AN ANALYSIS OF THE PRESIDENT'S BUDGET FOR FISCAL YEAR 2005

CONGRESSIONAL PLANNING AND BUDGET DEPARTMENT
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PART 1

MACRO ASSESSMENT OF THE PRESIDENT'S BUDGET

CHAPTER 1

FRAMEWORK AND ORGANIZATION OF THE REPORT

The national budget is more than a statement of the government's expenditures and sources of revenues. It concretizes and gives life to the government's policy statements and development goals. It reflects and shapes, and is in turn shaped by, the country's economic development. The nexus between the national budget and economic development is achieved through two major channels: (1) promotion of macroeconomic stability, and (2) structural reforms that enhance efficiency and equity.

This study reviews and assesses the national budget for fiscal year 2005 in terms of its consistency with the macroeconomic objectives and the 10-point Agenda of the government, namely: job opportunities and credit, education for the poor, balanced budget, electricity and water supply to towns and barangays, transport and digital networks, decongestion of Metro Manila, development of service and logistics centers in Clark and Subic, automation of electoral process, and successful conclusion of the peace process.

As pointed out by the President, the immediate concern of the government is the fiscal problem. The national government and the consolidated public sector have been in chronic deficit, resulting in huge outstanding domestic and external debts. Thus, a major issue confronting the 2005 national budget, which points to another year of deficit spending and additional borrowing, is the sustainability of the fiscal deficit.

One way to assess the sustainability of the fiscal deficit is to consider its consistency with the other macroeconomic targets, such as the real growth rate of GDP or GNP, inflation rate, interest rate and exchange rate. A good starting point to understand this relationship is through the national income accounting identity, which states that the government's budgetary deficit must be financed by domestic private sector savings and/or foreign savings.

FIGURE 1.1
THE NATIONAL INCOME ACCOUNTING IDENTITY
AND THE FINANCING OF FISCAL DEFICIT

Borrowing from the domestic financial markets increases the demand for domestic loanable funds. This puts pressure on interest rate to rise. High interest rate in turn reduces the number of viable projects and discourages private investments. Thus, the budget deficit can be regarded as prudent or sustainable if its implied domestic borrowing requirement will not cause interest rates to rise beyond the targeted interest rate that is consistent with the desired level of private investment.

External borrowing or borrowing from foreign savings can allow the government to run sizeable budget deficits without causing domestic interest rates to rise. This can lull the government into complacency and postpone needed fiscal reforms, resulting in huge external debts. The sustainability of external deficit financing can be assessed with regard to the targeted ratio of gross external debt to exports or the desired ratio of foreign reserves to import. By ensuring that the debt-servicing ratios are within the desired levels, the government can maintain its external credit worthiness.

A sustainable fiscal deficit is also defined as one that leads to a declining debt-to-GDP ratio. For this to be realized the government must eventually post a primary surplus, that is a positive balance between government revenues and expenditures excluding interest payments. The primary surplus ensures that current revenues cover at least the part of the interest on current debt resulting in declining debt-to-GDP ratio. The only exception to this requirement is if the growth rate of the economy—and of public revenues—persistently exceeds the real interest rate on public debt, which assumes highly efficient and effective use of resources. In general, however, it is not possible for the rate of economic growth to be consistently higher than the interest rate.

The fiscal deficit target that is used as the basis in formulating the budget could be within sustainable level. Experience shows, however, that the government has difficulties in keeping actual deficit within the targeted amount. Oftentimes, the macroeconomic assumptions and the revenue projections underlying the budget are very optimistic. This leads to the authorization of a bigger expenditure program than what can actually be supported by available revenues.

Thus, aside from the consistency of the fiscal targets to the macroeconomic targets, certain downside risks to the economy should be properly considered. For 2005, these downside risks include the continuing spikes in world crude oil prices, looming interest rate hikes, security threats and impending cyclical El Niño phenomenon. The country's precarious fiscal position renders its economy very vulnerable to these downside risks. Any deviation in the economic growth targets brought about by these downside risks would feedback to the government fiscal targets, primarily the revenue targets.

As pointed out earlier, in addition to the promotion of economic stability the national budget could be an effective instrument for effecting structural changes that enhance efficiency and equity, and promote poverty alleviation. In this regard attention is given to the composition and structure of government revenues and expenditures. The allocation and composition of the budget—by sector, by function, by type and object of expenditure, by agency and by region—and corresponding trends, should reflect the government's priorities. The President's

10-point Agenda spells out the government's priorities that should find support in the allocation of the national budget.

Part I of the report is largely devoted to the assessment of the national budget and its implied fiscal targets *(i.e. revenue, expenditure, deficit and financing requirements)* in terms of consistency to the macroeconomic targets or assumptions. Specifically, Chapter 2 on macroeconomic perspective reviews the underlying macroeconomic assumptions of the national budget including possible effects of potential downside risks factors on the fiscal targets. It also provides alternative fiscal scenarios arising from different sets of macroeconomic projections. Chapter 3 on government revenues examines in-depth the composition and trends in national government revenues. It analyzes the causes of the decline in the tax effort and assesses the likelihood of meeting the government's targeted revenues for the current and ensuing fiscal year. The section also provides a brief discussion on the government's priority revenue measures.

Chapter 4 on government expenditures discusses the size, trend and composition of government expenditures. It highlights the squeeze on the budget brought about the huge debt-servicing requirements. Chapter 5 on deficit financing presents the magnitude the deficits and the public sector borrowing requirements for fiscal year 2005 and the recent years. It also examines the sustainability of the current fiscal deficit.

Part II focuses on budgetary allocation to specific sectors specifically the sectors that are critical to the 10-point Agenda of the government namely: agriculture, education, health, housing and infrastructure. Each section presents the strategic importance and current situation of the sector, and the sector's budgetary allocation vis-à-vis past allocation and its resource requirement.

CHAPTER 2

THE MACROECONOMIC PERSPECTIVE

An analysis of the President's fiscal budget encompasses a review of the underlying macroeconomic assumptions. The first half of 2004 presents a rosy economic picture but nonetheless masks the economy's high vulnerability to downside risks.

Continuing spikes in world crude oil prices, impending interest rate hikes, emerging cyclical El Niño, security threats, geopolitical conflicts, and trade and industrial policies (such as on the issue of global outsourcing) of the country's major markets, all could have adverse repercussion on economic performance.

Chronic fiscal deficits are not only indicators of macroeconomic instability. Huge deficits breed inefficiencies that pose hazards to economic growth and lead to underdevelopment traps (*Prunera, 2000*). The persisting deficit not only contributes to inflation but also to possible payments difficulties (*De Dios, 2001*).[1]

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[1] De Dios (2001) cites Fabella (1994) in noting the fiscal deficit (apart from trade deficit) as an important link in the "boom-and-bust" chain.

The ensuing lack of discretionary expenditure for infrastructure, health, and education could end up in a vicious spiral with dire socioeconomic outcomes.

The President's recent declaration of a crisis entails making hard choices. However, the pursuit of critical reforms has been deemed quite slow. Hence, congressional oversight and review of proposed appropriations open avenues for both revenue and expenditure reforms.

BACKGROUND

First Half 2004 Growth Rates. The robust growth rates of gross domestic product (GDP) and gross national product (GNP) in the first semester of 2004 have exceeded expectations of the government and the multilateral institutions. On the production side, GDP grew by 6.3% fueled by growth in all sectors. Good weather boosted growth in agriculture, fisheries, and forestry by 6.3%. The industry sector posted a 5.3% increase, with manufacturing and construction as the leading sources of sector improvement. Services grew by 6.9% with all subsectors posting gains.

Downside Risks and Growth Sustainability. In spite of the remarkable figures in the first half of 2004, the economy remains highly vulnerable to downside risks. Worse, it is prone to growth spurts and sharp downturns, more commonly termed "boom-bust cycles" *(see Figure 2.1).* Although the Philippines is not in the same boat as Argentina, former DOF undersecretary Bernardo contends that "there are vulnerabilities like the fiscal problem that should preclude complacency". Further, he maintains that "a confidence run in a highly leveraged financial system may cause a serious systemic breakdown" *(ibid.).* Earlier, economists from the University of the Philippines have issued a wake-up call, warning of a looming crisis.

Even the draft 2004-2010 Medium-Term Philippine Development Plan, though perceptively upbeat over the plan period, assessed that economic growth over the past three years had not been underpinned by components that would accelerate long-term growth. It stressed that growth remained basically consumer-driven, supported by strong remittance inflows[2] from overseas Filipino workers.

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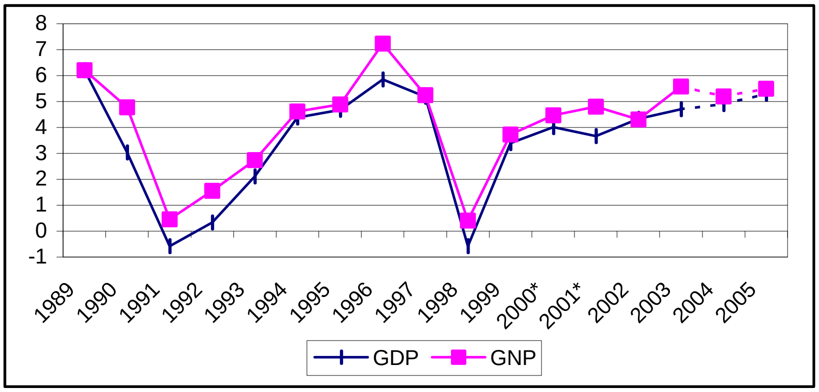
[2] The PDI (11/01/04) bannered in its business section that "Bulk of OFW inflows unproductive" and captioned that an "ADB-funded study says money went to excessive consumption".

FIGURE 2.1
REAL GROWTH RATES
OF GDP AND GNP, 1989-2005



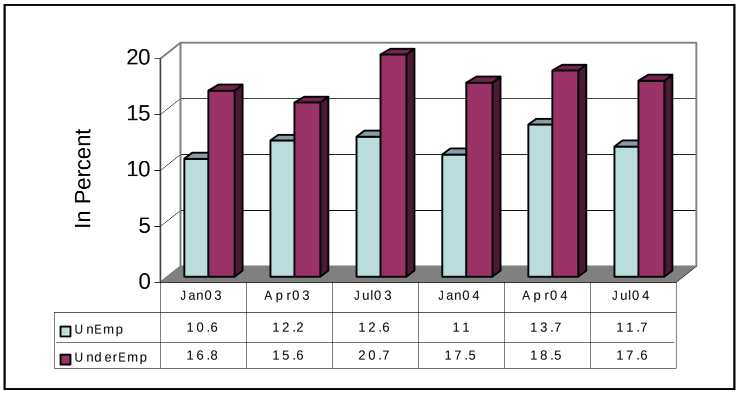
Sources: PSY, NSO, NIA, and NSCB
Notes: 2000 and 2001* were computed from data from NSO—may differ from series presented in other government websites. Figures for 2004 and 2005 are low-end BESF assumptions.*

Given the country's high dependency on energy imports and large stock of foreign debt, the current external shocks such as the tremendous rise in oil prices and the increase in world interest rates, may wipe out the gains in the last three years and exacerbate the problems of the economy. Rising interest rates, both domestic and foreign, would have a direct impact on public debt service payments. Again, this has negative implications on expanding public investments necessary to attain long-term economic growth targets.

Growth and Employment. The levels of employment depend on the levels of economic activity, labor intensity, and productivity. Institutional arrangements, such as labor laws, contracts, legislated wage rates, and collective negotiations, do matter in the labor market. Budgetary allocations directly influence the size of the government bureaucracy while government's collective labor policies and institutional arrangements on trade and investments impact on the labor market.

Notwithstanding impressive first semester economic growth, the unemployment rate (based on the January, April, and July Labor Force Surveys) averaged 12.1% in 2004 compared with 11.8% in 2003. The year-on-year unemployment rates were seasonally higher in the 2004 January and April surveys *(see Figure 2.2).*

FIGURE 2.2
UNEMPLOYMENT AND UNDER-EMPLOYMENT
2004 VS. 2003



A trend analysis of the labor market indicates that the unemployment gap will persist under present and normal growth conditions, considering that the 2.8% average annual growth of the labor force over the period 1992-2004 is greater than the 2.6% annual growth of employment. Some 785,000 individuals join the workforce every year compared with only 631,000 of new employment generated each year. In addition, the annual growth of the country's population over the age of 15 is approximately 1 ½ times greater than the average employment generated every year—i.e., roughly 1.05 million Filipino teenagers reach the age of employment annually.

This continuing saga indicates the need for a strategic population management strategy and the pursuit of a labor-demanding growth path.

OVERVIEW OF MACROECONOMIC ASSUMPTIONS

Comparative Economic Forecast. The President's budget for fiscal year 2005 is based on economic targets or assumptions of 5.3%-6.3% growth in gross domestic product in 2005 as enunciated in the draft Medium-Term Philippine Development Plan 2004-2010.

On the other hand, the BESF's GDP growth assumption of 4.9%-5.8% for 2004 was already scaled down from the prior 5.7%-6.3% target range contained in the MTPDP 2001-2004. Given the remarkable and rather surprising 6.3% GDP growth in the first half of 2004, the lower-end of the BESF GDP growth target of 4.9% would be easily surpassed.[3] However, the higher-end target of 5.8% would likely be subject to the drag of the enormous increase in world oil prices and increasing interest rates, both of which would temper GDP growth in the second half of 2004.

With this analysis, the Congressional Planning and Budget Department (CPBD) is updating its conservative estimate for 2004 by a percentage point and surmises GDP growth to hover between 5.3% to 5.7% vis-à-vis the BESF's 4.9%-5.8% for the year. However, the CPBD considers that the economy's vulnerability to downside risks and the slow pace of reforms would impact adversely on economic performance next year. As such, GDP growth would probably moderate to the range 4.5%-5.3% relative to the BESF target range of 5.3%-6.3% in 2005.

TABLE 2.1
PHILIPPINE GDP GROWTH PROSPECTS (%)

Particulars	2004 Forecast			2005 Forecast	
DBCC	4.9 – 5.8			5.3 – 6.3	
CPBD	5.3 – 5.7			4.5 – 5.3	
Multilateral Institutions	**Original**	**Revised**	**Update**	**Original**	**Revised**
ADB	4.2	5.0	5.5	5.0	5.5
IMF	4.0	4.5	5.2	5.2	4.2
WB	n.a.	4.2	5.4	4.1	4.5

Note: n.a. – not available
Sources: 2005 BESF, ADO Update and World Economic Outlook (September 2004)
World Bank East Asia Regional Update (November 2004)

The notable performance of the economy led the International Monetary Fund and the Asian Development Bank to revise upward their respective forecasts for 2004, which they again updated to 5.2% and 5.5% GDP growth, respectively. However, while the ADB foresees 2005 performance to match 2004 with a similar 5.5% growth rate (though with a caveat given high crude oil prices), the IMF forecasts a deceleration of growth in 2005 to just 4.2%.

Sectoral Growth Assumptions. Domestic growth hinges on sectoral performance. Table 2.2 shows the BESF targets by industrial origin as well as the assumptions of the CPBD.

[3] GDP growth anywhere between 3.5% and 5.3% in the second semester of 2004 will result in the achievement of BESF growth assumptions.

TABLE 2.2
SECTORAL GROWTH ASSUMPTIONS
(GDP BY INDUSTRIAL ORIGIN)

PARTICULARS	BESF		CPBD	
	Low	High	Low	High
Real GDP Growth Rate				
2004	4.9	5.8	5.3	5.7
2005	5.3	6.3	4.5	5.3
Agriculture, Fishery & Forestry				
2004 (Revised)	5.4	5.6	5.1	5.6
2005	4.2	5.2	3.7	4.5
Industry				
2004 (Revised)	5.3	5.5	4.3	4.8
2005	5.4	6.4	3.6	4.6
Services				
2004 (Revised)	6.6	6.8	6.0	6.4
2005	5.7	6.6	5.5	6.2

Agriculture. Given the unexpectedly strong growth performance in the first quarter of 2004, and with favorable weather persisting for the rest of 2004, the CPBD has upgraded its 2004 outlook with a 5.1%-5.6% growth range for the sector. These figures are closer to the revised BESF assumptions of 5.4-5.6% growth rates. Improved performance would largely be attributed to palay, corn, sugarcane and aquaculture farms that posted double-digit increases in the first half of 2004.

The sector is still expected to grow in 2005 but at a rate of 3.7-4.5% (lower than the BESF target range), not only due to a base effect but more on the probability of an El Niño occurrence gaining ground. This could be mitigated if the proposed irrigation budget for 2005 were fully disbursed, at the appropriate time, to construct the facilities estimated to provide water to 53,000 hectares of agricultural lands. However, provision of irrigation facilities should be in tandem with the increase in the number of farms adopting high yielding varieties of rice and corn in the first half of 2005.

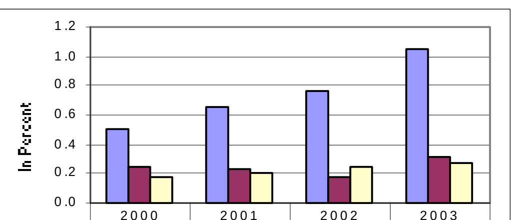
Industry. The CPBD has updated its 2004 growth prospect for the industry sector to range between 4.3-4.8%, still lower than the BESF revision. Manufacturing, which comprises 70% of total industry output, will be driven mainly by expansion in merchandise exports, which improved by 8.5% in the first half, led by increases in electronics.

For 2005, the CPBD expects growth in the industry sector to range only from 3.6% to 4.6%, tempered by a perceived slowdown in world economic activity due to high oil prices and low consumer demand. Demand for Philippine exports will be affected by the removal of the quota system for garments exports in January 2005 and the expected waning demand for information technology-related products in the coming year (*IIF cited in PDI*)[4].

The electronics industry has to contend with the decreasing market share in NAFTA specifically in the US. This could be addressed through diversification of product lines and more importantly negotiating for new favorable bilateral trading arrangements. South-South trade could be an important source of trading opportunities for the Philippines in the years ahead as indicated by rapid increases in the market shares of Philippine exports to other East Asian countries. Specifically, the country should exploit opportunities available in China, as the Philippines can be a good source of imported inputs *(i.e., electrical machinery)* for the labor-intensive segment of the production chain of multinationals in China (*Gutierrez 2004*).

Services. The service sector posted an impressive 6.9% growth during the first half of 2004, largely attributable to the whopping 11.4% performance of the transportation and communications sector. Note, however, that tax take has not been as responsive to the growth of telecommunications *(see Figure 2.3).*

FIGURE 2.3
TELCOM SECTOR TAX CONTRIBUTION TO TOTAL BIR COLLECTION



	2000	2001	2002	2003
VAT	0.51	0.65	0.77	1.05
OCT	0.25	0.23	0.18	0.32
CIT	0.18	0.20	0.25	0.27

Source: Large Taxpayers Service, BIR

In spite of the profitability of the telecommunications industry, its contribution to the total collections of the BIR hardly showed improvement from a measly 2.8% in 2002 to 3.5% in 2003. For instance, VAT contribution to total revenues averaged only 0.75%; 0.25% for OCT and 0.23% for CIT. Meanwhile, the collection effort – measured by the total collections in the industry as a percentage to the gross value added (GVA) of the communications subsector grew only by four (4) percentage points from 30% in 2002 to 34% in 2003.

[4] *The Institute of International Finance (IIF) is only projecting a 3.5% export growth in 2005 (PDI 11/04/04).*

The CPBD's 2005 forecast would be in line with the BSEF targets for the sector. Sustained growth in the communications sector would more than offset the negative impact of increasing oil prices on the transportation sector. It is only hoped that the contribution of the growth of the sector to tax effort would also increase commensurately.

Cross Country Comparison. The variances in the 2005 growth forecasts by multilateral institutions for various Asian countries are usually less than a percentage point except for Hong Kong and the Philippines. Both the IMF and the WB expect Indonesia to perform better than the Philippines in 2005. Apart from the East-Asia NIEs, the Philippines is predicted to post one of the lowest growth prospects in the region. Vietnam and Thailand have consistently registered creditable economic performance beyond 6%. With the economic heat still up in China, the caution is for a cooling down or risk a hard landing.

TABLE 2.3
CROSS-COUNTRY COMPARISON
GDP GROWTH RATES (%), 2003-2005

ECONOMIES	2003	2004			2005		
	Actual	ADB	IMF	WB	ADB	IMF	WB
Philippines	4.7	5.5	5.2	5.4	5.5	4.2	4.5
Indonesia	4.1	4.8	4.8	4.9	5.2	5.0	5.4
Malaysia	5.3	6.8	6.5	7.0	6.0	6.3	6.0
Thailand	6.8	6.4	6.2	6.5	6.6	6.4	5.8
Vietnam	6.0	7.5	7.0	7.2	7.6	7.0	7.5
China	9.1	8.8	9.0	9.2	8.0	7.5	7.8
Korea	3.1	4.4	4.6	4.9	3.6	4.0	4.4
Singapore	1.1	8.1	8.8	8.3	4.2	4.4	4.5
Taiwan	3.3	6.0	5.6	5.8	4.8	4.1	4.3
Hong Kong	3.2	7.5	7.5	7.4	6.0	4.0	4.6

Sources: ADO Update and World Economic Outlook (September 2004)
World Bank East Asia Regional Update (November 2004)

Factors Affecting the Economic Outlook. Key assumptions are bound to affect the economic outlook upon which hinges the proposed budget for fiscal year 2005.

Inflation. The BESF inflation target of 4%-5% for 2004 could easily be breached as the inflation rate in October jumped 7.7%, the highest since April 1999 (*PDI 11/06/04*), due to supply-side constraints. Higher oil prices would continue to push prices of basic goods and commodities. It has been reported (*BW 10/06/2004*) that although monetary authorities

TABLE 2.4
FACTORS AFFECTING ECONOMIC OUTLOOK

PARTICULARS	BESF Low	BESF High	CPBD Low	CPBD High
Inflation (%)				
2004	4.0	5.0	5.2	5.6
2005	4.0	5.0	5.5	6.0
Dubai Oil Price ($/Barrel)				
2004	33.2	-	34.0	35.0
2005	32.7	-	35.0	38.0
91-day Treasury Bill Rate (%)				
2004	7.5	8.5	7.5	8.0
2005	7.5	8.5	8.0	9.0
FOREX Rate (Php: $1)				
2004	54.0	56.0	56.0	56.0
2005	54.0	56.0	56.0	58.0

were expecting full-year inflation rate to average 5.4%, official targets would not be revised, for now. The CPBD's revised 2004 outlook stands at the 5.2%-5.6% range.

For 2005, even the Bangko Sentral admits that "headline inflation (is) expected to follow a hump-shaped path, briefly rising above the target in 2004-2005…." While the posted target in the BESF is between 4%-5%, the CPBD surmises average inflation to settle within the 5.5%-6.0% range. The ADB forecasts 5.5% while the IMF predicts 6.8% inflation outlook for the Philippines in 2005.

Dubai Oil Price. The average price of Dubai Oil FOB in September 2004 was at $35.55, while prices in October 2004 averaged $37.54 with spikes close to the benchmark level of $40 per barrel.

Oil prices are not simply demand and supply outcomes but are likewise a geopolitical concern. Unless OPEC members undertake supply-side measures and internecine conflicts in certain oil-producing countries were settled, oil prices would not soften especially with the wintry months nor would price expectations cool down. Hence, the BESF assumption of $32.72 per barrel for 2005 would probably be way off the mark. The CPBD expects full-year average Dubai Oil Price to range between $34 - $35 in 2004 and $35 - $38 in 2005.

According to the ADO 2004 Update, if global oil prices were at $40 a barrel for all of 2005, the ADB's projected GDP growth rate could fall by 1.9 percentage points and inflation rise by 1.4 percentage points.

