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LOCAL DEVELOPMENT ASSISTANCE PROGRAM
(492-0436)

PROGRAM ASSISTANCE INITIAL PROPOSAL

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ANNEX 31

LIST OF ACRONYMS USED

AAP	Accelerated Agricultural Production (Project)
ADB	Asian Development Bank
AID/W	Agency for International Development/Washington
ASEAN	Association of South East Asian Nations
BWP	Barangay Water Project
CIDA	Canadian International Development Association
DBM	Department of Budget and Management
DLG	Department of Local Government
DOF	Department of Finance
DPWH	Department of Public Works and Highways
ECD	Enterprise in Community Development
ESF	Economic Support Fund
FY	Fiscal Year
GNP	Gross National Product
GOP	Government of the Philippines
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
LDAP	Local Development Assistance Program
LGA	Local Government Academy
LGP	Local Government Project
LGC	Local Government Code
LGU	Local Government Unit (refers to barangay, province, municipality, component city)
LRM	Local Resource Management
NEDA	National Economic and Development Authority
NGO	Non-governmental organization
NIRA	National Internal Revenue Allotment
P	Designation for Philippine peso
PAAD	Program Assistance Approval Document
PAIP	Program Assistance Initial Proposal
PDAP	Provincial Development Assistance Program
PDC	Provincial Development Council
PDP	Provincial Development Project
PIL	Project Implementation Letter
PVO	Private Voluntary Organization
RDC	Regional Development Council
RPTA	Real Property Tax Administration
RRD	Rainfed Resources Development (Project)
UNDP	United Nations Development Programme
UNICEF	United Nations International Children's Emergency Fund

I. EXECUTIVE SUMMARY

The objective of the Program Assistance Initial Proposal (PAIP) is to request AID/Washington approval of the proposed Local Development Assistance Program (LDAP) that will provide $50.0 million in Economic Support Fund (ESF) grant funding to support decentralization in the Philippines. The Mission also requests that AID/Washington authorize the Mission to approve the Project Assistance Authorization Document (PAAD) at the Mission.

The Aquino Administration and Congress have been actively supporting a move toward local autonomy in the Philippines. Both the 1987 Constitution and Updated Philippine Development Plan (1988 - 1992) emphasize the importance of increasing local authority and resources of local governments to accelerate rural economic and social development. The momentum for decentralization is building and a virtual wave of legislation and administrative reform is on the horizon. The Mission believes that the GOP is strongly committed to implementing fundamental decentralization reform for the first time since the early 1970s and the imposition of martial law. The proposed assistance will provide the Mission with a valuable and timely opportunity to bolster advocates of this evolving movement to advance their cause.

The purpose of the proposed program is to support Government of the Philippine (GOP) decentralization reform by providing program support, small support grants, and policy analysis, monitoring, evaluation, and auditing services. LDAP will contribute to the attainment of USAID's Interim Strategy objectives of a strongly growing economy without policy biases against the rural areas, sustained and increased profitability, and increased coverage and effectiveness of social service delivery in rural areas by encouraging the GOP to provide increased resources, responsibility and decision-making authority for local governments. The use of the program assistance mode is appropriate to demonstrate USAID support for nationwide decentralization reform that will lead to more effective and efficient development at the local level.

The PAIP identifies a menu of desirable policy adjustments that addresses key constraints to decentralization in the Philippines over the next several years. The proposed $50.0 million in ESF grant funds for FY 1989 authorization includes: (1) an estimated $46.5 million in program support to be disbursed in three tranches over a period of approximately two years for acceptable GOP performance on mutually agreed-to policy indicators and (2) an estimated $3.5 million for projectized assistance. An initial tranche of about $10 million in program support will be disbursed in late U.S. FY 1989 or early U.S. FY 1990 based on acceptable performance from April 1989. Two additional tranches of about $18.25 million each will be disbursed thereafter in approximately nine-month intervals based on further acceptable performance. The GOP will also be required to demonstrate that policy actions result in local budget additionality for the GOP 1990 and 1991 budget years.

Through LDAP, USAID will support GOP decentralization policy implementation on a nationwide basis. The Mission will also seek GOP agreement to provide a substantially greater increase in discretionary funds and capacity building activities for up to six provinces to demonstrate the potential impact of decentralization. During PAAD preparation, the Mission will analyze and develop indicators for items included in the policy agenda menu as well as evaluation indicators of overall impact at the local level. The PAAD will also provide for the option of expanding the decentralization agenda and increasing the funding level through an amendment.

II. PROGRAM CONTEXT

A. Political Context

Fundamental political change characterized the first two years of the Aquino Administration. President Aquino's popularity created a climate conducive to reform, including the replacement of senior members of the judiciary and military reforms. With the ratification of the new Constitution by a three-fourths majority of Filipino voters in February 1987, elections of Congressional members in May 1987, and the convening of Congress in July 1987, Aquino's transitional legislative powers ended and a governing system of checks and balances was re-established. Provincial and municipal elections in January 1988 and barangay elections scheduled in March 1989 will complete the process towards the restoration of democratically elected political institutions in the country.

Sustaining the momentum for reform depends on the ability of the Aquino Administration to manage interest group pressures without undermining national interest, economic stability and confidence in government. The Administration must be able to move Filipino politics toward concrete action and public interest and away from traditional tendencies of rhetoric and personal interest. Consensus for reform is also important in order to counter the divisive leftist and Muslim insurgencies.

One of the most important emerging reform efforts expected of and supported by the Aquino Administration is the establishment of genuine local autonomy through decentralization of responsibility and authority to local government units (LGUs, including provinces, cities, municipalities, and barangays) * as mandated in the 1987 Philippine Constitution. Decentralization is viewed as an important goal in itself to permit people to control their own affairs. As importantly, decentralization is seen as a basic prerequisite to successful rural development and as desirable to curb graft and corruption. Aquino inherited an overly centralized government with power and resources concentrated in Manila. Widening disparities in living conditions among regions and between rural and urban areas had developed. Limited resources were reallocated to local governments during the Marcos era, but most assistance flowed through national departments and local governments had little real increased authority.

The momentum for decentralization is growing and advocates are exerting increasing pressure for decision-makers to act on emerging legislation and administrative reform proposals. Pressures will heighten with the passage of acts providing plebiscites that could increase the autonomy of parts of Mindanao and the Cordilleras. Many see decentralization as a means to improve the provision of services and rural development project implementation at the local level. Of particular note is the strong call for local autonomy by governors and mayors, elected in January 1988. Local executives have become frustrated with the limitation of resources,

* See the ANNEX for number, population, income, and other details.

particularly for discretionary use, and the bureaucratic red-tape that constrain their timely response to local basic service needs. The growing pressure for change is challenging reluctant legislators, particularly representatives, and certain government leaders to surrender powers and privileges to local governments. Legislators often argue that local governments are neither prepared nor trustworthy to exercise authority and responsibilities. At the same time, they recognize that central agencies are unable to provide LGUs with needed basic services or to reduce the huge backlog of funds allocated for local development activities. The pressure for change that would place decision-making authority and corresponding resources at the lowest possible level is spreading.

Many argue that the Philippines is moving to take the most significant decentralization reforms since the early 1970s and the imposition of martial law. New proposals to increase LGU authority and control appear daily in the news. President Aquino and her Cabinet have just approved a new budget disbursement scheme for 1990 which would give local officials more decision-making authority on infrastructure project financing decisions. At present Congress is reviewing a proposal to amend the National Internal Revenue Allotment (NIRA) system to increase revenue sharing levels for LGUs in 1990. Congress is also deliberating a Revised Local Government Code Bill. In addition, the government has initiated a nationwide campaign to encourage LGUs to increase tax collection efficiency. These examples are but a fraction of those currently being suggested for 1989 and 1990 implementation.

