Philippine Journal of Public Administration, Vol. XXX, No. 4 (October 1986)

Financing Government —(2)

JUANITA D. AMATONG*

The scope of government activity widened in the period 1976-1984 as evidenced by the mushrooming of various government-owned and controlled corporations. As a consequence of increased state presence, the national expenditure jumped to about a third of the nation's gross national product (GNP). Financing government's operation, is however hamstrung by a pattern of declining taxation, decreased reliance on self-financing and an increasing trend towards external and domestic borrowing. This trend implies unresponsive taxation system. In the public corporate sector, the same downward trend in non-tax and internal resources generation can be observed. The short run difficulties can be met by borrowing but long-term remedy requires increased taxation.

What is government? In the Philippine setting, the term government or public sector defies precise definition because the government undertakes enormous activities, either through regular government bodies, government corporations, or even through private enterprise and contracts. For instance, such diverse activities as the building and maintenance of basic infrastructure, the collection of toll fees or the imposition of a levy on coconut farmers are undertaken or done with the participation of the private sector.

It is therefore within this context that a definition of government must be made clear. The World Bank and the IMF use the public sector concept in their analyses of the Philippine economy, with a limited coverage of government corporations which include only the 15 major non-financial government corporations and social security institutions like the Government Service System (GSIS), Social Security System (SSS), and Medicare. This paper, however, defines government which include the national government, local government units and 55 government corporations.[1] Current knowledge would indicate that this is the first time that the concept of consolidated public sector, with a broader coverage of 55 government corporations, is used in any fiscal and monetary analysis. In this regard our attempt at a definition of public sector is more comprehensive than any existing classification of the Philippine public sector.

In the Philippines, institutions or bodies also exist which Sharkansky calls "margins of the state." These "margins of the state" are units attached

*Executive Officer, Government Corporate Monitoring and Coordinating Committee, Ministry of Finance.

to ministries or c[illegible] agencies. They are not accountable to the public and they enjoy enormous financial and managerial autonomy.[2] These so-called government corporations or public enterprises provide a variety of services ranging from the building of infrastructure and the provision of public utilities, to trading and consultancy services. The acquisition or transfer of the distressed private firms by the government sector further blurred the distinction between what is public and what is private activity.

Government has indeed become very large. In recent years it has gone beyond the delivery of traditional government services. In some areas, the government has even directly competed with the private sector. Realizing this encroachment and the financial costs inherent under this scheme, the present government has now embarked on a policy of privatization and through reorganization, a process of consolidation, merger and shedding off of certain activities which can very well be handled by the private sector.

Analysis of Public Sector Accounts

The cash basis of accounting is applied in the analysis of the public sector accounts. It is fortunate that national and the local government transactions are also recorded on a cash basis aside from the usual accounting records which are recorded on an accrual basis. Because government corporations keep their books on an accrual basis only, their financial operations were converted into cash using the Commission on Audit (COA) audited Income and Expense Balance Sheet Statements. However, COA reports suffer from inconsistency in concept and classification of accounts resulting in flaws or inaccuracies in some of the years covered.

Public Sector Expenditures

The expenditures of the public sector steadily rose from a level of ₱33.2 billion in 1976 to ₱152 billion in 1984 or an increase of almost 500 percent rising five times over the nine-year period. The three levels of government have nominally increased their total expenditures, but the upsurge in expenditures was accounted for primarily by government corporations, which registered an increase of more than 700 percent. Total public sector expenditure was 25 percent of GNP in 1976 rising to 29 percent in 1984. In the intervening years, however, notably 1978, 1979, 1980 and 1982, public sector expenditure to GNP ratios were below the 1976 level (Table 1).

