

A Time for Hard Decisions

UP School of Economics

The latest attempt by military elements to seize power should be taken as final proof that social and economic reforms cannot be postponed. This should be realized even as criminal responsibility is assigned and the guilty punished.

Before this coup attempt, one could conveniently take comfort in the view that taking difficult economic decisions and redressing glaring social inequities were in-temperate or unwise -- or at least they could be postponed -- because large-scale changes would antagonize entrenched social interests whose resistance could destabilize the government.

This comfortable view has been exploded by the recently attempted putsch, which has capitalized precisely on the administration's procrastination in resolving outstanding social issues, its failure to take sides between conflicting class interests, and the often technically inconsistent policies it has chosen to adopt. This state of affairs has allowed the plotters to portray themselves as all things to all men: both revolutionary and conservative, both poor and elitist, both democratic reformist and totalitarian, and nationalist and fair-haired boys all at once. Nevertheless, it should be recognized by all that this action was no more than a sheer grab for power.

That the December putschists could expect to ride to power on such a nebulous and meager social agenda is less a tribute to their audacity than an indictment of the government's own alternative program and performance which in many crucial aspects have failed to gain the active support of the large segments of the population.

Dissatisfaction and Passivity

There is no doubt the military rebellion had its own roots peculiar to the politics and economics of the military organization. We shall not speak on these here. What we address is the presumption on the putschists' part that they could count on some popular support for their cause -- although apathy would surely have sufficed.

From hindsight, it is not difficult to understand the timing of the coup. The putschists struck at a time of relative weakness, when significant pieces of the government's economic program had failed to fall into place and various segments of the population had legitimate grievances against one or another aspect of the government's program.

The obvious sources of dissatisfaction, especially in the Metropolis -- the putschists' main target -- were:

1. a severe transport crisis manifested in a shortage of public transport, inadequate infrastructure, and congestion;
2. power failures which crippled industries and households alike;
3. widespread dissatisfaction among farmers over lagging real incomes and perceived discrimination against their sector;
4. ill-formulated salary-standardization among government employees;
5. recent increases in fuel prices which threatened to provoke strikes for higher transport fares and workers' wages;

6. perceived apathy on the part of the three branches of government to address issues affecting the people's daily lives, especially the legislative and the executive, which have been preoccupied with petty political maneuvers and the expansion of perquisites; and,

7. a series of scandals involving government officials in possible cases of graft and corruption.

All this was occurring against a backdrop of double-digit inflation, high interest rates, and economic growth far below the target. Apprehension was growing both on the part of business, which had to bear the rising cost of capital, and workers whose real incomes were being rapidly eaten up by inflation.

The economy's current vulnerability has been aggravated by the failure of the present debt strategy to achieve even the modest financing goals the negotiators set for themselves. The "new money" from the commercial creditors for 1989 to 1990 under the current scheme seems certain to fall short of the goal set by the negotiators. This has placed a strain on the balance of payments and on the exchange rate, which can be relieved only by choking the rest of the economy through a regime of high interest rates.

These problems have provided the obvious focal points for discontent and passivity among the populace. And while they are certainly not enough to induce people to actively support a putsch, they are dangerous enough in that they may paralyze the people's resolve to support the present government.

If we are not to relive the same experience, lessons must be drawn and actions must be taken. The violence of the most recent putsch attempts has once more placed urgent social and economic reforms on the agenda.

Two types of reforms are proposed here. The first deals with those which can be readily implemented to relieve immediate problems; the second, those that may be implemented only through some legislation or reorganization. We argue that all of these measures must be taken as a whole. There are no halfway measures: im-

mediate problems merely reflect deeply rooted ones, and none of these measures can be implemented without hurting some sectors' interests; all them entail sacrifices.

Immediate Measures

■ Addressing the Transport Crisis

The present transport problem has arisen owing to the high cost of replacement and spare parts of vehicles on one hand, and the regulation of fares, on the other. In the last few years, this has led to the bankruptcy of several bus companies who were caught in the squeeze of controlled fares and high prices of parts and replacements. The importation of cheap replacements and parts (especially second-hand) is effectively prevented, however, by the existence of ill-conceived "progressive manufacturing programs" of the government.

We propose that imports of vehicles and spare parts for use in public transport be freed from any kind of government regulation or restriction.

