



PROCEEDINGS

Policy Dialogue Series 2004: Academe Meets the Government on the Philippine Economy

SEPTEMBER 9, 2004
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UNIVERSITY OF THE PHILIPPINES-DILIMAN

TERESA S. ENCARNACION TADEM (DIRECTOR, THIRD WORLD STUDIES CENTER, UNIVERSITY OF THE PHILIPPINES [UP]-DILIMAN): For 2004, the Third World Studies Center hosted and will continue to host a series of forums. The first of these was the “Academe Meets the Political Parties” held in March, which served as a venue for the academic community and the major political parties and party coalitions to discuss and debate on each party’s long-term programs and policies on the economy, foreign relations, and peace and order. The second of the series was the “Academe Meets the Party-List Representatives” held last August, which assessed the Party-List System Act or Republic Act (RA) 7941 vis-à-vis the performance of party-list groups in terms legislation and electoral viability as well as their prospects under this law. This third installment entitled “Academe Meets the Government on the Philippine Economy” endeavors to examine the trajectory of the macroeconomic policies of the Arroyo government for the next six years. This forum is most timely as it comes at a time when the Arroyo administration has called for austerity measures amidst the warning of the specter of an economic crisis by eleven faculty members from the UP School of Economics, as expounded in their paper on the

“Deepening Crisis: The Real Score on Deficits and Public Debt.” We are, therefore, most fortunate to have members from the government with no less than Secretary Romulo Neri of the National Economic and Development Authority (NEDA) who will be joined by Undersecretary Mario Relampagos of the Department of Budget and Management (DBM), Undersecretary Gracia Pulido Tan of the Department of Finance (DOF), and Undersecretary Elmer Hernandez of the Department of Trade and Industry (DTI). We are equally fortunate to have three respected reactors from the academe—Prof. Maria Socorro Gochoco Bautista of the UP School of Economics, Prof. Cristina Morales of the Department of Economics, Ateneo de Manila University; and Prof. Amado Mendoza Jr. of the Department of Political Science, UP-Diliman.

ROMULO NERI (DIRECTOR-GENERAL, NEDA): What I plan to do is present president Gloria Macapagal Arroyo’s national development agenda and later on I will talk about the Philippine political economy. The Philippine political economy is basically my own and the framework that I will present is my own framework, which I probably do not present in Malacañang but I would present in a more open academic circle. Anyway, let me start first with the national development agenda. First, I will start with the president’s own works. For her targets and basic tasks, she says in the next six years she must create ten million jobs, triple the loans to micro and small business owners, build 6,000 classrooms a year, grant a scholarship for every qualified student from a poor family, put a computer in every school, bring electricity to 45,000 *barangays* (villages) and reduce its costs to become the lowest in the region, bring clean water to all towns and Metro Manila *barangays*, reduce by half the price of commonly used medicines, and we must do so with fiscal discipline. We must increase revenue collection, clamp down on tax cheats, and cut waste, fraud, and abuse in our government. We must fight for self-sufficiency in rice and food production, fight for new roads, bridges and highways to link our nation, and fight for more property rights and more legal rights for our people. To achieve the president’s 10-point legacy are as follows:

1. create ten million jobs in the next six years,
2. increase the growth to a sustainable seven percent or more up to the year 2010,

3. bring the poverty incidence from 34 percent down to 17 percent,
4. increase investment rate from 19 percent of gross domestic product (GDP) to 28 percent of GDP in two years,
5. increase exports from USD 38 billion to USD 50 billion in two years, and
6. develop two million hectares of agribusiness land and support three million business entrepreneurs.

The next issue is balancing the budget and we have proposed the following legislative measures:

1. gross income taxation for corporation and self-employed individuals,
2. indexation of sin taxes,
3. increase in excise tax on petroleum products should the global prices go down for petroleum products,
4. rationalization of fiscal incentives,
5. general tax amnesty with the submission of the statement of assets and liabilities (SALs),
6. lateral attrition system,
7. franchise tax on telecommunications to replace the value-added tax (VAT), and
8. a two-step increase in the VAT rate.

However, these are things that we can do later on. I think the most urgent here is the indexation of sin taxes and the rationalization of fiscal incentives. Next, to balance the budget, we will:

1. push for the enactment of the Fiscal Responsibility Bill—meaning, no new expenditure without any new revenue measures,
2. push for the enactment of an Omnibus Reengineering Law,
3. rationalize the existing pension or retirement scheme of all uniformed personnel and veterans, and
4. remove the automatic guarantee provisions in certain government-owned and -controlled corporations (GOCCs).

Still on balancing the budget, as we all know, the National Power Corporation (NAPOCOR) is a big drain on the budget. To address these NAPOCOR losses, we need to privatize the transmission and generating plants but at competitive prices. To do so, Congress needs to pass the National Transmission Company Franchise Bill and the Energy Regulatory Commission has to formulate the pricing policy and regulatory mechanisms that make returns and risks manageable for investors. We also have to address the issue of access to Manila Electric Company's distribution lines to ensure the security of long term power generation costs of generating companies, promote greater competition among the generating companies, and effect the more efficient power mix among the generating companies.

On infrastructure. Philippine infrastructure and capital outlay performance vis-à-vis other East Asian countries has been lowest, averaging a mere 3.3 percent of GDP against other Asian countries of about five percent to six percent of GDP. The poor quality of Philippine infrastructure has been perennially cited as the main problem in the country's global competitiveness. What we plan to do is increase a spending on public infrastructure by an incremental PHP 100 billion per year. Our GDP is about PHP 5 trillion so PHP 100 billion represents a two percent increment to bring our spending on infrastructure to at least five percent. How to finance this is the main challenge. We need to find creative and less conventional ways such as project-based financing and the creation infrastructure corporation out of the National Development Corporation to secure funding for these projects. We also need to promote global competitiveness and exports to create jobs. To strengthen and maintain our global competitiveness and create the 10 million jobs, we will focus on the five strategic measures. One, make food plentiful at reasonable prices to make our labor costs globally competitive. Second, reduce the price of electricity to make the costs of running our machines and our manufacturing processes regionally competitive. Three, modernize physical infrastructure and logistics system at the least cost to ensure efficient movements of goods and people. Four, mobilize and disseminate knowledge, upgrade our technologies, and increase our people's productivity. And five, reduce red tape in all government agencies to reduce transactions costs. Let me put this in a framework—you have the worker, or the labor; you have the machinery and the production processes; then you have the transportation, handling, and warehousing; and, finally, you want to deliver quality products and

services to the consumer at competitive prices. As you will see, the first is food as it affects wages—you make food plentiful at reasonable costs. Second is electricity, as it affects power costs. Third is knowledge as it affects technology and productivity. Fourth is on infrastructure, which is logistics costs, as it affects transportation, handling and warehousing. Finally, the government's intervention to ensure that we can market better, provide information and promote Philippine products. In all of these, we need to reduce red tape in these types of businesses.

On macroeconomic thrusts to create jobs. In agriculture, we wanted to develop the two million hectares of land for agribusiness and reduce the costs of rice, corn and sugar and other wage goods for greater productivity and efficient transport and logistics. In terms of mining, we want to encourage mining projects that are environmentally sustainable by reducing the time to get exploration mining permits and quickly resolving issues pertaining to the Indigenous Peoples Rights Act. On housing construction, we have a huge housing backlog, it has a potential to employ a million workers in the next ten years.

Other microeconomic policies to create jobs include:

1. power generation by promoting greater efficiency through distribution and access, as well as promote competition among generating companies;
2. further liberalize the airlines industry to boost tourism;
3. increase shipping competition and demonopolize our ports;
4. reduce high costs and address policies that keep prices of medicine high;
5. take advantage of the voice over internet protocol (VOIP) to reduce long distance calls to immensely benefit our overseas Filipino workers (OFWs) and their families; and
6. provide credit, technology and marketing support for small, medium and microenterprises.

On mobilizing knowledge to create jobs and increase productivity.

The first priority is to disseminate knowledge and technology to the rural poor; increase monetary support for research and development (R&D) and field extension work; strengthen the Philippine Council for Agriculture, Forestry and Natural Resources, the Philippine Rice Research Institute, and other provincial extension models; and promote extensively mariculture activities with mangroves and fish sanctuaries.

The Land Bank of the Philippines, Development Bank of the Philippines (DBP) can provide financing for state colleges and universities' demonstration projects, as well as provide financing for small and medium enterprises (SMEs), ladderize interface between vocational and technical courses and college. In the job creation thrust in the high-skilled areas, we are looking at software business process outsourcing, call centers, fashion garments, jewelry and medical services. In medium-skilled areas, we are looking at tourism, hotels and restaurants, entertainment, mining, agribusiness and mariculture. In the low-skilled areas, we are looking at construction, SMEs and microcredit.

On efficiency in public spending and infrastructure. We will be operationalizing the Medium-Term Public Investment Program, continue to strengthen processes in the NEDA Investment Coordination Committee that reviews big projects for the government; complete the nautical highway and the Roll-on/Roll-off system to transport the produce of Mindanao to Visayas and Luzon, encourage to finance the local government units (LGUs) to build their own infrastructure rather than national government agencies, align budgetary appropriations including the pork barrel or the Priority Development Assistance Fund to the president's 10-point program. We also need to fully implement executive order (EO) 278 that prescribes guidelines for project loan negotiations and packaging of government foreign-assisted infrastructure projects to ensure fair participation of local contractors and consultants, encourage bids for design to ensure the most cost-efficient project design and avoid overpricing of projects, address critical infrastructure bottlenecks, set quality and price standards with the Department of Public Works and Highways (DPWH), and fully widen the use of e-procurement and allow outside observers in the bidding process.

On specific anti-poverty measures. Philippine poverty is basically rural poverty with 73 percent of the country's poor residing in rural areas. Rural poverty level is at 48.8 percent as against the urban poverty level which is only at 18.6 percent. Of the 18.6 percent urban poverty, Metro Manila accounts for only six percent. In response to this, we have the President's six pledges for the poor:

1. six million jobs for the poor,
2. clean water,
3. power for the entire country,
4. close the classroom gap,

5. low-cost medicines, and
6. livelihood and credit for micro-, small and medium enterprises.

In response to rural poverty, we encourage diversification of agriculture and off-season livelihood supported by extension services, microlending and the *Kapit-Bisig Laban sa Kahirapan* (Arm-in-Arm Against Poverty)-Comprehensive and Integrated Delivery of Social Services Project measures. We should also pursue the passage of the Land for Loan Collateral bill; food support for learning programs to ease school dropout rates in poor communities; emphasis on maternal and child health, women's health, family planning, and nutrition; affirmative action for Muslim Mindanao and conflict affected areas; and indexation of health and education budgets to the growth of the national economy.

On managing natural resources and environmental and spatial planning to create more jobs. Development plans should consider the archipelagic economy and its fragile island ecosystems. We will maximize physical planning as a development tool for greater job creation, develop maritime basins and major rivers as transport and trading areas, extensively implement mangrove tree planting as fish sanctuaries, have reforestation projects be rationalized, and prioritize watersheds and areas to preserve rivers and other fresh water systems.

On decongesting Metro Manila. There is a need to decongest Metro Manila by developing new centers for government, business and housing in each of Luzon, Visayas and Mindanao. We must focus on beginning the construction of commuter links between Metro Manila North to Clark by the Northrail Project and South to Batangas Port and complete the toll road all the way to the Batangas Port. This will make housing projects outside of Metro Manila, where land is cheaper and more conducive to family life, more viable. Once developers see the construction of the transport links breaking ground, they will begin working on auxiliary housing projects. Within Metro Manila, we must complete the Metro Rail Transit's (MRT) final linkage with the Light Railway Transit. Also within Metro Manila, the Metro Manila Development Authority, DPWH and the Philippine Amusement and Gaming Corporation must review the infrastructure programs to ensure that programs make sense and will produce visible results quickly.

