

Sustaining the Momentum of Debt and Underdevelopment

*Debt and the Proposed 2008 National
Government Budget*

November 2007

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Freedom from Debt
Coalition

“The debt problem is over. The budget is balanced at last.”

This is what Gloria Macapagal-Arroyo and her economic management team would want us to believe this year, three years before her term officially ends in 2010. In a show of absolute technocratic certainty, the Arroyo administration declared that they have solved the economic and fiscal woes of the country. They have even been able to achieve, as they put it, the highest growth the country has ever seen.

Arroyo, in her 2008 budget message, claimed that the proposed 2008 National Government budget is a “balanced budget”, the first time after ten years¹, and two years ahead of her own pre-set schedule. Thus, the PhP 1.227-trillion proposed budget program for 2008 will be funded by about PhP 1.236-trillion of projected revenues.

This budget includes the PhP 715.77-billion in Special Purpose Funds (SPF), PhP 295.75-billion of which is earmarked for Interest Payments of National Government (NG) Debts. Meanwhile, the government will be having a PhP 328.34-billion off-budget expenditure for Principal Amortization of these NG debts.

Arroyo declared the balanced budget as the ultimate solution to our debt problem, which she claims is rooted in our continued practice of borrowing for deficit spending. She also tells us that we are on our way to progress, that all we need to do is to sustain the “momentum of growth” her administration began.

Only by looking behind these words will we see which direction our economic managers have decided our country should take. Particularly at this time, when the budget deliberations have already begun, we should ask: What is the budget all about? Why do they call it balanced? Is our budget really balanced?

The administration’s definition of a balanced budget is controversial, to say the least, and has been attacked on all fronts by public finance and accounting experts. But even as the experts deal with the technicalities, the definition is challenged by a more daunting but valid question: Can a budget which places utmost priority on debt payments at the cost of social spending,

¹ The last budget surplus was during the administration of former President Fidel Ramos. For 2008, so determined is Arroyo in achieving this, that she had put her stern “or else” as a warning to her appointed officials that failure is not an option.

notwithstanding the fact that most of these payments are for illegitimate debts, be considered as “balanced” in the truest sense of the word?

Even as Arroyo concedes the problem of debt, she is dealing with it in a manner that would disproportionately place undue burden on the already disadvantaged: the malnourished, the uneducated, the homeless and the landless. This policy is not significantly different than the policy of eliminating poverty by exterminating the poor.

At the end of the day, it seems then that it is not “growth” which momentum we are sustaining through this kind of budget – it is the momentum of ever increasing debt and poverty that falls on the shoulders of every woman, man, and child.

Balanced Budget: The Solution to the Debt Problem?

Arroyo’s statement of the undesirability of borrowings is itself an indication of her awareness of the country’s growing debt problem². Arroyo stated in her 2008 budget message that we simply “cannot bequeath to our children and their children’s children a legacy of debt”.

As of end-August 2007, the NG Outstanding debt is pegged at PhP 3.871 trillion pesos, or US\$ 81.91 billion at the currency rate during that period. Much of this is acquired domestically (55.98%), with Treasury Bonds debt pegged at PhP 1.55 trillion.

While it is not yet part of the outstanding debt, the NG Contingent Liabilities is still very high at PhP 537 billion. Contingent liabilities are commitments by the national government, express or implied, to directly bear a liability or obligation of another entity (the principal debtor or obligor) upon the occurrence of an event, such as a payment default by the principal debtor or obligor. Most of our contingent liabilities are foreign currency denominated, pegged at PhP 472 billion.

² This should be clearer to Arroyo than to other post-dictatorship presidents. After all, she holds the record of being the biggest borrower and biggest debt payer among presidents since Marcos. In fact, her borrowings and payments are bigger than the combined borrowings and combined payments of her predecessors.

	Aquino (86-92)	Ramos (93-98)	Estrada (99-00)	Arroyo (00-06)
Debt Service (Interest + Principal)	596.069	776.420	433.239	3,465.228
Gross Borrowings (Domestic + Foreign)	565.659	372.339	571.568	3,385.101

Table C.1. Source: Bangko Sentral ng Pilipinas.

National Government Debt as of end-August 2007 (in trillion pesos)		
NG Outstanding Debt		3.871
Domestic Debt		2.167
<i>By Instruments</i>	Treasury Bills	0.594
	Treasury Bonds/Notes	1.550
	Loans	0.022
	Others	0.0
Foreign Debt (using US\$1=P47.26)		1.704
<i>By Creditors</i>	Multilateral	0.254
	Bilateral	0.400
	Commercial	0.037
	Foreign Denominated Securities	1.028
NG Contingent Liabilities		0.537
Domestic Debt		0.065
Foreign Debt		0.472
<p><i>Note:</i> Breakdown of totals may not sum up due to rounding of digits. The total national government debt must take into account the contingent liabilities, so it comprises both the outstanding and the contingent debt.</p>		

Table A.1. National Government Debt. Sources: Bureau of Treasury, Statistical Data Analysis Division.

The Freedom from Debt Coalition (FDC), in its two decades of existence, had consistently proposed a multi-pronged solution to address the debt problem. First, the illegitimate debts should be repudiated. This can be done through a Congressional Debt Audit which will scrutinize the loans we are currently paying. Second, the law on automatic appropriations³ for debt payments should be repealed. Third, sovereign guarantees on private debts should be immediately stopped. And fourth, debt-creating measures should be undertaken in a process fully transparent and inclusive of public participation and must solicit first the free, prior, and informed consent of the people.

But Arroyo seems to have in mind a different solution to the debt problem. According to her, the problem is not the policy we have in paying our debts. Rather, it is the policy of living beyond our means, i.e. spending above our revenues and borrowing to cover our expenses. She wrote in her budget message: “Deficit spending inevitably leads to large government debt that necessarily requires debt servicing which eats up the budget.”

