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Policy Study on the National and Local Government Expenditures for Millennium Development Goals, 2000–2005

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Abstract

In line with the commitment of the Philippine government to adopt the Millennium Declaration, there have been efforts geared towards the achievement of the millennium development goals (MDGs) particularly the specific targets set for each of the eight MDGs. The MDGs include eradication of extreme poverty and hunger; universal primary education; gender equality and women empowerment; reduction of child mortality; improvement of maternal health; control of HIV/AIDS, malaria and other diseases; environmental sustainability; and global partnership for development.

Maintaining the country's current rate of progress in achieving the MDGs for the reduction of poverty incidence, the reduction of the infant mortality rate and the under-5 mortality rate, the reduction in HIV/AIDS prevalence, and the increase in access to sanitary toilet facilities is sufficient to meet the targets set in 2015. Such is not the case for the MDG targets with respect to the under-5 malnutrition rate, the per capita dietary energy intake requirement, malaria morbidity, access to safe drinking water, the elementary participation rate, the elementary cohort survival rate, gender equality in education, the maternal mortality rate and the contraceptive prevalence rate. The country has to do better in certain aspects of all of the seven quantifiable goals, namely: Goal 1 (poverty and hunger), Goal 2 (education), Goal 3 (gender equality), Goal 5 (maternal health), Goal 6 (control of communicable diseases), and Goal 7 (environmental sustainability).

In this regard, it is critical that Philippines exercises greater vigilance and exerts increased effort in addressing the requirements of achieving the millennium development goals (MDGs). The study aims to support this initiative by tracking and analyzing the trend in MDG expenditures of both the central and local governments. It specifically attempts to analyze trends on MDG expenditures of the national and local governments, including ODA commitments for the period 2000-2005; relate the trends in MDG expenditures with human development outcomes and related outputs/ services and recommend policy actions on how to a) increase government revenues in the aggregate; b) increase the allocation of resources for MDG related programs and projects by improving both intersectoral and intrasectoral allocation, and c) identify ways of increasing the efficiency and effectiveness of the delivery of MDG-related programs.

Keywords: Millennium Development Goals, MDGs, poverty reduction, education, health, MDG expenditures, government/public expenditures, human development

POLICY STUDY ON THE NATIONAL AND LOCAL GOVERNMENT EXPENDITURES FOR MILLENNIUM DEVELOPMENT GOALS, 2000-2005

Rosario G. Manasan

1. INTRODUCTION

In September 2000, member states of the United Nations gathered at the Millennium Summit and adopted the Millennium Declaration which affirmed their commitment to the Millennium Development Goals (MDGs). The MDGs and the more specific targets pertaining to them are as follows:

Goal 1: Eradicate extreme poverty and hunger

- Halve the proportion of population living
  - below the food threshold between 1990 and 2015
  - below the overall poverty threshold between 1990 and 2015
- Halve the proportion of households with per capita intake below 100% of the dietary energy requirement between 1990 and 2015
- Halve the prevalence of malnutrition among 0-5 year old children between 1990 and 2015

Goal 2: Achieve universal primary education

- Achieve 100% participation rate by 2015
- Achieve 84.7% cohort survival rate at the elementary level by 2015

Goal 3: Promote gender equality and empower women

- Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015

Goal 4: Reduce child mortality

- Reduce by two-thirds the infant mortality rate by 2015
- Reduce by two-thirds the under-5 mortality rate by 2015

Goal 5: Improve maternal health

- Reduce the maternal mortality rate by three-quarters by 2015
- Increase the prevalence of couples practicing responsible parenthood to 70% by 2015

Goal 6: Combat HIV/ AIDS, malaria and other diseases

- Maintain prevalence of HIV/ AIDS at less than 1 up to 2015
- Reduce malaria morbidity rate from 123 per 100,000 population in 1990 to 24 per 100,000 in 2015

Goal 7: Ensure environmental sustainability

- Increase the proportion of households with access to safe drinking water from 73.7% in 1990 to 86.8% in 2015
- Increase the proportion of households with access to sanitary toilet facilities from 67.6% to 83.8% in 2015

Goal 8: Develop a global partnership for development

- Develop further an open, rules-based, predictable, non-discriminatory trading and financial system, including a commitment to good governance
- Deal comprehensively with debt problems of developing countries through national and international measures in order to make debts sustainable in the long-term

Table 1 summarizes the average rate of progress towards the achievement of the MDGs to date (1990-2005/6) and compares it with the rate of progress that is required in 2005/6-2015 if the MDG targets are to be met. It indicates that maintaining the current rate of progress is sufficient to bring about the achievement of the MDGs for the reduction of poverty incidence,[1] the reduction of the infant mortality rate and the under-5 mortality rate, the reduction in HIV/AIDS prevalence, and the increase in access to sanitary toilet facilities. In contrast, the rate of progress required to meet the MDG targets with respect to the under-5 malnutrition rate, the per capita dietary energy intake requirement, malaria morbidity, access to safe drinking water, the elementary participation rate, the elementary cohort survival rate, gender equality in education, the maternal mortality rate and the contraceptive prevalence rate are all higher than the actual rate of progress to date.[2] In other words, the country has to do better than its historical performance in certain aspects of all of the seven quantifiable goals, namely: Goal 1 (poverty and hunger), Goal 2 (education), Goal 3 (gender equality), Goal 5 (maternal health), Goal 6 (control of communicable diseases), and Goal 7 (environmental sustainability).

Given this perspective, it is critical that the Philippines exercises greater vigilance and exerts increased effort in addressing the requirements of achieving the MDGs. This study aims to support this initiative by tracking and analyzing the trend in MDG expenditures of both the central and local governments.

Specifically, the study aims to:

- Analyze trends on MDG expenditures of the national and local governments, including official development assistance (ODA) commitments for the period 2000-2005
- Relate the trends in MDG expenditures with human development outcomes and related outputs/ services

[1] The 2015 target for subsistence poverty has already been reached in 2003.

[2] The Philippines Midterm Progress Report on the MDGs (2007), however, note that gap between the required rate of progress and the actual rate of progress to date with respect to the first four of these targets are not so large such that the 2015 targets for these indicators are still likely to be met.

- Recommend policy actions on how to
  - increase government revenues in the aggregate
  - increase (expand) the allocation of resources for MDG related programs and projects by improving both intersectoral and intrasectoral allocation, and
  - increase (enhance) the efficiency and effectiveness of the delivery of MDG-related programs.

Table 1. Philippines MDG Rate of Progress at the National Level

MDG Goals and Targets	Baseline (1990 or year closest to 1990)	current level (2005/2006 or year closest to 2005/2006)	Target by 2015	Average Rate of Progress (1990-2005/06 or year closest to 2005/06) (a)	Required Rate of Progress (2005/2006-2015) (b)	Ratio of Required Rate to Average Rate to (I = b/a)	Probability of Attaining the Targets
Eradicate extreme poverty and hunger							
A. Proportion of families below	20.40	10.20 (2003)	10.20	-0.85	0.00	0.00	High
Subsistence threshold [a/]	39.90	24.40 (2003)	19.95	-1.29	-0.37	0.29	High
Poverty threshold [a/]							
B. Proportion of population below							
Subsistence threshold [a/]	24.30	13.50 (2003)	12.15	-0.90	-0.11	0.13	High
Poverty threshold [a/]	45.30	30.00 (2003)	22.65	-1.28	-0.61	0.48	High
Prevalence of malnutrition among 0-5 year-old children (%underweight) - Based on international reference standards [b/]	34.50	24.60 (2005)	17.25	-0.66	-0.74	1.11	High
Proportion of households with per capita intake below 100 percent dietary energy requirement [b/]	69.40	56.90 (2003)	34.70	-1.25	-1.85	1.48	High
Achieve universal primary education							
Elementary participation rate *	85.10 [c/]	84.44 [d/] (2005-06)	100.00	-0.05	1.37	28.98	Low
Elementary cohort survival rate	68.65 [c/]	69.90 [d/] (2005-06)	84.67 [k/]	0.09	1.48	16.54	Low
Elementary completion rate	66.50 [c/]	67.99 [d/] (2005-06)	81.04 [k/]	0.11	1.30	12.26	Low
Improve maternal health							
Maternal mortality ratio	209.00 [e/]	162.00 [f/] (2006)	52.20	-3.62	-12.20	3.37	Low
Increase access to reproductive health services							
Prevalence rate of men and women/couples practicing responsible parenthood	40.00 [e/]	50.60 [f/] (2006)	80.00	0.82	3.27	4.01	Low
Reduce child mortality							
Under 5-mortality rate (per 1,000 live births)	80.00 [g/]	32.00 [f/] (2006)	26.70	-3.00	-0.59	0.20	High
Infant mortality rate (per 1,000 live births)	57.00 [g/]	24.00 [f/] (2006)	19.00	-2.06	-0.56	0.27	High
Combat HIV and AIDS, Malaria and other Diseases							
HIV prevalence	<1%	<1% (2005)	<1% [l/]	0.00	0.00	0.00	High
Malaria morbidity rate (per 100,000 population) [h/]	123.00	59.00 (2004)	24.00 [l/]	-4.57	-5.83	1.28	High
Ensure environmental sustainability							
Proportion of households with access to safe drinking water	73.70 [i/]	80.20 (2004) [j/]	86.80 [l/]	0.50	0.60	1.20	High
Proportion of households with sanitary toilet facility	67.60 [i/]	86.20 (2004) [j/]	83.80	1.33	-0.22	0.17	High

Rate needed to reach target/current rate of progress <1.5 High; 1.5 to 2.0 Medium; >2.0 Low
Sources:
a/ TC on Poverty Statistics (former TWG on Income Statistics, NSCB); b/ National Nutrition Survey (NNS), FNRI; c/ DECS Statistical Bulletin SY 1991-1992; d/ DepEd-Basic Education Information System (BEIS); e/ 1993 National Demographic Survey, NSO; f/ 2006 Family Planning Survey, NSO; g/ National Demographic and Health Survey (NDHS), NSO; h/ Field Health Service Information System-DOH; i/ 1990 Census of Population and Housing, NSO; j/ Annual Poverty Indicator Survey, NSO; k/ Target in the Philippine EFA 2015 Plan; l/ Target by 2010 based on the MTPDP, 2004-2010.
** Beginning SY 2002-2003, participation rate was derived based on the age group consisting of 6-11 years old for elementary and 12-15 years old for secondary whereas the previos system used 7-12 and 13-16 years old for elementary and secondary, respectively.*

Without adequate funding support, the achievement of the MDGs, particularly those goals where the Philippines is lagging behind, may not be likely. It cannot be denied that financing does not automatically translate into outcomes. However, while financing may not be a sufficient condition, it is to a large extent a necessary condition for the attainment of the MDGs. In this sense, securing government's commitment to provide adequate budgetary support for the MDGs may be seen as an important first step towards the attainment of the Goals.

2. APPROACH AND METHODOLOGY

2.1. What expenditure items constitute MDG expenditures?

The answer to this question depends largely on the types of interventions that are key to the achievement of the MDGs. Because the achievement of Goals 2-7 involves the delivery of basic social services (or human development priorities such as early childcare, basic education, social welfare/ assistance, low cost water and sanitation, and primary health care including reproductive health and prevention/ treatment of communicable diseases), the link between these goals and public spending on these services is unambiguous. Moreover, it is argued that the public sector has an important role to play in the provision of these services. This is so because basic social services are associated with strong positive externalities. Thus, not only does the private sector tend to under-provide these services, society at large benefits from the expanded coverage and improved quality of basic social services.

In contrast, the link between public spending and poverty reduction (Goal 1) is not as clear cut. For instance, one can argue that the entire budget is supportive of Goal 1, given that poverty reduction is the over-arching goal of the Medium Term Philippine Development Plan (MTPDP). However, such an approach may not be instructive in terms of trying to focus attention on expenditures which are more supportive of MDGs than others.

In this regard, the poverty reduction framework presented in the 2000 World Development Report (WB 2000) is helpful in clarifying the link between public spending and poverty reduction (**Box 1**). This report suggests that public spending policy plays a critical role in poverty reduction in terms of improving the poor's access to human capital (by improving access to basic social services), assets, and physical infrastructure as well as social safety nets.

Box 1. Framework for Attacking Poverty

The 2000 World Development Report (WDR) suggests that a successful and comprehensive strategy to fight poverty consists of three elements: (i) promoting economic opportunities for, (ii) facilitating the empowerment of, and (iii) enhancing the security of the poor (WB 2000).

Economic growth and poverty reduction. The relationship between economic growth and poverty reduction is well documented. Accelerating economic growth creates more opportunities for the population, in general, including the poor. International cross-country comparison indicates that every additional percentage point increase in average household consumption reduces the incidence of poverty by about 2% (WB 2000).

The 2000 WDR suggests that sound macroeconomic management (i.e., fiscal and monetary discipline) and market-friendly reforms (e.g., openness to international trade and direct foreign investment, well-developed and judiciously regulated financial markets, privatization of state enterprises, industry deregulation and increased competition in the market place) promote sustained economic growth. However, it also emphasizes that the impact of economic growth on the incomes of poor people is uneven. There is evidence that "for a given rate of growth, the extent of poverty reduction depends on how the distribution of income changes with growth and on initial inequalities in income, assets, and access to opportunities that allow poor people to share in growth."

The report also underscores the importance of designing and implementing reforms in a way that takes into account local conditions and the likely impact of the reforms on the poor. It calls attention to the need for policies that will ease the costs that reforms may impose on poor people. These policies include complementary reforms at the micro level, e.g., regulations that affect SMEs' cost of doing business, labor standards, and microfinance programs.

Enhancing the poor's capacity to capture benefits of economic growth. The 2000 WDR also highlights the need for policies and programs that expand the opportunities of the poor to participate in economic growth. These include policies and programs that improve the poor's access not only to basic social services but also their access to assets (including land), infrastructure and other productive inputs. In particular, the report points to the need for infrastructure investments to address the physical isolation of the poor and enhance their ability to access markets.

Access (or the lack of it) to basic social services are central to their ability to accumulate human capital and to break away from the cycle of poverty (World Bank 1992). Access to basic education, health and water supply and sanitation is both a cause and an outcome of poverty. On the one hand, the provision of basic education, health and water and sanitation services improves the immediate well-being of poor people. As such, it has a direct and immediate effect in reducing non-income poverty. On the other hand, improved access to quality basic social services enhances the capabilities of poor people to earn income by building up their skills and improving their health status.

The case for the involvement of the public sector in expanding the access of the poor to basic social services and assets is premised on the fact that (i) markets do not work well for poor people because of market failure, especially in the financial, health and insurance markets, and (ii) government action is needed to reduce initial inequalities and increase the opportunities for poor people to benefit from growth.

Safety nets. Finally, the 2000 WDR points out the need for policies and programs that will reduce vulnerability of poor people to ill health, economic shocks, policy-induced dislocations, natural disasters and violence, and to help them cope with adverse shocks when they do occur. In this regard, programs of well-targeted transfers and safety nets to vulnerable groups and areas are called for.

Continuation of Box 1

Given this perspective, it is now clear that public spending policy plays a critical role in poverty reduction in terms of improving the poor's access to human and physical capital and assets as well as social safety nets. As such, government spending on basic social services for the poor,[1/] basic infrastructure, asset redistribution, and social safety nets may be viewed as forming part of government spending in the pursuit of poverty reduction.

Related to this, the Edillon (2006) study on the factors that contribute to making economic growth more pro-poor in the Philippines indicates that asset distribution (i.e., land reform) and investments in infrastructure (roads and electrification, in particular) are significant determinants of poverty reduction in the Philippines. More importantly, her study shows that the preferential distribution of the same investments in favor of lagging regions contributes to making growth more pro-poor. In particular, her simulations show that the poverty reduction targets will be met if the paved road density in all provinces increases to at least thrice the 2001 national average by 2015, if all barangays have access to electricity by 2010, and if the land redistribution program under the Comprehensive Agrarian Reform Program (CARP) is fully implemented.

[1/] In this framework, government spending on basic social services contributes directly to the achievement of Goals 2-7 and indirectly to the attainment of Goal 1.

Components of MDG expenditures. **Figure 1** provides a typology of public expenditure categorized in relation to their importance in human development and poverty alleviation. The columns classify expenditures to reflect their sectoral concerns: (1) social services, (2) income enhancement/economic services, and (3) support services, including general administration and peace and order. On the other hand, the rows classify expenditures in accordance to the development objectives that they are meant to address. Thus, the first row, "general expenditure," refers to a broad range of development objectives that are not specifically targeted to human development priorities and poverty alleviation. In contrast, the second row, "human development priorities and poverty alleviation," does precisely the opposite.

In this framework, public spending on the MDGs would consist of expenditures on human development priorities or basic social services (including basic shelter),[3] pro-poor infrastructure, land re-distribution, income enhancement measures (including livelihood projects), and social safety nets (including subsidies and cash or in-kind transfers to the poor). In turn, basic social services consist of basic health (including and reproductive

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[3] The inclusion of shelter in basic social services or in poverty alleviation programs is a matter of debate. The World Summit for Social Development (WSSD) Program for Action suggests the addition of shelter and employment as part of basic human needs. However, the role of governments in the provision of housing is less direct (i.e., more in the nature of providing an enabling environment rather than in providing direct budgetary support) than in the case of other basic social services and many analysts have argued that shelter should not be part of human development priorities or 20/20 expenditures (UNDP 1996). Nonetheless, for the purposes of this study, we have decided to include the government expenditures on pro-poor housing (specifically those related to the community mortgage program and the resettlement of informal settlers) as part of government spending on basic social services.

health), basic education (including early childhood, elementary, secondary, literacy, and life skill education), low-cost water supply and sanitation, nutrition support, and social welfare and development services.

