Sustainable Inclusive Growth via Less Government [1]

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I am thankful to the organizers of the 10th Young Economists Convention, for allowing me to present an alternative perspective in attaining a "sustainable inclusive growth".

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Defining sustainable inclusive growth (SIG). Sustainable means minimization of wide boom-bust cycles, the ability of the economy to sustain growth without compromising or incurring future fiscal and financial instability.

Inclusive Growth (IG) means a broad-based, people-centered economic growth. It is desirable as people are not just consumers and recipients of government welfare as what some pro-population control groups claim.. People are producers, they are entrepreneurs and workers, they are taxpayers. When hindrances to people's entrepreneurial spirit are reduced or abolished, a real broad-based economic growth will come out.

Attaining SIG is possible, no debate about it. The debate is how to attain it.

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Conventional perspective to attain SIG is via more government. More UN Millennium Development Goals (MDGs), more WB-ADB loans, endless welfare programs: Education and healthcare for the poor, housing and transportation for the poor, agrarian reform for the poor, irrigation and credit for the poor, cash transfers (CCT) for the poor, and soon, condoms and pills for the poor (RH bill). Lots of central planning, forced income redistribution in economic and social sectors, are involved in this philosophy.

I come here to argue that SIG is better attained if we have less government: less regulations, less bureaucracies, less spending, less borrowings, and less taxation.

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I will divide my presentation into three major themes.

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I. Free market and the poor: free trade, contestable market, monopolistic competition, productivity and employment.

II. Government bureaucracies and the poor, nanny state, high spending, high taxes, endless borrowings, government-created monopolies.

III. Inequality and the poor: rule of law, personal responsibility vs. government responsibility, self-reliance vs. state reliance.

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I. Free market and the poor

When the problem is supply gap (demand is larger than supply), the solution is not politics, but basic economics.

Here are two graphs, you should have taken them in basic economics course. Upper graph shows supply gap, or excess demand of a commodity, say tilapia. People want the price of tilapia at only P1. The demand is at Q1 but at that price, the supply is only at Q2. So you have a supply gap as tilapia farmers and sellers will not sell because they will lose money. To solve the problem, allow the price -- do NOT impose price control -- to rise to Po and that's where supply meets demand at Qo. Those who are willing to pay the price will get the tilapia. Those who are not willing to pay the price, they will find other food to buy, like more vegetables, or tilapia small size, and so on.

The lower graph is the opposite, there is supply glut or excess supply. The weather suddenly just turns too good for tilapia farming. Result is huge supply of tilapia. But consumer demand for tilapia remains the same. Tilapia farmers and sellers will be forced to sell at a lower price. Then more people will buy the tilapia, they will buy less bangus or chicken or pork.

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The graph on the left represents the market, the one on the right represents a single or representative firm. A perfectly competitive market, zero product or service differentiation that will introduce a "slightly different" product to the consumers, would have just one price. Any firm who will sell at a higher price will not be able to sell anything, all other things being equal.

A firm's location can affect this situation and will in effect, introduce service differentiation. The lesson for statists and price interventionists here, is that if most or all firms that supply a particular product in a given area or community have the same or almost-the-same price, it does not automatically mean "price collusion" or cartelization among them. Rather, it can be due to the existence of a perfect (or near-perfect) competition market for that particular product. Thus, government intervention and additional regulations in this case are totally unnecessary.

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This graph I developed in reaction to a suggestion by some health NGO leaders that "there should be only one price for each medicine with the same dosage and made by the same manufacturer, whether the drug is sold in the hospital, in a fancy drugstore or in a barrio drugstore." In effect, an across the board drug price control.

Each drug outlet or chain of drugstores, has its own cost structure different from the other drugstores, like the rental cost, having an air-con in the drugstore, etc. Thus, there is difference in pricing among various drug outlets. We can say that points A, B, C, are the prices of the same drug in different hositals. Points D, E, F are the prices of that same drug in fancy drugstores like Mercury and Watsons. And points G, H, I to X are the prices in various Botika ng Barangay, Botika ng Bayan, other small private drugstores.

The lesson is that market segmentation allows more equilibrium prices for various consumers and producers. We don't need government and drug price control policy to allow the poor to have access to cheaper medicines because there are outlets that precisely offer such cheaper drugs already.

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We now go to free trade. The main goal of protectionism is to make otherwise cheap goods become expensive, so that the local industries that sell expensive will be protected.

In this graph, import tariff and taxes immediately raise the price of imported goods, making these as expensive as, if not more expensive than, the locally-produced substitutes. Having Protected price (Pp) higher than Free trade price (Fp), many consumers who would have patronized the imported goods are discouraged; but the protectionists get lower sales volume or quantity (Pq) as consumers buy less.

The bigger the gap between Pp and Fp, the higher the motivation to do smuggling. Trade smugglers are usually from among the politicians in power, or their friends.

