



Republic of the Philippines
SENATE
Pasay City

RE : HIGHLIGHTS OF THE JOINT PUBLIC HEARING CONDUCTED BY THE COMMITTEES ON ECONOMIC AFFAIRS AND TRADE AND COMMERCE, RE: P.S. RES. NO. 93— ON THE IMPACT OF THE GOVERNMENT’S FISCAL PLAN ON PHILIPPINE ECONOMIC GROWTH AND DEVELOPMENT, HELD ON MONDAY, 20 SEPTEMBER 2004 AT 9:30 A.M., SEN. RECTO ROOM, PHILIPPINE SENATE

I. PRELIMINARY

Senator M A R Roxas, Chairman of the Committees on Economic Affairs and Trade and Commerce commenced the hearing at 9:40 a.m. to discuss P.S Resolution No. 93, focusing on the impact of the government’s fiscal plan on the economy.

With Senators Flavier, Enrile, Gordon, Magsaysay, Jr., and Madrigal providing the quorum, the Chair recognized the following resource persons:

RESOURCE PERSONS	DESIGNATION/AGENCY/SECTOR REPRESENTED
1. Ms. Nieves Osorio	Undersecretary, Department of Finance (DoF)
2. Mr. Augusto Santos	Deputy Director General, National Economic and Deveopment Authority (NEDA)
3. Mr. Rogelio Murga	President, National Power Corporation (NAPOCOR)
4. Mr. Raphael Lotilla	President and CEO, Power Sector Assets and Liabilities Management Corporation (PSALM)
5. Dean Raul Fabella	U.P. School of Economics, U.P. Diliman
6. Mr. Ernie Santiago	Executive Director, Semiconductor and Electronics Industries in the Philippines (SEIPI)
7. Mr. Dan Lachica	Treasurer, Semiconductor and Electronics Industries in the Philippines (SEIPI)

II. JOURNAL OF THE MEETING

1. At the outset, Senator Roxas stated that the meeting is an offshoot of the hearing of the Committee on Ways and Means with respect to the government’s fiscal plan, part of it calls for an increase in taxes combined with a power rate hike. While NEDA gave assurances that the plan presented by the government would be good for the economy, he noted that there were apprehensions and comments that it would lead instead to a contractionary series of events in the economy.
2. **Finance Undersecretary Nieves Osorio** reported that the target for 2005 consists of the passage of eight (8) new tax policy measures in addition to what the collecting agencies, the BIR and the BoC, would take up as administrative measures. She also pointed out the following: a) the new tax

measures are expected to generate a total of P80 billion while a reduction in government expenditures would amount to P20 billion; *b*) all government agencies, including the corporate sector, had been directed to submit specific measures to reduce the consolidated public sector debt (CPSD); and *c*) the CPSD includes Napocor's deficit amounting to P59 billion in 2005 assuming that the National Government would be able to reduce its outstanding liabilities by P500 billion.

3. PSALM President and CEO **Raphael Lotilla** clarified that the proposed power rate adjustment of P1.87, 97 cents of which had already been granted, would generate an additional revenue of P68 billion in 2005. Said figure, he added, will not cover all of the principal payments and capital expenditures.
4. The Chair summarized that the expected revenues from new taxes, reduction in government revenues and power rate hike would all sum up to P170 billion.
5. **NEDA Deputy Director General (DDG) General Augusto Santos** reported that their agency came up with simulation exercises to determine the impact on GDP of the following fiscal measures: a) tax on sin products; b) 2% increase in VAT; and c) excise tax on petroleum products. Based on their simulation model, DDG Santos reported the following results:

A. For sin taxes:

1. Without considering the impact of increased investor confidence, the effect of sin taxes amounting to around P9 to P14 billion on GDP is a .01% increase in the short run and a .03% increase in the long run.
2. Factoring in the increase in investor confidence, the long term effect on GDP is about 1.17%.

