



Working Paper 16

What Prevents the Philippines from Undertaking Tax Reform?

A Story of the Unravelling State

Rosa Maria Alonso i Terme

January 2014



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Rosa Maria Alonso i Terme

Summary

One of the crucial areas of government policy responsible for the weak development performance of the Philippines is tax policy and administration. By 2011, the tax to GDP ratio had fallen to a meagre 12.3 per cent, 4.6 percentage points below the pre-1997 level and around 7 points below the regional average. The absence of tax reform reflects a set of inter-related factors. First, long periods of political and economic stability have meant that crises have not provided the opportunity for reform that they allowed, for instance, in Latin America. Second, the highest level of income inequality in East Asia has resulted in state capture by the elite, which in turn perpetuates and increases income differences. Third, Filipinos exhibit a marked preference for the state to deliver private over public goods as a modern and legal version of patronage. Fourth, the middle classes, on whose shoulders the tax burden largely falls, aware of the state's inability to tax the wealthy and the relatively poor quality of public services, opt out of state services and provide privately for education, health and even security. Fifth, the disempowerment of the poor keeps them quiescent, not putting pressure on the state to cater to their needs.

Promising avenues for change include: a) academia and development partners to take a more active role in analysing and disseminating the reasons for the poor performance of the Philippine economy; b) stronger leadership by churches in encouraging integrity and pro-poor attitudes, behaviour, institutions and policies; and c) a coalition of all interested stakeholders for a more developmental, clean and pro-poor government, including committed civil servants and politicians, civil society organisations, academia, media, church groups and private sector representatives.

Keywords: tax policy; tax administration; political economy; policy reform; Philippines.

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Contents

	Summary	3
	Acknowledgements	5
	Acronyms	5
	Introduction	6
1	The institutional structure underpinning the fiscal status quo	10
2	A history of failed and partial attempts at tax reform	13
3	The political economy of the absence of tax reform	14
	3.1 Income inequality cum state capture by the elites	15
	3.2 Preference for private over public goods	19
	3.3 Middle class opt-out	21
	3.4 The disempowerment of the poor	22
	3.5 A case of historical path dependency?	25
4	The way forward – building on the country’s democratic strengths	28
	References	33
Figures		
Figure 1	Poverty incidence (percentage of the population under USD1.25 a day)	6
Figure 2	Link between government revenue and public investment	7
Figure 3	Primary education net enrolment rates	7
Figure 4	Evolution of revenue to GDP and tax to GDP ratios in the Philippines	8
Figure 5	Revenue as a percentage of GDP (1997 and 2011)	9

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Acronyms

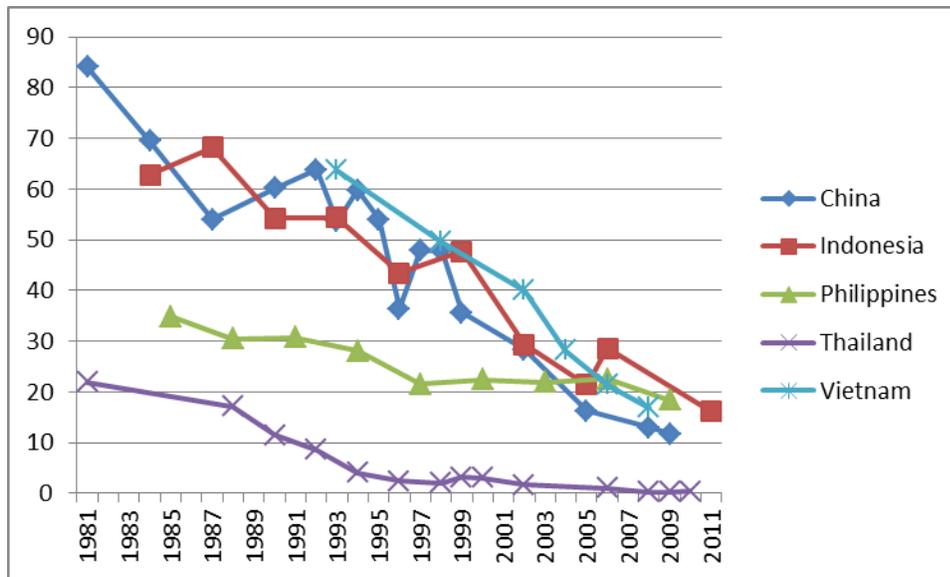
BIR	Bureau of Internal Revenue
BOC	Bureau of Customs
CCT	Conditional Cash Transfer
CPAR	Congress for a People's Agrarian Reform
CPP	Communist Party of the Philippines
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
HDI	Human Development Index
IMF	International Monetary Fund
NGO	Non-governmental organisation
PER	Public Expenditure Review
VAT	Value Added Tax

Introduction

The quandary - a declining tax effort and lagging development results

An often-quoted fact about the Philippines is that its income per capita after World War II was the second highest in East Asia, coming only after Japan. Almost sixty years later, in 2012 it had slipped down the rankings of the region behind all the by-now-developed countries, such as Korea, Taiwan and Singapore, and all the upper middle-income countries, such as China, Thailand and Malaysia. In addition, Vietnam and Indonesia had overtaken the Philippines in education results (Programme for International Student Assessment tests), and were fast approaching it in income levels. This drop down the rankings is not unique to the East Asian context. The Philippines is now also below the income per capita level of almost all Latin American countries, ranking below Guatemala. The Philippines also exhibits the highest level of income inequality (World Bank 2011a: 73), and the lowest rates of poverty reduction in East Asia 1980-2010 (World Bank 2013a: 40). Even more worrying, despite increasing growth in the 2000s poverty increased steadily from 2003 to 2009 (World Bank 2011b: 1), and only registered a statistically insignificant decline from 28.6 to 27.9 between 2009 and 2012 (World Bank 2013a: 10). The country also exhibits the highest tuberculosis prevalence rate in the region, and infant and maternal mortality rates that are significantly higher than the region's average.

Figure 1 Poverty incidence (percentage of the population under USD1.25 a day)

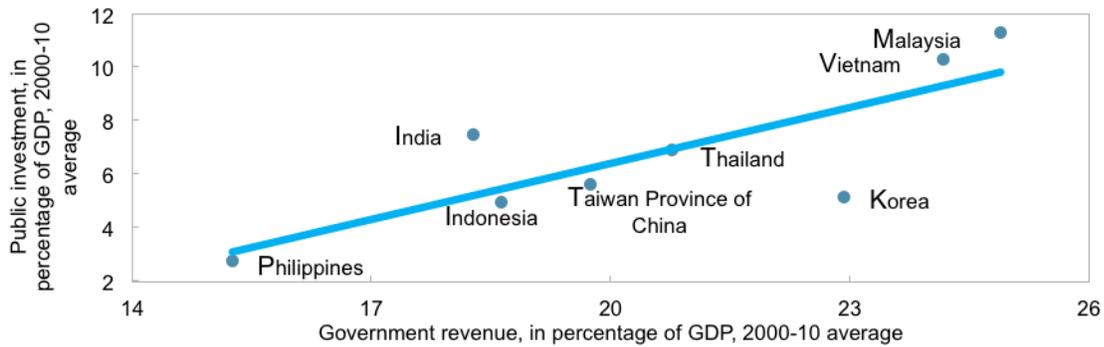


Source: World Bank, *World Development Indicators*

The role of the state is at the heart of this dismal performance. In particular, fiscal policy and governance failures explain weak accumulation of human capital, especially in the poorest 50 per cent of the population, as well as low levels of public and private capital investment. All combined, gross fixed capital formation in the Philippines is over 10 percentage points of Gross Domestic Product (GDP) below that of regional comparators, and in 2012 it was 8 points of GDP below its own 1990 level (World Bank, *World Development Indicators*). A World Bank Public

Expenditure Review (PER) finds that the (largely declining) path of public spending since 1997 mirrors that of public revenue. It argues that shortcomings in the size of public spending compared to other countries in the region are at the core of the relative weakness in education, health and infrastructure outcomes in the Philippines. These gaps are estimated at between 5 and 7 per cent of GDP (World Bank 2011a: 6).¹

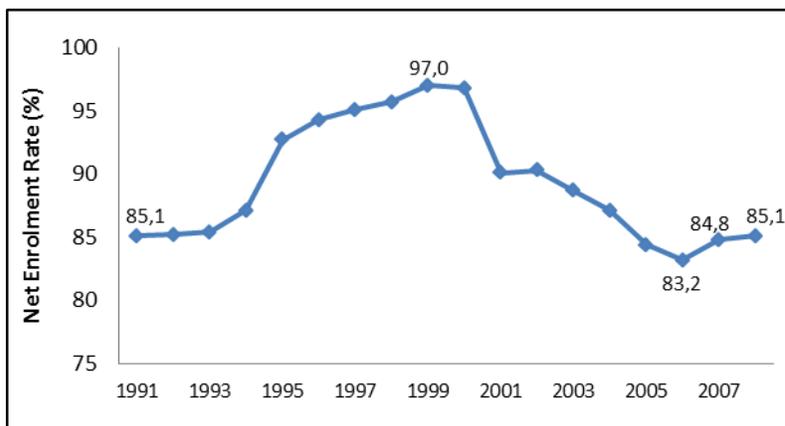
Figure 2 Link between government revenue and public investment



Source: World Bank, *World Development Indicators*

The spending gaps with East Asian comparators are, in turn, explained by revenue gaps (Figure 2). Insufficiency of public funds has been so great that in some areas there has been actual regression - primary enrolment rates fell between 1998 and 2005, when tax revenue and education spending were declining. After the 2005 tax reform, tax revenue increased and education spending and enrolment rates recovered. Overall, the report finds that government expenditure and, to some extent, development outcomes followed the same trend as tax revenue (see Figure 3).

Figure 3 Primary education net enrolment rates

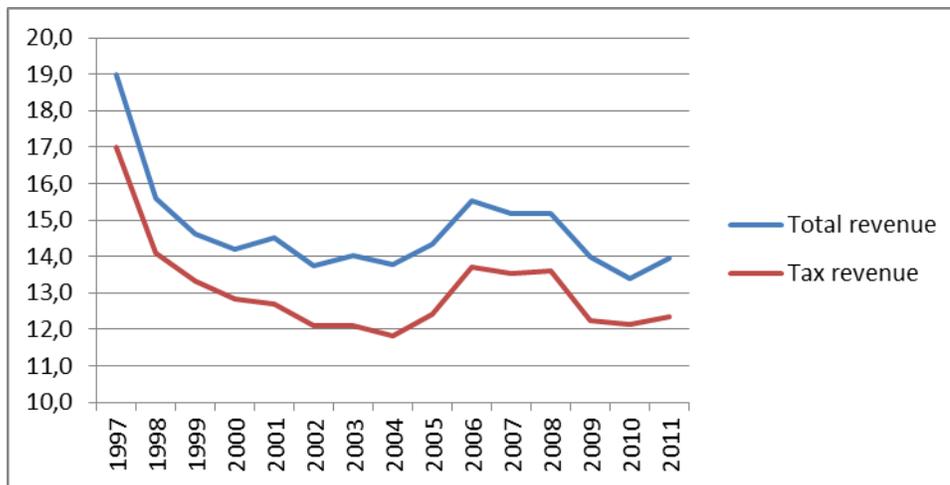


Source: National Statistical Coordination Board, *Philippine Statistical Yearbook*, various years

¹ The latest IMF Staff Report (International Monetary Fund 2013: box 6) and the World Bank's *Fostering More Inclusive Growth* Report (World Bank 2010) make exactly the same point.