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When government of rich countries provide export subsidies and domestic support to their own farmers and manufacturers, their goal is to make their expensive exports become cheaper to consumers of other countries. So when the governments of France, Germany and the US will tax-tax-tax their citizens partly to subsidize their exporters so that such exports will become cheaper to consumers in the Philippines and other poorer countries, we should be happy, right?

But protectionist interests and statist sentiments plus the itch to intervene by certain government bureaucracies, find this arrangement as "unfair". Thus, they invented anti-dumping laws, counter-vailing duties, or new import taxes to make the supposedly cheaper imported goods become expensive again. For me, this is an idiotic policy.

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Free trade results in commodity price equalization (CPE) through time, all other things being equal, like assuming that transport/shipping costs are low or zero.

Consider three group of countries:
Country A has rice surplus production every year.
Country B has rice deficit every year
Country C produces no rice.

If trade is disallowed or at least restricted, country A will have very low rice price because of over-supply. Country B will have expensive rice because of under-supply. And country C will have very expensive rice. With free trade, there should be rice price equalization among the 3 as whatever surplus in A will be bought and imported by B and C. That's the beauty of free trade.

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Free trade expands consumer surplus. Consumer surplus is difference between the maximum amount or price that a consumer is willing to pay for a commodity, and the current or actual price of that commodity.

Free trade expands the supply curve from the original S1 to S2. This results in reduction of the price from the previous equilibrium price of P* (before free trade) to P1. Likewise, the quantity sold in the market expands from the original Q* to Q1.

That is what free trade mainly does – first to expand the volume and quantity of various goods and services that are available to the local consumers, and second to make the price of those goods and services become cheaper and more affordable.

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Free trade is pro-poor. Take the case of Hong Kong.

Hong Kong does not need any Free Trade Agreement (FTA), Most Favored Nation (MFN) contracts, nor the World Trade Organization (WTO). HK simply declared a unilateral trade liberalization policy. Zero government to government negotiations, agreements and protocols. In fact, the WTO can be abolished and HK will not care a bit, it will not be affected.

Unilateral free trade is unconditional opening of borders to foreign goods at zero tariff. The only imported goods that HK subjects to government regulations are perhaps guns, bombs, poisonous chemicals and substances, drugs, shabu, virus-infested food products and drinks.

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Only when goods would possibly affect public health and security, that government regulations come in. Otherwise, it steps back, no unnecessary bureaucracies and taxation.

Thus, HK is able to efficiently utilize its bright minds. Away from trade politics towards actual trading and money-making. HK does not pay for trade negotiators, trade lawyers, and pay for their junkets in various global trade talks. And taxpayers keep their money, the poor have more jobs and increasing income.

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You remember this in your Econ 11 or Econ 101, the macroeconomic equation, **$Y = C + I + G + (X-M)$**.

National output or GDP (Y) is equal to the sum of private Consumption expenditures (C), private investments (I), government consumption and investments (G), and net exports (exports minus imports).

In the case of the Philippines, **C** constitutes about 76 percent of GDP. This is a significant component, thanks partly to the high population of the country. At this ratio, even if **I** and **G** will grow slow or remain flat, so long as there is fast growth in **C**. GDP growth will remain fast.

Now, **$C = a + (b \times Yd)$,**

Where **a** is autonomous consumption (even those with zero income like children, mentally/physically handicapped, the lazy, etc.) would still consume food, etc. And **b** is the marginal propensity to consume (MPC). Not all of disposable income (Yd) goes to consumption, some will go to savings to finance current and future investments.

Finally, **$Yd = Y - T$**,

Disposable income (Yd) is aggregate income (Y) minus taxes (T), or simply after-tax income.

The bigger or the plentier the **T**, the lower the disposable income (**Yd**), the lower the potential **C**, and GDP will be affected negatively. Statists and Keynesians can argue that the **T** should go to government spending **(G)** like many European countries where G/GDP ratio is up to 40 percent or even higher, and it is supposed to bring some "stimulus" to the Y. This does not happen in Europe and many other rich economies now.

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We now go to **Part II, Government bureaucracies and the poor**. Here I show the various government permits that entrepreneurs should display in their stores, shops and restaurants – barangay permit, sanitation permit, electrical permit, location permit, fire department permit, Mayor's permit, SSS permit, DTI or SEC permit, etc.

The government bureaucracies are simply saying, "Entrepreneurship and job creation is a crime, unless you get our signatures and permits." That's how government loves entrepreneurship and the entrepreneurs.

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In the **Doing Business 2011** Report, an annual study done by the WB-IFC, here are the bureaucracies and taxes that medium-sized companies in the Philippines have to face.

To start a business: 15 procedures in 38 working days, costing nearly 30 % of per capita income. In Paying Taxes: 47 diff. taxes and fees per year, 196 hours (or 24.5 working days). Profit tax is 21.3 % but when various mandatory labor and social security contributions are included, total tax rate is 45.8 % of a corporation's profit.

The **Doing Business** is among the few important projects done by the WB.

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A cartoon that I got somewhere. The farmers and entrepreneurs are huddled in a house finding a way to resume business. They checked outside if the bad wolf is still there – he's still there, the BIG government.

