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THE PHILIPPINES ON DEBT ROW

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Abstract

Heavy indebtedness and debt service payments, indicated by debt magnitudes and shares to national budgets, revenues, or outputs, mean that spending for public infrastructure and basic services is crowded out, even as they entail more borrowings in order to timely meet debt obligations. The failure to reduce indebtedness, improve national revenues, and raise incomes has contributed to the economic decrepitude of the Philippines. Debt relief is necessary to pull the country out of such a state of affairs.

INTRODUCTION

Debt penalty sounds much like *death penalty* but the two expressions are not the same. The former is punishment imposed on the *public;* the latter is punishment imposed on an *individual* for a serious crime (Habito, 2006; Habito & Beja, 2006). In short, debt penalty *is* collective punishment. Moreover, if the social structure is highly uneven like that of the Philippines, the poor disproportionately carries the burden of the debt penalty. Unless the debt itself is commuted or repudiated, it is not possible to mitigate the debt penalty through commutation or executive clemency.[2] Thus the seeming play of words in the title actually summarizes a most serious economic difficulty haunting the Philippines.

This paper explains why the Philippines is on debt row. Although debt is an old issue for the country, it is an unremitting problem because indebtedness and debt service payments continue to grow.[3] Precisely because it is an old issue, public discussion about debt in general and Philippine indebtedness in particular is dismissed as politicking or extremist lobbying. Regrettably, the public has been blinded or lulled by the situation. This paper is an attempt to look once more at the current state of indebtedness and to hopefully convince government to review its policy on debt and public finance.

The Philippine experience with the acquisition and utilization of debt has not been in line with the expected outcomes. It is troubling that government has to borrow to meet

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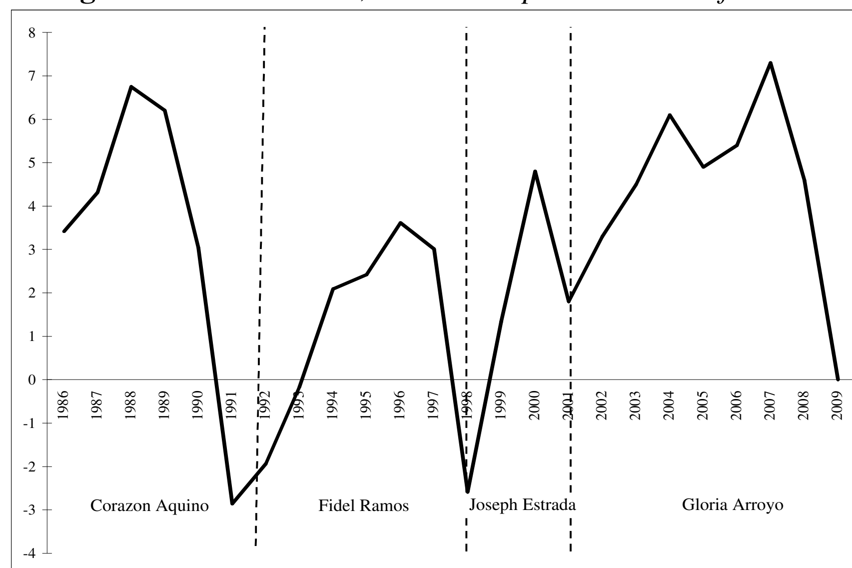
[2] Debt relief and related initiatives include: Brady Plan, Highly Indebted Poor Countries Program, Multilateral Debt Relief Initiative, and Stolen Asset Recovery Initiative
[3] "Indebtedness" means total outstanding debt, which includes domestic and foreign debts. "Debt service payments" comprise interest payments and principal amortizations.

debt obligations because the domestic resources it generates are not able to finance debt service payments. The problem, of course, has historical antecedents: the borrowings in the 1970s were mismanaged and eventually debt obligations exceeded capacity to pay; the debt crisis during the early 1980s forced the country into default; the subsequent heavy debt obligations throughout the 1980s plus a credit crunch and recession in the U.S. contributed to the recession in 1991-1992; then a fiscal crisis pushed the economy to near default in 2005 (for the period from the 1980s to the 1990s: Boyce, 1992a; Lim, 1996; Vos & Yap, 1996; on the fiscal crisis: Aldaba et al., 2005; de Dios et al., 2005). As tax efforts declined, national revenues could not cover national budgets. A contributing factor to the revenue problem was the reduction in tariffs instituted because of trade liberalization (cf. Grunberg, 1998; Khattry & Rao, 2002; Braunsgaard & Keen, 2005). The discussion also makes clear that since 2000 debt service payments have reached alarming levels. Of course, as debt obligations become onerous, government has to extract more resources from the public through taxation and other means even as less and less resources are put into the economy, while public goods and services are strained as demand on them increases. The only other way out for government is to borrow more. The combination of debt burden and penalties means that economic possibilities and public welfare suffer. Economic growth and human development are thus compromised which in turn intensifies and deepens any adverse consequences of indebtedness.

PHILIPPINE ECONOMY

It is useful to begin with a brief analysis of recent conditions in the Philippines. Vos and Yap (1996) and de Dios (2000) argued that, since the 1980s, the economy has proceeded on a boom-bust cycle. It is a pattern that the economy, as Figure 1 shows, has not been able to overcome. Figure 1 also shows that the turning point occurs around the mid-term of a presidency, with the trough of the cycle reached at the end of the term. An

Figure 1: *Growth Rates, 1986-2008 plus IMF 2009 forecast*



economic recovery takes place as soon as a new president takes office. An outgoing gov-

ernment seems to lose enthusiasm in implementing its programs, while an incoming government is vigorous in introducing its agenda to outperform the past government. There is an incentive for the new government to put significant effort at the beginning of the cycle and secure its legacy early on. There is also an incentive to transfer the fault for the prevailing or unsolved problems to past governments.

