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Improving Government Performance: Discipline, Efficiency and Equity in Managing Public Resources

A Public Expenditure, Procurement and Financial Management Review

April 30, 2003

Poverty Reduction and Economic Management Unit
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South East Asia Region



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Vice President:	Jemal-ud-din Kassum, EAP
Country Director:	Robert Vance Pulley, EACPF
Sector Director:	Homi Kharas, EASPR
Sector Manager:	Barbara Nunberg, EASPR
Task Team Leaders:	Amitabha Mukherjee (PEPFMR)
	Christian Rey (CPAR)
	Wijaya Wickrema (CFAA)
	Xuelin Liu (ADB)

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
AGILE	Acceleration Growth Investment Liberalization with Equity
AIM	Asian Institute of Management
AO	Administrative Order
APEC	Asia Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BAC	Bids and Awards Committee
BAS	Bureau of Agricultural Statistics
BFAD	Bureau of Food and Drugs
BIR	Bureau of Internal Revenue
BOC	Bureau of Customs
BOS	Budget Operations Statement
BOT	Build-Operate-and-Transfer
BLGF	Bureau of Local Government Finance
BSP	Bangko Sentral ng Pilipinas
BTR	Bureau of the Treasury
CAR	Cordillera Administrative Region
CDF	Congressional Development Fund
CIAC	Construction Industry Arbitration Commission
CIAP	Construction Industry Authority of the Philippines
CIDA	Canadian International Development Agency
CO	Collection Officer
COA	Commission on Audit
CPAR	Country Procurement Assessment Report
CPBO	Congressional Planning and Budget Office
CPPR	Country Portfolio Performance Review
CRPP	Currency Risk Protection Program
CSC	Civil Service Commission
DA	Department of Agriculture
DAP	Development Academy of the Philippines
DAR	Department of Agrarian Reform
DBCC	Development Budget Coordination Committee
DBM	Department of Budget and Management
DBP	Development Bank of the Philippines
DECS	Department of Education, Culture and Sports
DEPED	Department of Education
DENR	Department of Environment and Natural Resources
DICT	Department of Information and Communications Technology
DILG	Department of Interior and Local Government
DOE	Department of Energy
DOF	Department of Finance
DOH	Department of Health
DOJ	Department of Justice
DOLE	Department of Labor and Employment
DOTC	Department of Transportation and Communications
DPWH	Department of Works and Highways
DTI	Department of Trade and Industry
DSWD	Department of Social Welfare and Development
EO	Executive Order
EPS	Electronic Procurement Service
FAP	Foreign Assisted Project
GAA	General Appropriations Act
GAAM	Government Accounting and Auditing Manual
GFI	Government Financial Institution

GOCC	Government-Owned and/or Controlled Corporation
GOP	Government of the Philippines
GPIS	Government Procurement Information System
GPPB	Government Procurement Policy Board
GSIS	Government Service Insurance System
GSP	Generalized System of Preferences
HUDCC	Housing and Urban Development Coordinating Council
IA	Implementing Agency
ICB	International Competitive Bidding
ICC	Investment Coordination Committee
IDC	International Data Corporation
IDF	Institutional Development Facility
IFC	International Finance Corporation
IMR	Infant Mortality Rate
INFRACOM	Committee on Infrastructure
IRA	Internal Revenue Allotment
IRR	Implementing Rules and Regulations
ITC	Industry Tripartite Council
JBIC	Japan Bank for International Cooperation
LBP	Land Bank of the Philippines
LC	Letter of Credit
LCE	Local Chief Executive
LFS	Labor Force Survey
LGU	Local Government Unit
LMC	Labor Management Council
LOC	Letter of Credit
LOI	Letter of Intent
MOU	Memorandum of Understanding
MTEF	Medium Term Expenditure Framework
MTPIP	Medium-Term Public Investment Program
MTPDP	Medium-Term Philippine Development Plan
NCB	National Competitive Bidding
NCIP	National Commission On Indigenous Peoples
NCMB	National Conciliation and Mediation Board
NCR	National Capital Region
NEDA	National Economic and Development Authority
NGAS	New Government Accounting System
NGO	Non-Governmental Organization
NPC	National Power Corporation
NSO	National Statistics Office
NTC	National Telecommunications Commission
NTRC	National Tax Research Center
JBIC	Japan Bank for International Cooperation
ODA	Official Development Assistance
PAP	Programs, Activities and Projects
PARC	Presidential Agrarian Reform Council
PCAB	Philippine Contractors Accreditation Board
PCEG	Presidential Commission on Effective Governance
PD	Presidential Decree
PDIC	Philippine Deposit Insurance Company
PEAC	Pre-Qualification Evaluation and Awards Committee
PERA	Personal Equity Retirement Account
PHAP	Pharmaceutical and Healthcare Association of the Philippines
PHIC	Philippine Health Insurance Corporation
PPB	Procurement Policy Board

PSA	Philippines Shippers' Bureau
PSB	Procurement Service Board
PSO	Procurement Service Office
PUP	Polytechnic University of the Philippines
PWI	Procurement Watch, Incorporated
RA	Republic Act
RDC	Regional Development Council
RIV	Requisition and Issue Voucher
SCR	Securities Regulation Code
SEC	Securities Exchange Commission
SEER	Sector Effectiveness and Efficiency Review
SEI	Science Education Institute
SIE	Statement of Income and Expenditures
SPAV	Special Purpose Asset Vehicle
SSS	Social Security System
SWS	Social Weather Stations
TESDA	Technical Education and Skills Development Authority
TTL	Task Team Leader
TWG	Technical Working Group
USAID	United States Agency for International Development
WTO	World Trade Organization

FOREWORD

This Public Expenditure, Procurement and Financial Management Review (PEPFMR) is the first time such a process has been completed collaboratively between the Government, the Asian Development Bank and the World Bank in the Philippines, and also the first time that such an integrated report on these three related themes has been prepared. We thank the Philippine authorities for their continuous support and intensive participation in this process, which involved a range of national government agencies.

The authorities are to be congratulated for initiating implementation of some major reforms during the PEPFMR preparation. Examples include the enactment of the Procurement Reform Law, the restructuring of the Commission on Audit, and the introduction of the New Government Accounting System.

However, as the report notes, challenges abound on the revenue and expenditure fronts. The fiscal deficit increased sharply in 2002 as revenue and expenditure targets were both missed. Large public sector deficits, debt and contingent liabilities, a significant upturn in domestic interest rates in mid2002, and a rise in global bond spreads, signal that the Philippines' fiscal performance will continue to remain under close scrutiny by markets.

An improvement in the policy environment will require sustained actions on several fronts, many of which are not new. While some of the needed actions have been identified in this joint exercise, it is recognized that success depends on appropriate sequencing and effective implementation of the actions. Responding to the implementation assistance needs jointly identified during the PEPFMR exercise, both our institutions have worked with their government counterparts to put in place significant grant-based technical assistance. Examples include grants for institutional strengthening of the Bureau of Internal Revenue, procurement reform, expenditure management, wage bill control, and strengthening institutions for sustainable poverty reduction and good governance. We stand ready to continue such implementation assistance in coordination with other development partners.

Lastly, the PEPFMR process represents a collaborative partnership between our institutions where we have together worked with the government on issues affecting public expenditure management, procurement and financial management. We shall endeavor to continue this partnership with support from our respective institutions to the authorities in implementing the key messages from this report.

The Philippines Country Procurement Assessment Review (CPAR) is being published in its entirety as a companion volume.

Robert Vance Pulley
Country Director for the Philippines
The World Bank

Thomas Crouch
Country Director for the Philippines
Asian Development Bank

Manila
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This Public Expenditure, Procurement and Financial Management Review (PEPFMR) has been jointly prepared by a team comprising counterparts from the Government of the Philippines (GOP) and staff of the World Bank and the Asian Development Bank (ADB).

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AN UPDATE...

Background. This PEPFMR was begun in October 2001, completed in May 2002 and delivered to the Government in June 2002. Comments received from the Government were reflected in a revised draft, and a detailed chapter-by-chapter review was held with the Government in October-November 2002. Thereafter a revised draft was again shared with the Government in November 2002. GOP interlocutors and WB-ADB team members updated the PEPFMR to reflect recent events till the third quarter of 2002. The analysis reflects this position. Final clearance was received from the GOP in April 2003. Key developments between June and October 2002 have been reflected in the text. Other developments are summarized in this update by the WB-ADB team.

Overview. Economic growth in 2002 rose to its highest level since the Asian crisis, with real GNP and GDP growth rates reaching 5.2 percent and 4.6 percent, respectively, aided by an acceleration of growth at the end of the year: growth rates in the fourth quarter exhibited their strongest pace in six years with GNP growth topping 7 percent. This performance was anchored on stronger consumer demand and worker remittances, a moderate recovery in exports and favorable rains that boosted agricultural production in the final quarter. And it occurred despite sluggish investment, continued weakness in financial markets and heightened conflict in Mindanao.

On the policy front, progress was achieved in a number of legislative areas including Congressional passage of the Procurement Law, the Special Purpose Asset Vehicle Law and amendments to the Anti-Money Laundering Law. However, the fiscal deficit increased significantly in 2002 as revenue and expenditure targets were both missed by wide margins. Revenues began a modest recovery in late 2002 in response to a number of administrative initiatives, and preliminary estimates for the first quarter of 2003 indicate that revenues surpassed their target for the period, while measures were also announced to contain certain discretionary expenditures. With large public sector deficits, debt and contingent liabilities, a significant upturn in domestic interest rates albeit from historic lows in mid-2002, depreciation of the real exchange rate and a rise in global bond spreads, the Philippines can ill afford a repetition of the 2002 fiscal performance. This is particularly the case given the downside risks to the global economy, exacerbated by the war in Iraq and the spread of the SARS virus, and the uncertain repercussions to the Philippines in terms of exports, oil prices, remittances and access to global capital.

The key challenge for policy makers will therefore be to progress convincingly along the path of fiscal consolidation, in the first instance to adhere to the National Government's 2003 deficit target of PhP202 billion (4.7 percent of GDP).

Fiscal Performance and Policy. A disappointing fiscal performance in 2002 was partially responsible for financial market weaknesses. The National Government deficit increased from PhP147 billion in 2001 (4 percent of GDP) to PhP213 billion (5.3 percent of GDP) instead of falling to PhP130 billion as originally targeted, contributing to a parallel increase in the consolidated public sector deficit to 7.2 percent of GDP in 2002 (preliminary DOF estimate). Tax revenue was practically stable in nominal terms, and continued to fall in real terms thereby continuing the declining trend witnessed since 1998: the tax effort fell to 12.4 percent of GDP in 2002 from its peak of 17 percent in 1997. Through February 2003, tax revenue had risen by 7.4 percent relative to the same period in 2002, although this pace, if maintained, would not be sufficient to reverse the trend of a declining tax effort in 2003.

Several factors contributed to the decline in revenue: i) the concentration of growth in the lightly taxed export and agriculture sectors; ii) lower import tariffs which has reduced the revenue intake from this source; iii) the fall in interest rate which lowered withholdings on interest income; and, perhaps most importantly; iv) the persistence of administrative weaknesses that have resulted in revenue losses in assessments and collection. In addition to focusing on strengthening administrative weaknesses, the real value of excise taxes needs to be restored to its 1997 level and indexed to avoid further erosion with inflation. And losses incurred through tax incentives need to be limited in a manner that is not

detrimental to private investment. The bill to reform the Bureau of Internal Revenue—now called the National Autonomous Revenue Agency Bill—is under discussion in Congress.

Efforts to improve tax revenue were made in the last quarter of 2002. BIR performance improved as reflected in increased collections on net income and profits and the value-added tax (VAT), which increased by 12.5 percent and 21 percent, respectively, compared to the corresponding period a year earlier. Measures to enhance tax revenue by the BIR included: (i) sending over 1,700 demand letters to delinquent VAT taxpayers since September 2002; (ii) expanding an electronic filing and payment system for all types of tax payments; (iii) an alert system to taxpayers for tax payments. The rise in revenues in the last quarter of 2002 showed that administrative revenue-enhancement measures were beginning to take effect.

National Government expenditures overshot their target by PhP24 billion despite a PhP18 billion saving on anticipated interest payments (due to lower-than-anticipated domestic interest rates). In 2002, the government did not pursue the planned cut in capital outlays and instead allowed a significant increase in such spending in its desire to stimulate the economy. NG expenditures had however stabilized through February 2003, helping to lower the deficit to PhP31.5 billion, down from PhP35.9 billion as of February 2002. As of March 2003, the Government was also pursuing further spending restraints, including a 15 percent across-the-board cutback in discretionary spending. This, combined with the absence of public sector employment adjustments, may adversely impact expenditures on poverty-reducing programs and O&M in 2003.

Actual disbursements in 2002 (PhP769.8 billion) grew by 8.2 percent over those in 2001. The wage bill and other mandated expenditures accounted for a large part of total NG and LGU expenditures. Mandated payments included a payment of 50 percent of the last month's pay of Government employees (amounting to PhP9.0 billion in 2002) and further expansion of capital disbursements due to settlement of accounts payable (PhP4.8 billion). However, personal services and maintenance expenditures in general contracted in 2002 due to belt-tightening measures. During 2002, internal revenue allotment to LGUs grew by 16.4 percent given the need to support LGUs in their poverty alleviation and peace and order programs. Capital outlays increased in 2002, amounting to 29.9 percent of total expenditures, due to faster implementation of foreign-assisted projects.

Public Sector Institutional Reforms. On the institutional reform front, a major achievement was the enactment of an omnibus Procurement Law in December 2002; its effect will begin to be felt once the implementing rules and regulations are promulgated. The Commission on Audit initiated a phased implementation of a new government accounting system (NGAS) from 2002, based on a modified accrual accounting basis, with a single fund concept and a simplified chart of accounts. The Government has begun work to put in place a personnel information system, a necessary first step towards controlling the wage bill.

With non-financial public debt approximately equal to GDP not including sizeable contingent liabilities within infrastructure, pensions and banking, the strengthening of public finances will be essential to sustaining robust medium-term growth. A key element in that effort will be a sustained effort to strengthen tax administration and policy in order to reverse the decline in real tax revenue over the past five years.

Power Sector Reform. The recently enacted Electric Power Industry Reform Act (EPIRA) provides the overall framework for far reaching structural reform towards the development of an open and competitive power sector that is envisaged to attract substantial private investment. The EPIRA authorizes the Energy Regulatory Commission (ERC) to adopt alternative forms of internationally-accepted rate-setting methodology from the present return-on-rate base mechanism as it deems appropriate to ensure reasonable prices for electricity and to promote efficiency in the transmission sector. In January 2003, the ERC issued the final draft of a long-term performance-based regulatory framework in determining the transmission charges of the National Transmission Corporation (Transco). Finalization of this regulatory framework is one of the pre-conditions for the privatization

of Transco operations. Separately, the bill (approved by the House of Representatives) to provide Transco with the mandate to transfer its franchise to a private concessionaire is still pending the approval of the Senate. Nevertheless, potential investors were invited to express interest and the award of contract to the private concessionaire, through competitive bidding, is currently targeted for mid-2003. In the absence of the approval of the above franchise bill, the bid price from the concessionaire is likely to be lower than otherwise.

Further, special care has to be taken to balance the needs of investors with the desires of consumers for lower tariffs in a financially sustainable manner. In particular, the recent Supreme Court decision for Meralco to refund its customers is a contentious issue. Moreover, the preliminary decision of the ERC on the unbundled rate of Meralco is significantly lower than that requested by the company. Meralco has requested reconsideration of the above rulings, and its financial health will be critically dependent on the final outcome of these decisions. The above examples of regulatory contention transmit powerful signals to potential investors; the manner in which they are resolved will have repercussions for the investment climate, not only in the power sector but for regulated utilities in general.

Anti-Money Laundering Law. The Philippines passed an Anti-Money Laundering (AML) Act in September 2001 in order to comply with Financial Action Task Force (FATF) directives. However, the Act contained weaknesses that needed to be addressed to bring it in line with international standards. Two key amendments requested by the FATF were: (i) provision of authority to the AML Council to scrutinize bank accounts without a court order; and (ii) reduction of the threshold amount of covered transactions from PhP4,000,000 to PhP500,000. The March 7, 2003 amendments to the AML Act were acceptable to the FATF, which decided not to impose countermeasures on the Philippines. But the Philippines will remain on the FATF list of non-cooperating countries and territories until it has shown that it is effectively implementing the amended AML law. The AML Council is currently preparing the amended AML Act implementation plan, which will be submitted to the FATF for review. As of March 2003, the AML Council had frozen PhP954 million in 450 accounts since the passage of the legislation. In the coming weeks the number of reports that the AML Council will be handling is expected to swell as the amendments to the AML law take effect.

Pension Reform. The slow pace of pension reforms continues to be a concern. In particular, the financial condition of the Social Security System (SSS), the largest pension fund serving private sector employees, remains problematic. The latest actuarial valuation indicates that from 1999 to 2001, benefit payouts exceeded contributions by more than PhP7 billion. The deficit has been paid out from the pension fund reserve, reducing the remaining life of the fund at an accelerated pace. The actuarial valuation shows a possible depletion of the pension fund by 2015 without appropriate remedial measures. In an effort to contain the short-term financial problems faced by SSS, some adjustments have been made including a 1 percent increase in the employers' contribution. However, a carefully planned and phased-in increase in contribution rates together with other parametric and structural changes is needed to ensure SSS's medium and long-term viability.

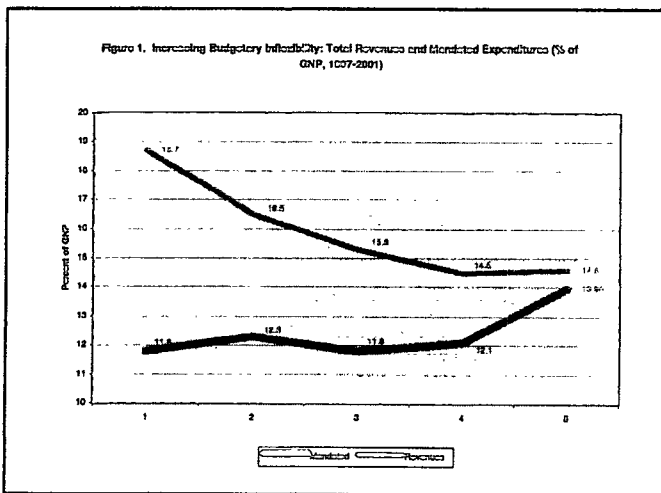
The problems of the Government Service Insurance System (GSIS) are different in scope from those of the SSS but of concern nonetheless. The GSIS has accumulated excess liquidity in an amount of approximately PhP30 billion and continues to face a shortage of investment options. This shortage has meant that returns on investment continue to fall below the levels needed for long-term sustainability. The GSIS needs to find alternative investment options (locally and/or abroad) to place its excess liquidity, diversify its portfolio and obtain better returns.

EXECUTIVE SUMMARY

1. The Philippine authorities, confronted with an unfavorable governance and macroeconomic environment in 2001, established a consistent track record in 2001 in stabilizing the economy and improving investor sentiment. The unfolding developments in 2002-2003, however, pose a threat to a still fragile fiscal and institutional environment, and can dim the prospects for attaining the Philippines' targets for higher growth and renewed poverty reduction. Fiscal sustainability and the government's ability to finance poverty-reducing programs continues to be at risk from falling revenues, rising public debt and debt service and off-budget risks. This constrained environment makes it doubly important to focus on increasing fiscal flexibility through increasing revenue collections and enhancing the discipline, efficiency and equity of public expenditures.
2. The objective of this Public Expenditure, Procurement and Financial Management Review (PEPFMR) is to examine selected issues in the allocation and management of public resources of interest to the Philippine authorities, the World Bank and the Asian Development Bank (ADB). It aims to help the authorities establish more effective and transparent policies and processes for the allocation and utilization of public resources to reduce poverty and promote economic growth.
3. This section summarizes the key PEPFMR findings and highlights critical actions to improve the management of public expenditures. Some of the messages are not new, and indeed are well-known to Philippine authorities and development partners. Moreover, the PEPFMR does not suggest that the Philippines 'do everything at once'; rather it demonstrates that sequencing and prioritization will be critical for greater discipline in managing public expenditures.

Aggregate Fiscal Discipline

4. ***Fiscal flexibility is being steadily eroded as revenues shrink and mandated expenditures remain high.*** Discretionary expenditures, severely constrained by low revenue collections, rising debt service and high expenditures on personal services, no longer provide adequate flexibility to respond to evolving needs. Public investments are low, limiting public sector facilitation of rapid long-term growth and diminishing the National Government's (NG) ability to combat poverty. If public deficits are to be reduced as targeted without further squeezing discretionary expenditure, ongoing government initiatives to reverse the slide in tax revenues must be pursued with vigor.
5. The problem of constrained finances is multi-dimensional, involving declining revenues, rising interest payments, and growing transfers to sub-national levels of government. Between 1997 and 2001, as a percentage of GNP, the gap between revenues and statutory expenditure obligations has shrunk from 6.9 percent to 0.9 percent (Figure 1). Revenues have declined from 18.7 percent of GNP in 1997 to 14.6 percent in 2001, and the continued revenue slump through 2002 contributed to a significant slippage in the NG deficit target for 2002. During 1997-2001, interest payments have risen from 3.1 percent of GNP to 4.5 percent. Maintenance and other operating expenses (MOOE) and capital outlays continue to be squeezed, and are insufficient for poverty reduction and improved delivery of basic services. Thus it is not the rise or fall of any individual item, but the combined effect of decreasing revenues and increasing statutory obligations that is having a pincer-like impact on the Government's expenditure program.
6. ***Revenue collections need to increase, and/or wage bill expenditures need to diminish, to adequately finance the Government's growth and poverty-reduction agenda.*** The authorities are aware that increasing fiscal flexibility in the short to medium term entails a three-pronged strategy of (a) aggressively implementing a strategy to increase revenue collections, (b) controlling the wage bill, the only element of mandated expenditures amenable to short-term adjustment, and (c) streamlining the executive.



fall since 1997 (except for corporate income tax). Furthermore, contemplated tax policy changes did not materialize in 2002.

8. *An appropriate blend of administrative and policy measures is now essential to establish a sound foundation for a sustained recovery in tax effort.* Without a turnaround in the tax effort, the recent gains on the macroeconomic front will be difficult to sustain, and the NG's ability to allocate a minimal level of public resources to essential infrastructure, human capital and social needs will be compromised.

9. Administrative measures could focus on improving the effectiveness of the LTS. Key actions could comprise provision of staffing and expansion of coverage; strengthening VAT administration through, for example, use of third-party information; improving audit performance to increase compliance incentives through selective audits and prioritization (e.g. focusing on large taxpayers, and on the BIR's Reconciliation List for Enforcement or RELIEF); improving the quality of BIR databases; and strengthening coordination between the Development Budget Coordination Committee (DBCC), the Department of Finance (DOF) and the BIR.

10. On the policy side, the best option seems to be to enact the proposed reform of the excise tax on alcohol and tobacco products – this may yield up to additional PhP10 billion over 2 years. It would also be desirable to consider rationalizing investment incentives to reduce their fiscal cost.

11. *The planned BIR reforms are widely seen as constituting a litmus test of the administration's ability and willingness to increase revenues, implement rightsizing options and streamline the executive.* The announcement of a comprehensive set of reforms (comprising improving tax collection, simplifying the tax structure and administration, minimizing discretion of tax examiners, broadening the tax base and making the tax system more equitable) is being keenly watched as an indication of the administration's resolve to tackle difficult but critical institutional reform issues. The BIR leadership is also seeking to address corruption problems through a reorganization of the BIR – a bill to reform the BIR (the National Autonomous Revenue Agency Bill) is pending in Congress. While the BIR reform is important, work on this cannot be allowed to delay administrative and policy measures to raise revenues.

12. *LGU-level revenue issues.* Is there a possibility that LGUs' collection of revenues from their own sources can, to some extent, offset the national government's weak revenue performance and provide resources to LGUs to better deliver devolved services? The overall share of revenues mobilized from local sources relative to GDP is not significantly greater now than it was before the Local Government Code (LGC) was enacted in 1991. In many cases Internal Revenue Allotments (IRA) seem to have created disincentives to mobilize local revenues. Revenue administration at the LGU level thus appears to be an area of great potential improvement.

7. Reversing the decline in public revenue is widely recognized as a key challenge and a priority: the Government must act quickly to increase revenues and restore the credibility of the revenue machinery. The continuance of the revenue shortfall into 2002, and the fall in tax revenue in real terms vis-à-vis 2001 collections, add urgency to this effort. Complicating the situation, the performance of BIR's Large Taxpayer Service (LTS) continues to be below expectations, performance has deteriorated on income and excise taxes, and compliance rates have continued to

13. Many LGUs seem to be able to collect only a small percentage of potential revenues due under their respective local tax codes. The main problems include: (i) lack of accurate taxpayer registration databases; (ii) lack of accurate cadastral information for property taxes; (iii) large numbers of non-filers, stop-filers, and non-payers; (iv) inadequate audit presence for business taxes; (v) lack of trained professional staff (which has led to the use of casual employees to collect some user fees, for example); (vi) inadequate data on payment delinquencies; (vii) cash-based payment systems; and (viii) virtually non-existent taxpayer services.

14. Greater transparency and accountability at the LGU level in (a) the assessment process and evaluation standards for assessment efficiency, and (b) the setting, collecting and auditing of fees for public markets and slaughterhouses, as well as in the leasing process for public markets, could greatly strengthen governance and improve revenue collection at the LGU level.

15. ***Off-budget risks pose a significant threat to macroeconomic stability and fiscal discipline.*** Public finance in the Philippines is replete with instances where taxpayers have bailed out, through re-capitalization and debt assumption, troubled corporations owned or sponsored by the Government, or shouldered the cost of having to sell some of these corporations at a fraction of what Government spent for them: notable examples in recent years include the Philippine National Bank, the old Central Bank, and the National Power Corporation. In many of these cases, the problems have built up over an extended period - and recur even after bailout. Because macro stability is dependent on the effective management of fiscal risks, achieving and maintaining fiscal discipline is critical; this in turn will depend on how effectively contingent liabilities are managed.

16. Some estimates of the contingent liabilities of the Government run to about PhP3.1 trillion, representing maximum exposures under obligations such as (a) unfunded liabilities of public pension institutions (PhP1.8 trillion); (b) direct guarantees on loans to Government owned and controlled corporations (GOCCs) and Government financial institutions (GFIs) – estimated at PhP66 billion; (c) guarantees on risks under build-operate-transfer (BOT) contracts, estimated at PhP45 billion; and (d) deposit insurance (PhP352 billion).

17. A first step is to construct a system for managing fiscal risks. Several specific tasks would be required in the near term. These include quantifying contingent liabilities (a preliminary inventory has been completed in early 2002); reviewing the charter provisions of GOCCs on NG guarantees; developing a framework for recognition, management, reporting and provisioning of contingent liabilities; establishing a centralized risk management unit in the DOF in coordination with the Bureau of the Treasury (BTR) with expertise in identification, measurement, monitoring and management of all implicit and explicit contingent liabilities; and reviewing the contractual obligations for public projects with private sector participation. A Presidential Executive Order (EO) has been issued to strengthen GOCC and GFI governance structures and processes. The DOF is also initiating special-purpose audits of critical GOCCs to support the planned disposition program, and initiating benchmark audits for other pension and trust funds. Some of the actions have already been initiated: it would be desirable to complete them as soon as possible.

18. Complementary actions on other fronts are also needed. Given the significant unfunded liabilities of pension institutions, it would be desirable to strengthen the performance of the Social Security System (SSS) and the Armed Forces Personnel Retirement Savings and Benefit System (AFP RSBS).

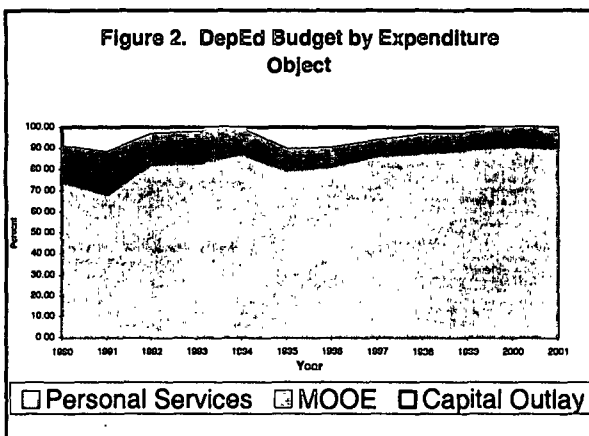
19. For the SSS, a core set of actions could comprise completion of an actuarial audit; narrowing the gap between pension fund contributions and benefits through a phased increase in contribution rates; limiting the administrative expenses of the SSS to the statutory 12 percent; improving the liquidity, yield and safety of the SSS investment portfolio by enhancing the collection efficiency of SSS salary loans; and highlighting the impact of recent suggestions to use the SSS for social policies. The AFP RSBS will need to specify and initiate implementation of a time-bound action plan to improve the liquidity, yield and safety of its investment portfolio, and begin exploring options to attain viability.

20. The Government Service Insurance System (GSIS) is under less immediate threat. Desirable actions here could comprise the engagement of professional investment managers to manage a portion of the GSIS portfolio, and permitting a portion of this portfolio to be invested abroad; enhancing collection efficiency on salary loans; and resolution of past due contributions from the Government.

21. In the medium term actions to improve management of off-budget risks could include: (a) moving towards a cash and accrual basis of accounting; (b) improving audit: strengthening the internal audit team to deal with management of contingent liabilities would ensure that transactions are properly booked and financial statements are reflective of GOCCs true state and well-being; and (c) provisioning for contingent liabilities.

Allocative Efficiency

22. **Composition of expenditures.** The economic composition of spending has deteriorated in recent years as both maintenance and other operating expenses (MOOE) and capital outlays have decreased as a share of GNP (Figure 2 provides an example from the education sector). In very broad terms current expenditures have held steady at about 16.7 percent of GNP while capital outlays declined over the period 1997-2002. Interest payments rose from 3.1 percent to 4.5 percent over the same period. However, MOOE as a percentage of GNP has been declining every year since 1996, with



the exception of a slight increase in 2000. At the same time capital expenditures fell considerably from 3.8 percent in 1997 to 2 percent in 2002, with infrastructure outlays down from 2 percent to 0.5 percent of GNP.

23. The decreases in the share of expenditures to MOOE are worrisome. While reduced interest payments would give the Government more room to maneuver, it would still seem that a reallocation from personal services to MOOE might improve the effectiveness and efficiency of government spending. The share of capital expenditures in 2002 fell short of that in 1996-1997. Moreover,

allocations to capital expenditures have been characterized by high degrees of annual variation in recent years.

24. Allocative efficiency is also diminished by various distortions: although the Government has made some progress recently with limiting the scope of distortion, more could be done to hold "development fund" expenditures to higher standards. A major concern is the allocation of scarce resources to special budget funds that are not necessarily aligned with NG policy priorities and non-transparent in their use. The prevalence of special congressional funds in the national budget raises the issue of budget comprehensiveness, as expenditures from these funds are frequently "off-budget" since they are accounted for neither at the budget formulation nor at the execution stage. Individual senators and congresspersons are also entitled to a variety of additional funds for development purposes, other congressional initiatives, and compensatory allowances. These congressional funds in effect represent a significant amount of "off-budget" resource allocation not subject to the prioritization, accountability and transparency requirements for other expenditures. An additional issue is the myriad of special authorities, corporations, funds and administrations affiliated with sectoral departments (e.g. the agriculture and agrarian reform sector has 11 government corporations and numerous special-purpose funds, whose total allocation represents more than two-thirds of the total sectoral budget).

25. The picture regarding strategic long-term poverty-reducing expenditures is mixed. Expenditures on social welfare, labor and employment have increased. Sector allocations in agriculture, health, education and housing are declining, and sub-sectoral allocations in health may be

deteriorating as well¹. Allocative distortions from congressional initiatives and earmarked revenues further constrain the Government's already limited flexibility.

26. In key social and economic services, sectoral allocations are falling, as a percentage of GNP and of total national government expenditures. NG social service expenditures have declined from 4.9 percent in 1997 to 4.1 percent in 2001 as a percentage of GNP. Education, health and housing have declined as both a percentage of GNP and of total national government expenditures (the only sub-sectors that grew were social welfare, labor and employment), and are also programmed to decline further in 2003 (comparatively, the Philippines spent 1.7 percent of GDP on social services on average during 1990-1998, compared to 2.3 percent for lower middle income countries).

27. The decline is exacerbated by the budgetary inflexibilities that also exist at the sectoral level. For instance, the Department of Education (DEPED) has limited room for maneuver given the high ratio of personnel costs to the total recurrent budget (92.4 percent in 2001). In contrast, the average ratio of personnel costs to total recurrent expenditure in education for lower middle income countries is 64.1 percent. The trend in the agricultural sub-sector is consistent with the trend in social services, though the agricultural sector grew in 2002. Resources for agrarian reform, on the other hand, though declining as a percentage of GNP from 1997-1999, are projected to increase steadily from 2000 to 2003. The budget for 2002 further constrains economic and social service spending due to the need to increase national defense and peace and order expenditures which, though not statutory obligations, take on priority status in times of conflict.

28. Increasing sectoral allocations will not necessarily improve service delivery and reduce poverty. In order to attain these goals the government must focus on providing strategic public goods, and must address issues of equity. At the sub-sectoral level there appear to be mixed trends on these grounds. The analysis suggests that sub-sectoral allocations in health appear to be deteriorating on both equity and efficiency grounds, while expenditures in education seem to be moving in the right direction by supporting productivity and focusing on the poor. The health sector concerns are reflected in a decline in expenditures on preventive care from 36.4 percent of the total DOH budget in 1996 to 26.4 percent in 2001.

29. Better medium-term expenditure planning and budgeting would make overall budget management and expenditure allocation more responsive to national priorities. Currently, resource, planning and implementation constraints are threatening maintenance and public investment in core poverty-reducing public programs. Studies of service delivery have shed light on the access to, quality of, and financing of basic public services. A snapshot of illustrative sectors below discloses the significant progress made and also points to areas requiring further attention for improving outcomes.

30. **Agriculture and agrarian reform.** Public goods and services account for only 40 percent of allocations (rice price stabilization, by contrast, gets 20 percent of budgetary allocations). The incomplete devolution of functions and resources in the agriculture sector has added to the complexity of the problem: because the DAR is not yet fully devolved, LGUs have not really been involved in agrarian reform – this seems to have contributed to the slowdown in the pace of land redistribution. And the budgets of the Departments of Agriculture (DA) and of Agrarian Reform (DAR) are growing faster than LGU budgets for devolved services. Continuing challenges in service delivery constrain the NG's ability to push the pro-poor agenda in this sector – research and extension, for example, are delinked, demonstration farms are not established, and essential sectoral infrastructure such as farm-to-market roads and communal irrigation is deteriorating.

31. It would be desirable to focus on growth-enhancing public goods and services; explore alternative sources to finance land acquisition for redistribution; and make greater use of market-oriented and community-driven modalities of land transfer.

32. **Education.** A broad-based basic education sub-sector largely provided and funded by the public sector coexists with a tertiary sub-sector with a high level of private sector involvement. Elementary education is provided by both public and private sectors. Though public elementary

schools do not charge tuition fees, families spend about 2 percent of total household expenditures on each child enrolled in a public elementary school (or 33 percent of total public elementary education costs). Access to public schools has improved over time. But high participation rates tend to mask the poor's difficulty in accessing quality education at all levels. Children drop out for health and economic reasons; three-quarters of drop-outs are from poor households. Class size, textbooks and facilities are rated poorly for public schools. Poor deployment of teachers results in higher average class size in rural areas (45) than the average teacher-student ratio (35). Around five students, sometimes more, share one textbook.

33. An analysis of prioritization and financing policies and processes indicates that (a) within the education sector, the share of basic education has risen, while that of higher education has fallen; (b) general government spending on education has declined after 1999, and is lower than other ASEAN countries except Indonesia; (c) the sector is characterized by very high wage bill expenditures, and the relatively high teacher salary levels can create pressures on LGUs to match such levels for LGU staff, constraining LGU financing of service delivery; (d) State Universities and Colleges (SUCs) generally have high staff costs (accounting for 83 percent of their budget), fee levels comprise only 5 percent of SUC expenditures, and they have little incentive to improve efficiency. Households' low satisfaction with public school class size, facilities and textbooks is well-known.

34. Key actions in this sector could comprise intensifying intra-sectoral restructuring towards basic education, continuing the reform of higher education, and working out how to devolve technical and vocational education and training to LGUs.

35. **Health.** The health sector is more devolved than education. Overall health status has improved through the nineties, and health indicators have improved quite significantly. For example, overall life expectancy has improved from 64.5 years in 1991 to 67.6 years in 1999; the crude birth rate dropped from 31.9 (average for 1991-94) to 27.3 in 1999; the infant mortality rate fell from 51 in 1991 to 31 in 1999; and the maternal mortality rate declined from 203 in 1991 to 172 in 1998. Despite the overall gains, the improvement has not been uniform across economic classes, gender and regions in the country. Surveys have also indicated inefficient and inequitable public health service utilization. There is an orientation towards tertiary-level and urban-based facilities, limited health insurance coverage, and an overly centralized public health service delivery system. The private sector accounts for about 54 per cent of total expenditures for health care, and is largely confined to the market for personal health care services.

36. The main plank of the government strategy for health care is the Health Sector Reform Agenda (HSRA). Although total expenditures have increased since 1991, the bulk of the budget of the Department of Health (DOH) goes to tertiary care (LGUs finance primary and secondary care services). And while the DOH spends more or less equally on personal services and MOOE, LGUs spend mainly on personal services: at the local level, resources for drugs, equipment and facilities therefore tend to be insufficient.

37. While more resources do flow to poor regions, the distribution of health resources among poor regions is still inequitable. Enrolment of poor families in the Philippines Health Insurance Corporation (PHIC) Indigent Program has improved, but the poor remain vulnerable to health risks and have lower access to basic health services. Regions in Mindanao still have the highest infant mortality rates (IMRs) in the country. There is a resurgence of tuberculosis, malaria and polio. Recent information on health outcomes is scanty.

38. The DOH and DBM are working on a set of core priorities. These comprise improving the DOH regional budget allocation process to better match IMR and poverty incidence; preparing a realistic implementation plan for HSRA to sequence reforms and prioritize technical assistance, completion of an actuarial study on the financial sustainability of the PHIC, and strengthening health statistics.

39. For the past three years the government has been implementing reforms in public expenditure management, led by the DBM. Such reforms require considerable time, commitment and coordination to yield the benefits of greater fiscal discipline, improved strategic allocation of resources and gains in operational efficiency. The policy framework for reforms and the basic building blocks of improved public expenditure management have been put in place. At the national level, the Public Expenditure Management Improvement Program (PEMIP) has begun to link the budget planning, execution and monitoring processes with nationally articulated priorities. The link between the Medium Term Philippine Development Plan (MTPDP) and the budget, including the Medium Term Public Investment Program (MTPIP), is also being strengthened, but more needs to be done: the MTPDP should provide cost estimates for proposed strategies, targets, and programs; strategies and targets require to be prioritized in terms of available resources; and more detail is needed in the MTPDP on the medium term expenditure perspective in terms of the sectoral allocation of resources (which is presented in aggregate terms). More directly addressing the LGU planning agenda in the MTPDP could also make the latter more relevant as an instrument for pro-poor interventions.

40. The Philippines has also introduced the elements of an MTEF. Its stated goals are to restructure the budget over the medium term to better support the government's development strategy. The MTEF was also intended to improve technical efficiency in sectors by "providing a more predictable resource environment for program planning and implementation." The MTEF is conceived of as a program of five inter-related components: (a) a three-year budgeting system to cost on-going as well as proposed programs, activities, and projects (PAPs); (b) better integration of the planning and budgeting system; (c) regular assessments of on-going PAPs through Sector Efficiency and Effectiveness Reviews (SEERs); (d) development of performance indicators and a performance measurement system; and (e) gradual simplification of budgeting rules at the agency level. The approach has been to roll out the reforms on an incremental and somewhat flexible, or experimental, basis.

41. The challenges in moving forward are to maintain the momentum of reforms, to coordinate and manage the process, to prioritize key actions and to continue to refine and strengthen the institutional framework. This requires sustained management and mainstreaming in line departments, coupled with the establishment of effective processes to link national, regional and LGU-level planning, prioritizing and implementation of poverty alleviation programs and pro-poor services². Equally importantly, the MTEF needs to attain a greater degree of technical credibility among line departments, and political credibility among key political stakeholders, to be able to attain its true potential and utility. The MTPDP would be strengthened by a chapter devoted to the MTEF, which could include a discussion of medium term budget composition, medium term sector and departmental ceilings, and budget priorities clearly linked to planning priorities in the MTPDP. The MTEF reform needs to be managed at the highest levels of the executive branch, with actions to strengthen the MTEF, such as mainstreaming the MTEF in line departments; moving towards an accord between the executive and the Congress on the MTEF; and developing a realistic and time-bound implementation plan for the MTEF. At the same time, the macro-economic fiscal framework requires considerable strengthening through improved accuracy of revenue forecasts, enhanced cooperation between the BIR, DOF, DBM and NEDA, and institutionalizing the revenue forecasting task force.

42. SEERs are being applied for a number of years to evaluate budget programs, activities and projects according to their relevance in attaining desired sectoral outcomes. In practice, however, oversight agencies³ have been more advanced than line departments in implementing the SEERs because of stronger capacity and skills. The government has made important strides with the development of the New Government Accounting System (NGAS). Now implementation needs to be managed carefully. Additionally, internal control weaknesses create cash management risks that need to be addressed by improving accounting and reporting requirements. The OPIF – in tandem with planning and SEER processes - is fundamental for implementing planning and budgeting reforms. Innovative initiatives in civil society and legislative participation in budget process.

43. To strengthen budget execution, it would be desirable to (a) evaluate and address risks in NGAS implementation, and link the Budget Execution and Tracking System (BEATS) and the Customized Budget Execution System (CUBES) with the NGAS; (b) promulgate a Government accounting and auditing manual; (c) promote greater DBM-COA coordination on performance evaluation plans; (d) enhance civil society's role in oversight of the budget process; (e) strengthen the capacity of the Congressional Budget and Planning Office (CBPO) to undertake budget and program analysis; and (e) strengthen the agency controllership function.

Operational Efficiency

44. *Procurement reforms to increase competition and transparency could enhance the cost efficiency of resource use and also improve governance.* The potential for, and possible gains from, procurement reform are high. This is appropriately an area that has received much attention from reformers. In fiscal 2000-2002, outlays for procurement of goods, works and services by national agencies, LGUs and GOCCs averaged more than PhP115 billion annually (Table 1).

Table 1. Philippines: Magnitude of Public Sector Procurement Outlays (billion peso)

Spending Entity	2000		2001		2002 (Budget)	
	Amount	%	Amount	%	Amount	%
National Government Agencies	65.1	56	49.7	43	57.3	42
Local Government Units	24.3	21	21.4	24	31.0	22
GOCCs	27.5	23	38.2	33	29.6	21
Total	116.9	100	109.3	100	117.9	100

Source: DBM, *Budget of Expenditures and Sources of Financing for Fiscal Year 2002*

45. The Ombudsman, the Commission on Audit and the Philippine Center for Investigative Journalism have estimated that large amounts of public funds are being lost to both political and bureaucratic procurement-related corruption. Although no reliable estimates are available of losses due to public sector procurement-related corruption, the perception of large leakages continues to persist. An October 2001 study by Procurement Watch, Inc. indicated that the potential leakage through procurement corruption could have run to about PhP95 billion in 2001. The DBM estimates that this could have been used to fund the DEPED twice over, or build more than 500,000 houses, or construct more than 1000 kilometers of farm-to-market roads. The experience of textbook and drugs procurement under World Bank-financed projects indicates that adoption of improved procurement processes and practices could reduce prices by about 40 percent.

46. A key achievement has been the enactment in late 2002, and signing into law in January 2003, of a new Procurement Reform Law. This follows several steps in recent years to streamline public procurement rules and regulations. Thus, enactment and implementation of the Procurement Reform Law applicable to the national government, LGUs and GOCCs was appropriately the top administration priority in procurement reform. Promulgation of the implementing rules and regulations will strengthen the legal and institutional framework for procurement, enhance transparency and accountability, generate further budgetary savings, and also contribute to improving governance. The law contains provisions to simplify pre-qualification procedures, encourage electronic procurement, reduce officials' discretion on bids and awards, establish a Government Procurement Policy Board for oversight and regulation of government procurement, professionalize the public procurement function, protect procurement officials from unjust legal suits arising from the performance of their duties, and impose criminal and civil liabilities for those found guilty of collusion.

47. Electronic procurement systems can enhance transparency, promote competition, and reduce the time for procurement of common-use supplies. Such systems have been developed in various public sector agencies in the Philippines, including (i) the Department of Public Works and Highways (DPWH) for determining contractors' eligibility; (ii) the Department of National Defense for procurement of military uniforms and defense hardware; (iii) the National Power Corporations for coal

procurement; (iv) the DBM for procurement of small-value office equipment, materials and supplies, and (v) by other agencies, including DEPED and DOH. The Philippines has also been prominent in involving civil society in the public procurement process at the national and local levels as a means to enhance accountability and transparency.

48. Priority actions on the procurement front would comprise: (a) promulgation of the IRRs for the Procurement Reform Law; (b) strengthening electronic procurement processes side by side with wider publicity for government procurement through media such as newspapers, radio and television; (c) continued support for civil society monitoring of procurement processes at the national and local levels; (d) establishment of a Procurement Policy Board as the sole regulatory and oversight entity for public procurement; and (e) long-term support for building procurement capacity, including at the LGU level.

49. ***Strengthening accounting, auditing, reporting and financial controls will initially reinforce aggregate fiscal discipline and, over time, improve resource allocation and operational efficiency.*** Focusing on public sector financial accountability, the analysis and recommendations in this area covers: (i) the current legal and regulatory environment; (ii) the government financial management system including budgeting, accounting, cash management and reporting; (iii) government auditing; and (iv) financial management at the local government level.

50. ***Accounting.*** Based on recommendations from existing analyses, COA has designed and initiated a phased implementation of a new government accounting system (NGAS) from January 1, 2002. The NGAS aims to: (a) simplify government accounting; (b) conform to international accounting standards; and (c) generate periodic and relevant financial statements for better performance monitoring. The NGAS has several features that make it a significantly better system, including a modified accrual accounting basis, improved accounting for assets, the adoption of a single fund concept and a simplified three-digit chart of accounts. COA is developing an accounting software package for NGAS computerization.

51. With the introduction of the NGAS a simplified annual financial reporting system is also required. All agencies are required to prepare a balance sheet, income and expenditure statement and a cash flow statement. There are approximately one hundred reports produced by agencies for budget and financial control purposes. The introduction of NGAS is an opportunity for the Government to review the requirements of the various oversight agencies and prescribe a more streamlined set monitoring reports for their use. Pilots are under way in the Department of Social Welfare and Development (DSWD), DEPED and DPWH to improve financial management reporting.

52. The introduction of NGAS means that approximately 2,000 independent accounting units at the NG and LGU level will have to switch to the new system. The logistics of such a large scale change without a period of parallel running carries very high risks. Notwithstanding COA's piloting and training efforts, the authorities will need to ensure that NGAS implementation take place without risks of a serious breakdown of financial controls during the transition period. The main risks arise from (a) the lack of a detailed accounting procedures manual to guide agency and LGU financial staff; (b) the possibility that training of staff may have been insufficient; (c) COA's capacity to provide adequate trouble-shooting support when implementation problems surface; (d) the lack of a link between the chart of accounts and budgetary classification; and (e) the uncertainty surrounding the management reports needed to carry out effective budget control.

53. To address these risks, COA has adopted a strategy of phased implementation, focusing first on setting up the basic manual system to be followed by computerization. The final step will be to develop a Government Integrated Financial Management System that will provide management and financial information at various level of government. To improve the chances of successful implementation, it would be desirable to focus on capacity-building, oversight mechanisms, provision of manuals, and effective coordination between central and line agencies.

54. *Internal audit.* Internal auditing is not a well developed function in government agencies. Although internal audit units are authorized under the Internal Audit Code, budgetary considerations have prevented their establishment in all government agencies and LGUs. Some agencies, though, have internal control units that perform some functions of an internal audit unit. With 11,000 auditors under COA, a careful study needs to be carried out before embarking on a program to universally establish internal audit units. Such a study should review the transfer of some of the routine audit functions from COA to internal audit units and the implications on COA staffing due to the establishment of internal audit units.

55. *External audit.* COA has undertaken an organizational restructuring in 2002. This has distributed audit responsibility from a regional basis to an agency-nationwide basis. The nationwide government agencies and GOCCs are being organized into audit clusters with a director taking responsibility for audit at the national and regional level. The audit of LGUs in several regions will be clustered under a director who will take responsibility for all local government audits in the cluster. This restructuring is meant to facilitate promoting the audit team approach which COA has not been able to fully implement in the past, and may offer valuable lessons for planning and implementing administrative restructuring in the central executive.

56. COA also plans to focus its work on financial and value for money audits and progressively move towards a risk-based auditing model. COA is being assisted by UNDP and AUSAID in these efforts. As COA is currently fully engaged in the reform of the accounting system and computerization of the accounting, development of a risk assessment model and training of staff will be done gradually over the next two to three years.

57. With the planned computerization of the accounting system, another area that would need COA's attention is the development of information technology (IT) audit capabilities. COA has agreed for the World Bank to carry out a peer review to enhance its quality assurance program. COA is also pilot testing a program to encourage participatory audits, allowing civil society organizations to participate in selected audits.

58. *Financial management at the LGU level.* The internal control environment and institutional arrangements for financial accountability remain extremely weak at the LGU level: in 2000, only 250 of the 1689 LGUs audited were given clean audit reports by COA. Although there are many reports of good practice in LGUs, weak internal control practices have been frequently flagged in COA annual reports, and the internal audit function is non-existent in most LGUs. Special attention hence needs to be given to financial management in LGUs.

59. *A reallocation of expenditures from personal services to MOOE can improve the effectiveness and efficiency of government spending: civil service reform is now crucial for flexibility to implement new performance-based public sector reforms and could make an important contribution to public sector efficiency and flexibility.* Given the pressing fiscal constraints, it is clear that the size and cost of the civil service requires review and adjustment as a priority, especially given the potential in the short- to medium-term for reallocation of personal services expenditures to MOOE. The key civil service constraints are well-known to policy-makers: establishment control, compensation, the legal and institutional framework, and institutional capacity.

60. The cost of the civil service has created a significant fiscal burden. The personal services category accounted for some 35 percent of total NG expenditures in 2002, and exceeded this level in key sectors. The same trend is evident at the LGU level: in Negros Occidental province, personal services accounted for 75 percent of the 2002 budget.

61. Establishment control is relatively weak despite efforts in recent years to control recruitment and impose selective hiring freezes. At present, there is no reliable method to verify information on the number of filled and unfilled positions. The DBM, CSC and the GSIS currently maintain their own personnel information databases, but these are not integrated with each other. The situation is

exacerbated by the employment of considerable numbers of non-permanent staff such as casuals and contractuels.

62. There may be specific sources of 'flexibility' that can be tapped in the short run. "Flexible" items within the overall personal services allocation comprise wages of non-permanent personnel, per diems, fringe benefits and certain other items. Roughly 18.4 percent of the 2002 personal services allocations across the national budget can be deemed to be "flexible".

63. Low salary levels for executives in the top pay grades and for professionals in the middle grades compared to the private sector have made it difficult to attract and retain key categories of personnel, including lawyers, auditors, IT professionals and doctors. There is pressure, especially from GOCCs and GFIs, to grant exemptions from the Salary Standardization Law. And allowances are often non-transparent and do not fulfill their objectives.

64. Key steps in controlling the wage bill could consist of expediting the establishment of a workable personnel information system, and deciding on fiscally affordable compensation improvement and rightsizing options. The latter would involve a review of the compensation policy, and assessing the fiscal impact of options for adjusting employment and compensation.

65. On administrative streamlining, which would need to accompany employment and compensation adjustments, expediting NG initiatives to streamline the structure and functioning of the executive would be appropriate, e.g. by eliminating overlapping or unnecessary functions and entities, and efficiency improvements. Starting and sustaining the transformation of the BIR would be widely seen as a litmus test of the ability and willingness to implement core institutional reforms.

66. The Civil Service Commission (CSC) has drafted a new Civil Service Code (now under legislative review) focusing on merit-based recruitment; more competitive compensation within fiscal constraints and linking compensation to performance; protecting upright civil servants; and strengthening accountability and integrity mechanisms. While executive commitment to modernizing the civil service legal framework is undoubted, the key issue – given the earlier history of such legislation - is whether the draft Code will be enacted.

67. Capacity building also needs to be addressed: fiscal pressures cannot by themselves be sufficient for sustainable civil service reform. It is desirable that the constitutional entity tasked with development and oversight of civil service policy – the CSC - be strengthened on a priority basis, and that coordination between the CSC and the DBM be intensified.

68. *Operational efficiency could be enhanced through more effective implementation of foreign-assisted projects (FAPs).* The key concerns relate to enhancing absorptive capacity; improving project identification, preparation and design; increasing the predictability of project financing; and strengthening the sustainability of project outcomes. These are being addressed through, for example, the completion of SEERs to sharpen prioritization of activities; more thorough project design and project evaluation arrangements; minimizing multi-agency implementation; development of a 3-year investment program; issuance of an EO on resettlement, and high-level attention to right-of-way issues which impede land acquisition. Rationalization of Project Management Units is being implemented to ensure speedier project implementation and facilitate ownership and accountability for projects. Once the teething problems are surmounted, the strengthened implementation arrangements - and speedier implementation - could bolster institutional capacity at NG and LGU levels, better sustain project outcomes and ensure faster absorption of ODA. The institutional capacity of LGUs involved in FAPs is also being strengthened, especially for procurement and financial management. Strengthening the linkage between planning and budgeting, and between the MTPDP and the MTPIP, is also likely to improve the predictability of resource flows over the medium term.

Decentralization

69. *Capacity building at the LGU level, including and especially in procurement and financial management, will be key to strengthening accountability and service delivery.*

70. The Philippines Local Government Code of 1991 is one of the most far-reaching decentralization reforms in the developing world. Anecdotal evidence (e.g. from the *Galing Pook* awards) suggests that decentralization has encouraged greater innovation at the local level, strengthened local management capability and promoted greater cooperation with the private sector and other LGUs. However, the preliminary evidence also suggests that, despite these achievements, the expected benefits of decentralization have yet to be fully realized. Institutional arrangements for service delivery remain unclear in many cases, with national agencies playing a significant role in some functions that should have been fully devolved to LGUs. In addition, unfunded NG mandates such as the Salary Standardization Law increase the cost of local services and impede local autonomy. Sufficient resources do not seem to be channeled to poorer LGUs, and NG ability to equalize fiscal capacity and monitor the financial performance of LGUs remains weak.

71. Planning and investment appraisal seem to be the weakest links in the chain of LGU public expenditure management. LGUs are also limited in their ability to manage and develop their human resources. The potential for improving revenue collection by LGUs has been outlined earlier, as have weaknesses in the internal control environment and financial accountability.

72. Improving LGU capacity to deliver basic services seems to hinge on four critical factors: (a) on the revenue side, improved assessment and collection of revenues from local sources to reduce LGU dependence on IRA; (b) on the expenditure side, strengthening planning, investment appraisal, procurement and financial management; (c) improving the quality of LGU public administration by controlling wage bill expenditures and strengthening LGU administrative capacity, accountability and oversight; and (d) replicating innovative LGU practices in managing revenues, expenditures and personnel, and promoting greater competition between jurisdictions. All of this requires long-term capacity-building.

73. There are plenty of examples of effective home-grown solutions to common problems. For example, cities such as Lapu-Lapu, Gingoog, Surigao, Cotabato and Puerto Princesa have adopted innovative measures to cope with the increasing demand for more and higher-quality health services from their constituencies. Perhaps the more exemplary among these innovations are the barangay primary health care facilities established by the provincial government of Negros Occidental and the provincial health insurance program adopted by Bukidnon and Guimaras. In the area of controlling personnel size and costs, and accessing non-IRA sources of funding, the example of Cabanatuan city seems noteworthy.

74. Although the 1991 LGC has been the key instrument for decentralization, and specific aspects of decentralization have been studied, no systematic assessment of how decentralization has worked on different dimensions has yet been carried out. It therefore seems apposite to undertake a Decentralization and Service Delivery Study to review the fiscal, administrative and political aspects of decentralization in the Philippines, and their impact on service delivery. The resulting diagnosis could help improve government performance and promote healthy competition between LGUs.

Looking Ahead

75. The preceding pages have outlined the key PEPFMR findings. It is desirable that on the implementation-related issues (e.g. on revenue measures, BIR reforms and administrative streamlining) the Government act quickly and decisively. For planning and diagnostic-type issues where assistance or advice from development partners could be valuable, the Philippines' development partners stand ready to provide the needed support.

76. The chapters which follow lay out the findings, issues and recommendations in greater detail. This report is arranged in three main sections – aggregate fiscal discipline, allocative efficiency, and operational efficiency. A fourth section on decentralization highlights some issues as a prelude to a review of the decentralization experience since 1991 and its impact on issues such as service delivery, equity and efficiency. Themes such as accountability and transparency pervade this report and have not been dealt with separately.

77. The action plan attached to this executive summary indicates the most pressing issues confronting the authorities, and on which immediate actions seem to be called for – in a sense, the overarching importance of the still-unfolding fiscal developments dictates quite clearly the sequencing and prioritization of the actions to be taken. The more detailed action plan at the end of this report contains the joint recommendations of the GOP and the task team.

78. The dissemination strategy for the PEPFMR envisages sharing of this report and the action plan with a wider audience, comprising national agencies, LGUs, legislators, development partners, civil society and the media. A dissemination workshop has been tentatively planned for May 2003; the exact dates will be finalized in consultation with the GOP.

