

WHY PURSUE **FEDERALISM?** WHY NOT JUST CHANGE THE **LOCAL GOVERNMENT CODE?**

PRESENTATION BY

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ROUND TABLE DISCUSSION ORGANIZED BY
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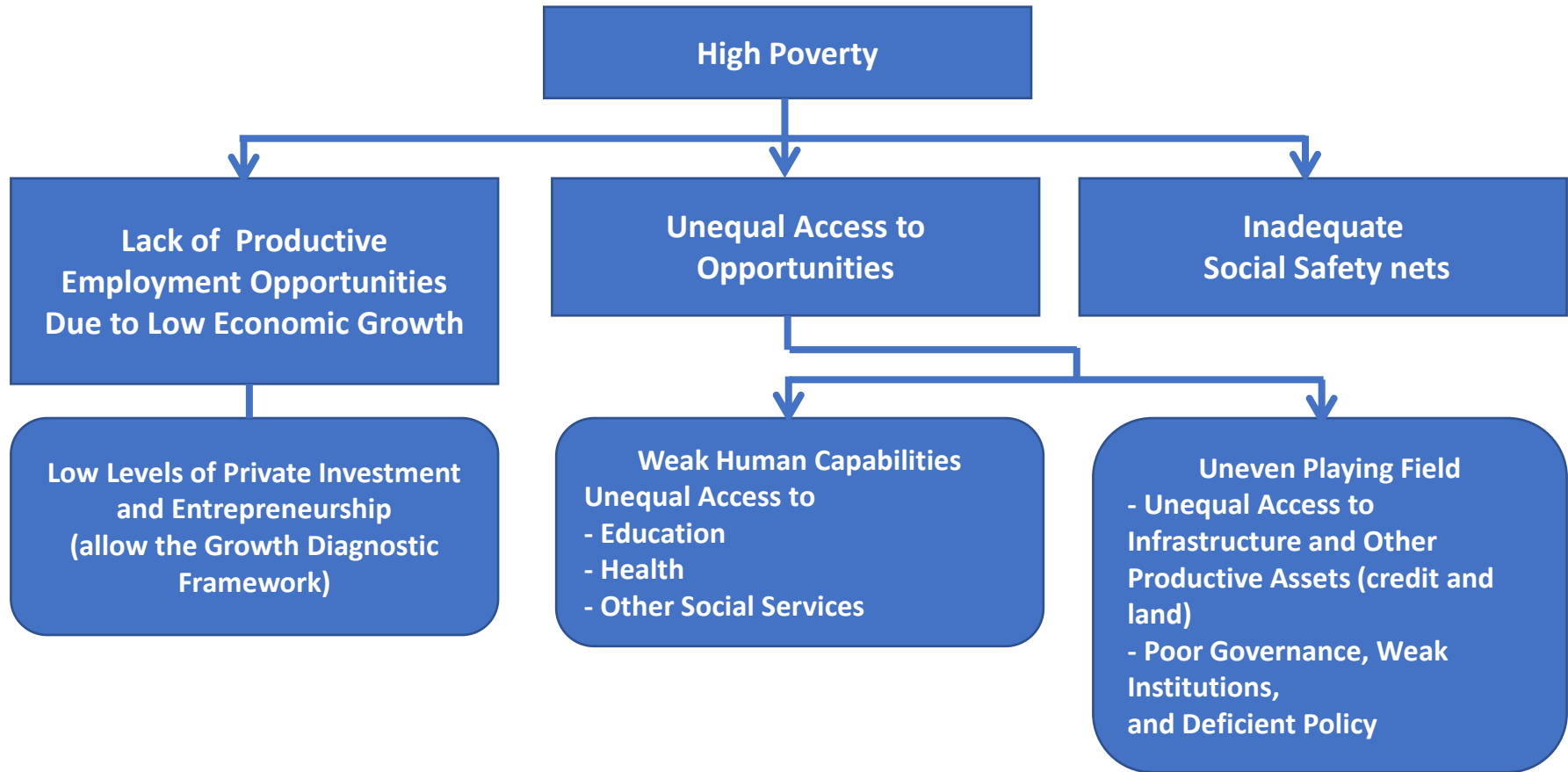


