Chapter 4

PROPOSED CHANGES IN BUDGET PREPARATION/LEGISLATION STAGES WITH IMPLICATIONS ON IMPROVING BUDGET EXECUTION

1. Alternative Ways of Dealing with Revenue Items that are Not Likely to be Realized

1.1 Alternative 1: Fully Program Aforesaid Revenues But Identify Programmed Expenditures that Will be Cut

The first alternative is to fully program aforesaid revenues (targeted proceeds from new revenue measures and privatization efforts) and identify programmed expenditures that will be cut in case revenue shortfalls materialize. In the 2002 budget, DBM has identified □soft cuts□ in this regard. (In the longer run, approved ABPs of SPFs and line entities may be regarded as the □soft cuts□.)
A problem with this alternative is that agencies will be expecting an amount that will likely be cut anyway.

1.2 Alternative 2: Adoption of □Risk Management Concept□ by Not Programming Part of Aforesaid Revenues

Historically, the collection of certain revenue items (targeted proceeds from privatization and new measures) have always contributed to revenue shortfalls. This paper suggests that a risk management concept be employed. Simply put, risk is a mathematically-expected level (probability of non-occurrence times the corresponding amount) of a certain adverse event happening. The risk associated with the aforesaid revenue items is the projected amount times a heuristically/historically determined probability that new measures or privatization proceeds will not be realized.

If the targeted proceeds from these revenue items is P20 billion and the aforesaid probability is 80%, then the risk is P16 billion (P20 billionX0.8). The idea is to deduct the risk from the revenue for purposes of expenditure programming. In this case, only P4 billion (P20 billion- P16 billion) will be included in the revenue. This does not mean that only P4 billion will be attempted to be collected from new measures and privatization proceeds. The goal is still P20 billion but the appropriation cover for the P16 billion will be in the proposed unprogrammed appropriations (UA).

2. Earlier Conduct of Sector Effectiveness and Efficiency Review (SEER) and Budget Preparation Activities to Clean Baselines and Reduce Proposed Appropriations that Need Clearance

Tungpalan (2001) favors an early conduct of SEER and budget preparation activities to improve allocative efficiency. SEER will classify or continuously review the classification of final outputs into low, medium, and high47 priorities. SEER will have to take as inputs President Gloria Arroyos policy pronouncements of giving priority to poverty alleviation through the creation of globally competitive employment opportunities, improving human capital through education and health programs, and improved governance which involves reducing corruption.

2.1 Longer Term Proposal Starting 2004 Budget Preparation For the 2004 budget preparation, the following schedule is proposed:

- NEDAs identification of SEER issues pertaining to appropriateness of final output production in attaining desired outcomes -Feb 15-April 15, 2002;
- discussion and resolution of SEER issues (to the extent possible) with planning units of departments/agencies/GOCCs-April 16,-June 30,2002;
- comments (if any) and further refinements of the preliminarily resolved SEER issues by DBM/agency budget officers-July 1-August 15, 2002;
- DBMs formulation (in consultation with agencies/NEDA) of long term view of ideal organizational frameworks and submission of line entities proposals on reorganization or staffing modifications-August 16 -October 31, 2002;
- Resolution of issues (if possible) on perspective on long-term ideal organizational framework48-November 1-December 15, 2002.

Subsection 2 in Chapter 3 suggests the giving of a package of flexibility to agencies based on accreditation. If that system shall have been installed by 2002, then accredited agencies will have the authority to introduce minor modifications in their staffing patterns. These agencies can formulate their own NOSCA considering the aforesaid long-term ideal organizational framework and other outcome-oriented guidelines of DBM.

For non-accredited agencies, DBM could act on proposed reorganization or staffing modification, reclassification of positions within the period December 16, 2002-February 15, 2003. On the latter date, the 2003 Budget Call will be issued.

If the list of final outputs of a department is quite long, the SEER review in the first item could be limited to a manageable number. The balance of final outputs will be reviewed later on for subsequent budget calls.

In the last item, a department secretary involved may propose49 a legislative bill to implement the ideal long-term organizational framework.

