PN-ABT-465

PHILIPPINES LOCAL FISCAL

INTEGRITY ANALYSIS REPORT

DECENTRALIZATION: FINANCE AND
MANAGEMENT PROJECT

Sponsored by the U.S. Agency for
International Development
Contract No. DHR-5446-Z-00-7033-00
(Funded by the USAID Office of Rural and
Institutional Development of the Bureau
for Science and Technology and by the
USAID Mission in the Philippines)

Managed by:

Associates in Rural Development, Inc.

In collaboration with:

Metropolitan Studies Program
Maxwell School of Citizenship
& Public Affairs
Syracuse University

Workshop in Political Theory
& Policy Analysis
Indiana University

Prepared by:

Kenneth Hubbell, Ph.D.
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ABBREVIATIONS AND ACRONYMS

AID	Agency for International Development, Washington, DC
barangay	the smallest LGU recognized by GOP
BIR	Bureau of Internal Revenue
BLGF	Bureau of Local Government Finance
COA	Commission on Audit
CPDC	City Planning and Development Council
DBM	Department of Budget and Management
DFM	Decentralization: Finance and Management Project
DLG	Department of Local Government
DOF	Department of Finance
DPWH	Department of Public Works and Highways
ES	equipment-supported
GOP	Government of the Philippines
INP	the national police
IRA	Internal Revenue Allotment
LB	labor-based
LDAP	Local Development Assistance Project
LGC	Local Government Code
LGRSF	Local Government Revenue Supplement Fund
LGU	Local Government Unit (barangays, municipalities, provinces, component and autonomous cities)
LRM	Local Resource Mobilization
MDC	Municipal Development Council
MOA	Memorandum of Agreement
MPDC	Municipal Planning and Development Council
NALGU	National Assistance to Local Government Units
NCR	National Capital Region
NEDA	National Economic Development Authority
NGO	Non-Governmental Organization
NIRA	National Integrated Revenue Allotment
NRO	NEDA Regional Office
NTA	National Tax Allotment
OP	Office of the President
P	pesos
PDAP	Provincial Development Assistance Program
PDC	Planning and Development Council
PDO	Planning and Development Office
poblacion	small town
PPDC	Provincial Planning and Development Council
PPDO	Provincial Planning and Development Office
PSE	personal service expenditures
RDC	Regional Development Council
RPT	Real Property Tax
RPTOP	an RPT reporting form
SB	Senate Bill
SEF	Special Education Fund

SOW	Scope of Work
STA	Specific Tax Allotment
USAID	U.S. Agency for International Development, Manila, Philippines

PREFACE

This report on Local Fiscal Integrity in the Philippines is the product of a three-week study by a joint Filipino-American team of consultants during July 1989. The U. S. Agency for International Development, Manila (USAID) solicited the team through the Decentralization: Finance and Management Project (DFM), which is sponsored by the Office of Rural and Institutional Development of the Bureau for Science and Technology of the Agency for International Development, Washington, DC (AID). The study was commissioned to gather information for use by USAID staff in designing the proposed Local Development Assistance Program (LDAP), which USAID expects to complete by the end of calendar 1989. The Scope of Work (SOW) called for a rapid review of public finance issues and supporting institutions. (See Appendix I.) The DFM team was asked to analyze:

- implementation of public financial systems including budgeting, disbursement and accountability, intergovernmental grants flow, performance monitoring, revenue collection, and organization of and relationships among government offices involved in financial administration (procurement and contracting were dropped from the original SOW list of topics);

- financial absorptive capacity of Local Government Units (LGUs), in light of projected increases in the funds available to LGUs; and

- overall system description, analysis and recommendations.

This document is meant primarily for use by USAID, which has indicated particular interest in the discussion of benchmarks, indicators, and monitoring in Section VI. Other readers, particularly officials of the Government of the Philippines (GOP), will be familiar with much of this material. Department of Finance (DOF) staff and other GOP personnel may find the text, tables and graphs of Appendix A, "Tax Effort," on the Real Property Tax (RPT) Index, of use.

The team was composed of:

- Ken Hubbell, public finance economist;

- Denise Pineda, accountant;

- Norman Ramos, economist;

- Cesar Saldaña, local government specialist; and
- James T. Thomson, institutional analyst and team leader.

See Appendix E for a list of individuals consulted.

I. EXECUTIVE SUMMARY

A. Introduction

This report presents the findings of a five-person team engaged by USAID through AID/S&T/RD's DFM project to analyze "local fiscal integrity" in the Philippines. The team worked together for three weeks in the Philippines in July 1989. Interviews were conducted in Manila with GOP officials and in seven LGUs. Five of these LGUs were provinces -- Albay, Antique, Catanduanes, Cavite and Leyte -- and two were chartered cities -- Legaspi and Tacloban.

The SOW called for a rapid review of a broad range of topics organized around three themes:

- implementation of financial systems;
- financial absorptive capacity of LGUs; and
- overall system description, analysis and recommendations.

B. Implementation of Financial Systems

Implementation of financial systems is variable. A summary of DFM-team findings includes:

- in most LGUs visited, budgeting practices are weak, and revenue forecasting is rudimentary;
- efforts to assess the adequacy of fees charged for use of public facilities are non-existent;
- reliance on supplementary budgets to adjust to improperly forecast revenues is universal and frequent;
- disbursement and accountability procedures are being loosened concerning some intergovernmental transfers, which has led to revision of Commission on Audit (COA) procedures in some provinces;
- intergovernmental funds flows are complex, but will soon be simplified;
- proposed transfer formulas emphasize equity over local revenue effort;

- though funds now available to LGUs will probably be increased in the near future, they may remain severely inadequate given tasks faced by LGUs;

- performance monitoring is pursued by some LGUs, but should be strengthened along with budgeting procedures;

- LGU revenue collection is less than adequate in almost all cases, although some local executives interviewed are increasing efforts to mobilize funds; and

- the GOP is strongly pressing LGUs to increase RPT collections.

In the limited time available the team could not address issues of fiscal organization in adequate depth.

C. <u>Financial Absorptive Capacity</u>

Absorptive capacity is difficult to assess over such a short period. In discussing absorptive capacity, the DFM team found it useful to distinguish between two different types of resource flows. The first includes funds provided by line agencies over which Regional Development Councils (RDCs) will exercise some control in the future. Most of these funds will be expended by central line-agency personnel seconded to LGUs. Even if LGUs obtain full control over a share of line agency budgets, they will still have the option of contracting with those agencies for project or activity implementation. Absorptive capacity in such cases will probably not pose a major problem.

The second type of resource flows includes all funds allocated to LGUs for their expenditure at their own initiative through force account or by contracting out for production of goods and services. LGU discretionary funds will probably increase by 85 percent to 150 percent, depending on the jurisdiction. Absorptive capacity of this type is more problematic, but field investigations suggest that many LGUs will expend a substantial portion of any increase in discretionary funds on upgrading services which they are already providing, e.g., health and infrastructure maintenance. In such cases, some funds will be used to increase LGU staff complements and to raise salaries, while other funds will be allocated to purchasing needed equipment and to increasing operating budgets. The remainder of discretionary fund increases will likely be spent on projects of local interest. Implementation will probably be contracted out to the private sector or to line agencies.

Within the general terms of the SOW, the DFM team also focused on issues raised by LDAP, which is currently under design and scheduled for implementation in early calendar 1990. In addition to USAID's concern with LGU financial absorptive capacity, it wanted to identify policy changes, and bench marks and methodologies for measuring progress on policy changes, which are to make up the LDAP negotiated policy reform agenda.

D. System Description and Recommendations

The situation in the Philippines concerning decentralization of public finance and political authority is in a state of transition. Significant positive changes can be expected in both areas during the next two years. USAID's LDAP effort should reinforce these changes, because most are strongly supported by USAID policy.

The DFM team recommends that USAID create two sets of incentives through LDAP to encourage these changes. The first set would be directed toward GOP central agencies to reinforce GOP commitment to decentralized public finance spending by making LDAP disbursements contingent on increased transfers to LGUs of discretionary funds. GOP would be rewarded for passing enabling legislation to permit LGUs to raise greater revenues from sources under local control, e.g., by increasing RPT and business tax rates.

The second set of incentives would be directed toward LGUs to encourage and reward LGU efforts to mobilize own source revenues, i.e., increased RPT collections, in particular, augmented by other local taxes including business, residency, and amusement. The appropriate mechanism for the second set of incentives would be to provide matching grants tied to improvements in own source revenue collections.

Two team members, Ken Hubbell and Norman Ramos, developed an instrument for comparing an LGU's RPT effort with the performance of neighboring LGUs within the same region. This tool permitted adjusting tax effort ratings for economic development levels. Similar tools could be developed for other types of local tax and non-tax revenues. These types of tools would be very useful as monitoring devices, and would permit both USAID and GOP to develop an accurate set of incentives to encourage improved resource mobilization by LGUs.

E. Follow-On Work

Further work should be undertaken on three major issues. First, an assessment should be undertaken of the effect of finalized Local Government Code (LGC) revisions on LGU revenues, and the adequacy of those revenues to meet LGU-assigned responsibilities.

Second, GOP appears to be considering allocating budgets to LGUs based on some formulas, which are currently undefined. It would be highly appropriate to develop a set of service-specific indicators which could be used to guide the disbursement of intergovernmental transfers/grants. Without such indicators, neither the GOP nor USAID can determine precisely whether resources are necessary for LGUs to provide an adequate level of services to their constituents, and if they are determined to be necessary, in what amounts.

Third, municipalities have been excluded from the analysis presented in this document because of time constraints. This creates a serious gap in the assessment of the current situation because municipalities -- intermediaries between the province and residents of rural and poblacion (small town) areas -- will be called upon more frequently to provide a growing range of services. The team strongly recommends that additional work be focused on assessing the role of municipalities within the new, decentralized framework of the local government sector.

II. INTRODUCTION

This report addresses several public finance issues that are linked with the GOP decentralization initiatives. These initiatives fall into four basic areas:

- Organic Acts for the autonomous regions of Cordillera and Muslim Mindanao;
- proposed revision of the LGC;
- Senate Bill No. 927 (SB 927), which proposes revising the current intergovernmental transfer system and reducing mandatory LGU contributions for health and public safety; and
- the new regional fund allocation system to be implemented through the RDCs.[1]

All are important initiatives and may have significant effects on relationships between the central government and LGUs. However, this report concentrates on the latter two initiatives.

The Organic Acts may become models for provincial autonomy in the future, as time clarifies relationships between the central government and these autonomous regions. At the moment, it is difficult to foresee the long-term impacts of the Organic Acts. It is clear though that other LGUs will closely monitor developments in the autonomous regions, and the attitudes of LGU elected officials about autonomy will be influenced by them.

If passed, proposed revision of the LGC, which is now under legislative scrutiny, will modify LGU officials' powers by delegating to them authority that cabinet officers currently exercise. The revised LGC is also expected to alter administrative procedures, tax regulations, and budgeting operations. However, it is not clear how congress will deal with the draft code. It may undergo marked changes in either or both houses and, in any case, is not likely to be passed in final form before 1991. Major revisions of current intergovernmental transfer programs, which have received broad endorsement and are of immediate importance to decentralization, have been incorporated into SB No. 927. Its passage seems probable.

SB 927 also integrates several existing LGU allotment and

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1 Office of the Cabinet Secretary, "Implementing Decentralization and Local Autonomy," 18 April 1989.

aid programs, and proposes modifications in current distribution formulas. It seeks to strengthen the fiscal position of LGUs, and increase the decision-making authority of LGU officials. Implications of this legislation will be discussed below.

The regional funding initiative will delegate responsibility to RDCs for allocating some part of central line-agency budgets among their constituent LGUs. The approach pioneered by the Department of Public Works and Highways (DPWH) may become a model for such delegation. The DPWH allocation formula divides budget ceilings among regions based on three criteria:

- population,
- equal share, and
- scarcity of infrastructure.

Other line agencies may select a similar arrangement in complying with the president's directives in this regard, but it is not now possible to say what methods other agencies will adopt to meet presidential directives. However, some structural issues that will arise as a result of this new initiative can be assessed. This topic is also examined below.

The report has four sections, following this introduction. The first (Section III) examines procedures and prospects for the limited delegation of national line-agency authority to RDCs. The second (Section IV) examines current and proposed governmental transfer programs. The third (Section V) addresses a number of policy issues. The final section (Section VI) considers how changes in policy issues could be monitored.

III. DELEGATION OF NATIONAL LINE-AGENCY AUTHORITY TO RDCs

A. Description of RDCs

To shift more of national line agencies' expenditures to subnational units for allocation, the Office of the President (OP) has decided to utilize the RDCs. The RDC concept was developed originally by the Marcos regime as a vehicle to strengthen planning. In the future, each concerned line agency is to allocate a portion of its national budget by region. The amount allocated by region becomes a ceiling for RDC expenditures on that function in the region. The DFM team understands that in the first phase, funds will not be fungible among sectors in the region. Instead, they must be spent on activities normally undertaken by the agency supplies them.

Each RDC is currently composed of:

- all governors in the region,
- representatives of concerned line agencies,
- chartered city mayors,
- representatives of nongovernmental organizations (NGOs), and
- representatives of professional groups.

In Region V, municipalities are also represented on the RDC.

B. RDC Planning Approach

The National Economic Development Authority (NEDA) Regional Office (NRO) performs the secretariat function for the RDC and seems to have played a pivotal role to date in defining the character of the planning process in municipalities, provinces, and regions. NEDA's strategy stresses a "bottom-up" approach, as planning nominally begins at the barangay level -- the smallest LGU recognized by GOP. The strategy involves attempting to compile a thorough listing of all project proposals -- infrastructure, livelihood, and socioeconomic -- identified for each LGU. At the municipal level, barangay and municipal projects are prioritized by the Municipal Planning and Development Council (MPDC). Each municipality's list is then forwarded to the province, where Provincial Planning and Development Office (PPDO) personnel collate the lists. The composite list is then forwarded to the NRO, whose staff then face the task of prioritizing literally thousands of proposed projects. They have little detailed knowledge or prior analysis on which to base these judgments.

One NRO director interviewed by the team noted that staff members simply classify the top third of each provincial list as "high priority," the middle third as "medium priority," and the bottom third as "low priority." Field interviews suggest that little effort is made to reduce the wish list of projects through critical analysis to a number that would permit informed decisions on ranking. For example, in Leyte and Antique Provinces PPDO staff indicated that no more than a third of all projects proposed are ever implemented.

In the opinion of many LGU executives and officials consulted by the team, these wish lists reflect the paucity of discretionary funds available to LGUs to undertake even the smallest projects of strictly local interest. For instance, many barangays cannot afford to cement local grain-drying platforms or basketball courts. They routinely request assistance with such projects from line agencies via the RDC, passing such requests to their Provincial Planning and Development Councils (PPDCs) via MPDCs. This planning process involves very high transactions costs in terms of staff and citizen time, money, and energy. Some LGU executives said those costs discourage them from pursuing project funding through the Planning and Development Council (PDC) route.

The GOP wants to promote greater LGU involvement in development operations and service provision at local levels. To this end, it intends to strengthen LGUs' capacity to undertake activities, simplify the overall planning process, and reduce the transactions costs of development work and service provision to more manageable levels by increasing the amount of discretionary funds allocated to LGUs at all levels. Most LGU executives interviewed by the team would prefer to spend funds they control on activities of proven local interest rather than wait several years or more until funds become available from a line agency or overriding LGU.

Another way to promote LGU activity would be to allocate a preappropriated budget to RDCs over which they have full authority. RDC approval of a project would then automatically ensure funding. As indicated in the next subsection, a proposal to vest more control in RDCs over a fixed portion of line-agency budgets is currently under consideration.

The RDC approach is separate from the integrated national allotment strategy incorporated in SB 927, but the two are closely linked. SB 927 should improve planning efficiency in the whole planning and budgeting process. For example, projects that cost out below given peso thresholds would be exempt from review by overriding LGUs or the RDC. Such small activities would be implemented directly by the concerned LGU (i.e., barangay, municipality, province, component and chartered city) on its own initiative.

C. GOP Policy Thrust on RDCs

The thrust of the GOP's RDC strategy is twofold:

- the primary goal is to increase LGU decision-making authority over augmented resources flowing into the regions, and

- a secondary goal is to reallocate some funds[2] from the National Capital Region (NCR) to the regions.

If achieved, this secondary goal will allow LGUs to increase marginally their expenditures for infrastructure, social services, and other activities.

Permitting the line agencies, OP and congress to revise RDC recommendations on line-agency expenditures in the regions undermines the discretionary decision-making authority of the regions in this regard. Subsequent changes, which have already been discussed at the cabinet level, may solidify regional control over a fixed portion of line-agency budgets. Therefore, distinctions need to be made between:

- enhancement of regional resources,

- a modest increase in regional control over allocation of line agency budgets, and

- full discretionary control over funds made available to LGUs for allocation entirely at their own behest.

While these three approaches to improving the fiscal and political position of LGUs relative to the national government are not the same, they are related. The fact that total funds in a region have been modestly enhanced means that any increase in true discretionary funds for LGUs will go somewhat further in

2 For example, Department of Finance (DOF) Undersecretary, Mr. Ramon K. Katigbak, Jr., calculates that DPWH will reallocate approximately P800 million from programmed NRC expenditures to amounts now slated for allocation by region. Regional DPWH budgets are estimated to total P14.5 billion. While this would appear to risk impairing infrastructure construction and maintenance programs in the Metro Manila area, it is felt that jurisdictions in the NRC have better direct access to foreign assistance for such activities.

providing services desired by citizens.

True discretionary funds at the LGU level must be distinguished from apparent increases in discretionary funds. Increased funds are scheduled to be provided to LGUs under the National Integrated Revenue Allotment (NIRA). These represent a real increase in discretionary funds. If the OP-preferred version of SB 927 passes, LGU discretionary funds will be augmented by the elimination of mandatory predeductions for health and public safety. These increases in discretionary funds may be offset to some extent by increased LGU service responsibilities and GOP-mandated minimum wage and salary increases for LGU officials.[3]

D. Assessment of RDCs

Despite the anticipated partial transfer of authority over funds to subnational levels, the RDC as an implementing vehicle appears to be a rather weak structure for this program. Several reasons underlie this assessment.

First, tradition exists for RDCs as a subnational government unit in the Philippines. In essence, it is a planning institution that has been inserted between the national government and traditional LGUs. New patterns of productive relationships between LGUs, NROs, and RDCs will have to develop over time if RDCs are to survive as effective organizations.

Second, congressmen now play no role in RDC deliberations. Yet, they have final decision-making authority over appropriations bills that incorporate RDC-recommended expenditures. Thus, uncertainty about the status of RDC project and activity recommendations may be considerable, depending on the level of conflict between congressional representatives and LGU executives. One way to address this problem would be to include congressmen in RDCs.

Third, if congressmen are represented on RDCs, there is some danger that RDCs will centralize resource allocation at that level, thereby reducing LGU discretionary funding. To avoid this, another alternative would be to allocate some or all discretionary funds directly to LGUs, in accordance with a predetermined formula. This would have the advantage of putting

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3 The DFM team did not determine whether the GOP is planning a supplementary appropriation for LGUs to cover all or part of wage increases that will follow if the proposed minimum wage increase is voted into law. The issue is significant -- some small LGUs may default in the face of higher wage and salary bills if they do not receive compensating supplemental appropriations.

discretionary funds immediately at the disposition of LGUs. Which option is most appropriate depends on the goals of the GOP's decentralization process.

IV. EVALUATION OF CURRENT AND PROPOSED INTERGOVERNMENTAL TRANSFER SYSTEMS

This brief report cannot provide a full elaboration of intergovernmental grants theory, but a rapid review of the purpose of intergovernmental transfer programs and major criteria by which they may be evaluated will help provide a context for analyzing proposed changes in the Philippine system.

