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POLICY BRIEF

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The "Whatever It Takes" Approach: Sizing Up Public Spending for COVID-19

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"Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."

- Former European Central Bank President Mario Draghi, 2012

The COVID-19 pandemic presents arguably the worst economic shock to the Philippines in the 21st century; the resulting economic crisis will place the country in recession for the first time since 1998 and snap the country's streak of robust economic growth. GDP growth in 2020 may contract by 2.7 percent to 4.4 percent, the lowest growth figure since 2009. Unemployment is expected to spike to 30-million workers by end-2020, up 12-fold from 2.5-million workers in January 2020. Dampened consumer sentiment and business confidence rule out the possibility of a V-shaped recovery, in our view.

Because of its broad-based impact, the pandemic has magnified the role of governments globally in terms of buoying the economy, securing jobs, and providing social amelioration. After all, when the "C" (consumption) and the "I" (investment) in GDP are insufficient, the "G" (government spending) component realizes a heightened level of importance. This is why we believe that state spending must take a "whatever it takes" approach to mitigate the economic effects of the COVID-19 crisis.

This means engaging in government spending that is "countercyclical" to the business cycle to cushion the fall of failing industries, aid newly unemployed wage-earners, and provide for an earlier and swifter recovery. In times of prosperity, governments are wont to rein in exuberance through fiscal and monetary policy. But in times of crisis, governments must themselves be the ones to spur economic growth by providing liquidity to businesses, investing in employment-generating programs, and reducing overhead costs by cutting taxes, among other things. Policy briefs in this series have endorsed such spending measures, particularly in the health care sector.

To be sure, concerns abound about the ensuing "crowding out" effect. This happens when governments engage in deficit spending that exhausts avenues for credit, decreasing available credit for private investment and reducing private sector participation in recovery. However, deficit spending also creates a "crowding in" effect, where businesses, seeing renewed economic activity as a result of public spending, are induced to expand their capacity in pursuit of additional profit. It would seem improbable to see the crowding out effect cancel out the stimulatory effects of increased expenditures, which at the very least would lead to government spending having a net stimulus effect.

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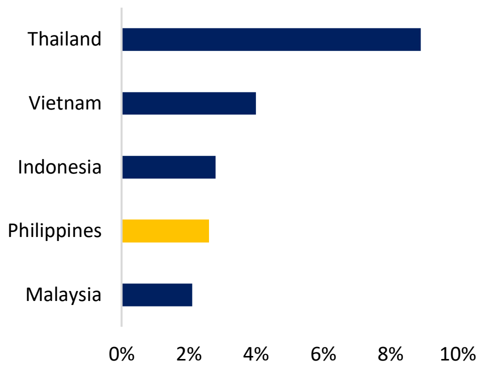
The Philippine government, in particular, has announced a “four-pillar economic strategy” versus COVID-19 focused on (1) emergency support for vulnerable groups and individuals, (2) marshalling resources to fight COVID-19, (3) fiscal and monetary actions to finance emergency initiatives and keep the economy afloat, and (4) an economic recovery plan to create jobs and sustain growth. On a headline basis, the strategy translates to PhP 1.5-trillon or 8.0 percent of 2019 GDP—relatively in line with the size of stimulus packages from other emerging markets. If one decomposes the line items in the four-pillar strategy however, one realizes a smaller figure for planned expenditures versus the pandemic. Stripping away monetary stimulus measures, sources of financing, and non-expenditure items (e.g. NOLCO, foregone revenues) leads one to see that the actual fiscal measures amount to PhP 501-billion or 2.6 percent of 2019 GDP. That would then pale in comparison to our ASEAN neighbors such as Thailand and Vietnam who have announced stimulus packages worth 8.9 percent and 4.0 percent of GDP respectively. Note that the response measures in the fourth pillar or economic recovery plan have not been disclosed.

Figure 1. Announced Stimulus as a Percentage of GDP vs. ASEAN



Source: Department of Finance, International Monetary Fund

It is likewise prudent to qualify that the elements in the four-pillar strategy do count as stimulus if the items are already appropriations from the 2020 General Appropriations Act (GAA) worth PhP 4.1-trillion. Current spending for COVID-19 seems to fall under the category of realigned expenditures as opposed to actual stimulus. To illustrate, planned expenditures for the emergency subsidy program under the four-pillar strategy (PhP 205-billion) roughly approximate the budget for social welfare and development in the 2020 GAA (PhP 201-billion).

In any case, we deem it absolutely vital that the stimulus be large: that is, large enough to buoy the resulting economic fallout from COVID-19. The initial estimates of the National Economic Development Authority (NEDA) showed a negative impact of 1.5 percent to 5.3 percent for Luzon gross value added for just one month of enhanced community quarantine (ECQ). Based on the calculations of the Philippine Institute of Development Studies (PIDS), sectors such has manufacturing and trade may see a hit of as much as PhP 855.2-billion and PhP 724.8-billion (23.8 percent and 20.3 percent of 2019 GVA). In determining the apt size of the overall stimulus package, the national government should disregard any notions of a stimulus package that is “too big.” Echoing the view of Roosevelt Institute Fellow Mike Konczal on fiscal stimulus, “the serious risk is in doing too little, not in doing too much.” The Philippine government should not fall into a situation of a fiscal response that is “too little, too late,” as forewarned by European Central Bank (ECB) President Christine Lagarde.

