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Economists Working Paper Series

**Fiscal Federalism in
Theory and Practice:
*The Philippines Case***

Tom Miller

Second Edition

January 1999

(first edition published April 1997)



United States Agency for International Development
Bureau for Global Programs, Field Support and Research
Center for Economic Growth
Office of Emerging Markets

Economists Working Papers Series ④

**Fiscal Federalism in
Theory and Practice:
*The Philippines Case***

(Revised)

**Tom Miller
G/EGAD/EM**

January 1999

The Economists Working Papers Series are designed to share research among USAID economists and the development community, as well as to encourage a discussion of timely and relevant issues. The views of each working paper are those of the author, and do not necessarily reflect the views of the Global Bureau's Center for Economic Growth or the United States Agency for International Development. Comments are welcome.

Fiscal Federalism in Theory and Practice
The Philippines Case

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1. Executive Summary

In 1992, the Philippines radically reconfigured the relationship between its governmental tiers. Local government units (LGUs), formerly providers of low level government services and implementers of central agency programs, were given resources, policy responsibility, and implementation authority over a wide range of governmental functions. More specifically,

- ▶ Local Government Units were empowered with lead responsibility for many locally-based citizen services; including public health, hospitals, and clinics; agricultural extension; economic development; environmental regulation; welfare services; and public sector infrastructure.
- ▶ Education and public safety remain a central government responsibility but with an upgraded local role.

To meet these new obligations, Local Government Units received:

- ▶ an entitlement share of central government internal revenues (40 percent, lagged three years - which amounted to 14% of the Central Government budget in 1997);
- ▶ somewhat greater taxing authority and relief from central agency dictates; and,
- ▶ 70,283 central bureaucrats who, together with their facilities, were transferred to local government rolls.

The Philippine experiment is still in process. A decade or more, and a new generation of bureaucrats, may be required before the full impact of devolution is clear. Nonetheless, initial results seem promising. In most jurisdictions, local government is aggressively pursuing its new charge. The evidence -- still soft -- strongly suggests that for many subnational units:

1. The mix of public sector goods and services has changed at the margin, giving greater expression to local and regional preferences. This is evidenced by increased education spending by LGUs, including the spending of discretionary funds for non-mandated expenses. At the same time welfare spending fell for LGUs as a whole. Further, since devolution, there has been an increase in differentiation of expenditure patterns among LGUs. Lastly, petitioners increasingly focus on local government for the solution to local problems, and there is greater popular participation in governmental decisions. To the extent that the basket of public sector goods and services more closely conforms to citizen values, as expressed through democratic process, an increase in welfare can be inferred.¹

¹ See footnotes 7, 31, and 37.

2. Procurement is more cost effective, better targeted, and time-sensitive. Local government construction costs per square meter of building and per kilometer of roadway are often well below the reference cost of national government procurement guidelines. Further, better targeting and more timely decision-making has been anecdotally noted in many areas. Disaster spending is often cited as a case in point. Localities now have resources and authority with which to address calamities. Though such funds are limited and further actions may be needed central government agencies, LGUs are routinely faster in responding to disasters and procure more cost-effectively. This is thought to reflect both greater procurement agility under the decentralized system and, equally important, the sensitivity of local procurement decision-makers to local needs. Local jurisdictions were faster to respond to recent typhoons, and at the same time are better able to deal with more localized micro-disasters which might otherwise be overlooked at the national level.
3. Popular identification with and participation in governmental activities are up, leading to more responsive public programs and greater private contribution of time and resources to public activities. This likely relates to the direct access individuals and groups now have to project planning and implementing officials. Illustratively, policing of environmental regulations by popular groups acting on behalf of and under the direction of local government seem to be occurring in many communities.
4. Innovation appears stimulated by the freedom from rigid, centrally-fiated procedures, and the proliferation of bureaucratic autonomy. Elimination of dysfunctional, staff-intensive, and time-wasting bureaucratic procedure inherited from central authorities remains high on the agenda of newly empowered subnational entities.
5. Anecdotal accounts of reduced corruption are plentiful. These seem associated with reforms taken as part of the decentralization process -- formal transparency requirements, multiperson approval requirements (three rather than one) and fewer bureaucrats in the disbursement chain. Other possibly relevant factors: procurement officials who now live where their financial life-style changes are more noticeable; and statutory requirements for external audits.

More negatively,

1. The match-up of local government responsibilities with financial resources is seriously flawed both horizontally and vertically, i.e., both across and between classes of governmental entities there are great inequalities in command of resources, as related to functional need.

2. The provision of an entitlement share of national revenues may have undercut incentives for improving local tax administration;
3. A clear linkage between a community's tax burden and the extent and quality of local government services is not in evidence.
4. Resources appear to be wasted through inconsistent and incomplete application of the enacted devolution concepts. For example, the Congress continues to provide funding to central health and agriculture ministries disproportionate to their reduced functions and staff; large numbers of devolved central government employees still identify with the central government and are not fully responsive to local chains of command; and career bureaucrats in national government agencies often retain a mind-set and institutional culture hostile to local government empowerment.
5. The central government retains dominance in education and public safety, sectors whose full decentralization would be consistent with the underlying philosophy of the Local Government Code, and with devolution theory.
6. National goals for devolved programs are threatened when local governments do not buy-in. The fate of national population programs in LGUs headed by those with a "right-to-life" perspective is an extreme example. Along these lines also, LGU's appear less inclined towards social equity goals than the national government.
7. Performance under decentralization has varied widely. Despite sizeable performance gains in the better performing LGUs, there are many LGUs that have accomplished little, if anything. (Although there are few if any cases apparent where devolution substantially worsen the local situation.) Further, capture by local elites serving a narrow or self-serving agenda is an ever-present danger

Recent Trends, 1996-present. Philippine decentralization continues to evolve in a positive manner. In the two and half years since the author's initial review of Philippine decentralization there have been a number of very auspicious developments.

1. The better performing LGUs have demonstrated competence and public support. This has raised the prestige of local government employment, and the self-confidence of LGUs.
2. The Congress is far less hostile to local governance. As had been predicted, term limits forced many congressmen to give up their legislative seats. A number of these ran for LGU offices and/or were replaced in Congress by

local political office holders. This blending of the two political cultures has defused tension. The elimination by the President in 1998 of the "country-wide development fund" -- public monies controlled directly by individual congressman and senators for development projects in their districts -- has further reduced congressional -- LGU mutual antipathy.

3. NGOs and LGUs have established a mutually supportive *modus vivendi*. LGUs found that the NGOs could and would work well within LGU agendas, and for their part, NGOs found LGUs capable of effective and well intended action. At a different level, LGUs found it easy to bypass the statutory role of NGOs, and both found that the NGOs did not constitute an effective political vehicle with which to challenge existing politicians. This made LGUs less fearful of NGOs and, NGOs more inclined to cooperation rather than confrontation. Lastly, there is speculation to the effect that declining overseas contributions to Philippine NGOs have made access to government resources more attractive to NGOs. In any case, NGOs and LGUs relations appear satisfactory now, as opposed to being highly negative just a few years ago.
4. National government agencies increasingly respect local government prerogatives. The new Estrada government appointed officials sympathetic to the concept of decentralization. For example, the Ministry of Health, formerly a die-hard anti-devolution stronghold is now under a minister who is reconfiguring it into a decentralization support mode. While there is still entrenched opposition among career bureaucrats in many agencies, it is being overcome. The major exceptions here are the Department of the Interior and Local Government (DILG) and the Department of Agriculture, both of which still view local governments in a paternalistic fashion.
5. Devolved government employees increasingly realize that they must adapt; that renationalization is no longer a credible possibility. Moreover, while almost all have lost income and job mobility, at least a few have found their new bosses more interested, open and accessible than the central agencies they used to work for.
6. Through 1997, the Philippines had sufficient resources to fund LGUs and not cut central agencies. The question was when hard times came who would take the hit; *i.e.*, what was the budgetary priority of decentralization. The answer came in 1998 when the executive declared a fiscal emergency. Both IRAs and national agency budgets were cut, but the latter disproportionately -- IRAs were cut by 10%, but national agency budgets by 25% (with various exceptions.)
7. Sectoral effects have become clearer over time as LGUs continue to recast inherited programs to suit their own immediate operational priorities.

Discussion with LGU officials suggest that the main LGU priorities appear to be dealing with squatter problems and solid waste disposal in the urbanized areas; and with job creation and environmental protection in the more rural areas. With regard to sector performance and emphasis:

Re: health delivery-- hospital care has deteriorated but most other aspects of health delivery system appear improved. Little change is apparent in national morbidity and mortality statistics. Uneven resource access and medical staff benefits remain severe problems. Salary is the chief complaint of devolved health workers whose salary is thought to average about 20% below central government scales.

Re: environmental protection -- LGUs have refocused on urban environment and marine protection with less emphasis on reforestation. Program effectiveness in the LGU targeted areas is thought to have improved significantly.

Re: agricultural extension-- LGUs have refocused on agricultural marketing; and, by anecdotal reports, seem to use devolved agricultural workers more for environmental protection. The Agriculture Department's goals of grain production and national food security appear to be of little interest to LGUs. Overall agricultural spending levels are below pre-devolution trend lines. Chief complaints of devolved agricultural workers is that they are being used as generalists and have lost technical specialist status; and that they have lost job mobility.

Re: social welfare-- narrowed focus, exclusion of migrants; housing and community development expenditures rose but most other areas of social welfare spending levels have fallen noticeably below pre-devolution trend lines.

Re: development planning & promotion-- sector planning is out. Emphasis now is on geographic planning with immediate operational significance. Some LGUs are very aggressive in investment promotion.

Re: education & public safety-- LGUs by all reports place a high priority on education, as evidenced by an increase in discretionary LGU spending on education, and even on areas of central government responsibility. The public safety situation is largely unchanged.

Re: municipal services (garbage, markets, cemeteries, feeder roads, *etc.*)-- anecdotal indications of improved efficiency. Barangays in particular are more active, having independent funding for the first time.

Re: management practices-- innovative behavior and managerial improvement on the part of the more progressive LGUs continues to proliferate, although they give insufficient attention to improving revenue collection.

IN SUM, substantial benefits have been demonstrated, although these are not yet systemic. The potential gains in economic efficiency appear large and are increasingly evident. At the same time the deficiencies uncovered, serious though they may be, seem correctable and of a lower order of magnitude. The flaws seem to relate to incomplete or ill-structured aspects of decentralization rather than the concept itself. Technically the corrections would appear easy, politically not so. Most importantly, time is now on the side of decentralization.

The Philippine experience displays a full range of problems and promise inherent in the decentralization of government. It is a valuable and easily accessible experience base for LDCs contemplating major decentralization or devolution efforts. As such it has immediate relevance to USAID development professionals.

2. Introduction

A surprising number of LDCs, emerging market, and transition countries are currently engaged in decentralization²; in many cases giving fiscal reality to what had been only a nominally federal system. Subnational responsibility for a wide range of government functions and services is seen as a solution to the alienation of government from the people, and the lack of governmental agility in addressing long-standing economic problems. For foreign donors³, decentralization also represents an opportunity to by-pass the political will deficiencies which so often plague the development support business. Donors such as USAID can and do choose to work with local governments demonstrating commitment and potential.

Philippine decentralization/devolution has proceeded with extraordinary speed and coverage. It lends itself well to study in that the process is still very recent, indeed, on-going. Key documents are in English. Moreover, local economists,⁴ political scientists, and other observers have been extensively studying the process as it unfolds. Fourth, there is a large, active foreign donor involvement (led by USAID) which has produced a multitude of evaluation and appraisal studies tracking the progress and problems in the devolution process.⁵

The present analysis is largely drawn from such studies, as well from: interviews with senior analysts and USAID-funded project technicians; discussions both in Manila and in the field with governors, mayors, barangay captains, other LGU officials, and devolved workers; conversations with national government officials involved in decentralization; and, visits to NGOs, and interviews with LGU associations (or leagues). The author also benefited from attending the innovation awards ceremony for local government excellence and innovation, and from luncheon conversation with knowledgeable LGU officials at that ceremony.

² The list of such countries includes many if not most of the former Eastern bloc countries including China, Russia, Poland, and Albania. In Latin America, Brazil and Colombia both are intent on active programs, and much of the rest of Latin America is considering what can/should be done to empower subnational jurisdictions. Lastly, in Asia, Indonesia, India, Bangladesh, and the Philippines all have major decentralization reforms underway. Some of these already were nominally federal systems, but are only now in the process of devolving a share of substantive and policy responsibility to subnational levels.

³ Decentralization is NOT, in any sense, donor driven in the Philippines. Donors play a critical but supporting role.

⁴ Rosario Manasan of the Philippine Institute of Development Studies (PIDS), has produced a number of particularly noteworthy analytic pieces examining the devolution process.

⁵ A series of Rapid Field Appraisals funded by USAID under the Governance and Local Democracy (GOLD) project, (8 appraisals thus far) tracks progress and problems in devolution contemporaneously. By providing objective and comprehensive (albeit impressionistic) information, the appraisals have helped defend the program from unfounded and politically motivated criticism.

This report is not meant to be comprehensive, nor detailed. Rather, it is aimed at drawing on the Philippine experience to gain insight and illustrate the essential analytic questions in fiscal federalism. The perspective is intended to be that of political economy with the emphasis on economics. Information is current as of the end of 1998.

THE KEY QUESTIONS of interest here are:

- ◆ ECONOMIC EFFICIENCY (of resource allocation in a Pareto optimality⁶ sense and, secondarily, in a cost-effectiveness sense;)
- ◆ VERTICAL AND HORIZONTAL BALANCE among governmental tiers in the assignment of functions and resource claims;
- ◆ EQUITY (in terms of "fairness" of treatment) and the operational efficiency of governmental intervention in support of national values;
- ◆ MACROECONOMIC STABILITY and management complications engendered by devolution; and
- ◆ THE DEVOLUTION PROCESS; the choice among alternative decentralized configurations as they affect all the above; and the ability of the devolution process to evolve in a positive direction.

It can be shown that democratic processes are critical to the welfare-maximizing selection of public goods and services; *i.e.*, to the welfare of the people as they define it. However, promotion of democratic values, as an end itself, falls outside the scope of this study; though it should be recognized that fiscal federalism can play a major role (positive or negative⁷) towards this end. Also decentralization can calm or exacerbate ethnic or regional political tension, this aspect also is beyond the scope of this report. The intention is that the present study be free-standing, but also contribute to G/EG's work on developing an USAID-relevant analytic framework for the economics of fiscal federalism.