There are basically two strategies (which can be used in combination) that the Arroyo government can employ in eliminating the budget deficit: cutting spending and raising revenues. Should these two fail, the government would have to resort to another strategy – finance your deficit by borrowing. Let us take a look at how the proposed 2008 National Government Budget incorporates all of these strategies – in the (1) debt-related expenditure side, the (3) non-debt expenditure side, the (3) revenue side, and the (4) financing side.

I. On Debt-related Expenditures: The Art of Obfuscation

First, the debt payments. Arroyo recognized that “too much interest payments take away resources from productive expenditures”, implying that interest payments are given the highest priority in her spending program. Thus, in order to ease the pressure on the deficit, interest payments then dropped to PhP 296 billion this year, a decrease of 2.55% from the PhP 303 billion on 2007.

³ Sec. 26 (B), Book 6 of the Revised Administrative Code of 1987 as copied from Sec. 31 (B) of Presidential Decree 1177

Sustaining the Momentum of Debt and Underdevelopment
Debt and the 2008 National Budget

This is, however, only one side of the coin. The Principal Amortization actually goes up by 6%, or PhP 18.842 billion. When we get the total of interest payments and principal amortization, debt expenditure actually goes up by PhP 11.296 billion, belying any claim of less expenditure for the debt. Overall, the total debt service is higher, not lower, contrary to the Arroyo government's claim.

National Government Debt Service for 2007 and 2008 (in trillion pesos)				
	2007	2008	Variance	Growth
Interest Payments (in the budget)	303.297	295.751 ↓	(7.546)	(2.55%)
Principal Amortization (off-budget)	309.499	328.341 ↑	18.842	5.74%
Total Debt Expenditure	612.796	624.092 ↑	11.296	1.81%

Table B.1. *Debt expenditures for 2007 and 2008.* Source: Budget of Expenditures and Sources of Financing, Fiscal Year 2007, 2008. Department of Budget and Management (DBM).

It is clear that her administration's top priority remains to be debt servicing. What is supposed to receive the highest budgetary allocation, education, is merely a third of what she will be spending on debt (PhP 181.86 billion compared to PhP 624.09 billion). The situation for health is much more horrendous – it's only 4% of what we will be spending on debt (or PhP 22.9 billion). Even if you add up the total proposed spending on education, health, agriculture, agrarian reform and the environment, these will still be LESS than interest payments alone by as much as PhP 39.75 billion.

Government Spending for 2008 (in billion pesos)			
Debt Service	624.09	Education	181.86
<i>Interest Payments</i>	295.75	Health	22.90
<i>Principal Amortization</i>	328.34	Agriculture and Agrarian Reform	41.18
		Environment	10.06
		Military	61.42

Note: Breakdown of totals may not sum up due to rounding of digits.

Table B.2. *Proposed 2008 National Budget.* Source: Budget of Expenditures and Sources of Financing (BESF) Fiscal Year 2008. Department of Budget and Management (DBM).

The reason for this, as FDC had already expressed in its 20 years of existence, is the automatic Appropriations provision in Sec. 31 (B) of Presidential Decree 1177 in Sec. 26 (B), Book 6 of the Revised Administrative Code of 1987. It ensures the automatic allocation for principal amortization and interest payments of loans.

As if it is not enough that debt is getting the lion's share of our budget, there have been allegations of *over-prioritizing* debt service, as revealed by even the most fiscally conservative of politicians. Former Senator Ralph Recto, for example, criticized the overstating of foreign

Sustaining the Momentum of Debt and Underdevelopment ***Debt and the 2008 National Budget***

exchange assumptions (as stated in the macro-economic assumption) as a means of padding debt service. Before the bicameral committee decided on the 2007 budget, he revealed that the original proposal for interest payments may have been padded by at least PHP 6.6 billion since it had been computed using \$1=P53 exchange rate instead of the more realistic \$1=P50⁴.

The Arroyo government regularly claims savings on interest payments because of either the strong peso or falling interest rates or both, easing the pressure on the deficit. But the question is: where were the savings applied? Where do they reflect? How these purported savings are used to make the numbers look good will be analyzed later in the analysis of the revenues side of the budget.

A more urgent question that we should ask now is, where does Arroyo get the money to pay for these debts? Former NEDA Director Felipe Medalla [2007] observed that until 2003, the public debt did not affect primary (non-interest) expenditures of government because interest payments were largely refinanced. With the increased revenues due to RVAT, and “expenditure compression”, he showed that the government is increasingly paying out its own revenues its interest payment expenses.

