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The J2K Crisis and the Economy: The Broader Context

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"It is this thinking which I think gives rise to the greatest tragedies of history, this sense of commitment to a past purpose which reinforces the original agreement precisely at a time when experience has shown that it must be reversed."

Kenneth Arrow, Nobel Laureate
The Limits of Organization

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THE J2K CRISIS AND THE ECONOMY:

THE BROADER CONTEXT*

Abstract

This analysis views the Jueteng 2000 crisis and its economic impact in the light of the dynamics and governance of the soft state. At the heart of the soft state is the widespread marketization of governance, i.e., of rules and enforcement. The latter generates the soft state's dominant texture: disorder. Disorder is the revenge of the market on a state that usurps the former's territory of competence. Business (i.e., the market economy) abhors disorder, which guarantees that poor economic performance and the soft state are inseparable. Disorder spikes when traditional bulwarks of the rule of law appear to sell out. The J2K appears to compromise the chief law enforcer in the eyes of business, not so much on the say so of a jueteng lord as on the litany of corroborating past misdeeds. The legalization of gambling is a correct step but a compromised president is vulnerable and invites defiance. Pandemonium followed. The *removal and punishment* of an erring chief executive will be a giant step in cauterizing the tentacles of the soft state. This is not about a choice between Estrada and Macapagal-Arroyo. This is about *empowering institutions* and *self-respect*. If the Senate can collectively prove to be bigger than life, then seldom would "so much (be) owed by so many to so few."

*This study is a chronicle and distillation of the intense and soul-searching polylogues that transpired in the halls of the UP School of Economics through October and November 2000. Interlocutors include Raul Fabella**, Corina Gochoco-Bautista, Joy Abrenica, Dante Canlas, Rolando Danao, Emmanuel de Dios, Emmanuel Esguerra, Solita Monsod, Edita Tan, Gwendolyn Tecson, Orville Solon, Fidelina Natividad-Carlos, Alex Herrin, Nimfa Mendoza, Florian Albuero, Susan Navarro, Stella Alabastro-Quimbo, Renato Reside, Jr., Joseph Capuno. Agreement on the logic, framework and conclusions is obviously far from unanimous. The chronicler (**) alone bears responsibility for all the remaining errors.

THE J2K CRISIS and the ECONOMY: The BROADER CONTEXT

Introduction

The Philippine economy is running into patches of turbulence and has started to lose altitude. Part of the loss is due to adverse developments in the world economic weather: the steep rise in the price of petroleum and the rise in US interest rate. The Mindanao conflict and Abu Sayyaf disturbance account for part of the dip. Most of it, perhaps most of the sharp depreciation of the Philippine peso in the last six months is accounted for by the *Jueteng 2000 political crisis*. The prime rate, following BSP maneuvers, spiked from about 13% to about 22%. Business stalled. There is no telling how far the drop will go.

The airship of state had some known structural weaknesses but it was adequate to attain and maintain the accustomed, if relatively slow, cruising speed. The mood was upbeat until the passengers realized what was only rumored and largely glossed over that the captain was having one drink too many while trying to negotiate the inclement weather. Business froze. Now the airship of state is a bit different than any ordinary vehicle; it gets its propulsion from within; its octane comes from the very business activity that has gone catatonic. Many refuse to be fastened to their seats and take the hit. They want to unseat the drunk captain. Some claim that this ruckus will only contribute to further freezing of business and faster loss of power. Others argue that a drunk pilot is better than a reckless replacement. Still others suggest that this is just a numbers game. The drunk pilot has a solid 40% of the voters! The replace bloc has less than that. Still for others, it is "Let the lawmakers decide." "In the business-as-usual way?" query some contrarians. The issue is, however, far more fundamental than the current crop of arguments.

A Modicum of Morality

Why has business responded with such vehemence? Philippine history offers a tempting parallel, perhaps wrought larger by some orders of magnitude, but with features eerily analogous.

The year is 1983 and Benigno Aquino lies dead on the tarmac. It triggered an explosive political crisis largely centered on the middle and upper classes. Marcos, like Estrada, today, still held C and D voters in thrall. Independent surveys such as the MBC's gave Marcos a solid core support of 40%. The economy did not immediately collapse but the handwriting was on the wall. Legitimate business voted to sign off. The economy, apart from some residual momentum and money printing, lost all propulsion and rapidly lost altitude. The crash in 1984-85 was hastened by the "interest rate cure" administered through the infamous "Jobo bills" which killed the Philippine economy while making certain banks ooze with fat. Recovery from this fall has, decades later, not yet been complete. Why did business, whose motivation is profit, respond with such revulsion? Had it suddenly become "moral"?

The 1983 Aquino assassination told of a chief law enforcer of the land in whose watch no rule was sacred. Suddenly, the previously glossed over shenanigans of the past began to form a pattern of greed and arbitrariness that emanated from the very top. There was no way to dodge the evidence. The perceived rule-of-law suddenly stumbled, bruised and bleeding. The state of (status quo biased) denial, so endemic even among thinking people, suddenly lifted and the seeing appalled them. It was no longer, as craftily cultivated, his greedy spouse nor his gobbling henchmen who formed the problem. His very *persona* was the anti-thesis of the rule of law just as darkness is the anti-thesis of light.

