INSTITUTE FOR CLIMATE AND SUSTAINABLE CITIES

POLICY NOTE:

The challenge to macroeconomic and corporate governance in an era of pandemic and climate risk

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28 October 2020

The national government is eager to get the economy back on track and restore its pre-pandemic growth trajectory as quickly as possible. In a briefing to Congress on September 4, 2020, officials described how we are currently in the recovery stage (from June to December 2020) and that “starting next year, we will be focusing on the resiliency of the economy towards a healthy and more resilient Philippines”.[2]

Recovery is supported by *Bayanihan To Recover As One Act (or Bayanihan 2)*, legislation passed on 11 September 2020 (to expire on 19 December 2020), which provides stimulus funding worth P140 billion plus P25 billion if revenue sources can be identified, to support medical front liners, displaced workers, farmers/fisherfolk, MSMEs, transport and agri-fishery enterprises/coops, and low-income households in hard lockdown, among others.[3] The proposed 2021 General Appropriation Act (GAA) also features higher infrastructure spending - an increase from an estimated 4.2% of GDP in 2020, to 5.4% in 2021 – essentially, a resumption of the pre-pandemic Build-Build-Build effort – to enable job creation. Other proposed legislation intended to support recovery include GUIDE (or GFI Unified Initiative to Distressed Enterprises for Economic Recovery), that provides interest free loans as well as greater loan guarantee coverage per borrower to benefit micro-small-and medium scale enterprises (MSMEs); FIST (Financial Institutions Strategic Transfer), which aims to create specialized asset-managing corporations that would acquire "bad loans and stagnant properties" from embattled banks and financial institutions so that they may be able to lend more; and CREATE (Corporate Recovery and Tax Incentives for Enterprises), which, among others, accelerates the lowering of the country’s corporate income tax rate to a level closer to the ASEAN average.[4]

Valid questions have been raised about the amounts allocated to, and the design of, recovery programs. The 140B of *Bayanihan* 2, which amounts to just 1 % of 2019 GDP, is unfavorably compared to what is being provided in Indonesia (7 percent of GDP), Thailand (9.6 percent) and Japan (21.1 percent), for instance.[5] Moreover, only P4.413 billion of the P140 billion, just 3.15 percent, has been distributed to date, less than two months before the law expires.

The more fundamental question, however, is: do we really want to simply restore pre-pandemic growth and development trajectories? This question is fundamental because it is now apparent that our economy is not as 'resilient' as we thought. Although economic managers, as late as mid-March,[6] said "economic fundamentals are on our side" and that "even under the worst possible scenario, the Philippines can still grow this year and in the medium term by about six percent", the country has gone on to record a negative 16.3 percent GDP growth in the second quarter of 2020, its lowest recorded quarterly growth in four decades since 1981, and the second lowest in the ASEAN + 3. It has also been forecasted that the Philippines will have the steepest contraction in 2020 (a -8.3 percent change in annual GDP), which will also mean the sharpest reversal in growth from 2019 (a 14.3 percentage point drop), among the ASEAN +3.[7]

Indeed, the pandemic has revealed significant weaknesses in the country's economic and social systems and glaring gaps in our ability to withstand these types of shocks. For one, the public healthcare system was ill-prepared and easily overwhelmed - without adequate disease control and prevention infrastructure, including surveillance systems and laboratory networks - despite at least a decade of warnings and even a demonstration in 2016 of how system failures could lead to more infections and deaths than the primary cause of a disease outbreak.[8] A strict community quarantine (the Enhanced Community Quarantine, or ECQ) had to be imposed on roughly 70% of the economy, beginning in mid-March, to slow down the spread of the virus and buy time for the public health infrastructure to provision itself to manage the virus moving forward.

