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Government "underspending" in perspective: Incompetence, inertia, or indigestion?

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Government “underspending” in perspective: Incompetence, inertia, or indigestion?

by

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Abstract

The measured underspending over the last 5 years has more to do with ambitious targets rather than apathetic or incompetent bureaucrats: while actual disbursements fell short of planned disbursements by about ten percent per year from 2011 to 2015, real per capita disbursements on capital outlays and maintenance and operating expenses *increased* relative to levels in 1999 to 2010 by an average of 41.6 and 76.8 percent respectively. The bureaucracy was unable to keep up with its own ambitions because of absorptive capacity constraints which were driven in part by the inertia from three decades of maneuvering in tight fiscal space as well as coordination problems and other structural bottlenecks, some of which have long-attended budget and plan design and execution but have not been recognized as binding constraints until now. The fund absorption problem is not uniform across agencies however indicating more fundamental organizational issues in certain sectors, and the need for actions beyond public finance management reforms to optimize the contribution of fiscal spending to inclusive growth.

Government “underspending” in perspective: Incompetence, inertia, or indigestion?

Toby C. Monsod ¹

(Revised December 2016)

I. Motivation

Over the last five years, the national government has been faced with a rather odd, “upside-down” fiscal problem. Actual disbursements by the government have been less than originally planned - and this despite the more-than-adequate “fiscal space” in which to spend. In 2014, cash disbursements by the national government were below programmed levels by about P302.7 billion. This was almost double the shortfall in 2013 (P140.9 billion), four times the shortfall in 2012 (P76.7 billion), and double the shortfall in 2011 (P142.3 billion). In 2015, the shortfall was P390.3 billion, bringing the average underspending per year to about P210.6 billion in nominal terms. About P104.6 billion or roughly 50% of this yearly average was accounted for by less-than-targeted spending in infrastructure and other capital outlays. ²

What is going on and how or when will it be fixed? Some critics have attributed underspending to ‘epic incompetence’ - a product of poor budget preparation and ineptitude of top officials - as well as to ‘apathy’, i.e. “it is a sin not to spend the budget for essential public infrastructure”.³ Others have suggested it is the chilling effect of a COA disallowance or suit, especially after the Supreme Court decisions on the PDAF and DAP. Budget authorities however explain that underspending is largely a function of structural weaknesses within implementing agencies - bottlenecks in program/project execution, project design, and procurement, among others - a fund absorption problem in short. An explanation about bureaucratic bottlenecks is the last thing the general public wants to hear however because it means that the ‘fix’ - particularly for mass transportation and related infrastructure, which are the lightning rods of the debate - may not be quick nor easy.

This essay hopes to provide some clarity on the matter, levelling off on what ‘underspending’ means and why it matters, how much underspending actually occurred, why it occurred, and what actions may be taken moving forward - not just for spending faster but for optimizing the contribution of fiscal spending to inclusive growth. This distinction is important because the link between government disbursements and output growth, much less *inclusive* growth, is not straightforward, and while the level of aggregate spending is important in the very short term (for

¹ Associate Professor, University of the Philippines School of Economics, with support from the Australian Embassy and The Asia Foundation Partnership, as part of an edited volume assessing the Philippine experience with budget reform (forthcoming), as well as from the Ayala Corporation-UPSE Economic Forum. An earlier version was presented at the 23 June 2016 Ayala-UPSE forum. Any errors, omissions, or flaws in analyses are mine alone.

² Yearly disbursement shortfalls are computed from raw data on originally programmed (BESF) and actual (BTr-Treasury) disbursements by object from DBM. The same data is also presented in published the year-end DBCC reports available at http://www.dbm.gov.ph/?page_id=8980

³ Diokno, B., August 2015 and April 2016. See <http://www.rappler.com/business/economy-watch/101830-government-underspending-benjamin-diokno> and <http://www.bworldonline.com/content.php?section=Opinion&title=underspending-a-bad-habit-that&8217s-hard-to-break&id=126262>

macroeconomic stabilization), it is less so in the longer term where improving efficiency, expanding productive capacity, and promoting equity are the larger concerns.

II. What is meant by “underspending” and why does it matter?

Government spending occurs at national and local levels. Spending at the national level is by departments and other executive offices (NGAs), state universities and colleges (SUCs), and government-owned or –controlled corporations (GOCCs), as well as by Congress, the Judiciary and other constitutional offices. National government (NG) spending also includes payments to creditors and releases to local government units (LGUs) of their share in national taxes and other transfers. Spending at the local level is by LGUs - provinces, cities, municipalities and barangays - and is financed by both transfers from the national government and own-source revenues. In the aggregate, roughly 64% of total LGU income for all LGUs combined was sourced from the national government in the form of IRA and shares in other taxes and grants, while 36% was from own-source-revenue.⁴

The ‘underspending’ issue as currently debated has to do with spending by the **national government**. In July of every year, the President proposes a national budget to Congress – which includes, among others, a **budget of expenditures and sources of finance** (BESF) and a **national expenditure program** (NEP) - that is intended to support program and policy priorities for the succeeding year. The BESF includes, among others, macroeconomic assumptions (GDP, inflation, forex, interest rates, etc.), a national government fiscal program (formerly, ‘public resource budget’, with estimated revenues, disbursements, deficit projections, and financing program), and sectoral, regional and agency expenditure priorities. While the national government fiscal program is basically a **cash** budget⁵, the expenditure program, is presented on an **obligation** basis, meaning, it details the maximum amounts the national government can legally contract for the delivery of goods and services in a given budget year. It also indicates which obligations require **new general appropriations** and which are already covered by **automatic appropriations** (automatically approved by existing laws) or **continuing appropriations** (appropriations from the previous year which are not yet obligated), although the latter is typically not known until the year-end. Congress is not permitted to increase the overall level of the proposed expenditure program but can reassign resources across programs within it. By enacting a general appropriations act (GAA), Congress authorizes the payment of goods and services out of government funds under specified conditions for specified purposes.

Given the GAA, and based on total available appropriations, DBM releases **allotments** on which basis agencies can incur obligations to pay personnel, contractors, suppliers or other providers of goods and service either immediately or in the future; appropriations for personnel services (PS) and maintenance and other operating expenses (MOOE) should be obligated in the same year but appropriations for capital outlays (CO) are valid for two years. To a large extent, the release of

⁴ DILG 2015. For 2012-2013. From 1994 to 2011, the proportions were 67% to 33%.

⁵ Defined in the BESF as “aggregate of revenues, borrowings and disbursement of the national government showing the cash deficit”, and reflecting the estimated “actual deposits and withdrawals of cash by the national government agencies to the Bureau of the Treasury.”

allotments is driven by the government's ability to attain its revenue target (i.e. to keep the fiscal deficit in check). Since 2014, the GAA itself has been the allotment release document, such that all funds, excepting items that remain in lump sums (e.g. calamity funds, special purpose funds) or items which have been identified for conditional implementation, are comprehensively released immediately (i.e. in January). From 2014 to 2016, up to 86 percent or so was comprehensively released. The balance is released later, through Special Allotment Release Orders, upon submission of pre-requisite documentation.

The BESF also includes one schedule detailing national **cash disbursements** by object (PS, MOOE, CO). Thus, the DBM also releases cash disbursement (Notice of Cash Allocation or NCA) and other disbursement authorities ⁶ to agencies during the year. Releases of NCAs are based on a monthly cash program and other budget execution documents submitted by agencies before the year begins (e.g. November) as well as the overall cash position of government. The cash program may also cover accounts payable of preceding years (obligations made in prior years but payable in the current year). During budget execution, actual cash disbursements are monitored closely by the Development Budget Coordinating Council (DBCC) keeping an eye on revenue performance and the fiscal balance, and a revision of the cash disbursement program is typically made at mid-year.

Technically then, national government spending performance can be reckoned on either an **obligation basis** or a **cash basis**. The former can be measured using two indices: the 'appropriation utilization index' (or API, aka the 'obligation rate'), defined as obligations incurred/total available appropriations x 100%, and the 'allotment utilization index' (or AUI), defined as obligations incurred/allotments x 100%. ⁷ The latter can be measured using a 'disbursement rate' (or DR), defined as cash allocation disbursed/cash allocation released x 100% (DBM 2016). The obligation-based indices indicate *how fast an agency has rolled out the programs and projects it is mandated to implement*, while the cash-based disbursement rate, *how fast an agency uses the cash it receives from the Treasury* (ibid).

Confusion arises because these measures are not directly comparable and will, moreover, give a biased picture in favor of agencies with relatively less CO outlays. They are not directly comparable because (i) the base for reported obligations and allotments is total available appropriations for the current year while the base for cash allocations disbursed/released includes previous year's accounts

⁶ Non-NCA authorizations include tax remittance advice for withholding taxes (TRA) and the non-cash availment authority (NCAA) which also pay for obligations. Amounts covered by these non-NCA authorizations are included in appropriations.

