Building Back Better towards inclusive Growth with Innovative Public Sector Governance

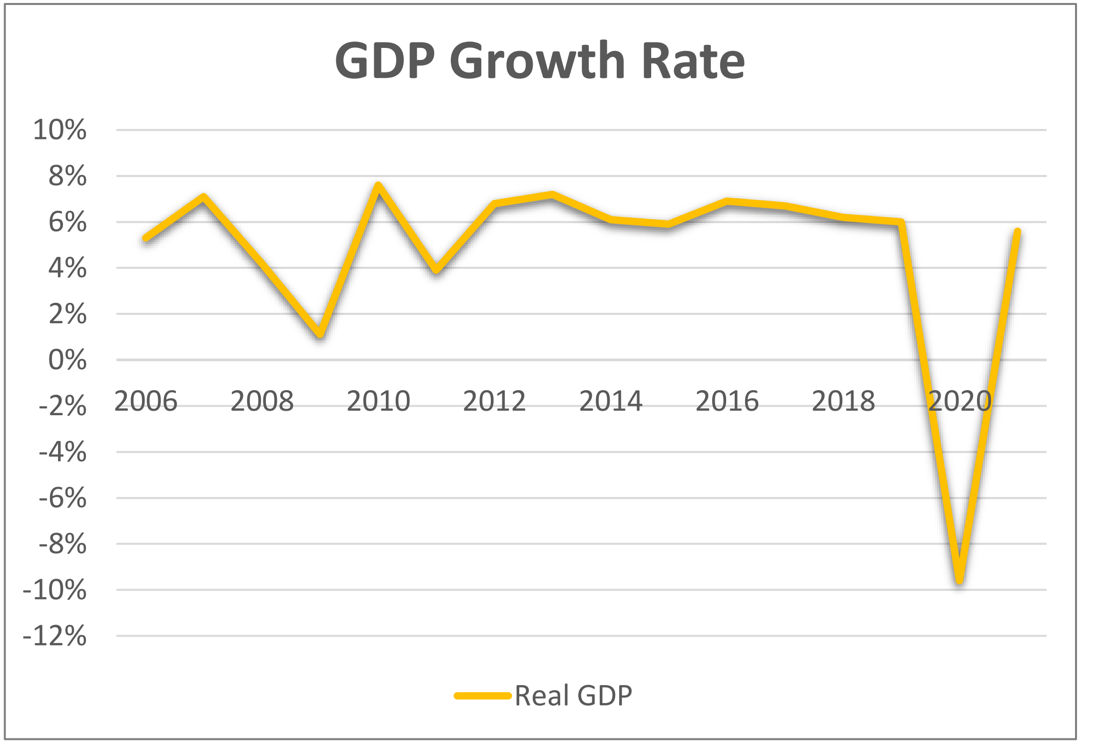
Justine Diokno-Sicat, Ph.D.

11 November 2022

(based on a Stratbase book chapter/article drafted in July 2022)

Major shifts in Philippine governance in 2022

- ❖ New President, administration, national and locally-elected officials
- ❖ Still managing the now endemic COVID-19 and recovering from the economic contraction of 9.6% in 2020 with recovery of 5.6% in 2021
- ❖ Re-devolution with the Mandanas ruling implementation

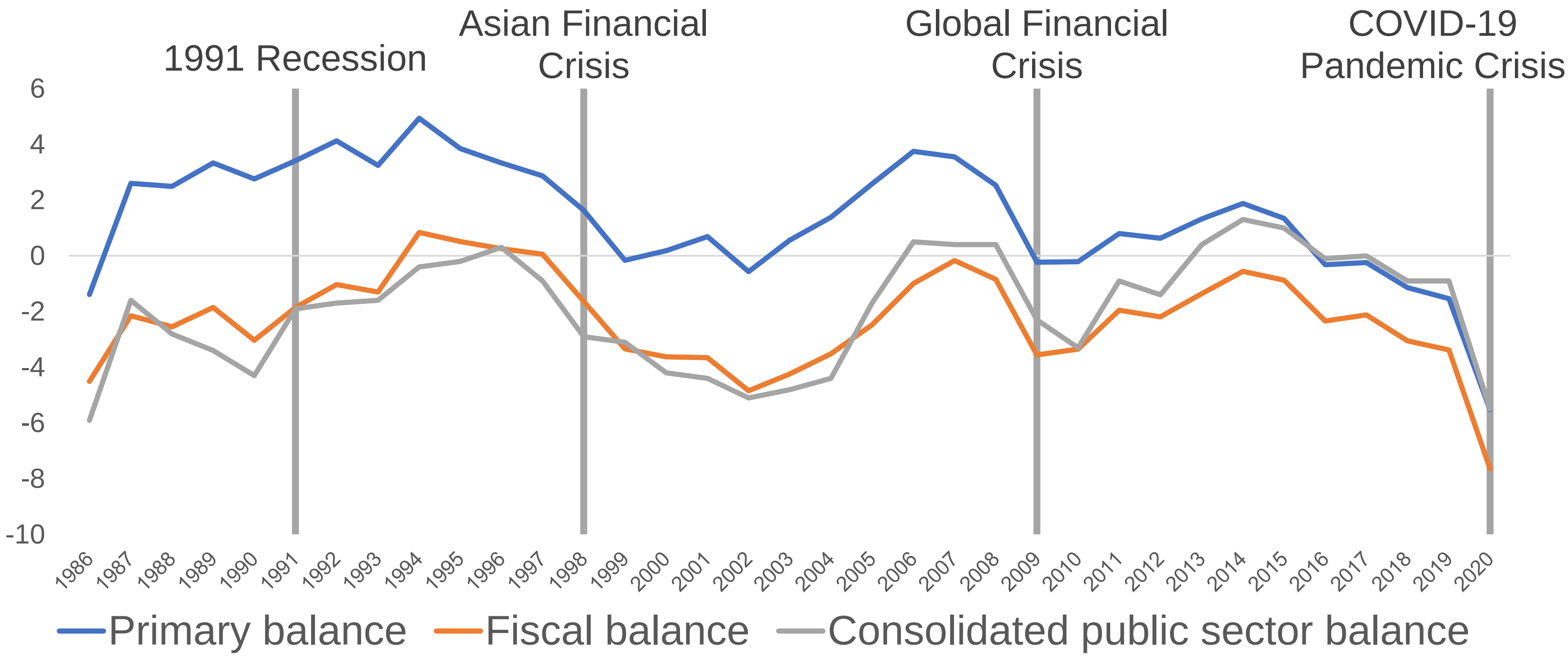


Source: DBM (2006-2019); PSA (2020-2021)