Bautista and Canlas (2003) rightly pointed out that from the mid 1980s to the early 1990s the Philippines was passed over by capital flows from Japan, South Korea, and Taiwan. The country throughout that period was in technical default as interest payments were capitalized as debt. Even with a hopeful scenario during the immediate post-Marcos period, economic and political problems haunted the Aquino government (1986-1992). Not surprisingly, only a few investors were eager to put capital in the country. In the end, severe infrastructure bottlenecks and debt service payments problems plunged the economy into recession in 1991-1992. Consequently, the recovery of the late 1980s was reversed in the early 1990s.

The Ramos government (1992-1998) had a cautious start, first, because of the recession and, second, because the public was wary about a military person running the government. But confidence quickly emerged after the electricity power shortages were speedily solved. Thereafter, the economy went into a recovery phase. Reforms were introduced in due course, including the liberalization of the peso, the liberalization of trade and investments, the deregulation of industries like telecommunication and transport, and the establishment of a new central bank to replace the bankrupt one.[4] Then capital started to flow again into the country. By the early 1990s, access to debt markets had been reestablished with the successful issue of sovereign bonds. Recovery continued until it was upset by the Asian Crisis.

[INSERT TABLE 1 HERE]

Modest economic progress characterized the Estrada government (1998-2001). Mr. Estrada enjoyed tremendous popularity among the poor because of populist policies but elicited shocking disgust among elites because of his involvement in numerous scandals. Uncertainties in the early 2000s slowed down the economy. The botched impeachment of Estrada eventually ended with his removal. Not surprisingly, the economic performance of the Estrada government fit well into the pattern of the boom-bust cycle, albeit a mild one.

The Arroyo government (2001-2010) has met a battery of attacks since taking power in 2001 but has managed to withstand them all except perhaps the election scandal in 2004. Figure 1 shows that the economy under Arroyo has attained the longest stretch of economic growth to date. The economy seemed to be moving steadily, at least until 2007. Capital flows and overseas income remittances contributed to the strengthening of

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[4] The Ramos government approved Executive Order 413, which sought to simplify the tariff structure, and Executive Order 464, which meant the reduction of tariffs to 1-5 percent by 2004.

the peso and in reducing inflation, thereby contributing to the positive outlook.[5] Sicat (2007) even argued that remittances helped ease debt burdens in the 2000s.

Economic growth accelerated from 1.8 percent in 2001 to 7.3 percent in 2007,[6] but it has slowed and is expected to reach zero percent in 2009. That the boom-bust cycle had been broken by 2005 was a determination made too soon. Table 1 shows that the Arroyo government has averaged 4.4 percent growth rate to date annually, or a percentage point higher than what the Aquino government achieved and about three percentage points higher than the growth rates achieved by both the Ramos and Estrada governments.

Still, there are tell-tale signs challenging the purported strength of the economy. First, unemployment has worsened despite strong economic performance, suggesting jobless growth. With about one million workers entering the job market each year, unemployment continues to worsen. One cause of the problem is that the economy has leaped into services without establishing a healthy manufacturing base. In short, the economy has undergone premature deindustrialization as both output and employment shares of the industrial sector, but especially manufacturing, to GDP fell in the long-term (Table 1).

Second, poverty has persisted at above 30 percent, despite improvements in incidence (Table 1). Put simply, one in three Filipinos is poor. There are 26 million poor Filipinos today compared to 22 million in the 1980s. Severino and Salazar (2007) noted that the poverty situation in the country is comparable to that in Cambodia, Laos or Myanmar; only Vietnam in Southeast Asia has a worse poverty situation than the Philippines. Poverty quite naturally is mainly located in rural areas and in areas that are far from metropolitan centers like Metro Manila, Cebu, or Davao. Coupled with poverty is persistent inequality. The Gini coefficient has worsened from 41.8 in the 1980s to 45.8 in the 2000s. Of course, inequality is a major factor in explaining the extent of poverty in the country but other factors like education and access to infrastructure play important roles as well in worsening poverty (cf., Balisacan & Fuwa 2006).

Habito and Beja (2006) thus described Philippine economic performance in the 2000s as (a) narrow because economic growth has been driven by a limited set of domestic activities that are restricted in geographic scope; (b) hollow because the few domestic linkages in production has meant limited jobs generation; and (c) shallow because gains from growth have not been effectively among the population and sectors. They also noted the concentration of activities in the National Capital Region, Central Luzon, and Southern Tagalog which contribute close to 60 percent of output and incomes.[7] Recently, Habi-

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[5] The Arroyo government equates a strong peso (viz. dollar) to a strong republic. The intuitive logic for such view is that a strong currency cheapens imports and makes debt service payments affordable to government. Of course, there are economic problems that come with such a position, namely Dutch disease and deindustrialization.

[6] Another 0.7 percentage points can be added to annual GDP growth rates if overseas Filipino remittances are included in national output.

[7] Capital expenditures have been falling in the 2000s. Domestic investment as a share of GDP was 25 percent in 2000 and became 15 percent by 2007. The norm in the region is 25 percent of

to (2009a) has raised the issue that growth has actually been adverse to poverty reduction, in contrast with the experience of Asian economies. It is therefore not surprising that Filipinos' subjective welfare assessment suggests an impoverishing rather than improving state.[8] Correspondingly, figures for total hunger incidence reveal a similar picture. Perhaps it is only a matter of time that the boom-bust cycle manifests itself again, possibly triggered by the present Global Crisis.[9]

Third, until recently, cheap fuel and raw materials and imports produced a pleasant economic environment. Mild inflation was achieved not because government was active in reducing inflation (cf. Beja, 2008; Lim, 2008). Concerns about jobs generation were eased because of high demand for overseas workers. Investments flowed into the country because of global surpluses brought about by global imbalances. Unfortunately, things have dramatically changed since mid-2008. A global recession could translate into serious economic slowdown that would push inflation and unemployment up and propel capital to flee thus aggravating the domestic situation.