■ Meeting Energy Needs

The present energy crisis is mainly a failure of decisive implementation. The decision not to operate the nuclear power plant in 1986 was, in fact, followed by contingency measures to replace the energy it was expected to generate as well as by the other plans to meet increased demand. But lines of authority were unclear, the bureaucracy was disorganized, and unwarranted interference from external agencies made it difficult for these plans to be implemented on time. *We, therefore, recommend a complete overhaul of the National Power Corporation (NPC) management and the lines of decision-making on energy matters.*

The other issue on energy is the pressure on the NPC from its creditors to raise user charges in order to "recover costs". While there is much to be said in principle for cost recovery, the requirement that users shoulder the entire burden of NPC's debt-service is unreasonable.

We propose that the servicing of NPC's old loans be assumed by the national government, in exchange for which its management be revamped. This solution has been adopted, after all, in the

rehabilitation of the Philippine National Bank and the Development Bank of the Philippines as well as for NPC itself in the case of the nuclear power-plant loan. There is no reason it cannot be adopted on a general basis. This move should help clean the books of NPC and relieve the pressure for a rate increase, as well as help it obtain new loans to expand capacity.

■ Changing Personnel

There should be a change of personnel in order to match people with the demands of their positions. For one, the present assignment imposes too great a conflict of interest on the occupant of key economic departments and agencies. For another, it has resulted in poor performance due to incompetence.

To illustrate: the appointment of commercial bankers to the Central Bank governorship runs the risk of decisions being made that favor specific commercial banks, given the sociological tendency for people to identify with their own kind; the appointment of people to oversee trade and industry when their families are involved in cartels which enjoy privileges that ought to be removed; the retention of agency heads who have clearly not performed according to target, or who have continuously reduced targets in order to make their performance appear *par*, e.g., transportation, social welfare. Cases abound not only among the upper echelons, but also at lower levels.

■ Formulating and Implementing Economic Policy

Try as hard as one might to formulate sound policy advice, however, the effort is still futile so long as the institutions and arrangements to implement them do not exist. In many senses, this has been the tragedy of the present administration. Complaints have been rife that the management style of the administration gives the impression that "no one is in charge" and that the government, or even the administration, "does not speak with one voice".

As far as economic policy goes, this problem is publicly manifested in the differences of opinion within the executive between the Departments of Agriculture, and Trade and Industry over incentives; within the legislature, on debt policy, and between the executive and legislative, over decentralization.

What is needed at the very least is coherence in the economic policies enunciated by the executive branch, although we should not overlook the necessity for similar action within the legislature and within the legislative and executive. This is quite apart from the correctness of the policies adopted, an issue we treat below.

We propose that the NEDA director-general be upgraded in his powers and responsibilities as primus inter pares with whom all department heads charged with economic matters must coordinate. This secretary of economic affairs should have the complete confidence of the President; secretaries and heads of all other economic agencies should be appointed upon his recommendation.

This should help ensure consensus among the economic departments and compel them to speak with one voice within the Cabinet and in public.

Intermediate Policies

All the foregoing are measures which can be implemented within a short period. However, many of them are linked to larger issues that have been outstanding for some time. For example, the relief of the transportation problem requires imports of cheaper vehicles and parts, but this runs against an existing industrial program; this program then needs to be reassessed. Or then again the need for better infrastructure is evident; but expenditure soon runs against the constraint on the budget or the trade deficit.

The more difficult problems will have to be addressed. One could argue whether the period immediately after a failed coup is the most opportune moment to do so. But we do not think that decisions postponed will become any easier.

■ The Debt Problem

An important incipient effect of the coup attempt has been to increase uncertainty and reduce foreign capital flows to the economy. One form of this is reduced direct foreign investments. It also seems probable that the current deal with foreign commercial banks will be reduced further, although even before the coup, grave doubts could already be raised whether that deal could close the estimated financing gap.

With respect to the foreign debt, some would insist on the current strategy, seeking to salvage as much of it as one can (e.g., pleading with the creditors not to back out of their already small commitments). Instead, *we recommend that we seize the opportunity provided by the coup to implement a new approach to the entire debt question.*

Now that the autonomous capital inflows are likely to be reduced, the advantage of asserting the country's interests over that of the foreign banks have become even greater. We contend that the country at this time -- as it did in early 1986 -- has the political leverage to seek a renegotiation of the terms of its package with the commercial creditors.

We recommend the appointment of a new and full-time negotiating team whose immediate goal is to reduce the country's net resource transfer to its foreign creditors to enable it to close its financing gap. In relation to commercial bank loans, putting a debt cap or going into temporary arrears should be a part of the new team's set of options.

