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Chapter Author: Robert S. Dohner, Ponciano Intal, Jr.

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2 Government Expenditure and Revenues

As described in the previous chapter, the public sector in the Philippines has historically been rather small. Government expenditure averaged 10 to 11 percent of GNP, with total government revenues somewhat less than this amount. The developmental role of the public sector was minimal; most government outlays were for recurrent expenses, and only about 2 percent of GNP was spent on public investment. Under relative neglect, much of Philippine infrastructure deteriorated in the generation after independence. This was particularly true of the road network and of almost all infrastructure outside of Manila and Central Luzon. To some extent this small scale of government was the product of ideology inherited from the United States, but funding had always been a more concrete obstacle to an increased public sector role in the Philippines. Resistance to revenue measures in Congress limited the expansion of government expenditure.

Sluggish economic growth during the import decontrol period in the early 1960s led to more support in the Philippines for an activist government. Ferdinand Marcos drew on this sentiment in his election campaign in 1965, and he greatly increased infrastructure investments during his first term. But this first term was only a precursor for what was to happen after 1972. Martial law transformed the character of the state, greatly increasing its expenditure, regulatory, and allocational role. Although security concerns were the pretext for the declaration of martial law in 1972, more rapid economic growth quickly became the regime's claim to legitimacy. Greatly increased public expenditure, particularly public investment, was the centerpiece of the government program. With Congress no longer functioning and Marcos able to rule by decree, the way was cleared to both raise domestic revenue in support of public expenditure and solicit outside sources of finance. The previous inactivity and small scale of the Philippine government made the country an attractive candidate for external project support under a modernizing government. As described below, the country was very successful in raising external funds for investment.

Philippine statistics make it difficult to document the growth of the public sector in the early martial law years. Public finance data before 1975 cover only spending obligations, not actual outlays. Since the budget was subject to frequent revision, obligations and outlays often differed substantially.[1] Budget obligations by category for 1969 through 1975 are shown in table 2.1. Actual outlays of the national government for 1975 onward are given in table 2.2.

Since government expenditure was rising in the early years of martial law, obligations ran ahead of actual outlays. But the actual growth of expenditure

Table 2.1 National Government Budget, Obligation Basis, 1969–75 (percentage of GNP)

	FY 1969	FY 1970	FY 1972	FY 1974	FY 1975
Current expenditure	8.9	8.2	7.8	7.9	10.2
Administration	2.5	2.6	2.5	2.4	3.1
General government	0.9	1.0	0.8	0.6	0.7
Justice, police	0.6	0.5	0.7	0.1	0.2
National defense	1.1	1.1	1.0	1.7	2.2
Economic services	1.7	1.5	1.3	1.9	1.9
Agriculture, resources	0.5	0.5	0.4	0.6	0.8
Commerce, industry	0.2	0.1	0.1	0.2	0.1
Transport, communications	0.8	0.6	0.6	0.7	0.7
Other development	0.2	0.4	0.2	0.3	0.3
Social services	3.3	3.2	3.0	2.4	2.6
Debt service	0.8	0.6	0.6	0.6	0.8
Subsidies, transfers	0.6	0.2	0.3	0.7	1.7
Capital expenditure	1.6	1.8	2.2	5.6	5.0
Administration	0.1	0.1	0.1	0.1	0.1
Economic services	1.3	1.5	2.0	5.3	4.5
Agriculture, resources	0.3	0.1	0.5	2.0	1.3
Commerce, industry	0.8	1.1	0.8	1.4	2.1
Transport, communications	0.0	0.0	0.0	0.3	0.2
Other development	0.2	0.2	0.7	1.6	1.0
Social services	0.2	0.2	0.1	0.2	0.4
Total expenditures	10.6	9.9	10.0	13.6	15.1

Source: World Bank (1976, 547–48).
Note: Fiscal year from July 1 to June 30.

was substantial. National accounts figures show a 15 percent per year growth in government expenditure from 1972 to 1975, with an almost 30 percent per year growth in total fixed investment outlays, including those by government corporations. By 1976 total government expenditure had risen to 15 percent of GNP and investment expenditures had climbed to 6.6 percent of GNP (table 2.3).

The change in priorities is clear from shifts in the obligational budget in the early years of martial law. Within current expenditures there is a huge increase in commitments for defense, which rose from 13 percent of the budget in FY 1972 to almost 22 percent by FY 1975 (see table 2.1).[2] Subsidies also increased rapidly as the government sought to limit the domestic price rises of grains, petroleum products, and fertilizer after the first oil shock.[3] The more activist role of the government is also reflected in a shift in current expenditures away from social welfare (education and health) and toward economic services, particularly agriculture and transportation. The shift in investment priorities in the early years of martial law is shown in table 2.1. Increased investment expenditures went into transportation (roads, highways, and ports), irrigation, and power and rural electrification.

Table 2.2 **National Government Expenditures (percentage of GNP)**

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Expenditures	16.0	15.2	14.9	14.8	13.7	14.4	15.8	15.7	14.0	12.7	13.5	17.8	17.0
Current	12.8	11.8	11.6	10.9	9.5	9.3	8.7	9.2	9.1	8.1	9.1	10.8	13.5
Personnel		10.4	10.3	4.2	3.8	3.5	3.5	3.2	3.7	3.2	3.9	4.0	4.6
Maintenance, operations		5.3	4.1	4.1	3.7	3.7	3.7	3.7	3.1	2.4	2.2	2.4	2.7
Interest		0.5	0.6	0.6	0.8	0.9	0.8	1.1	1.3	2.0	2.5	3.5	5.2
Transfers to local government		0.5	0.5	0.5	0.6	0.6	0.5	0.7	0.7	0.5	0.6	0.6	0.6
Transfers to GCs	0.2	0.3	0.2	0.4	0.2	0.2	0.2	0.6	0.3	0.1	0.2	0.3	0.3
Capital	2.6	2.0	1.8	2.6	2.3	3.1	4.2	3.0	2.8	1.9	1.7	1.9	1.8
Infrastructure			1.5	2.1	2.0	2.8	3.3	2.2	1.8	1.2	0.9	1.3	1.0
Other capital outlays			0.3	0.4	0.3	0.4	0.9	0.7	0.9	0.7	0.7	0.6	0.8
Equity and net lending	0.6	1.4	1.5	1.4	1.9	2.0	3.0	3.5	2.1	2.7	2.8	4.4	1.6
Equity contributions	0.5	1.3	1.5	1.3	1.6	1.7	2.7	2.8	1.5	1.9	2.4	2.0	0.6
Net lending	0.1	0.1	0.0	0.1	0.4	0.3	0.3	0.7	0.6	0.7	0.3	2.4	1.0
(Assistance to GFIs)						0.1	0.2	0.4	0.0	1.6	1.9	2.6	0.1
Revenues	14.4	13.4	13.0	13.6	13.5	13.1	11.8	11.4	12.0	10.8	11.5	12.8	14.6
Budget surplus/deficit	−1.6	−1.8	−1.9	−1.2	−0.2	−1.3	−4.0	−4.3	−2.0	−1.9	−1.9	−5.0	−2.4

Source: Philippines Bureau of the Treasury, *Cash Operations Statement.*

Note: GCs are government corporations. GFIs are government financial institutions.

Table 2.3 **Fixed Investment (percentage of GNP)**

	1970	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Fixed investment:																	
Government	1.2	2.1	2.3	3.4	4.3	6.6	6.9	7.2	7.3	6.9	8.0	7.2	6.1	4.1	3.7	N.A.	N.A.
General government	1.1	1.7	2.1	2.9	3.8	3.3	3.4	2.6	3.3	2.4	2.0	2.5	2.8	1.4	2.0	N.A.	N.A.
Public corporations	0.1	0.5	0.2	0.5	0.6	3.3	3.5	4.6	4.0	4.5	6.0	4.6	3.3	2.7	1.7	N.A.	N.A.
Private	15.9	14.4	13.6	15.1	19.4	18.5	16.9	16.7	18.5	18.8	18.1	18.5	19.0	16.0	11.5	N.A.	N.A.
Total	17.2	16.5	15.8	18.5	23.7	25.1	23.8	23.9	25.8	25.7	26.1	25.6	25.1	20.1	15.1	13.2	14.6
Memo:																	
Total government expenditure	9.9	11.5	10.9	12.3	16.0	15.2	14.9	14.8	13.7	14.4	15.8	15.7	14.0	12.7	13.5	17.8	17.0

Source: NEDA, National Accounts Section.

The most dramatic change in the budgetary process came in the emphasis on foreign funding. The Philippine government improved its planning and proposal mechanism and solicited funds from multilateral and bilateral sources. The Philippines met with considerable success in this effort; official aid flows more than doubled after 1972, and development loans rose from a total during the 1960s of $338 million to $1.6 billion from 1970 to May 1976.[4] Much of these funds flowed through publicly owned corporations. To increase the ability of these corporations to borrow, the government raised their equity base through capital infusions, and this is reflected in the sharp rise in equity contribution in the middle 1970s.[5]

2.1 After the First Oil Shock, 1975–79

The first oil shock and the subsequent collapse of commodity prices in 1975 had little effect on the Philippine government's expenditure plans. Martial law politics were tied up in a more activist and expanded national government, and the Philippines found sufficient external support to continue with its public expenditure program. The share of national government expenditures in GNP actually peaked in 1975 and remained near 15 percent for the rest of the decade.

