



Budget Notes



SENATE ECONOMIC PLANNING OFFICE

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The President's 2013 Budget: the Macroeconomic and Fiscal Perspectives

A day after his third State of the Nation Address (SONA), President Benigno S. Aquino III submitted to Congress his proposed P2.006-trillion national budget for the fiscal year 2013. Next year's budget is touted as an "Empowerment Budget" with the overarching theme Paggugol na Matuwid: Atas ng Taumbayan. The Executive claims that it will reinforce the administration's commitment to fulfill the Aquino administration's Social Contract with the Filipino people by seeking to drive up a stronger, sustainable and inclusive socio-economic growth.

As the financial blueprint of the government, the national budget warrants the legislature's approval. It is thus incumbent upon the Congress to review and scrutinize the President's budget proposal, particularly its underlying macroeconomic and fiscal assumptions.

Macroeconomic Assumptions of the Budget

Careful attention to economic trends is essential in budget formulation. The size of the budget and the revenue and expenditure estimates are all dependent on how the economy will fare for the period in consideration. The GDP, for instance, can affect the government's revenue targets. Higher GDP generally results in a larger tax base and consequently, higher revenue collections from the domestic market. Conversely, lower GDP normally leads to lower revenues. A higher-than-expected inflation rate, on the other hand, could lead to higher government revenues because of the increase in the price of the taxable goods. Meanwhile, changes in the foreign exchange rate as well as in the interest rate can affect both the revenues and disbursements. Moreover, the different macroeconomic variables are highly correlated and can significantly affect one another. The Bangko Sentral ng Pilipinas (BSP) for instance often look at the inflation rate when deciding on whether to cut, increase or maintain its policy rates. Changing interest rates, in turn, impact the currency values as higher interest rates attract foreign capital and cause the exchange rate to rise. Because of these interrelationships, it is of paramount importance that assumptions on macroeconomic indicators and forecasts about the economy are fairly accurate.

The macroeconomic parameters of the budget are deliberated on and determined by the Development Budget Coordination Committee (DBCC) and are stated in the Budget of Expenditure and Sources of Financing (BESF) published by the Department of Budget and Management (DBM).

While admittedly, macroeconomic forecasting is a difficult exercise as it is based on many variables and uncertainties, it is interesting to note that in the last thirteen years, from 1999 to 2011, not even once did the actual GDP growth rate fall within the growth range projected in the BESF. Actual GDP growth was lower than the forecast ten times and higher than what was targeted three times. During the said period, the inflation target was breached thrice--in 2004, 2005 and in 2008 which was the height of the global financial crisis. Except in 2008, actual T-bill rates are often lower than the assumed, indicating that the government spent less than what was programmed for domestic debt servicing for the said period. As for the foreign exchange rate, it was only in 2011 that

the actual peso-to-dollar exchange rate fell within the government assumption. Actual exchange rate deviated from the target by an average of PhP3.01.

**Table 1. Selected Macroeconomic Indicators
Projected vs. Actual, 1999-2011**

Year	Real GDP growth rate (in %)		Inflation rate (in%)		Foreign exchange rate (PhP:\$US)		T-bill rate ^{1/} (in%)	
	Projected	Actual	Projected	Actual	Projected	Actual	Projected	Actual
1999	3.5-4.5	3.30	8.0-9.0	6.60	43.0	39.09	16.0	10.20
2000	4.8-5.4	4.40	6.5-7.5	4.40	41.0	44.19	9.5-10.5	9.90
2001	4.0-5.0	3.00	5.5-6.5	6.10	42.0	50.99	8.9-9.9	9.90
2002	4.3-4.8	3.30	5.0-6.0	3.00	50-51	51.60	10.0-11.0	5.40
2003	5.0-5.5	4.90	4.0-5.0	3.50	51-52	54.20	8.0-9.0	6.00
2004	4.9-5.8	6.40	4.0-5.0	6.00	54.0	56.04	7.5-8.5	7.30
2005	5.3-6.3	5.00	4.0-5.0	7.60	56.0	55.09	7.5-8.5	6.40
2006	6.3-7.4	5.30	7.50	6.20	55-57	51.31	7.5-8.5	5.40
2007	5.7-6.5	7.10	4.3-4.8	2.80	53.0	46.15	5.5-6.0	3.40
2008	6.1 - 6.8	4.20	3.0 – 4.0	9.30	46.0	44.47	4.0- -5.0	6.5*
2009	6.1-7.1	1.10	6.0-8.0	3.20	42-45	47.64	5.0-6.0	4.6*
2010	2.6-3.6	7.60	3.5-5.5	3.80	46-49	45.11	5.0-7.0	4.3*
2011	5.00	3.90	3.0-5.0	4.60	45-47	43.30	4.0-6.0	2.4

Source: BESF, various years

^{1/} Starting 2008, the 364-day T-bill rate instead of the 90-day T-bill rate was used

Sensitivity Indicators. Table 2 shows the budgetary effects on revenues, spending and the fiscal deficit should actual macroeconomic indicators differ from those assumed in the budget's forecasts. Holding all other things constant, a one-percentage point increase in the GDP in 2013 will increase revenues by PhP15.2 billion and reduce the deficit by the same amount.

Table 2. Sensitivity Indicators, Year 2013, (in PhP billion)

Particulars	Revenues	Disbursements	Surplus/(Deficit)
1 percentage point increase in real GDP	15.2		15.2
PhP1 Depreciation in foreign exchange	8.6	2.6	6.0
1 percentage point (100 bps) increase in Treasury bill rate (all maturities)	8.2	3.2	5.0
1 percentage point Increase in imports	4.7		4.7
1 percentage point Increase in inflation	14.6		14.6

Source: Dept. of Finance

*/ Negative figures imply an increase in the deficit level while positive figures mean a decrease in the deficit

A higher-than-expected GDP, and the corresponding increase in revenues is particularly favorable for projects with unprogrammed funds. Unprogrammed appropriations are released only when the revenue collections exceed the original revenue targets submitted by the President or when additional foreign funds are generated. For 2012 and 2013, the unprogrammed funds amount to PhP152.8 billion and PhP117.5 billion, respectively.

DBCC forecasts for 2012 and 2013. For 2012 and 2013, the government is expecting the gross national income to grow by 4.4-5.4 percent and by 5.4- 6.4 percent respectively¹. The domestic economy, on the other hand, is expected to expand by 5 to 6 percent in 2012, with GDP growth increasing to 6 to 7 percent in 2013.

