

Chapter 1

INTRODUCTION

Public expenditure has long been used as an instrument of State policy. The improvement in the well-being of citizens, development of the infrastructure and the promotion of structural change and economic growth have all been objectives of government policies. However, the whole issue of the role of the State is presently under review and reassessment across the world.

By tradition, the national government in the Philippines plays a dual development role. It provides the basic physical infrastructure to support its development strategies. In addition, it assumes the responsibility for providing services to raise the quality of human resources. Hence, the size and structure of the national government expenditure program reflects the extent to which these roles are effectively pursued.

Various theories have been developed in an attempt to account for the changing size and allocation of public expenditure in both developed and developing countries. A review of the proliferating literature reveals a wide range of explanations. Most empirical studies attempting to explain the growth of public expenditure are cross-country studies where the cross-section consists of a sample of Organisation for Economic Cooperation and Development (OECD) countries, with relatively little effort directed at developing nations. Moreover, it should be recognised that the causes or influences of the growth of public expenditure are multidimensional. These range from rising income levels, urbanisation, and population increases and market failures.

The explosive growth of public expenditure as a proportion of national income at all levels of economic development is alarming. Based on the empirical analysis of selected Asian countries, including the Philippines, Kohli (1987) concluded that while the government revenues of these countries increased at a rapid rate, expenditures increased at an even faster rate resulting in an overall budgetary deficit both in absolute terms and as a percentage of GDP. According to Manasan (1988), in the case of the Philippines, most of the country's public investment program has given rise to a serious reduction in maintenance and other operating expenditure and the rapid growth of unsustainable fiscal deficit.

Why then is the growth of public expenditure a concern? Considering the complexity of the topic, there are many possible reasons why this should be the focus of attention. Bristow (1986) highlights three major reasons for concern over public expenditure. Firstly, public expenditure raises concerns due to its effects upon the liberty of individual. In particular, public expenditure programs reduce freedom of choice since the taxes used to finance them are coercive by definition. Secondly, at the macroeconomic level, the financing problems brought about by the increase in the ratio of public spending to national income usually translates to overall budget deficit. Thirdly, at the microeconomic level, focus falls on the efficiency of public expenditure. There is a growing concern among economists that many public expenditure programs are not capable of meeting standard efficiency criteria.

1.1 Objectives of the Study

In the light of the above considerations, the primary objective of the study is to analyse the patterns and growth of public expenditure in the Philippines on the basis of empirical data and historical facts over the period 1965-95. A second goal is to examine the general causes or influences that have contributed to the growth of public expenditure. The appropriate level and structure of public

expenditure for the Philippines is a question that has long needed examination. It is hoped that the present study would shed light on the course of future government action in terms of expenditure priorities and institutional reforms.

Two major approaches are employed in analysing the growth of public expenditure in the Philippines. The first approach corresponds to Wagner's demand-oriented hypothesis which relies essentially on structural factors to explain government growth. It takes into account changes in society's economic and social structure as causal factors and hypothesises that factors such as the level of per capita income, the size and age composition of the population, and the stage of development which a country has reached are significant. The second method considers the historical (time-series) approach inspired by the works of Peacock and Wiseman (1967). It concerns with the time-pattern of expenditure growth and hypothesises that major expenditure shifts are brought about by a "displacement effect" due to major phenomena such as wars, depressions and other social upheavals. These approaches are redefined in this study in order to fit the situation prevailing in the Philippines.

1.2 Organisation of the Study

The study itself consists of five main chapters. Chapter 2 describes the Philippine institutional structure and includes the historical background, political framework and an overview of the Philippine economy. To make the analysis more meaningful, some comparisons are made with those of other Asian countries. Chapter 3 provides the review of related literature on the various theories and empirical evidence available on the growth of public expenditure both in developed and developing countries. Arguments about the relationship between public expenditure and economic growth are also examined. Chapter 4 sets out the theoretical framework adopted in the study. The purpose of this chapter is to explain in detail the hypotheses propounded by Wagner and those by Peacock and Wiseman. Chapter 5 highlights the scope and methods of analysis which include definitions of terms, measurement

issues and the specific measures adopted in this study. The empirical analysis and results are presented in Chapter 6. Chapter 7 provides a summary of findings and attempts to discuss the policy implications and recommendations for future government actions and institutional reforms.

Chapter 2

THE PHILIPPINE INSTITUTIONAL STRUCTURE

The Republic of the Philippines lies at the heart of the South East Asia. It is an archipelago extending south from Taiwan to Indonesia, off-shore from Vietnam. While the Philippines shares with its neighbours a common colonial background, the island nation's culture, political system and economy are different from, and in many ways out of step with, those of its fellow Asian countries.

This chapter represents an attempt to provide at least some insight into the Philippine institutional structure. It comprises four main parts. Section 2.1 provides a brief history of the Philippines. The political framework of the Philippines is outlined in Section 2.2. Section 2.3 presents an overview of the economy against the background of several other East Asian countries. Section 2.4 focuses on the trends in public expenditures and revenues. The chapter ends with some brief concluding remarks in Section 2.5.

2.1 Historical Background

The recorded history of the Philippines began after the discovery of its constituent islands by the Portuguese explorer Ferdinand Magellan in 1521. Later expeditions were conducted in the service of Spain's King Philip II, after whom the country was named. Spanish rule lasted from the 16th to the 19th centuries but was marked with a series of revolts as various groups of revolutionaries formed the Propaganda Movement that would later pave the

way for the Philippine Revolution (Philippine Government, 1997). The Spanish colonisers succeeded in introducing Christianity into the Philippines and the majority of the population converted to Catholicism, with a politically important Muslim minority in the far south. But as Spanish rule ended on June 12, 1898, American domination began. From 1900, the Filipinos found themselves controlled by America until the Japanese occupied the islands in 1942. In 1945, United States (US) forces liberated the Philippines and, in 1946, following three years of Japanese occupation during the Second World War, the US granted independence to the Philippines. Political independence was not immediately followed by economic and cultural independence. Close economic ties between the Philippines and the US persisted in terms of trade and investment. Moreover, political links have remained strong with the Philippine foreign policy still closely aligned with that of the US. During the period of American control, the US authorities introduced the machinery of democratic government, civil liberty, public health and education, and a Bill of Rights ensuring freedom of speech, press and movement (Fegan and Purcal, 1993).

2.2 Political Framework

The Constitution under the Marcos administration, which was drafted under Martial Law, received ratification in 1973 from Citizens' Assemblies throughout the Philippines. The Constitution conferred the offices of both President and Prime Minister on Ferdinand Marcos. In 1981, Martial Law was lifted, and during the same year a national plebiscite approved constitutional amendments which in effect replaced the parliamentary system with a mixed presidential-parliamentary government with an appointed Prime Minister (Brown, 1993). The new Constitution strengthened the power of the central government against that of local government. The President was now in a position to have technocrats plan public works according to national priorities by means of ruling by decree, without having to resort to local "porkbarrelling" (Fegan and Purcal, 1993).

After the “revolution” in 1986, Corazon Aquino was inaugurated as President of the Philippines on 25 February 1986. A new Constitution was drafted during the same year and was subjected to a national plebiscite in 1987. The Philippines’ New Republic Constitution was designed to prevent any future President from setting up authoritarian rule. Moreover, it reflected a euphoric faith in democracy brought about by the “revolution” in 1986. In essence, it returned the Philippines to the constitutional form which operated (except for the war years) from 1935 to 1973, with a US-style bicameral legislature and an executive presidency (Brown, 1993). The national government now has three branches: namely, the executive; legislature and judiciary. The executive branch consists of the President who is elected directly by popular vote and who exercises the executive power of the government with the assistance of an advisory council or cabinet. The legislative branch, which enacts the law, consists of the Senate and the House of Representatives. They are composed of elected representatives and some appointed members from different sectors of society. On the other hand, the judicial authority is administered by the Supreme Court and other special and lower courts. It handles the justice system and exercises various checks on the powers of the executive President (Philippine Government, 1997).

Overall, the 1986 Philippine Constitution shifted power from the executive President laterally to Congress and down to local government. This limits the power of the President in terms of law, with a strong Congress that can scrutinise, modify and reject legislative programs, budgets and appointments (Fegan and Purcal, 1993). One of the radical pieces of legislation passed in 1991 which significantly affected the political framework of the country was the Local Government Code. It was enacted in order to carry out the central government’s commitment to genuine local autonomy and empowerment (Brillantes, 1994). The new Constitution and the Local Government Act devolve extensive powers to local officials, such as provincial governors, municipal mayors and village headmen. Such powers include many former national powers, along with staff, in areas of health, agriculture and

police. Furthermore, it surrenders the central government's fiscal weapon by giving local governments guaranteed shares in national revenue. Many functions, that in neighbouring countries belong to the central government, are decentralised to elected local government officials in the Philippines (Fegan and Purcal, 1993).

2.3 An Overview of the Economy

While many developing nations from all over the world may be diverse, they nevertheless often exhibit common economic characteristics which include, low standards of living, low levels of productivity, high rates of population growth, substantial dependence on agricultural production and primary products for foreign currency, and vulnerability to international crises and domestic pressures (Todaro, 1997). The Philippines, as a developing nation, is no exception and possesses many of these characteristics.

With a total land area of some 300,000 square kilometres, the country's overall population density in 1960 was estimated at 90 persons per square kilometre, and increased to 161 in 1980, and further to 234 in 1995. The 1995 census of households places the population at 70.3 million, growing at a rate of 2.4 per cent per year (National Statistical Coordination Board, 1995).

According to Hodgkinson (1997), the economy of the Philippines has certain similarities with some of the newly-industrialised countries (the so-called "tiger" economies of the Republic of Korea, Singapore and Taiwan). It has the added advantages of having abundant natural resources, a skilled, low cost workforce, and a potentially vast domestic market. However, economic growth in the Philippines cannot match the growth experienced in the "tiger" economies and it has tended to lag behind that of other middle income countries in the region (Economist Intelligence Unit, 1989).

The Philippine economy presented a different picture in the 1950s and early 1960s and considered one of the most promising economies of Asia. The country made a fast recovery from the destruction and economic dislocation caused by World War II, registering the highest average annual growth rate of real gross domestic product (GDP) among the East Asian countries as shown in Table 2.1. Growth in the Philippine economy was high in the early 1950s when GDP growth rates averaged 8 per cent per annum. According to Cabalu (1994), the initial boost to growth came from post-war reconstruction, but in the latter half of the 1950s the economy failed to sustain its previous remarkable performance when growth slowed down to an annual average rate of 4.8 per cent.

In the 1960s, growth was sluggish and most neighbouring countries grew much faster and overtook the Philippines (see Table 2.1). The growth rate gap widened during the 1970s and at the beginning of the 1980s when the economy slowed markedly and slipped further behind that of the economies in East Asia. Consequently, real living standards declined with the growth rate of real GDP slower than population rate (Cabalu, 1994).

Under the Aquino government, the economy grew steadily from 3.4 per cent in 1986 to 6 per cent in 1989. However, this was not sustained and faltered early in the 1990s. Throughout the 1980s, the country's average growth performance was the lowest for any decade in the post war years, and the Philippines was considered to be one of the weakest performers of the East Asian region.

In 1992, when President Ramos took over the reins of government, he introduced the "Philippines 2000" concept to transform the economy into an industrialised nation. After a period of two years, during which GDP growth was virtually flat, the Philippine economy showed signs of recovery in 1993 with low but positive growth rates achieved in all the main sectors of the economy (Asian Development Bank, 1994). According to Hodgkinson (1997),

this rate of economic growth is likely to be maintained through the rest of President Ramos's term of office (to mid-1998) as the result of major structural reforms that have been implemented by the administration.

Table 2.1
Average Annual Growth Rate of Real GDP
In selected East Asian Countries, 1950-95 (per cent)

Country	1950-60	1960-70	1970-80	1980-90	1990-95
Philippines	6.9	5.0	6.4	1.7	2.2
Indonesia	n.a.	3.8	7.9	5.5	7.0
Korea, Republic of	n.a.	8.8	8.3	9.3	7.5
Malaysia	4.9	6.5	8.0	5.9	8.7
Singapore	n.a.	9.2	9.0	7.1	8.5
Thailand	3.3	8.3	6.8	7.8	8.3

Note: n.a. - not available

Sources: Cabalu, 1994

International Monetary Fund, International Financial Statistics Yearbook, various issues

National Statistical Coordination Board, Philippine Statistical Yearbook, various issues

2.3.1 Economic Structure

In common with some other developing countries, the contribution of agriculture to the Philippine economy remained significant in terms of employment and net contribution to export earnings during the last three decades. In 1960, the agricultural sector, composed of agriculture, fishing and forestry, accounted for 26 per cent of total output, declining to 22 per cent in 1994. The sector employed close to 46 per cent of the national workforce in 1995.

On the other hand, the share of the industrial sector (mining and quarrying, manufacturing, construction and electricity, gas and water) grew from 28 per cent in 1960 to 37 per cent of total output in 1980. Despite embarking on industrialisation through import substitution, there has been no dramatic change in the structure of production in favour of industry since the 1980s, whereas in other East Asian countries there has been a significant shift away from agriculture (see Table 2.2). By 1994 the industrial sector accounted

for 35 per cent of the total output. The share of the manufacturing sector, however, has remained fairly consistent at 25 per cent since the late sixties, ranking almost equal to agriculture in its contribution to GDP. The share of the industrial sector to employment in 1990 was close to 20 per cent, while the manufacturing sector accounted for about 10 per cent of employment during the same period.

Finally, the service sector (trade, transport and communication, finance, public administration and others) which accounted for the highest share in GDP, decreased from 46 per cent in 1960 to 43 percent in 1994. The sector's contribution to employment remained significant. In 1990, close to 35 per cent of total employment was in the service sector (Fegan and Purcal, 1993).

Table 2.2
Share of GDP in Selected East Asian Countries,
By Sector, 1960-94 (per cent)

	Philippines	Indonesia	Malaysia	Singapore	Thailand
Agriculture					
1960	26	54	37	4	40
1970	29	46	32	2	30
1980	23	26	24	1	25
1990	22	22	19	0	12
1994	22	17	15	0	12
Industry					
1960	28	14	18	18	19
1970	29	21	25	30	26
1980	37	42	37	37	29
1990	35	40	42	37	39
1994	35	41	45	37	41
Manufacturing					
1960	20	8	9	12	13
1970	25	9	18	25	20
1980	26	9	23	28	20
1990	25	20	n.a.	29	26
1994	25	23	32	28	30
Services					
1960	46	32	45	78	41
1970	42	33	43	68	44
1980	40	32	39	62	46
1990	43	38	39	63	48
1994	43	43	40	62	48

Note: The manufacturing sector as a dynamic part of the industry sector is shown here separately

Sources: Cabalu, 1994

Asian Development Bank, Key Indicators of Developing Asian and Pacific Countries, 1995.

2.4 Trends in Public Expenditures and Revenues

The national government of the Philippines plays an active role in the pursuit of its economic objectives. In particular, it provides the policies and basic infrastructure to support the development of a dynamic private enterprise system. Moreover, it assumes the role of providing essential social services in order to raise the quality of human resources (UNDP, 1993). When the Philippines achieved its political independence, the government decided that the public sector should play a more active and direct role in promoting economic growth and development. For this reason, public expenditure has become the most important expression of the role of government in achieving national objectives.

