

Governance and Institutional Reforms in the Public Sector*

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1. Introduction

Governance is now the flavor of the times in international circles and the current buzzword in Philippine political discourse. In its current usage, *governance* has come to be understood as “the manner in which power is exercised in the management of a country’s economic and social resources.” Since the management of a country’s resources is generally allocated between the public and private sector, the term itself has given birth to two offsprings — public sector governance and corporate governance. My presentation is about the first, public sector governance.

Whenever people talk about governance, discussions about corruption invariably arise. It is because bad governance leads to corruption. More specifically, corruption, or the perception of it, has come to be the barometer for judging the quality of governance in the public sector.

I am reminded of a simple formula that Prof. Robert Klitgaard presented at the “International Conference on Governance Innovations” back in 1996. Prof. Klitgaard presented a simple but powerful pedagogic formula: corruption equals monopoly plus discretion minus accountability; in short, $C = M + D - A$. In the public sector, there are countless decision points where the individual decision maker exercises substantial monopoly power, considerable discretion, and very little accountability. Under such circumstances, it is very easy to divert public money for private gain. Under such circumstances, it is very easy to detect bad governance.

Let me expand a little on the Klitgaard formula. Monopoly power and discretion emerge usually because the rules governing public decision-making are not transparent and predictable. Take, for instance, our procurement processes. Very few people in government truly know and fully understand what the rules are. A study conducted by the Department of Budget and Management (DBM) in 1999 revealed that there are more than 100 laws and regulations that govern public procurement and that there are volumes of circulars, memos, and the like in the Commission on Audit

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(COA) that pertain to public procurement. Not surprisingly, confusion reigns in our procurement process. The rules cannot possibly be transparent since there are so many of them that no one can really have a full grasp of their implications. Nor can they be predictable since they contain inconsistencies that in turn can be easily manipulated to turn decisions in favor of some parties. As a result, the bids and awards committees of government agencies have considerable monopoly power and discretion over the awarding of contracts. It is, therefore, not surprising that procurement scandals often make it to the headlines.

The quality of public sector governance can be captured by three features of public decision-making: transparency, predictability, and accountability. Dysfunctions in the public sector lead to a lack of transparency, a high degree of unpredictability, and weak accountability. The result: bad governance and concomitantly high levels of corruption.

2. The need for institutional reforms

The Philippines has not fared well on the governance front. The most recent "Corruption Perception Index" of Transparency International ranks the country below countries like Peru, Malawi, El Salvador, and Lithuania and lumps it together with countries like Mozambique, Zambia, and China.

However, it is not just the international community that has this perception. Our people perceive this as well, and very strongly, as reflected by the powerful outcry of EDSA II. EDSA II has pushed good governance to the forefront of political discourse and to the top of the priority list of this government's agenda.

The DBM has long recognized the need for institutional reforms in the public sector. These are reforms that address dysfunctions in the public sector that are essential to improving the quality of public sector governance. With EDSA II having raised the ante considerably, the Department will push harder on on-going reform initiatives and prepare to launch others. These reforms will essentially cover two broad areas namely: public financial management and public administration.

3. Institutional reform initiatives: public financial management

The public sector is fraught with many dysfunctions, which confronts the reform minded government with a gargantuan task. Given its limitations, both in manpower and in funds, the government must prioritize and lay out a sequence of reforms that can be reasonably managed. For this administration, and most possibly the next, the priorities are not difficult to identify. We are today confronted with a huge budget deficit which, if not reduced, will surely derail our economy, hinder growth, and constrain our poverty reduction efforts. While some may say that controlling and managing the deficit is simply a macroeconomic problem, it is undoubtedly much

more complex than that. Our budget deficit problem is effectively a problem of *tax administration*, i.e. collecting revenues, and of *public expenditure management*, i.e. making sure the revenues are spent wisely.

3.1 Reforms in tax administration

Our low revenue effort is a problem of tax structure as well as of tax administration. I will emphasize the latter because I believe this is the root of the problem.

