

Local Public Finance in the Philippines: Lessons in Autonomy and Accountability

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ABSTRACT

Twelve years into the implementation of the Local Government Code of 1991, it is but opportune to assess how the key features of this landmark legislation has contributed to (or detracted from) achieving the balance between local autonomy and accountability. The literature on fiscal decentralization suggests that these two goals are not incompatible. In fact, real autonomy (in the sense of subnational governments being able to link their spending decisions with their revenue/tax decisions) promotes fiscal responsibility. In the context of the ongoing debate in the Philippines, however, local autonomy has been equated (by many LGUs officials) with the independence of LGUs from central government interference. As such, LGU officials have focused more on securing even higher levels of block grants in order to address the widely perceived vertical fiscal imbalance. However, closer scrutiny of the problem indicates that greater tax decentralization, coupled with a well-designed inter-governmental transfer system that includes elements of fiscal equalization and categorical grants conditional on the achievement of minimum service standards, would better enhance the gains that are forthcoming from the decentralization process while minimizing the risks of macro-instability.

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INTRODUCTION

The passage of the Local Government Code (Republic Act 7160) in 1991 marked the start of fiscal decentralization in the Philippines. Fifteen years into its implementation, now is an opportune time to assess how this landmark legislation has contributed to (or detracted from) the achievement of local autonomy with accountability.

It is clear from the literature on fiscal decentralization that these two goals are not incompatible. The theory of fiscal federalism suggests that autonomy (in the sense of local governments being able to link their spending decisions with their revenue/tax decisions) promotes fiscal responsibility (Bird 1999). In other words, when local governments are truly autonomous "only by choosing to pay higher or lower taxes can residents of subnational jurisdictions choose the level of public services they want" (McLure and Martinez-Vazquez 2002). Consequently, local constituents are more vigilant in enforcing the accountability of local officials because the connection between the amount of local services they receive and the amount of local taxes they pay at the margin is clear to them.

LOCAL GOVERNMENT STRUCTURE

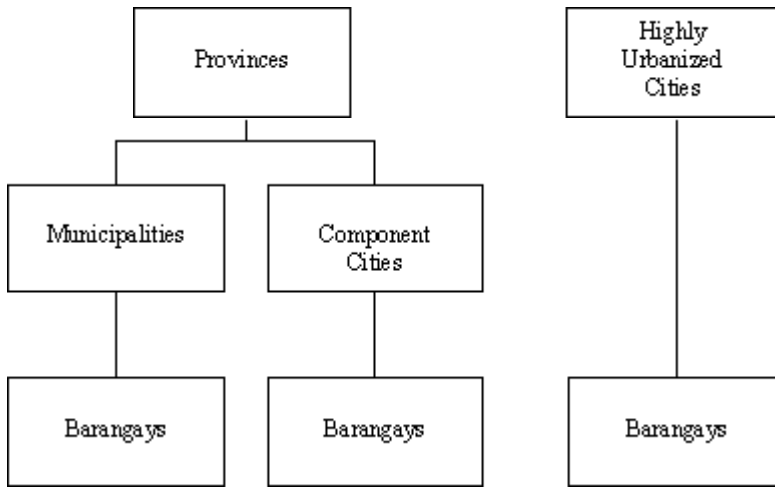
The Philippines has a unitary form of government with a multitiered structure. It is a presidential republic with a bicameral legislature. The central government operates through some 20 departments/agencies. Administratively, the country is divided into 15 administrative regions and most departments maintain regional offices. However, these regions (except for the Autonomous Region in Muslim Mindanao or ARMM) are just administrative subdivisions, not regional governments with elected regional officials.

The second tier of government is composed of local government units (LGUs) and one autonomous region, the ARMM. In general, the local government structure is composed of three layers.¹ Provinces comprise the first layer. In turn, the province is divided into municipalities and component cities, each of which is further subdivided into barangays, the smallest political unit. At the same time, independent cities exist at the same level as the provinces, i.e., they share the same functions and authorities. Independent cities, however, are divided directly into barangays (Figure 1).

Each level of LGU is headed by an elected chief executive (governor, mayor, or barangay captain) and has a legislative body, called Sanggunian (composed of an elected vice-governor/ vice-mayor and council members). All elected officials have a three-year term of office and are subject to a three-term limit. To a

¹ There are four layers in the case of the autonomous region, with the regional government comprising three layers of local government, as discussed below.

Figure 1. Philippine local government units



large extent, each level of local government is autonomous although the higher level of government (e.g., province) exercises some degree of supervision over lower level governments (e.g., municipalities and component cities) in terms of budgeting and legislation.

As of July 2004, the Philippines has a population of some 82 million living in 79 provinces, 116 cities, 1,500 municipalities, and some 41,974 barangays.² The barangay is the smallest political unit and typically composed of 100 to 500 households (or 500 to 2,000 individuals). The population of an average-size municipality is about 39,000; an average-size city has about 285,000 individuals; and an average-size province has about 835,000 individuals.

The Local Government Code of 1991 (also referred to as the Code) and the Organic Act for Muslim Mindanao (Republic Act 6734) of 1989³ jointly define central-local relations in the Philippines. On the one hand, the Organic Act granted the regional government powers that were previously held by the central government. It also provided for the ARMM's expanded share and automatic retention of national internal revenue taxes collected in the region, significant regional discretion in development planning, and primacy in the delivery of basic services and utilization and management of natural resources.

² These numbers change over time as new local government units are created or converted from one type to another. In 1991, there were 76 provinces, 66 cities, and 1,540 municipalities.

³ This law was subsequently amended in 2001.

