Operationalizing the Medium-Term Expenditure Framework in the Philippines: A Key to Reducing Poverty

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1. Introduction

During the past two years, the Philippine Department of Budget and Management has seen how the budget management of a government can be a potent tool for growth and poverty reduction. Budget management enforces fiscal discipline, fosters macroeconomic stability, improves the portfolio of programs by rewarding more effective and efficient programs, and builds a culture of performance and accountability within the government bureaucracy.

During the past decade and a half, Philippine economic history has provided valuable lessons about what works for promoting growth and equality. The most telling fact is that the resumption of growth from 1985 to 1997 brought about (i) a steady decrease in the proportion of Filipinos living below the poverty line, from 41 percent down to 25 percent; (ii) the promotion of broad-based growth stemming from structural reforms; and (iii) improved provision of public social services, especially education. Compared with other countries in the region, significant involvement of the private sector and civil society in development efforts in the Philippines has increased the ability of government to reduce poverty through growth. For instance, the People's Republic of China (PRC) and Indonesia have comparable per capita income and experienced higher growth rates than the Philippines, but have similar or l higher levels of poverty.

Now that the Asian economic crisis is receding and a new Government with a fresh mandate has been installed in the Philippines, the challenge facing the country and its economic managers is how to sustain the country's poverty reduction achievements and revitalize economic growth enough to make a serious dent in poverty. In the budget fund, for instance, the past two years of pump-priming efforts to stimulate growth have contributed to an unsustainable budget deficit. The Government's economic managers believe that a medium-term expenditure framework (MTEF), to be explained in this paper, is the key to achieving fiscal discipline, more strategic prioritization of resources, and better operating efficiencies over the medium term.

This paper explains problems and weaknesses that the government hopes to address by installing the MTEF, also called a multi-year budgeting system. It also enumerates elements of the MTEF, explains anticipated benefits, and outlines how the Government has been setting them in place during the country's ongoing budgeting process. Lastly, this paper mentions achievements that have already been registered since the MTEF's initial installation.

2. Limitations of a One-Year Budgeting System

The problem with the Philippines' current one-year budgeting system is that it provides no mechanism for the Government to control its budget and expenditure beyond a two-year time horizon. It provides no systematic way of projecting or managing the expenditure requirements of ongoing and new programs of government agencies. In fact, the government often approves the funding of new projects, which start from very modest beginnings, only to find that these projects require huge outlays in subsequent years. At the agency level, a one-year budgeting system creates an incentive to understate first-year requirements. A one-year budgeting system also limits the ability of the budgeting agency and the agencies administering programs to deal with resource shortfalls, because within the one-year budgeting system, agencies try to resolve their fiscal problems exclusively by reducing expenditures while maintaining existing program commitments. A one-year budgeting system increases the need to manage the agencies' budgets on an input basis, controlling the number of personnel deployed and the expenditures on specific items. During periods of across-the-board budget cuts, under a single-year scheme, this control gives the agencies an incentive not to attain the target agreed to during the budget preparation period. A one-year budgeting system also makes it difficult to develop a system for projecting the budget implications of legislators' proposals for spending .

One benefit of a multi-year system is that it affords policymakers an understanding of how cuts adversely affect agency operations. A multi-year budgeting system also provides information about how fiscal problems—low revenue, high expenditure, and borrowing measures—can be resolved over a number of years.

3. A Pragmatic Budgeting System

The Philippine Government wants to set in place a three-year budgeting system that systematically maps the requirements of ongoing programs and proposed new projects on a three-year basis. Under this system, programs approved by Congress automatically carry over to the following year and become part of the baseline; they do not start from scratch every budget preparation period. This carrying over highlights to decision makers that the cumulative expenditure commitments of past years will have to be considered in setting overall expenditure levels.

Employees in the Department of Budget and Management like to compare this system to the budget analyst ledger system. Each budget analyst now has an annual ledger to manage the agency budget. Under the MTEF, the department has moved into multi-year ledgers for managing agency budgets. The MTEF ledger works as an annual system in which budget decisions on new programs and projects are made at every budget preparation session. However, the approval of projects is based on three-year fiscal scenarios, to ensure that projects financed for the next three years will be approved under the annual system and will be consistent with the baseline budgeting approach. Identified resources go first into the funding of existing programs, and only if there are excess funds will new proposals be accommodated. Decisions made under the annual budgeting system will flow into the following year's budget, becoming part of the baseline budget for that year and the starting point for formulating the new budget.

