower.

Water supply is another example. Government ownership used to be seen as the antidote to monopoly power. But government ownership resulted in inefficiency and very high volumes of non-revenue water.

Moreover, if the privatization contract also defines how tariffs will be adjusted (e.g., what discount rate to use and which expenditures are recoverable) and the contracts stipulate penalties when private contractors fail to meet service obligations, privatization can result in a large improvement in population coverage and the quality of service (e.g., 24/7 availability at a prescribed minimum water pressure). In other words, there might be countries where government is not good enough to run large water utilities but is good enough to design and enforce a privatization contract that will improve the distribution of water from existing dams. Or, at the very least, there are reformers within government who will work hard to help ensure that privatization includes rewards and penalties to improve water supply and sewerage immensely relative to the counterfactual of continuing with MWSS directly operating the water utility. (It would not be hard to imagine how much worse the current water crisis would have been if the water utility were still being run by MWSS. Of course, because of population and economic growth, the debate as to whether the new dams will be done via PPP or ODA is still raging.)

The authors are clearly not blind to market failures, but they see such failures as a necessary but not sufficient condition for government intervention to produce good results. As one of the authors nicely puts it, government, when it intervenes, often does so with a reverse Midas touch. Every proposal to cure a market failure must explain why government's presence or intervention will not make a bad situation worse. A good example is the new law that eliminates tuition fees in all state colleges and universities. The argument for waiving tuition fees in government tertiary educational institutions is that the poor cannot afford to go to college. But where will government get the funds to replace the revenues that used to come from tuition fees? By reducing government expenditures on important services that government must deliver because they won't be done by the private sector? By collecting more indirect taxes, which will hit both the rich and the poor? The latter can't afford the university tuition that has been waived and but the small minority among them who do well enough in high school will not be able to afford the out-of-pocket costs of going to college. (You are guilty of wishful thinking if you think that most students in state universities are poor and that the revenue loss from the universal free tuition will be recovered by reducing income tax evasion.) Moreover, what happens to good private universities that will lose revenues as some of the new students who would have gone to private universities shift to state universities because of their free tuition?

Wishful thinking also hurts tax policy. The authors of this book have done their share to combat this prevalent tendency. They supported the expansion of the VAT base (to include fuel and electricity) and the increase in the rate from 10% to 12%. Many analysts now see VAT reforms as a major factor in the decline in the spread between the Philippine and US sovereign debt. The Philippine spread used to be the highest in ASEAN. Now, it is one of the lowest. Again, those who were against this tax reform (which was a major achievement because it happened under a president with very low popularity ratings) called for improving the tax administration, especially of the income tax as an alternative to the higher indirect taxes.

The TRAIN law, on the other hand, increased tax revenue ***and*** reduced the income taxes of a very large majority of wage and salary workers. Obviously the only way to do this is to raise taxes on fuel and motor vehicles. (Congress reduced the proposed additional taxes on fuels and added taxes on sugary drinks and coal.) Again, those who objected to the TRAIN law instead proposed improved tax administration as an alternative. They also criticized the cash transfers to the poor that are intended to reduce the regressiveness of TRAIN for not promptly and adequately compensating the poor who will be hurt by the additional indirect tax burden. But will cutting the tax on the most over-taxed wage and salary workers in Asia, infrastructure improvement and additional investments in human capital have to wait for the alternative and supposedly better solution? Or is this another case of wishful thinking, which means that we will have to wait forever? The authors of this book obviously did not think we should have waited any moment longer.

Despite the Philippine government's reverse Midas touch, the authors of this book are staunch supporters of conditional cash transfers (CCT) to the poor. The most absurd criticism of CCT is that it is inferior to teaching and helping the poor to become more productive. As the saying goes: "Give a man fish and you feed him for a day, teach a man to fish and you feed him for a lifetime." The authors of this book, as their columns show, are also students of history, philosophy and economic thought. They know that Maimonides did not have the Philippine government in mind when he said those words. He would have liked the CCT program. He would have said: give the poor fish but prepare a good list of who will receive the fish, and let's all monitor the giving. If the government gives money to contractors who teach people how to fish, there will be plenty of Napoles projects. If the money for

CCT is diverted to finance free tuition in state colleges and universities, the children of the poor will be less productive workers in the future and the parking problem in UP will worsen.

The authors should be thanked for reminding us that there are limits to government intervention. But we must thank them as well for pointing out that knowing where the limits lie is the starting point of framing the debate on economic reforms.

Felipe Medalla
Member, Monetary Board
Bangko Sentral ng Pilipinas

Preface

THE ESSAYS in this book first saw print between 2008 and 2019 as op-ed pieces under the weekly "Introspective" column that came out each Monday in *BusinessWorld* newspaper. Written by five of the country's most insightful economists, they represent not just timely commentary on the pressing issues of the day but also an enduring examination of the challenges and opportunities facing the country as it struggled for economic progress.

After more than 10 years taking turns to write the weekly column, the authors felt it was time to compile a selection of their most compelling pieces, and publish them in a single volume for the convenience of both long-time and new readers. It is hoped that policymakers, including the incoming members of the new Congress, business leaders and engaged citizens would read the book and keep a copy as a handy reference.

The columns were written at a time when the Philippines began enjoying modestly higher economic growth for a good number of years. Recurring cycles of boom and bust, when rapid expansion was quickly followed by a crippling slowdown, seemed to have dissipated. Hence, the book's quite optimistic title, *Momentum: Economic Reforms for Sustained Growth*.

Most of the columns convey the authors' observations and suggestions to help the country overcome big and small obstacles hampering faster and more equitable growth after it has achieved long-term stability. They outline the next generation of reforms necessary for the Philippines to meet its ambition to become a high-income country like South Korea and Singapore in the next two decades.

Past reform efforts were carried out in desperate times as the country sought to avert, or recover from, fiscal or foreign exchange emergencies. Making the case for reforms amid relatively benign economic conditions is more intellectually demanding, and it's what makes the columns in this collection such great reads. Apart from providing sound economic rationale for the proposed reforms, the authors also argue for options that are politically and administratively feasible given the government's limited strengths and abundant weaknesses.

The idea for the book was first discussed sometime in 2018 by four of the five authors — Romeo "Romy" Bernardo, Calixto "Toti" Chikiamco, Raul Fabella and Emmanuel "Noel"de Dios. It builds on the earlier efforts of the fifth contributor — the late Cayetano "Dondon" Paderanga, Jr., who passed away two years earlier, in 2016.

Not only did the former economic planning secretary produce the first pieces for the column, he also roped in the four other economists to alternate with him in writing the commentaries when he became too busy in 2008. It didn't hurt they were also his friends and colleagues. Romy and Toti worked with Dondon in putting up the Foundation for Economic Freedom (FEF), a policy advocacy group. Noel and Raul were his fellow professors at the UP School of Economics.

Fortuitously, the five economists were also directors of a private economics research consultancy, the Institute for Development and Econometric Analysis (IDEA), that Paderanga co-founded in the late 1990s. Based initially at the UP School of Economics, the think tank provided research and advisory services to private companies. Apart from their individual qualifications, their access to pioneering research helped turn the column into major fount of serious economics commentary in the Philippines over the years.

In organizing the contents for the book, we opted to arrange the selected columns chronologically by author rather than group the essays by overarching themes. Apart from being more straightforward, this should allow readers to get deep into each author's thinking on a wide variety of topics across time. Effectively, readers get to enjoy five mini-books from some of the Philippine economic profession's brightest minds for the price of one.

To guide readers, we included a brief summary of each column in the Table of Contents. This should help those reading up on specific topics to find the most relevant essays in the volume more quickly. Where appropriate, we also added postscripts and footnotes to provide updates, especially the passage of new laws and adoption of policies. Thus, the columns can be read pretty much as they first appeared, preserving their relevance as part of the historical record.

On a personal note, I'd like to thank the authors for inviting me to edit and help oversee the publication of this volume. Most of them were official or expert sources that I got to know as a business and economic journalist in the last three decades, and I consider it an honor to be able to help them reach a wider audience through this book. Let me express a special posthumous thanks to the late Economic Planning Secretary Cayetano Paderanga, Jr. I'll always remember his patience, generosity and good humor as he shared his knowledge and insights with me and other business reporters in his long career with the government and the private sector.

Roel R. Landingin
Editor

Acknowledgments

THIS BOOK WOULD NOT have been possible without our friend, the late Dr. Cayetano "Dondon" Paderanga Jr., Founder of the Institute of Development and Econometric Analysis (IDEA) and co-founder and first Chairman of the Foundation for Economic Freedom (FEF). It was he who had invited us to serve in the board of IDEA and then asked us to help him write his column, "Introspective," in the business newspaper, *BusinessWorld*, when the demands of his multiple responsibilities prevented him from coming out with economic analysis and insights weekly.

We included some of his best articles written before his death in this book and Dondon is listed as a co-author. To him, we dedicate this book.

However, there are many others whose contributions and assistance made this book possible:

Roel Landingin, who stepped in at a critical time as the book editor, and who has done a wonderful job curating and editing the work of five disparate writers. Roel is a veteran and multi-awarded business writer.

Neil Agonoy, a seasoned book designer, has produced superb work once again. He deserves credit for the excellent cover and book design.

Dr. Felipe "Philip" Medalla generously gave much of his time and wrote the Foreword that nicely ties together the common themes in the authors' curated collection of articles. In the Foreword, Philip is his usual sharp self. He's presently a member of the Bangko Sentral ng PIlipinas' Monetary Board and was a former Dean of the University of the Philippines' School of Economics and Socioeconomic Planning Secretary under former President Joseph Estrada.

We also want to thank our printers and book publication advisers, Elias Guerrero and Judith Juntilla, of the Manila Bulletin Publishing, and their bosses, Sonny Coloma, Executive Vice President of the Manila Bulletin, and Basilio Yap, Chairman of the Bulletin Publishing company.

The *BusinessWorld* owners and editors, particularly Arlet Laurente, have given us a valuable forum for our ideas these many years.

Special mention is given to Kara de Dios, who contributed ideas on typography and book design.

Our friends, colleagues, and peers in the Institute of Development and Econometric Analysis (IDEA), Foundation for Economic Freedom (FEF), the academe, government, and civil society have given us wonderful feedback and insights through the years and have helped shape the ideas in the book.

The donors of this book are also our readers and supporters and they deserve our gratitude and appreciation. Part of their donation will go to the free distribution of this book to influencers and opinion makers in social and mass media, decision makers in various branches of government, and to school libraries, where the book may be accessed by students.

We, the authors, would also like to respectively acknowledge and thank the following:

For Romeo "Romy" Bernardo, his dear wife (and occasional editor) Amina, and three children, Ibba, Mini and Peppy. Also, his GlobalSource Partners colleagues, namely Christine Tang (Co-author), Angeli Juani, Charles Marquez, and Shane Bernice-Sia (Research Associates) and Cyrill Morelos (Executive Assistant).

For Calixto "Toti" Chikiamco, his wife Norma Olizon, also a writer and book author; and two daughters, Pia, a Director of Comedy Development in HBO USA, and Clarissa, a curator in the National Gallery of Singapore. Also, the staff of the Foundation for Economic Freedom, which he currently serves as President, and the management and employees of his two companies, MRM Studios Inc., and Mobilemo Inc. By doing their work well, the teams in these organizations have given him the time to write his monthly column. He also acknowledges the support of The Asia Foundation, represented by Jaime Faustino and Chrys Pablo, for his reform initiatives in property rights.

For Emmanuel "Noel" de Dios, to his wife Loreli (Lee), for generously sharing her mobile phone with a Luddite; to daughter Kara for good ideas on typography and for book cover studies for this volume.

For Raul Fabella, to Dr. Christina (Teena) Fabella, wife and wind beneath his wings, who carefully edits all his writings before they go to the publishers.

List of Abbreviations

4P	Pantawid Pamilyang Pilipino Program (PPPP)
ADB	Asian Development Bank
AER	Action for Economic Reforms
AIIB	Asian Infrastructure Investment Bank
ALDA	ARC Land Development Assessment
AMLA	Anti-Money Laundering Act
ARB	Agrarian Reform Beneficiary
ARC	Agrarian Reform Community
ARMM	Automous Region in Muslim Mindanao
ASEAN	Association of Southeast Asian Nations
ATM	Automated Teller Machine
BBB	Build Build Build
BBC	British Broadcasting Corp.
BDA	Bangsamoro Development Agency
BIMP-EAGA	Brunei Indonesia Malaysia Philippines-East ASEAN Growth Area
BMLI	Bangsamoro Leadership Institute
BPI	Bank of the Philippine Islands
BSP	Bangko Sentral ng Pilipinas
Calabarzon	Cavite, Laguna, Batangas, Rizal, Quezon
CALAx	Cavite Laguna Expressway
CARL	Comprehensive Agrarian Reform Law
CARP	Comprehensive Agrarian Reform Program
CARPER	CARP Extension with Reform
CCT	Conditional Cash Transfer
CDO	Collateralized Debt Obligation
CEDP	Community Emergency Development Program
CLOA	Certificate of Land Ownership Award
CMTS	Cellular Mobile Telephone Service
CO2	Carbon Dioxide
CPP	Communist Party of the Philippines
CRA	Credit Rating Agency
CSR	Corporate Social Responsibility
DA	Department of Agriculture
DAR	Department of Agrarian Reform
DBM	Department of Budget and Management
DDS	Diehard Duterte Supporter

DepEd	Department of Education
Digitel	Digital Telecommunications Phils. Inc.
DILG	Department of Interior and Local Government
DMCI	D.M. Consunji Inc.
DOE	Department of Energy
DOTr	Department of Transportation
DSWD	Department of Social Welfare and Development
EDSA	Epifanio de los Santos Avenue
EJK	Extra-Judicial Killing
Endo	End of contract
EO	Executive Order
EPDP	Energy Policy and Development Program
EPIRA	Electric Power Industry Reform Act
ERC	Energy Regulatory Commission
Eximbank	Export-Import Bank
FAO	Food and Agriculture Organization of the United Nations
FDI	Foreign Direct Investment
FEF	Foundation for Economic Freedom
Finex	Financial Executives Institute of the Philippines
FIT	Feed-in-Tariff
FNRI	Food and Nutrition Research Institute
G2G	Government-to-Government
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GPS	Global Positioning System
GSIS	Government Service Insurance System
GST	Goods and Services Tax
HIV	Human Immunodeficiency Virus
IFC	International Finance Corp.
IP	Industrial Policy; also Indigenous People
IPP	Independent Power Producer
ISIP	Innovation for Social Impact Partnership
ISIS	Islamic State
ISLE	Integrated Survey on Labor and Employment
IT	Information Technology
kWh	Kilowatt-hour
LEDAC	Legislative Executive Development Advisory Council
LTFRB	Land Transportation Franchising and Regulatory Board
MAP	Management Association of the Philippines
Meralco	Manila Electric Co.

MILF	Moro Islamic Liberation Front
MITI	Ministry of Trade and Industry
MLD	Million Liters Per Day
MNLF	Moro National Liberation Front
MT	Metric Ton
MW	Megawatt
MWSS	Metropolitan Waterworks and Sewerage System
NaLUA	National Land Use Act
NBI	National Bureau of Investigation
NBN	National Broadband Network
NEA	National Electrification Administration
NEDA	National Economic and Development Authority
NFA	National Food Authority
NIE	Newly Industrializing Economy
NLEx	North Luzon Expressway
Northrail	North Luzon Railways Corp.
NPA	New People's Army
NPC	National Power Corp.
NRSRO	Nationally-Recognized Statistical Rating Organization
NTC	National Telecommunications Commission
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OFW	Overseas Filipino Worker
OIC	Organization of Islamic Cooperation
PCED	Philippine Center for Economic Development
PDP	Philippine Development Plan
PEMC	Philippine Electricity Market Corp.
PEZA	Philippine Economic Zone Authority
PhilHealth	Philippine Health Insurance Corp.
PIATCO	Philippine International Air Terminals Co.
PLDT	Philippine Long Distance Telephone Co.
PNP	Philippine National Police
PNR	Philippine National Railways
PPP	Public-Private Partnership
PRC	Professional Regulation Commission
PSALM	Power Sector Assets and Liabilities Management Corp.
QC	Quezon City
QE	Quantative Easing
ROE	Return on Investment
RE	Renewable Energy

RSD	Right to Self Determination
SCTEx	Subic Clark Tarlac Expressway
SDA	Special Deposit Account
SEC	Securities and Exchange Commission
SLEx	Southern Luzon Expressway
SME	Small and Medium Enterprise
SMS	Short Message Service
SSS	Social Security System
SWS	Social Weather Stations
TEC	Temporary Employment Contract
TNV	Transport Network Vehicle
TPLEx	Tarlac Pangasinan La Union Expressway
TPP	Trans-Pacific Partnership
TRABAHO	Tax Reform for Attracting Better and High Quality Opportunities Bill
TRAIN	Tax Reform for Acceleration and Inclusion
Transco	National Transmission Corp.
UAAP	University Athletic Association of the Philippines
UMNO	United Malays National Organization
UN	United Nations
UP	University of the Philippines
USA	United States of America
USAID	US Agency for International Development
VAT	Value Added Tax
VGF	Viability Gap Funding
WESM	Wholesale Electricity Spot Market
WPS/SCS	West Philippine Sea/South China Sea

"Never let a good crisis go to waste."

Romeo Bernardo

National leadership and our collective future

January 11, 2010

OUR COUNTRY is at a crossroad. Results of the May elections, an orderly transfer of power, and no less, the person who will occupy the country's CEO position, will define the course of our collective future for at least the next six years.

There have been worrisome declines in objective indicators of global competitiveness, governance and transparency, economic freedom, and credit rating since 1998.[1] It may be argued that there are factors that contributed to this decline beyond the control of the national leadership, say, economic tsunamis such as the Asian and global financial crises. Still, the consistent relative declines over such an extended period compared to peers outside and within our neighborhood, cannot but be attributed to leadership failure.

It has not always been this way, and more importantly, need not be. For example, can there be good reason for us to be ranked 144 out of 183 in a World Bank report released two weeks ago on ease of doing business, even below Pakistan, Bangladesh, the West Bank and Gaza, and down there with troubled countries Zimbabwe and Afghanistan? Or worse, continue on a downward descent?

---

1 See World Economic Forum, Global Competitiveness Index (www.weforum.org); Transparency International, Corruption Perceptions Index (www.transparency.org); The Heritage Foundation, Index of Economic Freedom (www.heritage.org); and Standard & Poor's (www.standardandpoors.com)

Assuredly none. I earlier wrote about a study that Christine Tang and I did for the World Bank Growth Commission, chaired by Nobel Prize winner Michael Spence, on the political economy of reform during the Ramos years.[2]

In it, we looked at what it took the Ramos administration to successfully push for reform (in telecom de-monopolization, water privatization and oil deregulation) working against strong special interests (e.g. from affected businessmen, labor constituencies, political ideologues) and using instruments, both formal and informal, at the disposal of the presidency in an environment of weak, lethargic or sometimes obstructive/compromised institutions, including an underdeveloped and poorly motivated bureaucracy. It finds, no surprise, that leadership matters crucially.

The personal qualities and experience of the leader for the most difficult job in the country matter much. His ability to think strategically; the clarity of his national vision and its articulation; his ability to attract, inspire, manage, and forge cohesion in a first-class team; his ability to build coalitions and political consensus and educate the public and get their support to overcome obstacles and persevere; and other leadership attributes and management skills come out as elements for success in pushing reforms in a difficult terrain.

Mr. Ramos has had preparation for leadership at an early age. A West Point graduate with a degree in Engineering and an MBA, he honed his executive skills over decades within the military and civilian bureaucracies, and his political skills in dealing with politicians and the public in areas of peacekeeping and development. As former Finance Secretary Roberto de Ocampo quipped explaining his successes upon receiving the Finance Minister award from *Euromoney* in 1996, a finance secretary has many key decisions to make; not least of them, which president to serve.

The case studies as well showed the importance of timing. A new president has six years to make a difference. He and his team cannot solve everything in one go — indeed some problems may be so intractable, or be met with overwhelming political opposition, that if he started on them first, he would have sown the seeds of, and demonstrably shown, abject failure early on, in what may become the signature of his administration.

2 Available at: https://openknowledge.worldbank.org/handle/10986/28020

He needs to hit the ground running, and score early and impressive, victories that build confidence and get the public fully behind him for more difficult items down the road of his reform agenda. During the Ramos administration, the immediate problem, and opportunity, was getting the economy on track after debilitating outages that saw GDP contract by 0.6% and to put back the lights on — both literally and in terms of business confidence. This was achieved in a record time of 15 months, thanks to Ramos' no-nonsense leadership and empowerment of known achievers: Energy Secretary Del Lazaro, recruited from a distinguished career in the private and briefly in the public sectors, and NPC President Sonny Viray, a Ph.D. in Electrical Engineering and dean of the UP College of Engineering.

Such a victory set the stage for reviving investments and rallying public support behind other reforms to improve global competitiveness, including bringing to the next stage the trade and investment liberalization that started earlier, deregulation, privatization, public-private partnerships, and fiscal consolidation that has contributed importantly to the resilience of the Philippine economy even during the Asian crisis and the more recent global financial tsunami. The improvements in objective indicators of competitiveness, governance, transparency, economic freedom, and credit rating since 1992 are a matter of record, as have been their deterioration since 1998.

The take-away from all this is not that our country is doomed to take one step forward, and then two steps backward, but that it is possible to reverse the decline. For our next CEO, improving fiscal performance, side by side with a well thought-out and executed infrastructure and social spending program, including through transparent public-private partnerships, would be a good place to start. Our collective future depends on it.

The good, bad, and somewhat stupid

March 15, 2010

IN AN EARLIER COLUMN entitled "Fiscal Imperatives for the Next Administration"[1], I focused on tax policy reform needed to sustain macro-stability and provide the much-needed resources for infrastructure and social spending.

This time, allow me to talk about how our government uses, well or badly, fiscal policy tools to help members of society who need help, focusing on recent programs for the poor and the elderly.

The good: Conditional cash transfers

Learning from the successful experience of two dozen countries, notably Indonesia and Brazil, to get maximum bang for the taxpayer buck to help reduce poverty, the administration, with the full technical and financial support of the World Bank, launched its own conditional cash transfer program under the banner of Pantawid Pamilyang Pilipino Program (4Ps). It provides a monthly stipend of up to ₱1,400 (₱500 per household for health and nutritional expenses and ₱300 per child for educational expenses up to a maximum of three children) to the poorest households of a community provided the children are kept in school. The DSWD selects the beneficiaries based on the targeting system developed for the program.

Despite apprehensions that this may end up being no different from many past programs done in the name of the poor that have ended up at best as wasteful political showcases, this program is showing good early results. Children are going back to school and getting immunized, while their mothers are having pre- and post-natal care. What it can achieve

1 http://romeobernardo.blogspot.com/2009/10/?m=0

at the end of the day is to break, for the next generation, the cycle of poverty — poor nutrition, poor health, poor education, and resulting unemployment and impoverishment.

The credit for this program goes to highly regarded Social Welfare Secretary Esperanza Cabral, and of course, the full support of President Gloria Macapagal Arroyo who clearly saw not just the economic soundness of the program, but also its political benefits.

(The next president, whoever he may be, can't do better than reappoint Secretary Cabral to see this program move to a higher level, perhaps refined to include conditions covering other socially desirable objectives like reproductive health. NB: I have never had the privilege of meeting Dr. Cabral.) [2]

The bad: NFA

Ask any good economist what is the biggest waste of government resources in recent years and he will readily point to the NFA program of rice subsidies. As a subsidy program, it fails the needs test since the subsidized rice is available to all, whether rich or poor. Indeed, studies have shown that less than 25% of the poor have access to NFA rice. Worse, it is quite likely that a large fraction — maybe more than half — of the rice is sold by the NFA at the official government price to some lucky people who repack the NFA rice and re-sell them at market prices. According to a recent World Bank study, it costs the NFA an estimated average of ₱5 to deliver ₱1 of subsidy to the poor, the big number reflecting the wastes, leakages, and the governance deficit in its administration. It does nothing for the poor farmers, who, especially at a time of high rice prices (like now), are deprived the benefits of a remunerative price. On a more fundamental level, it distorts market signals and misallocates resources in the agricultural sector and rest of the economy. Finally, it is very expensive: in 2008, NFA lost ₱37 billion per data from the Philippine Institute of Development Studies. According to the World Bank, this may have racked up to ₱63 billion in 2009 (coming from losses that averaged only ₱5 billion annually in earlier years).

Many studies have been written on why NFA needs to be re-engineered, and how better off consumers and farmers would be if

---

2 The conditional cash transfers program was greatly expanded by the administration of former President Benigno "Noynoy" Aquino III from 2010 to 2016.

funding is redirected as targeted subsidies to poor consumers and invested in productive assets like rural infrastructure to help farmers.[3] Indeed, generations of technocrats in NEDA, Finance, and the Department of Agriculture, assisted by multilateral and bilateral institutions, have tried to push for reform without success. The vested interests are just too entrenched, and the rents too much.

Contrast the cost of NFA with the cost of the conditional cash transfer. The ₱10 billion this year under the 4Ps program will benefit around 3.5 million people. Consider what this means: If we had shut down NFA last year and diverted the ₱63 billion to a conditional cash transfer program, we would have been able to cover 100% of the country's poor (against the 25% with NFA), with each household receiving seven times the benefits![4]

The somewhat stupid

Despite strong recommendation from the secretary of finance for her to veto it, the President recently signed into law a bill that would give exemptions from VAT for purchases of senior citizens for restaurant food, medicines, transportation, and movies. Like many tax exemption bills, one cannot find fault with the objectives — in this case to help the elderly, most of whom no longer receive current income. Indeed one can even argue that the amount of tax leakage is not that large, at least compared to NFA deficits, only ₱1.68 billion annually per DOF estimate; so it is not that bad from a fiscal standpoint.

However, it is somewhat stupid. Why? Because there are so many other ways of helping the elderly without reaping the unintended consequences of creating a loophole in the VAT system that gives rise to a compliance and administration nightmare, or be vulnerable to abuse by crooked traders, tax evaders, and BIR agents. The most straightforward way is the one suggested by the Department of Finance: simply raise the discount from 20% to 30%, thus restoring the savings to the elderly that the VAT law is supposed to have deprived of. The stores will simply recoup this additional expense from sales to other customers.

---

3 See, e.g. http://documents.worldbank.org/curated/en/376671468294991813/Philippines-quarterly-update-towards-an-inclusive-recovery

4 The National Food Authority (NFA)'s rice monopoly was finally abolished by the Rice Tariffication Act of 2019.

This will also keep the integrity and efficiency of the VAT system, one which is self-policing — somebody's credit is somebody else's payment — and does not create precedence for others to clamor for the same. (Doesn't society care for the young? Why not exempt children's medicines and baby milk from VAT? How about purchases of the handicapped? Or of our soldiers, teachers, or OFWs?)

If we want to help the elderly poor, how about unconditional cash transfer for them? Isn't this much better than this prime example of poorly thought-out politics of pander? VAT exemption for seniors that subsidizes in proportion to one's purchases effectively grants more subsidies to the rich. And for the poorest? *Nada*.

More fundamentally, if we are to improve revenue collection and maintain macrostability, we need to make our tax system — already complicated, full of discretion and loopholes — simple and easy to administer. Let us not overburden it further. Let us instead use expenditure policy to help the poor and the elderly, or for that matter all other sectors asking special support like industries seeking/enjoying fiscal incentives. This way, it is transparent, targeted and needs-based, and subject to annual evaluation if still deserving, all under the discipline of a budget process.

Postscript: The bill providing for value added tax (VAT) exemptions for senior citizens was signed into law in 2010 over the strong veto recommendation from then-DOF Secretary Margarito Teves. Despite turning senior in 2014, the author remains convinced the measure is unwise but has also learned to accept, and enjoy, it as a fair rebate for a lifetime of paying taxes.

Renewable energy — reality check

January 11, 2011

THE PHILIPPINE RENEWABLE ENERGY LAW passed in 2008 has been applauded by environmental groups, renewable energy firms, and official donor institutions keen to play a role in addressing global warming. We who pay taxes and high energy bills need to be a little more wary.

My attention was caught by a news article reporting a billion-dollar renewable energy (RE) loan program being negotiated between the Asian Development Bank, other official co-financiers, and the Philippine government. The news item said that most of the $1-billion loan will be focused on supporting solar, wind and biomass power projects. I hope this is inaccurate, and that most of the funding goes to sound components of the program like raising consumer awareness on energy efficiency and regulation for energy-efficient equipment and appliances, instead of subsidizing inefficient technologies.

The hard reality is that the technology for these three sources is far from mature as seen in their exceedingly high price: solar costs ₱25 per kilowatt-hour (kWh), biomass and wind around ₱10. This compares very poorly with the current grid rate of ₱4.50 per kWh — anywhere from two to five times the true cost now.

So who will carry the high cost of these immature technologies? Answer: feed-in tariffs (FIT), an add-on, a tax, if you will, to the average cost of power in the grid for everybody. The law obliges the power industry participants to source electricity from generation at a guaranteed price applicable for a given period of time but no less than 12 years, supposedly to accelerate the development specifically of emerging RE resources. This cost to the public is on top of the tax gives the Renewable

Energy Law provides developers, including income tax holidays for seven years, duty-free importation of renewable energy machinery, equipment, material for 10 years, special realty tax rates, etc.

The FIT provisions seem to have been adopted from laws in developed European countries, meant to subsidize emerging technologies by burying it in the general public's power bill. The FIT number floating around in discussions for the Philippines is 15 centavos add-on per kWh used by each consumer. This amount may seem small, until one considers that this is an add-on to one of the highest per-kWh costs of power in the region, arising from our archipelagic geography and legacy of stranded costs.

Moreover, this 15 centavos translates into a ₱10-billion annual subsidy, hardly the best use of money for a country that has huge social and basic infrastructure requirements. For perspective, the conditional cash transfer program, supported by the World Bank and ADB, which will bring millions and generations of people out of poverty by keeping children in school, only adds ₱20 billion to the budget this year. (It is as if a poor minimum wage earner in 1990 became an early buyer of first-generation mobile phone for ₱50,000 and signed up a ₱5,000/month contract for a dozen years.)

The direction discussions seem to be headed is to define a guaranteed FIT and quota for each particular RE resource, or worse, for each particular RE supplier. As the FIT can be as high as five times current per-kWh power cost, such customized arrangements for each resource or supplier will clearly be prone to rent-seeking.

To prevent this, ERC should set a single low FIT open for all RE, one only slightly higher than the current average cost of power. If they price too high, the mistake hounds us for 20 years or however long the subsidy lasts. On the other hand, the only consequence of pricing low is that there won't be enough takers.

That should not be a problem at all as the ERC can fine-tune the pricing the following year. Since RE is not expected to be part of baseload, the lack of takers should have no consequence on power supply. Besides, the cost of these technologies will surely decline over time and more efficient technologies will still emerge — so no advantage in rushing.

These solar and wind technologies are already being subsidized by those who can afford them — taxpayers and consumers in developed countries helping their firms in these emergent technologies — in many cases, though, with deep regret. Spain, in a fiscal and financial bind, is reportedly taking steps to nullify uneconomic long-term contracts with solar power providers. Australia too is shifting spending from RE to more pressing flood damage rehabilitation. (There is an important lesson here for the business and government in doing PPPs — in the long run, sound economics is the best, arguably the only, guarantee for contract compliance.)

If we don't support solar, wind, and biomass, are we failing to do our proper share in carbon emission reduction? No, we are not. The Philippines contributes a miniscule of carbon emission given our low income and level of industrialization. Moreover, we can hold our head high on our current RE resource mix. In contrast to the global average of under 10%, fully 42% of our generated power already comes from green, RE sources: geothermal and hydro. Our Department of Energy is right to focus on the basic problem of ensuring affordable and secure supply of electricity — and calling for caution in embracing these fashionable, but for now, costly, distractions.

Postscript: The government ended up adopting and implementing a FIT program, though at rates much lower than what the National Renewable Energy Board (NREB) was proposing, partly as a result of advocacy of consumers groups, including the Foundation for Economic Freedom (FEF) and the Philippine Chamber of Commerce and Industry (PCCI). Nonetheless, as the author feared, the FIT-All has grown overall, now well exceeding his estimate of ₱0.15/kWh.

De-monopolizing telecommunications

September 9, 2011

TWO KEY ISSUES on telecommunications have lately hogged business headlines: a) the PLDT-Digitel merger, and b) the proposed National Broadband project. Both these issues test the clarity of government's development vision and its commitment to sound regulation and competition policy. Its decisions will impact not only the efficiency of delivery of telephony and data services to both private users and government, but our country's competitiveness and development over the long run.

Let me start with a disclosure: I am a board director of Globe Telecom. In a previous life, though, for over two decades, I was a civil servant at the Department of Finance and in multilateral institutions. There, I had a good view of the politics of economic reform, especially as undersecretary under the reform-minded Aquino I and Ramos administrations. With this background, I was asked, together with my colleague Christine Tang, to do a case study on the subject by the World Bank Growth Commission.[1] A key chapter, "The De-Monopolization of Telecommunications," documents the political and regulatory fortitude needed to dislodge entrenched interests.

Then

It starts with a quote attributed to Singapore Senior Minister Lee Kuan Yew in 1992: The Philippines is a country where 98 percent of the residents are waiting for a telephone and the other 2 percent are waiting for a dial tone. Indeed it best describes the situation of the domestic telecommunications industry in 1992. An estimated 800,000 applicants, 75% in the country's capital, Metro Manila, were queuing for a telephone

1 Available at: https://openknowledge.worldbank.org/handle/10986/28020

line. At the time, the Philippine Long Distance Telephone Co. (PLDT), which owned the only nationwide transmission backbone, was a virtual monopoly, controlling over 90% of the country's telephone lines. Its controlling shareholder was politically well-connected, its influence extending across the three branches of government as well as the media.

None of the telephone companies operating at the time were in a position to challenge PLDT's leadership. Following news accounts, PLDT, instead of expanding its network to meet service demand, spent heavily for the protection of its market share. For instance, when the previous government decided to open up the sector to competition, reports indicate that PLDT was able to secure as needed favorable legal rulings to block prospective entrants. It had apparently been a risky venture for the president to go after PLDT. If he loses in this duel, the president's credibility as a strong leader will be severely dented, observed one report at the time.

Nevertheless, the Ramos administration proceeded to pry the sector open with various tactics, from encouraging the formation of consumer groups that took to the streets and clamored for change, to boardroom battles. One case reportedly led to the resignation of a Supreme Court justice whose decision favoring PLDT was alleged to have been written by a PLDT lawyer.

As a result, the twin executive orders (EO) that the president issued in 1993 opened the floodgates to investments in the sector. By the time Congress passed legislation largely echoing provisions of the two executive orders, the country's teledensity had doubled and PLDT had already embarked on a zero-backlog program.

Our 2008 paper continues: Fifteen years on, the benefits of the reform may be seen in (i) increased access to telecommunication services, with teledensity in the cellular mobile telephone service (CMTS) segment of the market reaching 50 per 100 population in 2007; (ii) increased market competition with the entry of more players representing domestic and foreign interests; (iii) the rise of new growth industries such as business process outsourcing; and (iv) a whole new range of business solutions using cellular mobile telephone technology that caters to the retail client, such as money transfers for overseas workers. An interesting, perhaps ironic, turn of events is that PLDT, which had strongly resisted the reform, managed to shape up and emerged a big winner of the reform.

Now

Fast forward to the present. PLDT, under new controlling ownership, proposes to acquire Sun-Digitel, threatening to reestablish a near monopoly situation. Together, the combined companies will control 73% of the market. Even more tellingly, the combined PLDT-Digitel will control three out of the four blocks of telephone frequencies —75% of the highway for delivering the service. This level of control is against the spirit, if not a direct contravention, of the Ramos era EOs which sought to limit each telco to only one bloc.

This issue has been recently deliberated in the appropriate Senate committee whose findings we await, and is now under consideration by the NTC. What was made clear during the hearings is that nowhere in the world is such a degree of concentration allowed without putting effective limitations on the dominant provider. For example, the recent AT&T and T-Mobile merger triggered alarm bells in the US top anti-trust agency even though both carriers combined subscriber bases would amount to a little less than 44% of the total wireless market. Well-established regulatory regimes everywhere else would have done the same.

Widely-followed analyst Boo Chanco wrote in his latest column about the ill-advised revival of the National Broadband project. He provided yet another reason why we need to strengthen competition in the industry. To combat the fear of Secretary Montejo that our private telecom companies might overcharge government for telco services, he cited that two noted economists (Dr. Raul Fabella and Dr. Noel de Dios) at that meeting with the secretary urged government to make sure no one of the private telcos gain even near monopoly powers. Government must exercise its function and duty to regulate the telcos not just to get the prices they are seeking for government operations but for the sake of the consumers as well.

I am hopeful that the present regulators — and the national leadership — will be equal to the challenge of the times.

Postscript: The NTC approved the merger of PLDT and Digitel in late 2011, which led to a two-telco industry. The current administration, convinced that there should be another major telco for greater competition, named a third player in late 2018.

The way forward for the power industry

January 26, 2014

THE RECENT SHARP SPIKE in power rates led to the understandable shock and anger of consumers; most are unfamiliar with the structure and workings of a now market-based power industry. Headline news and public discourse have generated more heat than light. It can be satisfying to embrace conspiracy as a short-cut to thinking about a complex subject which those ideologically opposed to privatization are quick to fan.

What is emerging though from various Congress hearings and submissions to the Supreme Court, is that this temporary two-month spike was a product of a most unlikely and unfortunate perfect storm of planned and unplanned plant outages on top of already-thin reserves. And what failures there were arose not from collusion, but from a bid-and-offer system that requires further refining, and perhaps, from insufficient diligence.

By way of disclosure, I was undersecretary of finance during the last two years of Aquino I administration and the first four years of the Ramos administration, an independent director in one major publicly-listed power company and in an unlisted diversified holding company active in the energy business. While in government, I was involved in trying to address crippling blackouts in the early 1990s that led the government to contract independent power producers (IPPs) as part of the solution. Quick solutions had to be found —the most expensive power was no power. Due to the outages, GDP flatlined for two years, in 1991 and 1992, and lost output of ₱800 billion in today's prices, equivalent to twice the cost of government's infrastructure budget last year, or 20 years of its conditional cash transfer program. This is not even counting investments that were driven away, and the country's lost momentum.

I resurrect this dark episode in Philippine economic history as a background to what may ensue if counterproductive actions are taken that lead to underinvestment yet again in power generation. Under the Electric Power Industry Reform Act of 2001 (EPIRA), it is private sector players who are expected to deliver electricity under a competitive playing field, with government providing the enabling environment. This national policy was not arrived at willy-nilly but after seven years of debate both within the executive department and in Congress, with the active participation of all affected publics.

Modeled after successful privatizing countries, EPIRA was a recognition of the fiscal and institutional limitations of government in building and running power assets efficiently. As we know, such led to costly under-provision during the blackout years, and expensive stranded costs when the long-term growth forecasts failed to materialize after the 1997 Asian financial crisis.

Today many questions have been raised on whether EPIRA was a success. I submit that, while there has been a delay, a fair call is "so far, so good." EPIRA has provided the framework for the restructuring of the electric power industry, including privatization of National Power Corp.'s assets, defining the responsibilities of various government agencies and the private sector, and transitioning to a functioning competitive structure. The end goal was to make sure we had an ample and reliable supply of electricity, at reasonable and competitive rates.

What has happened since EPIRA was passed?

1. Privatization of the Power Sector Assets and Liabilities Management Corp. (PSALM) assets began with a slow start, but started to gain traction in 2006. To date 80% of the country's generating plants have been sold, and a slightly lower number of contracted capacity has been privatized through IPP administrators. Transmission is now under a regulated private company. From less than a handful, there are now over a dozen players in the industry, including heavyweights such as San Miguel, Metro Pacific, Ayala, the Metrobank group, DMCI, and Filinvest, which were never in the power business before.

Where privatization took place, expansion and rehab of existing assets were done — increasing capacity and improving reliability.

2. The Wholesale Electricity Spot Market and Philippine Electricity Market Corp. were established and are now a fully functioning trading platform. This is crucial in a market-based system, providing an outlet for excess supply, and valuable signals for efficiency in dispatch and for new investments.

3. Performance-based rate setting was introduced and on the way to reaping the gains from replacing a backward-looking return-on-rate-base tariff regime with one that provides strong incentives to improve efficiency and service quality, forward looking capex over a regulatory reset period, and benchmarking utilities against each other.

4. Open access was introduced last year after long delays. This is crucial to developing a competitive market. The thresholds now of 1 MW and above represents around a quarter of total demand in the service areas of Meralco and Cebu's Visayan Electric Co. This will bump up to 40% once the threshold is brought down to 0.75 MW.

5. EPIRA removed one of the biggest sources of public debt burden and contingent macroeconomic risks. This was an important factor in our investment rating upgrade — and lowered borrowing cost for government and private sectors alike, and helped improve overall economic performance.

A common complaint has been that under EPIRA, power rates have actually gone up faster, and that, as a consequence, we now have the highest power rates in the region. While it is true that our rates are higher than our neighbors', this is because substantial subsidies have been removed as mandated under EPIRA so that "true cost of power" is adhered to while our neighbors continue to subsidize.

For example, Indonesia, Malaysia and Thailand have large oil and natural gas deposits and do not charge royalty on local sales. In contrast, the Philippines collects a royalty of about ₱1.46 per kWh of our own natural gas. Moreover, fuel prices for Malampaya and geothermal resources are indexed to international fuel prices. In a recent column, Boo Chanco estimated that around ₱3 of the average Meralco electricity charge is on account of government take.

According to a recent US Agency for International Development (USAID) 2013 study entitled "Challenges in pricing electric power services in selected ASEAN countries," the fastest growing component of electricity rates is taxes, which zoomed by a compound annual growth rate of 65% from 2004 to 2011. Once stripped of this and other adjustments, electricity rates only grew by 5.3% annually during this period, around the same as general inflation and cost of fuel. That is to say, tariffs net of taxes stayed constant in real terms, and for many under open access, actually dropped.

I do not disagree, however, that EPIRA has yet to fully deliver on its promise, as the recent black swan rate hike event and the shortages in Mindanao illustrate.

The right course though is not to turn back, but to go forward without further delay to complete its full implementation. And to execute better.

Some thoughts:

1. Government needs to be more active in encouraging generation and supporting private power developers in every way. The appetite to invest is there but developers are running into road blocks with "not in my backyard" advocates and unsupportive government units. For example, the 600-MW RP Energy in Subic is two years delayed now, pending judicial resolution of the writ of Kalikasan.

2. Continue to lower the threshold of Open Access so end-users can make their own choice of power suppliers. Generators can look at end-users as a competitive market, and thus bypass distribution utilities, the monopoly segment of the power industry.

3. All distribution utilities and coops can be made to contract closer to 100% of their requirements for their "captive market" (i.e. those not under Open Access) to ensure this segment of the market does not carry the brunt of thin reserves through volatile and higher tariffs.

4. The National Electrification Administration (NEA) needs to provide guarantees with automatic remedies, like a bond or L/C that can be drawn to make some rural electric cooperatives credit worthy. This will need to go hand in hand with NEA exacting financial and management disciplines on erring co-ops. And stronger political will to cut off recalcitrants. This and item (3) will also ensure there is no under-provision by generating

companies for the system as a whole because deadbeat co-ops are netted out in their demand forecasts, resulting in thin reserves.

5. The Department of Energy and Energy Regulatory Commission (ERC) have to be proactive in managing the market, including ensuring that the systems operator National Grid Corporation of the Philippines (NGCP) fully contracts what the system requires. The establishment of a reserve market has been long delayed.

I end this column with two notes. First, on the implementation of EPIRA: we have no choice but to move forward. We cannot put the toothpaste back into the tube.

Second, on the recent suspension of payments to Meralco and operators of generating companies: this is "a gift to the Filipino people," as headlined, only if the law of supply and demand has been suspended in the Philippine islands. What actually needs to be done is to de-risk the sector from political and regulatory uncertainty to make the market work and encourage more investments, yielding more competition, ample supply and reasonable, less volatile tariffs.

Plumbing the Manila Water story for corporate lessons

June 29, 2014

I WAS RECENTLY ASKED to say a few words at the launch of an Asian Development Bank (ADB) book by Perry Rivera, *Tap Secrets: The Manila Water Story*. I hope that readers would find the excerpt of what I said below interesting enough to access the free downloadable version in the ADB website, where it will be posted soon.[1] It is an amazing story of a most successful public-private partnership project.

My association with the Metropolitan Waterworks and Sewerage System (MWSS) Public-Private Partnership (PPP) goes back to when PPP was still called "privatization," now a bad word in certain Left-leaning circles. It has been 19 years ago almost to the day when, as a finance undersecretary, I was appointed to the Board of Trustees of MWSS. My assignment was to help make the PPP happen to cope with a "water crisis" in the metropolis. The water crisis arose from a vicious cycle of large systems losses, inability to raise rates because of poor service quality, a nonexistent waste water management, and the low productivity of a grossly overstaffed government agency.

Despite hiccups along the way — labor unrest, a couple of temporary restraining orders filed by vested business interests, and assorted hurdles — it was done in a record of time of less than two years. This was thanks to the clarity of vision and political will of former President Fidel V. Ramos, the thoughtful and dogged execution by a dream team – then-Public Works Secretary Gregorio Vigilar, former MWSS Administrator Lito Lazaro, and Mark Dumol, Vigilar's chief of staff and now an executive in the San Miguel group.

1 Available at: https://www.dropbox.com/s/z466q9aj17x80jd/0407_TAP%20Secrets_web-version-2.pdf

The accomplishment looked big then, but what we in government started was actually just the beginning. The real achievement was done over 17 years, and counting, of dedicated work by the men and women of Manila Water under the Ayala banner, surpassing by far any scenario I could have imagined.

As ADB Vice-President Bindu Lohani's foreword summarized, "With a $1-billion investment, Manila Water replaced kilometers of pipes, expanded service connections, increased service availability, and reduced non-revenue water from 63% in 1997 to 11% in 2012. The company now serves more than six million happy customers enjoying 24/7 water supply... In this book, Manila Water reveals its most classified corporate secrets, which finally sheds light on the company's successes in instituting water sector reforms."

To underscore, 17 years ago, 63% of every liter of water was lost, mostly due to leaking pipes and some to theft. I recall that number vividly because bringing it down to a more sustainable level was always part of the condition of every ADB loan that I had to negotiate as finance undersecretary together with then MWSS Chief Finance Officer Loida Dinio. And year in and year out, we failed to meet this condition.

Certainly, I never imagined that Manila Water could ever reach the current non-revenue water level of 11%. This number meets the highest global standards. More importantly, it obviated the need to build a major water source dam and protected the public from another water crisis.

This book is about how these and other milestones were achieved. For instance, there is the multi-awarded *Tubig para sa Barangay* that connected poor communities at affordable rates. The book delivers on its clever title. It releases a stream of knowledge to any student of management —public, corporate, civil society — as well as to anyone or any institution, here in the Philippines or elsewhere, striving to make a difference in the world.

This book is inspirational prose and user's manual rolled into one. The words flow freely, seemingly effortlessly. For example, take the memorable three EEEs (enable, empower, excel) or the beautiful imagery of the five marbles. And just like the Manila Water story, behind the excellent product is a lot of hard, thoughtful, dedicated plumbing.

In one sense, Perry's book is not just the tap secrets of Manila Water. It is also about the secret of how the Ayala group as a whole and over the years has succeeded where others failed. In a sense there is really no secret. The factors of success are well-known, though not easy to follow: leadership, a culture of excellence, integrity, teamwork, customer orientation, and a long-term commitment that goes beyond the bottom line.

Seventeen years ago, the Ayala group took a huge leap, taking risks in something that was untried here in the Philippines. This leap of faith was propelled by their 160 years of business experience, which include the first Manila rail system called Tranvia.

The Ayala group did this too in telecommunications. Until Globe Telecom and around 10 others (whose names few will remember) came along during the de-monopolization reforms in the Ramos years, we were described by Singapore's Lee Kuan Yew as a nation where "98% of the people are waiting for a phone, and 2% are waiting for a dial tone."

This would be seen as a biased review if I did not find a single shortcoming in the book. So here it is. The final chapter is devoted to "emerging challenges and issues." The regulatory regime section is one that business, governments, multilateral institutions, academe, and civil society would have found of particular interest. However, it is only three paragraphs long.

When chided on it, Perry replied that, as is done by all authors of best sellers, he is saving that for Volume Two.

The life and times of our only Prime Minister

September 1, 2014

I WAS PRIVILEGED to be master of ceremonies at a recent launch at the Yuchengco Museum of the book of Dr. Gerardo Sicat, *Cesar Virata: Life and Times Through Four Decades of Philippine Economic History* published by the University of the Philippines Press. I highly recommend it to students of economics and history and admirers of the only Prime Minister our country ever had.

We waited 30 years for this book, and only Gerry Sicat could have written it. Professor, most prolific author of economic researches, papers and textbooks, and development consultant, Sicat is also father of three economic-oriented institutions known for their excellence — the UP School of Economics, the National Economic and Development Authority, and the Philippine Institute for Development Studies. (More recently, he is known as the father of the also-excellent PSE President Hans Sicat.)

The hefty 800-plus-page book "stands on its own," the author joked, making reference to its ability to stay vertical without support. He explains the reasons for its physical gravitas. "I see it as several books. The scope is large. First there is Cesar Virata. Along with him are other running stories: our nation in its young age of independence, and the problems of economic nation-building, then the Marcos years — the positive, the controversial, and the crisis years. It is also about the transition afterwards." You need to read the book to fully appreciate its intellectual heft.

Those present at that book launch had the privilege of listening to three "reviewers" and a beautiful musical number. These were, in the order of the program:

• **Victor Macalincag** — I described him as "PM Virata's right-hand man at the DOF," "my former boss who was brilliant and hardworking," and not the least, according to my wife, "I heard the First Lady of that time call him the handsomest undersecretary in government."

• **Washington SyCip** — "One of the few who can claim the high honor of being a mentor to PM Virata, even when the latter was still a student. Founder of the SGV Group, now a continuing mentor and guru to the nation."

• **Ambassador Alfonso Yuchengco** — "Industrialist, banker, diplomat, taipan, belonging to that breed of post-war nation builders which perhaps comes only once in a country's history."

The music in the forum was provided by the same person who provided the music in PM's life: Mrs. Joy Virata, singing a soulful rendition of "Summertime."

In the remarks I would have made had my iPad cooperated, I underlined some lessons for the idealistic public servant from a man who is the gold standard for public service, integrity and patriotism.

"This is the humbling story of a man who persevered and shepherded the economy through the Philippines' most critical financial and political crisis. A man who sacrificed his own reputation, never abandoning the ship of state through the raging storm."

Sicat writes of how PM typically shirked the limelight. He writes about a posthumous honoring of the late Finance Secretary Jaime Ongpin in Malacañang, during the Cory Aquino presidency, where Virata was unacknowledged by virtually all of those who spoke. That is, until Maribel Ongpin took the podium to give her response. She acknowledged Virata. According to Sicat's recounting: "The full house thundered in applause. These were all faithful members of the Department of Finance, the career people who had worked for him for almost 16 years. He was a man they respected, who had performed his job in the department faithfully, and whose work was acknowledged as the most consistent and successful during his time in the post."

Allow me to end this piece with an excerpt from Vic Macalincag. After elaborating on the roles PM Virata played across a wide front of economic reform — banking and finance, trade, investment, industry, project development, international economic diplomacy, development of Mindanao, energy diversification, agrarian reform, etc., he ruefully considered:

"Reading his biography, one is tempted to conclude that in a different setting and stable political environment, and despite restrictive provisions in our laws, his economic management and policy prescriptions and strategies could have placed the Philippines not far behind South Korea, Singapore, Taiwan and Hong Kong."

Bangsamoro is a gamechanger

September 28, 2014

THE GOVERNMENT'S HERCULEAN effort to put behind us a four-decade old, costly and painful civil strife and gain for us all the benefits of peace deserve our support. This can be a potential gamechanger in our economic landscape, not just in what is now called the Autonomous Region in Muslim Mindanao, but for the entire country. True, there are risks along the way. But it is well worth giving peace a chance.

The legitimacy of the Moro wars for independence was the basis for the peace negotiations from the time of Marcos to the present. The Bangsamoro claim they are a separate nation with a distinct identity, culture and independent states (sultanates) with a long history of resisting the colonizers. Nations like this have the "right to self-determination" (RSD), according to the United Nations. The Organization of Islamic Conference (OIC) supported Nur Misuari and the Moro National Liberation Front in part because they supported the Bangsamoro fight for independence under the RSD and in part because they believed that the Muslims of Mindanao were under threat of genocide during martial law in the 1970s.

Peace in the South can bring up Mindanao's contribution to the gross domestic product (GDP). Mindanao has abundant primary resources, perfect agro-climatic conditions, lower wage rates (with the ARMM cost half of average labor cost in Mindanao), still lower power cost, and vast opportunities for growth and diversification through its BIMP-EAGA connection. Investments have stayed away from Mindanao, even more so than the rest of the country, due to security concerns. Remember the Zamboanga siege? The Ampatuan massacre? Those were killers for tourism and investments, and not just in Muslim Mindanao.

As for opportunities in the ARMM, the region has the biggest areas of untapped natural resources, rich fishing grounds and fertile lands, the best beaches anywhere in the Philippines or anywhere else, and closest cultural and historical links with Brunei, Indonesia and Malaysia which can allow the region to access new capital through Islamic financing as well as a new export market in the still-growing halal industry. Further, the barter trade between Sulu and Malaysia is an economic tie that is centuries old and can be revived, with BIMP-EAGA and the initiatives being mounted as part of ASEAN 2015, fully backed by the national governments and the Asian Development Bank.

The Bangsamoro will have even more powers than the ARMM government to help craft its own destiny. While the region has disadvantages largely due to the four decades of civil strife and neglect, it also has an important advantage: starting fresh. It can learn from the history of flawed policies that have hurt the flow of investments and creation of needed jobs in the rest of the country — rigid and costly labor policies, complex bureaucracies and red tape, a distorted fiscal incentive structure, a failed agrarian reform program and misguided environmental policies that choke the development of a responsible mining industry. As explained by Foundation for Economic Freedom President Toti Chikiamco in a workshop organized by the FEF and Philippine Center for Islam and Democracy, it may actually provide a model for the rest of the country, be the tail to wag the dog, the way Hong Kong and Shenzhen have shown the way for the rest of China.

Investors may, by adopting their business models and organizational and management styles to the traditional leadership (datus) structures of the area, find that these can be better places to operate than in other places in the country. This is the encouraging lesson of Unifrutti of former Agriculture Secretary Senen Bacani and the late Datu Toto Paglas which has won international awards.

It would be fair to ask, who are these guys in the Moro Islamic Liberation Front leadership and why do we trust them to succeed? Why do we think that leadership won't revert to the old traditional leaders and warlords after elections take place?

I posed this question to Amina Rasul, lead convenor of the Philippine Center for Islam and Democracy, also our home Bangsamoro expert.

This is what she said: "The MILF leadership is better prepared to take on the mantle of leadership of a civilian government (unlike the MNLF after the signing of the 1996 peace agreement). Under Chair Murad, the MILF has succeeded in establishing the Bangsamoro Development Agency (BDA) and the Bangsamoro Leadership Institute (BMLI). The BDA and the BMLI, chaired by civilians, are led by boards consisting of the MILF Central Committee and professionals. The BDA is tasked to prepare the Bangsamoro Development Plan and has been assisted by development partners and government. The BMLI is putting together training programs for the Bangsamoro. Further, the MILF has been sending young Bangsamoro professionals to study, with the help of development partners.

"While all development matters are still decided by the MILF Central Committee, it is clear that the MILF has been preparing for civilian government over the last few years. The failure of the MNLF to govern the ARMM, under Misuari, has been in large part due to their lack of preparation to govern under a democratic system. This is not the case with the MILF, which has been working with government and development partners to put in place programs such as the Sajahatra intended to provide services to its communities.

"The MILF leadership also has the support of several political and traditional leaders, particularly in Central Mindanao."

What can business do to help enhance chances of success at this time, and moving forward after the Bangsamoro entity is set up?

The most urgent is for the business sector to support the passage of the Bangsamoro Basic Law. The MILF leadership under Murad has invested political capital in the peace agreement. Should the Basic Law be watered down or not passed, the pragmatists in the MILF Central Committee will lose out to the fundamentalist faction which is supported by younger (and more aggressive) leaders who already feel that the original demands of the MILF have been greatly undermined during the peace negotiations.

In the short term, before transition to the establishment of the Bangsamoro political entity, the business sector should assist in providing support for education. First, support adult literacy. Over half a million adults of ARMM are illiterate (more than a third of the voting population). When businesses are established in the Bangsamoro, labor will have to be imported from neighboring non-Bangsamoro provinces if the existing labor force are unskilled and illiterate. This is a condition that will breed more conflicts, as the affected citizens will lose out on job opportunities to those who have not suffered from the armed conflicts. Second, support short management training for professionals who can run public and private sectors. Apprenticeships and internships can be provided by the private sector. Third, engage the BDA, the BMLI and the Bangsamoro private sectors (chambers of commerce and business councils) to identify opportunities for collaboration.

Let us begin.

Postscript: The Bangsamoro Basic Law was finally passed and signed into law by President Rodrigo Duterte on July 26, 2018.

On the Philippines joining the AIIB: What's there to 'wait and see'?

July 3, 2015

THE AQUINO ADMINISTRATION appears waffling on the Philippines being an original member of the China-led Asian Infrastructure Investment Bank (AIIB). Last October, it signed a non-binding memorandum of understanding, together with 22 other countries, to become a founding member. Last week, this newspaper reported that the President said, "The Philippines needs to be 'very very cautious' about becoming a member… with the government obliged to consider Beijing's behavior in the Scarborough Shoal crisis of 2012, during which the China Eximbank called in a loan that was to fund a rail line to Clark International Airport."

This indecision is understandable. There are pros and cons that need careful weighing, with intertwined and complex political and economic factors in play.

Many in the business community applauded the government, led by the Department of Finance, when it signed up for the AIIB. This is faithful to the spirit of the Aquino-Hu Jintao 2011 meeting that, "The territorial dispute shouldn't be the be-all and end-all of Philippine-China relations." Though this idea seemed to have been eclipsed by subsequent harsh exchanges, the fundamental soundness of it remains. My column last year, "Frozen," published in April 2014[1], underscored economic ties as an important layer to our multilayered relationship with China. Our joining AIIB will be in keeping with that approach.

---

1 Available at: http://romeobernardo.blogspot.com/2014/04/frozen.html

In the same spirit, my friend Raphael "Popo" Lotilla, University of the Philippines law professor and former energy secretary, provided precious lessons from Vietnam's richly textured multi-dimensional ties with China over the years, centuries even. His column in the May 2015 issue of *Forbes Philippines* magazine is a most insightful and fact-based telling of how Vietnam fought Chinese troops over centuries on land and at sea while at the same time engaging China, amicably and profitably, in a variety of ways, including in trade, investments and finance.

And yes, Vietnam is set to become a founding member of the AIIB. For that matter, as Popo observed, so with Taipei, "maintaining its application for membership even after its rejection as a founding member." And as far as territorial disputes go, this one is the mother of them all!

But wait, does Asia really need another development bank? The case for it is made by an Asian Development Bank (ADB) report that says Asia requires $8 trillion in infrastructure from 2010 to 2020. This is a huge number that dwarfs the capital of the ADB ($160 billion), the World Bank ($220 billion), and other official funders. Having one more funder will surely help.

Besides, some competition is healthy. This early, so as not to be outdone, Japan has announced a $110-billion infrastructure financing package for Asia. Moreover, it has not been lost on many how some of the policies and programs of the World Bank, and to a lesser extent the ADB, have, at times, seem dictated by narrow interest groups in the West, oblivious to infrastructure requirements of developing countries.

How else to interpret policies in the World Bank and International Finance Corp. that shun the financing of coal power plants even where such plants may be the only ones that makes economic sense for countries for dependable affordable power? Or take the case of a proposed $1-billion financing for highly subsidized solar plants being processed at ADB, until public scrutiny and more serious thinking within the organization shot it down. (See my column, "Renewable Energy, a Reality Check," published in *BusinessWorld* newspaper in January 2011.)[2]

In the case of the Philippines, the government's Comprehensive and Integrated Infrastructure Program calls for $150 billion of financing in the

2 http://romeobernardo.blogspot.com/2011/01/renewable-energy-reality-check.html

next five years. Only 25% of this is expected to come from private sources, and the balance from development financing either from the government budget or official development assistance. Assuredly, our having access to another source of concessional finance over the medium term will help.

Of course, our current constraint in infrastructure spending is not financing but execution. As a glaring example, had government spent available money as programmed, our GDP growth rate for the first quarter of this year would have exceeded the targeted 7% and not be the mediocre 5%.

And on the private side, what may well lead to underinvestment in infrastructure is the idiosyncratic nature of our regulatory regimes, exemplified in the reinterpretation of contracts by the Metropolitan Waterworks and Sewerage System for the water concessions to exclude recovery of the corporate income taxes — after 17 years of operation.

But surely, our current situation is not one which we should take as a given if we are to achieve over the medium term the poverty reduction and greater participation in prosperity that relieving infrastructure constraints can bring.

There is less reason to waver now that more countries are joining, including developed country allies of the United States (the country most critical of AIIB). These include the United Kingdom, Germany, France, South Korea, and Australia. As of April 15, the AIIB has 57 prospective founding members, including 16 of the world's 20 biggest economies and our fellow ASEAN countries. As a result, it is also clear now that China will not have veto power.

Officially, the reason given for the Philippines' sudden "wait and see" attitude is concern over governance, noting lack of transparency in Chinese bilateral aid. This will be given further clarity later this June when the Bank's charter will be finalized and up for signature. In the meantime, I would argue that the AIIB in fact helps address this concern, given the multilateral framework that enables sharing of knowledge and experience (especially from the WB and the ADB), and subjects projects and funding processes to greater scrutiny of other members.

Moreover, the reality is that China, with its $4 trillion in reserves, will continue to have bilateral facilities for projects meant to win friends, both countries and persons. And flawed projects (such as the still-born National Broadband Network and North Rail projects) being pushed by one sponsor or another, from China or elsewhere, will not go away. We just need to be more vigilant, especially in watching our own public officials.

And finally, the nomination of Jin Liqun as AIIB president is reassuring. He is a no-nonsense finance executive honed in the Chinese civil service and multilateral development institutions. Early on, he was a representative of China in the World Bank (we were both there in the 1980s), later pursuing a career as an official there, and later the Asian Development Bank, where he recently retired as vice president for operations, one rung below the president.

Postscript: The Philippines signed the agreement to join the AIIB on October 19, 2016 and the Senate rarified it on December 5, 2016.

Tribute to Francis Varela, 'raging incrementalist,' big bike enthusiast

September 14, 2015

AUGUST 29 was a very sad day. Francis M. Varela, undersecretary of the Department of Education (DepEd), perished in a motorcycle accident. Mourning the loss of such a good man, in every sense of the word, tributes flowed. At least three saw print in national newspapers.

Allow me to share excerpts of the testimonial by Dr. Felipe M. Medalla during the DepEd necrological service. Dr. Medalla, former dean of the UP School of Economics, former long-serving chairman of the Foundation for Economic Freedom (FEF), had worked with Francis in FEF. The foundation is an advocacy group for sound economic governance founded by a number of us in the mid-1990s. Francis raised the first million pesos to help it get started, and later served as its president. Many of us in FEF, like Francis, had served in government, and sought to continue to make a difference. "Raging incrementalists," we call ourselves half in jest.

Medalla said: "I'm here to honor Francis as a friend and in behalf of the Foundation for Economic Freedom or FEF. Francis was a former president of FEF and I was a former Chair. Until Francis joined DepEd (and in my case, the Monetary Board), we were both very active and vocal members of FEF because of what our advocacy-oriented NGO believes in — that good governance, transparency, accountability, good economic and financial analysis, market forces and competition together can contribute significantly to improving Filipino well-being — not just for those who are already well-off but especially for those who are so disadvantaged that they are not in a position to articulate why the policies that are being peddled by some interest groups supposedly for their benefit often do exactly the opposite.

"Francis of course fought against corruption, as pointed out by some of the previous speakers. His record in DepEd would attest to that.

"But he was very much aware that reducing corruption is not enough, since focusing solely on reducing corruption in an economic environment where people are driven by distorted prices and wrong incentives will, at best, improve Filipino welfare only marginally. Francis and the FEF believe that self-interest, guided by a moral compass and disciplined by competition and the rule of law, could be quite consistent with social welfare.

"What impressed me most about Francis is that he was so passionate about advocacies for better public policies, in spite of his own awareness of the capacity of those who benefit from the bad policies to thwart reform efforts. In short, that his own analysis often told him that many of the reform advocacies and efforts may not bear fruit did not stop him from trying.

"And Francis believed that short cuts such as non-democratic ways of changing society are likely to back fire. There's no Messiah that would solve our economic and social problems. And the converse must be true: long journeys require many small steps.

"In short, Francis believed that we should all do our share.

"And if a lot of people fight for the causes they believe in, they can bring about small improvement, which taken together could count for quite a lot.

"It therefore did not surprise me that Francis joined the DepEd as an undersecretary.

"After all, won't it be a bit hypocritical to call for reforms from the outside and refuse to be part of reforms from the inside when the opportunity to do so comes along? Of course, the financial and personal sacrifices for Francis to do so must have been significant, but Francis being Francis, these would not have stopped him from serving.

"In sum, passion and patience both describe Francis very well.

"How can someone so passionate be so patient? (It of course helped a lot that he was so handsome and charming.) Well, the 2 P's must be glued together by a third P — Patriotism. Francis loved our country. But even these three P's might not be enough. They must be supported by a strong intellect and good analysis. And it was therefore very fitting that Francis championed three P's of a different kind in DepEd — public-private partnership.

"By the way, some of you may be surprised that Francis is getting tributes from people who are at least twenty years older than him. But Francis is truly much wiser than his years on earth. And because of those relatively few years, we are all better off."

Allow me to end this column by touching on a side of Francis that tragically consumed him — motorcycle riding.

It is not easy to explain this diversion, passion really, which seem more like an insanity to people who do not have the DNA for it. And reasons for riding can be varied and personal.

It's been said that riding a motorcycle is freedom and vulnerability, adventure and wanderlust, meditation and therapy, merger of man and machine, technology and art, camaraderie with the boys, a quantum of solace, epic pointlessness, transcendence, life. And for many, we knew it from the moment we first tried a motorcycle as teenage boys — perhaps even before.

This transcendental meditative state is captured well by Milan Kundera in *The Unbearable Lightness of Being*: "The man hunched over his motorcycle can focus only on the present instant of his flight. He is caught in a fragment of time, cut off from both the past and the future. He is wrenched from the continuity of time... in other words, he is in a state of ecstasy."

I went the first night of Francis' wake to console with his family.

Wenna, his wife, and their children were inconsolable, in shock at the tragic event of the morning. I tried again on the third day, unsuccessfully. Wenna was fatigued.

I felt the need to apologize. A decade ago, I lent Francis my spare big bike that got him restarted on riding, against the better judgment of the women in our families.

An opportunity finally presented itself during the DepEd memorial.

I very contritely condoled and offered my hand in sympathy. She looked at me straight and her first words were: "I remember, you lent him his first bike." Perhaps seeing my eyes well with tears, she smiled and said, "He loved riding with a passion... A week he is unable to ride, *ang sungit, sungit* (he's grumpy) the whole week."

I can only console myself by believing that Francis died doing something he loved. The family he left behind can only find consolation in the knowledge that the good die young and God has called him to come home.

Francis was the essence of virtue. We who knew him well mourn the dimming of a flame that brightened our gray world.

The way forward: The path to inclusive growth

November 8, 2015

THIS LATEST BOOK of my fellow Introspective columnist, Foundation for Economic Freedom (FEF) President Calixto "Toti" V. Chikiamco is making the rounds of government and policy circles. I learned Speaker Feliciano R. Belmonte Jr. ordered 300 copies to give to congressmen. The candidates to high office in 2016 would do well to read his thematic compilation of his best columns in *BusinessWorld*.

Allow me to share my remarks on the occasion of its launch, and talk about as well of the FEF.

Thank you, Toti, on behalf of our chairman, Roberto "Bobby" F. de Ocampo, and all the other fellows for your kind dedication of this volume to us. And your resolute dedication to FEF as its president and chief executive officer since 2011.