While total expenditures stabilized, public investment continued to increase relative to GNP through a striking realignment of shares of current and capital expenditures. By 1979 national government current expenditures as a share of GNP had fallen by three percentage points (see table 2.2). In addition, investment expenditure by publicly owned corporations, not reflected in the published budget, continued to increase. By the end of the decade most of the government's infrastructure investment program was conducted through these corporations. The growth of government corporations is discussed in more detail below, but their importance in public investment expenditures is easily seen from national accounts data. From half a percent of GNP in 1974 and 1975, investment by public corporations had risen to 4 percent of GNP by 1978 and 1979 (see table 2.3). Funding for these corporations came primarily from foreign loans and from equity contributions and net lending from the national government, which took up an increasing share of national government capital outlays.

Data on the sectoral allocation of public investments comes from two sources. The first is data from NEDA on its infrastructure program (table 2.4). This covers the bulk, but not all of public investment. The second breakdown comes from estimates made by a World Bank mission in 1983 and is shown in table 2.5. Both sources show an increasing concentration of public investment in infrastructure during the 1970s. Transportation and irrigation diminish somewhat as a share of investment and GNP, while investment in the energy sector increases greatly in importance. By the late 1970s half of public fixed investment was in energy projects.

Table 2.4 NEDA Infrastructure Program (in millions of pesos)

	1975	1976	1977	1978	1979	1980	1981	1982
Total infrastructure	4.0	4.9	5.2	4.1	5.0	4.4	4.6	4.9
Agriculture	0.7	0.4	0.5	0.5	0.8	0.6	0.6	0.6
Water supply	0.1	0.2	0.1	0.2	0.1	0.2	0.3	0.4
Transportation	1.6	1.6	1.5	1.0	1.0	0.8	1.0	1.3
Power	0.9	1.5	2.4	1.9	2.6	2.4	2.3	2.3
Social services	0.2	0.4	0.2	0.2	0.1	0.2	0.2	0.2
National government	2.8	3.0	2.6	2.0	2.0	1.7	1.9	2.1
Government corporations	1.2	1.9	2.6	2.2	3.0	2.7	2.7	2.8

Source: World Bank (1979), table 5.12, and World Bank (1984b), table 1.12a.

Table 2.5 Public Fixed Investment by Sector, 1978–83 (percentage of GNP)

	1978	1979	1980	1981	1982	1983[a]
Economic services	5.7	5.5	7.0	8.0	7.3	6.8
Agriculture, forestry	0.8	0.6	0.9	0.7	0.9	0.9
Industry, trade, tourism	0.1	0.1	0.9	0.6	0.6	0.7
Energy	3.1	3.3	2.5	2.9	2.6	2.8
Transportation	0.9	0.9	1.8	2.2	2.0	1.4
Water supply	0.1	0.2	0.3	0.5	0.5	0.5
Other infrastructure	0.6	0.5	0.6	1.0	0.7	0.5
Social services	0.4	0.5	0.6	0.6	0.5	0.7
Defense	0.2	0.2	0.1	0.2	0.1	0.1
General administration	0.1	0.1	0.1	0.2	0.2	0.1
Local government	0.2	0.2	0.2	0.2	0.2	0.2
Total public fixed investment	6.6	6.5	8.1	9.2	8.2	7.9
of which:						
National government	2.4	2.3	3.2	4.2	3.0	2.6
Government corporations	4.0	4.0	4.7	4.8	5.0	5.1

Source: World Bank (1984b), table 1.16.
[a]Figures for 1983 are estimated.

The Philippine energy investment program was an ambitious plan to substitute domestic and other energy sources for imported oil, provide for additional capacity for economic growth, and extend electrification to rural areas. The Philippines, being mountainous and volcanic, offered a variety of possible sources. Hydroelectric energy was developed and by 1979 accounted for 21 percent of total electricity generation. By the 1980s the Philippines had one of the world's most extensive systems of geothermal energy. A small domestic oil field was developed, which in 1979 produced 10 percent of the total oil supply, and Philippine coal reserves offered large potential for development. However, the bulk of Philippine energy investments went into electricity generation. The institution through which these investments were made was the National Power Corporation (NPC), a government-owned corporation, which accounted for almost 80 percent

of the energy investment program by the end of the 1970s. Between 1977 and 1982, NPC's installed generating capacity rose from 1,038 to 4,323 megawatts.[6]

One particular investment, the Bataan nuclear power project, is worth describing in more detail, both because of its size and foreign loan exposure, and because of the controversy that surrounds it. The Philippine government made the decision to build a nuclear power plant in 1973, and by early 1974 intensive negotiations were underway with General Electric for its construction. General Electric's proposal was the construction of two 600 megawatt reactors for a total price of approximately $500 million.

The Westinghouse Corporation entered the competition for the plant at a late stage, but hired Herminio Disini, a presidential associate, to arrange a meeting with President Marcos and his cabinet in May 1974. At that meeting Westinghouse made an offer to build a complex similar to the GE proposal for about the same price. At the end of May, Marcos instructed NPC to sign a contract with Westinghouse, despite the fact that Westinghouse had not yet submitted a detailed proposal.[7]

By the time the contract was signed in February 1976 the proposal from Westinghouse was to build a single 626 megawatt reactor for a price of $1.1 billion, or roughly quadruple the cost per megawatt of the original GE proposal. The project was supported by a loan and additional loan guarantees from the Export Import Bank of the United States. The Westinghouse plant had a checkered history. The site approval process went on longer than anticipated because the plant was near an active volcano, there was vociferous domestic opposition to the plant, and construction was halted for eighteen months after the Three Mile Island accident in the United States in 1979. The renegotiated contract with Westinghouse, including inflation, delay costs, and capitalized interest, was for $2.2 billion, making the nuclear power plant alone responsible for almost one-tenth of Philippine external debt. Although almost finished, the plant never opened. Shortly after the Soviet Union's Chernobyl accident in 1986, President Aquino announced that the plant would not be put into operation.[8]

In addition to NPC, two other government-owned corporations have played an important role in the energy investment program. The Philippine National Oil Company (PNOC) has been responsible for domestic oil and coal development, as well as the geothermal energy program. The National Electrification Administration (NEA) extended loans to rural cooperatives to finance extensions of the electricity distribution system and to construct small-scale electricity generating facilities.

By the end of the decade total expenditure by the national government and public corporations exceeded 18 percent of GNP. Despite continued efforts, described below, to raise tax collections, national government revenues remained at about 13.5 percent of GNP, leaving a substantial gap to be closed by borrowing.[9] Foreign loans provided much of the funding for the

investment projects that the Philippines undertook; in fact, foreign-assisted projects made up three-quarters of Philippine infrastructural investment by 1979. But foreign project loans had requirements for domestic counterpart funds, funds that the national government (or a public corporation) would put up for its participation in the project. By 1978 the Philippine government was having difficulty generating sufficient peso funds to match the counterpart requirements of foreign-assisted projects. Part of the response of the government to revenue and funding shortfalls was to squeeze the current expenditure portion of the budget. In many cases this meant a reduction in operating and maintenance expenditures for the existing capital stock, despite its increase as a result of the investment program.

2.2 After the Second Oil Shock, 1980–83

A second leap in public expenditure occurred in the wake of the second oil price shock. After a reduction in 1979, real national government expenditure rose by 13 percent in 1980 and by an additional 12 percent in 1981. Once again the Philippine authorities had chosen to counteract the external shock with expansionary policies. However, the domestic recession was worse this time than it had been in the 1970s, and the Philippine industrial sector was particularly hard hit. Government revenues also dropped unexpectedly sharply, falling by 2 percent of GNP between 1979 and 1981. As a result, the national government budget, which was nearly balanced in 1979, was in deficit by over 4 percent of GNP in 1981.

As in the 1970s, the increase in outlays was almost entirely a rise in government investment expenditure (see table 2.2). Real capital spending of the national government nearly doubled in two years. Government-owned corporations also increased their investment expenditure, so that total public sector fixed investment rose from 6.5 percent of GNP in 1979 to over 9 percent in 1981 (see table 2.5).

The investment program was similar to that of the 1970s. The largest share of public investment went to energy, with transportation a close second. The Philippine government had prepared an ambitious ten-year energy plan, which was published in January 1980. President Marcos then ordered an accelerated energy program to compress most of the goals of that plan into five years. The NPC developed an accelerated program for conversion of oil-fired plants to other energy sources, against the criticism of the World Bank and Asian Development Bank, and was proposing new projects as late as 1983.[10]

But the 1980s also marked a shift in Philippine public investment strategy toward a greater emphasis on industrial development. One aspect of this policy was continued investment in, and expansion of, the country's export processing zones. The second was the Philippine government's Major Industrial Projects (MIPS). The MIPS were an elaborate and expensive

thrust into secondary import substitution through heavy industrialization. The goals were to deepen Philippine industrial structure, reduce the heavy dependence of domestic industry on imported materials, and establish growth poles away from Manila. The eleven projects are listed in table 2.6.