We believe that the aftermath of the putsch -- if used wisely -- presents a unique opportunity for the country to considerably improve the terms of its agreement with the commercial banks. Such an opportunity should not be squandered, as the country did in 1986.

■ The Exchange Rate

As for the currency's value in itself, however, it should be set at a low enough level to deliver the domestic market to domestic producers and make our products competitive abroad as well.

Having said this, we stress the following: Depreciation will always cause some inflation through higher prices for imports and to this extent will also hurt the poor, especially in the urban areas. However, it should be clear that if depreciation is to work, some real incomes must be cut, and adjustments in consumption must be made (especially from tradeable to nontradeable goods). The gain is that more people would be employed in producing substitutes for imports and producing for export.

The required depreciation must be accompanied by a removal of infrastructure bot-

tlenecks if the maximum benefits from it are to be derived. More employment opportunities will be opened within a shorter time if the government simultaneously solves the crises in transport, energy, and other infrastructure services. Otherwise, the inflation which normally accompanies depreciation will be unnecessarily prolonged. In order to cushion the inflationary effects and distribute the burden of adjustment more equitably, the government should reduce indirect taxes, especially on fuel. This is also in line with our recommendation below to make the tax system more progressive.

■ Monetary and Fiscal Policy

Another priority in the field of policy should be to revamp monetary policy and move away from the present high-interest rate regime. High interest rates have been maintained mainly through the auction of T-bills beyond what is required to finance fiscal deficits and through large reverse-repurchase agreements, under which the Central Bank borrows from commercial banks. Together with bottlenecks in infrastructure, the restrictive monetary policy has prevented investment, and, hence, output from keeping up with demand, thereby reinforcing inflationary pressures. Inflation, in turn, has caused the erosion of real wages implicitly violating the social pact and fueling discontent and mistrust in the ranks of wage-earners.

There are two influences working to keep interest rates high. One is related to the debt problem: because foreign financing is unavailable and foreign reserves are low the Central Bank and the government have had to resort to issuing high-yielding T-bills to prevent speculation on the currency and cover the budget deficits. If the debt problem were resolved more satisfactorily and no nominal level of the exchange rate was targeted, then the CB would be less obliged to resort to high T-bill rates to keep liquidity down and to prevent exchange-rate speculation.

But the second aspect of high interest rates relates to the large margins between commercial bank lending and deposit rates; this also contributes distinctly to discouraging investments. The existence of such wide spreads indicates a high degree of concentration or monopoly power in the financial sector, and this is something the CB is abetting by erecting barriers to entry in the commercial banking system. The current CB emphasis is to rehabilitate insolvent

banks; but this is in itself an entry barrier, since it forces new investors to take over bad portfolios. The implications of this policy are worse in the case of rural banks, since this means a further reduction of the credit made available to the countryside.

Quite apart from the relaxation of the monetary policy, therefore, we recommend that the Central Bank revamp its policy regarding entry into the banking system and adopt more liberal rules to break the existing cartel in the financial system.

To effect the required changes in monetary, exchange rate, and debt policies, and in line with the Constitution, we recommend that the composition of the Monetary Board be overhauled to reduce the participation of Cabinet members to a minority. Only the NEDA director-general should sit as an ex-officio member.

Finally, in regard to fiscal policy, we caution against a sudden surge in government consumption spending at this time, even if some "pork-barrel" methods seem attractive when there has been a recent threat to political stability. The noise about the revival of "pump-priming" activities such as the Community Employment Development Program at this time is particularly worrying. While these may have been appropriate in 1986 when there was large excess capacity, they are uncalled for today when no slack exists; they are rather likely to lead to inflation or a worsening payments deficit, or both. Such a move would be particularly unwise if the foreign financing gap is not closed through the appropriate debt policies.

■ Industrial Policy

The high degree of concentration in industry and the government's implicit sanction for this has been one of the most potent examples used to argue that the government is for the rich and not for the poor. Even as the poor must pay indirect taxes and take cuts in real incomes through inflation, large amounts of taxes are being foregone by the government in the form of "incentives" given to big business.

There is a general perception that the Board of Investments (BOI) has served less to promote than to restrict, and that despite its large discretion, it has not designed a coherent industrial program. Surprisingly,

this view is now shared even by businessmen themselves, proof that those who manage to avail of such privileges are restricted to a small coterie.