The International Energy Agency predicts that higher petroleum prices would hurt economic growth around the world next year. The agency said global demand for oil would be stronger than expected for the rest of 2004. High prices and the slowing world economy would eventually lead to an overall drop in oil consumption in 2005 and restrain consumption from China, which has been the driving force behind the demand for oil this year (*Sydney Morning Herald, 10/14/04*).

91-Day Treasury Bill Rate. With rising uncertainties over interest rates, the US Feds' rate and expected LIBOR hikes, and the lingering fiscal problem, the rate of bellwether 91-day T-bills is predicted to surpass the BESF estimate of 7.5%-8.5% by half a percentage point. Nonetheless, while authorities have the policy tools to be able to meet the BESF targets, the elbow room to exercise options (such as rejecting very high bids) becomes more and more constrained by weak fiscal conditions.

Foreign Exchange Rate. From a base figure of P55.53 per US$ in January of 2004, the peso has depreciated to P56.29 as of 26 October 2004. This would exacerbate the inflationary impact of rising oil prices as well as push up the costs of input-import-dependent semi-conductor exporting firms. Moreover, this has negative implications on the capacity of the government to pay its debt obligations. The full-year average exchange rate would likely settle at $56 in 2004. While the BESF targets an exchange rate between $54 - $56 in 2005, the CPBD perceives the forex rate to range between $56 - $58.[5]

CPBD ECONOMIC AND FISCAL SCENARIOS

Economic Growth and Fiscal Estimates. CPBD estimates were derived from sectoral growth assumptions and considered the notable growth performance in the first semester of 2004 and the underlying downside risks in 2005.

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[5] *The American Express Bank projected a likely recovery of the exchange rate to P54.50 in 2005 due to a likely rebound of the Japanese yen and revaluation of the Chinese yuan.*

The first scenario simply compares fiscal estimates that are outcomes of the CPBD's growth projections vis-à-vis the BESF growth targets. The official tax effort targets were also applied on the CPBD estimates *(see Table 2.5).*

The second scenario builds on the first scenario by assuming different tax and BIR efforts compared with official targets. This scenario considers a tax effort of 12.8% in 2005 (the same as 2004) as opposed to the official target of 13.2%. The CPBD also assumes a BIR effort of 10.2% compared with the official target of 10.5% in 2005.

In both scenarios the differences in deficit estimates are presented when considering the debt service for the National Power Corporation.

SCENARIO 1.1 ***Low-Low Growth and Official Tax Effort.*** The CPBD's low-growth scenario of a revised 5.3% GDP growth in 2004 and 4.5% in 2005 would likely yield a tax revenue of P670.4 billion and total revenues of P751.7 billion. The variance of P6.8 billion, from the BESF's projected total revenues of P758.5 billion, simply accrues from the CPBD's differing growth projections from the BESF.

Juxtaposed against expected total disbursements *(excluding Napocor debt service)* of P943 billion would result in an estimated deficit of P191.3 billion (3.8% of GDP), higher than the BESF deficit target of P184.5 billion. Inclusive of NPC debt service of P30.8 billion in 2005 brings the tally to a deficit of P222.1 billion (4.4% of GDP).

SCENARIO 1.2 ***High-High Growth and Official Tax Effort.*** Under this scenario, the CPBD assumes growth rates of 5.7% in 2004 and 5.3% in 2005. The tax and BIR efforts that were applied are similar to the official targets.

The outcome shows projected revenues surpassing official estimates by P4.6 billion and the deficit *(w/o NPC debt service)* at P179.9 billion (3.5% of GDP), better than results accruing from low-end official targets.

TABLE 2.5
ECONOMIC GROWTH AND FISCAL SCENARIOS

PARTICULARS	Official	Targets	Scenarios Based on: GDP Growth Rates		Tax Effort = 12.8% and BIR = 10.2%	
			S – 1.1	S – 1.2	S – 2.1	S – 2.2
	BESF low	BESF high	CPBD Low	CPBD High	CPBD Low	CPBD High
Real GDP Growth Rate						
2004	4.9	5.8	5.3	5.7	5.3	5.7
2005	5.3	6.3	4.5	5.3	4.5	5.3
Real GDP (PB) 2003	1,081.5	1,081.5	1,081.5	1,081.5	1,081.5	1,081.5
Nominal GDP (PB)						
2004	4,648.8	4,732.4	4,686.5	4,709.8	4,686.5	4,709.8
2005	5,122.5	5,262.7	5,078.8	5,155.9	5,078.8	5,155.9
Tax Effort (Tax/GDP) 2005	13.2	-	13.2	13.2	12.8	12.8
Tax Revenues (PB) 2005	677.7	-	670.4	680.6	650.1	660.0
Bureau of Internal Revenue						
2005 Revenues (PB) / Effort = 10.5	537.4	-	533.3	541.4	518.0	525.9
Total Revenues						
2005 Revenues (PB)	758.5	-	751.7	763.1	728.8	740.7
2005 Effort	14.8	-	14.8	14.8	14.3	14.4
Difference from official target	-	-	(6.8)	4.6	(29.7)	(17.8)
Total Disbursements						
2005 Disbursements (PB)	943.0	-	943.0	943.0	943.0	943.0
2005 Disbursements (including NPC debt service)	-	-	973.8	973.8	973.8	973.8
Estimated Deficit						
2005 Deficit (PB) w/o NPC	(184.5)	-	(191.3)	(179.9)	(214.2)	(202.3)
Ratio to GDP	(3.6)	-	(3.8)	(3.5)	(4.2)	(3.9)
2005 Deficit (PB) with NPC	-	-	(222.1)	(210.7)	(245.0)	(233.1)
Ratio to GDP	-	-	(4.4)	(4.1)	(4.8)	(4.5)

SCENARIO 2.1 ***Low-Low Growth, Tax effort at 12.8%.*** The outcomes turn out worst if there were no improvement in tax effort in 2005—in this case the same tax effort (12.8%) and BIR effort (10.2%) in 2004 were applied to the CPBD growth projections for 2005. With this scenario, tax revenues would be P650.1 billion—lower than the official target by P27.6 billion.

The resulting deficit under Scenario 2.1 would be P214.2 billion (4.2% of GDP). If the NPC debt service were considered, then the deficit would be a staggering P245 billion, (4.8% of GDP).

SCENARIO 2.2 ***High-High Growth, Tax effort at 12.8%.*** The attainment of higher economic growth rates would mitigate the adverse impact of the absence of improvement in tax and BIR efforts in 2005. Considering a scenario of 5.7% GDP growth in 2004 and 5.3% in 2005 with no change in tax effort from 2004, the deficit would amount to P202.3 billion (3.9% of GDP), higher than official targets by P17.8 billion

SENSITIVITY ANALYSIS

Sensitivity analysis shows the responsiveness of the fiscal targets to changes in the macroeconomic assumptions.

The tax effort seems to have the most severe impact on the fiscal deficit. Using the BESF growth target for 2005 but applying a tax effort of 12.8%, lower by 0.4 percentage point than the official assumption of 13.2%, the CPBD estimates that each 0.1 percentage point change in the tax effort impacts on the deficit by roughly P5.5 billion. The 0.4 percentage point variance in tax effort would result in a decline in tax intake by approximately P22 billion while a full percentage point improvement in collection efficiency would hike the government's coffers by around P55 billion in 2005. Hence, the imperative to enhance tax collection efficiency cannot be overemphasized.

Further, as pointed out earlier, the CPBD's differing growth projections from the BESF (under a low-low growth scenario and tax effort of 13.2%) translates to a variance of P6.8 billion, lower than the BESF's projected total revenues. On the other hand, a higher growth scenario would tend to mitigate the lack of improvement in the tax effort.

Using the sensitivity indicators provided by the Executive (*Box 2.1*), the CPBO's assumption of higher inflation rates between 5.5%-6.0% in 2005 would lead to P6 billion in additional revenues and P1.4 billion in incremental disbursements or a net decline in the deficit by P4.6 billion.

TABLE 2.6
IMPACT OF CHANGES IN MACROECONOMIC ASSUMPTIONS ON THE FISCAL DEFICIT (IN BILLION PESOS)

Particulars	CPBO Estimates		
	Revenues	Disbursements	Net Impact
Inflation*	6.0	1.4	(4.6)
Interest Rates*	2.25	3.1	0.85
Foreign exchange*	3.2	3.2	0.0
Tax Effort	22.0	-	22.0

** Estimated using sensitivity's provided by the Executive*
Note: A positive figure indicates an increase in the deficit while a negative figure means a decrease in the deficit.

A depreciation in the local currency by any amount whatsoever would turn out to be deficit-neutral based on the sensitivity indicators provided by the DOF. Hence, the CPBD assumption of P56 - P58 visi-a-vis the official target ranging from P54 - P56 per $1 would not matter on the deficit but certainly on revenues and disbursements—which effects cancel each other out.

However, sensitivity analysis based on the NEDA's Quarterly Macro Model shows that a 10% increase in the foreign exchange rate would ease the budget deficit by roughly P0.34 billion in the short run.

The 0.5% difference in the 91-day Treasury Bill rate of 8%-9% assumed by the CPBO compared with official target range of 7.5%-8.5% could add up a net increase of P0.85 billion to the deficit. The net expansion would be due to a P2.25 billion rise in revenues and a P3.1 billion increase in disbursements.

BOX 2.1
SENSITIVITY OF THE BUDGET TO MACROECONOMIC ASSUMPTIONS AS PROVIDED BY THE EXECUTIVE*

The fiscal program is highly sensitive to the movement of four major macroeconomic indicators – exchange rates, interest rates, imports and real GDP growth. The table below summarizes the impact of each variable to revenues and disbursements and, consequently, to the budget deficit.

TABLE 2.7
SENSITIVITY INDICATORS, 2005
(IN BILLION PESOS)

Particulars	Revenues	Disbursements	Deficit/[1]
P1 depreciation in Foreign Exchange	1.6	1.6	0.0
1% point (100 bps) increase in T-bill Rate	4.5	6.2	1.7
1% point decrease in imports	(2.8)	0.0	2.8
1% point increase in inflation	6.0	1.4	(4.6)
1% point increase in real GDP	6.4	0.0	(6.4)

1/ A positive figure indicates an increase in the deficit while a negative figure means a decrease in the deficit.

Sources: Department of Finance

Foreign Exchange Rate. The depreciation of the peso against the dollar has both positive and negative effects on the economy. It makes the country's exports more competitive while it makes imports more expensive. On the fiscal side, it increases revenues from the higher peso proceeds from import taxes but also raises expenditures through higher debt payments and increases in other foreign exchange sensitive expenditures. DOF estimates show that a peso depreciation in foreign exchange will increase revenues by P1.6 billion and raise expenditures by P1.6 billion, with a net outcome which is deficit-neutral. However, the NEDA's QMM model indicates that the short run impact of a 10% increase in the exchange rate would be to mitigate the deficit by P338 million.

Interest Rate. Higher T-bill rate, likewise, affects the fiscal position in two ways. It increases revenues through higher withholding tax on interest income but also raises disbursements through higher interest payments from domestic borrowing. Estimates show that a one-percentage point increase in the T-bill rate would increase revenues by P4.5 billion. However, the resulting increase in disbursement is much higher at P6.2 billion, resulting in P1.7 million increase in the deficit.

Imports. Revenues derived from international trade through import duties and taxes account for almost 20% of total tax revenues. Thus, a decline in imports would have adverse impact on total revenue collections. Estimates show that a one-percentage point decrease in imports would reduce revenue collections by P2.8 billion, thereby increasing the deficit by the same amount.

Gross Domestic Product. The GDP is used a general indicator of a revenue base. When it increases, revenues would also rise assuming a constant revenue effort. Estimates show that a one-percentage point increase in real GDP growth rate would increase revenues by P6.4 billion, thereby reducing the deficit by the same amount.

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CHAPTER 3

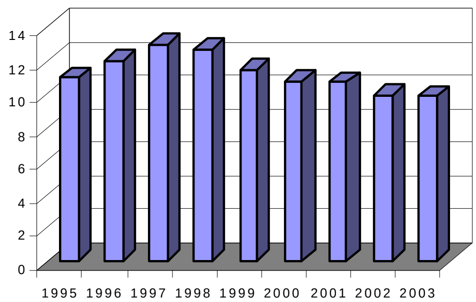
REVENUE PROGRAM

Government's ability to provide for public goods and basic services hinges on the health of its revenue stream. The President's 10-Point Agenda could be imperiled because of potential revenue shortfall. To implement the planned programs and projects of the National Government, significant improvements in revenue collection will be required—both through intensive enforcement of administrative measures of revenue-generating agencies and passage of new tax measures.

PERFORMANCE APPRAISAL

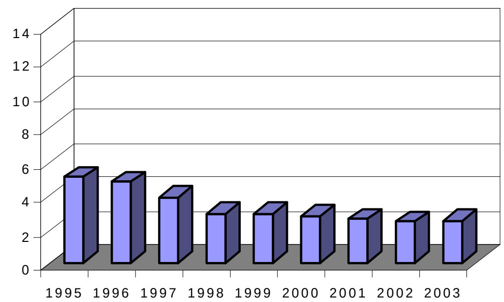
Revenue Effort. Over the years, the country's ability to collect revenues relative to growth in domestic income has been declining. Revenue effort (collection as a ratio of GDP) slipped from a high of 19.4% in 1997 to only 14.6% by end of 2003. Experts agree that the deterioration of revenue collection may be traced to four factors: (a) the Asian Financial crisis which slowed down economic growth; (b) the trade and tariff liberalization program which reduced the revenue

FIGURE 3.1
BIR TAX EFFORT



Source of basic data: BTr and NSO

FIGURE 3.2
BOC TAX EFFORT



take of the Bureau of Customs; (c) loopholes in the implementation of the Comprehensive Tax Reform Program (CTRP); and, (d) deterioration in tax administration.

In the late 1990s, the government embarked on a reform package intended to expand the tax base, provide a level playing field, and improve tax administration. However, the law that was finally approved by Congress was far from its original intent. While tax deductions and exemptions were expanded under the CTRP, the revenue-enhancing provisions were not passed—e.g., the rationalization of fiscal incentives, and the automatic indexation of tax rates that should have accompanied the shift from ad valorem to specific tax system. Note also that the tiering of tax rates on exciseable products created a wide disparity in tax payments between tiers.

Figure 3.1 shows that years prior to the implementation of the CTRP (1998), BIR tax effort was growing from 11% in 1995 to 13% in 1997. However, it started to decline from 12.7% in 1998 as low as 9.9% in 2003. A study by the National Tax Research Center (NTRC) points out that tax collection grew much faster than the GDP before the CTRP was implemented.

Tax buoyancy or the responsiveness of tax collection to the growth of the economy during pre-CTRP years (1990-1997) was 1.2 but this declined to only 0.5 during the CTRP years (1998-2002). Buoyancy of corporate tax dropped from 1.8 to 0.7 in the same period. Excise tax buoyancy also declined from 0.9 to 0.1, individual income tax from 1.6 to 0.7, and value added tax (VAT) from 1.5 to 0.6.

While other Asian countries similarly hit by the 1997 financial crisis were able to bounce back from the slump, the Philippines has not been as successful in terms of revenue mobilization. The country's revenue effort as of 2003 was only 14.6% but other Asian countries were much higher: Malaysia and Vietnam (22.7%), South Korea (20.9%), Singapore (20.6%), Indonesia (19.1%), China (18.8%) and Thailand (16.6%).

Revenue collection prospects for 2004 and 2005 look bright for the rest of Asia but not for the Philippines. Malaysia's revenue-to-GDP ratio is seen to further improve from 22.7% to 23.5% and 23.9% in 2004 and 2005, respectively. China's revenue effort is also expected to grow, albeit, minimally from 18.8% to a little over 19.0%.

TABLE 3.1
REVENUE EFFORT, SELECTED ASIAN COUNTRIES (1998-2005)

COUNTRY	1998	1999	2000	2001	2002	2003	2004	2005
Malaysia	20.0	19.5	18.1	23.8	23.2	22.7	23.5	23.9
Vietnam	19.9	19.3	20.4	21.4	22.6	22.7	22.9	20.3
South Korea	17.8	18.1	20.9	20.3	20.3	20.9	-	-
Indonesia	16.5	18.6	16.2	20.4	18.6	19.1	17.9	-
China	13.0	14.3	15.3	17.1	18.3	18.8	19.2	19.1
Thailand	15.6	15.4	15.4	15.0	15.8	16.6	16.9	16.6
Philippines	17.4	16.1	24.6	15.3	14.1	14.4	14.1	14.1

Source of basic data: Asian Development Outlook, 2004

While Thailand's revenue effort for 2005 will remain at 16.6% as in 2003, Philippines' revenue effort according to Asian Development Bank (ADB) will slightly decline by 0.3 percentage points from 14.4% in 2003 to 14.1% in the next two years (2004-2005). One Asian country that would possibly share the fate of the Philippines is Indonesia – from 19.1% of GDP, revenue collection is projected to drop to 17.9% this year but still better than the Philippine revenue effort.

Revenue Programming and Actual Collections. Congress approves the proposed annual budget based on revenue targets set by the Development Budget Coordinating Council (DBCC). During budget implementation, however, the DBCC adjusts the revenue goal based on changes in macroeconomic variables—primarily GDP growth and/or the non-passage of legislative measures that were included in the original revenue program.

Note that for the past six years, the revenue program as presented to Congress was revised almost every year *(see Table 3.2).* While it appears that government exceeded its revenue goal for 2001 by P5.5 billion, it was able to do so only because the revenue target was reduced from P607.2 billion to P558.2 billion. If the target was maintained at its original level, the revenue shortfall would have been P43.5 billion.

Similarly, the revenue goal was adjusted in 2003 from P640.1 billion to P584.1 billion or P56.6 billion less. As a result, NG posted a revenue surplus of P42.5 billion when it would have incurred a revenue shortfall of P14.1 billion. Note also that the revised program in 2001 and 2003 were even lower than the revenue goal of the immediately preceding year. A very optimistic revenue forecast creates an impression that a bigger budget can be appropriated. The danger of which is that while spending stays as programmed, shortfall in revenue collection can cause a breach in the deficit target.

TABLE 3.2
PROGRAM VS. ACTUAL REVENUE COLLECTION
(IN BILLION PESOS)

YEAR	Program		Actual	Actual vs.	
	Original	Revised		Original	Revised
1998	540.8	466.1	462.5	(78.3)	(3.6)
1999	550.5	490.7	478.5	(72.0)	(12.2)
2000	597.7	567.0	514.8	(82.9)	(52.2)
2001	607.2	558.2	563.7	(43.5)	5.5
2002	624.3	624.3	567.1	(57.2)	(57.2)
2003	640.7	584.1	626.6	(14.1)	42.5

Sources: BESF (DBM) and COR (BTr)

Current Revenue Performance. The government exceeded its revenue target of P332.8 billion for the period January-June 2004 by P10.5 billion or 3.1%. Actual collection for the first semester amounts to P343.3 billion which is higher by 12.1% than total collection of P306.3 billion during the same period last year.

Three significant factors which contributed to increased revenue collections are: (a) the P8.1 billion escrow account that was turned over to the National Treasury; (b) the implementation of the Centennial Taxpayer Recognition Program (CTRP) which gave BIR an additional P2.2

billion revenues; and (c) collections amounting to P182 million by BOC from non-traditional sources—e.g., public auction of forfeited cargoes, penalties from erring brokers, liquidation of surety bonds, and redemption of seized cargoes.

TABLE 3.3
MID-YEAR REVENUE PERFORMANCE
(IN BILLION PESOS)

AGENCY	Jan-Jun 03	Jan-Jun 04		Percent	
	Actual	Program	Actual	Deviation	Growth
BIR	209.21	234.75	229.19	-2.4	9.5
BOC	53.03	53.26	60.57	13.7	14.2
BTr	25.34	22.06	29.26	32.6	15.5
Others	18.76	22.78	24.28	6.5	29.4
TOTAL	**306.34**	**332.84**	**343.29**	**3.1**	**12.1**

Source: Bureau of the Treasury

REVENUE OUTLOOK

2004 Revenue Estimate. The CPBD projects that the full-year revenue target of P676.4 billion will be surpassed by as much as P5.6 billion *(Scenario 1)*. This assumes, based on 2003 performance, that total collection of the BIR and BOC as of September 2004 is roughly 73% of their respective full-year program.

Meanwhile, Scenario 2 projects a revenue shortfall of about P1.8 billion. This estimation was computed using the GDP projection by CPBD for 2004 *(see Chapter 1)* and the revenue efforts based on past performance of BIR (10.0%) and BOC (2.5%). The CPBD projects that GDP by end of 2004 will amount to P4,686.5 billion or P37.7 billion higher than programmed.

Scenario 1 shows that the revenue surplus will come from the Bureau of Customs. This could be attributed primarily to increased importation of refined petroleum products, as well as higher VAT payments from imports of businesses/industries located in economic zones (PEZA). However, it is not surprising that the BOC will exceed its revenue program given a rather low target. BOC's revenue effort of 2.4% as programmed is much lower than the average revenue effort (2.7%) during the period 1998-2003.

TABLE 3.4
2004 REVENUE PROJECTION
(IN BILLION PESOS)

PARTICULARS	2004 Full Year			Difference	
	Program	Scenario 1	Scenario 2	1	2
BIR	476.31	470.19	469.38	(6.12)	(6.93)
BOC	112.58	124.34	117.76	11.76	5.18
Other Offices	7.52	7.52	7.52	-	-
Non-Tax	80.00	80.00	80.00	-	-
Total Revenues	676.41	682.05	674.66	5.64	1.75

Source of basic data: Bureau of the Treasury

Collections by the BOC could further improve if it addresses the problem of smuggling. Incidence of smuggling is still high as evidenced by the declining VAT collection ratio (actual vis-a-vis potential) of imported products *(see Table 3.5).* While there appears a marked improvement in VAT collection on domestic products in 2002 and 2003, collection efficiency on imported goods has worsened particularly in 2003. To curb the incidence of smuggling, the President recently signed Executive Order No. 363 which expands the investigative powers of the BOC.

TABLE 3.5
VAT COLLECTION RATIO
(IN PERCENT)

YEAR	Domestic	Imports	Total
1998	80.5	92.8	85.5
1999	87.7	98.3	92.0
2000	70.0	98.4	80.9
2001	66.7	84.3	73.7
2002	67.8	85.5	74.7
2003	69.0	82.4	74.0

Source: Manasan (PIDS)

Based on past BIR performance (January-September 2003), collection as of the 3rd quarter 2004 (P343.8 billion) already represents 73% of full-year revenues. This means that for the rest of the year, BIR will likely collect only an additional P126.3 billion or a total of P470.1 billion by end of the year. Compared with its revenue target, BIR collections could be short by P6.1 billion.

To improve BIR collection, it needs to address problems like the declining trend in collection from individual income tax. Collection ratio among wage earners dropped from a high of 99.4% in 1998 to 69.2% in 2003 *(see Table 3.6)* which is highly improbable since income taxes from salaried employees are supposed to be captured through the withholding tax system. This calls for strict monitoring of withholding agents in order to increase compliance and timely remittance of withheld tax payments.

TABLE 3.6
COLLECTION RATIO
INDIVIDUAL INCOME TAX (%)

YEAR	Total	Wage	Non-Wage
1998	42.4	99.4	12.0
1999	41.0	90.2	11.5
2000	50.6	90.1	18.0
2001	39.1	78.9	9.5
2002	33.6	74.4	7.0
2003	30.4	69.2	6.0

Source: Manasan (PIDS)

Even more alarming is the low collection ratio from non-wage earners—i.e., professionals, self-employed, and business individuals. In 2000, collection ratio was already low at 18.0% but it further dropped to 6.0% by end of 2003. According to the NTRC, this could be attributed to the following reasons: (a) non-filing of income tax returns; (b) under-declaration of business or professional income; (c) overstatement of expenses; and (d) abuses in claims for tax exemptions and/or incentives.