Narrative/assumptions:

- Expenditures on tobacco and alcohol products constitute a small percentage of total consumption based on the National Statistics Office;
- Sin products are price inelastic, meaning— there is no change in consumer behavior caused by the tax;
- There is an increase in GDP since the government is assumed as the more efficient and productive spender of revenues than the manufacturing companies;
- Health benefits are not incorporated in the simulation; and
- Senator Enrile's one classification model (no tiers) has not yet been studied by NEDA and that the four-tier taxation model was used in the simulation.

B. Excise Tax on Petroleum Products

1. Without considering the impact of increased investor confidence, the effect of a P1 excise tax on petroleum products is a .06% increase in GDP in the short run and a -.01% decrease in GDP in the long run; and
2. Without considering the impact of increased investor confidence, the effect of a P2 excise tax on petroleum products is a .11% increase in GDP in the short run and a -.06% decrease in GDP in the long run.

Narrative:

- Based on the model output, a tax on petroleum products has a slight contractionary effect on GDP in the long run;
- There is no change in people's driving behavior caused by the tax (price inelastic); and
- There is an increase in GDP with the assumption that government will utilize the revenues more efficiently than the consumers;

C. Increase in VAT

1. Without considering the impact of increased investor confidence, the effect of a 2% point increase in VAT is a -.01% decrease in GDP in the short run.

Narrative/Assumption:

- Government is again considered as the better spender of money than consumers; and
 - It was assumed that the 2% point increase in VAT pertains to the same coverage, meaning— lawyers, doctors and other professionals are still excluded;
6. In addition, DDG Santos stressed that: a) the measures were applied to the simulation model, one at a time, in sequence; b) the same government efficiency in spending was assumed in all the models; c) it is assumed that there is no earmarking of expected revenues for other purposes;
 7. As to the query of Senator Flavier how investor confidence is quantified, DDG Santos referred to it as the ratio of investments to GDP which is estimated at 8% during the boom years. He clarified however that NEDA used a conservative estimate of 5% in the simulation model.
 8. Asked by Senator Flavier on the efficiency rate of VAT collection, Undersecretary Osorio pointed out that the effective rate is only at 3.1% and that the 7% of the present 10% VAT remains uncollected. In absolute terms, she disclosed the potential VAT revenue at P279 billion as against the P135 billion actual collection. She maintained however that the country's 10% VAT

rate is relatively low compared to China and other Latin American and non-OECD countries.

9. Further queries by the chair showed that the three measures are expected to generate additional revenues of P14 billion ('sin' taxes); P20 billion (higher VAT rate) and P30 billion or P15 billion, respectively for a P2 or P1 excise tax on petroleum products.
10. As to why a P2 excise tax on petroleum products leads to an increase in GDP in the short run while the VAT increase leads to a decrease in GDP, DDG Santos explained that the latter impacts directly and immediately on personal consumption while the impact of the former on personal economic behavior is relatively small.
11. Mr. Dan Lachica, Treasurer of the Semiconductor and Electronics Industries in the Philippines (SEIPI) and President of First Sumiden Circuits maintained that the power rate hike will have a negative impact on the competitiveness of local industries, which is already weakened by a high manufacturing and labor costs. If left unsolved, he cautioned that these industries or other multinational companies may relocate to other countries. He likewise cited the following: a) the electronics and semiconductor industry accounts for about 68% of total Philippine exports; b) the industry is expanding at 8% as against the 25% growth worldwide; c) there were instances of company closures and reduction in operations due to the high cost of doing business in the country; d) the power cost, considered three times higher in the country compared to China, Indonesia, Thailand and Malaysia, consumes about 5% to 20% of the industry's operating cost; and e) increase in the cost of power would further impede progress towards open/direct access.
12. Dean Raul Fabella narrated that the U.P. paper on the fiscal crisis was written to spark a discussion and to see to it that certain adjustments would be made to improve the country's long-term performance. He mentioned that the U.P. professors are studying how reforms could be phased in. For this year, he maintained that the only realistic measures that could be applied are the sin taxes and the NAPOCOR adjustment while the rest could be implemented on a staggered basis for a period of 3 years. Personally, he believed that there will be a slowdown in the economy and the cost of the fiscal package may be about 3% to 4% growth foregone. He mentioned however that if nothing is done to

address the fiscal problem, the cost is estimated at P700 billion to P1 trillion in lost income.