Philippines: Public Expenditure, Procurement and Financial Management Review

Action Plan – Short-Term Actions

Area of Concern	Joint GOCC-Disk Team Recommendation	Agency
A. Aggregate Fiscal Discipline		
Revenue Mobilization	Reverse the decline in revenues as a share of GNP	BIR, DOF
	Enact the proposed reform of the excise tax on alcohol and tobacco products	
	Improve the effectiveness of the Large Taxpayers Service: <ul style="list-style-type: none"> ○ Clarify its audit priorities by focusing on the RELIEF program and the issue-oriented audits ○ Prioritize selective audits (e.g. on VAT) over comprehensive ones ○ Increase the size of the proposed special audit team and require it to concentrate on large taxpayers ○ Require the special audit team to provide feedback to management on the LTS audit program, which should be subject to management approval 	
	Make a decision on the course and phasing of the medium-term BIR reform	
Contingent Liabilities and Off-Budget Risks Relating to GOCCs	Strengthen the recognition, management, reporting and provisioning for contingent liabilities: <ul style="list-style-type: none"> ○ Complete the quantification of contingent liabilities and establish a centralized risk management unit in DOF in coordination with BTR ○ Initiate special-purpose audits (financial, management and personnel audit) of critical GOCCs to support the planned disposition program ○ Initiate a benchmark audit for pension and trust funds such as the AFP RSBS, HGC, Pag-ibig, PHIC 	DOF
	Effectively implement the new power sector law	DOE
Reform of the Pension System	<u>Reform of the SSS:</u> <ul style="list-style-type: none"> ○ Complete an actuarial audit of the SSS ○ Design and begin implementation of a phased action program to increase contributions from the present 8.4 per cent to say 14 per cent (depending on the actuarial audit) ○ Highlight the impact of suggestions to use SSS for social policies by estimating the impact of the proposed socialized contributions under the current system prior to implementing them, and assessing the fiscal impact of enrolling informal sector workers under the SSS ○ Improve the liquidity, yield and safety of the SSS investment portfolio by enhancing the collection efficiency on SSS salary loans ○ Develop a strategy and implementation plan for the organizational restructuring of the SSS and a plan to limit administrative expenses to the statutory 12 percent ceiling 	DOF, SSS

Area of Concern	Joint GOP-Task Team Recommendation	Agency
	<p>statement of the MTEF (forward estimates) in the MTPDP, with sections on medium term budget composition (including costing of key programs) and on the explicit link between planning priorities and the budget (a draft document should be discussed in DBCC before official inclusion in the MTPDP)</p> <ul style="list-style-type: none"> ○ Build up sector expenditure frameworks through more developed SEERS: train oversight and line agencies in program costing and cost-effectiveness analysis and pilot costings and cost-effectiveness analysis of high priority PAPs in select departments ○ Improve the accuracy of revenue forecasts by: <ul style="list-style-type: none"> ○ Improving the quality of BIR databases by developing systems to capture and analyze data at district level ○ Enhancing cooperation between the BIR, DOF, DBM and NEDA through the new DBCC revenue forecasting task force ○ Establishing an official “revenue forecasting calendar” with clearly delineated functions and responsibilities to coincide with the annual budget calendar 	<p>DBM, NEDA</p> <p>DBM, NEDA</p> <p>BIR, DOF, DBM, NEDA</p>
C. Operational Efficiency		
Public Procurement	<ul style="list-style-type: none"> ○ Promulgate implementing rules and regulations (IRRs) for the Procurement Reform Law ○ Complete a study under the auspices of the Construction Industry Authority of the Philippines (CIAP) on the feasibility of allowing foreign contractors to bid without a Philippine License 	DBM
Financial Management	<ul style="list-style-type: none"> ○ Promulgate a systems and procedures Manual for the New Government Accounting System ○ Design and pilot-test an agency-level financial management training program ○ Prepare a position paper with an implementation plan to strengthen the agency controllership function 	DBM, COA
Wage Bill Control and Administrative Streamlining	<ul style="list-style-type: none"> ○ Continue hiring freeze on non-essential personnel ○ Prepare a position paper with options for employment and pay rationalization, including estimates of the fiscal impact of different options ○ Complete analytical work to design and cost a personnel information system shared by the CSC, DBM and GSIS, and decide on source of funds to finance implementation ○ Prepare an implementation plan for administrative measures to streamline the structures, functions and programs of selected agencies, task forces and similar NG bodies ○ Implement a pilot exercise to resolve mismatches between priorities, functional assignments, structures and staffing in one department 	DBM, CSC
D. Decentralization		
Financing and Delivery of Basic Services	<ul style="list-style-type: none"> ○ Initiate a cross-sectoral review of the fiscal, administrative and political aspects of decentralization, with special reference to the impact of decentralization on service delivery 	DBM, DOF, NEDA, COA, DILG

SECTION A. AGGREGATE FISCAL DISCIPLINE

1. Overview: The Institutional and Fiscal Context
2. Expenditures and Revenues: Trends And Issues
3. Off-Budget Risks And Their Management

OVERVIEW: THE INSTITUTIONAL AND FISCAL CONTEXT

1.1 The Philippine authorities, confronted with an unfavorable governance and macroeconomic environment in 2001, established a consistent track record in 2001 in stabilizing the economy and improving investor sentiment. The unfolding developments in 2002-2003, however, pose a threat to a still fragile fiscal and institutional environment, and can dim the prospects for attaining the Philippines' targets for higher growth and renewed poverty reduction. Fiscal sustainability and the government's ability to finance poverty-reducing programs continues to be at risk from falling revenues, rising public debt and debt service and off-budget risks. This constrained environment makes it doubly important to focus on increasing fiscal flexibility through increasing revenue collections and enhancing the discipline, efficiency and equity of public expenditures.

1.2 The objective of this Public Expenditure, Procurement and Financial Management Review (PEPFMR) is to examine selected issues in the allocation and management of public resources of interest to the Philippine authorities, the World Bank and the ADB. It aims to help the authorities establish more effective and transparent policies and processes for the allocation and utilization of public resources to reduce poverty and promote economic growth. The audience for this report comprises the Philippine authorities, the World Bank, the ADB, other development partners of the Philippines and civil society.

Matching The State's Role To Its Capability

1.3 Spread over 7,100 islands in three major island groups, the Philippines has a population of 74 million (1999) and a total land area of 300,000 square kilometers. History and a dispersed geographical setting provide the specific context to the Philippine decentralization arrangements: following the enactment of the 1991 Local Government Code, one of the most far-reaching decentralization reforms in the developing world, the country now has three tiers of Local Government Units (LGUs). At the top are 80 provinces followed by a second tier comprising 114 cities and 1,496 municipalities. 41,585 barangays comprise the third tier of local government. The country's territory is also divided into 16 regions for administrative purposes. These regions are not units of local government but essentially consist of groups of provinces and their component LGUs which are served by the deconcentrated regional offices of central departments and agencies.

1.4 Performing state functions efficiently and equitably tends to be a major concern in most countries. The Philippines is no exception. Figure 1.1 illustrates some of the generic functions that many states – including the Philippines – perform. However, the Philippine bureaucracy has been characterized by institutional dysfunctions which have weakened state capability and led to perpetuation of governance problems. Hence, the role, functions and architecture of the executive department are being rethought as part of a long-standing quest for institutional strengthening and improved service delivery, particularly in the light of greater public demand amidst tighter resource constraints. Recent institutional reform efforts have focused on streamlining the bureaucracy, simplifying procedures, and delivering better public services. Public demand for such improvements has been allied with demands for greater transparency and accountability in the utilization and management of public resources.

The unfolding developments in 2002-2003 pose a threat to a still fragile fiscal and institutional environment.

Figure 1.1. Functions of the state

	Addressing market failure			Improving equity
Core functions	<i>Providing pure public goods:</i> Defense: peace and order; property rights; macroeconomic management; basic education; public health; safe water			<i>Protecting the poor:</i> Antipoverty programs; disaster relief
Intermediate functions	<i>Addressing externalities:</i> Environmental protection	<i>Regulating monopoly:</i> Utility regulation; antitrust policy	<i>Overcoming imperfect information:</i> Insurance (health, life, pensions); financial regulation; consumer protection	<i>Providing social insurance:</i> Redistributive pensions; family allowances; unemployment insurance
Activist functions	<i>Coordinating private activity:</i> Fostering markets			<i>Redistribution:</i> Asset redistribution

Source: Adapted from World Development Report, 1997

1.5 The judiciary has already similarly initiated an institutional reform process to speed up the dispensation of justice and upgrade the quality of the country's court system. The blurring in practice of the respective roles of the executive and legislative branches in setting spending priorities and allocating public resources is gradually being addressed given the long recognition by the Philippine authorities of the need to improve the efficiency and effectiveness of public sector fiscal and economic management for better public sector outcomes. All of this underscores the necessity of streamlining and rationalizing state entities in the Philippines as a prerequisite for improved governance and more efficient utilization and management of state resources.

1.6 Figure 1.2 illustrates the structure and magnitude of public employment in the Philippines – the implications are discussed in Chapter 9. There have been several attempts since 1985 to pass legislation on restructuring of the executive and re-engineering the bureaucracy – all of them unsuccessful. The current strategy is a more pragmatic twin-track approach to institutional reform - reliance on administrative and executive measures which can be implemented without recourse to legislation, while continuing advocacy for passage of legislation on the reengineering the bureaucracy.

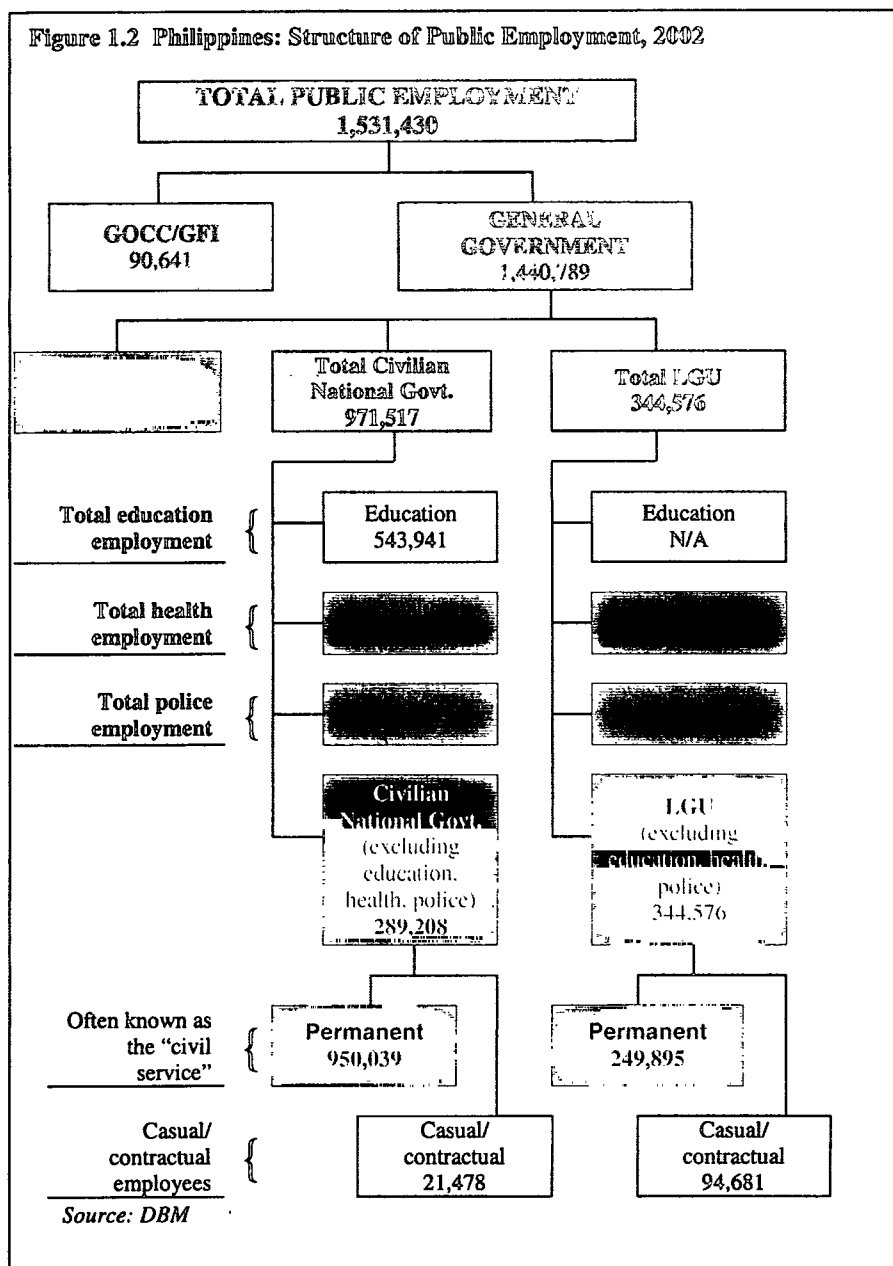
1.7 The administration is pursuing a Public Sector Institutional Strengthening Program, led by the Presidential Commission on Effective Governance (PCEG), aimed at improving the government's service delivery and institutional capacity. The Program seeks to strengthen core functions and strategic roles and responsibilities of the government in accordance with socio-economic priorities and resource constraints, by: (i) defining the role of the state and thereby the scope, level and focus of government interventions; (ii) rationalizing the distribution of functions between the public and private sectors, between national and local governments, and among government agencies; and (iii) designing administrative structures and systems to improve government operating efficiency and effectiveness.

1.8 *Lessons learnt in the last 2-3 years in particular, in designing and implementing specific reforms, now provide a solid foundation for moving ahead on key reforms to improve public sector performance.* Facilitating factors include a shared vision of institutional reform among key policy makers, improved cooperation among central oversight agencies, and a recognition of the need to engage civil society in monitoring progress in implementing reforms.

**Lessons learnt
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1.10 A key lesson learnt is that institutional reforms need to be accompanied by an impact mitigation program with agency-specific and culture-sensitive change implementation strategies. It seems to be now possible to move ahead more aggressively on some of the more difficult but necessary reforms, such movement being facilitated by the credibility of reform measures undertaken so far and the 'window of opportunity' afforded by the fact that the next presidential election is not due till mid-2004. *Institutional strengthening now requires deciding on and quickly implementing key reforms which do not require legislation, based on the ongoing PCEG-led review of the scope and functions of central executive entities.*

Institutional strengthening now requires deciding on and quickly implementing key reforms which do not require legislation, based on the ongoing PCEG-led review of the scope and functions of central executive entities.



The Fiscal Context

1.11 Review of the Full Structure of General Government Expenditures.

This section reviews and analyzes the fiscal developments for the consolidated public sector, the National Government (NG), local government units (LGUs), Government-owned and controlled corporations (GOCCs) and other Government-owned entities, and provides an overview for subsequent chapters.

1.12 Since the last public expenditure review was completed in 1995, there have been several noteworthy developments. First, after several years of surplus in the mid-1990s due to improved tax collections, fiscal deficits have re-emerged since 1998 in both NG and consolidated public sector finances (Table 1.1). Second, the financial position of GOCCs still requires strengthening despite privatization and management improvements, signifying the importance of continued efforts to improve GOCC performance (Table 1.2). Third, since 1994 the budget has become more rigid and inflexible because mandatory spending is crowding out productive spending on investment and maintenance (Table 1.3). Lastly, LGUs seem to lack financial resources for maintenance and other operating expenditures and for development. Strengthening fiscal management is therefore a key issue both at the national and LGU levels for the foreseeable future. This section examines key issues relating to the first two features above. The third development is examined in the next chapter and in Section B of this report, while the fourth development is expanded in Section D.

1.13 *The consolidated public sector financial position*, which consists of the revenues and expenditures of the National Government, the Central Bank Restructuring Fund, the GOCCs and others, disclosed a deficit of PhP172.2 billion or 4.5 percent of GNP in 2001, compared to 3.2 percent in 1999 and 4.5 percent in 2000 (Table 1.1).

1.14 The National Government's fiscal position deteriorated from a deficit of 1.8 percent of GNP in 1998 to 3.8 percent in 2000. In 2001 the deficit was limited to the targeted 3.8 percent and the authorities targeted to balance the budget by 2006. In 2002, however, there was a slippage in the deficit target – the first nine months disclosed a deficit of about PhP166.5 billion against the 2002 target of PhP130 billion.

Table 1.1 Consolidated Public Sector Financial Position: 1991-2001 (billion pesos)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total Public Sector Balance	-26.0	-26.0	-25.9	-8.4	-4.1	7.3	-24.1	-83.2	-102.8	-141.3	-166.3
Percent of GNP	-2.1	-1.9	-1.7	-0.5	-0.2	0.3	-1.0	-3.0	-3.3	-4.4	-4.3
National Government	-26.4	-16.0	-21.9	16.3	11.1	6.3	1.6	-50.0	-111.7	-136.1	-147.0
Monitored GOCCs	-7.4	-10.7	-25.6	-9.7	-1.3	-11.2	-17.2	-38.0	-4.6	-19.1	-24.5
OPSF	10.1	5.4	-7.9	2.6	-9.2	4.8	-0.8	0.7	1.9	0.3	0.8
CB Restructuring	0.0	0.0	-15.1	-24.3	-20.0	-13.8	-25.7	-26.4	-20.5	-19.1	-23.5
GFI's	2.4	3.8	6.1	3.1	5.0	8.4	4.3	5.4	3.3	3.2	3.9
SSS/GSIS	8.1	8.2	11.7	-12.0	0.01	8.5	3.9	17.8	36.4	15.4	15.6
Others/ Adjustment	0.4	-1.6	2.8	0.0	0.0	0.0	0.0	1.5	-6.1	-6.6	0.1

Source: Department of Finance

Table 1.2 Consolidated Public Sector Deficit and Surplus (% of GNP)

	1996	1997	1998	1999	2000	2001
Consolidated Public Sector Financial Position	0.29	-0.95	-2.95	-3.18	-4.34	-4.32
of which:						
National Government	0.28	0.06	-1.78	-3.56	-3.84	-3.81
Central Bank Restructuring	-0.61	-1.02	-0.94	-0.65	-0.55	-0.61
GOCCs	-0.49	-0.68	-1.36	-0.15	-0.55	-0.64
OPSF	0.21	-0.03	0.02	0.06	0.01	0.02
Others	0.87	0.61	1.01	1.20	0.66	0.82

Note: GOCC = Government-owned and -controlled corporation; OPSF = Oil Price Stabilization Fund (eliminated in 2001). Totals may not add up due to rounding.

Sources: Department of Budget and Management, Department of Finance

1.15 The main finance problem has been a shortfall in revenues, caused by a continuous decline of tax collections, 70 percent of which is collected by the Bureau of Internal Revenue (BIR) and 18 percent by the Bureau of Customs (BOC). With the onset of the financial crisis, BIR collections fell from its peak of 12.4 percent of GNP in 1997 to 10.9 percent in 1999, 10.3 percent in 2000 and down to 10.1 percent in 2001. In the same manner, import duties fell from its pinnacle of 5.5 percent of GNP in 1995 to 2.7 percent in 1998-2000 and 2.5 percent in 2001. The decline of tax efforts has forced the Government to trim necessary maintenance and capital expenditures.

It is critical to intensify efforts to reverse the decline in revenues.

1.16 *The consolidated public sector deficit (CPSD)* has increased in recent years. There are two main constituents of this deficit besides the NG: the Central Bank Restructuring Fund and GOCCs. The GOCCs' deficit, however, has been narrowed by privatization of certain GOCCs and improvements in GOCC management during 1990-2000. The CPSD was relatively sustainable before 1997 with a combination of increased tax efforts and management, and with privatization proceeds that improved both the NG and GOCCs' accounts. A decline in capital outlay expenditures and budgetary support to GOCCs during the nineties has contributed to limiting the CPSD. However, the CPSD position has worsened since 1998, when the NG began to run a deficit (Table 1.2).

1.17 *Consolidated Public Investment.* The behavior of consolidated public investment has reflected that of NG investment, but its composition has shifted,

Table 1.3 Fiscal Aggregates 1992-2001 (as percent of GNP)

	1992-3	1994	1995	1996	1997	1998	1999	2000	2001
Total Revenues	17.5	19.4	18.4	18.2	18.7	16.5	15.3	14.5	14.6
o/w Tax Revenues	15.3	15.6	15.9	16.3	16.3	14.9	13.8	12.9	12.7
Current Expenditures	15.8	16.0	14.8	15.6	16.6	16.7	16.7	16.6	15.6
Capital Expenditures	3.0	2.8	2.7	2.1	1.9	1.6	2.0	1.7	2.7
Infrastructure, etc	1.9	1.0	1.6	1.2	0.5	0.4	0.5	0.5	1.7
Total Expenditure	18.8	18.8	17.5	17.9	18.6	18.3	18.8	18.4	18.4
NG Deficit	-1.3	0.9	0.6	0.3	0.1	-1.8	-3.6	-3.9	-3.8

Source: Department of Budget and Management

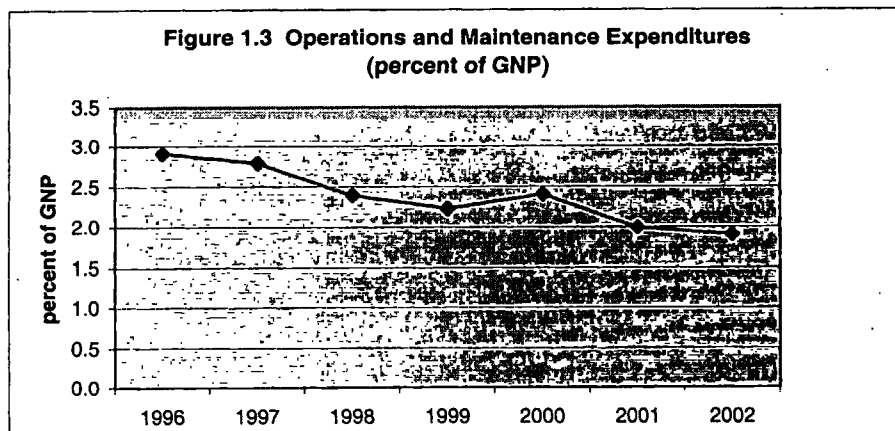
indicating the priorities of successive administrations. It was above 4 percent of GNP through the nineties and up to 1997. Both public investments and maintenance outlays have suffered since 2000 - much of the decline being due to strict limits on the overall public sector deficit imposed by the stabilization program. The consolidated public investment diminished from about 5.6 percent of GNP in 1994 to about 3 percent of GNP in the early 2000s. These cuts in productive expenditures have deteriorated infrastructure provision.

1.18 **The National Government.** The NG has continued to play an important role in economic development: the share of government expenditures has remained at about 18-19 percent of GNP during 1990-2001. However, the wage bill and other mandated expenditures accounted for a large part of total expenditures for both NG and LGUs.

1.19 Since 1996, current expenditures have stabilized at about 14-15 percent of GNP, maintaining the 15 percent in the first half of the nineties, but have largely become mandated (Figure 1 and Table 1.4). As a result, the share of capital investments has been reduced to only 2-3 percent of GNP (Table 1.5), insufficient for poverty reduction and better delivery of basic services. Maintenance and other operating expenditures (MOOE) have fallen from 2.7 percent of GNP in 1995 to 1.9 percent in 2002, and are well below the average of 2.8 percent for the period 1990-1994 (Figure 1.3).

1.20 The NG was able to maintain a surplus during the period 1994-1997 largely due to privatization proceeds and tax management improvements. Interest payments also contracted from 6.6 percent of GNP in 1990 to 3.1 percent by 1997 with improvement of the fiscal position. Coupling expenditure cuts with improvements in revenue generation, the NG was successful in maintaining a surplus until 1997. However, since then, the NG's tax effort has plummeted from 16.3 percent of GNP in 1997 to 13.2 percent in 2000 and 12.7 percent in 2001, severely constraining the NG's fiscal flexibility.

1.21 The structure and composition of expenditures have been outlined in Chapters 2 and 4.



Source: DBM

**Revenue collections
need to increase,
and/or wage bill
expenditures need to
diminish, to
adequately finance the
Government's growth
and poverty-reduction
agenda.**

Table 1.4 Budgetary Inflexibilities Due To Mandated Expenditures: 1990-2001 (% of GNP)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Wages	5.8	5.8	5.4	5.2	5.3	5.6	6.0	6.8	7.0	6.5	6.4	6.2
Interest	6.6	6.0	5.8	5.1	4.6	3.7	3.4	3.1	3.6	3.4	4.0	4.5
LGU Transfers	0.7	0.8	1.5	2.5	2.7	2.8	2.6	2.8	2.6	3.1	2.9	3.0
Total Mandated Expdrs.	13.1	12.5	12.7	12.8	12.6	12.1	12.0	12.7	13.1	12.9	13.3	13.8
Revenues	16.9	17.6	17.7	17.4	19.4	18.4	18.2	18.7	16.5	15.3	14.7	14.6
Difference Between Total Mandated Expdrs. & Revenues	3.8	5.1	5.0	4.5	6.7	6.3	6.2	5.9	3.4	2.3	1.4	0.9

Source: DBM

1.22 Local Government Units. Since the enactment of the Local Government Code (LGC) in 1991, locally elected officials have been expected to deliver services that reflect local needs and preferences at a level and quality equal to or better than national agencies. A national revenue-sharing scheme – the Internal Revenue Allotment (IRA) – provides annual block grants to LGUs under the General Appropriations Act. The distribution of the IRA among LGUs follows the prescribed formula: 23 percent for provinces, 34 percent for municipalities and 23 percent for barangays. The share of each LGU in turn is computed based on the following weights: population 50 percent, land area 25 percent and equal share 25 percent. While there has been significant increase in the IRA, the distribution does not consider the poverty incidence and development phase of individual LGUs. The IRA continues to be the fastest growing item in the national budget (Table 1.6).

Table 1.5 Capital Outlays 1996-2001 (percent of GNP)

	1996	1997	1998	1999	2000	2001
Capital Outlays	3.5	3.8	3.3	3.1	2.5	2.7
Infrastructure	1.9	2.0	1.5	1.8	0.4	1.7
Corporate Equity	0.2	0.1	0.1	0.1	0.1	0.0
Other Outlays	0.9	1.1	0.5	0.5	1.9	0.3
Transfer to LGUs	0.5	0.6	0.6	0.7	0.7	0.6

Source: DBM

1.23 Despite being on the front line of basic service delivery, however, LGUs account for a small portion of total government financial resources: the average percentage share of LGUs in total consolidated expenditures during 1994-2000 was only 4.4 percent, as against the NG share of 17.9 percent and the GOCC share of 78.5 percent (Table 1.8). There seems to be an issue here as to the adequacy of financial support for LGUs. According to the LGC, the IRA comprises 40 percent of the total internal revenue collection of three years ago. The IRA accounts for 67.4 percent of provinces' expenditure and 60.8 percent of municipalities'. However, barangays – the lowest tier of LGUs – depend totally on the IRA for their finances⁴. Overall, IRA transfers seem to act as a disincentive for some categories of LGUs to generate revenue from their own sources⁵.

Table 1.6 Assistance to LGUs from the National Budget

Year	Assistance to LGUs	NG Budget	(%) ss
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	(billion pesos) (a)	(billion pesos) (b)	percent of (b)
1992	19.7	262.0	7.5
1993	37.0	276.9	13.4
1994	47.4	330.2	14.4
1995	57.3	372.1	15.4
1996	62.3	416.1	15.0
1997	74.9	491.8	15.2
1998	77.5	537.4	14.4
1999	103.8	593.6	17.5
2000	129.6	682.4	19.0
2001	139.0	710.8	19.5

Source: DBM

1.24 **Government Owned and Controlled Corporations.** GOCCs were mainly established to improve provision of infrastructure services. Despite progress in enhancing efficiency, GOCCs in general still require management strengthening for more efficient functioning. They contributed less than 2 percent of GNP by value added, but their budgetary support needs accounted for 60 percent of public sector spending. To enhance efficiency in service delivery, the Government privatized more than 200 GOCCs and strengthened the performance of the remainder. The number of GOCCs now stands at about 98 (including subsidiaries). A supervision unit was established within the DOF to monitor the activities and operations of 14 major GOCCs⁶.

1.25 Many GOCCs still depend on NG resource transfers. Data on net flow of funds from the NG to major GOCCs suggests that the net flow significantly increased during the last two years due to increased tax payments. To ameliorate their financial position, many GOCCs curtailed their investment programs. The 14 monitored GOCCs decreased capital expenditures from PhP68 billion in 1996 to PhP35 billion in 2001. The National Power Corporation (NPC) alone reduced its capital expenditure from PhP32 billion in 1996 to PhP17 billion in 2001, reflecting reform efforts initiated by the Government⁷. Excluding the NPC, internal cash generation in the aggregate financed 61.8 percent of GOCCs' financial requirements between 1990-2000 (Table 1.7), domestic borrowing 14.9 percent and external borrowing the remaining 23.3 percent.

1.26 The NPC's borrowings have accounted for about 50 percent of the total contingent liabilities of GOCCs. The NPC's heavy reliance on debt finance, and the financial crisis in the region, caused a major depreciation of the peso against foreign currencies in NPC's debt portfolio and IPP contracts. The Electric Power Industry Reform Act (EPIRA)⁸, passed in June 2001, provides the legal framework for restructuring the electric power industry by privatizing the NPC and unbundling the electric power industry into generation, transmission, distribution and supply sectors. The EPIRA reduces the role of NPC to the operator of the Small Power Utilities Group and other non-privatized assets, and creates two new GOCCs, the National Transmission Corporation (TRANSCO) and the Power Sector Assets and Liabilities Management Corporation (PSALM). The PSALM's principal role is that of a liquidator, to manage the orderly sale, disposition, and privatization of NPC's generating assets, IPP contracts, and other property. The transmission and sub-transmission assets of NPC, including NPC's nationwide franchise for the operation of the transmission system and the

Table 1.7 Total Internal Cash Generation of Major GOCCs (billion pesos)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
All 14 GOCCs	7.68	13.15	15.40	15.96	32.34	21.05	20.40	17.85	5.99	15.11	6.09
Percent of GNP	0.71	1.04	1.11	1.06	1.86	1.07	0.89	0.71	0.21	0.48	0.17
Without NPC	4.22	9.75	4.93	8.26	17.83	8.79	5.11	7.14	1.12	4.56	(2.58)
Percent of GNP	0.39	0.77	0.36	0.55	1.03	0.45	0.22	0.28	0.04	0.15	(0.07)

Source: DOF- Corporate Affairs Group

grid, will be transferred to TRANSCO. These reforms are under way. The restructuring and privatization of the electric supply is expected to encourage greater competition and efficiency⁹.

1.27 **Other Entities of General Government.** The Social Security System (SSS) is the social security entity for private sector employees. With the implementation of the Social Security Law in 1957, the Government adopted the social insurance approach to social security, covering the employed segment of the private sector labor force. In 1993, household helpers earning at least PhP1,000 were included in the compulsory coverage of employees.

1.28 SSS net revenues have declined greatly since 1998. Benefit payments have been surpassing contributions since 1993. In 2000, for example, contributions amounted to PhP30.3 billion while benefits paid amounted to PhP33.9 billion. If the SSS does not increase its contribution rate or extend the contribution period, it is estimated that its resources will dry up by 2015. A second reason for the decline in financial resources is the low yield from investments. The SSS managed to avoid financial risks by using multiple investment options. However, since interest rates declined from time to time, it could not attain the needed income levels. Thirdly, in 1992 the Additional Benefit Enhancement in Republic Act 8282 regulated minimum pensions, increased dependents' pensions and gave them the option to receive the first 18 months' pension in a lump sum, but without augmenting contributions. This fundamentally worsened the financial situation of the SSS. Fourthly, the SSS was mandated to provide subsidized interest rates for housing and member loans – this led to a further income decline. Lastly, reported misuse of the fund also inflicted losses on the SSS.

1.29 The Government Service Insurance System (GSIS) is the Philippines' state insurance company, offering retirement, disability and other benefits to all workers employed by any level of government or by a government-owned corporation. GSIS administers the General Insurance Fund (GIF), which offers a full range of insurance products to the general public and to all entities controlled by the government or with a government shareholding interest.

1.30 The SSS and GSIS have investment funds of about PhP250 billion, large enough to dominate the local stock market and initiate a takeover of any company in the country. Hence, without a significant increase in the contribution rates, the reserves could be depleted, forcing benefits to be cut or not paid at all. For these reasons, pension reform efforts began in 1997 in both entities with the so-called "Social Security Act" but are not sufficient to ensure their long-term sustainability. Both entities need to embark on serious structural reforms to

Table 1.8 Total Public Sector Resource Distribution (billion pesos)

Year	NG	GOCC	Of which GFIs	LGU	Total
1994	259.2	3176.4	3020.1	64.0	3499.6
1995	293.4	3365.4	3238.7	66.3	3745.2
1996	336.4	1298.8	1143.1	81.5	1716.6
1997	401.1	1869.0	1607.3	104.9	2274.7
1998	442.1	1516.0	1295.0	108.2	2066.5
1999	460.1	883.5	1423.7	104.8	1448.5
2000	535.5	2039.2	1809.9	95.4	2670.2
2001	573.5	4080.2	1945.3	124.2	4777.9
2002	619.3	4555.3	0	139.0	5313.7

Source: DBM

improve their financial sustainability and, at the same time enhance the quality of their staff, management and the services they provide.

1.31 Possible solutions to protect the viability of the SSS range from increasing the contribution rate and contribution period, to expansion of coverage to overseas Filipino workers and strengthening the financial management of the SSS, or even – in the future - a merger of the SSS and the GSIS. Chapter 3 outlines the key issues confronting these and other state-owned entities and, more broadly, the importance of recognizing and managing fiscal risks.

Recommendations

1.32 To reverse the steadily diminishing flexibility that threatens to undermine the country's growth and anti-poverty agenda, it is critical to *intensify efforts to reverse the decline in revenues to permit a reduction in the deficit as targeted, and to begin freeing up resources for adequate investments in human development, infrastructure and MOOE.*

1.33 Second, it would be desirable to *accelerate ongoing administrative initiatives to streamline the architecture of the central executive and ensure effective financing for the performance of core state functions such as those relating to the provision of pure public goods and anti-poverty programs.* The PCEG is now pursuing the following specific actions: (i) preparation and implementation of administrative measures to streamline the structures, functions and programs of all attached agencies, task forces and similar bodies in the national government, based on its ongoing review; (ii) implementation of a pilot exercise to resolve mismatches between priorities, functional assignments, structures, staff complement and composition in one department; and (iii) continuing the abolition of unnecessary, duplicative or obsolete central executive entities.

**It is time to
streamline the
architecture of the
national government
– without relying on
passage of
legislation.**

2. EXPENDITURES AND REVENUES: TRENDS AND ISSUES

2.1 This chapter briefly overviews some issues and trends in public expenditures before turning to a discussion of revenue trends and issues.

2.2 A revenue shortfall through the year was the source of the PhP212.7 billion national government deficit in 2002. Tax revenue also fell in real terms vis-à-vis 2001 collections. These developments, which threaten to undo the gains from the sound economic management in 2001, prompted the authorities to initiate expenditure control measures for 2002 and into 2003. Departments and agencies were asked to make spending cuts. Moreover, as in 2001, line departments were given the flexibility to determine where to cut and by how much in 2002.

2.3 Compared to other ASEAN countries, public expenditures as a percentage of GNP are low for the Philippines (Table 2.1). The Philippines has the lowest expenditure-to-GNP ratios among all four ASEAN countries.

Table 2.1 Public Revenues and Expenditures
Selected ASEAN Countries 1994-1999 (percent of GNP)

	1994	1995	1996	1997	1998	1999
Revenues						
Indonesia	18.7	18.2	17.4	18.7	17.6	19.8
Malaysia	29.2	25.6	25.8	24.4	21.2	21.0
Philippines	19.4	18.4	18.2	18.7	16.6	15.3
Thailand	18.6	18.9	19.3	18.9	16.9	16.5
Expenditures						
Indonesia	16.6	15.1	15.0	18.5	19.3	21.7
Malaysia	24.5	23.1	22.7	20.8	23.4	24.8
Philippines	18.4	17.9	17.9	18.6	18.3	18.8
Thailand	16.5	16.0	16.8	20.7	23.5	25.9

Source: IMF: *Government Finance Statistics 2001*.

Expenditures

2.4 NG expenditures are distributed by the following major components: economic services, social services, defense, general public services, net lending and debt-service-interest payments. Sectoral allocations have been greatly impacted by the fiscal constraints within which financing decisions have been made. The share for economic activities was more or less stable during 1990-2002, while the share of economic services in total expenditure declined from 24.2 percent in 1990 to 20.9 percent in 2002. Within this category, however, the share of agriculture, agrarian reform and natural resources declined from 7.3 percent in 1990 to 3.8 percent in 2002. The share of communications, roads and other transport has remained steady between 8.1 percent in 1990 and 7.4 percent in 2002.

2.5 Expenditures for social services in 1990 constituted 22.0 percent of total expenditures, increasing to 30.7 percent in 2001. The share of education showed a slight decline from 17.0 percent in 1990 to 16.8 percent in 2002.

2.6 Expenditure for social security in 2002 accounted for 4.4 percent of the total expenditures, compared to 0.9 percent in 1990. The budget for general

public services amounted to P121.1 billion. In 2002, financial subsidies to LGUs totaled PhP134.3 billion (the bulk of which represented Internal Revenue Allotments) while interest payments and related expenses amounted to PhP191.9 billion. The share of debt servicing increased to 24.9 percent of total expenditures in 2002.

2.7 Structure and composition of expenditures. The share of current expenditure to total expenditure has remained at around 87.7 percent during 1999-2002 period, of which 8.9 percent was MOOE (after loan and interest payments and transfers to LGUs and GOCCs). Capital expenditures have also remained at about 12.3 percent of total expenditures during this period. The structure of expenditures has evolved from a low surplus configuration in the mid-1990s to a low-investment-high-deficit configuration since the 1997-98 financial crisis. Post-crisis restoration efforts pushed down capital and MOOE spending, while interest payments rose due to increased relative reliance on domestic financing of budget deficits. Wage expenditures also increased gradually since 1990. Government revenues, however, did not rise at the same pace as expenditures since 1998, and recurrent expenditures rose faster due primarily to the continued rise in interest payments, with public savings shrinking from 0.3 percent in 1990 to a negative savings rate in 2001.

2.8 Current expenditures As a rough estimate, since 1996 current expenditures have increased to about 16-17 percent of GNP from below 15 percent in the first half of 1990s and become mandated because a great part (around 30 percent of total expenditures) has been for wage bills. Since 1996, mandated current expenditures have been crowding out discretionary expenditures: the latter, expressed as the difference between mandated expenditures and total revenues, fell from above 6 percent in the mid-1990s to only 0.9 percent in 2001.

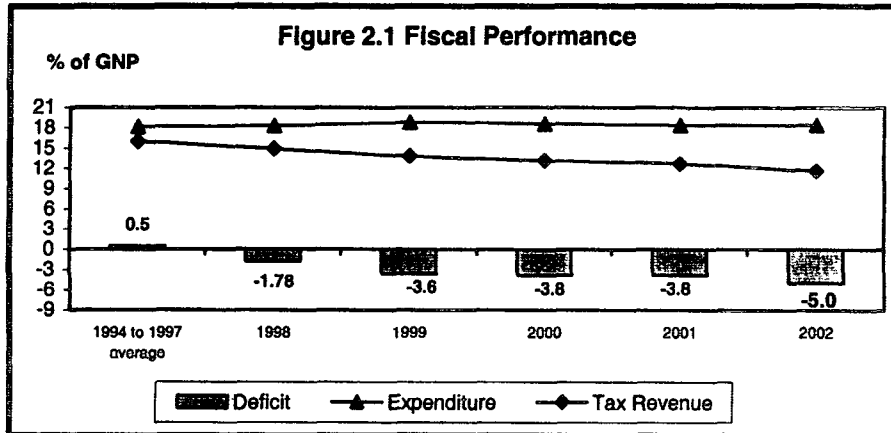
2.9 'Personal services' (i.e. wage bill and associated costs) and other mandated expenditures now account for a large part of the total expenditures for both the National Government and LGUs. In addition, especially for LGUs, expenditures on personal services tend to be understated, and overstated for those on MOOE and on development, since these latter two categories sometimes include wages of casual, contractual and other categories of non-permanent employees. The rise in personal services expenditures is not difficult to explain: the wage bill, which had been relatively low for a long time, rose to significantly higher levels with the implementation of the first round of the Salary Standardization Act through annual salary increases of civil servants. Furthermore, the 1991 Local Government Code mandated the NG to transfer annually an amount exceeding 10 percent of the total expenditures (2-3 percent of GNP) to LGUs since 1994, adding to the non-discretionary portion of NG expenditures.

2.10 In the effort to compress discretionary expenditures, operational and maintenance spending has been reduced in the 1990s. This used to be as high as 4 percent of GNP in the eighties. It fell to 2 percent in 2001, and declined further in 2002. These figures are likely to include an element of overestimation, since various sectors include other expenditure items within the MOOE category (such as wages for casual workers or administrative expenses unrelated to maintenance) and not the cost of physical maintenance itself.

***Fiscal flexibility
is being steadily
eroded as
revenues shrink
and mandated
expenditures
remain high***

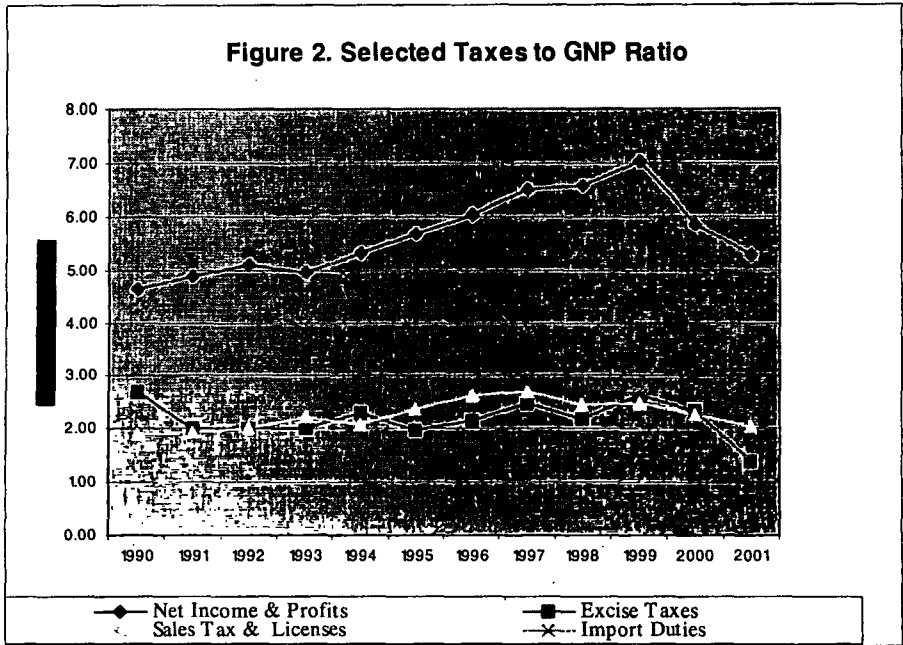
Revenues

2.11 Public revenues consist of revenues from taxes, tariffs, charges and proceeds from privatization. The national agencies chiefly responsible for revenue collection are the Bureau of Internal Revenue (BIR), the Bureau of Customs (BOC) and the Bureau of the Treasury (BTR). For several years, revenue and expenditure targets were missed by wide margins, and financing costs rose in line with the larger deficits (Figure 2.1).



Source: DBM

2.12 The outturn on the revenue side during 1990-2002 highlights the urgent need to improve the revenue performance of the NG. Although tax revenues declined gradually, they still accounted for 79.5 percent of total revenues in 2002. In 2002, taxes on net income, excise tax and value-added tax (VAT)¹⁰ accounted roughly for 46.0 percent, 12.0 percent and 12.1 percent of total tax revenues, respectively.



Source: Bureau of Treasury

2.13 The revenue performance of the NG has been weak: two-thirds of the contraction in revenue during 1990-2002 (or 2 percentage points of GNP) is due to reduction in tax revenues collected by the BIR, while the remainder (or 1 percentage point of GNP) is attributable to the fall in BOC revenues. The slippage in non-tax revenues is largely explained by the decrease in the income of the BTR following the decline in domestic interest rates.

2.14 The slide in tax revenues has been a major source of concern. Collections from import duties, excise taxes, income taxes and value added tax with licenses have exhibited the largest reductions. In particular, collection of import duties which were at 4.2 percent of GNP in 1990, had declined to 2.3 percent of GNP by 2001. Collections from excise taxes declined only slightly, from 2.7 percent to 2.3 percent of GNP, while revenues from taxes on income and profits increased from 4.6 percent to 5.2 percent of GNP. Collections from value added tax and licenses rose from 1.9 percent to 2.1 percent of GNP during the same period. In addition to the revenue shortfalls, tax evasion also continued due to under-declaration of incomes and a distorted tax base.

2.15 Consistent under-achievement of the tax collection target by the BIR seems to be the main problem on the revenue side. The picture is evident from Table 2.1 below¹¹.

Consistent under-achievement of the tax collection target by the BIR seems to be the main problem on the revenue side

Table 2.1 BIR Collections and Goals, 1991-2002 (Php million)

Year	Collection	Goal	Difference	
			Amount	Percentage
1991	116,256	117,760	(1,504)	-1.28%
1992	133,904	139,100	(5,196)	-3.74%
1993	145,927	143,337	2,590	1.81%
1994	187,444	185,486	1,958	1.06%
1995	210,195	222,060	(11,865)	-1.23%
1996	260,774	258,825	1,949	0.75%
1997	314,698	334,450	(19,752)	-5.91%
1998	337,177	355,064	(17,889)	-5.04%
1999	341,320	353,631	(12,311)	-3.48%
2000	360,802	397,764	(36,962)	-9.29%
2001	388,679	388,059	611	0.0016
2002	394,549	424,516	(29,967)	-7.06%

Source: BIR

2.16 An overview of BIR goals and collections during 1990-2002 reveals that before 1997, the BIR was more or less able to attain its collection targets, despite some small discrepancies and over-fulfillment. Table 2.1 indicates that 1997 was a turning point: collections deteriorated due to the recession and collapse of corporate profits caused by the 1997-98 Asian financial crisis. In 1997, while the programmed BIR revenue target was Php334.4 billion, the actual collection was Php314.7 billion: the shortfall was 5.9 percent of the target. In 2000, the shortfall grew to Php37 billion or 9.3 percent of the programmed revenues. When the BIR 'fulfilled' its collection target in 2001, this was achieved after a Php20 billion reduction of the collection target. The tax effort deteriorated from 16.3 percent of GNP in 1997 to 11.6 percent in 2002¹². The tax effort on average was 15.4 percent of GNP during 1990-1997, declining to 13.6 percent on average during 1998-2000.

2.17 An overview of excise taxes reveals that the problem here lies in the structure of the tax rather than in a deterioration of the revenue administration, except for 2000 when a 12 percent adjustment in the excise tax rates on alcoholic beverages and cigarettes was put into effect but did not result in a corresponding improvement in the effective tax rates. Revenues from excise taxes on tobacco, alcoholic beverages and petroleum products have all declined by some 10 percentage points when measured relative to nominal gross value added (GVA) in their products.

2.18 Withholding tax has gradually increased from 39.8 percent of the tax on net income and profits in 1990 to 55.8 percent in 2001 (Table 2.2). However, other income tax, mainly the corporate income tax revenues, dropped from 3.3 percent to 2.6 percent of GNP during the same period. Nevertheless, within the total withholding tax, individual withholding tax accounted for only 5.3 percent in 2001. This seems to indicate continued leakage in the individual income tax system and its inability or unwillingness to reach hard-to-tax groups such as professionals and the self-employed.

Table 2.2 Withholding Tax to Total Income Tax, 1990-2001 (percent)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Net Income and Profits	61.0	70.1	74.4	94.2	111.2	136.3	164.2	183.1	184.0	203.8	223.4
o/w Withholding tax	25.0	30.1	34.1	45.6	50.0	64.7	83.5	95.0	104.6	112.3	129.3
Individual Withholding	1.5	2.1	3.9	4.2	6.2	5.2	5.5	7.2	8.1	7.2	6.6
Withholding/Income %	41.0	43.0	45.8	48.4	45.0	47.4	50.9	51.9	56.8	55.1	57.9
Individual/total withholding %	6.0	7.0	11.4	9.2	12.4	8.0	6.6	7.6	7.7	6.4	5.1

Source: BIR

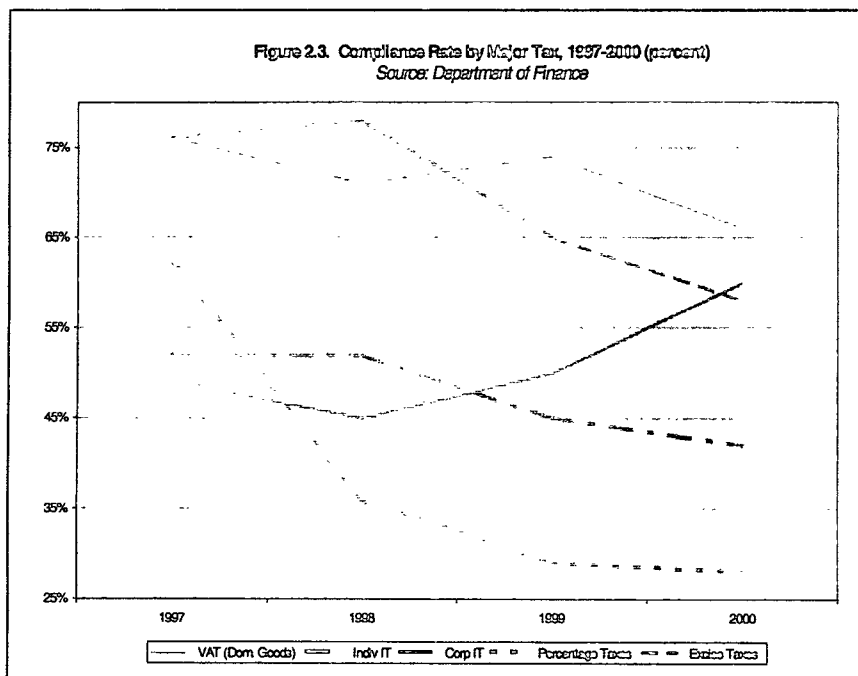
2.19 The Government's announcement of comprehensive reforms to the tax system (comprising improving tax collection, simplifying the tax structure, transforming the BIR, minimizing discretion of tax examiners, broadening the tax base and making the tax system more equitable) is being keenly watched as an indication of the administration's resolve to tackle difficult but critical institutional reform issues. The BIR is reviewing the options for simplifying tax administration to make tax collection easier and efficient. The current BIR leadership is also keen to address corruption through a reorganization of the BIR.

2.20 The significant constraints to BIR performance, however, seem to remain quite entrenched: (i) rent-seeking behavior of taxpayers and revenue examiners (contributing to revenue leakages); (ii) a complicated income tax system which creates discrepancies in tax collection and provides opportunities for evasion in tax assessments; and (iii) lack of modern tax management facilities and expertise.

2.21 A review of the BIR's performance during 2002 discloses that:

- a) Improvements in collections due to administrative measures started to kick off starting August 2002 with the changed management style of the new BIR Commissioner. Collections in August 2002 were 19.7 percent above year-ago levels and in September 2002 were 31.2 percent above. And for the first time since March 2002, cumulative collection for the year surpassed 2001 levels.
- b) However, the performance of the Large Taxpayer Service (LTS), which accounted for 52 percent of total BIR revenues, has fallen below expectations, as measured against the official target and 2002 collections.
- c) Low compliance rates continue to be the most pressing problem confronting the government's fiscal machinery, and DOF data show compliance rates dropping from 1997 for all major taxes, with the exception of the corporate income tax (Figure 2.3). However, several initiatives being introduced by the BIR including a more effective manual VAT audit system, a voluntary assessment and abatement program, new payment systems to minimize bank frauds, and electronic filing and payment systems could improve taxpayer compliance over time.
- d) The outlook for improving the tax effort (internal revenue collections as a percentage of GNP) in 2003, absent revenue-enhancing tax policy reform, still seems uncertain.

Progress on the comprehensive tax system reforms will be seen as an indication of the administration's resolve to tackle difficult but critical institutional reform issues.



- e) BIR has developed a program of short-term administrative measures to improve collections performance, yet its planning process was delayed such that new measures did not take effect until the third quarter of 2002. BIR has also had difficulties implementing its plans.
- f) Increasing the number of large taxpayers is proving difficult and slow. The entire LTS currently serves 1,133 taxpayers. With slow growth in both LTS staffing and the number of large taxpayers, it is uncertain whether BIR did in fact increase the total number of large taxpayers to 1,500 by the end of 2002. Moreover, given slow progress thus far and administrative difficulties, it might make more sense to focus scarce resources on improving services to existing large taxpayers, rather than widening the scope even more in the context of stagnant or deteriorating service (including audit) quality.

Recommendations

2.22 **Expenditures.** Specific recommendations on expenditures are provided in the following chapters of this volume.

2.23 **Revenue mobilization.** An appropriate blend of administrative and policy measures for raising the level of revenue collections should now be aggressively implemented. To increase the probability of substantially improving the tax effort, the government should seriously consider tax policy reform, including tightening up on tax incentives. The best option at this point is enacting the proposed reform of the excise tax on alcohol and tobacco products. DOF's initial estimation of revenue impact is an additional PhP10 billion over two years.

2.24 The main elements of the draft bill are: (a) indexation of tax brackets and tax rates to restore the real value of the unit taxes to their January 1997 levels, based on an accumulated inflation rate of 37.3 percent; (b) indexation of tax

An appropriate blend of administrative and policy measures to raise the level of revenue collections should now be aggressively implemented.

brackets and rates biannually after the initial indexation; (c) immediate reclassification of products based on their current retail price and biannually thereafter; and (d) introduction of a single structure of excise tax rates on distilled spirits regardless of the raw material used. The bill is intended to increase tax revenues, resolve WTO-related issues, and ensure a more equitable treatment for different product brands. The draft bill proposes phasing in the bracket and rate indexation so that the increase in tax rates occurs over an initial two-year period, with 50 percent of the increase effective in the first year of implementation.

2.25 It would also be desirable to take quick measures to **improve the effectiveness of the Large Taxpayers Service**. Presently the LTS, which consists of a central office and two regional offices, Makati and Cebu, has filled 775 out of 891 authorized positions, which represents a staffing ratio of 87 percent. The Cebu office became operational in March 2002, but still does not have a chief. There are plans to open a third office in Manila. A recent shake-up of top management in LTS led to the appointment of a new management team in February 2002. Further effort is needed to provide adequate staffing to the LTS, expand the coverage, and improve audit performance to increase compliance incentives. BIR's audit program for 2002 was released in May 2002, and its other audit initiatives are now being implemented. To achieve success it will be important for BIR management to: (a) clarify its audit priorities by focusing on the RELIEF (Reconciliation List for Enforcement) program and the issue-oriented audits; (b) prioritize selective audits (e.g. on VAT) over comprehensive ones; (c) increase the size of the proposed special audit team and require it to concentrate on large taxpayers; (d) require that the special audit team provide feedback to management on the LTS audit program, which should be subject to management approval.

2.26 BIR has established a program of short-term administrative measures for 2002 intended to increase discretionary revenue collection by PhP16 billion, but implementation thus far has been limited. BIR's RELIEF program is promising, but it is unclear how much revenue impact it will have. Given likely implementation constraints, and the late start in planning 2002 programs, it seems improbable that BIR will reach its target of additional collections through improved administration. At the same time BIR is making progress in planning for its transformation to a taxpayer-based revenue authority. However, the radical transformation envisioned by BIR's management would require the full political support of both the executive and the legislature, thus making its timing uncertain. To decrease the uncertainty associated with BIR's transformation program, the Government needs to make a decision on the course of medium term BIR reform. The sooner Government can decide this and provide its full support to a specific time bound reform program, the sooner it will begin to have an impact on revenues.

2.27 It is possible that the BIR leadership may gear up for special steps to facilitate collection and check corruption, such as formation of an internal audit unit to check audit methods of the examiners, coupled with prosecution of erring collectors. The manual VAT audit is being piloted in Valenzuela (Bulacan) and erring companies are to be closed. The piloting is to be extended to other MetroManila cities (Manila, Makati and Quezon City). It remains to be seen to what extent such actions will actually translate into an improvement in collections.

*Administrative
measures could
focus on
improving the
effectiveness of
the LTS.*

3. OFF-BUDGET RISKS AND THEIR MANAGEMENT

3.1 Public finance in the Philippines is replete with instances where taxpayers have bailed out, through re-capitalization and debt assumption, troubled corporations owned or sponsored by the government, or shouldered the cost of having to sell some of these corporations at a fraction of what government spent for them: notable examples in recent years include the Philippine National Bank, the old Central Bank, and the National Power Corporation. In many of these cases, the problems have built up over an extended period - and recur even after bailout. Because macro stability is dependent on the effective management of fiscal risks, of which contingent liabilities are a major element, effective management of contingent liabilities will be vital.

3.2 It will be especially important to establish clear criteria as to when contingent liabilities will be accumulated, and accrue them sparingly. In a well-managed program, the government debt office may be called on to assist in evaluating the government's cost and risks under contingent liabilities, and to recommend policies for managing these risks.

Fiscal Risks

3.3 Based on an inventory of contingent liabilities, the DOF is now estimating the quantitative dimension of contingent liabilities. However, some estimates of the contingent liabilities of the government run to about PhP3.1 trillion, representing maximum exposures under obligations such as (a) unfunded liabilities of public pension institutions (PhP1.8 trillion); (b) direct guarantees on loans to GOCCs and GFIs - estimated at PhP66 billion; (c) guarantees on risks under build-operate-transfer (BOT) contracts, estimated at PhP45 billion; and (d) deposit insurance (PhP352 billion).

3.4 Contingent liabilities in the Philippines may be described in terms of a fiscal risk matrix classifying sources of potential risks on government finance into four types: direct or contingent, each of which may be explicit or implicit (Table 3.1).

Table 3.1 The Philippines: A Fiscal Risk Matrix

Liabilities	Direct	Contingent
Explicit	<ul style="list-style-type: none"> o Sovereign debt (domestic and external) o Expenditures - non-discretionary and legally binding in the long term (civil service salaries and pensions) 	<ul style="list-style-type: none"> o Direct guarantees on GOCCs' obligations o Guarantees on currency risks of GFIs' foreign loans o Guarantees on various types of risks (including market, currency, regulatory, political) in BOT contracts o Umbrella guarantees for various types of loans (agriculture, micro-enterprise, housing) o Deposit insurance (P100k per account) o Guarantees on benefits (unfunded liabilities) of the social security system o Future health care financing o Tax credit certificates
Implicit	<ul style="list-style-type: none"> o Future recurrent costs of public investment projects 	<ul style="list-style-type: none"> o Bank failure (beyond state insurance) o Possible default of the Central Bank o Possible need to further re-capitalize

Macroeconomic stability is critically dependent on the effective management of off-budget risks.

		government banks <ul style="list-style-type: none"> • Cleanup of liabilities of privatized entities • Support to enterprises (covering losses and assuming non-guaranteed obligations)
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Managing Off-Budget Risks

3.5 **Philippine practices.** At present, the Government has only one tool to manage its contingent liabilities: the Foreign Borrowings Act sets a \$7.5 million ceiling on outstanding government guarantees of foreign loans of GOCCs. However, borrowings of certain GOCCs (e.g., LRTA, MWSS, NDC, NEA, NIA, PNO, and PNR) are explicitly exempted in their charters from being charged against this ceiling. These exemptions render this ceiling a less effective control mechanism, especially since corporations exempted are some of the largest GOCCs with large outstanding loan balances.

3.6 Beyond guaranteed GOCC loans, other types of government contingent liabilities are largely unmonitored. There are ongoing efforts in the DOF and BTR to monitor government guarantees for various types of risks under BOT contracts, but these are still in the initial stages. The Government also does not monitor the foreign risk exposures for loans secured by the Land Bank and the Development Bank of the Philippines from official creditors and on-lent to accredited private financial institutions in pesos. Likewise, the unfunded liabilities of the pension institutions (SSS, GSIS and AFPRSBS), also guaranteed by the government, are not monitored and managed. There is also currently no system for bringing together information on outstanding guarantees of government guarantee institutions that are explicitly or implicitly backed by the National Government.

3.7 **Overview of international experience.** A quick survey of the experiences of ten countries –Australia, Canada, Colombia, Czech Republic, Hungary, India, New Zealand, Sweden, the United Kingdom and the United States - with regard to the management of contingent liabilities discloses that while individual country practices differ in their dealing with contingent liabilities, all these countries share a common set of principles to capture contingent liabilities to the maximum extent possible, as they affect the government budget. The choice of countries was based on the advanced nature of the consideration of the problem of contingent liabilities and ready availability of such information.

3.8 In all the above countries, the consideration of contingent liabilities is an integral part of improving transparency in government operations in general and fiscal transparency in particular. Indeed it is tied to a process of ushering in more openness in government, so that citizens and outsiders (such as foreign investors, commercial banks, credit rating organizations and multilateral financial institutions) can more accurately assess the government's financial position. All frameworks tended to look at the issue as part of the Government fiscal framework, in line with the IMF Guidelines on Fiscal Transparency. In addition, these countries also publish information of the International Investment Position and report information on the new foreign exchange reserves template introduced by the IMF under the SDDS.

The consideration of contingent liabilities is an integral part of improving transparency in government operations in general and fiscal transparency in particular.

3.9 *Definition of contingent liabilities.* While all frameworks generally define contingent liabilities as costs borne by the Government if a particular event occurs, the precise scope and the detailed items reported vary across countries. Nevertheless, in most frameworks there are provisions to publish information in the form of quantifiable and non-quantifiable contingent liabilities. Some examples of quantifiable contingent liabilities are loan guarantees, non-loan guarantees, indemnities, warranties, promissory notes, callable share capital in international organizations and liabilities arising out of legal proceedings and disputes (though usually within maximum limits). Non-quantifiable liabilities include guaranteed benefits payable by national pension, provident and insurance schemes, environmental contingencies, exchange rate risks and in some cases (e.g. in the UK) liabilities relating to privatization. There is also an implicit reason for the non-disclosure or partial disclosure of contingent liabilities for tactical reasons such as “moral hazard” (arising out of say, bank failures) or litigation claims against the Government (e.g. litigation involving health matters).

3.10 *Legal and institutional framework.* Most Governments have in place legislation relating to powers to borrow, invest and enter into other financial obligations on behalf of its citizens, and the responsibility to report major contingent liabilities to the legislature through budget documents and other financial reports. The legal framework usually sets out the maximum amount of new borrowing and guarantees that the legislature or the Minister of Finance can approve over a specified period, usually the fiscal year. The authority to borrow and to issue guarantees is delegated to the Minister of Finance or the principal public debt manager under the Ministry of Finance or Treasury, and requires the Minister of Finance to be accountable for these decisions to the legislature. Text Box 3.1 provides an overview of the legal ceilings in selected countries on government debt and contingent liabilities.

3.11 In all regimes, the need to report on contingent liabilities is also underpinned by fiscal legislation and regulations. The most comprehensive example is the Federal Reform Act of the USA, whose key objective is to neutralize budgetary incentives, making policy makers indifferent as to whether they choose grants, direct loans or guarantees. The conditions for the recognition, measurement and disclosure of contingent liabilities are clearly spelt out.