⁷ Both terms are coined in Manasan and Mercado 2001. Because agency obligations are constrained by the allotments released to them (which is, in turn determined by how fiscal authorities prioritize programs based on available funds during the), the allotment utilization index may be a more accurate measure of agency performance. The allotment utilization index is also called the 'budget utilization rate' by the DBM (DBM 2016), which can be confusing since a differently defined Budget Utilization Rate (BUR), i.e. cash disbursements (as reported by government servicing banks) against actual obligations (based on Statement of Allotments, Obligation and Balances or SAOB), is supposed to be used by the NEDA Infrastructure Secretariat in prioritizing proposals in the three-year rolling infrastructure program (TRIP).

payable (e.g. for obligations incurred last year but payable this year), and (ii) disbursements depend on additional exogenous factors. For instance, disbursements are significantly affected by supplier/contractor performance, the timeliness of billings by suppliers/contractors, or the encashment of payments by them, factors which do not affect obligation rates. In other words, obligations may have already triggered economic activity even if no disbursements have been recorded. Agency-level disbursement rates may also be affected by unexpected or late changes in the assignment of cash authorities by DBM from one agency to another (e.g. from Deped to DPWH for school buildings in the second semester of the year). Table 1 which presents the API, AUI and DR for the four years where relevant data is available at the agency level (2012-2015), demonstrates how weakly correlated the measures can be.

All indices will also be biased in favor of agencies which have relatively greater shares of PS and MOOE relative to agencies with relatively greater shares of CO outlays. This is because infrastructure outlays have longer gestation and execution periods on average (for which reason Congress allows two years for CO to be obligated). This is illustrated in Table 2 which shows how, for one index, PS and MOOE expenditure rates are higher than CO by 28 and 11 percentage points for the years 2011 to 2015. Holding all other factors fixed, agencies with relatively higher PS and MOOE shares will log in as the better performers.

Table 1. Correlations between obligation-based and cash-based measures of expenditure performance, for 22 departments* , 2012-2015

	API vs. AUI	API vs. DR	AUI vs. DR
2012	0.99	-0.19	-0.20
2013	0.75	-0.21	-0.04
2014	0.98	0.38	0.37
2015	0.98	0.58	0.58

Source: DBM; * excludes offices of the President and Vice-President
API, Appropriations utilization index; AUI, allotment utilization index; DR, disbursement rate

Table 2. Aggregate AUI by object for 22 departments, 2011 - 2015

Year	Allotments (000s)	Share in Allotments			AUI			
		PS	MOOE	CO	PS	MOOE	CO	Total
2011	978,806	0.48	0.25	0.27	1.00	0.81	0.63	0.85
2012	1,137,649	0.46	0.24	0.30	0.92	0.78	0.66	0.81
2013	1,266,786	0.45	0.25	0.30	0.99	0.84	0.81	0.90
2014	1,380,148	0.44	0.27	0.30	0.98	0.80	0.64	0.83
2015	1,734,065	0.37	0.26	0.37	0.98	0.77	0.70	0.82
Average		0.44	0.25	0.31	0.97	0.80	0.69	0.84

Base data: DBM Statement of Allotments, Obligations and Balances 2011-2015

The point is, it matters which measure is chosen and for what purpose. Government spending is important in the very short term (particularly in a downturn) for macroeconomic stabilization, “which is solvable through larger or smaller doses of public spending” (de Dios 2011). But in the longer term, aggregate disbursements *per se* are far less important than how resources are used to increase efficiency, expand the productive capacity of the economy, and promote equity. In fact, contrary to what is popularly thought, the link between government disbursements and output growth, much less **inclusive** growth, is not straightforward.⁸ Consequently, if the real, underlying concern in this discussion is the allocative, distributive, or administrative efficiency of public spending, then aggregate disbursement rates and, relatedly, budget deficits and deficit-to-GDP ratios, are not particularly relevant as indicators. Instead, drilling down and identifying unobligated amounts and undisbursed amounts by agency and program/activity/project would be more telling.

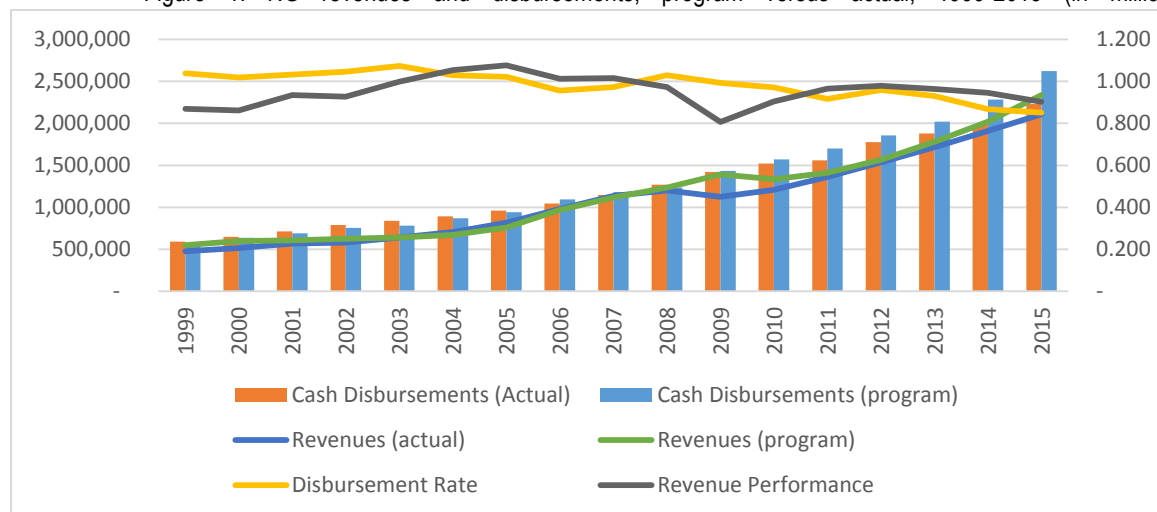
Unfortunately, this debate has revolved around aggregate disbursement rates, and the information required to look deeper is not readily available. But even when aggregate measures are employed, it turns out that in real per capita terms the national government has spent more over the last five years than it did for the twelve years prior. This is discussed in the next section.

III. To what extent did underspending occur?

Figure 1 presents aggregate levels of revenues and disbursements over the period 1999 to 2015. The figure shows that while national government disbursements have increased over time, disbursement performance has been on a continuous downward trend since 2009. In particular, the ratio of actual to programmed disbursements has been less than one – 0.992 in 2009 which declined to 0.851 in 2015 - indicating under-performance (a ratio of > 1.0 would indicate over-performance). The under-performance from 2011 to 2015 was also more acute than the under-performance recorded in 2006 to 2007 or 2009 to 2010, by 6 and 8 percentage points respectively (average of 0.905 in 2011 to 2015 versus 0.964 in 2006 to 2007 and 0.981 in 2009 and 2010). This despite the fact that the latter two periods were crisis years.

⁸ The economic analysis of the effects of fiscal policy typically employs on what is known as the fiscal multiplier, defined as the ratio of the change in output (ΔY) to a discretionary change in government spending (ΔG) or tax revenue (ΔT). A fiscal spending multiplier of 0.5 means that a P1 increase in government spending leads to a P0.5 peso increase in GDP. However, multiplier research indicates that ‘there is no single multiplier that can be applied mechanically to all situations’ (Wilson 2012). That is, the impact of fiscal policy changes will depend on the type of changes in question as well as the environment in which changes are implemented, e.g. if discretionary increases in spending involve investment or other types of spending, how quickly changes are implemented, whether changes are anticipated before they are authorized, how changes are to be financed, whether expectations of future government spending and taxes are affected, whether monetary policy counteracts or complements fiscal policy, the degree of trade openness, the state of the business cycle, i.e. effects are more positive on the downturn.

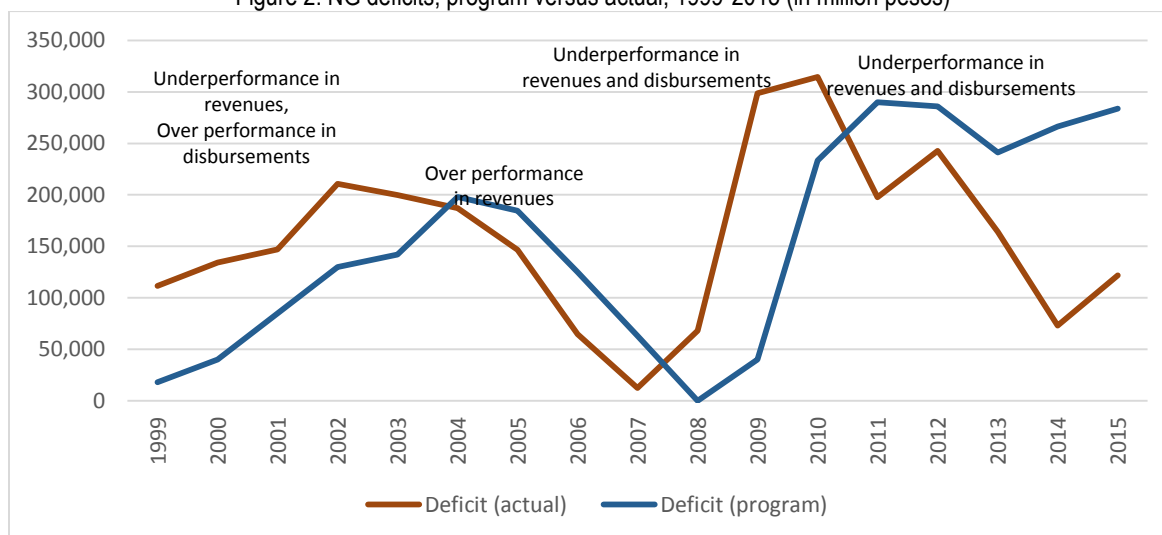
Figure 1. NG revenues and disbursements, program versus actual, 1999-2015 (in million pesos)



Base data: DBM

As an aside, Figure 2 shows the same base data but highlights the trend in the NG deficit. Note that the neither the sign nor size of the deficit per se indicates whether disbursements or revenues are under- or over- performing. Deficits were greater than planned in two periods – 1999 to 2003 and 2008 to 2010 – at the same time that disbursements were either over- or under-performing. Deficits were also smaller than planned in two periods – 2004 to 2007 and 2011 to 2015 – at the same time revenues were over- then under-performing. Again the point is, **unless the problem is one of macroeconomic stabilization, neither a deficit nor deficit-to-GDP benchmark may be particularly useful**. These statistics are very blunt indicators for gauging whether the level, much less the allocation and quality of government expenditures, are optimal or not.