A. Objectives of Transfer Programs

From the central government's perspective, a common goal of transfer programs is stimulation or encouragement of specific expenditures by recipient LGUs. In the case of the Philippines, grants made under the Specific Tax Allotment (STA) for infrastructure or the allocation formula used by DPWH for road maintenance, are both illustrations of programs that appear to have this objective. Encouraging specific expenditures is certainly justified when positive effects or externalities are expected to accrue to the spending government and recipient LGUs. This is particularly true when recipient jurisdictions are either unable or unwilling to undertake such expenditures with own-source revenues. Moreover, transfers may be expected to enhance overall productivity and economic growth in the local area and the country at large.

A second rationale for intergovernmental transfers is to redistribute resources spatially. Grants or transfers of this type may be based on several different criteria. Targeting grants to poor areas or regions in a country or providing minimal levels of public services to all areas are two examples. Grants to political regions may be used to resolve social strife or class conflict, as in the case of the Philippine Autonomous Areas Organic Acts.

A third and oft-cited purpose of transfers is to encourage greater resource mobilization efforts by LGUs. Typical of this approach are grants that are allocated on the basis of revenue mobilized locally or provide for only a portion of the total cost of a local activity, project, or capital investment.

Using this brief description of intergovernmental grant theory, an attempt will be made here to evaluate proposed SB 927 from several perspectives. The following issues will be addressed in the remainder of this section:

- size and growth of intergovernmental grants,
- effects of transfers on local government fiscal

planning,

- spending implications of the transfer system,
- implications for resource mobilization by LGUs,
- redistributional implications of changes in intergovernmental transfer formulas, and
- fiscal accountability.

B. Size and Growth of Intergovernmental Grants

The total impacts of these changes are still uncertain. The lack of complete data for 1989 makes it impossible to compare accurately the proposed 1990 NIRA with 1989 current-year allotments. The DFM team understands that 1990 NIRA grants will consolidate a number of grant programs that have been independently administered to date. Which funds will be collapsed into the common NIRA grant is still unclear, so the team was unable to develop detailed information about 1989 amounts that correspond to projected 1990 totals.

According to the most recent information furnished by the Department of Local Government (DLG) and DOF, the projected 1990 increase from the unadjusted 1989 combination of Internal Revenue Allotment (IRA), STA, and Local Government Revenue Supplement Fund (LGRSF) grants, is 105 percent, or from 5.094 pesos[4] (P5.094) billion to P10.4 billion. Other figures provided by the same sources suggest an increase from the unadjusted combination of grants to P8.9 billion, or by about 75 percent. Even if the low numbers are roughly accurate, LGUs will receive a substantial increase in nominal discretionary funds.

Regardless of the numbers on which these calculations are based, it is apparent that the main component of NIRA is tied to a highly buoyant tax base, i.e., Bureau of Internal Revenue (BIR) collections. Based on the actual growth of BIR collections from 1984 to 1988, grants from this source would have increased at an average nominal rate of 19.1 percent per year (see Table 1). If the BIR growth rate is expressed in real terms, the annual increase for the period is still an impressive 9.2%. Thus, other factors remaining equal, local governments can expect a buoyant stream of transfer income under NIRA.

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4 The exchange rate as of July 1989 was 21.1 Philippine pesos to one US dollar.

Table 1.
Calculated BIR Allotments for Years 1984 to 1988
in Billions of Pesos

Year	Total BIR Collectns	Fuel Tax	Net BIR Collectns	Calcltd IRA*	Real IRA**
1984	32.086	5.338	26.748	5.350	1.869
1985	41.658	7.391	34.267	6.853	1.944
1986	46.986	8.301	38.685	7.737	2.178
1987	58.583	11.701	46.883	9.377	2.543
1988	63.416	9.660	53.755	10.751	2.655
Average Annual Rate of Growth 1984-1988			19.1%	19.1%	9.2%

* Calculated as 20% of the Net BIR Collections.
** Calculated IRA adjusted for Annual CPI, 1984 to 1988.

Source: Bureau of Internal Revenue, DOF.

C. <u>Local Government Fiscal Planning</u>

Under SB 927, the total amount to be distributed in a given year is tied to the level of BIR receipts for two years previous to the current year, (i.e., the 1990 total is calculated based on total collections in 1988). This method of calculation should facilitate fiscal planning in LGUs by providing a planned external source of discretionary funds. If totally funded, this will be a particularly important development because the amounts actually received by LGUs have historically fallen far short of maximum amounts, averaging approximately one-half the potential allotments. While the GOP has clearly faced mitigating factors, the unpredictable nature of the annual allotments have made LGU fiscal planning extremely difficult.

Field interviews conducted by the team suggest that fiscal planning at the local level is not highly developed. The revenue-forecasting technique used by all the treasurers interviewed amounted merely to increasing last year's revenues by ten percent. Moreover, the extensive use of supplemental budgets -- frequently as many as one a month -- indicates that this budget-forecasting technique is very crude and must be constantly adjusted over the course of the year. In one case, a treasurer was aware of a massive increase in RPT payments to be derived from an enterprise located in an industrial park that had

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exhausted its tax holiday for capital equipment, yet failed to factor this predictable increase into projected revenue increases for the coming year.

Normally, the fiscal planning function is part of the budgeting process and, hence, is the responsibility of an office or department of budgeting. This is not currently the practice in the Philippines, where budget officers are a recent introduction in LGUs and seam to have a fairly narrow scope of responsibility. For instance, many are not privy to their treasurers' revenue projections. Furthermore, they apparently make no cash-flow analysis, nor do they attempt to evaluate the cost of providing public services on a sustainable basis. Few budget officers seemed concerned about pricing services to cover the total costs of provision -- i.e., operational expenses and capital costs.

These observed weaknesses in the budgeting process will continue to hamper fiscal planning at the local government level. Therefore, a significant program of training and professional development should be instituted by the responsible government agencies, notably DOF and the Department of Budget and Management (DBM). Such programs should be designed to upgrade the skills of these individuals in light of the projected increase in local discretionary revenues.

D. Implications for Resource Mobilization by LGUs

1. Encouragement of Revenue Enhancement under SB 927

Insights into the resource-mobilization aspects of SB 927 can be obtained by analyzing the allocation formulas in the bill. The version considered here is the one endorsed by the OP.[5] The sharing formula for the new NIRA transfer program strongly resembles that of the old IRA program and calls for the following allocation of funds.

First, the NIRA to be distributed to LGUs will be 20 percent of gross BIR collections, calculated from the second, rather than the third, calendar year preceding the current year (i.e., the 1990 allotment will be based on 1988). This will provide a one-time windfall to all LGUs and also reduce the impact of inflation.

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5 The OP-approved version is currently before the congress for review and action. However, at least ten other bills addressing several or all of the same issues have also been tabled. Thus, it is not clear that SB 927 as it is discussed here will emerge in its current form.

Second, the old allotment formula distributed funds as follows:

- 10 percent to barangays,
- 25 percent to provinces,
- 40 percent to municipalities, and
- 25 percent to cities.

The new formula calls for a slightly modified allocation of funds among LGU levels:

- 10 percent to barangays,
- 30 percent to provinces,
- 35 percent to municipalities, and
- 25 percent to cities.

Provinces will gain five percent more funds, while municipalities lose the same amount.

In addition to modifying the allotment formula between levels of government (provinces and municipalities), SB 927 changes the method of weighting shares going to LGUs in the same class. For provinces and cities, funds will be allocated as follows:

- 70 percent by population,
- 20 percent by land area, and
- 10 percent by equal share.

The weights for barangays will be modified to allocate:

- 2 percent to barangays of all cities
- 8 percent to barangays of all municipalities.

To summarize, the proposed method of allocation implies that:

- NIRA's primary objective is general-expenditure or service-level support for LGUs, and
- as far as the base 20 percent allotment is concerned, no emphasis is placed on resource mobilization -- local tax effort is not a criteria for basic assistance.

Incentives for local tax effort are incorporated only in the five percent RPT Tax Effort Incentive provision, which replaces the former five percent National Tax Allotment (NTA) that was distributed without regard to local tax effort. As proposed, the RPT Tax Effort Incentive is to be added to the 20 percent base NIRA allotment. The calculation for allocating the RPT Tax Effort Incentive is to be based on the second calendar year immediately preceding the current one. Disbursements will be predicated on individual LGUs RPT tax-collection efficiency as follows:

- 0 percent for less than 60 percent efficiency,
- 10 percent more for an efficiency of 60 to 69 percent,
- 15 percent more for 70 to 79 percent efficiency,
- 20 percent more for 80 to 89 percent efficiency, and
- 25 percent more for 90 percent and above efficiency.

While the SB 927 formula does represent a modest shift in favor of resource mobilization, there is a serious question as to how much incentive LGU officials will really find in the new formula. To be effective, the incentive offered must be sufficient to justify increased effort in collecting RPT. The team's analysis suggests that only 46 LGUs of the 124 in the combined province and chartered city group (slightly more than one-third) would currently receive incentives under the program. About half of the 46 would get the minimum ten percent incentive, assuming they continue at current tax-effort levels. Thus, effective impact of the incentive program thus may be less than anticipated.

2. RPT Tax Effort

The incentive provision of SB 927 and DOF's current special emphasis on RPT collection indicate that property-tax revenues are a major focus of GOP policy. For this policy to be effective in promoting achievement of target levels that the DOF's Bureau of Local Government Finance (BLGF) has set for LGUs, the government should reinforce its efforts in tax mapping. Tax mapping provides the foundation for reliable real-property assessments, and USAID and the GOP should finance completion of this effort. An effective strategy, and one that is currently being followed, is to concentrate on one or a few regions at a time. This maximizes the impact in terms of training and practice in a region. It also ensures that all LGU assessments in a region will be reasonably comparable in terms of their base and period.

Experience demonstrates that tax mapping will not automatically enhance RPT collection. Field interviews, as well as earlier research by others in this field in the Philippines, indicate that poor RPT collections also result from inefficiency in the collection process. At neither the municipal nor provincial levels do assessors' and treasurers' offices integrate their operations. Historical tradition partly explains this -- the two have long been viewed as separate functions.

Progress in the RPT effort cannot finally be achieved until these two offices integrate their responsibilities and operations. At a minimum, this will require improved coordination in the maintenance of records. BLGF has recently initiated changes in record management, and is introducing a new form, the RPTOP -- an RPT reporting form -- incorporating those changes to ensure that updated assessments are immediately transferred to the treasurer's office. This will at least keep the treasurer apprised of RPT amounts that should be collected from individual taxpayers.

USAID can support efforts in this area by providing continued technical training for treasurers, assessors, and tax mappers. Since provincial RPT collections are derived from property-tax revenues collected at the municipal level, the focus of USAID assistance should be on up-grading technical skills in collection at the municipal level. Field investigations by the DFM team indicated that chartered cities are in a position to computerize their tax-mapping, assessment, and record-keeping functions, which should also be promoted.

E. Tax Effort Analysis

Currently, the GOP is placing significant emphasis improved RPT collection by LGUs. RPT efficiency targets have been set and an incentive tax-collection program proposed. Thus, local tax efforts may be viewed as an integral part of the GOP's overall tax-enhancement strategy and, likewise, an important aspect of decentralization. Besides the obvious outcome of increased local receipts, and by extension, increased LGU expenditures on local services, tax enhancement also has the potential for fostering greater fiscal accountability. Residents tend to demand a higher degree of accountability from local officials when funding is locally generated, as opposed to externally supplied.

While tax efforts may be calculated in several ways, the simplest, most straightforward method is the ratio of per capita taxes to per capita income. This approach provides a reasonable benchmark for an LGU's tax effort, but oversimplifies the issue of a jurisdiction's taxable capacity. That is, it assumes a direct relationship between an LGU's ability to provide local services and personal income per capita. Admittedly, the assumed link between personal income and tax receipts is less direct for the RPT than other local tax sources (e.g., business and amusement taxes). However, personal income is deemed to be a more reliable gauge of taxable capacity than the value of assessed property because the latter measurement suffers from a number of serious statistical problems (i.e., unreliable assessment data because of poor tax administration).

Because of data limitations, the tax-effort model developed in this study (see Appendix A) is confined to the RPT, but with some slight modification, it can be easily expanded to encompass other major own-source tax revenues for LGUs. As outlined below, the computed tax-effort ratios provide a relative measurement by which the effort of a particular province can be compared to the region's average tax effort. Furthermore, it also permits analysis of a region's tax-effort performance relative to the nation as a whole.

1. <u>An Illustration</u>

Table 1 in Appendix A shows 1988 RPT data for the 73 Philippine provinces grouped by region. Two basic conclusions can be drawn from this information. First, in 1988, the overall tax effort in the Philippines was quite low. Based on adjusted 1988 personal income figures, actual per capita RPT collection was just 2.11 percent. Second, the tax effort index (column four) indicates a wide variation in effective tax-effort rates, both across regions and between provinces in the same region.

To illustrate the point and demonstrate how this analysis may be used, consider the Cavite and Leyte Provinces. According to Table 1 in Appendix A, Cavite Province is very affluent, but is situated in Region IV, which has an average income. Personal income for Cavite Province is P8,482; for the region P6,397; and for the nation, P6,621. Applying the nation's average RPT rate to regional income indicates that the region's potential tax revenue is P13.53 per capita (column five). Column three shows that actual collections in the region averaged P13.16 per capita -- in essence, the region nearly reached its potential. On the other hand, Cavite has an effective tax effort of 70.9 percent or 29.1 percent below its potential (see Annex 1, Graph, Region IV). From this brief analysis, it can be concluded that, in all likelihood, Cavite's relatively low tax effort is traceable to problems stemming from ineffective tax administration, not inadequate tax capacity.

In comparison, Leyte Province is located in Region VIII, which is relatively poor. Regional income is just 64 percent of the national figure. However, overall the region demonstrates a relatively low tax effort, however, since actual RPT collections average only P5.78, almost 35 percent below its potential. In contrast to the region's performance, Leyte exhibits a strong tax effort as actual provincial collections are nearly 70 percent above the estimated potential of P6.02 (see Annex A, Graph, Region VIII). Based on this simple analysis, Leyte would receive high marks for tax administration and/or efficiency.

While the foregoing quantitative approach is a useful way of assessing tax effort, it should not be employed indiscriminately. Once again using Leyte as an example, it was discovered that for the province's RPT effort in 1988, approximately half of the RPT collections came from two large industrial complexes -- Pasar and Philphos. Clearly, an anomaly of this magnitude distorts the analysis and may lead to some unwarranted conclusions concerning the actual configuration of tax burdens and collections in a jurisdiction. Assuming that these large enterprises continue to pay their RPT assessment, the burden of collecting from them is substantially lower compared to the effort involved in raising a similar sum from a large number of small and medium landowners. Furthermore, the concept of collection efficiency is at risk since payments by the enterprises correspond to a 100 percent efficiency for half of the province's current assessed RPT collections. A very low collection efficiency may exist on the remaining assessed properties, but this fact would be disguised in the computed tax-efficiency percentage.

2. <u>Future Policy Issues</u>

From this brief review, it is evident that additional empirical research is required on the complex of issues involved in local fiscal integrity. For example, on the issue of tax effort, the RPT-effort model discussed above and in Appendix A should be expanded to cover business and other local own-source taxes.

Second, additional attention should be devoted to the issue of tax buoyancy and adequacy. This question becomes even more important if all the tax and spending changes proposed in the LGC revisions are fully implemented.

Third, in the decentralization process, a balancing or matching of local government responsibilities (i.e., expenditures functions) and revenue sources must take place if LGUs are to emerge as viable entities in the Philippines. To better assess this critical balance, some effort should be directed to constructing a set of basic measures of social-service costs, which requires that some reasonable indicators of the costs of providing LGU services be devised. These indicators should reflect differences in:

- needs -- social, economic, and demographic factors beyond the LGU's control that affect the required level of services; and

- empirical costs of providing the required level of services.

To illustrate, measures of LGU needs might be derived from a "representative expenditure system." Such a system would provide estimates of the empirical relationship between certain need factors and expenditures for a social service, for example, between school-age population or enrollment and expenditures for primary and secondary education. At the risk of oversimplifying the issue, educational costs might be expressed in terms of basic or minimal per pupil outlays on administrative and teachers' salaries, school and laboratory supplies, and maintenance and capital expenditures. Disparities in RPT taxable capacity among LGUs, and hence, revenues to fund defined minimal educational costs, would serve as the basis of the "needs" calculation.[6]

The final policy issue relates back to the tax-effort measurement index itself. If fully developed, it could assist the GOP and USAID in focusing their training efforts and might work along the following lines. To obtain a crude comparative evaluation of the effects of training in LGUs with varying fiscal capacities, the set of jurisdictions would first be selected based on the index. Then, a standard format training program would be devised and offered in all target jurisdictions. Next, changes in tax-effort performance for the participating jurisdictions would be monitored over time. From the measures of tax effort for the initial and subsequent period, the effectiveness of different training groups and programs could be assessed. Finally, if USAID were to pursue a strategy of concentrating Local Revenue Mobilization (LRM) efforts in a single region or in contiguous regions, for instance, tax effort performance would be a particularly useful method of assessment, primarily because regional socioeconomic differences can be observed and quantified to some extent.

F. Spending Implications

This section deals with two aspects of "spending," that is, lump-sum grants by the GOP to LGUs. The first concerns the direct impact of the allotment system on specific categories of spending. The second concerns the spending implications of mandated functional expenditures. Under the proposed NIRA grant system, LGUs are not required to take any particular action to become eligible for funds; therefore, the GOP's primary focus is increased general spending rather than specific expenditure activities. In addition, if the earmarked 20 percent allocation to the Infrastructure Fund is no longer mandatory, as is

6 Currently, local education is funded partly by a Special Education Fund (SEF) levy on real property in the LGU.

presently proposed, the total grant will be available for discretionary expenditures. This policy shift, coupled with the other mandatory changes discussed below, signifies a decrease in GOP dominance of LGUs and encourages greater LGU expenditure decision-making by placing some meaningful revenues at their disposal. Some ways in which these discretionary grants might be spent were explored with local officials during DFM team field visits and their expenditure preferences are discussed in Section V.

Repeal of the statutory contributions to national agencies for the national police (INP) (18 percent of general revenues) and hospital care (seven percent of general revenues) will markedly increase the LGU's discretion over these functions. Moreover, dropping these mandatory payments should improve efficiency and produce a more optimal allocation of resources. Typically, when local control is established over a service activity, meaningful improvements in the level of performance and the cost of provision occur, essentially because of enhanced accountability at the local level. A better allocation of resources takes place simply because, under the system of statutory contributions, uniform rules rarely allow revenue flows to match expenditure requirements. In the absence of uniform contribution requirements, LGUs may adjust their budgets to reflect their preferences for these services. Some cities may elect to augment the national expenditures by the full amount of the repealed percentage, while others may opt for augmentation, but at a much lower level.

G. Redistributional Impacts of Intergovernmental Transfers

The issue treated under this heading is whether the NIRA grant formula redistributes income among subregions. Specifically, does the grant formula provide poorer jurisdictions with proportionately more resources than it allocates to more affluent LGUs? This question must be answered at two levels:

- does the grant formula shift funds vertically, i.e., among different classes of LGUs (chartered cities, provinces and municipalities); and
- within a class of LGUs, how are jurisdictions with differential fiscal capacity treated?

This is an important issue, but unfortunately, the DFM team did not have the time to address it, nor are the necessary data readily available. Follow-on activity could easily include an in-depth analysis of this issue. The redistributional impacts of intergovernmental transfers will continue to be important influences on the way that LGUs perceive grant funds.