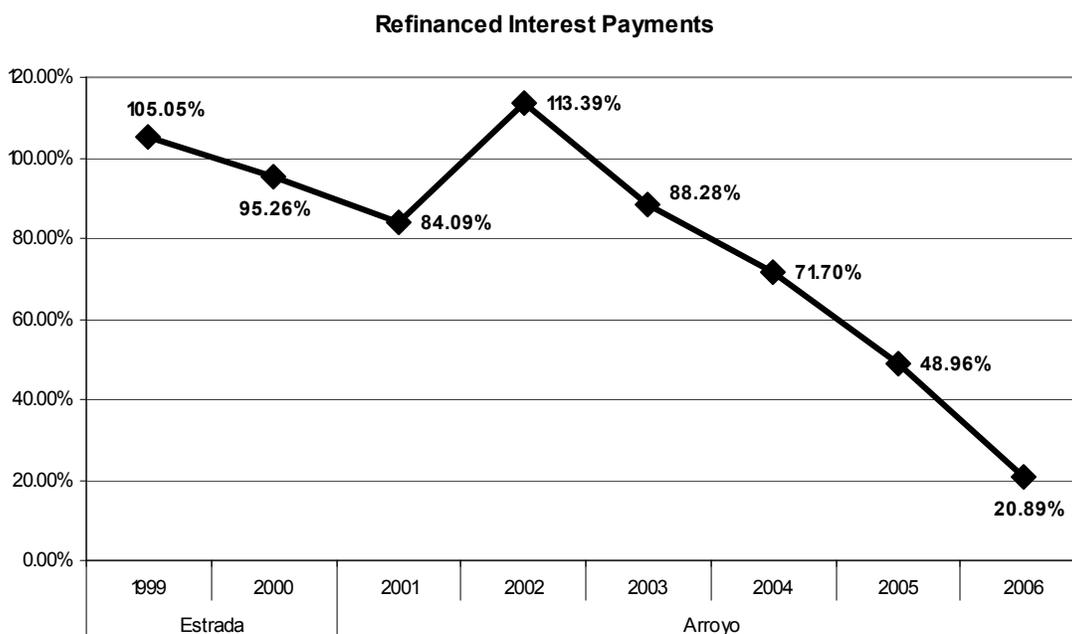


Fig. 1. Refinanced Debt. Source: *The Philippine Economy: Recent and Future Trends* by former NEDA Director Felipe Medalla. Note: To get the refinanced interest payments, you first obtain the primary surplus by subtracting the non-interest payment expenditures with the revenue. You then take the ratio of primary surplus and the interest payments.

From 2002, when the government depended entirely on financing to pay off its interest revenues⁵, refinanced interest payments dropped to merely 20.89% in 2006, meaning only one-

⁴ Senate Press Release.

⁵ During that year, primary surplus was negative, meaning that the revenue wasn't enough to pay even for the non-interest payment expenses.

fifth of the interest expenditures were financed through new debts. The rest of the interest payments, therefore, we paid from our revenues.

In a decision whether to pay for debt service or to allocate for social services, the Arroyo administration seems to unhesitatingly choose the former. In order to maximize the strengthening of the local currency due to the massive inflow of foreign currency from abroad, the government prepaid at least US\$220 million of debt owed to the International Monetary Fund (IMF) – allowing us to save about \$50-100 million in the process – and US\$72 million to the Asian Development Bank (ADB). Clearly, the Arroyo administration is striking while the iron is hot; she is paying and pre-paying debts while the peso is strong and the country is awash with dollars.

II. On Non-debt Expenditures: Reneging on the Budget's Promises

Let us take a look at the other half of expenditures. While debt expenditures are being padded, other expenses are being cut. Looking at the half-year expenditure performance of the government (January to June) this year, there had been an under-spending of about PhP 37.9 billion, most of the under-spending was in the *Others* item which includes allocations for education, health, social welfare, and infrastructure. It registered a PhP 24.8 billion difference between the actual and programmed allocation.

January-June 2007 Spending Performance (in billion pesos)			
	<u>Program</u>	<u>Actual</u>	<u>Variance</u>
All Expenditures, of which:	589.2	551.3	-37.9
<i>Net Lending and Equity</i>	5.7	2.8	-2.9
<i>IRA</i>	97.1	99.8	2.7
<i>Subsidy</i>	3.2	10.6	7.4
<i>Others</i>	333.3	308.5	-24.8

Table C. 1. *Spending Performance 2007.* Sources: Department of Finance.

As of September this year, programmed non-interest expenditures exceed the actual non-interest expenditures by as much as PhP 14.78 billion (PhP 644.358 programmed versus PhP 629.578 actual).

Non-debt expenditures are being cut in the recent years. The 2006 spending performance for example, reveals that actual expenditure is PhP 54.6 billion lower than what was programmed. The variance was actually caused by the PhP 68.4-billion cut, also on the *Others* item. Expenditure in 2005 is not much better, with a PhP 50.3-billion cut. What meager amounts the Arroyo government allocates in the budget for genuine social needs, is still being pared in order to make the deficit numbers look good.

2005-2006 Spending Performance (in billion pesos)						
	2005			2006		
	Program	Actual	Variance	Program	Actual	Variance
All Expenditures	963.2	942.2	-21.0	1,099.0	1,044.4	-54.6
Interest and Net Lending	320.3	301.8	-18.5	348.3	310.2	-38.1
IRA	120.2	160.6	40.4	134.1	174.7	40.6
Subsidy and Equity	4.9	12.4	7.5	6.1	17.4	11.3
Others	517.8	467.5	-50.3	610.5	542.1	-68.4

Table C. 2. Spending Performance 2005 and 2006. Sources: Department of Finance.

Notice that Internal Revenue Allotment (IRA) is always beefed-up, so was subsidy and equity. This, one speculates, is to ensure support of local politicians and the economic elite. Interest payments may have gone down, but this was mainly because of, as Recto pointed out, inaccurate estimation of the currency exchange rate⁶. This had also been possible because the Treasury can bring down interest rates of local banks by rejecting bids when the interest rates charged by the banks are higher than the Treasury's target⁷. This is possible because banks, while having a lot of cash, are hesitant to lend to borrowers other than the government [Diokno-Pascual, 2007].

The Arroyo administration had been spending much less in Social Services than her predecessor, former President Joseph Estrada, in terms of percentage of NG spending. The share of her economic services allocation dropped considerably compared to that during the last years of Marcos regime. In contrast, the percentage of her debt service interest is very high, second only to that during the term of former President Corazon Aquino who took it as a policy to honor and repay all debts of the dictatorship.

Sectoral Shares of National Government Spending (in percentage)					
	Marcos (1981-85)	Aquino (1986-92)	Ramos (1993-98)	Estrada (1999-00)	Arroyo (2001-04)
Economic Services	36.2	23.1	25.5	24.2	20.6
Social Services	21.9	22.2	28.0	32.2	29.8

⁶ Also, the lowering of interest payments was only enough to offset the increase in IRA.

