# Fiscal Deficit as a Critical Constraint to Economic Growth and Development

Aries Eroles Guia Mae Abaja

In the country's economic landscape, fiscal policy plays a critical role in directing its economic growth and development.Over the past decade or so, the Philippines is able to have a remarkable economic growth that at some point some observers, including the World Bank, hailed it as the "rising tiger of Asia" (Konishi 2013). Yet a decade and a half ago, when the ADB published its Country Diagnostic Study, the picture is somewhat different and is less remarkable. The country was experiencing fiscal deficits, falling government revenue, and less expenditure on critical areas for development (such as in infrastructure and the economic and social services).

In this paper, the authors will probe the question whether fiscal deficit remains a critical constraint to economic growth. By looking at the macroeconomic trends relating to the fiscal policy over the past decades, the authors examine some improvement (or deterioration) of the fiscal condition of the Philippines and attempt to explain the trends with regards to its effect on the economy and their interactions.

The first section of the paper discusses the 2007 ADB study and highlights some of ADB's key findings on fiscal as a springboard on later discussion. The next section discusses the progress of the fiscal health of the country since the ADB study and track the improvement (or deterioration) and the contexts of which that causes or influences the changes over time. The third section examines the future outlook of the Philippines including the novel 2022-2028 Medium-Term Fiscal Framework and some trends that could (adversely) affect the fiscal condition of the country. And finally, the authors conclude by answering whether the fiscal deficit remains a critical constraint and summarizing the main points of the paper.

## 1. The 2007 Asian Development Bank Study

The Asian Development Bank published a country diagnostic study in 2007 which presented a "diagnosis of the Philippine economy" which examined the critical development constraints (on growth and poverty reduction), the economic development performance and policy of the Philippines, and some policy recommendations. One of the critical development constraints cited in the ADB study is the "persistent fiscal deficits" which the bank identified as "a key source of the macroeconomic instabilities". (ADB 2007)

A fiscal deficit is a shortfall in a government's income compared with its spending. A government that has a fiscal deficit is spending beyond its capacity to generate revenues. ADB (2007) noted that the Philippines recorded fiscal deficits for most of the last two and a half decades before 2007 (Graph 1a). The country went through additional serious fiscal and public debt distress during 2002–2005 in the post-Asian Financial crisis, which resulted in sovereign credit downgrades and difficulties in accessing foreign capital. The most important cause of the deficits in recent years has been weak revenue generation, in particular, tax collection.

Since 2001, Philippine Government revenue as a share of GDP has been the lowest in East and Southeast Asia (Graph 1b). There is also this decline in the tax effort in the post-Asian crisis years of 1999–2005 (Graph 2a) partly caused by "lower profitability/losses of many businesses that were still feeling the impact of the Asian Financial Crisis" and the results on fiscal policies (on excise taxes) and (regressive) reform (i.e., Comprehensive Tax Reform Law of 1997). (ADB 2007)

ADB (2007) also observed the "serious weaknesses in tax administration" of the Philippines. Fiscal deficits were lowered during 2003-2006 but the improvement stemmed from "deep cuts in social and economic

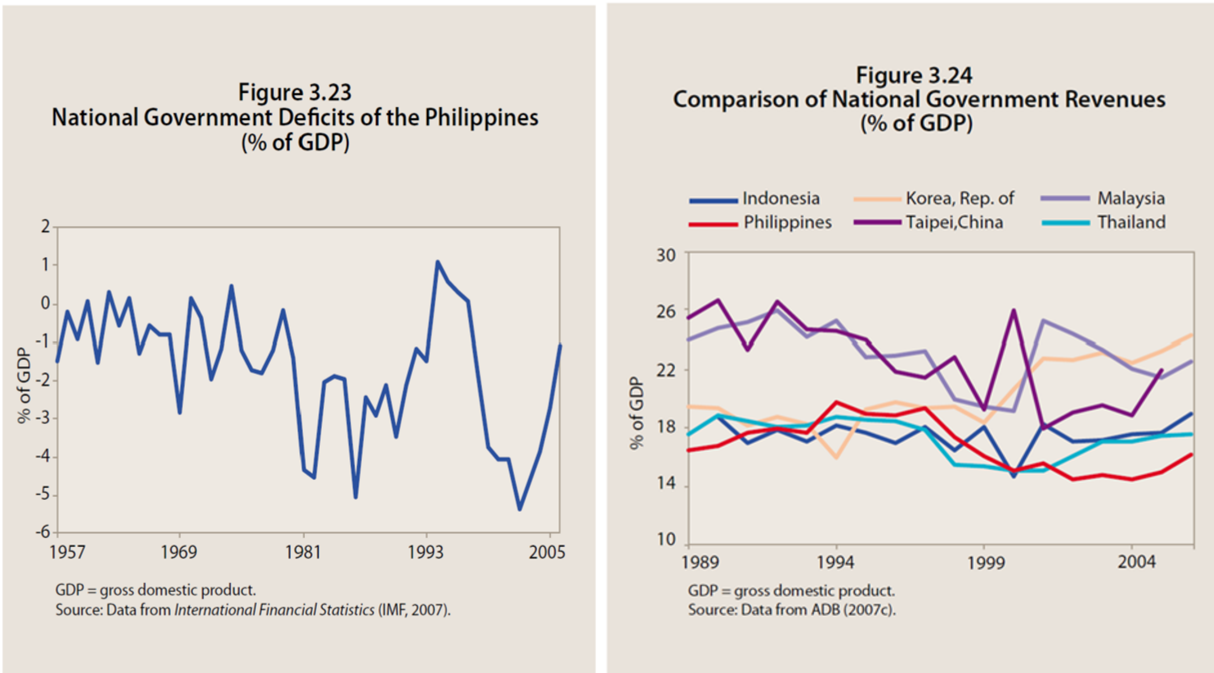



Figure 1: Graph **1**. a) National Government Deficits of the Philippines (% of GDP). b) Comparison of National Government Revenues (% of GDP). Adopted from (ADB, 2007)

services" (Graph 2b) that was detrimental to economic growth. Public debt was also a concern at 64% of GDP in 2006 and with interest payments reaching 5.5% of GDP and 31.1% of the government budget. This exposed the Philippines to interest rate and currency risks (due to currency speculation).

# 2. Progress in Fiscal Health of the Philippines Since 2006

This section will examine progress of the fiscal condition of the Philippines 2006 up to the present. The authors will examine trends of the government's revenue, expenditure, debt, and fiscal balance including the composition and comparison with ASEAN economies. Significant reforms affecting fiscal policy are also probed.

## Revenue

The National Government revenue is composed of tax revenues, non-tax revenues, and grants. In nominal terms, the National Government's revenue grew by almost 4-fold from ₱979 billion in 2006 to ₱3.545 trillion in 2022. Tax revenues are a significant contributor to total revenue which stands at 91% in 2022 (up from 88% in 2006) with the Bureau of Internal Revenue (BIR) as the major contributor.

Revenue effort improves from 15% in 2006 to roughly 18% in 2022. Tax effort also improved to 16% in 2002 (from 13% in 2006). It can be observed that during periods of economic downturn, such as the global financial crisis from 2008 to 2010, revenue and tax effort are also down as there is less that the government can tax. But such was not the case during the 2020 pandemic. That is because revenue effort and tax effort are expressed as a percentage of GDP. Even though government revenue/taxes (numerator) went down, the GDP (denominator) went down even further so that the overall fraction is fairly the same.

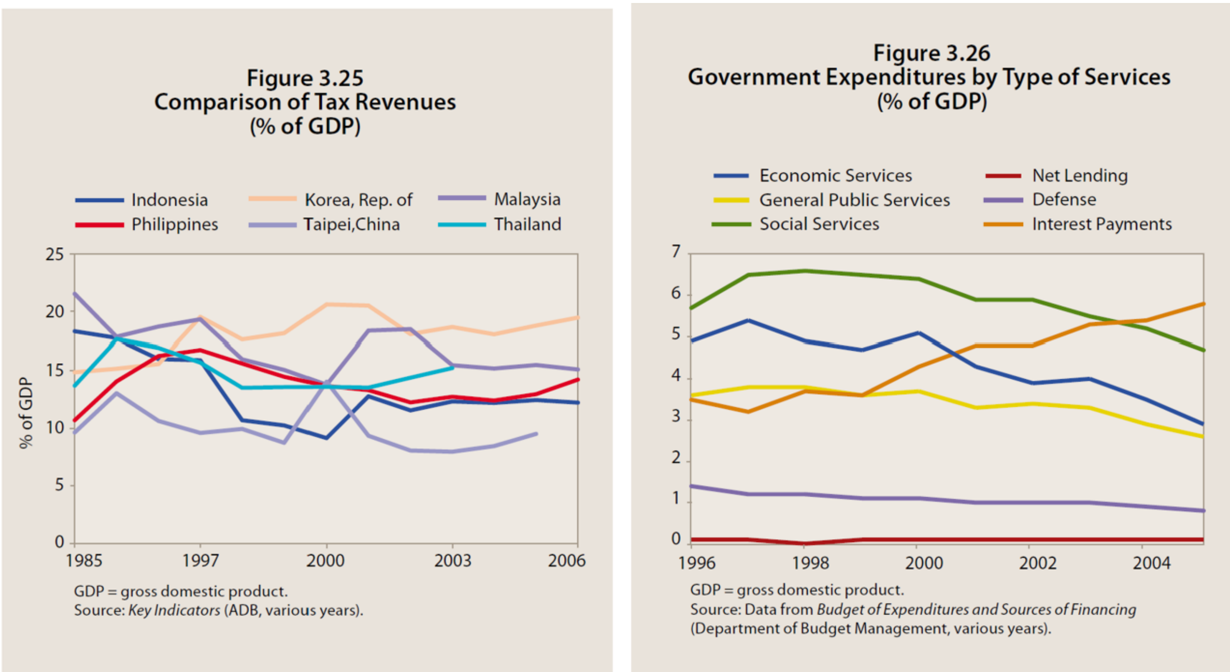
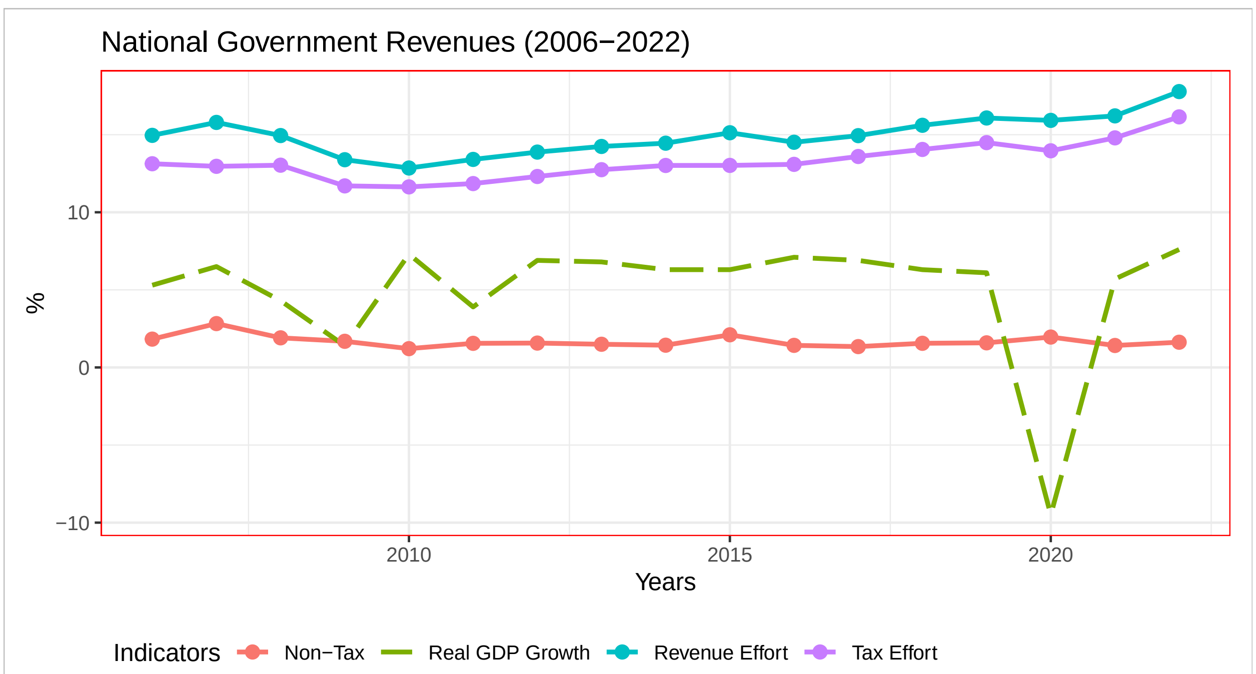
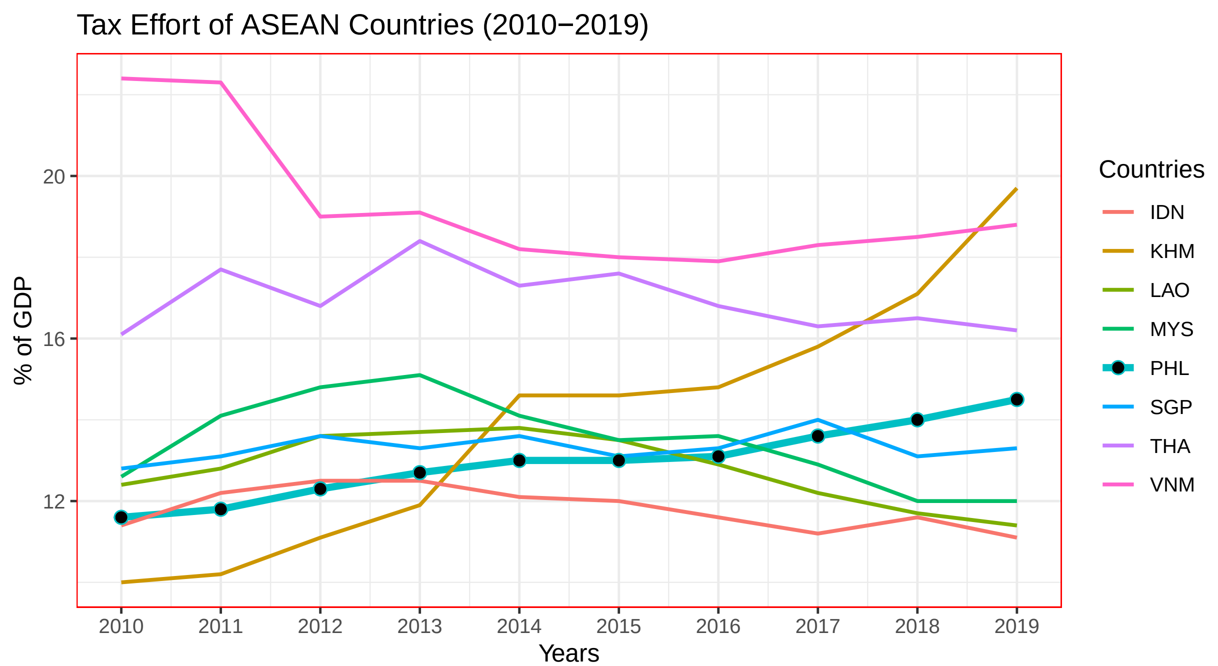



