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Philippine fiscal behavior in recent history

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The Philippine national government had large and unsustainable budget deficits in the 1980s. But after a brief period of near-balanced budget in the mid-1990s, large deficits have reemerged in recent years. What explains the poor fiscal performance of the Philippines in recent years? Was it the result of unfortunate events, macroeconomic shocks, or misdirected fiscal policy?

The large public-sector deficits in the early 1980s and those in recent years have similarities and differences. Both episodes of deficits occurred during periods of soaring oil prices, high interest rates, and volatile foreign exchange rates. Both episodes were also associated with low tax effort. The gains from the 1986 tax reform program during the middle years were lost in recent years because of discretionary changes. Over time, spending priorities changed. Marcos focused on infrastructure spending, while Aquino and Estrada focused on social services. Investment in physical infrastructure has a positive effect on fiscal balance. It makes private investment more productive, reduces transactions costs, increases the profitability of private-sector businesses, and thus expands economic output.

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1. Introduction

The Philippine national government experienced large and unsustainable budget deficits in the 1980s. After a brief period of near-balanced budget in the mid-1990s, large budget deficits have reemerged in recent years. But unlike the heavy fiscal imbalances in the early 1980s, which were caused by large investment in public infrastructure and low tax effort, the return of large fiscal deficits in recent years was accompanied by falling tax effort and underspending for education, health, and public infrastructure. With deficits rising and investment in human capital and public infrastructure deteriorating, an appropriate question is: what has caused the poor fiscal performance of the Philippines in recent years? Is it the result of unfortunate events, macroeconomic shocks, or misdirected fiscal policy?

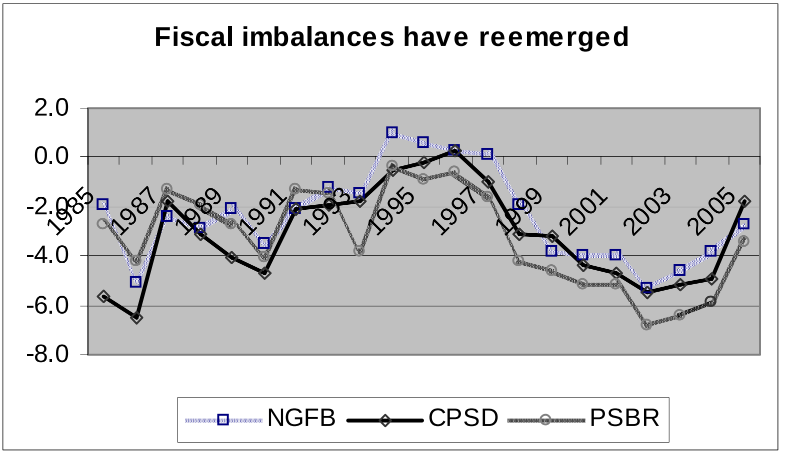

Figure 1.Various measures of fiscal deficits: NGFB, CPSD, PSBR

There are at least three possible ways of measuring the fiscal health of the Philippines: the national government fiscal balance (NGFB or NGAB for national government account balance), the consolidated public sector financial position (CPSFP or CPSD for consolidated public sector deficit), and the public sector borrowing requirement (PSBR). The NGFB or NGAB, which measures the fiscal performance of the national government alone, is the one generally understood by policymakers, media practitioners, and the general public. Among the three measures, NGAB is no doubt the narrowest and the least accurate in describing the "true" fiscal position of the government. The CPSD, on the other hand, is the combined deficits of the national government, the monitored government-owned and controlled corporations (GOCCs), government financial institutions (GFIs), local governments, and other public-sector entities. CPSD is a better measure of the public sector's true state of finances than NGFB. From the economic standpoint, PSBR is perhaps the most relevant measure of fiscal imbalance. It is the deficit of the national government and the 14 monitored corporations less the budgetary assistance to the monitored corporations in the form of equity contributions and net lending. It measures the amount the government has to borrow domestically or externally to finance the combined deficits of the national government and the monitored state corporations.

This paper will present the historical fiscal data by administration during the last 25 years. The administrative periods are as follows: Marcos, 1981-1985; Aquino, 1986-1992; Ramos, 1993-1998; Estrada, 1999-2000; and Arroyo, 2001-2005. For the Ramos and Estrada administrations, the attributed periods do not correspond to their exact term of office: 1992-1998 and 1998-2000, respectively. The fiscal policy of the President is defined by the years the executive drafted and passed the General Appropriations Act (GAA).

This study will focus on the tax system and spending policy of the government, including government policy involving GFIs and GOCCs, and the way the deficit is financed.

The paper is organized as follows. Section 2 discusses the revenue performance of five administrations during the last quarter of the century. Section 3 discusses the pattern of government expenditures during the last 25 years and the budgetary priorities under different administrations. Section 4 discusses the three different measures of fiscal imbalance under four different administrations. The mode of financing the deficit and the levels of public debt during the period under review is discussed in section 5. In section 6, we summarize the results of a previous study [Diokno 2007] on the economic and fiscal policy determinants of public deficits in the Philippines. The final section discusses some conclusions and implications for policy.

2. Revenue performance

The 1987 Philippine Constitution states that "the rule of taxation shall be uniform and equitable. The Congress shall evolve a progressive system of taxation".[1]

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[1]Article 6, sec. 28, par. 1, The 1987 Constitution of the Republic of the Philippines.

Taxation has multiple objectives. The first objective is to raise revenues equitably. If this were the sole objective of government, a progressive tax system is the best option. In principle, progressive taxes are equitable in that those who earn more are taxed more. In addition, the deadweight loss associated with progressive taxes is the least. Furthermore, Brennan and Buchanan [1980] have suggested that a progressive income tax system can control the size of government because it is difficult to collect; hence, there is less to spend. In practice, however, incomplete information and difficulty in administering progressive taxes encourage tax evasion and other distortions.

Still with the objective of raising revenues, higher tax rates should be imposed on goods with relatively low price elasticity. Goods for which demand is relatively price inelastic would provide a stable tax base. This form of tax is called a Ramsey tax. The downside is that many goods with relatively inelastic demand are basic necessities (e.g., rice, which is staple food in the Philippines) and constitute a large part of a poor man's budget. This inverse elasticity rule is not the best option if equity is the government's highest priority.

Another objective of tax policy is efficiency, that is, to ensure the proper allocation of resources, with or without externalities. Externalities, which could be negative or positive, occur when the behavior of one economic agent affects the behavior of another economic agent, without such behavior being appropriately priced. Pigouvian taxes try to correct such externalities. Sin tax is an example of taxes used to correct a negative externality. The aim is to alter consumption of certain *bads* (e.g., cigarettes and alcoholic beverages) by penalizing smokers and drinkers. For a negative externality like carbon monoxide emissions, government requires emissions testing for vehicles before allowing them to be registered. For a positive externality like a largely inoculated population, government provides immunizations as part of its basic health-care package; government intervention is in the form of a Pigouvian subsidy (or negative tax).

In designing the appropriate tax system, policymakers should consider some normative aspects such as (a) vertical and horizontal equity and (b) administrative simplicity.

One of the most important practical aspects of tax design, especially in developing countries, is the administrative capacity of government to collect taxes properly. If the government is able and information is complete, then a progressive form of direct tax would be the best taxing scheme. On the other hand, if the revenue collection institution is weak it may be better to depend more on indirect levies like value-added tax (VAT) and excise tax.

There is growing consensus that in designing a tax system, it is better for it to be broader and flatter. In order to broaden the tax base, the tax system should have fewer exemptions. With a wider tax base, marginal tax rates can be lower, and flatter, compared to a tax system with a narrow base. The trade-off between the tax base and the tax rate arises because the government has a revenue target that it must meet, if not surpass. As will be shown later, during the period under review, measures undertaken to simplify the Philippine tax system in the mid-1980s led to increased tax effort in succeeding periods. However, in the late 1990s, the tinkering of the tax system resulted in a decline in tax effort [Diokno 2005].

In practice, the reduction of tax dispersion and the introduction of VAT may not necessarily lead to the desired increase in tax revenues. In the case of Latin America, the short-run revenue goal was not attained with the above-mentioned tax reforms. Tax revenues will only grow to the extent that tax administration and compliance improve [Edwards 1996].

A final consideration in the design of a tax system is tax elasticity. A tax system should be responsive to changes in the economy. In times of economic growth, tax revenues should increase without having to enact new tax laws or raising existing tax rates. Paderanga [2004] observed that tax buoyancy in the Philippines had stagnated in 1999 and 2000, and attributed it to tax evasion.[2] Diokno [2005] argued, however, that the observed stagnation of tax buoyancy could have been due to other factors: first, the 1996 amendment to the expanded value-added tax (E-VAT) law, which had the effect of narrowing the VAT base; second, the restructuring of the tax on oil products as part of the oil industry deregulation; and finally, the change in the system of taxation of "sin" products—cigarettes and liquor—from ad valorem to specific [Diokno 2005].

Tax revenue is a crucial factor in reducing the probability of persistent budget deficits. In the case of the Philippines, there were two major tax reforms during the period under study: (a) the 1986 tax reform program (TRP) and (b) the 1997 comprehensive tax reform program (CTRP). Diokno [2005] argues that while the 1986 tax reform program contributed significantly to fiscal improvements in the late 1980s and early 1990s, the 1997 CTRP was a major contributor to the progressive decline in tax effort.

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[2]Tax buoyancy measures the point elasticity of taxes with respect to changes in GDP.

During the period under review, the tax effort, defined as taxes as percent of gross domestic product (GDP), was at its lowest in 1982 (9.9 percent), peaked in 1997 (17.0 percent), and decelerated to a new low of 12.3 percent in 2004. Direct taxes had the largest contribution to total taxes during the last three administrations (Ramos, Estrada, and Arroyo). International trade taxes, in percent of GDP, progressively declined largely because of the government's commitment to lower tariffs under various trade liberalization agreements.

During the final years of the Marcos administration, 1981-1985, overall revenue effort averaged 11.7 percent while tax effort averaged 10.3 percent.[3] The tax system can be characterized as one that is heavily dependent on indirect taxes and therefore regressive. Indirect taxes and international trade taxes, separately, accounted for about 35 percent of total taxes. A plausible explanation is the nature of the Philippine economy during the period: most import-substituting industry goods were heavily dependent on imported intermediate goods, which were the tax bases for import duties and excises. The contribution of direct taxes to total taxes averaged only 25 percent (Table 1).

Recognizing the inherent weaknesses of the tax system, Corazon Aquino, a few months after she took power in 1986, reformed the tax system. Operating under a revolutionary government, thus allowing her to exercise both executive and legislative powers, Aquino successfully overhauled the weak tax system with virtually no resistance.

The aim of the 1986 tax reform program (TRP) was to simplify the tax system, make revenues more responsive to economic activity, promote horizontal equity, and promote growth by correcting existing taxes that impaired business incentives.

On the personal income tax system, the dual tax schedules were unified with the lower 0-35 percent schedule adopted for both compensation and professional incomes. To minimize revenue loss and preserve the relative burden of individuals, ceilings on allowable business deductions were proposed and adopted. Unfortunately, due to strong lobby by various professional groups, this complementary measure was not fully implemented. Passive incomes were taxed at a uniform rate of 20 percent, which rendered passive income taxation neutral with respect to investment

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[3]Revenue effort is defined as total revenues as a percent of GDP while tax effort is defined as total tax revenues as percent of GDP.

Table 1. Descriptive statistics

Particulars	1981-85 Marcos	1986-92 Aquino	1993-98 Ramos	1999-2000 Estrada	2001-05 Arroyo
A. Revenues	**11.7**	**15.9**	**18.7**	**15.7**	**14.8**
1. Tax	10.3	13.1	16.2	14.1	12.8
Direct	2.6	4.1	6.0	6.1	5.9
Indirect	3.6	4.8	5.6	4.8	3.9
Taxes on international trade	3.6	4.1	4.5	2.9	2.6
Other offices	0.5	0.2	0.1	0.3	0.4
2. Nontax	1.4	2.7	2.4	1.6	2.0
B. Expenditures	**14.5**	**18.6**	**18.9**	**19.6**	**18.8**
1. Current operating expenditures	**9.0**	**14.8**	**15.3**	**15.9**	**16.0**
Personal services	3.5	5.2	6.2	6.8	6.2
Maintenance and other operating expenditures	3.1	2.7	2.3	2.4	1.9
Interest payments	1.5	5.6	4.0	3.9	5.1
Domestic	1.0	4.1	3.0	2.7	3.3
Foreign	0.6	1.5	1.0	1.2	1.8
Allotment to local government units	0.6	0.6	2.2	2.5	2.5
Petroleum price stabilization fund	0.0	0.1	0.1	0.0	0.0
Subsidies	0.3	0.4	0.3	0.2	0.2
Tax expenditures	0.0	0.2	0.2	0.1	0.0
2. Capital outlay	**4.9**	**3.1**	**3.5**	**3.6**	**2.8**
Infrastructure and other capital outlays	2.6	2.4	2.7	2.9	2.0
Others	2.2	0.6	0.8	0.7	0.8
3. Net lending	**0.6**	**0.8**	**0.1**	**0.1**	**0.1**
C. National government account balance	**(2.8)**	**(2.8)**	**(0.2)**	**(3.9)**	**(4.0)**
D. Expenditures (excluding interest payments)	**12.9**	**13.1**	**14.9**	**15.7**	**13.7**
E. Primary surplus/deficit (A-D)	**(1.3)**	**2.8**	**3.8**	**0.0**	**1.1**

Source: Department of Budget and Management.

decisions involving bank deposits and royalty-generating ventures. Personal exemptions were increased to adjust for inflation and to eliminate the taxation of those earning below the poverty threshold income. Married taxpayers were given the option to file separate returns, which lowered tax burden on married couples by removing the effects of the progressive rates on their combined incomes.