The usual knee jerk response of governments to a revenue crisis is to introduce new taxes or raise tax rates. However, either one has the unfortunate effect of (1) reducing take home pay – which means reduced consumer spending — and private investment – which means less job opportunities and potentially higher unemployment and (2) creating distortions in the tax system. Given the lethargic state of our economy, this approach is very likely to worsen the economic situation. Thus, the implication is obvious: we need to reform revenue administration, which means that we must reform the Bureau of Internal Revenue (BIR) since it provides about 60 to 65 percent of the government's revenue.

A recent World Bank report refers to anecdotal evidence that as much as fifty centavos out of every peso that the BIR is supposed to collect never finds its way to the public coffers. If tax administration reforms can capture even just half of this loss, this will provide an additional Php 200 billion annually, wiping out the deficit for this year and providing more for primary education and health systems, rural infrastructure, agricultural productivity, and other priorities. For this reason alone, it is imperative for us to undertake a serious reform in our tax administration system.

I am happy to note that determined efforts are underway for this purpose. Our recently appointed BIR Commissioner, Mr. Rene Bañez, has initiated efforts to seriously look into the dysfunctions in the BIR and to prepare a strategic plan for eventually undertaking a genuine reform of the agency. The DBM is committed to supporting these efforts as part of its on-going reform program on Reengineering the Bureaucracy (REBP).

3.2 Procurement reforms

Dysfunctional tax administration is perhaps the largest source of corruption in the public sector. There is, however, another large source — government procurement. There have been reports that losses could run to about Php 20 billion per year from public sector procurement alone. If one includes procurement involving build-operate-transfer (BOT) type operations, and local government procurement, the loss is likely to be significantly more. While these are estimates, they give us a good idea of how much our public coffers lose from corruption in government procurement.

The DBM has spearheaded a government wide effort to reform the public procurement process. In collaboration with the National Economic Development

Authority (NEDA), Commission on Audit (COA), and the big spending agencies such as Department of Public Works and Highways (DPWH), Department of Education Culture and Sports (DECS), and Department of Health (DOH), the Department formed an inter-agency technical working group to prepare and introduce changes in the administrative rules that govern the procurement of goods, supplies, materials, and civil works. These changes are now embodied in the revised implementing rules and regulations for Presidential Decree 1594 (on the procurement of civil works and consulting services) and Executive Order No. 262 (on the procurement of goods, supplies, materials, and contractual services). The changes have altered key steps in the procurement process, namely: (1) a shift in emphasis from pre-qualification of potential bidders to a simple eligibility screening at the beginning of the process combined with an extensive post-qualification towards the end; (2) a shift in the criterion for contract award to what is called the "Lowest Calculated Responsive Bid"; and (3) an elimination of bracketing in evaluating bid prices and the adoption of the approved budget for the contract as the ceiling on bid prices. These three major changes will increase competition, reduce delays, and limit the discretion of bids and awards committees, all of which will help reduce corruption.

But we have not stopped here. The DBM will likewise shepherd a bill in Congress, the Government Procurement Reform Act that will solidify the above changes and introduce more far-reaching reforms in the process.

In addition, the government has now introduced an electronic procurement system whereby a market is created for procuring agencies to register their procurement requirements. In this system, suppliers register their products and services, and a record of transactions is made available for everybody's scrutiny.

Apart from the reforms in procurement, the government is likewise undertaking a number of related reforms in public expenditure management. These include: (1) a re-orientation of the budget process towards the medium term, (2) the introduction of a performance focus to budgeting, (3) the development of a mechanism for incorporating government contingent liabilities into the budget process, (4) a rationalization and streamlining of the budget execution process, and (5) a shift in public sector accounting towards an accrual based system. All five are designed to increase transparency, accountability, and predictability in the budget process.

3.3 The medium term expenditure framework

The introduction of a medium-term framework (MTEF) will link planning, which has a medium term (3 to 5 years) outlook, with budgeting, which generally has a one-year horizon. Planning establishes the strategic priorities of the government over the medium term. Budgeting is supposed to allocate funds to programs and activities that help meet those priorities. However, to do this, the budget must consider expenditure allocations and implications beyond the typical one-year period within which budgets are made. And it must do this within the confines of binding annual ceilings. With an MTEF, the sustainability of the government's economic plan and

corresponding expenditure program can be reasonably assured over several years beyond the current budget year. Moreover, expenditure allocations can be better aligned with the planning priorities and thus the real needs of society. More importantly, spending agencies will become conscious of the implications of spending decisions they make at present on the configuration of their future budgets.