It was a collapse of what Nobel Prize winner K. Arrow (1974) calls the "invisible institution of morality" upon which is precariously perched the market economy. Without the rule-of-law and the institution of morality, there is no decent and civilized life, let alone a market economy. Did Marcos order the shooting? Did anybody proffer an incontestable proof? The fact is that, historical curiosity apart, the answers either way would not have made a whit of a difference. Then as now there are times when the verdict of history cannot be toyed around with by lawyers and lawmakers. In the broader scheme of things, the modicum of morality expired with Benigno Aquino on the tarmac. And with them went the economy

and the hugely important post-Plaza Accord window of opportunity went begging at the door of the subsequent Post-EDSA uncertainty.

Compromised Leadership and Economic Tailspin

If the bleeding is not stemmed and capital stays in voluntary self-exile, the nation is looking at an average growth of 2% in the next three years with only the deficit-strapped government providing the investment. This will add to the dubious list of national records of ignominy and incompetence. While an economic crisis has attended the end of every president's term in the last two decades (Marcos, 1984-85; Aquino, 1991-92; Ramos, 1997-98), a mid-term stumble is an unprecedented feat. With capital on the sideline, per capita income will decline and with it poverty incidence will shoot up. Estrada's public embrace of the *mahihirap* shall have been shown to be a pickpocket's ruse.

The supreme irony is that Estrada boasts of a bright and well-meaning economic team. *Angat Pinoy* is a well-crafted road map and the economic managers were largely speaking with one voice. When the IMF came calling in 1998 with its own *de kahon* brand of recovery strategy, it was sent home empty-handed by the team's uncommon, if un-IMF, handle of the issues. Hope was in the air. Recovery was at hand. How did the economy suddenly get so threatened? How presidential excesses trump "the best laid plans of mice and men" is worthy of serious reflection.

Bill Clinton's sexual excursion created a political scandal nonpareil but did not cause any economic ripple. Kakue Tanaka's problems in and exit from power did not get registered in the Japanese economy's radar screen. But the 1983 Aquino assassination and the J2K have. Why?

The answer lies in the nature of the Philippine state and how different an animal it is from states like Japan and the USA. In USA and Japan, *institutions are strong* and the presidency or premiership is a minor lever in a virtual redundancy of levers supporting the rule of law. Indeed, institutions are so strong that any little misbehavior at the center is immediately checked and the center neutered. Roo Tae Woo and Chun Du Hwan both past presidents of S. Korea paid dearly for misdeeds in office. In the Philippines, the institutions, even the courts of law, are so weak and so compromised by corruption that the rule-of-law, or its figment, clings for dear life on the inaugural oath of the sitting president to uphold the law. Hoodlums-in-robes, Estrada's own favorite phrase, suggested, perhaps without intent, that he was the last bulwark of rectitude. The general public therefore struggles to give the president the benefit of the doubt or it would be completely without recourse. This attitude is vintage *Brecht*: better to remain in blissful ignorance than face the pain of betrayal. This is a hallmark of the *soft state*. When a progressive cumulation of small and not-so-small corroborating evidence irrepressibly in the eyes of the public indicts the president himself as actively compromised, a sense of anger and revulsion sets in. This outrage cannot be put out by slick legal maneuvers or by any favorable vote considered compromised. His *persona* becomes the number one public enemy of order and civilized life. Excision is the only path to healing.

The clearer understanding of J2K and its economic impact requires an excursion through the undergrowth of the soft state and the whole arcana of *governance*.

The Governance Deficit

Most economic crises are precipitated by some unmanageable deficit. In Philippine economic history, the most frequent precipitant of an economic crash is a mounting fiscal deficit that gets thumbed by a balance of payments crisis. This was the case in the 1949 and 1969 crises. The 1998 crisis centered on the unrecognized gaping deficit in the financial sector's balance sheet. In other words, some deficit in crucial balance sheet somewhere always underlies an economic crisis.

The economic turmoil stemming from the J2K crisis reflects a new kind of deficit -- "governance deficit". Locating governance deficit in the economic map is tricky. There is no readily identifiable economic balance sheet onto which it maps. It cannot be reduced into a single negative number. Nor is it

simply a pollster's call because it has more to do with investment than votes. Votes can be bought or bullied but investors are another matter. To be worthy of intelligent inquiry, it must be more than a purely speculative or emotional phenomenon. It is, indeed, an economic epi-phenomenon that displays a lot of clout while defying facile characterization. It pulled the Philippine peso down, given other developments, by more than it should have dipped. Whence is its destructive muscle?

Rules of the Game

The economic condition at any given time is essayed by an array of numbers in the form of price trends, the interest rate, the exchange rate, the fiscal deficit, the trade balance, the investment rate, etc. This array of numbers are emanations of the underlying *rules of the economic game* such as property rights, price controls or absence thereof, import duties, rules on taxes, wages, banking, contracts, etc. coming as laws, executive or administrative orders or codes. In case of dispute, there are courts mandated to decide upon conflicting claims and there are agents and agencies that are tasked to enforce these rules and the decisions of the courts.