Otherwise, DBM will evaluate proposals for staffing modification in relation to the ideal long-term organizational framework.

2.2 Proposed Transition Schedule

For 2003 budget preparation, the following transition schedule is proposed:

- NEDAs identification of SEER issues pertaining to appropriateness of final output production in attaining desired outcomes-September 1-30, 2001;
- discussion and resolution of SEER issues (to the extent possible) with

DBM, budget/planning units of departments/agencies/GOCCs-October 1-15,2001;

- DBM's formulation (in consultation with agencies/NEDA) of long term view of ideal organizational frameworks and submission of line entities' proposals on reorganization or staffing modifications-October 16-31, 2001;
- Resolution of issues (if possible) pertaining to long-term ideal organizational frameworks-November 1-December 15, 2001;

3. Long-Run Shift to Accrual-Based Output Costing as Basis for Baseline Expenditure Estimation

The last two Budget Calls prescribed baseline calculation procedures for operating programs based on PS/MOOE allotment classes since full accrual accounting is not in place and consequently full MFO cost cannot accurately be estimated. In the long-run, it is necessary to shift to accrual-based[50] output costing as basis for baseline expenditure estimation. (Of course another alternative is to derive depreciation expense from the existing financial data and adding the same to PS and MOOE components of MFO costs, without changing the accounting system.)

4. Alternative Ways of Ensuring the Financial Sustainability of New Foreign-Assisted Projects (FAPs)

4.1 Alternative 1: ICC to be Informed of Sector Allocable Funds and NEDA to Propose to DBM New FAPs Based on ICC Deliberations

In this alternative during budget preparation stage, ICC will be informed of sector allocable funds for the budget year and two immediately subsequent years so it could gauge more or less the realistic levels of new FAPs that can be approved and be reasonably assured of funding. It should be emphasized to ICC that all ABPs (new FAPs, locally-funded projects, and program augmentations to cover additional clients and/or better service quality) will compete for allocable funds.) NEDA will be asked to propose to DBM new FAPs based on ICC deliberations. (This means that line agencies will no longer propose new FAPs in their budget proposal.) Castillo (2001) suggested that NEDA discloses to DBM the multiyear financial requirements of projects up to completion. The test of medium-term financial sustainability in Section 3.7 of NBM 92 will be applied. Only new FAPs that pass the test should be included in the FAPSF.

4.2 Alternative 2: Two Step Mechanism for Testing Medium-term Financial Sustainability

In 2000, the Foreign Assisted Project Support Fund (FAPSF) was arbitrarily set at P300 million for 2001 primarily on the basis of fund availability. It was not apparently equated to the 2001 fund requirements of new ICC-approved FAPs. (Per existing procedure, the fund requirements of new FAPs approved by ICC on or before end-March of the year immediately before the budget year are incorporated in the proposed agency appropriations regardless of whether a loan or grant agreement has been signed.)

The relevant control points for new FAPs are the approval of funding for feasibility studies[51] and/or the ICC approval/disapproval. At present, line departments undertake or cause the undertaking of project feasibility studies and the ICC approves FAPs without regard to any funding constraint for these projects.

4.2.1 DBCC to Set Annual Ceilings on the Total Costs of Major Projects to be Approved by the NEDA Investment Coordination Committee (ICC) and Issuance of Forward Obligational Authorities (FOA) in an MTEF Context

At present, all major foreign-assisted projects are subject to the approval of the NEDA ICC. To guide ICC52 on the volume of project approvals that are financially sustainable in the medium term, the DBCC (based on the recommendations of its Technical Staff and in consultation with the ICC Technical Staff) should prescribe annual expenditure ceilings for new project commitments as soon as possible. In this regard, the computer-based model specified in Section 1.3 of Chapter 4 of the PEMIP's paper entitled "Medium-Term Expenditure Framework: Focus on Proposed Guidelines in the Preparation and Use of Forward Estimates in the Philippines" should be modified and made more user-friendly.