A community quarantine continues (although in somewhat more relaxed form since June). Yet the public healthcare system continues to flounder. On August 1, forty medical societies publicly asked for a two-week re-imposition of a stricter community quarantine in Metro Manila (back to an ECQ), arguing that the health system was overwhelmed from the continued rise in infections, medical professionals were 'burnt out', and authorities needed the time to come up with a better plan to fight the virus.[9] And at this time (October), contact tracing remains unreliable and transmission in the Philippines continues to be classified as 'community transmission' by the WHO.[10]

Another example is the social protection system. There was little by way of social safety nets for those whose incomes took a direct hit (e.g. middle income wage workers, transport workers and other informal sector workers).[11] Roughly 5 M joined ranks of unemployed in the 1st quarter of 2020, with another 3 M leaving the labor force altogether.[12] However as of end-June, DOLE had provided financial aid to only 1.18 million displaced formal and informal workers, SSS had provided unemployment insurance benefits and calamity loan assistance to just 5,740 and 102,500 members respectively (with approved loans in the pipeline for 376,500 more members), and DTI and SBC had released zero-interest short-term loans to just 183 micro and small enterprises (with loans for another 1,817 enterprises being processed for release).[13]

The formal financial system has also been of little help. Informal or micro-scaled firms are not part of the tax and financial system and only a few small and medium-scaled enterprises are reached by formal financial institutions.[14] The results of a business pulse survey conducted in July 2020 thus reveal that only about 22 percent of small firms actually received direct government support, another 16 percent had applied but did not receive assistance, 15 percent were not eligible, 21 percent found applications too difficult, and 22 percent were not aware.[15]

The robustness of other networks – fabrication, transportation, food distribution, R&D – warrant discussion as well. The immediate point is, however, that it would be foolish to ignore revealed weaknesses and gaps and assume the economy can or should simply pick up from where it left off.[16]

Why the miscalculation? It seems that the usual 'economic fundamentals' (e.g. strong fiscal position, low and stable inflation, high and rising output growth) may not count as much, if at all, in the face of physical shocks, like pandemics, which do not originate from within the financial system.[17] Shocks like market crashes or bubble bursts may be remedied by restoring confidence with credible fiscal and monetary policy backstopped by strong economic fundamentals. However, physical shocks can only be stabilized and remedied "by understanding and addressing underlying physical causes".[18]

Thus, institutions with core capacities to manage such shocks are likely to matter more for economic recovery and resilience than standard macroeconomic fixes.[19] Consequently, unless the relevant government institutions step up so that Covid-19 is decisively contained, a robust economic recovery will probably be elusive, no matter how much the stimulus (i.e. 'build-build-build') spending or how low the policy rates.[20]

However, building economic resilience by investing in the capacity of essential systems, rather than engaging in stimulus spending *per se*, does not appear to be the plan moving forward. The proposed national expenditure program for 2021 actually *decreases* the budget of the Department of Health (DOH) by 50 billion, from P181 billion this year to P131 Billion, and, increases the allocations to DPWH and DoTr for infrastructure spending, by 49% .[21] Items that appear to receive cuts in the DOH budget are outlays for the operations of national reference laboratories, epidemiology and surveillance, health information technology, PPEs, testing kits, laboratory commodities, equipment and human resources for health deployment (to unserved and underserved areas). Moreover, no significant funding increases went to local health systems development or quarantine services and international health surveillance either. And only P2.5 Billion was allotted for COVID-19 vaccines.[22]

The profound insight that our economy is not all that resilient to physical shocks, and that resilience must be our focus moving forward, is also - and not coincidentally - the call to climate action. Climate risk also represents a physical shock that is translating (as we speak) into an array of grave socioeconomic impacts.[23] And climate risk and pandemics share many attributes:

> *"Both are systemic, in that their direct manifestations and their knock-on effects propagate fast across an interconnected world.... They are both nonstationary, in that past probabilities and distributions of occurrences are rapidly shifting and proving to be inadequate or insufficient for future projections. Both are nonlinear, in that their socioeconomic impact grows disproportionally and even catastrophically once certain thresholds are breached (such as hospital capacity to treat pandemic patients). They are both risk multipliers, in that they highlight and exacerbate hitherto untested vulnerabilities inherent in the financial and healthcare systems and the real economy. Both are regressive, in that they affect disproportionally the most vulnerable populations and subpopulations of the world..."*
> (Pinner et. al. 2020, 2)