Table 3. Macroeconomic Parameters, 2011-2013

Macroeconomic Parameter	(Actual)	Projection/Target	
	2011	2012	2013
Real GNP growth (%)	3.2	4.4-5.4	5.4-6.4
Real GDP growth (%)	3.9	5.0-6.0	6.0-7.0
Inflation rate (%), CPI (2000=100)	4.6	3.0-5.0	3.0-5.0
Population growth rate (%)	2.1	2.1	2.0
364-day T-bill rate (%)	2.4	3.0-5.0	3.0-5.0
Foreign exchange rate (PhP/US\$)	43.3	42-45	42-45
LIBOR,6 months (%)	0.51	0.4-1.4	0.5-1.5
Dubai crude oil (US\$/barrel)	106.19	90-110	90-110
Exports growth rate (%)	(6.9)	10.0	12.0
Imports growth rate (%)	1.6	12.0	14.0
Current Account Balance (% of GDP)	3.1	1.9	n/a
Gross International Reserves	11.3	10.3	n/a

Source: BESF 2013

Even with the higher growth projections, government predicts inflation to remain benign at 3-5 percent both for 2012 and 2013. This expectation is generally congruent with the DBCC's assumption that the price of the Dubai crude oil will continue hovering between US\$90-110 per barrel for the said period. The cost of domestic borrowings is likewise expected to be steady with the 364-day T-bill rate pegged at 3 to 5 percent while the London Interbank Offered Rate (LIBOR), which is the base for most interest quotations for foreign debt, is set between 0.5 to 1.5 percent for 2013. Meanwhile, the peso is anticipated to remain stable against the dollar, at the 42-45 peso-dollar exchange rate both for this year and the next.

Despite heightened regional and global uncertainties, the government's assumptions for exports and imports point to a more robust external trade in 2012 and 2013. From a negative export growth of 6.9 percent in 2011, the government expects the sector to rebound to 10 percent this year and rise further to 12 percent next year.

Unlike in the previous years, there are no projections for the current account balance and the Gross International Reserves for 2013. The DBCC may be asked why this is so. For 2012 though, the country's current account surplus is expected to narrow to 1.9 percent of the GDP from 3.5 percent in 2011, reflecting in part the increase in the country's trade deficit.

The government's growth projection for 2012 is generally at par with the outlook of local think tanks, Institute of Development and Econometric Analysis Inc. (IDEA) and Philippine Institute for Development Studies (PIDS) but is higher than the forecasts of multilateral institutions and major credit rating agencies (except for Fitch). Like the Philippine government, most, with the exception of

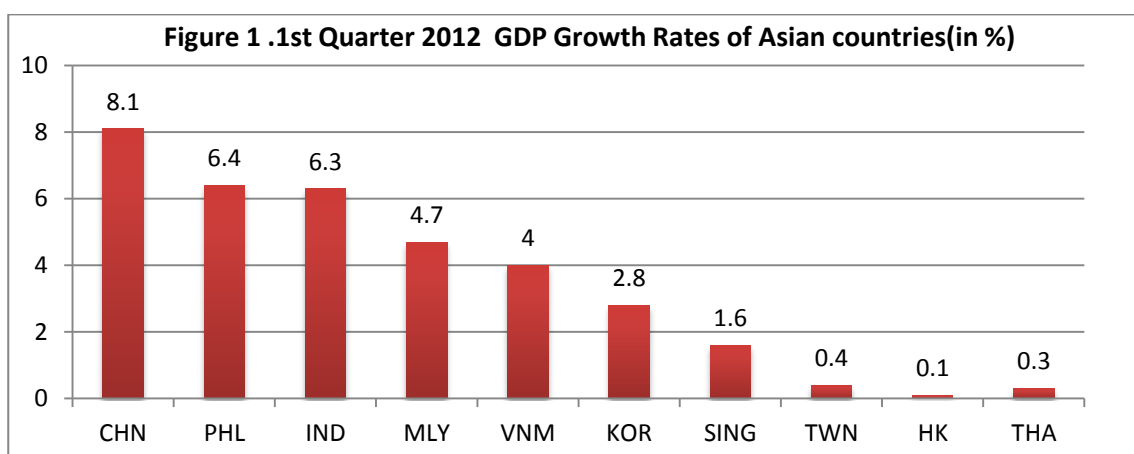
¹ What was formerly referred to as the Gross National Product is now termed Gross National Income (GNI). The GDP is the value produced within a country's borders, whereas the GNI is the value produced by the country's citizens (including income obtained from other countries (dividends, interests), regardless of their whereabouts.

IDEA, are looking at a faster pace of growth for the country in 2013. However, the projections are less sanguine than the DBCC's growth forecast of 6 to 7 percent GDP growth.

Table 4. Real GDP growth rate forecast for 2012 and 2013 (in %)

Institution	2012	2013	Remarks
DBCC	5.0-6.0	6.0-7.0	As of June 2012
World Bank	4.6	5.0	As of July 2012
Asian Development Bank	4.8	5.0	As of July 2012
International Monetary Fund	4.8	4.9	As of July 2012
Standard & Poor's	4.3	4.5	As of July 2012
Moody's	4.7	-	As of June 2012
Fitch Ratings	5.5	-	As of June 2012
IDEA	5.4-6.5	4.7-6.0	As of July 2012
PIDS	5.6	-	As of March 2012

Recent macroeconomic performance. After a lackluster performance in 2011, the Philippine domestic economy grew by 6.4 percent in the first quarter of 2012. It was the fastest growth rate in the ASEAN region and the second highest in Asia, next only to China which grew by 8.1 percent.



Source: various country websites

Services still the main engine of growth. On the supply side, services remained the prime growth driver. Its solid 8.5 percent growth in the first quarter was largely attributable to the strong performance of its trade, other services, real estate and transportation, storage and communication subsectors.

Agricultural growth, on the other hand, slowed down to 1.0 percent from 4.4 percent in Q1 2011, as a result of the adverse weather conditions and floods that ravaged a number of palay and sugarcane farms. The bad weather, aggravated by the high cost of fishing operations and the implementation of the fishing ban in some parts of the Celebes Sea and Panatag Shoal continued to take a toll on the fisheries sector which further contracted by 3.8 percent from -3.1 percent in the first quarter of 2011.

Likewise, industry's growth, while positive, decelerated to 4.9 percent from 7.3 percent in Q1 2011. Mining and quarrying, suffered the most, contracting by 11 percent from a double digit growth of 32.2 percent in the same period last year. The manufacturing sector recovered some grounds after posting low growth rates in the last two preceding quarters but at 5.7 percent, its expansion was still below the 8.1 percent growth it posted in the same period last year.