Considered a landmark legislation, the Code gave rise to a major shift in local governance. It consolidated and amended the Local Government Code of 1983, the Local Tax Code (Presidential Decree 231), and the Real Property Tax Code (Presidential Decree 464). The Code includes far-reaching provisions concerning the assignment of functions across different levels of government, revenue sharing between the central and the local governments, resource generation/utilization authorities of LGUs, and the participation of civil society in various aspects of local governance. In toto, these provisions are aimed at providing the framework for increased local autonomy.

EXPENDITURE ASSIGNMENT AND SPENDING DISTRIBUTION

Legal framework

The Organic Act for Muslim Mindanao transfers to the regional government of the ARMM all powers, functions, and responsibilities heretofore being exercised by the central government except (1) foreign affairs; (2) national defense; (3) postal service; (4) fiscal and monetary policy; (5) administration of justice; (6) quarantine; (7) citizenship, naturalization, and immigration; (8) general auditing, civil service, and elections; (9) foreign trade; (10) maritime, land, and air transportation and communications that affect areas outside the ARMM; and (11) patents, trademarks, trade names, and copyrights. Consequently, the regional government is primarily responsible for the implementation of programs and projects on agriculture; agrarian reform, education; environment and natural resources; health; tourism, trade and industry; social welfare; industrial peace, protection of workers welfare and promotion of employment; promotion of cooperatives; provision of assistance to LGUs; and development and regulation of cooperatives.

On the other hand, the Local Government Code transferred from national government agencies to LGUs the principal responsibility for the delivery of basic services and the operation of facilities in the following areas: land use planning, agricultural extension and research, community-based forestry, solid waste disposal system, environmental management, pollution control, primary health care, hospital care, social welfare services, provincial/municipal/ city buildings and structures, public parks, municipal services and enterprises (like public markets and slaughterhouses), and local infrastructure facilities (like municipal/city and provincial roads and bridges, health facilities, housing, communal irrigation, water supply, drainage, sewerage, flood control, and intermunicipal telecommunications).⁴ In addition, the Code devolved the construction of public school buildings to LGUs. In contrast, prior to the implementation of the Code, the functions

⁴ Local Government Code, Section 17 (b).

assigned to LGUs were limited to the levy and collection of local taxes; the issuance and enforcement of regulations governing the operation of business activities in their jurisdictions; and the administration of certain services and facilities like garbage collection, public cemeteries, public markets, and slaughterhouses. Then, the central government had the primary responsibility for agricultural planning and extension, as well as construction and maintenance of local roads and public buildings and hospitals/ health care facilities.

Under the Code, provinces are assigned functions that involve intermunicipal provision of services whose catchment area covers more than one municipality, like operation and maintenance of district and provincial hospitals. On the other hand, municipalities are generally responsible for the delivery of frontline basic services, e.g., primary health care, construction, and maintenance of public elementary schools.

The devolution program transferred over 70,000 personnel from selected national government agencies to LGUs (Table 1). Corresponding to the shift in personnel and facilities,⁵ the budgets of most of these agencies were then cut by 20 percent to 60 percent initially (Table 2). The national government agencies that were most heavily affected by devolution in these terms were the Department of Agriculture (DA), Department of Health (DOH), Department of

Table 1. Number of devolved personnel, 1992

	Number of personnel before devolution	Number of devolved personnel	Ratio of devolved personnel to predevolution personnel (%)
Department of Agriculture	29,638	17,673	59.6
Office of the Secretary	29,234	17,664	60.4
National Meat Inspection Commission	404	9	2.2
Department of Budget and Management	3,532	1,650	46.7
Department of Environment and Natural Resources	21,320	895	4.2
Department of Health	74,896	45,896	61.3
Department of Social Welfare and Development	6,932	4,144	59.8
Other Executive Offices	191	25	13.1
Philippine Gamefowl Commission	191	25	13.1
Total	136,509	70,283	51.5

Source: 1993 National Expenditure Program, Regional Coordination Staff.

⁵ Facilities devolved include hospitals, rural health units, barangay health stations, women's/children's centers, demonstration farms and nurseries, and the like.

Table 2. Agency budgets and devolution, 1992 (in million pesos)

	Budget before devolution ^a	Devolved budget ^b	Ratio of devolved budget to predevolution budget (%)
Department of Agriculture	5,210.0	1,160.7	22.3
Department of Budget and Management	465.4	193.2	41.5
Department of Environment and Natural Resources	1,941.8	87.6	4.5
Department of Health	9,991.4	4,079.6	40.8
Department of Social Welfare and Development	1,320.7	742.7	56.2
Philippine Gamefowl Commission	15.2	0.6	4.1
Total	18,944.5	6,264.4	33.1

^a Based on the 1992 Expenditure Program.

^b Based on cost of devolved functions as allocated nationally by DBM to individual LGUs.

Social Welfare and Development (DSWD), and Department of Budget and Management (DBM).

Under Executive Order 507 (which defined the actual implementation of the devolution program mandated under the Local Government Code)⁶, many health programs (e.g., immunization, control of communicable diseases, provision of drugs and medicines to devolved facilities, and operation of hospitals in the National Capital Region or NCR) continue to be funded by the central government under the budget of the DOH. This implies that the central government budget for these activities was not devolved in the sense of being "disallowed" in the budget of the DOH in the post-devolution period. Similarly, the central government continues to allocate monies for the school building program (now called the Basic Education Facilities Fund) despite the fact that construction of school building is devolved to LGUs. This practice has serious implications on how the cost of devolved functions is reckoned, which is an important first step in gauging the adequacy of the Internal Revenue Allotment (IRA).