Table 2.3
Central Government Expenditure as Percentage of GDP and
Central Government Revenue as Percentage of GDP
Selected East Asian Countries, 1965-1995

Year	Indonesia		Korea		Malaysia		Philippines		Singapore		Thailand	
	EXP	REV	EXP	REV	EXP	REV	EXP	REV	EXP	REV	EXP	REV
1965	10.4	3.8	13.3	9.8	27.5	20.1	8.1	8.8	18.8	17.2	14.1	13.1
1970	12.9	10.3	18.9	17.7	29.3	24.2	9.6	11.7	26.7	21.8	17.5	13.8
1975	11.1	9.9	17.3	16.9	23.0	22.9	16.6	14.5	30.5	23.1	15.1	13.3
1980	22.3	22.5	17.3	17.7	28.4	26.1	15.6	14.3	19.3	23.5	19.1	14.4
1985	21.6	19.4	18.1	17.0	32.7	30.2	14.0	12.1	35.9	38.0	21.4	15.2
1990	19.0	18.8	18.6	17.9	28.5	27.1	24.2	16.9	21.3	31.9	14.8	18.8
1995	16.3 ^a	16.2 ^a	17.7	20.2	23.7	23.8	20.6	17.9	14.4	20.4	15.8	18.7

Notes: EXP (Expenditure); REV (Revenue)
^a 1994

Sources: Department of Budget and Management, *Fiscal Statistics Handbook, 1994*
International Monetary Fund, *Government Finance Statistics Yearbook, 1996*
Asian Development Bank, *Key Indicators of DMCS of ADB, 1984*
Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries, 1996*

In comparison with other East Asian countries, the Philippines' government expenditure as a proportion of GDP (GEx/GDP) was lower (see Table 2.3). On average, the countries with the highest GEx/GDP ratio in the region are Malaysia and Singapore. However, the last decade witnessed an active public expenditure program in the Philippines. Although the Philippines has one of the lowest GEx/GDP ratio among its neighbouring countries, it was high compared to the country's available budgetary resources. In particular, public expenditure expanded rapidly in the last half of the 1980s and early part of the 1990s. This occurred in a period when government revenue mobilisation was inadequate compared to neighbouring countries. As a result, most of the country's public investment program has given rise to a serious reduction in maintenance and other operating expenditure and the rapid growth of unsustainable fiscal deficit (Manasan, 1988). This has prompted the present study. The appropriate level and composition of public expenditure for the Philippines is a question that has long needed examination. The analysis of the patterns and growth of public expenditure in the Philippines should shed light on the course of future government action in this area in terms of expenditure priorities and institutional reforms.

2.5 Summary

This chapter provided a background on the Philippines' historical and institutional setting. Similarly, a brief analysis on the past performance of the economy in comparison with other East Asian countries was included. Based on the examination, the economy presented a positive recovery during the early post war years, but failed to sustain its remarkable growth until the 1990s. While its East Asian counterparts have experienced rapid structural change and economic growth, the Philippine economy cannot be said to have performed as well. A similar contrasting trend occurred in terms of the country's public expenditures and revenues compared to its neighbouring countries. Specifically, the last two decades of the period under review saw a rapid expansion in public expenditure as a proportion of GDP. However, this took

place when the ratio of government revenue to GDP was inadequate compared to several East Asian countries. Consequently, this gave rise to persistent pressure and unsustainable growth of budget deficit especially during the 1980s and 1990s.

Chapter 3

REVIEW OF LITERATURE

Public expenditure plays an important role in the functioning of a market economy. Moreover, the extent of public expenditure may be used to measure the degree of government intervention in the economy, or the size of the government itself with reference to the share of public expenditure or tax revenue in gross domestic product (GDP).

Various theories have been developed in an attempt to account for the changing composition and growth of public expenditure both in developed and developing countries. A review of the proliferating literature reveals a wide range of theoretical explanations. While it is not the intention of this study to provide an exhaustive survey of the theories which have been put forward to explain the expanding role of the public sector, a brief examination of the relevant literature is deemed necessary since some of these theories and the attendant empirical evidence might have implications for the analysis of the patterns and growth of public expenditure in the Philippines.

This chapter is organised as follows: Section 3.1 describes the role of the public sector in general and the growth of public expenditure in particular. Section 3.2 outlines the various theories and empirical evidence purporting to explain the growth of government expenditure both in industrial and developing countries. Section 3.3 examines the literature focusing on the relationship between public expenditure and economic growth. Section 3.4 provides a summary of this chapter.

3.1 Role of the Public Sector

The past several years have witnessed a vigorous debate about the role that the public sector should play in a market economy. The collapse of the centrally planned economies and the real (or perceived) failures of the welfare state in mixed economies have all provided a new dimension to this debate (Tanzi, 1995).

Various reasons have been advanced as to why governments should intervene in the economic activities of their citizens. Firstly, the Keynesian approach to macroeconomics which prescribes injecting money into the economic system (i.e., if the people were not spending, then it was the responsibility of the government to do so) (Trotman-Dickinson, 1996). Secondly, from the microeconomic arguments concerning market failure which include, among others, the existence of externalities, public goods, monopolies and information failure (Gemmell, 1993). The principal justification for most public policy intervention lies in the purported shortcomings of the market (Tanzi, 1995).

As an economic document, the budget is the most important expression of that role and through the budget the government attempts to implement and promote its objectives. The degree of government involvement varies between different countries and most comparisons about the role of the government in a market economy are usually made with reference to the share of tax revenue or public expenditure in GDP (Tanzi, 1995). As Lindauer and Velenchik (1992, p. 60) have argued, “any nominal valuation of government, whether revenue or expenditure, assumes that what we are measuring is the government role as a direct economic agent”. Table 3.1 presents a numerical picture of this role with reference to both industrial and developing countries covering the period 1972-1988.

Table 3.1
Public Expenditure as a Percentage of GDP, 1972-88^a

	1972	1975	1980	1985	1988
Industrial Countries	36.7	42.1	46.0	48.3	48.9
Developing Countries	23.8	28.0	30.2	32.7	30.6
Africa	22.6	25.7	32.6	35.5	35.4 ^b
Asia	27.3	24.8	30.3	29.3	27.0 ^c
Middle East	32.2	50.7	44.6	43.1	42.7 ^b
Western Hemisphere	21.8	24.1	24.6	29.1	30.0

Notes: ^a General government
^b 1986
^c 1987

Source: Hemming, 1991

Despite the limitations of data provided in Table 3.1, the evidence suggests that on average, developing countries devote a smaller percentage of GDP to government spending compared with industrial countries. Similarly, although the rate of growth of spending in developing countries varies, and has even declined in few cases, continued expansion appears to be the norm.

3.2 Theories and Empirical Evidence

3.2.1 The Case of Developed Countries

Most empirical studies attempting to explain the growth of government are cross country studies where the cross-section consists of a sample of Organisation for Economic Cooperation and Development (OECD) countries. A large number of analyses have attempted to produce carefully documented explanations for the growth of government expenditure of OECD countries. In a seminal analysis, Johan Lybeck (1988) examined several theories and attendant empirical evidence concerning the growth of public expenditure. According to Lybeck, most of these theories are grouped according to whether they belong to the *demand side* or the *supply side*. Theories under the *demand side* hypothesise that the public sector has grown because the general public has

so desired. However, Lybeck (1988) argued that demand might have been augmented by the existence of strong interest groups, imperfect information, etc. The *supply side* theories, on the other hand, suggest that the major reason for the increasing share of government can be found inside the government sector itself. Consequently, these theories include everything from politico-economic models, where governments or politicians seek to influence various macroeconomic variables (e.g., unemployment, inflation) in order to better their chances of being reelected, to the model pertaining to the behaviour of bureaucrats with their personal interest in the expansion of the budget of their own agencies and of imbalance in productivity growth between public and private sectors as identified in Baumol's theory (Lybeck, 1988).

David Cameron (1978) also examined several of the more important of these theories regarding the perceived rapid growth in the public sector. Using the term "public economy"¹, he identified various distinct explanations of why the scope of the public economy changes over time which include: *economic, fiscal, political, institutional and international factors*.

Perhaps the most famous *economic theory* is that produced by Adolf Wagner. According to Taylor (1983), Wagner propounded a law of the increasing extension of state activity in which he asserted that the public economy expands in direct relation to expansion of the economy of a country. Furthermore, "this law which was formulated in the late nineteenth century, is generally interpreted to imply that as industrial societies develop and become more prosperous, the state will be called upon to supply an increasing number of services, for example, defence, education, communication, and infrastructure, and these will require an increasing share of the nation's resources" (Taylor, 1983, p. 20). Consequently, Levitt and Joyce (1987) claimed that such law both predicts and advocates the growth of public

¹ Refers to that portion of a nation's economic product which is consumed or distributed by all public authorities.

spending (as a share of national income) on social services and transfers, on infrastructure, and on a range of economic services.

A considerable literature exists presenting tests of Wagner's Law by comparing total government spending as a share of GDP across countries or over time. For instance, Gould's (1983) analysis on the development of public expenditures in western, industrialised countries covering the period 1960-1979 confirms Wagner's law of expanding state activity; he noted that the growth rates of public expenditures relative to the growth rates of GDP occur in all countries and are at all times greater than unity.

However, several scholars have rejected the logic and evidence in support of Wagner's law. Peacock and Wiseman (1967) have tested Wagner's ideas in examining the growth of expenditure in the United Kingdom. In some aspects, they found his "law" still working, but they provided a more complicated explanation. As Cameron (1978) has pointed out, Peacock and Wiseman (1967) rejected the "historical determinism" implicit in Wagner's "law", and in their discussion of what they call the "displacement effect" they posited that expenditure levels could rise in crises, such as war and depression, to new higher levels. Consequently, this will induce infrequent but large changes in the politically tolerable burden of taxation. A separate study by Musgrave (1969) found that any positive cross-national relationship between economic growth and government share in the economy disappears and a more complex pattern emerges once the sample is divided into low and middle income countries.

Another type of explanation for public sector growth is *fiscal* in nature and emphasises the structure of revenue generation. Lybeck (1988) argued that the expansion of government will probably be faster if the citizens do not realise what is going on. Since public goods are inherently nondivisible, costs and benefits are not directly linked. In addition, because each citizen has to pay for some programs from which no individual benefits are derived, public

goods are (when taken as a whole) less desirable. Hence, public officials can spend large amounts of money only when the real costs can be concealed (Taylor, 1983). In other words, complex and indirect payment arrangements produce a fiscal illusion that will lead to higher levels of public outlays than those cases with simple payment structures such as direct taxes (Buchanan and Wagner, 1977). Several studies suggest that public sector grows most in those countries having a large and increasing reliance on indirect taxes and social insurance (Cameron, 1978).

The third type of explanation is *political* in nature. It is recognised that politics may influence the size of the public sector in terms of the effect of electoral competition in bidding up the scope of expenditure programs. In particular, periodic electoral competition or the existence of “political business cycles” brings promises to cut taxes and to increase spending by political candidates or parties in order to enhance their electoral appeal. Accordingly, one might expect that countries with frequent elections are likely to have larger increases in their public sectors than nations with less intense political competition (Taylor, 1983). Cameron’s (1978) study, for instance, concluded that politics is important in influencing the scope of the public economy. Based on his empirical analysis among selected OECD countries, the frequency of electoral competition displays a modest positive correlation with the increase in the public economy, indicating that competition may indeed exert an expansionary impact on budgets.

The impact of interest groups under the public choice framework has also been suggested as an explanation for public sector growth. The study of Mueller and Murrell (1985) provide evidence in this area. They attempted to develop and test hypotheses regarding the impact of interest groups on the size of governments in selected OECD countries. They found that the formation of bargains between parties and interest groups leads to an increase in government size. Consequently, the empirical results support the theory in that the number of interest groups is positively related to the relative size of government

regardless of any substantial changes in the composition of the sample countries and other variables in the equation.

Explanations founded upon the *institutional structures of government* compose a fourth type of explanation identified by Cameron (1978). Most arguments considered in this area demonstrate that bureaucracies have internal pressures for public sector expansion. William Niskanen's (1971) model of bureaucracy, for example, suggests that bureaucrats will attempt to maximise their budgets in order to survive and promote their own welfare. For example, a larger budget will provide more jobs for bureaucrats, thereby improving promotion prospects and likewise increasing their prestige and patronage. Overall, the arguments suggest that bureaucracy is inefficient and expensive and that it has a tendency to grow (Dowding, 1995).

Another aspect of the institutional arrangement of government that may influence the expansion of the public sector is the degree of *centralisation of power*. This concerns the question of whether the constitutional structure of the country matters (Lybeck, 1988). Several studies conclude that relatively decentralised nations are likely to bring forth greater public sector growth than highly centralised nations. One of the main reasons for this finding is that the monopolistic control of the central government policymakers and their recognition of the cost-benefit tradeoffs serve to limit aggregate expenditure (Cameron, 1978).

The fifth type of explanation takes into account the *openness of the economy* (i.e., the dependence of certain nations on their external environment). In most cases, these nations are highly exposed to pressures on prices and markets brought about by other countries through international exchange. Lindbeck (1976) noted that a high degree of trade dependence limits the governments' ability to manage aggregate demand and control levels of unemployment and capital formation. Moreover, a high degree of penetration of the domestic market by external producers restricts government control over

production and pricing. According to Cameron (1978), an expansion of the role of the state can dampen the effects of the open economy on production, employment and consumption. He notes that measures such as social insurance, tax systems, unemployment benefits, subsidies to employment, etc. are some responses to external dependence.

3.2.2 The Case of Developing Countries

A survey on the literature pertaining to the size and growth of public expenditure showed that the focus falls almost exclusively on industrial economies or OECD countries. The challenge is to examine whether the theories and empirical evidence previously mentioned infer similar outcomes in the case of developing countries.

Most studies focusing on the trends in public expenditure in developing countries also concentrate on some of the theories applied in OECD countries, although comparable analyses of trends in government budgets over a broad range of expenditure categories have not been widely undertaken for the developing world (Lindauer and Velenchik, 1992). One notable exception is the research of Heller and Diamond (1990) which proposed other influences and explanations regarding public expenditure. In their findings, they supported the view that *demographic influences*, at least from 1975 to 1986, are positively associated with growing government spending, specifically in health, education and social security. In particular, the importance of population size, the rate of population increase, age structure and the geographical concentration of population have all been cited as possible explanations for public sector expansion. In his broad explanation, Prest (1985) argued that a rapid rate of growth of population will have repercussions on the need for roads, public housing, sewers, and other infrastructure and development projects. On the other hand, the study of Goffman and Mahar (1971) which focussed on the growth of public expenditure in selected developing countries, included the influence of other variables such as income and prices. Based on

their analysis, they concluded that the growth of public spending of these nations cannot readily be explained by the observed price, population and income alone. Hence, they argued that a more detailed analysis on the behaviour and patterns of growth is necessary such as those pertaining to social, economic and political characteristics peculiar to developing nations.

Recent attention has focused on attempts to explain the growth of public expenditure in terms of the development processes or the *influence of development theory* over the past twenty-five to thirty years. Following the Second World War, theories of development have emphasised the extent of market failure in many developing countries. The task of reorganising the economic structure and promoting faster growth as an explicit objective of economic policy was felt too important to be left in the hands of the private sector. As Diamond (1990) has pointed out, this led to policies of expansionary public spending, often coupled with increased government intervention. For instance, the increasing role of the public sector in the economies of Asian developing countries can be traced to the fact that most of these countries, after achieving political independence, embarked on national economic development plans involving ambitious investment programs, or what they called “take-off” points towards industrialisation. The need for building up development projects, such as physical and social infrastructure projects, and the risks involved with large industrial investments in the absence of developed capital markets, provided the rationale for the active participation of the public sector in the development process (Tanzi, 1986). Accordingly, the market failure argument has perhaps become the most cited reason for the expanded role of government in most developing countries (Todaro, 1997).

Parallel to this argument are the roles of both multilateral and bilateral aid, with their requirements for public sector rather than private sector involvement. It must be recognised that in many developing countries, the financial constraint on government spending has been shifted by inflows of foreign resources through foreign loans and grants, while at the same time

foreign debt service obligations have constrained other types of spending, and in most cases have contributed to increasing public expenditure (Heller and Diamond, 1990).