This article will thus address one of the crucial areas of government policy responsible for the weak development performance of the Philippines – tax policy and administration – and will seek to describe the political economy factors driving them. Tax effort in the Philippines is very low and has been declining over the past 10 years (Figure 4). By 2011, the tax to GDP ratio had fallen to a meagre 12.3 per cent, 4.6 percentage points below the pre-1997 level and well below the regional average.

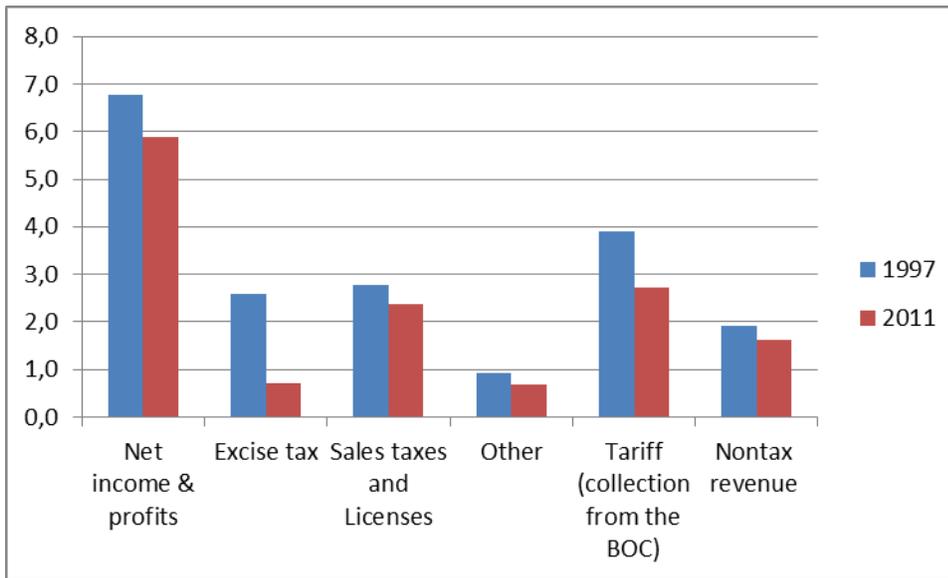
Figure 4 Evolution of revenue to GDP and tax to GDP ratios in the Philippines (percentage)



Source: Bureau of Internal Revenue

The decline in 4.6 percentage points in the tax to GDP ratio is due to the following: two percentage points are the result of a drop in collections from excise taxes, which are not indexed to inflation; one percentage point has been lost due to a decline in corporate and income taxation (0.5 points each) due to a combination of lower tax rates and increased tax exemptions; Value Added Tax (VAT) collections declined by a 0.4 percentage point because power transmission was exempted and the 70 per cent cap on input VAT crediting was lifted, as well as an overall weakening in tax administration; collections by the Bureau of Customs (BOC) declined by 1.2 percentage points due to lower trade taxes and increased smuggling (World Bank 2011a: 118-120; World Bank data).

Figure 5 Revenue as a percentage of GDP (1997 and 2011)



Source: Bureau of Internal Revenue

The resource gap compared to other East Asian countries is even greater than it seems since many countries in the region carry out large public investment in basic infrastructure through state-owned enterprises (for example, in water, sewerage and electrification); no such investment exists in the Philippines as all utilities were privatised. Privatisation, moreover, has not yielded the results one may have expected. Electricity prices, for instance, are the second highest in the region after Japan and the rate of electrification is relatively low, while access to an own water source is only 52 per cent.²

This is probably due to the fact that privatisation was, to an extent, coloured by the dynamics of state capture and linkages between the public sector and large private sector interests. As de Dios and Hutchcroft (2003) describe: 'liberalization may have unintentionally sharpened the already keen competition for influence over the state, since the large-scale privatization of sequestered properties of the Marcos cronies, foreclosed properties taken over by government banks, and of public utilities has created rent opportunities through insider information and first-mover advantages' (de Dios and Hutchcroft 2003: 3).³ To these weaknesses, one needs to add constitutional limitations on foreign investment in the utilities sector, and the shortcomings in regulation and supervision of natural monopolies that are to be expected in developing countries in general and in the political economy context of the Philippines in particular.

This paper will begin by laying out the institutional structure underpinning the status quo. It will then briefly survey the country's history of tax reform and its political economy. Next, it will portray a series of interrelated political economy factors explaining the relative failure of tax reform efforts – income inequality cum state capture; preference for private over public goods; middle class opt-out of the public sector; disempowerment of the poor; and historical path dependency. It will finish by providing some thoughts on potential avenues to foster tax reform

² Eighty-two per cent of the population have access to electricity, compared with almost universal access in countries with government-owned utilities such as China (99.4 per cent) and Vietnam (97.6 per cent). Similarly, access to an own water source is extremely low at 48 per cent (World Bank 2010: 26).

³ On the power sector in the Philippines, see Sicat (2002).

building on the comparative strengths of the Philippines – its democratic polity, vibrant academia, church and civil society, and capable technocrats.

1 The institutional structure underpinning the fiscal status quo

The institutional set-up of the Philippines is such that the Central Bank is sheltered from political pressure and is tasked with preserving macro-economic stability, while Congress largely shapes the structure of revenue and expenditure. Congress is the instrument of those socio-economic groups who largely control it, and is in the driver's seat when setting tax and expenditure policy. Macro-economic and fiscal management in the country largely reflects this twin institutional set-up and the structure of underlying interest groups.

The Philippines exhibits a historical pattern of low and declining government revenue, with Congress driving this through enacting revenue-eroding measures. The trend seems to be for revenue to decline until a primary budget deficit emerges and a fiscal crisis looms (World Bank 2011a: 29). The macro-economic situation is then at risk of becoming unstable, which threatens the interests of the elites. At the point where debt sustainability is threatened, public expenditure cannot be further compressed and monetary policy is not allowed to monetise deficits, a tax reform becomes politically possible (as was the case in 2005). As the threat of macro-economic instability recedes, however, Congress resumes the passage of revenue-eroding measures and revenues decline again. The 14th Congress (2007-10) alone passed thirteen revenue-eroding measures costing around 1.1 per cent of GDP, and introduced six more which would cost a further 0.5 per cent of GDP. Not a single revenue-enhancing measure was passed.

The structure of the tax system reflects the economic balance of power of the status quo in the country, as well as international trends. The fact that excise taxes have declined the most since 1997 is due to strong interest groups behind the tobacco and alcohol sectors. As argued by Sicat, for cigarettes and tobacco 'the Philippines is one of the least taxed countries in the world' (Sicat 2006: 14). Similarly, a recent World Bank report finds that excise tax rates on beer and wine in the Philippines are between half and one-tenth of the regional average, and the tax share in cigarette prices one-third of the regional average (World Bank 2011c: Table 11 and Figure 4). Filipino academics have pointed out that: 'so-called sin taxes cannot be raised sufficiently because of the inordinate influence of tobacco and liquor interests' (Severino and Salazar 2007: 332).⁴ International movements to lower direct taxation (corporate and personal income taxes), as well as reduce tariff barriers, have been reflected in the Philippines. These have led to a tax burden that is increasingly resting on income taxes from compensation earners and consumption taxation – both of which weigh particularly heavily on the formal sector working and middle classes.

⁴ Congress passed a bill in 2012 (the 'Sin Tax Bill') raising excise tax rates on alcohol and tobacco and levelling the playing field between foreign and domestic alcohol producers. Excise tax rates will be increased by four per cent every year effective 2016 for distilled spirits and 2018 for cigarettes and beer. The bill is expected to generate only 0.3 per cent of GDP in additional revenue (compared to the 2 points of GDP lost since 1997). The initiative was a concerted effort of the executive branch and civil society, including health groups, and it received technical support from development partners. It had to face strong opposition from traditional interest groups – particularly Philip Morris and San Miguel – who had managed to successfully lobby Congress and stall the effort for sixteen years.

The role of Congress is supplemented by that of the ‘investment promotion agencies’, which grant tax incentives to an increasingly large number of business initiatives, economic sectors, geographical areas (e.g. special economic zones, eco-zones) and population groups (e.g. senior citizens). Most of the businesses receiving tax incentives are domestic and have an above-average level of profits. This costs the country an estimated 1 to 4 per cent of GDP (Reside 2006). This abundance of tax incentives for highly profitable firms leads to a high level of horizontal and vertical inequity of the tax system. According to IMF estimates, the Philippines is one of the countries with the highest gap (20 per cent) between those businesses benefiting from the most tax incentives and those that do not benefit from any (Botman et al. 2008). A tax system with such an abundance of incentives – many of which are extremely difficult to ascertain and control, such as the VAT exemption for senior citizens – is also particularly difficult to administer.

The tax system is also inequitable across employment categories. According to World Bank estimates, salaried workers pay around 80 per cent of total personal income tax collections although they account for only 40 per cent of total non-corporate sector net operating surplus; the self-employed and professionals pay only 20 per cent despite a 60 per cent share of total non-corporate sector net operating surplus (World Bank 2011a: 12). Moreover, the actual personal income tax payments of the top income decile, at an overestimated 1.7 per cent of their income, are negligible (World Bank 2011a: 12).⁵

Although the overall tax system is slightly progressive, with taxes reducing the Gini coefficient by 2 points,⁶ the above-mentioned inequities across companies and employment sectors, the high tax burden of salaried workers and the negligible personal income tax contribution of the top income decile understandably colour the overall public perception of the tax system. The fact that the wealthy, the middle class self-employed, and the politically-connected benefiting from tax exemptions bear such low tax burdens, in comparison with lower-middle class and near-poor compensation earners and politically unconnected businesses, mirrors the balance of power in the economy and its reflection in government policies.

It is important to realise that, despite the fact that the revenue to GDP ratio is low and its role in investment in human and physical capital limited, de Dios and Hutchcroft (2003) describe the Philippine state as large. This large government is characterised by intrusive constitutional norms, legislation and regulation of the role of the private sector, and by the interaction between the state apparatus and the private sector. The result is an encroaching state machinery that makes doing business in the Philippines particularly difficult. The country ranked 136th out of 183 countries in 2012 (World Bank 2012a), and, though it had jumped to 108th in 2014, it still outperformed only Indonesia, Cambodia and Laos in East Asia (World Bank 2013b). Foreigners are not allowed to buy land. Moreover, the constitution establishes that only companies ‘substantially owned by Filipinos’ (defined as a 60 per cent share) are allowed in certain particularly lucrative sectors (such as natural resources and utilities), shackling foreign investment to domestic interests.⁷

⁵ It is overestimated because the computation needs to be done using taxable income and income taxes paid as reported in household surveys. Since income tends to be under-reported and taxes paid do not, such calculations necessarily over-estimate the tax burden.