In an effort to increase revenue collection, the BIR has initiated several administrative measures such as data matching with third party sources, electronic filing and verification of tax returns, industry benchmarking, and audit of exempt entities, among others. However, the BIR is financially-constrained to fully implement its programs. In 2003, total BIR budget amounted to only P3.5 billion. Given a collection of P425.4 billion, the estimated cost to collect P100 worth of revenue is P0.83. This is low compared with the average cost of P1.07 during the period 1998-2002.

TABLE 3.7
2005 REVENUE PROGRAM VS. PROJECTION
(IN BILLION PESOS)

PARTICULARS	2005 Full Year		Difference
	Program	Projection	
BIR	537.4	518.0	(19.4)
BOC	132.2	121.9	(10.3)
Other Offices	8.1	8.1	-
Non-Tax	80.8	80.8	-
Total Revenues	758.5	728.8	(29.7)

Sources of basic data: 2005 BESF, PSY and NIA

2005 Revenue Projection. The National Government projects that revenue collection will grow by 12.1% percent from P676.4 billion in 2004 to P758.5 billion in 2005. Of the total revenue, close to 90% or P677.7 billion will come from taxes and the rest will constitute the non-tax revenues (P80.8 billion). Note that the revenue program does not include the P83.4 billion estimated yield from the eight tax proposals submitted by Malacañang.

According to CPBD projections, it is unlikely that NG will meet its revenue target of P758.5 billion in 2005. The CPBD assumes a much lower real GDP growth of 4.5%-5.3% compared with 5.3%-6.3% as projected by the DBCC *(see Chapter 1).* Using the low-end growth estimate, nominal GDP will amount to P5,078.8 billion or P43.7 billion lower than the DBCC projection of P5,122.5 billion.

While the DBCC projects that BIR and BOC collection as a ratio to GDP will be 10.5% and 2.6%, respectively, the CPBD assumes a slightly lower revenue effort of 10.2% and 2.4%. Given these assumptions, full-year revenue collection in 2005 could amount to P728.8 billion, thus, a possible shortfall of P29.7 billion unless new tax measures are approved by Congress.

PROPOSED TAX MEASURES

The President submitted to Congress eight tax measures that are expected to generate P83.4 billion additional revenues *(see Table 3.8).* The House of Representatives has committed itself to pass at least four tax measures by end of 2004. House Bill No. 3174 which seeks to increase the excise tax rate on tobacco/alcohol products was already passed on Third Reading. Meanwhile, the following proposals have just finished committee deliberation: (a) Rationalization of Fiscal Incentives; (b) Tax Amnesty; and (c) Institutionalization of an Attrition System.

Excise Tax on Alcohol and Tobacco Products. House Bill No. 3174 (*Committee Report No. 60)* mandates a 20% increase in the excise tax rates of alcohol and tobacco products. It also provides a 3% adjustment in tax rates on the second year and another 3% on the third year from the effectivity of the Act. The present multi-tier tax structure was retained.

Even though the House-approved version of the bill does not include a provision for automatic indexation, the staggered increase as stipulated in HB 3174 automatically adjusts the tax rates for the next three years. This could readily generate for government about P7.6 billion during the first year of implementation or a total of P25.5 billion in three years.

Tax Amnesty. House Bill No. 2933 *(Committee Report No. 26)* offers tax amnesty to those with unpaid taxes in 2003 and prior years. The bill provides for mandatory filing of Statement of Assets, Liabilities and Networth (SALN) as of December 2003. Based on the declared networth, a 3% amnesty payment will be computed. However, those with pending tax cases will be charged higher rates. Ten percent (10%) will be imposed on those whose cases are still at the BIR—i.e., assessments have not been submitted to court for litigation. On the other hand, 20% applies to those with cases already filed in court. Under HB 2933, those who intend to avail of tax amnesty should pay the corresponding dues within four months following the effectivity of the law.

Lateral Attrition. The proposed Lateral Attrition is aimed at improving revenue collection by providing incentives and awards for good/exemplary performance of revenue-generating agencies. The process calls for expeditious action against non-performing officials and employees by removing them from their post (through transfer or separation) if they do not meet their respective revenue goals for the year.

Under the proposed measure, 10% of the excess collection (over-goal) is set aside as special incentives—50% of the amount will go to agency personnel at the local level that exceeded their target, and the remaining 50% will be distributed agency-wide. A Performance

TABLE 3.8
PROPOSED LEGISLATIVE TAX MEASURES

PARTICULARS	Estimated Yield (PB)	Suggested Timeframe
Two-Step Increase in the VAT Rate	19.90	2005
Tax on Telecommunications	5.00	2005
Gross Income Taxation for Corporation & Self-Employed Individuals	16.76	n.a.
Rationalization of Fiscal Incentives	5.00	2004
Indexation of Excise Tax on and Reclassification of SIN Products	7.00	2004
Grant of General Amnesty	n.a	2004
Institutionalization of an Attrition System	n.a.	2004
Increase in Excise Tax on Petroleum Products	29.70	2005

** based on results of the Legislative Agenda Planning Conference held 23 September 2004*
Source: 2005 BESF (DBM)

Evaluation Board will be responsible for issuing rules and procedures that will govern the conduct of the revenue performance evaluation. No lateral attrition in the form of separation shall be imposed unless revenue collection falls short of target by 30% and/or unless there is evidence of graft/corruption

Rationalization of Fiscal Incentives. The proposal seeks to repeal all other incentive laws by integrating them into one "omnibus investment law". This will make the incentive system easier and less costly to administer. It will do away with overlapping features of existing laws and regulations, and correct the unwieldy availment process that causes multiple claims to go unchecked. Projected revenue is P5 billion.

A clear set of criteria will be in place to qualify businesses/industries for incentives—e.g., higher preference is given to high value-added products and technology-based industries. The proposal also recognizes the importance of providing incentives to industries that utilize local/indigenous raw materials and to manufacturing activities with high degree of forward and backward linkages.

Franchise Tax on Telecommunications. Despite the tremendous growth and huge profits of the telecommunications industry, its revenue contribution to government coffers hardly showed improvement. On the average (2000-2003), sales of SMART and GLOBE increased by 54% and 36.4% respectively but contribution of taxes from telcos (VAT, overseas communication tax, and income tax) grew by just an average of 21% in the same period.

For government to benefit from the “windfall” profit of telecommunication companies, it is proposed that the franchise tax based on gross sales be re-imposed in place of the VAT. Under the VAT system, input VAT (on purchases) may be deducted from output VAT (on sales). But since telcos are generally capital-intensive, a high input VAT could usually result in a negative or zero net VAT.

The DOF proposed for a re-imposition of 3% franchise tax which can generate roughly P5 billion. Similar proposals have already been filed in Congress except that the tax rates are higher at 3.5% (HB 560) and 5% (HB 1469).

Excise Tax on Petroleum Products. Increasing the excise tax on petroleum products is aimed at arresting the downward trend in tax collection on said products. As a percentage to total tax revenues, the combined excise tax collections of BIR and BOC went down from 7.6% in 1997 to 6.2% in 2003. As a ratio to GDP, collections from petroleum products decreased from 1.3% to 0.8% in the same period despite the increase in direct importation of finished products by new oil players.

House Bill No. 1323 proposes an increase in excise taxes on petroleum products (except LPG) by P2 across the board. Once the P2-increase is materialized, it could raise P29.7 billion additional revenues.

Increase in the VAT Rate. To increase collection from VAT, the DOF proposed a two-step increase—i.e., an increase in VAT rate by two percentage points in 2006 if VAT effort does not reach 3.6% in 2005; and another two percentage point increase in 2007 if VAT effort of 4.1% in 2006 is not attained. According to the DOF, this will generate close to P20 billion. Meanwhile, the CPBD estimates P3.1 billion additional revenues if the proposed one-time increase of 2% in VAT rate materializes.

However, there are still debates on whether increasing the VAT rate is justifiable given a high level of VAT evasion. According to Manasan, total VAT evasion was about 26% in 2003. A separate estimate by the NTRC shows roughly the same evasion rate of 30% or an equivalent of P41.6 billion.

Gross Income Taxation. The proposed measure seeks to replace the current net income tax system with gross income taxation for self-employed individuals and corporations. Under the net income taxation, all-business related expenses—e.g., rentals, advertisements, travels, office supplies, representations, and donations—including cost of goods sold (CGS) can be deducted from gross sales/receipts. However, gross income taxation limits deductions only to CGS or to expenses directly incurred in the production of goods *(as defined in the Tax Code).*

It also seeks to align the treatment of self-employed individuals and professionals with that of corporations. Instead of a multi-rate tax structure, a single rate similar to corporations will be applied. Due to a change in the tax base, a much lower rate of between 10% to 15% will be imposed in lieu of the current 32% for corporations. Total revenue that will be generated from the proposed gross income taxation is estimated at P16.8 billion.

CHAPTER 4

EXPENDITURE PROGRAM

The President submitted to Congress a budget of P907.6 billion for 2005. The proposed 2005 obligation budget[1] in nominal terms is 5.3% higher than the 2004 appropriations of P861.6 billion – barely enough to cover the target inflation rate of 4%-5%. In real terms, however, the difference in spending levels is only 0.8%. This is insignificant compared with the projected population growth of 2.3%. As a result, per capita spending is likely to decline from P5,768 in 2004 to P5,641 the following year.

Under a fiscal deficit situation, the National Government (NG) is forced to constrain its spending. The 2005 budget translates to only 17.7% of GDP—i.e., lower than that of 2003 (19.2%) and 2004 (18.5%). The country's spending level as a percentage of GDP lags behind other Asian countries: Malaysia (28.1%), Korea (22.7%), China (21.6%), Indonesia (21.2%), and Thailand (18.2%).

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[1] *Obligation basis budgeting accounts for current year's expenditure requirements only. Cash budgeting, on the other hand, reports expenses as they are paid regardless of the period when the obligation was made.*

On the average (1986-2003), the country spends about 19.3% relative to GDP. The 2005 budget brings the expenditure-to-GDP ratio back to one of its lowest—government spending was constant at 17.8% in 1986-1988. The highest budget allocation was reported in 1990 at 20.7% but this was primarily due to a huge debt service[2]. Similarly, the 2005 budget allocates a significant amount for interest payments despite a much lower spending level of 17.7% relative to GDP. Net of debt burden, total spending for 2005 is only 11.7% of GDP *(see Table 4.1).*

SECTORAL ALLOCATION

Among the six sectors, only debt service and net lending will post significant growths in 2005. In particular, interest payments will increase by P30.2 billion from P271.5 billion in 2004 to P301.7 billion in 2005. For two consecutive years (2004-2005), debt service gets the highest sectoral share of the budget at 5.8% and 5.9% of GDP, respectively. On per capita basis, spending for economic services, social services, defense, and general public services has been shrinking since 2003 but per capita allocation for net lending and debt service are actually expected to grow in 2005.

TABLE 4.1
NG EXPENDITURE PROGRAM BY SECTOR, 2003-2005

PARTICULARS	Levels (Billion Pesos)			Growth Rates		Percent of GDP		
	2003	2004	2005	03-04	04-05	2003	2004	2005
Economic Services	169.9	155.6	159.2	(8.4)	2.3	4.0	3.3	3.1
Social Services	237.5	247.9	254.3	4.4	2.6	5.5	5.3	5.0
Defense	44.4	43.8	44.2	(1.3)	0.8	1.0	0.9	0.9
General Public Services	141.2	137.3	140.7	(2.8)	2.5	3.3	3.0	2.7
Net Lending	5.6	5.5	7.6	(2.1)	38.2	0.1	0.1	0.1
Debt Service	226.4	271.5	301.7	19.9	11.1	5.3	5.8	5.9
TOTAL	**825.1**	**861.6**	**907.6**	**4.4**	**5.3**	**19.2**	**18.5**	**17.7**

Source of basic data: 2005 BESF (DBM)

[2] *For budgetary purposes, only interest payment is recognized as current expenditure because servicing of principal loan is usually rolled over— i.e., deducted from gross borrowing. Net lending pertains to NG borrowings that are re-lent to GOCCs that are undergoing financial difficulties.*

Economic Services. Although the budget for Economic Services will slightly increase by P3.6 billion (nominal terms), it is insufficient to post a positive growth relative to GDP. Economic Services will decline from 3.3% of GDP in 2004 to 3.1% next year. Note that the 2005 allocation of P159.2 billion is much lower than the 2003 level of P169.9 billion. Apparently, programs intended to strengthen agriculture, industry, services and infrastructure sub-sectors to generate employment will face financial setbacks given the meager budget for the sector.

TABLE 4.2
ECONOMIC SERVICES EXPENDITURE PROGRAM, 2003-2005

PARTICULARS	Levels (Billion Pesos)			% Share to Total NG Budget		
	2003	2004	2005	2003	2004	2005
Agriculture, Agrarian Reform & Natural Resources	39.7	32.0	32.7	4.8	3.7	3.6
Trade and Industry	2.7	2.8	3.0	0.3	0.3	0.3
Tourism	1.2	1.2	1.4	0.1	0.1	0.2
Power and Energy	1.1	2.0	1.5	0.1	0.2	0.2
Water Resources Development & Flood Control	7.0	6.2	6.5	0.9	0.7	0.7
Communications, Roads & Other Transportation	67.1	54.9	54.9	8.1	6.4	6.1
Other Economic Services	1.7	7.1	6.0	0.2	0.8	0.7
Subsidy to Local Government Units	49.4	49.4	53.1	6.0	5.7	5.9
TOTAL	**169.9**	**155.6**	**159.2**	**20.6**	**18.1**	**17.5**

Source of basic data: 2005 BESF (DBM)

As a percentage of the total budget, allocation to economic services has been steadily declining from 20.6% in 2003 to 17.5% in 2005. By sub-sector, Communications, Roads and Other Transportation will get the biggest share of the total budget of the sector. However, the amount of P54.9 billion is a far cry from the 2003 allocation of P67.1 billion. The next biggest allocation is the subsidy to local government units (LGUs) which amounts to P53.1 billion, representing a portion of the Internal Revenue Allotment (IRA) of LGUs.

Agriculture, Agrarian Reform and Natural Resources sub-sector will get P32.7 billion which is equivalent to 3.6% of the 2005 budget. Table 4.2 shows that allocation for agriculture as a percentage of the total NG budget has been declining since 2003. Highest allocation in agriculture spending was posted in 1997 when government provided for safety nets in relation to the Agriculture Agreement under the GATT-Uruguay Round. A big portion of the agriculture budget went to subsidies for credit, post-harvest facilities, farm machines, and other agricultural inputs. Support to this sector is premised on the fact that nearly half of total labor force derives their income from this sector while 14% of total exports and about 20% of GDP are dependent on agriculture-based industries and services.

Social Services. Spending proposal for social services in 2005 amounts to P254.3 billion. This is 2.6% higher than the 2004 level, but it is barely enough to match the population growth which is projected at 2.3%. However, as a ratio to GDP, Social Services will experience a budgetary decline from 5.3% to 5.0% in the same period *(see Table 4.3).*

Budget for Education, Culture and Manpower Development may have been consistently increasing in nominal terms since 2003 but its share to total NG budget has been actually decreasing. In 2002, its share to total budget was 15.6%. This declined to 15.5% in 2004, and further down to 14.9% by 2005. In 1998, the Education sub-sector got a 19.9% budget share—the only time when the government nearly complied with the 20/20 funding requirement for education by the United Nations Development Program (UNDP).

Allocation for Social Security, Welfare and Employment will increase minimally by P1.7 billion in 2005. On the other hand, Housing and Community Development as well as Other Social Services will suffer budget cuts. The budget for Health is expected to stay at P12.9 billion as in 2004 because of the policy decision for NG to disengage from providing funds for devolved functions starting 2005.

TABLE 4.3
SOCIAL SERVICES EXPENDITURE PROGRAM, 2003-2005

PARTICULARS	Levels (Billion Pesos)			% Share to Total NG Budget		
	2003	2004	2005	2003	2004	2005
Education, Culture, & Manpower Development	129.0	133.3	135.5	15.6	15.5	14.9
Health	12.4	12.9	12.9	1.5	1.5	1.4
Social Security, Welfare and Employment	39.1	38.4	40.1	4.7	4.5	4.4
Land Distribution (ARF)	0.9	4.3	4.4	0.1	0.5	0.5
Housing and Community Development	3.0	2.6	1.7	0.4	0.3	0.2
Other Social Services	0.9	4.3	3.6	0.1	0.5	0.4
Subsidy to Local Government Units	52.2	52.2	56.1	6.3	6.1	6.2
TOTAL	**237.5**	**247.9**	**254.3**	**28.8**	**28.8**	**28.0**

Source of basic data: 2005 BESF (DBM)

Public Services. Total budget for public services accounts for 15.5% of the proposed NG expenditure program for 2005. Budget allocation for Public Order and Safety will increase from P53.2 billion in 2004 to P54.3 billion in 2005 possibly due to the urgency of purging terrorism and restoring law and order in the country. Subsidy to LGUs will also increase from P39.5 billion to P42.5 billion *(see Table 4.4).*

TABLE 4.4
PUBLIC SERVICES EXPENDITURE PROGRAM, 2003-2005

PARTICULARS	Levels (Billion Pesos)			% Share to Total NG Budget		
	2003	2004	2005	2003	2004	2005
General Administration	43.4	42.3	40.1	5.3	4.9	4.4
Public Order and Safety	52.6	53.2	54.3	6.4	6.2	6.0
Other General Public Services	5.7	2.3	3.8	0.7	0.3	0.4
Subsidy to LGUs	39.5	39.5	42.5	4.8	4.6	4.7
TOTAL	**141.2**	**137.3**	**140.7**	**17.1**	**15.9**	**15.5**

Source of basic data: FY 2005 BESF, DBM

On the other hand, budget allocation for General Administration will decline from P42.3 billion in 2004 to P40.1 billion in 2005. This may be attributed to austerity measures of government which include the following: (a) suspension of foreign and local travels, purchase of motor vehicles and advertisement; (b) reduction of at least 10% of services of non-permanent personnel and the consumption of supplies, utilities; (c) adoption of a scheme to compensate overtime services; (d) suspension of tax expenditure subsidies; and (e) strict compliance with the Government Procurement Reform Act.

OBJECT OF EXPENDITURES

Of the total P907.6 billion budget for 2005, about 88.5% are current operating expenditures—the bulk of which will go to interest payments (P301.7 billion), personal services (P289.3 billion), and as allotment to LGUs (P121.3 billion). Meanwhile, allocation for maintenance and other operating expenditures (MOOE) amounts to only P86.5 billion which is slightly lower than the current level of P86.9 billion.

Interest payments will receive the highest budgetary allocation at 33.2% of total NG budget. This does not sit well with President Arroyo's 10-Point Agenda given the limited funds that could be used to implement government programs and projects. However, to default on loan repayments could be equally detrimental—i.e., it can possibly close our access to foreign sources or disrupt the flow of foreign financing. Note that debt service is obligatory because of the "automatic appropriation" provision under the Budget Reform Law (PD 1177).

Personal Services (PS) will get the second biggest portion (31.9%) of the budget pie. However, the provision for personnel benefits will increase minimally by P2 billion or less than one percentage point due to current efforts to streamline the bureaucracy. Reportedly, 102 agencies under the Office of the President that have remained dormant or have fulfilled their mandate have already been abolished.

Only 10.7% of the total NG budget for 2005 will go to capital outlay. Although capital outlays is expected to be 4.0% higher than the 2004 level, the allotment of P96.7 billion is much lower than the actual spending of P109.6 billion in 2003. The breakdown of capital

TABLE 4.5
EXPENDITURE PROGRAM BY OBJECT, 2003-2005

PARTICULARS	Levels (Billion Pesos)			Percent Share			Growth Rates	
	2003	2004	2005	2003	2004	2005	03-04	04-05
Current Operating Expenditures	**709.9**	**763.1**	**803.3**	**86.0**	**88.6**	**88.5**	**7.5**	**5.3**
Personal Services	279.4	287.4	289.3	33.9	33.4	31.9	2.8	0.7
MOOE	68.5	86.9	86.5	8.3	10.1	9.5	27.0	(0.4)
Allotment to LGUs	112.8	112.8	121.3	13.7	13.1	13.4	-	7.5
Interest Payments	226.4	271.5	301.7	27.4	31.5	33.2	19.9	11.1
Subsidy	22.8	4.5	4.5	2.8	0.5	0.5	(80.2)	(0.1)
Capital Outlays	**109.6**	**93.0**	**96.7**	**13.3**	**10.8**	**10.7**	**(15.1)**	**4.0**
Infrastructure	60.7	51.4	56.5	7.4	6.0	6.2	(15.3)	9.9
Corporate Equity	4.6	1.1	0.2	0.6	0.1	0.0	(75.1)	(83.3)
Special Shares to LGUs	0.1	1.6	1.9	0.0	0.2	0.2	1,450.2	23.0
Other Capital Outlays	16.0	10.7	7.7	1.9	1.2	0.9	(33.2)	(27.6)
Capital Transfer to LGUs	28.2	28.2	30.3	3.4	3.3	3.3	-	7.5
Net Lending	**5.6**	**5.5**	**7.6**	**0.7**	**0.6**	**0.8**	**(2.1)**	**38.2**
TOTAL	**825.1**	**861.6**	**907.6**	**100.0**	**100.0**	**100.0**	**4.4**	**5.3**

Source of basic data: 2005 BESF (DBM)

outlays shows that P56.5 billion will be used to fund infrastructure projects and P30.3 billion are capital transfers to LGUs—representing 20% of the Internal Revenue Allotment which is intended for capital build-up at the local level. However, such transfers are allegedly being spent for current expenses like personal services and MOOE. Inadequate investment for infrastructure puts long-term development in question.

Source of Appropriations. More than half or 54.7% of the proposed 2005 budget is considered automatically appropriated. Only 45.3% or P411.2 billion will need Congressional approval as new appropriations. This is because transfers to LGUs amounting to roughly P155.9 billion are counted as "automatic" appropriations under the 2005 budget proposal. Previously, allotments to LGUs were included among the items under new appropriations *(see Table 4.6).*

TABLE 4.6
BUDGET LEVEL BY SOURCE OF APPROPRIATIONS (IN BILLION PESOS)

PARTICULARS	Amount	% Share
Programmed New Appropriations	**411.2**	**45.3**
of which: Personal Services	289.3	31.9
Automatic Appropriations	**496.4**	**54.7**
Interest Payments	301.7	33.2
Net Lending	7.6	0.8
Others*	187.1	20.6
TOTAL	**907.6**	**100.0**

**Includes transfers to LGUs*
Source of basic data: 2005 BESF (DBM)

Even though P411.2 billion or 45.3% of the budget is considered "new" appropriations, what will actually go under congressional scrutiny is only P121.9 billion or 13.4% of the total NG budget. This is because P289.3 billion representing 31.9% of the total budget are considered "fixed" expenditures for personal services.

Government re-engineering is presented as a solution to the huge PS that limits the allocable portion of the budget. To reduce massive cash flow in the event of a reengineering, DBM may want to consider the payment of separation benefits and pensions through the issuance of Treasury Bonds (HB 193). Streamlining of government processes, improvement of procedures, and tightening the system of "checks and balances" should also be undertaken to minimize leakages in the expenditure stream and to reduce the incidence of graft and corruption.

COST STRUCTURE

Total budget for agency programs *(net of debt burden)* is P598.3 billion, of which Operations will get the highest share of 48.7% or an equivalent amount of P291.1 billion. Operations pertain to activities directly addressing the agency's mandate. On the other hand, Projects including both locally and foreign-assisted will have a share of 44.5% or an allocation of P266.0 billion *(see Table 4.7).*

General Overhead has been trimmed down from P104.0 billion or 17.5% of the 2003 budget to P40.6 billion or only 6.9% in 2004. For 2005, its budgetary share will be maintained at 6.9% or P41.2 billion. The shifting away of the budget from General Overhead to Operations and Projects is a positive development owing to the relative importance of the latter to economic growth.

