



Title	Decentralization and Economic Development: The Philippine Experience
Author(s)	Guevara, Milwida,M.
Citation	Hitotsubashi Journal of Economics, 41(2): 97-109
Issue Date	2000-12
Type	Departmental Bulletin Paper
Text Version	publisher
URL	<a href="http://hdl.handle.net/10086/7712">http://hdl.handle.net/10086/7712</a>
Right	

## DECENTRALIZATION AND ECONOMIC DEVELOPMENT: THE PHILIPPINE EXPERIENCE

MILWIDA M. GUEVARA\*

*Ford Foundation, Philippines  
Makati, Philippines  
m.Guevara@fordfound.org*

Received July 2000; Accepted September 2000

### *Abstract*

The Philippines embarked on an ambitious decentralization program in 1991 to strengthen democratic processes and enhance economic growth. The national government devolved major responsibilities and revenues to local governments. Decentralization however goes beyond the transfer of responsibilities and resources to local governments. It requires reforming governance and empowering the community to participate in advocacy and decision making. These areas are the current challenges to local governments since power structures remain traditional and relationship with central government is still paternalistic. Revenue mobilization efforts are weak and LGUs are dependent on grants from the central government. The successful experiences of innovative LGUs can inspire confidence that decentralization can work. Sound policies, political will, systemic reforms and involvement of the community are key factors in governance.

*Key words:* Philippines; Local governments; Devolution; Decentralization; Grants

*JEL Numbers:* H71, H72, H77, O23

### I. *Introduction*

The Philippines is a country that is composed of 7,100 islands. Its people speak 87 dialects. There are “barangays”<sup>1</sup> in the country that can only be reached by literally crossing mountains and navigating through lakes and streams. These characteristics are by themselves strong reasons for decentralizing governance. Ironically however, centralism is more the tradition in the country. Power is deeply rooted in the central government and local governments have remained minions of the central government.

The concentration of power in the central government has been a result of the conquest

---

\* Ms. Guevara served as a Career Undersecretary, Department of Finance, Republic of the Philippines from 1994 to January 2000.

<sup>1</sup> The village is the smallest level of local government unit in the Philippines.

of the country by several invaders: the Spaniards, the Americans, and the Japanese. Prior to their coming, the different islands in the country were autonomous. Each community had a system of choosing its local chieftain called the "datu" and formulated its own rules and norms of behaviour. But history changed its course and the invaders moved power and control into the center. The conquerors had to rein in mutinies and revolts. Independence in later years was a period for rehabilitation and the national government saw the need for strong direction and management from the top. The martial law period in the 70s made local autonomy totally irrelevant. It was only after the end of the Marcos rule in 1986 that devolution was earnestly pursued. The long experience of the country with an autocratic regime provided a strong motivation to decentralize. In 1991, a Local Government Code was legislated to institutionalize a systematic allocation of powers and responsibilities between the national government and the local government units (LGUs).

Riding high on the platform of people empowerment, the Ramos administration implemented major reforms, which reinforced the spirit of decentralization starting 1992. The economy was freed from interventionist policies. Restrictions on foreign exchange, trade and investments were lifted. Industries, which used to be monopolies such as transportation and telecommunications, were opened to competition. Business activities were freed from excessive government regulation through intensive programs on privatization and deregulation. Interest rate was determined by the market. Price controls, even on politically sensitive products such as fuel, were lifted. Decentralization moved in step with the liberalization of the economy. Planning was made more participative and local governments became increasingly involved in national policy formulation and implementation.

The philosophy of decentralization remains robust in the Philippines although much has to be done with respect to its implementation. An analysis of the realities of fiscal decentralization, which is the core of the devolution program in the Philippines, is presented in this paper. It provides an overview of how expenditures and revenues are allocated between the central and local government. Thereafter, a discussion of the efficiency of LGUs in utilizing their fiscal powers is made.