Economic players write positive-sum contracts on the production, delivery and distribution of goods and services on the strength of these rules. In the process, i.e., when contracts are abided by, they realize profit and, as if by *Invisible Hand*, advance the welfare of society by creating value. The nation's GDP is the sum total of all the value created by these voluntary contracts. The whole production and mercantile structure in a sense sits on the foundation of a legal system.

Economists evaluate the adequacy of the *rules of the economic game* on the basis of the alluded-to array of numbers or outcomes also loosely referred to as *economic fundamentals*. A set of economic fundamentals is said to be "good" if it tells of an underlying set of rules which displays (a) *internal consistency*, i.e., no internal contradiction exists between and among the rules, and (b) *growth optimality* which causes the goods and services emanating from economic contracts based on these rules between agents *to be as large and sustainable as possible* given the economy's own and partner countries' endowments. Internal consistency ensures that the economic system does not run into periodic bubbles and stalls, e.g., inflationary finance is inconsistent with stable prices and sustainable balance of payments; or an open capital account is inconsistent with a fixed exchange rate and independent monetary policy. Growth optimality ensures that there is no secular stagnation over the long term as occurred in countries that pursued central planning (e.g., the Soviet bloc countries) and/or self-sufficiency via import substitution (most of Latin America before the 1980s). These two properties are what mainstream economics is all about. We shall refer to these as the *fundamental properties* of the economic rules of the game. These properties determine the type of investment chosen by private business.

Governance Properties of Rules

The extent to which economic players write contracts on the basis of the rules of the game depends, however, on two other properties of these rules, which we call *governance properties*: (c) the *stability* of these rules; and (d) the *quality of the enforcement* of these rules. If the rules are stable, then agents are reasonably sure that the rules that bound at the start of the contract will bind at its completion. One can, for instance, be reasonably certain that the interest earning of a fixed income investment will cover the mortgage payment on a house every end of the month. If, however, rules on interest rate or on mortgage obligation are not stable, one may avoid the instrument altogether and even refrain from buying a house. As a result, few positive-sum contracts will be written on the basis of a rule that mutates into something else overnight. As another example, where land tenure is shaky, fixed capital and long-term investments will be studiously avoided in favor of slash-and-burn.

Indeed, when rules are negotiable, people will direct resources towards the capture of political centers that decide the direction and timing of change (Fabella, 1996), which is why investment in politics is so important in the Philippines. These investments are, however, zero or negative sum propositions and do not create value for society but conjures up wealth for a few from the "mouths of babes" as it were.

Likewise, when enforcement of rules is spotty or is subject to truck and barter, law-abiding economic agents will stay away from contracts covered by such rule. When judges can be bought to annul provisions of contracts, only thugs will sign on. When enforcement is without teeth, the most fundamentally sound set of rules cannot quicken the pace of the economic machine. The wisest economic team becomes irrelevant.

With rules unstable and/or enforcement weak, the economy and society slips into a debilitating state of *disorder*. The J2K turmoil is just another manifestation of the overall disorder that characterizes the Philippine state since the 1950s. Indeed, as we will explain later, it represents a *backlash disorder* once identified by Adam Smith (more below). How this ties up neatly with the concept of the soft state cries to be minded.

The Soft State and Disorder

Disorder is the overwhelming texture of the soft state. Citizens experience the soft state in a myriad painful ways everyday: mountains of uncollected garbage, mulcting policemen, squatting, repeated violation of every rule in the book -- traffic, zoning, sanitation, property, etc. All these feed into a sense of chaos and disorder. Whence is this disorder? Why here and not, say, in Taipei?

At the heart of statal disorder is the *buying and selling of rules and enforcement*: TROs, land titles, licenses, traffic tickets, judicial decisions, oversight powers, procurement contracts, etc. In the soft state, the principal source of wealth is not created value but extracted value based on power over rules and enforcement. Bad infrastructure, poor revenue collection, higher cost of doing business, poor investment allocation, all result from this perverse sort of marketization. In turn, these lead to low and bad investment and slow growth. Riding a soft state in the global competition is like running a marathon with a *low grade fever*. The "soft state factor" in the Philippines may shave off about 2% of GDP annual growth. But whence is the soft state?

Types of Rules and Enforcement

Every state is a bundle of rules and enforcement instruments. There are three types of rules (see e.g., Fabella 2000a): (i) *socially beneficial rules* (SBRs): rules whose enforcement benefit many people and the benefits are widely diffused. These rules are necessary for the proper functioning of any civilized society as they address such classical problems as externality, "tragedy of the commons", "prisoner's dilemma" and such public goods, the provisions of which "...the profit could never repay the expense to any individual or small number of individuals." (Adam Smith, *The Wealth of Nations*, Book IX, 15). Example of these rules are traffic rules, sanitation, rules on property rights, rules on contracts, basic human rights, etc. (ii) *Transfer Rules* (TRs): rules that directly or indirectly transfer resources from the many to the few. Some examples are high tariff laws which indirectly transfer wealth from consumers to certain producers; rules creating private or public monopolies; artificial inducers of the high price of sugar; and, when the state does not deliver tax-financed basic services, even the tax laws. Finally, (iii) *morality rules* (MRs): rules that legally impose on all the moral beliefs of some sectors in society; such are anti-gambling, anti-alcohol, anti-prostitution rules, etc. Associated with MRs are voluntary contracts between private agents that appear *victimless* such as a wager in jueteng.

