BUILDING BACK TOWARDS INCLUSIVE GROWTH WITH INNOVATIVE PUBLIC SECTOR GOVERNANCE
BUILDING BACK BETTER TOWARDS INCLUSIVE GROWTH WITH INNOVATIVE PUBLIC SECTOR GOVERNANCE

The Philippine economy recovered with 5.7 percent growth in 2021 from a slump of 9.5 percent in 2020 primarily caused by the necessary measures taken to manage COVID-19. Apart from the need to sustain this recovery even with the surge in the public debt ratio from 39.6 percent in 2019 to 60.5 percent in 2021, there will be two major shifts in public sector governance in the Philippines in 2022, namely: (1) the transition to a new administration, and (2) the implementation of the Mandanas-Garcia Supreme Court decision (or Mandanas ruling). The Mandanas ruling broadens the base of the computation of intergovernmental fiscal transfers to local governments (LGUs), currently known as the national tax allotment (NTA). Given the impact of the Mandanas ruling on fiscal space, and combined with the increased public debt ratio, the new administration and local officials need to strategically coordinate investments and spending to help the economy outgrow debt and sustain economic recovery.

Sustained inclusive growth is dependent on good governance and the participation of the public and private sector (and its hybrid). Innovative governance is also needed to pave the way for improved public goods and services delivery. Innovative governance can therefore make an impact in many ways given the breadth of governance’s definition.

This paper surveys recent literature and presents prospects and challenges of the new administration with the aim of answering the question “How can the Philippines build back better towards inclusive growth with innovative public sector governance?” Recommendations focus on three areas of public sector governance. This paper accentuates the need for institutional and collaborative innovation investments in human capital, especially in improving the technical capacities of workers, in data and information systems and digitalization that are equally vital to the effective and efficient delivery of public services.
PHILIPPINE NATIONAL GOVERNMENT FISCAL POSITION

The fiscal impact of COVID-19 pandemic was the widening of the primary and consolidated public sector deficits (to 5.5%), the acceleration of national government spending (by 11.3% in 2020) due to fiscal packages (e.g., Bayanihan I and II), and the rise of fiscal deficit as share of GDP from 3.4 to 7.6 percent (Figure 1).

This large fiscal deficit caused a significant increase in government borrowing (debt as percent of GDP increased from 39.6% in 2020 to 60.5% in 2021) as seen in Figure 2. The need for fiscal stimulus will also continue in 2022 with the Department of Budget and Management (DBM) estimating a net financing requirement of 7.5 percent of GDP (or PHP 1.665 trillion) in 2022 (Table 1).

![Figure 1: Primary Balance, Fiscal Balance, and Consolidated Public Sector Balance](source: Debuque-Gonzales et al. (2022))

![Figure 2: Debt to GDP Ratio](1981-2022)

![Table 1: National Government Financing](2020-2022)

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Foreign Borrowing</th>
<th>Net Domestic Borrowing</th>
<th>Total Net Financing</th>
<th>Requirement/Deficit (as % of GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>600,759</td>
<td>1,894,321</td>
<td>1,371,447</td>
<td>3.2%</td>
</tr>
<tr>
<td>2021</td>
<td>332,526</td>
<td>1,940,565</td>
<td>1,855,645</td>
<td>1.6%</td>
</tr>
<tr>
<td>2022</td>
<td>421,364</td>
<td>1,910,223</td>
<td>1,665,089</td>
<td>1.9%</td>
</tr>
</tbody>
</table>

Memo item:
Nominal GDP: 18,856,315, 20,642,291, 22,080,772

Source: DBM (Various Years)
DEBT SUSTAINABILITY

Though the Philippines has had fiscal deficits for most of the past 40 years (except for 1995 to 1997 before the Asian Financial Crisis), this current debt episode is different since it was due to an economic slowdown resulting from measures to control the spread of COVID-19 (collapsing national government revenues by 9%) and of the need for government to increase spending on health, social protection, and infrastructure (Figure 3).

Unlike previous debt shocks, this current one is not due to: (1) high external debt and interest rate shocks (like in the 1980s); (2) national government absorbing hidden deficits of poorly performing public sector entities (in the late 1980s to early 1990s); and (3) declining tax and revenue effort (in the mid-2000s). It is instead the result of (1) a large exogenous shock to growth and revenues, and (2) the government’s precautionary move of accumulating cash reserves.