B. Rural Development Context

The Philippine economy has experienced a remarkable turnaround since 1986 as a result of the restoration of political legitimacy, better management and policy reforms. Yet per capita income, especially in rural areas, lags behind that of urban areas. The economy grew by 1.5 percent in 1986 and by an even stronger rate of 6.43 percent in 1987. The economy recovered fully in 1988 with a 6.69 percent growth in gross national product, exceeding the targeted 6.4 percent projection. Despite this progress, per capita income in 1988 is only P1,722 at 1972 constant prices (approximately $600), about the same level as in 1984 (P1,761) and 1977 (P1,746). Compared to its ASEAN competitors, the Philippines has been left behind in terms of per capita income (1986 figures), trailing behind Singapore ($7,410), Malaysia ($1,830), and Thailand ($810).

Poverty is widespread, especially in rural areas where the number of families living below the poverty line is 3.8 million as against 1.9 million in urban areas. Widening income disparity among regions aggravates rural poverty. Further, regional dispersal of economic income remains highly skewed. From 1983 to 1987, almost one-half of the total gross domestic product of the country was concentrated in the national capital and nearby Southern Tagalog regions.

Public investment in infrastructure has also favored highly urban areas. Principal infrastructure systems such as telecommunications,

transportation and financial services are largely concentrated in Metro Manila and, to a lesser extent, in Cebu for the Visayas and Mindanao. Widespread distribution of these systems is necessary to provide local access to information and domestic and international markets to accelerate development outside of the major urban centers. Otherwise, centralization will be reinforced and distribution of development benefits curtailed.

In an attempt to provide transparency and address regional disparities, the Department of Public Works and Highways (DPWH) now utilizes a fund allocation process across infrastructure project categories and across regions. However, resource distribution across regions is still subject to substantial value and political judgments. Even the Updated Philippine Development Plan for the 1988-1992 investment program favors richer regions such as Metro Manila. Infrastructure expenditures per capita for Metro Manila are 72 percent higher than those for the next ranking region (Cagayan Valley) and three times the least favored regions (Western Visayas and Western Mindanao). Water supply and urban transport investments account for a large portion of capital spending in Metro Manila. Only health facility public expenditures strongly favor the poorer regions. LGUs at present control only about 5 percent of the total public investment program.

Over the next decade, mobilizing economic development in rural areas will be the most critical factor for determining the rate and pattern of growth in the Philippine economy. The economy's capacity to expand the narrow rural development base depends on the availability of adequate rural financial resources, infrastructure and basic social services, along with export-oriented, labor-intensive industrialization. Meeting rural economic requirements is dependent, in turn, on the extent to which government decision-making power, authority and resources are decentralized to LGUs. The magnitude of control over resources and decision-making power that the national government gives to LGUs will be a key determinant to expanded rural development in terms of spread and delivery of infrastructure requirements and basic social services. Expanded rural development through enhanced decentralization could contribute significantly to the alleviation of poverty and the improvement in income distribution in rural areas.

C. GOP Priorities and Constraints to Local Autonomy

The Aquino Administration made a renewed commitment to central government department decentralization and greater local autonomy through support for the 1987 Constitution. The Constitution provides for local autonomy as follows:

-- Section 25 of Article II and Section 2 of Article X provide for local autonomy generally and for territorial and political subdivisions, respectively;

-- Section 5 of Article X addresses local revenue generation: "Each local government unit shall have the power to create its own sources of revenues and to levy taxes, fees, and charges subject to such

guidelines and limitations as the Congress may provide, consistent with the basic policy of local autonomy. Such taxes, fees, and charges shall accrue exclusively to local government"; and

-- Section 14 of Article X provides for regional entities: "The President shall provide for regional development councils (RDCs) or other similar bodies composed of local government officials, regional heads of departments, and other government officers and representatives from non-governmental organizations within the region for the purposes of administrative decentralization to strengthen the autonomy of the units therein and to accelerate the economic and social growth and development of the units in the regions."

The updated Philippine Development Plan (1988-1992) supports decentralization to: (a) enable maximum participation of the people concerned in the decision-making process; (b) encourage and develop local government self-reliance; (c) regionalize budgetary allocations; (d) promote more active private sector participation in rural development, particularly in the development and maintenance of infrastructure and local facilities;.and (e) increase LGU participation in the identification and implementation of local development projects and services. The GOP has embarked on a Decentralization Support Program for the Plan period (1988-1992) which includes adjusting policies, enacting legislation and establishing administrative guidelines to support decentralization. The program defines decentralization as devolving and deconcentrating power, resource management and responsibility from the center to local governments over a five-year period, with the shifting of budgeting responsibility to the regional level as a first step and of authority and responsibility to LGUs eventually. Objectives include:

- Strengthening Regional Development Councils;

- Strengthening Local Development Councils (provincial, municipal and barangay);

- Regionalizing budgets;

- Devolving powers of line agencies;

- Abolishing or rationalizing extra-central institutions (parastatals, etc.);

- Developing active non-government organizations (NGOs); and

- Broadening local government taxing powers.

As might be expected in a democracy, various groups have their own visions for decentralization and its meaning in terms of the degree of LGU financial and decision-making authority. Nevertheless, it is clear from the number and extent of recent proposals and actions that local executives are making significant headway in their push for local autonomy. As LGUs receive and effectively implement increased resources and authority, resistance to full autonomy will ease.

Notwithstanding the current support for decentralization, much needs to be done to address existing constraints. Constraints can generally be categorized into local authority, financial resources and local capacity, as discussed below:

1. Local Authority

a. Revenue Generation and Budgeting

Local government authority to raise revenue from local sources is governed by Presidential Decree No. 231 which was enacted during the Marcos regime. The Decree includes almost all potential revenue sources and specifies those that are off-limits for local governments, giving little leeway to local governments. For instance, while local governments are free to keep business taxes low to attract business to their respective area, they are prohibited from raising taxes beyond a fixed level. Hence, local governments have had to rely heavily on the national government for revenue shares. An average of 40 percent of total local government revenue comes from the national government. Nor do local governments have the authority to borrow from the national government.

Property taxes are the single largest source of revenue for LGUs. Both municipalities and provinces collect property taxes. Collections are reconciled monthly for sharing (45 percent to provinces, 45 percent to municipalities and 10 percent to barangays). Cities collect property taxes for their area (90 percent are retained and 10 percent go to barangays). However, property tax collections have been unable to keep pace with the escalation of other cost factors, particularly local government salaries. Various problems limit property tax collection, including undervalued and outdated property value assessments and poor and outdated records. In addition to the undervaluation of existing properties on tax rolls, many taxable properties escape taxation because of outdated and inadequate tax maps. Also, LGUs have given minimal effort to enforce tax collection, largely expecting people to come in and pay with no follow up. Furthermore, gross property tax yields have been affected by high personal services costs. According to a recent study, collection performance could feasibly improve by an estimated 60 to 70 percent.

The local tax code needs revision to encourage increased local authority and flexibility in local property valuation, assessment levels and tax rates. The current property tax is based on the 1985 valuation, and the property will soon be re-valuated. The Philippines also has a unique opportunity to revise local property taxation under the umbrella of land reform activities in the Comprehensive Agrarian Reform Program.

Additional local source revenue comes from business taxes and non-tax revenue, primarily licenses and fees. Local business taxes represent a significant resource for local economic development. Cities and municipalities have greater authority than provinces over business activities and thus collect and retain for their own use significant income from business

taxes. Notwithstanding the potential to increase locally generated revenue, formal revenue sharing with the national government will continue to be essential to provide sufficient resources for LGUs.