These declines were brought about by reductions in public sector investments. While public sector investments behaved erratically as a ratio to GNP, current expenditures demonstrated a more stable relationship to GNP. This phenomenon is generally explained by the fact, should any crunch in the finances of the government happen, the investment projects are the first to be sacrificed. Understandably, the laying off of employees or reduction in

TABLE 1. Consolidated Public Sector Expenditures (in Billion Pesos)

	1976	*1977*	*1978*	*1979*	*1980*	*1981*	*1982*	*1983*	*1984*
National Government	20.4	22.8	26.2	29.8	38.1	48.1	52.1	58.1	66.3
Local Government Units	2.4	2.9	3.2	3.8	4.2	5.1	5.8	6.5	7.4
Government Corporations	13.6	17.4	7.2	21.0	22.1	45.0	34.6	50.6	101.7
Less:									
Transfers to LBU's	0.9	1.0	1.0	1.5	1.5	2.0	2.0	2.9	3.1
Transfer to Gov't Corps.	2.3	2.3	3.1	4.7	5.9	9.4	11.7	7.9	20.3
Total Public Sector Expenditures	33.2	39.8	32.5	48.4	57.0	86.8	78.8	104.4	152.0
Total PS Expenditures as % of GNP	25%	26%	18%	22%	22%	[illegible]	24%	28%	29%

SOURCE: Bureau of Treasury Cash Operations of N[illegible] Government, Ministry of Finance and COA Audit Report of Government Corporations.

the size of the bureaucracy is seldom undertaken. In addition, current expenditures include expenses which are mandatory in nature such as interest payments and terminal pay.

A closer look at the pattern of public sector expenditures shows that the national government's total expenditure as a ratio to GNP has been declining and that of local governments has remained more or less steady at about 2 percent of GNP. However, government corporations showed an increasing trend. The latter development has been evident since 1981. The shift in expenditure focus from the national government to government corporations could be attributed to the fact that the large scale projects were undertaken by government corporations in the areas of energy development, transportation, water supply, and irrigation. In addition, some of the regular governmental functions such as road building, port construction and even

TABLE 2. Current and Capital Expenditures of Public Sector (in Billion Pesos)

	Current	*% of Total Public Expenditures*	*Capital**	*% of Total Public Expenditures*
1976	17.0	51%	16.1	49%
1977	21.6	54%	18.2	46%
1978	24.4	75%	8.1	25%
1979	29.5	61%	19.0	39%
1980	37.2	65%	19.5	35%
1981	50.4	58%	39.0	42%
1982	52.8	67%	25.9	33%
1983	57.5	55%	45.2	44%
1984	78.2	51%	73.8	49%
Average	41.0	59%	31.0	41%

* Net of Equity and Net Lending for National Government to Government Corporations

SOURCE: Bureau of Treasury Cash Operations of National Government, Ministry of Finance and COA Audit Report of Government Corporations.

subsidy programs have been undertaken by government corporations, as mandated by decrees, letters of instructions, and in many instances, even marginal notes and verbal instructions. In Table 2, we note that except for the year 1978, the capital expenditure outlays of the government corporate sector outstripped the capital expenditures of the National Government by wide margins.

A discussion of the subject of public expenditure, particularly that of the government corporate sector is not complete without a commentary on the budgetary system. Budgetary controls are designed to check national governmental expenditures through a complicated process of evaluation by the Office of Budget and Management (OBM). After going through the bureaucratic mill, the national government budget is forwarded to the Batasang Pambansa for legislative review and evaluation. Once the Batasan approves and passes the budget, it goes to the President for final approval. It becomes a General Appropriation Act upon the signing by the President. The budget process does not stop here. Other steps, such as issuance of advice of allotment and cash disbursement ceilings, follow another rigorous process of justification at the OBM. A comment by the World Bank official on the Philippine budgetary system is worth noting. "There is nothing automatic within the systems (of control) which ensures that appropriations, obligations and disbursements will actually match." While this budgetary process applies to National Government expenditure, this, however,does not apply to expenditures of government corporations. Government corporations expenditures are decided by the individual boards of the corporations. Capital outlays of government corporations, to the extent that they form part of the infrastructure program, are evaluated by the National Economic Development Authority (NEDA). The foreign financing aspects of the infrastructure projects are subject to the approval of the Ministry of Finance, because all borrowings of government corporations are guaranteed by the Republic through the Ministry of Finance, and of the Monetary Board to assure that foreign exchange will be available at the time the debt is serviced. The role of the Office of Budget and Management (OBM) and the budgetary process is limited only to that part of the national government expenditures which are transferred to the government corporations in the form of subsidy, equity and/or net lending. If a corporation does not need any such assistance, it has no compulsion to submit its budget to the OBM. The only instance government corporations submit their budget to the OBM is when they need National Government assistance. Recently, however, a sub-cabinet committee was formed to coordinate and monitor government corporate activities. The thrust of the Government Corporate Monitoring and Coordinating Comittee (GCMCC) is to oversee the financial operations of government corporations with respect to the (1) utilization of national government assistance; (2) contracting and utilization of borrowed domestic and external funds; and (3) installation of a performance evaluation system in conjunction with the development of a macrocorporate sector plan.The purpose of the creation of the GCMCC hopes to rationalize the government corporate sector, putting them on a sound financial footing and safeguarding the allocation of scarce government resources.