Proportion of population living on US\$1.90 a day, in percent
(2011 purchasing power parity), selected ASEAN countries, 1980s to 2010s

Country/Year	1980s	1990s	2000s	2010s
Indonesia	70.2	53.1	25.9	11.9
Malaysia	2.2	1.1	0.4	--
Philippines	26.6	23.1	15.9	13.1
Thailand	16.9	4.3	0.8	0.1
Vietnam	--	42.0	26.0	3.7

Source of data: World Development Indicators database, as updated on 01/03/2017

Diagnostic Framework for Poverty



SOURCE:
Asian Development Bank (2007). Philippines:
Critical Development Constraints

Selected Indicators on the Quality of Infrastructure
Global Competitiveness Index for 2015-2016

	Rank out of 140 Countries (1 as best, 140 as poorest)					
	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam
Quality of overall infrastructure	81	16	106	4	71	99
A. Transport infrastructure	39	10	81	3	34	67
Quality of roads	80	15	97	3	51	93
Quality of railroad infrastructure	43	13	84	8	78	48
Quality of port infrastructure	82	16	103	2	52	76
Quality of air transport infrastructure	66	21	98	1	38	75
Available airline seat km/week, millions*	15	22	27	20	14	30
B. Electricity and telephony infrastructure	80	45	95	5	64	78
Quality of electricity supply	86	36	89	3	56	87
Fixed telephone lines/100 pop.*	80	73	108	29	88	100
Mobile telephone subscriptions/100 pop.*	49	24	76	14	31	28

SOURCE:
World Economic Forum 2015



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Selected Indicators on the Quality of Public Institutions

Global Competitiveness Index for 2015-2016

	Rank out of 140 Countries (1 as best, 140 as poorest)					
	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam
Diversion of public funds	56	25	100	4	96	67
Public trust in politicians	41	14	89	1	118	45
Irregular payments and bribes	86	37	95	3	81	106
Wastefulness of government spending	30	8	61	3	113	85
Burden of government regulation	41	6	101	1	81	90
Transparency of government policymaking	66	17	85	1	97	89
Government efficiency	46	11	83	1	78	80

SOURCE:
World Economic Forum 2015



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Commission on Audit, Audit Performance Summary Report For Calendar Year 2011

Table II.7-A. Common Audit Findings with Pecuniary Loss

Particular	Total	
	No. of Findings	Amount (in Million Pesos)
1. Unauthorized/Irregular/Unnecessary expenses	1,642	18,653.516
2. Unliquidated Cash Advances	1,003	7,534.153
3. No bidding/Not in Accordance with Procurement Law	692	15,163.353
4. Underassessment/Undercollection	157	20,813.224
5. Unutilized/Ineffective Projects	104	13,583.533
6. Lack of appropriation	100	525.363
7. Unliquidated Fund Transfer	77	6,800.313
8. Delayed remittance/unremitted withholding tax/loans/premiums of employees and other trust liabilities	73	750.910
9. Non-existent cash/unaccounted assets	49	1,199.753
10. Unimplemented projects/Unutilized funds	47	3,276.235
11. Shortages and malversation of funds	42	282.327
12. Delayed implementation of projects/ suspended projects	36	2,554.056
13. Unremitted/ Uncollected income/Accounts Receivables	34	3,511.810
14. Overpricing / excessive contract cost	34	1,117.419
15. Unsettled Suspensions/Disallowances/Charges	32	203.750
16. Fictitious claims/expenses	26	5,198.772
17. Untitled land purchased/ owned	17	390.671
18. Undeposited collections	9	149.658
19. Unrecouped advances/mobilization	6	107.860

Economic growth and living condition in the Philippines are highly uneven across regions.