The decision to go ahead with the MIPS was made in 1979, after several years of discussion in the Philippines. The minister of industry, Roberto Ongpin, was a strong proponent of the projects and pushed actively for them within the cabinet. In deciding in favor of Ongpin and the MIPS, the Philippine cabinet was influenced by the heavy industrialization thrust of policy in many East Asian countries during this period. Korea and Taiwan had adopted extensive efforts to encourage heavy industry, but neighboring countries in Southeast Asia—Malaysia, Thailand, and Singapore—were also supporting investments in petrochemicals, aluminum smelting, pulp and paper, and other heavy industries.[11] The government's lead agency for this industrialization effort was the reactivated National Development Corporation (NDC), which was attached to the Ministry of Trade and Industry, headed by Ongpin.

The projected cost of the original proposals was $6 billion, but after critical external reviews, the projects were scaled back and the estimated

Table 2.6 Major Industrial Projects: Schedules, Costs, Financing (in millions of U.S. dollars)

	Start of Project/ Operations	Project Cost[a]	Financing			
			Government Equity	Private Equity: Domestic	Private Equity: Foreign	Foreign Loans
Completed projects:						
Copper smelter	1980/83	344	63		37	244
Diesel engine manufacturing	1980/83	9			4	5
Cement industry coal conversion	1981/83	37				37
Phosphatic fertilizer	1981/84	513	60		40	413
Coconut-based chemicals	1982/84	116		60	4	52
Started, but deferred projects:						
Heavy engineering	1982	23				23
Integrated steel plant	[b]	1,806	167	—	—	1,639
Subtotal		2,848	290	60	85	2,413
Deferred projects:						
Aluminum smelter		650				
Integrated pulp and paper		250				
Petrochemical complex		1,000				
Alcohol-gasoline facility		—				
Total		4,748				

Source: World Bank (1984b), table 4.1.

[a]Project cost includes fixed assets and interest during construction.

[b]Site development started in 1983.

cost was reduced to about $4 billion. The financing strategy that the Philippines adopted was to encourage foreign equity participation to cover as much of the costs as possible and to rely on foreign loans for the remainder, to minimize the use of domestic resources in the projects (IMF 1984b). All but one of the projects was to have some government participation and ownership.

The IMF, World Bank, and other outside agencies were critical of the MIPS, as is carefully phrased in their reports on the Philippines. The Philippine government was committed under the first Structural Adjustment Program with the World Bank to rationalize industrial investment incentives and reduce their bias toward capital intensity. Yet the MIPS represented a huge investment in highly capital-intensive industry. In a country in which the average investment per industrial worker was about $20,000, the cost of completing five of the initial projects was estimated to be $3.4 billion, or $500,000 per job created (Callison 1981, 24).

The financial and operational history of the MIPS is also shown in table 2.6. Much of the program was overtaken by events in the 1980s and the difficulties in raising external finance. In addition, foreign equity participation never lived up to expectations, resulting in a larger government participation. Five of the projects were completed, two were started but deferred in 1983 as a result of the debt moratorium, and the remaining four were deferred at an earlier stage, before contracting took place. The expenditure on the seven projects that went forward amounted to $2.8 billion, almost entirely financed through foreign loans.

In addition to increased investment expenditure on its own account, national government equity contributions and net lending rose sharply during this period, from 2 percent of GNP in 1980 to 3.5 percent by 1982. Some of this increase was government contribution to the planned investment program. However, two additional requirements emerged during these years. The first was the greatly expanded program of the Ministry of Human Settlements, headed by Marcos' wife, Imelda. Only limited information exists on the activities of the Ministry. Originally its efforts were directed toward housing construction and finance, but these rapidly expanded so that its work paralleled much of the efforts of other ministries. Much of the activity of the Ministry and most of its expenditure were done through public corporations and their subsidiaries. Nineteen government corporations were attached to the Ministry for Human Settlements, with at least thirty-six additional subsidiaries one level down.[12] The Ministry and its attached corporations were active in housing, food distribution, area development, finance, energy, public utilities, hotels, industry, cultural affairs, and health services. Through the Home Development Mutual Fund (the PAG-IBIG fund), the Ministry levied a payroll tax in support of housing. The Human Settlements Development Corporation alone received P. 1.1 billion in transfers from the national government, making it the ninth largest corporate recipient.[13]

But there were other, more important reasons for the rapid rise in government equity contributions and net lending. The domestic financial crisis in 1981 led to the failure of numerous large and highly leveraged companies, many of them owned by presidential cronies. The Philippine government organized rescue operations for these firms, acting through the NDC and through government financial institutions, supporting the resulting deficits with equity transfers from the government. The greatly increased investment program of other public corporations and their almost nonexistent ability to generate funds internally led to increased equity transfers from the national government to meet the peso counterpart requirements of project loans as well as to provide finance.

As the world and domestic recessions continued into 1982 and external debt continued to mount rapidly, the Philippine government tried to change course. National government capital expenditure on its own account fell by 26 percent in real terms in 1982. But other claims on the government continued to increase. Control over the investment programs of state-owned corporations was weak, and their investment expenditure continued to climb, rising to 5 percent of GNP (see table 2.5). As a result of this and the corporate rescue operations mounted by the government, equity contributions and net lending rose by 17 percent in real terms in 1982, enough to keep the share of national government expenditure in GNP almost constant.

The shift in government priorities in the 1970s and later, the almost desperate attempts to keep capital inflows going, show up clearly in the continuing pressure on outlays for current operations. Government current expenditures, after dropping in the late 1970s, held at a little over 9 percent of GNP until 1983 (see table 2.2). However, this figure is deceptive, since interest payments and transfers took up a much larger share of the total. Real wages of government employees fell between 1979 and 1983, while operations and maintenance expenditures were 14 percent lower in real terms in 1983 than in 1978, despite a greatly increased government capital stock (World Bank 1984b, 13). The Philippines continued to initiate new projects with foreign financing during this period, even as it had increasing difficulty in providing the required level of counterpart funds for existing projects. The reaction was to delay the implementation of existing projects and to squeeze current expenditures, particularly for operations and maintenance, in order to sustain the momentum of the investment program and maintain foreign capital inflow. By the early 1980s, operations and maintenance expenditures had been reduced to such an extent that the capital stock was deteriorating prematurely; the Philippines was in effect consuming its existing capital stock in order to maintain investment.

Ironically, despite the abolition of Congress and the decree-making powers of martial law, Philippine public expenditure continued to be constrained by the inability to raise government revenues. This was particularly true of the early 1980s, forcing the delay in existing projects, the compression of current expenditures, and the increasing resort to foreign loans, in many

cases at short term. The sluggishness of domestic revenue generation is the next topic we examine.

2.3 National Government Revenues

The level of taxation in the Philippines has historically been low, consistent with the country's relatively small government expenditure. International comparisons of tax effort place the Philippines near the bottom among less developed countries, both in terms of taxes collected as a share of GNP and the rates of effective taxation of the existing tax base.[14] Before martial law, the Philippine Congress had been a consistent obstacle to increased taxation or to tax reform measures. Dominated by the wealthy landowning class, the Congress viewed limited taxation as consistent with its own interests and as a way of limiting the power of the executive.[15]

There was widely expressed hope under martial law that the national government would become more effective in mobilizing domestic tax revenue as a means of financing public development expenditure. Recommendations for raising revenue generation were contained in reports by the International Labour Office mission (ILO 1974) and in an extensive country report prepared by the World Bank in 1975 (World Bank 1976). There were ambitious targets in the 1974–77 development plan to raise domestic revenue generation to 17 percent of GNP, and revenue targets were conditions included in the extended facility drawing from the IMF in 1976.

The government had considerable success in raising revenues during the first few years of martial law. The administration quickly moved on several reform proposals that had long been pending in Congress. One of the first presidential decrees was a tariff reform program that reduced the number of rate categories, set a minimum tariff rate of 10 percent, and eliminated duty exemptions for public bodies. Other decrees revised the individual income tax and the system of property taxation.[16]

The tariff revisions and the elimination of exemptions, coupled with the rise in external prices, resulted in a large increase in tariff revenues, nearly doubling the share of import taxes in GNP. Taxation of exports also increased during this early period. The export taxes that had been included in the 1970 stabilization program as temporary measures were made permanent in 1973. In early 1974 the government sought to capture some of the windfall gains from the rise in international commodity prices. A base price was set at 80 percent of the February 1974 price for a variety of commodity exports, and taxes of 20 to 30 percent were applied to the excess of current prices above this base.

The government also announced more vigorous enforcement of existing direct taxes on individuals and corporations, along with threats of severe penalties for tax evaders. The number of corporations and individuals filing tax returns increased sharply in 1973, resulting in much higher tax collections.

The result of these efforts was an increase in the revenue mobilization of the national government from 10 percent of GNP in the early 1970s to over 14 percent in 1975 (table 2.7). In the years that followed there were tax packages with revenue-enhancing measures introduced almost every year, including significant taxes on crude oil and petroleum products, revisions in domestic sales taxes, and some increases in business taxes. Even with these continued efforts and the targets that had been set in the development plan and in external loans, the share of tax revenue in GNP remained constant until 1980. Despite all of its running, the government had just managed to stay in place and had come nowhere near its revenue targets. The reasons behind this sluggishness of revenues point out some of the difficulties of the Philippine tax system and some fundamental problems of the martial law regime.