Figure 2: Graph **2**. a) Graph 3. Comparison of National Government Tax Revenues (% of GDP). b) Government Expenditures by Type of Services (% of GDP). Adopted from ADB (2007, pp. 32).

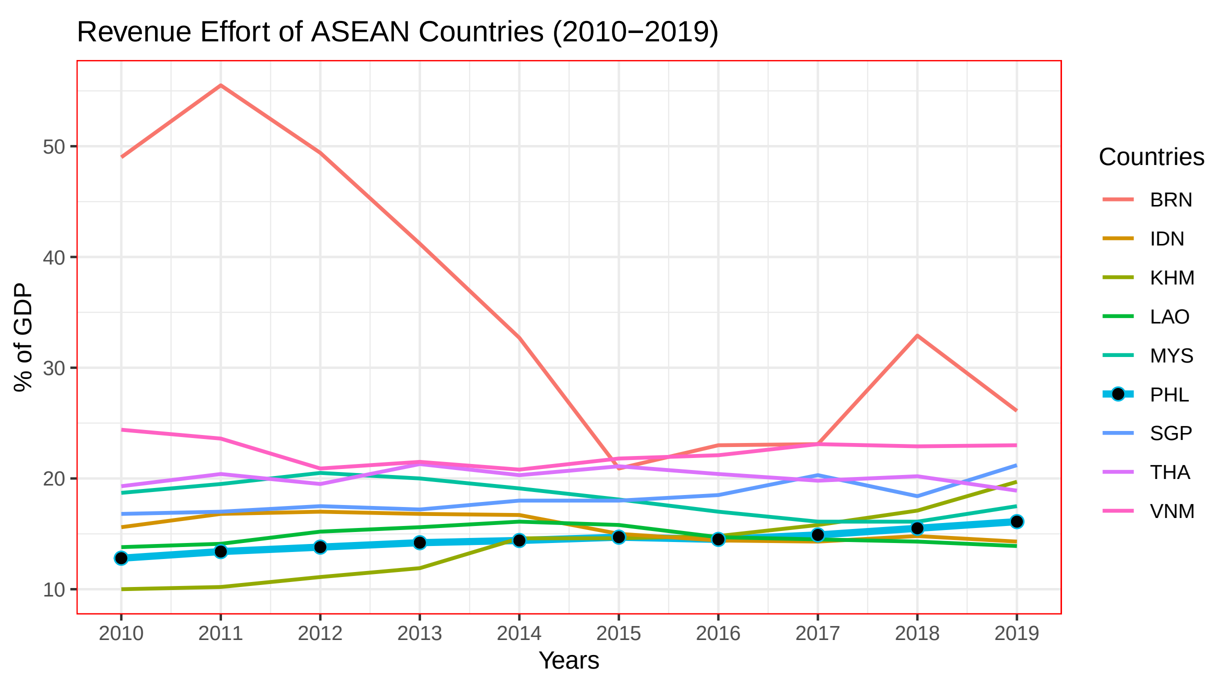



Graph 3. NG Revenue and Tax Effort as % of GDP, 2006−2022 (Source: BTr and DoF)

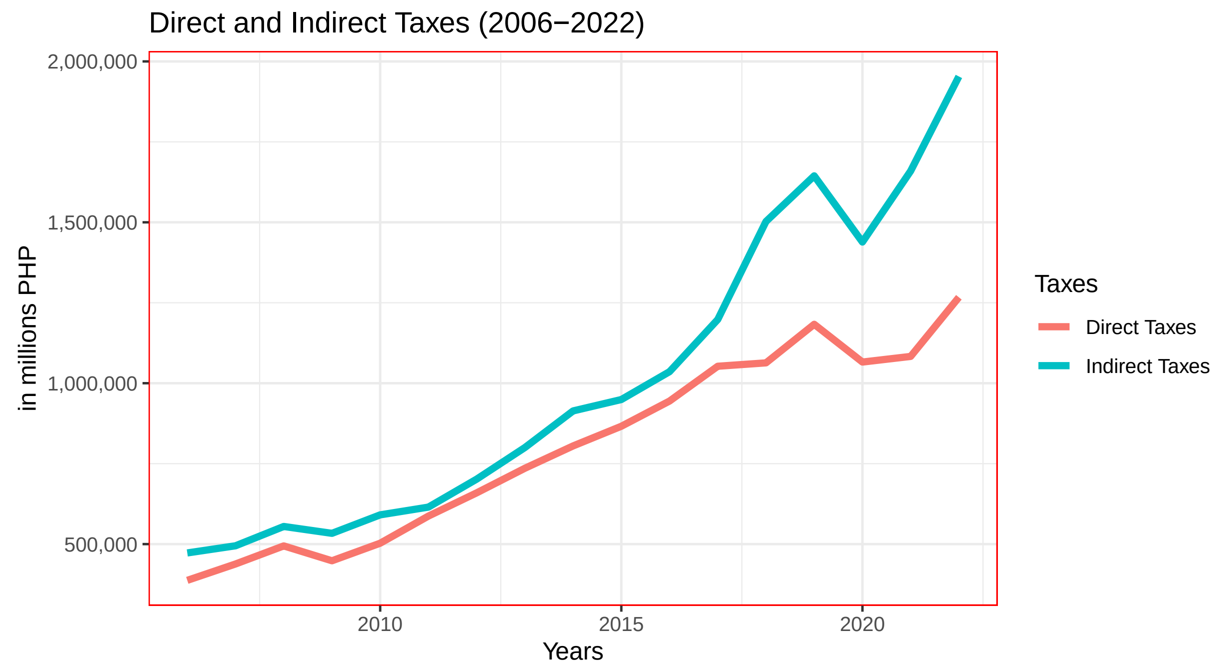



Graph 4a. Tax Effort of ASEAN Countries as % of GDP, 2010−2019 (Source: NTRC, 2021)

Compared with ASEAN countries, the Philippines tax effort has been gradually improving over the years. Since 2010, the Philippines inches up from lower half to upper half among its ASEAN neighbors in terms of tax effort.




Graph 4b. Revenue Effort of ASEAN Countries, 2010−2019 (Source: NTRC, 2021)



Graph 5. Direct and Indirect Taxes, 2006−2022 (Source: DoF)

But such is not the case with revenue effort. As revenue effort is influenced by a combination of tax and non-tax revenue, although the Philippines collected more tax revenue as a percentage of GDP than Indonesia (a petroleum-exporting country), the latter's non-tax revenue enables it to rank higher than the Philippines with regards to revenue effort. The Philippine non-tax revenue actually declined from 1.80% in 2006 to 1.62% in 2022 as shown in Graph 3, which likely contributed to the Philippines' lower ranking in terms of revenue effort. Non-tax revenue includes sources of income other than taxes, such as fees, fines, and income from government-owned enterprises. Taxes are classified as direct (levied directly to an individual's or organization's income, wealth or asset) and indirect (levied on goods and services rather than on income or profits). By tax composition, the biggest contributor of government taxes is the income tax of businesses which is roughly 41.7% of the total taxes while the biggest source of indirect taxes are the import duties and taxes which is at 21.5%. There is an increasing trend for both direct and indirect taxes over the years halted only during the 2020 pandemic. From 2006 to 2022, the growth of indirect taxes is much larger compared to direct taxes. In addition to economic conditions, fiscal policies (especially with tax reform) can affect the tax revenues of the government.

## Expenditure

The National Government expenditures grew from ₱1.044 Trillion in 2006 to ₱5.160 Trillion in 2022. Not only that expenditure increases nominally, as a percentage of GDP expenditure significantly increases from just around  of GDP (15.9%) in 2006 to ¼ of GDP (25.87%) in 2022. This indicates an increasing role of the government in the economy.

By composition, expenditures by the government can be analyzed by cash operations, expense class and sector (See Table 1). Looking at the cash operations, the main driver of the government expenditure is the NG Disbursement which goes to the agencies as current operating expenditure and capital outlay (See Graph 6). Interest payment as well as net lending is fairly stable over the years (averages around 3% and 0.1%, respectively, from 2005-2022) . The 2007 ADB study noted the high costs related to improvements made to fiscal deficits in the years 2003-2006 by making deep cuts in social and economic services (ADB 2007, 31). Significant improvements have been made in this regard with social and economic services accounting for 9.8% and 6.3% of GDP, respectively, in 2022 (from around 5% and 3% in 2007) (See Graph 7). This is due to the gradual decline of the debt servicing (See Graph 12) which enables the National Government to spend on priority programs (Diokno 2017, 90).

By expenditure class, capital outlays share of the total expenditure increases in 2016 to 2019 but was halted in 2020 as the government provided fiscal and social spending stimulus during the Covid-19 pandemic (See Graph 8). Capital outlays are generally desirable because of their high multiplier effect to the economy (DBM 2012).

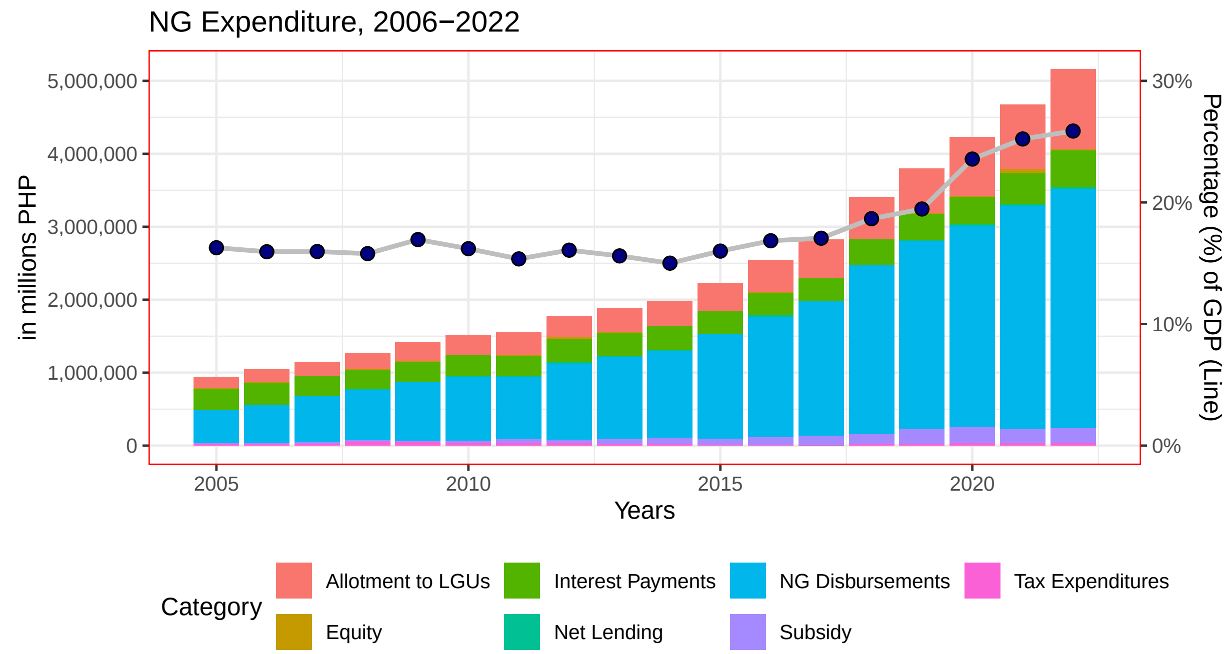
Table 1: Table 1. Different Forms of Decomposition of the NG Expenditures

| Cash Operations (BTr) | Expense Class (DBM) | Sector (DBM) |
|---|---|---|
| Allotment to LGUs | Current Operating Expenses | Economic Services |
| Interest Payments | Capital Outlay | Social Services |
| Tax Expenditures | Net Lending | Defense |
| Subsidy | | General Public Services |
| Equity | | Net Lending |
| Net Lending | | Debt Services - Interest Payments |
| NG Disbursements | | |