Population, Gross Regional Domestic Product, Poverty, Human Development Index by Region, 2012, 2015

Region	Population	Gross Regional Domestic Product		Poverty Incidence		Human Development Index
	Percent Share (%)	Percent Share (%)		Percent		
	2015	2012	2015	2012	2015	
PHILIPPINES	100.0	100.0	100.0	25.2	21.6	0.644
NCR	12.8	36.2	37.9	3.9	3.9	0.829
CAR	1.7	1.9	1.8	22.8	19.7	0.542
ILOCOS	5.0	3.1	3.1	18.5	13.1	0.660
CAGAYAN	3.4	1.7	1.8	22.1	15.8	0.584
CENTRAL LUZON	11.1	9.1	8.9	12.9	11.2	0.642
CALABARZON	14.3	16.8	15.5	10.9	9.1	0.700
MIMAROPA	2.9	1.8	1.5	31.0	24.4	0.558
BICOL	5.7	2.1	2.1	41.1	36.0	0.507
WESTERN VISAYAS	7.5	4.1	4.1	29.1	22.4	0.613
CENTRAL VISAYAS	7.3	6.4	6.5	30.2	27.6	0.605
EASTERN VISAYAS	4.4	2.2	2.0	45.2	38.7	0.494
ZAMBOANGA PENINSULA	3.6	2.1	2.1	40.1	33.9	0.505
NORTHERN MINDANAO	4.6	3.9	3.9	39.5	36.6	0.529
DAVAO	4.8	4.0	4.2	30.7	22.0	0.521
SOCCKSARGEN	4.5	2.7	2.7	44.7	37.3	0.483
CARAGA	2.6	1.2	1.2	40.3	39.1	0.506
ARMM	3.7	0.9	0.7	55.8	53.7	0.330