3.12 The regimes generally delegate authority to the Minister of Finance on the design and issue of guarantee instruments and other implementation aspects. Some countries, however, such as Colombia and Sweden, are passing on this responsibility to the government debt manager. In the case of Sweden, the Swedish National Debt Office is the only government agency which can issue government guarantees. The Office has developed a model for pricing guarantees in which clients are charged a risk-based premium and all revenues and losses are met from a fund separate from the Budget. In Colombia, the General Directorate of Public Credit is currently developing a methodology for valuing contingent liabilities based on Monte Carlo simulations. It plans to use this model to evaluate the risks associated with a wide range of government guarantees, and to establish clear budgetary procedures for disclosure and provisioning.

3.13 *Accounting.* In four countries (India, Colombia, the Czech Republic and the United Kingdom), as in the Philippines, a conventional budget is prepared on the basis of cash accounting, i.e. transactions and events are recognized when

cash is received or paid. Financial results are measured in terms of inflows and outflows of cash and changes in the cash balance. The focus of such reporting is on budgetary compliance and maintaining liquidity solvency - two aspects of Government's finances that are of prime concern to the legislature and to the executive for current decision-making. However, cash accounting has a number of serious drawbacks:

- a) It fails to take account of future commitments, guarantees, or other contingent liabilities. A liability is not recognized until cash is paid to settle the debt. The most significant omission is the pension liability of the Government, which is handled on a pay-as-you-go basis.
- b) It fails to accurately represent the amount of resource usage. For instance, a large capital acquisition will distort expenditure upward in the first year but the usage of that asset will not be recognized in subsequent years.
- c) Recognition of cash payments alone sometimes results in an unnoticed deterioration in fixed assets.
- d) Perhaps the most significant deficiency in the system is the absence of a system of cost allocation. The focus of cash costs alone results in understatement of costs incurred by the Government departments in delivering goods and services.

3.14 In other countries (such as Australia, Canada, Colombia, Hungary, New Zealand, and the United States) there is a clear preference for using the accrual accounting framework, although the extent of implementation of this method varies from country to country. Accrual accounts also show cash transactions but also record contingent liabilities when they are created. By measuring changes in assets and liability structure, it also provides invaluable information on the financial position of the Government.

3.15 Such an accrual and consolidation model requires that (a) a financial flow be reported at the time when an economic value is created, transformed, exchanged, transferred or extinguished, whether or not cash is exchanged at the time; (b) all economic costs, cash or non-cash, be covered and matched with the revenue (measured in terms of economic benefits) of the period; (c) both short term and long term items be included in the financial statements; and (d) all sub-entities are aggregated for the entity.

3.16 It is generally accepted that cash-based accounting systems are not well-suited to record contingent liabilities, which are often treated as off-balance sheet items. The preferred method is the accrual-based accounting systems, which can capture contingent liabilities as they are created. Within such systems, contingent liabilities are recorded at face value and expected present value of contracts. The Governments of Canada and the United States have formulated standards for accounting contingent liabilities.

***Cash-based
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sheet items.***

Text Box 3.1 Legal Ceilings on Government Debt and Contingent Liabilities

Australia. The Charter of Budget Honesty Act 1998 provides for the clear enunciation of government fiscal objectives consistent with principles of sound fiscal management. It provides the general framework for fiscal transparency on an accrual accounting basis: contingent liabilities are defined as costs faced by the Government if a particular event occurs. Contingent liabilities include loan guarantees, non-loan guarantees, warranties, indemnities, uncalled for capital and letters of comfort. The Budget provides a Statement of Risks which, among other events that affect the fiscal outcome, specifically includes the realization of contingent liabilities. The first budget under the system was presented for 1999-2000.

Canada. The Public Accounts of Canada, as required under Section 64(1) of the Financial Administration Act, are tabled each year by the President of the Treasury Board. The Annual Financial Report contains the Condensed Financial Statements of Canada in addition to audited financial statements and finance operations. The basic purpose of these condensed financial statements is to provide an overview of the financial affairs of the government and the resources for which it is responsible under authority granted by Parliament. Responsibility for the integrity and objectivity of these statements rests with the government. Along with financial information, the statements also set out contingent or potential liabilities which include guarantees by the government; callable share capital in international organizations; claims and pending and threatened litigation; and environmental contingencies.

Colombia. Law 448 of 1998 deals with effective management of contingent liabilities. The Law indicates the measures to be adopted for the administration of contingent liabilities of state entities, as also other measures in respect of public debt. According to the Organic Budget Law, the nation, territorial entities and decentralized entities must include in their debt service budgets the necessary appropriations to cover possible losses due to contingent liabilities. The National Government specifies the methodology for the inclusion of these liabilities in the budgets and distinguishes between contingent liabilities acquired prior to coming into effect of Law 448 and those acquired later. Likewise, the Government regulates the events under which the mentioned funds must be transferred to a State Entities Contingent Fund established under the Law: this Fund is to be utilized to attend to the contingent liabilities of the state entities that the Government determines. The Government also determines the types of risks that can be covered by the Fund. The deposits made to the Fund can only be reimbursed to the depositing entities when there is a definite extinction of the related risks. The resources of the Fund comprise deposits made by the state entities, transfers from the national budget, financial returns of its resources and recovery of overdue assets. The General Directorate of Public Credit of the Ministry of Finance and Public Credit approves the valuations of the contingent liabilities done by the state entities that make deposits to the Fund. Likewise, this Directorate carries out periodic verifications of the evolution of the risks covered by the Fund and determines the increase or decrease of the deposits necessary.

Czech Republic. The general government includes the central government (including state financial assets and extra-budgetary funds) and the local and municipal governments. The fiscal operations of the central government are governed by the Law on Budgetary Rules and secondary legislation. In addition, there are specific laws governing individual extra-budgetary funds. The legal framework for Czech budgetary operations tends to rely more on principles of handling public funds, combined with detailed instructions and regulations, rather than on high-level codified procedures and strong administrative control. A new Law on Budgetary Rules, however, provides a more comprehensive fiscal framework emphasizing greater transparency and accountability, including improving monitoring and reporting of information on guarantees, tax arrears, equity holdings, and the use of appropriate methods of asset valuation. While the distinction between fiscal and private sector activity is generally clear, there are several areas where the distinction is blurred, which is understandable for a country in transition. There are several institutions that were established under the Commercial Code, which are neither a part of the government sector, nor respond completely to private market incentives. The obligations of these institutions are either explicitly or implicitly guaranteed by the government, but their operations, which are of a fiscal nature, are not completely captured in the fiscal accounts.

Source: Tarun Das (PEPFMR Background Paper)

3.17 None of the frameworks, though, actually sets out the valuation methods for estimating the contingent liabilities. The greatest reliance is placed on the exposure method, which lists the maximum exposure or the maximum potential amount that can be lost from contingent liabilities. Thus a guarantee covering the full amount of a loan outstanding would be recorded at the full nominal value of the underlying loan. Such lists are available in the UK, New Zealand and Australian regimes. The obvious limitation of the method is that there is no information on the likelihood of the contingency occurring, and further research is necessary to ascertain the valuation methodologies that underpin the calculation of the contingent liabilities.

3.18 *Recording, monitoring and management.* In most of the regimes surveyed, further work is required to ascertain at the country level how each contingent liability is identified, measured, recorded, monitored and managed. Moreover, it is essential to evaluate vulnerabilities relating to the financial sector or the external sector. For this, additional information has to be ascertained from sources outside the fiscal sector, for example the reporting of international reserves, Central Bank Balance Sheets and private sector potential external liabilities. In other words, the frameworks for contingent liability disclosures tend to focus only on potential government liability, and not on other sources of systemic risks which the public and private sectors have to bear in special unforeseen circumstances.

3.19 The conclusion is that in understanding the comprehensive range of contingent liabilities that the government faces, the fiscal frameworks governing them are only one of many sources of information for monitoring and management. Information emanating from the fiscal framework requires to be supplemented by a range of information and disclosure requirements for early and effective identification of external and financial sector vulnerability.

3.20 It also needs to be emphasized that there is no uniform system for reporting off-budget risks. Standards and benchmarks need to be developed taking into account the diversity in country circumstances. While codes for data disclosures in a range of activities are being developed by the IMF, it will be left to individual countries to establish their own practical frameworks for the identification, measurement, disclosure and management of the range of off-budget risks that confront the Government.

Recommendations

3.21 For a government seeking to manage risks for contingent liabilities the first step should be to determine its degree of risk aversion in the area of contingent liabilities and the extent of the balance sheet risk it wishes to be accountable for. It also needs to decide whether it wishes to manage its own balance sheet solely, or whether to be accountable for risks generated in other parts of the public sector or in the private sector. International experience suggests that more complete disclosure, better risk sharing arrangements, improved governance structures for state-owned entities and sound economic policies can lead to very substantial reductions in the government's exposure to contingent liabilities.

3.22 Specific tasks that could be completed in the near term can set the stage for strengthening institutional capacity to manage off-budget risks. Some of

***A first step to
strengthen the
management of
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managing fiscal
risks.***

these have already been initiated by the Government. The near-term tasks on which the Government intends to focus include:

- a) Completion of the quantification of contingent liabilities and conduct of a risk assessment based on the recently completed inventory of contingent liabilities, including those relating to GOCCs and review of the charter provisions - explicit or implicit - on NG guarantees. The DOF has completed a summary review of charters with technical assistance from USAID. Grant-based technical assistance has been requested to take this work forward.
- b) Creation of a full-fledged centralized risk management unit in the DOF, in coordination with the BTR, to manage contingent liabilities. This may entail significant capacity-building. The unit needs to have the necessary expertise for identification, measurement, monitoring and management of all implicit and explicit contingent liabilities. The unit can also advise the government on (i) designing appropriate guarantee instruments, (ii) reviewing and restructuring of existing guarantees for minimizing Government risks, (iii) formulation of policies and regulations for new commitments, and (iv) evaluation of risks and screening of future projects before recommending provision of government guarantees to them, thus putting an end to the practice of automatically guaranteeing various obligations of certain GOCCs.
- c) Initiation of special-purpose audits of critical GOCCs to support the planned disposition program, initiation of benchmark audits for pension and trust funds such as the AFP Retirement and Separation Benefits System (RSBS), the Housing Guarantee Corporation, the Philippines Health Insurance Corporation and the Home Development Mutual Fund (HDMF), and recommendations on accounting and disclosure practices. An administrative issuance transferring supervisory authority from the Office of the President to the DOF will be required for the latter to move quickly on this front.
- d) Dealing with contingent liabilities arising out of private sector participation (PSP). The purpose is to review the contractual obligations for BOT/PSP projects for estimating monetary obligations, suggesting inputs for possible unbundling of risks, specifying early warning systems for defaults, providing inputs for possible renegotiating of contracts, and strengthening the legal and regulatory framework for BOT/PSP projects. Although work has been initiated (risk estimation has been completed for 11 out of 80 contracts examined), continued technical assistance is required for the work to be completed expeditiously.
- e) Completion of a capacity-building needs assessment and development of a time-bound implementation plan. This should include training on accounting for, and treatment of, contingent liabilities.

3.23 Complementary actions on other fronts are also needed, such as effectively implementing the new power sector law. Moreover, given the significant unfunded liabilities of pension institutions, it would be desirable to address the immediate financial sustainability risks - or strengthen the performance - of the Social Security System (SSS), the Government Service Insurance System (GSIS), and the AFPRSBS. This will also provide time for

It would be desirable to create a centralized risk management unit in the DOF, in coordination with the BTR, to manage contingent liabilities.

designing comprehensive and longer-term institutional reforms and obtaining consensus for their implementation.

3.24 For the SSS, a core set of actions could comprise completion of an actuarial audit; narrowing the gap between pension fund contributions and benefits through finalization of an action plan for a phased increase in contributions from the present 8.4 per cent to 14 per cent, and initiating implementation of a phased increase in contribution rates; limiting the administrative expenses of the SSS to the statutory 12 percent and specification/publication of milestones to assess whether the program is on track; improving the liquidity, yield and safety of the SSS investment portfolio by enhancing the collection efficiency of SSS salary loans; assessment and publication of the fiscal impact of the commitment to enroll informal sector workers under the SSS and specification of steps to address the financial stress and contain the administrative costs of doing so; and the development of a strategy and implementation plan for organizational restructuring of the SSS.

3.25 In the case of the GSIS, which is under less immediate threat, the situation calls for actions to shield the Pension Plan from possible losses from the General Insurance Group, improve its investment portfolio performance and shield the portfolio from inappropriate or undue influence and manipulation. This could be accomplished through, for example, completely separating the books of the General Insurance Group from those of the Pension Plan; diversifying GSIS investments; engaging professional investment managers and permitting a portion of its portfolio to be invested abroad¹⁴; enhancing the collection efficiency on GSIS salary loans through mandatory deduction of past due amounts from pension payments; and resolution of the issue of past due contributions from the Government to GSIS¹⁵.

3.26 The AFPRSBS will need to specify and initiate implementation of a time-bound action plan to improve the liquidity, yield and safety of its investment portfolio, and articulation of options to attain viability.

3.27 A Personal Equity Retirement Account (PERA) has been proposed – its clear objective should be to ensure financial health of providers and protect the funds. This could be facilitated by avoiding promising a defined benefit, an effective supervisory body with an appropriate governance structure, clear regulations (e.g. on vesting periods, investments, management of accounts, information disclosure, etc.) and penalties for early withdrawals.

3.28 Medium-term actions to improve the management of off-budget risks in the Philippines could comprise:

- a) **Agreement between Government and Congress** to set limits to the accrual of contingent liabilities. Without such a political concord, establishment of technical criteria alone may not be sufficient.
- b) **Moving towards a cash and accrual basis of accounting.** It would be desirable to move towards the requirements under the Revised Government Finance Statistics system (GFS 2000) recommended by the IMF. For uniformity and comparability of annual balance sheets, Government is moving towards prescribing a set of accounting rules for various types of contingent liabilities – it would be appropriate to expedite this effort. Given the lack of common accounting standards for government non-bank

For the SSS, a core set of actions could comprise completion of an actuarial audit; narrowing the gap between pension fund contributions and benefits through a phased increase in contribution rates.

financial institutions, an essential step would be to have an accounting manual for these entities, prescribing acceptable practices for income recognition or interest accrual, and setting standards on provisioning and treatment of past due accounts.

- c) **Strengthening internal audit arrangements in GOCCs.** Strengthening the internal audit team to deal with management of contingent liabilities, and a broader role for resident auditors in reviewing the financial statement of GOCCs, would ensure that not only are transactions properly booked but that financial statements are reflective of the true state and well-being of GOCCs.
- d) **Provisioning for contingent liabilities.** In the long run, budgeting for contingent liabilities could ideally follow the U.S. example where direct and contingent liabilities are integrated in the budget based on their subsidy costs, i.e., for loans, the present value of amounts not repaid and the difference between the interest rate charged from borrowers and government's cost of funds; for guarantees, the present value of the difference between cash payments for defaults and cash received from fees and recoveries. The main advantage of adopting this approach is that government becomes indifferent as to choosing between a cash subsidy, a loan or a guarantee on loans.

SECTION B. ALLOCATIVE EFFICIENCY

4. Allocative Efficiency: Selected Issues
5. The Medium Term Expenditure Framework and The Budget Cycle
6. Budget Execution, Financial Management And External Oversight

4. ALLOCATIVE EFFICIENCY

4.1 Recent trends in national government sectoral allocations have been greatly affected by the fiscal context in which allocative decisions have been made. As mentioned earlier, the amount of total discretionary expenditures available for allocation has been steadily shrinking for the past several years (Figure 1). The difference between revenues and statutory expenditure obligations (i.e. wages, interest and LGU transfers) decreased from 6.3 percent of GNP in 1995 to 2.3 percent in 1999 and down to 0.9 percent in 2001.

4.2 The problem is multi-dimensional, involving declining revenues and rising interest payments and LGU transfers. Revenues steadily declined from 18.4 percent of GNP in 1995 to 14.6 percent in 2001, slumping to a low of 13.4 percent of GNP in 2002. Interest payments have risen as a percentage of national expenditures from 16.6 percent in 1997 to 24.7 percent in 2001. At the same time national government transfers to LGUs (the bulk of which is IRA), which stood at 15.1 percent of total expenditures in 1997, have grown to 18.0 percent in 2002. Thus, it is not the rise or fall of any individual item, but the combined effect of decreasing revenues and high levels of statutory obligations that is having a pincer-like impact on the government's expenditure program.

4.3 This chapter examines selected issues relating to allocative efficiency, especially from the standpoint of key sectoral priorities in the Government's own reform agenda as enunciated in the MTPDP, namely agriculture and agrarian reforms, education and health care.

Economic Composition of Spending

4.4 In very broad terms, current operating expenditures increased as a share of GNP while capital outlays declined over the period 1996-2001. Personal services increased rapidly from 1996 to 1998. Likewise, interest payments have been expanding yearly by 22 percent since 1997. MOOE on the other hand, has remained at 2.2 percent of GNP since 1996 compared to 2.8 percent from 1986 to 1991. At the same time capital expenditures have fallen considerably from 3.8 percent in 1997 to 2.7 percent in 2001.

4.5 The low share of expenditures to MOOE is worrisome. The problem is a result, to some extent, of the increased share of the current budget dedicated to interest payments. While reduced interest payments would give the government more room to maneuver, it would still seem that an additional reallocation from personal services to MOOE might improve the effectiveness and efficiency of government spending. The share allocated to capital expenditures in 2002 is likewise expected to decline versus that in 1996-1997. The ratio of capital expenditures to total national government expenditures is low while the ratio of wages and salaries to total national government expenditures is high, especially as compared with other lower middle income countries.¹⁶ Moreover, allocations to capital expenditures have been characterized by high degrees of annual variation in recent years. Improving the planning process and its links with the capital budgeting process might help to reduce year-on-year variations.

The economic composition of spending has deteriorated in recent years as both outlays for MOOE and capital have decreased as a share of GNP.

Agriculture and Agrarian Reform

4.6 Persistent problems in the Philippine agricultural sector have prevented it from achieving competitiveness and providing adequate income to small farmers. It has been argued that the key sectoral bottlenecks go beyond the production system, and that sectoral problems are rooted in inadequacies in the marketing system beyond the farm level. In this view, the major traditional impediments to sustained growth in the Philippine agricultural sector have been (a) inadequate rural infrastructure, including irrigation and post-harvest facilities, farm to market roads, and communications infrastructure; (b) lack of competition in the agricultural marketing system, marked by monopsony in many local markets for primary farm products; (c) lack of access to formal credit by small farmers; (d) lack of processing facilities and/or enterprises and (e) difficulty in providing reliable, high-volume supplies to export markets.

4.7 The major policy directions of Government to address these issues comprise: (i) raising total factor productivity; (ii) modernizing agriculture ("with equity"); (iii) investing in human capital and continuation of asset distribution reforms; and (iv) strengthening governance arrangements. Agriculture and agrarian policy reforms in the Philippines are anchored in four landmark legislations: (a) the Agriculture and Fisheries Modernization Act of 1997; (b) the Fisheries Code of 1998; (c) the Comprehensive Agrarian Reform Law of 1988; and (d) Republic Act 8532 which augments agrarian reform program funding.

4.8 **Agriculture.** The agricultural system has been traditionally heavily dominated by rice, corn, coconut and sugar. However, there now appears to be potential benefit in reorienting policy and resource support towards non-traditional, high-value crops, especially given trends in international agricultural trade. At the institutional level, this requires beefing up the ability of the Department of Agriculture (DA) to respond more effectively to the needs of the sector. A key constraint has been the department's low absorptive capacity for budgetary resources. According to some estimates, the DA is able to expend an average of about 70-80 percent of its resources from the General Appropriations Act (GAA) by December each year. The record for ODA funds is reportedly 60-70 percent on the average. There is typically a rush to spend the rest of the annually budgeted resources within the final month (to avoid budget reductions in the succeeding year), leading to inefficiencies and waste of resources.

4.9 There are, however, two issues beyond the influence of DA, of particular relevance to improving the competitiveness of Philippine agriculture: (a) inordinately high transport costs, especially relating to cabotage, and (b) high costs and limited access of the majority of the country's farmers to formal credit markets. Both these issues have been extensively studied and debated, but resolution has been elusive. They remain fundamental reasons for high transaction costs and weak competitiveness, especially for agricultural products. In the case of cabotage, vested interests and virtual monopoly powers of the Philippine Ports Authority make inter-island shipping and handling both excessively expensive and inefficient, especially for fresh produce. In the case of credit, past policies have contributed to many producers being in arrears. In addition, the majority of banks/financial institutions continue to be unwilling to lend to agriculture and agriculture related enterprises, due to perceptions of risks in agribusiness ventures and credit unworthiness of most producer groups.

4.10 Given the myriad institutional constraints, it remains to be seen if the recent positive performance of agriculture and fisheries can be sustained over time.

Currently, the Government is financing a wide range of goods and services to promote modernization. Crop productivity is expected to be the major source of sustained growth in the future. Strategically prioritized public expenditure of increased magnitudes – within an improved policy environment – could be the major determinants of stable and sustained agricultural growth. But this would depend on the DA's ability to transform itself into a catalyst of change, able to use budgetary resources more effectively, and partner with LGUs.

4.11 **Agrarian reform.** The key issue here is the continuing slow-down in the pace of land transfer, owing to a shift in coverage towards privately-owned lands. The total scope of the agrarian reform program is 8.06 million hectares of land for redistribution, responsibility for which is divided between DAR and DENR. Of this total, DAR is responsible for 4.29 million hectares (53 percent) and DENR for 3.77 million hectares (47 percent). The significance of agrarian reform to the national economy can be seen in two ways: (i) the DAR program coverage is more than one-third of the country's total arable land area of 10 million hectares; and (ii) initial results of the Comprehensive Agrarian Reform Program (CARP) Impact Assessment suggest that agrarian reform has led to higher real per capita income of program beneficiaries. Poverty incidence among Agrarian Reform Beneficiaries (ARBs) is lower than among non-ARBs. However, there has been a sustained deceleration in the pace of DAR's land redistribution in recent years relative to target: achievement diminished from 84 percent (July 1992-June 1998) to 77 percent (July 1998-2000), and lower still to 70 percent in 2000. Land redistribution has become more difficult in light of declining allocations for landowner compensation, coverage of contentious privately-owned lands, and operational problems (e.g. untitled properties and uncooperative landowners). At the current pace of land transfer, it could take another 12 years to complete redistribution of DAR's remaining balance, unless policy, institutional and implementation constraints are effectively tackled.

4.12 **Service delivery.** Between agriculture and agrarian reform, it is certain functions of the former that have been devolved to LGUs. With the enactment of the LGC in 1991, some 17,000 DA field personnel were devolved to LGUs, to whom substantial responsibility for agriculture and fisheries development had been officially transferred. Thus, delivery of agriculture services is now shared between the DA and the LGUs. The Philippine Agriculture and Fisheries Modernization Plan 2001-2004 and the Fisheries Code of 1998 outline the role of the DA, while the 1991 LGC defines the role of the LGUs. The DA has 38 operating units composed of 14 Regional Offices, four staff bureaus, eleven attached agencies and nine attached corporations. These are overseen by the Office of the Secretary (OSEC) – including the Policy, Planning, Research and Regulation Group, Operations Group, and Fisheries and Livestock Group – which serves as the hub for orchestrating the delivery of agriculture and fisheries services. The DAR organizational structure, unlike that of the DA, has not been affected by the devolution. Thus, DAR still has an office in each region plus offices in each of the provinces and municipalities throughout the country. Besides DA and DAR, other major entities active in the rural sector include the Department of Environment and Natural Resources (DENR), the Land Bank of the Philippines (LBP), the Department of Trade and Industry (DTI), the Department of Labor and Employment (DOLE), the Department of Public Works and Highways (DPWH), the Department of Interior and Local Government (DILG), the Local Government Academy (LGA), the Department of Education (DepEd), the National Commission on Indigenous Peoples (NCIP) and the Land Registration Authority (LRA). LGUs are responsible for delivering "front line" goods and services. Given this multitude of institutions, all actively seeking to spur the growth of the rural sector, the continuing challenge is how to operationalize

convergence between and among not only government agencies, but also government agencies, NGOs and the private sector.

4.13 In the delivery of agrarian reform services, national-local coordination remains relatively effective, because the DAR organizational structure is intact down to the municipal level. Agrarian reform planning, budgeting, programming, implementation and monitoring thus follow a relatively unified approach. The biggest challenge, however, is for LGUs to become more actively involved in agrarian reform: LGU case studies undertaken for the PEPFMR indicate that neither Negros Occidental nor Nueva Vizcaya province, for example, finances any agrarian reform activity from LGU sources. More broadly, the challenge is for greater “convergence” among DAR, DA, LGUs and NGOs.

4.14 Delivery of agriculture services seems to be more challenging. When DA field personnel were absorbed by LGUs, there was an expected “transition period” during which LGU capacities were to be built up, and service quality was temporarily expected to decline. More than a decade after devolution, however, LGUs feel that while personnel and responsibilities have been devolved, resources have not: the DA and DAR budgets (especially for support services) continue to grow faster than the LGU budgets for devolved services. Consequently, gaps in service delivery persist: (a) research and extension are de-linked; (b) farm-to-market roads and communal irrigation are deteriorating due to inadequate maintenance; (c) demonstration farms have not been established; (d) farmers’ organizations are not being as vigorously supported; (e) training for agricultural extension workers has steeply declined.

Education

4.15 The 1987 Constitution mandates the establishment and maintenance of a system of free public education in the elementary and secondary level, and also ordains that the state should assign the highest budgetary priority to education. The Philippine education system consists of a broad-based basic education sub-sector that is largely provided by the public sector. The government thus has been the dominant provider of basic education: the public sector accounts for over 92 percent of total enrollment at the elementary level. In contrast, the public sector has traditionally been a relatively small player at the tertiary level. However, the national government has become increasingly involved in direct provision of post-secondary vocational education and higher education through the continued creation of State Universities and Colleges (SUCs): SUCs’ share in total tertiary enrollment has increased from 10 percent in SY 1981-1982 to 26 percent in SY 1999-2000. Table 4.1 indicates the public-private mix of institutions and enrolments in the Philippines in School Year (SY) 1999-2000.

4.16 **Service delivery: utilization, access and satisfaction.** The distribution of public school enrollment becomes increasingly skewed in favor of the rich as the level of education rises. Thus, while 61.1 percent of public elementary school students come from poor families, this figure goes down to 49.1 percent in the case of public secondary schools and 28.6 percent in public tertiary institutions.¹⁷ Only 27.6 percent of SUC students come from poor households. Region wise, the proportion of poor students to the total number of public school students at the elementary and secondary levels ranges from a low of 32.6 percent and 21.3 percent, respectively, in NCR to a high of 74.5 percent and 67.7 percent, respectively, in Central Mindanao. In contrast, the percentage of poor students in public tertiary institutions varies from 9.6 percent in NCR to 60.5 percent in CAR. Meanwhile, there is a wide variation in the proportion of poor students to the total number of

students in SUCs, from a low of 9.6 percent in the National Capital Region (NCR) to a high of 58.1 percent in the Cordillera Administrative Region (CAR). The 2001 Filipino Report Card on Pro-Poor Services shows that households currently sending their children to public elementary schools expressed least satisfaction with facilities, textbooks and class size.

4.17 **Prioritization and management of education expenditures.** In the Philippines, education finance closely follows education provision: most public funding goes to public educational institutions while private financial contribution to such institutions is generally low. Public subsidies to private education are also low. A review of government spending in the education sector (1990-1996) showed a relative increase in public spending on higher education and a relative decrease in public financing of basic education. This pattern was clearly regressive, since children from poor households were less likely to remain in school than children from rich households. However, recent policy initiatives have resulted in a realignment of spending priorities such that the share of basic education in general government education expenditure increased from 78.4 percent in 1996 to 81.6 percent in 1999 before slipping to 80.8 percent in 2000. In contrast, the share of higher education fell from 16.0 percent in 1996 to 14.5 percent in 2000.

**Table 4.1 Philippines: Public-Private Mix of Institutions & Enrolments
SY1999-2000**

	Public	Private	% Private
(a) Institutions			
Basic education			
- Elementary	35,757	3,555	9.04
- Secondary	4,193	2,935	41.2
Technical/vocational education	302	1,466	82.9
Higher education	232	1,173	83.5
(b) Enrolments (thousands)			
Basic education			
- elementary	11,770	911	7.2
- secondary	3,920	1,247	24.1
Technical/vocational education	82	212	72.1
Higher education	663	1,872	73.8

a/ data refers to 1999-2000

Sources: DECS and CHED (Statistical Bulletins); TESDA (Installing a Quality Assured TESD System);

4.18 The share of general government spending on the entire education sector expanded from an average of 14.7 percent of the total budget (or 2.9 percent of GDP) in 1987-1991 to 20.3 percent (or 4.3 percent of GDP) in 1998. It has declined since then to 17.8 percent (or 3.6 percent of GDP) in 2001. Thus, it appears that government expenditure on the sector was adversely affected by the fiscal difficulties that followed the Asian financial crisis. Moreover, whether expressed as a ratio of total government expenditure or GDP, government spending on education is lower than that of its ASEAN neighbors, with the exception of Indonesia.

4.19 In the 2001 budget, each of the 109 SUCs received a separate budget line, amounting to a total of P15.3 billion, or 13.1 percent of central government expenditure for the entire education sector. For this large slice of the education budget the taxpayer receives a very mixed bag, ranging from a few high-quality institutions like the University of the Philippines and the Philippine Normal School

(the leading teacher training institute) to many poorly-performing SUCs. The latter are generally more costly to run than their private counterparts.

4.20 The fees charged by most SUCs are minimal (generally less than P2000 per year per student). Moreover, SUCs charge tuition fees that are on average 75 percent lower than those of private universities and colleges. These fees account for 5 percent of total SUC expenditures¹⁸. Consequently, cost recovery in public higher education institutions is considerably lower than in their private counterparts. However, SUCs have not taken advantage of the greater managerial autonomy granted under R.A. 8292 to improve their operational efficiency. For this to happen, the budget allocation that each SUC receives from the central government being determined on the basis of norms or average per student costs by level and type of program (Johanson 1999) even as they are allowed greater financial flexibility. Hence, MOOE funds are distributed among SUCs based on the following factors: weighted enrolled units, 30 percent; research and development, 30 percent; and quality of instructions, 40 percent. However, at present, the budget process essentially guarantees the salaries of all their staff as of a cut-off date. Given that 83 percent of SUCs' budget is for personal services expenditures, the application of normative financing rules to the SUCs' MOOE allocation alone will not be enough to address systemic inefficiencies. Other incentive schemes to encourage SUCs to institute cost recovery programs such as conditioning the opening of new degree programs or establishing branches on the use of internally generated funds will need to be developed and sustained.

4.21 Personal services is the single biggest item in the DEPED budget. Its share in the DEPED budget rose from 74 percent in 1990 to 91 percent in 2001. The dramatic rise in personnel expenditures is largely attributable to adjustments in the salaries of public school teachers that were implemented by the government in the late 1980s and most of the 1990s. By 1997, the entry-level salary of a public school teacher was 70 percent higher than its private school counterpart. Moreover, public school teacher salaries appear to be on the high side by international standards: teacher remuneration as a ratio of GNP per capita in the Philippines is equal to 3.0 in 1997 compared to an "Asian" mean of around 2.5 at the primary level¹⁹.

4.22 The growth in teacher salaries was accommodated at the expense of MOOE, i.e., non-personnel recurrent expenditures and capital outlays. Consequently, the share of MOOE in the DECS budget was halved from 16.4 percent in 1990 to 8.3 percent in 2001 while that of capital expenditures dropped from 9.2 percent to 1.1 percent. Concomitant with these developments, per student DepEd MOOE at 2000 prices declined on average by 5.1 percent a year in real terms from PhP878 in 1990 to PhP422 in 2000²⁰. This squeeze on MOOE has resulted in constrained supplies of key educational inputs like textbooks, teaching/instructional materials, science laboratory equipment and supplies, school desks as well as provisions for teacher training and the maintenance of school buildings.

4.23 Meanwhile, although the increase in the number of teachers in government schools did not keep pace with the growth of enrollment, the student-teacher ratio in public schools in 1999-2000 (36 at the elementary level and 34 at the secondary level) is still within the range of 35-40 that educators consider appropriate. But, the average class size during the same year was 45 and 50, respectively, in public elementary and secondary schools. These numbers suggest an imbalance in the deployment of public school teachers. One problem is related to the Magna Carta for public school teachers, which prohibits reassignment of teachers across geographical borders without the latter's explicit assent. Another relates to the current practice of assigning teachers to administrative/clerical functions (that should otherwise be

assigned to lower level positions) at the school and district offices. DEPED officials point out that this practice came about because of the difficulty in securing the approval of the DBM for non-teaching positions. Such a practice unnecessarily increases cost, as clerical salaries are 30 percent lower than teacher salaries in government. The government, mindful of this, has already been creating some 2,700 non-teaching positions for public schools since 1999.

4.24 However, households' dissatisfaction with class size in public schools is surprising given that personal services is the single biggest item in the DEPED budget, and given also that the share of personal services in the DEPED budget rose from 74 percent in 1990 to 91 percent in 2000.

4.25 A continuing challenge in the education sector – in common with other sectors - is how to strengthen the link between planning and budgeting, and especially between the MTPDP and the budget. This is important in view of its implications for the achievement of at least one of the Millennium Development Goals – achievement of universal primary education. Manasan (2002) has shown, for example, that the estimated recurrent cost of basic education that would be necessary to meet the program targets set in the MTPDP exceeds the actual budget allocated by PHP23-28 billion (or 0.5 percent of GNP) per year in 2002-2004. How to strengthen these linkages, and better assure financing for core poverty alleviation and human development goals, has been explored in more detail in Chapters 5 and 6.

Health Care

4.26 **Health outcomes.** Overall health status continued to improve through the 1990s. However, the poor remain vulnerable to health risks, the regions in Mindanao still have the highest Infant Mortality Rates in the country, and male infants and children have higher death rates than their female counterparts. Worryingly, TB and malaria have not yet been controlled in recent years.

4.27 Similar to other Southeast Asian countries, the Philippines exhibits patterns of morbidity and mortality that suggest an epidemiological transition during which the country faces a “dual burden of disease”, i.e. while infectious or communicable diseases remain the major causes of illness, chronic or non-communicable diseases have emerged as the leading causes of death.

4.28 Recent, complete and detailed information on health outcomes is not available. The Philippine Health Statistics are no longer regularly published²¹, and available local-level health information may not be reliable²². To address this, EO 25 has been issued and initial consultations have been completed between DOH and DILG for drafting the implementing regulations.

4.29 **Delivery of basic health services.** According to the 1998 National Demographic and Health Survey, the poor continue to have relatively lower access even to basic health services such as immunization, medical treatment of diarrhea and maternal/child care than other income groups. But the number of poor families enrolled under the PHIC Indigent Program has increased tremendously between 1998 and 2001; together they are reported to account for about 10 percent of the total number of poor families in 2001. Surveys show that Barangay Health Stations (BHSs) and Rural Health Units are considered inferior to other government hospitals or to private hospitals/clinics in terms of quality of health services: a high proportion of health facility users bypass BHSs despite the relative proximity of these facilities. Most of the patients in the BHSs are the poor. Moreover, the number of BHSs is increasing and these are mostly attended by low-skilled Barangay Health Workers.

The Philippines fares better than many countries in terms of immunization coverage, but Indonesia, Vietnam and Bangladesh have higher immunization coverage.

4.30 Health sector public expenditures. The private sector, though largely confined to the market for personal care services, dominates the country's health sector. In terms of contribution to total health expenditures, the public sector, however, provides both public health care services and personal care services. The two main players in the public sector are the Department of Health (DOH), which allocates the bulk of its expenditures on personal care services, and the local governments, whose collective resources are spent more on public care services. Although social health insurance has been growing in recent years, it remains a minor source of health care financing.

4.31 Total public sector health expenditures have been increasing since 1991. Nominally, per capita public sector health expenditures have increased by an average of 12 percent annually during the period 1991-99. In real terms, however, the average annual increase over the same period is 3.8 percent. The total expenditure on public health during the period 1995-98 was about 2 percent of GDP, at par with China, and higher than that of Bangladesh, Cambodia, Singapore, Thailand, Vietnam, Indonesia, India, or Malaysia.

4.32 In terms of level of care, the bulk of the DOH budget goes to tertiary care services, while that of the LGUs goes to primary and secondary care services. In terms of functions, the DOH allocates roughly the same budget shares to personal services (PS) and MOOE. In contrast, the bulk of LGU health expenditures goes to PS: resources are insufficient for drugs, medicines, supplies and facility improvements (see Text Box 4.1).

Text Box 4.1 Issues in Health Care Financing

Why does the bulk of the DOH budget go to tertiary care? Tertiary hospitals were retained by the DOH while primary and secondary hospital care were mostly devolved to LGUs. The DOH estimates that the funding needs for retained and renationalized hospitals will account for 72 percent of its 2003 budget allocation. This will come at the cost of adequately funding public health. A second reason is the propensity of Congress to legislate increases in existing hospitals' bed capacities (and thereby the budget) without adequately considering the demand side. In such cases, too, the DOH is compelled to accommodate the increases by under-funding other sub-sectors such as public health.

What is the role of LGUs in health care? LGU investments in health care are believed to be rising, and LGUs are said to be emerging as the main actors in health service provision. However, this masks the fact that 70-80 percent of LGU expenditures are on personal services, leaving very little for MOOE and investment. In this context, central funding for national health programs such as vaccines and TB drugs is said to provide work for LGU health staff who would be otherwise underemployed.

4.33 There is a positive but low correlation between the regional budgets of the DOH on the one hand and Infant Mortality Rate and poverty incidence on the other. While more resources are now channeled to poor regions as a whole, the distribution of health resources among poor regions is still inequitable. The major source of finance for local health services remains the IRA. User fees remain negligible to support even partial cost-recovery.

4.34 Prioritization and management of public expenditures. The Health Sector Reform Agenda (HSRA) is the main plank of DOH strategy. It is now partially implemented in selected "convergence sites". Though broadly consistent with the MTPDP and other government policy pronouncements (e.g. SONA), the HSRA differs from them in specifics²³. Since it is deemed best adopted as a bundle of

reforms, the HSRA does not yet fit easily into the prioritization process used for the SEER for ranking programs, activities and projects. The expected benefits from HSRA, either to the whole country or to the convergence sites, have not yet been estimated in comparison with costs, which are relatively detailed (although they too may benefit from more accurate estimation).^{4.36} Local-level health planning is largely procedural. In many cases, the local health board is convened to provide inputs to the local health plan. The local chief executive's role is decisive in determining health priorities, programs and projects.

4.35 Budget execution data reveal variations between budget allocations and actual disbursements in DOH projects, especially FAPs. There seem to be two reasons for this. The first reason pertains to DOH ability to secure counterpart funds to access ODA assistance. Moreover, reported logistical problems hamper the delivery of drugs, medicine, supplies, equipment and other assistance from the central office to the regional offices and other field health offices. The second reason pertains to the limited absorptive capacity of the recipient LGUs. ODA fund utilization is especially low when LGUs are required to co-finance the DOH-initiated local programs and projects. The problem becomes acute when the targets of assistance are the lower-income LGUs. Arguably, therefore, securing LGU finances for health will help improve the utilization rate of ODA funds.

Allocative Distortions

4.36 The increasingly tight budget situation makes it imperative that all expenditures are held to high standards of efficiency, effectiveness, accountability and transparency if growth and poverty reduction are to be promoted. The major concern is the allocation of scarce resources to special budget funds that are (i) not necessarily aligned with the government's policy priorities and (ii) not transparent in their use.

4.37 Congressional allocations and initiatives. Congressional initiatives are budgetary reallocations made by Congress providing additional allocations for programs or projects or new items in the budgets of some agencies and for creation of special purpose funds. The release of these funds is subject to presidential approval pursuant to Section 25(5), Article VI of the Constitution, and in accordance with the requirements of Section 35, Chapter 5, Book VI of E.O. No. 292. Allocation of funds through congressional initiative can be made as a lump sum item or as a specific project. Projects are each presented in the GAA, with information on the name, type and allocation for the project. Lump sum items, on the other hand, are incorporated in the DPWH budget, for example, under "Various Infrastructures Including Local Projects." This category shows the total amount of infrastructure project for several members of Congress in a specific area without naming specific projects intended for the area.

4.38 One of the most prominent Congressional allocations, the "Countrywide Development Fund", was adopted and appropriated in the annual budget from 1990 to 1998. It was included in the National Expenditure Program submitted by the President and deliberated and acted upon by Congress. In 1999, the CDF was replaced by Congress with budgetary items providing similar lump sum allocations for: a) Rural Urban Development Infrastructure Fund (RUDIF); b) Food Security Program Fund; and c) "Lingap Para sa Mahirap" Fund. In 2000, the name was changed to Priority Development Assistance Fund (PDAF), one of the lump sum items currently in the General Appropriations Act (GAA). Apart from the CDF and its successors, Congressional allocations are, as mentioned above, also routed through lump sum allocations in the budgets of DPWH and other departments. In

While the Philippines system provides for local interests to be incorporated in the budget through special projects of members of Congress, this also weakens the budget process by introducing allocative distortions.

2002 however, a significant breakthrough was accomplished by government when these Congressional Allocations (CA) were localized to the PDAF and DPWH lump-sum budgets, sparing other department budgets from its distorting impact. But regardless of whether the allocation comes from the PDAF or the DPWH Infrastructure Fund, the expenditure is identified by the members of Congress but implemented by a national government agency, an LGU, or by a GOCC.

4.39 During the nineties, the budgetary allocation for the CDF was PhP2.2 billion.²⁴ In 1999, when the CDF was divided into three components, the amount increased to PhP5 billion. In 2000, when the PDAF came along, the amount was brought down to PhP3.3 billion although the allocations incorporated in the other agency budgets were increased. The 2002 PDAF amounted to PhP5.6 billion.

4.40 Identification of projects is initiated by Congress which prepares a project menu and forwards it to DBM. Once the GAA provides the regular and lump-sum funds, the implementing guidelines are outlined. The DBM Secretary sits with both Houses of Congress and they agree on the menu of projects which can be funded from the allocation. All projects are then published in a newspaper of general circulation and later on the DBM website. The publication lists the names, amount and the purpose of the projects. Generally, PDAF appropriations have to be allocated to provincial projects for education, health, agriculture and livelihood: identification and prioritization of specific projects is made by and implemented in consultation with members of Congress; and release of funds is made directly to the appropriate government implementing agency or LGU. A schedule of releases is determined in consultation with Congress (e.g. for 2002, Congress and DBM agreed that 50% would be released in March, 25% in June–July, and 25% in October).

4.41 As the foregoing demonstrates, a significant issue affecting the credibility of the annual and forward budget estimates in the Philippines is the role of the congress vis-à-vis the executive in the budget process. Many countries restrict the legislature from increasing the aggregate budget, most also impose limitations on the types or amounts of reallocations that the legislature may propose. In the case of the Philippines, the Constitution prohibits Congress from increasing the national budget submitted by the President. However, in previous years, Congress resorted to what superficial cuts on projected debt service payments to shift resources to their priority projects. Moreover, the existing system provides a mechanism for local interests to be incorporated in the budget through special projects of members of Congress. This allocative distortion weakens the budget process. To minimize this distortion, the Committee on Appropriations, in consultation with the DBM, has imposed restrictions for the past two years on the categories of expenditure allowed for Congressional allocations, although the overall size of the CDF has increased. It has also stopped the practice of resorting to ad hoc cuts on debt service funds.

Text Box 4.2 Congressional Allocations and Initiatives

Opacity renders the estimation of Congressional allocations and initiatives in all their forms extremely difficult though rough estimates put the CDF and other related funds at PhP15 billion annually. Such a large amount of discretionary funds that do not pass through the normal budget process diminishes the credibility of Government's strategic allocation procedures and efforts to instill fiscal discipline. CDF issues may also be seen as part of a broader governance problem. Viewed through the project cycle lens, the main distortionary effects can be summarized thus:

Project formulation: It is debatable whether local level and community consultations are adequately or appropriately done: even where needs and priorities are laid out, local plans reportedly may not be considered in selecting CDF projects. As a result, legislators' interventions may lead to inappropriate selection of projects and interruption of funding for

previously identified projects. More importantly, CDF projects sustain the patronage mentality among LGUs who view CDF allocations as additional sources of funds for desired projects. This, however, subverts national government efforts to minimize the use of national funds for devolved activities and induce fiscal discipline in LGUs.

Project procurement. Pre-identification of products, suppliers and contractors by Congressmen preempts competitive government bidding processes. And notwithstanding detailed guidelines and adequate procurement capability of national agencies, waivers of existing policies are known to be obtained for suppliers/contractors pre-selected by legislators.

Project implementation. National government agencies are commonly used as implementing agencies for CDF projects. It is commonly agreed that their performance in implementing CDF projects can be improved considerably. Implementation weaknesses stem from: (a) lack of consultation with LGUs and stakeholders, (b) such projects often not being part of the implementing agency's core functions, (c) field personnel (DPWH in particular) becoming vulnerable to undue influence from Congressmen who have the influence to have them replaced. A common problem in managing CDF resources is the frequent realignment of funds ordered by legislators from previously identified projects. The DBM has issued guidelines to minimize such realignments and prevent wasteful use of resources.

Project audit. The role and impact of the Commission on Audit in respect of CDF projects is somewhat unclear since these funds do not fall under the regular audit procedures. Greater disclosure of COA audit findings on such projects can help throw light on the manner, processes and quality of project selection, implementation, supervision and impact.

Monitoring, transparency and public oversight. While efforts are being made to publish the list of CDF projects, the public is generally not aware of how CDF resources are spent on projects and whether such allocations have resulted in actual benefits. Misuse and waste of CDF resources is perceived to be so widespread that it becomes "everybody's problem and nobody's personal responsibility". The CDF's opacity has been attributed to government inability to provide information for public disclosure. Historically, though, the CDF has had such a negative connotation that there seems to be a tendency on the part of both the legislature and the executive to veil CDF issues from public scrutiny.

Despite the drawbacks outlined above, it is also true that Congress has yet to be drawn productively into ongoing efforts to improve planning and budgeting, and Congress' need to be actively engaged in public expenditure management and budget monitoring and evaluation has not yet been given adequate importance.

4.42 Adjustments are made to the proposed budget as it makes its way through Congress, which has the power to reallocate within the total amount recommended by the President, but not to increase the total amount. While reallocations from the President's proposed budget (NEP) to the congressionally-approved budget in the General Appropriations Act (GAA) typically do not generate large shifts in sectoral allocation, they can have significant impacts on particular departments and funds. In FY2000, for example, Congress reduced the gross NEP by PhP50.2 billion (PhP15.8 billion from departments, including Transportation and Communication, Education, Interior and Local Government, and other executive departments, and PhP34.4 billion from special purpose funds, including the allocation to local government units, the FAPs support fund, and Agriculture and Fisheries Modernization Act fund).²⁵ At the same time it increased the gross NEP by PhP28.2 billion, PhP10.2 billion of which was reallocated to DPWH and PhP17.2 billion of which was reallocated to special purpose funds (PhP13.2 for the Salary Adjustment Fund and PhP3.3 for the PDAF). In the AARNR sector appropriations declined from 7.4 percent to 7.1 percent of total budgetary allocations. In other priority sectors, namely health and education, however, the share of sector allocations increased slightly.

4.43 Three interesting patterns emerge from the Congressional reallocation data in FY2000 (further analyses would have to be done to determine whether these patterns holds over time). First, funds were reallocated to locally-funded projects

within departments (for example, DECS, DOH, DSWD and DPWH). DPWH saw a net increase of PhP10.2 billion in its budget, with a large increase in locally-funded projects (LFPs), which jumped by nearly PhP12 billion. Congress also created entirely new LFPs in the areas of infrastructure, local infrastructure projects, other national public works, and water supply projects. The concern is the effectiveness and efficiency of these expenditures, which were not vetted by DPWH as part of the budget process. Requiring an evaluation of all LFPs would help to ensure that all expenditures were subject to evaluation standards.

4.44 Second, in many departments Congress reduced funds available for FAPs.²⁶ In FY2000, the reductions were quite drastic in some cases. FAPs in DECS were cut by nearly 19 percent, in DA by 30 percent, in DOTC by 43 percent, in DOH by 66 percent, and in DILG by 84 percent, indicating an apparent lack of consensus in Congress about the utility of the FAP resource allocations approved by the executive through the NEDA ICC process. Congressional realignments may likely stem from political reasons disregarding in the process the ICC evaluation methodology, and the relevance of the FAPs to the MTPIP and MTPDP.

4.45 Third, in most departments Congress reduced allocations for general administration and support services (GAS), in some cases considerably (32 percent in DECS and DOF, 24 percent in DILG, and 20 percent in DPWH). Reductions in GAS were mainly due to reallocation of terminal and retirement benefits to fund the mandatory salary adjustment of government employees. In some instances, however, it is unclear whether congressional cuts are efficient in removing bureaucratic waste or inefficient in cutting back necessary administrative functions. This suggests that the effectiveness of GAS expenditures should figure prominently in the next round of the Sector Effectiveness and Efficiency Reviews²⁷. It also suggests that there may be a counterproductive dynamic, in which departments, anticipating that Congress will reduce their GAS appropriations, inflate them in their budget proposals.

4.46 In sum, to the extent that Congress and the executive do not share the same priorities or preferences for certain types of spending in the annual budget process, not to mention the forward estimates developed in the MTEF, the program of annual and multi-year budgeting becomes less effective, and line agencies become less convinced of the credibility of budget figures. DBM has broached the idea of seeking a "Budget Accord" with Congress. The Budget Accord could be fleshed out by focusing on the areas of apparent disagreement identified in this analysis.

4.47 The prevalence of special congressional initiatives in the national budget process also raises the issue of budget comprehensiveness, as expenditures from such funds are frequently "off-budget" in the sense that they are not evaluated during the budget formulation stage. Individual senators and congresspersons are also entitled to a variety of additional funds for development purposes, other congressional initiatives, and compensation allowances. These congressional funds in effect represent a significant amount of "off-budget" resource allocation not subject to the prioritization, and transparency requirements imposed on other expenditures during the budget preparation process.

Recommendations

4.48 **Agriculture and agrarian reform.** It would be desirable to support and intensify Government strategies and plans to sustain agricultural growth and increase crop productivity as laid out in the MTPDP (2001-2004). The Plan highlights the need to focus public investments on public goods and services that would support the (i) attainment of sustained food security including self-sufficiency on rice and white corn, (ii) small holder productivity and competitiveness, and (iii) diversification of

farming systems, rural livelihood and employment toward high value added production. The Plan also highlights the need to expand and further enhance existing resource counterpart schemes among national government agencies, LGUs and rural communities in program and project planning, implementation and monitoring in order to extend and multiply limited budgetary resources, which may address the concern on the lack of LGU resources for agriculture development.

4.49 The Government is of the view that such areas targeted for allocation of more resources are best pursued under an institutional setting of greater private sector participation, enhanced NG-LGU collaboration and amidst operational convergence approaches among stakeholders, consistent with the Sector Efficiency and Effectiveness Review (SEER).

4.50 In the case of *agriculture*, given resource constraints, public expenditure will need to be more narrowly-focused more on “growth-enhancing public goods and services” for which less than 40 percent of budgetary appropriations has been allocated²⁸. Conversely, non-growth-enhancing expenditure such as rice price stabilization, which accounted for 20 percent of allocations, should be phased out. The Government has expressed determination in resolving issues related to the removal of the National Food Authority’s monopoly to import rice, and to allow farmers’ organizations to undertake direct importation²⁹. Major sources of growth in crop production are envisaged to require sustained public expenditure on improved and strategically-located irrigation and farm-to-market roads, increased farmer access and adoption of improved seed varieties, and limited area expansion.

4.51 For strengthening *agrarian reform*, key recommendations could comprise (i) exploring the financing of land acquisition more through alternative sources³⁰, in view of the sheer magnitude of resources required; (ii) greater use of market-oriented and community-driven modalities of land transfer, as is being pilot-tested under the World Bank-financed Agrarian Reform Communities Development Project Phase II (dependent, of course, on such modalities being proven to be effective and efficient); and (iii) pursuit of a “parallel approach” that balances public expenditure on land acquisition and distribution with provision of support services to previously redistributed landholdings – this being pursued through a convergence approach among rural development agencies and stakeholders.

4.52 The authorities are keen to further *strengthen the resource utilization and budget process*, which has improved in recent years. Two key recommendations could comprise: (a) moving towards a functional allocation of resources, from the existing commodity-based structure still in vogue in the DA, and (b) moving to greater convergence of resources and eliminating duplication of functions³¹. Short term actions – on which work is ongoing - comprise strengthening the linkage between planning and budgeting within each agency, and further simplification of the reporting system. Medium-term actions could comprise the gradual decentralizing of budget controls to regional and LGU levels consonant with strengthening capacity and accountability, finding ways to make levels of LGU financing proportionate to devolved responsibilities, increasing the regularity of the budget calendar and budget process, and strengthening the capacity of budget and accounting offices of line agencies. In the longer term, perhaps sector representation could be invited in the sector budget ceiling-setting process.

4.53 For *prioritization of programs, activities and projects* (PAPs), key recommendations comprise: (i) in the short term, pursuit of a “plan-driven” approach to budgeting with stronger output-outcome linkages, and a systematic review of the key reasons for reversion of funds at year-end; (ii) in the medium term, strengthening strategic planning capacity in agencies and LGUs, development and use of

quantitative methodologies for prioritizing agency and LGU PAPs, development and piloting of sector-level, agency and LGU performance monitoring and assessment methodologies; and (iii) in the longer term, adjustment of sector allocations based on sector performance assessment results, adjustment of inter-agency and LGU allocations based on performance assessment results, and developing Congressional capacity for more effective oversight of the planning and budgeting process.

4.54 Regarding the *levels of expenditure in agriculture and agrarian reform*, key actions could comprise: (i) in the short term, a more detailed review of apparent agency and LGU under-spending on agriculture and agrarian reform based on AFMA, AFMP and other objective criteria, exploring alternative methods of financing and implementing new land acquisition; (ii) in the medium term, a review of agriculture sector allocations based on AFMA levels, building LGU capacity to access alternative financing schemes (e.g. BOT) for agriculture and agrarian reform PAPs (because LGUs' IRA dependency in the agriculture sector may now be as high as 90 percent); and (iii) in the longer term, employment of alternative financing schemes and modalities for new land acquisition, and design and implementation of alternative LGU financing schemes.

4.55 The *composition of expenditures* could be improved by the following actions: (i) in the short term, the GOP could begin to phase out from private and non-growth-enhancing goods and services including price stabilization (which benefits only 3 percent of rice farmers) and production inputs (e.g. seeds), continue to study and implement recommendations on more efficient achievement of price stabilization and subsidy objectives, and move LGUs towards financing major gaps in devolved responsibilities (especially communal irrigation, research and extension and strengthening of farmers' institutions), and channel more resources more efficiently for agriculture development in Mindanao, considering its untapped potential; (ii) in the medium term, a sharpened focus on growth-enhancing public goods (e.g. irrigation, roads, research), a clearer division of labor and complementarity between and among national government agencies, between them and LGUs, and between and among levels of LGUs, and continued improvement of the policy environment for private investment (e.g. removal of rural credit policy bottlenecks); in the longer term, it would be desirable for the GOP to phase out from private and non-growth-enhancing goods and services.

4.56 Actions would also be needed to strengthen *impact on outcomes and service delivery*: (i) in the short term, desirable actions could comprise strengthening the SEER process, strengthen capacity at the LGU level (e.g. for agriculture sector planning, budgeting and extension), initiate the conduct of independent impact and outcome assessments as one of the bases for resource allocation, and pursuing the development of civil society performance rating systems; (ii) in the medium term, pursuit of effective cost-sharing mechanisms for expenditures on infrastructure, research, development and extension and production inputs, pursuit of convergence PAPs across DA, DAR, LGUs and the private sector especially in agrarian reform communities, and conduct of independent impact and outcome assessments at sector, agency and LGU levels; (iii) in the longer term, it may be necessary to 'mainstream' key issues regarding implementation of externally financed projects (e.g. project staffing, financial management and lessons learned)³².

4.57 The proposed World Bank-financed Diversified Farm Income and Market Development Project seeks to help reorient the current production-oriented approach of public sector support for the agriculture sector, to one focusing on promoting market development and private investment in the sector.

4.58 **Education.** The intra-sectoral restructuring of the education budget in favor of basic education evident from 1996 to 2001 requires to be at least sustained if not intensified. However, the scope for doing so will be increasingly limited without wide-ranging reform of higher education. Such reforms are contained in the policy component of the proposed Education Sector Development Program (ESDP) of the Commission on Higher Education (CHED).

4.59 The extent to which education sector expenditures can be rationalized and prioritized depends on how effectively the government can deal with the issue of SUCs. The proliferation of SUCs (as of October 2002 there were 111 SUCs) and their branches has led to a high burden on the education budget, and diverted scarce resources away from more productive uses³³. Hence Government proposals to rationalize budget allocations to SUCs are entirely appropriate and deserve support³⁴. The Higher Education Modernization Act of 1997 (RA 8292) has provided significant operational flexibility to SUCs by waiving the requirement that SUCs deposit proceeds from fees to the Treasury, provided the Board of Regents of the SUC allows this for operational uses. In addition, increasing SUC tuition fees would not only reduce their continued dependence on the national government budget but would also induce discipline in their operations. However, it is desirable that increased cost recovery be implemented hand in hand with a higher budget for a targeted scholarship program in higher education if equity and efficiency goals are to be addressed simultaneously. The issue of increasing the number of scholarships and the budget implications should also be seen in relation to increasing tuition fees and the need to increase the budget for basic education. The recommendations from the ADB's analytical work on higher education reform are currently under discussion with the government.

4.60 It would be desirable for TESDA to devolve the operation of the technical and vocational education and training (TVET) centers to LGUs/private sector in line with the SEER principles. TESDA has been requested to firm up a medium-term 'phase-out plan' to progressively its direct involvement in local training centers by the end of 2004. This would transform the TESDA into an effective oversight agency, focusing on planning, resource allocation, standard-setting and coordination of the Middle Level Skills Development (MLSD) sector.

4.61 It is desirable that monies allocated to basic education be used more efficiently. Given resource constraints, increased allocation for MOOE would require some relative reallocation away from personal services, for which there appears to be considerable scope. And improvements in facilities and textbooks cannot be achieved without increasing budget allocation for MOOE. At the school level, improving class size could be addressed by improving the deployment of teachers: current initiatives under the World Bank-financed SEMP and SEMP II projects should be sustained and accelerated. The issue of raising teachers' salaries and the potential impact on the wage bill should also take into account the rapid growth of population. Lastly, the procurement reforms initiated in the education sector (e.g. textbook procurement) should be sustained so that goods and services can be obtained in an efficient and timely manner and greater savings realized³⁵.

4.62 **Health care.** It would be desirable to continue the reforms being designed and implemented by the DOH and the DBM, key among which include: (i) strengthening the health statistics system; (ii) strengthening the allocation process for DOH regional budgets so as to better match IMR and poverty incidence; (iii) improving the design and implementation of DOH transfers to LGUs within the context of a wider effort to improve the overall system of intergovernmental fiscal transfers in the Philippines; (iv) formulation and execution of a more detailed

implementation plan for the HSRA to increase its effectiveness, in particular, a cost-benefit analysis of the HSRA even as it is implemented in the convergence sites. Such an analysis could provide pointers for sequencing reforms, prioritizing technical assistance to LGUs and identifying possible remedial measures; (v) a comprehensive health care plan for non-convergence sites to help improve the quality of health services at the barangay level, where most of the poor avail of health care facilities; (vi) completion of an actuarial study to ensure financial sustainability of the PHIC as it aggressively expands indigent coverage, to make clearer the fiscal and other implications of the current policy of aggressively enrolling those with high health risks (the poor); such an assessment would also be relevant for HSRA implementation, which aims to expand indigent coverage.

4.63 Other actions are also desirable to address DOH and DBM concerns. In the short term: (i) the IRRs for EO 25 require to be promulgated and regular publication of the Philippine Health Statistics resumed in order to strengthen the health statistics system; (ii) more detailed internal performance indicators would require to be developed and adopted to improve performance measurement and monitoring³⁶. Medium term actions could include the development of sentinel sites to monitor health outbreaks, reviewing continued DOH jurisdiction over supposedly devolved functions to avoid overlap in DOH and LGU roles in health care delivery, strengthening the SEER process in the health sector³⁷, phased adoption of new and more effective drug procurement systems, and enhancement of LGU capacity for health care planning, budgeting and service delivery. Finally, in the context of primary health care services, the shift toward the provision of local health services, which are not as efficient, requires careful examination, as does the demand side of health care services, especially the provision of more private health care services. The DOH would also like to put in place a mechanism for monitoring utilization of national and local government health budgets, given the continuing practice of realignment of budget allocations to other ‘priorities’.

