

# Of Economics, Politics, and Policies: Towards A Comprehensive Approach to Public Policy<sup>1</sup>

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Distinguished officers and members of the Stratbase  
ADR Institute, panelists, special guests, ladies and gentlemen,  
good morning!

It gives me great pleasure to take part in this very timely  
and important event. I say timely and important because of  
two things: First, this Conference provides the much needed  
platform for key government servants, policymakers and  
stakeholders to convene and assess the Philippines' current  
economic and socio-political environment and outlook.  
Second, it also provides an opportunity for the participants to

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<sup>1</sup> Keynote Speech of the Deputy Governor Diwa C. Guinigundo, delivered at the 2018 Pilipinas Conference, 7 December 2018, The Conservatory, The Peninsula Manila.

go beyond the ambit of politics and discuss the current political landscape's impact on the domestic economy.

In other words, ladies and gentlemen, this Conference reminds everyone of a very important but often overlooked aspect of policymaking – the unavoidable interaction between economics and politics.

### *The Politics of Economics and Economics of Politics*

In my view, the science of economic policy involves the politics of economics and the economics of politics. Let me elaborate.

The legacies of the Global Financial Crisis (GFC) have painfully taught policymakers around the world that economic policies do not operate in a vacuum. Political issues can

potentially cause a systematic grit on the wheels of policymaking and alter their intended outcomes. Similarly, sub-optimal economic policies can potentially fuel discontent among the public which could lead to adverse political events that can at times have widespread and enduring effects on the broader economy.

### *Bad Politics Begets Bad Economics*

This interaction has been particularly evident in the current economic environment where uncertainty has remained elevated. For many observers, this uncertainty has been driven more by political developments instead of the usual economic interplay of demand and supply factors in the markets.

Take for instance, the rising trend of populist sentiments which has fueled a greater incidence of zero-sum outcomes. We have already seen nations leave economic unions, as with the Brexit. More recently, concerns over rising trade barriers have materialized as US and China have been embroiled in a tit-for-tat trade strategy in recent months. In September 2018, the Trump Administration finalized tariffs on more than US\$200 billion of Chinese imports.

Certainly, these political events could have adverse effects on economic growth. First, these shocks can lead to transitory capital flow volatility and bouts of financial market turbulence.

Second, higher volatility could also dampen animal spirits and lead to what psychologists call an “affect heuristic” among economic agents. Long after the original trigger has

dissipated, risk perceptions endure and make people more cautious about the future. This translates to less investments and ultimately lower growth.<sup>2</sup>

Third, there is also the direct impact of protectionist policies on trade and growth. In fact, the International Monetary Fund (IMF) estimates that an escalation of the trade war could shave-off 0.8 percentage point of the global growth by 2020.<sup>3</sup>

In addition, the precipitation of all these risks can also complicate the conduct of economic policy, particularly in emerging economies including the Philippines.

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<sup>2</sup> Carney, M. (2016). “The Spectre of Monetarism” Speech delivered during Roscoe Lecture, Liverpool John Moores University on 5 December 2016.

<sup>3</sup> According to model simulations in the October 2018 IMF World Economic Outlook Report.

Political events are generally unquantifiable and difficult to predict. The uncertainty in the operating environment that they generate can confound causal relations between economic variables which, in turn, can render the formulation of appropriate policies even more difficult.

For example, the surge in volatile capital flows can complicate the conduct of monetary policy in at least two ways. First, domestic financial conditions could become increasingly affected by external shocks. This could pressure policymakers to respond to a broader range of developments without the necessary tools at their disposal. Second, domestic interest rates could become more sensitive to external forces which, in turn, could potentially weaken monetary authorities influence on asset prices and aggregate demand.

## *Good Economics Begets Good Politics*

How then should policymakers respond to these new challenges?

At this juncture, allow me to point out the good side of the relationship between economics and politics. Good economic policies could potentially lead to good politics. I am sure everyone is quite familiar with the works of Daron Acemoglu and James Robinson, in their book “Why Nations Fail?,” when they argued that developed countries such as the US attain wealth because of institutions, programs, and economic systems that are inclusive.<sup>4</sup> Inclusive because they create incentives for people to innovate, enable productivity growth through education and infrastructure, and maintain peace and order across geopolitical boundaries.

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<sup>4</sup> Acemoglu D. and Robinson, J. (2012). “Why Nations Fail?” Crown Business Publishing.

Towards this end, our main thrust in the Philippines for the past 25 years has been to embark on often difficult and painful reforms- ones that are necessary to build and strengthen our institutions.

These include expanding the role of market forces in key sectors of the economy through the liberalization of the banking, telecommunications, transport, and power sector, among others. Likewise, the creation of the Bangko Sentral ng Pilipinas (BSP), as the country's independent monetary authority, as well as efforts to strengthen the banking system were put forward and are equally vital.