⁷ And we see yield rates on government issues securities going down. For example, rates of 91-day, 182-day, and 364-day Treasury Bills went down from 9.86%, 10.84%, and 11.80% in 2000 to 5.35%, 6.15%, and 6.96% in 2006, respectively. Same is true for Treasury Bonds, with 2-year T-bond rates going from 12.31% in 2000 to 7.47% in 2006 and 25-year T-bond rates going from 18.25% in 2000 to 10.31% in 2006 [Bureau of Treasury, 2007].

Sustaining the Momentum of Debt and Underdevelopment
Debt and the 2008 National Budget

Defense	9.9	7.1	6.8	5.5	5.5
General Public Services	16.1	13.7	18.3	18.1	17.1
Net Lending	4.3	4.4	0.5	0.5	0.6
Debt Service Interest	11.6	29.5	20.7	19.5	26.8

Table C.3. *Sectoral distribution of national government spending.* Source: Prof. Benjamin Diokno's data on per capita spending, titled "Two Decades of Suffering", used in his presentation "The Real State of the Nation".

This decrease in allocation for social services is more evidently seen in the per capita and per student spending of the administration for health and education respectively. From Estrada's PhP 201.00, per capita spending on health dropped to PhP 184.00. Per pupil spending dropped from Estrada's PhP 5,830 to PhP 5,467.

Consolidated per capita health spending, by administration, 1981-2004 (in 2000 prices)					
	Marcos (1981-85)	Aquino (1986-92)	Ramos (1993-98)	Estrada (1999-00)	Arroyo (2001-04)
National Government	240	278	321	360	303
Local Government	203	247	160	159	119
Total	37	31	161	201	184

Table C.4. *Consolidated per capita health spending in 2000 prices.* Source: Prof. Benjamin Diokno's data on per capita spending, titled "Two Decades of Suffering", used in his presentation "The Real State of the Nation".

Average National Government Spending for Basic Education 1981-2004 (in 2000 prices)					
	Marcos (1981-85)	Aquino (1986-92)	Ramos (1993-98)	Estrada (1999-00)	Arroyo (2001-04)
Per pupil spending, 2000 prices	3,027	4,478	4,959	5,830	5,467

Table C.5. *Average National Government Spending for Basic Education.* Source: Prof. Benjamin Diokno's data on per capita spending, titled "Two Decades of Suffering", used in his presentation "The Real State of the Nation".

The table below shows that since 2003, the growth rate of revenues for each year has always outpaced the growth rate of non-interest expenditures, except for 2007⁸. This means that the increase of revenues does not necessarily translate to an expansion of government spending for the public except last year when economists and credit rating agencies began to publicly criticize this practice. This trend is upheld in the proposed 2008 budget, with the growth of revenues registering at 9.67% while the growth of non-interest expenditure is only at 6.24%.

Growth Rate of Non-interest Expenditures and Revenues (in percent)						
	2003	2004	2005	2006	2007	2008
Non-interest Expenditure	1.64%	3.21%	4.78%	10.74%	17.61%	6.24%
Revenues	10.60%	10.47%	15.49%	20.03%	14.21%	9.67%
Variance	-8.96%	-7.26%	-10.71%	-9.29%	3.40%	-3.43%

Table C. 6. *Growth rates of non-interest expenditures and revenues. Sources: Public Finance and Fiscal Indicators, Bangko Sentral ng Pilipinas for 2003 to 2006 data; General Appropriations Act of 2007 (Republic Act 9401) for 2007 data; Budget of Expenditures and Sources of Financing (BESF), Fiscal Year 2008, Department of Budget and Management (DBM) for 2008 data.*

Clearly, the primary strategy to “balance” the budget is, virtually, cutting-back non-debt expenditures, not pumping-up revenues. Clearly, non-debt expenditures such as infrastructure, social spending, agrarian reform and the like are taking a back seat to debt service under the Arroyo administration. This becomes obvious when we look at the revenue growth rate. The targeted revenue for this year, which is pegged at PhP 1.23 trillion, is only 9.67% higher than last year’s revenue. This is the lowest since 2003.

III. On Revenues: All That It Takes

This brings us to the revenue generation strategy of the administration. Since the fiscal crisis of 2004, the Arroyo administration made it a point to increase uncompromisingly both its tax and non-tax revenues. From 2006 to 2007, revenues went up by as much as PhP 139 billion, with revenue effort rising from 14.91% to 14.92%⁹ over the same period. The projected revenue for 2008 is PhP 117 billion more than programmed for 2007.

NG Revenue Program, by source, 2006-2008 (in million pesos)			
	2006	2007	2008
Tax Revenues	859,856	973,576	1,108,889
<i>Taxes on Net Income and Profits</i>	<i>376,992</i>	<i>419,633</i>	<i>477,552</i>
<i>Taxes on Property</i>	<i>1,114</i>	<i>1,276</i>	<i>1,471</i>
<i>Taxes on Domestic Goods and Services</i>	<i>283,143</i>	<i>328,913</i>	<i>374,817</i>

⁸ This is just the programmed expenditure. Given the tendency of the Arroyo administration to under-spend, it is likely that the actual variance will be negative also.

⁹ Using projected nominal GDP (low) as contained in the BESF 2008 and the programmed revenues for 2007

Sustaining the Momentum of Debt and Underdevelopment
Debt and the 2008 National Budget

<i>Taxes on International Trade and Transactions</i>	198,607	223,754	255,049
Non-Tax Revenues	119,781	145,185	127,339
<i>Fees and Charges</i>	30,979	34,904	40,502
<i>BTr Income</i>	74,446	55,089	57,275
<i>Privatization</i>	5,815	55,192	29,562
Total Revenues	979,637	1,118,761	1,236,228

Table D. 1. Revenue Program, Including New Measures, By Source, FY 2006-2008. Source: Table C.1. Budget of Expenditures and Sources of Financing, Fiscal Year 2008.

