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THE PHILIPPINE TAX SYSTEM AND SOURCE OF FINANCING
RURAL DEVELOPMENT

by
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A pessimist will likely raise his hands in abject surrender in looking for the proper and practical means of fighting poverty in our rural areas. This is so because the root cause of the dilemma is poverty itself. In our materialistic world in which social and economic progress or retrogression is measured in money values, the most or perhaps the only potent weapon that may be used to lick poverty is wealth - and to be precise - money.

Ragnar Nurkse's theory of "vicious cycle of poverty" can have no better application than the situation obtaining in our impoverished rural communities today. Our people in the rural areas who are mostly poor farmers cannot increase their real incomes because the land they till are unproductive. The land is unproductive because the small farmers cannot procure good variety of seeds, irrigate their land and apply fertilizer. Our financial institutions cannot lend them the money needed because they cannot offer adequate collaterals. And because most of them are unschooled, unskilled and fiesta-loving, money lenders do not consider them as good credit risks. The incomes of most families in the rural areas are not even enough to meet their basic necessities. They, therefore, cannot accumulate savings for

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investment to increase productivity. If they cannot increase their productivity then they will remain poor.

Seventy per cent of our population live in the rural areas. Of our total labor force, 61.1%^{1/} are employed in farming, fishing and related undertakings. It can, indeed, be concluded that only a very insignificant portion of the population living in the rural areas is engaged in occupations other than agriculture. It is an accepted fact that in the Philippines, as well as in other countries in the same stage of development as the Philippines, incomes from agriculture are the lowest among the other sources. It is not surprising that while incomes of families living in urban areas who derive their income from non-agricultural industries average P2,395^{2/} per family, family income in rural areas derived most from agriculture average only P1,203^{3/} per family. Economic surveys reveal that in rural areas savings are possible only when family incomes reach the P1,500 to P1,999^{4/} levels. It is sad to note that only 13.5%^{5/} of the rural families have incomes that could fully cover family living expenses. What makes the fight against poverty in the rural areas more difficult is the fact that less than 10%^{6/} of our farmers, farm laborers, fishermen and kindred workers have had the opportunity of

1/ BCS, Phil. Statistical Survey of Household, May, 1961
Bulletin Series 9

2/ BCS, Phil. Statistical Survey of Households, May, 1961

3/ Ibid ...

4/ Ibid ...

5/ Ibid ...

6/ Ibid ...

of attending school beyond the high school level. About 22%^{1/} of them had no schooling at all.

The social and economic problems in our rural areas are formidable indeed and unless financial assistance, which is not now being made available, is extended to the depressed rural areas, our hopes of increasing productivity to prop up the national economy may not be realized during our generation. How money may be generated so that financial assistance to our depressed rural areas may become a reality will be a good field to explore. Since taxation is the principal means of raising revenues which can be readily channeled to such projects as will improve life in the rural areas, an evaluation of our tax system is being attempted. The general objective of the undertaking is to determine what possible improvements may be introduced in the system so that taxation may be geared towards the achievement of a better life, particularly for our people in the rural areas. Inasmuch as taxation has certain limitations, if its destructive implications are to be avoided, this paper will attempt to discuss other modes of financial rural development.

The Inadequacy of Tax Revenues

In the fiscal year 1965, the Philippine Government excluding its local government units collected the total of P1,523,701,747^{2/} in tax revenues. In the fiscal year 1955 tax revenue collections amounted to P623,792,415, so that tax collections increased by P899,909,332 during the last ten year period.

^{1/} BCS, Phil. Statistical Survey of Households, May, 1961
^{2/} Report of the Auditor General, FY 1964-1965

In other words tax revenues in 1965 is 2.43 times as much as it was in 1955 in absolute terms. This may look impressive but actually tax collections in 1965 in terms of the value of the peso in 1955 (which is only P0.55) would amount only to P837,925,960 or greater than the collection in 1955 by only P213,916,628.