3.3 Public Expenditure and Economic Growth

The relationship between public expenditure and economic growth has also presented a challenge in the overall analysis of public sector growth. One point of view suggests that the growth in the size of the public sector can be detrimental to the economic growth of a nation. At the other extreme, one could argue that a larger government size is likely to be a more powerful engine of economic development (Ram, 1986). The main objective of most empirical investigations is to examine the impact that government expenditure, and in particular the composition of expenditure, can make on the growth process in order to assist policymakers in designing growth oriented programs and setting up expenditure priorities.

Numerous studies of this relationship have not been conclusive. Some results provide a positive relationship between public spending, usually as a proportion of GDP, and the rate of growth of GDP, while others show a negative outcome. A study by Ram (1986) found that the overall relationship between government size and growth is positive. His investigation involves cross-country comparisons using a sound theoretical framework, and internationally comparable data. Furthermore, he elaborated that the positive relationship is even stronger in lower-income countries than in higher-income countries and that government expenditures seem to have had positive externalities. Overall, the conclusion appears to apply in a vast majority of the settings considered.

However, other studies found a rather clear-cut negative relationship between government outlays and economic performance. Gould (1983), for instance, discovered a moderately strong negative association between these

two variables. Furthermore, the results of his analysis showed some tendency for countries with the fastest growth rates to have also the slowest growing ratios of public expenditures to GDP and vice versa. In a two separate studies, Landau (1983; 1986) provided a more comprehensive analysis using developed countries in one study and less developed countries in the other. He relates economic growth measured by the rate of increase in per capita GDP to several sets of independent variables that could influence economic growth such as human and physical capital, the structure of production, demographics, government consumption and investment, among others. He found out that the data he examined “support[ed] the view that government spending is associated with a reduction in a country’s capacity to grow” (Bruton and Hill, 1996, p. 1).

Given the conflicting results in the empirical research, Lindauer and Velenchik (1992) suggest that it should be interpreted with caution. Similarly, Bruton and Hill (1996, p. 25) noted that “econometric studies have failed to establish an empirically supported conventional wisdom about the relation between government spending and the achievement of development objectives”. Based on their discussion, they explained such failure in terms of the great diversity that exists among various countries with respect to how the market functions and the government’s capacity to provide policies that will improve economic performance. They emphasised that the institutions, perceptions, history, culture and the capacity of private agents to respond to markets signals and many other things must be taken into account in order to test the relationship between government spending and economic growth.

3.4 Summary

This chapter introduced the role of the public sector in general and outlined the underlying reasons why governments intervene in the economic activities of society. At the same time, emphasis was placed on the specific functions of public expenditure which is often used to measure the degree of government involvement between countries. The empirical picture revealed that public

expenditure has accounted for a rising proportion of GDP in both industrial and developing countries. This has prompted economists and political scientists to develop theories and generate empirical evidence that will contribute to a fuller explanation of such trends.

Existing empirical research in the field is mixed. Each study portrays the theories supported with empirical evidence in a different light with particular reference to different variables which are believed to cause, or to be conducive to, a larger public sector. As Lybeck and Henrekson (1988, p. 3) have pointed out “they seldom offer any guide as to the specific form the influence will or could take”.

The relationship between public expenditure and economic growth was also discussed. Considering the literature presented, some might conclude that the present state of public expenditure theory is partly the result of disagreement over measurement problems. In particular, the use of cross-section and time-series analyses with less attention being given on the great diversity that exists among nations. As Beck (1982, p. 164) has emphasised, “defining public sector and measuring its growth are relatively simple if the study is limited to public expenditure in a given country”. Patterns or trends in government spending emerge from a wide range of considerations, and that their explanation is far from straightforward.

Chapter 4

THEORETICAL FRAMEWORK

We have seen that controversy continues to plague efforts at explaining the growth of government expenditure in the latter half of the twentieth century. As Peacock and Wiseman (1967) have argued, it is difficult to find theories that explain rather than justify or condemn the facts of public expenditure growth.

For this chapter, the theoretical framework adopted in the study will be set out in Section 4.1. This is then divided into two sub-sections. Sections 4.1.1 and 4.1.2 explain the two approaches that will be employed in the study, namely: Wagner's Law of expanding state activity, and the Peacock and Wiseman's historical approach. Following some brief statements of these approaches, different empirical evidences bearing on its validity will be assessed based on the comments and arguments of some recent authors on related themes.

4.1 Theoretical Framework Adopted in the Study

The general framework adopted in the present study draws on the work of Goffman and Mahar (1971) which focused on the growth public expenditures in selected developing countries¹. In their study, they examined the applicability of two major approaches in analysing the growth of public expenditures of these nations: namely; Wagner's Law and the Peacock and Wiseman Displacement Effect. In testing the hypotheses inherent in Wagner's

¹ Goffman and Mahar examined the public expenditure behaviour of several of the smaller Caribbean nations

Law, they seek to identify and isolate the basic factors which have influenced the level of aggregate public spending in these developing countries for the last 25 years, and consequently measure the effects upon absolute expenditure growth of the so-called permanent influences such as *income*, *prices*, and *population*. Based on their empirical analysis, these “permanent influences” have had some effects on the level and composition of public spending. However, even after these influences have been given due consideration, in each of the countries under review, a sizeable portion of the growth in public spending still remains unexplained. Moreover, the pattern exhibited by this growth is the same as those observed by Peacock and Wiseman which they termed “displacement effect”. In other words, they argued that the growth in public spending of these developing nations cannot readily be explained by the observed price, population and income changes alone. Rather, a more detailed analysis on the behaviour and patterns of growth is necessary which may lend support to the displacement hypothesis. The study concluded that neither of the two approaches adequately explained the pattern of behaviour of the relevant aggregates. While expenditures did experience increases and while such increases exhibited a pattern, the traditional reliance upon wars (as theorised by Peacock and Wiseman) for explanatory purposes was not sufficient. Goffman and Mahar (1971) accordingly suggested that in understanding the behaviour of economies such as those they studied, one should direct greater attention to those factors which are more prevalent in developing nations. Hence, one should look deeper on the social, political and economic characteristics peculiar to developing nations.

Following this line of thought, some of the major ideas propounded by Adolf Wagner and those by Peacock and Wiseman will be utilised. In particular, some of their concepts will be redefined in order to fit the situation prevailing in the Philippines. The following section provides a detailed examination of these two approaches and some of the specific measures used by economists in testing their hypotheses. Their merits and flaws are also examined.

4.1.1 Wagner's Law of Expanding State Activity

As we saw in Chapter 3, Wagner's law of expanding state activity has dominated the literature on growth of public expenditure. Wagner's law relies essentially on structural factors to explain government growth. In particular, it takes into account changes in society's economic and social structure as causal factors and hypothesises that factors such as the level of per capita income, its composition, the size or age structure of the population, or the stage of development which a country has reached are significant (Gemmell, 1983).

Although most writers have disagreed on some of these causes of public sector expansion, almost all studies have upheld the general view that the public sector share of national income and expenditure tends to increase with economic development (Beck, 1982). In testing this hypothesis, Pluta (1981), Gould (1983), Beck (1979) and Peacock (1979) used the *income elasticity coefficients* (i.e., ratios of the percentage increase in government spending to the percentage increase in GDP) in their time-series, cross-section analysis. While some recent literature contains numerous tests of various interpretations of Wagner's Law, nearly all of these efforts have been based upon *trends* in either nominal or real values of government expenditure compared to some overall level of economic activity (Pluta, 1981). Most of the empirical analyses reveal that the growth rates of public expenditures relative to the growth rates of GDP are in all countries and at all times greater than unity, indicating that for all periods and for all countries, total public expenditures grew faster than GDP, confirming Wagner's Law of expanding state activity.

Interpreting Wagner's Law in a different way, Gould (1983) used the concept of *correlation* where the derived ratios of general government expenditure to GDP were correlated with a standardised measure of per capita GNP, argued by some economists to be the correct index of economic development. Applying this concept in the development of public expenditures in industrialised countries, Gould (1983, p. 44) found that no marked positive

relationship appeared in the data. His study concluded that “differences in the degree of economic development do not therefore explain differences in the relative size and growth of the public sector”. Beck (1982) argued that even in a relatively homogeneous sample, the results derived from most cross-country analyses will be affected by institutional differences between countries. Hence, he suggested that progress toward a theory of public sector growth is more likely to come from analysis of public expenditure trends in a given country.

Aside from examining the general hypothesis incorporated in Wagner’s Law, recent literature contains numerous tests of various interpretations of this law which have usually emphasised demand factors contributing to public expenditure growth which include, among others, population and income growth, urbanisation and industrialisation, and technological change. While rejecting Wagner’s overall conclusion, Peacock and Wiseman (1967, p. 21) adopted his historical approach and included in their examination of the British government expenditure the influence of these demand factors, which they termed “permanent influences” (i.e., forces operating continuously to affect the size of public expenditures). In their study, they concluded that “there are permanent influences affecting government expenditure at all times and in all societies, and that these must generate expenditure growth in developing societies, irrespective of their political and social characteristics”. Following the same argument, Goffman and Mahar (1971) examined this hypothesis and attempted to measure the effects of income, prices and population on the growth of public expenditures in selected developing nations. Using a *trend analysis* in describing the effects of such influences, their study concluded that although such influences have undoubtedly had some effects on the level and composition of public spending, the particular time pattern of public expenditure growth was not significantly changed by such influences. Dealing with more specific variables, the work of Kelley (1976) considered some of the analytical linkages between demographic changes and government spending shares. The statistical analysis employed international cross-section data, and which focused on countries in the intermediate phase of economic

development. Demographic influences considered in the study included total population size, location (urban and rural), density, and age distribution. Based on a *regression analysis*, the most important demographic influence found in the study was urbanisation.

4.1.2 Peacock and Wiseman's Historical Approach

While Wagner was interested only in the secular growth of public expenditure with relation to national output, Peacock and Wiseman are concerned primarily with the *historical (time-series) approach* in analysing public expenditure growth in the United Kingdom. With respect to their study, it was observed that public expenditures took the form of a series of peaks which increased in amplitude as the time series progressed. The highest of these peaks were observed during the years of two world wars. This should not be too surprising, since the share of government activity in the economy as a whole can usually be expected to rise during periods of major wars. However, it was found that the increased role of the government in wartime was not the only reason for this jump in public expenditures (Goffman and Mahar, 1971). According to Gupta (1967), the important finding of Peacock and Wiseman is that despite the fact that British government expenditure declined after the wars, it did not return to the pre-war level and the share of government expenditure in national product remained even greater after the wars than it was immediately preceding them. The upward shift in the level of government expenditure with relation to national output occurs due to the “displacement effect”. Their explanation of the displacement hypothesis rests on the concept of a “tolerable burden of taxation”. While the general public would have resisted higher taxation during normal times, the exigencies of war made an increase in tax levels possible. However, when the war or crisis was over, expenditure and taxation would stay at the higher level which had become accepted and tolerated (Lybeck, 1988). Accordingly, a shift in people's ideas about the tolerable burden of taxation due to a social upheaval may give rise to

a shift in the level of public expenditure with relation to national output (Gupta, 1967).

The findings of Peacock and Wiseman for the United Kingdom was followed by similar studies which showed that the displacement hypothesis existed not only in times of war but also during the Great Depression. This argument is partially mitigated by Gupta (1967), who showed for several countries that deficit-financed (as opposed to taxation) spending during the Great Depression had a similar post-episodic expansion in the size of the government sector. Gupta (1967, p. 427) argued that “if some public expenditures are financed by public debt or new money creation during a severe depression, the burden or the opportunity costs of financing such expenditures may be considered almost zero during that period”. One might therefore conclude that if the concept of the tolerable burden is expanded so as to include not only that of taxes but also other methods of financing government expenditure (i.e., through public debt and money creation), it could provide a better explanation of the growth of public expenditure.

In the case of many developing countries, Goffman and Mahar (1971) argued that while they are not immune to upheavals, the situation prevailing in these nations is more complex. Most of these countries are likely to experience major expenditure shifts as a result of social, political and economic characteristics peculiar to developing nations. Moreover, the displacement effect which rests upon a tax constraint exercised by the electorate on their representatives in a modern democratic society, is quite different in many developing nations where internal dictatorship or external pressure from a foreign power or even international agency may reduce the role of the ballot box and introduce instead a different set of constraints. For expenditure displacement to occur will require a type of upheaval which is different from that observed in most developed democratic economies.

Chapter 5

SCOPE AND METHODS OF ANALYSIS

Having discussed the theoretical framework employed in this study, we now focus on the scope and methods of analysis used. In addition, the specific measures selected are presented, together with some specification of and limitations of the data employed.

The chapter itself is structured as follows: Section 5.1 deals with the definition of the public sector while Section 5.2 outlines the different measurement issues. Section 5.3 explains the methods adopted in the analysis of public expenditure statistics. Section 5.4 discusses some of terminologies used. Section 5.5 sets out the different sources of data employed in the empirical analysis.

5.1 Defining the Public Sector

According to Gemmell (1993, p. 2), “one of the essential features of a good theory of government, especially if it is to be subjected to some empirical analysis, is an unambiguous definition of the public sector”. The appropriate definition depends on the questions at hand.

The concept of the public sector may be interpreted in various ways. It may be conceived as reflecting the various resources which the government uses (e.g., labour, capital, land and material inputs). Similarly, it may be

defined with respect to the amount of public expenditure, or with respect to the economic activities, institutions or individuals which it controls to some specified degree. Each of these approaches to defining the scope of the public sector has its merits. However, much of the theoretical and empirical literature on public sector growth has concentrated on *public expenditure*. According to Gemmell (1983), this is partly because it reflects economists' interest in the "non-market" aspects of providing goods and services to consumers through public sector expenditure rather than through the market mechanism. For this reason, among others, the present study is primarily concerned with *public expenditure* growth.

The study analyses and describes the patterns and growth of public expenditure in the Philippines during the period 1965-1995. It covers three political administrations in the Philippine history: namely, the Marcos administration (1965-1986); the Aquino administration (1986-1992); and the first three years of the Ramos administration (1992-1995). In particular, it seeks to explain the changing pattern and growth of the *national (central) government expenditure* (NGE) and does not cover the rest of the public sector (i.e., the Central Bank (CB), public sector enterprises (PSEs) and local government units (LGUs)). However, the financial and other implications of public policies on the activities of these remaining units as they affect the national government's fiscal operations will be considered.

5.2 Measurement Issues

Given the definition of the public sector based on public expenditure, we are mindful of the measurement issues involved. Based on the analysis of Abizadeh and Yousefi (1988), there are three dominant (and controversial) problems in measuring public expenditure. The first problem is related to the measurement of the size of public expenditure itself and hence to its growth. Almost all versions use either absolute government expenditure or the ratio of government expenditure to the total output of the economy (i.e., either GDP or

GNP). The absolute value (or total government expenditure) provides a helpful measure of the direct economic importance of government, especially for intertemporal comparison purposes (Buchanan and Flowers, 1987). On the other hand, the ratio of public expenditure to total output of the economy reflects the scope of a nation's public sector relative to the overall size of its economy. According to Berry and Lowery (1987), such ratio is the most commonly used measure of government size and provides the theoretical focus of the literature on government growth. Similarly, Buchanan and Flowers (1987) emphasised that the information concerning the growth of absolute government expenditure provides no indication of the *relative* importance of government in the economy as a whole. Accordingly, this study uses both versions. The expenditure ratio will be employed in the analysis of the aggregate level and size of public expenditure. In testing Wagner's demand-oriented hypothesis, this ratio is correlated with some explanatory variables which are believed to influence public expenditure in the Philippines. On the other hand, the absolute level of public expenditure is applied in examining the disaggregate level of expenditure using the time-series approach. This is explained further in the empirical analysis conducted in Chapter 6.