**Table 5. Gross National Income and Gross Domestic Product by Industrial Origin
Growth Rates, Full year 2011, First Quarter 2011 and 2012 (at constant prices , in %)**

Particulars	FY 2011	Q1 2011	Q1 2012
Gross domestic product	3.9	4.9	6.4
Agriculture, Hunting, Forestry and Fishing	2.7	4.4	1.0
Agriculture and Forestry	4.5	6.3	2.1
Fishing	-4.1	(3.1)	(3.8)
Industry	2.3	7.3	4.9
Mining & quarrying	7.0	32.2	(11.0)
Manufacturing	4.7	8.1	5.7
Construction	-7.3	4.2	3.6
Electricity, gas & water	0.6	(0.6)	8.0
Services	5.1	3.6	8.5
Transport, communication and storage	4.3	4.2	9.0
Trade and Repair of Motor vehicles, motorcycles, personal and household goods	3.3	2.8	8.9
Financial Intermediation	5.2	6.4	8.8
Real estate, Renting and business activities	9.3	6.2	7.9
Public Administration and Defense: Compulsory Social Security	0.3	(7.9)	1.5
Other services	6.6	5.0	10.5

Source: National Accounts of the Philippines, National Statistical Coordination Board(NSCB)

On the demand side, the growth came mainly from net exports as well as the robust household and government spending.

**Table 6. Gross National Income and Gross Domestic Product (Expenditure side)
Growth Rates, Full year 2011, First Quarter 2011 and 2012 (at constant prices , in %)**

Particulars	FY 2011	Q1 2011	Q1 2012
Household Final Consumption expenditure	6.3	5.9	6.6
Government consumption	1.0	(15.8)	24.0
Capital formation	8.1	36.1	(23.5)
Fixed capital	0.2	12.5	2.8
Construction	(6.2)	8.1	0.3
Public	(31.8)	(35.2)	67.7
Private	4.5	29.6	(6.2)
Durable equipment	5.2	17.2	3.6
Breeding stock & orchard development	-0.3	1.0	1.1
Intellectual Property Products	11.8	18.5	32.0
Exports	(4.2)	3.9	7.9
Exports of goods	(6.0)	6.5	7.1
Exports of services	4.0	(4.7)	11.1
Imports	0.2	11.2	(2.6)
Imports of goods	0.4	16.3	(6.1)
Imports of services	(0.7)	(6.6)	12.8

Source: NSCB

Strong rebound in exports. The recovery of exports in the first quarter was ascribed to the increase in the demand of North American manufacturing firms and the settlement of supply side disruptions in Japan and Thailand. Latest data from the National Statistics Office show that aggregate exports for the first five months of the year grew by 8.4 percent fueled by the strong outbound shipments of manufactured products such as machinery and transport equipment, chemicals, and other miscellaneous manufactures. However, receipts from exports of electronics, which account for the biggest share of total exports, dropped by 1.63 percent to US\$10.3 billion from US\$10.4 billion last year. This continuous drop is worrisome considering that there was already a 9.11 percent contraction in exports of electronics in the same period in 2011. Japan, the United States and China remain the country's top three export destinations during the said period.

Table 7. Growth Rate of Philippine Exports by Commodity Group, January to May 2011 and 2012 (in %)

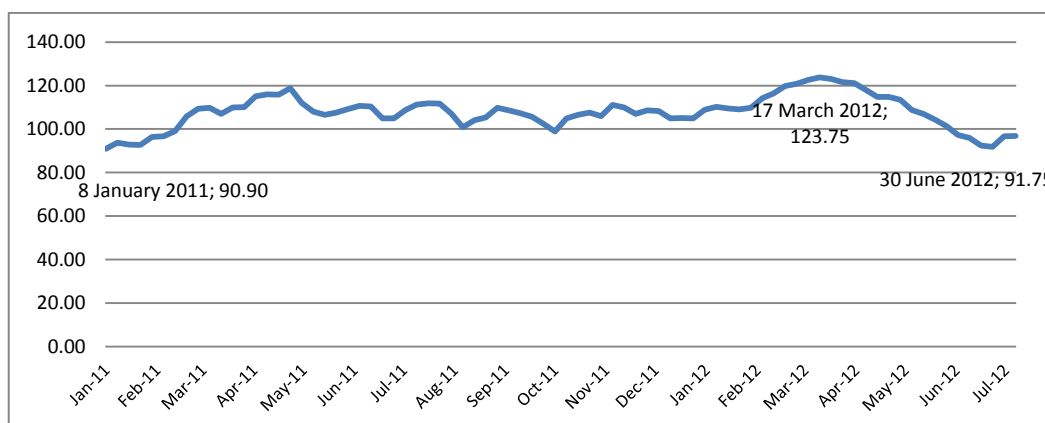
	Jan-May 2011	Jan-May 2012
Total Exports	7.51	8.36
Agro-based products	56.49	-11.77
Forest Products	-9.65	34.45
Mineral products	60.82	-23.06
Petroleum Products	143.55	-39.85
Manufactures	0.46	13.34
Electronic products	-9.11	-1.63
Special Transactions	26.17	8.1
Re-export	-6.72	-18.36

Source: National Statistics Office(NSO)

Growth still consumption-led. Household spending, was also a key growth driver, contributing 4.6 percentage points to the GDP growth in the first quarter. Consumption spending was supported by the moderate inflation and the continuous inflow of remittances.

Inflation in Q1 2012 averaged 3.1 percent, down from 4.5 percent in Q12011. The BSP reports that the decline was due largely to favorable domestic supply conditions which lowered the prices of most food items, notably vegetables, sugar, rice, and oils. Inflation further eased in the succeeding months on account of lower oil prices. Since April 2012, the Dubai crude oil price has been trading under US\$100 per barrel and economists predict that it is likely to stay below that mark for the rest of

Figure 2. Weekly average of Dubai crude prices from January 2011 to July 2012 (USD/barrel)



Source: Dept. of Energy

the year. Data from the in the local price of gasoline is PhP0.63 per liter, while the price of diesel actually declined by PhP2.08 per liter. This partly caused the inflation for January to June 2012 to settle at 3.0 percent, well within the BSP's target.

Remittances from overseas Filipinos, on the other hand, totaled US\$8.32 billion, from January to May 2012, an increase of 5.3 percent from US\$7.9 billion in the same period in 2011. The increase was due to the continued deployment of OFWs abroad. It must be noted though that while remittance inflows continue to increase, the pace of growth has been diminishing over the years. Prior to 2009, remittance inflows were posting double-digit growth rates. Last year, the growth registered was only 7.22 percent.

Monetary policy eases as peso strengthens. The low inflation outturn afforded the BSP to have a more accommodative monetary policy stance. The Monetary Board cut its policy rates thrice since January 2012, by a total of 75 basis points, bringing the overnight borrowing rate to a new record low of 3.75 percent and the overnight lending rate to 5.75 percent. The interest rates on special deposit accounts (SDAs) were also reduced accordingly.