⁶ Pareto optimality requires that there exist no possible changes which could make someone better off without making someone else worse-off.

⁷ The participatory aspects are usually stressed by local governance advocates. However, performance reflects not only on the specific government but also on the system. For example, there are people in the Philippines who will point to a lapse of public sector performance and assert, "it was better under Marcos."

3. Fiscal Federalism Theory

Strictly speaking, the term federalism refers to a system of layered government with each layer having a defined sovereign function. Fiscal federalism is economist terminology for the economics of such governance arrangements. Analytically speaking, sovereignty is not necessary, only that each layer have real decision-making power and control over resources, and behaves as if it were part of a federal system.

DECENTRALIZATION BENEFITS

Where substantial regional differences exist, economic welfare theory establishes a presumption in favor of decentralization. It can be shown that if the collective preference of the citizens of a given region are different from those of other regions within a country, an increase in welfare can be achieved by tailoring the mix and level of public goods and services to each region's collective preference function.⁸

Regional preferences will differ because of differences in basic values, in resource endowment, in the stock of public goods, and for all the reasons that make one region different than another. Local decision-making is much more likely to reflect local preferences than central decisions, which in any event are biased toward uniformity.⁹ Moreover, with geographic mobility, individuals can migrate to regions which better serve their preferences, thereby further raising economic welfare. The Philippines, with some 11 main islands, upwards of 80 languages and dialects, a number of very distinctive ethnic and religious groups, and effective local democratic process, should possess ample diversity for regional empowerment to be beneficial. (The argument can be made also that where the differences are extreme, or irreconcilable, regional empowerment may merely fuel centrifugal forces and secessionistic tendencies. Also, where the minority is unwilling or unable to achieve local concentrations, strong minority preferences may be ignored.)

⁸ Illustration: Assume a country of two regions, receiving a uniform allocation of public goods and services. At the margin, if region 1 values public sector good "a" more relative to good "b", than does region 2, then in theory both could be made better off by trading some of region 1's "a" for region 2's "b". However, strictly speaking, the gains have to be defined in terms of the subnational entities' preference functions as expressed through their political process. See footnote 31. 38

⁹ This all suggests that the more responsive (read democratic) the local government, the greater the potential gains from decentralization.

THE ESSENTIAL POINT is that:

DECENTRALIZATION ENGENDERS SOCIAL WELFARE GAINS by facilitating a level, mix, and geographic distribution of public sector goods and services that is adjusted for local values.

Further, decentralization is theorized to favor:

INNOVATION / FLEXIBILITY: Smaller autonomous units are considered likely to give collectively a far greater range of innovation, as well as a tailored response to local anomalies. Successful innovation not only benefits the initiating region but likely will be replicated.

ACCOUNTABILITY: A more immediate relationship between beneficiaries and public officials is seen as promoting accountability. Daily interaction with beneficiaries is conducive to empathy and pride in performance, and to electoral consequences. Feedback, both positive and negative, is direct and immediate. With regard to illicit gains it can be argued either way. A lifestyle disproportionate to legitimate income is far more likely to draw attention in the case of a local official. At the same time, conflicts of interest are often more immediate, with a greater likelihood of impacting on the financial interests of friends and associates. Further, some would argue that national-level waste, fraud, and corrupt practice, by virtue of scale and pervasiveness, is more damaging than the aggregate of it's localized counterpart.

AGILITY / RESPONSIVENESS / cost efficiency: It is generally assumed that small units can react faster, and with greater flexibility; and with better targeting to citizen wants/needs; and to do so without the overhead costs and diseconomies of a large, distant bureaucracy..

CENTRAL GOVERNANCE FUNCTIONS

Clearly, some governance functions are best undertaken at a national level. National defense, foreign policy, and the regulation of international and interstate commerce are the classic examples. Others involve:

SCALE ECONOMIES (e.g., highly specialized hospitals and training facilities, maintenance of national data bases, and other goods and services of a type that requires costs to spread over large potential user base.)

TAXATION OF GEOGRAPHICALLY MOBILE INCOME AND ASSETS; AND ON NATURAL RESOURCE EXTRACTION.

INTER-REGIONAL RIVALRIES AND DISPUTES: Sometimes regional preference must be suppressed for the perceived common good. Interregional transfers for equity promotion might be such a case.

SPILL-OVERS AND EXTERNALITIES: The actions of one governmental unit can have positive or negative consequences for its neighbors, suggesting the desirability of central coordination.

QUALITY OF THE BUREAUCRACY AND FINANCIAL MANAGEMENT: Subnational governmental personnel and systems are often thought of as inferior to those of central governments, though this is true neither in the Philippines nor in many other countries. The issue is more one of ensuring adequate compensation and status for local government personnel.

OVERRIDING MACROECONOMIC STABILITY PROBLEMS: Devolution seems to complicate macroeconomic management, at least once an economy is in trouble. (In theory, neutrality with respect to LGU impact on macroeconomic stability can be designed into decentralized systems through controls on LGU borrowing, changes in transfer payments from the national government, etc. Again, technical feasibility is quite different from political feasibility.)

RESOURCE / RESPONSIBILITY BALANCE

To be efficient, the system should be assigning the provision of public goods and services to the unit best able to internalize costs and benefits.¹⁰ In this context, a decentralized system has a greater need to insure an efficient and equitable balance of resources and responsibilities within and between governmental tiers. That is, without a relative correspondence between responsibilities and resources, among (vertical) and across (horizontal) the various governmental layers, the system as a whole will not work well. In its horizontal dimension, this means that governance entities of a given tier should have comparable command of resources and the ability to provide roughly similar service levels. Geographically disadvantaged regions, with extreme variations in the level of public sector goods (e.g., education, health, and public safety) are not generally desirable.

TAX AND REVENUE CONSIDERATIONS

In terms of the vertical dimension, each layer of government should have access to resources roughly proportionately to its share of total public sector burden. However, the comparative advantage of one tier in the provision of a class of public sector goods may not be matched with a similar advantage in revenue generation. Fortunately, in a decentralized system, revenues and expenditures can be disjoined, at the tier level. That is, one level of government, the federal level, may need to take a disproportionate share of the system's overall revenue raising requirement, systematically transferring funds to other levels of government.

¹⁰ "To internalize costs and benefits" means that both costs and benefits accrue within the unit. In garbage collection, for example, both benefits and costs accrue to residents of the residential area. By contrast, environmental protection may have "spill-over" effects that impose costs or confer benefits outside the initiating jurisdiction.

Assignment of responsibility for raising the revenues to pay for public expenditures is conceptually somewhat convoluted. The need is to efficiently raise revenues while minimizing economic distortion, preserving a linkage between tax liability and fiscal benefits, and facilitating social equity objectives-- often inconsistent objectives, with no overall clear-cut conceptual solution. Different tiers enjoy different comparative revenue collection advantages.¹¹ Thus the usual federal model structurally involves supplemental transfer payments from the national government to subnational governance entities.

As indicated, there are tax and revenue asymmetries that bear importantly on the nature of decentralization. While some differential subnational taxation is desirable, broad-based, national taxation has proven the most effective revenue generator. Highly progressive taxes on income for example, if imposed on a subnational basis, could distort the location of economic activity. Moreover, high proportional local tax burdens could lead to revenue reducing tax-break competition among regions, to the detriment (or benefit where the total tax load is dysfunctionally high) of all.¹² To minimize the distortive effect, taxes on mobile tax bases must be administered in a more or less uniform fashion over the country. (Or for equity objectives, explicitly orchestrated to promote underdeveloped regions.)

In addition, taxes on natural resource extraction are usually preferable at the national level. Local taxation here could exacerbate regional income disparities; and allow favored jurisdictions to acquire a disproportionate share of national resources and/or to export their tax burden to regions importing the extracted resource.

DECENTRALIZATION CONFIGURATIONS

While systems tend to be clustered at one extreme or the other, decentralization /devolution possibilities are in fact a continuum. There are an almost infinite number of quantitative and qualitative degrees and dimensions of (de)centralization possible under a host of governance configurations. For example, administrative and operational authority over an activity or field of activities can be locally based while policy authority and program sovereignty are centrally retained. This is sometimes referred to as "deconcentration". Nor does decentralization have to be geographic. Governance authority and responsibility in

¹¹ A recent paper by Wallace Oates (listed as item 18 of appendix A) summarizes theoretical insight on the relative tier advantages in utilizing the different types of public sector revenue vehicles: "... the central government is in the most advantageous position to employ progressive redistributive taxes (on personal income or, perhaps, expenditure), while highly decentralized levels of government should seek out relatively immobile tax bases (like local real estate) or should rely on user charges. Intermediate level governments like states or provinces obviously have more room to maneuver than small local governments; there is more scope here for the use of income and sales taxes -- although potential mobility is still operative to some degree as a constraint on tax policy." He then notes that, indeed, this is the way many country tax regimes are structured.

¹² Maintenance of minimum environmental, and labor standards would be an analogous case. Without some element of central coordination or control, polluters could play local jurisdictions off against one another.

varying degrees can be partitioned or devolved ethnically (e.g., Lebanon), functionally (say a water authority), professionally (professional societies with force of law authority over members), or even exercised in a transnational decentralized entity (a border area port or river authority). Optimality in the context of these dimensional continua relates to a country's cultural values and economic base; with actual practice often based in practicality and historical accident. For purposes of manageability, this current paper will confine itself to the geographic-based, subnational governance entities corresponding to the usual notions of state, city, municipality, and neighborhood. Even within this narrowed context, decentralization is a question of degree rather than kind.

4. The Philippine Experience -- Exposition

LOCAL GOVERNMENT CODE OF 1991: BACKGROUND

Delivery of citizen services at the local level is once again primarily a local government responsibility in the Philippines. The balance between tiers of governance has see-sawed over time. The precolonial Philippines had a village- or locality-based governance system. The Spanish authorities rigidly centralized political authority, but later the US colonial administration partially restored the local role. The Marcos regime in the 1970s and 1980s carried centralization to the extreme (while nominally empowering local government). Interestingly, irrespective of the degree of centralization, personalities rather than parties or ideology have always dominated Philippine politics.

Amidst revolutionary fervor, the Constitution of 1987 was ratified by plebiscite.

Reacting to the excesses of the martial law period, this new constitution mandated devolution of substantial power to local government units. In 1991, bowing to the demands of a very popular president, lead by powerful legislators with regional political bases,¹³ and needing support from local officials in a difficult election, the legislature acquiesced to a strong devolution law. It was in reality a unique political moment which allowed passage of a "Local Government Code" (LGC) fully implementing the intentions of the constitution. Local responsibility until then centered on: (1) administering low-level services such as garbage collection, public markets, and secondary roads; and (2) implementing a portion of central agency programs as directed by those entities.¹⁴

Philippine local governance consists of:

- 2 autonomous regions,
- 76 provinces,
- 1,540 municipalities,
- 66 cities, and
- 42,000 barangays.

The numbers change over time as new Local Government units are created or old ones combined.

Box 1

DEVOLVED RESPONSIBILITIES AND AUTHORITIES

The intent of the Local Government Code (LGC) of 1991 was to devolve responsibility for public sector goods and services to the lowest level of government deemed (as a class) capable of effectively providing it at the locale where it is being provided.¹⁵ Foreign Policy, National Security, and special programs for

¹³ Congressman Pimentell of Mindonao is often cited as being particularly effective.

¹⁴ A 1988 USAID study (item 7 in the reference list of Annex B) calculates that at that time 73 percent of LGU budgets were directly under the control of Central Government entities.

¹⁵ Roughly corresponds to what is sometimes called "the principle of subsidiarity", one version of which would assign responsibility for a given function to the lowest governance tier level capable of internalizing the bulk of costs and benefits.

underdeveloped areas remain central government monopolies. Education and police are shared concerns, with the central government agencies in the lead but with a substantially enhanced local government role. The major change, however, was to expand province, city, municipality, and barangay¹⁶ responsibilities to encompass primary jurisdiction over planning and provision of agricultural extension; health and hospital services, social welfare services, local economic development, environmental management and pollution control, public infrastructure, and zoning. In these areas, central government agencies are to support, rather than dictate local activities and decisions. Within a wide discretionary range, LGUs became free, at least in theory, to provide such services in the way and at the level they see fit.

The code prescribes responsibilities in great generic detail.¹⁷ Road maintenance, construction, and planning responsibility, for example, depend on whether a road is classified as a provincial, municipal, or barangay level road. Primary and secondary hospitals and major medical services are the responsibility of the province, but health clinic and day care centers belong to the barangay level. Prime responsibility for agricultural extension activities; environmental protection and forestry law enforcement; industrial research, low-income housing and social welfare services, trade promotion, tourism, and telecommunications services all devolved to the province level and below.

Sanitation and garbage collection remain at the Barangay level. Inter-tier communications, power, water and sewage and other infrastructure is the responsibility of the respective LGU development councils. Where disputes arise, they are resolved by the legislative body (sanggunian) of the covering (provincial or national) tier of government, the sanggunian being assisted by its corresponding development council.

DEVOLVED RESOURCES

PERSONNEL AND FACILITIES: Along with the functions and responsibility, over 70,000 central government officials were transferred to local roles, along with their facilities and equipment. (These were mainly from the Health and Agriculture ministries, and constituted more than 60 percent of the personnel of those ministries.) These individuals became employees of local government units, supervised by LGU officials, and paid from local government funds. Similarly, operating and capital expenses for devolvees and their facilities (e.g., offices, hospitals, clinics, maintenance depots) became part of Local Government budgets.¹⁸

¹⁶ A Barangay is an administrative subdivision of a municipality roughly corresponds to a ward or precinct in US political terms. The head of a Barangay is known as the Barangay captan.

¹⁷ See appendix C.

¹⁸ Unfunded mandates in the view of many LGUs, given that they had to take the devolved employees, are required to pay them at central government pay scales, and for all practical purposes, could not discharge them

TRANSFERS, TAXES, AND USER FEES To fund these new responsibilities Local Government Units (LGUs) were also given an entitlement share of central government revenues and some additional taxing powers.

Inter-Tier Allocation Formula for Internal Revenue Allotment (IRA)	
--Provinces:	23%
--Cities:	23%
--Municipalities:	34%
--Barangays:	20%
data as of 1996	
Box 2	

Specifically, the code prescribes required, and unconditional, revenue transfers to LGUs from the central government. Foremost of these is the IRA or "internal revenue allotment", i.e., the allocation to LGUs of a fixed share of central government internal revenues to subnational government levels. Forty percent of such revenues, (calculated from the third fiscal year preceding the current FY) are allocated to LGUs as an entitlement¹⁹. As long as inflation persists, the 3-year lag significantly reduces the real resource entitlement. In 1996, for example the IRA amounts to only 12 percent of the current year budget. A rigid formula under the code governs the allocation of the IRA to and within each LGU governmental tier. (Roughly equal amounts of central government earmarked and conditioned grants are also made. These tend towards the interests of the central agencies, but since field implementation personnel were largely transferred to LGUs, the latter are not without negotiating leverage.)