TABLE 4.7
COST STRUCTURE OF AGENCY PROGRAMS
(NET OF DEBT BURDEN), 2003-2005

PARTICULARS	Levels (Billion Pesos)			Percent Share			Growth Rates	
	2003	2004	2005	2003	2004	2005	03-04	04-05
General Overhead	**104.0**	**40.6**	**41.2**	**17.5**	**6.9**	**6.9**	**(60.9)**	**1.4**
General Administration & Support	69.9	26.7	27.1	11.8	4.6	4.5	(61.8)	1.7
Support to Operations	34.1	13.9	14.1	5.7	2.4	2.4	(59.1)	0.9
Operations	**259.8**	**281.6**	**291.1**	**43.8**	**48.2**	**48.7**	**8.4**	**3.4**
Project	**229.3**	**262.4**	**266.0**	**38.7**	**44.9**	**44.5**	**14.4**	**1.4**
Locally- Funded Projects	193.4	227.1	224.6	32.6	38.8	37.5	17.4	(1.1)
Foreign-Assisted Projects	35.9	35.3	41.4	6.1	6.0	6.9	(1.7)	17.2
TOTAL	**593.1**	**584.6**	**598.3**	**100.0**	**100.0**	**100.0**	**(1.4)**	**2.3**

Source of basic data: 2005 BESF (DBM)

REGIONAL ALLOCATION

The proposed expenditure program for 2005 shows that while the Central Office continues to get the largest portion (45.5%) of the budget, the highest increment from 2004 will go to the regions. Funds for regional distribution will increase by P30.2 billion from P321.3 billion in 2004 to P351.5 billion in 2005. The regional budget accounts for 38.7% of the total NG budget next year. Meanwhile, about P142.8 billion will be retained at the national level to support programs/projects that are centrally-managed and with nationwide application *(see Table 4.8).*

TABLE 4.8
NG EXPENDITURE PROGRAM
BY LEVEL, 2004-2005

PARTICULARS	Amount (In Billion)		Percent Share	
	2004	2005	2004	2005
Nationwide	151.5	142.8	17.5	15.7
Central Office	392.0	413.3	45.3	45.5
Regional	321.3	351.5	37.2	38.7
TOTAL	**864.8**	**907.6**	**100.0**	**100.0**

Source of basic data: 2005 BESF (DBM)

In absolute terms, the top five budget recipients for 2005 are Region IV (P44.4 billion), NCR (P36.3 billion), Region VI (P30.9 billion), Region III (P30.5 billion), and Region I (P22.7 billion). On the other hand, CAR (P10.0 billion), ARMM (P10.5 billion), and CARAGA (P10.9 billion) are among those who will receive the lowest allotment.

On per capita basis, however, CAR (P7,280) and CARAGA (P6,493) will receive the highest allocation along with Region VIII (P5,439) and Region II (P5,111). Even though NCR and neighboring Regions III and IV are among the top recipients of the 2005 budget, population in these areas are much higher which in effect brought their per capita allocation to one of the lowest *(see Table 4.9).*

TABLE 4.9
EXPENDITURE LEVEL
BY REGIONAL PER CAPITA ALLOCATION

REGION	2004			2005		
	Amount	Per Capita		Amount	Per Capita	
	PB	Level	Rank	PB	Level	Rank
NCR	35.5	3,260	14	36.3	3,255	15
Region I	19.8	4,397	6	22.7	4,923	5
CAR	10.0	6,830	1	10.9	7,280	1
Region II	14.9	4,908	2	15.9	5,111	4
Region III	28.0	3,000	15	30.5	3,183	16
Region IV	39.6	2,983	16	44.4	3,270	14
Region V	20.6	4,085	9	22.4	4,354	10
Region VI	27.5	4,173	7	30.9	4,594	8
Region VII	20.4	3,271	13	22.7	3,564	13
Region VIII	18.4	4,750	5	21.5	5,439	3
Region IX	15.0	4,786	4	15.2	4,725	6
Region X	14.7	3,794	11	17.4	4,377	9
Region XI	16.1	3,943	10	16.1	3,867	12
Region XII	14.6	4,105	8	15.2	4,152	11
CARAGA	10.9	4,836	3	14.9	6,493	2
ARMM	10.5	3,398	12	14.5	4,562	7

Source: DBM

ALLOCATION BY DEPARTMENT AND SPECIAL PURPOSE FUNDS

Tables 4.10 and 4.11 present the expenditure program for 2005 by department and by Special Purpose Fund (SPF). Unlike allocations to departments which are supported by programs/projects already identified in an Agency Budget Matrix (ABM), SPFs are usually lump-sum appropriations whereby projects or expense type will still need to be identified before any release of allotment is made by the DBM *(e.g., PDAF).* In some cases, the SPFs are set aside in anticipation of future expenditures, such as, in cases of calamity and payment of pensions/gratuity.

Allocation by Department. On the aggregate, a total of P389.9 billion will go to the different government agencies. This amount represents a minimal increase of 1.2% over the 2004 budget. Topping the list of budget recipients are DepEd including School Building Fund (P112.0 billion), DPWH (P49.5 billion), DND (P46.2 billion), DILG (P43.9 billion), SUCs (P16.9 billion), DAR (P14.8 billion), DA including AFMA (P14.3 billion), DOH (P10.3 billion), DOTC (P8 billion), and the Judiciary (P8 billion).

TABLE 4.10
NG EXPENDITURE PROGRAM BY DEPARTMENT
(IN BILLION PESOS)

PARTICULARS	2004	2005	Increase/Decrease	
			Amount	%
Department of Education a/	*109.5*	*112.0*	*2.5*	*2.3*
Department of Public Works and Highways	*47.2*	*49.5*	*2.3*	*4.8*
Department of National Defense	*45.5*	*46.2*	*0.6*	*1.4*
Department of Interior and Local Government	*43.6*	*43.9*	*0.3*	*0.7*
State Universities and Colleges	*16.7*	*16.9*	*0.2*	*1.1*
Department of Agrarian Reform	*14.8*	*14.7*	*(0.0)*	*(0.1)*
Department of Agriculture b/	*13.3*	*14.3*	*1.0*	*7.8*
Department of Health	*10.4*	*10.3*	*(0.1)*	*(1.0)*
Department of Transportation & Communications	*10.4*	*8.0*	*(2.3)*	*(22.3)*
The Judiciary	*7.6*	*8.0*	*0.4*	*5.1*
Autonomous Regions	5.5	7.1	1.6	29.2
Department of Finance	6.5	6.8	0.3	4.4
Other Executive Offices	4.7	6.3	1.6	32.9
Department of Environment & Natural Resources	5.5	5.9	0.4	7.3
Department of Foreign Affairs	4.5	5.1	0.5	11.8
Department of Justice	4.7	5.1	0.4	8.0
Congress of the Philippines	4.7	4.7	(0.0)	(0.5)
Department of Labor and Employment	4.4	4.5	0.1	1.2
Commission on Audit	4.0	4.0	0.0	0.0
Department of Science and Technology	2.6	2.5	(0.1)	(2.1)
Office of the President	2.6	2.4	(0.2)	(8.2)
Department of Social Welfare and Development	2.4	2.3	(0.0)	(1.3)
Department of Trade and Industry	1.9	2.0	0.2	9.0
Commission on Elections	6.4	1.4	(5.0)	(78.1)
National Economic and Development Authority	1.4	1.3	(0.1)	(5.2)
Department of Tourism	1.0	1.1	0.1	13.4
Department of Energy	1.3	1.0	(0.3)	(25.4)
Office of the Press Secretary	0.8	0.9	0.1	7.6
Office of the Ombudsman	0.5	0.5	0.1	11.0
Civil Service Commission	0.5	0.5	0.0	0.6
Department of Budget and Management	0.4	0.4	0.0	1.7
Commission on Human Rights	0.2	0.2	0.0	0.3
Office of the Vice-President	0.1	0.1	0.0	4.5
Joint-Legislative-Executive Offices	0.0	0.0	0.0	7.7
Departments	**385.4**	**389.9**	**4.5**	**1.2**
Special Purpose Funds	**476.2**	**517.7**	**41.5**	**8.7**
GRAND TOTAL	**861.6**	**907.6**	**46.0**	**5.3**

a/ Includes DepEd-School Building Program
b/ Includes AFMA

TABLE 4.11
NG EXPENDITURE PROGRAM BY SPECIAL PURPOSE FUND
(IN BILLION PESOS)

PARTICULARS	2004	2005	Increase/Decrease	
			Amount	%
Budgetary Support to GOCCs *b/*	11.4	12.5	1.1	10.0
Allocations to Local Government Units	145.4	155.9	10.5	7.2
Calamity Fund	0.7	0.7	-	-
Contingent Fund	0.8	0.8	-	-
E-Government Fund	-	1.0	1.0	
International Commitments Fund	0.8	1.8	1.0	132.0
Miscellaneous Personnel Benefits Fund	4.2	2.5	(1.7)	(40.5)
National Unification Fund	0.1	0.1	(0.0)	(35.4)
Priority Development Assistance Fund	8.3	6.1	(2.2)	(26.7)
Pension and Gratuity Fund	33.0	34.7	1.7	5.0
Debt Service -Interest Payment	271.5	301.7	30.2	11.1
TOTAL	**476.2**	**517.7**	**41.5**	**8.7**

b/ Includes AFMA

Special Purpose Funds. Total Special Purpose Funds for 2005 amounts to P517.7 billion, of which a sizeable portion (P301.7 billion) will go to Interest Payment. LGUs will receive a total allocation of about P155.9 billion while the Pension and Gratuity Fund will get P34.7 billion. A total of P12.5 billion is set aside as Budgetary Support to GOCCs (BSGC) either as government equity, subsidy or net lending. Out of this total, only 39% or P4.9 billion have been identified to go to specific GOCCs. The budget document indicates that recipient-GOCCs of the remaining P7.6 billion will only be determined during the implementation of the budget in 2005.

What is missing in the BSGC is the financial support to the National Power Corporation (NPC). This is because under the Electric Power Industry Reform Act (EPIRA), the national government automatically assumes P200 billion of NPC debts. Reportedly, servicing of NPC debts for fiscal year 2005 alone will cost the government P30.8 billion. But since this amount has not been included in the budget submitted to Congress, it is unlikely that the deficit will be contained at P184.5 billion as programmed. This implies that fiscal consolidation (balanced budget) may have to be further postponed beyond 2010.

Revolving Funds. Under special laws and provisions in the Appropriations Act, some agencies are authorized to earmark certain incomes and set up revolving funds. To some extent, this has been the reason why some agencies have increased their budget allocation relative to other departments. Recent efforts by the DBM to include earmarked revenues as part of the agency budget is a move in the right direction.

Earmarked revenues in 2005 are estimated at P26.2 billion from where disbursements amounting to P23.6 billion will be charged. However, the list of earmarked revenues submitted to Congress only includes agencies in the executive branch and not the Judicial Development Fund (JDF). All collections accruing to the JDF are directly deposited to the Land Bank of the Philippines (LBP) and not to the Treasury, thus, making it difficult to properly account the incomes *(e.g. from sale of publications, sheriff's commission, and confiscated bonds)* of the Judiciary. This also deprives the executive and Congress to appropriately consider such incomes when determining how much more should be given to the Judiciary.

Presidential Decree No. 1949 (18 July 1984) created the JDF and specifically provides that 80% should be used to augment the allowances of members/staff of the Judiciary and the remaining 20% to finance the acquisition, maintenance and repair of office equipment/facilities. According to COA, the JDF amounted to P1.5 billion in 2001 and P1.3 billion in 2002.

CASH VS. OBLIGATION BUDGET

The proposed budget of P907.6 billion is reckoned on obligation basis—it accounts only for the current year's expenditure requirements. However, the deficit is determined on cash basis which reports expenses as they are paid regardless of the year when the obligation was incurred. Total cash disbursement for 2005 is estimated at P943 billion, of which P894 billion represents current expenditures and P49 billion as payment for past transactions or obligations *(accounts payable).*

Accounts payable has become an increasing burden of the National Government. According to the DBM, government obligations have remained outstanding for longer period—the aging of accounts payable has lengthened from three to four months. An impression that government is unable to settle its accounts on schedule could encourage contractors and suppliers to factor into their bid price any cost due to delay in payments, therefore, increasing the cost of government purchases.

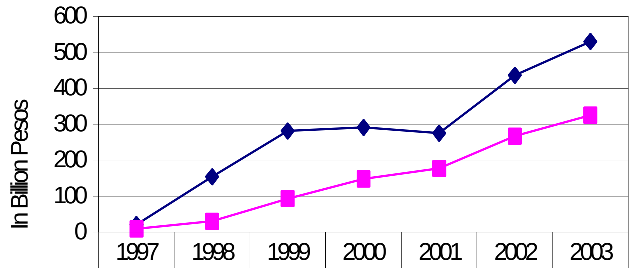
CHAPTER 5

DEFICIT FINANCING PROGRAM

The National Government (NG) will be in deficit for the eighth straight year in 2005, making the chronic fiscal gap one of the country's biggest challenges today. From fiscal surpluses during the mid 1990s, the national government is again in a fiscal bind as NG deficit persistently grew from 1.9% of GDP in 1998 (P50 billion) to 5.3% in 2002 (P210.7 billion) and 4.6% in 2003 (P199.9 billion). For 2004 and 2005, the budget deficit is estimated to be about 4.3% of GDP (P197.8 billion) and 3.6% of GDP (P184.5 billion), respectively *(see Figure 5.1).*

The large budget gap is caused by annual cash disbursements of at least 19% of GDP that has not been matched with adequate revenue collections. From close to 20% of GDP in 1994, revenue effort slid down consistently to as low as 14.1% in 2002. It slightly went up to 14.4% last year and is expected to remain the same (14.4%) for 2004. Revenue effort is estimated to slightly decline in 2005 at 14.3%.

FIGURE 5.1
NG FISCAL PERFORMANCE, 1990-2003
(PERCENT OF GDP)



	1997	1998	1999	2000	2001	2002	2003
Actual	20.6	153.6	280.8	290.8	274.8	436.3	530.4
Program	9.2	29.8	93.2	147.6	177.3	267.4	324.9

Source: BESF, DBM

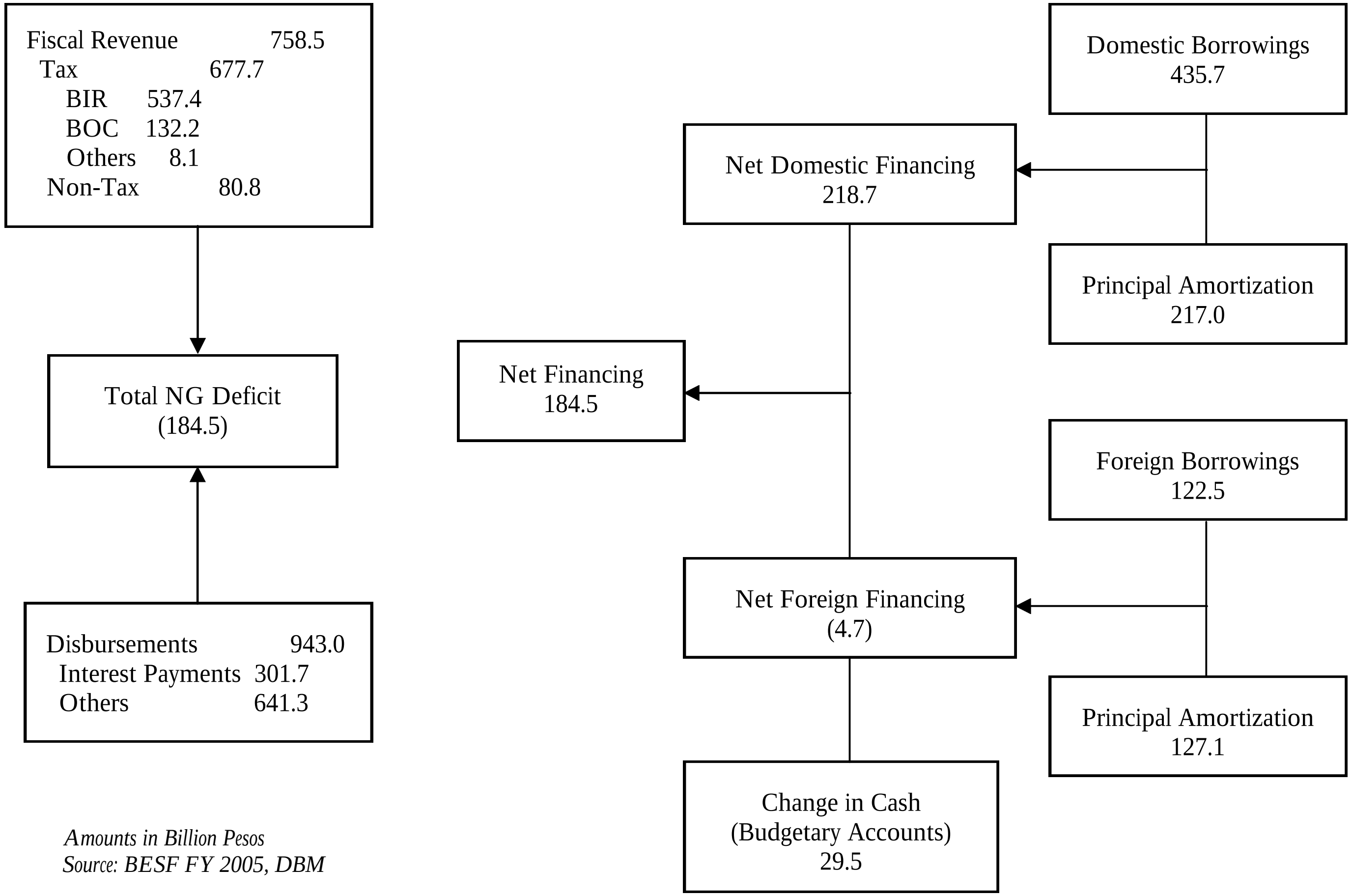
DEFICIT FINANCING

2005 Borrowing Program. Total borrowing requirements for 2005 is P558.2 billion–gross domestic borrowings will amount to P435.7 billion while gross foreign borrowings is P122.5 billion *(see Figure 5.2).* About 66% of total borrowing or P344.1 billion will be used to pay for principal amortization – P217 billion for domestic debts and P127.1 billion for foreign loans. Of the remaining P214 billion, P184.5 billion will be used to finance the deficit and P29.5 billion will be used partly to increase the government's cash account and also to augment the financial requirements of the Central Bank-Board of Liquidators (CB-BOL).

The CB-BOL is tasked to manage the accounts that were transferred from the old Central Bank to NG in relation to the creation of the new Bangko Sentral ng Pilipinas (BSP). For 2005, CB-BOL is projected to generate revenues of P4.7 billion but at the same time pay interest expenses amounting to P23.1 billion - resulting to a deficit of P18.4 billion. In addition, CB-BOL will also borrow from NG P6.5 billion as payment of its principal loans. All in all, the cost of CB Restructuring for 2005 is P24.9 billion.

Sources of Financing. For budget year 2005, the government will source its domestic borrowings through short-term Treasury Bills amounting to P189.7 billion (43.5%) and long-term Fixed Rate Treasury Bonds amounting to P246 billion (56.5%). This is in contrast to the 2004 borrowing mix where Treasury Bills were the more dominant debt instrument used.

FIGURE 5.2
NG DEFICIT AND FINANCING PROGRAM, FY 2005



Amounts in Billion Pesos
Source: BESF FY 2005, DBM

TABLE 5.1
BORROWING MIX, 2003-2005

PARTICULARS	Levels (Billion Pesos)			% Distribution		
	2003	2004	2005	2003	2004	2005
Gross Domestic Borrowings	**290.3**	**430.9**	**435.7**	**100.0**	**100.0**	**100.0**
Treasury Bills	94.7	225.4	189.7	32.6	52.3	43.5
Fixed Term Deposits	1.5	-	-	0.5	-	-
Dollar Linked Phil. Peso Notes	5.0	-	-	1.7	-	-
Retail Treasury Bonds	105.4	-	-	36.3	-	-
Fixed Rate Promisory Notes	14.0	-	-	4.8	-	-
Fixed Rate Treasury Bonds	69.7	205.5	246.0	24.0	47.7	56.5
Gross Foreign Financing	**240.2**	**107.4**	**122.5**	**100.0**	**100.0**	**100.0**
Project Loans	38.0	24.8	30.1	15.8	23.1	24.5
Program Loans	20.2	4.2	8.4	8.4	3.9	6.9
Global Bonds	182.0	78.4	84.0	75.8	73.0	68.6

Source: BESF, DBM

The shift in the mix is part of the government's strategy to lengthen debt maturity. But while this may be desirable to prevent a costly refinancing cycle, it raises the issue of whether the government is using borrowed funds to improve productivity. A good indicator would be the composition of government spending - whether more resources was poured into investments rather than in current consumption and interest payments. Unfortunately, the proposed budget allocation is taking the opposite direction *(see Table 5.1).*

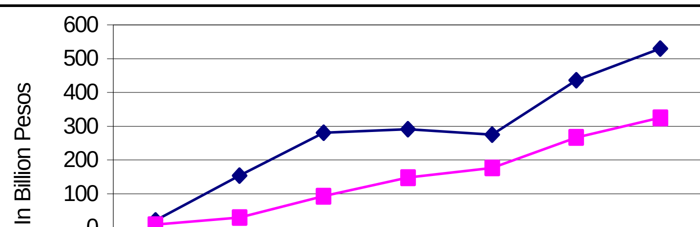
In the case of foreign borrowings, it was noted that Global Bonds or RoPs have become the major borrowing source since 1998—an alarming development in the NG debt structure. During the early 1990s, RoPs are practically non-existent but by 1999, it ballooned to 62.1% of that year's borrowings abroad. In 2003, three-fourths of gross foreign liabilities or P182 billion are in the form of Global Bonds.

Under the proposed financing program, Global Bonds will amount to P84 billion or 68.6% of total foreign financing while Project and Program loans will equal to 31.4% or P38.5 billion. Project Loans are obtained to finance specific projects. Program loans pertain to multi-purpose loans that are conditioned on basic changes in economic, monetary or fiscal policies, among others. Both Program and Project loans are concessional in nature *(i.e. Official Development Assistance).*

In contrast, Global bonds are commercial loans that fetch higher interest rate and are more vulnerable to foreign exchange shocks. They are also subject to "event risk" such that any unfavorable economic or political news may create negative perception on the country's credit-worthiness and/or payment potential. As of July 2004, Philippine bond spread over US Treasury Notes is already 448 basis points – the highest spread among ASEAN countries (Thailand at 97bps; Malaysia at 103bps; and Indonesia at 355bps). However, given the mounting pressure to augment the resources of financially distressed government corporations (*i.e. NG advances to GOCCs*), NG has to issue more RoPs on top of what is needed to cover its fiscal deficit.

Assessment of Prior Years' Borrowing Programs. From 1997 onwards, the government borrowed more than what has been programmed for each year. In 1999, for instance, NG borrowed a total of P280.8 billion or 200% more than its proposed financing requirement of P93.2 billion. And even during a surplus year *(1997)*, the government still borrowed in excess of the program *(see Figure 5.3)*.