## II. *The Focus of Empowerment: The Local Governments in the Philippines*

The political subdivisions of government in the Philippines are the provinces, cities, municipalities and barangays.<sup>2</sup> Being community-based political institutions, the local government units (LGUs) are the closest to the people. There are therefore efficiency gains in empowering them to determine and to deliver the goods and the services that the community needs. The proximity of the local officials to the voters enhances the process of accountability. An official who mismanages resources runs the risk of not being re-elected. Conceptually, corruption is expected to be far less when those who are in office are aware that the voters can easily know their decisions and actions. Empowered local leaders in the Philippines have demonstrably proven that they are able to succeed in areas where the central government failed or that they can implement programs with greater efficiency than the central government. There are inspiring cases of excellence in local governance where innovative projects are

---

<sup>2</sup> Sec. 1, Article X of the 1987 Constitution of the Philippines.

initiated and maintained by LGUs using local resources.<sup>3</sup>

The central government also stands to benefit from decentralization because LGUs can effectively mobilize community participation in implementing national programs.

The village (barangay) serves as the basic political unit of government and is the primary planning and implementing unit of public policies and programs. The barangay is also the forum where the views of the community are crystallized and articulated. The barangay is tasked with the provision of simple services such as the maintenance of the barangay health center and day-care center and the administration of “katarungang pambarangay” or the village justice system. It is a noteworthy mechanism through which disputes between community members are arbitrated or settled. Each barangay has an arbitration council that hears and makes opposing parties settle their differences prior to or without the filing of cases in judicial courts. The members of the council serve without compensation and the methods of arbitration are informal and culture-based.

The municipality is composed of a group or clusters of barangays. The municipal government is primarily responsible for primary health-care, social welfare services, solid waste disposal system, and agricultural extension and research activities.

The province is composed of a cluster of municipalities and component cities. The maintenance of provincial hospitals and the provision of tertiary health services have been devolved to the provincial government. In addition, provincial governments are responsible for relief operations and population development services.

The city is composed of more urbanized and developed barangays. Congress can convert a municipality into a city if it has an average annual income of twenty million pesos (US\$488 million) for the last two consecutive years and its population is at least 150,000. The city government is charged with the provision of services and facilities that the province and the municipality provide, as well as support for education, police and fire services. Highly urbanized cities, i.e. those with annual income of at least fifty million pesos (US\$1.22 million), are autonomous from the province. Cities with lower income are considered part of a province.

Local autonomy is not absolute however because the President of the Philippines is vested with authority to exercise general supervision over LGUs and to ensure that their acts are within the scope of their powers and functions.

### III. *The Resources of Local Governments in the Philippines*

The central and local governments in the Philippines raised public revenues amounting to P509.2 billion (US\$12.42 billion) in 1998 representing 18.75 percent of GDP. The central government generated collected 92 percent of the revenues accounting for 17.5 percent of GDP. The revenue effort of the local governments was 1.75 percent of GDP.

The revenues of the local governments have always been dwarfed by the income of the national government. Although LGUs have been vested with the power to generate their own revenues, the more productive revenue sources such as the income tax, the VAT, and excise

---

<sup>3</sup> The “Galing Pook Awards” recognizes excellence on local governance. The programs, which have been nationally recognized, include provision of clean water supply, computerization of property tax administration, and development of growth centers.

taxes have been allocated to the national government. To compensate for the relative disparity in revenue sources, local governments share from the collection of national taxes in the form of grants and allotments.

## 1. Grants and Allotments

The provision of grants to local governments serves varied purposes.

- They are a means through which the national government subsidizes the delivery of local public services. Allotments can be used by the national government to ensure that a minimum level of basic services is delivered by LGUs.
- Allotments can be used to equalize or at least adjust for disparities in fiscal capacities among LGUs.
- Allotments can also be used to influence the fiscal behavior of LGUs. The national government may provide specific purpose allotments, which are tied up to priority programs.