The genesis of FEF goes back to early 1990s, when our chairman, Sir Bobby de Ocampo, was finance secretary. FEF's philosophy was shaped by the circumstances and government thinking of that time — the unleashing of private sector energies through market-friendly reforms and good governance. Indeed this is thinking that traces back to reforms from an earlier period was pushed by former Prime Minister Cesar Virata and former Economic Planning Secretary Dr. Gerardo "Gerry" P. Sicat.

FEF started as an impromptu dinner club of like-minded people who came from different careers, but found themselves united by common cause on orphaned issues of the day. I recall the catalyst was the ₱1-per-liter Leung Levy in early 1990s which was opposed by everyone — communists, rightist putschists, some business groups like the Federation of Philippine Industries, Catholic Bishops Conference of the Philippines, you name it.

All except for guys who, in their individual capacities, were writing, talking, pushing for this necessary measure to stabilize the country's fiscal situation and nurture development. These guys then decided to meet every now and then for dinners, KKB or with a rotating host, to see how they might be listened to more, how to educate the public, especially legislators and policy makers, and how they might help reformers inside government who badly need support and encouragement.

These impromptu dinners, included from government — we in the Department of Finance (DOF), Ernest Leung, later Bobby De Ocampo, and at National Economic and Development Authority, Cayetano "Dondon" W. Paderanga, Jr. From the academe — mainly the University of the Philippines School of Economics, then Dean Felipe M. Medalla, Raul V. Fabella, Ruping Alonzo[1], Dante B. Canlas. From the private sector and civil society — former Prime Minister Cesar A. Virata, Mahar K. Mangahas, Ramon R. del Rosario, Jr., the late Francis Varela, Alexander R. Magno, Vaughn Montes, Simon Paterno, Tony Abad, Alan Ortiz, and Toti Chikiamco.

Although it was Mahar Mangahas — a University of Chicago alumnus at heart — who gave FEF its name and ex-DOF guys who made funding from bilateral grants happen, it was Toti who was the most consistent, persistent, and coherent as a public intellectual. His weekly columns which had a strong following among "shakers and movers," as one official termed it, contributed much to shed light, provide broader perspective on the issues of the day. He likewise lent his pen to the various advocacies of the FEF.

These FEF advocacies have met with various degrees of success over the years. With its fellows, who are "raging incrementalists" at heart, FEF took such setbacks under Philippine political conditions as a part of the game.

Such efforts and FEF's respective batting scores or contribution in the reform efforts included pushing "good-to-haves" like adjustments in excise taxes on tobacco, alcohol (check), reform of the value-added tax (check), liberalization of retail trade (question mark), privatization or public-private

1 Paderanga and Alonzo have sadly passed away since the column was written partnerships, notably the Metropolitan Waterworks and Sewerage System (check), opening up the economy to foreign investments (question mark), property rights (check, with success in land patent distribution), peace and development in Muslim Mindanao (question mark).

And trying to put a stop or expose such flawed policies and programs like wasteful subsidies for National Power Corp. (check), National Food Authority (cross), extension of a failed Comprehensive Agrarian Reform Program (check), central oil procurement by government (check), an overly generous feed-in tariffs for renewable energy (partly check).

More recently, President Toti brought the FEF from advocacy to hardcore development work in the area of property rights.

Thanks to him and FEF's land rights team, the number of free patents awarded to beneficiaries leaped from just only 3,000 to 60,000 titles annually by working with the Department of Environment and Natural Resources (DENR) and Local Government Unit (LGU) partners.

On Toti's book, *The Way Forward: The Path to Inclusive Growth*, FEF Chairman and former Finance Secretary Bobby de Ocampo, has this to say: "There are some who may think of economists as theoretical and obscure. Others may view them as simultaneously argumentative and detached. Not so economist Calixto "Toti" Chikiamco. Anyone who reads his book compiling his numerous articles and opinion pieces will probably think instead of adjectives like engaging, committed, courageous, and patriotic yet also global.

"Often one can feel his frustration at the country's seeming inability to rise above mediocrity brought in no small way by political leadership that is self-serving, myopic, small-minded and hypocritical, not to mention of course corrupt and bereft of vision. But still, one can equally sense his undying hope that a better day will inevitably come."

Our Senior Adviser, Dr. Gerry Sicat, captured in a thoughtful testimonial in the book the essence of why Toti refers to himself as a political economist in the tradition of Smith and Ricardo: "[Thus] economic problems involve the political process in order to correct them. This is one reason some of the essays carry on a political side. Solutions require convincing government and the men who compose and make decisions. The topics range from politics and economics in the large, to development issues in the small

— constitutional change, entrepreneurship, national security, wages, income and social inequity, poverty, land rights, property rights."

For those who only know Toti from his column, you should be aware that Toti has a day job as an internet entrepreneur. This has enriched his writings even more — perhaps just as hardships and ordeals contribute to the shaping of an artist?

This synergy between public intellectual and grounded entrepreneur is summed up well by former Chairman of SGV group, also a Fellow and Trustee of FEF, Glo Tan Climaco: "Toti is an economist who passionately loves his country. He is also a businessman who competes and has to survive in the real world. This rare combination makes his essays very compelling reading for me. I find his observations and suggestions realistic and practical. Many times I learn new ideas. This book has gems of wisdom."

Toti Chikiamco's book, *The Way Forward: The Path to Inclusive Growth*, is available in branches of National Book Store.

Corporate governance in the digital age

June 12, 2017

AS I WRITE THIS COLUMN, the dust has yet to fully settle on perhaps the most challenging 24-hour day for the management of the Bank of the Philippine Islands (BPI) in its over 165 years of existence. I hope to write a future column on lessons from this when all is done.

Still, it is not too early to congratulate its management and staff for how they have pulled together to resolve this in record time. And preserve the trust and confidence of its stakeholders, most importantly depositors and the regulators.

In today's digital age where data information base and service delivery are predominantly electronic, banks and similar institutions and their regulators should assume that debilitating computer system glitches, cyberattacks, and natural disasters will happen.

We thus need to ensure we have robust IT systems and take all protective and preemptive measures including providing for redundancy and quick recovery.

Equally important in this age of social media and instant connectivity is keeping stakeholders informed on a round-the-clock basis using all forms of communication. (And protecting them from predators. "Does BPI have a branch in Lagos?" goes an SMS received.)

And not the least, a crisis management structure and plan that can be triggered swiftly.

"Any system in which humans are involved will at some point be disrupted by human error. Organizations distinguish themselves not by stamping out the possibility of error, but by handling the inevitable mistake well," said a member in my Foundation for Economic Freedom Viber group.

At this time, I will just note that BPI President Cezar Consing at the first hour yesterday reached out to the leadership of the Bangko Sentral ng Pilipinas (BSP) and the public. Both he and Acting Governor [Nestor] Espenilla sought to assure via early morning television interviews that this was: 1) a computer glitch and no hacking was involved; 2) being addressed and that the system should be back up within the day; and 3) that no one will lose money.

There were subsequent round-the-clock updates ending in one late last night, in both traditional and social media, that the problem was fully addressed and all electronic channels will soon be accessible. (And apologizing once again for the inconvenience and thanking clients for their patience.)

I dare say, BPI is passing the test. Though I should quickly add that I am an independent director of the bank, and unashamedly have my biases.

As I am along this road, you will forgive me for flying the colors some more by excerpting my remarks at a forum on corporate governance last month organized by the BSP and the International Finance Corp. I will make the self-serving assumption that BSP asked BPI to precisely present because we are among the best pupils in class.[1]

1. We join the applause of the financial community and the broader Filipino public, on the recognition of a job superbly done by Governor Say [Amando M. Tetangco, Jr.] And the jubilation on the appointment of Deputy Governor Nesting [Nestor A. Espenilla, Jr.], a vote for continuity and an affirmation of the quality of monetary policy and banking supervision of the BSP and all its dedicated men and women over the years.

2. At BPI, when we speak of "corporate governance," we go beyond the formal rules that sets out the board's oversight and its policy-setting responsibilities. For us, it is all about imbibing and nurturing a culture of integrity, fairness, accountability and transparency cascaded from the board, its management, and to all our employees.

---

1 Available at: http://bit.ly/RBblogentry

3. In line with this, the board ensures, first and foremost, that BPI's corporate governance practices are consistent with the guidance of the BSP, Securities and Exchange Commission, and the Philippine Stock Exchange in strengthening corporate governance. And in October 2016, BPI was recognized as one of the awardees of the inaugural Institutional Investors' Award for Corporate Governance.

4. We recognize that good corporate governance is, ultimately, the responsibility of the board. As is often rightly said: "Companies do not fail, boards do," an observation I may have first heard from SEC Chair Teresita Herbosa.

5. The presence of independent directors on the board helps ensure the exercise of impartial judgment on corporate affairs and proper oversight of managerial performance, related party transactions, and potential conflicts of interest.

Today, in our 2017 board, seven out of 15 directors are classified as independent, exceeding the minimum regulatory requirement to have at least 20% of board membership and the recommendation for publicly listed companies to have at least 33%.

6. We bank with all of the country's major conglomerates and while Ayala is the bank's single largest shareholder, they are not our largest client. There are a number of conglomerates with whom we have more substantial dealings.

7. The nomination committee ensures that there is diversity in the board — in terms of gender, age, cultural background, education, professional experience, skills, knowledge, length of service. Our 2017 board is made up of three former bank presidents, a former member of the Monetary Board, a former assistant governor of the BSP, the representative of the Roman Catholic Archdiocese of Manila, a top regional officer of a global IT company, a retired founder and CEO of a top securities brokerage firm, a top CFO of major Philippine corporations, a topnotch corporate lawyer and a former undersecretary of the Department of Finance, to name a few.

8. Equally important in our diversity policy is the representation of women. To date, we have four women directors, comprising 27% of our board membership, the highest among our peer banks. In 2016, we had 5

women directors. (In our management of 3,000 plus officers, 67% are women.)

9. We take risk management and internal audit and control very seriously. Indeed as Governor Tetangco said in his keynote remarks, risk management is at the heart of corporate governance of a bank. Both our risk management committee and our audit committee are chaired by independent directors who have had distinguished banking careers culminating in being CEOs in their respective banks.

10. The board and its committees are regularly and actively involved in providing strategic guidance, risk appetite and risk metrics (operational, market, liquidity, regulatory, reputational, etc.), regular audits, capital adequacy reviews as well as oversight over pressing and urgent "issues of the day," such as anti-money laundering, IT, cyber risk, consumer protection, and others.

11. In all cases, the oversight by the board go well beyond the letter of the regulations in order to uphold depositors' and other stakeholders' interests, and protect the bank's reputation. Let me cite an example for our zero-tolerance policy for fraud and financial crime, whether external or in-house. Recently, we worked with government agencies in the first successful prosecution of international criminals involved in ATM skimming and card fraud. We do this beyond the value of the losses of the bank from specific instances, as a matter of principle and for deterrence.

12. Let me give another example of this high level of diligence and risk management mindset that has saved the bank from losses, where others have been blindsided. It is a matter of record at the BSP that in the global financial crisis a decade ago, BPI was the only big local bank that had zero holdings of international subprime securities. A quote from that period from a key board director on a proposal to purchase Lehman securities — "I don't care if it is triple-A rated, if we don't understand it, we are not buying it."

13. The bank has a Code of Conduct derived from the BPI Credo and Core Values. These are aligned with key global initiatives that promote responsible business practices. We have detailed rules on conflict of interest, insider trading, whistle-blower policy, and related party transactions. (We were among the first banks to set up a related-party transactions committee, before a formal circular by BSP on it was issued.)

While these codes are important, what is critical are internalizing these as values and culture.

14. I view my presence as a presenter here as BSP's recognition of BPI's efforts in promoting effective corporate governance. The high quality and professionalism of management and staff and the corporate culture that has been nurtured through the decades make the job of the board members relatively easy.

15. As observed by the previous speaker from IFC, good corporate governance also provide bottom line yields. For BPI, it has contributed to a price-to-book valuation and an ROE that has consistently led the industry.

16. Finally, thank you to the BSP and SEC for all the work and effort done to build world-class financial institutions capable of meeting the challenges posed by the other financial institutions in the region. We at BPI will continue our governance commitment for the long haul.

The great infrastructure debate

August 7, 2017

OUR LATEST REPORT for GlobalSource Partners (globalsourcepartners.com), a subscriber-based global network of independent analysts, dove into the issue of projects funded via public-private partnerships (PPP) versus official development assistance (ODA).[1]

In our view, the sharp dichotomy is not warranted. There are clearly good grounds to pursue one versus the other depending on the nature of the project, technical capacity of the government agency undertaking it, and the terms and conditions of particular ODA and the donor country.

We concluded that given the huge infrastructure requirements of the Philippines, it should not be PPP versus ODA, but rather PPP and ODA.

The lively debate may have been driven by the sudden change in public policy, yanking without compelling reasons, several projects at advanced stages of preparation to an ODA or tax-funded mode after these have been studiously prepared for a PPP bid over many years. This has raised concerns over consistency and stability of government policies from many capable local and global players who have invested substantial resources to bid for these. Included in these are the five regional airports projects, the Kaliwa Dam (a new water resource for Metro Manila) and Clark Airport as a second national airport.

Moving forward, government should be able to proceed using both PPP and ODA tracks by developing a richer project pipeline based on coherent masterplans, strengthening the institutional capability of line

1 Bernardo, R. and C. Tang. (2017). "The Great Infrastructure Debate." *GlobalSource Partners Special Report* (July).

agencies (notably the DOTr) and tapping proven technical experts local and foreign. On the latter, government has asked the Asian Development Bank for a $100-million Infrastructure Preparation and Innovation Facility to help in preparing feasibility studies, project design and procurement.

Is there enough time?

We think the problem becomes more acute the more non-PPP projects are pursued since government will not be able to leverage its limited technically-skilled manpower by off-loading project supervision and management to the private sector. This may just be the Achilles heel of Dutertenomics and argues for continuing to pursue PPP in parallel with ODA, particularly for projects that have clear commercial value that the private sector would find attractive.

In any event, even if the Duterte administration is able to do only 70% of what it is ambitiously targeting, this would still be a major gain for the economy, both in laying the foundation for future growth and in contributing to achieving its 7%-8% growth target. Sharing below a section of the report on the issues, the pros and cons of PPP versus ODA:

Who pays?

One source of contention is that users pay for PPP projects while taxpayers pay for ODA projects. Strictly speaking, whether users or taxpayers pay depends on the project's cost vis-à-vis its revenue profile, not on the mode of implementation. Projects that can demonstrate high revenues from market demand are able to pass a bigger share of project cost to users.

In comparison, projects that hurdle the economic but not the financial viability test would need higher, if not wholly, taxpayer funding.

The issue is somewhat muddled by several factors.

For instance, by their very nature, PPP projects need to hurdle some minimum financial viability test to be attractive to investors; and private investors would normally look for sources of cash flows independent of government. To the extent that commercial revenues are robust, investors would not require additional government subsidies. On the other hand, if investors find these cash flows insufficient or high risk, government would still need to step in to close "viability gaps." In these cases, taxpayers pay part of the cost. One can argue that the same projects built with

ODA financing can charge user fees as well. Realistically however, due to political reasons, government may not be able to impose the same level of fees that would otherwise be allowed if the facility were privately managed; in which case, ODA financing would mean that taxpayers shoulder a bigger share of the costs. On the other hand, there are also plenty of cases where government as regulator has failed to adjust user chargers as agreed under PPP contracts and would have to use the budget to compensate investors for any losses. In this and other cases related to realized contingent liabilities, taxpayers end up footing a bigger than expected portion of the bill.

Which is costlier?

In terms of investment costs, both PPP and ODA have their pros and cons, with overall costs also dependent on timely delivery. The case for PPP is the acknowledged efficiency of the private sector in managing whole-of-life project risks and costs, trading off its higher cost of capital against lower operating and maintenance costs. Moreover, completion risk that leads to cost overruns is seen to be smaller under PPP considering the private sector's incentive to start operating sooner to generate cash flows early. Hence, done properly, PPP projects should deliver value for money to government in terms of total lower cost. The usual argument for ODA is its favorable financing terms, with interest charges that may be below market and long maturity periods of as much as 40 years. However, since ODA loans are typically denominated in the donor's currency, it is arguable whether the loans remain concessional after factoring in currency risks. Also, limited competition for ODA-financed projects due to the "tied" feature of these loans has been observed to inflate project costs by about 15%-30%.

Which takes longer to prepare?

In shifting away from PPP, President Duterte's economic managers repeatedly cited the lengthy preparation time for PPP projects of nearly 30 months. However, PPP defenders claim that at their fastest, from project development to groundbreaking, ODAs take even longer, between 35 months and 40 months, depending on the donor agency. This is according to Vaughn F. Montes who delivered a presentation entitled "The merits of ODA and PPP for Infrastructure Financing and Development" during the MAP Forum in May.

Considering that all infrastructure projects are unique, project preparation time is likely influenced more by the projects' complexity and less by the mode of financing. Likewise, experience shows that both PPP and ODA projects are equally vulnerable to right of way acquisition delays.

Does ODA financing threaten fiscal sustainability?

Reacting to the shift away from PPP, the president of a local conglomerate active in the infrastructure space warned of the impact on fiscal sustainability of using ODA borrowings for infrastructure. This follows from government accounting where projects financed by ODA are added to the public debt at full cost from day one while PPP projects are largely treated off-budget (excepting any necessary upfront subsidy), with no budget provisions for contracted future payables (i.e., availability payments) nor contingent liabilities. But while public debt would indeed be higher if infrastructure were ODA-financed rather than PPP-financed, the assessment of fiscal risk goes beyond the headline number, with sovereign credit analysts digging into the terms and conditions of public debts as well as the risks from all types of contingent liabilities and their expected costs. The exercise would allow them to value the concessionality of ODA loans and apply some risk premium to unrecognized risks from PPP projects. In the end, what is important for fiscal sustainability is that projects are properly vetted for social and economic soundness and implemented well. Economically productive projects will pay for themselves over time.

Hybrid, best of both worlds?

Economic managers have touted the benefits of pursuing a hybrid structure to capture the best of both PPP and ODA (and/or government budget) schemes. Thus, to do away with lengthy PPP structuring and negotiations, government would build the facilities on its own, financing with own funds or ODA which reduces financing charges, then auction off the facilities to the private sector to benefit from the latter's efficiencies in operations and maintenance. According to skeptics, aside from the equally lengthy if not lengthier ODA processes, what the hybrid structure fails to consider are (a) the efficiencies gained from a proper allocation of risks over project life to the party best able to manage them that minimizes projects' whole-of-life costs, (b) the incentive to perform on the part of the private proponent who has skin the game and (c) the avoidance of inter-operability issues where operators are held accountable for facilities they did not design nor build.

It ain't Uber till it's Uber

September 4, 2017

THE UBER-LTFRB CONTROVERSY has highlighted, to our great inconvenience, what happens when modern technology clashes with antiquated laws and regulations. This is further complicated by the business conduct of a highly successful global upstart startup confronting the dysfunctions of Philippine bureaucracy writ large in the DOTr agencies.

To be better educated on the subject, I turned to our eldest son, Ibba Rasul Bernardo. He is an Internet entrepreneur/geek with deep experience in tech startups and social enterprise. He also has written for a number of publications like *Adobo* magazine, *T3*, and *GamesMaster*, and co-hosts Ride PH TV.

After listening to him, I thought it best to relay it in his words:

"Gustavo Petro once said: 'A developed country is not a place where the poor have cars. It's where the rich use public transportation.'

"Most people understand that when Petro said this, he contemplated public transportation so convenient that it was preferable to private car rides and luxury vehicles.

"The founder of Uber is not 'most people,' however. Upon hearing this quote, Travis Kalanick probably heard the ka-ching of a thousand cash registers and thought 'OK, Mercedes Benz S Classes for us and a hundred friends!' And Uber was born.

"Let me share with you the following potentially controversial thoughts about our favorite ride-sharing app.

"Why it's Game Uber in the Philippines

1. Boob-er: "Many things said about Travis Kalanick are not fit for publication: he is a misogynistic creep who has created a toxic company

culture. Uber is rife with stories/allegations of managers groping women, cocaine done in company retreats, to name a few. Kalanick even joked about an app for women on demand, 'Yeah, we call that Boob-er.'

"Ironically, because of the tracking and safety features inherent to Uber, women feel empowered to drive for Uber. Ask any Pinay Uber driver.

"Good news: reports say that a new CEO will be stepping in, Dara Khosrowshahi of Expedia, an immigrant from Iran and poster child of the American Dream.

2. God View: "Uber created a backdoor in their app called 'God View' where they can track — stalk? — specific users. They've been accused of allowing some employees access to this information to follow exes, spouses, celebrities, and politicians. After a 14-month investigation by the New York State Attorney, Uber agreed to pay a fine and to encrypt passenger data.

"Another privacy violating function was active until Aug. 29. Uber didn't only track you while you were in one of their cars. They tracked you even after you'd gotten off.

3. "Endo": "Uber's life blood is contractual labor whom they lovingly call 'partner drivers.' Their business depends on actively finding ways to minimize support for drivers. This has led to a string of lawsuits and settlements in the US (Google "Uber labor law suit").

"In the Philippines, many Uber 'partner drivers' work 10 to even 15 hours, by choice. An Uber driver I spoke with told me he earns more than twice what he earned when he was driving a taxi. Another driver told me she was getting ₱1,200 a day from Uber as support while they were banned from plying the streets of Manila.

"Why do drivers and riders in the Philippines and in many countries all over the world love Uber, despite its many faults? Simple: in many of these countries, the transportation system is broken. Normal people are sick and tired of lousy, inefficient, expensive, and dangerous taxis. Most of these countries' regulatory agencies are rent-seeking, corrupt, and, worst of all, inept.

"In a country like the Philippines, the few options commuters have are bad ones.

"Uber gives the driver the perception of becoming their own boss, and the ability to own (finance) a car. Uber also gives the riding public convenient, reliable, and safe transportation. Even with Uber's many faults, to the average commuter, Uber is heavenly ride compared to the commuting Hell we had to endure before Uber."

Our laws have understandably not kept up with accelerating advances in technology in our globally-wired sharing economy. Allow me to conclude by sharing and echoing the statement of our Foundation for Economic Freedom on this.[1]

Our Congress needs to move fast on a wide front lest we be left further behind. FEF and others are pushing for legislation that can help open up our economy to foreign investments and innovations.

A key one is the amendment of the Public Services Act which will redefine the present ambiguous description of what constitutes a public utility, expanding the sphere for the private sector to meet growing demand of the public and a growing economy, since government alone cannot, such as mass transport, ports, toll roads, info tech/telecommunications, water, etc.

This most forward-looking initiative is sponsored in the Senate by Public Services Committee Chairperson Sen. Grace Poe and championed in the House of Representatives by lawmakers Gloria Arroyo, Joey Salceda, and Arthur Yap. We are pleased to learn that this is now in the LEDAC priority list, thanks to Socioeconomic Planning Secretary Pernia.

Meanwhile, we plead with the authorities to be open to new private initiatives, regulate with a light touch, and take a broad view when interpreting our laws, with improved and expanded provision of public services as the primary concern. Don't be like old generals fighting the last war.

Postscript: The Public Services Act (PSA) amendment bill was passed by the House of Representatives but encountered opposition in the Senate despite support from the finance and economic planning secretaries. Senator Grace Poe, Chair of the Public Services Committee and sponsor of the bill, remains committed to get it through the next Congress.

---

1 See http://bit.ly/FEFUber

On globalization, inequality, and inclusive growth

November 6, 2017

SINCE THOMAS PIKETTY came out with his book, *Capital in the Twenty-First Century*, in 2013, it has become fashionable to blame globalization, open trade regimes, privatization, and other elements of "neo-liberalism" for inequality and many of the recent troubling political developments such as the rise of populist regimes like Donald Trump, even violent extremism.

Earlier this year, widely followed columnist Elfren S. Cruz wrote "that the eight richest individuals own more wealth than the poorest 50% of the world's population. Globalization and modern technology have increased global wealth which has been exploited by the rich to become richer; but the rest of the world has not benefited from these two phenomena."

Locally, calculations on the rise in net worth of the ten richest men or families (estimated by *Forbes* magazine) against the country's GDP growth — led to the glaringly wrong conclusion that the ten richest families own three quarters of the country's wealth. Apart from the confusion between net worth, a measure of wealth, versus income, an implied conclusion is that inequality causes poverty. And the culprit? Globalization and liberal economic policies.

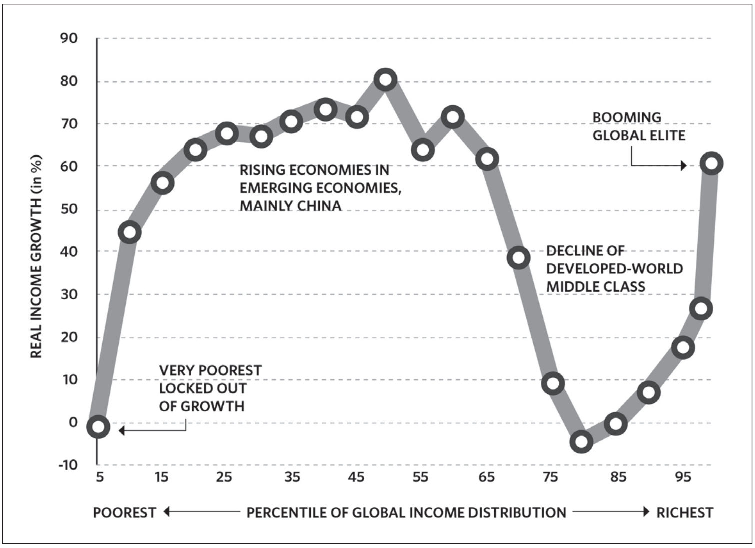
Two weeks ago, UN Special Rapporteur Agnes Calamard blamed neo-liberalism and theprivate sector — "the restructuring of economies and the liberal vision for development is trickling down to every community and is a killer in many ways… creating much instability and much conflict."[1]

Writings of National Scientist and Economics Professor Raul Fabella (also my fellow Introspective columnist) and author Edward Luce help provide proper perspective on this issue.

1 "Neoliberalism kills, says UN rapporteur." Philippine Daily Inquirer (October 20, 2017).

Edward Luce, in his 2017 book, *The Retreat of Western Liberalism*, drew a pachyderm, an elephant, on a chart to emphasize his point.

Figure 1. Global income growth, 1998-2008



Source: Edward Luce, The Retreat of Western Liberalism

Plotting the global income growth in the last generation by percentile, poorest to richest, we find that most of the world have benefitted from the wave of liberal economic policies established post-World War II under the Bretton Woods institutions, namely, the International Monetary Fund (IMF), World Bank and the World Trade Organization (WTO).

With income growth of 45% to 80% for those in the 10^{th}-70^{th} percentiles, the big losers in this global picture are relatively rich in the 75^{th}-85^{th} percentiles — with incomes now being 10% lower than a generation ago.

The dramatic improvements in the lives of most of the people globally is evident in every statistic on lower rates of absolute poverty, longer life expectancy, higher literacy, access to water and other basic services, eradication of major diseases, etc. in World Bank development statistics and the Human Development Report. The most considerable upliftment in lives has been in Asia, especially China after Deng introduced liberal market reforms.[2]

With this generally favorable picture, why the strident rhetoric versus inequality and liberal economic polices? Especially coming from the leadership of USA that championed this after WW II?

Well, the 75th-85th percentile-losers are basically the Trump and Brexit constituencies. Their discontent and political activism are driven by resentment over the top 1% and the loss of jobs, erroneously blamed on the countries whose peoples are in the lower end of the global income spectrum.

In truth most of the job losses were due to technological advances, and failure to adjust to these. This deepening anger is fueled by polarizing social media and populist nativist leaders such as Trump.

We and other developing countries have no common cause with the narrow band of rich-country losers complaining of inequality and globalization.

The rest of humanity (10th-75th percentile) have clearly benefitted from globalization — liberal trade and investment regimes, freer movement of technology and people. Including the Philippines whose two main drivers, BPO and OFW remittances, are enabled by it. Globalization has put us recently among the highest growing countries and with the best prospects, even in our high performance neighborhood.

Admittedly, here in the Philippines, historical progress in addressing the poorest (dropping only to 25% currently from 34% in 1990) has not been as substantial as with the rest of Asia. In Southeast Asia, Indonesia and Vietnam have halved their poverty rates.

But let us not blame globalization and liberal economic policies for this.

As Dr. Fabella underlines, "there are two flavors of inclusion: one is reduced income inequality; the other is reduced poverty incidence. They are not the same; nor does one necessarily follow the other. So they require different policy responses."

---

2 Fabella, R. (2017). "Inclusion and Delusion in TRAIN." Available at: http://bit.ly/trainde

Past policies in the Philippines have not favored investments and job creation that would have allowed us to participate with our neighbors in an export-led growth and addressed the problem of joblessness and poverty. Unfavorable policies include a constitution and laws that deter foreign investment and decades-long underinvestment in essential infrastructure.

Likewise, agricultural productivity has suffered from an inward-looking bias — a failed land reform program that favored inclusive poverty over efficiency needed for modern agriculture. Adding to the problematic mix is an anti-poor food security policy defined as self-sufficiency in rice at exorbitant cost, rather than affordability of food and focus on crops where we can have global competitiveness. A high population growth rate is an additional factor.

With poor and recently deteriorating scores in ease of doing business in the Philippines, government's efforts need to focus on making us globally competitive — more globalization, not less. A market-friendly investment environment — e.g. investments in infrastructure, liberalizing rules for FDIs — will foster more jobs for the unemployed. Coupled with more expenditure for social programs in health, primary education and conditional cash transfers, these policies will help the poorest.

This is well recognized in the ten-point agenda of this administration, and elaborated in the latest NEDA Philippine Development Plan. The TRAIN law is essential for this. Our Foundation for Economic Freedom urges Congress to approve the DOF-sponsored bill with the minimum of dilution.[3]

Let us persevere in achieving the goals of these economic programs under a democratic setting. And pay no heed to calls for quick fixes under a revolutionary government. Such siren songs are, at best, distracting.

3 See FEF statement "FEF Appeals to Senate to Preserve the Revenue Goals for TRAIN." Available at: http://bit.ly/FEFTrain

The gravy TRAIN is leaving and common sense isn't in it

December 4, 2017

OTTO VON BISMARCK once said that "laws are like sausages. Better not to see them being made." No one would agree more than observers of the ongoing TRAIN legislation.

The just released Senate version illustrates the point. New ingredients surreptitiously found their way into the mix, diluting the DOF's otherwise carefully thought-out recipe.

Package 1 of the reforms was intended to address the oppressive effects of inflation on taxable income — a phenomenon known as "bracket creep."

To pay for the consequent revenue losses from raising taxable income thresholds and help fund the government's ambitious "Build, Build, Build" infrastructure program, oil and auto excise taxes were supposed to be raised to reflect current price levels, combined with the scrapping of VAT exemptions for 144 product categories that made our VAT system both unfair and low-yielding.

What has come out instead is a bit of a *chop suey*, due to the blatant accommodation of narrow-vested interests aiming to avoid paying their share of the tax effort or tilt the playing field against competitors.

Below are some of the more glaring examples.

Expanded tax breaks for economic zones. Mind you, not just exemptions for the zones themselves but an expanded list for VAT zero-rating for locators in the zones, including their suppliers, and tourism sites. Recall that some of these economic zones have been mired in controversy from birth, with reports of rampant smuggling of oil, automobiles etc.

Lower tax rates on luxury vehicles. The Senate version establishes two tax brackets for vehicles, 10% for those costing a million pesos or less and 20% for those costing more. Given where tax rates are today, this will have the effect of shifting the tax burden from buyers of high-end luxury vehicles to those of cheaper, everyday cars.

As one investor newsletter put it, "this new proposal looks like it was crafted specifically by and for luxury car dealers." To illustrate, a Toyota Wigo (retail price of around ₱500,000) could see a price increase of around 8%. But a Toyota Land Cruiser (retail price over ₱5 million) could see a price decrease of over 20%."

How does the Senate version hope to cover the revenue losses from these proposals? Some illustrations:

Doubling documentary stamp taxes. Taxing financial transactions is a last resort of the poorest African countries that possess few alternatives and weak collection agencies. This is not apt for our country — a supposedly dynamic emerging market economy trying to develop and promote its capital markets in a highly competitive region.

Such a tax raises the already high friction costs of transacting legitimate business in our country and diminishes our image as a center for investment. More fundamentally and over the long term, such costs impose a tax on savings and investment, on economic competitiveness, and on job-creation.

There has been no consultation on this and other measures, which were not meant for consideration until Package 4 of the DOF's proposal covering capital income taxation. That the Documentary Stamp Tax was brought forward way ahead of schedule reflects the size of the hole that will be created by the Senate's generous exemptions and tax cuts.

Cosmetic surgery tax. Purely cosmetic. A nuisance tax that will yield peanuts and burden revenue authorities and legitimate patients. Imagine every patient having to wait for his or her procedure to be certified as medically required before being allowed to undergo surgery free of tax? Inconveniences aside, this gives birth to new opportunities for rent-seeking and extortion, new income sources for less-than-scrupulous practitioners.

Coal excise taxes. From the current ₱10 per metric ton (MT) to ₱300 per MT — that's a whopping three thousand percent increase. This measure comes out of nowhere, as it was neither in the DOF or Lower House version of Package 1.

Let me make the case against it.

First, a disclosure. I am an independent director of Aboitiz Power and PHINMA, Inc., both of which have investments in coal power plants as well as in renewables. I am also the private sector representative in the Steering Committee of the University of the Philippines-based Energy Policy Development Program (EPDP), co-chaired by the secretaries of NEDA and the Department of Energy.

The arguments of the proponents:

a) Coal needs to be taxed more due to the negative effect of its carbon emissions on the environment.

Whether this is true or not, the Philippines contributes less than 1% of world total carbon dioxide (CO2) emissions. At the same time, 35% of all the power we produce comes from renewable sources — a mix that is much more favorable than that of most countries, indeed better than almost all countries at a similar stage of development in the ASEAN and globally.[1] We are doing more than our fair share to arrest global warming, even at the expense of cheaper electricity (renewables like solar and wind enjoy taxpayer-funded government subsidies).

b) Gasoline, diesel, and natural gas are taxed more than coal.

My friend, esteemed economist, and columnist, Ciel Habito, estimates that the tax on motor fuels is 10%, on Malampaya gas, 43%. He advocates that coal be taxed at ₱600 per MT, arguing that at an effective 15%, this will still be lower than the tax on Malampaya gas and the proposed 18% for diesel in the Senate version.

Ciel seems to overlook two considerations. The tax on motor fuels has never been about CO2 emissions and climate change, a recent notion. It is about the "user pay" principle — motorists should pay for the roads

---

1 Fabella, R. et al. (2017). "Carbon Footprint, Inclusive Growth and the Fuel Mix Debate in the Philippines." EPDP. Philippine Economic Society Conference (September 22, 2017) that the government builds and maintains. And there is the second reason — to discourage the excessive use of private cars that contributes to traffic and air pollution. In economics-speak, "negative externalities" from urban congestion.

As for the taxes on Malampaya gas, this too has nothing to do with CO2 mitigation. These are royalty payments for the exploitation of the country's natural resources. The government collects the same 60% share of profits from oil and, yes, coal producers.

Given this, why single out coal for a carbon tax? Why not a carbon tax on every fuel based on its impact on the ozone layer, which incidentally should also include LNG? And why not throw in cattle-breeding, as cows emit ozone destroying methane with an aggregate impact similar to coal plants?

Regardless, using widely accepted global norms, EPDP Senior Adviser Prof. Jim Roumasset calculated the appropriate carbon tax for coal in the Philippines, given its contribution of 1% of the world's CO2 emissions — ₱60 per metric ton. Not ₱100. And certainly not ₱300.

The ₱300 per metric ton tax on coal will add ₱0.14 per kWh to our cost of generating electricity. This is on top of another measure climate change advocates and renewable energy developers pushed for — feed-in tariffs, a fancy term for what are just subsidies from the taxpayer. Combined, they will add ₱0.43 per KWh to our electricity bills or, at current consumption levels, a total of ₱40 billion for 2018.

This resulting 10% hike in generation cost comes at a time when our DOE is working hard to bring down power costs to attract investments and create jobs in manufacturing. Note that power costs represent the bulk of cement production costs, causing our local champions to struggle against foreign competition. High cement prices make it more difficult to provide low-cost housing for the poor.

But all is not lost.

There is still a bicameral committee that can hopefully inject some sense into the tax package. We implore the committee members: Pass the TRAIN but hold the gravy, please.

Legislation that matters

August 5, 2018

MUCH DRAMA accompanied the State of the Nation Address the other week. Hopes are high that action follows suit.

There are grounds for optimism.

We were pleasantly surprised by the President's statesman-like demeanor as he articulated a clear legislative agenda for this Congress in its remaining months before election season. Most of them are foundational legislation for peace and prosperity.

His first ask was for the Bangsamoro Organic Law — which Congress passed and he signed forthwith. We in the Foundation for Economic Freedom vigorously welcomed it, calling it "a giant step toward peace and development in Mindanao." We encouraged the future Bangsamoro Autonomous Government "to anchor their development efforts on free-market principles but steered by a responsible elected government assisted by competent, efficient and honest bureaucracy," noting there is "no reason why the BAR cannot be like Hong Kong and Shenzhen in China," exemplars "of free-market principles combined with good governance."

The President likewise asked Congress to urgently pass two pieces of priority legislation. One, the proposal to liberalize rice importation and shift away from quotas to tariffs, as a way to lower rice prices. The recent spike in rice prices and overall inflation owed much to the continued mismanagement by NFA. Its decades-long monopoly has consistently led to cost of rice for our people being as much as twice as high as our neighbors', as well as almost ₱200 billion of unpayable debt guaranteed by the national government.

Two, passage of the TRAIN law, not just the second package on lowering corporate income taxes and rationalizing fiscal incentives, but also pertaining to tax amnesty, capital income taxation, and "sin taxes." Package 2 is essential to make the Philippines competitive with its neighbors tax-wise and encourage investments and jobs. It will also favor the 90,000 small and medium size businesses which, unlike a small number of large firms, do not enjoy "forever fiscal perks."

The election of the new Speaker, Gloria Macapagal-Arroyo, a Ph.D. graduate from the highly respected UP School of Economics, has been widely welcomed. People who have paid close attention to the economy when she was President know well how key economic initiatives then contributed critically to the improved performance we have been seeing — over 6% GDP growth for 12 straight quarters, manageable inflation, low interest rates, higher levels of public and private investments.

I underline in particular two milestone pieces of legislation, the Electric Power Industry Reform law and the Reformed VAT law.

The first re-engineered our electricity sector. Competition and private sector efficiencies have made shortages a thing of the past, and at a more affordable cost of electricity. Just as crucially, it offloaded from government and taxpayers the burden of financing power sector investments, and helped improve our fiscal position.

The RVAT law on the other hand is well recognized by credit rating agencies, multilateral financial institutions, and the broader financial community as a game changer in improving our macroeconomic position and ushering upgrades in our credit rating. Then-President Arroyo was very hands on in ensuring its passage in good form, without being mangled as typically happens with tax legislation.

A case study Christine Tang and I did for the ADB — *Managing Reforms for Development*, particularly Chapter 2 entitled "Political Economy of the Reformed Value-Added Tax in the Philippines"[1] — told the story of how Ms. Arroyo drove this reform effort, getting the reform on the legislative agenda, forging consensus among not just legislators but also key stakeholders (including captains of industry whom she assembled at her home and Congress leaders whom she bent to her will.)

This kind of dogged persistence is needed from President Duterte, and from her as Speaker of the House of Representatives where tax

1 Available at: http://www20.iadb.org/intal/catalogo/PE/2013/11631.pdf legislation needs to originate, to get TRAIN 2 and the succeeding packages going. It seems stuck despite the vigorous efforts of Secretary Dominguez backed by the strong analytical studies of the technocrats in the Department of Finance, and weighing-in of civil society, including eminent economists and former finance secretaries.[2]

The Foundation for Economic Freedom likewise welcomes the President's push for the passage of the National Land Use Act but with some caveats. Permit me to quote FEF Fellow Art Corpuz, a known expert in city and regional planning (Ph.D., former Lecturer at Cornell University and former Professor of Urban and Regional Planning in UP).

"The importance given by the President to the NaLUA is well-founded. This is an opportunity to pass legislation on land use that serves to increase productivity, generate employment, reduce poverty, and protect the environment. Unfortunately, current drafts of the NaLUA are focused on imposing land use restrictions that penalize efficiency, discourage investments, encourage violations and corruption, and hamper the protection of lands that need to be protected.

"For example:

• In rural areas, the myth of food self-sufficiency is perpetuated instead of tapping market demand to raise productivity and farmers' incomes.

• In urban areas, the need for growth is ignored, which contributes to uncontrolled expansion and land conversion, while disregarding and thus hampering the established role of cities to lead innovation and productivity gains, attract investments and generate employment, and therefore serve as prime venues for poverty reduction.

"Unlike the national land use policies of other countries that have moved forward, the current NaLUA drafts have no references to competitiveness, innovation, and technology; the critical role of connectivity, strategic geopolitical considerations, and drivers of future growth (consistent with the PDP/Ambisyon 2040) are ignored.

2 See Fabella, R. (2018) "TRAIN 2: The failures it addresses." and Bernardo, R. (2018) "Eight former finance secretaries support TRAIN 2." BusinessWorld

"The drafts are outdated, mired in a shotgun protectionist mode that assumes unrealistic levels of competency in the bureaucracy.

"Instead, the NaLUA should remove constraints to investments in agriculture, promote urban and economic growth, especially at densities that discourage sprawl and allow more efficient infrastructure, and provide for the immediate identification and protection of environmentally constrained lands at the ground level."

I pray that Congress will devote its remaining months to legislation that improves productivity of the economy, generates investments and jobs, and uplifts the lives of our people, instead of allowing itself to be distracted by Federalism as the solution. As the UP School of Economics Lecture topic said — "If Federalism is the answer, what is the question?"

Postscript: The Bangsamoro Organic Law and the Rice Tariffication Act were passed late 2018. The components of TRAIN pertaining to tax amnesty on real estate taxes were approved.

Capitalism and inclusion under weak institutions

October 21, 2018

ONE COULD NOT HAVE thought of a better title for the latest book of UP Economics Professor, former Dean and National Scientist Raul Fabella, a deceptively slim volume (120 pages) but a real heavyweight. It has amazing sweep and depth on what ails our economy, and provides possible solutions, cogently pulling together literature and research on what has worked here and elsewhere.

There is a reason why we have only one National Scientist in Economics (possibly all the social sciences). Professor Fabella is without peer in profundity and originality of thought. And in the elegant and compelling way he explains these ideas.

I have been a fan of Raul's writing since we, then strangers, met as fellow travelers and Pinoy graduate students at a bus station in DC in 1976. He would write long letters to his friends (in paper and ink, pre-internet) on his observations of US society and academic life at Yale University. It was a correspondence I could not sustain, being more inclined to be lateral than literary. (The best I could do was send him postcards of Williams College I sent everyone.)

Fast forward to 1998, my learning from Raul would resume as our paths crossed again in lively social dinner discussions with like-minded academics, former public officials and private professionals united in advocating good governance and market-oriented reform. This would later metamorphose into the Foundation for Economic Freedom (fef.org.ph). Its founding members included, among others, Mahar Mangahas, Philip Medalla, Calixto Chikiamco, Alex Magno, Simon Paterno, the late Cayetano Paderanga and the late Francis Varela.

In honor of Dondon and Francis and their life's work in doing public good and advancing our common advocacies, our current President, Toti Chikiamco and Chairman, Bobby de Ocampo, initiated the Paderanga-Varela Memorial Lecture, now on its third year. The last two lectures featured FEF Fellows Dr. Vicente Paqueo ("Does Ending ENDO Contribute to Inclusive Economic Growth") and Dr. Art Corpuz, ("On a National Land Policy in the Philippines").

Later this month, Professor Raul Fabella will present his book's findings and recommendations. Just a sample of my favorite takeaways:

1) Crisis of inclusion in capitalism: Poverty incidence versus income inequality. The overarching problem of the Philippines is poverty, not the income inequality of Piketty that has become banner of the Trump and Brexit nativists and their counterparts in other rich countries. The two are not the same, nor are their solutions. This is well illustrated in the case of China under the leadership of Deng Xiaoping where, thanks to market-oriented reforms, "poverty incidence has been reduced from 64% in 1990 to 4% in 2015, even while income inequality (measured by the Gini ratio) rose from 31% to 42%."

2) Taming overreach: "The genius and heresy of Deng Xiaoping was in recognizing that there are spheres of provision other than the state and that these can do better than the state in many domains. The state, however strong, may be overreaching, that is operating beyond its domain of competence." Professor Fabella's (and my) favorite case in point of how private sector can do better in social provision and inclusion is the highly acclaimed MWSS Public Private Partnership. He wrote a chapter on this in the Asia Foundation book, *Built on Dreams, Grounded in Reality*.[1]

3) The impulse for size: "One very salient feature of the current Philippine economy is the unmistakable presence of conglomerates competing in many markets…The vent for size is more urgent in weak governance environments (such as the Philippines')." I have had direct learning of the built-in advantage of bigness when my late father left me a few hectares of land not too far from what has become Metro Manila, which would have been ideal for mass housing. My enthusiasm for developing it was quickly doused from step one by the difficulty of

1 Available at: http://regulationbodyofknowledge.org/wpcontent/uploads/2016/08/BuiltonDreamsGroundedinReality_AsiaFoundation_2011.pdf enforcing my ownership rights against illegal settlers. I happily sold to a major developer, part of a conglomerate, which has the knowhow and connections to solve this, navigate government permitting labyrinth and dealing with "revolutionary tax collectors."

4) Conglomerates and inclusion: "Do conglomerates contribute in a positive way to inclusion in its normal profit-motivated way? The answer is 'Yes.'" Professor Fabella then proceeds to illustrate how conglomerates have done this in various fields, from telecoms, water provision, tertiary education, not to mention through their Corporate Social Responsibility (CSR) initiatives.

5) The way forward: "Rather than threaten to shackle the conglomerates in our midst, we should re-channel them to the tradable goods sector, such as food production, or towards the segment of the non-traded goods that is ancillary to the traded goods sector — power generation." And I may add, create more room in public-private partnerships in other infrastructure needed to support our global competitiveness — airports, seaports, mass transport and telecommunications.

Picking up on the last item, from what I know of the sector as a director of Globe Telecom, the controversial proposal to limit the number of telecom tower operators to only two is a case of overreach. It is also anti-competitive. Quoting below the blog of Peter Wallace on the subject:

Don't limit towers

"Why would we limit the building of cell site towers to two companies? A tower is not exactly a highly technical thing to build. The equipment that goes on it is, but that's provided separately by the cellphone companies who lease space on the tower.

"Get specific specifications that must be met, then leave it to companies to bid for construction at the various sites. Sites identified by the cellphone companies who know where to locate to provide the best signal. This includes areas that are not considered as densely populated but nevertheless need connectivity and mobile services. With the backlog of 50,000 towers we are currently facing, the more companies who are willing and able to build according to agreed specifications should be allowed to build. This should include incumbent telcos and whoever is the chosen third player because this is part of their mandate."

NFA monopoly

Another live instance of government overreach is the NFA monopoly. With our rice prices double or higher than our neighbors', this has profoundly aggravated poverty, dampened manufacturing investments and job creation through wage uncompetitiveness, and periodically inflation shocks to our macroeconomy, like now.

The FEF's position on this is well articulated in various statements and columns over the years, most recently by Toti Chikiamco, in his Introspective column last week: "Abolish the NFA rice importation monopoly and fully liberalize rice importation. The bill passed by the House is defective: it allows the NFA to continue licensing and regulating traders. The Senate should completely abolish the NFA's rice import monopoly and remove its regulatory and licensing functions."

As a wise man said: "Never let a good crisis go to waste."

Better a good neighbor than a distant cousin?[1]

January 13, 2019

On the eve of his state visit to the Philippines last November, Chinese President Xi Jinping wrote that the two countries' relations "have now seen a rainbow after the rain," adding upon his arrival that friendship is "the only right choice." He came bearing gifts for the people, from rice for typhoon victims to promises of scholarship awards, work permits for English teachers and more imports from the Philippines. At the end of the highly publicized visit, observers could only wonder, is there really a pot of gold for the Philippines at the end of the rainbow?

Philippine-China relationship in the past few years has been a complicated one. To recall, under the Aquino Administration, the Philippines took China to an international court in 2014 over disputed areas in the West Philippine Sea/South China Sea (WPS/SCS), a case that secured a sweeping victory for the Philippines, albeit belatedly. By the time the UN-backed Permanent Court of Arbitration in the Hague issued the award to the Philippines in 2016, the Duterte Administration was already in power. Unlike his predecessor, President Rodrigo Duterte had no interest in letting the territorial dispute define the country's relationship with the regional behemoth, preferring a more pragmatic approach of broadening cultural and economic ties in the hope of securing Chinese funding for much needed infrastructure investments.

In a stunning "pivot" only a few months into his presidency, he directed Philippine foreign policy away from what many thought was an overly pro-US stance to what many say is an overly pro-China position. He opted to pursue bilateral talks with China, something his

---

1 This article is an excerpt from the GlobalSource Partners report, "Good not Great," November 13, 2018, written by Christine G. Tang and Romeo L. Bernardo. Check out globalsourcepartners.com predecessor had refused to do, and followed China's lead of simply setting the contentious WPS/SCS issue to one side. He managed to do this notwithstanding surveys showing the wide disparity in Filipinos' trust for the US ("very good") versus China ("poor"), a popular sentiment against China's control of Filipinos' traditional fishing grounds in the WPS/SCS, not to mention the military's close ties to the US.

Now, two years after President Duterte's China pivot, the question that keeps cropping up is, what has the Philippines to show for pursuing friendship with China? Economically speaking, there have been advances although critics would say that they're too little, too slow.

Among these are:

1. Chinese tourists are arriving in droves — almost doubling from 490,000 in 2015 at the height of the diplomatic chill to close to 970,000 in 2017. The number has reached 870,000 in the first 8 months of 2018, ranking second only to South Korea, and is expected to breach 1 million by yearend.

2. Bilateral trade has expanded almost 45% between 2015 and 2017 (from $17.6 billion to $25.5 billion) and by another 16% in the first half of 2018, not counting supply chain trade that passes through third countries. Based on this, China is now the country's largest trading partner, accounting for over 15% of total trade. In this, China is of course as much a winner as the Philippines evident in annual import growth (compounded average growth rate of more than 20%) far outpacing export growth (14% from 2015 to 2017, and only 8% in the first half of 2018).

3. FDIs, practically non-existent a few years ago, have trickled in and from 2016 to August this year, totaled $220 million compared to about $26-billion total inflows during the period. Moreover, there are worries that some of these monies are (a) invested in the gaming industry the sustainability of which is suspect and (b) possibly, helping to fuel a real estate bubble especially with the increasing number of Chinese nationals entering and working in the Philippines.

4. As to China's multibillion infrastructure commitments, reports indicate that to date, only two grant-financed bridges valued at $112 million have started construction and one loan agreement for an

$82-million irrigation project, signed. Here, sentiments are mixed: one side criticizing the slow pace of implementation; the other side relieved at the slow pace seeing as how other countries have fallen under China's supposed "debt trap diplomacy."

Yet recent developments suggest that the two countries are ready to "elevate" their friendship. Right before President Xi's visit, the Philippine government awarded the rights to operate a third telecommunications company in the country to a consortium that included state-run China Telecom. On his first day here, President Xi also witnessed the signing of 29 cooperation agreements, including the ₱18.7-billion ($350-million) loan agreement for the construction of a dam to provide additional water supply for Metro Manila and a Memorandum of Understanding on joint oil and gas development in the WPS/SCS.

In Manila's small business circle, one could easily hear grumblings about the first two deals. But the third, despite providing only a framework, is perhaps the most controversial especially since President Duterte is not seen as being assertive enough about the country's rights in the disputed waters. With it, many fear that the Philippines may play into the hands of China and validate the latter's claims over the WPS/SCS.

For now, the President's high popularity, which will not be challenged in next year's midterm elections, means that he would probably get his way in dealing with China. China, on the other hand, has found in President Duterte a like-minded ally to whom it could open its doors wider to the Philippines through more trade, investments and people-to-people linkages.

I have heard President Ramos quote a Chinese saying: "Better a good neighbor than a distant cousin." True for us? Only time will tell.

Never let a good crisis go to waste

April 1, 2019

THE LEADERSHIP and the management of Manila Water squarely took responsibility for inability to provide 24/7 service in many parts of its concession area. And the company voluntarily waived fees in the several hundreds of millions, despite the absence of any such obligation under its concession agreement. Such act of corporate governance and responsibility is exemplary, and from my recall, unprecedented in the Philippines. Especially since, in the view of many, the fundamental shortcoming is not theirs, but government's. More precisely, that of the MWSS in the last administration. Despite repeated warnings of the two concessionaires at that time, MWSS abysmally failed to develop a single water source, not a single stone was turned or a shovel lifted, even as they barred the concessionaires from developing such. It was the "original sin."

I reprint below excerpts from my October 2013 column, "Being Water Secure." MAP President Riza Mantaring described it as "prescient." I do so to provide perspective on where we were, why we are where we are, and most importantly, the way forward.

"Water security is ensured only when long-term investment and financing for the sector are sustainably and efficiently done to meet the needs of a growing population, the economy and the environment. This was the clear message delivered at a recent forum on Water Security organized by Finex.

"IFC Resident Representative Jesse Ang said in the forum that while the Philippines is not yet considered a water-scarce country, management of the resource needs to be strengthened. Former MWSS Administrator Dr. Lito Lazaro explained why: 'With the improved efficiency of both Manila Water and Maynilad in reducing previously big leakages (non-revenue water) the gain to Metro Manila is almost like building a new huge dam.'

"Dr. Lazaro was too modest to discuss the benefits reaped over 16 years of the highly successful "largest water privatization" in the world: the broad public welfare gains, not just in water security, but in environmental protection, health, and outreach to poor communities. In short, clean water made available to Mang Juan. As CEO of MWSS, he was one of the three architects, under the direction of President Ramos, who made this privatization happen. The other two were then DPWH Secretary Gregorio Vigilar, and Mark Dumol, his chief of staff.

"The success story of this privatization is objectively and engagingly told in a book *Built on Dreams, Grounded in Reality*, by former UP School of Economics Dean and our only living National Scientist in Economics, Dr. Raul Fabella.[1] Chapter 4, "The Privatization of MWSS: How and Why It Was Won" had this to say:

'The privatization of MWSS was clearly a triumph of the principle of comparative competence — the private sector proved more competent at the delivery of water and sewerage services than the state. It is now considered a singularly successful structural reform in the annals of Philippine political economy.'

"The welfare gains for the public is a matter of public record. In the Joint Statement on Water Public Private Partnership (PPP), the Foundation for Economic Freedom, the Management Association of the Philippines, the Employers Confederation of the Philippines, and Philippine Chamber of Commerce and Industries noted that the water PPP has 'contributed much to improve public welfare by having more than doubled the number of customers served, provided 24-hour water service availability that meets health standards, while addressing the needs of millions in the poor communities. The improvements in service delivery came after the two concessionaires poured in a combined ₱105 billion in investments to expand and upgrade the water and sewerage network, achieved without adding to government's fiscal

1 Available at: http://asiafoundation.org/resources/pdfs/Chapter4.pdf burden or public debt exposure.' They further lamented that it's a pity that this 'successful, internationally recognized model PPP has not been replicated outside Metro Manila where the water situation remains at pre-privatization MWSS standards.'

"It is disturbing indeed that instead of building on this success and nurturing the greater water security achieved over the years, we now observe populist myopic demands, not just by the usual suspects from the protest industry, but by MWSS itself, for arbitrary reductions in water rates — already the lowest in the country, and compare favorably internationally. This will inevitably compromise water security over the medium and long term as needed investments for maintaining service quality and protecting the environment are neglected.

"The Japanese Chamber of Commerce and Industry was quite emphatic in this regard: 'We view the MWSS' unilateral and arbitrary act of changing the terms or interpretation of the concession agreement, in total disregard of the contractual rights and intent of the parties, with grave concern.' Such unilateral populist action by government agents is referred to in regulatory economics literature as 'administrative expropriation,' a form of 'government opportunism' inflicted on captive investors in utilities.[2]

"There are a number of issues in the dispute notices that the two concessionaires submitted for international arbitration, ranging from the computation of the appropriate discount rate (allowed rate of return) to the disallowances pertaining to past and future investments, and incredibly, a reinterpretation 16 years hence, of treatment of corporate income taxes.

"The one item of contention that calls for comment is on who is responsible for investing in new raw water sources — a key element to water security. The insistence of the current MWSS management that investments in such are excluded under the Concession Agreements, and therefore disallowed in the tariff rate setting, squarely contradict the intent of the Agreements. More fundamentally, given MWSS', and government's, dismal track record in public service provision — especially when

---

2 Spiller, P. and M. Tommasi. (2005). "The Institutions of Regulation: An Application to Public Utilities," in C. Menard and M. Shirley, eds, *Handbook of New Institutional Economics*. US: Springer.

contrasted with the two concessionaires' — such revisionist interpretation will certainly bring us back to pre-privatization water insecurity.

"Mark Dumol was categorical on what they had in mind: 'Without any doubt, the original intent of the MWSS concession agreement was that all aspects of the provision of potable water, from raw water sourcing to treatment to distribution would be the responsibility of the concessionaires.'

"I also consulted Dr. Lito Lazaro on this and he said, 'In my mind it was clear that raw water development is the responsibility of the concessionaires. How can the concessionaires be held to their targets if they are not responsible for the raw water development, since complying with the targets assumes that water is available?'

"This unilateral reinterpretation by MWSS now risks all the gains achieved in one and half decades."

Sadly prophetic. But all is not lost. Thanks to short-term measures being undertaken collaboratively by MWSS, Manila Water and Maynilad, the current supply deficit of nine percent will likely be brought down to zero by June.

But this crisis would have been wasted, if we fail to address the roots of the problem, the non-development of new water sources. Two musts:

a) Government must fast-track the development of the Kaliwa project. We need the Duterte political will referred to by Secretary Dominguez recently in connection with BBB.

b) "The private water concessionaires, being accountable for rendering water service to the public, should be allowed the option to provide raw water supply for their respective zones."[3]

Finally, this "crisis" would be a good trigger for government to review its basic approach for funding water and sewerage. The three T's, Taxes, Tariffs and Transfers, and the proper shares are a policy and political decision. Angat was funded by taxes. Transfers, usually from donor

---

3 See MAP, Finex, FEF, et al. Press Statement (March 25, 2019). Available at: http://map.org.ph/wp-content/uploads/2019/03/statement-on-water-8-March-26-2019.pdf institutions, are limited and unpredictable. The literature is full of robust findings that tariff mode is the most sustainable. Given the still regressive Philippine tax system, and coupled with a "lifeline" rate for the poor that we have, the tariff mode is the most equitable and most conducive to conservation efforts.

In the same way that the "inflation blip" last year led to the game-changing reform of rice policy, let's use this "water shortage blip" to address the underlying problem of lack of raw water and failure to adhere faithfully to the Concession Agreements in language and spirit.

My plea to authorities: "Never let a good crisis go to waste."

About the author

WITH A PROFESSIONAL CAREER that spans both the public and private sectors, Romeo L. Bernardo offers a unique perspective on economic and development issues facing the nation. In his current role as country partner for a global network of independent analysts and board director in leading local companies, he has developed a knack for communicating thoughtful insights to busy and practical-minded business leaders and investors.

His public sector work, which lasted from the 1970s to the 1990s, includes stints as an instructor in financial management at the University of the Philippines and various posts at the Department of the Finance, where he rose to become an undersecretary. He also took up positions at the International Monetary Fund and World Bank in Washington DC as well as the Asian Development Bank in Manila, where he served as Alternate Executive Director for the Philippines, Pakistan, Mongolia and others.

He also provided policy advice to, and written and published studies for, multilateral and bilateral institutions and the Philippine government on public

Romeo Bernardo (front row, right) joins former government colleagues at the conferment by the Japanese government of the Imperial Decoration of the Grand Cordon of the Order of the Rising Sun on ex-Prime Minister Cesar Virata (seated) in November 2016. In the front row, from the left: Emmanuel Esguerra, Cynthia Paras-Santos, Amina Rasul Bernardo and Teresita Hata. In the second row, from the left: Jaime Laya, Ernest Leung and Victor Macalincag. All previously worked with the country's only prime minister.

Romeo Bernardo and the late Francis Varela take a break from a ride around Lake Caliraya in Quezon province. Romy writes poignantly about the untimely death of Francis in one of his pieces for this book.

finance, capital markets, public-private partnership, pension reform, and economic governance. He served as President of the Philippine Economics Society and Chairman of the Federation of ASEAN Economics Associations.

In 1997, he co-founded financial advisory firm Lazaro Bernardo Tiu and Associates (LBT) with former Energy Secretary Delfin Lazaro and corporate lawyer Helen Tiu.

Presently, he serves as board director in leading Philippine companies such as Bank of the Philippine Islands, Globe Telecom, Aboitiz Power, RFM Corporation, Philippine Investment Management (PHINMA) Inc., and the investment company ALFM Mutual Funds, where he is also chairman. He is the lead Philippine partner/advisor to GlobalSource Partners, a global network of independent analysts. He also serves as Vice Chair of the Foundation for Economic Freedom, a member of the Philippine World Bank Advisory Group, Financial Executives Institute of the Philippines (FINEX) Foundation Board and the International Centre for Settlement of Investment Disputes Panel of Conciliators.

He is a motorcycle enthusiast, and enjoys riding and learning about our country and our people on wheels. This has earned him the tag of "investment biker," and on painful occasions, a "wheelchair economist."

Romy received a Bachelor of Science degree in Business Economics from the University of the Philippines (*magna cum laude*) and a Masters Degree in Development Economics from Williams College, Mass., USA. He is married to Amina Rasul Bernardo, noted peace, security and development advocate and president of the Philippine Center for Islam and Democracy. They have three children.

"Change or be Uberized!"

Calixto Chikiamco

Five arrows for the next president

June 21, 2015

WHEN JAPANESE Prime Minister Shinzo Abe took power in December 2012, he promised three arrows to cure the ailing Japanese economy. The three arrows are: a) monetary policy characterized by quantitative easing, b) fiscal policy characterized by robust fiscal spending while at the same time increasing sources of revenue, and c) structural reforms, which include increasing labor participation by women, increasing inbound tourism, reducing regulatory barriers to trade, and membership in the Trans-Pacific Partnership.

These three arrows are collectively known as "Abenomics," a bold attempt to raise Japan out of its economic stupor and assert Japan's rightful place as the third biggest economy in the world.

The jury on Abenomics is still out. It still remains to be seen whether the three arrows can accomplish what China's Deng Xiaoping's "socialism with Chinese characteristics" has done for China. "Socialism with Chinese characteristics" meant getting foreign investors to help build China, decollectivization of Chinese agriculture, and adopting state-guided and state-led capitalism.

However, certainly Abenomics is bold. Japan is the only developed economy that is using both expansionary fiscal and monetary policy at the same time. (The US, UK, and Europe are fixated on curtailing fiscal spending.) It also goes against long-held Japanese cultural biases against women in the workplace and welcoming foreigners.

The beauty of Abenomics is that Shinzo Abe immediately knew what to do after taking power. It also constituted a vision around which the nation could unite.

What about here in the Philippines? Will the next president know exactly what to do or to articulate a vision after being sworn on June 2016?

To the next president, I'm offering, not three, but five arrows. These five arrows represent economic solutions to cure what principally ails the Philippine economy: widespread poverty. Take note, not solely sustainable growth, because increased growth without reducing poverty is meaningless.

The first arrow is openness to foreign investment. This means not only removing the foreign ownership restrictions in the Constitution, but all other barriers to entry, not requiring Constitutional change. This means reducing the foreign investment negative list, lowering the capital requirements for retail trade, and even liberalizing immigration rules to allow foreigners with certain skills to work here. The Belmonte resolution on constitutional change that just inserts "unless provided by law" in the Constitution, even when passed, still requires legislative amendments to open up the economy

The first arrow will mean more foreign direct investment, more jobs, more technology transfer, better infrastructure, more competition, and lower prices for consumers.

The second arrow is to modernize labor rules and regulations. Modernization will focus on labor productivity instead of unrealistic labor security and government-mandated wage-setting. This consists of: a) liberalizing the rule requiring labor permanency after six months, b) promoting on-the-job training through an apprenticeship program where young trainees are paid less than minimum wages, and c) allowing labor and capital to negotiate labor rates without regard to the legal minimum wage in select depressed, labor-surplus areas, or employment economic zones, as suggested by former NEDA Director-General Dr. Gerry Sicat.

Modernizing labor rules and regulations will promote employment especially among the young, the uneducated, and women; higher wages through higher productivity; and the creation of a skilled labor force. It will also allow industries, especially labor-intensive industries, to quickly grow and absorb all the surplus labor in the countryside. Labor will benefit not only from higher employment but also from the skills that they will gain from the job. With a global labor market, they can go anywhere if they are underpaid relative to their productivity.

The third arrow is to increase agricultural productivity. Increasing agricultural productivity requires the liberalization of the rice import trade and shifting resources away from subsidizing the National Food Authority and the rice sector to other higher-value agricultural products. Increasing agricultural productivity would also necessitate improving the security of property rights in the agricultural sector through amending the anti-development and anti-growth provisions in the Comprehensive Agrarian Reform Law, subdividing the collective titles under CLOA (Certificate of Land Ownership Award), and removing the restrictions on sales and conveyance on agricultural land patents.

What will increasing agricultural productivity accomplish? More investments in the agricultural sector, reduced unemployment in the rural areas, lower food prices, and increased demand for industrial goods in the countryside leading to a positive feedback loop between industry and agriculture.

The fourth arrow is a competitive exchange rate. I know, I know, we are supposed to have a "market-determined" exchange rate. We are supposed to have "inflation targeting," instead of exchange rate targeting.

In an open economy and where most of the world suffers from deflation or near-deflation, inflation targeting must be balanced against growth and poverty reduction objectives. In other words, in an open economy, one can be more aggressive in buying dollars to weaken the peso because the risk of inflation is mitigated by the ability to import. (The inflation rate just fell to a 20-year low.) Rice liberalization alone will result in a significant reduction in the consumer price index. Combined with a policy of massive infrastructure spending, the peso can be made to weaken without increasing inflation.

A weak peso will protect local industries from cheap foreign imports and curtail smuggling, boost export competitiveness of sectors like agriculture and BPO services, increase the purchasing power of OFWs and therefore drive higher consumer spending, cheapen labor for foreign investors, and provide a shield to Philippine manufacturing in the ASEAN Free Trade Area while we work on issues like port congestion and poor infrastructure.

The fifth and final arrow is institutional reform. Institutional reform is about competence and governance, not just *"daang matuwid."* For example, the problem of our poor infrastructure is not just about corruption but also competence. Sure, there's no corruption if an infrastructure doesn't get built but the economy suffers anyway. (Presently, government underspending is a problem.)

Institutional reform must encompass the bureaucracy, the judiciary, and political institutions. The next president must make institutions accountable, transparent, competent, inclusive, and responsive. These can be done in various ways, but it is institutions which will shoot the four arrows. If the shooter is corrupt or incompetent, the arrows will miss their mark. Hence, institutional reform is an economic issue.

So far, while the first part of President Aquino's promise of *"walang korupt, walang mahirap"* remains a work in progress, the second part about eliminating poverty remains unfulfilled. Therefore, job one for the next president is to reduce poverty. With these five arrows, the next president can.

Let the arrows fly.

Labor rigidities as a first-order problem

November 2, 2015

LABOR RIGIDITIES are a first-order problem, that is, they are a principal binding constraint to employment and output growth. By labor rigidities, I mean minimum wages that are unrelated to productivity and are inflexible downwards, and labor security rules that make it difficult to fire employees.

If a presidential candidate tells the voters that he or she will solve the lack of inclusive growth by investing more in infrastructure, he or she just wants to give a safe and popular answer but is being inaccurate.

Sure, improving infrastructure will slightly lower the cost of doing business – the cost of employees being late and tired from commuting or delays in shipment from the ports – but it won't do anything about attracting and keeping labor-intensive industries or incentivizing small- and medium-scale enterprises to hire more robustly. It's only by promoting labor-intensive industries can we make a significant dent in our unemployment rate, the highest in Southeast Asia.

For labor-intensive industries, labor cost can be as much as 90% of total cost. Our high power cost is not a deterrent because for this type of industries, power accounts for only about 3% to 5% of total cost.

