Financing Development: The Political Economy of Fiscal Policy in the Philippines

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1

INTRODUCTION[1]

In an underdeveloped country, the operations of the State shape the short-run performance and the development path of the economy. This significant role of the State arises from the characteristics of underdevelopment itself.

Domestic markets of an underdeveloped country are small and undeveloped. If they are not served by foreign producers, they are served by one or two local producers. Under such a situation, the State must determine how many will serve the market and who will be given the privilege to do so.

The average income levels in an underdeveloped country are low, and private savings are incapable of financing the development requirements. Thus, the State mobilizes the financial resources by taxing the few who can save, drawing on foreign savings, and taxing the many a little, then directs these resources to a few private investors.[2] Or it resorts to some forcible measures, such as inflicting inflation through its power to print currency.

The "Democratic" and the Corporate Approaches

Since 1946, these issues have confronted the Philippine fiscal system, the responses to which have been conditioned by the nature of the fiscal decision process and the interest of the groups

1. The first complete version of this paper, which extensively discussed the martial law experience in the Philippines, was completed on 3 February 1986, four days before the presidential elections that led to the overthrow of the Marcos regime.

2. As would be the case with industrial protection through tariffs and quotas.

that have participated in the said process. In the Philippines, two different processes have been attempted: an American-style "democratic" fiscal decision process before 1972, and a corporate approach from 1972 onward. In the "democratic" process, the decision was a result of the accommodation of competing interests which, as will be explained later, tended to prevent the system from addressing urgent development matters.

In the corporate approach, there had been an attempt to direct the fiscal system independently in promoting a development program. This required the elimination of the legal underpinnings of the previous system. However, this approach could only be sustained if the previously powerful groups could be neutralized. As will be explained later, the neutralization effort created inefficiencies and restrained the boldness of the reform program.

The declaration of martial law in 1972 led to a fundamental restructuring of the country's political system which had profound consequences on the fiscal system.

President Marcos justified the suspension of democratic institutions by citing the need to combat rightist and leftist threat to the state. This threat, in turn, was treated as arising from lack of development, and that the inadequacy of development itself could be traced to these obstructionist and unresponsive institutions. Thus, President Marcos used his authoritarian powers to reform society. A large number of fiscal reforms had been put in place so rapidly that by 1976 Kintanar (1976) could already declare: "One area where significant reforms have been achieved under the New Society is the area of fiscal reforms."

Even when martial law was lifted in January 1981, the changes that have been effected continued to have impact on the system. For this reason, we refer to the period before 1972 as the pre-martial law period, and that after as the post-martial law period.

This paper will evaluate the reforms instituted during martial law and explain why or how these reforms failed. Thus, the case study will deal with the effects on the fiscal system of the authoritarian form of government. It must be noted, however, that the authoritarian experiment had peculiarities, and one was the unprecedented availability of foreign financing during the experiment period.

A Note on Methodology

The methodology used in this study consisted of the following: (1) an analysis of the data on public finance in the post-martial law period, (2) a study of the perceptions of key decision makers through

interviews and analysis of newspaper accounts, and (3) an attempt to reconcile the actual performance of the decision makers with their perception.

This paper considered gathering data on perceptions through a sample survey, but it was abandoned since it was difficult to measure actual perceptions this way. The decision makers then--the bureaucrats of the Marcos regime whose legitimacy was under question--tended to answer questions according to the "official line," such as claiming that a particular decision was based purely on technical considerations.

The opposite problem would occur if the survey respondent was an objector to the Marcos regime. The opinion would tend to contain an inordinate amount of recrimination. Thus, it was difficult to elicit candid opinion from all sides during the interviews.

The attitude taken regarding the interview statements and newspaper analyses was to accept the individual statements at face value and then correlate these to actual performance. The two were then reconciled using the long-term politico-economic trends.

This paper has seven main sections, including this one. The second section presents a general economic background of and an introduction to the country's fiscal system. The third talks about the important social groups involved in fiscal decision-making. The fourth contrasts the fiscal decision process in the pre-martial law period with that after 1972. Section five explains and evaluates the reforms on the financing side undertaken during the authoritarian period. Section six does the same thing on the expenditure side. Section seven summarizes the main insights that have appeared in the previous sections.

2

FISCAL POLICY IN THE CONTEXT OF THE PHILIPPINE ECONOMY

This section serves as a brief introduction to the structure of the Philippine economy and to its fiscal system.

Structure of the Philippine Economy

The Philippines, an archipelago of three major island groups, has a population of 54 million, growing at a rate of 2.7 percent per year.[3] Its 1984 per capita GNP was estimated at $660 (1986 World Bank Development Report), down from $760 in 1983, when the economic crisis brought about by the assassination of former Senator Benigno Aquino began (see Tables 1 and 2).

Of its gross domestic product (GDP), 26 percent is contributed by agriculture, fishery, and forestry; 36 percent by the industrial sector; and about the same percentage by the service sector. The economy can be considered pre-industrial, where agriculture still employs over 55 percent of the labor force, 70 percent of the population lives in rural areas, and the service sector is dominated by low skill employment.

About 64 percent of GNP is accounted for by personal consumption expenditures, 29 percent by investment expenditures (gross domestic capital formation), 5 percent by government's fixed capital formation, and 9 percent by general government expenditures.

The value of exports of goods and services comprises about 19 percent of GNP, while imports account for 21 percent, so that total trade constitutes about 40 percent of GNP. In the recent period, between 20 and 30 percent of the country's total trade has been with

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3. The population growth rate was as high as 3.1 percent per year in the 1960s.

Table 1
Basic Statistics on the Philippines

1. Population (1985) — 54.378 million
   a. Percent of population in Urban Areas(1980) — 37.3

2. Percent of output from
   a. Agriculture (1984) — 26.8
   b. Industry (1984) — 34.4

3. Annual growth rates per decade (percent)

	Real GNP per capita	Real GNP	Agriculture	Industry
1950-1960	3.2	6.3	5.0	6.9
1960-1970	2.1	5.2	4.7	9.0
1970-1980	3.5	6.4	4.9	8.3
1980-1987	-2.4	0.2	1.4	-1.0

4. Per Capita GNP (1984) — P10,004; US$99

5. Exports as a percentage of GNP

1950-1960	19.56%
1960-1970	19.33%
1970-1980	17.27%

6. Total child mortality rate (1983) — 72.08%

7. Gini Coefficient (1984) — 0.5564

8. Inflation and variation in exchange rate

	Rates	Exchange Rate (P/$)	
	CPI Inflation	Nominal	Real
1950-1960	0.0	0.0	1.1
1960-1970	5.3	12.3	7.8
1970-1980	14.9	1.6	-4.9
1980-1984	26.8	22.1	1.7

Table 2
Selected Data on Public Finance

	1960	1970	1980	1984
Tax revenue/GNP (%)	8.2	9.6	12.1	9.5
Gov't.expenditure/GNP (%)	8.6	8.7	9.7	12.3
Gov't investment/GNP (%) (Construction only)	1.6	1.0	6.2	2.4
Social Security contribution/GNP (1984)				0.1%
	1978	1982	1983	1984
Government deficit/GNP (%)	1.2	4.7	2.0	2.2
Public corporations			1972	1984
Capital investments (P billion)			3.1	11.9
Internal cash generation (P billion)			0.1	0.8
Proportion of budget deficit financed from foreign sources (%)				
	1978-1982		64.8	
	1983-1984		88.3	

Sources: *Neda Statistical Yearbook*, 1985.
Philippine Development Report, 1984.

the United States, and between 20 and 25 percent with Japan. With each country, the Philippines has been running a trade deficit of some $300 million. The country's 10 principal exports are dominated by agricultural and primary products--copra, sugar, bananas, logs and lumber, desiccated coconut, coconut oil, and canned pineapples.

Phases in Economic Growth

Since independence from the US in 1946, the Philippines can be said to have tried four different policy regimes: the colonial regime from 1946 to 1949, the import-substitution regime from 1950 to 1962, an attempted export-oriented period from 1962 to 1970, and the debt-driven growth regime from 1970 to 1983.

The Colonial Period, 1946-1949

The grant of political independence in 1946 did not change the colonial character of the country's economic ties with the US. The Philippines shared currency with the US and continued to depend heavily on it for the importation of finished products, paying for these imports with the exports of agricultural products (copra, coconut oil, abaca, and sugar). The country financed its trade deficits during that period with the war damage funds and with aids from the US. These funds were exhausted in 1949, precipitating a balance-of-payments crisis that forced the country to address the issue of independent economic management.

The Import-Substitution Period, 1950-1962

With US advice, the Philippines established its own Central Bank and embarked on an import-substitution industrialization strategy, which had strong support from development theorists at that time. This strategy was pursued through an economic regime in which the currency was pegged at two pesos to a US dollar and was sustained by import controls on foreign exchange.

Most of the present industrial infrastructure of the country have their beginnings in this period. Investments in automobile and consumer-products assembly, tire manufacturing, and glass-products manufacturing were undertaken. US firms which used to serve the Philippine market carried out significant domestic investments. A treaty between the US and the Philippines extended equal business and opportunity rights to US nationals.

By its nature, the import control system imposed a high implicit price on finished products and subsidized intermediate inputs. This structure was maintained even when tariffs gradually began to replace controls in 1959. This generated a whole set of final-stage processing enterprises with very little domestic integration. It also guaranteed that the income coefficient of imports would be significantly larger than one, while exports, which continued to be agricultural, grew only at 4.8 percent per year. This meant that financing the importation of the needed intermediate inputs for industry became increasingly difficult.

The balance-of-payments crisis of 1962 forced the partial dismantling of the foreign exchange controls and a 50 percent devaluation of the peso.

Attempted Export-Oriented Period, 1962 - 1970

Under influence of the International Monetary Fund (IMF), the Philippines tried to pursue an export-oriented strategy in response to the 1962 crisis without actually abandoning the import-substitution system. The devaluation in 1962 and the removal of exchange controls helped to diversify export products. There was greater success in the export of raw-material products, such as copper and logs. There were also significant investments in these industries. Generally, however, the inflow of foreign investments similar to that experienced during the import-substitution period was never attained. Thus, in 1967, a comprehensive investment incentives program, patterned after those of Taiwan and South Korea, was developed in response to the slow rate of investment.

Near the end of this period, the country barely managed to avoid a large balance-of-payments crisis. Export, which grew by 9.5 percent per year between 1962 and 1967, fell by 11 percent in 1967 and did not recover its 1967 level until 1972. This meant that for the whole 1962-1970 period, annual export growth was only similar to that achieved in the import-substitution period.

Heavy government spending during the election campaign of 1969, when Marcos became the first president to be reelected, precipitated a balance-of-payments crisis in 1970. Thus, the Philippines was forced to deal with the IMF for the second time.

Debt-Driven Growth Period, 1970-1983

The 1970 economic program inaugurated a long-term relationship between the Philippines and the IMF, in which the country was constantly on a standby program, except for about a year between 1 January 1982 and 25 February 1983. Exports grew by 6.3 percent between 1970 and 1972. The world commodity boom of 1973 produced a 15 percent export growth and a rare current account surplus that year. The Philippines met the agreed upon targets in a program correctly designed to solve a crisis brought about by government overspending.

The strategy from 1970 onward seemed to have been that of trying to solve simultaneously the balance-of-payments and the investment rate shortfalls by increasing the utilization of foreign savings. The continuous relationship with the IMF and the World Bank were in support of this strategy, which required structural changes that would reduce import dependence, increase export earnings, and improve labor absorption.

The inflow of funds and the rise in investment rate allowed the average annual GNP growth rate to recover to 6.4 percent between 1970 and 1983. The industrial sector grew at 6.9 percent and the agricultural sector at 4.1 percent. Policies that encouraged non-traditional exports were tried, resulting in more diversification. Exports recovered to a 6.0 percent growth rate during the period.[4]

The onset of the international debt crisis in 1982 rendered unsustainable the debt-driven growth strategy. Between 1980 and 1983, when the country relied heavily on short-term borrowing to maintain the strategy, growth slowed down to 2.2 percent per year. The political crisis of 1983 triggered by the assassination of Senator Benigno Aquino shut off short-term credits and precipitated a severe balance-of-payments crisis. Thus ended the debt-driven growth policy regime.

The Philippine Fiscal System

All in all, government expenditures "directly" account for about 14 percent of GNP. "Indirect" government participation in the economy, in the form of government-controlled corporations and quasi-government operations such as the coconut and sugar monopolies, started after the martial law declaration in 1972 and grew rapidly since 1981.[5]

The size of government expenditures relative to GNP became noticeably larger since the Marcos administration took over in 1965. As shown in Table 3, government expenditure was 9 percent of GNP before 1965. Budget deficits, which are indirect measure of the extent to which government utilizes credit that might have been needed by the private sector, also grew steadily, from 1.9 percent of GNP in 1970 to 4.6 percent in 1981 and 4.7 percent in 1982 (Table 4).

Distribution of the national government budget is depicted in Tables 5 and 6. Table 5 provides a percentage breakdown between current operating expenditures and capital expenditures. A clear shift in expenditures toward capital outlays since 1985 can be seen. Capital expenditures, which comprised only about 15 percent of total government budget in 1965, increased to almost 40 percent in 1982.

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4. The long-term gain in exports has been problematic since the non-traditional exports, notably garments and silicon chips, have high import contents.

5. Government guarantees on loans by private and government businesses through government banks (Philippine National Bank, Land Bank,

Table 3
Total Government Expenditure and Gross National Product
(In million pesos)

Year	Total Government Expenditure	GNP (Nominal Prices)	Expenditure/GNP
1960	1,196	13,833	8.6
1965	2,035	23,382	8.7
1970	4,054	41,751	9.7
1975	19,049	114,265	16.7
1980	36,935	265,008	13.9
1984	66,352	379,345	17.5

Sources: Manasan (1982)
1983 NEDA Statistical Yearbook

Table 4
Budget and Current Account Deficits
(In million pesos)

Year	Budget Surplus	% of Budget Deficit to GNP	Current Account Balance
1975	-1,403	-1.2	-6,071
1976	-2,349	-1.8	-7,920
1977	-2,852	-1.8	-4,872
1978	-2,167	-1.2	-8,385
1979	-342	-0.2	-9,763
1980	-3,387	-1.3	-13,536
1981	-12,146	-4.6	-15,338
1982	-14,405	-4.7	-25,339
1983	-6,422	-1.9	-26,394
1984	-8,714	-2.3	-14,756

Sources: Amatong, et al. (1985), pp. 17-18.
NEDA Statistical Yearbook 1985.

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and Development Bank of the Philippines) have also grown substantially during the debt-driven growth period.

Table 5
Percentage Distribution of the Government Budget by Economic Classification

	1965	1970	1975	1980[1]	1982[1]	1983
1. Capital Outlay	14.6	19.2	38.7	34.1	38.2	27.6
2. Current Expenditures	85.4	80.8	61.3	65.9	61.8	63.5
a. Personal services	55.8	46.8	23.5	26.2	24.6	25.4
b. Maintenance and other expenses	24.7	28.1	32.8	28.8	28.5	29.2
c. Debt service	5.0	6.0	5.0	10.8	8.7	20.0

[1]Not completely comparable to previous years due to government reclassification.