Some quarters have argued that the latest rate cut, announced by the BSP on July 26, 2012, was unnecessary given the already high growth in the first quarter. There are also fears that it may further cause excessive liquidity in the domestic market. However, aside from the intended impact of stimulating growth in the face of a sluggish global economy, the rate cut is also a move to reduce speculative inflows and limit the peso strength. In the first seven months of the year, the peso outperformed other Southeast Asian currencies, appreciating by 5.1 percent against the greenback. The peso was buoyed by the continuous inflows of OFW remittances, foreign portfolio investments as manifested by the strong showing of the Philippine stock market, and foreign direct investments, particularly in the country's business process outsourcing (BPO) sector.

Vigorous public spending but weak investments. Consistent with government pronouncements to accelerate expenditures this year to prevent a repeat of the underspending last year, public spending made a remarkable turnaround, from a contraction of 15.8 percent in Q1 2011 to 24 percent growth in Q1 2012. The early and comprehensive fund releases to all agencies, strong budgetary support for infrastructure initiatives and the continuous implementation of the major antipoverty and social programs (i.e. CCT) helped ramp up government consumption in Q1 2012. Public construction, in particular, grew by 67.7 percent.

Weak investments, however, dragged over-all growth with low private construction spending and narrowing inventories primarily causing the decline. Construction spending of the private sector contracted by 6.2 percent, challenging the government's claim of renewed investor confidence.

Moreover, in the 2012 World Investment Report of the United Nations Conference on Trade and Development (UNCTAD), it was shown that the Philippines, while having favorable economic indicators failed to maximize its potential to attract foreign direct investments(FDIs). UNCTAD's FDI Attraction Index—which evaluates the success of economies in attracting FDI showed that the Philippines “received less FDI than could be expected based on economic determinants.” The Philippines is in the same boat as Argentina, Slovenia and South Africa. Out of the US\$116 billion FDIs that entered Southeast Asia in 2011, the Philippines got only US\$1.2 billion or only 1 percent. In contrast, Singapore received US\$64.0 billion worth of FDIs, Indonesia US\$18.9 billion, Malaysia, US\$12 billion, Thailand US\$9.6 billion and Vietnam US\$7.4 billion.

Table 8. FDI inflows, by region and economy, 2006-2011 (in million US\$)

Region/economy	2006	2007	2008	2009	2010	2011
South-East Asia	64,038	85,603	50,254	47,408	92,760	116,559
Brunei Darussalam	434	260	330	371	626	1,208
Cambodia	483	867	815	539	783	892
Indonesia	4,914	6,928	9,318	4,877	13,771	18,906
Lao People's Democratic Rep.	187	324	228	319	333	450
Malaysia	6,060	8,595	7,172	1,453	9,103	11,966
Myanmar	428	715	976	963	450	850
Philippines	2,921	2,916	1,544	1,963	1,298	1,262
Singapore	36,700	46,930	11,798	24,418	48,637	64,003
Thailand	9,501	11,359	8,455	4,854	9,733	9,572
Timor-Leste	8	9	40	50	27	20
Vietnam	2,400	6,700	9,579	7,600	8,000	7,430

Source: 2012 World Investment report, UNCTAD

External payments position remains robust. The Philippines registered a balance of payments (BOP)² surplus of US\$1.20 billion for the first quarter of 2012. Data from the BSP show that for the first half of the year, the BOP surplus amounted to US\$1.32 billion, supported by the inflows of foreign investments, income from exports, remittances sent by overseas Filipinos, foreign currency-denominated loans extended to the government and income by the BSP from its investments abroad. However, the said BOP surplus is just about a quarter of the US\$5.016-billion surplus posted in the same period last year. Both the current and capital and financial accounts yielded lower net inflows, reflecting the 'wait-and see' stance of investors due to the ongoing global economic turmoil. Still, the BOP surplus allowed the BSP to further build up its reserves to US\$76.3 billion as of June 2012. The end-June 2012 GIR level can adequately cover 11.2 months worth of imports of goods and payments of services and income. It is also equivalent to 10.3 times the country's short-term external debt based on original maturity and 6.0 times based on residual maturity.²

The comfortable level of the GIR also enabled the country to make a one billion dollar pledge to the IMF's Financial Transaction Plan (FTP), a facility that lends to critically distressed Eurozone countries. The move initially elicited negative reactions from various sectors, but the BSP has adequately explained that the IMF loan presents a profitable use of the country's foreign reserves as the interest earnings the country will make from it will be higher at 0.30 percent than the present earning of 0.29 percent from US treasuries. Also, as much of the country's GIR is invested in US Treasuries, Japanese bonds, Euro bonds and gold, the loan pledge is an opportunity for the BSP to diversify its portfolio.

The said contribution to the FTP will likewise help prevent a widespread financial contagion from the Euro zone crisis. Eurozone is a key segment of the country's export market and one of the major country destinations of OFWs. Thus, it is in the country's best interest if the Eurozone's economy will be stabilized. Moreover, Republic Act 7653, the law creating the autonomous BSP, prohibits the BSP to engage in development financing. Instead, the Monetary Board (MB) is directed to invest the country's dollar reserves or GIR in AAA investment grade financial instruments and institutions, such as the IMF.

² The BOP refers to the difference between foreign exchange inflows and outflows on a particular period and represents the country's transactions with the rest of the world.

Labor market improved but quality of jobs questionable. The high economic growth in the first quarter translated into jobs creation with the January and April 2012 rounds of the Labor Force Survey (LFS) showing that an average of 1.061 million jobs have been generated year-on-year. This is a welcome departure from the jobless growth pattern that has beleaguered the economy in the past.

Table 9. Selected Labor and Employment Indicators

Indicator	2011	2012	
	April	Jan	April
Labor Force Level Growth Rate (%)	3.1	2.8	2.4
Employment Growth Rate (%)	4.0	3.0	2.8
Employment Generated ('000)	1,408	1,101	1,021
Unemployment Rate (%)	7.2	7.2	6.9
Underemployment Rate (%)	19.4	18.8	19.3

Source: Labor Force Survey, NSO

However, the quality of employment remains an issue. While the number of wage and salary workers increased by 3.7 percent, the jobs created may be construed as mainly part-time and unskilled work. The number of full-time workers declined by 2.8 million to 20.3 million in April 2012 from April 2011 while the number of part-time workers (or those who worked for less than 40 hours per week) increased by 1.7 million over the same period. There was also an increase in the number of unpaid family workers from 4.4 million to 4.5 million. Self-employed workers (who do not have any paid employee) likewise increased from 10.8 million to 11.2 million. Workers in this class are often paid low and likely with no job security.

Risks to economic growth abound. Whether the high economic growth posted in the first quarter will be sustained for the rest of the year until 2013 is a big question. Downside risks abound, the most significant of which is the on-going sovereign debt crisis in Europe. As earlier mentioned, the Philippines is vulnerable to the Eurozone crisis through trade and remittance linkages.