Figure 1
Types of Development Expenditure [a/]

	Social Services	Economic Services/ Income Enhancement	Supporting Activities
GENERAL EXPENDITURES	• Most specialized health services and units • Tertiary, vocational, education • High-cost urban WATSAN	• General economic support for production and incomes (i.e., Economic infrastructure) • Untargeted subsidies	• General institutional reforms • Defense • Domestic security • Debt servicing • Culture
HUMAN DEVELOPMENT EXPENDITURES AND POVERTY ALLEVIATION	**HUMAN DEVELOPMENT PRIORITIES: 20/20** • Basic health care (basic preventive and curative care) • Reproductive health and family planning • Basic education (incl. preschool, elementary, secondary, literacy, life skills training) • Low-cost water supply and sanitation • Nutrition support (incl. community-based approaches, micro-nutrients) • Social welfare (incl. social safety nets) • Basic shelter	• Targeted income enhancement measures (incl. livelihood projects) • Pro-poor infrastructure • Land re-distribution (CARP)	• Information services • Environment and sustainable development

a/ adapted from Parker and Jespersen 1994

This manner of identifying the components of government expenditures for the MDGs clearly indicates that public spending on human development priorities (or what has come to be known as the 20/20 expenditures after the UNDP's 20/20 initiative[4]) is at the core

[4] The 1994 Human Development Report (UNDP 1994) proposed the 20/20 compact as a means of obtaining steady, certain and sufficient levels of financing for basic social needs of every human being. The initiative exhorts national governments and international donors to allocate 20% of their budgets on human

of the public spending on the MDGs. In this sense, tracking public expenditures on MDGs involves monitoring "20/20 Plus": i.e., public expenditures on basic social services plus public expenditures on pro-poor infrastructure, land re-distribution, and targeted income enhancement measures.

Some caveats. The efficacy of public expenditure policy in supporting the attainment of the MDGs depends on three important factors (Bird, Litvack and Rao 1995). First, how much is spent on MDG programs? Second, where is it spent? That is, to what extent are these expenditures directed to regions and provinces which are lagging behind in terms of the MDG targets? Third, how well is it spent? That is, to what extent are policies implemented so that the intended benefits and outcomes are attained?

On the one hand, governments have to ensure that the size and the composition of the public expenditure program are geared towards the provision of the basic social services and pro-poor infrastructure and investments. Although it cannot be denied that the government's expenditure program has a direct effect on human development outcomes, increased government spending on basic social services is not a guarantee for improvements in the well-being of the population, in general, and poor people, particular. Non-budgetary policies, including the governance framework that defines how government resources are spent, are just as important as the amount of budgetary support. The same is true of the targeting mechanisms employed to implement income enhancement measures and social safety net measures for the poor.

In sum, public expenditure programs are but a part of a good strategy to achieve the MDGs. Public spending programs, even if well targeted and cost-effective, are no substitute for efforts to align the broad stance of economic policy to the needs of the poor. Thus, "attacking poverty is not primarily a task for narrowly focused anti-poverty projects, vital though these may be. It is a task for economic policy at large" (World Bank 1990).

Finally, in allocating resources to MDG-related programs and activities, it is important to remember that basic social services are characterized by strong complementarities. That is, the impact and effectiveness of each basic social service component is enhanced by the availability of other basic social services (UNDP 1996).

2.2. Tracking Public Expenditures on the MDGs: "20/20" and "20/20 Plus" Expenditures

The 1991 Human Development Report (UNDP 1991) provides a framework for assessing governance based on improvements in human development indicators over time and based on how adequately governments have supported human development programs and

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priority expenditures in order to help nations achieve decent levels of human development. It argues that expenditure targets are important in protecting priority expenditure programs against disproportionate spending cuts during periods of fiscal contraction. The targets also serve to signal a firm commitment to social development and to encourage realistic planning and cost-effective use of allocated resources.

concerns financially. The government expenditure indicators suggested under this framework can be extended to apply to MDG – related expenditures.

Expenditure indicators. The following indicators may be used to help governments design and monitor expenditure programs that are highly focused on the attainment of human development objectives:

- *Public expenditure ratio* – the proportion of GDP that goes into the overall government expenditure program;
- *Social allocation ratio* – the proportion of government expenditures set aside for social services;
- *Social priority ratio* – the proportion of government social sector spending allocated for human priority concerns;
- *Human development expenditure ratio* – the proportion of GDP earmarked for human priority concerns;[5] and
- *Human development priority ratio* - the proportion of total government expenditure that is allocated to human development priorities.[6]

These indicators are helpful in decomposing the trend in government spending on human priority concerns. As such, they naturally suggest changes in policies that are needed in order to increase the amount of resources available for human development priorities and the attainment of the MDGs.

Over and above the expenditure ratios proposed in the 20/20 compact, the present study also tracks per capita public sector expenditures on the basic social sectors and on other MDG-related interventions. This is made in view of the usefulness of said indicator in measuring the overall adequacy of government spending and serving as a proxy for the amount of the amount of resources available to fund service levels relative to some benchmark year.

MDG spending of the national government and local government units (LGUs) are analyzed not just in the aggregate but also in a more detailed fashion. To the extent possible given data availability, the study also analyzes the expenditures made by the members of Congress using their allocations under the Priority Development Assistance Fund (PDAF).

2.3. Data Sources

[5] The human expenditure ratio is a product of the first three ratios, i.e.,: (1) the public expenditure ratio, (2) the social allocation ratio and (3) the social priority ratio. The 1991 HDR noted that the human expenditure ratio may need to be in the vicinity of 5% if a country wishes to perform well in terms of human development. Various combinations of values for the public expenditure ratio, the social allocation ratio and the social priority ratio will yield the targeted human expenditure ratio. However, the report pointed out that "a preferred option is to keep the public expenditure ratio moderate (around 25%), allocate much of this to the social sectors (more than 40%), and focus on human priority areas (giving them more than 50% of total social sector expenditures)."

[6] In this paper, "basic social services," "human development priority concerns" and "20/20 items" are used interchangeably.

The study made use of data on the spending of both the central government and the LGUs that are channeled to the MDGs. In the Philippines, government spending can be reckoned in several ways. *Appropriations* refer to the expenditure levels authorized by Congress under the General Appropriations Act (GAA) or other legislation. On the other hand, *allotment* refers to the authority to obligate (or authority to assume contractual obligations) that is released to implementing units by the Department of Budget and Management (DBM) in the case of national government agencies or the Local Budget Officer in the case of LGUs. The allotment advice is given in the form of an Allotment Release Order (ARO). The issuance of the ARO effectively limits what the various government agencies can spend given the appropriations provided them by Congress. Lastly, *obligations* refer to the amount of liabilities that are legally incurred and committed to be paid for by government either immediately or in the future. Obligations are incurred when the government agencies enter into a legally binding contract for the supply of goods and services with suppliers, contractors or employees.

From the perspective of tracking government spending on the MDGs, information on government spending categorized according to the functional <u>and</u> sub-functional classification is important because they capture the policy purposes for which expenditures are allocated. Moreover, in order to monitor government spending on the MDGs, such functional classification would have to be at a fairly dis-aggregated level in order for one to be able to distinguish basic from non-basic social services, for instance. At the minimum, government expenditure data would have to be dis-aggregated at the level of the programs, activities and projects (PAPs).

Unfortunately, the DBM's Budget of Expenditure and Sources of Financing or BESF (which is the main source of public finance documentation in the Philippines) and the Commission on Audit's (COA's) Annual Financial Report do not follow the GAA's budget classification structure (i.e., according to programs, activities and projects or PAPs). While the BESF reports on details of budget execution on the basis of expenditure obligations, disaggregated according to the sectoral distribution of public expenditures (i.e., similar to the functional classification), it does so by classifying administrative or implementing units according to sectors and by tracking expenditures of these units. However, the BESF does not report budget execution by PAPs (which is the basic structure of appropriations as found in the GAA). Neither does it include data on actual cash payments/disbursements. On the other hand, while the COA reports contain information on cash disbursements, they document budget execution according to the economic classification of expenditures (i.e., personal services, maintenance and other operating expenditures, and capital outlays) rather than according to PAPs.

Fortunately, government spending information on an obligation basis at the level of PAPs is available from the Statement of Appropriations, Allotments, Obligations and Balances (SAAOB) that individual government agencies prepare. While the SAAOBs are available for all national government agencies, they are not compiled by a single agency. On the other hand, the COA compiles and consolidates the SAAOBs of LGUs, providing spending information at a fairly dis-aggregated level up to 2003. However, starting 2002, sectoral spending information from LGUs, on a more limited scale, became available from the Bureau of Local Government Finance (BLGF).

Because of these data constraints, this study makes use of government spending information on an obligations basis. On the one hand, data on LGU expenditures were obtained from the Commission on Audit (COA) and from the Bureau of Local Government Finance (BLGF). On the other hand, information on the MDG spending of national government agencies was obtained from the Statement of Appropriations, Allotments, Obligations and Balances of the relevant agencies.

In particular, all the PAPs of the Department of Education (DepEd) were counted as part of spending on basic social services or 20/20, including:

- Operation of public elementary and secondary schools,
- Purchase of textbooks, desks and instructional materials,
- Repair, maintenance and construction of school buildings, and
- Implementation of alternative learning systems/ programs[7].

In like manner, all of the PAPs of the Department of Social Welfare and Development (DSWD) were included as part of basic social services. They are reported below as "social welfare and development services" and represent a mixed bag of social services that include:

- Early childhood care and development services,
- Food-for-school program,
- Self-employment assistance,
- Calamity relief operations and assistance to victims of disasters,
- Maintenance and operation of centers for neglected, abandoned, abused children and women,
- Assistance to distressed and disadvantage population, and
- Comprehensive and integrated delivery of social services (CIDSS).

On the other hand, the following PAPs of the Department of Health (DOH) were included under basic social services:

- Disease prevention and control, including control of communicable and non-communicable diseases,
- Family health and primary health care,
- Family health nutrition and welfare, including family planning and reproductive health,
- Environmental and occupational health care,
- Artificial and natural family planning,
- Epidemiology and disease surveillance,
- Health promotion,
- Health regulations, and
- Local health systems technical assistance, including provision of logistic support.

[7] The DepEd's implementation of alternative learning systems includes both informal and non-formal education.

In addition to these PAPs in the DOH budget, government subsidy for the premiums of poor households to the indigent program of the PhilHealth was also counted as part of MDG spending on health.

In this study, government spending on basic water and sanitation services refers to allocations for level 1 and level 2 water supply and sanitation projects that are made on account of the Department of Public Works and Highways (DPWH), the Agrarian Reform Fund (ARF), the Local Government Empowerment Fund (LGEF), and the Municipal Development Fund (MDF).

Also counted as part of government spending on basic social services are allocations for pro-poor housing including:

- community mortgage program,
- resettlement of informal settlers, and
- socialized housing.

In this study, government spending on pro-poor infrastructure refers to:

- Allocations for roads and bridges in the DPWH budget, and
- Allocations on farm-to-market roads in the budgets of the Department of Agriculture (DA), Department of Agrarian Reform (DAR), the Agriculture and Fisheries Modernization Fund (AFMA), the ARF, and the LGEF.

Meanwhile, the PAPs included under “targeted income/ employment enhancement measures are:

- Food-for-Work Program of the Department of Interior and Local Government (DILG),
- Targeted employment enhancement programs of the Department of Labor and Employment (DOLE), and
- All of the PAPs of DAR outside of land re-distribution.

It should be stressed that ODA funds, because they are appropriated, are taken into account when one examines national and local government spending as authorized by the General Appropriations Act (GAA) and local appropriations ordinances.

3. SIZE AND COMPOSITION OF MDG EXPENDITURES

The Philippines has had to contend with fiscal instability in the years following the Asian financial crisis. This situation effectively restricted the flow of resources aimed at meeting the MDGs at both the central and local government level between 1998/1999 and 2005 before posting a mild turnaround in 2006. It should be emphasized that while MDG spending has recovered somewhat in 2006 following the improvement in government’s revenue performance, the 2006 spending level is still lower than the pre-crisis level.

3.1. Central Government Expenditures

The national government's fiscal position deteriorated sharply from a small surplus of 0.3% of GDP in 1997 to a deficit of 5.6% of GDP in 2002, following a severe decline in its tax effort during the period (**Table 2**). Although some fiscal consolidation is evident in 2003-2006, the improvement in the national government's fiscal position, particularly in 2003-2005, was largely due to expenditure constriction rather than from a turnaround in tax effort. Moreover, since debt service levels were rigid and remained at fairly high levels, the expenditure adjustment came at the expense of productive expenditures (i.e., total expenditure less debt service). Also, the size of the national government's debt stock and debt service continues to be a major cause of concern.

Table 2. National Government Fiscal Position (Cash Basis) as a Percent of GDP, 1990-2006

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Total revenues	16.8	17.7	18.0	17.7	19.9	19.0	18.9	19.4	17.4	16.1	15.3	15.5	14.6	14.6	14.4	14.8	16.1
of w/c:																	
Tax revenues	14.1	14.6	15.4	15.6	16.0	16.3	16.9	17.0	15.6	14.5	13.7	13.5	12.8	12.5	12.3	12.7	14.0
Total expenditures	20.2	19.8	19.1	19.1	18.9	18.4	18.6	19.4	19.2	19.8	19.3	19.6	20.2	19.2	18.2	17.5	17.1
of w/c:																	
Interest payments	6.6	6.0	5.9	5.2	4.7	3.8	3.5	3.2	3.7	3.6	4.2	4.8	4.8	5.2	5.4	5.5	5.1
Surplus/ (deficit)	-3.5	-2.1	-1.2	-1.5	1.0	0.6	0.3	0.1	-1.9	-3.8	-4.0	-4.0	-5.6	-4.6	-3.8	-2.7	-1.0
Total expenditures net of debt service	13.6	13.8	13.3	14.0	14.2	14.6	15.1	16.2	15.5	16.3	15.1	14.8	15.5	13.9	12.9	11.9	11.9

It is noteworthy that total revenues of the central government rose from 14.4% of GDP in 2004 to 16.1% of GDP in 2006. The recovery of the revenue effort of the central government was primarily due to the increase in the excise tax rate on sin products in 2005 and the increase in the VAT rate from 10% to 12% in 2006.

Aggregate NG spending. On an obligation basis, the central government expenditure ratio (or the ratio of total central government spending to GDP) was fairly stable at 19%-20% of GDP in 1990-2000. This ratio exhibited a well-defined downtrend starting in 2001, reaching a low of 17.3% in 2006 as the national government doggedly pursued its goal to balance the budget even before progress has been achieved on the revenue side (**Table 3**). At the same time, a high initial debt stock and large fiscal deficits during the period led to a rise in the debt service from 3.2% of GDP in 1997 to 5.5% of GDP in 2005. Consequently, total national government expenditures net of debt service contracted from 17.1% of GDP in 1997 to 11.9% of GDP in 2005 and 2006.

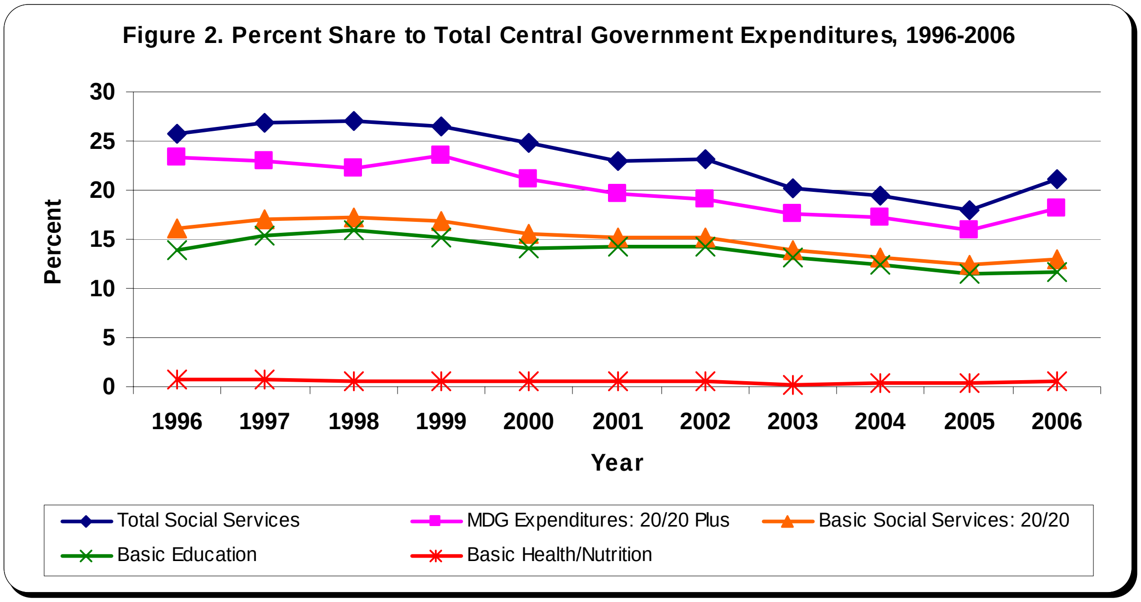
It is therefore not surprising that the growth in the budgets of many government agencies was near-zero, if not negative, in 2001-2005. Thus, when measured relative to GDP, national government spending on all sectors with the exception of debt service shrank in 1998-2005 (**Table 3**). In particular, national government spending on all the social sectors combined went down by 2 percentage points of GDP from 5.4% of GDP in 1997 to 3.1% in 2005. This is approximately equivalent to the reduction suffered by all the economic sectors as a group.

