

PROGRAM EXPENDITURE AND FINANCING ASSESSMENT

A. Expenditure Framework

1. **Macroeconomic context.** The Philippine economy grew at a sluggish 2.7% during 1998 and 2002 following the 1997–1998 Asian financial crisis. Government revenue fell from 17.6% of gross domestic product (GDP) to 13.8% of GDP during the same period. Given rigidity in spending due to fairly high debt levels in 1998, the national government's fiscal position took a turn for the worse and it incurred fiscal deficits averaging 4% of GDP during 1999–2004, despite efforts to reduce spending. The economy began to pick up in 2003, albeit at lower growth rates than those of its Southeast Asian neighbors. GDP growth averaged 5% during 2002–2011. Although national government revenues increased from 2004 to 2007, they remained below par and worsened from 2008 to 2010 because of weaknesses in tax policy and administration. However, the government's efforts to improve its fiscal position bore fruit when the share of debt service in the national budget began to fall after 2005. As a result, the fiscal space for additional social and infrastructure spending expanded moderately in 2005–2011.

2. Increased economic growth since 2012 and gains in national government revenue performance have vastly improved the national government's fiscal position and debt profile. GDP grew at an average 7% in 2012 and 2013, making the Philippines one of the fastest-growing economies in Southeast Asia. National government revenue rose from 14% of GDP in 2011 to 14.9% of GDP in 2013 following improvements in tax administration and the introduction of an excise tax on tobacco and alcohol products. Consequently, fiscal space expanded further during this period at the same time as past and ongoing government reforms in public financial management and governance have increased the level and efficiency of public spending.

3. **Department of Education budget.** The compression of national government expenditures during 1999–2004 in support of fiscal consolidation led to a contraction of government spending in most sectors, including basic education. This resulted in significant shortages in crucial resources—i.e., teachers, classrooms, textbooks, school furniture, and water and sanitation facilities. For this reason, the 2005–2015 medium-term expenditure plan (MTEP) of the Department of Education (DepEd) focused on estimating the budgetary resources needed to meet the minimum service standard (MSS) for these crucial resources under two alternative enrolment scenarios: (i) a low-growth scenario that assumed that the actual Grade 1 intake rate and the grade-specific cohort survival rates were maintained at historical levels, and (ii) an education-for-all (EFA) scenario where both the Grade 1 intake and grade-specific cohort survival rates were assumed to increase to the extent needed to meet the government's EFA commitments.

4. As the government's fiscal position began to improve and the fiscal space expanded, DepEd enjoyed significant increases in budget allocation. Actual DepEd budget obligations rose by 12% yearly on average in nominal terms during 2006–2013, compared with a 4% yearly average during 1998–2005. After declining from a peak of 2.9% of GDP in 1997–1998 to a low of 1.9% of GDP in 2005, national government spending on basic education posted a turnaround and rose gradually to 2.4% of GDP in 2013. Consistent with the MTEP for 1998–2005, the bulk of the increase in DepEd spending during this period was on addressing input gaps that had built up during the earlier period of slow budget growth. As a result, the department has been successful in reducing deficits in educational inputs, although some remain.

5. **Expenditure framework.** Given this background, the DepEd's updated MTEP for 2014–2020, intends to close the remaining gaps in crucial resources in 2014. Looking forward, the MTEP focuses on new policy and spending initiatives that are envisioned to (i) upgrade the quality and relevance of basic education, (ii) improve school participation and completion, and (iii) make the basic education system more inclusive by addressing the specific needs of the underserved. Foremost among these initiatives is the introduction of a kindergarten to Grade 12 (K to 12) reform program. It provides for the universalization of kindergarten and the addition of 2 years to the current 10-grade basic education cycle through the introduction of senior high school (SHS)—grades 11 and 12. The updated MTEP also provides for increased funding for inputs to improve quality, such as information and communications technologies, facilities, science equipment, and technical and vocational education and training (TVET) equipment. It also includes the cost of intensifying the department's program for out-of-school youth.

6. The 2014–2020 MTEP projects the total budgetary requirement for offering the K to 12 program, including the implementation of all the necessary quality-enhancing and outreach initiatives for the basic education cycle, to be around \$50.5 billion (in nominal prices) during 2014–2019. The cost of developing and mainstreaming the SHS program is estimated at \$4.41 billion in current prices over the same period. Of this amount, the SHS voucher program accounts for 34.5% of this cost. Another 29.1% is to be spent on teachers; 23.2% on classrooms; 8.9% on other capital investments, including science laboratory equipment, and TVET workshop equipment; and 3.1% on school level discretionary spending (Table 1).