H. LGU Fiscal Accountability and Project Monitoring

1. LGU Fiscal Accountability

In many cases, COA has substituted post-auditing systems for pre-auditing. This change coincides with a shift in the depository for National Assistance to Local Government Units (NALGU) funds from the provincial treasury to private banks. Thus, LGUs now enjoy more rapid access to their funds.

This new disbursement scheme has apparently facilitated disbursements and presumably improved the LGU service. However, the DFM team believes several aspects of LGU fiscal accountability should be reviewed and perhaps strengthened at the municipal level including:

- the role of internal control
- the new disbursement scheme and post-audit process, and
- enforcement of new audit policies and reporting deadlines.

For a fuller discussion of these questions, see Appendix B.

2. Project Monitoring

Project monitoring is not yet well developed in most of the LGUs visited by the team. Routine financial monitoring reports are prepared by most LGUs in accordance with DOF regulations. Financial monitoring uses traditional categories, such as offices and line items, and these documents focus on budget overruns, providing little analysis of project performance.

Some LGU executives are interested in monitoring and use it as a management tool. Others rely on their own, more informal methods. Even in the best LGUs, monitoring is per force a somewhat ad hoc exercise. Lack of easy access to vehicles for monitoring purposes forces project personnel to adopt cheaper methods. Typically, these permit greater involvement of local people and officials in monitoring activities and, thus, may be more effective. Further details on these issues are provided in Appendix C.

V. POLICY ISSUES

A. LGU Absorptive Capacity

There is considerable concern over the ability of LGUs to absorb dramatic increases in grant funding levels. This concern may be justified, particularly if actual distributions approximate those that are mandated. However, several factors may mitigate the impact of an increase in the size of total grants to LGUs on the order now envisioned by the GOP.

This section analyzes two different sources of funding increases over which LGUs will exercise control. The first is increased funding from line-agency budgets. In principle, roughly half of the budgets of line agencies that operate at the LGU level (e.g., DPWH and the Department of Agriculture, but not the Departments of Foreign Affairs, Justice, or Defense) will be subject to allocation by RDCs.

The second source of increased funding will result from a combination of fiscal changes. One portion will come from proposed increases in intergovernmental transfers to LGUs, to be consolidated under NIRA and based on a 20 percent share of BIR collections. The other part of this source will come from suppression of the pre-deducted, required 18 percent INP and 7 percent hospital LGU statutory contributions to the line agencies providing police and health services in local jurisdictions.

The combination of the two sources will probably increase LGU discretionary funds in the range of 85 percent to 150 percent above current levels. A potential third source of funding increases, though it will probably be not nearly as dramatic, is a rise in own-source revenues. The two major sources of increased funding are discussed in the following subsections.

1. Line-Agency Budgets

Several factors can be expected to reduce the strains on absorptive capacity potentially that are involved in giving LGUs greater control over line agency budgets. First, the GOP will allow line agencies two years to shift half of their budgets, personnel, and facilities to local control. This transfer is to be completed by December 1991. During the interim, the amount of money, staff, and material controlled by subnational jurisdictions and LGUs will increase gradually, but it is estimated that in the first year, no more than 50 percent will be placed under LGU control. In many places, LGUs may control no more than 20 percent of relevant line-agency budgets during the first year. This should cushion the strain on LGUs' absorptive capacity.

Second, line agencies can be expected to reallocate staff in light of LGU demands for services. Thus, LGUs will have the option of expanding the amount of contracting they do for services. Many already rely on private-sector firms to implement capital investment projects. Many also purchase some services from line agencies, in particular DPWH. If line-agency employees that are eventually brought under LGU operational control cannot handle the workload, it can be divided among in-house and contracted production of services.

Third, the development of alternative sources of supply for the same services should increase the power of LGU officials to bargain with suppliers for better quality or lower cost services.

2. <u>NIRA Increases and Suppression of LGU Statutory Contributions for Hospital and INP Services</u>

These funding increases are more likely to strain LGU's absorptive capacity, as they involve significant amounts that will be allocated solely by LGU officials. Assessing the extent to which they will in fact strain LGUs' absorptive capacity requires an informed guess about how increased discretionary funds will be spent. The DFM team analyzed the situation in the following manner.

The current NEDA planning mechanism encourages LGU officials to engage in making wish lists of projects. (See Appendix D for a fuller discussion.) When these officials are allocated real funds, their funding decisions about projects should become more realistic. Furthermore, NEDA's focus is on projects, not the enhancement of locally desired services. Thus, the lists of projects submitted by LGUs are often unrealistic and include no reference to possible increases in LGU spending on services because information about such activities is not solicited by the NEDA planning process.

At this stage, it is impossible to determine how LGUs will allocate additional discretionary funds. Once they have worked through a full funding cycle and empirical, and empirical results are available, it will be possible to assess spending patterns. (See Appendix E for a description of the budgeting process.) However, the team's field impressions suggest that additional discretionary funds will be allocated, depending on variable LGU needs, to the following major areas:

- enhancement of existing services -- e.g., maintenance, health care, and agricultural extension, and
- NEDA-type project lists.

Areas that are likely targets for priority spending are:

- additional staff;
- socioeconomic projects -- e.g., livelihood and health projects;
- production of locally desired services -- e.g., infrastructure maintenance, health services, etc.;
- capital equipment; and
- infrastructure projects.

Many of these may strain LGU's absorptive capacity, but that is not a foregone conclusion for several reasons. First, most LGUs have unmet needs for capital equipment, such as road machinery, office equipment, and materials involved in service provision. Second, most have some underutilized management and service-provision capacity. Many may be able to manage somewhat larger staffs and implement a fuller range of activities and infrastructure projects without undue strain. Others may find it considerably more difficult to manage their increased funds effectively. Given the team's limited time in the field, it is impossible to give a more definitive estimate of absorptive capacity. (See Appendix D for further details.)

B. Adequacy of LGU Resources to Meet LGU Responsibilities

At this point, it is difficult for the DFM team to determine an "appropriate" level of services for an LGU. Indeed, to do so would defeat the purpose of the GOP's decentralization initiative. However, assuming however that the objective of decentralization is to enhance the LGUs capacity to provide public services to their constituencies, it can be asked whether resources have increased during recent years at the same rate as some benchmark indicators -- i.e., have LGU resources kept pace with or increased above inflation and population growth?

Table 2 contains summary data on real per capita taxes and revenues obtained from LUGs surveyed by the team and offers some insights on this issue.

Table 2

REAL PER CAPITA TAX AND REVENUE FOR SELECTED LGUs: 1984 to 1988 (in Pesos)

Jurisdiction	Real Per Capita Taxes 1985	1986	1987	1988
Albay Province	.8	1.1	.7	.7
Antique Province	--	.6	.7	.7
Catanduanes Province	.8	.9	.7	.6
Cavite Province	2.8	2.4	3.6	3.8
Leyte Province	.7	.8	2.0	1.6
Legaspi City	14.8	15.3	13.3	12.4
Tacloban City	20.9	23.4	22.1	23.4
	Real Per Capita Revenues			
	1985	1986	1987	1988
Albay Province	8.9	10.4	10.3	7.7
Antique Province	--	15.8	9.8	10.5
Catanduanes Province	19.1	14.5	15.2	13.6
Cavite Province	15.0	10.5	12.0	11.4
Leyte Province	8.9	9.8	8.9	7.9
Legaspi City	52.4	50.9	44.4	53.0
Tacloban City	61.1	61.5	62.7	63.9

Source: Calculated by authors from data obtained from LGUs.

Viewed as a group, real per capita taxes remained flat or declined slightly for the majority of the five provinces and two cities over the four-year period from 1985 to 1988. Out of the seven jurisdictions, only Leyte and Cavite exhibited any real growth. The former has enjoyed a huge boost in RPT collections because of the fortuitous location of two large industries in the province, while the latter has benefited from its proximity to Manila.

If real per capita revenues is used as the base measure, the fiscal position of LGUs worsens, and only Tacloban City demonstrates any consistent growth. Comparing the two sets of data, apparently insufficient or inadequate growth of national aids/transfers was a major problem for provincial governments during this period. While growth in real per capita taxes showed little or no change, revenues declined in every one of the provinces surveyed. On the other hand, cities showed more consistency in the relationship -- Legaspi City recorded a decline in taxes and revenues, while Tacloban City had an increase in both measures.

Although there is direct evidence that inadequate governmental transfers were a contributing element, other factors may have played a part.[7] One highly probable cause is the lack of fiscal capacity. As discussed above in Section IV.D, fiscal capacity is related to tax bases, and tax buoyancy is a function of changes in the base and rate. While there is little doubt that current tax-efficiency levels are low and can be improved markedly,[8] for the most part, present LGU tax bases are inelastic or nonbuoyant (i.e., they do not keep pace with inflation or income). This is particularly true for the provinces and, to a lesser extent, the cities. RPT is more than 90 percent of own-source revenues for provinces (see Appendix G, Tables G.1 to G.5), but just 30 percent to 50 percent for cities (see Appendix G, Tables G.6 to G.7). Business-license taxes yield more revenue than the property tax for many cities and municipalities, and has good potential as a local revenue source, because it is a buoyant tax.

Turning again to Table 2., real per capita revenues for the two cities are nearly six times that of the provinces surveyed. Obviously, the primary reason for this large difference is that cities are responsible for the combined range of services provided by municipalities and provincial governments, and essentially have been given the authority to levy taxes commensurate with that of the two combined rural jurisdictions. However, team discussions with local officials suggest that revenue adequacy has been a persistent and continuing problem for cities. In particular, mayors pointed to a number of problems associated with urbanization -- inadequate housing, sanitation, public safety, and basic health services -- and a lack of resources to cope with them. According to them, these problems have become more acute in the last two years.

First, the accumulated strain of years of underfunding for local infrastructure construction and maintenance is now reaching the crisis point. In numerous cases, maintenance has been delayed for so long that many physical assets are literally beginning to collapse. Second, many service functions that were to have been handled by GOP line agencies were either not provided, or underfinanced, thereby causing the cities and provinces to reallocate scarce resources to maintain these

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7 See Angel Q. Yoingco and Milwida M. Guevara, "Fiscal Decentralization, Resource Mobilization and Effective Use of National Resources for Development: The Case of the Philippines," 27 January 1989, unpublished ms., p. 14.

8 As noted in Appendix F, "Property Assessments and Real Property Tax Collection Efficiency: Selected LDAP Provinces and Cities," the average RPT collection efficiency for the seven LGUs visited by the team was 43.73 percent, which ranged from a low of 25.2 percent in Legaspi City to a high of 61.79 percent in Leyte Province.

services. Third, to some extent, cities have fallen victim to the country's recent prosperity. Because much of the growth has been centered in urbanized regions of the Philippines, the pace of rural-to-urban migration has quickened, which overloaded LGUs' social service systems.

In light of these difficulties, USAID may want to consider introducing "urbanization" as a separate factor in any LDAP grant program. As stated above, the proposed NIRA formula does not give any direct weight to nor address the issue of urbanization.

C. Possible LDAP Policy Goals

The objective of the LDAP grant program will dictate which transfer method should be selected and, hence, the best mechanism for accomplishing stated goals. As previously discussed, some commonly accepted grant objectives are:

- stimulation or encouragement of specific expenditures or services,
- resource mobilization, and
- resource redistribution.

If USAID seeks to emphasize resource mobilization as a policy objective, a block grant system could be developed, based on some performance index of tax effort or other measure of own-source revenue enhancement. A second option is to offer matching block grants to LGUs based on service-related indices (service adequacy) along the lines developed in Section IV.D, i.e., "representative expenditure systems."

However, if USAID wants to focus primarily on service adequacy, a third option is to offer grants unrelated to revenue effort. For example, transfers could be made based on some crude index of the level of service needs (i.e., population and surface area). A more refined approach would establish needs indicators for critical services, once again along the lines discussed in Section IV.D. An inverse measure of fiscal capacity, like RPT base, could also serve as a rough indicator of the ability to finance services.

The grant option or combination selected will result in trade-offs among alternative economic objectives -- fiscal effort, service adequacy and fiscal capability. For example, the first option discussed above stresses LGU resource mobilization and ignores questions of equity (i.e., equal treatment of LGUs having different fiscal capability). It also ignores service adequacy among LGUs receiving LDAP funds. The second emphasizes service adequacy and, to a lesser extent, resource mobilization and ignores fiscal capacity. The third option stresses service adequacy at the expense of resource mobilization.

The feasibility of any of the three options will be heavily influenced by the availability of reliable and timely data that permit measurement and monitoring of these indices. Thus, it may be necessary to select a less preferred option because of a lack of adequate data to monitor a more preferred option.

D. Credit Financing

In addition to the intergovernment transfer approach, another method of increasing capital formation and leveraging local government resources is credit financing. LGUs have access to loans for income-generating projects through existing institutions, primarily the DBP and Land Bank, but participation levels are low. As catalogued in a 1983 study, a number of institutional and regulatory barriers plus the attitude of LGU officials themselves are reasons advanced for the limited use of project borrowing.[9]

The changed political environment for LGUs coupled with the GOP's decentralization initiatives may now make this historically shunned project financing method more attractive. While further inquiry is necessary, capitalization of an LGU lending authority provides USAID yet another option for supporting the GOP's decentralization policies.

In LDCs, the establishment of a loanable funds pool is most often accomplished through the creation of a separate credit financing authority. If so desired, the credit authority can be made part of a "Capital Grant Commission" or other capital allocation body. A total credit ceiling for the authority is usually set by the Ministry of Finance, the Central Bank, and/or the National Planning Agency. All borrowing is coordinated by the authority and limited to the established ceiling. Direct external borrowing by local governments is generally not allowed, but "on-lending" by the central government to LGUs is quite common.

1. Lending Mechanisms

In addition to the GOP's approach of lending through government-owned Development Banks, two other lending methods are commonly followed by LDCs. In Latin American countries, the approach is to create specialized credit financing authorities.

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9 See L. Kenneth Hubbell, "Local Government Credit Financing," in Roy Bahl, ed., Local Government Finance in the Third World: A Case Study of the Philippines. 1983.

The authorities receive capital contributions from the central government directly, from foreign aid, and from earmarked excise taxes. The authorities have their own in-house experts to assist the LGUs in project preparation and planning. Overall, an authority is expected to break even in their lending operations; therefore, applicants are scrutinized carefully in terms of credit worthiness. Allocations under this general model tend to follow the ability-to-pay principle, i.e., the wealthier LGUs tend to have more projects financed than do the poorer ones.

Another method of distribution is illustrated by the Indian system. Put simply, in the National Planning process, a Loan Plan is established and apportioned among state governments based on a set of objective standards. The share to an individual state is determined by a formula which includes population, tax effort, low income, and commitments to public projects within the state. As a pre-condition for receipt of loan funds, states are required to make matching expenditure commitments on certain types of projects.

E. Concluding Observations

Invoking the normal caveats associated with a limited survey of seven LGUs, some final observations are offered with respect to an LDAP grant program. First, the current low level of tax effort by LGUs points to revenue mobilization as a priority issue in the Philippines. Second, the accumulated years of delayed maintenance and the present poor physical shape of infrastructure and capital equipment suggest that grants for these purposes are greatly needed and, if extended on a matching basis, have the advantage of leveraging local resources. Unquestionably, a much more extensive evaluation of the categorical grant approval is a requisite condition of implementation, but is beyond the scope of this study. Third, as shown in Table 3, personal service expenditures (PSE) constitute a large percentage of all LGU expenditures.

Table 3

PERSONAL SERVICE EXPENSES FOR SELECTED LGUs: 1984-1988

Jurisdiction	Percent of Total Expenditures 1985	1986	1987	1988
Albay Province	30.0	33.1	38.7	45.0
Antique Province	41.1	28.7	67.8	56.6
Cantandusd Province	--	--	--	54.7
Cavite Province	--	--	--	--
Leyte Province	41.3	44.5	52.3	60.5
Legaspi City	40.2	50.1	51.0	50.2
Tacloban City	--	--	--	63.8
Average				
Provinces	37.5	35.4	52.9	54.2
Cities	40.7	50.1	51.0	55.3
All Combined	38.1	39.1	52.4	54.6

Source: Calculated by authors from data contained in Appendix G.

In 1988, the most recent year, personal services climbed to nearly fifty-five percent for cities and provinces representing a sharp increase over the 1985 figure of thirty-eight percent. Locally elected officials maintain that despite the increases, LGU employees remain poorly paid and an upgrading of their salaries is of paramount importance. For example, in Catanduanes Province the budget officer calculated that bringing the current labor force up to a proposed national minimum wage standard of P2,200 per month would cost the province an additional fifty percent in PSE. Therefore, by necessity, a sizable portion of the NIRA funds may provide increased LGU employee compensation. Such a use seems appropriate, however, some general wage adjustment guidelines may be warranted. Unfortunately, the DFM team's survey was not lengthy enough to provide more information on this subject.

VI. MONITORING LDAP FUNDS

In its "Discussion Paper for LDAP,"[10] USAID indicates its intention to monitor performance on a number of GOP policy reforms. In this section, several policy objectives are discussed that USAID has identified as possible foci of LDAP monitoring. In each case, performance indicators must be developed. Considerations concerning several of these foci are outlined here.

A. Implementation of NIRA

With the start of NIRA implementation in the GOP's fiscal year 1990, USAID should monitor the release of funds to LGUs under statutory regulations to determine how the amounts released compare with appropriate formula amounts. Historically, GOP central agencies have not released maximum statutory allotments to LGUs. If full NIRA releases are an agreed-on policy agenda item, monitoring will be necessary.

The timeliness of releases of funds to LGUs should also be monitored to determine if they are transferred on schedule. In the past, the GOP has not released programmed amounts on schedule and, indeed, has delayed releases to year-end in some cases. Such delays seriously impede LGUs' fiscal planning and implementation capability.

B. Elimination of LGU Mandatory Payments for Hospitals and INP

Monitoring this policy change will require two monitoring techniques. The first and simpler involves observing whether mandated predeductions are totally eliminated from LGUs' expenditure responsibilities. The second requires monitoring service levels with particular attention to any possible deterioration as a result of the elimination of LGU contributions. Monitoring should also determine whether the central government has found other ways to charge local governments for these services. It may be reasonable for the GOP to charge individual recipients for services received.

C. Project Development through RDCs

In terms of the implementation of decentralized decision-making authority for project development through RDCs, USAID

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needs to establish central line agencies' current allocation of funds between centrally versus RDC-controlled projects, notably with regard to DPWH. A GOP commitment to attain this objective would be reflected in a growing portion of line agencies' funds being transferred to RDCs for their discretionary allocation to regional activities. USAID should also monitor the extent to which RDCs are, in fact, able to allocate funds in a binding manner, as opposed to merely advising on project priorities, only to have them ignored when powerful LGU officials and congressmen lobby line-agency personnel to modify project rankings.

D. Increased Real Property Tax Collection by LGUs

The first objective of monitoring would be for USAID to determine the level of total RPT collection for each class of LGUs for the years 1988 and 1989. The annual real rate of growth in collections would reflect an overall improvement in tax effort in this area. In addition, it would be useful for USAID to monitor LGUs' efforts in tax mapping and reassessment. Progress in these areas should further enhance RPT collections in the country.

As part of its NIRA program, the GOP has proposed an incentive program for RPT collection. At first glance, the incentive levels established by the GOP appear high relative to tax effort in this area. Thus, it seems unlikely that the five percent portion set aside for this incentive program would be entirely utilized. This could reduce the amount of discretionary funds actually allocated to LGUs below GOP projections. Perhaps a more appropriate mechanism would be to adopt incentive programs that fully exhaust the five percent fund while ensuring that LGU's progress in the RPT tax effort is rewarded.

