The Global Economic Crisis as Opportunity

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There has been some talk about "green shoots of growth" springing up in the world economy, but as we said last March and April, when this chatter first emerged, these green shoots are an illusion. Let me quote from yesterday's *Financial Times:*

Last week, the green shoots shriveled. In South Korea, China, and Germany, exports were declining once again. In the US, the Federal Reserve's Beige Book said "economic conditions remained weak or deteriorated further during the period from mid-April through May."

The March signs of revival turned out to be little more than a technical inventory correction, with no change in the underlying trend. The world economy is still contracting, though perhaps not quite as fast as at the start of the year.

…[G]lobal industrial output is still on the same trajectory as it was during 1930. The only question is if we can avoid 1931 and 1932.

Long Night Ahead

The truth is, as we at the Freedom from Debt Coalition have reiterated for over a year now, we are merely at the start of a long night of stagnation and depression, one which will last for a couple of years. We are not at the trough of a regular business cycle, but on a swift downward spiral brought about by the four horsemen of the capitalist apocalypse: overproduction, globalization, financialization, and deregulation. In the last decade, the heroic American consumer kept an increasingly shaky global economy wracked by the contradictions of late capitalism together with his debt-financed spending, and the valiant Chinese state kept providing the American consumer with the wherewithal to keep on spending. Now that the heroic American consumer is bankrupt, who will take her place as the engine of the global economy?

The Chinese, say some, and they point to the allegedly positive impact of the Beijing's $585 billion stimulus package, one, they point out, is much larger in relation to gross domestic product than President Obama's $787 billion stimulus for the US economy.

Let us examine more closely this claim that China will snatch the global economy from the jaws of depression.

China to the Rescue?

With China's export-oriented urban coastal areas suffering from the collapse of global demand, many inside and outside China are pinning their hopes for global recovery on the Chinese countryside. A significant portion of Beijing's stimulus package is destined for infrastructure and social spending in the rural areas. The government is allocating 20 billion yuan ($3 billion) worth of subsidies to help rural residents buy televisions, refrigerators, and other electrical appliances.

But with export demand down, will this strategy of propping up rural demand work as an engine for the country's massive industrial machine?

The problem is simply allocating money to boost rural demand is unlikely to counteract the powerful economic and social structures created by subordinating the development of the countryside to export-oriented industrialization. These policies have contributed to greater inequality between urban and rural incomes and stalled the reduction of poverty in the rural areas. To enable the rural areas of China to serve as the launching pad for national and global recovery would entail a fundamental policy shift, and the government would have to go against the interests, both local and foreign, that have congealed around the strategy of foreign-capital-dependent, export-oriented industrialization.

Beijing has talked a lot about a "New Deal" for the countryside over the last few years. But there are few signs that it has the political will to adopt policies that would translate its rhetoric into reality. So no, the Chinese peasant cannot take the place of the profligate American consumer. No, the Chinese peasant will not be our savior.

End of an Era, End of a Model

What those who are in search of an alternative to the American consumer do not realize is that the halcyon days of the global economy have gone. Indeed, the realization is dawning that at the heart of our current crisis is economic globalization, or the accelerated integration of production and markets.

We are at the end of an era, one that begun with the ascendancy of the model of export-oriented industrialization (EOI). Beginning in the mid-seventies, technocratic elites from Manila to Seoul took the World Bank advice that "special efforts must be made in many countries to turn their manufacturing enterprises away from the relatively small markets associated with import substitution toward the much larger opportunities flowing from export promotion." What our elites did not want to face up to was that while globalizing economies would rise together in the boom, they would also go down together swiftly in the bust, which is what is happening now.

Aside from EOI, central to the recipe of economic globalization were structural adjustment and radical trade liberalization. In the case of the Philippines, structural adjustment, undertaken in the name of efficiency, simply exposed our agriculture and industry to dumping of subsidized agricultural commodities and cheap manufactures. Trade liberalization in this country was no joke. The effective rate of protection for manufacturing was pushed down from 44 to 20 per cent. Tariff rates were reduced across the board to zero to five per cent of the value of imports. This experiment in creating a free market nirvana a la Pinochet's Chile was achieved at the cost of multiple bankruptcies and massive job losses—in short, de-industrialization. The list of industrial casualties included paper products, textiles, ceramics, rubber products, furniture and fixtures, petrochemicals, beverage, wood, shoes, petroleum oils, clothing accessories, and leather goods. The textile industry was practically rendered extinct by the combination of tariff cuts and the abuse of duty-free privileges, with the number of forms shrinking from 200 firms in 1970 to less than 10 by the end of the century. As former Finance Secretary Isidro Camacho, Jr., admitted, "There's an uneven implementation of trade liberalization, which was to our disadvantage." While consumers may have benefited from tariff cuts, he said, liberalization "has killed so many local industries."

