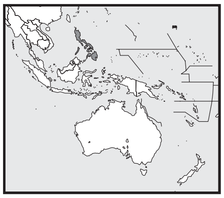
The crisis of financing development



More than two decades after the global debt crisis of the 1980s and the subsequent adoption of structural adjustment programmes, the Philippines continues to face a severe shortage of resources for financing development. Significant funds are still drained by loan payments, while mistaken tax policies limit the mobilization of domestic financial resources. Unless the necessary additional resources are raised, the Philippines will fail to meet its commitment to achieving seven of the eight MDG targets.

Social Watch Philippines
Prof. Leonor Magtolis Briones

The Philippines is one of the countries devastated by the global debt crisis. It struck the country in 1983, one year after Mexico's default triggered the global conflagration that destroyed developing nation economies throughout Latin America, Africa and Asia. The Philippine government dutifully swallowed the bitter pill of structural adjustment imposed by the group of creditor banks led by the multilaterals, in spite of a national campaign calling for selective debt repudiation. Scarce financial resources went to debt servicing at the expense of social services, particularly education and health. Poverty levels escalated.

The devastating effects of the debt crisis still linger. Twenty-one years later, on August 23, 2004, Philippine President Gloria Macapagal Arroyo admitted the existence of a fiscal crisis and conceded that the government was having difficulty managing its mounting deficits. Thus the Philippines, despite its official classification as a middle-income developing country, continues to suffer from massive deficits. The problem of inadequate financial resources persists. The spectre of the debt crisis continues to haunt the economy.

This country's report seeks to identify problems and issues related to financing social development in the Philippines. Obviously, the Government's commitments to the Copenhagen Declaration as well as the Millennium Development Goals (MDGs) cannot be achieved without additional resources.

Obstacles to mobilization of domestic financial resources

It has been two decades since martial law was dismantled and democratic rule was restored in the Philippines. It has also been 20 years since the country endured a series of structural adjustment programmes to solve its huge debt problem. Three presidents have come and gone after Ferdinand Marcos: Corazon Aquino, Fidel Ramos and Joseph Estrada. The current president is Gloria Macapagal Arroyo.

Regressive taxation.

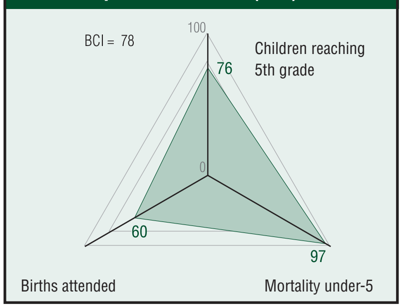
Why are public revenues never enough? There is general agreement that three reasons account for this persistent problem. The first is excessive dependence on indirect or regressive taxation. This has resulted in a double whammy: taxes based on income and wealth are not being fully exploited, and the low-income groups who compose the majority of the Philippine population are bearing the brunt of the tax burden.

The Constitution of the Philippines provides that the government must "evolve a progressive system of taxation." Yet, indirect taxes - particularly sales taxes - have formed the bulk of tax collections since the start of the Philippine Republic in 1946. During the administration of President Aquino, the regressiveness of the tax structure was aggravated by the imposition of the 10% Value Added Tax (VAT) which replaced the sales tax. It was considered the fastest way to generate more revenues. Aquino had inherited the Marcos era debts and needed more resources to pay them off.

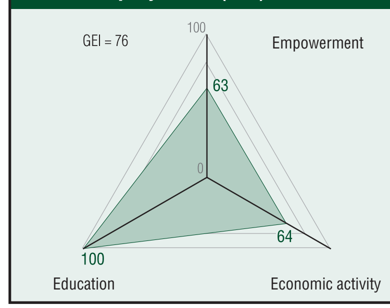
Twenty years later, President Macapagal Arroyo increased the VAT rate to 12% and expanded its coverage to encompass additional goods, including gasoline and other oil products. The reason was the same: her administration was mired in a fiscal crisis. Arroyo's financial advisers gave her a list of eight tax measures. She chose to implement the expanded VAT proposal over the proposals for more income and wealth-based taxes.