E. Provincial and Barangay Road Maintenance

If the objective is to verify that responsibility for road maintenance has been transferred from DPWH to LGUs, monitoring is fairly simply. However, to do a more sophisticated analysis of the impact of this change on LGU road maintenance levels and possibly levels of reliance on labor-based/equipment-supported (LB/ES) techniques, a more complex methodology would have to be developed.

F. Transfer of Operational Authority over Line-Agency Staff

Again, if the objective is to determine whether formal transfer of authority over pertinent GOP line-agency staff to LGU executives has occurred, monitoring will pose little difficulty. However, to monitor whether effective control over these agents has shifted to local government authorities, a more sophisticated analysis technique will have to be developed. For instance, if monitoring is to determine whether transfer of operational control over a treasurer to an LGU executive results in a change in the scope of the treasurer's responsibilities, how he reports, and how diligently he performs his functions, more in-depth evaluations will be required.

APPENDIX A

Tax Effort

Formally stated, the tax effort (E) measured for the RPT in province (i) of region (R) is given by the following formulation.

(1) The tax effort ratio for the RPT in province i is defined as

(2) $Ei = Ti/Yi$

where Ti = per capita current year (1988) RPT collections
Yi = per capita personal income in the province.

(3) A province's effective tax rate is calculated as follows:

$J_i = Ei/\bar{E}_R = \bar{r}$

where

Ei = tax effort of province (i)

$\bar{E}_R$ = tax effort of all provinces in region (j), more specifically,

$\bar{E}_R$ is defined as $\Sigma Ti/\Sigma Yi$

where

Σ = sum of provinces in region (j).

In a similar fashion, an effective tax rate is developed for each region. Hence,

(4) $I_R = \bar{E}_R/\bar{\bar{E}} = \bar{\bar{r}}_n$

where

$\bar{\bar{E}}$ = the average effective tax rate for the nation defined as:

(5) $\bar{\bar{E}} = \Sigma Ti/\Sigma Yi$ where Σ = total number of provinces in the nation (74).

Potential Tax Yield

Potential tax yield for a province (region) is indicated by $\hat{T}i$ where $\hat{T}i = \bar{t}_R Yi$, or the regional effective tax rate times a province's personal income Yi. Similarly, the region's potential tax yield is indicated by $\hat{T}_R = \bar{t}_n Y_R$, or the national average effective tax rate times the region's personal income (Y_R).

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Table A - 1

REGIONAL AND PROVINCIAL TAX EFFORT INDICATORS: 1988

	Population (In '000) (1988)	Per Capita Personal Income (P) (1988)	Actual Per Capita RPTA Collection (P) (1988)	Tax Effort Index (c) (1988)	Per Capita Potential Tax Yield (D) (P) (1988)
	(1)	(2)	(3)	(4)	(5)
Philippines	58,720	6,621	17.10	100.00%	
NCR	7,561	12,849	82.23	247.85%	33.18
Region I	4,133	5,570	8.67	60.30%	14.38
Abra	187	4,103	7.72	120.91%	6.39
Benguet	414	8,541	19.74	148.47%	13.30
Ilocos Norte	456	5,928	9.37	101.50%	9.23
Ilocos Sur	518	4,001	6.20	99.56%	6.23
La Union	529	6,492	11.77	116.40%	10.11
Mt. Province	120	4,229	1.04	15.76%	6.58
Pangasinan	1,910	5,177	6.49	80.48%	8.06
Region II	2,712	5,461	5.24	37.16%	14.10
Batanes	15	5,833	14.58	260.42%	5.60
Cagayan	870	4,927	5.84	123.55%	4.73
Ifugao	136	4,250	1.95	47.89%	4.08
Isabela	1,066	5,341	5.36	104.55%	5.12
Kalinga-Apayao	226	6,295	3.15	52.18%	6.04
Nueva Vizcaya	398	6,668	5.59	87.37%	6.40
Quirino	(A)	7,348			
Region III	5,863	7,672	11.05	55.77%	19.81
Bataan	394	6,844	27.01	274.07%	9.86
Bulacan	1,338	8,238	16.37	137.97%	11.86
Nueva Ecija	1,305	5,586	3.42	42.55%	8.04
Pampanga	1,443	8,882	10.16	79.43%	12.79
Tarlac	841	5,454	9.33	118.82%	7.85
Zambales	542	9,070	9.69	74.23%	13.06

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Region IV	7,692	6,397	16.54	100.16%	16.52
Batangas	1,476	6,404	18.62	112.42%	16.56
Cavite	969	8,482	15.53	70.87%	21.94
Laguna	1,223	8,800	28.33	124.55%	22.76
Marinduque	219	3,910	10.7[illegible]	102.28%	10.11
Occ. Mindoro	279	7,603	6.56	33.37%	19.66
Or. Mindoro	562	4,689	5.90	48.63%	12.13
Palawan	468	4,426	4.75	[illegible]1.51%	11.45
Quezon	1,554	4,211	6.79	62.30%	10.89
Rizal	699	8,223	41.46	194.93%	21.27
Romblon	243	3,383	3.57	40.86%	8.75
Aurora	(a)	3,942			
Region V	4,198	4,446	2.73	23.74%	11.48
Albay	977	4,941	2.55	84.21%	3.03
Camarines N.	372	4,484	9.27	337.30%	2.75
Camarines S.	1,327	4,787	2.85	97.15%	2.93
Catanduanes	211	4,400	2.47	91.40%	2.70
Masbate	706	3,739	0.02	0.75%	2.29
Sorsogon	605	3,763	1.96	85.03%	2.31
Region VI	5,439	5,066	7.63	58.35%	13.08
Aklan	391	5,879	5.62	63.44%	8.86
Antique	415	3,582	8.57	158.88%	5.40
Capiz	591	4,430	1.97	29.55%	6.67
Iloilo	1,723	4,339	9.62	147.16%	6.54
Negros Occ.	2,319	4,059	7.77	127.07%	6.11
Region VII	4,446	4,559	4.81	40.83%	11.77
Bohol	946	3,880	8.95	218.73%	4.09
Cebu	2,456	3,761	2.31	58.28%	3.97
Negros Or.	962	4,822	7.17	140.99%	5.08
Siquijor	82	4,083	4.05	94.13%	4.30
Region VIII	3,243	4,178	6.69	62.02%	10.79
Leyte	1,509	4,352	11.80	169.31%	6.97
S. Leyte	343	4,402	4.34	61.62%	7.05
E. Samar	372	4,274	1.40	20.44%	6.84
N. Samar	439	3,157	1.20	23.70%	5.06
W. Samar	580	4,293	2.33	33.94%	6.87
Region IX	3,061	5,339	1.57	11.38%	13.78
Basilan	243	3,633	1.65	154.13%	1.07
Sulu	436	5,355	0.25	15.67%	1.57
Tawi-Tawi	236	5,996	0.51	29.09%	1.76
Zamboanga N.	712	4,679	2.49	181.26%	1.37
Zamboanga S.	1,434	4,073	1.67	139.83%	1.20

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Region X	3.438	5.737	8.31	56.09%	14.91
Agusan N.	455	5,403	4.90	62.56%	7.83
Agusan S.	330	4,883	3.82	53.95%	7.07
Bukidnon	788	6,640	16.14	167.79%	9.62
Camiguin	71	3,150	9.50	208.13%	4.56
Misamis Occ.	481	3,390	2.97	60.44%	4.91
Misamis Or.	860	4,176	8.97	148.26%	6.05
Surigao N.	452	4,784	5.64	81.38%	6.93
Region XI	4,132	6,113	6.73	42.65%	15.78
Davao N.	895	5,616	9.98	161.43%	6.18
Davao S.	1,400	4,232	2.63	56.49%	4.66
Davao Or.	420	5,056	5.02	90.20%	5.57
S. Cotabato	951	6,518	7.12	99.14%	7.18
Surigao S.	467	4,630	13.55	265.76%	5.10
Region XII	2,802	5,768	3.55	23.82%	14.89
Lanao N.	569	4,556	2.93	104.68%	2.80
Lanao S.	500	7,100	0.15	3.55%	4.37
Maguindanao	661	5,067	2.76	88.69%	3.12
N. Cotabato	697	5,082	5.74	183.59%	3.12
Sultan Kudarat	375	6,494	6.31	157.92%	3.99

N O T E S:

(A): Included under Nueva Vizcaya.

(B): Included under Quezon

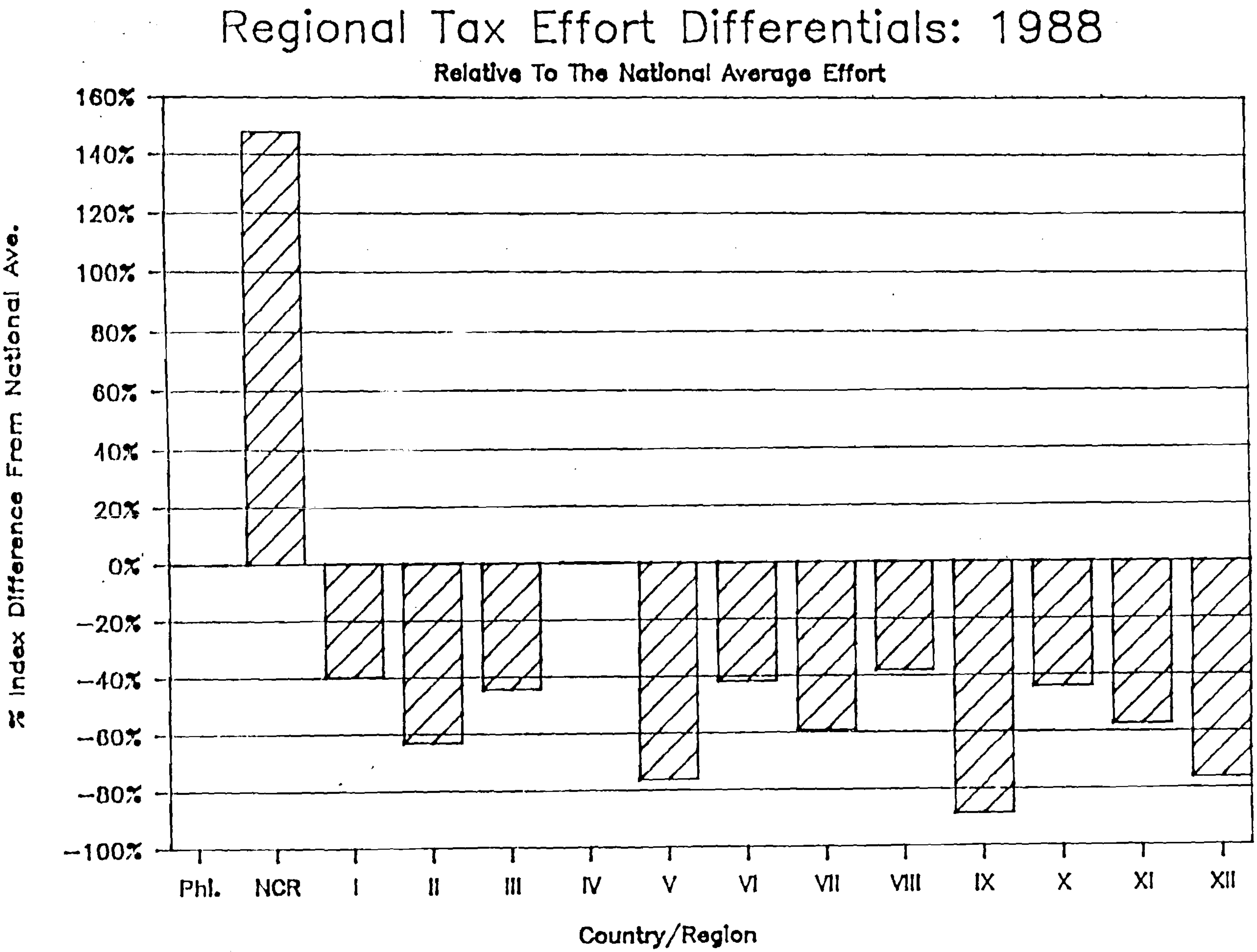
(C): Regional effort is compared to the national effort.

Provincial effort is compared to the regional effort.

(D): The national average tax effort parameter is multiplied by the regional average per capita income.

The regional average tax effort parameter is multiplied by the provincial average per capita income.

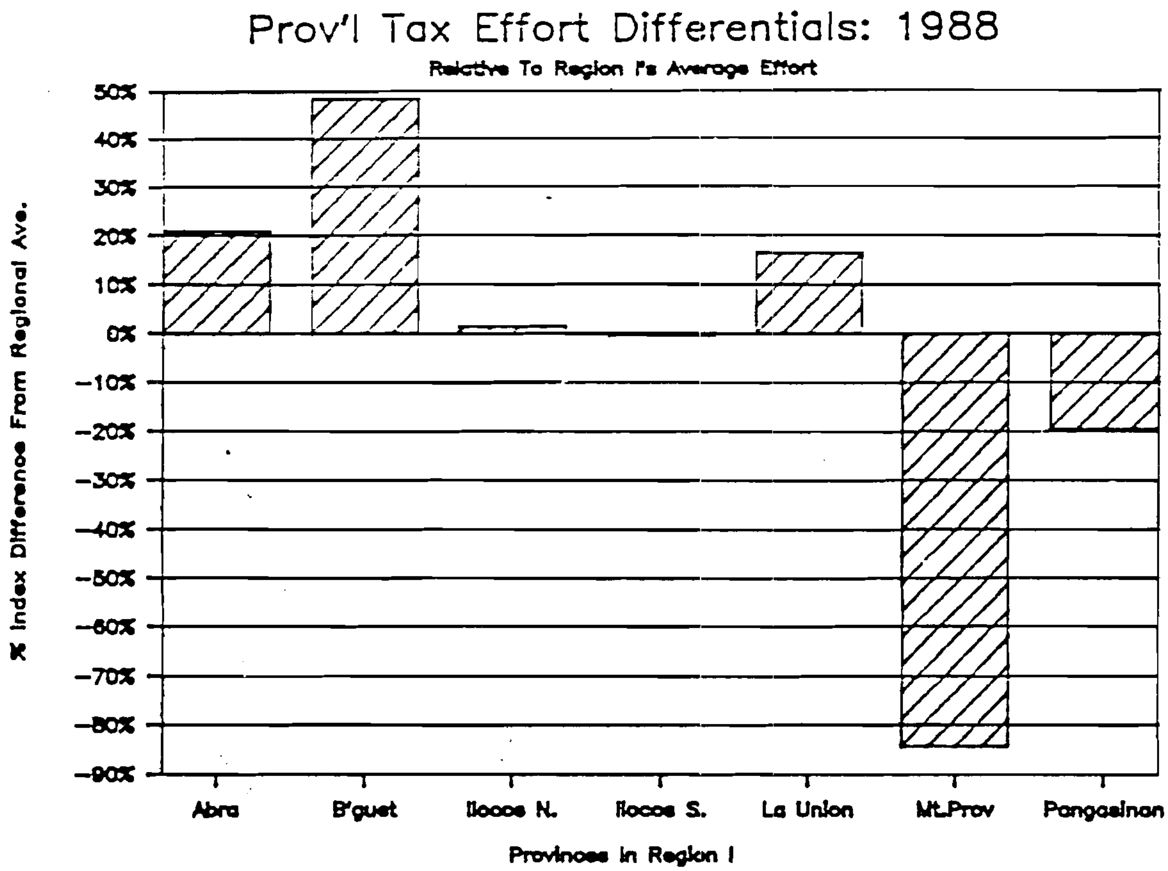
Figure A - 1



Regional Tax Effort Differentials: 1988
Relative To The National Average Effort
160%
140%
120%
100%
80%
60%
40%
20%
0%
-20%
-40%
-60%
-80%
-100%
% Index Difference From National Ave.
Phl.
NCR
I
II
III
IV
V
VI
VII
VIII
IX
X
XI
XII
Country/Region

A - 6

Figure A - 2



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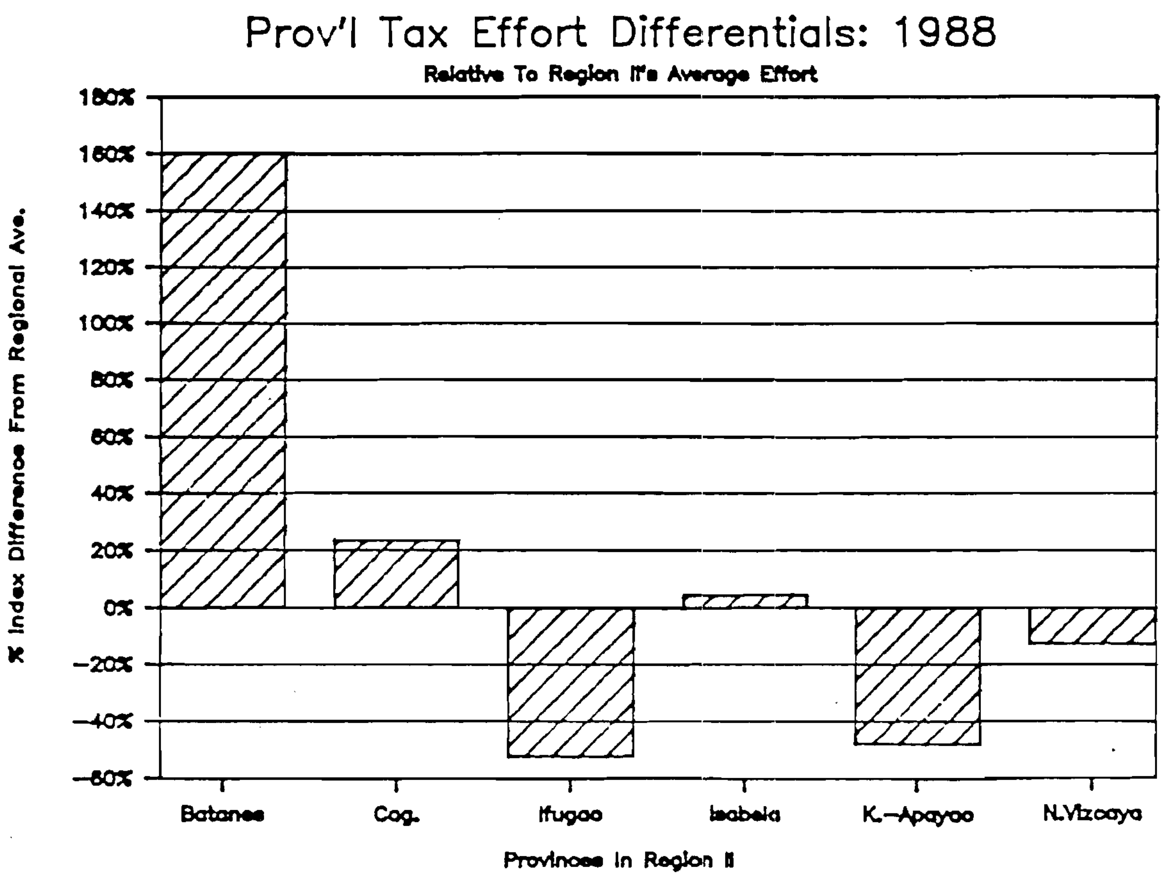