The increase in revenues up to 1975 had been heavily dependent on increased taxes on international trade, and the share of international trade taxes in total tax revenue rose from one-third to almost one-half by 1975. The premium duty system, which was designed to capture price windfalls, led to greatly reduced collections from export taxes in 1975–77, when world commodity prices fell and the taxable premium disappeared. Other early martial law tax measures represented only temporary gains. The tax amnesty brought in a significant amount of revenue, but the initial caution that had inspired additional filings in 1973 subsided, returning direct tax collections to more normal levels.[17]

Part of the revenue problem of the Philippines was the high reliance on indirect taxes—taxes on trade and on domestic sales—that had low income elasticities and therefore required continuing additional measures to keep up with the growth of GNP. But in addition to low elasticities, the Philippines also faced problems of erosion of the tax base and difficulties in administering the existing tax system.

The corporate income tax is a case in point. Despite the increasing importance of the organized corporate sector, collections from direct taxes on corporations fell sharply as a percent of GNP in the remainder of the 1970s. Here the problem was mainly the erosion of the existing tax base. Fiscal incentives for industrialization had been a feature of Philippine policy since independence, but the Investment Incentives Act of 1967 and the Export Incentives Act of 1970 provided more extensive fiscal tools to channel resources. Each act allowed accelerated depreciation, tax deductions for expansion reinvestments, tax credits for domestic capital equipment, and exemptions from selected business taxes. During the martial law period these incentives were liberalized by presidential decree and were extended to other industries, including agriculture.[18] In addition to these general incentives, there were a large number of special incentives for particular industries granted by legislation before, and by presidential decree after, martial law. The most important special incentives covered cottage industry, chemical fertilizers, mining, textiles, shipping and shipbuilding, tourism, and

Table 2.7 National Government Revenues (percentage of GNP)

	1970	1972	1973	1974	1975	1976	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Income and profit	2.5	2.6	3.6	3.1	3.0	2.7	3.1	2.8	2.8	2.6	2.5	2.3	2.3	3.1	3.1	3.1
Personal	0.7	0.8	0.8	0.6	0.8	1.1	1.9	1.5	1.3	1.3	1.2	1.0	0.9	N.A.	N.A.	1.1
Tax amnesty	0.0	0.0	0.8	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Corporate	1.7	1.6	1.9	2.1	2.0	1.6	1.2	1.3	1.5	1.2	1.3	1.3	1.5	N.A.	N.A.	1.4
Other	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	N.A.	N.A.	0.6
International trade	2.7	3.8	3.5	4.9	5.7	4.6	4.4	4.3	4.4	3.7	3.7	4.3	3.3	3.1	2.9	3.7
Import duties	1.5	1.9	2.0	2.8	3.3	4.2	4.2	4.0	4.2	3.6	3.6	4.3	3.0	2.7	2.7	3.7
Export taxes	0.3	0.9	0.6	1.1	1.4	0.5	0.2	0.3	0.2	0.1	0.1	0.1	0.3	0.2	0.1	0.0
Sales taxes imports	1.0	1.0	0.9	1.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.1	0.0
Domestic goods/services	2.6	2.3	1.9	2.3	2.5	3.4	3.7	4.5	4.1	3.8	3.7	3.5	3.6	3.8	4.3	5.1
General sales	1.2	1.1	0.9	1.1	1.0	1.2	1.4	1.9	1.9	1.8	1.7	1.5	1.4	1.4	1.7	1.9
Excise tax	1.4	1.2	1.0	1.2	1.5	2.2	2.3	2.6	2.2	2.1	2.0	2.0	2.2	2.3	2.6	3.2
Other taxes	0.7	0.6	0.7	0.7	0.5	0.7	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Total tax revenue	8.4	9.3	9.8	10.9	11.7	11.4	11.6	11.9	11.5	10.4	10.1	10.4	9.5	10.2	10.6	12.2
Nontax revenue	0.0	0.0	0.0	0.0	2.7	2.1	2.1	1.6	1.6	1.5	1.3	1.6	1.3	1.3	2.2	2.4
Total revenue	8.4	9.3	9.8	10.9	14.4	13.4	13.6	13.5	13.1	11.8	11.4	12.0	10.8	11.5	12.8	14.6

Source: Philippine Bureau of the Treasury, *Cash Operations Statements*.

Note: N.A. = not available. Components may not add to totals due to rounding.

overseas construction. Many of these industries were of particular importance to industrial groups or individuals associated with the martial law regime. In addition to the special industrial incentives, there were a large number of presidential decrees that benefitted particular firms, granting either exemptions from import duties on products or exemptions from certain taxes.

The result was a corporate tax system that was highly complex, with an array of deductions and loopholes, and a low effective rate of collection. A World Bank mission in 1979 calculated that nearly 45 percent of taxable corporations were exempt from paying taxes and that deductions claimed by corporations amounted to about 70 percent of gross income (World Bank 1979, 12).

The Philippine tax system flags after 1980, just at a time when countercyclical and corporate rescue outlays were swelling the expenditure side of the budget. Total national government revenue fell from 13.1 percent of GNP in 1980 to 11.4 percent in 1982, recovered slightly in 1983, and then fell sharply in 1984. Almost every category of taxes fell as a percentage of GNP. Part of this reduction is easily explained. The weak economy and corporate distress in the early 1980s depressed collections from a number of taxes. But in addition, tax collections fell as a result of several policy changes.

As a part of the first structural adjustment loan (SAL) from the World Bank, the Philippines initiated a tariff reduction and trade liberalization program starting in 1981. As a result, tariff collections fell from 24.5 percent of total imports in 1980 to 18.6 percent in 1982, and then to 14.5 percent by 1984.[19] The effect of the tariff reductions was counteracted by an import surcharge that reached 10 percent by 1984 and also by a foreign exchange tax of 10 percent that was briefly in force between June and October 1984.

The substantial drop in individual income tax collections was more disturbing. *Nominal* individual income tax collections fell in 1982 and 1983, and their share in GNP fell sharply. Between 1979 and 1984 the individual income tax registered a buoyancy of only 0.3, extraordinarily low for this type of tax.[20] There were two reasons for the drop in income tax collections. First, there was a major revision of individual income tax rules in 1982 that substituted separate schedules for different types of income for the global income tax system that preceded it. Other reforms adopted a modified gross income tax system for individual income, eliminating many deductions and reducing tax rates.

These reforms were adopted in order to simplify the tax system and increase the effectiveness of tax administration. While the reforms were designed to be revenue neutral, in fact they resulted in a substantial drop in individual tax collections. The reforms also shifted the tax burden away from the wealthiest taxpayers. A study by the Philippine's Bureau of Internal

Revenue (BIR) of taxpayers with over P. 1 million in income found the average tax rate declined from 48 to 32 percent for those who relied entirely on compensation income, and from 29 to 9 percent for those with multiple schedules, between 1981 and 1982.[21]

The second reason for the drop in personal income tax collections is an apparent increase in the amount of tax evasion. Little evidence exists on the trend of tax evasion, although the view of increasing evasion is widely held. The *level* of tax evasion was quite large, however. An IMF mission conservatively estimated that the individual income tax receipts in 1984 should have exceeded P. 10 billion, based on current rates and the distribution of household income, while actual collections were only P. 4.5 billion.[22]

2.4 Failure of Taxation Efforts

Despite the professed intent in Philippine development plans and external pressure for increased revenue generation through the tax system, the Philippines was not successful in raising government revenues. The fall in tax collections during the early 1980s was an important factor in the country's balance of payments crisis and external debt difficulties. In part, the failure to raise the revenue share reflects the structure of the Philippine tax system. Much of the tax system depended on indirect taxes on foreign and domestic trade that had low income elasticities. As a result, the government had to make continuing tax introductions and modifications just to maintain the share of these taxes in GNP.

But this explanation cannot be sufficient, for revisions in the tax structure itself formed an important part of the plans and of external conditions. The Philippines had on several occasions pledged to broaden the base of the tax system and to shift the emphasis toward direct taxes, away from taxes on international trade. The reasons for the lagging tax effort were more fundamental.

To a large extent the revenue efforts of the Marcos government were vitiated by a growing array of incentives, exemptions, and special privileges that steadily eroded the tax base. Much of the investment that was undertaken during the 1970s was done under Board of Investment incentives, and a growing number of industries benefitted from special industry incentives programs. Despite the early efforts at removing tariff and tax exemptions for government corporations, these crept back into the tax system so that by 1983 the value of government corporate tax exemptions was over P. 1.5 billion, or almost 4 percent of tax revenue.[23] Exemptions also went to private or quasi-private enterprises engaged in commercial activity, displacing tax-paying concerns. One example involves the Philippine Veterans Investment and Development Company (PHIVIDEC), which was given tax free importation of finished products such as tires and appliances, which it then resold

to favored companies. Another example was Nivico, a private concern, which was allowed to import televisions tax and duty free to support a program of extending television use to the countryside. Nivico in fact sold the televisions in Manila and other major markets.