On specific projects for investors and wealth creation. One is the development of Clark-Subic or the Diosdado Macapagal International Airport as the best service and logistics center in the region. We will link Northern Luzon to the Taiwan-Southern China-Hong Kong growth triangle, develop the Southern Tagalog Arterial Road Expressway as an industrial belt south of Metro Manila. We will develop the San Fernando airport and the Aparri port as gateways to Northern Luzon and the Panglao airport, the North Palawan airport, and the Iloilo airport as tourism gateways to central Philippines. We will enhance the following tourism complexes: Metro Manila, Cebu, Bohol, Siargao, Northern Palawan, Boracay, Clark, Subic, Cordillera, Ilocos, and Davao. We will tap more geothermal springs, develop our natural gas fields and use the gas for transport and power. We have to promote the national shipbuilding industry, and let the Natural Resources Mining Development Corporation develop Diwalwal and other mining sites. We will develop Poro Point and Lingayen Gulf as export outlet to Southern China. And finally, develop the Southern complex all the way to Bicol and build dormitory suburbs linked to railroad house.

I will now go to issues of political economy and the reasons it has been very difficult for the Philippines to grow faster. We will start with policy distortions and region situations and the main reason is that we are basically being dominated by the oligarchic elite who influence policies and appointments. Policy distortions and weak institutions as dominated by the oligarchic elite allow them to capture economic friends and therefore economic powers that allow them also to finance elections. Now, what is the impact of these policy distortions and weak institutions? One, it makes it very risky for investments to come. When policies are distorted and institutions are weak, you will have a high-risk perception by investors and therefore low investments. That is why Philippine investment rate is very low compared to other Asian countries. Therefore, if the investment rates are low, you will have low economic growth. Impact on the poor is high unemployment and low income. The same policy distortions and weak institutions produce corrupt bureaucracies, resulting to breaking of rules and diversion of expenditures. Corruption—say a combination of high cost and high risk—discourages investments in our country. As a result of this diversion on spending, you have limited social services and the bribery tax which impact on the poor. The final impact on the poor is poor education, poor health and low respect for law. The effect is a weak

state, poverty and social chaos—all the vicious cycles operating in our country and this explains the challenges that we face.

Paul Hutchcroft's cross-matrix divides states into rational-legal and predatory. On the one side, you have a state more powerful than business and on the other side business more powerful than the state. The best state is a *laissez-faire* regulatory state, where laws and regulations are done for the good of everybody and business dominates the economy. The state does not participate much on the economy. The next best is the developmental state, still a rational-legal state, but state tends to dominate the economy. In the first one, we have the countries like the US, United Kingdom (UK), and Hong Kong before it became part of China. For developmental states you have Singapore, Japan, South Korea, and Taiwan at its earlier developmental stages. Where the state is more powerful than business, it is a predatory state like Suharto's Indonesia where the generals were very powerful. Finally, we have the oligarchic state or the booty capitalistic state. Booty capitalistic because the oligarchs who finance elections win the elections with their candidates, thus they get all the booty. The worst state to be in is an oligarchic state. Investors would rather invest in a bureaucratic capitalistic state like China, Vietnam and even Indonesia because corruption is more predictable. In oligarchic states, the result of corruption is very unpredictable and very risky to do business. I will now summarize my presentation with this framework.

Let us start with the need to mobilize revenues and strengthen the capital markets. If we do that we will have an efficient public spending, investments in infrastructure and others, and therefore stabilize the fiscal side. We will have a stable macroeconomy and a stable fiscal and balance of payment situation. As a result, risks should go down and the risk of financing should also go down. And if that happens, we would have more private investments, more competitive and vigorous enterprises. Our export and foreign exchange reserves will be boosted. Next, by also solving, mobilizing revenues in capital markets, we would have more spending for infrastructures and more efficient public spending. Again that will help in our objective of increasing investments, promoting vigorous enterprises, and increasing exports. On microeconomic reforms that I have said earlier, again, central to these reforms is to increase investments and strengthen our enterprises. Another one is the mobilization and transfer of knowledge for greater productivity, again to effect the same objectives. Next is reform in the political economy. When you reform the political economy, we will

have good and predictable policies; reduce corruption and red tape in government. Again, when we reform the political economy and reduce the red tape and have predictable policies, this will again help achieve our objective of increasing investments and improving our enterprise situation. Again, law and order is important and societal value formation leading to law and order will enhance our investment climate. By doing these, investments will go up, competitive vigorous enterprises and exports and reserves go up. We will have a faster GDP growth, more jobs, and meet our people's basic needs better. The quality of life of our people will improve and societal value formation also improves the people's quality of life.

MA. GRACIA PULIDO-TAN (UNDERSECRETARY, DOF): Let me just do what I can to at least apprise you of where we are, how we got there and what we intend to do, at least, in so far as our revenue efforts are concerned. The year 1997 was a very good year in so far as our revenue performance is concerned because we reached the highest ever in tax effort—that is, the ratio of revenues to GDP was at 17 percent. Since then, it has steadily gone downhill. Today we are at 12.5 percent of our tax effort, which is the same ratio as our tax effort in 2002. Several reasons have been advanced for this sorry state of affair. Among other things was the financial crisis of 1997. However, it has been seven years since and we do not seem to be looking at a recovery. In fact, if we compare ourselves to our neighboring Asian countries, we are still at the bottom of the pack in terms of revenue to GDP ratios as well as tax effort. I am talking here of Malaysia, Thailand and even Vietnam and Indonesia. They all have much higher tax effort ratios than we have considering that we have all been hit by the 1997 financial crisis. So what really were the reasons for the performance of the Philippines? We have been looking at this for quite some time and we believe that one of the greatest impacts on our performance now is the Comprehensive Tax Reform Program (CTRP), which was adopted in 1998. First, it cut the tax rate of corporations from 35 percent to 32 percent. That three-percent point translates to a very, very hefty difference. Second, it increased the allowable deductions which, in the first place, covered a lot of areas. One example is the Network Operating Losses Carry-Over, which means that losing companies are allowed to deduct their losses in prior years against future years' income. This means they are exempted from paying taxes. But there is a corresponding safety net for this. We have what we call the Minimum Corporate Income Tax,

which requires losing companies to pay at least two percent of their gross revenue. However, our performance in so far as this particular tax is concerned is also not very good. Of course, there is the perennial problem griped about tax evasion, graft and corruption. Admittedly, there are no ifs and buts about it. In fact, it contributes to our poor performance in so far as revenues are concerned. It is about time that we also have to realize that while it is a problem, we are part of that problem and, therefore, we must also be part of the solution. One of the reasons why our tax enforcers from the Bureau of Internal Revenue (BIR) engage in corrupt practices is also because of the lack of compliance or tax evasion of some taxpayers. Noncompliance of taxpayers gives our tax enforcers an excuse to extort money from tax evaders to let them off the hook. What we are saying is that when we talk of tax effort, of revenue performance, this does not involve our collectors alone. The BIR is not the only one accountable for this effort. I think whatever reform we need to do must come from ourselves, from taxpayers. We are more than the BIR; we are the stakeholders in the revenue performance of this country. So what do we want to do? Our hope in the DOF and the rest of the economic team is very simple: we want to be able to have a revenue-GDP ratio of 17 percent.

Let us now discuss the policy objectives. Our policy objectives include balancing the national government budget by 2009. When we say a “balanced budget,” our revenues will be enough to meet our planned expenditures. In the national government level, we want to reduce the ratio of our consolidated public sector deficit to GDP to three percent. We also want to reduce our public sector debt to GDP ratio to 90 percent by 2009. The public sector debt at present, I think, is about 135 percent of GDP. Reducing it to 90 percent by 2009 will be very significant. So, the economic team has come up with a whole package of measures—reform and structural—to address and to meet all of these objectives. I want to assure you and I want to disabuse any misconception that anyone might have that the economic team only sees imposition of new taxes as the only solution. There other measures, which Undersecretary Relampagos will also be talking about later. Very briefly, I would like to discuss eight measures with you today. These measures will show us that this is not about imposing new taxes but more about reforming the structure that we have now in the hope that when we do, it will enhance our revenue raising enforcement and administration capabilities. The impact of our revenue performance

will almost be unquantifiable because of the improvements in the system that we hope will materialize.

The indexation of excise tax on sin products—the tax imposed on alcohol and cigarettes—before 1998 were under the ad valorem system. Ad valorem is the tax imposed based on the difference between the products' price before taxes and the cost to produce the product. We had a lot of problems then because this pricing is declared by the manufacturer, thus giving them liberty to declare the price of the product as well as the corresponding tax they have to pay. This was one of the bad aspects of the ad valorem tax system. What we did was to go to the specific tax. This means that the tax is fixed at per pack of cigarette or per bottle of beer, for instance. This is pegged on retail price in the market, specifically in the supermarkets. In this manner, there is some sort of a third party validation of the commodity's price. This is a better system but we were unable to index this. Indexing is needed because the price or the rate is not stationary, meaning it increases with inflation. That is what we want to do now. This is not really a new tax; we are just reforming the system to be able to catch up with the effects of inflation. I think we should not feel bad about imposing this tax because it will cover vices. While others argue that the poor will be most affected by this because these are the only luxury they can afford but these are still vices. Statistics from the Department of Health (DOH) show that in 2003, we spent PHP 27 million in health care costs for diseases related to smoking. This does not include diseases caused by alcohol consumption. Then we also had losses in productivity and other consequences of drinking and smoking, which the DOH estimates to cost at PHP 46 billion. This is not even half what we generate from taxes from tobacco and alcohol. So that is the rationale behind the indexation of the excise taxes on sin products.

On the rationalization of fiscal incentives, we offer a lot of tax incentives to encourage economic development, particularly foreign investments. We fully support the idea of granting incentives but we recently learned that there are about 124 pieces of provisions of laws that grant tax incentives. While we wanted to focus providing incentives to local and foreign investors, there was a resulting proliferation of incentives. Undersecretary Hernandez of the DTI will talk to you more about the fiscal incentives on the Philippine Economic Zone Authority (PEZA), Board of Investments (BOI), and others which we can really call the merit incentives. What we are trying to look into are those that are without merit, which we can take out from those being afforded

incentives. In terms of those special laws, based on our estimates of incentives availed by non-merit goods or non-merit transactions, this has amounted to PHP 55 billion in 2003 alone. I am not referring here to those under the BOI and PEZA. That is already 20 percent of our total deficit. But we forewent those taxes because we want to “incentivize” certain activities, certain interest groups among others. That is the focus of our rationalization.