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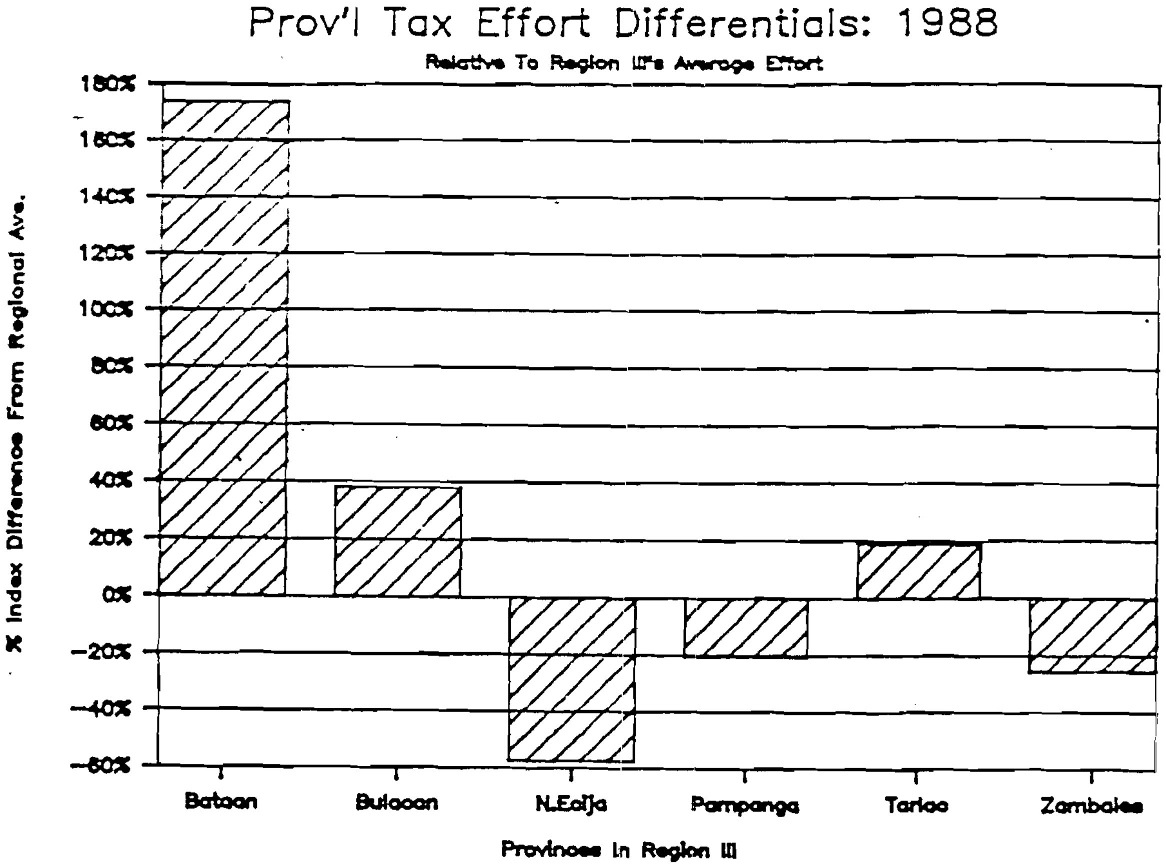
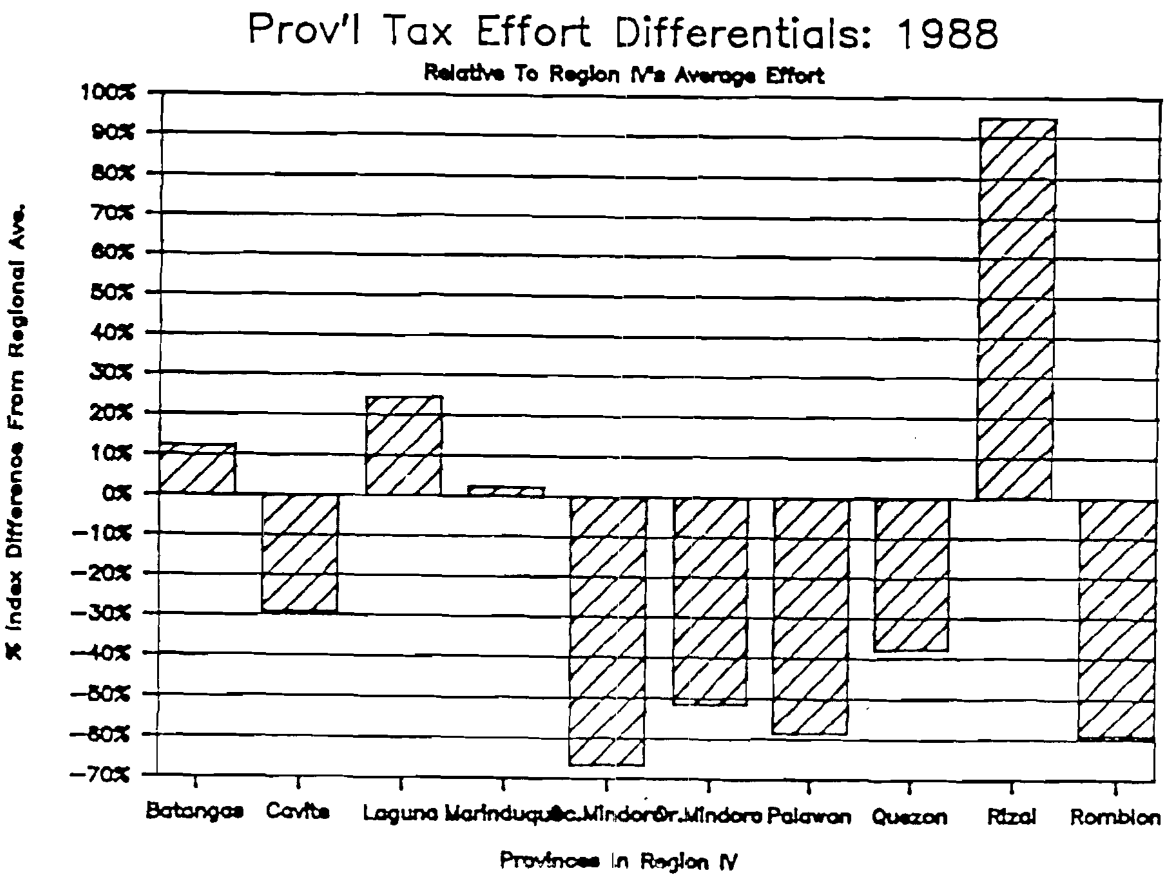


Figure A - 5



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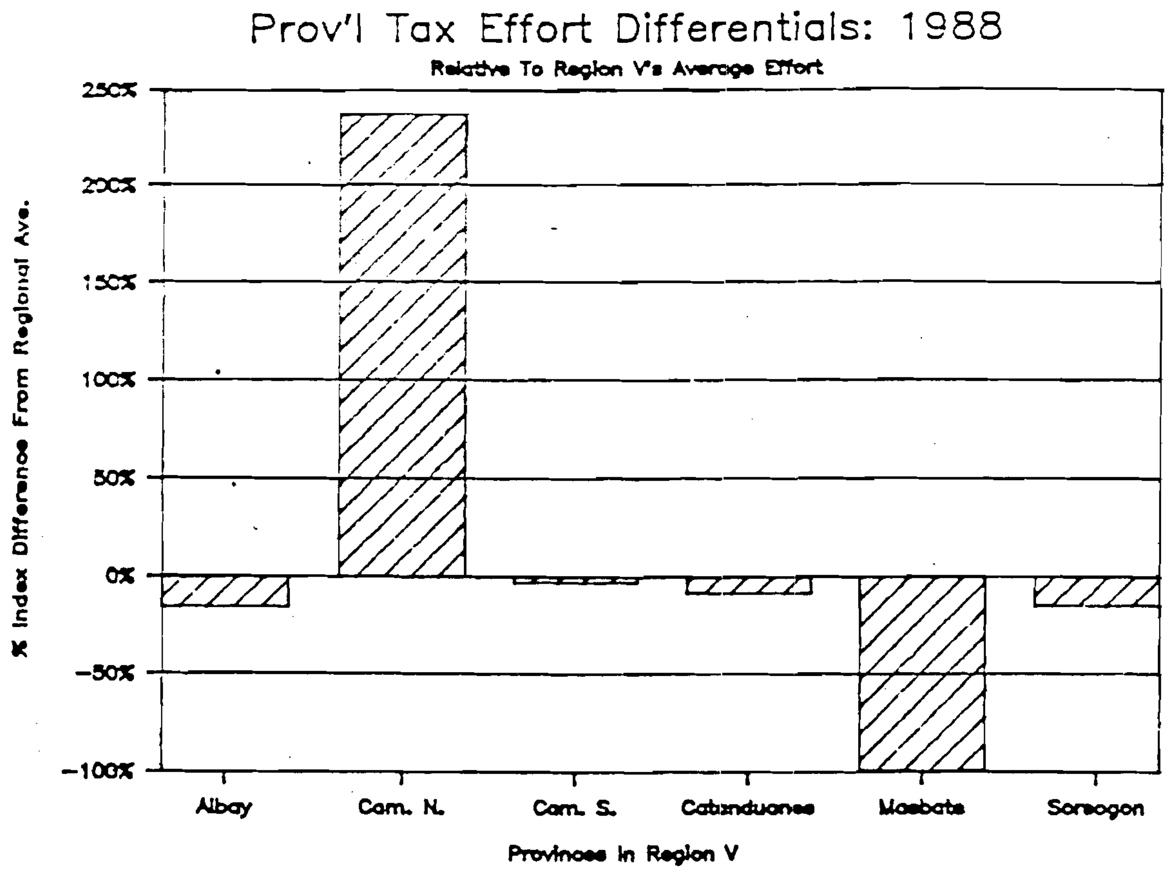

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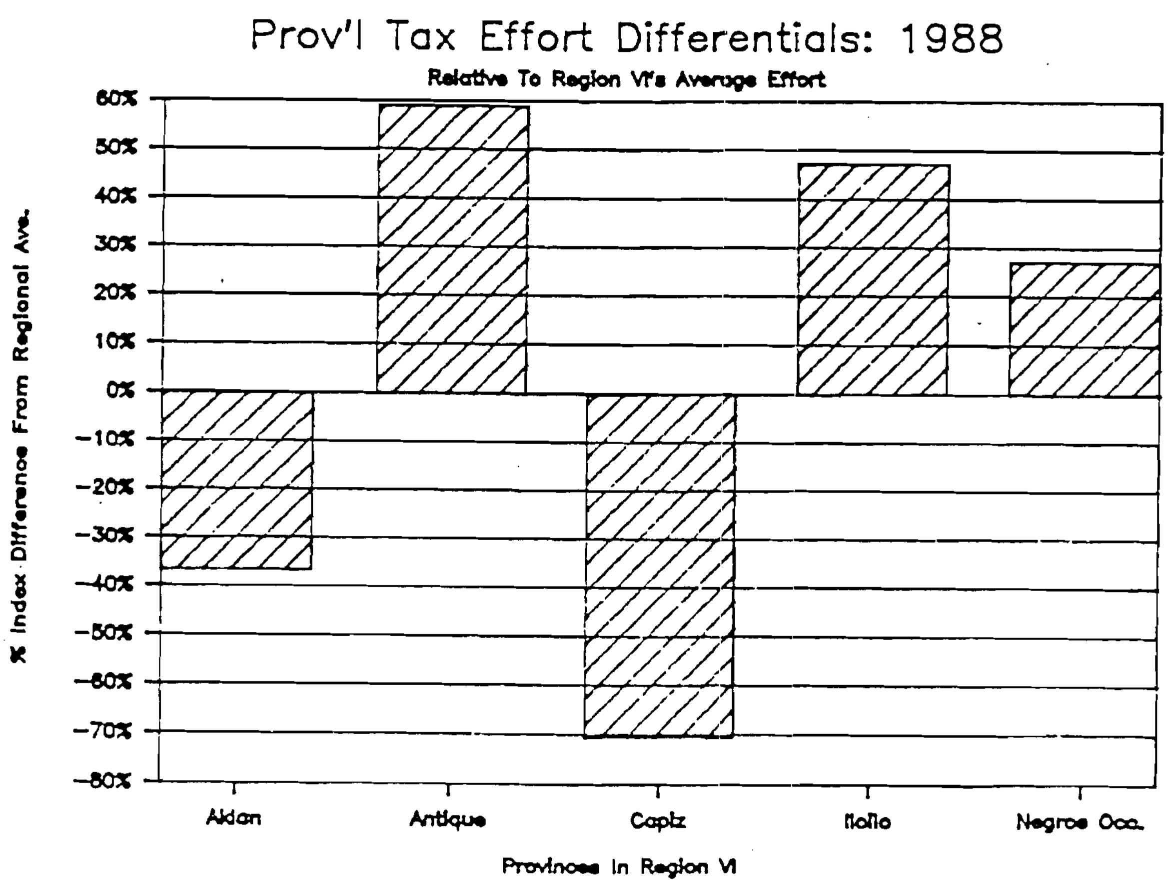

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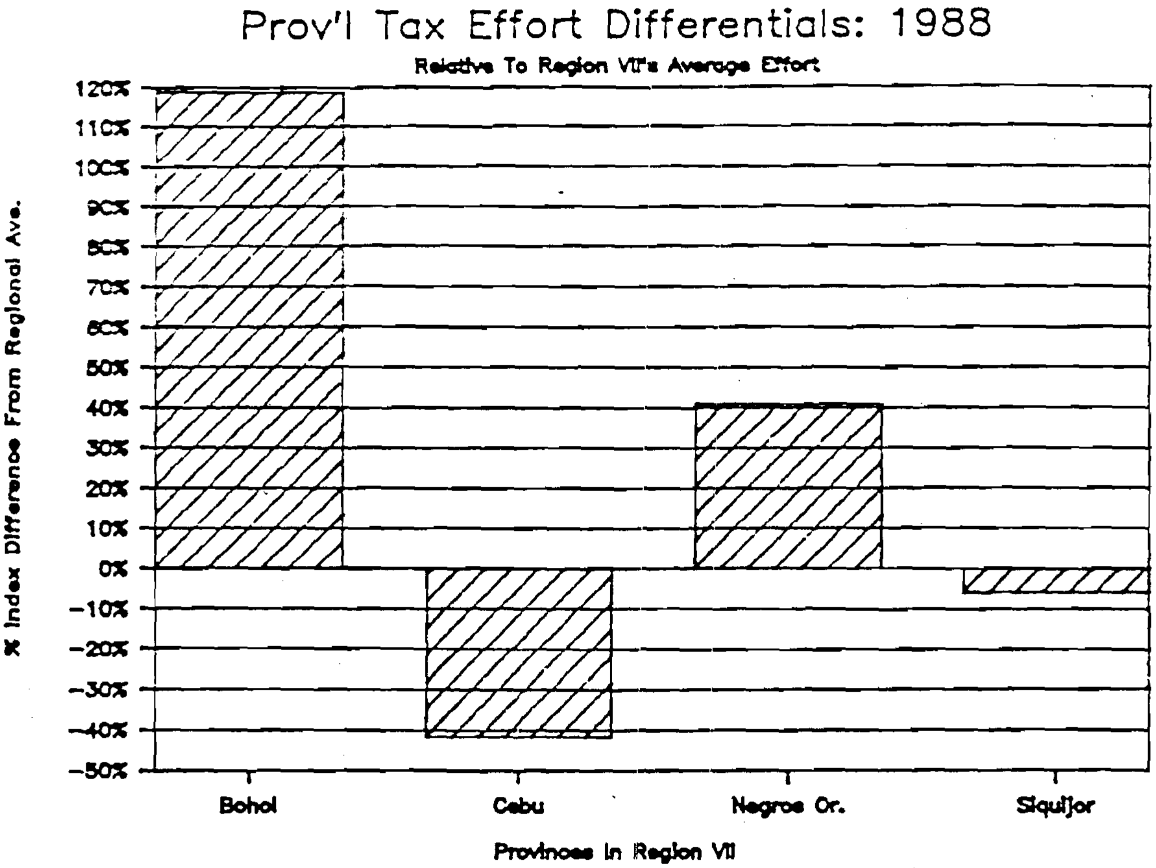

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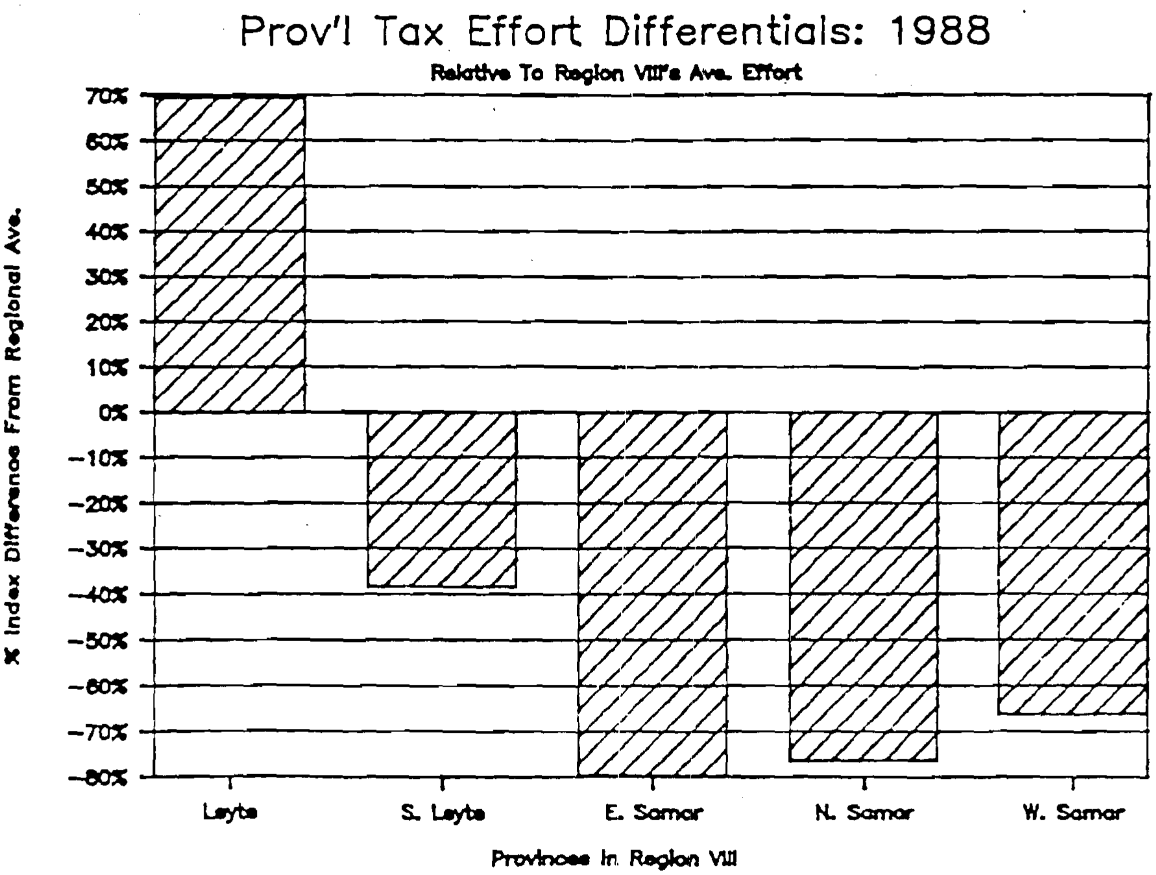

