Philippines – PIDS Webinar on the Review of the 2022 President Budget

Manila, December 9th, 2021

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Thank you President Orbeta, Dr Diokno- Sicat for the invitation to this excellent event and for the insightful analysis, which inspired me the following three discussion points:

1/ fiscal consolidation

2/ fiscal decentralization

3/ fiscal management and information system

1/ Fiscal consolidation supporting the post covid recovery & fiscal sustainability

– based on the analysis by the World Bank's economic team-

- COVID has disrupted public finances and fiscal balances across the world and the Philippines is no exception.
- The government was very proactive in its fiscal response to alleviate the economic and social impact of the pandemic, which was possible thanks to the fiscal buffers built up in previous years.
- But as Justine's presentation shows it led to a significant fiscal deficit, which increased to 9% GDP in 2021 and increase in government debt from 40% in 2019 to 60% by June 2021.
- There is both a numerator and denominator effect requiring a prudent and gradual fiscal consolidation balancing growth, recovery and fiscal sustainability. This seems to be the government's plan with a gradual reduction of the fiscal deficit to 7.5% GDP in 2022 and 5.3% GDP in 2024. While this is way above the pre-COVID deficit target (3.2 percent), it would allow to maintain 5 percent of GDP on infrastructure investment, supporting growth and competitiveness. The challenge is that this plan spans two administrations.
- The question of **timing and length of the fiscal consolidation** plan is indeed key. It needs to be aligned with the economic and political cycles. Initiating fiscal consolidation when the economy starts to recover and at the beginning of the new administration when political capital is highest and so it recreates the fiscal space it needs to deliver its program.
- However, the current high level of uncertainty with the successive waves of covid makes this difficult and will require flexibility.
- The next question is **what type of fiscal consolidation** and finding the right balance between revenue and expenditure measures which are supporting growth while reducing poverty and inequality exacerbated by the pandemic and public health measures.
- **What measures on the revenue side can be considered**? Tax administration reforms to improve collection and voluntary compliance are the most neutral and progressive. They may yield less but more constant revenue gains.

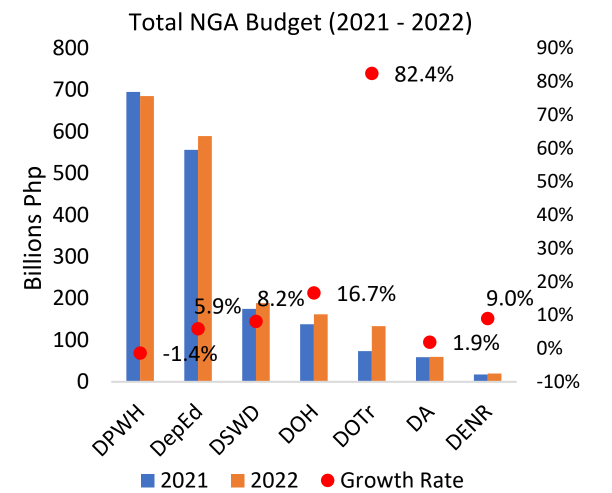
- The Ease of Paying Taxes bill and BIR digital transformation plans are good measures, that need to be expedited to yield the additional revenues when they are most needed. This will also require simplification, business process reengineering, change management.
- The customs modernization project is also expected to yield more revenues.
- The Digital economy tax is another simple, profitable and progressive tax that should be expedited. The House has approved the bill.

- **On the expenditure side,** the proposed focus on capital infrastructure to support economic recovery and competitiveness is welcome. However, to deliver the expected benefits it is important to simplify and strengthen public investment management and the project portfolio to maximize the potential efficiency gains, estimated at 23% according to the last IMF- WB. This particularly true at the **subnational level** where capacity and capital budget execution are lowest (on average 50% based on the estimates of the WB June economic update).

2/ Fiscal decentralization post Mandanas ruling: challenge and opportunities for re-devolution and equity