4.64 **Allocative distortions.** The government has made some progress recently with limiting the scope of distortion, but more could be done to hold “development fund” expenditures to higher standards, e.g. by issue of more stringent guidelines for such expenditures. For example, a standard cost-effectiveness or cost-benefit evaluation could be required for all Congressional initiatives.

4.65 Specific recommendations to address CDF issues include:

- a) *Enhancing the transparency of CDF expenditures* through wider public disclosure of funds allocated for CDFs, transparent reflection of CDF allocations in the GAA as a budgetary item, regular publication of information on DBM fund releases for ongoing projects, generating supporting financial information for project monitoring by beneficiaries/communities;
- b) *Minimizing individual discretion* by promulgating guidelines/criteria for prioritizing projects in accordance with a sectoral plan, and strengthening the Regional Development Council and its sectoral committees to match projects with actual community needs;
- c) *Improving the effectiveness of CDF expenditures* by making the DBCC responsible for programming sustainable CDF allocations; standardizing consultation processes between Congressmen, implementing agencies, LGUs and beneficiary communities (barangays) at the project identification phase; and subjecting CDF policy and guidelines to periodic reviews to inform policy makers of their impact on project effectiveness and costs; and

- d) *Strengthening public oversight* through, for example, beneficiary or participatory monitoring³⁸, establishing a national-level NGO to monitor CDF projects and programs (e.g. a “CDF Watch” as propounded by Congressman Villarama), and mounting public advocacy for tightening processes for Congressional initiatives.

5. THE MEDIUM TERM EXPENDITURE FRAMEWORK AND THE BUDGET CYCLE

5.1 The National Government's Public Expenditure Management Improvement Program (PEMIP) has set out a multi-year program of reform that has the potential to impact all significant aspects of public expenditure management in the Philippines. The centerpiece of the PEMIP is the utilization of a medium term expenditure framework (MTEF), which addresses macro-fiscal planning as well as key sectoral expenditure issues. At this early stage, the policy framework for reforms, and the basic building blocks, have been put in place. These include the elements of an MTEF, a performance evaluation framework, and mechanisms to improve the link between planning and budgeting. Such reforms require considerable time, commitment and coordination to yield the benefits of greater fiscal discipline, improved strategic allocation of resources and gains in operational efficiency. The challenges now are to maintain the momentum of reforms, to coordinate and manage the process, to prioritize key actions, and to continue to refine the institutional framework.

Policies, Plans, and Budgets: The Political Dimension

5.2 The technical aspects of the policy making, planning, and budgeting processes make sense only in relation to the political processes that underpin them. In the Philippines the key political actors who determine the outcomes of these processes, and are ultimately responsible for linking them, are the President, the cabinet, and the Congress. Within the executive branch the DBM is principally responsible for formulating and implementing the budget while the National Economic and Development Authority (NEDA) Board, acting through its Secretariat, is responsible for formulating and coordinating "social and economic policies, plans, and programs." It is the Congress, however, in which appropriation and revenue bills must originate. The way in which the President, in conjunction with DBM and NEDA, and the Congress interact determines how, and how effectively, policies and plans are translated into budgets.

5.3 Within the executive branch most of the key political decisions about budget formulation, which must be approved by the President, are made by the Development Budget Coordinating Committee (DBCC). The DBCC³⁹ is responsible for recommending to the President the annual aggregate level of expenditure as well as key sectoral ceilings and the allocation of expenditures between current and capital outlays.⁴⁰ Four concerns, which are treated in this chapter and the next, arise about the political and bureaucratic processes by which plans and budgets are put together in the executive branch.

5.4 First, the DBCC has no formal role, as yet, in the government's medium term expenditure program, as the DBCC is only required to make a recommendation to the President on the annual budget. The forward year estimates of the medium term expenditure framework (MTEF) are presented as part of the annual budget call, but unless they are given greater importance by means of cabinet endorsement, it is unclear whether they will be regarded as credible by key political actors.

5.5 Second, the National Government's policy-making process could be strengthened somewhat in comparison to the more technical planning process

Better medium-term expenditure planning and budgeting could make overall budget management and expenditure allocation more responsive to national priorities.

coordinated by the NEDA Secretariat. The policy making process largely centers around the President's State of the Nation Address (SONA), which is a general statement of policy directions, priorities and goals. A more active policy making process, managed by the cabinet, would help strengthen the planning process and make it more relevant to political realities.

5.6 Third, clarifying the responsibilities between NEDA and DBM over budget formulation as well as budget evaluation would make the budget process less complex and more transparent. For example, in some cases the complexity of the processes has led to the use of informal channels to make or convey departmental allocation decisions. In addition greater clarity about the division of labor between NEDA and DBM over the Sector Effectiveness and Efficiency Reviews (SEER) and the Organizational Performance Indicator Framework (OPIF) is necessary to avoid confusion at the line department level. DBM and NEDA have begun to address these concerns (three harmonization workshops were held in 2002), but further progress is needed.

5.7 An additional concern arises about the working relationship between the executive and the legislature during the annual budget process. At times the relationship has been conflictual, as would be expected in a democracy. The question is how to manage the policy and political differences that exist. Three key issues emerge. The first is the extent to which Congress revises the President's budget according to its own priorities, possibly shifting resources from the President's priorities. The second issue is the extent to which Congress and the executive tussle over budget prioritization issues via the budget execution process. The third issue, which is relevant from a longer term perspective, is the extent to which the MTEF's forward year estimates are credible without congressional endorsement.

5.8 These political and bureaucratic realities undergird the technical aspects of the Philippines budget formulation and execution process. The extent to which reform recommendations are successful will depend on whether they take into account these political realities, yet, at the same time, certain reform measures will necessarily address these realities directly. This chapter and the next analyze the technical aspects of the public expenditure management process, addressing and building on the political issues outlined above.

Planning: Processes and Instruments

A. Medium Term Planning and Budgeting: Issues and Actions Taken

5.9 The key document in the planning process is the MTPDP, a six-year plan that coincides with the presidential term and is updated and revised in the third year of the President's term. The starting point for the MTPDP is the President's SONA, which is a broad statement of policy directions, priorities, and goals.

5.10 In recent years the MTPDP has proven to be an impressive document that details key issues and policies in each sector as well as for the government as a whole. The challenge is now to improve the link between the MTPDP and the budget process, and subject the MTPDP to the resource-constraining function of the budget.

5.11 The link between the MTPDP and the budget, including the MTPIP, is known to still require strengthening, and toward the end of the presidential term,

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(a) sectoral and
national planning, (b)
national and regional
planning, and (c) the
MTPDP with the
MTPIP development
process would
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with the budget.*

when the MTPDP has less relevance, there tends to be less linkage between the MTPDP and the budget. The major concern about the MTPDP is that it is not resource-constrained, though the Government is moving toward developing forward budget ceilings that will be used to constrain the MTPDP in line with available resources. Another shortcoming is that the MTPDP does not provide cost estimates for proposed strategies, targets, or programs. Manasan (2002) has shown, for example, that the estimated recurrent cost of basic education that would be necessary to meet the program targets set in the MTPDP exceeds the actual budget allocated about 0.5 percent of GNP per year in 2002-2004. The MTPDP could draw on some cost estimates provided in sector plans, as in the case of health, which provided a cost estimate for its medium term plan (though it identified a funding gap of PhP36 billion). The MTPDP could also usefully indicate the indicative breakdown of funding by source: national budget, LGU resources, private sector participation, and funds from cost-recovery policies. Nor are strategies and targets prioritized in terms of available resources. Moreover, the MTPDP contains only a very limited discussion of medium term expenditures in terms of the sectoral allocation of resources.

5.12 The MTPDP would be strengthened by a more substantive discussion of the planned composition of expenditures over the medium term and clear linkages between the medium term estimates and the strategies and targets presented in the sector chapters. The usefulness of the MTPDP would be greatly enhanced by the inclusion of an additional chapter devoted to a presentation of the medium term expenditure framework, which would ideally include a discussion of the rationale for medium term budget composition and budgets clearly linked to planning priorities. Over the longer term, the government might consider preparation of an annual policy and budget statement, which would not only show how policy commitments in the MTPDP are to be funded but also would explain deviations from previous forward estimates.

5.13 Though the weak link between planning and budgeting is clearly the major concern, there are a number of challenges inherent in the current planning process that need to be overcome to enhance the utility of the MTPDP and its link with the budget. These include the greater integration of: (a) sectoral and national planning, (b) national and regional planning, and (c) the MTPDP and the MTPIP.

B. Sectoral and National Planning: Issues and Actions Taken

5.14 All sectors in the Philippines engage in some form of planning. Some departments have sophisticated planning processes that provide more than just inputs into the national planning process. The Department of Health, for example, produces its own planning document, the "Health Sector Reform Agenda" (HSRA),⁴¹ intended to serve as the basis of its short to medium term planning, programming and budgeting process, is presented in a number of external fora to solicit feedback and is used as an input for the MTPDP.

5.15 The national planning process aims to ensure that sectoral planning is fully integrated into the national planning process through the MTPDP. Comparing the HSRA (1999-2004) with the MTPDP (1999-2002) and the revised, mid-term MTPDP (2001-2004) is instructive for three reasons. First, it indicates that although the priority reforms are broadly consistent at the general level, there are different emphases in the underlying direction, which may result

in different policy and resource allocation decisions (including target setting). For example, the HSRA emphasizes the need for additional funding for public health, while the MTPDP (1999-2002) emphasizes management reform. In practice this will result in differences of opinion about the proper level of funding of public health programs. The HSRA and the mid-term MTPDP show greater discrepancies on the issues of tertiary sector reform. This would seem to indicate that in some cases sectoral planning is not fully integrated into the national planning process though the concern should be placed in the context of the rolling nature of the planning process, which evolves over time.

5.16 Second, different emphases of the plans can result in different sectoral budget allocations. For example, the mid-term MTPDP includes two priority actions from the SONA that would likely require either additional resource allocations or the reallocation of resources within the sector. These measures might “crowd out” in a budgetary sense the other priority reforms identified both in the MTPDP and the HSRA. If sectoral plans are not well linked with the budget process, some planning priorities do not become real budgetary priorities.

5.17 Third, the plan as designed by DOH in this case is intended to be holistic in the sense that its specific elements are intended to be complementary. To the extent that certain elements of its plan are de-emphasized and other elements added, the plan loses some of its complementarity among components, and thus becomes less effective.

5.18 Another recurring challenge for the government has been the stove-piping of the planning process in individual departments, which has resulted in the loss of a more comprehensive vision in some sectors. This has occurred in spite of NEDA’s efforts to bring together the planning process at the sectoral level in its social and infrastructure committees, which suggests that there has not been as much communication across the departments as intended by the system. As part of the government’s PEMIP, however, there has been some progress in moving from departmental to sectoral planning (e.g., DBM’s issuance of sectoral budget ceilings).

C. Regional and National Planning: Issues and Actions Taken

5.19 Given that the MTPDP is based on sectoral and regional planning, the LGU planning agenda is not directly addressed in the MTPDP. Rather, the MTPDP process works on the assumption that sectoral planning has already incorporated the regional planning process, which in turn is supposed to have already incorporated LGU planning priorities. Thus, regional planning is indirectly reflected in the MTPDP. There are constraints, however, that limit the genuine integration of regional priorities in the MTPDP.

5.20 The sectoral-regional planning link could be improved in general, though there are some regions in which the link is stronger than in others. The LGC of 1991 empowered LGUs to engage in their own planning processes, which implied a reduced role for NEDA, the national planning and policy coordinating body.⁴² Many LGUs at the municipal and provincial levels engage in comprehensive planning processes. NEDA, on the other hand, maintains 12 regional offices that serve the regional development councils (RDCs), which are meant to liaise with the LGUs in their areas and focus on issues of inter-provincial impact in order to produce regional development plans (RDPs). RDCs

*The LGU
planning agenda
needs to be more
directly
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MTPDP to make
the latter more
relevant as an
instrument for
pro-poor
interventions.*

are also intended to influence LGU planning processes through central planning guidelines and policy pronouncements. RDPs, however, do not explicitly consider local priorities unless they have region-wide impact. The result is a limited integration of LGU and regional plans.

5.21 An additional concern is the break in the planning chain, which is composed of two segments. The LGU segment runs from the barangays to the municipalities/cities to the provinces and the national segment runs from the regions to the sectors to the central level. The break occurs between the provincial and regional levels, indicating the need for a more formal linkage between the LGU and national planning chains, though fully respecting LGU autonomy. One option would be to reorient the RDCs/RDPs so that they become a forum for integrating sectoral and LGU planning. The RDC, presided over by the governor, could become a forum in which the sectors and relevant LGUs actually integrate their planning processes to strengthen complementarities and improved coordination without infringing on local autonomy. The key would be to make regional sectoral offices reflect LGU priorities in their planning submissions *before* forwarding those submissions on to their central offices, though regional and LGU planning timetables would have to be adjusted. Actually empowering RDCs to do this important work would likely be difficult in the short run, which would seem to suggest a pilot approach in a small number of regions to begin the transition to a more integrated local-national planning system (see Text Box 5.1).

Text Box 5.1 Integrating National and Local Planning in the Health Sector

Since 2001, the HSRA has been implemented in a number of areas called "convergence sites," which are mainly selected on the basis of the willingness of the LGUs in these areas to support the HSRA. In 2001, 13 LGUs were selected and an additional 20 are targeted for 2002. By 2004, an additional 32 provinces and cities will be included in the program. Essentially, the DOH provides technical assistance and other grants, facilitates the agreement among the LGUs within a convergence site (say, a province), and acts as a third-party enforcer and monitor of LGU commitments. The partial implementation of the HSRA is envisioned to cause ripple effects that will generate interest and advocacy for reform in the neighboring areas.

D. Planning and the Capital Budget: Issues and Actions Taken

5.22 The MTPIP is a rolling, multi-year public expenditure program, which is updated on an annual basis. The MTPIP includes not only capital investments, both ongoing and new, but also programs as well. The MTPIP also covers all departments and agencies, including domestically financed and ODA projects. The MTPIP is intended as a companion to the MTPDP and is scheduled to be published one month after the release of the MTPDP.

5.23 In practice there has not always been a tight link between the MTPDP and the MTPIP, though the government realizes this and has been working to improve the link. In 2001, departments were required to submit four year lists of their priority projects and programs. The prioritization of PAPs as well as projects, however, was not completely successful and the MTPIP continues to be a list of projects and programs lacking in prioritization. For example, the MTPIP has contained even low-ranked projects, which means that it has not fulfilled its role of allocating resources to the priorities set out in the MTPDP. To avoid this, sector plans would have to be prioritized in greater detail.

5.24 There are two main reasons for the difficulties linking the MTPIP with the MTPDP. The first is the status of the MTPIP itself: it is not a definitive budget in the sense that projects must still be evaluated and approved for funding even after being included in the MTPIP. Moreover, sector departments have every incentive to have projects included in the MTPIP as it serves as a gatekeeper for the actual investment budget. The result is that in practice the MTPIP serves less a function of allocating resources to priority programs and projects than encouraging departments to prepare lists of projects for which they might seek funding. In order to resolve this problem, the MTPIP needs to be constrained by the available resources. That is, indicative forward estimates approved by the DBCC as part of the MTEF need to be used to set limits on aggregate and sectoral resource allocations (any variations from the approved ceilings should also be approved at the cabinet level). Moreover, the ceilings should include estimated allocations for recurrent costs resulting from the new investments. The second problem stems from the difficulty the sectors have had prioritizing their PAPs (discussed in the next section).

5.25 For a project to be approved for funding it must pass through an evaluation process conducted by the ICC, which is responsible for conducting "technical, financial, economic, social, institutional," and environmental analyses of the investment projects submitted. Yet approval by the ICC guarantee funding, as the ICC process does not evaluate the budgetary implications of new investment decisions; DBM must still make a decision based on department ceilings about the inclusion of projects in the budget. The process could be simplified by eliminating one of the three stages, namely, by requiring ICC approval *before* listing projects in the MTPIP, which would potentially improve the linkage between the MTPIP and the MTPDP. Though it would be difficult to do this for the entire MTPIP, especially the outer years, prior ICC approval could be required for projects intended to be implemented in the early years (say over twelve to twenty four months).

E. Planning and Gender Issues: Innovative Action in the Philippines

5.26 The issuance of a directive in 1993 by then President Fidel V. Ramos to DBM and NEDA to ensure budgetary support for the gender and development (GAD) approach paved the way for institutionalizing gender concerns in mainstream programs and projects of government. The following year, NEDA, DBM and the National Commission on the Role of Filipino Women (NCRFW) issued Joint Memorandum Circular No. 94-1, which provided the policy framework and procedures for the integration of GAD into agency plans and budget proposals.

5.27 Under RA 7192, the NEDA is mandated to ensure the participation of women as recipients of foreign aid, grants and loans and for the determination of the amount to be allocated for development activities involving women. Together with the NCRFW, it is also tasked to assess the extent to which agencies' PAPs integrate women in the development process and of the impact of PAPs on women. It is also mandated to devise measures to build and strengthen linkages with the concerned legislative sub-committees for the purpose of ensuring complementarity in policy directions and recommending gender issues for the legislative agenda.

5.28 The 1995 General Appropriations Act (GAA) was a milestone in Philippine budgeting history in that it required all government departments, bureaus, offices and agencies to set aside five percent of their appropriations for projects designed to address gender issues in accordance with RA 7192. The same provision of the budget law provided for a reporting mechanism to enable NCRFW to monitor compliance. This policy has since been incorporated annually in the GAA, though revisions have been made to ensure effective implementation of the GAD budget policy. The advantage of this approach is that the inclusion of the GAD Budget law in the GAA has served as an enabling and advocacy tool that could be used by the NCRFW and its partners, from both government and non-government organizations, in working towards GAD mainstreaming. As an advocacy tool, it helps draw the attention of agencies to important gender concerns. However, some have raised concerns about the problem of earmarking and the additional complexity it introduces into the budget process.

5.29 On the whole, the implementation of the GAD budget policy has improved since its inception in 1995 as evidenced by the increasing number of reporting agencies as well as the amount of allocation to gender-related spending. However, the total amount of GAD budget resources of all government agencies accounted for an average of only 0.48 percent of the total general appropriations per year. In addition, the lack of a strategy to synchronize agency planning and budgeting for GAD with the government's budgeting cycle poses a major obstacle to increasing the number of GAD-related budget proposals submitted by the agencies. Thus, much progress has yet to be achieved on monitoring the actual implementation of PAPs that were funded under the GAD budget. The lack of a budget code that will help DBM monitor the extent of agencies' implementation of GAD-related PAPs exacerbates the problem, indicating the need for a monitoring and evaluation system for GAD-related PAPs.

The Medium Term Perspective: Revenue & Expenditure Planning & Budgeting

5.30 Executive Order 292 lays down that "The annual budgets of the national government shall be prepared as an integral part of a long-term budget picture." Through its MTEF, the government has put in place the elements of a state-of-the-art public expenditure management reform program. The central oversight agencies which are leading the different elements of these reforms, such as DBM, NEDA and COA, realize that -- as is to be expected with such reforms -- much work is required over the medium term to institutionalize and mainstream these reforms.

5.31 The Philippines began to introduce an MTEF with the FY2000 National Budget Call.⁴³ The stated goals of the MTEF were to restructure the budget over the medium term to better support the government's development strategy and improve technical efficiency in the sectors by "providing a more predictable resource environment for program planning and implementation." The government's reform program (PEMIP) is being rolled out on an incremental and somewhat flexible basis. The instruction on agency performance measures, which became the Organizational Performance Indicator Framework (OPIF), was introduced in the FY2000 Budget Call along with the MTEF, and was refined in the FY2001 and FY2002 budget calls, while the periodic assessment of on-going

Through its MTEF the government has put in place the elements of a state of the art public expenditure management reform program, but much work is required to institutionalize and mainstream the MTEF.

PAPs was introduced in the FY2001 Budget Call as the Sector Effectiveness and Efficiency Review (SEERs). The MTEF, OPIF, and SEER constitute the three pillars of the Government's public expenditure management reform program. There is no doubt that the government's PEMP is comprehensive and far-reaching; the next stage of reform should focus on consolidating the program and making the government's vision a reality.

A. Macroeconomic-Fiscal Framework: Issues and Actions Taken

5.32 The key issues comprise (i) improvement of the accuracy of revenue forecasts (by strengthening BIR's capacity to collect and analyze data), (ii) enhancing cooperation between DOF, BIR, NEDA and DBM through the DBCC, and (iii) institutionalizing the revenue forecasting process in order to provide the necessary impartial and technical expertise.

5.33 Improving the accuracy of revenue forecasting. One of the prerequisites of a medium term perspective in budgeting is the capacity to make realistic macroeconomic and fiscal forecasts. The credibility of the entire medium term perspective hinges on the credibility of the macroeconomic-fiscal framework. While the government has taken some measures to improve its ability to estimate aggregate resources, concrete results have thus far been somewhat limited. The problem is both technical, in the sense of information systems and modeling, and institutional, in the sense of the organizational arrangements used to produce the resource estimates.

5.34 The government's medium term fiscal framework serves as the basis for determining the annual budget proposal. The fiscal framework includes some discussion of the specific measures the government will pursue in order to increase tax revenues, though some of the measures are vague and, taken together, they seem rather more like a long list of generic reforms, lacking a strategy and timetable. Nor is the specific impact or timing of each measure considered. The government could enhance the credibility of its fiscal framework by prioritizing reforms on an annual basis and estimating the likely tax revenue impact of each reform measure.

5.35 Given the importance of revenue target setting to the overall management of public expenditures, it is especially critical that the targets be as realistic as possible. Recent experience suggests a pattern of undercollection relative to the official government target, especially in the area of internal revenues. In seven years out of ten, BIR's collections have not met the target goal. The breach between the goal and actual collections has grown since the late 1990s. The ripples from poor estimation of the resource envelope are felt throughout the entire expenditure management process. Inaccurate revenue estimation has undermined both attempts by the government to improve budgetary predictability and the nascent MTEF as well.

5.36 In practice, revenue estimates are calculated using multiple sources of data and multiple methodologies, which seem to have undermined the official estimates by generating ambiguity and controversy. In addition to the DOF, tax revenues are also estimated by NEDA, BIR and the National Tax Research Center (NTRC). Each uses different datasets and different methodologies. Estimates from different sources (though only DOF forecasts are official) have resulted in a lack of consistency.

5.37 To improve the predictability of resource allocations the breach between forecast and actual collections needs to be reduced as much as practically possible. One way to do this is to improve BIR's performance (see Chapter 2). The other way is to improve the accuracy of the revenue estimates. There are two problems with the formulation of the revenue estimates at present. The first concerns deficiencies in the tax revenue database maintained by BIR, which does not capture all the necessary data. For example, BIR compiles data by major tax type and region, but not by industry. The problem is compounded by the fact that only 43 of the 116 BIR districts are computerized. An even more pressing problem is that not all computerized districts actually input data into the system. There are also some issues with the design of BIR's tax forms. DOF will need to work closely with BIR to improve information capture and management.

5.38 Interagency cooperation and coordination. The second concern with the formulation of revenue estimates is the way in which they are produced. The MOF's Fiscal Policy and Planning Office (FPPO) has formal responsibility for producing the official revenue targets, which are then discussed and issued by the DBCC. Coordination between DOF and BIR, however, has been less than satisfactory, though BIR is represented on a DBCC technical working group. The lack of high-level BIR participation and coordination means that BIR's views are not necessarily taken into account, which, to the extent that BIR has asymmetrical information about expected revenues, may result in sub-optimal projections. Improved coordination would strengthen accountability as BIR would be required to explain how new administrative measures would impact collections.

5.39 In response to the apparent problem with revenue forecasting, the BIR organized the Inter-Agency Task Force on the Improvement of Tax Related Database (IATF) in February 2001 to address issues with the sources and integrity of data as well as the methodologies utilized to estimate revenues. The IATF was composed of four technical subgroups, each of which evaluated existing BIR databases and tax forecasting models. The IATF made recommendations on improving both the databases and the models, some of which are being considered for implementation.

5.40 The IATF task force has benefited from the participation of highly regarded researchers. The benefit of having independent researchers accrues not only in the application of their technical expertise to the challenge of accurately forecasting revenues but in their impartial, professional interest in carrying out the exercise. Given the perception that the revenue estimation process in the Philippines is undermined by political incentives, it would be desirable to make the process both more transparent and methodologically sounder. DOF has already begun to take measures, including: (1) the improvement of the forecasting models, (2) the creation of a new revenue forecasting task force under the DBCC, and (3) the adoption of administrative arrangements to improve the exchange of data and allow for development of models on a continuous basis. The Government should also consider establishing a "revenue forecasting calendar," by means of an official circular to coincide with the budget calendar, in which a timetable as well as a clear division of responsibilities, including provision and analysis of data, would be regularized.

B. Sector Expenditure Frameworks: Issues and Actions Taken

5.41 The government is keenly aware that the SEERs should continue to provide the basic building block of the sector expenditure frameworks, but also that the central oversight agencies should refine the instrument to include selected analysis of priority program costs, provide the necessary training and technical support to mainstream the instrument, and explore ways of increasing sector ownership.

5.42 The Government has been making progress toward the development of sound sector expenditure management through the introduction of the MTEF and the Sector Effectiveness and Efficiency Reviews (SEERs). The government has also improved on the budget process by introducing a baseline budgeting approach, which has increased the transparency of the budgeting process. Moreover, the government has taken seriously the challenge of developing medium term expenditure estimates and linking them with its medium term planning process. The challenge for the medium term is to improve and institutionalize the frameworks, which will require additional training and human resources in both oversight and line departments.

5.43 Baseline and above-the-baseline budgeting in the MTEF. The framework for sector expenditures is founded on the principle of baseline budgeting, and begins when DBM issues a circular containing three-year departmental baseline budget ceilings (budget year plus two outer years). The calculation of baseline budgets for the period 2001-2003 was done according to an iterative process.⁴⁴ In the first iteration baseline budgets were calculated as a function of net current operating expenditures for the previous year, funding for on-going multi-year projects, funding to maintain newly completed capital and infrastructure projects and programs, and other non-recurring items. Net maintenance and other operating expenditures (MOOE) were calculated taking into account the absorptive capacity (or the proportion of actual obligations incurred to allotments released) of the department over the previous two years and adjusting it by a “targeted efficiency improvement rate (TEIR).” Using this method, however, yielded individual ceilings greater than the total budget ceiling for 2001. DBM then carried out a second iteration in which “across the board cuts” were applied to the MOOE of low and medium priority PAPs, and then a third iteration, in which MOOE and capital outlays were cut uniformly by sector (with the exception of provisions for FAPs). The resulting allocations formed the baseline budget.

5.44 For the FY2003 budget call, additional changes have been being introduced.⁴⁵ Indicative ceilings for each department correspond to their specific appropriation levels for FY2002. Agencies are also required to submit their estimated expenditures for FY2004 and FY2005. DBM has initiated work on estimating actual costs of PAPs in FY2002 to complement the “top down” resource envelopes with “bottom up” cost estimates, and will refine these costings for the FY2004 budget call. DBM is in the process of developing uniform procedures for the costing exercise, which will be developed jointly with line departments. Forward estimates for FY2004-FY2005 will then be informed by the results.

5.45 There are a number of ways in which the government might consider improving its approach with the objectives of increasing the transparency of

allocation decisions and improving the prioritization of resource allocation. The main concern is that the forward estimate methodology is not primarily based on the prioritization of resources. That is, it takes as its starting point the previous year's budget, which may or may not accurately reflect inter- and intra-sectoral government priorities, and makes further uniform reductions to MOOE and capital expenditures, which are by definition devoid of any priority-enhancing impact. It is only in the second iteration in which reductions are made according to government priorities. Indeed, beginning the process with the previous year's baseline does not allow for any prioritization. The use of prioritization criteria should be adopted in the first iteration. Reductions could be made in low priority PAPs in the first iteration and further reductions, if necessary, could be made to medium priority PAPs. The replacement of across the board, uniform reductions with priority-based reductions in all sectors would also make the calculation process more transparent to line departments. For instance, instead of reducing expenditures "across the board," reductions could be made according to the medium term forward estimates of expenditures by sector, which are presented in the MTPDP. This would introduce the criteria of inter-sectoral prioritization, which was not explicitly used in the baseline budget approach.

5.46 Another potential improvement in the process would be to avoid the assumption of efficiency improvements in absorptive capacity. Basing the calculation on actual capacity would give agencies incentives to improve their resource execution mechanisms. In 2002 DBM initiated comprehensive mid-year reviews of agency performance focusing on income generation (where applicable), physical accomplishments, and financial management. The results of the mid-year review were used to allocate the remaining 25 percent of allotments for the fourth quarter based on agency performance. The mid-year review is an important innovation in the national expenditure management system and should be harmonized with the SEER process to maximize impact.

5.47 Some of the prioritization problem may be mitigated by existing measures. DBM has introduced an important measure allowing department secretaries and agency heads to "reallocate baseline budgets among the component agencies of the department," subject to certain limitations on personnel services and on-going FAPs.⁴⁶ In theory, departments could reallocate their baseline budgets to higher priority PAPs. DBM should also give departments the option of sharing in some of the cost savings by allowing them to reallocate resources from low priority PAPs toward new high priority PAPs. This would serve as a positive incentive for departments to prioritize expenditures. Given the difficulties with the ranking process thus far, it is unclear how much actual reallocation has taken place at the departmental level. Moreover, given the constraints on reducing personal services, which account for large shares of departmental budgets, it is unclear how much room for maneuver departments have.

5.48 The design of the current methodology is such that MOOE and capital expenditures bear the brunt of baseline reductions. Given the statutory nature of personal service obligations (for filled permanent positions) and the high priority accorded to FAPs, it is not surprising that non-wage recurrent and capital expenditures are reduced in the face of budget squeezes. A more effective approach would be to reduce all expenditures for low-priority PAPs, including those on personal services. If personal services, MOOE and capital expenditures

were all reduced for low-priority PAPs as necessary, it might be possible to avoid any cuts of medium-priority PAPs, or at least to minimize them.

5.49 In spite of DBM's reform program, there is some concern that they have not taken root at the departmental level. For example, in DepEd, on the whole, the current budgeting process at the national level largely involves incremental budgeting (Manasan and Atkins 2001). Thus, the DepEd central office, in conjunction with the regional and division offices, prepares an annual budget that is primarily based on the previous year's level of expenditures after allowing for salary increases, inflation adjustment (for MOOE) and major changes in provision (e.g., creation of new schools). Moreover, DepEd does not prepare forward estimates of its budget requirements. The SEER process and costing exercise underway have the potential to address the problem of incremental budgeting.

5.50 Credibility of the annual and forward budget estimates. Another issue of great import is the credibility of the baseline budgets and forward estimates. If the baseline budgets and forward estimates are not credible, their usefulness as management tools will be reduced. Moreover, if the forward estimates are not realistic, departments will not be assured of the predictability they need in order to develop meaningful plans. Though the baselines were issued in April 2000 for FY2001, the budget for FY2001 turned out to be a reenactment of the FY2000 budget, given that congress did not pass a new budget by the required date. The reenactment of the FY2000 budget, with adjustments made for the FY2001 resource envelope, meant that many priority departments received less than their proposed baselines, even though the baselines were meant as a minimum owing to the fact that they did not include above the baseline allocations. The Departments of Health, Education, Agriculture, and Transport and Communications all received less than their baseline budgets.⁴⁷ The reenacted budget undermined the government's efforts to move toward a medium term perspective. Strengthening the credibility of the forward estimates also requires greater attention to the link between planning and budgeting. It is not clear at the moment that sectors consider even the one year forward estimate as a solid allocation on which to base management decisions.

5.51 How the role of the Congress vis-à-vis the executive in the budget process affects the credibility of the annual and forward budget estimates has been outlined in Chapter 2. The key patterns to emerge from an analysis of the FY2002 budget process are: (i) funds were reallocated to locally-funded projects within departments and Congress also created entirely new LFPs, which raises concerns about these expenditures, given that they have not been vetted by departments during the budget process; (ii) in many departments Congress reduced funds available for FAPs (in some cases, quite drastically; and (iii) in most departments Congress reduced allocations for general administration and support services (GAS), in some cases considerably (32 percent in DECS and DOF, for example).

5.52 To the extent that Congress and the executive do not share the same priorities or preferences, the program of annual and multi-year budgeting becomes less effective, and budget figures become less credible. DBM has broached the idea of seeking a "Budget Accord" with Congress, which could be fleshed out over the medium term by focusing on these apparent areas of disagreement.

5.53 **Sector Effectiveness and Efficiency Reviews (SEERs).** The government is also building the MTEF from the “bottom up” by conducting SEERs, which are intended to strengthen the link between planning and budgeting. The introduction of SEERs is an important step toward prioritization of public expenditures in line with the MTPDP. The purpose of the SEER is to evaluate existing budgetary programs, activities, and projects (PAPs) according to their relevance in attaining desired sectoral and departmental outcomes.

5.54 In order to undertake these sector reviews agencies are required to perform the following steps: (i) reach consensus on sector outcomes; (ii) specify their major final outputs (MFOs) and the link of MFOs to sector outcomes; (iii) specify the relation of each of the PAPs to the relevant MFO(s); and (iv) classify all PAPs by priority. The priority ranking is determined by the extent to which an individual PAP contributes to the attainment of an outcome consistent with both the legal basis of the agency and the priorities of the MTPDP.

5.55 NEDA, the lead agency for the SEER process, was also supported by DBM.⁴⁸ NEDA and DBM issued joint guidelines to line departments for the development of their SEERs. Line agencies were then required to undertake an internal SEER, focusing on identifying sector outcomes and agency MFOs, and ranking PAPs in relation to MFOs. Agency SEERs were then reviewed by NEDA and DBM, which provided recommendations on improving the SEER outputs. The SEER process was also to include congressional staff to foster greater appreciation about the linkages between agency outputs and sectoral outcomes.⁴⁹ Based on the FY2001 experience, NEDA and DBM are drafting new SEER guidelines that focus on systematizing the rankings of PAPs and expanding the notion of MFOs to cover departmental objective statements. In addition, NEDA and DBM will require departments to specify basic information about each MFO: what is delivered, why, for whom, and how. With the new guidelines, NEDA and DBM will work with departments to refine their PAPs and MFOs for the FY2004 budget call.

5.56 The SEER component of the MTEF reform is an important innovation with promise for improving the PEM process in the Philippines. There is evidence that the SEER process is improving the way agencies think about formulating their budgets, though some departments have benefited more than others. In DepEd the SEER exercise has helped improve the relationship between the planning and budgeting units. Given the early stage of the SEER process, the government is interested in improving the way in which SEERs are conducted, and there are a number of ways in which the SEER instrument can be improved.

5.57 One of the problems characterizing the first SEER exercise was the reluctance of agencies to classify any PAPs as low, for fear of budget cuts (budget memoranda specified that low priority PAPs would be cut as part of the iterative baseline calculation procedure). Indeed, in the first round of the SEER exercise most agencies rated their PAPs as high or medium. Some agencies initially ranked all their PAPs as high. Agencies were even more reluctant to rank PAPs ordinarily, and some major departments refused or were unable to do so.

5.58 The problem of ineffective rankings was addressed by NEDA, which reclassified PAPs in some agencies. However, some agencies disagreed with NEDA's reranking of PAPs, resulting in stalemates over the outputs of the

The government is building the MTEF from the “bottom up” by conducting Sector Effectiveness and Efficiency Reviews (SEERs), intended to strengthen the link between planning and budgeting.

prioritization exercise. Since some agencies did not agree with NEDA's ranking, the prioritization exercise did not officially become part of the budget.

5.59 The explicit link between the SEER rankings and the calculation of budget ceilings also reduced the level of departmental ownership of the SEERs, which in turn reduced the usefulness of the exercise. If departments do not "own" their SEERs, and if SEERs only produce a limited ranking of priority programs, it is unlikely that agencies would use the SEER exercise to reallocate resources. Agencies did not have incentives to reveal their preferences about existing PAPs. Given the serious scarcity of budget resources, however, the government is right to link prioritization to budget cuts. The challenge is to find a way to do so that does not impede the prioritization process or limit ownership from the sectoral side. One option would be to require agencies to identify a predetermined number of low priority programs, expressed as a percentage of the agency's total budget. Agencies would then be allowed to retain and reallocate a set percentage of this amount to high priority PAPs. This would mean that agencies would not have to provide an ordinal ranking of PAPs, but would have to focus on an explicit ranking of the lowest priority ones, and that agencies would have incentives to reveal their preferences.

5.60 Another concern was the lack of an explicit link between the SEER and program costings. Instead of estimating any actual program costs, agencies worked from their previous baseline budgets. The lack of unit cost estimates for PAPs in some departments, such as education, has hindered management in its attempt to link cost with performance. Most agencies have not engaged in cost-effectiveness analysis through the SEER exercise, which also limits its utility, though agencies will work with DBM to estimate PAP costs. Introducing cost-effectiveness analysis on a selective basis, initially for high priority PAPs, would help improve the efficiency of expenditures.

5.61 There were other technical inadequacies that prevented departments from fully utilizing and adapting the methodologies, which were in some cases quite sophisticated, developed by NEDA and DBM. In the case of the DepEd, for example, many PAPs as they appear in the GAA are so broadly defined that it is difficult to rank them. The PAPs themselves may have to be redefined in some cases in order to facilitate meaningful prioritization. Moreover, many agencies do not have the capacity to engage in a sophisticated evaluation process and some disengaged from it as a result. For example, in many cases the specification of MFOs are still quite crude, which impeded effective prioritization. The difficulties with the specification of MFOs reveals a lack of understanding about the basic elements of the SEER process.

5.62 Human resource capacity in sectoral budget departments is considerably weaker in many cases than in the oversight agencies. It seems that the oversight agencies have moved past line agencies in developing potentially useful methodologies that simply cannot be fully implemented by line agencies at present.

5.63 Though NEDA and DBM have provided training in the form of several short workshops, the training has been insufficient for sectoral needs. Training during FY2002 is focusing first on DBM and NEDA, including regional offices, before addressing line agency needs. The government needs a technical assistance strategy to develop line agency capacity and to strengthen capacity in

Human resource capacity in sectoral budget departments is generally weaker than in the oversight agencies. The oversight agencies have moved past line agencies in developing potentially useful methodologies that cannot be fully implemented by line agencies at present.

the oversight agencies. NEDA plans to develop a SEER manual, which would be a helpful start. However, capacity building efforts should also move beyond “manualization” toward substantive training in line departments. That is, DBM and NEDA should develop capacity building programs for the line agencies, tailored to their specific needs, in terms of strategy development, program costings, and cost-effectiveness analysis (program costing and cost-effectiveness evaluation should be piloted for high priority PAPs in select departments). The technical assistance should help departments develop monitoring and information systems for use in program evaluation.

5.64 The joint management of the SEER and OPIF processes (see Chapter 6), which are tightly linked, by NEDA and DBM has been challenging for both agencies. There are still some areas of ambiguity in the division of labor, and even the definitions of the elements of each process, that have complicated implementation for the line departments. Some line agencies perceived ambiguity in guidance coming from the two oversight agencies, and there are even some areas of disagreement between the two agencies. A harmonization process is underway and should result in greater clarity about the organizational roles of NEDA and DBM, but greater cooperation is necessary to support implementation of these important initiatives. Given the overlap between the two instruments, it might make sense to have a joint DBM-NEDA committee with joint technical working groups responsible for both the SEERs and OPIF.

5.65 The SEER process, in seeking to prioritize departmental PAPs and provide greater focus on key organizational mandates, naturally implies critical thinking about agency missions, which implies analysis of organizational design and structure. To the extent that the SEER is used to reallocate resources within organizations, it may be necessary to rethink organizational missions and structures. Thus, there is an element of a functional analysis embedded in the SEER process that it being undertaken at the departmental level across government. Given the work of the PCEG on functional reviews, government should ensure that the two processes are integrated and complementary.

Management of the MTEF

5.66 The MTEF reform should be managed at the highest levels of the executive branch, according to an explicit time-bound reform program, in order to improve the chances of successful implementation in line agencies and to build support for the MTEF in congress.

5.67 The MTEF reform has been managed principally by DBM and NEDA with the involvement of the DBCC on high level decisions. To date, the government has focused on the more technical side of the MTEF. Given the breadth of the MTEF reform, which cuts across all the sectors as well as the national planning and budgeting processes, however, the MTEF needs to be managed at a higher political level. Increasing the involvement of the DBCC in the management process would give the MTEF greater political clout and would increase the chances of mainstreaming the reform. Moreover, the involvement of the executive at the highest levels in the MTEF is necessary for gaining congressional support, over the medium term, for the initiative. The government should require submission of the MTEF forward estimates and expenditure composition to cabinet for endorsement. Currently baseline budget forward estimates are presented to cabinet for discussion, but forward estimates inclusive

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of above the baseline allocations are not. Cabinet endorsement for inclusive forward estimates would provide additional support for the MTEF.

5.68 Once the Government's macro-fiscal outlook were presented to Congress for endorsement, Cabinet-endorsed forward projections could then be presented to Congress for discussion. Presentation of MTEF forward estimates and expenditure composition to Congress for discussion would foster greater interest, and perhaps support, in the legislature.

5.69 Implementation of the MTEF would also be strengthened by development of a concrete time-bound plan. The government has proceeded with implementation without specifying its targets for mainstreaming the reform. DBM should draw up an plan to phase in implementation of both the macroeconomic-fiscal framework and the sector expenditure frameworks.

Budget Foundation and Process Issues

A. Legal Foundations: Issues and Actions Taken

5.70 EO292 provides a comprehensive and sound budget framework, but it has not been fully implemented, nor has it been updated. It has a relatively low legal status given the importance of the national budget. EO292 could be updated to take account of the Local Government Code and consideration could be given to upgrading it to a budget law at the appropriate point.

5.71 In many countries, given the importance of the budget in giving effect to national plans for development, there is a budget law that provides the legal basis for developing and implementing the budget. A budget law provides clear rules that all stakeholders need to adhere to in preparing and executing the budget, and it can provide for sanctions to be applied where the rules are not followed.

5.72 In the Philippines at present, the legal framework seems to encompass three core components. The 1987 Constitution is the supreme law and it enshrines general principles guiding the budget process. Although it pre-dates the Constitution, PD 1177⁵⁰ and its associated budgeting manual are still relevant. Several key elements of PD1177 were incorporated into the subsequent EO292, which sets out the framework for national government budgeting.

5.73 The advantage of having a new budget law is that it would allow the Government to update the legal framework in light of recent reforms. A new law would bring together under one umbrella all the elements of the budget process. In particular it could provide for the integration of local, regional and national planning and budgeting, while respecting LGU autonomy. A budget law would institutionalize the budget process so that it is not subject to ad hoc amendments by incoming administrations, although it is argued that the downside is that a law introduces inflexibilities, particularly at this juncture when the process is still undergoing significant reforms. The budget law could be framed to enshrine the general principles, such as a medium term horizon and the interdependence of planning and budgeting, while leaving specific procedural details to the implementing rules and regulations. A law can also introduce greater accountability as it can provide for penal sanctions whereas an executive order can only impose administrative sanctions. Given the importance of the national budget, the greater weight of potential penal sanctions for mismanagement or misappropriation for personal use is important.

5.74 Although EO292 was drafted a decade prior to the current wave of budget reforms being implemented, it provides a comprehensive framework that embodies the key features of the current reform process. It does not, however, specifically refer to the need to provide forward estimates of fiscal aggregates, revenues or expenditures. Though a legal study would be necessary, a new law might be needed to institutionalize the MTEF and the OPIF. The EO provides guidelines for budget preparation, including the format and content of the budget and the information to be included in budget submissions. The EO further contains important provisions on budget accountability including sanctions for illegal use of funds although these have not been enforced.

5.75 Still, EO292, along with the LGU code and the PEM manual, should be reviewed and updated, to take account of developments over the past decade, especially the Local Government Code of 1991, to remove unnecessarily detailed provisions on budget execution, and to provide the general framework for budget preparation. It should provide guidelines for linking national and local budget processes and clarify roles and responsibilities of key agencies. To accompany a budget law and a revised EO292 the existing PEM Manual should be revised, updated, and finalized, to incorporate all the existing guidelines such that there is one manual being used by all of government. In addition thought should be given to developing a separate PEM manual for LGUs.

B. Institutional Budget Process Issues: Issues and Actions Taken

5.76 Prior to 1999 budget preparation was exclusively the responsibility of DBM and a line item approach was used to propose a budget for presidential consideration. As part of the 1999 reforms, NEDA Planning Committees (PCs) were given a significant role. A strength of the Planning Committees is that they include representatives from Congress, the private sector and civil society. It also gives determination of "relative priority" to a technical department, when, in fact, prioritization should be a political choice presented to cabinet. The 2001 mid-term planning process showed that the PC's were ineffective precisely because they were reluctant to make reallocations between sectors. Thus, the role of the PC's should be recast to serve as consultative bodies to advise on key issues raised by the Government.. A final decision on the relative priority of spending proposals and any reallocation of sectoral ceilings should be made by the DBCC, or a full Cabinet, based on the technical information provided. DBCC should issue recommendations for consideration by full Cabinet. Cabinet should make decisions on final sectoral and sub-sectoral allocations and the final choice on policy options.

5.77 The process of evaluation within TBHs is an important step as it represents an opportunity for departments and agencies to defend their proposals and to compete against the requests of other departments. Proposals should be made by the department or agency, with independent input or evaluation from the PC's on the validity of prioritization and recommendations for adjustments. From these hearings, recommendations should be formulated for DBCC/Cabinet consideration. There should not be other avenues for negotiating allocations, including conferring with Congress and within the executive branch, as these practices undermine the technical process.

C. Budget Calendar: Issues and Actions Taken

5.78 Recent government initiatives in this area can be strengthened by implementing a more realistic budget timetable based on a budget framework law and harmonizing the process of producing and collecting budgetary data. From a line agency perspective, the budget calendar is very tight. Agencies are being asked to implement significant changes in the way they plan, budget, account for funds and activities and report on performance. They are required to consult with civil society in drawing up their plans, and they are asked to complete numerous forms by the oversight agencies. If there are delays in the issuance of budget ceilings, or in the review processes of the oversight agencies, it places undue pressure on agencies.

5.79 The draft Public Expenditure Manual sets out a clear, logical and well sequenced budget timetable that begins 13 months prior to submission of the budget to Congress. It identifies all necessary steps and responsible agencies at each stage of the process. However, the timetable has not been fully implemented. Shifts in the political and economic environment also placed some activities out of sequence for the 2002 budget preparation. Updating of the baselines and re-prioritization of programs and projects should take place early in the budget cycle, prior to the budget call being issued. Delays in finalizing the MTPDP in early 2001 due to the change of administration rippled through the rest of the process, resulting in delays in the issuance of budget ceilings and undermining the credibility of the process.

Recommendations

5.80 Key short term actions could include: (i) the inclusion of a statement of the medium term expenditure framework in the MTPDP, with sections on medium term budget composition and on the explicit link between planning and budget priorities; (ii) allowing departmental managers to reallocate a specified percentage of resources from low priority PAPs to new high priority PAPs, thus providing positive incentives for departments to prioritize; (iii) establishing an appropriate technical assistance program to strengthen capacity in line agency budget departments and in central oversight agencies, focusing on strategy development, program costings, and cost-effectiveness analysis (program costing and cost-effectiveness evaluation should be piloted for high priority PAPs in select departments); (iv) establishing a joint DBM-NEDA committee with line department representatives and joint technical working groups to manage the SEER and OPIF reforms; (v) presenting MTEF forward estimates to Cabinet for endorsement and publishing them after cabinet approval; (vi) fully implementing the budget timetable set out in the Public Expenditure Management Manual; (vii) improving the quality of the BIR databases by rolling out its IT system to all districts and making changes to its tax forms to collect data necessary for improving revenue estimation and reducing opportunities for evasion; and (viii) establishing an official "revenue forecasting calendar" to coincide with the annual budget calendar. Other short-term actions to strengthen revenue collection have been outlined in chapter 2 of this Volume.

5.81 Medium term actions could include: (i) establishment of a task force composed of NEDA, DBM, and planning officers from key line agencies to work out an agreement on improving the linkages between the national and sectoral

Key short-term actions could include improving the presentation of the fiscal framework; allowing departments to reallocate a specified percentage of resources from low priority PAPs to new high priority PAPs, and establishing a joint DBM-NEDA committee with line department representatives and joint technical working groups to manage the SEER and OPIF reforms.

planning cycles; (ii) revising the MTPIP so that it is constrained by medium term forward estimates of budget ceilings and includes estimates of recurrent cost obligations of capital expenditures ; (iii) establishing a monitoring and evaluation system in NCRFW to monitor GAD mainstreaming, and institutionalizing reporting on the GAD budget during the formal annual budget process; (iv) using prioritization criteria from the start of the baseline budget estimation process to avoid across-the-board cuts to MOOE and capital expenditures; (v) incorporation of criteria for inter-sectoral prioritization in the calculation of baseline budgets; (vi) allowing department managers to reduce personal service expenditures (subject to a pre-determined maximum) for low-priority PAPs; (vii) requiring agencies to conduct cost-effectiveness analyses of selected high priority PAPs; (ix) presenting the macro-fiscal framework and MTEF forward estimates to Congress for discussion prior to the start of the annual budget process; (x) reviewing and updating EO292 to take account of recent reforms, including the Local Government Code of 1991 and the budget framework law (if applicable).

5.82 Longer term actions could comprise: (i) elevating the core budget process framework to the status of a budget framework law; and (ii) recasting the Regional Development Councils in the planning process so that they become formal, effective fora for integrating sectoral and LGU planning.

6. BUDGET EXECUTION, TREASURY CONTROL AND EXTERNAL OVERSIGHT

6.1 The government's reforms in the arena of public expenditure management must ultimately be underpinned by sound financial management practices and oversight arrangements in order to increase accountability and efficiency, and improve public sector performance. Hence, concurrent with expenditure management reforms, the government is likewise implementing a wide-ranging reform of its financial management system to support its performance-oriented management framework, make financial reports more timely and understandable, and promote accountability through better performance reporting and greater engagement with civil society and Congress. This chapter analyzes the important challenges facing the Philippines as it pursues this reform program.

Financial Management

A. Institutional Arrangements: Issues and Actions Taken

6.2 The responsibility for financial management in the Philippines is shared by several oversight departments headed by Cabinet level secretaries. The DOF has the major responsibility for revenue mobilization, cash management and borrowings, and oversight of GOCC and LGU finances. Within the DOF, planning and management of the government's cash balances and debt is handled by the Bureau of Treasury (BTR). Tax administration and collections are undertaken primarily by Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC). The DBM on the other hand, manages the budget, public sector compensation policy and organizational management. The Commission on Audit (COA) issues accounting rules and regulations in addition to its audit tasks. This fragmentation of the responsibility for financial management oversight has put a considerable strain on the sector departments and agencies. Inevitably, they have had to deal with conflicting policies and guidelines as well as numerous and overlapping regulatory reports to satisfy the needs of the oversight departments.

6.3 The most successful international model for efficient financial management is the establishment of a comptroller-general or an accountant-general function with responsibility for budgeting, accounting, and financial reporting. However, given the current legal and institutional system in the Philippines, creation of such an office is not considered feasible, as it involves a constitutional change. It has been suggested to the government that an inter-agency committee take the lead in integrating and harmonizing its planning, budgeting, accounting, and financial monitoring and reporting activities. The inter-agency committee will ensure that accounting policies, rules and regulations issued by COA are consistently applied in all public sector entities. The committee can also provide professional leadership to the agency finance staff in the improvement of financial management; and ensure that standards of accounting and financial reporting are maintained.

6.4 The government plans to establish this inter-agency financial management committee. Initially led by DBM with representatives from DOF, NEDA, COA, and DILG, this body will be responsible for integrating and

Internal control weaknesses create cash management risks that need to be addressed by improved accounting and reporting requirements.

harmonizing budget and cash management, accounting, financial monitoring and reporting. An essential sub-committee will be headed by COA to coordinate the implementation and the computerization of the New Government Accounting System (NGAS). The sub-committee, which should be in operation until the successful completion of the NGAS project, is responsible for implementing the decisions of the inter-agency committee and for acting as a facilitator for further improvement.

B. Budget Execution: Issues and Actions Taken

6.5 The Philippines maintains an impressive amount of data on budget execution. Government databases are so comprehensive that detailed analyses of budget execution can be carried out by COA for audit purposes and DBM for planning and management purposes. The systematic computerization of these databases at both oversight and agency levels will facilitate and enhance oversight and managerial control, which controls will become more important as responsibilities are further devolved.

6.6 In the budget execution phase, agencies are required to submit the Agency Budget Matrix and the Quarterly Performance Target; both serve as their financial and physical plans. This is supported by a cash program showing the monthly cash requirement of the agency to achieve the planned targets for the year. The DBM approves the ABM and releases the obligation authorization or allotments to agencies. Allotments for ongoing and specified projects and programs are released at the beginning of the year. The DBM then issues the notice of cash allocation (NCA) to the agencies either on a monthly or quarterly basis, which signals the availability of cash funds to agencies for the settlement of maturing obligations. The amount of NCAs are issued by DBM in consultation with the BTR to facilitate the latter's cash management and adhere to budget deficit targets. The DBM's role in managing the cash flow to agencies is therefore quite important for overall fiscal management, and in determining actual expenditures and ultimately service delivery.

6.7 However, the uncertainty and unpredictability of revenue inflows has made implementing a budget strategy that creates the proper balance between fiscal discipline and managing for results difficult. To assure resource flows to agencies, the DBM prior to FY1999, released all obligation allotments for ongoing and specified agency projects at the beginning of a fiscal year, with the GAA serving as the appropriation authority⁵¹. However, reserves or expenditure cuts were usually imposed on non-personnel expenditures. Ranging from 5 to 10 percent, the amount of reserves depended upon the extent of projected revenue collection shortfalls vis-à-vis the targets made during budget preparation. In FY 1999, 2000 and again 2002 however, alternative arrangements were tried in an effort to increase the credibility of the GAA enacted by Congress and to enhance the predictability of resources to agencies. The imposition of the reserves at the beginning of the year was discontinued and the portion of the annual budget released to agencies at the start of the year was reduced: from 82 percent of the agency budget (1999) to 85 percent (2000) and down to 75 percent (2002). In addition, in 2002, the release of the remaining 25 percent was conditioned on the result of the mid-year performance review. However, with the inability to improve revenue collection as targeted, coupled with the acceleration of agency disbursements because of other policy initiatives (i.e., the timely settlement of accounts payables in 2000, the pump-priming effort in 2001 and the close

The formation of an interagency committee to integrate planning, budgeting, accounting and financial monitoring will facilitate implementation of financial management reforms.

monitoring of agency performance by the President in 2002), the policy of doing away with expenditure reserves was not successfully implemented and the deficit exceeded targets. For 2001 therefore, the FY 2000 budget was reenacted and departments and agencies were subjected once again to economy measures and across the board expenditure cuts. In 2003, the release of allotments is planned to be made on a quarterly basis. This will be accompanied by a call for expenditure reserves as well as a mid-year evaluation of agency performance.

6.8 The DBM is also in the process of automating budget releasing and tracking through the implementation of the Budget Execution and Accountability Tracking System (BEATS). The system is targeted to be operational in 2003. The BEATS consists of the central programming and releasing system -- the Customized Budget Execution System (CUBES), housed in DBM -- and an agency-based system (ACUBES) which will link budget execution with accounting at the agency level. CUBES will automate the programming and issuance of Allotment Release Orders, including Special Allotment Release Orders (SAROs), which are released to authorize capital projects covered by lump-sum appropriations and other similar expenditures requiring additional clearance. It will also automate the programming and release of NCAs by linking the CUBES with the Agency CUBES modules in the line departments. This will facilitate programming on a departmental basis.

6.9 The BEATS will be linked to the NGAS, first on a pilot basis in several departments, which will include the oversight agencies. The same budget codes will be used in the NGAS and the BEATS. The Government is also pursuing the unification of the coding of personnel numbers used in the agency payroll with those used by the Commission on Civil Service (CSC), the DBM and the Government Service Insurance System (GSIS). The expected benefits of linking the NGAS with the budget execution system are high. Better integration of the financial accounting management and budget execution systems will lead to improvements in the oversight and control of budget execution, and enhance transparency, thereby fortifying the credibility of the MTEF.

6.10 Analyzing data on budget execution for key poverty-reducing sub-sectors however, is instructive in indicating the aspects of government operations which need to be improved for more efficient service delivery. One important indicator is the change of the composition of spending from budget appropriations to actual spending. Tables 6.1 and 6.2 show the share distribution of appropriations, allotments, and obligations for two high priority sectors at the sub-sectoral level. The data show that the appropriated sub-sectoral shares do not always correspond to actual expenditures (on an obligation basis). In the health sector, for example, primary care received 42 percent of the budget allocation in 1996, but only spent 30 percent (obligations basis). The same pattern of reduced shares for primary health care services in expenditures as compared to appropriations held from 1996-1999.

6.11 In 2000, however, expenditures on primary health care exceeded annual appropriations with the release of additional spending authorities to the health department from continuing appropriations. In some years the gap between appropriations and allotments in primary health services was fairly large, indicating that DBM withheld authorization of funding, while in other years the gap between allotments and obligations was quite large, indicating that DOH was not able to obligate the allotment releases while appropriations were valid, due

The DBM's Budget Execution and Accountability System (BEATS) will automate budget releases and tracking; this will be linked to the New Government Accounting System (NGAS).

to procurement and other implementation problems. The discrepancies in appropriations and expenditures merit further attention, given the importance of the sub-sector to the goal of poverty-reduction, as there seems to have been a pattern of reduced actual expenditures over the period 1996-1999. The data for 2000 seems to foreshadow the resolution of the problem, although data for 2001 should be examined to see if the problem has been resolved fully.

Table 6.1: Health: Schedule of Budget Appropriations, Allotments & Obligations by Function, 1996-2000
Share Distribution (%)

	1996			1997			1998			1999			2000		
	Appr op*	Allot**	Oblig **	Appr op	Allot	Oblig	Appr op	Allot	Oblig	Appr op	Allot	Oblig	Appr op	Allot	Oblig
Primary	42.0	32.8	30.2	34.8	33.5	28.0	36.3	32.1	19.0	26.4	30.8	23.6	25.7	31.3	30.9
Secondary	3.0	3.6	3.7	3.5	3.2	4.0	2.9	3.1	3.7	3.9	3.5	2.7	-	-	-
Tertiary	39.65	46.3	47.8	45.0	45.3	49.6	44.0	45.4	54.6	50.0	44.5	51.7	53.0	48.0	49.4
Gen. Admin.	7.8	8.8	9.4	8.4	8.9	9.3	8.3	9.8	11.2	9.5	11.0	11.0	10.6	10.3	10.0
Total	100.0	100.0	100	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Department of Health.

Note: Values represent percentage share of each category in total Appropriations, Allotments and Obligations.

*Appropriations are based on annual General Appropriations Act approved by Congress; **Allotments and obligations include current and continuing projects.

6.12 The other source of discrepancy between budget allocations and actual disbursements in DOH pertains to projects, especially the foreign-assisted projects (FAPs). There seem to be two reasons for this. The first reason pertains to DOH ability to secure budgetary funds to access ODA and implement FAPs. Secondly, reported logistical problems hamper the delivery of drugs, medicine, supplies, equipment and other assistance from the central office to the regional offices and other field health offices. Implementation problems particularly

Table 6.2: Education: Schedule of Budget Appropriations, Allotments and Obligations by Function, 1996-2000
Share Distribution (%)

	1996			1997			1998			1999			2000		
	Approp	Allot*	Oblig **	Appr op	Allot	Oblig	Appr op	Allot	Oblig	Appr op	Allot	Oblig	Appr op	Allot	Oblig
Primary	61.0	61.5	62.4	59.4	61.0	62.0	60.1	61.5	62.2	59.7	61.2	61.8	58.9	61.3	61.2
Secondary	19.4	19.5	19.8	19.1	19.7	20.0	19.2	19.6	19.8	19.2	19.7	19.9	19.0	19.8	19.7
TVET/a	1.3	1.6	1.0	2.1	2.1	1.0	2.1	2.1	1.6	2.5	2.4	2.0	2.5	2.2	2.1
Higher Education/b	18.2	17.4	16.7	19.3	17.1	16.9	18.5	16.7	16.3	18.4	16.6	16.1	19.5	16.6	16.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Department of Education, Commission on Audit.