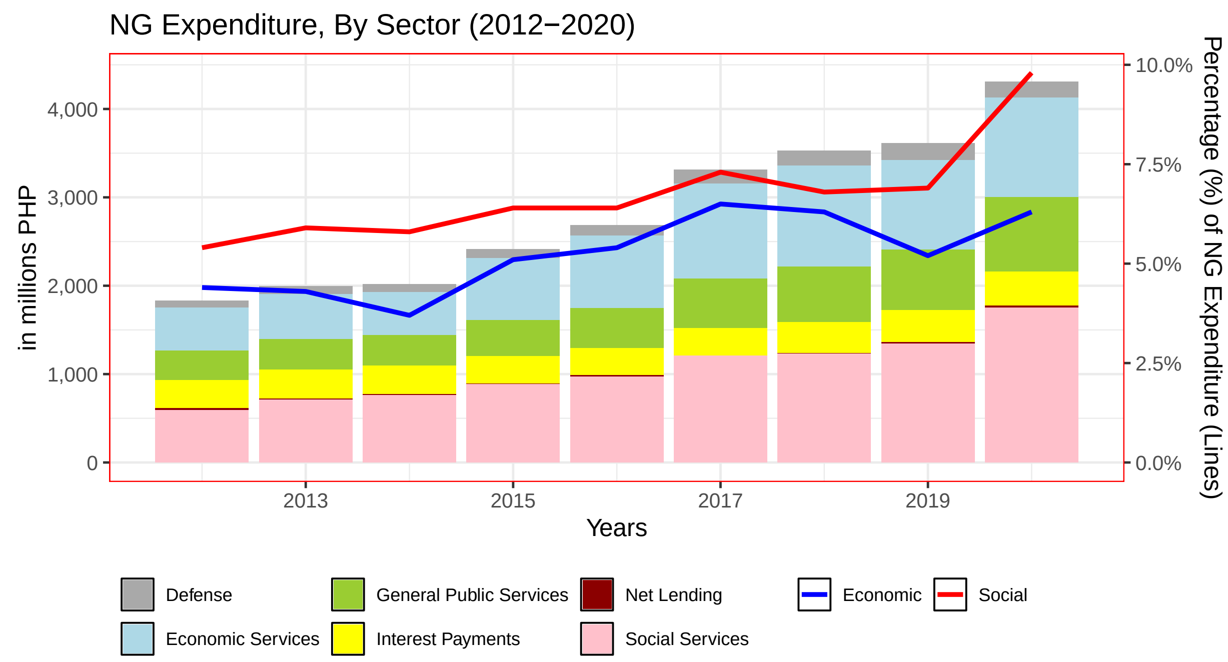
Table 2: Table 2. Sectoral Composition of NG Expenditures

| Sector | Composition |
|---|---|
| Economic Services | • Agriculture, Agrarian Reform<br>• Natural Resources and Environment<br>• Trade and Industry<br>• Tourism<br>• Power and Energy<br>• Water Resources Development & Flood Control<br>• Communications, Roads and Other Transportation<br>• Other Economic Services<br>• Subsidy to Local Government Units |
| Social Services | • Education, Culture, and Manpower Development<br>• Health<br>• Social Security, Welfare and Employment<br>• Land Distribution (ARF)<br>• Housing and Community Development<br>• Other Social Services<br>• Subsidy to Local Government Units |
| Defense | Domestic-Security |

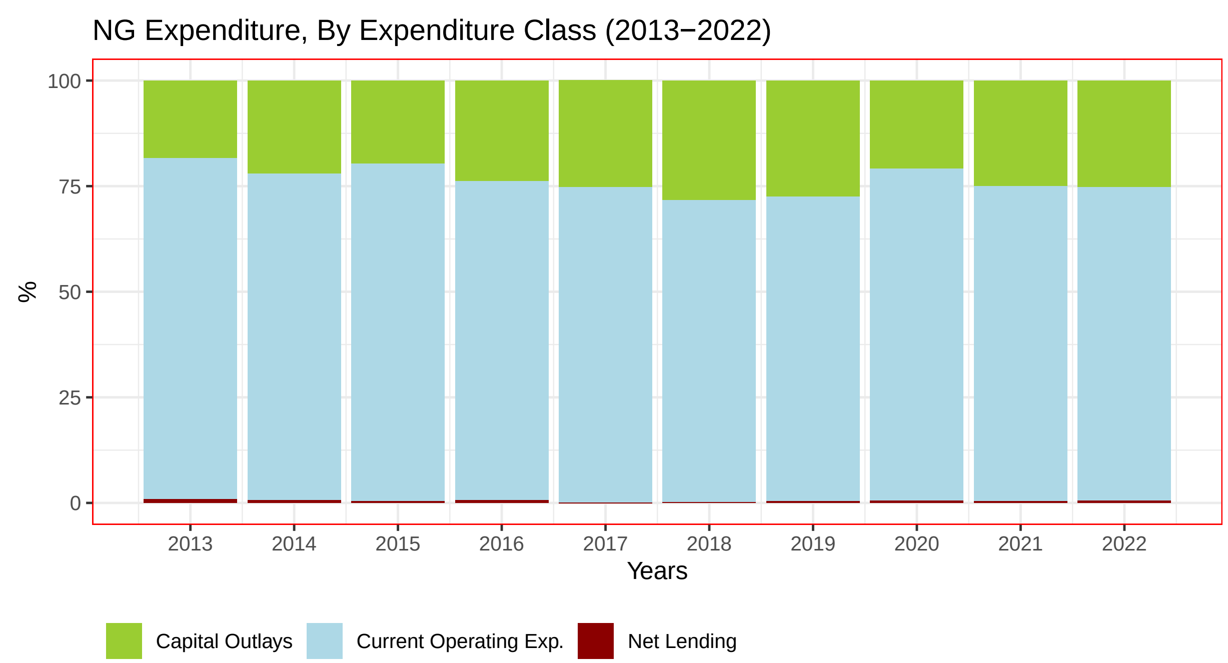
| Sector | Composition |
|---|---|
| General Public Services | • General Administration<br>• Public Order and Safety<br>• Other General Public Services<br>• Subsidy to Local Government Units |



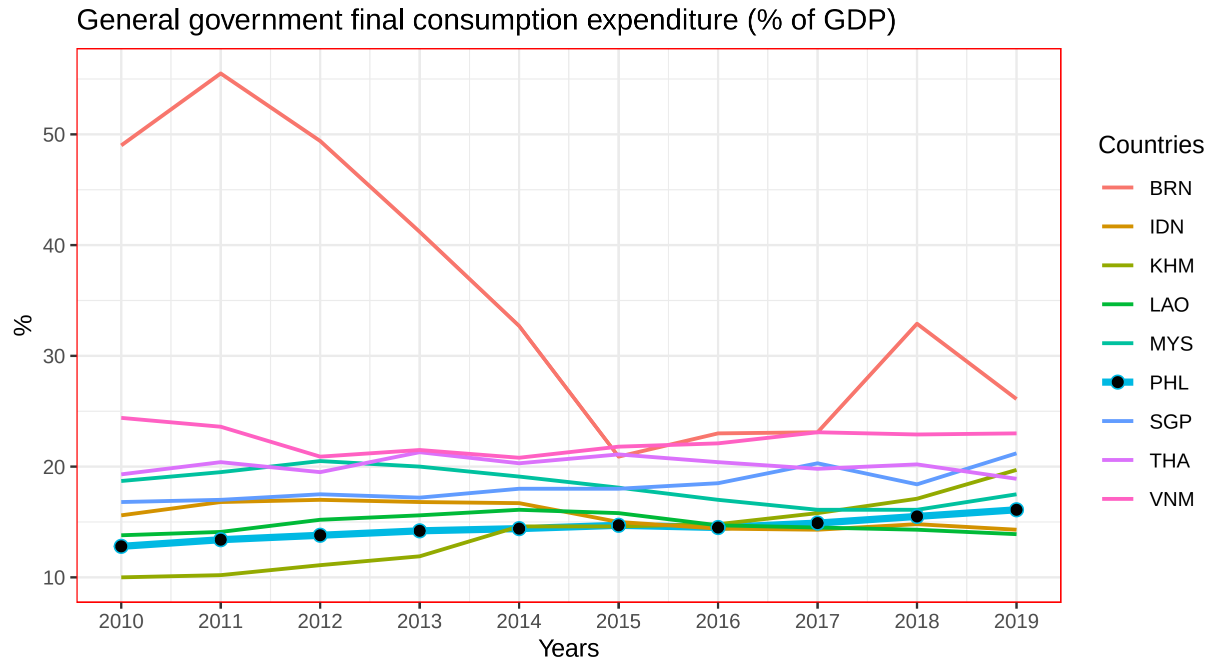

Graph 6. NG Expenditure, 2006−2022 (Source: BTr and DoF)




Graph 7. NG Expenditure, By Sector, 2012−2020 (Source: CPBRD, 2022)




Graph 8. NG Expenditure, By Class, 2013−2022 (Source: DBM 2014−2023)



Graph 9. General Government Final Consumption Expenditure, % of GDP (Source: World Bank)

One problematic area of government expenditure is the low utilization rate of certain agencies. From 2017-2022, the total utilization rate of government agencies, which is the obligation-to-allotment ratio, is at 74.4%. This means that 1/4 of the allotted budget does not turn into goods and services provided by the government. Particularly problematic are the Information and Communication Technology (DICT), Transportation (DoTr), Public Works and Highways (DPWH) and the Energy (DoE) departments that belong to the social and economic services with 44-60% of their allotted budget unused.

Table 3: Table 3. Utilization Rate of Government Agency , % of Allotment (Source: CPBRD)

| Departments | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Ave. 2017-2022 |
|---|---|---|---|---|---|---|---|
| DICT | 38.9 % | 67.7 % | 49.5 % | 31.7 % | 26.9 % | 25.6 % | 40.1 % |
| DOTr | 39.2 % | 40.7 % | 42.5 % | 36.9 % | 41.5 % | 47.4 % | 41.4 % |
| DPWH | 36.3 % | 42.9 % | 56.4 % | 31.2 % | 53.8 % | 61.2 % | 47.0 % |
| DOE | 45.0 % | 56.0 % | 49.3 % | 66.6 % | 60.0 % | 59.0 % | 56.0 % |
| NEDA | 74.7 % | 67.5 % | 65.4 % | 77.3 % | 53.8 % | 60.5 % | 66.5 % |
| DA | 66.1 % | 73.4 % | 75.3 % | 64.9 % | 70.3 % | 71.2 % | 70.2 % |
| DOH | 63.3 % | 65.0 % | 73.8 % | 80.4 % | 71.4 % | 68.7 % | 70.4 % |
| DFA | 80.3 % | 92.1 % | 87.3 % | 72.4 % | 58.4 % | 61.7 % | 75.4 % |
| TOTAL | 65.8% | 72.9% | 78.7% | 76.9% | 7 5.2% | 76.6 % | 74.4 % |

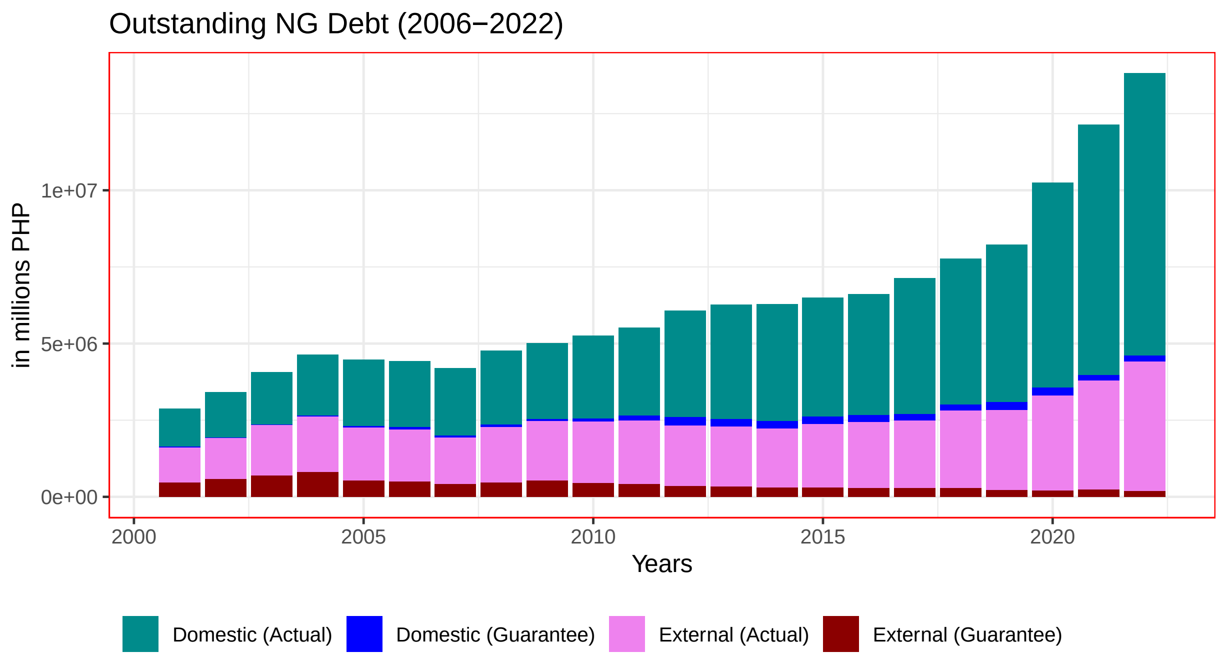
## Debt

With revenue effort at 17.8% in 2022 while NG expenditure is at 25.9% of GDP, the Philippines financed its budget deficit by borrowing. This caused the government's outstanding debt to balloon from ₱4.4 trillion in 2008 to ₱13.8 trillion in 2022 (See Graph 10).[1] Although the Philippines made significant progress of its gross debt position as % of GDP from 57.2% in 2006 to 37.0% in 2019, this rises again as the government

[1]Latest government data indicates that the government already breached the ₱14 trillion mark last May 2023.

