Policy Advisory

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2003 NG FISCAL PERFORMANCE

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Abstract

The National Government may have improved its fiscal standing in 2003 but this is not impressive enough considering a low internal revenue collection vis-à-vis GDP, reliance on non-recurring revenue sources, and significant decline in infrastructure outlay. Moreover, NG incurred more debts than originally programmed despite a lower-than-projected deficit.

The National Government may have been successful in trimming the budget deficit but not its borrowing. Full-year deficit for 2003 totaled P199.9 billion which is P2.1 billion lower than the original program of P202 billion. However, total net financing[1] exceeded the full-year projection of P198.5 billion by about 45% or P88.3 billion.

To borrow in excess of the program especially when the deficit is right on target could be inconsistent with plans to bring down the country's debt stock to a manageable level. Instead of borrowing more, government should be retiring debts given a smaller budget gap. Moody's recently downgraded the country's credit rating for long-term foreign currency bonds despite modest gains in trimming the deficit. The rating agency still finds the country's budget shortfall and debt level excessive. Total real NG debt *(excluding contingent of about P705 billion)* grew by 23% from P2.72 trillion in December 2002 to P3.36 trillion as of November 2003. Growth in NG debt was much higher than previous years when the debt stock increased by only 11% in 2001 and by 18% in 2002.

TABLE 1
DEFICIT VIS-A-VIS NET FINANCING, 2001-2003
(IN BILLION PESOS)

Particulars	2001	2002	2003
Net Financing	175.2	264.2	286.8
Deficit	147.0	210.7	199.9
Difference	28.2	53.5	86.9

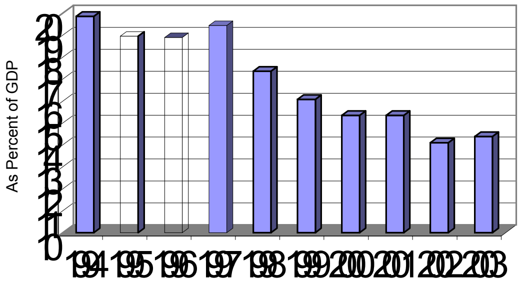
Revenue Performance

The national government surpassed the 2003 programmed collection of P584.1 billion by 7.3% or P42.6 billion, unlike the previous year when the revenue target was missed by P58.3 billion. Revenue effort slightly went up to 14.4% from 14.1% in 2002. However, even as NG made some progress in arresting the slide in collection efficiency, it is insufficient to bring the revenue effort to at least 15.3% as in 2001 *(see Figure 1).* Highest revenue effort was achieved in 1994 at close to 20% of GDP but note that total collection that year was beefed up by proceeds from privatization of government assets.

Compared with other countries in Southeast Asia, the Philippines' revenue effort is low at only 14.4%[2] of GDP. Although it is better off than Cambodia (13.6%) and Lao (13.3%), the Philippines trails behind countries like Vietnam (24.3%), Malaysia (23.1%), Singapore (18.7%), Indonesia (17.8%), and Thailand (15.9%).

[1] It is programmed to match the gap between the revenue target and the expenditure program for a given fiscal year (computed as Gross Borrowing less Principal Amortization).
[2] The Asian Development Outlook (2003) has a slightly lower revenue effort of 14.3%. The figure used by the author was computed using GDP and revenue collection data, as of December 2003.

FIGURE 1
REVENUE EFFORT, 1994-2003
AS PERCENT OF GDP



All three major revenue collecting agencies, namely, the Internal Revenue (BIR), Customs (BOC), and the Treasury (BTr) exceeded their respective targets for the year *(see Table 2).* The BIR which accounts for roughly 70% of total revenue collected P425.4 billion or P1.3 billion more than its target of P424 billion. This is a significant improvement considering the non-passage of several tax measures—i.e., the Indexation of Sin Taxes and Documentary Stamp Taxes (DST)—whose total estimated yield of about P7.5 billion already formed part of the programmed revenues. Moreover, the version of the excise tax on automobiles which was approved by Congress under Republic Act 9224 only translates to some P500 million revenues instead of the P2.5 billion as originally projected.

