

# **THE PHILIPPINES' CONTINUING QUEST FOR FISCAL STABILITY<sup>1</sup>**

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# **Philippines**

## **THE PHILIPPINES' CONTINUING QUEST FOR FISCAL STABILITY**

### **INTRODUCTION**

1. As with most developing countries, the Philippines faces the challenge of overcoming serious problems in its continuing quest for fiscal stability that will pave the way for economic growth. Recent developments indicate that the country is meeting head-on the challenges as evidenced by its 7.5% growth in the second quarter of 2007, the highest in more than two decades.

### **SOME BASIC FACTS AND FIGURES**

2. The Philippines is an archipelago located in Southeast Asia with Indonesia and Taipei, China as its closest neighboring countries. It is composed of more than 7,000 islands covering a land area of about 340,575 sq. kms. The Philippine population is estimated at 87 million in 2006 with 80% of the people practicing Roman Catholicism. The city of Manila is its capital and Filipino and English are the official languages.
3. The Philippines has a republican/presidential form of government with a legislature called Congress of the Philippines divided into the Senate and the House of Representatives. Judicial power is vested in the Supreme Court and the lower courts. The Philippines is a founding and active member of both the United Nations and the Association of Southeast Asian Nations (ASEAN).
4. The Philippine economy has steadily grown in recent years with GDP averaging an annual growth of 5.15% from 2004 to 2006 and GNP at 5.75% for the same period. The bulk of the GDP-GNP was provided by the service sector, 43.9%; followed by the industry sector, 29.8% and the agriculture, fishery and forestry sector, 17.1%. The remaining 9.2% was contributed by Net Factor Income from Abroad (NFIA). At 2006 current prices, Philippine GNP was ₱6,570.3 billion (US\$ 142.8 billion) while GDP was ₱6,032.6 billion (US\$131 billion). Per capita income is approximately ₱75,520 or US\$1,640.

**GROSS NATIONAL PRODUCT AND GROSS DOMESTIC PRODUCT  
BY INDUSTRY: 2002-2006  
(At Current Prices)**

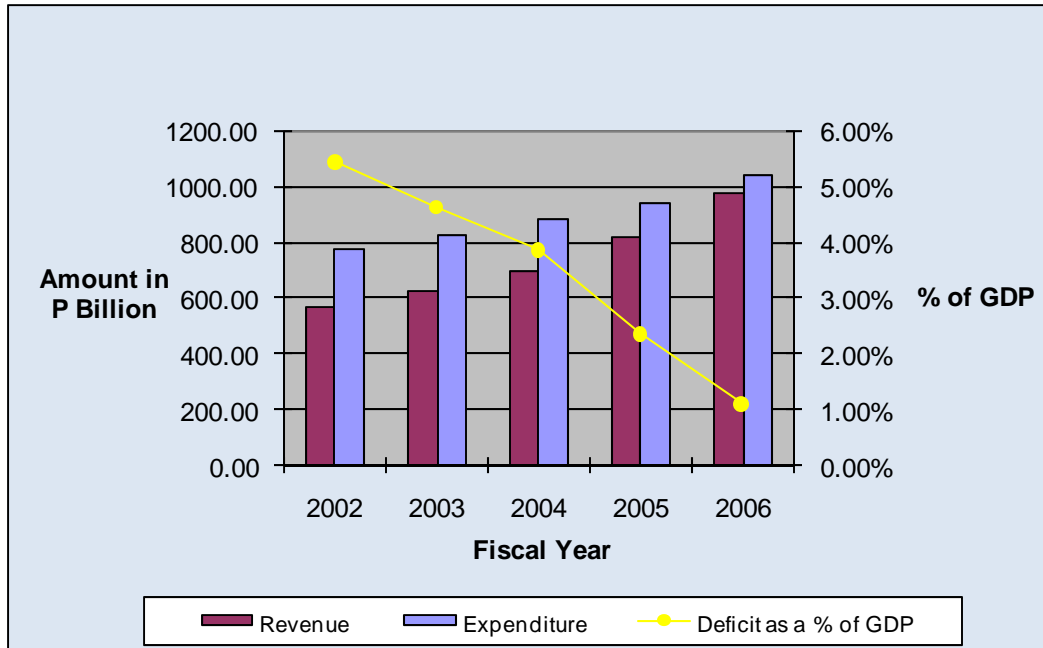
Particulars	Amount (In Billion Pesos)					Ave. % Dist.	Growth Rate				
	2002	2003	2004	2005	2006		2002-2003	2003-2004	2004-2005	2005-2006	Ave.
<i>Agriculture, Fishery and Forestry</i>	518.2	632.0	733.1	780.1	855.5	14.31%	22.0%	16.0%	6.4%	9.7%	13.5%
<i>Industry Sector</i>	1,261.6	1,378.9	1,536.5	1,735.1	1,908.0	31.90%	9.3%	11.4%	12.9%	10.0%	10.9%
<i>Service Sector</i>	2,103.4	2,305.6	2,589.3	2,922.7	3,269.2	53.73%	9.6%	12.3%	12.9%	11.9%	11.7%
<b>Gross Domestic Product (GDP)</b>	<b>3,883.2</b>	<b>4,316.4</b>	<b>4,871.6</b>	<b>5,437.9</b>	<b>6,032.6</b>	<b>92.86%</b>	<b>11.2%</b>	<b>12.9%</b>	<b>11.6%</b>	<b>10.9%</b>	<b>11.6%</b>
<i>NFI (Net Factor Income)</i>	255.0	315.1	376.4	447.1	537.7	7.19%	23.6%	19.5%	18.8%	20.3%	20.5%
<b>Gross National Product (GNP)</b>	<b>4,138.2</b>	<b>4,631.5</b>	<b>5,235.2</b>	<b>5,885.1</b>	<b>6,570.3</b>	<b>100.05%</b>	<b>11.9%</b>	<b>13.0%</b>	<b>12.4%</b>	<b>11.6%</b>	<b>12.3%</b>

