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Philippine Institute for Development Studies
Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas

Analysis of the President's Budget for 2003

Rosario G. Manasan

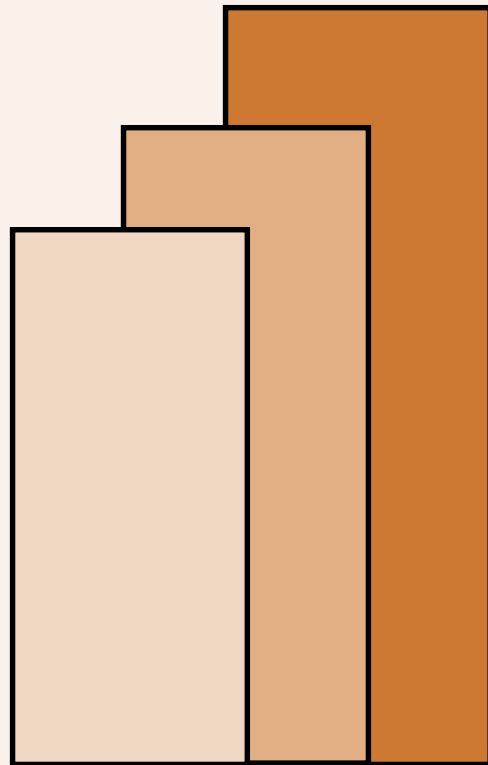
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ANALYSIS OF THE PRESIDENT'S BUDGET FOR 2003

ABSTRACT

Rosario G. Manasan

This study presents an evaluation of the President's Budget for 2003. First, it shows that the fiscal targets set out in the administration's Budget of Expenditures and Sources of Financing (BESF) for 2003 are not likely to be met. In particular, the fiscal deficit target of P130 billion (or 3.3% of GDP) for 2002 will be exceeded by P93 billion (or 2.4% of GDP). Thus, the paper projects that the national government's fiscal position will weaken from a deficit of 4.1% of GDP in 2001 to a deficit of 5.6% of GDP in 2002. In like manner, the fiscal deficit target of P142.1 billion (or 3.3% of GDP) in 2003 will also be exceeded by P34 billion – P64 billion (or 0.8% - 1.5% of GDP). While the government was able to run high deficits in the last three years without hurting macroeconomic stability, danger signs have begun to emerge. On the one hand, outstanding debt of the national government has been rising rapidly, from 65.5% of GDP as of December 2001 to 68.2% as of August 2003. On the other hand, while interest rates have remained low, the yield curve on government securities is steep indicating that inflationary expectations are high. Second, the problem with the fiscal deficit stems largely from the continuous slide in tax effort. Undoubtedly, evasion continues to be a major source of the leakage in revenues and the situation appears to have worsened in 2001. However, closer analysis indicates that weaknesses in tax structure (non-indexation of excise taxes and proliferation of tax incentives) also need to be addressed. Third, in the near term, fiscal consolidation cannot be achieved unless corrections on the revenue side are effected as government expenditures have already been cut to the bone. Although the expenditure program for 2003 is P34.4 billion (or 4.5%) larger than the obligation program for the previous year, national government services in 2003 are expected to be severely constrained as non-mandatory expenditures (i.e., total national government expenditures net debt service, transfers to LGUs and pensions/retirement gratuity) are programmed to decline by 1.4% relative to the 2002 level. This means that many government agencies, including those in the social service sectors, will have to work with smaller budgets in 2003.

Key words: expenditure program, tax effort, tax evasion, fiscal deficit, fiscal sustainability

ANALYSIS OF THE PRESIDENT'S BUDGET FOR 2003

Rosario G. Manasan

1. INTRODUCTION

In July of each year, the President of the Republic submits to Congress for its approval the budget that the executive branch has prepared for the incoming year. The President's Budget Message for 2003 asserts that this year's budget is one that supports the administration's vision of a strong republic that takes good care of its people and the people's future. It affirms that food, employment, education, health and housing are the core needs that the budget will seek to address. It also promises to provide funds and logistics necessary to ensure peace and order and to eliminate graft and corruption.

As such, the President's Budget for 2003 summarizes the spending priorities of the present administration. However, it goes beyond this. In fact, it is a documentation of its fiscal policy stance. It talks not only about how the government will expend its resources (i.e., its budget), it also discusses how it is going to mobilize resources to finance its budget either through taxation or borrowing. Thus, the President's Budget for 2003 presents the administration's fiscal program for the year by specifying concomitantly not only its expenditure program but also its revenue forecast and its fiscal deficit target.

Given this perspective, the following question begs to be asked. To what extent does the President's budget contribute to the attainment of the overall objectives of economic policy namely, stability, growth, and equity? In answering this question, it is important that the interlinkages between the revenue program, the expenditure program and the borrowing program are explicitly recognized and it is in this context that the President's budget proposal is evaluated in terms of twin objectives of a good fiscal policy: fiscal discipline and strategic allocation of resources.

On the one hand, fiscal discipline requires that the fiscal targets (revenues, expenditures, and resulting fiscal deficit) are made consistent with a realistic macroeconomic framework. On the other hand, allocative efficiency calls for government expenditures to be programmed across sectors and categories in order to promote the over-arching goals of governance: poverty alleviation and economic growth.

It should be emphasized the budget is as much a product of technocratic know-how as the processes and institutions that govern its preparation. For instance, "the tendency to overestimate government revenues may stem from informal incentives to do so rather than from technical weaknesses. ... like "the desire of ministries to include or maintain in the budget an excessive number of programs, while downplaying difficulties in financing them. ... At times, "forecasts are deliberately manipulated to ensure the continued functioning of the patronage system. When expenditures must be cut owing to 'unexpectedly' low revenues, cash rationing

is used as a way to favor client and kinship groups” (Schiavo-Campo and Tommasi 1999, pp. 7-8; p. 90). Needless to say, given the successive adjustments in the fiscal targets due to shortfalls in revenue collections, these points are particularly relevant in the Philippines.

At the same time, while economic theory and empirical analysis do provide some guidelines on expenditure categories that are beneficial to growth and equity (e.g., infrastructure investment, human capital expenditures especially with respect to basic education and basic health) or on budgetary practices that promote more efficient allocation of resources (e.g., performance based budgeting), it cannot be denied that “strategic” resource allocation (i.e., relative prioritization of government spending levels across sectors) is largely a political decision.

With this as background, the evaluation of the President’s Budget that is presented in this short note is composed of three parts: (i) an evaluation of the overall fiscal picture as projected in the President’s Budget and its consistency with the macroeconomic assumptions that are also embodied therein; (ii) an examination of its revenue program; and (iii) the congruence of the expenditure program with policy pronouncements and enunciated budgetary intent. In analyzing the President’s Budget, this paper likewise provides not only a longer-term but also a cross-country perspective.

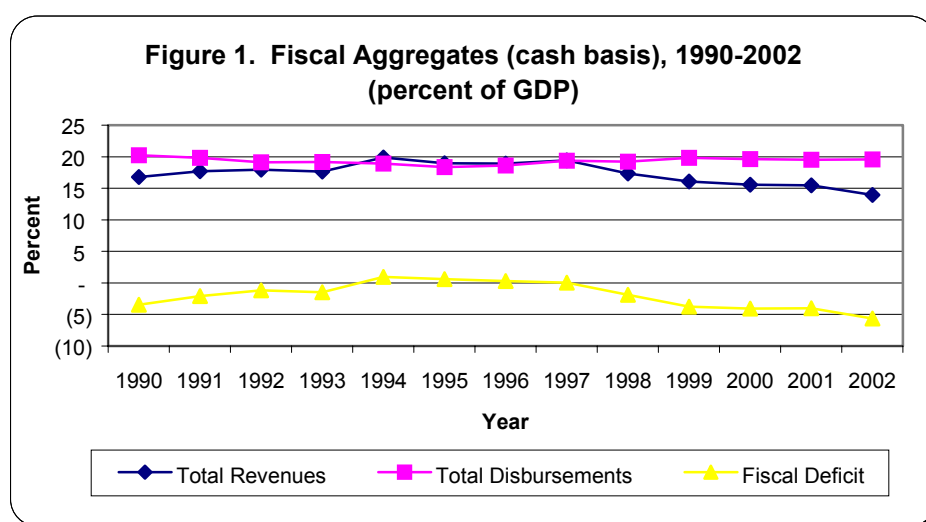
Section 2 documents how the national government will again overshoot the fiscal deficit targets for 2002 and 2003 in the President’s Budget for 2003. It also suggests that the current fiscal stance is unsustainable not only because it results in a higher ratio of government debt to GDP but also because the latter makes the country vulnerable to interest rate and foreign exchange rate fluctuations.

The fiscal outlook for 2002 and 2003 underscores more than ever before the fact that the problem with fiscal deficit stems largely from the continuous slide in tax effort. Meanwhile, the analysis of the sources of the decline in tax effort in 1997-2001 that is provided in **Section 3** indicates that while tax evasion continues to be a major source of the leakage in revenues, weaknesses in tax policy also contributed significantly to the deterioration in tax effort. In this regard, two major pieces of legislation are urgently needed in the following areas: (1) indexation of excise taxes and (2) rationalization of fiscal incentives. However, given the proximity of the 2004 election, moving these new tax measures through legislative mill will be a major challenge to both Congress and the executive branch in as much as raising taxes will undeniably hurt certain sectors.

On the other hand, although the expenditure program for 2003 is P34.4 billion (or 4.5%) larger than the obligation program for the previous year, national government services in 2003 are expected to be severely constrained as non-mandatory expenditures (i.e., total national government expenditures net debt service and transfers to LGUs) are programmed to decline by 1.4% relative to the 2002 level. This means that many government agencies, including those in the social service sectors, will have to work with smaller budgets in 2003 (**Section 4**).

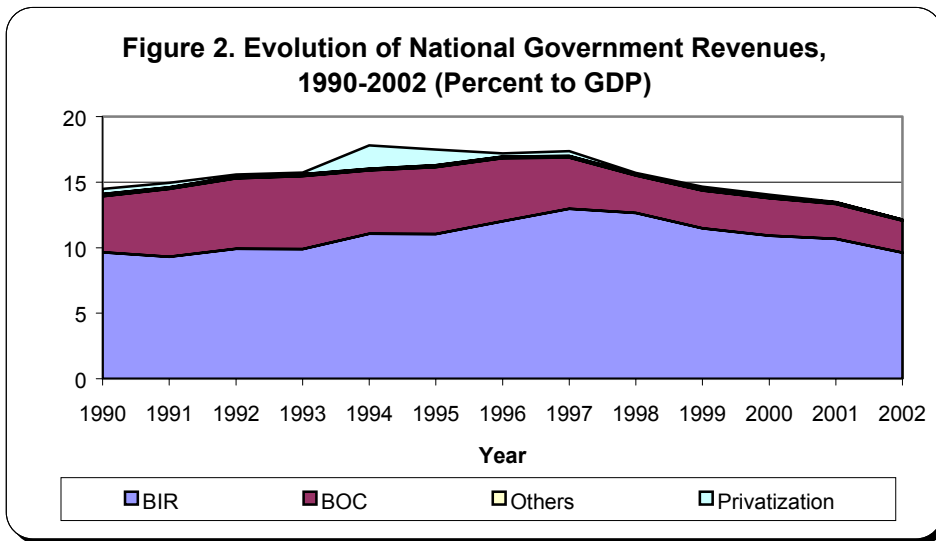
2. OVERALL FISCAL POSITION IN PERSPECTIVE

This section reviews the movements in the overall fiscal position of the national government from a longer term perspective in order to provide the context against which to assess the overall fiscal program in 2002 and 2003. The national government achieved dramatic gains in fiscal consolidation in the early 1990s. It turned its fiscal position around from a deficit of 3.5% of GDP in 1990 to a surplus of 1.0% in 1994 (**Figure 1**). About 70% of this improvement in the fiscal balance resulted from advances in its revenue program and the remaining 30% arose from expenditure cuts. On the one hand, the national government boosted its revenues as its tax effort rose from 14.1% of GDP in 1990 to 16.0% in 1994 even as privatization proceeds caused its non-tax revenue to balloon from 2.7% to 3.8% of GDP (**Figure 2**). On the other hand, the increase in transfers to LGUs (from 0.7% of GDP in 1990 to 2.8% in 1994) was partially offset by decrease in subsidies and capital outlays from 1.2% and 3.1% of GDP, respectively, to 0.4% and 2.5% (**Figure 3**). At the same time, the aggressive contraction of the fiscal deficit induced a virtuous circle as interest payments were concomitantly reduced from 6.6% of GDP in 1990 to 4.7% in 1994.