Sources: *1983 NEDA Statistical Yearbook.*
1985 NEDA Statistical Yearbook.

Table 6
Percentage Distribution of the Government Budget by Sectoral Classification

	1965	1970	1975	1980[1]	1982[1]	1984[2]	1985[2]
1. Economic Services[3]	16.7	31.7	45.5	42.3	42.4	26.8	29.9
2. Social Services	44.2	34.9	18.9	20.2	23.3	26.8	23.9
a. Education	36.5	28.0	11.6	11.8	12.4	16.4	14.8
b. Health, housing and population	6.2	5.6	4.1	6.6	9.0	6.9	6.0
c. Others	1.5	1.3	3.2	1.8	1.9	3.5	3.0
3. National Defense	16.7	15.2	20.9	12.0	11.2	9.2	8.6
4. General Services (including debt service)	27.3	18.3	14.6	25.4	23.0	37.2	37.6

[1]Not completely comparable to previous years due to changes in government classification.
[2]Agriculture, industry, utilities and infrastructure.
[3]Estimates.

Source: *1983 NEDA Statistical Yearbook.*

On the revenue side (see Manasan 1982), the government relies mainly on both direct and indirect tax collections. There are three main types of direct taxes collected: personal income tax, corporate income tax, and transfer tax.

The code on personal income tax provides for steeply progressive schedule for resident citizens.[6] The data base for determining actual compliance to such progressive tax structure is poor, but studies indicate that evasion is extensive.[7]

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6. Starting from a tax of 3 percent on an annual taxable income of P2,000 (on an exchange rate of P20 to $1), personal income tax rises through 37 steps to a maximum rate of 70 percent for annual income of P500,000 or more.

7. See Manasan (1982); NTRC (1988).

Corporate income tax rate is 25 percent on the first P100,000 and 35 percent on any amount after that.[8] Accounting procedures of the corporate tax system are sophisticated, both from the government and the corporate taxpayer's side. But as will be discussed later, there exists an extensive system of tax exemptions and incentives.

There are two transfer taxes, the gift tax and the estate tax. Both are forms of inheritance tax. The gift tax is applicable during the transferor's lifetime, while the estate tax is applicable after his death. Gift tax rates start from 1.5 percent for gifts of less than P50,000 to 40 percent for gifts of over P3 million. The estate tax ranges from 3 percent for inheritance of less than P60,000 to 60 percent for inheritance of over P3 million.

There are four main types of indirect taxes: sales tax, specific tax, export tax, and import duty.

A sales and specific tax system is applied to all goods exchanged in the country, except those exempted by special provision (such as goods imported by the armed forces). Tax rates vary according to the essentiality and origin of the commodity.[9]

The relative importance of these tax sources is shown in Table 7. Since income and wealth constitute the only source of direct taxation, between 75 and 80 percent of tax revenues are in the form of indirect taxation. Trade taxes (import tariffs and export taxes) constitute almost 40 percent of total tax revenues, while excise/

Table 7
Percentage Distribution of Tax Revenues by Source

	1960	1965	1970	1975	1980	1984
Income/wealth taxes	23.7	25.4	27.1	26.6	24.6	26.0
Trade taxes	27.9	26.9	23.4	31.9	36.3	33.5
Excise and sales taxes	46.7	46.5	44.5	31.7	29.2	33.3
Other taxes	1.7	1.2	4.9	9.7	9.8	7.2
Tax revenue to GNP	6.6	6.5	6.5	11.0	10.8	9.5

Source: Sicat (1984), p. 340

8. One of the first acts of the Aquino government was to impose a single 35 percent tax rate.

9. Before the change in government, non-essentials had 50 percent tax rate, and essential items, 5 percent. Locally produced goods were subject to a smaller tax.

sales taxes have declined in importance. The last line of Table 7 shows that tax revenues as part of GNP practically doubled in the 1970s, essentially due to increases in the collection of trade taxes.

Compared with other countries, the Philippine tax effort is ranked rather low, at rank numbers 41 (Lotz and Moras 1967), 34 (Shin 1969), and 39 (Bahl 1971). Other studies show deteriorating tax performance (Caballes 1975).

3

GROUPS THAT DETERMINE DECISIONS

We will now try to identify the important social groups that determine fiscal decision-making in the Philippines. This discussion will also deal with the changes that have occurred since the martial law period.

The structure of the Philippine economy largely determines the groups that influence fiscal decision-making in the Philippines. For example, the landlord groups trace their origin to the Spanish land grants and the sale of church lands to the local elite during the American occupation. The small domestic entrepreneurial class which depends on a protected market emerged during the import-substitution period of the 1950s.

Landlords

A tenanted mode of production continues to dominate the agricultural sector. However, there is no single group of landlords. It is difficult to identify formal organizations which represent specifically the landlord interest in public policy. The economic aspect of landlord interest is overshadowed by the political aspect, which is the protection of their local power and property. This political role is performed by the local chapters of the dominant political parties, in cooperation with local police and military forces.

The participation of landlord groups in fiscal policy questions is most directly felt in the inability of the state to collect real property taxes for development purposes. Until 1973, when Presidential Decree 464 was passed, the real property tax system was not codified. As Kintanar (1976) noted, this codification had "been discussed among proponents and objectors for decades," and it "required a change in the legislative procedure for such a reform to be promul-

gated because the duly elected representatives of the people were heavily representing landowners, industrialists, and commercial interests who could not be expected to tax themselves willingly."

The highly skewed land ownership pattern in the Philippines represents a hypothetically important tax base, but landlord participation in the legislative process effectively prevents any serious reliance on this tax base.

Filipino Businessmen

Profit-oriented enterprises in the Philippines trace their roots from the colonial-era merchant economy dominated by foreign and Chinese traders. Thus, the definition of a "Filipino" businessman is always problematic. Yoshihara (1985) presents a valuable account of the ethnic diversity of Philippine capital and discusses the difficulties of defining what Filipino capital is.

For our purposes, our main concern is in differentiating the Filipino businessman from the interests of foreign multinational enterprises in the country. Thus, almost any person, regardless of citizenship, would be considered a Filipino businessman as long as the home base of his capital is the Philippines.[10] According to this view, Filipino capitalists are those whose "bread currency" is that of the Philippines. Their situation is materially different from that of foreign entrepreneurs whose capital investment decisions are heavily conditioned by their ability to withdraw capital from the country, even permanently, so long as the comparative returns justify it.

For Filipino businessmen, capital has originated from trading surpluses (especially for many Chinese-Filipinos) and from land rents.

Filipino businessmen have formal organizations to represent their interests. The National Economic Protectionism Association (NEPA) was founded in the 1930s to advocate the interests of Filipino businesses, as opposed to non-Filipino, mostly American, interests. This association, which has grassroots organizations up to the city level, became a powerful lobby group during the import-substitution period of the 1950s. But it waned in importance and influence as the economic policies of that period were dismantled. In its place, the Philippine Chamber of Commerce and the Philippine Chamber of Industries, which later merged to form the Philip-

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10. Foreign capitalists raise a significant portion of their capital locally, so that a definition based on where the capital is raised would be meaningless.

pine Chamber of Commerce and Industries (PCCI), took over. Membership in this organization is not limited to businessmen; it includes executives of locally incorporated companies.

Most industrial enterprises in the country originated as import-substituting operations even before the import-substitution period.[11] It is not surprising that businessmen consistently pursued legislation to limit competition from foreign capital and to rapidly increase the domestic market through tariff walls and import controls. Notwithstanding their interest in protection from foreign competition, businessmen have consistently supported currency overvaluation in the post-war period. Because devaluation raises the costs of imported inputs and squeezes profit margins, the consistent support of business to overvaluation is probably due to the fact that protection derived from tariffs and import controls have made redundant the protection derived from exchange rate policy. It also indicates that the country never transcended the first phase of import substitution, which concentrated on final processing.

Businessmen from large companies have tended to dominate business associations and business participation in politics. This reflects a highly skewed distribution of economic power among business firms. Ten companies account for almost one-third of the gross revenues of the top 1,000 corporations. The combined net income of the top 10 was 1.3 times the total net income of the top 1,000 corporations in 1982 (IBON Databank, 1983).

A consistent interest of big business since the 1950s has been the raising of their capital from government-generated resources, which is not unique to the Philippines. This effort has taken many forms. In the 1950s, import controls and tariffs practically allowed protected firms to "collect taxes" from domestic consumers. In the 1960s, comprehensive investment-incentive legislation provided tax and tariff exemptions, accelerated depreciation, and other benefits to priority projects. In the 1970s, development programs, such as the progressive car manufacturing program, provided generous capital to large businessmen. Since the 1950s, development financing has been available at subsidized rates from the Central Bank (CB) and the Development Bank of the Philippines (DBP). In the 1970s, the Philippine National Bank (PNB) also provided huge amounts of development financing.

Government Bureaucrats

The US occupation left behind a well-defined and, by Asian

11. Yoshihara (1985) is a good reference for this.

standards, modern government machinery. Since the US had followed a policy of relying heavily on the local elite to run the colonial administration, the government machinery had been manned to the highest levels by Filipinos. The majority of government bureaucrats, then as now, came from the privileged classes.[12]

Before martial law, government bureaucrats tended to represent the interests of the faction of the elite from which they came. Elite factions competed vigorously with each other for government bureaucratic power because of the tremendous access to wealth it provided. But during martial law, bureaucratic power was concentrated in the faction around the President (see De Dios 1984).[13]

The post-martial law period saw an increase in the number of governmental departments and in the size of the bureaucracy. "Technocrats" in government bureaucracy rose in importance. Their most common feature was their possession of some advanced academic qualifications. These qualifications did not have to be in any particular field; they could be science, education, or a master's degree in business administration (as in the case of Prime Minister Cesar Virata).[14] A degree from the US was an advantage. Many of Marcos' technocrats came from university faculty position, particularly from the University of the Philippines (UP). Table 8 shows the list of technocrats who have been prominent in the Marcos administration.

The martial law period opened the possibility for a portion of the bureaucracy, the technocrats, to act as advocates of policies independent of the interests of any particular domestic faction. This permitted the bureaucracy to participate, in an important but not always decisive way, in fiscal policy formulation. Under martial law, the qualification by people's "election" was suspended in favor of qualification by academic background.

The technocrats, especially those from the universities, were not answerable to any elite faction, but they were directly responsible to the President. They have been characterized as advocating policies identified with the IMF-World Bank.[15] This advocacy went hand in

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12. A brief discussion of the dependence of US colonial administration on the local elite can be found in Corpus (1973).

13. Before martial law, all major appointments had to be approved by Congress, which also could carry out management audits of budgets and programs.

14. This did not prevent the technocrats of the Marcos administration from claiming to be all "economists."

15. See, for example, Bello, et al. (1982), Chapter 7.

Table 8
Technocrats in the Marcos Administration

Name	Degree and University	Position in the Government
1. Manuel Alba	MBA, Univ. of Minnesota Ph.D., Northwestern Univ.	Dean, College of Bus. Adm., U.P. Budget Minister
2. Jaime Laya	MS, Georgia Institute of Technology Ph.D., Stanford Univ.	Dean, College of Bus. Adm., U.P. Budget Minister Central Bank Governor Minister of Education
3. Placido Mapa, Jr.	Ph.D. in Econ., Harvard	Minister for Economic Planning
4. Roberto Ongpin	MBA, Harvard Univ.	Trade and Industry Minister
5. Gerardo Sicat	Ph.D. in Econ., Mass. Inst. of Technology	Faculty member, School of Economics, U.P. Minister for Economic Planning
6. Arturo Tanco, Jr.	Ph.D., Harvard Univ.	Minister of Agriculture
7. Vicente Valdepeñas	Ph.D. in Econ., Cornell Univ.	Minister for Economic Planning
8. Cesar Virata	MBA, Univ. of Pennsylvania MS in Industrial Management, Univ. of Pennsylvania	Dean, College of Bus. Adm., U.P. Minister of Finance Prime Minister

hand with the fiscal responsibility assigned to them by the Marcos administration, which was to provide the country access to foreign savings.[16]

Strains inevitably developed between business interests heavily dependent on a protectionist system and the "fiscal technocrats" advocating IMF-World Bank ideas. IMF-World Bank interventions were biased toward greater international economic integration and the exploitation of current comparative advantage. In the ensuing conflict, the fiscal technocrats found themselves in a losing battle with big business interests. However, there had been a permanent change from the pre-martial law situation: technocrats have become important participants in policy debates.

The evolution of Bretton Woods-inspired trade liberalization program in the post-martial law period illustrated the importance acquired by technocrats. Their influence in fiscal policy ebbed and flowed with the degree of indispensability of foreign financing. This will be discussed in a later section on decision-making process.

Foreign Capital

Foreign capital participation in the economy has always been significant. Even after independence in 1946, US corporations continued to dominate important sectors of the economy (Lindsey and

16. Some technocrats who did not have significant responsibility in fiscal financing, notably Roberto Ongpin of the Ministry of Trade and Industry, did not develop a reputation for advocacy of IMF-World Bank policies.

Valencia, 1982; Lindsey, 1976). But the aggregate level of foreign investments is small. The amount of US investments in the country is estimated not to exceed $3 billion, which is miniscule compared to the country's foreign debt outstanding of $26 billion in 1983. However, foreign firms are located in strategic industries and often have control of a significant part of their respective markets.

As Yoshihara points out, foreign capital entry into the economy was often in the interest of import-substitution. This was true before World War II and during the import-substitution period. An important element in the entry of foreign capital in the 1950s was the Laurel-Langley Agreement, which provided "parity rights" to US nationals. Parity rights gave US nationals treatment and opportunities equal to those enjoyed by Filipino nationals in business operations. Thus, parity rights suspended the nationalist features of the 1935 Constitution.

In the case of the Philippines, one must distinguish between foreign capital already in place behind the tariff walls and protectionist measures and foreign capital located outside the country. Foreign-controlled firms that have located domestically find a common cause with large Filipino business firms. They have active chambers of commerce (the American chamber being the oldest and most influential) and are active members in the Filipino chambers of commerce.

The interest of large Filipino businessmen in subsidized exchange rates, import controls, tariff protection, and tax exemptions are shared by domestically located foreign firms. The Investment Incentives Act (IIA) of 1967 allowed foreign firms to invest in "priority industries." To some extent, the IIA extended parity rights, which until then had been enjoyed only by US nationals, to all foreign nationals. The list of "priority projects" eventually became a laundry list that reflected more the interest of vested parties than of an economic development program. When a serious proposal for financial liberalization was put forward in 1974, foreign firms, which raise a significant part of their capital from domestic sources, supported the resistance to such liberalization.[17]

Foreign capital not directly situated in the Philippines tended to be supportive of this liberalization. In the post-martial law period, this type of foreign capital became an important participant in the

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17. To illustrate the importance of local capital market to foreign capital, we cite the finding of Warr (1984) which estimates that 90 percent of the capital invested in the country's first Export Processing Zone in Bataan was raised by foreign firms from the domestic capital market.

fiscal system as the country's foreign debt rose from $2 billion in 1972 to $26 billion in 1983.