The tax on corporations was simplified. A uniform rate of 35 percent on corporate income replaced the two-tiered corporate tax structure. Tax on inter-corporate dividends was eliminated and the tax on dividends was phased out gradually over a period of three years. The exemptions from income taxes of franchise grantees were withdrawn. The imposition of an income tax on franchise grantees put this previously favored group on an equal footing with similarly situated individuals or firms. Uniform franchise taxes were imposed on similar types of utilities.

One of the major reforms designed to simplify the tax structure and its administration was the introduction of the value-added tax. The new system has the following features: (a) uniform rate of 10 percent on sale of domestic and imported goods and services and zero percent on exports and foreign-currency denominated sales; (b) 10 percent in lieu of varied rates applicable to fixed taxes (60 nominal rates), advance sales tax, tax on original sale, subsequent sales tax, compensating tax, miller's tax, contractor's tax, broker's tax, film lessors and distributor's tax, excise tax on solvents and matches, and excise tax on processed videotapes; (c) 2 percent tax on entities with annual sales or receipts of less than Php 200,000; (d) adoption of tax credit method of calculating tax by subtracting tax on inputs from tax on gross sales; (e) exemption of the sale of basic commodities such as agriculture and marine food products in their original state, price-regulated petroleum products, and fertilizers; (f) additional 20 percent tax on non-essential articles such jewelry, perfumes, toilet waters, yacht and other vessels for pleasure and sports.

Table 2. Government revenues, 1981-2005
As percent of total revenues

Particulars	1981-85 Marcos	1986-92 Aquino	1993-98 Ramos	1999-2000 Estrada	2001-05 Arroyo
1. Tax	**88.0**	**82.7**	**87.0**	**89.8**	**86.4**
Direct	25.4	30.8	37.2	43.5	45.9
Indirect	35.0	36.9	34.2	33.7	30.5
Taxes on international trade	34.9	30.9	27.8	20.4	20.3
Other offices	4.7	1.4	0.8	2.4	3.3
2. Nontax	**12.0**	**17.3**	**13.0**	**10.2**	**13.6**

Source: Department of Budget and Management.

As a result of the 1986 tax reform program, average tax effort rose to 13.1 percent during the Aquino administration (1986-1992) and to 16.2 percent during the Ramos administration (1993-1998). Revenue effort rose steadily until the next round of tax reforms. Tax effort increased from 10.7

percent in 1985 to 15.4 percent in 1992, then peaked at 17.0 percent in 1997. The share of direct taxes to total taxes increased while that of trade taxes decelerated. Income taxes could have performed better, and the tax system's fairness enhanced, had BIR implemented fully the approved reform imposing ceilings on allowable deductions. Overall responsiveness of the tax system to changes in economic activity improved from an average of 0.9 percent from 1980 to 1985 to an average of 1.5 percent from 1986 to 1991. The buoyancy coefficient for import duties rose from an average of 0.5 percent before the reform to an average of 1.89 percent from 1986 to 1991.

The share of nontax revenues soared to 17.3 percent of total revenues during the Aquino years owing to the sale of sequestered assets of former President Marcos and his cronies [Diokno 1995]. With the government's thrust toward privatization, 30 percent of outstanding stocks of the Philippine National Bank (PNB) were offered to the public and listed in the stock exchange in 1989.[4] In addition, an initial effort to deregulate the oil industry involved the partial privatization of the Philippine National Oil Company in 1992 to the Saudi Arabian Oil Company [Sicat 2003].

The 1986 tax reform program resulted in higher tax effort, which peaked in 1997. Attempts were made to improve upon this tax performance by reforming the tax system in 1997. The objectives of the 1997 Comprehensive Tax Reform Program (CTRP) are the following: (a) make the tax system broad-based, simple, and with reasonable tax rates; (b) minimize tax avoidance allowed by existing flaws and loopholes in the system; (c) encourage payment by increasing the exemption levels, lowering the highest tax rate, and simplifying procedures; and (d) rationalize the grant of tax incentives, which equaled Php 31.7 billion in 1994.

The main features of the 1997 CTRP are as follows: First, the income tax system reverted to a uniform rate schedule for both compensation and professional income of individuals, after a brief experiment with the simplified net income taxation scheme (SNITS), which was legislated in 1992. The rate structure was reduced to seven brackets. Personal and additional exemptions were increased even as it allowed the deduction of premium payments for health and/or hospitalization insurance from gross income. Second, the corporate income tax (CIT) rate was reduced to 34 percent. Effective 1 January1999, the rate was reduced to 33 percent, and to 32 percent from 1 January 2000. Third, minimum corporate income tax (MCIT) will

[4]http://www.pnb.com.ph/history.asp.

be imposed beginning on the fourth year from the time a corporation commences the business operations. Fourth, fringe benefits granted to supervisory and managerial employees shall be subject to a tax equivalent to the applicable CIT rate of the grossed-up monetary value of the fringe benefit.

Fifth, Republic Act (RA) 8241 (Improved VAT Law) amended the coverage of RA 7716 (Expanded VAT Law). The major changes intended as a result of the amendment are the following: (a) restore the VAT exemptions for cooperatives (agricultural, electric, credit, multipurpose, and others, provided that the share capital of each member does not exceed Php 15,000); (b) expanded the coverage of the term "simple processes" by including broiling and roasting; (c) expanding the coverage of the term "original state" by including molasses; (d) exempting from the VAT the following: importation of meat; sale or importation of coal and natural gas in whatever form or state; educational services rendered by private educational institutions duly accredited by CHED; house and lot and other residential dwellings valued at Php 1 million and below, subject to adjustment using CPI; lease of residential units with monthly rental per unit of not more than Php 8,000, subject to adjustment using CPI; and sale, importation, printing, or publication of books and any newspaper. In effect, the VAT tax base was narrowed rather than broadened.

Sixth, as part of the legislation deregulating the downstream oil industry, taxes on oil products were restructured from ad valorem to specific taxation. The reform had overall effect of lowering taxes on oil products, including zero tax on liquefied petroleum gas (LPG).

Finally, the tax on "sin" products—cigarettes and liquor—was restructured from ad valorem to specific. The advantage of an ad valorem tax is that it factors in price changes; revenues adjust with price changes (usually increases) without need for new tax legislation. As a compromise, and to minimize the potential revenue loss, some form of indexation was introduced. The process of implementation is unrealistically impractical since the adjustment process would still require congressional imprimatur.

In sum, what came out of Congress was a watered-down version of the original 1997 CTRP program. Congress failed to pass the crucial rationalization of fiscal incentives and broadening of the value-added tax base. Worse, the Tenth Congress passed nine tax laws granting incentives and raising exemptions. The reason for this unwanted outcome was the delay in the approval of the 1997 CTRP tax proposals and the subsequent posturing of politicians who were then aspiring to run in the 1998 national and local elections. Some measures legislated were not even implemented, such as the VAT on banks and financial intermediaries, the tax on fringe benefits, and the minimum corporate income tax.

The most serious negative consequence of the 1997 CTRP program was the progressive deterioration of the tax effort—from a peak of 17 percent before the reform to 12.5 percent in recent years. The peaks and troughs of tax and revenue efforts in the Philippines are shown in Figure 2.

Direct tax revenue became the primary contributor to tax effort with a share of 37 percent. Indirect tax revenue, with a 34 percent share, was a

Figure 2. Tax and revenue effort, 1984-2005
As percent of GDP

close second. While privatization efforts continued, including the sale of Petron[5] in 1994, the share of nontax revenues dropped to 13 percent for this period. The Manila Waterworks and Sewerage System (MWSS) was also privatized in 1997-1998, giving two private companies 25-year concession for managing their respective areas, a downsized MWSS maintaining its regulatory function.[6]

During the Ramos administration, after a series of legislation, the outcome was a narrower rather than broader tax base. Congress passed, and

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[5]Petron is the oil refinery and marketing subsidiary firm of the state-owned Philippine National Oil Company (PNOC).

[6]The 1997 Asian financial crisis affected the success of this privatization effort since the contracts did not include a mechanism for foreign exchange adjustments. This resulted in a sharp increase in water rates, and finally, one of the two concessionaires was turned over to the MWSS regulatory office.

the President approved, ten new tax measures that raised revenues and 28 tax measures that decreased revenues through the grant of incentives and higher exemptions. Among these measures is the E-VAT law, which was subsequently amended by Republic Act 8241. The E-VAT sought to widen the VAT tax base. However, various law suits challenging its constitutionality led to its amended version that reversed E-VAT's original intention, leading to increased exemptions from VAT.

Overall revenue effort decreased to 15.7 percent during the truncated Estrada administration with tax effort decreasing to 14.1 percent. The share of direct taxes to total taxes rose to 43.5 percent while the share of indirect taxes was practically unchanged. The share of trade taxes, however, dropped sharply (see Table 2). Tax buoyancy, which measures the point elasticity of taxes with respect to changes in GDP, stagnated in 1999 and 2000 [Paderanga 2004]. The decrease in overall tax effort and tax buoyancy can be partly attributed to the new and revised tax laws during the Ramos administration.

The decrease in international trade taxes as percent of GDP, from an average of 4.5 percent to 2.9 percent, was not surprising, being a consequence of the trade liberalization and globalization efforts in the 1990s. This began with the growth of trade cooperation in the Association of Southeast Asian Nations (ASEAN) with the ASEAN Free Trade Agreement (AFTA) in 1992. Furthermore, the Philippines joined the World Trade Organization (WTO) in 1994 and the Asia Pacific Economic Cooperation (APEC).

During the Estrada administration, Congress passed RA 8761, which imposed value-added tax on some services that were previously exempt from VAT. This was passed in February 2000, prior to the impeachment proceedings of President Estrada. This expansion of the VAT tax base was subsequently deferred by Congress, pursuant to RA 9010, exactly one year after the enactment of RA 8761. This policy reversal has contributed to the decrease in tax effort in the succeeding period.

During the Arroyo administration, direct, indirect, and international tax effort decreased. Only nontax effort defied the fall, inching up by 0.4 percent. In 2004, one of the services, bank and nonbank financial intermediaries not performing quasi-banking functions, which was included in the deferred imposition of VAT in RA 8761, was subject instead to gross receipts tax.

What lessons have been learned from the two major tax reforms during the last quarter of the century? First, tax reforms should be done at the start, not toward the end, of any administration. The implication is that the incoming administration should be ready with a core of tax proposals within months of its assumption to office. Second, the probability of success of a tax reform program is enhanced if it is presented as a critical component of a comprehensive public sector reform program. Third, future tax reform programs should aim to recover what was lost in the area of corrective taxation. Taxes from goods with negative externalities—that is, cigarettes, liquor, and petroleum products—used to account for a large part of total taxes. In recent years, the share of these taxes has been eroded. Fourth, ad valorem system of taxation is superior to specific taxation in an environment where getting new taxes and upward adjustment of existing taxes are difficult to legislate. A consistent policy is to broaden the base of the value-added tax, which by definition is ad valorem in character to include practically all commodities, as well as cigarettes, liquor, and oil products.

Fifth, tax reforms require broad political support: from the Executive Department, legislature, business community, and the citizenry. A joint legislative-executive tax commission[7] should be reconstituted by law in order to develop broad multiparty support for tax legislation, and in order to minimize the delay in developing a tax reform package at the start of every administration.

Sixth, presidential leadership is crucial in the design and legislative authorization of a tax system. The President should be willing to exercise his broad powers in order to develop an appropriate tax system. He should not allow his own men and members of Congress to unnecessarily tinker with the tax structure if it is not defective. At the same time, when presented with flawed tax legislation, the President should be willing to use his veto power, including line-item veto.

3. Government expenditure: pattern and priorities

Government expenditure is the other major policy instrument used by the government to direct the economy to a path of growth and development. Economic growth theory emphasizes the importance of capital accumulation in the attainment of economic growth—the higher the stock of capital the higher the level of economic output in the long run. Governments invest in physical infrastructure in order to increase the productive capacity of an

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[7]Before martial law was declared in 1992, there used to be such a joint legislative-executive tax commission (JLETC). During the martial law years, with the closure of Congress, it was replaced by a purely executive tax body, the National Tax Research Center, which is under the Department (Ministry) of Finance.

economy. Government spending on public infrastructure reduces transaction costs for businesses and signals the commitment of government to ensure profitability for prospective investors. In a study by the World Bank, Philippine investment in physical infrastructure for the year 2005 was less than 2 percent of GDP—a level that is considerably lower than the World Bank–prescribed 5 percent of GDP to lead to a sustainable economic growth [World Bank 2005].

Another policy direction believed to have an effect on national government financial health is fiscal decentralization. In theory, local authorities are believed to be more attuned to their constituents and make decisions based on the preferences of their local constituencies. The theory of local public good[8] argues that efficiency is enhanced through a process by which constituents reveal their true preferences for local public goods by "voting with their feet", i.e., citizens move to the locality that offers their most preferred taxing-expenditure mix. Moreover, increased spending and revenue-raising responsibilities for local governments enhance accountability. Fiscal decentralization would allow the national government to focus on broader issues such as interjurisdictional externalities and income redistribution.