INTRA-TIER INTERNAL REVENUE ALLOTMENT (IRA) ALLOCATION:
for each entity class in box 1 available funding will be apportioned to individual LGUs on the basis of:
- 50% by population
- 25% equal share to all, and
- 25% by land area
Box 3

Highly discretionary project funds were also made available to the congressman for his/her district, again outside the control of LGUs, and not part of the IRA.²⁰ Lastly, local governments are entitled to a 40 percent share (1-year lagged) in central government tax and revenues associated with natural resource extraction within that LGU's territory. (To the great annoyance of LGUs, little has been forthcoming from this latter, nor has there been a

¹⁹ Thirty percent in fiscal 1992, but the central government picked up a substantial share of devolution costs during the transitional year..

²⁰ Until quite recently, Philippine Congressmen each control Ps 12 million (Senators, Ps 18 million) for development activities of their choice. This was known as the "Country-wide Development Fund" Generally regarded as pure Congressional "pork", it is outside the framework of the IRA. As Congressmen often bypassed municipal authorities in the use of such funds to ingratiate themselves with constituents (or in the view of skeptics to enrich themselves and their friends) it constituted a major irritant to LGU official. In 1998, President Estrada deleted the item from the National Budget, and it did not reappear in the 1999 Budget.

detailed accounting of such government revenues.²¹⁾

The LGU taxation power was also revised upward, giving limited power to change property and business tax rates, and wide discretion in setting user fees.²²

CODE INTERPRETATION / DISPUTE RESOLUTION

To definitively interpret the code, and arbitrate ambiguities and unavoidable differences in interpretation, the 1991 law sets up a joint congressional / executive branch oversight committee. Membership is weighted in favor of the executive, and individual members are change annually. In theory, the court system could have an overriding role, but the courts are slow in the Philippines and have had little immediate impact on decentralization issues. However, the number of decentralization court cases is rising.

²¹ Some provinces have been able to collect part of this entitlement but only with a great deal of noise, and the expertise and information to establish the amount they were owed.

²² The code enumerated rates for a number of types of taxes and allowed LGUs to increase rates by up to 10 percent of the specified levels. LGU could assess taxes of other types provide that the rates were reasonable and that various code requirements (including transparency and public hearings) be met. LGUs are allowed to make tax rate adjustments only once per five year period. The power to grant or revoke exemptions from local taxes was also provided to LGUs.

5. The Philippines Experience -- Analysis

A. Shake-out Period

It is well to remember that experience under the new code is still quite limited, and a continuing shake-out period should be expected. The code was enacted in October 1991, to take effect in January 1992. Complementing (or complicating) the devolution, synchronized national / local elections for almost all offices took place in May of 1991. With roughly one-third of all office-holders changing, massive shift of civil service personnel to local government roles, and a vastly different structure of governmental tier responsibilities, it was mid-'93 before most of administrative chaos was sorted out. Substantive program changes under the code really did not begin in earnest until late in 1993. Thus, there is less than five years data and implementation experience, and the results are still largely out in the future. Further, LGUs were locked into many programs, and into staffs and facilities not of their design. Lastly, some central agencies were and continue to ignore decentralization in so far as is possible. The reality is that 10 or 20 years will be needed to complete fully the decentralization process.

Number of Devolved Personnel & Percent of Ministry Staff Devolved Per Department		

-Agriculture	17,673	(59%)
-Budget & Management	1,650	(47%)
-Environment & Nat. Res.	895	(4%)
-Health	45,896	(61%)
-Welfare & Social Dev.	4,144	(59%)
-Other	25	(<0.1%)
-TOTAL	70,288	(100%)

Source: adapted from the Manasan study, Document no. 3 of Appendix A

Box 4

B. Deconcentration vs. Decentralization

An analytic distinction is sometime made between fiscal decentralization and administrative decentralization (sometimes called deconcentration.) In the former, decentralized units are independent actors servicing their own agendas: in the latter, they are field offices or implementing agents for central government programs. Philippine LGUs are of the former case: even where they are implementing central agency programs, they now do so primarily for their own reasons.

The degree of decentralization, fiscal or administrative, is reflected in the relative expenditure levels. In terms of the percentage of GNP, LGU expenditures rose from 1.9 percent in (1992) the year prior to full implementation, to 3.4 percent in the second year of implementation, and 3.7 percent in 1997. In budget terms, LGUs accounted for 7.7 percent of general government expenditure in 1991, the year preceding the code.

This has doubled to 15 to 16% in the each of the last four years for which there is data. Further, The 31 percent share of national government expenditures required for interest payment tends to skew the figures. Subtracting out debt service from the calculation puts the LGU proportion of government spending at roughly 20 percent, what most observers see as reasonably indicative of the relative level of local government controlled activity.²³ Consistent with this, Philippine political culture and patronage relationships seem to be changing as local government became a major player in the procurement and distribution of government goods and services.

(in percentages)	
1994	
Current Expenditures	83%
<i>of which</i>	
Personnel	27%
Maintenance & Operations	11%
Interest Payments	31%
Allotments to LGUs	11%
Subsidies	3%
Capital Expenditures	15%
<i>of which</i>	
Infrastructure	12%
Transfers to LGUs	3%
Equity & Net lending	2%
Source: unpublished government data	
Box 5	

As could be expected, local governments have become more dependent on central government transfers. The financial autonomy ratio (FAR -- the ratio of non-central government origin LGU revenue²⁴ to LGU expenses.) as calculated by Chat Manasan²⁵ show a significant deterioration since devolution. More specifically, the the FAR fell from 52 percent on average for the 7 years preceding the code to 37% in the subsequent 5 years. Moreover, FAR rates fell for all classes of LGUs. The averages can be deceptive however -- the 1996 USAID

²³ This is still far below the percentages experienced in many fully functional federal systems.. In Canada for example, provinces and local government account for some 59 percent of total government expenditures. The dominance of Central government expenditure in LDC federal systems is, however, quite common -- an unpublished World Bank report notes that in India, Indonesia, South Africa and Mexico, the central government accounts for more than 70 percent of total public sector expenditure.

²⁴ Borrowing is considered revenue. The misuse of the term provides a definitional solution to the legal prohibition on LGU deficits. Limited LGU borrowing for capital investment is permitted - see section 5.C.vi. for terms and conditions.

²⁵ See Appendix G.

Rapid Field Appraisal identified a number of LGUs with substantial improvement in revenue generation.

C. Tier Responsibilities and Resources.

The central concern of fiscal federalism is generally referred to as the "assignment problem." That is, the basis on which the assignment of responsibilities among the tiers of government is made; and equally important, the assignment of the means by which to meet these obligations.

Local Government Revenues 1994	
Local Source Revenues	36%
<i>of which</i>	
Property Taxes	9%
Business Taxes	12%
Nontax Revenues	15%
Grants	64%
Source: unpublished government data	
Box 6	

FORMULA -BASED APPROACH. The 1991 Local Government Code takes a formula-based approach to these questions; specifying -- perhaps even over-specifying-- these in great detail. The consensus among analysts and practitioners consulted is that such specificity is necessary to insulate the process from dysfunctional political maneuvering. Further, the planning / budgeting / implementing process requires a reasonable degree of predictability as to resource availability. Anything short of a clear, difficult-to-change entitlement formula, would have handicapped local government performance from the start.²⁶ Moreover, the code itself imposes a mandatory review of its provisions every five years (now two years overdue). However, while most observers find clear and correctable inequities in the formula, politically it has not been possible to address them.

VERTICAL BALANCE²⁷. The code created a major imbalance between the allocation of responsibilities to various government levels and the resource to support those responsibilities. In terms of the net balance of devolved costs and

²⁶ It came as a shock to LGUs when the executive declared, in accordance with a little notice provision of the local government code, declared a fiscal emergency in 1998 and reduced the IRA by 10%. On the positive side, this brought home to LGUs the problems with an over-dependence on National Government transfers.

²⁷ The vertical balance question arises because there is no necessary relationship between the comparative efficiency of a tier in raising revenue and in spending it. This is a particular problem of decentralized systems. While subnational units may be most efficient in providing for some classes of public goods they are disadvantaged in revenue raising. Taxes on mobile factors of production (e.g., income taxes) are best assessed and collected at national level. Collection at lower level risks factor distorting and revenue reducing tax avoidance behavior. Import duties are another category that for obvious reason are best collected at national level. This disconnect between the level at which a public good or service is most efficiently rendered and the level best able to generate the revenue to support that function is the reason inter-tier transfers are generally required to support federal systems.

revenue entitlement, provinces were net losers and cities were net gainers. More specifically, under the 1992 LGC devolution formula, cities and provinces got an equal share of entitlement transfer revenues (23 percent each of the IRA), yet they received disproportionate devolved responsibilities. In terms of salaries and operating expense costs for devolved central employees and facilities, the cities received roughly P300 million in devolved costs, while the provinces had to swallow ten times as much -- over P3 billion.²⁸ Cities and municipalities made out well under devolution IRA formula, with a strong positive net fiscal benefit.²⁹ By contrast, more than half the provinces had a negative net fiscal benefit (IRA minus devolved costs) in the first year, but by 1994 this was reduced to a handful³⁰. Barangays did well, not previously having much access to financial resources. Further accentuating the differential, on the tax base side, cities retained sole authority to levy and collect business (gross receipts) taxes -- by far the most productive of local taxes.³¹ To correct the imbalance, the provinces are demanding that the costs of devolution be compensated fully out of the IRA, and the formula allocation then applied to remaining IRA funds. A solution along these lines seemed likely initially, but proved too difficult politically in practice. Lately tier group organizations have stopped feuding with each other and concentrated on pressing for a larger overall IRA.

HORIZONTAL BALANCE: The code does little to foster comparable access to resources by like LGUs within a tier. Wide geographic variation in public goods and services, reflecting underlying socio-economic conditions are not conducive to political stability. IRA allotment formula favors entities with large areas and small populations -- population counts only for 50 percent in the allocation formula. Per capita IRA varies by a factor of some twenty-three times between the top and bottom province recipient. For per capita local source LGU revenue, the difference is even greater -- eighty-three times. In terms of horizontal equity or income redistribution from the richer to the poorer areas, the code is seen in practice as neutral or perhaps slightly

²⁸ The major element is the costs of operating and maintaining the hospitals.

²⁹ As in many countries Cities, and urbanized municipalities possess considerable political strength by virtue of the votes its administration can deliver or withhold. Representatives of the cities were very active at the time the formula was being brokered.

³⁰ In these provinces the mandated salaries and additional operating expenses necessitated a reduction of non-devolved activities such as road maintenance and bridges.

³¹ The biggest revenue generator for LGUs, aside from the IRA, is the property tax. However, in reality there is very little flexibility here. Property taxes are collected at the municipal level and shared among LGU tiers. However, the central government limits the tax rate, and tax collection efficiency is very low -- indeed, in many jurisdictions the cost of collection exceeds the proceeds.

regressive.³² Per capita expenditure rates vary considerably. Extreme variations in the quality, quantity, and administration of local government services reflect the general disparity between geographic locales. Financial autonomy ratios vary even more starkly, with the poorest province being forty times more dependent on the central government for transfer revenue than the richest. (See Appendix G.) Moreover, the code also encourages gerrymandering and municipal succession as LGUs try to divide themselves into multiple entities, or to increase their share of IRA revenues. Conversion from municipality status to city status (a semi-political process) will also boost the IRA entitlement..

TAX BURDEN AND FISCAL BENEFIT RELATIONSHIPS. From a theoretical point of view one would want to see a relationship, strong at the margin, between tax burden and fiscal benefit. Abstracting somewhat from equity concerns, one would like to see some linkage -- ideally a causal relationship but at least a monotonic one -- between payments and benefits. Indeed since different regions will place different relative value on marginal public services verses marginal income retained by the citizenry, one would like to see these preferences reflected in tax burdens and public sector operations. In other words, if the provision of public goods is unrelated to their (tax or user) cost, inappropriate demands will made on the public sector with likely excessive consumption and/or a resulting suboptimal mix.

Further, if the citizens of a community would like more or greater public services, and are prepared to pay the increased cost, there ought to be a mechanism to accomplish this. Regrettably, there appears to be little such responsiveness among local government entities in the Philippines. There have been only minor variations in overall tax level and burden during the code implementation period; though it would seem that there has been some increase in user fees.

LGUs show little inclination to exercise their (marginally) increased tax authority. Tax administration is particularly bad.³³ The estimate is that some 60 percent of potential real property tax revenues go uncollected, and that collection rates for other taxes are even worse. In some areas, the cost of

³² The code is not intended as an income redistribution mechanism. To the extent that regional income inequalities is an addressable concern, the government appears to favor projects, particularly donor projects, as the vehicle of choice. There are a number of projects for and a great deal of rhetoric about the "club of 20" (the 20 poorest provinces) but little progress in raising their living standards is apparent.

³³ The GOLD Project Paper Annex states that the Central Government Bureau of Internal Revenue collects P227 for each peso spent in collecting taxes while LGUs get only nine. This gap is so great that it likely reflects both inferior LGU tax vehicles and a certain lack of diligence on the part of LGUs and/or their central agency-responsive treasurers and assessors..

collection is thought to exceed revenues. This is partly a failure of political will on the part of LGUs. For their part, they blame a good deal of the problems on LGU Treasurers and Assessors, who are effectively outside their control. The legal ability of LGUs to vary tax rates and collection efficiency can be obviated by Department of Budget and Finance instructions to LGU Treasurers, nominally devolved personnel³⁴) who are in fact selected by and under the control of the Central Government's Department of Finance. Earlier in the devolution process, despite being formally devolved, tax assessors also were inclined to relate to the Finance Department (ministry) rather than their LGUs. The Department sets revenue targets and rates Treasurer and Assessor effectiveness based on these targets. Usually the LGU can do little to influence these targets. -- even raising the tax rate may have no effect on targets nor derivatively on collections. Moreover, for the property tax, it is a shared revenue with no provisions for piggy-backing (i.e., surtaxes). Raising the tax rate requires a multi-tiered cooperative effort.