Before martial law, Bretton Woods agencies such as the IMF and the World Bank did not have significant input into the decision-making process, which was then largely a power of Congress. In the post-martial law period, they became a significant "foreign group" involved in domestic policy discussions. This "group" relied heavily on economic models that were not situated in any particular social context. The models seemed to explain decisively economic events in their client countries without giving consideration to existing political and social constraints.[18] Because of this reliance on such models, their staff tended to find Filipino politicians and politics as inconvenience, if not actual hindrance, to development. The World Bank, for example, noted approvingly that martial law had "adversely affected the interests of various groups that had been well represented in the old Congress but that lost much of their power after 1972."[19]

The importance of this group, as will be discussed in the section on the fiscal process, is that while their suggestions have not always been implemented after martial law, they continued to have strong influence on the agenda. They have represented the interests of non-resident foreign capital in the sense that the financing that flowed in after the first oil shock depended heavily on this group's evaluation of, and preferred path for, the Philippine economy. The IMF-World Bank agenda is heavily oriented toward market solutions, which many of the local elite do not find conducive for their business. This group, therefore, had to rely on the slim representation of the technocrats in the hope that the authoritarian powers of martial law would be applied in favor of their reform agenda.

Other Groups

There are other groups in Philippine society which, because of

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18. This is the reason why failures of the programs of Bretton Woods agencies were blamed on a "lack of political will." Such is unacceptable in a competition-oriented account management. It is only sustained because, for many countries, the Bretton Woods agencies hold the key to access to international finance and, thus, are always paid first. In contrast, private commercial banks confidently insisted on government guarantees. But when the martial law economic experiment collapsed in 1983, they relied on the IMF current account management to guarantee the servicing of their Philippine exposure.

19. Bello, et al. (1982), p. 29, quoting from a World Bank document.

their voting population, theoretically have a role to play in the operation of the fiscal system. That they do not is a reflection of their limited political and economic power even under an electoral system.

The largest of these groups in the "other" category is that of peasants and small landowners. Peasant organizations have long interest in rent reduction and land reform and had occasion to express this interest in violent forms. Another important "other" group is that of workers, less than 10 percent of whom are unionized. Groupings of labor unions have been formed during and after martial law. One of them is the Trade Union Congress of the Philippines (TUCP) which, on several occasions, has participated in tripartite meetings with employers' associations and government representatives for minimum wage bargainings.

A third important group is that of small businessmen and would-be entrepreneurs. The protectionist economic system has tended to favor large business against small enterprises. Since the 1950s, large businesses have been practically guaranteed a margin because of the tariff differential between finished products and industrial inputs. Small businessmen have not successfully organized themselves to advocate their interests.

4

THE DECISION PROCESS

This section compares the fiscal decision process between the pre-martial law and the post-martial law periods.

The Pre-Martial Law Period

The 1935 Philippine Constitution, framed during the American occupation, determined the fiscal decision process before martial law.[20]

The Philippine Constitution took full effect after the country's independence from the US in 1946. It was patterned after the US Constitution and provided for three distinct branches of government--the legislative (vested in a bicameral Congress), the judicial (vested in a Supreme Court), and the executive (headed by the President). To the legislature was vested the ultimate power of taxation and government expenditure. The initiative for the budget process was assigned to the executive branch.[21]

Budget preparation was assigned to the Budget Commission, an executive body created under Republic Act 992. Each agency and bureau had its own budgeting staff. All budgets are consolidated and reconciled at the department level before submission to the Budget Commission.[22]

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20. The first modern definition of the Philippine fiscal process occurred during this period. In 1938, the Philippine Commonwealth Act defined the "budget" as the financial program of the national government which embodies the revenue and expenditure estimates for a given fiscal year.

21. The subsequent discussion on the official pre-martial law decision process draws much from Kintanar (1965).

22. Before martial law, the largest executive bodies were called "departments"; the post-martial law system referred to these bodies as "ministries."

The President was required to submit to Congress not later than two weeks after the opening of the regular Congressional sessions the proposed budget for the coming fiscal year. Congress followed an American-style budget process that moved from committee level (with public hearing, if needed) to the chamber, and finally to a house-senate conference committee. The budget was subjected to line-by-line scrutiny.

The timing of actual disbursements in the implementation stage, carried out in the executive branch, was controlled through the Budget Commission.[23]

The General Auditing Office (GAO) conducts the last stage of the process, the review of actual expenditures. Auditing service was, and continues to be, involved even in the disbursing phase since all fund releases required the approval of the office.[24] In addition, the auditing office has the duty to monitor the completion of projects and to make an annual report on the total appropriation experience of each agency.

The political context in which the official budget took place made it extremely unresponsive to development requirements. As pointed out by Kintanar, the fiscal process was such that the "calculus between benefits and costs at the margin precisely stated in economic theory" was all but lost in the decision-making process. In the first place, Congressmen concentrated their interest on particular items in the budget and lost sight of the total or the trade offs between items.[25] In the second place, the absolute power of Congress over the appropriation of funds superseded all the staff work that had taken place before the budget was submitted to Congress. This means appropriations for projects could be increased unnecessarily, or cut to levels that would make them unviable.

The fiscal process in the pre-martial law period was conditioned heavily by the principle that the ultimate power over public finance

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23. Before 1975, the Philippine fiscal year began on 1 July and ended on 30 June of the following year. Since 1975, the fiscal year corresponded with the calendar year.

24. The office, whose concurrence is required for all disbursements, would have its auditors assigned to each disbursing agency.

25. There was also the pre-martial law system in which the government budget was presented as two separate bills, a bill providing for the operating expenditures of the government, including proposals for the creation of new offices, and another bill, called the public works bill, for costs of construction of roads, bridges, irrigation systems, and other infrastructure projects.

belonged to Congress. This democratic feature had its unfortunate disadvantage because government bureaucracy did not have a direct means of sharing information with Congress. This inadequacy of information flow between the bureaucracy and Congress was traceable, in large part, to the Constitutionally mandated independence of the government branches from each other. Under this setup, the bureaucracy dealt with Congress only through the President. Congress was supposed to be a countervailing power to the executive and thus should maintain an independent position. Under this system, Congress and the President would have a common fiscal program if the President's party controlled Congress. This never happened before martial law.[26]

A potential stabilizing factor, the presence of political parties with well-defined and differentiated political positions, did not exist at that time. The elections and the decision processes were dominated by personalities and conflicts between personalities.

The two dominant parties were seen as convenient and temporary coalitions of essentially independent politicians. They became active only for the election contests. They constantly changed their platform every election and for every locality. They had no standing committees to study national issues in between election contests. Research staffs were essentially personal initiatives of individual politicians. Often, this situation was viewed as "more democratic" because issues could be commented upon from any angle, not from any fixed ideological viewpoint.

The instability of parties and the predominance of individuals arise from the essentially feudal characteristics of political power in the country. Under the US-style democracy reflected in the 1935 Constitution, social decisions were made on the basis of representation in government. The representatives were chosen by elections. During the US occupation, the landed and the trading classes dominated the government through elections because they had the resources and the education. The US withdrawal in 1946 saw the continuation of such class domination of the political process. This time, however, the process involved more blatant use by these classes of the material resources available to them. Vote buying, ballot stuffing, use of private armies, and other illegal practices became increasing features of election exercises.

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26. The political process in the Philippines had a strong tradition of the "split ticket," where even the President and the Vice President happened to be elected from different parties.

The pre-martial law decision process was cumbersome and slow. The budget was often approved in the last hours of the congressional session. The line-by-line scrutiny of the budget was a venue for grandstanding by individual members. The public works bill was the target of special interest by individual Congressmen who ensured that construction projects were allocated to their region.

The political context of pre-martial law fiscal policy made difficult the raising of tax revenues. Growth in real tax revenue averaged 10 percent per year in the 1950s and declined to 5 percent per year in the 1960s. It became increasingly difficult to fund public investment programs. Congress also did not give importance to foreign borrowings to finance beneficial national projects, such as electric power generation. During this period, none of the financing for local infrastructure projects was raised from foreign sources.

The Post-Martial Law Period

When martial law was declared in 1972, a Constitutional Convention was going on. It was convened in 1971 in accordance with the provisions of the 1935 Constitution. Delegates to the convention were chosen in special elections. Although a well-defined bloc of delegates was apparently advocating the interests of President Marcos, he went ahead with imposing martial law. He incarcerated a number of convention delegates and political opposition, including the late Senator Benigno Aquino. He also closed down Congress, the venue through which the traditional parties exercised their influence over fiscal policy.

In the meantime, the Constitutional Convention reconvened, minus some members who were jailed. The convention completed its work in 1973, and the new Constitution was ratified that same year. President Marcos, however, postponed the implementation of the Constitutional provision calling for the immediate convening of an interim national assembly.[27] Thus began a period in which the revenue and expenditure program of the government became the sole prerogative of the executive branch. During this period, the President ruled by issuing presidential decrees (PDs), which had the force of law. Budget and tax measures were promulgated through these decrees.

On 24 September 1972, two days after the declaration of martial law, President Marcos issued PD No. 1, called the Integrated Reorganization Plan, which carried out a thoroughgoing reorganization

27. See Macapagal (1975).

of the government service. The reorganization, designed by the Commission on Reorganization which Marcos convened in 1970, effectively strengthened the capability of the executive branch to design and implement government policy independently of Congress.

A notable result of that reorganization was the creation of the National Economic and Development Authority (NEDA), which consolidated national statistical generation and economic planning and which was tasked with designing the long-term development plans of the country. Another was the reconstitution of the old Joint Legislative-Executive Tax Council into the National Tax Research Center to provide staff support for the design of taxes.

Before the convening of the interim national assembly in 1978, budget preparation and tax design were done without a legislature. NEDA helped provide the necessary inputs to the budget process. Eventually, the Budget Commission was elevated to the ministry level. The coordinating fiscal function was enhanced with the creation of the Development Budget Coordinating Committee (DBCC), a subcommittee of NEDA. The DBCC consisted of the budget minister as chairman, and the finance minister, planning minister (who was also NEDA chief), and Central Bank governor as members. Its location in NEDA embodied the intention to remedy the deficient development orientation of pre-martial law fiscal policy.

The official process within the executive branch did not change drastically. The ministries submitted their proposed budgets to the DBCC, where they were required to justify their plans in formal hearings. This process allowed greater coordination between development programs and the budget since the DBCC had the capability to look simultaneously at revenue ceilings, expenditure totals, and borrowing constraints, especially those pertinent to foreign borrowings. The new process effectively allowed the estimated foreign fund inflow to be consciously factored in for the design of budget and tax measures of the next fiscal year. These things, as pointed out earlier, were hardly discussed expeditiously in the Congressional process (Fernandez 1973).

The rate of inflow of foreign financing increased during the period. Between 1950 and 1972, the Philippines received only $326 million in World Bank assistance, but between 1972 and 1981, it received more than $2.6 billion for 61 projects. Among the World Bank's Third World recipients, it ranked 30th in cumulative accommodations. After martial law, it rose to 8th rank.[28]

28. See Bello, et al. (1982), p. 24.

After the convening of the legislative assembly in 1978, the official process contained some notable features designed to circumvent the paralyzing Congressional conflicts surrounding fiscal policy. Instead of promulgating the budget himself, the President submitted the budget, prepared under the auspices of the DBCC, to the legislative body as the annual Appropriations Act. The legislative body had 45 working days within which to improve on the budget. Otherwise, the budget as submitted by the President prevailed.

The President had veto power which the legislature could override with a two-thirds vote. The legislature did not have the power to increase budget items, only to reduce them to any positive value. It also had no power to abolish any government operations (except implicitly by providing a ridiculously low funding). These restrictions on the legislature were meant to remedy the problems inherent in the pre-martial law fiscal process. But in combination with other official provisions, these restrictions effectively removed the power of fiscal policy from the legislature.

There were two important official restrictions. The first was Amendment 6 to the 1973 Constitution which allowed the President to pass legislation concurrently with the legislature. This gave the President the power to counter the legislature's veto override of two-third's vote. The second restriction was PD 1177 which allowed the President to reallocate budget items as he deemed appropriate. This presidential power had force even after the legislature had formally approved a fiscal budget.

This characteristic of the martial law period of fiscal decision process was carried over in the post-martial law period. Even when the legislature became officially operational in 1984, it never regained the power to design expenditure and tax policy which it had enjoyed under the 1935 Constitution.

Before martial law, the dominant control of the President's political party in Congress did not guarantee a consistent fiscal program between the President and Congress. But in the present system, all conflicts had been internalized in the executive branch. The fiscal decision process had relied heavily on the staff work provided by the Ministry of Finance, the NEDA, and the support staffs of cabinet officials, with the finance ministry staff playing the lead role.

Since 1970, the agenda on expenditures had been dominated by the need to respond to the foreign financing program to which the Philippines had access. This was true especially after the 1974 oil crisis. A World Bank-led consultative group, which represented

foreign countries (especially the US, Japan, and Arab countries) and multilateral financing institutions such as the Asian Development Bank (ADB), reviewed and approved foreign- financed projects for the Philippines. This group coordinated both lending (such as by export-import banks) and direct grants to the Philippines by other countries.

Most of the foreign-financed projects were public works. For most of the 1970s, the country's infrastructure projects were decided upon concurrently with the negotiation for their funding. Almost all of these projects required counterpart funding from the domestic budget. The economic downturn in the 1980s made difficult the raising of the required domestic funding to complete these projects, which were by nature multi-year, so that their requirements spilled over into subsequent budgets.

Similarly, the agenda on tax reform had been dominated by the need to respond to foreign financing. The country's IMF standby programs in the 1970s provided targets for reducing the government's budget deficit, thus creating pressure to increase revenue generation in the short run.

Another important ingredient of the executive fiscal process after martial law was the implicit agenda of the supporters of martial law government, namely, tax exemptions and subsidy. Even before martial law, the granting of tax exemptions and subsidized credit was an accepted approach to finance development. The passage of the investment and export incentives acts, which provided incentives to pioneering and export-oriented enterprises, was the most significant development-inspired fiscal change at that time. The concentration of power in the President provided some flexibility and responsiveness in instituting, through presidential decrees and letters of instructions, fiscal measures that directly influence economic activities, such as special tax grants or tariff privileges. Such privileges, granted to spur investments in vital areas of the economy, have applied not only to government corporations but also to private companies.[29]

One of the immediate effects of martial law was the suppression of severe factional conflicts over fiscal policy that have characterized the Congressional process. Consequently, in the post-martial law period, it became easier to resolve conflicts within smaller groups. In many instances, conflicts were resolved by ensuring that affected parties enjoyed a compensating advantage in another economic

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29. De Dios (1984) has classified these decrees by economic sector, providing a glimpse of the extent of this intervention.

area. Understandably, this generated a proliferation of interventions.

The Consultation Process

We now discuss the process of consultation in post-martial law decision-making. As explained above, the power of decision, then as now, lay with the President. But fiscal decisions are made up from details, such as tax rates, and laws have to be designed and drafted even when power is concentrated in one person. This consultation process will be described in this section based on interviews related to this subject.

The consultation process has five stages: (1) initiation, (2) initial design, (3) coordination with affected parties, (4) final decision, and (5) implementation.

Initiation

This means the origination of an idea in the fiscal process. In the Philippine context, the idea can originate from representatives of any of the groups concerned with fiscal policy.