Serious decentralization efforts took place in the Philippines after 1992. The 1991 Local Government Code of the Philippines was enacted with the aim of creating self-reliant local governments. In general, there is a mismatch between revenue-raising and spending responsibilities, owing to variations in the tax base and the unequal distribution of income across local governments; this provides the rationale for intergovernmental fiscal transfers (IGFTs). In the Philippines, the IGFTs—called internal revenue allotment (IRA)—are largely an unconditional block grant, except for 20 percent, which is required to be allocated to development purposes. The total IRA is 40 percent of all internal revenue, based on actual collections in the third preceding fiscal year.

Government spending is embodied in the national budget, which reveals the national priorities. There is no universal prescription on the appropriate size and distribution of the national budget. There are some core functions for any government. Every government is expected to provide public goods, such as national defense, administration of justice, maintenance of peace and order, conduct of foreign policy, and public infrastructure. But the level of

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[8]For a full discussion on this concept, see the seminal work by Tiebout [1956].

spending for particular programs and activities provided by the government would depend on the priorities of preferences of policymakers (the legislature and the President). Priority should be given to programs and activities that promote economic growth and development.

In practice, depending on the preferences of society and its leaders, the State may provide goods and services that are private in nature, the so-called public-provided private goods. Examples of these would be education, basic health care, and housing. This behavior is rationalized by the redistributive role of government. In addition, the externalities associated with a well-educated and healthy population compel government to provide such basic services. The problem is that government may not have enough resources to provide such goods. In order to enhance efficiency, government must resort to handles other than taxes, such as user fees.

What has been the level of public expenditures and its distribution during the last quarter of the century? The following observations appear warranted.

First, government expenditure as percent of GDP has declined in recent years. From an average percentage share of 14.5 percent during the final years of Marcos, spending peaked at 19.6 percent during the Estrada administration, and then dropped slightly to 19.2 percent in recent years (see Table 1).

Second, investment in public infrastructure has been less than optimal, and has declined in recent years. Ideally, an increasing share of the budget should be allocated for public infrastructure, which is needed to increase the economic capacity for growth of a country. During the final years of the Marcos regime, one-third of the budget was spent on capital outlays.[9] The share of capital expenditure dropped sharply to an average of 3.1 percent of GDP during the Aquino administration, as the government allocated a big part of its budget for the servicing of public debt incurred during the Marcos years. Infrastructure and other capital outlays in percent of GDP declined slightly from 2.6 percent during Marcos's final years to 2.4 percent during the Aquino administration. It rose to 2.7 percent during the Ramos years and 2.9 percent during the Estrada years, before hitting a historic low of 2.0 percent during the Arroyo administration. According to a World Bank

[9]The term capital outlay is not exactly equal to infrastructure spending. It is a broader term that includes (a) infrastructure and other capital outlays, (b) corporate equity, (c) capital transfers to local government units, (d) capital transfers to the Philippine National Bank and Development Bank of the Philippines, and (e) comprehensive agrarian reform program land acquisition and credit.

report, "middle-income countries in East Asia will, on average, need to spend over 5 percent of GDP on infrastructure to meet their needs over the next 10 years" [World Bank 2005]. The figures show that the Philippines is far from this target.

3.1. Government spending by object of expenditures

Third, current operating expenditures as share of total budget has progressively increased. It rose sharply from 62.7 percent during Marcos's final years to 84.9 percent during the Arroyo years. It averaged around 80 percent during the terms of Aquino, Ramos, and Estrada (Table 3). Personal services consistently received the largest share with an average of 39.3 percent for the entire period under study. Spending on personal services is mainly salaries and wages of government employees and is not considered to be as productive as infrastructure spending. Personal services as percent of the budget peaked during the Estrada years (an average of 42.5 percent).

Table 3. National government spending, by object, 1981-2005
As percent of total expenditures

Particulars	1981-85 Marcos	1986-92 Aquino	1993-98 Ramos	1999-2000 Estrada	2001-05 Arroyo
1. Current operating expenditures	**62.7**	**79.2**	**80.7**	**81.3**	**84.9**
Personal services	39.0	35.5	40.7	42.5	38.8
Maintenance and other operating expenditures	34.3	18.6	14.9	15.0	12.0
Interest payments	17.1	37.6	26.4	24.4	32.3
Domestic	60.5	72.8	74.1	68.5	64.6
Foreign	39.5	27.2	25.9	31.5	35.4
Allotment to local government units	6.7	4.1	14.1	15.8	15.8
Petroleum price stabilization fund	0.0	0.4	0.5	0.1	0.0
Subsidies	2.8	2.7	2.1	1.3	1.2
Tax expenditures	0.0	1.2	1.4	0.9	0.0
2. Capital outlay	**33.2**	**16.5**	**18.6**	**18.3**	**14.6**
Infrastructure and other capital outlays	52.9	82.1	77.4	81.4	71.4
Others	47.1	17.9	22.6	18.6	28.6
3. Net lending	**4.1**	**4.4**	**0.7**	**0.5**	**0.5**

Source: Department of Budget and Management.

Notes:

1. For the major categories, the computed share is in percentage of total national government expenditures. 2. For the subcategories—current operating expenditures (COE) and capital outlays (CO)—the share is as a percentage of total COE and CO, respectively. Furthermore, for the item Interest Payments, the share of domestic and foreign is as a percentage of total interest payments.

Maintenance and other operating expenditures, as percent of total expenditures, progressively declined from 34.3 percent during the Marcos years to 12.0 percent during the Arroyo years. This is alarming because funds for maintaining existing infrastructure fall under this budgetary item. The item Allotment to Local Government Units has been increasing consistently. This is because of the 1991 Local Government Code, which increased the taxing and spending powers and devolved some national government functions to local governments.

Fourth, debt servicing has been an increasing drag on the productive part of the budget. Interest payment as percent of the budget was highest during the Aquino years (an average of 37.6 percent). However, there had been a steady improvement during the Ramos and Estrada years, as the share of interest rates to total budget fell to 26.4 percent and 24.4 percent, respectively. Unfortunately, the decline has been reversed—the budget share of interest payment has risen to 32.3 percent during the Arroyo years.

3.2. Sectoral priorities

Fifth, government expenditure for economic services peaked during the final years of Marcos, declined during the Aquino years, and after a slight recovery during the Ramos and Estrada years, it hit rock bottom during the Arroyo administration. Economic services include (a) agriculture, agrarian reform, and natural resources; (b) trade and industry; (c) tourism; (d) power and energy; (e) water resource development and flood control; (f) communications, roads, and other transportation; (g) other economic services; and (h) subsidy to local government units. The largest part of this sector's spending went to infrastructure with an average of 41 percent going to communications, roads, and other transportation (CRT). Agriculture, agrarian reform, and natural resources and other economic services tie as the second-top priority for this economic sector. In recent years, CRT continued to have the largest share of economic sector spending with subsidy to local government units coming in second. The subsidy to local government units, as percent of GDP, increased from zero to 1.1 percent as a result of the 1991 Local Government Code, which devolved basic services to local governments, such as agricultural extension and on-site research; community-based forestry projects; tourism facilities, promotion, and development; and telecommunication services.

Sixth, in general, the share of social services to total government spending has been increasing; but during the Arroyo administration, spending for social

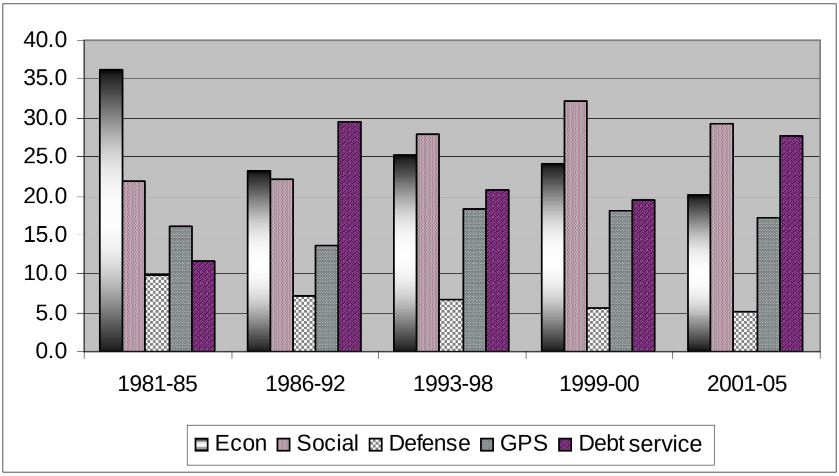

Figure 3. Budget priorities: debt service rising, social and economic services falling As percent of total expenditures

services as percent of GDP dropped to 5.4 percent of GDP from an all-time high of 6.4 percent during the preceding regime. Social services sector consists of (a) education, culture, and manpower development; (b) health; (c) social security and labor welfare; (d) land distribution (CARP); (e) housing and community development; (f) other social services; and (g) subsidy to local government units. During the period under review, education, culture, and manpower development had consistently received the lion's share of government spending for this sector. Education spending spiked at 65 percent of social-service spending during the Aquino administration, but has been decreasing ever since; under Arroyo's watch (2001-2005) it fell to a historic low of 53 percent. On the other hand, expenditures for social security and labor welfare and subsidy to local government units (SLGUs) increased significantly. Social security and labor welfare increased in recent years because of the Personnel Benefits Fund established for the retirement fund of uniformed personnel. For SLGUs, the initial share of 0 has increased to 21 percent because of social expenditure responsibilities devolved to local governments (primarily, basic health care and social welfare services) and intergovernmental transfers.

Seventh, there was no clear pattern for the expenditures for General Public Services. Spending for this sector peaked during the Ramos administration with an 18.3 share of total government spending.

Eighth, real per-pupil spending on basic education has been on the rise since Aquino took power in 1986, peaking during the Estrada administration,

Table 4. Sectoral shares of national government expenditure, 1981-2005

Particulars	1981-85 Marcos	1986-92 Aquino	1993-98 Ramos	1999-2000 Estrada	2001-05 Arroyo
I. As share of national government expenditures					
A. Economic services	36.2	23.2	25.5	24.2	20.2
Agriculture, agrarian reform & natural resources	19.3	26.6	25.7	22.3	23.8
Trade & industry	7.6	5.1	4.2	2.5	2.0
Tourism	0.8	0.6	0.7	0.8	0.7
Power and energy	8.1	4.8	3.2	1.7	1.0
Water resource development & flood control	3.6	5.5	4.0	3.5	4.2
Communications, roads & other transportation	41.0	39.8	39.9	42.2	37.4
Other economic service	19.5	14.9	3.1	3.0	1.7
Subsidy to local government units	0.0	2.6	19.3	23.9	29.2
B. Social services	21.9	22.2	28.0	32.2	29.2
Education, culture & manpower development	60.8	65.1	60.3	56.1	53.2
Health	20.2	16.4	9.2	7.3	5.7
Social security & labor welfare	4.2	4.2	8.7	12.6	16.9
Land distribution (CARP)	0.0	1.4	0.0	1.4	1.6
Housing & community development	11.0	2.2	2.5	3.0	0.9
Other social services	3.8	8.4	0.5	0.4	0.4
Subsidy to local government units	0.0	2.2	18.7	19.1	21.3
C. Defense	9.9	7.1	6.8	5.5	5.1
D. General public services	16.1	13.7	18.3	18.1	17.2
E. Net lending	4.3	4.4	0.7	0.5	0.5
F. Debt service (interest payments)	11.6	29.5	20.7	19.5	27.8
II. In percent of GDP					
A. Economic services	5.1	4.4	5.0	4.8	3.7
Agriculture, agrarian reform & natural resources	1.0	1.2	1.3	1.1	0.9
Trade & industry	0.4	0.2	0.2	0.1	0.1
Tourism	0.0	0.0	0.0	0.0	0.0
Power and energy	0.5	0.2	0.2	0.1	0.0
Water resource development & flood control	0.2	0.2	0.2	0.2	0.2
Communications, roads & other transportation	2.1	1.7	2.0	2.0	1.4
Other economic service	0.9	0.7	0.2	0.1	0.1
Subsidy to local government units	0.0	0.1	1.0	1.2	1.1
B. Social services	3.0	4.2	5.5	6.4	5.4
Education, culture & manpower development	1.8	2.7	3.3	3.6	2.9
Health	0.6	0.7	0.5	0.5	0.3
Social security & labor welfare	0.1	0.2	0.5	0.8	0.9
Land distribution (CARP)	0.0	0.1	0.0	0.1	0.1
Housing & community development	0.3	0.1	0.1	0.2	0.0
Other social services	0.1	0.3	0.0	0.0	0.0
Subsidy to local government units	0.0	0.1	1.0	1.2	1.1
C. Defense	1.4	1.3	1.3	1.1	0.9
D. General public services	2.2	2.6	3.6	3.6	3.2
E. Net lending	0.6	0.8	0.1	0.1	0.1
F. Debt service (interest payments)	1.5	5.6	4.0	3.9	5.1

Source: Government authorities.