During the ten year period from 1955 to 1965, our population increased from 23.76 million to 32.91 million or an increase of 9.15 million.^{1/} On the basis of these statistics the per capita tax burden in 1955 is P26.26 and P25.46 in 1966 in terms of the value of the peso in 1955. From this analysis it can then be concluded that our people in 1955 were being taxed more than in 1965.

It can, indeed, be said that taxation in the Philippines ranks low in comparison with other countries. This is quite true if the comparison is made with progressive countries of America and Europe. And to some extent it finds truth even if compared with some countries in Asia whose economic conditions more or less comparable with ours.

The present level of tax revenues falls short to meet governmental expenditure requirements. Under the General Fund from which more than 70% of the total government expenditures are covered, the total effective appropriation authorization in fiscal year 1965 amounted to P4,170,358,641.^{2/} These authorizations represent the cost of government projects and services which Congress believes should be undertaken to promote the well-being of the people. The

^{1/} Bureau of Census and Statistics

^{2/} Pres. Budget for the fiscal year 1966-1967

necessity for these projects can be presumed because in spite of the fact that members of Congress know that such cost cannot be supported by tax revenues they approved them due perhaps to reason of national necessity. As against this total appropriation authorization of P4,170,358,641, the total tax revenue collections of the General Fund for the fiscal year 1965 amounted only to P1,336,720,131.^{1/} This meant that in that year, because tax revenues were augmented by non-tax revenue receipts of P245,045,894, governmental projects and services worth P2,588,592,616 were not implemented for lack of funds.

Due to lack of funds the government failed to implement important legislations authorizing the creation of regional development authorities which are intended to bolster rural development; namely, the Mindanao Development Authority, Central Luzon-Cagayan Valley Authority, Panay Development Authority, Northern Samar Development Authority, Mountain Province Development Authority, Catanduanes Development Authority and San Juanico Strait Tourist Development Authority.

For the same reason, the land reform program calculated to bring about tremendous improvement in the social and economic status of our tenant farmer has not been implemented as vigorously as the authors of the land reform law would have wanted.

Also for lack of revenues, the general fund expenditures for the following general purposes which redound mostly to rural development

^{1/} Report of the Auditor General, FY 1964-1965

failed to increase in such extent as is compatible with our desire to bring about reasonable improvement in the rural life. A comparative statement of expenditure for such governmental expenditures to show the extent of increase during the fiscal year 1965 as compared to fiscal year 1964, follows:

	<u>Actual Expenditures</u> ^{1/}		Increase	% of Inc.
	<u>F. Y. 1965</u>	<u>F. Y. 1964</u>	<u>(Decrease)</u>	<u>(Dec.)</u>
Agriculture & Nat. Resources..	₱154,468,104	₱186,176,367	(31,708,263)	(17.03)
Transportation & Comm.	63,182,305	98,039,277	(34,856,972)	(35.55)
Education	586,682,416	563,961,632	22,720,784	4.03
Public Health & Medical Care .	<u>109,134,230</u>	<u>108,458,488</u>	<u>675,742</u>	<u>,62</u>
	<u>₱913,467,055</u>	<u>₱956,635,764</u>	<u>(43,168,709)</u>	<u>(4.51)</u>

Why Tax Revenues are Inadequate:

Based on actual tax revenue collection figures for the last ten years it may be said that one of the major tax policies pursued by the Government during the last decade was to keep tax burdens at minimum level. During that period, particularly in the last five years from 1961 to 1965, no tax legislation of significance have been approved. On the contrary, of the 36 revenue laws approved during the same period 24 were for the extension of tax exemption privileges.^{2/}

What real reasons support such policy are quite difficult to understand. All are agreed that there is a need to accelerate the pace of economic development in the country. Increase in national income

^{1/} President's Budget, FY 1967 and FY 1966

^{2/} JLETC - List of Phil. Tax Laws, 1946-1965

must outpace the growth of our population to avoid economic retrogression. Almost everybody knows that to speed up economic development big doses of investments in desirable fields are needed to increase national productivity. And everybody accepts the theory that taxation is the least inflationary fiscal tool in generating funds needed for an accelerated economic development program. Why then has our Government adopted such policy. Many are prone to think that our policy makers must have some reasons other than economic.