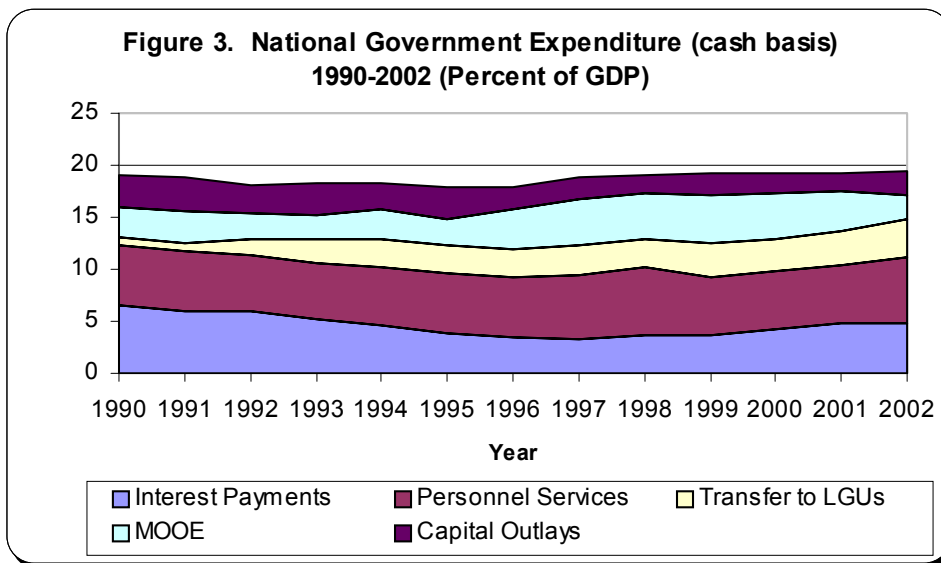


In 1995-1997, the national government continued to post small surpluses. On the revenue side, the slump in non-tax revenues (because of the slowdown in its privatization program) was moderated by fairly small improvements in tax effort. On the expenditure side, the expansion of expenditures on personal services and maintenance and other operating expenditures was neutralized in part by the contraction of interest payments and the continuing retrenchment of capital spending.

However, after enjoying a fairly extended period of fiscal consolidation in the first three-quarters of the 1990s, fiscal trends quickly reversed with the onset of the Asian financial crisis in 1997. Thus, the fiscal position of the national government took a turn for the worse from a surplus of 0.1% of GDP in 1997 to a deficit of 1.9% in 1998. The fiscal deficit continued to rise from 3.8% of GDP in 1999, 4.1% in 2000 and 2001 feeding into a vicious cycle of high deficits leading to large interest payments and even higher deficits.



Given that aggregate government expenditures have remained fairly constant at around 19% of GDP despite the surge in interest payments during this period, the uninterrupted deterioration of the national government’s fiscal balance is largely driven by the incessant decline in tax effort from 17.0% of GDP in 1997 to 13.5% in 2001.



Emerging Fiscal Picture in 2002. When the executive submitted the President’s Budget for 2002 to Congress in July 2001, it initially proposed to cut the fiscal deficit from 4.1% of GDP in 2001 to 3.1% in 2002. In the first quarter of 2002 as the 2003 Budget of Expenditure and Sources of Financing (BESF) was being prepared, the fiscal deficit target was adjusted upwards to 3.3% of GDP (**Table 1**). Since then, the fiscal deficit target was revised three more times, first to 4.0% of GDP, then to 4.5% of GDP and finally to 5.6% of GDP when data for the first 10 months of 2002 became available and showed that the adjusted fiscal deficit targets will not be attained.

Table1
National Government Fiscal Position, 2002-2003 (high growth assumption)
(in billion pesos)

Particulars	BESF Program 2002	Author's Projections 2002 ^{a/}	Difference ^{b/} 2002	BESF Program 2003	Author's Projections (high rev.) 2003	Difference ^{b/} (high rev.) 2003	Author's Projections (low rev.) 2003	Difference ^{b/} (low rev.) 2003
Revenues	596.1	550.0	46.1	640.7	617.3	23.3	588.4	52.2
<i>Tax Revenues</i>	528.4	479.2	49.2	579.9	539.7	40.2	510.8	69.1
BIR	422.5	380.0	42.5	465.6	438.5	27.1	409.6	56.0
BOC	99.6	96.1	3.5	106.8	95.6	11.2	95.6	11.2
Other Offices	6.3	3.1	3.2	7.5	5.6	1.9	5.6	1.9
<i>Non-Tax Revenues</i>	67.7	70.8	-3.1	60.7	77.7	-16.9	77.7	-16.9
Fees and Charges	27.8	26.1	1.7	29.3	30.1	-0.8	30.1	-0.8
BTr Income	36.3	43.5	-7.3	28.3	45.7	-17.4	45.7	-17.4
Privatization	3.2	0.4	2.8	2.0	0.6	1.4	0.6	1.4
Others	0.5	0.8	-0.3	1.2	1.2	-	1.2	0.0
Disbursements	726.1	773.1	-47.0	782.8	793.8	-11.0	794.3	-11.6
<i>Current Operating Expenditure</i>	657.0	681.0	-24.0	717.1	728.2	-11.0	728.7	-11.6
Personal Services	247.4	251.3	-3.9	262.6	262.6	-	262.6	-
MOOE	71.7	91.8	-20.1	83.1	83.1	-	83.1	-
Subsidy	5.7	5.7	-	4.0	4.0	-	4.0	-
Allotments to LGUs	140.3	140.3	-	144.1	144.1	-	144.1	-
Interest Payments	191.9	191.9	-	223.2	234.3	-11.0	234.8	-11.6
Tax Expenditures	-	-	-	-	-	-	-	-
<i>Capital Outlays</i>	69.1	92.1	-23.0	65.6	65.6	-	65.6	-
Infra/Other Capital Outlays	57.8	79.6	-21.8	56.5	56.5	-	56.5	-
Equity	0.8	2.0	-1.2	0.7	0.7	-	0.7	-
CARP	3.0	3.0	-	2.9	2.9	-	2.9	-
Net Lending	7.5	7.5	-	5.5	5.5	-	5.5	-
SURPLUS/(Deficit)	-130.0	-223.0	93.0	-142.1	-176.5	34.3	-205.9	63.8
(Percent to GDP)	(3.3)	(5.6)	2.4	(3.3)	(4.1)	0.8	(4.8)	1.5

a/ Based on actual data for Jan-Sept 2002

b/ Difference = target in Budget of Expenditures and Sources of Financing (BESF) less author's projections.

This unfortunate development is attributable in equal parts to the shortfall in national government tax revenues and the overshooting of the expenditure program in 2002. Thus, total tax revenue in 2002 is projected to be P49.2 billion less than the BESF target. Of this amount, P42.5 billion (or 86.4%) is attributable to the Bureau of Internal Revenue (BIR) while P3.5 billion (or 7.1%) is due to the Bureau of Customs (BOC) and P3.2 billion (or 6.5%) to other national government offices. Consequently, BIR tax revenues is forecasted to fall from 10.7% of GDP in 2001 to 9.6% in 2002 (compared with the BESF target of 10.7%) while BOC revenues will slip from 2.6% of GDP to 2.4% (compared with the BESF target of 2.5%).

The analysis in **Section 3** below indicate that BIR tax effort has been going down by some 0.25 percentage point of GDP yearly since 1997 due to the changes in tax structure that were implemented in 1996/1997 while BOC tax effort has been cut by 0.33 percentage point of GDP yearly since 1997 due to the reduction in tariff rates. These numbers then suggest that, other things being equal, the leakage from BIR taxes has increased by 0.8 percentage point of GDP in 2002 relative to 2001. In like manner, the leakage from BOC taxes appears to have decreased by 0.1 percentage point of GDP in 2003.

On the other hand, non-tax revenues are projected to overshoot the official target by P3.1 billion largely on account of the higher than targeted BTr income (P43.5 billion vs. P36.3 billion) which the projected shortfall of P2.8 billion in privatization proceeds and P1.7 billion in fees and charges fail to fully offset.

Meanwhile, national government expenditures are projected to exceed the BESF obligation program by some P47 billion reportedly due to the higher utilization of program loans and the retirement of accounts payables incurred in earlier years. Hence, total disbursements are predicted to reach 19.6% of GDP in 2002 compared with the BESF target of 18.4% and the 2001 level of 19.5%. With these, the fiscal deficit is projected to reach P223 billion (or 5.6% of GDP) in 2002 compared with the BESF target of 3.3% of GDP and the 2001 deficit of 4.1%.

Fiscal Outlook for 2003. The proposed 2003 President's Budget projects the fiscal deficit of the national government at P142 billion (or 3.3% of GDP) in 2003 (**Table 1**). However, this target has since been revised to 4.7% of GDP in 21 November 2002 ostensibly in order to align the revenue target with the current capacity of the fiscal system to generate revenues.

An analysis of the causes of the decline in tax effort in 1998-2001 (see **Section 3** below) suggests that the tax elasticities¹ used to arrive at the original BESF revenue goals for 2003 are unrealistic. In particular, the revenue goals in the President's Budget tend to overestimate the amount of revenues that are likely to be realized largely because the fiscal authorities either ignore the fact that the part of the decline in the tax-to-GDP ratio was brought about by changes in the tax and tariff codes in 1996-1997 (notably the non-indexation of excise taxes, the reduction in the income tax rates without a concomitant reduction in tax incentives and the reduction in tariff

¹ Tax elasticity is defined as the ratio of the proportional rate of increase in tax revenues to the proportional rate of increase in the tax base (usually proxied by GDP or GNP in the aggregative analysis).

rates due to trade liberalization)² and, therefore, are permanent in nature or they assume that such reductions will be fully compensated by gains in collection efficiency.

Given this background, this paper projects BIR tax revenues to range from a high of P438.5 billion (or 10.2% of GDP compared to the BESF's 10.8%) to a low of P409.6 billion (or 9.5% of GDP) while BOC revenues are forecasted to settle at P95.6 billion (or 2.2% of GDP compared to BESF's 2.5%). Both the high and low revenue scenarios take into account the projected decline in tax effort due to changes in tax structure. While both assume that some improvement in BIR's collection efficiency will be achieved in 2003, the two scenarios differ as to the degree of improvement. On the one hand, the high revenue projection assumes that the BIR's collection efficiency will improve sufficiently so as to generate P34.9 billion (or 0.8% of GDP) in additional revenues and to get the bureau back to the 2001 level of evasion even as the tax effort is projected to decline by 0.25 percentage point of GDP because of the 1996/1997 changes in tax policy. On the other hand, while the low revenue projection likewise assumes that tax effort will dip by the same amount due to changes in tax policy, it also assumes that BIR's collection efficiency will improve by only so much as to generate an additional revenues of P6 billion (or 0.1% of GDP).³

Meanwhile, this paper predicts BOC tax effort in 2003 to be lower than that projected under the BESF due to programmed reduction in tariff rates. At the same time, BTr income is projected to exceed its BESF goal in 2003 by P17.4 billion (to reach P45.7 billion) while fees and charges are expected to fall short of the target by P0.8 billion. Also, interest payments are expected to surpass their target level by P11.0 billion to P11.6 billion because of additional borrowings that will be necessitated by the revenue shortfalls that are expected and the higher peso-dollar exchange rate (P52.5) that is used in the paper compared to the BESF (P51).

All these developments combined are then expected to result in a fiscal deficit of P176.5 billion (or 4.1% of GDP) in 2003 based on the high revenue assumption and P205.9 billion (or 4.8% of GDP) based on the low revenue assumption compared with the BESF's projection of 3.3% of GDP.

