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Can Deficit Spending Serve as a Driving Force for Inclusive Growth in the Philippines

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Introduction

The Deficit Dilemma

“NATIONS FAIL TODAY because their extractive economic institutions do not create the incentives needed for people to save, invest, and innovate”

— Acemoglu & Robinson (2012, p. 419)

Recently, the Philippine government posted a budget deficit of 145.2 billion for the first 5 months of 2025 alone, reporting that it was largely spent on infrastructure and social services (Trading Economics, 2025). In most cases, deficit spending becomes largely visible during times of economic recovery or crisis, such as the COVID-19 pandemic (CPBRD, 2025), and whenever the country experiences an unexpected natural disaster. Whereas deficit spending does not automatically mean that they are bad, as they are sometimes used to solve problems.

What exactly is deficit spending? For many people, including me in the past, the word “*deficit*” can trigger an alarm in our brains, where we often think that it is unpleasant for our economy. In economics, *deficit spending* refers to a situation where the government’s spending is actually greater than the money it receives from taxes, investments, and more (Cambridge, n.d.). Just as we do in our daily lives, when we borrow money from someone, we know that it is our responsibility to repay our debts and avoid spending more than we can afford. Whereas, it seems

logical to us that the government should do the same. However, the Philippine government can control its currency and borrowings through the central bank. We know that government borrowing results in debt that needs to be managed responsibly, but having debt does not automatically mean that the government is in danger of ‘running out of money,’ because it operates under different rules from household funds.

Economists like Stephanie Kelton (2020) argue in her book that governments with sovereign currencies can issue and print money for government spending rather than solely relying on collecting taxes alone. In the context of the Philippines, the government could borrow money by issuing bonds or other forms of debt. Whereas the central bank in the Philippines, also known as the Bangko Sentral ng Pilipinas (BSP), can create, issue, and regulate the money supply in the economy (Bangko Sentral ng Pilipinas, n.d.). This explains that deficits are not necessarily harmful to the economy; because a government that has control over its own currency can always meet its obligations in that currency by creating or issuing more of its money through its central bank. What only matters in developing an inclusive economic growth is whether the deficit spending was used to contribute to a productive investment without causing inflation. Similarly, Dr. Jesus Felipe (2012) also highlights that fiscal and monetary policies, including deficit spending, can support full employment and promote long-lasting economic development if it was efficiently designed and aligned with the structural transformation. Noting that they must have a strong or inclusive institution with coordination to long-term development.

Deficit spending can serve as a driving force for economic growth, however, in the context of the Philippines, it must take into account that it must be efficiently designed to promote productive use that leads to inclusive growth. Such that public borrowing with coherent

industrialized strategies, structural transformation, and sound coordination between fiscal and monetary policies can contribute to economic development (Laurens & Piedra, 1998; Felipe, 2012). The Philippines has used deficit spending in order to fund public spending; however, these spending was not able to transform deficits into something productive and meaningful to the economy as they were often wasted on inefficiency or poorly planned projects (Debt Justice, 2013). To show how deficits can lead to actual growth, a relevant comparison to this would be South Korea, which is also a developing country during 1980-1986. Just like the Philippines during those times, the Philippines was also experiencing large debts (Solon & Floro, 1993), while South Korea was ranked as the world's fourth-largest debtor country (KDevelopedia, 2013). From experiencing an economic crisis, they were able to transform external debts and deficit spending into the long-term growth of their nation by having a strong institution, productive investment, and coordinating with fiscal, monetary, and industrial policies (Collins & Park, 1988). If deficit spending can drive progress elsewhere, the problem for the Philippines is clear. Despite the frequent deficit spending in the Philippines (Rubio, 2025), why has the country still struggled to achieve long-term economic growth?

This paper argues that deficit spending itself does not necessarily harm the country's development, but rather how it is designed, coordinated, or implemented, and how public debt is allocated and governed inclusively in the Philippines. Without strong institutions, long-term strategies, and effective coordination between fiscal and monetary policies, deficits are risked and become a wasted opportunity for the country. Through an analysis of the Philippines' deficit patterns and comparisons with other countries, this paper will explore how deficit can actually serve as a tool to create economic growth if it is managed effectively with fiscal and monetary policies.