The sale of enforcement is clearly more rampant in TRs and MRs because the general public hardly cares to aid enforcement of these rules and may, indeed, gleefully takes part in their violation. "Quis custodes custodiet?" is even more of a puzzle without the public. A good part of the populace buys smuggled goods and wagers in some numbers game. Likewise, enforcement of these rules is more likely to be *mercenary*. Which is why enforcement naturally begins to be auctioned. But once enforcement is for sale in TRs and MRs, it will, by contagion, eventually be for sale in SBRs (Fabella 2000b). The huge resources being generated in the sale of TRs and MRs are, in turn, used to buy policemen, judges, legislators and now, it is alleged, even a president. These are the people who make, arbitrate or enforce

rules. The soft state is the outcome of (a) the state usurping the realm of the market with TRs and MRs and (b) the market, in turn, usurping governance.

To begin to undermine the soft state, the imperative is for the progressive abolishing of TRs and MRs where enforcement will almost always be tainted by collusion between enforcers and violators. Thus, the legalization of gambling is a progressive step; the liberalization of tariffs and quotas is another. Bingo Two-Ball was a *step in the right direction!*

As the state reverts to its core competence, i.e., the SBRs, it refocuses its resources and attention and gets the public to join in to boot. Deregulation, insofar as directed towards TRs and MRs, is a healing step towards hardness (Fabella 2000c). But this does not come easy. The progress of change is at best spasmodic.

Backlash Disorder

The J2K crisis started with an attempt to put numbers game on a legal footing as the *Bingo Two-Ball*. This was, as observed, a step in the right direction. But the subplot to control the funnel of gambling coupled with the total absence of moral leverage among the proponents exploded into a conflict of who-gets-what which conflated all the way to the top. Disorder on top of disorder.

This J2K turmoil calls to mind Adam Smith's "another disorder" in connection with the "real disorder" introduced by TRs and MRs. Writes he:

"Every such regulation introduces some degree of real disorder into the constitution of the state, which will be difficult afterwards to cure without occasioning another disorder." (*The Wealth of Nations*, Book IV).

MRs and TRs produce disorder by progressively disemboweling enforcement. But to abolish MRs and TRs also produce backlash disorder. The denizens of the soft state do not take threats to their domain lying down. The subsequent turmoil over Bingo Two-Ball caused the suspension of the lifting of an MR. This is a triumph for the soft state, not the triumph of moral values.

A Singular Opportunity

But the J2K crisis also gives the Filipino nation a singular shining opportunity to strike at the heart of the soft state itself. *If* an erring President is not only *legally removed but also punished*, it is the supreme incontrovertible evidence that no soft state demi-god is safe. Everyone but everyone can be called to account. The Philippine state can harden. If, however, the President, despite the evidence, escapes removal and punishment through the usual soft state remedies, the Philippine state shall inherit an even more insidious disorder. And because in a globalized economy governance is the paramount immobile factor of production (Fabella, 1997), capital will stay away.

Because of its anti-value-adding ethos, the soft state will normally undergo periodic economic crisis as appetite outstrips production. These periodic economic crises are windows for *re-empowering institutions* and re-crafting the rules of the game. It is through the minefields of economic crises that the nation must negotiate the journey towards order. But it must seize every opportunity to undermine the moorings of the soft state. J2K is one such rare opportunity.

Governance Deficit as Entropy

There is a natural probabilistic measure of enforcement-related disorder called *entropy*. In a hard state, there is only one sense (or interpretation) of a law that is enforced, that is, the *letter of the law*. In a soft state, citizens do not know which sense (or interpretation) of the law will be enforced. The measure of

this unpredictability is entropy. In other words, in a hard state, the written law as a message or a signal of information is *very valuable* in the sense of a certainty about how to behave. In a soft state, the written law carries little informative value. Behavior is statistically unencumbered by the letter of the law. The concept is a propos because, as in the physical world, entropy never sleeps; its natural imperative is to grow!

Business *abhors* entropy. The larger is the latter, the less profitable is the business of value-creation and, thus, the less productive are the investment channels chosen by business. In particular, the "quality of national institutions" is gauged on the basis of the perceived entropy associated with rules. It is to be expected that when entropy is high (institutional quality poor), economic growth suffers. This is the sense in which Rodrik's (1996) regressions should be understood. Against per capita growth for East Asia he ran three arguments: a convergence proxy, years of education and quality of institutions and explained 99% of all variations with positive and significant coefficient for institutional quality! Capital accumulation also responded significantly to institutional quality. Quality of institution proxies for governance properties and, thus, low entropy. Root (1999) corroborates these results.