We propose that the BOI be abolished as an independent body, and that the entire system of investment incentives be re-examined with a view to their elimination. Henceforth, industrial priorities should, if at all, be set indicatively by NEDA without the need for incentives. The elimination of BOI tax credits should replace tax revenues foregone from fuel taxes or generate revenues for required public investment. Barriers to entry in important cartelized industries such as shipping, cement, flour, among others, should be removed.

Tariffs should be set at a low uniform rate mainly for revenue purposes to eliminate discretion and discrimination against potentially viable industries. The exchange rate should replace tariff and nontariff barriers as the appropriate and nondiscriminatory measure of protection.

The protection given to the ill-conceived progressive manufacturing programs, especially for cars and trucks, should be phased out within a short period. The protection given to these industries in the form of prohibitions on imports should immediately be replaced by a simple tariff.

Finally, government should devote its industrial promotion efforts to where it can do the most good and where they are most needed, namely, supporting scientific and technological research, training, and the acquisition and dissemination of information.

■ Progressive Taxation of Assets and Incomes

The charge that the government is only for the "big" and "rich" finds support in the current system of taxation. This system relies heavily on indirect taxes which hit the poor more than the affluent. By contrast, there is a consensus that income taxes are not effectively being collected, and that taxes on wealth, especially on landed property, are too low. Certain onerous features of the tax structure, especially those that discriminate against the poor should be removed. For example, the differential treatment of fixed and nonfixed income penalizes the low-income classes. The final

tax on interest income also favors the more affluent, since their marginal tax rates would certainly be much higher than 20 percent.

We recommend that taxes on property be raised and that the tax on interest income be treated as a withholding tax, rather than a final tax. The elimination of tax credits through the BOI and the entire omnibus incentives code should also provide additional revenue for the government.

It is remarkable that despite perennial calls for improved collection efforts, no major tax evader has been prosecuted, much less imprisoned. *We propose instead to reduce the discretion of bureaucrats in the disposition of tax-evasion cases and leave these to the impartial operation of the penal code.*

■ Agrarian Reform

Nowhere is the government's lack of political will for social reform clearer than in the field of agrarian reform. More important than the Garchitorena estate scandal and the fuss over Congress' reluctance to confirm the new secretary of agrarian reform (who has, however, finally been replaced - Ed.) is the fact that the actual process of transferring land to the tiller is going too slowly and with too narrow a scope. Two years after the enactment of the agrarian reform law, most beneficiaries are still concentrated on rice and corn lands. Agrarian reform has hardly touched sequestered and foreclosed lands. Agricultural lands of more than 50 hectares (which are not rice and corn lands) are only starting to be given notices of acquisition, which is a long way from actual land valuation and transfer. Plans for support services for beneficiaries are hazy and blurred.

The government should give priority to solving the centuries-old land tenure problem of the rural populace. It should concretize the call for people's participation in the agrarian reform process by directing the Department of Agrarian Reform to take seriously the operation of the Barangay Agrarian Reform Committee (BARC), to ensure popular representation of genuine peasants' organizations and rural folk in the committees, and to ensure their genuine participation in the process of improving land

tenure, helping program beneficiaries, and resolution of conflicts.

■ Other Problems

Although they cannot be addressed fully here, other problem areas are no less important. Among the pressing issues are: population, environment, the quality of education, and the lag in technology.

■ Interdependence of Reforms

We reiterate our earlier statement: the needed reforms are interdependent and must be regarded as a whole. A piecemeal implementation would cause possibly unforeseen outcomes or, what is worse, outcomes which are socially unjust.

Conclusion

Our newly-regained democracy has just survived the most serious threat thus far to its existence. It is said that the presence of large threats often engenders solidarity among normally disparate interests, enabling them to undergo great sacrifices and subsume selfish concerns under a higher goal. The recent coup attempt was such a threat. The call to all of us, especially to those who are in positions of power, is to take the long view and realize that our survival is bound up with the just resolution of our nation's problems. We must answer the call now.

(This article is the result of a workshop held on 6, 7, 8, and 14 December 1989 by the UP School of Economics faculty: Ruperto P. Alonzo, Arsenio M. Balisacan, Carlos C. Bautista, Dante B. Canlas, Ramon L. Clarete, Rolando A. Danao, Emmanuel S. de Dios [rapporteur], Jose Encarnacion Jr., Raul V. Fabella, Maria Socorro H. Gochoco, Alejandro N. Herrin, Joseph Y. Lim, Felipe M. Medalla, Casimiro V. Miranda, Solita C. Monsod, Manuel F. Montes, Fidelina B. Natividad, Edita A. Tan, and Gwendolyn T. Tecson.)