An important aspect of origination is that while the country has always operated based on a development plan, most development plans do not represent a reconciliation and accommodation of the different interests in society. They are often merely statements of intentions of the executive branch. The intentions are not necessarily inconsistent with each other. But because there is little effort in determining whether the resources are sufficient to meet all the goals, a development plan does not embody any decisions about what intentions must be given up in order to achieve the more important ones.[30]

Thus, initiation can start anywhere in the system. In actual practice, initiatives from international lending agencies, such as the World Bank and the IMF, have been important. These agencies frequently start the process by commissioning local academics or

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30. This is not to say that "priorities" cannot be read out of development plans. It only means that there is no social decision behind such a statement of priorities, so that the stated priorities do not have any force in guiding actual decisions. It is always convenient if some micro-decisions can be justified from some statement in the development plan (and this is relatively easy to do since development plans have tended to be comprehensive in terms of intentions), but development plans have not prevented new, unintended projects from being pursued.

the research staffs of government agencies to study some issues.[31]

The IMF initiatives have come in more direct form since the country began to rely on standby loans. Such initiatives were often in the form of advice, and were given in negotiations where secrecy was inherent. Direct, public, and explicit advice from foreign agencies was heavily discounted in the Philippine consultation process even during martial law. But this did not take away the initiative from these international agencies, which found representation in the technocratic groups. These agencies have always expressed frustration over the political decision process that allowed inappropriate policies to be pursued. The World Bank noted approvingly that the proclamation of martial law and the abolition of Congress provided the government with "an almost absolute power in the field of economic development."[32]

In actual practice, the effect of this representation had been minimal. The importance of technocratic influence varied directly with the need for foreign financing of the chronic current accounts deficits. This need was not yet significant when international commercial banks sought to lend OPEC funds to the country in mid-1970s. Even when foreign financing became important, the very nature of the advice coming from international agencies could not have elicited support from powerful interests outside the bureaucracy. The IMF-World Bank's advocacy of anti-protectionism in industry conflicted directly with the interests of existing powerful business groups and potential groups allied with the martial law regime. Thus, these groups have consistently resisted deliberate devaluation and tariff and tax reforms.

The word "minimal" is important here. Since the policies advocated by international agencies were directed at intervening in favor of the "whole" system, and since these policies conflicted directly with the interests of big business groups, the technocrats did not enjoy the support of these groups. Technocrats who came from the academe also did not have the requisite domestic base.

In the martial law period, only a few of the initiatives have come from organized business groups such as the PCCI. Most of the

31. For example, a large-scale project on industrial protection policies-summarized in Bautista, Power, and Associates (1979)--set the stage for the tariff liberalization program financed by the World Bank in 1980. Financing for this project came from government agencies, the Ford Foundation, and the World Bank. Another agency which has funded many research projects has been the U.S. Agency for International Development.

32. Bello, et al. (1982), p. 27.

private initiatives came from individuals, and were in favor of particular firms. The role of PCCI was generally relegated to reacting to these individual initiatives when the policies they have successfully implemented conflicted with the interests of many PCCI members. In most cases, because of the small domestic market, the conflict was between the interest of one member as against another. The PCCI had no basis for taking sides.

Initial Design

In the case of tax programs, there were two places where initial designs took place. One was the National Tax Research Center (NTRC). The other was the staff of the Prime Minister. In the post-martial law period, the designs have responded to the IMF-World Bank proposals. Programs of international agencies have invariably included a "technical assistance component." This was part of the loan package meant to increase the capability of the affected government agency to carry out research. It is fair to say that all tax initiatives after 1976 have been designed by the said two staffs, with the more comprehensive reforms, such as those pertaining to the gross income tax system, coming from the NTRC.

The design of fiscal changes directly related to private interests was generally initiated by individuals concerned. For example, the coconut industry tax program was designed by a private law firm (whose principal partner eventually became president of UP) with the help of the minister of trade and industry and the top employees of the Philippine Coconut Authority. Government agencies made extensive use of private research firms, especially when foreign funds permitted subcontracting, to make studies and design programs.

Consultation with Affected Parties

The consultation process was quite perfunctory, often non-existent, before the promulgation of a policy change. As noted above, the system did not encourage coordination between government departments. There was an almost weekly cabinet meeting presided over by the Prime Minister to thresh out issues to be brought to the President for promulgation. However, these meetings did not resolve many issues of coordination, and many who participate in such meetings, including the Prime Minister, have felt frustration over the fact that direct appeals to the President have often overturned or suspended cabinet decisions.

From time to time, ad hoc committees with private sector representation were created, but there has been no tradition of consultation with the private sector as such. Similarly, there has been no tradition of consultation with the press in the design of fiscal policies, unlike in other countries.

But although consultation with groups outside the government tended to be minimal, this did not mean there was no private input. In fact, there was tremendous private input in terms of self-interested representation. There were standard channels in which such inputting was carried out. Public hearings were held for tariff changes, and consultation was conducted for the incentive priorities list. Thus, for the tariff liberalization program, public hearings were called before rates were changed, as required by law.

However, these consultations were dominated by the need to protect individual interests. They were not sensitive to the interests of the private sector as a whole. The private sector did not have a well-defined interest as a sector (or as larger groups within the private sector). This protection of individual interests also involved the need for advanced information about government intentions. Again, access to information tended to be individual, based on kinship and other close ties.

Suppression of public criticism of the President's immediate circle also shut off the relatively costless generation of information from sectors of society that were being adversely affected by fiscal decisions. The resulting decline in the quality of the decision process was embodied in the rapid rise in the incremental output ratio.[33]

Final Decision

In the martial law period, the President had the final power to make fiscal decisions. Even with the reinstitution of the legislature, the President retained the power to reallocate budget and to pass tax legislation.

Such power assigned to one person has allowed the short-cutting of the decision process. It became possible to approach the President directly to issue decrees creating tax exemptions. It also allowed ministries to directly convince the President to change expenditure allocations even without consultation with the affected ministries. It became normal practice for the President to require, for example, ministries to attain a 10 percent savings in their

33. See De Dios (1984).

current budget. The funds thereby saved were used for special projects, notably those of the First Lady. The affected ministries learned of the reasons for such measures only informally.

It was inherent in the decision process that the affected groups often gave reactions only after a fiscal decision had been announced. Here, the President's vast power had been used to suspend or amend the promulgated decision in response to complaints.

Implementation

The implementation of fiscal policy includes the actual collection of taxes and the disbursement of funds. In the latter, the auditing function is important. Graft and corruption has always been present in both the spending and taxing aspects of policy. This seemed to ease somehow from the start of martial law up to about 1975, when an atmosphere of strict morality seemed to pervade the government bureaucracy. In 1975, Marcos tried to retire a large number of government employees for corruption. While many were reinstated, including those with significant graft records, the episode demonstrated the power of martial law government and secured the loyalty of those in service.

Exemptions and special treatment dominated the implementation of such a fiscal system. But after the onset of the current economic crisis, all tax exemptions of government corporations were removed by presidential decree. Exemptions for selected enterprises were eventually reinstated, but it seemed that the most inefficient ones have succeeded in getting re-exemptions. There was an ad hoc committee where pleadings were made, but the President had often decided independently of the recommendations of the committee. Similarly, the tariff reform program had been constrained by special exemptions and redefinitions.

5

REFORMS ON THE FINANCING SIDE

This section discusses and evaluates the reforms on the financing side during the authoritarian period.

Tax Reforms

It is a reflection of the reformist power of the government in the early period of martial law that "tax reforms" which never could have been instituted under the previous socio-political arrangements were finally adopted through Presidential Decrees under the new dispensation."[34] Reforms such as the revision of the tariff and the internal revenue codes had been pending in several committees of the Congress for years.

Kintanar puts the blame for this Congressional inaction on the fact that these reforms invariably increased the tax burden on the "wealthier classes of society--the landowning class, the industrialists, and commercial interests--who were heavily represented in both Houses of the Congress."[35]

The development imperative on the financing side was the raising of the country's tax efforts.[36] We now discuss the efforts taken toward this during the post-martial law period.

Tariff Reforms

One of the first acts of the martial law government was the reform in 1972 of the tariff and customs code through PD 34. This

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34. Kintanar (1976), p. 1.
35. Ibid., p. 2.
36. See also Sicat (1971).

reform simplified the system of classification by reducing the number of categories and the number of tariff rates. The new code provided for only six rates: 10, 20, 30, 50, 70, and 100 percent. The new code reduced the applicability of the catch-all category of "others," which was the basis of much discretion and abuse of the customs law.

The code had grown by accretion since last modified in 1957. It was promulgated after some consultation with businessmen who successfully objected to the reduction in maximum tariff rates for finished products and to the increase in tariff rates for industrial inputs, as reflected in the staff draft plan. It is important to note that both Filipino and foreign companies objected to the reduction in maximum tariff rates.

Subsequent efforts at trade tax gave rise to conflict between the technocrats and the entrenched big business. They also provided an interesting illustration of how a program's objectives might be achieved in terms of targets but not so in reality.

The IMF has had a long-standing interest in tariff reform as a strategy to improve resource allocation in the Philippines. The IMF adjustment programs in 1962, 1970, and 1973 all contained some elements of tariff reforms, such as the removal of specific import controls, a reduction in the number of tariff rates, and the lowering of specific rates. In 1976, the IMF tried another tariff reform by offering the Philippines an Extended Fund Facility (EFF) program. By 1978, the IMF had admitted failure in these efforts,[37] which were successfully resisted by businessmen close to the then Central Bank Governor Gregorio Licaros, who was not a technocrat.[38]

In 1980, after the second oil price shock, the need for foreign savings became critical again. This allowed the technocrats representing the Philippine government to conclude a structural adjustment loan (SAL) with the World Bank for a tariff liberalization program. In 1981, Jaime Laya, a technocrat, became Central Bank governor after a serious financial scandal involving an associate of the previous governor.

The objective of the program was to reduce the average tariff rates from 43 percent in 1980 to 28 percent in 1985. It called for a reduction in the peak rates of from 70 and 100 percent to 50 percent. In terms of overall objectives, the program targets were achieved on

37. See Thompson (1985).

38. See Bello, et al. (1982), Chapter 6; Thompson (1984); and Broad (1983).

schedule. The President's capability to rule by decree allowed the prompt implementation of scheduled tariff reductions so that even the intermediate objectives were attained to the letter.

It is difficult, however, to conclude absolutely that the tariff reduction program attained its objectives in spirit because of other policies that gained in importance during the same period. First, there was a proliferation of decrees exempting specific corporations from all customs duties, so that the drop in overall average tariff was a poor measure of the extent of liberalization.

An example of a corporation that was granted tariff exemption was the Philippine Veterans Investment and Development Company (PHIVIDEC), a government corporation created from the pension funds of military retirees. This corporation engaged in significant tax-free importation of finished products (such as tires and appliances) which it then sold to favored companies. Another example was NIVICO, a private company, which was granted the privilege to import television sets tax free to support a program of increasing the use of television in the countryside. NIVICO eventually participated in the domestic commercial market for TV sets.[39]

Second, import controls on many items were put in place as the Board of Investments and other agencies reserved certain industries as priorities for "industry rationalization." For example, the importation of kerosene engines, and of raw materials, parts, and components for electronic products were controlled by the Board of Investments. Similarly, the importation of raw cotton was controlled by the Development Bank of the Philippines (DBP) to protect the local cotton industry.

Tax Incentives

The use of tax incentives to pursue fiscal and development policy is well entrenched in the Philippine fiscal system. As early as 1948, Republic Act 35 granted "new and necessary industries" exemptions from some internal revenue taxes for a period of four years.[40] These types of incentives were extended in subsequent legislations until the promulgation of the Investment Incentives Act in 1967. This law, passed during Marcos' first term, created the Board of Investments, which determined which ventures could qualify for incentives.[41]

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39. Sicat (1984), cites these cases.

40. From Manasan (1982), which also contains a valuable summary of the history of incentives.

41. Sicat (1967) explained the rationale of the new approach.

With the use of the President's law-making power under martial law, these incentives were eventually extended to exports, agriculture, and other specific ventures. After martial law, PD 135 extended the incentives to chemical fertilizers, PD 237 to mining, PD 535 to tourism, and PD 1167 to construction. Powerful members of the martial law coalition benefitted from these extensions of incentives. For example, the construction industry incentives were enacted when the company of Rodolfo Cuenca, a Marcos associate, became deeply involved in overseas construction projects.

Self-Financed Programs

The numerous claims against the potential and actual tax revenue of the government created pressure on the government to undertake programs that were purposely self-financed. One was the "Alay Lakad" (Walk for a Cause) program of the Ministry of Social Services and Development (MSSD), which was intended to raise funds for self-employment projects of out-of-school youths.

A more controversial self-financed program was the coconut industry development program, or CIDP. The coconut industry is a key Philippine industry. Coconut products rank second in export earnings and, on the average, constitute about 15 percent of merchandise exports. In spite of such importance, there had been no public effort to improve the productivity of the industry until 1973.

The hypothetical basis for the CIDP was that the required productivity development could be financed from what in effect would be a levy on exports. At that time, the Philippines controlled at least 65 percent of the world coconut and copra markets, and it was presumed that the levy would be borne by foreign consumers. This turned out to be erroneous. The world market demonstrated its ability to shift to other vegetable oil substitutes when a newly formed unified marketing operation tried to restrict exports of coconut products in 1979. Subsequent developments in the industry resulted in a monopsony in the domestic trading of coconut products. Thus, the collections to the industry development fund were borne principally by coconut farmers.[42]

Because the coconut levy was legally a contribution by its intended beneficiaries to a private fund, the CIDP qualifies, at least in principle, as a self-financed program in which interested parties

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42. Clarete and Roumasset (1983) demonstrated that the "tax" fell principally on the farmers.

contribute to its financing. The evolution of this program underscored its private character. PD 755 authorized the diversion of part of the coconut levy fund (the part that had been allocated for "investment") for the purchase of a private commercial bank which was organized into the United Coconut Planters Bank, or UCPB. The coconut fund, thus, held 70 percent of the bank for the farmers, who could then exchange their levy receipts for shares of stocks in the bank. The remaining 30 percent of the stock came under control of a group headed by Eduardo Cojuangco, who also had a strong hand in helping the President choose who would be appointed to the board that controls the fund. In practice, it proved difficult to distribute the shares of stocks to the unorganized coconut farmers. They were dispersed throughout the country and, in many cases, could not produce levy receipts.

Thus, the private bank ("private" because it was now hypothetically owned by farmers and a private group) became the principal instrument of the coconut program. In 1978, PD 1468 created the Coconut Industry Investment Fund (CIIF) from a portion of the levy fund. Using CIIF fund, the UCPB proceeded to control 70 percent of the industry's milling capacity, which was consolidated under the firm United Coconut Mills (UNICOM), created through Letter of Instruction (LOI) 926 by President Marcos. The LOI enjoined all government agencies to give full support to the company and prohibited the entry of new firms into the industry. Thus, UNICOM became the largest buyer of copra and seller of coconut oil.