In terms of the rate of increase in the budget, however, social sector spending was relatively more secured than government spending on the economic sectors. In contrast, budgetary support for public administration, national defense and peace and order was even more protected than that for the social sectors.

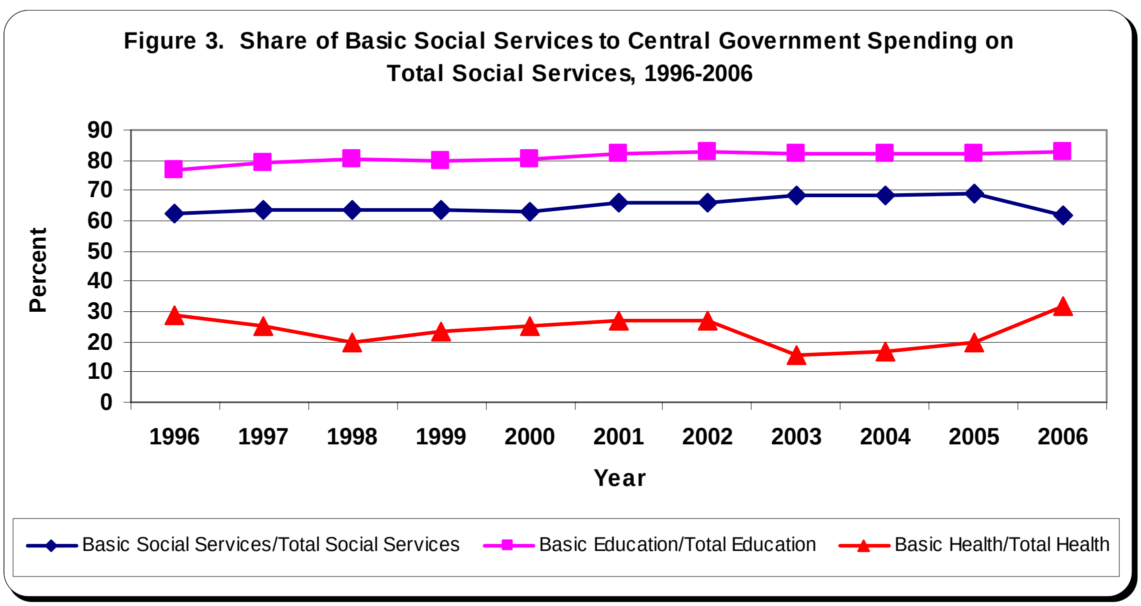
Table 3. National Government Expenditures (Obligation Basis) as a Percent of GDP, 1990-2006

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Total NG expenditures	20.5	19.8	19.0	18.8	19.4	19.5	19.2	20.3	20.2	19.5	20.3	19.5	19.1	19.1	17.8	17.4	17.3
Total economic services	4.8	5.2	3.9	3.6	4.3	4.4	3.9	4.5	3.8	3.6	3.8	3.2	2.6	2.7	2.5	2.2	2.7
of w/c infrastructure	2.9	3.4	2.5	2.3	2.8	2.7	2.2	2.5	2.4	2.3	2.4	2.0	1.5	1.6	1.6	1.2	1.8
Social services	4.2	4.0	3.9	3.6	3.7	4.4	4.9	5.4	5.5	5.2	5.0	4.5	4.4	3.9	3.4	3.1	3.6
Education	3.1	2.6	2.8	2.6	2.7	3.2	3.4	3.9	4.0	3.7	3.5	3.4	3.3	3.0	2.7	2.4	2.4
of w/c DepEd	2.6	2.2	2.3	2.2	2.2	2.4	2.6	3.0	3.1	2.9	2.8	2.7	2.7	2.5	2.2	2.0	2.0
Health	0.7	0.7	0.7	0.5	0.5	0.4	0.5	0.6	0.5	0.5	0.4	0.4	0.4	0.3	0.3	0.3	0.3
of w/c DOH	0.7	0.7	0.7	0.4	0.4	0.4	0.4	0.5	0.4	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.2
National defense	1.2	1.2	1.1	1.2	1.2	1.3	1.2	1.2	1.2	1.1	1.1	1.0	1.0	1.3	1.1	1.1	0.9
Public administration	1.3	1.3	1.6	1.5	1.6	1.5	1.6	1.6	1.6	1.2	1.3	1.3	1.2	1.1	1.0	1.3	1.1
Peace & order	1.2	1.1	1.1	1.1	1.1	1.2	1.3	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.3	1.2	1.1
Debt service	6.6	6.0	5.9	5.2	4.7	3.8	3.5	3.2	3.7	3.6	4.2	4.8	4.8	5.2	5.4	5.5	5.1
Others	1.2	1.0	1.5	2.6	2.8	2.9	2.7	2.9	3.0	3.4	3.6	3.3	3.6	3.5	3.0	2.9	2.9
Total NG expd net of debt service	13.9	13.8	13.1	13.5	14.7	15.7	15.6	17.1	16.4	15.9	16.1	14.7	14.3	13.9	12.4	11.9	12.2

Despite numerous government policy pronouncements in favor of the social sectors, the social services sectors in the aggregate failed to maintain their share in the total budget of the central government. This is largely attributable to the rigidities in the budget brought about by high debt service commitments and the mandated IRA transfers to LGUs. Thus, the share of all the social sectors combined in central government expenditures (i.e., the central government social allocation ratio) declined from 27% in 1998 to 18% in 2005 before increasing to 21% in 2006 (**Figure 2**). Moreover, real per capita spending on all the social services sectors as group (in 2000 prices) went down by about 5% yearly from PhP 2334 in 1997 to PhP 1528 in 2005 and PhP 1,827 in 2006.



On a positive note, basic social services as a group tended to be more favored relative to tertiary level services in the allocation of the budgets of the various social sector agencies of the national government during the period under study. To wit, the central government social priority ratio (i.e., the share of human development priorities in total central government social sector spending) improved from 63% in 1996 to 69% in 2005 (**Figure 3**).



On the whole, the movement in the social allocation ratio dominated the opposing trend in the social priority ratio so that a deterioration in the central government human development priority ratio (i.e., the ratio of central government spending on human development priorities to total central government expenditures) was evident during the period under study. Thus, the share of basic social services to total central government expenditures went down from 17% in 1998 to 12% in 2005 before inching up to 13% in 2006 (**Figure 2**). If funding for poverty reduction measures other than the provision of basic social services is included, the budget share of MDG-related interventions declined even more sharply from 24% in 1999 to 16% in 2005 but recovered somewhat to 18% in 2006 following some improvement in the revenue collection of the central government. This movement is attributable to the dramatic contraction in the budget share of pro-poor infrastructure in total NG spending from 6% in 1999 to 2% in 2005. It is notable, however, that the budget share of pro-poor infrastructure investments increased to 4% in 2006.

Consequently, real per capita NG spending on MDG interventions (in 2000 prices) decreased from PhP 1,997 in 1997 to PhP 1,344 in 2005 before posting a partial recovery to PhP 1,581 in 2006. On the other hand, real per capita NG spending on basic social services went down from PhP 1,482 in 1997 to PhP 1,056 in 2005 before climbing to PhP 1,124 in 2006. (**Table 4**).

Table 4. Real Per Capita MDG Expenditure of Central Government (in 2000 prices)

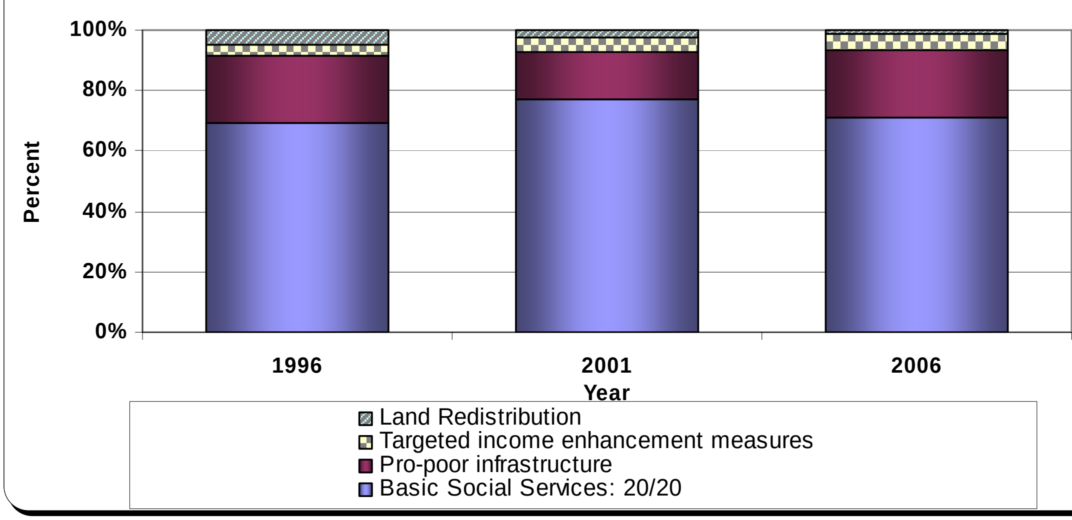
(in pesos)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Basic Education	1,108	1,333	1,337	1,256	1,249	1,203	1,198	1,142	1,051	976	1,015
Basic Health/Nutrition	62	63	41	49	47	42	44	21	24	25	43
Social Welfare & Development	25	25	26	25	28	21	22	27	27	29	28
Water and Sanitation	15	24	11	12	12	9	11	2	1	2	8
Pro-poor housing	78	37	37	43	49	11	6	12	13	25	31
Basic Social Services: 20/20	1,287	1,482	1,452	1,386	1,386	1,286	1,282	1,204	1,116	1,056	1,124
										0	
Pro-poor infrastructure	422	386	304	458	350	266	209	237	188	174	354
Targeted income/ employment enhancement measures	63	84	35	34	77	74	62	83	113	76	81
Land Redistribution	88	45	82	59	59	43	48	10	43	38	22
MDG expenditures: 20/20 Plus	1,861	1,997	1,873	1,936	1,872	1,669	1,601	1,534	1,460	1,344	1,581
Memo Item:											
Total Education	1,440	1,679	1,661	1,572	1,549	1,464	1,452	1,391	1,281	1,188	1,222
Total Health and Nutrition	216	250	209	210	190	156	162	133	143	125	133
Total Social Services	2,054	2,334	2,280	2,181	2,200	1,953	1,943	1,761	1,636	1,528	1,827

The cut in real per capita national government spending was deepest in basic water and sanitation (29% yearly on the average between 1997 and 2005), followed by basic health and nutrition (11%) and pro-poor infrastructure (10%). On the other hand, the contraction in real per capita spending on land redistribution (2%) and targeted income/ employment enhancement measures was more modest. It is also notable that, in contrast to the trends in other basic social sectors, real per capita spending on social welfare and development services actually went up by 1% yearly on the average in 1997-2005.

However, closer scrutiny of the composition of national government spending in the different social services sectors is helpful in better appreciating the movements in national government spending on basic social services.

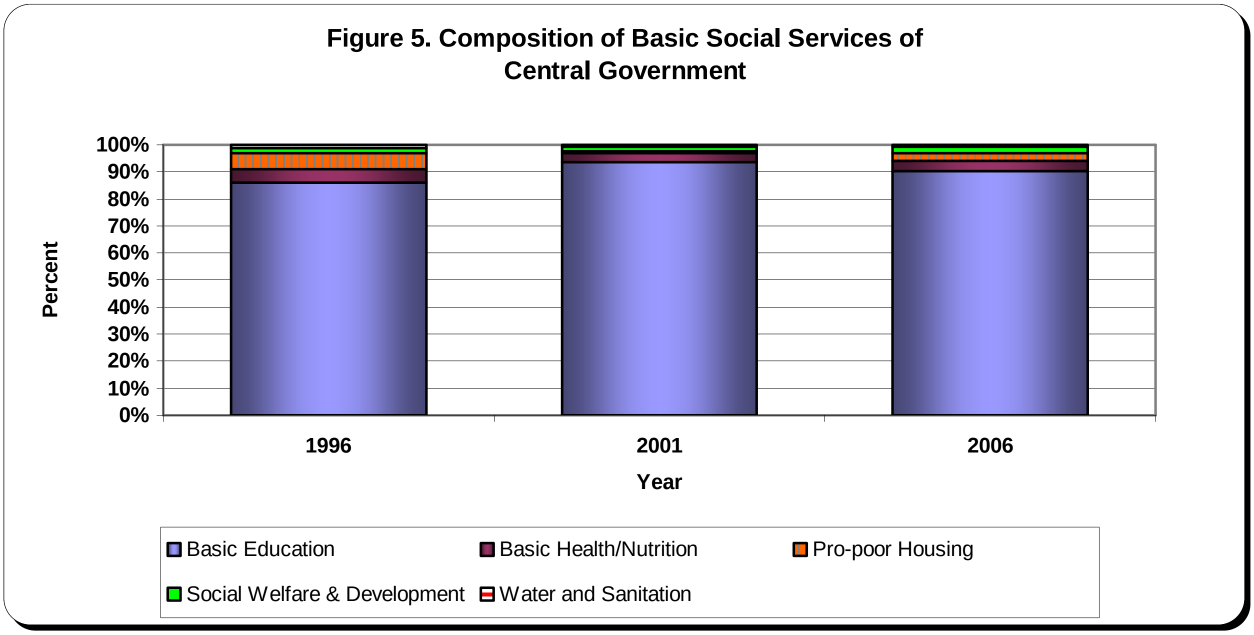
Composition of MDG expenditures of NG. On the average, the national government allocates 75% of its total MDG spending on basic social services, 18% on pro-poor infrastructure, 4% on income enhancement measures and 3% on land re-distribution in 1996-2006. (**Figure 4**).

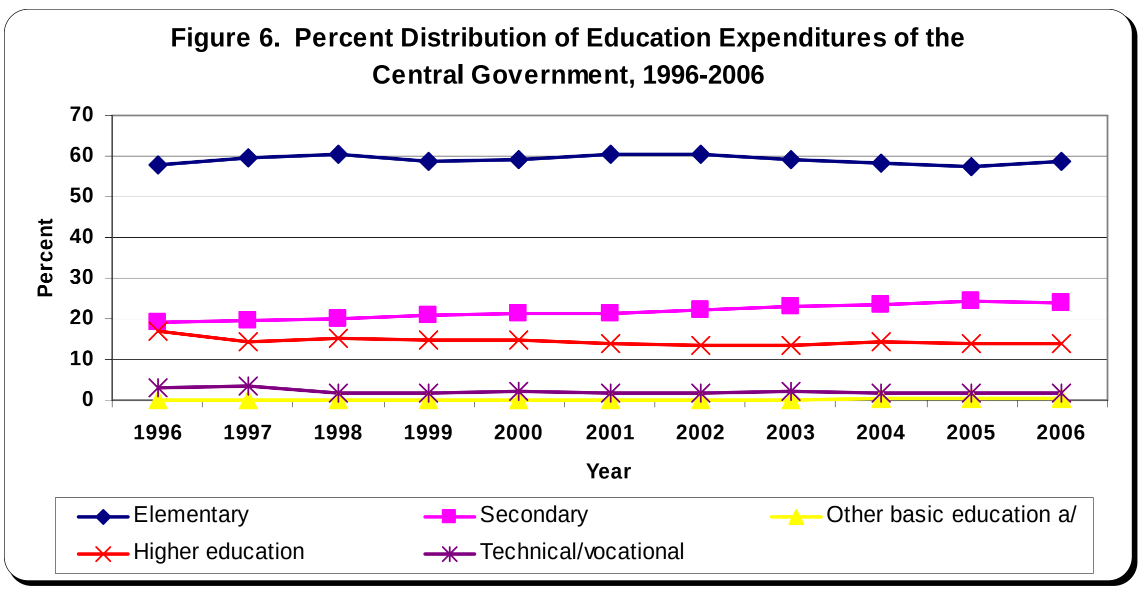
Figure 4. Composition of MDG Expenditures of Central Government



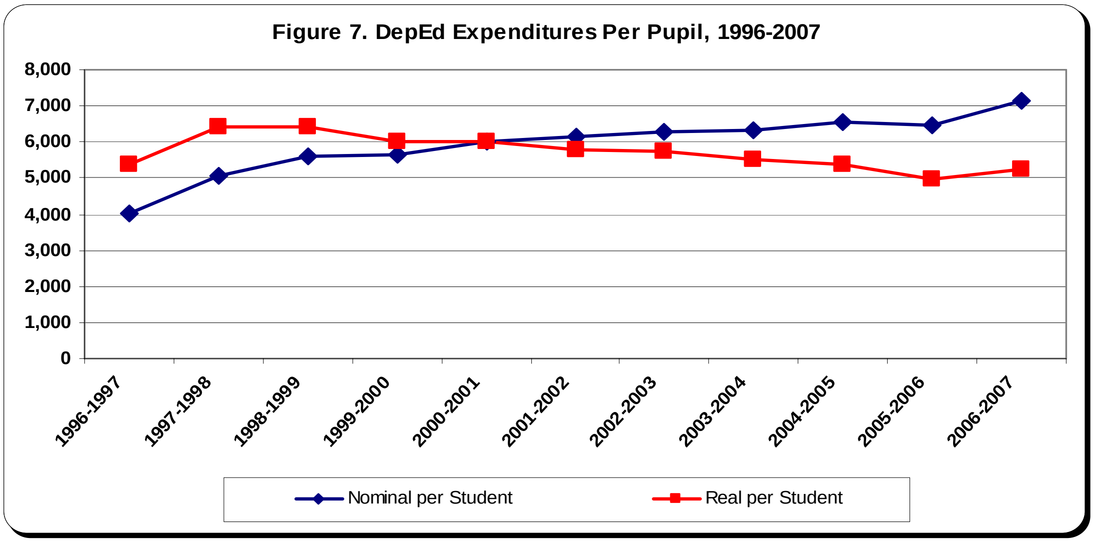
In turn, the national government allocates close to 92% of its total spending on basic social services on education, 3% on health, 2% on pro-poor housing, 2% on social welfare and development services and less than 1% on water and sanitation on the average in 1996-2006 (**Figure 5**).