## THE PHILIPPINE FISCAL SITUATION

5. In terms of the country's fiscal performance, both revenues and expenditures increased from 2002 to 2006. What is notable is that the deficit continued to drop from 5.43% of GDP in 2002 to 1.07% in 2006 as revenue collection registered significant increases especially in 2005 (17%) and 2006 (20%) while expenditures were contained from 20.03% of GDP in 2002 to 17.3% in 2006.

**FISCAL PERFORMANCE: 2002-2006  
(₱ billion)**

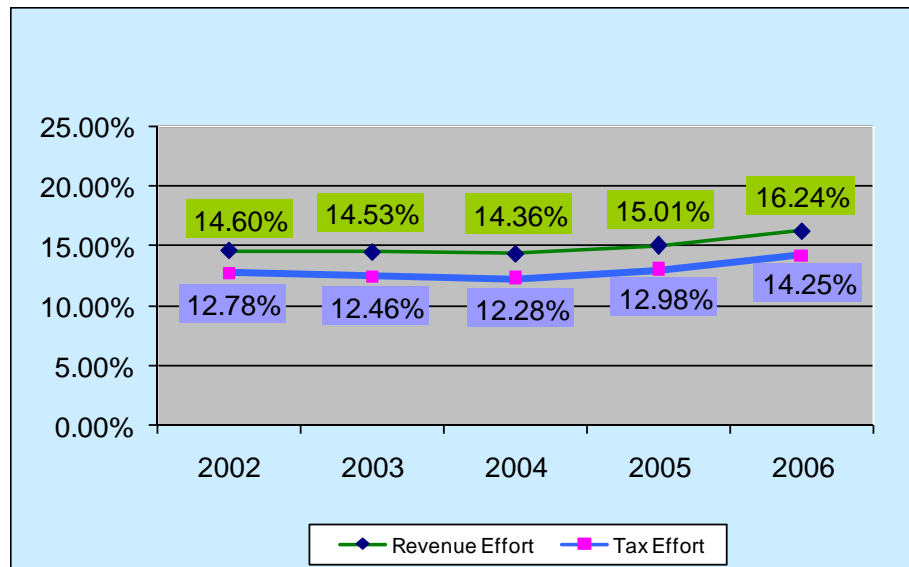
Particulars	2002	2003	2004	2005	2006
Total Revenue	567.14	627.29	699.77	816.16	979.64
<i>% of GDP</i>	14.60%	14.53%	14.40%	15.06%	16.33%
Total Expenditure	777.88	826.5	886.82	942.24	1,044.43
<i>% of GDP</i>	20.03%	19.15%	18.25%	17.39%	17.41%
Surplus/Deficit	(210.74)	(199.21)	(187.05)	(126.08)	(64.79)
<i>% of GDP</i>	-5.43%	-4.62%	-3.85%	-2.33%	-1.08%



6. Revenue effort or the ratio of revenue to GDP slightly declined from 2002 to 2004 (14.60% to 14.36%). It then showed some improvements in 2005 and 2006 at 15.01% and 16.24%, respectively. Tax effort, on the other hand, or the ratio of tax collection to GDP also registered a downward trend from 2002 to 2004. It then showed increases in 2005 and 2006 with a markedly improved tax effort of 14.25% in 2006.

