

DOF/NEDA/BSP vs. Congress: Which Way to a Sustainable Recovery?

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Situationer: Where do we Stand?

- Economy in a free fall during lockdown: slow recovery and cautious exit
- -2 to -7% growth forecasted for 2020; -0.2% Q1
- Worse than 1984-1986 crisis (zero growth)
- Up to 10-m workers idled; hunger rising
- U-shaped recovery envisioned; rapid recovery in 2021 due to low base?
- Fiscal deficit of 8-9%: 24% fall in tax collection

Situationer

- Falling OFW remittance impoverishing once better-off OFW households
- Gross International Reserves (GIR) at \$93.3-b still healthy; shrinking imports payments and borrowing receipts compensate for OFW remittance
- IMF forecast: -3.6% PH economy; -6% growth of global economy
- Bayanihan Heal as One: a combination of emergency powers and emergency payments, expired June 25; Bayanihan 2?
- T-bill rates fall below 2% after base rate cuts; banks flock auction (June 29)

Short-Term Goal (Stimulus) vs. Long-Term Goal (Growth)

- Stimulus:
 - ❖ short-term program designed to arrest the free fall
 - ❖ even doing things you normally avoid – BSP buying gov't bonds before anathema leading to inflation finance
- Market failure: in a free fall there is a coordination failure in the market:
 - ❖ Negative feedback loop: Demand falls, supply falls and demand falls further
- Stimulus programs arrest the negative feedback loop
- Natural healing takes a long time and at too high a cost

Reform / Seize the Day Initiatives

- “A good crisis is too valuable to waste”
- Reforms difficult to pass in old normal; may be easier to pass in the new normal
- Designed to push the economy to a higher sustainable growth trajectory
- Transportation reforms: BRT at EDSA; jeepney modernization
- CIT Reduction?

Basic Principles for Stimulus: Fiscal Spending

- Fiscal Spending via reduced CIT for private corporates does not work: pushing on a string
 - ❖ corporates park freed reserves in BSP safe deposits, use borrowings to shore up balance sheet or for share buybacks
 - ❖ It has dubious effect of increased corporate investment in the longer run
 - ❖ Cong. Stella Quimbo (2015): invest tax savings only when economy is growing

Basic Principles for Stimulus: Fiscal Spending

- This is just a transfer from poor to rich if with new taxes on poor to cover the deficit
- Fiscal Spending via direct payments (CCT or SAF) or gov't infrastructure jobs creation has demand stimulus impact
- Creates effective demand that stimulates investment

Basic Principles: Monetary Easing

Monetary easing via

- lower benchmark / base rate (-1.75 basis points since Feb) for borrowing from BSP and
- lower RRR (-200 basis points in February) does not work for stimulus
- corporates park freed reserves in BSP safe deposits
- use borrowings to shore up balance sheet or for share buybacks and
- wait for fixed capital utilization rate to rise before investing

Learning from the Past

- John Maynard Keynes: 1936 volume “General Theory of Employment Interest and Money”; father of Macroeconomics
- “Great Depression”: two schools for Recovery:
 - (i) Classical: market can heal itself; just lower the interest rate and firms will borrow and invest, hire workers and create demand
 - (ii) Keynes: market cannot heal negative feedback loop; gov’t must create purchasing power and jobs via infrastructure spend to arrest the free fall

CREATE

- ❖ CREATE: Corporate Recovery and Tax Incentives for Enterprises – The DOF / NEDA plan for stimulus and recovery; replaces
- ❖ CITIRA: Corporate Income Tax and Incentive Reform Act; replaced
- ❖ TRAIN 2: Tax Reform for Accelerated and Inclusion

Features of CREATE

- Corporate Income Tax (CIT) reduced from 30% to 25% immediately
- Rationalization of the antiquated Incentives Structure:
 - Overstaying and boundless lifetimes
 - Incentives no longer needed
- PEZA gross income tax at 5% replaced by CIT of 25% after 2 years
- GIT of 5% = 17% CIT (per DOF)

Features of CREATE

- Gov't will transfer Php42-b in 2020 and Php625-b in 5 years to private corporations
- NOLCO provision extended to 5 years: losses today serve as tax deduction for tomorrow; you pay less tax IF you survive!
- The Hope: corporations will reinvest these savings, create multiplier in jobs and income
- To cover the deficit, the poor who will face increased taxes on beverages, e-business and cigarettes

Problems with CREATE

- In a free-falling economy or anemic recovery, corporations batten their hatches: pay down debts, buy back shares but not than invest. BDO P20b loan–loss reserve.
- Also: 25% of 0 = 30% of 0 = zero stimulus
- OYS and Rep. Stella Quimbo: corporates invest tax savings only when economy is growing
- JM Keynes in 1936: supply stimulus = pushing on a string!