With these labor rigidities, investors won't locate here, especially when there are options to set up shop in Vietnam or Indonesia, where labor costs are cheaper. While indeed English proficiency gives our workers an advantage, it isn't enough to offset costs associated with labor rigidities. China has succeeded in attracting a lot of foreign investments in manufacturing and achieving rapid industrialization without an English-speaking labor force because they had cheap labor due to flexible labor rules and a devalued currency.

Likewise, rigidities in other sectors of our economy – for example, an employer can't directly import cheap rice from Vietnam to feed his workers – make establishing labor-intensive industries here daunting.

So, what do we do? Buy the lie that higher infrastructure spending is the magic elixir for inclusive growth?

Obviously, it would be politically impossible to repeal the minimum wage law. The ideal solution would be to modernize the labor code, but short of that, what may be politically feasible?

Dr. Gerry Sicat, the first Socioeconomic Planning Secretary and NEDA Director-General, suggests the establishment of "labor ecozones," where minimum wages and labor security rules are suspended, to attract labor-intensive industries (the secretary of labor has the power to suspend minimum wages). These can be located in labor-surplus areas, for example, Eastern Visayas (Region VIII) which had been devastated by Typhoon Yolanda, or in areas like Calauan, Laguna where informal settlers who have been resettled, have no jobs.

However, the government must build support infrastructures like ports and maybe even factory buildings where manufacturers can just move in with sewing machines or light machinery.

A further suggestion is for some form of targeted wage subsidy. If the government is spending for the Conditional Cash Transfer, the thinking goes, why not go further and subsidize employment, maybe even for a few years? In Singapore, they have no minimum wages but have some form of targeted subsidies to encourage employment.

Another suggestion is to pass the apprenticeship bill, which would have more flexible rules for apprentices. However, the current apprenticeship law limits apprenticeship to just six months and only for technical industries. There's a need to change the law for apprenticeship to cover all industries and to extend the period to at least two years. During their period of apprenticeship, apprentices can be paid lower than the legal minimum wage (the proposal is at 75%) and they won't have the same labor security protections as regular workers.

If passed, this is a win-win law. Apprentices will be paid while learning on the job. Six months is too short for learning. Two years should be a more reasonable period for apprentices to acquire skills, increase their productivity, and give employers enough time to decide whether to regularize them or not. At the very least, apprentices will build a resume.

Under the current law, employers lose a lot when they pay workers minimum wages and train them – only to have them bolt afterwards for another company.

It's not true that workers who are not being paid the legal minimum wage are being "exploited." First, a low-paying job is better than no job at all. Second, if wages are tied to productivity, there's greater likelihood that most members of a household will become employed. Their total household income would likely be greater than having just a single male being employed at the legal minimum wage. Third, once a worker gets employed, he can gain valuable skills on the job and increase his productivity. He can then have the option to move to another employer who will pay him a wage commensurate to his productivity, or he can even move to another country. On the other hand, if he's not employed at all, there's zero chance he will gain work-related job skills.

Also, let me quote the excellent study on "Labor Policy Analysis for Job Expansion and Development" by Drs. Paqueo, Orbeta, Lanzona, and Dulay of the Philippine Institute for Development Studies: "…minimum wages do have substantial negative impacts on household economic welfare. These are reflected in the income and poverty status of households. These are also indicated by the lower employment of individuals with low human capital (e.g. the young, the inexperienced, the less educated and women). Support for these findings is further strengthened by statistical results showing significant damaging effects of minimum wages on demand for workers by small and medium enterprises (SMEs). The foregoing observations are perhaps only the tip of the iceberg."

Labor rigidities are a first-order problem and there's no going around it. This binding constraint must be solved if we want inclusive growth.

It's understandable for a presidential candidate to play safe and be uncontroversial by saying he or she will increase infrastructure spending or reduce corruption to increase jobs and investments. But if that candidate really believes that and only that, then he or she doesn't understand what it takes to achieve inclusive growth.

The constricted rural land market

November 30, 2015

ONE OF THE MAJOR CAUSES of agricultural underdevelopment is our constricted rural land market. It's constricted because rural land, mainly agricultural, has so many restrictions, prohibitions, and limitations. In short, it's not freely traded, and therefore cannot go to the highest and best use. Furthermore, even when rural land is permitted by law to be sold, government imposes onerous requirements for clearances and approvals, raising transaction costs.

These restrictions and prohibitions apply to CARP lands with CLOAs (Certificate of Land Ownership Awards) given to the beneficiaries of the Comprehensive Agrarian Reform Program. What are these restrictions? During the period when the CARP beneficiary has not yet fully paid his amortization to the government, the farmer beneficiary cannot sell, mortgage, and encumber his property.

Because he can't sell it, unless to a qualified beneficiary, the farmer beneficiary is stuck with a property that he can't get full value for. He's also not allowed to mortgage or encumber it, thereby depriving him of the ability to secure cheap loans from the formal credit market, condemning him to borrow at usurious rates in the informal land market from lenders who have informal means to foreclosing on the property.

If the farmer beneficiary can't sell the property, neither can he lease it without permission from DAR. Together with the other restriction in the Comprehensive Agrarian Reform Law – that of a prohibition of ownership beyond five hectares, land consolidation, the natural process of by which efficient farmers can take over from inefficient farmers, is prevented.

Thus, we see the results after 27 years of CARP: agricultural productivity remains low, the average land size shrinks (about one hectare each), the average age of farmers trending upwards (57 years).

However, restrictions apply not just to CARP lands, but unknown to many, even to agricultural patents. The number of agricultural patents is not inconsequential: about 2.5 million, nearly as many as CLOAs at 3 million to 4 million.

What are agricultural patents? These are land grants to farmers (we may call them homesteaders or farmer entrepreneurs) given title under the public land act. To be entitled to a free patent, a farmer must be a) a natural-born citizen, b) in possession/cultivation of land for 30 years, and c) must have paid taxes for 30 years.

By no means are these farmers peasants, since they have no landlords. The land given them came from the public domain, and not a forced distribution from privately owned lands.

Agricultural patents, however, suffer from two major restrictions imposed by a Commonwealth-era law: The first restriction is that these may not be sold, mortgaged, or transferred within five years of the issuance of the patent.

The second restriction is more onerous. Section 119: "Every conveyance of land acquired under the free patent or homestead provisions, when proper, shall be subject to repurchase by the applicant, his widow, or legal heirs, within a period of five years from the date of conveyance."

With this restriction, who will ever buy agricultural free patents? Imagine: if you buy the land, and invest in it to make it more productive, the seller — the original agricultural patent holder, his widow or his heirs — have the right to buy it back within five years! The process by which land can go to higher and better use is stopped.

The restriction makes the agricultural land doubly-dead capital because it makes the land unattractive to banks as collateral. Banks can't foreclose on the property within the normal one-year period, but must wait five long years before they can foreclose and sell it. Holding the property penalizes the bank, not only because of opportunity loss in an illiquid investment for a long period, but also the capital charges it must set aside as required by the Bangko Sentral for holding the illiquid investment.

Banks are therefore wary of accepting any agricultural patent as collateral even if the holder says the five-year buy back option has expired. They have to do due diligence by researching the history of the patent – a tedious and expensive process.

Even developers shy away from buying agricultural patents, skewing growth toward lands without these restrictions, complicating land use planning.

These restrictions on agricultural lands, both for CLOAs and agricultural free patents, make for a very constricted rural land market with grave negative economic consequences. First, it stops the Coasian process by which land should go to the highest and best use. In other words, lands should naturally transfer to the owner who can make the most productive use of it.

Second, the agricultural land owner is prevented from improving his property by accessing loans from the formal credit market. Instead, he has to turn to the informal credit market, which is expensive and run by lenders who have no compunction about using illegal and violent means to enforce loan contracts.

Third, land consolidation, which is necessary to use scale economics, is stopped, both by the CARL prohibition of ownership beyond five hectares and by right to repurchase on agricultural free patents. The average size of agricultural lands today are from 1 hectare to 1.5 hectares, too uneconomic for farm mechanization.

Last, these restrictions chain the farmer to the land forever since he can't sell it for a fair price nor borrow against it.

Property rights reform in the agricultural land market is a key to inclusive growth. The government doesn't even have to spend anything to stimulate growth in the countryside. No cash handouts needed. No roads to be built. All the government has to do is to free the rural land market of all these legal restrictions on rural land.

The next administration's economic agenda should include two bills: one is amending Section 27 of the Comprehensive Agrarian Reform Law allowing beneficiaries to sell and lease their lands, and the other is a bill removing the restrictions on agricultural patents. If passed, these bills will surely raise rural incomes, boost growth and reduce poverty in the countryside.

Postscript: On February 22, 2019, through the advocacy of civil society, including the Foundation for Economic Freedom and Rural Bankers Association of the Philippines, President Duterte signed RA 11231 or "Agricultural Free Patent Reform Act" removing the restrictions on agricultural patents.

Government is the problem

March 21, 2016

When I hear candidates say that when they are elected, government will do this and will do that, I laugh. For example, on the problem of low agricultural productivity and rural poverty, we hear that the solutions proposed by candidates are that government will increase its budget for agriculture, offer subsidized agricultural credit, or build more farm-to-market roads.

Obviously, these candidates would like us to forget the fertilizer scam and the Napoles scams were coursed through the Department of Agriculture. Or that the high rice prices were caused by the DA limiting rice imports.

Government is the problem. It's not the solution. Government should do less, by focusing on providing public goods, such as policy and regulation, rather than doing an economic activity itself.

I have always said that government – the Philippine government, that is – is a reverse King Midas. Anything it handles it turns to crap. Exhibit No. 1 is the MRT. Its maintenance and operation has gone downhill since government took over.

How about those institutions or agencies that are run by government or used to be run by government? Weren't they inefficient, riddled with graft and corruption? PNR? Check. MWSS? Check. Meralco? Check. Power plants? Check. PNB? Check. National Steel? Check.

This is the reason why the Left's knee-jerk solution to every problem of nationalization is so laughable and so nonsensical that it has made them irrelevant politically. Higher oil prices? Nationalize the oil industry. Higher electricity prices? Nationalize Meralco. Poor MRT service? Nationalize it.....err, it's already nationalized.

Does the Left think that Joma Sison will be a better manager and prevent higher prices? Or, do they prefer Joseph Emilio Abaya, the government official who gave no car plates, no license cards, and no MRT, to run things? Or, maybe Agriculture Secretary Proceso Alcala, he of the high rice prices and the garlic cartel?

It's not only the Left that is guilty of this kind of thinking. Even international development agencies and foreign governments suffer from such wishful thinking. It assumes that government will always do the right thing. For example, if the government just had more money or more grants, it can provide more assistance to agrarian reform communities and make them highly successful.

Well, I have news for these guys: government had and has the money, except that it's dissipated in the fertilizer scam, Napoles scams, and all kinds of scams. We just have to accept the fact that we have an inefficient, corrupt and weak state and should craft solutions around this fact. (More on this later.)

In 2008-2009, when the financial crisis hit the US and capital fled the country, some economists called for Keynesian pump priming to counter the lower investment demand. That's the correct abstract, by-the-book answer, but given the inefficiency, corruptibility, and incompetence of our state, Keynesian pump priming will just prime the pockets of government officials.

The Marxists say "concrete analysis of concrete conditions." But many forget this, including international development agencies. Just because land reform worked in South Korea, Japan or Taiwan, they think it will work here. Wrong. Particular conditions made it work in those countries. Communist rural insurgencies were a threat after World War II and the respective states in South Korea, Japan, and Taiwan, to overcome these threats had to make rural land reform work, even to the extent of subsidizing it via financial repression (giving below market interest rates to savers and channelling the money to rural development). Besides, those states were smart enough to limit land reform to rice alone and for a limited duration. In other words, those states were efficient, motivated, and competent. Not so here.

If government is the problem and not the solution, what do we do? We have to let the market do the work.

In agriculture, for example, instead of government giving out fertilizers, it should just make the environment hospitable for investments. At least, CARP has ended, thank God, and the uncertainty it brings. However, it should free the rural land market so that the magic of the market will ensure change toward greater agricultural productivity.

This means lifting the restrictions that prevent rural land going to the "highest and best use." For CARP lands, this means allowing beneficiaries to enter into long-term leases or to sell the usufruct rights to their land so that more efficient farmers can take over, invest and scale. For agricultural patents, which number 2.5 million, this means removing the Commonwealth-era restriction of giving the patent-holder or his heirs an option to buy back the property within five years of alienation or sale. This onerous restriction makes agricultural patents toxic to bankers and to buyers of the land who want to make it more productive.

On the problem of deforestation, unsurprisingly, the government's ₱7.2-billion national greening program to plant trees is a failure, according to the Commission on Audit. Instead, the market should be allowed to work its magic in deforestation. The government should give secure property rights to wood producers via the Sustainable Forest Management Act. In other words, incentivize the private sector to invest in tree plantation and forest regeneration.

Unfortunately, the Aquino administration went totally in the opposite direction and imposed a total log ban, which not only scared off investors, but also encouraged illegal logging and rampant corruption.

On infrastructure, rolling out more PPPs or Public-Private Partnerships on infrastructure projects is in the right direction, not just because the private sector can put its own funds at risk, but also because the private sector is more motivated in accomplishing the infrastructure targets within a certain time frame and operating and maintaining it with operational efficiency.

However, the risk here is of market failure, which is high when there are only a few Philippine-controlled firms bidding for these projects again and again. This is why it's important to remove the foreign ownership restrictions in the Constitution so that there will be more private players bidding for these projects.

Uberized!

April 18, 2016

I WAS ASKED RECENTLY to talk to a group of stock market investors about my take on the coming presidential elections and how the results may affect the economy and the market.

I assured my audience that good fundamentals are in place: robust consumption spending, comfortable current account surplus, continued growth in OFW remittances and BPO revenues, low oil prices, lower government debt and room for increased fiscal spending. Therefore they need not worry that the economy will suffer a downturn.

True, whoever gets elected may or may not be able to make the reforms that would enable the Philippine economy to realize its potential of 8% to 9% per year growth, but they don't have to worry about the economy going south.

However, I told my investor audience that they have to examine whether the companies they invest in will be "Uberized."

By "Uberized," I mean that their investee companies will suffer the same fate as that of the taxi industry at the hands of Uber, the transport app. The fact of the matter is that there are gigantic changes in entire industries going on, one forced by rapidly evolving digital technologies, and the company that doesn't adapt to these rapidly changing technologies, will get "Uberized" – or if you will, "vaporized" by new or more nimble competitors wielding new technologies.

Examples are aplenty. Nokia is one. The once mighty Nokia got "Uberized" by Google and Apple in the smartphone space. Microsoft bought Nokia only to kill it.

Cameras, alarm clocks, calendars, dedicated car GPS gadgets like Garmin, and calculators have been "Uberized" by smartphones. The hotel and hospitality industry is being "Uberized" by Airbnb.

Even the Swiss watch industry, which survived the advent of digital watches, is feeling the heat of the introduction of smartwatches like Apple's iWatch. The Swiss watch industry's sales have fallen since the introduction of the iWatch and other smartwatches like Pebble and Samsung Gear.

I wouldn't want to be the CEO of a car company. Although profits are sky-high for the automotive industry (just as it was for Nokia and Blackberry), there are threats from all sides: cheap cars from China, electric vehicles from Tesla, and most of all, the very concept of car ownership, with the advent of driverless cars and car sharing platforms.

I wouldn't want to invest in the financial industry either. Fintech or financial technology is advancing rapidly and threatening to disrupt incumbents in the financial industry. I'm not referring just to virtual cash like G-Cash or SMART Money or online or mobile banking. Blockchain technology, the technology behind Bitcoin, is threatening the very concept of financial intermediation, i.e. banks acting as bridges between savers and borrowers, or remitters and remittee. Artificial intelligence or AI is beginning to replace human investment advisors.

Here, despite its monopolistic position and humungous cash flows, PLDT is being "Uberized." Its sales and profits are in steep decline because users are shifting toward cheaper, digital alternatives (e.g. Viber messaging instead of SMS, a lucrative product for telcos) and billions of its market value have been vaporized.

Manny Pangilinan is courageously trying to turn around the ship but history isn't kind to corporate turnarounds when the threat is digital. Kodak and Nokia (remember the "we are standing on a burning platform" speech by its last CEO, Stephen Elop?) both knew what was coming, but still couldn't adjust. Business history records only very few successful turnarounds, such as IBM under Lou Gerstner Jr. when IBM evolved to be a services company instead of a computer hardware company or Apple under Steve Jobs (but it still took Jobs six years before coming out with the iPod).

I find that most Philippine companies are still complacent, perhaps because protectionist barriers are still high (e.g. the Constitutional restrictions) or they think they can use political influence to ward off competition. Well, they can ward off competition only for so long because users will demand change as the taxi industry found out when the long arm of Uber (and also, Grab and other app-based businesses) stretched into the Philippines. I see the same thing happening with Netflix threatening to eat the lunch of Philippine cable and mass media companies, which, by law, must be Filipino-owned.

In the face of these disruptions, the government should not be picking winners and losers. Instead, it should make the economy as flexible as possible to enable Philippine companies not only to weather challenges but also to become regional or world-class players.

Firstly, it has to modernize bankruptcy laws to facilitate the exit of dinosaur companies. Otherwise, these dinosaur companies will devour scarce financial resources and prevent future winners from being born.

Secondly, it has to modernize labor laws to enable companies to quickly shed workers. Companies can't pivot if they are prevented from letting go of workers with obsolete skills. On the other hand, the government should provide safety nets for retrenched workers through unemployment insurance, portability of pensions, and government-subsidized retraining programs.

Labor laws should also take into account that on-demand companies like Uber require a new type of worker — one who chooses when he wants to work.

Thirdly, the educational system must be changed to enable students to do continuous, lifetime learning because what they learn in school can become quickly obsolete.

Having faster, cheaper internet is also critical to enable students and workers to access the latest technologies since schools might be too slow to change their curriculum or to train their teachers.

We have to welcome "Uberization" of companies as part of creative destruction. Stronger companies will be forged from the anvil of competition.

To try to protect endangered dinosaurs with subsidies, protectionist measures, and non-tariff barriers will only facilitate their extinction.

To cope with these rapid technological and business model changes, the economy needs a new operating system. Rigidities in the labor, rice, and land markets have to go. Barriers to entry, whether Constitutional restrictions to foreign ownership or predatory monopolistic behavior, must be removed.

To Philippine companies: ignore the political noise, change or be "Uberized."

What agriculture needs is property-rights reform

July 11, 2016

NUMBER FOUR in President Duterte's 10-point economic agenda is to "provide support services to small farmers to increase productivity and improve market access. Provide irrigation and better support services to farmers."

Agriculture Secretary Manny Piñol has said that to implement President Duterte's directive of producing affordable and available food, he will provide free irrigation, technology transfer, and improved market access to farmers.

While I have no doubt about the sincerity, determination, and competence of Secretary Manny Piñol, providing irrigation and better support for farmers seem to be a replay of an old movie. Every incoming administration promises "better support for farmers." This promise is made not only by every incoming secretary of agriculture but also by every secretary of agrarian reform, who has to explain the failure of the agrarian reform program to increase productivity and improve the lives of farmer beneficiaries.

This is not exactly the change in policy we have been promised. Secretary Piñol has also said that he will not change but will continue former Secretary Proceso Alcala's failed rice self-sufficiency program, citing climate change risks to the nation's food security. Granting that rice self-sufficiency is a desirable objective, how can this be achieved since funding doesn't seem to have been a problem for Alcala's failed rice self-sufficiency program? Alcala's DA budget from 2011 to 2015 was ₱339 billion, about equal to the combined agricultural budgets of the three previous administrations. Despite a huge budget, the DA's rice self-sufficiency program was a miserable failure, and agricultural growth was dismal (1.5% per year, lower than even population growth).

Simply throwing money (and good intentions) at the problem may not be the solution.

For one thing, the agriculture department historically hasn't been an effective and efficient instrument for farmers. It has been the home of the Napoles scam and the fertilizer scams. The reason is obvious: the constituency it serves – the farmers – is relatively voiceless and politically weak. Scams and inefficiency can be perpetuated here with little protest and oversight, unlike say in the Department of Trade and Industry, where its constituency — wealthy, politically-powerful, and media-savvy captains of industry — can howl in protest.

For another thing, the absorptive capacity of the average farmer may be limited. According to the Department of Agriculture, the average age of farmers is 57 years old. Their children have seen no future in farming despite CARP and all the support government has promised.

We like to romanticize farming with scenes of tranquil and verdant hills, but farming is, and must be, a scientific, business, and management enterprise. If he is to be productive, the farmer must be an entrepreneur-manager-scientist. To get the most from the soil, a farmer needs have some knowledge of soil science, biochemistry, genetics, meteorology, entomology, and mechanical engineering, among others. If he was a former peasant reporting to a landlord, he now has to become a manager, who must know how to handle farm workers and allocate resources for optimal efficiency.

However, the process by which efficient farmers – those who can apply management and science to improve productivity from the soil – can buy out inefficient ones is stopped by laws restricting the land market. If, say, Farmer A can produce ₱1 million from one hectare of land and Farmer B can only produce ₱100,000 from one hectare, wouldn't society be better off if Farmer A can buy out or lease Farmer B's land so he can produce ₱2 million from two hectares of land, even if he leases the land of Farmer B for ₱200,000?

Unfortunately, the Coasian process by which efficient farmers can buy out or displace inefficient farmers by buying or leasing the latter's lands, is stopped or made very difficult by our restrictive agricultural land market and uncertain property rights over agricultural land. Throwing money at inefficient farmers, even if you give them free irrigation, will not suddenly make them efficient.

What agriculture needs is property-rights reform. Only property-rights reform will unleash a productivity revolution driven by increased private investments in agriculture.

What do we need to do?

First, the two million hectares in collective Certificate of Land Ownership Awards (CLOAs) must be broken up into individual titles. The DAR, in trying to claim accomplishments measured in hectares, issued collective CLOAs, i.e. one certificate of over hundreds of hectares covering many farmers, instead of individual CLOAs.

In agrarian reform, we have fostered communism with collective CLOAs. Without individual titles, farmer beneficiaries have no sense of secure ownership to promote entrepreneurial initiative.

Agrarian Reform Secretary Rafael Mariano should make breaking up these collective CLOAs into individual CLOAs his first task, instead of fostering more uncertainty in the land market by pushing for a new agrarian reform law.

However, I don't disagree with Secretary Mariano's desire to give the land for free to farmer beneficiaries by relieving their amortization obligations to the Land Bank. Farmer beneficiaries are unable to pay them anyway. However, to truly empower them, farmer beneficiaries must be given individual titles and be able to mortgage their land or lease them, unlike now when they can't go to a bank to mortgage their CLOAs or to sell or lease them (the DAR rules are fuzzy with respect to CARP beneficiaries' right to lease) within the 10-year amortization period.

To achieve agricultural productivity, we have to allow land to be consolidated, i.e. allow more efficient farmers to increase the size of their farms. This is the second thing that the Duterte administration must do to increase agricultural productivity. Even socialist China, where all land is owned by the state and private property rights is a politically sensitive issue, is promoting land consolidation by giving farmers usufruct rights which they can lease to others. As National Scientist and economist Raul

Fabella pointed out, leasing acts as a safety net to farmers but will enable the market to determine who can make the land more productive.

The third property-rights reform needed in agriculture is to remove the Commonwealth-era restrictions on agricultural patents. These restrictions consist of a prohibition to sell or mortgage the property within five years of awarding of the free patent; and more perniciously, a perpetual option for the farmer, or his heirs, to buy back the property within five years of its alienation or sale. These restrictions make agricultural patents unbankable and toxic to buyers who want to improve the property.

Change must come to agricultural policy. In China, a simple property-rights (and capitalistic) reform – de-collectivizing agriculture – in 1978 started its agricultural revolution that underpinned its industrialization. In this country, we can't recycle old policies and hope government will do a better job. What Philippine agriculture needs is not more of the same tired formulas of government support, but property-rights reform.

Postscript: On February 22, 2019, through the advocacy of civil society, including the Foundation for Economic Freedom and Rural Bankers Association of the Philippines, President Duterte signed RA 11231 or "Agricultural Free Patent Reform Act" removing the restrictions on agricultural patents.

Labor rigidities are binding constraints to growth

August 8, 2016

LABOR RIGIDITIES are binding constraints to growth. By labor rigidities, I mean the high minimum wages and the inflexible rules in the Labor Code guaranteeing security of tenure to workers after a mere six months.

These are big binding constraints to growth, meaning if unaddressed, fetter the growth of labor-intensive industries that can make a significant dent on poverty and unemployment.

Yes, it's true that foreign ownership restrictions in the Constitution are also a big binding constraint to growth. However, liberalizing these restrictions will only promote competition and foreign investments in capital-intensive strategic sectors, such as telecoms, shipping, and ports. It will reduce costs of strategic inputs to industry but not do much in promoting large investments in labor-intensive industries.

Labor market reform should be front and center in conversations about economic reform for inclusive growth.

I'm not the only one talking about the critical need for labor market reform. In fact, much earlier (and I owe an intellectual debt to them), in their individual capacities, Dr. Gerardo Sicat, Dr. John Nye, and Dr. Vicente Paqueo have been pointing out that labor rigidities are constraining industrialization and employment, and are in fact, anti-poor.

Dr. Gerry Sicat is the country's first Socioeconomic Planning Secretary and founding NEDA Director-General. For many years, he has been saying that the minimum wage should be an entry-level wage and not be set so high, which it is, that it discourages the hiring of new and untrained workers in the formal sector. He has batted for special economic zones where the restrictive Labor Code can be relaxed to promote investments.

Dr. John Nye is the Frederic Bastiat Professor of Political Economy in George Mason University. He was the valedictorian in former President Aquino's Ateneo high school class. Check out his Youtube lecture zeroing in on labor rigidities as a core constraint preventing the country from industrializing.[1]

Dr. Vicente Paqueo is a retired World Bank economist whose expertise is in economics and human development. He led a team composed of economists from the Philippine Institute of Development Studies, the government's economic think tank, which wrote the paper, *Labor Policy Analysis of Job Expansion and Development* (available in the PIDS website) in 2014. It's a courageous paper because it goes against the prevailing political orthodoxy that ever-escalating minimum wages are good. In fact, Paqueo et al. concluded that the legal minimum wage is anti-poor and worse, anti-youth, anti-uneducated, and anti-women and reduces economic welfare where it is applied.

Comes now the World Bank, which recently published its *Republic of the Philippines Labor Market Review*, and confirms essentially what these eminent economists have been saying. The report can be downloaded from the WB website. On the state of jobs and employment in the Philippines, it says:

- Economic growth did not bring about wage growth;
- Employment structure remains traditional, and the modern sector of the economy is still relatively small;
- Informality looms large;
- Many jobs require little skills, and laborers are the largest occupational group;

1 Available at: http://bit.ly/2b9tQx5

- The problem of low educational attainment is particularly pronounced among youth from poor families, most of whom live in rural areas;
- A large fraction of the youth is idle;
- Incidence of low pay is particularly high in the informal sector;
- Incidence of low pay is significantly higher among women than men;
- People are poor in the Philippines because they earn little, not because they do not work;
- From the perspective of poverty, underemployment is a bigger problem than unemployment;
- Workers covered by the minimum wage policy represent a minority among the working poor;
- Workers who benefit from minimum wage are not necessarily poor;
- Labor regulations in the Philippines, on paper, provide workers considerable degree of protection but in reality, benefit only a small group of workers;
- Labor wages are high relative to worker productivity;
- Informality limits the actual coverage of the minimum wage policy;
- While informality confines the effective coverage of labor regulations, strict labor regulations contribute to informality;
- Strict employment protection legislation leads employers to increasingly use temporary employment contracts;
- High minimum wage may exclude low-productivity workers from formal employment;
- Making regular employment contracts more flexible could reduce segmentation; and

- Aligning minimum wage with worker productivity can improve the chances of less-skilled workers being hired formally.

It would be well, therefore, for President Rodrigo Duterte to be cautious about ending "Endo" as the centerpiece of his labor market reform. Companies resorting to "Endo" or terminating employees before their six-month contracts are up is a symptom of the overly strict and unrealistic protection provisions in the Labor Code. "Killing" employers for resorting to "Endo" is not going to solve the problem and will only drive more companies underground.

Even President Duterte admitted that government cannot police and ensure compliance with the law. Unleashing labor inspectors on erring companies is not only unrealistic but will also breed more corruption.

Curing the disease rather than the symptom requires a twin solution. One is liberalize the permanency provisions in the Labor Code and to relax administrative procedures for termination but protect workers with termination pay. The other is to encourage more low-productivity workers into the formal sector by aligning minimum wage with productivity.

To those politicians acting like ostriches and sticking their heads in the sand, I say: Stop. Labor market reform is central for inclusive growth.

There's no going around this: if we want to industrialize, if we want the economy to generate jobs and alleviate poverty, if we want inclusive growth, if we want the social justice that President Duterte wants for the Filipino people, the most urgent, the most important, the most consequential reform is minimum wage and labor security reform. Not tax policy reform, not power sector reform, not reorganization of the Bureau of Customs, but minimum wage and labor security reform.

Change and uncertainty under Duterte

September 5, 2016

WHAT'S THE DIFFERENCE between risk and uncertainty? According to economists, risk is the known unknown; uncertainty is the unknown unknown. Put it in another way, risk is measurable while uncertainty is unmeasurable.

To a bank, liquidity risk or the risk that it will run out of cash to service deposit withdrawals, can be measured, taking into account the liquid or near-liquid funds it holds in reserves, the average size of deposits, the profile of its depositors, its borrowing limit with the BSP, and so forth.

However, an event like a tsunami hitting Metro Manila due to an earthquake in Manila Bay that creates financial panic is an unmeasurable unknown. The famous trader, statistician, and risk analyst Nassim Taleb would call this kind of events, "black swans" or rare, high-impact and unpredictable events. One can even say that the lightning that hit Roberto Ongpin, whom President Duterte called an oligarch, is a black swan.

Risk can be managed, uncertainty cannot. Thus, businessmen hate uncertainty. They can prepare or hedge against risk, but not uncertainty.

In this light, while businessmen welcome the initiatives of President Duterte, such as his tough and swift crackdown on illegal drugs, they also fear the uncertainty. This is because of President Duterte's unconventional, out-of-the-box, unpredictable approach.

For example, dispensing with niceties and formalistic application of due process, President Duterte uses an unconventional "name and shame campaign" against those he perceives as enemies of the state. He makes strategic use of intelligence to "shock and awe" his opponents.

There may be a method to his madness. As a former prosecutor, he knows very well the limits of the criminal justice system in the Philippines where judges can be bribed, policemen fail to appear as witnesses, or even when the perpetuators are found guilty and jailed, continue their nefarious activities behind bars. He also knows that traditional media are controlled by "oligarchs" and that a number of media personalities can be bribed. Hence, to keep his enemies off-balanced, he resorts to pre-emptive strikes of naming and shaming. He's helped by his legion of passionate followers in social media critics call Dutertards.

However, while this unconventional style may be effective, it also breeds uncertainty costs. While businessmen are applauding the peace and order that the anti-drug campaign will bring, lurking at the back of their minds is the thought that they could be the next Roberto "Bobby" Ongpin. If strategic intelligence and naming and shaming can be brought against Leila de Lima, would it also be used against them, especially if they had supported Duterte's political opponents?

It's not only in the area of the tough anti-drug war that uncertainty casts a pall over investments. This is because Duterte is some kind of revolutionary disrupting the old order established by the Cory Constitution.

Take federalism, for example, which is Duterte's solution to the overcentralized, dysfunctional, unitary government created by the 1987 Constitution. The hope is that federalism will bring resources and government closer to the localities, especially the far-flung regions. The flip side of that, however, is that the federal states may be controlled by political dynasties.

There are also many unknowns as to what the Philippine federal state will look like, from the powers that will be devolved to the type that will eventually be approved (Federal-parliamentary? Federal-presidential? Unicameral? Two-party or multi-party system?, etc.).

Meantime, will businessmen, foreign and local, make large, long-term commitments in the face of this uncertainty?

Because the administration policies are still evolving and the programs are unpolished, there are lots of uncertainty in other areas of the economy as well. The mining industry doesn't know if there's such a thing as responsible mining in the vocabulary of the administration. Will open-pit mining be banned, whether it's done in accordance with Australian or Canadian environmental standards or not? Will coal mining be prohibited and will our energy sector be made dependent on intermittent, costly renewable energy? We simply don't know.

The Duterte administration's campaign against "Endo" or the practice of firing contractual workers before they enjoy security of tenure is also fostering uncertainty. Will all forms of contract employment be banned as the Leftist organizations want? A good question since an undersecretary of labor came from a Leftist organization. Indeed, there are reports that labor inspectors are terrorizing SMEs and even PEZA enterprises on the question of "Endo labor."

The same uncertainty hangs over the agriculture sector. DAR Secretary Rafael Mariano is threatening to undo all previous conversion approvals from agricultural to industrial use. He's also proposing another agrarian reform law that will extend uncertainty over property rights to agricultural land. Investors in the countryside will surely hold back if the agricultural land they will acquire will be subjected to land reform. Also, the DAR seems bent on breaking up lands into atomized units. This means agribusiness would have no place in a Duterte economy.

The one exception to the uncertainty over the administration's policies is the tax reform plan unveiled by the Department of Finance. The tax reform plan is detailed. Specific reforms are enumerated to either make taxes more progressive or penalize negative externalities (raising taxes on fuel, sugary drinks and junk food). The principles are also clearly spelled out: progressivity, competitiveness, expanding the tax base, fairness, simplicity and ease of compliance.

Thus, there are no uncertainty costs when it comes to tax reform. While certain industries will get hit, there's enough overall benefit that investors won't get discouraged and enough specificity, so that investors won't have to second guess what the administration will do.

To repeat, risk is knowable; uncertainty is not. Getting slapped with higher taxes is a risk; ending up in President Duterte's shame list is an uncertainty. The very nature of the Duterte presidency – disruptive, unconventional, unpredictable, swift and radical change – will result in more uncertainty.

Therefore, the economy will continue to post strong growth on the back of OFW remittances, low oil prices, and healthy BPO revenues. Higher infrastructure spending, which the administration promises will rise to 7% of GDP, will further boost growth.

However, uncertainty costs will prevent the economy from reaching its full potential. The reduction in uncertainty costs and the flowering of the economy will only happen after President Duterte has delivered on his promised revolution.

Poverty is a bigger threat to society and the state

October 10, 2016

PRESIDENT RODRIGO ROA DUTERTE thinks that the drug menace is the biggest threat to the state. He warned that the Philippines could be turned into a "narco-state." Hence, his all-out war on drugs.

He's wrong.

Poverty is a bigger threat to society and the state. In his fixation with the war on drugs, he's forgotten or sacrificed the greater war on poverty.

According to President Duterte, about 3 million drug dependent Filipinos are at risk. Drugs addle their brains. The next generation may be lost, he claims.

This is true. However, poverty does greater harm to society. People don't become drug dependent until at least their teens. Addiction is also a matter of choice. On the other hand, poverty, and its accompanying manifestation – malnutrition – affects children from the moment of birth. Nay, even from the moment of conception in their mother's wombs. Unlike drug addiction, being poor is not a choice.

Furthermore, lack of nutrition and health care in early childhood darkens a child's future as surely as the sun sets at night. Drug dependents can be rehabilitated. Children deprived of nutrition and health care in their early years cannot, because malnutrition has damaged their brains irreversibly.

There are 3 million drug dependents, according to the government. However, more than a quarter of the population, or slightly more than 25 million Filipinos, live below the poverty line. Another 25% are considered "near-poor." So, there are about 50 million-plus Filipinos who are suffering from poverty or near-poverty versus the 3 million drug dependents.

President Duterte says that drugs rip away families. That may be true, but what about our poor women in the rural areas who are forced to work as maids or sex slaves away from their famiies or in distant foreign lands where they can be abused? Or the millions of OFWs who have to live far away from their families?

While it's true that even rich people take illegal drugs, the fact is that poor people, faced with the stresses of poverty, are more prone to resort to *shabu* and other cheap drugs. They have less access to rehabilitation facilities and are more vulnerable to extrajudicial killings by the police.

Poverty is a bigger threat to democracy than the drug menace. Poverty is what vote buyers prey on. It enables political dynasties to perpetuate their rule unchallenged. Moreover, it provides the fertile soil which breeds terrorists and rebels.

It remains to be seen whether President Duterte will win the war against illegal drugs. Studies after studies have shown that by simply curbing supply without dampening demand, the drug war cannot be won.

However, at this point, judging from the absence of clear policies that promote inclusive growth, what I'm sure of is that President Duterte will lose the greater war on poverty.

So far, what he has unleashed are populist measures that don't attack the root causes of poverty. There's the one cavan of rice for each Conditional Cash Transfer (CCT) beneficiary. How the administration will give one cavan of rice for each family without wasting a lot of money escapes me. The sheer logistical problem – and even if vouchers were used – would pose high risks of leakage and wastage.

Then there's the boondoggle of a ₱21-billion rice program of the agriculture department. Essentially, the Land Bank will extend support to rice farmers and the government will buy rice at support prices to be given to CCT beneficiaries. Honestly? Those loans will really go to increased production and the local government officials will buy at the right prices? Don't pull our legs. Agriculture Secretary Piñol's program is no different from the expensive, but failed, rice self-sufficiency program of former Agriculture Secretary Prospero Alcala.

In addition, the war on poverty must begin by attracting labor-intensive industries on our soil. A quarter of our labor force is unemployed and underemployed. The only way we can make a dent on poverty is to create millions of jobs. (Don't believe those government statistics that says unemployment is down. The government defines "employment" as having worked just one hour the past week. The more meaningful measure is unemployment plus underemployment.)

Instead of fostering a climate for increasing employment, the administration is poisoning the atmosphere for labor-intensive industries with threats to close down companies which don't follow their end "Endo" (end of contract) policy. It follows that up with threats of a national minimum wage.

The war against "Endo" will surely fail – most companies will just go underground – because it doesn't tackle the root problem: the grant of permanency or labor security after a mere six months makes it cost prohibitive for companies to fire unproductive workers later on.

Duterte's Department of Agrarian Reform is also waging its own war against development. It imposed a moratorium of two years on land conversions from agricultural land to other uses. This is an anti-development and anti-poor policy because it prevents land from going to its highest and best use. Unproductive agricultural land cannot be converted into industrial, commercial and residential uses that generates jobs and incomes. This will also make housing unaffordable to many because developers will be prevented from converting acquired agricultural land into residential estates.

I voted for President Rodrigo Roa Duterte, thinking that he, with no vested interests behind him, will bring change. I can't say I'm not disappointed.

He has so far failed to tackle the monopolists in strategic industries, which are strangling the rest of the economy. Moreover, instead of fostering a favorable climate for private investments in agriculture, labor-intensive industries, mining and forestry, which are the job-generators in the countryside, he has fostered a climate of fear and uncertainty.

However, his track record in Davao is one of pragmatism. I'm hoping that he will already declare victory against the war on illegal drugs, make a course correction and really focus on the greater threat to society and the state: widespread poverty.

If he does not, he would not have fulfilled his mandate and will disappoint voters like me. It would be tragic if, after six years, the poor will find that their brash, foul-mouthed emperor had no clothes.

Ending "Endo" and the logic of collective action

November 7, 2016

THE LATE POLITICAL economist Mancur Olson taught us that concentrated interests lord it over dispersed interests, i.e. the noisy organized few can prevail over the unorganized, silent many. Why is this so? If the benefit to an organized few is large but the costs to the unorganized many is small on an individual basis or dispersed, the latter will not engage in a collective action to counter the former. Free-riding becomes a problem as groups become larger.

This is the logic of collective action in a democracy. Whereas democracy means the rule of the majority, in reality, in a democracy, the minority, because of the logic of collective action, trumps the majority.

We see Olson's logic, for example, in the feed-in tariff (FIT) for renewable energy, where consumers are taxed a few centavos per kilowatt-hour to subsidize the few rich renewable energy developers who get a guaranteed return of 16% of their investment for 20 years. From the billions they make, these renewable energy developers can afford to pay politicians, bureaucrats, judges, and mass media and cloak their depredation of millions of electricity consumers under the halo of environmentalism. On the other hand, for the many consumers, a few centavos per kilowatt-hour is just too small to fight against and the cost of organizing and protesting is too high.

I bring up Olson because we see his logic in action again in the campaign against "Endo" or temporary employment contracts. Who are the noisy few? The labor unions, primarily Leftist-oriented ones, which constitute not more than 3.3% of the total labor force and 6.7% of all wage workers. These are the noisiest groups demanding that President

Duterte fulfill his promise to end "Endo" or temporary employment contracts. They are hoping to expand their paltry membership base so they can extract more dues and so they can bask in the populist aura of "fighting for labor permanency."

Who are the silent majority which will suffer from the end "Endo" policy? The unemployed and underemployed who represent about a quarter of the labor force.

In the Paderanga-Valera Memorial Lecture on the topic, "Will Ending Endo Contribute to Inclusive Economic Growth?" during the Foundation for Economic Freedom's 20th anniversary, Dr. Vicente Paqueo, a former World Bank economist and professor at the University of the Philippines warned the government about an anti-contractualization policy. He said:

"The need for immediately ending Endo is overblown; comparatively, more numerous informal low productivity workers' have more urgent needs requiring government support.

"Endo and other TECs (temporary employment contracts) play valuable roles in keeping the PH economy efficient, competitive and inclusive.

"Ending Endo would adversely affect inclusive economic growth, depending on the aggressiveness and nature of government response to the anti-contractualization demands.

"This adverse impact would be intensified by the imposition of more restrictions on other forms of TECS and by other policies being pushed by President Duterte's militant allies, e.g. hefty increases in legal minimum wages and other more aggressive actions of militants."

In fact, he says that surveys of temporary contractual employees, though limited, show that the majority are satisfied with their jobs and see temporary contractual employment as a stepping stone to more permanent employment. A high 40% to 55% transition to permanent jobs after a few quarters. Ending "Endo" would raise the costs to employers, lead to less overall employment, and work against those who are seeking temporary employment even just as a means to gain skills or get the attention of employers.

Dr. Paqueo describes the Philippine labor market as inefficient, citing World Bank research showing the Philippines 91st out of 144 countries in terms of labor efficiency. The low Philippine ranking is due to high labor cost (minimum wages relative to value added per worker is high: 0.69 compared with Malaysia at 0.28), inflexible wage determination, and high costs of hiring and firing.

Instead, Dr. Paqueo called for lengthening the period of probationary status to permanency to be determined by regional authorities. He suggested targeting labor market liberalization for certain enterprises and groups (small- and medium-sized firms and disadvantaged workers, such as the uneducated and the youth). He also proposed the reform of the dispute-resolution process to reduce the costs, hassles, and uncertainty connected with dismissal of workers. A reactor later pointed out that in one case, the Supreme Court decided on an illegal dismissal case after more than a decade and dunned the stunned employer with millions in illegal dismissal costs.

Another reactor, former Labor Secretary Nieves Confesor, said that there had been attempts to modernize the labor code since it was passed way back in 1974 under former President Marcos, but to no avail. She warned, like Dr. Paqueo, that the new normal is globalization and disruptive, technological change. There's no such thing as a permanent job anymore. The dialogue should not be one of forcing employers to hire workers on a permanent basis, but one of risk-sharing. Government, employers, and workers should come up with mechanisms to mitigate job-destroying disruptive change. In my view, these would include portability of pensions, unemployment insurance, reskilling and lifelong education.

Therefore, the Duterte administration's campaign against "Endo" is misguided. In fact, it's a war against employment. It will lead to perverse consequences of employers less willing to hire and more likely to substitute machinery for workers. Investors will shy away from investing in the labor-intensive industries the country badly needs. It will further close the opportunities for the uneducated and the inexperienced from getting a job.

No doubt, the noisy, organized labor unions are behind the agenda against ending "Endo." True to Olson's observations, the vast majority – the unemployed and underemployed – have no voice while the organized, noisy few have the ears of politicians.

Ironically, Big Business is complicit with the labor unions in maintaining high labor costs and inflexible labor rules. Monopolists can afford to share part of their monopoly profits with the organized labor sector. The high cost of labor also acts as a deterrent to any insurgent competitor challenging the monopoly incumbents with low costs. Therefore, the existing situation benefits them. It's the small- and medium-sized companies which suffer from the high minimum wages and will suffer from a campaign against "Endo."

The way forward is not to end "Endo," but to modernize the labor code. However, with Olson's logic at work, will the few continue to triumph over the many?

The economic revolution the Philippines really needs

February 20, 2017

FOR POLITICAL, social, moral, and geopolitical reasons, the revolution that the Philippines really needs is a productivity revolution in agriculture.

Only a productivity revolution in agriculture will solve the problem of poverty in the countryside where most of the poor live.

Only a productivity revolution in agriculture will lay the foundation for long-term sustainable growth and for the take-off into industrialization. A productivity revolution in agriculture will lower the cost of inputs to industry, make more food more affordable to wage workers, and expand the market for industrial goods.

In addition, a productivity revolution in agriculture will strengthen democracy and change Philippine politics for the better. More and richer farmers and agri-entrepreneurs will serve to articulate the needs of the countryside and serve as a check to unequal relations fostered by political dynasties over their impoverished subjects.

A productivity revolution in agriculture will also strengthen the country geopolitically. At a time of rising global protectionism, export-led growth will be harder to achieve. On the other hand, increasing productivity in agriculture will lead to an expanded domestic market that can be the basis for industrial take-off.

Although climate change is a threat to agriculture, it also represents an opportunity. By planting climate change-resistant crops, the country can not only avoid the negative consequences of climate change, but it can also sell them to countries which are not as well-prepared or cannot do anything about them.

The aging demographics of the world also present an opportunity. The increasing average age of farmers in Japan, China, Thailand and elsewhere could presage lowering farm output in those countries. This represents a golden opportunity for us if we can create an environment that would make it attractive for our relatively younger population to take up farming and produce for the world.

Alas, productivity in the Philippines is low and has remained low for decades.

One reason is that there has been a historical bias in economic policy against agriculture. It started with gross overvaluation of the peso after independence in 1946. US colonizers deprived the Philippines of exchange rate sovereignty and imposed an overvalued exchange rate (₱2 to $1) as a condition for independence so that Philippine agricultural exports will not threaten the US market.

This bias continued with an import-dependent, import-substitution policy in the Fifties that favored finished goods industrialization at the expense of agriculture. On the other hand, the US also promoted rent-seeking and unproductive agriculture by awarding the Philippines sugar quotas that enabled sugar *hacenderos* (pro-American, of course) to sell sugar above world market prices.

Moreover, restrictive controls, from price control to fertilizer import control, hampered the growth of agriculture.

It didn't help that the Department of Agriculture was a nest of corruption and rent-seeking. It's not surprising that the major corruption scandals like the Napoles scam, the fertilizer scam, irrigation scams, and others occurred in the DA because its constituents, the farmers, are too poor, politically weak and dispersed to protest.

With low agricultural productivity persisting for decades, it's no wonder that rural insurgency found a fertile ground.

The post-EDSA Cory Aquino government tried to deal with the rural insurgency that had grown under Marcos's repressive rule by instituting the Comprehensive Agrarian Reform Program (CARP).

CARP essentially sacrificed middle class landlords by subjecting them to land reform (and forced land distribution) and exempting the big landlords, who used devices like stock distribution or conversion to industrial and commercial uses to escape CARP.

Although the Comprehensive Agrarian Reform Program succeeded in reducing rural insurgency, it didn't completely eliminate it, because it failed to increase agricultural productivity.

According to the World Bank, the Philippines has the most successful land distribution program in the world, with 84% of targeted lands having been distributed. Take note that the demand of the CPP-NPA has changed from "land to the landless" to "free land distribution to farmers" because under CARP, landless farmers got land but they are indebted to the Land Bank.

Why did CARP fail to increase productivity?

It created uncertainty in property rights and deterred investments in agriculture. It's the longest continuing land reform program in the world (about 28 years to be exact until CARPER expired in 2016.) Successful land reform programs are limited in duration and scope. It also covered all crops – rice, corn, coconut, sugar. According to Dr. Fabella, land reform in Taiwan was confined to rice alone and took only two years. It also helped that Taiwan, which had been administered by the Japanese, had good land records, thereby facilitating land reform.

By freeing him from bondage to a landowner, CARP was supposed to unleash the farmer's individual initiative. The problem was that most of the CARP beneficiaries didn't get individual CLOAs, but only collective title. DAR didn't bother with the tedious task of individual surveys and titling and instead relied on a single collective title to claim huge accomplishments.

CARP also saddled the farmer beneficiaries with so many restrictions. Beneficiaries can't borrow or mortgage the land for 10 years, and they can only do so after they have paid off their thirty-year amortizations to the Land Bank. If a beneficiary is allowed to sell after 10 years, it can only be to another beneficiary.

However, the most pernicious restriction is the prohibition to own more than five hectares of agricultural land. This prevents more efficient farmers from buying out inefficient ones, and condemns farms to be low productivity forever and poor farmers to be chained to their land.

The atomization of agricultural land is therefore encouraged. It's no wonder then that the average size of agricultural land is less than a hectare.

CARP was also implemented on public agricultural lands, applying the law on agricultural free patents, i.e. land was given to farmer-tillers out of the public domain rather than forcibly taken from private landowners.

Unfortunately, these agricultural patents, about 2.5 million of them, carry Commonwealth-era restrictions that prevent land consolidation and make them unbankable and unsaleable. These restrictions include a prohibition of the sale or mortgage of the land within five years of the grant of free patent, and a perpetual option of the free patent holder or his heirs to buy back the property within five years of its sale or alienation. These restrictions make them toxic to banks, which have to hold them as foreclosed property for five years, as well as to investors, who will not buy land and improve it only to have it bought back by the seller in five years.

The problem of increasing agricultural productivity has received short shrift from the Duterte administration. President Duterte appointed a politician to head the Department of Agriculture whose idea of developing agriculture is to give away goodies, such as free irrigation. Also, the secretary of the department agrarian reform is a Leftist who mainly pushes for an anti-development agenda, such as the two-year moratorium on land conversion from agricultural land to other uses.

How can we foster an economic revolution in agricultural productivity?

We have to make the countryside hospitable to private investments and the injection of management and science into agriculture. As I said before, increasing agricultural productivity requires management skills and some knowledge of genetics, biochemistry, soil science, meteorology, mechanical, civil and industrial engineering. It also requires the knowledge and use of digital technologies, such as sensors, satellites, drones, and lately, data science ("Big Data"). These technologies may be advanced but we have to move in that direction. Our agricultural sector needs the infusion of capital, modern management, and science and technology. Unfortunately, current laws favor agricultural stasis, with efficient farmers unable to buy out inefficient ones.

The process by which efficient farmers buy out inefficient ones and increase agricultural productivity should not be feared. Increases in agricultural productivity will lead to an increase in general welfare. The farmer who can produce only ₱10,000 from a hectare of land may be better off as a farm worker earning ₱50,000 a year in a land that can produce ₱1,000,000 from a hectare of land.

A productivity revolution in agriculture will also allow industry, especially those producing wage goods, to take off because the market in the countryside will expand and food costs, and therefore wage costs, will fall. The unemployed and underemployed in the countryside can find work and better paying jobs in labor-intensive manufacturing.

To increase agricultural productivity, we need to free the rural land market.

CARP lands should be free from restrictions. Farmers should be free to mortgage, sell, or lease them to whomever they want, not just to qualified land reform beneficiaries.

At the very least, according to Dr. Raul Fabella, National Scientist for Economic Science, CARP farmers should be able to lease them without DAR overregulation. The lease income acts as a safety net for small farmers while leasing will allow consolidation of lands in favor of more efficient and productive farmers.

(Transfer of ownership is still superior to leasing in land consolidation since it provides an incentive for maintaining soil productivity over the long term but for political reasons, leasing will do.)

The government, in fact, should encourage land consolidation. It should designate an agency to negotiate with farmers, consolidate lands, and offer them to investors on long-term leases or usufruct.

Even China, a supposedly socialist country, is encouraging land consolidation. About a third of China's farmlands have been leased and consolidated through a system of tradable land rights. Chinese

President Xi Jinping clearly sees agricultural modernization through land consolidation as a key to food security.

Aside from freeing CARP lands from restrictions, the Commonwealth-era restrictions on agricultural patents have to be removed. These property rights reforms in rural land will then form the basis of a productivity revolution in agriculture.

Of all the arrows needed to develop the Philippine economy, the arrow of a productivity revolution in agriculture is the most important. Not a golden age of infrastructure. Not investments in education. Not an expanded Conditional Cash Transfer program. A productivity revolution in agriculture is the economic revolution the Philippines really needs.

Postscript: RA 11231 or the "Agricultural Free Patent Reform Act," removing the restrictions on agricultural patents, was signed into law by President Duterte on February 22, 2019.

Where's the human resource strategy?

May 22, 2017

ONE THING I'VE LEARNED as an entrepreneur is that running an organization is 90% human resources. By that I mean people decisions and people management are keys to success. Although there are plenty of business books hyping the importance of strategy, it's not the key to success because if you have the right people, you, together with your team, can iterate the right strategy.

A human resource strategy, however, doesn't only mean recruiting the right people. It also means the systems shaping the behavior of people. There's a saying, for example, that what gets paid, gets done. Thus, if you reward punctuality and punish absenteeism or tardiness, you can expect people to be on time. Another saying is that what gets measured gets done. If you, for example, as a banker, measure only deposit growth but not compliance with AMLA (Anti-Money Laundering Act) rules, you will find transgressions of BSP rules.

I highlight the importance of a human resource strategy because it seems to me that President Duterte has a lack of it, leading to the many stumbles of his presidency.

Take his recruitment strategy. Instead of getting "the best and the brightest," he has confined most of his appointments up and down the bureaucracy to a small circle of Lex Talionis fraternity brothers, San Beda Law alumni, Davao friends, rabid campaign supporters like Mocha Uson, and a few recommendees from PDP-Laban, former President Arroyo, and Bongbong Marcos.

The stumbles he has had – the unceremonious firing of former DILG Secretary Mike Sueño, the abrupt dismissal of his former campaign spokesman Peter Laviña from the National Irrigation Authority, the appointment and subsequent rejection of Perfecto Yasay as Foreign Affairs Secretary by the Commission on Appointments, and the embarrassing extortion attempt on gambling lord Jack Lam by Duterte's fraternity brothers in the Bureau of Immigration – arose from this instinctive, but wrong policy, of only appointing from a small circle without vetting them for competence and integrity.

President Duterte has also built a team with dissonant voices. Former DENR Secretary Gina Lopez fought openly with Finance Secretary Sonny Dominguez. Department of Social Welfare Secretary Judy Taguiwalo criticized the administration's vital comprehensive tax reform package in front of congressmen. His agrarian reform and agriculture secretaries come out with policies and programs in conflict with the economic team's policies and direction.

Also, President Duterte may be accused of mere blustering if he doesn't follow up his tirades against so-called "oligarchs" with the right organizational strategy. For example, he has accused the family which owns the *Philippine Daily Inquirer* of being tax cheats and refusing to give back government land. However, if he doesn't get to have his government team to organize competent lawyers to file and prosecute the case, then it's all just bluster. Asking the Leftist organizations to occupy the contested lands is the lazy way of doing it.

In addition, President Duterte's "Build, Build, Build" mantra suffers from the lack of a human resource strategy. After all, it's people who will supervise and build infrastructure. The policy is too focused on the financing part, but not on the organizations and people who will implement it.

Just look at the Department of Transportation, a key unit in implementing "Build, Build, Build." There's a fast turnover and turmoil in that organization, with resignations of key people hitting that department. I understand that there are three vacant key undersecretary positions.

To be fair, the Department of Transportation under the previous administration was worse. Not only did Mar Roxas and Jun Abaya just appoint lawyers, they also exercised poor leadership, putting politics above public interest.

It's the lack of competent and fairly-behaved people in government that makes me skeptical of this wrong-headed turn of the administration toward ODA financing and hybrid PPPs for building major infrastructure projects. Our experience with failed, delayed, costly, and corruption-riddled ODA projects – SCTex, Subic Port, Northrail, NBN-ZTE – tells me that government doesn't have the competent and motivated people and the human resource systems to build and supervise infrastructure projects on time and on budget. On the other hand, PPP projects – TPLEx, the San Miguel-built airport lanes – have been fairly successful without cost to government. Why? Because the private sector imposes the discipline of the profit motive on its people to deliver the project at cost and on time. I can't say the same thing of government where there are no accountabilities. A lot of government malefactors are still on the loose.

To be fair, I think President Duterte is learning, the appointment of Mocha Uson as assistant secretary being the exception. He has appointed outside of his small circle of Davao friends, two retired generals to his Cabinet, namely, Roy Cimatu as Department of Environment and Natural Resources (DENR) secretary and Ed Año as Department of Local Government (DILG) secretary.

Now, appointing ex-generals could be a good thing or a bad thing. It's true that some of them have been associated with corruption (think "*pabaon*" and "*pasalubong*" for military chiefs as divulged by former military budget officer George Rabusa) but a number of them are highly competent and professional. Unknown to many, the Armed Forces of the Philippines is the unit of the bureaucracy with the most educated and trained professionals. Those who are alumni of the Philippine Military Academy were government scholars who entered via competitive examinations. To advance to higher ranks, officers have to have master's degrees and undergo numerous training. Roy Cimatu, for example, took up engineering before entering the PMA. He also holds an MBA from Ateneo. Colonels and generals are rotated and have experience managing large military units.

Although appointing so many retired generals in the government may not be best policy, President Duterte may have felt compelled to turn to the retired generals who are more experienced and more skilled than his Davao-based supporters.

Also, in the most significant appointment of his term, President Duterte reached outside of his small circle of Davao friends, San Beda Law alumni, and politically-sponsored wannabes, to name Deputy Governor Nestor Espenilla Jr. to the vital post of Bangko Sentral Governor, succeeding the highly acclaimed Say Tetangco. The fact that Duterte appointed Espenilla, clearly the best man for the job, despite the latter being a classmate of former President Aquino and despite lacking the backing of a powerful political sponsor, is highly commendable and shows President Duterte is learning about the importance of human resource decisions.

President Duterte's officials have been chanting the mantra of "Build, Build, Build" and projecting a "Golden Age of Infrastructure." I would rather have a Golden Age of Government, with the right human resource strategy as its core.

Business model, disrupted

October 9, 2017

IF THE PHILIPPINES were a company, its business model would be facing disruption.

Its business model, if you will, rests on OFW remittances and BPO revenues, i.e. on exporting labor and services. That translates to growth in consumption from the expenditure side, and services from the sectoral contribution side.

However, like most companies nowadays, its business model may possibly be under threat primarily due to technological disruption.

Let's take OFW remittances. A significant contributor to OFW remittances is remittances of OFWs in the Middle East. (Those figures showing the USA being the biggest contributor to OFW remittances misstate the true situation, since remittances from Middle East countries are routed through US money center banks and counted as US remittances.)

The technological threat to OFW remittances from the Middle East is the coming shift toward electric cars and self-driving autonomous vehicles. General Motors plans to introduce an all-electric new car model lineup by 2023. Furthermore, an analyst predicts that by the year 2021, autonomous cars will be launched. By 2025, oil use will reach its peak. By 2030, gasoline use for cars will fall to zero.

According to him, simple economics explain the inevitable shift toward electric vehicles and autonomous cars. There are more than 2,000 parts in an internal combustion engine, compared to only 20 for an electric vehicle. With fewer parts, EVs are more durable, cheaper to maintain, with no oil to change, no catalytic converter, no ignition coil. An average internal combustion engine lasts only 150,000 miles versus 500,000 miles for electric vehicles.

In addition, batteries are getting cheaper. Hence, Elon Musk was able to launch Tesla 3, a mid-sized sedan, at about $35,000. For the first time in the history of the car industry, buyers have been making deposits way in advance. Elon Musk's problem is not in selling cars, but how to produce them fast enough.

In addition to technological forces, there's regulatory pressure to lessen carbon emissions and phase out polluting internal combustion engines. Governments are forcing carmakers to meet stringent emission standards that can only be met by electric vehicles.

In sum, Big Oil will become Small Oil. Oil will still have some uses, such as for asphalt or to produce plastics and fertilizer, but it's no longer going to fuel transportation.

If that is so, the economies of the oil-dependent countries in the Middle East, already disrupted by shale oil and fracturing, will collapse, unless they can diversify quickly enough. This will be bad news for OFWs who work in the Middle East. In Saudi Arabia alone, there are more than a million Filipinos.

As if this scenario isn't scary enough, the other pillar of the Philippine economy – the BPO industry, which generates $25 billion in revenue and employs one million Filipinos – is facing headwinds short-term, medium-term, and long-term.

Short-term, the declaration of martial law in Mindanao, the perception that the Philippine government encourages extra-judicial killings, and the anti-Western rhetoric have scared investors in the BPO sector. Short-term and medium-term, the growing scarcity of qualified personnel due to the poor state of education in the country, is crimping the ability of BPO companies to expand. Short-term to long-term, the specter of artificial intelligence (AI) and associated technologies is a challenge to the industry.

I talked to one BPO executive and he said that AI isn't coming, it's already here, at least in the form of AI-assisted software. While AI-assisted software will not replace a call center agent, it will enable him to handle more calls. With AI-assisted software, what once used to require six agents, can now be handled by one. Therefore, the requirements for warm bodies will be less. Now, imagine if full AI, which is getting better at human tasks of cognitive intelligence, are fully deployed.

Staying in the base of the value chain isn't an option. The BPO industry has to level up, or else lose its position as the biggest contributor of foreign exchange.

With the current account now in deficit, any slowdown in the growth of remittances and BPO earnings will scare the markets, aside from putting into question the sustainability of Philippine economic growth.

What should we do? Here are a few ideas.

First, we have to attract investments, both domestic and foreign, by a significant order of magnitude. We would need to significantly increase investments to increase employment and absorb the displacement of our workers, especially in the Middle East.

The administration is correct in trying to remove the legal and regulatory barriers to foreign investment. Socioeconomic Planning Secretary Ernesto Pernia has declared that the government is trimming down the foreign investment negative list. It will also seek Constitutional amendments to remove all foreign ownership restrictions except in the ownership of land.

Furthermore, the Public Service Act Amendment should be passed soon. The bill seeks to provide an updated statutory definition of the term "public utilities," so that only electricity distribution, power transmission, water distribution and sewerage will fall under the Constitutional restriction of foreign investment in public utilities. Thus, telecommunications and transportation will no longer be considered as public utilities and 100% foreign investment will be allowed in those sectors.

If passed into law, the PSA Act will have huge, multiple benefits to the economy. Not only will much needed foreign investments flow into those sectors, it will also solve the problem of poor public services, from telecommunications to transport, which have degraded our competitiveness and deterred investments in other sectors of the economy.

Second, we need to diversify our economy, particularly toward agriculture and industry. Again, the secret is to make the investment climate favorable to investing in agriculture and industry. In agriculture, the key reform is to free the land market, from those restrictions on agricultural land imposed by the Comprehensive Agrarian Reform Law and the Commonwealth-era Public Land Act.

In industry, the key is removing the rigidities in our labor law, from the six-month security of tenure provisions to the minimum-wage rule. In fact, the recent labor regulations against "Endo" (end of contract or contractual employment) haven't really ended "Endo" but have just added regulatory costs to small- and medium-sized businesses. Also, the rise of the "gig economy" or jobs on demand, such as driving for Uber, underscores the need for labor rule flexibility.

We need to provide millions of jobs, not only for OFWs displaced in the Middle East, but also for our millions of currently unemployed and underemployed youth. We have to encourage labor-intensive industries, the kinds that have left for Cambodia and Vietnam, such as garments and light manufacturing, by removing those rigidities.

Third, we need to invest more in education and make education reforms big time. Our education is in a sorry state. We are churning out college graduates who can't write, can't analyze, can't adapt to a fast-learning environment and can't speak well either in Pilipino or English. This is why the BPO industry is constrained from growing.

However, it's not just college-educated labor that must adjust. Even factory machines need more computer and numeracy skills to operate.

We just have to invest more in education, primarily in primary and secondary school education, because the quality of primary and secondary graduates feed into the quality of college-level students.

Fourth but by no means the last, we need government to change its approach. The forces of technological change are moving too fast for government to cope with. Government is just too slow, too political, and too bureaucratic to adjust quickly to the disruptive changes going on. It should really be relying more on the private sector to respond to these changes. For example, instead of financing SUCs (state universities and colleges), it should have given scholarships targeted to poor students, who can choose to go to private colleges and universities. Private colleges can adjust their curriculum and training faster and better in response to market demands. Not so with SUCs.

For another example, instead of government doing infrastructure, it should rely on Public-Private Partnership (PPP). Government rules are just too rigid, from purchasing to firing people, to quickly do infrastructure projects. The name of the game in this era of technological disruptions is quick and efficient, which government is not.

Moreover, instead of government imposing more and more regulations on agriculture and industry, from prohibiting ownership of agricultural land beyond five hectares to specifying what is "core business" not subject to outsourcing and contractual employment, it should be more liberal and apply a lighter regulatory touch. The fact is that technological progress is moving so fast as to leave regulations behind. This is what is happening to the rise of Uber and other TNVs (transport network vehicles), which aren't covered by the Public Service Act, written in 1936.

Business model disruptions can be deadly. Witness Kodak. Witness Nokia. While a country is not a company, the similarity to existential threats isn't far behind. Yes, to paraphrase President Duterte, technological "change is coming." We better be damned prepared.

Is growth sustainable?

March 26, 2018

THE ANSWER appears to be yes. After a checkered history of boom and bust cycles since the founding of the Republic in 1946, punctuated by foreign exchange crises, the Philippine economy has broken out of this pattern and achieved significant growth the past few years.

The economic picture seems healthy: consumption spending remains strong, driven by OFW remittances and BPO growth; government infrastructure spending will boost the economy further in the coming years; and investment spending is picking up. The level of Gross International Reserves remains healthy and the country's debt-to-GDP ratio continues to improve. Government has also been trying to improve tax revenue – TRAIN 1 has just been passed, with TRAIN 2 and TRAIN 3 on the way – to finance its ambitious infrastructure and social spending program. Analysts are predicting 6.5% to 7% growth this year.

The economy seems to be humming. What could possibly go wrong?

One level of concern is the growing current account deficit. After years of surplus, the current account turned negative in 2016, posting a deficit of $1.2 billion. In 2017, the deficit ballooned to $2.5 billion.

The level of deficit, however, is presently manageable and understandable. The current account deficit is about 0.8% of GDP and reflects the country's thirst for imports as the economy picks up.

However, the trade deficit is expected to widen further in the years ahead. The current high level of imports cannot be explained by the "Build, Build, Build" infrastructure program of the government as that program has yet to break ground in many instances. Therefore, imports are expected to surge further when the BBB program takes off in earnest.

While imports will climb in the years ahead, the other components of the current account may face significant threats. BPO earnings, which have been a driver of current account inflows, face headwinds in the form of the emergence of artificial intelligence, constraints in the pool of educated workforce as it shifts toward higher-value services, and an uncertain tax regime.

The other driver of current account inflows, OFW remittances, is continuing to see healthy growth at 4.3% to $28.1 billion. However, the growth in OFW remittances and exports may be highly dependent on the state of the global economy. Presently, the US, China, Japan and the EU are enjoying healthy growth. The US tax cuts and fiscal stimulus are further boosting global growth.

However, the big question is how long will the global economic expansion last? A looming trade war between the US and China threatens global growth. A slowdown in both economies will feed on each other and drag global growth. That means our exports and even our OFW remittances may be severely affected.

Chronic and increasing current account deficits also pose a threat to the economy. An unwelcome steep fall in the peso may be the result. Speculative attacks against the peso will surely happen and undermine confidence. The BSP may be forced to increase interest rates to slow down imports and the economy.

To head off a foreign exchange crisis and to ensure that the current account deficit poses no danger to the economy, the country must dramatically increase foreign investments. The inflows from foreign investments will finance the country's growing current account deficits. Therefore, an important leg for sustainable growth is improving the foreign investment climate.

In this regard, Secretary Ernesto Pernia is spot-on when he pushes for the reduction in the foreign investment negative list. The most important part in the reduction in the negative list is to allow foreign investments in telecommunications and transport, which is presently barred by the current law on the definition of public utilities. The Public Service Act Amendment will cure that. However, the bill is still pending in the Senate for approval on second reading. The Senate must act on it soon to facilitate the entry of a third telco player and to attract foreign investors in the capital-intensive industries of telecommunications and transport.

Of course, laws liberalizing foreign investments are necessary but not sufficient in attracting foreign investments in large numbers. Sanctity of contracts, a rule of law, ease of doing business, and peace and order are also high among the factors foreign investors consider in where to invest. The government has to keep on working for that.