Financing the Public Sector

Tax Revenues

On the average, taxes have constituted 53 percent of source of financing public sector expenditures over the nine-year period (Table 3).

TABLE 3. Ratios of Financing Sources to Total Expenditures

	Taxes	*Non-tax Receipts Including Gov't Corps. Operating Receipts*	*Net Borrowing*
1976	48	15	37
1977	45	19	36
1978	81	58	-40
1979	64	34	2
1980	64	41	-5
1981	43	32	25
1982	51	35	14
1983	46	32	21
1984	36	36	27
1976-1984 Average	53	36	13

SOURCE: Bureau of Treasury Cash Operations of National Government, Ministry of Finance and COA Audit Report of Government Corporations.

For the national government however, taxes are the main source of national government expenditures contributing on the average, 75 percent for the nine—year period. Tax effort, defined as the ratio of tax receipts to GNP, ranges from 11 percent to 15 percent in 1976 to 1984. A declining tax effort ratio is noticeable in the last five years, averaging at 12.4 percent of GNP. By international standards, the Philippine tax efforts is much les than those in neighboring Asian countries.[3]

The main feature of tax effort is that over the years, there has been a dependence on discretionary tax measures to raise the tax revenue. For example, in 1983, the revision of sales tax and the specific tax on cigarettes together with import surcharge were estimated to bring to the National Government coffers ₱2.3 billion. In 1984, four sets of tax package were introduced, with an estimated revenue intake of ₱6.5 billion.

The introduction of new tax measures, very often to raise revenues, reflects a tax system which is not responsive to GNP growth. Elasticity of the national government tax revenue has historically remained at less than unity (0.88). An improvement in the tax elasticity would call for a restructuring of the tax system in the direction of more direct and progressive taxation and a system which is anchored on an *ad-valorem* basis rather than on a specific basis.

Broadening of the tax base has been one of the objectives of Philippine tax policy. This objective can partly be achieved through the lifting of tax exemptions. Tax exemptions in various terms have been a constant feature in the Philippine tax scene. Director Angel Q. Yoingco of NTRC puts a conservative estimate of ₱7.1 billion of taxes lost[4] through BOI incentives alone from 1981 to 1984. The lifting of tax exemptions among the 15 major non-financial government corporations is calculated to raise tax revenues by ₱6 billion in 1986.

The controversy about the growth-stimulating feature of taxation still rages. Whether progressive and direct taxes (especially on income) hinder growth because they discourage savings, and therefore, investments are still questions to which no conclusive answers have been made. Although tax incentives have been widely used to encourage investments, especially in areas which initially are not profitable, and/or those that require a long gestation period, the Philippine experience has shown that these have been done indiscriminately, so therefore has resulted in the downtrend of tax collections.

Erosion of the tax base through various means such as tax exemptions, misdeclaration, undervaluation, and nondeclaration of true values of income and other taxable bases, and an inefficient collection system have all contributed to a low elasticity of Philippine tax receipts.