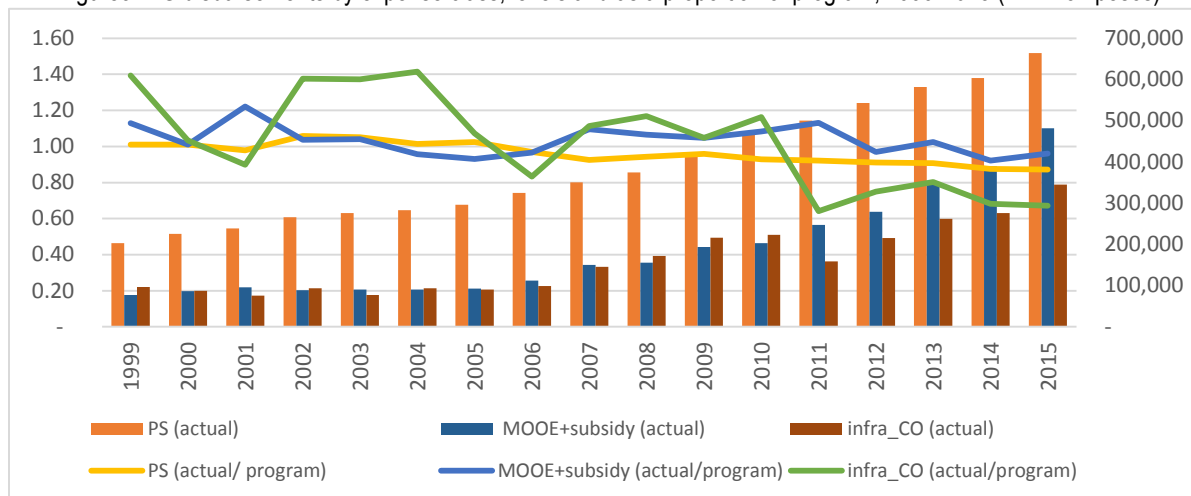
Figure 2. NG deficits, program versus actual, 1999-2015 (in million pesos)



Base data: DBM

Figure 3 shows spending ratios by expense class – PS, MOOE + Subsidy, and Infrastructure and other CO – and a decreasing trend from 2011 onwards. Relative to the disbursement ratios for PS and MOOE, the ratios for Infrastructure and other CO fluctuated quite wildly, both over- and under-performing sharply. Note that the graph also indicates that infrastructure spending has over-performed more than it has underperformed - over-performing in all periods except for 2001, 2006 to 2007, and 2011 to 2015. This gives the impression that infrastructure became a problem only in the last 5 years.

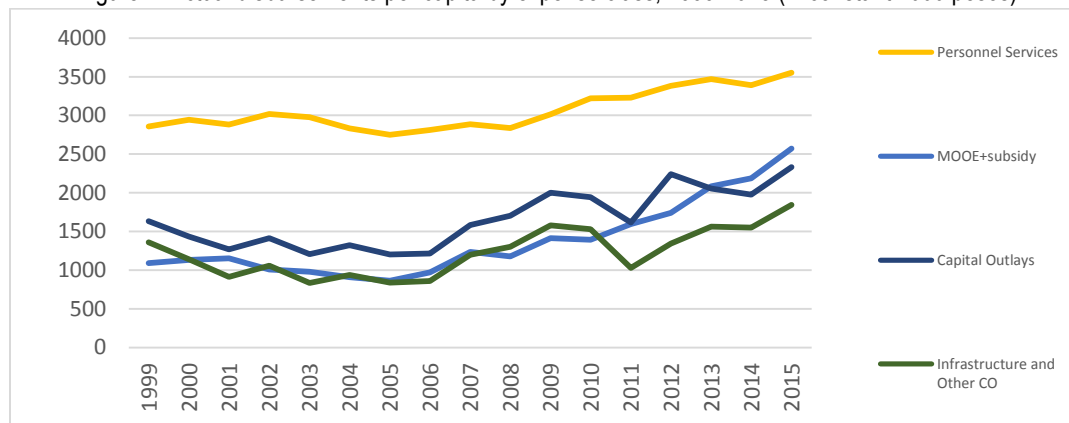
Figure3. NG disbursements by expense class, levels and as a proportion of program, 1999-2015 (in million pesos)



Base data: DBM

That impression would be inaccurate however which Figure 4 depicts. Real per capita infrastructure disbursements slid after 1999, recovered its 1999 levels in 2008, dipped sharply again in 2011, and has grown since. On average per year, real per capita disbursements on infrastructure and other CO were 41.6 percent higher during the years from 2011 to 2015 than they were from 1999 to 2010 (Table 4). Average annual real per capita disbursements on MOOE and PS were likewise 76.8 percent and 12.8 percent higher respectively.

Figure 4. Actual disbursements per capita by expense class, 1999-2015 (in constant 2000 pesos)



Base data: DBM

Table 4 Average annual disbursements by expense class, 1999-2010 vs. 2011-2015, in constant 2000 pesos

	Real levels			Real per capita		
	PS	MOOE, subsidy	Infra, other CO	PS	MOOE, subsidy	Infra, other CO
I: 1999-2010	250,411.0	95,820.2	94,540.2	2,972.1	1,132.9	1,118.9
II: 2011-2015	328,721	197,048	156,143	3,354	2,003	1,584
% change, period I to II	31.3	105.6	65.2	12.8	76.8	41.6
<i>Memo: expenditures on an obligation basis</i>						
I: 1999-2010	250,943.5	117,685.5	84,118.2	2,983.9	1,380.1	992.2
II: 2011-2014*	332,430.4	198,095.2	168,600.5	3,423.7	2,039.8	1,729.1
% change, period I to II	32.5	68.3	100.4	14.7	47.8	74.3

Base data: DBM, using implicit price indices for GFCE and Capital Formation

* Figures for *actual* 2015 obligations not yet available

In short, reckoned against planned levels of disbursements, *there has been underspending* of about 10 percent per year on average from 2011 to 2015. However, reckoned against previous levels of real per capita disbursements from 1999 to 2010, *there has been no underspending*. In particular, infrastructure/CO and MOOE disbursements have increased by an average of 41.6 and 76.8 percent respectively. How does one reconcile the latter with the former? Over the period 2011 to 2015, planned or targeted disbursements increased at a much faster rate than actual disbursements.

The upshot: it may be ambition rather than incompetence that explains the 2011 to 2015 underspending at the aggregate level (although pockets of ineptitude may of course exist across the bureaucracy). And while over-targeting may have opportunity costs (e.g. to the extent that government borrows money for planned disbursements that do not materialize), ambition in itself is not unwelcome. But then this begs the question: why is the bureaucracy, despite the absence of budget constraints, unable to realize its own ambitions?

IV. Why was the bureaucracy unable to keep up with its own ambitions?

In medicine, there is a condition known as the “refeeding syndrome,”⁹ “a potentially fatal condition, caused by rapid initiation of refeeding after a period of undernutrition.” This happens when a starving person is fed too aggressively and occurs because the body has already adapted to starvation. If the body is fed too many calories and too much fluid from the get-go, fluid and electrolyte imbalances and nutrient deficiencies can occur, leading to serious complications, including heart problems, breathing problems, impaired mental status, seizures, paralysis, insulin problems, even death.¹⁰

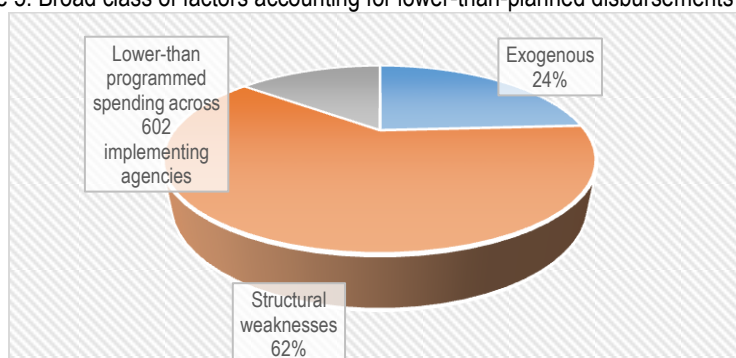
⁹ With thanks to Dr. Orville Solon who suggested the analogy.

¹⁰ “... It is most important for anyone who was starved for several days to resist the urge to eat and drink large amounts of food or liquid.” (<http://www.nutrition411.com/content/refeeding-syndrome-0>)

One must wonder where something similar might not explain what has been observed among some agencies. After three decades of maneuvering in very tight fiscal space - e.g. massive fiscal restructuring in the 1980s and 1990s; the imposition of mandatory reserves, austerity measures, economy measures, cash management measures in 1997-1999; economy measures again in the early 2000s and in 2008 - an inertia-laden bureaucracy may have been ill-prepared for the sudden permission and pressure to spend. Protocols, procedures, organizations and people, designed for or accustomed to different times, adjusted but not fast enough, giving rise to an acute fund absorption problem.