⁶ Using data from the 2006 household survey, the Gini coefficient of income distribution is found to be 2 points lower after taxes than before taxes (World Bank 2011a: 129)

⁷ Economically speaking, there are two reasonable competing approaches to the natural resource and utilities sectors. One is ensuring utilities are provided at a reasonable cost and natural resource rents reaped by the public through state provision. The other is relying on the open market, supplemented with sound regulation. Fostering oligopolistic or monopolistic control of domestic firms in these sectors has none of the potential virtues of either of the two preceding approaches, and can only benefit the domestic firms capturing those sectors.

The same type of political economy limitations that constrain and distort the tax effort are behind the investment climate weaknesses that hamstring private investment in the country. Jointly, these distortions result in the low public and private investment that has been behind the poor economic growth of the Philippines and its even worse income distribution. As Severino and Salazar state: 'the problems (of foreign ownership limitation) are ultimately rooted in politics. Restrictions on foreign ownership preserve the monopolies enjoyed by favoured industrialists or offer influential Filipinos opportunities for rent' (Severino and Salazar 2007: 332). These monopolies and favoured business groups were, to a large extent, created during the Marcos regime, but were never truly disrupted thereafter. They feature a governance system through which the public sector selectively enforces the property rights of one group of asset holders, and in which the line between the government and private asset holders becomes blurred.⁸ The political economy of poor investment climates is, overall, quite universal as investment climate reforms:

... involve significant transfers of income and opportunity. Moreover, those who lose in the short term tend to be powerful interest groups or politicians capable of blocking reform, while those who gain tend to do so only in the long term and are often too dispersed to matter. Thus while removing barriers to entry, for example, favours new entrants, it may be resisted by incumbents, feeling threatened by the prospect of competition and changes in traditional ways of doing business. The involvement of many players and political institutions also mean much slower and less predictable decision-making processes.⁹ (Kikeri et al. 2006: 3)

Arguably, the middle class is compensated for being the main taxpayer through wages set well above market-clearing levels. Labour regulation reflects the interests of the other key stakeholder behind Philippine policy choices – the middle class. The Philippine minimum wage in purchasing power parity terms is the highest in East Asia after Korea and Taiwan – more than twice the level of China and 40 per cent higher than in Thailand – and in the top 20 per cent in the world. In addition, minimum wage growth has been higher than increases in labour productivity, which in turn have been only one quarter of the East Asian average between 1961 and 2000. This means that formal sector middle-income workers tend to benefit as average wages are pushed up, but the economy is unable to create jobs for those workers whose low productivity cannot support such wages, namely the low-skilled and poor. As a result, 'The limited employment growth that has taken place has mainly favoured the more educated workers and capital-intensive industries such as electronics, contributing even less to poverty reduction, while sectors like garments, footwear, and furniture are more (unskilled) labour intensive, and their decline is more correlated with high minimum wages' (World Bank 2011b: 9).¹⁰

One area in which the state is allowed to function quite smoothly is monetary policy. The Central Bank of the Philippines has been insulated from the political pressures of other institutions so it can act as an independent agency and preserve macro-economic stability, a public good that benefits the ruling elites as well as the country as a whole. In fact, the Central Bank is one of the most independent in the region and has been able to keep inflation at bay. This institutional set-

⁸ The Philippines exhibits all the characteristics of what Haber et al. call vertical political integration, namely, a rent-seeking coalition, economic inefficiency, a negative distribution of income, political authoritarianism, and inefficient provision of public services. Even if the Philippines does not have an authoritarian regime, in many respects and particularly as regards economic governance, it operates as an oligarchy (Kushida 2003).

⁹ However, not all characteristics of a poor investment climate have the same political economy. For instance, bureaucratic impediments are typically linked to bureaucratic petty corruption, while barriers to entry are normally due to state capture by elites. Moreover, each country situation has its own idiosyncrasy (Kikeri et al. 2006: 3).

¹⁰ On the political economy of labour regulation in the Philippines, see Sicut (2004).

up reflects the interest of the elites in ensuring macro-economic stability, one area in which their interests and those of the country as a whole coincide. Overall, however, the combination of low government revenue and limited public investment with intrusive government bureaucracy is especially harmful for the business climate, investment and growth, let alone for income distribution or poverty reduction – but it is convenient for the elite.

This political economy-determined duality of a low level of resources and a high degree of encroachment through excessive regulation and poor governance is reflected in the tax arena. In the area of tax policy and administration, low tax intake is coupled with weak and poorly governed tax administration. The Bureau of Internal Revenue (BIR) tax collection gap is conservatively estimated at 4 per cent of GDP (World Bank 2010: 138). This is not mainly due to poor capacity, but rather to systemic corruption in tax and customs administration.

As de Dios (2005: 7) points out, ‘any discussion of the role revenue collection plays in Philippine political economy must begin from the assessment that large rents can be made from the agencies fulfilling that function’. Indeed, opinion surveys (e.g. by the American Chamber of Commerce and Social Weather Stations) regard the BIR and Bureau of Customs (BOC) as among the most corrupt government agencies in the Philippines. Reports of the Philippine Centre for Investigative Journalism confirm these perceptions (Philippine Centre for Investigative Journalism 2003). This helps explain the ranking of the Philippines in ‘ease of paying taxes’ at 131st out of 189 countries, only ahead of Indonesia, Laos and Cambodia in the East Asian context (World Bank 2013b). It also contributes to the high perception of corruption of the Philippines in international rankings, ahead of only Laos and Cambodia in the East Asia region (Transparency International 2011).

Corruption networks link the revenue agencies with Congress and key economic interests as ‘regularly generated and large rents in revenue agencies can form part of the return to investments of politicians who have come to power, or they might also form part of the return to favoured campaign contributors’ (de Dios 2005: 8). Because of the strength of this bureaucratic-political-economic alliance, it has proven all but impossible to carry out in-depth tax policy and administration reform.

2 A history of failed and partial attempts at tax reform

Fabella and Chua (2011) identify the three most successful cases of tax reform in the Philippines in the past 40 years as the Plana Reform (1975-1980) under President Marcos, the comprehensive tax reform of 1986 by President Aquino, and the 2005 reform under President Arroyo. The first two reforms were passed through presidential decrees at a time of political crisis (and hence did not need congressional support), and, in the case of President Aquino, at the beginning of a period of regime change towards democracy. The 2005 reform was approved by Congress, but under the duress of an emerging primary deficit and a looming fiscal crisis. All three were instances of tax policy reform, with some moderate accompanying tax administration reform. All three reforms were progressively rolled back as Congress subsequently passed revenue-eroding measures, and corruption crept back up at the never-thoroughly-reformed BIR and BOC.

An enlightening case of failed reform is that attempted by BIR Commissioner Rene Bañez. Commissioner Bañez envisaged turning BIR into a semi-autonomous revenue agency as the pathway to thorough tax administration reform. He planned to carry out a comprehensive firing and re-hiring process (as has been done in the most successful reforms in thoroughly compromised agencies). However, as his plan became known BIR staff went on a 'strike of zeal' – they basically stopped collecting taxes and collections fell dramatically. The president did not back up the reforming commissioner, and he was let go. As was remarked by a newspaper article at the time: 'The way Rene Bañez was shouted out means "no reform"' (*The Philippine Star*, 20 August 2002). Since that attempt the only tax administration reforms enacted have been of a very modest nature and have not fundamentally altered the status quo (which is why they have been able to be implemented). Significant tax administration reform would require a reformist commissioner with strong backing from a president willing to confront congressional and business group opposition, and to implement a thorough renewal of personnel, organisational structure, business processes and information technology (IT) systems.

3 The political economy of the absence of tax reform

Long periods of stability foster the creation and strengthening of organised interest groups that can distort government policies (and arguably institutions) to their advantage and stall potential reforms. Conversely, crises weaken existing interest groups and create windows of opportunity for policy and institutional reform (Olson 1965). This key principle of political economy applies powerfully to tax policy and administration reform. The catalysts of in-depth tax policy and administration reforms, especially in middle-income countries, have typically been political or economic crises (e.g. Latin American reforms in the 1980s and 1990s). The Philippines, by contrast, has been remarkably stable with neither a serious macro-economic crisis – and when one was looming in 2005 it introduced a tax policy and administration reform which raised the tax to GDP ratio by two points – nor a political crisis or regime change since 1986 when comprehensive tax policy reform was introduced.

The absence of crises to shake up the economic and political status quo in the Philippines goes a long way towards explaining why fundamental tax policy and administration reform has not taken place. The criticality of crises in generating reform is highlighted by the fact that the few reforms undertaken in the past fifty years have all taken place in a crisis context. Because this article aims to throw light on the political economy of the absence of reform, it will focus on analysing the political economy of the status quo.

The political economy story of the Philippine predicament can be told around five crucial axes that are interrelated and feed on each other – income inequality cum state capture; preference for private over public goods; middle class opt-out from the public sector; disempowerment of the poor; and historical path dependency.

3.1 Income inequality cum state capture by the elites

The Philippines, with a Gini coefficient of 48.0, is one of the most unequal countries in the world and the most unequal in East Asia.¹¹ Over 25 per cent of the population are poor, 25 per cent near-poor, and it is estimated that 45 per cent of Filipinos are vulnerable to poverty (World Bank 2010: 18). The top income decile captures the lion's share of national income (at a very much underestimated nine times the income share of the bottom decile) and wealth, and contributes negligibly to the public treasury. The country's high level of inequality is also manifested by the high ratio of net worth of Filipino billionaires to GDP, which is the highest among lower middle-income countries in the region (World Bank 2013a: 40).