Note: Values represent percentage share of each category in total Appropriations, Allotments and Obligations.

*Appropriations are based on the annual General Appropriations Act approved by Congress; **Allotments and obligations include current and continuing projects. a/ Includes Technical and Vocational Education (DepEd) and Technical Education and Skills Development Authority (DOLE); b/ Includes Commission on Higher Education and State Colleges and Universities.

hound projects involving LGUs because of the limited absorptive capacity of the recipient LGUs. ODA fund utilization is especially low when LGUs are required to co-finance the DOH-initiated local programs and projects. The problem becomes acute when the targets of assistance are the lower-income LGUs.

6.13 In education, the primary level tended to do better in actual expenditures (obligation basis), getting a larger share of the total budget than that initially indicated from appropriations (though Box 6.1 highlights additional concerns).

In health and education, two key elements in the budget execution process impacting

The opposite held true for higher education, which saw a smaller share of expenditures to the total budget as compared with appropriations. On the whole, DepEd registered high allotment-to-appropriation ratios and obligation-to-allotment ratios from 1996-2000, with the former ranging from 98 percent to 99 percent, and the latter from 96 percent to 99 percent. This is in part due to the fact that the major portion of the DepEd budget (95 percent) goes to the salaries of teachers and its workforce.

6.14 However, closer scrutiny of the data reveals problems during the budget execution phase in the purchase of textbooks and desks, the hiring of new teachers, and non-formal education programs. It is striking that the allotment-to-appropriation ratio for the purchase of textbooks was low at 59 percent, 30 percent, and 36 percent, respectively, in 1996, 1997 and 1998. Though rising to 100 percent in 1999, it declined sharply to 19 percent in 2000, raising concerns about the cash rationing strategy of the DBM. Equally worrisome is the low utilization of the already low allotments as indicated by an obligation-to-allotment ratio of 42 percent for textbooks in 1997 and 0 percent in 1998, which indicate weak capacity in procurement planning and monitoring in the department. In FY 2000 however, the DepEd began an major effort to improve its procurement processes to address reported anomalies in the existing decentralized processes by recentralizing textbook procurement while capacity and systems in its regional and division offices are upgraded. The low utilization rate, however, also points to problems in intra-departmental budget management having to do with the role of division offices and the lack of budget authority for local service delivery units.

6.15 As in the health sector, there are two key issues: the extent to which DBM issues allotments in line with appropriations, and the extent to which the agency is able to spend its authorized funds. Both issues played a role in the difference between appropriations and actual expenditures in these sectors over the years examined, and merit further attention because of their impact on the quality of service delivery.

In health and education, two key elements in the budget execution process impacting service delivery are (a) the extent to which DBM issues allotments in line with appropriations, and (b) the extent to which the agency is able to spend its authorized funds.

Text Box 6.1 Budget Execution and Service Delivery in the Education Sector

Improvements in service delivery are often attributed, in part, to increasing local control over resource use decisions. However, in the Philippine education sector, local service delivery units have little control over resource allocation decisions, in spite of recent attempts to devolve greater budgetary control.

In FY2000 the DepEd, with DBM, launched a system whereby MOOE funds are released directly to division offices and autonomous high schools. However, only those schools that had the appropriate finance personnel (one accountant/bookkeeper and one disbursing officer) were able to take advantage of this arrangement. The administration of MOOE is not devolved to the remaining secondary schools (known as "non-autonomous"). Instead, the division office makes the payments on the schools' behalf and is tasked to keep records on what has been spent per school so that expenditures can be checked against appropriations.

For elementary schools, the arrangements are different. The General Appropriations Act (GAA) does not specify the MOOE allocation for each elementary school for flexibility and manageability, the schools numbering some forty thousand. Moreover, it also appears that MOOE allocation for elementary schools is not tracked for them at division level. Instead, it is spent on their behalf by their respective division offices and the goods and services purchased are delivered directly to the schools concerned. Elementary schools do not therefore "see" any MOOE funds directly. In most divisions, the district offices and

the elementary schools receive supplies and materials "in kind" even as the division offices pay for the utility bills of the elementary schools and the travel expenses of district supervisors. (CHEG 2000a). In addition, some MOOE appropriated for elementary schools are actually utilized by the division offices to meet their expenses, since no formal allocation is made for such expenses in the GAA. Thus, some district offices and elementary schools get no MOOE at all from DepEd because many division superintendents claim there is not enough to reach all elementary schools (Nuqui and Solis 2000).⁵² Consequently, access to resources and control over resource allocation decision making at the level of the school continue to be seriously limited.

It has been argued that the direct release system to schools has the advantage of being supportive of the school-based management initiative that has been started (CHED 2000a). In terms of cash management, it also offers the advantage of reducing the "cash float" and enhancing the control over cash resources. However, the direct release system requires the presence of a competent financial management and monitoring function at the level of divisions and schools.

6.16 Congress, concerned about DBM's role in reallocating the budget appropriations, introduced an anti-impoundment provision in the FY2002 General Appropriations Bill. The "Prohibition Against Impoundment of Appropriations" required that DBM issue guidelines on the imposition of reserves in coordination with the congressional Committees on Appropriations and Finance. Congress' intent was to limit DBM's ability to steer resources toward its preferred programs and increase executive accountability to Congress. DBM's response has been to release 75 percent of allotments at the beginning of the fiscal year, basing the release of the remainder on the results of its mid-year review. This may turn out to be the forerunner of a scheme to move away from across-the-board budget cuts and support the performance management system (viz. the OPIF) that DBM is putting in place.

C. Accounting, Reporting, and the New Government Accounting System (NGAS): Issues and Actions Taken

6.17 Based on recommendations from existing analyses for improvements in accounting, COA, which is constitutionally mandated to promulgate policies, rules and procedures on accounting and auditing, has designed and initiated a phased implementation of a new government accounting system (NGAS) from January 1, 2002. The NGAS aims to: (a) simplify government accounting; (b) conform to international accounting standards; and (c) generate periodic and relevant financial statements for better performance monitoring. COA is also developing an accounting software package for computerization of the NGAS.

6.18 All national government agencies adopted the new system starting January 1, 2002. The NGAS has several features that make it a significantly better system, including a modified accrual accounting basis, improved accounting for assets, in which all depreciable assets shall be capitalized and depreciation shall be recognized in the income and expenditure statements, the adoption of a single fund concept, and a simplified three-digit chart of accounts, among others. COA is also developing a computerized version of the NGAS.

6.19 With the introduction of the NGAS, a simplified annual financial reporting is also required. All agencies are required to prepare a balance sheet, income and expenditure statement and a cash flow statement. There are approximately one hundred reports produced by agencies for budget and

COA has initiated the design and implementation of a New Government Accounting System (NGAS), and is working to develop an accounting software package for its computerization.

financial control purposes. The introduction of NGAS is an opportunity for the Government to review the requirements of the various oversight agencies and prescribe a more streamlined set monitoring reports for their use. Pilots are under way in DSWD, DepEd, and DPWH to improve financial management reporting.

6.20 The introduction of NGAS means that approximately 3,700 independent accounting units at the national and local government level will have to switch to the new system. The logistics of such a large scale change without a period of parallel implementation carry very high risks. However, given the complexities of the old system, COA had no option but to opt for a “big bang” approach in installing NGAS and organized a nationwide training of trainers during the three months preceding the introduction of the new system.

6.21 Notwithstanding the above efforts, the government will have to take careful measures to ensure that NGAS implementation takes place without the risk of a serious breakdown of financial controls during the transition. The main risks arise from (a) the fast tracking of the development of an accounting procedures manual to guide agency and LGU financial staff; (b) ensuring the full coverage and adequate training of agency and LGU staff; (c) COA’s capacity to provide adequate troubleshooting support when implementation problems surface; (d) synchronization of the linking of the new chart of accounts with the budgetary accounts; and (e) the development of the management information system needed to carry out effective budget control at the oversight and agency levels.

6.22 To address these risks, COA has adopted a strategy of phased implementation, focusing first on setting up the basic manual system. This will be followed by computerization. The final step will be to develop a Government Integrated Financial Management System that will provide management and financial information at various levels of Government.

6.23 It must be stressed, though, that implementation and sequencing issues will require very careful monitoring during the pilot phase, and users’ queries and system problems sorted out. It will be crucial to develop linkages between the NGAS on the one hand, and the BEATS and the other oversight agency systems on the other, as early as possible. This will entail very close coordination and consultation between COA, DBM, BTR and NEDA.

The NGAS has several features that make it a significantly better system. However, implementation needs to be carefully managed to avoid the risk of a breakdown of financial controls during the transition.

D. Treasury, Payment and Cash Management: Issues and Actions Taken

6.24 The DOF’s Bureau of Treasury (BTR) is responsible for all cash collections, payments and management of the public debt in the Philippines. As a result, DBM as manager of appropriations and BTR as manager of government bank accounts are closely involved in the cash management function.

6.25 The DBCC has the overall responsibility for budget and cash management. The DBCC Technical Group includes the Cash Programming and Monitoring Committee (CPMC), chaired by the Treasurer of the Philippines. The CPMC regularly meets to assess the fiscal performance of the national government and recommends to the DBCC the annual and quarterly cash budget programs of the national government. These cash budget programs are monitored

closely and updated from time to time to take into account significant fiscal developments and status of resources and expenditures.

6.26 In addition, the BTR monitors the Treasury's cash flow through a Cash Flow Committee. The Committee, chaired by the Treasurer of the Philippines, also reports the forecast on the level and direction of the yield rates for government securities to guide the Auction Committee composed on BTR, DOF and BSP. The Committee updates cash forecasts based on daily estimates of cash inflow, outflow and debt service requirements.

6.27 The authorization for government agencies to incur expenditure begins with DBM issuing budget allotments pursuant to appropriations authorized by the Congress. In addition, DBM also issues NCAs in consultation with BTR. The NCA acts as a second level of control as recipients of allotments can incur obligations but cannot make payments until they receive NCAs.

6.28 All government payments are made through authorized government service banks through the Modified Disbursement System (MDS) introduced in 1990. Under MDS, BTR deposits seed funds (estimated to equal two days of cash disbursements) with the head offices of the government service banks. The authorized government service banks maintain separate sub-MDS accounts for each agency by fund and for the central and regional offices. The spending agencies receive NCAs, which are treated as deposits, or authorizations to issue checks. Agencies issue checks against NCAs which are honored by the respective service bank branch. A summary of checks paid and a request for replenishment is submitted daily by the head office of the service banks to BTR. A daily summary of MDS checks negotiated is also sent to BTR through its provincial and regional offices. BTR validates the replenishment requests received from the service bank head offices against the data received from the regional offices and releases the replenishment daily.

6.29 The MDS system was designed to rationalize the payments system to a few bank accounts (currently only four banks are used) and eliminate idle cash by centralizing the cash floats to these banks. However, the system has some control weaknesses. Although BTR regional and provincial offices are required to reconcile the bank accounts with summaries of issued checks sent by the agencies, reconciliation is carried out several months in arrear. Also, BTR has no access to agency books of accounts (such access is given only to COA). Instructions on reconciling these pro forma accounts with the accounts kept by banks have yet to be developed.

6.30 Although the primary recipients of NCAs are required to use MDS bank accounts for disbursing funds, any secondary allocation of NCAs to district offices or another agency requires funding by commercial check. The recipients of these secondary allocations deposit these checks to separate bank accounts until they are actually disbursed. There are several thousand such accounts currently in existence. The total amount in deposit as of 2000 amounted to PhP52 billion. DOF-DBM Joint Circular 1-90 requires that the provincial offices and operating units receiving these funding checks withdraw the unexpended balance of the deposit account at the end of the year and remit the amount to the Bureau of the Treasury. A copy of the remittance advice is given to the pertinent regional office of the agency concerned. In addition, cash advances are made from the MDS bank accounts to disbursing officers for payment of salaries and

other expenses. The unliquidated cash advances with government disbursing officers at the end of 2000 amounted to PhP11 billion. The above cash balances are outside BTR control and pose a serious fiduciary risk.

6.31 Tax and customs collections are deposited into accredited bank accounts and transferred to the BSP on designated periods for the account of the BTR. In the collection and remittance of BIR taxes, three systems are being adopted. First, taxes collected by authorized agent banks, which are mostly over-the-counter payments made by non-large taxpayers, are required to be transferred by the collecting banks to the account of the BTR with the BSP on the sixth calendar day, counted from the day of collection. The BSP provides the BTR with a credit advice supported by a summary list of the bank's daily total collections and remittances by date. Second, taxes collected by government financial institutions (the Land Bank of the Philippines and the Development Bank of the Philippines) from large taxpayers are credited to the TOP account with the GFIs on the day of collection. The BTR monitors the collection through an on-line facility. The BTR withdraws the amount on day 6 through a letter authority. Third, taxes collected by BIR Collecting Officers (COs), and COs of other government offices and LGUs or local treasurers are deposited with the GFIs. These collections are credited to the BTR account on day 1 also. BTR withdraws the amount on day 6. The system of reporting and reconciliation is the same for national collections.

6.32 Effective August 1, 2002, another system of collecting BIR taxes was implemented. This system is called the Electronic Filing and Payment System (EFPS). As of September 30, 2002, there were two private banks, in addition to the 3 GFIs, which were collecting taxes through the EFPS. Participating banks are required to credit the tax collections to the BTR-BIR Hinged Account. This is a settlement account which is emptied/transferred by the banks at the end of the day to a liability account called "due to BTR." On the fifth calendar day, counted from the day of collection, the banks remit collected taxes to the BTR deposit account with the banks in the case of the GFIs or the BTR account with BSP, in the case of the private banks.

6.33 In the collection and remittance of customs duties on the other hand, two systems are being adopted. First, customs duties collected by the authorized agent banks are transferred by the collecting banks to the BTR account with the BSP on the eleventh calendar day from the day of collection. BSP provides the BTR with a credit advice. Second, customs duties collected by BOC's collecting officers are deposited with the GFIs which in turn credit the BTR account on day 1. BTR withdraws the amount on day 6. BIR and BOC maintain records of collections and reconcile with BTR. BTR accesses its bank statement with BSP electronically. BSP also prepares credit advice of bank's daily remittances with a summary list of banks' daily collections by date of collections and by date of remittance.

6.34 Reconciliation of remittances with BIR and BOC records are carried out by the accounting group at BTR (in the past, such reconciliation has proved difficult and has been a cause for concern). As with cash payments, delays in reconciling bank deposits with BIR and BOC records pose a serious control weakness in the current system.

6.35 The NGAS proposes a separate set of national books to be maintained by the collecting agencies with a reciprocal set of books by BTR for accounting for

government revenue that are required by law to be remitted to the Treasury. It is expected that this new accounting arrangement would largely solve the reconciliation problems encountered in the past. COA needs to develop more detailed accounting instructions, as part of the proposed accounting procedures manual, to avoid the past problems in accounting for revenues/collections.

6.36 Internal control weaknesses and resulting risks in cash management arise from (a) BTR reliance on bank information on deposits to account for revenue collection; (b) delayed ability or inability to fully reconcile bank information with collecting agency records; (c) reliance on bank information on payments for replenishment of service bank accounts and the backlog of reconciliation with agency records; and (d) the fact that large sums of cash and bank deposits that are maintained by agencies or disbursing officers outside BTR control.

6.37 Internal control weaknesses create cash management risks that need to be addressed by improved accounting and reporting requirements. As indicated, NGAS has changed the accounting arrangements for both payments and receipts of cash. The accounting rules and mapping of old accounting codes (on which Treasury's computerized cash management system is based) to new accounting codes have been developed. However, problems are being encountered in the compliance of agencies with regards to the new revenue coding system.

Performance Management: The Filipino Experience in International Context

A. Organizational Performance Indicator Framework (OPIF): Issues and Actions Taken

6.38 The OPIF is at the stage where it should be refined based on good practice in selected agencies and supported by systematic organizational development (including capacity building) for line agencies in the use of the framework.

6.39 The focus of the MTEF on outcomes is dependant upon the ability of the government to link and effectively use various elements of a performance measurement and management framework. In addition to the planning and SEER processes, the OPIF is fundamental for operationalizing planning and budgeting reforms. The government has introduced a performance measurement and management framework at the national level and is currently in the process of rolling it out to line agencies. Linked to the SEER and budgeting process, the goal of the OPIF, which was first introduced in the FY2000 Budget Call, is to increase the accountability of the agencies through a reporting of their outputs and outcomes that measures the agency impact on the development goals and objectives set out in the MTPDP.

6.40 The OPIF was subsequently refined. As presented in the FY2002 Budget Call, it requires the presentation of: (a) intermediate sectoral outcomes, which are based on the MTPDP, (b) intermediate sub-sectoral outcomes, which typically correspond to departmental outcomes, and (c) intermediate organizational outcomes, which are the agency-specific disaggregation of sub-sector outcomes.⁵³ BP206 requires agencies to specify performance indicators, capturing those intermediate outcomes over which the department has "significant influence or control." Agencies are also required to specify their

***The OPIF now
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major final outputs (MFOs) and performance indicators for each MFO. Types of performance indicators will include quantity, quality or timeliness, key processes, and client satisfaction feedback indicators.

6.41 The OPIF is still at the early stage of development, though it seems that the system envisaged by the oversight agencies has outpaced the capacity of the line agencies to implement it. During the FY2000 and FY2001 budget cycles agencies submitted performance indicators which conformed to the traditional input-based indicators. Many agencies submitted indicators such as “number of meetings attended” and “number of reports produced.” The health sector, for example, is thus far focusing on administrative indicators, rather than output-based indicators. Performance indicators submitted by DOH include, for example, “number of clinical practice guidelines developed,” “number of training sessions provided,” and “number of licenses issued,” which would fall under the classification of input indicator. It seems clear that the OPIF system has not been fully understood by line agencies. As a result, few agencies have thus far complied fully with BP206, and some agencies, though they have specified some performance measures, have not presented any performance data.

6.42 In the 2002 mid-year performance review, however, while reported performance indicators were still primarily on quantities of accomplishments (i.e. vis-à-vis quality indicators) hospitals for instance have started reporting on survival rates, length of stay, number of relapse. Another hurdle to implementation has been the difficulty agencies have in defining their MFOs and linking them with the MTPDP. Sectoral outcomes as specified in the MTPDP are not presented in a uniform way across sectors, resulting in some sectors having difficulty identifying their MFOs from the MTPDP. NEDA and DBM lent support to the sectors on deducing their MFOs, though that there is a problem deducing MFOs from the MTPDP suggests both insufficient capacity at the line agency level to utilize the OPIF and a lack of clarity in the MTPDP itself. Refining the planning process at the level of the oversight agencies and improving the sectoral planning process so that sectoral outcomes are clearly specified in all sectors could help develop performance indicators by line agencies.

6.43 Currently, DBM plans to discuss submissions of performance indicators with line departments during the FY2004 budget process. The goal is to agree on performance indicators, jointly develop targets, and present the indicators and targets as part of the FY2004 budget. However, given that many agencies have yet to develop adequate MFOs, the plan may be premature. To ensure that the development of the OPIF system in the oversight agencies does not continue to surpass line agency implementation capacity, DBM should consider how performance data can be included in the FY2003 budget in a meaningful way that will make a difference for managing line agencies and improving service delivery. Extensive capacity building might be required before this is feasible. Moreover, new initiatives, unless departments are sure they can implement them, should be postponed until the existing OPIF system is consolidated.

6.44 DBM's approach thus far has been to allow wide latitude to the agencies to develop their indicators. Both DAR (Text Box 6.2) and DSWD have made progress in the fleshing out of the OPIF to their respective departments. It would benefit DBM as well as other line agencies if the experiences to date with the OPIF were studied and disseminated. By producing a lessons learned note, DBM

could distill key challenges and successes that agencies have had in adapting the OPIF. To the extent that performance contracting at the level of agency managers is being adopted (as in the case of DSWD), DBM, the Civil Service Commission (CSC) and Career Executive Service Board can assist the agency to link personnel evaluation systems with agency organizational performance targets and use their learnings to replicate the activity to others.

Text Box 6.2 Performance Measurement & Management in Agriculture & Natural Resources

The Sub-Committee on Plan Performance Indicator System (SCPPIS) for the agriculture and natural resources sector has been in the forefront of initiatives to enhance sector performance. Originally, the link between "sector outcomes" and "agency-level outputs" was not clear. Agency performance was being assessed in terms of a minutiae of "input indicators," such as the number of meetings. Agencies have been complaining about tedious reporting on input indicators and the resulting perception of "micromanagement" by oversight agencies. Now, there is agreement among the rural sector agencies (DA, DAR, DENR) regarding sector level outcomes, and each agency's expected contributions defined in terms of Major Final Outputs – and an emerging shift toward results-management. This is a first step toward sector performance enhancement, to ensure that each agency's programs, activities, and projects are directly and strongly linked to agreed sector outcomes. As a result of this initiative, the social sector and other sectors are developing their own performance indicator systems.

The next step is for an independent and objective performance assessment system to be established for the sector as a whole, and for each agency. This is addressed under the ongoing Capacity Building for Operationalizing and RD/NRM Plan Performance Monitoring Project being supported by the World Bank. Under this project, each agency's monitoring and evaluation system is being improved such that within 12 to 18 months, outcome and impact indicators can be subjected to objective assessment by third parties. This is intended to clarify and strengthen accountability and transparency in each agency, including an active role for the private sector and civil society. In the rural sector, this has begun with the participation of private sector and civil society representatives in various consultation forums related to the capacity-building project. They are expected to participate more actively in the future and even to run a parallel performance indicator system.

The SCPPIS is being careful in addressing the political sensitivity of inter-agency resource allocation. The idea is to follow a phased approach. The first step is to enhance the intra-agency resource allocation system, and then to subject results to an independent objective assessment. The result of such an assessment can then serve as a basis for resource reallocation within and across agencies. After applying this system over a few planning and budgeting cycles, possible re-allocation of resources to more efficient uses can be considered.

6.45 Indeed, the shift from measuring and controlling inputs to measuring and controlling performance is huge, and requires not only a change in mindset but the necessary capacity building to adapt the new framework. It also requires an institutional framework that supports the application of a performance orientation on the job and aligns incentives accordingly (Text Box 6.3). The internal and external forces that are driving the shift to performance of the government as a whole must be coupled with a shift to performance by individual agencies and workers in those agencies. All actors in government must see that the derivation and sharing of information is a vital factor in achieving objectives, allocating scarce resources, and delivering benefits, and in doing so eclipse the simplistic notion of a system only for rewards and punishments. The strategy should reinforce the importance of performance at the level of the individual, managers

within agencies, the executive branch, and the larger system within which government operates.

6.46 Though DBM and NEDA conducted some workshops on the OPIF over the past few years, there is a clear, pressing need for a sustained capacity building program at both the line and oversight agency levels. Some agencies reported that the workshops were inadequate for their needs and decided to pursue reforms without requesting direct assistance from the oversight agencies. As a result DBM initiated sessions to coach agencies in the development of outcome-based performance indicators in 2002. This was followed by the undertaking of the mid-year performance review of DBM, focusing on results. These efforts will have to be sustained and NEDA and DBM can reinforce the message to agencies in the planning and budgeting activities.

Text Box 6.3 Good Practice in Performance Monitoring and Evaluation

For the past two decades, governments have been "in search of results." Although strategies vary across countries, similar elements appear to contribute to a successful shift to a results-based culture. Among these elements are: (i) a well-defined and comprehensive strategy, with phased implementation and strong leadership (champions) at the most senior levels of government; (ii) incentives for change—economic pressures, pressures from civil society, increased need for resource control and service delivery at decentralized levels, or external pressures; (iii) a clear mandate for making a shift to performance coupled with adequate capacity to do so; (iv) pockets of innovation to use as models for good practice and pilot programs; and (v) clear links to budget and resource allocation decisions.

No single best method exists to introduce performance management into the many institutions and policy-making activities of government. Some countries have, over several years, introduced strategic plans, performance indicators, and annual performance plans and integrated them into annual budget documents (Australia, United States). Other countries have included program performance indicators that can be audited in their annual financial reports (Finland, Sweden), or used performance agreements between ministers and heads of government agencies (New Zealand, United Kingdom). Argentina and Romania are initiating performance-based budgeting strategies. In these two countries, performance indicators for government programs are being linked to allocated budget envelopes, reported in budget annexes at the start of each budgeted year, and audited at year's end.

While most OECD countries have adopted government-wide approaches in introducing performance management, many countries began with performance pilots or with initiatives confined to one or more sectors. Some countries have granted freestanding authorities greater flexibility to use resources within an overall budget envelope in exchange for greater accountability from leaders and organizations for specific results (Next Steps Agencies in the UK). Other countries have supported pilot activities within government organizations to lead the way and encourage more initiatives and replication (Reinvention Laboratories). By beginning with a few programs and sectors, governments attempt to create favorable conditions for public sector learning and experimentation before mainstreaming the effort. Other countries find that encouraging and supporting sectors where a clear reform effort is underway (for example, the health sector in Bangladesh, Ghana and the Kyrgyz Republic) allows innovative efforts to move forward, regardless of commitment from the highest political levels to implement a more comprehensive strategy.

Still other countries have found it useful to focus on the users or beneficiaries of government services or on one client group, such as women and girls or children (United

Kingdom, Citizens' Charter). This strategy includes developing key performance indicators that cut across line ministries with a specific focus on improving those government programs to support a particular group of citizens. This strategy can also help move forward a national agenda in a program area, rather than waiting for the entire government to embrace performance management.

Finally, a few countries, such as Malaysia, have adapted to public sector reform a model known as 'total quality management', developed by industry to improve manufacturing processes. Total quality management has generally been introduced after reform processes are well underway, but the focus of quality management on customers is relevant to reform efforts at all stages.

Clearly, an array of strategies is required because each country is unique. International experience recognizes that reform strategies evolve and are modified over time, but to be sustainable, a results focus requires a solid foundation on which these systems must be built. The foundation includes incentives to support a performance culture, clearly defined roles and responsibilities, accountability, and sufficient technical and managerial capacity. It also requires a sustained commitment, a mix of positive internal and external pressures, sufficient capacity, and clear linkages to the country's reform agenda and resources.

6.47 In the Philippines, there has been considerable investment by donors throughout the 1990s in capacity development for oversight bodies, line agencies, local governments and project implementation units. While these may have helped to create awareness and proponents of improved performance at the policy level in agencies, sufficient capacity to shift to performance management remains weak. This is perhaps due in part to the predominate focus of capacity building programs on training, development of manuals, software, and use of international consultants without sufficient attention to institutional systems, personal responsibility, and incentives for sustainable integration of new skills into the workplace. On-going or future capacity building programs should be developed within a comprehensive organizational development model for human resources, including strategies for incentives and support structures in the workplace.

6.48 DBM and COA should also coordinate their performance evaluation plans, as COA is moving more into value for money type (VFM) audits. Integrating targeted VFM audits into the OPIF might help line agencies learn how to improve performance measurement. The traditional financial compliance and efficiency focus of independent agency audits should be augmented with a focus on if and how the agency is working to achieve its mission and its effectiveness. COA performs this role, but predominantly focused on traditional audit functions, with minimal VFM audits, which in most cases focus on efficiency rather than effectiveness of programs.

B. External Performance Management and Oversight: Issues and Actions Taken

6.49 The government has undertaken innovative initiatives in fostering greater civil society and legislative participation in the budget process and these should be extended and deepened.

6.50 Of the four stages of the budget process, performance evaluation and oversight remains the most underdeveloped. Structures and mechanisms for

oversight exist, but there is a reluctance to enforce sanctions or to take remedial action. There is limited capacity for independent budget monitoring, evaluation and analysis particularly at the local level. Oversight should be a fundamental role of Congress, but it is not fulfilling this function effectively. Enhancing transparency at all stages of the budget process will help to increase accountability and strengthen the oversight role of civil society groups. In most countries, the legislature and civil society form partnerships to oversee the executive. In the Philippines, there is a strong partnership between civil society and the executive, and more limited collaboration with Congress.

6.51 The Role of Civil Society in Budget Performance Management and Oversight. A movement toward greater transparency and accountability in public sector budgeting has accompanied the growing trend of introducing public expenditure reforms in developing countries. Historically, drawing up the budget was considered the exclusive domain of the executive, and was a closed process. Transparency, accountability and participation are mutually reinforcing and joint requirements for improving government performance. In order to hold government accountable, Congress and civil society need access to timely, reliable and understandable information on priorities, budget allocations and outcomes. If transparency is to lead to greater accountability, monitoring and evaluation should be converted into action, and civil society should have avenues to use the information for active participation. The Philippines has a long history of civil society monitoring of various aspects of public services, including quality, access and corruption. The government has stressed the importance of partnerships with the private sector and civil society to improve transparency and accountability.

6.52 The involvement of actors outside of the executive can improve policy and allocation decisions by bringing different perspectives to budget debates, and in particular in representing community interests. In many countries, the involvement of civil society in the budget is restricted to commenting on the final product once it has been passed by the legislature. In that regard, the Philippines can be considered progressive, since civil society is involved in the budget planning and preparation process. The Budget Call for the 2002 budget preparation specifically required agencies to consult with civil society "to ensure that the people's participation in the formulation of the FY2002 budget proposals is maximized." For the first time civil society groups were invited to attend the technical budget hearings as observers to orient them in the procedures and mechanics of the budget process. In addition, civil society groups are represented on NEDA Planning Committees. Such participation allows civil society to make inputs early in the process and increases understanding of the budget process and the trade-offs made.

6.53 A further encouraging development in fostering accountability has been the initiative to institutionalize client service delivery surveys, including those conducted by independent agencies. The results of such surveys serve as a useful input into the overall as well as agency planning and evaluation processes as they indicate priority areas for improvement, as perceived by users of the final outputs of agencies.

6.54 In the Philippines, civil society has formed a much stronger partnership with the executive than with Congress, and in particular with the Committee on Appropriations. Although the committee will allow civil society groups to attend

The government's innovative initiatives in fostering greater civil society participation in the budget process should be extended and deepened.

the budget hearings as observers, and to distribute materials to members, they are not permitted to make formal submissions unless specifically requested to provide expert input on specific topics. Part of the reason for the development of strong working relationships between civil society and the executive at the national level is the nature of civil society itself. A well developed informal network of relationships exist between the executive, academe, and NGOs, allowing greater understanding of policy issues, processes and the sharing of information. For example, oversight agencies interact with, and have given budget briefings to, a number of watchdog groups such as Procurement Watch, the Philippine Governance Forum (PGF) and Government Watch. The risk of this type of engagement is that it can lead to a diluting of independent analysis and critical reflection. The challenge for civil society is to play the role of critical ally, whereby a working relationship is established that allows civil society to work with government in providing research, training, and monitoring, but that retains the ability to provide constructive criticism where necessary.

6.55 Building these relationships can strengthen the budget process in a number of ways. Civil society groups can play an invaluable role in demystifying the budget and enhancing participation. Civil society groups (including private sector organizations and the media) can develop budget literacy and stimulate debate among citizens, interest groups and legislators. One common problem is that civil society groups themselves lack the technical expertise or resources to undertake this type of work. The Philippine Governance Forum has begun to do this type of work through the Budget Advocacy Project (BAP) and Government Watch. To date, however, the majority of technical inputs at briefings have been made by resource persons from the executive.

6.56 Budget advocacy tends to be demand-driven, because budget analysis takes time and requires some technical skills. Non-governmental organizations tend to be sectorally based, and focus more on policy issues than on budget analysis or expenditure tracking. For example, one area in which civil society coalitions are particularly active is anti-corruption. Three particularly active groups in this arena are Procurement Watch, the Transparent Accountable Government Network and the Philippine Center for Investigative Journalism. These groups are gaining credibility and a constituency, but their focus is on monitoring and reporting on corruption rather than on budget issues.

6.57 The BAP has been established to promote a more transparent national budget process. Its four main objectives are to (i) develop the capacity of sector NGOs to analyze sector budgets; (ii) provide reliable, timely data to allow organizations to intervene; (iii) provide independent budget analysis; and (iv) to raise budget literacy. To date the BAP has focused only on three departments – the Department of Agrarian Reform, the Department of Agriculture and the Department of Environment and Natural Resources. The focus has also been on the national level, given resource constraints. Very few NGOs currently have the capacity to effectively track expenditures, although the Legal Resources Center and the Agrarian Reform Alliance have begun to track local government expenditures in a limited number of locations.

6.58 Under its Government Watch project, the PGF is initiating expenditure tracking in projects of the DOH, DPWH, DepEd, and DSWD since these agencies have large budgets with significant social welfare implications. As mentioned previously, the partnership developed between the executive and the

PGF facilitates access to information and has led to a collaborative effort. The emphasis is on assisting the departments to track and verify the quantity and quality of reported outputs and assist the department improve aspects of operations, it is not primarily intended as an exercise in performance assessment. A Memorandum of Understanding is signed with the concerned agencies, and Government Watch tracks priority projects agreed with the agency. The findings of the studies are shared with the department prior to being published such that the initiative is collaborative rather than confrontational. A key strength of this initiative, in contrast to more detailed tracking studies, is that it relies on a simple monitoring mechanism that needs little technical expertise and could be easily replicated by local level.

6.59 Although these are innovative projects, they are presently restricted to the national level. Points of access for civil society intervention at the local level are more limited. They have tended to be concentrated in development planning committees (as required by the Local Government Code), school boards and so on. Some groups have formed linkages with the Sanggunian but these are not institutionalized. Many NGOs active at the local level do not have the capacity to engage with budget issues and concentrate only on participation in planning.

6.60 To enhance the ability of civil society to engage in budget analysis and advocacy and to hold Government to account, access to credible, timely and user-friendly information is critical. Publishing a summary of broad expenditure allocations by sector and sub-sector in conjunction with an explanation of the policy thrust of the MTEF would go a long way to improving transparency and generating public support. These documents could as serve as an indication of how the SONA commitments will be met over the medium term. If the medium term projections were submitted to Congress for discussion it could also help in promoting fiscal discipline. If Congress were to endorse the broad fiscal aggregates and sectoral ceilings, and this is publicized, it would be more difficult to backtrack or to make deviations from these during the approval process, without having to provide a public explanation. An appropriate strategy and timetable for gaining greater congressional commitment to the MTEF should be developed as the political situation allows.

6.61 The Role of the Congress in Budget Performance Management and Oversight. Legislative oversight is an essential mandate and responsibility of Congress, yet it is broadly accepted that the oversight function of Congress remains weak. A report by the newly constituted Committee on Oversight notes that "The legislative output and initiatives of Congress arising from the exercise of its oversight power is dismally low if not totally absent."⁵⁴ One measure the committee refers to is that since 1991, 23 laws of national significance have been enacted but not implemented owing to a lack of funds. In recognition of the importance of legislative oversight, the rules and regulations of the House of Representatives during the Ninth Congress specifically mandated all committees to create a sub-committee on oversight. These sub-committees became optional in subsequent congresses, and are regarded as largely being ineffective, owing in part to a lack of "resources, staff and expertise."⁵⁵

6.62 This observation is particularly pertinent with regard to the budget. Considerably more attention is paid by Congress to the budget approval process, where reallocations may be made, than to monitoring budget execution or evaluating the impact of expenditures. The Philippine Congress has considerable

authority to make amendments or reallocations within the proposed budget, as is typical in presidential systems. A presidential system provides the mechanism for local interests to be incorporated in the budget through special projects of members of Congress, but this also provides opportunities for introducing distortions. To minimize these distortions, however, for the past two years restrictions have been imposed by the Committee on Appropriations (in consultation with DBM) on the categories of expenditure allowed for congressional discretionary funds, although the overall size has increased. In addition, the amount of congressional initiatives in agency budgets has decreased over time.

6.63 It is in the context of congressional attention to resource allocation decisions during the budget approval process that questions about the credibility of the MTEF arise. Given the importance of Congress' role in the budget process, congressional support for the MTEF will be absolutely necessary for its success. Efforts must be made to convince congress that the intent of the MTEF is not to limit congressional control over resource allocation. To that end the executive should develop a strategy for engaging Congress' interest in the MTEF and building support for the medium term vision, both in terms of plans and budgets, through greater consultation and discussion. DBM has broached the idea of a law with Congress on the principles of fiscal responsibility following examples in the United States, Australia and New Zealand, recognizing the need for stronger cooperation on expenditure policy and allocation.

6.64 In technical, as opposed to political, terms, the capacity of Congress to undertake budget analysis and reprioritization of proposed expenditure allocations is limited and fragmented. The Committee on Appropriations has its own technical staff, several of whom were recruited from DBM and as such have requisite expertise in budget analysis. Many other sectoral committees, however, do not have the technical staffs necessary to undertake technical budget analysis. In addition to the appropriations committee, independent analysis of the President's budget proposal is also provided by the Congressional Planning and Budget Office (CPBO), whose reports are used predominantly by members of the minority parties, the media, and civil society groups. The institutional relationship between the CPBO and the Committee on Appropriations, however, is currently weak. The Appropriations Committee also currently maintains strong relationships with executive agencies, and as such has open access to budgetary information. CPBO is working to establish closer linkages with the oversight agencies of the executive – COA, NEDA, DBM and DOF – in order to improve access to information and to promote collaboration.

6.65 Moreover, the new Committee on Oversight has committed itself to conducting independent and objective policy and program analyses. The Committee has identified four main issues on which it will focus: (i) fighting graft and corruption in the Philippines; (ii) improving the generation and utilization of scarce resources; (iii) ensuring that government's anti-poverty reduction programs reach the intended beneficiaries and (iv) strengthening governance through the institutionalization of a Filipino Report Card-type system in government. Despite these laudable objectives, however, the Committee has made it clear that it intends to limit its oversight to undertaking monitoring activities and issuing recommendations. It remains to be seen whether the

committees on appropriations and oversight will increase congressional capacity to improve budget oversight.

Recommendations

6.66 In the short term the Government is pursuing the following actions:

- a) DBM and COA are linking the Budget Execution and Accountability Tracking System (BEATS) with the NGAS and simplifying key resource-releasing processes;
- b) DBM is working with DepEd, DOH and DSWD in the areas of procurement, financial management and information technology under the Social Expenditure Management Project in light of the problems with budget execution procedures at the departmental level to formulate a plan to improve absorptive capacity and install the needed systems.
- c) A position paper for an agency controllership function is being prepared (with an implementation plan), aimed at fully integrating financial management into agency management processes under the SEMP technical assistance program.
- d) BTR with the assistance of DOF is addressing the identified internal control weaknesses by taking immediate action to tighten cash control and management. A working group has been established under the DBCC to better define accounting and reporting requirements for revenue remittance and cash management by agencies and the BTR. Moreover, an electronic link is planned to be established between DBCC member agencies to facilitate the monitoring of fiscal performance. As part of the review, consideration should also be given to transfer of the responsibility for issue of NCAs to BTR. This will separate the cash and budget management functions and place BTR as the sole responsible agency for cash management.
- e) DBM, NEDA and the line agencies should review the OPIF experience to date to prepare a time-bound action plan (with estimates of resources needed at the central and line department level) for OPIF implementation government-wide. Specifically, the government could review the OPIF experience in selected departments to produce a 'lessons learned' note on best practice pilot experiences with the OPIF and disseminate the findings to line agencies; the review could also be used to prepare the time-bound action plan referred to above.

6.67 In the medium term, desirable actions could comprise:

- a) Development of a medium-term capacity building program by DBM, in conjunction with line agencies, including a strategy for change management for line agencies in implementing the OPIF;
- b) Development of a strategy by the executive for engaging Congress' interest in the MTEF and building support for the medium term vision, both in terms of plans and budgets, through greater consultation and discussion;
- c) To strengthen the credibility of the MTEF and build broad-based consensus on MTEF priorities across political lines, it would be desirable for the executive to negotiate a joint resolution on the principles of fiscal responsibility with Congress, the principal elements of which could be: (a)

endorsement by Congress of the MTEF in terms of policy directions, the fiscal framework, and three-year expenditure allocations; (b) agreements about the categories or amounts of expenditure reallocations that could be made; (c) dispositive actions on unfunded laws; and (d) training workshops for congress on selected public expenditure management issues; and

- d) It would also be appropriate to strengthen the capacity of the House Committee of Appropriations, Senate Finance Committee, and the CPBO to undertake budget and program analysis. Similarly, budget advocacy efforts with the civil society organizations should be promoted. The CPBO and CSOs can be enabled to become a more significant player in congressional-executive budget deliberations.

6.68 In the **longer term**, it would be preferable to develop a program to strengthen the controllership function, both at the agency and oversight levels, and develop a profile of future agency controllers.

SECTION C. OPERATIONAL EFFICIENCY

7. The Public Procurement Regime
8. Strengthening Financial Management
9. Controlling The Wage Bill
10. Implementation Of Foreign-Assisted Projects

7. THE PUBLIC PROCUREMENT REGIME

7.1 The last several years have seen a continued impetus from the executive for reforming public procurement in the Philippines. This chapter outlines the key initiatives taken so far⁵⁶. It also indicates that it is important to sustain the systems improvements and capacity-building needed to support procurement reforms to increase competition and transparency: this will have a significant impact on increasing the cost efficiency of resource use and also contribute to strengthening governance.

7.2 From FY 1997 to 2001, annual outlays for procurement of goods, works and services by national agencies, averaged more than PhP113 billion (Table 7.1). This excludes procurement undertaken by LGUs and GOCCs which amount to about PhP50 billion a year and for Build Operate Transfer (BOT) projects, estimated at about PhP372 billion in 2001⁵⁷. The Ombudsman, the Commission on Audit and the Philippine Center for Investigative Journalism have reported that large amounts of public funds are being lost to both political and bureaucratic procurement-related corruption. Although no reliable estimates are available of losses due to public sector procurement-related corruption, the perception of large leakages continues to persist. An October 2001 study by Procurement Watch, Inc. reported that the potential leakage from national government coffers through procurement corruption could have run to about PhP21 billion in 2001 (equivalent to 14 percent of the budget deficit of about PhP145 billion that year). The additional potential leakage in public-private transactions under BOT projects was estimated conservatively at PhP74 billion. The DBM estimates that the PhP21 billion lost by government from uncompetitive and nontransparent procurement practices could have been used to fund the DOH twice over, or build more than 60,000 school buildings, or construct about 3,000 kilometers of concrete farm-to-market roads.

7.3 The potential for procurement reform, and the budgetary savings realizable from more transparent and accountable procurement, is thus, high. The experience of textbook and drugs procurement under World Bank-financed projects demonstrated that adoption of more transparent procurement processes and greater competitive ICB practices reduced unit prices of textbooks by about 40 percent. This translated into a saving of about PhP1.2 billion⁵⁸ for the DepEd. In the case of the DOH, unit prices of TB Drugs were cut by 33 to 94 percent, similarly translating into substantial savings for DOH. However, the possibility of reforms being blocked by vested interests remain major concerns, as well as the extensive capacity-building needed.

Modernizing The Legal and Institutional Framework

7.4 Rapid modernization of the legal and institutional framework for public procurement is unambiguously recognized as the key issue in procurement reform in the Philippines today by the executive, legislature and civil society.

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Table 7.1 Philippines: Magnitude of National Government Procurement Outlays (bn. peso)

Expense Class	1997	1998	1999	2000	2001
Supplies and Materials	15.750	15.587	17.012	20.295	16.879
Library Books and Materials	0.034	0.158	0.094	0.225	0.071
Other Services	15.096	17.232	15.430	18.676	19.322
Gasoline, Oil and Lubricants	1.883	1.766	2.099	2.593	2.622
Land and Land Improvements Outlay	43.621	68.337	50.406	63.497	59.985
Buildings and Structures Outlay	17.533	12.579	10.175	11.431	6.570
Furniture, Fixtures, Equipment and Books Outlay	11.275	6.307	9.23	5.723	3.642
Information Technology (IT) Equipment Outlay	0.010	0.226	0.799	0.716	0.932
TOTAL	105.202	122.192	105.245	123.156	110.023
<i>Source: Tables B.1 and B.14, Budget of Expenditures and Sources of Financing, Fys 1999, 2000, 2001, 2002 and 2003</i>					

The Legal Framework

7.5 Public procurement in the Philippines was governed by more than 60 laws, executive orders, presidential decrees and administrative orders, including issuances from government agencies applicable to respective departments. Furthermore, most EOs and IRRs seem to have been promulgated to fill the gaps caused by the absence of procurement legislation, although their theoretical role is circumscribed to providing implementing details of an existing law, not to substitute for the lack of legislation. Additionally, many executive instructions (especially earlier ones) do not cite the laws authorizing their promulgation, although administrative issuances normally require a specific legal or statutory basis for their validity. And they do not indicate in their repealing clauses the specific provisions of previous EOs and IRRs which have been amended, modified, or repealed. This results in confusion and conflicting interpretation of some of the provisions, increasing the likelihood of rigged bidding, delay and irregularities in the bid evaluation process.

7.6 The government has taken several steps in recent years to streamline public procurement rules and regulations, culminating with the issuance in October 2001 of Executive Order 40 followed in early 2002 by its IRRs. These rules consolidated a plethora of existing executive orders and instructions on National Government procurement and streamlined and standardized the procurement for goods, works and services. However, reforms initiated need to be institutionalized through legislative enactment. Issues such as the composition and the manner of appointment of Bids and Awards Committee (BAC) members, the influence that LGU chief executives can exercise in this regard, and a stronger incentive system to professionalize the cadre of government procurement personnel and minimize graft and corruption required a legislative enactment which could modify, amend, repeal or consolidate inadequate or conflicting provisions, policies and practices.

7.7 Thus, enactment and implementation of a new law on public procurement applicable to the national government, LGUs and GOCCs was appropriately the top administration priority in procurement reform⁵⁹. The Government Procurement

Enactment of an appropriate public procurement law applicable to the NG, LGUs and GOCCs was rightly at the top of the GOP procurement reform agenda. The law now needs to be followed by quick promulgation and implementation of IRRs.

Reform Act was signed into law by the President on January 10, 2003 as Republic Act 9184. The law requires posting of procurement opportunities in the government's electronic procurement system so that a single source of public procurement opportunities is created. Moreover, it simplifies pre-qualification procedures, strengthens the post-qualification process, reduces officials' discretion on bids and awards, establishes a Government Procurement Policy Board (GPPB) for oversight and regulation of government procurement, professionalizes the public procurement function, protects procurement officials from unjust legal suits arising from the performance of their duties, and imposes criminal and civil liabilities for those found guilty of collusion and other anomalies.

7.8 The new law addresses the following fundamental issues:

- a) Proliferation of laws on public sector procurement, which has facilitated inefficiency, rent-seeking and leakage of scarce public resources;
- b) Reorganizing and strengthening agency and LGU BACs and procurement units to ensure accountability in the processes and procedures and the sustained improvement of systems for greater cost efficiency;
- c) Establishing one authoritative regulatory and oversight entity for all public procurement for the national government, LGUs and GOCCs. The law consolidates the regulatory and oversight functions in a Government Procurement Policy Board, and provides it more teeth and independence⁶⁰;
- d) Anomalous procurement practices such as rigged bidding, fake advertising notices, misrepresentations in bid proposals, irregularities in bid evaluation process or at the inspection stage or at the contract implementation stages, and weak warranty provisions for infrastructure projects;
- e) Lack of proficient procurement staff and professional practitioners in the civil service;
- f) Strengthening the system of rewards and punishments in the performance of the procurement function; and
- g) Establishment of an appropriate complaints mechanism.

Institutional Arrangements

7.9 Procuring entities. The primary responsibility for the implementation and execution of procurement laws and regulations rests with: (a) the head of each national agency or instrumentality; (b) the governing board for each GOCC; and (c) the elected head of each LGU. The size and capacity of the procurement set-up in each organization would depend on the complexity, variety and volume of procurement handled. Regulations such as PD 1594, EO 262 and EO 164 mandate that evaluation and award processes be handled by ad hoc committees established in each agency or office, such as: (a) a Bids and Awards Committee (BAC) for procurement of works and goods and (b) a Pre-qualification Evaluation and Awards Committee (PEAC) for the selection of consultant services. Technical Working Groups (TWG) assist the committees in the technical evaluation of bids. These

committees are assisted by secretariats to handle the administrative function in the bidding process.

7.10 EO 40 constituted the BAC which determines the eligibility of prospective bidders or consultants, receives and opens bids or proposals, conducts the evaluation of bids or offers, undertakes pre-qualification for complex works and post-qualification proceedings, including eligibility screening, and recommends the award of contract. The scope of the BAC activities spans the pre-procurement conference up to the recommendation of the award. The BAC is a five-member team composed of the chairperson and four members designated by the head of the agency. Three of these consist of regular BAC members; the other two are provisional members. Representatives from non-governmental organizations (NGOs) and the COA are invited as observers. EO 40 mandates the creation of a permanent Procurement Secretariat with fixed responsibility, for greater efficiency. It also prohibits the head of agency and/or the contract approving authority from any involvement in the bid evaluation process.

7.11 Although EO 40 mandated the constitution of a permanent BAC and full time Secretariats in agencies, these entities in most agencies at this time are still ad hoc and their members are designated together with the Committees. Departments such as the DPWH and DOH designate officials from among their senior and middle managers to be committee members for a year. In other agencies, such as the DepEd, the Department Secretary nominates members of the Committee for each specific procurement package from among the numerous departmental officials on a rotating basis.

7.12 In many agencies, proficient procurement staff are still lacking. Worse, those considered proficient staff refuse to be designated as members of the committees because of fear of harassment and legal suits from bidders in the absence of any legal or appropriate assistance from government.

7.13 Procurement practices and concerns. In general, laws and administrative issuances mandate the transparency of procurement proceedings. Competitive public bidding requires the public advertisement of requests for bid quotations in newspapers of general circulation, through the posting of notices in conspicuous public places, and lately through government websites and the Electronic Procurement System. Thus, invitations to bid are required to be publicly advertised at least twice within two weeks with at least seven days between publications in two newspapers of general circulation. Public bid opening is undertaken by the BAC with the participation of observers from expert organizations from the private sector, civil society, and the COA. It is required to follow the prescribed procedure for evaluating bids. Biddings are conducted according to the two or three-envelope system, where the eligibility requirements, technical proposal and bid price are submitted in separate envelopes. The bid opening is public, and may be attended by bidders or their representatives.

7.14 In spite of the enactment of the Procurement Reform Law and the issuance of EO 40, prevailing procurement policies and practices still disclose numerous areas of concern, key among which include:

- a) Transparency. It is recognized that the transparency of public procurement is not sufficient. There are still too many influences jeopardizing the efficiency and integrity of the procurement process including high rates of re-bidding, especially at the LGU level, and price negotiations before award create concern

about the process. Re-bidding sometimes results when the bidding is not in line with expectations, or the lowest bidder is not qualified.

- b) Lead Time. Delays or lengthy processes characterize public procurement, and bid activities are sometimes extended on a regular basis. EO 40 which supersedes AO 129 stipulates a maximum time per activity. It is desirable that this be enforced by the heads of agencies and the BACs, and monitored by the BAC Secretariat and enforced through procurement audits.
- c) Procurement Plans. Procurement plans are developed for budget purposes, but their implementation is not monitored nor their potential benefit for facilitating timely and quality agency service delivery as an accountability mechanism for procurement. Moreover, some plans are not implemented due to changing agency priorities and budget cuts. Consequently, there is often no clear link between budget formulation, planning of activities and procurement execution.
- d) Registration and Licensing of Foreign Contractors and Suppliers. For locally funded procurement, foreign bidders are required to be registered and licensed in the Philippines prior to the bidding. The contractor and supplier has to embark on a long process and tedious process of licensing and registration which also require them to establish offices in the country and to comply with citizenship requirement of at least 75 percent or 60 percent Filipino ownership in the case of infrastructure and goods procurement respectively, before getting the license. These raise the costs for potential bidders and may be an undue barrier to entry.
- e) Negotiation of Contract Price. Price negotiation is said to be a key entry point for possible corruption in the procurement process. While EO 40 prohibits price negotiation, most bidding documents still do not allow the reduction of quantities along pre-agreed percentages. Hence, some parties negotiate with the lowest bidder to stay within the approved budget.
- f) Congressional Initiative and CDF. The actual procurement practice in district-level projects tends to be non-transparent as some elected officials are reported to pre-determine the winning contractors. This jeopardizes the credibility of the process and compromises the integrity of BAC members.
- g) Price Monitoring. Currently, a small number of agencies such as the PS, COA, DOH and DTI maintain a price list of commonly-used goods, drugs and medicines. However, price monitoring should form part of a standard and efficient procurement function in all departments. There is also a need for an oversight entity to supervise, monitor and compare prices across the different departments. In essence, this will result in closer monitoring of public procurement expenditures.
- h) Bonds, Bank Guarantees and Letters of Credit (LC). It is common to use surety bonds as bid and performance security. However, these surety bonds are not actually callable on demand and difficult to garnish, demonstrating that a bond is not an irrevocable guarantee. Most foreign-assisted projects require bank guarantees. However, banks in the Philippines normally ask for the full amount of the guarantee (in cash or in property). The situation is the same for LCs, although access to LCs seems easier because suppliers provide them to cover guarantees related to contracts.
- i) Other Monopolistic Practices. PD 1466 requires that imported goods should be transported by Philippine vessels. Since Philippine vessels go only to Japan and

Korea, suppliers from these two countries are at a disadvantage compared to the other countries of the region, which can choose any vessel available. One can transport goods on another vessel only if the fare on Philippine vessels is more than 10 percent higher than the rest. A waiver must be secured from the Philippine Shippers Board before a non-Philippine vessel can be used. Again, this provision is monopolistic, expensive and contrary to open competition. Competitors are sometimes dissuaded by cumbersome administrative processes, e.g. relating to licensing of foreign contractors, transport on Philippine vessels, restricted access to foreign textbooks, difficult access to the cheapest drugs from foreign countries, etc.

- j) Pre-shipment inspection. The Government no longer engages in automatic pre-shipment inspection. Public and private sector inspectors make their own arrangements. The result is that, in many cases, the pre-shipment inspection is neglected or inspection is done only upon arrival in Philippine ports. This increases the burden or risk of the importer. When inspection is done at the destination port, it increases the cost of the remedy because goods have to be shipped back to the manufacturer for repair or replacement.
- k) International Arbitration. According to the Contractor Industry Authority of the Philippines (CIAP) and the Philippine Constructors Accreditation Board (PCAB), the Settlement of Disputes provision, which culminates in an international body, is not binding. The local party to the contract, if he/she so desires, may insist on having the final step of the process heard in a Philippine Court.
- l) Oversight arrangements. A number of central agencies and *ad hoc* bodies currently perform varying oversight responsibilities, either directly or indirectly, over the procurement function: the Procurement Policy Board, the Committee on Infrastructure (INFRACOM) of NEDA, the Philippine Licensing Board for Contractors, the Construction Industry Arbitration Commission, and the DBM's Procurement Service.

7.15 Other issues that emerged in a review of procurement conducted for national government agencies – and which are expected to be addressed by the proposed legislation – include: (i) compromising of the transparency of procurement due to incomplete and slow records retrieval; (ii) lapses in disclosure of information vital to a fair and open competition, during the advertisement and the evaluation of bids; and (iii) absence of a mechanism for systematic monitoring and feedback on suppliers' performance.

Electronic Procurement

7.16 E-procurement systems have been developed in various public sector agencies in the Philippines, including (i) DBM-EPS (see Text Box 7.1), (ii) DPWH for determining the eligibility of contractors; (iii) the Department of National Defense (DND) for procurement of military uniforms and defense hardware; (iv) the NPC for the procurement of coal; (v) DBM-Procurement Service for the procurement of small-value office equipment, materials and supplies, and (vi) by other agencies, including DEPED and DOH.

Text Box 7.1 The Philippine Government Electronic Procurement System

On November 22, 2000 the Procurement Service of the DEM, with a grant from CIDA, launched an internet-based pilot electronic procurement system (EPS) composed of a Public

Tender Board, Electronic Catalog, and Supplier Registry. The system improved access to government opportunities, saved cost, and enhanced the efficiency and transparency of government procurement.

The DBM oversees government expenditures through the release of budgetary allotments for different government agencies and departments, while its Procurement Service (PS) handles the purchase of goods and services for over 1,800 client agencies and monitors prices of goods and services. Transparency in government procurement is a systemic problem in the Philippines, and added to this are inefficiency, poor service delivery and low sales volumes resulting from manual and paper-driven procurement processes. A 1999 study conducted by the PS with CIDA assistance showed that a pilot EPS could improve transparency, efficiency and value for money in government procurement.

The system went live on December 1, 2000, and is now being marketed by the DBM to other agencies. The EPS advertises bids electronically. Bids are received in hard copy and evaluated by hand. The evaluation and award results are then posted electronically.

The EPS is supported by several EOs and AOs. EO 40 of October 2001 and Republic Act No. 8792, dated June 14, 2000, recognize and encourage the use of electronic commerce in general and of electronic procurement in particular. Section 27 of the E-Commerce Law (R.A. 8792) also mandates that by mid-2002, agencies/GOCC/GFIs shall "transact government business and/or perform governmental functions using electronic data messages or electronic documents ...", leaving room for the selective application of electronic procurement, depending upon the degree of sophistication of the existing systems, as well as their applicability to specific types of procurement and specific procurement processes. The implementing rules and regulations of EO 262 state that "bid requirements should be placed in two consecutive issues of two newspapers of general circulation and posted in the EPS and the website of the concerned agency." The previous practice was to advertise the bids in three major newspapers - advertising on the EPS has saved the government money in advertising costs.

The total cost of the EPS pilot program is estimated at about US\$400,000, shared equally between DBM and CIDA. Within six months after going live, the EPS had 86 agencies and 62 suppliers registered, and 71 bid notices posted on the EPS. (As of October 10, 2002, there are 1,797 agencies, 2,377 suppliers registered and 9,214 bid notices posted) Eventually all government procurement notices are envisaged to be posted on the EPS. Suppliers are able to access government bid opportunities 24 hours a day 7 days a week.

While the system has great potential for improving the transparency and efficiency of procurement, the GOP had noted the implementation challenges early and is taking steps to address them. For example, even with high interest and support for the EPS, its initial implementation was relatively slow. The reasons were numerous - agencies did not have the same resources or capacity for supporting the EPS, only about 25 percent of agencies trained in the EPS were ready for internet access, only about 8 percent of Filipinos were using the internet in 1999, there was resistance to change from employees who thought the EPS would lead to a loss of jobs, and this was also a time of larger political uncertainty and turbulence in the Philippines (the pilot testing ran into the presidential impeachment trial, the EDSA II people power revolution, and the assumption of office by a new government). Second, a key lesson learnt has been that the technology being used must consider the users' level of knowledge and skill, access to the necessary infrastructure/equipment and services, and needs and expectations. Third, leadership has to come from the highest levels of the government, and be sustained. Fourth, the agencies using the EPS must have intimate knowledge of their target market and know how to segment it - each segment will require a different marketing strategy and will have different service level expectations. Customers will start using a new system continuously only if it adds and continues to add value through its content and quality of information, and if the system and its support services meet or exceed their service level expectations. Third, in order that technical and logistical support can be provided on a timely

basis, implementation and maintenance of the electronic procurement service is being bid out to the private sector.

Source: DBM Case Study on the EPS

Civil Society Oversight

7.17 The Philippines has been prominent in involving civil society in the public procurement process as a means to enhance accountability and transparency. This has happened at both national and local levels.

7.18 Procurement Watch, Incorporated (PWI) is a non-profit, non-partisan, civil society organization (CSO) created by a group of concerned individuals from government, academe, the legal profession and the private sector, brought together by the challenge of reducing graft and corruption in government procurement through research, partnerships, training, and advocacy. Established on February 15, 2001 with support from an ASEM Trust Fund managed by the World Bank, PWI promotes transparency and accountability and assists in streamlining procedures in government procurement of goods, supplies, materials, services and infrastructure projects.

7.19 Active procurement monitoring, public fora, roundtable discussions, workshops, technical assistance to government, research, publications and media releases comprise some of PWI's activities. By exposing inefficiencies in public procurement policies and procedures, and presenting alternatives based on well-grounded research, PWI believes it can push for reforms that enhance competitive public bidding and lessen the possibility of corruption.

7.20 PWI has partnerships with several government agencies for monitoring implementation of EO 262 and PD 1594 and its IRRs. PWI has attended agency Bid and Award Committee meetings and monitored the public bidding for certain projects. PWI's recommendations based on its observations on the actual bidding process provide an independent evaluation and feedback mechanism for procuring agencies, and it also monitors whether its recommendations are implemented by the agency. PWI also provides training on existing procurement guidelines and provides updates on reforms to agency personnel.

7.21 In the area of policy advocacy, PWI participated in the formulation of the Government Procurement Reform Act, and also in the crafting of EO 40 and its IRR.