Assessment

The extensive literature on fiscal decentralization identifies the key features of expenditure assignment that enhance the efficiency gains from fiscal decentralization: (1) appropriate assignment of expenditure responsibilities across levels of

⁶ Executive Order 507 provides the DBM with guidelines on the choice of programs and activities that should be "excluded" or "disallowed" from the budgets of devolved central government agencies in the post-devolution period.

government and (2) unambiguous and clear assignment of functions.

The assignment of functions to the different levels of government is guided by the decentralization theorem, which states that "each public service should be provided by the jurisdiction having control over the minimum geographic area that would internalize the benefits and costs of such provision" (Oates 1972). This means that expenditure responsibilities whose benefits extend beyond subnational jurisdictions are best assigned to the central government while the provision of public goods and services whose benefits are confined within LGUs own political boundaries should be assigned to the respective LGUs. At the same time, the stabilization and the redistributive functions of government are best assigned to the central government because LGUs have limited capacity to affect macroeconomic conditions and they would find it difficult to sustain independent redistribution programs. On the other hand, the lack of clarity in the assignment of expenditure responsibility does not only give rise to disputes among the different levels of governments but also tends to blur accountability across levels of local government (McLure and Martinez-Vasquez 2002).

*Consistency with decentralization theorem.*⁷ The devolution of expenditure responsibilities to local governments under the Code is generally consistent with the decentralization theorem (Loehr and Manasan 1999). The activities devolved are those that can be provided at lower levels of government. Few of them have benefits that spill over outside the territorial jurisdiction of the LGU with the exception of those related to environmental management. Moreover, the Code permits LGUs to group themselves and coordinate their efforts, services, and resources for purposes that are mutually beneficial to them (Section 33 of the Code). To date, there have been many documented cases of smaller LGUs working together to carry out specific responsibilities (e.g., coastal resource management, solid waste management, water supply development and distribution) when economies of scale and/or externalities make such cooperative undertakings appropriate (e.g., Mercado and Manasan 1999).

One important exception to the application of the decentralization theorem in the Philippines is education. The primary responsibility for the provision of basic education rests with the central government although the construction and maintenance of school buildings is devolved to LGUs under the Local Government Code.⁸

⁷ The discussion that follows will focus on the assessment of expenditure assignment under the Code. The expenditure assignment under the Organic Act of the ARMM is explained in Box 1.

⁸ One of the reasons for not devolving basic education in the Philippines can be traced to the fact that teachers serve on the Board of Election Inspectors. That is, the teachers man the precincts during elections and play an important role in the counting of votes. During debates prior to the enactment of the Local Government Code, concerns were raised that devolving teachers could overly politicize elections at the local level.

Box 1. Assessment of expenditure assignment under the Organic Act of ARMM

A comparison of RA 6734 and RA 7160 shows that non-ARMM LGUs are treated on an almost equal footing as the regional government of ARMM in terms of expenditure assignment although the functions and responsibilities assigned to the regional government of ARMM are slightly broader than those given to non-ARMM LGUs. In particular, the regional government of the ARMM is charged with the provision of agrarian reform and education services, promotion of employment and workers' welfare, and promotion of trade and industry while LGUs outside of ARMM are not.

On the other hand, ARMM-LGUs and non-ARMM LGUs are treated asymmetrically in terms of the expenditure responsibilities that are assigned to them. This is so because the regional government of the ARMM has not devolved any of its functions to the LGUs within its jurisdiction even if RA 6734 allows it to do so. Thus, ARMM-LGUs are not responsible for any of the devolved activities that have been transferred to non-ARMM LGUs under the Local Government Code of 1991.

In contrast, basic education is administered by local governments in many countries. Three arguments are generally offered why primary education should be decentralized: (1) the provision of education services is spread out geographically; (2) smaller schools are generally found to provide higher quality education; and (3) direct involvement of parents and the local community in schools is observed to be a beneficial determinant of school quality (Ahmad et al. 1997). However, the decentralization of education finance tends to lead to large differences in the quality of educational services and many countries take steps to enforce minimum standards of access and quality even as they decentralize the delivery of education services.

Clarity in expenditure assignment. On the surface, Section 17 (b) of the Local Government Code provides an explicit and clear delineation of functions across levels of governments except perhaps in the area of environment and natural resource management.⁹ However, Section 17 (c) allows central government agencies to continue to implement devolved public works and infrastructure projects and other facilities, programs, and services provided these are "funded by the national government under the annual General Appropriations Act, other special laws, pertinent executive orders, and those wholly or partially funded from foreign sources." In line with this, Executive Order 53 mandates national government agencies (NGAs) to retain management control over all foreign-assisted projects and/or nationally funded projects even if these involve devolved activi-

⁹ To wit, the Code gives municipalities responsibility for the implementation of community-based forestry and watershed projects but allows the DENR to retain supervision and control over such projects.

ties. At the same time, the Code and its Implementing Rules and Regulations failed to define the mechanism/s through which the central government can direct assistance to LGUs under Section 17 (f), which allows the national government or the next higher level of local government unit to "provide or *augment* (emphasis added) the basic services and facilities assigned to a lower level of local government unit when such services or facilities are not made available or, if made available, are inadequate to meet the requirements of its inhabitants."