As mentioned earlier, the top income decile reportedly pays 1.7 per cent of its income in income taxes (World Bank 2011a: 12). This inequality has been historically inherited;¹² unlike in some of the most successful countries in the region, it has not been addressed:

Equally glaring has been the failure to ensure that the benefits of economic growth and the costs of economic crisis are shared equitably among the population as a whole – a task made all the more urgent and difficult by the historical absence of any thorough programme of land redistribution. Unlike South Korea and Taiwan at similar stages of their industrialisation process, the Philippines exhibits a particularly immense gulf in levels of wealth and income between members of the elite and the millions of Filipino workers, urban poor, and peasants below them. Despite the relative success of many recent economic reform initiatives, the lack of attention to issues of redistribution threatens the long-term viability of any programme of liberalisation. (de Dios and Hutchcroft 2003: 46)

Even in countries with high levels on income inequality, however, institutions and policies can reflect the interests of the country as a whole as well as those of the poor. This requires either a position of power by the poor (e.g. post-apartheid South Africa), the development of what de Swaan (1988) has called a 'social consciousness' by the elite, or a political coalition of the poor with either the rich or the middle class.¹³ De Swaan argues this consciousness is a pre-requisite for the implementation of sound social policies and that this took place in Western Europe and the United States in the post-war period. It has also taken place in Brazil since the Cardoso administration, and even more so since that of Lula da Silva.¹⁴ According to de Swaan, this social consciousness, which 'entailed tacit consent to a considerable tax burden', has three elements. First, an awareness by the elites of the *interdependence* among social groups in society and, most relevantly, of the external effects of poverty upon the elites, which may be perceived as either threats or opportunities. Second, the elites realise that, as members of the elite, they bear some *responsibility* for the condition of the poor. Third, the elites believe that

¹¹ Income distribution is not improving either: 'In 2012, *Forbes Asia* announced that the collective wealth of the 40 richest Filipino families grew \$13 billion during the 2010-2011 year, to \$47.4 billion – an increase of 37.9 per cent. Filipino economist Cielito Habito calculated that the increased wealth of those families was equivalent in value to a staggering 76.5 per cent of the country's overall increase in GDP at the time' (Keenan: 2013).

¹² During the Spanish colonial period, all land was considered to belong to the Spanish king and much of it was allocated to the Spanish settlers as well as to religious orders (Corpuz 2005: Chapter 7).

¹³ In his book on the origins of welfare policies in Western Europe and the US, de Swaan argues that a pre-condition for state action was the development of a social consciousness among national elites (Reis and Moore 2005). On top-bottom coalitions in Latin America, see Alonso i Terme and Steinberg (2006). Middle class-poor coalitions were the bread and butter of building welfare states in post-war Europe and America and arguably of much before.

¹⁴ The fact that Brazil has a 36 per cent revenue to GDP ratio (compared to 14 per cent in the Philippines), bears testimony to a deeper social contract and an implicit agreement between the elites and middle classes to fund social needs. Brazilian elites' social consciousness is reflected in a much stronger belief that government is responsible for reducing poverty and inequality than in other countries, including the Philippines (Reis and Moore 2005: 50-51).

feasible and efficacious means to improve the lot of the poor exist or can be created through identification with a larger community of interests (as opposed to private/individual action).

In the Philippines, such a consciousness is largely lacking. A study of elite views of the poor, poverty and inequality in the Philippines finds that less than a quarter of interviewees felt poverty was the biggest problem of the country, and even fewer found it was a problem affecting their own life. None of the interviewees mentioned fear of demonstrations or other acts of militancy by the urban poor or fear of illness or disease (Reis and Moore 2005: 233). Thus, de Swaan's first factor of perceived interdependence of the poor and the rich is not fulfilled. The isolation of the well-to-do (and, to a large extent, the middle class) from the poor through their compounds and their private education, health, security, infrastructure, etc. enable them to feel inured to the consequences their preferences have on the development of the country as a whole and on the poor in particular:

There is a real sense in which Filipino elites live in an enclave society, insulated from the poor and the effects of poverty ... even within Metro Manila, where an estimated 4 million of the city's 10 million population are squatters, the rich and well-off frequently live in private residential estates surrounded by high walls, sometimes protected by armed guards.

(Reis and Moore 2005: 231)

Second, there is little sense of responsibility for the lot of the poor. The wealthy tend to feel some sense of responsibility for the poor around them, but not for poverty as a whole. Fifty-eight per cent of respondents felt that the poor bear some responsibility for their own poverty, while interviewees as a whole tended to 'condemn the poor as lazy, opportunistic and fatalistic'.¹⁵ In the words of a former presidential candidate, the elites 'generally ... believe it is the business of every individual to lift themselves up from poverty through his own effort' (Reis and Moore 2005: 234). Moreover, in the Philippines a large majority among the elite view high levels of inequality as beneficial to the country. In particular, 57 per cent of respondents agreed that large differences in income are necessary for the Philippines' prosperity, while only 15 per cent disagreed (Reis and Moore 2005: 222).

The third element of de Swaan's triad does not hold either – the elites do not trust the government to be able to address poverty reduction effectively. The Filipino elites criticise what they see as lack of government commitment to poverty reduction, and tend to view government as more inefficient, ineffective and corrupt than it is in reality (Reis and Moore 2005: 228).¹⁶ This may be the case because they typically do not use government services, such as health or education, and their interaction with government is often limited to some of the most corrupt agencies, like the BIR.¹⁷ They also tend to distance themselves from government, as if it were a self-standing entity that did not reflect their own interests, preferences and actions. This demonisation of government, not exclusive to the Philippines, deflects responsibility and justifies, in the eyes of the elites, their keeping it starved of funds through a low tax policy effort

¹⁵ The contrast between the more sympathetic views of the actual poor people they know and their opinion of the anonymous poor is telling and, arguably, justifies their actions – supportive of the status quo policy-wise supplemented with a modest amount of private charity (Reis and Moore 2005: 228). Another common attack on the poor by elites and middle classes alike is that they have too many children.

¹⁶ World Bank (2010) found education and health spending in the Philippines was of average efficiency.

¹⁷ The example of corrupt interactions mentioned in Reis and Moore (2005) does indeed quote an interviewee's complaints about the BIR. It is possible that elites project their experience with BIR to the rest of government (which is unfair and inaccurate).

and their individual behaviour of tax evasion and tax avoidance.¹⁸ Those members of the elite that do wish to contribute to the well-being of the poor, but do not trust the government to deliver on the job, provide direct support to needy families in their personal network and, increasingly, through non-government organisations (NGOs), churches and even private foundations (Reis and Moore 2005: 233).

Income inequality creates an economic and social structure that is reflected in government institutions and policies that, in turn, perpetuate and aggrandise income differences. Key economic sections of the Philippine Constitution establish a system of stringent foreign investment limitations and minimum domestic ownership percentage requirements in several industries, including in the natural resource sector.¹⁹ These limitations and requirements reflect the interests of the elite and create a fruitful rent-seeking system for them in key economic sectors. This encroachment of the role of the state in the economy can also be seen as part of what de Dios and Hutchcroft (2003) describe as a large government. A great number of government policies can be best interpreted through this lens of preserving and aggrandising income inequality: from the tax system including fiscal incentives benefiting profitable well-connected firms and sectors; the high quality of public tertiary compared to primary education; the Special Education Fund which finances education highly regressively through property taxes; and an intergovernmental fiscal transfer system without a revenue-equalising factor or even minimum service standards that leads to enormous gaps in resource availability between rich and poor regions.²⁰

A number of observers have noted that state capture is strongly replicated at the local level. This development preceded decentralisation, but was arguably consolidated by it.²¹ For instance, it has been argued that one of the reasons for the poor developmental performance of some provinces in the 1990s lies in the 'initial dominance in those areas of political dynasties, which have been revealed to be inimical to subsequent growth. This is because elite capture fosters a patron-client relationship between those who govern and those who are governed' (Capuno 2007: 204).

John Sidel in *Capital, Coercion and Crime. Bossism in the Philippines*, emphasises 'the extent to which control over the agencies of the state provides the key to capital accumulation rather than vice versa' (Sidel 1999: 145). He convincingly argues that throughout the colonial history of the Philippines, especially under the United States, the state evolved as a resource extraction machine that created the existing oligarchy rather than being the result of state capture by a pre-existing traditional elite.²² Provocatively, he argues that the Philippine rent-seeking state emerged 'due in large part to the imposition of formal electoral democratic institutions upon an underdeveloped state apparatus' (Sidel 1999: 140). The necessary weakness of overall

¹⁸ President Aquino's motto, 'If there were no corruption there would be no poverty', jointly with his steadfast commitment not to increase the tax effort, are an exact reflection of this view.

¹⁹ 'Nicoletti and others (2003) find that removing foreign equity ceilings is the most important potent way to raise FDI, and removal of such ceilings could increase FDI significantly (by nearly 80 per cent). The positive impact of FDI on real growth through, inter alia, transfer of technology and management practices is well-documented (see papers cited in IMF 2012, "Liberalization and Management of Capital Flows"). For example, Aizenman and Sushko (2011) find that higher levels of FDI lead to an increased probability of growth take off. There is also strong evidence that greater competition raises growth. For example, Aghion and others (2009) find that increased entry into an industry promotes innovation and productivity of the incumbents' (International Monetary Fund 2013: 14).

²⁰ On the unequalising impact of the Special Education Fund and the intergovernmental fiscal transfer system, see Public Expenditure Review (World Bank 2011a), chapters 4 and 3 respectively.

²¹ Reliance on local politicians through patronage and rents was one of the strategies of President Marcos to consolidate his power (Kushida 2003: 124).

²² De Dios and Hutchcroft make a similar argument: 'the American colonial era produced a national oligarchy, dominant in both the economic and the political spheres, that remains enormously influential to this day' (de Dios and Hutchcroft 2003: 45).

accountability at that early stage of development allowed those with access to the state to use it to amass wealth and shape institutions in order to reinforce wealth accumulation in their hands.²³

De Dios and Hutchcroft (2003) go further and argue that the United States actively fostered the creation of a new state-dependent elite in order to weaken the pre-existing landowning elite due to the pro-independence leanings of the latter. The former, instead, became dependent on the United States as the colonial power and on its policies and trading opportunities: 'The American colonial government successfully co-opted local *caciques* (powerful landowners) into newly formed political institutions, in the process not only strengthening the *caciques*' power base at the local level, but also extending it upward to both the provincial and the national level' (Hutchcroft and Rocamora 2003 cited in de Dios 2007: 161-162). The creation of the national assembly became the instrument through which these interests were institutionalised and perpetuated:

The creation of a national assembly in 1907 enabled provincial elites to consolidate their hold on the national state and fostered the creation of 'a solid, visible "national oligarchy"' (Anderson 1988: 11). The oligarchy took advantage of its independent base of power, and came to exercise a powerful – yet particularistic – control over elements of the state apparatus through a spoils system that was already well entrenched at the national level early in the century.
(de Dios and Hutchcroft 2003: 46)

The system through which state institutions and government policies benefited this colonially-connected elite were manifold. They included, among others, preferential access to the American market, the plundering of the Philippine National Bank and manipulation of government agencies (de Dios and Hutchcroft 2003).²⁴

In the process, arguably, the democratic state was shaped to reflect pre-colonial economic structures and social traditions, and especially the colonial period's spoils and patronage system, rather than developing into a Weberian arms-length state and bureaucracy with a genuine representation of popular interests. To this effect, de Dios and Hutchcroft argue that 'formal state institutions have failed to assert themselves over more traditional institutions, such as the norms invoked in clans and families' (de Dios and Hutchcroft 2003: 3).