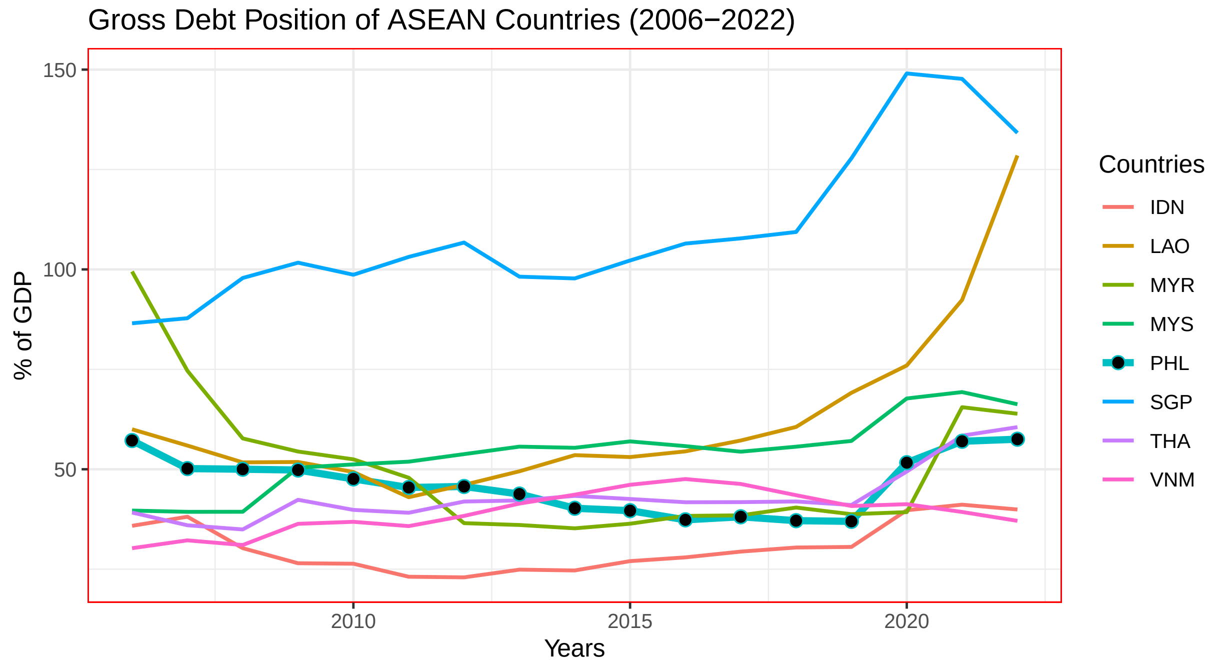
borrows heavily during the Covid-19 pandemic to finance its stimulus program amidst falling revenue. The present level of debt at 57.5% in 2022 is still considered healthy and is lower than Malaysia and Thailand and is only worse than Indonesia and Vietnam among ASEAN countries (See Graph 11).

In terms of sources of debt, it can be observed that the National Government shifted to domestic borrowing to finance its budget deficit over time. This is intended to minimize its exposure to foreign exchange volatility and to better manage its debt (Diokno 2017, 94). However, the external debt levels of the Philippines is still comparatively high among ASEAN-5 countries (Indonesia, Malaysia, Philippines, Thailand, and Vietnam) and is better only than Vietnam making it, still, comparatively more vulnerable (Debuque-Gonzales et al. 2022, 6).

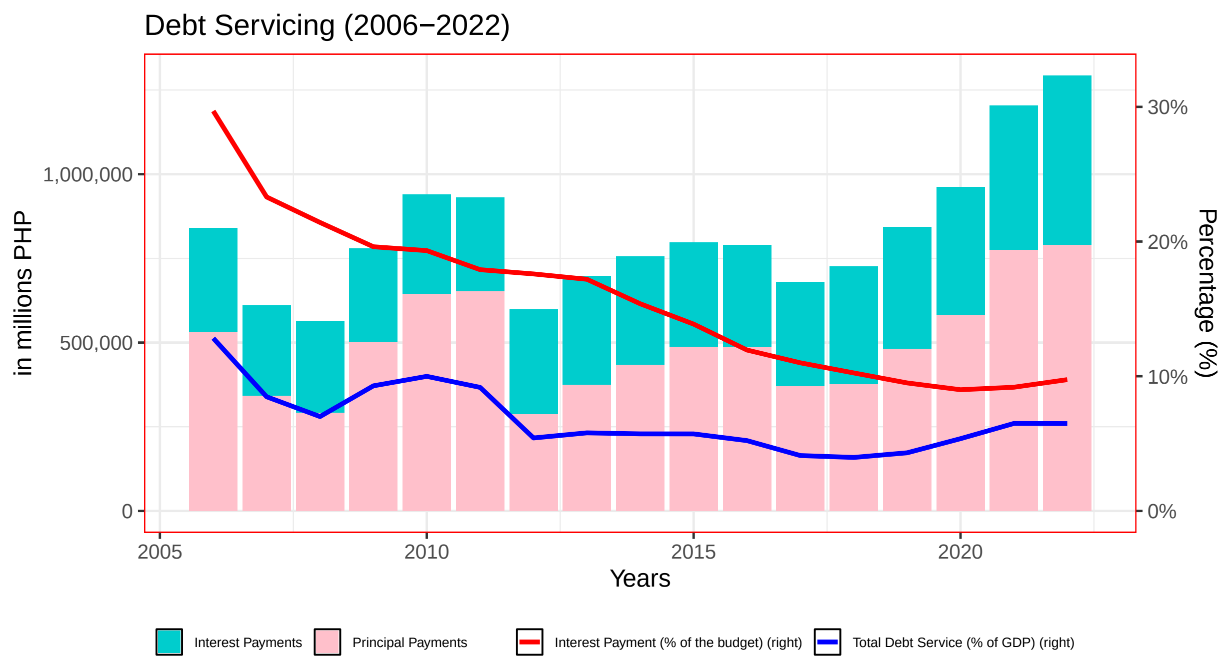



Graph 10. Outstanding National Government Debt, 2006−2022 (Source: Bureau of Treasury)

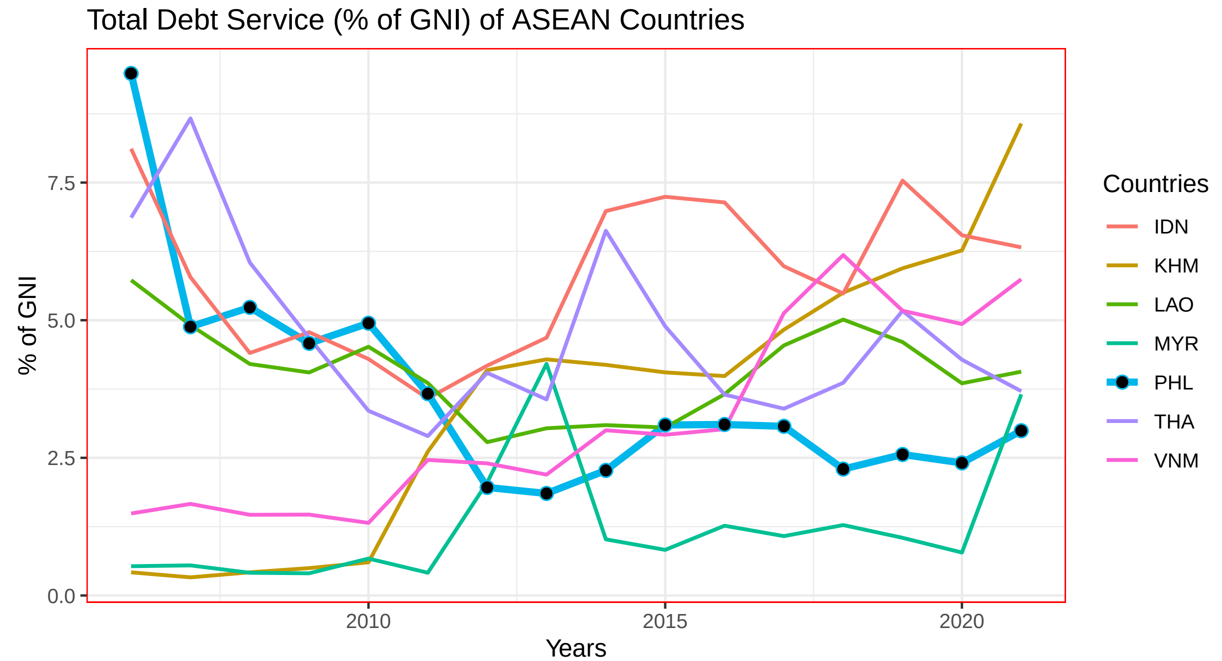
A high debt level could put pressure on the fiscal space as the government needs to service its debt. Total debt service has gone up especially since 2017 but is actually going down as a % of GDP from 12.82% in 2006 down to 6.48% in 2022. We can also see improvement in debt servicing as a percentage of expenditure from as high as 30% in 2006 to around 10% in 2022. (See Graph 12) In fact, the Philippines total debt service as % of GNI is lowest among the ASEAN countries in 2021 (See Graph 13).




Graph 11. Gross Debt Position of ASEAN Countries, 2006−2022 (Source: IMF)




Graph 12. Debt Servicing, 2006−2022 (Source: DoF and BTr)




Graph 13. Total Debt Service as % of GNI among ASEAN Countries, 2006−2021 (Source: World Bank)

The current increase of debt levels is different from debt crises covered by the ADB study. As the government relies more on domestic borrowing and less on foreign sources (See Graph 11), exchange rate and interest rate risks are lessened. Unlike also in the past debt crises, the ballooning debt has not involved "hidden deficits" from failing government corporations and institutions that have to be bailed out by the government. (Debuque-Gonzales et al. 2022)

## Fiscal Balance

Fiscal policy could impact the macroeconomy with respect to inflation, external current account, and economic growth. When the National Government finances its deficit not through tax and nontax revenue (especially through printing money), this can result in excess aggregate demand which leads to inflation. If government spending increases without additional tax or other revenue generation measures, the country's imports will likely grow relative to exports leading to current account deficits in the balance of payments. Finally, fiscal policy affects economic growth through the 1) savings and investment components and 2) the efficiency of which resources are allocated in the macroeconomy. (IMF 1995, 2–5)

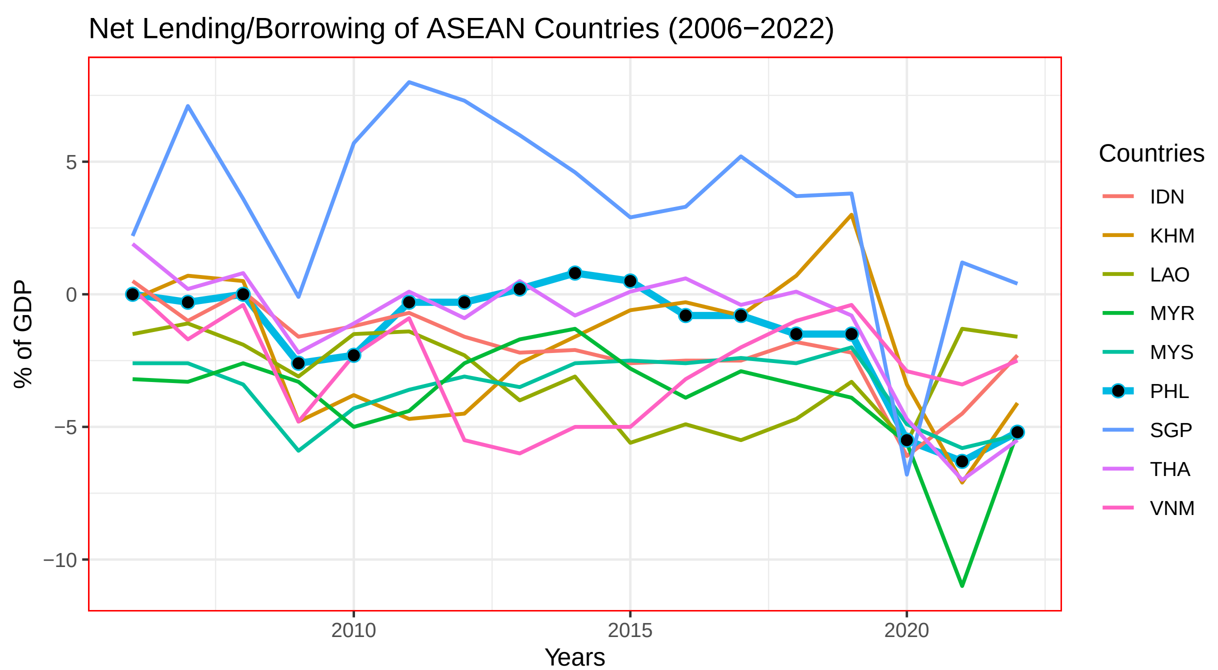
Fiscal policy can be assessed through the different measures of fiscal balances. These are the 1) Net Lending/Borrowing (or the Overall Balance), 2) Primary Balance, 3) Cyclically Adjusted Balance, and the 4) Public Sector Financial Position. One important thing to consider is that a deficit is not necessarily caused by fiscal expansion (nor surplus necessarily caused by fiscal tightening) as the fiscal balance is influenced by the business cycle, one time gains/expenditures, among others.