Transfers from the national government take the form of allotments and are used for the construction and maintenance of roads, bridges and other infrastructure; other development projects; and LGU operational expenses. The grants-in-aid from the national government undermine local autonomy by controlling LGU activities. About 73 percent of the local budget is constrained by mandatory legal provisions, leaving local government executives little decision-making discretion. Further, central government representatives indicate that they must monitor LGUs closely during the local budgeting process to ensure that national laws, regulations, and policies and, frequently, national objectives for local development are followed. Central government authorities often argue that LGUs lack administrative competence to allocate scarce resources to justify continued central control and supervision over local budgets and projects.

b. Project Approval and Implementation

LGUs and regional units participate in development planning but have had limited authority to approve development projects, especially projects funded by national assistance to LGUs. Until the GOP 1989 budget year, DLG at the central level had to approve projects funded from the 20 percent development fund provided under the local government shares of national internal revenue. Further, earlier national decentralization planning efforts resulted in giving higher priority to larger infrastructure projects identified at the central level than to regionally promoted ones.

Decentralization of the project development process is needed. Most pre-investment activities continue to be centralized in the line agencies. Support is building to give regional planning bodies greater control over allocating their resources to various sectors. Responsibilities for project preparation, monitoring and supervision are now being assigned to the Regional Development Councils and, through them, to the Provincial and Municipal Development Councils. However, real devolution of power to the local levels must include giving LGUs greater fiscal authority and direct access to sources and funds. Currently, only infrastructure projects under P200,000 are under the jurisdiction of provinces, although four provinces are now piloting experimental limits of P500,000. These limits are far too small to give the provinces any meaningful authority over infrastructure development (for example, one kilometer of barangay road costs more than P200,000 unless designed to very low standards).

c. Personnel

For LGUs to properly fulfill their functions, they must have more control over their staff. Currently, many of the staff serving in LGUs are not under the jurisdiction of the respective LGU chief executives. Local governments have no control over local police and limited control over

treasurers, assessors and budget officers. The Department of Finance (DOF) appoints and technically supervises treasurers and assessors while local units pay their salaries and provide administrative supervision. However, the Department of Budget and Management (DBM) appoints, supervises and pays local budget officer salaries. Personnel provided to local governments by the Department of Agriculture are also under the technical supervision of the central agency. There is little or no coordination and supervisory control of personnel from other central agencies, especially in terms of implementing centrally funded development projects at the local level.

Most national departments charged with line responsibilities maintain staff at the provincial level, the major exception being DPWH which uses a district system. However, tenure and promotion decisions for national government staff assigned to LGUs remain under national agency jurisdiction, preventing local leadership from effectively exerting control over staff. Provincial and municipal governments maintain their own engineering departments but have neither the equipment nor the human resources of the corresponding DPWH district offices.

DPWH has recently authorized higher ceilings to conduct biddings and approve infrastructure contracts at DPWH regional and district levels, a change which covers 98 percent of the total number of projects being implemented by DPWH. Notwithstanding this important devolution of decision-making to the regional level, DPWH regional officials remain a part of the national bureaucracy. A recent study suggests that DPWH should consider seconding its more experienced staff to LGUs to enhance skills to support local infrastructure implementation.

2. Financial Resources

In addition to authority limitations on budgeting and revenue generation, LGUs lack financial resources needed to accelerate local development. See Section III for an analysis of such resource constraints.

3. Local Capacity

The success of decentralization and local autonomy will depend greatly upon local capacity to plan and manage the delivery of basic services and the implementation of infrastructure and other development projects. LGUs have varying capacities to handle increased responsibility and funding. Provinces and component cities often have more available planning, management and technical skills than municipalities or barangays. At present, many local executives perceive that they are capable of managing local government affairs without central authority, supervision and guidance. However, this perception remains to be tested. Local executives increasingly seek and obtain support from the Department of Local Government (DLG) and other public and private sources to provide training and other capacity building services. More needs to be done and the GOP is actively expanding its training programs and other institutional development services through ongoing and proposed projects.

Some areas that need strengthening in selected LGUs include: planning; tax mapping capabilities; management and technical skills for supervising infrastructure design and construction for other than very small structures; property management and facility maintenance; equipment procurement, operation and maintenance skills; inventory control; and financial management capabilities. Related policy adjustments also need to be addressed in some areas. For example, LGUs do not have equipment replacement policies nor do equipment and infrastructure maintenance receive adequate priority. In the latter case, financial and technical resource limitations as well as limited priority for maintenance over the years have resulted in deterioration of existing structures and equipment.

D. USAID Role in Sector

1. Past USAID Decentralization Efforts

For more than 20 years, USAID has provided assistance to local governments in the Philippines through a variety of projects beginning with Operation SPREAD (Systematic Programming for Rural Economic Assistance Development) in 1966. Operation SPREAD assisted two provinces directly for two years on a pilot basis to develop provincial management and project implementation capacity. The project identified concepts, systems and inputs crucial to the local development process at the provincial level.

In 1968, based on lessons learned from Operation SPREAD, the GOP initiated the Provincial Development Assistance Program (PDAP) to strengthen local government capacity by providing advisors, commodity support and training assistance to selected provinces. PDAP was implemented in 28 provinces and 10 cities from 1968 to 1980 and followed a highly structured approach to planning and management capacity development, including: (a) the establishment of fully staffed provincial planning development offices; (b) the initiation of development performance budgeting; and (c) the preparation of annual design and work plans. Additionally, PDAP helped to expand the Provincial Engineer's Office from a maintenance-oriented to an implementing and supervisory office. USAID provided support to PDAD through the Provincial Development Project (PDP) and the Local Government Project (LGP). PDP financed advisors, commodities and training for selected provinces from 1968 to 1973 to develop sector programs in infrastructure and tax administration. LGP provided assistance to PDAP from 1974 to 1978 to develop mechanisms to reduce transportation costs, expand public investment, promote equitable taxation policies, and improve market access.

Other USAID projects developed under the PDAP umbrella included: (a) Rural Roads Projects I and II; (b) Barangay Water Projects I and II; (c) Rural Service Center Project; and (d) Real Property Tax Administration Project.

Rural Roads Projects I and II were implemented from 1976 to 1983 in 74 provinces and 10 cities and developed an administrative and organizational structure for selected provinces to plan, manage and implement

rural road projects following PDAP-identified systems. More than 1,000 kilometers of roads and 10,000 linear meters of bridges were constructed. The GOP continued to provide funding under this program through 1988.

Barangay Water Projects (BWP) I and II (1978 to 1986) developed the capability of 128 LGUs to design, install and maintain barangay cooperative water systems. Evaluations of these projects found that site selection, monitoring techniques, training and technical skills and profile of the target population were the most important elements for ensuring project success. The need to identify qualified staff (trainers and rural water and sanitation association officers) also hampered project implementation. Most importantly, the BWP evaluation concluded that institution building efforts should establish skills in permanent agencies for sustaining functions once USAID funding terminated.

The Rural Service Center Project (1978 to 1984) provided assistance to increase participation by the poor in the planning and implementation of local projects in six selected cities. The project developed infrastructure capability, including motor pool operation and radio communication, and conducted management training, revenue and income analysis, and socioeconomic surveys.

Building on initial studies under LGP (1974-1978) to improve the collection, assessment and records management, the Real Property Tax Administration I (RPTA I) Project undertook tax mapping and related management and collection activities from 1978 to 1984 as a basis for increased local revenue generation. RPTA I was pilot tested to plan, administer, replicate, and implement RPTA systems in 72 provinces covering 571 municipalities and cities.

A number of ongoing USAID projects provide assistance to strengthen local capacity, including: (a) Local Resource Management (LRM) Project; (b) Rainfed Resources Development (RRD) Project; (c) projects administered under the ESF Secretariat (Markets, Municipal Development Fund and the Regional Development Fund); (d) Enterprise in Community Development (ECD) Project; (e) Private Voluntary Organization (PVO) Co-Financing Project II; and (f) Accelerated Agricultural Production (AAP) Project.