Additionally, formal state institutions and policies reflect those traditional institutions and to a large extent function like them, while the state has significantly contributed to creating and continues to support the existing economic elites. This applies to both tax policy and administration. It also applies to the dedication of the state to the allocation of private rather than public goods, which can be seen as a continuation of traditional practices of gift-giving and patronage. I will argue below, however, that the preference for private over public goods is seen not only among the elite, but also among the middle classes and near-poor, and possibly even

²³ Similarly, Capuno (2007: 220) argues that 'the uneven pace of provincial development may also be due to the failure of elections to act as an effective instrument for exacting accountability'.

²⁴ Moreover: 'under the American regime, the oligarchs responded to countless new opportunities for enrichment. One source of largesse came in the form of preferential access for Philippine agricultural products (primarily sugar, coconut, and abaca) in American markets (Hawes 1987). A second source came from the effective manipulation of the growing colonial state apparatus at the national level – most dramatically evidenced by the plundering of the Philippine National Bank between 1916 and 1921 (Stanley 1974). Third, at the local level, effective manipulation of state agencies provided a range of means by which mayors, governors, and legislators could acquire land and obtain favourable access to timber, mineral, and marine resources (Sidel 1999)' (de Dios and Hutchcroft 2003: 46-47).

among the poor. The engine of this perverse dynamic is to be found in the combination of a high level of income inequality, formal and weak democracy, and state capture.

3.2 Preference for private over public goods

The role of the state in the economy changes as a country develops while the quality of democracy tends to progressively improve. However, in countries that become democratic at an early stage of development, there can be an especially strong tendency to shape democratic institutions and policies to reflect the role of the pre-modern state. In particular, citizens in democratic developing countries often exhibit a marked preference for the state to focus on delivering private over public goods as a 'modern' and 'legal' version of patronage. Hence the popularity of cash transfers, subsidies of all sorts, tax incentives, congressional allocations and school vouchers.

This preference for private over public goods is due to the uncertainty and time lag involved in reaping the benefits of investment in public goods. In the case of the Philippines, it has been argued that: 'governance measures that have only indirect or lagged welfare effects may have less appeal to voters than government jobs, subsidies and other forms of patronage that a local leader can dispense' (Capuno 2007: 230). Capuno, moreover, uses this reasoning to explain the absence of correlation found in the literature between development outcomes (measured through the Human Development Index (HDI)) and voting at the local level in the Philippines. His argument is that people do not see the link between government policies, e.g. investment in public goods, and outcomes, and they tend to prefer and vote for private goods. He finds that, between 1990 and 2000, only 8 out of 74 provinces showed any notable improvement in their human development indicators, as well as a weak correlation between HDI results and election outcomes. He concludes that 'voters may neither have the political maturity nor the requisite information to assess their government's contribution to overall development' (Capuno 2007: 221).

However, one could argue that this result is mostly due to the preference of voters for private over public goods. If this preference is indeed prevalent, government will under-invest in public education and public health leading to below par developmental results such as the stagnation of HDIs. Simultaneously, we would find a preference for private goods (that would not result in observable developmental results). There is evidence to this effect, as Diokno-Sicat (2012: Table 2.6) finds that the provincial median voter – who is near poor – demands more social welfare services (i.e. cash transfers and, hence, private goods) from the provincial government, but is indifferent to public spending on health and education.²⁵ The preference for private goods is also found in the fact that one-third of the meagre public spending on infrastructure is doled out as congressional allocations, rather than used for public infrastructure projects fulfilling the technical priority-setting and scrutiny of the Ministries of National Development Planning and Public Works and Highways.

Another reason for the preference for private over public goods may be the low prevailing level of trust in Philippine society. Part of this low level of trust could be due to the preference for attending to social needs by helping out those one knows through family and kinship ties rather than 'unknown others' through the state. Research on Filipino elites concluded with the observation that elite attitudes seem heavily biased towards benefiting 'one's own': 'this is the underside of Filipino *familism*: the seeming inability to care for the "anonymous stranger"' (Clarke

²⁵ There is evidence from other countries that Conditional Cash Transfers (CCTs) benefit the incumbent government that establishes or expands them. Baez et al. (2012) find that families benefiting from the Colombian CCT programme *Familias en Accion* were more likely to register and more likely to vote.

and Sison 2003: 219).²⁶ Moreover, there is international evidence that trust levels are lower in highly unequal societies. A World Bank study finds that trust levels in the Philippines tend to be 'very low', and particularly low in communities with high levels of asset inequality (Labonne et al. 2007). This low level of trust may be contributing to the weak preference for investing in government through tax policy reform, proper tax compliance rates and provision of public goods and services.

Low trust manifests itself particularly strongly in the population's diffidence towards the public sector as well as towards the poor. There is a predominant intellectual discourse that tends to portray markets and privately provided goods and services as efficient by definition, and government as inefficient and corrupt; this reinforces the preference for privately provided goods and services.

Philippine political discourse has traditionally emphasised limited State intervention in the economy and society, a legacy of American colonial rule and associated ideas concerning the role of the State. As a result, politicians are often unreceptive to appeals for greater State intervention.

(Reis and Moore 2005: 235)

Moreover, the fact that the middle classes – jointly with the elites – increasingly opt out of publicly provided services means they have little first-hand knowledge of the quality and efficiency of these services, while they do have plenty of first-hand knowledge of the government agency which is systematically ranked as (one of) the most corrupt – the Bureau of Internal Revenue.²⁷ This may negatively bias their view of government and further weaken their willingness to fund it. Finally, there is a widespread perception of the poor by both elite and middle classes as undeserving, which reinforces the political choice for limited public service provision in general and public service provision to the poor in particular.²⁸

This preference and the institutional and policy system it fosters becomes a trap – the more government expenditure is distorted towards the provision of private goods, the less money is available for investment in public goods and services such as education, health, roads or basic infrastructure that truly generate development outcomes. As these services are starved of funds their quality is undermined, their perception in the public eye diminished and the population's willingness to invest in them further declines, while the preference for private goods increases. Arguably, this is a trend that can be seen across the world, but especially in democratic developing countries that are particularly prone to this form of populism. This cycle leads to a further negative dynamic – middle class opt-out.

²⁶ 'The social roles and characteristics of the family have remained remarkably resilient over time and still permeate business life and politics ... The new representational system, Anderson argues, proved perfectly adapted to the ambitions of social geography and *mestizo nouveau riche*' (Anderson: 201 cited in Clarke and Sison 2003: 220).

²⁷ In surveys assessing the perception of integrity of various government agencies, BIR has come out as the most corrupt. See *Philippine Star* (18 March 2001): 'The Bureau of Internal Revenue (BIR) has been tagged as the most corrupt government agency based on findings of prestigious research groups'. In a 2005 Social Weather Station survey, BIR ranked number 3 in corruption <<http://www.philstar.com/headlines/90106/adb-bir-still-most-corrupt-agency>>.

²⁸ The amount of public backlash evidenced in the media and in parliamentary debates caused by the new CCT programme for the poor, compared with the relative absence of public outcry about fiscal incentives for the wealthy, is telling, particularly since the latter are at least ten times higher than the former and much more difficult to justify from an economic or equity perspective.

3.3 Middle class opt-out

As the quality of public goods and services declines – or is low to start with – the middle class progressively opts out of the public sector.²⁹ Because of political inability to enact tax policies and administration that would leverage the resources of the well-to-do, tax systems become increasingly regressive and place the tax effort squarely on the shoulders of the middle classes, which prefer to keep this burden as modest as possible. A large percentage of the population cannot even contribute to the tax effort since their productivity is very low due to poor public investment in their education.

As the resources available to the public sector are so meagre, it can afford to fund public goods and services of inadequate quality that are only – barely – attractive to the poor. An indicator of the poorly perceived quality of government services is the fact that, according to a 2001 nationwide survey, 74 per cent of people were bypassing rural health units and 68 per cent bypassing *barangay* (neighbourhood) health stations in favour of higher-level (but more distant) government and private hospitals. Those left using *barangay* and rural health centres are those with no other option – the poorest (Capuno 2007: 225).

As a result, it becomes more expedient and micro-efficient for the middle class to build its own private services than to invest in government services for the country as a whole.³⁰ Therefore the Filipino middle class uses its private resources to build its own education, health services, old age insurance, roads and private compounds with infrastructure and private security. Private spending on those services has been increasing as public spending has stagnated or declined. For instance, out-of-pocket health expenditure doubled in the first decade of the 2000s, while public health spending per capita was halved (World Bank 2011a: 39, 41).

Moreover, the middle class seeks to supplement its own spending on private services to the extent it can with government funds, such as school vouchers and funds from congressional allocations. As a result, private schools and hospitals mushroom, putting additional financial demands on the middle class and the elites, who are expected to sustain their functioning (Reis and Moore 2005: 236). Through this process private providers thrive, and government progressively deteriorates into a marginal entity viewed as mainly supplying low-quality services to the poor. Because an economy that under-invests in its poorest fifty per cent stagnates, it also fails to create sufficient managerial and professional jobs for its middle classes.

As a result, many of the Filipino middle class opt out of the country as a whole through emigration. In 2011, some 2.2 million Filipinos were working abroad, a huge 6 per cent of the domestic labour force (World Bank 2012b: 1). Available data confirms that the large majority of those who emigrate are from the skilled middle class (Rivera 2006: 182). According to a labour force survey, nearly nine out of ten Filipino overseas foreign workers had completed high school or higher education, and more than 63 per cent had some college education (World Bank 2012b: 2). This World Bank report finds that both push and pull factors explain Filipinos' high global labour mobility, with push factors including low salaries at home and limited opportunities for employment. However, pull factors should not be underestimated, especially the preference for

²⁹ It would be illustrative to see the changes in enrolment rates in public and private schools. Unfortunately, household surveys stopped including information on whether children are enrolled in public or private schools some years ago.

³⁰ The argument here is that it would be more efficient and the country as a whole would be better off if the middle class cooperated and developed a public sector that is financed equitably and provided services of reasonable quality for all its citizens (I would call this macro-efficient). Given political economy constraints (in particular the inability of the middle class to get the wealthy to pay taxes) it becomes more micro-efficient for them as a class to largely opt out of the state and its services and provide these for themselves privately.

Filipino workers in many countries and areas of work.³¹ The fact of the matter, however, remains – a large part of the Filipino middle class choose to opt out of the country, hence diminishing their pressure for improvements in development outcomes and better government services at home. These workers' transfers also fuel demand for private services, and further undermine the commitment of the middle class to government-provided health and education.

The Filipino middle class that remain in the country do not completely disengage from the state. On the contrary, they are deeply engaged in putting pressure on government in the areas of democracy and accountability. This activism was most patently manifested during the People Power Revolution of 1986 (in favour of democracy), but also in the 2001 revolt against the Estrada administration in what is often called the 'People Power 2' revolt (against corruption and lack of accountability); both of these were very much middle class-led revolts.³² It is also clear today in the dynamic role of the media, civil society and academia in the Philippines in the above-mentioned issue areas.