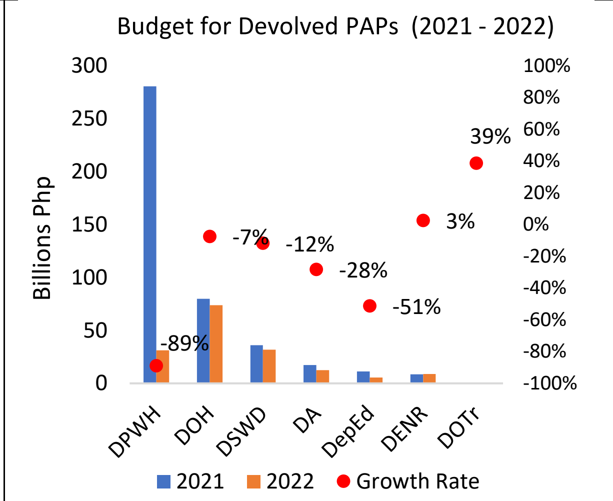
- As Justine's analysis shows, there are important shifts in budget allocations due to COViD but also to the Mandanas ruling.
- It led to a significant increase in IRA allotments 38% (+ 263 bn pesos)
- the 2022 budget also entails cuts in allocations to National Government Agencies' programs to LGUs in order to mitigate the fiscal impact of the Mandanas ruling in a fiscally constrained environment.
- However, the cuts do not seem as abrupt as expected though (eg only - 63 bn in cuts in LGU programs);
- There may also be some reallocations between national programs which still benefit LGUs.
- The agencies devolution transition plans are supposed to specify the functions, funds and personnel to be devolved to what level of LGUs. This is a complex process which requires the detailed costing of the functions, programs and projects to be transferred in order to ensure appropriate funding.
- It is good that the EO 138 foresees a 3 year transition plan. Because the devolution transition plans are still work in progress -from what we have seen so far- and there will likely be a mismatch as the cost of these devolved functions does not inform the level of additional transfers to LGUs (which are based on the Mandanas ruling).
- This is thus likely to exacerbate vertical and horizontal fiscal imbalances in the absence of a revision of the fiscal transfer and equalization rules.

Figure 1. Most NGA budgets will still increase in 2022…



Source: DBM

Figure 2. … while the budget for devolved PAPs will generally decline in 2022.



Source: DBM

- This also raises equity concerns at critical time when COViD has exacerbated poverty and inequality. We would thus recommend the revision of the fiscal transfer and equalization rules.
- In the meantime, these imbalances and equity concerns can be partially addressed through a phased and differentiated redevolution and through the new Growth and Equity Fund (GEF) set up in the 2022 budget.
- I understand from Justine's analysis that this seems to be the case as the poorest LGUs are spared from the budget cuts and the GEF is targeted at the poor and lagging LGUs. Unfortunately the allocation of this Fund is limited and has been halved to 4 bn pesos in the revised budget proposal.
- It will be important to look at how this new Fund is functioning and disbursing, to whom and for what projects, in order to strengthen it and simplify its processes going forward. It is also an opportunity to include performance and accountability criteria/ incentives to ensure these additional resources are spent well and in a transparent manner, building on DILG's seal of good governance.
- This raises another challenge of the limited absorption capacity of many LGUs. Capital expenditures represent overall a high share of spending (25%) and the largest reallocations of spending in the 2022 budget as projects are being devolved to LGUs. This is likely to exacerbate the already low capital budget execution (50% on average)
- It is therefore essential to increase capacity building of LGUs, particularly in public investment management. The 2022 budget does provide increased allocations for LGU capacity building. This can be used to establish public investment management tasks forces at provincial and regional level to support the development and implementation of these essential and increased public investments as ND withdraw.
- EO 138 foresees such an LGU technical assistance and capacity program, which has yet to be designed I understand as it cannot be left solely to national departments and LGUs.

3/ Supporting fiscal management and budget execution through digital transformation & integrated financial management information system (IFMIS)/ BTMS

- **It is great to see that digital transformation of the government is a policy priority in the 2022 budget proposal.**
- **However, it is concerning that** DBM has such a limited allocation (0.4 bn) despite the urgent need for an IFMIS which is at the heart of the digital transformation of public financial management.
- Was it budget considerations that led to the suspension this year of the Budget and Treasury Management System (BTMS) despite the important investments already made?
- BTMS is the core of an IFMIS for the integration, automation and digitalization of public financial management processes including budget formulation, budget execution (e.g. commitment control, cash/debt management, treasury operations) as well as financial accounting and reporting of budgetary transactions.
- **Such an IFMIS is essential for:**
  - **the effective management of the government's macro fiscal aggregates** which are important for ensuring fiscal discipline and sustainability as it helps addresses the current time lag, comprehensiveness, and consistency issues of fiscal data.
  - **to optimize budget allocations/ reallocations based on emerging priorities (eg COVID spending) and actual spending performance,** as it helps integrate the data on budget allocation and actual spending and provides real time and reliable data on budget execution, which is currently a challenge.
  - to **improve the timeliness and cost- efficiency of public spending** through (i) faster budget execution and electronic processing of 4 million financial transactions per year, (ii) digital commitment controls, reducing the risk of payment arrears, which impacts a private sector that is already struggling, and (iii) improved cash management and savings.
  - **enabling the direct electronic fund transfers** to citizens and companies/ vendors, thus reducing transaction costs for both the government and the beneficiaries.
  - **for LGU budget execution and oversight** in view of the increased resources following the Mandanas ruling

  - We therefore highly recommend the resumption of the BTMS roll out and to build on it to develop a full IFMIS which can serve both the national agencies and LGUS, while building the national capacity to maintain the system.