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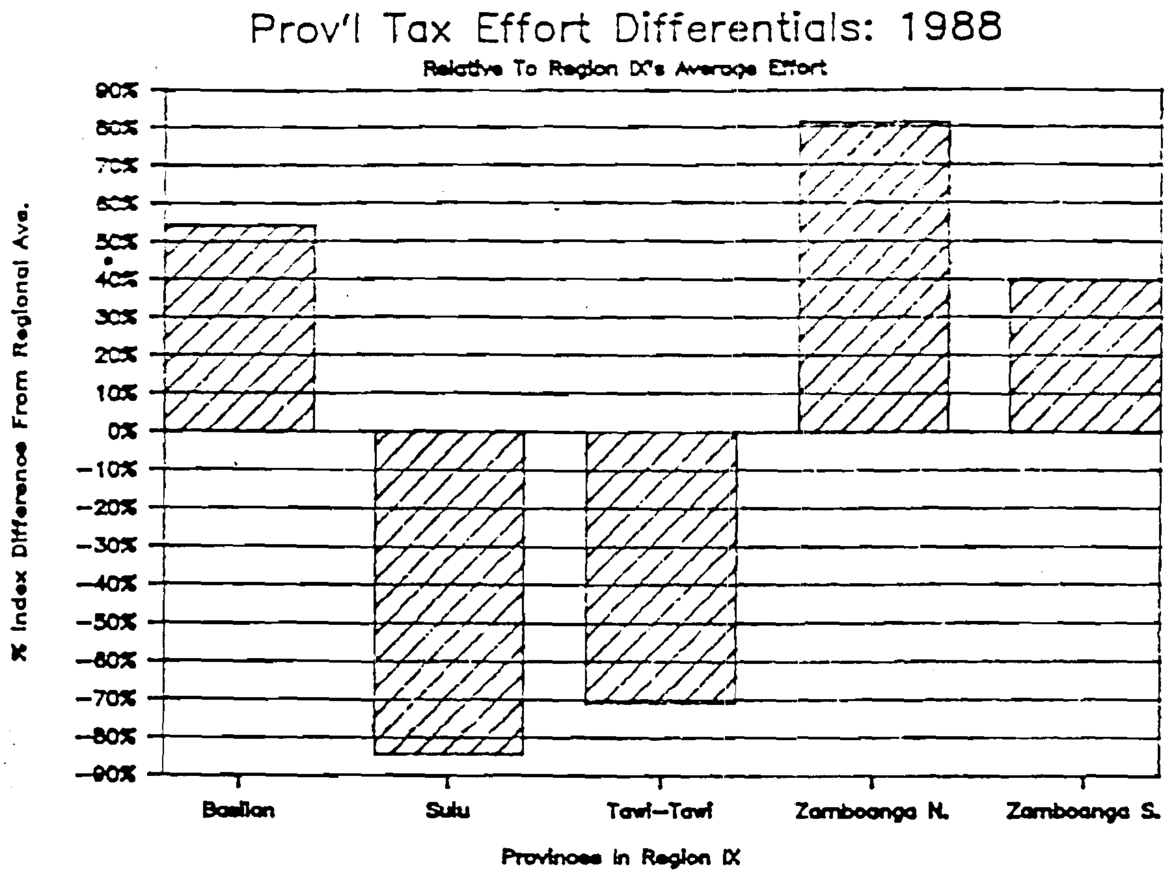

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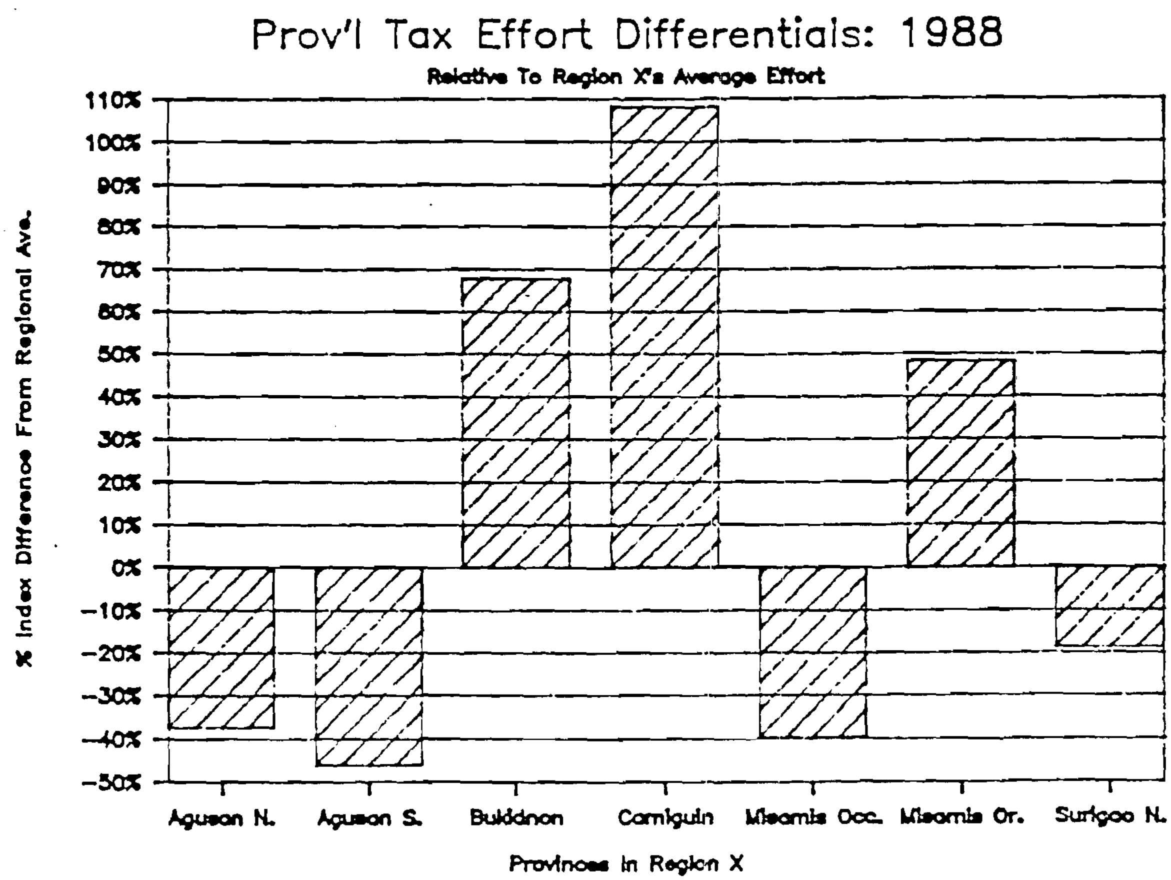

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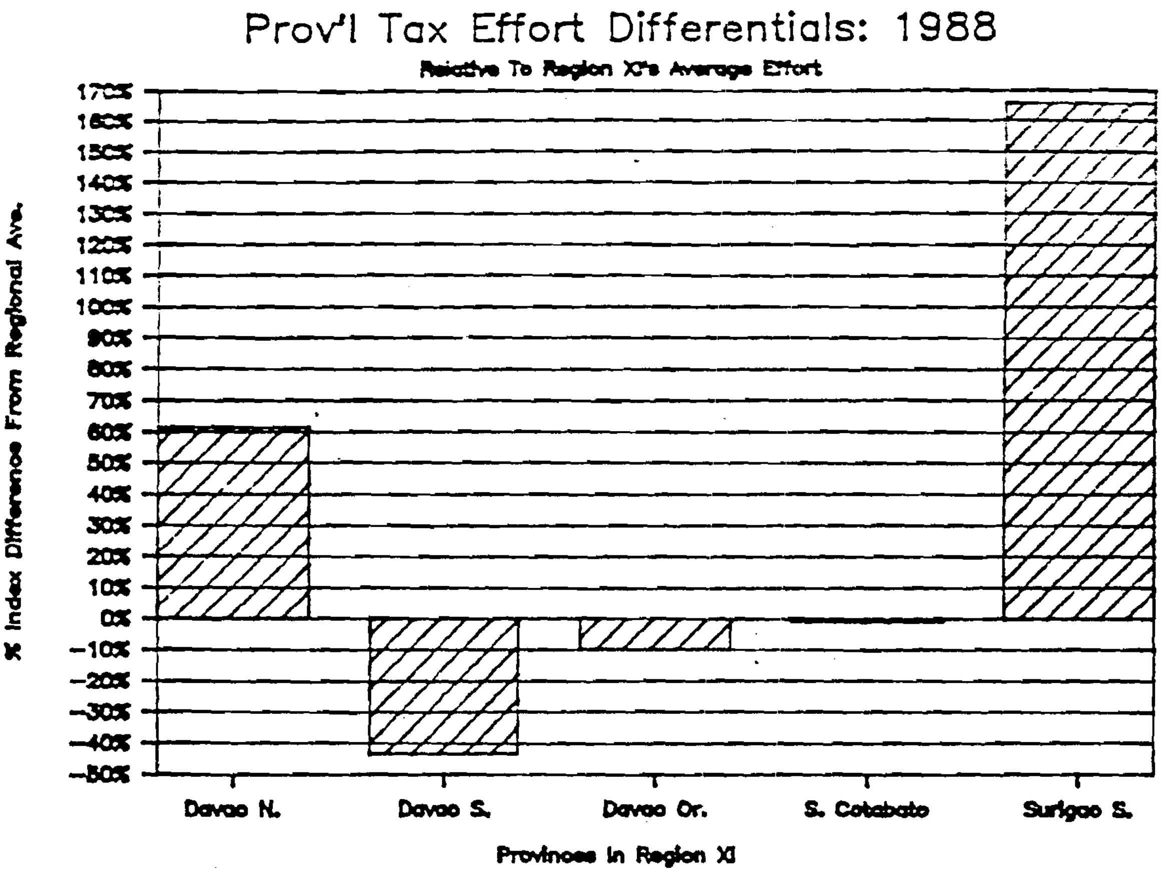
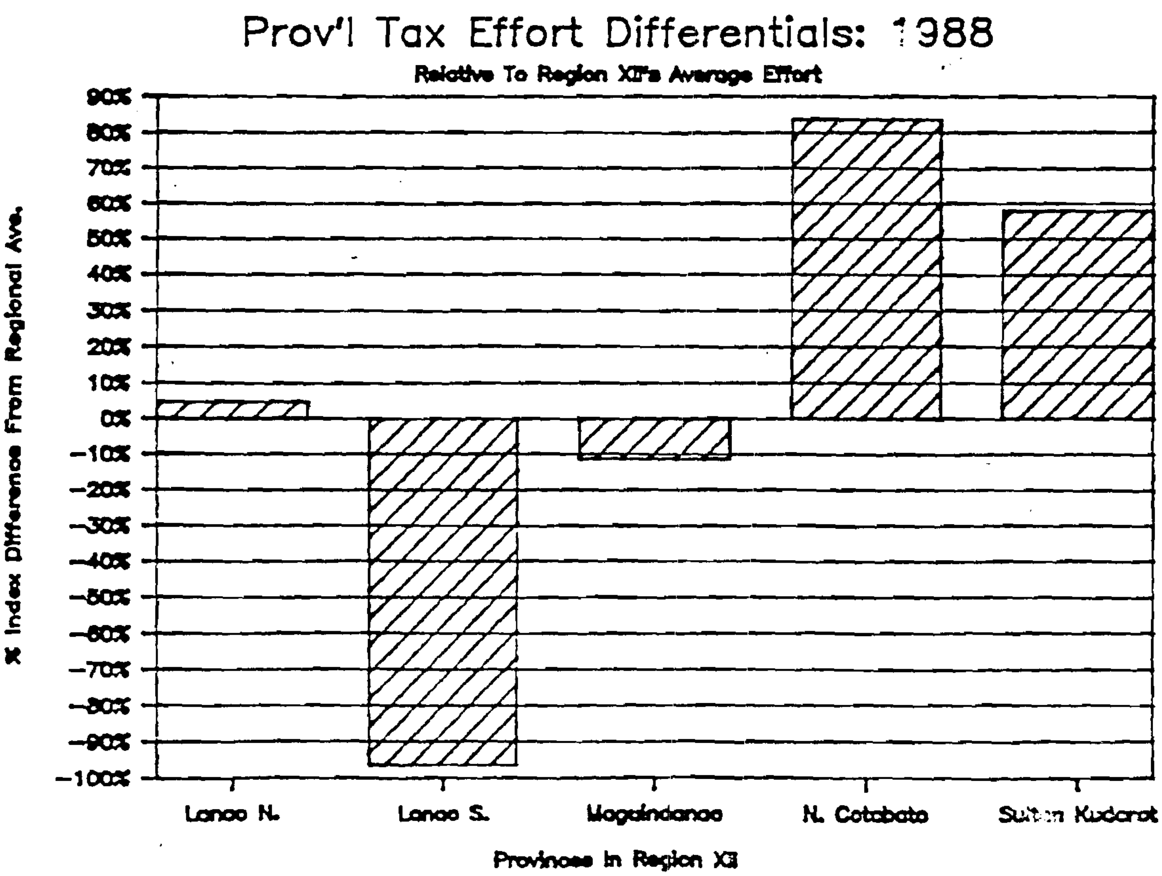


Figure A - 13



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APPENDIX B

COA Auditing Procedures

In the past, the COA pre-audit system required that all LGU disbursements pass through the provincial treasurer and auditor. Purchase requests for infrastructure contracts by administration officials are approved by the provincial auditor, who certifies that the project expense is authorized and funded. In this system, a full-control mechanism is in place because the payment process is not initiated until these requirements are met.

The post-audit system has coincided with implementation of the new disbursement scheme. In this scheme, NALGU funds for municipalities are deposited directly in their accounts with private commercial banks, rather than being placed on deposit with the provincial treasurer, as was formerly the case.

Pre-audit procedures still apply for construction payments in the following cases:

- the first payment under any contract,
- all payments in excess of P250,000, or
- any payment that brings the total of payments made above 50 percent of the contract price.[1]

Several problems with the new post-audit system were identified by DFM team members in discussions with provincial officials. COA auditors in Antique observed that under the new disbursement scheme, municipal treasurers tend to "juggle" funds among different accounts and intermingle them. COA officials believe municipal officials will require in-service training to fully master the new system. Under post-audit procedures, disbursement documents must legally be submitted to the COA provincial office within five days after the end of each month. At present, municipalities in Antique Province actually submit required documents two to three months after the transaction month. The promptness of the auditing process appears to have waned.

The new disbursement scheme has apparently facilitated disbursements and presumably improved the LGU's service. However, the team believes the following aspects of accountability should be reviewed and perhaps strengthened at the municipal level.

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1 Leyte provincial COA officer.

First is the role of internal control. When the new disbursement and post-audit systems were set up, LGU organization and staffing at the municipal level did not provide for a corresponding build-up of internal audit capacity. For instance, Antique's provincial COA auditor suggested the need for an internal auditor in the municipalities.

Second is the new disbursement scheme and post-audit process. When the disbursement scheme was revised, auditors at the provincial level were not consulted. Consultations held at the DBM and COA national levels, led to a memorandum of agreement that will need to be supported by detailed implementing procedures and policies. In Antique, guidelines on the direct-funding release system are being prepared at the provincial COA office in coordination with the treasurer's office.

Third is enforcement of new audit policies and reporting deadlines. In general, field visits confirmed that COA officials still accept the agency's traditional view that fiscal accountability means avoiding losses through malversation or misuse of funds. COA officials continue to feel that "moral leadership" by LGU executives is the most crucial element in maintaining fiscal integrity. Auditing focuses on the search for "anomalous" transactions. In Antique, good coordination among the COA, local executives, and treasurer has facilitated detection of anomalous transactions.

APPENDIX C

Performance Monitoring

Routine financial monitoring reports are prepared by LGUs in accordance with existing DOF regulations and procedures. These reports highlight budget overruns rather than examining reasons for deviation from planned budgets, or the impact of financed activities. Few output monitoring systems appear to exist at the provincial level. Financial monitoring is done by office and traditional budget line items.

LGUs should improve performance-monitoring by:

- using project reports to monitor fund allocation and operational decision-making, and

- using project reports to evaluate the progress and impact of projects.

LGUs visited by the team emphasize the first type of monitoring over second, particularly in the context of foreign-assisted projects and special national projects.

In Antique, a Project Monitoring Committee is being formed in accordance with the Presidential directive on this subject. The provincial budget officer will serve as chairman. This may indicate that the monitoring will focus largely on financial and budgetary issues. However, most issues in monitoring have not been resolved, including scope (locally- or nationally-funded projects) and methods. Delayed confirmation of nominees by DLG and DPWH has impeded organization of the Project Monitoring Committee in Antique.

In Cavite, the PPDO staff already monitor projects. Their system incorporates the basic elements of project evaluation including milestone dates, budget to actual comparisons, and analysis of variances/lessons learned. The monitoring reports themselves reveal many aspects of the system of project implementation and monitoring.

First, provincial monitoring needs to be closely coordinated with monitoring by the Municipal Planning and Development Office. It is physically impossible for the province to monitor a province-wide project without such assistance.

Second, the degree of cooperation between DPWH and local officials influences the capacity to monitor. In cases where the DPWH directly coordinated with barangay-level officials (ignoring the MPDC level), monitoring was not feasible.

Third, the monitoring reports properly correlate systems or implementation strategies adopted by projects with attainment of project objectives. For example, even when the project was subsequently implemented entirely by DPWH, if LGU officials concurred after consultation with plans, specifications, and program of work, the project objectives were more fully attained. (This was true for the Community Employment and Development Program in Cavite as of November 1987). Such lessons can be valuable for LGUs under a more decentralized system.

Fourth, provincial capacity to monitor development projects is improved by the availability of service vehicles. However, there is also evidence that provinces, e.g., Cavite, use alternative means for monitoring in the absence of service vehicles including certifications provided by MPDCs, barangay captains, or occupants of the project area. This implies the need to develop alternative models for monitoring to alleviate any future tendency to select monitoring models, e.g., extensive use of expensive service vehicles for field visits to projects convenient for provincial staff but costly to local development efforts.

Finally, in Tacloban City, formal monitoring is not done. The PPDO staff try to monitor projects, but the city mayor does not encourage these activities. For example, DPWH officials reported to the city but the PPDO could not assemble DPWH project documents in a regular monitoring form.

APPENDIX D

Implications of the Government Planning System on Decentralization

A. Brief Description and Main Objective of the System

The government planning system is a process of generating plans and programs from the lowest level of the government -- the barangay -- and involves the integration of these plans and programs at the municipal, provincial, regional and national levels consistent with the "bottom up" approach to planning. This planning mechanism is intended to help ensure that the economic development of an area is maximized in the context of its own parochial needs.

The key bodies involved in the planning process are the City/Municipal Planning and Development Council (CPDC or MPDC), the PPDC and the RDC. Each of these PDCs are composed of the local executives, line agencies representatives, representatives from the local legislative body, and representatives from the private sector. The Planning and Development Office (PDO) of the respective LGUs acts as the secretariat of the PDCs.

B. Implementation Experience Before Decentralization

The "bottom up" planning system was adopted during the Marcos administration. However, because of the highly centralized from of government during that time, the supposed participative process was never fully implemented. The higher levels of government dictated or influenced the activities of the lower levels resulting in the implementation of projects that were not necessarily in line with the needs of the beneficiary locality. In Antique for example, a municipal mayor complained that a school construction project was authorized in a barangay which did not need it.

C. Implications for Decentralization

1. Will the planning system promote development at the grassroots level?

One positive indicator is that the RDC, PPDC and CPDC are all in place. Most of the MPDCs are also in place, but their participation in the planning exercise operation is limited by inadequate funds. This implies that in general, priority projects would be included in the development plans of the LGUs forming one basis for the preparation of the budget.

Another positive indicator is that active participation of the private sector in the different planning bodies may help minimize the implementation of projects which are primarily politically motivated.

Negative indicators include:

- large transaction costs including wasted time, money, and energy which discourage local initiatives;
- a mindless listing of all projects in response to NEDA's misplaced emphasis on thoroughness; and
- strong executives in Cavite, for example, who may not cooperate leading to unfair allocation of funds.

