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BUDGETING IN THE PHILIPPINES

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FOREWORD

In exchanges between the OECD and the Philippine Department of Budget and Management in early 2009, it was agreed that the OECD would prepare a profile of the Philippines budgeting process. The profile would offer a general overview of the Philippines's system of budgeting. The profile concentrates on the national government only.

The report is divided into two parts. The first part focuses on the budget formulation process. The second discusses the role of Congress in approving the budget. Various aspects of budget implementation are integrated in those two parts.

An OECD mission visited Manila in April and December 2009 to prepare this profile.

The mission would like to express its gratitude and appreciation to **Mr. Rolando G. ANDAYA, Jr.**, Secretary, **Mr. Mario L. RELAMPAGOS**, Undersecretary, and **Ms. Laura B. PASCUA**, Undersecretary, Philippine Department of Budget and Management, and **Mr. Romulo E. M. MIRAL Jr.**, Executive Director, Congressional Planning and Budget Department, for their support and the generous time they and their colleagues shared with the mission during its stays in Manila. The warm and cordial reception by the Philippine authorities is gratefully acknowledged.

The views contained in this report are those of the OECD Secretariat and should not be attributed to governments of OECD Member countries, or to any organization or individual consulted for this report.

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THE PHILIPPINES – AN INTRODUCTION

1. The Philippines consist of over 7,100 islands. They are divided into three island groups – Luzon (North), Visayas (Central) and Mindanao (South). Its total land area of 300,400 square kilometers is roughly equivalent to the size of Italy. The capital city of Manila is located on Luzon.
2. The population of the Philippines is nearly 100 million.
3. Filipinos are overwhelmingly Christian (over 90 percent). Muslims make up the largest minority religion (5%), concentrated on Mindanao.
4. The Philippines have two official languages – Filipino and English. Filipino, which is based on Tagalog, is the national language. English is also widely used. In fact, the Philippines are the third largest English speaking country in the world.
5. The culture of the Philippines reflects nearly 350 years of Spanish rule and then nearly 50 years of American rule.
6. The Philippines regained its independence in 1946. At the time, it was the second richest country in Asia. The economy suffered greatly due to economic mismanagement and political volatility in the ensuing decades. In the last year of the Marcos regime, the economy contracted by over 10 percent of GDP. The *People Power Revolution* of 1986 returned democracy to the Philippines.
7. Significant economic reforms have been undertaken in recent years. Economic growth has averaged 5% since the current President assumed office. The Philippine economy grew at its fastest pace in three decades in 2007 with GDP growth exceeding 7%, but growth slowed to 3.8% in 2008 as a result of the global financial crisis.
8. Government stimulus measures, a relatively small trade sector, a resilient service sector, and large remittances from the nearly five million Filipinos who work abroad have helped cushion the economy from the current financial crisis.
9. The Philippines sit astride the typhoon belt and experience repeated and severe natural disasters.

PART I

BUDGET FORMULATION

Introduction

10. This part describes the budget formulation process in the Philippines. The first section is devoted to highlighting several special characteristics of Philippine budgeting. The second section outlines the key steps in the annual budget formulation process.

Special Characteristics

11. There are six characteristics in the Philippine budget process that deserve special attention:

- A commitment to fiscal discipline
- Tax Compliance and Corruption
- Subsidies: Government Owned and Controlled Corporations
- National Planning function
- Development Budget Coordinating Committee
- *Unprogrammed Funds and Special Purpose Funds*

A commitment to fiscal discipline

12. The assumption of power by President Gloria Macapagal-Arroyo in 2001 and especially her 2004 election marked a major turning point for budget policy in the Philippines.¹ She made restoring fiscal discipline and sustainability a key priority.

13. For the previous two decades, the Philippine government had recorded deficits in each and every year, except in the period 1994-1997 where privatization receipts outweighed the otherwise baseline deficit position. Deficits peaked in 2002 at 5.3% of GDP.

14. Between 2002 and 2004, the government averted fiscal crisis by severe expenditure restraint. Primary expenditure declined by 2 percentage points of GDP. Civil service salaries were not increased from 2001 to 2004 and spending on education, health and infrastructure declined as a share of GDP. This period was also marked by political/governance challenges.

¹ In 2001, President Joseph Estrada left office and the then Vice President Gloria Macapagal-Arroyo assumed the Presidency.

15. The newly elected President made very strong statements on the need to restore fiscal discipline and sustainability²:

- She declared that the country was on the verge of a “fiscal crisis” and identified the budget deficit as the “most urgent problem.”
- She noted that “sometimes stamping out deficits can slow growth. But ignoring them can kill the economy.”
- She further noted that “the program of restoring fiscal strength is premised on the painful fact that the government could, very soon, no longer afford to subsist on borrowed funds.”

16. The objective was to balance the budget in six years (2010), coinciding with the President’s term of office. The core of the programme was to reinforce revenue-raising while maintaining spending restraint. Any additional spending was to be focused on needed investments for economic and social development.

17. The Administration immediately introduced, and passed in Congress, strong revenue-raising measures:

- an increase in the excise levy on alcohol and tobacco,
- the elimination of a number of exemptions from value-added tax (VAT),
- a two point rise in the rate of VAT (to 12%); and
- a three-point rise in the rate of corporate income tax.

18. This reduced the deficit from 3.8% of GDP in 2004 to near balance in 2007. The outlook for eliminating the deficit by 2008 – 2 years ahead of the original schedule – became the government’s new goal.