Further, the ICC Technical Staff can monitor the pipeline feasibility studies that will be undertaken by line agencies. If the value of the projects in the pipeline is higher than the commitment ceilings recommended by DBCC by at least 50%, then ICC should suggest to agencies that greater selectivity in undertaking these studies should be exercised. It is also recommended that the issuance of Forward Obligational Authorities (FOA) be made in an MTEF context (following the principle embodied in Table 1 to ensure the medium-term financial sustainability of new expenditures).[53]

4.2.2 Assessment of the Medium-Term Financial Sustainability of New Foreign-Assisted Projects

Conceptually, after undertaking the procedures in the immediately preceding subsection, the new FAPs that may be approved by ICC would likely be financially sustainable. The computer model (based on a methodology developed by this consultant and Ms. Laura Pascua during the eighties and which is proposed to be improved as stated in the immediately preceding subsection) assumes average project implementation period and disbursement patterns and may therefore be viewed as rough estimates.

The budget proposals for new foreign-assisted projects[54] that have been approved by ICC (major FAPs) are submitted during budget preparation stage. As stated earlier, if ICC's approval was before end-March of the current year then the funds required for the budget year are appropriated in the line department/ agency budget.

Otherwise, the project will line up against the FAPSF. The entity involved will submit a "special budget" any time during the course of budget execution and are chargeable to the Foreign-Assisted Project Support Fund (FAPSF). In addition to the procedures specified in the immediately preceding subsection, the following are suggested to ensure the financial sustainability of new foreign-assisted projects.

Regardless of whether a loan has been negotiated or not, the new FAPS will be recommended as ABPs by the line departments involved. Ranking will be undertaken considering the guidelines in NBM 92 as operationalized (with possible future revisions) by a NEDA-DBM Task Force. The projects' fund requirements for three years will be analyzed by DBM in applying the procedure in Section 3.7 of NBM 92. Since FAPs are considered priorities, it may be likely that all new FAPs will be included in the approved ABPs. (In rare instances, a few FAPs may not be included[55] by PERB based on the application of ABP prioritization guidelines consistent with NBM 92.)

5. Fully Program Likely Direct Payment Transactions of Foreign Assisted Projects (FAPs)

Navarro (2001) stated that in the past, there was a tendency in DBM to unprogram likely direct payment transactions of FAPs. This is window-dressing the budget deficit during budget preparation stage and violates the principle of transparency. Eventually during BES, the occurrence of these transactions will register as part of the deficit.

6. Inclusion of a New Table in the 2004 Budget of Expenditures and Sources of Financing (BESF) Pertaining to Baseline Components and Total Approved Above-the-Baseline Proposals (ABPs) Classified into Final Outputs of Line Entities

To facilitate the implementation of potential savings based on approved ABPs[56] of sectors/subsectors, it is necessary to include Table 2 (in the BESF) pertaining to baseline components and total ABP by final output of each agency/department.[57] The baseline components may include the following: (a) personnel services (PS) broken down into filled permanent, unfilled permanent, and non-permanent positions; (b) maintenance and other operating expenditures (MOOE) split into mandatory and non-mandatory; and (c) capital outlays (CO). It may be noted that the difference between a department s budget program corresponding to the GAA and the corresponding baseline is the ABP of the department involved.

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[47] The high-priority final outputs may be further divided into very-high- and moderately-high priority sub-groups. Very-high-priority final outputs would be determined by the President/Cabinet upon the recommendation of NEDA and may include services in basic education and maintaining peace/order.

It may be noted that final outputs classified as medium-and high-priorities are MFOs.

It is ideal if congressional spending initiatives could be subjected to outcome-orientation analysis undertaken with the involvement of NEDA.

[48] Good practices and existing studies (like the Integrated Reorganization Plan or IRP during the seventies and the Administrative Code of 1987) may be considered so as not to reinvent the wheel .

During the 1990s, Chrysler was losing and reformed itself to be competitive. One of the things it did was to reorganize to easier pinpoint accountability from a functional set up based on specialization. From the traditional units of production, marketing, and finance, the organization was set up along the product lines like big and small motor vehicles. After 3 years, Chrysler became profitable again.