2. Will the planning system promote the desired distributional effects of decentralization?

Negative indicators include that though the planning system involves a decentralized approach to idea- or project-generation, the approval process for projects is essentially still centralized. The RDC approves projects to be included in the Regional Development Plan, and it is difficult to get funding for projects which are not RDC-approved. The membership bias of the RDC could prejudice local orientation, and as such, the poorer LGUs would remain at a disadvantage in the allocation of funds despite an increase in the overall regional budget.

D. <u>Alternative Approaches for Achieving Distributional Effects</u>

The regional budget could be divided based on the intended use. One portion would be earmarked for inter-provincial or regional projects as well as for providing additional budgetary aid to the LGUs. This would be allocated using an RDC-developed scheme. The second portion would be used at the discretion of the provinces and municipalities. This would imply that only projects supportive of region-wide or inter-provincial development objectives and thrusts would be submitted by the provinces to the RDC. In addition, although the municipalities would continue to plan for the delivery of services and the development of their respective areas, only projects directly supportive of province-wide or inter-municipal concerns would be submitted to the province for possible inclusion in the provincial budget proposal. This approach would have the advantage of:

- facilitating inter-LGU cooperation on projects of interest to more than one LGU with either regional or province-wide implications;

- helping ensure that there will be an increase in the discretionary funds to the municipalities;

- increasing the level of seriousness in planning; and

- encouraging resource-seeking among local executives by making it possible for them to obtain additional funds from the RDC for the activities of their respective localities.

E. Absorptive Capacity

1. Availability of "Fundable" Projects

Of the number of projects listed in the development plans of the municipalities and provinces, it was estimated that for the province of Antique, only approximately 30 percent are finally implemented. This would imply that LGUs would have an adequate number of pipeline projects which could be undertaken should increased funds be made available to them.

2. Types of Projects to be Undertaken

It was gathered from field interviews conducted and an examination of the development programs for the LGUs that local executives have identified infrastructure and livelihood projects (mainly agri-based) as the priority projects that would be undertaken should an increased level of funding be made available to them.

3. Technical Capability

The Planning and Development Offices (PDOs) in the three provinces visited appeared to be well staffed with both technical and professional personnel. Most of the staff have received training under the Provincial Development Assistance Program (PADP) and the Local Resources Management program funded by USAID. For example, about half the staff of the Tacloban CPDC have completed training under these two programs.

The project development-related activities of the office include structural surveys, preparation of work plans, and cost estimates as well as the conduct of pre-feasibility studies. In Antique, PPDO staff also act as project leaders/coordinators for special projects of the province. The PPDO also provides technical assistance to the MPDO.

The MPDO is still basically a one-person operation, and is usually manned by an engineer providing the municipality with a fair level of technical capability for planning and overseeing implementation.

APPENDIX E

Local Government Budgeting Process

A. Brief Description of the Process

The local government budgeting process consists of two basic activities -- revenue forecasting and expenditure allocation. Revenue forecasting is the responsibility of the Office of the Treasurer and the "certified" income becomes the ceiling for the program of expenditure. Expenditure allocation is a participative process. The different departments of the LGU provide their respective proposed expenditures for the budget year, and the Budget Office is responsible for coordinating preparation of the budget.

The following is a general description of the budget preparation cycle.

ACTIVITY	SCHEDULE
Issuance of a Memorandum from chief executive requesting the Office of the Treasurer and the different offices of the LGU to submit the estimate of the revenue and the proposed expenditures, respectively, for the incoming year.	March (year before the budget year)
Submission of the "certified" revenue estimate by the Office of the Treasurer and the expenditure proposals of the different offices.	May
Budget hearings by the Budget Committee which is composed of the local chief August executive, who is chairman, and the chairman of the Finance Committee of the local legislative body and the heads of the different offices of the LGU.	July - August
Presentation of the budget proposal, now termed the Executive Budget, to the local legislative body.	September
Approval of the Executive Budget after review by the local legislative body.	October
Declaration that the approved budget is "operative" by the local chief executive.	"
Post-review of the approved budget by the regional Department of Budget and Management.	"

Surpluses from previous years' appropriations and from the excess of actual revenue over the estimate may be realigned. Realignment of surpluses from the General Fund can be approved at the sole discretion of the Governor or Mayor, while those from the Infrastructure Fund and SEF require approval of the local legislative body.

B. Analysis of the Process

Revenue forecasting is essentially a rote arithmetic exercise. The previous year's actual revenue is increased by 10 to 25 percent to arrive at the new estimate. This is particularly evident in Leyte where actual revenue was 180 percent of the estimate in 1988. The discrepancy was largely attributed to the collection of RPT on land and buildings from the Pasar Copper Smelting Corp., a government-controlled enterprise. Pasar paid RPT for the first time in 1987, and in 1989, it is expected that Pasar will pay RPT on equipment. However, this potential increase in revenue was not properly integrated into the income estimate for the year because of the practice of simply applying a standard percentage factor for the increase.

The effort devoted to revenue estimation is indicated by the number of supplemental budgets prepared. In Cavite, ten supplemental budgets were prepared in 1988. In Antique, only four were prepared. Although some of the supplemental budgets were due to realignment of previous years' surpluses, many were prepared to program the excess of actual over estimated revenue. For example, Cavite had a deficit in 1988 in both the General and Infrastructure Funds. Unfortunately, the supplemental budget scheme encourages short-term planning by Treasurers and local executives.

The following are the recipients of expenditure allocation listed in order of priority:

- personnel;
- fixed obligations (like servicing of loans), contributions to the national government, and payment of employee health care insurance premiums;
- operating and maintenance requirements; and
- projects.

This priority scheme may be explained by the limited revenues available to the LGUs visited. Revenues are insufficient for meaningful development planning, thus highlighting the importance of the NALGUs' funds as the main funding avenue for development projects. Low revenues also explain the "wish-list" nature of the projects submitted primarily by municipalities to their province for eventual submission to the RDC.

It was observed that LGU Budget Offices have not been able to provide local executives with adequate analytical support for understanding the budget. For example, analysis has been confined to the changes in the amount of expense items for each of the offices in the LGU. No evidence was noted regarding any conscious attempt to relate the proposed budget to the development plans submitted to NEDA.

In general, it appeared that the Budget Officers do not consider themselves part of the "planning team" of the LGU. They view their role in budget preparation as largely limited to assembling budget document.

C. Implications of Decentralization

The prevailing short-term orientation in revenue forecasting as well as in expenditure allocation should be addressed. Although the seriousness in budget planning should increase with the increase in the amount of funds that will be available to LGUs, technical assistance will be necessary.

There is a definite need to improve the planning orientation and analytical capability of the Budget Office in order for it to become a more effective member of the planning team of LGUs.

APPENDIX F

Property Assessments and Real Property Tax Collection Efficiency: Selected LDAP Provinces and Cities

Table F - 1
Property Assessments: Selected LDAP Provinces and Cities
(As of December 1988)

›vince/ :ity	Number of Property Parcels	Assessed Value of Real Properties (In Millions of Pesos)	Unit Value Per Parcel (P/Parcel)
›ay	157,322	740.93	4,710
̡aspi City	27,370	439.23	16,048
:ique	127,582	199.11	1,561
:anduanes	85,210	163.17	1,915
rite	255,451	3,320.76	13,000
/te	303,089	2,528.20	8,341
:loban City	28,115	627.70	22,326

ırce of Basic Data: Provincial Assessor's Office

Table F - 2
Real Property Tax Collection Efficiency: Selected LDAP Provinces and Cities (As of December 1988)

ovince/ City	Taxable Assessed Value Of Properties (In Millions P)	Current Year Collectible Taxes (In Million P)	Actual Collections (In Million P)	Collection Efficiency (In Percent)
bay	740.93	7.41	2.66	35.92
gaspi City	439.23	4.39	1.15	25.22
tique	199.11	1.99	1.11	55.64
tanduanes	163.17	1.63	0.34	20.95
.vite	3,320.76	33.21	11.99	36.09
:yte	2,528.20	25.28	15.36	60.74
.cloban City	627.70	6.28	2.47	39.30
)TAL	8,019.10	80.19	35.07	43.73

›urces of basic data: assessed values from the Provincial Assessor's :fice; collectible data estimated using a one percent tax rate; and ›llections from the Provincial/City Treasurer.

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Table F - 3
Assessed and Market Value Differentials
in Selected LDAP Provinces/Cities

	Assessed Values as a Percent of Market Values
Provincial Level	50 to 200
City Level	50 to 60

Source of basic data: Interviews with Provincial/Ciy Assessors

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APPENDIX G

Provincial and City Revenues and Expenditures

General and Infrastructure Funds, 1985-1988

This appendix is comprised of the following tables:

- Table G - 1 Albay Province,
- Table G - 2 Antique Province,
- Table G - 3 Catanduances Province,.
- Table G - 4 Cavite Province,
- Table G - 5 Leyte Province,
- Table G - 6 Legaspi City, and
- Table G - 7 Tacloban City,

Table G - 1

ALBAY PROVINCE REVENUES AND EXPENDITURES
GENERAL AND INFRASTRUCTURE FUNDS (P 000)

ITEMS	1985	PERCENT	1986	PERCENT	1987	PERCENT	1988	PERCENT
TOT RPT	1814.2	6.41%	2912.6	8.47%	1800.3	5.08%	1627.5	5.58%
CUR RPT	1376.1	4.86%	1813.0	5.27%	1160.8	3.28%	1195.8	4.10%
PAST YRS	351.3	1.24%	458.5	1.33%	339.2	0.96%	337.6	1.16%
AMNESTY		0.00%	474.1	1.38%		0.00%		0.00%
PENAL	86.8	0.31%	167.0	0.49%	106.9	0.30%	93.6	0.32%
TOT OTAX	676.7	2.39%	607.1	1.77%	720.5	2.03%	1011.0	3.46%
TOT LTAX	2490.8	8.80%	3519.7	10.24%	2520.8	7.12%	2638.5	9.04%
NON-TAX	209.0	0.74%	275.3	0.80%	309.3	0.87%	458.8	1.57%
TOT OINC	25591.5	90.46%	30586.9	88.96%	32595.0	92.01%	26087.4	89.39%
IRA	16284.2	57.56%	17484.3	50.85%	18598.4	52.50%	18805.5	64.44%
IRA+LRGS	21089.4	74.54%	24773.8	72.05%	18598.4	52.50%	25266.7	86.58%
NALGU		0.00%		0.00%		0.00%		0.00%
TOT REV	28291.3	100.00%	34381.9	100.00%	35425.1	100.00%	29184.7	100.00%
TOT EXP	24302.2	100.00%	26167.9	100.00%	39797.1	100.00%	31277.4	100.00%
PER SER	7299.1	30.03%	8653.5	33.07%	15396.0	38.69%	14075.9	45.00%
MOE	10672.2	43.91%	8808.4	33.66%	12052.3	30.28%	10577.8	33.82%
CAP	6330.9	26.05%	8706.0	33.27%	12348.8	31.03%	6624.1	21.18%
FISC SUR	8644.4		10542.0		6467.6		2476.8	
FISC-REC	7695.7		9493.4		4580.4		949.6	
POP.(000)	908.0		929.0		951.0		973.0	
PR INDEX	350.7		355.3		362.7		391.4	
RPC TAX	0.8		1.1		0.7		0.7	
RPC REV	8.9		10.4		10.3		7.7	
RPC EXP	7.6		7.9		11.5		8.2	

Sources: financial data provided by Albay Province LGU, Philippines Statistical Yearbook

Table G - 2

ANTIQUE PROVINCE REVENUES AND EXPENDITURES
GENERAL AND INFRASTRUCTURE FUNDS (P 000)

ITEMS	1985	PERCENT	1986	PERCENT	1987	PERCENT	1988	PERCENT
TOT RPT	N/A		691.5	3.0%	203.4	1.4%	874.5	4.9%
CUR RPT				0.0%		0.0%		0.0%
PAST YRS				0.0%		0.0%		0.0%
AMENSTY				0.0%		0.0%		0.0%
PENAL				0.0%		0.0%		0.0%
TOT OTAX	N/A		224.9	1.0%	278.3	1.9%	324.8	1.8%
TOT LTAX	N/A		916.4	3.9%	1051.3	7.0%	1199.3	6.8%
				0.0%		0.0%		0.0%
NON-TAX	N/A		303.9	1.3%	230.5	1.5%	659.3	3.7%
				0.0%		0.0%		0.0%
TOT OINC	N/A		22085.2	94.8%	13679.0	91.4%	15894.2	89.5%
IRA	N/A		10304.1	44.2%	10958.5	73.2%	8929.4	50.3%
IRA+LRGS	N/A			0.0%		0.0%	11216.8	63.2%
NALGU	N/A			0.0%		0.0%		0.0%
				0.0%		0.0%		0.0%
TOT REV	N/A		23305.5	100.0%	14960.8	100.0%	17752.8	100.0%
								0.0%
TOT EXP	15053.0	100.0%	23061.2	100.0%	12335.9	100.0%	19366.2	100.0%
PER SER	6182.0	41.1%	6609.0	28.7%	8359.0	67.8%	10955.8	56.6%
MOE	5382.0	35.8%	9570.0	41.5%	4814.0	39.0%	6215.4	32.1%
CAP	3489.0	23.2%	183.0	0.8%	0.0	0.0%	128.4	0.7%
OTHER			0.0	0.0%	0.0	0.0%	2066.6	10.7%
FISC SUR	2036.0		2280.0		4066.0		6242.0	
FISC-REC	887.0		1323.0		2808.0		912.0	
POP.	386.0		395.0		404.0		413.0	
PR INDEX	375.1		373.4		379.5		409.5	
RPC TAX			0.62		0.69		0.71	
RPC REV	0		15.8		9.8		10.5	
RC EXP	10.4		15.6		8.0		11.5	

Sources: financial data provided by Antique Province LGU, Philippines Statistical Yearbook.

Table G - 3

CATANDUANES PROVINCE REVENUES AND EXPENDITURES

GENERAL AND INFRASTRUCTURE FUNDS (P 000)

ITEMS	1985	PERCENT	1986	PERCENT	1987	PERCENT	1988	PERCENT
TOT RPT	297.1	2.3%	434.6	4.2%	387.1	3.4%	362.6	3.2%
CUR RPT		0.0%		0.0%		0.0%		0.0%
PAST YRS		0.0%		0.0%		0.0%		0.0%
AMENSTY		0.0%		0.0%		0.0%		0.0%
PENAL		0.0%		0.0%		0.0%		0.0%
TOT OTAX	264.3	2.0%	209.9	2.0%	163.1	1.4%	208.0	1.8%
BUS TAX		0.0%		0.0%		0.0%		0.0%
TOT LTAX	561.4	4.3%	644.5	6.2%	550.2	4.8%	479.7	4.3%
		0.0%		0.0%		0.0%		0.0%
NON-TAX	514.1	3.9%	556.5	5.4%	272.1	2.4%	589.5	5.2%
		0.0%		0.0%		0.0%		0.0%
TOT OINC	12067.2	91.8%	9147.0	88.4%	10554.4	92.8%	10099.8	89.7%
IRA	4045.2	30.8%	6338.9	61.3%	6562.6	57.7%	6747.2	59.9%
IRA+LRGS	5922.8	45.1%		0.0%		0.0%		0.0%
NALGU		0.0%		0.0%		0.0%		0.0%
		0.0%		0.0%		0.0%		0.0%
TOT REV	13142.7	100.0%	10348.0	100.0%	11376.7	100.0%	11259.9	100.0%
TOT EXP	13250.3		11507.2		11804.0		10972.8	100.0%
PER SER							5997.8	54.7%
MOE							3566.3	32.5%
CAP							418.6	3.8%
							990.1	9.0%
FISC SUR	1878.8		1124.1		[illegible]		1434.0	
FISC-REC	944.5		-71.1		-456.9		452.2	
POP.	196.0		201.0		206.0		211.0	
PR INDEX	350.7		355.3		362.7		391.4	
RPC TAX	0.8		0.9		0.7		0.6	
RPC REV	19.1		14.5		15.2		13.6	
RPC EXP	19.3		16.1		15.8		13.3	

Sources: statistical data provided by Catanduanes Province LGU; Philippines Statistical Yearbook.

Table G - 4

CAVITE PROVINCE REVENUES AND EXPENDITURES
GENERAL AND INFRASTRUCTURE FUNDS (P 000)

ITEMS	1985	PERCENT	1986	PERCENT	1987	PERCENT	1988	PERCENT
TOT RPT	6934.1	15.7%	6901.0	20.6%	10598.2	25.0%	11292.7	30.4%
CUR RPT	5551.9	12.6%	5977.2	17.9%	8062.7	19.0%	7454.9	20.1%
PAST YRS	1168.3	2.6%	1159.7	3.5%	2178.6	5.1%	1668.6	4.5%
AMENSTY					31.5	0.1%	4.0	0.0%
PENAL	223.9	0.5%	264.0	0.8%	325.4	0.8%	447.8	1.2%
TOT OTAX	1204.0	2.7%	716.2	2.1%	2106.2	5.0%	978.4	2.6%
TOT LTAX	8138.1	18.5%	7617.2	22.8%	12704.4	32.9%	12271.1	33.0%
NON-TAX	20283.9	46.0%	88.9	0.3%	315.6	0.7%	3745.9	10.1%
TOT OINC	15683.5	35.6%	18890.7	56.5%	20546.1	48.6%	19691.1	53.0%
IRA	8148.8	18.5%	10103.3	30.2%	10928.0	25.8%	12640.0	34.0%
IRA+LRGS	12906.0	29.3%	13503.8	40.4%	11083.5	26.2%	16314.0	43.9%
NALGU								
BORROWNG			6832.6	20.4%	8741.2	20.7%		
TOT REV	44105.5	100.0%	33429.4	100.0%	42307.3	100.0%	37156.7	100.0%
TOT EXP	50118.6		32483.4		45805.5		35270.9	
PER SER								
MOE								
CAP								
FISC SUR								
POP.	886.0		911.0		937.0		964.0	
PR INDEX	332.6		350.7		375.1		337.3	
RCP TAX	2.8		2.4		3.6		3.8	
RPC REV	15.0		10.5		12.0		11.4	
RPC EXP	17.0		10.2		13.0		10.9	

Sources: financial data provided by Cavite Province LGU, Philippines Statistical Yearbook.

Table G - 5

LEYTE PROVINCE REVENUES AND EXPENDITURES
GENERAL AND INFRASTRUCTURE FUNDS (P 000)

ITEMS	1985	PERCENT	1986	PERCENT	1987	PERCENT	1988	PERCENT
TOT RPT	2828.5	6.6%	3440.1	7.3%	9627.5	21.1%	8259.9	18.0%
CUR RPT		0.0%		0.0%		0.0%		0.0%
PAST YRS		0.0%		0.0%		0.0%		0.0%
AMENSTY		0.0%		0.0%		0.0%		0.0%
PENAL		0.0%		0.0%		0.0%		0.0%
TOT OTAX	510.3	1.2%	638.0	1.4%	661.4	1.4%	797.6	1.7%
TOT LTAX	3333.8	7.7%	4078.1	8.6%	10288.9	22.5%	9057.5	19.8%
		0.0%		0.0%		0.0%		0.0%
NON-TAX	250.6	0.6%	1218.6	2.6%	366.0	0.8%	113.8	0.2%
		0.0%		0.0%		0.0%		0.0%
TOT OINC	39474.7	91.7%	41940.4	88.8%	34972.9	76.6%	36674.3	80.0%
IRA	25819.4	59.9%	27430.8	58.1%	29788.7	65.3%	29938.8	65.3%
RVERSE AP		0.0%		0.0%		0.0%	4185.7	9.1%
NALGU		0.0%		0.0%		0.0%		0.0%
		0.0%		0.0%		0.0%		0.0%
TOT REV	43069.1	100.0%	47237.1	100.0%	45627.8	100.0%	45845.6	100.0%
TOT EXP	46911.0		43588.2		43245.3		37857.1	
PER SER	19400.0		19400.0		22.6		22906.5	
MOE	27900.0		23600.0		16800.0		10092.9	
CAP	2100.0		1400.0		6200.0		159.5	
OTHER							4648.2	
FISC SUR	1610.0		1350.0		1310.0		1750.0	
FISC-REC								
POP.	1427.0		1453.0		1479.0		1506.0	
PR INDEX	337.3		332.4		346.3		383.3	
RPC TAX	0.7		0.8		2.0		1.6	
RPC REV	8.9		9.8		8.9		7.9	
RPC EXP	9.8		9.0		8.4		6.6	

Sources: financial data provided by Leyte Province LGU, Philippines Statistical Yearbook.