The proponents of such tax policy have, of course, their own reasons. And some of their reasons are quite valid. Some argue that to increase tax burdens by increasing certain existing tax rates or by imposing new taxes is not only unnecessary but also unfair to honest taxpayers. The validity of this reasoning finds strong support from the fact that enormous amount of taxes due the Government are not being collected. While no studies or investigations to determine the actual tax revenue loss (or tax gap)^{1/} due to evasion has been seriously attempted, some tax experts, however, have estimated that only between 60% to 70% of taxes due the Government are being collected annually. The imposition of new taxes and the increase of existing rates would therefore mean only additional tax burdens to honest taxpayers but will not hurt those who do not pay their tax obligations at all.

^{1/} In a report of the Tax Commission entitled Tax Administration Study in the Philippines conducted in 1965, it is stated that "if incomes are accurately reported, and all taxes are honestly assessed and effectively collected, the revenue yield can easily reach P3 billion.

Another logical reason given is that additional tax burden will mean the mere transfer of much needed funds from the private sector to the public sector. Those who advance this reason believe that such transfer will be uneconomical. It is contended, and many agree, that the private sector is more efficient than the public sector as regards the production of goods and services needed by the economy.

Since most of the proposals to impose new taxes or increase existing tax rates will mean more additional tax burdens to persons and entities engaged in non-agricultural industries, it is argued that the approval of such tax proposals will impede the government's program of industrialization. Spokesmen of the industrial sector assert that in the light of the tight credit situation the only hope of expanding industry is to channel all savings to investments to increase the productive facilities of industry.

Tax Administration

The defective system of administration of our tax laws has compounded and complicated the difficulties of the government in instituting the proper reforms to correct other weaknesses in our present tax system. Rampant tax evasion has not only resulted in tremendous revenue losses for the Government but it has produced more evil effects than can be imagined. In some cases the real purpose of tax evasion is economic sabotage. The loss of confidence of the people in their government due to ineffective and dishonest administration of tax laws although not measurable in money terms must be taken as a more serious problem. Ruinous smuggling

into the country of both contrabands and goods of commerce aside from stifling local production has resulted in revenue losses running to hundred of millions of pesos. Technical smuggling which constitutes non-assessment or underassessment of goods passing through our customs ports reenforce the problem in tax administration.

Although much have been published about the desolating effects of smuggling, greater amount of revenue losses are being suffered in the collection of internal revenue taxes. It is also recognized that an appreciable number of people succeed in either evading altogether the payment of income tax or having their income tax returns underassessed. Businessmen in collusion with dishonest Internal Revenue employees have defrauded the Government of millions of pesos by evading or paying only part of actual excise, license and business taxes legally due the Government.

The present Administration is committed to use its power and influence to eradicate smuggling activities. But to support these efforts, millions have to be appropriated out of the meager funds of the Government.

The Joint Legislative-Executive Tax Commission, mindful of the deficiency in the administration of tax laws, made a serious study on tax administration in this country to determine the factors which have contributed in making the BIR weak and ineffective. In this study the Commission identified the following problems as the causes of the defective performance of the BIR as the primary tax

collection agency of the Government:

I. Organization

1. The present organizational set-up conduces to duplication of functions.
2. There is too much centralization which extends even to small administrative matters.
3. A faulty communication system hampers effective control and management of field offices by the National Office.
4. Planning as a tool of management has not been effectively utilized.

II. Personnel

1. There is lack of a concrete basis for measuring the competence and qualifications of the applicants.
2. The Bureau of Internal Revenue has made sparing use of competitive examinations in selecting personnel.
3. The Bureau has not effectively used the six-month probationary period.
4. There is no strict adherence to a staffing pattern.
5. The level of compensation in the Bureau is low.
6. Promotion policies designed both by the Civil Service Commission and the Bureau of Internal Revenue have not been strictly followed.
7. The present in-service training program is inadequate.
8. There are no set standards for the assignment (or reassignment) of personnel.
9. The Internal Security Division charged with the responsibility of maintaining administrative discipline is ineffective.