I. Is Deficit Spending and Public Debt really bad?

Many people mistakenly believe that government spending on public services is funded entirely by the taxes they pay. This could sometimes lead to assertions like, “*Oh, I don't want to pay taxes, because it will only benefit the poor when they aren't doing anything much*”. Whereas, in reality, governments like the Philippines often finance it through a mix of tax revenues, borrowing, and monetary operations that involve the central bank also known as the Bangko Sentral ng Pilipinas (Felipe, 2012; Bangko Sentral ng Pilipinas, n.d.). The Modern Monetary Theory (MMT) also explains that governments that issue their own currencies can spend first and then tax later on, in order to manage inflation and support the value of the nation's currency (Murphy, 2024). While MMT is more interrelated to nations like the US, UK, or Japan (Bhansali, 2020), the Philippines also issues its own currency, but they don't have the same degree of monetary sovereignty as the Philippine Peso is not a global reserve currency and the country heavily relies on foreign debts and imports (Malicse, n.d.).

Another misleading statement is when government officials state that “*they don't have a budget*” for certain projects. The truth is, money is not as limited, especially in a country that issues its own fiat currency, whose value comes from government decree and the public trust (Chen, 2024). The BSP has the capacity to create money and support government spending if it's truly necessary. However, there are limitations to these powers because printing too much money without considering the *productive capacity* could more likely result in inflation (Felipe, 2012; Rebener, 2021). While government spending does not entirely rely on taxes that are collected in advance, taxes still play an important role in the economy as they help manage inflation by removing the excess money

that is circulating in the economy (Felipe, 2012; IMF, n.d.).

The book “Why Nations Fail” by Acemoglu & Robinson (2012) also offers valuable insight that can help explain how deficit spending can either hinder economic growth or serve as a tool in creating inclusive economic development in the Philippines, depending on the quality of the country’s institutions. Driving accountability in deficits requires an inclusive political change (The World Bank, 2020). Whereas, deficit spending in an inclusive institution will more likely contribute to the country’s long-term development, as the government or those who have economic power are the ones committed to improving and creating more opportunities that could benefit citizens and the whole country. Meanwhile, in an extractive institution, deficit spending may be wasted on corruption or projects that don’t really benefit most citizens (NRGI, 2023).

In the context of the Philippines, a deficit becomes harmful when it is managed inefficiently. According to Debt Justice (2012), the Philippines has historically wasted borrowed funds through corruption and deficit spending on useless projects, which created a *social debt* that harms Philippine citizens instead of actually helping them (Debt Justice, 2013). Moreover, according to Manasan (1981), from 1955 to 1979, deficit spending harmed the Philippines as the country’s borrowings has increased to 13% to 57% of the total public debt, using it to finance non-capital expenditures or expenses that does not create long-term assets or investments for the country inclusive growth. Reflecting on the country’s growing burden, Sioson (1975) noted that this has raised concerns about the country’s sustainability and productivity of its deficit spending (Manasan, 1981).

Deficit spending can serve as a powerful tool for a nation’s development when it is designed effectively. It should not be simply used to cover shortfalls in the government's revenue but should

provide strategic long-term investment that private markets may not address on their own. These investments can include infrastructure, public health, and education, all of which are essential for the benefit of citizens. As Dr. Jesus Felipe (2012) emphasized, fiscal policy, including deficit spending, should not be viewed as inherently harmful. Instead, it must aim for *structural transformation* that actually raises productivity, reduces inequality, and supports the goal of full employment. The country has the capacity to move towards development when government spending is actually directed towards areas that have the potential to produce high growth, such as those that have unused resources. Moreover, what truly makes it an improvement is when it is “long-term” growth, which is mostly driven by an inclusive institution (Acemoglu & Robinson, 2012). Long-term development means that deficit spending is used effectively to fund investments where it generates *sustained returns* over time, this can be in the form of stronger industries, improved human capital, and higher living standards that will continue to benefit the nation long after borrowed funds are spent.