The national government allocates forty percent (40%) of its collection from internal revenues to LGUs with a lag of three years (i.e. the basis of the allotment is the amount of internal revenue collection three years back). The grant is allocated following this proportion:

Provinces: 23 percent  
Cities: 23 percent  
Municipalities: 34 percent  
Barangays: 20 percent

The share of each LGU is then determined in accordance with three criteria with the following weights:

Population: 50 percent  
Land area: 25 percent  
Equal sharing: 25 percent

Grants to local governments are required by law to be automatically released to local treasurers within five days after the end of each quarter. They cannot be subject to any lien that may be imposed by the central government except when the national government experiences an unmanageable public sector deficit. The President with consultation with the leaders of Congress and the leagues of Local Executives can reduce the amount of grants by 10 percentage points. This prerogative was exercised by then President Ramos who ordered a reduction in total government spending, including grants to prevent a huge budgetary deficit due to the Asian crisis. A disturbing development is the provision in the 2000 budget, which makes the availability of funds as a precondition for the release of allotments. This has raised apprehension that the grants may again be utilized to foster political patronage.<sup>4</sup>

Grants have increased the resources of local governments in general. Grants in 1999 amounted to P80.85 billion in 1999 or US\$1.96 million, representing 17 percent of the national government budget.<sup>5</sup> Even if the costs of the devolved functions are netted out, LGUs are still

<sup>4</sup> It should be recalled that the allotments during the Marcos regime were arbitrarily distributed.

<sup>5</sup> The amount of debt service is netted out.

left with additional resources to finance new programs.<sup>6</sup>

The equity goal of the allotment system is far from accomplished however. LGUs with more revenues from local sources, higher taxable capacity and more expenditure outlays are provided with more grants. Instead of directing resources to LGUs that need them most, allotments are channelled to areas who do not need help as much as the others. On a regional level, grants flowed heavily to more developed regions like Region 4, Region 3, and the National Capital Region in Luzon. Grants to depressed regions like the Cordillera Autonomous Region, Regions 7 and 8 were below the average.<sup>7</sup> Likewise, if the number of people that an LGU has to support is an indicator of need, more populous regions are not fully assisted by the allotment system. Heavily populated LGUs like Manila, Quezon City and Caloocan receive smaller allotment per capita.<sup>8</sup> It can be said therefore that the formula for distributing the grant is unable to allocate resources to LGUs in accordance with needs and resources. As earlier discussed, one-fourth of the allotments are distributed equally among local government units regardless of needs and resources.<sup>9</sup>

The grant system does not also have any fiscal stimulation effect, i.e.; it does not encourage LGUs to generate additional revenues to support any additional expenditure. Instead, LGUs substitute allotments for revenues that should have been raised locally. The inherent structure of the grant formula has nothing in it to induce LGUs to improve their revenue effort. The grant formula does not also consider the tax effort or the taxable capacity of an LGU.

The allotment system may have also influenced the propensity of Philippine Congress to create new cities and provinces. The splitting of a province into two doubles its grant and the conversion of a city into a municipality increases its grant substantially. In the case of the premier municipality in the country, Makati, its grant increased by almost 200 percent when it was converted into a city.

## 2. Revenue Raising Powers

The LGUs are vested with the power to create their own revenue sources. Such power is not absolute however, because they should be exercised within the limitations prescribed by law. The central government has reserved for itself the imposition of the income tax, the value-added tax, excise taxes and customs duties. Local governments are not allowed to impose a tax with any semblance to such national taxes, although they can impose a surtax on firms subject to the national sales tax.

There is a neat allocation of taxing powers among local government units to prevent double and multiple taxation. A ceiling on the tax rates is also provided under the law.

- a. The provincial government can impose levies on real properties, i.e. basic real property tax at one percent (1%) and a Special Education Fund tax on the same base. The province

---

<sup>6</sup> Net transfers represented 56% of allotments to LGUs in 1993, i.e. out of every peso of allotment; P0.44 covered the costs of the responsibilities, which were transferred to the LGUs. This is discussed more extensively in "A Study of the Internal Revenue Allotments to Local Governments" by Guevara, Figueroa, Gracia and Espano, 1995, a study conducted for the Associates for Rural Development and funded by the USAID.

<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

<sup>9</sup> Under the old allotment formula, only 10% of the grants was distributed on an equal sharing basis.

can also impose an idle land tax at 5 percent (5%) and a special levy on lands that have benefited from public infrastructure. The levy can recoup as much as 60 percent of the costs of the public works project from landowners within 10 years. There is also a tax on the transfer of real property ownership.