A study by Edita Tan concludes that the Philippine revenue system is regressive because of its reliance on taxes on commodities including those which are consumed by the low income group.[5] Therefore, taxes, especially progressive taxes, as a source of public sector expenditure should be encouraged because this is one of the tools for redistributing income. Unless we restructure tax system in such a manner that the burden of taxation is borne by the well-to-do members of society, taxes as a means to finance government expenditures will only aggravate the uneven distribution of income and wealth. The most recent initiatives in tax reform hopefully will bring about the much desired changes in our tax system.

TABLE 4. Financing of Public Sector Expenditures (in Billion Pesos)

	1976	1977	1978	1979	1980	1981	1982	1983	1984
Taxes	16.1	17.8	26.5	31.0	36.3	37.7	40.2	48.2	60.0
Non-tax Receipts									
Government Corporations Operating Income	4.9	7.6	19.1	16.3	23.6	27.5	27.4	33.7	59.8
Net Borrowing	12.2	14.4	-13.1	1.1	-2.9	21.6	11.2	22.5	32.2
Foreign	1.8	6.1	5.5	7.9	7.7	10.5	15.4	30.7	8.2
Domestic —[1]	10.4	8.3	-18.6	-6.8	-10.6	11.1	-4.2	-8.2	24.0
TOTAL	33.2	39.8	32.5	48.4	57.0	86.8	78.8	104.4	152.0

[1] Computed as a residual. Positive sign means availment of domestic credit; negative sign represents repayment or increase cash balance and/or deposits.

SOURCE: Bureau of Treasury Cash Operations of National Government. Ministry of Finance and COA Audit Report of Government Corporations.

Non-Tax Revenues

Operating receipts of government corporations, together with non-tax revenues, financed, on the average, 34 percent of total public sector expenditure (Table 4).

By sector, financial corporations registered total operating receipts of ₱70 billions; that of infrastructure and industrial public utility corporations at ₱56 billion and the agricultural group of corporations at ₱34 billion. The internal cash generation, which is total operating receipts less current operating expenditures, showed a positive total of ₱57 billion. The infrastructure and public utility corporations were the best earners, recording a total internal cash generation of ₱26 billion as against the financial sector total of ₱23 billion. The agricultural sector tailed behind with ₱5 billion in internal cash generation.

The internal cash generation which represents the savings of the government corporations, however, did not match the government corporate investments (capital expenditures) of ₱198 billion. The savings investment gap of ₱144 billion in the government corporate sector necessitated other sources of financing, heavy infusion of national government assistance (subsidy, equity and net lending) to the government corporate sector and other means of borrowing, especially foreign borrowings.

As a percentage of GNP, non-tax revenues and operating receipts of the public sector averaged 8 percent. Data showed that this type of revenue has not been responsive to changes in GNP and prices, with an average elasticity of 1.07. However, when individual corporations are examined, the elasticity of this type of revenues to GNP and prices varied. Government corporations like the National Power Corporation (NPC), Metropolitan Waterworks and Sewerage System (MWSS), Metro Manila Transit Corporation (MMTC), Philippine National Oil Company (PNOC), National Development Corporation (NDC) and the financial corporations, adjusted their charges in accordance with the movements in foreign exchange and other market forces. On the other hand, the majority of the corporations have not been able to adjust their tariffs. Many government corporations which still collect charges at original rates include the National Irrigation Administration (NIA), National Electrification Administration (NEA), and Local Water Utilities Authority (LWUA), to name a few. Complicating the low tariffs and sticky tariffs of most of the government corporations, is the government's low collection efficiency. As of the end of 1984, COA reported that net accounts receivable of government corporations amounted to ₱26 billion.

The fiscal implications of inadequate levels of self-financing for the government corporate sector as a whole could only mean that the corporate investment program will have to be financed either by borrowing or by national government financial support. In both cases, these exert pressure on the national budget, the balance of payments and money supply. In the final analysis, the national government will have to raise taxes. This, in effect, shifts the burden from those who benefited from the services of government corporations to the general taxpaying public.