Fiscal impact of the COVID-19 pandemic

In 2020, the halt in economic activities resulted in an economic contraction of 9.5%. While increased financing needs in response to the COVID-19 pandemic led to a widening of Philippine government's:

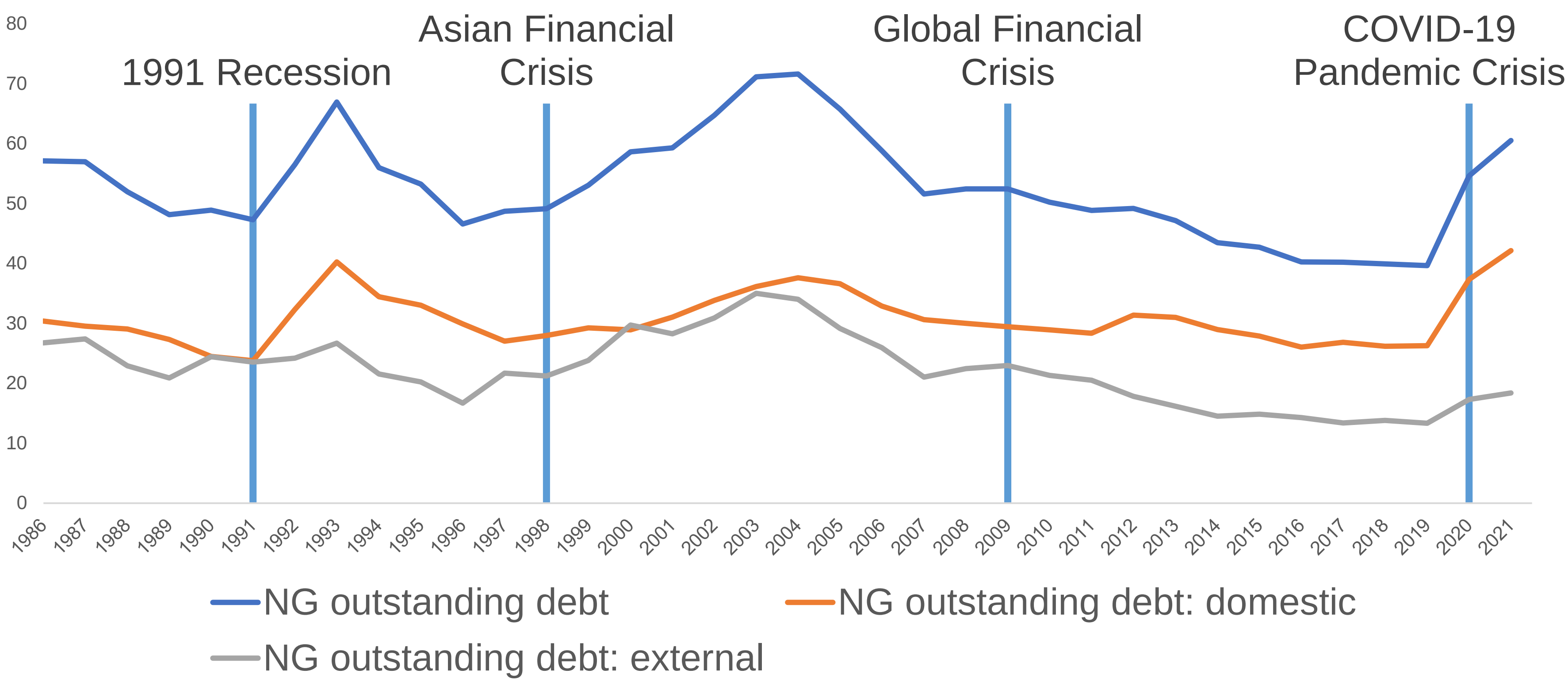
- Primary and consolidated public sector deficits to 5.5% of GDP,
- Fiscal deficit to 7.6% of GDP