Between August 1973 and August 1982 (when the levy was suspended), the CIDP has accumulated fund amounting to P9.7 billion. Of this amount, P2.6 billion went to the acquisition of industry milling capacity under the CIIF; P2.1 billion financed a program to subsidize the purchase by coconut farmers of cooking oil, laundry and bar soap, filled milk, and animal feeds; P1.1 billion went to planting hybrid seednuts in 55,000 hectares; and about P0.8 million for socio-economic projects among the farmers. The rest of the fund went to various purposes, including additional equity to UCPB and donation to a children's hospital project of the First Lady. UCPB then had to meet some equity requirements in order to become a full-service commercial bank. Thus, from a minor bank before acquisition, it grew into the largest domestic bank in terms of assets. In 1984, Eduardo Cojuangco, through the UCPB, purchased controlling interest in San Miguel Corporation, the country's largest Filipino corporation.

Because the coconut program was a private, self-financed operation, its funds were not subject to government audit. The

coconut industry policy was the subject of much infighting in the Marcos group as the internationally minded technocrats tried to remove the legal underpinnings of the program.

On 27 May 1980, the levy was suspended. Because it was collected as a fixed amount on quantity,[43] the sharp fall in world copra prices at that time caused much suffering in the countryside. But President Marcos resumed the collection of levy 45 days later, under a slightly different name. The resumption was purportedly in response to the clamor by farmers as expressed by the private industry group, which was led by coconut businessmen close to the government.

In 1981, the levy was suspended for a month and then was resumed under still another different name. In January 1982, the levy was changed to respond to the level of copra prices. In August, it was again suspended.

The IMF-World Bank and the internationally minded technocrats have often resisted efforts to increase Filipino control of the coconut industry through the CIDP. In 1983, the World Bank proposed to fund a coconut replanting program.[44] The group in control of the coconut industry eventually rejected it. Under the 1984-1986 IMF program, the dismantling of the monopoly control over domestic trading was a "qualitative criterion." The Aquino government proceeded to remove the coconut monopoly upon assuming power.

Evaluation of Tax Reforms

By 1981, the post-martial law government had succeeded in consolidating, simplifying, and codifying the tax system of the country. Many of these reforms had been impossible to achieve in Congress. The furious pace with which many of the original reforms were carried out in the beginning seemed to hold promise that the tax system could be reformed so that the tax revenues would become consistent with development goals. In 1972, taxes made up 11.2 percent of GNP.[45] In 1983, the figure had increased to only 11.9 percent, and went down to 10.0 percent in 1984, the first full year

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43. At the start, P150 per metric ton of copra; but in 1980, it was already equivalent to an export tax of P1,000 per metric ton).

44. The World Bank was to be paid back through an export tax on coconut product exports, so that it appeared as if the World Bank was not only proposing to impose another distortion but also proposing to replace the local group as a collector of the levy.

45. Using the tax revenue estimates in the national accounts.

of the present balance-of-payments crisis. For the period 1975-1984, total tax revenue averaged 10.8 percent of GNP (Table 9).

At the end of the period, the tax system had not been freed from its heavy reliance on taxes on goods and services and on international trade. Tariff reforms had reduced total national taxes derived from these two sources from 75.0 percent in 1975 to 66.7 percent in 1984. In 1983 and 1984, however, other taxes which were dominated by temporary surcharges on imports increased to 7.3 percent of total taxes, so that the government also tended to depend on these types of taxes (Table 10). Property taxes collected never exceeded 0.9 percent of GNP and averaged only 0.2 percent of GNP between 1975 and 1984 (Table 9). Taxes on income averaged 2 percent of GNP before martial law. They increased to an average of 2.5 percent after martial law due to tax amnesty, but this was not sufficient to reduce dependence on indirect taxes.

Table 9
Tax Revenues as Percentage of GNP

Year	Taxes on Net Income and Profit	Taxes On Domestic Goods and Services	Taxes On International Trade	Taxes on Property	Other Taxes	Total Tax Revenue
1975	2.8	8.2	5.8	.02	.19	12.01
1976	3.2	4.7	3.7	.11	.23	11.95
1977	3.0	4.0	3.2	.06	.76	11.00
1978	1.9	4.1	4.8	.95	.15	11.97
1979	2.5	4.3	4.9	.28	.21	12.33
1980	2.8	4.1	4.4	.21	.22	11.76
1981	2.5	3.7	3.7	.10	.58	10.52
1982	2.5	3.7	3.6	.11	.24	10.16
1983	2.3	2.9	4.2	.03	.73	10.31
1984	2.4	3.2	3.2	.02	.70	9.49
Total	2.54	3.65	3.96	.15	.46	10.78

The failure to achieve the necessary increase in resources mobilization can be attributed to the severe constraints (as will be discussed below) placed by the country's political economy on the authoritarian government. These constraints weakened efforts to raise tax and collection rates on real property and on personal income. They also led to the proliferation of tax and tariff exemptions. Although collection rates improved in the first few years of martial law, they eventually declined as corruption consistently worsened after 1976.

Table 10
Tax Sources as Percentage of Total Tax Revenues

Year	Taxes on Net Income and Profit	Taxes on Domestic Goods and Services	Taxes on International Trade	Taxes on Property	Other Taxes	Total Tax Revenue
1975	23.11	26.34	48.73	.21	1.6	100
1976	26.39	39.40	31.35	.96	1.9	100
1977	27.50	36.50	28.59	.50	6.9	100
1978	16.05	34.30	40.38	8.0	1.3	100
1979	20.64	35.45	39.90	2.3	1.7	100
1980	23.82	35.01	37.48	1.8	1.9	100
1981	23.92	34.78	34.82	.96	5.5	100
1982	24.89	36.76	34.98	1.1	2.3	100
1983	22.75	28.80	41.12	.26	7.1	100
1984	25.84	33.30	33.47	.21	7.4	100
Total	23.62	33.93	36.79	1.42	4.28	100

Let us now discuss more thoroughly the politico-economic constraints on the martial law government.[46]

When martial law was declared in 1972, the Marcos government faced resistance not only from the lower classes of society but also from the elite groups, whose political power lay in Congress. The latter's resistance was no less threatening to the stability of the authoritarian experiment than that posed by the radical and underground groups.[47]

As has been explained in previous chapters, while Congress seemed ineffective in addressing the development imperatives of Philippine society, it effectively served as the means by which the landlord and industrial classes protected and reconciled their occasionally conflicting interests. Marcos' dissolution of Congress effectively shut off the majority of elite classes from political participation. The authoritarian government detained many members of Congress and delegates to the Constitutional convention that was then in session. Those who demonstrated unwillingness or inability to resist the new government were released. Some of them were actually won over by the new government, at least temporarily, and cooperated in the completion of the 1973 constitution.

The permanent objectors to the martial experiment, which included Senator Benigno Aquino, were never released or spent

46. Many of the ideas presented here have been discussed in De Dios and Montes (1985).

47. In 1972, the Communist Party was geographically concentrated and had less than a thousand members. At that time, moreover, the military did not have a distinct political personality.

longer time in prison. The Lopez family, one of whose members was Marcos' vice president, never reconciled with the experiment and were constrained to divest themselves of their domestic income-earning assets--which included a newspaper-TV chain and the electric utility for Metropolitan Manila.

The declaration of land reform for rice lands all over the country one month after the declaration of martial law[48] held out the promise that the authoritarian government would attempt to dismantle the feudal basis of political power in the country and, thus, provide the permanent basis for this government. But the reform was never extended to other croplands, and in 1975, a decree exempted rice landholdings of seven hectares and less from land reform. This effectively exempted 67 percent of the total riceland.

To sustain political control and the operation of the bureaucratic machinery, the authoritarian government needed to create its own social base. Because of the constrained parameters within which it had to operate, it ultimately had to create its own loyal followers or elite groups.

The question was, from which constituency would this social base be formed? The dominant families before martial law were on the opposition. While they could be expected to continue to operate their domestic income-earning assets, they also could not be counted upon to participate in the new government.

The disadvantaged groups--peasants, workers, and small businessmen--presented an attractive alternative. The announcement of land reform was seen as an effort in this direction. However, given the entrenched economic power of the elite opposition, it would probably have been foolhardy at that time to consider these groups as a core of a stable and immediately dependable social base. As explained earlier, these groups were not well organized. Their members have not been active participants in the country's political life, except for some who have engaged in insurgency. Any serious effort to draw in support from these groups would have required accommodating their interests, which certainly would invite reaction from the elite. Such an accommodation would have required a thoroughgoing land reform program that would reduce the holdings of the landlord class and the dismantling of the protectionist system that favored large businessmen.

That the government bureaucracy did not have a distinct personality and that the military then was neither capable of taking over some civilian duties nor did it have a political orientation meant

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48. The decree was issued in the President's own handwriting.

that the social base had to be created from outside the state machinery. To the extent that the authoritarian experiment threatened the sanctity of the Constitution which the officers' corps have had a long tradition of defending, the military support for the experiment was unstable and, at best, temporary. The idea of most military officers was that the necessary restructuring of society would not take very long, and a return to normal civilian processes would be undertaken as soon as reforms were carried out. In any case, the "necessary restructuring" of society was not conceived of by the military supporters as leading to the permanency of political power in the Marcos family and their allies.

Thus, the authoritarian government had to create its own reliable social base from a new group, a "new elite." The formation of this new elite made necessary the diversion of resources in favor of its members. This diversion was done by "bending the rules" or by creating new rules that conferred "exceptional" privileges to the members of this new elite. The word exceptional is important, because changing only the rules, which could apply to all, would have provided advantage to those already dominant during the pre-martial law period.

The rapid formation of a coalition of the new elite was not surprising under a political process in which stable political parties did not operate. The stability and strength of the new coalition depended heavily on the economic benefits conferred to it. At the same time, as the technocrats in government have learned to accept, the authoritarian powers of the President could not be used to withdraw these privileges since this could destabilize the regime. In fact, as the challenge to the regime mounted, the conferring of these economic benefits became a more critical necessity. In the twilight years of the Marcos regime, the First Lady's relatives and allies became more powerful because of this process.

The politico-economic parameters within which the authoritarian government had to operate explain the most important features of the evolution of the tax side of fiscal policy in the post-martial law period. The government had enough power to override the technical and obstructionist objections in Congress. This power enabled the government to codify and simplify tax laws and administration. Moreover, it had enough power to carry out a tariff liberalization program, which would have been impossible during pre-martial law.

However, the authoritarian government did not have enough power to threaten the economic power of the dominant groups during pre-martial law. That explains why effective increases in tax

rates could not be undertaken simultaneously with codification. That also explains why the system of incentives, which threatened the tax base, could not be rationalized during the period. Apart from the continued expansion of coverage, the only change in the incentives system was its codification in 1981.

The authoritarian government had enough power to grant exceptional privilege in terms of tax and tariff exemptions, and to impose quasi-public taxation such as the coconut levy in favor of its social allies. These allies provided political support in terms of such activities as referenda and election exercises. The resources consolidated under these privileges also financed the buying out of the assets of the pre-martial law elite. In a sense, the purchase by Cojuangco of the country's largest Filipino corporation can be seen as a culmination of the effort to reduce the power of the old elite.

The requirements that attended the creation of a new social base also explain the post-martial law developments on the expenditure side of public finance, as will be discussed in the next chapter.

6

REFORMS ON THE EXPENDITURE SIDE

The development imperative that confronted the martial law government on the expenditure side was the need to increase the rate of capital investment. A program to raise public expenditures on investment was successful. In 1970, public expenditures on investment was only 1.5 percent of GNP; by 1979 it had been raised to 7 percent.

Almost 50 percent (46.4 percent between 1979 and 1984) of the national government's capital expenditure was directed at utilities development and road transport construction (Table 11). Energy development was considered a priority investment area in response to the oil shocks of the 1970s. Agriculture and social services had very low priorities. Table 11 shows that between 1979 and 1984 the debt repayment burden of the national government had increased nine times. The unimpeded ability to contract foreign debt, which was so difficult under pre-martial law procedures, was crucial.

Favorable international developments, especially the unprecedented availability of international commercial lending after the first oil shock, helped efforts to raise public investments. As in other countries, the bottleneck that had to be overcome was the absorptive capacity of the economy, especially since the private sector had limited capability to absorb. The constraint in the private sector was that only a few companies had sufficient international reputation to be able to borrow on their own account. But these companies were so large domestically and had access to locally available subsidized credits that they did not have to use foreign credits in substantial amounts.

The response of the Philippine government was to increase the rate of borrowing on its own account for infrastructure projects and

Table 11
National Government Capital Expenditure on Its Own Account by Sector, 1979-84

(In million pesos, obligation basis)

	1979	1980	1981	1982	1983	Est. 1984
ECONOMIC SERVICES	**4,818**	**6,737**	**6,256**	**6,130**	**7,391**	**4,713**
Agriculture, Forestry, and Fishery	830	782	609	641	993	544
General administration, regulation, and research	179	226	84	211	423	208
Agriculture	600	483	484	392	463	292
Stabilization of farm prices and income	—	—	—	2	—	—
Extension programs	14	15	23	9	9	7
Irrigation	530	366	392	380	443	280
Other agriculture	56	102	69	1	11	5
Forestry and hunting	14	15	25	7	20	18
Fishing	37	58	16	31	92	26
Industry, Trade, Labor, and Tourism	63	41	64	33	213	9
Labor, Wage, and Employment Programs	0	1	18	2	4	1
Mining	8	1	8	0	1	0
Manufacturing	18	14	18	1	1	1
Construction	0	0	1	0	3	0
Tourism	—	—	—	—	—	—
Commerce	2	2	2	3	4	6
Others	35	23	17	27	200	1
Utilities and Infrastructure	3,925	5,914	5,583	5,456	6,180	4,160
General administration, regulation, and research	1,178	1,511	1,786	1,862	2,161	1,545
Electricity	203	165	450	1	3	0
Water supply	565	390	329	383	443	279
Roads and road transport	1,847	3,219	3,004	3,111	3,464	2,265
Other transport	132	623	8	85	100	62
Water transport	125	84	7	85	99	62
Air transport	7	539	1	0	1	0
Communications	0	0	0	9	2	5
Other utilities and infrastructure	0	6	6	5	7	4
SOCIAL SERVICES	**880**	**944**	**662**	**799**	**2,212**	**1,177**
Education	326	348	409	494	515	462
General administration, regulation, and research	99	90	123	156	155	117
Schools	136	173	151	187	206	214
Primary and intermediate	102	140	112	144	158	171
Secondary	34	33	39	43	48	43
Universities and colleges	64	58	75	102	101	75
Technical, vocational, and others	5	5	18	13	18	28
Subsidiary services	22	22	42	36	35	28
Housing and Community Amenities	422	437	102	151	1,543	528
Housing	205	205	96	150	1,542	527
Community development	217	232	6	1	1	1
Health	119	111	84	115	97	133
General administration, regulation, and research	8	7	6	7	6	8
Hospitals and clinics	60	57	36	52	39	65
Individual health services	40	36	23	33	26	39
Family planning	1	1	12	14	19	11
Others	10	10	7	9	7	10
Social Security and Welfare	0	4	5	3	5	2
Other Social Services	13	44	62	36	52	52
DEFENSE	**463**	**319**	**384**	**240**	**462**	**194**
GENERAL PUBLIC ADMINISTRATION	**228**	**383**	**361**	**523**	**436**	**579**
DEBT SERVICE (repayments)	**524**	**1,266**	**1,418**	**1,660**	**2,388**	**4,690**
TOTAL	**6,913**	**9,649**	**9,081**	**9,352**	**12,889**	**11,353**

to create corporations that could enter into debt contracts. Thus, public sector foreign borrowing was the leading sector in the 1970s (Table 12). From 1974 to 1983, total debt grew at 23.9 percent per year. Total medium term debt grew at 12.4 percent per year, but the public portion of this grew at 16.5 percent per year. Total long-term debt grew at 23.5 percent per year, with the public portion of it at 30.4 percent per year. Total short-term debt grew at 23.5 percent per year, with its public sector portion at 77.7 percent per year.