but has been falling at an average rate of 3.6 percent per year from 2001 to 2005. In nominal terms, total education expenditure and per-pupil spending have increased. But correcting for inflation, real per-pupil government spending on basic education has been on the decline under the Arroyo administration. Growth in total nominal spending for basic education spending has slowed down during the past two administrations, from a high of 15.6 percent in the early 1980s to a current low of 3 percent.[10]

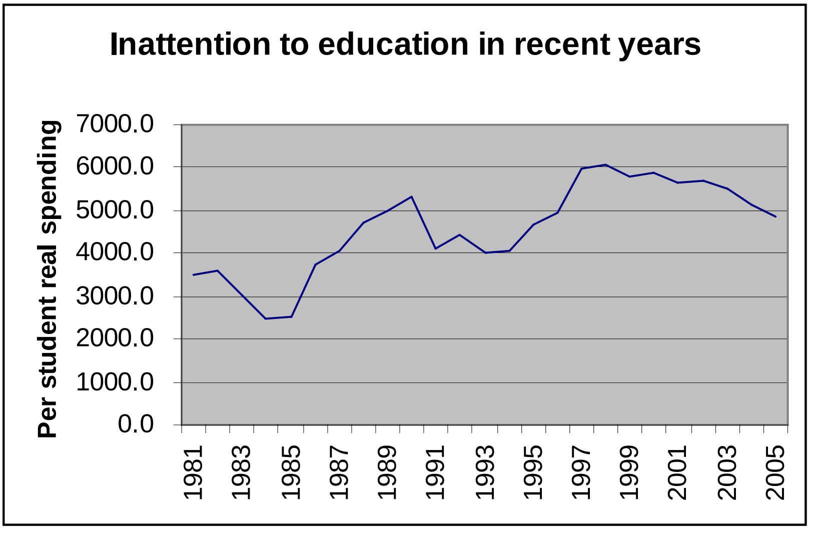

Figure 4.Waning support for basic education
Real per-pupil spending in 2000 prices

Ninth, real consolidated (national plus local governments) health spending decreased during the period 2001-2004—both in total and per capita terms. Real consolidated health spending contracted at an average of 3 percent while real consolidated per capita health spending contracted at an average of 5 percent. Real national government health spending, both in total and in per capita terms, which had peaked during the Aquino administration, hit its lowest level during the Arroyo administration. It may be argued that the recent decline is to be anticipated because of decentralization; however, real local government health spending has decreased. Total local government health spending, in 2000 prices, has been decreasing at an average of 2 percent

[10]Basic education spending refers only to the actual expenditures of the Department of Education, Culture and Sports. Source of basic data: DBM [2005].

Table 5. Average national government basic education spending, by administration, 1981-2005

Particulars	1981-85 Marcos	1986-92 Aquino	1993-98 Ramos	1999-2000 Estrada	2001-05 Arroyo
I. Basic education spending					
A. Total spending					
1. In current prices	5,653	21,873	54,651	89,773	104,370
2. In 2000 prices	30,042	52,626	69,969	91,484	90,086
B. Per pupil spending					
1. In current prices	565	1,836	3,847	5,720	6,207
2. In 2000 prices	3,027	4,478	4,959	5,830	5,363
II. Growth rates					
A. Total spending					
1. In current prices	15.6	23.2	17.9	5.4	3.0
2. In 2000 prices	(5.7)	13.4	9.0	0.5	(2.2)
B. Per pupil spending					
1. In current prices	13.7	19.5	14.5	3.0	1.5
2. In 2000 prices	(7.3)	10.0	5.8	(1.9)	(3.6)

Sources: Department of Budget and Management, National Statistical Coordination Board.

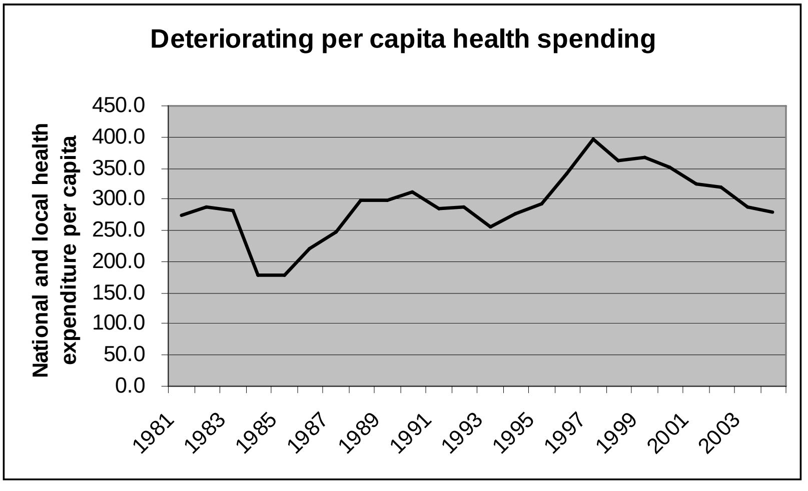

Figure 5. Failing support for basic health care
Real per capita basic health expenditures, in 2000 prices

per year since 2001. Real per capita local government health spending has been decreasing at 4 percent per year since President Arroyo took office.

Table 6 shows the pattern of consolidated health spending—that is, for both national and local governments. In current prices, total consolidated

Table 6. Consolidated (national and local) government health expenditure, 1981-2004 Average by administration

Particulars	1981-85 Marcos	1986-92 Aquino	1993-98 Ramos	1999-2000 Estrada	2001-04 Arroyo
I. Total Expenditures					
A. Consolidated health spending					
1. In current prices (in million pesos)	2,293	6,945	17,382	26,791	27,715
a. National government	1,931	6,187	8,586	11,835	10,837
b. Local government	362	757	8,797	14,956	16,878
2. In 2000 prices (in million pesos)	12,416	16,637	22,359	27,315	24,609
a. National government	10,480	14,803	11,096	12,081	9,631
b. Local government	1,936	1,834	11,263	15,234	14,977
B. Consolidated per capita health spending					
1. In current prices	44	115	249	354	343
a. National government	37	102	123	156	134
b. Local government	7	13	126	197	209
2. In 2000 prices	240	278	321	360	303
a. National government	203	247	160	159	119
b. Local government	37	31	161	201	184
II. Growth rates					
A. Consolidated health spending					
1. In current prices (in million pesos)	12.9	20.1	15.8	5.9	1.4
a. National government	13.3	21.1	6.4	0.6	0.2
b. Local government	12.3	14.5	68.8	10.6	2.5
2. In 2000 prices (in million pesos)	(6.4)	10.0	7.0	0.9	(3.2)
a. National government	(5.8)	11.0	(1.5)	(4.2)	(4.4)
b. Local government	(8.0)	4.6	54.8	5.5	(2.2)
B. Consolidated per capita health spending					
1. In current prices	10.4	17.4	13.2	3.5	(0.7)
a. National government	10.8	18.3	4.0	(1.6)	(1.9)
b. Local government	9.8	11.8	65.0	8.1	0.4
2. In 2000 prices	(8.5)	7.5	4.6	(1.4)	(5.4)
a. National government	(8.0)	8.4	(3.7)	(6.4)	(6.6)
b. Local government	(10.1)	2.2	51.3	3.0	(4.4)

Source: Government authorities.

health spending has been consistently increasing along with the share local governments. This change in the mix of consolidated health spending, with local government spending overtaking that of the national government, can partly be attributed to the 1991 Local Government Code that devolved the responsibility of Field Health and Hospital and other Tertiary Health Services [Nolledo 1995].

The current trend of health spending has been unsatisfactory. The average growth rates for all of the categories of health spending have been decreasing in recent years. Although the decline in national government health spending is to be expected because of decentralization, this should be replaced by increasing, or at least constant, local government health spending. It can be seen in Table 6 that the negative growth in real health spending by local governments combined with the larger decline in real national health spending is not a sign of continuing efforts to maintain human capital.

3.3. Net fiscal impact

What is the net impact of government spending and taxing policies on a representative citizen? A rough approximation of the net effect of government fiscal action on a representative citizen is to deduct from the average "productive" part of the government spending (that is, total

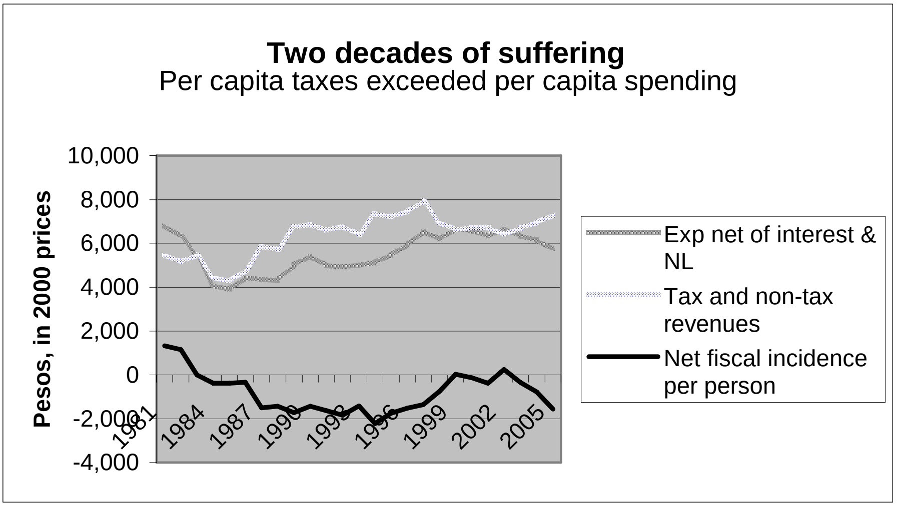

Figure 6. Net fiscal incidence
Per capita expenditure less per capita revenues in real prices, 2000=100

disbursement less debt service and net lending)[11] average revenue. If positive, the representative Filipino has received more benefits from government expenditure than what he has paid in taxes or user charges; if negative, he has paid more in taxes and user charges than what he has received in terms of benefits from government programs and projects. Figure 6 indicates that during the last quarter of the century, the representative Filipino had been a net contributor to rather than a net recipient of government services, except for two years, 1999 and 2002.

4. Various measures of deficits

This section presents the trends of three different indicators of fiscal health, namely: the national government account balance (NGAB), the consolidated public sector financial position (CPSFP), and the public sector borrowing requirement (PSBR).

4.1. National government account balance

The national government account balance compares national government revenues to national government cash disbursements. Balanced budget is achieved when revenues equal cash disbursements (excluding debt repayments and payments on nonbudgetary accounts)[12] of the national government during a given year. Budget deficit (surplus) is incurred when revenues are less (more) than cash disbursements, excluding debt repayments and payments on nonbudgetary accounts.

National government budget fiscal balance averaged 2.8 percent of GDP during the final years under Marcos (1981-1985). President Corazon C. Aquino took office in February 1986 after President Marcos left the Philippines for exile in Hawaii. This promise of a new democracy brought hope to the Filipino people. However, it too brought a huge foreign debt overhang; several coup attempts, with the most serious one in 1989; and two major catastrophes, the 1990 earthquake and the 1991 explosion of Mt. Pinatubo.

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[11]Net lending is net advances by the national government for the servicing of government-guaranteed corporate debt. It covers the national government loan outlays to government corporations.

[12]Nonbudgetary accounts are trust liabilities, securities unloaded or purchased, sinking fund, and other accounts not included in the national government budget.

From a fiscally weak position, where the national government-to-GDP ratio was around 5.1 percent, Arroyo was successful in reducing the fiscal imbalance through improved tax effort—largely as a result of the 1986 tax reform program. The servicing of public debt was extremely burdensome, with interest payments averaging about 6 percent of GDP during her entire term. The fiscal imbalance, which progressively improved from its initial point of 5.1 percent of GDP, reemerged in 1990 because of high interest rates, accelerated payment of the foreign debt, and the implementation of the Salary Standardization Law (SSL) [Diokno 1995].

Another benchmark law drafted, passed, and enacted during the Aquino administration was the 1991 Local Government Code, which increased the revenue and spending responsibilities of local governments. The law increased the national government grants to local governments and also improved the grant system by making its release automatic, formula based, and predictable.

The Ramos administration had budget surpluses for four of its six years in power. During the first two years of this regime, the country was beset by power outages. Mr. Ramos asked, and Congress agreed, for emergency powers for fast-tracking the construction of power projects. The contract for these independent power plants (IPPs) provided for government guarantee to purchase the built capacity whether used or not. The additional cost associated with this guarantee is incorporated in power rates to date [Sicat 2003].

In the last couple of years of the Ramos regime, there was a real estate boom and huge foreign direct investment inflow to the Philippines. During this period, the peso was overvalued, thus the sudden devaluation of the Thai baht in 1997 at the onset of the 1997 Asian financial crisis instigated the sharp depreciation of the peso, by almost 40 percent.