As for agriculture, liberalization mandated by our joining the World Trade Organization swept through Philippine agriculture like a super-typhoon. Swamped by cheap corn imports, a large part of it subsidized American grain, farmers sharply reduced the land devoted to corn, from 3,149,300 hectares in 1993 to 2,510,300 hectares in 2000. The travails of corn were paralleled in other sectors: massive importation of chicken parts nearly killed the chicken parts industry, while surges in imports destabilized the poultry, hog, and vegetable industries.

During the campaign to ratify WTO membership in 1994, Philippine government economists said that the collapse of the old agricultural sectors would be more than compensated for by the emergence of a new export industry specializing in the production of so-called "high-value-added" crops such as cut flowers, asparagus, broccoli, and snow peas. These industries did not materialize. Neither did the 500,000 new agricultural jobs that were supposed to be created yearly by the "magic" of the market; instead, employment in agriculture dropped from 11.2 million people in 1994 to 10.8 million in 2001.

All that came from the one-two punch of IMF-imposed adjustment and WTO-imposed trade liberalization was the swift transformation of an agricultural economy with a high degree of self-sufficiency into one that was permanently import-dependent, its small farmers steadily marginalized. It was a wrenching process, the pain of which was captured by a government negotiator during one of the sessions of the WTO's Agricultural Committee in Geneva. "Our agricultural sectors that are strategic to food and livelihood security and rural employment," he told the body, "have already been destabilized as our small producers are being slaughtered by the gross unfairness of the international trading environment. Even as I speak, our small producers are being slaughtered in our own markets, [and] even the more resilient and efficient are in distress."

The Consequences of the Model Debtor Strategy

We cannot fully comprehend, however, the massive damage done to our economy without taking into consideration the national economic priority that successive governments have placed on debt repayment. Owing to pressure from international creditors, the fledgling democratic government of President Corazon Aquino adopted the so-called "model debtor strategy" in the hope of continuing to have access to international capital markets. This approach was cast in iron by Executive Order 292, which affirmed the "automatic appropriation" from the annual government budget of the full amount needed to service the foreign debt.

What this meant is that instead of picking up the investment slack, government resources flowed out in debt service payments. In the critical period 1986-1993, an amount coming to some 8 to 10 per cent of GDP left the Philippines yearly in debt service payments, with the total amount coming to nearly $30 billion. This figure was nearly $8.5 billion more than the $21.5 billion Philippines total external debt in 1986. What is even more appalling is that owing to the onerous terms of repaying debts that were subject to variable interest rates and the practice of incurring new debt to pay off the old, instead of showing a reduction, the foreign debt in 1993 had gone up to $29 billion!

What this translated into was that interest payments as a percentage of total government expenditure went from 7 per cent in 1980 to 28 per cent in 1994. Capital expenditures, on the other hand, plunged from 26 to 16 per cent. Debt servicing, in short, became, alongside wages and salaries, the no. 1 priority of the national budget, with capital expenditures being starved of outlays. Since government is the biggest investor in the country--indeed, in any country--the radical stripping away of capital expenditures represented by these figures goes a long way towards explaining the stagnant 1.0 per cent average yearly GDP growth rate in the 1980's and the 2.3 per cent rate in the first half of the 1990's.

The anti-growth implications of the state's being deprived of resources for investment were already very clear to Filipino economists during the mid-eighties. As the University of the Philippines professors who authored the famous 1985 "White Paper" warned: "The search for a recovery program that is consistent with a debt repayment schedule determined by our creditors is a futile one and should therefore be abandoned."

This trend of continuing outflow of government resources in the form of payments to creditors and the shrinking of capital expenditures continued into the first years of this decade. In 2005, according to the World Bank, 29 per cent of the government expenditures went to interest payments for both foreign and domestic creditors and 12 per cent to capital expenditures. Compare that to many of our neighbors, where the figure for capital expenditures as a portion of the budget is quite high, some 30 per cent in the case of Thailand and 47 per cent in the case of Indonesia. This configuration of government spending prompted the UP School of Economics faculty to complain once again in 2004 that the budget left "little room for infrastructure spending and other development needs. They were joined--in an extraordinary example of hypocrisy, given its historical role in foisting the debt service at the head of the trough of government spending--by the World Bank, which complained in a 2007 policy brief:

"The Global Competitiveness Index ranks the Philippines at only 71 out of 131 countries, rating the country particularly poorly on a majority of the infrastructure indicators. The quality of transport infrastructure (which includes roads, railways, ports, airports, and logistics) is a particularly serious concern, with consequences for trade-related transaction costs and overall competitiveness. Recent assessments indicate that transport infrastructure is poorly maintained and badly managed, with years of underinvestment, especially in maintenance."