To accomplish this, they used an aggressive taxation measure, focusing on consumption taxes (R-VAT, or Republic Act 9337), in order to beef-up revenues. The Department of Finance itself admitted that 70% of the revenues generated from R-VAT would go to debt service in the first six months of implementation, with only 30% going to social services and infrastructure programs [Hizon, 2006].

According to the budget message, the proposed revenues from privatization dropped, from PhP 55.9 billion programmed revenues in 2007 to PhP 29.6 billion in 2008. Half of next year's privatization proceed is expected to come from the privatization of the 120-hectare Food Terminal Inc. (FTI) in Taguig City, estimated at about PhP 15 billion.

But just a few months later, the government declared that instead of the original PhP30-billion target, the government is now expecting as much as PhP86.1 billion revenues from privatization of state-owned assets such as the Philippine Telecommunications Investment Corp. (PhP25.2 billion), the 20 percent stake in Philippine National Oil Company-Energy Development Corp. (PhP16.6 billion), the remaining stake in PNOC-EDC (PhP32 to PhP36 billion), the 4.6 percent stake in Philippine National Bank (PhP998 million), and the stakes in San Miguel Corp. (PhP50 billion) and Manila Electric Co. (PhP10 billion). The government earlier sold the 54-hectare old Iloilo Airport property valued at PhP1.2 billion [Gonzales, 2007].

This only expresses government's commitment to trim the government, as it believes that too much government is not "prudent" and "crowds out" private initiative. We need only look at the data on privatization proceeds to confirm this.

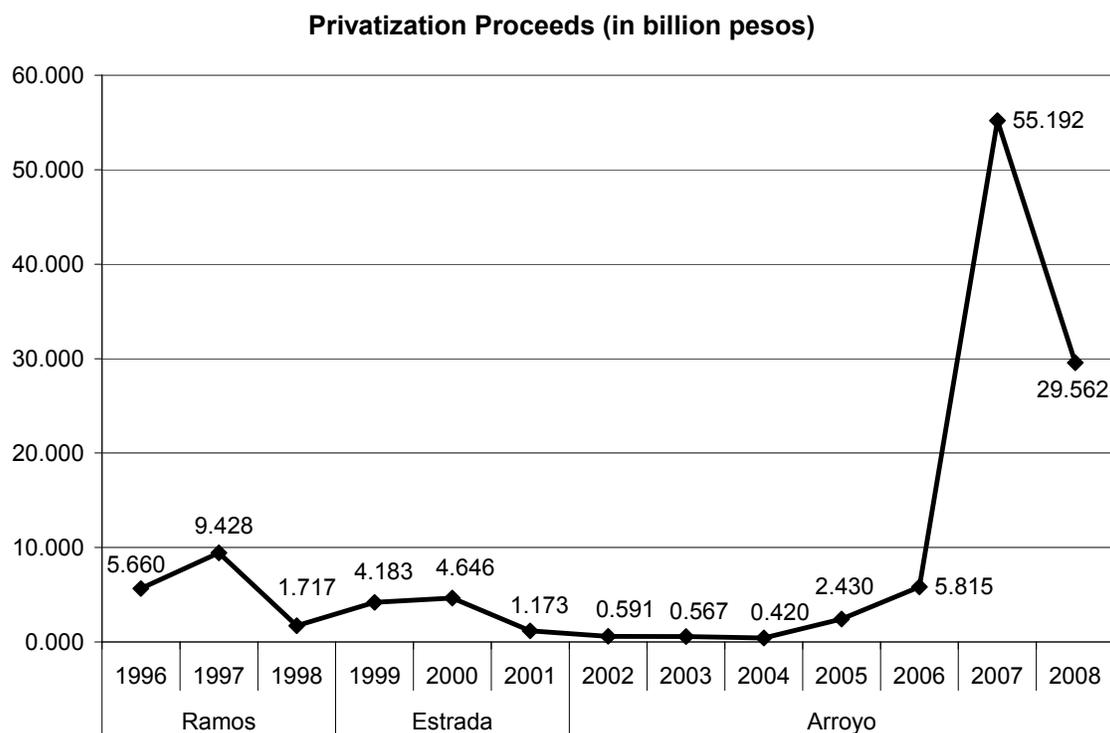


Fig. 2. Privatization Proceeds (1996-2008). Sources: National Government Revenues, Bureau of Treasury for 1996-2006 data. Revenue Program, Including New Measures, By Source, FY 2006-2008 (Table C.1. of Budget of Expenditures and Sources of Financing, Fiscal Year 2008) for 2007-2008 data.

The Arroyo government is selling off whatever it can in order to pick up the slack in its tax revenues it set for itself – the targets of which it has not been able to meet. The problem here, however, is if the government fails to sell its assets at the price it intended to sell them. This will have an impact on the so-called revenue-expenditure balance.

This dependence is, in fact, due to its ineffectiveness when it comes to meeting tax targets. Looking at the January-September 2007 revenue performance alone, the government is PhP 24.72 billion away from its original target for September, with tax shortfall reaching as high as PhP 56.02 billion.