Net Borrowing as Financing Source

Net borrowing is defined as loan availments less repayments or increase in deposits with the banking system. National government equity contributions and net lending to government corporations are also treated as net domestic borrowing by the corporations. Thus, net domestic borrowing is equal to the public sector deficit.

Total net borrowing financed on the average, 13 percent of the total public sector expenditures from 1976-1984. Over the nine-year period, the share of net borrowing to total public expenditure fluctuated between a negative 40 percent to a high of positive 37 percent. In 1976 and 1977, borrowing was resorted to as a major source of financing. By 1984, the share of net borrowing had registered a high of ₱32 billion, the bulk of which came from domestic sources.

Net foreign borrowing dominated the borrowing source of public sector expenditure. The build-up in net foreign borrowing is evident from the mid-seventies to the early eighties. However, while foreign borrowing rose steadily from 1976 to 1983, capital expenditures in current terms did not rise as much in the second half of the seventies. In fact, all through the second half of the seventies, capital expenditures averaged at 10 percent of GNP with the exception of 1976 which registered at ₱18-19 billion. From 1981 to 1984, capital expenditures registered increases with the biggest increase occuring in 1984. Curiously, net foreign borrowing declined tremendously in 1984. This relationship between foreign borrowing and capital expenditures seems to contradict the justification often given for going into foreign indebtedness.

Disaggregating the net foreign borrowing between the national government and the government corporations, it was observed that government corporations relied more heavily on foreign borrowing than the national government. It may be noted here that government corporations are recipients of foreign borrowing through the net lending scheme of the national government. Thus, at the same time that the national government is a borrower of loans, it also lends same to government corporations.

The net domestic borrowing of the public sector consists of bank and non-bank borrowing. On the whole, net domestic borrowing showed high degree of fluctuation from 1976 to 1984. A decomposition of the net domestic borrowing further showed that net bank borrowing has been a relatively more stable source of financing than non-bank financing (Table 5).

TABLE 5. Breakdown of Net Domestic Borrowing[1]
(In Billion Pesos)

	Total	Bank		Total Bank Credit	Non-bank
		CB	*DMB's*		
1976	10.4	0.6	0.4	1.0	9.4
1977	8.3	nil	0.5	0.5	7.8
1978	-18.6	-0.8	-0.2	-1.0	-17.6
1979	-6.8	1.2	1.1	2.3	-9.1
1980	-10.6	3.3	0.6	3.9	-14.5
1981	11.1	3.3	6.1	9.4	1.7
1982	-4.2	3.4	2.4	5.7	-9.9
1983	-8.2	-5.0	6.0	1.0	-9.2
1984	24.0	9.1	-4.7	4.4	19.6

[1] Net Domestic borrowing consists of bank and non-bank borrowing, the latter is defined as borrowing from the public through issuance of government securities, National Government equity and net lending to government corporations.

SOURCE: Central Bank for Bank Credits and Table 4.

The national government was the more heavy user of bank credit especially from the Central Bank.

The distinction between bank and non-bank sources should be considered and the effects of public sector deficit on money supply. With a bank credit multiplier of 3 or 4, net banking sector credit to the public sector will have a substantial impact on total liquidity and prices.[6]

The non-bank credit to the public sector for 1976-1984 was scarcely used. This is perhaps due to the undeveloped government securities market in the country. Note, however, should be made that in 1984, there was a surge in non-bank credits to the public sector, amounting to ₱19.6 billion. This was at a time when interest rates were high and the non-bank buyers found government securities to be very attractive investment outlet. It is important to note this development, because the non-bank source of financing can be a good potential source of government expenditures in the future.

Conclusion

The coverage of government has expanded rapidly with the proliferation of government corporations. This expansion brought about expenditure levels reaching to about a third of GNP especially in the first half of the 1980s. The financing of government in the past ten years shows a pattern of declining taxation, declining reliance on self—financing and an increasing trend of borrowing, both externally and domestically. This trend in financing government implies a system of taxation which is not responsive to the needs of a growing public sector and also not capturing the growth in national product. The non-tax and self-financing of many government corporations likewise show deteriorating trend and implies a certain degree of inefficiency. Borrowing which has been resorted to are merely stop-gap measures but in the long pull the citizenry will have to answer the call in financing government through taxation.