The revenue numbers in the low revenue scenario presented here are largely consistent with the revised fiscal targets for 2003 that have reportedly been adopted by the administration recently.⁴ Furthermore, note that the 2003 BIR tax evasion level that is projected under the low revenue assumption is lower when compared to the 2002 level but still considerably higher when compared to the 2001 level. In a sense then, the government appears to have almost given up on improving BIR tax administration outside of being able to generate a token P6 billion from administrative measures. It is as if the government has already conceded that the capabilities (in terms of manpower, systems and procedures) that enabled the BIR to collect taxes at the 2001 level of efficiency have been lost for good.

² Recognizing the uncertainty in passing new tax legislation during the year, the BESF does include the expected revenue gains from proposed legislative measures in the revenue projection for 2003.

³ This is the amount of additional BIR tax revenue that the BESF projects to generate from administrative measures in 2003.

⁴ Refer to the 20 November 2003 issues Business World.

Fiscal sustainability. In theory, current fiscal policy is deemed to be sustainable if it can be continued indefinitely into the distant future without threatening government solvency. In practice, however, the indicators that have been used in the literature to assess fiscal sustainability utilize a non-increasing government debt-to-GDP ratio as benchmark.

Undeniably, fiscal deficits are not inherently bad. However, the concern about fiscal deficits stems from the fact that persistently large fiscal imbalances may lead to fiscal instability. This is so because as government debt accumulates over time, interest payments on the debt may increase as the government pays interest not only on debt that it had in the past but also on the new debt that was issued to cover the deficit of the current year. This development results in even larger fiscal deficits and even higher levels of government debt stock, thus leading to an explosive situation where fiscal deficit feeds on itself.

In this regard, one of the simplest ways to appraise fiscal sustainability is by looking at the country's overall fiscal position, the level of public indebtedness and the interest payments on public debt. As indicated earlier, the fiscal position of the national government has weakened very quickly and persistently from a surplus of 0.1% of GDP in 1997 to a deficit of 4.1% in 2001 and 5.6% in 2002. While the government was able to run high deficits in the last three years without hurting macroeconomic stability, danger signs have begun to emerge. On the one hand, outstanding debt of the national government has been rising rapidly, from 55.7% of GDP in 1997 to 65.5% in 2001 and 68.7 as of the end of September 2002. Furthermore, if its contingent liabilities are taken into account, the outstanding debt stock of the national government rose from 66.9% of GDP in 1997 to 79.1% in 2001 and 82.5% as of the end of September 2002. On the other hand, while domestic interest rates have remained low, the yield curve on government securities in the primary market has remained steep indicating that inflationary expectations are high (Lamberte 2002). Moreover, news of larger than projected fiscal deficits have prompted two international credit rating agencies (Fitch and Standard and Poor's) to downgrade their credit outlook for the Philippines recently. This will necessarily put pressure on domestic interest rates as the government turns to the domestic market following the increase in the rates on government dollar bonds.

From a cross country perspective, while the overall fiscal balance of the Philippines when measured relative to GDP is not the highest in the region in the post-crisis since 1999,⁵ the country had always outranked the other countries in terms of the size of its national government's debt (**Table 2**). In this sense, then, the Philippines is more vulnerable than the other countries in the region to fluctuations in the interest rate and the foreign exchange rate.

At the same time, it is notable that while the Philippines posted primary surpluses⁶ during most of the late 1990s, it registered a primary deficit in 2001. In addition, when fiscal sustainability is evaluated in terms of the ability of fiscal policy

⁵Thailand registered the largest fiscal deficit in the region in 1997-1999 while Malaysia posted the highest fiscal deficit in 2000-2001. During this period, however, the Philippines had the second largest fiscal deficit amongst ASEAN countries.

⁶ The primary surplus is equal to government revenues less non-interest outlays. Alternatively, it is equal to the total surplus plus interest payments.

to stabilize the ratio of government debt-to-GDP, it is found that the actual primary deficit has exceeded the sustainable primary deficit⁷ in 2000-2002 (**Table 3**). Moreover, from all indications, the same would hold again in 2003.

Table 2. Fiscal Balance and Outstanding Debt of the Central Government in ASEAN Countries, 1996-2001 (Percent of GDP)

	1996	1997	1998	1999	2000	2001
Overall Fiscal Balance to GDP Ratio						
Indonesia	n.a.	0.0	-3.7	-2.8	-1.6	-2.3
Malaysia	1.1	2.5	-1.5	-4.1	-4.2	-6.7
Thailand	2.4	-2.1	-7.6	-10.5	-3.2	-3.8
Philippines	0.3	0.1	-1.9	-3.8	-4.1	-4.1
Debt to GDP Ratio						
Indonesia	23.9	24.2	68.8	53.3	48.6	n.a.
Malaysia	35.9	31.9	36.4	37.3	36.9	n.a.
Thailand	3.9	5.1	10.7	20.9	22.6	25.0
Philippines (without contingent liabilities)	53.2	55.7	56.1	59.6	65.5	65.5
Philippines (with contingent liabilities)	61.3	66.9	67.6	72.0	80.1	79.1

In **Table 3**, fiscal sustainability (fs) is measured by comparing the actual primary deficit with sustainable primary deficit. In turn, following Anand and van Wijbergen (1989) and Catsambas and Pigato (1989), the sustainable primary deficit (sus pdef) is defined as:

$$\text{sus pdef} = -(r - g) b - (i^* + \Delta(E)/E - \pi - g) b^* \quad (1)$$

where g is the growth rate of real GDP;
 r is the real domestic interest rate;
 b is the ratio of national government domestic debt to GDP;
 b^* is the ratio of national government foreign debt to GDP;
 i^* is the nominal foreign interest rate;
 $\Delta(E)/E$ is the proportional rate of change in the exchange rate;
 π is the domestic inflation rate.

Thus, fiscal sustainability may be written as:

$$\text{fs} = \text{act pdef} - \text{sus pdef} \quad (2)$$

⁷ The sustainable primary deficit is defined as the level of the primary deficit that could be financed without adding to the debt burden.

Equation 2 suggests that sustainability requires the actual primary deficit to be less than the estimated sustainable primary deficit. In particular, if fs is positive, then the actual deficit exceeds the sustainable primary deficit and the debt-to-GDP ratio will increase. Conversely, if fs has negative sign, then the actual deficit is less than the sustainable primary deficit and the debt-to-GDP ratio will decline. In other words, the government's fiscal stance is sustainable if its debt-servicing requirement does not exceed its primary surplus.

Table 3
Sustainable Primary Deficit
1995-2002

	Actual Primary Deficit % GDP	Sustainable Primary Deficit % GDP	Actual Less Sustainable Primary Deficit % GDP
1995	-4.392	2.690	-7.082
1996	-3.811	2.237	-6.049
1997	-3.277	-2.396	-0.882
1998	-1.869	-10.448	8.579
1999	0.180	2.328	-2.147
2000	-0.202	-4.210	4.008
2001	-0.732	-4.134	3.402
2002	0.788	0.570	0.218
2003	-0.671	-1.008	0.338

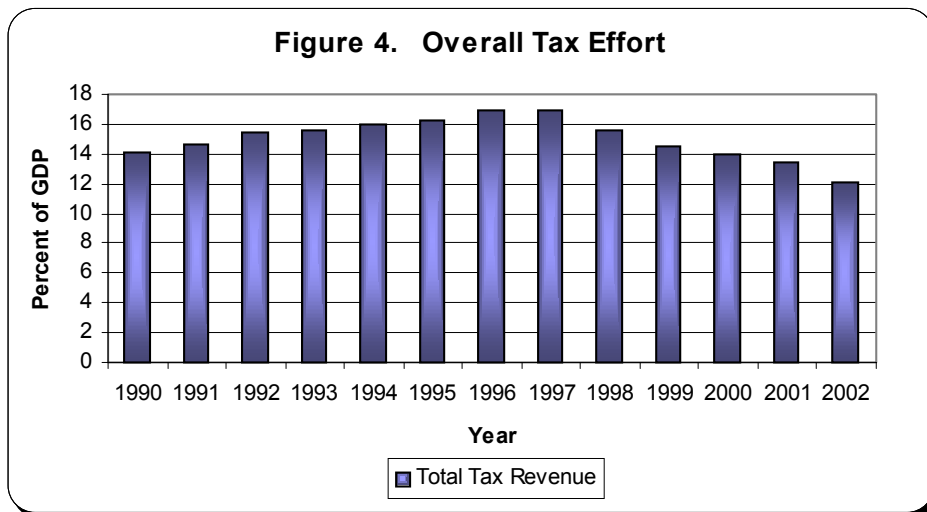
3. REVENUE PROGRAM

The weakening of the government's fiscal position in 2002 and possibly in 2003 underscores more than ever the urgency of arresting the undeterred contraction of the revenue effort of the national government which slipped since the onset of the East Asian financial crisis from 19.4% of GDP in 1997 to 15.5% of GDP in 2001 and 13.9% in 2002. Although other countries in the region have likewise suffered a deterioration in their revenue effort since 1997/1998, the decline in these countries with, the exception of Malaysia, has not been as severe as in the Philippines (**Table 4**).

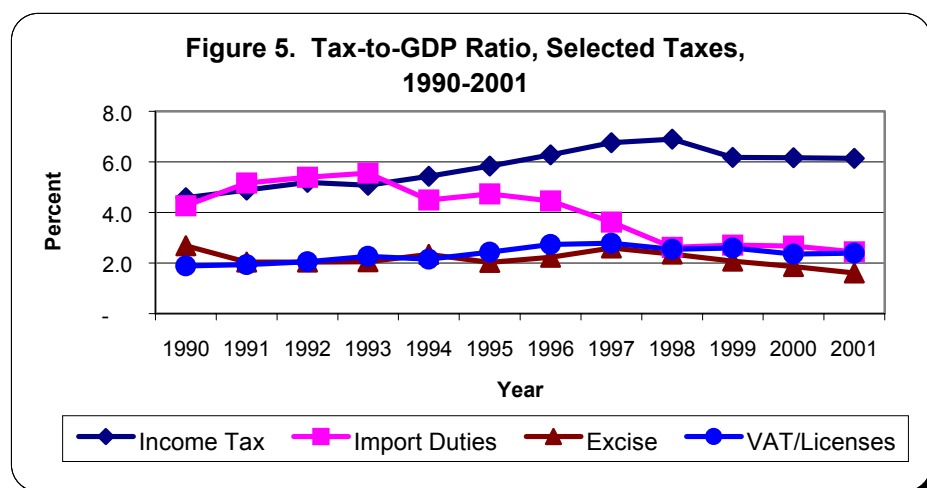
Table 4. Revenue and Tax Effort in ASEAN Countries, 1996-2000
(Percent of GDP)

	1996	1997	1998	1999	2000
Total Revenue					
Indonesia	17.0	18.1	12.6	17.9	15.9
Malaysia	23.3	23.5	20.0	19.7	18.3
Thailand	19.5	18.6	16.2	16.2	16.5
Philippines	18.9	19.4	17.4	16.1	15.6
Tax Revenues					
Indonesia	14.7	16.5	11.8	16.6	14.5
Malaysia	19.4	19.8	16.7	16.0	14.3
Thailand	17.6	16.5	14.2	14.0	14.3
Philippines	16.9	17.0	15.6	14.5	13.9

Although non-tax revenues dipped as well, the erosion of the revenue effort in the Philippines is largely due to the weakening of the tax effort as in the other countries in the region. Thus, overall tax effort in the Philippines plummeted by 3.5 percentage points from a peak of 17.0% of GDP in 1997 to 13.5% in 2001 (Figure 4). About two-thirds of the contraction (or 2.3 percentage points of GDP) is due to the reduction in BIR tax revenues while the remainder (or 1.3 percentage point of GDP) is attributable to the reduction in BOC revenues.



Collections for all the major tax groups fell relative to GDP in 1997-2001. The biggest reductions are exhibited by the import duties, excise taxes, and income taxes (Figure 5). In particular, tariff revenues tumbled from 3.9% of GDP in 1997 to 2.6% of GDP in 2001. Meanwhile, collections from excise taxes shrank from 2.6% to 1.6% of GDP, revenues from taxes on income and profits dipped from 6.8% to 6.1% of GDP and collections from value added and licenses contracted from 2.8% to 2.4% of GDP during the same period.