The Philippines also developed a number of special tax funds with revenues earmarked for a particular use. Some of these, such as the petroleum industry special fund which supported energy investments, were little different from general revenue taxation. However, others were more in the nature of private funds and competed with the tax system in raising revenues.

An example of the latter was the Coconut Industry Development Fund, which was supported by a levy on coconut production. The coconut levy had a variety of goals, including the maintenance of domestic price ceilings and the capture of windfall gains in the mid-1970s. By the late 1970s it became a privately administered fund for the benefit of the industry, effectively controlled by Eduardo Cojuangco, a private businessman and a friend of Marcos. The levy was initially P. 150 per metric ton (about 12 percent of the price of copra) and eventually P. 1,000 per metric ton (32 percent of the copra price). Revenues from the fund were used to purchase the United Coconut Planters Bank and much of the country's coconut milling capacity through the United Coconut Oil Mills (UNICOM), as well as some expenditures for replanting and various benefits for coconut farmers. But much of the revenue collected cannot be accounted for; the fund was privately administered and not subject to audit. Estimates of the cumulative collections from 1973 to 1983 range as high as P. 9.7 billion, about one quarter of 1983 tax collections (Montes 1986, 44).[24]

A second example of a special tax that competed with the domestic tax system was the PAG-IBIG fund attached to the Ministry of Human Settlements. This was a compulsory savings scheme to provide housing for its members and was supported by a payroll tax of 3 percent. Collections under the fund were P. 100 million in 1981, 600 million in 1982, and 1.1 billion in 1983.[25]

While these special levies were at times effective in raising revenue, they ranged from being beyond the government's control (as in the case of the coconut levy) to being unavailable for other pressing budgetary needs (as was the case with the oil industry special levy, which built up a surplus at a time when nonenergy projects were being delayed for lack of peso counterpart funds). And the existence and growth of these funds limited the expansion of the general revenue of the national government.

Beyond this erosion of taxing power, the revenue experience of the Marcos government illustrates some of the weakness of the martial law regime and the deterioration in its later years. While Marcos was able to dislodge the traditional elite from power with the declaration of martial law and the dissolving of Congress, the victory was never a complete one. The

early dissipation of the land reform program in the 1970s was an indication that Marcos could or would not press his challenge to the landed elite too far. The hold that the Marcos government had on power may have been too weak to allow a significant increase in taxation on the wealthy. Instead, he sought to create a competitive elite, using the rent mobilization powers of government to favor his own interests and those of his associates. Many of the policy measures benefitting Marcos and his associates involved special privilege or tax and tariff exemptions. Thus the ability to raise revenue was compromised by the erosion of taxation that this policy created.[26]

The failure of the revenue effort also illustrates the loss of momentum of the Marcos administration as a development-oriented and reforming government. The decree-making power of the martial law government was used initially to implement reform measures that had been widely discussed, but blocked by Philippine politics. After the initial successes in the 1970s, the character of the martial law government shifted toward concern with regime maintenance and enrichment, and the decree-making power was used in more particularistic and preferential ways. Special exemptions for individual industries and, in some cases, individual firms proliferated, as Marcos associates were fostered. Rules were enforced in different ways depending upon the individual or case involved. In tax administration, this meant the shift from enhanced participation and self-assessment in the early Marcos years to the (perhaps traditional) feeling that the rich and influential were exempt from taxation. This was echoed in the perceptions of BIR employees, who were reluctant to pursue large taxpayers for fear of who their sponsors might be.[27] As a result the compliance and self-enforcement necessary to make an income tax system function weakened considerably, and widespread evasion was the result.

2.5 Public Corporations

Focussing on the budget of the national government provides only a partial understanding of the Philippine fiscal position. During martial law there was a tremendous growth in the number and importance of government-owned corporations. These entities became the primary vehicle for infrastructural and industrial investment programs. And, although the accounts of these firms are not carried on the books of the national government, the corporations came to have an increasing share of the public sector deficit and of total public external borrowing. During the 1980s the continued investment of these corporations, coupled with their heavy losses, provided a huge drain on the national budget at a time when policymakers were belatedly trying to adjust to external shocks and the mounting debt burden.

Although many government corporations were audited by the government's Commission on Audit, there was no attempt until quite recently to put

together consolidated figures for the government corporate sector. In fact, the report of a mission of the World Bank in 1983 was the first attempt to achieve a consolidation of their accounts (World Bank 1984b). While government-owned corporations existed before the martial law period in the financial, public services, and industrial promotion areas, their role in the Philippine economy and in the public sector was relatively small. At the beginning of martial law there were about 30 government-owned corporations. By 1984 there were 96 parent companies, with at least 149 subsidiaries.[28]

The increasing importance of these firms may be gauged from a few summary figures. Investment by government-owned corporations in 1975 amounted to 0.4 percent of GNP and 12 percent of public sector investment. By 1982 investment of public corporations was over 5 percent of GNP and 60 percent of total investment of the public sector. By 1982 the deficit of public sector corporations had grown to over 2 percent of GNP, and their external debt was almost three-fifths of the public sector total.

Data on the sectoral breakdown of government corporations are shown in tables 2.8 and 2.9. State-owned financial institutions dominate in terms of gross value added. However, the bulk of the investment and the use of external funds was accounted for by nonfinancial public corporations. The most important of these were in the energy sector, but government corporations played a crucial role in agriculture (mostly in irrigation investments), transportation, and later, in manufacturing. Table 2.9 presents

Table 2.8 Gross Value Added (GVA) of Government Corporations by Sector (in percentages)

	Shares of Total Government Corporation GVA			
	1975	1978	1982	1984
Agriculture	10.8	3.5	2.3	5.1
Manufacturing	4.4	5.1	5.3	6.0
Electricity	2.9	8.3	10.6	30.7
Transportation	1.7	5.0	2.7	4.3
Finance	79.9	76.1	77.6	50.0
Others[a]	0.3	2.0	1.5	3.9
All government corporations	100	100	100	100
	Shares of Total Sectoral Value Added			
Agriculture	1.1	0.5	0.5	0.7
Manufacturing	0.5	0.8	1.1	0.9
Electricity	9.2	33.1	46.7	85.9
Transportation	1.0	3.4	2.2	2.5
Finance	58.6	66.6	95.5	84.1
All Industry	3.0	3.7	5.3	3.7

Source: Manasan and Buenaventura (1986), tables 3, 4.

[a]Mining, construction, trade, other services.

Table 2.9 Fifteen Major Nonfinancial Government Corporations

Companies	Number of Employees. 1984[a]	Capital Expenditures. 1980–84 (million pesos)	Cash generation as % of Capital Expenditures, 1980–84	Debt Outstanding 1984[a] (million pesos)
Agriculture				
NFA	11.195	641	3.6	8,286
NIA	7,382	8.905	−8.0	2,981
Industry				
EPZA	1,705	478	−10.9	—
NDC	4,670	10.718	3.6	6.445
Energy				
NEA	915	3,453	−11.4	5,716
NPC	11,523	29,859	8.8	N.A.
PNOC	13,513	7,053	31.6	34.969
Transportation				
LRTA	34	2.675	−11.5	—
MMTC	2,136	106	11.3	329
PNR	6,222	469	−43.5	687
PPA	2.033	1,844	51.0	1,157
Water supply				
LWUA	687	898	−9.5	1,551
MWSS	4,497	4.152	18.1	3,983
Housing				
HSDC	2,556	1,477	3.5	206
NHA	2,531	2,369	2.1	977

Sources: Presidential Commission on Government Reorganization (1985b); and World Bank (1986), vol. 3. tables 5–6, 5–7.

Note: N.A. means data were not available. and a dash indicates that the amount was negligible.

[a]Includes subsidiaries of government firms, but not firms acquired from the private sector.

Company Names: NFA: National Food Authority; NIA: National Irrigation Administration; EPZA: Export Processing Zone Authority; NDC: National Development Corporation; NEA: National Electrification Administration: NPC: National Power Corporation; PNOC: Philippine National Oil Company: LRTA: Light Rail Transit Authority; MMTC: Metro Manila Transit Corporation; PNR: Philippine National Railways; PPA: Philippine Ports Authority; LWUA: Local Water Utilities Administration; MWSS: Metropolitan Waterworks and Sewerage System; HSDC: Human Settlements Development Corporation; and NHA: National Housing Authority.

more detailed information on the largest of the public sector corporations. Within this group the NPC stands out, both for the size of its investments and the size of its losses during the early 1980s.

As in other countries, the Philippines had a variety of reasons for using the corporate form for major infrastructure investments. Government corporations offered a more flexible organizational vehicle for many objectives. Since they were outside the national government, they were not subject to the same restrictions nor to the same pressures of the budgetary cycle. Corporations were not bound by civil service requirements and could, and did, pay higher salaries than the government. Public corporations were also an effective way of raising salaries for key civil servants or for rewarding

political allies and military officers, either through seats on corporate boards or through corporate hiring of individuals who were then released to work at ministries on a more or less permanent basis.