The LRM Project supports GOP decentralization policy by assisting local groups to plan and implement development projects at the local level. LRM also provides assistance for tax mapping and management systems for improving revenue generation in selected provinces. LRM has strengthened provincial and municipal capability to increase local revenue through real property taxes and other local taxes. LRM has also utilized NGOs to organize and assist poverty groups to mobilize and manage resources for local development. Currently four NGOs provide technical assistance to municipalities and provinces under the project; plans are underway to contract an additional three to assist provinces.

The Upland Access Component of the RRD Project is strengthening the capability of selected LGUs to plan and undertake construction of minor

roads, foottrails, footbridges, river crossings and rehabilitation of provincial roads using labor-intensive technology. The recently completed evaluation of the component concluded that the provision of technical supervision, the strengthening of provincial engineering office capabilities, and the development of maintenance programs for infrastructure are important to ensure sustained benefits. The evaluation also recommended that roads should be reclassified to permit DPWH to retain responsibility for maintaining national networks, with the provincial engineering office and municipalities having responsibility for periodic maintenance responsible for other levels. The Natural Resources Component of the RRD Project uses NGOs to undertake institutional strengthening tasks for agroforestry and reforestation activities at the community and provincial levels.

The Municipal Development and Regional Development Fund Projects of the ESF Program provide assistance to municipals and provinces, respectively, to implement and manage small-scale, locally prioritized infrastructure project development. The Markets Project assists LGUs to manage market rehabilitation in selected market towns. Major lessons learned from the ESF projects include: (a) Infrastructure development requires effective subproject design and design review systems; (b) enforcement mechanisms are needed to hold engineering/construction firms accountable; (c) resident engineers need systematic monitoring/evaluation to develop skills; and (d) the improvement of municipal government capability to implement construction activities is dependent upon the provision of needed technical support.

Under the PVO Co-Financing II (1984-1992) and ECD (1986-1992) Projects, USAID supports U.S. and indigenous PVOs and other private local organizations, to encourage the wider participation of rural residents in local development activities. USAID has found that PVOs and NGOs may be more effective than government units in delivering basic social services in certain areas in the Philippines. PVO Co-Financing II has funded 64 subprojects for a total obligation of over $18 million focusing on community development. The ECD Project is directed at the improvement of community project design and implementation capacity under private sector sponsorship.

USAID is also supporting Department of Agriculture efforts to improve capacity for decentralized operations through the ongoing AAP Project. The proposed Child Survival Project will likewise support improvements in decentralized Department of Health operations.

PDAP activities and other completed and ongoing projects have been successful in increasing LGU participation in planning and implementation but have contributed little to the decentralization of authority and financial control of local governments. LDAP will complement earlier and ongoing project efforts by emphasizing key GOP policy adjustments to place decision-making and financial control at the lowest possible level. The program will also encourage GOP expansion of capacity building activities in selected provinces to enable LGUs to undertake increased responsibilities effectively.

2. Relationship to USAID Strategy

LDAP will contribute to the attainment of USAID's Interim Strategy objectives of a strongly growing economy without policy biases against the rural areas, sustained and increased profitability, increased coverage and effectiveness of social service delivery in rural areas. Through the anticipated reforms, LGUs will have resources and authority to plan and implement expanded rural development activities.

LDAP will also support the three guiding USAID interim strategy statement principles: decentralization, policy reform, and private sector involvement. The program will promote decentralization by encouraging the GOP to provide more resources and financial management responsibilities for LGUs. Additionally, LDAP will provide for policy discussions on decentralization between GOP and USAID officials. LDAP will also encourage the GOP to develop local capacity through coordination with private sector firms and NGOs.

In support of decentralization and increased local autonomy, USAID assistance seeks to:

- Decentralize operations

The success of decentralization in the Philippines depends greatly on increased local control over locally situated agencies and personnel and public resources to be used locally. USAID supports placing responsibility and authority for local operations, budgeting, and revenue generation into the hands of local officials where appropriate since local officials are better positioned to understand and respond to local needs.

- Increase local government authority for local development

With appropriate training and technical support, local government officials are better able to establish development priorities and develop and implement projects which address local development needs. USAID supports actions to increase the authority of local officials to approve and implement development projects in their respective areas. In some cases, this would mean local control over central staff working on local development activities; in others, authority for negotiating agreements with donor agencies to provide funding for local development.

- Create a policy environment which encourages private sector participation in local development

More than five million families live in poverty outside metro Manila. The magnitude of the GOP's task of reaching such numbers requires an approach to development that utilizes non-government sources. NGOs and PVOs can often provide more expeditious and effective assistance in delivering basic social services and monitoring development activities than government. USAID will support policies which enhance opportunities for NGO provision of technical services and training for local officials and private sector involvement in activities, including infrastructure construction and maintenance.

- Increase productivity and income of rural families through improved rural infrastructure and delivery of support services

Many areas have limited access to basic social services and infrastructure. USAID will support GOP policies and actions which encourage more equitable investment in basic infrastructure and support services across regions and in regional rural areas.

- Upgrade the quality of human resources and institutions undertaking local development

USAID will support GOP activities to strengthen LGU managerial capacity through the expanded training and technical support efforts of the Local Government Academy under DLG and other organizations. Improvements to management information systems will also be encouraged to improve project monitoring and evaluation.

E. Relationship to Other Donor Programs

The United Nations Development Programme (UNDP), the Canadian International Development Agency (CIDA), the International Bank for Reconstruction and Development (IBRD), the United Nations International Children's Emergency Fund (UNICEF), the Asian Development Bank (ADB), and the Australian Government are also providing assistance for local government development projects in the Philippines. LDAP support for policy reform will complement the ongoing capacity building efforts of other donors.

Most donors disburse all development assistance through official, centralized channels. UNDP is the only agency which utilizes direct donor payment procedures to local governments. It has the flexibility to release funds directly to implementing agencies, contract with consultants on behalf of the GOP, or pay for commodities directly in the implementation of the 45 projects in its $6.0 million portfolio. UNDP is planning to pilot test a District Development Management Systems project in Region V that will support district planning and management with DLG. UNDP also support the Regional Project Development Training Program which has strengthened regional capacity to design and implement projects.

CIDA has only recently begun to support local development projects and is planning to establish eight to ten "regional funds" to decentralize the financing for local project development. CIDA has obtained GOP agreement that the funds for local project development can bypass national government channels without prior notice if disbursements were delayed.

One objective of a $40 million IBRD Municipal Training Program is to strengthen the Local Government Academy (under DLG) training programs for local executives. The program has targeted 33 municipalities for executive management training for mayors, is encouraging private sector involvement through contracts to such organizations as the Asian Institute of Management to train municipal mayors and is testing a program to strengthen LGU administrative, technical and managerial capabilities.

Other donors are working in technical areas to support decentralization efforts. For example, UNICEF has provided assistance directly to seven provinces to improve child survival programs through the development of local capacity and commitment. The Australian Government is expanding their efforts in supporting decentralization of Department of Agriculture activities to the regional level. The ADB has recently extended technical assistance to the National Economic and Development Authority (NEDA) for a study on mechanisms to improve tracking of projects under the public investment program. A computer system to monitor projects will increase the GOP's capacity to manage and formulate policies to improve local development.

III. ANALYSIS OF RESOURCE CONSTRAINTS

A. National Government

Current financial difficulties and pressing material priorities limit the amount of resources that the national government can transfer or give up to LGUs. In 1988, the national government expenditure program continued to reflect efforts of the last two years to utilize fiscal measures to propel further economic growth. These efforts are evident in the growth of total expenditures and revenues: total expenditures grew by 9.3 percent, from P121 ($5.9) billion in 1987 to P132.2 ($6.3) billion in 1988; total revenues expanded to P110.9 ($5.3) billion from P103.2 ($5.0) billion in 1987 or a growth rate of 7.5 percent. The acceleration of domestic demand fueled the economic expansion in 1988; to some extent, the increased government expenditures through increased civil servant salaries and increased infrastructure spending contributed to full economic recovery in 1988.