The softening of the growth of China and India, two of the world's fastest growing economies are also important threats to the country's growth outlook. Though a "soft landing" for China is expected to be the likely growth outturn, a more rapid-than-expected slowdown should not be discounted. Relatedly, the prevailing tension between China and the Philippines over conflicting territorial claims should also be closely monitored.

On the domestic front, a potential growth booster is next year's local polls. It has been observed that the GDP growth rates were higher during election years. In fact, in the last ten years, it was only during election years (2004, 2007 and 2010) that real GDP growth exceeded 6 percent.

However, weather vagrancies and the potential losses and damages they will bring may put a damper on the country's growth prospects. The Philippines ranks third in the world in terms of being at risk to climate change -related disasters and risks. The World Bank estimates that the country loses PhP15 billion annually to disasters like typhoons and floods. In 2009, damages brought by typhoons Ondoy and Pepeng are estimated to have amounted to 0.4 percent of the GDP³.

³ Initial losses and damages are estimated to be equivalent to 2.7 percent of the GDP. However, once projected public and private recovery and reconstruction spending are included, the net impact of the natural disaster becomes much lower.

There is also uncertainty on how the government's public-private partnership program (PPP) will turn out. While the government reports that significant headways have been achieved in pushing for the PPP as an investment promotion strategy, to date, only the DPWH's Daang Hari-SLEX Link Road project have been successfully tendered.

Another key risk is the continuing peso appreciation. According to Dr. Raul Fabella, National Scientist and noted economist, allowing the peso to further strengthen beyond P40:\$1 will hit hard the country's sunshine industries (i.e. tourism, BPOs and export industries, as well as the OFW households) and will be disastrous to the economy. With foreign loans appearing cheaper, it may also give the economic managers the idea to tinker with the borrowing mix and borrow more from foreign creditors, which he said, should not be the case. He said that a calibrated depreciation of the peso should be followed by the BSP as this may also serve as a tool to protect the country's domestic industries.

The critical challenge that thus appears is bolstering the domestic economy to cushion it from external shocks and ensuring that growth is broadbased, sustainable and inclusive.

Experts have attributed the high unemployment and underemployment rates and the massive poverty in the country to its failure to transform from a low-income agricultural economy to one that is industrial and highly productive. Unlike other Asian countries which pursued industrialization first, the Philippines leapfrogged and prematurely shifted to services thereby bypassing the process of industrialization.

To achieve inclusive growth and to create productive employment opportunities for the growing labor force, the Philippines needs to develop a stronger industrial sector. Though the modern services sector, particularly the BPOs, has been propping up the economy, it cannot be relied upon to absorb the country's surplus labor as it is biased in favor of the relatively skilled workers. The ADB (2012) recommends that industrial upgrading and diversification be prioritized by the government. For such to happen, public intervention is needed to improve information and coordination and help entrepreneurs take advantage of market opportunities.

Moreover, long-standing bottlenecks, such as the underprovision of basic infrastructure, the low level of human capital development due to the underfunding of the health and education sectors, weak governance and the discouraging perception of the country's business environment should be addressed.

As it is the sector which provides surplus labor to the industry and services sector, agriculture and fisheries must likewise be given adequate attention. Development efforts should be geared towards the transformation of the agricultural sector into one that is not only highly productive but also climate-resilient given its vulnerability to weather conditions.

Lastly, there is a need to ensure that government resources are adequate to finance public spending for these undertakings, especially in the event that global economic environment further deteriorates.

Fiscal assumptions of the budget

Fiscal Outlook for 2013. Despite the global economic woes, the Aquino administration is still committed to pursue fiscal consolidation in 2013, that is, bringing down the deficit and debt to manageable levels. To achieve this, the government has vowed to continue increasing spending but focusing it more on infrastructure, and the education and health sectors.

The national government deficit for 2012 is targeted to reach PhP279.1 billion (2.6% of GDP), higher than last year's deficit of PhP 197.8 billion. For 2013, deficit is set at PhP241.0 billion or 2.0 percent of the GDP (Table 11).

Latest fiscal data, however, show that both revenues and spending appear to be falling short than what were programmed for 2012. Fiscal deficit for January to June 2012 stood at PhP34.5 billion which is PhP74.8 billion lower than the planned target of PhP109.3 billion. While this would seem to be good news, the lower than expected deficit was achieved by reining in government spending with revenues falling short of the target. Despite the administration's pronouncements that spending will be accelerated and that there will not be a repeat of the underspending last year, national government expenditures for the first half of the year was still below the program by PhP89.9 billion.

Table 10. NG Fiscal Performance, Jan – Jun 2012
(In billion PhP)

PARTICULARS	Actual Jan - Jun 2011	Program Jan - June 2012	Actual Jan - Jun 2012	Variance	% Growth
Revenues	681.7	776.0	760.9	(15.1)	11.6%
Tax	593.5	710.1	671.5	(38.6)	13.1%
Non-tax	88.2	65.9	89.4	23.5	1.4%
Expenditures	698.9	885.3	795.4	(89.9)	13.8%
Surplus/(Deficit)	(17.2)	(109.3)	(34.5)	74.8	100.7%

Source: Bureau of Treasury

Table 11. NG Account Balance

PARTICULARS	Level (In Billion Pesos)				Percent of GDP (%)			
	Actual 2010	Actual 2011	Program 2012	Proposed 2013	Actual 2010	Actual 2011	Program 2012	Proposed 2013
Revenues	1,207.9	1,359.9	1,560.6	1,780	13.4	14.0	14.5	14.9
Expenditures	1,522.4	1,557.7	1,839.7	2021.1	16.9	16.0	17.1	16.9
Surplus/(Deficit)	(314.5)	(197.8)	(279.1)	(241.0)	(3.5)	(2.0)	(2.6)	(2.0)
<i>Memo Item: GDP</i>	9,003.5	9,735.5	10,734.2	11,951.9				

Source: DBM

Meanwhile, the Consolidated Public Sector Financial Position (CPSFP) will remain in the negative. The public sector deficit will swell to PhP213.9 billion (2% of GDP) this year from PhP178.75 billion (1.8 percent of the GDP) in 2011 before substantially narrowing to PhP158.3 billion in 2013.

Bulk of the consolidated public sector deficit is still accounted for by the national government. Despite the implementation of the GOCC Governance Act of 2011 which laid the groundwork for enhanced fiscal discipline within GOCCs, monitored GOCCs will still contribute PhP32.01 billion in 2012 and PhP 41.01 billion in 2013 to the public sector deficit. Meanwhile, the positive financial performance of the Social Security Institutions(SSIs) and the Government Service Insurance System(GSIS), the Government Financial institutions(GFIs) and Local Government Units(LGUs) is

expected to contribute to the improvement of the consolidated public sector financial position. A notable improvement will come from the Bangko Sentral ng Pilipinas (BSP), from negative PhP47.43 billion in 2011 to PhP1.00 billion in 2012 and 2013.