The second problem deals with the two broad components of government expenditure: namely, *productive expenditures* and *transfer expenditures*. The first includes those expenditures on goods and services that affect resource allocation, while the second consists of transfer payments only. Although this distinction is an accounting one, it may be argued that the inclusion of transfer payments in total government expenditure will overstate the size of the government-expenditure ratio (Abizadeh and Yousefi, 1988). Moreover, some commentators have noted that where total government expenditure to GDP ratios are used, transfers are included in the former but not in the latter (Gemmell, 1993). Musgrave and Musgrave (1984) share the same opinion and propose to exclude transfer payments from the measurement of the public expenditure ratio. An opposing view is put forth by those who argue that transfer payments are as important as other categories of government

expenditure, and as such they should be accounted for in measures of the actual growth and size of the public sector. In addition, the inclusion of both transfer and productive expenditure offers a more realistic portrayal of public sector growth. For the purpose of this study, transfer payments will be included in the overall assessment of public expenditure following Gould's (1983, p. 218) argument that "it [transfers] is after all total government expenditure that has to be funded, and it is the level of this aggregate that influences the levels of taxation, borrowing and interest rates, and possibly through them, investment, economic growth and inflation".

Finally, there is an issue on whether to use real (constant) or nominal (current) value for these expenditures. For instance, Beck (1979) argues that the conventional measure using nominal value is deficient since it fails to consider the impact of different inflation rates on measures of public sector size. In favour of nominal values, some researchers suggest that the nominal measure is preferable since it gives a better indication of government scope and power vis-a-vis the national economy. Similarly, it is the change in the nominal share that should be considered, given the assumption that public services are worth their cost (Abizadeh and Yousefi, 1988). Gould's (1983) study, on the other hand, emphasised that from the point of view of economic management, it is the level of expenditures in current prices which has to be financed and which, through public sector's budget constraint, has possible implications for government borrowing, interest rates, investment, economic growth, monetary expansion, inflation, and so forth. Considering these views, it is not obvious which of the two approaches - the real or the nominal ratio - is the more meaningful one. The use of either values seems to depend on the nature of the problem at hand. Abizadeh and Yousefi (1988, p. 83) suggest that, "if one is primarily interested in a measure of the changing public sector claim on the economy's real resources, then real values should be used. However, if one attempts to explain the trend in the public sector's share in the value of total output, then the unadjusted ratio is a more appropriate dependent variable". Most of the analysis in this paper uses current prices both in the

absolute government expenditure and in the ratio of expenditure to GDP (i.e., NGE/GDP), although some attention is paid to public expenditure growth in real terms.

5.3 Methods of Analysis

The questions the paper seek to answer is examined in the context of a case study of the Philippines. It describes and analyses the patterns and growth of public expenditure from 1965-95. It is an exercise of identifying trends and patterns considering two alternative approaches accompanied by some economic theories. The first approach corresponds to “non-institutional” explanations containing economic variables of a structural character and thus embraces Wagner’s demand-oriented hypothesis. On the other hand, the alternative approach, is more or less “institutional” in nature which corresponds to some economic and stabilisation policies, political conduct, bureaucracy and so forth.

The analysis commenced by considering public expenditure as a whole, from both a secular point of view and in relation to the behaviour of those influences upon expenditure which are believed to operate in a more or less permanent manner. In the empirical analysis, we indicated three influences or explanatory variables that are likely to be both relevant and capable of statistical interpretation in the case of the Philippines: namely, (1) economic growth (as measured by per capita income); (2) total population; and (3) urbanisation (measured as a share of urban population to total population). The size of public expenditure is represented in the study as the ratio of public expenditure to total output (i.e., NGE/GDP). All are based upon fiscal years and market prices although some will be examined in the context of real (or constant) terms. As has been mentioned earlier, such a measure raises a number of problems, nevertheless, it provides a valid basis in terms of the degree of total government involvement and is widely used for this purpose.

The ratio is correlated¹ with the three explanatory variables using the SHAZAM (White, 1993) statistical software package.

As an alternative method, the concept of historical approach is used as the basis for a general and systematic method in analysing and interpreting public expenditure statistics. Moreover, this method is employed to explain changes in the importance of public expenditure through time by examining what happened to government expenditure over periods of different social, economic and political disturbances. Empirical examination to this process must include in some part a qualitative matter and dependent upon description. Finally, this is facilitated by analysing public expenditure statistics by groups and particularly by economic and functional classifications.

5.4 Growth, Size and Change

While some public sector theories relate to growth and others to size or changes in the size of public sector in general and public expenditure in particular, in this study these terms are used interchangeably although the term “growth” is employed more frequently. As an example, it is most likely that the examination of Wagner’s demand-oriented hypothesis helps to explain the growth of government due to income growth trends while theories of bureaucracies or interest groups explain size of government.

¹ The correlation coefficient, r (or sometimes denoted by the Greek letter rho, ρ), is given by:

$$r = \frac{\text{cov}(X, Y)}{\sqrt{\text{var}(X) \text{var}(Y)}}$$

where X (the explanatory variables) and Y (i.e., in this study, the ratio NGE/GDP) are random variables. The correlation, r , must lie between -1 and 1. Therefore, if the correlation between X and Y is 1 or -1, this means that X is a perfect positive or negative linear function of Y . Zero correlation means that there is no linear association between X and Y . The strength of correlation between two variables depends on the absolute value of r , $|r|$. The larger the absolute value, the stronger the correlation is between X and Y (Hill, C. et. al, 1997).

Chapter 6

ANALYSIS OF THE PATTERNS AND GROWTH OF PUBLIC EXPENDITURE

The preceding chapters focussed on various explanations relating to public expenditure in general and the measurement issues relating to its size and growth in particular. The purpose of this chapter is to place some of those ideas in the longer-term context of the determinants of the historical growth and pattern of public expenditure in the Philippines.

The rest of the chapter is organised as follows: Section 6.1 sets out the overall growth of public expenditure in the Philippines. Section 6.2 analyses the general causes of this growth using two alternative approaches. This section is subdivided into different subsections which explain the behaviour of public expenditure and its likely influences or causes.

6.1 Growth of Public Expenditure

Table 6.1 presents a comprehensive picture of the growth of public expenditure (i.e., total NGE) in the Philippines during the past three decades. It is apparent that total NGE grew considerably during the period under review. It rose from ₱1,894 million in 1965 to ₱392,449 million in 1995 in nominal terms. On average, it increased annually by 8 per cent with an annual rate of growth fluctuating widely from 21 per cent to 47 per cent in nominal terms (see Appendix 1).

Table 6.1

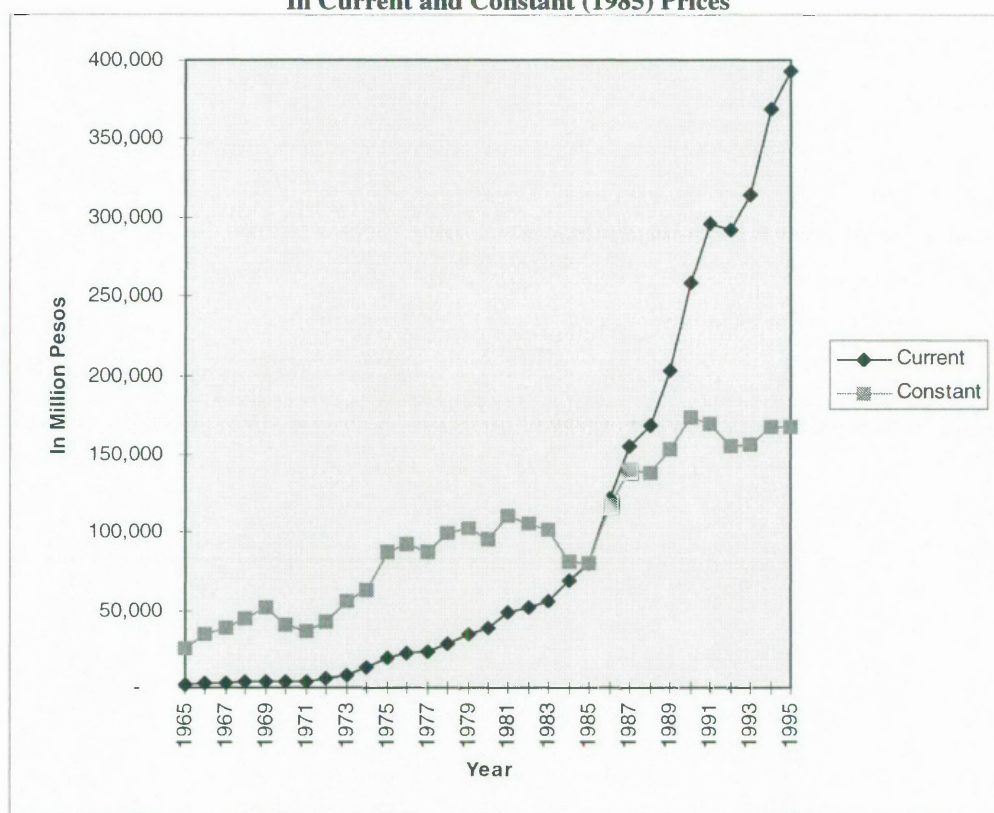
**Total National Government Expenditure (NGE),
Gross Domestic Product (GDP) and
Total NGE as Percentage of GDP, 1965-1995
In Current and Constant 1985 Prices**

Year	Total NGE (In Million Pesos)		Gross Domestic Product (In Million Pesos)		Total NGE (Percentage of GDP)	
	Current	Constant (1985=100)	Current	Constant (1985=100)	Current	Constant (1985=100)
1965	1,894	24,921	23,500	263,749	8.06	9.45
1966	2,762	34,525	25,900	275,532	10.66	12.53
1967	3,200	38,095	29,000	291,751	11.03	13.06
1968	3,817	44,384	32,100	308,061	11.89	14.41
1969	4,460	51,264	35,300	323,260	12.63	15.86
1970	4,053	40,530	42,400	337,580	9.56	12.01
1971	4,429	36,303	50,100	354,314	8.84	10.25
1972	5,588	42,333	56,100	371,523	9.96	11.39
1973	8,574	55,675	72,300	405,496	11.86	13.73
1974	13,024	63,223	99,500	425,942	13.09	14.84
1975	19,049	86,586	114,700	453,360	16.61	19.10
1976	22,069	91,954	135,300	489,685	16.31	18.78
1977	23,043	87,284	154,200	519,717	14.94	16.79
1978	28,066	98,824	177,700	548,457	15.79	18.02
1979	34,154	102,565	217,500	582,485	15.70	17.61
1980	38,079	95,269	243,700	613,082	15.63	15.54
1981	49,083	109,928	281,600	632,667	17.43	17.38
1982	51,142	105,404	317,200	655,372	16.12	16.08
1983	55,811	100,778	369,100	668,175	15.12	15.08
1984	68,510	80,572	524,500	617,349	13.06	13.05
1985	80,262	80,262	571,700	571,700	14.04	14.04
1986	121,339	117,851	609,300	591,209	19.91	19.93
1987	154,542	139,579	685,900	619,770	22.53	22.52
1988	167,761	138,223	803,000	659,223	20.89	20.97
1989	202,137	152,752	952,200	718,804	21.23	21.25
1990	258,705	173,105	1,070,900	717,233	24.16	24.14
1991	295,239	169,483	1,224,000	701,111	24.12	24.17
1992	291,693	155,172	1,342,500	712,315	21.73	21.78
1993	313,746	156,201	1,474,500	667,799	21.28	23.39
1994	369,047	167,043	1,693,900	766,471	21.79	21.79
1995	392,449	167,000	1,905,300	803,585	20.60	20.78

Sources: *Department of Budget and Management, Fiscal Statistics Handbook, various issues*
National Statistical Coordination Board, Philippine Statistical Yearbook, various issues
Asian Development Bank, Key Indicators of Developing Asian and Pacific Countries, 1996

The unadjusted or current figures do not, however, explain everything about the *real* growth of the economy's public sector. It is conceivable, but not probable, that average prices could have moved up as rapidly as the total government expenditure over the period since 1965. In order to see the impact of price changes in the total expenditure trend, NGE was deflated using the *implicit price index* (IPIN) which reflects the price behaviour of goods and services produced in the economy (see Appendix 2)¹.

Figure 6.1
Total National Government Expenditure
1965-1995
In Current and Constant (1985) Prices



Sources: Department of Budget and Management, *Fiscal Statistics Handbook*, various issues
National Statistical Coordination Board, *Philippine Statistical Yearbook*, various issues
Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries*, 1996

Public expenditure (expressed in terms of pesos at constant 1985 prices) displays a different trend with some fluctuations over the period under review

¹ IPIN is the same deflator being used by the Philippine Department of Budget and Management in the calculation of the real levels of national government expenditure.

(Table 6.1). Although some years saw contraction in real total government expenditure, the data still indicate that real government expenditure has grown substantially from 1965-95. Major expenditure shifts occurred during the periods 1969, 1975, 1987 and 1990. A better perspective on the growth of public expenditure, expressed in current and constant prices is provided in Figure 6.1.

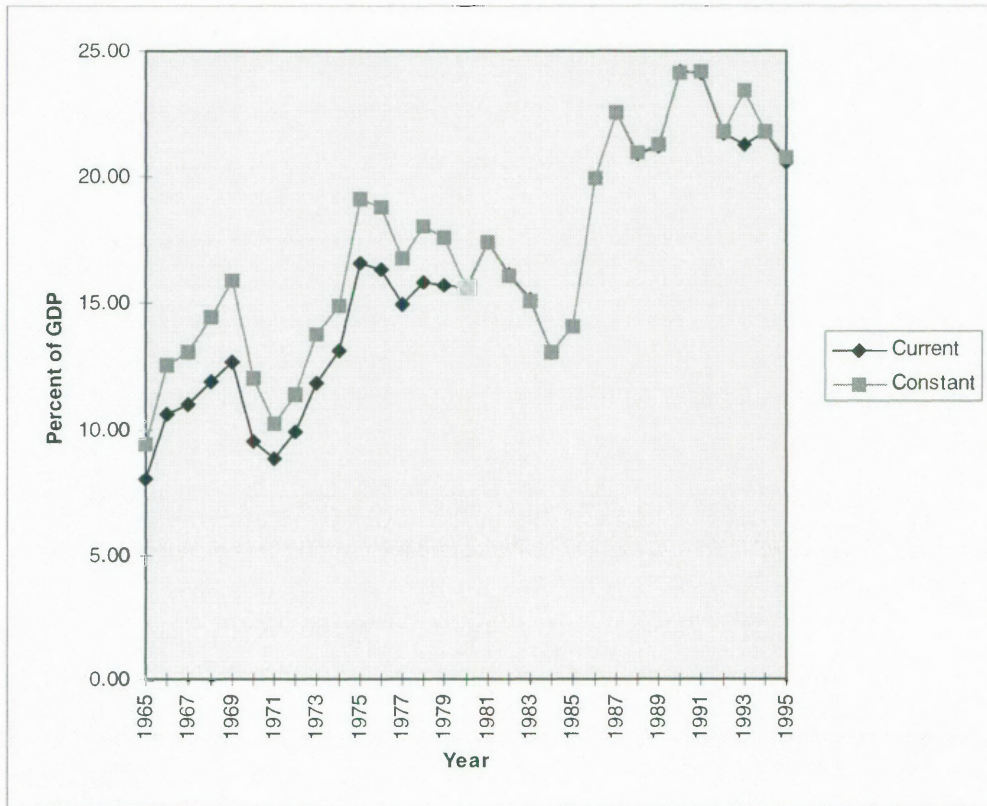
The growth of public expenditure occurred not only in absolute and real terms but is also alarming if viewed as a proportion of GDP. Following Buchanan and Flowers' (1987) argument, the information regarding the growth of government outlay provides no indication of the *relative* importance of government in the economy. The next step, therefore, is to adjust the data by comparing the growth of public expenditure with the growth of the economy as a whole. This is done by computing the total national government expenditure for each year as a percentage of GDP (i.e., NGE/GDP). As a proportion of national income, public expenditure rose from 8.06 per cent to 20.60 per cent over the time period under review. Expressed in adjusted or constant terms by deflating both GDP and NGE with their respective deflators (i.e., GDP deflator and IPIN), the patterns of growth were not significantly altered and showed almost the same trend as in current prices (see Figure 6.2).