On the general tax amnesty with the submission of assets and liabilities, the SAL is nothing but a listing of assets and liabilities. The difference of the former from the latter is the net worth. What we are proposing is that all those earning more than a PHP 100,000 per annum, or even those not earning but has properties valued at more than PHP 100,000, will have to file a SAL annually. If they want to avail of the amnesty, that will still be possible. The amnesty is optional but what we want to do is to make the submission of the SAL mandatory. There are some who favor the amnesty while others do not. Some say that it is a moral hazard. If it is possible not to avail of the amnesty in the filing of the SAL, we encourage citizens to do that. But we cannot also close our eyes because we have to admit that it is something we need to do to clean the house. If we want reforms, especially in the tax area, to really bear fruit in the future, we have to clean the house first. In 1998 when the CTRP was enacted, that was a big overhaul in the tax system. That would have been a very good time to do an amnesty, especially because there were shifts in certain tax treatments. But this did not happen. The things of the past are still catching up with us. So, we want to do an amnesty if only to clean the house and increase the tax fees. What is more important for us is the submission of the SAL. The other thing about tax amnesty is that it should be under certain terms and conditions and not a matter of amassing money. With the tax amnesty, We are projecting PHP 9 billion in revenues. But the PHP 9 billion will amount to nothing if the submission of the SAL is not mandatory. It is going to be just a one-time fund raising drive. After that, it will be forgotten and we will go back to our old ways. Perhaps in the next years or so, there will be a need once again to discuss the tax amnesty. So, without the mandatory submission of SAL, we will not be satisfied with the tax amnesty alone. They have to go together.

For the two-step increase in the tax rate, the VAT is the perfect one. It is the only system that has a built-in self-checking mechanism because of the input-output mechanism of the VAT. But what we have now is a leakage because of underdeclaration of sales. A lot of our vendors get

away with it because majority of consumers are not interested to claim receipts. If a receipt is claimed, there is an additional 10 percent in the amount because of the VAT. If receipt is not claimed, the 10-percent tax in that particular sale will not be charged. That behavior feeds on the chain of corruption and leakage in the system. Again, we have to face the fact, I think, that we are part of the problem. So what are we proposing with the two-step increase in tax rate? Let us give everybody this one last chance to help each other—meaning taxpayers and our administrators should improve the efficiency of the VAT because right now, our VAT effort is about three percent. Our system can potentially generate up to seven percent efficiency. We will be satisfied if by next year we will attain an efficiency of four percent and I think it is very doable. If we do attain four percent efficiency then the VAT rate will stay at 10 percent. That is a promise we are making if we help each other out to increase the efficiency so that we can bring the leakage back to the system. In 2005, we believe that we should push ourselves a little farther and let us go for five percent efficiency, which we think is doable. If we get to this efficiency, the VAT will stay at 10 percent. So, it is up to us to decide whether we will go for an increase or not. I think from a potential of seven percent and our target of four percent in the first year and five percent in the second is peanuts if we just do our share, we are very optimistic that we can get there.

On the excise tax on telecommunications, I think this is the reason why we are flooded with complaints. We are actually not considering imposing tax on text messaging. Rather, what we are looking at is a tax on the telecommunications companies and all other companies, for that matter, which use our airwaves. Our theory is that all our country's resources are owned by the government. When we say government, that includes us, so any use of these resources by anyone should be regulated and should be properly compensated. Right now, if we look at mining, for example, we have an excise tax on mining because they extract minerals from the earth, which is a finite resource of the state. Mining companies also pay the VAT. The same goes for the telecommunications companies (telcos) because they are using the airwaves. That is our idea on the excise tax on telcos.

On increasing the excise tax on petroleum products, again, our problem is the same with the sin taxes that we discussed earlier. We are now on specific tax system but we have not indexed this yet. We have the lowest rate of taxes on petroleum in the whole of Asia. But petroleum products are not the same as cigarettes and alcoholic

beverages in the sense that these are prime commodities, principal and basic commodity. The transport sector uses about 80 percent of all petroleum products, which makes it very sensitive. The plan is to impose a two-peso increase in the tax on petroleum products. We are with the Department of Energy on how to best mitigate the inflationary impact of this proposed tax. As of this time, I will not be able to tell you any concrete plan in this area because we are still carefully studying this. Right now, what we are very sure of is that we will exempt liquefied petroleum gas, which is currently exempted, we will continue with the exemption of kerosene. Kerosene is not exempt right now but we will probably keep it at the same level because it is used all over the country especially by fishermen and farmers. So, we may just have to keep kerosene at the present level.

Now on the lateral attrition system, again this is not really to generate taxes and it will not impose new taxes but this is to enhance the system. In terms of lateral attrition, our revenue-raising agencies, particularly the BIR and the Bureau of Customs (BOC), have their performance targets. If they do not reach these targets, they will be demoted to a less sensitive and less responsible position. If they exceed their performance goal, then we will reward them accordingly. These are measures to encourage everybody to do a better job in tax collection.

Finally, let me go the gross income tax system for corporations and self-employed. This is the most difficult because this involves a very comprehensive review of the system. This is the gist of the income tax system at present. By next month, we will still be able to come up with a more concrete idea on what the design will be, but right now, let me just tell you that what we are looking into is really how to limit the deductions so that taxpayers are not exploited, and thereby reduce their taxable income. Therefore, they will be paying less.

MA. SOCORRO GOCHOCO-BAUTISTA (PROFESSOR, SCHOOL OF ECONOMICS, UP-DILIMAN): There seems to be a great disjoint between what Secretary Neri discussed and what Undersecretary Tan is talking about. Secretary Neri was looking at the process of development and growth while Undersecretary Tan was talking about specific tax measures to deal with the fiscal crisis that we are undergoing at the moment. Looking at Secretary Neri's presentation, we are looking at the basic tasks and fighting targets. You cannot argue with these things because these are basically a wish list. But if you look at the fighting

targets—create 10 million new jobs, increase growth to a sustainable seven percent or more up to 2010, bring poverty incidence down from 34 percent to 17 percent—these are all problems or proposed solutions which obviously require structural change. Being able to contain monetary deficit is not really going to address the fundamental structural problems that we have in order to achieve these fighting targets.

Having said that, I do have many questions and comments regarding the measures being proposed to balance the budget, but I would address the questions to Undersecretary Relampagos later. My other comment on Secretary Neri's presentation goes to the heart of the role of government. What is the role of government in all these? You talked about the microeconomic thrusts, for example, to create jobs. Who will want to create jobs? What is the role of government in creating ten million or six million jobs? Government provides public goods, infrastructure. It also regulates certain industries. When we talk about economics being the role of government in the economy; when you talk about reducing the costs of rice, corn and sugar, and other wage goods, or develop two million hectares of land, the whole point being what exactly is the government doing here. Does it intend to intervene in the workings of the private market, private sector, the market economy? Or, is it not its role basically to set up an incentive system, provide the public goods, set up the correct regulatory agencies so that the incentives facing private actors in the economy are correct and, therefore, you get the jobs, the investments, the low-cost goods from the workings of the private system? I do not subscribe to this and it is not specifically stated but it is not clear exactly how interventionist government intends to be. We have seen how and when the government becomes interventionist such as in the pricing of power. We create problems that we have to try and deal with as in the case of the deficit today. So, Secretary Neri, in that whole explanation about creating wealth and all these, government has to find a way to make the market system work. It clearly cannot take on this role by itself for the following reasons: it has a huge deficit and we have a weak state, as you said.

If you look at governance, clearly governance is important in the efficient working of the economy. We cannot assume that government is the solution and we will actually be able to achieve all these goals that you have said. Government has an important role to play but how interventionist it will be, given the current state of affairs, including the

historically weak state that we have had, makes me a little bit anxious about all the goals that have been said. I think we should dissuade ourselves from this impression that the government is the solution to everything. I mean, when the DTI Secretary goes to the market and looks at the price of basic goods, is that supposed to tell the Filipino consumer that government has the power to change the price of *galunggong* (round scad) or the price of rice? No, this is also partly the problem. What really is the role of government? How can we prevent some of the political intervention of the government in the workings of the market such as pricing policies to prevent the problems such as the one we have now from arising?

MA. CRISTINA MORALES (INSTRUCTOR, DEPARTMENT OF ECONOMICS, ATENEO DE MANILA UNIVERSITY): I would only comment on Secretary Neri's presentation and will withhold my comments about the fiscal crisis and the fiscal policies, or fiscal options. I like the presentation in the sense that Secretary Neri has this talent for presenting things in a very organized framework and a framework that makes sense. However, my own feeling is that there is still much on the framework of heavy reliance on the free market which I do not have much faith in. I do not have much faith in the government either. A bad government will definitely do great misdeeds to your economy and to the developmental process. But the free market, as we have seen in the past decades, is also not the solution to any of our problems, particularly the problem of underdevelopment and poverty. I have always said that God is in the details but unfortunately, so is the devil. We say that we want self-sufficiency in rice and yet, our fighting target is to develop agribusiness. We know that in the rice sector, it is the small farmers who suffer most. In particular, the hybrid rice program of the government, which the government has been trying to promote in recent years, has been, in reality and in the experience of farmers, unsustainable. We plant the hybrid rice seeds one season; the next season you have to buy new seeds so that you can get a high yield. In other words, simply addressing agribusiness will not be able to address self-sufficiency needs of this country and it will definitely not be able to address the development needs of small rice farmers in particular. Meaning to say, when we talk about a sector, we also have to think about the different kinds of people playing in that sector. In agribusiness, for instance, there are farmers in irrigated lands but there are also small farmers who are absolutely

deprived of any infrastructures, be it irrigation or drying facilities, and others.

At the same time, I would have loved to hear something about extension of quantitative restrictions. Is that a fighting target of the Philippines or are we just using it as a special leverage for special products within the World Trade Organization (WTO)? Another point that I would want clarified is our position, for example, when it comes to industrial development and technology policies. We have seen that in industrialized countries, the markets are quite well in providing incentives for particular industries where those countries are competitive in. However, we have seen also in developing countries, much like the Philippines, there is much need for some activist role, not central planning, not complete intervention, but at least some coordinative role for government when it comes to technology policy and industrial development. We disseminate technology and invest in R&D in particular sectors but that does not mean that those sectors are going to adopt those policies. The shoe industry is a perfect example. You have the technology, R&D when it comes to modernization of the shoe industry and yet, it is the sector themselves who are resistant to that technological upgrading for various rational reasons. One, technology might be labor-saving in the sense that when you adopt that technology, you create a lot of unemployment in that sector, which obviously will generate a lot of resistance to that policy. At the same time, we always think of the technology as being in a shelf that we can just take whatever technology that we want and simply adopt it. But adapting to new technology is very costly and very risky. Without certain coordinating mechanisms—hopefully to be done by DTI or maybe even NEDA—it will be very difficult for sectors to modernize and adopt new technologies and become finally competitive in the market.

AMADO MENDOZA JR.(ASSOCIATE PROFESSOR, DEPARTMENT OF POLITICAL SCIENCE, UP-DILIMAN): I have grouped my response into three items. The first item is: What is government's response to the UP School of Economics paper? Are we in a fiscal crisis or not? The President has already acknowledged that we are in a middle of a fiscal crisis and yet, three of her economic managers say we are not. Who will we believe, the president or the members of her cabinet? If it is true that we are in a crisis, why are we in it? Is it because of our excessive support for GOCCs? Is it because we faltered in the implementation of the

CTRP, having the highest tax effort in 1997 and has continued to decline since then? Is it also because of massive domestic borrowing and interest rates have been going up? Or what role would premature lowering of tariffs and bravado liberalization play in this fiscal crisis? Former President Fidel Ramos accelerated the lowering of tariffs during his time; does this have something to do with the crisis that we are in now? How about the election spending done by our president since 2003 until the time she was elected in 2004? Does this have something to do with the crisis? If we are, indeed, in a crisis, how are we going to get out of it? How soon and what must be done?

