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The logo for the Congressional Planning and Budget Department (CPBD) is a dark blue square with the white letters "CPBD" inside.

THE DEBIT TAX AS A SOCIAL INSURANCE TOOL*

By Jaime Singson

Abstract

The Congressional Planning and Budget Department (CPBD) last year proposed the introduction of a debit tax – a light but high yield financial transaction tax set to automatically take effect during a high deficit situation. The National Tax Research Center (NTRC) raised concerns to this proposal as it cited possible negative consequences of the debit tax to the local banking system and its customers. This paper addresses the NTRC's main arguments against the proposed debit tax. It recognizes the strategic importance of the debit tax as a ready form of social insurance in future occurrences of fiscal distress. It points out that introducing the tax when the prevailing situation does not trigger its use makes greater sense than taking action when the hour is late and the costs are much higher.

In January 2006, the Congressional Planning and Budget Department (CPBD) came out with a proposal for a debit tax as an automatic response to fiscal emergencies.¹ The debit tax is a form of financial transactions tax (FTT) based upon the Latin American experience during the 1980s and 1990s when FTTs generated large amounts of revenues during fiscal emergencies.

The National Tax Research Center (NTRC), while acknowledging the potential of the debit tax to generate quick and easy revenues, concluded that “at this point when the country’s fiscal situation has improved, the proposed debit tax will only bring negative consequences that will far outweigh whatever positive revenue impact it may have.”² The NTRC pointed to possible tax distortions and the reduced role of banks in savings mobilization (if the debit tax induces local bank customers to switch to offshore banks, non-banks and the informal market to avoid the charge).

This paper answers each concern and maintains its key argument that the debit tax is a short-term measure applied only during a fiscal emergency like when the deficit breaches 3.5% of GDP. This paper likewise argues that the economic benefits of saving the government from collapse will necessarily outweigh the possible costs.

Background on Debit Tax

Since the late 1980s, Latin American countries, including Argentina, Brazil, Colombia, Ecuador, Peru and Venezuela, have implemented variants of financial transaction taxes

* This paper benefited from the comments of Director General Rodolfo V. Vicerra.

¹ Vicerra, Dir. Gen. Rodolfo V. and Jaime Singson, *Proposal for a Debit Tax: Automatic Response to Fiscal Emergencies*, Congressional Planning and Budget Department (CPBD), Policy Advisory No. 2006-01