Recommendations

7.22 The Government and Procurement Watch, Inc. have shepherded the Public Procurement Law through Congress. This Law consolidates existing legal acts and presidential/administrative issuances, addresses existing gaps and inconsistencies, and provides a comprehensive legal basis for procurement by NG agencies, LGUs and GOCCs. Passage of this law was appropriately a top administration priority: this now needs to be followed by promulgation and implementation of IRRs.

7.23 At the same time, the administration's institutional strengthening efforts require long-term support. These initiatives focus on: (i) establishing a Government Procurement Policy Board as the sole regulatory and oversight entity for public procurement and defining its scope of work – this will be transformed into an appropriate oversight and regulatory entity through the IRRs for the Government Procurement Reform Act; (ii) establishing an appropriate protest and complaints mechanism; (iii) setting up an incentive system to professionalize the procurement

The GOP has been prominent in involving civil society in the public procurement process to enhance accountability and transparency at both national and local levels.

function including the establishment of a national training program for procurement officers and for COA auditors on procurement audit; and (iv) conduct of a study to corporatize the Procurement Service as an independent entity.

7.24 Other ongoing initiatives to strengthen procurement include: (i) continued development of GEPS to include e-bidding and e-payment; (ii) non-acceptance of surety bonds as a form of security with bank guarantees, letters of credit or other reliable instruments, proposed to be done through IRRs; (iii) review of the BOT Law and the “unsolicited proposals” rule and tabling of suitable amendments based on the recommendations from the study; and (v) allowing foreign contractors to bid without a license from the Philippine Contractors’ Accreditation Board.

3. STRENGTHENING FINANCIAL MANAGEMENT

8.1 The financial accountability perspective in this PEPFMR focuses on the public sector. Some aspects – such as budgeting, accounting, cash management and reporting -- have been covered in chapter 6. This chapter focuses on the current legal and regulatory environment, government auditing, and the unfolding COA restructuring⁶¹.

Public Financial Accountability In The Philippines

8.2 There is a long history of accounting and auditing development in the public and private sectors. The Commission on Audit (COA) – now an independent constitutional body and the country's supreme audit institution -- was initially established in 1935 with considerable powers and independence from the executive branch of the Government. The accounting profession is well-developed, with a national institute of Certified Public Accountants. The 1987 Constitution further strengthened public financial accountability structures.

8.3 In recent years the Government, in association with development partners, has carried out several analyses on improving financial management and auditing in the Philippines. At the outset of the PEPFMR process it was agreed that the exercise should build on the wealth of existing analyses and recommendations. In view of these developments, the financial management aspect of the PEPFMR exercise focuses on proposed reforms, implementation plans and what further work needs to be done. The recommendations are supportive of ongoing reforms, and a short list of feasible actions has been preferred to a long list of desirable actions.

External Audit

8.4 COA has undertaken a restructuring of its organization to address existing institutional limitations. The restructuring distributes audit responsibility from a regional basis to an agency-nationwide basis. The nationwide government agencies and GOCCs will be organized into audit clusters with a director taking responsibility for audit at the national and regional level. The audit of the LGUs in several regions will be clustered under a director who will take responsibility for all local government audits in the cluster. This restructuring is meant to promote the audit team approach which COA has not been able to fully implement in the past. COA has implemented the restructuring plan in 2002. This exercise will be keenly watched for lessons to be drawn for other restructuring initiatives in government.

8.5 COA also plans to focus its work on financial and value for money audits and progressively move towards a risk-based auditing model. COA is being assisted by UNDP and AUSAID in these efforts. As COA is currently fully engaged in the reform of the accounting system and computerization of the accounting, development of a risk assessment model and training of staff will be done gradually over the next two to three years.

8.6 With the planned computerization of the accounting system, another area that would need COA's attention is the development of IT audit capabilities. COA already has several auditors trained in audit of computerized applications.

Improvements need to be continued in key focus areas such as government accounting, reporting and auditing at the national and local government levels.

The COA reorganization will be keenly watched for the lessons it holds for restructuring initiatives in government.

COA plans to develop a strategy to develop its computer auditing capability and the upgrading of IT software and hardware.

8.7 COA has agreed for the World Bank to carry out a peer review to enhance its quality assurance program. COA is also pilot testing a program to encourage participatory audits, allowing civil society organizations to participate in selected audits. COA plans to mainstream this audit approach after reviewing the experience of the pilots. COA's public disclosure of audit findings is enhanced by the establishment of a website (www.coa.gov.ph) where all audit reports are placed for public access.

Accounting

8.8 Based on recommendations from existing analyses for improvements in accounting, COA, which is constitutionally mandated to promulgate policies, rules and procedures on accounting and auditing, has designed and initiated a phased implementation of a new government accounting system (NGAS) from January 1, 2002. The NGAS aims to: (a) simplify government accounting; (b) conform to international accounting standards; and (c) generate periodic and relevant financial statements for better performance monitoring. COA is also developing an accounting software package for computerization of the NGAS.

8.9 All national government agencies have adopted the new system starting January 1, 2002. The NGAS has several features that make it a significantly better system, including a modified accrual accounting basis, improved accounting for assets, in which all depreciable assets shall be capitalized and depreciation shall be recognized in the income and expenditure statements, the adoption of a single fund concept, and a simplified three-digit chart of accounts, among others. COA is also developing a computerized version of the NGAS.

8.10 With the introduction of the NGAS, a simplified annual financial reporting is also required. All agencies are required to prepare a balance sheet, income and expenditure statement and a cash flow statement. There are approximately one hundred reports produced by agencies for budget and financial control purposes. The introduction of NGAS is an opportunity for the Government to review the requirements of the various oversight agencies and prescribe a more streamlined set monitoring reports for their use. Pilots are under way in DSWD, DEPED, and DPWH to improve financial management reporting.

8.11 The introduction of NGAS means that approximately 2,000 independent accounting units at the national and local government level will have to switch to the new system. The logistics of such a large scale change without a period of parallel implementation carry very high risks. However, given the complexities of the old system, COA had no option but to opt for a "big bang" approach in installing NGAS and organized a nationwide training of trainers during the three months preceding the introduction of the new system.

8.12 Notwithstanding the above efforts, the government will have to take careful measures to ensure that NGAS implementation takes place without the risk of a serious breakdown of financial controls during the transition to the new system. The main risks arise from (a) the lack of a detailed accounting procedures manual to guide agency and LGU financial staff; (b) the possibility that training of staff may have been insufficient; (c) COA's capacity to provide adequate troubleshooting support when implementation problems surface; (d) the

The Philippines has made important strides with the development of the NGAS, but its implementation needs to be carefully managed to avoid the risk of a breakdown in financial controls during the transition.

lack of a link between the chart of accounts and budgetary classification; and (e) the uncertainty surrounding the management reports needed to carry out effective budget control.

8.13 To address these risks, COA has adopted a strategy of phased implementation, focusing first on setting up the basic manual system. This will be followed by computerization. The final step will be to develop a Government Integrated Financial Management System that will provide management and financial information at various levels of Government.

8.14 It must be stressed, though, that implementation and sequencing issues will require very careful monitoring during the pilot phase, and users' queries and system problems sorted out. It will be crucial to develop linkages between the NGAS on the one hand, and the BEATS and CUBES on the other, as early as possible. This will entail very close coordination and consultation between COA, DBM, BTR and NEDA.

Internal Audit

8.15 Internal audit is not a well developed function in government agencies. Although internal audit units are authorized under the Internal Audit Code, budgetary considerations have prevented their establishment in all government agencies and local government units. Some agencies, though, have internal control units that carry out some of the functions of an internal audit unit.

Recommendations

8.16 NGAS implementation. To ensure successful implementation, the government has appropriately focused on capacity-building, oversight mechanisms, provision of manuals, and effective coordination between central and line agencies, and it is desirable that the attention being given to such details, and the high-level intensive oversight of implementation, be continued till such time as the initial system implementation problems are ironed out and the NGAS is securely established.

8.17 Strengthening audit. Institutionalization of peer reviews of COA audits would promote a culture of openness and upgrade audit functions and services.

8.18 Internal audit. The internal audit function needs to be strengthened at national and LGU levels, in careful coordination with COA: with 11,000 auditors in COA alone, a careful study is a pre-requisite to embarking on a program to universally establish internal audit units. Such a study should review the transfer of some of the routine audit functions from COA to internal audit units and the implications on COA staffing due to the establishment of such units.

8.19 Given the importance of effectively managing contingent liabilities, it is also desirable that internal audit systems in GOCCs be strengthened to deal with management of contingent liabilities, and a broader role assigned for resident auditors in reviewing the financial statements of GOCCs.

The internal audit function needs to be strengthened at national and LGU levels, and should be closely coordinated with COA.

9. CONTROLLING THE WAGE BILL

9.1 Civil service reform is now critical for flexibility and could make an important contribution to public sector efficiency. This is because personal services expenditures – salaries, allowances, payments to wages of casual workers, bonuses, and the like – have emerged as the key variable (absent increases in tax collections) which the government can influence if it is to better finance core poverty-reducing investments and MOOE. In particular, it would seem that a reallocation from personal services to MOOE might improve the effectiveness and efficiency of government spending, especially in sectors such as education. Actions to address civil service employment and compensation issues are hence overdue, especially given the potential in the short- to medium-term for reallocation of personal services expenditures to MOOE.

Public Employment: Size, Structure, Cost

9.2 The structure and size of public employment in the Philippines has been depicted in Figure 1.2. Leaving aside the armed forces, GOCCs/GFIs and LGUs, the national budget pays for a total of 950,039 permanent staff (including education, health, police and other uniformed personnel) and approximately 21,478 casual/contractual and temporary positions. The five largest employers of permanent staff in 2001 were DepEd (480,348 filled positions), State Universities and Colleges (SUCs) (58,189), DOH (26,625), the Judiciary (26,422), and DENR (21,023); they were followed by DOF (19,145), DPWH (18,145) and DOTC (16,957). DA and DAR together employ 20,117 permanent staff.

9.3 The quality of the civil service at national and local levels affects the quality of policy advice and policy development on the one hand, and the quality of policy implementation and service delivery on the other. The key civil service constraints are well-known to policy makers: they involve issues relating to the fiscal weight of the wage bill; compensation levels and structure; establishment control and staffing; the legal framework; and capacity building.

9.4 The cost of the civil service has created a significant fiscal burden in the Philippines. Personal services expenditures accounted for some 35 percent of total national government expenditures in FY 2000 and 2001 and, if mandatory expenditures (debt service and IRA) are excluded, 58 percent of national government expenditures. This is not a recent development: from 1996-2001, personal services rose from a low of 6.1 percent of GNP to a high of 7.4 percent in 1998. Thereafter they have declined to 6.7 percent in 2000 and have remained at about that level through 2002.

9.5 There are good fiscal reasons why these expenditures need to be controlled even more tightly: low revenue collections, coupled with increasing debt service obligations, have squeezed the budget so much that the most realistic path to adequately protect the growth and anti-poverty agenda – apart from increasing revenue collections – is to rein in the wage bill more speedily.

9.6 The effort to control the wage bill has been led by the PCEG, DBM and CSC. The broad government strategy has been to control the wage bill through a series of incremental measures: minimizing contractual positions, containing the growth of permanent positions, and controlling LGU and GOCC expenditures on personal services. In 2001, the PCEG began a serious effort to streamline the

The cost of the civil service has created a significant fiscal burden: a reallocation from personal services to MOOE might improve the effectiveness and efficiency of government spending.

executive department. Beginning with the Office of the President, scores of contractual positions were abolished in 2002. That year the President also issued Memorandum Order (MO) No. 20 directing GOCCs and GFIs exempted from the Salary Standardization Law to standardize their pay practices and make the compensation of their senior officers comparable with their counterpart positions in the national agencies. The DBM and COA were tasked to monitor implementation of this order. The CSC issued Memorandum Circular No. 17 which obliges both national government agencies and LGUs to submit their job orders for contractual and casual employees to the CSC for review. This begins the gathering of information about this segment of employees which had heretofore escaped systematic hiring and compensation regulation. In 2002, the DBM also issued Local Budget Circular No. 75 to clarify and reiterate the guidelines with respect to waiver of the personal services cap provided for under the LGC. The net impact of these steps on the wage bill, however, has been minimal so far.

9.7 The government has also taken a decision in principle to integrate stand-alone project management offices (PMO) of foreign-funded projects into regular government structures to ensure operational sustainability and the alignment of project concerns with the overall agency program. This will arrest the increasing number of contractual personnel and minimize yet another avenue for avoiding salary standardization, through the use of higher-paid contractual positions for essentially core PMO functions such as administration, finance, project monitoring and evaluation. Additional contractual positions will as a rule be only for technical positions not readily available from the regular plantilla or existing contractual positions of the agency. The impact of this decision will become clearer in the months ahead.

Compensation

9.8 Salaries. There are three main constraints which the DBM and CSC are working to remove:

- (i) civil service salaries are unsustainably low by comparison with equivalent jobs in the private sector. A 1997 pay survey suggested that civil service salaries for senior managers might be as little as 20 percent of private sector equivalents. More notably, salaries for senior executives in the top grades and for professionals in the middle grades lag well behind salaries for equivalent jobs in the private sector, whereas salaries for lower pay groups are comparable;
- (ii) civil service salaries are also compressed – they hardly allow room for reward and significant milestones; and
- (iii) compensation levels are not adequate to attract, retain and motivate staff in certain jobs. The number of vacancies are rising and have remained unfilled in key professional categories including auditors, lawyers, IT professionals and medical professionals.

9.9 The single civil service salary schedule, with 33 grades each with 8 steps, is coming under increasing pressure. Many GOCCs and GFIs have already broken away, fuelling pressures. It has been contended that the principle of equal pay for equal work is no longer being followed: fiscal pressures have led to numerous entities being granted exemptions from salary standardization on the

Civil service compensation reform is overdue: salaries are generally low, allowances non-transparent, and disparate retirement laws have caused demoralization.

basis of their revenue-generating capacity. These exemptions have created a special class of civil servants whose compensation has increased disproportionately to those covered by the Salary Standardization Law. This debasement of the salary standardization principle enunciated in the Constitution has demoralized civil servants, and is part of the reason why national government agencies completely dependent on the budget are finding it difficult to recruit or retain personnel for highly technical and managerial positions.

9.10 These issues are being partly addressed. Across-the-board salary increases were granted in 2000 (10 percent) and 2001 (5 percent). The pay of the uniformed personnel was also increased starting 2000 for the Philippine National Police and starting 2002 for the Armed Forces of the Philippines. But more importantly, the PCEG has also approved the general framework for improvement of government compensation, namely that it be market-driven for high-turnover skills, and performance-based to the maximum extent possible. Notwithstanding the above, there is still pressure for proliferation of salary schedules. The DBM is trying to stem the tide by piloting in its Regional Offices the development of generic job descriptions. These are meant to minimize the diversity of positions, and broadband skills.

9.11 Allowances. There is a growing abundance of increasingly perverse and non-transparent "allowances", especially in GOCCs and GFIs. Pressure to contain the defined benefit pension bill has resulted in growth of unconsolidated "allowances" rather than increased basic salary. In addition, the productivity and performance pay has degenerated into merely another allowance, paid at a flat rate to almost all employees. Its original intention has been lost. On the other hand, geographical differences in pay and allowances have been abolished. But this has led to an unintended consequence: national government staff in regional offices are now said to be better off in real terms than their Metro Manila counterparts, and experienced staff are now reluctant to move to the national capital area from regional offices.

9.12 Pensions. Disparate retirement laws cause demoralization and are a burden to a stretched national budget. In addition, the three key pension funds (SSS, GSIS and the AFP RSBS) either face immediate financial sustainability risks (SSS and AFP RSBS) or need to strengthen their performance (GSIS) while comprehensive and longer-term pension reforms are designed and consensus is obtained for their implementation.

9.13 Sources of 'flexibility'. Allocations for wages of non-permanent personnel, per diems, fringe benefits, bonuses and incentives, other benefits and certain other items are known as 'flexible' items within the overall personal services allocation. Seen thus, roughly 18.4 percent of the 2002 personal services allocations across the national budget can be deemed to be "flexible" (within Congress, the comparable figure is 34 percent). There are departments with seemingly high allocations for wages of non-permanent personnel, such as DepEd (PhP638 million) and DND (PhP508.6 million), but these comprise less than 2 percent of their allocations for salaries of permanent staff. However, allocations for wages of non-permanent staff, as a ratio of the allocation for salaries of permanent staff, seem to be relatively high for some entities such as the Agriculture and Fisheries Modernization Program (1.4:1) and the Office of the President (1.1:1).

9.14 The data seem to show that reallocation from personal services to MOOE and/or capital outlays in sectors such as health and education could improve the efficiency of government spending. As discussed, some 95% of the DepEd budget is eaten up by personal services. The education sector is later used in this chapter to illustrate the interlinked personnel-related issues (size, structure and cost), and their effect in suppressing capital outlays and MOOE.

9.15 Effect of congressional initiatives. As mentioned in chapter 4, congressional initiatives to improve service delivery (e.g. through creation of SUCs, or increasing the number of beds in hospitals) has led to increasing pressure on the national government to fund all or part of the costs of the associated positions. The national government has attempted to deal with this by allowing SUCs, for example, to fund staff compensation from fees and charges, some of which may be off-budget.

Strengthening the Public Administration

9.16 The high cost of personal services – as demonstrated in the preceding sections - is compounded by proliferation of agencies, functional duplication, and overlaps among agencies and within and between departments. Some agencies seem to be over-staffed, while some are also over-layered, with too much middle management. There are staff surpluses in many functions and staffing shortages in others. Equitable distribution of staff across regions and provinces is an issue. Overlap and duplication of functions also adds to numbers.

9.17 As has been mentioned earlier, the “legislative track” to restructuring is pending in Congress. Various drafts of a Restructuring Bill have been stalled for 9 years in 3 successive Congresses. Comprehensive streamlining does not seem to be likely in the near term. Particular agency reorganizations, however, have been enacted by Congress, such as those of the Securities and Exchange Commission (SEC), the NPC, and the DepEd. Thus, the “administrative track” to restructuring is the current focus. Furthermore, the Supreme Court has upheld the authority of the President to reorganize the Executive Branch. Executive action to restructure and realign selected agencies in conformity with state priorities and policies seems to be the most feasible route.

9.18 The streamlining of agencies and offices attached to the Office of the President has been completed, based on a PCEG-led review. A first step was the issue, in February 2002, of EO 72 which abolished 77 offices and transferred 13 other offices to other agencies and departments where their functions are more aligned. Those abolished include inter-agency committees, ad-hoc committees and other bodies, most of which have already accomplished their mandate but have been allowed to continue. The fiscal impact of this abolition has been minimal, most of the affected employees being casual or contractual employees. Permanent employees in those offices will continue to be employed and have been placed in a pool administered by the CSC; the latter will place those civil servants into other agencies. But the signal this EO sent was welcome – that the government was keen to take administrative measures to reduce overlaps and duplication. Similar streamlining efforts are being pursued under the administrative track in DOH, DBM, DSWD, BIR and the Department of Energy.

9.19 Another signal of planned but fundamental restructuring comes from COA - with more than 10,500 employees across all regions, COA has begun the

Executive action to restructure and realign selected agencies seems to be the most feasible route: the BIR reforms are a litmus test of willingness to tackle core institutional reforms.

difficult process of restructuring its offices and reporting arrangements to strengthen its external audit function. The first round of changes are expected to be completed within 2002. To sustain these restructuring efforts, the DBM is leading a review of structures, functions and programs of all attached agencies, task forces and similar bodies in the national government. The expected outcome is abolition of unnecessary and proliferating attached agencies and ad-hoc bodies. DBM is currently preparing profiles of such entities. The government expects to deactivate 13 agencies through this process and support this with a more reasonable separation benefit package.

Institutional Issues

9.20 Establishment control. Establishment control is relatively weak despite efforts in recent years to control recruitment and impose selective hiring freezes. At present, departments do not present accurate information on the number of filled and unfilled positions and there is no reliable method to verify the submissions to oversight agencies. The DBM, CSC and the GSIS currently maintain their own personnel information databases, but these cannot “communicate” with each other, cover different sets of employees, and have their own reliability and accuracy issues. The situation is also exacerbated by the employment of considerable numbers of non-permanent staff such as casuals and contractuels. What this means in reality is that there is only weak control over staffing – and efforts to control staffing may founder on the rock of insufficient control points and outdated/incorrect information, unless addressed expeditiously.

9.21 Establishment controls need strengthening by having one authentic source of information on authorized positions (the approved plantilla) and filled positions, both also for use for payroll data, for more effective controlled of civil service employment and costs. An initiative to design and implement a common civil service personnel information system is under way. It seeks to harmonize existing disparate databases so that the information residing in different agencies can be used for payroll purposes and establishment control. An interagency Working Group (CSC, DBM, GSIS) has been established to review and recommend options for integrating the existing systems in GSIS, DBM and CSC.

9.22 A key issue constraining the setting up of effective establishment control mechanisms has been the limited capacity of the CSC. This has meant in effect that the DBM has had to shoulder much of the burden of establishment control. However, the CSC has been making a concerted effort over the last two years to enhance its capacity. It has prepared a Strategic Plan to address key civil service reform issues (box 9.1).

9.23 Some progress on pay and employment reform at the national government level has been recently made with the development of a modeling tool which can help authorities forecast the payroll, assess the fiscal consequences of pay and employment reform options, and apply it to national departments and agencies.

9.24 Institutional weaknesses. The CSC’s Strategic Plan document sets out the key institutional weaknesses constraining the professional upgrading of the Philippines civil service. Although they are well-known and have persisted for decades, they are nevertheless worth outlining:

The government is putting in place a human resource management information system – a first step towards strengthening establishment control.

- a) The bureaucracy functions too much as an adjunct of the political executive. Civil servants see themselves as mere implementers and followers of the prevailing political leadership, and are vulnerable to the dictates of the political executive.
- b) The operational behavior of the bureaucracy is still largely top-down, and there are few debates or consensus-building activities on issues affecting the civil service.
- c) Civil servants see themselves primarily as individuals employed by the organizations they serve, rather than as members of an institution dedicated to serving the people or driven by the ethos of public service. Rigid implementation of rules continues to offer scope for graft and corruption.
- d) Political influence and the spoils system continue to hold sway in appointments to senior and other key career positions. Open selection for career executive positions continues to be eroded by political influence. This is exacerbated by the fact that the President is the legally mandated appointing authority for most career executive service positions: the President appoints no less than 11,000 personnel comprising 3,000 constitutional positions, 6,000 career executive service positions, 1,650 prosecutors and 500 other positions created by special laws⁶².
- e) Some minimum qualification standards have been established for appointment. But they hardly guarantee real competence and desired behavioral attributes. There is too much emphasis on academic requirements, training and experience. Value dimensions of public service employment, e.g. service orientation, work ethic and character integrity, have yet to be factored into the system.
- f) The impact of information technology on productivity improvements has yet to be felt, and personnel management is crippled by a lack of integration of existing data systems.
- g) The existing compensation regime does not attract and retain the best and the brightest in public service.

9.25 Modernizing the legal framework. The CSC has worked extensively to prepare an updated draft of a new Civil Service Code which has been submitted to the legislature and is currently under review. Among other things, it aims to (i) improve merit-based recruitment, performance evaluation and promotion processes; (ii) make compensation more competitive within fiscal constraints, and link compensation to performance; (iii) protect upright civil servants in the discharge of their functions; (iv) strengthen accountability and integrity mechanisms; (v) clearly separate political and professional positions (at present there are numerous "positions of confidence", i.e. political or so-called 'elective' appointments, and the practice of offering 'courtesy resignations' with changes of administration creates the potential for high turnover of senior officials); (vi) strengthen the Third Level or the Career Executive Officers; (vii) allow CSC to appoint and discipline those below assistant secretary positions; and (viii) reinforce the contempt power of CSC. While the executive's commitment to updating the legal framework is undoubted, the real issue is whether this latest draft will be approved by the legislature, or whether it will meet the same fate as earlier attempts.

Political influence and the spoils system hold sway in appointments to senior career positions. Open selection for career executive positions is eroded by political influence. The President appoints no less than 11,000 central personnel.

9.26 On the integrity front, the PCEG is working with the Presidential Anti-Graft Commission and the Transparency and Accountability Network in the formulation of an integrated anti-corruption strategy for the government to strengthen integrity in the civil service.

9.27 Capacity building needs also require to be addressed: international experience shows that fiscal pressures cannot by themselves be sufficient for sustainable and longer-term civil service reform. And in order that civil service issues can be effectively addressed, it is desirable that the constitutional entity tasked with development and oversight of civil service policy – the Civil Service Commission – be strengthened on a priority basis, and that coordination between the Commission and the DBM be intensified.

Text Box 9.1. The Civil Service Commission's Strategic Plan 2002-2004

The CSC's Strategic Plan is significant because it represents the first integrated vision of strengthening the civil service in the medium term by harnessing the strengths of key stakeholders such as the CSC, national government agencies, public sector unions, local government units and, most importantly, the users of the public services that civil servants provide. The objective of the Plan is to gradually transform the civil service into an institution enjoying the trust of the Filipino people.

The Plan is frank in its assessment of bureaucratic gaps and weaknesses: overlapping organizational mandates, inefficient systems and procedures more concerned with adherence to rules rather than attainment of results and improving productivity, patronage-based appointment to executive and other key career positions, and a spotty record on enforcing accountability and weeding out incompetent civil servants.

The Plan focuses on 6 key result areas: (i) effective and efficient administrative justice; (ii) civil service professionalization; (iii) improving public service delivery; (iv) harnessing public sector unionism; (v) strengthening external relations; and (vi) management and support services. Specific actions are proposed for each key result area.

The CSC has held several rounds of consultations with relevant stakeholders. Next steps comprise costing the Plan, sequencing the steps, and finalizing the timeline for attaining the proposed results.

Source: Civil Service Commission

Education Sector: An Example

9.28 The education sector has the largest share of public employment. A review of data indicates the significance of personal services expenditures across this sector, and also the deleterious effect it has had on MOOE and capital outlays.

9.29 Basic education. In the basic education sub-sector, personal services comprises the single biggest item in the DepEd budget. The share of personal services in the DepEd budget rose incessantly from 80.1 percent in 1994 to 88.3 percent in 2001. The dramatic rise in personnel expenditure is largely attributable to adjustments in the salaries of public school teachers that were implemented by the government in the late 1980s and most of the 1990s. On the other hand, the growth in teachers' salaries was accommodated at the expense of MOOE (i.e. non-personnel recurrent expenditures) and capital outlays. Consequently, the share of MOOE in the DepEd budget was halved from 10.9 percent in 1994 to 8.1 percent in 2001 while that of capital expenditures dropped from 9.0 percent to 3.6 percent. Concomitant with these developments, per student DepEd

MOOE at 2000 prices declined on average by 5.1 percent a year in real terms from PhP878 in 1990 to PhP422 in 2000. The squeeze on MOOE has resulted to the short supply of key educational inputs like textbooks, teaching/instructional materials, science laboratory equipment and supplies, school desks as well as provisions for teacher training and the maintenance of school buildings. Thus, it should come as no surprise that households sending their children to public schools gave low satisfaction ratings to school facilities and textbooks.

9.30 Overall, between 1990 and 2001, personal services expenditures on basic education as a percentage of general government expenditures have grown from 73.7 percent to 87.5 percent. At the same time, the share of MOOE has fluctuated between 9.5 percent and 11 per cent between 1997 and 2001 – but lower than the levels during the period 1990-1996. Capital outlays have been squeezed far more – steadily dropping from more than 10 percent in 1995 to less than 2 per cent by 2001. Table 9.1 indicates these expenditures during the period 1990-2001.

9.31 In spite of the prevailing expenditure assignments, data show that LGUs do provide funding support for teacher salaries and honorarium, textbooks and instructional materials, supplies, school supervision, and utilities.⁶³ In fact, LGU spending on basic education is more evenly divided into personnel services, MOOE and capital outlays than one would expect given expenditure assignments across levels of government. The share of capital outlays in total basic education expenditure of all LGUs was 38 percent on the average from 1992-1995 compared to 28.0 percent for personal services and 33.8 percent for MOOE. However, LGUs appear to have also given increasing priority to personal services and MOOE during 1996-2000. The share of capital outlays in total education spending of LGUs declined to 34.6 percent in 1996-2001 to provide for the expansion of personal services expenditures to 29.6 percent during this period.

9.32 On the whole, changes in the composition of LGU expenditures on basic education reinforced the trend in central government expenditures. Thus, the composition of general government expenditures on basic education became even more skewed in favor of personal services expenditures in 1996-2001 relative to the situation prevailing during 1992-1995.

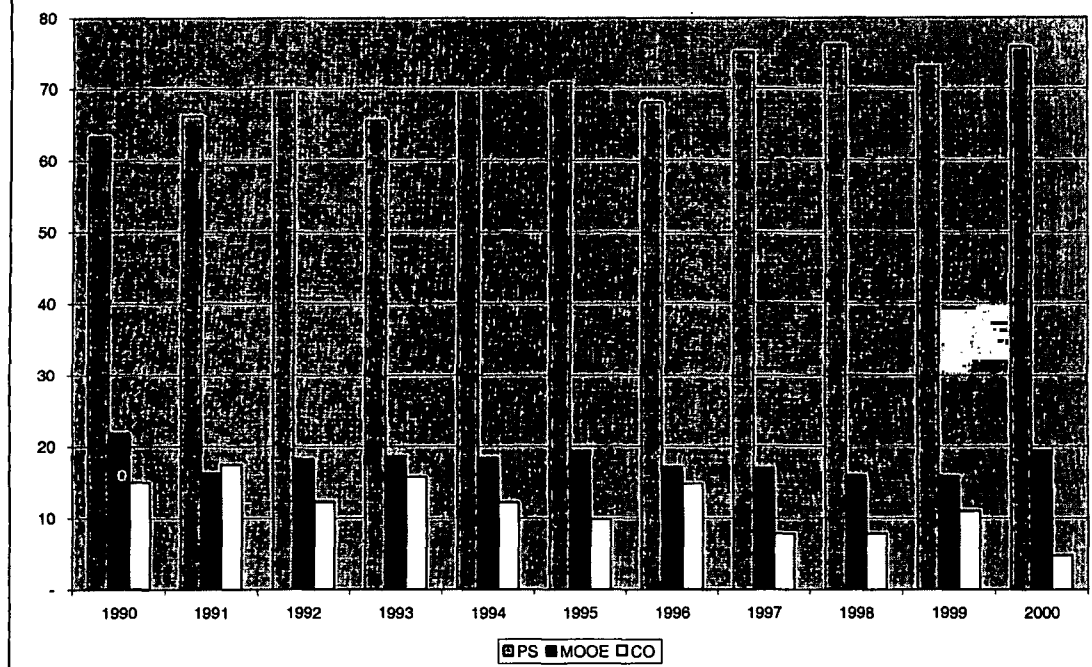
Table 9.1 General Government Expenditures On Basic Education By Object, 1990-2001

Level (mn. PhP)	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Personal Svcs.	20,955	18,700	26,432	27,189	32,993	42,105	50,517	68,407	77,022	81,340	86,854	90,912
MOOE	4,875	5,642	5,214	5,770	5,406	6,488	7,216	7,671	9,939	8,909	10,766	11,407
Capital Outlay	2,603	3,324	2,185	2,130	3,614	5,545	6,014	5,790	3,997	3,181	3,480	1,578
TOTAL	28,432	27,666	33,831	35,089	42,013	54,138	63,747	81,868	90,958	93,429	101,100	103,897
% Distribution	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Personal Svcs	73.70	67.59	78.13	77.49	78.53	77.77	79.25	83.56	84.68	87.06	85.91	87.50
MOOE	17.14	20.39	15.41	16.44	12.87	11.98	11.32	9.37	10.93	9.54	10.65	10.98
Capital Outlay	9.16	12.01	6.46	6.07	8.60	10.24	9.43	7.07	4.39	3.40	3.44	1.52
TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Department of Education, Department of Budget and Management

9.33 Higher education. The composition of SUCs expenditures exhibited a trend similar to that of basic education. The share of personal services in the combined budget of all SUCs rose from 64.1 percent in 1987 to 83.3 percent in 2001 (Figure 9.3). This reallocation came at the expense of MOOE and capital

Figure 9.3 General Government Expenditures on SUCs (By Object, 1987-2000)



outlays whose budget shares dropped, respectively, from 19.4 percent and 16.6 percent in 1987 to 16.7 percent and 7.2 percent in 1999. This budget shift was further reinforced in 2000-2001 following the implementation of a policy by government to reduce the budget allocation for SUCs by 10 percent annually in nominal terms relative to 1999 levels in order to shift the funds to basic education. Thus, the budget share of MOOE contracted further to 14.1 percent in 2001 while that of capital outlays declined to 2.6 percent. On the other hand, since LGU expenditures on higher education is less skewed in favor of personnel services than those of the SUCs, the share of wages and salaries in general government expenditures on higher education was lower than that of the central government expenditures. The upward trend in the budget share of personnel services that is evident for the central government is also however, observable for the general government. It is also notable that the expansion in the share of personnel services in higher education spending of the general government came at the expense of capital outlays alone.

9.34 High administrative costs in SUCs has been associated with low internal efficiency. Tan (1995) shows that the ratio of administrative costs to instructional costs is unduly high in many SUCs: these ratios were 35 percent for 47 percent of SUCs, and were as high as 45 percent for another 35 percent of SUCs.

9.35 It may be argued that low internal efficiency may reflect low utilization of resources. Johanson (1999) shows that the share of personal services in total operating cost is fairly invariant across SUCs. Part of the problem appears to be that teachers are used less intensively in SUCs than they are in private institutions. The student-teacher ratio is 18 for SUCs compared to 29 for private institutions, indicating the absence of standardization of budget subsidies on a per-student basis. Clearly, unless this issue in the area of personal services is

addressed, recent initiatives to reduce the budget allocation of SUCs may not be enough to turn the tide in reducing overall allocation on higher education.

9.36 Remuneration in the education sector. Between 1985 and 1997, the remuneration of government teachers went up by a multiple of 5 in nominal terms and by a multiple of 3 in real terms. It is notable that in 1997 the entry-level salary of a public school teacher was 70 percent higher than its private school counterpart. Moreover, even by international standards, public school teacher salaries appear to be on the high side: teacher remuneration as a ratio of GNP per capita in the Philippines is equal to 3.0 in 1997 compared to an "Asian" mean of around 2.5 at the primary level.⁶⁴

9.37 Given budget constraints, high teacher salaries naturally constrain the government's capacity to hire new teachers to cope with expanding enrollments. In basic education, the increase in the number of teachers (teachers holding position titles Master Teachers I-II and Teacher I-III) in government schools did not keep pace with the growth of enrollment. At the elementary level, the number of teachers rose by 1.3 percent yearly on average, from 261,131 in SY 1981-1982 to 329,198 in SY 1999-2000, while enrollment grew by 2.1 percent on average. At the secondary level, the number of public school teachers grew by 3.9 percent from 54,555 to 107,706, compared to the average growth of 5.1 percent in enrollment. Consequently, the student-teacher ratio in government elementary schools went up from 31 in SY 1981-1982 to 36 in SY 1999-2000 while that in government secondary schools increased from 29 to 34.

9.38 Employment and deployment of teachers. Despite the above movement, the gross student-to-teacher ratio across schools is not too far from the standard ratio of 34:1 being used by DBM. However, there is a wide disparity between the average class size and the gross student-to-teacher ratio in public elementary and secondary schools. In SY 1999-2000, the average class sizes were 45 and 50, respectively, in government elementary and secondary schools compared to gross student-to-teacher ratios of 36 and 34. These numbers suggest an imbalance in the deployment of public school teachers. One problem is related to the Republic Act 4760 (the so-called Magna Carta for Public School Teachers) which prohibits the transfer of teachers from one station to another (i.e. across geographical borders) without the latter's explicit assent.⁶⁵ Another relates to the current practice of assigning teachers to administrative and clerical functions that can otherwise be assigned to non-teaching personnel at school and district offices because of the absence of these positions. Realizing the problem, non-teaching positions have been created annually for DepEd in recent years. This has included positions for bookkeepers and accountants, created for district elementary and secondary schools to strengthen their financial management and pave the way for greater school-based management.

9.39 15,000 new teacher positions and 5,000 non-teaching positions were created under the General Appropriations Act for 2002. In addition, the DepEd received technical assistance on improving teacher deployment under the Social Expenditure Management Program (SEMP) which recommended that (a) the placement of newly-created teacher positions be targeted to divisions where they are most needed, (b) existing teacher positions in teacher-surplus divisions and schools be transferred to teacher-shortage jurisdictions when these positions fall vacant through retirement or death⁶⁶, (c) unfilled teacher positions in teacher-surplus divisions and schools be transferred to teacher-shortage jurisdictions⁶⁷, and (d) teachers currently doing administrative tasks be reassigned to teaching (Somerset 2001). Field work suggests a need to revisit and clarify the flexibility regarding re-assignment of teachers within a given division in the Magna Carta for teachers. Prospectively, there also seems to

While public school teachers' remuneration in the Philippines is higher than in other Asian countries, this also constrains national government capacity to hire new teachers to cope with expanding enrolment.

be a need in the near term to factor in the number of LGU-paid teachers in determining the teacher requirement of divisions and schools for determining the assignment of newly-created teacher positions.

9.40 The discussion above highlights that some LGUs, particularly the more urbanized cities, do fund additional teachers. In the medium term, however, unless the assignment of the education function across levels of government is changed, it seems that the DepEd will have to absorb LGU-paid teachers on its rolls.

Recommendations

9.41 Rationalizing employment and compensation. Given the pressing fiscal constraints, it is clear that the size and cost of the civil service requires review and adjustment as a first priority. There are three aspects to this. The first is to **establish an effective system to control employment and the wage bill.** The second – keeping within the bounds of fiscal realities – is to **increase the transparency and competitiveness of civil service compensation** while at the same time decompressing salary levels for key civil service grades. Third, it would be desirable to **design and implement a feasible strategy for adjusting civil service employment** to the appropriate role, functions and structure of the state – in concert with budget process reforms and administrative restructuring efforts.

9.42 Two key initial steps in controlling the wage bill could include the expeditious establishment of a workable civil service personnel information system, and deciding on fiscally affordable compensation improvement and rightsizing options using a civil service pay and employment financial modeling tool recently customized to the Philippine context. The former would involve the sustained pursuit of the **development of a common database on government personnel** to be shared by the CSC, DBM, GSIS and other oversight agencies. Simply put, the objectives of the common database would be to ensure that each permanent appointment is to an authorized position funded under the government's fiscal targets, that no person can be appointed to more than one authorized position, and that no person can draw pay from more than one payroll or obtain more than one set of benefits. The latter would involve a **review of the compensation policy, preparation of options for compensation and employment reform, and the assessment of the fiscal impact of employment and compensation adjustment** through (a) a mix of attrition and other measures, and (b) a phased upward adjustment of compensation for key skills.

9.43 Strengthening public administration. On the administrative streamlining front, **sustained actions to improve efficiency, attack duplication and overlap of functions, and do away with obsolete functions and entities** are necessary. The precedent set by the PCEG review-inspired EO 72 which initiated the streamlining of the Office of the President, now needs to be taken to line departments and agencies. The composition and functional assignment of staff requires adjustment to better match priorities. Quick actions seem to be called for, although it will be important to avoid unsustainable precedents being set. The planned deactivation of 13 agencies will be an important step in the right direction. But this will clearly not be enough.

9.44 Actions here would need to go hand in hand with the employment and compensation adjustments. Such a process would clearly need to include: (a) actions to streamline the central executive departments by eliminating duplication and overlaps, doing away with inappropriate and unnecessary functions and entities, efficiency improvements through further simplification of business processes and reduction of red tape, and (b) starting and sustaining the transformation of the BIR. In particular, **the implementation of the BIR organizational reforms** would

Sustained actions to improve efficiency, attack duplication of functions, and abolish obsolete entities are desirable. While the COA reorganization is a good example, the litmus test will be the implementation of the BIR organizational reforms.

constitute a litmus test of the ability and willingness to undertake core institutional reforms.

9.45 It would be desirable to sequence and implement these actions hand in hand with public expenditure management reforms intended to clarify the roles and mandates of state entities, and prioritize their programs and activities. Actions to reform the civil service and streamline the administration will also involve a delicate balance between flexibility in redeployment of human resources including hiring and firing, and providing the performance-based security and protection that neutral and impartial civil servants need to perform professionally through changes in administration at national and local levels.

9.46 Passage of the Civil Service Code is necessary, but it is not yet clear whether this will pass in Congress, given the length of time it has been awaiting legislation. However, an important beginning can be made by basing civil service appointments and promotions more transparently on merit, and not only on 'fitness'.

10. IMPLEMENTATION OF FOREIGN-ASSISTED PROJECTS

10.1 The government has been pursuing efforts to utilize official development assistance more efficiently by stepping up the pace of implementation of foreign-assisted projects (FAPs). This has assumed urgency because the pace of implementation of FAPs has been comparatively slow, and the budget squeeze, especially the declining flexibility in discretionary expenditures, has made FAPs an important source of financing development. The challenges in this area, and the key actions taken so far by the administration, are summarized below.

Enhancing Absorptive Capacity

10.2 Recent significant actions to improve portfolio performance include: (i) reducing the number of signatories for project documents; (ii) partial cancellation of about \$500 million equivalent of loans in 2001 to declog the ODA portfolio of non-performing or poorly-designed projects and excess loan components; (iii) conduct of quarterly portfolio reviews by the government with the three largest funding agencies to address bottlenecks; (iv) accessing quick-disbursing program loans generally intended to assist in overall deficit financing in exchange for the implementation of policy reforms; (v) initiating reforms in the power sector and other steps to improve governance.

10.3 The above measures appear to be bearing fruit. For the first semester of 2002, disbursement level posted an increase of more than 20 percent against the same period in 2001. Actual disbursement against target was 95 percent. Provided this rate is sustained, the government will be on track to meet the call of ODA partners to increase disbursement ratio to 20 percent by 2004.

Improving Project Identification and Preparation

10.4 Actions in this area also address weak demand for on-lending programs. Strengthening the linkages between planning and budgeting, and between the MTPDP and MTPIP, is expected to lead to improved project prioritization and more sustainable project financing. The implementation of SEERs has helped agencies to begin prioritizing their activities in order to align their projects to directly contribute to their major final outputs and sector outcomes. In addition, the integration of the project management offices into the mainstream operations of agencies should also reinforce the SEER and prevent FAPs in being over-designed but rather address persistent issues and concerns of the implementing agencies. The ICC has recently sent standards for implementing cost-sharing schemes with LGUs.

10.5 Under laws (e.g., Build-Operate-Transfer), as well as Executive and Administrative Orders, Government is increasingly providing incentives for private sector to take a more active role in services delivery to rural areas. What remains to be done, however, is to enhance the timing and adequacy of public expenditure, such that these are able to effectively leverage private investments. Related initiatives to mobilize and synchronize public and private resources are on ARC development planning, preparation of regional and local AFMPs (which incorporate various fund sources including private sector), and preparation of SAFDZ plans.

The declining flexibility in discretionary expenditures has made Foreign Assisted Projects (FAPs) an important source of financing development. Faster ODA absorption could speed FAP implementation and strengthen development financing.

Increasing The Predictability Of Project Financing

10.6 Constraints here include the timely and predictable provision of counterpart funds. The 2001 (re-enacted) budget led to a mismatch between previously allocated funds and new financial requirements of projects, and project financing was slowed down by budget deficit reduction measures. Some PhP41 billion was allocated for FAPs in the 2002 budget (as against PhP29 billion in 2001). The same extent of budgetary support for FAPs was incorporated in the 2003 budget.

10.7 The government is also reviewing the NG-LGU cost-sharing arrangements for FAPs. It is proposed that NG-LGU cost sharing in the implementation of FAPs be defined across all sectors that are devolved, maintaining a maximum 50 percent grant by the national government and a minimum LGU cash equity of 10 percent of project cost.

Strengthening The Sustainability Of Project Outcomes

10.8 This is being addressed through appropriate project design and improved institutional arrangements for project coordination, management, implementation and evaluation. Slower project implementation in 2001 was attributed to the change in administration (contracts were reviewed by new sets of agency/LGU officials, and agencies' and LGUs' priorities changed) and by September 11, 2001 (which delayed deliveries of imported supplies and materials).

10.9 Unlike most regular government programs, FAPs have been subjected to independent evaluations and thus their impacts and outcomes are well-documented. The main challenge is to mainstream these projects in terms of (a) lessons learned, as these relate to policy reform and refinements in strategies and programs; (b) budgeting and funds flow, particularly the continuing need to streamline the regular government fund release system; and (c) management, in order to ensure that capacities are internalized within regular structures, and to reduce disparity in salary rates.

10.10 Two of the bothersome "distortions" accompanying FAPs are (i) budget and finance – particularly special priority in budgeting and funds flow outside of the regular system; and (ii) higher salary rates of project staff compared to regular government personnel. The trade-off is between operational efficiency (using enclaved project-specific "special arrangements") on the one hand and, on the other, capacity-building and institutionalization of resource flows and personnel reforms.

10.11 Significant actions to strengthen sustainability have included:

- a) Issuance of Executive Order 109 which further streamlined the contract review process (except for contracts required by law to be acted upon and/or approved by the President, the EO gave full authority to Department Secretaries to give final approval and/or enter into all government contracts of their respective departments, awarded through public bidding, regardless of the amount involved);
- b) Issuance of EO 40 and subsequent enactment of a consolidated Procurement Reform Law to streamline procurement and harmonize local procurement procedure with best practices worldwide;

Strengthening implementation arrangements and speed could ensure faster ODA absorption, enhance institutional capacity at national and local levels and help sustain project outcomes.

- c) Enactment of RA 8974 which defines the procedure for right-of-way acquisition for infrastructure projects;
- d) Enactment of RA 8975 which now prohibits issuance by lower courts of temporary restraining orders on government projects; and
- e) Designation of project implementation officers at the Under Secretary (i.e. Deputy Minister) level in implementing agencies who are responsible and accountable for efficient implementation of their respective projects.

Rationalizing Implementation Arrangements

10.12 Most foreign-assisted projects are implemented through project management/implementation units. Often confronted with a choice between (a) the twin demands of ease and speed of project implementation and disbursement, and (b) the need to foster permanent implementation capacity, implementing agencies and development partners have adopted a pragmatic approach. Wherever necessary, they supported the establishment of dedicated units, both within and outside governmental structures, to assist speedy and effective implementation of FAPs. These have varied, however, from coordination units staffed by civil servants and located within existing organizational structures of the implementing department or agency to stand-alone and legally separate entities.

10.13 To address issues on capacity-building and sustainability of project outcomes, the government created a Task Force to look into the rationalization of Project Management Offices (PMOs). Four major agencies (DPWH, DOTC, DA and NIA) were reviewed. The Task Force recommendations include: (i) creation of a single or unified PMO for each department; (ii) implementation of agency-based rationalization strategies; and (iii) issuance of policy guidelines on PMO rationalization in the interim i.e., deployment of organic personnel, adoption of a scrap-and-build strategy and no net increase in agency staffing and personal services.

10.14 Typical implementation issues confronted by implementing agencies, the central oversight entities and development partners relate to fiduciary responsibilities (such as procurement, financial controls, reporting, accounts and audit) and personnel policies and practices. GOP oftentimes encounters differences in policies and procedures with financing institutions. These include, among others, compensation of project-affected persons, disbursement procedures (use of reimbursement scheme), selection of consultants, protocols for closure of loan accounts and procurement procedures.

Recommendations

10.15 Absorptive capacity could be increased through: (a) periodic undertaking of SEERs to sharpen prioritization of activities and so lead to improved project identification; (b) more thorough project design and project evaluation, especially for those with LGU participation and/or with multi-agency participation; (c) minimizing multi-agency implementation.

10.16 Sustainability of project outcomes could be enhanced by (a) strengthening project implementation arrangements and capacity (especially for procurement and financial management) in implementing agencies and relevant

***The ongoing
rationalization of
Project Management
Offices is an
important step in
enhancing ownership
and sustainability of
FAPs.***

LGUs; (b) addressing changes in project scope and design during implementation; (c) dealing effectively with poor contractor performance; (d) strengthening line agency and LGU capacity to prepare, evaluate, oversee and monitor implementation of projects, and assess project sustainability and impact; (e) involving civil society for accountable and transparent implementation; (f) addressing peace and order issues impacting projects; (g) issuance of an EO on resettlement, and high-level attention to right-of-way issues in land acquisition for projects, and (h) further strengthening coordination between implementing agencies and coordinating agencies, and removal of functional overlaps and duplication among national government agencies.

10.17 Greater predictability in project financing could be ensured through (a) a 3-year investment program with an indicative budget for each implementing agency; (b) conduct of SEERs of individual agency portfolios to establish medium-term priorities within the ICC process; and (c) continued streamlining of document processing and fund flow within implementing agencies.

*Increased absorptive
capacity, improved
sustainability of
project outcomes
and greater
predictability of
project financing
can enable more
efficient utilization of
ODA.*

SECTION D. DECENTRALIZATION

11. Decentralization: A Selective Overview

11. DECENTRALIZATION: A SELECTIVE OVERVIEW

11.1 The Philippines Local Government Code (LGC) of 1991 is considered to be one of the most far-reaching decentralization reforms in the developing world. The reform devolved to three tiers of LGUs - provinces, cities and municipalities and barangays – important responsibilities in areas such as agriculture, environment, natural resource management, health, public works and highways, as well as up to 40 percent of national government revenues. There are about 43,635 LGUs in the country today: 80 provinces, 114 cities, 1,496 municipalities and 41,945 barangays.

Intergovernmental Finances and Service Delivery

11.2 So far there has been no systematic evaluation of how local governments have performed under decentralization. Anecdotal evidence suggests that decentralization has encouraged greater innovation at the local level (i.e. the *Galing Pook* awards), strengthened local management capability and promoted greater cooperation with the private sector and other LGUs. However, the preliminary evidence also suggests that, despite these achievements, the expected benefits of decentralization have yet to be fully realized. Sufficient resources do not seem to be channeled to poorer LGUs, and the national government's ability to equalize fiscal capacity and monitor the financial performance of LGUs is weak.

11.3 Institutional arrangements for service delivery remain unclear in many cases, with national agencies playing a significant role in some functions that should have been fully devolved to LGUs. In addition, unfunded mandates from the national government such as the Salary Standardization Law have increased the cost of local services and impeded local autonomy.

11.4 The increase in aggregate Internal Revenue Allotment (IRA) to provinces, cities and municipalities seems to have exceeded the cost of devolved functions and other mandates, even when adjusted for inflation and population growth.⁶⁸ Despite this aggregate funding "surplus," poorer LGUs seem to suffer from insufficient resources. It is encouraging, however, that the national government is taking steps to strengthen its ability to equalize fiscal capacity and monitor the financial performance of LGUs.

11.5 In spite of the challenges, there are plenty of examples of effective home-grown solutions to common problems. For example, in the area of health service delivery and financing, cities such as Lapu-Lapu, Gingoog, Surigao, Cotabato and Puerto Princesa have adopted innovative measures to cope with the increasing demand for more and better quality health services from their constituencies. Several municipalities have also introduced innovations. Perhaps the more exemplary among these innovations are the barangay primary health care facilities established by the provincial government of Negros Occidental and the provincial health insurance program adopted by Bukidnon and Guimaras. In the area of controlling personnel size and costs, and accessing non-IRA sources of funding, the example of Cabanatuan city seems noteworthy.

Decentralization may have encouraged greater innovation at the local level. However, the preliminary evidence also suggests that, despite these achievements, the expected benefits of decentralization have yet to be fully realized.

Public Expenditure Management

11.6 Planning and investment appraisal appear to be the weakest links in the chain of LGU public expenditure management. Two key issues merit attention: (i) the coordination of the planning function across government levels, and (ii) the efficiency of LGU expenditures. First, NG-LGU planning coordination appears to be limited. Allocation decisions are informed by LGU development plans, which are supposed to be coordinated with regional and national plans. Preliminary observations indicate that the coordination of national and LGU plans is weak in some cases and non-existent in others, undermining the effort to focus expenditures on key priority areas, especially to pro-poor services.

11.7 Second, most LGUs seem to lack adequate project evaluation capacity. It is not clear that investment decisions are made on a technical basis or that there is a system for filtering and ranking investment projects. Many LGUs have weak capacity to formulate development projects. This is important because a large percentage of the small amount of capital expenditures in the Philippines occurs at the LGU level, especially in key economic and social sectors.

Revenue Administration

11.8 The overall share of revenues mobilized from local sources relative to GDP is not significantly greater now than it was before the LGC. In many cases IRA transfers seem to have created disincentives to mobilize local revenues.

11.9 Revenue administration is thus an area of great potential improvement. Many LGUs seem to be able to collect only a small percentage of potential revenues due under their respective local tax codes. The main problems include: (i) lack of accurate, computerized taxpayer registration databases (many taxes and fees do not in fact have taxpayer registries); (ii) lack of accurate cadastral information for property taxes; (iii) large numbers of non-filers, stop-filers, and non-payers; (iv) inadequate audit presence for business taxes; (v) lack of trained professional staff (which has led to the use of casual employees to collect some user fees, for example); (vi) inadequate data on payment delinquencies; (vii) cash-based payment systems; and (viii) virtually non-existent taxpayer services.

11.10 The confluence of these problems has led to under-assessment as well as under-collection of most taxes and fees, thus perpetuating LGU reliance on transfers from the central government. Improving the assessment and collection capacity could reduce reliance on IRA transfers. Moreover, improving tax administration is necessary to ward off pressures to increase tax rates at the local level (anecdotal evidence indicates low collections are prompting local officials to call for higher tax rates, which would only make the system more distortionary). There are other significant institutional issues which, if appropriately addressed, could greatly strengthen governance and improve revenue collection at the LGU level, for example, greater transparency and accountability in (a) the assessment process and in the standards by which assessment efficiency can be evaluated, and (b) the setting, collecting and auditing of fees for public markets and slaughterhouses, as well as in the leasing process for public markets.

LGU capacity to assess and collect revenues could be greatly improved, reducing reliance on IRA transfers.

Human Resource Management

11.11 LGUs are limited in their ability to manage and develop their human resources. As a result, LGU capacity for expenditure management is uneven, especially in planning, investment appraisal, financial management, and personnel functions. Moreover, LGU financial integrity is often weak: COA reports have cited numerous LGUs for inadequate financial management.

11.12 Improving the quality of public administration at the LGU level assumes importance because administrative capacity, incentive systems, skill mix, and the management and deployment of human resources can significantly impact the operational efficiency of public expenditures. The main issues comprise the following: (i) expenditures on personal services (PS) constitute the largest category, squeezing out MOOE and Capital Outlays; (ii) although PS expenditure is formally capped at 45–55 percent of total LGU resources, it needs to be seen whether such expenditures are higher in reality if payments to casual and contractual workers are taken into account; (iii) the cost of personal services is sometimes charged to MOOE; (iv) remuneration levels and structure vary enormously depending on the resources – and resourcefulness – of LGUs, and grant of allowances and benefits to LGU officials without legal basis is not unknown; (v) even for functions and positions whose personnel costs are supposed to be funded entirely by the NG budget, LGUs commonly supplement such NG allocations (reliable data on the amount and nature of such supplements does not seem to exist, though); and (vi) managers and administrators seem to be slack in enforcing basic fiscal discipline in their offices (e.g. claims for disallowed payments have been rising steadily, and stood at P1.7 million at end-2000 – leniency in pursuing remedial measures against delinquent officials is reported to be the main cause). Otherwise, as the 2000 COA Annual Financial Report on Local Governments notes, the ‘injudicious discharge of fiscal responsibilities’ will continue to contribute ‘to the failure of local government units to become self-reliant communities’.

11.13 Recent actions taken to strengthen human resource management have focused on: (a) improving the management and career development of tax assessors and treasurers; (b) examining how to scale up pilots on governance and service delivery performance indicators and management; (c) developing an LGU “hall of fame” to enable recognition for outstanding performance or outcomes; (d) pilot-testing a Customer Feedback Survey in 21 sites to increase citizen’s access to information, develop 2-way feedback with citizens, and involve citizens and agencies in setting performance and service delivery standards.

Financial Management

11.14 LGU financial management rests with the local chief executive (governor/mayor). The chief executive is assisted by three key financial officials: the treasurer, the budget officer, and the accountant. Each of these officials reports directly to the chief executive and are independent from one another. The treasurer is appointed by the Bureau of Local Government Finance (BLGF) of the DOF from among three nominees recommended by the Chief Executive.

11.15 The accounting and budgeting guidelines are issued by COA and DBM respectively. A new Local Government Accounting System (LGAS) consistent

Strengthening the management and deployment of human resources by LGUs would greatly improve the operational efficiency of public expenditures and service delivery.

The weak internal financial management and control environment in LGUs needs substantial strengthening for LGU accountability to improve.

with accounting principles of NGAS has been introduced (starting January 2002). COA has the power to audit all LGUs.

11.16 The internal control environment and institutional arrangements for financial accountability remain extremely weak at the LGU level. In 2000, for instance, only 250 of the 1,689 LGUs audited were given clean audit reports by COA. Although there are many reports of best practice in a number of LGUs, weak internal control practices have been frequently flagged by COA annual reports, and the internal audit function is non-existent in most LGUs. The main reasons for this poor internal control environment seem to be: (a) frequent turnover of elected officials; (b) disregard of laws, rules and regulations by elected and appointed officials; (c) lack of clarity in the oversight agencies; and (d) inadequate LGU-level financial management capacity.

11.17 The principal LGU-level financial management weaknesses identified by COA are: a) lack of compliance with laws, rules and regulations; b) weak control over fixed assets and lack of recording and inventory of fixed assets; c) weak control over cash management due to retention of collected revenue in cash by treasurers in contravention of regulations requiring deposits at authorized banks; d) weak control over accounts payable; e) weak human resource capacity in financial management, particularly in rural LGUs where it is difficult to find qualified and experienced accountants; f) incomplete implementation of audit findings.

11.18 Financial management capacity in most LGUs is very weak. BLGF, the principal oversight agency, has played a somewhat passive role. There is no clear financial leadership role as responsibilities are split among the three principal officials. Financial management reporting is essentially regulatory in nature. There are no updated accounting, treasury and budget management manuals, and similar reports submitted to oversight agencies often contain different data.

11.19 The Government acknowledges that reforming and improving such a diverse group of independent political and administrative units will take time and resources. Several initiatives aimed at capacity building are under way, including a World Bank-financed Local Government Finance Development Project and an IDF Grant to assist financial management capacity building.

Procurement

11.20 Rule 35 of the IRR of RA 7160, known as the local Government Code (LGC) of 1991, governs the procurement process of LGUs for supply of property or goods, and PD 1594 serves as the basis for infrastructure contracts. PD 1594, which has been repealed by the LGC of 1991 insofar as locally funded infrastructure is involved, is still widely applied among LGUs.

11.21 Except as otherwise provided, the general policy on procurement and acquisition of property by LGUs is through competitive public bidding. The procurement process however, especially the bidding process, is generally perceived to have resulted in higher procurement costs at the local level. In general, the cities seem to have the most problems, followed by the municipalities and then the provinces. The process of implementing procurement laws and rules appear to give rise to inconsistencies. Significant adaptations or so-called shortcuts of various rules and procedures apparently abound, and some LGUs have established enabling resolutions for legal application. Text Box 11.1

***LGU capacity to
develop
procurement plans
and implement
them needs
sustained
strengthening.***

outlines the procurement process for medical supplies in one province of the Philippines.

Performance Monitoring

11.22 LGUs are now subject to several different reporting requirements, which use a variety of reporting formats, periods and frequency. This, however, has meant that information about LGU performance is dispersed, there are inconsistencies in data and information, and duplication. BLGF, for instance, now consolidates the data by provinces, cities and municipalities on a quarterly basis. Recent attempts to take stock of LGU performance monitoring indicators disclosed that there are more than 40 indicators of varying coverage and quality developed by government, donors, academia and civil society organizations.

11.23 Of the several ongoing government efforts to develop an integrated performance monitoring system, the BLGF has piloted a new fiscal and financial reporting format for LGUs in 2001. The new report, called the Statement of Income and Expenditures (SIE), will replace the existing Budget Operations

Text Box 11.1 Procurement of Medical Supplies in Agusan del Norte

The Provincial Health Officer (PHO) submits an Annual Procurement Program that includes everything the hospitals need for their operation for a year. Once approved by higher authorities, the PHO submits a purchase request (PR) for a quarter for drugs, medicines, office and medical supplies and reagents to the Provincial General Services Office (PGSO). The PGSO then schedules the bidding with the participation of the Provincial Auditor, Treasurer, Budget Officer, Accountant, and representatives of the Governor and the PHO, who together constitute the Pre-qualification, Bidding and Awards Committee (PBAC) of the province.