In respect to what must be done, I am looking at the projections presented here. I want to ask: What are the political and other assumptions for these revenue projections? We have seen that the revenue projection is increasing. What are your assumptions? You present various scenarios and we know that these measures will entail the cooperation of our legislature. Beyond the cooperation of our legislature, even if you have new tax laws, the bigger problem is implementation. Even if you have nice tax laws, if your revenue collection machinery is not that efficient—and it is not an unreasonable assumption to make that our revenue collection agencies are not operating at their maximum efficiency—what kinds of assumptions are we making with respect to the kinds of laws that can emanate from the legislature? What are the assumptions with respect to the quality of implementation that we will get from our revenue bodies given all of the kinds of things that you are trying to put in, including lateral attrition systems among other things? I believe that these assumptions must be made explicit so that people like us could examine whether these assumptions are plausible, whether these assumptions are, shall we say, realistic. Now, with respect to the political economy, granting that we have a weak state and let us grant that a weak state is simply a reflection of the quality of our society since the state cannot be better than our society—our propensity to cut corners, our disdain for law, which we regard as a suggestion rather than a command—given these circumstances, what reforms are possible? What reform coalition must be built in order to strengthen the possibility of reform on all fronts? How do we ensure that the benefits of reform will be spread in unorganized fronts, whose support is very difficult to elicit? On the other hand, you have a front against reforms that is organized and are very easily mobilized because of their small number. Who are the enemies of reform? You cannot simply call them “vested interests,” the

“destabilizers.” They must be identified. If we need to wage a battle against the enemy, then the enemies must be explicitly identified. How are they going to be defeated or neutralized? Who are the friends of reform? How are they going to be mobilized? What rewards can go their way so that they will join and stick to the reform coalition? I also have some technical questions such as why gross income taxation is reintroduced. Why argue for the superiority of ad valorem taxation over specific taxations with respect to sin taxes, and others? But I will have to reserve those questions for later.

ROMULO NERI: I would like to address Dr. Gochoco's comments. Yes, we need structural reforms. And the role of government is maybe to facilitate these reforms. Some of these thrusts need money, others do not. Let us say like in mining, money is ready to come. We are just waiting for the Supreme Court decision to just reverse its previous decision and we are already expecting billions of dollars to come in. With regards to housing construction, we already have the credit facilities available in the banking system. We just have to facilitate it by putting in the secondary mortgage market to give greater liquidity to the housing sector. Power generation is really a big problem, but again structural reforms are still very important. If you look at power reform, we are only paying NAPOCOR PHP 2.50 while Meralco's independent power producers (IPPs) are getting between PHP 4.00 to PHP 7.00. How did it come about? Why did the Electric Power Industry Reform Act allow Meralco IPPs to get four to seven pesos? What provisions were inserted to allow that and, in the process, NAPOCOR gets only PHP 2.50 when its cost of production is PHP 3.60, which is even better than the Meralco IPPs?

Take the case of pharmaceuticals; the president wants to reduce the price of commonly used drugs by half. The main reason it is expensive is because a lot of our laws and regulations, especially the Bureau of Food and Drugs (BFAD), is captured by certain interests. The BFAD can classify imported medicines as fake medicines, so if it is not imported by a favored company then it is considered fake. These are regulatory capturing issues and we just need to have money if you want to gain the social effect. For telecommunications, VOIP is a regulatory issue. Fortunately, I think Department of Transportation and Communications Secretary Leandro Mendoza is willing to take on the issue. If there is going to be resistance, there will be very, very powerful lobbies. For the SMEs, the money is there. It is a matter of really

preparing the small and medium entrepreneurs to be able to plan better so they can avail of better credits. When there is resistance, this comes from very powerful lobby groups. Again, it is the political will. You are right, the weak state stands in the way and there is lot of regulatory capture in power sector, in the medicine sector. In the case of agriculture, Fair Trade Alliance have been telling Agriculture Secretary Arthur Yap that the reason farmers cannot be productive is because production costs are too high and our pesticide policy favors a few to profit from trade in imported chemical pesticides. Again, you need to dismantle regulatory capture in that area. The role of the state is to remove all these regulatory impediments in these captured agencies. That is why we are hoping when the president says she is willing now to fight vested interests it will be translated to action. But again, we need to make it happen. In terms of the price of foods, for example, how do we reduce the costs of these goods? What is happening now is that Metro Manila, Pampanga and Southern Luzon are becoming our industrial belt. We are losing agriculture in that area and they account for 35 percent of the population but 55 percent of the GDP. More and more become residential and industrial areas. In this case, logistics becomes very important. The DBP has programs for this and about PHP 35 billion is available for this. It is a matter of getting more and more private sector to come in and borrow the money and go into it. The government does not do it, we are just facilitating the credit and it is there. So, the role of the state again is very clear. Clear those regulatory obstacles, facilitate the infrastructure, provide the credit or facilitate the credit. But there is no role for government to do it on its own. In the case of Clark and Subic, the government's role is to approve the port project, which allows huge vessels now to dock at Subic port. We stopped for a while the Subic-Clark-Tarlac road because it was extremely expensive. In the road study conducted, PHP 13.5 million is for road construction alone. When the Bases Conversion Development Authority bid it out, they bid it out at PHP 22.7 million. The final bid came out at PHP 29.7 million. In other words, we are going to lose tens and millions of pesos if we do it now. Let us intervene in some collusion on the part of the bidders here because these are tight loans from the Japanese. We had to stop it, the president instructed me to stop it and re-bid it, for which I got attacked because those other contractors who were ready to make a big dealing were affected. These are things we have to do. This is what is under the issue of ensuring the cost-effectiveness and cost-efficiency of our public

spending especially on infrastructure. In the process, though, you will get attacked.

On the quantitative restrictions on rice, are there still risks to remove the quantitative restrictions? Quantitative restrictions, as any country knows, only lead to more graft and corruption because when you assign these licenses to import, you are giving favors to people. In just freely tariffing it, the state is the one that makes the differential between the cheap products abroad and the more expensive products here. Technology also is very, very important. One intervention, I think, that has been successful was through the help of the private sector through the Philippine Chamber of Commerce and Industry (PCCI). Raul Hernandez, former President of San Miguel Packaging, has decided to use his retirement years to help out PCCI and the Department of Science and Technology (DOST) to promote good packaging for entrepreneurs. Whenever good packaging happens, the entrepreneur benefits a lot because number one is, his products get along with market trends and wastage is reduced and the entrepreneur will even have better prices for his product. This is a case of technology intervention which is very useful and really enhanced the productivity and income of the fishermen in Samar. The problem Raul Hernandez has encountered, though, is that some entrepreneurs stopped making their products better when they have reached a certain level that benefited them. The incentive to work harder diminishes. I guess this is also part of the culture of some Filipinos that when they feel that they earn enough, they stop working harder.

On the fiscal crisis issue, the UP paper is an excellent paper; the points are very, very good except for that small mention of Argentina. But I do not think it was really meant to compare the Philippines to Argentina. We could be like Argentina if we do not do anything. The reason we also had to make our comments as economic managers was that we had to clarify that the President meant it more in a conventional sense. She was talking during the Philippine National Police turnover ceremony. Fiscal crisis, as international bankers understand it, happens at three conditions: One is you have debt default, meaning you cannot pay the interest and principal, which we are not. Second, your deficit is unsustainable in financing, which is not our case because we exceed the finance. Third, you have no more access to capital markets, which we have. We have had successful bank sales very recently at prices that were not exactly favorable but can make do unlike Argentina. The definition of fiscal crisis is when you start paying 2,000-basis points

above the US Treasury Bills, which Argentina and Brazil had to pay during the height of their fiscal crises. We are not yet there but the UP School of Economics is correct that if we do not do anything, maybe two years from now, we might get there. But the solution is in our hands. Congress can do something if it just has the political will to do so.

Why are we in this fiscal mess? One is the fact that we did not index the alcohol and other taxes including the fuel taxes. From about two percent of GDP on specific taxes, we are now down to 1.2 percent each point, 1.4 percent each point differential, which translates to about PHP-70-billion loss. You are also correct that when we hastened liberalization, in a sense, we lost about PHP 100 billion. Then, of course, there are the GOCCs. NAPOCOR was not losing money before. It was only losing PHP 5 billion but sometimes it was making a little money. Only recently did it start losing money because number one, we decided to put a cut on the power purchase adjustment (PPA) that NAPOCOR could get that causes about PHP 30 billion in losses. Second, the expensive IPPs started operating together with all their stranded costs or take provision. I would also like to say the fact that since we could not talk to Meralco to stretch out its PPA, which is PHP 1.75 to PHP 2.00 of the PHP 6.00 that everybody is paying as power cost now compared to the PHP 2.50 pesos PPA of other IPPs. NAPOCOR is getting only PHP 0.50 in the PPA. So we were hoping that if Meralco would be a little more cooperative, they would stretch out their PPA payment so they can play it down to PHP 1.25 pesos over 10 years instead of paying PHP 1.75 to PHP 2.00 over five years. In this manner, NAPOCOR can also get a better share of the PPA. However, they are totally uncooperative saying that they do not want to renegotiate their contract. While NAPOCOR has already saved more than USD 1 billion on the renegotiation, Meralco has still not shown anything significant in their renegotiation.

Regarding the cooperation in the legislature, we have to focus on two people—Speaker Jose De Venecia and Congressman Jesli Lapus—and some key persons in the House Committee on Finance.

Weak state versus strong society? I think our society is good and strong but is weak. To some extent, the defects of our society leaks into the will of the state. However, there are also strengths in the society that do not get effected in the state. Take the case of Subic and Clark. When we go to Clark and Subic, we follow all the rules and regulations. We are very careful about overtaking, about turning right, when to turn

left, when to stop, and so forth. We follow all the US base rules. When we go back to Manila, we violate all the rules. Why is that? It is not inherent in us to violate all the rules. Maybe it is the system that we do not respect. When the Filipinos go abroad, our crime rate abroad is almost zero. When we get back to the Philippines, we disobey all the rules. So maybe, it is not the Filipino character. Maybe the system allows a lot of these weaknesses of Filipino society to be the one magnified instead of the good things in society.

Now, who are the enemies of reforms? One, if you want to look at the transport sector, especially our transport system, guess who is standing in the way? If you want to look at the power reform sectors, guess who stands in the way of making electricity cheaper? When you want to reduce the price of medicine, guess who stands in the way? Why is the Philippines paying forty cents per minute for long distance calls when other countries only pay six to seven cents? It may even go down to two cents and we are still paying forty cents a minute. Guess who stands in the way? If you will look at all these issues then find out who stands in the way. Now, if you look at the oligarchs, they have shifted from land-based power to manufacturing after World War II. Now, they are into services because services are still highly regulated—shipping, ports, power, airlines and so forth—and that is where they can still make big profits. Who are the allies? Well, it is really a matter of communicating these problems to everybody in the society. We need to have convergence and consensus.

FELIPE MIRANDA (PROFESSOR, DEPARTMENT OF POLITICAL SCIENCE, UP-DILIMAN): The first that we must flippantly address has to do with the quality of Philippine leadership. Now we have somebody who is technically framed in economics from one of the best schools of economics worldwide. I think that there is some legitimate reason for us whether technical proficiency may really be a passive factor in considering the leadership of this country. I am not referring only to President Macapagal-Arroyo and her doctorate from the UP School of Economics. I am also making reference to the College of Law and the kind of leader that President Marcos was, an excellent lawyer, in a technical sense. I do not think lawfulness was much furthered by the technical competence of President Marcos. Now, there are some concerns that the technical competence of the present president also might not be doing the country much good. Perhaps the thing to consider is not the quality of leadership if what we mean by this is the

technical ability to manage a situation. The second thing has to do with analytical frames. We have an agency called the National Economic and Development Authority, and I will now emphasize “and” While premium might be put on the economic dimension of development, the emphasis on a separate term for development also says that there are many things that might not be comprehended by economics. As a matter of fact, it makes it quite difficult for professional economists and other people similarly well-framed to help manage the Philippine economy and everything that is attached to it. As a matter of fact, in cabinet briefings and across five presidents now, I have said and I have suggested that one must have a political leverage when assuming the position of secretary of the NEDA. Until that time comes, the frame would be coming only from one school and, therefore, basically one persuasion to manage the country economically.