The new budgeting system is very pragmatic. With the approval of new projects and the expansion of programs one year at a time, the budgeting system recognizes the uncertain nature of fiscal resources and economic development. It ensures that next year's budget starts with an accounting for decisions made during the previous year. By providing agencies with a three-year baseline budget that is considered and decided upon with them during budget preparation, multi-year budgeting reduces uncertainty and fosters efficient and effective use of funds. Certainty about the availability of resources that the agency can draw upon in planning and programming its activities contributes to better operational and technical performance.

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The three-year baseline budget will comprise total budget ceilings that the agency must comply with and represents the entirety of funds available to them, unless they are able to negotiate with other agencies and reallocate resources. By focusing the agency's budget preparation strategically on the consideration of new projects and changes in the scope of programs, issuance of hard baseline budget ceilings paves the way for fiscal discipline and allocative efficiency. At the oversight level, development of three-year budgeting increases the knowledge and control of multi-year expenditure trends, and thus contributes to fiscal discipline.

Systematically projecting the multi-year requirements of past or pending decisions also indicates the availability of funds for new project proposals, indicates required savings and revenue measures, and fosters understanding of the implications of changes in the fiscal and resource scenario in a more rigorous and deliberate manner. What the Philippines has experienced in past years is that the baseline budget approach permits budgetary decisions made during a longer period of budget preparation, and allows more time for analysis and deliberation of new projects and program decisions. All told, the shift to an MTEF paves the way for achievement of three desirable outcomes in public expenditure management: fiscal discipline, strategic allocation of resources, and greater operational efficiencies at the oversight and agency level.

Successful experiences in other countries with multi-year budgeting systems illustrate the important elements for installing a working, well-functioning MTEF. After two years of budget preparation, the department has the basic for the MTEF in place. The budget should embody the country's strategy for social and economic development. It should not be merely a compilation of financial requirements for ongoing programs, new programs, and projects of the different agencies, but over time should enable the reallocation of resources toward what society needs and prioritizes.

In the past, plan updates had a three-year planning period. These updates have evolved to become a national consultative process that captures society's preferences and priorities. Aside from the usual agency representatives, the planning period involves multisectoral subcommittees composed of members of Congress, the private sector, academia, and civic society groups. At this level, subcommittees plan targets and strategies that are integrated into plans at the regional level. More concretely, individual departments link the plan to the budget by ensuring that national programs and new national projects included in the budget have been approved and included in medium-term public investment programs.

Several projects have been evaluated by the National Economic Development Authority and studies have been conducted to verify that the targets in the plan are met. Such checks are required as part of the MTEF process. In the symbiotic relationship between the plan and the budget, the budget reflects a constrained version of the plan and the Medium-Term Public Investment Program is refined regularly according to the budget. The plan is linked with the budget during this stage of MTEF installation through the classification and ranking of programs, activities, and projects.

This linkage is a prerequisite activity for including new projects and ongoing programs in the budget. Under this system, agency projects and programs are classified into three priority levels, high, medium, and low, in accordance with their link to plan results and agency mandates. High-priority activities are not only in accordance with the agency's mission, but also directly contribute to the attainment of the plan's outcome. Medium priority activities fulfill the agency mandate, although they contribute only indirectly to the plan results. Low-priority programs are those that the department wishes the agency to effect. These low-priority projects are better devolved to local government units or undertaken by the public sector. Through this approach, most programs and activities in the budget directly or indirectly contribute to the attainment of the plan.

4. Elements of a Medium-Term Fiscal Plan

Having a medium-term fiscal plan is important. First, it provides a framework and sets the direction for fiscal planning in terms of the formulation of expenditure, revenue, and borrowing programs. Second, it ensures the medium-term feasibility of the annual budget that is proposed to Congress. Third, it provides a systematic way of capturing the effect of macroeconomic changes in the fiscal program.