III. Assessment

1. The Bureau has not efficiently tapped all possible bases for assessment over and above tax returns.
2. Assessment problems are also attributable to the low level of competence and honesty of revenue examiners.
3. There is limited power granted to regional offices in assessment matters.
4. There has been abuse of the compromise power of the Commissioner of Internal Revenue.

IV. Collection

1. Much is lost due to indiscriminate prescription of cases and ineffective follow-ups on warrants of distraint and levy.
2. Several cases were unearthed in the past whereby the amount of taxes paid as shown in the original copy of the receipt was not identical with that recorded in the duplicate copy.
3. The collection of taxes has been hampered by the failure to post tax payments.
4. Payment of income tax in different places complicate posting problems.
5. There is a dearth not only of field collectors but also of properly trained collectors.

V. Tax Fraud Investigation

1. Personnel of the Investigation Division should desist from certain practices that jeopardize investigation of tax fraud cases.
2. There is need for more and thorough investigations as well as prompt prosecution of tax fraud cases.
3. Republic Act No. 1407 is a major stumbling block to effective investigation of tax fraud cases.

VI. System of Internal Control

1. There is lack of personnel compounded by the absence of training on inspection functions among those who man the Department.
2. Political intercession and fraternization render futile character checks and background investigation.

Regressivity of the Tax System

The major character of our tax system which probably adversely hits directly the standard of living of the people in the rural areas is the regressive nature of our tax system. To make things worse the poor people of the rural areas are unconscious of the injury inflicted on them by such highly regressive tax system. Most rural folks, fortunately or unfortunately, do not know that the rich and the poor share the same amount of tax burden for every unit of goods or service they consume or enjoy. Because our poor people suffer the injury in silence not enough pressure has been exerted upon the Government to reform the tax system to make it more equitable.

Almost all students of taxation and commission or bodies created to study the proper solutions to the problems of our tax system decry the need of readjusting the tax structure along the principle of "ability to pay" in the distribution of the tax burden. However, in spite of their great concern on the matter, the Government has failed to introduce material reforms to make our tax structure progressive. In the following table, it will be noted that during a ten-year period the proportion of direct taxes to

indirect taxes has changed very slightly, from 20.06% in 1955 to 25.47% in 1965 or only 5 percentage points.

NATIONAL GOVERNMENT TAX REVENUES^{1/}
(In Million Pesos)

Direct Taxes -

Income Tax	379.78	24.92	127.62	18.78
Estate & Inheritance Taxes .	7.65	.50	4.49	.66
Residence taxes	<u>.76</u>	<u>.05</u>	<u>4.20</u>	<u>.62</u>
	<u>388.19</u>	<u>25.47</u>	<u>136.31</u>	<u>20.06</u>

Indirect Taxes -

Excise taxes	700.54	45.96	342.87	50.47
License & business taxes ...	371.80	24.42	176.26	25.94
Other indirect taxes	<u>63.17</u>	<u>4.15</u>	<u>23.96</u>	<u>3.53</u>
	<u>1,135.51</u>	<u>74.53</u>	<u>543.09</u>	<u>79.94</u>
	<u>1,523.70</u>	<u>100.00</u>	<u>679.40</u>	<u>100.00</u>

A few reasons may be cited why our tax structure is regressive. The tax policy of keeping tax burden down at minimum level has developed into a policy of maintaining a "status quo" in the tax structure. The need for more tax revenues had made it impractical for our policy makers to reduce indirect taxes. And to increase direct taxes, particularly income tax, may not only result to the killing of the "goose that lays the golden egg" so to speak but besides being regarded as political suicide for the policy makers who sponsor such measures.