USER CHARGES. Limited use is made of "user charges". Many LGU officials claim their constituents are too poor for them to charge, or raise fees for services. Hospitals illustrate the point. A 1991 Department of Health Study showed that hospitals in 1989 were recovering only 6.4 percent of expenditures.³⁵ One major problem was that hospitals did not get to retain user fees, thus limiting incentives to collect them. Under the devolution, these restrictions have been lifted, but still little has happened. A 1993 PADS study estimated that, overall, public enterprises run by city governments cover only a third of costs, and public utilities, only 20 percent. (This despite the fact that the 1991 local government code effectively removed restrictions on the rates LGUs can charge for municipal services.) In addition to raising revenue, user charges improve resource allocation by discouraging excessive consumption of "free" goods and services. While later data was not readily available there are unlike to have been major changes in the

³⁴ Lack of control over the local unit's Treasurer is resented by many LGU officials, who often see them as corrupt as well as unresponsive. These are the major exceptions to de facto as well as the de jure devolution of transferred Central Government field personnel. While the LGU nominally select their financial officers, they must select from a list approved by the Finance Office, and their choice must be confirmed by the finance office. this arrangement is justified in that Treasurers have an election role (securing the ballots) and a comptroller role (blocking any illegal expenditures.) While initially a major irritant, most LGU executives have come to a modus vivendi with their treasurers. Indeed in the few GOLD project site LGUs visited by the author, governors and mayors seemed to have mutually supportive relations with treasurers, based on mutual need. (The LGU executive controlled the treasurer's office budget and many of his perks.)

³⁵ According to the PADS 1993 *Review and Outlook of the Philippine Economy*, this is roughly the same level as the overall figure for the national government. More importantly, the PADS report notes that the percentage contribution of user charges to total national government revenues declined monotonically from 15.3 percent in 1976 to 5.8 percent in 1992.

aggregate, particularly so in the case of health and hospital services which account for more than half of all devolved costs. At the individual LGU level however there are numerous exceptions. Solid waste disposal and other fees have in fact been raised substantially.

FISCAL DISINCENTIVE /DISCONNECT. Disturbingly, some independent observers see the lack of local initiative in revenue raising as evidence that the entitlement IRA is undercutting incentives for local revenue enhancement. LGUs seem far more inclined to lobby and politically pressure for greater transfer revenues. Further, better local revenue performance would reduce the pressure to increase the IRA and revise the sharing formulas. Borrowing and debt are also being increasingly explored by many LGU officials. Skeptics point to past problems necessitating a central government bail-out. LGU debt service, in any event, is limited by the code to 20 percent of reasonably foreseeable revenues. Indeed, only the major cities are deemed credit-worthy by private banks; and the government financial institutions loan only with sound development proposals and an "IRA intercept."³⁶ Interestingly, an Undersecretary of Finance, who has long been associated with the Innovation Awards program (Galing Pook) said that aside from a few cases of computerizing property tax role, the Awards Committee had never received a nomination for an innovative practice in tax collection or revenue raising.

The bottom line here is that a whole class of efficiency gains is being lost because LGUs' inability to vary the level of public sector services so as to relate marginal benefits with marginal provision costs; and because of the disconnect between fiscal benefits and tax payments. Even where the public demands a higher level of public service and is willing to pay for it, the ability of LGUs to accommodate is limited.

D. EFFICIENCY

There are several components to the efficiency issues.

SHIFTS IN COMPOSITION OF PUBLIC SECTOR GOODS AND SERVICES: Regression analysis by Rosario Manasan at PADS indicates that devolution has resulted in a substantial change in the mix of government goods and services. In the short post code period, LGU expenditure on education, housing and community development each rose by more than the costs of devolution

³⁶ LGUs can borrow from government financial institutions (GFIs) to implement revenue generating, self-liquidating projects. Interest is charged at market or near-market rates. The GFIs require that LGUs must not only be able to demonstrate the favorable economics of the proposed project, but also must hypothecate future IRA payments as collateral. Most recently, in a reversion, the DILG has assert the prerogative of approving all LGU loans and bond issues.

and inflation, and were outside their trend lines; while expenditure on health was insufficient to sustain the 1991 real level. Other areas of economic and social welfare spending other than education declined. Given a modicum of democratic process,³⁷ it can be argued that the communities have raised the efficiency of governmental process by reallocating expenditures to acquire a public goods basket of greater value to the community.³⁸

COST-EFFECTIVENESS: Local officials are convinced that they can procure goods and services far more cost-effectively than central agencies. Anecdotal examples abound. One governor illustrated the point with an irrigation project which his people costed-out at one-fifth the price the Agriculture Department was paying. Others point to central agency cost manuals and say that they can, and do, beat the reference costs by at least 30 percent on roads, bridges, and construction. (Not incidental, perhaps, is the widely held rule of thumb, that the graft, corruption, and inexplicable losses account for 30 percent of the costs of most government projects.³⁹) However, in practice it is difficult to make valid systemic cost comparisons. Even where the same good/service is provided there are differences in time, location, and specifications that compromise the comparison. None-the-less, the weight of anecdotal evidence clearly suggests that many tasks can be done more economically at local level, and can be specified more appropriately to local needs.

ACCOUNTABILITY / CORRUPTION: While there is no hard, systematic evidence either way, many observers believe that the increase in accountability brought

³⁷ The 1991 LGC also introduced a number of measures to make LGU more responsive to their constituents. These include: provision for referendum and recall; and a requirement for public hearings prior to an ordinance becoming effective. (Also required was national agency consultation with LGUs on national projects within their areas, but this latter provision has been routinely ignored.)

³⁸ However, one cannot prove that overall social welfare necessarily has been enhanced. From a purist point of view, collective welfare functions are impossible creations involving interpersonal utility comparisons. Absent actual compensation, there is no way of appropriately valuing the interests of those hurt against that of the majority. Thus the fact that, gainers could in theory compensate losers and still be better off, is not sufficient to demonstrate a social welfare gain. However, making such judgements is the essence of the political process. In fact, gains from decentralization are demonstrable in terms of preferences expressed through the political process.

Further, the political process, democratic or otherwise, may be flawed, to the detriment of minorities and/or the local poor and disadvantaged. Philippine Governors and LGU officials report that their constituents are very much aware of the shift to local decision making; and now heavily lobby local government officials. This contrasts with, but does not contradict, a recent evaluation finding that the majority of those interviewed were not aware of the impact of the reforms on who makes the decisions. Wide disparities in education levels and political sophistication are the likely explanation, and this has implications for public choice.)

³⁹ This is consistent with the Rapid Field Appraisal. This latter asserts that the per kilometer costs of roads and the per square meter cost of school and public building construction are routinely 25-30 percent less when undertaken by LGUs.

about by devolution in itself reduces corruption⁴⁰. This is not simply a question of commitment to one's friends and neighbors. Rather, responsibility is clearer, there are fewer individuals and pressure points in the procurement process, the responsible officials are more accessible, and their life-style changes are readily observable.

BUREAUCRATIC EFFICIENCY: It is sometimes argued that central bureaucracies have better quality personnel and systems than subnational level entities. This could detract from the ability of devolution to raise the quality of government services and goods. In the Philippines, variation in LGU administrative competence is extreme, but for the better-off LGUs, there is no reason to believe that their bureaucrats are not at least as competent as their central agency counterparts. Mayors and governors argue that if there is any loss of bureaucratic expertise, it is more than made up for with a gain in commitment. Moreover, under devolution, the field personnel of the central agencies, with their expertise, were devolved to the LGUs in the locale where they in any event worked. The USAID-sponsored Rapid Field Appraisals suggest that management practices for the devolved field facilities -- e.g., hospital procurement, cash management, and fee structures -- are all reported improved and continuing to improve under devolution.

Another management area reported to have benefited is planning. LGUs can no longer be required to contribute to top-down, sector-wide planning exercises that were totally divorced from reality and a sink-hole for bureaucratic time and effort. Rather, now LGUs are largely free to determine their own planning needs. LGU planning seems geographically focused rather than sectoral, and concentrates on operational decision areas. Along similar lines, there are reports of improved agricultural extension services as technician time is freed-up from excessive report-writing and other central ministry bureaucratic requirements. Lastly, Central Agency technical support is now more demand driven and presumably more in line with local needs.

INNOVATION: By all accounts, devolution has facilitated a great deal of LGU innovation. Most changes have been procedural, involving eliminating excessive red tape and taking common-sense short cuts. A major substantive area of change has been the greater involvement of the citizenry in government programs. By devolving project/program management to a level where local residents have ready access to management, local individuals and groups are encouraged to participate. The province of Palawan provides prize-winning examples. Under the code, primary

⁴⁰ In devolving functions, central agency bureaucrats have included transparency and audit requirements beyond those to which they themselves were subjected.

responsibility for environmental protection becomes a provincial and local government responsibility. Municipalities have responsibility for environmentally policing the ocean out to 15 kilometers from their shores. The authorities at Puerto Princessa City mobilized local fishermen and concerned citizens towards this end, providing them with hand radios to access the police, a motor boat and fuel. Similar initiatives have been undertaken by municipalities in Bohol and other provinces. Local fishermen, with a strong vested interest, have been very effective in guarding ocean resources. They have helped stop polluters, and illegal fishing (dynamite fishing, cyanide fishing, illegal nets, illegal (over 50 tons) domestic trawlers and foreign trawlers, catching of undersized fish, etc. The community participation created a credible, if localized, marine protection effort where none existed before. A number of communities throughout the Republic have also mounted a successful community based campaign against littering and trash, enforcing regulations and introducing educational awareness programs on this theme into the schools. Similar stories exist in forest protection, reforestation, and in "greening" villages. Tree farming on public land, day care centers, scientifically managed land-fills, environmental codes, tool lending programs, satellite libraries, schools for street children, river shed protection, and a host of other innovative programs have proliferated. At the same time public participation is being built into the fabric of LGU decision making. (One interesting but still quite limited innovation is in Polling. Provincial level public opinion polls are used as a source of feedback and reinforcement by the Bohol province provincial authorities.) In general, the essence of the successes is that local residents can identify with and readily access top project/program management. Examples of other areas of innovative LGU action can be seen from the list of Galing Pook Award winners (See appendix E);⁴¹ Further, there is increasing partnership with national government departments such as DENR in these types of community-based environmental programs.

E. IMPLEMENTATION ISSUES

TIMING PHASING AND SEQUENCING: In theory, it could have been more efficient to phase-in decentralization. More specifically, one could argue, that there ought to be an optimal sequencing order to devolution measures -- as there is in many macroeconomic reforms. For example, should training and skill enhancement for LGU officials precede devolution? Or, maybe the reforms should proceed sector by sector -- first health, then schools, etc. Or perhaps geographically, first the north, then the south, etc. Or maybe

⁴¹ Galing Pook awards are given for excellence and innovation on the part of local government by the Asian Institute for Management, and the Local Government Academy with funding support from the Ford Foundation and the Canada Fund.)

administratively, first provinces, then cities, etc. There are any number of sequencing combinations. However, its hard to find anyone in the Philippines who believes at a partial or sequenced approach to decentralization would have worked. The political dynamics made anything short of a comprehensive program a non-starter. Only by devolving everything at the start and focusing strong presidential will at a unique high leverage moment, could a reluctant congress be compelled to share power with LGUs. Vested interests would have killed anything less than an all-or-nothing devolution. A piecemeal approach would have precluded the focus and leverage necessary to get the program approved. Attention would have centered on the elements of the program rather than the program concept. This would have given opponents the ability to bog-down the process with endless debate and ultimately kill the program, without having to oppose it frontally. Moreover, the everything at once approach made it more difficult to reverse course and tended to place time on the side of the devolutionists as Increasingly, acceptable solutions to implementation problems have been found.

PERSONNEL DEVOLUTION: In theory it sounded fine to say all field personnel of the Agriculture and Health ministries would be devolved to the staff of the local government entity which absorbs the responsibility for the task they had been performing. However, the reality is that field personnel often lived in Manila, or provincial capitols and spent much of their duty time outside the assignment areas. Many others were detailed to the projects of international donors, e.g., on Sabbaticals. Having to report to a LGU supervisor in a rural area was a real shock. Transferring more than 70,000 people from employment with the Central Government to Employment with subnational level government created a procedural nightmare for all levels of government. Moreover, LGUs were not overjoyed at having to pay prescribe salaries (above local scales) to the involuntarily devolved officials, who were endowed with almost absolute civil service style job protection,⁴² and often came with an attitude problem. Over time these difficulties appear to be resolving. Nonetheless, the attendant chaos impacted strongly, if transitorily, on public sector performance.

TRAINING AND SKILLS UPGRADING: Responsibility for upgrading LGU officials skill resides with the Local Government Academy of the Ministry of the Interior and Local Government. Although the management of the Institute is very pro-decentralization and professional, many in its parent agency, the DILG,

⁴² Under the Code and other relevant statutes the LGU had to accept the devolved personnel, had to pay them the salaries proscribed, and were unable to readily fire them. However, there is in theory no restriction on how these people could be used. The Mayors and governors consulted had a very low opinion of the utility of the devolved personnel, citing attitude problems. Even with these palliative -- mandated positions, salaries, and civil service type job protection -- the devolved employees bitterly opposed the shift.

still have a paternalistic mindset. Perhaps related to this, the institute does not have funding commensurate with its task and depend heavily on UNDP and other donors. Also, it should be noted that many LGU officials benefit from donor training activities, and the better-off entities sometimes hire consultants and make direct arrangements with local and foreign entities to address training needs.

PUBLIC AWARENESS: Interestingly, surveys undertaken for a CDIE impact analysis suggest that even though more than half those polled were aware of the local government act, only 36 percent knew that cities now had substantially more resources with which to meet needs. Local government officials, for their part, report wide spread awareness and petitioning for services, contracts, jobs, etc. Unless the lower tier of citizenry also understand the shifts of resources and the responsibilities of local government, there may well be a regressive effect to the distribution of benefits under devolution.

THE AUTONOMOUS REGIONS: By all reports, devolution has not worked well in the Moslem, insurrection prone areas. These should not be thought of as part of the Philippine decentralization experiment. In theory, the local government code applies in these areas until such time as they create their own code to supersede it. However, by opting to become part of the autonomous region, LGUs ceded power to a regional government and in effect may have less not more freedom of action. In any case, the complications of economic distress, political unrest, low education levels, lack of administrative personnel, and general alienation seem to have overwhelmed devolution -- as they have the various programs to spark economic improvement in these areas. On the positive side, devolution has not worsened the situation in these areas.