² Medium-Term Philippine Development Plan

Figure 1. Fiscal Balance

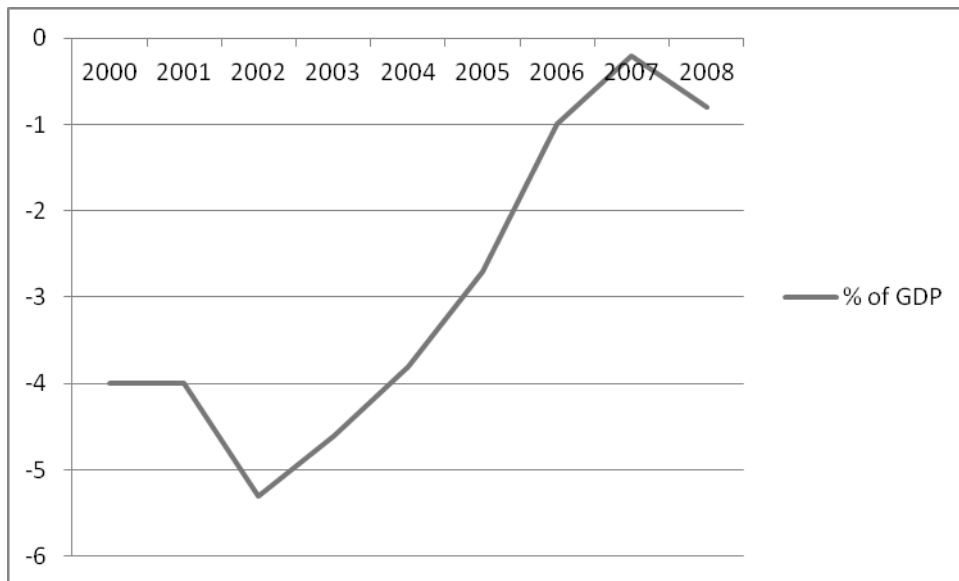


Figure 2. Revenue

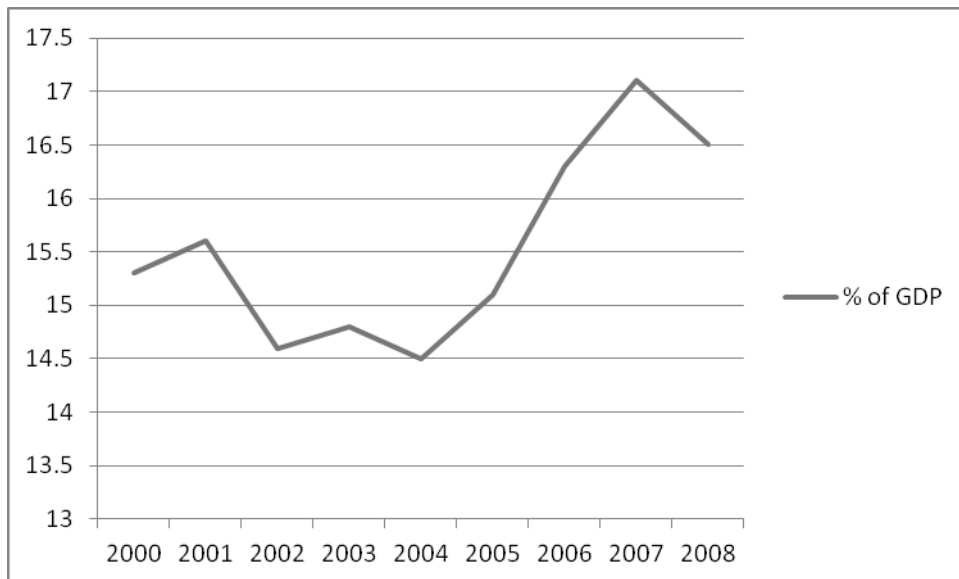


Figure 3. Expenditure

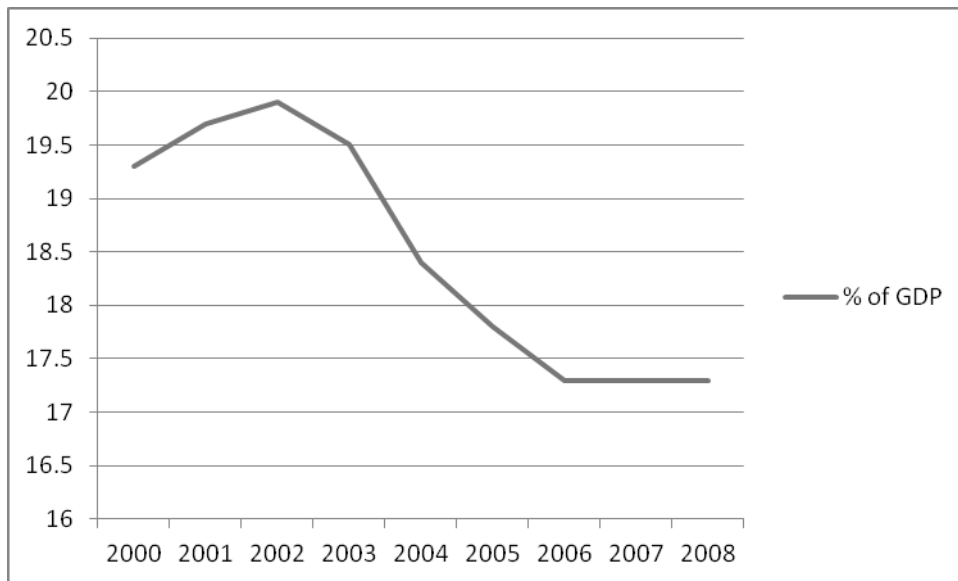
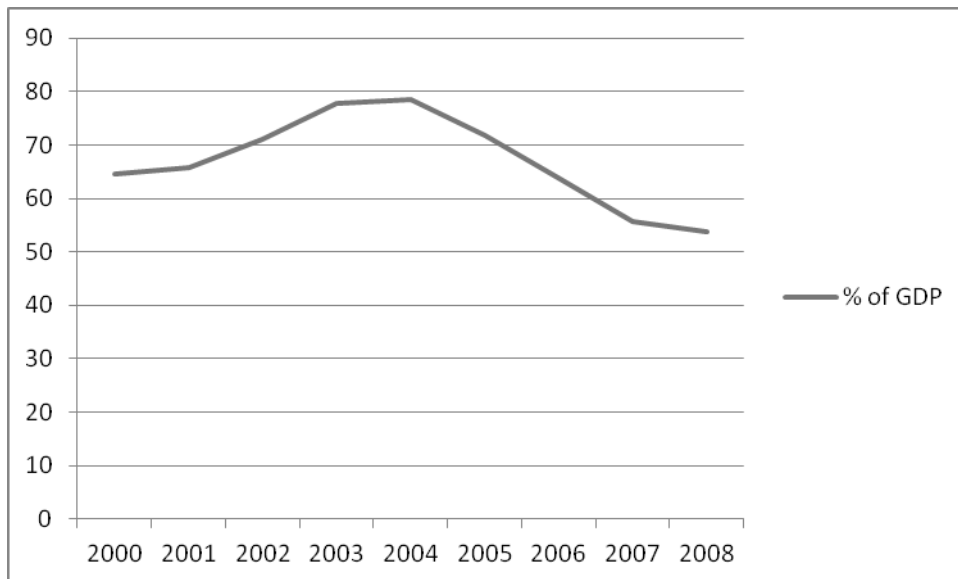


Figure 4. Debt



19. As can be seen from the above graphs, the level of accumulated debt went from a high of 78.5% of GDP in 2004 to 53.7% of GDP in 2008. This was accomplished with higher revenues while maintaining strong expenditure discipline – in line with the government’s original intentions.