Meanwhile, he contended that the money will be used by the government to repay the debt as against NEDA's model that it will be used to pump prime the economy.

13. Senator Enrile wanted to determine how much would be raised from the sin taxes and how would it be allocated among the rich or the poor sector. He

cited that the present income from cigarettes is valued at P19.5 billion and that 50% of the consumers pay only P1.12 specific tax out of the total 88 billion sticks sold. Senator Enrile then proposed that said P1.12 tax could be increased to a floor rate of P6 per pack, adding P1.50 every year and ending with a uniform rate of P12 in the 5th year. This proposal, he believed, would result to about P6.5 billion incremental revenue every year, reaching P53 billion on the 5th year.

14. As to the query of Senator Gordon, DoF estimated that about P24 billion is lost due to revenue leakages and customs duties. Senator Gordon believed that the figure is understated since a large percentage can be attributed to smuggling. He wondered why the people should be made to pay additional taxes when the government has failed to implement measures to plug the revenue loopholes.

Further, he mentioned that additional revenues would be generated from the following: a) streamlining the bureaucracy; b) revenues from government corporations; c) reduced government expenditure; and d) improving the system of accountability.

15. For his part, Senator Magsaysay emphasized the following: a) lawyers, doctors and other professionals should not be exempted from VAT payments; b) the semiconductor industries should be allowed to directly connect with Napocor to insulate them from the adverse effects of the power rate hike.

16. Napocor President Mr. Rogelio Murga stated that they could not implement open access because of the conditions under Section 31 of the EPIRA law which provides that the privatization of at least 70% of the generating assets of Napocor must first be realized. ERC regulation, he added, is to allow open access by the year 2006.

17. In closing, the Chair asked whether or not the Finance Department will amend or refine the fiscal package given the inputs made in the hearing—specifically with respect to smuggling, VAT efficiency and other improvements in administrative measures.

III. DOCUMENTS FOR SUBMISSION TO THE JOINT COMMITTEES

Member-Senators	FURTHER INSTRUCTIONS
Sen. Roxas	1) DoF / BIR- to submit information on what the P14 billion from sin taxes translates to on a per pack basis for the various tiers/classification; 2) DoF- to clarify the issue on VAT collection since it will affect the legislators' view on whether there is need to approve an increase in VAT; 3) NEDA- to run new simulations using its fiscal measure model, this time without assuming the beneficial impact of government action. The

	<p>assumption is that the government instead sequestered the money and used it to pay the debt; and</p> <p>4) Senate Secretariat- to prepare the appropriate resolution expressing the sentiment of the committee that the semiconductor industry, as well as other exporting industries, is recognized and that there is need to amend the EPIRA law so that open/direct access is allowed.</p> <p>5) Staff of the Joint Committees- to coordinate with the staff of Dean Fabella and matrix the U.P. paper vis-à-vis the fiscal plan.</p>
Sen. Flavier	<p>1) DoF or NEDA- to submit information on the conventional wisdom of increasing sin taxes and its effect on the consumers' smoking habit;</p> <p>2) NEDA- to consider Sen. Enrile's proposal for a single classification for the cigarette tax;</p>
Sen. Enrile	<p>1) NEDA/DoF- to do a simulation on how much revenue will be raised as well as the impact on demand/consumption of cigarettes if the minimum tax for all cigarettes will be set at P6 per pack to be graduated uniformly to P12 per pack in 5 years (an additional of P1.50 per year).</p>

ADJOURNMENT

The Chair manifested that another hearing will be conducted to look into the totality of the fiscal plan and its integrated impact on the economy and thereafter adjourned the meeting at 12:10 p.m.