Source: NSCB & Philippine Statistics Authority

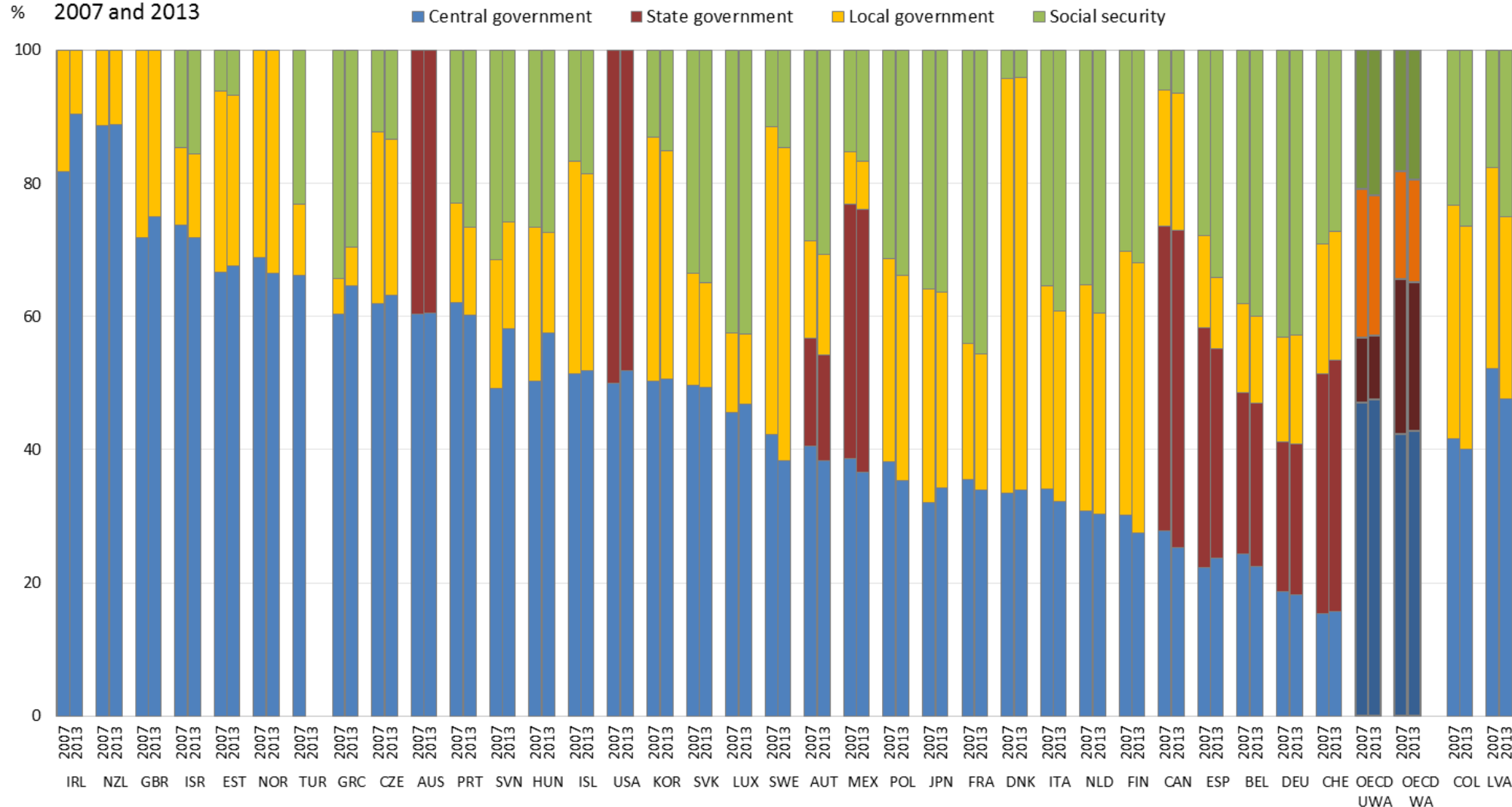
National Government and Local Government shares in total Government Expenditures, Philippines, 2009, 2011, 2013, and 2015

	Billion Pesos				Percent Share (percent)			
	2009	2011	2013	2015	2009	2011	2013	2015
National Government	841.3	987.9	1,352.3	1,810.1	75.7	76.3	80.0	82.7
Department	624.4	806.7	1,025.3	1,411.4	56.1	62.3	60.6	64.5
Central Office & NCR	330.2	494.4	383.3	496.0	29.7	38.2	22.7	22.7
Regional	294.1	312.3	642.0	915.4	26.4	24.1	38.0	41.8
Special Purpose Funds Net of Transfers to LGUs & Debt Service	216.9	181.2	327.0	398.8	19.5	14.0	19.3	18.2
Local Government	270.8	306.5	338.8	378.1	24.3	23.7	20.0	17.3
Provinces	63.7	73.1	76.0	89.7	5.7	5.6	4.5	4.1
Cities	111.4	120.3	144.9	150.7	10.0	9.3	8.6	6.9
Municipalities	95.7	113.1	117.9	137.7	8.6	8.7	7.0	6.3
TOTAL	1,112.0	1,294.5	1,691.0	2,188.2	100.0	100.0	100.0	100.0

Source of basic data: Department of Budget and Management, Budget of Expenditures and Sources of Financing (various issues). Bureau of Local Government Finance, Statement of Receipts and Expenditures (various issues).