In July 1998, at the height of the Asian financial crisis, President Joseph E. Estrada took office. The national government budget deficit rose from 1.9 percent of GDP in 1998 to 3.8 percent in 1999 and 4.0 percent in 2000. This result could be attributed largely to the sharp deterioration in the tax effort and higher interest payments owing to the sharp depreciation of the peso. Tax effort plummeted from 17.0 percent in 1997 to 13.7 percent in 2000 owing to the continuing and expanded tax incentives, the narrowing of the VAT base, and the lowering of tariff walls. Expenditures rose slightly largely because of higher foreign interest payments, owing to the large peso depreciation and the payment of accounts payables[13] to contractors and suppliers (estimated at around Php 60 billion), which Estrada inherited from the Ramos administration. In response to the Asian financial crisis, and in an apparent attempt to window-dress the national government fiscal picture, the Ramos administration deferred the payment of valid claims of contractors and suppliers.[14]

In the period 2001-2005, the average national government budget deficit inched up to 4 percent of GDP. It peaked at 5.3 percent of GDP in 2002 and tapered off to 2.3 percent in 2005. The poor tax effort and high interest payments were the main reasons for the Arroyo administration's poor fiscal position. Taxes as percent of GDP averaged 12.8 percent during the five-year period—a major departure from the 17.0 percent in 1997. During the same period, interest payments as percent of GDP averaged 5.1 percent. With weakening tax effort and rising debt servicing costs, the Arroyo government responded by underspending in public infrastructure and social overhead (education and health care). This pattern of expenditures raises concern, since government spending should be geared toward investment in physical infrastructure and human capital in order to propel the economy into a higher growth trajectory.

4.2. Consolidated public sector financial position

The consolidated public sector financial position is an indicator of the overall fiscal performance of the public sector of the Philippines. It is the combined surplus (deficit) of the national government (NG), the Central Bank (CB) restructuring accounts, the major nonfinancial government corporations (MNFGC), the government financial institutions (GFI), the local government units (LGUs), the social security institutions, the Oil Price Stabilization Fund, and the Bangko Sentral ng Pilipinas (BSP). CPSFP is a better indicator of the public sector's true state of finances than the NGAB.

The CPSF measure was first reported in 1985 to correct the erroneous reporting of accounts during the Marcos regime. It has been in deficit during the past two decades, except for the fiscal year 1996, averaging 3.2 percent

[13]Accounts payable are obligations or commitments of national government agencies, whether current year and prior years, for which services have been rendered, goods have been delivered, or projects have been completed and accepted.

[14]This was done through Administrative Order (AO) 372 issued in December 1997 instituting economy measures. For figures, see Diokno [1999].

of GDP. The increase in the consolidated public sector deficit in recent years was largely due to the ballooning national government fiscal deficits and the large losses of some of the monitored nonfinancial government corporations (MNFGCs). Among the major state-owned corporations, the National Power Corporation (Napocor) was the biggest deficit spender.

During the Aquino years, the CPSD averaged 3.5 percent of GDP. The main contributor to the deficit was the national government (with an average deficit-to-GDP ratio of 2.8 percent), followed by the financially distressed Central Bank of the Philippines (CB)[15] (with an average deficit-to-GDP ratio of 2.0 percent). In addition, the government assumed the servicing and liabilities of the Philippine National Bank and the Development Bank of the Philippines (DBP), which were at an all-time high of Php 47.2 billion [Diokno 1995].

During the Ramos administration, the CPSD decreased to 1 percent of GDP on average. The improvement was attributable to two factors: healthier national government account (average deficit-to-GDP ratio of 0.2 percent) and financial turnaround of the restructured Central Bank (called Bangko Sentral ng Pilipinas). The national government financial position was aided immensely by higher tax effort and sizable proceeds from sale of state assets (for example, the Bonifacio property) and privatization of state-operated enterprises. With the restructuring of the Central Bank in 1992-1993, much of its debts were transferred to the national government. From the total public sector viewpoint, there is no difference. But it has the effect of showing a smaller deficit (large surplus) for the BSP, and a bigger deficit (smaller surplus) for the national government. However, with cleaner financial books, and an independent Monetary Board, the BSP is now able to pursue monetary policy more effectively.

4.3. Public sector borrowing requirement

From the economic standpoint, the public sector borrowing requirement is perhaps the most relevant measure of fiscal imbalance. It measures the amount the government has to borrow domestically or externally to finance the combined deficits of the national government and the major monitored corporations. PSBR, as percent of GDP, averaged 2.4 percent during the Aquino years (1986-1992) and 1.9 percent during the Ramos years (1993-1998). It rose during the two-year stint of Estrada—4.6 percent in 1999 and

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[15]The Central Bank is labeled as Bangko Sentral ng Pilipinas (BSP) in Table 7.

Table 7. Consolidated public sector financial position, 1986-2005
Average for each administration

In particulars	1986-92 Aquino	1993-98 Ramos	1999-2000 Estrada	2001-05 Arroyo
I. In billion pesos				
A. Public sector borrowing requirement	(56.4)	(51.6)	(159.0)	(207.7)
1. National government	(63.1)	(6.9)	(125.1)	(154.6)
2. CB restructuring	0.0	(27.4)	(20.2)	(15.3)
3. Monitored nonfinancial government corporations (MNFGCs)	(14.0)	(22.3)	(12.0)	(42.2)
4. Oil price stabilization fund	0.4	(2.6)	1.1	0.2
5. Adjustments of net lending and equity to GOCCs	0.0	0.2	3.7	4.3
6. Other adjustments	20.4	7.5	(6.5)	0.0
B. Other public sector	(23.2)	23.1	34.5	43.7
1. Government financial institutions (GFIs)	(1.0)	7.2	3.1	4.5
2. Bangko Sentral ng Pilipinas (BSP)	(47.2)	2.4	(2.0)	2.5
3. SSS/GSIS	13.8	6.1	26.6	22.6
4. Local government units (LGUs)	3.0	5.4	7.2	13.2
5. Timing adjustments of interest payments to BSP	8.3	2.1	(0.9)	1.0
6. Other adjustments	0.0	0.0	0.5	(0.1)
C. Consolidated public sector surplus (deficit) (CPSD)	(79.6)	(28.5)	(124.5)	(163.9)
II.In percent of GDP				
A. Public sector borrowing requirement	(2.4)	(1.9)	(4.9)	(5.5)
1. National government	(2.8)	(0.2)	(3.9)	(4.1)
2. CB restructuring	0.0	(1.0)	(0.6)	(0.4)
3. Monitored nonfinancial government corporations (MNFGCs)	(0.6)	(0.8)	(0.4)	(1.1)
4. Oil price stabilization fund	0.0	(0.1)	0.0	0.0
5. Adjustments of net lending and equity to GOCCs	0.0	0.0	0.1	0.1
6. Other adjustments	0.9	0.3	(0.2)	0.0
B. Other public sector	(1.0)	0.9	1.1	1.1
1. Government financial institutions (GFIs)	(0.1)	0.3	0.1	0.1
2. Bangko Sentral ng Pilipinas (BSP)	(2.0)	0.1	(0.1)	0.1
3. SSS/GSIS	0.6	0.2	0.8	0.6
4. Local government units (LGUs)	0.1	0.2	0.2	0.3
5. Timing adjustments of interest payments to BSP	0.4	0.1	(0.0)	0.0
6. Other adjustments	0.0	0.0	0.0	(0.0)
C. Consolidated public sector surplus (deficit) (CPSD)	(3.5)	(1.0)	(3.8)	(4.4)

Sources: Department of Budget and Management; National Statistical Coordination Board.

5.2 percent in 2000. The dramatic rise in PSBR was attributable to the huge jump in the national government budget deficit owing to the increase in VAT exemptions; inelasticity of tax revenues from petroleum, cigarettes, and liquor; and the expenditure-side payment of inherited government accounts payable.

During the Arroyo administration, the PSBR reached historic levels—averaging 5.5 percent of GDP during the period 2001-2005. There are two factors: large national government deficits and heavy losses for the monitored government corporations. The average national government deficit, as percent of GDP, reached 4.1 percent—the highest in the nation's recent history. In addition, the losses of the major monitored corporations (MNFGCs) increased by more than 250 percent owing largely to the poor performance of the Napocor and the National Electrification Authority (NEA). The losses of the MNFGCs averaged 1.1 percent of GDP during this period.

5. Financing of the deficit and public debt

5.1. Financing of the deficit

If revenues are inadequate to finance planned expenditures, the government has three options to close the budget gap: borrow, print money, or increase taxes. In the past, the Philippine government has resorted to external and domestic borrowing to finance its deficits. It has amassed huge public debt not only to finance previous years' budget deficits but also to pay for losses incurred by other public sector institutions—such as poorly performing government-owned or controlled corporations, public financial institutions, and the Central Bank (CB)—but which were later assumed by the national government.

Government borrowing can crowd out investments in two ways. First, if borrowing is largely domestic, this may lead to lower investment because of less loanable funds available for private investors, which lowers output and consumption in the long run [Stiglitz 2000]. Second, if debt was incurred to settle other debt rather than to finance government projects in human and physical infrastructure, then crucial public spending is being forgone. The financing of debt negatively affects important public investment spending [Diokno 1995]. A study by the Asian Development Bank [2005] looked at the implications of the current Philippine fiscal policy on government debt. It concluded that the government debt situation is not sustainable given the current policy regime. Furthermore, it found evidence of a weak-debt Ponzi game.[16] This implies that the Philippine government is simply borrowing to pay off its current debts. Current government debt is vulnerable to adverse shocks, and simple budgetary deficit control policy is inadequate.

During the final years of Marcos (1981-2005) the government relied more on domestic financing to finance the deficit—on average, 65.6 domestic financing and 34.4 percent external financing. This pattern of financing was uneven. The share of domestic financing started at about half (50.4 percent) in 1981, dipped to a low of 27.0 percent in 1983 before it soared to as high as 102.5 percent in 1985. Effectively, Marcos borrowed from abroad in 1985 to retire some local debts. The deeper reliance on domestic financing was in response to the higher world interest rates and the weakening of the peso.

Table 8. Budget deficit financing
In billion pesos, unless otherwise specified

	1981-1985 Marcos	1986-1992 Aquino	1993-1998 Ramos	1999-2000 Estrada	2001-2005 Arroyo
Financing	11.2	24.3	8.3	192.8	240.9
Net foreign	3.54	6.9	-2.1	83.6	89.9
Net domestic	7.66	17.4	10.4	109.2	151.0
Percent share	0.0	0.0	0.0	0.0	0.0
Net foreign	34.4	34.2	63.7	43.5	35.5
Net domestic	65.6	65.8	36.3	56.5	64.5

Source: Philippine authorities; see Appendix C.

The Aquino administration relied heavily on domestic sources to finance its budget deficits from 1986 until 1991. In 1992, the financing mix was reversed, with heavier reliance now on foreign financing at 90 percent.

The Ramos administration relied heavily on external financing of the budget deficit. This financing mix, which peaked in 1995 (119.8 percent foreign, -19.8 percent domestic), was revised in response to the Asian financial crisis. Recognizing the serious risk of relying heavily on foreign financing, the share of external financing was reduced to 25.1 percent in 1997 and 13.8 percent in 1998.

[16]A government is playing a Ponzi game when it keeps on paying old debts with new ones (see Duo Qin et al. [2005]).

Estrada pursued a more balanced financing mix—56.5 percent foreign, 43.5 percent domestic—during his short stint in office.

Arroyo relied heavily on domestic financing (average of 64.5 percent) from 2001 to 2005. But the numbers for net external financing—that is, gross foreign borrowing less amortization—understate the extent of heavy external borrowings that took place in recent years. From 2002 to 2005, the Arroyo administration borrowed over Php 858 trillion, of which global bonds floated was about Php 619 billion.[17]

5.2. National government debt

From a low of 9.1 percent in 1981, the national government debt as percent of GDP, peaked at 36.9 percent in 1992, averaged at about 25 percent thereafter before it rose again at 36.6 percent in 2004 and 35.8 percent in 2005.

The surge in the debt-to-GDP ratio during Aquino's term can be attributed largely to the decision of the government to assume the losses of major financial institutions like the Development Bank of the Philippines, the Philippine National Bank, and the Land Bank of the Philippines as well as other monitored corporations such as Napocor. The debt-to-GDP ratio averaged 58.2 percent for this period from a previous 19.5 percent. Total debt service expenditures as percent of total government spending, on average, soared to 47.2 percent from a previous 16.5 percent. Worse, and perhaps a more accurate measure of the debt burden, total debt service expenditures as percent of total taxes zoomed from 22.6 percent to 76.2 percent.

Total interest payments as share of total expenditures averaged 42.5 percent of tax revenues from 1986 to 1992. This indicator shows how much government resources are left, after deducting interest payments, for the provision of public goods and other publicly provided private goods and investment in public infrastructure. It went down sharply during the Ramos and Estrada administrations before it reemerged, quite strongly, in recent years (average of 56.3 percent in 2001-2005). Effectively, interest payments had "crowded out" the more important expenditure responsibilities of the government, such as education, health, and public infrastructure.

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[17]In 2006 and 2007, the Arroyo administration borrowed from external sources Php 284.1 billion and Php 118.4 billion, respectively. Some Php 209.9 billion global bonds were floated in 2006.