"Governance deficit" is, thus, identified here with entropy of rules. A spike in governance deficit means a spike in the gap between previous and currently perceived entropy. This is also the sense in which the famous *Magee effect* is to be understood (Magee, S., Brock, W. and L. Young, 1989). The less informative is the letter of the law, the more conflict it generates and the more room for the courts and for lawyers. The Magee effect is evidenced by data showing that the more lawyers per thousand population, the lower is economic growth. This was reinforced by Murphy, Vishny and Shleifer (1991) who showed in a regression that the high proportion of law students in the student population results in lower economic growth. It seems that the more lawyers, the less law.

High level of entropy is the standard of the soft state. If one needs confirmation, just compare Singapore's Changi Airport and Manila's NAIA. Or Singapore's mass transportation and Manila's mass transportation. It's night and day. The consequence is that tourism will never flourish in the Philippines as it does in orderly states. Nor will other value-adding businesses. A soft state has *no shot* at becoming modern, civilized and self-respecting because business will always be defensive and speculative rather than expansive and innovative. It must first recover "hardness".

Soft State Corruption and Periodic Eruption

Under every presidency since the 1950s, the truck and barter of enforcement (customs laws, internal revenue laws, anti-gambling laws, etc.) has been a growing fixture. Import substitution made "smuggling" the most important industry in the 1950s. Since then, law enforcement has been progressively captive. This means that over the years, the corruption infrastructure has become permanent and *politically appropriable* as one prize of electoral victory. The change of administration brings about a change in the *state counterpart* to the illicit contracts. It is so lucrative it may even form part of the recovery strategy for election spending. This has been called *soft state (systemic) corruption*.

The soft state has a sizeable twilight zone of activities stemming from illegal contracts between enforcers and violators on the one hand, and private agents on the other, centered on prohibited activities such as gambling, usurious lending, the traffic of contraband goods, smuggling, prostitution, squatting, tax evasion, etc. Its survival strategy is the capture of decision-makers -- politicians, judges, and lawmakers -- and the coursing of any legal tussle through safe compromised territory.

The twilight zone of illicit contracts generates a mountain of tax-free revenues for the willing officials and enforcers. The zone of law (light) is constantly under attack coming from twilight zone. The electoral process represents the most porous border between the two. That's how Al Capone became governor of Illinois. This mountain of illegal resources in the twilight zone fosters an active, and sometimes bloody, competition for bigger shares. Conflicting claims are resolved by raw firepower (Mafia shootfests or 3K gang wars). Losers in the contest are, time and again, found dead in their front doors or in lonely back alleys. But losers may also *surface from the twilight zone* to tell all and, for a while, the zone of law becomes entranced and appalled by how much territory has been lost to the twilight zone (essentially law

enforcers, judges and politicians). In hard states, this is an opportunity for counterattack. It sets off a posse to punish the guilty and not a few get canned.

As long as the truck and barter of governance remains fairly contained and isolated from the zone of law and stays say well within the sale of the enforcement of MRs and TRs, the economic system pays a fee and remains largely oblivious to the goings-on in the twilight zone. When, however, the truck and barter of enforcement creeps up to the rules or laws that are beneficial and necessary for economic activity and civilized living (e.g., traffic laws, taxes, peace and order, etc.), governance entropy shoots up and the economy settles at a lower growth orbit. If finally the extent of the enforcement metastasis, already suspected to be wide, is revealed to touch even the vital organs, like the liver, then perceived governance entropy spikes sending capital scampering and the economy quickly stalls. How more vital than the Commander-in-Chief and chief law enforcer of the land!

The Presidency and the Twilight Zone

When a president comes to power, he/she is confronted with several options: (a) try cleaning the Augean stables in the government side directly. It can, say, kick out wholesale key BIR, PNP or Customs agents. It then faces a thousand lawsuits in the sala of purchasable judges and, in all likelihood, loses (the state has no wherewithal to make illicit payments, thanks to COA rules). It can also put them to pasture, whence it is faced with sudden drop in revenue collection (the usual J-curve) with lower level functionaries resorting work-to-rule or even sabotage (drag their feet). Judges and legislators enlist to protect the gravy train. The soft state is a very stable local equilibrium. Aquino tried this and failed; (b) he/she can tolerate it as systemic ("It was here before we were; there are more important things to do"), passively allowing his/her people to inherit the gravy; (c) he/she can aggressively transfer the rents from previous appointees to his own henchmen and allies, and (d) actively parry other independent or unattached enforcers' pursuit.

The chasm of a difference between (b) and (c) is *active intervention* by the executive in favor of crony violators. For many people, (c) is just "stealing from robbers" and is not morally or ethically wrong. If one accepts this premise, then staying other enforcers' hand (d) may appear to be also ethically neutral. "The loot is already there; rather than have it go to barbarians, let it go to our own people." Ditto redirecting procurement contracts to friends and family. To many people schooled in the ethos of the soft state, that is not corruption! That is just "doing as the Romans do." But when this compromises the instruments of enforcement, legitimate business is left completely vulnerable. Between (b) and (d) lies the perceived governance deficit of the Estrada Administration.