The national government's total expenditures for 1988 reached P132.2 ($6.3) billion, which was 12.1 percent lower than the P150.4 target. This below-target performance is due mainly to the overall low disbursement of funds for the finance of both government capital outlay and government current operations. Disbursement for capital expenditures was 27.8 percent below target, which partly illustrates the limited capacity of central government to spur further economic growth through more expenditures.

Revenue generation efforts of the government were far from satisfactory since both tax and non-tax revenue collections were below targets. Total tax revenues amounted to P90.7 ($4.3) billion, 10.1 percent lower than the target of P100.9 ($4.8) billion. Government performance in the non-tax revenue area was also below par, with collections reaching only P20.2 ($1.0) billion as against the target of P27.4 ($1.3) billion. Net domestic borrowings allowed for deficit financing and foreign obligation payments.

Due to underspending and lower revenue generation, the budget deficit was pared to P21.3 ($1.01) billion, about 3.6 percent below the target of P22.1 ($1.05) billion. This deficit represented about 2.6 percent of the gross national product (GNP) in 1988.

In 1989, the budget deficit is expected to increase to P23.5 ($1.09) billion, representing about 2.5 percent of GNP. Total government expenditures will amount to P169.8 ($7.9) billion, with 81 percent to be used to finance current operations. Total tax and non-tax revenues will reach P146.3 ($6.8) billion, with tax income comprising 79 percent. Authorities expect the deficit to be financed mainly by domestic borrowings. Net domestic borrowing, which is projected to be P31.6 ($1.4) billion, will also pay for foreign obligations.

Recent estimates show much bigger deficits for 1990-1991, about P30 ($1.4) billion for 1990 and more than P30 ($1.4) billion for 1991.

B. Local Government

Meager available resources constrain local government efforts to help improve rural living conditions quickly. Total LGU financial resources (total receipts from both tax and non-tax revenues) average ₱11.3 ($0.54) billion annually for the period 1987-1989, which representing an average of about 9% of total GOP resources for the period. Total annual LGU expenditures average an estimated ₱10.3 ($0.49) billion for the 1987-1989 period, indicating that LGU share of total government expenditures is only about 6 percent.

LGUs receive only a limited share of national government funds for the delivery of basic services and infrastructure to meet the needs of the rural poor. Total appropriated national government assistance to LGUs amounted to P9.5 ($0.5) billion in 1987, P6.8 ($0.3) billion in 1988, and P11.0 ($0.5) billion in 1989. These figures represented only 12 percent, 7.8 percent, and 9.4 percent of the total 1987, 1988 and 1989 national budgets, respectively.

The bulk of national assistance to LGUs came in the form of share of national revenue collections and funds for local roads construction, repair and maintenance. From 1987-1989, the total appropriated LGU share of national revenue collections averaged 37.7 percent of total national assistance to LGUs. During the same period, total appropriated funds for local roads construction, repair and maintenance represented around 24.7 percent of the total. Other forms of national assistance to LGUs include funds for budgetary aid, barangay development fund, provincial development assistance fund, regional development fund, local government revenue stabilization fund, provincial health and agricultural program, repair and construction of school buildings and rural health units, local government planning and zoning fund, local communities assistance program, integrated area development, etc.

From 1976 to 1987, local governments spent an average of only about 10 percent of total public expenditures, with the national government spending the remaining 90 percent. The use of the general fund in the local government budget, which comprises 66 percent of its budget, is dictated by the national government. Local governments receive only 20 percent of their income tax collections for their use. Meager available resources constrain local government efforts to improve living conditions quickly. The limited share that local governments receive from the national government also contributes to the relatively poorer conditions of rural families.

IV. LOCAL DEVELOPMENT ASSISTANCE FRAMEWORK

A. Recent Progress on Decentralization

While actions are being initiated, actual implementation of decentralization has been limited primarily to administrative reforms. Central departments have augmented their regional staffs and decentralization of some responsibilities to regional offices. For example, the DPWH has increased the level for contracting at DPWH regional offices, the National Economic Development Authority (NEDA) has delegated increased responsibility to NEDA regional directors, and Regional Development Councils (RDCs) have received more budgeting and planning authority. More needs to be done and numerous executive and legislative proposals are emerging.

The Executive Branch has recently undertaken a number of recent initiatives to implement decentralization:

- Initiation of an activity in four pilot provinces (Laguna, Tarlac, Davao, and Negros Occidental) to develop and test decentralization models;

- Embarkment by the DLG on a re-orientation of its functions from one of control and decision-making to one of support for LGUs (e.g., regulations, manuals, technical support, etc.); and

- Decision by the Cabinet and President to a new budget disbursement scheme for 1990 to permit regional development councils to approve local infrastructure project selection.

Congress has also initiated proposals to support decentralization:

- National Internal Revenue Allotment (NIRA) Bill. Congress is currently reviewing a proposal to amend the NIRA system to increase LGU discretionary resources and authority for the 1990 budget year and reduce the present provisions that now mandate about 73 percent of LGU budgets. The proposed NIRA bill seeks to enlarge the local government share of national revenue collections by an estimated 13 percent, release LGUs from selected mandatory legal provisions for local budgets (estimated 10 percent reduction), and encourage LGUs to increase local revenue generation by providing additional national revenue grants for improved real property and local business tax collection performance. The proposal enjoys support from the President and Executive Branch, the Leagues of Governors and Mayors and Congress. Passage is expected by mid-1989.

- Revised Local Government Code. Congress is deliberating a proposed bill which is supported by DLG and the Leagues of Governors and mayors and provides for a more responsive and accountable local government structure instituted through a system of decentralization. The bill is being reviewed book by

book of which there are five. Books 1 and 2 dealing with general principles and local finance, respectively, are expected to be passed in 1989. The bill proposes seconding national government staff to LGUs, revenue sharing and block grants, placing infrastructure and most line functions under local government jurisdiction, establishing a minimum set of basic services and facilities for each LGU level, setting up uniform standards and guidelines for LGU implementation, and institutionalizing the use of NGOs or PVOs to gain increased local autonomy. Further, the problem of appointment and supervision of personnel is addressed -- namely, by specifying that local personnel, except for treasurers, would be appointed by local chief executives within the framework of civil service rules and regulations. Also espoused is that centrally funded project implementation at the local level be devolved to the local governments concerned, subject to such specifications, cost standards, reporting and performance audit as may be prescribed by the national government instrumentalities (projects funded by foreign sources may be exempted). Finally, the bill seeks to expand LGU taxation power by lifting the limitations on LGUs to impose numerous income and other taxes. Some disagreement has surfaced on the role of governors and on the secondment of national agency personnel to local executives.

- Local revenue generation. Both the national and local governments are giving preferential attention to the real property tax, which is a major source of local revenues collected and retained at the local level. The national government through the Department of Finance (DOF) recently launched a nationwide campaign to increase real property collections. The 1988 collection was P1.7 billion and the projected target is P3.9 billion in 1989 or an increase of about 125%. From 1990 to 1992, the projected increase will be about 18 percent annually. According to local and national officials, the targets are attainable because of intensive efforts to improve real property tax administration through tax mapping, property appraisal and assessment, and tax collection.

B. Decentralization Performance Agenda

The USAID Mission strategy is to assist the GOP to accelerate current and planned decentralization actions. Through LDAP, USAID will support increased local autonomy, increased LGU revenues, and increased LGU discretion over funding utilization. Demonstrated acceptable GOP performance on a menu of probable and possible policy adjustments and planned LGU capacity building actions will be critical to disbursements under the program. Performance indicators for the agenda items will be specified in the PAAD from areas listed below.