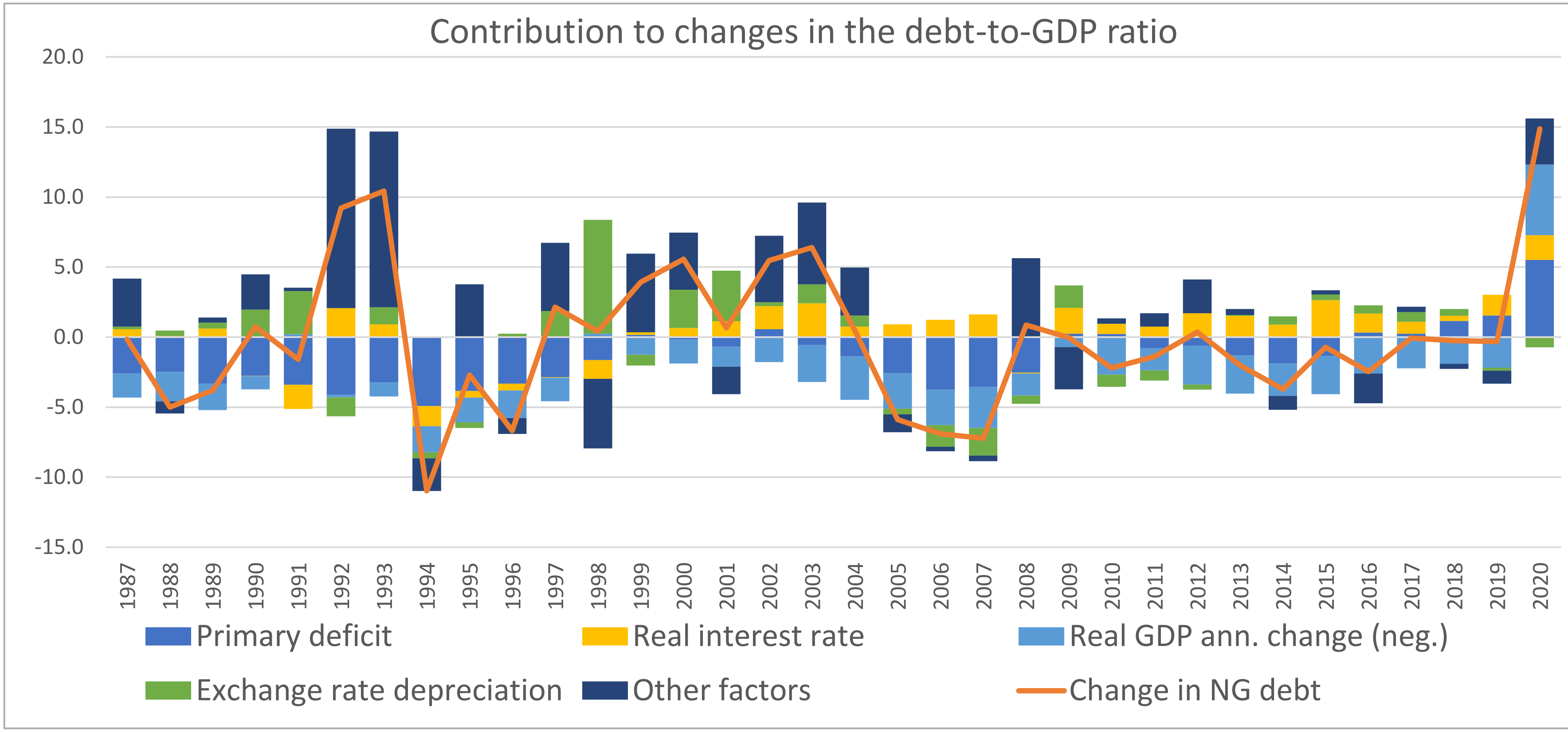


COVID-19 pandemic economic contraction and increased public debt ratio

- Pre-pandemic debt levels managed at about 40% of GDP.
- The resultant fiscal deficit led to the unanticipated rise to 54.6 in 2020 and 60.5 in 2021

National government debt as percent of GDP, 1986-2021





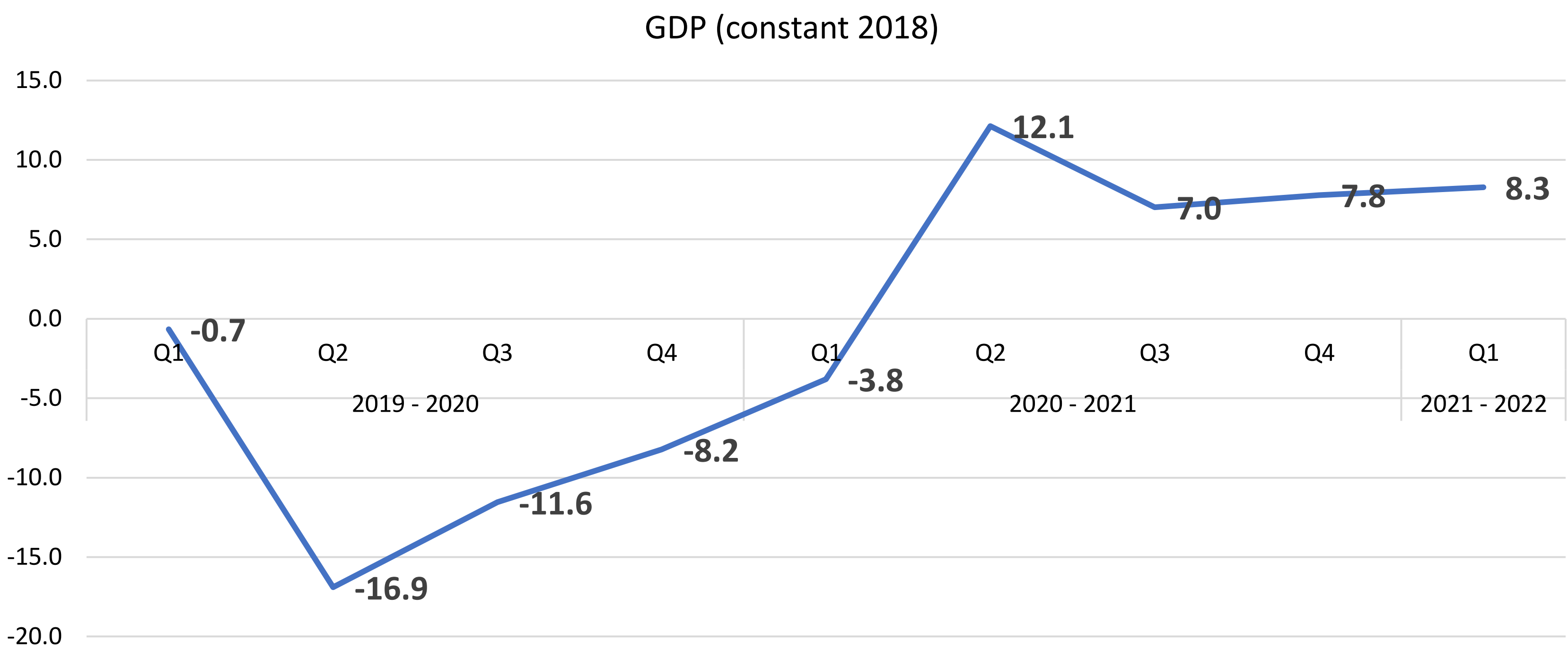
This time is different: debt

- ❖The rise in debt in 2020 was mainly due to a drop in GDP growth owing to COVID-19, and a large primary deficit, unlike previous episodes with the absorption of hidden liabilities (late 1980s and early 1990s) and high external debt (1980s-1990s, and again in 2002-2003)