7. The allocation for the SHS voucher program is meant to incentivize about 800,000 students a year who would otherwise attend DepEd SHSs to opt for non-DepEd SHSs instead. This number does not include erstwhile Education Service Contracting (ESC) program beneficiaries proceeding to the SHS program, who it is assumed will continue their schooling in private SHSs. The per-student subsidy under the SHS voucher program is expected to be set at around the expected unit cost of delivering SHS in DepEd schools—currently estimated to average about ₱15,000. If the voucher take-up is lower than projected, the share of the voucher program in the spending will decline and that of teachers, classrooms, and other capital investments will increase. Since the SHS voucher subsidy will be set at an amount that is equivalent to the unit cost of public sector provision, this adjustment will not lead to a change in the total financing requirement of the Senior High School support program (SHSSP) in the medium term.

Table 1: Expenditure Framework for Senior High School Support Program, 2014–2019

Item	Amount (\$ million)	Share of Total (%)
1. SHS teachers	1,283	29.1
2. Textbooks	39	0.9
3. SHS vouchers	1,522	34.5
4. School MOOE	138	3.1
5. Classrooms	1,024	23.2
6. Other capital investments	391	8.9
7. All other items	13	0.3
Total	4,410	100.0

MOOE = maintenance and other operating expenses, SHS = senior high school.

Note: Figures are in nominal prices.

Source: Asian Development Bank.

8. **Effectiveness.** In line with a government-wide shift toward results-based budgeting, the updated MTEP of DepEd is based on a detailed costing exercise that is directed at achieving results and outcomes. In general terms, the MTEP is focused on funding the programs that support the government's core responsibilities of providing quality basic education to its constituents as a basic human right and as a means of ensuring more inclusive economic growth through public investment in human capital formation. In more specific terms, the MTEP estimates the total budgetary requirements of the K to 12 program that are essential to achieving the outcomes envisioned in the Enhanced Basic Education Act of 2013, including all the quality-enhancing and outreach initiatives of the current presidential administration.

9. The K to 12 program, by adding kindergarten and 2 years of SHS to the basic education cycle, is intended to make the basic education system in the Philippines more comparable internationally and make SHS graduates more competitive globally. The SHS program is aimed in particular at providing secondary school graduates with better preparation for the workplace and for higher levels of learning. It is expected to do so by (i) providing graduates the opportunity to learn the skills necessary to obtain employment in the formal sector, if they wish to do so; and (ii) giving graduates who aspire to go to higher education better preparation for college work by spreading the existing 10-year curriculum over more years, and moving some of the general education courses now offered at the college level to the SHS program.

10. **Efficiency.** A 2012 basic education public expenditure review in the Philippines documented challenges in budget execution that hampered DepEd's ability to spend its budget allocation efficiently and quickly during 2006–2008.¹ In particular, DepEd's absorptive capacity was found to be low, as shown by (i) low budget execution ratios (i.e., obligation-to-allotment ratios) for maintenance and other operating expenses (MOOE) and capital outlays, (ii) the sizeable shares of obligations for MOOE and capital outlays that were charged against continuing appropriations, and (iii) the amount of lapsed appropriations, particularly for capital outlays. Overall budget execution in 2013 was 96.1%, although it was only 79.3% for MOOE and 81.7% for capital outlays. Budget execution has been adversely affected by complex administrative procedures for hiring teachers and procuring textbooks. In 2007, for instance, the hiring and deployment of new teachers required 12 steps that involved the central office and regional offices of both DepEd and the Department of Budget and Management, and the division offices of DepEd and the Civil Service Commission. These steps took at least 12 months to complete. Similarly, in 2006 the procurement process for textbooks from tender to delivery to end users took 17 months, while the pre-procurement process to evaluate titles took 6 months. The requirement that DepEd consult with Congress on the schools and districts that will get new classrooms delays school construction. Many of the challenges in budget execution documented in the public expenditure review by Australian Aid and the World Bank in 2012 remain of concern.

11. The overall budget execution ratio, and the execution ratios for MOOE and capital outlays, were higher in 2013 than in 2006 (Table 2).

¹ World Bank and Australian Aid. 2012. *Basic Education Public Expenditure Review*. Manila.