II. The reality in the Philippines – How we waste Deficits

For a developing country like the Philippines, South Korea offers a powerful example of how deficits, when managed wisely, can drive meaningful economic progress. According to Collins, & Park (1988), in 1981, South Korea was ranked as the fourth largest debtor nation in the world with a 49% debt/GDP ratio. Instead of falling into long-term economic stagnation, South Korea was able to transform its deficit spending into economic growth and structural transformation by being inclusive, growth-driven, and backed by strong institutions that are focused on actual long-term development rather than waste.

In the case of South Korea, the country was able to efficiently use its deficit spending into a clear and export-led industry that is planned with clear strategies, such that its government implemented “Five Year Plans” that are focused on “productive” investments. Its external borrowing was tightly monitored, where funds were channeled through industries that have a potential for growth and export power that are complemented by active government coordination between fiscal and monetary policies, industrial policies, and close government-business cooperation (Collins & Park, 1988). This, despite being the world’s fourth-largest debtor in the past, South Korea was able to efficiently handle its deficit spending.

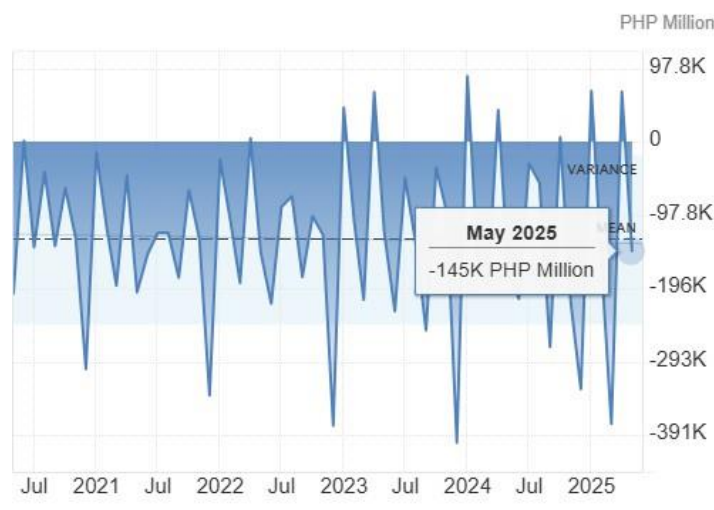


Figure 1. Philippine Government’s Budget Deficit.

Meanwhile, in the Philippines, data shows that the country has been running a deficit at least every year. The most recent data shows that the government has recorded a budget deficit of 145.2 PHP billion as of May 2025. It also reported that over the past 2 years, since 2025, government expenditures have surged by 35.37% to 655.0 billion, where it disclosed that it was mainly driven by

increased disbursements for road infrastructure, regular operating requirements, various productive services, and significant fiscal transfers to local government units (Trading Economics, n.d.). Deficit spending is not always inherently bad, especially when it is allocated effectively to sectors that have unused resources. In the context of the Philippines, decades of debt and loans have been wasted on corruption and useless or fraudulent projects that don't really contribute to inclusive economic growth.

A case study by Debt Justice (2013) stated that the “*debt crisis*” originated after gaining independence from the U.S. after World War II. The Philippines largely fell into debt mainly during the Marcos dictatorship between 1965 and 1986 where Marcos declared martial law and secured massive loans from foreign governments. Though President Aquino pledged to honor all debts, the Philippines still owed billions in the end, and corruption and debts still became rampant. However, the problem in achieving actual economic development did not mainly derive from the “debt” itself, but from how deficit spending is handled. – whether fiscal and monetary policies were coordinated, and whether deficits were handled inclusively for the benefit of most Philippine citizens (Felipe, 2012).

An illustration that shows that deficits are wasted is when it is spent on projects that fail to build productive capacity. An example of this is the Bataan Nuclear Power Plant (BNPP), which was planned recklessly and surfaced due to corruption of the government. This project was developed by taking out huge loans, but it failed to deliver its main goal of producing electricity in the country. As a result, these large debts have left the Philippines with long-term struggles for accountability, mainly to foreign lenders (Mendoza et al. 2018). While deficit spending is not inherently bad, this case highlights that without transparency and inclusive institutions, deficit-funded projects may turn into

costly, useless projects that don't really benefit the country if it doesn't consider the result of the project's productivity.