Many of the so-called devolved NGAs tend to make full use of Section 17 (f) of the Code and EO 53 regarding augmentation because they deem it their responsibility to direct LGU behavior in support of national objectives (Loehr and Manasan 1999).¹⁰ Section 17 (f) also allows Congressmen easy access to pork barrel funds by merely inserting a special provision in the General Appropriations Act, which states that monies from such augmentation funds can only be released for "projects that are identified by members of Congress." Because of these incentives on the part of both Congress and devolved central government agencies to retain control over funding and implementation of devolved activities at the center, the budgets of devolved central government agencies grew disproportionate to the IRA in the post-Code period. In particular, while the IRA grew by 15 percent yearly on the average between 1994 and 1997, the budget of the DA expanded by 48 percent, the DOH's by 25 percent, and the DSWD's by 22 percent. Along this line, Capuno et al. (2001) estimate that central government agencies (specifically, the DepEd, DOH, DPWH, and DILG) spent significant amounts on devolved activities in 1995-1999 (Table 3).

In effect, Section 17 (c) and (f) obfuscate what initially appears to be a clear-cut assignment of expenditure responsibilities. Gonzalez (1996) goes even further to say that the prevailing regulatory framework effectively permits the

Table 3. Budget allocations of selected central government agencies for devolved activities, 1995-1999 (in billion pesos)

	DepEd	DOH	DILG	DPWH	Total
1995	4.7	0.6	0.2	4.7	10.2
1996	4.2	0.5	0.2	10.6	15.5
1997	4.7	0.4	0.6	10.8	16.5
1998	2.9	0.3	0.2	30.6	34.0
1999	2.8	0.5	0.1	4.0	7.4

Source: Capuno et al. (2001), Table 1a, Table 1b, Table 1c, Table 1d, and Table 1e.

¹⁰ For instance, the DOH is accountable for the overall health status of the country in the same way that the DENR is accountable for overall environmental and natural resource management results.

existence of a two-track delivery system, where both NGAs and LGUs can initiate devolved activities.

On the other hand, a continuing source of irritant between the central government and LGUs is the propensity of the central government to pass on so-called unfunded mandates to LGUs. The most important of these unfunded mandates refers to the implementation of the salary standardization law and the provision of additional benefits to health workers under the Magna Carta for Health Workers. More recently, LGUs are also mandated to pay for the health insurance premiums of their indigent residents. At the same time, LGUs are expected to provide budgetary support (either in the form of additional personnel benefits or outlays for maintenance and other operating expenses) to many central government agencies operating at the local level like the police, fire protection bureau, and local courts.

Trend and composition of LGU expenditures, 1991-2003

Central-local expenditure distribution. Consistent with the devolution program, total LGU expenditure doubled relative to the gross national product (GNP) and to the total general government expenditure. Thus, the total LGU spending increased from an average of 1.6 percent of GNP in 1985-1991 to 3.3 percent of GNP in 1992-2003. Similarly, the share of LGUs in total general government expenditure net of debt service rose from an average of 11.0 percent in the pre-Code period to an average of 21.2 percent in the post-Code period (Table 4).

Meanwhile, Table 5 documents the changing distribution of government spending on various sectors across different levels of government over time. It confirms that many devolved functions continue to be shared by the LGUs with the central government in a significant way.

In line with the transfer of functions to LGUs mandated under the Local Government Code, the share of local governments in the aggregate in total general government spending net of debt service doubled from 12.6 percent in 1991 to 25.4 percent in 2003. In particular, the local government share in general government spending registered substantial increases in the areas of water resource development and flood control (from 13% in 1991 to 86% in 2003), housing and community development (from 33% to 71%), health (from 10% to 58%), power and energy (from 4% to 40%), other economic services (from 57% to 93%), agriculture (from 3% to 15%), environment and natural resource management (from 0% to 15%), and education (from 2% to 7%). It is remarkable, however, that the share of LGUs in total general government spending on the social welfare and labor/employment sector declined from 11 percent in 1991 to 8 percent in 2003 despite the transfer of about 60 percent of pre-devolution DSWD personnel to LGUs. LGUs' share in total general government spending on the transportation and communication

Table 4. LGU expenditure relative to GNP and general government expenditure

	Ratio of LGU expenditure to GNP (%)	Expenditure to general gov't. expenditure net of debt service (%)
1985	1.54	11.42
1987	1.44	10.04
1989	1.53	10.62
1991	1.89	12.61
1993	2.72	19.97
1995	3.53	21.83
1997	3.75	21.39
1999	3.67	23.04
2001	3.75	25.70
2003	3.43	25.38
Average		
1985-1991	1.61	11.00
1992-2003	3.32	21.23

sector has grown only minimally (from 15% to 18%) although the Local Government Code calls for the devolution of the construction and maintenance of all local infrastructure facilities and the provision of local telecommunication services to LGUs.

Distribution of LGU spending by function. With more resources at their disposal, total LGU expenditures rose from an average of 1.6 percent of GNP in 1985-1991 to 3.5 percent of GNP in 1993-2003 (Table 6). The increase in total LGU expenditure was particularly rapid in 1993-1995 but started to taper off in 1996. It is noteworthy that LGU expenditure at all levels of local government (with the exception of cities¹¹) declined relative to GNP in 1998 and 1999 following the onset of the Asian financial crisis. It bounced back in 2000 but contracted once again in 2001-2003 due to the adverse impact of fiscal restraints on LGU financing.

LGU spending on all sectors also posted increases when expressed relative to GNP. Thus, LGU spending on the social services sector almost tripled from 0.3 percent of GNP in 1991 to 0.8 percent of GNP in 2003. Meanwhile, LGU allocation on the general public services sector rose from 0.8 percent of GNP in 1991 to 1.4 percent in 2003. In contrast, LGU spending on the economic services sector expanded only minimally, from 0.7 percent of GNP in 1991 to 0.8 percent in 2003.