- b. The local business tax is the major revenue-source of municipalities. The rates are varied depending on the nature of business and are either ad valorem or specific rates. Because of the philosophy that local taxes should be progressive, the tax rates are graduated depending on gross receipts. The collection from the property tax is shared with the municipality (40%) and the barangay (30%) where the property is located. The municipal government has a municipal assessor and treasurer who administer and collect the tax under the supervision of the province.
- c. Cities are given wider taxing powers because they can impose the provincial and municipal taxes. In addition, they can increase the tax rates by fifty percent.
- d. Barangays have been provided with nominal taxing powers. Small retailers pay a tax to the barangay government. Firms are also required to secure a barangay clearance.
- e. The different subnationals have common revenue-raising powers. They are allowed by law to collect permit fees and user charges.

Local government revenues accounted for only 1.75 percent of GDP in 1998 while its tax effort was 1.07 percent. For over a decade, the revenue effort of LGUs has remained static averaging at 1.13 percent and its tax effort at 0.67 percent. In contrast, the central government has made considerable effort to raise its revenue effort from 12.1 percent in 1985 to 19.5 percent in 1997, prior to the Asian financial crisis. Its tax effort increased from 10.7 percent in 1985 to 16.7 percent in 1996. Although much remains to be desired with respect to the revenue mobilization efforts of the central government, it has introduced significant measures to strengthen its fiscal sustainability. The Ramos Government introduced a Comprehensive Tariff and Tax Reform in 1997.

The bulk of revenues of LGUs comes from grants (63%) and only 37 percent is generated locally. Prior to the enactment of the Local Government Code in 1991, grants contributed only an average of 39 percent to local revenues. The current pre-dominance of grants is due to the doubling of the share of LGUs from internal revenue taxes and the weak utilization of their revenue-raising powers

Provinces are most reliant on grants and allotments. About 75 percent of their incomes are accounted for by grants. This is primarily because their revenue-raising powers are nominal, save for the real property tax. The tax bases of the provincial taxes have been made narrow by the numerous exemptions that have been granted by the national government. Provincial governments are also dependent on municipal treasurers to collect the provincial taxes.

Cities prove to be the most financially independent among LGUs considering that they generate almost sixty percent of their revenues from local sources. The business tax is a buoyant source of revenues and account for more than one-fifth of their income.

Municipalities are also dependent on grants, which account for 65 percent of their total income. The business taxes are their most important local revenue source.

Local revenue mobilization efforts have been hamstrung by inefficiencies in the tax structure and tax administration. The tax base of the real property tax is only a percentage of

the market value of real properties, i.e. 20 percent for residential and timberlands; 40 percent for agricultural lands and, 50 percent for commercial and industrial lands. Under-taxation of lands does not put any pressure on landowners to make full use of their lands. The different assessment levels or the different tax base on the real property tax also distort decisions on resource allocation. Since farmlands are taxed more heavily than residential lands, there is an incentive rather than a disincentive to convert farmlands into residential subdivisions. The provisions of law on idle land taxation are structurally infirmed. A land needs to have 1,000-sq. m. in area to be declared as idle. The law does not provide any criterion in determining whether a land is "unutilized." Thus, a dumping area in a city can be defended as being utilized by the owner.

In the eighties, the real property tax accounted for 23 percent of total local revenues. Its contribution has now declined to 12 percent on the average. It is difficult to account for the annual growth of property tax revenues because they come in spurts rather than regular flows. Among others, this is because of the lack of regularity in property revaluation. The current law provides for a revaluation, once every three years (which used to be once every five years earlier). But the process of revaluation has always been a political one. Presidential decrees used to postpone the period for revaluation. Under the law, the process has even become more political because the local legislative council has to approve the assessed levels, or the percentage of the market values that would serve as the tax base. In some ways however, this process can enhance the accountability of local government officials to the electorate. Failure to harness the potential of the property tax can mean deterioration of the services provided by LGUs. Choices have to be made by the community between paying a tax based on current property values or coping with inadequate facilities that are provided by local governments. More often, the choice is always the latter.