However, to my mind, it's not the current account deficit that represents a structural threat to sustainable growth. It's the government's inattention to the problems in agriculture. As a recent newspaper article, "The Philippines on the Wrong Path to Agro-Industrialization," said, the Duterte government is pursuing the failed agricultural policies of the past. It's still focusing on rice self-sufficiency, which is unrealistic and unable to improve agricultural productivity, crop diversification, and poverty alleviation.

Why is improving agricultural productivity important for sustainable long-term growth? First, increased incomes in the rural sector will expand the domestic market, thereby ensuring that the country is not dependent on the state of the global economy for growth. Second, increased agricultural productivity will free up labor that can be shifted toward higher productivity manufacturing. Third, increased agricultural productivity will mean wider and lower-costing inputs to agro-industrialization, i.e. manufacturing making use of agricultural products from soap making (from coconuts) to brake fluids (from castor beans). Fourth, since poverty has a rural dimension, increasing incomes in the rural areas is essential to combating poverty.

Without improving agricultural productivity, the country's march toward Ambisyon 2040, or the NEDA's vision of most Filipinos living a middle class life of increased standards of living, will not come to pass. The sociopolitical problems alone that massive rural poverty spawns, from terrorism to stunted child development, will ensure that growth cannot be sustained.

Climate change is also a reality and is a threat to our already anemic agricultural sector. Yet, our government officials are mired in the past: insisting on rice self-sufficiency (while the NFA is conniving to press for graft-ridden G2G or government-to-government rice imports) and burdening the agricultural sector with agrarian reform regulations that deter investment in agriculture.

What must we do? First, we need to abandon rice self-sufficiency as a policy. We should freely allow the importation of rice and focus our resources toward developing higher-value crops, where we can have a comparative advantage. Second, we should deregulate the farm sector from many burdensome regulations, from the restrictions on agricultural patents to the prohibition in accumulating more than five hectares of land, in order to attract investments in the farm sector. Third, we must remove the rigidities in the labor law (e.g. minimum wages and labor security tenure) because, as agricultural productivity improves, excess labor must be shifted toward higher-productivity manufacturing.

However, policies that make labor artificially expensive will prevent the growth of labor-intensive manufacturing. In other words, the growth in agricultural productivity must be accompanied by growth in labor-intensive manufacturing.

Let not the present high economic growth rates lull us into complacency. Tailwinds, such as the current global economic growth, will not last. We have much more to do if we are to forge an economy that is strong enough and resilient enough to grow at high rates for at least two decades and achieve the goals of Ambisyon 2040 of a prosperous Philippines.

The structural weaknesses of the Philippine economy

September 8, 2018

RECENT ECONOMIC DATA show the structural weaknesses of the Philippine economy.

In August, inflation accelerated to 6.4% per annum from 5.7% in July, the highest inflation rate in nine years.

The tighter monetary stance of the Bangko Sentral and higher inflation will slow growth even as GDP posted a disappointing 6% growth in the second quarter, far below the government's target of 7% to 9% a year. Trade and current account deficits continue to widen. More alarmingly, exports have continued to slide despite the weakness of the Philippine peso and strong global growth, which is supposed to lift the demand for exports.

Government economic managers have dismissed these recent economic data as mere hiccups. On the contrary, the higher inflation rate, the widening current account, balance of trade and balance of payments deficits, reveal the structural weaknesses of the economy, which remain unaddressed. This means that the economy is very much vulnerable to shocks of the sort we are seeing now. It also shows that the economy is performing far below its potential and that the economy is just cruising along on the back of OFW remittances. Therefore, the government can take little credit for economic growth.

These structural weaknesses are related to the four binding constraints I keep writing about:

1) Monopolies in strategic industries, namely, shipping, ports, and telecommunications; 2) The National Food Authority (NFA) monopoly in rice importation and the Department of Agriculture's obsession with rice self-sufficiency; 3) Labor rigidities, in the form of high minimum or entry-level wages and highly restrictive labor security regulations; and 4) The restricted rural land market due to CARP laws and overregulation by the Department of Agrarian Reform.

Take for example, the recent inflation. If you take away oil price increases, much of the inflation is the result of food inflation. Rice prices continue to surge because of the NFA's mismanagement of the rice supply situation. The lack of rice supply from importation can be strictly traced to NFA since it has the sole authority under the law to import.

In other words, the culprit is the NFA and its legal monopoly is to blame. However, the buck stops with President Duterte because he favored the NFA's head Jason Aquino in a policy dispute with Cabinet Secretary Jun Evasco, who was pushing for the private sector to import rice. We must ask President Duterte why he favored Aquino and hold him accountable.

The NFA's monopoly on rice importation has many negative effects on the economy: 1) It saddles the government with large fiscal losses since it imports rice and sells them below cost, ostensibly for the poorer rice consumers. Actually, there's a lot of diversion going on, probably by the NFA in collusion with unscrupulous rice traders. 2) It makes our manufacturing uncompetitive because rice represents the biggest source of calories for the Philippine worker. High rice prices mean higher wages and lower competitiveness. (This also relates to the uncompetitiveness of our labor-intensive export manufacturing, which has shown significant weakness in this year's economic figures.) And 3) the NFA and the Department of Agriculture's unrealistic rice self-sufficiency program consumes at least 60% of the budget for agriculture. There's not enough budget for higher value crops, the cultivation of which would benefit the economy more.

The ideal situation is this: Let the private sector import rice with the lowest tariff rates possible (higher tariffs will only encourage smuggling.) Rice prices should then fall. More than 100 million rice consumers will benefit. Workers will see an increase is their real disposable incomes, enabling them to buy wage goods that should benefit local manufacturing.

The budget that's now going to rice can then be used to increase production of higher value crops, which would mean more income for rice farmers. As a bonus, the majority of rice farmers, who consume their own production during the harvest season and buy from the market during the lean season, will benefit from lower rice prices as well.

However, it's not only rice but the entire agricultural sector as well that's the culprit in the disappointing inflation, GDP and export numbers. Agricultural growth was flat in the second quarter. Copra prices have also collapsed, contributing to the poor export and agricultural production numbers.

With agricultural production growing much less than population growth, food prices will always be under pressure. Again, manufacturing gets impacted because workers have to spend much more of their pay on food. Workers then have to demand higher wages to keep up with food inflation.

What is the cause of our low agricultural productivity and anemic agricultural growth? The three binding constraints of monopolies in strategic industries, the NFA rice monopoly, and CARP laws and regulations come into play. Monopolies in ports and shipping make transport of agricultural goods expensive. The NFA rice import monopoly and the DA's rice self-sufficiency program mean government's budget for agriculture goes mainly for rice, a low value-added commodity for which we have no competitive advantage. CARP laws and regulations discourage private investments in agriculture, hinder loans to the agricultural sector (there are many restrictions on rural land that prevent banks from lending against farmlands, particularly those with CLOAs [Certificate of Land Ownership Awards]), and cause the fragmentation of farmlands.

The weakness of our export sector despite strong global growth and the weakness of the peso should similarly be a cause for concern. It has resulted in growing current account, balance of trade and balance of payments deficits and decline in international reserves. While import-intensive electronics exports have remained steady, agricultural exports have declined while other manufacturing exports also fell. The former is due to low agricultural productivity in primary agricultural exports, such as copra, and the latter is most probably due to the uncompetitiveness of our exports caused by labor rigidities (high minimum wages and security of tenure provisions in the Labor Code).

We have not been able to diversify our exports beyond import-intensive electronics. Labor-intensive export industries, such as garments and light manufacturing, have fled to countries such as Cambodia, Bangladesh and Vietnam. Our high entry-level wages, the most number of official holidays, increased SSS pension contributions, security of tenure provisions in the Labor Code, and threats such as ending "Endo" and giving 14th month pay proposed by the secretary of labor, have caused labor-intensive manufacturing investors to flee.

On the other hand, while Vietnam has become the biggest coffee exporter in the world, our Department of Agriculture is obsessed with rice self-sufficiency. Our farms are also fragmented, with an average size of one hectare because of CARP (Comprehensive Agrarian Reform Program) restrictions. Due to restrictions on farmland ownership, efficient farmers are prohibited from buying out inefficient ones. Even leasing of rural land is difficult due to overregulation of the rural land market by the Department of Agrarian Reform. Finally, credit doesn't flow to agriculture because of restrictions on agricultural land that make them unbankable.

The inflation surge is but the tip of an iceberg. More fundamentally, our rising current account, trade and balance of payments deficits are causes for concern. "You ain't seen nothing yet," as the Americans say. The balance of trade has widened when BBB or the government's infrastructure program hasn't yet taken off in earnest. Imagine a jump in the level of capital imports and the trade deficit once the infrastructure program gets going.

The prescient purchase of dollars by the BSP by former BSP Governor Say Tetangco is the only thing keeping us from being another Indonesia, where the rupiah has fallen steeply amidst rising current account deficits. But maybe not for long because the deficits are rising and depleting our international reserves while our structural problems remain unaddressed.

In my next column, I will discuss what the government should do. However, I will say now what the government should NOT do. It should *not* spend its political capital on charter change toward a flawed federalism and on prosecuting the opposition. President Duterte should *not* keep Jason Aquino, Manny Piñol, Art Tugade, and Silvestre Bello III, who are responsible for the failures in governance we see today.

I repeat: the unwelcome rise in inflation is but the tip of an iceberg. Other shocks, from a speculative attack on the peso to double-digit interest rates, await the economy if the structural weaknesses of the economy remain unaddressed. Time for the administration to go off its high horses, remove its air of arrogance and hubris, and buckle down to work. Otherwise, it will keep breaking records in terms of inflation rate, decline in the peso, and loss of business confidence.

Postscript: The Rice Tariffication Act was signed into law by President Duterte on February 14, 2019, removing the National Food Authority's monopoly on rice imports and providing for the imposition of tariffs on rice shipments from other countries.

Agriculture, agriculture, agriculture

November 18, 2018

MY FORMER COLLEGE economics professor, Dr. Bernie "Dr. Boom" Villegas, was once quoted chanting the mantra of "agriculture, agriculture, agriculture" when asked about the development direction of the country. Indeed, while the political Left was enamored with "nationalist industrialization," and rent-seekers with "import-substituting industrialization," Bernie was an outlier. After all, agriculture was unsexy, while industrialization with its image of mighty steel mills and factory sinews, represented progress and modernization.

Guess what? It turns out Bernie was and is right, after all. Not that we shouldn't pursue industrial modernity, but first things first, and that means agricultural development. Agricultural development is the foundation of sustainable, inclusive growth.

That truism has been brought to the fore with the recent economic data showing higher consumer inflation on the back of higher food prices and weak export performance, resulting in record trade deficits marked by faltering agricultural exports. In the last quarter, agricultural growth turned negative. As a result, agricultural production is estimated to be 1% for the year, way below population growth.

The weakness of our agricultural sector shows our vulnerability to all sorts of shocks, from natural disasters to oil price shocks. The pain of increasing oil prices would not have mattered so much if it weren't accompanied by higher food prices. Further, our export base is undiversified. We have miniscule agricultural exports, unlike say, Vietnam. A global recession can cause exports, primarily in import-intensive electronics, to spiral downward, further pressuring the peso and our ability to finance capital imports.

The beauty of agricultural development is manifold: It will address the problem of rural poverty since the poorest of the poor work in the countryside; it will create a domestic demand for wage goods since rising incomes in the countryside will make an expanding market for industry. It will also act as a buffer to the vagaries of global demand for exports, especially in this age of trade wars and anti-globalism; it will spawn agro-industries, i.e. factories processing raw agricultural products and transforming them to higher value-added goods.

Agricultural development will also have a collateral, but very important, benefit: it will help reduce insurgency and bad peace and order in the countryside, which, in turn, would lead to more investments and increased tourism. Moreover, a rising rural middle class will help check the proliferation of political dynasties and strengthen our democracy.

I know of very few countries which industrialized without agricultural development as the foundation of their modernization and industrialization. Land-poor economies like Singapore and Hong Kong essentially developed by importing the agricultural productivity of other countries through free trade. However, for the rest, agricultural development goes hand in hand with industrialization. In fact, the United States' economy is sustained by the high productivity of its agricultural sector. Just about 1% of the population feeds the rest and there's even a bountiful surplus which it exports.

By the way, it's not true that agricultural development leads to dead-end growth. The Netherlands is an example of how a country continues to derive increasingly higher value output from agriculture and in the process, has become the second largest agricultural exporter in the world despite being a tiny country. This is more true now in the age of biotech. Plants and animals can be transformed into factories of complex chemical, pharmaceutical, and environmental products. (Rice can be infused with Vitamin A through biotech. Plants can be turned into biofactories producing peptides for medicine.) In this, the Philippines has a competitive advantage, having one of the most diversified flora and fauna in the world.

And what about China? Deng's first reform involved agriculture. Under Mao, the emphasis on heavy industry under the Great Leap Forward led to widespread famine and millions of deaths. When Deng took over, the first and most important reform he did was to change the property rights in agriculture: he decollectivized farming and instituted the household responsibility system. Essentially, Deng introduced capitalism in agriculture by allowing farming households to determine what to plant, sell to the market, and keep the fruits of their produce.

Deng's agricultural reform was a Big Bang of sorts for China's development: it resulted in dramatic increases in agricultural productivity, which in turn not only led to the reduction in rural poverty, but also led to agricultural savings that financed industrial development. While increased agricultural productivity led to surplus labor, displaced peasants and farm workers went into gainful employment in higher productivity manufacturing. Sharp devaluations of the Chinese yuan, an open door policy for foreign investments, flexible labor policies, and emphasis on infrastructure (ports, roads, bridges) for export-led manufacturing, enabled industry to take off.

In contrast, here in the Philippines, we have neglected and continue to neglect agriculture. Instead of productivity, the emphasis is on land distribution – of the wrong kind. CARP (Comprehensive Land Reform Program) has transformed landless peasants into, in the words of National Scientist Dr. Raul Fabella, "impoverished landowners." Equity for farmer-peasants as a matter of social justice is fine, but the state has shackled them with all sorts of restrictions. They can't borrow or sell their land within ten years, or until their amortizations are paid. They can't succeed too much either, because they, or anybody else for that matter, can't own farmland beyond five hectares. Since farmers die, their heirs divide the land into ever smaller cuts of land. (The average size is now just a hectare.) To top it all, the state gave them collective CLOAs, a sort of communistic documentation of their land ownership with many farmer-beneficiaries covered under just one land title. (About 50% of all CARP lands are still under a collective title.)

What we need to do is to free the rural land market: free from the restrictions imposed by CARP and the overreach by the Department of Agrarian Reform over all types of rural land. The second stage of social justice, after distribution, is to give farmer beneficiaries control over their own land and not shackle them with all sorts of restrictions. Even China, which is socialist in name and doesn't allow their farmers to own the land but to lease it, has given its farmers tradable leasing rights, which allow small farms to be consolidated. What Philippine agriculture needs is more capitalism, and not statism.

Unfortunately, the Duterte government has neglected agriculture. Agriculture Secretary Manny Piñol, Mr. "Missing in Action" after typhoons, is a populist politician and just rehashes old and tired policies: free irrigation, free fertilizer, and rice self-sufficiency. The result is what we see now: anemic agricultural growth, rising rice prices, and falling agricultural exports.

It's not surprising, however, that the agricultural department is bereft of imagination and innovation. It's more known for corruption (remember the fertilizer and Napoles scams?) because the farmers are too poor and politically weak to protest. Its policies reek of control and giveaways that make it a fertile ground for corruption.

It would also have been better if BBB (Build Build Build) had been more oriented toward agricultural development in the rural areas. Instead of big-ticket white elephants like trains and subways, which take time to implement and could be economically infeasible, BBB could have incorporated more regional roads and regional ports which would be faster to implement and give access to metropolitan markets for agricultural produce. Again, regional roads and ports are unsexy while big-ticket projects, especially Official Development Assistance (ODA)-funded ones, are easier to extract rent from.

The Duterte administration's mantra is "Build, Build, Build." I say, however, that it should listen and learn from the wise Dr. Villegas, who has chanted, quite correctly, "Agriculture, Agriculture, Agriculture!"

The main trends in the world today

January 27, 2019

WHAT ARE THE MAIN TRENDS in the world today? What are the geopolitical forces driving change and impacting societies? What will shape the future?

In my mind, irrespective of the specific events that will happen in the future, these are the main trends or fundamental forces driving change:

1. *The US-China rivalry* – It's official. The US considers China its strategic rival. The trade war that US President Donald Trump unleashed against China is but the opening salvo of what is probably going to be a long geopolitical clash between these two competing states.

It's going to be similar to the Cold War between the Soviet Union and the US, but also different. It will be similar in the sense that this rivalry, as did the Cold War, will affect global and local politics. We have already seen how this rivalry affects Philippine foreign and economic policy. The return of the Balangiga bells, for example, can't be considered as an act of wanton generosity by the US but as a deposit of goodwill to try to woo the Philippines back from its warming relations with China and cooling relations with the US under President Duterte.

The rivalry between China and the US will also be different from the Cold War because the nature of the conflict is different. For one thing, the Cold War was primarily ideological: communism versus capitalism. For another, the Cold War was between two vastly different economic systems. However, today, both China and the US may be considered "frenemies," both friends and enemies. Their economies are tied together. Witness how China's economic slowdown has greatly affected the stock of Apple, which considers China its second largest market for its iPhones.

While US President Trump may have unleashed a trade war with China, there is widespread bipartisan support in Washington for containing China. The Trans-Pacific Partnership (TPP) which was initiated under President Obama, was actually meant to isolate and contain China, but US President Donald Trump dumped the idea and opted for a frontal trade war instead.

Witness, too, how the Republicans and the Democrats came together with a $113-million investment program that will invest in new technology, energy, and infrastructure projects in Asia as a counter-strategy to China's "Belt and Road Initiative." Republicans, usually adverse to foreign aid, also joined with Democrats to create a new foreign aid agency, the US International Finance Development Corporation, which will give financial support to US private companies doing business in developing countries. The intent is to provide countries like the Philippines an alternative to China financing under the latter's "Belt and Road Initiative." The new Cold War between China and the US will last beyond the Trump Republican administration.

Analysts are saying that a "hot war" between the US and China may be inevitable, following the concept of the Thucydides Trap, first elaborated on by Harvard professor Graham Allison. The Thucydides Trap refers to an inevitable war between a prevailing power and a rising one, described by the ancient Greek historian, Thucydides: "It was the rise of Athens and the fear that this instilled in Sparta that made war inevitable." Historians claim that of 16 instances of a prevailing power being threatened by a rising one, 12 have ended in war (e.g. Carthage versus Rome, Spain versus England, Russia versus Japan, etc.)

Because of its strategic location, the Philippines is in the frontlines of the rivalry between China and the US. We can either exploit the rivalry or be collateral damage. In either case, the US-China rivalry is a main trend we cannot ignore.

2. *Demographic decline* – The saying "demography is destiny" is trite but true. There's no escaping demographic forces. Singapore and China, which had implemented successful birth control programs, are now trying to move from population control in the opposite direction and failing. China, South Korea, Japan, and even Thailand, yes Thailand, are aging fast. This demographic decline will affect their respective economies.

Japan, for example, where the population is shrinking (Japan's population is foreseen to shrink from 127 million today to 85 million by the end of the century) and where the average age is 47, is being forced to revise its immigration policies if its xenophobic society wants to maintain its standard of living. Despite misgivings from the Japanese public, Prime Minister Abe recently liberalized its immigration policy, allowing legal immigration and issuance of working visas in certain industries. Japan's immediate problem is that industries cannot expand due to dearth of labor. Furthermore, Japanese agriculture is also suffering because the average age of Japanese farmers is 67 and six out of ten farmers are over the age of 65. Japanese agricultural policy will have to change as it has in "socialist" China, which has allowed land consolidation to increase efficiency and to solve the ageing of its farming population.

Likewise, our ASEAN neighbor, Thailand, faces a huge problem, which would make it unlikely to escape the "middle income" trap. The average age of its population is 37.8 years (compared to the Philippines' 23) and its working-age population will shrink by 10% in 2040. Its population control program was too successful. Thailand will not only face the loss of labor-intensive industries but will also face the burden of financing its social security before it has become an advanced economy.

Therefore, because of the demographic winter in many countries, migration cannot be stopped. With migration, however, many societies will be disrupted with the arrival of new peoples bringing in their own values, culture, and traditions.

3. *Technological disruption* – Technological disruption is accelerating and will affect almost all industries and touch every aspect of daily life. Disruption will be severe because even established companies employing thousands of workers will see their business models disappear. GM and Ford, for example, will have to find a new business model other than selling cars if self-driving electric vehicles make it more attractive for commuters to just book rides rather than own cars. Those who make a living out of driving, such as truck drivers and delivery men, will find themselves useless to employers.

No industry is safe. Blockchain technology, for example, will disrupt and reorder the banking and insurance industry. Artificial intelligence will challenge the financial consultancy industry. Logistics, hotels and restaurants, retail, transportation, and telecommunications to name a few, will be disrupted.

However, this broad-based technological disruption will also cause mass anxiety and political disruption. For example, economists Daron Acemoglu and Pascual Restrepo in a paper on *Robots and Jobs: Evidence from US Labor Markets,* showed that in the US Midwest and portions of the South that went for Trump had a far higher ratio of robots to population. Automation disproportionately affected blue collar white male workers in those counties, exactly the demographic which also disproportionately went for Trump.

Acemoglu and Restrepo only looked at industrial automation. Imagine what will happen when new, disruptive technologies like self-driving vehicles, artificial intelligence, and Internet of Things (IOT) are applied beyond factories to society at large. Or, imagine what will happen if artificial intelligence takes away even white collar jobs like those of financial advisers, lawyers, and accountants.

As a result of growing mass anxiety, we are already seeing that populism and autocrats offering simplistic solutions are on the rise. Disruptive politics is bound to strengthen and challenge the existing order.

In sum, the US-China rivalry, demographic decline, and technological disruption are the main trends in the world today. These are the macro, irresistible forces that will shape our future.

Duterte's unfinished revolution

March 10, 2019

PRESIDENT RODRIGO ROA DUTERTE has unfinished business.

No, it's not the drug war, which he looks likely to lose, given his hammer-to-the-fly strategy and his failure to put any big-fish drug smuggler and kingpin to jail.

His unfinished business is to complete the anti-Yellow revolution which he promised to set out to do. After all, he was elected on the promise of systemic change – "change is coming" was his slogan – and on the people's obvious disappointment with their lot thirty years after the 1986 EDSA People Power Revolution.

So far, he has targeted only the political foundations of the EDSA People Power or Yellow Revolution. Indeed, one can understand his political actions through the prism of his anti-Yellow revolution. He has targeted the Catholic Church, seeking to demean and degrade the institution. It's not because he was, as he says, a victim of a Catholic priest's abuse in his youth, but because the Catholic Church was part of the coalition, together with the anti-Marcos Big Business, that was responsible for the EDSA People Power Revolution.

He has also targeted ABS-CBN and the *Philippine Daily Inquirer*, two media outfits strongly associated with the Yellow revolution. ABS-CBN because former President Cory Aquino allowed the anti-Marcos Lopezes to reclaim it after the People Power Revolution, and the *Philippine Daily Inquirer* because its rise to a major daily traces its roots to its role in that revolution. In the case of the *Inquirer*, he made a particular point of targeting its owners, the Prietos, regarding its lease of the Mile Long property, which sits on government-owned land.

Indeed, President Duterte tries to be the anti-Yellow, even in foreign policy. He has shifted the country's foreign policy away from former President Noynoy Aquino's staunch pro-American and anti-Chinese foreign policy. The Yellows' pro-Americanism can be traced to the help that the Yellow forces allegedly got from US officials in a critical juncture of the uprising against Marcos: Senator Paul Laxalt's crucial call to former President Ferdinand Marcos "to cut and cut cleanly" and to the US forces spiriting former President Marcos against his will out of Malacañang and into exile in Hawaii.

However, he has not completely swung Philippine foreign policy to the Chinese side, given the strong pro-American and anti-Chinese sentiment of the public and the strong bond between Philippine armed forces and the US military. A number of treaties also tie the Philippine government to its US alliance.

To his credit, however, President Duterte has expanded his own political coalition to include former prominent "Yellow" figures or Cory Aquino acolytes. His Foreign Affairs Secretary, Teddyboy Locsin, used to be former President Cory Aquino's speechwriter and spokesman. His Presidential Adviser on Entrepreneurship is Joey Concepcion, whose father was a prominent member of former President Corazon Aquino's cabinet.

However, if all President Duterte does is demonize the Yellows (read: the Liberal Party and its allies), and strengthen his political power at their expense, then his anti-Yellow counterrevolution is a fake, i.e. it's nothing more than just a struggle of political factions over rent-seeking positions, and not the "systemic change" or revolution that he promised.

The reason for this is that President Duterte has yet to act on the economic foundations of the EDSA Revolution: the 1987 Constitution and the 1988 Comprehensive Agrarian Reform Law (CARL), which were instituted shortly after former President Aquino took power.

These two economic foundations laid by the Yellow revolution are the reason why the EDSA Revolution essentially failed. Thirty years after the revolution, there has been no inclusive growth, poverty remains endemic, rural poverty is widespread, strategic services are controlled by monopolies or duopolies, and government services, whether issuing licenses or running the MRT, remains abysmal. As a result of the Yellow revolution's failed promises, a tenth of our population have sought greener pastures abroad and to work as OFWs, even at great social cost.

Although the stark cronyism and corruption practiced by a single political faction was no longer evident with the return of liberal democracy in 1987, nonetheless, corruption, albeit by alternating factions of the political elite, remains rampant, amidst deteriorating public services.

This background of economic and social failure engendered by the EDSA Revolution was what a foul-mouthed, tough-talking Mayor Duterte exploited to win the presidency in 2016. To a weary public, he promised that finally "change was coming."

Let us now try to understand the twin economic foundations of the EDSA Revolution: why they were instituted and why they failed.

We should understand that the EDSA Revolution wasn't really a "revolution" in the classic sense of one class overthrowing another class. It was more a restoration of the pre-martial law order, where factions of the political elite took turns on political power in a relatively peaceful manner under the rubric of democratic elections. The EDSA Revolution returned the anti-Marcos oligarchy to power and the 1987 Constitution protected its economic interests with the restrictive foreign ownership provisions in the Constitution. These restrictive provisions limited competition, particularly in strategic sectors of the economy (public utilities and media).

These restrictive provisions even became more onerous because while the Cory Aquino administration bowed to globalization and embarked on reducing tariffs, the protected sectors were in non-tradable services – power distribution, shipping, ports, media, banking and real estate. Shielded by being non-tradable and the restrictive provisions in the 1987 Constitution, monopolies and oligopolies came to control strategic sectors of the economy. Consequently, the public suffered from high prices and shoddy service of these monopolies. "Captured regulators," like the National Telecommunications Commission, added to the misery of the public. In the meantime, manufacturing, battered by globalization, a strong peso policy, and high prices of non-tradable services, shrunk.

With respect to 1988 Comprehensive Agrarian Reform Law, it was supposed to be the landmark and defining legislation of the EDSA Revolution. However, while it was touted as a social justice legislation, it was actually an anti-insurgency measure, meant to snuff the oxygen out of the communist rural insurgency whose political cry was "land to the landless."

The focus of CARL was land distribution, and not raising agricultural productivity. Small- and medium-sized landlords were sacrificed for this anti-insurgency measure but big landlords got exemptions through a so-called stock ownership plan or conversion to residential and industrial estates. However, as a land distribution measure, it was very successful. The World Bank has said that the Philippines has the most successful land distribution program in the world.

So successful has the land distribution program been that you no longer hear the communist left demand "land for the landless." It's now "condonation of land amortizations to the Land Bank." The CPP-NPA forces have dwindled and this is why the communists are recruiting from the *lumads*, rather than landless farmers since the *lumads* feel exploited by the lowlanders or unscrupulous mining companies. It's worth noting that leftist leader Satur Ocampo and others were arrested last year after visiting a *lumad* school in Davao del Norte.

However, as a measure to alleviate rural poverty and increase rural prosperity, the CARL has been and is a gigantic failure. The CARL just turned landless farmers into impoverished landowners, according to National Scientist and economist, Dr. Raul Fabella. Agricultural productivity is the lowest in the ASEAN. Agricultural growth even fell behind population growth.

The premises of the CARL were also wrong: 1) That the government is better than the private landlord. The government became the new landlord as the mortgagee of CLOAs (Certificate of Land Ownership Awards); 2) That the government, which is corrupt and inefficient, will be able to extend support and services to the farmer; 3) That big farms are, *ipso facto*, bad since ownership beyond five hectares are prohibited; 4) That the country has a good land administration system with clear and updated land records; and 5) That the farmer is better off with restrictions (CLOAs cannot be mortgaged or sold in the first 10 years, for example) and should not be allowed to dispose of the land as he wishes.

The twin economic foundations of the EDSA revolution have therefore run their course. They have failed. Besides, there have since been enormous changes in political economy and technology. The Lopezes, for example, are no longer in power distribution and telecommunications. Technology has rendered the 100% local ownership of mass media meaningless.

Therefore, it's time for President Duterte to finish his unfinished revolution and complete his counter-revolution. Finishing his revolution doesn't mean pushing for federalism but attacking the economic model of the Yellow revolution. That's the only way to give substance to his revolution and to bring systemic change. It will also ensure the sustainability of his political revolution and cement his legacy.

Therefore, he has to push for a Constitutional change to remove the foreign ownership restrictions in the Constitution (which he has already hinted at). Also, he has to remove the restrictions in the CARL and curb the overreach of the Department of Agrarian Reform.

These are his unfinished business which he must address in the remaining years of his presidency.

About the author

DESCRIBED BY A BUSINESS LEADER as a "public intellectual and grounded entrepreneur," Calixto "Toti" V. Chikiamco is a well-known writer on political economy as well as a pioneering internet and business process outsourcing (BPO) entrepreneur. The rare combination of serious thinking about the Philippines' economic challenges and a day job as a CEO in intensely competitive global businesses infuses an urgent and pragmatic quality to Toti's writings.

A widely-followed newspaper columnist, Toti has authored three books on Philippine political economy, namely, *Reforming The System, Why We Are Who We Are*, and *The Way Forward: The Path to Inclusive Growth*, published August 2015. He contributed an essay, "The Political Economy of Martial Law," in the book *Not On Our Watch: Martial Law Really Happened. We Were There.*

Calixto Chikiamco (left) speaking at a consultation with stakeholders for the Property Rights Project. Beside him is Jaime Faustino of the Asia Foundation. In many of his columns, Toti advocates the right of agrarian reform beneficiaries and agricultural patent holders to sell or lease their property without government restrictions.

Calixto Chikiamco (front row, sixth from the left) poses with Foundation for Economic Freedom (FEF) fellows and advisers and guests at the launching of his book *The Way Forward: The Path to Inclusive Growth* in August 2015. In the front row, from the left: Romeo Bernardo, Simon Paterno, Arsenio Balisacan, Cesar Virata, Sen. Sonny Angara, Vaughn Montes, Bern Sy, Alex Escucha, Benjamin Espiritu and Ric Balatbat. In the second row from the left: John Forbes, Epictetus Patalinhug, Rene Santiago, Rene Bañez, Tom Allen, Gary Teves, Raul Fabella, Gerardo Sicat, Alan Ortiz, Eduardo Yap, Cayetano Paderanga and Victor Manhit.

He's the founder and CEO of MRM Studios Inc., a digital musical services company which exports karaoke musical files to Japan, and of Mobilemo Inc., a cloud-based enterprise Software-as-a-Service (SaaS) startup.

Apart from writing on political economy and running his businesses, Toti is active in advocacy work to further the cause of economic reform in the Philippines. He co-founded and heads the Foundation for Economic Freedom (FEF), an organization advocating economic and political liberty, good governance, and secure and well-defined property rights. He is also a board member of the Institute of Development and Econometric Analysis (IDEA), a think tank based at the University of the Philippines School of Economics. He also serves as a property rights consultant to The Asia Foundation, and has been active in pushing for legislative reform in property rights, resulting in RA 11023 or the Residential Free Patent Act in 2010 and RA 11231 or the Agricultural Free Patent Act in 2019.

He finished his Bachelor of Arts degree in Economics (*summa cum laude*) at the De La Salle University and obtained a Master's in Professional Studies in Media Administration at Syracuse University in New York. He is married to Norma Olizon Chikiamco, a prominent food writer and editor.

"There is a deeper reason for putting some things beyond the reach of majorities and public opinion: to avoid the possible tyranny of the majority. So much the worse if the majority is in reality being manipulated by demagogues."

Emmanuel de Dios

A development puzzle

January 24, 2011

AMONG THE PARADOXES of the Philippine economy is its surprising emergence as a service economy without having gone through a period of industrialization. Sometime in 1997, services overtook agriculture as the economy's largest employer. Services now claim the largest share of employment: 51%, compared with agriculture's 34%, and industry's even smaller share of 14%. Meanwhile, the shares in GDP of services, agriculture, and industry are 42%, 18%, and 32%, in that order (more about this later).

You might think this is all because of the burgeoning business-processing phenomenon, but you would be wrong: services surged well before there were any call centers.

In the typical pattern of industrialization, industry first overtakes agriculture before itself being surpassed by services. That is what has been observed historically both for the West and Asia. The Philippine paradox is that even as agriculture declined rapidly, industry stagnated, so that services quickly outstripped them both.

So what really happened and why? Here's a reconstruction.

Half of the blame must be laid at the door of agrarian reform. Not land redistribution per se, but rather the time it took to do it. Land reform in Japan and South Korea took all of three years. Taiwan's reform was already extended at 11 years. In the Philippines, however, agrarian reform has already taken more than five decades. Indeed by the time the CARP extension ends in 2014 the country will have been preoccupied by land reform for almost 60 years. (Why it has taken so long is another story.)

From first principles, however, we know that when property rights are fuzzy or under question, little investment is likely to occur. More than 50 years of uncertain land rights was bound to drive private capital and credit away from agriculture. No new investment means little growth and employment, so it is no surprise agriculture has the lowest productivity of the economy's branches. Low productivity in turn leads to low incomes, so the unsurprising result is an exodus out of traditional agriculture. (To check the productivity of sectors, divide their GDP shares with their employment shares. The answer is a sector's labor productivity relative to the overall labor productivity. It is about 1 for services, 2.3 for industry, and 0.6 for agriculture.) With industry more than twice as productive as services, why are not more people employed there?

The problem is that industry cannot take in the agricultural exodus. Formal employment in industry has long been hobbled by all sorts of laws and rules that specify work conditions, from minimum wages, to bonuses, to social security, Medicare, and housing, to hiring, firing, and retirement. These are rules only the largest and most productive firms can afford, so it is no wonder the industrial sector consists only of two types of firms – those too large to hurt, and those too small to matter.

Shut out of productive industry, then, the surplus population has access only to the most unstructured and unregulated alternative, namely, self-employment and primarily in services. Entering services is easier than entering industry, since it requires much less capital. Not finding employment, people create their own. As much as 43% of the work force today consists of the self-employed and of unpaid family workers, many of them having morphed, among others, into household help, *kuliglig* and jeepney drivers; sidewalk vendors, superfluous shop attendants and wait-staff; *biyaheros* and watch-your-car boys; and the ever-versatile lumpenproletariat. They have proliferated not only in the metropolises but even in smaller urban centers. Such services, unfortunately, have low productivity, low incomes, and low prospects.

Notwithstanding the brave new world of the BPOs, therefore, much of the rise of services in this country thus far has signified ambiguous progress at best. Put it another way: the BPO sector was boosted by a deregulation (of telecoms) and technological progress (digital information and communication). Fat lot of good that does the pedicab driver, who if anything has backpedalled his way from motor technology to human power!

With agrarian reform ending in 2014, it remains to be seen whether the country can still retrace its steps. Can agriculture get a second chance when the land market opens up again? Will capital then enter agriculture and will more agro-processing jobs open up to reabsorb people now trapped in low-productivity services? Can industrial arrangements be made more flexible so that even small and medium firms get a chance to expand industrially? Can we still retrace our steps back to the "right path"(*tamang daan*, as PNoy puts it) and get more balanced development?

But I forget: such questions may be too hard and distant for a society whose concerns rarely extend beyond the latest deadline, headline – or bottom line.

You cannot legislate morality

March 21, 2011

IT WAS CARDINAL ROSALES who used something equivalent to this phrase earlier this year, when it was reported the administration might include the reproductive health bill pending in Congress as one of its priority bills. (The phrase itself is much older, dating from the 1850s.) The Cardinal's exact words were: "You don't have to dictate on morals. Morals are guided of course by the Word of God, by the Lord Jesus Christ [but] it [*sic*] cannot be legislated."

There are two issues here. First, is it true as a general proposition that morality cannot be legislated? Second, does the RH bill really legislate morality? Or is it the Catholic Church that wants to turn its own morality into a legal statute?

On the first question, it is obviously not true that morality can never or should never be legislated. Murder, rape, theft, and perjury, after all, are universally regarded as immoral and are also punishable by law. Indeed, the *raison d'etre* of the law is to embody and sanction what one might call secular or public morality, lest society fail to exist.

Secular morality is a minimal set of rules that allows people in society to live peacefully together without infringing each other's rights. It needs to be a minimal set because the other function of secular morality is to expand the sphere of personal freedom. Society should regulate the conduct of its citizens only as it harms the interests of others. For this reason, masturbation, consensual sex among adults, and practising contraception are not regarded as crimes, although the church and many religions may regard them as sins. The fact is that they do not affect others, besides the persons who willingly engage in them.

All crimes are sins, but not all sins are crimes. This is not an anomaly that needs to be remedied: it is exactly how things should be in a free society. Nothing prevents individuals and groups from defining and adhering to stricter and narrower private codes as long as these do not breach the overall framework of the broader public morality. The minimal nature of secular morality is what permits the freedom of speech, belief, and worship. So, while Catholics are perfectly free to regard various forms of contraception as a sin, they are not free to define it as a crime. It is limited public morality that allows polygamy to be practised among Filipino Muslims but prevents them from legislating the eating of pork as a crime. The 18th-century statesman and economist Turgot put it aptly when he said, "I am, in matters of morality, a great enemy of indifference and a great proponent of indulgence." That is, secular morality must be indulgent, even where private morality cannot be indifferent.

Which brings us to the RH bill itself. Does this bill legislate morality? That is, does it really define what ought to be done by citizens? Quite the contrary. It does not define what a citizen must do; it only defines what a citizen can do. The RH bill is essentially founded on the principle that family planning and the choice of contraceptive method lies outside the sphere of public morality and falls only within the sphere of private and religious morality. The choice of contraceptive method is not a *res publica*, since it does not infringe the rights of others, and can therefore be governed by the choice of individual citizens. The bill stipulates that health services and information about contraception should be provided to citizens so that they may make an informed decision in the light of their own interests. It is for the same reason a government doctor might offer a patient a choice between several types of equally efficacious medicine, depending on the patient's condition, convenience, and preferences. Rather than legislating secular morality, therefore, the RH bill actually reduces its scope and by this token expands the sphere of personal freedom.

The bill leaves it to the Catholic Church to proselytize the public against some types of contraception that it may regard as sinful or offensive. But that is the Church's job, not the state's. From this viewpoint, then, it is those persons and sectors opposed to the RH bill, especially the Catholic Church, who implicitly want to legislate morality. This turns Cardinal Rosales's criticism on its head; it is in fact he who wants to turn Catholic catechism into law, flirting with a violation of the Art. II, Sec. 6 of the Constitution.

So, in the end, we ought to agree with Cardinal Rosales's chosen phrase, though not with his conclusion. It is true you cannot legislate (a complete) morality. For the job of the state is, in fact, to legislate the smallest scope of public behavior. The rest is up to a person's conscience, culture, and values — and religion.

Yes, Cardinal, we cannot legislate morality; which is why we should pass the reproductive health bill.

Libertádes ó preocupaciónes

August 8, 2011

RIZAL IS FAMOUS for his polymathic genius and political prescience, but little is written about his economic views. It is wrong to think, however, that Rizal had no economic philosophy at all. (Shameless plug: the Philippine Economic Society is devoting the December issue of its journal to the content and context of Rizal's economics.)[1]

Some of Rizal's views issue from the mouths of his major characters. In particular the following dinner-table observation by Ibarra (*Noli*, Chapter 3) is probably the most explicit and general statement from Rizal's pen regarding the nature and causes of the wealth of nations: *[H]e visto siempre que la prosperidad o miseria de los pueblos estan en razon directa de sus libertades o preocupaciones y por consiguiente de los sacrificios o egoismos de sus antepasados*.

This statement's importance is underscored by irony: the ignorant Damaso actually dismisses it as trite and commonplace. But more suggestively in the *Fili* (Ch. 16), when Simoun is asked for remedies for the country's economic problems, he advises his audience to "study how other nations prosper." Pressed for a more explicit recommendation, however, he simply shrugs his shoulders and provides no answer. Obviously Simoun no longer wanted to repeat what he, as Ibarra, had already proffered. For that would have meant helping people understand their situation and possibly addressing it — and helping was no longer on Simoun's agenda.

1 Available at: http://pre.econ.upd.edu.ph/index.php/pre/issue/view/100

Here at any rate is Derbyshire's 1912 translation of the said passage: "I have observed that the prosperity or misery of each people is in direct proportion to its liberties or its prejudices and, accordingly, to the sacrifices or the selfishness of its forefathers."

Rizal, a late offspring of the Enlightenment, obviously highlights "liberties," which refers here not only or necessarily to political rights and civil liberties but also to commercial rights and freedoms, such as the protection of property against takings and the unimpeded and untaxed movement of persons and goods. Elsewhere Rizal also observed how "the most commercial and most industrious countries have been the freest." But it was Braudel who noted the crucial difference between "liberties" and "liberty": the former referred narrowly to the exemptions from dues and other obligations that were granted to townspeople, notably merchants. Only later did such small medieval privileges develop into the more comprehensive notion of inalienable human rights and Liberty with an upper-case L.

Rizal fully supported human rights and Liberty writ large, but he was observant enough to accept that political rights — or even independence, for that matter — were not indispensable for material prosperity. In words that would have pleased Lee Kuan-Yew, Rizal grudgingly praised the unsentimental way Britain ran its colonies, which was "tyrannical and selfish without hypocrisy or deception, with a whole system well-planned and studied out for dominating by compelling obedience, for commanding to get rich, for getting rich to be happy."

More enigmatic, however, is the word *preocupaciónes*. Derbyshire's "prejudices" becomes "problems" in Guerrero's popular 1961 translation, and turns into "concerns" in Lacson-Locsin's 1996 effort. It is puzzling that Guerrero and Locsin translate the idiom *preocupaciónes* as "prejudices" almost everywhere else. But why not in the above quotation as well? And as any reader will see, using either Guerrero's "problems" or Locsin's "concerns" reduces Ibarra's well-considered observation into a banal tautology worthy indeed of Damaso's derision. Hence they cannot be right. But Derbyshire's straightforward translation is little better: for how could Ibarra logically attribute the Filipinos' poverty to their own "prejudices?" As normally understood, prejudices (as in racial prejudices) are after all the stigma of conquerors and not the subjugated. Such variability and illogic only indicate that Rizal's true meaning has been lost and his translators are grasping at straws.

I'll go out on a limb: I think *preocupaciónes* is better (if crudely) rendered as "uncritical beliefs." Like prejudices in the usual sense, they are unexamined mental preconceptions, but are a species of what Douglass North more generally calls "ideology." This reading is entirely consistent with Rizal's strident criticism of his countrymen's ruling beliefs, which were dominated by religious superstition, empty but extravagant rituals, conspicuous personal consumption, a blind servility to wealth and authority, and a hostility to science. In this sense Poblete's (1912) old Tagalog translation of *preocupaciónes* may be closest to the mark — he called them *mga cadiliman ng isip*.

This exegesis also makes sense in economic terms. For uncritical beliefs will frequently lead to wasted resources and talents because these will either be misapplied or diverted to unproductive uses. Output is reduced either way, and society takes a step closer to misery. Rizal for this reason ridiculed his countrymen's penchant for conspicuous feasts and religious observances that devoured time and money and lowered saving. He bristled at the habitual subservience that killed initiative and the slavish imitation that stifled creativity and innovation, all necessary ingredients for successful enterprise. Instead he praised education and scientific effort, which he thought were the antidote to religious superstition, excessive deference to authority, and a shallow human existence.

Though cryptic, Rizal's view of material progress was well-reasoned and rested on two elements: freedom and education (the latter being the antithesis of uncritical beliefs). The first demanded formal rules that permitted people to exercise their initiative and industry. Adam Smith, who advocated "peace, easy taxes, and a tolerable system of justice," would have said as much. But the second could only have come from Rizal, who demanded an uplift of the quality of his people's beliefs, as these influenced their mutual dealings and their relation to authority. Hence, he demanded reforms of both formal and informal institutions. Douglass North would be pleased.

Political dynasties: cause or consequence?

October 8, 2012

THE APPROACH of next year's elections has refocused public attention on everyone's *bête noire* — political dynasties. In both the popular press and the academic literature, dynasties are blamed as the root cause of the problems plaguing Philippine politics. This conventional wisdom has become so established that a provision (Article II, Sec. 26) was included in the 1987 Constitution to "prohibit" political dynasties. Public discussion now appears to suppose that the most important hindrance to political progress is lawmakers' failure to pass a statute to implement the constitutional prohibition of dynasties.

But are things really so simple? Political dynasties are merely symptoms, not the disease itself — like pustules in a body politic afflicted with the plague. Lancing them will do little good.

To begin with, political dynasties are by no means unique to the Philippines, and examples in other countries are not hard to find. Well-known US examples are the Kennedys and the Bushes, but also the Tafts, the Rockefellers, and a whole Wikipedia list of others. (Indeed, the number of US dynasties would have been bigger if the US had electoral term limits and left their relatives more room to run — after all some US senators and representatives have been in power for more almost 60 years!)

In Japan, previous prime ministers Koizumi, Abe, and Fukuda as well many other less prominent names are associated with political dynasties. India has the Nehru-Gandhis, Pakistan the Bhuttos and Sharifs. And as a clincher, observed the well-entrenched tradition of "princelings" (offspring of early revolutionary leaders) in China. The recently disgraced Bo Xilai was a prime example (being the son of Bo Yibo, one of the "eight immortals" of Chinese politics). The incoming Chinese president, Xi Jinping, is himself a "princeling," son of the first-generation revolutionary and politician, Xi Zhongxun.

In short, "dynasties" also exist in other countries, where their presence is regarded as a sometimes curious, sometimes annoying, feature of their politics. But rarely are they regarded as the primary obstacle to political development, as the primordial cause of political immaturity. Wherein lies the difference?

In most of these and other examples, political families and dynasties are not prohibited, but they are not the principal vehicles for politics. Rather, dynasties are embedded in and subject to the larger discipline of impersonal organizations, namely political parties or movements. While members of a dynasty may gain some advantage, the fact itself seldom suffices to determine their successful election. They must still compete for and answer to larger impersonal bodies and constituencies that — at least ostensibly — subsume family ties, personal alliances, and ambitions to larger, overarching, problems.

Many countries have been lucky to have history itself lay down overarching issues as a natural basis for inclusive mass-based parties: an independence struggle created India's Congress Party; wars of national liberation forged the communist parties of China and Vietnam; serious ethnic grievances formed Malaysia's UMNO; and Japan's defeat and drive for economic recovery provided a focus for the Liberal Democratic Party. In each case mass loyalties could be forged for causes that were larger, more urgent, more compelling than an individual clan's ambition. It made more sense, therefore, for clans, sects, and tribes to join the larger movement as a means to gain power rather than to go it alone.

Not so for the Philippines, where historical conditions (too long to examine but relating mostly to peculiar US-Philippine relations) made it unnecessary for the elite to form mass parties. In a sense, Philippine elites have had it too "easy." Their access to power depended not on the mobilization of masses for an epic struggle but on idiosyncratic, often personalistic, accommodation with the occupier. Beyond the defeated Revolution, history did not provide a need for elites to organize far beyond their family spheres and personal cliques. As a result the parties they formed — to this day — have invariably been as transient, superficial, and fickle as the individual egos around which they revolve. The exception that tests the rule is the only impersonal mass party in

Philippine history that has been mildly successful — the communist party in its various incarnations. Communist longevity is supported by the fact they have a long-term cause whose realization entails significant difficulty and therefore demands organization. The MILF and Moro identity are another example. The tragedy, of course, is that neither of these organizations has thus far shown any interest in participating fully and openly in the current political system.

Philippine politics, in short, is not broken because dynasties are strong; rather, dynasties are strong because politics is broken. Douglass North's distinction between organizations and institutions comes to mind. Prohibiting dynasties merely prevents some organizations from playing. What we really need is a change in the rules of the game, i.e., institutional change.

What then is to be done? The answer may seem paradoxical. It is perhaps time to make things difficult, not for political dynasties but for political parties. What is urgently needed is not the prohibition of dynasties but the tightening of rules in order to ensure commitment, enlarge the scope, and establish the longevity of political parties. The problem, after all, is not in putting up political parties; it is putting up parties of an adequate quality. For starters, a higher minimum number of registered members — numbering, say, in the hundreds of thousands — might be required before parties are allowed to field candidates. Significant evidence of party activity and organization in off-election years, large funds deposited and held in government escrow, and a host of other conditions can be imposed to screen out the frivolous, weed out the transient, and establish long-term commitment. A lesson from industrial organization is important: difficult entry implies difficult exit, and it is the latter we desire. At the very least, that should help ferret out the clowns and opportunists now exploiting the lax rules of the party-list system. Ultimately, it may affect the behavior of the national parties as well.

The "facial-feedback" hypothesis in psychology (actually anticipated by Darwin) suggests that externally moving the facial muscles associated with an emotion can enhance or even engender that emotion itself. Stimulating your smile-muscles, for example, might actually make you happy. If history has been stingy in providing us the material for genuine mass parties, then perhaps we might at least encourage their form, in the hope that by doing so we might stimulate their substance.

The Twain meeting

November 12, 2012

AT THE LOBBY of the University of California-Berkeley's Doe Library is a wonderful life-size bronze of a seated Mark Twain reading a book on a park bench. Visitors (okay, I plead guilty) cannot resist seating themselves beside the figure and hamming it up for a photo-op, as if conversing with the famous literary icon. Through historical and editorial twists of fate, Berkeley has become the repository of the world's most comprehensive collection of Mark Twain's papers. Its ongoing Mark Twain Papers Project aims to organize and make publicly accessible everything the author ever wrote, whether previously published or not. The first fruit already appeared in 2010 — a definitive annotated edition of Twain's hitherto unpublished attempt at an autobiography, which he decreed should be published no sooner than a century after his death (he died in 1910).

Few Filipinos today realize Mark Twain's unique connection to their country. Even their parents will probably remember him only as the creator of the lovable Tom Sawyer, Huckleberry Finn, and the "celebrated jumping frog of Calaveras County." Still the connection is there, and it is an important one.

Twain was one of the most prominent and consistent oppositors to the US conquest and occupation of the Philippines in 1898. He was an "anti-imperialist" well before that term was monopolized by the Marxist Left. In Twain's mind, however, opposition to imperialism was a thoroughly American position. He was joined in this view by other mainstream American figures, including the poet Edgar Lee Masters, the philosopher John Dewey, the redoubtable German-American politician

Carl Schurz, the ex-President Grover Cleveland, and even the steel magnate Andrew Carnegie.

Swimming against the jingoist tide of his time, Twain believed it was, on the contrary, expansionists like McKinley and Roosevelt who had betrayed the core American ideals of republicanism and non-intervention by seeking overseas possessions in order to join the club of (then exclusively West European) imperial powers as a latecomer. Twain had initially supported the Spanish-American war, since he thought the US was intervening on the side of the oppressed peoples of Cuba and the Philippines (shades of the "Arab Spring"?). He was soon appalled, however, by the incongruousness and inconsistency of US policy, which on the one hand supported the Cubans to the end in their fight for independence, but which turned against and suppressed the Philippine Revolution, on the other hand. "Against our traditions," he wrote, "we are now entering upon an unjust and trivial war, a war against a helpless people and for a base object - robbery."

In his most famous tirade, "To a person sitting in darkness," Twain used withering sarcasm and satire to put across his point about the duplicity of official policy toward the Philippines: "Yes, we had been so friendly to them, and heartened them up in so many ways! We had lent them guns and ammunition; advised them; exchanged pleasant courtesies with them... fought shoulder to shoulder with them against 'the common enemy' [the Spanish]... petted them; lied to them — officially proclaiming that our land and naval forces came to give them their freedom and displace the bad Spanish Government — fooled them, used them until we needed them no longer; then derided the sucked orange and threw it away."

Twain continued to write extensively from 1898 to 1906 about the Philippine-American War and the wrongheadedness of the American imperial adventure — even for America. It was an argument he would ultimately lose, however, and — in the hyper-patriotic era he lived in — his position would cost him many admirers and friends. He would go on to describe the sheer imbalance of forces as between Americans and Filipinos and the corresponding lopsidedness in casualties. He admired the heroism of the revolutionaries and the justness of their cause and denounced the deception and ingratitude of Funston's capture of Aguinaldo; Roosevelt's nepotism in advancing Leonard Wood; and the brutality of US forces during the hostilities. He was especially and utterly horrified by the Bud Dajo massacre, to which he devotes an extensive narration in his autobiography.

In the end, after his experience, Twain came to re-examine critically the way public opinion in a democracy was formed and questioned the way patriotism could be shaped and misdirected by the media and the political class. He asked his audiences to reflect on what it really meant to be patriotic and poked bitter fun at the then-popular phrase "Our country, right or wrong!" He wrote: "We have thrown away the most valuable asset we had — the individual's right to oppose both flag and country when he (just he) believed them to be in the wrong. We have thrown it away, and with it, all that was really respectable about that grotesque and laughable word. Patriotism."

Fast forward to the present, well over a century since.

As the Philippines now comes to recast its relations with America; and as the US itself seeks to redefine its role in a world that in a few more decades it may no longer solely dominate — it may perhaps be benefit both peoples to listen to the serious voice of a long-dead humorist who once had both countries' interests at heart. Who knows, reading Twain may even be salubrious to some Chinese souls. (They also used him after all to attack "US imperialism.") Then perhaps East may meet West — in Twain.

Postscript: Four years after this column, in 2016, President Duterte would refer repeatedly to the Bud Dajo massacre to remind the US of the atrocities it committed during the Philippine-American War, which both Filipinos and Americans seemed to have forgotten. Forgotten too was Twain's consistent opposition to the war and his support of the Filipinos.

What is a public utility? Defense and opulence

July 22, 2013

ONE NEVER KNOWS what will arise in conversations between economists and lawyers. A casual dinner with Popo Lotilla and other colleagues brought up topics far and wide: from the historical imprint left by Filipinos in Acapulco, Barcelona, and Bordeaux, to church art and prominent sacerdotal families in Betis, Pampanga. (The erudite Popo, of course, is the former energy secretary, ex-NEDA deputy director-general, and current PCED fellow-in-residence at the UP School of Economics.)

On a more utilitarian and topical note, however, Popo repeated his lawyerly observation that the idea of a "public utility" was not fixed in the law but a changing one. His favorite example is ice plants, which in the past were regarded as a public utility but are now no longer so. (Nostalgia among us then brought up the iconic Insular Ice Plant that used to be visible as one crossed Quezon Bridge.)

Popo's astute idea is that the constitutional 60-40 nationality requirement on the ownership of public utilities (Art. XII, Sec. 11) is not really cast in stone but rather fluid, since the definition of a public utility itself has been changing. Even without a constitutional change, therefore — which is not in the cards under this administration, anyway — significant parts of the economy could actually be opened to foreign investors if only specific legislation declared them to be non-public utilities. His more current example was the unbundling of the power sector, where he played a role. By identifying the natural monopoly element in the value chain (namely, transmission and distribution), the law made it possible for foreigners to own 100% of generating plants (as well as the Chinese owning 40% of Transco). So, Popo's challenge to us economists was to come up with clear economic bases for denominating some industries as "public utilities" — in order that other sectors may be freed from such a designation and any unnecessary nationality restrictions consequently removed.

The problem, of course, is that there is no intrinsic definition of a "public utility" to go by. Even the law is ambiguous: while the Constitution speaks of "public utilities," statutes since as early as 1939 (CA 454) have abandoned that term and refer only to "public services," raising the question whether the two are even the same thing. Legal definitions of public utility are also vague. A well-cited definition proceeds only by examples, laying down no principles and only referring to "a business or service engaged in regularly supplying the public with some commodity or service of public consequence such as electricity, gas, water, transportation, telephone or telegraph service" [from American Jurisprudence]. The qualifying term "public consequence" is especially amorphous.

Here's a stab at it: my own effort to seek a rational basis for the ownership restrictions in the Constitution concludes that they probably reflect an implicit concern for national defense or security. This is quite legitimate and should cause no blushing among economists. Even Adam Smith asserted that "defense is of much more importance than opulence" when he defended Britain's Navigation Acts, which effectively imposed nationality restrictions on shipping. Drafters of the Constitution likely feared foreign control of important sectors which — if relations with foreign nations deteriorated — could be weaponized and used to undermine the home country's defenses. Think of illicit intelligence-gathering and misinformation through the telecoms systems, or sabotage or withholding of service in power, water, and transport. (I leave open the question whether fellow Filipinos cannot be worse enemies of their own country in peace than foreigners during a war.) If this premise is true, then a minimal criterion for a public utility designation should be the activity's potential importance in civil defense and national security.

From this broad security or defense concern flow two other criteria for a possible characterization. First, public utilities should typically affect or be patronized by broad sections of the population. After all, crippling a transport or communications system on which multitudes depend would certainly be of "strategic" importance (in the original Greek sense). By contrast, a disruption of the supply of phablets would probably not do much damage. From this also flows the principle that industries devoted mainly to serving mainly foreign demand (i.e., exports) cannot be called public utilities. Hence, for example, there is no reason foreign-owned cruise ships carrying tourists should not be allowed to navigate inland waters freely and put into domestic ports, or even put up and operate their own wholly-owned ports in the process. Foreign-owned and -operated international airports might also be considered under this rubric. The same principle also means that tollways and freeways cannot be properly regarded as public utilities, since their function inherently demands that public access be restricted to avoid congestion (with the toll serving as the rationing device). The more exclusive the access to an activity, the more it resembles a club good or service; the less it qualifies as a public utility.

The club-good exception is in fact already well established in the law (with a 1923 precedent involving, of all things, an ice plant!): if a facility provides services under private contract then it is not a public utility. On this principle, then, there should even now be nothing to prevent, say, a completely foreign-owned and -operated transport system (or telecommunications, or power distribution system) from serving any number of subdivisions or industrial estates under private contract. The bottom line is that "public utility" cannot refer to activities that do not serve or affect a wide general public.

A second criterion to consider is whether the good or service provided entails a natural monopoly. This does tend to be the case for many network industries — think of telecommunications, power transmission and distribution, railways, and water distribution — where the required infrastructure is idiosyncratic, sunk costs are large so that both entry and exit are difficult, and average costs fall with a larger subscriber base. Even abstracting from nationality of ownership, such a situation already presents a case for some form of regulation for the consumers' sake. In addition, however, the strategic consideration is obvious. If malice existed, a smaller number of foreign providers could make it easier for outside parties to threaten security. In the light of our current territorial disputes, for example, one might imagine the degree of state insecurity if, say, the Philippines' Transco were fully owned by State Grid of China (which already currently owns 40% — whoops!). By contrast, while the supply of rice is of undoubted national importance, no one would seriously suggest its processing and distribution should be designated a "public utility." This is in large part because it is in the hands of many agents, diminishing the likelihood of malicious combination. Notwithstanding the paranoia against the Sangleys by earlier generations, the existence of many suppliers would have been a sound reason to argue that the Retail Trade Nationalization Law was a bad idea all along.

More sophisticated regulation has also provided greater flexibility in this respect. "Unbundling" — the legally ordained separation into separate enterprises of various stages of a hitherto vertically integrated operation — typically isolates the parts of the process subject to natural monopoly, allowing competition and free entry in other parts. In the power sector, for example, distribution and transmission have remained monopolies, but generation and retail have not. In this instance, the law has effectively determined that the "public utility" label — and therefore the relevant ownership restriction — is substantively applicable to transmission and distribution but not to retail and generation. The reason is implicitly found in the contestability of the latter two stages; hence direct foreign ownership is feasible. This template is also applicable, say, to telecommunications and water-supply systems. While "tubes-and-pipes" systems might be subject to public utility ownership rules, what flows through them need not be. Such a delineation can be used, for example, to lay the ground for the development and operation of dams, water-impounding, and other water-supply projects by foreign direct investors, while various value-added services and content can be provided by foreign entities using the broadband, cellular, broadcast, or other transmission services of current telecoms incumbents. (Regulatory mechanisms may be needed, of course, in order to enforce access to such networks, but those are called for in any case.)

To sum up, one might consider the following lean characterization of a public utility: it refers to a service or activity characterized simultaneously by (a) broad public access or dependence (inelasticity of demand); (b) inherent seller-concentration (noncontestability); and (c) nontrivial implications for civil defense or national security. Nationality restrictions might in principle be justified in such cases. But they should be seriously reconsidered in all others.

Proceeding in this way does not seem to be significantly more tedious than the proposal to go the route of constitutional change. For all the hue and cry, all the current proponents of charter change want to accomplish is to insert the phrase "unless otherwise provided by law" in the relevant constitutional provisions — a change that *per se* will not directly stimulate foreign investments anyway. Even with charter amendment, legislators must in the future still do the grunt work of examining each industry in detail and enacting specific legislation for it. We suggest here, however, that they can begin with that difficult task even today by simply applying a leaner definition of a public utility. The real work can start now.

Postscript: From 2016 and thereafter, various bills were filed in the House of Representatives and the Senate seeking to amend the Public Services Act along the lines first suggested here. Despite its certification as urgent by the Duterte administration, however, the proposed legislation still did not pass before the close of the 17th Congress in June 2019. Legislators promised a renewed effort in the 18th Congress.

Unemployment has no welfare significance

September 30, 2013

GOOD AMOUNTS of spittle and bile have been expended analyzing the country's unemployment statistics. That's understandable. It was the government itself, after all, which made the question of "inclusive growth" turn on the question of job-creation. So the rate of employment — or its converse, the unemployment rate — seems to be the natural measure of success. Critics of the government, on the other hand, pooh-pooh high GNI (gross national income) growth rates as an instance of "jobless" growth — using the same largely stagnant unemployment rate as the proof of failure.

But hang on. Just how good is unemployment as a measure of welfare in a developing country? If the principal concern of the government and its critics is to relieve the poverty of the vast majority and to pull them into the middle class, then the unemployment rate is actually a bad statistic to focus on.

The reason — as most development economists (should) know — is that poverty is only very imperfectly related to unemployment in the absence of social insurance and in the presence of a large informal sector. In reality, most of the poor are not unemployed, and most of the unemployed are not poor.

You will see this if you look hard enough. The Institute for the Study of Inequality and Poverty (ISIP, based in the UP School of Economics) used the merged labor-force and family income surveys of 2009 to estimate the incidence of poverty among various sections of the labor force. (See Table.) As it turns out, poverty incidence is worse among the employed than among the unemployed (23% versus 17%).

If poverty incidence is any metric of welfare, therefore, one must recognize that the unemployed as a group are in fact in a better position than those who are employed. This conjecture is supported by other data, including the fact that the average unemployed person has completed high school, while the average employed person has not.

Poverty in the labor force

	Poverty Incidence (%)	Number of poor (000s)	Share in poor population (%)
Unemployed	17	485	4
Employed	23	8,202	68
Of whom:			
Fully employed	19	5,512	46
Underemployed	36	2,690	22
Labor force	22	7,687	64
Not in labor force	20	4,348	36

Source: PCED-ISIP computations from NSO data for 2009

A sharper picture emerges when we divide the employed into the fully employed and the underemployed. A surprising statistic that emerges is that poverty among the fully employed (19%) is almost the same as among the unemployed (indeed slightly worse). It is among the underemployed that poverty incidence is the worst. The 36% poverty incidence in that group is more than double that of the unemployed and is the most severe among groups of the labor force.

Here's a final twist: in terms of number, most poor people are actually found among the employed. Indeed, almost half of the poor (46%) are already fully employed, while 22% of them are underemployed. The unemployed account for only 4% of the poor. The deficit in employment opportunities is understated, therefore, if one assumes it can be measured by unemployment or underemployment. For even unemployment and underemployment lumped together comprises only one-quarter of the number of poor.

Such apparent paradoxes are not hard to explain. To be counted among the "unemployed," one needs not to have worked even a single hour in the reference week and to have been actively seeking work. In rich countries, once a person loses a job, unemployment insurance and welfare payments kick in, which allow her to devote herself full time to her job search. The level of such benefits will typically be well below income from regular employment, so that the roster of the unemployed will largely coincide with the list of the poor.

No such luck in a developing country, however. Without social and unemployment insurance, poor people have no other means of subsistence to fall back on and must find work no matter how low the pay and productivity. These are mostly informal sector jobs in agriculture and in small-scale retail services (e.g., hawking and vending). Entering those jobs is easy since the pay is low, as are skill-requirements. Some economists have actually termed this "disguised unemployment," since it is statistically indiscernible. As the old development saw says, "The poor cannot afford to be unemployed; in the extreme, they must employ themselves."

By contrast, it is people with savings, who come from better-off families, and who have better qualifications and prospects (e.g., college graduates) that have both the incentive and the means to support themselves through a spell of full-time job-hunting. This is why an unemployed person in the Philippines is more than 80% likely not to be poor. Unemployment is largely a middle-class phenomenon.

For government and its critics to obsess about unemployment, therefore, is to completely miss the mark and underestimate the task at hand.

It is the quality of jobs that matters for the poor, a fact to be addressed only by shifting the country's employment structure away from low- to high-productivity employment. Indeed one might imagine a situation where unemployment barely changed, but where poverty was drastically reduced. That would occur if low-productivity workers managed to shift from marginal jobs to high-productivity sectors such as manufacturing and high-value services. Or if massive private investment increased the productivity of farm employment. Or if labor's skills were enhanced through training and education.

Don't count jobs, silly; think structural shift instead.

Manufacturing renaissance?

March 2, 2015

GOVERNMENT POLICY has until now implicitly assumed that a good part of inclusive growth can be achieved mainly by promoting manufacturing. This follows from two inferences that are sensible on the face of it. First, beating poverty is indeed about moving people from low- to higher-productivity jobs — and manufacturing is certainly home to some of the economy's high productivity occupations. Second, the Philippines failed to catch the wave of export-oriented industrialization that lifted many dragon-boats in the 1980s and 1990s, leaving an obvious gap in the country's industrial structure, where manufacturing is underrepresented for an economy of this size. So surely there is a chance to catch up? Perhaps even belatedly replicate the experience of the NIEs?

Recent trends seem encouraging at first glance. There is renewed interest in the country as an investment destination; manufacturing growth has been robust; and some important foreign investments have entered the country (yes, including that indirectly famous Mitsubishi plant). This has led some quarters to even proclaim a "manufacturing renaissance."

But take a slightly longer view of the matter and things look a lot less dramatic. Manufacturing's share in GDP has barely risen — from 22.2% in 2010 to 23.3% in 2014. On the other hand, the employment share of manufacturing actually stagnated at 8.4% in the last five years, which is even lower than the 10% employment share a decade ago. But what about the high manufacturing growth we hear about? Doesn't that matter?

Math is cruel. For the share of manufacturing to grow, it must grow faster than the total itself. So, suppose the economy was growing at 7% and we wanted to raise the output share of manufacturing by just one percentage point from 23% to 24% in one year. Manufacturing would then have to grow by almost 12% in that year — which has never happened. Manufacturing value-added grew by an average of only 8% in the last five years, with no sign of accelerating.

Even crueler algebra applies to employment. Total employment currently grows at 2.8% annually (about a million new workers added per year). To raise its share in employment from by just one percentage point — from 8.4% to 9.4% — manufacturing would have to expand employment by 15% a year, i.e., add 5.6 million workers — an absurd proposition, since that would mean shrinking employment in the rest of the economy.

In last December's issue of the *Philippine Review of Economics*, Jeffrey Williamson and I ask whether the Philippines can still follow the old and well-worn path of the first- and second-tier NIEs. Our answer — after reviewing a series of unfortunate events in recent Philippine economic history — is that it is highly unlikely. With the large and irreversible current-account surpluses piled up by overseas workers' remittances and the still-increasing revenues from the service-industry BPOs, there is no obvious way to engineer a sustained currency undervaluation the way the Koreans, Taiwanese, and Chinese did. And given the country's now-higher living standards and enhanced labor protection (relative to, say, some South Asian or African countries), there is little room to compete in the lowest-wage and least-skilled categories (e.g., garments and textiles). Finally technology is also changing, with the appearance of robotics and digital technology (e.g., 3D printing and customization), making low-cost labor less crucial in production. The latter, spurred on additionally by tax breaks or penalties, has even induced the "onshoring" of some manufacturing jobs back to the United States.