For the year 2006, for example, total projected revenue is PHP 969 billion (USD 18.9 billion). Of this total amount, PHP 566 billion (USD 11 billion) will be from indirect or regressive taxes and non-tax revenue. This constitutes 59% of total projected revenue. On the other hand, projected direct taxes total PHP 402 billion (USD 7.8 billion), which amounts to 41% of total revenue.

Basic Capabilities Index (BCI)



Gender Equity Index (GEI)



Inefficient tax administration

Tax administration in the Philippines has traditionally been perceived as both corrupt and inefficient. The government tax collection agencies are considered "flagships of corruption." In spite of the efforts of administrators to change this unsavoury image, public perception has remained largely the same. Inefficiency and corruption have resulted in the non-collection of significant amounts of government revenue.

Tax incentives

A third factor responsible for inadequate revenue collection is the practice of granting tax incentives to attract investors. While the government is passing new tax measures or collecting existing taxes, it is also granting incentives and tax benefits. Last year, the House of Representatives conducted a study on foregone revenue due to incentives. It was found that this amounted to PHP 150 billion (USD 2.9 billion). On the other hand, the projected financing needs of the government for 2006 amount to PHP 125 billion (USD 2.4 billion). Obviously, foregone revenue could have covered all or at least a part of the Government's financing requirements.

While the Department of Finance has been calling for a rationalization of fiscal tax incentives, the Philippine Congress continues to pass laws to provide more incentives, especially to foreign investors. The Board of Investments then grants these incentives. According to a study from the University of the Philippines, "the fiscal incentives granted by the Board of Investments in 2004 alone resulted in a negative economic benefit of PHP 55.72 billion," (USD 1.1 billion) which means that the amount of foregone revenues due to tax- and duty-free privileges was higher than the amount of economic benefits resulting from the investments for which these perks were provided.[1] Thus, while foreign investors are benefiting significantly from tax incentives, host countries like the Philippines are losing heavily and have to turn to regressive taxes and borrowing to cover urgent financing needs.

Limited external sources of public financing

Official development assistance (ODA) is an important source of financing for development in the Philippines. For 2006, for example, ODA accounts for more than 50% of projected funds for MDG-related health sector activities. While government funding is calculated at PHP 687 billion (USD 13.4 billion), expected ODA funding is PHP 784 billion or USD 15.3 billion.[2]

Policymakers tend to prefer ODA funding over borrowing from commercial banks, even if the Philippines does not qualify for grants. Interest rates are lower and terms can be generous. Nevertheless, there are downsides to ODA assistance. Bilateral partners have their own global, regional and country-specific agendas. Levels of assistance are determined by these agendas, even though there might be other national priorities. ODA-funded projects tend to be more costly than locally funded projects because of the involvement of consultancy firms from the donor countries and other service providers. Furthermore, complex and overlapping monitoring mechanisms add to costs.

Borrowing

The Philippines has never really recovered from the debilitating effects of the global debt crisis; the country is still paying debts that were restructured and securitized 20 years ago. Even the Government has adopted the phrase “unproductive expenditures”, which civil society organizations use to describe debt service for debts that were wasted, mismanaged and tainted with corruption.

The following table shows the enormity of the problem. For the past eight years, the percentage share of interest payments in the national budget has been steadily rising. In 1999, 18% of the national budget went to interest payments. This will rise to 32% of the budget in 2006. In 1999, 34% of the budget went to social expenditures. In 2006, this will go down to 28% of the budget. In 1999, 25% of the budget went to economic development expenditures. In 2006, this is expected to go down to 19%. The percentage shares of all other sectoral expenditures are declining. Only interest payments continue to rise.