Prospects for the new administration

Prospects for the new administration

- ❖Strong economic fundamentals; sustainable debt
- ❖More flexible tax system; reforms in place
- ❖New laws that encourage foreign direct investments



- Source: Philippine Statistics Authority

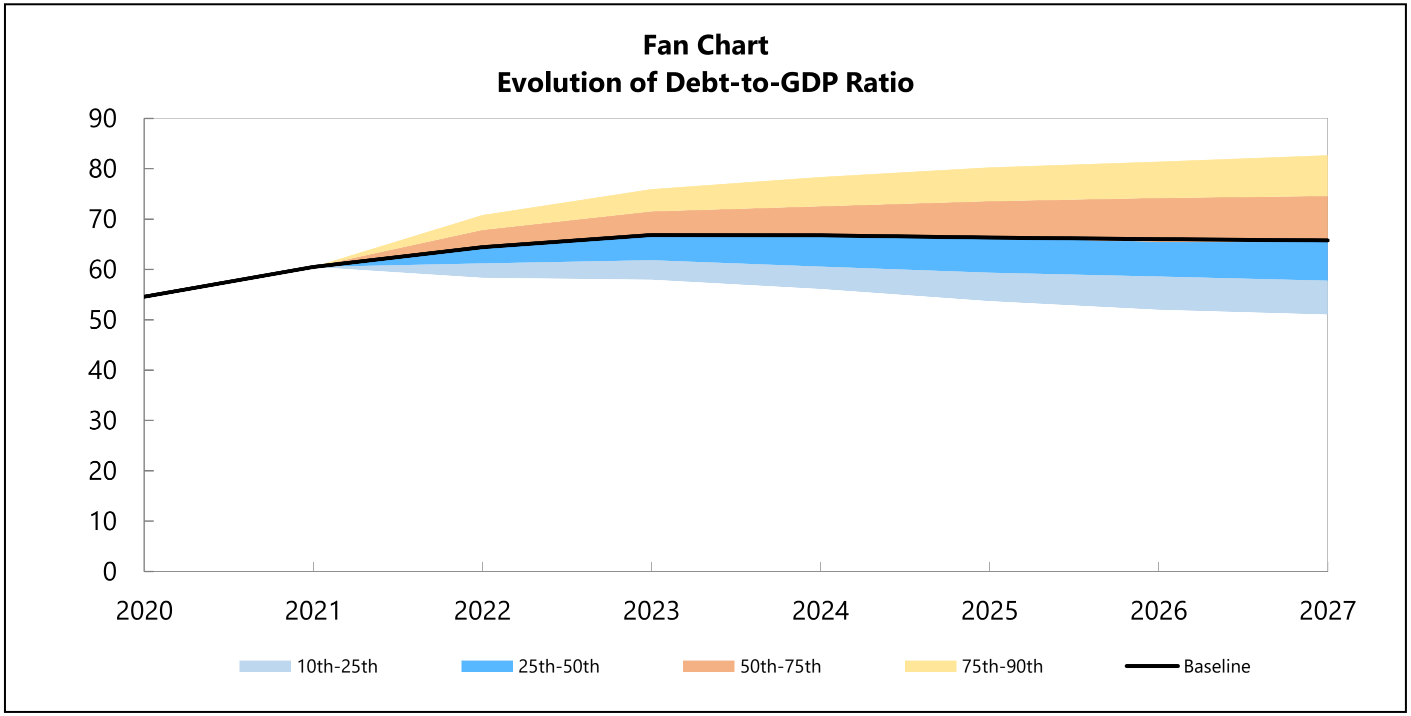
GDP growth in Q1 2022 at 8.3% (Q2 7.4% and Q3 7.6%)

IMF Debt Sustainability Analysis: medium term trajectory

- The public debt-to-GDP ratio is expressed as:

$$d_{t+1} - d_t = \left(\frac{1}{1+g_{t+1}}\right) * \left(d_t * \underbrace{\left[r_{t+1}^{d}\frac{d_t^d}{d_t} + r_{t+1}^{f} * \frac{d_t^f}{d_t}\right]}_{\text{Contribution of the effective real interest rate}} - \underbrace{d^t * g_{t+1}}_{\text{Contribution of real GDP growth}} + \underbrace{d_f^t * \xi_{t+1} * \left(1 + r_{t+1}^{f}\right)}_{\text{Contribution of the real exchange rate}}\right) \underbrace{- pb_{t+1} + o_{t+1} + res_{t+1}}_{\text{Contribution of primary balance and other factors}}$$