Composition of NG education expenditures. The share of basic education in the total expenditure of the national government on the education sector remained fairly constant in the 80% range in 1997-2000. However, the budget share of basic education improved slightly to 82% in 2001-2006 as government spending on secondary education rose in response to the rapid growth in the enrollment of public secondary schools due to the migration of students from the private sector to the public sector during the period. This expansion came at the expense of higher education. From 2000 onwards, the budget share of higher education contracted as the Department of Budget and Management used the budget process to help rationalize the higher education sub-sector (**Figure 6**).





The budget of the Department of Education was relatively more protected than the budgets of other agencies, posting better than average growth in 2000-2006. Despite this, real DepEd spending per pupil fell from PhP 6,435 in 1997 to PhP 4,980 in 2005 (**Figure 7**).



It is creditable that the DepEd was able to gradually address the deficits in teachers and classrooms[8] that hounded the basic education sector for years in spite of budget constraints (**Table 5**). However, the shortfall in the number of teachers and classrooms is still significant. In contrast, the textbook-pupil ratio improved dramatically from 1:6 in SY 1999-2000 to an average of 1:1.2 for all subjects with the exception of secondary level English which had a ratio of 1:2 in SY 2007-2008 (**Table 6**). This occurred as improvements in procurement arrangements cut the unit cost of textbooks in half.

Also, the basic education sub-sector is a major beneficiary of the fiscal space created by improvements in NG revenue stream starting in 2006. During the preparation of the 2007 and 2008 President's budget, basic education was one of the few sectors accorded high priority in the allocation of the budget.

Composition of NG health expenditures. The share of the public health in total health expenditures of the national government contracted continuously from 22.3% in 1999 to 7.0% in 2003 (**Figure 8**). Moreover, national government spending on public health was cut by more than half in nominal peso terms in 2003 causing the share of basic health services in the aggregate to drop just as drastically. This cutback was reversed in 2004-2006, albeit gradually. This became possible as the Department of Health, whose budget was fixed in nominal peso terms during the period, started to gradually shift resources away from retained hospitals towards public health including foreign-assisted projects even as retained hospitals are allowed to retain their income from hospital fees. This shift became even more significant with the adoption of the "Fourmula One for Health" reform initiative in 2006.

[8] A total of 41,546 new classrooms were constructed from various funding sources in 2004-2007. However, more than half of this number was actually utilized to replace dilapidated or sub-standard classrooms that were previously in use prior to the availability of the new classrooms. This situation indicates the need to improve the inventory of public school buildings classified according to physical condition.

Table 5. Addressing Input Gaps in Basic Education, 2003-2007

Teacher Requirements		Classroom Requirements
Teacher deficit as of SY 2003-2004	37,986	Classroom deficit as of SY 2003-2004 a/
Additional teachers required for 2004-2007 due to enrollment growth	9,023	Additional classrooms required for 2004-2007 due to enrollment growth
Total teachers required	47,009	Total classrooms required
Number of teacher positions created in 2004-2007	37,676	Net increase in number of classrooms between S 2003-2004 and SY 2007-2008 b/
Gap as of end of SY 2007-2008	9,333	Gap as of end of SY 2007-2008

a/ without double shifting
b/ A total of 41,546 new classrooms were built from various funding sources in 2004-2007 but many of these were actually used to replace dilapid
standard classrooms.

Table 6. Textbook Ratio in SY 2007
as of 31 August 2007

Level	English		Science	Math	Filipino		Makabayan				Values
	Language	Reading			Wika	Pagbasa	Social Studies	EEP/TLE	MSEP/MA	PEH	Education
A. Elementarty											
Grade 1	1 : 1.10			1 : 1.66	1 : 1.07		1 : 1.00				n/a
Grade 2	1 : 1.09			1 : 1.12	1 : 1.11		1 : 1.00				n/a
Grade 3	1 : 1.02	1 : 1.02	1 : 1.33	1 : 1.28	1 : 1.01	1 : 1.01	1 : 1.00		n/a		n/a
Grade 4	1 : 1.24	1 : 1.24	1 : 1.27	1 : 1.34	1 : 1.22	1 : 1.22	1 : 1.00	n/a	n/a		n/a
Grade 5	1 : 1.50	1 : 1.50	1 : 1.96	1 : 1.84	1 : 1.83	1 : 1.83	1 : 1.00	n/a	n/a		n/a
Grade 6	1 : 1.17	1 : 1.17	1 : 1.16	1 : 1.16	1 : 1.88	1 : 1.88	1 : 1.98	n/a	n/a		n/a
B. Secondary											
Year 1	1 : 1.55		1 : 1.55	1 : 1.15	1 : 1.29		1 : 1.36	n/a	n/a	n/a	n/a
Year 2	1 : 1.28		1 : 1.16	1 : 1.05	1 : 1.15		1 : 1.16	n/a	n/a	n/a	n/a
Year 3	1 : 2.43		1 : 1.14	1 : 1.18	1 : 1.21		1 : 1.09	n/a	n/a	n/a	n/a
Year 4	1 : 2.89		1 : 1.03	1 : 1.07	1 : 1.16		1 : 1.08	n/a	n/a	n/a	n/a

Note:
1. Based on consolidated BEIS Estimated Enrolment for SY 2007-2008.
2. Total inventory covered only all centrally procured textbooks under SEMP, TEEP and SEDIP but with the following considerations such as:
   a) All deliveries prior to CY 2002 (SEMP-TEEP 1999/Repeat Order) were disregarded, deemed obselete/unservicable;
   b) Assumed a 1% allowance for losses on second year of implementation onwards and 1% allowance due to wear-and-tear beginning the 3rd year of use.

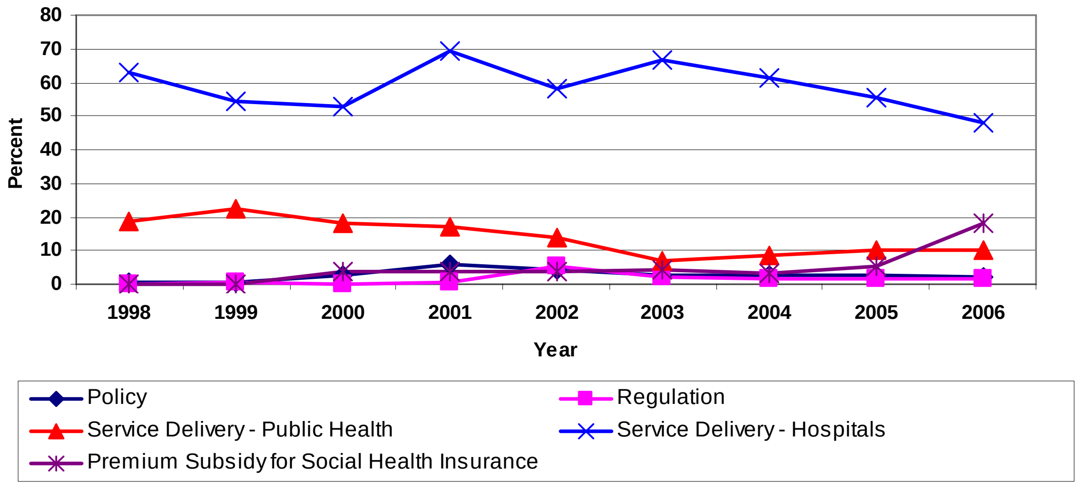
n/a - not apllicable; no procurement undertaken yet
Source: Instructional Materials Council Secretariat

On the other hand, it is significant that the budget share of the subsidy for the premiums of indigents to the social health insurance program of the PhilHealth rose sharply to 18%

in 2006 after remaining at a fairly constant level of 4% in 2000-2005.[9] The proper targeting of the poor to be enrolled in the social health insurance program has been a major cause of concern as high inclusion and exclusion errors[10] may result when the selection of beneficiaries is politicized. It is noteworthy that the PhilHealth has taken significant strides in this area by putting in place a means test to identify indigents. More recently, the use of a proxy means test to select beneficiaries is being considered.

On the other hand, PhilHealth reports show that the availment rate under the indigent program pales in comparison with that under the regular program of PhilHealth. This indicates the need to improve the access of enrolled poor households to health facilities and other health services.

Figure 8. Percent Distribution of Health Expenditures of Central Government, 1998-2006



In 2007, the Paper on Budget Strategy formulated as part of the preparation of the 2008 President's budget identified the health sector as one of the high priority sectors in terms of budget allocation. As a result, the DOH's budget (and the public health sub-sector, in particular) and the social health insurance program are expected to receive a boost when the 2008 GAA is enacted and approved.

Composition of national government spending on social welfare and development. On the average in 2002-2006, the DSWD allocated more than half of its total budget for improving the access of poor communities to basic social services through programs like the Kalahi-CIDSS[11]. It is notable that the allocation for protective services including

[9] PhilHealth officials point out that oftentimes the release of the national government counterpart to the premiums of indigent households is usually delayed. Thus, a significant portion of the allocation for 2006 is meant to cover arrearages on the part of the national government.

[10] An inclusion error occurs when non-poor households are included in the program while an exclusion error occurs when poor households are not included in the program.

[11] DSWD-implemented PDAF projects of members of Congress mostly went to CIDSS-type projects during this period.

assistance to individuals in crisis (AICS) and center-based services went down from 30% in 1996 to an average of 11% in 2004-2006 (**Table 7**). On the other hand, the share of disaster relief in the DSWD budget fluctuated between 3% and 13% during the period. Moreover, the allocation for disaster relief remained at a fairly constant level of PhP 200 million in nominal peso terms in 2000-2006.

At first glance, the budget share of technical assistance to LGUs rose from less than 1% of the DSWD budget in 1996-2001 to about 15% in 2005. Such an increase appears to be consistent with the devolution of social welfare services. Closer scrutiny of the DSWD budget, however, reveals that this increase is illusory because it resulted largely from a change in the treatment of allocation for general administrative services of field offices rather than from a real increase in the allocation for technical assistance to LGUs and other intermediaries. .

3.2. LGU Expenditures

An analysis of the trend in the size and composition of LGU revenues and expenditures in 2001-2006 reveal how economic uncertainties and the fiscal constraints faced by the both the central and local government have diminished not only the size of the overall LGU spending pie but also the budget share of the social services sectors in 2001-2005. The concomitant decline in LGU spending on social services in real per capita terms is a cause of concern because it has been associated with the stagnation, if not deterioration, in the service levels of these sectors.

Table 7. Social Welfare / Development Spending of Central Government, 1996-2005

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
General administration services	31.5	27.5	29.7	28.7	25.5	29.0	9.2	6.0	5.9	5.3	6.1
Policy, program development and standards	3.7	3.6	3.7	3.2	3.2	3.8	7.9	5.8	5.7	5.6	6.4
Technical assistance to LGUs, & other intermediaries	1.3	0.5	0.4	0.4	0.4	0.4	16.5	12.8	14.0	11.0	10.5
Disaster relief and rehabilitation	6.6	7.4	8.0	6.2	13.0	10.1	3.3	9.0	7.7	3.5	6.7
Income enhancement measures	2.5	3.8	4.3	2.4	1.7	2.2	1.6	0.1	0.0	0.0	0.0
SEA-K/ self-employment program	0.0	0.5	0.9	0.6	0.5	0.6	0.1	0.1	0.0	0.0	0.0
Productivity skills capability building	2.5	3.3	3.4	1.9	1.3	1.6	1.4	0.0	0.0	0.0	0.0
Improved access to services	21.9	32.1	26.1	38.2	33.2	28.8	40.0	37.6	42.3	37.2	29.4
CIDSS/ KALAHI CIDSS	21.9	32.1	26.1	38.2	33.2	28.8	26.7	22.4	27.7	30.2	27.9
Core shelter	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.5
ECD	0.0	0.0	0.0	0.0	0.0	0.0	13.3	15.2	14.5	7.0	0.0
Income transfers/ subsidies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.0	6.1
Food-for-School	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.0	5.1
Tindahan Natin	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Protective services	29.7	22.5	25.5	20.8	20.1	21.8	16.6	13.3	11.1	10.6	12.3
Assistance to PWDs,seniors, etc	4.7	3.3	2.5	2.2	1.9	2.1	0.5	0.4	0.2	0.2	0.4
Assitance to individuals in crisis situation	4.9	0.0	4.0	0.0	2.0	0.0	2.5	1.4	1.4	1.3	1.2
Center-based interventions	20.1	19.3	19.0	18.5	16.3	19.8	13.7	11.5	9.5	9.0	10.7
PDAF	2.8	2.5	2.2	0.1	2.8	3.8	4.9	15.6	13.4	23.8	22.4
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

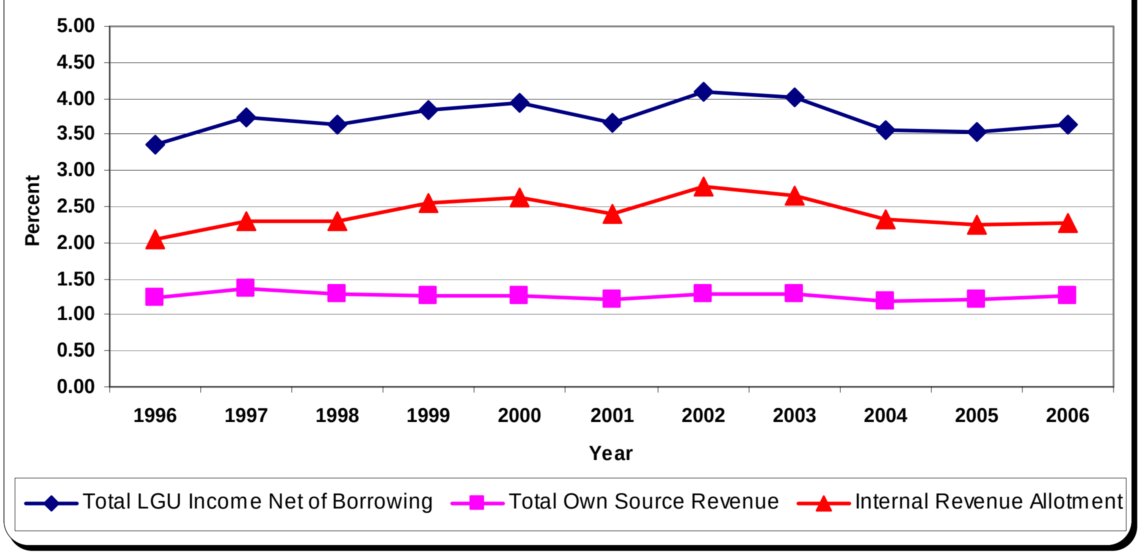
On a more positive note, the easier fiscal situation at both the national and local government level in 2006 has resulted in some improvements in various indicators of MDG spending at the local level. But, even then, MDG spending of LGUs has not recovered enough in 2006 to equal its pre-crisis level.

Given the results of earlier studies which suggest that LGU spending is largely determined by the size of their resource envelope, the analysis of LGU spending in 1996-2006 is best seen in the light of the trends in the level and composition of LGU income during the same period (**Box 2**).

Whether measured relative to GDP (**Figure 9**) or in real per capita terms (**Figure 10**), total income net of borrowings of all LGUs combined dipped in 2001-2005 after rising almost consistently in 1996-2000. However, it showed some sign of recovery in 2006.[12] The same trend is also evident for all levels of local government but is more magnified in the case provinces and relatively more muted in the case of cities and municipalities.

This movement is largely driven by the fluctuations in the IRA as a result of the effective withholding of the mandated IRA share of LGUs in 1998-2004.[13] In turn, this came about as the central government implemented fiscal austerity measures in response to a persistent weakness in its fiscal position. Consequently, the IRA which accounted for some 65% of total LGU income grew at a slower pace in 1998-2004 than it would have had the provisions of the Local Government Code been implemented to the letter.

Figure 9. Percent to GDP of Total LGU Income, 1996-2006



[12] This is due to the passage of RA 9358 in July 2006 which calls for the automatic appropriation and release of the IRA.

[13] The mandated IRA share of LGUs was either not appropriated in full, the amount appropriated for IRA was not released in full, or the IRA share was effectively cut due to the re-enactment of the budget during this period.