FIGURE 5.3
NG GROSS BORROWING, 1997-2003



	1997	1998	1999	2000	2001	2002	2003
Actual	20.6	153.6	280.8	290.8	274.8	436.3	530.4
Program	9.2	29.8	93.2	147.6	177.3	267.4	324.9

Source: BESF, DBM

Deviation between program and actual borrowing may be explained by four factors: (a) larger-than-programmed deficit; (b) higher principal amortization; (c) higher-than-programmed CB-BOL financial requirements; and (d) NG advances to GOCCs. In 2001, for example, programmed borrowing was at P177.3 billion but what was actually sourced during the year was P274.8 billion–or P97.5 billion higher *(see Table 5.2)*. NG deficit for the year was estimated at P85 billion but the government ended up with a P147 billion deficit instead—or a

TABLE 5.2
DECOMPOSITION OF PROGRAM AND ACTUAL BORROWING, 2001-2003

PARTICULARS	2001		2002		2003	
	Program	Actual	Program	Actual	Program	Actual
Gross Financing	177.3	274.8	267.4	436.3	324.9	530.4
Less Amortization	85.0	99.6	155.6	172.1	188.2	243.6
Net Financing	92.3	175.2	111.8	264.2	136.7	286.8
Deficit	85.0	147.0	130.0	210.7	142.1	199.9
Change in Cash	**7.3**	**28.2**	**18.2**	**53.4**	**-5.5**	**86.9**

Source: BESF, various years

difference of P62 billion. Principal amortization was also higher by P14.6 billion, partly due to the depreciation of the peso (from P42:US$1 as projected to P51:US$1) and also because of additional short-term borrowings that have to be rolled-over during the same year.

Difference in change in cash of P20.9 billion can be attributed to higher CB-BOL financing requirement of P33.0 billion, from a program of P28.4 billion. On the other hand, total advances granted to *GOCCs (i.e. NG borrowings that were relent to GOCCs and advances to guaranteed loans)* during the year was P13.2 billion.

The same explanation applies for 2002 and 2003 except that Change in Cash was initially projected to decline *(i.e. withdrawal from available cash in Treasury)* by P18.2 billion in 2002 and P5.5 billion in 2003. As it turned out, funding deficiency was not taken out of the Cash account as planned. Instead, additional borrowings were made to build up the Cash account further – at least on paper.

Reportedly, the additional cash was used to prop NPC. Note that beginning 2001, NG collected interest income from NPC bonds *(P3.8 billion in 2001, P6.5 billion in 2002 and P11.5 billion in 2003 or a total of P21.8 billion).* This implies that the cash-strapped NG needed to invest in NPC because it will be more costly for the power corporation to borrow from the market given its dire financial state. Aside from investments in NPC bonds, NG also extends advances to the same government corporation. From 2001-2003, net lending to NPC *(i.e. advances less repayments)* amounted to P5.9 billion.

OUTCOMES OF DEFICIT FINANCING

Huge Debt Service Burden. Debt service expenditures *(interest payment and principal amortization)* have been on the rise since 1986. Total debt service in 2003 was reported at P470.0 billion or about 11.0% of GDP. Under the proposed budget, debt service will be equivalent to 12.6% of GDP or P645.8 billion—P301.7 billion for interest payments and P344.1 billion for principal amortization *(see Table 5.3).*

For every P1 cash disbursements in 2005, almost one-third (P0.32) will be spent for interest payments. And for every P1 revenue collected, P0.41 will be allotted for interest on loans. A huge debt service burden, constricts what government can do with an already tight government budget.

TABLE 5.3
DEBT SERVICE RATIOS
(IN BILLION PESOS)

PARTICULARS	2003	2004	2005
Outstanding Debt	**3,351.1**	**3,689.9**	**3,960.5**
% of GDP	78%	79.4%	77.3%
Debt Service	**470.0**	**575.6**	**645.8**
% of GDP	10.9%	12.4%	12.6%
Interest Payments	**226.4**	**265.8**	**301.7**
% of GDP	5.3%	5.7%	5.9%
% of Cash Disbursements	27.4%	30.4%	32.0%
% of Revenues	36.1%	39.3%	41.3%
Principal Amortization	**243.6**	**309.8**	**344.1**
% of GDP	5.7%	6.7%	6.7%

Source: Department of Finance

Stockpiling of Debts. From only P395.5 billion in 1986, NG debt rose to P870.8 billion in 1992 and breached the trillion mark (P1.1 trillion) in 1993. After seven years, it reached P2.2 trillion. By the end of 2003, outstanding debt of the national government ballooned to P3.4 trillion. NG debt increases by an average of 18% for the past five years.

More than half (50.8%) of NG outstanding debt as of December 2003 is due to local creditors while the remaining 49.2% is due to external lenders. Of the total domestic debt, about 30% is short-term, 44% is medium-term and the remaining 26% is long-term. Foreign debts are predominantly (at 92%) long term liabilities. The average maturity of National Government outstanding debt is 19 years.

Accounting for the change in debt stock of around P2.0 trillion from 1997 to 2003, de Dios et.al [2004] observed that 42.6% of the increment is due to NG deficit financing *(see Table 5.4).* Another reason for increase in debt is the depreciation of the peso because a large portion of NG debts are foreign-currency denominated. But what is rather disturbing is that liabilities of other public sector components (*e.g. non-budgetary accounts, assumed liabilities, lending to GOCCs*) are now part of NG outstanding debts. This raises the issue of whether NG should continue its policy of providing automatic guarantee to GOCCs, and sends strong warning on proper treatment of contingent liabilities.

TABLE 5.4
ACCOUNTING FOR THE INCREASE IN DEBT 1997-2003

PARTICULARS	Amount (PB)	Percent Distribution
Increase in NG debt	2,009.42	100.0
Due to NG deficit	855.69	42.6
Due to exchange-rate change	377.54	18.8
Due to non-budgetary accounts	320.55	16.0
Due to assumed liabilities and lending to corporations	428.10	21.2
Increase in Cash	27.54	1.4

Source: UP School of Economics

Contingent liabilities are indebtedness of GOCCs, GFIs, LGUs, and private proponents of infrastructure or other government projects that are guaranteed by the NG. This guarantee is a commitment on the part of the guarantor (NG) to assume the debts of the borrower-institutions if and when they become financially incapacitated to pay their loans.

Before the close of the 1980s, contingent liabilities amounted to less than P100 billion only. In 1998, the national government started to take in more and more contingent debts that by December 2003, NG has a risk exposure of close to P705 billion. As of June 2004, outstanding guaranteed loans of NG stands at P760.1 billion—about 96% of which are foreign loans and the remaining 4% are from domestic sources *(see Table 5.5).* This explains the change in composition of debt from project loans to RoPs, as mentioned earlier.

But the NG contingent liabilities being monitored by the BTr is only part of a bigger picture. Bernardo and Tang [2001] estimate that other risk exposure of the public sector could reach as high as P2.7 trillion: BOT Projects (P455.1 billion); Guarantee Institutions (P40.1 billion); Public Pension Institutions (P1,828.1 billion) and Deposit Insurance (P352 billion). These contingent liabilities can significantly add pressure to an already tight fiscal situation once they become real debts and are transferred to the account of NG.

FISCAL DEFICIT SUSTAINABILITY

As pointed out by the President, the immediate concern of the government is the fiscal problem. But aside from NG, other components of the public sector are also in the red, resulting to huge outstanding domestic and external debts. Thus, a major issue confronting the 2005 national budget, which points to another year of deficit spending and additional borrowing, is the sustainability of the fiscal deficit.

Public Sector Borrowing Requirement. The Consolidated Public Sector Financial Position, which shows the financial status of all the instrumentalities of the government, has been in deficit since 1997 and this has been increasing over the years. Total public sector deficit in 1997 was only P24.1 billion or a deficit-to-GDP ratio of less than one percent. As of year-end 2003, public sector deficit stood at P234.7 billion or about 5.5% of GDP.

For 2004, total public sector deficit-to-GDP ratio is expected to climb up to P307.8 billion or 6.6% as NG incurs a deficit of P197.8 billion which is equivalent to 4.2% of GDP. GOCCs will also register higher deficits amounting to P125.5 billion (2.7% of GDP) from P65.3 billion a year earlier *(see Table 5.6).*

TABLE 5.5
OUTSTANDING NG GUARANTEED/CONTINGENT LOANS
(AS OF JUNE 2004)

PARTICULARS	Amount (In million)	
	Dollars	Pesos
NG Direct Guarantee - Foreign	***12,743.58***	***716,204.60***
BCDA	11.81	663.49
CB-BOL	9.96	559.47
DBP	2,242.64	126,036.34
LBP	687.99	38,664.92
LRTA	172.05	9,668.93
LWUA	7 7.91	4,378.64
MIAA	8.20	460.69
MWSS	388.54	21,835.88
NEA	59.97	3,370.21
NFA	12.19	684.86
NPC	8,145.86	457,797.13
PDA	16.94	952.12
PEA	0.00	0.00
PEZA	2.58	145.02
PNOC	387.72	21,790.03
PNOC-EDC	225.31	12,662.25
PNR	35.88	2,016.29
PPA	77.43	4,351.34
PTA	12.48	701.37
SMBA	79.63	4,475.37
TIDCORP	88.79	4,990.25
GFI Guarantee Assumed	***243.99***	***13,712.24***
PNB	111.39	6,260.14
DBP	126.42	7,104.84
TIDCORP	3.23	181.73
NDC	2.95	165.53
NG Direct Guarantee- Domestic		***29,979.88***
Bonds		27,778.46
LBP		486.46
NDC		2,000.00
PAG-IBIG		4,000.00
HGC		7,000.00
TEXTER INVST CERT (LBPT)		1,740.00
NPC		12,552.00
Other Domestic (RPB)		2,201.41
GFI Guarantee Assumed		***183.43***
DBP		36.83
NDC		146.60
GRAND TOTAL		**760,080.14**

Source: Bureau of Treasury

TABLE 5.6
FINANCIAL POSITION OF 14 MONITORED GOCCS
(IN MILLION PESOS)

PARTICULARS	2004	2005
NPC, Transco, PSALM	(80,346.0)	(59,736.4)
National Food Authority	(10,640.7)	(13,525.3)
Light Rail Transit Authority	(9,016.2)	(6,995.8)
Home Guaranty Corporation	(6,122.3)	(1,446.5)
Philippine National Oil Company	(5,384.0)	(1,962.5)
Metropolitan Waterworks and Sewerage System	(5,297.0)	(966.0)
National Irrigation Administration	(2,824.4)	(3,696.0)
Philippine National Railways	(2,283.3)	(1,046.2)
National Housing Authority	(2,272.7)	(889.9)
Local Water Utilities Administration	(1,466.5)	(214.0)
Philippine Economic Zone Authority	(707.8)	399.6
Philippine Ports Authority	(377.6)	(276.2)
National Electrification Administration	679.0	211.0
National Development Company	551.4	(1,695.0)
TOTAL	**(125,508.1)**	**(91,839.2)**

Source: Department of Finance

Public Sector Borrowing Requirement (PSBR) for 2005 is projected at P285 billion or 5.6% of GDP—P51.4 billion lower than the 2004 PSBR estimate of P336.4 billion or 6.7% of GDP *(see Table 5.7).* This is premised on assumptions that NG deficit for 2005 will be contained at P184.5 billion and that monitored GOCC deficits will go down to P91.9 billion from P125.5 billion in 2004. A high PSBR coupled with a financing strategy of NG to rely more on domestic sources may eventually result in high interest rates, crowding out private sector investments.

To mitigate the rise in interest rate and avoid crowding out of private investments, the public sector can turn to foreign sources for its borrowing requirements. But external borrowing also has its drawbacks. When a government borrows from foreign sources, it exposes itself to risks associated with currency fluctuations. Whenever the domestic currency weakens against the currency of creditor countries, outstanding debt increases and debt servicing becomes more expensive. This also puts pressure on the country's international reserves since there would be greater demand for foreign currency by the government.

TABLE 5.7
CONSOLIDATED PUBLIC SECTOR DEFICIT
(IN BILLION PESOS)

PARTICULARS	2003 Actual	2004 Estimate	2005 Program
Public Sector Borrowing Requirement	(275.0)	(336.4)	(285.0)
% of GDP	(6.4)	(7.2)	(5.6)
National Government	(199.9)	(197.8)	(184.5)
CB Restructuring	(15.7)	(17.2)	(18.4)
Monitored GOCCs	(65.3)	(125.5)	(91.9)
Adjustment in Net Lending-GOCCs	5.8	4.1	9.8
Others	40.2	28.7	31.4
CPSD	(234.8)	(307.8)	(253.6)

Source: 2005 BESF (DBM)

The country's external debt as of end December 2003 is US$57.4 Billion or about 67.4% of Gross National Income *(see Table 5.8).* This huge debt level has lead to a high debt service burden (DSB), which has been steadily increasing over the years. From US$6.9 billion in 2000, DSB reached up to about US$8 billion in 2003. DSB for 2004 is expected to reach US$7.8 billion. Debt service-to-export ratio, which measures the country's capability to repay its external debt using earnings from exports of goods and services as benchmark, is also increasing. From only 12.4% in 2000, the ratio was at 17.2% in 2003. This is estimated to reach 19% in 2004 *(ADO 2004).*

The rising amount of export earnings going to debt service is unlike the experience of our ASEAN neighbors, particularly Indonesia, Malaysia and Thailand whose respective ratios have been on the decline. Thailand's debt service ratio decreased from 25.1% in 2001 to only 16% in 2003. Malaysia's ratio is almost constant at about 6% while Indonesia managed to improve its ratio to 26.5% in 2003 from 32.1% the year prior.

About 27.2% of the country's external debt can be financed by gross international reserves (GIR) [2002 figures]. As of August 2004, GIR is 2.2 times the country's short-term debt based on original maturity and 1.3 times based on residual maturity (outstanding short-term external debt based on original maturity plus principal payments of medium and long term loans of the public and private sectors falling within the next twelve months). BSP considers the GIR at a comfortable level. But the possibility of dipping into the GIR to refinance obligations denominated in foreign exchange is being raised due to differences in the projection of the country's dollar needs.

Peso depreciation, increase in LIBOR rate, or a downgrade of the country's sovereign credit rating can lead to a higher-than-projected dollar requirement in the coming year. If this would not be financed through external borrowing, the government will have no choice but to dip into its reserves to pay its obligations. A less than comfortable GIR level will make the economy vulnerable to currency speculation. Without the means to defend the currency, the peso may sharply depreciate thereby making debt service more expensive and more burdensome.

TABLE 5.8
EXTERNAL DEBT AND DEBT SERVICE BURDEN

PARTICULARS	2000	2001	2002	2003
External Debt (US Mn)	51,206	51,900	53,645	57,395
External Debt as % of GNI	72.6	76.5	71.4	67.4
Debt Service Burden (US Mn)	6,072	6,564	7,445	7,967
Debt Service Burden to XGS (%)	12.4	15.8	16.4	17.2
Debt Service Burden to CAR (%)	12.2	15.6	16.2	17.0

Note: GNI-gross national income; XGS-exports of goods and services; CAR-current account receipts

Debt-to-GDP Ratio. A sustainable deficit is also defined as one that leads to declining debt-to-GDP ratio. Public indebtedness is said to be unsustainable if the size of its debt grows unabatedly in relation to GDP. For a declining ratio to be realized, the government must eventually post a primary surplus that is a positive balance between government revenues and expenditures excluding interest payments. The primary surplus ensures that current revenues cover at least part of the interest on current debt resulting in declining debt-to-GDP ratio.

As of end December 2003, public debt stands at P5.9 trillion or 137.5% of GDP—an increase of about P800 billion from its 2002 level *(see Table 5.9).* Public sector debt is composed of domestic and foreign liabilities incurred by NG, 14-monitored GOCCs, BSP, GFIs, Social Security Institutions (SSS, GSIS, and PHIC), and the old Central Bank.

TABLE 5.9
PUBLIC SECTOR DEBT
(IN BILLION PESOS)

PARTICULARS	1998	1999	2000	2001	2002	2003
National Government	1,421.1	1,692.5	2,166.7	2,384.9	2,815.5	3,241.6
Monitored GOCCs	643.9	930.9	1,118.7	1,139.9	1,370.1	1,573.9
Bangko Sentral	387.5	492.8	587.8	593.8	614.6	637.4
GFIs (DBP, LBP, Philexim)	396.8	475.2	534.9	301.4	387.6	374.0
Central Bank-BOL	102.2	74.9	81.8	73.9	67.1	60.5
SSIs (LBP,DBP,PHIC)	-	-	-	-	-	25.2
TOTAL	**2,951.5**	**3,663.3**	**4,397.2**	**4,411.4**	**5,162.7**	**5,912.8**
% of GDP	110.7	123.1	131.1	120.1	128.8	137.5

Source: Department of Finance

According to de Dios (et. al), a primary surplus of 2% to 5% is necessary to keep the current debt-to-GDP ratio constant. Last year, the NG registered a primary surplus of 0.6 % of GDP or P26.5 billion. Consequently, NG's outstanding debt-to-GDP ratio rose from 70.8% in 2002 to 78% in 2003. This year, the government hopes to post a primary surplus of about P68 billion or 1.5% of GDP. Thus, it is estimated that NG's outstanding debt-to-GDP ratio in 2004 would increase further to 79.4%, amounting to P3.7 trillion.

The government plans to arrest the rise in outstanding debt-to-GDP ratio starting 2005 to ensure sustainability of the fiscal deficit. To do this, the National Government targets to generate a primary surplus of P117.2 billion equivalent to 2.3% of GDP in 2005. Thus, even if NG's fiscal position remains in deficit and it continues to borrow to finance the deficit, its outstanding debt-to-GDP ratio may go down to 76.9%. However, this is contingent to meeting the other macroeconomic targets—i.e., GDP growth, inflation, interest rate and exchange rate *(see Chapter 2)*. It also presupposes that the National Government will not assume additional liabilities from GOCCs, GFIs and the rest of the other public sector beyond the amount proposed in the 2005 National Government budget.

PART 2

SECTORAL ALLOCATION AND GMA'S10-POINT AGENDA

CHAPTER 6

INFRASTRUCTURE

Infrastructure development is fundamental in the government's agenda of sustained growth and poverty alleviation. Studies have shown that the quality and quantity of infrastructure has a significant positive impact on long-term economic growth and a strong negative effect on income inequality[1]. Infrastructure development not only fosters a conducive investment climate and stronger private sector participation in the market, but also contributes to the attainment of the country's millennium development goals.

In the President's 10-Point Agenda, the following imperatives form part of the country's infrastructure development goals: (a) decongesting Metro Manila; (b) nautical highways to link the entire archipelago; (c) modernizing the country's digital infrastructure; (d) improving access to potable water; (e) improving access to electricity; and (f) developing Clark and Subic as services and logistics hub in the region. Infrastructure has been perennially cited as one of the

1 Based on the World Bank study on "The Effects of Infrastructure Development on Growth and Income Distribution" by Cesar Calderon and Luis Serven. The study noted that better infrastructure quality and quantity result in long-term per capita growth gains and decline in Gini coefficients.

major bottlenecks to rapid growth and development in the Philippines. The International Management Development (IMD) ranked the Philippines 59th, second from the bottom to Indonesia, in terms of infrastructure competitiveness in 2004. In various forms of infrastructure classified by IMD–i.e., basic infrastructure, science and technology, health and environment, the Philippines performed dismally poor as compared with neighboring countries in Asia.

TABLE 6.1
PHILIPPINE INFRASTRUCTURE COMPETITIVENESS RANKING, 2004

SUB-CATEGORY	Ranking
Basic Infrastructure	60
Technological Infrastructure	43
Science Infrastructure	58
Health	58
Environment	57

Source: International Management Development (IMD)

One of the major reasons which explain the deficiency of infrastructure in the Philippines, is the low public spending allotted for infrastructure development. Hence, the increasing dependence on private sector participation in financing, construction, operation, maintenance and rehabilitation of critical infrastructure projects in power, water, and transportation. However, private sector participation has been beset by a number of concerns—i.e., contract disputes, distorted regulation, political interference, low recovery rates of investments, barriers to entry, etc. Together with the peace and order situation in the country, these factors create negative perception and relatively high-risked business environment in the Philippines.

PUBLIC SECTOR INFRASTRUCTURE BUDGET

Public sector infrastructure budget[2] grew nominally by 10.6% in 2005 to P117.4 billion from P106.2 billion in 2004. In particular, infrastructure allocation under the GAA which is composed of the budgets for NG and LGUs, grew by 9.2% in 2005 to P88.7 billion after it declined by 10.3% in 2004 *(see Table 6.2).*

[2] *Defined as the total budget for infrastructure development allotted by the National Government, LGUs, and GOCCs.*

TABLE 6.2
PHILIPPINE INFRASTRUCTURE ALLOCATION
(IN BILLION PESOS)

PARTICULARS	2003	2004	2005
GAA Allocation for Infrastructure Development	90.5	81.2	88.7
National Government (NG)	60.7	51.4	56.5
Local Government Units	29.8	29.8	32.2
GOCCs	33.2	25.0	28.6
Public Sector Infrastructure Budget	123.7	106.2	117.4

Source: FY 2005 BESF, DBM

The National Government comprises almost half of the total public sector infrastructure spending averaging 48.6% for 2003-2005. Infrastructure improvement allotted to the local government through the Internal Revenue Allotment (IRA) and capital projects inched up by 8.3% to P32.2 billion in 2005 from P29.8 billion in 2004.

TABLE 6.3
PUBLIC SECTOR INFRASTRUCTURE BUDGET
(IN BILLION PESOS)

YEAR	Nominal	Growth Rate (%)	Real	Growth Rate (%)
2000	116.8	-	76.7	-
2001	125.9	7.7	77.9	1.5
2002	113.7	-9.7	68.3	-12.3
2003	123.7	8.9	72.2	5.7
2004	106.2	-14.2	59.0	-18.3
2005	117.4	10.6	62.1	5.3

Source of basic data: BESF, DBM

Public sector infrastructure budget *(in constant prices)* shows an erratic movement for the period 2000-2005. While it has been proposed that the public sector infrastructure budget for 2005 be increased by 5.3% to P62.1 billion from P59 billion in 2004, this is insufficient to offset the 18.3% decline in the period 2003-2004. At current (nominal) prices, public infrastructure spending requirements is set to increase by 10.6% in 2005, from P106.2 billion in 2004 to P117.4 billion *(see Table 6.3)*.

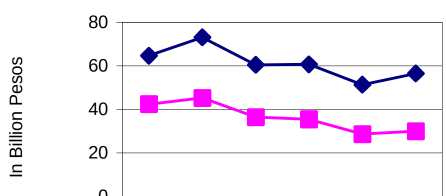
The National Government (NG) budget for basic infrastructure in both real and nominal terms has been on a downtrend since 2001. The annual decline in real NG infrastructure allocation averaged 6.1%. In real terms, NG infrastructure expenditure nose-dived from P45.5 billion in 2001 to P28.6 billion in 2004. It improved in 2005 by 4.7% to P29.9 billion from its level in 2004 *(see Figure 6.1)*. The nominal infrastructure budget under the GOCCs grew by 14.6% to P28.6 Billion in 2005 from P25 billion 2004. The gain in 2005 was nil compared to the decline in 2004 of 25% from the 2003 level of P33.2 billion.

Public infrastructure allocation at current prices, as ratios to current GDP, also exhibits a downward trend from 3.5% in 2000 to 2.3% in 2005. Over the period 2000-2005, public sector infrastructure budget to GDP averaged 2.9%. The 2004 and 2005 ratios are expected to be the lowest since 2000 *(see Figure 6.2)*.

BUDGETARY ALLOCATION BY INFRASTRUCTURE TYPE

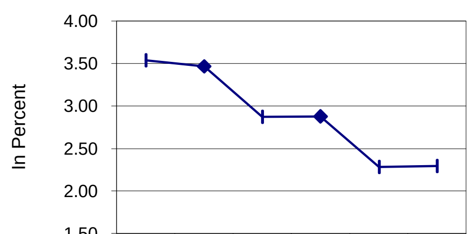
Although government has increasingly relied on the private sector for the financing and maintenance of major infrastructure projects such as those in the power, water and transportation sectors, it still plays a major role in the provision of basic infrastructure– e.g., water supply and missionary electrification. As itemized in the BESF Public Infrastructure Budget *(see Table 6.4)*, critical infrastructures were considered and analyzed as to the consistency of the proposed allocation with the national infrastructure development agenda of the government identified in the 10-Point Agenda.