6.2 General Causes of Growth

6.2.1 *Wagner's Law of Expanding State Activity*

The rapid expansion of public sector expenditure is a reflection of the activist role played by the government specifically during the period under review. This growth is a combined outcome of many factors. As we saw in the review of literature in Chapter 3, various theories have been presented and revealed a wide range of explanations. The present paper examines Wagner's *demand oriented* analysis which takes into consideration changes in society's economic

Figure 6.2
Total National Government Expenditure
as Percentage of GDP
1965-1995
In Current and Constant (1985) Prices



Sources: Department of Budget and Management, *Fiscal Statistics Handbook*, various issues
National Statistical Coordination Board, *Philippine Statistical Yearbook*, various issues
Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries*, 1996

and social structures as causal factors and specifically hypothesised a relative increase in the demand for social goods as *economic growth and development* took place. Moreover, it also considered such factors or forces operating continuously to affect the size and growth of public expenditure such as the linkages between demographic change and public expenditure shares. Specifically, the demographic influences considered include *total population size* and *urbanisation*.

These explanatory variables were based on various studies focusing on the trends of public expenditure in developing countries which supported the

view that demographic influences and the growth of the economy are associated with the growing spending in most developing countries. For instance, the study of Abello (1964), focusing on the patterns of Philippine public expenditure and revenue, indicated the more important general causes of rapid growth of Philippine public expenditure in the post war era (i.e., 1951-1960) included population growth, urbanisation, economic growth, and the expansion of government functions.

6.2.1.1 Economic Growth

The demand-oriented hypothesis was originally employed by Wagner. It held that as per capita income rises, public sectors will grow in relative importance. According to Trotman-Dickinson (1996), this was found to be empirically plausible: “social progress” leads to increased state activity, this in turn gives rise to greater public expenditure which results in bigger public sector. For instance, the government must inevitably increase its expenditure for infrastructure projects such as highways, roads, etc. to facilitate the flow of a greater volume of goods as a result of the expanded productive capacity of the country. Moreover, there is reason to expect that as per capita income rises, people would demand not only an increased number of government services but better quality as well. As the standard of living rises, it seems realistic for people to impose these demands on governments (Abello, 1964).

One measure of the growth of the Philippine economy is the movement of per capita income. As shown in Table 6.2, nominal GNP per capita increased from P737 to P28,030 with an average annual growth of 14 per cent. Following Gould’s (1983) analysis using statistical tests of correlation, the derived ratios of NGE to GDP covering the period under review were correlated with a standardised measure of per capita GNP, both expressed in current prices. The result of this empirical analysis suggested a strong relationship (coefficient of correlation $r = 0.83$) which may indicate that in the case of the Philippines, the growth of public sector is partly associated with the

growth of the economy. It is also important to consider the statistical relationship between these variables in real or constant terms. GNP per capita, in constant 1985 prices, increased from ₱8,266 to ₱11,822, marking an average growth rate of only 1.4 per cent due to the negative growth rates experienced during the 1980s and 1990s. Consequently, there appears to be a weak relationship between the size of the public sector (NGE/GDP) and economic growth ($r = 0.53$) when all variables were adjusted in real terms. It should be noted, however, that economic outcomes are the result of the complex interaction of a number of factors and its relationship with the growth of public sector is unlikely to be unicausal (Gould, 1983).

6.2.1.2 Population

Generally, demographic changes would seem more promising avenue to try to explain changes in the growth of public expenditure in developing countries. Since public expenditure is putatively intended to benefit the people of a country, it could be expected that an increase in total population would result in higher public expenditure. The responsibilities of the government increase with increased population size since it has to provide a greater number of people with defence protection, justice, education, health and social services and other public improvements (Trotman-Dickinson, 1996).

The population of the Philippines was recorded at 31.8 million in 1965 and increased to 70.3 million in 1995, growing at an annual rate of 2.4 per cent (see Table 6.2). It can be logically assumed that population growth results in growth of public expenditure which means that part of the increasing share of expenditure to GDP can be attributed to the growing population size. In order to test the relationship, the derived ratios of NGE to GDP for 1965-95 were correlated with the total population in the same period. The result suggested a strong positive correlation ($r = 0.89$). It can thus be argued that the increase in population undoubtedly compelled the government to increase its services and

Table 6.2
Selected Economic and Demographic Variables

Year	GNP per Capita (In Pesos)		Population (In Millions)	Growth Rate of Population (In %)	Urban Population (In Millions)	Urban Population (% of total Population)
	Current	Constant (1985=100)				
1965	737	8,266	31.77	3.02	10.03	31.6
1966	785	8,353	32.73	2.93	10.51	32.1
1967	851	8,565	33.71	2.91	10.99	32.6
1968	916	8,787	34.73	2.94	11.50	33.1
1969	978	8,960	35.77	2.91	12.02	33.6
1970	1,134	9,031	36.85	2.93	12.12	32.9
1971	1,309	9,255	37.90	2.77	10.50	34.3
1972	1,423	9,427	38.99	2.80	13.26	34.0
1973	1,785	10,009	40.12	2.82	13.88	34.6
1974	2,419	10,355	41.30	2.86	14.50	35.1
1975	2,717	10,739	42.07	1.83	14.98	35.6
1976	3,057	11,064	43.41	3.09	15.63	36.0
1977	3,461	11,666	44.58	2.62	16.18	36.3
1978	3,638	11,229	45.79	2.64	16.80	36.7
1979	4,326	11,586	47.04	2.66	17.40	37.0
1980	5,035	12,667	48.32	2.65	18.07	37.4
1981	5,662	12,721	49.54	2.46	18.78	37.9
1982	6,174	12,756	50.78	2.44	19.50	38.4
1983	6,978	12,633	52.06	2.46	20.30	39.0
1984	9,531	11,219	53.35	2.42	21.07	39.5
1985	10,172	10,172	54.67	2.41	21.87	40.0
1986	10,648	10,332	56.00	2.38	22.68	40.5
1987	11,695	10,567	57.36	2.37	23.57	41.1
1988	13,488	11,073	58.72	2.32	24.43	41.6
1989	15,175	11,455	60.10	2.30	25.36	42.2
1990	17,609	11,794	61.48	2.24	26.25	42.7
1991	20,138	11,535	62.87	2.21	27.22	43.3
1992	21,562	11,441	64.26	2.16	28.21	43.9
1993	22,393	10,142	67.00	4.09	32.16	48.0
1994	25,325	11,459	68.60	2.33	34.99	51.0
1995	28,030	11,822	70.30	2.42	37.96	54.0

Sources: *Asian Development Bank, Key Indicators of Developing Asian and Pacific Countries, 1996*
Asian Development Bank, Key Indicators of DMCS of ADB, 1985
World Bank, World Tables, 1994

therefore its expenditure rose. However, according to Goffman and Mahar (1971), this result must be interpreted with caution since the total effects of population growth on the level of public expenditure are very difficult to ascertain. Hence, the extent to which the growth of population has led to growth of public expenditure depends on the specific conditions prevailing in a country.

some impact on the growth of the public expenditure share in GDP. However, as some economists have argued, these are hardly sufficient explanations especially in the case of developing countries like the Philippines where the situation is more complex². As an alternative paradigm, we also considered the historical approach which seeks to investigate the behaviour of Philippine public expenditure by looking at the relevant time-series data and salient historical facts.

The focus is now to concentrate on the time-pattern of expenditure growth rather than on the absolute magnitude or size of public expenditure; that is, on how one might expect government expenditure to change through time as a result of various political, social and economic developments. The path of overall expenditure growth (as measured by the ratio of total NGE to GDP) is shown in Table 6.1 and is illustrated in Figure 6.2. As can be observed, the patterns of growth of public expenditure took the form of a series of peaks which increased in amplitude as the time series progressed. For example, it can be observed that these major shifts occurred during the years 1969, 1975, 1987 and 1990³.

The ratio of government expenditure to GDP, as we have argued earlier, reflects the theoretical focus of the literature on government growth. However, according to Berry and Lowery (1987), such ratio is too highly aggregated a concept to explain any kind of trend. Clearly, different components of total national government size have experienced different patterns of change as a result of various developments that have taken place during the last three decades. Expenditure patterns on the different components of public

² Adolf Wagner was writing in the midst of a period of rapid urbanisation and industrialisation and the “law” holds that, among European nations, the pressure for social progress leads inevitably to the growth of the public sector (Cameron, 1978).

³ Based on the study of Peacock and Wiseman (1967), the major shifts in expenditure pattern were synonymous to the increased role of the government brought about by some major disturbances such as wars in the case of the United Kingdom. Recent studies relate these displacements in expenditure to such instances as a result of the Great Depression and other social upheavals.

expenditure are now considered in terms of the percentages of various expenditures in the total expenditures. It is anticipated that considerable light can be shed in explaining the major shifts in public expenditure in the Philippines by applying the historical (time-series) approach and by disaggregating the concept of government size into major expenditure classifications.

6.2.2.1 Classification of Public Expenditure

According to Abello (1964), it is useful to decompose the total NGE into major classifications which relate to the arrangement of the expenditure data relative to government activities. Public expenditures are usually categorised into two major classifications: namely, functional and economic. The *functional or sectoral* classification of expenditure is based on the purpose or function toward which spending is directed, and includes expenditures by sector and sub-sectoral programs, such as transportation, health, education, among others (Pradhan, 1996). On the other hand, the *economic* classification is based on the economic characteristics of transactions on which resources are spent. The economic composition includes (i) capital investments, and (ii) current or recurrent expenditures, which consist of wages and salaries, other goods and services, interest payments and subsidies, amongst other items. It has been argued that the distinction between the two broad components can become hazy in practice since the capital (or development) budget cannot be treated as purely capital expenditure budget. On the other hand, from a developmental point of view, it is often considered a useful distinction by many economists and policymakers who believe that a large share of developmental expenditure in total expenditure is an indication of good economic policy. However, there is no standardised way of classifying expenditure as current or capital so that what is classified as current in one country may be classified as developmental in another (Tanzi, 1987). For the purpose of this study, the two major classifications and their components are employed to analyse the patterns of growth from a historical perspective.

A. The Functional/Sectoral Classification of Expenditure⁴

In the case of the Philippines, the functional/sectoral classification of expenditure is composed of six components: namely, economic services, social services, defense, general public services (GPS), debt service and net lending. As shown in Table 6.3 and Figure 6.3, for the decade of the 1960s, expenditure on social services accounted for more than 40 per cent of the total NGE--the highest among the six sectoral classification of expenditures. During the 1970s however, the shares of so-called economic services constituted more than one-third of the total public expenditure until the early 1980s. On the other hand, other sectoral components, such as defence, had a larger share from 1975-79 and gradually declined from 1980 (i.e., averaging to 20 per cent of total NGE) while general public services (GPS) expenditures accounted for an average annual share of about 11 per cent.

Bearing in mind the demand-oriented influences examined earlier, it can be argued that the growth of population, urbanisation and economic capacity directly influenced the pattern of these expenditure components. For instance, the growth of population and urbanisation necessitated higher outlays for such government functions as health, education, community development, and other economic and social services. Likewise, economic growth raised the standard of living of people and therefore increased their expectations of the standard of government services. It would thus appear that the rate of population growth, urbanisation and economic growth that occurred were contributory factors in the increases in the overall expenditure pattern.

⁴ All data series were presented on an *obligation basis*. Philippine statistics on national government expenditure on an obligation basis included debt amortisation in the calculation of overall expenditure.

Table 6.3
National Government Expenditure, Obligation Basis
By Sectoral/Functional Classification
1965-1995
(In Million Pesos)

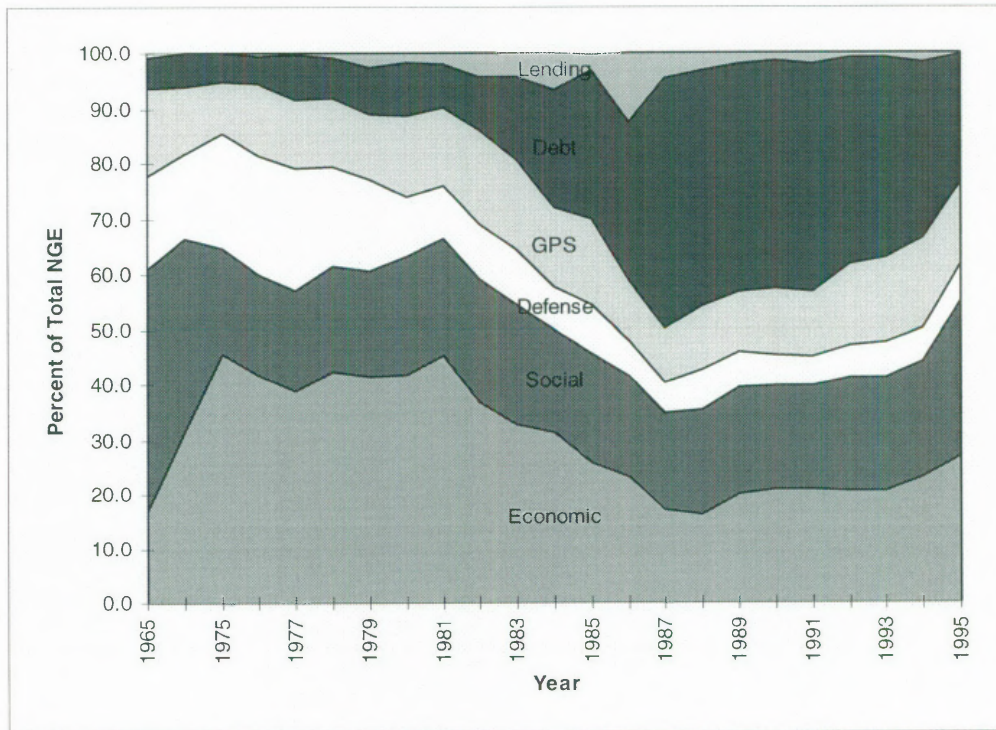
Year	Economic Services	Social Services	Defense	General Public Services	Debt Service	Net Lending	TOTAL NGE
1965	317	838	317	319	104	0	1,894
1970	1,283	1,413	615	499	244	0	4,054
1975	8,672	3,615	3,982	1,825	955	0	19,049
1976	9,227	4,032	4,724	2,909	1,077	100	22,069
1977	8,922	4,244	5,038	2,960	1,834	45	23,043
1978	11,841	5,385	5,085	3,484	2,033	238	28,066
1979	14,132	6,563	5,600	4,175	2,831	853	34,154
1980	15,884	8,165	4,153	5,619	3,583	675	38,079
1981	22,132	10,388	4,879	6,858	3,897	929	49,083
1982	18,886	11,341	5,180	8,625	4,892	2,218	51,142
1983	18,287	12,148	5,591	8,944	8,448	2,393	55,811
1984	21,487	12,726	5,391	9,601	14,882	4,423	68,510
1985	20,694	15,882	7,129	12,399	21,603	2,555	80,262
1986	27,996	22,451	7,611	13,320	34,813	15,148	121,339
1987	26,632	27,128	8,437	15,441	69,825	7,077	154,542
1988	27,134	32,220	12,356	19,471	71,164	5,416	167,761
1989	40,586	38,954	13,051	22,663	83,217	3,666	202,137
1990	54,015	49,088	14,544	30,925	106,346	3,787	258,705
1991	61,822	55,368	15,778	35,064	121,482	5,725	295,239
1992	59,970	60,108	17,306	42,829	109,222	2,258	291,693
1993	64,691	64,732	20,002	48,294	113,378	2,649	313,746
1994	85,076	77,300	23,125	59,686	117,967	5,893	369,047
1995	109,474	112,911	29,133	63,059	93,249	1,031	392,449