While the slide in non-tax revenues is largely explained by the diminution in the income of the Bureau of Treasury following the decline in domestic interest rates, the reasons for the fall in tax revenues have been somewhat of a puzzle to many

analysts. On the one hand, many believe that the slump in tax effort reflect the lack of political will to tackle tax evasion. On the other hand, some groups point out that changes in the structure of the economy (e.g., economic recovery being led by lightly taxed sectors like agriculture and exports) during the period partly explain the degeneration of tax effort. Still others note that some of the tax policy changes introduced in 1996/1997 under the umbrella of the Comprehensive Tax Reform Package (**Box 1**) may have resulted in loss of revenue that was not compensated adequately by the expected revenue gains from other provisions which were not legislated and therefore not implemented.

Table 5 shows the varying importance of each of these factors in explaining the decline in tax effort at the BIR and BOC in 1997-2001.⁸ While the fall in BOC revenues account for over three-quarters of the overall contraction in tax effort between 1997 and 1998, BIR has since then emerged to be the dominant source of the flagging tax effort. The programmed reduction in tariff rates under the trade liberalization program of the government accounts for some 40%-50% of the reduction in tax effort at the BOC in 1998-1999. Changes in the composition of imports (i.e., the shift away from dutiable imports) also adversely affected the BOC's tax take in those two years. A deterioration in the quality of customs administration was evident in 1998 but not in 1999-2001. Thus, almost all of the diminution in the BOC's tax effort in 2000 and 2001 is due to the lower tariff rates. On the average, BOC tax effort dipped by 0.33 percentage point of GDP every year between 1997 and 2001 due to the programmed reduction in tariff rates.

The negative impact on revenues of lower import tariffs was compounded by weaknesses at the BIR which has resulted in huge tax leakages even prior to 1997.⁹ Higher tax evasion (relative to 1997) accounted for 98% and 54% of the reduction in BIR tax effort in 1998 and 1999. While some improvement in BIR tax administration was evident in 2000 (relative to the 1999 level but not 1997), further weakening of the system was registered in 2001. In that year, the VAT as well as the tax on income and profits were the major sources of evasion.

On the other hand, the contribution of changes in tax policy to the collapse of BIR tax effort rose persistently in 1998-2001. In particular, 46% of the 2.3 percentage point decline in BIR tax effort between 1997-2001 is attributable to changes in tax policy (notably the reduction in effective tax rates for the income tax and the excise tax due to non-indexation), another 46% to increased evasion and only 7% to changes in economic structure. On the average, BIR tax effort declined by 0.26

⁸ In column 1 of **Table 5**, the change in the tax-to-GDP ratio for each year in 1998-2001 is always measured relative to 1997. For each of the major taxes, the contribution of the change in economic structure to the decline in tax effort was derived by estimating the amount of tax revenue that would have been collected if there were no changes in the composition of the economy relative to 1997 (i.e., if the tax base-to-GDP ratio was kept at the 1997 level). On the other hand, the contribution of the change in tax policy to the deterioration of tax effort was computed by estimating the amount of tax revenue that would have been collected if the effective tax rates that were prevailing in 1997 were applied to the current year's tax base. Meanwhile, the contribution of higher tax evasion was derived as a residual. That is, what cannot be explained by the first two factors was attributed to increased tax evasion.

⁹ The Department of Finance (1998) estimated the total tax leakage in 1997 at 7.8% of GNP (with 7.2% of GDP due from the BIR and 0.6% of GNP due from the BOC).

percentage point of GDP every year between 1997 and 2001 due to the changes in tax structure wrought by CTRP. It is also notable that, on the whole, the reduction in tax effort brought about by modifications in tax policy (specifically that due to the non-indexation of excise taxes) is not a one-off reduction but has been growing over time.

Box 1. The 1996/1997 Comprehensive Tax Reform Package

In 1996-1997, the government launched another round of tax reform under the umbrella of the Comprehensive Tax Reform Package. As originally designed, it was meant (1) to widen the tax base; (2) to simplify the tax structure so as to minimize the tax evasion; and (3) to make the system more elastic and easier to administer. While intended initially to be legislated as a comprehensive measure, it was actually passed into law in piecemeal fashion.

As a result, Republic Act (RA) 8184 which provided for the restructuring of the excise tax on petroleum products hand in hand with tariff restructuring in the sector was enacted into law in June 1996. Meanwhile, RA 8240 which reverted the excise tax on fermented liquor, distilled spirits and cigarettes back to the specific scheme from the *ad valorem* system took effect in January 1, 1997. On the other hand, RA 8241 (which also took effect in January 1, 1997) expanded the list of items that are exempted under the Expanded Value Added Tax (EVAT) to include printing, publication, importation or sale of books, newspapers, magazines, reviews or bulletins; operators of taxicabs, rent-a-car companies; operators of tourist buses; small radio and television broadcasting franchise grantees; the sale of properties used for low-cost and socialized housing and the lease of residential units with a monthly rental not exceeding P8,000 per month. Lastly, the RA 8424 (otherwise known as the Tax Reform Act of 1997) was passed by Congress in 1997. It provided for (1) the phased reduction in the corporate income tax rate from 35% in 1997 to 32% from 2000 onwards; (2) the levy of a 2% minimum corporate income tax rate; (3) the adoption of the net operating loss carry forward (NOLCO); (4) accelerated depreciation using double declining balance or sum-of-the-years digits method; (5) cap on deductibility of travel and entertainment expense; (6) disallowance of the tax benefits of interest arbitrage; (7) introduction of a tax on fringe benefits; (8) reimposition of the final withholding tax on dividends although intercorporate dividends remain exempt; (9) levy of final withholding tax of 7.5% on interest earned by residents on foreign currency deposits; (10) increase in the level of personal exemptions for the individual income tax; and (11) gradual reduction of the top marginal tax rate for the individual income tax from 35% in 1997 to 32% in 2000 onwards.

It should be emphasized that the various bills adopted by Congress deleted key proposed features of the tax reform package. In consequence, the overall impact of the Package on the revenue performance of the tax system has been negative. On the one hand, the broader coverage of the VAT under the expanded VAT (i.e., EVAT) improved VAT effort (albeit to a lesser degree than projected by government) with revenues from the VAT and selected tax on services (like other percentage taxes, tax on insurance premiums and franchise tax) rising from 2.2% of GDP in 1995 to 2.4% of GDP in 1997. On the other hand, while the adoption of specific rates for excise taxes was meant to guard against evasion, the move reduced the buoyancy of the tax system because the indexation provision that was part of the original proposal was not approved by Congress. In like manner, although the rationalization of fiscal incentives was an integral part of the Package when it was first conceived, the proposal has not passed Congress even as the key departments (DOF, DTI, NEDA and DBM) continue to debate the design and coverage of tax incentive regimes.

Meanwhile, the provisions of RA 8424 relating to the corporate income tax were estimated to increase revenues not all of the expected gains in revenue were realized on time because of but delays in the issuance of the regulations needed to implement its various provisions. On the other hand, the revenue loss arising from the increase in personal exemptions for individual income tax payers were felt immediately.

Table 5. Explaining the Decline in Tax Effort^{a/}

	1998				1999				2000				2001			
	Economic Structure	Tax Policy	Increased Evasion	Total	Economic Structure	Tax Policy	Increased Evasion	Total	Economic Structure	Tax Policy	Increased Evasion	Total	Economic Structure	Tax Policy	Increased Evasion	Total
BIR	0.3	-0.3	-0.3	-0.3	-0.2	-0.5	-0.8	-1.5	-0.8	-0.8	-0.4	-2.1	-0.2	-1.1	-1.1	-2.3
% contribution	-84.4	85.9	98.4	100.0	16.0	30.4	53.6	100.0	38.8	40.8	20.4	100.0	7.3	46.5	46.2	100.0
Value added tax	0.0		-0.2	-0.2	0.0		-0.2	-0.2	0.0		-0.4	-0.4	0.0		-0.4	-0.4
cit	0.0	0.0	-0.5	-0.6	0.1	-0.1	-0.7	-0.7	-0.5	0.1	-0.3	-0.8	-0.5	0.0	-0.2	-0.7
iit	0.1	-0.2	0.0	-0.1	0.1	-0.2	0.0	-0.1	0.2	-0.3	0.0	-0.2	0.2	-0.5	0.0	-0.3
int	0.3	0.1	0.4	0.8	-0.3	0.1	0.4	0.2	-0.3	0.1	0.5	0.3	0.3	0.1	-0.1	0.3
Tax on income and profits	0.4	-0.1	-0.1	0.1	-0.1	-0.2	-0.4	-0.6	-0.7	-0.2	0.2	-0.6	0.0	-0.3	-0.3	-0.6
Excise taxes	-0.1	-0.1	0.0	-0.2	-0.1	-0.3	-0.1	-0.5	-0.1	-0.7	0.1	-0.7	-0.2	-0.7	-0.1	-1.0
Other domestic taxes			0.0	0.0			-0.2	-0.2			-0.3	-0.3			-0.3	-0.3
BOC	-0.3	-0.4	-0.3	-1.1	-0.5	-0.5	0.0	-1.0	0.0	-1.0	0.0	-1.0	-0.1	-1.3	0.1	-1.3
% contribution	28.6	39.0	32.4	100.0	47.0	49.0	4.0	100.0	3.9	98.1	-1.9	100.0	4.8	106.3	-11.1	100.0
Tax revenues	0.0	-0.7	-0.7	-1.4	-0.7	-0.9	-0.8	-2.5	-0.8	-1.9	-0.4	-3.1	-0.2	-2.4	-0.9	-3.6
%	2.2	50.0	47.8	100.0	28.4	37.8	33.8	100.0	27.2	59.9	12.9	100.0	6.4	67.7	25.9	100.0

a/ change in tax effort relative to 1997, measured as percent of GDP

In sum, **Table 5** suggests that tax evasion continues to be a major source of the leakage in revenues and that the situation appears to have worsened in 2001. However, it also indicates that weaknesses in tax structure (non-indexation of excise taxes and the lower effective income tax rates without compensating changes in other taxes) also contributed significantly to the decline in tax effort.

4. THE EXPENDITURE PROGRAM

The President's Budget for 2003 proposes an obligation program amounting to P804.2 billion. It avows that food, employment, education, health and housing are the core needs that the budget will seek to address. It also promises to provide funds and logistics necessary to ensure peace and order and to eliminate graft and corruption.

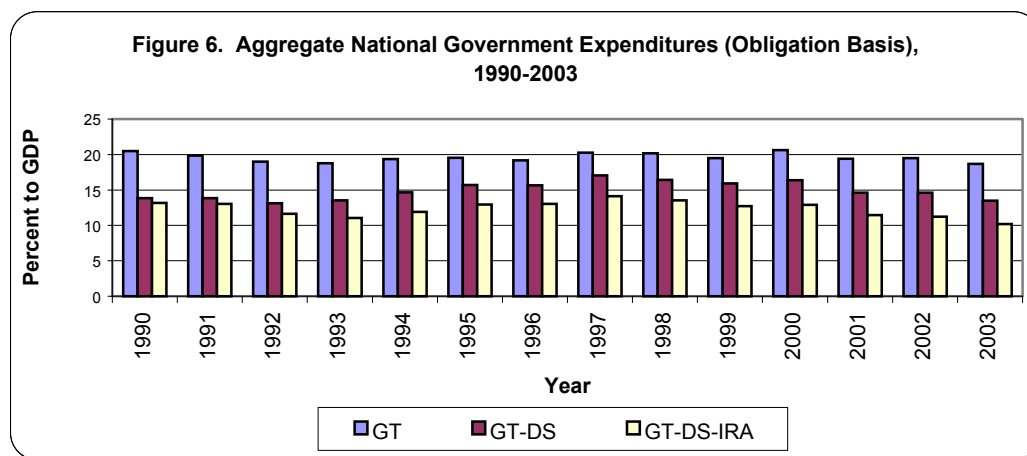
However, because the increase in interest payments and transfers to LGUs when taken together is even larger than the total increase in the President's Budget 2003 budget, there is a squeeze on non-mandatory expenditures (i.e., total expenditures net of debt service and IRA). Hence, the propose 2003 budget of most government agencies is lower compared to that in 2002, thus threatening the delivery of adequate public services in 2003. Furthermore, the higher allocation in the few agencies whose budgets will increase in 2003 is due in many instances to mandatory commitments. For example, the higher allocation for social security/ social welfare is explained mainly by the higher allocation for entitlements (i.e., retirement gratuity and pensions) while the increase in the budget of the Department of Energy (DOE) is largely on account of earmarked expenditures from its special accounts. However, peace and order continue to receive high priority.