A debt sustainability analysis done by Debuque-Gonzales et al. (2022)—which adopted the standard debt sustainability analysis and publicly available template of the International Monetary Fund (IMF) to compute public debt dynamics in the Philippines—determined that public debt will peak in 2023 (66.8%). The same study (Debuque-Gonzales, et al., 2022) shows that—assuming the country will make efforts toward fiscal consolidation that will result in having less of a need for substantial new debt—the country will have and maintain a 1.7 percent primary deficit from 2024 to 2027 (Figures 4a and 4b). This shows that returning to pre-pandemic levels in the medium-term is not feasible, but debt is still manageable and sustainable.
**PROSPECTS FOR THE NEW ADMINISTRATION**

Pursuing fiscal consolidation and resource mobilization programs may help to: (1) continue productive spending, (2) the Philippine economy outgrow the pandemic-induced debt; and, (3) provide substantial buffers to respond to lingering and future economic shocks (Department of Finance [DOF], 2022). The new Marcos administration has, to its advantage, the reformed tax system and reforms in decades old laws that encourage more foreign investments. The TRAIN and CREATE laws are both intended to increase national income by triggering consumption spending (by increasing disposable income for households) and investments (by lowering corporate income taxes).

**TAX REFORMS**

Section 2 above states how the current debt episode is different from previous experiences in the Philippines. Figure 5 shows the status of the tax effort before the pandemic, and this further indicates that there is a presence of strong economic fundamentals through a more flexible tax system with reforms that are already in place (Table 2).

In consideration of the improvements brought about by these tax reform laws (until the COVID-19 pandemic), the immediate goal of the DOF is to sustain growth and solve tax problems by focusing on tax administration to improve collection (Diokno, 2022). Digitalization is seen as a possibility as to how this can be improved.

Changes to the tax structure is not seen as an immediate priority aside from the two residual packages from the previous administration (i.e., Packages 3 and 4 above) which the Marcos administration will continue to support (Diokno, 2022). However, there were preliminary proposals of the outgoing Duterte administration that were later approved and implemented.

![Figure 5](image-url)

**FIGURE 5. REVENUES AND EXPENDITURES AT POINT OF TAX REFORMS**

Source: Debuque-Gonzales et al. 2022

**TABLE 2. COMPREHENSIVE TAX REFORM PROGRAMS, 2016 TO 2022 ADMINISTRATION**

<table>
<thead>
<tr>
<th>Comprehensive Tax Reform Program</th>
<th>Salient Points</th>
<th>Status (Passed Into Law/Remaining Bill In Congress)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Package 1: TRAIN law</td>
<td>Higher consumption tax</td>
<td>Passed into law on 19 December 2017</td>
</tr>
<tr>
<td>Package 1B: Tax Amnesty Act</td>
<td>Improve taxpayers’ compliance rate to increase revenue</td>
<td>Passed into law on 14 February 2019</td>
</tr>
<tr>
<td>Package 2: CREATE law</td>
<td>Tax relief and tax incentives for businesses</td>
<td>Passed into law on 26 March, effective on 11 April 2021</td>
</tr>
<tr>
<td>Package 2+: RA 11346 &amp; RA 11467, or sin taxes</td>
<td>Increase excise tax on tobacco, alcohol, heated tobacco products and e-cigarettes</td>
<td>RA 11346 passed into law on 04 June 2019, effective on 01 January 2020; RA 11467 passed into law on 22 January 2020</td>
</tr>
<tr>
<td>Package 2+: Mining taxes</td>
<td>Impose royalty on all metallic and non-metallic minerals, small- and large-scale mines</td>
<td>House Bill (HB) 8400 approved on 3rd and final reading last 12 November 2018</td>
</tr>
<tr>
<td>Package 3: Real Property Valuation Reform</td>
<td>Adopt internationally accepted valuation standards and professionalize real property valuation</td>
<td>Passed on third and final reading last 25 November 2019</td>
</tr>
<tr>
<td>Package 4: PIFITA</td>
<td>Simplify and harmonize the taxation of passive income, financial services, and transactions</td>
<td>HB 304 passed and approved on 3rd and final reading on 9 September 2019</td>
</tr>
<tr>
<td>Motor Vehicle User’s Charge</td>
<td>Impose unitary rate based on weight for all vehicles</td>
<td>RA 11239 approved 08 March 2019</td>
</tr>
</tbody>
</table>

Source: (DOF, n.d.)
administration for initiatives to improve fiscal consolidation and resource mobilization from 2023-2025 which the new administration is still reviewing (Table 3).