Department of Budget and Management

It cannot be denied that at present, the government is borrowing not so much for development as for the amortization of loans. For 2006, for example, the Bureau of the Treasury has programmed PHP 221 billion (USD 4.3 billion) in foreign borrowing. Of this amount, PHP 119 billion (USD 2.3 billion) will go to interest and principal payments. Less than one-half is left as net foreign financing, in the amount of PHP 102 billion (USD 2 billion). The situation in domestic borrowing is much worse. The Treasury has programmed PHP 310 billion (USD 6 billion) for domestic borrowing, and of this, PHP 263 billion (USD 5.1 billion) will go to interest and principal payments, leaving a mere PHP 47 billion (USD 916 million) in net borrowing. To summarize, out of PHP 532 billion (USD 10.4 billion) in programmed borrowing, net financing of only PHP 149 billion (USD 2.9 billion) is expected, because the rest will go to interest and principal payments. It is clear that in the Philippines, the debt burden is a major drain on government finances.

Underspending on social development

The Philippines is a signatory to the Millennium Development Declaration and has committed to attain seven of the eight MDG targets by 2015. Social Watch Philippines has consistently advocated adequate financing for the MDGs since 2000.

Social Watch Philippines was a key player in the unique process that mobilized civil society, government, the private sector and the donor community in producing a country position on financing the MDGs. It monitors achievement of the MDG targets and has raised issues ranging from statistical methodology and disaggregation of data to inadequate financing.

On June 22, 2006, Social Watch Philippines launched a new book in cooperation with the United Nations Development Programme (UNDP) and graduate students from the National College of Public Administration of the University of the Philippines. Entitled *Moving Forward with the Millennium Development Goals: May Pera Pa Ba?* (Is Money Still Available?), the book raises two major questions: Is there money available for the MDGs? And if there is money, is it adequate? The Department of Budget and Management was asked to submit a write-up on budget allotments for the MDGs. These numbers were compared with resource requirements for the MDG targets. The findings were astounding.

In the education sector, for example, the MDG target of universal primary education would require PHP 133 billion (USD 2.6 billion) in 2006. But the budget for education in 2006 is PHP 119 billion (USD 2.3 billion), which means the resource gap is PHP 14 billion (USD 273 million). The picture for health financing is just as dismal. The resource gap is calculated at PHP 7.5 billion (USD 146 million). What is surprising about health financing is that the donor community is contributing more to the health budget than the Government itself. The table below shows that while available resources from the Government amount to PHP 687.4 billion (USD 13.4 billion), the donor community is contributing PHP 783.7 billion (USD 15.3 billion).

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TABLE 1

Percentage share of budget expenditure by sector (1999-2006)

	1999	2000	2001	2002	2003	2004	2005	2006
Economic Services	25.25	24.5	20.18	20.19	20.59	18.06	17.54	18.72
Social Services	33.81	31.21	31.04	29.84	28.79	28.77	28.02	27.91
Defence	5.03	5.31	4.68	5.91	5.39	5.09	4.87	4.98
General Public Services	17.64	17.95	17.15	17.12	17.12	15.93	15.50	15.33
Net Lending	0.09	0.38	1.00	0.78	0.68	0.64	0.84	0.78
Interest Payments	18.17	20.65	25.95	26.16	27.44	31.51	33.24	32.28
Grand Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

TABLE 2

Financing for health related MDGs - Summary

MDGS programs & projects	Total cost (PHP)	Department of Health funding (PHP)	ODA (PHP)	Budget gap (PHP)
Reduce Child Mortality	1,469,938,544	370,544,000	3,500,000	1,095,894,544
Improve Maternal Health	4,825,928,227	107,880,277	11,230,000	4,706,817,950
Combat HIV/ AIDS, Malaria & Other Diseases	2,692,233,557	208,976,667	768,978,810	1,714,278,080
HIV/AIDS	358,253,587	22,899,667	153,377,920	181,976,000
Malaria	1,727,102,970	19,200,000	354,400,890	1,353,502,080
Tuberculosis	606,877,000	166,877,000	261,200,000	178,800,000
GRAND TOTAL	**8,988,100,328**	**687,400,944**	**783,708,810**	**7,516,990,574**