The public corporations were outside the regular lines of authority of the national government and had substantial independence. They could borrow in their own name and could, to a considerable degree, determine their own budgets. Oversight and control by the government was often lax. Each corporation was attached to a government ministry, and the relevant minister had a seat on the corporate board. But in practice this arrangement did not provide for effective supervision. Cabinet ministers often sat on multiple corporate boards. In addition, a presidential decree or letter of instruction could overrule any minister or policy review process, and those who had direct access to President Marcos used it extensively to create functional autonomy for their corporations. In certain situations, notably in the public corporations involved in the sugar and the coconut industry, the heads of the corporations had cabinet rank and sole responsibility for matters affecting their industry and were able to win out in key battles with other cabinet ministers.[29] Although nominally subject to government audit, many of the corporations resisted, and accounts are difficult or impossible to come by.

This independence and relative obscurity was a decided advantage for government corporations that intervened in domestic markets, particularly where substantial rents were involved. In both sugar and coconuts huge sums of money were collected from producer levies. In addition to sugar and coconuts, there were interventions, through government firms, in food marketing and distribution and in overseas labor services. Government-owned corporations also became the favored approach for the projects of Mrs. Marcos, for heart and kidney research and treatment, for international film exhibitions, and for the various activities of the Ministry of Human Settlements. During martial law, the number of government corporations greatly proliferated, in many instances far beyond the natural monopoly or public good rationale that justified the initial corporate entities. Thus by 1985 the Philippines had public sector corporations formed

> for any or all purposes, ranging from banks, nuclear plant, real estate, racehorses and gamecocks, gambling casinos and lottery houses, poultry farms and tomato paste, to a dizzying array of Centers concerned with culture, music, science, health, artists, and all known fields of human endeavor including the meaning of life. (Briones 1985, 2)

Based on the obligational budgets in table 2.4 and national accounts investment breakdowns, the investment expenditures of the government corporate sector increased sharply beginning in 1976. Estimates of the accounts of the nonfinancial public corporate sector are available starting in 1978 (table 2.10). These show a level of investment by public corporations in excess of 4 percent of GNP at that time. Also evident from the table is the

Table 2.10 Public Nonfinancial Corporations, Cash Operations (in billions of pesos)

Year	Investment	(% of GNP)	Government Contribution	Cash Generation	Surplus/ deficit	(% of GNP)
1978	7.5	(4.3)	2.5	0.9	−4.1	(−2.3)
1979	10.4	(4.8)	4.2	0.8	−5.4	(−2.5)
1980	12.0	(4.5)	5.3	0.2	−6.6	(−2.5)
1981	16.5	(5.4)	8.4	0.1	−8.0	(−2.7)
1982	16.8	(5.0)	10.2	−0.3	−7.0	(−2.1)
1983	18.8	(4.9)	7.9	2.7	−8.1	(−2.1)
1984	16.5	(3.1)	5.6	2.7	−8.1	(−1.5)
1985	16.2	(2.7)	5.3	4.2	−6.7	(−1.1)
1986	9.1	(1.5)	11.4	0.3	2.6	(0.4)

Source: Philippines, Government Corporate Monitoring Committee.

large jump in corporate investment that took place in 1981 as the Philippines moved to offset the domestic recession, accelerate its energy program, and start on the MIPs. Between 1981 and 1983, over 65 percent of public fixed investment was done by government-owned corporations.

The fourth column in table 2.10 shows the cash generation of the public corporations, or the surplus after meeting current operating and interest expense that was available to fund investment. Cash generation by Philippine public corporations has been very low, averaging only 6 percent of the annual investment of the corporations covered in the table. To some extent this performance represents the long gestation times characteristic of many of the infrastructural investments, coupled with a rapidly expanding public capital stock. But it also represents low profitability of operation of existing capital equipment. In some cases, tariffs for public services were set too low to achieve targeted rates of return. This was particularly true of the electricity charges of the NPC, which were judged in a 1979 study to be 30 percent below the long-run marginal cost of electricity. Low rates of collection of existing tariffs have plagued the National Irrigation Administration, leading to minimal cash generation in that agency. Finally, those government corporations that have engaged in lending operations, such as the National Electrification Administration's loans to rural cooperatives or the Local Water Utilities Administration's loan to local water authorities, have had large arrears in repayments, resulting in substantial losses in those agencies.

Despite recognition of the problem and pressure from the IMF and World Bank to raise public corporate revenue mobilization, increasing the cash generation of public corporations was made quite difficult by the inflation and exchange depreciation of the 1980s. Although there were repeated increases in rates, revenues of government corporations little more than kept pace with increases in domestic costs and debt service costs on foreign loans. (The improvement in cash generation shown in table 2.10 for 1983 was largely the result of an increase in arrears by the NPC on external loans.)

Low internal cash generation and high rates of investment resulted in large demands for external funds by the government corporate sector. A large part of the burden was borne by contributions of the national government, and the remainder through external borrowing. Contributions from the national government took the form of operating subsidies, equity contributions to the corporations, and loans. Each has a distinct accounting implication, but in practice the difference among them was blurred. There are no easily accessible data on interest payments from government corporations to the national government, and there have been numerous instances in which outstanding loans were converted to equity. Public corporations have generally not paid dividends to the national government (Manasan and Buenaventura 1986, 6–7).

National government contributions to public corporations are shown in table 2.11. By the 1980s as much as 20 percent of government expenditure, and in several cases all of the national government deficit, were accounted for by these contributions. These are explicit contributions from the national government to public corporations; they do not include the implicit subsidies offered to these firms by tax and import tariff exemptions. In 1983 tariff and tax exemptions to government-owned corporations were estimated to have been worth P. 1.5 billion, or 20 percent of explicit budgetary contributions to the corporations. Although these exemptions were reduced by presidential decrees in 1984, many were reinstated during the following months.[30]

More extensive data on the financing of investment are available for the fifteen largest public corporations and are shown in table 2.12. Internal cash generation financed less than 10 percent of investment over the 1978–84 period. National government contributions made up 45 percent of the additional funding requirement, and the remainder came from external loans. The domestic capital market was not tapped as a source of funding for government corporations. In fact, they slightly reduced their indebtedness to

Table 2.11 **National Government Contributions to Public Corporations (in millions of pesos and percentages)**

					Share of:		
Year	Current Transfers	Equity	Net Lending	Total	Government Expenditures	Government Deficit	GNP
1975	285	522	122	929	5.1	66	0.8
1976	392	1,804	100	2,296	11.2	98	1.7
1977	245	2,252	45	2,543	11.2	89	1.7
1978	632	2,245	238	3,115	11.9	144	1.8
1979	478	3,391	853	4,722	15.8	1,380	2.2
1980	505	4,739	675	5,919	15.5	175	2.2
1981	564	7,862	929	9,355	19.5	77	3.1
1982	889	8,419	2,218	11,526	21.9	80	3.4
1983	586	4,821	2,393	7,800	14.7	105	2.1
1984	429	9,819	10,086	20,334	30.5	207	3.9

Source: Manasan and Buenaventura (1986), table 8.

Table 2.12 Sources of Financing for Fifteen Major Nonfinancial Corporations

Years	Capital Expenditures	Internal Surplus[a]	Total Financing	National Government Contributions	Net Domestic Borrowing	Net Foreign Borrowing
			(in millions of pesos)			
1978	7,281	1.636	5.645	2.236	907	2.512
1979	9.518	2.917	6.601	3.335	−2.253	5.519
1980	11.079	1.083	9.996	4.300	16	5.680
1981	15.293	705	14,588	7.169	−514	7.933
1982	15.028	−1.985	17.013	8.378	701	7.934
1983	19.448	1.889	17.559	6.402	600	10.557
1984	15.282	2.831	12.451	5.664	−3.320	10.108
All	92.929	9.076	83.853	37.484	−3.863	50.243
			(as percentages of GNP)			
1978	4.1	0.9	3.2	1.3	0.5	1.4
1979	4.4	1.3	3.0	1.5	−1.0	2.5
1980	4.2	0.4	3.8	1.6	0.0	2.1
1981	5.0	0.2	4.8	2.4	−0.2	2.6
1982	4.5	−0.6	5.1	2.5	0.2	2.4
1983	5.1	0.5	4.6	1.7	0.2	2.8
1984	2.9	0.5	2.4	1.1	−0.6	1.9
All	4.2	0.4	3.8	1.7	−0.2	2.3

Source: Manasan and Buenaventura (1986), table 14.
[a]Including change in cash balances.

the private sector over this period. Domestic counterpart funds for investment projects were made up entirely from contributions from the national government, which explains the correlation between size of national government contributions and external borrowing that has been noted for the Philippines.[31]

Public corporations in the Philippines played a crucial role in the early 1980s. The combination of their large funding requirements and the difficulty in bringing their outlays under control gave public expenditure a momentum that could not be reversed when there was a critical need for the Philippines to adjust to the worsened external environment. Monitoring and control of public enterprises was made more difficult by the fact that the available budgetary information covered only the national government; there were no integrated accounts of expenditure and funding requirements of public corporations. After the Philippine debt crisis, at the prodding of the IMF, the government put together data on the major public corporations. This data, from which the tables in this section have been compiled, make possible the construction of accounts for the nonfinancial consolidated public sector going back 1978. These figures give a much clearer indication of the fiscal stance of the Philippine government. Before we examine these

consolidated accounts, we review briefly the two remaining components of the nonfinancial public sector, local governments and the social security institutions.