Potential bidders for medical supplies are accredited upon submission of a governor's permit, accreditation from the DOH, company profile, notarized price list, tax identification number, and a proof of good track record as appraised by the PGSO. Closed bidding procedures are followed in Agusan del Norte. Suppliers submit closed bids to the PGSO who then turn the bids over to the PBAC, which opens them in public. The winning bidder is then furnished a copy of the purchase order (PO). Due to limited funds, however, the PO usually covers only a quarter's supply of drugs, medicines and other supplies. Bids are called and scheduled only if the total worth of the PO exceeds 150 thousand pesos. POs for less than this amount are issued on the basis of canvassing from at least three potential suppliers.

Statement (BOS), which reports LGU fiscal operations on a yearly basis. The BOS is cumbersome and takes time to complete. Oftentimes, too, the reports come in late (sometimes 6 months and more). The SIE, by contrast, is more user-friendly: there is a one-page summary of the fiscal operations of LGUs with attached schedules which contain more details. Reporting is on a quarterly basis. DBM has agreed to use the SIE instead of developing another format. The SIE may now provide a single source of data on LGU fiscal and financial operations.

11.24 The BLGF has also developed 14 fiscal performance indicators, and plans to pilot them after revising the fiscal reporting format. These indicators, it is hoped, will be able to show how LGUs are performing in terms of local resource mobilization and expenditure management (e.g. whether they are spending more for current vs. development expenditures, their debt management

performance). There are 13 BLGF regional offices nationwide whose staff are being trained to develop regional data bases and analyze the data by regions.

Recommendations

11.25 Decentralization and intergovernmental finances. It now seems time to review the fiscal, administrative and political aspects of decentralization in the Philippines and assess how the Local Government Code and related legislation have worked in practice. Such an assessment could entail an examination of how decentralization has worked in relation to objectives such as service delivery⁶⁹, accountability and governance⁷⁰. Reviewing the intergovernmental transfer mechanism in order to identify opportunities for greater equalization and clarifying institutional arrangements and responsibilities could lead to improved service delivery. Such information could be used to clarify LGU responsibilities and assess the need for transfers from the national government. However, given the political and institutional complexities involved, this needs to be carefully handled, with the widest possible participation and debate at all levels.

11.26 It therefore seems appropriate to undertake a cross-sectoral analytical exercise – a Decentralization and Service Delivery Study - to examine the above issues in the context of decentralization in the Philippines. This study would address the ‘supply side’ of decentralization (i.e. policies, practices, and processes). A companion survey-based exercise – a Governance and Service Delivery Diagnostic – could examine the ‘demand side’: it could benchmark the effectiveness of the national government and LGUs in delivery of selected public services, especially those to the poorest and most vulnerable, and assess related governance issues such as accountability and transparency. This diagnostic assessment could be based on three sets of surveys of key stakeholder groups. Representative samples of enterprise managers and households could be surveyed about their interactions with state entities and LGUs; their responses can provide external assessments of the access to, quality of and satisfaction with services provided by various bodies, as well as about their experiences with corruption, from the perspective of the users of these services. A representative sample of public officials could also be surveyed, providing the insiders’ perspective, as well as self-evaluations of the quality of their work. Such a survey of public officials can also highlight progress in the actual implementation of governance-related reforms in key areas such as procurement, financial management, budgeting, revenue assessment, revenue collection and public administration, and can provide information on the business culture of national government and LGU offices. The resulting diagnosis, based on the dual analytics, could help improve public sector performance and promote healthy competition between LGUs to improve service delivery.

11.27 Service delivery. There is a clear need to strengthen LGU capacity on several fronts, to enable them to better deliver services. The diagnostic proposed above could inform the assessment of service delivery and governance, and be of use to the authorities. Improving service delivery hinges on three factors: (i) on the revenue side, improving the assessment and collection of revenues from local sources to reduce LGU dependence on IRA, and to offset weaknesses in national government revenue collection, (ii) on the expenditure side, strengthening planning, investment appraisal, procurement and financial management, and (iii) controlling expenditures on personal services and improving the quality of public

***A Decentralization
and Service Delivery
Study could be an
appropriate lens
through which to
assess the
decentralization
experience, a
decade into the
implementation of
the landmark Local
Government Code.***

administration through stronger accountability and integrity arrangements. All three will require long-term capacity building, including through replication of innovative LGU-level approaches and practices.

11.28 Public expenditure management. In the medium term, a high priority is to improve local fiscal and performance information, including updating the income classification system and establishing local government information systems as part of the Government Financial Management Information System. The BLGF could build on its work underway to computerize local accounts to develop a comprehensive information system on LGU finances. Indicators could include revenue and expenditure data, outstanding debt and future debt service, budgets, procurement, and some performance indicators.

11.29 Human resource management. The proposed Decentralization Study could develop detailed recommendations for: (a) reviewing LGU compliance with the cap on 'personal service' expenditures as percentage of total resources in light of employment of and expenditures on casual, contractual, and other non-permanent workers; (b) reviewing the levels and structure of remuneration, which vary enormously across LGUs (including unofficial allowances, benefits and perks for LGU officials); (c) reviewing the LGU practice of providing salary supplements for functions and positions whose personnel costs are supposed to be funded entirely by the national government; (d) improving the coverage and quality of human resource-related statistical data.

11.30 Financial management. Improved management and career development of assessors and treasurers can enhance the quality of fiscal management. The introduction of LGAS will provide an opportunity to address accounting procedures and training of LGU accounting staff. However, the large volume of staff and LGUs that need to be trained and supervised make this a challenging task. COA will need to augment its existing capacity speedily to meet LGU needs. BLGF will pilot the introduction of 14 performance indicators to monitor LGU performance from 2002. The LGAS will also require submission of standard financial statements starting from end-2002. These initiatives, if implemented and observed by LGUs, could go a long way to address financial discipline issues at the LGU level.

11.31 A desirable strategy would be to build on GOP and donor-funded initiatives and develop a program which includes: (i) strengthening the BLGF by empowering it to be the main driver of local government finance; (ii) strengthening the internal control environment in the short term; and (iii) designing an LGU-level financial management improvement program to build capacity over the longer term.

11.32 Procurement. Key actions that the government proposes to take, and which would be desirable, include: (i) ensuring that LGU procurement is adequately covered in the IRRs for the Procurement Reform Law; (ii) prohibiting local chief executives from chairing Bid and Award Committees; (iii) mandating strict implementation of the Annual Procurement Plan by procuring entities; (iv) incorporating consultations with LGUs in preparation of national procurement plans; (v) professionalizing the procurement function and strengthening procurement capacity at the LGU level; and (vi) streamlining payment of contractors and suppliers.

LGU capacity to better deliver basic services hinges on long-term capacity-building aimed at

(a) improving assessment and collection of own source revenues,

(b) strengthening planning, investment appraisal, procurement and financial management, and

(c) improving the quality of LGU public administration.

11.33 Performance management. Building on the results of piloting the SIE and the fiscal performance indicators, it would be desirable to rank LGUs by performance, and to develop an incentive system for well-performing LGUs. The GOP is keen to computerize the data gathering and analysis of LGU fiscal operations – this will require early development of an action plan and cost estimates for technical assistance and financing.

SECTION ONE. NEXT STEPS AND ACTION PLAN

12. NEXT STEPS

Dissemination Strategy

12.1 The preceding pages have outlined the key PEPFMR findings: some are diagnostic in nature, others relate to planning, still others pertain to implementation issues. It is desirable that on the implementation-related issues (e.g. revenue collections, BIR reforms, or reallocating personal services expenditures) the Government act quickly and decisively – in a sense, the overarching importance of the still-unfolding fiscal developments dictates quite clearly the sequencing and prioritization of the actions to be taken. The more detailed matrix at the end of this volume contains the joint recommendations of the GOP and the task team.

12.2 The dissemination strategy for the PEPFMR envisages sharing of this report and the matrix of recommendations with a wider audience once it has been reviewed and endorsed by the World Bank and ADB management and by the GOP. This wider audience comprises national agencies and LGUs, legislators, development partners, academia, civil society and the media. A first dissemination workshop has been tentatively planned with the GOP for May 2003. The exact workshop dates will be finalized in consultation with the GOP.

Next Steps

12.3 This PEPFMR is a joint document of the Government of the Philippines, the Asian Development Bank and the World Bank. The litmus test of its relevance will be the extent to which its recommendations will be taken on board and implemented over the medium term.

12.4 Some actions have already been initiated by the Government even as the PEPFMR exercise was under way. For example, working with the ADB and the World Bank, a series of grant-based technical assistance programs have been prepared. These are aimed at building capacity at the national level in critical areas (e.g. for management of contingent liabilities, strengthening the BIR, and expenditure management) or for more detailed diagnostic work (e.g. pension reform, pay and employment modeling).

12.5 Next steps in the PEPFMR process could comprise:

- a) A series of consultations and workshops to develop some of the themes outlined here more fully and obtain consensus on the actions proposed in this PEPFMR; and
- b) Chalking out more detailed and costed action plans to address such issues.

12.6 For those planning and diagnostic-type issues where assistance or advice from development partners could be valuable, the Philippines' development partners stand ready to provide the needed support.

ACTION PLAN⁷¹

Public Expenditure, Procurement and Financial Management Review

Action Plan

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
PART A. AGGREGATE FISCAL DISCIPLINE				
1.	OVERVIEW: THE INSTITUTIONAL AND FISCAL CONTEXT			
1.1	<p>Fiscal flexibility has been steadily declining as revenues shrink and mandated expenditures grow.</p> <p>After several years of surplus in the mid-1990s due to improved tax collections, the fiscal deficit has re-emerged since 1998 in both National Government (NG) and consolidated public sector finances⁷²</p>	<p>Aggressive efforts to contain the deficit were and are being undertaken:</p> <ul style="list-style-type: none"> • On the revenue side, efforts to identify new tax and non-tax revenue measures have been coupled with plans for the institutional transformation of the BIR • On the expenditure side, cost cutting and mandatory savings have been mandated and budget execution is being closely monitored to control expenditures <p>Specific actions taken have been outlined in this Action Plan.</p>	<p>Achieving and maintaining fiscal discipline, and continued attention to improving governance and institutions, will be critical for poverty reduction, economic growth and investor confidence.</p> <p>Details are in the rest of this Framework.</p>	<p>Specifics are in the rest of the action plan.</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
	<ul style="list-style-type: none"> • The government's growth and poverty agenda is threatened by the budget squeeze. • Budgetary inflexibilities have become more rigid because high mandated expenditures and resource, planning and implementation constraints are suppressing core poverty-reducing capital and maintenance expenditures. 	<ul style="list-style-type: none"> • Part B of the Framework. • GOP is trying to put in place better medium term expenditure planning and budgeting to ensure that overall budget management and expenditure allocation are tightly focused on the national priorities and strategies enunciated in the MTPDP and the 2001 and 2002 SONAs. • Steps are being taken to improve the predictability of resource allocations and resource flows to strengthen operational efficiency. 	Part B of the Framework.	
	Technical and operational constraints – e.g. those relating to procurement, financial management and human resources processes - limit the efficiency with which available resources can be utilized, and key public services delivered.	Part C of the Framework.	Part C of the Framework.	
	Capacity building at the LGU level, including and especially in procurement and financial management, is critical for strengthening accountability and service delivery, especially of those services targeted to the poor, the disadvantaged and the vulnerable.	Part D of the Framework.	<ul style="list-style-type: none"> • Part D of the Framework. • Dissemination and replication of in-country good practices and innovations • Augmentation of LGU capacity to obtain, allocate and manage financial, human and physical resources • Strengthen LGU accountability and transparency 	
1.2	Strengthening the core functions, strategic roles and responsibilities of the government in accordance with socio-economic priorities and resource constraints	<p>The PCEG is leading an initiative aimed administrative streamlining and business process re-engineering based on examination of the following issues for each sector:</p> <p>a) The role of the state vis-a-vis the private sector and civil society</p>	<ul style="list-style-type: none"> • Start streamlining the bureaucracy by reducing committees and task forces and abolishing or deactivating redundant agencies. • Implement restructuring/realignment of selected agencies in priority sectors based on laws and administrative fiats when possible and in 	NEDA, DBM, CSC, concerned agencies (under PCEG guidance)

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Force Recommendations	Agency
		<p>private sector and civil society</p> <ul style="list-style-type: none"> b) Existing and appropriate functional relationship between the national and local governments c) Existing organizational set-up of executive departments and agencies and their functional transformation based on the appropriate role of the state d) Existing systems and operations of concerned departments and potential improvements thereto based on the desired role of the government e) Other relevant re-engineering issues <p>The twin-track reform strategy envisages:</p> <ul style="list-style-type: none"> o Pursuing passage of a Bill to rationalize the scope and functions of government agencies. Lack of clear enabling legislation for comprehensive executive restructuring including an attractive separation package may constrain implementation of such reforms. The Administration version of the Public Sector Institutional Strengthening Bill was refiled in 2002. If passed into law, the reorganization of government could be expedited. Passage of this law in Congress will be a challenge, given that such bills have stalled in Congress for the last 7 years o Completion of strategic reviews of high-priority sectors (e.g. social sectors, infrastructure) to serve as basis for proposed passage of individual laws to reorganize each departments and beginning streamlining of small executive agencies within the existing 	<p>coordination with ongoing budget process reforms and proposed civil service reforms</p> <ul style="list-style-type: none"> o Submission to Congress of Public Sector Institutional Strengthening Bill o Completion of strategic reviews for agriculture, social and infrastructure sectors (details in Part B). (by 12/02) 	

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
		legal framework. Some results have been achieved in DOH, DSWD, NSO, DBM and DND. This is a more pragmatic and practical approach. Details are in Part B.		
2.	<p style="text-align: center;">AGGREGATE FISCAL DISCIPLINE</p> <p style="text-align: center;"><i>Key message: Financing for the government's growth and poverty-reduction agenda is inadequate without revenue increases: an appropriate blend of administrative and policy measures is now essential to establish a sound foundation for a sustained recovery in tax effort.</i></p>			
2.1	<p>Revenue administration: selected reform issues</p>			
2.1.1	Transformation of the BIR.	<p>Strengthen DOF-BIR relationship:</p> <ul style="list-style-type: none"> • DO on delineation of roles and responsibilities between DOF and BIR done and provided to BIR for finalization including the following: <ul style="list-style-type: none"> ➢ Mechanism to discuss key taxation issues ➢ Establishing a calendar of key events and milestones in the annual budget formulation and monitoring cycle ➢ Establishing joint DOF-BIR working groups on revenue leakages and revenue forecasting ➢ Ensuring that BIR provides DOF with necessary tax return data • Completed organizational effectiveness study in February 2002 • Completed strategic planning and operational planning including performance indicators for departments and divisions in BIR • Completed individual planning down 	<ul style="list-style-type: none"> • Adequate allocation for BIR's operating budget during 2002-2004 • Complete individual planning down to staff • Issue reorganization EO for BIR • Undertake independent evaluation of BIR's computerization program • Outsource BIR's IT to accelerate its refinement and utilization 	DBCC, DOF, DBM, BIR BIR OP, DOF DOF BIR

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
		to regional directors and district officers level (April 2002) ◦ Submission of reorganization EO to structure BIR according to taxpayers (May 2002)		
2.1.2	Other tax administration issues	◦ Increased the rate of withholding taxes to enhance Government access to tax revenue collection and to provide savings in public debt interest outlays (BIR Revenue Regulation 12-2001, Sept. 2001) ◦ Benchmarks for input VAT by industry will be completed by June 2002 ◦ Intensify VAT audit work for large tax payers services based on industry benchmarks (2002)	◦ Develop an electronic linkage between BIR, BOC and petroleum refineries to support reporting, monitoring and collection of excise taxes ◦ Develop mechanism to establish benchmarks for withholding of taxes of professionals (i.e. presumptive income)	BIR BIR
			◦ Compromise settlement program ◦ Devise formal guidelines for negotiating tax settlements and a more comprehensive approach for assessing applications for compromise based on financial incapacity	BIR BIR
		Installed metering machines in banks (2001)	◦ Continue to install additional metering machines in other establishments	DOF

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
		<p>Submitted tax bills to Congress to:</p> <ul style="list-style-type: none"> • Increase the specific rates for alcoholic beverages, tobacco products and petroleum products to restore their real value to that of January, 1997 • Expand the automobile excise to include all vehicles that can be used as family cars <p>Implementation of Comprehensive Tax Reform Program (CTRP):</p> <ul style="list-style-type: none"> • Revenue regulations on ceilings on representation expenses being finalized • Limit the regulations relating to accelerated depreciation to depreciation methods • Redraft the draft regulations relating to travel and entertainment expenses 	<ul style="list-style-type: none"> • Enact and implement legislation on excise taxes • Implement CTRP • Seek technical assistance to learn about best practices in excise tax collection for different products 	<p>DOF, NTRC</p> <p>DOF, NTRC</p> <p>DOF</p>
3.	OFF-BUDGET RISKS AND THEIR MANAGEMENT			
3.1	Improving recognition of contingent liabilities	<p>A Task Force has been set up by the DBCC to look into contingent liabilities (CLs) and their management</p> <p>An initial inventory of CLs has been completed by DOF.</p>	<ul style="list-style-type: none"> • Develop a framework for recognition, management, reporting and provisioning of contingent liabilities. Complete quantification of CLs (2003) • Extend and complete ongoing inventory of CLs to: i) encompass all categories of CLs (explicit and implicit), ii) analyze institutional arrangements for recognition, management and provisioning of CLs – analysis to include inter- and intra-agency arrangements (2003) • Use (i) the inventory of CLs, (ii) reporting mechanisms, and (iii) training and capacity-building needs assessment to develop a time-bound implementation plan (including the need to develop contingency plans based on risk assessment) (2003) 	<p>DOF, NEDA, DBM, COA</p> <p>DOF</p> <p>DOF, DBM, NEDA, COA</p>

Key message: Effective management of off-budget risks is critical for sound fiscal management and macro stability

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
3.2	Strengthening institutional capacity to monitor and manage fiscal risks	DOF has begun working with Bureau of Treasury to establish a centralized risk monitoring and management unit in DOF	<ul style="list-style-type: none"> o Establish a centralized risk management unit in the DOF in coordination with BTR; ensure adequate DOF staffing and capacity to review and act on reports from GOCCs/GFIs (2003-2004) o Undertake capacity-building needs assessment for DOF (2003) 	<p>PCEG DOF, BTR</p> <p>DOF</p>
3.3	<p>Direct guarantees on GOCC loans</p> <p>Fiscal risks emanate from:</p> <ul style="list-style-type: none"> o GOCCs that have outstanding "advances" from the Bureau of Treasury and which appear to be in no position to repay o GOCCs which may not be generating sufficient tariff revenue to service debts 	<p>Completed review of GOCC charters to identify different degrees of guarantees given</p> <p>Phase 1 of GOCC reform completed in 1987. Now DOF to complete Phase 2 i.e. reform the role and appropriation of GOCCs</p> <p>A.O. issued transferring GCMCC functions to DOF (August 2001)</p> <p>Benchmark audit completed for SSS and GSIS</p>	<p>Determine which type of guarantees are suitable and draft a bill prohibiting issue of automatic guarantees (2003-2004)</p> <p>Other steps to improve management of CL:</p> <ul style="list-style-type: none"> o Conduct a special purpose audit (financial, management and personnel audit) of critical GOCCs to support planned disposition program (2003-2004) o Empower DOF to recommend sanctions on corporations, including assignment of financial controller, suspension of future eligibility for guarantees, recommendation to President for management/Board revamp (beyond 2004) o Commission a benchmark audit to be done by a recognized auditing firm for rest of pension and trust funds: RSBS, HGC, PHIC and Pag-ibig (2003) 	<p>DOF, DBM, DOJ</p> <p>DOF, DBM, COA</p>
3.4	<p>Guarantees on benefits of the social security system</p> <p>Substantial risk factors, due to:</p> <ul style="list-style-type: none"> o Actuarial mismatch between contributions and benefits that could force SSS and GSIS into insolvency o Pressure to keep contribution rate at existing unsustainable level (they have never been increased since SSS was 	<p>Adoption of a market-oriented financial and credit policies are already in place</p> <p>Fund management: Both SSS and GSIS charters allow this. Both are intending to hire external fund managers to enhance investment capacities.</p> <p>AO 5 already mandates cost cutting measures. MCO 20 has been issued to can</p>	<ul style="list-style-type: none"> o Address immediate fiscal sustainability risks of SSS and AFP RSBS and strengthen performance of GSIS through: <ul style="list-style-type: none"> a) adopting a more conservative investment portfolio by implementing international best practice principles of safety, liquidity and good yields to improve asset allocation, reduce risk and obtain better return on investments b) outsourcing fund management c) increasing collection efficiency of contributions and loan portfolio 	DOF

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
	<p>founded)</p> <ul style="list-style-type: none"> ◦ High levels of evasion and under-reporting ◦ Pressure to increase benefits across the board ◦ Poor returns on investments due to pressures to invest in politically driven investment vehicles, e.g., housing loans, directed credit to "strategic" sectors, current member benefits 	<p>measures. MO20 has been issued to cap the salary of Chief Executives.</p> <p>Through proposed Personal Equity Retirement Account (PERA) Bill, public and private employees as well as self-employed individuals can open a retirement account with either a bank or non-bank financial institution. This is expected to encourage savings being portion of personal contributions to savings fund and enjoy certain tax privileges.</p>	<ul style="list-style-type: none"> d) increasing SSS contribution rates e) increasing interest rates on salary loans f) increasing the minimum number of contributions for a 1-year service credit from 6 months to 12 months g) moratorium on across-the-board pension increases h) reduction of administrative expenses <ul style="list-style-type: none"> ◦ Shift to a new architecture for the pension system, by adopting a mandatory, fully-funded defined contribution system that combines workers in the public and private sectors. In such a system, the defined benefit system is split into: <ul style="list-style-type: none"> a) a smaller defined benefit system to be managed with conservative investment guidelines; and b) a defined contribution system where individuals are free to choose their savings instruments and financial intermediaries among accredited institutions at any time (portable) 	
<p>3.5</p>	<p>Guarantees on various types of risks involving PSP contracts Substantial risk factors, including from:</p> <ul style="list-style-type: none"> • Currency risks • Demand risks • Construction delays • Other factors: <ul style="list-style-type: none"> ➢ Regulatory ➢ Political ➢ Force majeure ➢ Design ➢ O&M 	<ul style="list-style-type: none"> • Administrative instruction already existing: Office of President (OP) requires all applications for guarantees beyond a certain single transaction size and/or aggregate threshold to go through the DOF for approval • Began provisioning for CL in 2001 based on guidelines to be jointly developed by DOF, DBM and COA • GOCCs now required to submit reports on CLs to DOF, and to disclose these in budget documents • Move to accrual accounting initiated • COA NGAS mandates disclosure of 	<ul style="list-style-type: none"> • Draft a bill on removing automatic guarantees on certain GOCCs (2003) • Charge risk-based guarantee premiums which will include foreign exchange risk premiums (2003) • Other measures for management of contingent liabilities: (2003-2004) <ul style="list-style-type: none"> ➢ Build capacity in line and oversight agencies to undertake risk assessment of projects ➢ At start of year, DOF reports on CL by sector on cumulative basis to establish an annual limit on commitments to explicit guarantees for the entire government ➢ Start provisioning for CL (charged directly against agency budget) based on guidelines to 	<p>DOF</p> <p>DOF</p> <p>DOF, DBM, COA</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
	➤ Financing	CLs under accrual accounting	<p>be jointly developed by DOF, DBM and COA</p> <ul style="list-style-type: none"> ➤ Continue the move to accrual accounting ➤ Identify other measures to lessen coverage of guarantees 	
3.6	<p>Umbrella guarantees for various types of loans in agriculture, micro-enterprise, housing, etc.</p> <p>Substantial risk factors:</p> <ul style="list-style-type: none"> • HGC solvency threatened by poor program design of APCs and pressures to revert to failed NHMFC formula lending approach • Substantial losses in other guarantee institutions (Quedancor, SBGFC, GFSME) requiring periodic capital infusion 		<ul style="list-style-type: none"> • Commission a benchmark audit to be done by a recognized audit firm, including recommendations on future accounting and disclosure practices • Issuance of EO: <ul style="list-style-type: none"> a) Limiting/restraining automatic guarantees on certain GOCCs b) Requiring all guarantees to be charged against guarantee ceiling in RA 4860 c) Requiring all applications for guarantees beyond a certain single transaction size and/or aggregate threshold to go through DOF for approval 	<p>DOF</p> <p>DOF</p>
3.7	Timely, regular and accurate reporting by GOCCs and GFIs	<ul style="list-style-type: none"> • Issuance of EO to strengthen the governance structure of GOCCs and GFIs (enhancing the accountability of directors, requiring them to undergo mandatory training etc.). (2002) 	<ul style="list-style-type: none"> • COA to review and oversee introduction of uniformity of standards and practices in accounting, reporting and disclosure by GOCCs and GFIs (2003) 	COA
3.8	Recovery of costs of assuming risks		<ul style="list-style-type: none"> • Share the upside, i.e., make provision for recovery by NG in an appropriate manner (e.g., link level of guarantee fees to risks, impose recovery through dividends, etc.) (2003) 	DOF
3.9	Preventive steps to avoid unnecessary fiscal risks		<ul style="list-style-type: none"> • NG agencies to stress quality at entry for projects, ensure that projects undergo/are subject to adequate risk analysis, and that NG agencies (especially DOF) are provided with top-quality legal and technical advice for informed decision-making regarding assumption of fiscal risks (2002-2004) 	DOF, ICC

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PART B. ALLOCATIVE EFFICIENCY: SELECTED ISSUES				
4.	ALLOCATIVE EFFICIENCY <i>Key Message: Strengthen implementation of Sector Effectiveness and Efficiency Reviews (SEER) and Organizational Performance Indicator Framework (OPIF) to focus and prioritize resource use to anti-poverty programs.</i>			
4.1	<p>Reconsideration of the roles and functions of key sectoral agencies (also covered in Parts A and C of the Framework).</p> <p>Overview of economic and sectoral allocations</p>	<ul style="list-style-type: none"> • Started measures to address the declines in outlays for MOOE and capital expenditures, which have decreased (as a share of GNP) due to increased interest payments and a wage bill, which though it has decreased slightly as a share of GNP, remains high (2002): <ul style="list-style-type: none"> ➢ Issuing department ceilings ➢ Mandatory savings ➢ Review of borrowing strategy • DBM and NEDA have initiated the formulation and or refinement of government line agencies' major final outputs, an exercise by which sectors and agencies with overlapping functions or irrelevant activities are identified. 	<ul style="list-style-type: none"> • Review of the implication of the sectoral composition of spending to ensure that resources are utilized for priority programs and projects, particularly anti-poverty projects • Map out a realistic medium term strategy through the MTEF for increasing the share of discretionary expenditures for poverty related expenditures and capital investment • Start refinement of agency MFOs in 2003 budget preparation exercise and 2002 mid-year performance review for full implementation in 2004 budget preparation 	<p>DBCC, DBM, NEDA, line departments</p> <p>DBCC, DBM, NEDA</p> <p>DBCC, DBM, NEDA, line departments</p>
		<ul style="list-style-type: none"> • Restructuring of specific sectors is under examination by the PCEG. This is a fallback option in case of non-passage of a law which would authorize a comprehensive restructuring of the executive • Selected sector reviews (agriculture, infrastructure, social sectors) are expected to produce sectoral and departmental 	<ul style="list-style-type: none"> • Complete selected sector reviews and prepare time-bound implementation plan to address issues 	<p>DBM, NEDA, line departments</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
		restructuring plans with strategic adjustments to roles, functions, organization structures, operations and systems of agencies within specific sectors.		
4.2	<ul style="list-style-type: none"> Protection of pro-poor policy agenda and overview of selected sub-sectoral allocations in agriculture, health and education 	<ul style="list-style-type: none"> In fiscal 2001, DBM protected priority agencies from expenditure cuts: their allocations were cut by 5 percent, as against a 10 percent cut for all other agencies. 	<ul style="list-style-type: none"> At sub-sectoral level, conduct SEER for primary health, basic education, and key anti-poverty programs to focus and protect key allocations 	ICC, DBM, NEDA, line departments
4.3	<p>Agriculture and agrarian reform:</p> <ul style="list-style-type: none"> Sustainability of agricultural growth and increase in crop productivity Continuing slow-down in the pace of land transfer Greater LGU involvement in agrarian reform More resources to LGUs for agriculture 	<ul style="list-style-type: none"> 	<p><u>Agriculture:</u></p> <ul style="list-style-type: none"> Focus on growth-enhancing public goods and services Phase out non-growth-enhancing expenditure such as rice price stabilization whose objective can be achieved through other and more efficient means Resolution of issues related to the removal of the National Food Authority's monopoly to import rice <p><u>Agrarian reform:</u></p> <ul style="list-style-type: none"> Move towards financing land acquisition through alternative sources, including progressive land taxation, land conversion tax, idle land tax, foreign funding, etc. Greater use of more market-oriented and community-driven modalities of land transfer Pursuit of a "parallel approach" that balances public expenditure on land acquisition and provision of support services to previously redistributed landholdings 	<p>DA, DBM, NEDA, LGUs</p> <p>DAR, DENR, DBM, NEDA, LGUs</p>
4.4	<p>Education Financing and Service Delivery</p> <ul style="list-style-type: none"> 83 percent of SUCs' budget is for personal services expenditures; fees are low 	<ul style="list-style-type: none"> Recent policy initiatives have resulted in a re-alignment of spending priorities such that the share of basic education in general government education expenditure has increased 	<ul style="list-style-type: none"> Sustain and intensify intra-sectoral restructuring of education budget in favor of basic education Initiate work to design reform of higher education Move towards devolving operation of technical and vocational education and training (TVET) 	DepEd, CHED, DBM, NEDA

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
	<ul style="list-style-type: none"> • Growth in teacher salaries at the expense of MOOE and capital outlays • Imbalance in deployment of public school teachers • Constrained educational inputs and training, leading to low household satisfaction levels with class size, facilities and textbooks <p>Millennium Development Goal – achievement of universal primary education :</p> <ul style="list-style-type: none"> • The estimated recurrent cost of basic education necessary to meet the program targets set in the MTPDP exceeds the actual budget allocated by PhP23-28 billion (or 0.5 percent of GNP) per year in 2002-2004. 	<p>has increased</p> <ul style="list-style-type: none"> • SEMP and SEMP II Projects are addressing critical issues in education financing, especially constrained input supply and teacher deployment • The GOP is moving to strengthen the links between planning and budgeting in general, and between the MTPDP and the budget in particular (Chapters 5 and 6) 	<p>institutions to LGUs</p> <ul style="list-style-type: none"> • Reduce SUCs' continued dependence on the national budget and induce discipline on their operations: support Government efforts to rationalize budget allocations to SUCs and increase SUC tuition fees • Implement increased SUC cost recovery hand in hand with a higher budget for a targeted scholarship program in higher education for addressing equity and efficiency goals • Given resource constraints, increased allocation for MOOE would require some relative reallocation away from personal services • Finance improvements in facilities and textbooks by increasing budget allocation for MOOE • Improve class size by improving the deployment of teachers (support, sustain and accelerate current initiatives under SEMP and SEMP II projects) • Strengthen the link between planning and budgeting, and especially between the MTPDP and the budget, to enable program targets to be met 	<p>DepEd, DBM, NEDA</p>
<p>4.5</p>	<p>Health Care Financing and Service Delivery:</p> <ul style="list-style-type: none"> • Poor remain vulnerable to health risks and continue to have relatively lower access even to basic health services • Regions in Mindanao still have the highest Infant Mortality Rates in the country • Male infants and children have higher death rates than their female counterparts • Resurgence of TB, malaria and 	<ul style="list-style-type: none"> • Budget process reforms are being pursued by DOH (see Chapters 5 and 6) • The SEER and OPIF processes are being further refined 	<ul style="list-style-type: none"> • Continue the reforms being designed and implemented by the DOH, DBM and NEDA • Strengthen the health statistics system by: <ul style="list-style-type: none"> ➢ Promulgating IRRs for EO 25 ➢ Resuming regular publication of the Philippine Health Statistics • Strengthen allocation process for DOH regional budgets to better match IMR and poverty incidence • Improve performance measurement and monitoring, through adoption of more detailed internal performance indicators • Improve the design and implementation of DOH transfers to LGUs within the context of a wider 	<p>DOH, DBM, NEDA, LGUs</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
	<p>polio in recent years</p> <ul style="list-style-type: none"> • DOH budget mainly provides for tertiary care services • The bulk of LGU health expenditures go to personal services • Recent, complete and detailed information on health outcomes is not available <p>Millennium Development Goals: reduce child mortality improve maternal health combat HIV/AIDS, malaria and other diseases</p> <ul style="list-style-type: none"> • Financing may be insufficient to meet MTPDP targets or to finance HSRA unless link between planning and budgeting is strengthened 		<p>effort to improve the overall system of intergovernmental fiscal transfers in the Philippines</p> <ul style="list-style-type: none"> • Formulate and execute a more detailed implementation plan for the HSRA • Develop a comprehensive health care plan for non-convergence sites to help improve the quality of health services at the barangay level, where most of the poor avail of health care facilities • Early completion of an actuarial study to ensure financial sustainability of the PHIC as it aggressively expands indigent coverage • Develop sentinel sites to monitor health outbreaks • Review continued DOH jurisdiction over supposedly devolved functions to avoid overlap in DOH and LGU roles in health care delivery • Strengthen the SEER process in the health sector • Phased adoption of new and more effective drug procurement systems • Enhance LGU capacity for health planning, budgeting, and service delivery 	
4.6	<p>Allocative distortions - impact on allocation and efficiency of:</p> <ul style="list-style-type: none"> • Congressional initiatives and insertions • Earmarked revenues by virtue of laws 	<ul style="list-style-type: none"> • Starting 1999, DBM has tried to finalize a budget accord with Congress which would result in a joint agreement on the medium term fiscal framework, obtain joint commitment on the use and management of budget funds and introduce greater discipline to the reallocation process • For the last two years guidelines have been issued limiting the use of the Priority Development Fund to infrastructure and social programs supportive of 	<ul style="list-style-type: none"> • Develop a "Fiscal Responsibility Act" that can act as a budget accord with congress, setting fiscal targets and expenditure policy to be followed by executive and legislature (2002-2003) • Review current need and relevance of earmarked revenues for amendment of pertinent law (2003-2004) • Presentation to cabinet and congress of fiscal scenarios on the impact of earmarked revenues (2003-2004) • Strengthen the capacity of the CPBO to undertake budget and program analysis (Medium Term) 	<p>DBCC, DBM</p> <p>DOF/DBM</p> <p>DBCC</p> <p>DBM, NEDA</p>

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		agricultural modernization. For 2002 the focus is on anti-poverty programs <ul style="list-style-type: none"> ◦ For the 2002 Budget, Congress was encouraged not to cut interest payments to reallocate funds to other projects ◦ A Task Force (DOF and DBM) has been tasked by the DBCC to make an inventory of earmarked revenues to measure the magnitude of "free revenues" for presentation to Congress (June 2002) 	<ul style="list-style-type: none"> ◦ Orient members of Congress and their staff on MTEF, OPIF and SEER, particularly Committees on Appropriation and Finance (2002-2004) ◦ Require a standard cost-effectiveness or cost-benefit evaluation of all LFPs created by Congress (Short Term). 	DBM, NEDA Congress, DBM
4.7	Other issues: <ul style="list-style-type: none"> ◦ Transparency and accountability for Congressional allowances: the manner of creation and spending of such allowances can distort the way obligations are incurred, resources allocated and expenditures incurred 	<ul style="list-style-type: none"> • A 1997 Report of the Presidential Commission on Graft and Corruption outlined the issues relating to lack of accountability and transparency in respect of amounts paid to and expenses incurred by members of the legislature. • DBM has started publishing allocations on its website from 2002 and instructed posting of these releases at conspicuous places at local levels. DBM is working with NGO groups to involve them in budget preparation, monitoring of key projects and agency procurement. 	<ul style="list-style-type: none"> • Subject Congressional allowances to the same review, disclosure and audit guidelines and processes as those of senior officials of the executive branch (2004) • Promote greater transparency in the release of funds by completing details of releases on website • Expand partnership with civil society in monitoring government programs and projects, procurement and formulation of budget • Institutionalize report card surveys to obtain feedback from citizens on the allocation of budget resources 	Congress, DBM, COA DBM DBM DBM
5.	THE MEDIUM TERM EXPENDITURE FRAMEWORK AND THE BUDGET CYCLE <i>Key message: Better medium term expenditure planning and budgeting would ensure that overall budget management and expenditure allocation are responsive to national priorities</i>			
5.1	Medium Term Planning and Budgeting: Coordination Mechanisms	<ul style="list-style-type: none"> • Strengthened link between MTPIP and budget to ensure that new projects included in the budget are 	<ul style="list-style-type: none"> ◦ Improve planning through: <ul style="list-style-type: none"> ➢ Better coordination between sector planning units and NEDA/DBM by establishing regularized, 	NEDA, DBM, line departments

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	<ul style="list-style-type: none"> ◦ National and sectoral planning ◦ National and regional (LGU) planning ◦ Planning and the capital budget (MTPIP) 	<p>approved in the MTPIP.</p> <ul style="list-style-type: none"> ➤ The ICC has issued a directive that requires agencies to present their budget strategy over the medium term to ensure that projects for review by the ICC can be funded within budget ceilings. ➤ ICC has started requiring proponent agencies to submit a project logical framework which captures performance indicators and targets <p>◦ Harmonization meeting conducted by NEDA and DBM (March-April) to:</p> <ul style="list-style-type: none"> ➤ Adopt common terminologies ➤ Define delineation of responsibilities in MTPIP and budget formulation ➤ Refine concept of major final outputs and performance indicators 	<p>standardized interaction with full participation in each other's planning processes (this implies harmonizing sector reform agenda and MTPDP planning cycles) (2003-2004)</p> <ul style="list-style-type: none"> ➤ Improve integration of national and regional/LGU planning by reforming role of Regional Development Councils to give them responsibility for overseeing incorporation of LGU plans into MTPDP process (beyond 2004) <p>◦ Institutionalize resource-constrained MTPIP: link investment programming formulation with 3-year baseline ceilings (2003)</p> <p>◦ Include a statement of the MTEF in the MTPDP, with sections on medium term budget composition and on the explicit link between planning and budget priorities (Short Term).</p> <p>◦ Make MTPIP a more definitive budget by reforming ICC process so that ICC evaluation precedes "entry" into MTPIP (2003-2004)</p> <p>◦ Strengthen ICC Approval Process by capturing major locally funded projects into the ICC process</p>	<p>NEDA, DBM, DILG, LGUs</p> <p>NEDA, DBM</p> <p>NEDA, DBM</p> <p>NEDA, DBM</p> <p>NEDA, DBM</p>
5.2	<p>Medium Term Expenditure Framework (MTEF)</p> <ul style="list-style-type: none"> ◦ Macroeconomic/Fiscal Framework ◦ Sector Expenditure Frameworks: Developing sector budgets, improving resource predictability and rationalizing and prioritizing expenditures ◦ MTEF Management: participation of line agencies 	<ul style="list-style-type: none"> ◦ Introduced 3- year budgeting in 2001 budget call ◦ Development of Medium Term Fiscal Program consistent with macroeconomic projections, featured in MTPDP, and updated semi-annually to serve as basis for setting annual budget proposals ◦ Departments were issued 3-year baseline budgets starting 2000 budget preparation and granted greater flexibility in reallocating baseline budgets to higher priority programs, activities and projects 	<ul style="list-style-type: none"> ◦ Enhance credibility of the MTEF by improving revenue forecasting techniques (ongoing) <ul style="list-style-type: none"> ➤ Presentation of enhanced DOF methodologies ➤ Contestability of revenue forecasting - each oversight agency shall have a revenue forecasting model (2002-2004) ◦ Improve the presentation of the fiscal framework by prioritizing reforms in tax policy and administration and estimating the likely impact on tax revenue. ◦ BIR to improve the quality of its databases by (a) rolling out its IT system to all the districts and ensure that all districts input the necessary data; and (b) making changes to its tax forms to collect data necessary for improving revenue estimation and 	<p>DOF, BIR</p> <p>DOF, NEDA, DBM, BIR, BOC</p> <p>DOF, DBM, NEDA, BSP</p> <p>DOF, BIR</p>

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	participation of line agencies and high level political support	<p>programs, activities and projects (PAPs):</p> <ul style="list-style-type: none"> ➤ Issued sector/sub sector budget ceilings rather than departmental ceilings ➤ DBM and NEDA conducted Sector Effectiveness and Efficiency Reviews (SEERs) for 2000 budget preparation and 2001 budget execution to approve new program proposals and to prioritize agency programs within budget ceilings ➤ Granted flexibility to departments to redeploy staff to sub-departmental agencies (Circular Letter 2000-4) <ul style="list-style-type: none"> • Drafted PEM Manual • Starting 2000, conducted MTEF training for departments/agencies and trained a group of DBM technical staff to serve as pool of trainers on PEM • Align incentives of line agencies to support MTEF implementation (e.g., provide agencies incentives to prioritize their PAPs without fear of budget cuts as a consequence): <ul style="list-style-type: none"> ➤ Adopt scrap and build policy ➤ Encourage agencies to re-deploy resources to higher priority programs ➤ Lay down department ceiling ➤ Agencies to go back to ICC for project extension ➤ Undertake midyear assessment of agency budget from financial 	<p>necessary for improving revenue estimation and reducing opportunities for evasion (Short Term)</p> <ul style="list-style-type: none"> • Improve coordination between the DBCC, DOF and BIR by increasing BIR's participation in DBCC decision-making processes as resource persons • Institutionalize the Inter-Agency Task Force on the Improvement of Tax Related Database (IATF) by placing it under DOF and establishing formal role for other agencies in DBCC to validate methodology (Short Term). • Build up capacity of BIR to analyze data and forecast revenues (2002-2003) • Develop 3-year department budgets to guide departments in planning and programming new and ongoing PAPs: (April 2002 – 2003) <ul style="list-style-type: none"> ➤ Finalize agency MFOs with agency heads ➤ Clean up agency baseline programs ➤ Develop cost standards to link budget formulation with output targets • Use prioritization criteria from the start of the baseline budget estimation process to avoid across the board cuts to MOOE and capital expenditures (Medium Term) • Discontinue use of the targeted efficiency improvement rate in order to provide better incentives to line agencies (Short Term) • Incorporate criteria of inter-sectoral prioritization in the calculation of baseline budgets (Medium Term) • Allow departmental managers to reallocate some percentage of resources from low priority PAPs to new high priority PAPs, providing positive incentives for departments to prioritize (Short Term) • Allow departmental managers to reduce personal service expenditures (subject to a pre-determined maximum) for low priority PAPs (Medium Term) 	<p>DOF, BIR</p> <p>DOF, BIR</p> <p>BIR, DOF</p> <p>DBM, NEDA</p> <p>DBM, NEDA, line departments</p> <p>DBM, NEDA</p> <p>DBM</p> <p>DBM, NEDA</p> <p>NEDA, DBM</p>

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		<p>and physical points of view</p> <ul style="list-style-type: none"> ◦ Promotion of greater transparency in the release of funds by publishing details of releases in website (on-going) ◦ Formulation of a system on the inclusion of contingent liabilities into the Budget (on-going) 	<p>maximum) for low priority PAPs (Medium Term)</p> <ul style="list-style-type: none"> ◦ Automate MTEF to systematize updating, data archiving, and tracking of budget levels (2003 – 2005): (a) design and development stage, (b) implementation stage ◦ Simplify PEM Manual ◦ Develop a plan for outsourcing PEM training to be funded from GAA and donor co-financing ◦ Establish an appropriate technical assistance program to support the SEERs and strengthen human resource capacity in line agency budget departments and central oversight agencies (Short Term) ◦ Implement harmonization process for oversight on forms, reports, information sharing, data: improve ability of line agencies to generate and use budget and performance data by making data useful to agencies; rationalize and simplify data collection and reporting (2002-2004) ◦ Ensure that SEERs evaluate the effectiveness of GAS expenditures (Medium Term) ◦ Require line agencies to identify a number of low priority programs expressed as a predetermined percentage of the agency's budget (Short Term) ◦ Require agencies to conduct cost-effectiveness analyses of high priority PAPs (Medium Term) ◦ Integrate the SEER process with the PCEG's functional reviews to ensure that both initiatives are complementary in their approaches and recommendations (Short Term) ◦ Develop capacity in oversight agencies to provide tailored SEER implementation training to sectors (2002-2003) ◦ Produce manual on SEERs 	<p>NEDA, DBM</p> <p>DBM, NEDA</p> <p>DBM, NEDA</p> <p>DBM, NEDA</p> <p>NEDA, DBM, COA</p> <p>NEDA, DBM</p> <p>NEDA, DBM</p> <p>NEDA, DBM</p> <p>DBM, NEDA</p> <p>NEDA, DBM</p> <p>NEDA, DBM</p>

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			<ul style="list-style-type: none"> ◦ Provide a formal role for DBCC in managing and overseeing MTEF process: <ul style="list-style-type: none"> ➢ Require DBCC/cabinet approval for MTEF forward estimates (2003) ➢ Require DBCC to oversee development of forward estimates by sectors • Continued advocacy and capacity building within DBM and across agencies and congress on MTEF: <ul style="list-style-type: none"> ➢ Orient congressional committees in MTEF forward estimate development and overall PEM strategy and program (2002-2004) ➢ Require formal presentation of MTEF forward estimates to congress for discussion (2004) • Based on the above recommendations, develop an action plan for improving MTEF implementation (Short Term) 	<p>DBCC, NEDA, DBM</p> <p>DBM, NEDA, DOF, Congress</p> <p>DBM, NEDA, DOF</p>
5.3	Build partnerships to support MTEF implementation		<ul style="list-style-type: none"> • Continue workshops with civil society, e.g., budget briefings, governance forum • Develop advocacy materials: PEM, MTEF (2002) • Identify NGOs who can train other NGOs – Philippine Governance Forum, CBCP, FEF, FOCIG, IPD (2002) • Build core team reformers in agencies (2002) • Publication of “Public Eye” newsletter on budget reform to provide information on concepts, status of reforms, and best practice (2003) • Line agencies to develop capacity on: <ul style="list-style-type: none"> ➢ MTEF preparation and the basics ➢ How to advocate, work with civil society, Congress ➢ Information made useful at ground level for management ➢ Working towards a fully developed MTEF by 2005 using the NEDA rural sector development 	<p>NEDA, DBM</p> <p>NEDA, DBM</p> <p>NEDA, DBM</p> <p>DBM, NEDA, line departments</p> <p>DBM, NEDA, DOF</p> <p>DBM, NEDA</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
	<p>Budget Process</p> <ul style="list-style-type: none"> ➤ Budget Framework ➤ Comprehensiveness ➤ Calendar ➤ Predictability of allocations and resource flows ➤ Sustainability and credibility of forward estimates ➤ Calculation of baselines to be consistent with ceilings ➤ Unfunded policy mandates 	<ul style="list-style-type: none"> ○ NEDA Planning Committees were involved in the process of project review and determination of ceilings (1999 budget preparation) ○ Introduced PEM innovations developed by DBM and NEDA and applied to all departments ○ DBM efforts with Congress to broaden program classification and move beyond line item categorization ○ DOF and DBM efforts to stop congress practice of illusory cuts on debt payments to shift funds to preferred programs ○ DBM efforts to rationalize areas of Congressional intervention/participation in 	<p>approach</p> <ul style="list-style-type: none"> ○ Reactivate Budget Dialogue Group (consisting of public-private representatives) to provide input into budget preparation and guide efforts on civil society role in other budget processes (2002) ○ Institutionalize use of client satisfaction surveys and Report Card survey to influence budget allocation and enhance accountability for performance (2003) ○ Develop a proposal to provide legal foundation for the budget framework through a Fiscal Responsibility Act by elevating the core budget process framework to the status of a budget framework law ○ Review and update EO292 to take account of recent reforms, including the Local Government Code of 1991 and the budget framework law (if applicable) (Long Term) ○ Fully implement the budget timetable set out in the PEM Manual (Short Term) ○ Revise and update existing PEM Manual to incorporate all existing budget guidelines (Medium Term) ○ Rationalize programs and projects structure of agencies and establish their proper costing (2002-2003) ○ Consolidate existing budget preparation guidelines in the Public Expenditure Manual (2003-2004) ○ Streamline and improve formulation and promulgation of indicative budget ceilings for sectors/departments (if necessary, study process to figure out sources of delays) (2002-2003) ○ Subject LFPs to the same screening, prioritization and other processes as FAPs 	<p>DBM, NEDA, COA</p> <p>DBM, NEDA, DILG</p> <p>DBM, NEDA</p> <p>DBM, NEDA</p> <p>DBM, NEDA</p> <p>NEDA, DBM</p> <p>DBM, NEDA</p> <p>DBM</p> <p>DBM, NEDA</p> <p>DBM, Congress</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
	<ul style="list-style-type: none"> ➤ Flexibility for contingencies ➤ Limited flexibility to agency heads to reallocate resources to meet major final outputs (MFOs) 	<p>intervention/participation in agency projects and program implementation</p> <ul style="list-style-type: none"> • Unprogrammed funds may not be accessed unless overall revenue target has been exceeded • Introduction of MFOs to prioritize PAP; outputs to budget allocations; shift to outcome based performance indicators allocations • Sequencing of activities strengthened such that SEER is done prior to budget preparation so that priorities and strategies in MTPDP are funded. 	<ul style="list-style-type: none"> • Cost policy proposals in accordance with the MTEF as part of the legislative process. Evaluate existing laws creating expenditure mandates for fiscal sustainability (beyond 2004) • Present the NEP at a more aggregate level (for example, at program/project level) to provide more flexibility and in more user-friendly form for transparency and greater accountability (2004) • Limit the role of NEDA Planning Committees to conducting technical analyses and proposing recommended reallocations, subject to approval by the DBCC (Short Term) 	<p>DBM, NEDA</p> <p>DBM, NEDA</p> <p>DBCC, NEDA</p>
	<p>Budget Formulation</p> <ul style="list-style-type: none"> • Budget Framework • Comprehensiveness • Process and Calendar • Predictability of allocations and resource flows • Sustainability and credibility of forward estimates • Calculation of baselines to be consistent with ceilings • Unfunded policy mandates • Flexibility for contingencies: ➤ Limited flexibility to agency heads to reallocate resources to meet major final outputs (MFOs) 	<ul style="list-style-type: none"> • NEDA Planning Committees were involved in the process of project review and determination of ceilings • Draft budget preparation manual developed by DBM and applied to all departments • Introduction of MFOs to link outputs to budget allocations • Issuance of clear guidelines of fund release strategy at start of year • DBM efforts with Congress to broaden program classification and move beyond line item categorization • Stoppage of earlier policy of imposing 10 percent internal reserve on budget allocations 	<ul style="list-style-type: none"> • Develop a proposal to provide legal foundation for budget framework through a Fiscal Responsibility Act • Extend budget timetable (particularly if GAA delayed): budget cycle should begin earlier, prior to approval of GAA to allow adequate time for evaluation, consultation, updating of baselines and reprioritization (2003-2004) • Rationalize programs and project structure of agencies and establish their proper costing (2002-04) • Consolidate existing budget preparation guidelines in the Public Expenditure Manual (2003-2004) • Implement harmonization process for oversight on budget-related forms, reports, information sharing, and data; simplify forms for budget preparation to only capture information necessary for the NEP (2002-2003) • Eliminate delays in formulation and promulgation of indicative budget ceilings for sectors/departments (2002) 	<p>DBM, NEDA, DOF</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
		<ul style="list-style-type: none"> ◦ Unprogrammed funds may not be accessed unless overall revenue target has been exceeded 	<p>(2002)</p> <ul style="list-style-type: none"> ◦ Subject LFPs to the same screening, prioritization and other processes as FAPs ◦ Cost policy proposals in accordance with the MTEF as part of the legislative process. Evaluate existing laws creating expenditure mandates for fiscal sustainability (beyond 2004) ◦ Present the NEP at a more aggregate level (for example, at program/project level) to provide more flexibility (2004) 	
6.	BUDGET EXECUTION, TREASURY CONTROL AND EXTERNAL OVERSIGHT			
6.1	Budget Execution	<ul style="list-style-type: none"> ◦ Finalize testing of BEAT for implementation in May 2002 ◦ Shifting to quarterly releasing of NCA starting April 2002 ◦ Focusing budget execution on performance monitoring; mid-year review (August 2002) of agency performance undertaken prior to release of remaining 25 percent of agency allocation ◦ Improving cash management in the agencies by imposing a 2-month validity on NCAs released for accounts payable 	<ul style="list-style-type: none"> ◦ Continue the streamlining of current budget allotment and cash authorization system for better budget and cash management (2002 onwards) ◦ Link BEATS with COA NGAS (starting 2003) ◦ Simplify releasing process (2002 – 2003) ◦ Simplify regulatory reports (2002 – 2003) ◦ Develop flash reporting system for better cash management (2003 – 2004) ◦ Review separation of budget and cash management by transferring issue of Notices of Cash Allotment to BTR starting with the IRA (2003) 	<p>DBM</p> <p>DBM, COA</p> <p>DBM</p> <p>DBM, COA, NEDA</p> <p>DBM</p> <p>BTR, DBM, COA</p>
		<ul style="list-style-type: none"> ◦ Introduced Performance Indicators in 2001 	<ul style="list-style-type: none"> ◦ Refine implementation of Performance Indicator framework ◦ Introduce a variance table on financial and physical performance of agencies in budget documents to be submitted to Congress (2004). 	<p>DBM</p> <p>DBM</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP Task-Team Recommendations	Agency
6.2	<p>Treasury and Cash Management</p>	<ul style="list-style-type: none"> • NGAS has reformed the previous interlocking ledger system that resulted in most of the reconciliation problems 	<ul style="list-style-type: none"> • Strengthen the Modified Disbursement System (MDS) by: <ul style="list-style-type: none"> ➢ Requiring BTR regional and provincial offices to reconcile bank accounts with summaries of checks issued sent by the agencies on a more timely basis (2002) ➢ Developing instructions on how to reconcile new proforma bank accounts (under NGAS) with corresponding accounts kept by banks (2003) • Establish BTR control over NCA secondary allocation accounts and unliquidated cash advances (2003) • Reduce BTR reliance on bank deposit information used to accounting for revenue collection (2003-04) • BTR should establish a working group to better define accounting and reporting requirements for cash management by agencies and BTR • Transfer responsibility for issue of NCA to BTR, which will separate the cash and budget management functions and place BTR as the sole responsible agency for cash management. (2002-2004) 	COA, BTR
6.3	<p>Performance Measurement and Management</p> <ul style="list-style-type: none"> • Internal: Organizational Performance Indicator Framework (OPIF) • External: NGOs 	<ul style="list-style-type: none"> • OPIF concept (BP 206) was introduced in 2001 and 2002 budget calls • Agencies were required to submit performance targets/major final outputs (MFOs) as part of 2002 budget submission and asked to group PAPs according to contribution to MFO • Training sessions on OPIF have been conducted for oversight and implementing agencies • Started involving civil society in budget preparation through 	<ul style="list-style-type: none"> • Establish a joint DBM-NEDA committee with line agency representatives and joint technical working groups to manage the SEER and OPIF reforms (Short Term). • Refine Organizational Performance Indicator (OPIF) and Sector Efficiency and Effectiveness (SEER) methodologies: DBM and NEDA will work together to promote consistency and eliminate ambiguities (2002-2005) • Review OPIF experience to date to prepare a time-bound action plan (with estimates of resources needed at the central and line department level) for OPIF implementation government-wide (Medium Term) 	<p>DBM, NEDA</p> <p>DBM, NEDA</p> <p>DBM, NEDA, line departments</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
		briefings on budget processes and concepts and participation in technical budget hearings as observers ○ NEDA-DBM harmonization workshops held on February 28, 2002 and March 7, 2002	○ Assess capacity (skill, organizational model) of different agencies to adopt and use OPIF and MTEF in order to develop capacity- building program targeted to need and audience (2002)	DBM

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
PART C. OPERATIONAL EFFICIENCY – SELECTED ISSUES				
7.	THE PUBLIC PROCUREMENT REGIME <i>Key message: Continued procurement reforms to increase competition and transparency could increase the cost efficiency of resource use, and also contribute to improved governance.</i>			
7.1	Strengthen legal and institutional framework for public procurement	Government has initiated a series of measures to modernize the legal framework for procurement, key being: <ul style="list-style-type: none"> • Enactment of Procurement Reform Law. Presidential assent thereto in January 2003. • Issuance of EO40 in October 2001 consolidating existing executive instructions and removing inconsistencies and overlaps • Drafting and promulgation of IRRs for EO 40 (March 20, 2002) • Initiated a review of the BOT Law, including the “unsolicited proposals” rule • Prepared draft implementing rules and regulations (IRR) for the Procurement Reform Law (April 2002) 	<ul style="list-style-type: none"> • Early promulgation of Implementing Rules and Regulations (IRRs) for Procurement Reform Law • Finalize proposed amendments to the BOT Law, including the “unsolicited proposals” rule • Review the law on arbitration so as to align it with international practice (Dec. 31, 2003) • Study on feasibility of allowing foreign contractors to bid without PCAB license but will need to present the license prior to award 	DBM NEDA PCAB CIAP

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
7.2	Enhance transparency of procurement including through: <ul style="list-style-type: none"> o Electronic procurement o Facilitation of civil society oversight and monitoring of procurement process 	<u>Electronic procurement:</u> <ul style="list-style-type: none"> o DBM has installed initial phase of Electronic Bidding System which includes Tender Board, Supplier Registry and Electronic Catalogue o DPWH has established a computerized registry of contractors and computerized eligibility screening for contractors o COA and DOH have likewise established respective computerization programs on procurement o Completed Government Electronic Procurement System (GEPS) to include virtual store, electronic payment system, and e-bidding system 	<ul style="list-style-type: none"> o Push for exceeding 60 percent participation of all government agencies in the GEPS for the purchase of common goods/supplies/ materials o Use of computerized registry by all projects following progress of computerization o Encourage civil society organizations to acquire training in monitoring of procurement at all levels 	DBM-Procurement Service (DBM-PS) DPWH PPB
		<u>Civil society participation:</u> <ul style="list-style-type: none"> o Civil society participation in procurement at all levels is being encouraged and implemented (EO 40 and IRR) 	<ul style="list-style-type: none"> o Complete 60 percent participation by all agencies of GEPS (Dec. 31, 2002) o Use of computerized registry by all projects following progress of computerization (Dec. 31, 2002) o Encourage and monitor civil society participation in procurement at all levels. o Develop guidelines and training of NGOs and civil society (ongoing) 	DBM-PS DPWH PPB DBM
7.3	Strengthen organization and staffing	<ul style="list-style-type: none"> o Merging of Procurement Policy Board and NEDA-Infrastructure Committee on procurement related matters 	<ul style="list-style-type: none"> o Establish the Government Procurement Policy Board through IRRs after passage of Procurement Reform Law o Establish and implement a continuing 	DBM, NEDA, CSC PPB, DBM/CSC