The problems on tax administration have been chronic. These relate to inaccurate tax rolls, lack of computerized methods of valuation and assessment, and failure to use sanctions against delinquent taxpayers. The law empowers LGUs to sell real properties at public auction and to file civil cases in courts. The stories of reluctance to demonstrate political will to collect what is due government have been the same through the years. It is not surprising therefore that the average effective tax rate or the ratio between the collection from the property tax to assessed values is 1.27 percent.<sup>10</sup> This is not even equal to the 2 percent statutory rate. LGUs have to overcome the obstacles of political patronage when it comes to enforcing the law. The delinquent taxpayers are the powerful ones who have contributed to the campaign kitty of local officials.

The collection of business taxes has also been stymied by administrative problems. In most cases, the problem is the correct assessment of gross receipts. In some cases, the assessment is made by the Office of the Mayor or the Local Chief Executive rather than the Treasurer who has the expertise and the detachment from politics to perform assessment work.

---

<sup>10</sup> Guevara, Gracia, Figueroa, and Espano, "A Study of the Internal Revenue Allotments to Local Governments", 1995, a Study conducted for the Associates in Rural Development and funded by the US-AID.

#### IV. *Credit Financing for Local Governments*

The experience of LGUs on credit financing had not been pleasant for both the lender and borrower. At the height of the economic crisis in 1985, more than 50 percent of the LGU loans from government financial institutions (GFIs) were in arrears. No payment was ever made on one-fifth of the loans and only one-fifth of the loans was kept current.<sup>11</sup>

The macro-environment was hostile to the efforts of LGUs to tap the credit market in the early eighties. Interest rates skyrocketed to 42 percent in 1984. Allotments to LGUs were not also given in full due to the budgetary problems of the central government. Although the LGUs were entitled to 20 percent of the collection from internal revenues, they were only given an average of thirteen percent (13 percent).

LGU loans gravitated towards market, slaughterhouses and heavy equipment where opportunities for bribes and kickbacks were numerous. Unfortunately, these were investments where cost recovery was low due to low market fees and competition among contiguous areas. It also did not help any that the political environment cuddled behest loans.

The framework within which loans could be obtained by LGUs was weak. Loans from government financial institutions (GFIs) had to be endorsed by the Department of Finance. Some GFIs required that collaterals of LGUs should cover as much as 80 percent of the loan value. In simple terms, LGUs were not considered creditworthy.

The Local Government Code of 1991 retained the authority of LGUs to “create indebtedness and avail of credit facilities to finance local infrastructure and other socio-economic development projects in accordance with their local development program.”<sup>12</sup> The credit market however operates on profitability and no institution would provide loans to LGUs unless they are perceived to be creditworthy. The top lender to LGUs, the Land Bank of the Philippines classifies 43 percent of LGUs with low creditworthiness and only 2.4 percent is considered prime creditors. The volume of loans to LGUs remains thin, P3.9 billion or US \$95 million in 1998. This is far in comparison with the P62.6 billion or US\$1.53 billion of gross domestic borrowings of the national government in 1998.

But banking reforms have been instituted by government, particularly by the Ramos government, that could revitalize the access of LGUs to credit financing. These are the reforms relating to bank liberalization and financial stability of the economy. LGUs have presently greater access to banks since competition has spawned the establishment of branches in the countryside. Banks have also become service-oriented and their lending policies, market-oriented. Thus, it is notable that loans of the Land Bank of the Philippines, have been mostly directed to the financing of infrastructure, many of which are non-traditional- credit-financed-projects such as roads, reclamation, ports, schools and commercial buildings. The other GFI, the Development Bank of the Philippines (DBP), financed livelihood projects in LGUs such as cattle financing and fisheries sector financing program.

A direct intervention was also made by government to address the perception that LGUs are not creditworthy. Since local elections are held every three years, financial institutions face

---

<sup>11</sup> The paper written by Dr. Angel Q. Yoingco on “Credit Financing: The Philippine Experience” for ESCAP, United Nations in 1986 provides an excellent background.

