
Prema-chandra Athukorala Comment on
**Rethinking “Economic Fundamentals” in an
Era of Global Physical Shocks: Insights from
the Philippines Experience with COVID-19**

Prema-chandra Athukorala, Australian National University: At the time of the onset of the COVID-19 pandemic, the economy of the Philippines had strong macroeconomic fundamentals—a decade of robust growth at an average annual rate of 6 percent, low inflation, remarkably low external debt exposure, strong fiscal position, and the highest ever sovereign debt rating—which are commonly identified as prerequisites for facing external economic shocks with comfort. Yet the Philippines has turned out to be one of the worst-hit countries in East Asia from the coronavirus. Its mortality rate (19.9 per million population, at the time of writing this paper) is comparable only to that of Indonesia, and, on average, almost five times that of other countries in the region. The projected growth contraction in 2020 (−8.3 percent) was by far the highest among these countries. The authors set out to examine why this massive growth contraction in GDP occurred against the initial robust macroeconomic fundamentals that permitted the government to predict that, even under the worst possible scenario, the economy could still grow in 2019 and in the medium term by about 6 percent.

The paper begins with a stage-setting analytical narrative from a comparative East Asian perspective of the economic conditions of the country in the lead up to and during the pandemic, the humanitarian cost of the pandemic in terms of morbidity and mortality, and the response of the government to cushion the economy against the pandemic’s effects. The authors endorse the view that the lockdown of the economy—via an enhanced community quarantine imposed on the island of Luzon that constitutes 70 percent of the Philippine economy for six weeks and a general community quarantine in the rest of the country—was necessary to hold the pandemic at bay and thus buy time to capacitate the health system to effectively respond to the pandemic. They then convincingly argue, based on a comparison with Korea, Taiwan, and Vietnam, that the Philippines failed to utilize this “breathing space” to develop an effective country-wide system of testing and contact tracing to contain spread of the virus.

The authors hypothesize that the underlying institutional deficiencies of the national health system played an important part in explaining the economic outcome of the

pandemic over and above the anticipated cushioning effect of the Philippines' strong macroeconomic fundamentals. Using a cross-sectional data set of 24 countries, the authors sought to test this hypothesis by probing the relationship between the projected economic contraction in 2020 and the capability of the national health system to detect, assess, and respond to a public health emergency, while controlling for initial fiscal position, the age structure of the population (which captures vulnerability to the pandemic), indicators of response to external shocks, and vectors of country-specific geographical effects.

The empirical findings strongly support the hypothesis that stronger national capabilities to detect and respond to emergency outbreaks determine inter-country difference in the severity of the predicted economic contraction in 2020, over and above fiscal conditions and other controlled variables. Interestingly (and perhaps surprisingly), the regression coefficient of the fiscal position variable in the alternative regression specifications is either statistically insignificant or significant but with the wrong sign (indicating worsening of the economic contraction). These inferences need to be treated with caution and are worth revisiting using a larger sample size when the data are more settled for the entire duration of the pandemic. I suspect that results are biased in favor of the variable representing the capacity of the health system because of the "omitted variable" problem relating to the selection of controls.

The authors have taken pains to represent this variable in the regression equation, but some relevant control variables are either not properly specified or missing. For instance, regarding the cushioning effect of fiscal policy, what is relevant is not the perceived fiscal capacity per se but whether the government has effectively used the available fiscal space to cushion the economy against the pandemic shock. Exposure to foreign trade (captured by the exports to GDP ratio) and dependence of the economy on international labor migration (measured by inward remittances to GDP) are conspicuously missing. The pandemic has affected virtually all the trading nations in the world. Therefore, trade orientation is much more important in explaining inter-country differences in economic contraction due to the COVID-19 pandemic, than a crisis that encompasses only some countries/regions in the world such as the 1997–98 Asian financial crisis or the 2008–09 global financial crisis (Reinhart and Reinhart 2020). Disruption of migrant labor flows could invariably have had a much greater contractionary effect on the economy of the Philippines compared with other countries in the region and in the world. In addition to the capacity of the national health system, overall state capacity, social trust, and leadership are also vital for successful pandemic responses (Fukuyama 2020).

Included in the data set are Australia and New Zealand, which would have biased the results in favor of the authors' preferred hypothesis, as both have much superior national health systems compared with Asian countries and would have benefitted from their peculiar geography as island nations located "down under" in facing the pandemic.

Finally, the empirical evidence in the paper is based on the regression coefficients estimated across all 24 countries (the coefficients are simply 24-country averages). Estimating the equation with both intercept and slope dummies for the Philippines would have helped readers understand how the hypothesized relationship relating to the Philippines differed from the averages for the countries covered. Of course, the authors would have naturally been faced with the “degrees of freedom” constraint when working with a cross-sectional data set with 24 observations. Nonetheless, including both slope and intercept dummies for the country of interest in the paper would have been a superior alternative to only including arbitrary intercept dummies for some countries (Table 3).

COVID-19, or any other pandemic for that matter, is concomitantly a health *and* economic crisis (Reinhart and Reinhart 2020). The humanitarian costs and socioeconomic effects of the health crisis in any given country entail adverse demand and supply shocks on the economy. These negative shocks are naturally compounded by external demand shock emanating from the global speed of the pandemic. In this context, macroeconomic policy and health system responses need to be treated as complementary rather than competing tools in a successful pandemic response. The macroeconomic response is perhaps much more important than public health response in terms of averting economic contractions during the health crisis. Of course, the need for public health system reforms to make the country agile to react to future pandemics is an important lesson from the current pandemic. There are simply no quick fixes to robust public health infrastructure and laboratory ecosystems.

References

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