Aggregate national government spending. The President's Budget for 2003 proposes an obligation program amounting to P804.2 billion for 2003. The 4.7% increase in total national government expenditure is just marginally higher than the 4.5% inflation rate that is projected for the year (**Annex Table 1**). Thus, the obligation program for 2003 is not much higher than that for 2002 in real terms.

When measured relative to GDP, aggregate national government expenditures for 2003 stands at 18.7% of GDP, lower than the 19.5% level registered in 2002 and the 19.3% of GDP average in 1986-1998 and 19.7% of GDP average in 1999-2002 (**Figure 6**). However, because of the rapid expansion of interest payments following the widening of the fiscal gap in 1998-2002, interest payments continue to eat up an ever-increasing slice of the budget, 27.8% in 2003 from 24.9% in 2002 and an average of 20.0% in 1993-1998 (**Annex Table 3**). Thus, total expenditures net of debt service will actually decline to 13.5% in 2003 from 14.6% of GDP in 2002 and average of 14.8% in 1986-1998 and 15.3% in 1999-2002 (**Annex Table 2**).

At the same time, the IRA increased at a faster rate than most expenditure items as a result of the implementation of the Local Government Code. To wit, its budget share rose from an average of 4.3% in 1986-1992 to 14.0% in 1993-1998, to 16.8% in 1999-2002 and 17.6% in 2003 (**Annex Table 3**). Hence, the amount of resources left for non-mandatory expenditures (i.e., resources over which the national government may exercise some scope for allocation) is further reduced to 10.2% of GDP in 2003 from 11.2% in 2002. Furthermore, the 2003 level is about 2 percentage points lower than the 12.8% average in 1986-1998 and the 12.0% average in 1999-

2002 (**Annex Table 2**). This situation, thus, gives the national government very little room for maneuver not only in terms of being able to influence economic growth by adjusting the overall level of government expenditures but also in reallocating resources across sectors (**Figure 6**).



In addition, personal services accounts for a substantial chunk of the national government expenditures – 34.3% of the budget in 2003. For the most part, expenditures on personal services also form part of mandatory expenditure commitments of the government. If expenditures on personal services treated in this manner, non-mandatory expenditures of the national government are trimmed down some more to 3.5% of GDP in 2003 from 4.4% in 2002 and an average of 6.6% in 1986-1998 and 5.0% in 1999-2002. Given this background, the crunch on MOOE and capital outlays should come as no surprise. Government capital spending is not only lowest in the Philippines in 1995-2000 compared to other countries in the region, it has also been cut relentlessly during the period (**Table 6**).

Table 6. Government Capital Spending in ASEAN Countries, 1995-2000 (% of GDP)

	1995	1996	1997	1998	1999	2000	Average 1995-2000
Capital Expenditure							
Indonesia	6.8	6.0	5.5	4.8	4.8	3.3	5.2
Malaysia	5.0	4.1	4.5	6.0	7.2	7.4	5.7
Thailand	5.6	5.9	9.0	10.3	11.4	4.7	7.8
Philippines	3.0	2.3	2.0	1.7	2.1	1.8	2.2

Allocation across sectors. The proposed expenditure program for 2003 is P34.4 billion higher than the program for 2002. However, the P31.3 billion increase in interest payments (which is the fastest growing item in the obligation program) and the P7.2 billion increase in the IRA, when taken together, clearly exceed the total increment in the proposed obligation program. This means that total expenditures net of debt service and the IRA for 2003 is P4.1 billion lower than the level posted in 2001 (**Table 7**).

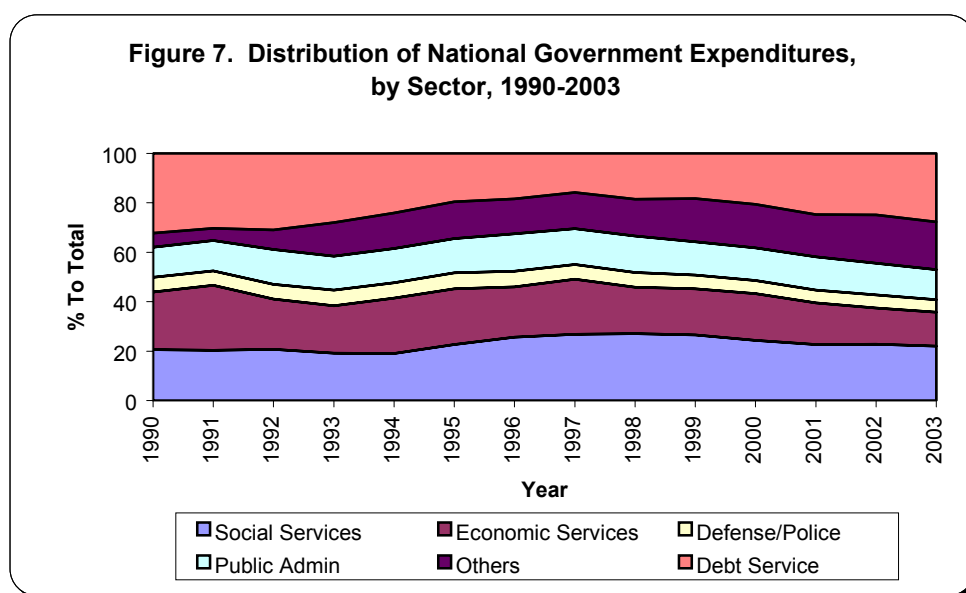
**Table 7. National Government Expenditures, Obligation Basis
2002-2003 (in million pesos)**

Nominal	Total Expenditures		Difference (2003-2002)	Percent Difference
	2002	2003		
GRAND TOTAL	769,804.7	804,200.0	34,395.3	4.5
Total Public Administration	98,029.9	97,571.6	-458.3	-0.5
Public Administration	42,369.6	40,988.2	-1,381.4	-3.3
Peace & Order	55,660.3	56,583.4	923.1	1.7
National Defense	41,514.8	41,020.2	-494.6	-1.2
Total Social Services	175,446.1	176,848.3	1,402.2	0.8
Education	131,015.8	132,411.3	1,395.4	1.1
Health	14,549.8	14,060.1	-489.7	-3.4
Social Services, Labor Welfare & Employment	27,854.0	28,657.0	803.0	2.9
Housing & Community Development	2,026.4	1,720.0	-306.4	-15.1
Total Economic Services	112,468.9	110,311.7	-2,157.2	-1.9
Agrarian Reform	11,461.7	11,554.0	92.3	0.8
Agriculture	22,699.1	21,128.6	-1,570.5	-6.9
Natural Resource	8,338.1	8,025.0	-313.1	-3.8
Industry	3,510.1	2,847.3	-662.8	-18.9
Trade	303.0	277.9	-25.0	-8.3
Tourism	1,113.0	1,290.6	177.6	16.0
Power	1,378.7	2,251.7	873.0	63.3
Water	57.8	54.8	-2.9	-5.1
Transportation	61,967.6	61,756.5	-211.1	-0.3
Other Economic Services	1,639.8	1,125.1	-514.7	-31.4
Debt Service	191,932.0	223,235.0	31,303.0	16.3
Others	150,413.1	155,213.2	4,800.1	3.2
MEMO ITEM:				
Grand Total - Debt Service	577,872.7	580,965.0	3,092.3	0.5
Grand Total - Debt Service - IRA	443,450.4	439,389.1	-4,061.3	-0.9
Grand Total - Debt Service - IRA - Net Lending	435,965.8	433,889.1	-2,076.7	-0.5
IRA	134,422.4	141,575.9	7,153.5	5.3
Priority Development Assistance Fund	5,677.5	3,377.5	-2,300.0	-40.5
Net Lending	7,484.6	5,500.0	-1,984.6	-26.5

Source: 2003 BESF

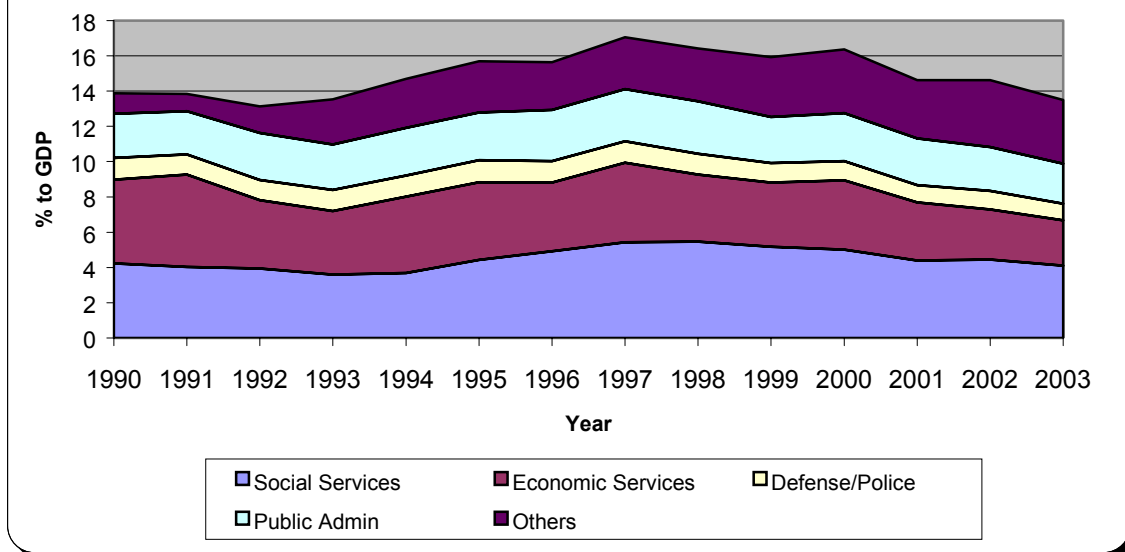
Consequently, the delivery of many public services will be at risk as many government agencies will have to work with smaller budgets in 2003 relative to 2002. Government spending in all the major sectors with the exception of social services will take a cut in 2003. However, the 0.8% increase in aggregate spending on the social services sector is not enough to allow government expenditures in the sector to keep pace with inflation, population growth nor GDP (**Table 7**).

Although spending on all social services combined will continue to receive the biggest slice of the 2003 national budget, its budget share in 2003 (22.8%) is even lower than that in 2002 (22.0%) as debt service and the IRA crowd out spending in other sectors (**Figure 7**). Also, the downward trend in real per capita government spending on social services that started in 1998 continues into 2003 (**Table 8**). Furthermore, the combined national government budget for social services will decline from 4.4% of GDP in 2002 to 4.1% in 2003 (**Figure 8**). Moreover, the amount of resources available for the achievement of the Millennium Development Goals for Human Development in the proposed 2003 budget is short of the requirement by some P26.8 billion (or 0.6% of GDP).



At the same time, **Table 9** shows how the social sectors, particularly education and health, have been badly affected by the fiscal crunch. Government spending on education and health in the Philippines is not only one of the lowest in the region (second only to Indonesia), a downward trend is evident since 1997.

**Figure 8. National Government Expenditures, by Sector
1990-2003, (Percent to GDP)**



Among the social service sectors, government allocation for education and social welfare/social security will increase in nominal terms in 2003 while those for health and the housing/ community development subsectors will decrease (**Table 7**). The higher government spending on the education subsector that is programmed in 2003 is largely on account of the Department of Education (DepEd) as the budgets of all the other important agencies in the education sector (i.e., SUCs, CHED, TESDA) are lower in nominal terms in 2003 relative to 2002. As result, the budget for the entire education sub-sector will contract from 3.4% of GDP in 2002 to 3.1% in 2003 (**Annex Table 2**).