However, the absence of a coincidence of interests and preferences between the poor and the middle class means that there is significantly less political activism to foster a broader pro-developmental fiscal policy through a higher tax effort and greater spending on public services. In short, since the tax burden falls mainly on it, the Philippine middle class prefers to fund its own services and keep government as small, democratic and accountable as possible. These preferences are reflected in their chosen type of social activism and their political activity, which can be qualified as 'a conservative force' (de Dios and Hutchcroft 2003). To an extent, one could speak of an uneasy, yet rather stable, elite-middle class consensus on these issues.

3.4 The disempowerment of the poor

Poor social groups in democratic low and middle-income countries often constitute an absolute majority of the population but only infrequently influence national policy. There are many explanations for this, including the malfunctioning of democratic institutions. (Houtzager and Pattenden 2000: 107)

The poor and near-poor form half of the population of the Philippines. Their total number has increased since the mid-1980s; poverty incidence has not declined in the past 10 years, and increased from 2003 to 2006. There has been no household survey since 2006, and therefore we cannot know for certain how poverty has evolved in the past six years. However, indications from Social Weather Stations point to stagnation in the poverty rate even in the midst of growth and, in 2010, self-rated hunger remained 'at record high levels' (World Bank 2011b: 3). Moreover, according to Social Weather Station polls the prevalence of self-reported hunger has continued to increase between 2012 and the first quarter of 2013.³³ There is little political activism by the poor despite the absence of progress in improving their welfare, even in the midst of economic growth and high levels of inequality.

³¹ The majority of overseas Filipino workers are employed in the service sector – domestic helpers, nurses, teachers, engineers (including information and technology), architects, and seafarers. Demand for Filipinos has been global, ranging from the Middle East to Asia, Europe and the US. Another reason why so many Filipinos emigrate is that they are particularly appreciated, especially in the services sector, due to their education, English proficiency and reputation. To these reasons cited by the report, I would add their affability and cultural adaptability (World Bank 2012b: 1).

³² Bautista (2002) reports survey results from Pulse Asia suggesting that participants in People Power 2 rallies in Metro Manila consisted of some 18% from the elite, 47% from the middle classes, 31% from the poor, and 4% from the very poor, utilising the AB-C-D-E socioeconomic classification typically used in such surveys (Balisacan and Hill 2003: 72). Rivera also points out that the middle class played a key leadership role in the People Power 1 and 2 movements (Rivera 2006: 182).

³³ 'The First Quarter 2013 Social Weather Survey, fielded over March 19-22, 2013, found 19.2% or an estimated 3.9 million families experiencing involuntary hunger at least once in the past three months. This is almost 3 points above the 16.3% (est. 3.3 million families) in December 2012' <<http://www.sws.org.ph/>>.

In fact, the type of obstacles to effective political mobilisation of the poor found in low- and middle-income countries can all be found in the Philippines, from large socio-economic power gaps to poor education, social fragmentation, high opportunity cost of collective action and low trust that the status quo can be fundamentally altered. Whenever they are politically organised, the poor seem to focus on policy areas of immediate direct and high relevance to them, such as land issues. Probably due to capacity and influence reasons, even in these areas their movements tend to be leveraged by other non-poor organisations in civil society, some of which can be argued to be playing the role political parties are not playing (Houtzager and Pattenden 2000).³⁴ Even these coalitions of the poor have not been able to face down much stronger and well-organised interests.³⁵ Overall, however, the political activism of the poor has been almost nil, especially regarding broader issues including tax and expenditure policies.³⁶

In their description of the role of the poor, de Dios and Hutchcroft use the terms ‘unorganized and relatively unpoliticized poor’, ‘normally politically inchoate masses’, ‘amorphous masses’, and ‘unorganized poor’ (de Dios and Hutchcroft 2003). These terms are used in the context of one of the few recent political events in which the poor took a leading role: what some have come to call ‘People Power 3’ or the reaction of the poor to the ousting of President Estrada, who they viewed as ‘their’ president. De Dios and Hutchcroft emphasise the gulf in perceptions between the middle classes and elite groups behind People Power 2 and the poor behind People Power 3 (de Dios and Hutchcroft 2003). The middle classes and elites behind People Power 2 felt President Estrada’s governance was beyond the pale even in the fragile institutional context of the Philippines, and saw their interests threatened by it. On the other hand, the poor of People Power 3 took to the streets because they felt President Estrada was no more corrupt than other presidents but had taken up their agenda, and that was the reason why he was being unfairly and unconstitutionally targeted by the establishment (de Dios and Hutchcroft 2003). People Power 3 stands out as one of the very rare cases in which the poor – especially urban – masses came together to press what they perceived to be their interests.³⁷

Aside from rare mass unrest, the poor are not regularly represented in the Philippine political system, with dire consequences for the nature of policy-making: ‘Meaningful social change has been inhibited because political parties have failed to structure political competition to allow for representation of the interests of the poor and marginalized sectors’ (Montinola 1999 cited in Balisacan and Hill 2003: 133).³⁸ An important reason for this institutional failure is that political parties are not programmatic. Because the electoral system is dominated by individual

³⁴ Houtzager and Pattenden (2000: 116) argue that ‘in such countries (recent democracies), NGO-brokered coalitions appear to serve as partial “functional” equivalents of progressive parties, providing such a channel’.

³⁵ For instance, the Congress for a People’s Agrarian Reform (CPAR) was an NGO-brokered coalition including, aside from peasant organisations, the Catholic Church, urban intellectuals and other groups. ‘Perhaps the clearest indication of CPAR’s sensitising influence was the widespread media support for its agricultural reform amendment to the Constitution. The peasant coalition’s efforts to change Government policy, however, were blocked by the weakness of the state and closed nature of the party system, which ensured that conservative, anti-reform groups dominated both the executive and legislative branches of Government ...The closed nature of the party system and the absence of a left party ensured that CPAR’s efforts would be defeated’ (Houtzager and Pattenden 2000: 120).

³⁶ Alonso i Terme and Steinberg (2006) argue that in Latin America in the 1990s the poor were politically-relevant enough to be able to be part of a top-bottom coalition to re-orient public spending to the higher and the lower income groups, while placing the burden of fiscal adjustment on the formerly state-dependent middle classes. No such coalition exists in the Philippines (either formally or de facto).

³⁷ ‘For all the pro-poor rhetoric and vague redistributive promises made on behalf of those who felt excluded by the economic gains of the Ramos years, the major redistributive benefits of the Estrada administration were extended to those who enjoyed most favourable access to the Palace’ (de Dios and Hutchcroft 2003).

³⁸ ‘The party system was not a viable channel through which to make demands in the political arena and, at least for coalitions of the poor, didn’t provide access to the critical decision-making centres within the State.’ (Houtzager and Pattenden 2000: 117).

constituency seats it has fostered patronage and private goods policies, as individual representatives tend to 'earn' the vote of their constituents rather than focus on developing a sound political programme focused on delivering public goods and services with broad appeal. An attempt to provide room for programmatic political parties was made by allowing for a small percentage of seats to be filled by political parties running with a party list (rather than individual politicians running for individual constituencies).

There was enormous opposition to this initiative from established politicians and, as a result, the party list law enacted by Congress was highly flawed. It was unclear who would be able to join the party list, as well as how seats would be allocated (Coronel et al. 2007: 223). The system put even more sand in the wheels of this process as the Supreme Court imposed a temporary restraining order against the proclamation of any party list representative. In addition, in 2003 the leadership committee of the House of Representatives cut off funds for new members. Programmatic parties were also seen as a threat by other groups. There were reports that party list groups were being intimidated by the Communist New People's Army, which felt some of these groups were competing for their constituency.

Because of institutional barriers, opposition by the status quo and weak organisation of the poor, there has been no single party representing what could be called a social democratic agenda along European or Latin American lines. This has contributed to the absence of a tax policy reform agenda, as left-leaning governments tend to implement policies yielding a higher revenue effort and a more equitable tax burden.³⁹ The political left has instead been taken up by an array of Maoist communist and communist-leaning guerrilla groups and political parties without much following or credibility (Coronel et al. 2007: 227). The Communist Party of the Philippines (CPP) has refused to take part in the democratic system, and has therefore neither undergone the process of moderation of its political position nor been able to exercise the political influence that other communist parties have mustered, for instance, in Europe.⁴⁰ Moreover, arguably, 'in large measure due to the CPP's dominant position on the left, no centre-left party emerged during the democratic transition' (Houtzager and Pattenden 2000: 117).⁴¹ Similarly, there has been nowhere near the extent of Catholic political activism of the liberation theology variety as in Latin America.

In fact, the parallel with Latin America, where political pressure from the poorest 50 per cent is palpable across the continent, is striking. The electoral system goes a long way towards explaining the difference, with programmatic parties largely and increasingly dominating the political scene in Latin America. A further reason for the political mobilisation of the poor in Latin America compared to the Philippines may be the racial-cultural divide in the Americas between the indigenous and mestizo population on the one hand, and the white-European ruling elites on the other. This racial divide and the social exclusion it created in the Americas is without parallel in the Philippines, and can help explain the absence of political mobilisation of the poor. In fact, racial, religious and cultural homogeneity between the rich and the poor in the Philippines helps underpin the continuation of an informal system of 'support from the well-off... (which) represents an important safety net for the poor' (Clarke and Sison 2003: 231).⁴² This support,

³⁹ A paper using data from 17 Latin American and Caribbean countries between 1997 and 2010 found that left-leaning governments are associated with increases in total tax revenue and income tax revenue of 2.1 and 1.3 per cent of GDP, respectively. There is no effect on revenue from VAT or social security taxes (Caro and Stein 2013).

⁴⁰ On the contrary, arguably the extreme Maoist leanings of the CPP, its rejection of the democratic process, its embracing guerrilla warfare and violence, and its alliance with China have critically weakened any possibility of real influence on the political agenda and possibly strengthened the conservative reaction to any left-leaning movement (Houtzager and Pattenden 2000: 120).

⁴¹ 'The only ideologically-coherent mass-based party was the CPP' (Houtzager and Pattenden 2000: 117).

⁴² In interviews, Clarke and Sison (2003: 232) found that elite Chinese Filipinos distanced themselves from these traditional support arrangements and that their attitudes towards poor Filipinos were harsher than those of other elite respondents.

jointly with democracy and the absence of discrimination – one of the greatest blights on the well-being of the poor in countries where it exists – help explain the lack of social and political mobilisation of the poor in the Philippines.

The only area of the Philippines where we can find a combination of cultural divide with high poverty and perceived exclusion is Mindanao, which is also the only region in the country with widespread political discontent and activism. The prominence of the feeling of cultural exclusion from the constructed national identity of the Philippines by Mindanao Muslims in the Moro nationalist movement has been stressed by Filipino Muslim academics:

Moro nationalism and struggle cannot simply be dismissed as an unreasonable challenge to the State and addressed by expedient means and narrow ends. The challenge must be viewed partly as a symptom of State failure in nation-building and partly as a culmination of the struggle of people whose time has come after being unjustly misunderstood for decades if not centuries.
(Wadi 2005: 19)

Regardless of the reasons for this situation, weak pressure from the poor for the government to deliver goods, services and economic opportunities for them greatly reduces the political incentive to reform the status quo. Arguably, the poorest 50 per cent in the Philippines do not have real representatives of their interests in Congress or in government, and resulting government policies reflect this. In this situation, the limited activism of the poor has focused on their most urgent and immediate needs – access to land in both urban and rural areas – but has stayed away from broader issues such as fiscal policy.