What is disturbing about all these developments is that the Arroyo government does not find an urgency to tackle the problems. Government is simply making pronouncements that the economy is robust because reforms have prepared the country for the Global Crisis. Diokno (2009) has pointed out that it is unlikely that reforms done in response to the country's fiscal crisis in 2005 would have erected the fortifications against the Global Crisis. Beja (2000) even argues that government is merely implementing an accounting stimulus program response to the Global Crisis. Government is now more aggressive in pursuing its strategy of pushing Filipinos to seek jobs abroad since not enough jobs could be generated inside the country. It could only encourage employment in sectors like business process outsourcing which has been found to generate little linkages with other productive sectors (cf. Magtibay-Ramos et al., 2008). What government appears to be doing is masking the situation with gimmicky and other devices to get by while awaiting the next government. The pattern is very much consistent with the boom-bust cycle in Figure 1.

PHILIPPINE INDEBTEDNESS

Statistics show that debt service payments have reached disturbingly high amounts in recent years, even exceeding half the national budget since 2003 (Table 2). In

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GDP. Growth of capital expenditures averaged about 0.6 percent for the same period, in contrast to the norm in the region of above 6 percent. Gross capital formation fell as well, from 7.2 percent of GDP in 2000 to 3.4 percent in 2008. What took up the slack in investments was foreign capital inflow. An implication is that domestic capital has been steadily moving out of the country, while foreign capital has been coming in to replace it. A further implication is that finance-led economic growth rather than investment-led growth is what has occurred in the country.

[8] Social Weather Stations data indicate that rural self-rated poverty incidence is at least 5 percentage points higher than urban self-rated poverty incidence. See http://www.sws.org.ph.

[9] Research shows that the country was adversely affected by Asian Crisis, shown by indices on poverty, health, education, and gender employment (cf. Lamberte, 1999; Reyes & Mandap, 1999; Reyes et al., 1999; Lim, 2000). Similar impacts could be expected from the present Global Crisis.

fact, between 2004 and 2006, debt service payments comprised two-thirds of the national budget. Table 2 shows that, in 2000, outstanding debt stood at PhP 2.2 trillion or 65 percent of GDP. It increased to PhP 3.8 trillion in 2004 or 78 percent of GDP. Except in 2005, when indebtedness fell by PhP 300 billion because of rescheduling and adjustment, outstanding debt continued to increase in the following years. By 2008 the amount was already double that reported in 2000, at PhP 4.2 trillion or 56 percent of GDP. The amount increased further to PhP 4.4 trillion in 2009.

As Boyce (1992a) and Vos and Yap (1996) explained, Philippine indebtedness is the progeny of past policy mistakes, debt mismanagement, and historical conditions that entailed heavy borrowing. Persistent weakening of fiscal capacity and finances contributed to rapid debt accumulation, and the deterioration in fiscal position led to a fiscal crisis that threatened a default in 2005 (cf. Aldaba et al., 2005; de Dios et al., 2005). As discussed below, even though the crisis was addressed with considerable fiscal consolidation[10] and a quick institution of the expanded value added tax, indebtedness still worsened since the problem was resolved largely by debt rescheduling without restoring fiscal capacity.

[INSERT TABLES 2 AND 3 HERE]

Table 2 reveals other interesting figures. The burden of debt has been increasing in most of the 2000s. In 2000 alone, the share of debt service payment to national budget was already 36 percent of the national budget; that is, at least a third of the national budget was allocated to debt service payments. It ballooned to more than half the national budget from 2004 to 2008. Even in 2009, the figure was close to half the national budget. Thus debt service payments already corner more than half the national budget, and consequently the allocations for public expenditures have to compete for the remainder of the budget.

The figures, analyzed against national revenues, illuminate why government continues to borrow. In 2000, debt service payments comprised 44 cents to a peso of tax revenue. In 2004; the figure doubled. In 2005, almost all of national revenue (95 cents to a peso of revenue) went to debt service payments, leaving just 5 cents to a peso for public expenditures. The figure remained high even in 2006, at 86 cents to a peso of revenue, although it declined in 2007 and 2008 to 60 cents and 55 cents to a peso, respectively. Recently, the figure rose again to 61 cents to a peso of revenue, which is still large relative compared to pre-2000 levels. These figures are without comparison in recent history. It goes without saying then that pressing public infrastructure and basic services are not fully supported when government does not have adequate finances.

The figures in Table 3 are also telling. For instance, debt service payments in

[10] Fiscal consolidation refers to the government's attempt at reducing budget deficits and indebtedness through the reduction in public spending, borrowings, or both. Often increased taxation accompanies fiscal consolidation.

2000 could finance 177 percent of the basic services budget,[11] 197 percent of the education budget or 841 percent of the health budget. In the following years, the figures portray a worrisome scenario as debt service payments hovered between 408 and 465 percent of the basic services budgets during 2004 to 2006 before dropping to 290 percent in 2009. Put simply, debt service payments could provide more than triple the budgets for basic services for the period from 2000 to 2009. In fact, interest payments alone could fully finance basic services for the same period.