20. The global financial crisis however upset these plans. The government abandoned both its 2008 and 2010 deadlines for eliminating the deficit. The deficit in 2008 was 0.9% of GDP and due to weakening tax revenues and stimulus spending, the government planned a 3.2% of GDP deficit for 2009. The actual deficit for 2009 is estimated at 3.6% of GDP. This is due to the fiscal effects of severe natural disasters and various revenue-eroding measures which were passed by Congress and took effect in 2009.

21. The fiscal consolidation achieved in the first four year of the Administration allowed the Philippines to be in a much better condition to withstand and respond to the impact of the global financial crisis. Its deficit for 2009 is moderate by OECD standards given the circumstances.

Tax Compliance and Corruption

22. The central and long-standing fiscal problem in the Philippines has to do with revenue mobilization. One aspect of this is the need to broaden tax bases and increase rates – as noted above. It could be argued however that the greater problem is tax *collection*. The Philippines suffers from rampant tax evasion and complicit corruption in the revenue collection agencies.

23. This also creates a vicious circle as opponents of efforts to raise tax rates and broaden the tax base point to this as a means to avoid needed tax policy measures.

24. Tax evasion and complicit corruption in the revenue-generating agencies is massive in the Philippines. The National Tax Research Center – a highly respected think-tank within the Department of Finance – regularly estimates the tax gap for various taxes and groups of taxpayers. The tax gap is the difference between the amount of tax that taxpayers should pay and the amount that is actually paid, *i.e.* it is a measure of non-compliance with the tax law. Some estimates of the extent of non-compliance in the Philippines:

- About thirty percent of value-added tax is evaded.³
- About two-thirds of professionals and the self-employed evade paying income tax.⁴
- About ten percent of salaried wage-earners evade paying income tax.⁵
- About eighty percent of those classified as “large taxpayers” claimed between 70-90% of reported gross income as allowable deductions.⁶

³ Congressional Planning and Budget Department. An Analysis of the President’s Budget for Fiscal Year 2005. November 2004. (The report refers to uncited National Tax Research Center analysis.)

⁴ National Tax Research Center. Estimate of the Individual Income Tax Gap, 2001-2005, *NTRC Research Journal*, Volume XVIII. Number 6. November-December 2006.

⁵ Ibid.

⁶ National Tax Research Center. Profile of Large Taxpayers: CY2003. *NTRC Research Journal*, Volume XVII. Number 3. May-June 2005.

25. It should be emphasized that the figures for non-compliance come from official government bodies.

26. The reasons cited for this exceptionally poor collection performance include non-filing of tax returns, underdeclarations, overstatement of expenses, and abuses in claims for exemptions. This is made possible by extensive corruption in the two main revenue-generating agencies – the Bureau of Internal Revenue and the Bureau of Customs. They are regularly cited as among the most corrupt bodies in the Philippines.

27. The Department of Finance – which the two revenue-generating agencies report to – has programs to identify and prosecute tax evaders and smugglers and corrupt officials. A system of “lifestyle checks” on government officials was introduced in 2003 to reduce opportunities for misconduct by revenue collecting agencies. A special unit to prosecute corrupt revenue officials was also launched. These efforts have all been given increased resources in order to increase the government enforcement capability. The problem however persists.

28. Most recently, the Administration’s efforts to revamp the tax and customs administration is the *Lateral Attrition System*, which institutionalizes a system of incentives for revenue-collecting officials who meet or exceed targets. This is highly controversial. A member of the Senate declared his opposition to it on the following grounds:

“Because it would only legalize the racket of BOC [Bureau of Customs] and Bureau of Internal Revenue who connive with unscrupulous businessmen to lower their tax dues to the government.”⁷

29. This issue also poses problems with setting revenue estimates for the budget as is discussed later in this chapter.

Subsidies: Government Owned and Controlled Corporations

30. The government operates a number of *Government Owned and Controlled Corporations*, some of which carry out quasi-fiscal activities with significant contingent liability implications. The two most notable are the National Power Corporation (electricity generation and transmission) and the National Food Authority (rice marketing). The deficit of the National Power Corporation reached a high of 1.8 percent of GDP in 2004. The deficit of the National Food Authority reached a high of 1 percent of GDP in 2008. Their deficits are in the first instance financed by their own borrowings, guaranteed by the Government.

31. The losses at the National Power Corporation (NPC) stemmed from a failure to keep electricity rates at cost-recovery levels. Significant reforms were undertaken in 2004, namely raising rates by 30 percent and the government taking-over a significant share of the Corporation’s outstanding debt. Rates have risen largely on a commercial basis since. The

⁷ Senator Francis Escudero, as quoted in Philippine Daily Inquirer, First Posted 05:19:00 07/02/2008

government has actively worked on privatizing the various power generating and transmission assets of the NPC.

32. The National Food Authority (NFA) mandate is to ensure the stable supply and prices of rice, a Filipino food staple. Its commercial function involves procurement and distribution programs. It procures from individual and organized farmers at prices that reflect government support to ensure that farmers earn a reasonable rate on their investment. As domestic supply is not sufficient, the NFA has to import rice based on world market prices. It has the monopoly on the import of rice. The distribution program on the other hand seeks to make available affordable food supply to consumers.

33. The losses of the NFA stem from “buying high, selling low.” Specifically, the need to import rice at higher prices than it pays domestic producers to meet the demands of the nation have placed the greatest strains on its finances. In 2008, there were fears of a global rice shortage which raised the price of rice to unprecedented levels with the concomitant fiscal effects. Again, the NFA rice importation program is financed through direct borrowings, which are guaranteed by the national government.

34. The subsidy implicit in the operation of the NPC and the NFA are aimed to help the poor by making these commodities available at reasonable prices. There would appear to be ample scope to make such assistance to the poor better targeted, which would also lessen the associated fiscal pressures. In fact, the Government has taken measures in this regard with the issuance in 2009 of access cards to poor families to better target NFA subsidies.

