

INTRODUCTION

1. Objective

This paper, which is prepared under the auspices of a two-and-a-half year technical assistance grant of the United Nations Development Programme (UNDP) to the Department of Budget of Management (DBM) in Manila, proposes improvements in the existing budget execution processes to complement budget preparation improvements under the Public Expenditure Management Improvement Project (PEMIP) which was undertaken with the assistance of World Bank.

The Terms of Reference (TOR) prepared by UNDP specified the need to align DBM budget execution processes along the following principles: (a) promotion of aggregate fiscal discipline; (b) predictability (in agency budgets to enable them to plan better) and transparency in budget procedures; (c) agencies' flexibility in exchange for accountability; and, (d) contestability of outputs (including programs, activities, and projects or PAPs) through an annual sector effectiveness and efficiency review (SEER).

While the TOR specified comprehensiveness as a principle, this should be understood in terms of (a) completeness of coverage of all receipts and payments of government as internationally defined and (b) within the context of information required by this paper's proposed decision frameworks for releasing allotments and disbursement authorities, notably the notices of cash allocations (NCAs). In addition to these principles, DBM under the auspices of PEMIP has introduced budget preparation procedures that encourage the (a) focusing of expenditures to line entities' production of major final outputs (MFOs), goods or services serving clients external to the entity involved and are linked to desired outcomes and (b) funding of financially-sustainable MFOs.

It may be noted that through the efforts initiated by Secretary Emilia Boncodin way back in mid-nineties, DBM has been reengineering budget preparation procedures consistent with PEM. A gap exists in relation to budget execution processes and this paper attempts to fill in that gap.

2. Organization

Chapter 1 defines the existing budget execution stage (BES) and explains its intent and governing principles. It also compares the existing BES with PEM. Chapter 2 presents the control points in the existing BES and identifies the issues that have to be addressed. Proposed improvements (like focusing on performance management) that apply to both budget preparation and execution stages are discussed in Chapter 3. It is noted in this chapter that the last two Budget Calls prescribed baseline calculation procedures for operating programs based on allotment classes (for personnel services or PS and maintenance and other operating expenditures or MOOE) 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 output costing as basis for baseline expenditure estimation.

Chapter 4 proposes certain changes in the budget preparation and legislation stages

that will help improve the budget execution stage. Chapter 5 discusses proposals to improve budget execution processes. It includes budget execution decision frameworks pertaining to the release of allotments and cash disbursement authorities. If implemented, these frameworks will drastically reduce discretion by DBM officials/personnel in deciding the timing of releases of allotments and cash disbursement authorities. Following the guidance by Secretary Boncodin to consider a cash disbursement control system that does not rely on NCA, a second alternative is presented in Section 2.2 of Chapter 5. The alternative is based on direct payment by DBM to line entities □ creditors for certain type of transactions or above a certain cut-off payment. *(However, it should be noted that Australia has recently shifted from this centralized system to a decentralized one. New Zealand is also using a decentralized system apparently because the same is more consistent with performance management.)* The reporting system and associated aspects of management information system in Chapter 6 limit data reporting to that required by the aforesaid frameworks.

3. Complexity of Reality Necessitates Judgment in the Implementation of Certain Proposals

Economics which is the foundation of PEM is not an exact science. In fact, even economists do not agree on the relative importance of supply or demand side factors in macroeconomic management pertaining to their field although almost all economists agree that both factors will have to be considered. An economist likened demand-side management to stimulating¹ an individual and throwing to him/her cold water once he/she has overheated. Once the individual has subsided, then stimulation is again applied and so the cycle is repeated. If overheating is as natural as the rise and fall of the sea waves, why not focus on supply-side factors? If an economy is overheating, why not a supplementary information campaign by government that stock or property valuations are not supported by earning fundamentals? *(Pascua [2001] shares the view that focus must be on supply-side improvements.)*

As stated in Chapter 3, the budget deficit is a figure in search of a theory. It does not measure government □s contribution to GNP; nor does it measure the money creation attributed to government. *(For instance, government □s interest payments to foreign creditors reduce money supply but increase the deficit.)* It may be noted that while bank financing of the government □s deficit *(not the deficit per se)* increases money supply, inflation is probably less sensitive to money supply nowadays in the context of international global production competition compared to that during the eighties.

This is the context of a longer-run suggestion that government should not be enslaved by a deficit target per se. In the long run, a footnote in Chapter 5 suggests that expenditure baselines should not be cut if (a) borrowing sources are available, (b) debt-to-net-worth ratio is manageable *(assuming future availability of government balance sheet based on the 1993 System of National Accounts)*, and (c) inflation is not likely to increase by more than two percentage points from the original forecast. In other words, the burden of proof should be on inflation to manifest its □ugly head□ before baselines are cut in the long run. In the short run, the same chapter supports the position of Secretary Boncodin that even baselines, serving as the last line of defense, could be cut so as not to exceed the deficit target. *(Pascua [2001] noted that the key to the effective control of the fiscal sector deficit in the Philippines is higher revenue collections.)*

Perhaps in the very long run when economists unanimously agree on economic theory, then by that time perhaps fiscal policy (*and PEM*) can be conducted mechanically, without any judgment. (*Meanwhile, the responsible conduct of fiscal policy geared towards country's best interest will have to consider judgment in the longer run since economic theory is not yet perfect.*)

¹ During the late eighties, loose monetary policy and aggressive fiscal spending were used to stimulate the Japanese economy. The excess liquidity fed a real property speculative bubble which was pricked during the nineties. (*The low interest rates and aggressive fiscal stance encouraged inefficiencies in resource allocation. This may perhaps indicate a dynamically-changing optimum domestic interest rate level, which is a function of international interest rates.*) The Japanese economy has been in the doldrums for about a decade now.

(End of Introduction)