CREATE and Foreign Investment

- Higher effective income taxes for DFIs: Immediately for New and in 2 years for Old PEZA locators.
- PEZA locators oppose TRAIN 2 / CITIRA and now CREATE
- There is a rebalancing of global DFI from China
- Indonesia is winning US MNCs; Vietnam is winning S. Korean and Chinese MNCs
- PHL will eat their the dust again as in 1987-1990!

Rather...

- Postpone CIT reduction program till better times;
- Unbundle major parts of CREATE as separate bills:
 - ❖ General Fiscal Incentives Overhaul
 - ❖ DFI and PEZA Issues
- Stay the course on PEZA and DFIs
- Avoid making the recovery a transfer from poor to rich: new taxes on text, e-business etc
- Concentrate on demand-side stimulus for recovery with such bills as ARISE/CURES

BSP Weighs IN

- **BSP has reduced RRR 150basis points since Feb**
- **BSP has been reducing base rate**
- **BSP has bought PHL Gov't Treasuries**
- **Only buying of gov't Treasuries is stimulus**
- **The RRR reduction and base rate reduction are “pushing on a string”.**
- **Banks are parking loanable funds in BSP.**

ARISE: Accelerated Recovery and Investment Stimulus for the Economy

- Focus: employment protection: June 4, 2020
- ARISE with P708-b vs CREATE with P130-b
- Wage subsidy: Php110-b
- DOLE Cash for Work Program: Php25-b
- Education (Php42b), small business (Php75-b) and agri-fishery loans (Php50-b), loan guarantee (Php40-b)
- Tourism (Php58-b), Transportation (Php70-b,) Manu, Exports, Services (Php44-b)

ARISE

- Meaningless gestures: DA Balik Probinsya: (Php66-b), National Emergency Investment Vehicle (NEIV) (Php100-b) for recovery of businesses
- **BBB: Php650-b with 20% released in 2020; the rest next two years**
- Overall: ARISE larger by factor of 10 than the Php130-b budget of Progreso / CREATE
- Size matters for stimulus!

CURES

- **Covid-19 Unemployment Reduction and Economic Stimulus (CURES): June 5, 2020**
- **Largely for Infrastructure stimulus**
- **P1.5t: P5b in 2020, P5b in subsequent 2 years**
- **Emphasis on shovel-ready – already in the pipeline infra projects.**

Comments on ARISE/CURES

- ARISE/CURES is superior to CREATE but needs some pruning
- Demand stimulus better in ARISE/CURES: put money directly in the hands of the poor via CCT, electronic platforms; jobs protection program
- Next best stimulus is BBB to create jobs; stronger in ARISE
- Spending needing “new plumbing” (NIEV, sectoral subsidies, balik probinsya) will just waste money.

Constitutionality/Fundability

- Constitutionality: Supplemental budget can be funded only by gov't savings not borrowing
- Gov't savings is now Covid-zilched
- DOF/NEDA prudence rule: fiscal deficit ceiling - least don't go too far out of line
- ARISE must raise own revenue
- “Funds actually available”: Gov't issues bonds for BSP purchase or underwritten by banks under RA 4860 and NT certifies.

Fundability

- No Money?
 - ❖ How come: CREATE proposes to forego CIT of Php42-b this year and Php625-b next five years?
- Emerging Impasse: Executive refuses to finance CURES/ARISE, Congress delays passage of CREATE
- A compromise?