“Absorptive capacity” was the diagnosis of the DBM after consultations with the 13 agencies and corporations with the lowest disbursement rates and highest undisbursed amounts in 2014.¹¹ After tracing where and why allotments were not moving, it turned out that a huge chunk - 61.5 percent – could be accounted for what was called ‘structural’ bottlenecks (Figure 5 and Table 5). This could be broken down into project execution issues (25.9 percent), planning/design and pre-execution difficulties (13.5 percent), procurement difficulties (6.9 percent), and factors that had not yet been identified by major departments but likely to be among these categories (15.3 percent). Another 14.4 percent had to do with small amounts across the 600 or so implementing agencies (e.g. 547 SUCs, 32 OEOs), leaving a balance of 24.1 percent attributed to exogenous factors, both positive and negative, such as savings on interest payments, the chilling effect of the Supreme Court rulings on PDAF/DAP, peace and order issues, and weather problems.

Figure 5: Broad class of factors accounting for lower-than-planned disbursements in 2014



¹¹ This paragraph and the next three (e.g. examples of bottlenecks) draw heavily from various years’ “Assessment of National Government Disbursement Performance” found on the DBM website (http://www.dbm.gov.ph/?page_id=8980) as well as other documents provided by fiscal planning and reforms bureau of DBM.

Table 5 Share of factors accounting for undisbursed allotments in 2014 (percentage to total undisbursed)

A. Structural weaknesses	61.5		
		Execution issues	25.9
		Planning, design, pre-execution issues	13.5
		Procurement difficulties	6.8
		Still be to classified/accounted for by major departments	15.3
B. Other amounts spread out across 602 implementing agencies	14.4		
C Exogenous Factors	24.1		
		Savings on interest payments, net lending	14.2
		Deferred	0.8
		Chilling effect of Supreme Court decisions on PDAF and DAP	1.0
		Weather, Peace and Order, Delays from higher authorities	8.1

Base data: DBM

Some examples of bottlenecks¹²:

- **In the planning, design and pre-execution stages:** delays in the submission of pre-requisite documentation and other requirements for allotment release, such as geo-tagged photos for the national greening program; master plan for the provision of agricultural equipment and facilities across the country; pre-requisites for the basic educational facilities program and farm-to-market roads; DPWH certifications of LGU capacity to implement projects. Revisions in program design and program deferments are also examples, accounting for chunks of undisbursed funds (e.g. P4 Billion due to the redesign of AFP/PNP housing, P 5.1 billion due to the postponement of the Expanded CCT program till mid-year.)
- **In project execution,** accounting for up to 34.7 percent if procurement-related bottlenecks are included: coordination problems primarily, such as problems relating to securing clearances and permits from other agencies - e.g. agency/LGU clearances for housing and infrastructure projects, BIR clearances for contractors, BIR rulings on tax questions - or program coordination issues between partner agencies - e.g. DPWH and DA for the construction of farm to market roads, DPWH and Deped for the construction of school buildings; DILG and LGUs, which also involves COA rules as they concern unliquidated cash advances dating back

¹² Draws heavily from various years' "Assessment of National Government Disbursement Performance" and other documents provided by DBM.

more than 5 or 10 years; TESDA and its own regional offices. Other examples: unresolved RROW problems, delayed billings and documentation by suppliers/contractors, and the other problems attendant to DPWH projects.

- **In procurement:** on the demand side, delays in the finalization of requisite documents (e.g. for PPP projects, for textbooks and other instructional materials content), changes in technical specifications, and delays in the evaluation of bids. On the supply side, delayed submission of bidding requirements, non-compliant technical/financial proposals, or simply, no submissions. There are, in short, weak capacities on both the demand (weak technical and management capacity of implementing agencies) and supply (limited number of interested or qualified bidders) sides. Procurement difficulties were common among key agencies (e.g. DepEd DOH, DA, DILG, DPWH, DOTC, NHA)

It should be noted that savings on interest payments is not a bottleneck but a ‘happy’ problem and accounted for the second largest portion of undisbursed allotments at 14.2 percent. Also worthy of note is the surprisingly *small* contribution of the “chilling effect” of the PDAF/DAP decisions: as self-reported by agencies, it accounted for only 1 percent of undisbursed allotments. It is possible however that the PDAF/DAP decisions did not introduce new behavior (or new bottlenecks) but aggravated existing ones. For instance, procurement-related bottlenecks could have been magnified after the PDAF/DAP fallout.

Focusing on items A and B of Table 5 and classifying loosely by origin or location, bottlenecks related to weak coordination and capacity among and between national government agencies and corporations accounted for about 75 percent of undisbursed allotments, while bottlenecks related to LGUs and their capacities accounted for 10 percent (Table 6 and Figure 6). There is no way to know whether this 10 percent is “too large” or “too small” but it certainly opens up the interesting question of whether more national government funds may be spent faster or better by local governments in the longer run.¹³

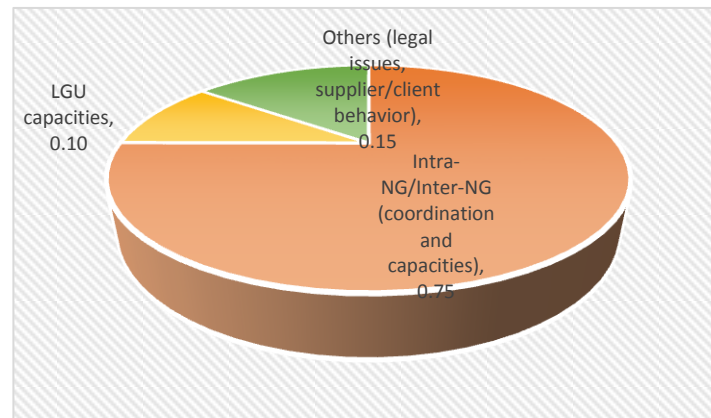
Table 6. Location of bottlenecks (Table 5, A and B) by ‘locus of control’

	Share to total undisbursed amount
Within NG/Inter-NG (e.g. coordination, capacities)	0.75
LGU (capacities)	0.10
Others (Legal issues, supplier/client behavior)	0.15

Base data: Table 5, Authors classification.

¹³ In 2014, the share of LGUs in national government disbursements was about 17 percent compared to the 60 percent that went to national government agencies and the 6 percent to GOCCs. One could say that the coordination and capacity problems accounted for by LGUs in total undisbursed allotments was proportionately less than their share in total national government disbursements.

Figure 6. Classification of structural weaknesses by locus of control



The fact of ‘bottlenecks’ is not new however. Many clients, suppliers and partners of government are familiar with them, having experienced them in some form - the ubiquitous ‘red tape’ for instance - although not many may appreciate that bottlenecks are more structural and less transactional in nature, embedded deeply in the design of organizations and processes. Bottlenecks have also figured more significantly in headline events than is popularly known. For instance, in the long-delayed Typhoon Yolanda rehabilitation program, still ongoing. In this case, it took nine months, from November 2013 to August 2014, for national agencies to submit a comprehensive rehabilitation and recovery plan (CRRP) to the President and another two months for that plan to be approved - this despite the fact that affected provinces and regional offices had mobilized and put forth plans much earlier (e.g. NEDA/RDRRMC Region VI by December 2013; NEDA/RDC region VIII by March 2014).¹⁴ Once approved, local partners and proponents had to wait another few months for clarity about implementing mechanisms, including how funds were to be released, as well as for a detailed listing of what programs/activities/projects per province were actually approved for funding.

Contrary to what may have been assumed however, the problem was not incompetence nor corruption but rather a national government who, accustomed to agency-led planning and budgeting, was unable to adapt itself to province-and region-led plans, leading to multiple layers of recovery plans, confusion and delays -

“....multiple layers of planning were not deliberated ex-ante, but were borne by the [national] government's improvisation of the process, as they tried to meet the demands of Congress for inputs to the budget, post-disaster assessment as mandated by law, and the need for sectoral, regional and local plan to confirm priority and establish transparency in the process.” (GFDRR et. al. 2015: 19).

¹⁴ NEDA VI. 2 December 2013. Western Visayas Rehabilitation and Recovery Plan (Aftermath of Typhoon Yolanda) https://drive.google.com/folderview?id=0B7LBwu5bszYyaUhSQUNXYW1LT1E&usp=drive_web

Confusion spilled over to implementation, described as “saddled by weakened capacities of implementing agencies, absence of ex-ante implementation mechanisms and tools, and delays in addressing bottlenecks that arose during implementation.” (Ibid: 24). To date, the ‘resettlement’ component of the CRRP, which was the single largest component (comprising about 45 percent of total outlay) and arguably the most urgent, has a completion rate of only 14.6 percent (about 30,000 housing units completed out of a targeted 205,000) and an occupancy rate of just 8 percent (2,500 units out of the 30,000 completed).¹⁵ Poor performance of the resettlement component continues to be attributed to “bureaucratic red tape”¹⁶

While not new, this is probably the first time bottlenecks have been collectively recognized by fiscal authorities and associated with some quantitative measure – in this case, lower than planned, or delayed, spending by national government instrumentalities. Fiscal crises of past years were characterized by binding constraints on the revenue side and not on the spending side – and so bottlenecks in budget (and plan) execution never demanded attention. Now they do.