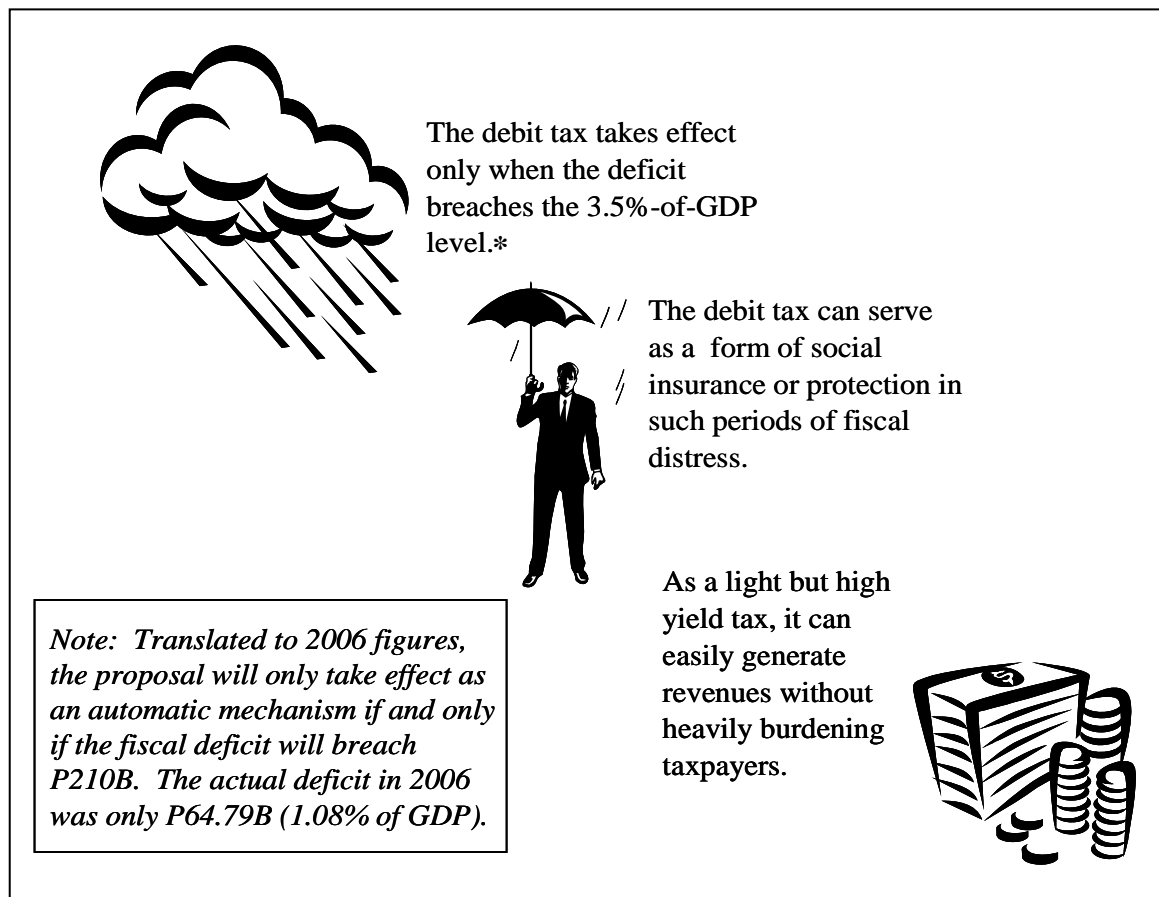
² Rempillo, Monica G., “The Proposed Debit Tax”, *NTRC Tax Research Journal*, Vol. XVIII.2 March-April 2006.

(FTT) and have succeeded in collecting revenues ranging from 0.29% to 3.5% of GDP. The proposed debit tax is a form of FTT.

The debit tax may be applied on bank withdrawals from checking, savings and term accounts at 1/5 of 1% (or 0.2%) of the transaction value. To cushion the impact on the financial system, a number of exemptions were proposed: (1) transfers between accounts of the same person in the same financial institution, (2) transactions with the central bank; (3) inter-bank clearing and inter-bank transfers to ATM operations; (4) stock market and government bonds transactions; and (5) foreign exchange market transactions. The conservative yield estimate was at PhP 24.8 Billion based on the value of cleared checks from Jan-Oct 2005.

The debit tax operates automatically only when the deficit figure reaches 3.5% of GDP and should be removed once the fiscal position improves.

Figure 1.



* This trigger point was breached during the period of 2001 to 2004.

Comments of NTRC

The National Tax Research Center's overall argument is that the possible costs of imposing the debit tax will outweigh the possible benefits. The possible costs are mainly the distortions from two sources, namely from the possible relegation of the role of domestic banks in the economy, and burden of increased tax to bank customers.

The NTRC's concern is that as people and corporations are charged more when they do their bank transactions, they might resort to switching to offshore banks or to the informal market to avoid the 0.2% charge. As a result, the yield from more conventional taxes such as documentary stamp, income and value added taxes may be reduced. Moreover, the placement of savings in banks may lose its appeal and entities may switch to the stock market, bonds, and other investment funds. Such a situation would exacerbate the low savings rate in the country as compared to those of its neighbors (Please see Table 1).