Table 8. Budget deficit financing
In billion pesos, unless otherwise specified

Particulars	1981-85 Marcos	1986-92 Aquino	1993-98 Ramos	1999-2000 Estrada	2001-05 Arroyo
A. National government outstanding debt					
1. Total debt	86,455	554,869	972,575	1,678,878	2,928,249
a. Domestic debt	50,280	303,195	509,102	798,913	1,493,248
b. Foreign debt	36,175	251,675	463,473	879,965	1,435,000
In percent of GDP					
2. Total debt	19.5	58.2	48.2	52.9	65.6
a. Domestic debt	11.5	31.9	25.2	25.2	33.3
b. Foreign debt	8.0	26.4	22.9	27.6	32.3
As percent of total outstanding debt					
3. Domestic debt	60.0	54.7	52.5	47.9	50.8
4. Foreign debt	40.0	45.3	47.5	52.1	49.2
B. Debt service expenditures					
1. Interest payment	7,209	54,958	80,426	123,592	229,562
a. Domestic	4,484	40,749	59,612	84,278	148,098
b. Foreign	2,726	14,208	20,814	39,315	81,464
2. Amortization	3,535	30,195	48,977	93,028	247,040
a. Domestic	1,359	16,501	20,130	53,491	151,640
b. Foreign	2,176	13,694	28,847	39,537	95,400
3. Total (B.1 + B.2)	10,744	85,153	129,403	216,620	476,602
a. Domestic	5,843	57,250	79,742	137,768	299,738
b. Foreign	4,902	27,902	49,662	78,852	176,864
In percent of GDP					
4. Total	2.3	8.8	6.4	6.8	10.5
a. Domestic	1.3	5.9	4.0	4.4	6.6
b. Foreign	1.1	2.9	2.5	2.5	3.9
As percent of total debt expenditures					
5. Domestic	53.8	66.7	61.6	63.7	62.0
6. Foreign	46.2	33.3	38.4	36.3	38.0
Total debt service as percent of total expenditures					
1. Total debt service expenditures	16.5	47.2	34.0	35.0	56.3
a. Domestic	8.9	31.6	21.0	22.3	35.3
b. Foreign	7.6	15.6	13.1	12.7	21.0
Total debt service as percent of taxes					
1. Interest payments	15.1	42.5	24.9	27.6	40.3
a. Domestic	9.3	30.9	18.4	18.9	26.0
b. Foreign	5.8	11.6	6.5	8.8	14.3
2. Interest payments + principal amortization	22.6	67.2	39.8	48.6	82.5
a. Domestic	12.2	44.9	24.5	30.9	51.6
b. Foreign	10.4	22.3	15.3	17.6	30.9

Sources: Department of Budget and Management; National Statistics Coordination Board.

Memo items:

1. Interest payments as percent of tax revenues show the debt burden on the recurring resources of government.
2. Total debt service as percent of total expenditures shows the nonproductive component of the budget.

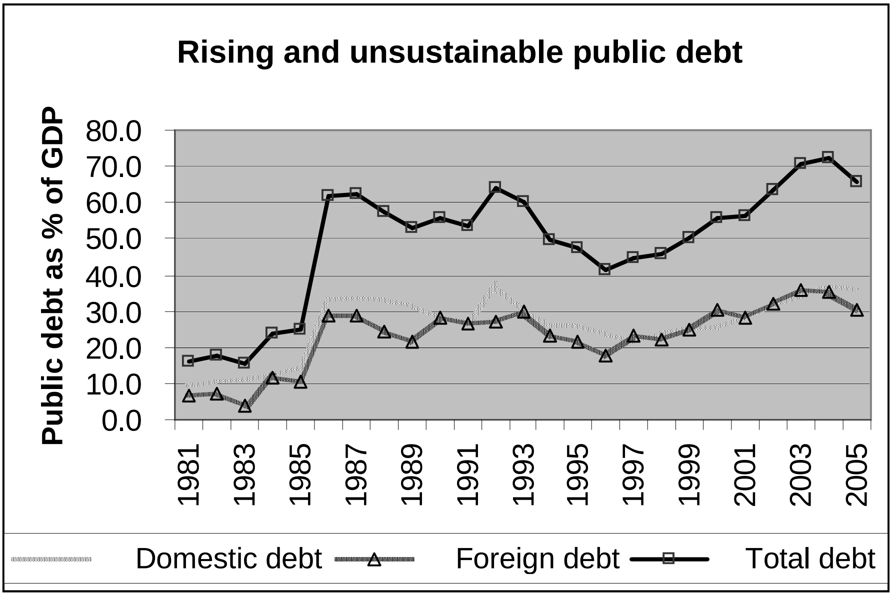

Figure 7.Total public debt, 1981-2005
In percent of GDP

During the Estrada administration, there was a slight shift in the nature of the public debt, with the share of domestic debt decreasing and the share of foreign debt increasing. There are two reasons for the shift: first, the preference for domestic financing and, second, the revaluation of the dollar debt because of the sharp depreciation of the peso after the Asian financial crisis. The total debt-to-GDP ratio declined, however, to 52.9 percent from 48.2 percent under Ramos. Debt was managed well since debt servicing as a share of total spending increased by only 1 percent, and interest payments as a percent of tax revenues increased by only 3 percent.

The national government debt-to-GDP ratio averaged 65.6 percent during Arroyo's watch, the highest among all administrations. Debt servicing—interest plus principal amortization—as percent of total taxes was at its highest under the Arroyo administration. From 2001 to 2005, it averaged 82 percent. But the mean statistic hides the sharp rise in the debt burden in recent years—debt servicing-to-tax ratio was 87.4, 100.6, and 96.2 in 2003, 2004, and 2005, respectively. This means that in 2004, for example, payments for interest and principal amortization exceeded taxes collected.

Is the current debt situation sustainable? A study by the ADB [2005] looked at the implications of the current Philippine fiscal policy on government debt. It concluded that the government debt situation is not sustainable given the current policy regime. Furthermore, it found evidence of a weak-debt Ponzi game [Duo Qin et al. 2005]. This implies that the Philippine government is simply borrowing to pay off its current debts. Current government debt is vulnerable to adverse shocks,[18] and simple budgetary deficit control policy is inadequate. The government's responses to the rising debt and stagnating tax effort are as follows: first, constraining expenditures by underspending in public infrastructure and social overhead (education, health, and nutrition) and, second, selling state assets. The first response is shortsighted and could adversely affect long-term growth and development. The second response may have merits if the sale of assets is consistent with the desire to narrow the scope of government intervention, and the proceeds of asset sales are used to retire more expensive public debt or to invest in productivity-enhancing public infrastructure.

6. Economic and fiscal determinants of public deficits

In recent years, budget deficits have reemerged. With deficits rising and investment in human capital and public infrastructure deteriorating, an appropriate question is: what has caused the poor performance of the Philippines in recent years? Is it the result of unfortunate events, macroeconomic shocks, or misdirected fiscal policy?

The results of my previous study are as follows. First, using NGAB, the narrowest measure of fiscal balance, the statistically significant determinants are the following: inflation, domestic liquidity, capital outlays, and tax effort. On the other hand, the following variables were found to be statistically insignificant: economic growth, real effective exchange rate (REER), interest payment as percent of GDP, and intergovernmental grant (IRA) as percent of total government expenditures.

Second, using consolidated public sector fiscal position (CPSFP), the broader measure of fiscal balance, the statistically significant determinants of fiscal balance are the following: economic growth, inflation, domestic liquidity, capital outlays, intergovernmental fiscal transfers (IRA), and tax effort. Two variables—economic growth and intergovernmental fiscal transfer—which were not statistically significant using the national

[18]For example, the recent surge in oil and food prices and the slowdown of the US and world economy could raise inflation and slow the growth of the domestic economy.

government fiscal balance as the explanatory variable for budget deficit, turned out to be significant using the consolidated public sector deficit concept.

Third, the negative association of domestic liquidity with fiscal balances implies that in financing the deficit, the government may opt to resort to debt financing first, rather than printing money or increasing taxes. In the Philippine context, monetizing the deficit is not a preferred option because of legal restrictions and financial limitations on the monetary authorities (BSP). On the other hand, passing new tax laws to raise revenues has always been a difficult option politically.

Fourth, tax effort has been the most robust determinant of national government fiscal balance or the broader measure of fiscal balance (CPSFP). What is more interesting though is the exploratory regression of tax effort and the tax reform dummy variables. It is found that tax effort is positively related to the 1986 tax reform at 1 percent level of significance while it is negatively associated with 1997 CTRP at 15 percent level of significance.[19] A plausible explanation why the coefficient of the 1997 CTRP is less significant is that while major reforms initiated in 1986 such as value-added (VAT) are still in place, the VAT's effect was not as potent as before because the tax base was narrowed as a result of the 1997 CTRP [Diokno 2005].[20]

Fifth, real GDP growth rate (ECONGR) is found to be positively associated with fiscal balance using CPSFP as the explanatory variable, but insignificant if the more limited deficit concept (NGAB) is used. The results suggest that strong economic growth may lead to a better fiscal position. While the effect of economic growth on the national government deficit is unclear, its effect on other public sector entities is unequivocally positive. The monitored corporations, the government financial institutions and social security institutions, including PhilHealth,[21] and local governments perform better financially when the economy is growing and poorly when the economy is slowing down.

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[19]See Appendix B.

[20]The most important are RA 8184, An Act Restructuring the Excise Tax on Petroleum Products; RA 8241, Additional exemptions to value added tax; and more recently RA 9010, An Act Deferring the Imposition of VAT on Certain Services Imposed in RA 8761.

[21]Philippine Health Insurance Corporation.

Finally, intergovernmental fiscal transfer (IRA) is found to be positively associated with the consolidated public sector fiscal balance, although its association with the national government deficit is found to be statistically insignificant. The empirical result suggests that the higher the IRA, the higher the consolidated fiscal balance. The explanation is that under existing budget rules, local governments are mandated by law to generate a surplus of at least 5 percent to cover future contingencies; the higher the grant, the higher the mandated overall mandated surplus for local governments, and consequently the higher the consolidated fiscal surplus.

7. Conclusions, observations, and implications for policy

There are similarities and differences between public sector deficits in the early 1980s and those in recent years. Looking at macroeconomic factors, the deficits of the early 1980s and recent years occurred during periods of high oil prices. The two periods differ in that the early 1980s had higher prevailing interest and inflation rates compared to recent years. Interest rates averaged 20.2 percent during the period 1981-1985, whereas interest rates averaged 7.0 percent in 2001-2004. Inflation rates in the early 1980s were almost 300 percent higher than in recent years. In addition, the foreign exchange rate (peso to US dollar) was more volatile during the early 1980s.

In order to arrive at more meaningful decisions, policymakers should use the broader measure of consolidated public sector fiscal position (CPSFP) rather than the narrower concept of national government account balance (NGAB) in evaluating the government's fiscal health. The empirical results for the regression using NGAB as the dependent variable suggest that economic growth rate and intergovernmental fiscal transfers do not affect fiscal balance. But using the broader concept of CPSFP, the results suggest that economic growth rate and intergovernmental fiscal transfers are both positively associated with fiscal stance.

Tax effort has been the strongest positive determinant of the Philippines' fiscal health. During the last quarter of the century, tax effort was lowest in the two periods when public deficits were large. In the early 1980s, the low tax effort was due largely to a complicated tax system, narrow tax base, and an unresponsive tax system; in recent years, it was mainly because of a narrower tax base and an increasingly unresponsive tax system. Public policy must be directed at improving tax effort, not only by correcting existing weaknesses in the tax system (such as, for example, narrow tax base because of the proliferation of fiscal incentive laws) but also by improving tax administration.

Spending priorities have changed over time. Infrastructure was the focus of public spending during the Marcos years, while spending for social services was the focus during the Aquino and Estrada administrations. In recent years, both infrastructure and social services received less attention because of the heavy debt burden and low tax effort. From 2001 to 2005, both real per-pupil spending on education and real per capita health spending plummeted. Unless reversed, the falling investment in human capital and physical infrastructure would propel the Philippine economy on a lower long-run growth path.

There should be increased spending on both human and physical infrastructure to increase domestic productivity, attract investments, and promote economic growth and development. The results of our econometric work suggest that the effect of investment in physical infrastructure on fiscal balance is positive. Investment in productivity-enhancing capital projects makes private investment more productive, reduces transaction costs, and increases the profitability of private sector businesses.

Public policy, including fiscal and monetary policy, works with a lag. Consider the following examples. First, the decrease in overall tax effort after its peak in 1997 can be attributed partly to the changes in the tax laws introduced during the final years of the Ramos administration. Second, the surge in public debt as a result of the sharp depreciation of the peso as an aftermath of a misplaced foreign exchange policy and the Asian financial crisis has contributed to the surge in the public debt after Ramos. Subsequent administrations—and future generations of Filipinos—have to bear the brunt of adjustment in terms of higher taxes or constrained public services in the future. Finally, the Aquino government's decision to transfer to the national government the losses incurred during the time of Marcos by some government financial institutions and major nonfinancial corporations helped improve the fiscal picture of the distressed government corporations. But as a result, it magnified the fiscal deficit of the national government and constrained its ability to deliver the appropriate level of public services. Put differently, Marcos's public policy—tax less, spend more, use state enterprise to engage in the provision of private goods—made him look good then at the expense of the administrations that followed him. A review of the fiscal behavior of any administration should therefore consider the lag in public policy.