Endnotes

[1]The list of government corporations included are in Annex 1.

[2]Ira Sharkansky, *Wither the State? Politics and Public Enterprise in Three Countries* (New Jersey: Chatham, 1979).

[3]For 1980-1982, average tax to GNP ratios in Asian countries are as follows:

Indonesia	—	23.4%	Sri Lanka	—	17.0%
Korea	—	17.4%	Thailand	—	12.7%
Malaysia	—	24.0%			

[4]Angel Q. Yoingco, "Reflections on Philippine Tax Policy," *Budget Management, December 1985.*

[5]Edita Tan, *Taxation, Government Spending and Income Distribution in the Philippines,* 1975.

[6]Mario Lamberte made a study on the monetary impact of National Government deficit. A study on public sector deficit and monetary variables still need to be undetaken.

ANNEX 1

List of Government Corporations Included in the Public Sector Classification

AGRICULTURAL

1. National Cottage Industry Development Authority (NACIDA)
2. National Food Authority (NFA)
3. Philippine Coconut Authority (PCA)
4. Philippine Cotton Corporation (PCC)
5. Philippine International Trading Corporation (PITC)
6. Philippine National Lines (PNL)
7. Philippine Tobacco Administration (PTbA)
8. Philippine Tourism Authority (PTrA)
9. Philippine Trade Exhibit (PTE)
10. Philippine Virginia Tobacco Administration (PVTA)

PUBLIC UTILITY

1. Communications and Electric Development Authority (CEDA)
2. Farm Systems Development Corporation (FSDC)
3. Light Rail Transit Authority (LRTA)
4. Manila International Airport Authority (MIAA)
5. Metro Manila Transit Corporation (MMTC)
6. Metropolitan Waterworks and Sewerage System (MWSS)
7. Local Water Utilities Administration (LWUA)
8. National Electrification Administration (NEA)
9. National Irrigation Administration (NIA)
10. National Power Corporation (NPC)
11. Philippine Aerospace Development Corporation (PACD)
12. Philippine National Railways (PNR)
13. Philippine Ports Authority (PPA)
14. Rural Waterworks Development Corporation
15. National Housing Authority (NHA)

INDUSTRIAL

1. Export Processing Zone Authority (EPZA)
2. Human Settlement Development Corporation (HSDC)
3. Laguna Lake Development Authority (LLDA)
4. Leyte Sab-A Basin Development Authority (LSBDA)
5. National Coal Authority (NCA)
6. National Development Company (NDC)
7. Philippine Fisheries Development Authority (PFDA)
8. Philippine National Oil Company (PNOC)
9. Public Estates Authority (PEA)
10. Southern Philippines Development Authority (SPDA)

SOCIAL/CIVIC/SCIENTIFIC

1. Cultural Center of the Philippines (CCP)
2. Development Academy of the Philippines (DAP)
3. Lung Center of the Philippines (LCP)
4. Lungsod ng Kabataan Children's Hospital (LKCH)
5. Metal Industry Research and Development Center (MIRDC)
6. Music Promotion Foundation of the Philippines (MPFP)
7. National Research Council of the Philippines (NRCP)
8. Philippine Charity Sweepstakes Office (PCSO)
9. Philippine Heart Center for Asia (PHCA)
10. Philippine Institute for Development Studies (PIDS)
11. Technology Research Center (TRC)

FINANCIAL

1. Development Bank of the Philippines (DBP)
2. Government Service Insurance System (GSIS)
3. Home Development Mutual Fund (HDMF)
4. Home Financing Corporation (HFC)
5. Land Bank of the Philippines (LBP)
6. National Home Mortgage Financing Corporation (NHMFC)
7. Philippine Crop Insurance Corporation (PCIC)
8. Philippine Export and Foreign Loan Guarantee Corporation (Philguarantee)
9. Social Security System (SSS)