Box 1. No Fuel Subsidies

It should be highlighted that the Philippines is the only country in Southeast Asia aside from Singapore to have no fuel subsidies. The consumer price reflects the world market price. This has shielded the budget from problems many others have recently encountered with subsidizing higher oil prices.

Development Budget Coordinating Committee

35. A long-established Cabinet committee – the *Development Budget Coordinating Committee* – meets throughout the year to co-ordinate budget formulation and implementation activities.

36. Its functions are, *inter alia*, to:

- Establish the level of annual government expenditure
- Determine the proper allocation of expenditure
- Analyze macroeconomic prospects
- Assess reliability of revenue estimate
- Recommend appropriate tax or other revenues measures and the extent and type of borrowings.

37. Chaired by the Secretary of Budget and Management, it consists of the heads of the four economic agencies and makes recommendations to the President.⁸ A representative from the Office of the President is also a member of the Committee.

Box 2. The Economic Agencies

The four economic agencies are:

- **Department of Budget and Management**
 - Budget formulation and execution
- **Department of Finance**
 - Revenue forecasting
 - Revenue generation (oversees the Bureau of Internal Revenue and the Bureau of Customs)
 - Cash and debt management (Bureau of the Treasury)
- **National Economic Development Authority**
 - Economic assumptions
 - National planning function
 - Coordinate official development assistance
- **Bangko Sentral ng Pilipinas**
 - The central bank

38. The Committee at the level of principals meets at least quarterly.

39. An *Executive Technical Board* consisting of the senior civil servants in the respective agencies meets every other month and is chaired by the Undersecretary of the Department of Budget and Management. The Board serves as a screening and review body of policies, measures and targets for recommendation to the principals' Committee.

40. A number of expert-level Working Groups have been established to focus on specific issues. They generally meet monthly and are chaired by the relevant lead agency.

41. The Development Budget Coordinating Committee can best be described as a consultative forum where each of the economic agencies explains what is within its specific remit, which is then endorsed by the Committee. It has a collegiate atmosphere.

⁸ As an independent central bank, the *Bangko Sentral ng Pilipinas* is not officially a member of the DBCC but it participates in its meetings nonetheless as a resource institution.

Box 3. The President

The Philippines has a presidential form of government.

The President is elected by direct popular vote for a term of six years. The President is not eligible for re-election. All executive power is solely vested in the President.

The President appoints a Cabinet to assist in carrying out executive functions. The Cabinet consists of the secretaries of executive departments and other officials designated with Cabinet rank by the President. There are presently 19 secretaries of executive departments and 7 other designated officials that form the Cabinet.

The *Executive Secretary* is the head and highest ranking member of the Cabinet. The Executive Secretary can issue orders in the name of the President, can review and modify decisions of other cabinet secretaries on appeal and performs numerous other functions as delegated by the President. The position is known colloquially as the "*Little President*".

A Vice-President is elected at the same time who assumes the Presidency to serve the unexpired term in case the President is not able to perform his duties.

National Planning Function

42. The Philippines has a long history of employing national development planning. Under the auspices of the National Economic and Development Authority (NEDA), a multitude of mechanisms are employed in this regard with each President typically operating them differently. Currently, it is useful to divide these into three groups.

- President's 10-Point Development Agenda
- Medium-Term Philippine Development Plan
- Mid-Term Philippine Investment Program

43. The *President's 10-Point Development Agenda* is a very succinct – one page – document that highlights in bullet-point form the key election commitments of the President. This document was issued immediately upon the President taking office. It was subsequently elaborated into the President's 10-Point Development Agenda. This can be viewed as an "action plan" based on the President's priorities.

44. The *Mid-Term Philippine Development Plan* by contrast is all encompassing. It is organized into plans for 25 separate sectors – including such sectors as foreign affairs and national defence. It is not prioritized beyond the President's 10-Point Development Agenda and it makes no references to specific budget amounts. It has been described as aspirational and academic/scientific in nature for each sector and as a comprehensive "menu" overall. Agencies typically make a reference to the Plan in their budget submissions, but since the Plan is all-

encompassing this offers little real guidance for resource allocation decisions. *Strategic Planning Matrixes* were recently introduced to "operationalize" the Plan vis-à-vis the Budget. This appears to be a highly ineffective and inefficient, if not futile, exercise due to the nature of the Plan. The established annual *Socio-Economic Report* which assesses progress against the Plan seems the most appropriate vehicle to report on the macro implementation of the Plan.

45. The *Medium-Term Public Investment Program* contains a list of desirable capital projects. In fact, the origins of this Program was to attract and co-ordinate official development assistance to the Philippines. The projects do not have an amount attached to them, but are tagged with the name of the foreign development agency partnering the project through grants or concessional funding if already agreed. Otherwise it acts as a "wish list" to attract development assistance.

Box 4. Investment Coordinating Committee

Each capital project worth at least 500 million Pesos (about 10 million USD) is subject to review by the *Investment Coordinating Committee*. Its function is to evaluate and monitor the fiscal, monetary and balance of payments implications and viability of major national projects, and to make recommendations to the President. Chaired by the Secretary of the Department of Finance, its membership includes the other economic agencies.

The evaluation process is to take 8-10 weeks but often takes longer. Measures to improve the quality of the submissions from spending agencies are being implemented.

46. All in all, the *Agenda* plays a similar role as election manifestos and political programmes in many OECD countries. The *Plan* plays an important role in monitoring economic and social developments but it plays only a perfunctory role in the budget process. The *Program* is more geared to attracting official development assistance for major capital works than as an integral part of the budget process. Such large projects undergo review by the Investment Coordinating Committee, which is the strongest direct link between the overall planning function and the budget process.

Unprogrammed funds and Special Purpose Funds

47. Another special feature of the Philippine budget process is the extensive use of *unprogrammed funds*. These are appropriations that can only be used once certain conditions have been met. These involve either certain government revenue benchmarks having been met - - *i.e.* the funds can only be spent if new financing is available, or the fulfillment of certain contractual benchmarks -- *i.e.* counterpart funding for official development assistance projects whose documentation was yet to be completed during the preparation of the national budget. Nearly 10 percent of the total budget was dedicated to "unprogrammed funds" in 2008.

48. However, due to strict conditionalities and possible adverse impact on the deficit, *unprogrammed funds* are used sparingly and in fact usually require an offset from the *programmed appropriations* so as not to affect the overall budget deficit.