However, even as BIR collection increased in nominal terms from P394.5 billion in 2002 to P425.4 billion in 2003, its performance as a ratio to GDP slipped from 9.81% to 9.76% in the same period. This is low when compared with BIR's revenue effort of 11%-13% during the period 1997-2001.

TABLE 2
REVENUE PERFORMANCE
(IN BILLION PESOS)

Agency	2002	2003		% Deviation	% Growth
	Actual	Program	Actual		
BIR	394.55	424.01	425.35	0.3%	7.8%
BOC	96.25	100.05	106.09	6.0%	10.2%
BTr	47.19	30.86	56.66	83.6%	20.1%
Others	29.15	29.14	38.53	32.2%	32.2%
Total	**567.14**	**584.06**	**626.63**	**7.3%**	**10.5%**

Source: BSP-IRO

It is also important to note that part of last year's tax collection which enabled the BIR to meet its target were rather non-recurring in nature *(e.g., proceeds from tax amnesties, back taxes and penalties)* and which do not necessarily expand the tax base. Such revenue sources are rather unsustainable—i.e., aside from being one-time revenues, the ability of the Bureau to penalize and recover back taxes may have to depend on the initiatives and commitment of the BIR leadership.

Revenue collection by the Bureau of Customs (BOC) also exceeded its target of P100.1 billion for 2003 by an all-time high of P6 billion. It even surpassed the highest collection of P104.6 billion that it posted in 1996. Note, however, that BOC was assigned a low revenue goal due to scheduled reduction in tariffs. Since the planned tariff reduction did not materialize, it was easier for BOC to surpass a rather

conservative target. Decisions of oil companies to close their refining plants and instead import oil also resulted in additional gains for Customs at the expense of taxes for BIR.
Meanwhile, the Bureau of Treasury's (BTr) collection of P56.7 billion exceeded its full-year goal of P30.9 billion by about 84%. A breakdown of BTr income will show that aside from investment profits from managing government securities (P16.6 billion), a large portion of its income also comes from interest income on NPC domestic bonds (P11.5 billion), and guarantee fees (P7.2 billion). Shares from PAGCOR income also contributed to the Treasury a total of P8 billion.

About 30% of BTr income comes from investments using the Bond Sinking Fund. According to Republic Act 1000 (1954), the national government is required to set aside every year sufficient amounts that shall be used to redeem maturing bonds in the future. This essentially provides NG with investible funds that can generate additional revenues to improve its current cash position. What could be worrisome is that the accumulation of debts, even though it helps the existing cash flow, may endanger future generations who will be responsible for redeeming the bonds.

Income from NPC bonds accounts for 20% of the Treasury's total income. With the central government operating on a deficit, funds used to purchase the bonds could have been sourced through borrowings as well. It is important, therefore, to ascertain whether NG actually earns from such investment by determining interest expense from corresponding loans incurred vis-à-vis interest income.

Earnings from guarantee fees, while advantageous in the short-term, can put the country at greater fiscal risk. This could mean greater NG exposure to financial vulnerabilities of the corporations that it guarantees. Increasing liabilities and deteriorating net worth of GOCCs can force government to attempt a rescue *(e.g., capital infusion to restore fiscal health or assumption of debts)* with serious implications on the budget, as was the case with the Philippine National Bank (PNB) and the Development Bank of the Philippines (DBP) in the 1980s.[3]

A breakdown of guarantee fee collections from the BTr shows that out of P6.3 billion *(as of 31 October 2003),* P5.1 billion are fees paid by Napocor, P467.8 million by DBP, and P186.4 million by Land Bank of the Philippines (LBP). Total outstanding NG guaranteed loans *(as of 31 December 2002)* reached US $10.5 billion, of which $6.2 billion and $2.1 billion were incurred by Napocor and DBP, respectively.