Not surprisingly, with government capital expenditures remaining low, total fixed investment has remained anemic, indeed running at only 14 per cent of GDP, which the World Bank notes is "substantially lower even than during the deep recession in the first half of the 1980's and substantially lower than in most other larger East Asian economies."

The Global Crisis and the Philippines

Let me now return to the global economic crisis and draw out some of its implications for the Philippines. All throughout the world, we see the collapse of the export-oriented industrialization and people saying goodbye to globalization. The new mantra is to massively increase government spending on the domestic economy to increase local demand to take the place of vanishing export markets. Instead of squeezing workers to produce cheap exports, the idea now is to increase local purchasing power through government transfer payments or income redistribution. The conversion of economic thinking to a point of view that critics of globalization have espoused for years is, of course, to be welcomed.. But the problem is that, as we noted earlier with respect to China, you cannot transform overnight an economic structure built on the priority of the export sector. Nor can you easily dismantle the structure vested interests that have congealed around the old economic regime.

In the Philippines, the problem is complicated by the fact that the government continues to be in denial that we have entered a period of recession and stagnation brought about by the global collapse into depression. This is an attitude brought about by the current administration's focus on changing the constitution to keep itself in power. Indeed, we are probably the only country in East Asia that downplays the economic crisis instead of putting the country on economic war footing.

We in FDC decry the administration's attitude of denial and its wrong set of priorities. Moreover, we have lobbied incessantly for an economic program to deal with the crisis. We agree that we need a stimulus package, but it should be a stimulus package that contains significant new spending instead of being a reallocation or reconfiguration of already planned government budget expenditures, as has been the case in the last year. We have said that a major source of resources for domestic stimulus is our foreign debt service, which now comes to some $4 billion a year, and that a moratorium on our debt servicing is, in the context of the economic crisis, in order. We should, in short, keep our resources for domestic spending instead of having it incessantly flow abroad in debt servicing for debt that has been paid many times over.

Is this proposal really that utopian and dangerous, as some of our economic managers claim? The merits of a strategy of radically pricing down developing country debt and channeling the savings into the domestic economy have already been shown by Argentina, which unilaterally reduced its debt to bondholders to 25 cents to the dollar in 2002 and saw 10 per cent GDP growth five years in a row. Ecuador recently followed Argentina's example by canceling $30 million worth of payments on foreign bonds deemed illegitimate. And, in fact, the United Nations Conference on Trade and Development's (UNCTAD) has called for an immediate debt moratorium of all highly indebted countries to provide "breathing space in the current global crisis."

It is the model-debtor strategy that is an anachronism. Indeed, at a time that the international banks and financial institutions have been severely weakened by the crisis, bold moves should be made by the debtors to shift the balance of power in their favor. At the very least, our economic managers must call for a renegotiation of our debts to various creditors, instead of saying don't even mention the word "renegotiate" for fear of chasing away the creditors. They will come to the table if you are willing to challenge them at their moment of weakness. Fortune, as they say, smiles on the bold.

A debt moratorium and cancellation of payments for illegitimate debts are, however, merely the first steps toward economic health. A truly healthy economy can only be achieved by junking the wrong-headed policies of export-oriented growth, structural adjustment, indiscriminate trade liberalization and by ending the extremely unequal distribution of income that has been the central factor preventing the creation of a vibrant domestic market that can serve as the axis of sustained development.

In conclusion, let me say that we are at the end of an era, the era of the second wave of globalization and of export-oriented growth. The heroic American middle class consumer has vanished from the scene, and the poor Chinese peasant is not a viable substitute. Those who have called for a focus on the domestic market as the center of gravity of our economic development have been vindicated as even the economics establishment now calls for channeling resources into reflating national economies through government spending and income redistribution. For developing countries like the Philippines, a major source of funds to channel into raising effective demand locally is our debt service payments. A moratorium on foreign debt payments is an idea whose time has come. In short, the global economic crisis is an opportunity. The question is: will we have the courage to seize it?

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