Reconcile ARISE and CREATE

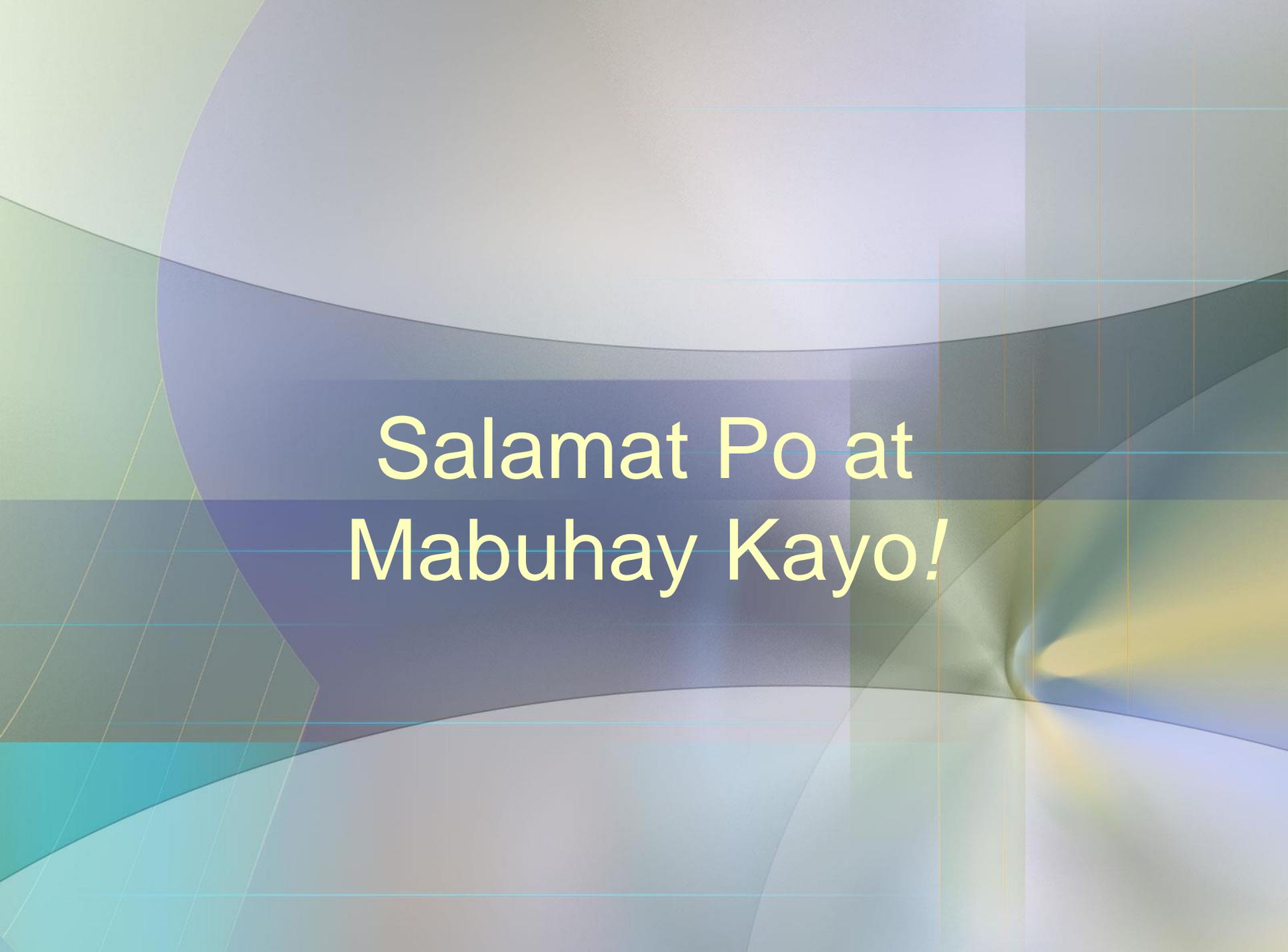
- Reconcile CREATE and ARISE:
 - ❖ ARISE can include temporary tax increases on real property of over Php10-m and motor vehicles of over Php1m;
 - ❖ ARISE drops some useless gestures, e.g., REIV, *Balik Probinsya*, etc; reallocate to more pro-poor programs
 - ❖ CREATE defers CIT reduction for ten years to provide fiscal space for stimulus

Which is the better Recovery Program?

- **ARISE/CURES superior to CREATE**
 - ❖ More pro-poor: no transfer to rich from poor
 - ❖ Serves both Equity and Efficiency
 - ❖ Programs that have short- and long-run stimulus effect: like arterial infrastructure
- Reconciliation is possible as suggested

Even better: Programs with Short and Long Benefits

- ❖ A weaker peso as short-term stimulant: gives money to OFW households and a long-term growth effect helps Agriculture and Manufacturing, exports and DFIs.
- ❖ For Agri: for short run stimulus - condone CARP nbeneficieary debt as quid-pro-quo.
- ❖ For Agri: for long-run growth, pass the bill to encourage farm consolidation: 5 to 25 has. for households and to 100 has. for firms.
- ❖ Contingent “Idol Rooftop Tax” for smaller carbon emission



Salamat Po at
Mabuhay Kayo!