A number of the agenda items could be influenced by legislation -- for example, the NIRA Bill. However, in developing and negotiating the agenda

items, the Mission will emphasize the desired output -- i.e., increased discretionary resources for LGUs -- as the performance objective rather than legislation per se. Accordingly, the GOP could provide for increased resources through legislation, executive order or the budgeting process.

1. Policy Reforms

Performance indicators will be developed from these areas:

a. Implementation of increased funding for LGUs for 1990. The enactment and implementation of the proposed NIRA Bill, described in Section IV.A, is important to increase LGU financial resources. Passage of the bill is expected in mid-1989 with implementation slated for Philippine FY 1990, beginning January 1990. DBM has already proposed an overall 4.3 percent budget increase for 1990. The bill is expected to result in an average 13 percent increase for LGUs over the planned 1989 GOP budget levels. Whereas initial disbursement will not be contingent on passage of the bill, significant progress on actions related to implementing increases in resources at the local level will be critical to initial disbursement. Later disbursements will be related to acceptable performance on the implementation of a system of increased discretionary resources and local authority.

b. Reduction of mandatory revenue contributions required of LGUs. The proposed NIRA Bill would eliminate contributions for national hospitals and integrated national police.

c. Implementation of decentralized decision-making authority for project development. The President and Cabinet have recently approved the proposal that Regional Development Councils have decision-making authority for 1990 infrastructure projects. Implementation of this authority is dependent on procedures being instituted to devolve budget approvals and the allotment of lump sums to the regional levels.

d. Increased real property and local business tax collection. DOF and LGU officials are currently developing targets for increased tax collection in 1990. Incentives for increased local business and real property tax collection are also included in the proposed NIRA Bill. Incentives and procedures are expected to be implemented in 1990.

e. Implementation of a general revision (re-valuation) of real property.

f. Implementation of increased LGU power to impose local taxes.

g. Placing authority for the maintenance of barangay and municipal roads under the province.

h. Implementation of increased authority of local executives over locally assigned national staff. The proposed Revised Local Code being discussed in Congress would increase significantly the number of national staff under local executive control.

i. Strengthening of the role of local development councils in project development and implementation.

2. LGU Capacity Strengthening

While past and ongoing efforts have been contributing to strengthening LGU technical and managerial capacity, accelerated efforts to train new officials and strengthen capacity in selected areas is important to facilitate the effective use of additional resources and increased authority. The GOP through a variety of training institutions and other mechanisms has considerable capacity to provide assistance in these areas. For example, the Local Government Academy (LGA) under DLG has the mandate to:

- Unify fragmented and disjointed local government training activities;
- Identify and/or develop an adequate supply of qualified trainers;
- Develop up-to-date quality training curricula;
- Improve training information and monitoring systems; and
- Generate sufficient financial resources for training.

LGA has plans to expand training and technical support efforts through contracts with organizations such as the Asian Institute of Management experienced NGOs, the Development Academy of the Philippines, the University of the Philippines, regional public and private higher education institutions, etc. Additionally, DOF and NEDA are currently strengthening LGU tax mapping and planning skills, respectively, in selected regions. DLG is also exploring how technical capacity for managing infrastructure development and maintenance at the local level can be enhanced. While considerable capacity to undertake training and technical support activities exists, financial resources to accelerate such activities is limited. Thus, the Mission will propose that the GOP, as a condition to receiving support under LDAP, increase its efforts in selected training and technical support areas. Performance indicators will be developed from these areas:

a. Provision of revenue capacity building for LGUs. The DOF is providing counterpart funds for tax mapping, records conversion/upgrading and tax collection in Region VI under the AID-financed LRM Project. Financing of similar capacity building activities in areas not covered under the LRM Project would provide an important base for improved tax collections throughout the country.

b. Provision of management capacity training for increased numbers of local officials. The GOP through various institutions has the capacity to undertake training in planning, project preparation, and financial and other management skills. Further, LGA is currently conducting executive management programs for local officials under the IBRD-financed Municipal Training Program. Expanded training efforts in selected provinces would be important to test and demonstrate local competence in implementing increased funding levels.

c. Improvement of management systems for LGUs. LGA has plans to establish a sub-regional/local information system for local planners and councils. Improved management systems will enable LGUs to: (1) estimate progress in meeting policy objectives; (2) determine compliance with national and local statutory requirements; (3) determine the most appropriate staffing arrangements and skill levels; (4) identify management, control and communication problems; and (5) relate services and their impacts to the cost of production.

d. Improvement of municipal treasurers' and assessors' office staff capability. Availability of qualified staff could enhance LGU capacity to expand tax collection efforts.

e. Development of local autonomy model. LGA officials have proposed a model for determining policies and infrastructure/service priorities. Testing of this model and/or assessment of experiences gleaned from the ongoing pilot effort in four provinces could provide useful information for institutional strengthening activities.

f. Improvement of project design and feasibility analysis. Project development has often been delayed in the past because of inadequate feasibility studies or ill-conceived and highly capital-intensive designs. Expanded training for local officials could improve project quality.

g. Improvement of project monitoring. Limited implementing capacity of some agencies has led to poor project performance and accountability. At the central level, the GOP has adopted several initiatives to increase project implementation capacity. The Project Development Institute was set up recently within the Development Academy of the Philippines to train line agency personnel in project work. In addition, a national-level Project Facilitation Committee was established in 1987 to address the project implementation delay. LDAP would encourage the GOP to continue implementation of improved management systems, training and technical support to improve and track project performance.

h. Institutionalization of NGOs and private sector participation in local development. While increasing the role of the private sector is the avowed goal of the government, especially for power generation and telecommunications, the implementing guidelines for private sector involvement have been unclear. LDAP could encourage greater experimentation with private sector maintenance contracting, especially for road infrastructure. Additionally, LDAP could support expanded GOP use of NGOs to provide technical support, project monitoring services and training for local development.

i. Improvement of capacity for infrastructure development and maintenance. Such capacity varies among provinces and cities and is limited at the municipal and barangay levels. The USAID-financed ESF Secretariat projects provide assistance to selected provinces and municipalities to improve construction contract management and to conduct design and feasibility studies. The RRDP Upland Component has initiated maintenance training for

project-financed roads, trails, etc. LDAP could encourage GOP exploration of expanded efforts in these and other areas to improve local capacity.

C. Expected Benefits and Costs

GOP policy reforms and capacity building efforts that LDAP will advance are expected to provide direct and immediate benefits to LGUs as well as indirect and long-term benefits to local communities. Through national policy reforms, the LGUs will be provided with more financial resources and greater discretionary power in identifying and providing basic services and infrastructure to foster community development. With more money and power, LGUs will likely respond more quickly to community needs. Thus, the delivery of community basic services such as health, water, and education to rural dwellers as well as infrastructure development and maintenance will be available through a faster mode. Through GOP capacity building efforts, LGUs will receive both technical and managerial/administrative training and technical support. The training and technical support are projected to provide most LGUs with the necessary skills and capacity to determine and respond to constituent needs and, likewise, to improve their development planning, implementation and administration functions. Improved functions, in turn, will enable the LGUs to become generally more responsive, innovative, efficient, and effective.

LGU implementation of more and/or larger infrastructure and other development projects by the LGUs should create more jobs and encourage additional income-generating business opportunities for the community and nearby communities. As a whole, members of the community will benefit from improved availability of services such as health, transportation, water systems, etc., thereby improving the quality of life.

LDAP is also expected to benefit the private sector indirectly. The creation of more efficient and effective social service delivery and of improved infrastructure will provide a more supportive environment for private sector development. First, having funds directly and immediately available to LGUs should substantially reduce local problems of dealing with central bureaucratic red tape. Second, development projects will more likely address local, rather than national, priorities. Third, if selected regions are targeted for increased funds, competition for limited funds would encourage LGUs to plan and implement their development projects more efficiently and effectively. An improved local economic climate would more likely encourage private business investment in the local community.