Table 4: Table 4. Fiscal Balance Indicators; Sources: Government Finance Statistics Manual (GFSM) 2014 (IMF, 2014), pp. 79, Table 4A.1) and (DBM, 2012).

| Fiscal Balance Indicators | Equivalent Term in Statistical Methodologies |
|---|---|
| Net Lending/ Borrowing (Overall Balance) | • Revenue minus expense minus net investment in nonfinancial assets; or<br>• Revenue minus expenditure; or<br>• Net operating balance minus net investment in nonfinancial assets; or<br>• Gross operating balance minus gross investment in nonfinancial assets.<br>• Net lending/net borrowing is also equal to total financing. |
| Primary Balance | • Net lending/net borrowing excluding interest expense or net interest expense.<br>• For gross debt sustainability analysis use net lending/net borrowing excluding interest expense. For net debt sustainability analysis use net lending/net borrowing excluding net interest expense. |
| Cyclically adjusted balance | • Trend balance through an economic cycle, which is the fiscal balance, stripped of the impact of cyclical movements in revenue and expenditure (for government, usually only unemployment benefits payable are eliminated). |
| Fiscal impulse | • Change in the structural primary balance between two reporting periods. (Often also calculated using the [overall] structural balance, or the cyclically adjusted [primary] balance.) |
| Consolidated Public Sector Financial Position | • Net deficit or surplus calculated after summing-up the budget balances of all government entities, namely the national government, the non-financial government corporations (usually includes only the 14 major GOCCs), government financial institutions, local government units, the social security institutions, the Oil Price Stabilization Fund, the Bangko Sentral ng Pilipinas, and the Central Bank-Board of Liquidators. |

The simplest fiscal balance measure is the Overall Balance (also called Net Lending/Borrowing) which is simply government revenue minus expense and net investment in nonfinancial assets. Since 2006, the Philippines has had a deficit in overall balance except in the years 2013 to 2015 (See Graph 15). Revisiting the revenue and expenditure of the National Government during those years, we could see revenue as % of GDP improves until it reaches 15.1% in 2015 (from 13.9% in 2012) while expenditure declines to 15.0% in 2014 which is the lowest level since 2006. The overall balance worsened during the Covid-19 pandemic as the government maintained large spending for fiscal stimulus, among others, amidst falling nominal government revenue.

Graph 14. Net Lending/Borrowing as % of GDP, 2006−2022 (Source: IMF)



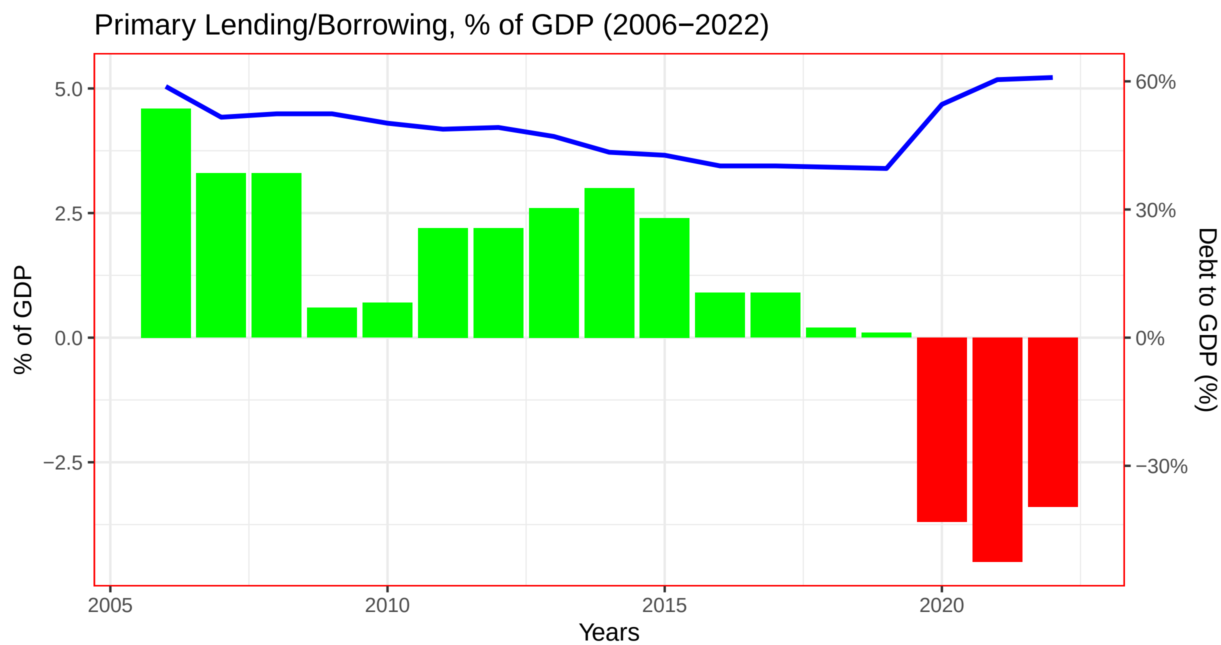
Graph 15. Net Lending/Borrowing of ASEAN Countries as % of GDP, 2006−2022 (Source: IMF)

If we are to compare the overall balance among ASEAN countries, the Philippines was actually performing well relative to others until the Covid-19 pandemic hit. While other countries are able to recover quickly, the Philippines is in the bottom half and is only better than Malaysia and Thailand. (See Graph 16)

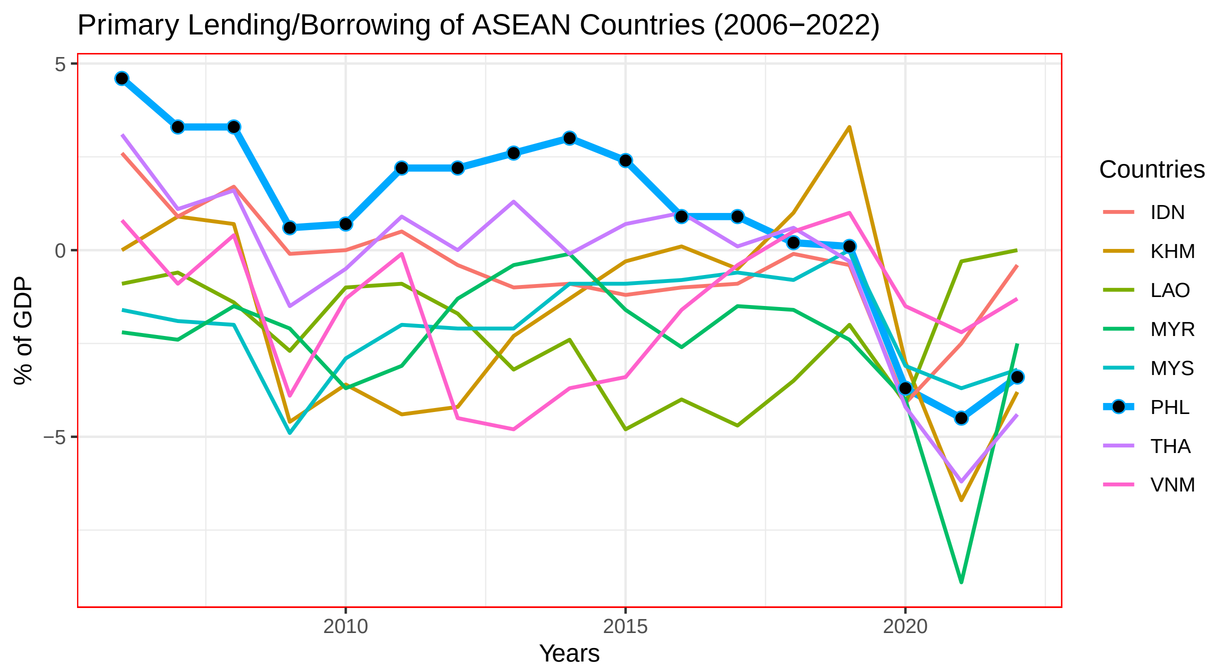
The second fiscal balance measure is the Primary Balance (also called Primary Lending/Borrowing) which is simply overall balance excluding the interest payments. A positive primary balance (primary surplus) means that the government's core operations are generating enough revenue to cover its non-debt-related expenses. Having a primary surplus is important, while may not sufficient, for the reduction of the Debt-to-GDP ratio

(IMF, 1995), pp. 14).

While the overall balance is mostly negative, the Philippines have primary surpluses over the years only halted during the recent pandemic. With positive primary lending/borrowing, the country is able to bring down Debt-to-GDP ratio until the trend is reversed in 2020 coinciding primary deficits so that it is now back to almost the same level as in 2006 (see Graph 16). When comparing across ASEAN economies, the Philippine's primary balance has the same trend with the overall balance (i.e., the Philippine primary balance is performing well relative to its ASEAN peers until the pandemic hit).

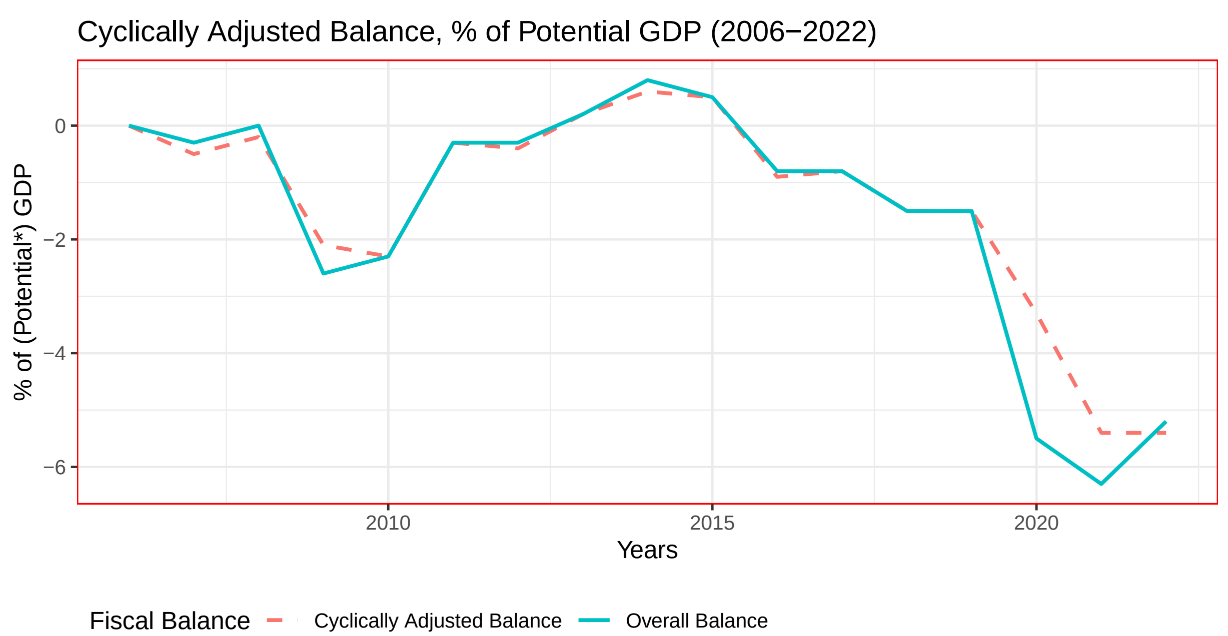



Graph 16. Primary Lending/Borrowing as % of GDP, 2006−2022 (Source: IMF);
Bars − Primary Lending/Borrowing (left), Line − Debt−to−GDP, % (right)