Distribution of general government expenditures across levels of government, 2007 and 2013

% 2007 and 2013



Source: OECD National Accounts Statistics (database)

**National government and local government shares in total government revenues,
Philippines, 1990, 2000, 2010, and 2015**

Particulars	Percent Share							
	1990		2000		2010		2015	
	NG	LGUs	NG	LGUs	NG	LGUs	NG	LGUs
Tax Revenues	96.2	3.8	93.5	6.5	93.9	6.1	93.7	6.3
Non-Tax	89.2	10.8	83.6	16.4	76.3	23.7	85.4	14.6
Total Revenues	95.1	4.9	92.4	7.6	91.9	8.1	92.4	7.6
As Percentage of GDP								
	1990		2000		2010		2015	
	NG	LGUs	NG	LGUs	NG	LGUs	NG	LGUs
Tax Revenues	14.1	0.6	14.6	1.0	12.1	0.8	13.6	0.9
Non-Tax	2.5	0.3	2.8	0.3	1.3	0.4	2.2	0.4
Total Revenues	16.8	0.9	17.7	1.3	13.4	1.2	15.8	1.3

Source of basic data: Department of Budget and Management. Budget of Expenditures and Sources of Financing (Various issues), Bureau of Local Government Finance. Statement of Receipts and Expenditures (Various issues)

Tax revenues of sub-sectors of general government as % of total tax revenue

	Central government		
	1975	1995	2014
Federal countries			
Australia	80.1	77.5	80.0
Austria	51.7	64.8	66.5
Belgium	65.3	60.1	57.4
Canada	47.6	39.1	41.4
Germany	33.5	31.4	31.2
Mexico	..	73.9	73.3
Switzerland	30.7	31.6	35.2
United States	45.4	41.4	42.1
Unweighted average	50.6	52.5	53.4
Regional country			
Spain (1,2)	48.2	50.4	42.3
Unitary countries			
Chile	..	89.9	86.7
Czech Republic	..	57.7	54.5
Denmark (2)	68.9	68.2	74.6
Estonia	..	84.3	82.0
Finland	56.0	46.6	47.4
France (2)	51.2	42.3	33.1
Greece (2)	67.1	66.8	68.6
Hungary	..	63.8	60.8
Iceland	81.3	79.2	75.5
Ireland	77.4	83.1	82.4
Israel	..	79.7	75.6
Italy	53.2	62.7	53.4
Japan	45.4	41.2	36.9
Korea	89.0	69.2	56.2
Netherlands	58.9	56.0	55.6
New Zealand	92.3	94.7	93.3
Norway	50.6	58.4	86.1
Poland	..	61.9	48.2
Portugal	65.4	72.3	67.8
United Kingdom	70.5	77.5	75.8
Unweighted average	65.1	65.5	63.5

Source: Revenue Statistics 2016 / Statistiques des recettes publiques 2016 - © OECD 2016

Sectoral vs Integrated, ecosystem-based governance

- Past policy and institutional arrangements have failed to adequately address the implications of local geography and have caused significant costs to human development (e.g. lost adult productivity and healthy days, missed school attendance, substandard agricultural yields, food insecurity, forfeited agglomeration economies, and lost growth).
- Human development costs arise from a national organization that is arranged as vertical silos by sector or agency and, within each agency, by program.

-- 2012/2013 Philippine Human Development Report

Common Pool Resource

A common resource pool is a resource that is available for the joint use of numerous individuals (property of non-excludability) but where the consumption of the resource by an individual or group reduces the amount available to others (property of rivalry in use). Individuals or groups are thus inclined to use more of these resources but to invest less in their upkeep. The result is the overuse of common pool resources or a condition called “*tragedy of commons*” (Grossman, 2010).

Common Pool Resource Problem

The *centralization of revenues* created a *common pool resource* with its *attendant problems*:

- Fiscal illusion and weak fiscal discipline
- Weak allocative and operational efficiency
("Divide by N" – Fragmentation)
- Tolerance of corruption
- Patronage politics and political dynasties

Common Pool Resource Problem

- It is also the interest of each sector/locality/group to minimize its share of the tax burden.
- A major reason for the Philippines' weak tax effort relative to its regional peers is the numerous tax exemptions given to various sectors and groups, e.g., senior citizens, persons with disabilities, boy scouts and girl scouts, cooperatives, economic zones, etc.
- The Philippines' value added tax system, for instance, has the highest number of line exemptions at 143 compared to Indonesia's 37, Thailand's 35, Vietnam's 25, and Malaysia's 14 (Department of Finance, 2017).