3.5 A case of historical path dependency?

Historical-cultural theories can throw additional light on the quandary under scrutiny in this paper:

A number of Spanish accounts and later ethnographic descriptions of Philippine feasts note that all of the participants, including chieftains and nobles as well as commoners and slaves attached to the sponsor were obliged to contribute to the feast ... these contributors to an elite-sponsored feast were consistent with 'tribute' payments (that is, mandatory payments exacted by an elite patron either in the form of goods or enforced labour) ... It is probably not a coincidence that the largest and most protracted of the ... feasts ... occurs just after the annual fall rice harvest, when the granaries are full of available rice for large tribute exactions ... these periodic feasts ... provided opportune occasions for extracting resources from commoners in bulk contributions as part of the annual chiefly tribute exactions ... In contrast, the prestations from members of the nobility to the elite sponsor took place in the context of alliance-building reciprocal 'gift' exchanges.
(Junker 2006: 55-56)

The above quote, describing the traditional practice of competitive feasting in 16th century Philippines, bears an uncanny resemblance to the current Philippine state and, in particular, its tax system. 'The feast' is the elite-sponsored state, and the 'contributions' are the taxes that 'commoners and slaves' (mainly politically unconnected businesses and compensation earners) are obliged to pay. Also as in the 16th century, the elites are the 'sponsors' and organisers

Similarly, the degree of resentment of wealthy Chinese Filipinos by the non-wealthy non-Chinese in the Philippines is also much higher than their resentment of non-Chinese Filipino elites.

running the event and exchanging favours such as tax exemptions and goods and services through pork-barrel Congressional allocations among other policy instruments (see Coronel et al. 2007).

One can thus argue for the presence of a certain path dependency in the social and political structures of the Philippines from pre-colonial times to the Spanish period, the American period and the post-colonial era. The above-mentioned pre-colonial socio-economic and cultural practices would thus find historical continuity and be compounded with the establishment of large *latifundia* during the Spanish period, and the creation of a US-dependent commercial elite during the American period. The policies and institutions established in the post-colonial era would have consolidated the status quo ante by adapting the representational institutions to the needs of a clan-based society, and directing government policies to entrench pre-existing economic interests from the pre-colonial period. In Anderson's words: 'The social roles and characteristics of the family have remained remarkably resilient over time and still permeate business life and politics ... The new representational system ... proved perfectly adapted to the ambitions of social geography and *mestizo nouveau riche*' (Anderson 1988: 201 cited in Clarke and Sison 2003: 220). Meanwhile, through the economic policies of import substitution implemented between 1954 and 1972 'the heyday of the cacique democracy, the national oligarchy dominated the political system and consolidated its economic position through privileged access to US markets for agricultural commodities and diversified into industry and services behind tariff walls in an era of import substitution industrialization' (Anderson 1988: 207-208 cited in Clarke and Sison 2003: 220).

The elites would have become less land-based and even more dependent on state patronage as well as on finance during the fourteen years of Marcos dictatorship. Academic observers highlight the subsequent disappointment of the population in the fact that no substantial change to this stronghold of the elites on government institutions and policies ensued from democratisation after the People Power movements.⁴³ Some observers also point out, however, that the economic elites are becoming less traditional, namely less clan-based and more based on private sector wealth and public sector patronage.⁴⁴ They also include wealthy celebrities from the entertainment and sports world. Their being less traditional, however, does not seem to have had any impact on improving state institutions and policies. Arguably, these new elites are even more disengaged from the poorest 50 per cent, as they do not share with them the typically broad traditional clan ties with their concomitant sense of responsibility.

Some Filipino anthropologists also believe that the geographical conditions of the Philippines, chiefly its being an archipelago, jointly with its related pre-colonial history of small-scale economy, society and political organisation, have shaped a culture of incremental change, risk-avoidance and limited horizons.⁴⁵ This legacy could have led to a cultural preference for progressing through small steps and precluded grand visions and big leaps forward:⁴⁶

⁴³ 'NGOs played a significant role in the ouster of Marcos and in President Aquino's People-Power movement and then became disillusioned with Aquino for her failure to introduce meaningful reforms' (*Far Eastern Economic Review* 1991: 21).

⁴⁴ Of 214 members of the House of Representatives elected in May 2001, 50 per cent were members of established family-based political clans compared to 73 per cent in 1992 and 82 per cent in 1987 (Clarke and Sison 2003: 221).

⁴⁵ It is true that archipelagos, especially those that are isolated from the mainland and located in tropical climates, have typically developed subsistence economies with limited trade and largely local clan-based societies lacking overarching states and related bureaucracies (arguably because they were unnecessary).

⁴⁶ Arguably, absence of long-distance trade with other peoples and the exchange, competition and conflict that it brings, and the accompanying impulse to innovation, could help explain the absence of technological progress that is common to relatively isolated societies such as other Pacific Island countries.

Society for the Filipino is a small rowboat: the *barangay* ... Are we not confusing timidity for humility and making a virtue of what may be the worst of our vices? ... The depressing fact in Philippine society is what seems to be our native aversion to the large venture, the big risk, the bold extensive enterprise ... Because we cannot unite for the large effort, even the small effort is increasingly beyond us ... having mastered a material, craft or product, we tend to rut in it and don't move on to a next phase, a larger development, based on what we have learned ... Our cultural history, rather than a cumulative development, seems mostly a series of dead ends. One reason is fear of moving into a more complex phase ... it was the colonial years that pushed us towards the larger effort ... (Joaquin 2004: 351-367)

As difficult as it is to agree on any sweeping anthropological characterisation, let alone draw continuities from it in cultural legacy, one cannot help but see a semblance of the above in Philippine institutional and policy reform both in tax policy and other areas. The contrast is particularly stark when one compares the Philippines with the grand-sweep reforms in Latin America in the 1980s and 1990s, or with the great Asian transformations from Korea and Malaysia to China and Vietnam.⁴⁷ The other tropical archipelago with a similar geographical and cultural heritage – Indonesia – may be viewed as suffering from a comparable excessively slow pace of economic and, even more so, governance reform.⁴⁸

Arguably, on top of the limitations of the pre-colonial past, the colonial period bequeathed what I would call a 'problem of perspective', which is common to countries having suffered periods of long and intensive colonisation. This problem is one of excessive affinity with the cultures, institutional systems and policies of developed countries (especially, but not exclusively, the former metropolis). In the Philippines, this symptom is seen in the continuous comparison of the country's institutions, policies, and society with those of its former colonial powers, especially the United States, and other western countries such as Australia.

The Philippines, when looking for economic models and policies to learn from, does not typically look to either the Asian context or Latin America when seeking guidance on how to manage highly unequal democracies. Instead, it looks to developed western countries, whose economy, society and political systems are utterly incomparable to those of the Philippines. This severs the country from its natural frame of reference, and leads to excessive zeal to adopt economic and political models that do not suit its context, while breeding a sense of inadequacy.

Indeed, the wholesale adoption of western developed country models creates a great gap between formal and informal institutions and a concomitant credibility gap. In many areas, the Philippines will have one of the 'most advanced' regulations, policies or systems in the developing world (e.g. competition law, customs systems), when actual practice will be much below that of countries with less sophisticated formal systems. In other areas, policies will be modelled on those of developed countries in ways that greatly harm economic development. For instance, labour regulation and minimum wages have been set at standards and levels typical of those of developed countries. As a result, they have greatly contributed to weak industrialisation, particularly in labour-intensive industries, and a concomitant low elasticity of poverty to growth (World Bank 2009: 10 and Sicat 2004).

⁴⁷ An important difference with Latin America is that they did not become outright American colonies as the Philippines did, despite important economic and political influence from the United States after independence. As noted in other parts of this paper, the American period was critical in the process of creation and consolidation of a domestic elite and its capture of the state, its institutions and its economic policies.

⁴⁸ In both cases, however, popular revolts led to democratisation (in 1986 in the Philippines and in 1997 in Indonesia). It is unclear how this would fit in with the 'small steps, progressive' reform argument in other arenas.

Finally, the continuous comparison with the former colonial power rather than its own neighbours breeds an unjustified sense of inadequacy:

The depressing fact in Philippine history is what seems to be our native aversion to the large venture ... We try to equate the odyssey of the migrating *barangays* with that of the Pilgrim Fathers of America, but a glance at the map suffices to show the difference between the two ventures ... They were more enterprising ... The air droops with a feeling of inadequacy.

(Joaquin 2004: 354-355)

This feeling is hard to prove in an empirical manner. However, it is arguably one of the key characteristics of societies that have suffered from deep and lasting colonisation, from Africa to Latin America – the insecurity in one’s own capacity fostered by the colonial rulers and by comparison with the metropolis. One of the manifestations of this perceived sense of inadequacy (which contrasts sharply with that found in countries like China, Japan or Vietnam) is what has been termed ‘a weak sense of national identity’ and a lack of collective confidence.⁴⁹ This sense of ‘no, we can’t’ can be palpably felt and affects the willingness of actors, from bureaucrats to policymakers and even citizens, to undertake big enterprises, including in tax policy and administration reform.

4 The way forward – building on the country’s democratic strengths

The greatest strength of the Philippines as regards the path to tax reform lies in its democratic nature. With all its faults, the Philippines is a dynamic democratic country. There is wide recognition that it has the largest, most capable, well-organised and creative civil society in East Asia, and it ranks among the best in the world.⁵⁰ This civil society includes a large and varied number of NGOs, active and committed Catholic and Protestant Churches and a wealth of people’s organisations, such as trade unions, women’s groups and community-based organisations - especially regarding rural issues.

Possibly the greatest asset of Philippine civil society, in contrast with political parties and Congress, is its programmatic orientation and independence from the ruling elites.⁵¹ NGOs also play a political role, and provide what has been termed as ‘an outlet for young people who might otherwise join the traditional left either above or below ground’ (*Far Eastern Economic Review* 1991: 20).⁵² These organisations concern themselves largely with service delivery, human rights

⁴⁹ It is argued that this weak nationalism is related to ‘the defeat of the Katipunan by the Americans in a brutal counterinsurgency campaign, followed by colonisation by the Japanese during World War II has left deep scars on the national psyche. A number of respondents, for instance, suggested they felt ashamed that the Philippines had fallen behind relative to other countries. Related to this weak sense of nationalism or national identity is the close relationship between the Philippines (and Filipino elites) and the US ... Close links to the US also provide Filipino elites with the option of migrating to the US or elsewhere eroding the sense of national identity and commitment’ (Reis and Moore 2005: 23).