2.6 Local Governments

Local governments have not played an important role in the Philippines. Government functions and authority have been concentrated in Manila, and this centralization was greatly strengthened under martial law. Local government expenditure has been constrained by severe revenue limitations. Property taxes are the primary source of revenue, but tax rates are low and, since no process of cadastral surveying exists, many properties are not on the tax rolls. The expansion of activity by the communist New People's Army (NPA) has reduced tax collections in many localities, and in some areas the NPA operates as the only government, levying taxes of its own. In addition to local sources, about 40 percent of the revenue of local governments comes directly from the national government through revenue sharing and as additional aid and allotments. Total revenues of local governments from all sources have hovered around 2 percent of GNP (table 2.13).

Local government expenditure has been almost entirely for current operations. Capital expenditures of local governments, on roads and local facilities, have made up only about 15 percent of total local government expenditure. Borrowing by local governments is possible, but in general strictly limited. In total, local governments have run balanced budgets or small surpluses.

2.7 Social Security Institutions

The Philippines has two government-sponsored employment security institutions. The larger, the Social Security System (SSS), covers nine million workers in the private sector, while the Government Service Insurance System (GSIS) covers about one million government workers. Total revenue collection by these bodies has averaged just under 2 percent of GNP, while their surpluses (after expenses and net lending to members) have been about 0.8 percent of GNP in recent years. About one-third of this surplus has been invested in government securities, and most of the remainder has been invested in the Philippine National Bank or the Development Bank of the Philippines. In recent years the social security institutions, particularly GSIS, have made equity investments at the direction of the government, often in companies in financial difficulties. As a result, the character of the GSIS portfolio has deteriorated substantially, and the institution now owns some of the most prominent assets slated for privatization by the Aquino government, including the Manila Hotel and Philippine Airlines.

Table 2.13 **Consolidated Income and Expenditures of Local Governments, 1975–85 (percentage of GNP)**

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Total revenue	1.9	1.7	2.0	1.9	1.8	1.6	1.8	1.9	1.8	1.4	1.4	1.4	1.4
Tax revenue	0.7	0.6	0.7	0.7	0.7	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5
Nontax revenue	0.5	0.4	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.3
Aid and allotments from national government	0.8	0.7	0.7	0.6	0.7	0.6	0.7	0.8	0.8	0.6	0.6	0.6	0.6
Expenditures	1.9	1.8	1.9	1.8	1.7	1.6	1.7	1.7	1.7	1.4	1.4	1.4	1.3
Current	1.6	1.5	1.6	1.6	1.5	1.4	1.5	1.5	1.5	1.2	1.3	1.3	1.2
Capital	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1
Surplus/deficit	0.0	−0.0	0.0	0.0	0.1	0.0	0.1	0.1	0.1	0.0	0.1	0.0	0.0

Source: Philippines, Ministry of Finance, Office of Local Governments.

Note: Components may not add to totals due to rounding.

2.8 Government Financial Institutions and the Central Bank

With the material in the previous sections and tables we are now in a position to assemble budget figures for the consolidated nonfinancial public sector in the Philippines. This consolidation is done in table 2.16 below. However, in the Philippines even this degree of consolidation misses an important part of the fiscal story, since it excludes the operating balances of the state-owned financial institutions and the central bank. In the 1980s these bodies were used for fiscal operations, particularly for the rescue of failing private corporations, many of which were owned by Marcos cronies. In addition, public financial institutions were forced to make good on loan guarantees extended to private borrowers who could not meet their external debt service obligations. The losses of the state-owned financial institutions and the central bank reached major proportions in the 1980s, rivaling the deficits of the entire nonfinancial public sector.

Only very limited data exist on the balances of the public financial institutions, covering only the 1983–86 period. These are shown in tables 2.14 and 2.15. Table 2.14 shows the balances of the three major financial institutions, the Philippine National Bank (PNB), the Development Bank of the Philippines (DBP), and the Philippine Export and Foreign Loan Guarantee Corporation (PhilGuarantee). Both PNB and DBP suffered major losses as a result of the devaluations in 1983–84 and the following domestic recession. For PNB the losses arose primarily on domestic operations, particularly from the collapse of the sugar industry in 1985.

The Development Bank of the Philippines was used extensively as a corporate rescue agent in the 1980s. The period saw a sharp rise in DBP's industrial loans and investments, many of them extended at the behest of the government to financially strapped firms (Lamberte 1984, 16–17). DBP was also used to support domestic commercial banks associated with the Marcos government. Equity investments totaling P. 267 million were made in Associated Bank and Pilipinas bank. These investments were in turn rediscounted with the central bank, in effect channeling central bank funds to these two private banks at a cost far below that charged by the central bank on its emergency advances (1984, 17). By the end of 1983 DBP had equity investments totalling P. 9.2 billion, or 17 percent of its assets, the bulk of which were in banks, hotels, mining, textile manufacturing, steel, and construction. A remarkable memorandum from the director of DBP to Marcos in 1983 lists the loans and investments made at the government's behest. These totaled P. 28.2 billion ($2.5 billion at 1983 exchange rates), or over five times DBP's capital (Tengco 1983, 1).

In 1982 and 1983 support for the deficits of the state-owned financial institutions came primarily from the central bank. The reserve money targets of the IMF program limited the use of central bank credit after 1983, and the burden of supporting the deficits of these financial institutions fell on the

Table 2.14 **Deficits of Major Government Financial Institutions[a] (in billions of pesos)**

	1983	1984	1985	1986
Domestic surplus/deficit[b]	N.A.	-2.2	-6.6	-4.8
PNB	N.A.	-1.8	-5.8	-3.9
DBP	0.9	-0.3	-0.8	-0.9
PhilGuarantee	—	-0.1	—	—
Foreign interest and net foreign payments[c]	N.A.	-6.3	-11.9	-7.7
PNB	N.A.	-2.5	-2.2	-1.8
DBP	-3.1	-3.6	-8.7	-4.5
PhilGuarantee	-0.2	-0.2	-1.0	-1.4
Overall deficit	-5.3	-8.5	-18.5	-12.4
(% of GNP)	(-1.4)	(-1.6)	(-3.1)	(-2.0)
PNB	-2.9	-4.3	-8.0	-5.7
DBP	-2.2	-3.9	-9.5	-5.4
PhilGuarantee	-0.2	-0.3	-1.0	-1.4
Transfers from national government	0.2	7.3	10.7	15.5
PNB	N.A.	1.0	1.5	6.4
DBP	N.A.	5.5	8.3	8.0
PhilGuarantee	N.A.	0.8	0.9	1.1
Memo:				
Foreign debt service				
after first rescheduling[d]	N.A.	6.6	16.1	9.1
PNB	N.A.	2.7	5.0	2.9
DBP	10.1	3.7	10.1	5.2
PhilGuarantee	0.2	0.2	1.0	1.0

Source: IMF (1986a. 24). table 8: and IMF (1987).

Note: N.A. means data were not available. and a dash indicates the amount was negligible.

[a]Philippine National Bank. Development Bank of the Philippines. and Philippine Export and Foreign Loan Guarantee Corporation.

[b]Domestic operations. net payments on domestic guarantees. captial expenditures. and sales of assets.

[c]After 1985 debt rescheduling.

[d]Interest and principal repayments on foreign loans plus gross advances on foreign loan guarantees.

national government, as is shown from the rapidly rising transfers in table 2.14. By 1985 these institutions had become a fiscal nightmare, and their annual losses amounted to more than 3 percent of GNP.

What table 2.14 does not adequately show is the capital loss and continuing obligation shouldered by the government as a result of the rapidly deteriorating loan portfolios of PNB and DBP. At the end of 1983, the DBP had external liabilities of approximately $1.5 billion, plus an additional $1 billion in outstanding foreign loan guarantees.[32]

Even larger losses were suffered by the Philippine central bank during this period; in the four years shown in table 2.15, central bank losses averaged 3.5 percent of GNP. Some of the reasons for this loss are indicated in the table. The central bank entered a number of forward cover and swap contracts in the early 1980s. When the exchange rate depreciated in 1983 and 1984, the central bank was forced to accept the resulting losses. Much of the forward cover was extended to public corporations, particularly the

Table 2.15 **Central Bank Net Income, 1983–86 (in billions of pesos)**

	1983	1984	1985	1986
Net interest	−2.0	−8.3	−15.6	N.A.
Payments	−7.2	−16.4	−24.6	N.A.
(Domestic)	−0.7	−5.3	−12.6	N.A.
(Foreign)	−6.5	−11.1	−12.0	N.A.
Receipts	5.2	8.1	9.0	N.A.
Forward cover profits	−5.0	−5.3	−7.6	N.A.
Swap profits/losses	−6.8	−14.0	7.0	N.A.
Total surplus/deficit	−13.8	−27.6	−15.5	−16.9
(percent of GNP)	(3.6)	(5.2)	(2.6)	(2.8)

Sources: Net interest—"CB Deficits Mount Due to 'Jobo' Bills," *Manila Chronicle*, 15 September 1986, p. 1. Forward cover, swaps, and total—IMF (1987).

Note: N.A. = not available.