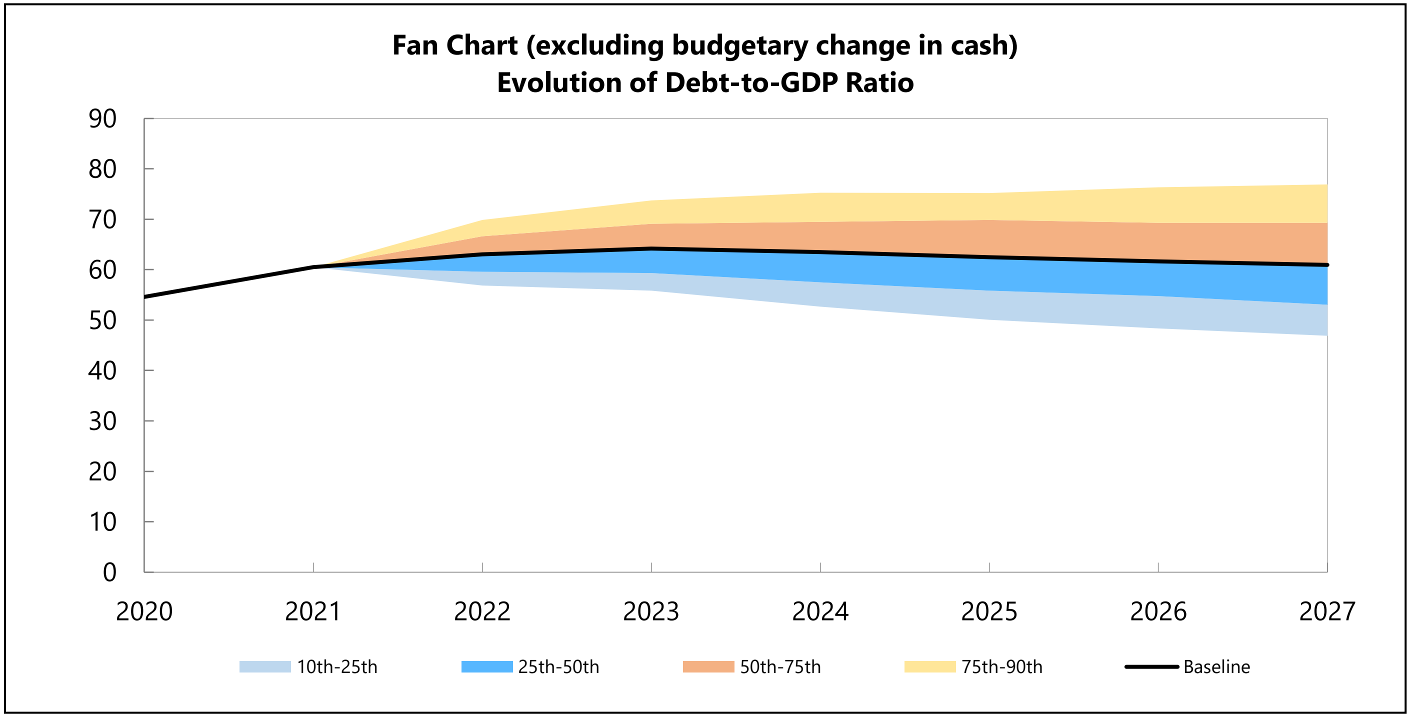
IMF-DSA Debt ratio projected to decline after 2024



- The NG debt-to-GDP ratio will peak in 2023 at 66.8 percent before gradually declining over the succeeding years
- It is assumed that the country will make efforts toward fiscal consolidation, maintaining the 1.7 percent of GDP primary deficit from 2024 to 2027.

	2020	2021	2022	2023	2024	2025	2026	2027
NG debt/GDP	54.6	60.5	64.4	66.8	66.8	66.4	66.0	65.7

IMF DSA Analysis
Debt ratio projected to decline after 2024



SOURCE: Debuque-Gonzales; Diokno-Sicat et.al. 2022

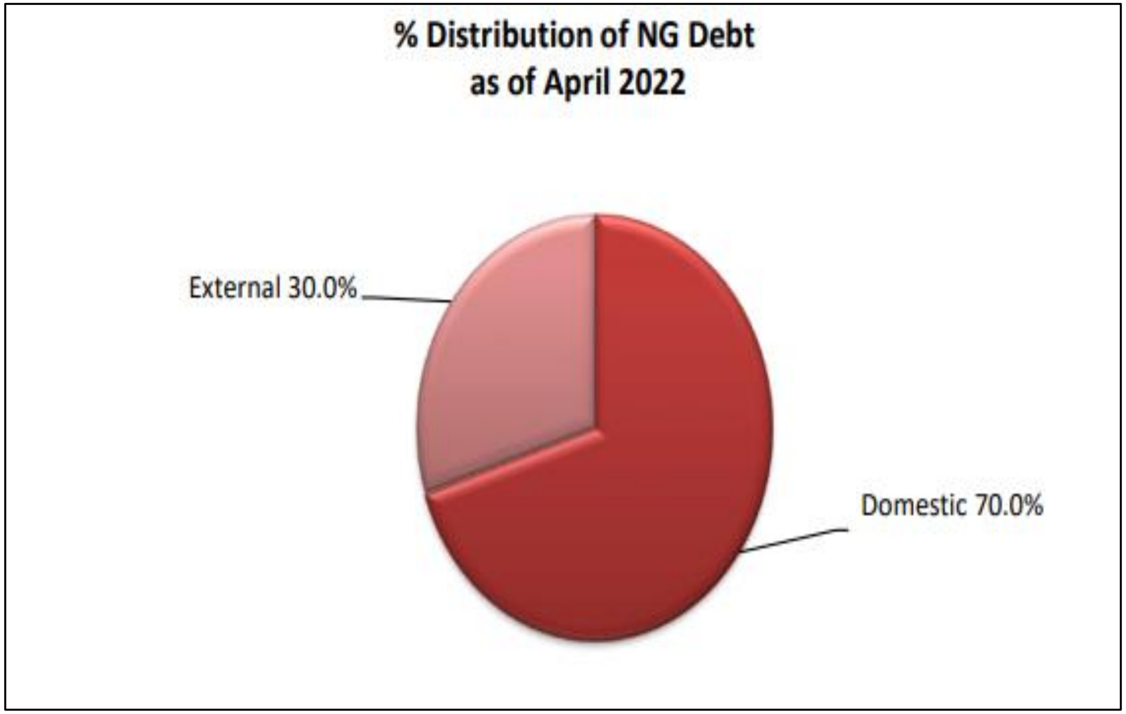
- The NG fiscal program show the presence of cash reserves which could be drawn against if needed. The, debt-to-GDP ratio will peak in 2023 at 64.2 percent.