Revenue Performance (January-September 2007)			
	Program	Actual	Variance
Revenues	836,978	812,257	-24,721
<u>Tax Revenues</u>	738,995	682,975	-56,020
<i>BIR</i>	566,902	521,920	-44,982
<i>BOC</i>	164,988	152,957	-12,031
<i>Other Offices</i>	7,105	8,098	993
<u>Non-Tax Revenues</u>	97,983	129,282	31,299

Sustaining the Momentum of Debt and Underdevelopment
Debt and the 2008 National Budget

<i>BTr Income</i>	43,656	57,201	13,545
<i>Fees & Charges</i>	29,034	29,560	526
<i>Privatization</i>	25,293	42,393	17,100
<i>Grants</i>	0	128	128
Expenditures	890,953	852,267	-38,686
<i>o.w. Interest Payments</i>	246,595	222,689	-23,906
Surplus/Deficit	-53,975	-40,010	13,965

Table D. 2. National Government Revenue Performance (January to September 2007). Source: Department of Finance.

No wonder Bureau of Internal Revenue Commissioner Jose Mario Buñag was sacked early this year for failing to meet targets. If we will remember, this is not the first time Buñag failed in his target. Last year's revenue data states that the BIR had a shortfall of at least PHP 23.42 billion (see revenue performance table below).

This is only evident of the lackluster tax performance of the Arroyo administration, which actually registered the lowest tax effort since 1988, a mere 11.53% in 2004. Revenue effort is also very low that year, pegged at 13.47%. This has since risen to 15.00% as projected in 2008, but is nowhere near the revenue effort during 1994, pegged at 19.86%. Compared with neighbors Thailand, Malaysia and Indonesia, with average revenue efforts from 2001 to 2005 ranging from 17.1% to 22.8% [Isonera, 2007], the Philippines rates very poorly indeed.

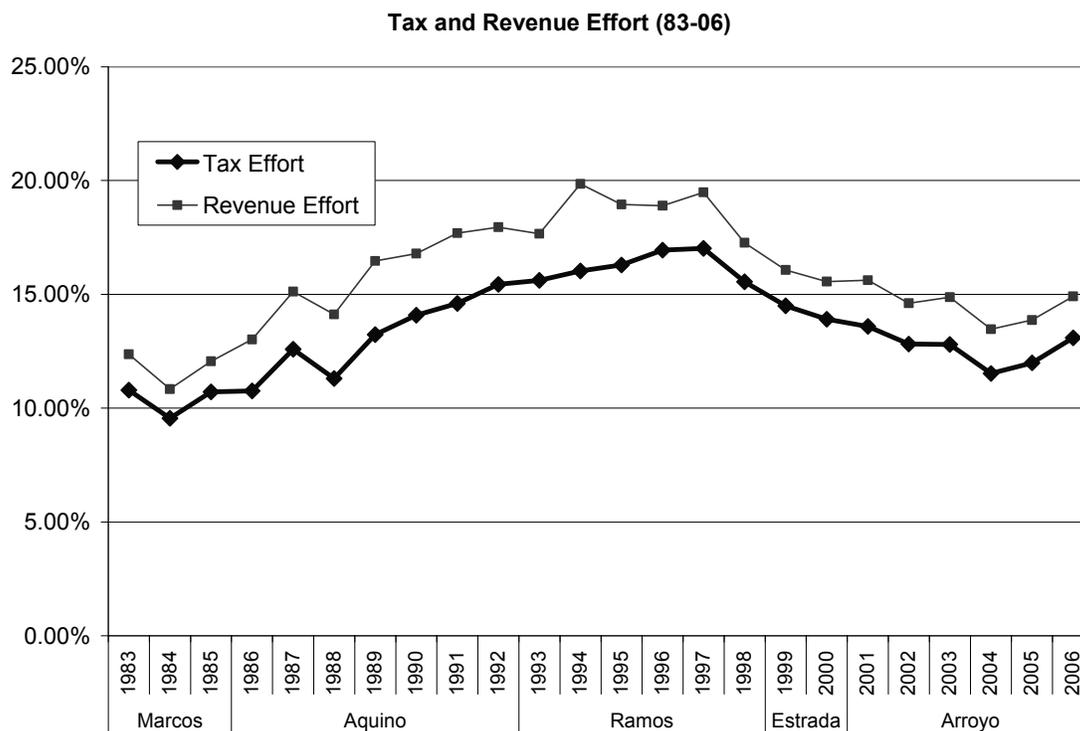


Fig. 3. Tax and Revenue Effort. Source: NSCB for GDP, BSP for Tax and Revenue proceeds. Note: To get Tax and Revenue Effort, divide Tax and Revenue proceeds with GDP.

Sustaining the Momentum of Debt and Underdevelopment
Debt and the 2008 National Budget

So how does the government manage to resolve this poor revenue performance when it comes to taxes? Former FDC President Maitet Diokno-Pascual revealed that the Arroyo government is padding its revenues [Pabico, 2006]. It does this by (1) by borrowing more than what was needed, (2) by earning interest from parked debt proceeds, and (3) by allowing the Bureau of Internal Revenue and Bureau of Customs to declare as part of revenues non-cash tax revenues (e.g. taxes paid by a government agency to another government agency).

2005-2006 Revenue Performance (in billion pesos)						
	2005			2006		
	<u>Program</u>	<u>Actual</u>	<u>Variance</u>	<u>Program</u>	<u>Actual</u>	<u>Variance</u>
Total Revenues	783.2	793.2	<u>10.0</u>	974.1	978.7	<u>4.6</u>
Tax Revenues	698.1	684.4	<u>-13.7</u>	879.8	859.2	<u>-20.5</u>
<i>BIR</i>	546.9	534.5	-12.4	675.3	651.9	-23.4
<i>Customs</i>	151.2	141.7	-9.5	196.0	198.2	2.2
<i>Others</i>				8.5	9.0	0.6
Non-tax Revenues	85.1	108.8	23.7	94.3	119.5	25.1
<i>Treasury</i>	36.6	70.6	<u>34.0</u>	51.9	73.9	<u>22.0</u>
<i>Others</i>				42.0	39.7	-2.3
<i>Privatization</i>				0.5	5.8	5.3
<i>Grants</i>				0.0	0.2	0.2