Table 12. Consolidated Public Sector Financial Position, 2010-2013 (in billion PhP)

	2010	2011	2012	2013
TOTAL SURPLUS+/-DEFICIT-	(355.81)	(178.75)	(213.92)	(158.34)
as percent of GDP	-4.0%	-1.8%	-2.0%	-1.3%
TOTAL Public Sector Borrowing Requirement	(389.08)	(224.96)	(314.52)	(287.29)
as percent of GDP	-4.3%	-2.3%	-2.9%	-2.4%
National Government	(314.47)	(197.75)	(279.11)	(241.00)
CB restructuring	(7.69)	(3.54)	(3.40)	(5.28)
Monitored GOCCs	(66.93)	(23.67)	(32.01)	(41.01)
SSS/GSIS	40.12	47.97	66.76	63.70
BSP	(63.72)	(47.43)	1.00	1.00
GFI	9.45	9.94	9.34	12.28
LGUs	34.10	34.72	23.51	25.47
Other adjustments	13.32	1.02	0.00	26.50

Source: 2013 BESF

Revenue Program. With several administrative and governance reforms being implemented, revenue is projected to grow by 14.8 percent of GDP this year and 14.1 percent next year. Of the projected total revenue in 2013, PhP1,651.3 or 92.5% would come from tax collections while the meager 7.2% would be accounted for by non-tax sources.

Moreover, the Bureau of Internal Revenue (BIR) is targeted to generate the bulk (69.6%) of collections at PhP1,238.6 billion while the Bureau of Customs (BOC) would only contribute around P397.3 billion(22.3%). Meanwhile, fees and charges' collection is programmed to decline in 2012 and 2013 implying that there will likely be no rate adjustments on government fees and other charges paid by the public.

The revenue projection does not yet include the impact of the pending sin tax reform and rationalization of fiscal incentives bills.

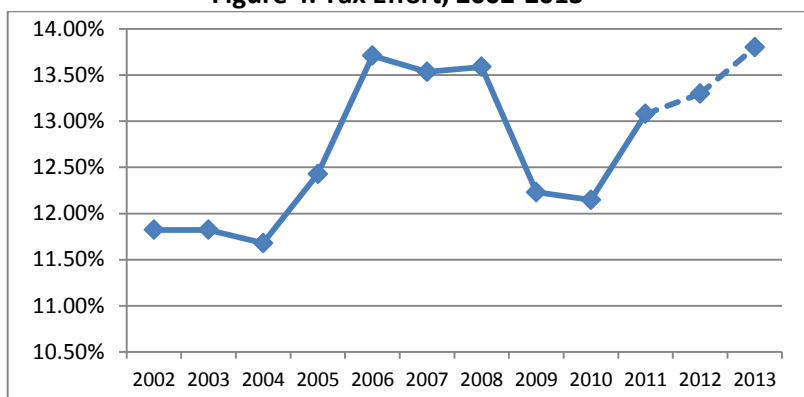
Table 13. Revenue Program by Source, CY 2011-2013

Particulars	Amount (In Million)			Percent Distribution (in%)			Growth Rates (in%)	
	2011 Actual	2012 Program	2013 Proposed	2011 Actual	2012 Program	2013 Proposed	2011-2012	2012-2013
Revenue	1,359.9	1,560.6	1,780.1	100.0	100.0	100.0	14.8	14.1
Tax Revenues	1,202.0	1,427.4	1,651.3	88.4	91.5	92.8	18.8	15.7
% of GDP	12.3%	13.3%	13.8%					
BIR	924.1	1,066.1	1,238.6	68.0	68.3	69.6	15.4	16.2
BOC	265.1	347.1	397.3	19.5	22.2	22.3	30.9	14.5
Other Offices	12.8	14.2	15.4	0.9	0.9	0.9	10.9	8.5
Non-tax Revenue	157.9	133.2	128.8	11.6	8.5	7.2	-15.6	-3.3
Fees & Charges	75.2	61.8	53.2	5.5	4.0	3.0	-17.8	-13.9
BTR income	81.5	69.4	73.6	6.0	4.4	4.1	-14.8	6.1

Source: 2013 BESF

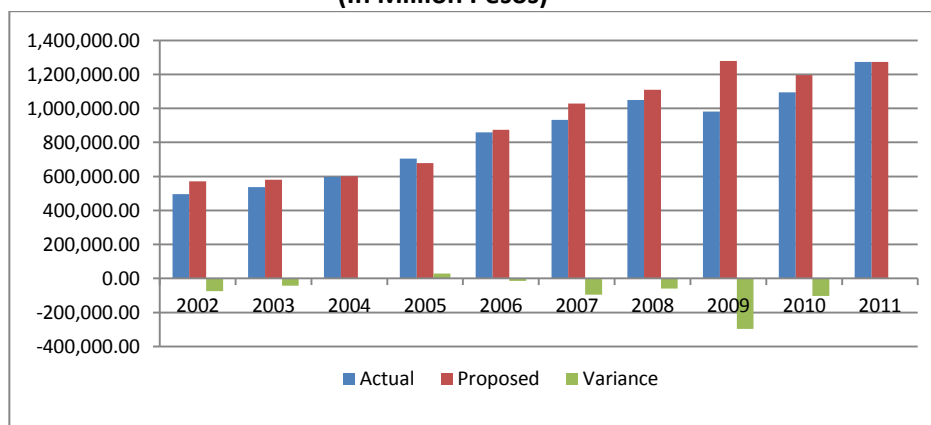
The tax effort (tax –to – GDP ratio), on the other hand, is positioned to climb from 13.1 percent in 2011 to 13.3 percent this year and increase further to 13.8 percent in 2013. The more vigilant implementation of the Run After Tax Evaders (RATE) and Run After The Smugglers (RATS) programs of the BIR and BOC, respectively, as well as the establishment of Revenue Integrity Protection Service (RIPS) within the sphere of the DOF, are seen to help improve tax collection.

Figure 4. Tax Effort, 2002-2013



Source: DoF

Figure 5. Actual Vs. Proposed Revenue Targets (In Million Pesos)



Source: BESFs, various years

The government has had a poor track record in meeting its revenue targets. In the past 10 years, from 2002 to 2011, the government hit or exceeded its projected revenues (Figure 3) only twice. The excess Php27.9 billion tax collection in 2005 can be attributed to the enactment of new tax measures (RA 9334 – amended excise tax on sin products and RA 9337 – Reformed VAT Law) in late 2004 and in the first half of 2005 (Manasan, 2011). RA 9335 or the Lateral Attrition Law is also seen to have contributed to the improved fiscal performance. On the other hand, the Php391 million excess collection in 2011 can be ascribed to BIR and BOC’s improved administrative efforts to apprehend tax evaders and smugglers. Last year’s revenue collection performance was particularly notable as the target collection was met even if the actual GDP was lower than projected.