	2020	2021	2022	2023	2024	2025	2026	2027
NG debt net budgetary change in cash/GDP	54.6	60.5	63.0	64.2	63.5	62.5	61.7	61.0

This time is different: debt is mostly from domestic sources

Distribution of debt is about 70% domestic and 30% external and are mostly with medium- to long-term maturities

Domestic	External	Total Outstanding NG debt
PhP 8.936 Tr	PhP 3.827 Tr	PhP 12.763 Tr

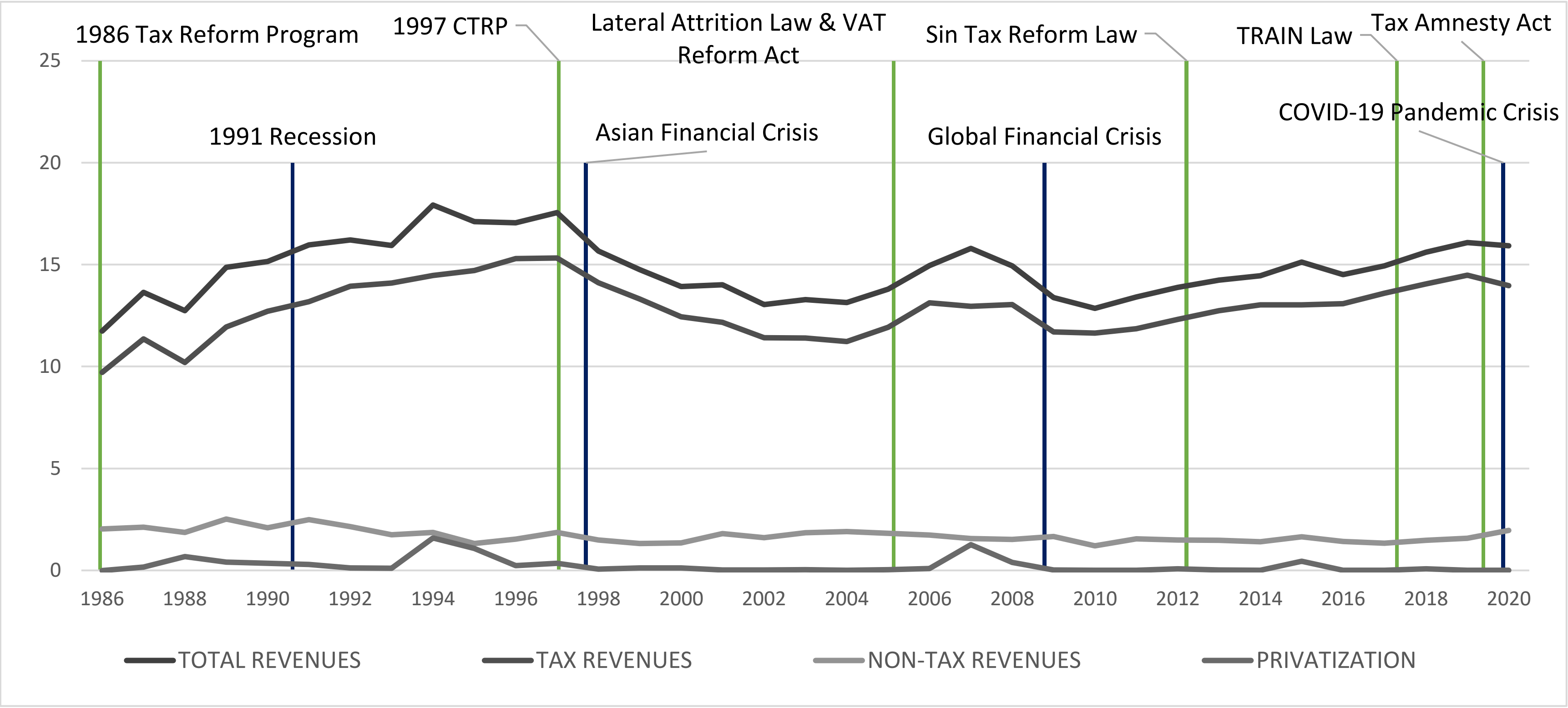


Source: Bureau of Treasury NG Debt Indicators (2022)

Comprehensive Tax Reform Program	Salient points
Package 1: TRAIN law	Higher consumption tax
Package 1B: Tax Amnesty Act	Improve taxpayers' compliance rate to increase revenue
Package 2: CREATE law	Tax relief and tax incentives for businesses
Package 2+: RA 11346 & RA 11467, or sin taxes	Increase excise tax on tobacco, alcohol, heated tobacco products and e-cigarettes
Package 2+: Mining taxes	Impose royalty on all metallic and non-metallic minerals, small- and large-scale mines
Package 3: Real Property Valuation Reform	Adopt internationally accepted valuation standards and professionalize real property valuation
Package 4: PIFITA	Simplify and harmonize the taxation of passive income, financial services, and transactions
Motor Vehicle User's Charge	Impose unitary rate based on weight for all vehicles

More flexible tax system and reforms are in place (and in the pipeline)

National Government Revenues (in % of GDP), 1986 - 2020



New laws encouraging more investments

New/Reformed Philippine Law	Description
RA 11032 or Ease of Doing Business and Efficient Government Service Delivery Act of 2018	Aims to cut excessive red tape and make starting/operating businesses easier
RA 11203 or Rice Tariffication Law	Lifts quantitative restriction on rice imports and exports, and imposes tariffs on rice imports
RA 11337 or Innovative Startup Act	Incentivizes creating and/or investing in startup businesses
RA 11534 or CREATE Law	Lowers corporate income taxes (CIT) and introduces fiscal incentive reforms

New laws encouraging more investments

New/Reformed Philippine Law	Description
RA 11595 amends the Retail Trade Liberalization Act of 2000	Lowers the required paid-up capital for foreign retail enterprises
RA 11647 amends the Foreign Investments Act of 1991	Eases the limitations/ restrictions to foreign investors by allowing non-Philippine nationals to do business or invest up to 100% of its capital (unless limited by certain provisions)
RA 11659 amends Commonwealth Act No. 146 or the Public Service Act of 1936	allows 100% foreign ownership of public services except for some public utilities that remain subjected to the 40% ownership restriction
<u>EO No. 175</u>	promulgates the Twelfth Regular Foreign Investment List in accordance with the recent new laws on foreign ownership