To ensure stability, *soft state* corruption's net is cast far and wide. The tested doctrine is: "The more people are on the take, the more stable the machine." In certain governmental departments and agencies, the employees' pay is twofold: the official paycheck and the unofficial envelope. The less is the former relative to the latter the more stable is the system. The net encompasses janitors, judges and jail wardens. The suspicion confirmed in the eyes of many by the unanswered Jueteng 2000 allegations is that Estrada indulged in "active intervention" and, therefore, unhinged the rule of law.

A Nonexistent Divide

A proper perspective on the J2K crisis requires not only insights about the soft state but also on some facts of the Estrada presidency. The parable of the candid Health Secretary is a propos:

Once there was a Health Secretary nominee who visited the head office, gathered the important key officers and announced, "You good and bright people will take care of health policy and delivery; I will have nothing to do with them. I alone, on the other hand, will take charge of procurement; you will have nothing to do with it." The key people were happy. Their pet ideas will define the grand program. Sounds too good to be true! But then, the supply of antibiotics and blister packs began to run low. Procurement was delivering less drugs for more

money. The pet projects started to wither for lack of logistics and equipment. The candid Secretary, under public criticism, began taking his key people to task, saying, "I gave you full powers to define and deliver. Why this mess? I may have to fire you." No one dared tell him that his own link in the service chain is broken and that *he himself should be fired*.

When Joseph Estrada came to power it was symbolic that he chose to retain the Department of Interior and Local Governments for himself after he picked some bright and competent people for the other departments. They were to craft economic policy of which he was professedly ignorant; he was to inherit whatever was available in the Interior and Local Governments. A *convenient divide* was to separate the two realms. DILG is a publicly recognized intersection between the twilight zone and the zone of light. Jueteng, for one, is controlled and run at the local level. But that was a separate realm. Bright boys swallowed the idea of technocratic independence. They were free to write on a *tabula rasa*. They just were not bright enough to realize that the boss has a few schemes up his sleeves; not bright enough to anticipate that cronies would be quicker with the chalk and the EOs.

Symbol Savaged

Estrada's ethics and lifestyle were factored in when he ran for president. The optimistic expectation nonetheless was that *The Office will mold the man* and his professedly anti-corruption posture will, at least, preserve inherited level of order. The president, as leader, is not only chief executor of laws and conjurer of visions but should also be a symbol of decency, hard work and honor. He must inspire the citizenry, by example, to greater exertion and performance. The worst fear aired by some is that the presidency will be dragged down into the twilight gutter. But most everyone gave Estrada a chance.

The unfolding of events confirmed the worst fear rather than the optimists. Estrada imposed his twilight zone lifestyle and his twilight zone friends on the Executive Branch (as consultants and midnight cabinet members). Suddenly nothing seemed sacred but the cronies, the wives and the all-night drinking parties. Chateau *Petrus* at a thousand dollars a bottle flowed freely. Affairs of the state, however urgent, must cool their heels outside the bedroom door. It reminded people of a mythical king who "urinated and vomited on the throne and defecated on the steps of the temple." For many, it was the ritual disregard of the presidency as symbol, which galled the most and bordered on contempt for the people it represents. But the people popularly elected him and, after all, people get the leaders they deserve. And, oh yes, Lucio and Dante Tan could really be *mahirap* despite the impression! So we swallowed the desecration of the presidency as symbol. If only the presidency as function was better served.

Function Prostituted

The number of signals was growing that even the presidency as function was being prostituted. The replacement of the hard-driving but squeaky-clean gang-of-four women technocrats in housing agencies with a bouncing check artist was the first palpable evidence that under Estrada the denizens of the deep shall be allowed to swagger in the sun. The replacement of the Justice Secretary and BIR Commissioner who were doggedly pursuing a well-known cigarette and beer crony for tax fraud was a warning shot to all law enforcers that some people are not to be messed with. Indeed, the same beer magnate became 2000's taxpayer of the year awardee! The transfer of NFA from DA to Malacanang ensured that the lucrative rice import contracts are in safe hands. The BW scandal showed the Chief Executive to be very tenacious and alert in defense (some say, cover-up) of erring friends. That *fateful telephone call* to a talk show told of a President, completely insensitive to the dignity of the office, out to publicly exonerate his allies. The awarding of a gambling-related franchise, without a contract or a bidding to a known gambling buddy and of a consultancy fee of ₱500 thousand a day, told of an iceberg of shady deals difficult to imagine.

The Jueteng allegations proper, thus, seemed absolutely *déjà vu*. The surprise was the utter hubris of simple denial in the face of an increasingly damaging paper trail. "Mas marami akong alam sa kanya," told volumes of the President as law enforcer. Why, indeed, respond when money trumps evidence any day. Why respond when you can instead paint everyone blacker than the devil. By the time this is over, Estrada will have become a saint, relatively. And Ninoy Aquino shall have shot himself to spite Cory Aquino's infidelity. Grotesque, but quintessentially soft state.