Because of an automatic appropriation policy, debt obligations are guaranteed in the national budget but public expenditures can only be guaranteed with more borrowings. What remains of the budget when debt service payments are excluded are allocations for salaries, maintenance and operating expenses, and allotments for local government units. Evidently, these items cannot be foregone because they involve the day-to-day operations of government. Over time, therefore, public infrastructure and basic services deteriorate as the demand on them increase and as the increased demand on them strain the system.

Just the same, most analysts point out that the country is not in a dire situation. After all, its debt to GDP ratio is 57 percent as of 2009 (Table 2). Neither does the country face difficulties in paying its debt obligations because supposedly the increase of the value added tax in 2005 improved national revenues. In short, there is no imminent danger of default. There is no need nor does the country qualify for debt relief. In fact, even with the difficulties, the country can still boast of progress in meeting developmental targets like the Millennium Development Goals (MDG).

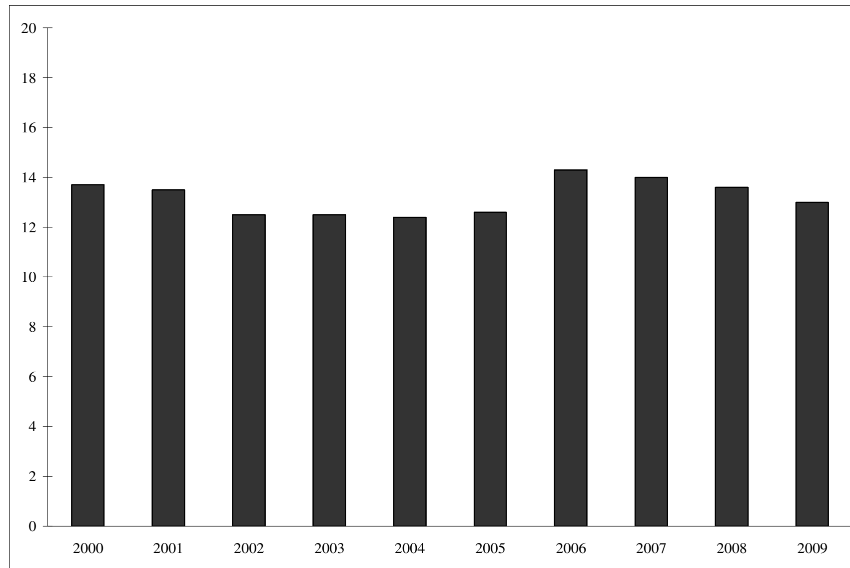
The fact of the matter is that when government prioritizes debt service payments, it effectively forsakes budgets for education, health, and infrastructure, whose shares in the national budgets, national revenues, and GDP have in fact declined since 2000. Basic education, health services, and public infrastructure are crucial in the formation of a solid domestic base to support long term economic growth and human development.

One reason for the fiscal constraint in the country is that tax effort has deteriorated during the past ten years (Figure 2). Tax effort averaged almost 20 percent between 1994 and 1997. It was about 13.2 percent between 2001 and 2008. An improvement in tax effort was seen in 2006 after the value added tax was raised in 2005 but it fell thereafter and is expected to reach 13 percent in 2009. The decline in tax effort was the result partly of tariff harmonization and reduction plan that trade liberalization brought in starting in the 1990s (see Footnote 3) and partly of the shift to value added taxation. Ta-

[11] "Basic services" refer to economic and social services. "Economic services" cover the following items: agriculture, agrarian reform and natural resources; trade and industry; tourism; power and energy; water resources development and flood control; communication, roads and other transport; subsidy to local government units; others. "Social services" cover the following items: education, culture and manpower development; health; social security, welfare and employment; housing and community development; land distribution; subsidy to local government units; others. "General public services" cover the following items: "general administration; public order and safety; subsidy to local government units; others.

riffs were reduced but government did not introduce alternative taxes to compensate for the lost national revenues. Meanwhile, tax leakages remained a big problem (see, e.g., Manasan, 2008; Habito, 2009b). Still, Emran & Stiglitz (2004) argue that value added tax could work if there is no significant informal economy. If tax effort is raised to its 1997 level, government could generate enough revenues for public expenditures.[12] Unfortunately, the inability of government to raise its tax effort is largely due to the strong grip on it of special interest groups who are against meaningful tax administration. The irony of the situation is that government cannot set itself free from special interests because its capacity to do so has been weakened by a history of cooption and control.

Figure 2: *Tax Effort, Revenue as share to GDP*



Fiscal consolidation is another explanation. Government has tended to resort to uninteresting ways of raising national revenues because, as already suggested, it cannot institute meaningful tax administration. By taking such a route, government has allowed its policy space to be reduced and defined by special interests who are interested in diverting government's attention from instituting income and wealth taxation to induce social transformation. Indeed, because value added tax is not a good substitute for genuine income and wealth taxation and tax administration, government has failed to build its capacity to provide for public infrastructure and basic services thus further undermining its ability to deal with indebtedness.

Of course, government has managed to increase value added tax to compensate for low revenues. Its effort at improving tax effort has sadly focused on the value added tax which has regressive effects that impinges on public welfare.