Another ill effect of the regressive tax system is that money cannot remain for long in the rural areas because rural money is

^{1/} Reports of the Auditor General, FY 1965 and FY 1955

quickly siphoned through indirect taxes back to Manila and other progressive cities or towns. It is hardly possible to promote trade and commerce or even develop small industries in rural communities where money does not circulate freely. This situation supports the observations that while there is inflation in centers of commerce, rural regions suffer from deflation. Rural communities under these conditions will remain poor because they have no other recourse but to depend on agriculture for their survival.

The Tax System in Local Governments

Another vital area requiring reforms in order that it can effectively assist in rural development is local finance.

The levels of local government are those of the cities, provinces, municipalities and barrios. All of them except the provinces enjoy taxing powers. Their tax powers, however, are limited in the sense that taxes may be imposed by the local governments only when so authorized by law. The laws granting local government in all cases prescribe what taxes may be imposed, the tax rates that may be imposed and for what purpose tax revenues may be used. It is through this legal mechanism which lead many people to say that the National Government practically holds the purse strings of the local governments.

The local Autonomy Act, Republic Act No. 2264 which took effect on June 19, 1959 grants the following taxing powers to cities and municipalities:^{1/}

^{1/} JLETC, Tax structure of Manila and Neighboring Suburbs (Unpublished)

- a) Imposing license taxes on businesses and persons doing business within the local unit;
- b) Charging of fees for services rendered by the local unit (such as the operation of a public market), and for reimbursement of the cost of regulating businesses (such as the regulation of building construction); and
- c) Levying of other tax, except those specifically reserved for the national government.

In addition, cities possess either specific taxing powers which may have been granted in their respective charters. The imposition of real property taxes by city governments are governed by specific provisions in their respective charters.

The Assessment Law, Commonwealth Act No. 470, as amended governs the power of provinces and municipalities to impose the real property tax. Republic Act No. 1435 empowers cities and municipalities to impose a tax on gasoline in addition to those already levied by the National Government of not exceeding 25% of the national rates.^{1/}

The taxing powers of the barrio governments are governed by Republic Act No. 3590, the Revised Barrio Charter. Under this law barrio councils are authorized to levy, raise and collect taxes or license fees at such rates not exceeding 50% of similar taxes or fees already levied, assessed or imposed by the municipal councils on the following:^{2/}

- a) Stores, signs, signboards, and billboards displayed or maintained in any place exposed to public view except those displayed at the place where professions or business advertised is conducted;

^{1/} JLETC, Tax Structure of Manila and Neighboring Suburbs (Unpublished)

^{2/} JLETC, Tax System and Sources of Financing Barrio and Municipal Governments (Unpublished)

- b) Gamecocks owned by residents of the barrio and on cock-fights conducted therein;
- c) An additional percentage tax not exceeding one-fourth of one per cent of the assessed valuation of property within the barrio

Three main reasons may be mentioned why tax revenues of local governments are insufficient to meet local fiscal needs. They are:

1. The tax base of local governmental units is too limited to serve their purpose. The tax base which may be tapped by local authorities under existing laws is narrow on account of the fact that the high yielding tax sources have been pre-empted by the national government. Low incomes and lack of tax consciousness in the rural areas have adversely affected the local government's authority to exercise their taxing powers.

2. The local tax system also suffers from low collection efficiency. The Joint Legislative-Executive Tax Commission found in its study of the Tax Structure of Manila and Neighboring Suburbs that in the area covered by the study only about 46% of the collectible taxes was actually collected on the dates due. Only one-half of delinquent taxes were collected subsequently.

Another defect found in local tax administration is the lack of systematic classification of taxable subjects. Also, a considerable number of businesses and individuals subject to taxation are not included in the tax roll. If these defects exist in Manila and its neighboring cities and municipalities, it could be imagined how defective tax administration is in the far-flung and less progressive communities.

3. Local taxing powers are not fully exercised because of political considerations. It would require a great amount of courage on the part of elected local officials to work for the imposition of higher or new local taxes. Such an act particularly in rural communities where people are quite removed from governmental affairs is politically unwise. In most cases, the inefficiency of local government machinery in rendering public services suppresses the civic consciousness of rural citizens. A general feeling is thus generated that hard earned money legally taken away from the people through the process of taxation will only be squandered or wastefully spent by the local governments.