As a strategy, foreign borrowing was especially convenient because it allowed a rise in investment rate while bringing in the needed balance-of-payments financing. But a new unfavorable international credit environment stopped this strategy. Based on a World Bank mission estimate, the country's incremental capital output ratio increased from 3.9 in 1970-1979 to 10.6 in 1980-1983.

This section will take as a case-study one of the main elements in the government strategy to raise public capital investment--the rise of the public corporate sector.

Table 12
External Debt Outstanding and Disbursed at End-Year, By Maturity and Borrower
(In million dollars at end of period)

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983[d]
Short-Term Credits[a]	331	438	715	1,009	1,357	1,814	2,548	3,664	4,046	4,071
Public Sector	11	29	147	267	330	566	947	1,862	2,149	1,938
Private Sector	320	409	568	742	1,027	1,248	1,601	1,802	1897	2,133
Medium-Term Credits[b]	355	398	456	481	395	442	728	868	856	1,013
Public Sector	217	234	295	354	258	357	654	783	717	859
Private Sector	138	164	161	127	137	85	74	85	139	154
Long-Term Credits[c]	2,037	2,567	3,928	5,073	6,443	7,478	8,911	10,392	12,153	13,631
Public Sector	962	1,320	2,277	3,036	4,489	5,492	6,531	7,716	9,063	10,493
Private Sector	1,075	1,247	1,651	2,037	1,954	1,986	2,380	2,676	3,090	3,138
MLT Debt—Subtotal	2,392	2,965	4,384	5,554	6,838	7,920	9,639	11,260	13,009	14,644
Public Sector	1,179	1,554	2,572	3,390	4,747	5,849	7,185	8,499	9,780	11,352
Private Sector	1,213	1,411	1,812	2,164	2,091	2,071	2,454	2,761	3,229	3,292
Total All Maturities	2,723	3,403	5,099	6,563	8,195	9,734	12,187	14,924	17,055	18,719
(of which IMF drawings)	(128)	(239)	(452)	(551)	(639)	(783)	(1,083)	(1,232)	(1,073)	(1,133)

[a]Consists of revolving credits and fixed-term credits with original maturity of up to one year, excluding Central Bank compensatory financing.
[b]Original maturity of 1-5 years.
[c]Original maturity exceeding 5 years.
[d]Preliminary.

Note: "Public" refers to debt of the Republic of the Philippines, government corporations, government financial institutions, and includes transactions with IMF. "Private" refers to all direct loans to the private sector, including those guaranteed by government financial institutions.

Source: *Central Bank of the Philippines*

Case Study: The Public Corporate Sector

Definition and Macroeconomic Significance

One of the most prominent features of the fiscal history of the Philippines in the martial law period was the rise of the public corporate sector. This sector had come under increasing scrutiny because of the heavy debt burden that now attends its operations. The government's reorganization commission had been directed to concentrate its efforts on determining the correct strategy to be applied to this sector in the future. This sector was an innovation of the post-martial law period. It was only in the 1974-1977 Development Plan that an explicit policy and a planned investment program on this sector was articulated.

The Philippine government defines public enterprises as "corporate bodies, stock or non-stock, owned or controlled by the government and created by special law under the corporation law for the purpose of performing governmental or proprietary functions which are socio-economic in nature." As Manasan (1984) points out, this definition differs from the economic conception, but when it is applied the resulting list of enterprises does not differ significantly from a list that might be constructed from an economic definition. The official definition excludes such non-economic corporations as the Boy Scouts of the Philippines or the Integrated Bar of the Philippines.

Based on this definition, there is currently a total of 245 public sector corporations, broken down as 96 parent companies and 149

Table 13
Sectoral Distribution of Government Corporations, 1985[a]

Sector	Parent	Percentage Distribution	Subsidiary	Percentage Distribution	Total	Percentage Distribution
1. Agriculture, Forestry, Fishery	5	5.2	15	10.1	20	8.2
2. Mining and Quarrying	0	0.0	8	5.4	8	3.3
3. Manufacturing	6	6.2	41	27.5	47	19.2
4. Construction	0	0.0	4	2.7	4	1.6
5. Electricity, Gas, and Water	4	4.2	2	1.3	6	2.4
6. Transportation, Communication, and Storage	10	10.4	15	10.1	25	10.2
6.1. Communication	0	0.0	0	0.0	0	0.0
7. Trade	6	6.2	12	8.1	18	7.3
8. Financing and Housing	25	26.0	17	11.4	44	18.0
8.1. Financing	22	22.9	17	11.4	39	15.9
8.2. Housing	3	3.1	12	8.1	15	6.1
9. Service	40	41.7	23	15.4	63	25.7
Total	91	100.0	149	100.0	245	100.0

[a]Excluding acquired assets.
Source: Manasan (1986), Table 1.

subsidiaries. In 1970, there were only 35. Thus, the phenomenon of government corporations can be properly associated with the post-martial law period. To be sure, the gross value added of government corporations grew faster than the economy between 1975 and 1984. Public enterprise output grew at 24.6 percent per year, as against 14.1 percent for (nominal) gross domestic product (Manasan, 1985).

Of the total government corporations, 25.7 percent can be classified under the services sector (Table 13). This does not reflect preponderance of size or conscious government policy. The Ministry of Human Settlements, headed by the First Lady Imelda Marcos, has been particularly aggressive in spinning off its operations into corporations, where it would be subject to less cumbersome disbursement and audit rules.

The government also has a preponderant presence in the financial sector, under which 15.9 percent of public corporations can be classified, and in manufacturing, comprised of 19.2 percent of government corporations.[49]

In terms of current presence in the economy, Manasan (1985) has documented the increasing participation of government corporations. The measure she used was the proportion of sectoral gross value added that could be attributed to government corporations. In the financial sector, the proportion contributed by the government increased from 51.3 percent in 1975 to 84.1 percent in 1984 (Table 14). This was attributed to the fact that the government-owned PNB accounted for 30 percent of commercial bank assets, while the DBP and the Land Bank accounted for 20 percent of the total assets of banking institutions (Lamberte, 1985; Table 15). For electricity, gas, and water, the government corporations' share of gross value added increased from 25.9 percent in 1975 to 60.1 percent in 1984.

In some industries where government corporations had no presence in 1975, there is now a discernible government participation (see Table 14). This is true for mining/quarrying and construction. As a whole, "the public corporate sector's share in Gross Domestic Product increased from 3.4 percent in 1975, peaked at 6.1 percent in 1983, and dropped to 5.2 percent in 1984."[50] A new balance-of-payments crisis started in 1983.

Investment in government corporations made impressive the rate of capital formation. Between 1978 and 1984, the capital

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49. The sources from these breakdowns are Manasan and Buenaventura (1986) and Amatong, et al., (1985).

50. Manasan (1986), p. 13.

Table 14
Percentage Share of Government Corporations to Sectoral Gross Value Added, 1975-1984
(At current prices)

Sector	1975	1980	1984
Agriculture, Forestry, and Fishery	1.3	0.4	0.5
Mining and Quarrying	—	0.1	2.6
Manufacturing	1.1	1.6	1.7
Construction	—	0.1	0.8
Electricity, Gas, and Water	25.9	54.4	69.1
Transport, Communications, and Storage	1.0	2.4	2.5
Trade	1.4	1.7	0.8
Financing	51.3	64.4	84.1
Housing	0.2	1.0	0.6
Services	1.0	0.1	0.9

Source: Manasan (1986), Table 3.

Table 15
Capital Expenditures of 15 Major Non-financial Government Corporations and Gross Domestic Capital Formation, 1978-1984
(In million pesos)

Year	Capital Expenditures of 15 Government Corporations ( )	Gross Domestic Capital Formation (2)	(1) + (2) (percent)
1978	7,281	51,348	14.4
1979	9,518	67,687	16.2
1980	11,979	81,153	9.4
1981	15,293	93,261	16.4
1982	15,828	96,521	15.6
1983	19,449	184,414	18.6
1984	15,282	188,820	15.2
1978-1984	92,930	595,204	15.6

Source: Manasan (1986), Table 7.

expenditures of 15 major government corporations never went below 9.4 percent of total gross domestic capital formation and averaged 15.6 percent (Table 15). The largest investments were in energy projects, which were in turn dominated by the $1.9 billion nuclear power plant project.

Fiscal Burden of Government Corporations

The public's contributions to these corporations include preferential tariffs and monopoly profits. These are difficult to measure. In the subsequent discussion, we will utilize the government's budgetary contributions as a measure of public sector burden.

Under the Philippine fiscal system, there are three kinds of government contributions to these corporations: (1) current transfers, (2) equity contributions, and (3) net lending. Current transfers are direct subsidies for costs of current operations, such as salaries of personnel. Equity contributions are the shares of stock the government receives, based on the value of its contribution, from the corporation. Net lending represents loans net of repayments to these corporations from the government.

The distinctions between these three types of contributions in terms of their differential effects on the fiscal burden have been blurred by actual practice. Theoretically, amounts lent out by the national government to government corporations are meant to be repaid. However, information we have gathered informally have convinced us that almost none of the amounts lent out have been repaid. The repayment rate is much less than 5 percent of the amounts lent out. There have been cases in which the amount originally lent has been converted into equity contributions. Amatong, et al. (1985, p. 3) also point out that, except for two or three, public enterprises have not remitted dividends on the paid equity of the national government and have generally applied equity contributions to their current operating expenditures.

Given these considerations, we can only rely on budget documents to classify the types of contributions made to government corporations. The first are "current contributions," which are budget items intended for "maintenance and operating expenses." Then there are "capital contributions," which are all other contributions. Using this approach, we can see that total budgetary contributions to government corporations grew from less than 4.8 percent of budgetary receipts in 1975 to 17.8 percent in 1984. In 1982, the last full budget year before the current economic crisis, these contributions peaked at 24.4 percent (Table 16).

Over 90 percent of these contributions were "capital contribu-

Table 16
Annual Budgetary Contributions to Government Corporations, Cash Basis
(In million pesos and percent)

	Contribution			Total as Percent of	
Year	Current	Capital	Total	Budgetary Expenditures	Budgetary Receipts
1975	285	522	807	4.4	4.8
1976	392	1,804	2,196	10.7	12.1
1977	246	2,252	2,498	10.9	12.5
1978	632	2,245	2,877	11.0	12.0
1979	478	3,391	3,869	13.0	13.1
1980	505	4,739	5,244	13.8	15.1
1981	564	7,862	8,426	17.5	23.4
1982	889	8,419	9,308	17.7	24.4
1983	586	4,821	5,407	10.2	11.6
1984	429	9,819	10,248	15.4	17.8
Total	5,006	45,878	50,880	13.5	15.8

Source: Amatong, Beltran, and Boncodin (1985)

tions" that, in the nature of the process, were never expected to be repaid. Thus, while theoretically it is inappropriate to consider all of the capital contributions as part of the burden in the current year, in practice the budgetary burden of these corporations has increased permanently since they have incurred losses, have not paid dividends, and have been unable to service the foreign debt they have incurred. Of the total contributions, 90.9 percent went to "economic" oriented corporations, with the power sector getting 33 percent, the financial sector 23 percent, agriculture 13 percent, and industry 11 percent.[51]

The pattern of equity contributions (Table 17) reflects the government priorities, especially before 1981. These were power generation (National Power Corporation and National Electrification Administration) and housing. After 1981, the priorities were not so clear anymore as equity contributions increased in almost all sectors.

These contributions have had significant effects on the increas-

51. Amatong, et al. (1985), p. 26.

Table 17
National Government Equity Contributions by Recipient, 1978-1984
(In million pesos, Cash Basis)

	Actual						
	1978	1979	1980	1981	1982	1983	Total
Government Financial Institutions and Credit Programs	**461**	**446**	**400**	**1,404**	**2;247**	**205**	**5,163**
Central Bank	26	37	38	583	325	25	1,034
DBP	105	76	85	300	607	—	1,173
DBP Rural Bank Trust Fund	—	5	—	—	—	—	5
Philippine National Bank	100	100	72	210	160	150	792
Land Bank of the Philippines	30	110	140	—	125	30	435
Home Financial Corporations	—	—	—	78	50	—	128
Nat'l Home Mortgage Finance Corp.	—	100	50	25	20	—	195
Philguarantee	200	—	—	50	—	—	250
KKK (Livelihood Program)	—	—	—	150	950	—	1,100
Others	—	18	15	8	10	—	51
Government Corporations	**1,972**	**2,952**	**4,122**	**6,677**	**7,121**	**5,573**	**28,417**
Energy Sector	1,474	2,004	2,408	2,443	2,971	1,497	12,797
National Power Corporation	1,195	1,628	1,983	1,834	2,504	1,060	10,204
National Electrification Admn.	230	220	273	302	199	137	1,361
Philippine National Oil Co.	49	156	152	200	142	300	999
National Coal Authority	—	—	—	107	126	—	233
Industrial Sector	65	158	679	1,951	999	456	4,308
National Development Co.	38	94	618	1,873	893	406	3,922
Export Processing Zone Authority	27	64	61	78	106	50	386
Housing Sector	85	228	209	763	882	477	2,644
Human Settlements Dev't Corp.	—	12	5	342	513	268	1,140
National Housing Authority	80	208	154	363	555	168	1,328
Southern Philippines Dev't Authority	5	8	50	58	14	41	176
Water Supply	128	154	249	419	393	398	1,741
MWSS	61	79	122	265	301	346	1,174
Local Water Utilities Administration	67	75	115	135	80	25	497
Rural Waterworks Dev't Corp.	—	—	12	19	12	27	70
Agricultural Sector	115	188	359	859	1,369	1,082	3,972
National Irrigation Administration	38	84	249	706	1,115	891	3,083
Philippine Cotton Corp.	19	5	16	5	10	4	59
Philippine Virginia Tobacco Admn.	37	50	44	7	34	26	198
Philippine Fisheries Dev't Authority	6	—	—	28	23	34	91
Farm Systems Development Corp.	10	32	36	47	49	30	204
National Food Authority	—	—	—	44	41	48	133
Philippine Crop Insurance Corp.	—	—	—	8	75	25	108
Other Agriculture	5	17	14	14	22	24	96
Transportation Sector	70	191	195	183	376	583	1,598
Philippine National Railway	58	136	130	106	102	79	611
Metro Manila Transit Co.	—	35	65	15	—	7	122
Light Rail Transit Authority	—	—	—	62	274	210	546
Philippine Ports Authority	—	—	—	—	—	142	142
Other Transportation	12	20	—	—	—	145	177
Others	35	29	23	59	131	1,080	1,357
Total	**2,433**	**3,398**	**4,522**	**8,081**	**9,368**	**5,778**	**33,580**

ing pattern of budget deficits before the 1983 crisis. One could carry out a hypothetical exercise on what the budget deficit would be like if these contributions had not been made (Table 18). Before 1981, there would actually have been budget surpluses in the years 1978, 1979, and 1980 if the contributions have not been made. From 1981 on, when the economic dimension of the authoritarian experiment started to unravel, the corporate contributions still had significant effects on the deficit. In 1984, there would have been a budget surplus if not for the corporate contributions.