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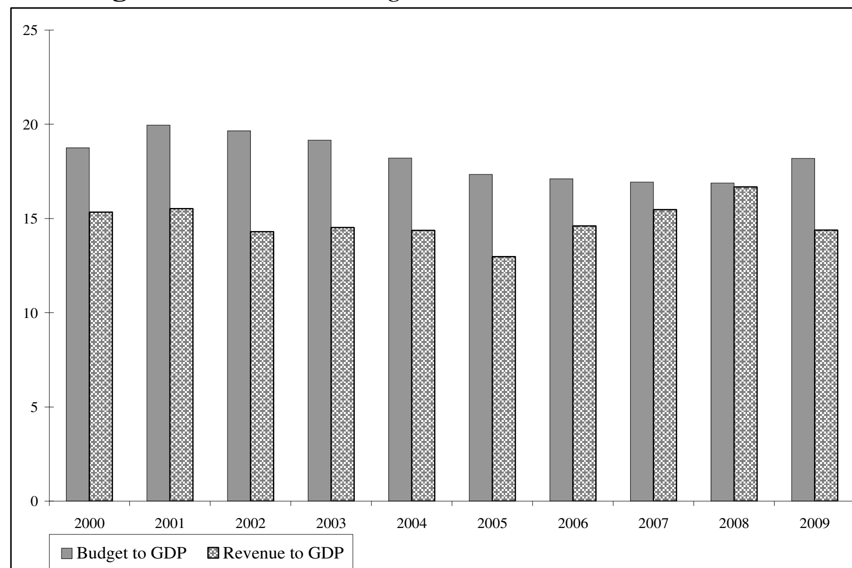
[12] Raising the tax effort from its present level of about 13 percent of GDP back to the 1997 level of 17.0 percent of GDP would mean about PhP 300 billion additional revenues, enough to enlarge the allocation for social services alone by 75 percent or economic and social services by 30 percent. Tax effort should be raised to 20 percent of GDP to meet financing needs for economic and social services.

Government burrows more in order to maintain operations. But at the same time it wants to minimize its borrowings, so it limits budget deficits to, say, two percent of GDP. Government thus needs to be conservative because if deficits exceed three percent, credit agencies would downgrade their ratings on the country. Such a combination of conditions limits fiscal space and means that less and less funds are spent on public infrastructure and basic services. Here again we see a pernicious bleeding out of the foundations for growth and development.

The deterioration in government finances in the 2000s boils down to a revenue generation problem. It is definitely not a case of a sudden upsurge in expenditures or profligate spending (Figure 3). The national budget has averaged 18.2 percent of GDP between 2000 and 2009; it was only 17 percent throughout the period from 2005 to 2008 with the higher figure in 2009 due to increased allocations for public spending to cushion the impact of the Global Crisis (but spending could be politically motivated, too, as national elections are coming up in 2010). The share of revenues to GDP has continuously fallen in recent periods due to the contraction in economic activities. Nonetheless, the gains from the increased value added tax have probably evaporated by 2008 given that private and public consumption shares of GDP have fallen throughout the 2000s from 82.7 percent to 79.9 percent, respectively, and that imports have declined since 2008 because of the global crisis and leakages remain significant. Net of debt interest payments, the national budget has fallen from 14.5 percent of GDP in 2000 to 14.3 percent of GDP in 2009, so public spending is clearly not the problem.

Figure 3: *National Budget and Revenue, share to GDP*



In sum, government is caught in a Ponzi situation of having to keep on borrowing because it is troubled by an inability to generate revenues.

Needless to say, complicating factors are the enduring problems of graft and corruption and bad governance, which contribute to wastage. With the world economy anticipated to fall into stagnation in the medium term, capital inflows could stop and reverse,

pulling domestic capital away, while borrowing becomes difficult. Debt obligations could become difficult to refinance. Such a configuration could soon push the country into another debt crisis.

COMMUTING DEBT

It is wrong to conjecture from the above discussion that borrowing is damaging to an economy and therefore should not be resorted to by any country. Such a view does not account for the contexts that bring about debt problems. In general, as long as funds are employed well and result in an expansion of domestic productive capacity, borrowing helps raise domestic output which, in due course, generates resources to pay off those debts. Similarly, borrowing helps provide resources for smoothing out domestic consumption and economic cycles. In a downturn, borrowing would mean resources to finance recovery. As the economy recovers, resources become available to pay the debt. Alternatively, borrowing brings funds to a politically insecure government which it can deploy to capture interest groups and maintain their support.

How government pursues its policies in managing the economy in general or debts in particular explain in large part why borrowings do not produce their expected benefits. For the Philippines, Bello (1982), Broad (1988), Dohner and Intal (1989), and Boyce (1992a), among others, have argued that mismanagement typically entailed wasteful and duplication of projects as well as diverted public funds through dodgy transactions. Projects that were poorly financed in the end failed. So incomes and welfare were adversely affected. Thus, government could not generate resources for debt service payments and had to borrow even more to meet debt obligations. Of course, as Boyce (1992b) and Beja (2006) suggested, the ease by which debts were acquired – often abetted by an external environment awash in cash and lax credit policies – encouraged mismanagement since government could easily tap resources whenever debt obligations came due.

How can the debt penalty on the Philippines be reversed? Debt relief is one step. Even with reduced borrowings in the coming years, debt service payments would still mount given the heavy indebtedness. As shown in the previous section, debt service payments eat up a significant portion of domestic resources. Compounding the problem is that domestic capacity to generate resources is also weak. Government ought to be weaned from borrowing but creditors could also help reduce debt by not lending to the country.

Debt relief would help enlarge government's policy space and help stop the cycle of borrowing. Resources would be released from debt service payments and made available for essential public expenditures. There is also a developmental reason. Lim (2006) and Manasan (2007), for instance, noted financing problems for the Millennium Development Goals. As Table 4 shows the main hurdles in the MDGs concern the education and health indicators, two of the sectors that have gotten the least budgetary support

(Tables 2 and 3).[13]

[INSERT TABLE 4 HERE]

One form of debt relief is debt cancellation or repudiation. According to Jubilee Debt Campaign (2009), the Philippines would need about 62 percent debt cancellation on outstanding debts, which covers the odious or illegitimate debts of past regimes.[14] However, because some of these odious or illegitimate debts have been paid by government for good or ill and/or that some of these debts have been reissued in the secondary markets thereby removing the "original sin" link between debtor and creditor, what might be a sensible demand for relief?[15] Redoing the calculations of Jubilee Debt South, and following Hanlon (2000), about 35 percent debt cancellation might be required for the Philippines. For debt cancellation or repudiation to be justifiable, however, it would be necessary for government to reverse its declaration in 1986 to honor *all* odious or illegitimate debts of the country which was made for fear of retaliation from creditors and has been unduly burdened to meet its debt obligations. Selective debt cancellation or repudiation is a sensible approach provided that the procedures for and the purposes of the reversal are clear.