Interestingly, the data shows that the depth or intensity of the absorption problem is not uniform across agencies; some agencies are struggling more than others. Annex A presents the API of selected agencies from 1992 to 2015 using actual obligations and total available appropriations for each year.¹⁷ Focusing on the years from 2011 and 2015, it appears that DOH was able to adapt better than DA (Annex figures A.1 and A. 2), increasing its absorptive capacity by 10 percent while receiving 90 percent more appropriations since 2011. In contrast, DA’s absorptive capacity initially surged with its new funds but then dipped; absorptive capacity then recovered in 2015 but with lower levels of appropriations than in 2013 or 2014. Other agencies which appear to have been overstretched are DepEd, DENR and DSWD (Annex figures A.3 to A.5). DTI and DILG, after initially sliding, may have found new footing (Annex figures A.6 and A.7). DOE does not look like it has been able to absorb much at all (Annex figure A.8).

DPWH and DOTC make for an interesting pair for comparison (Figures 7 and 8 below).¹⁸ Both received sharp increases in appropriations since 2011, with DPWH’s appropriations growing by 117 percent and DOTCs by 109 percent. However DOTCs absorptive capacity fell by 23 percentage points while DPWHs rose by 18 percentage points over the same period. Project bottlenecks *per se* cannot explain this wide difference as both agencies were equally prone to them (e.g. coordination problems with partner agencies, right of way problems, late billings and incomplete documentation

¹⁵ Yolanda Updates, October 2016, <http://yolanda.neda.gov.ph/reports/yolanda-updates/>

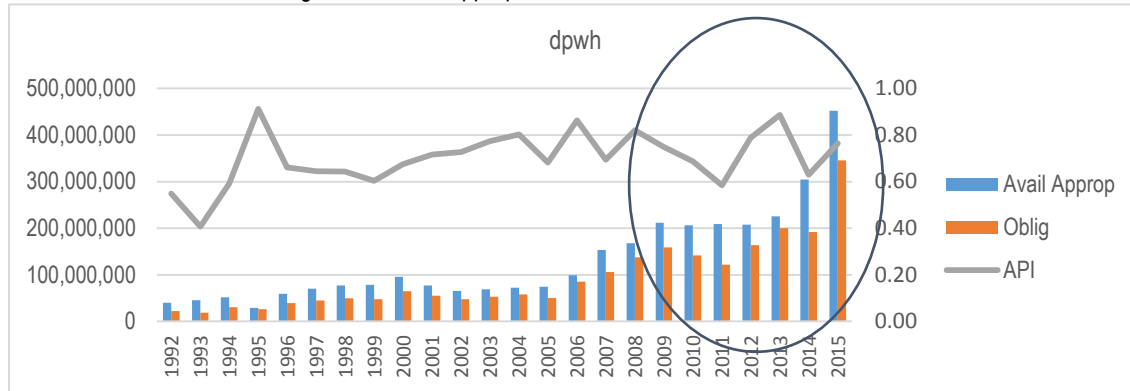
¹⁶ “The problem is very common in most of the areas. It’s really bureaucratic red tape.” <http://www.philstar.com/nation/2016/09/18/1624843/robredo-only-1-houses-yolanda-victims-completed>.

¹⁷ The “actual” amounts for each year are presented in the National Expenditure Program two years ex-post. That is, the NEP in year X lists the “actual” appropriations and obligations for year X-2, the “adjusted” appropriations and obligations for year X-1, and the “proposed” appropriations and obligations for year X.

¹⁸ DOTC became the Department of Transportation (or DOTr) after the creation of a Department of ICT in May 2016 through R.A. 10844. This meant the transfer of internal operating units with functions and responsibilities dealing with communication out of DOTC. The budgets of these units cannot be disaggregated from the Office of the DOTC Secretary however but are likely not to have any material impact on utilization trends.

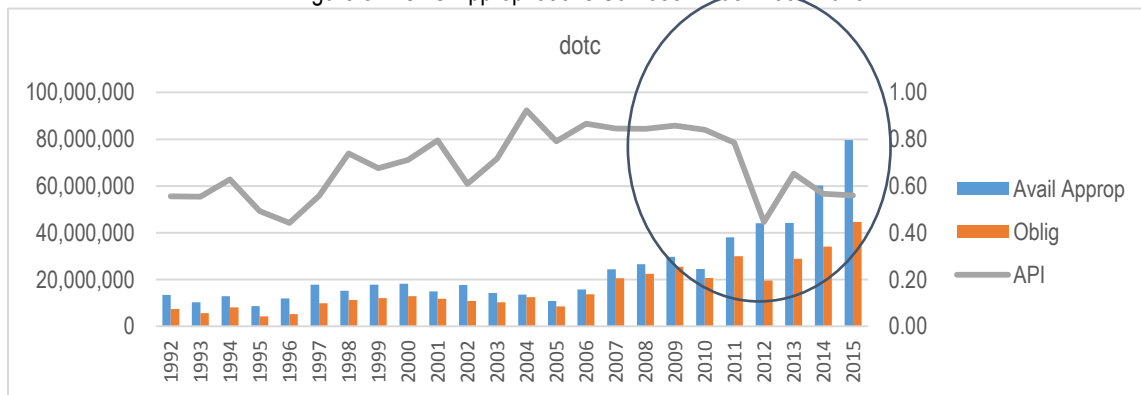
by contractors at DPWH, PPP procurement issues at DOTC.) Neither are ‘quality of top leadership’ or ‘greater complexity of mass transport projects’ (relative to roads) - while contributory - particularly satisfying explanations.

Figure 7. DPWH Appropriations Utilization Index, 1992- 2015



Source Author's computation from the National Expenditure Program 1994-2016

Figure 8. DOTC Appropriations Utilization Index 1992-2015



Source Author's computation from the National Expenditure Program 1994-2016

What could be important is the fact that there are fundamental differences in the way the two agencies are organized despite similarities in their operational portfolios. Both agencies are involved in the development of transportation infrastructure - DPWH is the State's engineering and construction arm responsible for national highways, flood control, water resources development and other public works while DOTC is the “primary policy, planning, programming, coordinating, implementing and administrative entity of the Executive branch in the promotion, development and regulation of dependable and coordinated networks of transportation and communications systems” (E.O. 292, series of 1987). However, DPWH has roughly 10,000 engineers, 303 of which are in key positions, while DOTCs has 26; and the DPWH Secretary has full control over what appears to be horizontally integrated full service agency, comprising “five (5) bureaus, six (6) services, 16 regional offices, 24 project management offices, 16 regional equipment services and 118 district engineering offices”,¹⁹ while the DOTC Secretary does not. Instead the DOTC Secretary presides over what some

¹⁹ By virtue of EO 124, s. of 1987. See http://www.dpwh.gov.ph/about_us/brief_history.htm

have called ‘a collection of fiefdoms’: three sectoral agencies (which have their own regional offices or districts), one project management office and sixteen agencies/corporations which are only laterally “attached” to the department for purposes of policy coordination and general supervision but not control (Annex B).

If differences in organizational design and organic capacity explain the contrasting performances of the two agencies, then an argument could be made for either (i) scaling down the operational portfolio, e.g. infrastructure development, of the DOCT to better align it with the department’s organic capacity,²⁰ or (ii) scaling up the organization and powers of DOCT to better align it with its current portfolio. However, these differences bring up a larger question concerning the sector as a whole: **Are the differences in organization and capacity material to the degree of complementarity and interoperability that has been (or not been) achieved in the sector?** If they are, then there is an even stronger argument for (iii) revisiting the functions and form of both agencies and reconfigure them in tandem so that the objectives of the sector can be advanced.

V. Optimizing the contribution of fiscal spending to inclusive growth

In recent years, budget authorities have begun to re-engineer budget execution processes in order to accelerate disbursements. Apart from the ‘GAA-as-release-document’ which was an important first step, a few nudges have gone a long way.²¹ For instance, allowing national agencies to start procurement early, i.e. in August for projects scheduled the following year, so that bidding is implementation-ready as soon as appropriations are available; the issuance of AO 46 (2015) which requires national government agencies and corporations to, among others, assign full time support staff to the Bidding and Award Committees (BACs), hire more procurement personnel, create more BACs and create a full-time delivery unit, led by an Undersecretary; the review of the implementing rules of the Procurement Law for provisions that are unnecessarily tedious, e.g. the need for a contractor to obtain BIR clearance twice.²² A new law was also proposed and enacted - Republic Act 10752, An Act Facilitating the Acquisition of ROW Site or Location for National Government Infrastructure Projects, signed on March 7, 2016 - which seeks to ensure that “owners or real property acquired for national government infrastructure projects are promptly paid just

²⁰ Infrastructure development per se is not specified in E.O 292 for DOTC, although it is mandated to operate services in areas “where private initiatives are inadequate or non-existent”. The DOTC asserts that infrastructure development is one of its four functions however, along with policy formulation, industry/services regulation, and international cooperation. See <http://www.dotc.gov.ph/index.php/2014-09-02-05-01-41>

²¹ Where the General Appropriations Act (GAA) serves as the primary fund release document, i.e. “appropriations” or budget of agencies - except for those included in a negative list - are considered released as allotments when the GAA takes effect. This began in 2014 and was instituted to fast track spending and program delivery. See <http://www.dbm.gov.ph/?p=6941>

²² But as observed by former DPWH Secretary Rogelio Singson “We have 13,000 projects nationwide, all needing BIR clearance. How many BIR offices are there than can issue BIR clearance?” (23 June 2016 Ayala-UPSE Economic Forum)

compensation for the expeditious acquisition of the required ROW for the projects”.²³ The law is expected to “address the substantial delays that right of way issues have caused for vital infrastructure projects across the country in the past.”²⁴

Innovations like these may have contributed to the 9.4 percent growth of government final consumption expenditures in 2015, compared to 2014’s growth of 1.7 percent, and to the 20.6 percent growth of public construction in 2015 from 6.3 percent in 2014. That said, growth in gross value added in construction *fell* from 9.9 percent in 2014 to 8.9 percent in 2015 (along with private construction which fell from 12.1 to 5.4 percent), just as GDP itself fell from 6.1 percent in 2014 to 5.8 percent in 2015 – demonstrating the earlier point that an increased level or faster pace of public spending does not necessarily translate to faster output growth (and much less poverty reduction).²⁵ Put another way, **there is only so much public financial management reform *per se* can accomplish** and optimizing the contribution of fiscal spending to inclusive growth may require other actions.