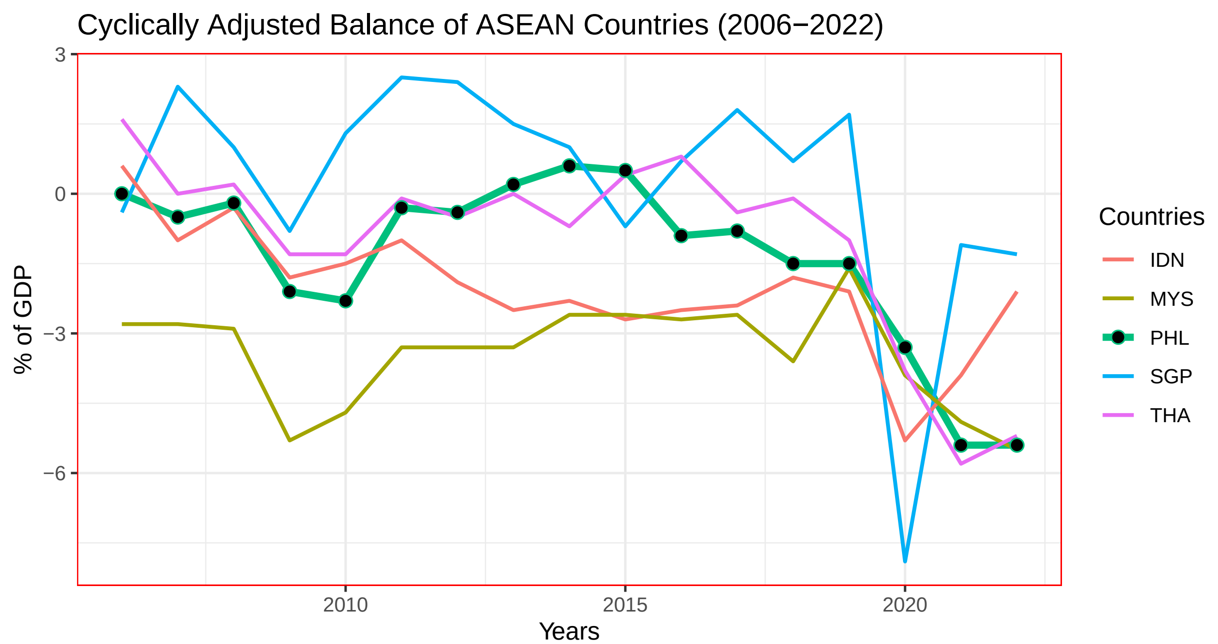


Graph 17. Primary Lending/Borrowing of ASEAN Countries as % of GDP, 2006−2022 (Source: IMF)

Another fiscal balance measure is the Cyclically Adjusted Balance (CAB) which attempts to remove the effects of the business cycles by adjusting the revenues and expenditures as if the economy is operating at its potential output (IMF 1995, 14). If cyclically adjusted overall balance is less than zero, fiscal policy is expansionary and vice versa. Based on the IMF Data, the Philippines overall balance and the cyclically adjusted balance mirror each other which may indicate that persistent deficits (and some surpluses in 2013-2015) are structural in nature and are not due to business cycles. Comparison among ASEAN countries also yields similar observations with the earlier fiscal balance measures. (See Graphs 18 and 19)



Graph 18. Cyclically Adjusted Balance as % of Potential GDP, 2006−2022 (Source: IMF);
*For Cyclically Adjusted Balance, as % of Potential GDP

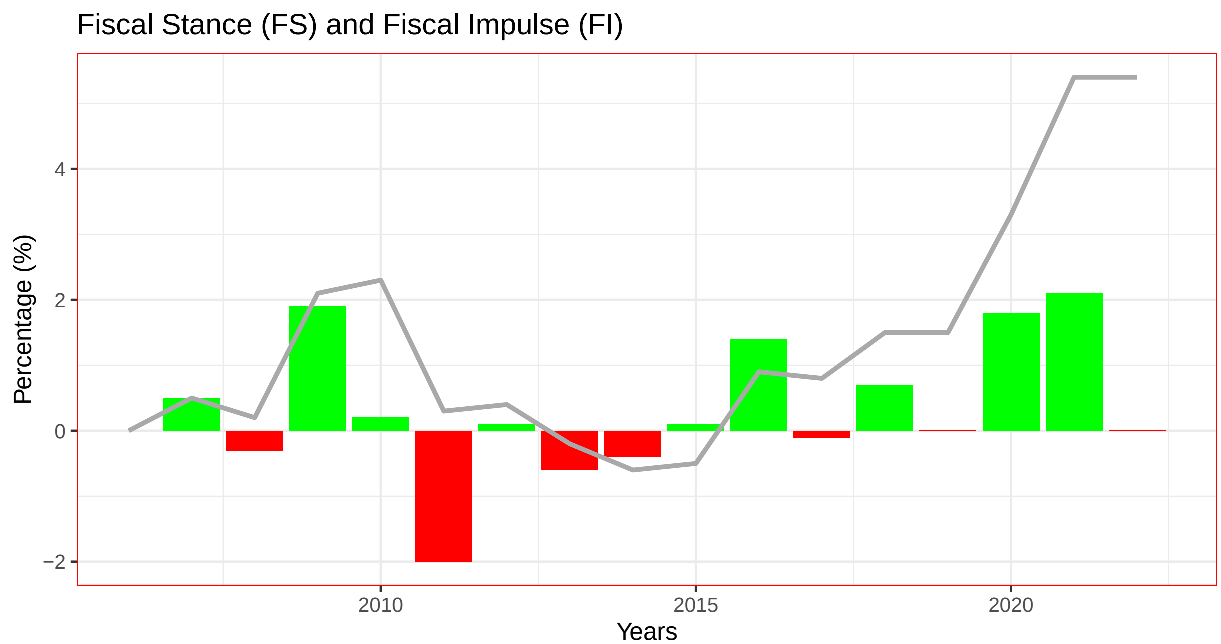



Graph 19. Cyclically Adjusted Balance as % of Potential GDP of ASEAN Countries, 2006−2022 (Source IMF)

Fiscal Stance (FS) is a measure of whether fiscal policy is expansionary, contractionary or neutral and is simply just the negative of Cyclically Adjusted Overall Balance (CAOB). The differences of Fiscal Stance between two succeeding years is the Fiscal Impulse (FI) which indicates the trend whether fiscal policy is more expansionary or more contractionary (IMF Institute for Capacity Development 2020). The Philippines Fiscal Stance indicates more expansionary fiscal policy (except in 2013-2015) and is even more expansionary during the pandemic with a reversal last year (2022). (See Graph 20)

Table 5: Table 5. Fiscal Stance (FS) and Fiscal Impulse

| Fiscal Stance (FS) | Fiscal Impulse (FI) |
|---|---|
| $\text{FS}_t = -\text{CAOB}_t$ | $\text{FI}_t = \text{FS}_t - \text{FS}_{t-1}$ |
| $\text{FS} > 0 \Rightarrow$ Expansionary Fiscal Policy | $\text{FI} > 0 \Rightarrow$ More expansionary |
| $\text{FS} = 0 \Rightarrow$ Neutral Fiscal Policy | $\text{FI} < 0 \Rightarrow$ More contractionary |
| $\text{FS} < 0 \Rightarrow$ Contractionary Fiscal Policy | |

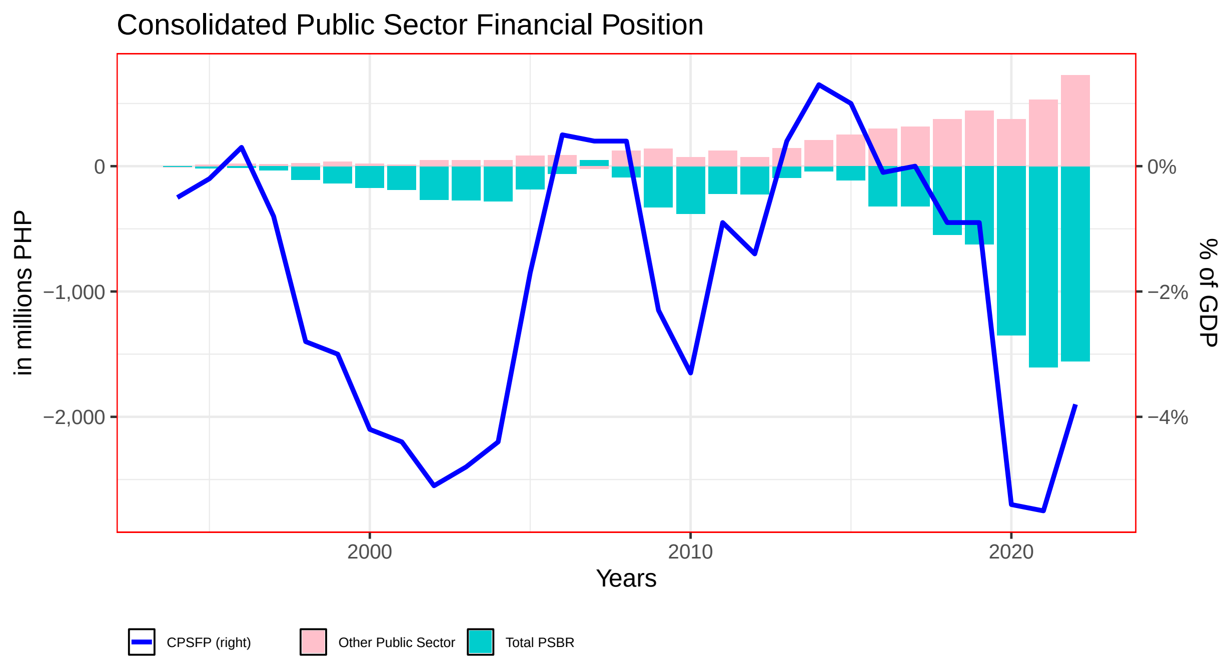



Graph 20. Fiscal Stance (FS) and Fiscal Impulse (FI), 2006−2022 (Source: Authors' Computation Based on IMF Data); Line − Fiscal Stance, Bars − Fiscal Impulse

Table 6: Table 6. Components of Public Sector Financial Position (PSFP)

| | |
|---|---|
| Public Sector Borrowing Requirement (PSBR) + | National Government +<br>Central Bank (CB) Restructuring +<br>Monitored Government Owned and Controlled Corporations (GOCCs) +<br>Net Lending +<br>Others |
| Other Public Sector | SSS/GSIS +<br>BSP +<br>Government Financial Institutions (GFIs) (e.g., LBP and DBP) +<br>Local Government Units (LGUs) +<br>Others |
| = **Public Sector Financial Position (PSFP)** | |

The final fiscal balance measure that is discussed in this paper is the consolidated Public Sector Financial Position (PSFP). This takes into account the public sector including outside of the National Government account such as the public financial and non-financial sectors. The PSFP is computed by adding the Public Sector Borrowing Requirement and other sector's net lending/borrowing (See Table 6). There were years when the Bangko Sentral had deficits (2007, 2010-2015) which caused the "Other Public Sector" deficit in 2007 but it is the PBSR that is consistently in deficit (except in 2007). The surpluses from the "Other Public Sector" actually contributed to surpluses in Public Sector Financial Position (PSFP) from 2013 to 2017 but these surpluses in "Other Public Sector" are not anymore enough in recent years. (See Graph 21)




Graph 21. Public Sector Financial Position, 2006−2022 (Source DoF)

## Fiscal Reforms

The Critical Development Constraints study of the Asian Development Bank discussed policy options in order to address the fiscal constraints of the Philippines. The ADB (2007) recommended that the Philippines shall 1) institute efficient tax collection machinery, 2) streamline the tax incentive program, 3) cut losses of and subsidies to Government corporations, and 4) strengthen expenditure management. Since 2006, the government has implemented various fiscal reforms. Key reforms are heavily on imposition of "sin taxes" which are used to help finance the universal health care program of the government. Major tax reforms were instituted by the Aquino III and Duterte administrations. Tax effort improves gradually from a low of 12.9% during the post 2007-2008 Financial Crisis, to around 16% in 2022.