| Package 1: 2023 Implementation | Deferment of TRAIN personal income tax reduction  
| Expansion of the VAT base and possible VAT rate reduction  
| Repeal of the immediate expending of input VAT on capital goods  
| Imposition of VAT on digital service providers  
| Reform on the Motor Vehicle Users’ Charge (MVUC)  
| Repeal of the excise tax exemption of pick-ups and imposition of excise tax on motorcycles  
| Rationalization of the mining fiscal regime  
| Imposition of taxes and charges on gaming  
| Excise tax on single-use plastics  
| Excise tax on luxury goods  
| Real Property Valuation and Assessment Reform Act  
| Passive Income and Financial Intermediary Taxation Act  
| Strengthening of tax administration for income tax on social media influencers (administrative issuance) |

| Package 2: 2024 Implementation | Reform on health taxes (Alcopops, cigarettes, e-cigarettes, sweetened beverages, and non-nutritious food)  
| Indexation of the petroleum excise tax and excise tax reform on coal and repeal PD 972  
| Tax on cryptocurrencies  
| Transfer pricing (administrative issuance) |

| Package 3: 2025 Implementation | Carbon tax |

In connection to what was mentioned above, monetary policy that keep interest rates low and encourage investments will likewise result in expanding the economy. New laws that encourage more foreign direct investments are seen in Table 4.

<table>
<thead>
<tr>
<th>Republic Act</th>
<th>Title</th>
<th>Salient Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>RA 11534</td>
<td>Shall be known as the Corporate Recovery and Tax Incentives for Enterprises Act (CREATE)</td>
<td>Lowers corporate income taxes and introduces fiscal incentive reforms</td>
</tr>
<tr>
<td>RA 11595</td>
<td>An act amending RA 8762 (Retail Trade Liberalization Act of 2000)</td>
<td>Lowers required paid-up capital for foreign retail enterprises</td>
</tr>
<tr>
<td>RA 11647</td>
<td>An act amending the Foreign Investments Act</td>
<td>Eases the limitations/ restrictions to foreign investors by allowing non-Philippine nationals to do business or invest up to 100% of its capital (unless limited by certain provisions)</td>
</tr>
<tr>
<td>RA 11659</td>
<td>An act amending Commonwealth Act No. 146 (Public Service Act)</td>
<td>Allows for 100% foreign ownership of public services, except for some public utilities that remain subjected to the 40% ownership restriction</td>
</tr>
<tr>
<td>EO No. 175</td>
<td>Promulgates the twelfth regular foreign investment negative list</td>
<td>Promulgates the Twelfth Regular Foreign Investment List in accordance with the recent new laws on foreign ownership</td>
</tr>
</tbody>
</table>

Source: DOF (2022)
Current operating expenditures, with an average of 78.8 percent in the past 40 years, has been receiving the largest share of national government expenditures (Figure 6). Meanwhile, capital outlays had an average share of 19.6 percent of national government expenditures (from 1983 to 2021). The shares of capital outlays saw a recent increase due to the government’s Build, Build, Build infrastructure programs (Figure 6).

In terms of sectoral distribution, Figure 7 shows that the social services sector has been receiving the most shares since 1996 with an average of 29.4 percent of national government annual expenditures (followed by the economic services [25.7%] and general public services [17%]). The bulk of the shares of this sector are for education, culture and manpower development (ECM) (averaging 54.5% for the past 40 years). Shares for ECM have decreased in recent years with the increased shares of Social Security and Labor Welfare sub-sector (Figure 8). 2019 also saw the shares of Subsidy to LGUs increasing and surpassing health expenditures (Figure 8). This increase led to the decrease of the expenditures for communications, roads, and other transportation (CRT) and the agriculture, agrarian reform and natural resources (AAN) (Figure 9). This was due to the implementation of the Mandanas ruling.

Moving forward, investment in both human capital and infrastructure should continue. In line with endogenous growth theory—which argues that continuous investments in human capital increases productivity and leads to sustainable economic growth (Barro & Sala-i-Martin, 2004; Mankiw, 2019)—efforts that address the economic scarring of the poor and vulnerable must be strengthened.

The recommended push for the continuation of the increase of infrastructure spending is justifiable considering its impact of...
increasing incomes in the short-run and the built infrastructure encouraging business investments and tourism in the long-term. These prioritizations on spending should be continued to further jumpstart the economy.

CHALLENGES FOR THE NEW ADMINISTRATION

MACRO-FISCAL SHOCKS

Despite these prospects, the new administration would have to deal with different challenges that may derail the steady improvement of the Philippine economy. These challenges come in the form of various macro-fiscal shocks and other debt sustainability risks.

The study by (Debuque-Gonzales, et al., 2022) that tackled debt sustainability used various stress tests and came out with results that show that the country is vulnerable to different macro-fiscal shocks and other debt sustainability risks.