Table 8. Real Per Capita National Government Expenditures on Social Services, 1975-2003 (in 1985 prices)

	Average			1996	1997	1998	1999	2000	2001	2002P	2003F
	75-85	86-92	93-98								
Total Social Services	372	432	547	597	678	659	634	628	555	570	540.96
Education	232	309	395	418	488	480	457	439	414	426	405.04
Health	75	78	59	63	73	60	61	55	45	47	43.01
Social Welfare, Labor & Employment	22	30	78	87	107	105	99	103	90	91	87.66
Housing & Com. Devt.	43	16	15	29	11	13	17	31	6	7	5.26

Although it will increase by P1.1 billion in 2003, the DepEd budget when measured relative to GDP will decrease from 2.6% in 2002 to 2.4% in 2003. Moreover, closer scrutiny of the DepEd budget shows that all of the said increase which will be allocated to personal services simply represents the annualized salaries of new teachers hired in time for school opening in June 2002. Thus, no new teachers

items are authorized under its 2003 budget.¹⁰ Furthermore, the DepEd’s budget for textbooks, desks, MOOE and schoolbuildings in 2003 will be exactly as it was in 2002 for the most part. This means that the department will have to work with the same amount of meager inputs that were available in the previous school year despite the projected 3% increase in the number of students in public schools in school year 2003.

Table 9. Government Social Sector Spending in ASEAN Countries, 1995-2000 (% of GDP)

	1995	1996	1997	1998	1999	2000	Average 1995-2000
Education							
Indonesia	1.3	1.3	1.4	1.0	1.3	0.9	1.2
Malaysia	4.8	4.9	4.5	4.7	5.1	5.9	5.0
Thailand	3.5	3.5	4.1	3.9	4.1	4.1	3.8
Philippines	3.2	3.5	3.9	4.0	3.7	3.5	3.6
Health							
Indonesia	0.4	0.4	0.4	0.3	0.5	0.3	0.4
Malaysia	1.3	1.4	1.2	1.4	1.5	1.6	1.4
Thailand	1.3	1.3	1.6	1.5	1.5	1.5	1.5
Philippines	0.4	0.5	0.6	0.5	0.5	0.4	0.5

Meanwhile, the increase in the allocation for social welfare/ social security subsector is attributable mainly to the P1.0 billion increment in the retirement gratuity and pension of the Armed Forces (**Table 7**). In contrast, the budgets of the most other agencies in the subsector (e.g., DSWD, DOLE) will be reduced. In particular, while the DSWD’s budget for the Comprehensive Integrated Delivery of Social Services will increase by some P100 million in 2002, the budgets for the Early Childhood Development Project will decrease by P94 million, that for “support services to intermediaries in their implementation of social welfare and development programs for distressed and displaced individuals, families, communities in difficult circumstances” by P54 million.

On the other hand, the lower government spending in the health subsector in 2003 is largely explained by the P500 million cut in the budget of the Department of Health (DOH). Many of the public health programs bear the brunt of the reductions, notably vaccine preventable disease control, family health and primary health care, health operations of centers for health development (including TB control, disease prevention and control, and health promotion). In contrast, not only do the direct allocations for DOH hospitals increase, the provision for the hospitals’ use of their own income also rises in 2003.

The reduction in the allocation for the housing/ community development subsector is due to the zero allocation for the community mortgage program (CMP) in

¹⁰ Note that the allocation of P2 billion in the 2002 budget of the DepEd for new teacher items was only enough to fund the June –December 2002 salaries of said teachers. In its 2003 budget, the P3 billion that is set aside for new teachers hired in 2002 will enable the DepEd to pay for the January-December 2003 salaries of the same teachers. In short, no new teachers will be hired under its 2003 budget.

the 2003 budget compared to an allocation of P300 million in the 2002 budget (**Table 7**). In 2002, the allocation for the CMP was handled by the National Home Mortgage and Finance Corporation (NHMFC). While questions can be raised as to whether the NHMFC is the most appropriate agency to implement the community mortgage program, it cannot be denied that available funding for the CMP is inadequate when measured relative to demand.¹¹

The economic service sectors combined suffer the deepest cut amongst the major sectors as government spending in the sector dip by 1.9% in nominal terms in 2003 (**Table 7**). As a result, aggregate government spending on economic services fall from 2.9% of GDP in 2002 to 2.6% of GDP in 2003 (**Figure 8**). Within the economic service sector, only three subsectors receive higher government allocations in 2003 compared to 2002 (**Table 5**). The budget for the power and energy subsector will increase by P900 million in 2003 (or 63% over its 2002 level) on account of earmarked expenditures of P775 million under the special account of the Malampaya (representing shares of LGUs in Malampaya income) and P134 million under the special account of the PNOC-EDC (to fund the Barangay Electrification Program using new and renewal energy, the power conservation and demand management project, the fuel conservation and efficiency in road transport program and the oil industry deregulation management program). Meanwhile, the budget of the tourism subsector will rise by P177 million (or 16% over its 2002 level) to fund its Visit Philippines 2003 program while the budget for the agrarian reform subsector will increase by P93 million (or 0.8% over its 2002 level) due to the higher allocation for the Agrarian Reform Fund.

In contrast, the aggregate government budget for the agriculture subsector is cut by some P1.6 billion in 2003 (or 6.9% less than its 2002 level) despite an increase in the allocation for the Agriculture and Fisheries Modernization Act (AFMA) of P600 million (**Table 7**). This is so because the expansion in the AFMA budget of the Department of Agriculture (DA) is not enough to counteract by the contraction in its regular budget. Moreover, the allocation for the National Irrigation Administration (NIA) is reduced by P2.1 billion in 2003. In like manner, the budget for the environment and natural resources subsector is cut by some P300 million (or 3.8% less than its 2002 level) due to lower allocations for a number of foreign assisted projects like the Metro Manila Air Quality Improvement Development Program, the Forestry Sector Project and the Water Resources Project.

At the same time, the budget for the transportation subsector decreases by P211 million (or 0.3% over its 2002 level) despite an increase of P3.2 billion in the allocation for the Department of Public Works and Highways (DPWH) as the allocations of the Department of the Transportation and Communication (DOTC), the Philippine National Railways (PNR), and the Light Railway Transit Administration (LRTA) are reduced. Consequently, the combined budgets of the infrastructure group (composed of the power/ energy, water resources development and transportation/ communication subsectors) will fall from 1.6% of GDP in 2002 to 1.5% in 2003 and an average of 2.5% in 1986-1998 and 2.1% in 1999-2002 (**Annex Table 2**). This persistent contraction of government spending in the sector does not augur well for

¹¹ To be fair, the community mortgage program will receive additional allocation from the President's Social Fund in 2003. What is not so clear, however, is whether this represents additional money. Note that the Social Fund is extra-budgetary.

the long-term growth prospects of the economy given the well-known positive relationship between infrastructure spending and economic growth. Furthermore, business surveys have time and again identified the country's inadequate infrastructure as one of the weakest links in investment environment.

Consistent with the budget message, military and police spending combined expands in 2003 mainly because of higher allocations for personal services. On the one hand, government spending on the peace and order subsector in 2003 rises by P0.9 billion (or 1.7% over its 2002 level) because of the annualized cost of the salary adjustments that were made effective in July 2002 and the hiring of an additional 4000 policemen in 2003. On the other hand, the allocation for the national defense subsector slides by P0.5 billion (or 1.3% over the its 2002 level) as the funding for the AFP Modernization Program is temporarily discontinued under the 2003 expenditure program. Nonetheless, the budget of the Armed Forces contains additional resources that will enable it to fund not only the salary adjustments of July 2002 but also 7,000 additional personnel.

5. CONCLUSION

From the foregoing discussion, it is clear the fiscal problem that currently confronts the country stems not so much from the expenditure side but from the revenue side. On the one hand, tax effort has declined continuously since 1997. On the other hand, national government expenditures have remained fairly stable in the aggregate. However, because interest payments and transfers to LGUs have expanded rapidly, there is a squeeze on non-mandatory expenditures (i.e., total expenditures net of debt service and IRA). In particular, the increase in interest payments and transfers to LGUS when taken together is even larger than the total increase in the President's Budget for 2003. Consequently, the propose 2003 budget of most government agencies is lower compared to that in 2002, thus threatening the delivery of adequate public services in 2003.

Given this context, two pieces of legislation are urgently needed. First, there is a need to amend RA 8240 so as to allow for the indexation of the excise taxes on tobacco and alcoholic products. While the fiscal authorities talk about the "restructuring of the excise taxes on distilled spirits and the indexation of the tax rates and the tax rates two years thereafter by the amount of cumulative inflation" in the BESF, it is not clear whether such indexation is intended to apply to excise taxes on fermented liquor and cigarettes.¹² Moreover, the BESF is silent about indexation of excise tax on petroleum products. Second, there is a need to revisit proposals for the rationalization of fiscal incentives (**Box 2**). These proposals call for the shorter list of activities that would qualify for investment incentives and the adoption of an operative budget for tax expenditures pertaining to fiscal incentives. In addition, the BESF is also calling for the lifting of the present exemption of Asian Utility Vehicles from the excise tax on automobiles. Given the proximity of the 2004 election, moving these new tax measures through legislative mill in their undiluted form will

¹² With respect to alcoholic and tobacco products, the BESF only talks about the reclassification of products based on their current retail price.

be a major challenge to both Congress and the executive branch in as much as raising taxes will undeniably hurt certain sectors.

Box 2: Fiscal Incentives

At present, there are some 150 laws that provide tax incentives to various industries and special interest groups. These are mainly in the form of tax credits and exemptions that have narrowed the tax base and increased the opportunities for tax avoidance, primarily because of the wider scope for discretion in the administration of the incentive system.

Fiscal incentives are wide ranging across activities and sectors and extend to various taxes. The most important of these are those that provide income tax holiday and exemption from import duties to selected industries through the Board of Investments (under the 1987 Revised Omnibus Investment Code) and to locators in special economic zones through the Philippine Export Zone Authority (PEZA). For example, export enterprises are exempted from customs duties and sales taxes on inputs and received additional deductions for labor costs and tax credits for using of domestic raw materials. Further incentives are granted to “pioneer” industries, which introduce new products, use labor-intensive processes or produce more than 50 percent for export. In addition a variety of fiscal exemptions are extended to the agricultural sector.

Although numerous studies conclude that tax incentives are not a major determinant of investment location decisions of firms, analysts and policy makers agree that foreign direct investment (FDI) play a critical role in the growth prospects of the country. Consequently, in more recent years, the focus of fiscal incentives has shifted from “attracting investment to selected sectors” to simply “attracting investments” in the context of a highly competitive regional environment for FDI (Medalla 2002).

Studies have also raised various concerns with the Philippine fiscal incentives regime: (1) high fiscal cost in terms of foregone revenues estimated to be equal to 1%-2% of GDP¹ (**Box Table 1**); (2) ineffectiveness in promoting investments because of the reliance on non-performance based incentives; (3) distortionary impact on the economy; (4) too wide coverage of the investment priorities list and (5) duplication and double of incentives from various special laws (World Bank 2000). The rationalization of fiscal incentives and tax exemptions was, thus, an integral part of the Comprehensive Tax Reform Package in line with the reduction in the corporate tax rate, and the introduction of the NOLCO and accelerated depreciation in Tax Code. However, the bill that was originally proposed under the Tax Reform Package was not acted upon by Congress. To date, even the executive branch appears to have ambivalent views on fiscal incentives. In fact, the President’s Budget for 2003 is silent about fiscal incentives.

Box Table 1. Summary of Revenues Waived from Various Fiscal Incentives Provisions, 1998-2000 (in billion pesos)

Statutory Basis	1998	1999	2000
Tax-and Duty-exempt imports under various laws	38.2	30.6	9.6
BOI-approved incentives	11.6	6.2	3.9
Tax credits	-	0.6	0.8
Subsidy availment through E.O. 93	-	3.4	2.6
Subsidy availment through the GAA	-	1.7	12.2
Conditionally-free importation under Section 10 of The Tariff and Customs Code	0.8	0.6	0.5
Economic zones incentives	-	0.7	3.7
Exemption from internal revenue taxes under various law	-	-	4.6
Total	50.6	43.8	37.9
<i>Percent of GDP</i>	<i>1.9</i>	<i>1.5</i>	<i>1.1</i>

¹ The numbers shown in **Box Table 1** does not include revenue foregone from the exemption of inputs to exports from taxes and duties as part of the free trade regime given to exports.

In the near term, however, a price survey of tobacco and alcoholic products should be conducted immediately to permit the reclassification of said products for excise tax purposes. Such a survey is prescribed in RA 8240 but has not been implemented to date. This move will provide temporary relief to the unmitigated erosion of revenues from excise taxes pending the legislative action on indexation.