FIGURE 6.1
NG ALLOCATION FOR INFRASTRUCTURE
NOMINAL VS. REAL



	2000	2001	2002	2003	2004	2005
Nominal	64.7	73.1	60.5	60.7	51.4	56.5
Real	42.5	45.2	36.4	35.4	28.6	29.9

FIGURE 6.2
PUBLIC SECTOR INFRA
BUDGET



	2000	2001	2002	2003	2004	2005
Nominal	3.54	3.47	2.87	2.88	2.28	2.29

Source of basic data: BESF (DBM)

TABLE 6.4
ITEMIZED PUBLIC SECTOR INFRASTRUCTURE BUDGET
(IN MILLION PESOS)

PARTICULARS	2003	2004	2005
National Government	**60,727.1**	**51,439.4**	**56,548.0**
Roads and Bridges	21,443.3	17,926.7	29,362.1
Flood Control/Seawalls	5,883.3	11,048.6	8,297.3
Land Transportation	333.8	388.1	450.1
Ports and Lighthouses	368.1	278.4	84.5
Water Supply	20.0	20.0	15.0
Others[1]	19,418.3	11,990.8	4,478.2
GOCCs	**33,267.5**	**24,985.6**	**28,624.1**
Light Rail Transit	11,889.4	7,137.7	7,429.5
Rural Electrification	70.9	312.6	509.0
BCDA[2]	1,658.0	6,323.0	10,132.0
Housing and Community Development	3,820.1	1,162.6	1,228.0
Local Government Units	**29,750.2**	**29,750.2**	**32,231.8**
Internal Revenue Allotment	28,200.0	28,200.0	30,324.6
Special Share of LGUs–Capital Projects	1,550.2	1,550.2	1,907.2
TOTAL	**123,744.7**	**106,175.0**	**117,403.8**

[1] *This is composed of unidentified items under DPWH, DOTC, ARMM, Agrarian Reform Fund, Municipal Development Fund, and Pasig River Rehabilitation Commission*
[2] *Bases Conversion Development Authority*
Source: BESF (DBM)

Roads and Bridges. Expanding the country's paved road and bridge networks is essential in achieving the government's overall plan to broaden opportunities for growth especially in areas outside of Metro Manila. This will open prospects for new business centers and development areas, which can potentially minimize congestion problems in the National Capital Region (NCR). Apparently, there is still a huge backlog in the country's infrastructure specifically with regards to roads and bridges. The Department of Public Works and Highways (DPWH) data as of August 2004, shows that 29.6% of the country's total national roads of 28,266 km. are still unpaved [3] *(see Table 6.5).*

[3] *Based on the DPWH data, paved roads as a percentage to total roads is derived by dividing number of roads (kilometers) made of concrete and asphalt with the total number of roads. Unpaved roads are made of earth and gravel. This does not include the 444 km. national road in ARMM.*

TABLE 6.5
PAVED/UNPAVED ROADS
AS PERCENT TO TOTAL ROADS*

REGION	Paved Roads/ Total Roads[1] (%)	Unpaved Roads/ Total Roads[2] (%)
Philippines	**70.4**	**29.6**
NCR	99.9	0.1
CAR	33.5	66.5
Region I	87.6	12.4
Region II	71.5	28.5
Region III	84.1	15.9
Region IV-A	87.0	13.0
Region IV-B	48.1	51.9
Region V	69.9	30.1
Region VI	72.4	27.6
Region VII	82.6	17.4
Region VIII	77.4	22.6
Region IX	56.5	43.5
Region X	69.6	30.4
Region XI	58.3	41.7
Region XII	66.1	33.9
Region XIII	48.2	51.8

** CBPD Generated Data from information accessed at DPWH website*
[1] Paved roads are those roads made of concrete and asphalt as a percentage of total road length of 28,266
[2] Unpaved roads are those roads made only of gravel and earth as percentage of total road length

Roads and Bridges account for 25% or P29.4 billion - the largest share in the whole public sector infrastructure budget of P117.4 billion. This is an improvement of 63.8% from the 2004 allocation of P17.9 billion. On the other hand, the same item under the DPWH allocation, accounts for more than half or about 51.9% of the NG infrastructure budget.

Rail Transportation[4]. Improving the mass transport system is essential in addressing traffic congestion problems in Metro Manila and directing people and cargo to distant areas through fast and cost-effective means. For 2005, the budget allotted for rail transport improvement under the Light Rail Transit Authority (LRTA) increased by 4.1% to P7.4 billion from P7.1

[4] Budget for improving the country's rail transportation will only consider that of the LRTA, not including the Philippine National Railways (PNR) budget considering that government budgetary support for the PNR–worth P135 Million, is limited to MOOE-related expenditures.

billion in 2004. Majority of this budget will come from the corporate funds of LRTA as well as corporate borrowings. Nonetheless, government funds are still necessary to finance projects critical to rail transport improvement. For one, out of the Department of Transportation and Communication (DOTC) budget for locally funded projects of P343.7 million, P303.9 million will be allotted to support LRTA project for Line 2 expansion, specifically to finance right of way (ROW) acquisitions, civil works and systems including consulting services.[5]

Water Supply. Waterless areas are those with less than 50% access to safe water. Data from the Department of Health (DOH) showed that as of 2002, 16.9% of the total Philippine households have no access to safe water supply. Moreover, data from the DPWH showed that there are 433 waterless municipalities nationwide. Similar data revealed that the eight (8) of the top ten (10) waterless municipalities in the country belong to the Autonomous Region of Muslim Mindanao (ARMM). As declared in the draft MTPDP (2004-2010), the government aims to provide potable water for the entire country by 2010 with a priority given to at least 200 waterless barangays for Metro Manila, and 200 municipalities outside Metro Manila.

TABLE 6.6
TOP 10 MUNICIPALITIES WITHOUT ACCESS TO SAFE WATER

RANK	Municipality	Total HH	HH with Access	Proportion of HH w/o access to water	Province	Region
1	Tubaran	1,680	8	0.48%	Lanao Sur	ARMM
2	Turtle Islands	648	6	0.93%	Tawi-tawi	ARMM
3	Pangutaran	4,643	44	0.95%	Sulu	ARMM
4	Tandubas	3,395	39	0.99%	Tawi-tawi	ARMM
5	Quezon	2,958	34	1.15%	Quezon	Region IV
6	Maguing	2,734	41	1.50%	Lanao Sur	ARMM
7	South Ubian	4,748	73	1.54%	Tawi-tawi	ARMM
8	Simunul	4,910	107	2.18%	Tawi-tawi	ARMM
9	Magsaysay	2,289	61	2.69%	Palawan	Region IV
10	Taraka	2,548	79	3.10%	Lanao Sur	ARMM

a/ Ranking is according to least access to safe water.
Source: DPWH

[5] *Based on an interview with the Department of Budget and Management. Also indicated in the Special Provision No. 1 in the DOTC budget as provided in the 2005 National Expenditure Program.*

TABLE 6.7
STATUS OF ENERGIZATION
(AS OF 31 AUGUST 2004)

PARTICULARS	Barangays*		
	Potential	Energized	(%)
Philippines	**35,980**	**32,496**	**90**
Luzon	**15,486**	**3,012**	**96**
Ilocos Region	3,027	2,231	99
Cagayan Valley	2,372	2,212	94
CAR	1,099	1,934	96
Central Luzon	2,240	1,257	99
CALABARZON	1,939	3,177	99
MMROPA	1,414	1,257	89
Bicol Region	3,395	3,177	94
Visayas	**10,957**	**9,925**	**91**
Western Visayas	3,870	3,584	93
Central Visayas	2,713	2,628	97
Eastern Visayas	4,374	3,713	85
Mindanao	**9,357**	**7,697**	**81**
Zamboanga Peninsula	1,869	1,414	76
Northern Mindanao	1,833	1,659	91
Davao Region	894	826	92
SOCSARGEN	1,024	865	84
ARMM	2,609	1,707	65
CARAGA	1,308	1,226	94

** Barangays served only by electric cooperatives*
Source: National Electrification Authority

Total proposed 2005 budget for water supply improvement under the Local Government Empowerment Fund (LGEF) amounts to P15 million[6]—i.e., 25% lower than the 2004 level of P20 million. This is a counterpart fund for an Asian Development Bank (ADB) loan allotted for a rural water supply, sewerage and sanitation project of the DPWH targeted to serve the poverty-stricken areas. Nonetheless, initiatives to improve access to potable water supply especially in impoverished areas will come from the coordinated efforts of the MWSS, LWUA, DPWH, National Anti-Poverty Commission (NAPC), Department of Interior and Local Government (DILG), various water districts and the private sector.

Rural Electrification. As provided in the Electric Power Industry Reform Act (EPIRA), it is imperative to speed up the rural electrification program of the government with the support from the private sector. Out of 35,980 barangays covered for energization, about 90% or 32,496 barangays have been energized as of August 2004 *(see Table 6.7).*

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[6] *The 2005 proposed budget does include funding for the Local Water Utilities Authority (LWUA) and the Metropolitan Waterworks and Sewerage System (MWSS).*

The government will allot P509 million through the National Electrification Administration (NEA) to support its barangay electrification campaign, and its target to energize 638 barangays in 2005[7]. This translates to a modest increase of 62.8% from last year's rural electrification infrastructure budget of P312.6 million. Most of funds allotted for barangay electrification will be sourced from NEA's corporate funds and borrowings. However, government's infusion to NEA rural electrification drive (in the form of MOOE) declined by 42.2% to P260 million in 2005 from P450 million in 2004. The NEA may use these funds as a form of subsidy or loans outlay to electric cooperatives.

Ports and Airports. For 2005, public sector infrastructure budget for port development only includes locally funded projects of the Department of Transportation and Communication (DOTC), unlike the 2003 and 2004 budgets, which includes foreign assisted ports improvement projects. This explains the wide disparity between the budget for ports and lighthouses in 2003 and 2004, which are P368.1 million and P278.4 million, respectively, with the 2005 budget of only P84.5 million.

Meanwhile, airport and navigational facilities budget for 2005 is up by 73.1% to P1.3 million from P751.2 million in 2004. The budget for airport improvement only consist of a meager share of the overall public sector infrastructure budget of 1.1%, and 2.3% of the total NG infra budget. Specific airport projects (under the DOTC) vital to national infrastructure development are still under feasibility study. These include the Panglao Airport (Bohol), Northern Palawan Airport, Bagabag Airport (Nueva Ecija), Katiklan Airport (Aklan), and Siargao Airport which cost P2.5 million each.

E-Government Fund. The government's plan to modernize the country's digital infrastructure is aimed at making the delivery of frontline services more efficient and accessible. In the Global IT report of the World Economic Forum for 2003-2004, the country ranked 20th out of 69 countries surveyed in terms of the quality of government online. However, on a regional level, the country ranked 12th (out of 16 countries in Asia-Pacific) in the e-readiness ranking of "The Economist" in 2003 *(Philippine Star, 2 Feb '03).*

While various national government agencies (NGAs) have their own separate budget for computerization and ICT projects, the E-Government Fund was primarily established to finance e-government or ICT projects that are cross-agency in nature. The P1 Billion e-government fund in 2005 will be used to finance projects endorsed by the Commission on

[7] *Based in the Philippine Energy Plan (PEP) 2004-2013 on Rural Electrification Targets.*

Information and Communications Technology (CICT), previously done by the Information Technology and E-Commerce Council (ITECC). These projects are geared towards the interconnection of all government bodies and the use of electronic media in facilitating public transactions. The 2005 allocation is actually a milestone from the P4 Billion e-government budget in 2003 – which came from reserves and savings, because this time, it is a line item under the special purpose fund, which sets the tone of institutionalizing e-governance in the country.

As of October 21, 2004, the total cost of the 23 projects endorsed by the CICT is approximately P3.0 Billion. Specific projects endorsed among others include BIR and BOC computerization and modernization projects worth P1.8 Billion, and the Anti-Money Laundering ICT project worth P100 million. However, the special fund has not penetrated the grass roots level of e-government – referring to the many municipalities that have failed to take advantage of the e-government fund. This is on account that none of the country's LGUs has created websites with solid transactional features.

According to the standards set by the United Nations and the American Society for Public Administration Stages for E-Government (UN-ASPA), majority of these LGU websites are classified under Stage 1, functioning only as a public information source which is usually a static page containing contacts, statistical information, and answers to the frequently asked questions (FQAs).

Bases Conversion and Development Authority (BCDA). Budgetary allocation for the development of Clark and Subic under the BCDA grew strongly by 60.2% in 2005 to P10.1 Billion from P6.3 Billion in 2004. This comprises 8.6% of the overall public sector infrastructure budget. Unlike the period 2003-2004, the NG will infuse almost P2 Billion in the form of tax subsidy to the BCDA in 2005.

CHAPTER 7

AGRICULTURE

Agriculture in GMA's 10-Point Agenda

One of the 10-Point Agenda of President Macapagal-Arroyo is to create six to ten million jobs in the next six years. The Medium-Term Philippine Development Plan (MTPDP) for 2004-2010 has broadly outlined the strategic directions that need to be taken in the agriculture sector to help achieve this goal. These are to make food plentiful at competitive prices, and to develop two million hectares for agribusiness to contribute three million to the ten million jobs targeted as legacy by 2010.

Agriculture plays a major role in the generation of incomes and employment in the countryside. It accounts for 20% of the Gross National Products (GNP) or one-fifth of the economy and employs one-third of the country's workforce.

Hence, it is critical to attain higher productivity growth in the sector. A highly productive agriculture sector ensures plentiful and affordable food, as well as competitive wages for the largely urban factory-based labor force. Likewise, it will help generate substantial employment linkages in the off-farm economy, thereby sustaining income growth in the rural areas.

AGRICULTURAL PERFORMANCE AND TRENDS

The performance of the agricultural sector is important in the country's food security and poverty alleviation efforts. From 2001-2003 the country's agriculture sector performed relatively well as far as production targets is concerned *(see Table 7.1).*

TABLE 7.1
GVA IN AGRICULTURE, FISHERIES AND FORESTRY
(GROWTH IN PERCENT, AT 1985 PRICES)

COMMODITY	Average 2001-2003	
	Actual	Targets*
Major Crops	3.2	2.3
Other Crops	2.3	4.0
Livestock	3.5	4.2
Poultry	5.2	4.5
Fisheries	6.6	4.0
Forestry	(11.4)	-
GVA in Agriculture, Fishery and Forestry	3.8	-

**MTPDP 2001-2003*
Source: NEDA, 2004

However, the modest gains posted by the sector were not enough to improve its international competitive position. Philippine agriculture has one of the lowest annual growth rates in Gross-Value Added (GVA) and in exports relative to countries such as Malaysia, Indonesia, Thailand, and Vietnam (*see Figure 7.1 & 7.2*). In addition, the yields of primary crops such as rice and corn are far behind compared with other Asian countries *(see Table 7.2).*

FIGURE 7.1
GROSS VALUE ADDED FOR AGRICULTURE AVERAGE ANNUAL GROWTH, 1962-2000

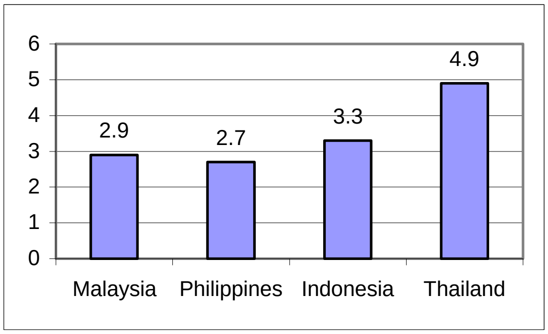
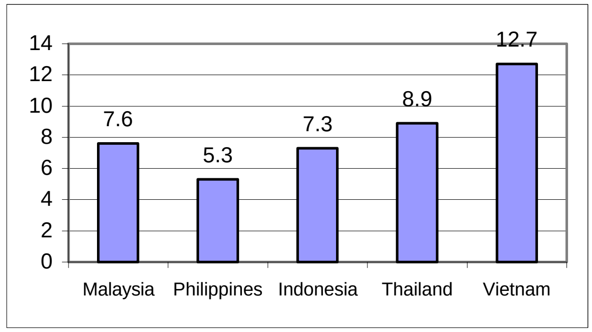


FIGURE 7.2
AVERAGE ANNUAL GROWTH IN AGRICULTURE EXPORTS, 1962-2000



Source: PIDS (2004)

Despite the government's consistent policy to fight for self-sufficiency in rice production, the rate of growth in the Philippines rice productivity lagged behind most Asian countries. Worse, the average annual growth (1990-2000) of rice production at 1.9% is much lower than the growth rate of population at an average of 2.3%. This means that to be competitive in the region and meet the rising domestic demand for food arising from the growth of population, the country needs to be comparatively more productive than the other countries or have a faster productivity growth in most areas in the agriculture sector.

Erratic growth in rice production combined with the rapid growth of population, explain why the country is losing its self-sufficiency in rice—to the extent that the country has now turned into a regular importer of rice *(Tolentino, 2004)*. In 2000-2001, rice imports as proportion of total rice supply has climbed to a high of 8%. In general, the large productivity deficit of the Philippines has already made the country a net importer of a wide range of agriculture products. The agricultural sector has ceased to be a net earner of foreign exchange, as agricultural imports rose from about 30% of agricultural exports in 1960's and 1970's to more than 150% by the late 1990's *(David, 2003)*.

Given its erratic and poor performance, the agriculture sector is not in the position to improve rural welfare. Poverty in the country continues to be a rural phenomenon with the rural sector accounting for four out five poor Filipino families. About 55.5% of household heads of poor families are in agriculture-related activities—e.g., animal husbandry and fisheries *(FIES, 1985-2000, NSO & Reyes, 2003)*. The large share of the agricultural sector in total poverty is mainly due to the high share of population dependent on this sector for livelihood.

TABLE 7.2
RICE AND CORN YIELDS, SELECTED ASIAN COUNTRIES
(IN MT PER HECTARE)

COUNTRY	Average Rice Yield 2000-2003	Rank	Average Corn Yield 2001-2003	Rank
Asia	4.0		3.8	
China	6.2	1	4.8	1
Vietnam	4.5	3	3.1	3
Indonesia	4.4	2	3.1	4
Myanmar	3.7	5	2.2	6
Sri Lanka	3.6	4	1.1	9
Bangladesh	3.4	6	2.0	7
Philippines	**3.2**	**8**	**1.8**	**8**
Malaysia	3.1	7	3.0	5
Thailand	2.5	9	3.7	2

Source: Food and Agriculture Organization (FAO)

BUDGETARY ALLOCATION

In terms of sectoral allocation, the Agriculture, Agrarian Reform and Natural Resources sector gained a 2.2% increase in its 2005 budgetary allocation as compared to this year's budget. From P32 billion in 2004, it will be raised to P32.7 billion. Despite this modest increase, this is still 17% lower than the 2003 level. In real terms, the budgetary allocation for the sector has continued to decline by an average of 13% in the last two years. Likewise, the sector's share in the NG budget has been decreasing from 4.8% in 2003 to 3.6% in 2005. Its share to GDP also decreased from 0.9% in 2003 to 0.6% in 2005.

The 2005 total budget of the Department of Agriculture (DA) amounts to P18.9 billion, 16% (or P3.1 billion) of which is allocated as regular budget of the Department and 84% (or 15.8 billion) is for AFMP budget. In nominal terms, the DA's proposed regular budget will receive an incremental increase of P30 million or 0.8% increase as compared to this year. In real terms, the Department's budget continues to slide downward. In fact, the 2005 budget for DA is roughly equivalent to P1.6 billion that is just about the same amount to the DA's budget in 1999.

Based on expenditure type, the bulk of DA's regular budget (or 74%) goes to personnel services (PS) and the remaining 26% will be shared among maintenance and other operating expenses (MOOE) and the capital outlays (CO) and net lending. It is interesting to note that almost 70% of the incremental increase in the DA's budget will go to PS, while MOOE and CO spending continue to decline in both nominal and real terms.

AFMA FUND

The 2005 proposed budget of P15.8 billion for AFMA is 9% more than this year's allocation. Over the last two years, the budgetary support for AFMA has ranged from P10 to P15 billion. While its allocation continues to increase by an average of 27% from 2003 to 2005, this amount is still below the targeted annual budget of P17 billion that was expected to provide a steady stream of public investment support to agriculture and fisheries *(MTPDP, Oct. 2004).*

About 67% of AFMA 2005 budget will be spent on infrastructure items such as irrigation, farm-to-market roads, post-harvest facilities, water system and others (*see Table 7.3*). Infrastructure spending for 2005 will be raised by as much as 87% as compared to this year's budget.

Over the past few years, the bulk of infrastructure outlay has been allocated to irrigation. Much of these investments, however, have been spent on the rehabilitation of national and communal irrigation system as a result of cumulative operation and maintenance (O&M) neglect and design mistakes. These traditional systems account for 87% of the country's total service areas. It has been estimated by David (2000) that an average of 70,000 hectares of communal (CIS) and national irrigation systems (NIS) service areas must be rehabilitated each year in order to arrest the deterioration of irrigation facilities.

Assuming that the average cost of NIS and CIS rehabilitation per hectare is P69,500 this is based on Gonzalez (2004) estimates of national and communal rehabilitation cost at P65,000 and 74,000 per ha, respectively. Hence, if the P5.33 billion earmarked for irrigation will be spent on rehabilitation on these traditional systems alone, this is just enough to irrigate about 76,258 hectares per year which is within the estimated range of the rehabilitation requirement. However, there is not enough investment left to expand the service area under irrigation. There are still 3.1 million hectares that are currently unirrigated—this would indicate a vast potential for irrigation development.

TABLE 7.3
INFRASTRUCTURE OUTLAY UNDER AFMA
FY 2003-2005, (IN BILLION PESOS)

PARTICULARS	2003	2004	2005
AFMA	**10.06**	**14.45**	**15.82**
Non-Infra Programs	**2.42**	**8.79**	**5.26**
Infra Outlay	**7.64**	**5.66**	**10.56**
Irrigation	5.91	3.97	5.33
Farm-to-Market Roads	1.02	1.33	1.95
Post Harvest Facilities	0.56	0.26	1.69
Water System	0.14	0.05	0.14
Others		0.06	1.44

Source: FY 2005 BESF, DBM

Given the level of budgetary support to irrigation, it is important to concentrate limited public investments to irrigation systems that generate the highest economic benefits at the least cost. Constructing new large systems (national system) may not be viable considering its prohibitive cost and low internal rate of return. There are better alternatives such as shallow tubewells (STWs) and low lift pumps (LLPs) that are more cost effective, e.g. investment per unit area of STWs is only about 20% of the average cost of rehabilitating NIA communal irrigation systems *(David, 2000).*

Another critical infrastructure item that needs government attention is post-harvest facilities. These will receive a hefty 85% increase in 2005 from P0.3 billion in 2004 to P1.7 billion in 2005. This will help address significant post-harvest losses being incurred due to inadequate equipment, infrastructure and poor post-harvest handling practices. In the case of rice, post-harvest losses have been alarming at 14.8% of which 4.5% is due to drying, 3.1% from milling and 2.7% on storage *(NFA, 2004).*

Despite some notable improvements, the level of public sector support to infrastructure facilities *(e.g. irrigation and post-harvest facilities)* may not be sufficient to make any improvement in agricultural productivity and rural income. Balisacan (1999) simulated the impact of a policy and investment scenario (to rural welfare and agricultural productivity) where agricultural quantitative restrictions (QRs) were removed and total public investments in agriculture were raised annually in real terms by 2.5%, irrigation investment by 2%, and agricultural R&D by 3%.

The simulation results showed positive outcomes—yield growth of major crops will be faster; rural poverty incidence much lower; and out-migration from rural to urban areas will be moderated. Thus, unless the present pace of public sector investment in the agriculture sector is significantly improved, it is unlikely that any changes in productivity and output will be achieved.