Table 7: Table 7. Philippine Fiscal Reforms

| Reforms (Years) | Salient Features and Fiscal Effects |
|---|---|
| RA 10351 – Sin Tax Reform (2012) | *Salient Features:*<br>• Alcohol and tobacco products with higher retail prices are subjected to higher tax rates<br>• Restructured excise taxes on alcohol and tobacco<br>*Fiscal Effects:*<br>• Helped finance the universal healthcare program (Debuque-Gonzales et al. 2022, 15) |
| RA 10708 – Tax Incentives Management and Transparency Act (2015) | *Salient Features:*<br>• Sought to optimize the social benefits of tax incentives |

| Reforms (Years) | Salient Features and Fiscal Effects |
|---|---|
| RA 10963 – TRAIN Law (2017)<br>(Tax Reform Package 1 under the Duterte Administration) | *Salient Features:*<br>• Increased excise taxes petroleum, sugary beverages, and tobacco products.<br>• Changes personal income tax structure by lowering income tax rates for majority of taxpayers<br>• Expanded the VAT base by including previously exempt transactions<br>*Fiscal Effects:*<br>• Mixture of "revenue increasing and revenue losing measures"<br>• Estimated to reduce total tax revenues of the National Government of ₱66 billion in 2018 and ₱33 billion in 2019<br>• Additional revenue is estimated at ₱6 billion annually in 2020 onwards[2] (Manasan 2018, 25)<br>• Overall income distributional impact is regressive when including proposed targeted subsidies (Manasan 2018, 26) |
| RA 11213 – Tax Amnesty Act (2019)<br>(Tax Reform Package 1B) | *Salient Features:*<br>• Extended amnesty on estate taxes to June 2025<br>*Fiscal Effects:*<br>• Together with TRAIN law, improves tax effort by half a percent (Debuque-Gonzales et al. 2022, 15) |
| RA 11346 – Tobacco Tax Law 2019 | *Salient Features:*<br>• Previously excise-free e-cigarettes are levied ₱10 per pack<br>• Higher excise taxes on cigarettes<br>*Fiscal Effects:*<br>• Raised revenues as tobacco products are generally inelastic<br>• Improve tax effort (and revenue effort) |
| RA 11467 – Increase excise taxes on alcohol and e-cigarettes | *Salient Features:*<br>• Further increases the excises taxes on e-cigarettes and alcoholic beverages<br>*Fiscal Effects:*<br>• Raised revenues as tobacco products and alcoholic beverages are generally inelastic<br>• Improve tax effort (and revenue effort) |

| Reforms (Years) | Salient Features and Fiscal Effects |
|---|---|
| EO 91, s. 2019 – Adoption of Cash-Based Appropriations (2019) | *Salient Features:*<br>• Appropriations are valid only for one year<br>*Fiscal Effects:*<br>• Supposedly to speed up project implementation and increase budget utilization of NGAs<br>• Effects not apparent when looking at utilization rate trends (Table **3**) |
| RA 11534 - Corporate Recovery and Tax Incentives for Industries (CREATE) Act (2021) | *Salient Features:*<br>• Lowered the Corporate Income Tax (CIT) from 30% to 25%.<br>• For domestic companies with a taxable income of P5 million and below, and with total assets of not more than P100 million, their CIT was cut from 30% to 20%.<br>• Reduced percentage tax for non-VAT taxpayers from 3% to 1%.<br>• Reduced minimum corporate income tax (MCIT) from 2% to 1%.<br>*Fiscal Effects:*<br>• Decrease government tax revenue with lower tax rate; estimated at ₱456 billion (Prodent 2021)<br>• Expected firms to reinvest tax relief, increase the country's competitiveness (with lower (CIT), therefore increase economic activity, which allows for greater tax revenue in medium to long term |

Table 8: Table 8. ADB Policy Recommendations vis-à-vis Some Philippine Policy/Actions/Programs

| ADB Recommendations | Government Policy/Actions/Programs |
|---|---|
| Institute efficient tax collection machinery | • Increase excise taxation through RAs 11346 and 11467 |
| Streamline the tax incentive program | • RA 10708 or the Tax Incentives Management and Transparency Act<br>• RA 11543 or the CREATE Act (on amendments to Title XIII of the National Internal Revenue Code with regards to Tax Incentives) |
| Cut losses of and subsidies to Government corporations | • Privatization of the National Power Corporation (NPC) generation assets<br>• Privation of idle government assets (through the Privatization Council) |
| Strengthen expenditure management | • EO 91, s. 2019 – Adoption of Cash-Based Appropriations (2019) |

[2] This is significantly lower than the projections by the government of ₱104 billion in 2019 and ₱140 billion in 2020.

# 3. Future Outlook of the Philippine Fiscal Health

## 2022-2028 Medium-Term Fiscal Framework

The Marcos administration developed the 2022-2028 Medium Term Fiscal Framework (MTFF) which provides some guidance on the fiscal policies to be instituted by the National Government in the medium term. Its aims include the attainment of "short-term macro-fiscal stability" and the mobilization and utilization of government's resources for "maximum benefit and high multiplier effects" in the economy. The framework adopted an 8-point near term agenda which included enhancement of bureaucratic efficiency (item 7) and to pursue "sound fiscal management" (item 8).

To enhance bureaucratic efficiency, indicated measures include the continuous implementation of right-sizing of the National Government, full devolution initiatives, and the introduction of the Budget Modernization Bill.

In pursuing sound fiscal management, the government seeks to implement tax administration reforms, realign expenditure priorities and introduce tax revenue measures such as adjustment of taxes on non-essential and luxury goods and the spectrum auctioning.

The 2022-2028 MTFF also pushed for fiscal consolidation, which means government policy is towards reduction of deficits and to reduce debt accumulation. Proposed policy measures for fiscal consolidation and resource mobilization include the 1) charter amendments to the Landbank of the Philippines (LBP) and Philippine Crop Insurance Corporation (PCIC), 2) enactment of the Capital Market Development Act (CMDA) and Public-Private Partnership bill, 3) revision of the Build-Operate-Transfer Law's IRR, and 4) auctioning of the radio frequencies.

The medium-term fiscal program in the MTFF is regularly updated by the Development Budget Coordination Committee (DBCC) to reflect the recent economic developments. For instance, one of the macroeconomic assumptions is the price level of the Dubai Crude which the revised assumptions expects to be within the range of 70-90 USD/bbl (US Dollars per barrel) in 2023 and 2024 and 60-80 USD/bbl onwards (DBCC 2023) (See Table 8). With the recent geopolitical turbulence caused by the 2023 Israel-Hamas War, latest data from FRED® shows that the Dubai crude already exceeds the DBCC's assumptions.[3]

Table 9: Table 8. Macroeconomic Assumptions (DBCC, 2023)

| Indicators | 2023 | 2024 | 2025-2028 |
|---|---|---|---|
| Inflation (%) | 5.0 - 7.0 | 2.0 - 4.0 | 2.0 - 4.0 |
| Dubai crude oil (USD/bbl) | 70 - 90 | 70 - 90 | 60 - 80 |
| Forex (Php/USD) | 53 - 57 | 53 - 57 | 53 - 57 |
| Goods Exports Growth, BPM6 (%) | 3.0 | 6.0 | 6.0 |
| Goods Imports Growth, BPM6 (%) | 4.0 | 8.0 | 8.0 |
| Services Exports Growth, BPM6 (%) | 17.0 | 16.0 | 6.0 |
| Services Imports Growth, BPM6 (%) | 11.0 | 10.0 | 8.0 |

In the Medium-Term Fiscal Program, Government revenue is expected to grow, as % of GDP, from 16.1% in 2022 to 17.4% in 2028 (an increase of 1.3%) while expenditure, as % of GDP, is expected to fall from 23.4% in 2022 to 20.4% in 2028 (a decrease of 3.0%). This, in turn, results in an expected surplus/deficit ratio to improve by 4.3% from -7.3% in 2022 to -3.0% in 2028 (See Table 9).

With regards to the debt-to-GDP ratio, the MTFF targets at 51.2% by 2028 (Planning and Reforms Bureau 2023, 90) which is still far from its lowest level (since 2006) of around 40%. Debuque-Gonzales et al. (2022)'s DSA (Debt Sustainability Analysis) study, however, suggests a more elevated and prolonged level of debt-to-GDP.

[3] Latest data from FRED shows Global price of Dubai Crude in Sept. 2023 is already at 93.23857 USD/bbl (updated on Oct. 18, 2023).

**Table 58. Medium-Term Fiscal Program, FYs 2023-2028**

(In billion pesos, unless otherwise indicated)

| Particulars | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 |
|---|---|---|---|---|---|---|---|
| | Actual | Program [a/] | Projections [b/] | | | | |
| **REVENUES** | **3,545.5** | **3,729.0** | **4,272.6** | **4,729.5** | **5,294.9** | **5,939.7** | **6,670.3** |
| *% of GDP* | *16.1%* | *15.2%* | *16.1%* | *16.3%* | *16.6%* | *17.0%* | *17.4%* |
| *Growth Rate* | *18.0%* | *5.2%* | *14.6%* | *10.7%* | *12.0%* | *12.2%* | *12.3%* |
| **DISBURSEMENTS** | **5,159.6** | **5,228.4** | **5,629.4** | **5,922.7** | **6,409.4** | **7,056.8** | **7,819.2** |
| *% of GDP* | *23.4%* | *21.3%* | *21.2%* | *20.4%* | *20.1%* | *20.2%* | *20.4%* |
| *Growth Rate* | *10.4%* | *1.3%* | *7.7%* | *5.2%* | *8.2%* | *10.1%* | *10.8%* |
| **SURPLUS/(DEFICIT)** | **(1,614.1)** | **(1,499.4)** | **(1,356.8)** | **(1,193.2)** | **(1,114.5)** | **(1,117.1)** | **(1,148.9)** |
| *% of GDP* | *-7.3%* | *-6.1%* | *-5.1%* | *-4.1%* | *-3.5%* | *-3.2%* | *-3.0%* |
| Infrastructure Disbursements [c/] | 1,278.5 | 1,292.7 | 1,365.2 | 1,470.0 | 1,617.7 | 1,916.0 | 2,303.3 |
| *% of GDP* | *5.8%* | *5.3%* | *5.1%* | *5.1%* | *5.1%* | *5.5%* | *6.0%* |
| Memo Item: | | | | | | | |
| Nominal GDP | 22,024.5 | 24,522.1 | 26,604.7 | 29,102.1 | 31,841.9 | 34,908.6 | 38,297.9 |

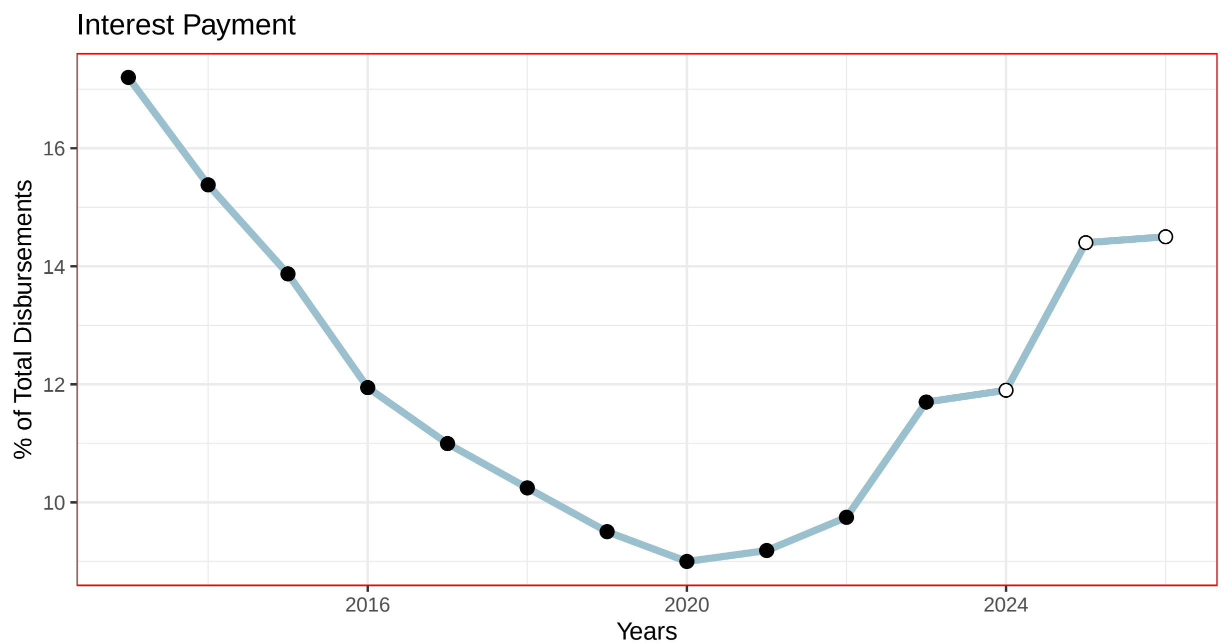
[a/] Program approved by the DBCC on April 24, 2023.
[b/] Program approved by the DBCC via an Ad Referendum on July 12, 2023.
[c/] Include estimated NG infrastructure disbursements, and infrastructure components of subsidy and equity to GOCCs and transfers to LGUs.

Figure 3: Table 9. Medium-Term Fiscal Program, FYs 2023-2028 (Adopted from DBCC's FY 2023 Mid-Year Report (pp. 89))

If we are to look at the Interest Payments as % of the Total Government Expenditures, there is a reversal of previous decreasing trend as it is programmed to rise to 14.5% in 2026 based on the Budget of Expenditures and Sources of Financing FY 2024. Rising percentage share of interest payments is of course detrimental as it crowds out other government spending.

Table 10: Table 10. Interest Payments (2022-2026) (DBM, 2023), A.2.)