<sup>12</sup> Section 296 of the Local Government Code of 1991.

the risks that debts incurred by the outgoing government would not be honored. An LGU Guaranty Corporation (LGUGC) was established to provide guarantees to loans and credits granted by participating member commercial banks for various capital investment projects of local governments. In case of default by the LGU on the loan, the guarantee can be called or a restructuring exercise can be undertaken by the lending financial institution.

### V. *Bond Financing for LGUs*

The LGUs are given the power to issue bonds to finance self-liquidating projects that are components of the local development plan or the public investment program of the LGU. The flotation of the bond as well as its terms must be approved by the local legislative council.<sup>13</sup>

Although the issuance of bonds had long been a power of LGUs, it was only in 1990 when a local government unit, the province of Cebu, ventured into bond flotation. The P300 million issue had a term of three years, tax-free interest income at 16 percent with principal repayments in the form of class A shares of a corporation that was formed by the province in a joint venture with a private corporation. The bond marked a milestone in the history of credit financing for LGUs, and was well received by the market. Three factors proved crucial to the success of the bond: a partnership with a respected private corporation; the securitization of the assets of the provincial government; and a tax exemption on the interest income.

There had been five more issues of bonds by LGUs and they were all for the purpose of financing housing projects. The term of the bonds was from two to three years and was of relatively small size (P8.0 to P26.0 million). Although the interest from the bonds was subject to tax, the bonds were also received well by the market. The safety net was a national government guarantee.

The bond market for LGUs has relatively been timid. Many have suggested that it could have more life if income from the bonds is exempt from taxation. This can be a panacea however. The overall bond market in the Philippines is still in its infancy stage. There is no secondary market for bonds. Most of the credit instruments of the central government and the private sector are mostly short-term in nature.<sup>14</sup> Longer-term bonds are needed to finance infrastructure projects in LGUs given their long gestation period. Local governments would also be competing with the central government and the private sector in the bond market. A tax exemption cannot compensate for the lack of a strong confidence on the bond issuer.

### VI. *The Structure of LGU Expenditures*

The allocation of expenditure responsibilities to LGUs started in the right way. They were assigned functions that they could perform best. Primary health care, which used to be a function of the national government, was devolved to the municipal government. The operation and maintenance of provincial hospitals was also turned over to the provincial

---

<sup>13</sup> Sec. 299 of the Local Government Code of 1991.

<sup>14</sup> The Ramos government introduced long-term credit instruments (5 to 15 years) in 1996 and the initiative was helped by the strong fiscal position of government.

government.

It was also deemed that the enforcement of environmental laws could best be carried out by LGUs where the natural resources are. It was reasonable to expect that the local community would have a greater sense of ownership and responsibility over them.

The provision of on-site research and extension services in agriculture was also turned over to the LGUs with the belief that these would be demand-driven.

Following the assignment of expenditures, the costs of the devolved functions were quantified. The estimate provided a rough gauge of the additional resources that should be transferred to LGUs to enable them to continuously finance the devolved functions. In 1993, the total costs of functions that were devolved to LGUs were estimated at P6.6 billion. The internal revenue allotment (IRA) on the other hand was about P27.96 billion leaving LGUs with a total net transfer of P10.83 billion.<sup>15</sup>

On the aggregate level, some rhyme and reason could be discerned in the effort of Congress to match national allotments with LGU expenditures. But the rhyme ended there. It did not continue in the design of the allotment formula or in the rationalization of local taxing powers. Thus, it happened that some LGUs found themselves with abundant resources and others ended with meager income. Many of the provincial governments were worse-off with the devolution program. In some provinces, i.e. Bataan and Catanduanes, the costs of devolved function were bigger than the increase in their allotments. About 34 percent of the provinces faced similar dilemma. In other provinces, e.g., Ilocos Sur, Surigao Del Norte, Southern Leyte, Romblon, and Northern Samar, the increase in their allotments was just enough to finance the devolved functions. This financial problem was not helped by the assignment of nominal taxes to the provincial governments.