TURF BATTLES: Changes in the power structure inevitably engender rivalries. These have plagued Philippine devolution. Until quite recently, Central agencies and their ministers have sought to minimize the consequences on themselves of devolution. They, and the personnel devolved from them, continuously lobbied the legislature to reverse some or all of the devolution provisions. (Indeed, President Ramos had to veto a bill that would have restored the Health field personnel to the Health Department.) A major LGU complaint is that central ministries fail to consult with them on projects within their jurisdictions. (Under the Code, the LGU should have veto rights on these projects, but they are routinely ignored.) With time and a changed political context, this is changing. The departments now recognize that devolution is not going to be reversed. The fact that the new President is a former mayor has not escaped their attention; nor has the increasing political influence of subnational government. Illustratively, the health ministry -- long a strong hold of reactionary influences -- now is receiving

strong direction from the top to get into a decentralization support mode. LGU relations with the Congress are also characterized as difficult, but vastly improved. Congress passed the Local Government Act only under political duress and, as a whole, is still not overly taken with the concept. Chief area of personal rivalries is between the city mayors and the congressmen both of whom are contesting for the loyalties of the same constituents. Until this year, a major irritant to the LGUs has been the formalized "pork barrel" or "Country-Wide Development Fund (CDF). Each congressman was entitled to near absolute control over 12 million pesos for development work in his district (18 million for Senators). The funds are spent with political objectives (or self-aggrandizement) in mind and are often at cross-purposes with LGU development spending. Moreover, in total the pork barrel funds often exceed the discretionary development project money available to LGUs. In the context of 1998's fiscal crisis, President Estrada deleted the CDF from the budget, and it is not in the Administration's 1999 proposed budget.

More generally, the main LGU complaint is that the "mind-set" of congress is hostile to devolution, and does not understand it. Much changed with the 1998 elections. A number of congressional incumbents up against term limitations successfully stood for governor or Mayor. Similarly, some previously LGU politicians ran for and won seats in the Congress. In the process, the scrambling of the two political cultures, together with the election of a President who had been a mayor, changed the overall political equation.

There is also a rivalry between LGU classes. Governors complain of lack of line authority over cities within their jurisdiction. Cities see the governors trying to assert control over some of their affairs; and more importantly, to get the IRA formula revised at their expense. More recently, the statutory based representative entities of the LGUs -- the Leagues of Cities, of Provinces, and of Municipalities -- like their principals, seem to have found common ground in fighting off challenges to devolution. Indeed, a "league of leagues." has now been established under which the LGUs are collectively pressing for a larger overall IRA, specifically for a 60\40 rather than a 40-60 split of central government revenues.

Unfunded Mandates are an area of particular concern to LGUs. These shift the political heat for unmet needs. Some see such requirements as a congressional weapon to vitiate autonomy by draining LGU discretionary resources.

F. THE ROLE OF NGOs

A unique aspect of the Philippines devolution is the statutory role of NGOs (Non-governmental Organizations -- excluding for profit enterprises). Under the

code, NGOs and POs (people's organizations) serve as statutory members of planning councils, procurement boards, and other LGU governmental entities.⁴³ In theory, NGOs within the political district are themselves to select the NGO members to the various boards. However, an equitable, transparent way of systematically selecting NGO representatives has yet to evolve. In practice, the NGO executive can usually get away with appointing the NGO representatives -- and creating new NGOs from which to select if he is so inclined.

The NGOs played a key role in resisting the tyranny of the Marcos regime. Their inclusion in the provisions of the local government code was seen as an element of democratization (*i.e.*, peoples' surrogate), and source of expertise to LGU. Initially there was hostility in some communities between the LGU officials and statutory NGO representatives. LGU officials sometimes viewed the NGO reps as unelected, politically unresponsive, and having their own agenda, while the NGOs sometimes had concerns as to the competence and motivation of LGU officials. Moreover, in the Marcos and immediate post Marcos period, the NGOs were very anti-government in outlook.

Initially, the result was mixed with conscientious and competent NGO membership a decidedly positive element in some LGUs; but in others they have been disruptive, sought institutional advantage, or ignored their duties. Over time, LGU officials and NGO statutory representatives to LGU entities seem to have established positive, mutually supportive relationships. Several factors are seen at work here. It became clear in the electoral process that NGO leadership was far less of a springboard to elective office than had been thought. Accordingly, LGU and NGO leadership became less concerned about supporting potential political rivals. Further, it became clear that mayors and governors could readily bypass the statutory roles of NGOs, if they so choose. Lastly, NGOs found increasing need for government resources. The increasing competence of local government also helped to further cooperative relationships.

G. MACROECONOMIC MANAGEMENT

Devolution of revenue / expenditure authority poses potential macroeconomic management problems. Additionally, the three year lag in the IRA formula will complicate counter cyclical fiscal policy and, might even build in an inflationary bias (directed at reducing the real burden of the LGU IRA entitlement.)

So far complications have been inconsequential. In 1997 LGU spending amounted to only 3.7% of GNP or 17% of public sector spending. Devolution as practiced in

⁴³ Of the estimated 52,000+ NGOs, more than 17,000 have thus far been accredited for activities under the local government code. NGOs have been most active in Local Development Councils where they hold a minimum of 25 percent of the membership. The Code also requires membership of representatives of women's groups, agricultural or industrial labor, and indigenous cultures in municipal legislative bodies.

the Philippines will take spending equivalent to roughly 7 percent of government spending or 1.6 percent of GNP out of the central governments control (assuming continued inflation at current levels and except under a presidentially declared fiscal emergency). Counter-cyclical fiscal policy will be further complicated by the three-year IRA lag, and the one-year lag for LGU natural resource revenue sharing. Nonetheless, the government retains control over the bulk of government spending. Even at the LGU level, central agency discretionary grants and programs outweigh local government entitlement. Moreover, Central authorities control directly loans to LGUs from government financial institutions, and indirectly, loans from private banks.

The Philippines is currently in the midst of the Asian Financial crisis and, thus far, decentralization has not greatly handicapped its macroeconomic managers. But increasing budget stringency does give some insight into the staying power of decentralization. Despite the need for an IMF package, the mid-1990s were not difficult times for the budget. Privatization receipts⁴⁴ -- some 1.25 percent of GNP in 1995 -- together with falling interest rates on international and domestic debt have provided considerable maneuver room in the austerity that otherwise would have been required. These enabled the legislature to avoid some hard choices. The Ministry of Agriculture, for example, by some estimates lost 70 percent of its functions but suffered only a 15 percent cut in its budget. Generally, the cuts in function and staffing were by no means fully reflected in central government agency budgets. The question of which, LGUs or national agencies, would take the hit when hard times came has now been answered. Both, but disproportionately so the National Agencies. Under a declared financial emergency President Estrada cut IRAs by 10% and National Agency budgets by 25%.⁴⁵

⁴⁴ Sale of the land of a single Philippine military (formally US) base in the Manila area alone reportedly gained the government well over US\$ 1 billion.

⁴⁵ There were some exceptions made. The cut, which came late in the fiscal year, fell largely on contract personnel and cost some Christmas bonuses as well. It also brought home to LGUs the jeopardy of over-dependence on the IRA.

6. Conclusions

PROGRAM EFFECTIVENESS

It is far too early to make any systematic judgements. But clearly the LGU absorption of primary responsibility for local level citizen services and programs has not been a disaster anywhere. In a substantial number of localities, devolution has improved government efficiency (broadly defined in terms of efficiently allocating public sector resources towards citizen needs as defined by the political process). Whether the political process adequately defines those needs at the local level was not addressed within the framework of this study.⁴⁶ Moreover, it is still early in the experiment. Efficiency will improve -- as the bureaucratic and political trauma of devolution continues to heal and local government has more time to limb the learning curve. On this basis, the initial results seem highly promising. Some initially difficult areas -- political context, city-province relations and LGU-NGU relations for example, are already perceived as substantially improved.

Already it is very clear that there has been a fundamental shift in the governance processes of the Philippines. Local jurisdictions now have far more influence (but not control) over their own destinies. Illustrative of this in a different dimension, the government of the province of Bohol was able to block a water diversion scheme which would have piped fresh water from Bohol (which currently has a surplus) across the channel to the rapidly growing but water-scarce neighboring island of Cebu. This would have sustained Cebu's industrial development at the expense of Bohol's economic potential. Since the scheme had the backing of the president, the central agencies, and powerful commercial interests, it would have been a done deal in the pre-devolution days.

With less than a decade elapsed, the Local Government Code should be considered a qualified success. There are obviously a number of areas needing improvement. Most immediately, the IRA formula needs revision to correct inter-tier inequity and to subtract out and pay LGUs up-front the continuing costs of devolution. Alternative corrective measures, e.g., direct subsidies for hospitals are also a possibility. Curbs need to be put on unfunded mandates. The CDF Congressional pork-barrel needs to be permanently abandoned. Lastly, Central Agencies need to be made to respect the intent of the code that they seriously confer / dialog with LGU authorities on projects within that LGU's geographic jurisdiction.

Over the longer run, local empowerment will make a major improvement in

⁴⁶ For example, it is not impossible that efficiency may have risen but to the benefit of local elite, and/or the detriment of the very poorest.

governmental efficiency in the Philippine. Over time the practices and governmental styles practiced by the most progressive LGUs will spread to the others. The measures listed above will help the system consolidate its gains thus far. But unless devolution proceeds to encompass the full range of appropriate local government activity (including education and public safety), and unless local officials have a fair degree of sovereign power over these affairs, the full potential of fiscal federalism will not be realized. It is another example of where the whole can be greater than the sum of its parts -- the more aspects of governance that are locally decided, the better each element can be tailored to public preferences in a mutually reinforcing manner.

EXTERNAL RELEVANCE

The Philippines case has immediate relevance for LDCs seriously contemplating large scale decentralization. USAID missions in countries contemplating decentralization programs would do well to fund host government study visits to the Philippines. The on-going Philippine decentralization program provides important perspective and insight in a number of areas critical to design and execution of decentralization efforts. Included here are:

- ◆ The political and economic feasibility and benefit potential of decentralization in an emerging market country.
- ◆ Intergovernmental rivalries and relationships. Ceding political power, even in part, to another tier of government is never easy. The Philippines provides many positive and negative object lessons in the political dynamics of decentralization.
- ◆ Attention to vertical and horizontal balance considerations (tier responsibilities and resources) is critical to any successful decentralization program. These issues are well defined and very visible in the Philippines.
- ◆ Fiscal empowerment. Control over resources is at the heart of decentralization.
- ◆ Governance efficiency: The Philippine experience suggests structural options within decentralization for maximizing local government responsiveness, minimizing corruption, and fostering civic participation.
- ◆ The catalytic role of donor organizations in supporting and sustaining decentralization.
- ◆ NGOs can contribute to the efficiency and the political staying power of decentralization; or can be disruptive and destabilizing. The Philippine experience suggests that an overly structured, and statutorily based NGO

partnership with local government complicates arrangements and can lead to an adversarial NGO role. In contrast, where statutory structure has been superseded by informal, locally worked out relationships, the commonality of interest pervades.

7. Appendices

- A. Devolved Functions of National Government Agencies (NGAs).
- B. List of Studies and Reports Utilized.
- C. Excerpt from the Local Government Code of 1991 on the Allocation of the Internal Revenue Allotment. (Sections 284 through 294 of the Code.)
- D. Excerpt from the Local Government Code on the Apportionment of Responsibilities Between Classes of Local Government Units.
- E. Philippines: Selected Economic Indicators, The World Bank, September 1998
- F. Descriptive Brochure on the Galing Pook Awards describing the award program for excellence and innovation in Local Government; and a listing of 1993-97 award-winning activities.
- G. Decentralization Ratios for all LGUs, 1985-97.
- H. Financial Autonomy Ratio of Different Levels of Local Governments.
- I. LGU Expenditure Patterns.

Appendix A: Devolved Functions of National Government Agencies (NGAs)*

NGAs	FUNCTIONS
Department of Agrarian Reform	- land and home development improvement projects.
Department of Agriculture	<ul style="list-style-type: none"> - agricultural and fishery extension services; - regulation of agricultural and fishery activity; - conduct of agricultural and fishery research activities; - procurement and distribution of certified seeds; - purchase, expansion and conservation of breeding stocks; - construction, repair and rehabilitation of water impounding systems; - support to fishermen, including purchase of fishing nets and other materials.
Department of Budget and Management	- local government budget officer services.
Department of Environment and Natural Resources	<ul style="list-style-type: none"> - forest management services; - mine and geo-sciences services; - environmental management services; - reforestation projects; - integrated social forestry projects; - watershed rehabilitation projects.
Department of Health	<ul style="list-style-type: none"> - extension of medical and health services through provincial health office, district, municipal and medicare community hospitals; - purchase of drugs and medicines; - implementation of primary health care programs; - field health services; - aid to puericulture; - construction, repair, rehabilitation and renovation of provincial, district, municipal and medicare hospitals; and - provision for the operation of 5-bed health infirmaries.
Department of Public Work and Highways	<ul style="list-style-type: none"> - repair and maintenance of infrastructure facilities; - water supply projects; and - communal irrigation projects.
Department of Social Welfare and Development	<ul style="list-style-type: none"> - implementation of community-based program for rebel returnees; - provision for the operation of a day-care center in every barangay; - provision for poverty alleviation in low-income municipalities and depressed urban barangays.
Department of Tourism	<ul style="list-style-type: none"> - domestic tourism promotion; - tourism standard regulation.
Department of Trade and Industry	- promotion and development of trade, industry and related institutional services.
Department of Transportation and Communication	<ul style="list-style-type: none"> - telecommunication services; - transportation franchising and regulatory services.
Cooperatives Development Authority	<ul style="list-style-type: none"> - promotion, development and regulation of cooperatives function; - cooperatives field operation function.
Housing and Land Use Regulatory Board	- regulation of human settlement plans and programs function.
Philippine Gamefowl Commission	- regulation and supervision of cockfighting function.
<p>* In addition, functions and locally-funded projects of the Commission on Population, Fiber Industry Development Authority, National Agricultural Fishery Council, Livestock Development Council and National Meat Inspection Commission are also devolved.</p>	
<p>Source: Executive Order 507</p>	

Appendix B: List of Studies and Reports Utilized

Recent Philippine Reference Items

1. United States Agency for International Development, "Rapid Field Appraisal of Decentralization," No. 1-8, Governance and Local Democracy (GOLD) Project, (#492-0436), USAID/Manila

Dates of each Appraisal:

#1	Aug 1992	#3	Octr 1993	#5	Jun 1995	#7	Aug 1997
#2	Feb 1993	#4	Jun 1994	#6	Jul 1996	#8	Sep 1998

2. Department of the Interior and Local Government, The Government of the Philippines, *Local Government Code of 1991*, February 6, 1992 (*Sections 284. - 294. of the Law*)

3. William Loehr and Rosario Manasan, "Fiscal Decentralization and Economic Efficiency: Measurement and Evaluation," (DRAFT) January 1999, *Consulting Assistance for Economic Reform (CAER) II Paper*, (sponsored by USAID contract PCE-C-00-95-00015-00) Harvard Institute for International Development

4. Rosario G. Manasan, *Patterns of Budget Allocations using Social and Human Priority Expenditure Patterns with Special Focus on Provincial Governments in 1993 and 1994*, The Philippines Institute for Development Studies (PIDS), *manuscript*, August 1996

5. United States Agency for International Development, *Governance and Local Democracy Project Paper: Annexes*, USAID/Manila, September 1994

6. Rosario Manasan, *PIDS Review and Outlook of the Philippine Economy 1993-1994; Part II, Reforming the Fiscal System*, November 1993

7. Milwida M. Guevara, *Primer: Internal Revenue Allotment (IRA) System of the Philippines: Changes and Effects upon Local Government Finance*, Local Government Assistance Program, USAID/Manila

Milwida M. Guevara is the Undersecretary of Finance, Government of the Philippines

8. Napoleon de Sagun and Charles Rheingans, *Philippine Local Government Development*, USAID/ORAD, September 1988

9. Gary Hawes, *Impact Evaluation*, Local Development Assistance Program, USAID/Manila, March 1995

10. United States Agency for International Development, "Building Democratic Local Government in the Philippines," (Draft Impact Evaluation), USAID/CDIE, September 1996

11. Gilberto Llanto, Rosario Manasan, *et. al.*, "Local Government Units' Access to the Private Capital Markets: A Report to the Department of Finance," PIDS, May 1996

12. Cecilia G. Sariano, "LGU Financing of Basic Services and Development Projects: A New Vision and Proposed Policy Framework," Presentation to a World Bank seminar, September 1996

Cecilia G. Sariano is the Undersecretary for Local Development Financing, Ministry of Finance, the Philippines

Recent General Reference Items on Fiscal Federalism

(A few of the more recent and useful works.)