Table D. 3. *National Government Revenue Collections January-December 2005-2006. Sources: Department of Finance.*

Data for 2006 will show that tax revenues are actually below target. What accounted for the net increase in total revenues are the earnings of the Treasury Bureau, which was P22 billion above target (P34 billion above target in 2005). According to Diokno-Pascual, what the government did was to borrow the bulk of its requirements early in the year and then earn interest from the loan proceeds that it didn't need to use right away. To quote:

“The Arroyo government is borrowing heavily from itself. Again based on the same COA reports, from 2002 to 2004 the Bureau of the Treasury ‘invested’ PhP 953.6 billion in Treasury bills issued by ... itself. The amount came from the Bond Sinking Fund which is money set aside for payment of maturing government securities. In effect, the Treasury earns from lending to itself. Nearly a third (31.4%) of the non-tax revenues earned by the Arroyo government from 2001 to 2005 consisted of interest earned from money the Treasury lent to itself. What this means is that the Arroyo government augments its revenue by borrowing from itself [2006, Diokno-Pascual].”

Profiteering on Own Debts (in billion pesos)				
	Treasury "Investments" in T-Bills	Income from Bond Sinking Fund (BSF)	Non-Tax Revenues of National Government	BSF Income as % of Non-Tax Revenue
2002	177.454	10.099	69.717	14.5%
2003	251.969	16.627	88.071	18.9%
2004	506.201	22.940	101.680	22.6%
2005	N.A.	34.671	110.456	31.4%

Table D. 4. *Proceeds of Investments on T-bills.* Source: COA Reports, as cited in *Lies, Lies and Damn Statistics* by Maitet Diokono Pascual. Note: According to the COA, the Treasury "investment" in T-Bills is an off-budget cash outflow using reserved funds of the National Government in the Bond Sinking Fund, Securities Stabilization Fund, etc. The Bond Sinking Fund is earmarked for the payment of maturing government securities and is managed by the Bureau of the Treasury. At the end of 2004 it stood at PhP 414B, of which PhP 387B were in Treasury Bills and Bonds.

But clearly, revenues are not enough to really balance the expenditures, even if we are only to account for the principal amortization expenditures. As it has done in the last six years, the Arroyo administration solves this through borrowing.

IV. On Financing: Still Debt-driven

Arroyo is proud to have trimmed the borrowing program, from PhP 394 billion in 2007 to PhP 346 billion as proposed in 2008. This, she said, is her "commitment to narrow the budget gap this year as our financing requirements declined" in order to "reduce our dependence on borrowings and reallocate more resources to the needs of the people".

National Government Financing for 2007 and 2008 (in billion pesos)				
	2007	2008	Variance	Growth
Gross Foreign Financing	129,891	125.432 ↓	(4.459)	(3.43%)
Gross Domestic Financing	264,117	220.746 ↓	(43.371)	(16.42%)
Total	394.008	346.178 ↓	(47.830)	(12.14%)

Table E.1. *National Government Financing, 2007-2008.* Source: Table D.1. of Budget of Expenditures and Sources of Financing (BESF), Fiscal Year 2008, Department of Budget and Management (DBM).

It is Budget Secretary Rolando Andaya who first announced that this year's budget is "an outlay that will be totally supported by internal revenues" which means that it "would not be propped up by a single borrowed peso" [Gonzales & Marasigan, 2007]. DBM later explains that this does not cover off-the-budget expenditures, like principal amortization, for which we need to borrow in order to finance.

But is this "no new borrowings" claim even true? To verify this, let us look at the government's budgeting logic as to why principal amortization is off-budget. According to them, placing

Sustaining the Momentum of Debt and Underdevelopment
Debt and the 2008 National Budget

allocations for principal amortization as part of the current national government budget amounts to *double-accounting* because the expenditures financed by these debts are already included in the previous budgets.

Using the same logic, we can then say that the current budget also contains expenditures that are financed by new borrowings, by debts which principal payments will be paying in the future. We find some of such expenditures in the Foreign Assisted Projects (FAP), Table B.14 of the Budget of Expenditures and Sources of Financing (BESF) fiscal year 2008. Loan proceeds to finance these projects is pegged at PhP 30.67 billion¹⁰. The national budget, thus, as always, remains to be debt-driven.

If this is not proof enough, let us look further at the tables D.4 and D.6 of the BESF, particularly on the column "Added Borrowings". If added borrowings are only to service the principal amortization, then the two should be equal. However, there is as much as PhP 56.45-billion difference between the total added borrowings and principal payments for outstanding debt of regular liabilities.

Outstanding Debt on Regular Liabilities F.Y. 2008			
<i>in billion pesos</i>	<u>Added Borrowings</u>	<u>Principal Amortization</u>	<u>Variance</u>
Foreign (\$US1=PHP46)	120.206	81.690	38.516
Foreign (\$US1=PHP48)	125.432	85.242	40.191
Domestic	844.894	828.630	16.264
Total (\$US1=PHP46)	965.099	910.320	54.780
Total (\$US1=PHP48)	970.326	913.872	56.454

Table E.2. Outstanding Debt on Regular Liabilities. Source: Table D.4 (Outstanding Foreign Debt for Regular Liabilities) and D.6 (Outstanding Domestic Debt for Regular Liabilities) BESF F.Y. 2008. Comment: Curiously, the information on added borrowings had been deleted from the table D.4 as available in the Department of Budget and Management website after Rep. Roilo Golez raised the issue during the deliberations for the 2nd reading of the HB 2454.

Therefore, the claim that no new borrowings will be made is not only misleading as some people proposed, but completely false. Since we are expecting to finance entirely out of revenues our interest payments, the debt stock will be increased by whatever amount of borrowing made not for the financing of principal amortization. Government projections thus show that we will have *more*, not less, national government debt at the end of 2008, due to higher added borrowings than principal payments.