Also, the program has the potential to spread benefits to communities beyond the LGUs concerned. The development of municipality centers could stimulate economic growth in outlying areas by encouraging other municipalities, cities, and provinces to improve their performance to realize similar benefits.

Sustainability of program benefits may be enhanced through improved systems of communication and coordination among participating LGUs and the

institutionalization of expanded system transparency and accountability measures.

Notwithstanding the benefits to be derived from the program, some costs will likely exist. The main cost is the economic opportunity cost of the grant assistance to encourage GOP decentralization reforms affecting LGUs as against alternative activities. The second is the social cost. The additional "political capital" made available to local government officials could heighten political competition among LGU politicians or between Congressional representatives and LGU politicians, thereby threatening the viability of efficient and effective project planning and implementation systems. Another possible social cost is the creation of additional local opportunities for corruption and graft which increase as additional resources are made available. This latter cost, however, might be countered by greater local control through the local election process and increased transparency through greater local participation in community development activities.

Overall, the program's benefits will most likely far outweigh the costs. The immediate direct benefits will flow from the use of additional resources either made available by the national government or collected locally under the stimulus of decentralization and from improvements in the efficiency of existing resource use resulting from GOP policy changes and capacity building efforts. During PAAD preparation, the magnitude of these expected gains will be explored further and compared to the minimum benefits needed to justify the program. However, the substantial size of the expected increased resource flows, potential local revenue generations and current total LGU resources, taken together, assure economic feasibility. Particular LGU activities will also be identified in the PAAD for use in evaluating the overall impact of the program on local development. Activity indicators could include health services rendered, kilometers of road rehabilitated/built, and school rooms built. Appropriate baseline date will be collected early in the program.

V. LOCAL DEVELOPMENT ASSISTANCE PROGRAM

A. Program Objectives

The purpose of the proposed program is to support GOP decentralization reform through the provision of program support, small support grants, and policy analysis, monitoring, evaluation, and auditing services. Decentralization is expected to contribute to improvements in the delivery of basic social services and the provision of basic infrastructure. These contributions should, in turn, help to increase rural productivity and incomes. By program end, it is expected that the GOP will have made substantial progress on decentralization reform, particularly in addressing LGU resource and local authority constraints.

B. Program Versus Project Assistance Mode

The use of the program rather than the project assistance mode is appropriate to provide financial assistance to encourage policy reforms and improved decentralization performance that will lead to more effective and efficient local development. The GOP is demonstrating commitment and actions to undertake significant decentralization policy reform. However, implementation of key reforms will strain an already tight government budget -- for example, providing additional discretionary resources for LGUs as proposed by the NIRA bill could require the GOP to provide an estimated additional P1.2 billion ($57 million) to local units in 1990. USAID could facilitate and possibility accelerate implementation of this measure by providing a portion of the increased amount in program support. Given the importance of the policy implementation anticipated and the shorter term deficit requirement, a program mode is appropriate. Furthermore, the GOP has the capacity to provide needed training and related support to assist LGUs in the improvement of their capacity to handle additional funding.

C. Description

USAID proposes to provide about $46.5 million for program support and about $3.5 million for projectized assistance. Program support will be provided in three tranches to be disbursed over about a two-year period based on a Mission determination that the GOP has achieved acceptable progress on mutually agreed-to performance indicators. An initial tranche of about $10.0 million will be disbursed in late U.S. FY 1989 or early U.S. FY 1990 based on acceptable performance progress from April 1989. Two additional tranches of about $18.25 million each will be disbursed thereafter in approximately nine-month intervals based on further acceptable progress on policy adjustments. The GOP will also be required to demonstrate that policy actions result in local budget additionality for the GOP 1990 and 1991 budget years. The Mission considers progress on agenda items related to increased LGU resources and authority over resource expenditure as critical decentralization actions.

Through LDAP, USAID will support GOP decentralization policy implementation on a nationwide basis. The program will also encourage the GOP

to provide a greater increase in discretionary funds and capacity building activities for up to six provinces to demonstrate the potential impact of decentralization. Suggested criteria for province selection include need, absorptive capacity to utilize funds, extent of ongoing USAID project activities in the province, quality of leadership, and peace and order considerations. Final criteria and province selection will be made during PAAD preparation.

LDAP also provides assistance for a projectized element to finance small support grants and services for financial and program monitoring, policy analysis, evaluation, and auditing. The support grants will provide financial assistance for organizations, such as the League of Governors, that are undertaking studies and related activities to support decentralization objectives.

Mission representatives have already met with senior figures from key GOP departments and the League of Governors to discuss possible USAID assistance for decentralization reform. It is anticipated that throughout program implementation a group made up of representatives from DOF, DLG, DBM, NEDA, the League of Governors, USAID, and possibly other departments will meet regularly to discuss policy issues and review progress on decentralization agenda actions. A decision on the program implementing agency will be made during PAAD development. The agency will likely be DLG, DBM, NEDA, or DOF. See Section VI.C. for a discussion on potential counterpart agencies.

D. Financial Plan

1. Funding

The program will provide a total of $50.0 million in ESF grant funds over a two-year period. An FY 1989 obligation of $25.0 million is anticipated. The estimated allocation of program funds is as follows:

Component	Amount ($000)
Program Support	46,500
Small Support Grants	500
Technical Services for Policy Analysis, Monitoring, Evaluation and Auditing	3,000
Total	50,000

As previously indicated, the program support will be disbursed in three tranches over a two-year period, with an initial tranche of about $10.0 million to be disbursed in late FY 1989 or early FY 1990. Decisions on the timing and level of dollar tranches will be based on GOP (a) performance progress on the decentralization agenda, (b) budget additionality and (c) ability to disburse program dollar and peso generations.

Grant dollar principal and interest funds will be used for servicing GOP official debt to multilateral development institutions such as the IMF, IBRD and ADB. The generated pesos will be for program support for selected sectors of the national budget. Budget categories for basic services

and economic development will be given priority. Other dollar and peso uses may also be agreed to.

2. Disbursement Process and Controls

Disbursement procedures will follow those USAID has used previously for budget support.

a. Dollars

Upon GOP satisfaction of legal and administrative Conditions Precedent to initial disbursement of dollars, AID will disburse dollars for the program support, through the electronic funds transfer system, for deposit in a separate LDAP Dollar Special Account(s) with a GOP-designated bank(s). In accordance with mutually agreed-upon implementation plans, GOP multilateral debt payments will be made directly from the LDAP Dollar Special Account. For non-program support items, USAID will disburse funds directly.

Prior to all subsequent dollar disbursements: (1) AID will have determined that performance criteria is satisfactory for a specific period under consideration, including fulfilling LGU budget additionality requirements; (2) the GOP will have provided evidence that the debt service payments agreed upon are being or have been made; (3) the GOP will be in substantial compliance with all terms and conditions of the grant agreement; (4) the GOP will have furnished to AID appropriate bank information where disbursed dollars will be deposited and the amount of dollars to be deposited in each account; and (5) the GOP will have provided AID a GOP payment schedule implementation plan for use of the Dollar Special Account. Earned interest will be programmed the same as principal. The grant agreement will provide for appropriate audit and re-deposit provisions.

b. Pesos

Within one business day of a dollar transfer, the GOP will deposit into a LDAP Peso Special Account an amount of local currency equivalent to the dollar transfer. Any interest earned on the LDAP Peso Special Account will be programmed and used as though it were principal.

The GOP and USAID will agree on a list of acceptable budget categories and on the total minimum peso amount to be disbursed by the GOP for eligible budget categories. The GOP's quarterly unaudited disbursement reports will be the basis of AID's quarterly reimbursement of funds from the LDAP Peso Special Account to the GOP General Fund. The GOP will undertake disbursement for the selected budget categories from the GOP General Fund under its regular budgetary and disbursement rules and procedures and will submit audited reports within an agreed upon period. The grant agreement will provide for appropriate audit and re-deposit provisions.As indicated previously, the program includes a projectized component to finance program and financial monitoring and other services. Any unused funds will be re-allocated for program support.