Expenditure Accounts

The Arroyo administration deserves some credit for sustaining efforts of previous administrations in institutionalizing expenditure reform measures that can improve the prioritization of public investments, rationalize fund releases, and create incentives to encourage efficient spending among government offices.

To contain the deficit at program level, NG imposed mandatory savings of 15% on non-personal services items during the 1st quarter. Reserves particularly for health and education were later lifted while other disbursements were calibrated to revenue inflows. Fund releases were also linked to results of agency/project performance reviews. An Official Development Assistance (ODA) review resulted in a total savings of US $247.2 million from the following: $31 million due to cancellation of loans/excess financing, $100 million due to termination of a project, and $116.2 million due to restructuring of 30 loan portfolios.

[3] Gerardo P. Sicat and Rahimaisa D. Abdula in "Public Finance" of the Philippine Economy by Balisacan and Hill (2003).

The 2003 budget also has a lesser carryover to 2004. From a beginning balance of P131.7 billion in accounts payable *(as of January 2003),* the national government was able to reduce its payables to P121.3 billion[4] as of yearend.

In exchange for spending efficiency, state universities and colleges (SUCs) through their respective governing Boards were given greater flexibility in managing their finances. Public schools and hospitals were also allowed to use their income instead of remitting them to the Treasury. The DBM also authorized agencies to use budget savings from procurement and streamlining activities.

Excess revenue collection in 2003 allowed the national government to spend more than originally programmed. Total spending of P826.4 billion for 2003 slightly exceeded the expenditure program of P786 billion by 5%. In nominal terms, this translates to about P40.4 billion additional spending for government operations.

Close to 80% of NG expenditures in 2003 went to mandatory expenses—i.e., personal services (PS), interest payments, and allocation to local government units (LGUs). Roughly one-third or 33% of the national government budget was spent for salaries and wages alone. In fact, spending for personal services exceeded the 2003 program by about P10.4 billion. This may be attributed to salary adjustments for personnel of the Armed Forces of the Philippines (AFP) and the Philippine National Police (PNP), and to payment for new teacher and police positions.

To pay off interests on accumulated debts, NG set aside 27% of its budget for debt service. About 18% automatically went to LGUs as shares in the internal revenue taxes or the Internal Revenue Allotment (IRA)[5]. The national government is left with only about 20% for maintenance and other operating expenditures *(e.g., supplies, communication, training, and travel expenses)*, and capital outlay.

TABLE 2
NATIONAL GOVERNMENT EXPENDITURES
(IN BILLION PESOS)

Particulars	2002	2003		% Deviation	% Growth
	Actual	Program	Actual		
Current Operating	650.5	696.0	708.9	1.9	10.0
Personal Services	265.9	265.7	276.1	3.9	3.8
MOOE	83.4	77.0	78.5	1.9	(5.9)
Allotment to LGUs	109.8	116.1	115.7	(0.3)	5.4
Interest Payments	185.8	230.7	226.4	(1.9)	21.9
Subsidy	5.6	6.5	12.2	87.7	117.9
Capital Outlays	124.3	84.5	114.6	35.6	(7.8)
Infrastructure	93.0	49.7	77.6	56.1	(16.6)
Equity	1.5	1.6	2.6	62.5	73.3
Capital Transfer to LGUs	27.8	30.3	29.0	(4.3)	4.3
CARP Land Acquisition/ Credit	2.0	2.9	5.4	86.2	170.0
Net Lending	3.9	5.5	2.9	(47.3)	(25.6)
Total Expenditures	778.7	786.0	826.4	5.1	6.1

Source: DBM and BSP-IRO

[4] Preliminary data as presented by Usec. Laura B. Pascua (DBM) in a Yearend Economic Briefing: Expenditure Accounts, held 3 February 2003.
[5] The 1991 Local Government Code provides that 40% of the internal revenue collection of the third year preceding the current fiscal year shall go to LGUs. Twenty percent (20%) of which is allocated by NG as capital transfers.