Moreover, throughout the years, public debts have mostly failed to reduce poverty or at least create economic growth. According to an article, the interrelationship between corruption and rising debt has contributed to the country's persistent poverty. As of October 2024, the Philippine national debt has reached P16.05 trillion, equivalent to around 61% of the country's gross domestic product (Lim, 2024; Maligro, 2024). This emphasizes the country's debt growth, which raises concerns about its fiscal sustainability and its ability to create long-term development, where an inclusive institutional framework is needed.

**Figure 2. Poverty Incidence among Population (%), Philippines and CAR:
2018, 2021 & 2023**



Source: Philippine Statistics Authority

Figure 2. Poverty Incidence among the Population.

Statistics have shown that from 18.1% in 2021, the poverty rate has dropped to 15.5%,

showing slight progress despite the ongoing economic recovery of the country (PSA, 2024). However, in 2024, the Philippines received a positive credit rating outlook, whereas “credit ratings” shouldn’t be used as any kind of measure of the economic performance of the country, as surveys conducted in late 2024 pointed out that 59% of Filipino families still considered themselves poor (Flores, 2024).

III. Why do we keep failing?

The Philippines keeps failing to turn public deficits into economic development because it is deeply rooted in the country’s extractive institutions, where there is elite dominance, poor coordination, and insufficient use of resources (Felipe, 2012; Acemoglu & Robinson, 2012). Both Stephanie Kelton (2020) and Dr. Jesus Felipe (2012) argue that deficit spending is not inherently harmful when it is efficiently planned and coordinated with monetary policy. It must also align with long-term structural transformation goals and deficit spending that could serve as a tool for full employment and economic growth. However, this requires strong institutions, a clear long-term strategy, and stability that ensures productive investment rather than wasting funds on useless projects.

If we observe, the Philippines does not really apply the conditions of having a strong institution. Just as explained by Acemoglu & Robinson (2012), extractive institutions have corrupt and weak oversight as they focus on short-term incentives rather than long-term projects that could benefit the country. This explains how the Philippines is struggling to efficiently use deficit funds as they only ended up serving a narrow political and economic interest, rather than contributing to

economic growth and addressing issues like poverty and inequality within the country.

Moreover, instead of working together to achieve full employment and structural transformation, fiscal and monetary policies in the Philippines often oppose or conflict, which limits the developmental impact of borrowing (Felipe, 2012). For example, fiscal policy may aim in another direction by running deficits. While monetary policy, on the other hand, might tighten or raise interest rates to counter risks of inflation or depreciation in the currency. Without addressing these structural weaknesses, deficit spending will definitely continue to fall short, regardless of its potential for national development.

IV. Conclusion

Deficit spending does not necessarily mean that it is inherently harmful to the economy, as it can actually serve as a tool to create long-term growth for a nation, especially for a developing country. As this paper has argued, the Philippines is struggling to transform deficit spending into meaningful long-term economic growth. This is mainly due to the extractive institutions that the country has, which have poor governance, weak oversight, and a lack of coordination for long-term strategies. Throughout history, the country has experienced failed projects such as the Bataan Nuclear Power Plant (BNPP), which illustrates that deficits were used for something unproductive and often because of corrupt undertakings. This has resulted in a burden to the country as not only did the country carry off large debts, but it was not even able to address inclusive growth, poverty, or structural weaknesses.

As seen in South Korea, deficit spending can turn into an engine of economic growth.

Deficit spending requires being accompanied by a strong and inclusive institution that has a commitment to actual long-term development and effective coordination between fiscal and monetary policies. It is essential to know that in the context of the Philippines, there are a lot of failures that transform deficits into inclusive development due to weak institutions, poor coordination between fiscal and monetary policies, and a lack of vision for long-term development.

Though deficit spending has often been wasted on corruption, useless projects, and short-term political gains, rather than contributing a sustained growth for the nation. It can become a driving force for inclusive growth only if it has the means of prioritizing inclusivity, productive investments that target specific sectors that still have unused resources, and strengthening transparency within the nation. Overall, the real challenge is whether the Philippines can break free from extractive practices and use the deficit as a tool for long-term growth that benefits all citizens.

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