In particular, the Philippines is most vulnerable to real GDP growth shocks. The COVID-19 pandemic is one example of an experience that can lead to this. The country may also face primary balance shocks due to a sudden need for increased government spending (e.g., from effects of natural disasters), real exchange rate shocks that would affect the cost of foreign debt servicing (e.g., if remittances increase resulting from increased global economic activity) and, real interest rate shocks (e.g., when higher market yields put pressure on debt servicing).

Aside from the sustainability risks above, the country may also face issues that can be caused by the reforming of the military and uniformed personnel pensions, net losses of PhilHealth, aggregate

![Figure 8: Social Sector Expenditures Distribution in Percent (1983-2022)](image_url)

![Figure 9: Economic Sector Distribution in Percent (1983-2022)](image_url)
demand risks, cybersecurity. The Mandanas ruling also poses a significant risk given its effects on the government’s fiscal space.

**EFFECTS OF THE MANADANAS RULING ON THE NATIONAL BUDGET**

The immediate impact of the Mandanas ruling on the government budget was a reduction of fiscal space. As a share of NG expenditures NTA (formerly known as Internal Revenue Allotment [IRA]) has averaged 16.3 percent for over more than a decade (Figure 10). In 2022, there was a 38 percent increase of PHP 263.5B, totaling PHP 959 billion, almost 20 percent of the 2022 PhP 5.024 Tr budget, about 4 percent of GDP.

To recover fiscal space, NG-LGU support programs were reduced and poorer LGUs were prioritized. With this increase in intergovernmental transfers, the Mandanas ruling also led to the need to devolve certain functions to LGUs. As a result, the national government’s budget for NG-LGU support programs have declined by 29 percent (Table 2). Local Government Support Programs also declined by 36 percent while the Basic Infrastructure Program declined by 27 percent (Table 5).

Local governments contribute an average of 3.7 percent to GDP from 2009 to 2020 (Figure 11). Furthermore, local sources—which are part of local government income—only averaged 1.2 percent of GDP. LGUs have thus been dependent on external sources given that LGUs spend more than what they obtain from local sources. The bulk of these external sources are from IRA/NTA (Figure 12), which falls under the government’s Allocations to Local Government Units (ALGUs).

Nonetheless, LGUs, with their increased funding, may also contribute to economic recovery if there is strategic fund utilization.
through: a) strengthened identification and prioritization of investment programs, b) investments encouraged across different LGUs, c) ensuring LGUs spend on prioritized investment programs, and d) alignment with NG for strategic use of funds. One of the challenges here is that LGUs do not spend the mandated amounts of their local development fund (LDF, mandated to be 20 percent of annual IRA/NTA). What this means is delayed development and growth in an LGU and has been attributed to low absorptive capacities of LGUs, especially in terms of infrastructure (Commission on Audit, 2018).

The enhancement of local revenue generation will also lead to economic recovery given that this may lead to LGUs no longer depending on intergovernmental fiscal transfers. Lastly, innovations in service delivery, which increased during the pandemic, should be continued.

INSTITUTIONAL AND CROSS-CUTTING INNOVATIONS IN PUBLIC SECTOR GOVERNANCE

This section focuses on other needed reforms in public sector governance that may support the proposed recommendations for national and local governments. Also discussed is the role of the private sector in sustaining and ensuring inclusive growth.

DIGITALIZATION

Digitalization offers many opportunities to enhance public sector governance if it can be maximized. The Philippine government has been making efforts to make use of the benefits that come with digitalization. This includes adopting the Government Information Transition Plan (GISP), which is a framework and guide to computerize services and operations to improve governance. A
decade after its introduction, the GISP was eventually updated by the E-Government Master Plan (EGMP) and then by the Medium-Term Information and Communication Technology Harmonization Initiative (MITHI). MITHI seeks to promote a systemic process that ensures that ICT-related efforts across the government are harmonized.

However, challenges that have existed since the introduction of E-government in the Philippines remain. The COVID-19 pandemic highlighted the issues with the effective use of digitalization in the country. This is evident in the use of the Philippine Identification System (PhilSys)—which aims for a singular system for national identification—that faced issues brought about by the current ICT infrastructure and data privacy concerns. The deficiencies in ICT infrastructure are due mainly to the: a) lack of hardware, b) inoperability or incompatibility across government agencies, c) lack of available developers, d) the need to enhance the technological skills of the developers, and e) lack of participation from the private sector.

INFORMATION AS INNOVATIONS IN INSTITUTIONAL REFORMS

The strength of information has a huge impact on the analytical and decision-making capacities of the public sector. The success of policy interventions will be limited if it is based on outdated, fragmented, or missing information/systems.