I am glad that in the presentation of Secretary Neri, he used a dissertation, unfortunately, by an American. However, in the booty capitalism dissertation, you will not find anything new in terms of analyzing the Philippine situation as a matter of political economy. You will discover that the pattern analysis has been done in the 1920s and extends all the way up to now. Dr. Onofre Corpuz would have the sharper, more analytical examination in his two works, *The Roots of the Filipino Nation* as well as *An Economic History of the Philippines*. Here, he examines the so-called “state.” In the local level, you have Dr. Remigio Apgalo doing that kind of work. To speak of the analytical frame used in your presentation, I think it might be quite embarrassing if you are asked, for instance, in public what Hutchcroft decided, after examining our case, would be the particular political regime characteristic of this country—which for most of the time, that is booty capitalism. There, you are not speaking of an economy that must be reckoned in terms of weak and strong state. As a matter of fact, this is a terminology that we, professional political scientists, must not inflict anymore on our students. Unless we supply the appropriate clarification, the students will wind up disoriented rather than properly educated. To speak of the Philippine state as weak is to say that the Philippine state is unable to do things that are rational and in the interest of the society as a whole. That is not only a technical statement; that is more of a political statement. Our state, government in particular, across the decades had been quite strong and even authoritarian when it was working in the interest of what it wanted to protect. It is not a question of weakness on the part of the state. Not even a question really of weakness on the

part of civil society or society taken as a whole. It is a question really of rationality. You take out the morality part of rationality and you will be able to explain what government has done in this country quite efficiently. Weak and strong, the thing that I would like to suggest as regards analytical frames is that in this country as well as in others, we are not alone. Our situation is not a unique situation. The appropriate distinction has to be drawn really between what is technical and what is political. Poverty is not primarily a technical problem. It is a political one. If a country like the Philippines is unable to design a poverty index between 1965 and 1982, and countries like Malaysia and Indonesia are able to do so incidentally using Filipino talent, then you might wonder why we are unable to see that the problem is not a technical one. It is a political one. When population as a problem is looked into, when disease has to be managed, again, it is not basically a technical issue. It is a political issue. I suggest that in looking into the nature of a crisis, we might do better in expropriating the common *taos'* (person) definition of a crisis which is an improvement over what the DOF, what Malacañang, and what our esteemed colleagues from the School of Economics would supply an ordinary Filipino. A crisis is something that has not worsened beyond the point of the capability to manage. In a sense it is closer to the DOF and NEDA idea, but I would like to let you know that for a Filipino, until something completely breaks down and the breakdown is irremediable or irreversible, there is no crisis. We have not gone critical really from the point of view of the public using this particular terminology.

The last thing has to do with databases. Databases provide us the basic material for analysis. Analytical frames are more important than databases because they define the direction in which databases will be put together. But when we speak of databases now, I wonder why some of the targeting work that comes not only from NEDA but from other agencies of government would be so inappropriate to the kind of situation not even in a crisis that we confront. For instance, I remember at one time the fantastic hope of the Ramos administration that if all Filipinos were to be patriotic, and if all government people were to be angelic and archangelic at that, then by year 2000 the Filipino per capita income would be just about that of the Thais. That statement was made in 1994 and I thought of mildly chiding the National Security Adviser and also the NEDA head at that time. In the current situation, if you say by 2009, you expect that you will have the public debt reduced to just about 90 percent of the GDP that is an extremely

conservative target. An extremely conservative target, if you are talking particularly in terms of an economy that we will assume together with Secretary Neri, I believe, to grow at the rate just about five percent a year. If you use that particular calculation, you are saying that by year 2009 relative to the year 2004, you will be reducing the vulnerability of this nation in terms of public debt exposure by just about 7.3 percentage points. That is not good enough. I think that you have to be much more aggressive and obviously we have to take into consideration the kind of debt profile that is building up even now as we speak. Let us get serious and in discussing a problem let us not assume that we are not engaged in romanticizing or “cosmetizing” a situation if we are serious also about what solutions we have to reckon with.

ROMULO NERI: Maybe we can put it all together and to these ideas. Yes, I agree about the database. Unfortunately, for example, in the poverty index and even the index of incomes and savings, there are still a lot missing there. Unfortunately, the National Statistics Office does not have enough money. Even in our budget, we cut down our budget for the next census and statistics, so it is really unfortunate. We are really groping around sometimes because we have very inaccurate data. Even that data does not go along with the final National Statistical Coordination Board (NSCB) report on industrial production. We really need to have much better database. In terms of the quality of leadership, in the end, the question is how many enemies you are willing to make in the process of enacting these reforms.

MARIO RELAMPAGOS (UNDERSECRETARY FOR OPERATIONS, DBM): The issue at hand is really the definition of what is fiscal crisis and I thank Secretary Neri for mentioning in what context the President said that—that it was not said in the context of the international market. Nor are we in a crisis as defined by Professor Miranda. Our indicators on the fiscal crisis will be laid out in a little while. All the medium-term fiscal program shown here is really to balance the national budget by 2009 to 2010. The target used to be 2006 but because of some events like the Iraq crisis, our fiscal performance in 2002, and the phasing down of the GDP targets we have to adjust also to balance the national budget from 2007 to 2009. We would also like to reduce the consolidated public sector deficit to GDP ratio to three percent in six

years' time. Right now, we have more than six percent consolidated public sector deficit. If you look at our fiscal position over a number of years from President Corazon Aquino's administration up to the present time, we are not better off from where we started during her time. The revenue line has been going up and down while expenditures of national government basically remain flat, especially during the times of Estrada and Arroyo. The gap has widened between revenue and expenditure after 1997 so that if you plot the deficit line, you will see that what we had in Aquino's time of some -5.1 percent deficit to GDP ratio, we were worst off in 2002 when we had -5.3 percent. We are now trying to improve that to -4.2 percent of GDP. So that is one indicator that we have a fiscal problem.

If you look at the totality of the public sector, or what we consider as the GOCCs and government financial institutions, you will see again the consolidated public sector deficit as percentage to GDP which was just about the same level as when President Aquino started in 1988—around 6.5 percent—and now 6.8 percent. Certainly, when the consolidated public sector debt (CPSD) deteriorated and the consolidated public sector deficit is growing, then your borrowing requirements will also be growing. Certainly before, when GDP ratio was still a little bit manageable, we have more flexibility to borrow some more. Then again, if you look at our public sector debt to GDP ratio ending last year is already 135 percent over the GDP and the national government had 78 percent to GDP. So these will point out to some fiscal crisis that is already not far from us if we will not do something now.

What are the action plans, therefore, that we are looking at? We would like to reduce the deficit target from 6.7 percent this year to a balance line some time 2009. The same with the CPSD—from 6.7 percent to at least three percent of GDP—and the debt targets from 135 percent ending 2003 to at least 90 percent six years from now, as well as with the national government debt—from 7.8 percent to 5.8 percent. So what are the specific measures to do this? On the revenue side, which Undersecretary Tan started to discuss with you earlier, what we have now is just the historical performance of the revenue percentage GDP. The next one is just working it down between BIR and BOC. The BIR contributes 80 percent of our revenue, the BOC some 15 to 20 percent and some other offices.

Now, for our revenue targets, as explained by Undersecretary Tan earlier, we would like increased efficiency in collection based on existing tax measures and ask Congress to pass additional tax measures.

In terms of our revenue again, if you will look at tax and non-tax you can see that our tax effort in 2004 is very low. It is only a little more than 12 percent and we aim to increase that over time to 15 to 17 percent before the financial crisis. Tax revenues rely on the collection of BIR and BIR performance today is a dismal 10 percent. We are targeting and moving heaven and earth to change that for once by retrieving a better performance of 14 percent over time. BOC will just remain flat because of our agreements with WTO on tariffication, liberalization and zero-tariffication drive that was initiated before. Now on the specific action plans on the revenues, we are encouraging agencies to collect fees and charges that will recover the cost for services rendered to the public and improve enforcement mechanisms through computerization of the working systems of the BIR, enhancement of audit program, enforcement of procedures, and the conduct tax payer verification drive. So, BOC would like also to modernize its information systems, create an anti-smuggling task force, strengthen internal audit services, and purchase of container x-rays for the ports.

For the proposed legislative measures, as mentioned earlier, we have the gross income tax system, which we hope can generate PHP 16.8 billion; the indexation of excise tax on sin products, another PHP 7 billion; excise tax on petroleum, hopefully some PHP 30 billion; rationalization of fiscal incentives resulting to PHP 5 billion; and, tax amnesty lateral attrition, tax on telecoms to replace VAT, another PHP 5 billion, and a two-step increase in VAT worth PHP 20 billion.

Now, let me zero-in on the expenditure side. Here, we have again a very poor expenditure performance because it is simply flat compared to GDP. Then if you look at the flexibility also of the budget, you will know that in 1992, interest payment was only 26 percent, Internal Revenue Allotment (IRA) was only seven percent of the budget. Compared to this year, interest payment will eat up 30 percent of the budget and the IRA has gone from seven percent to 16 percent. You will note also that personnel services have increased from 20 percent to 32 percent of the total budget. That looks like that there is less room for us at the moment to rationalize the budget unless, again, we have to do some measures on the expenditure side. You will see here that our expenses for personnel services are the highest among our neighboring countries—6.6 percent of GDP. Personnel services as percent to tax collection is the highest whereas capital outlays over the years, or capital expenditures investments by our country, is on the bottom line when, in fact, this should be given more support because this will

provide the economy with more capacity to produce goods and services. So again, given that kind of expenditure, there are a lot of areas to improve the expenditure configuration. There are three items that I discussed—interest payments, personnel services, capital outlays—and our target is to improve our allocation to capital outlay as percentage of GDP from 2.1 percent to four percent over time up to at least 2010. This is also part of reducing our fiscal burden to reduce interest payments from 5.8 percent this year to 3.7 percent of GDP by 2010. And we are adopting some rationalization of the government departments and agencies where today personnel services constitute 6.2 percent of GDP. We hope that by 2010 that will only be 4.8 percent of GDP.

As to specific measures on expenditures, the president has already issued administrative order (AO) 103, which is the economy measure, deferring the nonessential activities of the government and other expenditure items. We expect that within the next four months, from this economy measure, we should be able to cut expenditure by PHP 2 billion. Next year, we are aiming a minimum of PHP 5 billion to a maximum of PHP 9 billion savings from expenditures as a result of the economy measure under AO 103. Another is the rationalization of personnel services. We have already reviewed the functions of various departments and agencies and, as an example, functions between the DOF and DBM that overlap will be eliminated. We should strengthen instead the core functions of various departments and agencies. So those savings that we get from eliminating the functions that are no longer relevant or overlapping, we hope to reallocate to more priority programs and functions. The mechanics here is that if your position is declared redundant, you have two options here: to remain in government or to avail of separation package which is not golden but only silver parachute. If you opt to remain in government, the Civil Service Commission will try to relocate you to other office or position depending on your skill. If you do not want your new office, you will be advised to retire without any incentive. The incentives include additional 0.5 percent of your monthly salary for every year of service if you have been in service in government for 20 years. This is increased to 0.75 percent if you have 21 to 30 years of government service and a full 1 percent of monthly salary for every year of service if you have been in government for more than 30 years.