49. *Special Purpose Funds* are lump sum funds within programmed appropriations which are presented as such for various reasons. More than half of all appropriations are in the form of Special Purpose Funds. These can be divided into two groups. First, the major ones are presented to highlight certain programs for Congress. For example, the *Agriculture and Fisheries Modernization Fund* consists of appropriations for 8 different agencies. These are all specific, identified appropriations released to agencies but aggregated under the fund to highlight their common purpose. Transfers to local governments and interest on the debt are also considered Special Purpose Funds.

50. Second, some Special Purpose Funds are presented as lump sums with their specific use only to be identified during budget execution. These include the *Priority Development Assistance Fund* and the *Calamity Fund*. This second type of Special Purpose Funds is controversial in the Philippines. Many in Congress contend that such funding should be approved on a line-item basis in a supplemental budget. The government counters that it is necessary to have the flexibility to implement urgent and unforeseen projects – noting that many budget decisions were made 18 months in advance of the end of the respective fiscal year. Executive-Legislative relations are discussed further in the next chapter.

Box 5. Appropriations

The Philippines has a complex system of classification of budget appropriations.

First, appropriations are classified as *programmed* or *unprogrammed*, as discussed above. Programmed funds are allocated to Departments and agencies for specific projects, activities and programs.

Second, appropriations are designated as *general*, which lapse at the end of the fiscal year; *automatic*, which do not require authorization in the annual budget; or *continuing*, which allows appropriations to be automatically carried-forward. The latter applies mainly to capital investments.

Third, a significant share of all appropriations are in the form of *Special Purpose Funds*, as discussed above.

Upon approval of the budget, the Department of Budget and Management approves a detailed *Agency Budget Matrix* for each Department and agency. This is the comprehensive allotment release which provides the legal authority to obligate / disburse funds up to a specific monetary limit. Typically, DBM will authorize 75% of the total appropriation. In case in-year adjustments need to be made to preserve the overall fiscal target, DBM has a 25% “cushion” in terms of authorized expenditures.

It is possible to reallocate funds with the approval of DBM. Some degree of reallocation is permitted without the need for DBM approval. For example, within maintenance expenditure, appropriations can be freely shifted from one object to another.

Budgeting in the Philippines is on an obligations / cash basis. The government accounting system is on an accrual basis.

Annual Budget Formulation Cycle

51. The annual budget formulation cycle can be divided into two phases. First, to set the overall budget parameters. Second, to allocate resources to Departments and agencies.

Box 6. Budget Formulation Timetable

March-April	Formulating Economic Assumptions and Revenue Forecasts Updating Medium-Term Expenditure Framework Preparing Paper on Budget Strategy (PBS)
April	Budget Call issued
May	Departments and agencies submit their spending bids Technical Budget Hearings
May-July	Bilateral discussions between DBM and Departments and agencies DBM Bureaus assesses bids and recommend levels of spending
Late July	DBM Executive Review Board finalizes recommended levels of spending Appeals by Departments and agencies Presidential approval of final budget proposal
Late July/ Early August	President's State of the National Address Budget proposal submitted to Congress

Fiscal Year = Calendar Year

Phase I – Setting Budget Parameters

52. The first phase in the annual budget formulation cycle is to set the parameters for the upcoming budget. This is a three-step process:

- Developing the economic assumptions and revenue forecasts
- Assessing the continuing costs of existing programmes, through a medium-term expenditure framework
- Identifying the uses of the resultant “fiscal space” through a Paper on Budget Strategy

Economic Assumptions and Revenue Forecasts

53. The lead responsibility for overall economic assumptions lies with the National Economic Development Authority. The lead responsibility for the revenue forecasts lies with the Department of Finance and its Bureau of Internal Revenue (BIR) and Bureau of Customs (BOC). Their proposals are discussed and endorsed by the Development Budget Coordinating Committee as the official budget parameters. This generally takes place in March and establishes the level of resources available for the upcoming budget and forms the bedrock for the budget system.

54. Recent experience in the Philippines shows that revenues have been less than estimated. This serves to undermine the integrity of the budget process. This, however, is not the classic case of making “optimistic” revenue projections.

55. The key issue in the Philippines is that the “tax effort” of the two key revenue collection agencies -- the Bureau of Internal Revenue and Bureau of Customs – is limited due to compliance and corruption issues as discussed earlier. The BIR and BOC make their own projections based on “historical experience” of collection. The BIR and BOC submit their forecast to the Department of Finance, which insists on using forecasts based on progress in raising the “tax effort.” These assumptions are used in the budget but the progress in this area has been limited, and actual revenue has fallen short.

56. This issue is known throughout government and clouds the entire budget process as it is generally known that in-year adjustments will need to be made in view of actual revenue. It is acknowledged that it is imperative to improve the performance of the revenue agencies for the sake of the integrity of the budget process.

Medium-Term Expenditure Framework (MTEF)

57. The Department of Budget and Management is in the process of establishing a medium-term expenditure framework – known as “forward estimates” – to show the baseline cost of continuing existing policies. The difference between the forecast revenue and the baseline costs reveals the amount of fiscal space available for new projects.

58. The MTEF was originally introduced in 1999, but it did not fare well. Rather than being introduced as an analytical tool to assist the annual budget process, it was designed as a set of fixed multi-year expenditure ceilings and presented as such to the Congress for approval. In technical terms, this was an extremely ambitious objective when first introducing an MTEF. This was in fact akin to introducing multi-year budgeting as opposed to a medium-term expenditure framework. In any case, the Congress rejected this approach as usurping its constitutional authority in the annual budget process.

59. The MTEF was re-introduced in 2006, this time designed as an analytical tool. The MTEF consists of the upcoming budget and two years beyond. The second year should roll-over and become the basis for that year’s budget with a new out-year being added. The MTEF is however still a work-in-progress as the quality of the forward years information is being improved. Upgrading technical skills for effectively using the MTEF is taking place both at the Department of Budget and Management and in spending departments.

60. There are several challenges in implementing an MTEF in the Philippines:

- First, a significant share of the budget is accounted for by capital projects, which are by their nature one-off. Aside from their specific capital outlay profile and resulting operating costs, they do not lend themselves to the MTEF concept of baseline cost of continuing existing policies.