**REVENUE AND TAX EFFORT:  
2002-2006**

Particulars	2002	2003	2004	2005	2006
Total Revenue (P Billion)	567.14	627.29	699.77	816.16	979.64
Revenue Effort (%)	14.60%	14.53%	14.36%	15.01%	16.24%
Total Tax Revenue (P Billion)	496.37	538.02	598.01	705.61	859.86
Tax Effort (%)	12.78%	12.46%	12.28%	12.98%	14.25%



7. In comparison with the other ASEAN countries, the Philippines did not do very well in terms of revenue and tax effort. Taking the average ratios for the period 2001 to 2005, the Philippines ranked 7<sup>th</sup> in revenue effort and 6<sup>th</sup> in tax effort.

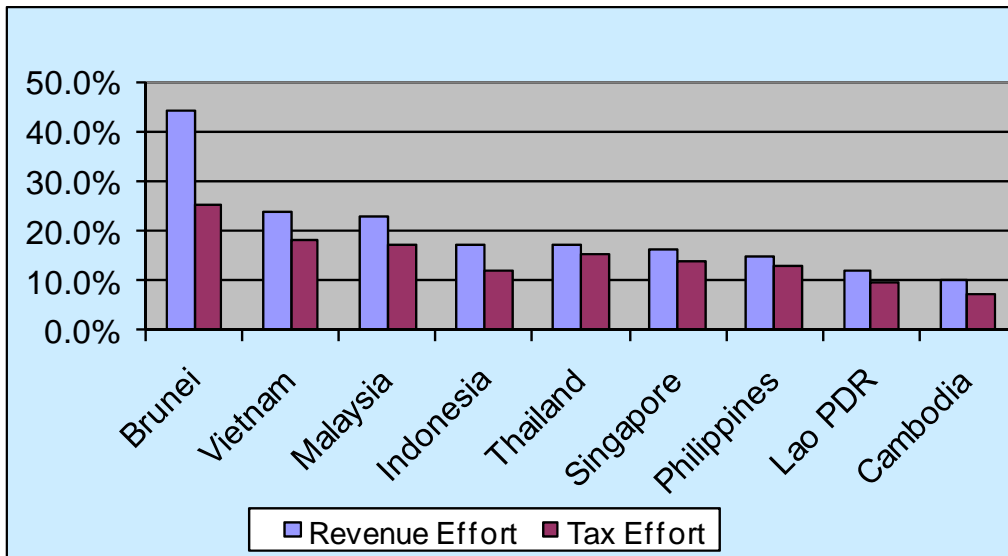
**COMPARATIVE REVENUE EFFORT OF ASEAN COUNTRIES:  
2001-2005**

Country	2001	2002	2003	2004	2005	Average	Rank
Brunei	42.2%	40.8%	43.3%	46.2%	49.9%	44.5%	1
Vietnam	21.2%	22.3%	24.5%	26.3%	25.6%	23.8%	2
Malaysia	23.8%	23.1%	23.4%	22.1%	21.7%	22.8%	3
Indonesia	17.8%	16.0%	16.7%	17.7%	18.1%	17.3%	4
Thailand	15.1%	16.1%	17.1%	18.5%	18.6%	17.1%	5
Singapore	19.7%	16.0%	15.3%	14.5%	14.5%	16.0%	6
Philippines	15.5%	14.6%	14.5%	14.4%	15.1%	14.8%	7
Lao PDR	13.2%	13.1%	10.4%	10.6%	11.1%	11.7%	8
Cambodia	9.8%	10.3%	9.5%	10.0%	9.8%	9.9%	9