Tax revenues raised from local sources constitute only 47.5% of the total income of local governments of P525,101,311.^{1/} Of the total expenditures of local governments of P532,183,126^{2/} during the fiscal year 1964 only 46.9% are covered from tax revenues. These circumstances are quite peculiar for in most governments of any form ordinarily revenues from taxation constitute the predominant source of financing expenditures.

The main source of income of local governments come in the form of allotment and aid from the National Government. Thus a big portion of their expenditures (27% or P145,673,936^{3/}) has been made possible due to revenue allotments, direct doles, loans and contribution from the Philippine Charity Sweepstakes. Except for the revenue allotments to local government which cannot be withheld by the National Government because they are prescribed in the National Tax Code,

^{1/} Report of the Auditor General on Local Governments, FY 1964

^{2/} Ibid

^{3/} Ibid

local officials must always make representations with national officials in order that their units may be the recipient of the other forms of aids. And at times, for reason of financial necessity, the National Government delays the distribution of revenue allotments and in such instances local officials have to come to Manila to request the immediate release of their respective revenue allotments. These are other contributory factors which enable the National Government to control the finances of local governments.

The following table shows that unlike the tax system of the National Government, that of the local governments is appropriately progressive.^{1/}

	<u>Provinces</u>	<u>Cities</u>	<u>Municipalities</u>	<u>Total</u>
<u>Revenue from Taxation</u> <u>(In Thousand of Pesos)</u>				
Real Property Taxes	20,314	39,909	21,261,	81,484
Taxes on income, estate, legacies, inheritance and gift taxes	19,936	25,393	37,596	82,925
Municipal licenses	--	49,104	15,347	64,451
Residence taxes	2,010	1,520	1,905	5,435
Franchise taxes	454	3,494	1,379	5,327
Taxes on agricultural products	932	456	376	1,764
Ad valorem taxes	278	--	334	612
Other taxes	<u>638</u>	<u>6,084</u>	<u>1,128</u>	<u>7,850</u>
	<u>44,562</u>	<u>125,960</u>	<u>79,326</u>	<u>249,848</u>

^{1/} Report of the Auditor General on Local Governments, FY 1964

The narrow tax base and low money incomes in rural communities make the problem of increasing tax revenues of local governments difficult. The proposition to empower barrio councils to levy a tax payable in labor for barrio development purposes may serve as a solution to the problem and should therefore be seriously considered. One significant advantage of the proposal is that a man who otherwise can not contribute his financial share in the cost of barrio development for lack of property or income can still be an active participant to the effort by contributing his labor through taxation. Of course, there are many pitfalls in this proposition such as the varying skills of the barrio people, the forced labor idea which has never been popular with our people, the administrative difficulty of operating the system, and host of other technical and political obstacles that such a tax imposition will raise.

A discussion of the tax system of local governments will be incomplete without any reference to property taxation because it should be the main source of their tax revenues as it is in advanced countries. In 1964, property tax collection amounting to P81.4 million was about one third of the total tax revenues of all local government units. It is reasonable to estimate that collection from this source should have been no less than P250 million or a little less than P170 if only real property tax administration and practices are improved. Such a huge tax loss due to the deficiency in the system of assessment and collection of the property tax had and will continue to hamper tremendously all efforts for rural development.

While the law prescribes that the base of the property tax shall be the true and full value of the real property, generally only 45%^{1/} of the actual value of real property is being made the basis of the assessment. The principal cause of this defect may be traced to the practice of using the schedule of values prevailing about fifteen years ago.^{2/} On top of this, there are still many real properties which have not yet been pinpointed for tax purposes because of the absence of tax maps and other modern assessment tools. The lack of competent personnel to undertake collection has also greatly contributed to the low collections of property taxes.