Turns out we weren't alone in our worries. A recent paper by the Princeton economist Dani Rodrik (who should probably get the Nobel at some point) documents a global trend showing that the manufacturing surge in developing countries is petering out much earlier than it used to — he calls it "premature deindustrialization" (though my colleague Raul Fabella coined the earlier term "development progeria"). Mr. Rodrik cites technology and globalization as reasons. He suspects that manufacturing technology is now trending towards saving in unskilled and semi-skilled labor and a greater use of skilled labor, the greatest decline being in the use of unskilled labor. The problem, of course, is that manufacturing technology tends to be global in nature, adopted and diffused notably by multinational enterprises and their affiliates. (Which also explains why manufacturing productivity is "converging" globally — another trend found independently by Messrs. Rodrik and Williamson.) Trade liberalization abets this by letting in the trend of cheaper manufactures, turning the terms of trade against the manufacturing industry.

As a practical matter, however, what this implies is a smaller likelihood that manufacturing will assume the same development importance as it did in the past. Mr. Rodrik predicts that manufacturing shares of output and employment will begin to decline at lower levels of income (around one-third to one half less) than they did before 1990. It will be more difficult for manufacturing output to reach the 30%-35% shares that Japan, China, Malaysia, or even Thailand displayed in the 1990s. Today, for example, Indonesia, with a slightly higher income per capita than us, still has a manufacturing share of only 24% of GDP. Brazil and Mexico, both richer than the Philippines, all have shares below 20%. If Mr. Rodrik is right, the share of manufacturing *in employment* is also likely to peak earlier and well below the 18% China achieved in the 1990s. Indeed rising manufacturing productivity means employment will grow more slowly than output, so that manufacturing's share in output rises even as its share in employment falls or stagnates, a pattern already found in the Philippines.

Make no mistake: we should still try to clear obstacles to get as much manufacturing as we can, e.g., improve infrastructure and logistics, cut the red tape, reduce energy costs, keep labor markets flexible, and at least keep the peso from rising too far. It should be clear, however, that manufacturing itself cannot play the key role in providing the jobs that can lift large numbers of people out of poverty. Numbers simply don't add up. With new manufacturing jobs increasingly requiring more skills, most poor people will have less and less of a chance to enter them, for the same reason the BPOs don't make too big a dent on poverty. Rather than burden a sector with unrealistic hopes and inflating it through unwarranted subsidies and other incentives to fulfill those hopes — it is more prudent to spend on the education and training that will allow people to adapt to whichever sector emerges to employ them. Not the Renaissance, which sought to recreate a classical past; rather the Enlightenment, which looked toward the future.

Postscript: Three years later, as of 2018, manufacturing still accounted for only 8.8% of total employment and remained at 23.3% as a share of GDP in constant prices. In current prices, manufacturing's share in GDP has fallen continuously from 21.4% in 2010 to 20.6% in 2014 and 19% in 2018.

Working for peanuts

June 16, 2015

FRUCTUOSA LLANA of Frux Food Products is a progressive entrepreneur. She recently started a promising line of snacks made from cassava flour and fortified with *malunggay* and other vegetables (grown in her own small garden). But her main business is still the peanut butter line she has been producing for more than a decade now.

With help from the Department of Science and Technology, she recently managed to acquire machines to homogenize the peanut butter (i.e., keep the oil from separating) and to pack it in sachets to cater to the *tingi* penchant of the Filipino consumer. She sells to a growing clientele in her native Mindanao and in the Visayas and is looking to break through the Manila market.

In short, Mrs. Llana is just the type of small-business champion anyone would admire — industrious, upbeat, creative, and constantly looking for ways to extend and improve her product line. This is just the kind of agri-processing one hopes will link farmers to that all-important bulging "value chain" (the latest development meme) to the consumer.

Through their value-adding expansion, it is hoped, small businesses can create a larger and more diverse demand for farm produce, generating income for farmers and lifting agricultural folk out of poverty. Good, no?

There's just one problem: Frux doesn't buy peanuts locally. It imports all the peanuts it uses from Vietnam and China.

We asked Frux (also Mrs. Llana's byname) why this was the case. She replied that local peanuts just did not have the right moisture content needed to make peanut butter: too wet, too uneven in quality. Meanwhile, the peanuts from Vietnam and China come sorted in neat sacks, are even in color, and have a uniform moisture content. She once tried to exhort local farmers she knew to improve their supply quality but got only a tepid response.

In the end she found it too tedious and gave up. After all, social organizing was not her core competence, and in any case she was busy enough trying to keep her own business afloat.

The story is a microcosm of the country's recent growth, which on the face of it has been creditable. It is well known by now that the growing sectors are largely driven by the growing consumption and investment of an expanding middle class — think overseas Filipino workers (OFWs) and business process outsourcing (BPO) workers. Hence the growth in malls and retail in general, condos, schools, the demand for cars, luxury brands of clothes and accessories, smartphones, fast-food franchises — and, yes, even the unprepossessing snacks that Frux makes. All are fortunate parts of the growing economy. But the fact is that these glistening supply chains of higher value-added don't reach far enough into the dark corners of poverty to make a difference.

The middle-class economy can subsist on its own and frankly has no existential need to develop the poorer and less efficient parts of the economy.

Given the substantial and still growing remittances of OFWs and the export earnings from BPO services (already poised to surpass remittances in the near future), there is enough foreign exchange to go around to import the things the domestic economy is too inefficient to produce — good peanuts, among others.

What is needed to complete the domestic supply chain? Amalgamation, classification and standardization. Transport and logistics costs, for instance, could be lowered if large-enough areas specialized in the same crop. Technology and agricultural extension could improve quality standards to the point where output could be bought in higher-price markets. Well-defined market standards for such things as size, color, moisture content — with corresponding price differences — would provide farmers with definite ideas for which market niches to produce. Consolidated buying and selling would reduce transaction costs and provide access to larger markets.

The problem is, who is responsible for these functions, particularly in a post-agrarian reform era? Who should (must) play the role of Frank Knight's entrepreneur, that residual claimant after all factors of production have been paid? Small farmers themselves will protest that, being on the margin of subsistence, they have access to neither credit, nor technology, nor markets to organize things for themselves. Nor is it reasonable to expect people like Frux Llana or other small businesses to do the job: they are saddled with their own problems.

That leaves only the large-business sector, the government, and private philanthropy. None of these is without its own problems. For starters, neither the government nor philanthropy has any core competence in organizing production or markets.

As for big business and finance, the temptation to construct malls, condos and expressways, and the lucre from car and housing loans must seem eminently more compelling than the prospect of having to deal with hundreds of fractious small producers, scheming local governments, and ransom-seeking insurgents — and for what result? Peanuts. (Sorry, couldn't resist that.)

There are, of course, exceptions. Intrepid business people like Messrs. Senen Bacani, John Perrine, and Philip Soliven have managed to thrive in challenging areas by working with local leaders or organized cooperatives. Corporations like Jollibee and Nestlé have their own versions of working around the problem of dispersed ownership among small producers, which has undoubtedly made it more difficult to achieve the organization of large-scale output.

In all cases, what has invariably worked is a combination of social preparation, reliable local leadership, and a large established business partner.

At least thus far, these appear to provide the ingredients needed to overcome Coasian transactions costs and form either markets or lasting relationships.

But these exceptions are well known because they are so few. They are also fraught with implicit costs and draw on scarce and unique talents, so the question remains whether they are replicable on any wider scale or are just freaks of nature. Until that is settled, Mrs. Llana will just have to source her peanuts from Vietnam and China.

And in the meantime the only value-added local peanut producers can expect is from those vendors whose pushcarts-cum-stoves artfully dodge Manila traffic to serve up fresh-boiled peanuts on demand. No moisture content problem there.

The truth about the economy under the Marcos regime

November 16, 2015

NEARLY THREE DECADES after it ended, still no proper account has been written of the economy under authoritarian rule, which is a big reason that millennials have only an inkling of what transpired during those years. It is also why one now hears the mind-blowing judgement that "Marcos was the best president the country ever had." And if you ask millennials today who in their mind was the country's worst president, their likely answer is "Gloria Arroyo." (Sigh.)

This is obviously no place to write an economic history (*hanc columnis exiguitas non caperet*). But there may be enough room to correct a few bad habits when thinking about the Marcos period.

A common foible is selectivity: Marcos-admirers wax nostalgic about the "earlier years" of martial law but forget its later consequences. Ah, yes... remember when order and discipline seemed to reign, grand industrial and infrastructure plans were in the works, governance was discharged by a simple snappy salute, newspapers carried no muckraking reports about corruption, spanking new hotels were on the rise, a glittery cultural scene was on display, and foreign celebrities, bankers, and business people regularly came in and out — not to mention the beauty pageants! What was not to love?

The customary counterpoint to this has been to cite the gloomy human rights record: arbitrary arrests, disappearances, suppression of dissent and civil rights, and the brutal war on Muslim rebels in the South. But all this is typically swept aside by the regime's lovers as being the "necessary cost" of all that economic progress — and in any case, it is argued, these were just the concern of a few Leftist activists and some collateral victims.

That argument might hold some plausibility if the economic record was brilliant to begin with. But it was not. And here one needs to underscore the importance of assessing the entire period of authoritarian rule, from late 1972 to early 1986.

Take gross domestic product (GDP) for instance: the average GDP growth rate from 1972 to 1985 (Marcos's last full year) was all of 3.4% per annum. Per-capita GDP grew annually at less than 1% average over the period — more precisely 0.82%. Hardly a roaring-tiger performance. At that rate it would have taken 85 years for per capita income just to double.

For comparison, the average GDP growth from 2003 to 2014 — even under a bumbling and quarrelsome democracy — has been 5.4% per annum, with a rising trend. On a per capita basis, GDP today is rising 3.5% annually, more than four times the growth rate under the dictatorship.

The reason for the dismal performance under martial law is well understood. The economy suffered its worst post-war recession under the Marcos regime because of the huge debt hole it had dug, from which it could not get out. In fact, all of the "good times" the admirers of the regime fondly remember were built on a flimsy sand-mountain of debt that began to erode from around 1982, collapsing completely in 1984-1985 when the country could no longer pay its obligations, precipitating a debt crisis, loss of livelihood, extreme poverty, and ushering in two lost decades of development.

The economy's record under Marcos is identical to that of a person who lives it up on credit briefly, becomes bankrupt, and then descends into extreme hardship indefinitely. It would then be foolish to say that person managed his affairs marvelously, citing as evidence the opulent lifestyle he enjoyed before the bankruptcy. But that is exactly what admirers of the Marcos regime are wont to do.

It is instructive that neither Thailand, Indonesia, Malaysia, nor any major Asian country catastrophically experienced negative growth in the early 1980s. The Philippines was the exception, following instead the example of protectionist and over-borrowed Latin American countries. This suggests that there was nothing unavoidable about the crisis the

Philippines suffered, and that it was the result instead of failed policies. In 1977 the Philippines' total debt was all of $8.2 billion. Only five years later, in 1982, this had risen to $24.4 billion. Thailand's debt in 1982 was still only half that amount. Thailand and other countries of the region thus avoided a debt crisis and ultimately went on to attract foreign direct investments in export-oriented industries in the now-familiar East Asian pattern. But no such thing happened under Ferdinand E. Marcos, notwithstanding the arguments and exhortations of people like Gerardo P. Sicat (who would cease to be active in the regime by 1980). By the early 1980s, the pattern would be set where foreign direct investments in neighboring countries regularly outstripped those in the Philippines. (The intermittent *coups d'etat* post-Marcos did us no favors either.)

All this should correct the common misconception that the country's troubles stemmed entirely from conjunctural "political factors," notably that it was caused by ex-Senator Benigno "Ninoy" S. Aquino, Jr.'s assassination. One might not even entirely blame the mere fact of authoritarianism itself — after all Thailand, Indonesia, and Malaysia at the time were also ruled by despots of some sort or other, yet suffered no crisis. Rather the Philippine debacle was linked to the misguided policies that were structurally linked and specific to Marcos-style authoritarianism. For all its technocratic rhetoric and rationale, the Marcos regime never took economic reform, liberalization, and export-oriented industrialization seriously; it remained a heavily protectionist and preferential regime (think the cronies and the failed major industrial projects). The availability of easy loans was well suited to the priorities of a regime that thought it could stoke growth without deep reform and slake the greed of Marcos and his cronies at the same time. In the end a corrupt regime fell victim to its own hubris.

In three decades more, the whole Marcos episode will probably be regarded as no more than an avoidable nightmare; a wasted opportunity; a bump on the road on the country's ultimate march to development.

But this narrative, for different reasons, is unpalatable to many of the regime's lovers.

Indeed, one of the "alternative truths" propounded by some otherwise respectable people is that the fatal flaw of the Marcos period was really just the fact that Marcos failed to provide for a proper succession — as if the regime's logic of patronage would have allowed it to behave otherwise.

A more pedestrian version of it, however, simply says Marcos gave Imelda too much power. The story runs as follows.

There were really two Marcoses: Marcos B.C. and Marcos A.D., i.e. "before concubinage" and "after Dovie" (kids, you can ask your grandparents what this refers to).

Marcos B.C. was a statesman, out for greatness for himself, brooking no deviation from his vision of the nation's future.

But Marcos A.D. was a weakling hostage to his vengeful wife, who exacted inordinate power as the price of the discovery of her husband's indiscretion. It was she and her obscene taste for extravagant projects that caused the country to run huge debts; she and her ambition and greed that skewed policy making and ruined the chances of an orderly political succession. Imelda in short was the real villainess; Marcos by contrast was little more than a hapless victim of spousal politics, a tragic hero ruined by guilt, having falling victim to that all-too human weakness — the need for love! It's an almost Shakespearean story (think Antonius and Cleopatra) of an entire nation's fate being determined by human passions and foibles.

For some, this "alternative truth" will continue to be more riveting than any dry economic history based on real facts and hard economics. (Sigh.)

Postscript: Amid hefty controversy and widespread protest, the remains of Ferdinand Marcos were buried at the Libingan ng mga Bayani *on Nov. 18, 2016 on orders of President Duterte.*

Not human

December 19, 2016

SOMETIME IN THE DISTANT FUTURE, when Filipinos regain their sanity, they will likely remember some enduring memes in the government's current war on drugs. Those memes must certainly include President Duterte's answer on Aug. 26 to a reporter's question on the mounting death toll of drug users and the threat of his being charged with crimes against humanity. The President responded: "Crime against humanity? In the first place, I'd like to be frank with you. Are they humans? What is your definition of a human being?"

But this itself merely elaborates an earlier statement by the President in Cebu on June 25 when he said: "The problem is once you're addicted to *shabu*, rehabilitation is no longer a viable option. ...If I couldn't convince you to stop, I'll have you killed... if you're into drugs, I'm very sorry. I'll have to apologize to your family because you'll surely get killed."

This view of drug users as being beyond all help and hope was a common one — in the 1970s. The scientific work underlying it, fittingly enough, was based on nonhumans. Researchers devised ingenious lab experiments that allowed rats and monkeys in cages to administer drugs (usually morphine) to themselves. The scientists observed that the animals pressed on levers with increasing frequency to inject themselves with drugs until they became fully addicted. A typical study of the time concluded that "becoming addicted requires nothing more than availability of the drug, opportunity for its use, and (in man) willingness to use it" (Goldstein, 1972).

The message conveyed is that psychoactive drugs are just so potent, ingesting even small amounts leads to an irreversible slide into addiction and its inevitable consequences — compulsive behavior to feed the habit, permanent brain damage, dysfunctional social relations, inability to fulfill work obligations, psychosis, and even death. The classic anti-drug ad in the US was that of a rat compulsively licking at a bottle with cocaine-laced water, running around uncontrollably in its cage until it fell dead from exhaustion. From this it was but a small step to the belief that anyone who even tried drugs was inevitably going to be addicted; and that his life from then on was likely to be meaningless shit. (Ergo, what's the big loss in snuffing it out?)

Since then, however, the understanding of addiction has changed. The fact is, the great majority of people who have tried using psychoactive substances do not become addicted.

In the US, only a fifth of people who had ever tried drugs in their lifetime still used it within the past month. Philippine figures (for 2008) are not too different: in the 10-69 year-old age bracket, some seven million people said they had tried drugs in their lifetime. Yet only 1.7 million of them were still using drugs in the past month.

Why and how do so many manage to avoid chronic use and addiction? Frankly the jury is still out. A forum in *The New York Times* a few years ago (Feb. 10, 2014) hints at where things stand: Is addiction a disease? Or caused by a lack of will power? Is it a learned habit that can be unlearned? Or a behavior induced by larger socioeconomic circumstances like poverty, race, etc.?

One might simplify, however, and reduce the matter crudely to genetics or environment — or both. Certainly genetic-metabolic theories force us to modify the caricature of an inevitable downward descent into perdition. Just as some people get drunk less easily, others may just have a more robust dopamine reward system that is less vulnerable to the pharmacological effects of drugs. Studies of twins suggest that as much as 50%-60% of the risk of alcoholism and drug addiction may be inherited (Prescott et al. 2016). Good genes may be the reason that people like Manny Pacquiao — who has confessed to using *shabu* and cocaine "for years" — still manage to kick the habit without any rehab and to succeed magnificently in their careers. Similarly, many recreational drug users (especially of marijuana, but also of tobacco and alcohol) are actually "high-functioning addicts" who occupy responsible positions and discharge their work reliably. The point is there is no one-size-fits-all. Not all experimenters become users; not all users become addicts; and not all addicts are dysfunctional.

As for environment and learning, it turns out even those old rat experiments themselves were defective in a fundamental respect. For they placed the animals in a deprived environment, kept each isolated in a cage, and left them no alternative activity except to press the lever to administer morphine to themselves. Bruce Alexander and his colleagues (1978, 1981) created an alternative environment for rat-subjects (calling this "Rat Park") with opportunities for varied play, real food, and sex. Most importantly, in this second environment, the rats were given two liquid options: the morphine-laced solution or plain tap water. The result was that rats reared in Rat Park consumed far less of the morphine than those reared in isolated cages. Even rats originally raised in the morphine-only cages came to prefer tap water once they were moved to the richer environment. This experiment strongly suggests a more varied, more activity-filled environment may reduce the attractiveness of psychoactive drugs. Indeed, one might argue that the addiction itself may have been prompted by deprivation and a problematic environment.

As it happens, a similar phenomenon is observable in humans. Carl Hart, the department chair of psychology at Columbia University (and former drug user), became widely known for his research observing the choices of real-life crack and *shabu* addicts. His research team (Kirkpatrick et al., 2012) offered addicts varying amounts of cash — payable only at the end of the experiment several weeks later — in exchange for their refraining from smoking crack or meth on a given day. As the cash reward rose ($5, $10, $15), more and more addicts chose the prospective cash over the immediate pleasure of shooting drugs for the day. At a $20 payoff, all the addicts chose to forego taking drugs on the given day. Hart had essentially mapped an upward-sloping supply curve of effort and shown that addicts were not the mindless zombies with uncontrolled urges that they were portrayed to be. Rather they were fully capable of making rational economic decisions — particularly that consummate human trait of sacrifice and delayed gratification. Like Alexander's Rat Park, Hart's experiments showed that addictive behavior can be modified by a provision of options and alternatives: "Treatments based on providing alternatives to drugs have shown repeatedly that they can be effective in changing addictive behavior... The idea comes from basic behaviorism: our actions are governed to a large extent by what we are rewarded for in our environment" (Hart, 2014).

This work and others like it suggest that drug use and addiction may be largely prompted by a lack of options in the social environment, which may also turn genetic switches on and off.

Like rats in isolated cages, people burdened by poverty, anomie, and lack of prospects may merely be responding to their circumstances by taking to drugs. And they may just as likely abandon such behavior – as people like Hart and Pacquiao were able to do – when prospects change for the better, or when they are presented with superior options. It is a functioning society that is able to provide such options to its citizens; it is a failed state, on the other hand, that takes lives away before a chance at recovery can occur.

The true scandal of the current drug war is that it is run by old men who operate on old ideas and obsolete knowledge. It therefore subjects citizens to what is ultimately an unnecessary — and therefore unjust — ordeal. Our predicament is not far from the episode of bizarre lobotomies performed on thousands of patients in Europe and the US during the 1950s. Ordered by authorities who thought they were treating "mental disorder," these procedures led not only to unneeded deaths during the operations themselves, but also to suicides and the permanent mental maiming and "surgically induced childhoods" of thousands of citizens. With the introduction of antipsychotic drugs, this practice was almost universally abandoned and regarded as cruel and unusual, though not before thousands of lives had been ruined or lost.

When we do finally recover from our collective mania — and we will — we might well wonder, given what we now know, whether it was addicts who were not human, or rather we who were inhumane.

Postscript: Dr. Carl Hart, the neuroscientist mentioned in this piece, later visited the Philippines in May 2017 to speak at a drug policy forum at the University of the Philippines. He cut short his visit after his contrary views on addiction were publicly condemned by President Duterte and he began to receive death threats on social media.

A law that produces criminals

January 30, 2017

THE RECENT REVELATION that rogue police have been using the "war on drugs" as a cover to extort from business people — in the most notorious instance involving the kidnap and murder of the unfortunate Mr. Jee Ick Joo — is more than enough reason for the administration to pause and radically rethink its whole approach to the drug problem.

Beyond expletives and theatrics, the Duterte "innovation" is really just an intensification of an already-existing regime of prohibition. It applies a strategy of extreme punishment — well beyond what is in the statute books — aimed at striking fear among users, dealers, protectors and enablers alike, without distinction.

Viewed dispassionately, the logic is simply to reduce both drug supply and demand. What is effectively a death penalty for drug consumption (read: EJKs) is a "demand-reducing" strategy that pushes the demand curve left and downward. The same lethal strategy, however, also reduces supply, since it disrupts drug conduits and networks by threatening prohibitive costs and risks to dealers. Shift the supply curve up far enough and the demand curve low enough, and at some point the two no longer intersect. *Et voila*, drug-free Philippines!

The economics of prohibition, however, has never been just about demand and supply. We know this from the experience of US alcohol prohibition in 1922-1933, and more recently the various unsuccessful "drug wars" waged in various countries like the US, Mexico, and Thailand. Almost invariably, the unintended institutional effects of prohibition dilute or even swamp the direct effects. What are these indirect consequences?

The most important consequence is that prohibition makes criminals of people who at bottom are merely struggling with health problems and dealing with social want. Some countries decriminalize drug use and treat addicts and pushers differently. But not Philippine law: RA 9165 specifically imprisons persons possessing any quantity of drugs, e.g., 12-20 years for less than five grams of *shabu*; life-imprisonment for 10 grams or more; and the death penalty for 50-plus grams, just in case capital punishment is reinstated. It makes no difference whether the amount you possess is for your own use or for sale. Notwithstanding the pious slogan "Save the user, kill the pusher," the law actually lumps users and drug lords together. It was not the President who innovated by treating rabbits like rats; the only novelty he introduced was to use a cannon to kill both.

An interesting sidelight is how the President has successfully bludgeoned churchmen and tycoons with his appeal for them to stop criticizing his drug war and build drug-rehab centers instead. Eager to please, some Filipino and foreign business interests actually stepped forward with their checkbooks. They must realize, however, that this is all for show, and those centers will more likely end up as white elephants. The success of the current drug campaign is frankly premised not on rehabilitation but on terror. Duterte is on solid ground, since even the law makes only a feeble gesture at redemption: rehabilitation is an option only for persons who test positive for drugs a first time — testing positive a second time will land you in jail for 6-12 years anyway.

Rehab is also a recourse if you voluntarily admit to your addiction and submit to the authorities (always remembering not to get caught with any amount of *shabu*, or otherwise it's jail time anyway).

In practice, of course, the surrender-and-submit option of *tokhang* these days only exposes one to further harassment and execution. This explains why Zumba classes organized by local governments — their miserable excuse for a detox and rehab program — have seen numbers drastically decline. Nope, if business people and churchmen truly want to advance the President's war on drugs, they should invest in facilities we truly need — bigger prisons and more funeral parlors for the poor.

As a second institutional consequence, by driving an activity underground, prohibition hands over the industry to professional criminal organizations and therefore automatically invites violence. Where payments and contracts cannot be legally enforced, only organizations with their own mechanisms for enforcement — i.e., that have a comparative advantage in violence — can engage in the business. If you can't take your supplier to court for failure to pay or deliver the goods, you need your own armed muscle to enforce the agreement. For this reason, the Mafia thrived especially during the Prohibition Era. (It moved on to the drugs business once alcohol was legalized.) And this is also why the Yakuza and Triads dominate the illegal drug trade in Asia.

But it gets worse.

An illegal business can at some point become so lucrative that its criminal organizations can corrupt and annex that other large organization with a comparative advantage in violence, namely the police. The government half-admits this when it concedes that many of the observed extrajudicial killings are perpetrated by drug networks wanting to eliminate small dealers and simple addicts who might turn into police informants. What it omits saying is how many of these killings are by members of the police themselves who are part of the criminal syndicates. It is unclear at the moment what part of the 6,000-odd killings in the drug war were perpetrated by rogue cops as part of "housekeeping" measures by drug syndicates in which they were involved, and what portion represents killings "in good faith" by death squads dutifully implementing the President's iron-fist approach to the drug problem.

One might surmise that from the viewpoint of the drug user shot dead and lying face down in a Payatas street, the distinction might not be all that important. The danger created by the President's indulgent attitude toward drug-related killings is that it broadens the license and opportunity for both types of abuse. Ultimately, however, as Mr. Jee's case shows, the real and irreparable loss is the public reputation of law enforcement itself.

It is such larger and graver social consequences that have led to a growing global rethinking of the entire prohibition-and-punishment approach to drugs. The Global Commission on Drugs, whose members include (yes, millennials, you may wiki these names) Kofi Annan, Paul Volcker, George Shultz, Fernando Cardoso, Richard Branson, Mario Vargas Llosa, George Papandreou, and Ernesto Zedillo, among others, has consistently pronounced the "war on drugs" to be a failure on its own terms. The punitive approach — such as that we have — only "threatens public health and safety, undermines human rights and fosters discrimination, fuels crime and enriches criminals, and undermines development and security," aside from being a huge waste of resources.

Heeding this advice, other countries have adopted various alternative approaches that are more humane in varying degrees, ranging from full decriminalization of drug use (as in Portugal), to legalization of milder drugs such as marijuana (as in some states in the US), to various harm-reduction strategies (as in the Netherlands and Switzerland). The bold Portuguese experiment in particular demonstrates that full decriminalization eliminates the worst crime, violence, and corruption that attends the drug trade in other jurisdictions and has led to improvements in public health (e.g., lower HIV incidence).

There is something deeply wrong with laws that not only define crime but also promote criminality. But that is essentially what our current drug laws do.

In a related context, it is worth listening to a famous (non-Nobel Prize winning) economic thinker who contemplated taxes on trade but showed unexpected compassion for the lawbreaker: "The smuggler is a person who, though no doubt blamable for violating the laws of his country, is frequently incapable of violating those of natural justice, and would have been in every respect an excellent citizen had not the laws of his country made that a crime which nature never meant to be so."

This is suggestive.

If by some miracle, drug use were only decriminalized as tobacco and alcohol consumption are now, then perhaps we would be less preoccupied with preventing kidnap and murder of citizens and foreigners and could devote more attention to what is really crucial — tax reform, right, Karl?

Arrow

March 6, 2017

BARELY NOTICED in our part of the world, Kenneth Arrow, probably the greatest economist in the second half of the last century, passed away at age 95 two weeks ago, on Feb. 21.

His death makes for poor headlines: his name is not a household word; it rings no bells for the wealthy and mighty. Instead he was the economists' economist. His work — mostly formal and abstract and therefore inaccessible to the lay person — was nonetheless completely fundamental to many fields, including the economics of welfare, general equilibrium, social choice, uncertainty, insurance, incentives, employment, and the many sub-subfields derived from these. One is hard put to name a field in economics that has not benefited somehow from some primordial concept or comment due to Arrow. Even the practical analysis of health insurance and health care, for example, would be unthinkable without Arrow's insights, from basic concepts of risk aversion to moral hazard and adverse selection.

His typically popularized epitaph however is that he — alongside the French-born Gerard Debreu — laid down the formal (mathematical) conditions under which Adam Smith's "invisible hand" conjecture is valid. The "Arrow-Debreu model" of general equilibrium is the canonical description of a competitive market economy running on pure private interest that yields socially optimal (i.e. efficient) results. Students who first confront this work however are inevitably struck by the unrealism or restrictiveness of the assumptions needed to obtain the desired efficiency results, among them the assumed existence of markets for all goods (even potential future ones), no economies of scale, fixed and regular consumer preferences, and so on. One is allowed to wonder: how can this possibly be of any use?

As it turns out, however, unrealistic assumptions themselves are the necessary gaps that let the light in. The fact that some markets are missing in real life, for example, helps one understand why entrepreneurs exist, why employment contracts make sense, why the law defines property rights, why governments impose taxes and provide public goods, and even why traditional communities and ethnic groups have a *raison d'etre*. All these are social mechanisms or institutions that precede or replace markets because there are costs to organizing and operating the latter. The genius of Arrow's model of frictionless markets is not that it asserts that ideal conditions exist (although we can and might strive for them, as in the development of markets for financial futures and derivatives). But perhaps more importantly for a developing country, it also shines a light on the valuable functions fulfilled by nonmarket institutions in a non-ideal, friction-laden world.

As for the epitaph, it's not quite true either that Arrow completely nailed down Smith's invisible hand. Arrow did show how a decentralized price-system under ideal conditions could perform well in allocating known resources. But that only did part of the job. For Smith's larger problem was not how to allocate resources to known uses but rather how to find new uses for resources, uncover new technologies and sources of productivity that often involved economies of scale. In short, the unfinished canvas painted by Smith's invisible hand was not that of efficient allocation but rather the larger one of technical progress and development. That even Arrow's prodigious mind could only push the matter so far is a measure of the enormity of the intellectual task — as well as of the continuing challenges of real-world development, where high theory is less of a sure guide.

Curiously enough, the part of Arrow's work of more current interest to the Philippines may not be his work on markets but that on social choice, which touches on politics. Using methods of mathematical logic, Arrow showed that majority rule in the midst of great diversity of individual preferences inevitably ran the danger of being inefficient or even perverse, such as when voting leads to A being preferred over B, and B over C, but C being preferred to A. The real-world implications of what is called "Arrow's impossibility theorem" remain a contentious issue among political theorists. For while the predicament obviously happens frequently enough on a small scale (e.g., fractious committees and university councils), its larger challenge to the possibility and desirability of democratic rule is disturbing to some. Indeed it may be interpreted as giving intellectual comfort to those (Rodrigo Duterte and Bongbong Marcos?) who favor the imposition of dictatorship for consistency and efficiency.

As in Arrow's work on general equilibrium, however, the real issues lie with examining what is assumed. Various ways around Arrow's dictatorship conclusion have centered on relaxing one or more of the axioms he used (among them, consistency, accommodation of all kinds of individual preferences, and Pareto optimality). On a practical plane, one obvious takeaway is that societies whose citizens have very heterogeneous preferences (e.g., because of wide social inequalities, differing racial or ethnic origins or experiences) may have a harder time with democracy. Conversely, if people's preferences and political opinions are more convergent, or at least mappable along fewer dimensions, e.g., Left or Right, or aggregable in larger political programs, then Arrow's impossibility may be mitigated. At the very least, the indirect caveat is that would-be democracies cannot neglect their citizens' education, particularly civic and political education.

More recently A.K. Sen has suggested that complete optimality (an Arrovian axiom) may itself be too restrictive a requirement that is incompatible with liberty: within a minimal personal sphere, without hurting others, I should be able to do as I please, regardless of how others feel about it. The converse, of course, is the regime of the intrusive *tokhang*, EJKs, and the quasi-police state.

The weighty and far-reaching implications of his work notwithstanding, Arrow always left it to others to draw their own conclusions, preferring to remain in the role of the self-effacing academic. Nowhere in his writing can one detect a hint of self-pride, nor even a taste for controversy or for scoring debating points; only ever a measured, ethical, and serious tone. Those of us who read him were impressed not only by his formidable intellect but also his humane, magnanimous character, which shone through the page. His nephew Lawrence Summers called him a "gentle genius."

Arrow was not a "public intellectual." He rarely spoke out on current topics, but he would on a few occasions lend his name to petitions on issues about which he felt strongly. For what it's worth, one of these was a 2014 statement on drugs that said: "It is time to end the 'war on drugs' and massively redirect resources toward effective evidence-based policies underpinned by rigorous economic analysis. ... Continuing to spend vast resources on punitive enforcement-led policies, generally at the expense of proven public health policies, can no longer be justified."

Just saying...

Charisma and its limits

April 24, 2017

THE POPULIST WAVE that has hit global politics has surprised and perplexed scholars, who in turn have produced a backwash of analyses struggling to explain the phenomenon and predict its consequences. Most analyses put down the phenomenon to heightened economic inequality owing to globalization, anemic economic recoveries, or cultural backlash and xenophobia owing to immigration. This is all very good for many Western countries. But it unfortunately does nothing to explain populism in the Philippines, or indeed the rise of President Rodrigo R. Duterte.

Common to all instances of populist resurgence, however, is the charismatic leader — which is the necessary flipside of populism. Charisma is popularly used to loosely describe some ineffable personal characteristic, an attractive *je ne sais quoi* exuded by certain showbiz celebrities, politicians, and business leaders. But it was Max Weber (1864–1920) — that lapsed but talented economist who invented sociology — who gave charisma a precise political significance.

In *Economy and Society*, Weber applies the term to "a certain quality of an individual personality by virtue of which he is considered extraordinary and treated as endowed with supernatural, superhuman, or at least specifically exceptional powers or qualities."[1] Weber then considers how a species of political authority can be based on charisma, along with the better-known Weberian categories of political rule based on tradition (e.g., patrimonialism and feudalism) and rationality (as in the modern bureaucratic state).

Charismatic leadership is typically born from crisis — or at least the perception of one — which is what gives rise to its insistent call for

1 All quotes come from Weber, M. [1978] *Economy and Society*. Roth, G. and K. Wittich, eds. University of California Press measures to save the community. Hitler rose by pointing to the economic crisis that followed Germany's humiliation after World War I, blaming the Jews (a *non sequitur*) as the vermin eating away at the people's well-being. The Philistine threat to Israel paved the way for the rise of a David; a struggle for national and religious survival in the face of Roman oppression was the fertile milieu for the Maccabees, John the Baptist, and ultimately Jesus of Nazareth; the Mao Zedong cult was rationalized by the need for a cultural revolution to save the socialist project from "capitalist-roaders." Closer to home, Marcos justified his brutal dictatorship through an alleged conspiracy between oligarchs and communists. And then of course there was that life-and-death national crisis that carried President Duterte to power — *laglag-bala* and traffic on EDSA (joke) — of course I meant the drug menace and criminality. ("I have to solve this problem. Drugs — it will continue. I don't care whether there [are] a thousand hearings everywhere. I am focused on the problem." "Do not destroy my country, the youth — I will kill you.")

Unlike the modern bureaucratic state governed by laws and rules, and unlike patrimonial rule that harkens to tradition, the source of charismatic leadership is invariably imagined to be something greater than the body politic itself. Some divine inspiration or intervention selects the charismatic leader and raises him (or her) above the multitudes in order to fulfill a mission only s/he can accomplish. There might be a special sign (e.g., perhaps a transfiguration, an adoration by magi, or even just a 39% electoral plurality), or maybe even a miracle (e.g., raising Lazarus from the dead, slaying the enemy with a donkey's jawbone, or OK, maybe lowering the crime rate in a third-level city). But at any rate, according to Weber, "It is recognition on the part of those subject to authority which is decisive for the validity of charisma. This recognition is freely given and guaranteed by what is held to be a proof, originally always a miracle, and consists in devotion to the corresponding revelation, hero worship, or absolute trust in the leader."

The legitimacy of a charismatic leader is therefore a function of nothing but sheer belief in that person and his qualities.

In Weber's words: "This basis [of legitimacy] lies rather in the conception that it is the duty of those subject to charismatic authority to recognize its genuineness and to act accordingly. Psychologically, this recognition is a matter of complete personal devotion to the possessor of the quality, arising out of enthusiasm, or of despair and hope." The result is a curious inversion of democratic values — especially where charisma takes hold of what was formerly a democratic polity. While democratically elected leaders normally have the duty to serve the people, here it is the people who think it is their duty to serve the leader.

Hence the invariable call among true followers to "help our President Duterte" — and the vicious backlash against those who try to sound a dissenting note (*sorry na lang*, Leni and Leila).

It puzzles many that Duterte's outbursts of profanity, *outré* announcements, and flip-flopping policy intentions fail to dent his popularity. Pundits always seek out the latest Pulse Asia (or SWS) surveys to see whether Duterte's latest antics have finally caused a precipitous drop in his ratings — mostly only to be dismayed that the numbers have held up. But that is actually par for the course for charismatic authority and a validation of its power. Flowing from the superhuman source of charisma is leader's ability to disregard or show contempt for rules or tradition.

Weber again: "...[C]harisma, in its most potent forms, disrupts rational rule as well as tradition altogether and overturns all notions of sanctity. Instead of reverence for customs that are ancient and hence sacred, it enforces the inner subjection to the unprecedented and absolutely unique and therefore Divine." Extraordinary actions and words are justified and tolerated owing to the supposed emergency the community finds itself in, and the superhuman source of the leader's power. (Profanity after all can be likened to speaking in tongues.) For this reason, the followers of a charismatic leader, when called to do so, will think nothing of ignoring legal tradition, insulting venerable institutions, ramrodding legislation, suspending elections, even changing the form of government itself. "Charismatic authority," says Weber, "repudiates the past, and is in this sense a specifically revolutionary force." But not to worry: all is good, since all is inspired by the higher goal of solving a crisis, and direction after all comes from a Higher Source.

This impression is reinforced by the fact (and this is important) that the leader is disinterested in the evident power he has been given; indeed he himself is not the wielder of that power but only the unworthy instrument of a greater cosmic actor. Indeed the leader would rather have foregone the privilege: "Let this cup pass from me; yet not my will but yours be done." The latest Philippine version of this heroic fatalism is this: "This is my last hurrah. After this, 77. I am not sure if I will still be around by the end of my term." "I do not need the presidency at my age." Nonetheless, "in this quest, I will put at stake my honor, my life, and the presidency itself." "Oust me — good; assassinate me — better." "I do not care if I burn in hell, as long as the people I serve live in paradise." Then finally, of course, the heartfelt appeal to the supernatural: "*Tabangi ko, Ma*." That's textbook charisma.

It goes without saying, of course, that charisma lasts only while it lasts. "Charismatic authority is naturally unstable," warns Weber. This type of leadership is justifiable only as a response to crisis; its spell wears off once the crisis passes, or the leader's powers are seen to fail. The first requisite for maintaining authority therefore is to sustain the belief in the idea of perennial crisis. For this reason, we are told, it is impossible to solve the drug problem in only six months, as promised — it's far worse than we thought, so give us more like six years.

Still, the real danger to charismatic leadership is not that a leader should fail to solve his preferred crisis. It is rather that other, more everyday concerns — especially economic problems — crop up and intrude upon what the leader sees as the greater primordial battle. Instead of the cosmic struggle between good and evil, what you have is traffic congestion, tax reform, rice importation, cumbersome bidding and procurement rules, delayed PPP contract approvals, foul-ups in mass housing, trade negotiations, peace talks, labor regulations, health insurance, budget deficits, credit ratings, and so on — in short, the daily grind of poverty and unglamorous gray issues of development which are just so many inconvenient distractions from what the leader insists is the central issue and that which justifies his rule. Indeed, the quotidian and mundane (*der Alltag*) is the true enemy of charisma.

Again Weber: "[C]harisma is basically an extraordinary and hence necessarily non-economic power, and its vitality is immediately endangered when everyday economic interests become predominant, as it threatens to happen everywhere."

Confronted with the many petty problems of daily existence, the leader's repetitious speeches about the old same topic begin to sound tired, talk of crisis sounds hollow, threats and insults lose their shock value, and the leader's audiences can only politely look at their shoes.

At that point where mundane concerns arise but are not solved, when people's lives fail to improve, then the spell of charisma is broken and people realize the emperor has no clothes: "It may appear to [the leader's] followers that 'his powers have left him.' Then his mission comes to an end, and hope expects and searches for a new bearer; his followers abandon him, for pure charisma does not recognize any legitimacy other than one which flows from personal strength proven time and again."

"If the people withdraw their recognition, the master becomes a mere private person... and if he claims to be more, [then he becomes] a usurper deserving of punishment."

What, me worry?

May 29, 2017

THE EARLY 1980S in Germany were a time of growing environmental concern. One of the main issues at the time was the dying-out of forests. Acid rain caused by automobile and coal-power plant emissions were rapidly killing off the trees. A minor sidelight in the midst of this otherwise grim context, however, was a half-ironic, half-recalcitrant car sticker that gained some fame. It read: "*Mein Auto fährt auch ohne Wald*." (My car will run even without the forest.)

Black humor has its role during dark days, so it may be about time a bumper sticker was produced here, too — maybe in lieu of car plates, which are still unavailable. It could read: "We shall thrive even without the poor," to be issued only to the rich and middle classes, who are those who can afford cars, anyway. A similar attitude might well be advertised in view of recent events. Bumper sticker: "Business is good, even without human rights," or "I will get rich even under martial law — now *na*."

In the meantime, for those who are still mildly interested, poverty may actually be on the rise. An SWS survey for the first quarter of 2017 showed 50% of respondents regarded themselves as poor, a marked increase over the 44% in the last quarter, or an additional 1.5 million households. This reverses a trend of consistently falling self-rated poverty since 2014. The hitherto declining trend was confirmed even by official poverty statistics, which showed poverty incidence among families had fallen from 19.7% in 2012 to 16.5% in 2015 (or from 25.2% to 21.6% among individuals). But that may now have ended.

Nor is this deterioration just a matter of subjective perception. It may well be connected with some hard facts. Headline inflation has risen sharply from only 1.4% and 1.8% respectively in 2015 and 2016 to 3.4% by March and April of this year (and don't say this is just "base effects"). Food inflation alone already reached 4% as of April — no doubt worsened by the silly hemming and hawing over rice imports.

The other real variable that has escaped notice is jobs.

For all the preaching and hand-wringing about the need to generate employment, no one seems to have noticed — or to care — that employment has actually been declining since July last year. Based on preliminary but official statistics, the total number of people employed was 40.9 million in July 2016; it fell to 39.7 million last October; and fell further to 39.3 million in January this year. This is not a normal trend. Employment generally dips only in April because of the holidays but usually continues to rise from July to January of the next year. As things stand, however, total employment as of January 2017 was 1.36 million people fewer than in January 2016 (again don't say this is because of "base effects"). If past patterns are any guide, employment should drop off further in April, which will then make two quarters of falling employment for this year. We're not even mentioning the minor fact that unemployment has also risen. If Trump were only concerned, he would have tweeted: "So alarming."

Then there is that ultimate issue people already seem tired of: extrajudicial killings that fall disproportionately on the poor. Quibbling over statistics seems perilous these days — it got the personable Dr. Benjamin Reyes fired as chair of the Dangerous Drugs Board. What is not in doubt, however, are the police's own figures showing that murders and homicides under the present administration have risen by 40% over the same period the previous year (7,022 in July-November 2016, versus 5,019 in 2015), mostly with the poor as victims.

But, hey, who cares? Bumper sticker: *Mein Geschäft läuft auch wenn arme Leute sterben*. Duterte still gets "very good" ratings across the board, so there's little chance of a political upheaval soon on the order of EDSA I or II — certainly not one led by the middle classes and the well-heeled. Indeed, according to Pulse Asia, President Duterte's approval ratings rose the most (by 17 percentage points!) among the relatively well-off ABC demographic between December last year and March this year. Just goes to show who's applauding the loudest. By contrast, his approval ratings fell by six and eight percentage points respectively among the D class *masa* and the poorest class E. Disapproval rose by 8% among the poorest.

Fortunately, despite the attacks and indignities being heaped on them, the *masa* and the poor are so powerless and confused they cannot even register a coherent protest. But of course they must continue to support the war on drugs — the very war that is decimating them. Why not? It seems the good thing to do and to say. Even their betters and superiors say so. For this reason one gets paradoxical results (e.g., from SWS): 73% are worried they themselves may be possible victims of extrajudicial killings; 93% say it is important to keep drug suspects alive; only 24% believe the police when they say the suspects killed were really "resisting arrest."

And yet 78% continue to support the "war on drugs."(Trump-tweet: "So ironic.")

The fact that GDP still grew at 6.4% (even if it's looking like jobless growth), that the stock market has rebounded, and that now Gina Lopez is out of a job can only further warm the cockles of the hearts of business, high-society denizens, and would-be high achievers.

To top it off, now there's Martial Law — what's not to love?

After all, we should simply trust this President to do the right thing: such as when he declared of a state of lawlessness in the whole country in September; such as when he scuttled the peace agreement with the Bangsamoro, which gave more radical terrorist groups the opening they were waiting for; such as when he turned away from the US and Europe, appeased China, then complained of helplessness when China threatened us with war. It's all good!

In fact, with our infallible economic managers saying it will not harm and may even help the economy, what's wrong with expanding Martial Law to cover the whole country? It may even finally bring 8% GDP growth. Sure, it will bring some inconvenience — maybe shut down or takeover a media outlet or business here and there — but just remember, "It's not about us." It's really about this or that oligarch, this particular business, or that particular freedom. In any case, we can always make our individual deals with the powers-that-be. (Why do I suddenly smell boiling frog? Trump-tweet: "So delicious.")

More seriously, however, what we are witnessing is the gradual erosion of belief in human rights and civil liberties, a growing retreat into the private sphere, and an abdication of the citizenry's responsibility to be informed and to hold their officials to account. Duterte often claims to admire Marcos, but the two are slightly different. Marcos surprised an unwitting populace with a dictatorship, but tried to buff up its reputation with highly qualified technocrats (many of whom were corrupted anyway). Duterte's creeping authoritarianism, however, is being implemented in full view of an apathetic crowd (think Sauron and the orcs). Since there is no need to burnish the regime, it can be populated with mediocre provincials, rank amateurs, and outright clowns. (Question: under which one are you more confident the economy will fare better? "So obvious.")

It will bring cold comfort that the Philippines is not alone. But the long view and the last word must, of course, come from the administration's favorite *éuropeenne*:

"What is exceptional is the very question of human rights is being questioned and in many places rejected. And that constitutes a marked alteration of our environment globally and locally, possibly the most significant human rights development since the establishment of the modern global and universal human rights system at the end of world war two. ...

"Most crucially, however, this rejection of human rights is predicated on rejection of our common humanity. The rejects — those that don't fit in, are not welcome, are to be rejected, criminalized, punished, may differ from country to country, community to community, leader to leader — but be assured they are all human... Their demonization — and the unaccountable empowerment of authority that accompanies it — pushes open a door onto an abyss — a void into which humanity has thrown itself before with awful consequences — because, of course, one cannot deny the humanity of some people without losing humanity for all people."

So true.

Postscript: The quote is from a speech delivered at the University of the Philippines by Agnes Callamard, United Nations Special Rapporteur on Extrajudicial, Summary, or Arbitrary Executions, on May 6, 2017.

Just take it, it's good for you

July 10, 2017

THE WARM RECEPTION of the Duterte administration's proposed tax reforms, even among some of the bright and the good, has lent an unexpected halo to indirect taxes of all sorts. The administration's tax proposals, as is well known, include higher excise taxes on petroleum products, new-car purchases, and sugary drinks — all in exchange for a moderation of income taxes on the middle class.

In all this, of course, it has been easy to forget that to begin with, direct taxes — such as those on income and wealth — should be preferred on first principles to indirect taxes on commodities and transactions. The reason is that direct taxes can be adjusted to the circumstances of the individual taxpayer. By contrast, indirect taxes like excises impose the same rate whether the buyer is rich or poor, old or young, a commercial trader or a home consumer — a fact that often makes the tax inequitable, inefficient, or both.

So why — contrary to first principles — should we nudge the tax system towards more reliance on indirect than on direct taxation?

Textbooks allow two exceptions that might support a rationale. The first exception is ease of collection. Direct taxes can be notoriously difficult to collect where evasion and corruption reign — as Kim Henares of the past administration ultimately realized — so indirect taxes may be forgiven as a second-best measure. But this cannot have been the rationale for the current excise tax proposals. For if ease of collection was the problem, the better option would have been to raise a general sales tax (as India recently did), or to increase the existing value-added tax (as

Japan did in 2014 and as Ben Diokno proposed in an earlier avatar). By not focusing specific goods and transactions, general taxes such as VAT or GST can be set lower and have the redeeming feature of introducing smaller distortions in the relative prices between any two goods.

'Pigovian tax'

The administration's tax proposals, however, claim to be more than just lamentable-but-unavoidable second-best measures — they are actually supposed to do us good. They appeal to that second case where indirect taxes are superior to direct ones, i.e., where the former are needed to correct "negative externalities." The latter has a specific meaning in economics: it's when an economic transaction between A and B inadvertently harms a third party (say C, or the public in general) who is otherwise uninvolved. Someone who buys cigarettes fully pays for the tobacco but takes no heed of the damage he causes to the health of passive smokers around him. A motorist fully pays the car company for the vehicle and the oil company for the fuel but is unmindful of the congestion and pollution she inflicts on others. In such cases, the British economist A.C. Pigou thought a properly designed tax (say on cigarettes, on fuel, and on car use) would make the consumer realize the extra harm he causes others that is not adequately reflected in the market price of the product. By raising the price of the good, a "Pigovian tax" equates private cost with social cost, causing consumers to cut back on using that good and mitigating the unintended harm caused to others.

But take note: the harm a Pigovian tax seeks to meliorate is not to the buyer or the seller — who presumably already took those risks into account when they entered the transaction. Rather the concern is for possible harm to an uninvolved third party, i.e., the passive smokers, victims of pollution, commuters delayed for work. They are the reason the transaction between A and B becomes a social issue and not just a private matter.

From this viewpoint, the part of the administration's tax reform that stands on the weakest ground is the tax on sugary drinks. Secretary Dominguez last week defended this particular proposal as "a health measure" that tries to "discourage the consumption of unhealthy products, just like cigarettes, alcohol." But apart from the irony of this administration expressing a concern for better health and longer life, a perceptive student of Econ 11 may well ask: "Sir, where is the negative externality? Why is the solution a tax on all consumers of sugary drinks?"

First consider the science. It is true that 24% of Filipinos 20 years and older are overweight, with another 6.8% even being obese (FNRI 2015). But that also means 69% of Filipinos either act responsibly and do not over-consume sugar or, even if they did, they are among the lucky ones whose genetics or lifestyles dispose them not to become overweight notwithstanding. Malik, Popkin et al. (2010) report that the link between sugar-sweetened beverages and diabetes-2 or metabolic syndrome becomes evident only among those who consume 1-2 such drinks daily. Those who indulge at this level are at about 1.2 times higher risk of developing those adverse conditions. But even this is less dire than it seems. If the risk of overweight/obesity is, say, 30% among the general population, then it is 36% (30 x 1.2) for those who overconsume sweetened beverages. Conversely, therefore, 64% of those who "overindulge" will not become overweight or obese (on this ask the Reverend Bayes).

Like it or not, the facts here are similar to those on drugs: not all who take sugar-sweetened beverages will indulge to excess. And not even all who over-indulge will become obese or diabetic — indeed the vast majority, 70%, will turn out not so. Yet, the proposal would penalize all these people in the same way. I hate to say it: just like the war on drugs.

Second and more important, however, is whether there is even any externality involved. Where is the third party inadvertently affected by obesity — the equivalent of the passive smoker, the loser from pollution and congestion, or the victim of drunk driving? From Secretary Dominguez's pronouncement, the only evident health motive behind the sugary drinks tax is to protect the sugar-consumer — from himself!

Dietary authoritarianism restricts free choice

One recalls the public howl over Senator Cynthia Villar's proposal to restrict the amount of rice served in restaurants. (How dare she? We know best how to decide for ourselves.) It is curious how a similar outcry is absent when the administration now presumes to know better how much sugar we should consume. (Ironic as well, since rice is probably the larger source of excess calories in the Filipino diet than sugary drinks.) Yet the issue involved is the very same: free choice for the citizen versus paternalism by the government (one is tempted to call it dietary authoritarianism). As our favorite Scotsman put it, "Every man is, no doubt, by nature, first and principally recommended to his own care; and as he is fitter to take care of himself than of any other person, it is fit and right that it should be so." A person's diet, lifestyle, waistline, blood-sugar and lipid levels — with their attendant health consequences and risk of death — are all essentially his private business, and the repercussions are mainly his to bear.

The situation is different in some countries with comprehensive health care systems. There the availability of good-quality public health facilities and medical insurance can induce some people to become complacent about their own health. Confident that a social safety net will always catch them, some people risk making otherwise poor health choices (aka "moral hazard"), which often enough make them ill and land them in costly care. That would pose no problem if they paid their own way. Since the bill is picked up by social insurance, however, the heedlessness of some raises costs and premiums rise for everyone else. The cost of an individual's health choices then do not fully reflect the costs to others, so that sometimes a tax or restriction on unhealthy individual behavior may be justified. It is in this context that a sweetened drinks-tax has sometimes been tried.

However, such a situation is nowhere close to prevailing in this country where, according to the health accounts, family out-of-pocket payments are the "biggest and fastest growing" source of health spending, exceeding all public and private organized health financing combined. In short, each Filipino is "principally recommended to his own care," not by choice or out of principle, but by necessity. This fact largely undercuts any notion that if people failed to look after their own health, then undue costs to the rest of the population might arise. Perhaps this situation may change when PhilHealth reimburses at, say, half of its members' medical bills (now still only 13%). Until then, however, the purely economic foundation for a Pigovian tax on sugar is built on sand.

Tax will make the poor worse off

None of these arguments on principle even delve into the question of whether the tax proposal will produce the health benefits it promises. Mexico's two-year tax on sugary drinks did lead to a drop in consumption, but it remains unclear whose consumption dropped and whether the fact will ultimately lead to better health outcomes. In the Philippines we know that overweight/obesity is more prevalent among the richest (44%) than among the poorest (17%). But to what extent is this attributable to the sugary drinks covered by the bill? And whose demands will be more affected? Will a tax really suffice to discourage the well-off, or will it just affect the poor — an equal number of whom are actually undernourished? Will it be those at risk who will cut their consumption, or those who were healthy to begin with? To what extent will a tax simply make the poor worse off by cutting off what Dr. Antonio Dans points out is a cheap source of calories. To what extent will the poor merely replace more expensive colas and 3-in-1 coffee with unsafe sugared water in plastic bags, *samalamig*, or home-brewed sugared coffee, none of which are covered by the tax? At the moment, especially with regard to Filipino behavior and diets, there is simply a great deal we do not know, which is all the more reason to proceed with reserve and caution.

The Department of Finance and its clever and sincere staff have done a fine job turning the prose of raising revenues into the poetry of externalities and Pigovian taxes. They are right on most counts. But as this piece has shown, not on all counts, and there is still a good chance to improve on things. On the other hand, these arguments from first principles and a demand for evidence may ultimately prove futile.

It will not be the first time this administration and its loyal congress will proceed from a more antecedent fundamental principle that has guided them, i.e., that regardless of argument and evidence, they can do what they want, simply because no one can stop them.

Vox populi vox Dei?

September 19, 2017

IT IS A COMMON misapprehension that the essence of democracy is sufficiently defined as the popular will expressed through elections or plebiscites and as implemented by the rule of the majority. *Vox populi vox Dei*, the saying goes, and on this basis elected representatives believe they have carte blanche to change rules big and small, violate unwritten codes, deviate from customary behavior, and reduce established institutions. Such is the implicit justification cited by those who recently voted to impeach the chief justice (and who also threatened the vice president, the ombudsman, and the Comelec chair), those who would kill the human rights commission by defunding it, and those who would short-circuit constitutional change in order to place the country under indefinite Dutertian rule.

Given the President's high approval ratings, it is argued, it behooves everyone to move in lockstep, support his policies, ease his vexations, and disable his enemies. In the words of a senator: "*Kung ikaw nagtatrabaho ka sa gobyerno at hindi mo gusto mga polisiya ng namumuno, eh di umalis ka*." The Speaker's words carry a similar message, appealing to a putative majority: "*Kung sinasabi na ng karamihan na hindi niya ginagampanan yung trabaho niya, hindi niya ginagawa, eh dapat mahiya ka na eh*." Either conform — or wither and die.

A similar urge to conformity was present at the beginning of the Nazi era in Germany when Hitler's star was on the rise.

Following the Nazis' popular electoral victory in 1933, the demand was for *Gleichschaltung* ("synchronization"), i.e., the reorganization of politics and society to conform to the victorious party's ideology and policy. Existing institutions were pressured to prove that they had aligned themselves with the Nazi party line, being required to affiliate with Nazi federations, to change their leadership (especially pressuring Jews to resign), to dismiss problematic members, or simply to dissolve themselves if they were unwilling to adjust. More crucially, the elected parliament, with heavy Nazi representation, willingly surrendered its powers to Hitler as chancellor and president.

Question: were these "democratic" actions? They were after all enacted by an elected government with no doubt a substantial degree of support in popular opinion. Remember, Hitler had won 43% of the popular vote in the last elections. (President Rodrigo Duterte by comparison got only 39% of the vote, though since grown to 82% approval.) If *vox populi* is indeed *vox Dei*, then there should be no reason to object to such measures.

So suppose a majority of the electorate (not just 39%) decides to abrogate the present constitution, establish a dictatorship, and never hold elections again. Would that be democratic? That's like asking: is a man free to sell himself into slavery? Can majority rule justify democracy committing suicide?

Herbert Spencer, the great Darwinian, sought a similar test of the reasonable limits of majority rule and popular opinion when he asked what people would think if parliament — perhaps heeding dire Malthusian warnings — were to pass a law ordering all infants born in the next decade to be drowned. He asked, "Does anyone think such an enactment would be warrantable? If not, there is evidently a limit to the power of a majority." His example actually hits close to home. Congress only recently considered the President's suggestion to lower the age of criminal responsibility to nine years (i.e., considered putting grade-three pupils in prison!). It is fortunate they chose not to heed his call — but only just.

In practice many issues are placed beyond the reach of majority rule or public opinion — for good reason. One is simple efficiency. The innocence or guilt of accused persons, the valuation of damages and property claims, people's tax liabilities, the incidence of poverty and the growth rate of GDP, the actual number drug-users — all these are (or ought to be) decided not by vote or influence but by bureaucrats and judges. Such is the pragmatic solution to a well-known result in public-choice theory — Arrow's Impossibility Theorem — which implies that a universal application of majority rule in deciding issues is likely to be inefficient, inconsistent, or both. The solution is to remove such decisions from the political realm and leave them in the "undemocratic" care of specialists exercising informed discretion. The political independence and professionalism of the bureaucracy and the courts are part of constitutional design. It is foolish and uninformed of politicians to demand that they conform to political trends and opinions of the day, no matter how "popular."

There is a deeper reason however for putting some things beyond the reach of majorities and public opinion: to avoid the possible tyranny of the majority. So much the worse if "the majority" is in reality being manipulated by demagogues.

In principle, civil liberties and the bill of rights are really intended to protect minorities; a majority after all needs no protection from itself. And since none of us knows when and how we might be a minority in the future, such guarantees must be couched in universal terms. Rosa Luxemburg put it best: "Freedom only for the government's adherents, only for the members of a party — no matter how numerous these are — that is not freedom. Freedom always means the freedom of those who disagree." [*Freiheit ist immer die Freiheit des Andersdenkenden.*]

In placing human rights, civil liberties, and the administration of justice — including institutions that guarantee them, such as the Supreme Court, the Office of the Ombudsman, and the Human Rights Commission — beyond the pale of politics, society makes a credible commitment that it will not be arbitrary or be swayed by current political opinion and habit, e.g., that drug users are beyond salvation and so may be killed without too much compunction; or that "intelligence reports" are sufficient grounds to publicly denounce and persecute individuals.

To attack the integrity of these institutions is to place in doubt that universal commitment to due process and against arbitrariness. Yet this is exactly what politicians caught up in the hubris of commanding a majority do when they seek to bend independent institutions to their will. Pushed further, this is bound to end badly. And — since this is a business paper — this also means ending badly economically.

Since the threatened institutions and constitutional guarantees are universal, their erosion is bound to affect business confidence as well. Viewed historically, most investment crises in this country (from Marcos's original power grab to Arroyo's desperate attempt at a second term) have been related to attempts to improvise beyond limits set by the

Constitution. That remains true today. As proof, we already witness how direct foreign investments, both in pledges and actual flows, have declined relative to year-ago levels under Duterte's watch. Major fiddling around with the Constitution is bound to worsen investors' hesitation, and Duterte's charisma is not enough to offset it.

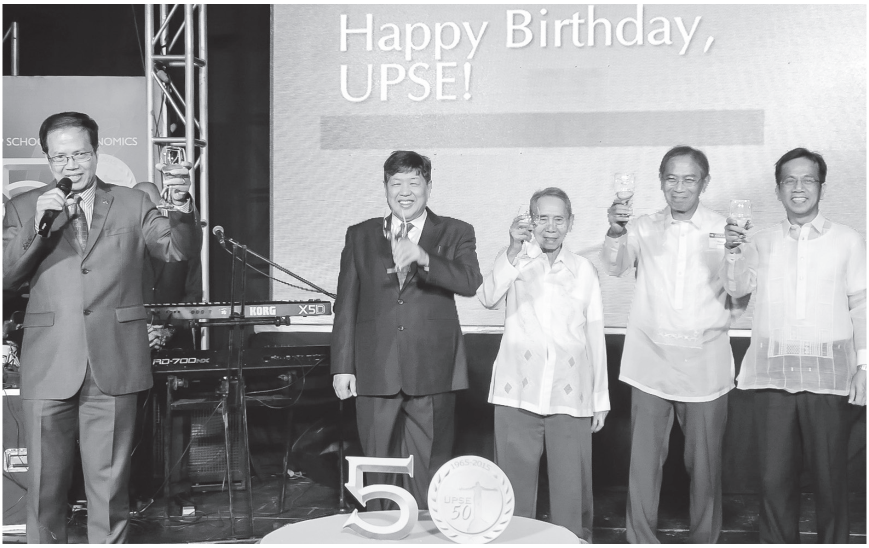
The point is made: without universal rights that extend to minorities, without autonomous institutions guided by reason and justice, the mere existence of a majority in numbers does not embody democracy. It is still only a mob. It is in this sense we should understand the words of Alcuin, the medieval scholar who was among the first to use the phrase when he advised Charlemagne: "*Nec audiendi qui solent dicere, vox populi, vox Dei, quum tumultuositas vulgi semper insaniae proxima sit* (Do not listen to those who like to say *vox populi, vox Dei*, for the noise of the mob always verges on madness)."

About the author

SINCE EDITING what is perhaps the country's most read workshop report (*An Analysis of the Philippine Economic Crisis: A Workshop Report*, June 1984), Emmanuel de Dios has gained a well-deserved reputation as an economist who writes clearly and engagingly. In addition to his day job as economics professor, he has become a much sought-after editor of economic publications issued by government agencies and international institutions, helping turn otherwise dry tomes into readable prose. Some of the works he wrote and edited have received recognition from organizations ranging from the Catholic Mass Media Awards (CMMA) to the National Academy of Science and Technology (NAST) and the United Nations Development Programme (UNDP).

Noel began his academic career as an instructor at the UP School of Economics in 1980, became professor in 1989 and served as dean from 2007 to 2010. He has been professor emeritus at UP since August 2019. He has

Emmanuel de Dios finds time to pose beside a statue of Philippine national hero Jose Rizal in Wilhelmsfeld near Heidelberg while pursuing post-doctoral studies at the Universität Konstanz in Germany from 1987 to 1988. In one of his columns in this book, Noel parses Rizal's ideas on the wealth or poverty of nations.



Emmanuel de Dios (second from left) is joined by former deans of the UP School of Economics in a celebratory toast to the 50th anniversary of the educational institution that produced most of the leading lights of the economics profession in the Philippines. From left: Ramon Clarete, Amado Castro, Raul Fabella and Arsenio Balisacan.

written papers on institutions and economic development, political economy, the history of economic thought, international economics, and the theory of individual choice. A well-loved mentor, he received the UP's *Natatanging Guro* (Outstanding Teacher) award. Former students still recall him bringing wine (one of David Ricardo's two examples to illustrate comparative advantage) to mark the end of his theory of trade classes. He also wrote an editorial style handbook on technical writing for economists and economic students titled *Form and Functions.*

Outside of academia, he has been an independent director since 2013 at ABS-CBN Corp., the country's top broadcasting company by revenue. He is also chair of the Board of Trustees of Pulse Asia (Phils.), the non-profit polling group. He is a founding member and president (since 2012) of the Human Development Network, which publishes the *Philippine Human Development Report*, and advocates a broader consideration of progress beyond traditional economic indicators such as per capita income.

He received his AB Economics degree from the Ateneo de Manila University *cum laude* in 1978, his MA and Ph.D. in Economics from the University of the Philippines in 1980 and 1987, respectively. He pursued post-doctoral studies at the Universität Konstanz in Germany from 1987 to 1988.

"The annals of underdevelopment are painted on the canvass of squandered opportunities, not on the canvass of scarce resources."

Raul Fabella

CARPER: Time to let go[1]

October 28, 2013

CARP EXTENSION with Reform (CARPER or RA 9700) which extended the 1988 Comprehensive Agrarian Reform Law (RA 6657) will itself expire in June 2014. By the end of 2012, 4.49 million hectares shall have been acquired and distributed. That figure represents 84% of the 5.37 million hectares targeted for distribution. By 2014, the CARP shall have distributed 5.05 million hectares, leaving but 321,000 hectares or an accomplishment rate of 99%. By then 2.6 million farmers shall have gained some form of ownership to an average 1.2 hectares of land. One can argue that CARP and CARPER represent one gargantuan obeisance to the principle of equity: 202,000 hectares acquired and distributed per year for 25 years!

CARP shall have distributed 16% of the total Philippine land area of 30 million hectares. For a government program in a weak democratic state, that is quite a feat. Japan's vaunted land reform distributed only 1.76 million hectares of its total 37 million or 4.7%. Taiwan distributed 0.5 million hectares of its total of 3.62 million or 14%. Note that the Japanese land reform was carried out by the Allied Occupation Forces while Taiwan's was by the virtual military government of the Kuomintang Party. Where's the catch? Those land reform episodes did not last more than five years. They were clinical and did better because they knew when and where to stop. Japan's, Taiwan's and South Korea's land reform largely stopped at rice lands! Ours lasted 25 years and spared none. Counting the years from the original rice and corn land reform in 1964, we already had half a century of land reform. As in every weak state, ambition replaces delivery and everything takes so much longer. That means that government programs start to deliver long after they have outlived their usefulness and their social rates of return have turned negative. The exception: ghost projects!

---

1 This column owes much to Dr. Fermin Adriano's "Sustaining the Momentum of Inclusive Growth in the Post-CARP Scenario."

The same can be said of CARP and CARPER. Their clearly stated objective is the enhancement of the beneficiaries' dignity and quality of life through the necessary pathway of farm productivity (Chapter 1, Section 2 of RA 6657). Farm productivity, an a priori in the enhancement of quality of life, is where CARP messed up.

A 2011 ARC Land Development Assessment (ALDA) of agrarian reform beneficiaries (ARB) located in agrarian reform communities (ARC) showed that average (ton/hectare) yield among ARC beneficiaries in *palay* was 10% higher than national average (consisting of non-ARBs, non-ARC ARBs *palay* farmers); in corn it was 50% higher; in coconut it was 40% lower; and in sugar it was 8% lower. So in the two crops that were largely covered by the 1964 land reform, farm productivity looked better. But even then a proviso is required: only 54% of ARBs are in ARCs. Agrarian reform communities are where most of the government and non-government aid get poured in. From 2010 to 2012, ARC-affiliated ARBs received on average ₱22,446 in credit support and ₱23,246 in irrigation support (see Adriano's manuscript). The figures could look much worse if non-ARC ARBs (46% of total) are included. But even in ARCs, sugar and coconut productivity fell! That's a mess-up in my book. For crops that came under land reform with CARP, the figures are ominous.