⁵⁰ *Far Eastern Economic Review* (1991: 20); Houtzager and Pattenden (2000: 118).

⁵¹ ‘The NGOs’ organization, strong programmatic orientation, and autonomy from clan politics contrasts markedly with that of party politics’ (Houtzager and Pattenden 2000: 118). The article also points out that the strength and relative autonomy of NGOs from domestic actors is to a large measure a result of the funding provided by European and American donors.

⁵² This is an observation by the current Secretary of the Department of Budget and Finance. The same article notes that ‘the oldest Philippine NGOs were set up in the early post-war period. The Philippine Rural Reconstruction Movement, for

and democracy-strengthening objectives. These objectives are in line with some of the dynamics described in this paper: the tendency for private individuals and organisations to substitute for the weakness of public service delivery,⁵³ and, especially among the middle classes, to keep government as transparent, democratic and accountable as possible. There are also some NGOs that devote themselves to advocacy on development and poverty issues. Those, however, tend to focus either on advocacy on a specific sector (e.g. education or health) or on improved transparency and accountability (e.g. Social Watch). As is typical, especially in developing countries, there is no organised voice in favour of sufficient, fair and transparent taxation. This compounds the imbalance in the political system and weakens the chance of tax reform.

Another great strength of the Philippines is its media. It is free, well-developed and dynamic.⁵⁴ It is concerned with all subjects, including economic, social and political issues, and much of it is well-informed and insightful. The press, however, has also typically reflected the societal – especially middle class – perspective on preferences regarding both coverage and advocacy. Namely, the press is very active in covering the integrity aspect of tax administration (especially corruption scandals), as well as reporting shortcomings on the efficiency of public expenditure (for instance, congressional allocations). However, it does not reflect the view that one of the main reasons for the poor performance of the country is insufficient revenue and concomitantly inadequate expenditure on public goods and services. This gap contributes to the consolidation of the prevailing view that government is inefficient and corrupt, and that it is therefore most desirable to keep it small, strengthen transparency and accountability, and supplement-circumvent it through private provision.

The Philippines is also endowed with a very strong academia. Its universities (University of the Philippines, Ateneo de Manila and others) are staffed with highly capable professors. These academics have benefited from reading the best of contemporary economic and political science theory thanks to their command of English and links of their country to the United States, Australia and the rest of the western world, and add to this asset their knowledge and understanding of the local context. The resources devoted to tertiary education and the democratic environment of the country, including longstanding academic freedom, have also contributed to the development of a strong academia.

Much of this academia, including economists, is strongly committed to the well-being of the country, and focuses its research on issues of high relevance to its development. It is to local researchers that we owe the most insightful analyses of the economics, as well as political economy, of tax policy and administration in the Philippines. However, the research that stresses the weaknesses of the existing system could be more effectively used to support tax administration reform. Moreover, academics could be more actively engaged in highlighting the links between tax effort on the one hand, and public expenditure and development outcomes on the other, making specific policy and institutional reform proposals and leading reform coalitions advocating for sufficient, fair and transparent revenue.

The Philippines also has a highly capable bureaucracy. None of the main weaknesses in policymaking in the country are due to weak capacity, especially at national level. They are

instance, was founded in 1952 by middle class professionals committed to working with the poor' (*Far Eastern Economic Review* 1991: 21).

⁵³ 'To a greater extent than anywhere else in the region, so-called NGOs have taken over from the Government the work of improving the lot of the poor majority through political, cultural and economic programs' (*Far Eastern Economic Review* 1991: 20).

⁵⁴ The Philippines has, however, one of the highest rates of murder of journalists in the world.

governance problems. The capacity of the Philippine bureaucracy is strong as it benefits from the graduates of its – also strong – universities.⁵⁵ The bureaucracy has within its ranks many individuals who are not part of the corruption machine, and are committed to the well-being of the country. These civil servants – who exist both at the rank-and-file as well as managerial levels – quietly try to implement the limited reforms that are possible within their highly constrained environment. These people could be key leaders of the reform process if they were appropriately empowered by a reform champion at the top with presidential support, and were placed in critical management positions in the revenue agencies.

Similarly, Congress has within its ranks highly capable and committed representatives. If enough of a groundswell could be generated from improved data availability, analysis and advocacy from civil society, the churches, the media and academia, with sufficient legitimacy with the population, a coalition of committed Congress people could be constructed to support the case for tax reform. Congress, moreover, has an excellent Budget Research Office staffed with capable and dynamic economists. The Congressional Budget Research Office could act as a facilitator in ensuring that data and analysis produced by academics, NGOs and development partners find their way into Congress.

Finally, the international donor organisations and political allies of the Philippines have an important role to play, especially the United States, Australia and Japan. The Philippines has particularly close ties to the above-mentioned countries, which could work together to encourage the government and support non-governmental actors in advancing the tax reform agenda. So far, support has been limited to enabling the implementation of the – very timid – reforms that the BIR and government have been prepared to implement. It is critical for these countries to engage actively with high-level government officials, academia and civil society to help catalyse the changes in information, analysis and advocacy that are necessary for tax reform.

These countries could work hand-in-hand with international organisations like the World Bank, International Monetary Fund, Asian Development Bank and their own bilateral aid agencies to foster just such a dynamic, and to catalyse government commitment. International donor agencies can also more actively disseminate their research highlighting the relative efficiency of government interventions in education and health, and the fact that their main shortcoming lies in scarcity of funds. This could help strengthen the belief of the middle and upper classes in the ability of the public sector to deliver on its function.

The international aid agencies could lead an effort to produce better data on tax collection, more and better revenue analysis, including on the potential impact of various proposed tax reforms, make tax reform proposals and act as catalysts for the establishment of coalitions for tax reform. This is already happening to a certain extent. However, efforts could become bolder with more active political support from the top of these agencies to complement engagement at the technical level, and could be better coordinated across agencies. If there was a concerted, coordinated effort among these agencies in collaboration with the international partners of the Philippines, in dialogue with the highest political level in the country, it may be possible to garner the support needed from the top of the Philippine government.

To support these efforts, a change in perspective among the population and, in particular, civil servants would be of great help. The Churches could play a leading role in this task, using existing knowledge on how best to appeal to people's religious beliefs to support behavioural

⁵⁵ For instance, a university degree is required for most positions in the public administration, and a Master's degree is required for a management position.

change and create consistency between beliefs and behaviour. The Philippines is a profoundly Christian country, in which people have Christianity and their Church at the core of their identity and community life. Insights from behavioural economics indicate that countering people's tendency towards 'compartmentalised identities' and thus fostering unity of identity can increase consistency between beliefs and actions. Therefore, it would be important for the Catholic Church and other Christian churches to promote more actively an improved public morality focused on integrity and pro-poor attitudes, behaviour, policies and institutions.

Existing civil society organisations working on this issue could generate ideas, and develop and implement programmes. A parallel process could take place with Muslim leaders in Mindanao and other communities with a Muslim presence. If the Catholic Church and other religious leaders placed the issue of integrity and solidarity with the poor at the top of their preaching agenda, supplemented with a set of educational and advocacy activities with government officials, business leaders and the population at large – including in the public and private education system – it could potentially have a significant impact in changing civil servant behaviour.

Another initiative that could help catalyse energy for reform, as well as provide specific ideas on how to engineer it, would be South-South exchanges with countries that have implemented successful tax reforms. These countries could be from East Asia and Latin America. The similarities in economic structure, political system and political economy between the Philippines and middle-income countries in these two regions would provide a useful comparator in exchanging experiences. Moreover, many Latin American countries have implemented highly successful tax policy and tax administration reforms in similar democratic environments with a significant presence of corruption and income inequality. Therefore, their lessons could be of great relevance and inspiration to the Philippines.

The way ahead to reform should build on these strengths in academia, civil society, the press and faith-based organisations, as well as on the existence of committed champions within the bureaucracy and the political system. The creation of an NGO devoted to fostering tax sufficiency, efficiency, integrity and equity could be of great help. This organisation could be led by civil society but include academics, private sector and faith-based organisations and have strong connections with the press to ensure adequate coverage. Alternatively, one of the existing NGOs – such as Social Watch – could expand its activities to carry out a more active and comprehensive coverage of tax policy and administration. Donor organisations and allies of the Philippines could contribute with technical assistance, financing and policy leverage. They can also help foster linkages with international NGOs like Tax Justice Network or Tax Watch Australia.

Commitment to reform from the private sector could also be explored. It is unlikely that this support would come from the large domestic incumbents who have been benefiting from the extraordinary rents of a protected investment market and a low tax effort, who have strong connections to the political establishment. However, one possibility would be a coalition of potential winners from the competitive and currently constrained parts of the domestic private sector, in partnership with multinational corporations interested in expanding their investment in the Philippines. This coalition could connect with other supporters of investment liberalisation and possibly (though much less likely) even support tax reform. If a thoroughgoing investment and tax reform package were to be put together, this support might be forthcoming as gains from liberalisation may outweigh somewhat higher tax rates.

Bolder and quicker action could be taken if there were to be commitment at the level of the president. The executive could propose a plan for tax policy and administration reform based on the advice of international organisations and the diagnostics of its own capable bureaucracy at the Department of Finance. It could also empower the Commissioner of the Bureau of Internal Revenue (and arguably the Bureau of Customs) to carry out in-depth tax administration reform and build a coalition for tax policy reform in Congress. Tax administration reform would require either a full revamping of the organisations (with wholesale firing and re-hiring based on merit and integrity along the lines of the Superintendencia Nacional de Aduanas y de Administración Tributaria (SUNAT) reform in Peru) or, at the very least, a changeover of key management positions at both headquarters and regional and district offices. With enough management-level staff on board to carry out an in-depth tax administration reform, BIR could ensure that rank-and-file officials opposing reform or engaged in corruption are either sidelined and isolated or investigated. In a BIR environment energised for tax reform, supported at the presidential level, human resource reform would complement ongoing business process re-engineering and upgrade of IT systems and tax administration reform would be possible.

Reform on the tax policy side is more uncertain, even with presidential support. It would require a broader understanding by the public of the need to enhance tax sufficiency, and a belief by the middle classes that they stand to benefit from it. This change in perspective among the middle classes could be fostered by accompanying tax administration reform with a broader and energetic anti-corruption strategy (as was done in Bolivia in the 1990s). A tax policy design and tax administration reform focused on ensuring the top of the income distribution spectrum pays its fair share of taxes could also help convince the middle classes to buy back into the social contract with the state, and to pay taxes in exchange for the delivery of useful quality public goods and services. The reform could be supported by trying to engage Congress in a fiscal pact. The fiscal pact could include a medium-term fiscal framework with the promise of certain deliverables as development outcomes. The groundswell of support for such an initiative could be fostered by active dissemination of existing research on the impact of the scarcity of spending on key sectors such as education, health and infrastructure. It could be a joint effort of reform champions in government, Congress, civil society and the donor community.

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