Although the national government originally intended to spend only about P49.7 billion for infrastructure, actual spending for public works by end of 2003 reached P77.6 billion. The growth in infrastructure outlay can be attributed to higher-than-projected loan inflows for foreign-assisted projects (FAPs). Note, however, that even with additional inflows from FAPs, infrastructure spending is still low by 17% compared with P93 billion in 2002.

Subsidies and advances (net lending) to government corporations continue to drain the NG budget. In particular, the conversion of NG advances to subsidy automatically converts receivables from GOCCs to direct expense of the central government. Actual net lending was only P2.9 billion which is only half of the P5.5 billion that was originally programmed. On the other hand, subsidies totaled P12.2 billion which is almost twice the P6.5 billion program.

Public Sector Deficit

A smaller NG deficit level in 2003 may indicate the serious intentions of our fiscal managers to reverse the deficit trend and eventually achieve a balanced budget by 2009. However, a growing concern is the consolidated public sector deficit (CPSD) which includes the GOCCs. From only P46.4 billion or 17% of the total public sector borrowing requirement (PSBR) in 2002, the deficit of the 14 monitored GOCCs grew to P97 billion or roughly 31% in 2003.

The financial deficits of government enterprises are captured only partially in the budget as “net lending” or NG advances, equity injections, and subsidies. To have a better picture of the fiscal position of public enterprises, it is best to examine the magnitude of growth in their loan liabilities. As many of these GOCCs accumulate losses and increase their liabilities, they become fiscal burdens to the national government that eventually condones receivables and replenishes their coffers to prevent fiscal insolvency.

Most notably, the operational inefficiencies of Napocor continue to exact a heavy toll on government with its estimated funding deficiency of P73.1 billion in 2003—i.e., about 75% of total deficiencies of government corporations. The NPC case and other similar lapses in the past *(e.g., the old Central Bank engaging in non-monetary activities or financial institutions like PNB and DBP for accumulating non-performing loans)* should make government more concerned with the modality and level of interventions as well as the choice of administrators for government corporations.

Conclusion

Keeping the 2003 deficit level within target is laudable but it is disturbing that the national government continues to borrow in excess of its program. It is questionable to be borrowing more when the deficit is low, and revenue-generating agencies were collecting more than expected. What is equally alarming though is that a large portion of existing liabilities was sourced abroad which makes them vulnerable to foreign exchange adjustments whenever the peso depreciates.

With due credit to incumbents at the BIR and BOC, collection in 2003 showed serious effort to rebound from a rather dismal performance in 2002. Revenue goals were met but only because the targets were low. Total collection as a ratio to GDP did not show any improvement from 2002. And since the growth in collection cannot be attributed to an increase in tax base, but to non-recurring sources like penalties and back taxes, there are doubts as to whether such level of revenue inflow can be sustained. On the other hand, BIR's effort to improve tax collection can send positive signals that may eventually increase public compliance.

Revenues from guarantee fees and interest income from NPC bonds may be advantageous only in the short term. It improves the current fiscal position, but in the long term, it can put the government at high fiscal risk especially with many of the government corporations accumulating losses and eventually making a contingent claim on the national budget. Moreover, increased earnings from deposits and investments in government securities using borrowed money could be illusory and worrisome if used to finance current expenditure needs. Interest payments and future redemption of bonds will later lay claim on future budgets, and could put additional pressure on government finances.

The increasing share of mandatory expenses in the national budget sacrifices government operations and capital investments supposedly for strategic sectors like telecommunications and infrastructure. With 80% of the budget already allocated to salaries/wages, interest payments, and allotment to LGUs, there is very little funds left that could be allocated to programs and projects that can improve the country's productive capacity.