13. Vito Tanzi, "Fiscal Federalism and Decentralization: A Review of Some Efficiency and Macroeconomic Aspects," in *Proceedings of the Annual Bank Conference on Development Economics*, The World Bank, May 1995
14. Rudolf Hommes, "Conflicts and Dilemmas of Decentralization," in *Proceedings of the Annual Bank Conference on Development Economics*, The World Bank, May 1995
15. Jayanta Roy, ed., *Macroeconomic Management and Fiscal Decentralization*, EDI Seminar Series, (based on a September 1994 conference), The World Bank's Economic Development Institute, December 1995
16. Robin Broadway, et. al., "Reform of the Fiscal System in Developing and Emerging Market Economies: A Federalism Perspective," World Bank Policy Working Paper No. 1259, The World Bank, February 1994
17. William Loehr, G. Guess, and J. Martinez, "Fiscal Federalism, Economic Growth, and Democracy: Literature Review and Methodology for Case Studies," *Consulting Assistance for Economic Reform (CAER) II Discussion Paper, Number 2*, March 1997
18. Wallace Oates, "Principles of Fiscal Federalism: A Survey of Recent Theoretical and Empirical Research," IRIS, Working Paper # 21, 1991

Appendix C: Excerpt from the Local Government Code of 1991 on the Allocation of the Internal Revenue Allotment. (Sections 284 through 294 of the Code.)

TITLE THREE. - SHARES OF LOCAL GOVERNMENT UNITS IN THEIR PROCEEDS OF NATIONAL TAXES

CHAPTER 1. - Allotment of Internal Revenue

SECTION 284. Allotment of Internal Revenue Taxes. - Local government units shall have a share in the national internal revenue taxes based on the collection of the third fiscal year preceding the current fiscal year as follows:

- (a) On the first year of the effectivity of this Code, thirty percent (30%);
- (b) On the second year, thirty-five percent (35%); and
- (c) On the third year and thereafter, forty percent (40%).

Provided, That in the event that the national government incurs an unmanageable public sector deficit, the President of the Philippines is hereby authorized, upon the recommendation of the Secretary of Finance, Secretary of Interior and Local Government, and Secretary of Budget and Management, and subject to consultation with the presiding officers of both Houses of Congress and the presidents of the liga, to make the necessary adjustments in the internal revenue allotment of local government units but in no case the allotment be less than thirty percent (30%) of national internal revenue taxes of the third fiscal year preceding the current fiscal year. Provided, further, That in the first year of the effectivity of this Code, the local government units shall, in addition to the thirty percent (30%) internal revenue allotment which shall include the cost of devolved functions for essential public services, be entitled to receive the amount equivalent to the cost of devolved personal services.

SECTION 285. Allocation to Local Government Units. - The share of local government units in the internal revenue allotment shall be allocated in the following manner:

- (a) Provinces - Twenty-three percent (23%);
- (b) Cities - Twenty-three percent (23%);
- (c) Municipalities - Thirty-four percent (34%); and
- (d) Barangays - Twenty percent (20%)

Provided, however, That the share of each province, city, and municipality shall be determined on the basis of the following formula:

- (a) Population - Fifty percent (50%);
- (b) Land Area - Twenty-five percent (25%); and
- (c) Equal Sharing - Twenty-five percent (25%)

Provided, further, That the share of each barangay with a population of not less than one hundred (100) inhabitants shall not be less than Eighty thousand pesos (P80,000.00) per annum chargeable against the twenty percent (20%) share of the barangay from the internal revenue allotment, and the balance to be allocated on the basis of the following formula:

- (a) On the first year of the effectivity of this Code:
 - (1) Population - Forty percent (40%); and
 - (2) Equal Sharing - Sixty Percent (60%)
- (b) On the second year:
 - (1) Population - Fifty percent (50%); and
 - (2) Equal Sharing - Fifty percent (50%)

- (c) On the third year and thereafter:
 - (1) Population - Sixty percent (60%); and
 - (2) Equal Sharing - Forty Percent (40%)

Provided, finally, That the fiscal requirements of barangays created by local government units after the effectivity of this Code shall be the responsibility of the local government unit concerned.

SECTION 286. Automatic Release of Shares. - (a) The share of each local government unit shall be released, without need of any further action, directly to the provincial, city, municipal or barangay treasurer, as the case may be, on a quarterly basis within five (5) days after the end of each quarter, and which shall not be subject to any lien or holdback that may be imposed by the national government for whatever purpose.

(b) Nothing in this Chapter be understood to diminish to share of local government units under existing laws.

SECTION 287. Local Development Projects. - Each local government unit shall appropriate in its annual budget no less than twenty percent (20%) of its annual internal revenue allotment for development projects. Copies of the development plans of local government units shall be furnished the Department of Interior and Local Government.

SECTION 288. Rules and Regulations. - The Secretary of Finance in consultation with the Secretary of Budget and Management, shall promulgate the necessary rules and regulations for a simplified disbursement scheme designed for the speedy and effective enforcement of the provisions of this Chapter.

CHAPTER 2. - Share of Local Government Units in the National Wealth

SECTION 289. Share in the Proceeds from the Development and Utilization of the National Wealth. - Local government units shall have an equitable share in the proceeds derived from the utilization and development of the national wealth within their respective areas, including sharing the same with the inhabitants by way of direct benefits.

SECTION 290. Amount of Share of Local Government Units. - Local government units shall, in addition to the internal revenue allotment, have a share of forty percent (40%) of the gross collection derived by the national government from the preceding fiscal year from mining taxes, royalties, forestry and fishery charges, and such other taxes, fees, or charges, including related surcharges, interests, or fines, and from its share in any co-production, joint venture or production sharing agreement in the utilization and development of the national wealth within their territorial jurisdiction.

SECTION 291. Share of the Local Governments from any Government Agency or -Owned and -Controlled Corporation. - Local government units shall have a share based on the preceding fiscal year from the proceeds derived by any government agency or government-owned or -controlled corporation engaged in the utilization and development of the national wealth based on the following formula whichever will produced a higher share for the local government unit:

(a) One percent (1%) of the gross sales or receipts of the preceding calendar year; or

(b) Forty percent (40%) of the mining taxes, royalties, forestry and fishery charges and such other taxes, fees or charges, including related surcharges, interests, or fines the government agency or government-owned or -controlled corporation would have paid if it were not otherwise exempt.

SECTION 292. Allocation of Shares. - The share in the preceding Section shall be distributed in the following manner:

(a) Where the natural resources are located in the province

- (1) Province - Twenty percent (20%);
- (2) Component City/Municipality - Forty-five percent (45%); and
- (3) Barangay - Thirty-five percent (35%)

Provided, however, That where the natural resources are located in two or more provinces, or in two (2) or more component cities or municipalities or in two (2) or more barangays, their respective shares shall be computed on the basis of:

- (1) Population - Seventy percent (70%); and
- (2) Land Area - Thirty percent (30%).

(b) Where the natural resources are located in a highly urbanized or dependent component city:

- (1) City - Sixty-five percent (65%); and
- (2) Barangay - Thirty-five percent (35%)

Provided, however, That where the natural resources are located in such two (2) or more cities, the allocation of shares shall be based on the formula of population and land area as specified in paragraph (a) of this Section.

SECTION 293. Remittance of the Share of Local Government Units. - The share of local government units from the utilization and development of national wealth shall be remitted in accordance with Section 286 of this Code; Provided, however, That in the case of any government agency or government-owned or -controlled corporation engaged in the utilization and development of the national wealth, such share shall be directly remitted to the provincial, city, municipal or barangay treasurer concerned within five (5) days after the end of each quarter.

SECTION 294. Development and Livelihood Projects. - The proceeds from the share be appropriated by their respective to this chapter shall be appropriated by their respective sanggunian to finance local development and livelihood projects: Provided, however, That at least eighty percent (80%) of the proceeds derived from the development and utilization of hydrothermal, geothermal, and other sources of energy shall be applied solely to lower the cost of electricity in the local government unit where such a source of energy is located.

Appendix D: Excerpt from the Local Government Code on the Apportionment of Responsibilities Between Classes of Local Government Units.

from Book I. - General Provisions, Sections 14. - 20.

SECTION 14. *Beginning of Corporate Existence.* --

When a new local government unit is created, its corporate existence shall commence upon the election and qualification of its chief executive and a majority of the members of its sanggunian, unless some other time is fixed therefor by the law or ordinance creating it.

SECTION 15. *Political and Corporate Nature of Local Government Units.* -- Every local government unit created or recognized under this Code is a body politic and corporate endowed with powers to be exercised powers as a political subdivision of the national government and as a corporate entity representing the inhabitants of its territory.

SECTION 16. *General Welfare.* -- Every local government unit shall exercise the powers expressly granted, those necessarily implied therefrom, as well as powers necessary, appropriate, or incidental for its efficient and effective governance, and those which are essential to the promotion of the general welfare. Within their respective territorial jurisdictions, local government units shall ensure and support, among other things, the preservation and enrichment of culture, promote health and safety, enhance the right of the people to a balanced ecology, encourage and support the development of appropriate and self-reliant scientific and technological capabilities, improve public morals, enhance economic prosperity and social justice, promote full employment among their residents, maintain peace and order, and preserve the comfort and convenience of their inhabitants.

SECTION 17. *Basic Services and Facilities.* -- (a) Local government units shall endeavor to be self-reliant and shall continue exercising the powers and discharging the duties and functions currently vested upon them. They shall also discharge the functions and responsibilities of national agencies and offices devolved to them pursuant to this Code. Local government units shall likewise exercise such other powers and discharge such other functions and responsibilities as are necessary, appropriate, or incidental to efficient and effective provision of the basic services and facilities enumerated therein.

(b) Such basic services and facilities include, but are not limited to, the following:

(1) *For a Barangay*

- i. Agricultural support services which include planting materials distribution system and operation of farm produce collection and buying stations;
- ii. Health and social welfare services which include
- v. Information services which include investments and job

maintenance of barangay health center and day-care center;

- iii. *Services and facilities related to general hygiene and sanitation, beautification, and solid waste collection;*
- iv. *Maintenance of katarungang pambarangay;*
- v. *Maintenance of barangay roads and bridges and water supply systems;*
- vi. *Infrastructure facilities such as multi-purpose hall, multipurpose pavement, plaza, sports center, and other similar facilities;*
- vii. *Information and reading center; and*
- viii. *Satellite or public market, where viable;*

(2) *For a Municipality:*

- i. *Extension and on-site research services and facilities related to agriculture and fishery activities which include dispersal of livestock and poultry, fingerlings, and other seeding materials for aquaculture; palay, corn, and vegetable seed farms; medicinal plant gardens; fruit tree, coconut, and other kinds of seedling nurseries; demonstration farms; quality control of copra and improvement and development of local distribution channels, preferably through cooperatives; interbarangay irrigation system; water and soil resource utilization and conservation projects; and enforcement of fishery laws in municipal waters including the conservation of mangroves;*
- ii. *Pursuant to national policies and subject to supervision, control and review of the DENR, implementation of community-based forestry projects which include integrated social forestry programs and similar projects, management and control of communal forests with an area not exceeding fifty (50) square kilometres; establishment of tree parks, greenbelts, and similar forest development projects;*
- iii. *Subject to the provisions of Title Five, Book I of this Code, health services which include the implementation of programs and projects on primary health care, maternal and child care, and communicable and non-communicable disease control services; access to secondary and tertiary health services; purchase of medicines, medical supplies, and equipment needed to carry out the services herein enumerated;*
- iv. *Social welfare services which include programs and projects on child and youth welfare, family and community welfare, women's welfare, welfare of the elderly and disabled persons; community-based rehabilitation programs for vagrants, beggars, street children, scavengers, juvenile delinquents, and victims of drug abuse; livelihood and other pro-poor projects; nutrition services; and family planning services;*
placement information systems, tax and marketing

- vi. *information systems, and maintenance of a public library; Solid waste disposal system or environmental management system and services or facilities related to general hygiene and sanitation;*
- vii. *Municipal buildings, cultural centers, public parks including freedom parks, playgrounds, and sports facilities and equipment, and other similar facilities;*
- viii. *Infrastructure facilities intended primarily to service the needs of the residents of the municipality and which are funded out of municipal funds including, but not limited to, municipal roads and bridges; school building and other facilities for public elementary and secondary schools; clinics, health centers and other health facilities necessary to carry out health services; communal irrigation, small water impounding projects and other similar projects; fish ports; artesian wells, spring development, rainwater collectors and water supply systems; seawalls, dikes, drainage and sewerage, and flood control; traffic signals and road signs; and similar facilities;*
- ix. *Public markets, slaughterhouses and other municipal enterprises;*
- x. *Public cemetery;*
- xi. *Tourism facilities and other tourist attractions, including the acquisition of equipment, regulation and supervision of business concessions, and security services for such facilities; and*
- xii. *Sites for police and fire stations and substations and the municipal jail;*