One possible action is an overhaul of institutional arrangements in the transportation sector.²⁶ As discussed, the DOTC organization looks surprisingly ill-equipped to oversee, much less undertake (and maintain) complex inter-modal mass transportation planning and provision; there is an asymmetry in capacities between DOTC and DPWH. But the issue here is not the asymmetry *per se*. Rather, **it is whether the current configuration impedes the development of a coherent and interoperable transportation network**. Coherence and interoperability of connective infrastructure as a network – and not roads alone or ports alone, nor rapid bus/rail transit in isolation (if that is all possible) – is what matters for inclusive urbanization and growth.²⁷

As it stands, anecdotal evidence indicates that the current configuration is an impediment. For instance, roads, ports and rapid bus/rail transit are currently planned and executed separately (by DPWH, PPA and DOTC respectively), with little to no assurance that network externalities and other complementarities are taken into account. A recent assessment of the PPP capacities of selected agencies confirms this as it observes that DOTC does not have “a sector vision, integrated plans for transportation sub-sectors, a funding plan, or project master plans to guide infrastructure investment”

²³ Prior to the law, government would only offer zonal value for the land, depreciate value for structures and require property owners to shoulder all transfer costs.

²⁴ <http://www.philstar.com/business/2016/03/11/1561609/p-noy-inks-law-easing-right-way-process>

²⁵ The Philippine Statistical Authority reported first semester poverty incidence among Filipinos to be 24.9 percent in 2013 and 25.8 percent in 2014, which are based on APIS data. It was 27.9 percent in the first semester of 2012 and 26.3 percent in the first semester of 2015 based on the FIES. (<https://psa.gov.ph/content/poverty-incidence-among-filipinos-registered-263-first-semester-2015-psa>).

²⁶ There are at least two other sectors where a rethink and reorganization is long overdue – the agriculture and natural resource sector and the urban development and housing sector. These are not covered here but suffice to say that current proposals (e.g. department of housing) may serve to preserve rather than correct administrative inefficiencies.

²⁷ Transportation infrastructure at subnational levels connects rural and urban areas in a province or city and guides land use; efficient transport systems also widen residential location options and housing choices of the urban poor. Transportation infrastructure at the national level connects lagging and leading regions, allowing the former to participate in the growth process of latter (HDN 2013)

(PPP or otherwise), nor processes in place to communicate or coordinate with other government stakeholders like DPWH during PPP project development. PPP projects are also observed to encounter structural interface issues with other DOTC projects demonstrating “poor coordination within DOTC and a siloed approach to project development and implementation.” DPWH scored significantly higher than DOTC in capacity on all fronts.²⁸

It is not clear whether the sector has always been this disjoint. From the early 1900s to the mid-70s, public works, highways and transportation evolved as one portfolio “for simplicity and economy of operations”.²⁹ They were split into two in 1979 through Executive Order No. 546, “Creating a Ministry of Public Works and A Ministry of Transportation and Communications”, in consideration of the growing portfolio, anticipated sea/airports, the LRT, and other franchises.³⁰ Formally, the rationale is stated in part as: “*whereas, the development, rehabilitation, improvement, construction, maintenance and repairs of ports, flood control and drainage systems, buildings, water supply systems; and other public works facilities involve the utilization of technologies and manpower different from those required for the control and supervision of transportation and communications facilities and services...*” (E.O. 546)³¹ – wording which gives the sense that, in contrast to public works and highways, government engagement in transportation was intended to be heavily regulatory in nature rather than involving direct infrastructure provision on a project-to-project basis. Yet, extensive infrastructure provision (i.e. through PPP) is where DOTC now finds itself.

If the State aspires for coherence, interoperability and efficiency in transportation networks, the policy questions that immediately arise are: Should the mandate, functions and organization of DOTC and DPWH be clarified in tandem and redistributed and reconfigured where warranted, or can retrofitting DOTC on its own, even granting it emergency procurement powers, suffice to obtain

²⁸ Assessment by the PPP Center and JICA, in consultation with DOTC and DPWH, March 2016 version, forthcoming. The assessment observed that while DOTC has gained experience in tendering, it was still quite weak in selecting and implementing PPPs, the initial stage of which is particularly critical, involving the delivery of government obligations that will govern and monitor the project over the concession period.

²⁹ For a short time, from 1974 to 1981, Public Highways had its own agency separate from Public Works (see http://www.dpwh.gov.ph/about_us/brief_history.htm. See also Manasan and Mercado, 2001 for a history of DPWH.)

³⁰ As recalled by R.Cuenca, then head of the Construction Development Corporation of the Philippines. Some have suggested that political reasons were behind the split, e.g. Jose P. Dans became the minister of transport and communications was an associate of the Romualdez’s, but the operational decision to split the ministries preceded the appointment.

³¹ Also: “Whereas, in keeping with the policy of government to effect continuing reforms in the organizational structure to enhance efficiency and effectiveness, it is necessary to entrust in one ministry all functions pertaining to the construction, repair and maintenance of public works facilities and restructure the organization for the control and supervision of transportation and communications facilities and services in the country...”

sector outcomes? If functions and organizations are to be re-considered, should one option be to re-merge the two agencies? ³²

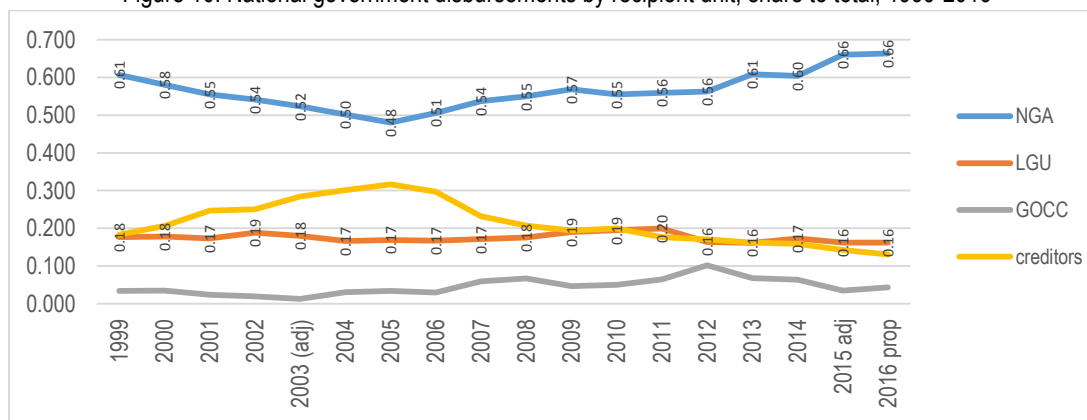
Another possible action is a **re-balancing of the allocation and disbursement control of funds from national government agencies to local governments**. Figure 10 and Table 7 present the distribution of national government disbursements by recipient unit – national government agencies, local government units, government owned and controlled corporations, and creditors - over the period 1999 to 2016. The figure shows that the share of creditors has been declining since the mid-2000s at the same time the shares of NGAs and GOCCs have been rising. In particular, there was an 8 percentage point decline in the share of creditors between the periods 2005-2010 and 2011-2015 which was offset by a 7 percentage point rise in the share of NGAs and 2 percentage point rise in the share of GOCCs over the same period. The share of LGUs' remained steady at 18 percent before dropping by 1 percentage point in 2011 to 2015.

Table 7 National government disbursements by recipient unit, average share to total, 1999-2016

	1999-2000	2001-2004	2005-2010	2011-2015
NGA	0.59	0.53	0.53	0.60
LGU	0.18	0.18	0.18	0.17
GOCC	0.03	0.02	0.05	0.07
Creditors	0.19	0.27	0.24	0.16

Base data: BESF 2001-2016

Figure 10. National government disbursements by recipient unit, share to total, 1999-2016



Base data: BESF 2001-2016

³² This is not a new question in infrastructure policy circles in government. The model of Japan is cited, where not just Infrastructure and Transport but Land and Tourism are effectively handled in one portfolio (i.e. Ministry of Land, Infrastructure, Transportation and Tourism). The US model also has highways and other infrastructure subsumed under a Department of Transportation.

NGAs were the primary beneficiaries of the wider fiscal space in recent years in other words. However, it is not immediately clear why this had to be or why, moving forward, it has to persist. In contrast, there are practical and economic reasons in favor of a pivot or rebalancing of fund control in favor of LGUs, particularly **provinces**.