Appendix A
National government account balance, 1981-2005
In percent of GDP

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
A. REVENUES	11.8	11.2	12.4	10.8	12.1	13.0	15.1	14.1	16.5	16.8	17.7	18.0	17.7
1. Tax	10.3	9.9	10.8	9.6	10.7	10.8	12.6	11.3	13.2	14.1	14.6	15.4	15.6
Direct	2.5	2.5	2.5	2.3	3.3	3.1	3.2	3.4	4.1	4.6	4.9	5.2	5.0
Indirect	3.5	3.4	3.3	3.6	4.2	4.5	5.4	4.5	4.8	5.1	4.4	4.7	4.8
Taxes on international trade	3.6	3.6	4.5	3.3	3.0	2.9	3.8	3.1	4.1	4.3	5.2	5.4	5.6
Other offices	0.6	0.5	0.6	0.4	0.3	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.2
2. Nontax	1.5	1.3	1.6	1.3	1.4	2.3	2.5	2.8	3.2	2.7	3.1	2.5	2.1
B. EXPENDITURES	15.8	15.4	14.4	12.8	14.0	18.1	17.6	17.0	18.6	20.2	19.8	19.1	19.1
1. Current operating expenditures	8.6	9.3	9.4	8.2	9.7	11.0	14.1	14.2	15.4	16.9	15.9	15.9	15.5
Personal services	3.5	3.1	3.8	3.2	4.0	4.1	4.8	5.1	5.6	5.8	5.8	5.5	5.3
Maintenance and other operating expenditures	3.7	3.9	3.2	2.4	2.3	2.5	2.9	2.4	2.9	2.8	2.9	2.5	2.3
Interest payments	0.8	1.0	1.4	2.0	2.6	3.5	5.4	5.7	5.9	6.6	6.0	5.9	5.2
Domestic	0.5	0.7	0.7	1.1	1.8	2.5	3.5	4.0	4.4	4.9	4.5	4.7	3.8
Foreign	0.3	0.4	0.6	0.9	0.8	1.1	1.9	1.7	1.5	1.7	1.5	1.2	1.4
Allotment to local government units	0.5	0.7	0.7	0.5	0.6	0.6	0.6	0.5	0.4	0.4	0.5	1.2	2.0
Petroleum price stabilization fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.0	0.0	0.0
Subsidies	0.2	0.6	0.3	0.1	0.2	0.3	0.3	0.3	0.6	0.7	0.5	0.3	0.3
Tax expenditures	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.1	0.1	0.2	0.2	0.6	0.3
2. Capital outlay	6.8	5.5	4.4	3.7	3.9	4.7	2.4	2.1	2.8	3.0	3.4	3.1	3.5
Infrastructure and other capital outlays	4.2	2.7	2.8	1.9	1.5	1.9	1.8	1.9	2.3	2.7	3.0	3.4	2.4
Others	2.6	2.8	1.6	1.9	2.4	2.8	0.6	0.2	0.5	0.3	0.4	(0.3)	1.1
3. Net lending	0.3	0.7	0.6	0.8	0.4	2.5	1.0	0.7	0.4	0.4	0.5	0.2	0.2
C. NATIONAL GOVERNMENT ACCOUNT BALANCE	(4.0)	(4.2)	(2.0)	(1.9)	(1.9)	(5.1)	(2.4)	(2.9)	(2.1)	(3.5)	(2.1)	(1.2)	(1.5)
D. EXPENDITURES (excluding interest payments)	15.0	14.4	13.0	10.8	11.4	14.6	12.2	11.3	12.7	13.6	13.8	13.3	14.0
E. PRIMARY SURPLUS/DEFICIT (A-D)	(3.2)	(3.2)	(0.7)	0.1	0.6	(1.6)	3.0	2.8	3.8	3.1	3.9	4.7	3.7

SOURCE: Department of Budget and Management

Appendix A (continued)
National government account balance, 1981-2005
In percent of GDP

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
A. REVENUES	19.9	19.0	18.9	19.4	17.4	16.1	15.3	15.5	14.3	14.6	14.4	15.1
1. Tax	16.0	16.3	16.9	17.0	15.6	14.5	13.7	13.5	12.5	12.5	12.3	13.0
Direct	5.4	5.8	6.3	6.8	6.9	6.2	6.1	6.2	5.7	5.7	5.7	6.0
Indirect	5.6	5.2	5.7	6.2	5.8	5.3	4.2	4.1	3.8	3.8	3.6	4.2
Taxes on international trade	4.8	5.1	4.8	3.9	2.9	2.9	2.8	2.7	2.4	2.5	2.5	2.9
Other offices	0.1	0.1	0.1	0.1	0.1	0.1	0.5	0.5	0.5	0.5	0.5	0.0
2. Nontax	3.8	2.7	2.0	2.5	1.7	1.6	1.6	2.0	1.8	2.1	2.1	2.0
B. EXPENDITURES	18.9	18.4	18.6	19.4	19.2	19.8	19.3	19.6	19.6	19.3	18.3	17.4
1. Current operating expenditures	15.2	14.4	15.2	15.4	15.9	15.8	16.0	16.6	16.4	16.5	15.4	15.0
Personal services	5.5	5.7	6.2	7.1	7.4	6.8	6.7	6.6	6.7	6.4	5.8	5.5
Maintenance and other operating expenditures	2.2	2.3	2.2	2.1	2.4	2.4	2.4	2.4	2.1	1.8	1.7	1.6
Interest payments	4.7	3.8	3.5	3.2	3.7	3.6	4.2	4.8	4.7	5.3	5.4	5.5
Domestic	3.5	2.7	2.7	2.4	2.8	2.5	2.8	3.1	3.0	3.4	3.5	3.5
Foreign	1.1	1.1	0.8	0.8	1.0	1.1	1.4	1.7	1.7	1.8	1.9	2.0
Allotment to local government units	2.2	2.2	2.1	2.3	2.1	2.6	2.4	2.5	2.8	2.7	2.3	2.3
Petroleum price stabilization fund	0.0	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Subsidies	0.4	0.2	0.4	0.4	0.2	0.2	0.2	0.2	0.1	0.3	0.1	0.2
Tax expenditures	0.3	0.2	0.3	0.3	0.0	0.2	0.1	0.0	0.0	0.0	0.0	0.0
2. Capital outlay	3.3	3.7	3.3	3.9	3.3	3.9	3.3	2.9	3.1	2.6	2.7	2.4
Infrastructure and other capital outlays	2.5	2.8	2.6	3.3	2.7	3.2	2.6	2.1	2.4	1.8	1.9	1.7
Others	0.8	1.0	0.7	0.7	0.6	0.6	0.7	0.8	0.8	0.8	0.8	0.7
3. Net lending	0.3	0.2	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0
C. NATIONAL GOVERNMENT ACCOUNT BALANCE	1.0	0.6	0.3	0.1	(1.9)	(3.8)	(4.0)	(4.0)	(5.3)	(4.7)	(3.8)	(2.3)
D. EXPENDITURES **(excluding interest payments)**	14.2	14.6	15.1	16.2	15.5	16.3	15.1	14.8	15.0	14.0	12.9	11.9
E. PRIMARY SURPLUS/DEFICIT (A-D)	5.6	4.4	3.8	3.3	1.9	(0.2)	0.2	0.8	(0.6)	0.6	1.5	3.2

SOURCE: Department of Budget and Management

Appendix B
NGAB, PSBR, CPSD, 1985-2005
Consolidated public sector financial position, 1985-2005
In percent of GDP

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
A. Public sector borrowing requirement	(2.7)	(4.2)	(1.3)	(1.9)	(2.7)	(4.1)	(1.3)	(1.5)	(3.8)	(0.4)	(0.9)	(0.6)	(1.6)	(4.2)	(4.6)	(5.2)	(5.2)	(6.8)	(6.4)	(5.9)	(3.4)
1. National government	(1.9)	(5.1)	(2.4)	(2.9)	(2.1)	(3.5)	(2.1)	(1.2)	(1.5)	1.0	0.6	0.3	0.1	(1.9)	(3.8)	(4.0)	(4.0)	(5.3)	(4.7)	(3.9)	(2.7)
2. CB restructuring	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(1.0)	(1.4)	(1.0)	(0.6)	(1.1)	(1.0)	(0.7)	(0.6)	(0.6)	(0.4)	(0.4)	(0.4)	(0.3)
3. Monitored nonfinancial government corporations (MNFGCs)	(1.4)	(1.1)	0.0	0.4	(0.3)	(1.8)	(0.6)	(0.8)	(1.7)	(0.6)	(0.1)	(0.5)	(0.7)	(1.4)	(0.2)	(0.6)	(0.7)	(1.2)	(1.5)	(1.9)	(0.4)
4. Oil price stabilization fund	0.0	0.0	0.0	0.0	(0.9)	(0.1)	0.8	0.4	(0.5)	0.2	(0.5)	0.2	(0.0)	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
5. Adjustments of net lending and equity to GOCCs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.2	0.0
6. Other adjustments	0.6	2.1	1.1	0.6	0.7	1.2	0.6	0.1	1.0	0.4	0.1	0.1	0.1	0.1	(0.2)	(0.2)	0.0	0.0	0.0	0.0	0.0
B. Other public sector	(2.9)	(2.3)	(0.5)	(1.2)	(1.4)	(0.6)	(0.7)	(0.4)	2.0	(0.0)	0.7	0.9	0.6	1.1	1.4	0.8	0.6	1.3	1.2	1.0	1.6
1. Government financial institutions (GFIs)	(3.2)	(2.0)	0.1	0.2	0.3	0.3	0.2	0.3	0.4	0.2	0.3	0.4	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
2. Bangko Sentral ng Pilipinas (BSP)	(2.7)	(3.0)	(1.6)	(2.1)	(2.3)	(2.0)	(1.7)	(1.6)	(0.1)	0.3	0.2	(0.1)	0.1	0.1	(0.1)	0.0	(0.0)	0.0	0.2	0.1	0.1
3. SSS/GSIS	1.0	0.1	0.7	0.6	0.4	1.0	0.6	0.6	0.8	(0.7)	0.0	0.4	0.2	0.7	1.2	0.5	0.4	0.6	0.4	0.5	0.9
4. Local Government Units (LGUs)	0.1	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.4	0.3	0.1	0.3	0.1	0.1	0.3	0.2	0.0	0.5	0.5	0.3	0.4
5. Timing adjustments of interest payments to BSP	1.9	2.5	0.1	0.0	(0.1)	0.0	0.0	0.2	0.5	(0.1)	0.1	(0.0)	0.1	(0.0)	(0.1)	0.0	(0.0)	(0.0)	0.0	0.1	0.1
6. Other adjustments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	(0.1)	(0.0)
Consolidated public sector surplus/(deficit)	(5.6)	(6.5)	(1.8)	(3.1)	(4.1)	(4.7)	(2.1)	(1.9)	(1.8)	(0.5)	(0.2)	0.3	(1.0)	(3.1)	(3.2)	(4.4)	(4.7)	(5.5)	(5.2)	(4.9)	(1.8)

Source: Department of Budget and Management , Fiscal Statistics Yearbook 1984-2003, BESF various years

Appendix C
Budget deficit financing, 1981-2006
In billion pesos, unless otherwise specified

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Financing	12.1	14.4	7.4	10.1	12.0	31.3	16.7	23.2	19.6	37.2	26.3	16.0	21.9	-16.3	-11.1	-6.3	-27.1	88.9	181.7	203.8	175.2	264.2	286.8	242.5
Net foreign	6.0	4.6	5.4	2.0	-0.3	3.6	6.8	4.2	8.2	4.1	6.9	14.4	12.9	-11.6	-13.3	-5.9	-6.8	12.3	82.8	84.4	22.9	109.1	143.9	81.1
Net domestic	6.1	9.8	2.0	8.1	12.3	27.7	9.9	19.0	11.4	33.1	19.4	1.6	9.0	-4.7	2.2	-0.4	-20.3	76.6	98.9	119.4	152.3	155.1	142.9	161.4
Percent share																								
Net foreign	49.6	31.9	73.0	19.8	-2.5	11.5	40.7	18.1	41.8	11.0	26.2	90.0	58.9	71.2	119.8	93.7	25.1	13.8	45.6	41.4	13.1	41.3	50.2	33.4
Net domestic	50.4	68.1	27.0	80.2	102.5	88.5	59.3	81.9	58.2	89.0	73.8	10.0	41.1	28.8	-19.8	6.3	74.9	86.2	54.4	58.6	86.9	58.7	49.8	66.6

Source: Department of Budget and Management , Fiscal Statistics Yearbook 1984-2003, BESF various years

