SUBJECT : REPORT ON THE PUBLIC HEARING CONDUCTED BY THE COMMITTEE ON FINANCE HELD ON SEPTEMBER 14, 2004, TUESDAY, 9:00 A.M. –3:30 P.M. AT THE SENATE, GSIS BUILDING FINANCIAL CENTER, PASAY CITY, ON THE BRIEFING BY THE DEVELOPMENT BUDGET COORDINATING COUNCIL (DBCC) ON THE PROPOSED 2005 BUDGET

I PRELIMINARY

The Committee on Finance, chaired by Senator Manuel B. Villar, Jr. held a briefing on the proposed 2005 budget.

Resource Persons: Secretary Emilia T. Boncodin, Department of Budget and Management (DBM); Secretary Juanita D. Amatong, Department of Finance (DOF); Secretary Romulo L. Neri, National Economic and Development Authority (NEDA); Assistant Governor Diwa Guinigundo, Bangko Sentral ng Pilipinas (BSP)

Also present were Senate President Drilon, Senators Flavier, Gordon, Osmeña III, Enrile, Lacson, Madrigal and Jinggoy Estrada..

II HIGHLIGHTS

Mr. Neri, the director-general of the National Economic and Development Authority, in his description of the country's economy stated:

- Gross Domestic Product adjusted for inflation grew 6.2 percent in the second quarter of 2004, slightly lower to the first quarter year on year growth of 6.5 percent.

- Growth in the Gross National Product was weaker at 5.7 percent as net income from abroad rose a mere point three percent due to the higher interest payments. This brings the first semester growth to 6.3 percent which is higher than the full year high-end target of 4.9 to 5.8 percent. This total GDP growth of 6.3 percent is the highest the country has had in 16 years.

- Services grew at 7.3 percent which cushioned the deceleration of growth of agriculture which increased by 4.3 percent.

- Industry expanded at a sustained pace of 5.6 percent led by construction. Construction increased by 13.7 percent, the highest since the third quarter of 1997 due partly to election-related spending and higher demand for housing.

- Manufacturing had a robust growth with expansion coming strongly from domestic consumer related sectors such as food processing, beverages, publishing, printing and export related sectors like electrical machinery, transport equipment, furniture and fixtures.

- Personal consumption expenditures rose to a record growth of six percent mainly on account of higher spending for utilities as more barangays are connected to water and electricity services.

- An increase in the number of tourists and expansion of call centers led to a robust expansion and exports of non-factor services.

- Investments posted a healthy 8.5 growth coming mainly from public and private construction which benefited from the payments of accounts payable by government to private contractors and the prevailing favorable interest rates in the second quarter.

- Total job generation reached 1.3 million for the first semester, almost three times compared to the same period in 2003. However, unemployment rate increased from 11.4 percent to 12.3 percent during the period as the number of entrants in the labor market swelled to 1.8 million from only 82,000 last year. Underemployment also rose 2.2 percentage points reaching 18.0 percent.

- Inflation rose to 6.3 percent by August 2004 from an inflation rate of 3.0 percent a year ago.

- With a rising inflation rate, interest rates have also moved up to 7.2 percent compared to just 6 percent a year ago.

- For 2005, the economy is expected to expand by at least 5.3 percent in 2005, it can even go to 6.3 percent if investor's confidence picks up as the government is able to show that it is serious in addressing the major problems, namely the fiscal deficit and the power sector.

- Government is targeting GDP growth to accelerate by at least 5.3 percent in 2005 and accelerating to 7 percent from 2009 to 2010.

Senator Manuel Villar expressed doubts on the rosy projection of the Philippine economy for the next two years in the light of the fiscal crisis, the high oil prices and the escalating interest regimes.

Senator Enrile expressed the observation that a correction was made into 4.2 and the four point something to 3.6. The senator emphasized that the correction is not just to correct an accidental error.

Senate President Drilon expressed concern on the country's power need for the year 2006-2007. The National Economic and Development Authority might have overlooked the fact that it requires a three to four years period before a generating set becomes operational. The Senate President emphasized the need to include in the NEDA's economic projection for the next three years the investment requirements for the power sector.

Senator Sergio Osmeña pointed out that the assumption of the P500 billion in NAPOCOR debt will cost the national government 36.7 billion for 2005; 45.5 billion for 2006; 48.8 billion for 2007; 53.2 billion for 2008; 61.2 billion for 2009 and 66.3 billion in 2010. The figures cited by the Senator was confirmed correct by Secretary Amatong.

Senator Osmeña stressed that the present policy of government of subsidizing the power sector is the primary reason that keep investors away from this sector. A businessman who buys one or two generating companies cannot compete against the generating plants remaining in the hands of government as these are subsidized.

On the plan of government to increase the EVAT from 10 to 12%, Senator Osmeña proposed the maintenance of the EVAT at its present level and expand the coverage instead and include those who are enjoying exemptions now.