**COMPARATIVE TAX EFFORT OF ASEAN COUNTRIES:  
2001-2005**

Country	2001	2002	2003	2004	2005	Average	Rank
Brunei	23.0%	22.3%	22.8%	26.7%	30.9%	25.1%	1
Vietnam	15.8%	16.8%	19.3%	19.3%	19.8%	18.2%	2
Malaysia	18.4%	18.5%	16.4%	16.0%	15.5%	17.0%	3
Indonesia	11.0%	11.3%	11.8%	12.2%	12.7%	11.8%	7
Thailand	13.5%	14.4%	15.3%	16.7%	16.5%	15.3%	4
Singapore	16.4%	13.6%	12.8%	12.5%	13.0%	13.7%	5
Philippines	13.5%	12.8%	12.5%	12.3%	13.0%	12.8%	6
Lao PDR	10.7%	10.6%	8.5%	9.0%	9.1%	9.6%	8
Cambodia	7.0%	7.3%	6.7%	7.5%	7.5%	7.2%	9

**COMPARATIVE REVENUE AND TAX EFFORT OF ASEAN COUNTRIES:  
2001-2005**



8. Total government revenues increased from P567 billion in 2002 to P980 billion in 2006 with an annual average growth rate of 14.7%. The bulk (87%) of total revenue comes from taxes while the remaining 13% comes from non-tax sources.

**COMPOSITION OF PHILIPPINE REVENUE  
(TAX AND NON-TAX REVENUE): 2002-2006  
(In P Billion)**

Particulars	2002	2003	2004	2005	2006	Ave % Dist	Ave. GR
Total Revenue	567.14	627.29	699.76	816.16	979.65	100.00%	14.71%
Tax Revenue	496.37	538.02	598.01	705.62	859.87	86.66%	14.85%
Non-Tax Revenue	70.77	89.27	101.75	110.54	119.78	13.34%	14.28%

9. As regards the composition of tax revenues, about 44% comes from income taxes with the value added tax contributing about 30%. Excise taxes and customs duties contribute about 8% each to total collection while other percentage taxes and other minor taxes contribute the remaining 9% of collection. It will be noted that the VAT showed a hefty increase in 2006 (more than 60%) due to the full implementation of the most recent amendments to the VAT which were the expansion of the VAT coverage to include oil and electricity and the increase of the rate from 10% to 12% in February 2006.

**REVENUE COLLECTION BY MAJOR TYPE OF TAX  
(in P billion)**

Particulars	2002	2003	2004	2005	2006	Ave. % Dist. (2006)
Type of Tax/ Total	490.8	532.08	590.65	697.27	850.91	100%
Income Taxes	226.51	244.13	278.21	323.43	376.99	44.30%
VAT	115.31	135.29	139.01	156.67	259.89	30.50%
Excise Tax	66.97	68.79	76.53	76.42	69.01	8.10%
Customs Duties	36.54	41.41	46.36	71.15	68.46	8.00%
Other Percentage Taxes	24.02	18.89	27.95	34.47	37.95	4.50%
Other Taxes	21.45	23.57	22.5	35.13	38.61	4.50%

## **RECENT DEVELOPMENTS IN TAX POLICY AND ADMINISTRATION**

10. Some of the recent major tax legislation and policy reforms includes Republic Act (RA) 9334 or what is generally called the “New Sin Tax Law” which became effective on January 1, 2005. The law increased the excise tax rates on alcohol and tobacco products.
11. RA 9335 or the Attrition Act of 2005 (approved on January 25, 2005) provides for a system of rewards, incentives and sanctions to encourage Bureau of Internal Revenue and Bureau of Customs officials and employees to perform beyond their revenue targets. Those who exceed their revenue goals get to share a certain amount from the excess collection while those who fall short of their targets beyond a certain level can be dismissed from service. A problematic issue with this law is the setting and allocation of revenue targets among the revenue officials.
12. On November 12, 2005, amendments to the existing VAT law were implemented through RA 9337. Among the amendments introduced by the “Reformed VAT Law” was the broadening of the VAT base by including previously exempt sectors such as power, fuel, transport and medical and legal services in the ambit of the VAT. The law also increased the VAT rate from 10% to 12%, the increase to be triggered by certain factors. The increase became effective in February 2006. RA 9337 also provided mitigating measures to soften the impact of the VAT on certain petroleum products by either lowering the excise tax rate or reducing it to zero for these socially sensitive products such as kerosene and diesel oil. Finally, the law also temporarily increased the corporate income tax rate from 32% to 35% beginning July 1, 2005 but it is as well provided that the rate will be reduced to 30% starting 2009.
13. In a move to enhance environmental protection, the Philippine Congress has passed on January 12, 2007 RA 9367 or the Biofuels Act of 2006. The law mandates the use of biofuels as a measure to develop and utilize indigenous renewable and sustainably-sourced clean energy sources and reduce the country’s dependence on imported oil. The tax incentives given are 0% specific tax on local or imported biofuel components and exemption from VAT of the sale of raw materials used in the production of biofuels.
14. The most recent tax law passed was RA 9480 or the Tax Amnesty Law. It was approved on May 24, 2007. The law seeks to improve revenue administration and collection by granting amnesty on all unpaid internal revenue taxes imposed by the national government for taxable year 2005 and prior years. In return for the payment of an amnesty tax, the taxpayer will enjoy immunity and be freed from civil, criminal and administrative liabilities under the Tax Code. But the law requires all those who will avail themselves of the tax amnesty privilege to submit