However, even if the Philippines improves its tax effort to 13.8 percent in 2013, it is still low compared to its neighboring countries. For 2010, the Philippines only outperformed Cambodia and Indonesia in terms of tax effort. Viet Nam topped the list. Surprisingly, even Lao PDR had a better tax-to-GDP ratio than the Philippines. According to economist and former Budget secretary Benjamin Diokno, the government should increase its tax effort to 15-17 percent in order to adequately finance

its programs and projects. He furthered that even the PhP33 billion projected revenue from sin tax reform may not be enough to reach this level.

Table 14. Tax Effort of Selected South Asian Countries, 2010

Southeast Asian Countries	Tax Effort
Viet Nam	24.3
Thailand	15.5
Malaysia	14.3
Lao PDR	13.8
Philippines	12.1
Indonesia	11.6
Cambodia	10.8

Source: ADB

PIDS fellow and fiscal expert Dr. Manasan (2011) avers that to attain fiscal consolidation without sacrificing rapid and sustained inclusive growth, there is a need for tax policy reforms. The least distortionary measures, she said, are the restructuring of sin taxes, rationalization of fiscal incentives and a review of the road user's charge.

There is also a need to review RA 9335 or the Lateral Attrition Law to ensure that it is serving its purpose. Despite the Supreme Court's ruling on its constitutionality in 2008, the implementation of the law was postponed by the Dept. of Finance. According to the DOF, the government's revenue goal-setting process needs further refinements as it still based on the growth of the country's gross domestic product (GDP), inflation, peso-dollar exchange rate, and other macro-economic factors and not on what's actually happening in the BIR's revenue regions or the BOC's port districts.

As pointed out in the earlier part of this paper, in the last 13 years, actual GDP, which is used to project revenue targets, did not fall even once within the GDP growth targets set out in the BESF.

National Government Debt. As of May 2012, the national government's debt stock rose to PhP5.147 trillion, of which PhP 3.04 trillion or 59 percent are domestic liabilities and PhP2.11 trillion or 41 percent are foreign obligations. This is a 7.76 percent increase from the debt level in May 2011. Of the total government debt, 5.1 percent were short-term, 9.2 percent were medium-term and the remaining 85.7 percent were maturing in the long-term.

Meanwhile, the government's interest payments for the first half of 2012 was posted at PhP150.0 billion as against the PhP155.9 billion estimate for the period. A total of P96.8 billion or 64.5 percent went to domestic liabilities while the remaining P53.2 billion or 35.5 percent was applied to foreign obligations. Actual domestic interest payments were lower by 4 percent from the programmed PhP 155.8 billion, while actual foreign interest payments fell short by only 0.03 percent from the programmed PhP53.1 billion. The Bureau of Treasury's (BTr) issuances of Treasury Bills were 85 percent behind the planned PhP32.3 million for January-June 2012 effecting to lower than expected domestic interest payments. The BTr rejected most of the bids submitted by banks during its T-bills auctions due to high rates as the market remained cautious given the developments in the United States and Europe.

**Table 15. Comparative Table on NG Debt Service Performance
For 1 January to 30 June 2012 (in million PHP)**

Particulars	Full Year Program	Jan 1- Jun 30		Difference
		Program	Actual	
Interest Payments	317,652	155,855	150,010	(5,845)
Domestic	208,140	102,662	96,803	(5,859)
Regular	208,140	102,662	96,803	(5,859)
Treasury Bills	13,480	6,647	1,021	(5,626)
Fixed Rate Treasury Bonds	159,160	80,228	78,339	(1,889)
Retail Treasury Bonds	29,258	15,074	17,378	2,304
Treasury Bonds	0	0	3	3
Others	6,242	713	62	(651)
Foreign	109,512	53,193	53,207	14
Regular	109,511	53,193	53,207	14
Assumed	1	0	0	0
DBP	0	0	0	0
NDC	1	0	0	0
PAL	0	0	0	0

Source: Bureau of Treasury

Debt Ratios. Major external debt indicators remained at comfortable levels. Gross International Reserves (GIR), which reached US\$76.3 billion in June 2012, was enough to cover 11.2 months worth of imports and the cost of 6 times the country's foreign currency-denominated debt maturing within one year. By convention, GIR is deemed adequate if it can pay for three months of imports and can pay for all public and private foreign debts falling due within the year. With a higher GIR, lenders would be confident of getting back their money while investors would be assured that at the opportune time they would get back their investments and profits.

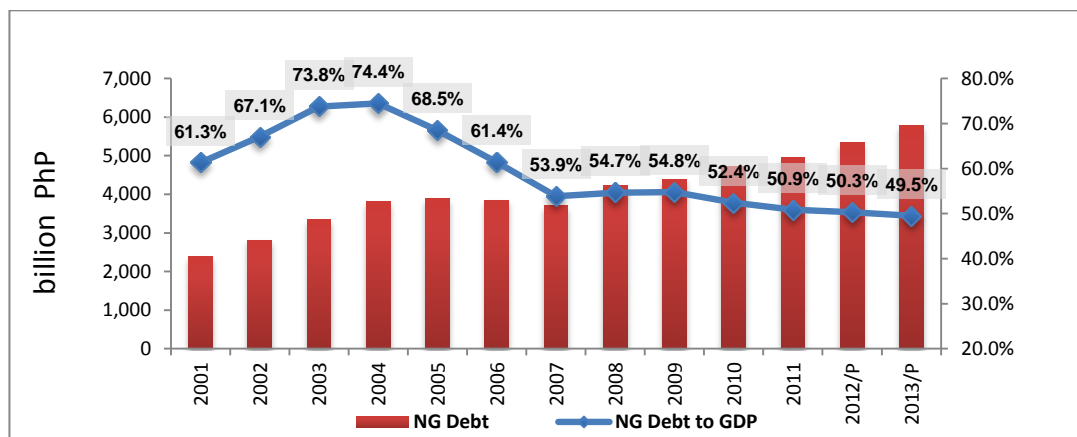
Similarly, the external debt service ratio, or the ratio of principal and interest payments relative to exports of goods and receipts from services and income, improved from 8.2 percent to 8.0 percent and remained well below the 20 to 25 percent international benchmark, indicating that the country has sufficient foreign exchange earnings to service maturing principal and interest payments during the year.

However, the debt service-to-revenue ratio of 53 percent, while declining, is still high and may increase fiscal vulnerability in the event that interest rates increase.