The mismatch in the assignment of expenditures and resources especially to provincial governments continues to be a lingering problem. Interim measures were adopted in the past including netting out the costs of devolved functions prior to the allocation of grants. These were palliative in nature and the need to adopt long-term solutions remained. Some of the problems resulted from the inefficient allocation of national expenditures due to political patronage during the martial law regime. It happened thus that some provinces ended up with more provincial hospitals, and public infrastructure relative to the others. It was fine as long as the central government financed them. But with the devolution program, LGUs have been faced with the choice of maintaining these facilities, downsizing the local bureaucracy, closing these facilities or privatizing them. The choice has been hard for many provinces. Those who opted to privatize and downsize the LGU bureaucracy have been few in numbers, e.g. the province of Bulacan. The reluctant LGUs cope by living within their budgets.

On the average, annual expenditures of LGUs grow by only as much as their revenue growth. From 1986 to 1998, LGU expenditures grew by 22.41 percent their while revenues grew at 21.64 percent every year. During periods when expenditure growth outpaced revenue growth, LGUs introduced adjustment measures either through reducing their expenditures on capital outlays or reducing the amount intended to generate a surplus. The existence of a surplus in LGU budgets can be quite intriguing considering the low provision of LGUs for capital spending. The irregularity in the release of allotments contributes to the accumulation

---

<sup>15</sup> Net transfer was estimated in the Guevara et. al. study as:

Net transfer = [1993 IRA less 1991 IRA] – costs of devolved functions.

of surpluses. There are cases when LGUs are informed of their actual allotment after they have formulated and enacted their budgets. Such a situation gives them very little leverage to adjust their expenditure programs. As a result, they find themselves with unspent funds at the end of the fiscal year. The short-term orientation of LGU officials stunts investments on projects with long gestation period.

About 90 percent of the expenditures of LGUs are used to finance their current operating expenditures. These are goods and services that are used or consumed within a calendar year. This pattern leaves only 10 percent of their income to be spent for capital outlays. This trend has not changed in the last decade and is true for all levels of local governments.

About one-third of LGUs income are spent for general administration and a little over one-fifth is spent for public welfare and internal safety. The latter includes maintenance of the police force and health workers. Only 13 percent is spent for economic development and a measly 4 percent is devoted to operation of economic enterprises. In most cases, expenditures on economic enterprises only equalled the revenues, which these enterprises raised.

LGU budgeting rules and procedures are similar to those that are followed by the national government. These are prescribed by the Local Government Code. The Local Chief Executive submits a proposed budget for consideration of the Local Legislative Council on or before October 16 of each year. The budget contains an estimate of the income of the LGU and its expenditure program. A Local Finance Committee that is composed of the treasurer, the budget officer and the planning officer, helps the local chief executive in drawing up the local budget, in coordination with all the departments.

While the LGU budgets are no longer reviewed by the central government as practiced in the past, there are still a number of restrictions on budgeting that are prescribed by law.

- Twenty percent (20%) of the allotment from the central government should be used for development expenditures.
- The budget for personal services cannot go beyond ceilings: 45 percent of the regular income for first to third class LGUs; and 55 percent for LGUs from lower income classes.
- The amount of salaries for local personnel cannot exceed those that are prescribed under national laws.
- The discretionary fund of the local chief executive cannot exceed 2 percent of the actual receipts from the real property tax from the preceding year.
- Earmarked revenues, i.e. the special education fund tax, proceeds from loans and borrowings, receipts from public utilities and economic enterprises; should be maintained in special accounts.

Supplemental budgets can be enacted by LGUs but only to meet exigencies such as public calamities.

In cases when the local legislative council fails to enact the budget before the beginning of the fiscal year, the current operating budget is deemed re-enacted until a new budget is approved.

## VII. *The Realities of Decentralization*

There are major initiatives in Congress to amend the Local Government Code. Topping the list of priority measures is the increase in the allotment shares of LGUs to as much as 60 percent. It is as if the provision of more resources to LGUs is the heart of decentralization.