A suitable alternative to the above scheme is a standstill on interest payments coupled with negotiated arrangements with creditors for principal amortization.[16] The debt workout would mean spreading out the payments over the medium- to long-term so as to ease the burden of the remaining debts. But it should be done in a way that benefits both the country and its creditors. For the Philippines, a standstill on interest payments would release around PhP 300 billion each year. Again, using Table 3, the amount would be more than enough to double the budgets for education and health programs or augment by more than 50 percent the budget for economic services in general. Standstill on interest payments would also mean enough funds for the MDG.

From an economic point of view, debt relief makes development not only affordable but also possible. From a justice point of view, however, debt relief is a first step toward correcting the injustice and the pain of the debt penalty.

It goes without saying that an important responsibility of government is ensuring that public funds benefit the public. Thus if debts are mishandled by government or are deployed to suppress or oppress the public thereby financing human rights violations and

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[13] Government has admitted that the present Global Crisis would hold back further progress on the targets. Recent test scores of school children in the *Trends in Math and Science Survey* are already below global averages, suggesting that a generation of Filipino children has received inadequate schooling (Del Mundo 2006). ADB (2009) indicated that the country would need about PhP 80 billion each year to finance climate mitigation programs.

[14] On odious debts, see Adams (1990), Hanlon (2000), Boyce and Ndikumana (2002), Hanlon (2005), Hanlon (2007), and Kremer and Jayachandran (2006).

[15] Debts incurred for the Bataan Nuclear Plant were completely paid off in April 2007.

[16] If the present value of accumulated debt service payments matches the present value of the original debt, there will be automatic standstill on interest payments. Thus the principal is amortized. In other cases, government negotiates with creditors for a standstill on interest payments.

curtailment of freedom, or when public funds are laundered by officials or those who have privileged access to public funds into money havens or private accounts, etc., the public is doubly penalized from undue indebtedness and lost resources. Undue indebtedness because the funds have to be paid, thus the public is unnecessarily burdened by debt. Lost resources because the funds could have been used productively and generated resources to pay debts or the funds could have financed developmental projects and benefited the public. As such, the government that mishandled or misused the debts and/or those who benefited from the privileged access to the funds are liable for the debt problems, and on them the debt burden should be imposed by creditors. Investors and creditors should also take some responsibility to ensure that borrowings actually contribute to the enlargement of national output and welfare and benefit the public.

Prudence is required throughout a debt's life cycle from application to acquisition until full payment. If at any stage an irregularity is found or suspected, then due diligence dictates that appropriate actions are immediately taken to deal with the situation. Often, such discovery comes after the fact. In cases where proof cannot be presented to conclusively demonstrate that public funds were appropriately used or if public funds could not be reasonably traced, the presumption should thus be that the funds were mishandled, misused, or diverted for private ends. The government that was part of such misconduct (either by commission or omission) and the officials or privileged people who enjoyed the funds should be made accountable. If creditors ignored or pretended not to see that there were in fact irregularities, and they did not act to correct the problem even if they were aware of the problem, then they too should be accountable. In this case, creditors lose standing to demand payments. They should demand payments only from those who took advantage of or were responsible in the misuse of the debt. Such standard provides a basis to challenge the legitimacy of debts in general and the rationale for honoring debts that the public did not enjoy. It also puts in doubt the notion that unregulated capital flows always bring benefits to the public. More importantly, such standard would go a long way to address concerns about the cover up of actions of government and creditors to sweep away their responsibility.

If it can be demonstrated that government and officials and creditors exercised prudence or due diligence, there should be no need to question the legitimacy of debts. Of course, there would be cases where government or private sector was truly unaware that it was exploited as conduit for funneling resources out of the country. This is a problem of capacity. Government thus needs to remain robust and be armed with technology, know-how, and personnel to quickly detect and respond to such challenges. International action to clamp down on malpractices is needed, and government should forge collaborative relationships and cooperate in the international sharing of information and monitoring of transactions and activities and in prosecuting wrongdoers.

The third step in reversing the debt penalty, complementary to both debt relief and prudential control, is for government to make the domestic economy stronger. First, in terms of economic performance, robust economic growth is critical because it increases incomes and raises welfare. Stable economic performance in turn enlarges national savings, which then provides the resources for domestic investment. Government of course

should facilitate the development of the financial system.

Synergy among the different economic sectors would emerge in due course, thereby generating healthy competition that helps deepen industrialization, raising the economy to a higher level of trajectory. Complementary social programs would be needed throughout this process in order to deal with adjustments as the economy expands but, more importantly, to bring people to participate more effectively in the economy. Given existing fiscal constraints, however, government need not provide all components for growth; but the essentials should be provided by government or at least those that market processes would not provide or would be too expensive for the public if the private sector supplied them. Some partnership scheme between government and the private sector could then be forged for the formation of basic conditions for long-term expansion.