a Statement of Assets, Liabilities and Net Worth (SALN) which hopefully, will form part of the BIR's taxpayer database that can help improve tax enforcement activities in the future.

15. In the area of tax administration reforms, the priority thrust is to enhance the audit program by implementing the use of computer assisted audit tools and maximizing the potentials of the RELIEF program. RELIEF (Reconciliation of listings for Enforcement) is a system that requires business entities to submit to the BIR a list of their sales and purchases to enable the Bureau to match the data on sales provided by the suppliers with the data on purchases provided by the buyers. This matching technique discloses large discrepancies in sales and purchases which can provide the BIR a basis to assess and collect substantial deficiency income tax and value-added tax from many taxpayers. Another audit tool that will be pursued is the matching of income payments of withholding agents with the reported income of recipients. Industry profiling and benchmarking will likewise be undertaken to serve as guide for the selection of firms that will undergo intensive audits.
16. Intensifying tax enforcement activities will involve pursuing vigorously the prosecution of tax evaders under the government's "Run After Tax Evaders" program or RATE. Under RATE, the BIR zeroes in on high-profile personalities who have evaded their taxes and conducts highly-publicized investigations to maximize their symbolic and psychological impact on the tax paying public. There shall also be improved surveillance of establishments and more effective use of business intelligence. To address the serious problem of smuggling particularly of certain exciseable products, the BIR will use fuse-on stamps on cigarettes and labels on alcohol products and implement marker dye on petroleum products.
17. Another administrative strategy is to continuously improve the BIR's tax computerization program. This program calls for an integrated tax system with a standard processing framework designed to increase revenue collections, improve taxpayer service, promote better taxpayer compliance and improve operational efficiency and transparency. The integrated tax system is a set of related systems and processes that provides maximum automation and minimum manual intervention.
18. To be likewise given priority is the broadening of the taxpayer database by cleansing existing records and developing a single registry of taxpayers. Taxpayer profiles will be updated and there will be tax mapping of inactive taxpayers/stop filers.
19. Third party information shall be maximized as the BIR embarks on an information sharing program on taxpayers' data through linkages with other government agencies. The matching of BIR records with Bureau of Customs records will likewise be undertaken.

20. Finally, the BIR will improve its arrears management by cleaning up its accounts receivables and actively pursuing the liquidation of forfeited properties. All the foregoing measures and strategies are designed to substantially improve the collection of revenues.

## **PROSPECTS FOR THE FUTURE**

21. The present administration has announced that there will be no new taxes in the near future but the government will continue to pursue certain tax policy reforms. Among these policy reforms is the rationalization of fiscal policy incentives which have exacted a great toll on the government's ability to generate revenue. Studies show that billions of pesos were lost with the proliferation of tax incentive laws. The plan is to radically reduce these incentive laws and retain only those that are key to improving the Philippines' competitive advantage over its neighboring countries.
22. There is no plan to simplify the individual income tax structure to improve compliance and to exempt from tax minimum wage earners. The present imbalance in the respective contributions of fixed income earners and the self-employed and professionals to the total income tax take will also be addressed by adopting measures that will ensure a bigger contribution from the professionals and self-employed.
23. With the implementation of the recent tax laws and policy amendments and the continued improvements in tax administration, the Philippines hopes to attain some measure of fiscal stability in the next two or three years. The government is sticking to its plan to balance the budget by 2008 or 2009 at the latest, and barring any unforeseen event or circumstance, indications are that this can be achieved.