Box 2. Elasticity of Social Sector Spending of LGUs with respect to Changes in Own-Source Revenue (OSR) and IRA

Earlier studies on the possible determinants of per capita LGU spending [e.g., available resources (IRA as well as own-source revenues), cost adjustment factors (e.g., population density), household demand factors (e.g., per capita household income)], reveal that LGU spending is largely dependent on the size of their resource envelope (i.e., per capita IRA and per capita OSR).

Provincial-level marginal propensity to spend

Per capita spending of provinces on health is found to be significantly related to their per capita IRA (**Box Table 1**). In contrast, the coefficient of per capita OSR in the equations for provincial per capita spending on this sector was not statistically significant. This result suggests that provinces largely fund the cost of health services (which are devolved functions) out of their IRA. At the same time, the marginal propensity of provinces to spend on the health sector is found to be equal to 0.08, indicating that provinces tend to spend 8 centavos on the health sector out of every one peso increase in their IRA.

Box Table 1. Marginal Propensity to Spend on the Social Service Sectors a/

	Provinces				Cities			
	per capita IRA		per capita OSR		per capita IRA		per capita OSR	
Education	-0.016		0.10	**	0.02	*	0.05	**
Health	0.08	**	0.08		0.06	**	0.02	**
SWD	-0.01		0.04	*	0.01	**	0.05	**

* statistically significant at 5%

** statistically significant at 1%

a/ based on 2001-2005 panel data

On the other hand, per capita spending of provinces on the education sector and on the social welfare and development (SWD) sector depend solely on their per capita OSR. However, provinces appear to give higher priority to the education sector than the SWD sector. Their marginal propensity to spend on the education sector out of their OSR (0.10) is more than twice that for the SWD sector (0.04). This result is not surprising given the fact that education services are largely funded out of the Special Education Fund (SEF) which is part of LGUs' own-source revenue.

City-level marginal propensity to spend

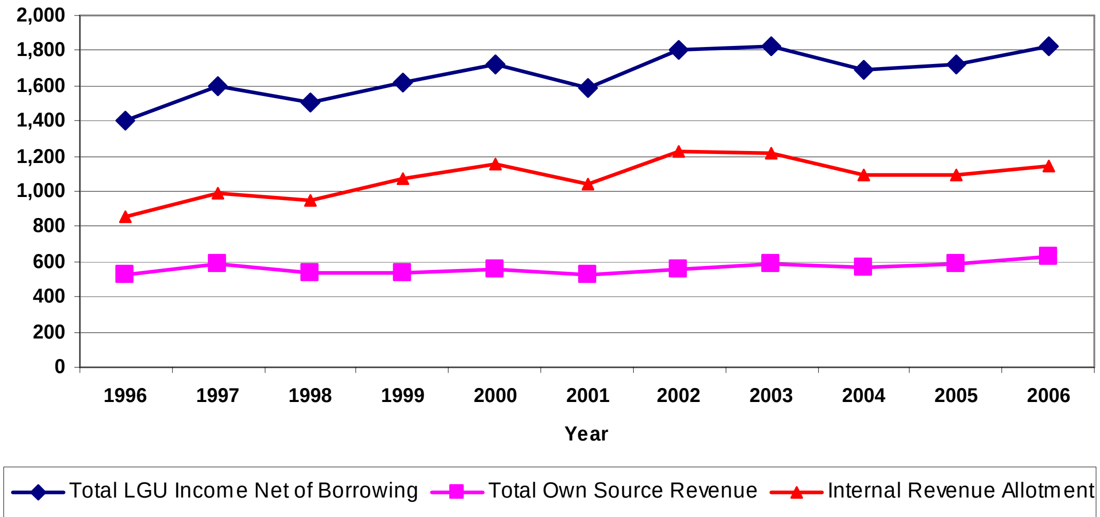
Unlike provinces, cities' per capita spending on the all three social services sub-sectors (i.e., health, education and SWD) are found to be dependent on both their per capita IRA and per capita OSR (**Box Table 1**). As expected, cities' marginal propensity to spend on the education sector out of their OSR is higher than that on the health sector. However, it is surprising that their marginal propensity to spend on SWD out of their OSR is also higher than that on the health sector.

On the other hand, the marginal propensity to spend of cities out of their IRA is highest for the health sector, followed by the education sector and then the SWD sector.

Given the fact that the distribution of the local revenue base of LGUs is highly uneven and the fact that the IRA distribution formula does not fully compensate for this disparity, it is likely that per capita spending of LGUs on the social sectors will also be uneven. These findings also suggest that the disparity in inter-provincial human development outcomes (like health status and education achievement) will likely remain high.

Admittedly, there has also been a slowdown in the growth of LGU own-source revenue in 2001-2005 relative to the previous 5-year period, albeit to a lesser degree than the IRA. To the credit of LGUs, own-source revenue performance of all LGUs in the aggregate (and total local tax revenue, in particular) outpaced that of the national government in 2001-2005 with own-source revenues of LGUs growing at 11% compared to the 9% growth of central government revenues and of the IRA during the period.

Figure 10. Real Total LGU Income Per Capita, 1996-2006 (in 2000 prices)

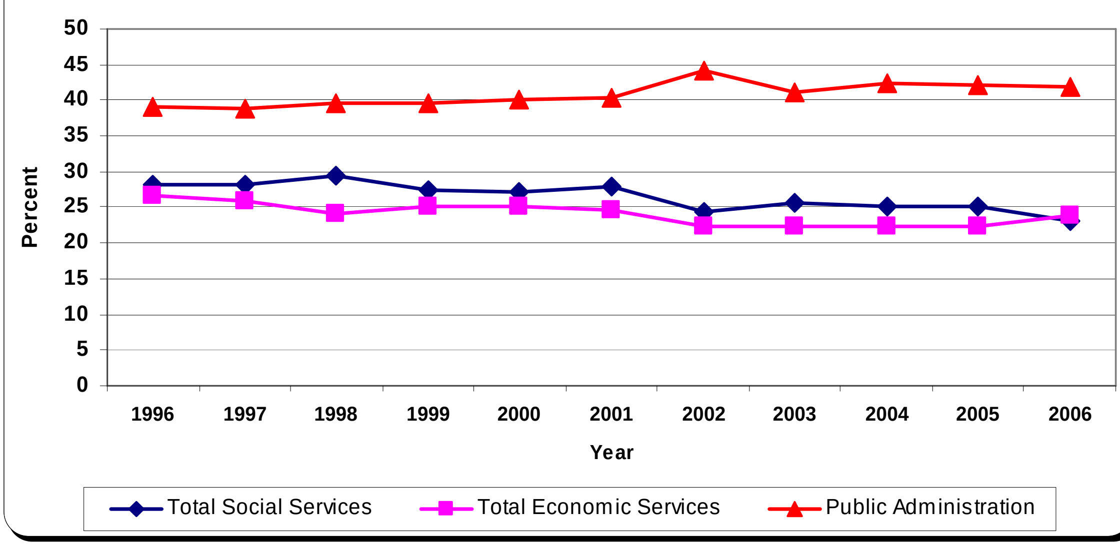


Aggregate LGU spending. Given the close link between LGU income and LGU expenditures, the movement in LGU income levels in 1996-2006 is closely mirrored by movements in LGU spending. Consequently, the LGU expenditure ratio contracted from a peak of 4.1% of GDP in 2000 to a low of 3.1% in 2005, after exhibiting an uptrend in 1996-2000.

From the perspective of human development, however, it is worrisome that the social services sectors appeared to have been given lower priority relative to the other sectors in 1998-2002 with budgetary resources being shifted out of the said sectors towards public administration. To wit, while the budget share of all the economic services sectors as a group also slipped, the budget share of all the social services sectors combined (or the social allocation ratio) contracted the most from a high of 28.0% in 1998 to a low of 24.4% in 2002 before rising to about 25.6% in 2003 and slipping again to 23.2% in 2006. In contrast, the budget share of general public administration expanded from 6.2% to 7.6% (**Figure 11**).

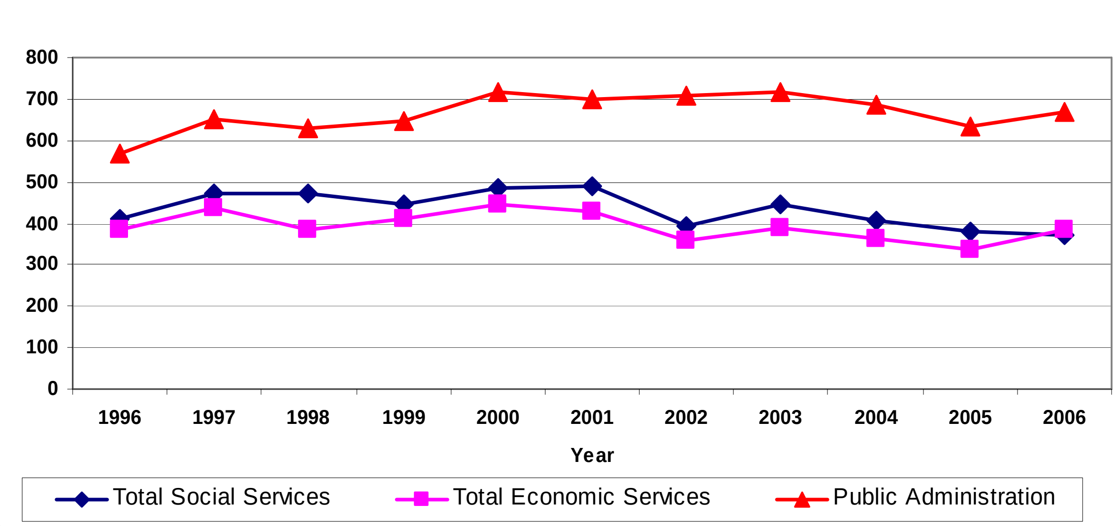
Although the priority given by LGUs to the social services sectors showed some resurgence in 2003-2006, the movement is not enough to compensate for the contraction of the total spending pie. Thus, real per capita spending on all the social services sectors combined (in 2000 prices) went down by 5.3% yearly from PhP 488 in 2001 to PhP 371 in 2006 (**Figure 12**).

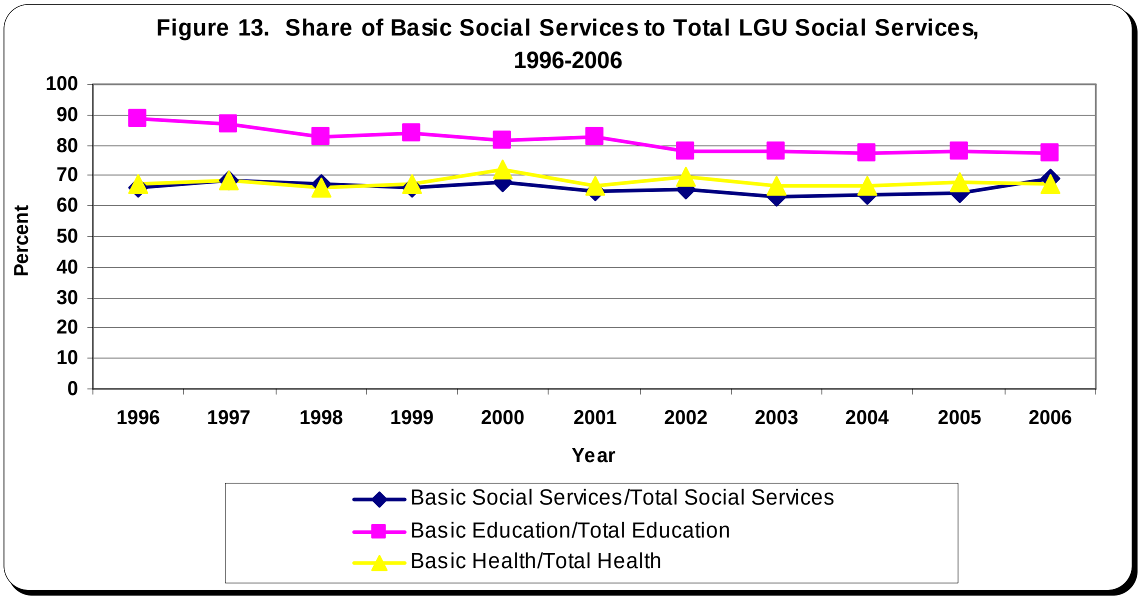
Figure 11. Sectoral Distribution of Local Government Expenditures, 1996-2006



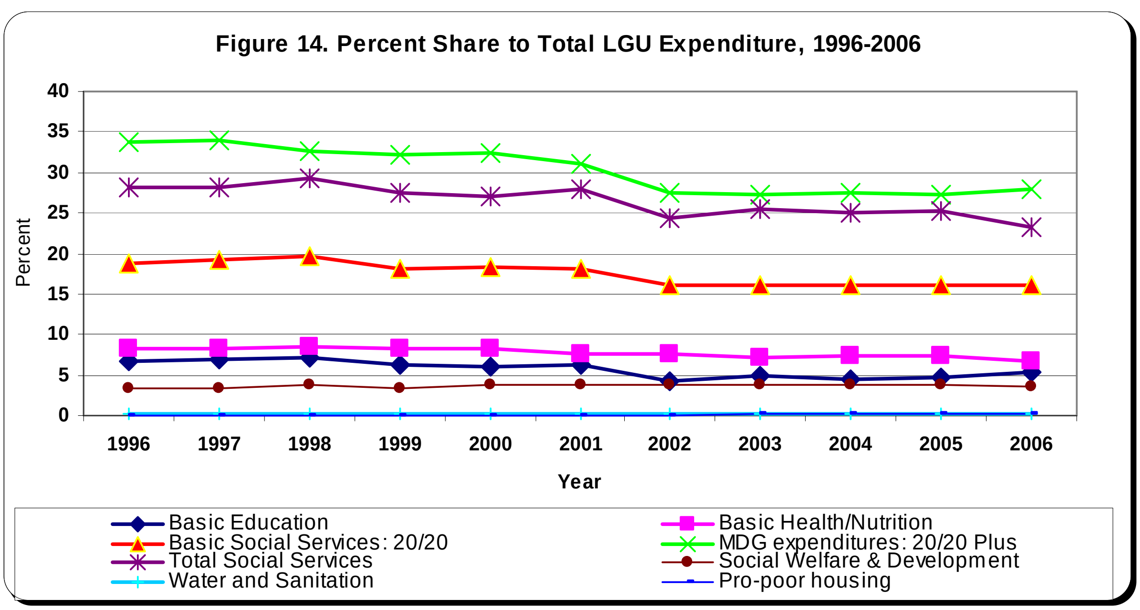
On the other hand, while the share of basic health in total health spending of LGUs was fairly stable in the 67%-68% range in 1996-2006, the share of basic education to total education spending of LGUs decreased from a high of 89% in 1996 to an average of 78% in 2002-2006 as LGUs (cities and municipalities, in particular) devoted a bigger portion of their education budgets to higher education. This movement consequently pulled down the overall social allocation ratio (i.e., the share of basic social services in total social sector spending of LGUs) from a high of 68% in 2000 to an average of 64% in 2001-2005 before posting a turnaround to 69% in 2006 (**Figure 13**).

Figure 12. Real Per Capita LGU Expenditures (in 2000 prices), 1996-2006





With the movement in the social priority ratio re-enforcing that of the social allocation ratio, the human priority ratio (i.e., the share of basic social services to total LGU spending) went down from a high of 20% in 1998 to an average of 16% in 2002-2006 (**Figure 14**). At the same time, funding for poverty reduction measures is also less protected than other types of spending. Thus, the share of LGU spending on poverty reduction interventions (i.e., pro-poor infrastructure, targeted income enhancement measures) in the total LGU budget decreased from a high of 15% in 1996 to an average of 11% in 2002-2005 before increasing to 12% in 2006. Consequently, the share of MDG expenditures in the total LGU budget declined from 34% in 1996-1997 to an average of 27.5% in 2002-2006.

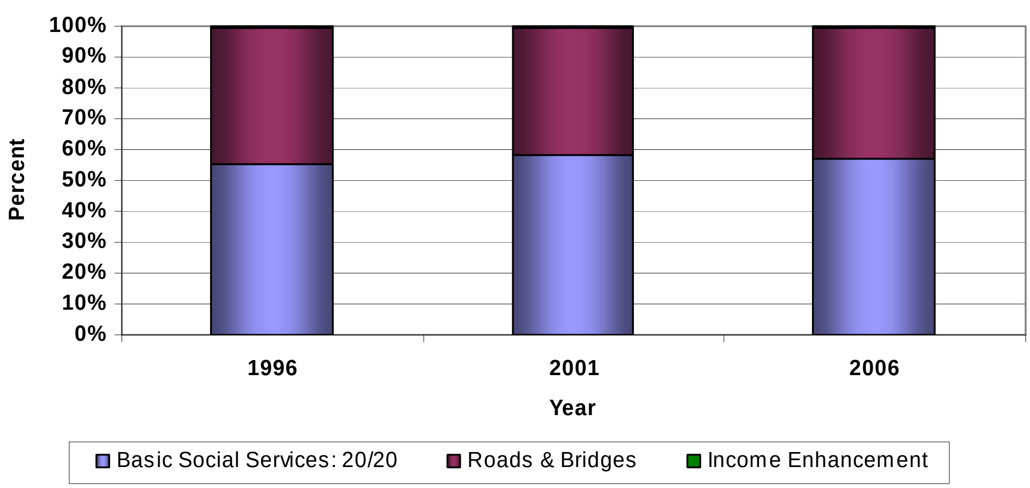


In turn, real per capita LGU spending on all MDG interventions in the aggregate (in 2000 prices) went down from a high of PhP 578 in 2000 to a low of PhP 413 in 2005 before posting a partial recovery to PhP 448 in 2006. On the other hand, real per capita LGU spending on all basic social services combined declined from PhP 330 in 2000 to PhP 244 in 2005 and PhP 256 in 2006. (**Table 8**). The reduction in real per capita LGU spending on human development priorities in 2000-2005 is largely driven by the retrenchment in LGU spending on basic education (a decrease of 8.0% yearly on the average during the said period). However, the reduction in LGU spending on pro-poor infrastructure (7.5%) and basic health (5.6%) are also substantial.