We would also like to improve the management and control of GOCCs. We will do this by improving supervisory or operational responsibility over GOCCs through the departments they are attached

to. Very important here is the moratorium in the establishment of subsidiary corporations because through subsidiary corporations, these GOCCs can exempt themselves from salary standardization and other controls of the national government. Next, we would like to fully implement the devolution to LGUs. I have shown earlier that IRA in 1994 was only seven percent of the total budget and it has gone to 16 percent already. More and more of the general fund is going to the LGUs and we would like to see that these locally-funded projects should be funded out of IRA. The remaining funds should just fund core functions of government. We have created a municipal finance corporation to handle the loans to LGUs that were contracted before by the national government. So this is now an off-budget, which will not impact on the national government deficit. We can afford increased social safety net program within the budget by transferring to the General Fund all balances of dormant accounts, which are special accounts in the depositor banks of government agencies and department. On the other hand, the Treasury was borrowing money every week just to generate funds to pay for our expenditures. These dormant accounts are now transferred to the General Fund so that we have more flexibility; the central baskets of the state have more funds to reallocate to more pressing and priority expenditures of government.

On the legislative side, we are asking Congress to pass what we call the Fiscal Responsibility Bill that will reduce public debt to more manageable levels by imposing a debt cap. We are saying that Congress should have passed a new law that requires budget without any accompanying revenue measure and that will have impact on our deficit. Also, aside from the administrative powers of the president to reorganize government, we are asking Congress for an Omnibus Reengineering Law seeking authority for the president to reorganize the executive branch including GOCCs and offer appropriate incentives. Right now, the power of the president is limited only to rationalization or the activation of departments of government agencies. It will take a law to abolish an office that was created also by a law and the president does not have that kind of power now. Another is the rationalization of government retirement and pension schemes. RA 1616 mandates that when a government employee retires from government service, it is the national government who will pay for his retirement benefits. This is not correct because during the time this employee is working, the national government was contributing to the Government Service Insurance System (GSIS) insurance premium. We are saying that when

an employee retires, he should go to the GSIS for his retirement package. Veterans' benefits should also be rationalized; make pension benefits commensurate to what we contribute to the fund. Right now, we have an allocation for pension and an allocation for those in active duty, which includes salaries. Some time in 2009, these allocations will be intersecting, meaning we will be funding more those in inactive duty rather than those in active duty. I do not think that is the correct way of handling the military and we have to do something with that.

Another thing is to rationalize government compensation system. We would like to simplify position classification; we would like to go to generics because right now your position limits what you are allowed to do. For example, if your position is Driver, you cannot be given instructions to do photocopying or sending memoranda from one office to another because you are just a driver. We would like to adopt a generic position where multitasking is allowed for such position. We also would like to improve compensation for highly competitive posts—positions above salary grade 17 or those from the middleman up to the cabinet member—because we are far off from our counterparts in the private sector. We would like to have some kind of compensation that will really attract those who are qualified. We would like to simplify the compensation structure and implement performance-based compensation system. But what we are saying here is that we would like to stop the policy of increasing salaries across the board because not all government employees are doing or performing well. We would look at the performance of the agency tied up with the performance of the employees so there is always some reward system that will benefit employees in that agency who have a “Very Satisfactory” or “Outstanding” rating performance in that department.

We also propose to remove automatic guarantee provisions in certain GOCCs because when GOCCs borrow or go into build-operate-transfer (BOT) schemes, the national government provides sovereign guarantee and if something goes wrong with the project, the national government is called upon to pay for the difference. We have many instances when contingent liabilities of the national government have become real. I think we already have some PHP 7 billion in the General Appropriations Act just to answer these liabilities. Take for example the operations of the MRT the national government is paying, aside from the direct payments, a five-peso subsidy per passenger. That rate cannot even pay for the maintenance of the rolling stocks, much more for that service. We should limit guarantees of GOCCs because

of our experience with NAPOCOR. The national government deficit has improved a little bit but the overall consolidated public sector deficit has worsened because of the GOCCs.

On debt management, since we have been operating deficit over time, debt has been growing over time and has gone to a level that is not comfortable anymore. We want to reduce the debt targets—both domestic and foreign—but we would be relying more on domestic debts. An action plan to manage our debts is to secure long-term maturity bonds to replace our short-term. We would also like to make sure that we were also using official development assistance with concessionary rates, instead of commercial rates.

ELMER HERNANDEZ (UNDERSECRETARY FOR INDUSTRY AND INVESTMENTS GROUP, DTI): I will talk about the president's reform agenda, the Philippine comparative advantages, challenges, and policy imperatives. Quoting the president in her state of the nation address last July 2004: "I want to create employment opportunities at home and abroad. I do not want just one or the other. I want both. But it can only be done with energy and with a common purpose that still lies within our power. Put our economic house back in economic order before it finds itself doomed to share the fate of failed nations." Basically, the president's reform agenda, the Ten-Point Legacy, could be summarized into five packages: job creation and economic growth, energy independence and savings, anti-corruption and good governance, social justice and basic needs; and education improvement and youth opportunity. The DTI supports creating jobs and growing the Philippine economy. This is how we would wish to operate as part of the ten-point agenda. The DTI would fit in programs, namely livelihood, education, fiscal strength, decentralized development, and national harmony.

We have analyzed the Philippine situation and looked at what exactly are the country's comparative advantages. From this viewpoint, we were able to identify demography, national endowment and location as our inherent comparative advantages. From this point, we are now looking at three measures, namely investments and trading infrastructure, investments and exports, and SME development. The bottom line here is we are looking basically at the consumer welfare.

Let me talk about demography—our people. We know that we are highly educated; we are world-class English speakers, although it is deteriorating; we have a strong customer service orientation; we have a universal cultural adaptation; we are very open to other peoples of

different cultures; we are third in terms of the availability of competent senior management personnel after the US and Chile; and, we have a very young population—55 million Filipinos, or 72 percent of the population, are under 25 years old. We have likewise 739,000 registered health professionals namely, doctors and nurses as of 2000. Take into consideration the demography and in what industries we can really excel. So we are looking at information technology (IT) services, medical and retirement services, specifically giving medical and retirement services to the aging population of Japan. I understand that the average age of Japan today is something like 61 years old and the Japanese are getting worried that in due time, nobody will take care of their old people. This is an opportunity that we will and should really take advantage. Take note that just recently, Japan has already agreed to take in a good number of nurses to work in Japan. We are also looking at the semiconductor and garments sector where our people have an advantage.

We are also very rich in natural resources. We are the fifth biggest producer of gold, ninth biggest producer of copper, and based on the estimates of Mines and Geosciences Bureau, the total ore reserves of the country is currently valued at USD 1 trillion. You know what USD 1 trillion can do to our country if we are able to exploit those natural resources. Sometimes, we keep blaming ourselves why we are poor but the problem is we do not utilize the resources provided to us by God. Take, for example, the Middle East. They have plenty of oil and they use oil as their leverage, as a natural resource to make sure that their country can also attain some economic growth.

Some time in 1992 when I was in a mining conference in China sponsored by the United Nations Conference on Trade and Development and the topic was on how to promote foreign direct investment in the mining industry for developing countries. I remember Cuba, which is a communist country, opening its arms to foreign investments in mining. Cuba's Minister of Mining said that their resources mean nothing unless they are utilized for the benefit of the people. One thing that we have to guard against, which is very important, is that once we are able to exploit these resources, make sure that such money is spent for the benefit of the people because it is depleting our resources. Once the resource is depleted, then you have nothing. What is important is to make wise use of those resources. We also have a fertile land. As the government focuses on agricultural modernization, irrigation and increased productivity, more and more

SMEs are getting in the food industry and agribusiness. In terms of natural endowment, we are looking at mining, agriculture and food production.

We also want to encourage more tourism activities in the country. Our plan actually is to declare Palawan as an ecotourism zone and we expect about two billion pesos worth of investments to be generated once we are able to implement our plan in tourism for Palawan alone for the period 2005 to 2007. Our competitive advantage here is our nearness to China, Japan and Korea. Yet we are not able to exploit fully what the opportunities generated by this close proximity and affinity with these three bustling economies.

We are looking at making the Philippines a regional hub for logistics. For example, for automotive, we are already exporting cars made in the Philippines. Last year, we have already exported approximately 14,000 units assembled and made in the Philippines. For this year, we are expecting between 20,000 to 30,000 completely built-up units. We are also exporting more than a billion dollars worth of automotive parts and components used all over the world. We also want to make use of the Association of Southeast Asian Nations (ASEAN) market. The Philippine domestic market is very limited and we would thus want to integrate with the ASEAN and take advantage of the 550 million people within ASEAN. Another strategic advantage that we have is that we are reachable within four hours by plane from any key Asian cities. What are the challenges connected to this? We must be able to make the economy grow. The sustainable growth of the economy is our overriding challenge in the face of the fiscal problem and uncertainties in the global economy. The inadequacy of our infrastructure has likewise deterred investments and limited economic growth. We also need to create new jobs to address unemployment and the needs of a growing labor force. Production of gainful employment is the viable approach to improving the living conditions of our people. In response to these challenges, the DTI is pursuing a three-pronged approach to propel the economy to sustainable and even higher growth. We call this the DTI Policy Thrusts. In this approach we focus on promoting investments in infrastructure, promoting investments and exports, and promoting entrepreneurship and SME development to catalyze growth of the Philippine economy. In terms of the promotion of investments and exports, we are talking here of rationalizing incentives. We focus on seven priority areas, namely infrastructure development, IT services, automotive parts and

components as well as CBUs, electronics, mining, medical tourism, and food exports.

From January to June 2004, exports already grew to 8.5 percent. We have already had a diversification of export products in this connection. At this point, we already know that semiconductors as part of the electronics sector account for about 45 percent of our total export. Electronics as a whole is about 68 percent; 45.2 percent of this is attributed to semiconductors. We are now expanding the base for our export products and not rely purely on semiconductors. Of course, we will have to continue to sustain our competitive edge as far as the electronics sector is concerned. In the case of the food sector, just look at the *halal* food (food processed according to Islamic law) sector. The halal industry, globally, is estimated to be USD 150 billion. If you are able to tap even only one percent of that, that will translate to about USD 1.3 billion additional exports for the country. There are eight million OFWs and if we are able to provide the food requirements of our OFWs abroad, we made an estimate of living spending of USD 100 per month, just for food that will translate to additional exports for our country. We are also looking at promoting our regional and multilateral trading agreements primarily with the ASEAN, China, and Japan. We are about to conclude the Japan-Philippines Economic Partnership Agreement. We hope that by the end of this month we will be able to do that and we expect that we will be able to take advantage of this economic partnership with Japan. The ASEAN-China Free Trade Agreement negotiation is expected to be completed in June of this year. However, due to some problems with the Philippine position, we were not able to conclude it. The expectation is that the implementation of the measures leading to the free trade agreement some time in 2010 to 2012 between ASEAN and China will start in 2005. Likewise, we are talking here of the 11 priority sectors identified by ASEAN. For us to hasten the economic integration of ASEAN, the expectation is that by 2007, all tariff rates for this identified 11 priority sectors will be at zero already. Electronics, for example, is one of these priority sectors and the Philippines is designated as the head of shepherding the electronics sector in the ASEAN. By 2007, we expect that all tariff rates of products—from raw materials to finished products involving the electronics sector—will be zero. As agreed in the last ASEAN Economic Ministers meeting, we can only be given an exclusion of about 15 percent of all our tariff lines.