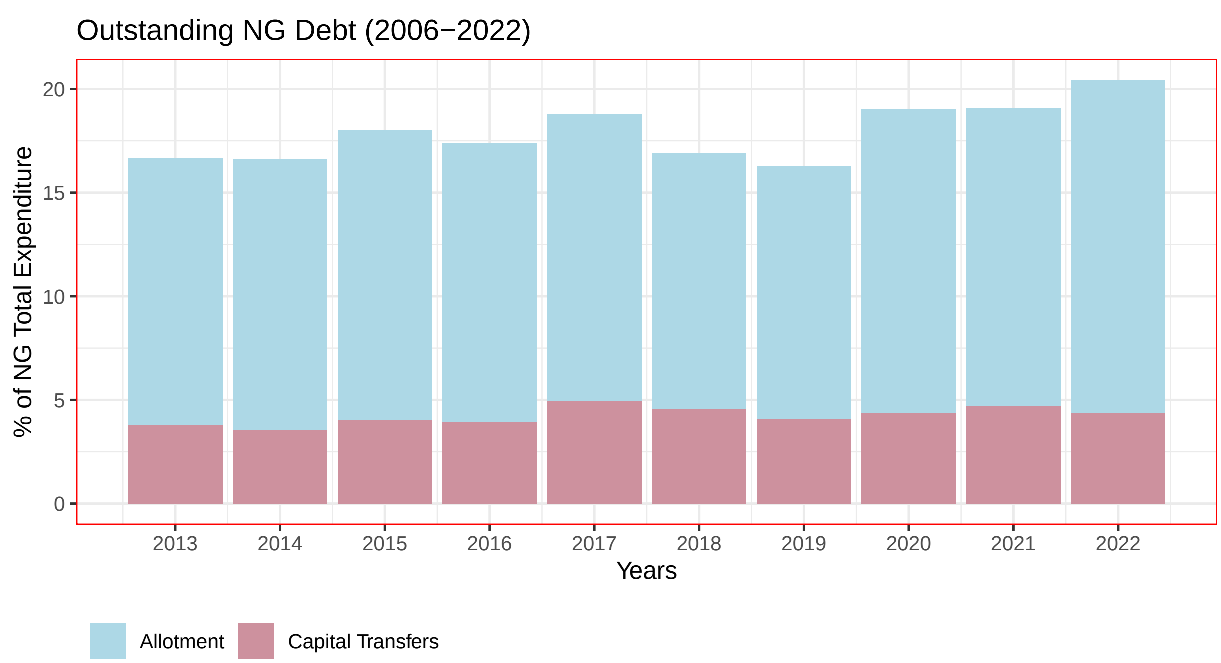
| Particular | **2022** (Actual) | **2023** (Program) | **2024** (Projection) | **2025** (Projection) | **2026** (Projection) |
|---|---|---|---|---|---|
| **Interest Payments ( billions PHP)** | 502.9 | 610.7 | 670.5 | 855.8 | 928.8 |
| % Share to Total Disbursements | 9.7 | 11.7 | 11.9 | 14.4 | 14.5 |




Graph 22. Interest Payment (2013−2026) (Source: DBM);
Years 2024−26 are projections

## Current and Emerging Issues affecting Fiscal Health

There are current and emerging issues that could potentially adversely impact the fiscal health of the country. For this paper, we will focus on the 1) Mandanas-Garcia Ruling, 2) Military and Uniformed Personnel (MUP) pensions, and 3) Maharlika Investment Fund (MIF).




Graph 23. Allotment and Capital Transfers to LGUs, 2013−2022 (Source: DBM)

Graph 23. Allotment and Capital Transfers to LGUs, 2013-2022 (Source: DBM)

## Mandanas-Garcia Ruling

The Supreme Court ruling Mandanas-Garcia case (GR. No. 199802) increased the automatic appropriations of internal revenue allotment (IRA) (or National Tax Allotment or NTA) to the LGU due to the larger base of which it is computed. The National Government's transfer to LGU (allotment and capital) is already around 15-20% (see Graph 23) and would likely increase further because of the ruling.

In response, President Rodrigo Duterte issued Executive Order No. 138, s. 2021 for the full devolution of certain functions to the LGUs not later than the end of Fiscal Year 2024. Because the devolution of functions is gradual while the NTA release is immediate, this causes additional budgetary requirements for the National Government's programs. Compounding this burden is the falling revenue caused by the pandemic. Despite the devolution of functions, the National Government is still expected to subsidize LGUs especially those with low fiscal capacity in the form of Growth Equity Fund (GEF). (Diaz-Manalo, Estrada, and Baluyot 2021, 2, 18)

Aside from the structural changes of the National Government Agencies (NGAs), other issues include the cooperation between the National Government and LGUs with regards to program implementations. Diaz-Manalo et al. (2021), citing a World Bank study, raises concerns on the absorptive capacities of LGUs as they tend to have "lower budget execution" when "capital outlays increases" "given the complexity of capital spending."

## Military and Uniformed Personnel (MUP) Pensions

Another huge fiscal concern is the unsustainability of the Military and Uniformed Personnel (MUP) pensions that the Finance Secretary Benjamin Diokno even warns of a "fiscal collapse." Diokno even once remarked that it is the "most generous pension system for the military in the entire world." So generous, that the average MUP pensioner receives 8.8 times of a pensioner of the Social Security System (SSS) and 2.9 times of a Government Service Insurance System (GSIS) pensioner. The Armed Forces of the Philippines (AFP) expenditure on pensions is now even higher than its maintenance and operating expenditures (MOOE). A study by the GSIS estimates that the government has to spend Php 850 billion annually for the next 20 years to meet its current pension system for the MUP. The Bureau of Treasury further added that the current system will add 25% to the public debt. (Rivas 2023)

The House of the Representatives recently passed the MUP pension bill (HB No. 8969) that will now require new entrant MUP to contribute 9% of the monthly compensation to their pension with the National Government contributing the remaining 12%. The active personnels are spared though from contributing. Two new pension funds will also be created – one for the AFP and another for the other uniformed personnel. Another policy measure that is absent in the bill is the removal of the automatic indexation of pension. (Leon 2023; Lalu 2023)

## Maharlika Investment Fund

The Maharlika Investment Fund (MIF) created a maelstrom of criticisms among economists. In a discussion paper, around 20 economists from the University of the Philippines School of Economics outlined their observations (a total of six main observations) of the MIF bill.[4] A key issue they raised is our current account deficit which means that the Philippines is a net borrower from the rest of the world and should therefore not have "fiscal or external surpluses to spare and invest in a sovereign wealth fund." Because of this, also, the MIF has to "scour money from other agencies and corporations of government." Among the funding sources of the MIF is the BSP (50 billion), LBP (50 billion) and DBP (25 billion). In the case of the

[4]MIF is signed into law with some changes made on the proposed bill but issues raised still left unresolved.

BSP, by diverting funds to the MIF, it will make its effort to reach a capital of Php 200 billion for 14 years. For the LBP and DBP, aside from the solvency and liquidity risk of diverting capital of the banks' capital to the MIF, that also cost them Php 750 billion of foregone lending.(Abrenica et al. 2023; CuUnjieng 2023)

# 4. Conclusions

For almost two decades since the publication of the ADB Critical Development Constraints study, the Philippines was able to make inroads to improve its fiscal health by instituting fiscal reforms, apply prudent budget management, and steer debt sourcing to domestic among others. From 2006 to 2022, 1) revenue effort is slightly up, 2) government spending rises significantly but with significant improvement at the sector level (with improvement in spending at the critical sectors – infrastructure, social and economic services), 3) debt servicing is significantly lower, and 4) while the overall balance is mostly in deficit, the primary balance is not.

But the Covid-19 pandemic erased much of the gains as the National Government had to incur debt to finance its stimulus packages with the decrease also of revenue. As a result, the debt-to-GDP rises to the levels seen almost two decades ago at around 60%. Debt servicing is also rising and is expected to reach, hopefully plateauing, at around 15% in 2026. Albeit,this growing debt is seen as less worrisome as "it is not due to sharp interest rate shocks, excessive external debt, or a buildup of hidden (non-budget) deficits, nor a steady decline in the country's tax effort (Debuque-Gonzales et al. 2022, 47).

Issues compounding the fiscal health of the country include the impacts of the Garcia-Mandanas ruling, the pension of MUPs, and the Maharlika Investment Fund. Very critical among the three is the MUP pension as it could exacerbate the fiscal conditions by draining the government coffers and increasing the national debt.

The MTFF expected improvements of the fiscal indicators with slightly growing revenue effort, declining government expenditure, and improvement of fiscal deficit towards 2028. But until the current levels of fiscal indicators improve, the authors posit that the fiscal condition of the Philippines is still a constraint to Philippine development.

# References

Abrenica, Ma Joy V., Luzeta C. Adorna, Patricia T. Coseteng, Emmanuel S. de Dios, Marian S. de los Angeles, Noel B. Del Castillo, Benjamin A. Endriga, et al. 2023. "Maharlika Investment Fund: Still Beyond Repair." *UPSE Discussion Papers*, UPSE Discussion Paper, 2023 (02). https://econ.upd.edu.ph/dp/index.php/dp/article/view/1551.

ADB. 2007. "Philippines: Critical Development Constraints." https://www.adb.org/publications/philippines-critical-development-constraints.

CuUnjieng, Stephen. 2023. "Funding Maharlika and Attention to Detail." *The Manila Times*, October. https://www.manilatimes.net/2023/10/20/opinion/columns/funding-maharlika-and-attention-to-detail/1915521.

DBCC. 2023. "Joint Statement of the DBCC on the Review of the Medium-Term Macroeconomic Assumptions and Fiscal Program for FY 2023 to 2028." https://neda.gov.ph/joint-statement-of-the-dbcc-on-the-review-of-the-medium-term-macroeconomic-assumptions-and-fiscal-program-for-fy-2023-to-2028-2/?appgw_azwaf_jsc=wFrIPZx8uuuFW35IHwj1G3Ia-VYvZFgJBAUTffJnfLM.

DBM. 2012. "Basic Concepts in Budgeting." https://www.dbm.gov.ph/wp-content/uploads/2012/03/PGB-B1.pdf.

Debuque-Gonzales, Margarita, Charlotte Justine Diokno-Sicat, John Paul P Corpus, Robert Hector G. Palomar, Mark Gerald C. Ruiz, and Ramona Maria L. Miral. 2022. "Fiscal Effects of the COVID-19 Pandemic: Assessing Public Debt Sustainability in the Philippines." *PIDS Discussion Paper* 2022-17. https://pidswebs.pids.gov.ph/CDN/document/pidsdps2217.pdf.

Diaz-Manalo, Pamela, Miguel Antonio Estrada, and Dulce Baluyot. 2021. "Implications of the SC Ruling on the Mandanas-Garcia IRA Case." *CPBRD Discussion Paper*, CPBRD discussion paper series, 2021 (02). https://cpbrd.congress.gov.ph/images/PDF%20Attachments/Discussion%20Paper/DP2021-02_Implications_of_the_SC_Ruling_on_the_Mandanas_-_Garcia_IRA_Case_final.pdf.

Diokno, Benjamin E. 2017. "The Fiscal Program in Recent Philippine History: Looking Back and Looking Forward." *Philippine Review of Economics* LIV (2): 88–99.

IMF. 1995. *Guidelines for Fiscal Adjustment.* Pamphlet Series 49. Washington, D.C. https://www.imf.org/external/pubs/ft/pam/pam49/pam49.pdf.

IMF Institute for Capacity Development. 2020. "Fiscal Policy." https://courses.edx.org/assets/courseware/v1/dcc943b4867eb3d9e1b2a6e52dc6dfcc/asset-v1:IMFx+MDSx+3T2016+type@asset+block@MDSx_M07_SLIDES.pdf.

Konishi, Motoo. 2013. "Press Statement of Motoo Konishi, Co-Chair Philippines Development Forum." https://www.worldbank.org/en/news/speech/2013/02/06/Press-Statement.

Lalu, Gabriel Pabico. 2023. "House Approves MUP Pension Bill on Final Reading | Inquirer News." *Inquirer*, September. https://newsinfo.inquirer.net/1836628/house-oks-mup-pension-system-on-3rd-reading.

Leon, Dwight de. 2023. "House Passes MUP Pension Bill, Putting Ball in Senate's Court." *Rappler*, September. https://www.rappler.com/philippines/house-representatives-passes-military-uniformed-personnel-pension-system-reform-september-2023/.

Manasan, Rosario G. 2018. "Assessment of Republic Act 10963: The 2017 Tax Reform for Acceleration and Inclusion." *PIDS Discussion Paper* 2018 (27).

Planning, Fiscal, and Reforms Bureau. 2023. "FY 2023 Mid-Year Report." https://www.dbm.gov.ph/wp-content/uploads/DBCC_MATTERS/Mid-Year%20Reports/FY-2023-DBCC-MID-YEAR-REPORT_for-posting_sept-29.pdf.

Prodent, Lisa. 2021. "The Philippines CREATE Act Comes into Effect, Pushing for Accelerated Economic Recovery." https://www.aseanbriefing.com/news/the-philippines-create-act-comes-into-effect-pushing-for-accelerated-economic-recovery/.

Rivas, Ralf. 2023. "EXPLAINER: How Generous Military Pension Is Pushing Philippines to Fiscal Collapse." *Rappler*, May. https://www.rappler.com/business/how-generous-military-personnel-pension-pushing-philippines-fiscal-collapse/.