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Here are pictures of those buko vendors, the guys who sell young coconuts for P20 to P25 each. See the Makati City government truck hauling and confiscating those buko kart for the crime of "No city hall permit."

From my interview of some of those buko vendors, the penalty is P1,000, no receipt. They complain that if they steal, they will be arrested. If they work legally, their goods or kart are confiscated. Yeah, that's another instance of how government loves the poor and the micro entrepreneurs.

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I took this picture about a month ago in Guadalope, Makati. A woman selling Indian mangos were hauled into a barangay tricycle, along with her fruits, for the crime of "blocking an intersection". The woman protested that she has 7 kids to feed and working hard legally, and is too poor to be further penalized by the barangay officials. That government people do not run after the thieves who victimize ordinary people like her.

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Here are pictures of two ambulant vendors. One has a vehicle, they sell at different municipalities which have "market day" then move to another municipality or city the next day which has a scheduled "market day." The other vendor has a fishball kart, selling from one busy intersection to the next.

The lesson here is that those micro entrepreneurs do not need special government programs and "encouragement". They only want freedom from harassment and high business permit fees.

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More pictures of small scale stalls in some municipalities and big barangays in the country. The desire to stand on their own, to be self-reliant, to seek little or no government subsidies is there. These micro entrepreneurs simply want freedom from government harassment, freedom from high business permit fees and taxes.

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A table showing the extent of indebtedness of many governments in Asia-Pacific. My main issue here is the extent of fiscal irresponsibility of many governments, in Asia, Europe and elsewhere, of living beyond their means, of over-spending even if their revenues are not sufficient to cover those huge spending, resulting in ever-rising public debt.

Singapore and Japan have the same situation of developed economies with very high public debt; Hong Kong, China and Australia have similar situation of a modern economy with very little public debt. The Philippines is midway, its Debt/GDP ratio in 2010 was 47.3 percent.

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We now go to the last section, **Part III, Inequality and the poor**. Ironically, I will argue that "inequality is good". Why?

1. Because it respects and rewards hard work, efficiency and ambition.
2. There are people who have little or zero ambition in life. To drink and party everyday, to rely on some outside support for their continued existence are their joys and complacency.
3. Between the two, inequality is sure to happen in the short term, and such inequality will widen over the long term.

The sticker or card says it appropriately. Socialism and forced equality is a great idea, so long as you do not run out of other people's money to confiscate and redistribute.

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Why inequality is good, Continued:

4. Government welfare and entitlement programs that are meant to reduce inequality and improve equality among the people are mostly unproductive.
5. "The rapid economic advance that we have come to expect seems in a large measure to be the result of this inequality and to be impossible without it."
6.. "All obstacles to the rise of some are, in the long run, obstacles to the rise of all… To prevent progress at the top would soon prevent it all the way down." – Friedrich Hayek, <u>The Constitution of Liberty</u>

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Why inequality is good, Continued:

7. Government policies of institutionalizing forced equality penalizes hard work, performance and being ambitious.
8. When the poor and initially less ambitious see that there are less entitlements coming, they will become more self-driven and independent, & society can progress faster.

The cartoon here depicts what many entrepreneurs, from small to big ones (except cronies) experience. Government intervention and bureaucracies are heavy burdens that they have to live with.

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This chart is from the National Statistics Office (NSO), “Death Statistics 2007” which they released several months ago. The top killer diseases in the Philippines now are no longer those old, communicable ones like dengue, malaria, polio, flu, etc. It's the "lifestyle diseases" like heart diseases, stroke, hypertension and cancer. The top 4 diseases responsible for nearly 50 % of all deaths in the country in 2007.

The growing influence of “lifestyle-related diseases” to mortality highlights one important fact. That healthcare is first and foremost, personal and parental responsibility, and less as government responsibility. People cannot over-drink, over-smoke, over-eat, over-sit, over-fight, etc. and when their internal organs are dilapidated, they just go to the government to demand that “health is a right.”

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Concluding Notes: The highly ambitious, the highly innovative and inventive among us, are the key risk-takers in society. They are the ones who first invented the cellular phones, the computers, new rice and corn variety, the new disease-killer drugs and vaccines.

The picture and quote say it perfectly: People are warned not to steal because government hates competition. And bad criminals go to jail, while the best criminals go to Washington DC.

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When being poor is rewarded with lots of welfare programs and such programs have no timetables, then there are implicit incentives to remain poor.

The cartoon shows government police interrogating Madoff. He was asked where he got the idea of paying early investors with money from the late ones. Madoff simply answered, “from the government, the Social Security System.” Bright answer, Madoff.

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Final concluding note: Society will be better off if there are more personal responsibility assigned to people and less government responsibility, less bureaucracies, less taxation.

Meanwhile, here is my favorite quote from former US President, Ronald Reagan. He said, *“If it moves, tax it. If it keeps moving, regulate it. If it stops moving, subsidize it.”*

Thank you.