How do we reduce the common pool resource?

- Expenditure Assignment (Subsidiarity and Fiscal Equivalence)
- Tax Assignment (Finance follows function)
- Appropriate intergovernmental transfers (design follows objective)
- Better intergovernmental relations

Considering

- Vertical Fiscal Balance
- Horizontal Fiscal Balance

CONSOLIDATED PUBLIC SECTOR FINANCIAL POSITION

(in billion pesos)

PARTICULARS	2015	2016	2017 Program	2018 Projection
PUBLIC SECTOR BORROWING REQ'T.	(113.8)	(316.4)	(464.9)	(510.3)
National Government	(121.7)	(353.4)	(482.1)	(523.6)
CB Restructuring	(3.7)	(3.2)	(2.7)	(6.1)
Monitored GOCCs *	2.8	24.9	3.9	2.7
Adjustment of Net Lending & Equity to GOCCs	8.9	15.3	16.0	16.8
OTHER PUBLIC SECTOR	250.0	295.3	295.2	349.1
SSS/GSIS/PHIC *	60.6	72.4	75.5	84.7
Bangko Sentral ng Pilipinas	(3.7)	17.7	1.0	1.0
Government Financial Institutions *	13.8	15.5	12.2	14.2
Local Government Units	179.2	189.6	206.5	249.2
CONSOLIDATED PUBLIC SECTOR SURPLUS/(DEFICIT)	136.2	(21.1)	(169.7)	(161.2)

Highly Fragmented Local Government System

TABLE 1.3 Vertical Organization of Intergovernmental Systems in East Asia, 2005

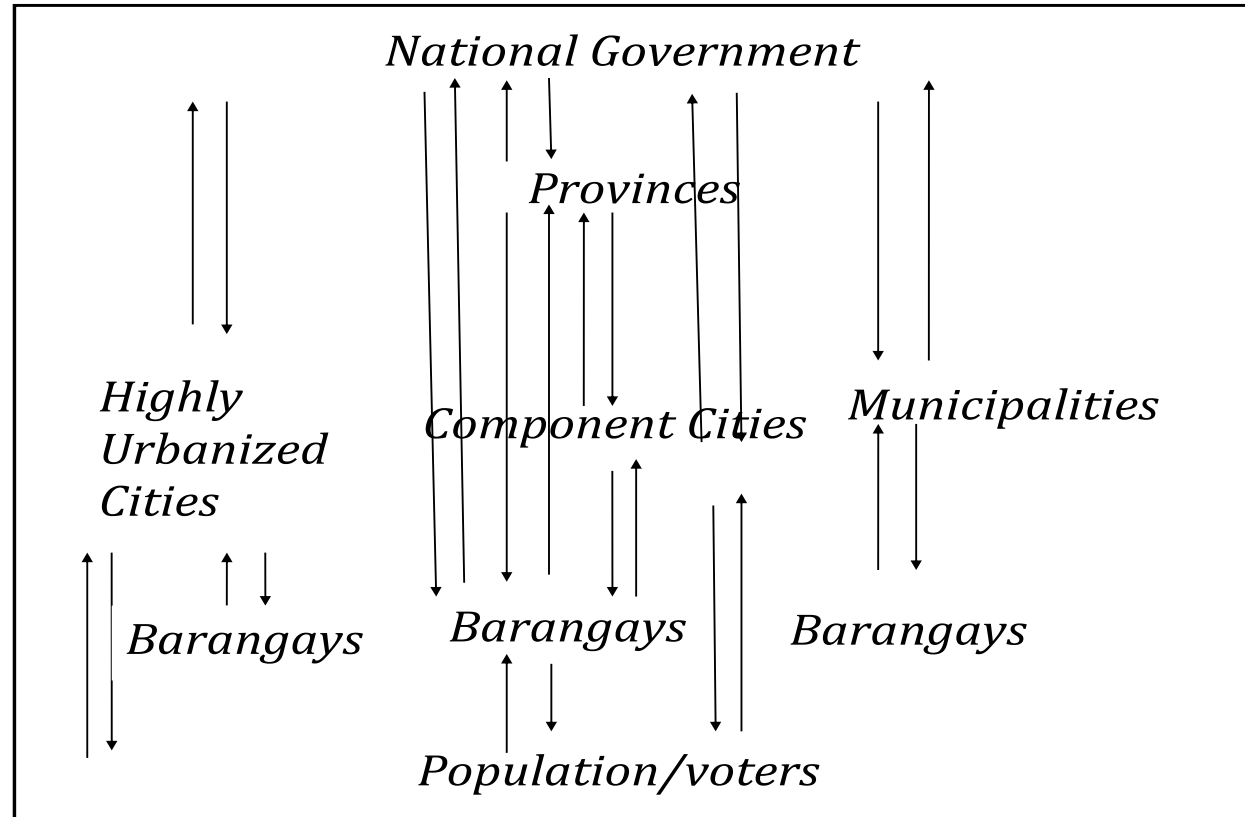
Country	Levels of subnational government ^a	Number of first-tier subnational governments	Average population of first-tier subnational governments (millions, 2002)
Cambodia	2	24	0.5
China	4	32	40.0
Indonesia	3	32	7.0
Philippines	4	149	0.5
Thailand	3	76	0.8
Vietnam	3	61	1.3