Thus, some have described the Covid-19 crisis as 'fire drill for climate change', providing us with a "foretaste of what a full-fledged climate crisis could entail in terms of simultaneous exogenous shocks to supply and demand, disruption of supply chains, and global transmission and amplification mechanisms." [24]

It is important to remember that neither pandemics nor climate risk was/is unforeseen.[25] So now that we have experienced the cost of failing to better prepare for the former when we had the chance, the urgent question becomes: how well is climate risk accounted for in national and local government development plans?

The pandemic has also made clear that society depends on well-functioning companies to meet its most basic needs and that companies do not exist solely to maximize returns to shareholders.[26] The new environment features "increasingly complex pressures and demands from various stakeholders, heightened expectations for societal engagement and corporate citizenship, and radical uncertainty about the future", all of which pose a direct challenge to the traditional shareholder-centric model of corporate governance. Rather than the standing 'primacy' of shareholders as fixed once-and-for-all, the pandemic has shown that each stakeholder group – customers, workers, suppliers, community, shareholders – is important to a company's ability to function.

It also brought home the reality that 'social issues' cannot be waved away by executives and fiduciaries as beyond their scope of concerns. Large-scale societal issues, such as declining public health and health systems, income inequality, wealth inequality, urban and environmental degradation, and climate change, are "not only legitimate areas of concern for business" but are, more importantly, "sources of both risk and opportunity."

In the same way that national and local development policy must be challenged for old notions of economic resilience, corporate thinking must also be. How well do risk management and oversight systems encompass risks arising from these large-scale societal issues? How well do strategic planning and resource allocation processes take these into account so that, at the very least, they are not exacerbated by company actions (and ideally, they are ameliorated)?[27]

In sum, the common challenge for both macroeconomic and corporate governance, in this era of pandemic and climate risk, is to undertake a fundamental shift in thinking and doing from 'optimizing largely for the shorter-term performance of systems to ensuring equally their longer-term economic and environmental resiliency'.[28]

For macroeconomic governance, this involves a pivot away from the traditional definition of 'economic resilience', based on the strength of one's fiscal position, to one based on the capacities of essential institutions. It also means a pivot away from resorting to 'stimulus spending' per se, to boost output growth in the short term, to resilience spending on institutions engaged in the real economy, for safer, more sustainable economies in the longer term. **Resilience spending serves as a stimulus. But stimulus spending may not necessarily contribute to resilience.**

For firms, it means a pivot away from the traditional shareholder-centric model of governance, to a model "that puts the health and resilience of the company at its center." (Paine 2020)

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Endnotes:

[1] Professor. The views and opinions expressed here are mine alone and do not necessarily reflect the official policy or position of any institution I am affiliated with.

[2] 4 September DBCC briefing on the FY 2021 GAA. https://www.neda.gov.ph/transcript-of-neda-acting-secretary-karl-kendrick-chuas-statement-at-the-dbcc-budget-briefing-on-the-fy-2021-proposed/

[3] https://www.rappler.com/nation/duterte-signs-bayanihan-2-law-extending-his-special-powers. The rest of this section draws from the September 4 DBCC briefing.

[4] CREATE recalibrates the CITIRA (Corporate Income tax and Incentives Reform Act) bill which had passed the House of Representatives and was undergoing interpellations in the Senate before the lockdown. Recalibrations were to "vigorously fight the impact of COVID-19 and help get businesses back on their feet as quickly as possible."

[5] https://opinion.inquirer.net/132915/they-are-playing-with-our-lives

[6] https://www.dof.gov.ph/govt-economic-team-rolls-out-p27-1-b-package-vs-covid-19-pandemic/

[7] IMF Regional Economic Outlook: Asia and Pacific, October 2020. https://www.imf.org/en/Publications/REO/APAC/Issues/2020/10/21/regional-economic-outlook-apd

[8] This is the case of the 2016 diarrhea outbreak in Samar, where facts suggest that the failure of the system to respond led to more infections and deaths than the contaminated water supply, which was the reported primary cause of outbreak (Gonzales 2016). Specifically, the epidemic was declared only after three months from when the first reported case was seen and after it had already affected 14 towns in three Samar provinces. By the time the epidemic was declared under control, 9,432 people were infected and 81 have died.