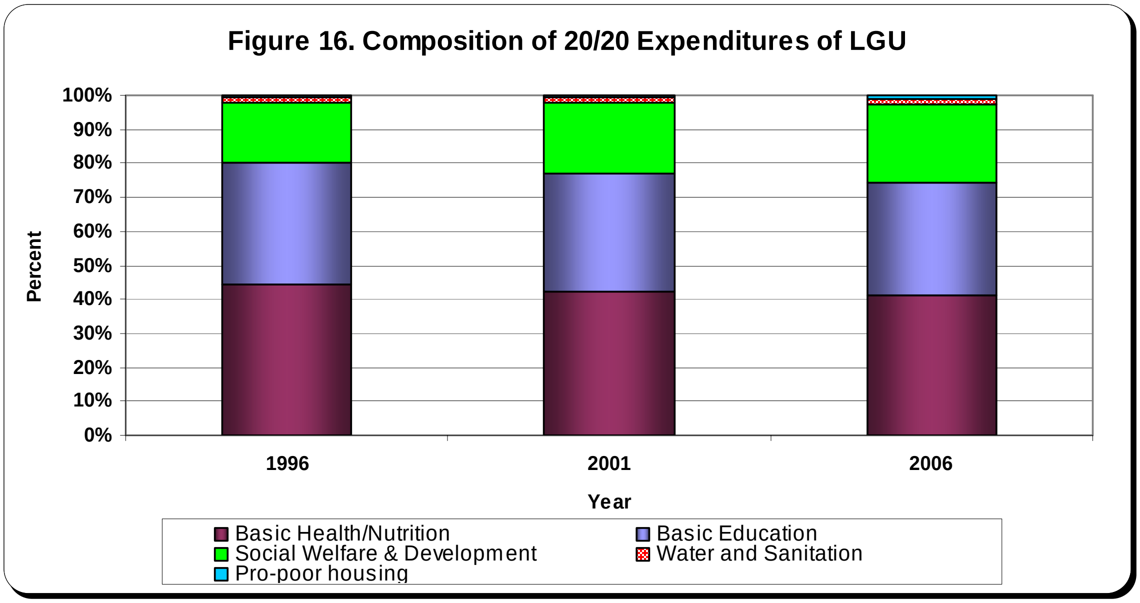
LGU spending on MDG. On the average, LGUs allocate some 58% of their total MDG spending on basic social services, 42% on pro-poor infrastructure and less than 0.5% on targeted income enhancement measures in 1996-2006 (**Figure 15**).

On the other hand, LGUs allocate about 44% of their total spending on basic social services on basic health services, 32% on basic education services, and 21% on social welfare and development services, less than 2% on water supply and sanitation and less than 1% on pro-housing (**Figure 16**).

Figure 15. Composition of 20/20 Plus Expenditures of LGU



LGU spending on education. The share of LGUs in total general government spending on education has been fairly stable at 7% in 1996-2006. However, the share of basic education in total LGU expenditures on education contracted to an average of 78% in 2002-2006, down from 83% in 1998-2001 and 88% in 1996-1997. As noted earlier, this development may be traced to the increasing priority given by cities and municipalities to higher education in 2000-2006.



In 1996-2006, LGU spending on basic education is divided almost evenly between personal services (28%), MOOE (37%) and capital outlay (35%). For instance, in SY 2006-2007, LGUs paid for the salaries and wages of some 24,250 teachers, representing 5% of the total number of nationally funded and locally (SEF/ LGU) funded teachers. On the other hand, instructional materials and office supplies, electricity and water consumption of public schools, repair of public school buildings and janitorial/ security services for the schools contribute the bulk of maintenance and other operating expenditures (MOOE) of LGUs in basic education. Meanwhile, school building construction account for most of the capital outlays of LGUs in basic education.

Table 8. Real Per Capita MDG Expenditures of LGU (in 2000 prices)

(in pesos)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Basic Education	97	118	114	102	107	109	69	85	74	71	85
Basic Health/Nutrition	121	140	135	134	148	134	121	126	120	112	106
Social Welfare & Development	48	58	61	54	69	66	61	65	61	57	59
Water and Sanitation	4	5	4	5	4	5	4	4	4	4	4
Pro-poor housing	1	1	1	1	1	1	2	3	2	2	2
Basic Social Services: 20/20	271	322	315	295	330	316	257	282	261	244	256
Pro-poor infrastructure	215	245	206	226	246	224	184	192	183	167	190
Targeted income/ employment enhancement measures	3	2	1	4	2	3	1	2	2	2	2
Land Redistribution	0	0	0	0	0	0	0	0	0	0	0
MDG expenditures: 20/20 Plus	490	569	522	526	578	542	442	476	445	413	448
Memo Item:											
Total Education	109	135	138	121	131	132	89	109	95	91	110
Total Health and Nutrition	180	204	203	199	207	200	174	189	179	164	157
Total Social Services	409	472	471	447	484	488	393	446	407	381	371

LGU spending on health. Because of the devolution of health services, LGUs account for some 52% of total general government spending on health on the average in 1996-2006. During this period, the share of basic health services to total LGU spending on the health sector was fairly constant at 68%. Of this amount, LGUs spend roughly 55% of their basic health budget on personal services and practically all of the remainder on MOOE (including drugs, medicines, supplies and training of health personnel).

LGU spending on SWD. LGUs account for 70% of general government spending on SWD services in 1996-2006. Of this amount, 37% was allocated to disaster relief while the remaining 63% was spent on various types of social welfare and development services. About 46% of the total amount allotted to SWD services by LGUs was made by municipalities largely on account of day dare center services.

3.3. General Government Expenditures

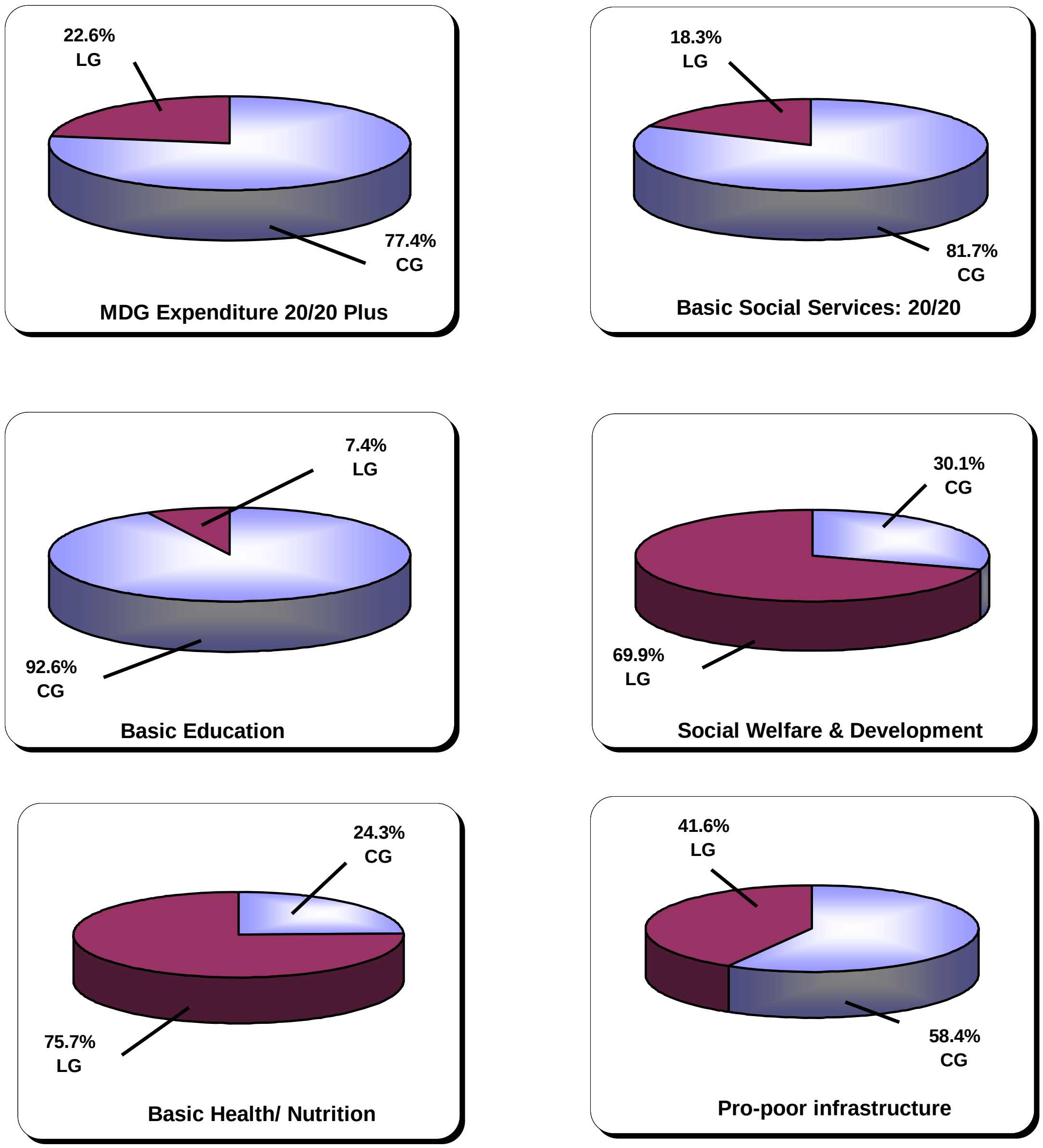
Overall, the movements in total general government expenditures were largely driven by similar movements in central government expenditures. This is so because central government expenditures accounted for 82% of general government expenditure on basic social services and 78% of general government spending on all MDG-related programs on the average in 1996-2006 (**Figure 17**).

The social sectors were on the whole not shielded from the austerity measures implemented during the fiscal crisis. Thus, the share of all the social services sectors combined in total general government expenditures (or the social allocation ratio) contracted from a high of 31.4% in 1998 to a low of 22.2% in 2005 before rising to 24.9% in 2006 (**Figure 18**).

However, the allocation for basic social services was more protected relative to tertiary level services during the same period. To wit, the general government social priority ratio rose from an average of 64% in 1996-2000 to 68% in 2005 before slipping back to 63% in 2006 (**Figure 19**).

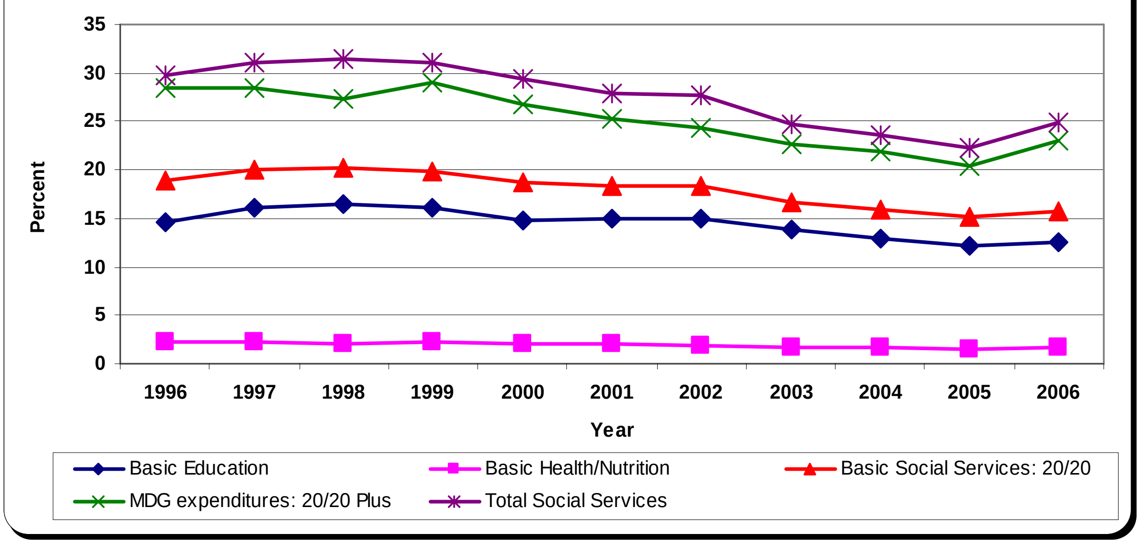
Nonetheless, the movement in the aggregate social allocation ratio is repeated in the downward trend in the general government human priority ratio which dipped from 20% in 1998 to 15% in 2005-2006 (**Figure 18**). In like manner, the budget share of all MDG-related expenditures contracted from 29% in 1999 to 20% in 2005 and 23% in 2006.

Figure 17. Composition of General Government Basic Social Services Expenditure by Level of Government, 1996-2006

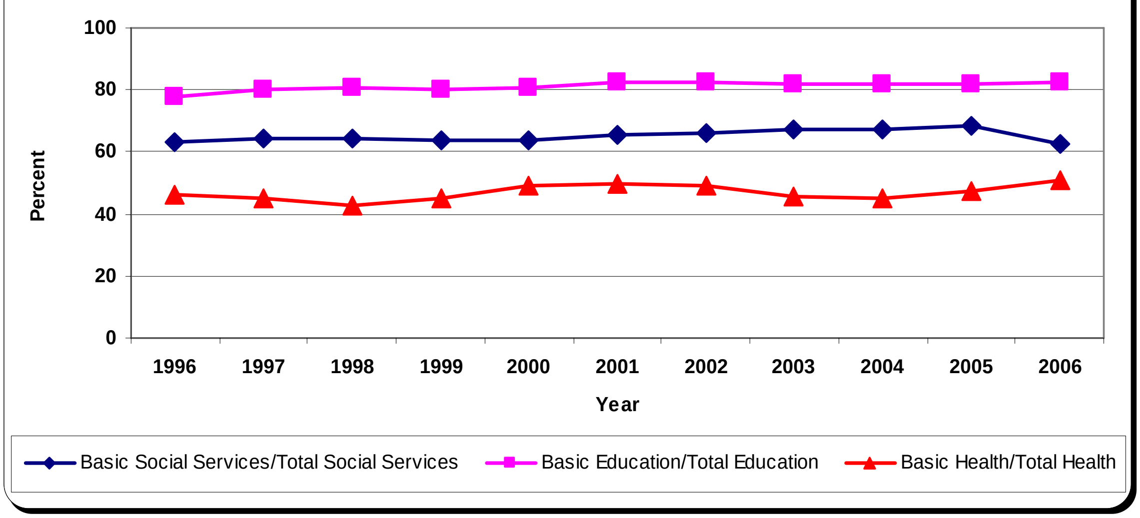


As a result, general government spending on all basic social services as well as on all MDG-related activities went down when measured as percentage of GDP and in real per capita terms between 1997/1998 and 2005 before posting a small increase in 2006. To wit, the human development expenditure ratio decreased from 4.2% of GDP in 1997-1998 to 2.7% of GDP in 2005-2006. On the other hand, general government spending on all MDG-related measures combined dipped from 6.0% of GDP in 1997 to 3.6% of GDP in 2005 before going up to 4.1% in 2006 (**Figure 20**).

Figure 18. Percent Share to Total General Government Expenditure



Figuer 19. Share of Basic Social Services to Total Social Services Expenditures of General Government, 1996-2006



Meanwhile, real per capita general government spending on all basic social services (in 2000 prices) was cut from PhP 1,805 in 1997 to PhP 1,301 in 2005 before inching up to PhP 1,380 in 2006. Likewise, real per capita MDG spending of the general government went down from PhP 2,566 in 1997 to PhP 1,757 in 2005 and PhP 2,029 in 2006. (**Table 9**).