What is worse for CARP is its outcome on beneficiaries' quality of life. Quality of life is correlated with being above or below the poverty line. The same survey shows that among ARC-affiliated ARBs, 54% of households fell below the poverty line! Already for 2009, FIES data show that only 36% of farmers fell below the poverty line. And that's when the economy was weighed down by the world financial crisis. This seems to say that ARC-affiliated farmer beneficiaries of CARP had become poorer! Since the plight of non-ARC beneficiaries can only be worse, that number can only look even more indicting. CARP, it seems, has created a new class of farmers: the landed poor!

There are many reasons why CARP has failed in its most crucial test. CARP has effectively chased away private capital from agriculture with the five hectare ownership limit. While private capital is not interested in owning the land, they cannot be expected to deal with 1,000 farmers to get 2,000 hectares to cultivate. Where private capital dared test the waters, it ended up in a circus: San Miguel Food Corp.'s swine project at Sumilao. It has effectively sent the agricultural credit market underground.

It has presumed that farmers automatically morph into entrepreneur-businessmen with access to land. Farmers beneficiaries are not allowed to sell or rent land in the open market until paid-up, and paid-up is elusive under the CARP restrictions. With 1.2 hectares average landholding, farmers, especially in sugar and coconut, cannot be expected to breach the poverty ceiling.

It is time to let go of a failed land and agriculture policy. We have served land equity long enough. We must now serve efficiency. We have to let private capital back into agriculture. We have to let the more productive farmer cultivate 50 or more hectares as market efficiency dictates. Philippine Stock Exchange-registered firms should be allowed a much higher land ownership ceiling. It's time to stop redistributing poverty!

Rules, overlords and hope

January 6, 2014

WHEN OVERLORDS trump rules, the nation has little hope of progress. The first fundamental step in development is to replace overlords with rules. How far are we?

A number of pipes and some fire hydrants are discovered missing from the storeroom of a Commonwealth Avenue subdivision homeowners' association. The items are finally traced by Mr. D and Mr. E, the chief of security and the hired manager, respectively, to the private *bodega* (warehouse) of Mr. S, a member of the Board of Directors (BOD) of the association. The two promptly report the matter to the subdivision's security committee. Mr. S is enraged when apprised of the report. How dare these underlings take on their superiors. Mr. S threatens the specter of "no peace in the subdivision" if no one is fired by the BOD. He raises the ante by filing a suit of illegal trespass against Mr. D and Mr. E. These two are poor, cannot afford a costly legal defense and are practically toast. A handful in the BOD insist that Mr. D and Mr. E were "just doing their job." The majority in the BOD, however, rallies around Mr S who manages to spin the issue away from attempted theft to a choice between himself, an insider, and outsiders, Mr. D and Mr. E. "To keep the peace," the BOD fires Mr. D! One concurring BOD member boasts: "Of course, my brother first."

Late November 2013, a ruckus was brewing in the UP School of Economics lobby. A young man was going ballistic at the blue guard on duty. Upon inquiry, it turned out that the young man took offense at the guard for minding his (the intruder's) not wearing a proper ID which was a rule at the School in view of the many instances of theft. Asked to explain, he reasoned that he lost his cool because "*bakit pinag-initan ako ng guwardiya.*" How dare a mere blue guard put an abstract rule over his exalted persona! He impressed on the blue guard his umbrage in terms overlords use: threats and insults.

Then there was the Aug. 15, 2013 incident along Tandang Sora, QC, when a motorist, Carabuena, apprehended for running a red light by the Metropolitan Manila Development Authority (MMDA) enforcer Fabros, made his contempt clear by slapping him. Once again, how dare a mere MMDA enforcer take on his betters! The slap was a reminder that underlings should behave according to their position in society. Overlords trump rules. Mind you, Carabuena was a human resource manager of Fortune Tobacco!

When in 2010 the members of the faculty of the UP College of Law criticized the Corona Supreme Court for absolving by majority decision one of their own — the Associate Justice Del Castillo — of plagiarism on a flimsy excuse of an underling error, the Corona Court counterattacked, issuing a show cause order and threatening legal sanctions. As everyone knows, no one wins a legal case against the Supreme Court. Coincidentally, or so some say, plagiarism accusations were floated against the leaders of the critics. Again, overlords make the rules.

And then comes the revealing Dasma-Binay scandal caught by a CCTV camera, which Vice President Binay aggravated with a plea for "courtesy," a euphemism for "We are above the rules." My colleague Solita "Winnie" Monsod breaks down the incident with steely logic in *Philippine Daily Inquirer* (PDI, Jan. 4, 2014) and friend Chit Roces-Santos (PDI, Dec 29, 2013) decipher it with tongue-in-cheek dexterity. Both conclude that the phony settlement does not finish the business and closure has to be found either in the courts and/or in the 2016 elections.

These illustrate overlords blaming "arrogant enforcers" for refusing to exempt them from rules. Normally overlords get away with it. But not in these cases thanks in part to technology. A TV5 camera caught the slapping of MMDA Fabros *flagrante delicto*. The MMDA commended and promoted Fabros for doing his job well. A direct assault charge was filed against slapper. The slapper was suspended from his job. In the case of the overlord-in-his-mind in UPSE, the UPSE authorities intervened and told him, "*Ang kaaway mo rito ay ang buong UPSE at hindi ang guwardiya; kung ayaw mo ng aming patakaran, huwag ka nang magpakita rito*. (Your fight here is with the entire UPSE and not with the guard; if you don't like our rules, don't come here.)" In the Supreme Court plagiarism scandal, two of the critics threatened with sanctions are themselves now justices of the Supreme Court while erstwhile Chief Justice Corona has been impeached.

In the case of the fired Mr. D, the homeowners rose up in collective outrage and in the following annual meeting forced the BOD to reverse itself. One homeowner executed an affidavit of no illegal entry; another took up Mr. D's case *pro bono*. In the subsequent BOD election, all the pro-firing BOD members lost.

History teaches that progress begins when rules begin to trump overlords. As a nation, we talk "rule of law" but we still walk the "rule of overlords." As my colleague Emmanuel de Dios keeps reminding us, culturally hardwired informal rules will keep trumping formal rules until the overlords who thrash rules are themselves thrashed by the people. Lest we forget.

Fighting yesterday's war

April 7, 2014

THE NEW CENTRAL BANK ACT of 1993 which circumscribes the monetary policy of the Bangko Sentral ng Pilipinas (BSP) is in the process of being recast. It is long overdue. That the BSP of the recent years is a far cry from the BSP of the previous decades is however due largely to the changed outlook and openness of the recent BSP leadership rather than to, and even despite, the act itself. For RA 7653 tended largely to be backward-looking and defensive in character. That is understandable. Every institution at its inception embodies the lessons distilled from recent past. For example, the EPIRA (Electric Power Industry Reform Act) of 2001 proscribed "take-or-pay" contracting and government direct procurement of power generation (without an emergency declaration), suspected to be carriers of abuses of the decade past. RA 7653 was no exception. The pertinent recent history was of debacles emanating from the 1980s economy characterized by chronic balance of payments (BOP) crises and dependence on foreign borrowing (the so-called boom-and-bust economy). RA 7653 was to be a firewall against the excesses of the old economy. It may, however, hamper future growth in the new economy.

The overarching principle that underpinned RA 7653 is "monetary policy independence." Its principal driving force was however historical: the rape by the Marcos regime of the old central bank (CB), which resulted in the collapse of government banking institutions supposedly under the supervision of the CB. The result was the trillion-peso tab to absorb the losses of the CB and government banks imposed on the wobbly Cory economy. Thus Section 28 of the law proscribed the development banking role for the CB:

Section 128: Prohibitions: "The Bangko Sentral shall not acquire shares of any kind or accept them as collateral, and shall not participate in the ownership or management of any enterprise, either directly or indirectly... The Bangko Sentral shall not engage in development banking or financing..."

Thus, also, the exclusion of goals other than price stability:

"Section 3: The primary objective of the Bangko Sentral is to maintain price stability conducive to a balanced and sustainable growth of the economy. It shall also promote and maintain monetary stability and the convertibility of the peso."

The phrase "balanced and sustainable growth of the economy" allows many interpretations. An economy can be balanced and sustainable at 1% GDP growth. Likewise, the open-market operation of the BSP has an exclusive goal — price stability:

"Section 90: Principles of Open Market Operations: The open market purchases and sales of securities by the Bangko Sentral shall be made exclusively in accordance with its primary objective of achieving price stability."

The emerging awareness of the importance of the composition of output and employment as important objectives is exorcised. The wherewithal of the open market operations of the BSP is limited to borrowing from the private sector:

"Section 92: In order to provide the Bangko Sentral with effective instruments of open market operations, the Bangko Sentral may... issue, place, buy and sell freely negotiable evidences of indebtedness of the Bangko Sentral: Provided, that issuance of such certificates of indebtedness shall be made only in cases of extraordinary movements of in price levels."

This underpins the BSP's use of the high-interest-rate (since then lowered) SDA facility to pursue the goal of price stability. More pertinently, the latter seems to proscribe the use of increasingly popular monetary instrument, "quantitative easing" (QE), which involves the printing of money.

The BSP Law of 1993 was cast to serve a Philippine economy whose time has passed. Since 2002, the Philippine economy has become a BOP-surplus economy. This new phenomenon is accounted for by, on the positive side, a massive OFW remittance ($25 billion annually) helped along by the growing contribution of services exports (business process outsourcing or BPO, $12 billion); on the negative side, the very low investment rate (20% of GDP) puts a lid on imports. The familiar pressure to a (forced) devaluation of the peso is a thing of the past; the pressure in the foreseeable future is for chronic appreciation of the peso. But sustained rapid growth requires massive infrastructure investment which can, but is not, financed from the BSP's ample gross international reserves by virtue of, among others, Section 128. The monetary authorities have bravely fought the appreciation despite the limitations but at the cost of a big hole in its balance sheet. "Tapering" has temporarily eased the losses.

Like the formidably defensive Maginot Line built by the French on the Franco-German border (and rendered completely nonsensical by the German *blitzkrieg* through Belgium), the BSP Law of 1993 is fighting the last war. Like the Maginot Line, it has become a straitjacket. This view is echoed by Rodrik (2011, "The Future of Economic Convergence"):

"Developing countries have opened up to the world economy, placed greater emphasis on macroeconomic stability, and are for the most part better governed... My reading of the evidence is that these are improvements that serve mainly to enhance these economies' resilience to shocks and help avert crises, which often interrupted economic progress in the past. They do not necessarily stimulate ongoing economic dynamism and growth... Another way of putting the same result... avoiding truly awful policies can prevent a country from turning into an economic basket case, but ... (they) do not reliably generate high growth."

The BSP Law should be recast now to fight today's and not yesterday's war.

Poverty, inequality and growth

May 6, 2014

ON APRIL 29, the National Economic and Development Authority (NEDA) announced that after three years of reasonably rapid economic growth, poverty incidence is finally responding, with a 3-percentage-point drop from 27.9% in 2012 to 24.9% in 2013, while the incomes of lower income quintiles grew at a rate faster than inflation. Welcome news indeed. This attests to the view that sustained growth is the holy grail that brings measurable relief to the poor. Economic growth is so much easier to trigger than to sustain. Growth episodes in lagging Third World economies are as a rule spasmodic — here today, gone tomorrow; on the successful catch-up trajectory, growth persists for at least a decade.

It is a general observation that in the long term, economic growth decreases and income inequality increases poverty incidence *ceteris paribus*. But it is not a mystery why spasmodic growth fails to reduce poverty. Production growth spurts, like those following a recession, largely involve the utilization of idled capacities and longer hours for the retained workers. New investments and new hires in projects with longer payback periods follow only after the exhaustion of idled capacity and the return to healthy firm balance sheets. These are corollaries of sustained growth. Before then, whatever new investments there are gravitate towards projects with shorter payback periods as in the service sectors. In the Philippines for as long as one can remember, the busts that followed the short booms skewed the incentives in favor of short-horizon investments, thus the service sectors.

The jury is still out whether the Philippines can extend the run of current healthy growth. The indicator of interest is the investment rate. Growth has so far been dragged along by consumption, underpinned partly by growth in OFW remittance whose growth is slowing. We need to switch to investment. Our investment rate has been stuck at

20% of GDP for so long, it feels like an act of God. The government has correctly signaled its commitment to sustained growth by raising its own investment, the government capital outlay (GCO) — long stuck at 2.5% of GDP for decades — to 5% of GDP. This would raise the investment rate to 22.5% of GDP for starters. The inauguration of new expressway segments to the north of Luzon is good news. The expressway extension to Batangas Port is another. The recent start of construction of the much delayed Connector Road Project also spurs hope. Hopefully, segments of it can be used before PNoy leaves office in 2016. And the green shoots go beyond Luzon.

Recently, I was in Bacolod City which is growing impressively. But what struck me most are the four-lane roads radiating to the north and south of Negros from the city. Along these roads are sprouting new factories, distribution outlets and jobs. Negros Occidental also built an impressive separate dedicated highway connecting the new Silay-Bacolod Airport to Bacolod City. Business process outsourcing firms are flocking to the city. Bacolod City now has the amenities but without the chaos and congestion of Metro Manila. Vibrant cities like Bacolod further strengthen the hope that growth will move from consumption- to investment-driven and thus sustained.

Sustaining growth is Task No. 1 for the Philippine economy. But what contributes to sustained growth? The well-cited 2011 Berg and Ostry piece "Inequality and Unsustainable Growth: Two Sides of the Same Coin?" focused on this. As expected, the usual attractors of investment — namely, good institutions, openness and stable macro — figured prominently as extenders of growth duration. But they also showed that income inequality shortened the duration of growth even after taking on board other factors. Concluded Berg and Ostry: "Inequality still matters, moreover, even when other determinants of growth duration — external shocks, initial income, institutional quality, openness to trade, and macroeconomic stability — are taken into account." In other words, growth in high inequality economies tends to be spasmodic.

Inequality is the crux of the new highly touted volume *Capital in the Twenty-First Century* by Thomas Piketty (2013). Piketty shows with an impressive array of empirical evidence running through centuries and an ingenious use of extant income tax data that ever rising income inequality is the inevitable outcome of unimpeded thriving market economies. It flies in the face of the venerable Kuznets Curve that claimed that in the process of development, income inequality first rises, reaches an apex and then falls as income per capita rises. Piketty suggests that this signals capitalism's inherent self-destructive tendency, reminiscent of Marx's "progressive impoverishment of the masses." At times through its well-writ and deftly argued pages, the reader feels "an iron law of Economics" aborning. But even sympathetic Martin Wolf of the *Financial Times* asks a valid question: Why dread income inequality? After all, inequality is a corollary of the market and thus can be the price of hundreds of millions graduating the poverty line as in China. Berg and Ostry, without meaning to, provide an interesting perspective: increasing income inequality makes economic growth increasingly tenuous and may even abort it. Capitalism as an adaptive system may have a self-correcting mechanism akin to Schumpeter's creative destruction to keep inequality extremes at bay.

While Piketty's work has inspired both more rapture and scorn, Berg and Ostry's is the more relevant thesis for emerging economies. For the Philippines, absorbed as it should with poverty reduction, inequality matters first directly, since income inequality *ceteris paribus* (sans growth) tends to raise poverty incidence, and, second indirectly, since as chief reducer of poverty, economic growth dents poverty only when sustained. That said, however, directly engineering greater equality by undermining the market is the wrong way to proceed.

China's example is compelling: reduce poverty through sustained rapid growth albeit with rising income inequality. Many times the largest anti-poverty gains come piggybacked on better roadways, credible courts of law, less obstructive government (as in mining), letting go of failed programs (as in agriculture), cheaper power, more trade and capital openness and more accountability. These together raise private investment, create jobs, and sustain growth.

Power and the pursuit of equity

June 9, 2014

INEQUALITY IS BACK. The trigger is the book *Capital in the Twenty-First Century* by Thomas Piketty. Three allusions to the book have appeared in the *BusinessWorld* opinion section in the last month alone. Piketty claims that ever-rising income inequality is the inevitable harvest of unimpeded market economies. And the market cannot heal itself of this infirmity. Piketty flies in the face of the venerable Kuznets (1955) who claimed that in the process of development, income inequality first rises, reaches an apex and then falls as income per capita rises. Inequality was already the focus of the widely cited 2011 Ostry and Berg piece "Inequality and Unsustainable Growth: Two Sides of the Same Coin?" They showed that income inequality shortened the duration of growth even after taking on board other factors.

The Piketty thesis is being subjected — as it should — to a spirited academic debate. But whatever the final verdict on the thesis, the inequality aversion it triggered is now a global staple. We can expect this aversion in the West to wash up the shores of developing countries and recalibrate development policy. There is great promise but even greater risk here for developing countries.

If equity must be served, how should it be pursued? In the past, many attempts to level the income distribution took the form of shackling the market. The most popular form is administered prices: price controls on basic commodities, productivity-divorced minimum wages, rent controls, and usury laws. Another is making illegal certain markets, such as for farm land in the rural areas. What they mostly accomplish is an empty cupboard that leaves most everyone but especially the poorest worse off. These efforts turn pro-poor intentions into anti-poor outcomes. This lesson has a long history.

According to Lactantius (A.D. 300), in the late 3rd century, Emperor Diocletian issued the Edict of Maximum Prices in an attempt to limit prices of commodities by law. As a consequence, "much blood was shed for trifles, men were afraid to offer anything for sale, and the scarcity became more excessive and grievous than ever. Until, in the end, the law, after having proved destructive to many people, was from mere necessity abolished." Unfortunately, Will and Ariel Durant's famous paean to human frailty still holds: History teaches but man never learns.

The fact of the matter is that equity could be pursued without stultifying the market. The main lesson of microeconomics' venerable Second Fundamental Theorem of Welfare is that equity can be pursued without sacrificing efficiency. While this may be an unattainable ideal itself, the residual rule remains wise: Employ equity-pursuing policies which give the market the widest berth. Thus, wealth taxation is preferred to income taxation and income taxation when duly collected is preferred to commodity taxes.

If you want to help the poor, give cash transfers to the targeted poor; don't artificially keep prices of commodities low. Artificially-low prices, say, of electricity, are leaky buckets that benefit Forbes Park more than the poor. In general, fiscal transfers to expand opportunities for the targeted poor and their children, such as education, are the best equity strategy.

It is now fashionable to attract investment through public-private partnerships (PPP). But the state must be ready to respect the pricing provisions of the contract despite populist pressure. The government, for example, has lately buckled on the treatment of corporate income tax in the concession contract for water in Metro Manila. This sours the PPP climate and will raise the cost of future procurements. As part of the original come-on for bidders, the tax treatment provision has been priced into the calculation and should be respected by the state.

Currently, the government via the Energy Regulatory Commission has embarked on a creeping administration of the Wholesale Electricity Spot Market (WESM) and bilateral contract prices on the pretext of market failure and abuse of market power. At the root of periodic spikes in electricity prices in the recent past and the highest electricity prices in the region is the dearth of new lower-cost baseload generation capacity coming on stream since the Electric Power Industry Reform Act (EPIRA) became law. This makes the energy market a sellers' market.

If administered pricing becomes the rule, private investment in new capacity envisioned in EPIRA will be even less forthcoming.

The energy secretary recently said that there is enough power for 2014 and 2015. If this is as much assurance as the government can give, potential investors in the Philippines will look elsewhere. The government can step in to procure new capacity to forestall a looming power crisis, but EPIRA prohibits the government from directly procuring new units unless there is a declaration of a power emergency by the president. Shouldn't PNoy seriously consider declaring a power emergency now and sign contracts for delivery of new baseload to ensure growth beyond 2016? After all, a zero or negative GDP growth is peerless in growing inequity.

Grains and Gilas: Geography, genes, dashed dreams

September 8, 2014

WE CAME VERY CLOSE to beating Croatia, Puerto Rico and Argentina in FIBA Spain. We beat Senegal by a whisker. All the basketball world marveled at our fighting spirit. The entertainment value was unmatched. But in the end we were eliminated. We tried; we even enlisted Congress to accord citizenship to foreign behemoths to raise our ceiling. This leaves a bad taste in the mouth, for how far can you go with instant citizens without eroding our team identity? Still, a win is a win. It was not quite our dream but it was certainly better than a "zero win" for China and India. Our genes in the end let us down.

And yet there is nothing wrong with our genes; the wrong is with our choice of competitive games. Basketball is a game of physical, not mental elevation. That is why a Jewish NBA player always inspires a chuckle like a ghost. And Jews are not insulted. It's the case again of some Ivy League schools — when their lowly football teams surprise some nationally ranked teams, a blue moon moment, there follows a groan of self-examination: a sign perhaps that we have lost our academic edge? For there is no free lunch, not even and especially academic edge. Wisdom dictates that we embrace our genetic make-up and choose the contests that enlist our genetic strengths. And for Filipinos, basketball cannot be the repository of lofty dreams. Jews don't do so badly reposing their dreams in bio-, nano- and other techs. We can too.

As in sports, so in life. But in life, swimming against the tide can be disastrous. Basketball is at least fun and costs the taxpayer no money. Not rice self-sufficiency. In the annals of myths, rice self-sufficiency stands out as the most enduring. Dreams repeatedly get bludgeoned here, but it does not die. The fallacy is that any nation can just engineer it and thus should. In December 2011, Agriculture Secretary Proceso Alcala bragged that by 2014, the Philippines will be a rice exporter because by then the Philippines will have achieved rice self-sufficiency.

So a program of rice import reduction pulled imports down from 860 metric tons in 2011 to 350 metric tons in 2013 in the hope that domestic rice production will fill the void. Well, domestic production did not, despite the huge budget allocation for rice. In the first quarter this year, rice prices spiked. PNoy's sagging rating had little to do with the Disbursement Acceleration Program (DAP) and everything to do with the price of rice.

Alcala's was not just a shattered dream; it almost derailed *Matuwid na Daan*. The besieged Aquino administration quickly reversed course and rushed an import order of 800 metric tons of rice. It also stripped Alcala of four crucial units of the Department of Agriculture. In Japan, where honor is highly regarded, the same chain of events would have triggered a *hara-kiri*. Here, Alcala is still there.

Why did rice self-sufficiency fail? Rice self-sufficiency is a matter of geography. This is the message of the recent International Rice Research Institute study. Many economists, including Planning Secretary Arsenio Balisacan, have raised the warning. We do not have a comparative advantage in rice production. Our cost per *cavan* is too high. You can blame lack of infrastructure and farm-to-market roads till you are blue in the face, but if you do not have steady abundant water and a friendly soil, you will be marginal. Which means only limited areas in the Philippines will be competitive and not nearly enough for self-sufficiency. As Adam Smith once observed, Scotland can produce more wine, but if you have to artificially provide the warmth and abundant sunshine freely available in Portugal, you will go bankrupt. Why not produce woolens instead? Producing efficiently if only a fraction of consumption requirement and importing the rest is common sense. Geography is unfair; but it gets bloody if you bang your head against it. As with genes, you choose crops that suit your geography and not the geography that suits your crops.

It is the familiar law of comparative advantage in trade theory once again. If a country specializes according to comparative advantage — that is, produce crops where it has a cost advantage, say rice for Thailand — it realizes increases in its welfare. I prefer to emphasize perverse specialization in my class: countries often harvest a nightmare because their governments decide to defy comparative advantage, which for the Philippines is self-sufficiency in rice.

For an epilogue, I always observe that if left to the private sector, this madness does not arise because private business hates to lose money, its own money. Government bureaucrats, though, lose only other people's money and worse perhaps make a pile for themselves on the side, making perverse specialization common.

Let me end by telling the story of a friend and fellow *BusinessWorld* contributor, Romy Bernardo, who turned 60 last week. Romy's singularly successful career is a parable of genetic jujitsu. Had Romy chosen the tennis or basketball court as his Thermopylae, he would be dirt poor and miserable. But he chose as rapiers what the genetic gods dealt him — abundant IQ and charming wit — and he and we are all the better for it.

Hunger, inequality and saying Grace

November 12, 2014

"THERE IS NO FINER investment for any community than putting milk into babies," is the more famous Winston Churchill's version of Senator Grace Poe's thesis on hunger and child malnutrition.

Senator Grace may have been outdone in verbiage but she was not outdone in moral outrage. And so must we all. "We should let the issue of hunger gnaw at bureaucracy's thick walls or the officialdom's thick hides the way an ulcer lacerates the gut," she urged.

Fifteen million undernourished and malnourished kids do not bode well for the country's future. And they are not just statistics — we behold them every day on the streets of our cities and we are diminished by the sight. Surely we are willing to pay some amount to eradicate that daily brush with diminishment. And we are. But the problem seems so overwhelming that ordinary citizens are hard put to know where to start.

A massive increase in the school feeding program budget of the Department of Education (DepEd) is the best place to start. But it is best that it widens its breadth for the very young where hunger scars are more lasting than for older children. Learning is an effortful activity. Committing ideas in the mind requires milk in the tummy. It is also the best use of tax money. And to reiterate an iron truth from the annals of development, Senator Grace adds: "And this has a long-term negative impact on the development of our human capital. We cannot build the foundation of our future on emaciated bodies who are no longer in school. No nation on Earth can."

Child hunger and poverty are manifestations of a larger structural failure to which Senator Grace also alluded. Massive waste in government spending is one. It would have been nice had she named some monsters of frivolity that, if discontinued, can immediately finance the requirement of an increased feeding program. A radical transformation of the National Food Authority (NFA) into a mere rice price stability organ while letting the importation of rice be done by the private sector will free up a lot of budget space. Inconsistent regulation is another issue.

Nonexistent job creation due to the flight of private capital from the rural and agricultural sectors drives the rural populace to urban destitution and *pagpag*. Attracting private capital back to agriculture by allowing economic-sized farms will help. So will entrenching the rule of law which entices more private investment. The latter has lately been threatened with a body blow: Malacañang intervened in the decision to award the CALAx road project to the bid winner of a transparent and aboveboard auction. This is a violation of elementary rule of law: you set the rule, the rule applies to everyone and you stick by it.

Reminds one of Emperor Frederick the Great of Prussia who established the courts of law in Prussia in its way to becoming a world power. A legend has it that the emperor was kept awake at night by the noise of the nearby mill and offered to purchase the mill from Johann William Gravenitz, the mill owner. But the latter had the temerity to refuse. Threatened the emperor: "Does he not know that I can take the mill away from him by virtue of my royal power without paying one groschen for it?" The miller calmly replied: "Of course, your majesty, your majesty could easily do that, if — begging your pardon — it were not for the Supreme Court in Berlin." The emperor was said to have been so struck that he desisted and instead had carved at the palace gate the words: "There are law courts in Prussia." Having given the court's jurisdiction on such cases, any intervention even by the emperor himself was out of order. That is the rule of law in action. That is true "*matuwid na daan*."

As Senator Grace saw the problem, the government should lead the way in this battle against hunger. As a nation we have chosen the way of the market and God forbid that we go back on that. But again, resorting to Winston Churchill's peerless verbiage: "The inherent vice of capitalism is the unequal sharing of blessings; the inherent virtue of socialism is the equal sharing of miseries."

Markets are great at bringing prosperity; it is not as great at inducing equity. Not just that, but ever-increasing inequity may indeed be the thriving market's traveling companion. That is where the state becomes a crucial player — to keep the market from self-destruction due to ever-increasing inequality. This, by the way, is the now-famous thesis of Thomas Piketty in his celebrated 2014 volume *Capital*.

Finally, wouldn't it be a delicious godsend if Grace makes herself available for the highest office in the land in 2016?

Widodo, the Danes, and lessons from the little match girl

May 25, 2015

HANS CHRISTIAN ANDERSEN'S "The Little Match Girl" is the tale I share with my students to welcome the Christmas break. A little girl, clad in rags, blue with cold, and ravaged by hunger, was hawking matches to passing churchgoers and townspeople on a New Year's Eve. Winter ruled in its near-arctic majesty. The little girl ambled along, one foot unshod, having lost a shoe when sideswiped by a speeding carriage and a little tyke made off with it. She could see and smell the roast from the window in every home. She dared not go home herself because she hadn't sold a match and her father would beat her up if she came home empty-handed. At her wits' end, she started striking the matches which gave her fleeting mirages of love and warmth. On the first day of the year, the townspeople found her cold and dead.

How such a tableau of utter wretchedness was painted by a forebear of a nation synonymous with order, reverence for rules and social compassion is a source of fascination. Wrote G. Keillor for *National Geographic* about Danes in 1998: "People stand on the curb and wait for the red light to change, even if it's 2 a.m., and there's not a car in sight. The red light is part of the system: You cross against it and you are showing disdain for your countrymen." To parody a famous quote inspired by that other Danish original, existentialism, "You and the rules are one."

How could the townspeople — forebears of this remarkable community — be so blind to the fate of the little girl? Were they of the same DNA as the Danes of today? I found a hint in the same account by G. Keillor: "I feel sheepish waiting for the red light, so I cross, and several times I discovered that Danish drivers don't slow down for jaywalkers. They don't see you in the crosswalk because you're not supposed to be there." The townspeople could not see the tragedy unfolding in their midst because it was an utter incongruity. We do not see with our eyes;

we see with our cerebral cortex. Not being part of the nexus of cortical expectations, the little girl and her silent scream were invisible. But Denmark today owes much to this selective blindness.

Denmark in the 18th century was poor and survival in the harsh Norse land was precarious. What stood between extinction and the community was order and cooperation — everyone doing his/her part in the grand survival project. Adults work together like ants in the summer to store food and, yes, matches and fuelwood for the family in winter. The little match girl's father defied this order; he opted to be a guitar-lugging grasshopper, a wastrel who forced his little girl to earn the family's provenance. He and his strain must be neutralized. The little girl, bearer of his strain, sadly had to go too. And Hans Christian Andersen was not about to slight this covenant by giving the little girl a fairy tale out. Verily, the sin of the parent visited on the child. But biology at the edge has no regard for contemporary sensitivity.

Nor did the Danes stop at blindsightedness as countermeasure. For most of its modern history, Denmark, like most other European nations, employed a royal government executioner called a *skarpretter* (headsman) to chop the heads off sowers of disorder. The death penalty was finally abolished only in 1978 when affluence had become commonplace. The result is that Denmark today is a highly ordered society of rule-reverent citizens, poised like a ferromagnet's coherent electron spins, to accomplish great things.

And Joko Widodo? Over the deafening howl of protest from the West, the Indonesian President ordered on April 30 the execution of eight convicted drug traffickers. "This is our legal sovereignty," he asserted defiantly. "Don't ask me again."

The spin favored in the West is reflected by Elisabeth Pisani, writing in *The New Yorker*: "Widodo, however, is far too weak politically to have hesitated over these issues. He desperately needed to signal his strength at home, and he could most easily do that through the crack of the firing squad. He doesn't give a fig how it sounds to the rest of the world." If you don't bow to the West's bidding, you are weak, if not in the head then in the polls. Thankfully, Widodo has Indonesia's good in mind.

Indonesia is a poor economy on the rise. Its most important asset is a people pulling together in the same direction. It cannot afford its social fabric being rent by foreign subversives, ISIS or drug runners. The enforcement of its laws — however harsh — is, at this stage, necessary to erect the rule of law without which catch-up sputters as it does in the Philippines. Evolutionary biology or economics tells us that a Denmark-like cooperative polity cannot emerge on the soil of pervasive forgiveness of malfeasance. The adoption by less developed countries of the affluent West's ethical standards increasingly privileging individual over community rights may actually hinder their capacity for social coherence and economic catch-up. The acclaimed — albeit controversial — volume *Kicking Away the Ladder* argues that the now affluent West has anathemized economic paths which they themselves took when they were poor — thus "kicking the ladder" for late-comers. The same may be truer of ethical and even social standards.

I attended a National Academy of Science and Technology roundtable on the health hazards of using antibiotics in meat production while writing this. Something seemed oddly missing amid the technical analyses: the standards used were largely OECD where the problem has long ago moved to overdose and obesity. Most Filipinos outside Dasmariñas Village are faced not with nutritional overdose but with massive nutritional deficiency. At the moment, our children will be better served with "more" protein than with "less but Brussels-compliant" protein.

Widodo has weighed in on this fateful debate. I salute him and am proud to be of the same race.

Of CALAx, industrial policy and the nature of the state

June 29, 2015

THE CAVITE LAGUNA EXPRESSWAY (CALAx) is a 47-km. eight-interchange tollway project to link the South Luzon Expressway and the Cavite Expressway. CALAx is to be procured under the government's public-private partnership program.

The first CALAx auction in June 2014 — won by Team Orion with a bid of ₱11.66 billion in premium payment — was scrapped by the government when a technicality disqualified contender, San Miguel Corporation-affiliated Optimal Infrastructure, opened its bid document to the public, revealing a ₱20.1-billion bid. President Aquino — responding to the revelation — ordered a rebid with bid floor of ₱20.1 billion.

This produced a howl because the government seemed to have reneged on an implicit promise to honor an aboveboard auction. The government's response was that the disqualification was too harsh for too flimsy an infraction over the bid security and it cannot, in conscience, leave ₱8 billion on the table. In the rebid held on May 26 this year, Metro Pacific Investments Corporation won with a bid of ₱27.3 billion.

The spirited debate provoked by CALAx can be decomposed into two issues: (1) the correctness — or otherwise — of the President's decision to scrap the result of the first auction; and (2) the correctness — or otherwise — of using the highest premium payment to the government instead of the lowest tariff as the bid parameter in the auction. This piece is only about the second issue.

The PNoy government trumpeted the revenue bonanza for the state treasury as evidence of the correctness of the President's rebid decision and a triumph for the Filipino people. And who in PNoy's stead wouldn't? This may also have been instrumental in the rebound of

PNoy's approval rating in the May 30 to June 5 survey. But critics insist that this premium payment has to come from somewhere — the higher toll fee paid by users of the facility. The winner will just be acting as a tax farmer for the government. If usage is much reduced due to the higher tariff, the social return to the public investment will be lower and this could trigger future renegotiation. The point is then made that the bid parameter should have been the lowest toll charge rather than highest premium payment to the government.

There is here a real conflict of world views: the lowest toll fee option maximizes the benefit (consumer's surplus) for actual local users of the asset but which the many more non-users — who nevertheless also contribute to the subsidy — do not share. Many infrastructure projects cannot be financed fully by user-fee financing alone and require a subsidy from the state treasury called the "viability gap financing" (VGF) to be built at all by the private sector. The state would like to minimize this subsidy for projects in specific localities so it will have more left to finance projects in other localities.

This squares well with the ideal state as the unbiased mediator among conflicting claims by different regions on limited resources. Lowest toll fee auction reduces the social friction arising from the disproportionate sharing of project cost and benefits. This is ideal behavior for the state. Most projects are deemed to require a positive VGF (the VGF for CALAx was estimated to be +₱6.5 billion).

But sometimes aggressive bidding forces the VGF to turn negative, becoming a premium payment to the state worth a whopping ₱27.3 billion in the case of CALAx. Non-users of the facility will now in theory benefit from CALAx, as infrastructure projects in their localities requiring positive VGFs will now be afforded. A first-best outcome in the flesh.

But the controversy persists. One headline read: "Government wins, public loses in CALAx rebid." Apart from the higher tolls charged to users, critics are also well aware of weak governance in the Philippines. At the heart of the weak state is the inability to credibly commit to the upright use of resources. There is a fear borne out of past experience that such a bonanza can end up being wasted — or worse, stolen! If the weak state perception is correct, what appeared "first-best" at first blush could turn out as nth-best. The "lowest-tariff" auction, in contrast, leaves much less room for fiscal shenanigans. First-best under strong governance becomes nth-best under weak governance! Truly a case of Robert Burns' "The best laid schemes o' mice an' men gang aft agley an' lea'e us nought but grief an' pain for promised joy."

Neglect of the nature of the state is a serious frailty in the choice of policy instrument and indeed in economics in general. In a forum on industrial policy (IP) organized by Action for Economic Reform (AER), the recurring theme from the speakers was that industrial development has retreated because we do not have an industrial policy. As a reactor, I observed that the country has in fact an industrial policy: the private sector is the engine of growth, with the state acting as enabler by providing the required infrastructure. This economizes on limited government capacity. That the outcome has fallen short so far is because the state hasn't delivered even its limited share — a marker of weak states. One can shove a more ambitious IP, perhaps of the Japanese MITI variety requiring the picking of winners, upon a weak state and the result could be worse because such IPs will require the nonexistent Japanese standard of governance. Dictator Ferdinand Marcos's bright boys had an IP which left us "nought but grief an' pain." Whether the country has or hasn't an IP is not the right question; whether or not its IP is smart — one which adequately accounts for the nature of the state — is.

I would like to thank the spirited debaters in the Foundation for Economic Freedom e-group managed by fellow contributor Romeo Bernardo for insights. Likewise, I thank AER for bringing IP to open debate.

Dado, flight of tradables and innovation

April 11, 2016

IN ONE WORKSHOP called FIL 2040, Friday, 8 April, organized to ruminate over possible futures for the Philippines which has been mired in the last 40 years, as it were, on south side of mediocrity, I was gladly surprised that Diosdado 'Dado' Banatao was a resource person. Dado is a rare *Pinoy* who made it big in Silicon Valley, way more prestigious than in the pugilist's ring in Las Vegas. He was coming to us during the workshop via video feed all the way from California. The *soup du jour* was how to engineer in the next 25 years a breakout of the long-term secular decline that pushed the Philippines to the bottom of the Asian league table.

Dado had many interesting points but three in particular stuck with me. The first is that he asked Michael Spence, an Economics Nobel Memorial Prize winner and a fellow member of one of the many boards that Dado graces, how the few countries that made it to OECD status in fact did it. Spence's answer was succinct: "Inclusive growth." That is a call familiar to the gathered luminaries in the workshop but the timing of its recall cannot be more bang on. Just announced in the broadsheets of the day was that Tessie Sy and Robina Gokongwei had made it to the *Forbes* list of Asia's most powerful women. They represent both wealth and power. The controversy of the day also just happens to be the Kidapawan incident where farmers or so-called farmers clashed with police resulting in two farmer deaths and two policemen in coma — the undercurrent being that poverty and hunger consequent to the El Niño drought was driving people to desperate and even illegal measures such as blocking a highway. The night before the workshop in a BBC interview, Thomas Piketty of the *Capital* fame was saying that inequality breeds social unrest which stops growth, reaffirming what Berg and Ostry (2011) had shown that income inequality shortens episodes of growth. Fair sharing of the harvest or in the Kidapawan's case, of the no-harvest, ensures that growth is sustained. In the Philippines, sustained rapid growth of decadal variety is still an aspiration. That poverty incidence still remains high in the Philippines should surprise no one.

The second point is that many large reputable companies — even those that had abided with us for some time — had left the Philippines. Such, for example, is Intel, the first semiconductor company to locate in the Philippines in 1974, which relocated to Malaysia in 2010. No wonder, our share of direct foreign investment is dismally low what with such news as Intel exit, the PIATCO fiasco, and the Tampakan Gold and Copper Mine fiasco which aborted 2,000 high-paying stable jobs. The flight of foreign capital is happening in the traded goods sector.

Dado's third is that, on the innovation league table, we are fast headed for the dregs in the region. The second and third points are systematically related. Innovation in J. Schumpeter's view is the engine of sustained growth. But the incentive to innovate is in A. Smith's view a function of the size of the market. The returns to innovation is pittance in narrow domestic markets. Thus, generally, innovation is more rapid in firms whose market is global, implying that these firms are in the traded goods sector especially the merchandise export sector. But the Philippine GDP is 57% services sector which sell to the narrow domestic markets prone to rapid saturation.

Manufacturing is just around 20% of GDP. Plus, there is the Baumol Effect which states that the services sector as incubator of innovation is a comparative midget. Putting it colorfully, you don't expect innovation in barbershops! Thus, the dearth of innovation and the flight of tradable-sector foreign investment are slices of the same loaf: a policy regime that punishes investment in the traded goods sector. This policy regime includes the land policy (CARP) which continues to drive private capital out of agriculture and agri-industrial concerns. It also includes an exchange-rate regime that fails, in D. Rodrik's weak institutions view, to level the playing field for manufacturing and agriculture and instead makes smuggling of agricultural products (rice, pork, onions and garlic of recent controversy) very profitable. Choking the tradable goods sector that generates the durable and high-paying jobs chokes poverty reduction.

More apropos, wealth sharing in the services sector where capital gains is king is inherently more unequal than in the manufacturing sector where value-added is king.

For the long-term performance of the Philippine economy I prefer the label development progeria: the industrial share dynamics in a low-income economy that mimics the industrial share dynamics of high-income mature economies. In high-income mature economies, the services sector share rapidly forges ahead while the manufacturing sector retreats dictated by logic of the factor-price movements and the shift of consumption patterns consequent of high incomes. Economic growth among these slows down considerably. Development progeriacs experience a rapid growth of the services sector share and the retreat of the manufacturing share but without the high incomes. What's more, as in affluent OECD countries, growth among progeriacs is slow and convergence is blocked. Priority one: stop choking the traded goods sector!

How to give manufacturing a breathing space? Daway and Fabella (2016)[1] explored this question using cross-country data for countries with per capita incomes less than $10,000 and found that an exchange rate policy favoring the traded goods sector, governance quality, and the investment rate (GFCF/GDP) are strong positive correlates of the manufacturing share while the growth and the capacity of the services to absorb labor are strong negative correlates. If we are to break the cruel chains of development progeria, we shall have to unshackle manufacturing and agriculture.

1 "Development Progeria: The Role of Institutions and the Exchange Rate" is available upon request at ssdaway@econ.upd.edu.ph

Math Olympiad gold medals and brain parity

November 28, 2016

A NATION'S SENSE OF SELF, like everything else in the universe, is subject to the Second Law of Thermodynamics: its natural tendency is to dissipate into heat death unless it is sustained continuously by a flow of energy. Our sense of national self-worth comes from comparative successes in contests pitting our group against other groups in the global arena. It can come from commercial success (Singapore), from engineering success (Three Gorges Dam for China or Shinkansen for the Japanese), from technological success (iPhone 7 for Americans, orbiting satellite for India) or from scientific success (Nobel Prizes and Fields Medals for Israelis). These are facts on the ground that transcend argument and establish brain parity if not prowess. The success can also be military: the world never forgot the Greeks at Thermopylae; nor the Vietnamese beating both the French and the Americans in the last century. And finally, there are facts that establish brawn parity: Usain Bolt, Olympic golds and Manny Pacquiao's belts. Until and unless established by direct or derivative facts, the parity of a human group vis-à-vis other groups, though universally subscribed to, always remains a hypothesis. That is why Olympic golds and the Davis Cup trophies inspire such frenzy.

Jose Rizal was a believer in the universal hypothesis of brain parity. When he wrote *La Indolencia de los Filipinos*, his sharpest point was that indolence was a strategic, thus, a cerebral, response to the unjust sociopolitical milieu rather than a genetic straightjacket. The difference is massive: the first, being phenotypic, is ours to change; the second, being genotypic, is ours to carry to our graves. In the right nurturing garden, *los Indios* too will rise and conquer. Providing the nurturing garden is our responsibility.

The demarcation between the cerebral and the physical can be politically disparaged but never dismissed. I recall that while a grad student at Yale, the prohibitive underdog, Yale University, beat the perennial powerhouse, Air Force Academy, in regional conference football match. Some pundits in a fit of snobbery alluded to a sinister cloud hovering over the unprecedented victory: Yale is trading its cerebral birthright for a mess of brawn pottage! Comments of the genre also surfaced when the Paras-Magsanoc-powered UP bagged for the first time the UAAP basketball championship in the 1980s. The naughty lament of my friend and former NEDA honcho Manny Esguerra on the solitary recent win of UP in the UAAP basketball issue from the same provenance: "A brilliant record soiled by one lousy win!"

Even occasional suggestions of brain parity can be heartwarming. I particularly savored Eugene Torre's crashing the top six in the World Candidates Chess Championship in the 1980s. My friends at Yale, mostly Israelis, were especially felicitous to me as Filipino on Torre's feat. Chess, the game of kings and brainards, appeals and correctly so to those who have less physical gifts. You know Yale Jews? Acrimonious debates over the latest scientific breakthroughs get light-heartenend with Allenesque self-deprecators. "Ever heard of a Jewish jock?" or "Who's your shrink?" As if to say, we cannot dunk the hoop and, what's more, there is an added price to pay for being Kurt Gödel.

Indeed the price to pay for abiding too long in cerebral stratosphere transcends physical inferiority. Gödel discovered the celebrated Incompleteness Theorem which placed even Mathematics in the realm of the great perhaps. That pearl of great prize established him as a supernova in the cerebral firmament. But he died of self-starvation because he feared everyone was out to poison him. Notwithstanding and in the grand scheme of the universe, wisdom resides with celebrating Gödel ahead of King Lebron.

Lately, we celebrated Hidilyn Diaz for winning an Olympic silver medal in a discipline as brawny as brawny gets. She got a house, a hefty monetary reward, and numerous TV spots besides a presidential audience. She was nationally iconized because silver towered over everything on arid Olympic "brawnscape."

By contrast, on July 14, 2016, it rained cats and dogs for Filipinos in "brainscape." It was announced that two *Pinoy* high schoolers — Farrell Eldrian Wu of MGC New Life Christian Academy and Kyle Patrick Dulay of the Philippine Science High School, bagged one gold medal each in the recently concluded 57th International Mathematical Olympiad (IMO) 2016 in Hong Kong. Two other high schoolers, Clyde Wesley Ang and Albert John Patupat, bagged a silver medal each. Shaquille Wyan Que and Vince Jan Torres each won an Honorable Mention award. The best we did in the past was two silvers in 2015. A gold medal in the Math Olympiad is a stuff of dreams. Two golds and two silvers — are you kidding! Our medal haul brought us to Rank 17 out of 109 participating countries all over the world, ranking higher than Australia, Germany, France, and other countries who have performed strongly in past IMOs such as Romania, Belarus, and Iran. For the denizens of "thinkspace," this is big, bigger by far than if Pacquiao beat Mayweather. These Filipino high schoolers, the repository of our future, and their support team led by Richard B. Eden, Louie John Vallejo, and Ernie Lope, have etched the Filipinos' brain parity in stone. While this is not yet a Terence Tao or a Grigori Perelman moment, both started as gold medalists in the IMO.

But then a whimper! After the perfunctory reportage and a quiet visit with the Senate and a Senate resolution of commendation, there was hardly a ripple on the national stage. No audience with the president, no monetary reward, no posters, no TV spots! The contrast with the weightlifting silver accolade is troubling. And yet little in our past was more affirmative of our higher Filipino-ness! Sure, we are still poor and massive snarls still beset our commutes, but now "we know" we have the innate mojo to lick them. For Mathematics is like the New York City of song: "... if you can make it there you can make it anywhere."

It is said that our icons define us. If our icons are all brawn-bound, we can forget about soaring the skies. To grow wings, we have to start building pantheons to our brain heroes. The year 2016 with the IMO golds is where we start.

Our 2016 IMO laurels must now be recounted to every grade- and high-schooler; they must be assured that romancing Euclid is not only cool but will be amply rewarded by a grateful nation. We owe it to ourselves to provide the nurturing garden. This is our sacred duty.

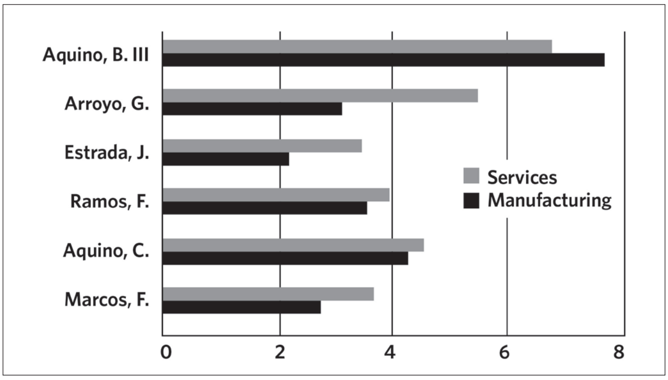
Manufacturing, quality of growth, and poverty reduction

January 16, 2017

THE ECONOMIC CLUSTER of the Duterte watch has been making noises about the revival of manufacturing and bringing its poverty-reducing bonanza to the regions. That is unequivocably a correct strategy. The recent past points to its validity. That recent past is the poverty reduction performance of the Aquino watch. We compared the comparative performance of manufacturing and services of the different past presidents of the Republic and noted a peculiarity.

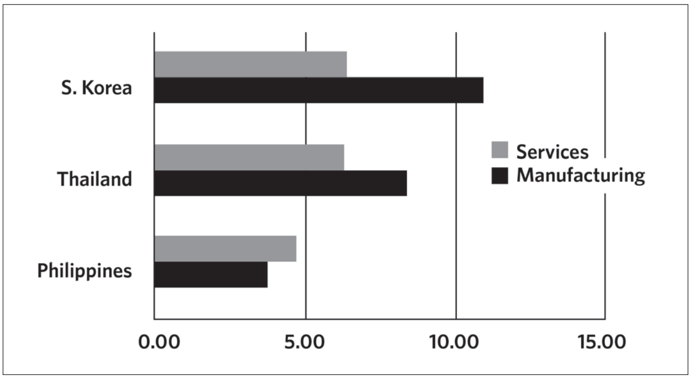
Among all the past presidents since the 1970s, only in Aquino Jr.'s watch did manufacturing manage to grow faster than services (see Figure 1). Manufacturing growing faster than services is what we call "quality growth." To put this in proper perspective, we compared the average annual growth rate (AAGR) of services and manufacturing for the four decades from 1973 to 2016 for three countries, Philippines, Thailand, and South Korea (see Figure 2).

Figure 1. Average annual growth rates of manufacturing and services sectors under the terms of various Philippine presidents (%)



Source of basic data: Philippine Statistics Authority

Figure 2. Average annual growth rates of manufacturing and service sectors in three Asian countries, 1973-2016 (%)



Source of basic data: World Bank

What comes out in sharp relief is that in South Korea and Thailand, countries that left the Philippines to eat their dust, manufacturing growth outstripped services growth by a mile in those four decades; the opposite was true of the Philippines. The poverty outcome is no less dramatic! By 2012, poverty incidence in South Korea was 5% while in Thailand it was 7.8% compared with 27% in the Philippines. Quality growth is as potent as quantity growth for poverty reduction!

The Philippines' growth trajectory is what we have called development progeria elsewhere (Fabella, 2013[1]; Daway and Fabella, 2015[2]): the premature advance and dominance of the services sector in a low-income country. Development progeria produces slow economic growth, persistent poverty, and low investment rate. In Ducanes et al. (2016)[3], we show that manufacturing dominates other large sectors in terms of average wage and stability of employment. More telling, manufacturing's new hires include a higher fraction from the poorest quintile of households and from the least-educated. The message: manufacturing and poverty reduction are fellow travelers in the development landscape.

1 Fabella,R. [2013] "Development progeria: malady and remedy," *Transactions* 35 (1): 191-192

2 Daway, S. and R. Fabella. [2015] "Development progeria: the role of institutions and the exchange rate," *Philippine Review of Economics* 52 (2): 84-99

3 Ducanes, G., S. Daway, M. Ravago, and R. Fabella. [Forthcoming] "Blameless in stratosphere: CO2 emission reduction, manufacturing growth and poverty reduction in the Philippines," UP School of Economics Discussion Paper

The Aquino watch, as wimpy as it seems now in comparison to its immediate fire-and-brimstone successor, bucked the stubborn tide of progeria as no president has done before, not the much-admired Ramos administration, not the martial law-muscled Marcos watch. Was it just luck or did his early gains in governance clear some poisons in the underbrush? Clearly six years is hardly enough to erase all the blights of 40 years of development progeria. But it is a mighty good start.

How about the poverty reduction record of the Aquino watch?

Poverty incidence hardly budged from 2010 to 2015; our conjecture on the manufacturing-poverty reduction nexus seemed a nonstarter.

Nonetheless, we know that long time lags govern the relationship between the rise in manufacturing share and poverty reduction. Then in October 2016, glad tidings from the Philippine Statistical Authority: poverty incidence dropped dramatically from 25.2% in 2012 to 21.6% in 2015! The manufacturing-poverty reduction nexus may not be too far off after all! A startling development that the Duterte administration would do well to match, if not exceed.

If Duterte's watch manages to maintain the pushback on progeria began by Aquino, poverty incidence will further wane. If, God forbid, Duterte's watch returns the Philippines back to the embrace of development progeria, a drug-free Philippines will only be a tad, but not much better.

After all, as one wit quipped in the run-up to the May election: "There is no drug problem in North Korea; but there is poverty and starvation."

Duterte's economic team displays a firm grasp of the economic problem facing the country. The proposed tax reform program is compelling.

Who can argue against raising the infrastructure spending to 8% of GDP? Who can go against higher tax on soft drinks and recouping foregone tax revenue from oil products? Who can argue against bringing manufacturing jobs into the regions? Who can argue against raising the government capital outlay to 5%-7%? The program deserves the support of every Filipino, Dutertards or not.

But all this can be blindsided if political capital is spread too thin.

To work, the program must draw in private investment, both local and foreign, into the regions. There's the huge devil in the detail! The regional waters are poisoned: the most important economic sectors in the regions — namely agriculture, industrial farming, mining and forestry — are virtually "no-go zones" for private capital. Banks would rather pay the penalty (about ₱1.5 billion) for non-compliance with Agri-Agra loan program than lend because qualified farmer borrowers are slim pickings. Excessive farmland fragmentation and noneconomic farm sizes are behind this.

PRC and Taiwan, the erstwhile models of land reform, have now moved towards farm consolidation (see Fabella, "The Liuzhuan System")[4]. The government seems bent on CSR (corporate social responsibility)-type access to credit rather than on a sustainable market-type access. Those who dare dip into the regional waters, as did the San Miguel Foods Inc. with the industrial swinery project in Sumilao, Bukidnon, run into a gamut of legal hurdles. No wonder, private capital has been fleeing rather than flocking the regions. The regions need to be first cleared of these toxins before an investor pivot called for by the program. But the toxins for investors are honey for the Maoist branch of the Duterte government.

Deng Xiaoping was chased into exile by the Maoists for trying to clear the farm sector of state-mandated landmines to free enterprise and markets like collective farming. Maoists will insist on artificial life support for their cherished but clinically dead ideological horse. The market is anathema to Maoists. Only after Deng Xiaoping finally routed the Maoists in the 1990s did China firmly turn the corner towards quality economic growth and poverty reduction.

The question of the sphinx: Will Duterte emerge as a Deng Xiaoping who routed the Maoists and set the markets free? Or a Mao Zedong who routed the market in route to shared poverty?

---

4 Fabella, Raul V. "Liuzhuan: small steps to farm efficiency," *BusinessWorld* (December 16, 2014) Available at: http://bit.ly/farmefficiency

The punisher's dilemma: Helicopter drop or exoneration by due process

February 6, 2017

I CONFESS TO having been elated with the pivot in Digong's anti-drug war if temporary. The pursuit and neutralization (EJK as it is understood here) of drug users along with a sprinkling of traffickers (pushers and drug lords) was stayed to give way to the intended cleansing of the PNP and NBI of rogue cops and scalawags who connive with and abet traffickers. This pivot is clearly a step in the right direction and should have been the first step rather than an afterthought. My friends and co-contributors, Romy Bernardo, Noel de Dios, and Toti Chikiamco were less sanguine than me on the depth of the resolve. I cannot blame them.

A day after the pivot announcement, PNP Head Gen. Ronald "Bato" dela Rosa threw cold water on my elation. After the fire and brimstone rhetoric, he ordered, as the account went, the seven Angeles city PNP policemen implicated in the abduction and extortion of three Korean tourists to do pushups! Pushups? The treatment that cadets get for dirty fingernails? Bato and pushups don't even belong in the same sentence! And after EJK for drug addicts too! Truth indeed is sometimes stranger than fiction in the Philippines.

Forewarnings abounded.

Weren't we apprised that chief suspect Ricky Sta. Isabel in the Jee kidnap and murder was a re-instatee to PNP after being suspended from service? That three QC cops in an extortion case are being reassigned in February to ARMM; that in December 2016, three police officers of the Tactical Motorized Unit accused of extorting a million pesos were also sent to ARMM; that in November 2016 four officers tagged in the extortion complaint case were reassigned to ARMM? Re-instatement and reassignment seem to define payback for crimes in PNP and NBI.

During the Senate hearing on the Jee case, the NBI director vehemently argued that being separated from service was tantamount to a death sentence because the agent loses his job and income. He was either lying through his teeth or is a complete nincompoop and should be fired.

Happily, four NBI bigwigs have since been relieved of their positions. For re-instatement with full backpay is a well-traveled detour in these agencies. Rogue members are accorded due process PNP-NBI style: (i) a suit is filed against a rogue cop; with his accumulated millions (₱20 million as alleged of Sta. Isabel) the rogue cop mounts a legal or extra legal defense (including intimidation and/or neutralization of potential witnesses and their families; bribery and/or threats to the presiding judge); being *absuelto*, the rogue cop applies for and is reinstated by the NBI or PNP. Having beaten the system and learning how easy, he repeats the crime with increasing impunity. Result: the kidnapping and murder of Jee and who knows how many others in Camp Crame. (ii) reassignment to ARMM: with his ₱20-million wealth, he either (a) resigns from service and sues the agency for abuse of authority, gets a favorable ruling and is reinstated with backpay; (b) if with unfavorable ruling, he insinuates himself as intelligence asset, thus, nameless and supported by non-audited intelligence fund, to his old or another rogue agency; (c) accepts the ARMM reassignment and restarts his kidnapping/extorting ways there. With insider roguery going unpunished, is it any wonder that enforcement has gone rogue?

Still, I cling to naive hope.

A step in the right direction is precious even if it is only the first in a thousand. How do we ensure the next 999 steps are "right"? More levers of accountability must be installed. In the annals of *quis custodes custodiet*? one fact stands out: without adequate punishment for knavery by guardians of the law, the guardians will turn predators. Let the penalty for rascals among members of the enforcement fraternity be ten, nay, a hundred times that imposed on ordinary citizens.

The mention of a "helicopter drop" for Dumlao and Sta. Isabel was roundly applauded in staid gatherings I happened upon. No other punishment seems appropriate. But alas the rogues will instead be accorded "due process Philippine-style" which they have learned long ago to beat. Hope ebbs.

The stink revealed in the Jee case is symptomatic of the necrosis in the Philippine criminal justice system as a whole. "Due process Philippine-style" and the inability to punish bigwigs is the anchor of the massive approval rating of Digong "The Punisher." We are aware that big-time traffickers and rapists in New Bilibid penitentiary have transformed the prison into a luxury hotel complete with furlough and escort services on demand.

The Supreme Court, yes the Supreme Court, bent backwards and allowed Al Argosino to take his oath in 1995 after he was convicted in connection with the death of law student Raul Camaligan because he (Argosino) was "not inherently of bad moral fiber." Now BI Commissioner Argosino is videotaped with a bagful of alleged bribery money!

It is yet another example of the general observation that hard measures, whether criminal or economic, unsupported by strong institutions, will turn gold into muck. In the Jee case, the rogue elements used the hard war on drugs to cover an orgy of extortion and murder.

What the skeptics and optimists alike would like to see in this pivot is the installation of strong and lasting levers of accountability. The helicopter drop or its equivalent will help. But without permanent measures that excise the necrotic elements before they wreak havoc, the problem quickly returns. We cannot waste this opportunity for stronger institutions of enforcement.

Digong faces "The Punisher's Dilemma": subjecting the Jee murder enforcers to "due process Philippine-style" is tantamount to exoneration — these rogues have and will again beat the system; they will deflate "Digong the Punisher" into "Digong the Abettor"; reassigning the scoundrels to the afterlife (a helicopter drop) confirms Digong "The Punisher" in the public's mind but will subject him to the withering jeremiads from Amnesty International and the human rights advocates. It is not easy to be Digong nowadays.

Which way will Duterte turn?

April 3, 2017

POGROM IS EUROPE'S infamous contribution to the lexicon of barbarism. The Jewish pogroms in Europe lasting up to the mid-20th century were state-perpetrated or state-sanctioned spectacles of wanton violence where mostly crazed and drunken anti-Semitic rabbles descend into Jewish ghettoes to kill or maim whoever they chance upon. They wreaked havoc and destruction alright but if they hoped to inflict vengeance on their real or imagined tormentor, the hated and ruthless Shylock, they were out of their depths. For Shylock and the other ghetto deep pockets, dining with dukes and barons (who wanted to borrow money) in the latter's chateau, were untouchable to the drunken rabble. Their victims were mostly winos, homeless, wastrels, petty shopkeepers, and prostitutes who made the dark alleys their homes. Many of these would be, like the pogromers themselves, among Shylock's tormentees. The pogroms, some commentators would later claim controversially, cleansed the Ashkenazi (European Jewish) gene pool of weaker strains; that the remaining stronger strains produced scientists (Einsteins), bankers (De Rothschilds), and musicians (Mendelssohns). One wonders whether there is a Mendellian twist to the Duterte drug war.

In July 2016, we wrote the piece "The Duterte-Dominguez Disconnect," identifying possible fault lines within the Duterte Administration. Then, the ten-point program was our only clue to the economic direction of the Duterte administration. It was a vision to take heart by. The framers fully intended to plug the known frailties of and outdo the Aquino III watch in growth and inclusion. For despite the anemia in investment, the economy bequeathed by Aquino was surprisingly buoyant. Aquino III's watch accomplished what no other presidential watch in history could — quality growth — manufacturing grew faster than the services sector.[1]

This normally augurs well for poverty reduction. Some confirmation of this manufacturing-poverty reduction nexus emerged with the announcement in November 2016 by the Philippine Statistics Authority: poverty incidence drastically fell from 26.2% to 21.6% in the past three years! Nonetheless, the paper red-flagged a disconnect: "What should give us pause... is that... the 10-point program may just be a Dominguez-Economic Cluster (DEC) credo rather than a Duterte credo." Instead of markers of ownership, that is, building coalitions behind the economic program, the President-elect displayed a penchant for insulting and threatening those who balked at his notion of the rule of law, a notion that smelled and felt like cemetery peace.

But the frontal threat to the 10-point program, we thought, would come from Duterte's embrace of Maoists who were given charge of three crucial Cabinet positions.

Undue process

What has become clear since then is President Duterte's follow-through on two core beliefs: first, "a good pusher is a dead pusher," and second, "every user is also a pusher." Marry these to his boundless contempt for "due process Philippine-style," and the offspring is undue process. Due process Philippine-style means criminals with money are, like Shylock, virtually untouchable: they buy the police and the judges; they kill or maim witnesses. Seeking redress in undue process (EKJ or DDS) is par for the course on the scorched-earth of due process.

The war on drugs can take two paths (see e.g., De Dios, January 29, 2017): either drain the swamp of demand or squeeze the spigots of supply. But the spigots (drug lords) are too slippery? They either fly to other climes or bend due process in their favor; so draining the swamp of demand (users) carries the brunt of the boast to turn Manila Bay red. Unfortunately, these are, as Duterte himself admitted lately, mostly the very poorest, mostly the victims of the drug trade — the people who cannot make a joke of due process.

1 See, e.g., Fabella, R. "Manufacturing, Quality of Growth, and Poverty Reduction" page 279 of this book

Pushed into near oblivion is the authentic rule of law challenge: to start to mend the bankrupt due process — say, by putting erring judges and enforcement scalawags under a Damoclean sword and occasionally letting it drop (say from a helicopter!). If you must have undue process (some will argue its interim necessity just as the occasional prairie fire renews the savannah), its axes must fall on the most guilty and not on the victims. If compliant with the Magsaysay doctrine (rephrased), viz., "Those who have more in due process should have less in undue process," undue process may excite less abhorrence for the same level of bloodletting. The Espinosa *fil* and the Supt. Marcos syndicate, untouchable by due process Philippine-style, should be first in firing line of undue process.

A solid economic program

The 10-point agenda has now morphed into the tax reform and spending program proposed by the economic cluster — it is bold and balanced. Who can argue against raising the infrastructure spending to 8% of GDP? Who can argue against bringing manufacturing jobs into the regions? Great harvest is promised here.

But the seeding and the weeding have to be paid for. That is where the pushback starts. To date, the tailwind coming from President Duterte feels more like a headwind. Nibbled at its revenue core, the program risks being like 1996 Comprehensive Tax Reform Program — a revenue-loser. Without financing, the program is dead.

The question of the moment is: Will Duterte ever own the program?[2]

There is a clash of China-inspired world views in the Cabinet: one is Maoism (shared poverty), the other is Dengism (no free lunch). Duterte's reluctance may be a nod towards Maoist friends.

Between Mao Zedong and Deng Xiaoping

Duterte seems fascinated with China and who can blame him. China has pulled 600 million people out of poverty. It is an economic miracle thrice over. But who can claim credit?

---

2 See Bernardo, R., "Dominguez's Tax Reform?" (Available at: http://bit.ly/Duterteown) and Chanco, Boo, "Duterte's Political Will" (Available at: http://bit.ly/Dutertewill)

Mao Zedong shackled the market and managed only "inclusive poverty"; Deng Xiaoping by contrast unleashed the market, graduated 600 million out of poverty and made China the economic miracle we envy and fear. The Maoist anti-market dogma will wreck the market-based plan of the economic cluster.

Peter Wallace has called as "idiocy" the plan of DAR now under the sway of Maoism to break up the highly successful Marsman Estate Plantation, Inc. (MEPI) in Mindanao and a template for our agricultural future.[3] Amen. Sounds familiar? Maoists hounded Deng Xiaoping as capitalist roader and sent him into exile because he let farmers play the market and applauded when they became affluent. Allergy to affluence and the market is a congenital Maoist malady.

The question of the ages: Will Duterte turn out to be a Deng Xiaoping steadfast behind the market and affluence, or will he turn out to be a Mao Zedong steadfast behind shared poverty?

---

3 Available at: http://bit.ly/wallacep

Conglomerates and inclusion

May 15, 2017

ONE UNMISTAKABLE REALITY of the Philippine economic landscape is the large and growing footprint of conglomerate businesses. Almost every market niche sports two, three, or more competitors connected with some conglomerates. Whether it is banking, real estate, retail and supermarket trade, food service, broadcasting and media, power generation, energy, infrastructure — you name it, conglomerates are in it. Is conglomerate dominance to be feared? No, on the contrary. Firstly, conglomerates are large because economic size is a trait selected for long-term survival especially in weak governance environment. Smallness is a statistical death sentence. If Lapanday Foods Corp. in Davao was puny and undiversified, it would have been put out of business by the NPA attack. As it is, Lapanday jobs in the thousands survive the attack; children of families dependent on those jobs will continue to eat and go to school.

In weak governance environment, legitimate businesses are forced to resort to what Nobel Laureate Oliver Williamson calls "private ordering" to supplement weak "public ordering." Conglomerates can mount defensive ramparts that SMEs cannot afford — predatory syndicates in government organs (BIR and customs, say) face a phalanx of high-priced specialized lawyers and accountants they can't intimidate to cough up (which explains why it was very hard to recruit BIR insiders for the large taxpayers unit); conglomerates can bankroll the election of lawmakers or governors to reduce uncertainty from predatory rule changes (the infamous "ACDC"); they can maintain private armed sentries (blue guards in Lapanday's ranch killed two NPA thugs) to repel banditry. The NPA called the Lapanday attack "revolutionary punishment" but non-Marines know it as "revolutionary tax."

Naturally, such defensive ramparts, once in place, can also be trained to prey on others and/or resist reform. These strategies are well-documented in the development episodes of other countries, such as the Gilded Age of the USA (1870-1900) when the West was still "wild." The railroad companies and banks bankrolled the private posses that finally killed off the Jesse James and other gangs. Despite public sentiment for the small guy, it was the railways that won and enriched the West.

Conglomerates in small emerging markets are different from their large market counterparts. In the latter, firms can grow large staying in their original niches (Walmart in retail merchandising; Bank of America in banking; Goldman Sachs in finance). In small markets like the Philippines, conglomerates attain size by competing in many markets, a phenomenon we have termed elsewhere as "conglopolistic competition."[1] This phenomenon is interesting because it eases the burden on the Philippine Competition Commission: as long as the conglomerates are in each other's throats, consumers have a choice in each market leading to higher consumer welfare.

Thus, the Ayala group, having entered retailing and malling business (TriNoma and Landmark), has put SM North EDSA on notice that consumers can just walk across the street; likewise, SMDC's entry into residential apartments means that Ayala Land will not have all its own way in residential properties in the West Triangle area. The Aboitiz group's entry into contestable power market in Metro Manila means that Meralco will now watch its electricity rates so as to keep its customers. Already Meralco has lost about 1 gigawatt of demand to contestable providers.