Evolution of Public Corporate Activity

As far as government corporate activity is concerned, 1981 was a watershed year. Before 1981, government corporate activity was consciously encouraged, as can be seen from an examination of the incorporation dates of the larger corporations. In the 1974-1977 development plan, the responsibility for control and growth of these government corporations was located in the ministries that managed them. This set the pattern in which there was no overall view of public corporate activity.

Table 18
Effect on Budget Deficit of the Contributions to Government Corporations

Year	Budget Deficit (P million)	Total Contribution to Government Corporations (P million)	Hypothetical Budget Surplus (Deficit) Without Contribution: Level (P million)	Hypothetical Budget Surplus (Deficit) Without Contribution: As % of GNP (Percent)
1975	1,403	807	(596)	(0.5)
1976	2,349	2,196	(153)	(0.1)
1977	2,852	2,498	(354)	(0.2)
1978	2,167	2,877	710	0.4
1979	342	3,869	3,527	1.6
1980	3,387	5,244	1,857	0.7
1981	12,146	8,426	(3,720)	(1.4)
1982	14,405	9,308	(5,097)	(1.7)
1983	6,422	5,407	(1,015)	(0.3)
1984	8,714	10,248	1,534	0.4
Total	54,187	50,880	3,307	(0.1)

Source: Amatong, et. al. (1985), Tables 4.4 and 4.5

The 1978-1982 plan was an improvement in that it articulated some priorities for public corporations--energy, transportation, and even international trading. In this period, the nuclear power plant was being built, intensive improvements in the transportation system of Metro Manila were being planned, and there was an idea that the government should encourage Japanese-style trading companies to support the export drive. However, no mechanism was set up to ensure that the priorities would be followed.

The corporate bodies under government control performed many functions of convenience. First and foremost, they were the most convenient vehicle for responding to the availability of foreign financing. They could contract debt on their own account, either from government financial institutions (which were relending funds borrowed from abroad) or directly from foreign institutions. Government equity contributions provided about 48 percent of total fixed capital investment carried out by these companies between 1975 and 1983 (Table 19). Corporations in capital-intensive industries such as power, transportation, and water were especially efficient in this regard.

The second convenience, related to the first, provided by government corporate bodies was greater flexibility in mobilizing funds to finance industrial operations. The National Development Corporation (NDC), operated by the Ministry of Trade and Industry, has in turn many subsidiary companies (see Appendix 1) which could be given loan from government funds. They could borrow with government guarantee. From the list of NDC subsidiaries, one can see the extent of government participation in the industrial sector. This will be further discussed below.

Flexibility in lending out finances was especially important to enable private enterprises to fund expanded operations. In the interest of tourism development, the DBP financed the construction of five first-class hotels in Manila. The PNB provided financing to the Construction and Development Corporation of the Philippines (CDCP) so that it could carry out a reclamation project in Manila Bay for office and residential purposes.

The third convenience of the public corporate approach was its greater flexibility in operation by providing insulation from cumbersome government regulations. Using a corporate body instead of a government agency made it possible to exempt the operation of government corporations from following civil service rules and wage levels in the hiring of personnel, allowing for the hiring of higher caliber personnel, which would not have been possible under civil

Table 19
Dependence of Government Corporations on Equity for Capital Investment, 1975-1983
(In million pesos)

	Equity Contributions of the National Government	Fixed Capital Investment	Ratio of Capital Contributions to Fixed Capital Investment (%)
Economic Services	40,947	89,629	45.7
Agriculture	10,484	11,096	94.5
Financial	6,889	5,344	128.9
Industry	5,844	2,206	264.9
International Relations	111	679	16.3
Trade	614	325	188.9
Power	12,587	56,507	22.3
Transportation	2,409	8,495	28.4
Water	2,009	4,845	41.5
Real Estate	—	132	—
Social Services	3,438	2,857	120.3
Education and Culture	60	1,007	6.0
Health	142	157	90.4
Housing	3,236	1,289	251.0
Social Welfare	—	404	—
Gen. Public Services	100	146	68.5
General Research	100	123	81.3
General Services	—	23	—
Total	44,485	92,632	48.0

Source: Amatong, et. al (1985)

service rules. It also allowed these companies, at least hypothetically, greater flexibility in firing personnel.

The more important aspects of the flexibility had to do with actual operations. The corporation's capital budget could be determined internally, without the need for review elsewhere, as long as a combination of government contribution and outside financing could be packaged to support it. The corporation's day-to-day

disbursal of funds was not subject to a very close scrutiny from the government auditing service. On the extreme, many corporations have been exempted from even a periodic audit. In the case of the Philippine National Oil Company (PNOC), the papers have reported that the exemption came from a handwritten instruction by the President himself. There were corporations which did not report financial statements, and were not audited.

The ultimate flexibility of some of these corporate bodies was that, as corporations, they could establish their own corporations engaged in assorted enterprises. The clearest example was the Human Settlements Development Corporation (HSDC) under the Ministry of Human Settlements (Appendix 2). Some of these subsidiary companies were involved in the production of bricks, processing of vegetables, and genetic engineering.

But events in 1981 permanently changed the nature of the public corporate sector. On 9 January 1981, a local businessman, Dewey Dee, fled the country leaving behind him P635 million in debt borrowed in the name of his textile company.[52] This led to the collapse of a large commercial bank and two largest investment houses, and to the government's rescue of four commercial banks. Because the public sector approach was directed especially at financial resource mobilization, this financial crisis had a profound effect on the public corporate sector.

1981 also saw the near default of Mexico and the end of the era of easy international credit. From this point on, the public corporate sector, which had been charged with providing the means to absorb foreign credit, was being forced by circumstances to pay it back.

The government's response was to rely even more heavily on its own resources and on short-term international borrowings to maintain these corporations (see Table 12, particularly 1981). The whole rescue effort made it necessary for the government to forego calling in its exposures to public corporations. In many cases, amounts that were due to government financial institutions were converted into equity. (See Appendix 3 for a list of corporations that had been rescued by July 1983.)

The NDC became the company by which the government exercised ownership over rescued companies (see Appendix 4). At present, the operations of these acquired companies, and the servicing of the debt of both acquired and non-acquired companies, are the most critical public finance issues. In the 1984 and 1985 budgets, P10 billion pesos have been allocated in each year for "net

52. IBON Databank (1983), pp. 90-91.

lending," which was directed toward servicing the debt of public corporations. Another P10 billion was allocated for "equity" contributions.

Overall Evaluation

Can the evolution of the public corporate sector be understood in terms of the political economy of the fiscal process, in the context of the particularities of the Philippine situation? In this section, we will further develop the interpretation we had suggested in Chapter 5 in connection with the tax reform.

The issue that the authoritarian government had to confront in the 1970s was this: Given a country suffering from a chronic trade deficit, how does one continue to develop and operate the country's industrial capacity with the quadrupling of the oil price in 1974? One response would have been to let the relative world price of oil be reflected in the vector of domestic prices. This would have forced a structural adjustment at that time. The other response, the one that the government took, was to find the financing to pay for the increased cost of oil. This response turned out to be self-sustaining until 1981, as international commercial banks sought to relend the oil money. This response conditioned all subsequent policies and, to this day, continues to bedevil current efforts toward economic recovery.

The financing response after 1974 (the public corporation burden only began to grow in 1975) avoided assigning the burden of adjustment to the general public at a time when the new government was consolidating its power over the old oligarchy. The ease with which borrowing could be undertaken then increased the government's confidence in the new strategy. There was a quick learning experience which, if private interviews are to be believed, occurred in 1976, right after the IMF-World Bank conference in Manila.

The problem was how to direct the foreign fund inflow to consolidate the authoritarian experiment. The public corporate sector, erected after 1975, provided a convenient means not only to increase the fund inflow but also to control it. Thus, the country's indebtedness was directed toward favored corporations, resulting in the rapid rise of their operations. Appendix 4 lists one corporate grouping that grew rapidly from two employees in 1970 to a conglomerate in 1981. By 1983, this group, owned by a person close to the President, had all but closed down. Its rise and fall thus mirrored the developments in the public corporate sector.

An important element of the public corporate strategy was to stabilize the economic power of the group that held political power by helping it attain a position of equality with, if not dominance over, the old business conglomerates. It was not surprising, as indicated by the list in Appendix 4, that in many cases the existing companies were purchased by members of the Marcos group. Since they had neither the resources nor the collateral for these purchases, many of their loans were financed by the collateral of the properties being purchased, and were expected to be paid from the earnings of such properties. In terms of economic activity, however, such asset transfers could not be expected to result in new investment and to an increase in productive capacity.

To some extent, these private groups did undertake new investment. In the case of the abovementioned conglomerate, there was an investment in a cellophane manufacturing venture. Since the new investments tended to be in a product or a process not yet domestically produced or developed, these investments almost without exception enjoyed tax incentives and, more important to our immediate interest, access to government financing. As in the pre-martial law period, these investments tended to be capital-intensive and heavily oriented toward serving the domestic market, which was protected from foreign competition.

The downturn which began in 1981 and which accelerated in 1983, when foreign financing ground to a halt, posed a new problem to the government. The owners of the new conglomerate did not have sufficient economic stability to sustain their debt service as their operations failed. Moreover, many of the loans had ultimately been borrowed from abroad, for which the government had provided guarantee. The taking over of these assets by the government, and the further increase in the government corporate sector became the only feasible response.

7

CONCLUSION

It would be fair to say, on the basis of the record, that the attempt to operate the country's fiscal system along corporate lines in the 1970s did not result in a restructuring of the system in a way that it could be more supportive of the requirements of development.

The immediate cause of the failure was the disappearance of foreign financing in the 1980s. As we have shown in Chapter 5, the authoritarian government was unable to raise the tax effort and had to rely on foreign financing both to consolidate its position and to maintain economic growth.

We have proposed the idea that the survival imperatives of the martial law government constricted its ability to raise the tax effort. The same government was constrained to implement a rapid growth in the public corporate sector to increase the country's absorptive capacity when foreign credit became available on demand. The same government, however, failed to address the incentive problem that was already embodied in the system before martial law--the protectionist, capital-encouraging tax incentive system. More than failing to address this problem, the authoritarian government found that it had to expand this system of incentives.[53] This encouraged financial exposure in projects that did not survive the international credit crunch in the 1980s.

The recent Philippine fiscal experience raises many questions about the organization of fiscal policy in developing countries.

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53. Not in the averages, since, for example, it undertook a serious tariff liberalization program, but on a case-to-case basis, which can even be more damaging.

Because of the feudal basis of political power, the operation of a democratic decision-making system leads to fiscal paralysis. This is not worrisome if private initiatives undertake the necessary investment effort. But precisely because economic power is based on feudal privileges, the private investment rate is low in domestic enterprises. The state, to the extent that it is committed to "private enterprise," is called upon to guarantee the private return.

The authoritarian experiment was an attempt to break out of this cycle. Its reliance on foreign savings, as a temporary substitute for domestic resource mobilization, attests to the fragility of the experiment. It could not rely heavily on domestic resources since this would have called for a dismantling of the system of protectionist and rental privileges in society. While the authoritarian government had enough power to redirect existing economic resources in favor of its objectives, it was not powerful enough to carry out the reforms necessary to create the new economic resources.

The decision process in the post-martial law period seems now to have transcended the limitations of the "democratic" system only superficially. The new process did permit more timely and more forthright decisions. However, the "corporate" approach continued to labor under the feudal social basis of political power, so that its use did not improve the consultation process or the quality of social decisions.

Our analysis suggests that the dramatic overthrow of the Marcos corporatist experiment in February 1986 will not, by itself, "de-paralyze" the Philippine fiscal system. The fiscal record since 1986 bears this out.

An initial attempt to raise real estate taxes in 1986 by updating property assessment value to 1983 levels met fierce resistance and the new Aquino government had to discontinue cabinet discussion of the proposal. The rapid recovery period of 1987-1989 was characterized by a boom in real estate prices. Reform in this area continue to lag behind the economic recovery.

The rapid economic recovery has created a rapidly growing fiscal deficit. An important explanation of this deficit has been the increase in interest payments on domestic debts. The Aquino government has found it expedient to float treasury bills at interest rates that make the financial asset holders indifferent between holding pesos and foreign currency. These borrowings had helped finance the foreign debt service, which had accounted for at least 40 percent of the government's budget since 1987. The outstanding domestic debt, estimated at P300 billion, now threatens the viability

of the domestic financial system itself, and the fiscal sector is in a new junction of paralysis.

As might have been expected in a restoration of the pre-martial law Congress, the legislature has been unwilling and unable to take responsibility for the rapidly increasing expenditure (including the debt service) and for the stagnant trend in tax revenue.

In early 1991, with the approval of an IMF standby facility, the impasse was temporarily broken with the imposition by the Executive Department of a 9 percent levy on imports. Both the executive and the legislative agree that the solution, even with IMF acquiescence, is temporary by nature. But the choice of strategy once again provides rich insights into the political economy of fiscal policy in the Philippines and the limits of economic ideas.

The import levy, while protecting against imports, provides no advantage to the export sector, which must now bear the tax on its inputs. A devaluation would have been a more technically appropriate response, but less acceptable politically to the industrial class. The import levy, just like the 5 percent levy the Marcos regime imposed in December 1983, is also a choice in favor of reducing the rate of economic growth; as an extreme measure, its effect exceeds that of all the natural disasters that have befallen the country since 1990. A lower rate of economic growth induces the disappearance of the financing gap and liberates the resources needed for servicing the foreign debt.

The strategy also provides for the emergency reduction of fiscal policy deficit to levels consistent with a standard IMF stand by facility.

In some important sense, therefore, the import levy response "solves the problem," but solves it in the "wrong" and contradictory manner. The lower economic growth rate will make fiscal revenues more difficult to raise, and will ultimately threaten the sustainability of the target budget deficit. It taxes exports and, in the long run, renders unfeasible the current account deficit projections. Because the strategy requires that Congress provide for the substitute tax revenue, it creates a football field when responsibility over fiscal policy can be passed around between legislative and executive branches.

Thus, we have come full circle. The corporatist structure has been replaced by the old form of democratic process. Things seem to be very different, but then they seem to be very much the same. The fiscal strategies have shown incredible stability throughout the upheavals of the 1980s.