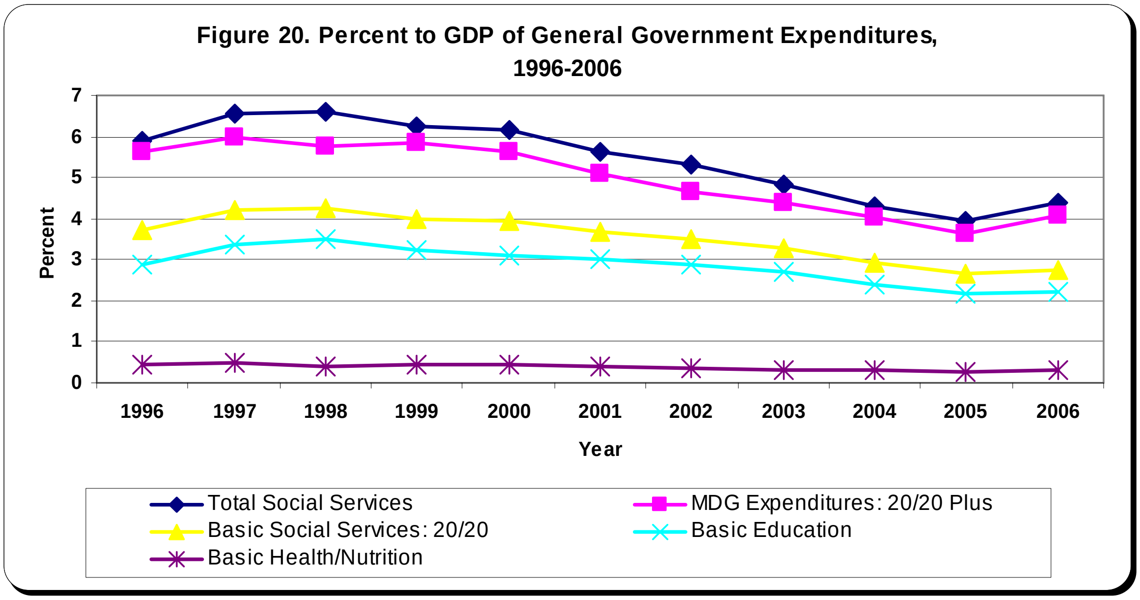


Figure 20. Percent to GDP of General Government Expenditures, 1996-2006

Table 9. Real Per Capita Expenditure of General Government Expenditures (in 2000 prices)

(in pesos)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Basic Education	1,205	1,451	1,452	1,358	1,356	1,312	1,267	1,227	1,125	1,046	1,100
Basic Health/Nutrition	183	203	176	183	196	176	165	147	144	136	148
Social Welfare & Development	72	83	87	80	97	87	84	92	88	86	86
Water and Sanitation	19	29	15	16	17	14	15	6	4	5	12
Pro-poor housing	79	38	37	44	49	12	8	15	15	27	33
Basic Social Services: 20/20	1,558	1,805	1,767	1,681	1,715	1,602	1,539	1,485	1,377	1,301	1,380
Pro-poor infrastructure	637	631	510	684	597	489	393	430	370	340	545
Targeted income/ employment enhancement measures	67	85	36	38	79	76	63	85	115	77	82
Land Redistribution	88	45	82	59	59	43	48	10	43	38	22
MDG expenditures: 20/20 Plus	2,350	2,566	2,395	2,462	2,450	2,211	2,044	2,009	1,905	1,757	2,029
Memo Item:											
Total Education	1,549	1,815	1,799	1,693	1,681	1,596	1,540	1,500	1,375	1,278	1,331
Total Health and Nutrition	396	454	412	409	397	357	336	322	322	289	290
Total Social Services	2,462	2,806	2,750	2,628	2,685	2,440	2,336	2,207	2,043	1,908	2,198

4. MDG EXPENDITURES AND HUMAN DEVELOPMENT OUTCOMES

The adverse impact of the fiscal crisis on government spending on MDG interventions is a cause of concern because it appears that the observed decline in real per capita MDG spending of the general government has been accompanied by a corresponding stagnation, if not deterioration, in some human development outcomes/ outputs (**Table 10** and **Table 11**). The correspondence between general government spending on basic education services and basic health services, on the one hand, and selected education outcomes and selected health sector outputs, on the other hand, is shown graphically in **Figure 21** and **Figure 22**, respectively.

Table 10. Selected Education Indicators, 1990-2005

	1990		1996	2000	2002	2003	2004	2005	2006
Elementary level participation rate	84.6		85.2	92.7	90.3	88.7	87.1	84.4	75.6
Secondary level participation rate	54.7		56.8	62.3	59.0	60.2	60.0	58.5	45.0
Elementary level cohort survival rate	69.7		68.7	69.3	72.4	71.8	71.3	70.0	64.3
Secondary level cohort survival rate	76.4		71.4	71.0	76.8	71.7	72.4	61.0	60.1
elementary level achievement score a/	40.1	b/	44.5	51.4			58.7	54.7	59.9
secondary level achievement score a/	35.6	b/	42.6	51.9		44.4	46.8	44.3	46.6

a/ based on NEAT and NSAT for 1994-2000 and on NAT for 2003-2006
b/ refers to 1994

This relationship is also evident at the sub-national level. For instance, an analysis of division level data for 2005 indicates that a positive and statistically significant relationship exists between elementary level cohort survival rate (CSR), on the one hand, and per capita DepEd spending and per capita LGU spending on education, on the other. In like manner, an analysis of regional level data for 2003 reveals a positive and statistically significant relationship between the number of children given complete immunization and number of mothers given two doses of tetanus toxoid vaccine, on the one hand, and government spending on health, on other.

Table 11.Selected Health Indicators, 1998-2006

	1998	2000	2002	2004	2005	2006
% of pregnant women with 3 or more pre-natal visits	59.4%	64.8%	60.5%	64.7%	62.3%	61.5%
% of pregnant women given tetanus toxoid vaccination at least twice	68.8%	62.5%	54.3%	60.0%	58.8%	59.1%
% of lactating mothers given Vitamin A	49.1%	57.0%	52.9%	53.2%	54.7%	59.3%
% of livebirths attended by medical professional, incl. trained hilot	94.3%	95.4%	93.4%	95.6%	96.3%	96.3%
% of fully immunized children under 1	84.8%	86.5%	76.7%	84.8%	83.7%	82.9%
% of diarhhea cases amongst children under 5 given ORS	28.4%	24.1%	17.7%	15.5%	14.2%	14.0%
% of pneumonia cases amongst children under 5 given treatment	94.7%	93.9%	94.7%	99.9%	95.3%	96.0%
% of children under 1 given Vitamin A	72.8%	76.9%	74.7%	79.2%	80.0%	81.0%
% of children between 1 and 5 given Vitamin A	89.6%	101.3%	94.1%	111.1%	97.8%	95.7%
TB morbidity rate a/ b/	206.7	174.1	154.1	133.3	137.1	169.9
Malaria morbidity rate a/	96.8	66.6	50.3	24.9	43.3	27.6

* data shown for entire Philippines but data by province and city also available
a/ per 100,000 population
b/ respiratory plus other forms of TB
Source: Field Health Service Information System, various years

Figure 21. Education Outcomes and Basic Education Spending of General Government, 2001-2006

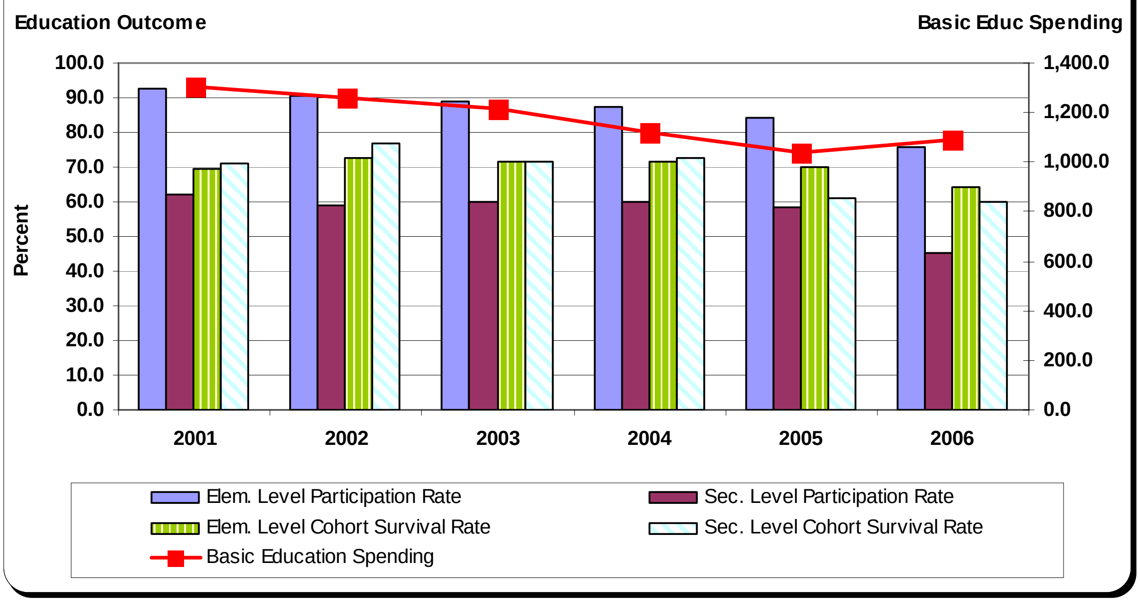
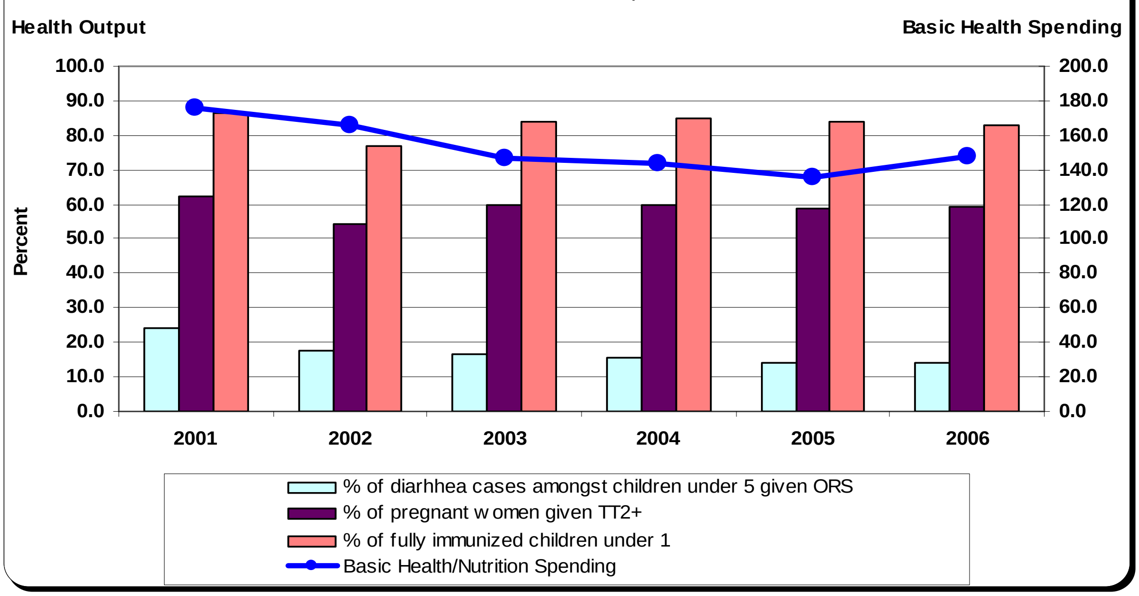


Figure 22. Health Outputs and Basic Health Spending of General Government, 2001-2006



These analyses also show a negative correlation between per student DepEd education spending and per student LGU education spending. In contrast, a positive correlation was found between NG basic health expenditures and LGU basic health spending. Thus, while the DepEd tends to allocate its resources, consciously or unconsciously, in an equalizing fashion relative to the distribution of LGU education spending per capita, the opposite is true in the case of DOH spending. This finding has serious implications on the ability of the central government to help reduce the disparities in human development outcomes across regions/ geographic areas.

5. RECENT DEVELOPMENTS, OUTSTANDING ISSUES AND RECOMMENDATIONS

5.1. Increasing Government Revenue

In response to the fiscal crisis, Congress has passed three laws that are meant to increase the revenue take of the central government. In late 2004, Congress passed the Attrition Act of 2005 (Republic Act 9335) and a law amending the excise tax on sin products (RA 9334). The Attrition Act of 2005 provides for the creation of a reward and incentives fund in the BIR and the BOC equal to at least 15% of the difference between their actual collection and their revenue target, proceeds of which will be apportioned to the various units, officials and employees in proportion to their relative contribution to the "excess" collection. It also provides that officials and employees of these bureaus may be removed from the service if their revenue collection performance falls short of the target by at least 7.5%. On the other hand, RA 9334 provides for discrete increases in the tax rate on cigarettes (15%-80% in 2005) and on alcoholic products (22% in 2005) and every other year thereafter until 2011.[14]

In April 2005, Congress then passed another amendment of the National Internal Revenue Code (RA 9337 or the reformed VAT law). It expands the coverage of the VAT (to include power and electric cooperatives, petroleum products, medical and legal services, agricultural non-food products, and works of art); converts the Philippine VAT system from a "consumption-type" VAT (where producers are allowed to get credit for taxes paid on their inputs including their capital goods purchases) to an "income-type" VAT (where producers are allowed to get credit for taxes paid on all their inputs but the credit on the capital goods purchases is limited only to the depreciated part of capital); limits the input VAT credit to 70% of the output VAT; zero-rates the transport of passenger and cargo to foreign countries, services provided to aircrafts/ vessels engaged in international transport, and sales of goods, supplies and fuel to aircrafts and vessels engaged in international transport; reduces the excise tax rate on kerosene, diesel and bunker fuel; removes the franchise tax on power distribution utilities and domestic airlines; removes the common carriers tax on domestic shipping; increases the presumptive input VAT of agro-processors from 1.5% to 4%; provides for a temporary increase in the corporate tax rate from 32% to 35%; and increases the gross receipts tax (on royalties, rentals of property, real or personal, profits from exchange and all other items treated as gross income) of banks and non-bank financial intermediaries from 5% to 7%. In addition, as provided under the reformed VAT law, the President authorized the increase the VAT rate from 10% to 12% in January 2006.

[14] Under the amendment, the tax rate on cigarettes in 2011 will be 34%-143% higher than that in 2003 while the tax rate on alcoholic products in 2011 will be 122% higher than that in 2003.

As indicated earlier, the turnaround in the central government's revenue effort in 2006 was primarily due to the increase in the excise tax rate on sin products in 2005 and the increase in the VAT rate from 10% to 12% in 2006. After the credible performance of the tax collection agencies in 2006, sustained improvement in tax administration has remained elusive despite the passage of the attrition law. The record of the Bureau of Internal Revenue and Bureau of Customs in meeting their revenue goals has been erratic and frequent changes in leadership has not helped any. There are also indications that the very intense focus of the tax collection agencies and the Department of Finance (DOF) on meeting revenue targets may have had adverse effects on collection effort in periods other than the very near term. Said focus may have also distracted efforts to institutionalize systematic reforms in systems and procedures.

Given the political environment, it is unlikely that the new tax measures aimed at generating additional revenues will be passed by Congress in the near to medium term. At the same time, the positive revenue impact of the excise tax amendment and the reformed VAT law is expected to wane in the next two years as both measures have built-in sunset provisions. After the mandated adjustment in excise tax rates on sin products in 2011, they will remain fixed at that level <u>in nominal peso terms</u> unless Congress passes a new law mandating otherwise. On the other hand, the reformed VAT law temporarily raised the corporate tax rate but the rate will revert back to its old level after 2009.

Needless to say, improvements in tax administration are urgently needed if another fiscal crisis is not to loom its ugly head again. The experience in 1998-2005 very clearly shows that MDG spending is cut back during periods of fiscal restraint despite the lip service paid to protecting social sector spending.

5.2. Budget Reform Initiatives

The public expenditure management (PEM) reform introduced by the DBM as early as 2000 augurs well for shifting budgetary resources to MDG-related activities. The PEM shifts the focus of the budget process from inputs and rules-based compliance to outputs/ outcomes and greater performance orientation. It also promotes greater flexibility, transparency, and accountability.

The reforms under the PEM have two major strands: the Medium Term Expenditure Framework (MTEF) and the Organizational Performance Indicators Framework (OPIF). The MTEF is a tool for linking policy, planning & budgeting over the medium-term. By giving emphasis on the operationalization of a multi-year (e.g., three-year) expenditure perspective, the MTEF injects the future into budgeting. In doing so, it effectively bridges the difference in the time horizon pertinent to planning and budgeting.

The MTEF also helps ensure greater predictability in the amount of resources that will be available in the medium term by encouraging the formulation of honest and realistic multi-year forecasts of government revenues. It should be emphasized that the success of the MTEF to actually yield more predictable funding for the implementing agencies is premised not only on the existence of technical capacity to arrive at good revenue forecasts but also on the executive's commitment to have a transparent budget process and its willingness to make hard choices early on in the budget process.

In order to achieve fiscal discipline, the MTEF calls for the matching of the demand for government spending in the aggregate with the amount of resources that is available. Under the MTEF, budgeting takes on a more strategic and policy-based approach to resource allocation by ensuring the consistency between resources and aggregate policy commitments. Thus, if the MTEF is successfully applied, it can (i) promote macroeconomic stability, (ii) improve predictability of funding for line departments, and (iii) improve the allocation resource between & across sectors.

The deliberation of the Development Budget Coordinating Committee (DBCC) on the Paper on Budget Strategy (whereby implementing agencies in high priority sectors are called to defend their new spending proposals) serves as the venue for enforcing a more strategic allocation of resources during budget preparation. In line with the President's declaration that it is "social payback" time, the Paper on Budget Strategy formulated during the preparation of the President's budget for 2007 led to the identification of basic education and infrastructure as high priority sectors in the allocation of that year's budget. In 2008, the application of the same process led to the addition of basic health to the high priority list.

In this regard, there is a need to help strengthen the capacity of the implementing agencies that play a major role towards the achievement of the MDGs to prepare Medium-term Expenditure Plans. Well-crafted MTEPs will facilitate these agencies' articulation of new spending proposals that will help them upgrade their service levels in a manner consistent with the MDG targets. In this way, they will be in a better position to secure a greater share of the fiscal space that is available.