PNOC.[33] Swap contracts were entered with domestic commercial banks and their foreign currency deposit units, as a way of encouraging further international borrowing. Losses under both of these contracts were posted in every year, except in 1985 when the peso appreciated and the central bank earned a profit on its swaps.

Much of the loss of the central bank during this period came from increased net interest payments in 1984 and 1985. In order to reduce the domestic money supply, the central bank sold its own bills in 1984 and again in 1986, sometimes at rates in excess of 40 percent per annum. Outstanding central bank securities, net of repurchase agreements, reached almost P. 40 billion ($2 billion) by September 1985. Additional losses came from the external liabilities of the central bank. Net foreign assets of the central bank turned negative in 1982, and by the end of 1984 the net external liabilities of the central bank had reached P. 35 billion ($1.8 billion), almost 6 percent of GNP.

The most difficult effect to gauge is the weakening of the central bank portfolio from the emergency advances to financial institutions and, indirectly, to troubled nonfinancial firms in the private sector. Assistance to financial institutions increased sharply at the end of 1984 during the adjustment crisis and again in early 1986 during the post-election boycott of government-associated banks. The central bank was also exposed to the two troubled government financial institutions, PNB and DBP, having indirectly supported some of their rescue operations of private firms. Central bank emergency loans and overdrafts to financial institutions reached P. 11 billion (2 percent of GNP) at the end of 1984. Of this, P. 1 billion was to specialized government financial institutions, a category made up almost entirely by DBP. These and other issues surrounding the Philippine financial system are discussed in more detail in chapter 5.

2.9 Consolidated Budget

We can combine the accounts of the various units of the public sector, netting out the transfers among them, to arrive at a consolidated public sector budget. Two consolidations are shown in table 2.16. The first is of the nonfinancial public sector, which includes the national and local governments, social security institutions, and public nonfinancial corporations. The second consolidation, available only for 1983 through 1986, adds in the major public financial institutions and the central bank.

Several things are apparent from the consolidations. The first is that the relatively low deficit of the national government between 1978 and 1980 is deceptive. Most of the public sector deficit was contained in the accounts of public sector corporations, although this information was not readily available at the time, and the consolidated nonfinancial public sector deficit was about three times that of the national government.

Although the consolidated figures are larger, the jump in the deficit in 1981 and 1982 was not as dramatic as that of the national government. What is also apparent is the momentum of the public sector deficit in the critical 1982–83 period, despite the efforts of the national government to change fiscal course. Continued investments by public corporations in 1983 added to the deficit, while the huge increase in losses of the public financial sector continued the deficits after 1983.

While the deficit figures contained in table 2.16 are respectable, they are not extraordinarily large. The nonfinancial public sector deficit never reaches 6 percent of GNP, while even with the losses of public financial institutions, the combined deficit peaks at just over 8 percent of GNP. While public sector deficits play a role in the drift of the Philippines into debt crisis, they are not the sole, nor perhaps the most important, explanation.

The problems caused by the public sector deficits in the Philippines are more a matter of timing and content than size. The Philippines was unfortunate to have had a sharp increase in the deficit of the public sector at precisely the time when external signals called for a scaling back of public borrowing to limit external borrowing. A more fundamental difficulty that the Philippines had was the increasing weakness of public investment expenditure. Analyses of sustainable foreign borrowing make the distinction between borrowing for investment and borrowing for consumption. Although the Philippines maintained high and increasing rates of public investment, in fact what was purchased with that investment expenditure made it little different from consumption.

Much of public sector investment in the 1980s was loans and equity contributions to failing private sector corporations, absorbing the losses of those enterprises. Certainly not all, but much of the Philippine investment effort was ill advised, in assets that never paid out or, in some cases, never materialized. Public sector investment took on a momentum of its own and

Table 2.16 **Public Sector Balances (percentage of GNP)**

	1978	1979	1980	1981	1982	1983	1984	1985	1986
National government									
Revenue	13.6	13.5	13.1	11.8	11.4	12.0	10.8	11.5	12.8
Expenditure	14.8	13.7	14.4	15.8	15.7	14.0	12.7	13.5	17.8
Current	10.9	9.5	9.3	8.7	9.2	9.1	8.1	9.2	10.8
Capital	2.6	2.3	3.1	4.2	3.0	2.7	1.9	1.7	1.9
Total equity, net lending	1.4	1.9	2.0	3.0	3.5	2.1	2.7	2.8	4.4
Aid to GCs	1.4	1.9	2.0	2.8	3.0	2.1	1.1	0.9	1.9
Aid to GFIs	0.0	0.0	0.1	0.2	0.4	0.0	1.6	1.9	2.6
Savings	2.7	4.1	3.9	3.1	2.2	2.9	2.7	2.4	2.0
Surplus/deficit	−1.2	−0.2	−1.3	−4.0	−4.3	−2.0	−1.9	−1.9	−5.0
Local government									
Revenue	1.9	1.8	1.6	1.8	1.9	1.8	1.4	1.4	1.4
Aid from national government	0.6	0.7	0.6	0.7	0.8	0.8	0.6	0.6	0.6
Expenditure	1.8	1.7	1.6	1.7	1.7	1.7	1.4	1.4	1.4
Current	1.6	1.5	1.4	1.5	1.5	1.5	1.2	1.3	1.3
Capital	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1
Savings	0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.1
Surplus/deficit	0.0	0.1	0.0	0.1	0.1	0.1	0.0	0.1	0.0
Social security									
Investment	0.4	0.3	0.3	0.4	0.3	0.3	0.2	0.2	0.2
Savings	1.0	1.1	1.0	1.2	1.2	1.0	0.8	1.0	1.0
Surplus/deficit	0.6	0.8	0.8	0.8	0.9	0.8	0.6	0.8	0.8
Government corporations									
Investment	4.3	4.8	4.5	5.4	5.0	4.9	3.1	2.7	1.5
Contributions from national government	1.4	1.9	2.0	2.8	3.0	2.1	1.1	0.9	1.8
Cash generation	0.5	0.4	0.1	0.0	−0.1	0.7	0.5	0.7	0.0
Surplus/deficit	−2.3	−2.5	−2.5	−2.7	−2.1	−2.1	−1.5	−1.1	0.4

(continued)

Table 2.16 (continued)

	1978	1979	1980	1981	1982	1983	1984	1985	1986
Consolidated nonfinancial public sector[a]									
Investment	7.5	7.5	8.2	10.4	9.0	8.2	6.9	6.4	6.2
Savings	4.5	5.8	5.2	4.7	3.6	5.0	4.1	4.3	3.2
Surplus/deficit	−2.9	−1.7	−3.0	−5.7	−5.4	−3.2	−2.8	−2.2	−3.6
Public financial sector									
Surplus of GFIs						−1.4	−1.6	−3.1	−2.0
Net income of central bank						−3.6	−5.2	−2.6	−2.8
Contributions from national government						0.0	1.6	1.8	2.7
Surplus/deficit						−5.0	−5.3	−3.9	−2.1
Consolidated public sector									
Surplus/deficit[b]						−8.2	−8.3	−6.1	−5.8

Source: Tables 2.1, 2.7, 2.10, 2.13, and the Philippines, Government Corporate Monitoring Committee.

Note: GCs are government corporations and GFIs are government financial institutions.

[a]National government, local government, social security institutions, and nonfinancial public sector corporations, net of interagency transfers and investments.

[b]Consolidation of nonfinancial public sector and public sector financial institutions, net of interagency transfers and investments.

became more of a way of assuring foreign currency inflows than a means of creating capital stock. New projects were started as late as 1983, despite delays and stretch-outs of existing projects due to the inability of the government to come up with counterpart funds. Current expenditure, particularly operations and maintenance expenditures, were cut back to sustain investment, in some cases prematurely retiring the existing capital stock.

Finally, the Philippines shifted the public sector deficit from the national government to public corporations and later to government financial institutions and the central bank, using the borrowing ability of each to keep the system afloat, until the process could no longer be sustained.

3 Trade Policy, Industrial Policy, and the Exchange Rate

Trade and industrialization policy have been the vortex of Philippine economic debate. Trade policy has been more extensively argued in the Philippines than has any other economic policy, starting with the outcry over the administration of the import control program in the early 1950s and extending through the current debates on import liberalization. This prominence is reflected in research on the Philippine economy, and there is now an extensive literature on Philippine trade and industrial policy.[1] Trade policy issues are also central to our analysis of the Philippine debt crisis. In comparative studies of LDC borrowers, the extent to which exports grew appears to play a key role in determining whether or not countries were forced to reschedule.[2] In the Philippines in particular, trade and industrial policy were powerful forces behind the slide of the economy into crisis in the 1980s.

Despite the importance given to industrial and trade policy, Philippine industrial and trade performance has been largely disappointing. The initial period of import substitution led to rapid economic growth in the early 1950s. However, in what has now become a classic pattern of import substitution, growth slowed as the industries that were created reached the limits of the domestic market and as their high dependence on imports of capital goods and intermediates meant that the growth of the economy as a whole was limited by recurrent balance of payments crises. The Philippines went through an import decontrol program in the early 1960s, but with disappointing results. Economic growth remained sluggish, particularly in the manufacturing sector, and the country failed to develop significant new export industries.