The practical argument for a pivot to local governments is straightforward: it is an immediate way to relieve the fund absorption problem the national level. If critical parts of the national bureaucracy are clogged, bypassing them is the simplest solution. If there is a question of absorptive capacity on the province side, there is an efficiency argument for proceeding nonetheless: returns to capacity investments in choke points at the national level are likely to be small or certainly much less than what could be obtained if those investments were made in local institutions. This is because problematic national agencies are likely to have structures that are outdated or costly to change while local institutions are likely to have structures that can still be redefined, having less to protect by way of legacy systems. Capacity investments may even be self-generated by the province if transfer-facilities (to operationalize the pivot) are **performance based** – which was demonstrated by the immediate and near -100 percent compliant response of provinces to the 2016 KALSADA program.³³

There is also an economic argument which is provided in the 2012/2013 Philippine Human Development Report (PHDR): national policy, embodied in vertically-siloed, one-size-fits-all programs, has so far failed to take into account the effects of the country's geography on development and as a result “a steep price has been paid in terms of foregone human achievements, market expansion and local growth”. In contrast, the province may be “the most practicable level of political authority to give full weight to the specificity and diversity of local conditions ... even as it is capable of adopting a viewpoint comprehensive enough to adopt programs that exploit economies of scale and scope.” (HDN 2013).³⁴

Giving provinces greater allocation and disbursement control over non-IRA funds for devolved services was one of the measures recommended by the PHDR to immediately empower provinces in this role.³⁵

³³ KALSADA provided transfers to provincial governments for rehabilitation and upgrading of provincial roads, and transfers these road assets to the provincial governments for maintenance, in return for compliance with governance and technical prerequisites. In its first run, 79 out of 80 provinces qualified, with 68 provinces or 86% submitting technical prerequisites (duly approved by local development councils) by January 18, 2016. Draft guidelines for 2017 have de-emphasized performance incentives however.

³⁴ Municipalities and component cities may be too small geographically to horizontally integrate important components needed for inclusive growth.

³⁵ Non-IRA funds for devolved services exist because the Local Government Code (specifically Sections 17 (c) and (f)) allows national government agencies to continue implementing devolved services, as long as these are covered by the national budget, other special laws, or executive orders and the like, creating what amounts to a ‘two track delivery mechanism’ (HDN 2013: 36).

VI. Closing remarks

In closing, the measured underspending over the last 5 years has less to do with apathetic or incompetent bureaucrats and more to do with inertia and indigestion (after three decades of maneuvering in tight fiscal space) in the face of ambitious targets. While actual disbursements fell short of planned disbursements by about ten percent per year from 2011 to 2015, real per capita disbursements on capital outlays and maintenance and operating expenses actually *increased* relative to disbursements between 1999 and 2010 by an average of 41.6 and 76.8 percent respectively. In other words, actual disbursements have been increasing in real terms but planned or targeted disbursements have been increasing at a much faster rate. The bureaucracy has simply been unable to keep up with its own ambitions.

The challenge now is how to deal with the coordination problems and other structural bottlenecks that have long-attended national government budget design and execution processes but which have not been recognized as binding constraints until now. These problems are not uniform across agencies however which indicates more fundamental organizational issues in specific subsectors – such as in the transportation sector - and the need for actions beyond public finance management reforms *per se* to optimize the contribution of fiscal spending to inclusive growth. Apart from overhauling institutional arrangements between certain national agencies, transferring more control over fund allocation and disbursement to provincial and other local governments may be warranted.

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Annex A Total Obligations to Total Available Appropriations, 1992 – 2015

Source: National Expenditure Program, 1994 - 2016

Figure A.1

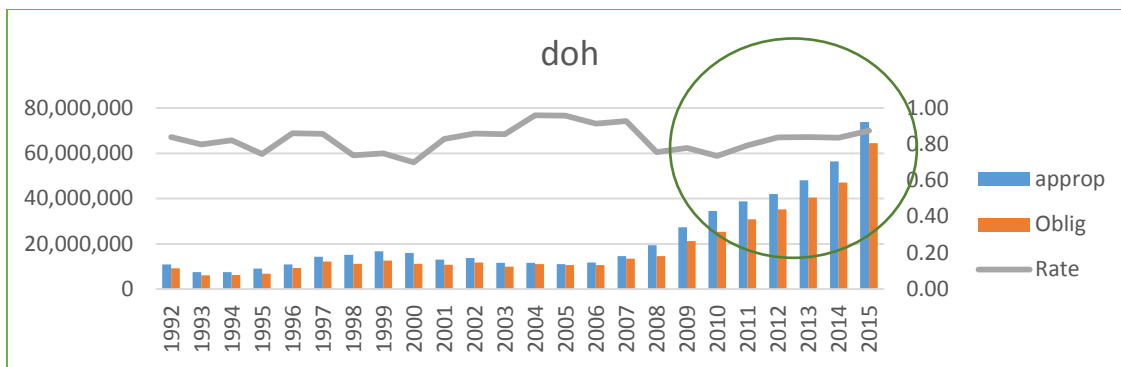
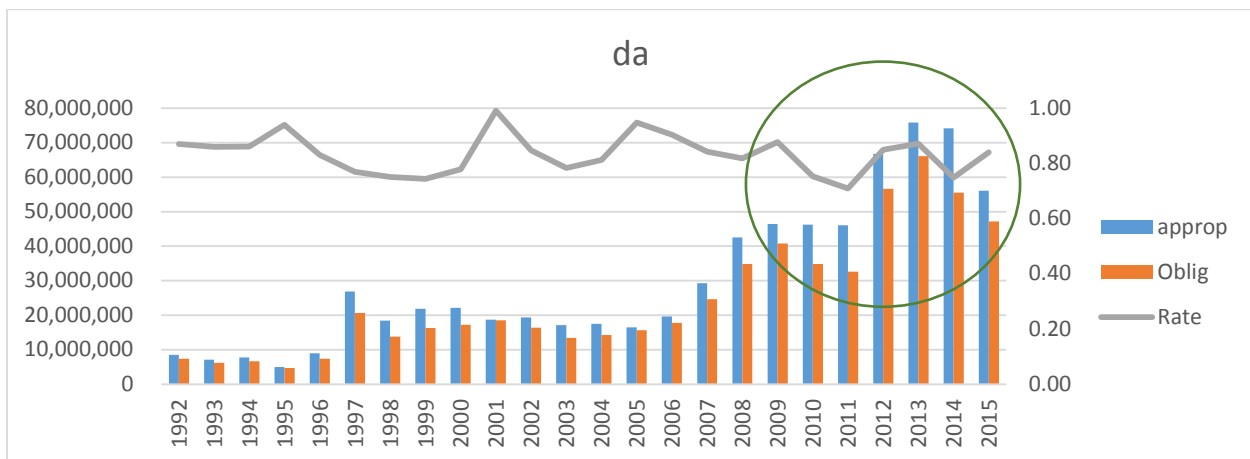


Figure A. 2



Annex A Total Obligations to Total Available Appropriations, 1992 – 2015

Source: National Expenditure Program, 1994 - 2016

Figure A.3

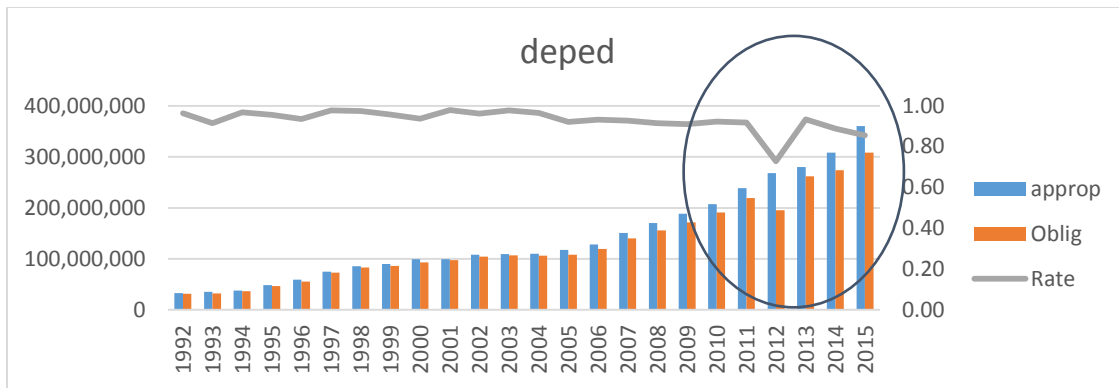


Figure A.4

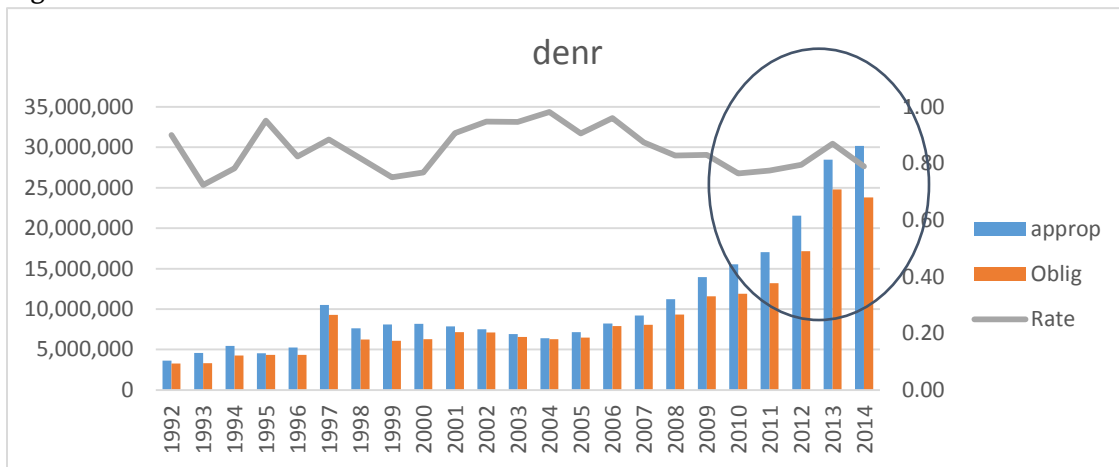
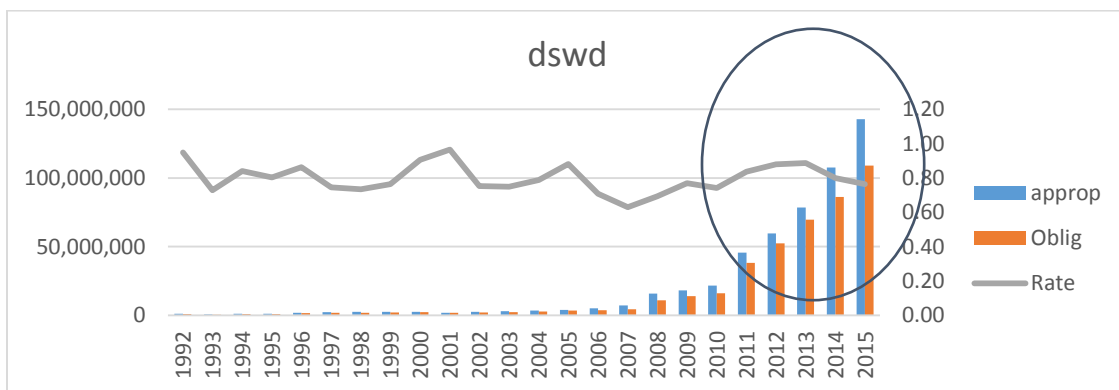