Source: Department of Health

1 Remo, M. (2006). “DOF wants to limit tax perks grant”. *Philippine Daily Inquirer*. 10 July, p. B11.

2 Department of Health.

PERU

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But the road ahead is still long and difficult. There has been some progress and there is a climate of rejection for the economic and political system, but the movements for concerted action that have sprung up are lightweight compared to the whole framework of economic, coercive and symbolic power that perpetuates a system that is unjust and intolerable for the majority of Peruvians. ■

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PHILIPPINES

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Additional sources of financing

Social Watch Philippines does not limit itself to exposing problems in financing for social development. It has analyzed the budget rigorously and has identified specific expenditure items which can be utilized for social development, such as the special purpose funds of the President, the unprogrammed funds in the budget, and the pork barrel allocations to legislators. It has also proposed revenue sources other than regressive taxes, as well as measures to improve revenue administration. At present, it is working closely with selected legislators towards a more people-oriented budget. It continues to monitor the country's debt and works with the UNDP on feasible solutions.

The Philippines' financial problems are formidable. Social Watch Philippines continues to campaign for the interests of poor Filipinos through mass actions, information campaigns, rigorous research and the formulation of viable alternatives. ■

ROMANIA

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Since 2005, NGOs have been involved in the process of developing a Romanian platform of non-governmental development organizations (NGDOs), within the framework of TRIALOG, a project of the European NGDO platform CONCORD (the European NGO Confederation for Relief and Development). Throughout 2005 and 2006, NGOs were involved in the elaboration of the National Strategy for Development Cooperation drafted by the Ministry of Foreign Affairs (MFA).

The priorities for NGOs in this respect are to ensure that the Government meets its commitments with regard to ODA expenditure levels, and that ODA spending is based on genuine partnership with communities in the beneficiary countries, addressing their specific needs and respecting their concerns. Another focus is on building capacity for civil society to become more aware and to engage more actively in the field of international development and humanitarian aid. Due to the lack of previous interest in this area, a considerable amount of effort has to be dedicated to increasing public awareness through development education campaigns. ■

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SPAIN

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It is clear that Spanish trade policy is still operating exclusively to promote the interests of Spanish enterprises and strategic sectors, and this leaves little room for manoeuvre when it comes to adopting policies to support the Southern countries in line with agreed plans for international cooperation. Probably the biggest challenge facing the Spanish government in this sphere is how to change this trade policy, but it has to be changed because this is the only way Spain can progress from cooperating in development to actively fostering development.

Conclusions

The Spanish government has made an economic contribution to international cooperation for development, and it is increasingly showing signs that it will back up its declared political intention to help the countries of the South. This is certainly an improvement on the policies of previous governments and it is a good sign, but not enough is being done.

What is needed is a courageous and far-reaching reform in foreign policy so that the extremely urgent needs of developing countries will no longer be subordinated to Spanish economic interests, and this involves a lot more than mere political posturing or a percentage increase in the development cooperation budget.

The present government has raised high hopes not only among civil organizations in Spain but also on the international stage. Now it is time to move on from gestures and take real effective action. If development is to be fostered, there is still a lot to be done in spheres like agricultural, investment, trade and development policies. And this applies not only inside the country but also in the international ambit, where Spain has the opportunity to follow through on her commitments and pull her European partners in the same direction. This is the least we might expect from one of the members of the Quintet Against Hunger and Poverty.[2] ■

2 A joint initiative on the part of Brazil, Chile, Spain, France and the United Nations aimed at cutting poverty indicators by half before 2015.

THAILAND

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Civil society's proposals

There should be public participation in the budget process at all levels. People must be provided with more information and increasingly take part in national financial management. At the same time, horizontal networks of financial management for public welfare must be expanded in earnest.

Every effort should be made to promote a widespread and effective social welfare system, as well as the passage of the National Health Security Act to ensure that all Thai people will be equally entitled to health services. ■