More interesting is that conglomerates boost the government's weak capacity for public goods provision — the privatization of water distribution in Metro Manila, a signal legacy of President Ramos and General Almonte, could not have happened without the conglomerates'

1 Fabella, R. "Conglopolistic Competition in Small Emerging Economies: When Large and Diversified is Beautiful," Available at: http://bit.ly/conglocompete sizeable resources and, more importantly, their reputation, which the foreign partners seized upon. The Connector Road projects which will connect SLEx and NLEx, the delayed legacy of the Benigno S. C. Aquino III administration, were bankrolled by Metro Pacific and San Miguel Corp. The government will collect ₱28 billion in givebacks from Metro Pacific for the privilege to build and operate CALAx. Many observers think that public goods are the most poverty-reducing activity of the government (Keefer, 2012).

Many times profit is painted as incompatible with people — the so-called profit versus people dichotomy. Such dichotomy is many times exaggerated.

Few people know that Manila Water has provided piped water connection to some 350,000 informal settlers who could be paying three or four times for *lako*-borne water. Government in the Philippines provides only basketball courts, not piped water. Why? Incentives! NRW (non-revenue water, water which is stolen or leaked) is lost profit. Piped water connection cuts NRW and raises profit. Profitable inclusion!

If Duterte allows his tax reform program to be mangled in Congress, DBM as reported will resort to massive low-interest ODA from Japan and China which will again marginalize our by now well-honed domestic construction conglomerates from the infra space. The low-interest borrowing under Marcos funded an orgy of Marcosian thievery that bankrupted the country. Worse, if Duterte keeps condoning open violations of property rights (the Kadamay takeover of NHA housing units and its call for a nationwide occupation), the wings of conglomerates (for investing and creating stable jobs, that is) will be clipped. The plain truth is that RCBC and the Yuchengco Group will create more high-paying jobs and stable income for more poor people in the 500 hectares it legally bought from Hacienda Luisita in 1995 (a sale upheld by the Supreme Court) than Mariano and his Maoist ilk will ever attain! But no surprise there: inclusive poverty is what Maoists want in the run-up to eventual Maoist takeover of this country.

Lapanday has lately made noises about expanding to real estate — again true to its conglomerate aspirations but no doubt hastened by the NPA's revolutionary taxation. If you operate in farm areas, you pay tax to the government and you pay extortion tax to the NPA or your assets are burned. Another stark reality in the Philippines: the shackles with which government hamstrings agriculture with its CARP and its bankrupt ideas mean that conglomerates are staying clear off food production where they are most needed for poverty reduction. San Miguel Foods' industrial swinery project in Sumilao got embroiled in a national brouhaha of conflicting CARP and IP claims. This country needs many more Lapandays and San Miguel Foods in the rural areas.

Inclusive growth? Unshackle the conglomerates!

"Endo" and manufacturing

April 30, 2018

HB 6908 or "An Act Strengthening the Security of Tenure of Workers" was approved on third reading by the House of Representatives. It proposes "Endo" or end of contractualization. "Endo" was DU30's political promise but he refrained from issuing an executive order on "Endo" in favor of proclaiming his support for this bill. What is the extent of contractualization?

As per PSA data (ISLE, 2014), about 1.3 million workers or 30% of the 4.5 million workers employed in establishments with 20 or more workers in 2014 are non-regulars. Of these about 50% (630,000) are contractual/project-based workers. Non-regulars are most prevalent in construction (27%), manufacturing (22%) and wholesale and retail trade (11%). Non-regular workers posted a growth rate of 16 % from the 2012 level.

We can safely assume that the overwhelming majority of workers in establishments of 19 or less workers (the informal sector) would be non-regulars, mostly casuals and seasonal. Workers here may not be covered by formal contracts, only verbal ones. No "Endo" here.

Contractualization has been painted as "evil" by rabid anti-"Endo" advocates. Yes, abuses happen but even freedom is abused. We don't ban freedom for a reason. "Endo" too can be beneficial as "labor sharing": scarce employment opportunities are being shared by more workers; permanent workforce are paid less than they would be without labor sharing; contractual work-force realize some income, however sporadic, instead of none at all. Work attitude and work aptitude decay much faster among the long-term unemployed than among those with sporadic spells of employment.

If HB 6908 becomes law, fewer workers will be employed and many workers now currently listed as underemployed will become openly unemployed. Businesses will invest in labor-saving machines — more smart ATMs to replace bank tellers. Investment will locate in businesses where labor cost can be passed on.

HB 6908 does not outlaw "contractors" outright; it just makes life very onerous for would-be contractors to operate. HB 6908 would mandate 80% of every firm's workforce should be regular. The bill also mandates that employers and contractors are jointly and severally liable for violations of the provisions of the law. So McDonald's will now be liable for violation of labor laws by its blue guard and janitorial services contractors. That raises the cost of McDonald's. But McDonald's and its similarly burdened food service competitors can pass on the added cost to the consumers. Food manufacturers like Mama Sita and Universal Robina Corp., by contrast, cannot.

The Dominguez economics has identified manufacturing as the vehicle towards accelerated economic growth and job creation.

For a low-income economy like the Philippines this strategy is spot-on. Manufacturing average growth outstripped services average growth in more successful neighbors South Korea and Thailand in the last four decades. The opposite is true of the Philippines.

No wonder we lagged behind these countries in poverty reduction and income growth.

Although we started to buck this trend from 2010 on, manufacturing in the Philippines remains very shallow and very sparse outside Calabarzon, Metro Manila, and Metro Cebu. The Philippine investment rate remains puny at 22%-23% when 25%-40% is the norm in East Asia.

The Dominguez economics proposes to reverse this: TRAIN will bankroll a rise in government capital outlay from 4% to 7% of GDP to support the "Build, Build, Build" program. The upgraded infrastructure will reduce logistics cost which will spur private investment from around 15% of GDP to 18%-20%. The investment rate of no less than 25% of GDP will be attained. Manufacturing will provide the extra push that was previously absent. But there's a rub. Manufacturing may not show up. Private investment may get stuck at 15%. The relative profitability of manufacturing hasn't risen significantly to attract investment away from services.

What has happened thus far?

Power cost, a very powerful influence in manufacturing growth, has just risen because of the coal tax and the elimination of VAT exemption of power transmission. We know that the 22% non-regular workforce in manufacturing lowers its labor cost which partly offsets higher power and logistics cost. This offset will be *finito* with "Endo."

Mama Sita will see its labor cost rise and it cannot pass this on to consumers because foreign rivals will eat its lunch. Its profitability has to fall. Chances are Mama Sita and manufacturers as a group will reduce their work force by acquiring new equipment that supplant workers.

"Endo" will also lower the profitability of manufacturing relative to services in the Philippines. Why? Services sector firms compete only with local rivals subject to the same higher labor cost; they can thus as a group pass on the cost to consumers. Manufacturers cannot. Investment or what's left of it will flock to the services sector. The unintended consequence of misplaced generosity to organized labor may be less employment — as employment destruction over the long run takes over! Contrary to rhetoric, the facts on the ground reveal a growing — not shrinking — anti-manufacturing bias. What one hand proposes the other disposes. The clean separation between the DU30 politics and the Dominguez economics is proving illusory. In fact, the Duterte politics is beginning to pillory the Dominguez economics. Would that the Senate version is kinder to manufacturing — to save not just the Dominguez economics but the nation.

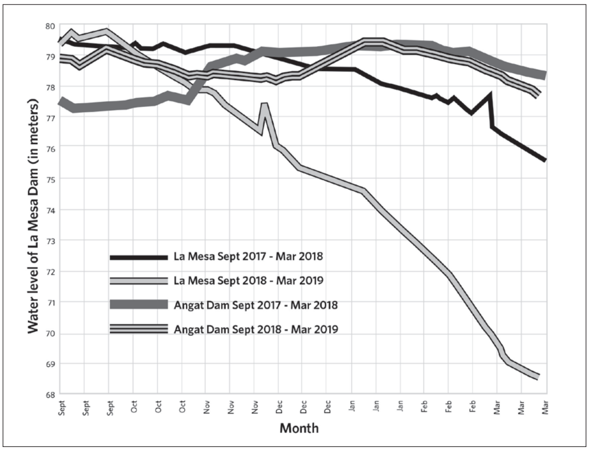
Twilight of the rule of law

April 28, 2019

IN LIABILITY LAW, who causes the injury pays. This is the cornerstone of the rule of law. In the case of the ₱1.134-billion penalty imposed on Manila Water (*BusinessWorld*, 25 April 2019), MWSS obligates the concessionaire to pay! But if the MWSS is itself the cause of the injury, we are standing the liability principle on its head.

The water crisis exploded because of the shortage of bulk water in Metro Manila. Figure 1 below shows the trajectories of water of the La Mesa Dam and Angat Dam from September 2017 to March 2018, and from September 2018 to March 2019. Note how steeply the water level dropped in La Mesa Dam in the drought-hit period compared to more normal same period last year. Angat Dam water level held up better. Drought had taken its toll on the main water source for Manila Water.

Figure 1. Water levels of La Mesa and Angat dams



Source: M. Lagmay, UP National Institute of Geological Studies

The customer base of Manila Water which stood at three million in 1996 now stands at seven million and with higher average per capita income. But the sources of bulk water are still the same. Why the water crisis?

It's MWSS incompetence, stupid! No clearer evidence could be provided than the statements of MWSS Chief Regulator Patrick Ty, the government's main man on water in Metro Manila: "It's our fault. It's the government because the Kaliwa Dam, Laiban Dam have been proposed since Marcos and due to a lot of opposition and accommodations for IPs, from the informal settlers, from Leftist group, church group, these projects kept getting moved on… Are you saying it's our fault? Yes, it's our fault because we've been delaying all these projects… Manila Water has been raising this issue since I took over in 2017 so all this is our problem and we need to fix it." (*Philippine Star*, 14 March, 2019).

Honest Mr. Ty may still get the sack. What are the obligations of Manila Water in respect to raw water provision? According to the July 1996 Privatization Strategy Report (not explicitly in the concession agreement but part of the preliminary spadework (Lazaro, 2019)), "The concessionaires…will be responsible for the supply of their respective future bulk requirements," which seems to suggest that bulk water shortfall is the liability of Manila Water alone. But water distribution service in Metro Manila is a regulated activity — this means that any project proposed by Manila Water to improve water security must be approved by the regulator, MWSS. Without MWSS approval, the concessionaire cannot be reimbursed and the project is "drowned in the water." A case in point, the Cardona Water Treatment Plant — evidence many said of the negligence of Manila Water — would have produced additional bulk water from Laguna de Bay for the East Concession customer. This was proposed by Manila Water in 2008 but construction could not start until 2016 because squatters occupied the designated MWSS property. Informal-settler clearing is not Manila Water's mandate. But even had the Cardona Water Treatment Plant been fully operational at 100 mld in early 2019, the shortage would not have been avoided – the shortfall, estimated at 160 mld, meant that water rationing would still happen. Water treatment plants and groundwater sourcing are short-term remedies; they cannot substitute for new bulk water sources which task MWSS has claimed for its own and at which it has failed. But even the stop-gap measures will fail if MWSS foot-drags. In 2013, MWSS delayed the capex applications by Manila Water for Tayabasan East Water Source which it deemed unnecessary; the Long Term East Source and the Kaliwa Low Intake projects were denied because MWSS would itself finance and build those projects. The regulator turning provider?

The Kaliwa Dam Project

The story of Kaliwa Dam with water yield of around 600 mld and would have completely sidestepped the 2019 water crisis is a cautionary tale. In February 2013, a PPP modality was proposed for the 2012-2016 MWSS Road Map for Water Security comprising of the Laiban (high) Dam and the Kaliwa (low) Dam on Kaliwa River, Tanay, Rizal. The proposal was for a 53-meter Kaliwa Dam with water yield of 926 mld at the cost of ₱15 billion (Tabios III, 11 April 2019).

When the NEDA ICC met in October 2013, it changed the plan, proposing instead that MWSS implement the project in stages: the Kaliwa Dam first and the Laiban Dam later. The NEDA Board approved the revised PPP plan in May 2014. Two bids were pre-qualified when President Aquino left office in 2016.

The incoming Duterte administration made noises about preferring the ODA modality to PPP, and seemed to have entertained the offer of a Japanese private firm to build a 7-meter weir on the Kaliwa River. This was to yield 500 mld at the cost of ₱20 billion. The administration took its time and, finally in 2019, scrapped the Japanese proposal in favor of a Laiban (high) dam to be financed by Chinese ODA. This was to be 73 meters high with water yield of 600 mld and to cost ₱12 billion. Unfortunately, these continuing pivots effectively ensured that no work was done and no bulk water flows to Metro Manila from Kaliwa River.

The kindest, but not the only, interpretation of events is that the government was hankering for an ever more perfect plan and violated a common-sense adage: "Don't let the perfect be the enemy of the good." The March 2019 water crisis is the harvest of unbridled zeal.

The MWSS decision constitutes a rape of the rule of law even if the concessionaires decided to hold their horses. If left to stand, it establishes a precedent that a guilty party can reap political *pogi* points by scapegoating a vulnerable party. The scapegoating of Manila Water certainly deflects the conversation from the threatened firing of the MWSS leadership for incompetence. Would well-meaning lawyer groups challenge it? Otherwise, it could be the twilight of the rule of law in the Philippines. And progress will, as the introduction to a Sinatra song goes, "…slowly fold its tent and silently slink away."

About the author

A FORMER SEMINARIAN whose concern for the poor led him to study economics, Raul V. Fabella, is credited for enriching economic discourse in the Philippines with terms such as “development progeria,” “conglopolistic competition,” “landed poor,” “debt-adjusted real exchange rate,” and “divide-by-N.” The catchy word combinations underscore Raul’s work on novel analytic constructs for thinking about puzzling problems in economics and his keen desire to communicate ideas that would help improve society to a broader audience.

Raul is emeritus professor of the University of the Philippines and still occasionally teaches at the UP School of Economics, where he was former dean for several terms. He is a member of the National Academy of Science and Technology. Since April 2019, he has accepted the position of Honorary Professor of the Asian Institute of Management. He was elevated to the rank of National Scientist by President Benigno Aquino in 2011.

Raul Fabella delivers a talk on “Capitalism and Inclusion Under Weak Institutions” at the 3rd Paderanga-Varela Memorial Lecture in October 2018. One of his main conclusions, which he writes about in his columns, is that conglomerates, contrary to populist notions, play a positive role in poverty alleviation.

Raul Fabella (second from right) takes part in a panel discussion after delivering the 3rd Paderanga-Varela Memorial Lecture in October 2018. Other participants (from left) are Eduardo Yap, Dindo Manhit and Amado Mendoza Jr.

He was for a long time a member of the editorial board of *the Journal of Economic Behavior and Organization* and still is of *Philippine Review of Economics*. He is a member of the Board of *BusinessWorld* newspaper and is a regular contributor to the same daily. His 2018-2019 research interests are in regulation and competition policy and the electricity industry.

His recent works include *Capitalism and Inclusion under Weak Institutions,* a book published by UP CIDS in 2018; "Federalism and Inclusion in Developing Economies", a discussion paper published by the UP School of Economics and co-written with S. Ducanes-Daway (DP #2018-04); "Competition Policy and Inclusion in the Philippines," a paper co-written with Senen Bacani and Andre Palacios for the Philippine Competition Commission in 2017; and *Room for Maneuver*, a book co-edited with Jaime Faustino, Adrian Leftwich and Andrew Parker, and published by The Asia Foundation in 2014.

Raul obtained his Bachelor in Philosophy degree from Seminario Mayor-Recoletos in 1970 and his Master's in Economics degree from UP in 1975. He completed his Ph.D. in economics in Yale University in 1982.

His favorite local tune is Cinderella's *Bato sa Buhangin*; he is partial to Michel Legrand (e.g., *Hands of Time*), Rachmaninov (e.g., Second Piano Concerto) and Debussy (e.g., Reverie). His favorite fairy tale story is *The Little Match Girl* by Hans Christian Andersen; Ishiguro Kazu's *Remains of the Day* is his favorite book and film; Boublil and Schönberg's *Miss Saigon* is his favorite musical. He hits tennis balls with wife, Teena, pedals a bicycle around the subdivision and tends to the garden for his endorphin fix. He loves the guitar though this love is unrequited.

"Such is the penalty of unintended consequences. Ultimately, one harms those one professes to protect."

Cayetano Paderanga, Jr.

Juggling mandates

August 25, 2008

MORE THAN A YEAR after the credit crunch began in the US, the Fed and other financial regulators find themselves at a crossroad over their roles in the economy.

Aside from acting as lender-of-last-resort to commercial banks and promoting price stability, the Federal Reserve is tasked by the Humphrey-Hawkins Act to look after full employment.

However, the Fed's recent interventions in the financial markets, particularly the rescue package it arranged for Bear Stearns and later made available to mortgage giants Fannie Mae and Freddie Mac, raised serious issues on whether it can balance this new role with the conduct of monetary policy.

These concerns heightened after the US Treasury unveiled its reform proposal aimed at overhauling the regulatory framework of the financial system. Among its plans, the designation of the Fed as "market stability regulator" (MSR) got the most attention and criticism. As MSR, the Fed would receive a broad range of oversight and authority over all major players in the system, including existing federal regulatory agencies. In effect, the Fed becomes a "super regulator" whose responsibility will include financial stability apart from sound monetary policy. Its earlier role as emergency liquidity provider for troubled firms will also be made permanent under the US Treasury plan.

Since the crisis emerged in August 2007, the Fed has adopted a series of rate cuts to ensure adequate liquidity. It rightly feared that credit conditions will tighten as lenders try to recoup their losses by raising interest rates, putting more borrowers at risk of default. While fearing the threat of a spillover to the financial markets, the Fed and the market in general had no idea just how exposed the large investment banks are to the housing crisis. Monetary authorities also felt that the drop in housing prices is inevitable for it to correct itself and bring back discipline. It never anticipated that the housing crisis will eventually morph into a crisis of confidence in the markets, putting otherwise sound institutions in peril.

This fear is what almost brought Bear Stearns Co. to near bankruptcy in March 2008. To avert a crash, the Fed had to discard its hands-off approach in the crisis and ended up facilitating the sale of the former to JPMorgan Chase. The Fed guaranteed around $29 billion in Bear Stearns Co.'s assets for JPMorgan to close the deal. It also opened a credit facility at the Federal Reserve Bank of New York for mortgage-finance firms. This was done to assuage concerns that Fannie Mae and Freddie Mac, major players in the mortgage industry, were likely to slide into bankruptcy. Despite the emerging concerns over its being the MSR, the Fed plans to make available permanently these measures and rescue package for other troubled mortgage giants.

Ideally, government bailout of private firms is warranted when their financial ruin poses a threat to the economy. This was the argument used during the rescue of hedge fund Long Term Capital Management in 1998. Had the monetary authorities not stepped in, the hedge fund's failure could have led to further instability in the market.

The Fed's bigger role in market stability poses problems of its own. The use of the Fed's funds beyond open market operations complicates its operations since it may end up becoming another government institution that only grants credit. It also risks damaging the Fed's credibility since these credit facilities would likely invite political interference. Another major concern is the moral hazard problem attached to the Fed's proposed bigger role. Financial firms may wrongly perceive the central bank's credit lines as having no preconditions, prompting them to engage in riskier activities.

Given these concerns, the US Treasury's proposition has been met by disagreement from some, including the former US Fed chairman, Alan Greenspan. Instead of designating the Fed as the MSR, he suggests creation of a government panel composed of finance officials to decide on bailouts. Under the proposal, the panel can create a "conservatorship" that gains control of the bailed-out firm's assets, which will then be used to pay off its debts. Such conditions should be put in place before any government guarantee can be granted. This proposed system frees the Fed of its duties for market stability (and the attached political risks), allowing it to focus on its conduct of monetary policy.

With the end of the credit crunch still nowhere in sight, federal agencies are under tremendous pressure to stabilize the markets. Nevertheless, a year in the subprime crisis is enough to show that while restoring market confidence is needed for the crisis to end, the Fed should heed the hard lesson other central banks face. As the Asian Development Bank puts it, "Credibility can be lost far more easily than it is gained."

Patching the investment hole

September 15, 2008

IT DOES NOT COME as a surprise to say that the Philippine capital market is underdeveloped. Compared with our neighbor countries, our stock market is dwarfed. In 2007 alone, the Philippine Stock Exchange's total value of share trading was around $29 million while those of Malaysia, Indonesia, and Thailand amounted to more than $110 million. The country's turnover velocity of domestic share is only half those of Thailand and Indonesia.

Furthermore, the country's domestic saving rate has been small, playing within the interval of 12% to 19% of the nominal gross domestic product. In 2005, the country's saving rate was 18.5% while those of Indonesia and Thailand were 27.8% and 29.5%, respectively. All this boils down to the lack of investment vehicles, including alternative retirement schemes.

For many years, the country has been in a chronic situation of low investment rate. In 2007, the ratio of the country's savings-investment gap to nominal GDP reached its seven-year peak at 21.6%, which is disturbing. Given the fact that the country already has a low saving rate compared with its neighbor countries, the level of its investment still manages to be even lower.

As has always been the case for a long time now, the country is consumption-driven. Nothing is wrong with it. However, it does not support long-run or sustainable growth. Investments do. Unfortunately, growth in domestic capital formation has been so low through the years. The ratio of capital formation over nominal GDP cannot even get past 20% since 2001. The problem must lie somewhere in the mobilization of funds for investments since even the surge of OFW remittances into the country does not get into its long-run growth potential. Mobilizing these funds is particularly important since the inflow of remittances has been behind much of the developments in the macroeconomy.

With the enactment of the Personal Equity and Retirement Account (PERA) bill into law, its proponents expect it to inject energy into the country's capital markets. The new law is seen to be capable of mobilizing scattered savings by providing incentives and by developing institutions. Compared with the retirement schemes under the GSIS and SSS, the PERA scheme is voluntary in nature. This is so since the latter is a type of defined contribution plan such that the contributors are given a say over how much and how long they will invest provided they meet the minimum five-year contribution period. Employer contributions are also voluntary, the incentives for which are in the form of tax credits and exemptions.

That the PERA law targets overseas Filipino workers (OFWs) and the self-employed was not a coincidence. Though both groups can open their own SSS accounts, their numbers in the system remain small. Features of the new plan such as compounded interest earnings, control over where to invest funds, and tax exemption on interest and investment earnings are much likely to encourage participation from these groups.

The PERA scheme has been patterned from the 401k retirement plan in the United States. Its key benefits include tax advantage, investment flexibility, hardship withdrawals, and employer match programs (that is, the employer matches the employee's contribution by some percentage of that contribution depending on tenure). This scheme was intended to increase savings in the US. However, whether an increase in its domestic saving is attributed to the scheme is still subject to debate due to two reasons. First, since retirement schemes in the US are voluntary, 401k would only induce shift of funds from existing retirement plans to the new plan. Second, the government forgoes revenues from tax exemptions.

Due to the drawbacks of the 401k scheme, it is explicable why the Department of Finance was initially lukewarm in its support for the law while it was still pending in Congress. However, the structure of existing retirement plans in the country is different from that of the US. Since contributions to GSIS and SSS are mandatory, the new retirement plan does not really compete for the funds available for saving. It merely provides an alternative investment vehicle for groups not captured by existing mandatory retirement saving schemes. At the same time, it induces more saving from the working class already under GSIS and SSS. As for the forgone revenues from tax exemptions of earnings from the PERA scheme, the earnings would not have been realized if not for the passing of the law. Without it, there will be no PERA earnings to be taxed so there's nothing that is currently collected to be sacrificed. In addition to the scheme's benefits, it is just a bonus that it leaves a paper trail of activities that would be of great use to tax administrators.

How this new scheme fares is yet to be seen, though. But clearly, for the 10 years that passed since the PERA bill was filed, savings and investment have not grown much. Considering the success of Chile in effecting economic and institutional transformation through the development of its pension funds, the new law must be a promising solution to the sluggish performance of the Philippines' capital market. And since an economic aspect is never isolated, it might be the first step toward sustainable economic growth.

Financial crisis: Genesis, evolution

October 27, 2008

HOW DID IT ALL HAPPEN? A good candidate for where and when the crisis started would be the Americans' penchant for consuming more than they were producing. That, in turn, can be partly traced to the special role that the US dollar plays in the world economy. Global trade has been growing in a sharply accelerating manner in the last 25 years, creating the need for an international currency "to grease the wheels of trade."

Backed by the largest economy (therefore, with the most goods that may be purchased) and supported by the most efficient financial markets in the world, the US dollar was the best candidate. As the producer of money, the US enjoyed the seignorage that came with being the printer of global money. Essentially, it could buy real goods from other countries with just paper, and up to the point where these countries needed dollars to keep circulating in their areas, they willingly accepted the paper. As long as these countries trusted the dollar as the global currency, this arrangement could continue. In fact, to that extent, there was actually a demand for the US dollar to circulate outside the US.

The catch was that American consumers got used to saving less and consuming more. For about a decade, this continued because after the Berlin Wall fell in 1989, Eastern Europe shifted from socialist planned economies to market-oriented capitalist countries. As they set up their own central banks, they continued to demand dollars to build up their foreign exchange reserves. This additional absorption of US dollars supported the large US balance-of-payments deficit.

The beginning of the end came with what then looked like the good times. As the global economy started to slow down and, coincidentally, with the attack on the World Trade Center in New York on September 11, 2001, the Federal Reserve started a long period of interest rate reductions. This was also allowed or induced by the declining price levels as the large US imports from China and other low-cost producers brought down the inflation rate. This declining interest rate had two effects: first, it induced a search for alternative investment vehicles providing higher rates of return; and, second, it allowed new homebuilders to enter the home mortgage market on lower credit ratings but with higher interest rates — the phenomenon now known as subprime credits. The second trend fed the first and — together with increasing liquidity provided by wealth coming from oil and mineral producers and balance-of-payments surplus countries like China — the two forces engendered an increasing credit spiral described in an earlier column ("Why the bailout was needed...by us!" *BusinessWorld*, Oct. 13, 2008).

In hindsight, the incipient recession was the market's signal for the US economy to restructure its consumption patterns. With the recession, the balance-of-payments deficit would decline, if not disappear, as the demand for goods (including imports) decline. When consumption surged anew during the economic recovery, it would presumably settle at more sustainable levels and patterns. The interest rate reductions, therefore, postponed this restructuring and instead inflated the credit bubble that was building up. On the other hand, these interest rate cuts were permitted by a benign inflation picture as the US imports from cheaper sources overseas allowed lower nominal interest rates. On this issue, the final judgment will come later.

Evolving parallel to developments in the credit sector, the large US balance-of-payments deficit (manifesting the overconsumption of Americans) finally overwhelmed the global demand for US dollars. As the US BOP deficit continued, the dollar weakened and induced upward corrections in the dollar prices of key prices such as oil and minerals. These corrections triggered a global inflationary trend that, in turn, induced policy makers to start raising interest rates. The rising interest rates pricked the "subprime credit bubble," starting the current financial crisis.

The overconsumption of the American economy that lies at the kernel of the phenomenon is important because it affects how the crisis may evolve and what further adjustments are needed. It turns out these further adjustments are significant factors for emerging economies such as the Philippines to consider. A look at how the recovery may unfold reveals just how things may work out.

First, the financial shock that is hurting the American economy (and the rest of the world) would have to be solved. Two of the concerns with the purchase of mortgage papers are related to the pricing and the process, including the speed. Buying the papers at face value would unduly protect the (irresponsible, as some say) creditors because these are overpriced in the first place. At the same time, too low a price would make the cure unpalatable and would make the effort ineffective. So, the correct pricing is critical. The second concern deals with the procedure that will be used for "price discovery."

The problem is that the process has to be designed and vetted, and only then will it be implemented, which may take several weeks to unfold. While the process is still unfolding, the full discovery of values is unfinished and the adverse selection problem (where people are unsure who will survive or how much each of them can pay) emerges. During that period, the balance sheet of firms continues to deteriorate, enlarging the problem and deepening the danger to the real economy.

Direct investment by government into the banks was designed because ownership suggests a guarantee, as the government tries to ensure that its investment does not go bad. The uncertainty is expected to dissipate sooner and the financial shock is also sooner relieved.

If the uncertainty is dissipated, the credit channels will gradually be unblocked and credit will start flowing through the financial system again. Production and investment funds will be available and the economy can start its recovery, which will depend on the speed that the financial squeeze is eased. Financial firms will only start to fully recover once their balance sheets are freed of toxic securities that threaten their solvency. The unblocking of credit is only a start. With time, the values of these assets stabilize, and the firms will operate on firmer ground to grow back their business.

Observations of the credit markets are difficult to characterize, but the behavior of the stock markets may be a good indicator, since the credit markets contribute funds to equity buildup. Anecdotal evidence seems to indicate that US equities tend to substantially recover their levels after eight months if the crisis is domestic, but the recovery takes 16 months if the crisis is global. Since this crisis is global, one can expect that time to elapse before the full recovery of the equity markets (starting from, say, July–September of this year). At least, the end can be seen. The other comfort is that this period is not one of continuous decline. Rather, once the markets find the bottom, prices will linger around that position for most of that period (what is termed as "the long tail"). Finally, we may also remember that credit is already flowing during that period — just not surging.

Credit ratings and financial meltdown[1]

December 15, 2008

AT THE HEIGHT of the financial turmoil, various factors were looked at and blamed for the market crash. Among these was the too-optimistic ratings given to structured products, particularly those that are mortgage-related.

Specifically, credit rating agencies have been criticized for failing to notice the poor credit quality of these products. The problem was compounded by the rapid growth of asset-backed securities — reaching $11.92 trillion at its peak in 2008 — and introduction of new products, which overwhelmed the rating companies. Since this happened seven years after the Enron collapse (an episode where the same firms also failed to detect the company's troubles), the ratings industry proves it still has a long way to go to being a credible gatekeeper in the financial system.

Whereas agencies before earned by selling their ratings to investors who then used this information as investment guide, the current setup has debt issuers paying for their credit ratings. This business model obviously leads to serious conflict-of-interest issues as statistical rating organizations (SROs) have the incentive to give positive ratings to maintain their clients. Ideally, the possible backlash arising from poor-quality ratings should be enough to counter this problem. The industry's highly concentrated nature, however, makes this unlikely as it remains dominated by three firms, namely, Standard & Poor's (S&P), Moody's Investor Services, and Fitch Ratings. No other company poses serious challenge to their market power.

The inclusion of ratings in government regulations serves as another barrier to entry for new firms, apart from the high reliance on reputation

---

1 Co-written with Kristine Canales

involved. For example, present Securities and Exchange Commission (SEC) regulations use credit ratings as reference whenever companies have to make investment decisions. This has made asset managers overly reliant on credit ratings, reducing the need to conduct their own due diligence and giving them a false sense of security in the process.

The lack in accountability and transparency in the ratings sector prompted calls to tighten its rules. In response, the US SEC introduced additional prohibitions in the conduct of these firms' business effective in the next six months. The new ratings rules focused on three major issues — conflicts of interest, disclosure, and record-keeping. To limit conflicts of interest, rating firms cannot rate debts they helped structure, analysts involved in ratings cannot participate in fee negotiations, and gifts from clients must not be over $25. On disclosure, company-paid ratings must publicly disclose a random sample of 10% of its credit ratings six months after its issue. Additionally, these firms are required to disclose figures on changes in ratings and defaults for all asset classes over some periodic intervals. New requirements on record-keeping include the need for rating firms to maintain a history of complaints against analysts and a record of the analyst's rating for structured finance debt against the rating from a quantitative model.

As many have pointed out, this set of changes is definitely not enough so regulators should avoid being complacent and end up pursuing reforms halfway. Unfortunately, government oversight is not the solution as some quarters would like to believe. Apart from inviting unwarranted state intervention, it fails to address the industry's two main problems: one, the conflict-of-interest issues found in the industry's present business model; and two, the investors' overdependence on ratings. The new rules try to address the second issue by shifting decision-making once more to fund managers. By requiring ratings companies to disclose their performance, for example, fund managers have no other choice but to conduct personal assessments whether the ratings and the firms are credible enough based on its past reviews. In this way, the lines of accountability are once again set among fund managers, rating companies, and investors.

Since it's almost next to impossible for rating companies to go back to their previous business model, there are moves instead to require all information shared by debt-issuing companies with SROs to be disclosed to the public as well. This helps solve the serious asymmetric information problems found in the system.

A bigger and tougher issue for regulators is how to foster competition in an oligopolistic industry. Currently, there is no serious incentive for SROs to improve their rating methodologies since the market has nowhere else to go to. Apart from preventing any of the big three to merge with other smaller companies, it has been proposed that the US SEC remove the "nationally recognized statistical ratings organization" (NRSRO) designation which is another high barrier to entry. The US SEC should take the lead in improving the industry's competitive structure. Since it will take some time for other rating companies to pose serious challenge, requiring more transparency and accountability will have to do for the time being. This is in stark contrast with the European Union's response to the credit-rating debacle. Whereas the US SEC is set to improve the competition in the industry, the European Union Inter-Market Commission has released a draft law that further regulates the SROs industry. Apart from stifling free competition, the draft law allows national regulators to change the ratings given by the SROs. This provides an opportunity for affected companies to lobby, which is unfortunate for SROs given the cross-border nature of the services they provide. Which of the two responses proves to be better is yet to be seen.

Developments in the financial system have been guided by the idea that market players are rational and that each one knows what is for his best interest. Hence, state intervention must be kept to a minimum. The demise of the US-based investment banks in a short span of time and the failures of the rating agencies now have forced some regulators to question the wisdom of markets left largely on their own. Their European counterparts, for one, have been quick to blame the US version of capitalism as the main culprit. Not only did it allow an unsustainable bubble to inflate asset prices rapidly, the eventual bust has also led to recession in other parts of the world. Accordingly, a free market system fuelled and sustained by unabated greed would eventually fold up from its own excesses. Thus, the present crisis gives an excuse for the state to justify its entry in the free markets. What must be kept in mind is that any intervention should always include an exit strategy once the markets start to properly function again.

The global economic slowdown in this era proved that no country is effectively "decoupled" from another as a result of rapidly integrating markets. Addressing the present financial crisis requires close coordination — not limited to just among the G7 economies but must also include the developing economies. If there is anything good that came out of this crisis, it is that a change in the global system is finally in order.

Economics and leadership

December 22, 2008

I HAVE BEEN ASKED frequently in recent days why Barack Obama's assumption of the presidency would make such a big difference in the hoped-for recovery of the United States. Of course, one can never be sure whether his taking office would start the recovery. In fact, it might take a bit of time for any of the effects he makes to be perceptible. But the inquiries indicate that people wonder how such a factor like a country's leadership can make such a big difference for quantitative variables like the gross domestic product.

Indeed, it can be quite surprising that such nonquantifiable factors as confidence, optimism, outlook, and, yes, leadership, can affect the direction and strength of economic developments. Those of us who follow these matters as part of our work have come to appreciate how these factors can confound the most stable trends and firmest expectations by taking the whole economy in the other direction. This is one of the key elements of uncertainty that often hover around the projections and forecasts needed in today's economic environment. How does it happen?

Just what these intangibles are and how they produce their results may vary by place and time (but their effects are palpable). It can be what the pioneering economist John Maynard Keynes called "animal spirits" or what we now term "confidence," or may go by a completely different name. The effects can be quite dramatic as when instead of saving 40% of their income (because of fear about what will happen in the future) people decide to save only 20% and spend 80%. This increased consumption translates directly to more income for the suppliers and sub-suppliers of the product purchased, which then goes to the previous stage of the production process, etc. If the change in sentiment is infectious and widespread, then the process is multiplied throughout the country and (*voila!*) what used to be a moribund economy is transformed into a heaving engine.

One classic example of this is how the American economy was transformed within a very short period from civilian manufacturing into a very efficient war machine, producing munitions and arms that overwhelmed enemies in not one but two war fronts simultaneously during World War II. It was so efficient that an average of one ship a day was launched from the San Francisco Bay shipyards during the five years of the war. That required taking resources from household products and moving it to arms production. One can do this by imposing heavy taxes or outright confiscation which could cause resentment and hit all households living in differing circumstances uniformly.

The alternative used in the Vietnam War was to produce a fiscal deficit, leading within a few years to a stubborn inflation that led to the breakdown of the dollar standard in international finance. The government under Franklin Delano Roosevelt invoked patriotism and households "liberty bonds," which essentially lent their purchasing power to the government. As a result, resources were shifted to war production without causing inflation or bottlenecks, were not resented and allowed families to adjust according to their circumstances. A very good example of what a great leader can do!

A similar phenomenon, achieved over the longer term, is sometimes observed in countries' development. Here, too, effective leadership can produce a deep-seated and often subtle but profound difference. As a country develops, many sacrifices are called for, competing interests have to be mediated, countless efforts have to be coordinated and a lot more complex processes have to be undertaken. So many things can go wrong and so many wrong turns can be taken that one can really express surprise that any country has actually developed. And yet, countries have developed. There are enough of them that practically every nation now hopes to follow in their wake. And in the past 50-60 years, the process of development for those who have succeeded has been faster and, perhaps, more comprehensible. In our immediate region, for example, there are the four "Asian dragons" and those that have followed them such as Malaysia, Thailand and, of course, China and India. The role of key leaders in some of these countries' development provides unambiguous examples of how leadership is crucial.

How does a leader accomplish this? Development can be very difficult to achieve. There are so many sacrifices that have to be made, so many compromises to be brokered among various groups, so many difficult decisions to be arrived at. The valid but competing claims of the various groups, as well as the differing views on how to achieve goals, could stymie the most intelligent heads of government and derail development. A leader must be able to impress upon people the sense of a shared destiny. He must be able to distill for the people their common objectives and produce a convincing map of how to attain these. Above all, he must lead by showing a shared experience with the people of the sacrifices and effort that have to be made. That is, he must lead by example.

Two thousand years ago, a little-known preacher talked about change in the hearts and souls of people and was ridiculed, tortured, and finally crucified for his efforts. He made the extreme sacrifice of dying for his ideas. Almost a hundred years later, his ideas — kept alive in scattered communities that had survived the Roman destruction of the Jewish country and had spread among the Greek and Roman cities around the Middle East and the Mediterranean Ocean — started spreading until it finally became one of the great religions of the world. That is probably one of the strongest demonstrations of how nonquantifiable factors make all the difference in the world. It also shows the power of ideas — especially those backed by the force of example. It has happened in some of the Asian dragons. Now, if it could only happen here, that would really be something!

Merry Christmas and a Happy New Year!

Business rationality, market myopia

February 23, 2009

IN THE PREVIOUS COLUMN we saw how credit ratings lulled buyers of collateralized debt obligations into overconfidence (or overindulgence). These ratings induced laxity in the prudential due diligence efforts of investors. Buyers of CDOs relied on the ratings agencies, as they lacked the ability to monitor credit performance and/or estimate expected cash flows.

On the other hand, the fragmented (i.e., decentralized in a market sense) view of both credit rating agencies (CRAs) and their clients disabled the market's ability to keep count of the growing cumulative risk building up — a classic case of individual firm rationality and market myopia.

Recent developments in financial innovations seem to have aggravated this weakness. First was the special form of structured finance, typified by collateralized debt obligations (CDOs). Using the technique of tranches created triple A (i.e., AAA) securities out of subprime credits. However, while these securities got separated as the successive trading evolved, proponents and buyers forgot that all the tranches were still essentially connected. Therefore, the complicated mathematical models used in the credit rating industry probably (grossly?) underestimated the risks because these had not fully incorporated how the various tranches in a collateralized pool remained closely correlated. Thus, while the senior tranches of a collateralized pool of subprime credits could be rated because of their seniority, they nevertheless suffered downgrades when the defaults in the pool went beyond the thresholds delineated. And these happened on a broad scale when the rise in interest rates revealed that the underlying borrowers could not realistically afford the debt service on the original mortgages.

Amplifying the risk was an underlying conflict of interest in the credit rating process of structured investment vehicles (CDOs are examples). As CRAs advised issuers on how to raise the credit rating on bonds, their judgments could have been unduly influenced even if the (advisory and rating) services were supposedly being done by separate sections of the agency. This has brought into the open the old question of why ratings should be financed by the issuers of bonds. (Originally, ratings were done by CRAs that then sold their ratings in rating books to the investing public. But that business model was destroyed when the advent of copying machines allowed the wholesale pirating and distribution of the rating books).

How could the CRAs have given such high ratings to mortgage-backed securities? Ironically, regulators and investors have asked themselves the similar questions after Enron collapsed in 2001: why did the credit rating system give high ratings to corporations, only to be proven wrong? During that time, credit rating agencies (CRAs) also granted high ratings to Enron-issued corporate bonds, only to find itself largely on the defensive and subject to lawsuits when the company collapsed. A major portion of the blame then was placed on accounting practices that allowed too much leeway in valuation and recording of income and expenses (that were then subject to abuse, especially with the use of subsidiaries). Now the weakness appears to be in the inability to distinguish between the inherent qualities of single corporate firms' bonds and those of mortgage-backed securities. These CRAs would later win those earlier cases on the grounds that their ratings are no different from opinions, and are thus protected by the US Constitution's First Amendment. The CRAs were not blamed for being unable to look beyond the furnished (audited?) financial statements and other documentation. Even then, investors should have learned that credit ratings are not an excuse for not conducting their own due diligence of investment prospects.

Second, the business model that drove the financing of subprime credits contributed to both the reach of subprime credits (it was propagated swiftly and rapidly all over the world) and the loss of prudential controls. Under the "originate and distribute" model, mortgage lenders would just locate, qualify, and lend to the borrowers (i.e., originate the mortgage loan) for which they would get the origination fees and other income. Then an investment bank or fund would organize the corporate entity housing the pool of loans (in a real estate investment trust or REIT, for example) and market the resulting shares and bonds. The organizer would earn the corresponding income for organizing the fund and marketing the instruments. Finally, the record-keeping and collection on underlying loans would be entrusted to a collection entity which would then earn the servicing and collection fees. Note two important effects of this business model: first, because of the securitization feature the source of funds broadened to potentially the whole world; and, second, the connection between granting the credit and carrying the risk of default has been broken into at least two legs. As a result, prudential connection between credit granting and collection has been severed at the same time that the potential size of the risk has been magnified.

These perceived weaknesses have given rise to regulatory changes that our own regulators may want to consider. The US Securities and Exchange Commission has introduced new restrictions in the conduct of CRAs' business focused on three major issues — conflicts of interest, disclosure, and record-keeping. To limit conflicts of interest, rating firms cannot rate debts they helped structure, analysts involved in ratings cannot participate in fee negotiations, and gifts from clients must not be over $25. The prohibition of simultaneous rating and structured advisory services by CRAs and of analysts' participation in fee negotiations may need to be buttressed. Game theory, the study of strategic behavior, has shown that in cases of infinitely (or even just indefinitely) repeated games, collusive behavior among the players of a cartel — which the CRAs are wont to be — arises. Thus, some more rules of conduct to ferret out and prevent collusive behavior may have to be added in due time.

To improve disclosure, company-paid ratings must publicly disclose a random sample of 10% of its credit ratings six months after its issue. Additionally, these firms are also required to disclose figures on changes in ratings and defaults for all asset classes over some periodic intervals. New requirements on record-keeping include the need for rating firms to maintain a history of complaints against analysts and a record of the analyst's rating for structured finance debt against the rating from a quantitative model. This set of changes will be effective over the next six months.

The four-pronged strategy

April 6, 2009

THE LATEST MEETING of world leaders in London has taken place under crisis conditions similar to some in the past. But this time the grouping has mutated into a larger grouping that recognizes the growing clout of emerging countries like China and India. The task at hand was to foster global economic recovery and, perhaps, some discussions on rule changes designed to prevent similar cataclysms in the future.

A major issue we will discuss here is the differing attitudes of policy makers toward the propriety, manner, and size of bailout or stimulus programs. We will review the approach and components of the recovery program. Other issues like changes in global financial architecture, regulatory coordination and monitoring, and related topics will be left for succeeding columns.

There seems to be two main positions on the bailout and stimulus programs. The first one, mainly advocated by the United States, encourages the expansion of government expenditures to shore up aggregate demand, rescue pivotal financial institutions to revitalize credit, and participate in asset markets to hasten the discovery of property valuation and, thereby, shorten the period of inactivity. The other side is wary of these actions. First, some policy makers are concerned that these packages would lead to large budget deficits that would burden present and future generations. Further, there would be attendant side effects such as lowered credit ratings and higher interest costs as leverage ratios rise above some threshold levels. The second worry is the moral hazard that the stimulus programs and rescue packages may introduce into the behavior of major private players. Key corporations and institutions, having experienced being saved by governments at this time, may come to expect that they would be too important to fail under other circumstances. As a result, they would become less careful in their activities and less vigilant in their dealings with others. This resulting lax behavior may increase the chances that crises like the present one will happen in the future.

There could be two reasons for this difference in attitude between the US and some of its group partners. One is practical and the other is ideological. The first reason is that their positions may not be symmetric. Most of the international assets that reside in various countries and are being traded across borders are denominated in US dollars. As leverage ratios deteriorate, lowered confidence may amplify risks associated with operating and owning assets in specific countries, concerns that occupy foreign policy makers. The US is largely exempted from the uncertainty coming from currency mismatches (which happens when the cash receipts and disbursements are denominated in different currencies) because most of these cross-border assets and liabilities are denominated in dollars. Having one less risk to worry about — currency risk — may allow the US more flexibility. Besides, as the supplier of the *de facto* global currency, it in a way owns the money-printing press and this allows it much more leeway in expanding the money supply. Thus, there is a fundamental difference in situation between the United States and other countries.

The other difference could be ideological in the sense that the two concerns mentioned above and other reasons are ingrained in the psyche of some people, leaving them with a basic distrust of government initiative as a matter of balance in policy making. For some people, it would be best if markets are free to choose winners and losers and free to reward and punish. While others are more preoccupied with the market's inability to make allowances and control how private actions affect other market players, some are more worried about using policies to mitigate these side effects. This attitudinal difference may explain a large part of the difference in approach between the Obama and Bush administrations (aside, of course, from the difference in the degree of the crisis during their terms).

The current United States is primarily engaged in a four-pronged approach to bring about economic recovery. A brief review of its components may clarify the aims behind it. The strategy approaches the problem from the two ends of the low-spending freeze. The first looks at the start of the credit-expenditure sequence and breaks into the first two components of the program: purchase of "toxic" assets to revitalize the financial markets by facilitating the price-setting ("price-discovery") for rapidly deteriorating asset values; and, second, the rescue of key banks and other financial institutions at the core of the financial system. The aim here is to unfreeze credits. Pricing the financial assets halts the continuing slide in market values and deterioration of balance sheets that produces the uncertainty as to whether the counterparties to transactions can ultimately pay for obligations they incur. When asset prices stabilize, firms can book their losses, restate their capital values, streamline and restructure their liabilities, and base their plans on firm balance sheets that are also more transparent to their creditors, suppliers, and even customers. As a result, credit can restart and loans to both financial and operating firms can be extended in the normal course of business. The economy can then start its path to recovery.

The rescue of banks reinforces this effort by putting a stop to the chain of uncertainties that bedevil a collapsing market. A market freezes because participants cannot be sure if their counterparties can fulfill their obligations. Even if a party looks healthy it can deteriorate rapidly in the face of defaults by its own debtors and customers. This condition leads to uncertainties that eventually dry up credit, leading to suspension/delay of operations leading in turn to losses and, eventually, insolvency by firms. A government rescue of key financial institutions keeps the credit flowing by enlarging (even unlimited if the government provides full standby credit or outright ownership) the budget for absorbing by these banks until the economy can grow out of its predicament.

The other end of the recovery program works on the eventual object of credit granting: actual spending by businesses and consumers. The third component involves the government's actual expenditure in projects that would have waited for their place in the budget queue during ordinary times. In the face of collapsing demand, producers uncertain about their ability to sell their products stop operations and lay off employees. The resulting losses of their suppliers and the income loss of their ex-employees further reduce aggregate demand that then leads to another round of operational suspensions and employee layoffs, adding another cycle to a vicious downward spiral of economic activity. Government expenditures try to halt this spiral by giving jobs to government workers and provide demand for suppliers as it spends on projects, often infrastructure programs. Milton Friedman, probably the best-known modern monetarist, once suggested that a solution to the sagging demand is to drop money from helicopters so that people would get the money and spend it, ending the economic meltdown. Government projects are the frugal and pragmatic man's version of the helicopter money drop. The advantage of the approach is that you can expect some tangible output for the money. You can also be sure that the money will be spent (as against the danger that people who get it from the helicopter drop may just hoard the money). The disadvantage is that there is an expenditure lag as projects need time for preparation and implementation. One's final take on this could depend on gut feel that may then be attributed to "ideological differences."

The final component also works through increasing aggregate demand. This time, the basis is the belief that private consumption has been severely diminished by asset losses experienced by consumers, the biggest loss being on the house values caused by defaults. To reverse this condition, the government can provide the financing for restructuring and refinancing homeowner loans. This reduces homeowners fear over their ability to pay and revives consumer spending. The resulting reduction in defaults also helps to lower interest rates on homebuilding loans, further increasing consumer confidence.

Will the effort succeed? Only time will tell although the recent seesawing of the US stock index is a very welcome sign. It signals a possible stop to the continued slide in stock prices. As prices jump around, the one-way bet downward is eliminated and some money can actually be made on correct guesses for prices. Funds may start flowing back into the financial markets and the reawakening of credit can start. However, the rehabilitation of financial markets will take time. There will be a lag there. After the financial revival has taken some time, the real economy can then also recover. That will also take some time. As these happen, the beneficial effects on emerging markets will then follow. (And remember that a structural adjustment to correct the large balance-of-payments imbalance of developed economies, especially the United States, will mean an additional step before the recovery of our own exports.) In sum, while there are hopeful signs, the period of recovery will still take time. Let's hope that time is shorter rather than longer.

Dreams from my father[1]

June 22, 2009

I REMEMBER IT WAS a bright sunny day when my father gave me a "guided tour" of Manila in the late Sixties. It was then an orderly, tidy place, and we could do it by public transportation — we took jeepneys and buses. We went by the beautiful Post Office building in pretty Plaza Lawton with what was then the Besa boxing arena, passed by the Congress building (now the National Museum) and the rest of Agrifina Circle (where the Departments of Agriculture and Finance were), the Luneta, Manila Hotel, Quiapo, Makati, Cubao, and other places.

There was a hint of pride in his jaunty walk that day. I had come to Manila on the strength of a full-scholarship given by the Philippine Packing Corporation that enabled me to study at La Salle and he gave me a tour. The message seemed to be that I could share in that prosperity if I (and for that matter, any of my generation) worked hard enough. Those were heady days of high hopes and bright futures.

Who could blame him for thinking that way? Our development problems were still hidden under a veneer of Western-style consumption and the cover of having broken out of World War II's ruins ahead of almost everybody else in Southeast Asia. Makati with its "skyscrapers" was the showcase of the region then and our "democracy" seemed to be the ideal contrast to what was then evolving in the "other system" under the communists. That was before a minor uprising under somebody

---

1 With apologies to President Barack Obama for the use of the title from his book; I write these thoughts in honor of the fathers that raised our generation.

named Valentin de los Santos, quelled violently with scores killed by the Philippine Constabulary in Pasay City, hinted at the boiling volcano and the hidden fissures in Philippine society; before Typhoon Yoling and other natural disasters unveiled the ineptness of our governance and the deep inequalities of our system. That was also before demonstrating students laid bare the frayed threads of our society with the rotten eggs they threw at President Marcos when he went to address Congress in 1970.

The tumult that erupted in our streets as students, workers, professionals, and other sectors started to question and agitate shook the foundation of my father's generation's worldview, but I don't think they really lost the optimism that underlay their belief that things were basically alright and that all that was needed for progress to continue was for people to work hard. Their working view was of a world where progress would continue.

Those were still essentially optimistic days when I went abroad to study economics. I remember those days quite clearly, the hopes we had, and the dreams we carried in our heads. While some went abroad very soon after to avoid being caught in the authoritarian web of martial law and its prisons — some to China, others to the US and other Western countries — it took a while for these realities to catch up with my father's optimistic view. It took the fear and the growing discontent with martial law for his generation's perception to change. And in the sterile, antiseptic academic world abroad, the reports we received from home somehow missed erasing the mind-view that I had taken with me when I left.

That was almost 40 years ago, four years before I left to study abroad, 11 years before I came home, and almost 20 years before I had the opportunity to take the helm at the National Economic and Development Authority (NEDA). And what a shock I got! What I found as I reviewed the data and reports were worlds away from what I had imbibed from my father. Where I had once thought I would watch the continuous progress toward higher welfare for Filipinos, I found instead a country down on its knees, unable almost to cope with natural and man-made disasters, grappling with high inflation, slow growth, more known for its entertainers abroad than for progress at home. The state of economic disrepair was such that I wanted to ask my father what his generation had done to leave such a mess to my generation. But I still harbored hopes that my cohort would somehow right things back to a smooth path towards progress. We had such high hopes, too, then.

I reflect on these thoughts as I think of my father who passed away almost 20 years ago while I was at NEDA. That time we both still had our dreams that somehow our country could pick itself up, that it was just a matter of hard work, a few adjustments here and there, and things would be back to that golden path to progress.

But now, as the impatience and irascibility of age creep into my sentiments, I start to see that our failure has never been in the resources, the hard work, and the incremental adjustments that we have somehow missed. That somehow we have always found defeat in victory, that we would somehow undercut our own selves, that what we lack is something fundamental. Perhaps, it is the common vision, the common soul, the collective spirit that would make us work really, really hard and work as one with little attention to what is coming to us or our families; that special something that gives meaning to the self-sacrifice for the common good among us. I find this piece missing every time I witness the supreme egoism manifested in traffic snarls where nobody gives in to anybody, or when I see insensitive attention to the public in service areas, or when I witness the high-handed treatment of powerless individuals by powerful interests or officials. In fact, I see it everywhere; sometimes I see it in me. And I start to lose the optimism that my father gave to me.

Yet, somehow there is something that does not want me to let go. The hope refuses to die. And I keep on telling myself, "perhaps, next year..." In me, my father's dreams refuse to die. Perhaps, finally, next year...

Working with President Cory

July 27, 2009

LATELY, I HAVE BEEN frequently asked about how it was to work with President Cory Aquino. I confess it has been difficult to convey exactly how we, who have worked closely with her, feel blessed by the experience. I am, of course, very thankful that she gave me the opportunity to serve my country at a high policy-making level. But more than that, there is the sheer satisfaction of being treated with dignity and respect by no less than the highest official of the land.

She made it clear that she valued our work and was thankful for our efforts. Beyond that, I witnessed grace under pressure, kindness toward others and a willingness to listen to all sides. Contrary to some misimpressions, she weighed the options and the costs and made decisions with the full knowledge of risks being taken, as I will recount the episode on currency liberalization later in this article.

It was much easier to work because it was obvious she had no preconceptions about what should be done. We had our chance to present our case and to defend it. After the Cabinet got the hang of it, Cabinet and NEDA board meetings were often long, difficult but substantial, and issues were ventilated and discussed. For most of my stay in the Cabinet, we were organized into clusters (peace and security, macroeconomics and finance, agro-industrial, social development, among others) that met on their own and presented proposals that had already been pre-digested among cluster members. It was often interesting how clusters were almost like debating teams presenting their arguments while the other clusters argued their own cluster views/agenda. During these discussions, President Aquino would be observing and discussing with the more senior secretaries at the head of the table, essentially the executive secretary, finance secretary, the chief presidential adviser, and the two senior secretaries we tried not to tangle with because of their clout with the President — Fidel Ramos (defense) and Raul Manglapus (foreign affairs). After a long discussion, one of the secretaries at the head of the table would propose a compromise that most around the table would understand as having the tacit approval of the President and discussion would end.

I remember that because of the issues at that time (stabilizing the economy and the need for economic reforms), the economics and finance cluster would win most of its arguments, except when the peace and security cluster would trump us with the security issues. I remember very clearly, in November 1991, a month after the last major *coup* attempt, Secretary (by then) De Villa told me, "Don, you guys can now do your reforms. We can now handle things." The economics and finance cluster then went full blast to carry out economic reforms that we thought were necessary in the remaining period of the administration. For some of those reforms, we ran out of time, but there is a very strong record of economic reforms done by the Aquino administration.

That leads me to look at the economic record of the Aquino administration, and take an opportunity to correct what I feel is an inadequate appreciation of its economic accomplishments. One can often "damn with faint praise." Here I refer to the very much-deserved Aquino accomplishment of restoring political freedom and institutions to the Philippines. While I don't disagree with that assessment, I feel that overemphasis on political achievements sometimes eclipses the economic accomplishments. This would be a pity because the achievements in the economy can compare favorably with any other president's.

Among the major accomplishments were the early policies to rehabilitate a severely damaged economy. The community emergency development program (CEDP) and the dismantling of the agricultural monopolies in coconut and sugar had an almost immediate stimulus effect, initiating the economic recovery starting in 1987. The deferred industrial reform program was also restarted, initiating the movement away from aging, heavily protected industries that were not competitive at global standards. Part of this effort was the overhaul in the later part of the administration of the 1967 Investment Incentives Act that had by then become a heavy administrative burden on industrial policy. But, perhaps, the more important though subtle change was in the way that business was done. As Gem Carague (budget secretary during the second half of the term) noted, during the Aquino regime, businessmen were not found lobbying in Malacañang; they were presenting their position papers in the appropriate departments. That made policy reforms easier to consider systematically and greatly assisted the reform effort.

A major game-changing but implicit economic reform was the de-politicization of key economic variables such as wage determination, foreign exchange, and important products like oil. Wages became a major national issue every time there was a need to adjust compensation. The administration moved to strengthen the regional wage boards, allowing a more geographically attuned level of wages. This eased tension during wage adjustments and made it conducive for industry to be dispersed to areas outside of Metro Manila. While oil deregulation had to wait for the next administration to finally accomplish, the major economic decision to free foreign exchange and the political risk of any turmoil was taken during the Aquino administration. Important reforms in the tax and tariff structure came later. The former was to stabilize government revenues and close the budget deficit. The latter was designed to align our tariffs with needed commitments in international trade negotiations going on at that time.

Before the currency reform, foreign exchange earners had to surrender their foreign exchange to the banking system except for 2% that they could retain for out-of-pocket expenses abroad. Exporters had petitioned that this be raised to 5%. After intense discussion within government, the Monetary Board proposed to President Aquino that the retention limit be lifted to 40% and, absent any currency turmoil, raise it to 100% after one year. The consultation with the President was needed because of the risk of social disturbance if the currency depreciated drastically (as some were warning against). Jess Estanislao (Finance Secretary) and Joey Cuisia (Central Bank Governor) went to discuss it with the President. I remember asking Jess after their meeting whether President Aquino was aware of the political risks and his answer was "Yes." So I asked what she said and he answered, "She said, if that was what was needed, then we should proceed with the reform." It helped, of course, that she was immensely popular and her goodwill was available for pushing difficult reforms. Besides, this was November 1991, after Secretary De Villa had given us the signal to go ahead with reforms.

A final example showcasing the economic reforms was the build-operate-transfer (BOT) law for private production of public services such as toll roads. The law was worked out with the help of Congress to ease the pressure on the budget deficit at the same time that infrastructure investments critical for economic growth had to be made. If private initiative and resources could be harnessed for key infrastructure facilities, then we could continue to initiate infrastructure projects even as the tax system was still being reformed. Since these projects entailed public services, most of them would require franchises, but Congress was not willing to give its franchising authority away so the law required that the executive department submit the list of BOT projects for assessment and approval. As soon as the law was passed, we submitted a list that included more than 100 projects. Congress took one look at the assessment process needed and proceeded to pass a joint resolution that delegated the approval to the Investment Coordination Committee (ICC) of the NEDA board. When the Ramos administration took over, it re-codified the BOT Act, including the delegation as part of the law.

Now, in the twilight of our lives, I sometimes hark back to those days and thank God for the chance to serve the country. That was an exhausting time but it was also exhilarating. One felt that one was contributing to the future of the country. Behind all of these was always the joy of serving President Cory who made it all bearable, fruitful, and worth everything.

Accounting lessons from the crisis

September 28, 2009

AS WE SIFT THROUGH the still-glowing embers of the global financial crisis, part of the debris to study will be the role played by accounting practices and how to learn from the lessons of the fiasco. Some of us will be excused if we say, "Again?" After all, wasn't there a substantial overhaul of accounting procedures after the dot-com crisis of 2000? But here, caution and a deeper look may be worthwhile.

The current crisis and the dot-com collapse appear to have fundamental differences. In the dot-com crisis, the main defect uncovered was both (suspected) active and unintentional connivance between the accounting firms' personnel and the finance divisions of companies issuing stocks and bonds. One of the milder (benign?) forms of this cooperation was the rather loose and flexible treatment of certain forms of expenditures that could be classified as current expenses, pre-paid expenses or even amortizable investments. This could be found in research and development costs, marketing campaigns that could be amortized over more than a year, and valuations of goodwill that arose in the mergers and acquisitions of subsidiaries. A very specific example can be found in the amortization of exploration costs by oil companies and similar ventures. When does an outlay represent costs that need to be "expensed" in the current period and when can it be capitalized to be depreciated over (sometimes) several years or even longer periods? The difference in treatment can mean several tens of millions or even a few billions.

On the revenue side, similar flexibility in recording income from installment sales, continuing projects or contracts spilling over one or more accounting periods, and when sales revenue was recognized even though only a receivable was recorded. The flexibility in the treatment of these costs and expenses allowed chief financial officers (CFOs) to advance or postpone revenues and costs so as to show a smoothly rising income. And if the entity is a conglomerate such as General Electric, the practice (together with the timing of sales and acquisitions of subsidiaries) allowed the firm to show smoothly rising profit figures that were predictable. This made investment analysts happy. The predictability of the profit forecasts given by the CFO during periodic conferences with analysts further endeared the company to these analysts, earning extra points in the stock and bond valuations. If one uses the price-earnings ratio as, at least, a first approximation to pricing a company's value, volatility in profit is penalized with a discount on the stock price (and, therefore, also on the price of its bonds) because investors are less secure about the future value of their placements when they may have to dispose. More volatile earnings mean deeper discounts on stock and bond prices.

One of the most insidious accounting practices then, of course, was to tolerate or not to strongly investigate whether the counterparties in company transactions were real customers or whether the transactions were genuine arms-length processes. Enron, for example, resorted to putting up companies with which it then engaged energy trading on credit. None of these companies were real customers and the sales were essentially back-to-back, offsetting transactions with each other that just bloated sales and receivables without adding real income to the company. The result was continuously higher income earnings even while the company was being run to the ground. As the company continued to have access to large amounts of credit because of the favorable income figures, this deception continued for some time. In the meantime, the potential losses of the creditors built up exponentially. The resulting atmosphere of recriminations gave rise to the penalties that eventually led to Andersen's demise.

On closer look, the lapse was more of a problem of ethics and practice, even though the looseness and flexibility of accounting procedures and interpretation allowed distorted ethics to prevail. As a result of the disaster, accounting procedures became less flexible, more stringent, and complicated. The Sarbanes-Oxley law in the United States also added more responsibility on those who prepare and review the financial statements by making the chief executive officer (CEO) and the CFO attest to the sound preparation and review of the financial statements. The current crisis, on the other hand, seems to involve less of lax moral standards and more of a lag of accounting techniques relative to the changing business and financial environment. Of course, in the end, there is the question of how prudent investors and management were in the face of exploding debt loads. The lapse seems to be in how management and accounting reports may not have adequately given danger signals regarding increasing exposure of the companies to counterparty failure.

The current crisis can, at least, be partly traced to the buildup of risk in the system as more and more funds were drawn into the markets. Since at any time limits to the production of real goods and assets (e.g., houses) exist, growth of these physical assets were outpaced by the increasing credit and liquidity buildup with the result that more and more of the demand increases were being translated into price increases — a classic case of an asset bubble. With securitization and the development of exotic financial instruments, financial and physical assets became increasingly divorced. And as exotic derivatives were fashioned out of underlying credit contracts (e.g., collateralized debt obligations on home mortgages), more credit was drawn into the market. With the increased demand, prices of both physical and financial assets rose. As more exotic derivatives were built on the basis of earlier exotic derivatives, asset prices accelerated upward. But, since these exotic derivatives were increasingly dependent on each other, the resulting framework was not much different from complicated structures built out of cards or toothpicks; any small tremor could bring the house down.

One of the deficiencies — how the overall danger to the system grew unnoticed — will be taken up in a later column on the reforms in market monitoring and regulation. The contribution of the credit rating process to the crisis has been discussed in an earlier column. Here we are occupied with asking why regular management and accounting reports allowed management to remain oblivious to the mounting dangers. The main danger here is that even a minor market shift such as, say, an interest rate change can cause game-changing differences in asset and liability values in the company and its counterparties. In a bubble environment, these assets can build up to a substantial portion of a (especially financial) firm's assets and when the market's vulnerability is triggered, asset values tumble. Mark-to-market rules (where firms have to price their assets at the prevailing market prices and, presumably, force management to recognize changes in a firm's value) do not cure this weakness because when the market values change it is already too late; panic during a crisis will already have caused a downward spiral in asset values. The key is to force management awareness of the buildup of market risk which would, in turn, prevent or mitigate such a buildup.

Under present accounting rules, these potential changes should be recognized in notes to the financial statements. This has a few weaknesses. First, notes to financial statements being essentially *ad hoc* information are essentially non-standardized and, therefore, have limitations in comparability among firms. This is true even if management and accounting firms do not intentionally mislead in the notes. Additional form on these notes could be imposed, but that would raise the question why these are not incorporated into the statements in the first place. Second, many (most?) stockholders and investors do not pay adequate attention to these notes. In fact, some investment officers acquire competitive advantage by just reading these notes more intensively than other investors. This inattention may result in less emphasis in preparing these notes than otherwise. And finally, these notes use various approaches for estimating the value of potential losses (if they even attempt an explicit valuation; most don't). The lack of concrete valuation of potential losses probably lessens the impact of these notes for stockholders, investors, and even management. Thus, management is not automatically alerted to rising risks coming from market shifts. If this caution had been ingrained by accounting procedures and techniques, some element of a natural, self-correcting attention to market risks would have been introduced through individual, decentralized firm caution.

The question now for accounting researchers and practitioners is how their techniques and procedures can be developed to introduce such a feature of self-correction into the decentralized decisions of firms. If they can do so, they will have contributed to a much orderly and faster growing world economy that does not teach expensive and painful lessons against excess every now and then.

Too big to fail

October 26, 2009

IN A RECENT ARTICLE ("In the World of Banks, Bigger Can Be Better," *AWSJ*, Oct. 21, 2009), Charles Calomiris of Columbia University advised against the current drive to limit the size of financial institutions coming out of the current global financial crisis. He cites four advantages of large financial institutions, especially in an environment of internationally integrated financial markets.

First, financial institutions need to be large to operate on a global basis, given the size of the volatility experienced in a larger market. And they need to do so to serve their clients who are also large and global. This leads to lower total, overall costs and the gains could then be passed on to customers, lower costs that come with global competition.

Second, there are economies of scope when financial firms combine different products that are essentially based on the same financial platform owned by one firm. A financial firm offering multiple products to a customer means lower marketing costs and (especially) lower costs of information that can be used and reused for several financial services. These economies of scope also imply economies of scale as being large means that some of these overhead costs can be shared by many products.

Third, much of the gains from larger institutions have accrued to consumers rather than banks in the form of cheaper and better financial services. Even consumers in areas where financial institutions have remained small have gains as increased reach of these larger institutions have put competitive pressure on their local banks. Large-scale global finance has also increased the supply of credit to emerging markets, lowering the costs of funds. His own research has shown that from 1980 to 1990 the cost of accessing the equity market fell by more than 20%.

Finally, global financial institutions have also made the other financial (stock, bond, and foreign exchange) markets more globally integrated and efficient. These global firms provide the funds for arbitrage across markets, facilitating international market integration and leading to even more efficiencies.

The Calomiris article leads us to look more deeply into the reasons to fear these gargantuan financial institutions. The main danger from institutions that seem too big to fail comes from the moral hazard that may afflict the management of these firms. When they feel that they are too large to be allowed to collapse, they may be less prudent about taking excessive risks or be less careful about their operations because the government may have no choice except to bail them out when they run into trouble. They may bank on the generally held belief that the loss from a systemic failure caused by their collapse may outweigh the cost of saving them. As a result, they may feel insulated from any of their failures; thus, the loss of care and caution. If, in fact, this happens the ultimate result would be irresponsible actions from these institutions' management, continual losses from relatively more frequent failures, and a general erosion of the whole system's stability. Thus, the perception leads to a dilemma that regulators solve by going for the safety-first rule; prevent them from growing too big and causing this decision problem.