Sources: Various country case studies prepared for this report and World Bank statistics.

a. "Level" refers to an organ of government with some degree of formal budget (expenditure) authority. In some cases (such as Indonesia), this can be highly circumscribed, particularly at the lowest levels.

NOTE: As of 2017, the Philippines has 81 provinces and 145 cities (except for Isabela City and Cotabato City, all cities are highly urbanized and independent cities).

Fragmented local government units + patronage politics = Fragmented government services



Number of LGUs

Provinces:	81
Cities:	145
Municipalities:	1,489
Barangays:	42,036

Notes:

- National Government deals directly with all local government levels
- Provinces are fiscally, the weakest.
- Cities are fiscally, the strongest.

Autonomy and Coordination

- Based on international experiences, autonomy, by itself, is not sufficient guarantee of improved governance and service delivery. Government services are diverse and complicated; they have both national and local dimensions that require coordination and cooperation among players at all levels (Australia DFAT and The World Bank, 2015) .
- Effective coordination among government tiers requires clear division of responsibilities, adequate funding, and bureaucratic capacity at all government levels. As a whole, the Philippines falls short of these requirements (Balisacan, Hill, Piza, 2006)

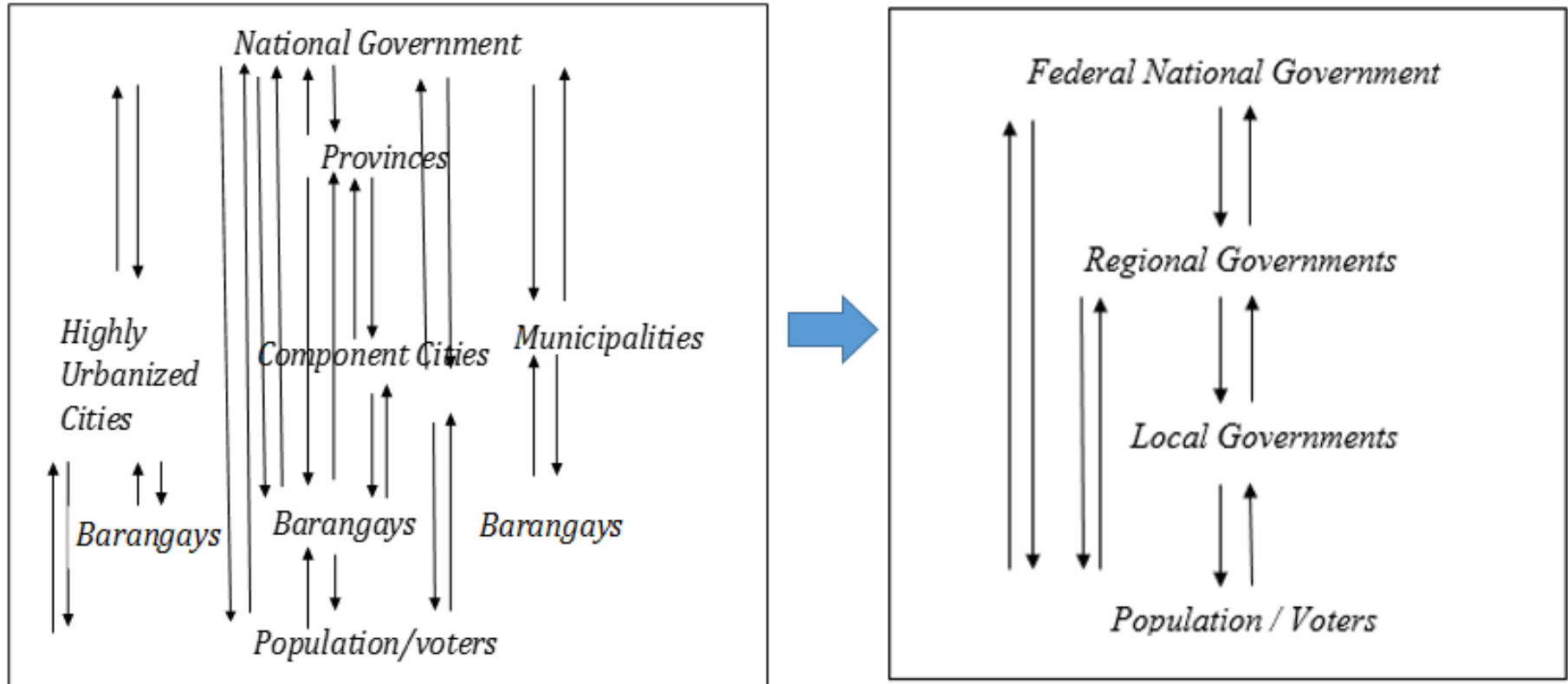
1987 Philippine Constitution

- **SEC. 2.**
The territorial and political subdivisions shall enjoy local autonomy.
- **SEC. 11.**