Apart from the actual size of the stimulus, two points of consideration must be made on (1) public deficit and debt levels and (2) budget utilization. First, on fiscal deficit and debt levels, historical data shows that the government has been fairly conservative with the budget deficit and national government debt post-crises (1983 crisis, 1997 Asian financial crisis, 2008 global financial crisis), arguably at the expense of spending. The Philippines' budget deficit as a percent of GDP would even shrink to 1.9 percent in 1984 from 2.0 percent in 1983; notably, the Philippines remained in recession through 1984 and 1985 in the absence of countercyclical spending. Meanwhile, while the deficit-to-GDP ratio did increase to 1.7 percent in 1998 and 3.7 percent in 2009, we note that (1) these deficit levels were still fairly comfortable and (2) expenditure effort increased by only 69 basis points and 90 basis points in those respective years. Public debt levels would practically remain unchanged in the years following the height of previous crises: debt-to-GDP would increase by 50 basis points in 1998 and decline by 10 basis points in 2009. The 8.3 percent increase in the debt-to-GDP ratio in 1984 is suspect given the lukewarm impact to the expenditure effort and fiscal deficit.

Figure 2. Philippines Deficit-to-GDP (1981-2019)

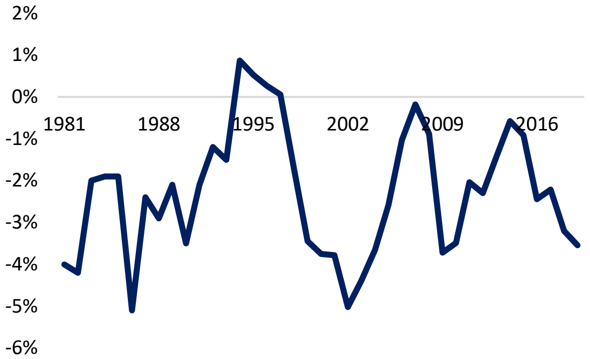


Figure 3. Philippines Expenditure Effort (1981-2019)

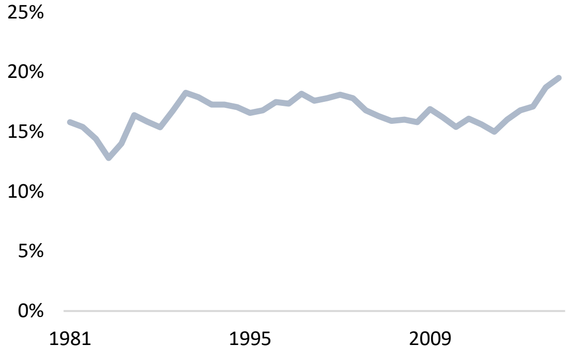
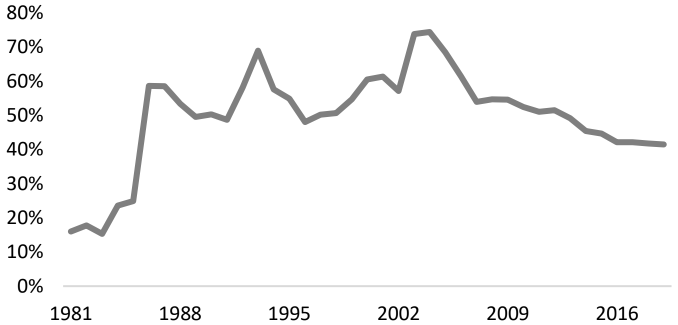


Figure 4: Philippines Government Debt-to-GDP (1981-2019)



Sources: Bureau of the Treasury, University of the Philippines School of Economics

To allow for a strong and sufficient fiscal response, we believe that the national government should set aside its ceiling for the budget deficit-to-GDP ratio (3.0 percent) and target for the debt-to-GDP ratio for the next one to two years. Former ECB President Mario Draghi, in a guest piece for *The Financial Times*, says:

> Public debt levels will have increased. But the alternative—a permanent destruction of productive capacity and therefore of the fiscal base—would be much more damaging to the economy and eventually to government credit.

> We must also remember that given the present and probable future levels of interest rates, such an increase in government debt will not add to its servicing costs.

It is also worth highlighting that the Philippines is in a much stronger fiscal position than in previous crises. *The Economist* ranks the Philippines sixth among select emerging economies based on public debt levels as a percent of GDP, foreign debt as a percent of GDP, cost of borrowing, and reserve cover. The fiscal position that the country currently enjoys provides a strong backdrop for meaningful fiscal stimulus; the country can afford the subsequent increase in budget deficit and public debt levels.

However, this does not give government *carte blanche* to resort to unprecedented levels of public indebtedness. Government should remain on guard in maintaining its favored position vis-à-vis the fiscal deficit. We do not endorse profligate spending, but at the very least, the country should be allowed to benefit from the fiscal discipline it has exercised for the last two decades or so. Past policy briefs have identified what sectors public spending will have the most impact on job creation and poverty alleviation, which government would do well to consult.

Second, on historical budget utilization, historical data shows that the national government has tended to "underspend" and fall short of spending their budget allocations. Disbursement data from 2013 to 2019 shows that the national government spends only 94.9 percent on average of its programmed expenditures. The latest President's Report to the Joint Congressional Oversight Committee shows that seven weeks into ECQ, only PhP 54.5-billion of the budgeted PhP 205-billion (26.6 percent) has been received by beneficiaries. Efforts must be made to address capacity constraints that impede the disbursement of funds; stimulus measures will only come to fruition if the funds reach their intended beneficiaries in the real economy.

With a large enough stimulus and a strong enough fiscal response, the country might yet rise again after the pandemic. The devastation wreaked on our economy may be minimized if our government takes an aggressive and proactive role in recovery. Now is the time for a bold approach. Our government needs to do whatever it takes.