Lastly, it is also important that public governance, especially tax administration, be improved. Not only does government need to make the tax system progressive, it also needs to strengthen tax effort and administration. All things being the same, enlarged incomes with economic growth would allow government to collect more taxes, and more resources would become available for public infrastructure and basic services, including debt service payments. All things being the same again, genuine income and wealth taxation enlarges tax revenues. On the spending side, government needs to improve its operations by rationalizing procedure, stopping corruption at all levels, and discouraging patronage, etc. Good governance would emerge if government embedded itself in society, that is, if it engaged diverse sectors and interests to come up with practical or workable solutions that not only protect the public welfare but also improve it in the process while still satisfying private interests.

CONCLUSION

Indebtedness and debt service payments have reached considerable amounts such that expenditures for public infrastructure and basic services have been crowded out. From 2000 to 2009, the country's indebtedness averaged 65 percent of GDP. In the same period, debt service payments averaged about 70 cents for each peso of national revenue. The heavy debt obligations as well as the need to maintain public expenditures occasioned more borrowing. In the end, indebtedness continued to increase.

The Philippines has had a difficult experience with indebtedness. One set of problems involved policy mistakes, debt mismanagement, and historical conditions that entailed heavy borrowings. Complicating factors included trade deregulation and liberalization programs as well as enduring problems with graft and corruption and bad governance that contribute to wastage and reduction in national revenues. Other factors include the absence of meaningful income and wealth taxation and the inability of government to institute solid tax administration, a problem because of cooption and control of government by special interests and because of weaknesses in capacity to institute sound reforms because of cooption and control of special interests. Because value added tax is not a good substitute for genuine income and wealth taxation and meaningful tax administration, government failed to build its capacity to provide for public infrastructure and basic

services. Government's ability to deal with indebtedness was undermined, too.

Notwithstanding the reasons for indebtedness, debt relief has become necessary to reverse its immediate debilitating effects. One approach is cancellation or repudiation of odious or illegitimate debts. The modified approach is selective repudiation. Debt relief would release billions of pesos each year, thereby expanding budgets for public infrastructure and basic services.

Finally, there are the long-term implications of indebtedness. Heavy debt penalties ultimately mean limited economic growth because of weak domestic capacity and human development. Limited provisions of public infrastructure and basic services because of poor public finance contribute in further weakening the economy. In the end, the economy is easily destabilized by shocks which, in turn, aggravate an emaciated domestic capacity and human underdevelopment. Thus imperatives to pull the Philippines out of debt row are debt relief, healthy economic performance, and solid public administration and fiscal position.

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Table 1: *Comparative Socio-Economic Indices of Philippine Governments, period averages*

	Aquino	Ramos	Estrada	Arroyo
Basic Statistics				
Population, millions ave.	59.0	66.7	74.3	82.4
Output in GDP, billions ave.	667.3	794.0	926.4	1,193.9
Economic Growth, percent ave.	3.5	1.5	1.2	4.2
Inflation, percent ave.	9.7	7.3	6.4	5.8
Unemployment, percent ave.	8.2	8.3	9.6	11.4
Fiscal deficit, millions ave.	24.2	7.3	111.2	132.4
Poverty and Inequality				
Gini Coefficient, percent ave.	41.8	44.5	48.2	45.8
Poverty Incidence, population ave.	36.5	32.6	34.0	31.5
Self-rated Poverty, percent ave	58.9	60.0	59.3	56.9
Top 20 deciles, share ave.	25.8	26.7	28.2	28.3
Bottom 20 deciles, share ave.	8.7	9.3	8.8	8.5
Sectoral Production Structure				
Agriculture to GNP, share ave.	23.8	21.3	18.7	17.7
Industry to GNP, share ave.	35.7	34.1	33.2	30.5
Manufacturing to GNP, share ave.	25.8	24.3	23.2	22.1
Services to GNP, share ave.	42.3	41.9	42.6	43.8
Factor Income to GNP, share ave.	-1.8	2.8	5.5	8.1
Sectoral Employment Structure				
Agriculture to Labor Force, share ave.	43.4	39.8	34.4	31.4
Industry to Labor Force, share ave.	14.6	14.6	14.6	13.3
Manufacturing to Labor Force, share ave.	9.5	9.2	8.9	8.1
Services to Labor Force, share ave.	33.7	36.4	40.6	43.8

Sources: National Statistics Coordinating Board Online and National Economic Development Authority Online. Figures for the Arroyo government include IMF 2009 projections. Unemployment rate is based on the old definition.

Table 2: *Philippine Indebtedness (billion pesos)*

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	*Average*
Total Outstanding Debt	2,167	2,385	2,816	3,355	3,812	3,523	3,675	3,646	4,221	4,450	3,405
Share to GDP	65	66	71	78	78	65	61	55	56	57	65
Share to Revenue	421	423	496	535	545	499	417	355	338	396	442
Share to Budget	345	329	361	406	430	374	356	324	333	313	357
Total Domestic Debt	1,068	1,248	1,471	1,704	2,001	2,164	2,154	2,201	2,415	2,560	1,899
Share to GDP	32	34	37	39	41	40	36	33	32	33	36
Share to Revenue	207	221	259	272	286	307	244	214	193	228	243
Share to Budget	170	172	189	206	226	229	209	195	191	180	197
Total Foreign Debt	1,099	1,137	1,344	1,651	1,811	1,724	1,697	1,511	1,806	1,890	1,567
Share to GDP	33	31	34	38	37	32	28	23	24	24	30
Share to Revenue	214	202	237	264	259	244	192	147	144	168	207
Share to Budget	175	157	173	200	204	183	164	134	143	133	166
Interest Payments	141	175	186	226	272	300	310	268	272	302	245
Share to GDP	4	5	5	5	6	6	5	4	4	4	5
Share to Revenue	27	31	33	36	39	43	35	26	22	27	32
Share to Budget	22	24	24	27	31	32	30	24	21	21	26
Principal Amortization	87	100	172	244	341	379	544	346	340	379	293
Share to GDP	3	3	4	6	7	7	9	5	5	5	5
Share to Revenue	17	18	30	39	49	54	62	34	27	34	36
Share to Budget	14	14	22	30	38	40	53	31	27	27	29
Total Debt Servicing	228	274	358	470	581	679	754	622	682	681	533
Share to GDP	7	8	9	11	12	12	12	9	9	9	10
Share to Revenue	44	49	63	75	83	96	86	60	55	61	67
Share to Budget	36	38	46	57	66	72	73	55	54	48	54