Challenges for the new administration

Debt sustainability risks

- ❖Real GDP growth shock, largest impact in stress-tests
- ❖Aggregate supply/demand shocks (geopolitical tensions, reduced trade, oil price shocks)
- ❖Natural disasters and calamities
- ❖Military and uniformed personnel pensions
- ❖Net losses of PhilHealth
- ❖Cybersecurity
- ❖Mandanas-Garcia Supreme Court ruling

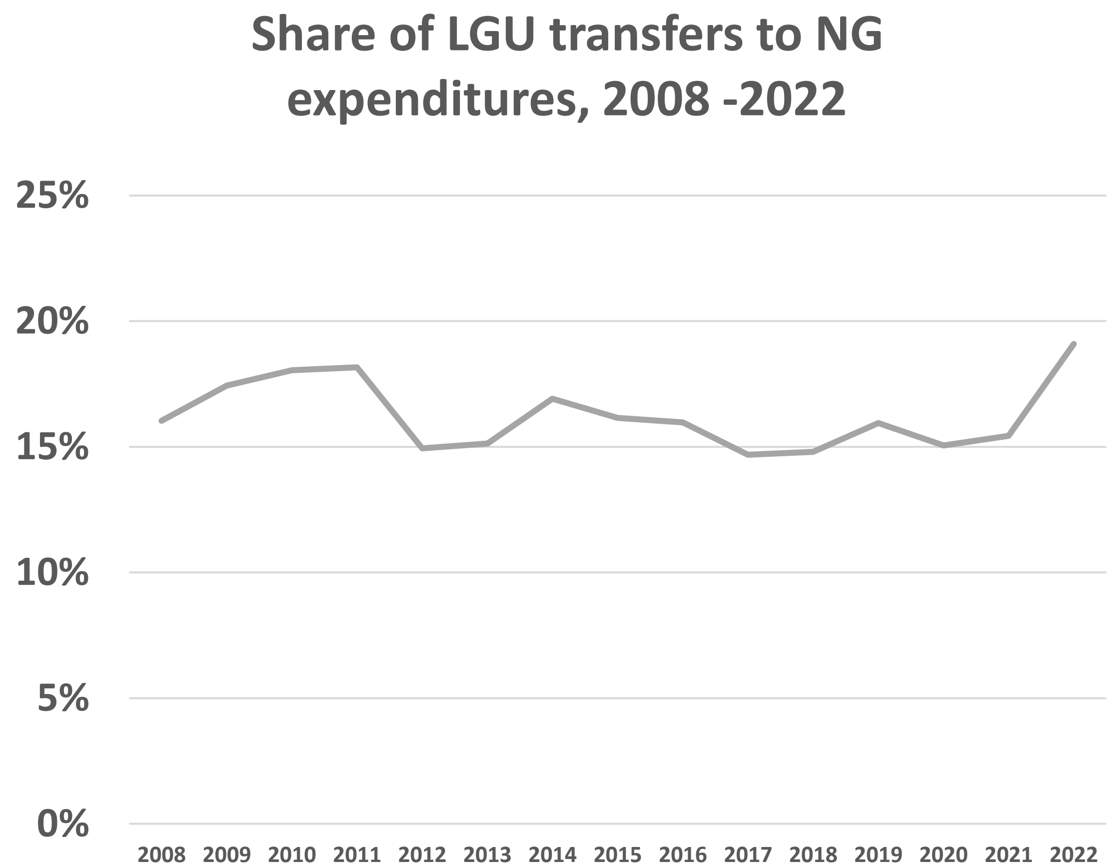
Mandanas-Garcia Supreme Court ruling risk

What is the Mandanas-Garcia Supreme Court ruling?

- ❖The Mandanas ruling ultimately broadened the national government revenue base on which to compute the annual intergovernmental fiscal transfers of local government units (LGUs);
- ❖Before it was estimated only on Bureau of Internal Revenue collections but now this include Bureau of Customs collections
- ❖Executive Order No. 138 (E.O. 138) offers guidelines on the full devolution of certain functions of the executive branch to local governments and the creation of a Committee on Devolution (ComDev) that would oversee the efforts of local government units (LGUs) and affected national government agencies (NGAs).
- ❖Other laws such as the Seal of Good Local Governance and the Community-Based Monitoring System Acts also offer targeted assistance in capacity building for poorer, disadvantaged LGUs.

Budgetary Implications of the Mandanas ruling in 2022

- There was a 38% increase in LGU fiscal transfers of PHP 263.5 B.
- This totaled PHP 959B almost 20% of the 2022 GAA;
- To recover fiscal space, reduced NG-LGU support programs and prioritized poorer LGUs
- By sector, the increases in the share of Subsidy to LGUs were accommodated by decreases in the shares of
  - Education (Social Services)
  - Agri/AR/NR, Trade and Industry, Tourism and Communications, Roads & Transportation (Economic Services)



How can LGUs be partners in national development? Through improved local governance

1. Utilize funds strategically
2. Enhance revenue mobilization
3. If national government assistance programs to LGUs will be continued, these must be clearly targeted.
4. Implement institutional reforms and strengthened coordination and alignment for devolved goods and services that spillover boundaries.

1. Utilize funds strategically

- <u>Through strengthened identification and prioritization of investment programs</u>, and to the extent possible, encourage investments across LGUs such as in local water service delivery

- In 2018, only 40% of municipalities had updated CDPs, 31% valid LDIPs and only half prepared project briefs for these.

1. Improve strategic fund utilization

- Ensure LGUs spend on prioritized investment programs: Evidence showed that municipalities in 2017 spent an average of only 76% of mandated LDF (which is 20% of NTA and will be larger starting 2022).