- Second, the systemic issue with revenue forecasting, as discussed above, which inflates the MTEF in terms of fiscal space for new expenditures.
- Third, the high degree of flexibility permitted in the implementation of the budget, both to “crawl back” expenditures in view of actual revenue receipts and because of extensive in-year re-allocations, as discussed later in this report.
- Fourth, the great effort needed to keep the MTEF up-to-date throughout the year in view of the above. Otherwise, the MTEF risks becoming obsolete and there would in effect be a need for a new MTEF each year, rather than having an updated rolling one in place.
- Fifth, this places a great premium on the MTEF being integrated into the same units that deal with the annual budgeting, rather than being placed in a special unit. They will have the most ready access to the information and have an incentive to keep it up to date because they see value for themselves in doing so. Having the MTEF follow the same format as the annual budget fosters this, as it makes the linkages between the two natural.

61. The budget for the current year has generally acted as the starting point with one-time changes being made for inflation, non-recurring expenditures, demographic change, operating costs of completed projects *et cetera* in order to show the cost of continuing existing programs. Again, these are one-time changes, not part of a rolling exercises. Progress is however being made each year in this direction.

Paper on Budget Strategy (PBS)

62. The economic assumptions/revenue forecasts combined with the MTEF yields the amount of fiscal space available for the upcoming budget.

63. The Department of Budget and Management prepares a *Paper on Budget Strategy* to discuss the uses of additional resources deemed available. This is also a new initiative having originated in 2006.

64. This is an internal document used as a basis for discussion within the Development Budget Coordinating Committee (DBCC) for deciding on priority sectors for the use of new resources. The President endorses the recommendations of the DBCC.

65. Since its inception, three priority sectors have been consistently identified: Education, Health and Infrastructure Development. In 2008, Agriculture and Welfare were added because of the global rice crisis.

66. The PBS is over 20 pages in length. It discussed the macroeconomic outlook and fiscal targets, the President’s priorities, current achievements and challenges in achieving the *Plan* and options for priority sectors.

67. The revenue forecasts, the Medium-Term Expenditure Forecasts, and the Paper on Budget Strategy remain in the background throughout the budget process rather than forming the basis for top-down allocation at the beginning of the budget formulation process.

Phase II – Allocating Resources

68. The second phase in the annual budget formulation cycle is the actual allocation of resources to Departments and agencies. This is also a three-step process:

- The issuance of a Budget Call to all government agencies
- Submissions and review of spending bids by DBM
- Final political decision-making on resource allocation

Budget Call

69. The annual budget process officially starts with the issuance of the *Budget Call* by the DBM – usually in late April – to guide all government agencies in budget preparation activities.

70. It's organized into five parts:

- Overall direction on economic goals and fiscal target;
- Priority areas of government activity, programs and projects;
- Budget ceilings to departments/agencies;
- Guidelines in formulation of agency budget proposals given prescribed forms;
- Calendar of budget preparation activities.

71. The first two bullets elaborate on the conclusions by the President of the options presented in the *Paper on Budget Strategy* (PBS).

72. The budget ceilings refer only to the baselines for continued services, i.e. what's called for in the medium-term expenditure framework. The ceilings are subdivided into four categories: salaries, non-salary operating, capital and transfers.

73. They are presented in aggregate for the total of a Department's budget, including indicative ceilings for its subsidiary agencies. Departments are free to – in fact, encouraged to – reallocate funds although this is very limited in practice.

74. The last two bullets involve administrative “housekeeping” issues concerning the conduct of the budget round.

75. Immediately after the Budget Call, the DBM convenes the heads of all government Departments and agencies in a *Budget Forum*. This is to further elaborate on the contents of the Budget Call and to clarify any issues departments may have.

Box 7. Department of Budget and Management

The Department of Budget and Management is physically located at the very center of government in Malacanang, also the site of the presidential complex. It is the only government Department located there.

It has a staff of 1,100 people. It's headed by a politically-appointed Secretary. It's divided into an *Operations Group* and a *Policy Group*, in addition to a *Management and Support Services Group*. Each is headed by an under-secretary, a career civil servant. Several Assistant Secretaries are also attached to the DBM.

The Budget Operations Group includes seven *Budget and Management Bureaus*, each shadowing a set of government Departments and agencies. They are responsible for budget formulation and for monitoring budget implementation. They also handle staffing levels and organizational restructuring of Departments and agencies. They operate on a "one-stop-shop" basis where all interactions with government Departments and agencies are handled within the same bureau.

Submission and Review of Proposals

76. In May, Departments submit their proposals for funding --- both in terms of amending their ceilings for continuing operations and for funds for new initiatives. These proposals are without exception in excess of any reasonable expectation for actual funding.

77. This takes place in formal *Technical Budget Hearings*. Departments will highlight their proposals and offer a summary of their agencies' proposals. In some cases, Departmental secretaries attend these meeting. Each agency will then explain in detail its specific proposals, accompanied by a representative of its Department.

78. It should be highlighted that these are not forums for negotiations, but an official hand-Over of the proposals to the Department of Budget and Management.

79. NEDA – the planning agency – does not participate in these hearings except in the case of major capital investments.

80. A series of bilateral exchanges on the proposals take place from May to July between Departments and agencies and their respective Budget and Management Bureau. It should also be noted that a separate discussion is taking place by the same officials on the implementation of the current budget which invariably affects the discussion about next year's budget.

81. The practices of how Departments deal with their subsidiary agencies in these exchanges varies. In most cases, however, agencies have a direct relationship with DBM.

82. Each Bureau will then submit its assessments of the proposals and recommend funding levels for their respective Departments and subsidiary agency to the *Executive Review Board*. This is an internal DBM body consisting of the Secretary, Undersecretaries and the Assistant

Secretaries of DBM. This is a formal procedure with specific forms and protocols. This is by no means an automatic endorsement of the recommendations of the Bureaus and the Executive Review Board will often seek revisions for specific programs funding levels.

83. DBM would consult with the President and the Development Budget Coordinating Committee at this stage. An update of the economic assumptions and revenue forecasts would also be available at this time.

Box 8. Performance and Results Information

The Philippine budget process is informed by extensive information on performance and results. This information is an integral part of the dialogue between DBM and Departments and agencies.

DBM introduced the *Book of Outputs* in 2007. Designed to change the way policymakers and implementers view the budget and the budgeting process, the *Book of Outputs* seeks to translate the traditional presentation of the Budget into one based on outputs with clear, measurable, verifiable performance indicators and targets. The Book contains a matrix on Performance Measures and Targets which shows “what has been done, what is being done, and what remains to be done.”

The Philippines is however a challenging environment for successfully implementing a performance and results framework for many of the same reasons as highlighted for MTEFs. Reliability of performance data continues to be a key concern.