We also have to promote investments in infrastructure. No matter what kind of incentive package you provide, if you do not address infrastructures, investors will not come in. Infrastructure is the basic requirement for investments to come in and we will try to address this by creating the Philippine Infrastructure Corporation that will provide vital infrastructures for the economy and raise revenue base of the government. We are not getting any money from the National Government, from the national appropriations, to provide these vital infrastructures through the PIC, which will be operated like a fund. The money will come from taking over the crown jewels of the government; what these are, I will tell you later. We are now also looking at amending the implementing rules and regulations of the BOT Law to ensure that we will encourage more investments in this connection. We are the envy of other countries in terms of the implementation of the BOT Law because we were able to provide infrastructures with the government not spending a single centavo for the infrastructure development.

The third item that I wish to talk about is the promotion of entrepreneurship and SME development. We are looking at microenterprises and SMEs as engine for jobs. You will take note that SMEs comprise 99.6 percent of total registered enterprises. Our task is really to provide one to six million jobs up to 2010. Just looking at one million jobs per year, we are looking at SMEs and microenterprises. There are 1.1 million microenterprises registered in the DTI for the last six years and 8.8 million registered SMEs. If all these registered enterprises—excluding the underground economy—will employ just one additional worker per year that will translate to 1.9 million additional jobs for SMEs. How do we encourage them to do this? We have the SME Unified Loan Lending Program for National Growth Program and we have already extended some PHP 36 billion in this connection. We have created the SME Development Group and we are also working with the Big Brothers-Small Brothers Program, which was launched earlier and we already have twenty SME assistance centers. We are also looking at converting the OFWs to become Overseas Foreign Investors. The problem with OFWs, however, is that when they come back, they do not know what to do with their money, so we will try to make use of those available resources. In conclusion, we need to create jobs and an economic growth package to create a strong economic environment. Domestic and foreign investments and public-private sector partnership are crucial to achieve our goals.

MA. SOCORRO GOCHOCO-BAUTISTA: When we wrote the discussion paper “Deepening Crisis: The Real Score on Deficits and Public Debt,” what we really wanted to do is put on the table the gravity of the situation we are in, look at it very carefully and propose measures to address the problem and measures that would ensure a more or less equitable sharing of the burden as well as the phasing in of the measures. Now, one of the things that I heard from Undersecretary Tan, which is very correct, is that new tax measures are necessary. However, not everybody in government is of that opinion. I think one of the things we want to show in this paper is that there is no magic bullet. You cannot do away with the new tax measures. Having said that, however, I wanted to get from these fiscal managers from government their take on how and what the government is going to do about the problem. I think part of an incongruity had to do with the assumptions that the fiscal managers made. When they showed all these graphs with trends in revenues, deficits from 2004 to 2010, it is so unclear what the assumptions are. In the UP paper, it is very clear what we are saying. At the moment, off-budget items and lending to government corporations take three percent of the GDP. First thing you do is to lower that to 1.5 percent. Given that, if you want to maintain the GDP ratio at the current 78 percent, you need to raise an additional PHP 80 billion in taxes, or 1.9 percent assuming that the 0.9 percent now is still applicable, so you have 2.5 percent. You add another percent to GDP of one percent for new expenditures so you have a 3.5 percent total. So it is very clear what parameters you are addressing. What was unknown in that UP paper, which we talked about, was exactly how much the government was going to absorb in terms of the debts of the GOCCs. That is an unknown in the paper. When I went to the Senate hearing, I found out that NAPOCOR alone has a debt cap of PHP 600 billion and that the government intends to assume PHP 400 billion of it with the PHP 200 billion supposed to be resolved by selling the generating company. Even the PHP 200 billion that they are assuming, apparently, is a tremendous undervaluation because the market will probably only give a billion dollar, or a maximum of four billion or five billion for it. So my question is, when you made all these projections, what was the assumption as far as national government assuming the debts of the GOCCs? The second point about the report was we showed the tax structure and administration are partly to blame for this drop in tax

effort. As Undersecretary Tan pointed out, something happened in 1997 with the new tax laws that gave a lot of exemptions, net operating loss, carry over provisions, and others that eroded your tax base. That tells you that increasing tax administration efficiency alone will not solve the problem. Getting rid of corruption, which is endemic, will not solve the problem alone. When you present a program to the people, because it requires new taxes, you have to tell them straight: these are the assumptions, we got into problem the whole period because of the following reasons and this is how we are going to address the problem. The problem I have listening to our finance people is that I do not think that they internalized the problem. For example, at that Senate hearing, when Finance Secretary Juanita Amatong showed this plot of tax revenues to GDP, assuming no new taxes and assuming new tax measures, the senators did not grasp it because if you look at the numbers for the one assuming no new tax measures, it does not look too bad. In the presentation, in 2010 you get 16.1 percent tax revenue to GDP. Thus, you do not need new tax measures. You know how politically difficult it is to sell new tax measures to the people and there your fiscal managers showing a plot that says in 2010, without any tax measures, your revenues to GDP will go up to 16 percent. Now, I have a sense that these things were made before the president declared a fiscal crisis. This is probably what you are telling our foreign creditors that we are in good shape. This is my problem, the real politics of it is that it is so hard to sell. There is a tax revolt going on. People are saying it is rational for me not to pay taxes because this government does not spend the tax revenue correctly. It just goes to corruption and now you want me to pay more taxes for things that clearly the government has a hand in creating whether it be the politicization of the pricing of power which made the NAPOCOR debt ballooned, the inefficiency of administration, the usual graft and corruption. My major problem is, I agree with the fiscal managers that we need new tax measures and that all these politicians who say we do not—that we can substitute this for others or privatize—are wrong. We need the new tax measures; there are no ifs and buts to it. They are not substitutes for any other measure. But I have a problem on how this government is selling their package. The reason is, I do not know the assumptions and I can also quibble about the types of taxes that you are proposing. For example, this gross income taxation was an old proposal. But there are good economic reasons for not pursuing this line of thinking. If your aim is to simplify the tax administration system using gross income taxation, it would

fail because you have to define very well what costs of goods sold mean for every sub-industry. That ranges from three percent to ninety-something percent. If you have to do that, you lose the simplicity of the system that you are trying to get. On the other hand, if you do not do that and you just simply gross income tax every one of x percent, then clearly, some industries will be hurt. This is not going to be fair; so much for burden sharing. Is it not better to simply use existing tax laws and limit or put a ceiling on deductions? There are so many things that can be implemented because it is already in the law. We do not have to reinvent the wheel. Here we are trying to sell the idea of more taxes but you want to change the system into something that we rejected in the past already for this very reason.

In the case of the VAT, some have argued quite convincingly that it is not so much raising the VAT rate as opposed to broadening the VAT. Why? Precisely because part of the laws of the tax rate have been caving in to all kinds of vested interests who got exemptions from the VAT—movie stars, law firms, lawyers, doctors. Now look at that proposal about giving a tax amnesty with the submission of SAL. That is the most ridiculous proposal I have heard. We at UP are required to produce that SAL every year. Why do you not produce and then use the SAL as a cross-check to the income taxes paid? What are you trying to do? You want to forgive the doctors and lawyers who have been evading taxes all these years? You are giving away revenue again unnecessarily. And then there is the issue on the phasing of all these. You have this nice chart that could project what looks like a linear projection such that you want to end up at 90 percent of it. You just work it backwards to where we are. What is your assumption? For example, how do tax revenues grow to 14.4 percent of GDP next year without any new taxes? I think you can have a very nice way of selling a package. First, it has to be a coherent package. People have to know that you know what you are doing, you know what your assumptions are, you know what the source of your problem is and you have a very concrete way to attack the problem. Part of the reason we wrote this paper was that we wanted to rally people around a sound package of reforms, taking into account the best we could, though we are not political economy experts; the idea that everybody would share the burden and that is how we will sell the package. I do not see anything like that from the part of the government. It is not even clear how much you are assuming here in NAPOCOR. This is what we are waiting for from the government. So, my main problem here, aside from the

technical things about the types of taxes you are proposing, is really what is your package? What are your assumptions? How are you trying to sell this? Because, as Prof. Miranda says, it is not all technical; it is also political. And if you are going to be divided debating on the types of taxes, we will not move forward on this. So we want to support you but we want to support the right measures and we want to know what your assumptions are and why you think some of these proposals are sound.

MA. CRISTINA MORALES: My main contention would be—it seems the debate has not focused on whether or not we have a crisis and that is really not the point—that the deficit is becoming unsustainable and Dr. Gochoco is right; we need new taxes. However, when it comes to framework, we are also concerned about the sustainability. We need new money now and we need new tax measures now. However, with this debate of whether we are in a crisis or not, we seem to lose sight of the more important or the equally important question of equity. When it comes to taxation, we can raise new taxes; we can raise the VAT to 20 percent. We can even have a new consumption tax. There are certain policy proposals right now that I think would be very, very regressive in a sense that the poor will be suffering more of the new tax burden. At the same time, we also have to remember that new taxes will also have the effect of dampening effective demands, in which case you also run into the problem of creating unemployment all over again. That is why you also have to be very careful with the particular policies that you are going to propose. If I may just run through some of the policies that I personally support, these are the following:

1. Indexation of sin taxes. However, that bill has been waiting in the shelves of Congress for years now and it is all a question of political will. We never said we do not want new taxes on cigarettes or on alcohol. The one who said that was probably somebody who owns a cigarette company.
2. Targeted petroleum tax. It has to be targeted because it has the tendency to be inflationary. You can have rebates for public utility vehicles; you can have the UK system where they have colored fuel—the red-taxed fuel is for private

vehicles, the blue-taxed fuel would be for public utility and agricultural vehicle.

3. In the case of the NAPOCOR, how can you propose increased tariffs on electricity and not say anything about the IPP contracts; or not say about the sovereign guarantees that individual power producers enjoy? These have to be renegotiated because they are blatantly onerous.

On tariffication, this is not a question of whether to liberalize or not to liberalize. The point of the matter is your bound tariffs under the WTO. For example in agriculture, it is about 35 to 40 percent. Your applied rates are at 10 percent. A two percent surcharge will not risk the economy too much. It might even protect some of your local industries so it is not a question of being ideologically protectionist or liberalist. It does not even need congressional approval. You just need the Tariff Commission to raise these two points. You are not going to run into any problems with your WTO agreements because the bound rates are very, very high—much higher than the actual applied rates that we have on agriculture, on manufacturing. Another professor from the UP School of Economics, Prof. Joseph Lim, looked at the BOC revenues as a percentage of imports. He found that in 1994, this percentage was about 15.84 percent. In 2004, that percentage was down to less than five percent, meaning to say, that cannot be discounted. Yes, there is a problem on the tax structure but also a lot of the foregone revenues because of the lower tariffs and leakages, meaning, smuggling. Just the other day, some industry representatives were all complaining why the anti-smuggling body monitoring the BOC was suddenly abolished after five or six months of operations. What they are saying is, when it comes to customs bonded warehouses, there are already a lot of funds that we can liquidate, but we are not doing that and I wonder why. To do that does not even take new rationalization of fiscal incentives. Just follow the rules, follow the contract. What are the incentives, therefore, and what are the checks and balances of those incentives? I would support the broadening of the VAT base but I would be very against the increase in the rate. Although it is one of the easiest taxes to collect, it is also probably one of the most regressive taxes you can find in the world. It burdens disproportionately your formal sector as opposed to your informal sector.

