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Sustainable public debt assured with fiscal consolidation — PIDS

By Lee C. Chipongian – June 21, 2022

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The Philippine Institute for Development Studies (PIDS) is backing the outgoing Duterte government's fiscal consolidation program to bring back the debt-to-GDP ratio to its pre-pandemic level, and is recommending to the incoming administration to not reverse fiscal policies to ensure debt sustainability.

PIDS cited the significant economic stimulus package under the fiscal consolidation program as well as investments in infrastructure and social services that will allow better management of the budget deficit beyond 2022.

"(As) PIDS pointed out that, unlike in the past when public debt spiked because of interest rate shocks or fundamental issues with state enterprises or institutions, the country's latest borrowings were the result of the pandemic-induced crisis that was preceded by a steady rise in the government's tax effort and the implementation of tax reform," according to the Department of Finance (DOF) which received the PIDS presentation last week.

"Thus, the country's high-debt episode is 'not as deeply rooted or self-inflicted as in the past'," said DOF, quoting PIDS' analysis.

PIDS presented its study before DOF Secretary Carlos Dominguez III last week. The PIDS authors are Margarita Debuque Gonzales, Charlotte Justine Diokno Sicat, and John Paul Corpus.

Gonzales et al said the high debt level is "the result of a large exogenous shock to growth and revenues and of the government's accumulation of cash reserves as a precautionary move in the event of a long-haul public health crisis."

The DOF highlighted the study recommendation that "no policy reversals be done so as not to compromise debt sustainability, and that the next administration (should) maintain fiscal responsibility, not necessarily fiscal stringency."

Both the national and local governments should also continue their productive spending to jumpstart the economy, PIDS added.

"There is a need for medium- to long-term fiscal consolidation to anchor market expectations. But a fiscal stimulus is needed on items that present large multiplier effects such as infrastructure. Investments in human capital are also needed to address the risks of scarring," said the report.

The DOF reiterated on Tuesday, June 21, that the fiscal consolidation is necessary to maintain spending for productive activities that could help the country recover from Covid-19.

The DOF said the fiscal consolidation will protect the country from fiscal or economic shocks. This was backed by PIDS which also warned against fiscal risks that could undermine the country's debt sustainability.

The PIDS study followed the debt sustainability analysis framework outlined by the International Monetary

Fund to compute the country's medium-term debt trajectory based on combined macroeconomic assumptions and forecasts of government and private sector institutions.

Both the DOF and PIDS identified these risks as: a possible surge in Covid-19 cases that could again lead to lockdowns and limited economic activity; natural disaster and calamities; higher contingent liabilities of social security institutions, public-private partnership projects, underfunded pension plans of uniformed personnel which would all result in government shouldering these financial burdens; real foreign exchange shocks; interest rate shocks; and lower GDP growth associated with lower inflation and higher public spending, which leads to costly borrowings arising from higher interest rates and exchange rates.

The DOF said other risks cited by the study include: reduced fiscal space for the national government resulting from the implementation of the Supreme Court ruling that gave local government units a bigger share in national tax collections; geopolitical tensions such as the Russia-Ukraine conflict; lower remittances and increased number of displaced overseas Filipino workers; decreased global credit; reduced trade; and cybersecurity glitches.