**Table 2: DepEd budget execution ratio,
2006 to 2013**

	2006	2007	2008	2009	2010	2011	2012	2013
Personal Services	99.8	99.6	100.8	100.4	100.1	99.1	99.9	98.9
MOOE	71.8	71.9	73.9	79.5	74.3	72.9	70.1	79.3
Capital Outlays	56.7	76.4	64.7	64.7	43.5	60.0	54.6	81.7
Total	94.6	93.8	94.1	94.1	94.3	92.9	91.8	96.1

MOOE = maintenance and other operating expenses.

Note: Budget execution is defined as total allotment releases compared to total obligations, by object of expenditure Source (2006-2012): World Bank and Australian Aid. 2010. *Philippines: Basic Education Public Expenditure Review*. Manila and Program Preparation Technical Assistance team calculations. Source (2013): DepEd. 2014. *Status of Appropriations, Allotments, Obligations, Disbursements and Balances: Consolidated Including Attached Agencies as of December 31, 2013*.

12. The procedures for hiring and deploying new teachers have been streamlined. This enabled the DepEd to fill 90% of the 61,500 new teacher positions created under the 2013 GAA on time, a substantial improvement in the budget execution ratio, despite the larger number of positions to be filled compared to previous years. Budget execution for school construction also improved in 2013. A number of government-wide reforms are helping to improve budget execution. These reforms include (i) stopping the practice of continuing appropriations for MOOE and capital outlays, (ii) treating the GAA as the allotment release document for most expenditure items, and (iii) allowing agencies to start the procurement process short of contract award and even prior to the issuance of the allotment release order. Nonetheless, close monitoring of budget execution is still needed to ensure that these improvements are sustained.

13. The 2012 public expenditure review noted inefficiencies in the allocation and deployment of teachers, especially at the elementary level (footnote 1). This occurred despite an earlier development by the DepEd of classroom and teacher deployment protocols (e.g., a color coding scheme) that were designed to ensure efficient allocation of inputs at the school level. The review found that more teachers were assigned than necessary to meet the MSS in a considerable number of schools. DepEd has taken steps to address this so as to ensure that allocations for new classrooms and teachers are targeted at schools that need them most.

14. Meanwhile, the expenditure framework for SHS, including aspects pertaining to ADB's SHSSP, is consistent with the government's policy of using a PPP modality in the provision of basic education to provide better quality education to more students. Almost one-third of public expenditure under the government's SHS program will be used to enable about 40% of DepEd junior high school graduates who would otherwise attend public SHSs to enroll in non-DepEd SHSs through the SHS voucher program. DepEd estimates that, in the absence of the voucher program, the SHS program could increase enrolment in public schools by 1 million students in 2016 and another 1 million in 2017. PPP arrangements are envisioned to help ease the management and organizational pressures on DepEd of gearing up and mainstreaming SHS in the short time frame available before it is launched in 2016/17. A voucher arrangement is being proposed rather than an expansion of the education service contracting program to avoid some of the governance issues associated with expanding the latter.

15. The government is not expected to generate savings from the use of a voucher arrangement—i.e., it will not spend less by providing vouchers for students to attend private SHSs than it would bearing the expense of them attending the public SHSs. By design, the subsidy that will be provided to students under the voucher program will approximate the cost of public provision. However, the voucher program is expected to improve the quality of education

by fostering greater competition between providers as it incentivizes a diversity of supply and system-wide innovation. It will also allow less-affluent students to choose where to attend school and possibly gain access to better-quality schooling at private schools generally affordable by only the country's better-off households.

16. No focal unit exists within DepEd that is tasked with oversight of the government assistance to students and teachers in private education program, which includes the ESC program. If the voucher program is to achieve its intended outcomes,² it is important that such a unit be established in the department to perform general oversight of the voucher program, budgeting and fiduciary monitoring, and possibly direct administration of voucher payments and voucher monitoring.⁶

17. It is also important to ensure that DepEd division-level plans provide guidance on where to build classrooms for the SHS program, while taking into account the number of places that will likely be provided by non-DepEd providers. These plans need to be developed by the end of 2015. This will help ensure that DepEd does not build more classrooms than needed, using its projections of the likely supply forthcoming from non-DepEd providers. In 2013, DepEd initiated the development of division-level plans for SHS implementation, but this has been delayed.