¹¹ The total spending level of city governments in the aggregate did not contract in 1998-2001 but started to decline in 2002 and 2003.

Table 5. Percent distribution of NG and LGU expenditures, by type of government

Sectors	1991			1995			2003		
	TOTAL	NG	LGU	TOTAL	NG	LGU	TOTAL	NG	LGU
GRAND TOTAL	100.0	91.0	9.0	100.0	82.0	18.0	100.0	81.1	18.9
Total Economic Services	100.0	88.5	11.5	100.0	81.5	18.5	100.0	77.2	22.8
Agrarian Reform	100.0	100.0	0.0	100.0	100.0	0.0	100.0	100.0	0.0
Agriculture	100.0	96.6	3.4	100.0	86.1	13.9	100.0	85.2	14.8
Natural Resources	100.0	100.0	0.0	100.0	94.6	5.4	100.0	85.0	15.0
Industry	100.0	100.0	0.0	100.0	100.0	0.0	100.0	100.0	0.0
Trade	100.0	100.0	0.0	100.0	100.0	0.0	100.0	100.0	0.0
Tourism	100.0	100.0	0.0	100.0	100.0	0.0	100.0	100.0	0.0
Power and Energy	100.0	95.6	4.4	100.0	93.0	7.0	100.0	60.0	40.0
Water Resource Devt/Flood Control	100.0	86.6	13.4	100.0	82.5	17.5	100.0	13.6	86.4
Transportation and Communication	100.0	84.2	15.8	100.0	80.1	19.9	100.0	81.9	18.1
Other Economic Services	100.0	46.8	53.2	100.0	35.4	64.6	100.0	7.0	93.0
Total Social Services	100.0	93.2	6.8	100.0	82.2	17.8	100.0	82.7	17.3
Education	100.0	97.5	2.5	100.0	92.6	7.4	100.0	92.8	7.2
Health	100.0	90.3	9.7	100.0	51.5	48.5	100.0	41.8	58.2
Soc. Welfare/Labor/Other Soc. Serv.	100.0	89.3	10.7	100.0	88.2	11.8	100.0	91.7	8.3
Housing/Community Development	100.0	67.4	32.6	100.0	46.0	54.0	100.0	29.3	70.7
General Public Service	100.0	74.2	25.8	100.0	64.8	35.2	100.0	59.4	40.6
Public Administration	100.0	60.7	39.3	100.0	49.9	50.1	100.0	40.0	60.0
Peace and Order	100.0	99.3	0.7	100.0	98.4	1.6	100.0	98.8	1.2
Others	100.0	75.4	24.6	100.0	0.0	100.0	100.0	35.4	64.6
Defense	100.0	100.0	0.0	100.0	100.0	0.0	100.0	100.0	0.0
Debt Service	100.0	99.8	0.2	100.0	97.8	2.2	100.0	98.1	1.9
Total Net of Debt Service	100.0	87.4	12.6	100.0	78.2	21.8	100.0	74.6	25.4

Table 6. Ratio to GNP of local government expenditures (in percent)

ALL LGUs	1991	1995	1999	2001	2002	2003
GRAND TOTAL	1.9	3.5	3.7	3.8	3.4	3.4
Total Economic Services	0.7	1.0	0.9	0.9	0.8	0.8
of which:						
Agriculture	0.0	0.1	0.1	0.1	0.1	0.1
Transportation and Communication	0.5	0.6	0.5	0.5	0.4	0.4
Total Social Services	0.3	0.9	1.0	1.0	0.8	0.8
of which:						
Education	0.1	0.3	0.3	0.3	0.2	0.2
Health	0.1	0.4	0.4	0.4	0.4	0.4
General Public Service	0.8	1.4	1.5	1.5	1.5	1.4
Others	0.1	0.2	0.2	0.2	0.3	0.3
Debt Service	0.0	0.1	0.1	0.1	0.1	0.1

* Adjusted for DOH and DA advances.

Source: Annex Table 1.

The mandated transfer to LGUs of functions previously discharged by national government agencies caused a major shift in the size and composition of LGU budgets. Among the major sectors, social services posted the fastest rate of growth in 1991-2003, increasing by 21.7 percent yearly on the average during the period compared to the overall growth in total LGU spending of 8.2 percent. In contrast, the general public services sector and the economic services sector grew at a slower pace (respectively, by 16.4 and 12.6 percent yearly on the average). Consequently, the share of the social services sector to total LGU expenditure expanded from 20.5 percent in 1985-1991 to 25.9 percent in 1993-2003 while that of the economic services sector and the general public services sector contracted, respectively, from 32.9 percent to 24.6 percent and from 42.8 percent to 40.7 percent (Table 7).

The increase in LGU spending on social services between 1991 and 2003 went to (in order of priority) health, education, housing/community development, and social welfare. Thus, aggregate LGU expenditure on health rose almost five-fold from 0.08 percent of GNP in 1991 to 0.38 percent of GNP in 2003 while LGU spending on education increased by more than three-fold from 0.07 percent of GNP to 0.22 percent of GNP (Table 6). In contrast, total LGU expenditure on housing/community development and social welfare services in 2003 was less than twice their 1991 levels when expressed relative to GNP.