Meanwhile, the economic reform program was hardly being advanced as Estrada signed errant EOs with nauseating frequency and legislators neutered reform bills. The economic managers spent most of their waking hours trying to prevent backsliding and repairing the damage from those EOs. "Saving (the economy from) Private Erap" could aptly title the journal of policy-making in the first three years of Estrada's presidency. Clearly, Estrada's attention-deficit on matters economic quickened even more the resolve of the forces of reform reversal and quick buck-savvy cronies. Entropy was having a field day.

The irony is that it may no longer be material to capital, whether or not it will be proven that Estrada received Jueteng money or not. To business applies the legal dictum "*de minimis non curat lex*" (the law has no time for trifles). The fact is he partied, hobnobbed, gambled and won with a known jueteng lord. The first and ultimate function of the president is to enforce the law. That he can enforce the law while he drinks, gambles and what not with the known violators taxes credulity. This is how governance entropy spiked. The tolerance band, already very stretched, finally snapped. Business decided, based on a lengthy trail of moral and legal question marks, that the rule of law itself is now mortally wounded. Estrada's surviving the Senate trial will hardly change that.

The J2K crisis itself shows how a compromised president fails to lead reform. The legalization of gambling is, in enforcement terms, a step in the right direction. Had it been a Ramos who pushed Bingo Two-Ball, it would have gone through uneventfully but for the usual sniping of church and jueteng lords alike. But the president's past history, if not his actual take, made him vulnerable. The subplot to corner gambling revenues betrayed crass greed and opportunism behind legitimization. Vulnerability invites defiance. And the dirt hit the fan.

Managing the Economy in J2K

The initial reaction of the BSP, which was to hike the OBR steeply and then raise liquidity reserve requirement twice (by two percent each time) to stem the sharp drop of the peso against the US dollar was, if understandable politically, economically wrong. The BSP had, previous to this, *correctly* allowed the exchange rate to absorb all volatility in the foreign markets. This time it was an incipient "interest rate cure" that would have decimated the economy. The prime rate promptly spiked from around 13% to around 22% and business stalled. Only drug pushers, smugglers and jueteng operators make profit at this rate. It is a tribute to the common sense of the economic managers that the BSP was prevailed upon to soft pedal its artificial defense of the peso despite strong outcries of some banks for a Jobo bill-type defense. Some members of the team were prepared to resign over this. But the damage has already been done.

There is no question that the rise in the exchange rate will pose a problem for banks with heavy forex liabilities. But solving these banks' private problems by heaping upon them public resources (raised through high interest rate BSP bills) is wrong, both morally and economically. It would have hastened the economic collapse. As it stands, the public backpedal on the interest rate has still to materialize on the ground in terms of a lower prime rate. Whether this suffices to stem the loss of altitude, forestalling a severe slowdown in 2001 hinges on how the political crisis plays out.

End-Game Scenarios

How the political crisis plays out will determine where the economy will head. We consider the following end-game scenarios:

A. President Estrada Survives Impeachment and a Super Technocratic Cabinet Takes Over

The premise of this scenario is that President Estrada survives the Senate impeachment with or without satisfactorily answering the allegations. President Estrada is so weakened that he agrees to become *titular*, i.e., attaches his signature to a document only after the legitimate and now super-cabinet, effectively the Executive, has approved. The super-cabinet can then push its first-best economic agenda including *Angat Pinoy* to the front burner. Presumably all contracts will now be subject to public bidding with winners determined finally by the super-cabinet. This can be viewed as a natural progression in the Estrada-cabinet relation: from the *midnight cabinet* to the *ECC* to the *super-cabinet* -- mutations all mediated by some political crisis. Proponents of this scenario can point to concessions to reform (e.g., open skies, auction of telecom rights, self-exile from ECC), in the "point-by-point at an appropriate time" speech.

This has two hurdles: (1) Since this is only an internal arrangement, both business and the public have to be convinced that the chastened Estrada will indeed abide by his "titularity". There is no guarantee *except his word* that Estrada will not regrow the balls he lost in the J2K fracas and reassert his legal prerogative when his many feminine and allied interests are stepped on. And his word is *not worth much* after the oft repeated "*Walang kamaag-anak, walang kaibigan, etc.*" (2) It is Estrada's role as the chief law enforcer of the land, which is the eye of the storm. How can one, perceived to be himself coddling violators, stop graft by line enforcers? Shall he be also titular in governance? This excises plausibility and taxes credulity.

Businessmen are pragmatic rather than moral. It is conceivable that, with Estrada staying on the rest of the way, they will reluctantly swallow their slogan and get back to the business of creating value. This is the best hope of the pro-Erap bloc for a resumption of normal growth. But their return, if at all, would be very tempered because: (a) The next election may change the equation in Congress, and if so, a year later, another impeachment initiative is likely to be launched. (b) Estrada, having beaten the odds and feeling the tag of untouchability, may turn even more reckless. The temptation to muscle in on the next election as a surrogate referendum on his presidency will be titillating in view of a possible second impeachment run and, if given in to, will only plunge the country into more turbulent waters.

Even without these, the turmoil may take all of remaining three years to calm down. Bad for the bottom-line. Capital will likely stay in the sidelines. The economy shall, in the eventuality, slow down to a canter to average around two percent annual GDP growth. This is not 1984-85, but the Erap factor shall have cut by half the growth of the economy in his last three years. If so, there will, indeed, be no economic *bust* at the end of the Estrada presidency. But then there would have been hardly any per capita growth! "The best laid plans of mice and men gang aft ugly," goes an old line.