ALLOCATION BY POLICY INSTRUMENTS

About 47.5% or P6.9 billion of the AFMA (DA) budget will be allocated to productivity-enhancing expenditures such as irrigation, research and development, extension and other support services. Of these productivity-enhancing services, the bulk will go to irrigation services that account for 29.6% (P4.3 billion) of this amount. About 6.8% (P1 billion) will go to production support, 8.7% (P1.3 billion) to other infrastructure and/or post-harvest development, 2.5% (P0.4 billion) to research and development and the remainder will be allocated to regulatory services, policy planning and formulation, market development, information support and credit facilitation.

In particular, government support to agricultural R&D is critical as it has been proven to be an effective public investment measure for productivity growth and poverty reduction *(Intal, 2003).* Moreover, investments in agricultural R&D have very high rates of return even as high as 163% which is considerably well above the benchmark rate of 15% for public investment projects.

However, the Philippines has underinvested in R&D that largely explained the large productivity deficit in so many agricultural products. The Philippine has had the lowest investment in R&D, averaging only 0.4% of agricultural GVA as compared with Malaysia (1.1%), Thailand (1.6%) and Taiwan (3.4%). More significantly, this is way below the World Bank recommendation of at least 1% of agricultural GVA.

Allocation for agriculture R&D should therefore total about P2.74 billion based on the sector's GVA for 2003. However, DA budgetary support to R&D from 2003 to 2005 averaged only P450 million a year.

ALLOCATION BY COMMODITY

By the fact that these are staples, rice and corn remained priority commodities and are accorded with substantial government support. This is consistent with the programs of the Arroyo administration to reduce the high cost of rice, corn and food products through greater productivity, quality and price competitiveness. More importantly, this reflects the Government's priority to fight for self-sufficiency in rice production. In the proposed budget of the Department, about P2 billion will be allocated to *Ginintuang Masagana Ani* (GMA) for Rice and Corn Program (*see Table 7.4*). Of this amount, the GMA Rice Program will receive P1.5 billion or 75% of program's total budget.

TABLE 7.4
BANNER PROGRAMS/PROJECTS
(IN MILLION PESOS)

PARTICULARS	2003	2004	2005
Development of the Crops Sector (OSEC & AFMP)	**1,760.1**	**2,686.9**	**2,502.2**
Ginintuang Masagang Ani for Rice and Corn (OSEC)	1,476.0	2,149.5	2,029.7
Technology generation and dissemination for the growth and development of the vegetable industry	12.7	15.2	15.2
Agricultural Intensification and Diversification Program	13.0	16.2	15.2
Bohol Agricultural and Promotion Center	7.4	9.9	9.9
National Government Subsidy for Crop Insurance	45.3	113.8	113.8
Ginintuang Masagana Ani-HVCC	205.6	382.9	317.4
Development of the Livestock Sector (OSEC & AFMP)	**189.7**	**348.9**	**259.6**
Implementation of Various Agricultural Research	**133.1**	**155.0**	**155.0**

Sources: DA 2005 Proposed Budget, NEP-DBM

To achieve rice sufficiency, an average of P2 billion a year is needed to provide necessary infrastructure and production support services (*see Table 7.5*). Critical to this goal is improving access to certified high-yielding rice varieties. The continued use of certified seeds is expected to result in an increase in yield by 70% to 140% and net returns increasing by 130% to 370% compared to using home saved seeds *(NFA, 2004).*

TABLE 7.5
GMA RICE PROGRAM, 2004-2010

YEAR	Palay (Mmt)		Milled Rice (Mmt)		Percent of sufficiency	Budgetary Req't (PB)
	Production	Demand	Production	Demand		
2004	14.1 -14.3	16.1	9.1 - 9.3	10.0	91.8 - 93.6	
2005	15.1	16.5	9.8	10.2	96.5	1.5
2006	15.9	16.9	10.3	10.4	97.0	2.0
2007	16.5	17.3	10.7	10.7	100.8	2.0
2008	17.0	17.6	11.1	10.9	101.6	2.1
2009	17.6	18.1	11.4	11.2	102.6	2.3
2010	18.3	18.5	11.9	11.4	104.3	2.4

Source: Department of Agriculture

However, the issue of unpredictable budget allocation for DA has continued to hamper implementation of vital crop programs. For instance, the Department was forced to trim down this year's rice production targets because DBM has released only 33% of the total P550 million allocated for the rice program this 2004 (PDI, October 23,2004). The balance of P369 million is supposed to be paid to local hybrid rice seed growers contracted by the Philippine Rice Research Institute (PhilRice) to supply the high-yielding hybrid rice seeds that would be distributed to farmers at the subsidized rate of P1,200 per 20-kilogram bag.

With the insufficient and unpredictable budget allocation for DA that has resulted to its performance shortfall, the target for self-sufficiency in rice and increased productivity in agriculture could remain a huge challenge.

CHAPTER 8

EDUCATION

Education in GMA's 10-Point Agenda

Under the 10-Point Agenda of President Gloria Macapagal-Arroyo, the Government shall pursue an education for all policy by constructing 6,000 classrooms every year, providing college/vocational/technical scholarship to qualified poor families, and providing books and computers in every school.

Good quality education provides people with knowledge and skills. It enables the poor to participate in market-oriented and income generating activities and improve their productivity and social mobility.

People with education have wider access to information about careers and job openings thereby leading to improve their household welfare. A study of poverty in regions finds that the rate of poverty incidence falls by 3% for every 1% improvement in functional literacy (*Balisacan, 1999*).

EDUCATION PERFORMANCE AND TRENDS

The country's basic education sub-sector made significant progress in sustaining the high participation and simple literacy rates *(see Table 8.1)*. Improvements in the participation rates were possible as government expanded resources for education to accommodate relatively rapid growth of the school-age population (*Herrin, 2004*). The greater challenge lies in arresting the continuing decline of the quality of formal basic education. Likewise, the state of higher education remains discouraging as shown by the lack/poor readiness of a large number of college graduates to enter the labor market.

Compared to its Asian neighbors, the Philippines has one of the shortest basic education with six years of elementary and four years of high school. The average Filipino child starts formal education in elementary at age six. But children who are expected to avail of private education undergo pre-schooling at the age of three.

TABLE 8.1
PARTICIPATION RATE AND FUNCTIONAL LITERACY RATE

School Year	Participation Rate		Functional Literacy Rate
	Elementary	Secondary	
1997-1998	95.09	64.04	83.8
1998-1999	95.73	65.22	83.8
1999-2000	96.95	65.43	83.8
2000-2001	96.77	66.06	83.8

Source: Department of Education

While most Filipino children availed of early childcare and development (ECCD) via daycare centers or formal preschools, at least 23% of Filipino children between three and five years old were not involved in any form of ECCD. DSWD estimated *(as of June 2002)* 25.8% of barangays remain without daycare centers, and access to early childcare and development is scarce in rural areas.

TABLE 8.2
PERFORMANCE EVALUATION: KEY OUTCOMES

PARTICULARS	National Test (%)	
	Diagnostic (June 2002)	Achievement (March 2003)
Grade 4, Overall	**39.99**	**43.55**
English	42.14	41.8
Science	39.38	43.98
Math	38.45	44.84
First Year, Overall	**28.04**	**36.13**
English	29.67	41.48
Science	27.7	34.65
Math	26.71	32.09

Source: DepEd FY 2004 Budget Proposal

However, high enrollment rates mask unacceptably low cohort survival rates and low quality of schooling. Only 63% of elementary pupils finish grade six, and only 72% of high school students finish high school. The cohort survival rate is the proportion of school children at the beginning grade or year that reached the final grade or year at the end of the required number of years of study.

The low quality of schooling is reflected in the poor performance of students in standardized tests. Based on the National Diagnostic Test (NDT) in June 2002, the percentage of correct responses in testing Grade 3 competencies to Grade 4 students and Grade 6 competencies to First Year High School students were alarmingly low (s*ee Table 8.2*). Various surveys by Department of Education (DepEd) have shown that children aged 11 to 15 who finished Grade 6 were assessed to have learning skills equivalent to only 3.4 years of elementary schooling instead of the 7 school years.

Moreover, mastery levels of Filipino students are either 50 percent or below. They have greater difficulties in learning when they reach the higher grades while their level of learning declines when it comes to science and mathematics. These conclusions can be deduced from the results of the National Achievement Test (NAT) given last March 2003.

International tests bear out similar results with Filipino students performing well below average. The 1999 Third International Mathematics and Science Study (TIMSS) indicated that the average Filipino high school student performed much worse relative to other countries.

Among 38 countries, the Philippines ranked second to the last in science and mathematics. In 1994, the country ranked 40th and 38th in the order of 42 countries for achievement in science and mathematics respectively, indicating an almost unchanged status.

In the same breadth, the quality of higher education graduates, especially those coming from publicly funded higher education institutions (HEIs), is also discouraging. The average passing rates in board exams are lower than the previous MTPDP's target of 50% suggesting poor readiness of college graduates to take on professional and high skilled jobs in the labor market.

TABLE 8.3
HIGHER EDUCATION INDICATORS, 2000-2003

INDICATOR	2000	2003
Enrolment (all Disciplines)	2,430,842	2,448,390
Graduates (All Disciplines)	363,640	419,072
Enrolment (Priority Programs)	1,440,286	1,480,914
Graduates (Priority Programs)	209,265	241,535
Number of SUCs	108	111
Enrolment (SUCs)	700,199	737,150
Graduates (SUCs)	106,083	145,300
Average Passing Rate in Board Exams	45.35	41.71
Number of Scholars	44,868	52,510

Source: MTPDP, 2004-2010

Enrolment in higher education programs of state universities and colleges (SUCs) increased by 5.3% from 700,199 students in 2000 to 737,150 in 2003 (*see Table 8.3*). Overall, the SUCs served about 30% of the total number of students.

To address the issues of access and equity, the Commission on Higher Education (CHED) has implemented various student scholarships and financial assistance programs which resulted in substantial increase in the number of recipients from both public and private HEIs from 44,868 in 2000 to 52,510 in 2003.

TABLE 8.4
TOTAL PUBLIC SPENDING ON EDUCATION
AS PERCENT OF GNP

COUNTRY	1980	1985	1990	1995
Indonesia	1.72	-	1.04	1.40
Japan	5.79	5.02	-	-
Korea	3.73	4.45	3.45	3.68
Malaysia	6.04	6.61	5.45	4.68
Philippines	1.72	1.35	2.90	2.96
Singapore	2.84	4.40	3.01	2.98
Thailand	3.42	3.79	3.59	4.14

Source: UNESCO, 2002

BUDGETARY ALLOCATION

A major reason for this consistently dismal student performance is that budget allocations for this sector have been meager and unwisely spent. Public spending on education has yet to surpass 3% of real GNP. Because of the country's low GDP and High population, per capita spending on education remain low. This is in stark contrast to Japan, Malaysia, South Korea, and Thailand where the allocations have never been less than 3%, since 1980 (*see Table 8.4*).

The country spends an average of US$440 per student in basic education. This is way below East Asian standard—per capita spending in Japan and Korea is US$5,640 and US$3,128, respectively. Moreover, Malaysia spends twice as much for its students in both elementary and high school compared to the Philippines.

For the fiscal year of 2005, the share of the proposed education budget to the total national budget is 14.93%, which is lower compared to 15.47% of this year. As a percentage of the social services budget, spending on education will decrease from 54.31% for 2003 to 53.27% for 2005.

In nominal terms, the proposed budget of the DepEd is P111 billion or 3.3% increase over this year's budget. However, this represents a decline of 2% in real terms. As expected, personnel services (PS) account for the biggest single expenditure item in the education budget. The share of capital outlay (CO) to the national budget has improved from 2.42% in

2003 to 3.59% in 2005. Despite this modest gain, effective capital development planning cannot occur with such small share.

Per capita spending based on total budget increased from P6,293 in 2004 to P6,345 in 2005. However, real per capita spending declined by P139 from P3,496 in 2004 to P3,357 in 2005. In real terms, the per capita operations budget dropped by P1 from P262 in 2004 to P261 in 2005 (*see Table 8.5*).

TABLE 8.5
PER CAPITA COST VS. PUBLIC ENROLMENT
NOMINAL VS. REAL, 2004-2005

PARTICULARS	2004	2005*
Public Enrolment	17,362,093	17,652,992
Per capita cost		
(based on total budget)		
Nominal	6,293	6,345
Real	3,496	3,357
Per capita cost		
(based on operations budget)	472	493
Nominal	262	261
Real		

**MTPDP's estimate: 1.67% growth rate in enrolment*
Source: DepEd

The share of maintenance and other operating expenses (MOOE) further contract from a high of 16.5% in 1990 to 7.8% in 2005. At least 15% of agency budget should be spent on MOOE to have a good quality of basic education (*WB-ADB Study, 1998*). Nominal spending for MOOE has slightly increased by 6% but spending level is lesser in real terms compared to 2000 levels. MOOEs are used for the purchase of basic inputs, such as textbooks and instructional materials, critical to learning outcomes. Meanwhile, budgetary support to SUCs will gain a slight increase of 1.1% in the proposed budget. The number of SUCs from 2000 to 2003 still grew by 2% while the average growth of SUC's budget from 2003 to 2005 is less than 1% (*see Table 8.6*).

The rationalization of the public higher education system remains a paramount concern of the education sub-sector. Hence, interventions are needed to minimize the cost inefficiencies resulting from duplication of program offerings and enable the SUCs to generate internal

TABLE 8.6
SUC BUDGET, 2003-2005
(IN BILLION PESOS)

PARTICULARS	Nominal	Real
2003	17.07	9.95
2004	16.67	9.26
2005	16.85	8.91
Growth Rates (%)		
2003-2004	(2.35)	(6.94)
2004-2005	1.07	(3.78)

Source: BESF,2005

revenues towards some degree of financial independence from the government. Towards this end, corporatization of SUCs is being pushed to provide solution in improving quality, efficiency and funding for higher education.

CLOSING THE RESOURCE GAPS

School Building Program (SBP). The proposed 2005 budget allocation for School Building Program (SBP) will be 50% lower than this year. From 2 billion pesos in 2004, SBP will have an allocation of one billion pesos. This drastic cut of budget for classroom construction is not consistent with the funding requirement being prescribed by DepEd to eliminate backlog by 2008 *(see Table 8.7)*.

To complement for constrained budgetary support, important measures have been undertaken to address the classroom situation. These are: (a) adoption of a double or multi-shift classes; and (b) expansion of educational subcontracting program or providing high school students' scholarships or financial assistance to study in private schools.

Multi-shifting is being implemented in schools where there is overcrowding, especially in Metro Manila. Based on DepEd estimates, adopting a double shift system nationwide would help reduce classroom shortages in 2004 to only 6,000 classrooms in both elementary and secondary.

Moreover, an increase in the budget for the Education Service Contracting (ESC), a component of the Government Assistance to Students and Teachers in Private Education (GATSPE), will enable the government to use unutilized private classrooms. Since many private high school students have transferred to the public system because of economic reasons, many private schools have unused classrooms.

GATSPE. With the GASTPE, public high school students who cannot be accommodated by the public system because of lack of classrooms can be enrolled in private schools at the expense of government.

A budget of P2 billion (at P4, 000 per student) assures accommodation of 475,000 high school students in the private sector (*DepEd, July 2003*). This saves the government some 9,500 classrooms. It may be more economical to expand the voucher system than to put up the needed classrooms. Given its importance, the share of GATSPE in the MOOE budget has significantly increased from 12.54% in 2003 to 27.01% in 2004. For 2005, however, GATSPE's share will decline to 23.26%.

TABLE 8.7
CLOSING THE CLASSROOM GAP, 2004-2010

PARTICULARS	SCHOOL YEAR					
	04-05	05-06	06-07	07-08	08-09	09-10
Enrolment	17,362,093	17,652,992	17,987,991	18,350,080	18,733,112	19,136,921
Shortage at the beginning of SY	17,873	8,684	3,203	1,150	-	-
Class size	50	50	50	50	50	50
Requirements due to enrolment increment	3,233	3,515	4,438	4,499	4,509	4,955
Classrooms to be provided*	7,422	7,996	5,491	4,875	4,746	4,490
Regular SBP	10,000	4,785	4,579	4,445	4,316	4,190
FAPS (TEEP & SEDIP)	1,901	2,112	496	-	-	-
Other SBPs	521	1,099	416	430	430	300
Expansion of GASTPE-ESC	-	1,000	1,000	1,000	1,000	1,000
Shortage at the end of the SY (@ 2 shifts)	8,684	3,203	1,150	-	-	-
Inflation rate (%)	-	4.5	4.5	3.0	3.0	3.0
Cost per classroom (PhP)	400,000	418,000	436,810	449,914	463,411	477,313
Funding req't., Regular SBP (PhP million)	2,000	2,000	2,000	2000	2,000	2000

**/ For SY 2004-2005, the programmed number of classrooms is increased by 5,000 units to include FY 2003 program which has been funded but will be implemented only in 2004.*

Textbook and Teacher Gaps. Although the textbook gap has been reduced to 24.5 million in 2004, the additional cost needed to completely close this gap and achieve an ideal textbook-pupil ratio is P1.1 billion. By 2005, an additional P116 million will be required plus the P1.1 billion backlog of the previous year. The P116 million was derived by multiplying the number of new enrollees by eight (8) textbooks *(number of subject areas)* per student at P50 per textbook. In addition, P1.2 billion is needed to provide additional 5,818 teachers for next year, which puts the total teacher backlog at 15,931 at a cost to the government of P2.9 billion (*see Table 8.8*).

TABLE 8.8
OTHER RESOURCE GAPS, FY 2004
(COST IN MILLION PESOS)

PARTICULARS	Gaps		GAA		Remaining Backlog	
	Number	Cost	Number	Cost	Number	Cost
Textbooks (in million)	35	1,735	10	555	25	1,180
Teacher Items @1:50	20,113	3,401	10,000	1,691	10,113	1,710
TOTAL	**-**	**14,625**	**-**	**9,839**	**-**	**4,454**

**Unit Costs Used: 1 Classroom = P375,000; 1 Seat = P600; 1 Textbook = P45*
Source: DepED

In general, provision of education services in the country remains reliant on government. But government stands to benefit more from better quality of services through the concept and practice of “service purchasing”. This is already done through the contracting scheme in the secondary education. Government has been spending so much in construction and maintenance yet so little has been achieved in education outcomes. Instead, government should purchase from qualified private providers a wide range of education services in order to cut cost and improve the quality of education.

CHAPTER 9

HEALTH

Health in GMA's 10-Point Agenda

Improvements in health are essential in ensuring a better quality of life for the population and in increasing their productivity. Like education, health services improve the quality of human resources today and in the future. Better child health and nutrition promote future productivity growth directly by helping children develop into stronger, healthier adults.

Given this importance, the Government accords priority attention in addressing major concerns in the health sector as part of its human development activities. In her 10-Point Agenda, President Gloria Macapagal-Arroyo stressed the need to lower by 50% the prices of medicine to ensure access and affordability of safe and quality medicines especially to the poor. In addition, the MTPDP (2004-2010) identified key strategies to improve public health care services, namely: (1) expand health insurance particularly for indigents; (2) ensure universal coverage of cost-effective preventive, public health programs; and, (3) provision and promotion of low priced and quality essential medicines.

HEALTH PERFORMANCE AND TRENDS

The current national health situation is improving but at a slower rate than desired. The downward trend in the total fertility rate (TFR) in the Philippines, that declined from an average of 4.1 in 1990-1995 to 3.6 in 1995-2000, is still slow by East and even Southeast Asian standards. For the same period, Indonesia and Thailand have reduced their TFRs much lower than the Philippines. Life expectancy in the Philippines is comparable to that of Thailand but relatively better than Indonesia with an average life expectancy of 65 years *(see Table 9.1).*

TABLE 9.1
SOME DEMOGRAPHIC INDICES
FOR SELECTED ASIAN COUNTRIES

PARTICULARS	Total Fertility Rate		Life Expectancy	
	1990-1995	1995-2000	1990-1995	1995-2000
Indonesia	3.0	2.6	62.6	65.1
Thailand	2.1	2.1	69.1	69.6
Philippines	4.1	3.6	66.5	68.6
Japan	1.5	1.4	79.5	80.5

Source: Asia-Pacific Policy Center, 2004

Key indicators in the health sub-sector have shown mixed performance in the government's effort to meet its MTPDP and Millenium Development Goals (MDGs) targets. A significant improvement has been achieved in infant mortality rate from 48.9 in 1998 to 29 in 2003, and has already exceeded the MTPDP target for 2004 (*see Table 9.2*). More importantly, the country is on track in meeting its MDG targets for 2015 on infant mortality.

However, the same cannot be said on other health-related goals. Malnutrition among 0-5 year-old children has declined albeit at slow rate. Malnutrition levels remain above the MTPDP target of 25.6% for 2004 and far from achieving the MDG target of 17.25% by 2015. Based on 1998 National Demographic and Heath Survey (NDHS), maternal mortality has declined but is not fast enough to instill confidence that it would reach the MTPDP target of 40 per 100,000 livebirths by 2004.

TABLE 9.2
HEALTH TARGETS AND ACCOMPLISHMENTS

INDICATORS	Actual	Target*	Latest Data
Life expectancy (in years)	67.4	70.1	69.8[a]
Male	-	-	67.2[a]
Female	-	-	72.5[a]
Infant Mortality Rate (per 1000 livebirths)	48.9	35	29[b]
Maternal Mortality Rate (per 100,000 livebirths)	60	40	Na
Pre-natal Care (% of pregnant women who sought pre-natal care)	62.5	90	87.6[b]
Post-natal Care (% of pregnant women who sought post-natal care)	70.6	80	Na
Fully immunized children (in %)	89	95	70[b]
Health insurance coverage	38	70	77[e]
Prevalence of underweight preschool children aged 0-5 years old (in %)	32.0	25.6	27.6[f]
Prevalence of underweight preschool children aged 6-10 years old (in %)	30.2	24.2	26.7[f]

Sources: Draft MTPDP (as of August 2004)
**Targets were from 2001-2004 MTPDP*
a-2003 projections based on the 1995 Census of Population and Housing;
b-2003 National Demographic and Health Survey;
c-2000 Census of Population and Housing;
d-2002 Annual Poverty Indicators Survey;
e-Accomplishment Report of PHIC
f-2003 National Nutrition Survey

Health insurance coverage has been able to expand to 77% of the population as of June 2004. This has been largely attributed to the implementation of the Greater Medicare Access 500 in 2001 to ensure the enrollment of some 500,000 urban poor *(MTPDP, Aug. 2004).* However, social health insurance coverage and benefits remain limited. It is unlikely that universal coverage will be reached because of difficulties in sustaining local counterpart contribution especially for indigents.

Despite some progress in the health sector, it important to note that disparities across income and region remain wide. The infant mortality rate (IMR) among households in the poorest quintile is 2.3 times higher compared to those from the richest quintile. Likewise, the under-five mortality rate is 2.7 times higher among the poorest quintile than the richest.

Lagging health improvements in some regions reflect the inequities in health outcomes. Maternal mortality rate in ARMM is almost three times higher in NCR in *1995 (MDG Report, 2003).* At the provincial level, IMR rate for males ranged from a low of 42.8 infant deaths per

1,000 livebirths in Bulacan to a high of 73.4 infant deaths per 1,000 livebirths in Sulu, suggesting that Sulu was about 20 years behind in IMR improvements *(Herrin, 2004).*

BUDGET ALLOCATION

The slow rate of progress in the health sector can be generally attributed to declining health expenditures. The data from National Health Accounts in 2002 revealed several points. First, total health expenditure has decreased in real terms. Real health expenditures declined from 34.9 billion in 2000 to 32 billion in 2002 or an average of 4% decrease. Second, the share of health expenditures to GNP continued to fall below the 5% standard set by the World Health Organization (WHO) for developing countries.