2013 NG Debt. For 2013, the total outstanding debt of the national government is projected to reach P5.77 trillion, increasing by 7.46 percent over the projected level in 2012. Using the revised/rebased GDP, the debt-to-GDP ratio is projected to decline below the 50 percent mark to 49.5 percent in 2013, the lowest since 2001.

Albeit declining, interest payments will still account for a significant chunk of the 2013 budget at 16.65 percent, even higher than the budget for education which only comprises 16.42 percent of the budget.

Figure 6. NG Debt level and NG debt to GDP, 2001 to 2013



Source: DOF

Financing program. Next year, the gross borrowings of the NG will reach PhP757.7 billion, up by 6 percent from the 2012 program. This will allow the government to fund the PhP241.0 billion deficit and to pay maturing debts of PhP449.3 billion.

Table 16. NG Financing Program, 2011-2013

Particulars (in Billion Pesos)	2011 Actual	2012 Program	2013 Program
Net Financing	115.3	333.3	308.4
External (Net)	51.2	118.1	80.9
External (Gross)	194.3	181.4	189.8
Less: Amortization	143.1	63.3	108.9
Domestic (Net)	64.1	215.2	227.5
Domestic (Gross)	364.7	535.1	567.9
Less: Amortization	300.6	319.9	340.4
Change in cash	(79.7)	5.8	10.2
Budgetary	(82.5)	54.2	67.4
Non-Budgetary	2.8	(48.5)	(57.1)
NG Transactions	6.9	(44.8)	(51.9)
CB Restructuring	(4.1)	(3.6)	(5.3)
Gross Financing Mix	100%	100%	100%
Foreign	35%	25%	25%
Domestic	65%	75%	75%
US\$ Billion Equivalent of Foreign Financing	4.5	1.2	4.4
Project	0.6	0.6	0.6
Program	1.1	1.3	0.8
Bonds and Other Inflows	2.8	2.3	3.0

Source: BESF 2013

A foreign-domestic borrowing mix of 25:75 is proposed, with PhP189.8 billion⁴ of the borrowings to be sourced from external sources and PhP567.9 from the domestic market. In resonance with the government's thrust to lessen its reliance on foreign financing, it plans to further issue global peso notes and exchange foreign denominated bonds for peso notes. The government aims to reduce the debt foreign currency component even further to 20 percent by 2016.

Borrowing more locally than abroad is preferred as it will siphon off the excess liquidity and at the same time strengthen the domestic capital market. It will also help banks and financial institutions lower their cost of borrowing. Moreover, having bulk of the country's debt in local currency lessens its exposure to interest rate volatilities and foreign exchange fluctuations in the international capital market, thereby resulting in a more precise debt service schedule for the government.

For this year, there was an increase in the availments of project loans and program loans compared to 2011, but come 2013, there will be a significant decrease of 40 percent in program loans and 6 percent in project loans in the government's programmed Official Development Assistance (ODA) loans. The drop is largely driven by the decline in the government's availment of funds from the Asian Development Bank (ADB) of US\$400 million. According to the Department of Finance, the government will now focus more on acquiring project loans rather than program loans. Project loans refer to foreign loans which are used to finance specific projects of public sector borrowers. Program loans refer to foreign loans which are used by the National Government on an unrestricted basis for general development purposes or for the development needs of the specific sector that is the focus of the program loan. To compensate for the drop in ODA availment, the government will increase its commercial borrowings through bonds by 33 percent. It should be noted however, that with tepid US growth and lurking Eurozone uncertainties, the government's issuance of bonds in the international capital markets is still subject to much interest rate volatilities.

Table 17. NG External Financing Program

	2011 Actual	2012 Program	2013 Program
Project Loans	US\$587 million	US\$643 million	US\$604 million
Program Loans	US\$1.1 billion	US\$1.27 billion	US\$759 million
Bonds and Other Inflows	US\$2.76 billion	US\$2.25 billion	US\$3.0 billion
Total	US\$4.45 billion	US\$4.16 billion	US\$4.36 billion

Source: BESF 2013

Recently, with the marked improvement both in the interest environment and the country's creditworthiness, the Philippines was able to issue a 25-year global bond at 5 percent, currently yielding at 4 percent. In the past, the government had to make do with high coupon securities and bonds with interest rates ranging from 7.5 percent to 10.625 percent.

Moving forward, one way to create fiscal space is to engage in liability management exercises such as bond exchanges and buy backs, which the country has repeatedly done in the last couple of years.

⁴ US\$4.36 billion at PhP43.50/US\$1 exchange rate

Table 18. Philippines Outstanding Global Bonds

ITEM	ISSUE DATE	COUPON (%)	MATURITY
ROP USD Global Bond	10/07/96	8.750	10/07/16
ROP USD Global Bond	10/07/96	8.750	01/18/17
ROP USD Global Bond	01/15/99	9.875	06/17/19
ROP USD Global Bond	10/21/99	9.500	03/16/25
ROP USD Global Bond	03/16/00	10.625	03/30/11
ROP USD Global Bond	01/18/02	9.375	01/15/19
ROP USD Global Bond	11/25/02	9.000	02/15/13
ROP USD Global Bond	07/15/03	8.250	01/15/14
ROP USD Global Bond	03/17/04	8.875	03/17/15
ROP USD Global Bond	02/02/05	9.500	02/02/05
ROP Euro Global Bond	09/14/05	8.000	01/15/16
ROP USD Global Bond	01/11/06	6.250	03/15/16
ROP USD Global Bond	01/11/06	7.750	01/14/31
ROP USD Global Bond	09/25/06	7.500	10/21/24
ROP USD Global Bond	01/17/07	6.375	01/15/32
ROP USD Global Bond	01/14/09	8.375	01/20/20
Samurai Bonds (JPY)	07/20/09	6.500	03/02/20
ROP USD Global Bond	10/23/09	6.375	10/23/34
ROP USD Global Bond	03/02/10	2.320	01/15/21
ROP USD Global Bond	09/17/10	4.950	09/25/24
ROP Global Peso Notes	10/06/10	4.000	01/15/21
ROP Global Peso Notes	01/14/11	6.250	01/14/36
ROP USD Global Bond	01/13/12	5.000	01/13/37

Source: Bureau of Treasury

Ultimately though, as public debt is largely determined by the deficits in the budget, the national government must step up its efforts to close the gap between its revenues and expenditures. This entails addressing the inherent weaknesses of the tax system, further improvements in tax administration, prudent expenditure management and improved governance.

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This Budget Notes was prepared by Maria Cristina R. Pardalis, Myrna E. Diana and Carole Kaye C. Malenab, under the supervision of SEPO's Directors and the overall guidance of its Director General.

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