Calomiris, however, contends that this is a false dilemma because firms can be very large and yet we may actually be able to punish careless management. If true, then it would be a real pity if regulations discourage bigness because, as the article shows, there are tremendous benefits given by large and global financial institutions. The trick is to get the benefits without triggering unnecessary risks. A first step would be to build an international monitoring and regulatory framework where regulators can coordinate their activities in information transfer, transparency and information requirements, and regulatory standards and codes of conduct. This would ensure that the types and extent of business activity, the total value at risk of these financial institutions and related issues can be seen in a holistic way to at least one but, perhaps, more regulators. This would allow regulators to assess the systemic danger posed by each of these institutions. (The other task related to these would be to work out reporting and prudential practices that would induce these institutions to act in the appropriate manner and allow the market to monitor and duly value them. That would make these practices self-enforcing and privately induced.)

A complementary step would be to work out beforehand a system for orderly settlements through pre-ordained (by comprehensive and easily implementable formulas) loss-sharing arrangements, assigning assets among branches and subsidiaries, even across national boundaries. This would allow for an orderly transfer of assets and liabilities to successor institutions without too much business interruption in case of an actual failure. (Calomiris suggests giving the job to deposit insurance corporations in the case of banks and to the courts for nonbanks.) With such arrangements in place, governments will have no hesitation in "routinely" closing failed institutions and transferring their operations to successor organizations. And managements will no longer be able to expect protection from its own folly or hard luck and would be more careful and cautious. Depositors and creditors will be protected. The loss to stockholders will be minimized because of the orderly closing (asset values will not plummet because the business will largely remain a "going concern") and whatever loss they do suffer can be ascribed to their fault in not overseeing enough the management of their institutions.

This assertion is well illustrated in banking systems. Where similar arrangements are in place, bank behavior has been exemplary (although there still are accidents, it's the manner of action that matters). When the reward and punishment system is not felt either because bank managements feel that regulators are too scared of systemic failure or if they feel that they have an easy path to the powers-that-be, bad behavior ensues. And by the way, systemic failure has been a rather convenient excuse for what is known as "regulatory forbearance." There are examples on both sides of the performance line; some are recent, others more remote.

The problem actually goes beyond banks and the financial sector. Any management that feels that it is beyond reproach for its actions will have a tendency to act irresponsibly (except where social and civic responsibility is overwhelming and dominates self-interest, as in *noblesse oblige*, unfortunately rather rare). The solution would be to ensure that a system similar to that described above be installed. Another way moral hazard surfaces is when management is judged and rewarded or punished based on short-term results (such as quarterly earnings growth) while the full consequences of their actions take several years to be fully observable. Part of the solution is to design information/reports that capture the long-term impact of their decisions. Then the rewards/punishment system can be duly designed.

The main lesson is that managers believe that they will be shielded from just punishment for their irresponsible behavior and careless judgment. This can appear in any situation, not just in the financial sphere. The solution is to make management feel that they will be punished for bad behavior. Rules become self-enforcing, the monitoring cost becomes less expensive and the overall system becomes more stable.

Smugglers' dreams come true

November 30, 2009

MERCIFULLY, Executive Order 839 has been withdrawn. People were starting to worry about what would happen if it had been allowed to continue. Some even had visions of long queues of cars leading to gas stations (wasting even more gas!) just to get limited amounts of fuel. Those old enough remembered scenes of these gas queues in the 1970s both here and the United States during the oil embargo after the 1973 Yom Kippur war in the Middle East and supply episodes during that period.

While the government recovered in time from the ill-advised action, it demonstrates how haphazard responses that have not been well-considered can have serious unintended side-effects. And it warns us all against rash knee-jerk reactions to what are sometimes occasions of genuine crisis.

Upon closer examination, the executive order turns out to be a heaven-sent, dream-come-true for rumored oil smugglers. With the cap on pump prices, companies find it unprofitable to supply enough volumes of gasoline products for the market. Prices cannot rise to fulfill their usual function of rationing available supply among consumers. Some form of alternative rationing is needed. A queue is one of the alternatives; here the effective price rises, but it is expended in two parts, the first through the explicit cash out for the pump price and the second through the cost to people spending their time in the queue (and the gas cost as the car runs while waiting). It often has perverse effects. While rich individuals can have their drivers (with lower wage-opportunity cost) wait in their place, middle-class drivers have to use their own time in the queue, presumably with wage costs higher than those of chauffeurs. The non-cash extra cost is a deadweight loss to the economy; it does not go to anybody, it just disappears.

What may escape the casual observer is the very insidious effect of the government's interference with the market on the gasoline distribution system. The inability of prices to fulfill their rationing function just leads to shortages in the customary, legal market. Traditional, legal suppliers who are easy to monitor would find it unprofitable to continue providing their usual volumes. As a result, the explicit price in the formal market is held constant, but the effective price rises as we see above. In fact, many consumers may be left unsatisfied. Furthermore, many of those who are unable to procure the product or even some of those able to do so under the alternative rationing scheme may be willing to buy these products on the side even at higher explicit prices. Thus, a "black market" develops to provide extra supply (but at higher black market prices). Since legal suppliers are easier to monitor, they are unable to sell on the side. On the other hand, illegal suppliers are difficult to monitor and find it much easier to sell on the side at black market prices. The net result, therefore, is to provide a ready market and higher profits to illegal suppliers, which in the present circumstance are able to evade the supply monitoring by smuggling in these additional supplies! Surely, these unintended consequences are not the aim of policy makers. Rather, these undesirable outcomes result from hasty and careless decisions, a lesson to remember for the future.

We can explore the government's best responses to sudden price rises in future columns. For now, let us examine another historical example of the unintended consequences of trifling with the market process. In the early 1980s, as Japanese imports started to invade the US car market, a very strong lobby to keep out cars from Japan emerged. Since the US government was unwilling to explicitly bar or impose high tariffs on these imports, it persuaded the Japanese car exporters to practice "voluntary export restraints" (VERs). The Canadian government soon followed suit since some of the US car companies had large manufacturing plants there. In Canada, this policy allowed the Korean car companies Kia and Hyundai to rapidly increase their market share. Korean cars soon became acceptable throughout the world.

In the United States, the response of the Japanese car companies was to "go upmarket." They muted the increase in their car exports but started selling more luxurious versions (which had higher profit margins). As a result, Japanese cars ceased being known as small and cheap car imports and became more acceptable competitors to American cars in their traditional markets. Before long, Japanese cars became formidable competitors of American-manufactured cars, leading to the near collapse of the remaining American car companies very recently. Still later, as the US appetite for Japanese-made cars persisted, Japanese car companies started putting up their own plants in the US. This even led to the almost-indecent spectacle of American state governors parading before Japanese car executives pleading that the manufacturing plants be put up in their states, offering all sorts of blandishments. This is how the Americanization of Toyota and Honda happened.

As a last warning on unintended consequences, let's not forget the impact of price control actions on overall investments. Investors need to take a long-term view as they make decisions on whether to invest or not. This, for example, is why high inflation is so harmful to investments; it causes investors to lose their long-run perspective and constrains them to a very short-run view. Since the investments that increase overall worker productivity (the ultimate secret to high income per person) require investments with economic lives of 20 years or more, high-inflation countries (like the Philippines used to be) are relegated to small short-run investments with little long-run impact. Factories do not get built; buy-and-sell activities based on imports predominate and manufacturing growth is constricted.

Government propensities to impose price controls have a similar effect. Because firms can no longer be sure if they can adjust their prices to prevailing market conditions, they are no longer able to project their revenues and costs into the future. Their planning horizons are drastically shortened and the country loses the investments on which to build long-run economic growth. This in the end is, perhaps, the most deleterious effect of haphazard impositions of price controls. Both domestic and foreign investors start avoiding countries that behave this way. Such is the penalty of unintended consequences. Ultimately, one harms those he professes to protect.

Dilemmas in bank regulation

December 21, 2009

As a consequence of the Federal Reserve System's perceived inability to prevent the global financial crisis or the harm of the market collapse, some influential sectors of the United States are calling for significant curbs to the powers of their central bank. Two of the main proponents come from almost opposite sides of the ideological spectrum, demonstrating the breadth of the dissatisfaction with the financial regulators.

On one hand is Congressman Ron Paul, a conservative Republican from Texas and former candidate for his party's nomination to the presidency, and on the other is liberal Democratic Sen. Christopher Dodd from Connecticut, a state generally known as one of the bases of the country's financial sector. This provides an occasion to reflect on some of the aspects of financial sector regulation.

Congressman Paul has persuaded more than half of the US House of Representatives to support a bill that would subject the Federal Reserve to audits by the Government Accountability Office, opening the door to second-guessing, lowering its independence. Such moves raise fears that political "kibitzing" from the sidelines will lead to pressures to lower interest rates and to a weakening of inflation control. Paradoxically, Mr. Paul is a known proponent of commodity-backing for the money supply (he proposes legitimizing gold and silver as legal tender but stops short of going back to the gold standard). One often-cited advantage of commodity-backing is the limit it imposes on the central bank's ability to expand the money supply — an awkward position for a populist in a country where populism has been identified with advocating increases in the money supply to lower interest rates for the "common man" and freeing him from the "control of powerful unseen bankers." In fact, scholarly reviews of *The Wizard of Oz* (by L. Frank Baum) pioneered by Henry Littlefield in *The American Quarterly* in 1964 ascribe the story (since then romanticized by Disney Pictures) to agitation by Midwestern farmers in the late 1800s to add silver to gold as base money in order to increase the money supply and, thereby, reduce interest rates. Presumably, the common thread between both brands of populism is suspicion of central government authority. For the Federal Reserve, this means less power to undertake monetary policies that may seem remote and opaque to the layman.

Senator Dodd, on the other hand, would strip the Federal Reserve of its power to regulate banks. This is not as excessive as it may initially seem. The US regulatory system for banks is multi-layered with several agencies having regulatory power over banks, starting with the Office of the Controller of Currency — the original bank regulator of federally-registered banks, the state bank regulator for each state, the Federal Deposit Insurance Corporation (the Philippine Deposit Insurance Corporation here) and, finally, the Federal Reserve. Multiple regulators probably increase the cost of reporting, although the harmonization of information requirements and the synchronization of inspections could greatly reduce that regulatory burden. However, the Fed's reason for monitoring and regulation flows from its task of regulating the money supply (through reserve requirements on deposits, among others) and its function as the lender of last resort. In times of crisis, the only way the central bank can provide emergency liquidity loans to banks is by constant monitoring of its assets and liabilities.

While there is room in the United States for some centralization and bank regulation and, perhaps, merger of functions, the Federal Reserve regulation of banks seems inherent to its core functions of monetary policy and lender of last resort and may be difficult to remove. In the Philippines, the dilemma comes from the multiple tasks assigned to the Bangko Sentral ng Pilipinas in the Constitution. As the independent central monetary authority, the BSP is tasked with policy direction in the areas of money, banking and credit, has supervision over the operation of banks, and regulates institutions with similar functions. As the supervisor of banks, it must prevent systemic failure of the banking system and oversee the services of individual institutions. The danger of conflict of interest arises, for example, when the needs of the economy (price and financial system stability and economic growth and stability, among others) require, say, an increase in interest rates, but this would put pressure on individual banks. Afraid that a collapse or extreme difficulties of one or several banks may be interpreted as their failure, monetary authorities may hesitate to implement the correct monetary policy. Thus, monetary policy may be adversely affected by assumed public perception, weakening the central bank independence that the constitutional provision sought. While the policy difficulties may be understandable from the human and even policy viewpoint, it does highlight a latent dilemma that may require some structural adjustment in the organization of government agencies. For example, one suggestion in other countries is for a review and possible strengthening of the deposit insurer's powers and capabilities so that bank supervision becomes more of its power and responsibility rather than that of the central bank. This has its own concerns because of the deposit insurer's limited financial strength given that it does not have the power to create money. Another suggestion is to place most regulatory power over financial institutions (i.e., including finance. insurance, and related companies) under a centralized financial regulator. This has already been done to some extent in countries like the UK and has the effect of isolating monetary policy from banking and credit. But we must hasten to add that monitoring and supervision of banks by the lender of last resort, the monetary authority, is difficult to remove. Still another possibility is to restructure the central monetary authority so that isolation between monetary policy and bank and financial regulation can be achieved. This can be done by outright division of the authority or internally within the central bank.

Fiscal discipline in history

June 8, 2010

IN OUR PREVIOUS COLUMN we discussed how William the Conqueror of England, Oda Nobunaga, Toyotomi Hideyoshi and Tokugawa Ieyasu of Japan, and Otto von Bismarck of Prussia built strong governments on the foundation of a basic, robust, enforceable tax system. Here we explain why. While we already know that the basis for growth is a strong government with enough resources to provide services to its citizens on a sustained basis, it is useful to examine how the breakdown can occur.

Even in early times, governments had to satisfy their citizens, and even the feudal system, much-maligned during those exciting days of student activism in our youth, had evolved to address these issues. During its time, feudalism satisfied the purpose enough — i.e., the essential mutual exchange of rights and obligations between serfs and lords — to last for several centuries, breaking down only with the growth of markets and the expansion of property rights. Even when they were invoking "the divine right of kings," monarchs were aware of this requirement and strove to satisfy one way or another. And until the democratic form of government provided a smoother way there were two main ways of replacing sovereigns. First was through the weakening of the sovereign's power either because the people withdrew physically by deserting or more subtly by withdrawing their work effort or some subtle form of withholding their product. The sovereign could be weakened enough that a neighboring kingdom would swallow his domain either through conquest or subversion. The second was through a violent internal upheaval.

When sovereigns were still the accepted embodiment of authority, this would be exercised by switching support to a rival claimant, or by outright support of someone with an inadequate claim to the throne who would be called a "usurper." While these "usurpers" had incomplete claims some of them had enough popular support that they went on to set up their own line or dynasty. (In modern game-theoretic form, this change would be characterized as a decisive block of the coalition switching to an alternate combination of ruling blocks or outright opting out of the game [i.e., kingdom]). As a digression, sovereigns were not averse to killing their own children in order to remove rival claimants among their children just to ensure the continuation of their line. Contemporary Muslim observers opine that Suleiman of the Ottoman Empire made the wrong choice of sacrifices and chose probably the least capable person in his son, Selim. Without a sustainable source of resources, the monarch would be hard-pressed to continue providing the expected level of government services even if at that time this was very basic, personal and physical security, some level of justice, protection or relief from natural disasters or typhoons. Absent this, the monarch would be susceptible to overthrow. This would be most acutely felt if the danger came in the form of an advancing rival's army. Quite often, moving to prevent disaster would be too late by that time. The best antidote was to have a strong base of continuing government revenue, shown at different periods and in different countries by William the Conqueror, the Japanese trio, and Otto von Bismarck.

How does the unprepared monarch try to escape his situation? The possibilities depend on the acuteness of the threat. If the threat is immediate as an observed military buildup of rival, the monarch may try to borrow funds, soldiers and/or provisions. But if he already is significantly in debt because of continuing inadequacy of resources, additional borrowing can raise doubts in creditors as to whether he can eventually pay or whether he can even survive the crisis. In modern situations this would be similar to the erosion of a country's credit worthiness and the downgrading of its credit rating. With each additional borrowing, the borrowing costs rise and funds become more difficult to obtain. On the other hand, if a kingdom's finances were properly managed in the first place, this buffer would be available for emergencies like this because credit worthiness was intact. The modern equivalent is the ease of raising money when the country maintains its credit worthiness.

If the financial strain is gradual in development, historically caused by the monarchs' excessive spending and financial irresponsibility, a sly monarch can try to cheat by methods mentioned in the earlier column. Sovereigns in medieval and renaissance Europe would dilute the gold or silver content or try to imperceptibly reduce the size of the coinage. But this physical debasement would often be shortly discovered and result in the loss of trust in the realm's money and business would suffer as commerce would move outside the kingdom's monetary environment. Alternatively, in areas where the police authority of the monarch was less complete, alternative or foreign coins would circulate as money. In the United Kingdom of the

15th–17th centuries, French coins coexisted with English money. What this implied was that English goods had been shipped to France in exchange for French money. This in turn implied that the French economy had enjoyed at least temporary, advantage by making use of British goods in exchange for French money of less intrinsic value. (Note that if money even with gold and silver had equal or more intrinsic value than the goods exchanged for it, the coins would be kept by people and would not circulate, losing its use as money. Why was it accepted for money? Because in addition to its intrinsic value it also possessed utility as the medium of exchange making it equal in ultimate value to the goods being traded.) In a later column we shall discuss the advantage to the French monarch through the concept of "seignorage" from monetary circulation. At any rate, all these served to weaken the British monarch and economy at that time.

In modern society, the equivalent phenomenon would be an increase in the money supply leading to a continuing increase of prices (inflation). This financial debasement (loss of value) of modern money is the equivalent of physical debasement of medieval times. When governments can borrow directly from the central banks, the fiscal deficit is met directly by printing money and releasing it to the government to spend. In situations where (like the Philippines today) the government cannot borrow from the central bank, the banks can buy government securities, allowing the government to pay private people who then deposit the money in banks. The resulting increase in bank assets allows more loans to be given out, which then increases the money supply through the money multiplier process. If the public buys the government securities (or the banks who then resell to the public), money goes to the government and the process described ensues. If the government borrows abroad, the foreign currency can be used to bring in more goods mitigating the first round of inflation. However, the money supply still increases through the money multiplier process. Besides, the inflow of goods competes with domestic production leading to an unnecessary and unwanted pressure on our producers. In sum, as this process is carried out on a continuing basis, domestic money is debased and the economy is weakened, as in the medieval and renaissance times.

Again, history teaches us a valuable lesson in fiscal discipline. There is no substitute for a firm and robust tax system and a judicious public expenditure process if a developing economy is to grow on a sustained basis. Emerging economies ambitious to graduate to the level of world-class players have no choice but to instill fiscal discipline on itself.

Why PPP?

August 6, 2012

PEOPLE HAVE BEEN wondering why there has been so much emphasis on public-private partnership (PPP).

Given the total investment (or even just the infrastructure) needs of the economy, the enthusiasm seems out of proportion to the total amount of projects that may be expected from the program. The Official Development Assistance (ODA) program certainly looks much larger, at least for the moment. Direct government implementation on its own is also quite substantial.

Quite a few attribute this attention to its potential for solving budget limitations. There was certainly a time when this was a tantalizing prospect for government managers. The first time I was at the National Economic and Development Authority (NEDA) in 1991, when the initial build-operate-transfer (BOT) law was first passed, we were quite attracted by its potential for advancing large but critically needed projects in the face of the very dire budget picture then.

More than financing

My appreciation of the approach has changed, however, as I have observed it more recently. As we moved the PPP Center to NEDA, making it ready for more effective project development given NEDA's role in investment programming and the project approval process, I became aware of the groundwork that is needed for a successful PPP program and facilitation center.

At the same time, we have become aware of the advantages of the approach for governance in general and for infrastructure in particular.

PPP is more than just the financing.

It also exploits the efficiencies, the speedy and timely decision-making, the single-mindedness and nimbleness of private initiative. It offers the opportunity to pinpoint and implement the strategic and critical projects that support and are interconnected with national infrastructure networks and clusters.

And it may afford us the benefit of getting this social overhead capital (using the old term used by Walt Rostow half a century ago) earlier and in better form.

There are good examples (there are bad ones too) of how PPP efforts, sometimes just in the form of simple privatization, have improved the provision of public services that show the potential of how this mode can be of significant benefit to an economy.

No shortcut

At the same time, we need to be aware of the dangers of PPP so we can move to avoid these.

The private sector can be a very efficient operator and implementor. It can also be a very efficient negotiator. It has the unalloyed advantage of a very intense profit objective. And it can leverage its advantage in resources and nimbleness while negotiating with a sometimes lumbering government that has to consider how its rules, decisions and actions can set precedent that it will have to deal with in the future. This unbalanced condition can easily lead to government's disadvantage even with very good projects unless the resulting contract is properly structured.

The paradox of public-private partnership is that while it offers the promise of the merger of public and private resources and abilities, it is not a shortcut and it will not suffer shortcuts.

PPP demands just as or even more stringent requirements from the public sector as ODA and direct government implementation. The institutional infrastructure includes, among others, well-structured rules that are clear and transparent for everyone's guidance. Transparency, fairness and a level playing field are critical to bringing in the right private sector players and heading off unwanted legal hassles later.

At the same time, it is important for the government to have an effective planning and programming process to identify and prepare public projects amenable to this mode of implementation.

With the complexity and size of public projects nowadays and the complicated, interrelated (a "noodle dish") government laws and regulations, one cannot anticipate all of the potential issues in project design, development and contracting.

For complete and effective implementation, we need to take care of the details "from A to Z."

It is difficult to do this in concept.

Actual cases are needed to go through the whole process and see where the kinks are. More often, we need more than one pilot case.

There are too many interlacing procedures and rules that one cannot possibly predict where inconsistencies and gaps are going to be. One just has to go through the whole exercise of actual projects.

This is where PPP projects come in. While these projects are critical and are at the nexus of many development activities, the program's ultimate benefit may not lie in its physical contributions, no matter how critical those are.

Unexpected issues

As it turns out — as we go through the motions of bringing PPP projects forward — we encounter project development and investment programming issues that do not crop up in direct government implementation and ODA.

For example, typical mundane issues in private sector contracts such as the careful specification of levels of service, guarantees, methods of monitoring and margins of error, etc. reach higher levels of need for public projects as it deals with the private sector.

Given the myriad of possibilities, it is almost impossible to specify a taxonomy of rules and procedures to cover even just the majority of cases. Like jurisprudence, the whole body of explicit and implicit rules, practices and custom need to be built up with practice. Since laws, customs and business practices differ from one country to another, it is not possible to just copy from another country, no matter how advanced it is.

In other words, as we apply PPP as an important mode of public sector project implementation, we are finding out that there is a very large lacuna of processes that should govern the way government interacts with the private sector.

These processes need to be developed; and they are being developed as they have to be.

Except that, given the litigiousness of our society and the stringency of the consensus interpretation of the anti-graft law and the code of ethics, errors of judgment are not given the benefit of the doubt.

As a result, bureaucrats are loath to exercise judgment. Thus, project development is slow and tedious.

The speed will pick up as projects of each genre are successfully implemented. (Other areas that are being developed are auction rules, contract structure, monitoring and several more areas.)

But the initial costs of discovery have to be matriculated and the going is quite sluggish. And even as the processes are developed, applications under the existing environment will still not be speedy enough.

Fortunately, development partners like the Asian Development Bank, the Australian Government Overseas Aid Program and Canadian International Development Agency have been willing supporters of our learning efforts.

Building up experience

As PPP projects are being developed and implemented, emerging issues help improve policies and processes. This mode of implementation could turn out to be an important plank of the government's governance reform process.

And as experience is built up, the body of knowledge expands and may be propagated to lower levels of government.

That is one reason the PPP Center has developed the initial manual and template of PPP for local government units. This is an important example of "institutional externalities" where good practice is propagated and absorbed by other institutions.

If we are successful, the overall improvement in processes over a broad front that ultimately results in good practice on a routine basis may ultimately be the lasting and sustainable legacy of this program.

Our task now is how to speed up the development of this package of good practices to accommodate the needs and advantages of PPP and to facilitate the propagation of these lessons to all levels of government.

About the author

FOR THE LATE Cayetano W. Paderanga, writing a newspaper column allowed him not only to communicate ideas but also to express deeply personal feelings that had no room in government reports, policy papers and even academic studies. He once wrote about his first visit to Manila in the mid-1960s as a college student on a full scholarship and recalled his father's optimistic outlook for country then, and contrasted that with the deep-seated problems that he confronted as the government's chief economic planner in the early 1990s. "The state of economic disrepair was such that I wanted to ask my father what his generation had done to leave such a mess to my generation," he wrote poignantly in 2009.

"Dondon," as friends and colleagues called him, had plenty of occasions to take a good, close look at the country's economic challenges. He served not once but twice as socioeconomic planning secretary and director-general of the National Economic and Development Authority (NEDA). He first served as the planning agency's chief in 1990-1992, when the country was reeling

The late Cayetano Paderanga likes to inject a bit of humor into serious discussions of economic issues and policy, endearing him to colleagues and subordinates alike.

As Socioeconomic Planning Secretary, the late Cayetano Paderanga is open and transparent about his views on economic issues of the day, making him a favorite interview subject of business and economic journalists.

from power shortages and the lingering effects of coup attempts against then-President Corazon Aquino. From 2010 to 2012, he was again appointed to the same post, this time by former President Benigno Aquino III, the former president's son. He was also a member of the Monetary Board, the policy-making body of the Bangko Sentral ng Pilipinas, from 1993 to 1999 and executive director for the Philippines at the Asian Development Bank (ADB) from 2001 to 2003.

A native of Camiguin province in Mindanao, he finished his Bachelor's degree in Accountancy at the De La Salle University in Manila as a scholar of the multinational company Del Monte Packing Corp., and his Master's degree in Economics at the Center for Research and Communication (now the University of Asia and the Pacific). He obtained his Ph.D. in Economics at the Stanford University in California. He later joined the faculty of the UP School of Economics and won fellowships from the Rockefeller Foundation and Yale University's Economic Growth Center. He was also appointed a visiting professor at Kobe University in Japan.

He is married to Delia C. Paderanga. He died of complications from heart surgery in January 2016.

The late Cayetano Paderanga (fourth from left) with Former President Fidel Ramos (second from left), Romeo Bernardo (left) and Anthony Abad

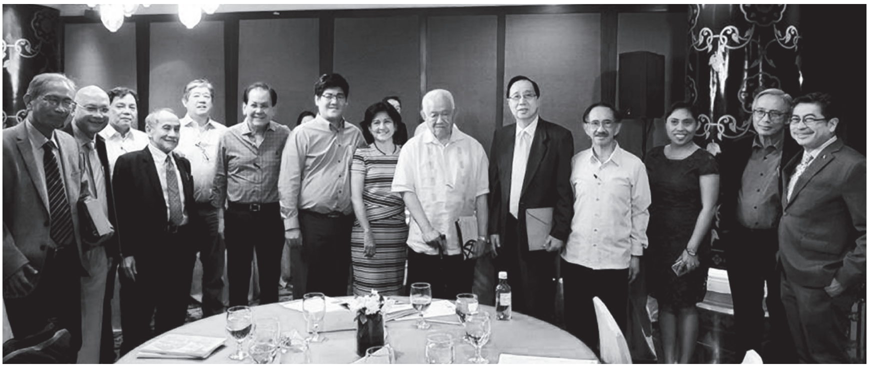
Romeo Bernardo (front row, right) and the late Cayetano Paderanga (front row, third from left) pose with former government colleagues. In the front row, from left: Miguel Luz, Felipe Medalla, Arsenio Balisacan, Dante Canlas and the late Emilia Boncodin. Behind them are officers of the Asian Development Bank (ADB).

Raul Fabella (second from right) and Emmanuel de Dios (second from left) in a lively discussion with Jaime Augusto Zobel de Ayala (left) and Ramon Clarete (right) during a ceremony to mark the signing of a memorandum of agreement on the Ayala-UPSE Economics Forum.

Emmanuel de Dios (left) and Raul Fabella (second from right) are joined by former UP School of Economics deans. From left: Felipe Medalla, Amado Castro and Ramon Clarete.

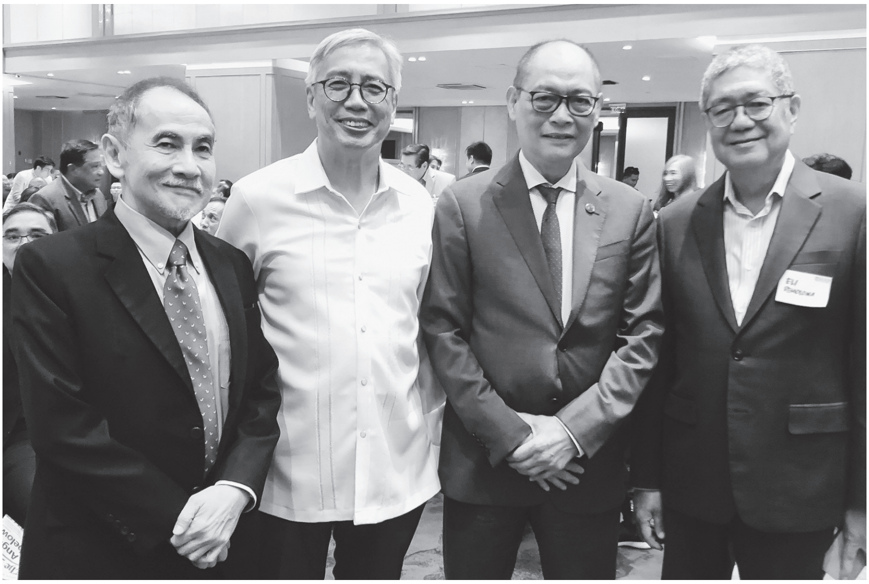
Romeo Bernardo (second from left) and Calixto Chikiamco (right) pose with Cesar Virata (second from right) at the 3rd Paderanga and Varela Lecture Series in October 2018. Attending the event as special guests are the late Cayetano Paderanga's widow, Delia Paderanga (third from left), and their son, Paolo Paderanga (left).

Calixto Chikiamco (left) and FEF Chairman Roberto de Ocampo (right) meet with Japanese Ambassador to the Philippines Koji Haneda.



Raul Fabella (leftmost) with some of the guests after delivering the 3rd Paderanga-Varela Memorial Lecture on "Capitalism and Inclusion Under Weak Institutions" in October 2018. Also in the picture are co-authors Romeo Bernardo (second from left) and Calixto Chikiamco (fifth from right), and Felipe Medalla (second from right) who wrote the book's foreword.

Calixto Chikiamco (seated, rightmost) and Raul Fabella (seated, second from left) pose with some of the guests at the 3rd Paderanga-Varela Memorial Lecture in October 2018.



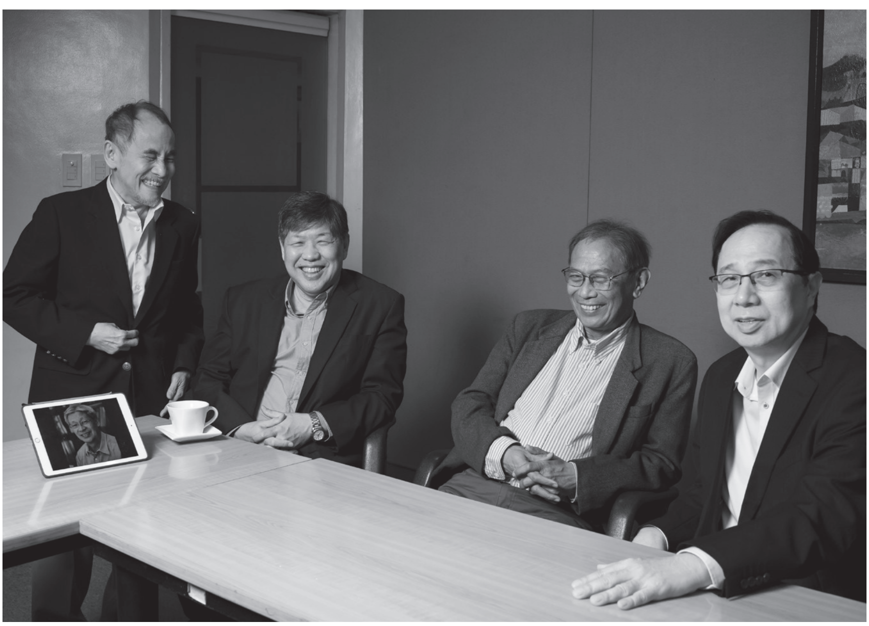
(From left to right) Romeo Bernardo with Felipe Medala, Benjamin Diokno and Eli Remolona at a luncheon meeting of the Financial Executives Institute of the Philippines

Romeo Bernardo (center) joins a gathering of former secretaries of the Department of Finance to mark the 122nd anniversary of the government agency shortly after a recent credit ratings upgrade for the Philippines to BBB+ from BBB. (From left to right) Edgardo Espiritu, Jose Pardo, Cesar Virata, incumbent DOF Secretary Carlos Dominguez, DOF Undersecretry Gil Beltran, Margarito Teves and Jose Isidro Camacho.

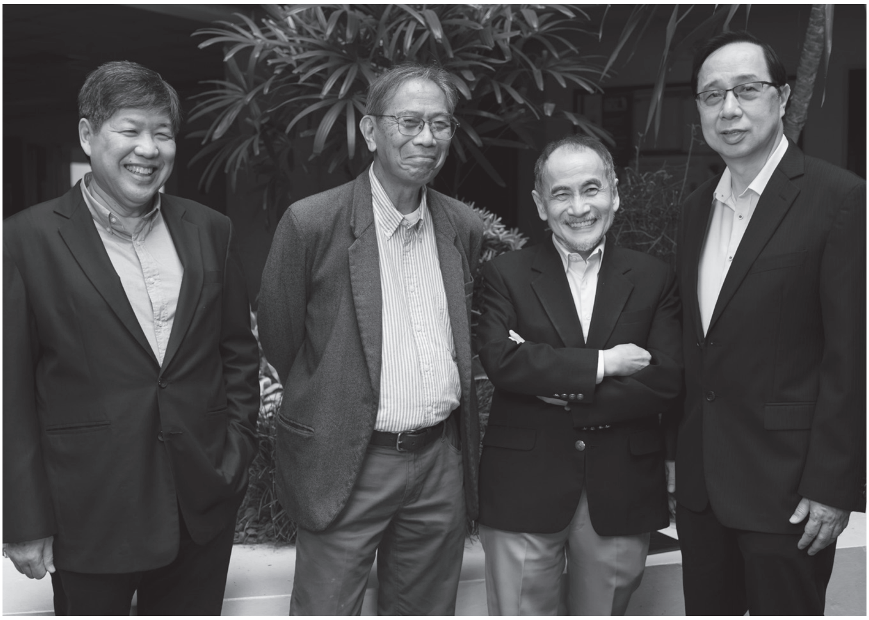
Emmanuel de Dios (left) is joined by *Rappler* editor-at-large Marites Vitug (right) and *Rappler* columnist JC Punongbayan after an interview at the online media organization's newsroom.

Emmanuel de Dios (standing, third from right) joins Dean Orville Solon (extreme right) and other faculty members of the UP School of Economics after a forum where Ma. Lourdes Sereno (seated, centre) was a speaker. Sereno is flanked by former UP Mass Comm dean Georgina Encanto (left) and Etta Rosales (right)

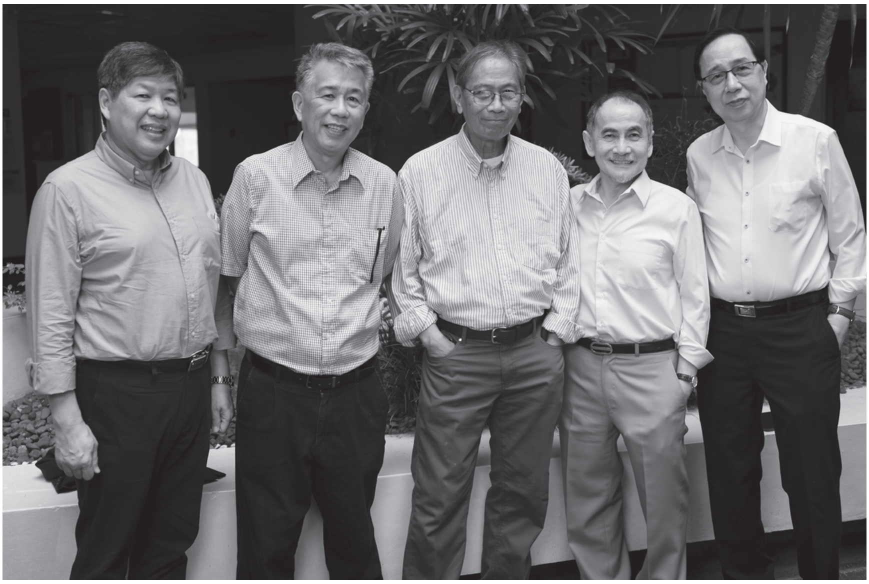
Emmanuel de Dios pays a visit to a UP School of Econonics alumna



The authors enjoy a private joke during the photo shoot at the UP School of Economics. From left: Romeo Bernardo, Emmanuel de Dios, Raul Fabella and Calixto Chikiamco. The late Cayetano Paderanga's image is displayed on the iPad.



The authors at the courtyard of the UP School of Economics Library building. From left: Emmanuel de Dios, Raul Fabella, Romeo Bernardo and Calixto Chikiamco



The authors with the book's editor. From left: Emmanuel de Dios, Roel Landingin, Raul Fabella, Romeo Bernardo and Calixto Chikiamco

Index

1

1987 Constitution 173, 175

A

Abad, Antonio "Tony" 57
Abaya, Joseph Emilio "Jun" 112, 146
Abe, Shinzo 100
Abenomics 100
Aboitiz group 291
ABS-CBN Corp. 171, 243
Acemoglu, Daron 170
Action for Economic Reforms (AER) 272
Agrarian reform (see also Comprehensive Agrarian Reform Program)
 as a deterrent to agricultural investments 157
 in East Asia 112, 141
Agricultural free patents
Agricultural Free Patent Reform Act (RA 11231) 110, 122, 144
 need for removal of restrictions 122
 number 108
 restrictions on sale 142
Agricultural productivity
 and Duterte administration 142
 and land consolidation 121
 and land reform 75
 and sustainable growth 156
 binding constraints 160
 as key to economic revolution 139-144
 compared with industry and services 181
 factors behind low level 140
 inadequacy of government proposals 111
 policy reform proposals 102, 142
Agriculture
 agri-processing linking farmers to modern value chains 206
 and vulnerability to shocks 163
 average growth 119
 bank loans to the sector 108
 farming as modern enterprise 120, 142
 in China 164
 in the Netherlands 164
 in the US 164
Aguinaldo, Emilio 193
Alcala, Proceso 112, 119, 133, 262
Alcuin 241
Alexander, Bruce 215
Allison, Graham 168
Almonte, Jose 291
Alonzo, Ruperto "Ruping" 57
Ambisyon 2040 82, 156
***An Analysis of the Philippine Economic Crisis*, 1984** 242
Andersen, Hans Christian 267
Ang, Clyde Wesley 278
Ang, Jesse 91
Animal spirits 317
Annan, Kofi 219
Año, Eduardo 147
Antibiotics 269
Apathy 229
Apprenticeship 101, 105
Aquino, Benigno, Jr. "Ninoy" 211
Aquino, Benigno Simeon III "Noynoy"

agreement with Hu Jintao 48
delayed infrastructure projects 292
faster manufacturing growth 281
poverty reduction 281

Aquino, Corazon "Cory"
de-politicization of decisions on prices, wages and foreign exchange 332
economic impact of coup attempts against her 357
economic reforms and accomplishments 331
leadership style 330
willingness to face political risks for needed economic reforms 332
workings of Cabinet 330

Aquino, Jason 159, 161

Argosino, Al 285

Armed Forces of the Philippines (AFP) 147

Arrow, Kenneth

Arrow-Debreu model 221
impossibility theorem 222
on the global war on drugs 223
problems with majority rule 222

Arroyo, Gloria Macapagal
as "worst president" for millennials 209
backing for bill amending Public Services Act 71
election as House speaker and support for tax reforms 81
support for conditional cash transfers for the poor 24

Artificial Intelligence (AI) 116, 150, 170

Asian Development Bank (ADB)
loans to MWSS 39
public-private partnerships 66
solar power plants 49
support for flawed renewable energy project in the Philippines 357

Asian Infrastructure Investment Bank (AIIB) 48

Autonomous Region in Muslim Mindanao (ARMM) 44, 284

Ayala group 39, 40, 291

B

Bacani, Senen 45, 208

Balance of payments (BOP) 252

Balisacan, Arsenio 262

Banatao, Diosdado "Dado" 273

Bangko Sentral ng Pilipinas (BSP)
and currency appreciation 254
and infrastructure investment 254
and price stability as primary goal 253
conflicts in function as monetary authority and banking regulator 346
monetary policy independence 252
open market operations limited to private sector borrowing 253
overdue recasting of monetary policy 252
New Central Bank Act (RA 7653) 252
role in managing public worries about Bank of the Philippine Islands computer glitch 61

Bangsamoro Development Agency (BDA) 46

Bangsamoro Leadership Institute (BMLI) 46

Bangsamoro Organic Law (BOL) 80

Bank of the Philippine Islands (BPI)
and computer glitch that disrupted ATM and online banking services 60
and investment in Lehman Brothers securities 63

diversity in board membership 62
independent directors 62
prosecution of criminals in ATM skimming and card fraud 63
Bank regulation 345
Bankruptcy laws 117
Basketball 261
Baumol effect 274
Beams, Dovie 212
Bear Stearns 304, 305
Belmonte, Feliciano Jr. 56, 101
Belt and Road Initiative (BRI) 168
Berg and Ostry 256, 258, 273
Bernardo, Amina Rasul 45, 97
Bernardo, Ibba Rasul 69
Big banks 338, 340
Big Business 138, 208
Big Oil 150
Bill of rights 240
Binay, Jejomar 250
Biotechnology 164
Bitcoin 116
Blockchain 116, 169
Boom and bust cycles 154
Branson, Richard 219
Braudel 187
Bretton Woods institutions 73
Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA) 44
Bud Dajo massacre 194
Build Build Build program 166
Build-Operate-Transfer (BOT) 332
Business Process Outsourcing (BPO)
and artificial intelligence 150
and growth of services sector 180
and telecoms deregulation 181
poised to exceed OFW remittances in foreign exchange earnings 207
policy proposals to cope with possible slowdown of the sector 151
short-term and long-term threats 149, 150
BusinessWorld 56, 301

C

Cable TV 117
Calamard, Agnès 72, 232
Call centers (See also BPOs) 180
Calomiris, Charles 338
Camaligan, Raul 285
Canlas, Dante 57
Capital in the Twenty-First Century (See Piketty, Thomas)
Capitalism and Inclusion under Weak Institutions 84, 301
Carague, Guillermo 331
Carbon emissions 29, 78, 150
Cardona Water Treatment Plant 298
Cardoso, Fernando 219
Carnegie, Andrew 193
Catholic Church 171, 183
Cavite Laguna Expressway (CALAx) 270
Central Bank 252
Certificate of Land Ownership Award (CLOA) 107, 121, 141
Charisma 224, 227-228
Child hunger 264, 265
China Telecom 90
China-Philippine relations
bilateral trade 89
major developments since 2014 88
China-funded infrastructure projects 89
Chinese foreign direct investments 89
Chinese tourists 89
Memorandum of Understanding on joint oil and gas development 90
Churchill, Winston 264

Cimatu, Roy 147
Civil liberties 240
Cleveland, Grover 193
Climaco, Gloria Tan 59
Climate change 139, 156
Coal excise tax 78, 79
Coasian process 108, 120, 143
Coasian transaction costs 208
Cold War 167
Collateralized debt obligations (CDO) 320
Collective action 135
Communist insurgencies 112
Communist Party of the Philippines (CPP) 191
Comparative advantage 262
Competition 221
Competition Policy and Inclusion in the Philippines 301
Comprehensive Agrarian Reform Program (CARP)
and agricultural productivity 174
and low levels of private investments in agriculture 247
and public agricultural lands 142
and rural insurgency 140
and the middle class and big landlords 141
as a foundation of the post-EDSA Revolution economic system 172
as anti-insurgency measure 173
average yields of agrarian reform beneficiaries 247
CARP Extension with Reform (CARPER) 141, 246
driving out capital out of agriculture and agri-industrial sectors 274
expiration in 2014 181
failure to alleviate rural poverty 174
failure to boost agricultural productivity 141, 247
land-to-the-tiller program 3
lengthy duration as a factor for agriculture's decline 180
need for individual land titles 121
need to free rural land markets from restrictive provisions of CARP 165
poverty incidence among agrarian reform beneficiaries 247
proposed amendments to the CARP law 102
RA 6657 or Comprehensive Agrarian Reform Law 246
restrictions on farmer beneficiaries 141
restrictions on operation of rural land markets 165
restrictions on selling or renting land 248
restrictive rules of the program 107
Concepcion, Jose Ma. "Joey" 172
Conditional cash transfers (CCT; see also Pantawid Pamilyang Pilipino Program) 6, 23, 259
Confesor, Nieves 137
Conglomerates
factors behind dominance in the Philippines 290
in emerging markets and rich countries 291
positive role in inclusive growth 292
rise of conglomerates in weak governance environments 85-86
Consing, Cezar 61
Contraceptive method 184
Corporate social responsibility (CSR) 282
Corpuz, Arturo "Art" 82, 85
Cosmetic surgery tax 77
Credit ratings
additional regulations from US SEC 315

conflicts of interest in rating CDOs 321
EU approach to regulations compared with US 316
fostering competition in an oligopolistic industry 316
fragmented view of CDO market 320
new regulations from US SEC 322
role in the US subprime crisis 314
Crimes 184
Cruz, Elfren 72
Currency debasement 350
Currency exchange rate 102
Currency reform 332
Current account deficit 154, 158

D

Daang matuwid 102
Danes 267
Dangerous Drugs Board (DDB) 230
Dans, Antonio 237
Darwin, Charles 191
de Lima, Leila 128
de Ocampo, Roberto "Bobby" 56, 57, 58, 85
Debreu, Gerard 221
Deforestation 113
Del Castillo, Mariano 250
del Rosario, Ramon Jr. 57
dela Rosa, Ronald "Bato" 283
de los Santos, Valentin 328
Democracy 238
Demographic decline 168
Deng Xiaoping
and agricultural reforms in China 164
reforms and poverty reduction in China 74, 85
"Socialism with Chinese characteristics" 100
struggle against Maoists 282
Denmark 268
Department of Agrarian Reform (DAR) 121, 165, 289
Department of Agriculture (DA) 111, 119, 140
Department of Education (DepEd) 264
Department of Energy (DOE) 37
Department of Finance (DOF) 129, 308
Department of Science and Technology (DOST) 206
Department of Social Welfare and Development (DSWD) 23
Development progeria 204, 275, 280
Dewey, John 192
Diaz, Hidilyn 277
Dietary authoritarianism 235
Digital disruption 115
Digital Telecommunications Inc. (Digitel) 30, 32
Diocletian 259
Direct taxes 233
Documentary stamp taxes 77
Dodd, Christopher 345
Domestic savings rate 307
Dominguez, Carlos "Sonny" 146, 234-235, 286-287, 295-296
Drug addiction
and poverty 216
behavior modification options 215
penalties for drug possession 218
Dangerous Drugs Act of 1972 (RA 9165) 218
role of environment and learning 215
scientific studies 213

statistics on drug use in the US and Philippines 214

Drug war
and police extortion 217
and rise in murders and homicide 230
compared with lobotomy 216
indirect consequences 217
rethinking of prohibition and punishment approach 219

Dulay, Patrick 277

Dumol, Mark 38, 92, 94

Duterte administration
"no-go zone" policy covering mining and other key industries 282
division within Cabinet between economic pragmatists and Maoist ideologues 288
flawed agricultural policies 156
neglect of agriculture 166

Duterte, Rodrigo
"name and shame" campaign 127
and charisma 224
and rogue cops 285
and war on poverty 132
declaration of Martial Law in Mindanao 231
declaration of state of lawlessness 231
high popularity ratings 226
initial assessment of first three years 171
key government appointees 145
on drug addicts as non-humans 213
rise to power on back of perceived crisis 225
seen as favoring dictatorship for efficiency 222
uncertainty arising from unpredictable policies 127

E

Ease of doing business 20, 75

Economic growth
emerging threats 154
factors behind spasmodic episodes 255
sources of further expansion 154
structural weaknesses as binding constraints 158

Economic reforms
boost from end of coup attempts in the late 1980s 331
two broad types 4

Economic zones 76

Economy and Society 224

Eden, Richard B. 278

Edict of Maximum Prices 259

EDSA People Power Revolution 171

Education 117, 152

El Filibusterismo 186

Electric Power Industry Reform Act (EPIRA)
and Gloria Macapagal Arroyo 81
as an example of laws that attempt to fight past battles 252
assessment since the law took effect 34-36
dearth of low-cost baseload generation capacity 259
performance-based rate (PBR) setting 36
recommendations to make the law work better 37
return-on-rate-base (RORB) tariff regime 35

Electric vehicles 149

Employment (See also unemployment and labor policy)
declining trend in 2016 and 2017 230
flaw in definition 133

number of non-regulars or contractuals 294
unpaid family workers 181
End of contract (Endo; see also labor policy and employment)
and a competitive economy 136
and abusive government labor inspectors 129
and collective action in a democracy 135
and Security of Tenure bill 294-296
and Uber 70
as a symptom of strict and unrealistic provisions in the Labor Code 126
benefits as "labor sharing" 294
employees' opinion on 136
impact of war against "Endo" 133
legislative bill on strengthening the security of tenure 294
main provisions of the Security of Tenure bill 295
Security of Tenure bill and its adverse implications for manufacturing companies 295-296
temporary employment contracts and employment protection 125
Energy Policy Development Program (EPDP) 78
Energy Regulatory Commission (ERC) 28, 37, 259
English proficiency 104, 152
Enron 314, 321, 335
Equity 259
Esguerra, Emmanuel "Manny" 277
Espenilla, Nestor Jr. 61, 148
Esperanza Cabral 24
European Union Inter-Market Commission 316
Evasco, Leoncio Jr. "Jun" 159
Executive Order No. 839 342
Exports 160, 203
Extra-judicial killing (EJK) 283

F

Family planning 184
Fannie Mae 304, 305
Federal Reserve Bank
as market stability regulator 304
proposals to curb its powers 345
response to subprime crisis 304-306
Federalism
pros and cons 128
uncertainties from constitutional shift 128
Federalism and Inclusion in Developing Economies 301
Federation of ASEAN Economics Associations 97
Feed-in tariffs (See Renewable energy)
Fertilizer scam 120
FIBA (International Basketball Federation) 261
Financial innovation 320
Fiscal policy 23-26
Fitch Ratings 314
Foreign investments
and restrictive laws 75
negative list 155
restrictions on foreign ownership 101
Foundation for Economic Freedom (FEF)
advocacies 57-58
beginnings 52, 56, 84
core beliefs 53
on amendments to Public Services Act to allow more foreign investments 71
workshop on Bangsamoro prospects 45
Freddie Mac 304, 305

Frederick the Great 265
Free tuition fees in government-owned schools 5
Friedman, Milton 325
Frux Food Products 206

G

GCash 116
Garments 161
Global financial crisis 323-326, 334
Globalization 74
Globe Telecom 40
Gödel, Kurt 277
Gokongwei, Robina 273
Government intervention
  and government failure 111
  and market failure 5
  necessary conditions for 4
  negative examples in labor market and water supply 4
Great Leap Forward 164
Greenspan, Alan 305

H

Habito, Cielito "Ciel" 78
Hacienda Luisita 292
Hart, Carl 215, 216
Health spending 236
Herbosa, Teresita 62
Hitler, Adolf 225, 238
Human Development Network (HDN) 243
Human rights 213-216
Humphrey-Hawkins Act 304

I

Import-substituting industrialization 163
Income inequality
  and poverty incidence 85, 257
  and spasmodic economic growth 256
  flawed policies to address problem 258
Incompleteness Theorem 277
Independent power producers (IPP) 33
Indirect taxes 233
Indonesia 205, 268
Industrial policy 272
Inequality 258
Inflation
  and poverty incidence 255
  inflation blip and rice tariffication policy 95
  inflation targeting 102
  surge in inflation 36, 80-81, 158-163
Informal sector 125
Infrastructure
  and current account deficits 161
  China funding 88-89
  debate on best mode 65-68
  projects needed to promote agricultural growth 105
  role of conglomerates 290
  three basic modes of financing: taxes, tariffs and transfers 94
  underinvestment 75
  Asia's funding requirements 49
Innovation 274
Institute for the Study of Inequality and Poverty (ISIP) 200
Institute of Development and Econometric Analysis (IDEA) 9, 177
Institutional reform 102
Intel 274
International Mathematical Olympiad (IMO) 278

International Monetary Fund (IMF) 73
Internet 117
Internet of Things (IOT) 170
Investment rate 255-256, 295, 307

J

Japan 49, 169
Jee Ick Joo 217, 283
Jesus Christ 319
Jin Liqun 51
Jollibee Foods Corp. 208
Journal of Economic Behavior and Organization 301
JPMorgan Chase 305

K

Kakistocracy 4
Kalanick, Travis 69
Kaliwa Dam 94, 299
Keillor, G. 267
Keynes, John Maynard 2, 3, 317
Keynesian pump priming 112
Khosrowshahi, Dara 70
Kicking Away the Ladder 269
Kidapawan incident 273
Knight, Frank 207
Kundera, Milan 54

L

La Indolencia de los Filipinos 276
Labor policy (see also Employment, Unemployment and End of contract)
and industrial growth 181
and poverty alleviation 126
as a central concern in promoting economic growth 123-126
disguised unemployment 202
employment economic zones 101, 105
informal sector growth because of strict labor regulations 125
labor rigidities 104
legal minimum wage as anti-poor 124
membership in labor unions as proportion of labor force 135
need to modernize labor laws 117
need to liberalize permanency provisions in Labor Code 126
predominance of self-employment 181
targeted wage subsidies to complement conditional cash transfers 105
modernizing labor rules and jobs for the young, the uneducated and women 101
proposals to liberalize labor market 137
proposals to mitigate disruption 137
Labor Policy Analysis of Job Expansion and Development 106, 124
Lam, Jack 146
Land Bank of the Philippines 121
Land consolidation
in China and Taiwan 143, 282
need for a designated government agency 143
two-year moratorium 133
Lapanday Foods Corp. 290, 292
Laviña, Peter 146
Laxalt, Paul 172
Lazaro, Angel III "Lito" 38, 92, 94
Lazaro, Bernardo, Tiu and Associates 97
Lazaro, Delfin "Del" 22, 97
Lee Kuan Yew 30, 40, 187
Left 112

Leung Levy 56
Leung, Ernest 57
Lex Talionis 145
Liberal Party 172
Llana, Fructuosa 206
Locsin, Teodoro, Jr. "Teddyboy" 172
Lohani, Bindu 39
Long Term Capital Management 305
Lope, Ernie 278
Lopez, Gina 146, 231
Lotilla, Raphael Perpetuo "Popo" 49, 195
Luce, Edward 73

M

Macalincag, Victor 42
Magno, Alexander 57, 84
Majority rule 239
Mangahas, Mahar 57, 84
Manila Electric Corp. (Meralco) 37, 291
Manila Water Corp.
and informal settlers 292
and water shortage in Metro Manila in the summer of 2019 91, 297
obligations with respect to water provision 298
Tap Secrets: The Manila Water Story 38-40
Mantaring, Riza 91
Manufacturing
and "Endo" 294
and newly industrializing economies 203
and poverty reduction 203, 280
compared to services sector growth 279
conditions conducive to growth 275
global trends 205
greater reliance on skilled labor 204
in developing countries 204
policies to cope with decline 205
share in GDP and employment 203-205
Marcos regime
and bankruptcy of the old Central Bank 252
and economy 209-212
and industrial policy 272
and investment crises 240
and low-interest borrowings that led to the country's bankruptcy 292
as a major subject in Gerardo Sicat's biography of Cesar Virata 41
compared with economic record of other ASEAN countries 210
debt crisis 210, 211
GDP growth 210
half-hearted attempts at economic liberalization 211
per capita GDP growth 210
worst post-war recession in the Philippines 210
Marcos, Ferdinand
and student demonstrators in 1970 328
brand of authoritarianism distinguished from Duterte's 231-232
justification for dictatorship 225
US support for uprising against Marcos in 1986 172
Marcos, Ferdinand Jr. "Bongbong" 145, 222
Marcos, Imelda 212
Mariano, Rafael 121, 129
Mark-to-market rules 336
Market stability regulator 304
Markets 5, 266
Marsman Estate Plantation, Inc. 289
Mass media 117
Masters, Edgar Lee 192

Maynilad Water Services Inc. 92, 94
McKinley, William 193
Medalla, Felipe "Philip" 52, 57, 84
Metro Pacific Investments Corporation (MPIC) 270, 292
Metropolitan Waterworks and Sewerage System (MWSS)
amendments in the interpretation of Concession Agreement 93
and corporate income taxes 50
and the water shortage 297
as a public private partnership 85
beginnings of water privatization 38
as regulator rather than producer 5
role in the water shortages hitting Metro Manila 91
MGC New Life Christian Academy 277
Middle East 150
Middle-class economy 207
Minimum wage
and worker productivity 126
Duterte administration's threat to promulgate a national minimum wage 133
and value added per worker 137
as an example of labor rigidities 104
as entry-level wage 123
limited coverage 125
lower employment of the young and low-skilled workers 106
Misuari, Nur 44
Monsod, Solita "Winnie" 250
Montes, Vaughn 57, 67
Moody's Investor Services 314
Moral hazard 340
Morality 183
Moro Islamic Liberation Front (MILF) 45-46, 191
Moro wars for independence 44
Motorcycle riding 54
Murad, Ebrahim 46

N

Napoles scam 120
National Broadband Network (NBN) project 30
National Bureau of Investigation (NBI) 283
National Economic and Development Authority (NEDA) 41, 328, 356
National Electrification Administration (NEA) 36
National Food Authority (NFA)
financial losses 24
liberalization of rice import trade 102
mismanagement of rice supply 159
monopoly of rice importation 2, 24, 86, 89, 159
National greening program 113
National Grid Corporation of the Philippines (NGCP) 37
National Land Use Act (NaLUA) 82
National Power Corp. (NPC) 34
Nationalist industrialization 163
Nationalization 112
Nazis 238
Neo-liberalism 72
Nestlé 208
Netherlands 220
New Central Bank Act of 1993 252
Newly Industrializing Economy (NIE) 203, 204
Nokia 115, 153
Noli Me Tangere 186
Non-revenue water 39
North, Douglass 188, 191

Nye, John 124
Obama, Barack 168, 317

O

Oda, Nobunaga 348
Official Development Assistance (ODA) 65-68, 147
Olson, Mancur 135
Ongpin, Jaime 42
Ongpin, Maribel 42
Ongpin, Roberto "Bobby" 127, 128
Open access 35, 36
Open-pit mining 129
Organization of Islamic Conference (OIC) 44
Ortiz, Alan 57
Otto von Bismarck 78, 348
Overseas Filipino Workers (OFW)
OFW remittances and state of global economy 155
OFW remittances and savings 307
OFW remittances and Philippine economy 207
policy proposals to cope with possible slowdown of OFW remittances 151
technological threats to OFW jobs and remittances 149

P

Pacquiao, Emmanuel Jr. "Manny" 214
Paderanga-Varela Memorial Lecture 85, 136
Paglas, Ibrahim III "Toto" 45
Pangilinan, Manuel "Manny" 116
Pantawid Pamilyang Pilipino Program (4Ps; see also conditional cash transfers program) 23
Papandreou, George 219
Paqueo, Orbeta, Lanzona and Dulay 106
Paqueo, Vicente 85, 124, 136, 137
Paterno, Simon 57, 84
Patupat, Albert John 278
Paul, Ron 345
Peanuts 206
Perelman, Grigori 278
Performance-based rate (PBR) setting 35
Permanent Court of Arbitration (PCA) 88
Pernia, Ernesto 71, 151, 155
Perrine, John 208
Personal Equity and Retirement Account (PERA)
and OFWs 308
compared with GSIS and SSS retirement schemes 308
patterned after US 401K retirement plan 308
Peso appreciation 254
Petroleum price caps 342, 343
Philippine Center for Islam and Democracy (PCID) 45, 97
Philippine Daily Inquirer 146, 171
Philippine Economics Society (PES) 97
Philippine Electricity Market Corp. (PEMC) 35
Philippine Institute for Development Studies (PIDS) 41
Philippine Long Distance Telephone Inc. (PLDT)
and telecoms deregulation in the 1990s 31
declining profits due to disruption 116
merger with Digitel 30
under new controlling ownership 32

Philippine National Police (PNP) 283
Philippine Packing Corporation 327
Philippine Review of Economics 301
Philippine Science High School (PSHS) 277
Philippine Stock Exchange (PSE) 307
Philippine-American War 193
PIATCO fiasco 274
Pigou, A.C. 234
Pigovian tax 234
Piketty, Thomas 72, 85, 256, 258, 266, 273
Piñol, Emmanuel "Manny" 119, 132, 166
Pisani, Elisabeth 268
Poe-Llamanzares, Mary Grace 71, 264, 265
Pogrom 286
Political dynasties
- and strong political parties in other countries 190
- and weak political parties in the Philippines 190
- as symptom not disease 189
- in other countries 189
- reform proposals 189-191

Political leadership
- and economic performance 317
- as a key element in development 318
- role in the rise of "Asian dragons" 318

Populism 224
Portugal 220
Poverty
- and unemployment 200
- as a bigger menace compared with drugs 131
- high levels in the Philippines 74
- possible rise in 2017 due to higher inflation 229
- poverty incidence 255
- poverty reduction and rapid growth and rising income inequality 257
- rural poverty 111
- poverty reduction under President Benigno "Noynoy" Aquino III 287

Power generation industry
- performance-based rate (PBR) setting 35
- power rates 35, 36
- privatization of power transmission 34
- return-on-rate-base (RORB) tariff regime 35, 33

Power Sector Assets and Liabilities Management Corp. (PSALM) 34
Premature deindustrialization 204
Price controls 344
Property rights 109, 119-122, 180
Public utility
- and club good or service 197
- and national security 196
- and natural monopoly 197
- benefits of proposed amendment of Public Services Act 151
- fluid legal definition 195
- proposed amendment of Public Services Act 71, 155
- proposed definition 196-199
- unbundling in telecoms and water-supply 198
- unbundling in the power industry 198

Public-private partnership (PPP)
- advantages for governance 351
- and the administration of President Benigno "Noynoy" Aquino III 113
- as an option for government in an era of technological disruption 153

compared with official development assistance 65-68
factors for slow progress in initial phase 354
hybrid PPP and need for competent government officials 147
institutional requirements 352
merits of lowest toll charge as bid parameter 271
PPP Center 355
risks to government and public 352
unexpected issues 353

Pulse Asia 243

Q

Quantitative easing 253
Que, Shaquille Wyan 278

R

Rabusa, George 147
Ramos, Fidel 21, 38, 92, 291
Regulations 153
Renewable energy
and Asian Development Bank 27
feed-in tariffs 27, 135
policy reversals in other countries 29
Renewable Energy Law 27
share in Philippine energy resource mix 29, 78
Reproductive health bill 183-185
Republic of the Philippines Labor Market Review 124
Restrepo, Pascual 170
Retail **Trade Nationalization Law** 198
Return-on-rate-base (RORB) tariff regime 35
Reyes, Benjamin 230
Rice
benefits of rice import liberalization 159
cost of rice subsidies 24
factors for failure of rice self-sufficiency policy 262
proposal to abandon policy of rice self-sufficiency 157
reduction in rice imports as a result of government policy 262
rice import trade 102
rice importation monopoly 2
rice prices 159
rice self-sufficiency as an enduring myth 261
rice self-sufficiency as an obsession of the Department of Agriculture 161
rice subsidies compared with conditional cash transfers 25
rice tariffication 80, 162
Right to self-determination 44
Risk 127
Rivera, Perry 38
Rizal Commercial Banking Corp. (RCBC) 292
Rizal, Jose
and his economic views 186-188
and issues in translation 187,188
on British colonialism 187
on indolence of Filipinos as a strategic response to unjust milieu 276
views on "liberties" 187
Robots and Jobs: Evidence from US Labor Markets 170
Roces-Santos, Chit 250
Rodrik, Dani 204
Room for Maneuver 301
Roosevelt, Franklin Delano 318
Roosevelt, Theodore 193
Rosales, Gaudencio Cardinal 183, 184
Roumasset, James "Jim" 79

Roxas, Manuel "Mar" 146
Rule of law 265
Rules 249
Rural electric cooperatives 36

S

Salceda, Jose Maria Clemente "Joey" 71
San Miguel Corp. 247, 282, 292
Sarbanes-Oxley 335
School feeding program 264
Schurz, Carl 193
Secular morality 183
Services 180
Shabu 132, 213
Shultz, George 219
Sicat, Gerardo "Gerry"
as an advocate of foreign investments and export-oriented industrialization under the Marcos regime 211
author of *Cesar Virata: Life and Times Through Four Decades of Economic History* 41
on Calixto Chikiamco's book *The Way Forward: The Path to Inclusive Growth* 58
on labor economic zones 101, 105
on need for labor flexibility 123-124
Sin 184
Sison, Jose Maria 112
SM Development Corp. (SMDC) 291
Small- and medium-enterprises (SMEs) 106
SMART Money 116
Smith, Adam 3, 188, 196, 221, 262
Soliven, Philip 208
Spence, Michael 21, 273
Spencer, Herbert 239
Sta. Isabel, Ricky 283
Standard & Poor's (S&P) 314
State of the Nation Address (SONA) 80
Statistical ratings organizations (SRO) 314
Subprime crisis
bailouts and stimulus programs 323
beginnings 310
business model of subprime credits 321
paths towards recovery 312
role of the accounting profession 334
US strategy to address crisis 324, 304-306
Sueño, Mike 146
Suleiman 349
Summers, Lawrence 223
Supply chain 207
Supreme Court 31, 250, 285
Sustainable Forest Management Act 113
Switzerland 220
Sy-Coson, Teresita "Tessie" 273
SyCip, Washington 42

T

Taguiwalo, Judy 146
Taleb, Nassim 127
Tampakan Gold and Copper Mine 274
Tang, Christine 21, 30, 65, 81, 88, 99
Tao, Terence 278
Tax reforms
additional proposals outlined by President Duterte in his 2018 SONA 80
assessment of Duterte administration's first tax reform package 76-79, 233-236

balancing income tax cuts with higher taxes on fuel and motor vehicles 6
exception among Duterte policies creating more uncertainty for investors 129
tax on sugary drinks 234-235
Tax Reforms for Acceleration and Inflation (TRAIN; see tax reforms)
Tax Reforms for Attracting Better and Higher Quality Opportunities bill (TRABAHO; see tax reforms)
Tax system 348
Taxi industry 69, 117
Tayabasan East Water Source 298
Team Orion 270
Technological disruption 149, 169
Telecommunications industry
and business process outsourcing 181
benefits of telecom industry reforms 31
proposed limit on number of telecom tower operators 86, 30-32
Third telecommunications company 89
Temporary employment contracts (See End of contract or Endo)
Term limits 240
Tetangco, Amando Jr. 61, 148, 161
Thailand 169
The Asia Foundation 85, 177
The Way Forward: The Path to Inclusive Growth 58-59
Thucydides Trap 168
Tiu, Helen 97
Tokugawa, Ieyasu 348
Torre, Eugene 277
Torres, Vince Jan 278
Toyotomi, Hideyoshi 348
Trade war 155, 167
Trans-Pacific Partnership (TPP) 168
Trump, Donald 72, 167
Turgot, Anne Robert Jacques 184
Twain, Mark 192, 192-194
Ty, Patrick 298

U

Uber 69-71, 115, 152
Unemployment
as a middle class phenomenon 202
definition of 201
underemployment as a bigger problem than unemployment 125
weak relation to poverty 200-202
Unifrutti 45
United States 220
University of California-Berkeley 192
UP School of Economics (UPSE) 9, 41, 242, 300
US balance-of-payments 311
US credit boom 311
US dollar 310
US Treasury 304
US-China rivalry 167
Uson, Mocha 145

V

Vallejo, Louie John 278
Value added tax (VAT)
exemptions 25, 76
Reformed Value Added Tax law (RA 9337) 81
reforms 6
Value chain 206
Varela, Francis 52, 57, 84
Vargas Llosa, Mario 219
Viability gap financing (VGF) 271
Vietnam 49
Vietnam War 318

Vigilar, Gregorio 92, 38
Villegas, Bernardo 163
Virata, Cesar 41, 42, 57
Virata, Joy 42
Viray, Francisco "Sonny" 22
Volcker, Paul 219

W

Wallace, Peter 86, 289
Water and sewerage projects 94
Water privatization 91, 291
Weber, Max 224
West Philippine Sea/South China Sea (WPS/SCS) 88
Wholesale Electricity Spot Market (WESM) 35
Widodo, Joko 268
William the Conqueror 348
Williamson, Jeffrey 204
Williamson, Oliver 290
Wishful thinking 3
Wolf, Martin 257
Wood, Leonard 193
World Bank 49, 73
World Trade Organization (WTO) 73
World War II 318
Writ of Kalikasan 36
Wu, Farrell Eldrian 277

X

Xi Jinping 88

Y

Yap, Arthur 71
Yasay, Perfecto 146
Yuchengco group 292
Yuchengco, Alfonso 42

Z

Zedillo, Ernesto 219