Final Decision-making

84. The decisions of the Executive Review Board are submitted to the Cabinet at a July meeting where each Secretary would see their proposed level of funding for the first time. At the same time, DBM will be transmitting its proposed levels of funding to the agencies within each Department.

85. Departments and agencies then have 3 days to appeal the decisions of DBM. The appeals take the form of bilateral discussions between the Secretary of DBM and the secretaries of Departments. These requests are consolidated and the Executive Review Board meets again to consider them. In some cases, the President may get directly involved and endorse a request.

86. The final touches on the budget proposal are made following the President’s *State of the Nation* address, which marks the opening of the Philippine Congress in late July-early August.

87. The government must submit its budget within 30 days of the State of the Nation address and generally does so shortly after the Address. This time is also used to finalize technical details and the budget documentation.

Conclusions

88. The Philippines have achieved impressive fiscal outcomes in recent years despite significant obstacles, including governance challenges and most recently the effects of the global financial crisis.

89. The central and long-standing fiscal problem in the Philippines has to do with revenue mobilization – both in terms of broadening tax bases and increasing tax rates and tax collection. The Philippines suffers from rampant tax evasion and complicit corruption in the revenue collection agencies.

90. A strong national planning function exists in the Philippines and employs a multitude of mechanisms in that regard. It would appear to play an important role in monitoring economic and social development but plays only a perfunctory role in the budget process at present.

91. The Development Budget Coordinating Committee is an important consultative forum where the key economic agencies meet throughout the year to co-ordinate budget formulation and implementation activities.

92. The Philippines have also been active in introducing modern budgeting reforms. These include a medium-term expenditure framework (MTEF), a Paper on Budget Strategy to guide top-down budget allocation decisions, and extensive use of performance and results information.

93. Senior officials at the Department of Budget and Management– while recognizing further development is needed – believe the MTEF and the Paper on Budget Strategy have been instrumental in systematically restructuring the budget in recent years to significantly increase spending for infrastructure development, education and health.

94. Again, it must be emphasized that the impressive fiscal outcome and implementation of modern budgeting reforms have been accomplished within a most challenging environment as discussed in the paper.

PART II

ROLE OF CONGRESS

Introduction

95. This part reviews the role of Congress in the budget process. It highlights the structure of the Congress of the Philippines, outlines constitutional restrictions on its role and describes the annual budget approval process.

Congress of the Philippines

96. The Congress of the Philippines is a bicameral institution and consists of the Senate and the House of Representatives.

97. The Senate has 24-members elected on a nationwide-basis, rather than a regional basis. They can serve a maximum of two consecutive terms of six years. Half of all Senate seats are up for election every three years.

98. The House of Representatives is composed of up to 250 members. The exact number is decided in legislation, currently 240 members. Members of the House serve three year terms, and can serve a maximum of three consecutive terms. Voters cast two votes during elections to the House. The first elects a district representative. The second elects a party-list representative.

99. Most members (currently 212) represent single-member districts. These are reapportioned regularly within three years of each Census. Members are elected on a first-past-the-post system.

100. In addition, there are members elected through a nationwide party-list system. Up to 20% of the House of Representatives can be elected in such a manner, currently 21. The purpose of the party-list system is to seek representation for various “marginal” groups who would not gain election in a single-member district. Special laws define eligibility to stand on a party-list.

Box 9. Politics in the Philippines

Two characteristics of politics in the Philippines deserve special mention.

First, party affiliation is not strong in the Philippines. It is common for members of Congress to have belonged to several different political parties at various times during the course of their careers.

Second, the prominence of “political families” .All over the Philippines, it is not unusual to see close family members holding key elective and appointed positions in governments. If not a member themselves, national officials often align themselves with these political families to ensure local support.

Both of these characteristics are under intense political debate in the Philippines with a number of reform proposals being discussed.

Constitutional Restrictions and Executive-Legislative Relations

101. The Constitution places restrictions on the role of Congress in the budget process which are designed to foster fiscal responsibility.

102. The President has the exclusive right to propose a budget and Congress must respect the President’s aggregate expenditure ceiling. It can however reduce appropriations and reallocate expenditures within the President’s overall ceiling.

103. The Constitution also provides the President with a line-item veto authority, *i.e.* the ability to veto specific appropriations within the budget while signing the overall budget into law. The Congress can, however, over-ride the veto with a two-thirds majority vote in both houses of Congress.

104. In cases where the budget has not been enacted into law prior to the start of the fiscal year, last year’s budget is automatically “re-enacted” until Congress passes the budget.

105. The President also enjoys the power to impose restrictions on the disbursement of funds appropriated by Congress, in line with specific legal provisions and on the recommendation of the Department of Budget and Management

106. Finally, the President is authorized to augment any appropriation in the budget with savings from other appropriations.

Box 10. Key Constitutional Restrictions

- President has exclusive right to propose a budget;
- Congress can only reduce or re-allocate appropriations in the proposed budget;
- President can use a line-item veto;
- Last year's budget is automatically "re-enacted" if the budget is not passed prior to the start of the fiscal year;
- President can impose restrictions on the disbursement of funds appropriated by Congress;
- President can augment any appropriations from savings in other appropriations.

107. These are not dormant constitutional provisions. They are all regularly used and deployed with great tactics in terms of executive-legislative relations.

108. Congress has increased the total amount of appropriations by reducing items such as interest on the debt which does not diminish the underlying need for payment. The "savings" from interest on the debt is then used to fund new and higher appropriations in other areas.

109. The President regularly uses her line-item veto power, especially in the case of the reduced appropriations for interest on the debt. In some cases, the President did not veto the new and higher appropriations which may result in higher overall expenditure.

110. Congress often fails to enact a budget prior to the start of the fiscal year. In fact, there have been years when no budget was passed, most often because the House and the Senate could not reconcile their respective versions of the budget, triggering a re-enacted budget.

111. Re-enacted budgets do limit total spending to that of the previous year's budget. However, there are no constraints on resources allocated for projects in last year's budget that have been completed. Re-enacted budgets give the President discretion to allocate those resources to augment other items in the re-enacted budget.

112. The President regularly imposes restrictions on the disbursements of funds appropriated by Congress. Any money not disbursed as a result of the restrictions is treated as savings and can be used to augment other appropriations at the President's discretion.

113. As can be seen from the above discussion, the President has extraordinary power in the budget process vis-à-vis Congress and can reallocate funds to priority programmes during the budget implementation phase.