During the years after the financial crisis, which wreaked havoc on the resources of the Government, it became clear that an MTEF has to have very conservative revenue projections in order to work. There are two steps in formulating the budget: first, setting sector ceilings, and second, prioritizing different activities within the sector ceilings. This prioritization is a more strategic method of allocation, because it clearly delineates the tradeoff among competing needs and forces of prioritization for programs within resource constraints.

The fourth element of the MTEF is the use of medium-term estimates for the cost of ongoing and new projects to insure that new proposals can be financed over the entire medium term. Estimates also encourage savings measures within agencies and allow systematic adjustment of spending estimates in response to changes in parameters. An MTEF that starts from the baseline budget offers several advantages: it takes account of parameter changes and incorporates savings measures and new spending measures into the budget ceiling. The department has clear rules for updating these estimates and it follows these rules. At least annually, the department updates its rules in response to any changes in macro parameters, and then takes account of proposed expansions for existing projects. Circulars and manuals clearly explain to all concerned agencies how to update baseline and new program estimates.

The last element of the MTEF is program evaluation. This evaluation is actually a series of exercises conducted with the agencies, to distinguish low-priority programs and projects and to improve the effectiveness and strategy of programs and activities that are included in the budget. These exercises are yielding promising results. For example, the Department of Social Affairs and Development seems to lead the way in applying budget concepts and improving their programs and projects.

The Department of Education is also not only considering how to increase access to education; it is concentrating more on improving the quality of education, shifting further away from proposing additional school buildings or new teachers and emphasizing instead more critical inputs for education: textbooks, training, and better deployment.

The Commission on Higher Education is a Department of Education component that has taken advantage of the new budget system. Last year, in weeding out underperforming programs in state colleges, the Commission cancelled 90 courses in 86 private and government state colleges where the percentage of graduates passing exams for a license was less than 3 percent.

There are still many issues to resolve in the current MTEF: for instance, improving revenue estimation and working with the Commission on Audit for accounting and audit reforms. However, MTEF is a framework for managing the deficit and allowing the Government to allocate more resources to programs that demonstrate effectiveness in poverty reduction.

Mrs. Sarojini, a poverty reduction practitioner, has proposed as a budgeting strategy that funding be increased for programs that are meant for poor areas and poor groups, and to make certain that benefits flow exclusively to those identified groups. She also asks if there is any mechanism for bringing about this second way of budgeting. One goal of the government's budgeting reforms is to provide an enabling environment that frees more resources for programs that are pro-poor. The state of poverty in the Philippines is such that poverty remains a critical concern in the development plan.

In addition, budgeting reform aims to empower different agencies to improve their delivery of services. For example, the Department of Education, the Commission on Higher Education, and the Department of Labor have very innovative leaders at their helms. These departments are taking advantage of new systems that are in place to improve delivery of services and focus more on areas that need these services. The agencies are developing strategic mechanisms that will enable them to do more effectively the things that they are mandated to do.

5. The Importance of Governance

A representative from the Economic and Social Council for Asia and the Pacific mentioned at February's forum that the subject of governance is extremely important. However, the relationship between good governance and poverty reduction is inconclusive, judging from the experience of the past two decades in East Asia, Southeast Asia, and South Asia. Some countries, despite lacking elements of good governance such as transparency, lack of corruption, and accountability, have substantially reduced poverty. It is up to ADB to see whether policy growth can be advocated through good governance.

One problem in many countries is that responsibility has been devolved from the central level to the district level, the province level, or further down. A number of countries are facing the difficulties of human resource development at the grassroots level. These countries have worked to improve governance through legal provisions.

Such attempts have been partly successful in India, Indonesia, Nepal, and Thailand. However, the beginning of this millennium may see increased inefficiencies at the grassroots level, because these countries have not yet prepared fully by providing the required human resources training or basic infrastructure.

When researchers evaluate these attempts at human resource development in 2005, any shortcomings should not be attributed to a lack, on the part of government, of willingness to improve governance through decentralization. It is the international community's responsibility to provide training facilities and proper connectivity, so that this decentralization process can bear fruit at the end of those first experiments.