The experience of the government in handling the COVID-19 pandemic showed that the public sector’s information systems are and have been insufficient. Data on citizens are either lacking, of poor quality, and in need of validation (Philippine Institute for Development Studies [PIDS], 2020). This led to difficulties faced by local governments in the distribution of the shares of qualified citizens from the Emergency Measures Program (EMP) and the Social Amelioration Program (SAP). Coordination regarding contact-tracing was also affected. Having effective information systems, such as through a database of the citizens, would have made for better contact-tracing and distribution of safety nets. However, beyond having sufficient data, relevant workers must also be able to have access to this data and have the capacity to apply this data to support their initiatives.

Digitalization can play a huge role in solving these issues but maximizing digitalization in the country requires a whole-of-society approach. This means that the private sector must be involved to be able to contribute to economic recovery.

INNOVATIONS IN COOPERATION

Innovations in cooperation are needed in making alternative arrangements to be able to provide and obtain public goods and services for all stakeholders. This involves not only cooperation between national and local government offices, but also inter-LGU (whether horizontal or vertical) collaboration for inclusive growth and development. Innovative cooperation may also be an essential aspect in having a more strategic and efficient use of the limited fiscal space caused by the Mandanas ruling.

Cooperation between the different levels of government (whether national or higher levels of LGUs) includes the role of higher levels of government in overseeing the different functions of constituent LGUs. A PIDS’ study (2020) identified that provincial governments rarely exercise their mandate to oversee component cities and municipalities. Diokno-Sicat et al. (2020) also identified that the improving the supervision of the national government (through the DILG) over local governments is an important factor, especially considering devolution and fiscal consolidation.

Inter-LGU cooperation should also be strengthened, especially with regard to the provision of devolved services known to have spillover effects across LGUs. In relation to the previous sections, LGUs need accessibility to data and capability to use it for regulatory reviews that aim to address overlaps and ambiguities to be able to provide for needed services across LGUs.

RECOMMENDATIONS FOR INSTITUTIONAL INNOVATIONS FOR PUBLIC SECTOR GOVERNANCE

- Given the importance of infrastructure and systems that aim to improve government online platforms for better services, it is recommended that MITHI be continued.
- It is also necessary to invest in human capital in terms of investing on the technical capacities of workers. This includes the improvement of skills and the ability to learn new technologies to prepare workers for the outcomes of the shift to digitalization and digital platforms.
- It is recommended that systems will be improved to aid the efficiency of payment systems. This can be aligned with the Bangko Sentral ng Pilipinas’ goal to convert 50% of total volume of retail payments to digital form, which is attainable if 70 percent of Filipino adults open transaction accounts for the digital payment system.
- The private sector should likewise be involved with businesses partnering with the government to come up with solutions to priority areas. Further improvements can be aligned with successful initiatives, such as with the I(individual) to I(individual) platform solutions utilized during the pandemic.
RECOMMENDATIONS

How can the Philippines build back better towards inclusive growth with innovative public sector governance?

• The national government should strategize fiscal consolidation while balancing the need for investments on infrastructure and human capital to recover the economy inclusively.

• LGUs should strategize how to use the adjusted intergovernmental fiscal transfers due to the Mandanas ruling to contribute to economic recovery. This can be done by strengthening development and investment planning, enhancing local revenue mobilization, and considering alternative arrangements for the provision of devolved goods and services (including inter-local arrangements or arrangements with the private sector).

• Implement institutional and governance innovations to invest in data and information systems and digitalization to make the delivery of public services timely and more efficient.

What is needed to do this?

• Continue innovations and reforms for public services delivery including the remaining tax reform proposals of the previous administration

• Fast track the implementation of the PhilSys Law (RA 11055) and the Free Internet Access in Public Places Act (RA 10929) and focus on other reforms in data and information for more efficient development planning, investment programming, and social protection targeting

• Engage with the private sector (especially given the limited fiscal space) for investments. For instance, streamlining regulatory frameworks can be done for the improvement of national and local public private partnerships.

• Capacitate all those involved under each recommendation.
ENDNOTES

1 The Research Fellow, Philippine Institute for Development Studies. The author acknowledges the valuable research assistance of Mr. Robert Hector G. Palomar and Ms. Lucita M. Melendez.
2 Based on aggregate demand theory, the fiscal and monetary policy may trigger economic growth, through lowering of taxes and/or increasing government expenditure for the former and through keeping interest rates low for the latter (Mankiw, 2019).
3 From Executive Order No. 265, s. 2000

REFERENCES

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