E. Monitoring and Evaluation

1. Monitoring Dollar and Peso Transactions

a. Dollars. The GOP will be required to provide quarterly reports of unaudited disbursements by the end of the subsequent quarter. Within an agreed-to period, the GOP will be required to provide reports audited by the GOP Commission on Audit (COA) and covering the use of dollars disbursed from the LDAP Special Account.

b. Pesos. The peso report will include cumulative actual disbursements by specific budget category through the end of the period reported upon for costs incurred during the GOP's budget year for eligible budget categories, together with the appropriate certification. The GOP will be required to provide reports audited by COA within an agreed-to period that will include peso disbursements for costs incurred during the budget year in the agreed-upon budget categories.

2. Monitoring Policy Implementation Progress

The GOP through the implementing agency will provide quarterly reports for joint GOP and USAID progress revise of progress on the policy agenda implementation. These reports will provide information on policy agenda implementation, dates undertaken, problems encountered and anticipated solutions, and next steps. During PAAD preparation, the Mission will determine to what extent technical assistance should be provided to review performance progress regularly.

3. Mission Management Arrangements

The Division of Rural Development in the Mission Office of Rural and Agricultural Development (ORAD) will have principal responsibility for program management. Other offices or divisions, including the Program Economist Office, the Controller's Office, the Office of Capital Development, Program Office, Contract Services Division, and Regional Legal Office will provide program implementation support. Mission management details will be developed during PAAD preparation.

4. Program Evaluation

In late FY 1990, an assessment will be conducted to review program accomplishments. The evaluation will: (a) assess the effectiveness of program implementation mechanisms; (b) examine actual as against anticipated policy and institutional implementation and any effects identified; (c) on a sample basis, examine the impact on basic services and infrastructure provision at the local level and the subsequent impact on local development; and (d) recommend future policy and program actions and adjustments in implementation mechanisms.

An external evaluation of LDAP will be conducted after approximately 24 months of implementation, or by January 1992. The main

objective of the evaluation will be to assess LDAP progress on providing additional financial resources to LGUs, the impact of selected policy reform and capacity building activities and the effects of overall GOP decentralization efforts. The evaluation will review the status of LDAP implementation in light of the agreed-upon performance indicators. The assessment will consider the context in which the program has been operating, including the economic, political and social factors that may have affected overall GOP decentralization policy reforms, either negatively or positively, and should include a sampling of the impact on various local development activities. Evaluation results will be used as a guide in determining if further assistance in this sector is merited and to make overall implementation improvements.

F. Gray Amendment Alert

USAID has fully considered the potential involvement of small and/or economically and socially disadvantaged U.S. enterprises. It has determined that U.S. technical assistance required for monitoring and project evaluation under the project will be provided through open competition, with special consideration given to firms submitting proposals that utilize the resources of small and/or disadvantaged U.S. firms.

G. Relationship to Women in Development

Although LDAP will not provide direct assistance for women, it will benefit Philippine population generally by channeling resources more directly to the public through decentralized planning and management. Increased decentralization will result in activities which are more responsive to the needs of the rural population, including women.

H. PAAD Preparation

With AID/Washington approval of the PAIP in March or early April, the Mission will proceed to finalize the PAAD in April, May and June. Ongoing informal discussions with DLG, NEDA, DBM, and League of Governors and Mayors representatives will be formalized and policy agenda items discussed and specific indicators developed. The Mission will seek additional assistance from local and external consultants to analyze key policy issues and project their their potential rural development impact during PAAD preparation using Project Development & Support and Technical Resources Project funding. A tentative schedule for PAAD completion is late June or early July to be followed by negotiations in July and agreement by August.

VI. ISSUES

A. Approach to Additionality

USAID has reached agreement with the GOP in principle that any additional quick-disbursing funding for FY 1989 and FY 1990 will require the GOP to demonstrate local budget additionality. By providing funding at increased levels for LGUs, the GOP can demonstrate local budget additionality. Based on a very preliminary estimate, GOP implementation of the proposed NIRA bill would require about $57.0 million for 1990 to increase LGU funds. It is neither realistic nor desirable to expect the GOP to demonstrate overall budget additionality given their probable commitments with the IMF to minimize overall budget increases. Additionality can also be demonstrated by the increased level of discretionary control LGUs have over national revenue grants. An estimated 10 percent (from 73 to 63 percent) decrease of control would result if the currently proposed NIRA bill passes.

B. GOP Capacity to Undertake Program

As demonstrated previously, the GOP has the capacity to implement program assistance. Where capacity may be lacking to produce timely audited reports, funding will be reserved for USAID to undertake the necessary auditing using technical assistance. As indicated above, the Mission believes GOP capacity exists to provide the necessary additional institutional building support to ensure effective implementation of increased resources at the local level. Local political officials throughout the country are actively seeking assistance for training and planning to enable them to respond effectively to local needs and use funds efficiently.

C. Counterpart Agency

The implementing agency for LDAP will be selected during PAAD development from among DBM, DOF, DLG, and NEDA. Some arguments for and against each agency are discussed below. To its advantage, DBM is the sole department involved in the recently initiated effort to provide and monitor funds for four provinces on a pilot basis; however, it may not have the capacity to coordinate broader policy discussions or adequately identify and monitor performance on capacity building indicators. DOF has already decentralized some operations and is likely to play key roles in the implementation of the proposed NIRA Bill and increased revenue generation activities that are important for LDAP. On the other hand, DOF as a regulatory agency may not be capable of effectively promoting decentralization reforms. DLG has a clear advantage as the department responsible for supervising local government activities, has played a coordinating role among various groups to advance proposed legislation, and is currently administering numerous training activities for local officials. Nevertheless, DLG could be reluctant to carry out reforms affecting its own future role and, subsequently, may try to direct rather than be flexible in support of wide-ranging reform. The last, NEDA, is actively promoting decentralization for efficiency and economic growth; however, its own operations are highly centralized and the primary function of NEDA regional offices has been to implement central office mandates. Like DLG, NEDA might dictate rather than facilitate working group coordination on reform. This brief summary suggests why the Mission wants to move carefully in implementing agency selection.

ANNEX

LOCAL GOVERNMENT UNITS

All LGUs are strictly regulated corporations which carry out administrative functions on behalf of and within standards set by the national government. The existing Local Government Code (LGC), passed in 1983, provides local government with minimal authority and little discretion. The five different types of local governments in the Philippines as defined under the LGC are: (1) barangays; (2) municipalities; (3) component cities; (4) highly urbanized cities; and (5) provinces. A comparison of 1983 and proposed LGC minimal requirements follows:

UNIT		MINIMAL REQUIREMENTS			
		1983 LGC		Proposed LGC	
	No.	Population	Income (P000)	Population	Income (P000)
Barangay	40,904			5,000	
Municipality	1,481	10,000	200	25,000	500
Component City	45	100,000	10,000	100,000	10,000
Highly Urbanized City	11	150,000	30,000	150,000	30,000
Provinces	75	500,000	10,000	1,000,000	15,000

Under the LGC, cities and municipalities are defined as "general purpose" local governments while barangays and provinces are defined as "political units." Taxing power of "political units" is very limited, while "general purpose" governments have greater taxing power and are also technically responsible for the overall coordination and delivery of basic, regular and direct services. However, local governments of both types have extremely limited functional responsibilities. National government agencies continue to deliver the following services for all local governments: education, health, water and sewerage. In addition, regulatory authority over local resources is often reserved to national agencies and major construction activities are managed by the central DPWH.

In 1987, under Executive Order 249, province and city categories were further scheduled into six classes based on average income for the four prior fiscal periods.