[9] https://www.cnn.ph/news/2020/8/1/Frontliners-call-for-time-out.html

[10] https://covid19.who.int/table. In contrast, transmission in Vietnam is described as 'clusters of cases'.

[11] What is in place is the mechanism designed for the 4Ps program, our flagship poverty alleviation program to improve the health, nutrition, and education status of roughly 4.35 million poor or near poor families across the country with children who are 0 to 18 years of age or members who are pregnant. The program was institutionalized in April 2019 through RA 11310.

[12] https://psa.gov.ph/content/employment-situation-april-2020-0

[13] Pre-SONA EDC Briefing by Sec. Carlos Dominguez, July 8 2020 (https://www.dof.gov.ph/2020-pre-sona-economic-devt-and-infrastructure-forum-presentations-and-speeches/)

[14] MSMEs account for 99.5 percent of business enterprises in the country, are responsible for two-thirds of total employment, but account for only 8.8 percent of total business loans of the Philippine banking system as of end-December 2019 (https://www.bsp.gov.ph/SitePages/MediaAndResearch/SpeechesDisp.aspx?ItemId=772). The 2019 Financial Inclusion Survey of the BSP also reports that a large proportion of Filipino adults (71%) remain unbanked.

[15] World Bank East Asia and Pacific Economic Update, October 2020

[16] https://econ.upd.edu.ph/dp/index.php/dp/article/view/1527

[17] Monsod and Gochoco-Bautista (forthcoming). Exploring why the Philippines had such poor outcomes despite strong economic fundamentals pre-Covid, the authors find that stronger national capacities to detect and respond to emerging outbreaks are associated with better short term economic outcomes in the region. They also find that traditional channels, via government spending, to increase economic output are either not operative or are overshadowed by the importance of having these core capacities.

[18] Dickon Pinner, Matt Rogers, and Hammid Samandari. "Addressing climate change in a post-pandemic world," McKinsey Quarterly. 7 April 2020. https://www.mckinsey.com/business-functions/sustainability/our-insights/addressing-climate-change-in-a-post-pandemic-world

[19] Monsod and Gochodo-Bautista (forthcoming).

[20] Ibid

[21] Punongbayan, J. C., Luis Abad, Zy-Za Suzara. "Why you should be alarmed by Duterte's 2021 budget," Rappler, 4 September 2020 (https://www.rappler.com/voices/thought-leaders/analysis-why-you-should-bealarmed-duterte-2021-budget). The authors further note that DPWH and DoTr disbursed less than half of their total obligations over the last three years on average.

[22] The proposed 2021 budget also features severe cuts in economic aid for households affected by the lockdown; allocations to the Department of Social Welfare and Development will be more than halved, including a wipeout of funds for the social amelioration program. Implicitly, economic managers assume that the mobility and livelihoods of low and low-middle incomes households will either be fully restored next year or that any multiplier effects from 'build-build-build' will trickle down to them. Meanwhile other countries may be more circumspect, "doubling down on the provision of cash transfers for poor households." (Ibid)

[23] The rest of this paragraph draws heavily from Pinner et. al. 2020. See footnote 17 for complete citation.

[24] Ibid.

[25] https://www.rochester.edu/newscenter/covid-19-pandemic-a-fire-drill-for-climate-change-421862/

[26] This section draws heavily from Paine, Lynne S. "Covid-19 is Rewriting the Rules of Corporate Governance", Harvard Business Review, October 06, 2020. https://hbr.org/2020/10/covid-19-is-rewriting-the-rules-of-corporate-governance.

[27] Both of these questions paraphrase insights from Paine.

[28] Pinner et. al. 2020, adapted.

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