Figure A.5



Annex A Total Obligations to Total Available Appropriations, 1992 – 2015

Source: National Expenditure Program, 1994 - 2016

Figure A.6

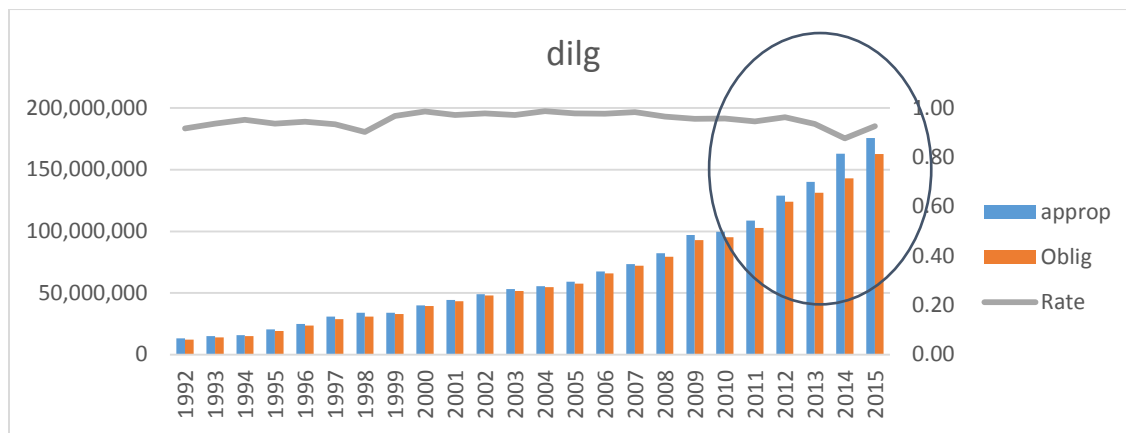


Figure A.7

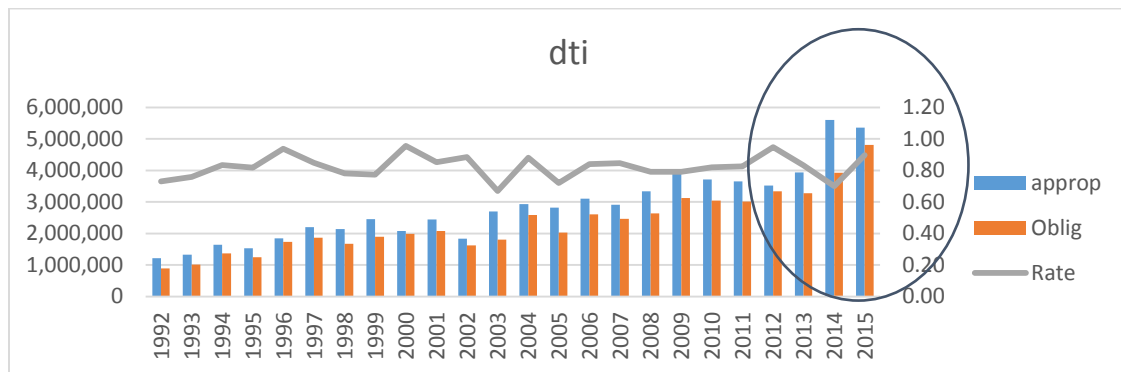
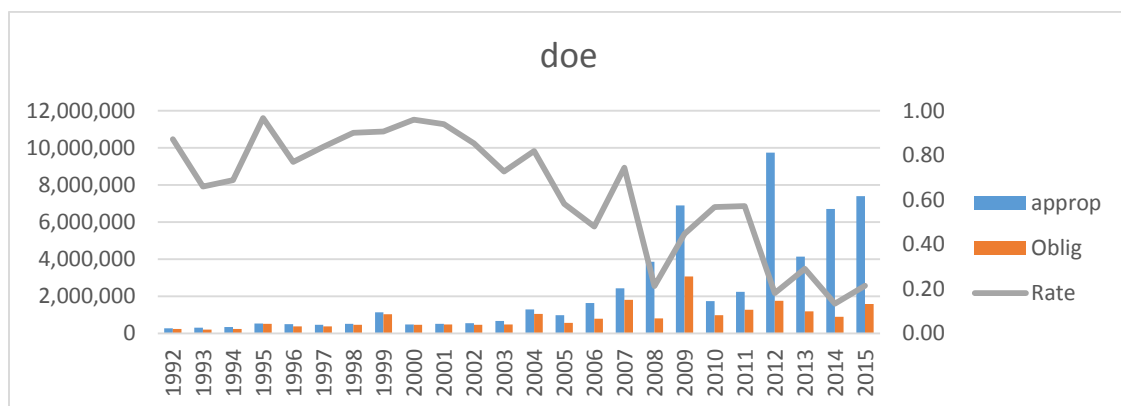
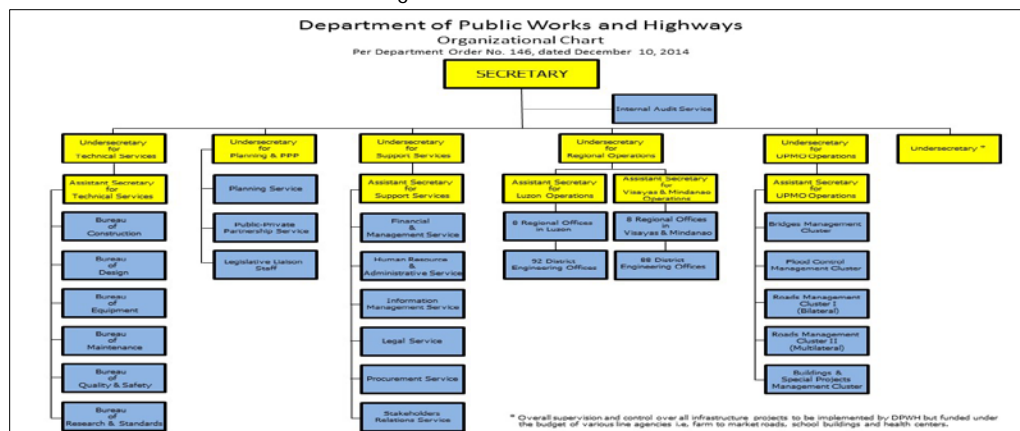


Figure A.8



Organizational Chart of DPWH



/Source: http://www.dpwh.gov.ph/about_us/org_chart (downloaded 6/23/2016)

DOTC Sectoral offices, Attached Agencies and Project Management Office

Project Management Office	Sectoral offices	Attached agencies *			
			Civil Aviation	Road Transportation	Maritime Transportation
Metro Rail Transit (MRT)	Land Transportation Office (LTO)	Office for Transport Security (OTS)	Civil Aviation Authority of the Philippines (CAAP) +	Toll Regulatory Board (TRB) +	Philippine Ports Authority (PPA) +
	Land Transportation Franchising Regulatory board (LTRFB) **		Manila International Airport Authority (MIAA) +	Office of Transport Cooperatives (OTC)	Maritime Industry Authority (MARINA)+++
	The Philippine Coast Guard		Clark International Airport Authority +	Philippine National Railways (PNR) ++	Cebu Ports Authority (CPA)+
			Civil Aeronautics Board (CAB) +	Light Rail Transit Authority (LRTA)+	Philippine Merchants Marine Academy (PMMA) ++++
			Mactan Cebu International Airport Authority (MCIAA)+	North Luzon Railways Corporation (NLRC)++	
			Philippine Aerospace Development Corporation (PADC)+		

Source of data: <http://www.dotc.gov.ph/index.php/2014-09-02-05-01-41/2014-09-03-06-32-04>. No organizational chart can be found on the DOTC website.

* Agencies with a lateral relationship with DOTC for policy coordination and general supervision but not control. Coordination may be accomplished by having the Department represented in the governing board. Agency CEO is a separate position.

** Secretary exercises administrative supervision and control. BOD chair and members are of assistant secretary rank (EO 202, s. of 1987)

+ Secretary is chair ex-officio of the BOD

++ Secretary is co-chair ex-officio of the BOD

+++ Secretary is a member of the BOD. The President appoints a chair from among board members.

++++ Secretary is not represented in the BOD or BOT