On the other hand, the prominence given to performance/ results in the budget process under the PEM naturally reinforces the link between the government's budgetary allocations, on the one hand, and the goals, policies, strategies and priority programs, activities, and projects (PAPs) that they have included in their plans. This performance-orientation is enshrined in the OPIF which is essentially an outcome and output framework that describes a logical hierarchy of causal relationships that link the outputs (i.e., goods and services) that government delivers to the outcomes that it seeks to achieve. The OPIF is an accountability framework that helps government agencies to establish the link between the outputs that they are mandated to provide and the outcomes that government wants to achieve, to assess their accomplishments and to report on results. As such, the OPIF helps agencies focus on core activities that deliver results, and helps set priorities for allocating resources to critical outputs and activities. By clarifying how agency performance is to be measured, the OPIF also has the potential of improving the reporting of results, thereby enhancing transparency.

At present, the OPIF is still in the process of being adopted by the national government agencies. However, the OPIF has the potential of enhancing public sector accountability by making more transparent to Congress and the general public the outputs and monitorable performance targets that agencies are supposed to achieve given the budgetary resources they receive.

Prospectively, however, there is a need for the executive branch, in general, and the DBM, in particular, to engage with Congress towards the adoption of an OPIF-compliant budget.

5.3. Under-utilization of Appropriation Cover: Poor Absorptive Capacity or Inadequate Release of Funding Authority

The discussion of budget execution at the DepEd in 2004 and at the DOH in 2004 and 2005 suggests that, paradoxically, some of the social sector agencies have not been able to fully utilize their appropriation cover despite the apparent lack of budget support. At this point, it is not clear whether this situation is due to poor absorptive capacity on the part of the concerned agencies or to the late/non-release of either funding authority or cash allocation by DBM.

The fund utilization rate (i.e., ratio of obligation to allotment) is a good indicator of absorptive capacity. However, the data that is available does not include allotment levels by program. Thus, we are only able to compute the ratio of obligation to appropriations. The obligation-to-appropriation ratio may also indicate absorptive capacity assuming that allotments are released on time as needed. However, in times when austerity measures are put in place and allotments come in trickles then low obligations-to-appropriations ratios may simply indicate the rationing of allotment/ cash rather than low absorptive capacity *per se*. Note that the analysis of fund utilization for this study covers 2004 and 2005, years when the national government has had to struggle with fiscal consolidation. In those years, what appear to be problems with utilization may instead indicate problems with release of allotments and Notice of Cash Allocation (NCAs).

On the one hand, these findings underscore the importance of having realistic revenue estimates in ensuring the predictability of funding. On the other hand, if it is ascertained that the low utilization rates arise because of implementation problems, then these implementation issues should be addressed and should not automatically be used as a justification for a cut in future funding. This is critical given significant levels of unmet needs and funding gaps towards the attainment of the MDGs.

DepEd. Across programs, the following programs exhibited low utilization rates in 2004: teacher training (less than 1%), support to operations of distance education (76%), support to elementary education (82%), support to physical education (76%), operation of non-formal education for accreditation and equivalency program (75%), operation of medical/ dental/ nursing services (76%), school sports (81%), purchase of armchairs (0.08%). In 2005, the following programs had problems in their utilization rate: support to distance education (56%), support to elementary education ((80%), support to physical education (86%), operations of medical/ dental / nursing services (61%), hiring of new teachers (47%), operations of science high schools (72%), purchase of armchairs (82%), acquisition of textbooks (78%), creation of principal positions (61%), rationalization of school MOOE, conversion of Master Teacher Position (7%).

DOH. Across programs, the following public health programs exhibited low utilization rates in 2004 and 2005: Essential National Health Research (67% in 2004 and 62% in 2005), provision of drugs and medicines to collaborating units for emergencies (62% in 2004 and 73% in 2005), regulation of food and drugs (49% in 2005), regulation of health facilities and services (45% in 2005), regulation of health devices and technology (44% in 2005), quarantine services (75% in 2005), local health systems development (81% in 2004 and 38% in 2005), disease surveillance (80% in 2004 and 38% in 2005), TB control (87% in 2005), malaria control (60% in 2004 and 40% in 2005), schistosomiasis (50% in 2004 and 40% in 2005), prevention and control of other communicable diseases (77% in 2004 and 85% in 2005), family planning (40%-43% in 2005), family health and primary health care (76% in 2004), environmental health (61% in 2005), other population initiatives (59% in 2004 and 37% in 2005), health promotion (59% in 2004 and 33% in 2005). Likewise, health care assistance (59% in 2004 and 33% in 2005), social health insurance (62% in 2004 and 35% in 2005) and provision of drugs and medicines for collaborating centers (62% in 2004 and 73% in 2005) also had low utilization rates.

In 2008, the DOH has developed and put in place a budget expenditure tracking system that is focused on the utilization of budgetary support for public health programs. The intent is to guard against poor absorptive capacity given the large increase in the budget for said programs.

5.4. PDAF Allocation of Members of Congress

In 2003, PhP 6.2 billion was obligated as part of the PDAF allocations of members of Congress. In 2005, the aggregate PDAF obligation was equal to PhP 5.3 billion (**Table 12**). MDG programs captured 22% and 34% of total PDAF obligations in 2003 and 2005, respectively. Clearly, there is scope for further reallocation in favor of MDG programs in the use of the PDAF. In this regard, it is incumbent on LGUs and local communities to demand that their Congressmen prioritize MDG interventions in using their PDAF allocations.

In particular, the opportunity for such a reallocation appears to be large in the case of PDAF projects implemented by LGUs. It is noteworthy that for this sub-set of the PDAF, the share of MDG programs is a low of 6% for 2003 and 2005 (**Table 13**).

5.5. Opportunities for Shifting Resources towards MDGs at the Local Level

A number of issues and constraints in local revenue generation and public expenditure management at the local level continue to fester to date. Some of the problem areas in local revenue generation that need the attention of local officials include: (1) poor tax registration systems and procedures which results in delinquent payments and accumulation of arrears, (2) infrequent exercise of LGU audit and enforcement authority which erodes the credibility of the system and results in low compliance; (3) limited availability of taxpayer services which increases taxpayer compliance costs, (4) inadequate local capability in tax administration, (5) complex tax structure, and (6) less-than-business-like management of local economic enterprises.

Table 12. Percent Distribution of PDAF Allocation of Members of Congress

	2003	2005
Education	**9.9**	**12.4**
Elem& HS	7.2	7.7
Health	**7.2**	**5.9**
Basic health	0.3	0.3
Hospital	3.8	0.4
Philhealth	0.0	0.8
Medical Assistance	3.1	4.5
Social Welfare and Development	**6.4**	**15.5**
Infrastructure	**7.2**	**6.5**
Roads & Bridges	4.6	4.5
Water Supply	**0.9**	**1.1**
Other Structures	**0.7**	**2.1**
Others	**67.8**	**56.1**
Total	**100.0**	**100.0**
Memo item:		
Total PDAF (in million pesos)	**6167.94**	**5322.9**
MDG programs as percent of total PDAF	**22.3**	**34.3**

On the other hand, some of the problem areas in planning and public expenditure management include; (1) unrealistic income estimation, (2) large lump-sum allocations and too much pork in the Annual Investment Program (AIP) and the budget, (3) poor performance targeting and measurement, (4) excessively large fiscal surpluses.

However, earlier studies show that even when incentives facing local governments are inappropriate and even under the most perverse conditions, there is scope for local initiative and for some LGUs to do better than others. Numerous examples of LGU "good practices" are available all over the country, highlighting the possible gains from interventions that aim to build LGU capacity.

At the same time, emerging developments present opportunities that augur well for increasing the flow of resources towards MDG programs and in improving local planning and public expenditure management. First, IRA is now not only automatically released but also automatically appropriated, thereby ensuring its predictability. This situation thus presents an opportunity for LGUs to plan and manage their allocation of resources more effectively and efficiently.

Table 13. Percent Distribution of PDAF Projects Implemented by LGUs

	2003	2005
Education	**1.1**	**1.5**
of which: Elem& HS	0.9	0.4
Health	**1.7**	**1.5**
of which: Basic Health	0.1	0.5
Hospital	1.0	0.3
Philhealth	0.0	0.0
Medical Assistance	0.6	0.6
Social Welfare and Development	**0.4**	**3.3**
Infrastructure	**4.3**	**1.4**
of which: Roads & Bridges	3.0	0.3
Water Supply	**0.7**	**0.6**
Other Structures	**0.8**	**0.3**
Others [1]	**91.1**	**91.3**
Total	**100.0**	**100.0**
Memo item:		
TOTAL PDAF (in million pesos)	**3,382**	**2,347**
MDG programs as percent of total PDAF	**5.7**	**5.7**

[1] Refers to assistance to programs and projects of LGUs which are not specified, e.g., Financial Assistance to Priority Development Programs

Second, in February 2006, the Department of Budget and Management (DBM), Department of Finance (DOF), the Department of Environment and Natural Resources (DENR) and Department of Energy (DOE) issued Joint Circular No. 2006-1 which streamlined the guidelines and procedures for the release of the share of LGUs in national wealth by reducing the documentary requirements for the same from 5 to 2. At the same time, the DBM is doing additional work on to further streamline the process. These reform initiatives are expected not only to expedite but also to increase the release of the LGU share in national wealth.

Third, the BLGF is currently putting in place mechanisms that will support LGUs in improving local revenue generation. In 2006, the BLGF has completed and distributed the updated Local Assessor's Manual so as to enhance real property tax collection. It is set to complete the revision of the Local Treasurers' Manual in 2007, the first such revision since 1954. It has also drafted an amendment of DOF/ Local Finance Circular 1-93 which is aimed at revising the situs of tax rule for banks.

Fourth, the Municipal Development Fund Office (MDFO) has launched recent initiatives that are aimed at improving LGU fiscal performance and at providing support for the MDGs. In 2007 the MDFO established a program-policy lending facility (PROLEND) which will provide provinces with a program loan in support of their policy reform efforts. The MDFO is also preparing a PhP 500 million facility in support of the achievement of the Millennium Development Goals (MDGs). The MDG Fund will be available to finance MDG-related projects of 3rd - 6th income class LGUs.

Fifth, in March 2007, the DBM, DOF, Department of Interior and Local Governments (DILG), and the National Economic and Development Authority (NEDA) issued Joint Memorandum Circular No. 1 – Guidelines on the Harmonization of Local Planning, Investment Programming, Revenue Administration, Budgeting, and Expenditure Management. This circular aims to strengthen the interface between national government agencies and LGUs as well as the complementation between and among all LGU levels in planning, investment programming, revenue administration, budgeting and expenditure management.

Sixth, the NEDA has also completed its Provincial Planning Guidelines for LGUs and is set to provide further assistance to provinces in formulating their Local Development Plans. The NEDA guidelines take the MDGs into consideration, among other concerns.

Seventh, the issuance of the Updated Budget Operations Manual (UBOM) by the Department of Budget and Management in 2006 is a major step towards the improvement of the support mechanisms for local budgeting. The UBOM makes a strong advocacy for a stronger planning-budgeting linkage. It also contains the basic principles which provide the framework for the institutionalization of results-based budgeting through the introduction of the Organizational Performance Indicator Framework (OPIF). Prospectively, there is need to further support its application at the local level.

Given this perspective, the need to continuously intensify awareness and advocate MDGs with LGU officials cannot be over-emphasized. At the same time, there is a need for the national government to be able to leverage LGU spending priorities, especially as they relate to the MDGs, if LGUs are to maximize the gains from these emerging opportunities for greater MGD finance. In this regard, there is a need to explore the benefits of a grant program aimed at ensuring that LGUs provide MDG services that are consistent with minimum service standards of access and quality. The rationale for such a grant program stems from the fact that many of the MDG-related services (e.g., public health and environmental protection) generate externalities, i.e., benefits spillover beyond the boundaries of the local jurisdiction. Also, the central government exhibits a strong interest to achieve an over-riding national level outcome for many of these services because they fall under the ambit of what are referred to as merit goods.

In principle, national standards can be enforced in several ways. One, local governments may be enticed to spend more on a specified service with a matching grant program (McLure and Martinez-Vazquez, 2002). Alternatively, the problem could also be addressed by designing equalization transfers aimed at providing sufficient resources to enable all local governments to provide a basic package of local services (Bird and Smart 2002).

At the same time, there is a need for policy makers to have a good understanding of how to best address the government's equity objectives in a decentralized regime. If poverty alleviation and the provision of social safety nets are viewed as a purely redistributive task, then the basic principles of public finance dictate that their provision is best assigned to the central government. To wit, local governments are constrained by the mobility of the local population in implementing poverty alleviation measures.

In particular, the implementation of poverty alleviation measures by any given LGU will tend to attract the mobile poor from other jurisdictions and drive away the better-off mobile taxpayers. This is so because the higher local tax rates needed to finance poverty alleviation measures at the sub-national level will tend to induce the migration of the better-off mobile taxpayers (Boadway and Wildasin 1984). Thus, a significant part of financing poverty alleviation expenditures will have to be generated by redistributive tax policies at the central level.

However, local governments, in general, tend to enjoy significant information and transaction cost advantages in implementing anti-poverty policies because of their very proximity to local communities. Rao (1995) posits that, in cases like this, it would be desirable to make the local residents to bear a part of the cost of such programs in order to increase the accountability of local governments in the implementation of anti-poverty programs. Thus, the case is made for a cost sharing programs between the central and local government in the implementation of anti-poverty interventions.

5.6. Need for Greater Budget Transparency and Credibility

Tracking actual spending. The discussion in Section 2.3 on data sources for tracking MDG spending and Section 5.3 on how the availability of spending authorization (either in the form of appropriations and allotments) does not always result in actual spending on the MDGs underscore the need for better documentation of budget execution.

Since the budget is the principal tool for articulating and implementing government policy, budget transparency and credibility requires that the composition of actual expenditure should not differ considerably from the original budget. Otherwise, the budget is not a useful statement of policy intent. For purposes of tracking government's commitment to the achievement of the MDGs, Section 2.3 highlights the importance of monitoring not only the <u>total</u> expenditures of the implementing units but also the spending of these units on MDG-related PAPs.

As indicated earlier, both the BESF and the COA Annual Financial Report do not report actual spending at the level of the PAPs. The BESF reports on details of budget execution on the basis of expenditure obligations, disaggregated according to the sectoral distribution of public expenditures. However, the BESF does not report budget execution by PAPs (which is the basic structure of appropriations as found in the GAA). Neither does it include data on actual cash payments/disbursements. On the other hand, while the COA reports contain information on cash disbursements, it does not also document budget execution according to PAPs.

The Statement of Appropriations Allotments, Obligations and Balances (SAAOB) of each agency tracks expenditures on the basis of the budget structure found in the GAA (i.e., PAPs). However, a system that will help DBM consolidate and keep a record of the SAAOBs that are submitted by the agencies is sorely lacking.

Information on expenditure at both the commitment and the payment stage is important for monitoring budget implementation and utilization of funds released. Given the peculiarities of the Philippine budget system, DBM might also consider additional indicators by computing (i) the deviation of obligations for current year's new and automatic appropriations from allotments for current year's new and automatic appropriations, and (ii) the deviation of allotments for current year's new and automatic appropriations from the sum of new and automatic appropriations for the current year, instead of simply lumping together current and continuing expenditures. This kind of analysis is informative in terms of differentiating absorptive capacity problems from purely cash rationing problems.

At the same time, a lot remains to be done in improving the transparency of LGU fiscal data. On the one hand, the BLGF reports on the fiscal operations of LGUs and published these with a lag time of about 18 months from the close of the fiscal year. However, the sectoral dis-aggregation used by BLGF does not easily lend itself to the monitoring of MDG spending of LGUs. Also, the fiscal information reported does not include ex-ante data (i.e., budgeted as opposed to actual expenditure).

On the other hand, the COA consolidates LGU fiscal data with a lag time of 9 months. COA's LGU data cover both revenues and expenditures. The revenue classifications used is similar to that of the BLGF but is more detailed. Prior to the introduction of the NGAS, the COA reported LGU expenditures broken down into both functional and economic categories (with the functional classification hewing closely to the BESF's sectoral classification for the national government and is certainly better than what is found in the BLGF report). With the implementation of the NGAS, the COA now only reports LGU expenditures broken down into economic categories (i.e., PS, MOOE and CO and their various subdivisions). The NGAS no longer requires the SAAOBs to be part of the financial statements (trial balance, etc.) that accountants are required to prepare and submit to COA.[15]

[15] The preparation of the SAAOB is now the responsibility of the local budget officer.

Given this, there is a need for DBM to train local budget officers how to prepare the SAAOBs and then for DBM to consolidate the SAAOBs of LGUs. The functional classification of LGU expenditures currently found in both the BLGF and DBM reports are too aggregated for policy analysis and need urgent improvement. Just restoring the functional classification used by COA prior to NGAS will be a step in the right direction. In fact, it might even be better if COA goes back to consolidating the SAAOBs.

Tracking outputs and outcomes linked to the budget. At the same time, performance reporting of the various agencies, linking agency performance with funding, should also be made available in a more accessible manner to the public. This will help the wider public monitor both spending and results of spending, not just at the broad sectoral level but also at the level of the implementing agencies. Starting with the preparation of the 2007 budget, the DBM has published the OPIF budget document, initially covering the 20 departments of the national government at the level of the Office of the Secretary. For the 2008 budget, the coverage of the said document has been expanded to include all attached agencies as well as the other executive offices. It is envisioned that the OPIF budget document for 2009 will include all of the fiscally autonomous agencies (FAAs) and state universities and colleges (SUCs). This effort needs to be supported until it gets embedded in the budget process and budget documentation not just at the national government level but also at the local level.

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