On the rationalization of fiscal incentives, in the immediate run, what we need to do is to cut down on smuggling. Industry representatives say that we are losing a lot because of smuggling particularly in

garments. People who import clothing say they are used clothes and they are going to make rags for export from these used clothes. So these imports, supposedly imported inputs to make these rags that we can export, get into warehouses that are basically tariff-free. What they do, instead of becoming rags for export, they become clothes for *ukay-ukay* (second-hand clothes) sale. Smuggling undermines not only your revenue collection but also the competitiveness of your industries. Finally, it is sad that Secretary Neri seems to have relegated the DTI to mere promotion marketing and information work in his framework. I wanted to point that out earlier because I think the DTI has a huge potential when it comes to industrial development, job creation, and export diversification. Yet, we are saying now that we are just focusing now on labor export—medical services, IT services. What about the future? When we say 1.9 million jobs, it seems to be huge. But your labor supply sector grows at about 1.5 million every year. That is not even going to make anything to your 13 percent unemployment rate. When it comes, for example, to industrial promotion, what sectors are we targeting in? With these new free trade agreements and with these new international agreements, what are the new sectors that we wish to be competitive in? What education and training our labor force needs in order to compete in those markets? In other words, what's the plan? I do not see any reason we have to confine DTI's role only to marketing promotion and information. Also, I think the DTI should look seriously at the diversification of imports because while it might sound good that 68 percent of your exports is in electronics, this is just basically testing and assembly. How can we move up the value chain? How can we ensure that these exports have forward and backward linkages in the economy? We are importing pineapple and *langka* (jackfruit) chips from Vietnam. These are food manufactures. These are industries that have great backward linkages to your economy. It pulls up agriculture, it pulls up packaging and then finally trade. The fiscal side is important but we also have to remember that we have a job crisis in our hand and 1.9 million jobs in a year cannot do it—especially not in electronics, not in garments, unless we export that 1.9 million every year.

AMADO MENDOZA JR.: I will return to my point about political coalitions for reform. This is quite clear based on the admission of Secretary Neri that even the Philippine state itself is actually an agent and target of reform. Secretary Neri has admitted that several agencies have already been captured and, therefore, these captured agencies

could be classified as enemies. So you have a state, or a political leadership, that has to go to war against components of its state machinery. Therefore, you need allies from all over the place. Now, I remember reading news about the Peruvian economist Hernando de Sotelo being hired as a special economic adviser. When I heard that, I was thinking that probably the leadership in our country is thinking of broadening the reform coalition by increasing the sense of ownership of poor people in our country by following de Sotelo's advice, which is to give them property rights. I also remember correctly that several informal vendor groups have already manifested their desire to pay taxes than to pay bribes because bribing does not give them the goods. Every time there is a new commander, they have to renegotiate the terms of the *kotong* (bribe). A lot of these people want to be recognized and be part of the so-called Philippine project but existing policies and institutional arrangements keep them off. We should not be surprised, therefore, if they are going to be receptive to destabilization schemes and appeals of demagogues. So if a significant part of the elite class would be enemies of reform, you may intend to neutralize, if not defeat, them, then the political coalition for reform must be broadened by enfranchising those who have not been enfranchised before. They may have been enfranchised politically but their sense of ownership in the economic house is not there. Therefore, a significant item in any recovery program, which apparently is forgotten here, is property or assets reform. Unless and until the majority of our population can be convinced that they are part of the Philippine nation and not part of a nation that we disdain—we forget because they are poor and do not look nice and so on—our society will remain divided. These people will not care about the economic indicators as long as they live and survive through whatever means.

ELMER HERNANDEZ: Let me just comment on the tariff liberalization. Yes, many of our tariff lines are unbound but the applied tariffs are rather low. In our comprehensive tariff review conducted last year, we actually tried to match and benchmark this to our neighboring countries and, if possible, use the highest tariff rate possible. The only problem there is that we have to balance this; whether this material is a finished product, which will translate to higher cost as far as our consumer is concerned, or this is an intermediate product or a raw material that may be used by other sectors as well. So we have to balance this and make sure we come out with a realistic and practical tariff. But, of course, we are also talking here of most favored nation tariff rates.

Under our agreement with ASEAN, we are already implementing the common effective preferential tariff and we cannot go beyond the maximum of five percent. If we exceed that, we have to pay. Right now, for example in the petrochemical industry where we exempted 11 products from the zero to five percent tariff, we are paying already a form of compensation in terms of much more reduced tariffs for certain sectors to pay for the difference. Another point: from a layman's point of view, a tariff is not a revenue measure but a protection measure. It should never be looked into as a revenue-generating measure but more of a protection measure. That is how I look at tariff and we can only use tariff in certain cases as a protection because basically, the higher your tariff wall is, the more you encourage smuggling. At this point where the tariff rate is already very low, we still encounter a lot of smuggling activities. You are right in your assessment that due to technical smuggling alone, we are already losing some PHP 100 billion in revenues which is enough already to make up for whatever revenue we expect to generate for this new tax measures. But as I said, there was the National Anti-Smuggling Task Force (NASTAF) and another body was created, the Cabinet Oversight Committee for Anti-Smuggling (COCAS), to which the NASTAF reports. This was disbanded and the whole idea was to transfer the power of NASTAF to the Bureau of Customs. The problem there is that you are going to put the NASTAF under the office that it is supposed to monitor. Our position here, as well as the private sector's, is that we should maintain the COCAS and NASTAF in the hands of another oversight committee. As a matter of fact, during the period that the NASTAF and COCAS were in operation, technical smuggling has been significantly reduced. In the case of customs bonded manufacturing warehouse, we are moving towards the so-called customs industry specific on customs bonded warehouse to make sure that we are able to plug the loopholes as far as importations of tax and duty-free raw materials of finished products are concerned. Then, these are brought up to the customs bonded warehouse without the necessary payment of correct tax and duties. What happens is the legitimate domestic industries are definitely disadvantaged because of this. A lot of things have to be done as far as smuggling is concerned.

On the issue of why we are promoting the seven sectors, it looks like we are just right for export labor. I would like to clarify the fact that the seven sectors are not only in terms of services but manufacturing as well. You have the electronics sector and you have the manufacturing sector. One thing against the electronics sector is that it is not so much

value-added. I agree on that aspect but the problem is that we are already losing. We are already moving towards the high-value electronics because our labor rates are no longer competitive and the low-end electronics sectors are already transferred to China. We are now more on the high-end side and therefore has more value-added. What we are saying here is that we want to sustain that competitive advantage in the electronics sector because, in due time, China will catch up with us. We might also lose the high-end part of the electronics sector. That is why we want to maintain that, at least. At the same time, we are also diversifying our export base. We are looking at the services sector as an opportunity and it is where you can easily provide labor. We have to find a solution to the increase in labor force per year because the industry by itself cannot absorb all these additional labor force. I did mention one of our thrusts is to make use of the SMEs and microenterprises to provide the solution to the 1.9 million additional workers per year because traditional employers like the industries that we have cannot even provide that additional one million jobs. It is really the microenterprises and SMEs that we are looking into.

We are focusing on the seven sectors in terms of providing the incentives because of our very limited resources. It does not mean that we are already forgetting the other sectors but we will continue to assist them if need be. But since we have limited resources, we will focus our efforts on these seven identified priority sectors and they are not limited to services but also to manufacturing and mining as well.

The last item is on education requirement. We have already worked out the problem with the Department of Education in so far as the realigning, and probably, the introduction of a new course on entrepreneurship in the high school level. We must make sure that our high school graduates are able to learn this. If they cannot go to college then they can become entrepreneurs. One perfect example is the case of the franchisers. We now have an Association of Filipino Franchisers, Incorporated where there are 37 homegrown franchisers. With their 11 years average length of existence, their projected sale for 2004 is PHP 5.4 billion. To date, their total employment is about 11,300. We are also working with the Commission on Higher Education (CHED) in order to prepare what kind of graduates we really need to serve the needs of our industry. A program of the DOST will provide the necessary engineers, scientists and technologists that our industries would need. Again, we are working with CHED to make sure that what the industry leaders and players are saying about the kind of graduates they need. We are now working with various universities to make sure

that we are able to bridge courses to make sure that what the industries need will be provided.

MARIO RELAMPAGOS: On the assumptions, we were coming from a retroactive budget and we are only talking of the deficit that we are currently facing. We said we will have strong measures to control the deficit through expenditure rationalization. We were not thinking so much of tax requirements. We thought we would be assuming only PHP 200 billion of the NAPOCOR deficit but eventually it became PHP 400 billion, then PHP 600 billion. That really distorted our assumptions on the fiscal targets, our fiscal program for the medium term. As I said earlier, we thought 2006 was tenable to balance our budget—then you have NAPOCOR. I agree that even if BIR, for a change, will reach their annual targets, it will not be enough. We need more taxes—taking into consideration how it will be implemented, the issue of equity, the consideration of whether regressive or not. From the expenditure side, when you look at our expenditures, it was very flat as percentage of GDP. What can government do to provide the correct incentives for the private sector to lead economic growth? If you dissect or segregate these expenditures, you will see that the expenditures go so much to interest payments, to IRA, and to personnel services. What will these expenditures do to our economy? Every time we craft a budget, we hope we can provide more than 10 percent for capital outlays. That is not even feasible at this time because all the budgets now are committed. Every year when we do budget formulation, there is hardly any free amount where we can reallocate to more priority spending. That is how tied down we are on the expenditure side. However, we will continue to rationalize expenditures. We have also adopted what we call the Organization Productivity Improvement Framework because we do not even know how to measure government output—if are we doing things correctly when we do not know what we are expecting from these agencies. So we defined, together with the NEDA and other agencies, what really was the major final output of each department and agency that can be linked to the overall sectoral outcome, or the overall outcome of reducing poverty. When we can measure that, then we can have a better allocation of the budget—from the less to more important priority programs of government. We also went into the rationalization of government departments and agencies, the savings of which will be put in capital investments. On the real savings, we are looking at PHP 2 billion this year for AO 103 and a maximum of PHP 9.5 billion in AO 105. That is our contribution on

how to reduce the deficit. Now, we are submitting two budgets for 2005. The core budget assumes the national government deficit, but we hope to submit a supplemental budget that will address the NAPOCOR issue. We can submit the supplemental budget if, again, Congress will pass the additional revenue measures. We are also filing the Fiscal Responsibility Bill that will put a moratorium on borrowings, and, at the same time, we will not allow Congress to pass laws that will require additional budget and support without new revenue measures. At present, I think there are some PHP 400 billion worth of unfunded laws because these laws are passed without any new revenue measure. In the process, it was depleting the general fund and that even worsens the situation. My final word is that we need all the macroeconomic measures that we were talking about. After discussing these in all forums, whether Congress will buy our proposal for new taxes or not, all we are saying is that fiscal discipline is not enough. What we are saying to government agencies is for them to have a good planning, look at their major final outputs if these are indeed traceable to the fulfillment of the desired sectoral outcomes.

The public forum was sponsored by the **THIRD WORLD STUDIES CENTER** and the **DEPARTMENT OF POLITICAL SCIENCE**, College of Social Sciences and Philosophy, University of the Philippines-Diliman. **MA. ELA ATIENZA**, Associate Professor of Political Science served as the forum's moderator.