At the same time, efforts to strengthen tax administration should be pursued even more vigorously. In particular, the administration of the VAT has been shown to be a big source of the higher tax leakage in 1998-2001 (**Table 5**). In principle, VAT evasion may arise from two sources: (1) the underdeclaration of sales and/or (2) the overdeclaration of claims for input VAT. The BIR has recently launched a program that is meant to flush out firms which underdeclare their sales. Prospectively, the Bureau could also minimize the leakage from the overdeclaration of claims for input VAT through the use of industry benchmarking. In this regard, it is notable that some 45% of the large VAT-payers were found to have exceeded their respective industry benchmark (for the ratio of the value of VAT-able inputs to value of VAT-able output) by more than 50% (Manasan 2002).

On a more general note, the computerization of the BIR has to be strengthened further. Better use of information technology will clearly go a long way in plugging leakages in the tax system as it provides the BIR with increased access to internal as well as external sources of information and make way for greater automation and less discretion on the part of BIR examiners.

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Annex Table 1
GROWTH RATE OF THE NATIONAL GOVERNMENT EXPENDITURES, BY SECTORAL CLASSIFICATION, 1975-2003
(In Percent)

	Average					1996-97	1997-98	1998-99	1999-2000	2000-2001	2001-2002	2002-2003
	75-85	86-92	93-98	86-98	99-2002							
GRAND TOTAL	15.66	18.07	13.09	15.74	7.32	18.18	9.28	7.99	17.59	3.61	8.87	4.47
Total Economic Services	13.84	7.15	11.70	9.23	0.96	29.49	-7.54	7.06	19.59	-7.44	-6.13	-1.92
Agriculture	10.81	11.71	10.34	11.07	0.48	57.37	-29.56	28.98	-7.24	6.79	2.89	-6.92
Agrarian Reform	1.05	29.16	25.99	27.69	13.61	-1.36	-3.80	-7.67	49.85	-5.90	18.14	0.81
Natural Resources	10.45	19.41	11.54	15.71	8.02	67.77	-32.60	-2.37	2.79	23.68	7.10	-3.76
Industry	14.51	9.08	10.96	9.95	5.78	6.35	-34.96	-0.97	63.88	-45.47	40.13	-18.88
Trade	24.13	-21.82	9.80	-8.55	43.02	7.04	-42.25	-78.25	38.32	303.03	-24.94	-8.27
Tourism	7.61	19.41	24.18	21.59	6.37	31.80	23.74	-28.30	74.40	-41.94	26.41	15.96
Power & Energy	-3.02	24.70	-3.46	10.80	-31.50	111.95	-17.65	186.46	-40.80	28.03	-70.95	63.32
Water Resources Devt.	35.48	5.18	-7.87	-1.06	-46.07	15.06	-50.61	17.65	-24.37	-17.36	-86.47	-5.09
Transp. & Comm.	8.94	15.89	12.34	14.24	0.71	21.95	10.22	-2.58	32.35	-12.30	-11.38	-0.34
Other Econ. Services	32.70	-30.93	3.51	-16.75	-5.27	7.01	-41.53	80.01	-1.05	-31.31	18.50	-31.39
Total Social Services	15.58	21.06	18.21	19.74	3.34	23.58	10.36	5.65	7.85	-3.59	9.66	0.80
Education	16.01	21.48	18.83	20.25	4.26	26.84	11.75	4.50	4.56	2.80	9.93	1.07
Health	15.03	20.26	5.03	12.98	-0.40	25.87	-5.64	10.91	-1.39	-10.51	11.50	-3.37
Soc. Serv., Labor & Emp. & Other Social	7.37	37.04	27.28	32.45	3.66	34.23	12.07	3.56	12.42	-4.11	7.11	2.88
Housing & Com. Devt.	22.36	-16.43	46.65	8.33	-15.93	-59.84	38.22	40.34	104.45	-78.95	16.09	-15.12
National Defense	7.54	11.35	12.51	11.88	5.94	10.79	7.87	4.59	9.86	-0.99	15.81	-1.19
Total Public Services	16.67	23.80	14.04	19.20	5.93	13.25	10.53	-1.97	15.85	6.44	2.12	-0.47
Public Administration	15.29	18.99	11.79	15.61	3.40	9.04	9.37	-11.66	16.04	5.78	-6.88	-3.26
Peace and Order	24.23	35.56	16.99	26.65	8.09	18.49	11.87	8.88	15.68	7.03	10.23	1.66
Others	18.76	25.52	25.67	25.59	10.42	21.95	11.93	26.51	18.38	0.69	24.71	3.19
Debt Service (Interests)	36.21	27.34	3.85	15.90	15.92	1.89	27.99	6.51	32.56	24.09	9.78	16.31
MEMO ITEM:												
IRA	18.61	29.19	24.86	27.18	8.98	25.54	8.29	23.85	19.92	1.36	16.05	5.32
Grand Total - Debt Service	13.76	15.25	16.24	15.71	5.07	21.85	5.76	8.33	14.23	-1.72	8.57	0.54
Grand Total - Debt Service - IRA	13.55	14.13	14.86	14.47	4.02	21.11	5.23	5.02	12.80	-2.54	6.49	-0.92
Infrastructure	8.35	15.97	11.07	13.68	-1.44	24.14	7.79	4.00	24.96	-10.55	-15.57	1.04
Defense & Peace & Order	9.25	18.74	14.79	16.90	7.14	14.77	10.01	6.92	13.08	3.55	12.54	0.44

Annex Table 2
NATIONAL GOVERNMENT EXPENDITURES AS PROPORTION OF GDP, BY SECTORAL CLASSIFICATION, 1975-2003
(In Percent)

	Average					1997	1998	1999	2000	2001	2002	2003
	75-85	86-92	93-98	86-98	99-2002							
GRAND TOTAL	14.85	18.74	19.63	19.32	19.74	20.27	20.17	19.50	20.63	19.43	19.49	18.67
Total Economic Services	6.28	4.53	4.09	4.25	3.39	4.51	3.79	3.64	3.91	3.29	2.85	2.56
Agriculture	0.89	0.79	0.72	0.75	0.63	1.01	0.65	0.75	0.62	0.61	0.57	0.49
Agrarian Reform	0.12	0.35	0.31	0.33	0.28	0.32	0.28	0.23	0.31	0.27	0.29	0.27
Natural Resources	0.24	0.28	0.27	0.28	0.21	0.38	0.24	0.21	0.19	0.21	0.21	0.19
Industry	0.25	0.16	0.17	0.17	0.10	0.18	0.11	0.09	0.14	0.07	0.09	0.07
Trade	0.12	0.04	0.03	0.03	0.01	0.02	0.01	0.00	0.00	0.01	0.01	0.01
Tourism	0.04	0.02	0.04	0.03	0.03	0.04	0.05	0.03	0.05	0.02	0.03	0.03
Power & Energy	0.76	0.34	0.19	0.24	0.12	0.11	0.08	0.21	0.11	0.13	0.03	0.05
Water Resources Devt.	0.14	0.08	0.05	0.06	0.01	0.05	0.02	0.02	0.02	0.01	0.00	0.00
Transp. & Comm.	2.67	2.07	2.22	2.17	1.96	2.31	2.32	2.02	2.41	1.92	1.57	1.43
Other Econ. Services	1.06	0.40	0.08	0.19	0.05	0.08	0.04	0.07	0.06	0.04	0.04	0.03
Total Social Services	2.97	3.88	4.74	4.43	4.72	5.44	5.46	5.17	5.02	4.40	4.44	4.11
Education	1.86	2.76	3.42	3.19	3.44	3.91	3.98	3.72	3.50	3.27	3.32	3.07
Health	0.60	0.70	0.50	0.57	0.41	0.58	0.50	0.50	0.44	0.36	0.37	0.33
Soc. Serv., Labor & Emp. & Other Social	0.16	0.29	0.68	0.55	0.76	0.86	0.87	0.81	0.82	0.71	0.71	0.67
Housing & Com. Devt.	0.35	0.13	0.13	0.13	0.12	0.09	0.11	0.14	0.25	0.05	0.05	0.04
National Defense	1.85	1.34	1.21	1.25	1.06	1.20	1.18	1.11	1.09	0.98	1.05	0.95
Total Public Services	1.59	2.28	2.84	2.64	2.61	2.96	2.98	2.62	2.73	2.64	2.48	2.27
Public Administration	1.19	1.28	1.57	1.47	1.21	1.58	1.57	1.25	1.30	1.25	1.07	0.95
Peace and Order	0.40	1.00	1.26	1.17	1.40	1.38	1.41	1.37	1.43	1.39	1.41	1.31
Others	0.77	1.19	2.84	2.26	3.55	2.94	3.00	3.40	3.62	3.31	3.81	3.60
Debt Service (Interests)	1.39	5.53	3.92	4.48	4.42	3.21	3.74	3.57	4.26	4.80	4.86	5.18
MEMO ITEM:												
IRA	0.61	0.81	2.76	2.07	3.31	2.93	2.89	3.20	3.45	3.18	3.40	3.29
Grand Total - Debt Service	13.46	13.21	15.71	14.83	15.32	17.05	16.42	15.93	16.37	14.62	14.63	13.49
Grand Total - Debt Service - IRA	12.85	12.40	12.96	12.76	12.01	14.12	13.53	12.72	12.92	11.44	11.22	10.20
Infrastructure	3.56	2.48	2.46	2.47	2.09	2.47	2.42	2.26	2.54	2.06	1.60	1.49
Defense & Peace & Order	2.25	2.33	2.47	2.42	2.45	2.58	2.59	2.48	2.52	2.37	2.46	2.27

Annex Table 3
PERCENT DISTRIBUTION OF NATIONAL GOVERNMENT EXPENDITURES, BY SECTORAL CLASSIFICATION, 1975-2003

	Average					1997	1998	1999	2000	2001	2002	2003
	75-85	86-92	93-98	86-98	99-2002							
GRAND TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Total Economic Services	42.27	24.16	20.85	21.98	17.15	22.23	18.81	18.65	18.97	16.95	14.61	13.72
Agriculture	5.98	4.24	3.68	3.87	3.20	4.98	3.21	3.84	3.03	3.12	2.95	2.63
Agrarian Reform	0.83	1.86	1.60	1.69	1.40	1.58	1.39	1.19	1.51	1.37	1.49	1.44
Natural Resources	1.62	1.51	1.39	1.43	1.04	1.89	1.17	1.06	0.92	1.10	1.08	1.00
Industry	1.66	0.84	0.88	0.86	0.49	0.89	0.53	0.48	0.67	0.35	0.46	0.35
Trade	0.79	0.22	0.15	0.17	0.03	0.12	0.06	0.01	0.01	0.06	0.04	0.03
Tourism	0.28	0.13	0.18	0.16	0.16	0.20	0.23	0.15	0.22	0.12	0.14	0.16
Power & Energy	5.11	1.79	0.99	1.26	0.59	0.54	0.41	1.08	0.54	0.67	0.18	0.28
Water Resources Devt.	0.92	0.43	0.24	0.30	0.06	0.24	0.11	0.12	0.08	0.06	0.01	0.01
Transp. & Comm.	17.98	11.03	11.33	11.22	9.92	11.41	11.51	10.38	11.68	9.89	8.05	7.68
Other Econ. Services	7.12	2.12	0.42	1.00	0.26	0.39	0.21	0.35	0.30	0.20	0.21	0.14
Total Social Services	19.97	20.71	24.12	22.96	23.92	26.83	27.10	26.51	24.31	22.63	22.79	21.99
Education	12.51	14.72	17.41	16.49	17.41	19.31	19.74	19.11	16.99	16.86	17.02	16.46
Health	4.02	3.73	2.56	2.96	2.08	2.87	2.48	2.55	2.14	1.85	1.89	1.75
Soc. Serv., Labor & Emp. & Other Soc	1.06	1.55	3.49	2.82	3.84	4.23	4.33	4.16	3.97	3.68	3.62	3.56
Housing & Com. Devt.	2.39	0.71	0.67	0.68	0.59	0.43	0.54	0.70	1.22	0.25	0.26	0.21
National Defense	12.46	7.13	6.16	6.49	5.35	5.94	5.86	5.68	5.31	5.07	5.39	5.10
Total Public Services	10.72	12.17	14.45	13.67	13.22	14.61	14.78	13.41	13.22	13.58	12.73	12.13
Public Administration	8.01	6.84	8.01	7.61	6.13	7.80	7.81	6.39	6.30	6.43	5.50	5.10
Peace and Order	2.71	5.33	6.44	6.06	7.09	6.81	6.97	7.03	6.91	7.14	7.23	7.04
Others	5.21	6.34	14.46	11.69	17.96	14.53	14.88	17.43	17.55	17.06	19.54	19.30
Debt Service (Interests)	9.38	29.49	19.97	23.21	22.41	15.85	18.57	18.31	20.65	24.73	24.93	27.76
MEMO ITEM:												
IRA	4.09	4.34	14.04	10.73	16.78	14.45	14.32	16.42	16.75	16.38	17.46	17.60
Grand Total - Debt Service	90.62	70.51	80.03	76.79	77.59	84.15	81.43	81.69	79.35	75.27	75.07	72.24
Grand Total - Debt Service - IRA	86.54	66.17	65.99	66.05	60.81	69.70	67.12	65.27	62.61	58.89	57.61	54.64
Infrastructure	24.01	13.24	12.55	12.79	10.57	12.19	12.02	11.58	12.30	10.62	8.24	7.97
Defense & Peace & Order	15.17	12.46	12.60	12.55	12.43	12.75	12.83	12.71	12.22	12.21	12.62	12.14