Table 1. % of Gross Domestic Savings to GDP

Country	Years				
	1999	2000	2001	2002	2003
Philippines	18.6	23.1	17.5	18.8	16
Singapore	50.1	48.1	43.9	44.8	47
Malaysia	47.4	47.2	42.3	41.9	-
Thailand	33.1	31.4	30.6	31.1	32
Indonesia	19.5	25.6	24.9	21.1	22

Source: *The Capital Market Development Plan: Blueprint for Growth and Expanded Contributions to the Philippine Economy, 2005-2010*, June 30, 2005

The NTRC has likewise pointed to additional burdens to bank customers. It has argued that "those who will be most affected by the proposed tax will be those who are heavy users of the banking system, such as corporations, whose volume/magnitude of banking transactions is not an indicator of capacity to pay but is only dictated by business requirements."³

Apart from the burden based on the relative use of banks in transactions, the NTRC highlighted the burden of paying yet another tax in addition to already existing taxes. The existing taxes are a final withholding tax of 20% on interest income, documentary stamp tax (DST) of P1.50 per check, and P7 to P10 fee if an ATM is used to withdraw money from other banks' ATM machine(s).

The NTRC's argument of additional burden is capped off with the statement that to earn interest in the savings, checking, and corporate accounts, the deposit must be three times greater than the maintaining balance of P3,000 to P5,000 for savings, P10,000 for individual accounts, and P25,000 for corporate accounts.

³ *Ibid*

Beyond the possible distortions, NTRC has raised other arguments against the debit tax. The NTRC cited an IMF (International Monetary Fund) paper which concluded that the debit tax should be avoided. The IMF paper discouraged use of the said tax in the long run due to “significant domestic disintermediation which could be difficult to reverse even if, and when, the bank debit tax is revoked.” The NTRC also finds the tax unnecessary based on the government’s expectation of a balanced budget by 2008, two years ahead of schedule in the 2004-2010 Medium-Term Philippine Development Plan (*Please see Table 2*).

The NTRC has also pointed to three types of transactions that should be discussed to balance the achievements of the proposed debit tax and avoidance of tax distortions. These transactions are trust releases in the form of cash, dividend withdrawals from government bonds that are exempted from interest income, and salaries withdrawn from banks that may cause double taxation.

Table 2. Projected Deficit as % to GDP

Year	MTPDP 2004-2010	20-Sept-05 Emerging Estimates
2006	-2.9	-2.2
2007	-2.0	-1.0
2008	-1.1	0.0
2009	-0.2	0.2
2010	0.0	0.2

Source: Development Budget Coordination Committee

Arguments by CPBD

One of CPBD’s key arguments is that the imposition of the debit tax is meant to help a government on the brink of collapse due to its fiscal problems. A country with a high debt and fiscal deficit in relation to its GDP is in a very risky position. An exogenous shock from either a downgrade from an international ratings agency or an oil price hike would easily affect the government’s fiscal stability. Possible debt defaults and breakdowns in social services would then follow. In this light, the benefits of imposing the debit tax would certainly outweigh the possible costs. The benefits of saving a government from collapse would outweigh the costs of whatever possible distortions pointed to by NTRC.

It is worth noting that even with their low rates of savings, Latin American countries still implemented the debit tax because they recognize the importance of using this short-term solution to rescue their failing economies (*Please see Table 3*).

Table 3. Savings Rate (as % of GDP)

Year	Argentina	Brazil	Colombia	Ecuador	Peru	Venezuela
1989	14	25	20	12	21	21
1990	16	19	22	15	16	26
1991	14	19	23	17	10	21
1992	14	20	18	21	12	18
1993	16	20	18	17	13	15
1994	16	21	18	16	17	19
1995	16	19	17	16	18	21
1996	16	17	13	19	17	29
1997	15	17	13	19	20	25
1998	15	16	12	18	18	18
1999	14	17	9	26	19	21

Source: Oxford Latin American History Database: <http://oxlad.qeh.ox.ac.uk/>

Once the economies are back on track, the debit tax could be discontinued. The debit tax will only be imposed if the NG deficit breaches 3.5% (% of GDP) and will be discontinued when the deficit goes below the said level. This emphasizes the use of the tax as a short-run solution only. Table 4 shows the Philippine savings rate from 1999 to 2003 (at par with those of Latin American countries).