Appendix D
Philippine public debt statistics, 1981-2005

	1981	1982	1983	1984	1985	1986	1987	1988
A. National government outstanding debt								
1. Domestic debt	28925	35619	41685	62639	82533	201270	229687	265447
2. Foreign debt	20015	25112	14820	61110	59818	174175	195082	192888
3. Total debt	48940	60731	56505	123749	142351	375445	424769	458335
As a percentage of GDP								
4. Domestic debt	9.5	10.5	11.3	11.9	14.4	33.1	33.6	33.2
5. Foreign debt	6.6	7.4	4.0	11.7	10.5	28.6	28.6	24.1
6. Total debt	16.0	17.8	15.3	23.6	24.9	61.7	62.2	57.4
As percent of total outstanding debt								
7. Domestic debt	59.1	58.7	73.8	50.6	58.0	53.6	54.1	57.9
8. Foreign debt	40.9	41.3	26.2	49.4	42.0	46.4	45.9	42.1
B. Debt service expenditures								
1. Interest payment	2429	3560	4997	10409	14652	21612	36905	45865
a. Domestic	1445	2312	2615	5785	10261	15022	24224	32183
b. Foreign	984	1248	2382	4624	4391	6590	12681	13682
2. Amortization	1468	1332	3451	4473	6951	13201	32920	25299
a. Domestic	736	541	1203	1408	2907	7012	24281	12251
b. Foreign	732	791	2248	3065	4044	6189	8639	13048
3. Total	3897	4892	8448	14882	21603	34813	69825	71164
a. Domestic	2181	2853	3818	7193	13168	22034	48505	44434
b. Foreign	1716	2039	4630	7689	8435	12779	21320	26730
As a percentage of GDP								
4. Total	1.3	1.4	2.3	2.8	3.8	5.7	10.2	8.9
a. Domestic	0.7	0.8	1.0	1.4	2.3	3.6	7.1	5.6
b. Foreign	0.6	0.6	1.3	1.5	1.5	2.1	3.1	3.3
(4. Total for regression only)	1.3	1.4	2.3	2.8	3.8	5.7	10.2	8.9
As a percent of total debt service expenditures								
5. Total								
a. Domestic	56.0	58.3	45.2	48.3	61.0	63.3	69.5	62.4
b. Foreign	44.0	41.7	54.8	51.7	39.0	36.7	30.5	37.6
C. Total debt service expenditures as shared of total spending (%)								
1. Total debt serviceing	8.1	9.3	15.9	22.2	27.0	31.5	58.2	52.3
a. Domestic	4.5	5.4	7.2	10.7	16.4	19.9	40.5	32.7
b. Foreign	3.6	3.9	8.7	11.5	10.5	11.6	17.8	19.6
D. Debt servicing as % of tax revenues								
1. Interest payments	7.7	10.5	12.5	20.8	23.9	33.0	43.0	50.8
a. Domestic	4.6	6.8	6.6	11.5	16.8	22.9	28.2	35.6
b. Foreign	3.1	3.7	6.0	9.2	7.2	10.1	14.8	15.1
2. Total debt servicing	12.4	14.5	21.2	29.7	35.3	53.2	81.3	78.8
a. Domestic	6.9	8.4	9.6	14.4	21.5	33.6	56.5	49.2
b. Foreign	5.5	6.0	11.6	15.3	13.8	19.5	24.8	29.6

Appendix D (continued)
Philippine public debt statistics, 1981-2005

	1989	1990	1991	1992	1993	1994	1995
A. National government outstanding debt							
1. Domestic debt	289330	300146	338155	498327	450291	440760	494162
2. Foreign debt	198496	302376	331327	367378	436000	395419	412080
3. Total debt	487826	602522	669482	865705	886291	836179	906242
As a percentage of GDP							
4. Domestic debt	31.3	27.9	27.1	36.9	30.5	26.0	25.9
5. Foreign debt	21.4	28.1	26.5	27.2	29.6	23.4	21.6
6. Total debt	52.7	55.9	53.6	64.1	60.1	49.4	47.5
As percent of total outstanding debt							
7. Domestic debt	59.3	49.8	50.5	57.6	50.8	52.7	54.5
8. Foreign debt	40.7	50.2	49.5	42.4	49.2	47.3	45.5
B. Debt service expenditures							
1. Interest payment	54714	71114	74922	79571	76491	79123	72658
a. Domestic	41032	53323	56347	63113	56183	59806	50805
b. Foreign	13682	17791	18575	16458	20308	19317	21853
2. Amortization	28503	35232	46560	29651	36887	38844	64517
a. Domestic	16760	14952	30354	9898	11574	14981	34338
b. Foreign	11743	20280	16206	19753	25313	23863	30179
3. Total	83217	106346	121482	109222	113378	117967	137175
a. Domestic	57792	68275	86701	73011	67757	74787	85143
b. Foreign	25425	38071	34781	36211	45621	43180	52032
As a percentage of GDP							
4. Total	9.0	9.9	9.7	8.1	7.7	7.0	7.2
a. Domestic	6.2	6.3	6.9	5.4	4.6	4.4	4.5
b. Foreign	2.7	3.5	2.8	2.7	3.1	2.6	2.7
(4. Total for regression only)	9.0	9.9	9.7	8.1	7.7	7.0	7.2
As a percent of total debt service expenditures							
5. Total							
a. Domestic	69.4	64.2	71.4	66.8	59.8	63.4	62.1
b. Foreign	30.6	35.6	28.6	33.2	40.2	36.6	37.9
C. Total debt service expenditures as shared of total spending (%)							
1. Total debt serviceing	48.4	48.8	49.2	42.2	40.2	36.9	39.2
a. Domestic	33.6	31.3	35.1	28.2	24.0	23.4	24.3
b. Foreign	14.8	17.5	14.1	14.0	16.2	13.5	14.9
D. Debt servicing as % of tax revenues							
1. Interest payments	44.7	46.9	41.1	38.1	33.2	29.2	23.4
a. Domestic	33.5	35.2	30.9	30.2	24.4	22.0	16.4
b. Foreign	11.2	11.7	10.2	7.9	8.8	7.1	7.0
2. Total debt servicing	68.0	70.1	66.6	52.3	49.3	43.5	44.2
a. Domestic	47.2	45.0	47.6	35.0	29.4	27.6	27.4
b. Foreign	20.8	25.1	19.1	17.4	19.8	15.9	16.8

Appendix D (continued)
Philippine public debt statistics, 1981-2005

	1996	1997	1998	1999	2000	2001	2002
A. National government outstanding debt							
1. Domestic debt	517661	525207	626533	754009	843816	1023299	1246617
2. Foreign debt	386729	557790	592820	734410	1025520	1021631	1267965
3. Total debt	904390	1082997	1219353	1488419	1869336	2045130	2514782
As a percentage of GDP							
4. Domestic debt	23.8	21.6	23.5	25.3	25.2	28.2	31.5
5. Foreign debt	17.8	23.0	22.2	24.7	30.6	28.1	32.0
6. Total debt	41.6	44.6	45.8	50.0	55.7	56.3	63.5
As percent of total outstanding debt							
7. Domestic debt	57.2	48.5	51.4	50.7	45.1	50.0	49.6
8. Foreign debt	42.8	51.5	48.6	49.3	54.9	50.0	50.4
B. Debt service expenditures							
1. Interest payment	76522	77971	99792	106290	140894	174834	185861
a. Domestic	59002	58350	73525	74980	93575	112592	119985
b. Foreign	17520	19621	26267	31310	47319	62242	65876
2. Amortization	41220	47678	64717	99106	86949	99605	172098
a. Domestic	13260	17865	28761	61552	45429	54038	80944
b. Foreign	27960	29813	35956	37554	41520	45567	91154
3. Total	117742	125649	164509	205396	227843	274439	357959
a. Domestic	72262	76215	102286	136532	139004	166630	200929
b. Foreign	45480	49434	62223	68864	88839	107809	157030
As a percentage of GDP							
4. Total							
a. Domestic	5.4	5.2	6.2	6.9	6.8	7.6	9.0
b. Foreign	3.3	3.1	3.8	4.6	4.1	4.6	5.1
(4. Total for regression only)	2.1	2.0	2.3	2.3	2.6	3.0	4.0
As a percent of total debt service expenditures	5.4	5.2	6.2	6.9	6.8	7.6	9.0
5. Total							
a. Domestic	61.4	60.7	62.2	66.5	61.0	60.7	56.1
b. Foreign	38.6	39.3	37.8	33.5	39.0	39.3	43.9
C. Total debt service expenditures as shared of total spending (%)							
1. Total debt serviceing	29.1	26.7	32.1	34.8	35.1	38.6	46.0
a. Domestic	17.9	16.2	20.0	23.1	21.4	23.4	25.8
b. Foreign	11.3	10.5	12.1	11.7	13.7	15.2	20.2
D. Debt servicing as % of tax revenues							
1. Interest payments	20.8	18.9	24.0	24.6	30.6	35.7	37.4
a. Domestic	16.0	14.2	17.6	17.4	20.3	23.0	24.2
b. Foreign	4.6	4.6	6.3	7.3	10.3	12.7	13.3
2. Total debt servicing	32.0	30.5	39.5	47.6	49.5	56.0	72.1
a. Domestic	19.6	18.5	24.6	31.6	30.2	34.0	40.5
b. Foreign	12.4	12.0	14.9	16.0	19.3	22.0	31.6

Appendix D (continued)
Philippine public debt statistics, 1981-2005

	2003	2004	2005
A. National government outstanding debt			
1. Domestic debt	1479396	1776835	1939895
2. Foreign debt	1553032	1701234	1630940
3. Total debt	3032428	3478069	3570835
As a percentage of GDP			
4. Domestic debt	34.4	36.6	35.8
5. Foreign debt	36.1	35.0	30.1
6. Total debt	70.5	71.6	65.9
As percent of total outstanding debt			
7. Domestic debt	48.8	51.1	54.3
8. Foreign debt	51.2	48.9	45.7
B. Debt service expenditures			
1. Interest payment	226408	260901	299807
a. Domestic	147565	169997	190352
b. Foreign	78843	90904	109455
2. Amortization	243582	340771	379144
a. Domestic	147322	222405	253492
b. Foreign	96260	118366	125652
3. Total	469990	601672	678951
a. Domestic	294887	392402	443844
b. Foreign	175103	209270	235107
As a percentage of GDP			
4. Total			
a. Domestic	10.9	12.4	12.5
b. Foreign	6.9	8.1	8.2
(4. Total for regression only)	4.1	4.3	4.3
As a percent of total debt service expenditures	10.9	12.5	12.5
5. Total			
a. Domestic	62.7	65.2	65.4
b. Foreign	37.3	34.8	34.6
C. Total debt service expenditures as shared of total spending (%)			
1. Total debt serviceing	56.9	67.8	72.0
a. Domestic	35.7	44.2	47.1
b. Foreign	21.2	23.6	24.9
D. Debt servicing as % of tax revenues			
1. Interest payments	42.1	43.6	42.5
a. Domestic	27.4	28.4	27.0
b. Foreign	14.7	15.2	15.5
2. Total debt servicing	87.4	100.6	96.2
a. Domestic	54.8	65.6	62.9
b. Foreign	32.6	35.0	33.3

Appendix E
Fiscal performance: An overview
Per capita, real terms (2000=100)

Fiscal aggregates	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
A. Nominal terms																
1. Total disbursement	48,079	52,610	53,064	66,926	80,102	110,497	119,907	136,067	171,978	218,096	247,136	258,680	282,296	319,874	350,146	404,195
2. Interest payments	2,429	3,560	4,997	10,409	14,652	21,612	35,905	45,865	54,714	71,114	74,922	79,571	76,491	79,123	72,658	76,522
3. Net lending	929	2,218	2,393	4,423	2,555	15,148	7,077	5,415	3,666	3,787	5,725	2,258	2,649	5,893	3,696	1,161
4. Total disbursement net of IP and NL	44,721	46,832	45,674	52,094	62,895	73,737	76,925	84,787	113,598	143,195	166,489	176,851	203,156	234,858	273,792	326,512
5. Total revenues	35,933	38,206	45,632	56,861	68,961	79,245	103,214	112,861	152,410	180,902	220,787	242,714	260,405	336,160	361,220	410,450
B. In real terms (2000=100)																
1. Total disbursement	363,159	360,444	330,539	277,293	269,574	369,039	385,912	402,648	453,579	503,815	461,075	461,105	454,583	466,289	478,342	513,590
2. Interest payments	18,347	24,390	31,127	43,127	49,310	72,180	115,558	135,723	144,304	164,278	139,780	141,838	123,174	115,340	99,260	97,233
3. Net lending	7,017	15,196	14,906	18,326	8,599	50,591	22,777	16,024	9,669	8,748	10,681	4,025	4,266	8,590	5,049	1,475
4. Total disbursement net of IP and NL	337,794	320,857	284,506	215,840	211,666	246,268	247,578	250,901	299,606	330,789	310,614	315,242	327,143	342,359	374,033	414,882
5. Total revenues	271,415	261,758	284,244	235,591	232,080	264,663	332,187	333,977	401,970	417,895	411,916	432,645	419,332	490,029	493,470	521,537
C. Per capita, real terms																
1. Total disbursement	7,331	7,098	6,349	5,232	4,970	6,647	6,791	6,922	7,618	8,267	7,394	7,225	6,959	6,976	6,992	7,336
2. Interest payments	370	480	598	814	909	1,300	2,033	2,333	2,424	2,696	2,241	2,222	1,886	1,726	1,451	1,389
3. Net lending	142	299	286	346	159	911	401	275	162	144	171	63	65	129	74	21
4. Total disbursement net Expenditure net of IP & NL	6,819	6,319	5,465	4,072	3,902	4,436	4,356	4,313	5,032	5,428	4,981	4,940	5,008	5,122	5,468	5,926
Total revenues	5,479	5,155	5,460	4,445	4,279	4,767	5,845	5,741	6,751	6,857	6,605	6,779	6,420	7,331	7,213	7,449
Net fiscal benefit per capita	1,340	1,164	5	-373	-376	-331	-1,489	-1,428	-1,719	-1,429	-1,624	-1,840	-1,411	-2,209	-1,746	-1,523
Memo items:																
Population	49.54	50.78	52.06	53	54.24	55.52	56.83	58.17	59.54	60.94	62.36	63.82	65.32	66.84	68.41	70.01
IPIN (2000=100)	0.132	0.146	0.161	0.241	0.297	0.299	0.311	0.338	0.379	0.433	0.536	0.561	0.621	0.686	0.732	0.787

Source: Department of Budget and Management , Fiscal Statistics Yearbook 1984-2003, BESF various years

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