Percentage Distribution of National Government Expenditure
By Sectoral/Functional Classification

Year	Economic Services	Social Services	Defense	General Public Services	Debt Service	Net Lending	TOTAL NGE
1965	16.7	44.1	16.7	16.0	5.5	0.0	100.0
1970	31.7	34.9	15.2	12.2	6.0	0.0	100.0
1975	45.5	19.0	20.9	9.5	5.0	0.0	100.0
1976	41.8	18.3	21.4	13.1	4.9	0.5	100.0
1977	38.7	18.4	21.9	12.7	8.0	0.2	100.0
1978	42.2	19.2	18.1	12.3	7.2	0.8	100.0
1979	41.4	19.2	16.4	12.1	8.3	2.5	100.0
1980	41.7	21.4	10.9	14.7	9.4	1.8	100.0
1981	45.1	21.2	9.8	14.0	7.9	1.9	100.0
1982	36.9	22.2	10.0	16.9	9.6	4.3	100.0
1983	32.8	21.8	9.9	16.0	15.1	4.3	100.0
1984	31.4	18.6	7.8	14.0	21.7	6.5	100.0
1985	25.8	19.8	8.9	15.3	26.9	3.2	100.0
1986	23.1	18.5	6.2	11.0	28.7	12.5	100.0
1987	17.2	17.6	5.4	10.0	45.2	4.6	100.0
1988	16.2	19.2	7.3	11.6	42.4	3.2	100.0
1989	20.1	19.3	6.5	11.1	41.2	1.8	100.0
1990	20.9	19.0	5.5	12.0	41.1	1.5	100.0
1991	20.9	18.8	5.3	11.8	41.1	1.9	100.0
1992	20.6	20.6	5.9	14.6	37.4	0.8	100.0
1993	20.6	20.6	6.4	15.3	36.1	0.8	100.0
1994	23.1	20.9	6.3	16.1	32.0	1.6	100.0
1995	27.0	28.2	6.4	15.0	23.0	0.3	100.0

Sources: Department of Budget and Management, *Fiscal Statistics Handbook*, various issues
National Statistical Coordination Board, *Philippine Statistical Yearbook*, various issues

Figure 6.3
Percentage Distribution of NGE
By Sectoral/Functional Classification
1965-1995



Sources: Department of Budget and Management, *Fiscal Statistics Handbook*, various issues
National Statistical Coordination Board, *Philippine Statistical Yearbook*, various issues

However, these factors appear unable to explain the changing pattern of expenditure allocations during the 1980s. As can be seen in Figure 6.3, economic, social, defence and GPS showed the same trend or pattern from 1965 up to 1981, accounting for the highest share of total NGE. On the other hand, from 1984 onwards, the bulk of total expenditure was concentrated on debt service while the rest of expenditure components continued to contract.

In common with other Asian developing countries, the Philippines, after achieving political independence, embarked on a series of national economic development plans involving various investment programs. From a historical perspective and in comparison with other periods of Philippine economic history, the beginning of the 1960s can be characterised as the trend towards the concentration of power in the hands of government and the use of

governmental functions to dispense various programs and projects. It was the time when the rate of growth of total NGE in money terms doubled compared to the immediately preceding period (i.e., 1960-65) (Canlas, et.al., 1984). The period 1965-70, or the initial years of President Marcos' first term, represented new developments in many respects. The government then staked its reputation on a program of vast infrastructure projects such as irrigation, roads, schools and communications. Increasing public expenditure was first designed to improve social and physical infrastructure, which is reflected from the very large share of both economic and social services from 1965-75 (as depicted in Figure 6.3). In particular, expenditures on *communications, roads and other transportation*⁵ (under the economic services) and *education, culture and manpower development* (under social services), captured the largest part of total NGE. In addition, the share of defence expenditure started to increase significantly in 1973 as a result of President Marcos' declaration of Martial Law in 1972. Defence expenditure's share declined after Martial Law was lifted in 1981.

However, the rise in total expenditure brought about by social and physical infrastructure expenditure, as well as defence expenditure, was financed primarily by borrowing from both domestic and external sources and contributed to the accumulation of external debt in the early 1980s (as presented in Figure 6.3). Due to increasing national government debt, debt service⁶ emerged as the most important component of total expenditure in 1985. Its share in total expenditure leaped from 5.5 per cent in 1965 to 45.2 per cent in 1987 and declined to 23 per cent in 1995 as a result of debt rescheduling program pursued by President Ramos' administration (see Table 6.3).

⁵ Appendix 3 provides the various components of the sectoral allocation of public expenditure

⁶ Composed of interest payments and debt amortisation.

B. Economic Classification of Expenditure

In common with the analysis presented above, the expenditure components under the economic classification has also changed dramatically (as shown in Table 6.4). Current operating expenditure (COE) constituted the biggest share of total NGE and showed an increasing growth, while capital expenditure displayed some major fluctuations from 1985 to 1995 (see Figure 6.4). The following sections sketch the different components of this expenditure classification.

B.1 Current Expenditure

During the past three decades, the bulk of current expenditure went to personal services which accounted for around 38 per cent of total current expenditure (see Table 6.5). This large allocation was primarily attributed to the increased size of the national government bureaucracy and a series of salary adjustments. Similarly, the national economic development plans involving huge investment programs which started in 1965 were not only designed to improve the social and physical infrastructure but also to stimulate employment (Asian Development Bank, 1989).

Maintenance and other operating expenses (MOOE) was another big expense item which accounted for almost one-third of current operating expenditure. However, the share started to decline in 1986 when the large proportion of current expenditure accruing to debt service payments increased tremendously from 6.5 per cent in 1965 to 30.3 per cent in 1995. This was reflective of the growing debt burden of the national government.

Table 6.4
National Government Expenditure, Obligation Basis
By Economic Classification
1965-1995
(In Million Pesos)

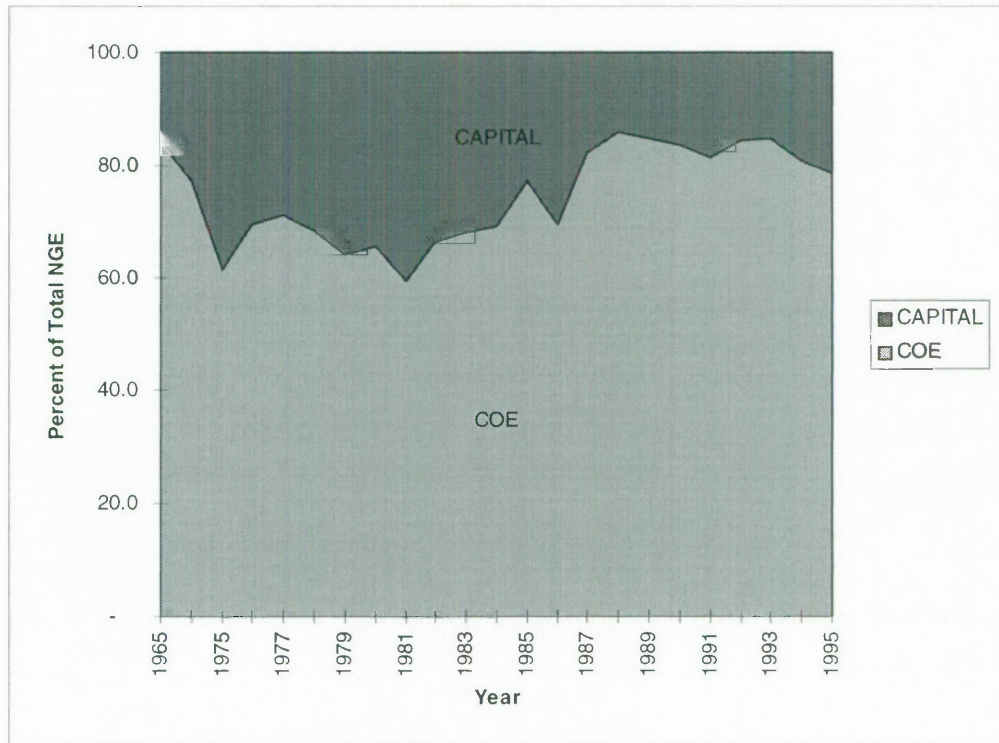
Year	Current Operating Expenditures	Outlays	TOTAL NGE
1965	1,592	302	1,894
1970	3,128	925	4,053
1975	11,685	7,364	19,049
1976	15,363	6,706	22,069
1977	16,373	6,670	23,043
1978	19,206	8,860	28,066
1979	21,943	12,211	34,154
1980	24,926	13,153	38,079
1981	29,179	19,904	49,083
1982	33,990	17,152	51,142
1983	37,939	17,872	55,811
1984	47,432	21,078	68,510
1985	61,949	18,313	80,262
1986	84,152	37,187	121,339
1987	127,204	27,338	154,542
1988	144,107	23,654	167,761
1989	171,108	31,029	202,137
1990	216,682	42,023	258,705
1991	239,877	55,362	295,239
1992	246,330	45,363	291,693
1993	266,116	47,630	313,746
1994	298,332	70,715	369,047
1995	308,049	84,400	392,449

Percentage Distribution of National Government Expenditure
By Sectoral/Functional Classification

Year	Current Operating Expenditures	Capital Outlays	TOTAL NGE
1965	84.1	15.9	100.0
1970	77.2	22.8	100.0
1975	61.3	38.7	100.0
1976	69.6	30.4	100.0
1977	71.1	28.9	100.0
1978	68.4	31.6	100.0
1979	64.2	35.8	100.0
1980	65.5	34.5	100.0
1981	59.4	40.6	100.0
1982	66.5	33.5	100.0
1983	68.0	32.0	100.0
1984	69.2	30.8	100.0
1985	77.2	22.8	100.0
1986	69.4	30.6	100.0
1987	82.3	17.7	100.0
1988	85.9	14.1	100.0
1989	84.6	15.4	100.0
1990	83.8	16.2	100.0
1991	81.2	18.8	100.0
1992	84.4	15.6	100.0
1993	84.8	15.2	100.0
1994	80.8	19.2	100.0
1995	78.5	21.5	100.0

Sources: Department of Budget and Management, *Fiscal Statistics Handbook*, various issues
National Statistical Coordination Board, *Philippine Statistical Yearbook*, various issues

Figure 6.4
Percentage Distribution of NGE
By Economic Classification
1965-1995



Sources: Department of Budget and Management, *Fiscal Statistics Handbook*, various issues
National Statistical Coordination Board, *Philippine Statistical Yearbook*, various issues

Allotments to local government units (LGUs) also expanded over the years, indicating the continued financial inadequacy of local governments. Specifically, its share of current expenditure increased dramatically in 1992 when the Local Government Code took effect which mandated the devolution or transfer of certain functions and the corresponding personnel and assets from the national government to LGUs. The small share of subsidies to government corporations are rather misleading because much of the support for these corporations was provided in the form of equity contributions and net lending which are separate expense item as reported by the budget management (Manasan, 1988).

Table 6.5
Components of Current Operating Expenditure (COE)
1965-1995
(In Million Pesos)

Year	Personal Services	MOOE	LGU Allotments	Debt Service	Subsidies	Tax Exp	TOTAL COE
1965	1,140	348	0	104	0	0	1,592
1970	1,895	681	0	244	310	0	3,128
1975	4,486	4,219	596	955	1,429	0	11,685
1976	6,044	6,414	697	1,077	1,131	0	15,363
1977	6,285	6,646	836	1,834	772	0	16,373
1978	7,419	7,556	1,103	2,033	1,095	0	19,206
1979	8,206	8,821	1,071	2,831	1,014	0	21,943
1980	9,687	9,014	1,426	3,583	1,216	0	24,926
1981	13,184	9,684	1,743	3,897	671	0	29,179
1982	13,583	12,381	2,291	4,892	843	0	33,990
1983	14,282	11,714	2,598	8,448	897	0	37,939
1984	18,329	10,410	2,795	14,882	1,016	0	47,432
1985	22,046	13,780	3,522	21,603	998	0	61,949
1986	28,527	15,444	3,382	34,813	1,545	441	84,152
1987	31,537	19,449	3,835	69,825	1,509	1,049	127,204
1988	43,596	22,088	4,363	71,164	2,298	598	144,107
1989	52,006	27,814	3,337	83,217	3,734	1,000	171,108
1990	64,289	32,002	4,746	106,346	8,001	1,298	216,682
1991	69,327	35,023	6,754	121,482	6,253	1,038	239,877
1992	77,554	36,606	16,244	109,222	4,678	2,026	246,330
1993	76,948	36,267	29,379	113,378	6,840	3,304	266,116
1994	92,573	36,814	37,452	117,967	10,646	2,880	298,332
1995	113,100	44,387	41,600	93,249	8,400	7,313	308,049

Components of Current Operating Expenditure (COE)
As Percentage of Total COE

Year	Personal Services	MOOE	LGU Allotments	Debt Service	Subsidies	Tax Exp	TOTAL
1965	71.6	21.9	0.0	6.5	0.0	0.0	100.0
1970	60.6	21.7	0.0	7.8	9.9	0.0	100.0
1975	38.4	36.1	5.1	8.2	12.2	0.0	100.0
1976	39.3	41.7	4.5	7.0	7.4	0.0	100.0
1977	38.4	40.6	5.1	11.2	4.7	0.0	100.0
1978	38.6	39.3	5.7	10.6	5.7	0.0	100.0
1979	37.4	40.2	4.9	12.9	4.6	0.0	100.0
1980	38.9	36.2	5.7	14.4	4.9	0.0	100.0
1981	45.2	33.2	6.0	13.4	2.3	0.0	100.0
1982	40.0	36.4	6.7	14.4	2.5	0.0	100.0
1983	37.6	30.9	6.8	22.3	2.4	0.0	100.0
1984	38.6	21.9	5.9	31.4	2.1	0.0	100.0
1985	35.6	22.2	5.7	34.9	1.6	0.0	100.0
1986	33.9	18.4	4.0	41.4	1.8	0.5	100.0
1987	24.8	15.3	3.0	54.9	1.2	0.8	100.0
1988	30.3	15.3	3.0	49.4	1.6	0.4	100.0
1989	30.4	16.3	2.0	48.6	2.2	0.6	100.0
1990	29.7	14.8	2.2	49.1	3.7	0.6	100.0
1991	28.9	14.6	2.8	50.6	2.6	0.4	100.0
1992	31.5	14.9	6.6	44.3	1.9	0.8	100.0
1993	28.9	13.6	11.0	42.6	2.6	1.2	100.0
1994	31.0	12.3	12.6	39.5	3.6	1.0	100.0
1995	36.7	14.4	13.5	30.3	2.7	2.4	100.0

Sources: Department of Budget and Management, *Fiscal Statistics Handbook*, various issues
National Statistical Coordination Board, *Philippine Statistical Yearbook*, various issues

B.2 Capital Outlay

Table 6.6 lists the amounts and shares of capital expenditures that went into infrastructure, corporate equity and other capital outlays. Between 1965-76, infrastructure constituted 85 per cent of total capital outlays. However, this expense item became increasingly less important from then on, with only 36 per cent on average from 1977-95. The share of corporate equity gained prominence as a form of capital outlay from 1977-87. It should be noted here that after Martial Law was declared in 1972, a high degree of state intervention in the economy began and continued to rise even after it was lifted in 1981. Various decrees were passed setting-up major public corporations (i.e., the so-called government-owned and controlled corporations (GOCCs)), often in competition with existing private entrepreneurs, but supported by government subsidies and equity contributions (Hodgkinson, 1993). The situation was further exacerbated when the national government assumed the responsibility for bailing out these corporations and other large private industries and financially troubled financial institutions affected by the oil price shocks in the 1970s and early 1980s.