Annex Table 4
GROWTH RATE OF THE NATIONAL GOVERNMENT EXPENDITURES, BY ECONOMIC CLASSIFICATION CLASSIFICATION, 1975-2003
(In Percent)

	Average					1996-97	1997-98	1998-99	1999-2000	2000-2001	2001-2002	2002-2003
	75-85	86-92	93-98	86-98	99-2002							
TOTAL	15.66	13.17	11.68	13.13	7.32	18.18	9.28	7.99	17.59	3.61	8.87	4.47
I. Current Operating Expenditures	16.65	17.33	11.04	15.15	7.88	17.10	8.46	12.96	18.25	5.97	8.09	6.75
A. Personal Services	16.71	15.36	17.78	16.40	5.37	29.35	14.81	4.83	9.24	5.28	7.20	3.80
B. MOOE	16.61	18.55	6.89	14.21	9.66	9.08	3.54	19.96	25.03	6.42	8.68	8.64
a. Interests	36.21	20.47	4.34	12.49	15.94	1.88	27.99	6.51	32.69	24.09	9.75	16.30
b. Transfers	12.06	18.55	8.30	19.09	7.26	15.90	-13.51	47.89	23.15	-3.39	11.25	3.90
1. to local government	19.82	28.73	9.13	24.72	9.05	20.41	-14.74	53.25	20.84	2.40	14.29	4.38
2. to all government corporations	10.64	6.55	7.00	13.47	(21.98)	-6.97	-6.42	25.40	34.25	-37.24	-56.03	-7.37
3. to others	(2.46)	0.01	2.06	5.08	17.14	13.62	-10.88	24.98	36.82	-15.52	62.87	2.68
c. Loan Repayment & Sinking Fund Contrib. (less Loan Amortization)			(1.31)			-85.17	487.41	-99.95	-100.00			
d. Other MOE	10.33	14.74	10.07	12.67	1.56	9.36	-2.24	5.54	15.58	-8.40	0.50	-2.35
II. Capital Outlay	13.96	1.01	15.15	7.37	3.51	23.83	13.34	-15.58	13.40	-12.02	15.05	-12.62
A. Land, Land Improvements & Structure Outlays (w/ Buildings & Structures from 1975-77)	(0.08)	30.42	22.47	27.13	1.76	26.59	56.66	-26.24	25.97	-5.53	-9.88	0.11
B. Buildings & Structures		5.21	18.13	5.93	7.91	7.06	-28.26	-19.11	12.34	-42.52	110.02	-26.49
C. Equipment (Others & Livestock & Eqpt. Outlay starting 1992)	13.97	38.95	5.55	20.72	6.97	42.44	-43.17	51.44	-36.78	-28.75	190.65	-49.77
D. Investment Outlay	9.84	(20.00)	(5.75)	(7.81)	(3.96)	33.62	-21.67	-54.33	51.42	-81.49	203.59	49.30
a. to local government		98.87	115.60	29.95		12640.57	-86.49	-100.00		-75.78	23.75	-64.43
b. to all government corporations	10.69	(20.55)	(17.61)	(13.45)	(4.71)	-19.72	-38.46	-19.76	69.87	-97.09	1565.95	0.00
c. to others	(19.69)	(5.11)	58.36	23.95	(5.48)	630.60	2.34	-80.83	-54.04	99.32	-12.86	233.65
E. Loans Outlay	94.04	(18.90)	(16.14)	(16.55)	5.70	18.53	-62.45	321.08	-16.50	38.22	8.14	-25.87
a. to local government		29.10	16.30	22.10	(39.91)	54.52	-45.65	133.94	21.09	1.21	-89.36	43.77
b. to all government corporations	205.16	(24.04)	(30.76)	(24.57)	8.94	3.38	-79.06	1278.93	-22.27	50.61	20.30	-26.52
c. to others	22.99	80.34	7.23	33.59		33.18	-47.42	-74.73	34.98	-59.16	-100.00	

Annex Table 5
NATIONAL GOVERNMENT EXPENDITURES AS PROPORTION OF GDP, BY ECONOMIC CLASSIFICATION CLASSIFICATION, 1975-2003
(In Percent)

	Average					1997	1998	1999	2000	2001	2002	2003
	75-85	86-92	93-98	86-98	99-2002							
TOTAL	14.85	18.74	19.63	19.32	19.74	20.27	20.17	19.50	20.63	19.43	19.49	18.67
I. Current Operating Expenditures	9.67	15.08	16.32	15.88	17.31	16.87	16.66	16.85	17.92	17.26	17.19	16.83
A. Personal Services	4.02	5.48	6.53	6.16	6.95	7.37	7.71	7.23	7.11	6.80	6.72	6.40
B. MOOE	5.66	9.59	9.79	9.72	10.37	9.49	8.95	9.61	10.81	10.46	10.47	10.44
a. Interests	1.45	5.53	3.92	4.49	4.43	3.21	3.74	3.57	4.26	4.81	4.86	5.19
b. Transfers	1.23	1.56	3.50	2.82	3.99	3.76	2.96	3.92	4.35	3.82	3.91	3.73
1. to local government	0.66	0.86	2.80	2.12	3.43	3.09	2.40	3.29	3.57	3.33	3.50	3.35
2. to all government corporations	0.23	0.35	0.48	0.43	0.33	0.45	0.39	0.43	0.52	0.30	0.12	0.10
3. to others	0.34	0.35	0.22	0.27	0.24	0.22	0.18	0.20	0.25	0.19	0.29	0.27
c. Loan Repayment & Sinking Fund Contrib. (less Loan Amortization)	0.07	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
d. Other MOE	2.91	2.50	2.37	2.42	1.94	2.52	2.24	2.12	2.20	1.83	1.70	1.52
II. Capital Outlay	5.18	3.66	3.32	3.44	2.43	3.40	3.51	2.65	2.71	2.16	2.29	1.84
A. Land, Land Improvements & Structure Outlays (w/ Buildings & Structures from 1975-77)	1.58	1.36	1.84	1.67	1.64	1.80	2.56	1.69	1.92	1.65	1.37	1.26
B. Buildings & Structures	0.60	0.78	0.66	0.70	0.30	0.72	0.47	0.34	0.35	0.18	0.35	0.24
C. Equipment (Others & Livestock & Eqpt. Outlay starting 1992)	0.27	0.32	0.37	0.36	0.25	0.49	0.26	0.35	0.20	0.13	0.34	0.16
D. Investment Outlay	1.93	0.46	0.30	0.36	0.05	0.23	0.16	0.07	0.09	0.02	0.04	0.06
a. to local government	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.00	0.00	0.00
b. to all government corporations	1.84	0.43	0.26	0.32	0.04	0.13	0.07	0.05	0.08	0.00	0.03	0.03
c. to others	0.09	0.02	0.04	0.04	0.01	0.10	0.09	0.02	0.01	0.01	0.01	0.03
E. Loans Outlay	0.79	0.75	0.14	0.36	0.18	0.16	0.05	0.20	0.15	0.19	0.19	0.13
a. to local government	0.00	0.02	0.01	0.01	0.01	0.02	0.01	0.02	0.02	0.02	0.00	0.00
b. to all government corporations	0.74	0.62	0.09	0.28	0.17	0.08	0.01	0.18	0.12	0.17	0.19	0.13
c. to others	0.05	0.11	0.04	0.06	0.00	0.06	0.03	0.01	0.01	0.00	0.00	0.00

Annex Table 6
PERCENT DISTRIBUTION OF NATIONAL GOVERNMENT EXPENDITURES, BY ECONOMIC CLASSIFICATION CLASSIFICATION, 1975-2003
(In Percent)

	Average					1997	1998	1999	2000	2001	2002	2003
	75-85	86-92	93-98	86-98	99-2002							
TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
I. Current Operating Expenditures	65.13	80.46	83.11	82.20	87.67	83.23	82.60	86.40	86.89	88.86	88.23	90.16
A. Personal Services	27.05	29.25	33.25	31.89	35.18	36.38	38.22	37.10	34.47	35.03	34.49	34.27
B. MOOE	38.09	51.21	49.86	50.32	52.50	46.84	44.38	49.30	52.42	53.84	53.74	55.89
a. Interests	9.78	29.52	19.97	23.23	22.43	15.85	18.57	18.31	20.67	24.75	24.95	27.78
b. Transfers	8.27	8.32	17.82	14.58	20.23	18.57	14.69	20.12	21.08	19.65	20.08	19.97
1. to local government	4.46	4.58	14.28	10.97	17.36	15.23	11.88	16.86	17.33	17.13	17.98	17.96
2. to all government corporations	1.53	1.87	2.43	2.24	1.67	2.23	1.91	2.22	2.53	1.53	0.62	0.55
3. to others	2.29	1.87	1.12	1.37	1.20	1.11	0.90	1.04	1.22	0.99	1.48	1.46
c. Loan Repayment & Sinking Fund Contrib. (less Loan Amortization)	0.46	0.01	0.01	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
d. Other MOE	19.58	13.36	12.06	12.50	9.84	12.42	11.11	10.86	10.68	9.44	8.71	8.14
II. Capital Outlay	34.87	19.54	16.89	17.80	12.33	16.77	17.40	13.60	13.11	11.14	11.77	9.84
A. Land, Land Improvements & Structure Outlays (w/ Buildings & Structures from 1975-77)	10.66	7.24	9.37	8.64	8.32	8.87	12.72	8.68	9.30	8.48	7.02	6.73
B. Buildings & Structures	4.02	4.15	3.34	3.62	1.53	3.57	2.34	1.75	1.67	0.93	1.79	1.26
C. Equipment (Others & Livestock & Eqpt. Outlay starting 1992)	1.85	1.71	1.91	1.84	1.28	2.44	1.27	1.78	0.95	0.66	1.75	0.84
D. Investment Outlay	12.99	2.44	1.55	1.85	0.26	1.12	0.81	0.34	0.44	0.08	0.22	0.31
a. to local government	0.00	0.01	0.00	0.01	0.01	0.02	0.00	0.00	0.03	0.01	0.01	0.00
b. to all government corporations	12.40	2.30	1.32	1.65	0.20	0.62	0.35	0.26	0.38	0.01	0.16	0.15
c. to others	0.58	0.13	0.23	0.19	0.05	0.48	0.45	0.08	0.03	0.06	0.05	0.15
E. Loans Outlay	5.35	4.00	0.73	1.84	0.94	0.78	0.27	1.04	0.74	0.99	0.98	0.70
a. to local government	0.01	0.09	0.06	0.07	0.07	0.08	0.04	0.09	0.09	0.09	0.01	0.01
b. to all government corporations	5.01	3.32	0.46	1.44	0.85	0.37	0.07	0.92	0.61	0.88	0.97	0.68
c. to others	0.33	0.58	0.21	0.33	0.02	0.32	0.15	0.04	0.04	0.02	0.00	0.00