18. **Adequacy.** The MTEP costed all the recurrent and capital resource requirements for meeting the MSSs for teachers, classrooms, textbooks, seats, science laboratories, information and communication technologies equipment, and TVET equipment; and to ensure the provision of quality places for all students who are projected to enroll in DepEd schools during 2014–2020 (paras. 5–6). Shortages in crucial inputs were validated at the school level to help ensure that MSSs for teachers, classrooms, textbooks, seats, and water and sanitation facilities were met not just in the aggregate, but at the school level as well. The MTEP includes the cost of all DepEd programs, including the cost of operating its elementary and secondary schools in all divisions and is updated on a regular basis. Thus, the MTEP estimate of financial requirements is deemed to be adequate for the achievement of key results of the K to 12 program, including those of the SHS program.

19. With the development budget coordinating committee (DBCC) approval of the MTEP in December 2013, the MTEP expenditure estimates form the basis of the Department of Budget and Management forward estimates of the budget ceiling. In this way, the MTEP helps the department secure its funding requirements. Given the uncertainty around voucher uptake and, consequently, the estimates of classroom and teacher requirements of DepEd SHSs, the MTEP needs to be updated on a regular basis. While the risk of underfunding is always present, especially if macroeconomic and external shocks negatively affect the national government's fiscal position, the current assessments of multilateral development banks and international credit rating agencies all point to the strong and improving macroeconomic fundamentals in the country.

B. Financing Plan

20. Of the \$4.41 billion estimated cost of the SHS program during 2014–2019, ADB will finance \$300 million (or 6.8%). The remaining \$4.11 billion (or 93.2%) will be financed by the national government (Table 3).

² Alternatively, voucher payments and voucher monitoring may be outsourced.

Table 3: Program Financing Plan

Source	Amount (\$ million)	Share of Total (%)
Government	4,110.0	93.2
Development partners		
Asian Development Bank		
Ordinary capital resources	300.0	6.8
Total	4,410.0	100.0

Note: In current prices.

Source: Asian Development Bank.

21. **Sustainability.** The government has been able to sustain the pace of fiscal consolidation since 2010 primarily because of the progress made in improving its overall revenue effort. As a result of a virtuous cycle of reduced fiscal deficits, declining debt, and a downward trend in debt service charges, fiscal space has expanded since 2010. The improvement in the government's fiscal capacity is projected to continue, given forecast economic growth of 6.4% in 2014 and 6.7% in 2015.³

22. Also suggesting sustainability of the K to 12 reform, including the SHS program, is the government's demonstrated commitment to both, which has been shown by the DBCC's approval of the DepEd's latest MTEP and the increasing share of public spending on the basic education sector as a proportion of GDP. This rose from 2.1% of GDP in 2010 to 2.4% of GDP in 2013 and is projected to rise further to 2.6% of GDP in 2014. The country's strong economic and fiscal performance also augurs well for the affordability and sustainability of the K to 12 program. More specifically, assuming the government's GDP targets for 2014–2019 are realized, and assuming a basic education sector spending ratio of 2.6% of GDP, the budget envelope for the basic education sector from this period is estimated to be higher than the total budgetary requirement for the entire K to 12 program. However, if the economic growth projections and/or the basic education spending ratio are lower than projected, the government's capacity to finance the K to 12 program will be constrained, and the budget allocation for the basic education sector may be lower than the levels outlined in the MTEP. Nonetheless, long-term sustainability of the SHS program will be supported by the results-based lending for programs modality for ADB's SHSSP. Both the SHSSP program action plan and its disbursement-linked indicators are designed to strengthen DepEd's management and financial systems and the government's commitment to the SHS program.

B. Mitigating Risk and Improving Capacity

23. A key risk is that inefficient placement and/or capacity of newly constructed SHSs would reduce quality and raise the cost of education delivery, thus putting SHS program outcomes at risk and potentially pushing the cost of implementing SHS beyond what is set out in the MTEP. A second risk potentially affecting the achievement of K to 12 outcomes is the capacity of DepEd to implement the K to 12 reform, including the introduction of grades 11 and 12. Slow implementation of the DepEd reorganization plan may cause delays in (i) the establishment and/or strengthening of special units to manage curriculum and materials development; (ii) the development of a new national assessment tool; (iii) classroom delivery; (iv) human resource development, including the hiring and deployment of new teachers and the training of existing ones; (v) development of administrative arrangements for the implementation of the SHS voucher program; and (vi) the licensing and accreditation of schools.

³ ADB. 2014. *Asian Development Outlook: Fiscal Policy for Inclusive Growth*. Manila.