In comparison with other oil-importing developing economies, the first oil shock in 1973-74 and the second oil price shock in 1980 brought particular difficulties into the Philippine economy⁷ and constituted a *displacement effect* on the overall pattern of public expenditure. The slower growth of the economy and the high interest rates severely affected subsidised domestic

⁷ Full documentation of the effects of these oil price shocks on the different sectors of the economy are beyond the scope of this paper. However, some explanation is necessary. The first oil shock in 1973-74 hit the Philippines hard through terms of trade deterioration and a slowdown in the growth of external markets. The dependence of most of its energy consumption on oil imports and the change in external prices had a severe effect on the country's national income which posted a real income loss of 6 per cent of GNP. The current account deficit increased after the first oil price shock and consequently foreign debt grew rapidly. The public sector did most of the borrowing and held two-thirds of the foreign debt of the non-banking sector by the end of the decade (Cabalu, 1994). Similarly, the second oil price shock in 1980 further damaged the Philippine economy and led to an increasing fiscal burden on the national government.

firms⁸. A domestic financial crisis in 1981 brought difficulties to several large firms, many of which were bailed out by the government. Similarly, the national government was forced to absorb the losses of some government-owned financial institutions, as well as GOCCs⁹.

As a consequence, the deficits of these GOCCs had to be financed by equity contributions from the national government funded through foreign borrowing thus increasing further the debt service obligation of the national government. Beginning in 1988, the share of corporate equity declined as a result of the attempt by the new administration of President Aquino to privatise some public sector enterprises and to abolish or merge others with existing agencies.

The category “other capital expenditure” was partly affected by the costs incurred in bailing out some of the public sector enterprises during the financial collapse of 1981-83. Similarly, it included expenditure on huge building complexes which have been cited by Canlas, et.al. (1984), and Fegan and Purcal (1993) as evidence of a shift towards less productive investment.

⁸ The situation was further encouraged due to government’s practice of guaranteeing foreign loans made to certain group of people as well as financing selective investment projects in the private sector (Canlas, et.al, 1984).

⁹ Most of these corporations were unable to service their debt obligations which were mostly guaranteed by the national government. The national government, in effect, had to assume these debts to avoid default and possible negative consequences (Briones, L.M., et.al, 1990).

Table 6.6
Components of Capital Outlay
1965-1995
(In Million Pesos)

Year	Infrastructure	Corporate Equity	Other Capital Expenditure	TOTAL CAPITAL OUTLAY
1965	269	0	33	302
1970	720	0	205	925
1975	n.a.	n.a.	n.a.	7,364
1976	2,774	3,145	787	6,706
1977	2,446	2,971	1,253	6,670
1978	2,886	4,784	1,190	8,860
1979	5,269	4,762	2,180	12,211
1980	4,782	6,510	1,861	13,153
1981	6,126	11,611	2,167	19,904
1982	5,856	9,632	1,664	17,152
1983	6,215	7,953	3,704	17,872
1984	4,441	13,552	3,085	21,078
1985	6,195	7,327	4,791	18,313
1986	5,831	27,452	3,904	37,187
1987	6,914	11,692	8,732	27,338
1988	8,614	7,536	7,504	23,654
1989	9,797	6,363	14,869	31,029
1990	18,127	6,686	17,210	42,023
1991	19,187	7,477	28,698	55,362
1992	25,591	6,139	13,633	45,363
1993	20,438	9,459	17,733	47,630
1994	34,763	9,612	26,340	70,715
1995	42,600	13,100	28,700	84,400

Components of Capital Outlay
As Percentage of Total Capital Outlay

Year	Infrastructure	Corporate Equity	Other Capital Expenditure	TOTAL
1965	89.1	0.0	10.9	100.0
1970	77.8	0.0	22.2	100.0
1975	n.a.	n.a.	n.a.	n.a.
1976	41.4	46.9	11.7	100.0
1977	36.7	44.5	18.8	100.0
1978	32.6	54.0	13.4	100.0
1979	43.1	39.0	17.9	100.0
1980	36.4	49.5	14.1	100.0
1981	30.8	58.3	10.9	100.0
1982	34.1	56.2	9.7	100.0
1983	34.8	44.5	20.7	100.0
1984	21.1	64.3	14.6	100.0
1985	33.8	40.0	26.2	100.0
1986	15.7	73.8	10.5	100.0
1987	25.3	42.8	31.9	100.0
1988	36.4	31.9	31.7	100.0
1989	31.6	20.5	47.9	100.0
1990	43.1	15.9	41.0	100.0
1991	34.7	13.5	51.8	100.0
1992	56.4	13.5	30.1	100.0
1993	42.9	19.9	37.2	100.0
1994	49.2	13.6	37.2	100.0
1995	50.5	15.5	34.0	100.0

Sources: Department of Budget and Management, *Fiscal Statistics Handbook*, various issues
National Statistical Coordination Board, *Philippine Statistical Yearbook*, various issues

Overall examination of the above major classifications of expenditure suggests that the rise in NGE as a proportion of GDP (especially during the 1980s) was mainly due to the large share of current operating expenditure at the expense of the very contracted capital outlay. A reduced trend in capital outlay started when the country began to feel the ill-effects of its huge borrowings.

6.2.2.2 Public Expenditure and Public Debt

As we have seen, the national government of the Philippines pursued a very aggressive expenditure program in the 1960s and 1970s partly to reorganise the economic, social and political structure and promote growth through public investment programs. Similarly, it was also used to counter the negative effects of the international oil price increases on the domestic economy in the 1980s, where substantial part of the resources were used for financing selected private firms and public sector enterprises. As a consequence, the pattern of government expenditure far exceeded the resources available in the economy.

As shown in Table 6.7, the public sector posted a surplus in 1965 and during the early 1970s. However, by mid-1970s onwards, the government posted large and growing fiscal deficits that proved to be unsustainable. For a while, the country attempted to follow traditional financial principles by raising taxes to finance the additional expenditure, but due to the absence of a consistent and systematic approach to achieve revenue objectives, the Philippine tax/GDP ratio deteriorated and was surpassed by the growing NGE/GDP ratio (Table 6.7). As Hodgkinson (1997, p. 834) has pointed out, “tax revenues failed to keep pace with the expanded expenditure largely because of the proliferation of exemptions, poor compliance, inefficiency in tax administration and widespread evasion”. Consequently, the public sector relied heavily on both foreign and domestic borrowings to finance its substantial fiscal deficits which had resulted in a growing share of public debt in the overall government expenditure in the early 1980s. The increase in foreign indebtedness further added to the interest burden and required more borrowing

for repaying interest, which now accounted for 65 per cent of total debt obligation since 1980 (see Figure 6.5).

After 1985, the debt obligation of the national government began to increase substantially which restricted the long-run growth potential¹⁰ of the Philippine economy as expenditures were shifted away from both investment in infrastructure and economic and social services (see Figure 6.3).

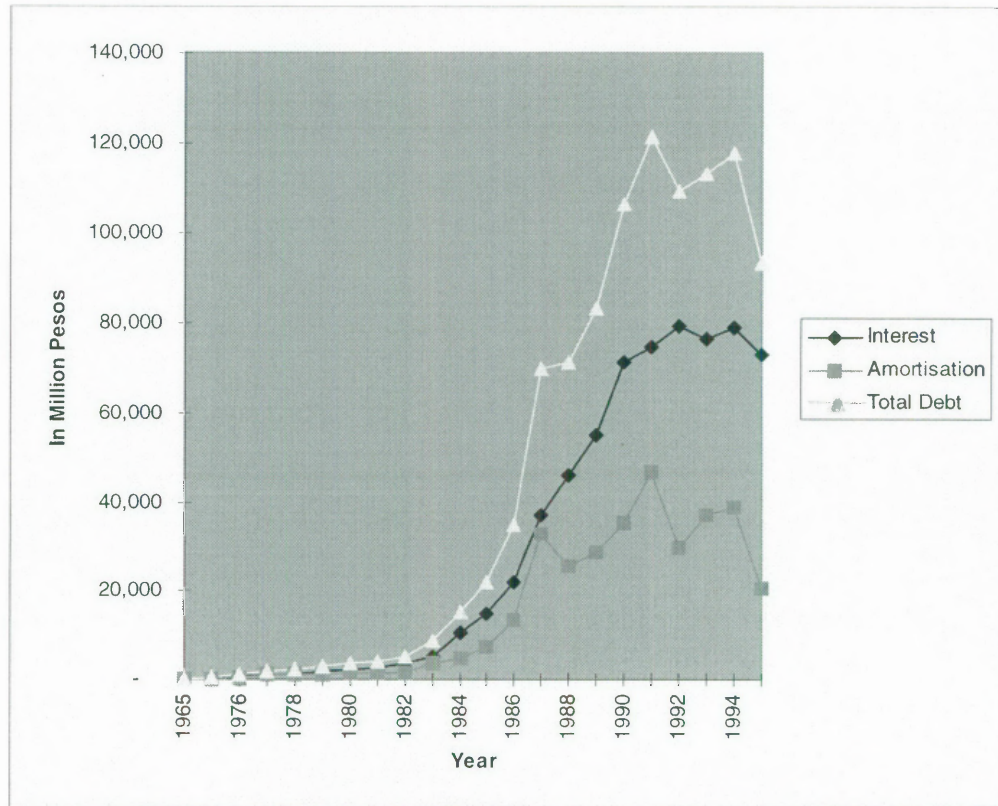
Table 6.7
Total National Government Expenditure (NGE)
and Revenue, Current Prices
1965-1995

Year	Total NGE (In Million Pesos)	Total Revenue (In Million Pesos)	Total NGE (Percentage of GDP)	Total Revenue (Percentage of GDP)	Fiscal Balance (Revenue - NGE) Surplus/(Deficit) (In Million Pesos)
1965	1,894	2,063	8.06	8.78	169
1966	2,762	2,626	10.66	10.14	(136)
1967	3,200	2,886	11.03	9.95	(314)
1968	3,817	3,252	11.89	10.13	(565)
1969	4,460	3,611	12.63	10.23	(849)
1970	4,053	4,940	9.56	11.65	887
1971	4,429	5,790	8.84	11.56	1,361
1972	5,588	6,948	9.96	12.39	1,360
1973	8,574	9,415	11.86	13.02	841
1974	13,024	11,913	13.09	11.97	(1,111)
1975	19,049	16,638	16.61	14.51	(2,411)
1976	22,069	18,089	16.31	13.37	(3,980)
1977	23,043	19,959	14.94	12.94	(3,084)
1978	28,066	24,073	15.79	13.55	(3,993)
1979	34,154	29,470	15.70	13.55	(4,684)
1980	38,079	34,731	15.63	14.25	(3,348)
1981	49,083	35,933	17.43	12.76	(13,150)
1982	51,142	38,206	16.12	12.04	(12,936)
1983	55,811	45,632	15.12	12.36	(10,179)
1984	68,510	56,861	13.06	10.84	(11,649)
1985	80,262	68,961	14.04	12.06	(11,301)
1986	121,339	79,245	19.91	13.01	(42,094)
1987	154,542	103,214	22.53	15.05	(51,328)
1988	167,761	112,861	20.89	14.05	(54,900)
1989	202,137	152,410	21.23	16.01	(49,727)
1990	258,705	180,902	24.16	16.89	(77,803)
1991	295,239	220,787	24.12	18.04	(74,452)
1992	291,693	242,714	21.73	18.08	(48,979)
1993	313,746	260,405	21.28	17.66	(53,341)
1994	369,047	336,160	21.79	19.85	(32,887)
1995	392,449	340,849	20.60	17.89	(51,600)

Sources: Department of Budget and Management, *Fiscal Statistics Handbook*, various issues
Asian Development Bank, *Key Indicators of DMCS of ADB*, 1984
United Nations, *Statistical Yearbook for Asia and the Pacific*, 1975

¹⁰ The Philippine economy was considered the weakest performer in the East Asian region (see Chapter 2 on the overview of the economy)

Figure 6.5
National Government Debt Service Expenditures
1965-1995



Sources: Department of Budget and Management, *Fiscal Statistics Handbook*, various issues
National Statistical Coordination Board, *Philippine Statistical Yearbook*, various issues

6.2.2.3 Public Expenditure and Public Investment Program

Although they fall outside the scope of this study, some points regarding the efficient allocation of resources have to be considered which according to some economists indirectly caused the expansion of public expenditure in the Philippines. From the above analysis, it can be argued that the provision of various physical and infrastructural projects, for which most of the foreign loans had been raised, were economically justifiable since it was aimed at the development of a dynamic private enterprise system (i.e., on the argument that a good public investment program can encourage growth). However, in the case of the Philippines, the bulk of infrastructure and other capital outlays were not very productive and many were downrightly wasteful. For instance, the

construction of highways, schoolhouses and its involvement in hotels (not to mention monument-construction) yielded little or no cash returns to the government or to government corporations. Moreover, the returns on other public investments, like irrigation, harbours, rural electrification, etc. were only meager in the immediate years after construction (Cabalu, 1994). This may be traced to the insufficient funds allocated for the appropriate operation and maintenance of these capital projects which resulted in lower productivity and reduced longevity of the capital stock. Similarly, the poor performance of the public sector enterprises has contributed to the weakness in overall public finances. It should be noted that capital expenditure in power, energy, water and other utilities was largely undertaken by the public sector enterprises which according to Briones, et. al. (1990) showed unfavourable performance in terms of factor productivity and financial profitability, especially during the last two decades of the period under review. Their losses were covered by the national government budget. The overall outcome of such resource utilisation was the limited capacity of the government to spend on strategic areas, such as the maintenance of capital stock. In addition, the huge debt-service commitments further reduced the government's degrees of freedom with respect to the country's social and economic needs (see Figure 6.3).

6.2.2.4 Major Shifts in Public Expenditure

In Section 6.2.2, it has been emphasised that the major shifts in public expenditure as a share of GDP occurred in 1969, 1975, 1987 and 1990. Based on the work of Peacock and Wiseman (1967) and other recent similar studies, these major shifts in expenditure pattern are synonymous to the increased role of government brought about by major disturbances and other social upheavals (e.g., wars, Great Depression) (Goffman and Mahar, 1971).

As demonstrated in the previous analysis, the time pattern of expenditure growth can be summarised as follows: The major shift in public expenditure which occurred in 1969 was brought about by the national economic

development plans of the Marcos administration. Starting from 1965, major infrastructure projects were designed and implemented. Consequently, it increased the share of social and economic services or the infrastructure component of capital outlay. On the other hand, the significant changes in 1975 up to the early 1980s were attributed to both internal and external factors. The former dealt with the imposition of Martial Law in 1972 which dramatically increased the share of defense expenditure. Due to the power of the national government to intervene in the economy, public investment programs continued to be implemented, thus increasing further the share of economic services component. The latter disturbance had to do with the oil price shocks in 1974 and 1981 which severely affected the Philippine economy and displaced the overall pattern of public expenditure. In particular, it increased the share of capital outlays through corporate equities and subsidies when the national government bailed out and absorbed the losses of selected financial institutions and GOCCs.

Finally, the major changes in public expenditure which took place between 1987 to 1990 were primarily associated with the financial constraint experienced by the national government. The growth of public expenditure far exceeded the growth of revenue resulting in an overall budget deficit. However, instead of raising taxes to finance the rise in public spending, the government decided to borrow from domestic and foreign sources. Thus began an extended period of deficit financing for the government. As the final outcome, the debt service component absorbed a very large part of the overall expenditure of the national government.

Chapter 7

CONCLUSION

The present study describes and analyses the patterns and growth of public expenditure in the Philippines. Moreover, it attempts to examine the general causes or influences that may explain the growth of public expenditure on the basis of some empirical data and historical facts covering the period 1965-95.

The following discussion is organised as follows: Section 7.1 presents the summary of findings. Section 7.2 outlines the policy implications. Section 7.3 identifies some areas for further research.