(3) *For a Province:*

- i. *Agricultural extension and on-site research services and facilities which include the prevention and control of plant and animal pest and diseases; dairy farms, livestock markets, animal breeding stations, and artificial insemination centers; and assistance in the organization of farmers' and fishermen's cooperatives and other collective organizations, as well as the transfer of appropriate technology;*
 - ii. *Industrial research and development services, as well as the transfer of appropriate technology;*
 - iii. *Pursuant to national policies and subject to supervision, control and review of the DENR, enforcement of forestry laws limited to community-based forestry projects, pollution control law, small-scale mining law, and other laws on the protection of the environment; and mini-hydro-electric projects for local purposes;*
 - iv. *Subject to the provisions of Title Five, Book I of this Code, health services which include hospitals and other tertiary health services;*
 - v. *Social welfare services which include programs and projects on rebel returnees and evacuees; relief operations; and population development services;*
 - vi. *Provincial buildings, provincial jails, freedom parks and other public assembly areas, and other similar facilities;*
- (g) *The basic services and facilities herein above enumerated shall be funded from the share of local government units in the proceeds of*

- vii. *Infrastructure facilities intended to service the needs of the residents of the province and which are funded out of provincial funds including, but not limited to, provincial roads and bridges; inter-municipal waterworks, drainage and sewerage, flood control, and irrigation systems; reclamation projects; and similar facilities;*
- viii. *Programs and projects for low-cost housing and other mass dwellings, except those funded by the Social Security System (SSS), Government Service Insurance System (GSIS), and the Home Development Mutual Fund (HDMF): Provided, That national funds for these programs and projects shall be equitably allocated among the regions in proportion to the ratio of the homeless to the population;*
- ix. *Investment support services, including access to credit financing;*
- x. *Upgrading and modernization of tax information and collection services through the use of computer hardware and software and other means;*
- xi. *Inter-municipal telecommunications services, subject to national policy guidelines; and*
- xii. *Tourism development and promotion programs;*

(4) *For a City:*

All the services and facilities of the municipality and province, and in addition thereto, the following:

- i. *Adequate communication and transportation facilities;*
- ii. *Support for education, police and fire services and facilities;*

(c) *Notwithstanding the provisions of subsection (b) hereof, public works and infrastructure projects and other facilities, programs and services funded by the national government under the annual General Appropriations Act, other special laws, pertinent executive orders, and those wholly or partially funded from foreign sources, are not covered under this Section, except in those cases where the local government unit concerned is duly designated as the implementing agency for such projects, facilities, and programs, and services.*

(d) *The designs, plans, specifications, testing of materials, and the procurement of equipment and materials from both foreign and local sources necessary for the provision of the foregoing services and facilities shall be undertaken by the local government unit concerned, based on national policies, standards and guidelines.*

(e) *National agencies or offices concerned shall devolve to local government units the responsibility for the provision of basic services and facilities enumerated in this Section within six (6) months after the effectivity of this Code.*

As used in this Code, the term "devolution" refers to the act by which the national government confers power and authority upon the various local government units to perform specific functions and responsibilities.

(f) *The national government or the next higher level of local government unit may provide or augment the basic services and facilities assigned to a lower level of local government unit when such services or facilities are not made available or, if made available, are inadequate to meet the requirements of its inhabitants.*

national taxes and other local revenues and funding support from national government, its instrumentalities and government-owned or -

controlled corporations which are tasked by law to establish and maintain such services or facilities. Any fund or resource available for the use of local government units shall be first allocated for the provision of basic services or facilities enumerated in subsection (b) hereof before applying the same for other purposes, unless otherwise provided in this Code.

(h) Regional offices of national agencies or offices whose functions are devolved to local government units as provided herein shall be phased out within one (1) year from the approval of this Code. Said national agencies and offices may establish such field units as may be necessary for monitoring purposes and providing technical assistance to local government units. The properties, equipment, and other assets of these regional offices shall be distributed to the local government units in the region in accordance with the rules and regulations issued by the oversight committee created under this Code.

(i) The devolution contemplated in this Code shall include the transfer to local government units of the records, equipment, and other assets and personnel of national agencies and offices corresponding to the devolved powers, functions, and responsibilities.

Personnel of said national agencies or offices shall be absorbed by the local government units to which they belong or in whose areas they are assigned to extent that it is administratively viable as determined by the said oversight committee; Provided, That the rights accorded to such personnel pursuant to civil service law, rules and regulations shall not be impaired: Provided, Further, That regional directors who are career executive service officers and other officers of similar rank in the said regional offices who cannot be absorbed by the local government unit shall be retained by the national government, without any diminution of rank, salary or tenure.

(j) To ensure the active participation of the private sector in local governance, local government units may, by ordinance, sell, lease, encumber or otherwise dispose of public economic enterprises owned by the them in their proprietary capacity.

Costs may also be charged for the delivery of basic services or facilities enumerated in this Section.

SECTION 18. Power to Generate and Apply Resources. –

Local government units shall have the power and authority to establish an organization that shall be responsible for the efficient and effective implementation of their development plans, program objectives and priorities; to create their own sources of revenue and to levy taxes, fees, and charges which shall accrue exclusively for their use and disposition and which shall be retained by them; to have a just share in national taxes which shall be automatically and directly released to them without need of any further action; to have an equitable share in the proceeds from the utilization and development of the national wealth and resources within their respective territorial jurisdictions including sharing the same with the inhabitants by way of direct benefits; to acquire, develop, lease, encumber, alienate, or otherwise dispose of real or personal property held by them in their proprietary capacity and to apply their resources and assets for productive, developmental, or welfare purposes, in the exercise or furtherance of their governmental or proprietary powers and functions and thereby ensure their development into self-reliant communities and active participants in the attainment of national goals.

SECTION 19. Eminent Domain. – A local government unit may, through its chief executive and acting pursuant to an ordinance, exercise the power of eminent domain for public use, or purpose, or welfare for the benefit of the poor and the landless, upon payment of just compensation, pursuant to the provisions of the

Constitution and pertinent laws: Provided, however, That the power of eminent domain may not be exercised unless a valid and definite offer has been previously made to the owner, and such offer was not accepted: Provided, further, That the local government unit may immediately take possession of the property upon the filing of the expropriation proceedings and upon making a deposit with the proper court of at least fifteen percent (15%) of the fair market value of the property based on the current tax declaration of the property to be expropriated: Provided, finally, That the amount to be paid for the expropriated property shall be determined by the proper court, based on the fair market value at the time of the taking of the property.

SECTION 20. Reclassification of Lands. – (a) A city or municipality may, through an ordinance passed by the sanggunian after conducting public hearings for the purpose, authorize the reclassification of agricultural lands and provide for the manner of their utilization or disposition in the following cases: (1) when the land ceases to be economically feasible and sound for agricultural purposes as determined by the Department of Agriculture or (2) where the land shall have substantially greater economic value for residential, commercial, or industrial purposes, as determined by the sanggunian concerned: Provided, That such reclassification shall be limited to the following percentage of the total agricultural land area at the time of the passage of the ordinance:

- (1) For highly urbanized and independent component cities, fifteen percent (15%);
- (2) For component cities and first to third class municipalities, ten percent (10%); and
- 3) For fourth to sixth class municipalities, five percent (5%): Provided, further, That agricultural lands distributed to agrarian reform beneficiaries pursuant to Republic Act Numbered Sixty-six hundred fifty-seven (R.A. No. 6657), otherwise known as "The Comprehensive Agrarian Reform Law," shall not be affected by the said reclassification and the conversion of such lands into other purposes shall be governed by Section 65 of said Act.

(b) The President may, when public interest so requires and upon recommendation of the National Economic and Development Authority, authorize a city or municipality to reclassify lands in excess of the limits set in the next preceding paragraph.

(c) The local government units shall, in conformity with existing laws, continue to prepare their respective comprehensive land use plans enacted through zoning ordinances which shall be the primary and dominant bases for the future use of land resources: Provided, That the requirements for food production, human settlements, and industrial expansion shall be taken into consideration in the preparation of such plans.

Appendix D: The Philippines: Selected Economic Indicators, The World Bank, September 1998

The Philippines: Selected Economic Indicators

	Philippines	East Asia & Pacific	Lower- & Middle- Income	
Poverty and Social Indicators				
Population, millions, 1997	73	1,753	2,285	
GNP per capita (<i>Atlas</i> method, US\$), 1997	\$1,220	\$970	\$1,230	
GNP (<i>Atlas</i> method, billions of U.S.\$), 1997	90	1,707	2,818	
Average Annual Growth Rate of Population, 1991-97	2.3%	1.3%	1.2%	
Average Annual Growth Rate of Labor Force, 1991-97	2.7%	1.4%	1.3%	
The following indicators are taken from the most recent year available during 1991-97				
Poverty - % of population below national poverty line	54%	n.a.	n.a.	
Urban Population - % of total population in cities	56%	32%	42%	
Life Expectancy at Birth - in years	66	69	69	
Infant Mortality Rate - per 1,000 live births	36	38	36	
Child Malnutrition - % of children under 5 years old	30%	16%	n.a.	
Access to Safe Water - % of population	85%	84%	84%	
Illiteracy Rate - % of population age 15 or higher	5%	17%	19%	
Gross Primary Enrollment - % of school-age population	116%	115%	111%	
	1976	1986	1996	1997
Key Economic Ratios and Long-Term Trends				
GDP - billions of U.S. dollars	17.2	29.8	82.8	82.2
Gross Domestic Investment / GDP	32.9	16.0	24.0	24.8
Exports of Goods & Services / GDP	19.3	26.3	40.5	49.0
Gross Domestic Savings /GDP	26.9	19.9	15.2	14.5
Gross National Savings / GDP	27.7	19.3	19.3	18.8
Current Account Balance / GDP	-6.4	3.2	-4.8	-5.2
Interest Payments / GDP	1	3.8	2.1	2.3
Total Debt / GDP	35.1	94.5	49.7	55.5
Total Debt Service /	16.9	33.7	14.4	9.1
Present Value of Debt / GDP	n.a.	n.a.	46.6	n.a.
Present Value of Debt / Exports	n.a.	n.a.	96.3	n.a.

The Philippines: Selected Economic Indicators (cont.)

	1976-86	1987-97	1996	1997
Average Annual Growth Rates of:				
GDP	1.8%	3.2%	5.7%	5.3%
GNP per capita	-0.8%	1.4%	4.5%	3.3%
Exports of Goods and Services	6.0%	9.5%	15.4%	17.5%

	1976	1986	1996	1997
Structure of the Economy				
Agriculture - as a % of GDP	29.3	23.9	20.6	18.7
Industry - as a % of GDP	35.7	34.6	32.1	32.2
<i>of which</i> Manufacturing - as a % of GDP	25.4	24.6	22.8	22.3
Services - as a % of GDP	35.1	41.5	47.3	49.2
Private Consumption - as a % of GDP	62.3	72.1	72.8	72.5
General Government Consumption - % of GDP	10.8	8.0	11.9	13.0
Imports of Goods and Services - as a % of GDP	25.2	22.4	49.3	59.4

	1976-86	1987-97	1996	1997
Average Annual Growth Rates of:				
Agriculture	1.4	1.8	3.0	3.7
Industry	0.7	3.1	6.3	6.0
Manufacturing	0.5	3.0	5.6	4.2
Services	3.2	3.9	6.5	5.4
Private Consumption	2.4	3.7	5.3	3.7
General Government Consumption	-0.3	3.9	5.2	0.6
Gross Domestic Investment	-3.2	6.3	15.6	9.2
Imports of Goods & Services	2.1	11.3	16.7	14.4
Gross National Product	1.5	3.8	6.9	5.5

	1976	1986	1996	1997
Domestic Prices - Percentage Change				
Consumer Prices	9.2	0.8	8.4	5.1
Implicit GDP Deflator	8.3	3.0	7.8	6.0
Government Finance				
Current Revenue- as a % of GDP	n.a.	13.0	18.9	n.a.
Current Budget Balance - as a % of GDP	n.a.	1.4	n.a.	n.a.
Overall Surplus/Deficit - as a % of GDP	n.a.	-5.0	0.3	n.a.

note: Government finance data includes current grants

The Philippines: Selected Economic Indicators (cont.)

	1976	1987	1996	1997
Trade - in millions of U.S. dollars				
Total Exports (fob)	n.a.	4,842	20,543	25,228
Coconut Oil	n.a.	333	571	673
Sugar	n.a.	103	136	83
Manufactures	n.a.	2,672	17,106	21,488
Total Imports (cif)	n.a.	5,044	31,885	36,355
Food	n.a.	193	1,578	1,435
Fuel and Energy	n.a.	869	3,008	3,074
Capital Goods	n.a.	839	10,472	14,369
Index of Trade - 1995 = 100				
Export Price Index	n.a.	76	100	n.a.
Import Price Index	n.a.	61	101	n.a.
Terms of Trade	n.a.	124	99	n.a.
Balance of Payments - in millions of U.S. dollars				
Exports of Goods and Services	3,262	7,702	27,627	34,359
Imports of Goods and Services	4,381	5,868	41,371	50,477
Resource Balance	-1,119	1,834	-13,744	-16,118
Net Income	-253	-1,321	9,202	10,735
Net Current Transfers	268	441	589	1,080
Current Account Balance	-1,105	954	-3,953	-4,303
Financing Items (Net)	1,051	184	8,060	7,666
Changes in Net Reserves	54	-1,138	-4,107	-3,363
Reserves Including Gold	n.a.	n.a.	11,745	8,768
Exchange Rate (end of year, pesos per U.S.\$)	7.4	20.4	26.2	29.5
External Debt - in millions of U.S. dollars				
Total Debt Outstanding and Disbursed	6,039	28,204	41,214	45,603
Total Debt Service	571	2,961	5,778	4,463
Composition of Net Resource Flows				
Official Grants	61	401	246	260
Official Creditors	212	198	-310	107
Private Creditors	883	294	1,859	3,022
Foreign Direct Investment	132	127	1,408	1,253
Portfolio Equity	0	0	1,333	0

source: The World Bank, September 1998.

note: Data for 1997 are estimates.