As of this writing, the betting heavily favors the soft state winning the vote in the Senate.

B. Estrada is Removed But Otherwise Unpunished

Gloria Macapagal Arroyo (GMA) takes over but Estrada goes otherwise unpunished. The Estrada defenders claim that a politically castrated Estrada will allow more economic reforms than a resurgent GMA. This could very well be the case but it is a conjecture. It stands to reason that Estrada's economic team has more elbow room to maneuver than will ever GMA's. After all, GMA has an economics doctorate. But GMA will respect, for one, the presidency as a precious heirloom. She will not surprise her economic managers with a BW scandal. As a symbol, she will be a substantial improvement despite the full scale war to deigrate her. The ratio of GMA's excesses to Estrada's is effectively zero!

GMA will, at the very least, restore conventional presidency, one that is not a bane to national dignity. What else she will do as chief law enforcer remains to be seen and it is idle to speculate. But the fact that Estrada goes scot-free beyond removal will continue to haunt the Philippine polity just as failure to punish after EDSA hamstring subsequent development. The likelihood is great that the whole experience will prove *restorative* i.e., restorative of the *status quo ante* Estrada. While Philippine political democracy will get some shot in the arm, the economic growth orbit will most likely remain conventional, i.e., soft state conventional. Low-grade soft state disorder will likely continue to hamstring GDP growth to a

historical average of between 4.0% and 4.5% per year. Note that post-EDSA forgiving democracy did not, to any significant extent, slow the march of the soft state. Of course, we should not rule out surprises.

C. Estrada is Constitutionally Removed, Convicted and Punished

Lee Kuan Yew once remarked in undisguised contempt that the "Filipinos are soft and forgiving," referring to the national treatment of the Marcos family and cronies who, instead of languishing behind bars, have been allowed to re-establish a foothold. What he meant was that such a *Kaspar Milquetoast syndrome* will never afflict Singapore. Singapore is a serious proposition that will never be a laughing stock to the world.

If the EDSA uprising failed to be a genuine revolution to many people, it is because nobody of any substance and plunder ever went to prison. EDSA's biggest failure was a *retributive failure*. Because of this, EDSA chased Marcos away but failed to start the rooting out process of the dominant ethos that he advanced, and which characterizes the soft state. The sale of rules mutated from the sale of Presidential decrees to the sale of TROs and judicial decisions.

If an erring president is not only *constitutionally removed but also punished*, it will be the biggest historical blow to the iron grip of the soft state. Another hallmark of the soft state is *untouchability*. The demi-gods of the soft state are beyond the shortened arms of the law because they have managed to privatize the police and the judges. *Dura lex sed lex* applies only to the poor. The *constitutional removal and punishment* of an erring president will shatter, for good, the aura of *untouchability*. No demi-god will, from hereon, be safe. Resignation should not be an excuse for non-prosecution. That will be a grand step towards tearing down the scaffoldings of the soft state. The low grade fever will begin to recede.

Economically, this will be a tremendous shot in the arm apart from being a redemption of EDSA. The economy will begin, if slowly at first, to shift to a higher growth orbit of 6.5% annual average GDP growth as the level of disorder is pushed back. This is a slow and painstaking process but the hardest first step shall have been taken. At that rate, now rendered sustainable, the Philippines has a clear shot at rejoining the civilized world.

Epilogue

The J2K crisis is much more than a choice between Estrada and GMA, however some quarters may simplify it. It is much more than a skirmish between excess and convention. For all the bellyaching over GMA, she is peripheral to this historic conjuncture. This is all about *empowering institutions* by reenshrining retributive justice above every individual and above any purchase price. This is about redefining the Philippine state and its future destiny. This is about cauterizing the soft state tentacles that holds the nation hostage. The constitutional *removal and punishment* of an erring president will shatter, once and for all, the aura of untouchability that surrounds the demi-gods of the soft state. Once the institutions are re-energized, the affairs of the state and the welfare of society will be properly safeguarded from the follies and foibles of elected officials.

The Philippines as a soft state has no shot at becoming a self-respecting, progressive modern state. Only those states that muster the discipline and the cooperative synergy required for civilized intercourse get a shot. The best conceived economic programs are condemned to mediocre performance without a modicum of Arrow's "invisible institution of morality." The J2K crisis is really the Philippine state at war with itself. It is groaning and straining to preserve national dignity and self-respect. As such, it is pregnant with hope as well as with outrage.

The opportunity to decisively move the goalposts towards a modicum of morality does not come often. We as a nation have, in the past, let shining opportunities go begging. And underdevelopment is not an epic about the paucity of resources; it is, rather, an epic about lost opportunities. This one opportunity is

more golden than others. It could be the Philippine Senate's one shining moment. This body of men and women can, like gods, change the course of history. And if they collectively prove to be bigger than life, seldom would "so much (be) owed by so many to so few."

The J2K crisis is a battle for the Filipino soul!

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