The serious defects in Property Taxation has prompted the JLETC to propose to Congress the revision of Commonwealth Act No. 470. The revision proposal was embodied in House Bill No. 10410 which unfortunately has not as yet been enacted into law. Among the significant features of the bill are:

- (a) Updating the valuation of all properties by providing for a general revision of assessment values within one year upon the approval of the bill;
- (b) Reassessment of values of real property shall be made at least once in five years;
- (c) Specification in greater details the factors to be considered in arriving at the assessed value to make the work of tax assessors less complicated;
- (d) Creation of the Office of Real Property Tax Administration, a national agency, the primary function of which shall be to extend to local assessors technical assistance.

^{1/} JLETC, Local Government Finance, 1962

^{2/} 7th Annual Report of the JLETC, 1965

Loan Financing of the Cost of Rural Development

While it has been pointed out that tax revenue collections may be improved by either increasing existing tax rates, imposing new ones, or increasing the level of efficiency of tax administration, it is foolhardy to immediately expect that the tremendous sum necessary to reverse the cycle of poverty in the rural areas can fully be raised by taxation. In a democratic government like ours, where the power to levy taxes belongs to the people's representative of varying interests and orientations, approval of new tax measures is always hard to get. Legislators would rather prefer that appropriation laws remain unimplemented for lack of funds rather than increase taxes. Of course, the congressional alibi had always been - why increase taxes when existing ones are not yet fully collected. This line of reasoning can, of course, hardly be overcome because it is true. On the other hand, tax collection efficiency cannot be increased overnight. Problems of organization and procedure, personnel recruitment and even promotion of honesty and integrity have to be considered side by side in the improvement of tax administration efficiency. These institutional improvements take years to effect. If the objective, therefore, is to accelerate development so that its benefits may be enjoyed by the present generation, then taxation must be supplemented by borrowings to generate the funds needed.

The classical thinking that financing public projects by borrowings is not advisable is no longer justified today. Borrowing for developmental purposes is not bad. The power of the state to borrow

is as important as its power to tax. Both are effective tools of fiscal policy if exercised in a proper and judicious manner. Borrowing may be viewed as nothing else but a deferred tax imposition. The stock argument that the Government by borrowing is mortgaging the income of the future generation cannot have ground to stand on if only borrowed funds are devoted to development purposes of which the future generation will be the preponderant beneficiaries.

The danger of loan financing lies in the manner the proceeds are spent. Wasteful spending and misallocation of such funds for unproductive projects and services would bring about inflation. The economic gains that will be derived from wise expenditure of borrowed funds will overwhelmingly offset whatever other minor dislocations loan financing may produce in the economy. Provided that borrowings are kept within the limits which the economy can support, the fear against this mode of financing will remain imaginary.

The construction of roads to connect rural communities with centers of commerce, the building of irrigation systems to make agricultural lands more productive, river control projects to protect cultivated lands from destructive floods, spring development and construction of artesian wells to provide the people of the rural areas with potable water supply, construction of much needed school houses and a host of other permanent improvement projects which will stimulate greater economic activity in the rural areas cannot be made possible by the government in such a short period desired if the government will merely depend upon taxation.

The government is expected to provide the rural areas with the permanent facilities of production, commonly known as infrastructure projects; otherwise the proper climate can not be created to induce the people to expand production.

The public debt of the government has already reached the ₱3.5^{1/} billion level on June 30, 1965. It can be truthfully said that had not Government resorted to loan financing, the prevailing economic conditions, although relatively not yet satisfactory, could not have been realized. However, this level of indebtedness could have produced more economic gains were it not for the fact that a big portion of the proceeds of borrowing had been utilized to meet budgetary expenditures of the Government. Moreover, the inefficiency of the government machinery which consequently increased abnormally the cost of undertaking developmental projects has somehow lessened the accomplishment of the government.

The Government can avail of the credit facilities offered by foreign financial institutions for developmental purposes and should take advantage of the opportunity. Progressive countries are willing to assist developing countries by offering attractive credit accommodations. The approval of the bill which is now pending in Congress amending Republic Act No. 16 to increase the borrowing authority of the Government from foreign sources will go far in providing needed funds for rural development. Another legislative measure which will further

^{1/} President's Budget, FY 1966-1967

generate funds for the same purpose is the bill proposing to increase the borrowing limits under Republic Act No. 1000. If approved into laws, it will authorize the Government to float additional public works and economic development bonds.