The Congress may, by law, create special metropolitan political subdivisions, x x x. The component cities and municipalities shall retain their basic autonomy and shall be entitled to their own local executives and legislative assemblies. The jurisdiction of the metropolitan authority that will hereby be created shall be limited to basic services requiring coordination.
- **SEC. 12.**
Cities that are highly urbanized, as determined by law, and component cities whose charters prohibit their voters from voting for provincial elective officials, shall be independent of the province. x x x

FEDERALISM

- 2 Constitutionally established orders of government primarily accountable to its respective electorates:
 1. Federal Government
 2. Regional Government (includes our current local governments)
- Self-rule (Autonomy) and Shared-rule

Shift to Federal Government



Critical Aspects of (Fiscal)Federalism:

- Proper and Clear Assignment of Functions (exclusive vs shared)
- Vertical Fiscal Balance: Expenditure functions of the different levels of government should be matched with corresponding revenue raising powers
- Horizontal Fiscal Balance: Each unit within a particular level of government (or each state in a federal system) has the capacity to provide services at a comparable standard.
- Well designed intergovernmental relation and institutions that facilitate self-rule and shared-rule (e.g. state representation in federal policy making, intergovernmental fiscal institutions to facilitate tax harmonization and fiscal equalization, etc.)

Thank you very much.



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