Similarly, an international bank was organized based on specialization like policy group and loan/grant disbursing group by area. The actions of each group are not harmonized. Grant assistance to the Philippines of less than US$ 300,000 to improve public expenditure management resulted in improvements reviewed by policy group member as being 20 years ahead of Thailand which was supported by the same bank with millions of US$. The loan/grant disbursing officer for the Philippines was oblivious of the outcomes and stick literally to tedious procedures partly resulting to very significant delays in the payment of consultant s salaries.

[49] This is after clearance with the Presidential Committee on Effective Governance (PCEG). (The earlier mentioned framework is subject to yearly reviews.)

[50] If an accrual accounting system is implemented in government, the budgetary allocation to agencies could still be on the basis of output cost net of non-cash expenses, like depreciation. Allocation for capital outlays could be made once accumulated depreciation (based on capital asset revaluation every two years) in the balance sheet of an agency is sufficient to finance replacement of worn out capital assets.

In the very long run, the possibility of removing security of tenure (assuming change in the legal framework) may be explored, so that agency heads could quickly resolve overstaffing issues and consequently adjust the PS component of unit MFO costs based on accrual accounting.

[51] In this regard, this paper suggests that a DBCC policy be issued preventing line departments/agencies from accepting bilateral grants for project feasibility studies and entering into loan agreements with country creditors (bilateral sources). It is preferable from the perspective of lower project cost to use multilateral sources (like ADB and World Bank) or to bid out projects including financing as a package.

The DOTC availed of a bilateral grant for the formulation of a feasibility study of public telephones for a group of municipalities in Mindanao. The study found out that the project was feasible and a loan agreement was signed between the same country creditor and the Philippine government. The agreement limits the projects procurement of equipment from the supplier (which, in this case, was only one) of the country of the creditor. The negotiated cost was $US 25,000 per telephone. DOTC found out later on that the same supplier participated in a World Bank funded project and proposed a bid of about $US 5,000 per telephone. The feasibility study grant resulted into a very expensive project.

[52] After at least five years when a performance culture will have existed in the Philippine bureaucracy, it is suggested that the ICC functions be delegated to line agencies to be consistent with worlds good practices. (During the interim period, (a) line agency planning personnel should be trained in project analysis from the countrys perspective and (b) the performance accountability system for planning units should be improved to encourage good project analysis.)

[53] Pascua (2001) clarified that funds for annual work scope are appropriated in the GAA. Letter of Instruction (LOI) 880 stipulates: Loans shall not be contracted by agencies of the National government, including state universities and colleges, unless the full amount of the loan is covered by Obligational Authority issued by the Ministry of Budget within the regular program. Since the obligational authority is associated with the program for a given year and given that foreign project loans finance multi-year requirements of projects, the DBM consequently created another release document called Forward Obligational Authority.

It is also suggested that major (at least P300 million pesos of total costs) locally-funded projects be subjected to the issuance of FOA, which specifies the total project cost and fund requirements per year.

[54] During budget preparation, DBM prepares an indicative list of these new projects which are not presented in the General Appropriations Acts.

[55] If the fund requirements of a new foreign-assisted project are not financially-sustainable during the medium-term (for instance, the total allocable fund for the second forward year

is not sufficient to take care of the funds required by the aforesaid project), then the DBM may request the agency involved to reschedule implementation or scale down scope of project in a manner that the economic internal rate-of-return is still acceptable and ranking of ABPs is not altered. If this is not possible, then the DBM could consider the following alternatives: (a) stop the project or (b) continue the project and identify the existing lower priority programs that would be scaled down. In relation to item b, the detailed implications on the clientele of affected programs should be analyzed.

[56] Even though the aforesaid inclusion is too late for the 2002 BESF, it is still possible (by getting baseline data from a DBM circular and subtracting from the program corresponding to the approved GAA) to implement an ABP-based reserve.

[57] In the longer-run when accrual accounting principles are used, the table may be modified so that GASS could be allocated (using a certain base like number of personnel) to the various final outputs.

(End of Chapter 4)

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