Senator Enrile emphasized the need to restudy the present tax structure for cigarettes. The present system of using the price of cigarette as the basis for its tax is susceptible to cheating and the result is that the tax revenue from cigarettes had been going down.

Senator Enrile expressed his objection to the plan of government to adopt gross taxation for individual tax payers as it would complicate the tax system. The senator told the officials of the Department of Finance to impose the tax on the people that can bear it and not on the people who are having a hard time surviving in our society.

Further, he suggested the amendment of the country's present laws on land to allow foreigners to own or lease for a long period of time the reclaimed land. This is a potential source of revenue for government according to the senator.

Mr. Diwa Guinigundo, Assistant Governor, Bangko Sentral ng Pilipinas, in its presentation of recent developments in the monetary and banking sector, stated:

- The growth in commercial bank lending slowed to 3.6 percent in July from 3.8 percent in June. In other words, the demand for credit continues to be weak as far as commercial banks are concerned.

- R.P. and the U.S. interest rate differentials have narrowed but have remained substantial.

- For inflation, the average for 2004, 2005 and 2006 is about 4 to 5 percent. But starting 2007 up to 2010, inflation is expected to be moderating to 3 to 4 percent. As a result, the 91-day treasury bill rate assumption is expected to come down from 7.5 to 8.5 for 2004 to 2006, to 7 to 8 percent for the next four years after 2006.

- In case of money supply, we expect a higher growth rate from 10.5, 10.4 for 2004 and 2006 to about 11.2 percent by 2010.

- Exports grew 8.5 percent during the first semester of 2004. The uptrend in exports was driven by higher demand for electronics, machineries and transport equipments.

- As of end of August 2004, foreign reserves level was at $15.75 billion. In terms of imports of goods and payment of services, this would translate to 4.3 months.

- Despite its recent weakness, the peso was less volatile. In 2002, the volatility was P1.13; in 2003, it went down to 0.98 centavos. For the eight months of 2004, this was brought down further to 0.27 centavos compared to last years level of 0.83 centavos.

- For the first eight months of 2004, the actual or real depreciation of the peso amounted to more than 6 percent compared to last year's 10.7 percent.

- As of March 2004, the level of external debt is US$56.7 billion. The average maturity of this debt is 17 – 17.3 years.

- In terms of debt-service ratio, the Philippines is moving up, 12.4 in 2000, it went up to 15 in 2004. In the case of Malaysia it is almost steady 5, 6, 6.3, 5.8. For Indonesia, there was a reduction from 22.5 to 16.9 in 2003. A reduction for Thailand, from 25.1 at the height of the crises to 26 percent in 2003.

- In 2004, our assumption for the exchange rate is between 54 to 56.

- For 2005 up to 2010, we expect the exchange rate to be between P55 to P57 to a dollar.

Senator Villar wondered as to how much cost did that pronouncement of a "financial crisis" has brought to the country's credit standing.

Mr. Guinigundo explained that for every one percentage point on one hundred basis point increase in LIBOR would translate into US$185 million. He admitted to the chair that this talk of a fiscal crisis had increased the interest rate of some of the country's borrowings by P5.6 billion pesos.

Ms. Juanita D. Amatong, Secretary of the Department of Finance, briefing the Committee on its revenue targets, stated:

- The Bureau of Internal Revenue exhibited a turn around in its revenue performance surpassing the target by 1.3 billion, an increase of 7.8 percent from 2002.

- The Bureau of Customs collections grew by 10.2 percent to 106.1 billion well ahead of the target by 6 billion. Non-tax revenues increased by 26.1 percent to 89.3 billion in 2003 from 70.8 billion in 2002.

- The Bureau of Treasury's income rose by 20.1 percent to 56.7 billion from 47.2 billion.

- A conservative estimate is for the national government to meet its revenue target collection of 646.4 billion. In 2004 program, BIR and BOC are targeted to grow by 12 percent and 6.1 respectively. The BIR collection until the month of July grew by 10.3 percent while BOC is collecting at a much faster rate of 14.2 percent, higher than last year.

- For Fiscal Year 2005, total revenues are estimated to reach a total of 758.5 billion, representing a growth rate of 12.1 percent. The administrative measures which were started in the last three years are now starting to bear fruits.

- In 2003, the consolidated public sector deficit to GDP was 5.5 percent, but it reached 6.7 percent in 2004. We expect to bring this down to 5 percent in 2005.

- The actual deficit of the national government in 2003 is 199.9 billion pesos. Our debt financing in 2003 is 286.8 billion pesos. The financing mix is 45 percent foreign and 55 percent domestic.

Senator Villar expressed skepticism on the figures cited in the consolidated public sector deficit. He pointed out that the country's credit rating had been continuously downgraded and its cost of borrowings has gone up continuously.

The Chairman of the Committee emphasized the need to review the overhead expenditures of government controlled corporations before asking the people to pay more taxes. These government controlled corporations are losing billions and have increased the country's foreign debt and yet its officers are receiving millions in salaries despite the mismanagement.