3.4 The organizational performance indicator framework

Corollary to the MTEF is the Organizational Performance Indicator Framework (OPIF).

The OPIF is a system designed to induce government agencies to focus their efforts and activities on delivering higher priority programs at reasonable cost and quality. It introduces the concept of performance indicators and links these with organizational performance such that government agencies will be encouraged (1) to allocate and reallocate resources towards higher priority programs/activities/projects (PAP's) and (2) to provide each PAP in a cost effective manner. In short, it states more clearly and directly what government agencies are accountable for their delivery of services to the public.

The OPIF is linked to the MTEF through the planning priorities. The MTEF requires that PAPs be prioritized in accordance with their linkage(s) to the planning priorities (and their implied societal outcomes). The OPIF, on the other hand, requires each agency to define its final output and link them to its PAPs. Outputs linked predominantly to higher priority PAPS are then designated as major final outputs (MFOs) and the budget of the agency is allocated accordingly to these MFOs. Performance indicators are designated for each of these MFOs. The performance of the agency can then be judged on the basis of these indicators with their budgets adjusted accordingly.

With the OPIF, we expect the re-orientation of budgeting towards outputs and outcomes, rather than inputs. Thus, we will be evaluating agency performance on, for instance, the performance of a licensing agency in expediting the issuance of licenses, given a certain cost, rather than in scrutinizing how much they spent for paper in issuing such license.

One critical aspect of the OPIF is the use of client feedback surveys, alternatively referred to as report card surveys. The DBM plans to introduce report card surveys in evaluating the allocative efficiency of public expenditures. In particular, it intends to use the surveys to evaluate the extent to which budgetary allocations actually translate into the delivery of services to the poor.

3.5 Contingent liabilities

The policy and treatment of contingent liabilities is another area that is ripe for reform. Government guarantees have come to haunt the budget in the last few years. In the past, guarantees have been used to attract private sector funding into government

activities such as BOT projects. While they do not put an immediate call on the budget, they potentially impose a heavy burden on government finances. For example, the government now has to pay private energy generators for unused energy capacity under take or pay contracts signed in the early and mid 1990s; the government essentially guaranteed these firms a revenue flow regardless of whether they actually managed to sell their capacity. Such payments have not been included in budgetary estimates, and the guarantee calls are now beginning to further stress the expenditure program of government.

At the moment, the government is reviewing the policy on guarantees and developing a procedure for estimating the amount of contingent liabilities that could become real liabilities in the future. The Department of Finance (DOF) has declared that guarantees are not to be resorted to, especially in BOT-type arrangements, where it can in fact develop a procedure for estimating the amount of contingent liabilities that could become real liabilities in the future. The DBM is in turn developing a mechanism for incorporating these estimates into the budget in order to prepare the government for any eventuality.

It has been noted that BOT-type arrangements provide an opportunity for corruption. Because BOT contracts are not usually publicly scrutinized, they can be cleverly structured in such a way that guarantees are given to the private proponent in exchange for favors. For this reason, it becomes imperative to amend the procurement rules governing BOT projects. The NEDA has been reexamining the BOT law precisely to plug loopholes of this sort.

3.6 Rationalizing the budget execution process

In the area of budget administration, we will rationalize the budget process such that (1) budget formulation is strengthened and (2) the release of funds is fast, timely, predictable and transparent. For these purposes, we will institute the following measures: One is to tighten the budget allocation criteria to focus the agencies on their core functions and to ensure strategic funding of key programs. Second is the computerization of budget release procedures in order to eliminate discretionary factors in the release of funds. Third, is the provision of information not only on the national budget but also on the actual release of funds up to the most reasonable detail on the DBM website.

The quest for greater transparency, accountability, and predictability will be the driving force in the reform of budget execution processes. I would like to see the day when the budget process will be the real tool for ensuring public accountability.

3.7 Accounting reforms

The accounting system in the public sector leaves much to be desired. Ideally the public sector accounting practices should be more or less consistent with practices in the private sector. This way, the public sector financial accounts are understood

by ordinary accountants, if not the general public and, therefore, are more transparent. Unfortunately, this is not the case at the moment. Private accountants find it rather difficult to analyze government accounts. Anyone who has bothered to take a look at the accounting reports of government must have experienced some sense of discomfort at not readily comprehending the meaning of the reports. Believe me, it is not because of some lapse of intellectual capacity. It is because the accounts are truly not friendly to ordinary comprehension.