These reforms have helped propelled the economy to an impressive streak of 79 consecutive quarters of uninterrupted



growth. That means 19 years and 3 quarters since the 1<sup>st</sup> quarter of 1999. Moreover, the structural reforms have been translated into higher potential output for the economy. Our estimates show that potential output growth has been rising, averaging 6.0 percent for the period 2010 – 2017.<sup>5</sup> So the talk about the large output gap is without basis. Our output gap is either a small positive or a small negative. So the issues about overheating is quite misplaced.

Our efforts are also positively recognized by independent third-party assessors such as the World Bank (WB) and the World Economic Forum (WEF). Results of various institutional and governance reform surveys have shown a consistent improvement in the country's competitiveness over the years.

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<sup>5</sup> Potential output growth was estimated using growth accounting method.

Indeed, the reforms that we have pursued in the past puts the current administration in a favorable position to push for further reforms and leverage on the strong political capital that it possesses. It has to leverage on that very important aspect of policy making.

In fact, the government is currently proactively addressing bottlenecks in government services by automating processes, establishing on-line services, and improving public's transactional interface with government. Now these ongoing reforms are aimed at further reducing cost of doing business to translate to a more competitive and productive business and workforce.

The country's improved creditworthiness, exemplified by the country's elevation to investment-grade territory, has undoubtedly cemented the Philippines' status as an economy with one of the brightest prospects globally.

### *BSP as a Steward of Good Economics*

Now even as I say these, the changing landscape has made the operating environment increasingly becoming more complex.

To complicate things further, new challenges from rapid technological innovations such as the Fourth Industrial Revolution have also come along. For instance, while fintech innovations such as digital currencies and distributed ledger technologies (DLT) like blockchain have useful applications for central banking, they could also have significant

implications on the conduct and efficacy of monetary and other public policies.

Thus, we at the BSP have made it a policy imperative to enhance our existing monetary framework and operations to make our policies more responsive to emerging challenges.

First, we recognize that economies have evolved to be extensively interconnected and open. As such, price and financial stability is no longer affected by normal dynamics of demand and supply of goods and services, but also by non-economic factors such as politics, the speed of technological innovation and even geopolitical conflict. Thus, we have been sharpening continuously our frameworks to consider these emerging trends and tipping points.

Second, we have proactively engaged in dialogues relating to the issue of inequality. While it could appear for now as a non-monetary concern, we have witnessed how this issue could later on transform itself into a major disruption if it feeds into political unrest or dissatisfaction.

In this regard, the BSP has focused more on the issue of inclusive growth and integrate this in our traditional objectives of price stability, the stability of the financial system and a credible and efficient payments and settlements system. We are committed in advancing our financial inclusion, financial education, and consumer protection agenda to ensure that no one is left behind and everybody is given the opportunity to ride the economic growth our country is presently enjoying.

Third, we intend to leverage on technological innovations and digitization to further our goal of more inclusive growth. We are encouraging digital innovations and fintech solutions through an enabling regulatory environment while raising the bar for guarding against cybercrime and related risks. With digital innovation and fintech, the reach of financial services in the country will expand to the unbanked and the underbanked and at much lower cost. I think this is the essence of inclusive growth.

Fourth, our focus on income inequality has also reaffirmed our commitment to price stability. In an emerging and developing economy like the Philippines, keeping prices within target benefits the poor most, specifically the lowest income classes of the population. The BSP tracks inflation rates for the poorest segment of Philippine society, cognizant

of the difference in their basket of goods and economic behavior. We observe that this segment relies heavily on the ability of monetary policy to rein in inflation, especially because they feel a heavier brunt if we miss the target. Hence, monetary policy directly affects the people's welfare and, in turn, affects economic opportunity and income distribution.

### *Conclusion: The Bigger Picture*

You can be assured that the BSP will continue to adopt a comprehensive approach to monetary policy. One that takes into account a broader set of variables without losing focus on its primary mandate of price and financial stability.

Focusing solely on one factor could put us in the danger of policy myopia reminiscent of the parable of the five blind monks who encounter an elephant for the very first time. Of

course, you know the story. While one monk feels the elephant's legs and concludes that an elephant is just like a tree. Meanwhile, another monk feels the trunk and concludes that an elephant is just like a snake, and so on. While each monk's impressions are technically correct, they all fail to capture the bigger picture.<sup>6</sup>

We need to look at the bigger picture because good policymaking is about good economics, good politics and their interaction.

Again, we like to thank you for this opportunity to share our thoughts and we look forward to a very productive discussion.

Thank you very much

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<sup>6</sup> Lo, A. (2017). "Adaptive Markets: Financial Evolution at the Speed of Thought" Princeton University Press.