Source of data: Bureau of Treasury Online

Table 3: *Philippine budgetary allocations (billion pesos) and shares*

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	*Average*
Economic Services	324	337	405	317	367	320	393	444	535	556	400
Share to GDP	10	9	10	7	8	6	7	7	7	7	8
Share to Revenue	63	60	71	51	52	45	45	43	43	49	52
Share to Budget	62	47	52	38	41	34	38	39	42	39	42
Share of Debt Servicing	70	81	88	148	164	212	218	138	115	123	136
Social Services	213	225	232	230	247	286	346	310	380	409	288
Share to GDP	6	6	6	5	5	5	6	5	5	5	5
Share to Revenue	41	40	41	37	35	41	39	30	30	36	37
Share to Budget	34	31	30	28	28	30	34	28	30	29	30
Share of Debt Servicing	107	122	154	204	244	237	247	198	161	167	184
Education	116	120	128	129	133	131	146	167	187	205	146
Share to GDP	4	3	3	3	3	2	2	3	3	3	3
Share to Revenue	23	21	23	21	19	19	17	16	15	18	19
Share to Budget	18	17	16	16	15	14	14	15	15	14	15
Share of Debt Servicing	197	229	280	365	452	517	584	367	328	333	365
Health	27	26	16	14	15	17	19	22	38	45	24
Share to GDP	0.8	0.7	0.4	0.3	0.3	0.3	0.3	0.3	0.5	0.6	0.5
Share to Revenue	5	5	3	2	2	2	2	2	3	4	3
Share to Budget	4	4	2	2	2	2	2	2	3	3	3
Share of Debt Servicing	841	1,051	2,183	3,338	3,979	4,012	4,486	2,780	1,622	1,523	2,581
National Defense	36	34	41	46	45	48	53	62	62	65	49
Share to GDP	1	1	1	1	1	1	1	1	1	1	1
Share to Revenue	7	6	7	7	6	7	6	6	5	6	6
Share to Budget	6	5	5	6	5	5	5	6	5	5	5
Share of Debt Servicing	629	809	863	1,018	1,345	1,429	1,623	991	990	1,043	1,074
General Public Services	147	153	166	176	177	212	208	245	256	276	202
Share to GDP	4	4	4	4	4	4	3	4	3	4	4
Share to Revenue	29	27	29	28	25	30	24	24	21	25	26
Share to Budget	23	21	21	21	20	22	20	22	20	19	21
Share of Debt Servicing	155	179	216	267	340	321	411	250	240	247	263

Table 4: *Philippine Millennium Development Goals (targets 1 to 7)*

	Baseline=1990	Current level	Target=2015	Progress	Required	Pr(Success)[1]	Pr(Success)[2]
1. Eradicate Extreme Poverty and Hunger							
a. Proportion of Families below:							
i. Subsistence threshold	20.4	10.2	10.2	-0.85		High	High
ii. Poverty threshold	30.9	24.4	19.9	-1.29	-0.37	High	Low
b. Proportion of Population below:							
i. Subsistence threshold	24.3	13.5	12.1	-0.90	-0.11	High	High
ii. Poverty threshold	45.3	30.0	22.6	-1.28	-0.61	High	Low
c. Prevalence of malnutrition among 0-5 yrs old children, international standards	34.5	24.6	17.2	-0.66	-0.74	High	Medium
d. Prevalence of malnutrition among 0-5 yrs old children, poverty threshold	69.4	56.9	34.7	-1.25	-1.85	High	Medium
2. Achieve University Primary Education							
a. Elementary participation rate	85.1	84.4	100.0	-0.05	1.37	Low	Low
b. Elementary cohort survival rate	68.6	69.9	81.0	0.09	1.48	Low	Low
c. Elementary completion rate	66.5	67.9	81.0	0.11	1.30	Low	Low
3. Improve Material Health, mortality ratio	209.0	162.0	52.2	-3.62	-12.2	Low	Low
4. Increase Access to Reproductive Health Serv, couples practicing responsible parenthood	40.0	50.6	80.0	0.82	3.27	Low	Low
5. Reduce Child Mortality							
a. Under 5 mortality rate (per 1,000 live births)	80.0	32.0	26.7	-3.00	-0.59	High	High
b. Infant mortality rate (per 1,000 live births)	57.0	24.0	19.0	-2.10	-0.56	High	High
6. Combat HIV/AIDS, Malaria, Others							
a. HIV prevalence	< 1.0	< 1.0	< 1.0			High	High
b. Malaria morbidity rate (per 100,000 pop)	123.0	59.0	24.0	-4.57	-5.83	High	Medium
7. Ensure Environmental Sustainability							
a. Households with access to safe drinking water	73.0	80.2	86.8	0.50	0.60	High	Medium
b. Households with sanitary toilet facility	67.6	86.2	83.8	1.33	0.22	High	High

Sources: UNDP Philippines Online and NEDA (2009)
Notes: 1 = government score; 2 = UN statistics score