This lopsided view could partly explain why local governments are still dependent on the central government. It ignores one of the basic rules of decentralization, that is, local governments must believe that they are "on their own."<sup>16</sup>

Local governments had hardly been on their own. For many years, the national government continuously financed the costs of devolution. Congressional leaders constantly used their pork barrels to prop up the local budgets. The President is constantly besieged for dole-outs. Regional cabinet meetings are used as forums by LGU officials to ask for financial assistance

Thus, the relationship between the central government and the local governments remains paternalistic. The parent-child relationship serves as a political handle, which continuously provides national officials with power and control. The President acts as the godfather and the congressmen serve as the district chieftains. Since the party system practically does not exist in the Philippines, local leaders shift their allegiance to the political party, or the person in power. There are no philosophies or platforms. The rule is to be allied with the party or person in power to keep the goodies flowing.

The political structure provides little incentive or pressure for LGUs to optimize their revenue-raising powers. They have recourse to national sources to help finance their budget. The allotment system does not also provide an incentive to LGUs with high revenue effort. The criteria for the grant distribution are almost neutral with respect to taxable capacity and tax effort. These conditions do not promote accountability. Voters are unable to realize that they have to pay a price for the production of adequate public goods and services. Local leaders also shy away from using their taxing powers efficiently so as not to antagonize the community.

The more difficult part of decentralization is developing governance. LGU officials should be held accountable on how public funds are spent. The mechanisms whereby public decision and transactions can be made transparent are currently inadequate. Although there are rules on budgeting and procurement of public goods and services, access to information on how these rules are complied with remains limited. More importantly, there is very little incentive for the community to get itself informed and involved with the decision making process in government. Since the community has been unable to organize itself for advocacy, corruption problems persist and the traditional power structures remain strong.

## VIII. *Hope for the Future*

But there is hope for the future. There are numerous examples of LGUs that have excelled

---

<sup>16</sup> Roy W. Bahl, "Implementation Rules for Fiscal Decentralization", a paper presented at the International Seminar on Land Policy and Economic Development, International Center for Land policy Studies and Training, November 17, 1998.

in local governance with the use of their own resources. A notable example is Marikina, a suburb outside Manila. On its own, the city has revived its dying river, reinvigorated the shoe industry, resettled squatters, instituted discipline among the citizens to keep the community clean and green, kept the market place orderly, installed public facilities that are regularly maintained, and replicated the “911 emergency service” in the United States. The taxpayers willingly pay their taxes because they see where their money is being spent. There are examples of Marikina in many places in the Philippines and efforts are being institutionalized to replicate such inspiring and pioneering programs of excellence as well as leadership styles.<sup>17</sup>

Certain practices, which foster decentralization, are also in place. LGU officials are elected locally and many of the local personnel are appointed directly by the local chief executive.<sup>18</sup> Budgets are also approved by the local legislative councils.

Non-traditional means of providing public goods or services are currently available to LGUs. The opportunities to finance infrastructure projects through Build-operate transfer schemes (BOT) are unlimited. The LGUs can bank on the very successful experience of the central government in solving the power crisis in the early nineties through BOT programs. The BOT Law, or Republic Act 6957 provides the framework for the use of BOT schemes by the LGUs.<sup>19</sup> BOT schemes require very little upfront investments from LGUs. In addition, the private sector assumes certain risks, which were traditionally borne by government.

The Philippine government has also proven its capability to introduce drastic and structural reforms with a few policy reformists who are armed with good policy studies.<sup>20</sup> The agenda for reforms can include:

1. The restructuring of the grant system so that the formula can help equalize fiscal resources and encourage LGUs to efficiently mobilize local resources;
2. The automatic release of grants to respect the fiscal autonomy of local governments;
3. The reallocation of revenue-raising powers to consider the assignment of expenditures among different levels of government;
4. The rationalization of local taxing powers so that the tax bases can be broadened and the tax administration simpler;
5. The transformation of national government agencies from regulators of LGUs to providers of technical assistance to LGU officials; and,
6. The empowerment of communities to participate in local planning and monitoring the execution of the budget.

---

<sup>17</sup> The “Galing Pook Awards” is expected to be a nationally popular movement among local governments in the Philippines.

<sup>18</sup> One exception is the local treasurer who remains to be an appointee of the Secretary of Finance.

<sup>19</sup> Sec. 302 of the Local Government Code.

<sup>20</sup> The Ramos Government instituted major structural reforms on banking, taxation, tariff, energy, education, privatization, among others.