Both the DBM and the COA are determined to change this. In particular, they are determined to move the public sector accounting system to an accrual basis, which is the standard in the private sector. In addition, it will be geared towards showing how much it costs the government to perform an activity or deliver a service, and not just how much it costs to run a bureaucracy. More significantly, the importance of accounting reports in decision-making cannot be overemphasized. Therefore, the reports must not only be reliable, they must be timely as well.

4. Institutional reform initiatives – public administration

The reforms that I have discussed so far deal with public financial management. Reforms, however, are also on going on the administrative side. One of these is the Reengineering of the Bureaucracy Program (REBP). This initiative aims to strengthen the government's management capacity to deliver public services more efficiently and effectively. Its thrust is to focus the role of government agencies on tasks for which they are best suited and to restructure them accordingly.

This reform is proceeding on two tracks – administrative and legislative. The first track pursues the streamlining and rationalization of government agencies within the confines of the powers of the President and existing legal statutes. The second track involves a comprehensive re-structuring of the Executive Branch, either wholesale or sequentially, i.e. one sector at a time. This requires a new legal mandate.

To guide both tracks, the DBM has initiated strategic sector reviews to prepare blueprints for the reengineering of sectors and the departments in those sectors. To date, three such reviews have been started – agriculture sector (DA¹, DENR², DAR³), social sector (DECS⁴, DOH⁵, DSWD⁶, CHED⁷, TESDA⁸), and infrastructure sector (DPWH⁹, DOTC¹⁰).

¹ Department of Agriculture

² Department of Environment and Natural Resources

³ Department of Agrarian Reform

⁴ Department of Education, Culture and Sports

⁵ Department of Health

⁶ Department of Social Welfare and Development

⁷ Commission on Higher Education

⁸ Technical Education and Skills Development Authority

⁹ Department of Public Works and Highways

¹⁰ Department of Transportation and Communication

Three cross-cutting reforms are being contemplated to support the streamlining and re-structuring efforts. These are: (1) the rationalization of the compensation and the human resource development system, (2) the development of impact mitigation measures, and (3) the institutionalization of a more effective individual performance accountability system.

At this point, I will remark on an item, which has become one of the favorite topics of the day, if not the season. I refer to the issue of the so-called "pork barrel."

I would like to raise the issue of the propriety of allowing members of both houses of Congress to identify projects funded in the General Appropriations Act. When the President submits the national budget proposal to Congress, it is in compliance with a Constitutional mandate. Congress according to the Constitution, has the power of the purse. I take it to mean that Congress has the right to scrutinize the budget, introduce amendments and finalize the same into law. If Congress does not change the President's budget proposal, I will be the happiest budget secretary in the world.

The reality, however, is that they do make changes in the budget given to them. I do not apologize for the fact that they do. I believe it is their prerogative as the people's duly elected representatives. Unfortunately, these projects identified by them, although implemented by executive agencies of government, have come to be known as the "pork barrel".

My proposal is that instead of denying them the prerogative to identify projects, we should institute a mechanism whereby the funds released to agencies for such projects are put to good use.

For this purpose, beginning next month, I am instituting a scheme where all releases made by DBM for all projects of whatever kind, anywhere in the country, will be posted on the DBM website. With this, anyone can see whether the projects actually exist and whether the projects reasonably reflect the amounts allocated to them. I have also requested the assistance of civil society. We will soon institutionalize a scheme whereby they can help monitor the progress of project implementation of programs that respond to their particular advocacy.

5. Concluding remarks

The institutional reform agenda on governance is extensive and daunting. I have talked about the initiatives that are on going and those planned for the executive branch at the national level. There are other reforms focusing on the judiciary and local governance, which for the lack of time I have not been able to talk about. In fact, on the latter, there are many little initiatives scattered throughout the provinces and municipalities, which we only hear about anecdotally. Whatever the case, it is clear that there is a fruitful and healthy fermentation of institutional reform efforts in government. This administration is bent on supporting and sustaining this effort.