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
			<p>national training program for government procurement officers, program officers and financial management personnel (2002)</p> <ul style="list-style-type: none"> • Study to corporatize Procurement Service as an independent entity • Professionalize the procurement function: <ul style="list-style-type: none"> ➤ Design system & implementation plan ➤ Implement the program • Improve enforcement of procurement processing milestones (AO 129 and EO 40) by monitoring and application of sanctions 	<p>PPB, CSC, DOJ</p> <p>COA, PPB, Infracom</p> <p>DBM, PPB, COA</p>
7.4	Procurement practices and processes	Existing IRR of EO 40 already prohibits negotiation of price and contract amount (goods and works) after bid opening	<ul style="list-style-type: none"> • Enforce the regulation on transparency through procurement audit: <ul style="list-style-type: none"> ➤ Develop and implement procurement audit training program for COA auditors • Study on registration and licensing of contractors; design and implement an action plan to streamline processes for registration and licensing of contractors • Replace surety bond with Bank guarantee/Letters of Credit/other forms (IRR) • Review the operation of the irrevocable letters of credit as performance bonds to reduce transaction costs and expedite payments • Provide the same waiver for goods from Korea and Japan as other countries per Philippine Flag Vessel Law • Price monitoring to be included as an important function of oversight Board 	<p>COA</p> <p>NEDA, DPWH, CIAP-PDCB</p> <p>DBM, NEDA, BSP, DOJ</p> <p>BSP, World Bank, ADB</p> <p>DTI, Phil Shippers Bureau</p> <p>DBM</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
			(IRR) ◦ Strictly implement procurement plan. ◦ Provide support to BAC/PEAC members subjected to harassment	Agencies PPB, DOJ, CSC
8	<p style="text-align: center;">STRENGTHENING FINANCIAL MANAGEMENT</p> <p style="text-align: center;"><i>Key message: Strengthening government accounting reporting, financial controls and auditing will initially reinforce aggregate fiscal discipline and, over time, improve resource allocation and operational efficiency.</i></p>			
8.1	Accounting and Reporting	<ul style="list-style-type: none"> ◦ NGAS Accounting Policies and Procedures Manual is being developed. ◦ National sector exposure draft of the manual has been issued by COA in March 2002 for NG and LGUs ◦ Study of accounting standards for BOT initiated 3 years ago ◦ NGAS includes registry for contingent liabilities arising from BOT projects ◦ 2003 Budget Call required agencies to disclose real and contingent liabilities by putting maximum claims based for contracts 	<ul style="list-style-type: none"> ◦ Strengthen agency controllership function and Financial Management (starting 2002) ◦ Enhance and finalize NGAS Accounting Policies and Procedures Manual including policies for consolidation of national government and LGU financial statements (end of 2002). Completion of: <ul style="list-style-type: none"> ➤ National manual (end of 2002) ➤ LGU manual (end Feb 2003) ◦ Establish accounting rules for Innovative Financing Arrangements (During 2002) ◦ Accounting policies for contingent liabilities and maintaining register of contingent liabilities 	Interagency Committee COA COA, NEDA COA, DOF, BTR

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
		<ul style="list-style-type: none"> • Developed a computerized accounting system for piloting in 11 agencies and LGUs by July, 2002. • Started design of GIFMIS in 1999 through an Interagency Committee 	<ul style="list-style-type: none"> • Finalize computerized accounting system based on pilot • Continue development of Integrated Financial Management System using NGAS as initial building block for integrating financial reporting requirements: <ul style="list-style-type: none"> ➤ Formulate implementation plan including annual budget allocation for NGAS roll out for the period 2002-06 ➤ Provide resources for developmental training through budget allocation for conduct of training and skills development of accountants and budget officers on implementation of NGAS and BEAT 	<p>COA</p> <p>DBM, COA</p> <p>DBM</p> <p>DBM</p>
<p>8.2</p>	<p>Internal Controls and Internal Audit</p> <ul style="list-style-type: none"> ➤ Review of current internal control procedures and legal framework ➤ Review of internal audit capacity ➤ Review of proposed procedures for authorizing and accounting for public funds ➤ Proposed COA reform program on accounting and reporting 	<ul style="list-style-type: none"> • Numerous reviews of the financial management strengths and challenges have been undertaken in collaboration with the authorities, e.g. by the UNDP • An Interagency Committee of DBM, NEDA, DOF, COA, DILG, BLGF has been established to initiate work on the agency controllership function. DBM will chair Committee. • The COA has initiated implementation of a New Government Accounting System (NGAS) from January 1, 2002 • A sub-committee of Interagency Committee chaired by COA will manage NGAS implementation 	<ul style="list-style-type: none"> • Develop a comprehensive manual of accounting policies and procedures as NGAS implementation proceeds, as revisions may have to be made to NGAS in light of practical experience • Introduce computerized accounting and integrated financial management system. • Carry out a study to introduce internal auditing in accordance with the Internal Auditing Code. • DBM should take the lead in initiating a financial management training program at the agency level with emphasis on the use of computerized accounting and reporting. (2002-2004) • DBM should lead the development of an agency controllership function to fully integrate financial management into the agency management (2003-2004) 	<p>COA, DBM, NEDA</p> <p>COA</p> <p>COA, DBM</p> <p>DBM, Interagency Committee on FM Development</p> <p>DBM, Interagency Committee on FM Development</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
9.	HUMAN RESOURCE MANAGEMENT: CONTROLLING THE WAGE BILL <i>Key message: Wage bill control is crucial for flexibility to implement new performance-based public sector reforms and could make an important contribution to public sector efficiency and flexibility</i>			
9.1	<p>Wage bill: fiscal weight</p> <ul style="list-style-type: none"> ◦ The rise in current expenditure has been driven mostly by the increase in personal services expenditures, which increased from below 5 percent of GNP in 1980s to 6 to 7 percent in the 1990s. ◦ The personal services component of the national government budget is high, partaking about 55 percent of the national budget in 2001 (excluding debt service, LGU transfers and net lending) ◦ The high cost of personal services is compounded by proliferation of agencies, functional duplication and overlaps among agencies within and between departments 	<ul style="list-style-type: none"> ◦ Proposed Civil Service Code under deliberation by Congress ◦ Study on appropriate role and size of government is ongoing; reorganization bill already filed in Congress ◦ Laws have been passed reorganizing agencies (DOE, SEC, etc.) ◦ Staffing modifications have been encouraged through the budget call ◦ Scrap and build policy: positions can only be created if other non-essential positions are offered for abolition ◦ As a general rule, only population-related positions, such as for teachers and police, are being created ◦ Fiscal discipline measures in 2001 including a hiring freeze on non-essential personnel 	<ul style="list-style-type: none"> ◦ Enhance civil service professionalism and consistent standards (June 2002): <ul style="list-style-type: none"> ➤ Passage of Civil Service Code ◦ Pursue the reorganization of government through administrative fiat and legislation (2002-2004) ◦ Continue hiring freeze on non-essential positions ◦ Design impact mitigation program for those who may be affected: <ul style="list-style-type: none"> ➤ Retooling for redeployable staff ➤ Early targeted separation scheme 	<p>CSC, PCEG</p> <p>DBM, PCEG</p> <p>DBM</p> <p>DBM, PCEG</p>
9.2	Arrive at a national government-level civil service size and structure consonant with the envisioned role of a streamlined and efficient executive structure			

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP Task Team Recommendations	Agency
9.2.1	<p>Streamlining and rationalizing agencies attached to the Office of the President: This is a key component of public sector institutional strengthening and streamlining.</p>	<p>Current initiatives comprise:</p> <ul style="list-style-type: none"> • Tightening the management span of the Office of the President by unloading direct responsibility of supervising agencies whose functions are more properly aligned with/subsumed under different departments • An ongoing review process aims at greater operational efficiency and better policy coordination capability within the Office of the President. 	<ul style="list-style-type: none"> • Pursue the initiatives to streamline and rationalize activities of national government agencies 	PCEG

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
		<ul style="list-style-type: none"> o EO 72 (February 11, 2002) abolished 77 offices and transferred 13 other offices under the OP to other agencies and departments where their functions are more aligned. Those abolished include inter-agency committees, ad-hoc committees and other bodies, most of which have already performed their mandate but have been allowed to continue. o The impact of EO 72 on employment and spending is so far insignificant: the offices abolished by EO 72 are mostly staffed by contractual workers whose contracts will be discontinued. For permanent employees in those offices, the IRR provides that those employees will continue to be employed and will be placed in a pool to be administered by the CSC; the latter will place those civil servants into other agencies. 	<p>Issue an EO targeting a second batch of entities and functions.</p>	<p>DBM, CSC</p>
		<ul style="list-style-type: none"> o Another batch of offices to be abolished is currently under review. 	<ul style="list-style-type: none"> o Complete review o Issue and implement EO and IRRs 	<p>OP, DBM</p>
		<ul style="list-style-type: none"> o Technical assistance is being provided on winding-up of agencies affected by the streamlining process. 		<p>DBM (in coordination with OP, CSC, COA)</p>
<p>9.2.2</p>	<p>Rationalization of the proliferation and duplication of attached agencies and ad-hoc bodies</p>	<ul style="list-style-type: none"> o Review by DBM of structures, functions and programs of all attached agencies, task forces and similar bodies in the national 	<ul style="list-style-type: none"> o Complete the review and submit recommendations to PCEG 	<p>DBM</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
		<p>government. The expected outcome is abolition of unnecessary and proliferating attached agencies and ad-hoc bodies. DBM is currently preparing profiles of such entities.</p>		
9.2.3	<p>Institutional strengthening of priority departments and agencies</p>	<ul style="list-style-type: none"> • BIR is being assisted in review of its substantive and support systems and in developing improvements thereto. • Pilot two departments (e.g. DSWD and DOH) and resolve mismatches between priorities, functional assignments, structures and staff complement and composition. 	<ul style="list-style-type: none"> • Complete transformation of BIR • Document current efforts as a guide to undertaking similar initiatives in other agencies. (ongoing) • Select a set of initial revenue generating agencies, frontline agencies, and oversight agencies (DBM/NEDA/DOF) where such initiatives will be extended, and develop an action plan and timetable for such initiatives. • Develop and implement technical assistance programs for streamlining/commercialization of priority agencies e.g. DPWH. 	<p>BIR DBM (in coordination with CSC and other oversight agencies)</p>
9.2.4	<p>Strengthening DBM capacity to function as the PCEG Secretariat: a persistent internal constraint has been a lack of sufficient personnel complement and staff skills to enable DBM to more effectively undertake its secretariat functions</p>	<p>DBM plays a key role in the public sector institutional strengthening effort and acts as the secretariat of the PCEG. Its functions in this respect are to:</p> <ul style="list-style-type: none"> • Provide technical staff support (including conduct of studies and development of policies and strategies) to the PCEG and external consultants • Facilitate coordination among agencies and other stakeholders involved in institutional strengthening discussions and 	<ul style="list-style-type: none"> • Continue the strengthening of the PCEG Secretariat to support the reorganization of the government. 	<p>DBM</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
		actions DBM is currently receiving TA from UNDP.		
9.3	Compensation: levels, structure and transparency of salaries, allowances, perquisites, pensions etc.			
9.3.1	<ul style="list-style-type: none"> o Salaries are too low relative to the private sector for middle and senior executive levels to attract and retain talent o Salary schedules are compressed o Uncompetitive pay for key professions such as lawyers, IT professionals and accountants results in unfilled vacancies 	<ul style="list-style-type: none"> o Grant of across the board salary increases: 10 percent in 2000 and 5 percent in 2001 o PCEG approved the general framework for improvement of government compensation: <ul style="list-style-type: none"> - market driven - high turnover - performance based 	<ul style="list-style-type: none"> o Review existing position classification and compensation system (PCCS) to identify weaknesses o Develop a competitive compensation package/scheme (both cash and non-cash e.g. possibly including health and education assistance) that takes into consideration market factors and performance (2002-2003): <ul style="list-style-type: none"> ➤ Prepare a draft law including provision of assistance during public hearings ➤ Prepare and implement advocacy strategy ➤ Prepare a manual for implementation and maintenance of the PCCS ➤ Implement capability building program for implementors of the PCCS ➤ Design a scheme allowing agency heads to implement upgrading of positions within authorized budget for personal services o Rationalize non-transparent and non-productive allowances o Prepare and implement a plan to extend such rationalization to GFIs/GOCCs 	DBM, CSC CSC, DBM
9.3.2	Pressure for grant of exemptions from the Salary Standardization Law (SSL)	<ul style="list-style-type: none"> o Grant of exemptions from SSL has consistently been opposed by DBM. MO 20 has been issued to rationalize the relatively excessive pay of senior officials in exempt GOCCs/GFIs 	<ul style="list-style-type: none"> ➤ Prepare a manual for implementation and maintenance of the PCCS ➤ Implement capability building program for implementors of the PCCS ➤ Design a scheme allowing agency heads to implement upgrading of positions within authorized budget for personal services 	DBM (with PCEG) PCEG (with DBM)
9.3.3	<ul style="list-style-type: none"> o Allowances are often non-transparent and do not fulfill their objectives, particularly in GOCCs/GFIs 		<ul style="list-style-type: none"> o Prepare and implement a plan to extend such rationalization to GFIs/GOCCs 	DBM (with PCEG) PCEG (with DBM)
9.3.4	Disparate retirement laws	<ul style="list-style-type: none"> o Employees are being encouraged to retire under the GSIS Law 	<ul style="list-style-type: none"> o Study existing discrete systems and design and implement an interim measure towards rationalizing existing retirement laws 	DBM

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
			<ul style="list-style-type: none"> • Rationalize existing laws within the public sector • Draft a rationalized retirement bill (2003) 	<p>DBM, CSC, GSIS</p> <p>DBM, CSC, GSIS</p>
9.4	<p>Setting, implementing and overseeing civil service policy more effectively</p>	<ul style="list-style-type: none"> • The CSC and DBM have several ongoing initiatives, and have also reached out to GOCCs/GFIs such as the GSIS to obtain better information for policy-making. • Coordination between civil service pay and employment reform initiatives, reforms of the budget process, and institutional streamlining efforts has improved during the last 2-3 years. 	<ul style="list-style-type: none"> • Further strengthen coordination between central entities involved in human resource policy and management 	<p>CSC, DBM</p>
9.5	<p>Strengthening establishment control</p> <ul style="list-style-type: none"> • Move to one authentic source for information on authorized positions (approved plantilla) and filled positions, and for payroll data, so that civil service employment and wage bill size can be controlled more effectively. At present departments do not present accurate information on the number of filled and unfilled positions and there is no reliable method to verify their submissions to oversight agencies. 	<ul style="list-style-type: none"> • An interagency Working Group (CSC, DBM, GSIS) has been established to review and recommend options for integrating existing personnel information systems of GSIS, DBM and CSC. • Each agency presently maintains its own database: <ol style="list-style-type: none"> a) DBM's Government Manpower Information System (GMIS) has data on non-uniformed civilian national government positions; b) CSC has data on civil service applicants; c) GSIS data covers enrollees (about 1.1 million) and pensioners (about 144,000) in respect of their eligibility for benefits and for calculation 	<ul style="list-style-type: none"> • Establish a Civil Service Personnel Information System capable of being accessed by central oversight agencies such as CSC, DBM and COA, and if necessary by line departments, so that a unique identification number for each employee can ensure that: <ul style="list-style-type: none"> ➤ Each permanent appointment is made against an authorized position ➤ No person can be appointed to more than one authorized position ➤ No person can draw pay from more than one payroll or obtain more than one set of benefits • Pursue the development of the common database on government personnel to be shared by CSC, DBM and GSIS (2003-2004) • Review and – as required – augment technical capacity in CSC and DBM to maintain and operate the database. 	<p>DBM, CSC, GSIS</p> <p>CSC, DBM</p> <p>CSC, DBM</p>

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
		and disbursement of benefits.		
9.6	Link organizational performance framework with individual performance appraisal system	<ul style="list-style-type: none"> ◦ DBM has developed the OPIF and has begun implementation (see Part B) 	<ul style="list-style-type: none"> ◦ Strengthen individual performance appraisal system linked to organizational performance measurement system: <ul style="list-style-type: none"> ➤ Involve Career Executive Service Board with respect to career executive system 	<p>CSC, DBM, NEDA</p> <p>CSC</p>
9.7	Strengthen human resource management and capacity at the LGU level, including: <ul style="list-style-type: none"> ◦ appointment, performance evaluation and accountability ◦ compensation issues ◦ employment issues 	Covered in Part D	Covered in Part D	Covered in Part D
9.8	<p>Strengthen the civil service legal framework for accountability, integrity, efficiency and professionalism by updating the Civil Service Code (this effort has been ongoing for several years) with the aim of:</p> <ul style="list-style-type: none"> • Improving merit-based recruitment, performance evaluation and promotion • Making compensation more competitive within fiscal constraints, and linking compensation to performance • protecting upright civil servants in the discharge of their functions • strengthening accountability and integrity mechanisms 	<p>CSC has worked extensively to prepare an updated draft of a new Civil Service Code which has been submitted to the legislature and is currently under review by the legislature.</p> <p>The PCEG has been formulating an integrated anti-corruption strategy for the government aiming, among other things, to strengthen integrity in the civil service.</p>	<ul style="list-style-type: none"> • Enact and implement an updated Civil Service Code which (i) separates professional civil service positions and “positions of confidence” (political appointments), (ii) separates key policy provisions from other details of employment and (iii) provides for appropriate accountability and integrity arrangements • Strengthen technical capacity of CSC to oversee implementation of Civil Service Code and to develop civil service policy. • Promulgate and implement amendments to the Administrative Code of 1987 (EO 292) to bring it into line with the provisions of the Civil Service Code once enacted • Amend the definition applicable to civil servants’ selection and promotion to competitive assessment of merit • Review and redefine parameters for 	CSC, DBM

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
			appointment of non-Career Executive Service (CES) individuals to CES positions.	
10.	IMPLEMENTATION OF FOREIGN-ASSISTED PROJECTS <i>Key message: Strengthening implementation arrangements and speed of implementation could ensure faster absorption of ODA, strengthen institutional capacity at national agency and LGU levels and help sustain project outcomes.</i>			
10.1	Enhancing absorptive capacity, key indicators for which include (as proxies for physical accomplishment): <ul style="list-style-type: none"> • Disbursement level (down to less than \$1 billion in January 2001) • Disbursement rate • Availment rate (about 63 percent in 1999-2000) • Disbursement ratio (2001 average was 12 percent for 3 biggest portfolios: ADB, WB, GOJ) (60 loans are beyond closing dates, average time overrun is 2.3 years) 	Significant actions to improve portfolio performance include: <ul style="list-style-type: none"> • Implementing agencies have reduced the number of signatories for project documents • ICC endorsement of partial cancellation of about \$500 million • Portfolio reviews were conducted with the three largest funding agencies in April and September 2001 to address bottlenecks. • Power sector reforms and other steps to improve governance 	Continue monitoring of key indicators	NEDA, DBM
10.2	Improved project identification, preparation and design, including: <ul style="list-style-type: none"> • Addressing weak demand for on-lending programs 	<ul style="list-style-type: none"> • Implementation of SEERs has helped focus agencies on prioritization of their activities 	<ul style="list-style-type: none"> • Completion of SEERs to sharpen prioritization of activities and so lead to improved project identification • More thorough project design and project evaluation, especially for those with LGU participation and/or with multi-agency participation • Minimize multi-agency implementation 	NEDA, DBM ICC, NEDA ICC
10.3	Greater predictability in project financing, including provision of counterpart funds [The 2001 (re-enacted) budget led to a mismatch between previously allocated funds and new financial requirements of projects; project	<ul style="list-style-type: none"> • PhP41 billion allocated for FAPs in 2002 budget (as against PhP29 billion in 2001) • See Part B re. strengthening linkage between planning and budgeting, and between MTPDP 	<ul style="list-style-type: none"> • 3-year investment program envisaged with indicative budget for each implementing agency (see also Part B) • Conduct SEERs of individual agency portfolios to establish medium-term priorities within the ICC process 	DBM, NEDA ICC

Chapter	Issue/Area of Concern	Actions Taken by GOP	Joint GOP-Task Team Recommendations	Agency
	financing was slowed down by budget deficit reduction measures]	and MTPIP	priorities within the ICC process ◦ Continue streamlining of document processing and fund flow within implementing agencies [See also Part B on strengthening linkage between planning and budgeting]	Agencies
10.4	Strengthening sustainability of project outcomes through improved institutional arrangements for project coordination, management, implementation and evaluation, including: ◦ Strengthening capacity in implementing agencies and relevant LGUs ◦ Addressing changes in project scope and design during implementation ◦ Strengthening project implementation arrangements ◦ Dealing with poor contractor performance ◦ Strengthening line agency and LGU capacity to prepare, evaluate, oversee and monitor implementation of projects ◦ Civil society involvement for accountable and transparent implementation ◦ Addressing peace and order issues impacting projects ◦ Slower project implementation due to change in administration	◦ Issuance of AO 7 (transferred contract review function from OP to NEDA, mandated a maximum duration for the process, increased accountability of Cabinet secretaries for project implementation, and more effective oversight by the Office of the President through a Presidential Adviser for ODA Absorption) ◦ Issuance of EO 40 to streamline procurement processes (see Part C) ◦ RA 8974 enacted: it defines the procedure for right-of-way acquisition for infrastructure projects ◦ RA 8975 enacted: it prohibits issuance by lower courts of temporary restraining orders on government projects ◦ Project implementation officers (Undersecretary level) designated in implementing agencies ◦ Implementing agencies have reduced the number of signatories for project documents	◦ Issuance of EO on resettlement ◦ Priority and high-level attention to ROW issues ◦ Review FAP management/coordination/ implementation arrangements so as to enhance implementing agency ownership and accountability ◦ Strengthen institutional capacity of LGUs involved in FAPs, especially for procurement and financial management (see also Parts C and D) ◦ Further strengthening of coordination between implementing agencies and coordinating agencies, and removal of functional overlaps and duplication among national government agencies (see also Parts A and C) ◦ Further steps to improve project procurement (see also Part C) ◦ Further measures to strengthen project financial management (see also Part C) ◦ Special attention to projects with largest backlogs since implementation	Oversight agencies (NEDA, DBM, DOF, COA), DILG and line departments

Chapter	Issue/Area of Concern	Actions Taken	Joint GOP-Task Team Recommendations	Agency
PART D. DECENTRALIZATION				
11.	DECENTRALIZATION: A SELECTIVE OVERVIEW <i>Key message: Capacity building at the LGU level, including and especially in procurement and financial management, is critical for strengthening accountability and service delivery.</i>			
11.1	Overview	<p>Various studies and analyses of different aspects of decentralization and devolution have been conducted in recent years by GOP, development partners and academia.</p> <p>More than ten years have elapsed since the enactment of the 1991 Local Government Code (LGC). This is an appropriate time to take stock of the opportunities, strengths and weaknesses of devolution and decentralization, review the key findings and recommendations, and work out an action plan to strengthen the decentralization process and delivery of basic services, especially to the poorest and most vulnerable.</p>	<p>Conduct a Decentralization Study to review the fiscal, administrative and political aspects of decentralization, including:</p> <ul style="list-style-type: none"> • Actual devolution by the national government to LGUs • Adequacy of the IRA transfer system and opportunities for greater equalization • LGC provisions regarding local taxation and fiscal matters • LGU responsibilities, (e.g., by defining expenditure requirements and service standards by sector) and the need for transfers from the national government • Impact of decentralization on the poor and other vulnerable groups • Conduct a study on how to introduce a performance-based system of fiscal transfers (on-going) 	PCEG, DBM, DILG, DOF, NEDA, COA, line departments, World Bank, ADB,
11.2	Expenditure Assignment <ul style="list-style-type: none"> • Key areas of formal responsibility • Clarity of overall assignment • Extent of unfunded mandates from national government 		<ul style="list-style-type: none"> • In many cases institutional arrangements for service delivery need to be clarified and the role of national government and its agencies reviewed (beyond 2004) • Review imposition of unfunded mandates (from the national government) on LGUs 	DILG DILG, DBM, NEDA

Chapter	Issue/Area of Concern	Actions Taken	Joint GOP-Task Team Recommendations	Agency
	<ul style="list-style-type: none"> ◦ Key issues to be resolved 		(beyond 2004) <ul style="list-style-type: none"> ◦ Develop a plan to transfer the implementation of infrastructure services from DPWH to qualified LGUs (2003) 	NEDA
11.3	Revenue Assignment <ul style="list-style-type: none"> ◦ Key local revenue sources ◦ Local authority to set tax rates ◦ Local administrative capacity ◦ Key issues to be resolved 	<ul style="list-style-type: none"> ◦ Some LGUs have established taxpayer databases (e.g. Bulacan) ◦ Provided adequate training for staffs and avoid use of casual employees to collect user fees ◦ Submitted amendment of the LGC that will create a regional technical valuation committee to update the schedule of real property values 	<ul style="list-style-type: none"> ◦ Replicate establishment of accurate, taxpayer registration databases including delinquent taxpayers (beyond 2004) ◦ Replicate setting- up of accurate cadastral information databases for property taxes (beyond 2004) ◦ Review and reform procedures for detecting and managing non-filers, stop-filers and non-payers (2003-2004) ◦ Improve audit process for business taxes. Need to review confidentiality of ITR by BIR (2003-2004) ◦ Formulate an action plan to encourage alternative payment schemes (2003-2004) ◦ Continue to develop strategies for improving taxpayer services (beyond 2004) ◦ Eliminate/reduce tax exemptions: (2002) <ul style="list-style-type: none"> ➤ Review and rationalize/revoke DOF circulars on tax exemption of professionals 	DOF DOF DOF DOF DOF DOF/DILG DOF
11.4	Intergovernmental Transfers <ul style="list-style-type: none"> ◦ Equalization: to what extent addressed ◦ Key issues to be resolved ◦ IRA releases are not performance-based: <ul style="list-style-type: none"> ▫ Schedule for IRA releases and computation used is not clear to LGUs ▫ Unclear rules for allocation of Priority Development Assistance Funds (PDAF) 	<ul style="list-style-type: none"> ◦ DBM has clarified to LGUs in March 2002 the methodology and computation used for IRA releases ◦ DBM has issued a circular on the project menu and processes to guide the use of the PDAF disseminated 	<ul style="list-style-type: none"> ◦ Issue implementing guidelines for the payment of EVAT shares of LGUs (2003) ◦ Continue to publish PDAF allocations each year in conspicuous places, community papers, LGU newspapers, LGU newsletters, DBM website; furnish COA list of releases (June 2002) ◦ DBM could issue a matrix to explain details 	DOF, BIR DBM-Regional Offices, LGUs DBM

Chapter	Issue/Area of Concern	Actions Taken	Joint GOP Task Team Recommendations	Agency
	Development Assistance Funds (CDF) <ul style="list-style-type: none"> ▪ No implementing guidelines for the EVAT Law. No guidelines for the computation of the LGU share in the EVAT Law. 	of the PDAF, disseminated widely through DBM-ROs and publication in local/regional newspapers	of computation for 2002 IRA <ul style="list-style-type: none"> • Verify and clarify reports of discrepancies between DBM releases and amounts received by LGUs • Conduct a study on how to introduce a performance-based system of fiscal transfers (on-going) 	DBM DILG/DBM/ NEDA/DOF
11.5	Local Government Borrowing <ul style="list-style-type: none"> • Regulatory framework • Mechanisms (e.g. direct borrowing, on-lending from central authority) • LGU borrowing: trends, willingness, issues 	<ul style="list-style-type: none"> • An LGU financing framework was developed in 1996. Its implementation requires review and strengthening. 	<ul style="list-style-type: none"> • Review and clarify IRA intercept provision in the Local Government Code in order to enhance LGU creditworthiness 	NEDA, DILG, DBM
11.6	Planning and budgeting at the LGU level: policy, practice, issues	See Part B.	<ul style="list-style-type: none"> • Review the national and local planning processes to improve coordination on pro-poor service delivery (beyond 2004) • Accelerate strengthening of the capacity of LGUs to formulate, appraise, and rank development projects (beyond 2004) 	NEDA, DBM, DILG DILG, NEDA
11.7	Procurement in LGUs <ul style="list-style-type: none"> • Legal framework • Policy and practices • Organization • Staffing • Capacity issues 	<ul style="list-style-type: none"> • LGU procurement is covered in proposed Procurement Bill • The draft IRR for the Bill includes the streamlining of procurement methods for LGUs (see also part C) 	<ul style="list-style-type: none"> • The highest ranking career and permanent official should chair the Bid and Award Committees • Make the implementation of Annual Procurement Plan by LGUs mandatory (June 30, 2002) • Develop and implement training program on procurement (see also Part C) 	DBM DILG/League of Cities DBM, DILG, CSC
11.8	Financial management in LGUs <ul style="list-style-type: none"> • Legal framework • Policy and practices • Organization 	<ul style="list-style-type: none"> • Designate and strengthen BLGF as the focal agency to enforce fiscal discipline and restructure to play an active role in LGU financial management reform (2002- 	<ul style="list-style-type: none"> • Strengthen the BLGF by empowering it to be the main driver of local government finance (2002-2003) • Strengthen internal controls: <ul style="list-style-type: none"> ➢ Form sub-committee on LGU financial 	DOF BLGF, COA, DBM, DOF,

Chapter	Issue/Area of Concern	Actions Taken	Joint GOP-Task Team Recommendations	Agency
	<ul style="list-style-type: none"> ◦ Staffing ◦ Capacity issues 	<p>2003)</p> <ul style="list-style-type: none"> ◦ Reengineering of BLGF ongoing ◦ The new local government accounting system (NLGAS) will require submission of standard financial statements starting 2002 (year end). ◦ In 2001, BLGF piloted a new fiscal and financial reporting format. The new report, called the Statement of Income and Expenditures or SIE replaced the old format of reporting. The Budget Operations Statement (BOS) reports the fiscal operations of the LGUs on a yearly basis and the report was cumbersome, bulky and covered several pages. The SIE is user friendly, and is reported on a quarterly basis. The summary of the fiscal operations of Local Governments is contained in one page but there are schedules attached to the summary sheet which show more details. DBM has agreed to use the SIE instead of coming up with their own reporting format. Thus, a single source of data on LGU fiscal and 	<p>management under IAC on FM Development</p> <ul style="list-style-type: none"> ➤ Review and harmonize issuances on financial management ➤ Reconcile accounts/treatment accounts ➤ Professionalize financial management functions (to include capacity-building interventions) (on-going) ◦ Design a financial management improvement program to build capacity, focusing on LGAS implementation (2003-2004) ◦ Issue circular requiring prospective treasurers to undergo competency examinations ◦ Issue circular requiring municipal treasurers to enforce bond requirement for barangay officials and enforcing sanctions for violation ◦ Develop long term financial management improvement project including strengthening of poor LGUs ◦ Develop an incentive system for well-performing LGUs 	<p>DILG</p> <p>COA, DBM, DILG</p> <p>DOF</p> <p>DOF</p> <p>BLGF, DILG, LGA, COA</p> <p>BLGF, DILG, DBM, NEDA, COA,</p>

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		<p>financial operations will be available. BLGF consolidates the data by provinces, cities and municipalities on a quarterly basis.</p> <ul style="list-style-type: none"> • BLGF also developed 14 fiscal performance indicators. In 2002, BLGF is piloting these indicators after revising the fiscal reporting format. With these indicators BLGF will be able to see how LGUs are performing in terms of local resource mobilization, expenditure management. LGUS will be ranked on the basis of their fiscal performance. • The next step is to develop an incentive system for the good performing LGUs. 		
11.9	<p>Human resources: management, development, accountability and incentives</p> <ul style="list-style-type: none"> • Official data on LGU-level employment understates the real situation • Current high levels of employment in LGUs may not be compatible with competitive salaries and affordable size of the public service at the LGU level • Most LGU expenditures seem to be on personnel. Hiring of casual, contractual and project-related workers (not reflected in official data) is pervasive, resulting in: 	<ul style="list-style-type: none"> • Improve management and career development of tax assessors and treasurers (on going) • Examine how to scale up pilots on governance and service delivery performance indicators and management (ongoing) • Develop LGU “hall of fame” to enable recognition for outstanding performance or outcomes (ongoing) 	<p>The Decentralization Study proposes to develop recommendations for:</p> <ul style="list-style-type: none"> • Reviewing LGU compliance with cap on ‘personal service’ expenditures as percentage of total resources in light of employment of and expenditures on casual, contractual, and other non-permanent workers • Reviewing levels and structure of remuneration, which vary enormously across LGUs (including unofficial allowances, benefits and perks for LGU officials) • Reviewing LGU practice of providing salary supplements for functions and positions 	<p>DILG, DBM, DOF, COA</p> <p>DILG, CSC, DBM</p> <p>DILG, DBM,</p>

Chapter	Issue/Area of Concern	Actions Taken	Joint GOP-Task Team Recommendations	Agency
	<ul style="list-style-type: none"> ➤ Diminution of resources available for MOOE and investment ➤ Avoidance of the legal cap on the extent of personnel expenditures ➤ Avoidance of transparent hiring procedures ➤ Facilitation of patronage and other undesirable practices ○ LGU-level remuneration varies enormously across levels and tiers of LGUs. While personal services expenditures are high, official salaries are low and the compensation system is characterized by non-transparent official and unofficial allowances, add-ons, perks and benefits ○ Career prospects and professional development of key categories of LGU staff require review and modernization ○ Most LGU personnel are hired by the local chief executive: accountability tends to be to the person and not to the law, adversely affecting the quality, efficiency and equity of resource use and service delivery 	<p>or outcomes (ongoing)</p> <ul style="list-style-type: none"> ○ Pilot-test Customer Feedback Survey in 21 sites to achieve the following: (on-going) <ul style="list-style-type: none"> ➤ Increase citizens' access to information ➤ Develop 2-way feedback with citizens ➤ Involve citizens and agencies in setting standards 	<p>whose personnel costs are supposed to be funded entirely by the national government</p> <ul style="list-style-type: none"> ○ Improving the quality of statistical data: <ul style="list-style-type: none"> ➤ Harmonize forms, reporting formats, classification system (on-going) ➤ Develop integrated database template to rationalize programs/system on information supply ➤ Reduce the number of regulatory report requirements ○ Build awareness of constituency on how to access information using regional offices, media and community papers (starting 2002) 	<p>CSC,COA</p> <p>DILG, NEDA, NSO, BLGF, DBM, NSCB, other national government agencies</p> <p>NEDA, DILG, BLGF</p>
11.10	<p>Monitoring and Evaluation</p> <ul style="list-style-type: none"> ○ Capacity ○ Regular fiscal reporting 	<ul style="list-style-type: none"> ○ Coordination and synchronization of plans/actions by oversight agencies using the MDFO as lever (on-going) ○ Develop a coordinated performance evaluation system (on-going) ○ BLGF will pilot the introduction of 14 performance indicators to monitor LGU performance 	<ul style="list-style-type: none"> ○ Strengthen national government's ability to monitor financial performance of LGUs ○ Increase awareness and consultations with Congress on Executive initiatives: put in place mechanisms to improve and institutionalize dialogue among LGUs, NGAs and Congress (e.g. preparation of national plan) (on-going) 	<p>DOF (BLGF)</p> <p>NEDA, DILG, DBM, COA, DOF</p>
11.11	Capacity-building at the LGU level	○ Numerous initiatives –	○ Develop framework, systems and institutions	DILG, BLGF,

Chapter	Issue/Area of Concern	Actions Taken	Joint-GOP-Task Team Recommendations	Agency
		locally as well as externally financed – have been undertaken and are ongoing to strengthen LGU capacity.	to rationalize delivery and content of training programs (2002-2003) <ul style="list-style-type: none"> ➤ Assess existing capacity level of LGU in the conduct of capacity building • Facilitate exchange of good practice between LGUs, NG and international experience by documenting and propagating information on good practices (on-going) • Strengthen partnership implementation (on-going) 	DBM, COA, CSC DILG, BLGF DOF, BLGF, DILG, DBM, NEDA

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www.gsis.gov.ph Government Service Insurance System.

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www.coa.gov.ph Commission on Audit.

www.csc.gov.ph Civil Service Commission.

www.opnet.ops.gov.ph Office of the President.

www.chanrobles.com/index1 Chan Robles Virtual Law Library.

www.lawphil.net The LawPhil Project, Arellano Law Foundation.

DETAILED ACKNOWLEDGEMENTS AND LIST OF WORKSHOP PARTICIPANTS**Detailed Acknowledgements**

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From the GOP side, a Steering Committee comprising Secretary Emilia T. Boncodin (DBM – Chair), Secretary Jose Lina (DILG) and Chairman Guillermo Carague (COA) oversaw the PEPFMR work. Three GOP Technical Working Groups worked intensively with the World Bank-ADB task team. The principal interlocutor on the PEPFMR was Undersecretary Laura B. Pascua (DBM), who also chaired the GOP Public Expenditure Working Group, comprising Deputy Director General Gilbert Llanto (Vice Chair - NEDA), Assistant Secretary Austere Panadero (DILG), Director Gisela Lopez (DBM), Director Joey Virtucio (NEDA) and Director Lyn Capones (NEDA). Resource persons included Assistant Secretary Lourdes de Vera (DEPED), Director Mario Villaverde (DOH), Director Agnes Miranda (DA), Director Tomas A. Cabuenos, Jr. (DAR), Assistant Secretary Lucille Ortille (HUDCC) and Director Didith Tan (DOF). The Financial Management Working Group was chaired by Commissioner Emmanuel Dalman (COA) and comprised Assistant Secretary Evelyn Guerrero (Vice Chair), Deputy Treasurer Nina Figueroa (BTR), Director Rolando Tungpalan (NEDA) and Assistant Secretary/Director, LGU Supervision (DILG). The resource persons comprised Undersecretary Ernesto Pangan (DEPED), Assistant Secretary/Director, Finance (DA), Assistant Secretary/Director, Finance (DOH), Director Edilberto R. Ramirez (HUDCC) and Director Emily Tanquintic (DPWH). The Procurement Working Group was chaired by Undersecretary Teodoro Encarnacion (DPWH) and comprised Director Estanislao Granados (Vice Chair), Director Arcadio Cuenco (COA), Director Normando Toledo (DILG), Director Ruben Reinoso (NEDA) and Mr. Cipriano Ravanes (NEDA). The resource persons were Ms. Edna Formilleza (DEPED), Director Carol Herradura (DOH), Director, Procurement (DA), Director Zacarias A. Abanes (HUDCC), Director Burt B. Favorito (DPWH), Project Manager Antonio Molano (DPWH) and Atty. Edilu P. Hayag (DOTC). All three GOP Working Groups contributed substantially to the analytics and recommendations, for which the PEPFMR team expresses its grateful thanks. The team would also like to express its thanks to Undersecretary Juanita Amatong (DOF) who was unstinting in her assistance and advice throughout the process.

The overall World Bank-ADB PEPFMR task team comprised three integrated teams: (i) the procurement team, comprising Mmes./Messrs. Christian A. Rey (TTL for the CPAR), Cecilia Vales (coordinator), Federico Gimenez (consultant), Sofronio Ursal (consultant), Jaime Galvez-Tan (consultant), Omar Costibolo (consultant), Benjamin Albarece (consultant), Norman Cabangal (consultant) and Hiroki Kobayashi (ADB); (ii) the financial management team, comprising Mmes./Messrs. Wijaya Wickrema (TTL for the CFAA), Joseph G. Reyes (Financial Management Specialist) and Preethi Wijeratne (consultant); and (iii) the public expenditure team, comprising Mmes./Messrs. Joven Balbosa (Economist, World Bank), Joseph Capuno (consultant), Tarun Das (consultant), Malcolm Green (consultant), Chris Jones (consultant), Xuelin Liu (Country Economist for the Philippines, ADB), Hazel Malapit (consultant), Rosario Manasan (consultant), Edward Mountfield (Economist, World Bank), Amitabha Mukherjee (TTL, public expenditure element and coordinator for the PEPFMR), Miguel Navarro-Martin (Senior Financial Sector Specialist, World Bank), Merwin Salazar (consultant), Robert Talierno

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List of Workshop Participants

A consultation workshop was held on January 24-25, 2002, to test and validate PEPFMR emerging messages. The team thanks all participants, whose names are listed below.

PEPFMR Preparation Workshop: January 24-25, 2002

List of Participants: January 24, 2002

A. Participants From National Government Agencies

Department of Agriculture

1. Ms. Lerma Abesamis, Division Chief, Public Investment Program Division, Planning Service
2. Ms. Nieva Natural, Senior Staff, Program Monitoring and Evaluation Division, Planning Service

Department of Agrarian Reform

3. Ms. Clemencia Padrinao, Project Development Officer, Project Development and Management Staff/Foreign-Assisted Projects Office

Department of Budget and Management

4. Mr. Jose Edgardo Campos, Senior Strategy Adviser for Public Sector Reform
5. Ms. Cynthia G. Castel, Undersecretary
6. Ms. Amelita Castillo, Director, Organization and Productivity Improvement Bureau
7. Ms. Carmencita N. Delantar, Director, Regional Operations and Coordination Service
8. Ms. Gisela Lopez, Director-OIC, Physical Planning Bureau
9. Ms. Laura Pascua, Undersecretary
10. Ms. Solita S. Recolizado, Director, Organization, Position Classification and Compensation Bureau

Department of Education

11. Ms. Edna Formilleza, Bids and Awards Committee Coordinator

Department of Finance

12. Ms. Juanita Amatong, Undersecretary, International Finance Group
13. Mr. Gil Beltran, Assistant Secretary, Domestic Finance Group
14. Mr. Benjamin Geronimo, Director, Bureau of Local Government Finance
15. Mr. Norberto Malvar, Division Chief, Bureau of Local Government Finance
16. Ms. Salve Rios, Chief, Bureau Budget Division, Bureau of Treasury

Department of Health

17. Ms. Carol Herradura, Director, Procurement Logistics Service
18. Mr. Mario Villaverde, Director, Health Policy, Development and Planning Bureau

Department of Internal and Local Government

19. Mr. Rolando Acosta, Director, Bureau of Local Government Supervision
20. Mr. Austere Panadero, Assistant Secretary for Administration and HRD
21. Ms. Ellen Pascua, Project Manager, Water Supply and Sanitation Project

Commission on Audit

22. Ms. Divinia Alagon, State Auditor, Local Government Audit Office
23. Mr. Emmanuel Dalman, Commissioner
24. Ms. Estela dela Paz, Director, Corporate Audit Office

Civil Service Commission

25. Ms. Celia Bernardo, Director, Technical Cooperation and International Relations Service

Housing and Urban Development Coordinating Council

26. Ms. Rowena Dineros, Project Evaluation Officer

National Economic and Development Authority

27. Ms. Rowena Cham, Chief Economic Development Specialist, Investment Planning Division, Public Investment Staff
28. Mr. Elmer Dorado, Supervising Economic Development Specialist
29. Mr. Gilbert Llanto, Deputy Director-General
30. Ms. Aleli Rosario, Supervising Economic Development Specialist
31. Mr. Rolando Tungpalan, Assistant Director-General, Investment Programming
32. Mr. Joey Virtucio, Director, Agriculture Staff

B. Participants From Local Government Units

1. Hon. Rodolfo Agbayani, Governor, Province of Nueva Vizcaya
2. Atty. Honorio Alumno, Head, Research and Information, League of Municipalities
3. Hon. Estelita Aquino, Assistant Treasurer, League of Municipalities
4. Mr. Serafin Blanco, City Administrator, City of Mandaue, Cebu

5. Mr. Danny Buenviaje, Staff, Office of the Mayor, City of Cabanatuan, Nueva Ecija
6. Ms. Anita Carbon, Clerk, Office of the Mayor, City of Valencia, Bukidnon
7. Mr. Jose de Leon, Jr., City Administrator, City of San Fernando, Pampanga
8. Ms. Edith de Luzuriaga, Staff, Office of the Mayor, City of Cabanatuan, Nueva Ecija
9. Hon. Elpidio B. Dulay, Governor, Bayombong, Nueva Vizcaya
10. Mr. Rodenio Eduave, Program Manager, League of Barangays
11. Hon. Loreli Fajardo, Treasurer, League of Cities
12. Hon. Jose M. Galario, Jr., Mayor, City of Valencia, Bukidnon
13. Mr. Alfredo Guzman, City Engineer, City of Valencia, Bukidnon
14. Mr. Eugene Mintu, Staff, Office of the Mayor, City of Cabanatuan, Nueva Ecija
15. Hon. Thadeo Z. Ouano, Mayor, City of Mandaue, Cebu
16. Hon. Roberto Pagdanganan, Foundation for Local Autonomy & Good Governance
17. Ms. Junaida Prantilla, City Planning Officer, City of Valencia, Bukidnon
18. Mr. Calvin Sadiua, Executive Director, League of Barangays
19. Mr. Rommel Sanson, Barangay Captain, Barangay Taculing, Bacolod City
20. Atty. Edwin Salvilla, City Administrator, City of Tagum, Davao del Norte
21. Hon. Luzviminda Valdez, Mayor, City of Bacolod, Negros Occidental
22. Hon. Julius Cesar Vergara, Mayor, City of Cabanatuan, Nueva Ecija

C. Other Participants

Asian Development Bank

1. Ms. Xuelin Liu, Country Economist, Philippines Country Office
2. Ms. Laura Walker, Governance Specialist, Southeast Asia Regional Department

GTZ

3. Mr. Herwig Mayer, GTZ Project Advisor, NEDA Institutional Strengthening Project

Procurement Watch, Inc.

4. Mr. Jun Ravanos, Executive Director
5. Mr. Jose Luis Syquia, Program Director

World Bank

6. Mr. Benjamin Albarece, Consultant
7. Mr. Joven Balbosa, Economist
8. Ms. Maribel Belizario, Operations Officer
9. Mr. Norman Cabangal, Consultant
10. Mr. Joseph Capuno, Consultant
11. Mr. Malcolm Green, Consultant
12. Ms. Hazel Jean L. Malapit, Consultant
13. Ms. Rosario G. Manasan, Consultant
14. Mr. Amitabha Mukherjee, Senior Public Sector Management Specialist
15. Mr. Christian Rey, Manager
16. Mr. Joseph Reyes, Operations Officer
17. Mr. Merwin H. Salazar, Consultant
18. Mr. Robert R. Taliercio, Economist
19. Mr. Sofronio B. Ursal, Consultant
20. Ms. Elizabeth White, Consultant
21. Mr. Wijaya Wickrema, Senior Financial Management Specialist

USAID Project Gold

22. Mr. Robert Wuertz

List of Participants: January 25, 2002

A. Participants From National Government Agencies

Department of Agriculture

1. Ms. Lerma Abesamis, Division Chief, Public Investment Program Division, Planning Service
2. Ms. Nieva Natural, Senior Staff, Program Monitoring and Evaluation Division, Planning Service

Department of Agrarian Reform

3. Ms. Clemencia Padriao, Project Development Officer, Project Development and Management Staff/Foreign-Assisted Projects Office

Department of Budget and Management

4. Mr. Jose Edgardo Campos, Senior Strategy Adviser for Public Sector Reform
5. Ms. Cynthia G. Castel, Undersecretary
6. Ms. Amelita Castillo, Director, Organization and Productivity Improvement Bureau
7. Mr. Estanislao Granados, Director
8. Ms. Evelyn Guerrero, Assistant Secretary
9. Ms. Gisela Lopez, Director-OIC, Physical Planning Bureau
10. Ms. Laura Pascua, Undersecretary
11. Ms. Solita S. Recolizado, Director, Organization, Position Classification and Compensation Bureau

Department of Education

12. Ms. Lourdes de Vera, Assistant Secretary
13. Ms. Edna Formilleza, Bids and Awards Committee Coordinator
14. Mr. Armando Ruiz, OIC, Budget Division

Department of Finance

15. Ms. Juanita Amatong, Undersecretary, International Finance Group
16. Mr. Ed Mendiola, Deputy Treasurer, Operations Subsector, Bureau of Treasury
17. Ms. Nieves Osorio, Undersecretary, Corporate Affairs Group
18. Ms. Salve Rios, Chief, Bureau Budget Division, Bureau of Treasury

Department of Health

19. Ms. Carol Herradura, Director, Procurement Logistics Service
20. Mr. Mario Villaverde, Director, Health Policy, Development and Planning Bureau

Department of Internal and Local Government

21. Ms. Ellen Pascua, Project Manager, Water Supply and Sanitation Project

Department of Public Works and Highways

22. Mr. Jun Molano, OIC-Assistant Director, Bureau of Research and Standards

Commission on Audit

23. Mr. Arcadio Cuenco, Director, Information Technology
24. Mr. Emmanuel Dalman, Commissioner
25. Ms. Estela dela Paz, Director, Corporate Audit Office
26. Ms. Emma Espina, Assistant Commissioner

Civil Service Commission

27. Ms. Celia Bernardo, Director, Technical Cooperation and International Relations Service
28. Ms. Maryann Fernandez, Assistant Commissioner

29. Mr. Fernando M. Porio, Chief Personnel Specialist, Office of the Assistant Commissioner
Housing and Urban Development Coordinating Council
30. Ms. Rowena Dineros, Project Evaluation Officer
31. Ms. Emmy Molo, Computer Operator, Policy Formulation and Review Group
National Economic and Development Authority
32. Ms. Rowena Cham, Chief Economic Development Specialist, Investment Planning Division,
Public Investment Staff
33. Mr. Elmer Dorado, Supervising Economic Development Specialist
34. Ms. Aleli Rosario, Supervising Economic Development Specialist
35. Mr. Rolando Tungpalan, Assistant Director-General, National Development Office,
Investment Programming
36. Mr. Joey Virtucio, Director, Agriculture Staff

B. Participants From Local Government Units

1. Atty. Honorio Alumno, Head, Research and Information, League of Municipalities
2. Hon. Estelita Aquino, Assistant Treasurer, League of Municipalities
3. Mr. Serafin Blanco, City Administrator, City of Mandaue, Cebu
4. Ms. Anita Carbon, Clerk, Office of the Mayor, City of Valencia, Bukidnon
5. Mr. Jose de Leon, Jr., City Administrator, City of San Fernando, Pampanga
6. Hon. Elpidio B. Dulay, Governor, Bayombong, Nueva Vizcaya
7. Hon. Loreli Fajardo, Treasurer, League of Cities
8. Hon. Jose M. Galario, Jr., Mayor, City of Valencia, Bukidnon
9. Mr. Alfredo Guzman, City Engineer, City of Valencia, Bukidnon
10. Hon. Leonides Theresa B. Plaza, Mayor, City of Butuan, Agusan del Norte
11. Ms. Junaida Prantilla, City Planning Officer, City of Valencia, Bukidnon
12. Ms. Lorraine Reginalde, Staff, Office of the Governor, Municipality of Bayombong, Nueva
Vizcaya
13. Atty. Edwin Salvilla, City Administrator, City of Tagum, Davao del Norte

C. Other Participants

Asian Development Bank

1. Ms. Xuelin Liu, Country Economist, Philippines Country Office
2. Ms. Laura Walker, Governance Specialist, Southeast Asia Regional Department

GTZ

3. Mr. Herwig Mayer, GTZ Project Advisor, NEDA Institutional Strengthening Project

Procurement Watch, Inc.

4. Mr. Jun Ravanos, Executive Director
5. Mr. Jose Luis Syquia, Program Director

World Bank

6. Mr. Benjamin Albarece, Consultant
7. Ms. Maribel Belizario, Operations Officer
8. Mr. Norman Cabangal, Consultant
9. Mr. Joseph Capuno, Consultant
10. Mr. Jaime Galvez-Tan, Consultant
11. Mr. Malcolm Green, Consultant

12. Ms. Hazel Jean Malapit, Consultant
13. Ms. Rosario G. Manasan, Consultant
14. Mr. Amitabha Mukherjee, Senior Public Sector Management Specialist
15. Mr. Christian Rey, Manager
16. Mr. Joseph Reyes, Operations Officer
17. Mr. Merwin H. Salazar, Consultant
18. Mr. Robert R. Taliercio, Economist
19. Mr. Sofronio B. Ursal, Consultant
20. Ms. Cecilia Vales, Senior Operations Officer
21. Ms. Elizabeth White, Consultant
22. Mr. Wijaya Wickrema, Senior Financial Management Specialist

Amitabha Mukherjee

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¹ E.g. preventive care expenditures as a percentage of the DOH budget have fallen from 36 to 26 percent during 1996-2001.

² E.g. national government initiatives on public housing do not seem to be matched by LGUs, which cite cumbersome and tortuous processes, lack of access of the poor to credit for down payments, and lack of availability of suitable acquired land as impediments to speedy implementation of shelter programs for the poor despite strong Presidential support for fast-tracking housing assistance implementation.

³ The Commission on Audit (COA), the Department of Budget and Management, the Department of Finance and the National Economic and Development Authority (NEDA) comprise the oversight agencies.

⁴ Strengthening Public Finance and Planning of Local Government Units, TA 3145-PHI, ADB, April 2000.

⁵ Chapter 11 provides an overview of key LGU issues.

⁶ The 14 GOCCs comprise EPZA (later renamed PEZA), LWUA, LRTA, MWSS, NDC, NEA, NFA, NHA, NIA, NPC, PNOC, PNR, PPA and MMTC. In 1994, MMTC was privatized. Effective 2000, the Home Guaranty Corporation was considered a monitored GOCC.

⁷ The Power Sector Reform Act of 2001 was approved in June 2001.

⁸ The EPIR is the centerpiece for restructuring the power industry.

⁹ ADB and World Bank staff feel that the key question is the extent of legislative support for the TRANSCO bill.

¹⁰ The rates for taxes on net income were 32 percent for corporate income tax and personal income tax. For VAT, it was 10 percent on gross sales and for withholding income, 10 percent of net income. Taxes on net income were classified as company taxes and individual taxes and others.

¹¹ Issues and actions taken on revenue forecasting have been discussed in Chapter 5.

¹² The tax effort in other ASEAN countries has also declined. In 2000, the tax effort in Malaysia, Thailand and Indonesia was recorded at 14.3 percent, 14.3 percent and 15.2 percent of GNP, respectively.

¹³ This draws on (i) extensive analytical work by Mr. Romeo Bernardo and Ms. Marie-Christine G. Tang; (ii) a USAID-funded study on contingent liabilities, and (iii) a World Bank-funded consultant study by Mr. Tarun Das.

¹⁴ Current regulations allow the GSIS to invest abroad but it has apparently been "advised" against proceeding in this direction, and hence cannot effectively do so.

¹⁵ Past due contributions from the Government to GSIS reportedly exceed PhP14 billion to date (including past due interest).

¹⁶ These data on the Philippines do not include expenditures at the LGU level. For example, including LGU capital expenditures would raise the overall national share.

¹⁷ Over 60 percent of students in public elementary schools belong to poor households despite the fact that only 40 percent of households are considered poor because a disproportionate number of the children from non-poor households tend to go to private schools.

¹⁸ The income-to-expenditure ratio rises to 10 percent if income is reckoned inclusive of their income from business enterprise.

¹⁹ The ratio for the Philippines is from Maglen and Manasan (1999) while the ratio for the average Asian country is from Lewin (1997).

²⁰ These items are expressed in 2000 prices.

²¹ The DOH notes that these are in fact published, but that there is a 5-year lag (i.e. the latest available report in 2002 is that for 1997).

²² Delays in compilation of mortality statistics is due to the fact that registration of births and deaths is done at the LGU level.

²³ Chapter 5 discusses this in more detail.

²⁴ World Bank staff estimates.

²⁵ All data comparing FY2000 NEP with GAA are from "FY2000 General Appropriations Act: Analysis of Budget Cuts/Additions Made by Congress and the Nature of the Cuts/Additions," NEDA, n.d., ms.

²⁶ According to one congressional source, this practice has been discontinued recently.

²⁷ See Chapter 5 for a discussion on Sector Effectiveness and Efficiency Reviews.

²⁸ This should cover conservation and management of natural resources, since they would be essential for sustainable agricultural growth.

²⁹ The ADB has supported a Grains Sector Reform Program to help private sector participation.

³⁰ The Government feels that this approach should be cautiously pursued and proposed measures evaluated from the fiscal, efficiency and welfare angles, and that the appropriate level of government to administer such measures should also be carefully determined. The Government also feels that the proposed use of foreign funds for agrarian reform should be carefully assessed given prevailing low recoupment rates from ARBs.

³¹ E.g. several agencies are involved in construction of farm-to-market roads.

³² These issues are discussed more fully in Chapter 10.

³³ Most SUCs are legislated into being by Congresspersons to demonstrate support for local and provincial initiatives; the process effectively sidesteps contestable resource allocation processes.

³⁴ Meanwhile, an independent initiative spearheaded by Senator John Osmena has mandated CHED to study the possible restructuring of SUCs and other areas of rationalization.

³⁵ Chapter 7 deals with procurement reforms, including in the education sector.

³⁶ See Chapters 5 and 6. The DOH has requested the WHO for assistance with performance assessment of LGU health care services.

³⁷ See Chapters 5 and 6.

³⁸ Regional and provincial-level officers of national line agencies are unavoidably beholden to the Congressmen of their districts. This relationship makes the implementing agencies quite vulnerable to interventions from legislators. In order to protect local projects and local staff from possible after-effects of tightened CI processes, it would be desirable to introduce a system of project monitoring by beneficiary communities as early as possible.

³⁹ The DBCC is composed of the Executive Secretary, the Director General of the NEDA Secretariat, and the Secretaries of Finance and Budget and Management.

⁴⁰ Executive Order 292, Title II, Subtitle C, Ch. 2.

⁴¹ "Health Sector Reform Agenda: Philippines, 1999-2004," DOH, December 1999.

⁴² The DILG also has responsibilities for local planning.

⁴³ National Budget Memorandum (NBM), No. 88, February 1999.

⁴⁴ NBM, No. 91, April 2000. The baseline budget approach was continued for the FY2002 budget cycle (NBM, No. 93).

⁴⁵ National Budget Memorandum, No. 95, March 2002.

⁴⁶ NBM, No. 91, April 2000.

⁴⁷ Based on comparison of baselines issued in April 2000 (NBM 91) with 2001 budget allocations (adjusted, from BESF FY2002).

⁴⁸ NEDA is supported by GTZ's Institutional Strengthening Project, which has played an important role in the SEER process.

⁴⁹ "A Manual on Public Expenditure Management in the Philippines," Revised Draft, December 13, 2000.

⁵⁰ Presidential Decree 1177, 1977 "Revising the Budget Process in Order to Institutionalize the Budgetary Innovations of the New Society"

⁵¹ Over the years as the resource back-up for continuing appropriations for major programs such as the public works and the Comprehensive Agrarian Reform Program were depleted, the General Appropriations Act or the GAA has become the major comprehensive appropriations law, incorporating even the budget of the three major government power corporations.

⁵² Because of this, many public elementary schools are dependent on the LGUs' SEF for their MOOE.

⁵³ National Budget Memorandum No. 93, Budget Preparation Form #206.

⁵⁴ "Enhancing Transparency, Accountability in Government: Institutionalization of an Efficient, Effective Dynamic legislative Oversight System in Congress", A concept paper of the Committee on Oversight, January 2002.

⁵⁵ "Pork and other Perks: Corruption and Governance in the Philippines", PCIJ 1998.

⁵⁶ The procurement element of the PEPFMR is also available as background material.

⁵⁷ Presentation by Dr. Jose Campos Jr., in Procurement Watch Inc Press Briefing, October 5, 2001.

⁵⁸ Textbook Procurement, A Philippine Experience by Mr. Noel Sta. Ines, March 23, 2001.

⁵⁹ The Government Procurement Policy Board (GPPB) will shortly be completing its IRR with the Joint Congressional Oversight Committee created under the law.

⁶⁰ EO 359 creating the Procurement Policy Board under DBM for procurement of goods does not have the mandate of a law enacted by Congress. EO 230 creating the Infrastructure Committee under the NEDA Board to oversee procurement of works and consultancy services was issued in 1987.

⁶¹ Chapter 10 looks at financial management in foreign-assisted projects, while Chapter 11 outlines key financial management issues pertaining to LGUs. The full text of the Country Financial Accountability Assessment (CFAA) is also available as background material. This report does not cover private sector financial accountability: a separate analysis of the private sector was undertaken for a recent Report on the Observance of Standards and Codes (ROSC).

⁶² Judicial interpretations have also perpetuated the discretionary nature of the power of appointment by defining appointment as a "political question involving considerations of wisdom which only the appointing authority can decide."

⁶³ In this context, expenditures on school supervision refer to those made in support of the operations of the DepEd division and district offices.

⁶⁴ The ratio for the Philippines is from Maglen and Manasan (1999) while that for the average Asian country is from Lewin (1997).

⁶⁵ For elementary level teachers, station is defined with reference to the division. For secondary level teachers, however, station is defined with reference to the school itself.

⁶⁶ The scope for doing this at the elementary level appears to be large since there are a significant number of teachers who are about to retire in the next 5 years.

⁶⁷ In this regard, the study suggests the need for the installation of more flexible, less complex procedures for the transfer of existing plantilla positions from one secondary school to another.

⁶⁸ Manasan, Rosario G. (1999) "Impact of Local Government Code and Proposed Amendments on Ability to Finance Infrastructure: Towards a Framework for LGU Finance," mimeo.

⁶⁹ E.g. assignment of services and expenditures; administrative and budgetary deconcentration, delegation and devolution; coordination of local service delivery regionally and nationally.

⁷⁰ E.g. transparency and accountability; user groups and community-driven development.

⁷¹ A World Bank-funded PEPFMR Preparation Workshop was held in Manila on January 24-25, 2002. Participants included members of the GOP Working Groups, the World Bank-ADB task team and LGU representatives. The objective was to confirm, validate and modify key messages emerging from the exercise, and to more closely consolidate the three interconnected strands into a single integrated process and report. In addition, the GOP also organized another workshop in April 2002 with participants from the central oversight bodies and line departments to review the emerging findings and messages.

⁷² Consisting of the revenues and expenditures of the national government (NG), the Central Bank Restructuring Fund, GOCCs, GFIs, SSLs and LGUs.