**Table 4. Philippine Savings Rate
(as % of GDP)**

Year	Rate
1999	18.6
2000	23.1
2001	17.5
2002	18.8
2003	16.0

Source: *Bangko Sentral ng Pilipinas*

On the possibility of local bank customers placing their savings elsewhere to avoid the tax, the CPBD maintains that non-bank institutions certainly have their place in an economy. Non-bank institutions have complementary roles in providing financial and investment opportunities. An economy will therefore also require such institutions even without the debit tax.

On the IMF paper cited by the NTRC, the CPBD argues that the paper's findings are by no means conclusive. IMF Working Papers express the view of the author and do not

represent those of the IMF or IMF policy.⁴ Working papers describe research in progress by the author(s) and are published to elicit comments and to further debate. As such, there is no official IMF policy on bank debit taxes, even in Latin America.

On the expectation by the administration of a balanced budget by 2008, the CPBD also maintains the debit tax is still needed (Please see Table 5). The tax is a social insurance tool that is similar to the SSS/GSIS and Philhealth (i.e. dormant when not needed and immediately accessible in case of emergency). While the debit tax may not be required today, future circumstances may dictate its use to avert the high political cost of deflecting a fiscal crisis. It is hoped the government does not face great difficulty or incur high political costs in its efforts to deflect an incoming fiscal crisis. The political turmoil in the enactment of the Expanded Value Added Tax was evident.

Table 5. Fiscal Position as % of GDP

Year	Emerging Program	Actual
2006	-2.1	-2.7
2007	-0.9	-1.0
2008	0.0	
2009	0.1	
2010	0.2	

Source: Department of Finance

On the transactions identified by the NTRC to require further discussion, the CPBD agrees that such transactions have their place in the debate, whether these transactions are to be slapped with a debit tax or exempted. Dividend withdrawals from government bonds may be exempted to encourage financial deepening and capital market efficiency, as considered in the previous CPBD proposal. However, the CPBD maintains that trust distributions and salaries withdrawn through the banking system should still be covered by the debit tax.

Conclusion

The NTRC, through its arguments, has contended that the debit tax is unnecessary. In response to these arguments, the CPBD re-emphasized the importance of timing in the imposition of the debit tax. The tax takes effect in an environment of fiscal instability, where the short-term consequences are given greater weight relative to long-term disadvantages. As such, while the debit tax may be a convenient tool to raise cash in the short run, the tax should necessarily be cancelled once the fiscal deficit is no longer at a crisis level.

⁴ *IMF Working Papers carry a disclaimer*

The debit tax should never be used as a long-term instrument for raising fiscal revenues. It must be reviewed after six months of implementation or when the fiscal deficit has gone below 3.5% of GDP. In this regard, the debit tax can serve as any insurance tool that lies dormant when not needed and automatically implemented when circumstances dictate its use.

The CPBD recognizes the value of having the tax as a ready form of insurance in future occurrences of fiscal distress. It has proposed that the tax be introduced when the prevailing situation does not yet trigger its use.⁵ This would make more sense than working painstakingly to enact a new tax law only in the midst of a full-blown fiscal crisis.

The history of the FTT in Latin America indicates it has mostly been used as a temporary supplemental revenue source during fiscal emergencies, rather than as a replacement for conventional taxes. It was subsequently withdrawn within a few years as fiscal conditions stabilized.⁶

Based on the Philippines' own economic experience, the use of the proposed debit tax as a precautionary measure to aid fiscal stabilization is deemed essential. The CPBD therefore recognizes the clear need for a debit tax as an automatic response to fiscal emergencies.

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⁵ *Vicerra and Singson, Proposal for a Debit Tax, CPBD, Policy Advisory No. 2006-01*

⁶ *Ibid*