Outstanding Debt of the National Government, As of Year End, 2006-2008 (in billion pesos)							
	Outstanding at the Beginning	2007		Outstanding at the Beginning	2008		Outstanding at the End
		<i>Added Borrowings</i>	<i>Principal Payments</i>		<i>Added Borrowings</i>	<i>Principal Payments</i>	
Domestic	2,154	947	942	2,159 ↑	845	831	2,173 ↑

¹⁰ PHP 30,665,447,000.00 to be exact

Sustaining the Momentum of Debt and Underdevelopment
Debt and the 2008 National Budget

Foreign	1,522	127	64	1,584 ↑	125	85	1,625 ↑
Total	3,676	1,075	1,007	3,744 ↑	970	916	3,798 ↑

Table E.3. *Outstanding Debt of the National Government, As of Year End, 2006-2008. Source: Table D.3. of Budget of Expenditures and Sources of Financing (BESF), Fiscal Year 2008, Department of Budget and Management (DBM).*

This is not surprising. Borrowings during the Arroyo administration always exceeded the budget deficits. The excess comes out as change-in-cash, which had only been in deficit in 2002 and 2004, the height of the fiscal crisis.

Deficit Financing from 2001-2008 (in billion pesos)								
	2001	2002	2003	2004	2005	2006	2007	2008
Deficit	-147.0	-210.7	-199.9	-187.1	-146.8	-64.8	-7.4	0.0
Net Financing	175.2	264.2	286.8	242.5	236.0	110.1	84.5	17.8
Variance	28.2	53.4	87.0	55.5	89.2	45.3	77.1	17.8

Table E.4. *Deficit Financing. Sources: National Government Fiscal Position CY 1999-2006, Bureau of Treasury, for 2001 to 2006 values; Budget of Expenditures and Sources of Financing (BESF), Fiscal Year 2008, Department of Budget and Management (DBM) for 2007 and 2008 data.*

The practice of borrowing more than what is needed increases the country's debt stock, and with it the debt-servicing requirement. Naturally, there is a limit to how long a particular government can sustain an aggressive borrowing policy. It was fortunate for Arroyo that the Treasury can bring down local interest rates, as we stated earlier.

Conclusion: Arroyo's "Balanced" Budget, Government's Imbalanced Priorities

The main impetus for having a balanced budget is clearly the implicit recognition of the problem of debt. By avoiding deficit spending, the administration would be able to lessen its reliance on borrowing – the primary root of the debt problem according to the existing government's paradigm. However, since only interest payment on the debt is on the budget, the government would still have to borrow to pay for principal amortization.

A balanced budget would necessarily mean that we have to raise more revenues. But with the government's poor performance when it comes to collecting tax revenues, it will most likely rely on a) consumption taxes which are easiest to collect, b) privatization, and c) raising revenues by the Bureau of Treasury, more likely than not through padding or getting interest from borrowing its own treasury bills.

Failing to meet revenue targets would thus mean cutting-back on expenditures, since payment for debts is automatically appropriated. As we have shown, there has been a deceleration of growth in non-interest spending.

The government, pushed by its own self-imposed administrative constraints towards a contractionary economic policy and a conservative fiscal policy, does not recognize the problem of automatic payments as the primary cause of budget deficit. No wonder it proposes instead an austere spending program which cuts social spending.

This solution, while it may satisfy creditor standards of correct fiscal governance, will have serious developmental ramifications due to lack of government investment in the social infrastructures. FDC insists on solving the debt problem, not through palliative measures of expenditure compression or through cannibalistic measures of selling public assets, as in privatization, or eating up people's purchasing power, as in aggressive imposition of consumption taxes. Rather, we must attack the source of the whole debt quandary itself.

Clearly, the root of the problem is the government's policy of relying heavily on creditors to finance social projects highly susceptible to corrupt practices – a policy which, ironically, would have been unnecessary had the government chosen to allocate more to social services than debt payments¹¹. In fact, there is no shortage of cases of loan-financed projects going to waste due to inefficiency or corruption.

The solution would be to stop this policy at once. We should allocate more to building our socio-economic infrastructure so that we will no longer be reliant on debt for pump-priming, as Arroyo herself said.

Unlike what Arroyo proposed, however, the solution would be to drastically reduce debt servicing by 1) knowing what we should pay and what we should not pay in the first place through a Congressional Debt Audit which will be able to screen out illegitimate debts, 2) paying ourselves first, investing on social welfare and economic growth first, through the Repeal of Automatic Appropriations Law on debt service, 3) not shouldering private sector debts through sovereign guarantees, and 4) and putting debt-creating activities such as bilateral loan agreements with export credit agencies under full public scrutiny and participation.

And unlike how the Arroyo administration framed it, it is not a choice between a contractionary but balanced budget and an expansionary but deficit-driven and debt-creating one. The choice is between a budget which prioritize creditors' interest and that which satisfies the country's need. Whether it is entirely financed by revenues or through deficit spending, a budget that puts prime on satisfying the concerns of lenders and that inevitably ties the hand of government in dealing with fundamental development issues such as poverty and inequality will only pull us further into debt and poverty.

It is time the government finally give the people their due. At the end of the day we need a progressive spending program where as you say the people are finally given their due. Creditors certainly cannot and must not come first if we are to break the momentum of debt and underdevelopment we are now in.

¹¹ There is an ongoing phenomenon in government policy of allocating the majority of the country's revenues to debt service (Aquino allocated a yearly average of 102.10% of the country's revenues to debt payments for the whole of her term, Ramos allocated 61.99%, Estrada, 70.22%, and Arroyo, 97.69%), causing the government to finance its deficit through loans.

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