The hefty increases in LGU spending on health and social welfare were largely due to the fact that the LGUs had very little discretion but to absorb the cost of devolved health and social welfare personnel, which accounted for more

Table 7. Sectoral distribution of local government expenditures (in percent)

All LGUs	Average		1991	1995	1999	2001	2002	2003
	1985-1991	1993-2003						
GRAND TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total Economic Services	32.9	24.6	35.8	27.6	25.2	24.6	22.2	22.4
of which:								
Agriculture	1.3	3.0	1.1	3.0	3.1	2.9	2.9	2.7
Transportation and Communication	24.6	13.2	27.9	16.1	13.9	12.8	10.7	11.1
Total Social Services	20.5	25.9	15.4	26.5	26.3	26.6	22.8	24.4
of which:								
Education	7.5	7.1	3.6	7.2	7.4	7.6	5.4	6.3
Health	4.9	11.7	4.2	11.4	12.2	11.5	11.1	11.0
General Public Service	42.8	40.7	44.5	38.4	39.9	40.6	44.7	41.3
Others	3.0	6.6	3.5	5.1	6.5	5.9	7.7	9.2
Debt Service	0.9	2.3	0.8	2.4	2.1	2.2	2.7	2.8

* Adjusted for DOH and DA advances.

Source: Annex Table 2.

than half of the total cost of all devolved personnel. In contrast, higher LGU expenditures on education and housing/community in the post-Code period largely reflect the higher priority that local officials assign to these sectors in the more decentralized regime as LGUs were not locked into previously set (i.e., predevolution) central government expenditure levels in these sectors precisely because they did not have to absorb devolved personnel. The increase in LGU spending on the education sector may also be attributed to the substantial increase in LGUs' Special Education Fund in the post-Code period as a result of the mandated adjustments in real property assessments under the Code.

Although aggregate LGU spending on the social services sector registered a general upward trend in 1991-1997 (when measured relative to GNP and in real per capita terms), it manifested some stagnation (especially with respect to health expenditures) in 1998-2001 and a small decline in 2002 and 2003 (Table 6 and Table 8). These movements are common across all levels of local government and appear to be related to the fiscal difficulties faced by LGUs during this period.¹² This observation is worrisome, considering that provinces and municipalities are primarily responsible for the delivery of basic health services. It also highlights the need to explore the benefits from a grant program aimed at ensuring that LGUs provide health services that are consistent with minimum service standards of access and quality.¹³

The transportation/communication subsector bore the brunt of the contraction in the budget share of the economic services sector in 1991-2003. With the devolution of agricultural extension and environment/natural resource management, the expenditure share of these subsectors rose somewhat between 1991 and 2003. In contrast, despite the devolution of the responsibility for local infrastructure (including the construction and maintenance of local roads) to LGUs, the share of the transportation/communication subsector in total LGU expenditure dipped from 24.6 percent in 1985-1991 to 13.2 percent in 1993-2003 (Table 7). Such decline is unexpected since investment in infrastructure (classified as building roads, bridges, and canals) ranks high in citizens' preferences. For instance, local infrastructure is one of the top two priorities of households with respect to gov-

¹² While the IRA share of LGUs declined relative to GNP in 1998 and again in 2001, own-source LGU revenue has been on a downtrend since 1998.

¹³ The rationale for such a grant program and/or the establishment of minimum service standards stems from the fact that some services like health and environmental protection generate externalities (i.e., benefits spillover beyond the boundaries of the local jurisdiction) or are services that are considered meritorious and in which the central government has a strong interest to achieve an overriding national level outcome (e.g., merit goods). National standards can be enforced in several ways such as by enticing local governments to spend more on the specified service with a matching grant program (McLure and Martinez-Vazquez 2002). Alternatively, the problem could also be addressed by designing equalization transfers aimed at providing sufficient resources to enable all local governments to provide a basic package of local services (Bird and Smart 2001).

Table 8. Per capita local government expenditures, in 1985 prices (including transfers to NG)

ALL LGUs	1991	1995	1999	2001	2002	2003
GRAND TOTAL	218	426	474	506	471	486
Total Economic Services	78	118	119	124	104	109
of which:						
Agriculture	2	13	15	15	14	13
Transportation and Communication	61	68	66	65	51	54
Total Social Services	34	113	124	135	107	119
of which:						
Education	8	31	35	38	25	31
Health	9	49	58	58	52	53
General Public Service	97	163	189	206	210	201
Others	8	22	31	30	36	45
Debt Service	2	10	10	11	13	13

*Adjusted for DOH and DA advances.

Source: Annex Table 3.

ernment resource allocation in 16 (80%) out of 20 provinces surveyed in a study conducted by Azfar et al. (2000).

Although aggregate LGU spending on transportation/communication was fairly stable at 0.5 percent of GNP for most of the post-Code period, a downtrend in LGU transportation spending (when measured relative not only to total LGU spending but also relative to GNP) became evident in 2002-2003. This trend is true for all levels of local government (Annex Table 3).

These developments appear to be linked to the mismatch in the distribution of resources and expenditure responsibilities across levels of local governments. (See further discussion on this below.) At the same time, these movements are a cause of concern considering the robust and strong association between economic growth and infrastructure spending. Given that the Code assigns the primary responsibility for the construction and maintenance of local infrastructure to local governments, such pattern also points to the increasing disparity in economic development across levels of local government. It likewise underscores the importance of creating a suitable regulatory framework for encouraging private sector participation in infrastructure (through build-operate-transfer and joint ventures) at the local level as well as the need for an appropriate grants program for LGU capital investments.