Appendix F: Descriptive Brochure on the Galing Pook Awards describing the award program for Excellence and Innovation in Local Government, and a listing of 1993-97 award-winning activities

*A program to promote excellence
in local governance*

GALING POOK AWARDS

Center for Development Management
Asian Institute of Management

Local Government Academy
Department of the Interior and Local Government

GANTIMPALANG PANG-LINGKOD POOK PROGRAM

BACKGROUND AND RATIONALE

A confluence of need and opportunity gave impetus to Galing Pook Awards. The promulgation of the 1991 Local Government Code and the recent proliferation of civil society organizations at the provincial, city, municipal, and barangay levels have created unprecedented opportunities to promote good local government.

Opportunities abound but local officials have had little preparation, in some cases insufficient resources, to properly respond to the challenges. However, some local government units (LGUs) have found innovative solutions to difficult problems and managed to serve their constituents effectively despite constraints in time resources. And local officials have begun to look at their peers as sources of new ideas and approaches.

What is needed is a mechanism to inform our local government officials on programs that work effectively, inspire them to strive for excellence in local governance and recognize them for their efforts. Thus, the birth of the Galing Pook Awards. GALING POOK seeks to recognize and replicate outstanding programs of local government units that have effectively addressed pressing social and economic problems in their respective communities.

The National Selection Committee which consists of a distinguished group of individuals from the government, non-government organizations, academe, business sector and media is spearheading the Galing Pook Awards. The Center for Development Management of the Asian Institute of Management (CDM-AIM) manages the awards process in cooperation with the Local Government Academy (LGA).

Funding support for the 1995-96 Galing Pook Awards comes from the Ford Foundation and the Canada Fund.

WHO CAN NOMINATE?

Any government or non-government organization, people's organization, business or civic group may nominate one or more local government programs which can be examples of excellence in local governance. Nomination forms can be secured from AIM and LGA. The forms should be submitted to the AIM on or before November 15, 1995. AIM, in turn, will send preliminary application forms to the nominated LGU programs. However, it is not necessary for a program to be nominated in order to apply.

WHO CAN APPLY?

All LGUs with any type of program can apply provided that such program meets the following eligibility criteria:

- Must have been initiated and/or managed by a local government unit;
- Must have been in operation for at least one year on or before November 29, 1995;
- Must have shown measurable results.

HOW AND WHERE TO APPLY

- Any LGU can directly apply by submitting the Galing Pook preliminary application form to CDM-AIM on or before November 29, 1995.
- The preliminary application form will be the basis for evaluating the program's eligibility. A more extensive application form will be sent to eligible programs. This form should be submitted to AIM together with a letter of endorsement from the governor or mayor of the concerned local government unit on or before February 15, 1996.

CRITERIA FOR SCREENING & SELECTING WINNING PROGRAMS

The screening of applicants and the selection of the winning programs will be based on the following criteria:

- **Effectiveness of Service Delivery.** The degree of relevance of a program in responding to the pressing needs of its target beneficiaries; impact on its beneficiaries and the capacity of the LGU to deliver its services;
- **Positive Socio-Economic and/or Environmental Impact.** The ability of the program to significantly improve the social and material living conditions of the client community; and the milestones achieved by the program in conserving, protecting, and rehabilitating the environment.
- **Promotion of People's Empowerment.** The extent to which the program has facilitated access and control of resources by the local people; built their capabilities in managing their resources; and organizing themselves to demand changes; and actively participate in local government decision making, implementation, and evaluation.
- **Transferability and Sustainability.** The degree to which the program will be continued beyond the current administration and its potential to get the support of the successor; the extent to which the benefits of the program will continue to flow to its beneficiaries despite the change in leadership and funding arrangements, the degree to which the program will inspire replication by other LGUs.
- **Creative Use of Powers provided by the 1991 Local Government Code** such as taxation, land use planning and evaluation, resource mobilization and utilization, expenditure management, local enterprise development, credit financing, grants/donation availment, linking with NGOs and POs, and eliciting and maximizing private sector participation.

THE SCREENING AND SELECTION PROCESS

- **First screening - shortlisting of eligible program applications** by the Screening Team composed of representatives from government and non-government organizations, business, academe, media, and other groups;
- **Second screening - determining programs to be evaluated on site** by members of the Screening Team and the National Selection Committee;
- **Third screening - selecting the 20 program finalists** based on the preliminary and extensive application forms and the site visit reports;
- **Final interview - of the 20 program finalists** by the National Selection Committee to select the 10 outstanding programs who will each receive a plaque of recognition and P100,000 grant to document, strengthen, and replicate the program.

1996-97 GALING POOK WINNERS

- Environmental Resource Management, Bais City, Negros Oriental
- Ecological Amelioration for Sustainable Development, Palompon, Leyte
- Politika Sa Bangketa (Red Side Walk), Marikina City
- Save the Working Child, Butuan City
- Road for Progress, San Carlos City, Negros Occidental
- A Clean Sea, A Healthy Community, Aparri, Cagayan
- Provincial Health Insurance, Guimaras Province

- Sagay Marine Reserve, Sagay City, Negros Occidental
- Barangay Tanod Partners for Progress, Pulilan, Bulacan
- Voluntary Blood Sufficiency Program, Davao Province
- Sports Development, Madridejos, Cebu
- Fishery Development, Masbate Province
- Todo Unlad, Padre Garcia, Balangas
- Lingap Tanaw, Naujan, Oriental Mindoro
- Volunteerism-Olongapo Style, Olongapo City
- Basco Waterworks, Basco, Batanes
- Irosin Agrarian Reform Program, Irosin, Sorsogon
- Talahib Handicrafts, Jones, Isabela
- Community-Based Rehabilitation Program for the Disabled, Almodan, Iloilo

- Alternative Commercial Business District, Legazpi City

1995-96 GALING POOK WINNERS

- Sustainable Food Security, Davao del Sur
- Marine Conservation of San Salvador Island, Masinloc, Zambales
- Municipal Infirmary and Health Assistance, San Miguel, Bohol
- Government Computerization, Naga City
- Oplan Linis, Puerto Princesa City
- Agora Mobile School for Street Children, Cagayan de Oro City
- Ecological Waste Management, Sta Mana, Bulacan
- Lote Para Sa Mahirap, San Carlos City
- Alay Paglingap, Bulacan Province
- Eco-Walk, Baguio City
- Satellite Libraries, Puerto Princesa City
- Satellite Hospitals, Puerto Princesa City
- Upland Agricultural Development, Magsaysay, Davao del Sur
- Comprehensive Cooperative Development, New Lucena, Iloilo
- Sipaglakas Movement, Lipa City
- Peace and Reconciliation, Eastern Samar
- Potable Water Development, Clarin, Bohol
- Early Education & Development, Naga City
- Sustained Health Services, Malalag, Davao del Sur
- Management of Human Settlements, Muntinlupa City

1994-95 GALING POOK WINNERS

- Kalibo Save the Mangrove of Kalibo, Aklan
- Strategic Development Intervention in Transforming Malalag into a Provincial Agro-Industrial Center of Malalag, Davao del Sur
- Community Primary Hospital/Community Based Resource Management of Negros Oriental
- Acquisition of A Complete Equipment Pool of Muñoz, Nueva Ecija
- Kapit-Bisig Program of Sampaloc, Quezon
- Municipal Bond Flotation for Pabehay Program of Victorias, Negros Occidental
- Save the Marikina River of Marikina, Metro Manila
- Productivity Improvement Program of Naga City
- Guagua Integrated Approach Towards Sustainable Development of Guagua, Pampanga
- Cultural Development Program of Bulacan

1993-94 GALING POOK WINNERS

- Bentay Puerto Program of Puerto Princesa City
- Nutrition, Food, Environment and Medicare Program of Binmaley, Pangasinan
- Kaularan sa Pagkakaiba Program of Bulacan
- Build, Operate and Transfer Program of Mandaluyong City
- Solid Waste Management Program of Olongapo City
- Metro Naga Development Program of Naga City
- Tax Computerization Program of Cebu City
- Integrated Area Development Program of Irosin, Sorsogon
- Kabalikat Rubber Development Program of North Cotabato
- Tulunan Peace Zone Program of Tulunan, Cotabato

For more information, write or call:

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Asian Institute of Management
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Local Government Academy
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Appendix G: Decentralization Ratios for all LGUs, 1985-97

Decentralization Ratios for All LGUs, 1985-97				
	RDR	EDR	MEDR	FAR
1985	5.93	9.12	11.42	51.10
1986	5.50	6.92	9.06	52.90
1987	4.52	5.70	10.04	50.90
1988	4.67	6.21	10.48	49.20
1989	4.85	7.36	10.62	55.90
1990	4.87	6.75	11.21	51.40
1991	4.55	7.70	12.61	44.60
1992	4.35	18.98	14.26	42.14
1993	6.36	12.88	19.97	43.33
1994	5.41	15.09	21.87	34.00
1995	5.89	15.43	21.83	32.69
1996	6.20	16.01	21.00	35.95
1997	6.52	16.33	21.39	34.71
Averages:				
1985-1991	4.86	7.04	11.00	51.60
1992-1997	5.82	14.74	20.54	36.66
1992-1994	5.41	12.56	19.10	38.80
1995-1997	6.23	15.92	21.41	34.52

NOTES:

RDR = Ratio of LGU revenue from local sources to general government revenue

EDR = Ratio of LGU expenditure to general government expenditure

MEDR = Ratio of LGU expenditure net of debt service to general government expenditure net of debt service

FAR = Ratio of LGU revenue from local sources to LGU expenditure

SOURCE: Loehr & Manasan, "Fiscal Decentralization and Economic Efficiency: Measurement and Evaluation," (DRAFT) January 1999.

**Appendix H: Financial Autonomy Ratio of Different Levels of Local Governments ,
1985-1997**

Financial Autonomy Ratio (FAR) of Different Levels of Local Governments

	Provinces	Municipalities	Cities
1985	31.79	55.19	64.23
1986	31.49	57.01	67.13
1987	30.73	53.45	65.03
1988	32.31	44.65	68.61
1989	48.71	48.89	72.39
1990	36.02	48.63	68.45
1991	28.24	43.07	61.55
1992	29.72	41.98	50.98
1993	24.04	48.88	51.09
1994	20.51	28.90	48.29
1995	19.63	27.58	46.26
1996	19.23	28.40	52.58
1997	19.02	28.26	50.49
Averages:			
1985-1991	34.32	48.33	66.41
1992-1997	21.53	33.42	49.83
1992-1994	23.59	38.74	49.70
1995-1997	19.48	28.10	49.97

Notes:

FAR = Ratio of LGU revenue from local sources to LGU expenditure

SOURCE: Loehr & Manasan, "Fiscal Decentralization and Economic Efficiency: Measurement and Evaluation," (DRAFT) January 1999.

Appendix III: LGU Expenditure Patterns

Distribution of Public Sector Expenditures by Type of Government 1997

	Total	NG	Local	Prov.	Mun.	Cities
As a Percentage of Government Expenditures						
GRAND TOTAL	100.00	83.07	16.93	4.12	6.20	6.61
Total for Economic Services	100.00	81.28	18.72	5.16	5.81	7.75
Agrarian Reform	100.00	100.00	0.00	0.00	0.00	0.00
Agriculture	100.00	89.21	10.79	3.98	5.25	1.56
Natural Resources	100.00	95.29	4.71	1.14	0.19	3.39
Industry	100.00	100.00	0.00	0.00	0.00	0.00
Trade	100.00	100.00	0.00	0.00	0.00	0.00
Tourism	100.00	100.00	0.00	0.00	0.00	0.00
Power and Energy	100.00	83.43	16.57	4.19	2.51	9.87
Water Resources Devel. & Flood Control	100.00	80.54	19.46	2.10	12.37	5.00
Transportation & Communication	100.00	99.65	0.35	0.08	0.16	0.11
Other Economic Services	100.00	20.42	79.58	21.26	23.07	35.25
Total for Social Services	100.00	82.85	17.15	5.27	5.08	6.80
Education	100.00	92.46	7.54	1.49	1.68	4.37
Health	100.00	53.10	46.90	21.33	14.67	10.90
Social Services, Labor, & Employment	100.00	86.51	13.49	2.91	6.03	4.55
Housing & Community Development	100.00	37.48	62.52	9.09	19.34	34.08
General Public Service	100.00	65.77	34.23	6.36	16.20	11.65
Public Administration	100.00	57.53	42.47	7.97	20.19	14.32
Peace & Order	100.00	98.30	1.70	0.03	0.46	1.21
Others	100.00	0.00	100.00	20.32	27.40	52.27
Defense	100.00	100.00	0.00	0.00	0.00	0.00
Debt Service	100.00	98.06	1.94	0.39	0.40	1.15

	Total	NG	Local	Prov.	Mun.	Cities
As a Percentage of GNP						
GRAND TOTAL	21.78	18.09	3.69	0.90	1.35	1.44
Total for Economic Services	5.13	4.17	0.96	0.26	0.30	0.40
Agrarian Reform	0.17	0.17	0.00	0.00	0.00	0.00
Agriculture	1.01	0.91	0.11	0.04	0.05	0.02
Natural Resources	0.38	0.36	0.02	0.00	0.00	0.01
Industry	0.11	0.11	0.00	0.00	0.00	0.00
Trade	0.01	0.01	0.00	0.00	0.00	0.00
Tourism	0.04	0.04	0.00	0.00	0.00	0.00
Power and Energy	0.12	0.10	0.02	0.00	0.00	0.01
Water Resources Devel. & Flood Control	0.06	0.05	0.01	0.00	0.01	0.00
Transportation & Communication	2.23	2.22	0.01	0.00	0.00	0.00
Other Economic Services	1.00	0.20	0.79	0.21	0.23	0.35
Total for Social Services	5.77	4.78	0.99	0.30	0.29	0.39
Education	3.95	3.65	0.30	0.06	0.07	0.17
Health	0.96	0.51	0.45	0.20	0.14	0.10
Social Services, Labor, & Employment	0.61	0.53	0.08	0.02	0.04	0.03
Housing & Community Development	0.26	0.10	0.16	0.02	0.05	0.09
General Public Service	4.24	2.79	1.45	0.27	0.69	0.49
Public Administration	3.38	1.94	1.44	0.27	0.68	0.48
Peace & Order	0.86	0.84	0.01	0.00	0.00	0.01
Others	0.19	0.00	0.19	0.04	0.05	0.10
Defense	1.46	1.46	0.00	0.00	0.00	0.00
Debt Service	5.00	4.90	0.10	0.02	0.02	0.06

SOURCE: Loehr & Manasan, "Fiscal Decentralization and Economic Efficiency: Measurement and Evaluation," (DRAFT) January 1999.