TABLE 9.3
GOVERNMENT HEALTH EXPENDITURES
OF SELECTED ASIAN COUNTRIES, 2001

COUNTRY	As % to total NG Spending	Per capita at ave. exchange rate (US$)
Indonesia	3.0	4.0
Malaysia	6.5	77.0
Philippines	**0.9**	**10.5**
Vietnam	6.1	6.0
China	10.2	18.0
Korea	9.5	236

Source: PhilippineNational Health Accounts, 2002

And third, the country's health spending in proportion to total government expenditure is the lowest among selected Asian countries. However, in terms of per capita health expenditure, the country spends more than Vietnam and Indonesia *(see Table 9.3).* The level of government health expenditure has not changed significantly in terms of level and category. Health services will receive a total of P12.9 billion in 2005 that is similar to this year's amount. However, its share to total NG budget will shrink from 1.5% in 2004 to 1.4% in 2005. Per capita health spending in both nominal and real terms has exhibited a downward trend. Real per capita health spending has dropped significantly from P89.2 in 2003 to P80.3 in 2005.

TABLE 9.4
DISTRIBUTION OF DOH BUDGET
BY OBJECT, 2001-2005

YEAR	Amount (in billion pesos)				Percent Share			
	PS	MOOE	CO	TOTAL	PS	MOOE	CO	TOTAL
2001	5.02	4.39	0.04	9.45	53	46	1	100
2002	5.40	5.12	0.90	11.42	47	45	8	100
2003	5.94	3.25	0.66	9.85	60	33	7	100
2004	5.89	3.97	0.55	10.42	56	38	6	100
NEP 2005	5.93	3.99	0.38	10.31	58	39	3	100

Source: 2005 BESF (DBM)

The Department of Health (DOH) accounts for 80% of total health expenditures. From a low of P9.45 billion in 2001, it recovered slightly to P10.42 billion in 2004 and dropped by 1% in 2005 to P10.31 billion. In terms of function, the proposed DOH budget allocates roughly the same budget shares to personal services (58%) and MOOE (39%) *(see Table 9.4).*

More importantly, the bulk of DOH budget goes to tertiary care services—about 56% of MOOE—that are basically for the operation and maintenance of government hospitals. This will come at the expense of adequately funding public health. However, it is important to note that all 72 retained hospitals of DOH has already been given 100% income retention since 2003 to help them decrease their dependence to NG budget.

The proposed budget for public health programs in 2005 will increase by 0.6% from P1.63 billion in 2004 to P1.64 billion in 2005 *(see Table 9.5).* Of the public health programs, it is the allocation for Health Emergency Management that grew significantly from P21 million in 2004 to P240 million in 2005. This huge increase was part of the realignment of resources to cover for the expansion of Gamot na Mabisa at Abot-Kaya (GMA 50). This priority program of President Macapacal-Arroyo is designed to increase in number the type of low-cost commonly bought drugs and medicines and the outlets for these medicines.

TABLE 9.5
ALLOCATION FOR PUBLIC HEALTH SERVICES
(AMOUNT IN THOUSAND PESOS)

PARTICULARS	2004		2005	
	Amount	% Share*	Amount	% Share*
Prevention & Control Program on:	251,197	15	251,560	15
Tuberculosis	139,007	9	154,007	9
Malaria	3,400	0	3,400	0
Schistosomiasis	2,947	0	2,947	0
Rabies Control	23,958	1	24,063	1
Other Infectious Diseases	27,792	2	28,000	2
Degenerative Diseases	27,550	2	27,698	2
Environmental & Occupational Health	2,000	0	2,000	0
Philippine National AIDS Council	9,543	1	9,445	1
Assist. to Philippine Tuberculosis Society	15,000	1		0
Immunization & Vaccine Self-Sufficiency	443,960	27	346,960	21
Family Health & Primary Health Care	104,978	6	105,226	6
Epidemiology & Disease Surveillance	21,851	1	21,926	1
Health Promotion	41,984	3	41,977	3
Quarantine Services & Int'l Health Surveillance	38,547	2	44,830	3
Health Emergency Management	20,997	1	240,406	15
Local Health Systems Development	27,604	2	130,834	8
Health Operations/Promotion in 15 CHDs	198,551	12	91,617	6
Local Health Technical Assistance	229,994	14	114,203	7
TOTAL	**1,630,860**	**100**	**1,641,099**	**100**

** As percent share of Total Public Health Budget*
Sources: 2005 NEP and DOH

There are no significant improvements, however, in the spending of other vital public health programs such as the prevention and control program of major diseases like TB, malaria, and other vaccine-preventable diseases. These are mainly prevalent infectious diseases, which requires substantial amount of investment to make an impact. Investment plan for such public health programs for the period 2000-2004 was estimated at P8.9 billion or an average of P2.2 billion a year. Hence, a multi-year budgetary scheme must be pursued for these programs to sustain disease reduction or elimination. Without such support, this can further slow down the country's progress to meet its targets set in the 2004-2010 MTPDP and its commitments under the MDG.

CHAPTER 10

HOUSING

Housing in GMA's 10-Point Agenda

In support of her 10-Point Agenda, President Gloria Macapagal Arroyo stressed the need to recognize housing not only as a means to provide decent housing that would uplift the quality of living of Filipinos, but also as a rich source of employment with the potential to create one million jobs annually.

Traditionally viewed as a social development service, the housing sector is now a critical component of the government's economic engine and growth strategies. Its high multiplier effect (16.6 times) can generate downstream economic activities, which could significantly enhance productivity and increase the value-added output of the construction industry and its allied sectors. In short, every P10 billion of direct expenditure in housing multiplies to P166 billion worth of economic activity for the country.

The Medium-Term Philippine Development Plan (MTPDP) for 2004-2010, broadly outlined government plans to resolve the problems on housing by addressing the issues in land prices, housing finance and guarantees, high transaction and production costs, and problems on informal settlers. Moreover, the Plan underscores the need for government to shift its role from that of a direct provider of housing to a market enabler of housing markets. In line with this change, the government intends to pursue reforms in the housing market which will bring about programs for housing assistance for the poor, and the creation of a sustainable housing finance system.

HOUSING PERFORMANCE AND TRENDS

Given its high social and economic impact and direct links with poverty alleviation, shelter programs have always been a focal point and a centerpiece program of every administration in the past. But because of the enormity of the problem, all efforts to reduce the country's housing needs have failed.

The country's total housing need has ballooned significantly over the past two decades, from 2.1 million units in the 80's to more than 3.5 million units at the turn of the century despite spending billions of pesos and enacting numerous policies and legislative reforms in housing.

The total housing needs for 1999 to 2004 were estimated at 3.4 million units. To address this huge demand, the National Shelter Program (NSP) under the Estrada government adopted an 80%-20% resource allocation in favor of socialized housing programs. The allocation for socialized housing projects was later modified to 73%, when the national shelter plan was revised in 2001.

Under the revised plan for 2001-2004, the Arroyo government targeted to provide shelter security to 1.2 million households with an equivalent project cost of approximately P215.2 billion or 300,000 housing units annually at P180,000 each. Shelter Security Units (SSU) refer to the total number of houses, lots, and house and lot packages, in contrast with the common strategy and idea of providing completely built house and lot packages. Although the targets seem ambitiously high, this is significantly below the annual demand of 800,000 units that is needed to close the country's huge housing gap. Although working with a limited budget, the HUDCC claimed to have accomplished 68.6% of its target, and even surpassed its target figures for low-cost housing *(see Table 10.1).* However, even with such remarkable accomplishment the country's housing needs remain high as ever.

In 2002, a total of 82,790 Shelter Security Units (SSU) were constructed, financed and/ or administered by the government. This accomplishment was the lowest in nearly 10 years and more than twice as low as the average number of SSUs provided by the government from 1994 to 1998—the time when the Social Reform Agenda (SRA) of the Ramos administration, which included housing as a priority agenda, was launched.

TABLE 10.1
HOUSING TARGETS AND ACCOMPLISHMENTS
(PER HOUSEHOLD, IN THOUSAND)

Housing Package	Target	Actual Accomplishment					
	'01-'04	2001	2002	2003	2004	'01-'04	%
Socialized (below P225)	800	207.94	118.98	84.71	88.31	499.95	56.81
Low Cost (P225 -P750)	320	54.44	74.30	114.51	85.61	328.87	102.77
TOTAL	1,120	262.38	193.28	199.22	167.92	822.82	68.56

Source: MTPDP, HUDCC; 2004

In 2004, the HUDCC estimated the housing backlog at 984,466 units and a total 3.76 million housing units are needed for 2005 to 2010. Almost 70% of the total housing needs or 2.6 million units are needed just to cover for increases in the number of households in the next six years. A total of 775,187 housing units, equivalent to 20% of the country's housing needs, are needed to relocate families living in subhuman and dangerous conditions *(see Table 10.2).* The demand for housing continues to grow, as the Philippines continues to experience high population growth and rapid urbanization of its rural communities.

In a bid to decongest the National Capital Region (NCR), priority for housing development has slowly shifted to adjacent regions. These regions include the Region IV (Southern Tagalog) and Region V (Central Luzon). The Southern Tagalog region, the NCR and Central Luzon were identified as having the highest concentration of housing needs, accounting for 22%, 13% and 12% respectively of the country's total housing needs *(see Table 10.3).*

TABLE 10.2
HOUSING NEED, 2005 – 2010

PARTICULARS	Number
Doubled - up	387,315
Replacement/Informal Settlers	588,853
Homeless	8,292
Housing Backlog (Sub-total)	946,466
Add: New Households	2,585,272
Upgrading (Sub-standard)	186,334
TOTAL	**3,756,072**

Source: MTPDP/ HUDCC, 2004

While the government's policy to subsidize interest rates on socialized housing has made housing more affordable to the masses, it impeded the flow of private capital in the low cost and social housing markets. This was attributed to the low interest rate spread and low returns brought about by government's interest rate controls. But in spite of the low interest rates on socialized housing, more Filipinos are still unable to afford complete housing packages commonly offered by public housing programs. This shows the existence of a mismatch between public housing programs and their target beneficiaries.

RESOURCE AND BUDGET ALLOCATION

Based on a World Bank (WB) report, direct government spending on housing averages about 2% of government budgets in developing countries. In addition, housing investments typically account for 2% to 8% of Gross National Product (GNP), plus an additional 5% to 10% of GNP coming from the flow of housing services. Thus, the ideal spending on housing should account between 7% and 18% of GNP. In the Philippines housing has received an average of less than 0.5% of the national budget in the last eight years, while housing expenditures account for just 7.7% of GNP.

Under the shelter plan for 2005-2010, the Arroyo government aims to provide shelter security to about 1.15 million households, with a total project cost of about P217 billion at approximately P189,000 per unit. In addition, socialized housing is expected to receive 68% of the program's overall funding. Apparently, this share is lower than the average share of 76%

that socialized housing received from 1999–2001. However, the Plan does not seem to include the impact of inflation on the prices of construction materials, which could negatively affect the program's target figures.

The current target of 1.15 million housing units in a span of six years translates to a supply target of 191,667 units annually. This is roughly equivalent to a third of the required annual demand of 626,012 units to bridge the country's housing gap. Given this scenario, approximately 435,068 units will be added every year to the country's existing housing backlog. To provide housing for the bottom 30% of the population, the government needs to come up with at least P16.8 billion every year for social housing projects. This figure assumes that about 31.9% of the total funding requirement will come from private sources—which is the average private sector participation in social housing for the last ten years.

TABLE 10.3
HOUSING NEED PER REGION, 2005-2010
(BACKLOG AND NEW HOUSEHOLDS, IN THOUSAND)

REGION	Annual Backlog	2005	2006	2007	2008	2009	2010	Total
NCR	58.4	82.2	82.4	82.7	82.9	83.2	83.5	496.9
CAR	1.3	6.5	6.6	6.7	6.8	6.9	7.0	40.4
I	5.6	25.0	25.4	25.9	26.3	26.8	27.2	156.6
II	4.1	17.7	18.0	18.3	18.7	19.0	19.3	111.1
III	12.6	71.9	73.8	75.8	77.8	79.9	82.1	461.4
IV	23.8	127.9	131.7	135.8	139.9	144.2	148.7	828.2
V	12.3	28.3	28.3	28.8	29.1	29.4	29.7	173.9
VI	16.8	36.9	37.3	37.6	37.9	38.3	38.6	226.5
VII	10.6	45.9	46.9	47.9	48.9	50.0	51.1	290.6
VIII	7.3	18.8	18.9	19.1	19.9	19.4	19.7	115.3
IX	7.6	21.8	22.1	22.4	22.8	23.1	23.4	135.7
X	5.9	18.9	19.2	19.5	19.8	20.1	20.4	117.7
XI	11.2	41.9	42.7	43.5	44.4	45.2	46.1	264.0
XII	6.7	18.0	18.3	18.5	18.8	19.0	19.3	111.8
ARMM	5.1	22.8	23.5	24.2	24.9	25.7	26.5	147.6
CARAGA	5.9	12.8	12.9	13.0	13.1	13.2	13.4	78.5
TOTAL	195.1	597.4	608.4	619.7	631.4	643.4	655.8	3,756.1

Source: HUDCC

Unlike low-costs housing projects and open-housing markets, the funding for social housing is harder to obtain, considering the low returns on such projects. Likewise, it may not be politically correct to tap government and private pension funds *(i.e., Pag-Ibig, SSS and GSIS)* for social housing, as these could be detrimental to the interest of its members. Therefore the provision and financing for social housing will rest almost entirely upon the national government. Sadly, only P1.2 billion pesos was allotted for housing this year by the NHA, which is only 7% of the total required funding needed to remain within the targets for social housing.

TABLE 10.4
EXPENDITURES FOR HOUSING AND COMMUNITY DEVELOPMENT (IN MILLION PESOS)

YEAR	NG	GOCCs	Total
1998	286.3	12,721.9	13,008.2
1999	1,611.5	15,475.0	17,086.6
2000	1,302.7	12,487.8	13,790.5
2001	208.9	6,195.4	6,404.3
2002	228.7	10,078.8	10,307.4
2003	208.3	2,349.2	2,557.5
2004	217.4	3,171.4	3,388.8
2005	238.8	3,092.2	3,331.0

Source: BESF 2005

The funds for low cost expected to come primarily from loan take-outs from government and private pension funds and various mortgage and financial markets. The government also intends to induce greater private sector and local government involvement in financing housing projects, with its proposed reforms and policies directed to enhance housing markets.

Over the last eight years, the budget for housing and community development was merely 0.4% of the overall expenditure program of the government. Moreover, the appropriations for housing, both in real terms and in nominal terms, have declined significantly over the past years. In real terms, the budget for housing infrastructure for 2005, will be the lowest in the last eight years *(see Table 10.4).*

TABLE 10.5
NG EXPENDITURES FOR HOUSING AND COMMUNITY DEVELOPMENT BY AGENCY
(IN THOUSAND PESOS)

PARTICULARS	Year			Object of Expenditure (2005)		
	2003	2004	2005	PS	MOOE	CO
HLURB	158.0	160.5	164.1[1]	114.5	49.6	-
HUDCC	50.2	52.7	72.2[1]	29.5	42.8	-
SPF–Misc.	-	-	2.5[1]	2.5	-	-
HIGC	2,200.0	1,000.0	-	-	-	-
NHMFC	-	500.0	500.0[2]	-	500.0	-
NHA	610.0	860.0	1,000.0[2]	-	1,000.0	-
TOTAL	**3,018.3**	**2,573.2**	**1,738.8**	**146.5**	**1,592.3**	**-**

[1] NG Sources = P238,821; [2] GOCC Sources
Source: BESF 2005

In so far as the National Government's budget for housing is concerned, nothing was allocated for direct housing projects - all P238 million were for Personal Services (PS) and Maintenance and Other Operating Expenses (MOOE) of government housing agencies (*see Table 10.5).*

Given the current housing situation, it is imperative that the development or reform of institutions engaged in housing finance should be part of an overall effort to develop and strengthen the financial system of the country. In the past, housing programs have relied on both budgetary and non-budgetary sources (*i.e., GSIS, SSS, HDMF)*—but with the near exhaustion of non-budgetary sources, housing programs particularly for the lower income classes, will inevitably depend on the national budget. Thus, the capacity of the national government to continue funding its housing program hinges on the adequacy of the funds that flows back into the housing finance system. To do this, the government must continue its asset and mortgage securitization programs to induce greater private investments in housing.

Equally important is the need for social preparation, such as the need to educate borrowers on the procedures and requirements of a program, as well as the implications of defaulting on loans. Moreover, the government's role should not be to subsidize housing, but to mobilize private capital and LGU participation in housing, and to develop the environment for a sustainable secondary mortgage market for low cost housing, duly organized and controlled by the private sector.

Considering that the government has only been able to provide between 30% to 40% of the country's housing needs in the past due to resource limitation, it must stop the habit of setting high yet unrealistic quantity targets. Target demands must consider supply-demand conditions, to ensure optimum utilization of housing resources. A distinction between "total housing needs" and "effective demand" must be made—the latter being the true measure of housing demand and the best basis for setting quantity targets. Effective demand equates the total number of housing needs with the total number of the homebuyers that can actually afford to purchase and/ or service the amortization of housing units. The effective demand of the country's housing market is estimated at 27.1% of total housing needs for each year.

Given the limited budget for housing it will be impossible for the government to solve the problem on its own. It would therefore require substantial support from private sectors and LGU's to even come close with its housing targets.

CHAPTER 11

CONCLUSION AND RECOMMENDATIONS

The 2005 National Budget reflects hard choices the government must make to "*put our economic house in order* and *set the stage for a united front to fight the scourge of poverty*". On one hand, the government is faced with a huge outstanding debt nearing unsustainable level that casts doubts on the government's debt-servicing capability. The government is, thus, hard put to contain the budget deficit and eke out a respectable level of primary surplus to ensure the sustainability of its fiscal deficit and maintain the confidence of the financial community. This is important to keep interest rate, inflation and exchange rate manageable and stable, which are *sine qua non* to sustained economic growth.

On the other hand, the government is under severe pressure to meet a huge backlog in the provision of essential social, economic and general government services that are of basic importance to arrest poverty, and promote growth and development. The President's 10-Point Agenda appears very ambitious given the available resources at government's disposal. However, viewed from the demands of the various sectors, the 10-Point Agenda is just responding to the minimum requirements.

Thus, the 2005 national budget faces a major challenge of containing the fiscal deficit and servicing a huge outstanding debt, while at the same time providing for the basic social, economic and general government services needed by the people and the economy. Sustaining the high growth path in 2005 as enunciated in the Medium-Term Development Plan (MTPDP) and fleshed out in the President's budget proposal would seem to be a tall order. Economic vulnerability and the slow pace of reforms could weigh down heavily on the growth prospects. The persistent and huge fiscal deficit is not only an indicator of macroeconomic instability but *per se* may slow down economic growth and lead to underdevelopment traps.

Aside from promoting macroeconomic stability, structural reforms that promote greater efficiency and equity should be pursued. The structural reforms should focus on broadening the tax base, fostering a labor-demanding growth path, and enhancing productivity to enable the economy to withstand adverse external shocks.

In this regard, the following concerns and recommendations contained in this report are worth highlighting:

- The government's chronic budget deficits and huge outstanding debt are largely due to weak revenue effort. Though painful and unpopular, tax measures will have to be authorized by Congress to beef up existing revenue sources and send strong signals on the government's resolve to get out of the fiscal bind. Revenue generating agencies, notably the BIR and BOC, should improve tax administration and should be held accountable for achieving the revenue targets of the government.

- Attention should also be given to the nature and performance of GOCCs. It has been noted that a significant proportion of the national government outstanding debt is due to assumed liabilities and advances to GOCCs, which are supposed to be financially and operationally independent of the national government. These assumed liabilities are generally classified as non-budgetary accounts which do not undergo congressional review and approval. It is crucial for Congress to review *(a)* performance and internal structure/ processes of GOCCs, *(b)* the legal framework that defines the system of accountability and oversight, and *(c)* the general relationship of these GOCCs to the government, including the need for transparency in public contracts. Corollary to this, the government should conduct an exhaustive inventory of all its contingent liabilities.

- Fiscal discipline and effective control over the deficit should start from the preparation and approval of the budget. The macroeconomic assumptions and revenue projections that are the bases for determining the overall size of the budget should be carefully assessed vis-à-vis economic downside risks and threat of credit downgrade. Any deviation in the economic growth targets brought about by these downside risks would feedback to the government fiscal targets, primarily the revenue targets. Enacting a budget that is bigger than what actual resources would allow not only weakens fiscal discipline but also distorts the allocative and operational efficiency of the budget system. It disrupts the prioritization process by allowing the inclusion of programs and projects that are of lesser priorities. It also results in uncertainty in budget releases which raises costs and breeds corruption in government procurement.

- Note that the 2005 national budget is a minimalist budget. The 2005 proposed budget is only 5.3% higher than the 2004 appropriations. This increase in the budget is barely enough to cover the projected inflation of 4%-5% and the population growth of 2.3%. Moreover, the Electric Power Industry Reform Act (EPIRA) mandates the National Government to directly assume a portion of the financial obligations of NPC in an amount not to exceed P200 billion. However, since the 2005 budget does not include any allocation for NPC debt service requirement of P30.8 billion, the deficit target of P184.5 billion could be breached.

  Only P121.9 billion or roughly 13.4% of the 2005 national budget will remain allocable after accounting for personal services and the mandatory requirements for debt service and internal revenue allotment. Of the total budget, personal services (PS) account for 31.9% while interest payment and internal revenue allotment (IRA) account for 33.2% and 17.2%, respectively. As a result, allocation for social, economic and general public service has been crowded out. In particular, the budget for economic services (as percent of GDP) has declined from 4% in 2003 to 3.1% in 2005. Similarly, NG spending for social services also dropped from 5.5% to 5% in the same period.

- It appears that the local government units have greater flexibility and elbow room in their local finances than the national government. Transfers to LGUs consisting primarily of the IRA amounts to P155.9 billion which is already more than the P121.9 billion allocable portion of the national budget. Hence, schemes such as matching grants to leverage LGU finances in support of national government programs and projects should be explored and encouraged.

- While the development goals set in the 10-Point Agenda are laudable, the 2005 budget does not reflect the priorities required to achieve the goals within the next six years. In particular, the level of health and education expenditures has not significantly improved. Current expenditure levels in these sectors are still far below international standards that it would be difficult for the country to meet in its commitments in the Millenium Development Goals (MDGs) as well as targets set in the MTPDP (2005-2010).

  It is important to realize that the allocation for social and economic services—i.e., sectors that are critical to poverty alleviation and human development programs are squeezed out due to the increasing share of interest payments in the budget. Moreover, the burgeoning population has put additional pressure on the limited public resources. At less than P6,000 real per capita expenditure, it is clear that government inadequately spends for a poor Filipino household that requires subsidized basic health, basic education, protection against crimes, and other public goods and services.

Given these circumstances, it becomes more imperative for government to ensure the allocative efficiency of the budget in terms of meeting its development objectives. Moreso, expenditure items in the social and economic sectors should be prioritized based on the level of economic and social benefits they generate. In the case of agriculture, spending on productivity-enhancing measures should be sustained considering the impact on output and rural incomes. Similarly, it is important to concentrate public investments in pre-school and basic education, and in preventive health services as they generate higher positive externalities.

However, government should not be relied upon to be the sole provider of basic goods and services because the national budget is barely sufficient to cover the needs of a growing population. In most other areas such as housing and education, government production complements private production. Hence, there must be selective combination of limited public spending in economic and social areas with considerable private sector participation through targeting and partnerships.

As far as Congress is concerned, it should assert its role in setting budgetary priorities and must take a more active stance in the oversight of executive agencies. Given the limited resources of government, this will help minimize waste and improve the quality and timeliness of program/project implementation. The need for setting better performance standards cannot be overemphasized especially in the area of revenue generation.

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