Table G - 6

LEGASPI CITY REVENUES AND EXPENDITURES
GENERAL AND INFRASTRUCTURE FUNDS (P 000)

ITEMS	1985	PERCENT	1986	PERCENT	1987	PERCENT	1988	PERCENT
TOT RPT	2533.6	12.99%	2738.5	13.80%	2545.8	13.88%	2754.7	11.19%
CUR RPT	1709.1	8.76%	1969.1	9.92%	1758.4	9.59%	2088.7	8.49%
PAST YRS	763.0	3.91%	345.5	1.74%	418.1	2.28%	538.4	2.19%
AMNESTY		0.00%	380.3	1.92%	295.8	1.61%	2.0	0.01%
PENAL	61.5	0.32%	34.6	0.17%	73.5	0.40%	125.0	0.51%
TOT OTAX	29998.8	153.83%	3228.9	16.27%	2958.6	16.13%	2996.7	12.18%
BUS.TAX	2227.3	11.42%	2381.2	12.00%	2279.1	12.43%	2296.0	9.33%
TOT LTAX	5531.7	28.37%	5967.4	30.08%	5504.4	30.01%	5751.4	23.37%
		0.00%		0.00%		0.00%		0.00%
NON-TAX	1511.8	7.75%	2113.8	10.65%	3144.7	17.15%	3443.1	13.99%
		0.00%		0.00%		0.00%		0.00%
TOT OINC	12458.2	63.88%	11759.1	59.27%	9692.4	52.84%	14758.8	59.98%
IRA	2333.7	11.97%	9869.3	49.74%	3344.5	18.23%	13824.6	56.18%
IRA+LGRSF	10989.8	56.35%	9869.3	49.74%	9263.5	50.51%	13824.6	56.18%
NALGU		0.00%		0.00%		0.00%	654.3	2.66%
TOT REV	19501.7		19840.3		18341.5		24607.6	
TOT EXP	18334.5	100.00%	18538.0	100.00%	18906.0	100.00%	23210.7	100.00%
PER SER	7372.9	40.21%	9290.7	50.12%	9640.7	50.99%	11663.5	50.25%
MOE	8684.6	47.37%	6097.8	32.89%	7954.9	42.08%	9800.1	42.22%
CAP	216.6	1.18%	206.5	1.11%	408.5	2.16%	448.6	1.93%
FISC SUR	1594.8		2134.8		1333.0		1941.5	
FISC-REC	1413.9		828.4		386.9		1661.8	
NALGU 88							301.9	
POP.	112.0		115.0		118.0		120.0	
PR INDEX	332.6		338.7		349.9		386.6	
RPCTAX	14.8		15.3		13.3		12.4	
RPCREV	52.4		50.9		44.4		53.0	
RPCEXP	49.2		47.6		45.8		50.0	

Sources: financial data provided by Legaspi City LGU, Philippines Statistical Yearbook.

Table G - 7

TACLOBAN CITY REVENUES AND EXPENDITURES
GENERAL AND INFRASTRUCTURE FUNDS (P 000)

ITEMS	1985	PERCENT	1986	PERCENT	1987	PERCENT	1988	PERCENT
TOT RPT	2115.9	9.2%	2869.6	12.3%	2613.0	10.4%	3045.5	10.5%
CUR RPT		0.0%		0.0%		0.0%		0.0%
PAST YRS		0.0%		0.0%		0.0%		0.0%
AMNESTY		0.0%		0.0%		0.0%		0.0%
PENAL		0.0%		0.0%		0.0%		0.0%
TOT OTAX	5793.0	25.1%	6005.2	25.8%	6266.4	24.9%	7546.9	26.1%
BUS TAX	3471.4	15.0%	3453.2	14.8%	3506.6	13.9%	4428.7	15.3%
TOT LTAX	7909.8	34.3%	8874.9	38.1%	8879.4	35.3%	10592.5	36.7%
		0.0%		0.0%		0.0%		0.0%
NON-TAX	2611.1	11.3%	3490.5	15.0%	4398.5	17.5%	4474.5	15.5%
		0.0%		0.0%		0.0%		0.0%
TOT OINC	12547.6	54.4%	10954.3	47.0%	11908.6	47.3%	12818.3	44.4%
IRA	10728.9	46.5%	9210.1	39.5%	10260.0	40.7%	12818.3	44.4%
IRA+LRGS		0.0%		0.0%		0.0%		0.0%
NALGU		0.0%		0.0%		0.0%		0.0%
		0.0%		0.0%		0.0%		0.0%
TOT REV	23068.6	100.0%	23319.6	100.0%	25186.5	100.0%	28885.2	100.0%
TOT EXP	22823.2		24618.2		25519.2		27957.5	
PER SER							17850.8	
MOE							6004.0	
CAP							1923.0	
OTHER							2179.7	
FISC SUR	4611.0		1608.0		736.0		673.0	
FISC-REC								
POP.	112.0		114.0		116.0		118.0	
PR INDEX	337.3		332.4		346.3		383.3	
RCP TAX	20.9		23.4		22.1		23.4	
RCP REV	61.1		61.5		62.7		63.9	
RCP EXP	60.4		65.0		63.5		61.8	

Sources: financial data provided by Tacloban City LGU, Philippines
Statistical Yearbook.

APPENDIX H

Individuals Consulted

Albay Province

Ms. Natividad	Assistant Provincial Treasurer
Archimedes Reynoso	Engineer, Provincial Planning and Development Office
Justiniano Panambo	Provincial Assessor
Niceto Atos	Provincial Budget Officer
Abundio Nuñez	Provincial Treasurer
Danny Asaña	Vice Governor

Antique Province

Pedro Juluat	Assistant Provincial Treasurer
Exequiel Javier	Congressman
Ruffino V. Rosonaro	DPWH District Engineer
Jovito Plameras, Jr.	Governor
Bernardo Pitate	Head, Tax Mapping
Vergilio Arendon	Mayor, Anini-y Town
Rolando Palomado	Provincial Auditor
Pacifico Galindo, Jr.	Provincial Budget Officer
Guillermo Clemente	Provincial Engineer
Henry Bernardio	OIC, Provincial Planning and Development Office
Roberto Operiado	Vice Governor

Catanduanes Province

Merito Tarrago	Assistant Assessor
Rogelio V. Tria	OIC Provincial Assessor
Florina Tubianosa	Provincial Auditor
Irineo C. del Rosario	Provincial Budget Officer
Luis A. Manlapay, Jr.	Provincial Treasurer
Ms. Vargas	Supervising Accountant

Cavite Province

Luisa Montano	Assistant Provincial Auditor
Pete Angelia	District Engineer
Armando Perez	Provincial Budget Officer
Eden Austria	Planning Division Head, Provincial Planning and Development Office
Salvador Gonzales	Provincial Assessor
Antonio Seguitan	Provincial Engineer
Eduardo Tirona	Provincial Planning and Development Coordinator
Alfredo Mercado	Provincial Treasurer
Telasforo Unas	Vice Governor

Department of Finance

Ramon K. Katigbak	Undersecretary
Cipriano P. Cabaluna, Jr.	Regional Director, Bureau of Local Government Finance/ Region VI

Department of Local Government

Cesar Sarino	Undersecretary
Andy Sanchez	Assistant Secretary

Legaspi City

Ricardo M. Santos	City Assessor
Benjamin Imperial	City Manager
Mr. Meneses	City Planning and Development Coordinator

Local Revenue Management Project, NEDA Region V Office

Ms. Beth Barela

Local Revenue Management Project, NEDA Region VIII Office

Emanuel Calero, Jr.	Senior Economic Development Specialist

Leyte Province

Leopoldo E. Petilla	Vice Governor, OIC
Tente U. Quintero	Provincial Administrator
Evelia Martine	Provincial Planning and Development Coordinator
Les Pastor	Sanggunian Panlalawigan Head
Florencio Luna	Provincial Treasurer
Enrique Aguilar	Deputy Administrator, Provincial Treasury Office
Mr. Corpin	Assistant Provincial Assessor
Gloria Alcober	Provincial Budget Officer
Tereso Pasagui	Assistant Provincial Auditor

Igmedio Tolibas	State Auditing Examiner
Josie Perez	Provinicial Accounts Division Director

<u>NEDA/Regional Office VIII</u>

Romeo C. Escandor	Regional Director
Staff members	

<u>Tacloban City</u>

Uldarico E. Mate	Mayor
Trofila H. Bronsas	City Planning and Development Sociologist
Francisco Brigoli	City Planning and Development Urban Planner
Leonido Basada	City Planning and Development Fiscal Analyst
Simona Esperame	OIC Treasurer
Sylvester Ramos	City Assessor
Advarico Alvero	Chief Deputy Assessor
Heraclea Segovia	Budget Officer

APPENDIX I

Scope of Work for the Local Fiscal Integrity Analysis

I. Background

The proposed Local Development Assistance Program (LDAP) will provide $50.0 million to the Government of the Philippines (GOP) to support decentralization reform. The Program Assistance Authorization Document (PAAD) will detail a policy reform agenda, including benchmarks for policy implementation and monitoring which places the emphasis on policy performance, including performance on agreed-to institutional and administrative reforms. The program, as against project modality, places the emphasis on policy performance, including performance on agreed-to institutional and administrative reforms. USAID will seek GOP agreement to provide additional financial resources (additional to those planned for implementation of the proposed National Internal Revenue Allotment-NIRA Bill) to local government units (LGUs) to demonstrate the likely use and potential impact of substantially increased resources. USAID funds will not be provided directly to the LGUs but agreement will be sought with the GOP to provide such increases itself through the normal GOP budgeting accountability procedures for fund use at the local level. However, USAID will provide a limited amount of technical assistance to monitor use of funds on a sample basis.

LDAP, unlike past USAID-assisted decentralization efforts, will support nationwide GOP policy reforms that will lead to greater autonomy for LUGs to increase their descretionary resources and effective level of decision-making authority. Within the two-year period, LDAP is expected to bring about policy reform that will actually transfer increased authority and responsibility to LGUs. Beyond two years, with reformed policies in place, it is expected that local governments with more resources plus genuine decision-making responsibility and authority will, in general, be more responsive to constituents' needs for infrastructure and basic social services.

The Executive and Legislative Branches have initiated various actions to support decentralization. The Executive Branchs' initiatives include: a program in four pilot provinces to develop and test decentralization models; embarkment by the Department of Local Government (DLG) on a re-orientation of its functions from one of control and decision-making to one of support; and decision to embark on a new budget disbursement scheme to permit regional development councils to approve local infrastructure project selection. Those of the Legislative

Branch include the proposed NIRA Bill and bills outlining various books of the proposed Revised Local Government Code.

The decentralization policy agenda will include a menu of desirable policy adjustments that addresses key constraints to decentralization in the Philippines. Critical agenda items will include those reforms that increase the level of discretionary resources and transfer decision-making authority to LGUs. Performance indicators will be developed from these agenda items:

- implementation of increased funding for LGUs for 1990,
- reduction of mandatory revenue contributions required of LGUs,
- implementation of decentralized decision-making authority for project development,
- increased real property and local business tax collection,
- implementation of a general re-valuation of real property,
- implementation of increased LGU power to impose local taxes,
- placing authority for the maintenance of barangay/municipal roads under the province,
- implementation of increased authority of local executives over locally assigned national staff,
- strengthening of local development council role in project development and implementation,
- provision of revenue capacity building for LGUs,
- provision of management capacity training for increased numbers of local officials,
- improved management and information systems for LGUs,
- improvement of municipal treasurers' and assessors' office staff capability,
- development of local autonomy model,
- improvement of project decision and feasibility analysis,

- improvement of project monitoring,
- institutionalization of NGOs and private sector participation in local development,
- increased attention to environmental issues at the local level, and
- capacity for project design and implementation at the local level.

USAID representatives have met with senior officials from key GOP departments and the Leagues of Governors and Mayors to discuss possible USAID assistance for decentralization reform. It is anticipated that throughout program implementation a group made up of representatives from the Department of Finance (DOF), DLG, Department of Budget and Management (DBM), the National Economic and Development Authority (NEDA), and the Leagues will meet regularly to discuss policy issues and review progress on decentralization agenda actions. Criteria for the selection of the implementing agency will include the capacity to facilitate the implementation of priority reforms such as increased discretionary resources and authority for LGUs, mandates of particular departments and related sensitivities, and capacity to coordinate the program activity and chair the policy discussions.

Large increases in financial resources are projected for LGUs from national revenue allotments and increased emphasis on local revenue generation, primarily real property tax collections. Therefore, there is a need to examine (1) local government financial systems strengths and weaknesses, including the systems for fiscal integrity; (2) what the financial systems need to prepare for increased services due to management of larger resource flows; and (3) anticipation of even greater increase in funds. In addition, criteria will be developed for the selection of participating provinces that have the capacity to utilize additional funding from LDAP.

The Mission is undertaking various analyses as a basis for preparing the PAAD to be completed during the last quarter of 1989. The assistance will provide part of the required analyses.

II. Objective

To analyze the strengths and weaknesses of selected financial systems, including financial accountability, capacity, financial resources, and organization of a sample of local government units to provide input for PAAD to address the issue of fiscal integrity of local governments and provide basic information on local budget resource allocations.

III. Statement of Services

A. General

The Contractor shall undertake a general analysis of four to six LGUs in the area of budgeting, disbursement and accountability, intergovernmental funds flow, performance monitoring, procurement, revenue collection, and organization for local financial administration. From this analysis, the Contractor shall provide recommendations on potential policy adjustment areas, institutional constraints to be addressed and possible indicators for monitoring.

B. Specific Tasks

1. Analysis of System Implementation

The analysis shall concentrate, among others, on strategic transaction points determined in the review of the prescribed system and related studies. Compliance with the prescribed system shall be analyzed together with the strengths and weaknesses in the implementation of the system. The degree of implementing the recommendations of various studies, if there are any, shall also be looked into. In addition, attention shall also be focused on the following.

Budgeting

The actual process and considerations in budget preparation and implementation shall be reviewed and analyzed, including budgetary allocations among various governmental functions/ activities and visions of local executives on how the budget process and implementation can be improved to upgrade the delivery of basic service to its constituents. Attention should be given to identifying earmarking areas, e.g. for D&M for rural infrastructure.

Disbursement and Accountability

The procedures of disbursement shall be analyzed covering documentation flow and requirements, timing, responsible staff/officials, and compliance with the approved budget/ schedules and other regulations. The audit process and procedures shall also be covered together with the operation of the internal control system and penal provisions.

Intergovernmental Funds Flow

This shall include analysis of grants and subsidies to local governments, tax sharing between central and local governments, approval of tax structure changes, and borrowing. Is the grant/subsidy program structured so as to encourage the mobilization of additional resources at the local government level? Is it equitable? Does it provide an adequate flow of revenues to local governments? And does it stimulate capital spending?

Performance Monitoring

There shall be an analysis of the mechanism used by local governments in monitoring their fiscal performance. Are local governments examining their fiscal data? Are they analyzing their fiscal situation and planning for the future?

Procurement and Contracting

The procurement and contracting process shall be analyzed in terms of procedures, requirements, responsibilities, and their impact on the overall local government operations.

Revenue Collection

This shall concentrate on analyzing the extent by which local governments are exercising the revenue powers devolved to them and tapping their revenue potentials. The gap between taxable capacity and tax effort shall be determined, including analysis of existing and potential non-tax local revenue sources.

Organization

This shall cover analysis of the prescribed and actual organizational structure, staffing and qualifications, functions and responsibilities, and coordination of the various offices involved in local financial administration such as the offices of the local chief executive, legislative body, treasurer, budget officer, auditor, and international control officer. What controls exist on the number, type and quality of staff LGUs can now hire if sufficient financial resources were available?

2. Analysis of Absorptive Capacity

Based on historical records and through personal interviews, an analysis of the financial absorptive capacity of local government shall be undertaken, including an analysis of the trends, level and composition of local revenues and expenditures. Emphasis shall also be given to the type and level of development activities (including foreign-assisted projects and operation and maintenance--as against construction--of infrastructure) undertaken and basic services being delivered. Likewise, answers should be explored to questions, such as: (a) What types of projects have been implemented? (b) What problems have been encountered and what actions have been taken in response to these problems? (c) How does the LGU propose to use the increased financial resources? (d) Are LGUs actively preparing plans and systems to manage the anticipated increased resources? Furthermore, various parameters or indicators that will be helpful in determining basic and improved local financial absorptive capacity shall be identified.

3. Overall System Description, Analysis, and Recommendations

Based on outputs from the above-mentioned tasks, the Contractor shall develop an overall description of the local financial system, an analysis of financial system operations and local government capacity to management and utilize financial resources, and an analysis of local budget allocations and expenditures. Strengths and weaknesses should be summarized and recommendations on possible policy adjustments should be provided. Specifically, the Contractor should indicate what areas (particularly those most prone to abuse) need to be strengthened in order for the LGU to handle increased financial resources effectively. Relatedly, the Contractor should indicate who best to undertake strengthening and what indicators might be used for monitoring purposes.

IV. Duration of Service

The services are scheduled to cover a period of 25 working days broken down as follows.

	Activities	Working Days
1.	Preparation, discussion and finalization of assessment methodology	3
2.	Interviews and data gathering	12
3.	Data analysis and interpretation	5
4.	Report writing, discussion and finalization	5
	Total	25

V. Workplan and Reports

Within five (5) working days after contract signing, the contractor will submit for approval by USAID, a detailed workplan and methodology for assessment.

The report should follow this outline:

A. Executive Summary
B. Background and Methodology
C. Description of Analysis Results
D. Recommendations
E. Attachments/Appendices (Details of Assessment and and Instruments, etc.)

The draft report should be presented to USAID three working days before expiration of the contract. The final report (in six copies) shall be submitted at least ten (10) working days after contract termination and will be the basis for final payment.

VI. Other Requirements

1. Level of Effort and Assessment Team Composition

The estimated level of effort is a total of 90 person-days of expatriate and local consultant services. The team will be composed of a principal expatriate consultant with expertise on institutional analysis, a public finance economist and two local finance specialists.

2. Specific Responsibilities

Each of the consultants will have specific responsibilities which correspond to his or her field of expertise.

Institutional Analyst

Aside from being primarily in-charge of the issue on local financial absorptive capacity, shall act as the team leader responsible for the overall coordination of activities. As a team leader, he/she will be responsible for the following:

- preparing detailed work plan for approval by the LDAP committee,
- coordinating the respective assignments and schedules of each team member,
- monitoring and reporting on the progress or lack of progress of individual assignments of the overall team efforts,
- editing and integrating the individual reports,
- preparing a draft report to be distributed at least 48 hours before the scheduled presentation to USAID and other concerned institutions, and

- revising and finalizing the report for submission to USAID.

Public Finance Economist

Will be primarily responsible for all areas related to local government finance and budgeting.

Local Finance Specialists

Will be primarily responsible for all areas pertaining to disbursement, accountability, financial systems, and organization/staffing.