Congressional Budget Approval Process

114. The Congressional budget approval process can be divided into three phases:

- Deliberation and approval by the House of Representatives

- Deliberation and approval by the Senate
- Deliberation and approval by a Bicameral Conference Committee to reconcile the House and Senate versions of the budget

115. The President opens each session of the Philippine Congress with her *State of the Nation Address* in late July/early August each year. This takes place in a joint session of the House and the Senate and is a very high profile event. This address highlights the key policy priorities and initiatives of the President and foreshadows the main contents of the budget. The speech generally lasts about one hour.

116. The President must then submit her budget proposal – which elaborates on her State of the Nation Address – to Congress within 30 days. In practice, the proposal is submitted earlier than this deadline. As a result, Congress has about four months to review the budget proposal before the start of the fiscal year on 1 January.

117. The budget proposal is first introduced in the House of Representatives. Only after it has finished its deliberations and approval of the budget does it go to the Senate.

118. Aside from purely procedural points, there is no discussion in plenary upon its introduction in the House. The budget proposal is immediately referred to the *Committee on Appropriations*.

119. The Appropriations Committee is unique compared to other Committees in the House in that it contains over 125 members, more than half of all the members of the House. The line between it as a committee and a plenary session of the House is thus blurred.

120. The Committee's review can be divided into three steps.

121. *First*, the Committee conducts hearing with representatives of the Development Budget Coordinating Committee (DBCC) and its constituent bodies. This part of the hearing focuses on overall economic and fiscal performance, including the macroeconomic assumptions and revenue forecasts upon which the proposed budget is based.

122. *Second*, the Committee is divided into numerous sub-committees – in recent years between 21 and 50 sub-committees. They scrutinize the budget proposal of their respective Departments and agencies, which are usually sectorally-defined. The heads of the respective Departments and agencies go to Congress to explain their respective programs and projects. Officials from the relevant Bureaus of the Department of Budget and Management are also present. Members of the House of Representatives generally focus most on how the budget affects their own districts. This normally occurs over an intensive 1-week period at the end of September.

Box 11. Budget Approval Timetable

Late July/ Early August	President's <i>State of the Nation</i> Address
August	Budget proposal submitted to the House of Representatives (First Reading of the Budget)
August- September	House Appropriations Committee scrutinizes the budget proposal
Early October	House amends and approves budget proposal (Second and Third Reading of the Budget) House-approved budget proposal introduced in Senate
Early December	Senate amends and approves the budget proposal Bicameral Conference Committee formed to Reconcile House and Senate versions
December	House and Senate approve the reconciled Budget
Late December	President signs budget into law President exercises line-item veto of individual appropriations

123. *Third*, the Chairman of the Appropriations Committee and its Vice-Chairs (the Chairs of each Subcommittee) put together a collective Committee report and report it to a plenary sitting of the House. This will generally include numerous amendments, often raising individual appropriations and cutting others, including (notionally) interest expenditure in order to finance it. This is in the form of a draft *General Appropriations Act* – *i.e.* a different format than the President's budget proposal.

124. The Committee will approve the report which is then referred to plenary session where it is approved – with or without discussion. The large composition of the Appropriation Committee means that most discussion takes place there, with the plenary session being more of a formality. This generally takes place in early October.

125. The approved bill is then transmitted to the Senate for action. The Senate scrutinizes the House bill through its Finance Committee.

126. The Finance Committee consists of 17 members (out of 24 member of the Senate as a whole) and divides into numerous sub-committees which hold hearings to scrutinize groups of Departments and agencies in much the same way as the House Appropriations Committee.

127. The orientation of the Senate scrutiny of the budget proposal is however different than the House. The Senate is elected on a nation-wide basis, rather than a district basis as is the House. The Senate generally demonstrates more fiscal responsibility in its amendments than the House. In fact, Senate amendments often reverse amendments made in the House.

128. The Senate then formally approves the budget in plenary session based on the report and amendments of the Finance Committee.

129. If the Senate bill differs from the House bill, which is typically the case, a Bicameral Conference Committee is convened to reconcile the difference in a compromise bill. The length of time needed to reach a compromise varies greatly and in some cases they have not been able to reach a compromise and no budget passes the Congress.

130. The deliberations in the Conference Committee are not open to the public – unlike the deliberations in the House Appropriations Committee and the Senate Finance Committee. Any agreement reached in the Conference Committee is approved by the House and Senate in plenary on an up-and-down vote without debate. This has led to controversy regarding amendments introduced by the Conference Committee that had not been discussed in either the House or Senate earlier.

131. The Congress is to approve the budget in December prior to the start of the fiscal year in January. As has been discussed, it has not always fulfilled this objective and a re-enacted budget takes effect.

Box 12. Congressional Planning and Budget Department

The Congressional Planning and Budget Department was established in 1990 and is modeled on the United States Congressional Budget Office. Its primary mandate is to provide data and analyses on the implications of various policies, issues and other developments in the economic field. It focuses on research and analysis of fiscal measures, including the macro-economic implications of the government's annual budget, proposed revenue measures, public expenditure management, and governance reforms.

Its flagship publication is the *Macro Analysis of the Budget*. This is an annual report which discusses the macroeconomic dimensions of the budget focusing on the level of projected government revenues and expenditures as it relates to fiscal policy and the macroeconomic targets. It also examines national expenditure program in terms of its distribution by region, sector and objects of expenditures, implementing agencies and cost structure.

They also prepare various other reports to support Members of Congress in their scrutiny of the budget proposal, including *Agency Budget Notes* which provide summary information ahead of each committee hearing on the budget proposal of a specific Department/agency.

The Congressional Planning and Budget Department is headed by an Executive Director appointed by the Secretary-General of the House of Representatives. It has a staff of 49.

Conclusions

132. The Congress has a very active and vocal role in the budget process in the Philippines. The fact that a majority of members of both the House and the Senate are also members of their respective chamber's budget committees is most noteworthy.

133. The budget approval process is often tense between the House of Representatives and the Senate and within the Bicameral Conference Committee. Congress is not always able to approve a budget prior to the start of the fiscal year, or in some cases not at all. This together with the practice of nominally reducing appropriations for interest on the debt in order to increase other appropriations raises questions about the commitment of Congress to fiscal responsibility.

134. The Constitution gives the President extraordinary power vis-à-vis the Congress in budgetary matters, which have served to counteract the effects of these practices.