The development projects which may be undertaken with borrowed funds by the Government should be complemented by credit facilities that may be extended to people in the rural areas on a private basis. The importance of development banks, rural banks and even commercial banks come to focus. The expansion of the banking system both in terms of resources and number of banks that may service the credit needs of rural communities will greatly assist in the development of poor rural areas. Financing and banking institutions should offer the best credit source for the needed capital of farmers. Farmer borrowings from private money lenders and even from relatives should be discouraged if possible because it generally breeds serfdom. Usurious practices can hardly be avoided in this type of borrowing.

Due to the lack of regular banking facilities in the rural communities, farm households generally borrow more often from individuals than from banks and other credit institutions. The Survey of Households^{1/} conducted by the Bureau of Census and Statistics reveals that 38.3% of the total farm household borrowings were from relatives, 22.8% from merchants and 16.8% from landlords. Only 8% of the total number of loans were extended to farm households by

^{1/} BCS, Phil. Statistical Survey of Households, Bulletin Series 12, May 1961

banks in rural communities are not fully availed of because of the conservative policies of the banks as regards the extension of loans to farmers.

One disturbing aspect of borrowing in the rural communities is the finding that the principal reason of farm families for incurring indebtedness was to meet current living expenses. About 45.2%^{1/} of the total number of loans received by farmers was spent for consumption purpose. More disturbing is the fact that 6.2%^{2/} of the total amount of cash loans which amounted to about P10 million were spent for fiestas, weddings, baptisms and similar special occasions. It is indeed sad to note that only about 44% of loans extended to farm families were used for the purchase of tools, animals, farm machineries, seedlings, fertilizers, feeds, insecticides and for the construction of permanent farm improvements.

Changes must be instituted in the current borrowing practices in the rural communities so that the benefits of loan financing for rural development may be realized. Otherwise, it is feared that the unproductive use of borrowed funds may neutralize if not totally offset the economic gains that such kind of financing may induce. People of the rural areas need proper guidance on this matter more than in any area of productive endeavors.

The organization of credit cooperatives must be encouraged further. They will not only promote the accumulation of small savings but will offer the needed capital resources for the farmers.

^{1/} BCS, Phil. Statistical Survey of Households, Bul. S. 12, May 1961
^{2/} Ibid

If the cooperative system have greatly contributed in the agricultural and industrial development in other countries, there is no reason why it cannot succeed in this country if more are organized and properly managed.

Conclusion

The pace of rural development must be accelerated if the real aim is to achieve a better life for the mass of our people during their lifetime. The great majority of the people of the rural areas must be freed from the morass of poverty. A nation with poor countryside cannot be great. The Government and the people must collaborate in this great undertaking. Courage, fortitude and sacrifice on the part of both the Government and the people are needed to lick poverty in the rural areas.

Taxation is a potent fiscal tool of the Government which readily can be exercised to bring about an improvement of the social and economic life in the rural communities. Unfortunately, our tax system has not materially improved during the last fifteen years. It can reasonably be said that during those past years the Government failed to make good use of an effective fiscal instrument to achieve a faster rate of economic growth in the rural areas. To know the defects of the system will not mean anything unless proper measures are adopted to solve the deficiencies. While the Government has been quite outstanding in the formulation of plans and enactment of appropriate laws, the same commendation can not be said when it comes to the execution and administration of such

plans and laws. Ultimately it will be the level of efficiency of the government in administering and executing the laws that will bring about the desired improvement of the economic and social life of our people. But the Government can only do as much as its sovereign people are willing to cooperate and support the proper administration and execution of the laws of the land.

The most effective antidote for poverty is wealth which can readily be used to clip the tentacles of poverty. To institute measures to bring about prosperity in the rural areas will be costly and even painful. The availability of money needed for the purpose will depend on both the Government and the people.