Distribution of LGU spending across levels of local government. In 1991, prior to the implementation of the Local Government Code, provinces contributed 29.0 percent, municipalities 40.1 percent, and cities 30.9 percent of

Table 9. Distribution of LGU expenditures across levels of local government by function

Sectors	1991				2003			
	LOCAL	Prov.	Mun.	Cities	LOCAL	Prov.	Mun.	Cities
GRAND TOTAL	100.0	29.0	40.1	30.9	100.0	23.6	34.5	41.9
Total Economic Services	100.0	35.4	33.7	30.9	100.0	27.8	31.9	40.3
Agriculture	100.0	46.9	8.2	44.9	100.0	34.0	46.2	19.8
Natural Resources					100.0	16.1	4.5	79.4
Power and Energy	100.0	16.2	16.3	67.5	100.0	9.0	73.4	17.6
Water Resources Dev't. & Flood Control	100.0	37.0	49.3	13.7	100.0	4.8	73.5	21.7
Transportation and Communication	100.0	39.6	31.2	29.2	100.0	32.5	19.2	48.3
Other Economic Services	100.0	14.5	55.2	30.3	100.0	22.4	42.6	35.0
Total Social Services	100.0	33.5	24.1	42.4	100.0	27.8	26.5	45.7
Education	100.0	12.9	41.8	45.3	100.0	20.7	21.0	58.3
Health	100.0	19.8	16.7	63.5	100.0	41.9	27.7	30.3
Soc. Welfare/Labor/Other Soc. Serv.	100.0	19.2	32.1	48.7	100.0	17.4	44.9	37.7
Housing/ Community Development	100.0	68.9	12.8	18.3	100.0	9.6	22.0	68.3
General Public Service	100.0	22.4	51.0	26.6	100.0	19.9	42.9	37.2
Public Administration	100.0	22.6	51.2	26.2	100.0	20.0	43.2	36.8
Peace and Order	100.0	1.6	25.5	72.9	100.0	3.3	19.5	77.2
Others	100.0	30.1	44.9	24.9	100.0	20.2	30.3	49.5
Debt Service	100.0	10.1	15.4	74.5	100.0	20.1	15.2	64.7
Total Net of Debt Service	100.0	29.1	40.3	30.5	100.0	23.7	35.1	41.2

the total local government expenditure (Table 9). Under the devolution program, provinces absorbed 47.5 percent, municipalities 48.10 percent, and cities 4.3 percent of the total cost of functions devolved to said levels of government (Table 10).¹⁴

¹⁴ Table 10 was computed using 1992 budgets of devolved national government agencies. The numbers listed refer to personnel costs (and maintenance and other operating expenditures associated with them), which were actually transferred to LGUs starting in 1993/1994.

Table 10. Distribution of cost of devolved functions across levels of local government by function, 1992

Percent distribution across levels of local government	Provinces	Mun.	Cities	All LGUs
General Public Services	7.1	87.7	5.2	100.0
Economic Services	37.9	57.4	4.8	100.0
Agriculture	33.4	61.6	5.0	100.0
Environment and Natural Resources	97.6	0.8	1.6	100.0
Social Services	51.7	44.2	4.2	100.0
Health	60.2	37.2	2.6	100.0
Social Welfare and Employment	4.8	82.3	12.9	100.0
TOTAL	47.5	48.1	4.3	100.0
Percent distribution across functions				
General Public Services	0.5	5.6	3.7	3.1
Economic Services	15.9	23.8	22.0	19.9
Agriculture	13.0	23.7	21.5	18.5
Environment and Natural Resources	2.9	0.0	0.5	1.4
Social Services	83.7	70.6	74.3	77.0
Health	82.5	50.4	38.9	65.1
Social Welfare and Employment	1.2	20.3	35.4	11.9
TOTAL	100.0	100.0	100.0	100.0

Given the relative importance of the provincial and municipal levels in terms of both pre-Code spending levels and the cost of devolved functions, the dramatic expansion in the share of cities and the corresponding contraction in the share of provinces and municipalities in total LGU expenditures in the post-Code period were rather unexpected and could be best explained by the distribution of resources across levels of local government in the post-Code period. Thus, while the share of cities in total expenditure of all LGUs in the aggregate rose from 37.8 percent in 1995 to 41.9 percent in 2003, the share of municipalities declined from 37.6 percent to 34.5 percent; that of provinces dipped from 24.6 percent to 23.6 percent. Admittedly, these figures exaggerate the increase in the share of cities in the total expenditure of all LGUs combined because of the continuous conversion of municipalities into cities in the post-Code period. Nonetheless, the expansion in the share of cities in total LGU spending in the post-Code period remains disproportionate even after one adjusts the numbers for the increasing number of cities in the post-Code period (from 31% in 1991 to approximately 33%-37% in the post-Code period).

Despite the devolution of the responsibility for local infrastructure, agricultural extension, and some environment/natural resource management functions to

provinces, municipalities, and cities, the share of provinces and municipalities in total LGU spending on the economic services sector contracted from 35.4 percent and 33.7 percent, respectively, in 1991, to 27.8 percent and 31.9 percent, respectively, in 2003, while the share of cities expanded from 30.9 percent to 40.3 percent. This development is largely driven by the growing share of cities in total LGU spending on the transportation/communication subsector in the post-Code period. Such movement dominates the expansion in the share of provinces in total LGU spending on other economic services subsector and the increase in the share of municipalities in total LGU spending on the agriculture and the water resource development subsectors. Again, these figures tend to exaggerate the expansion in the share of cities in aggregate LGU spending on the economic services sector owing to the continuous conversion of municipalities into cities in the post-Code period. However, the growth in the share of cities in the post-Code period is significant even after one adjusts the numbers for the increasing number of cities in the post-Code period.