APPENDICES

Appendix 1
National Development Corporation's list of holdings as of 1982

Company	Activity	% Interest
ASEAN Aceh Fertilizer	fertilizer production	--
ASEAN Bintulu Fertilizer Corp.	fertilizer production	13
ASEAN Soda Ash Co., Ltd.	soda ash production	--
Acoje Mining Co., Inc.	mining	8.2
Agusan Plantation, Inc.	palm oil plantation	--
Air Mindanao Corp.	air chartering	--
Aluminum Smelter	aluminum smelting	--
Asia Industries, Inc.	heavy machinery mktg	100
Bataan Pulp & Paper Mills, Inc.	pulp and paper mfg	--
Batangas Land Co.	real estate management	60
Benguet Management Corp.	management firm	--
Cellophil Resources Corp.	paper and pulp mfg	11
Commonwealth Dev't Corp.	plantation project	--
Consolidated Transport, Inc.	air cargo forwarding, warehousing	--
Construction & Dev't Corp. of the Phils.	construction	19
Dasmarinas Estates Dev't Corp.	real estate management	--
Domestic Satellite Phils., Inc.	communications	--
Elizalde Steel Consolidated, Inc.	steel manufacturing	--
Energy Corp., The	oil exploration, mining	80
Equitable Venture Capital Corp.	venture capital investing	--
Filipinas Carbon & Mining Corp.	mining	40
Filipinas Synthetic Fiber Corp.	synthetic fiber mfg	25
Filipino Contractors Int'l Corp.	overseas marketing, construction	--
Gomez Cellulose, Inc.	cellulose production	--
Goodyear Realty Corp.	real estate management	60
Heavy Engineering Ind., Inc.	--	--
Herditex Textile Mills	textile	100
Hinobaan Mining Co., Inc	mining	--
Hyacinth Research & Dev't Corp.	hyacinth development	--
Hydro Resources Corp.	construction	--
Int'l Corporate Bank, Inc., The	banking	22
Iron & Steel Corp. of the Phils.	iron & steel production	--
Kamayan Realty Corp.	management and lease of real estate	60

Appendix 1 (continued)

Company	Activity	% Interest
Luzon Activated Carbon, Inc.	activated carbon from coconut shells	--
Luzon Integrated Services, Inc.	security services for government offices	--
Luzon Stevedoring Corp.	inter-island shipping	100
Manila Gas Co.	marketing of LPG	60
Marina Properties Corp.	real estate	90
Mindanao Textile Corp.	garment and textile mfg	65
Multi-Natural Resource and Drilling Corp.	mineral exploration	50
NDC-Dunlop Plantation, Inc.	plantation	55
NDC Estates, Inc.	real estate management	--
NDC-Guthrie Plantation, Inc.	palm oil plantation	60
NDC Holdings, Inc.	management company	100
NDC-Nacida Raw Materials Corp.	raw materials marketing	100
NDC-Shell Minerals Investment Co.	mining investments	60
NDC-Shell (Billiton) Minerals, Inc.	mining	60
Nadeco Realty Corp.	real estate management	60
National Galleon Shipping Corp.	shipping	100
National Industrial Tree Corp.	tree plantation	100
National Precision Cutting Tools, Inc.	tool manufacturing	99.98
National Rattan Corp.	rattan production	--
National Rayon Corp.	rayon fiber mfg	--
National Steel Corp.	steel mill	100
Negros Occidental Copperfield Mines, Inc.	copper mining	60
New Agrix, Inc.	food manufacturing	100
Paper Industries Corp. of the Phil.	paper manufacturing	26.5
Paragon Paper Mills, Inc.	paper manufacturing	100
People's Pulp and Paper Mills, Inc.	pulp and paper mfg	--
Philippine Airlines, Inc.	air transportation	33
Philippine Associated Smelter and Refining Corp.	copper smelter	34.42
Philippine Cellophane Film Corp.	cellophane film mfg	16.66
Philippine Communications Satellite	communications	--
Philippine Dockyard Corp.	ship maintenance and shipbuilding	48

Appendix 1 (continued)

Company	Activity	% Interest
Philippine National Lines	merchant vessels management and ship brokerage	20.41
Philippine Petrochemical Products, Inc.	polystyrene resin production	--
Philippine Phosphate Fertilizers Corp.	fertilizer manufacturing	60
Philippine Plate Mills Co, Inc.	steel mill	100
Pinagkaisa Realty Co.	real estate management	60
Refractories Corp. of the Phil.	basic refractors manufacturing	58.3
Resort Hotels Corp.	hostelry	41.28
San Jose Oil Co.	oil exploration	20
Seafront Petroleum Corp.	oil exploration	4.5
Semirara Coal Corp.	mining	43.6
Summa Insurance Corp.	non-life insurance	100
Transport Contractors, Inc.	trucking	--
Usiphil, Inc.	heavy machinery mktg	69.1
Vanimo Timber Resources Corp.	logging	--
Venture Capital Corp.	chemical manufacturing	20
Vulcan Chemical Corp.	chemical manufacturing	--
Vulcan Industrial & Mining Corp.	mining	51
Western Minolco Corp.	mining	100

Source: IBON Databank, **Facts and Figures**, September 1983, Table 14, p. 10

Appendix 2
Subsidiaries of the Human Settlements Development Corporation

Name of Subsidiaries	Name and Position of Managing Head	Total Paid-In Capital	Government Equity (G.E.)	% of G.E. to Total Paid-In
Agro-Livestock Commercial Development Corp.	Eduardo A. Morato, Jr. President	P 6,250,000	6,250,000	100
Alfombras Manuales Filipinas Inc.	Jose Eduardo Alarilla, Jr. President	4,000,000	3,988,000	99.95
Bliss Development Corp.	Roberto P. Alvarez President	200,000,000	191,369,400	95.68
Bliss Marketing Corp.	Eduardo V. Laureola, Jr. General Manager	33,652,537	33,652,537	100
Builder's Brick, Inc.	Virgilio L. Chico, Jr. Executive Vice-President	2,000,000	1,999,500	99.98
RICA Coffee Estates Corp.	Jose Eduardo Alarilla, Jr. Acting General Manager	2,430,000	2,430,000	100
Kaunlaran Food Corp., Inc.	Eduardo A. Morato, Jr. President	700,000	700,000	100
National Agribusiness Corp.	Jose Eduardo Alarilla, Jr. Officer-in-Charge	15,000,000	15,000,000	100
People's Technology Corp.	Rolando Atienza Chairman/President	2,000,000	2,000,000	100
Philippine Fruits and Vegetable Industries Corp.	Pete A. Castillo President	2,000,000	2,000,000	100
Philippine Genetics, Inc.	Reynaldo Bantug Exec. Vice Pres. & OIC	13,000,000	13,000,000	100
Recto Central Park Dev't Corp.	Jose Conrado Benitez President	25,000,300	25,000,300	100
San Carlos Fruit Corp.	Pedro A. Castillo Pres. & General Manager	5,340,000	5,140,000	96.25
Woodwaste Utilization and Development Corp.	Amborsio A. Lina, Jr. President	1,330,300	1,330,300	100
ZNAC Rubber Estates Corp.	Jose Eduardo Alarilla, Jr. Acting General Manager	2,500,000	2,500,000	100

Source: Commission on Audit (1985).

Appendix 3
Rescued Corporations

Name of Company (Private Partner)	Government Exposure* (In million pesos)	% of State Equity*	State Firm
Herdis companies:	4,600	—	NDC
1. Asia Industries			NDC
2. Energy Corporation			NDC
3. International Corporate Bank			NDC
4. Refractories Corporate Bank			NDC
5. Semirara Coal Corp.			NDC
6. Summa Insurance			NDC
7. Usiphil, Inc.			NDC
8. Vulcan Ind'l and Mining Corp.			NDC
9. Cellophil Resources Corp.			NDC
10. Philippine Cellophane Film Corp.			NDC
11. Acoje Mining Co.			
12. Multi-Natural Resources Drilling Corp.			DBP/PNB/Union Bank
13. San Jose Oil Co.			
14. Seafront Petroleum and Mineral, Inc.			
15. Herditex Mills, Inc			
16. Commercial Bank of Manila	490	99	GSIS
17. Hotel Development Corp.	2,500	—	DBP
18. Hotel Mirador and Tradewinds Hotel	—	—	DBP
19. Manila Hotel	253	100	GSIS
20. Manila Mandarin Hotel (Soriano, Recio, Uytengsu, Puyat)	56	—	DBP
21. Maranaw Hotels & Resort Corp.	63	30	DBP
22. Century Park Sheraton	180	—	DBP
23. Phil. Hoteliers, Inc. (Ayala, Gokongwei)	126	—	DBP
24. Silahis International Hotel (Enriquez)	101	—	DBP
25. Philippine Village Hotel	65	—	GSIS
26. Ambassador Hotel	27.7	—	GSIS
27. Puerto Azul Beach	9.2	—	GSIS
28. Manila Hilton	5.5	—	GSIS
29. Mayon Imperial Hotel	5.0	—	GSIS
30. Nalinac Beach Resort	1.8	—	GSIS
31. Carlston Hotel	0.3	—	GSIS
32. Baguio Country Club	1.3	—	GSIS
33. Premier Vima Hotel	0.3	—	GSIS
34. Delta Motors Corp. (Silverio)	1,000	70	PNB
35. Marinduque Mining & Ind'l Corp (Cabarrus)	10,000	46	DBP/GSIS/PNB
36. Batangas Sugar Central (Dolor)	—	60	PNB
37. Paragon Paper Mills	400	—	DBP
38. Phil. Blooming Mills (Cheng Ban Yek)	1,100	—	PNB/DBP
39. Negros Occ. Copperfield Mines, Inc.	30	70	NDC
40. Alfa Textile Mills (formerly Ramon Siy, recently bought by Carag)	241	—	DBP

Appendix 3 (continued)

Name of Company (Private Partner)	Government Exposure* (In million pesos)	% of State Equity*	State Firm
41. Continental Manufacturing Co. (formerly Dewey Dee)	109	—	DBP
42. Lirag Textile Mills	213	—	DBP
43. Riverside Mills Corp.	213	—	DBP
44. Solid Mills	6	—	DBP
45. Texfiber Corp.	200	—	DBP
46. Mindanao Textile Corp.	30	—	NDC
47. Synthetic Textile Mills, Inc.	—	—	DBP
48. Pilipinas Bank (Silverio)	280	—	DBP/PNB
49. Traders Royal Bank (Benedicto)	10	—	DBP
50. Piso Bank (Barrios, Pica)	50	—	DBP
51. Producers Bank of the Phil. (Henry Co)	10	—	DBP
52. Republic Planters Bank (Benedicto)	36	—	DBP
	1		PNB
53. Associated Bank (Leonardo Ty)	212	—	DBP
54. Merchant Investment Corp. (Rufino)	40	—	DBP
55. Union Bank of the Phil. (Bancom Group)	500		SSS
	150	80	SSS
	159		LBP
56. Construction and Development Corp. of the Phil.—CDCP (Cuenca)	5,000	89	DBP/PNB GSIS/LBP
57. Philippine Air Lines (Toda)	982	92	GSIS
	500		
58. Mabuhay Vinyl Corp. (Guevara, Ayala, Araneta)	120	—	—
59. Paper Industries Corp. of the Phil. (PICOP)	388	—	DBP
60. Sarmiento Industries, Inc.	50	—	—

*Government exposure includes government loans to and capital investment or equity in the rescued companies.

Source: IBON Databank (1983).

Appendix 4
Herdis Group of Companies[a]

Company/EquityInvestment (% share)[b]	Principal Activity	Current Status
Acoje Mining Co., Inc.	chrome mining	taken over by NDC
Anselmo Trinidad & Co./75	stock brokerage	taken over by Interbank
Asia Industries, Inc./100	heavy equipment distributor	taken over by NDC
Asia Pacific Finance Corp.	financing	taken over by Interbank
Asia Pacific Real Estate	real estate management	non-operational
Asia Petrochemical Dev't Corp./60	petrochemical manufacturing	no longer under Herdis
Atrium Capital Corp./75	investment banking	taken over by Interbank
Beta Electric Corp./60	electrical systems distributor	taken over by NDC
Cellophil Resources Corp./60	cellophane manufacturing (as of 1978)	taken over by NDC
Cellulose Processing Corp./100	cellophane manufacturing	taken over by NDC
Commercial Bank of Manila/28	commercial banking	acquired by GSIS
Energy Corp.	oil exploration	taken over by NDC
Equipment Credit Corp./100	equipment financing	no longer under Herdis
Far East Merchants & Trading Corp./100	trading	retained by Herdis
Farewinds Warehousing Corp.	warehousing	retained by Herdis
Farmacor, Inc.	agricultural equipment and machineries	taken over by NDC
Ferrochrome Phils., Inc./49	ferrochrome manufacturing	acquired by Voest Alpine AG
Financial Center of Asia/55	n.a.	non-operational
First Summa Savings & Mortgage Bank/70	savings bank	acquired by Manapat-Lagman Group
Food Industries, Inc./90	cleanser, paper cup, vending machine distributor	no longer under Herdis
HJD Corp.	distributor, Memorex computer peripherals	non-operational
HMC Marketing Corp./96.40	marketing of cigaret filters	retained by Herdis
Herditex Mills/67	polyester and nylon mfg (as of 1978)	taken over by NDC
International Corporate Bank, Inc./30	commercial banking	taken over by DBP and NDC
Koppel, Inc./100	refrigeration and air conditioner distributor	taken over by NDC
Limay Ind'l Dev't Corp./100	n.a.	non-operational
Perkins Engines Phils. Co.	distributor of Perkins diesel engines	taken over by Asia Industries
Perma Marketing Corp.	distributor, welding electrodes/equipment	non-operational
Petrolog, Inc./100	n.a.	non-operational
Phil. Cellophane Films Corp./53	cellophane packaging	taken over by NDC
Phil. Tobacco Filters Corp./66	tobacco filter manufacturing	retained by Herdis
Phil. Transparent Film Corp./100	n.a.	non-operational
Power Contractors, Inc./100	construction and egineering works	retained by Herdis
Refractories Corp. of the Phils./51	refractory bricks manufacturing	taken over by NDC
Relcom Development Corp./51	real estate management	non-operational
San Jose Oil Co./65	oil exploration	taken over by NDC
Semirara Coal Corp./44	coal mining	taken over by NDC
Sterling Int'l Brokerage Corp.	customs brokerage	retained by Herdis
Summa Computer Services Corp./50	computer systems	no longer under Herdis
Summa Insurance Corp./100	non-life insurance	taken over by NDC
Summa-Jardine Davies Phils., Inc.	distributor of Memorex computer products	non-operational
Summa Kumagai, Inc./60	construction	retained by Herdis
Summa Public Mgt Services Corp./60	n.a.	non-operational
Tambuli Telecommunications, Inc./80	electronic automatic exchange distributor	no longer under Herdis
Technosphere Mfg. and Recyclers, Inc./62	tobacco recycling	retained by Herdis
Technosphere Consultants Group, Inc./100	construction management services	no longer under Herdis
USI Pacific Apparel Corp./100	garments manufacturing	no longer under Herdis
Vulcan Industrial and Mining Corp.	coal and mercury mining	taken over by NDC
Usiphil, Inc./100	heavy equipment distributor	taken over by NDC
Westinghouse Asia Controls Corp.	manufacturer and distributor	no longer under Herdis

[a]Founded by Herminio T. Disini. A few years back, it was known as "the fastest-growing non-oil based conglomerate in the country." It started out with only two employees in 1970, operating the Philippine Tobacco Filters Corp.
[b]As of 1980.
Source: IBON Databank, **Facts and Figures** (September 1983), p. 8.

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