7.1 Summary of Findings

Various characteristics of the growth of public expenditure during the period 1965-95 have been discussed as well as the general causes or influences that seem to explain the major shifts in the Philippine public expenditure. Two major approaches were applied in analysing the growth of public expenditure: namely, Wagner's law of expanding state activity and the historical time-series approach inspired by the works of Peacock and Wiseman. We examined the demand-oriented hypothesis propounded by Wagner which included variables relating to economic growth, population and urbanisation as likely general causes of public expenditure growth. While the influences of these explanatory variables have undoubtedly had some effects on the growth of the public expenditure share in GDP, further analysis indicated that a sizeable portion of

public expenditure in the Philippines still remains unexplained. Based on the historical (time-series) approach, it was found that in the case of the Philippines, the growth of public expenditure was partly influenced by the national economic development plans of the government which involved ambitious investment programs combined with a high degree of state intervention using public funds. Thus, the period under review was characterised by higher government expenditure, coupled with a very weak tax collection effort which resulted in budget deficits. Public expenditures were financed primarily by public debt which absorbed a very large part of the national governmental expenditure, especially in the mid-1980s. Moreover, public expenditure growth was further boosted by the external disturbances brought about by the oil price shocks in the 1970s and 1980s. In effect, the national government had to assume the financial obligations of highly subsidised firms, financial institutions, and public sector enterprises, which contributed substantially to the fiscal deficits, public debt and the overall expansion of government expenditure.

The notion of “tolerable burden of taxation” as set forth by Peacock and Wiseman was examined in this study and the results showed that “deficit-financed” spending through public debt during major disturbances further increased the role of the public sector through public expenditure. Finally, even after the “disturbances” were over, public expenditure stayed at an even higher level due to public sector’s debt obligations. Overall, the government was severely constrained in pursuing other economic and social objectives which restricted the nation’s long-run growth potential compared to its neighbours.

7.2 Policy Implications

From the empirical analysis presented in the study, the government budgets indicate that public expenditures have increased beyond levels that can be

supported by revenues, which led to increasing borrowing from both domestic and external sources. It should be pointed out, however, that in pursuing the country's development goals through public expenditure, policy makers should be aware that such spending will help create capacities for higher production, and that the tax system is efficient enough to ensure revenues increase commensurate with the rise in income and output. But if public expenditures yield no commensurate returns, then budgetary imbalances would be aggravated. According to Kohli (1987), the solution lies in either restraining the growth of public expenditures or designing expenditures in a way that leads to increase revenue commensurate with higher public investment. The latter solution might be difficult in the short run given the Philippines' administrative constraints and the social and political environment. It would be unrealistic to expect any dramatic change in the revenue yielding capacity of the tax system. However, for purposes of long-term planning, the government should undertake structural and administrative reform of the tax and non-tax revenue system with the view to improving the government's revenue generating capacity without sacrificing equity and efficiency considerations (Manasan, 1988). For instance, a program of computerisation of the tax system should be a priority of the national government for tax administration reform. Moreover, simplifying the tax system will help discourage distortions and evasion.

Meanwhile, in the short-term, it is important to find ways on how to reduce expenditures or enhance its productivity. The study has provided several possibilities where public expenditures can be reduced or improved. For instance, the need to review various expenditures in the form of subsidies, grants or equity contributions given to public sector enterprises. Kohli (1987, p. 18) argued that "transfers of government funds often provide an easy avenue for political patronage, while subsidies are a major burden on the budget". Thus, these expenditures need to be reexamined and subjected to rigorous cost-benefit tests. Similarly, it could be desirable to accelerate public sector reforms in order to improve the productivity of government departments and

state-owned enterprises through rationalisation of administrative and staffing resources. In particular, the growth of bureaucracy must be arrested and staff deployed for more productive and efficient activities. Finally, it should be emphasised that the remedy does not lie in an indiscriminate reduction of public expenditure as this may impose a heavy social cost through the impairment of productive capacity and the reduction of social welfare. According to Tanzi (1995), the radical reforms must aim at maintaining the public sector objectives while reducing the level of spending.

7.3 Areas for Further Research

The scope of this dissertation has been broad and wide-ranging. It has attempted to provide a numerical picture of the overall involvement of the national government of the Philippines through public expenditure over the last three decades and partly tried to explain the factors that have contributed to changes and development that occurred during the same period. In general, such growth can be attributed to the fact that developing countries, like the Philippines, accepted the view that government must play a larger role in the economic restructuring and development objectives of the nation. In particular, the dissertation pointed some underlying reasons why the Philippine government was not able to resist the pressures to increase spending. Economic, social and political factors have been seen to affect both the size and structure of public spending.

What is disturbing at present time are the consequences of this growth in public expenditure. The macroeconomic imbalances, for instance, have underscored the imperative to cut aggregate spending and, at the same time, the difficult choices that the government has to make about where to cut spending and how to allocate scarce resources while maintaining the public sector objectives.

This study, therefore, has identified a number of areas where further research is necessary. The first concerns on the debate about the relationship between government size and economic growth. Moreover, the study has mainly focused on the growth of public expenditure which is just one component of economic development of the Philippines. Hence, the complete analysis must include the relationship between public expenditure on the one hand and other specific economic factors such as inflation, employment, income distribution, on the other. The second issue concerns with the impact of public expenditure on various programs such as in areas of health, education, defence and so forth. Further research must try to answer questions relating to what the country has gained from the growth in public expenditure, both in economic and social aspects.

Appendix 1

Rate of Growth of Total NGE 1965-1995 In Current and Constant 1985 Prices

Year	Total NGE (In Million Pesos)		Rate of Growth	
	Current	Constant	Current	Constant
1965	1,894	24,921		
1966	2,762	34,525	38.5	45.8
1967	3,200	38,095	10.3	15.9
1968	3,817	44,384	16.5	19.3
1969	4,460	51,264	15.5	16.8
1970	4,053	40,530	(20.9)	(9.1)
1971	4,429	36,303	(10.4)	9.3
1972	5,588	42,333	16.6	26.2
1973	8,574	55,675	31.5	53.4
1974	13,024	63,223	13.6	51.9
1975	19,049	86,586	37.0	46.3
1976	22,069	91,954	6.2	15.9
1977	23,043	87,284	(5.1)	4.4
1978	28,066	98,824	13.2	21.8
1979	34,154	102,565	3.8	21.7
1980	38,079	95,269	(7.1)	11.5
1981	49,083	109,928	15.4	28.9
1982	51,142	105,404	(4.1)	4.2
1983	55,811	100,778	(4.4)	9.1
1984	68,510	80,572	(20.1)	22.8
1985	80,262	80,262	(0.4)	17.2
1986	121,339	117,851	46.8	51.2
1987	154,542	139,579	18.4	27.4
1988	167,761	138,223	(1.0)	8.6
1989	202,137	152,752	10.5	20.5
1990	258,705	173,105	13.3	28.0
1991	295,239	169,483	(2.1)	14.1
1992	291,693	155,172	(8.4)	(1.2)
1993	313,746	156,201	0.7	7.6
1994	369,047	167,043	6.9	17.6
1995	392,449	167,000	(0.0)	6.3

Sources: *Department of Budget and Management, Fiscal Statistics Handbook, various issues*
National Statistical Coordination Board, Philippine Statistical Yearbook, various issues

Appendix 2

Implicit Price Index (IPIN) and GDP Deflator 1965-1995

Year	Implicit Price Index	GDP Deflator
1965	7.6	8.9
1966	8.0	9.4
1967	8.4	9.9
1968	8.6	10.4
1969	8.7	10.9
1970	10.0	12.6
1971	12.2	14.1
1972	13.2	15.1
1973	15.4	17.8
1974	20.6	23.4
1975	22.0	25.3
1976	24.0	27.6
1977	26.4	29.7
1978	28.4	32.4
1979	33.3	37.3
1980	40.0	39.8
1981	44.7	44.5
1982	48.5	48.4
1983	55.4	55.2
1984	85.0	85.0
1985	100.0	100.0
1986	103.0	103.1
1987	110.7	110.7
1988	121.4	121.8
1989	132.3	132.5
1990	149.5	149.3
1991	174.2	174.6
1992	188.0	188.5
1993	200.9	220.8
1994	220.9	221.0
1995	235.0	237.1

Note: Based on 1985 prices

Sources: Department of Budget and Management, Fiscal Statistics
Handbook, various issues
International Monetary Fund, International Financial
Statistics Yearbook, various issues

Appendix 3
National Government Expenditure, Obligation Basis
By Sectoral/Functional Classification
1965-1995
(In Million Pesos)

PARTICULARS	1965	1970	1975	1976	1977	1978	1979
ECONOMIC SERVICES	317	1,283	8,672	9,227	8,922	11,841	14,132
Agriculture, Agrarian Reform and Natural Resources	134	260	1,022	2,709	2,087	3,343	1,992
Trade and Industry	122 ^a	782 ^a	1,478	226	231	307	393
Tourism				71	55	110	179
Power and Energy				1,172	1,081	2,197	2,945
Water Resource Dev't. and Food Control				545	643	549	863
Communications, Roads and other Transportation	61	241	6,172	3,548	3,717	4,469	6,994
Other Economic Services				956	1,108	866	766
Subsidy to Local Government Units (LGUs)							
SOCIAL SERVICES	838	1,413	3,615	4,032	4,244	5,385	6,563
Education, Culture, and Manpower Development	692	1,133	2,212	2,632	2,776	3,681	4,039
Health	117 ^b	226 ^b	785	870	961	956	1,239
Social Security and Labor Welfare	29	54	618	372	344	463	488
Land Distribution	0	0	0	0	0	0	0
Housing and Community Development				61	142	257	768
Other Social Services				97	21	28	29
Subsidy to LGUs							
DEFENSE	317	615	3,982	4,724	5,038	5,085	5,600
GENERAL PUBLIC SERVICES	319	499	1,825	2,909	2,960	3,484	4,175
General Administration	n.a.	n.a.	n.a.	1,711	1,570	1,815	2,365
Public Order and Safety	n.a.	n.a.	n.a.	246	252	297	369
Other General Public Services	n.a.	n.a.	n.a.	952	1,138	1,372	1,441
Subsidy to LGUs	0	0	0	0	0	0	0
NET LENDING	0	0	0	100	45	238	853
DEBT SERVICE	104	244	955	1,077	1,834	2,033	2,831
Interest Payments	57	149	n.a.	743	898	1,136	1,841
Debt Amortization	47	95	n.a.	334	936	897	990
TOTAL	1,894	4,053	19,049	22,069	23,043	28,066	34,154

Notes:

^a Includes Tourism Expenditure

^c Includes Housing and Community Development

Sources: Department of Budget and Management, *Fiscal Statistics Handbook*, various issues
National Statistical Coordination Board, *Philippine Statistical Yearbook*, various issues

PARTICULARS	1980	1981	1982	1983	1984	1985	1986	1987
ECONOMIC SERVICES	15,884	22,132	18,886	18,287	21,487	20,694	27,996	26,634
Agriculture, Agrarian Reform and Natural Resources	2,331	3,346	4,064	3,742	3,576	4,696	4,339	7,562
Trade and Industry	1,014	2,384	1,428	1,333	1,585	1,085	2,626	1,073
Tourism	135	188	227	150	114	163	136	157
Power and Energy	2,571	3,070	1,798	1,146	897	1,346	1,332	1,778
Water Resource Dev't. and Food Control	777	854	598	98	688	1,544	1,486	1,395
Communications, Roads and other Transportation	7,487	9,073	8,559	8,647	6,796	8,263	7,187	9,887
Other Economic Services	1,569	3,217	2,212	3,171	7,831	3,597	10,890	4,782
Subsidy to Local Government Units (LGUs)	-	-	-	-	-	-	-	-
SOCIAL SERVICES	8,165	10,388	11,341	12,148	12,726	15,882	22,451	27,128
Education, Culture, and Manpower Development	4,811	6,125	6,627	6,695	8,121	10,749	14,128	16,988
Health	1,486	1,921	2,294	2,685	2,468	3,275	3,531	4,245
Social Security and Labor Welfare	451	586	449	465	485	586	674	818
Land Distribution	0	0	0	0	0	0	0	253
Housing and Community Development	902	1,264	1,632	1,831	1,182	676	1,541	443
Other Social Services	515	492	339	472	470	596	2,577	4,381
Subsidy to LGUs								
DEFENSE	4,153	4,879	5,180	5,591	5,391	7,129	7,611	8,437
GENERAL PUBLIC SERVICES	5,619	6,858	8,625	8,944	9,601	12,399	13,320	15,441
General Administration	2,169	2,751	3,958	3,496	3,716	5,177	4,762	6,135
Public Order and Safety	2,066	2,429	2,542	3,062	3,336	4,092	5,417	5,772
Other General Public Services	1,384	1,678	2,125	2,386	2,549	3,130	3,141	3,534
Subsidy to LGUs	0	0	0	0	0	0	0	0
NET LENDING	675	929	2,218	2,393	4,423	2,555	15,148	7,077
DEBT SERVICE	3,583	3,897	4,892	8,448	14,882	21,603	34,813	69,825
Interest Payments	2,296	2,429	3,560	4,997	10,409	14,652	21,612	36,905
Debt Amortization	1,287	1,468	1,332	3,451	4,473	6,951	13,201	32,920
TOTAL	38,079	49,083	51,142	55,811	68,510	80,262	121,339	154,542

PARTICULARS	1988	1989	1990	1991	1992	1993	1994	1995
ECONOMIC SERVICES	27,134	40,586	54,015	61,822	59,970	64,691	85,076	109,474
Agriculture, Agrarian Reform and Natural Resources	8,239	12,014	16,276	16,211	15,508	15,550	20,728	21,195
Trade and Industry	1,321	1,878	2,265	2,911	2,430	2,480	3,709	5,971
Tourism	261	276	241	279	337	375	477	559
Power and Energy	211	944	6,826	2,004	2,036	5,646	2,650	1,593
Water Resource Dev't. and Food Control	1,413	1,868	3,833	2,806	3,929	3,625	3,599	4,162
Communications, Roads and other Transportation	12,305	18,210	18,107	29,522	26,672	22,752	35,670	50,295
Other Economic Services	3,384	5,396	6,467	4,204	1,871	1,264	1,858	7,524
Subsidy to Local Government Units (LGUs)	-	-	-	3,885	7,187	12,999	16,385	18,174
SOCIAL SERVICES	32,220	38,954	49,088	55,368	60,108	64,732	77,300	112,911
Education, Culture, and Manpower Development	22,046	27,378	33,528	33,510	37,696	38,986	45,131	64,948
Health	5,632	6,532	7,962	9,178	9,908	6,984	7,947	11,788
Social Security and Labor Welfare	1,045	1,485	2,115	3,709	3,367	3,266	4,872	7,386
Land Distribution	0	328	277	4,044	0	0	0	3,297
Housing and Community Development	595	403	679	1,158	329	1,673	1,607	2,999
Other Social Services	2,902	2,828	4,527	1,999	1,349	333	421	3,282
Subsidy to LGUs				1,770	7,459	13,490	17,322	19,212
DEFENSE	12,356	13,051	14,544	15,778	17,306	20,002	23,125	29,133
GENERAL PUBLIC SERVICES	19,471	22,663	30,925	35,064	42,829	48,294	59,686	63,059
General Administration	7,273	8,946	12,529	16,325	20,489	18,112	25,560	22,352
Public Order and Safety	8,030	9,538	12,285	14,126	14,606	15,727	18,288	24,320
Other General Public Services	4,168	4,179	6,111	426	2,075	4,172	2,683	801
Subsidy to LGUs	0	0	0	4,187	5,659	10,283	13,155	14,586
NET LENDING	5,416	3,666	3,787	5,725	2,258	2,649	5,893	1,031
DEBT SERVICE	71,164	83,217	106,346	121,482	109,222	113,378	117,967	93,249
Interest Payments	45,865	54,714	71,114	74,922	79,571	76,491	79,123	72,900
Debt Amortization	25,299	28,503	35,232	46,560	29,651	36,887	38,844	20,349
TOTAL	167,761	202,137	258,705	295,239	291,693	313,746	369,047	392,449

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