- The LDF will be the main source of infrastructure spending if NG-LGU support programs are discontinued/reduced.

- A PIDS study estimated a P167B fiscal gap for municipal roads, RHUs and evacuation centers existing in 2017. LGUs have to take on this spending and fulfill the LDF mandate.

2. Encourage enhanced local revenue mobilization

- LGUs have long been dependent on the NTA, averaging 66% of regular local income in the past decade:
- It is important to pass the Real Property Valuation Bill to provide additional funds in local service delivery.
- However, the disincentive created by the increased income because of the Mandanas-Garcia Supreme Court ruling, LGUs might continue to be lax in tax effort.
- Engage the private sector through PPPs.

3. If NG-LGU assistance programs are continued these must be clearly targeted

- A 2020 PIDS study showed that some NG programs (which were mandated to prioritize poorer LGUs) showed weak, at best moderate association between regional poverty incidence and expenditure allocations.
- The 2022 growth equity fund (GEF) should be well targeted with clearly defined objectives.
- To avoid duplicative efforts and spending, the GEF should be aligned with the programs under other laws that prioritize poorer LGUs (SGLG and CBMS Acts).

4. Need for institutional reforms

- Improved coordination and alignment in the delivery of devolved goods and services that spillover boundaries
- A Philippine Journal of Development (2021) article found that ambiguous and overlapping regulatory mandates of oversight bodies resulted in fragmented and, at times duplicative, local water supply interventions
- Need to review oversight, regulatory mandates and streamline implementation to address overlaps and ambiguities
- Related to rightsizing government

Moving forward with LGUs as partners in national development

- For improved and strategic fund utilization and revenue mobilization
  - Need to improve technical capacities of local officials for development planning and investment programming
  - To make an impact on local development outcomes, these must be implemented and monitored
  - Must spend as mandated especially the LDF
  - Institutional reforms
  - Partner with the private sector
- For NG-LGU programs that are continued, these must be better designed, targeted and time bound.

Key takeaways

- ❖Debt is manageable with **no major policy reversals**. This cause of the rise in public debt was exogenous, the COVID-19 pandemic crisis, unlike other Philippine debt crisis.
  - ❖Policymakers must be prepared/address what could be in the risks.
- ❖The new administration faces an improved tax system and is equipped with new laws that promote more investments in the country.
- ❖Though there is a need for fiscal consolidation, in the medium-term, however, there is still a need (and room for) government spending (including local governments). But this should be prudent and strategically spent on both human capital and infrastructure.
  - ❖This includes rethinking how goods and services are provided, harnessing digitalization and rightsizing institutions.

Thank you!

References

- Bureau of Treasury (BTr). (2022). NG Debt Indicators April 2022. https://www.treasury.gov.ph/wp-content/uploads/
- 2022/06/NG-DEBT-INDICATOR_Apr-2022.pdf. (Accessed June 28 2022).

- Debuque-Gonzales, M., Diokno-Sicat, C.J., Corpus, J.P.P., Palomar R.H.G., Ruiz, M.G.C., & Miral, R.M. (2022). Fiscal Effects of the COVID-19 Pandemic: Assessing Public Debt Sustainability in the Philippines. Philippine Institute for Development Studies Discussion Paper Series No. 2022-17. https://www.pids.gov.ph
- /publication/discussion-papers/fiscal-effects-of-the-covid-19-pandemic-assessing-public-debt- sustainability-in-the-Philippines. (Accessed June 9 2022).

- Development and Budget Coordination Committee (DBCC). (2021). 2022 Fiscal Risks Statement. https://www.dbm
- .gov.ph/wp-content/uploads/DBCC_MATTERS/FiscalRiskStatement/Fiscal-Risks-Statement-2022-for-Circulation.pdf. (accessed January 31 2022).

- Executive Order 175, s. 2022. Promulgating the Twelfth Regular Foreign Investment Negative List. Manila, Philippines

- Financial Stability Coordination Council (FSCC) (2022).Statement on the State of Financial Stability. https://
- www.bsp.gov.ph/Media_And_Research/Media%20Releases/2022_06/Statement_on_the_State_of
- _Financial_Stability_062122.pdf. (Accessed June 28 2022).

- Philippine Statistics Authority (PSA). (2022). Quarterly National Accounts Linked Series (Q1 2000 to Q1 2022) (at Current and Constant 2018 Prices, as of May 12, 2022). https://psa.gov.ph/national-accounts/base- 2018/data-series. (Accessed June 30 2022).

- Republic Act 11032. An act promoting ease of doing business and efficient delivery of government services, amending for the purpose Republic Act No. 9485, otherwise known as the Anti-Red Tape Act of 2007. Manila, Philippines: Congress of the Philippines.

References

- Republic Act 11203. An act liberalizing the importation, exportation and trading of rice, lifting for the purpose the quantitative restriction on rice, and for other purposes. Manila, Philippines: Congress of the Philippines.

- Republic Act 11337. An act providing benefits and programs to strengthen, promote and develop the Philippines startup ecosystem. Manila, Philippines: Congress of the Philippines.

- Republic Act 11534. An act reforming the corporate income ta and incentives system, amening for the purpose sections 20, 109, 116, 204, and 290 of the National Internal Revenue Code of 1997, as amended, and creating therein new Title XIII, and for other purposes. Manila, Philippines: Congress of the Philippines.

- Republic Act 11595. An act amending Republic Act No. 8762, otherwise known as the “Retail Trade Liberalization Act of 2000”, by lowering the required paid-up capital for foreign enterprises, and other purposes. Manila, Philippines: Congress of the Philippines.

- Republic Act 11647.An act promoting foreign investments, amending thereby Republic Act No. 7042, otherwise known as the “Foreign Investments Act of 1991”, as amended, and for other purposes. Manila, Philippines: Congress of the Philippines.

- Republic Act 11659. An act amending Commonwealth Act No. 146, otherwise known as the Public Service Act, as amended. Manila, Philippines: Congress of the Philippines.