Similarly, the share of provinces in total LGU spending on the social services sector declined from 33.5 percent in 1991 to 27.8 percent in 2003 despite the absorption of a large number of personnel in the health subsector by provinces (and the corresponding dramatic rise in the share of provinces in total LGU spending on the said subsector) as the share of provinces in total LGU spending on social welfare and housing/community development subsectors declined in the post-Code period. In contrast, the share of municipalities and cities in total LGU expenditure on the social services sector rose from 24.2 percent and 42.4 percent, respectively, in 1991, to 26.5 percent and 45.7 percent, respectively, in 2003. The movement was due to the expansion in the share of municipalities in total LGU spending on the health, social welfare, and housing/ community development subsectors and the expansion in the share of cities in total LGU spending on the housing/community development and education subsectors in the post-Code period.

Distribution of LGU expenditure by economic category. In the aggregate, LGU spending on personal services (PS) grew from an average of 0.7 percent of GNP in 1985-1991 to an average of 1.6 percent of GNP in 1993-2003 (Table 11). This development is reflective of the transfer of personnel from devolved national government agencies to LGUs following the implementation of the Local Government Code. Because LGU spending on personal services has grown at the same pace as total LGU expenditures, its share in total LGU spending has remained fairly stable at 47 percent in the pre-Code period as well as in the post-Code period, making it the most important expenditure item according to economic category (Table 12).

Table 11. Ratio to GNP of local government by object

	Average		1991	1993	1995	1997	1999	2001	2003
	1985-1991	1993-2003							
A. ALL LGUs									
GRAND TOTAL	1.6	3.5	1.9	2.7	3.5	3.8	3.7	3.8	3.4
PS	0.7	1.6	0.8	1.3	1.6	1.8	1.8	1.7	1.4
MOOE	0.6	1.2	0.6	0.9	1.2	1.2	1.3	1.3	1.4
CO	0.3	0.7	0.4	0.5	0.8	0.7	0.6	0.7	0.6
B. ALL PROVINCES									
GRAND TOTAL	0.5	0.8	0.5	0.7	0.9	0.9	0.8	0.9	0.8
PS	0.2	0.4	0.2	0.3	0.4	0.4	0.4	0.4	0.3
MOOE	0.2	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3
CO	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.2	0.1
C. ALL MUNICIPALITIES									
GRAND TOTAL	0.6	1.3	0.8	1.2	1.3	1.4	1.3	1.3	1.2
PS	0.3	0.7	0.4	0.6	0.7	0.8	0.8	0.7	0.6
MOOE	0.2	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4
CO	0.1	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.1
D. ALL CITIES									
GRAND TOTAL	0.5	1.4	0.6	0.9	1.3	1.5	1.5	1.5	1.4
PS	0.3	0.5	0.3	0.3	0.5	0.6	0.6	0.6	0.5
MOOE	0.2	0.5	0.2	0.3	0.5	0.5	0.6	0.6	0.6
CO	0.1	0.3	0.1	0.2	0.4	0.4	0.4	0.4	0.3

Table 12. Percent distribution of local government expenditures by type of expenditure (in percent)

A. ALL LGUs	Average		1991	1993	1995	1997	1999	2001	2003
	1985-1991	1993-2003							
GRAND TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
PS	46.5	46.4	44.7	46.6	45.3	47.3	48.1	45.5	49.2
MOOE	37.1	35.2	32.8	34.5	33.4	33.0	34.3	35.5	34.1
CO	16.4	18.4	22.4	18.9	21.4	19.7	17.5	19.1	16.7
Ratio of PS to Reg. Income in Previous Year	63.9	53.9	66.0	72.8	55.4	62.4	57.8	50.4	54.2

B. ALL PROVINCES	Average		1991	1993**	1995	1997	1999	2001	2003
	1985-1991	1993-2003							
GRAND TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
PS	44.2	47.7	41.6	49.9	48.4	48.8	50.8	45.1	42.1
MOOE	36.9	35.7	35.2	37.3	35.9	33.8	33.9	35.4	42.8
CO	18.9	16.5	23.3	12.8	15.6	17.4	15.3	19.6	15.1
Ratio of PS to Reg. Income in Previous Year	75.5	55.2	75.9	87.1	58.4	67.5	59.1	50.1	41.2

Table 12 continued

C. ALL MUNICIPALITIES	Average		1991	1993**	1995	1997	1999	2001	2003
	1985-1991	1993-2003							
GRAND TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
PS	45.9	55.0	46.1	51.5	52.6	55.7	57.9	55.3	50.8
MOOE	39.2	32.0	33.3	32.4	31.3	30.8	31.0	31.1	36.9
CO	14.9	13.0	20.5	16.1	16.1	13.5	11.2	13.6	12.3
Ratio of PS to Reg. Income in Previous Year	63.6	61.7	68.4	80.7	62.4	71.8	68.8	57.6	48.4

D. ALL CITIES	Average		1991	1993**	1995	1997	1999	2001	2003
	1985-1991	1993-2003							
GRAND TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
PS	49.4	37.8	45.8	37.4	35.9	38.4	38.1	37.5	34.2
MOOE	34.6	37.8	30.0	35.1	33.8	34.5	37.6	39.2	43.7
CO	16.0	24.4	24.2	27.4	30.3	27.1	24.3	23.4	22.1
Ratio of PS to Reg. Income in Previous Year	57.1	45.4	57.1	53.8	45.8	50.5	47.0	43.8	36.1

The share of capital outlays (CO) in aggregate LGU expenditures expanded from an average of 16.4 percent in 1985-1991 to an average of 18.3 percent in 1993-2003 even as the budget share of maintenance and other operating expenses (MOOE) contracted from 37.1 percent to 35.2 percent. These figures mask the variations across different levels of local government. Because the budget share of personal services expanded in the post-Code period in the case of provinces and municipalities, there was a squeeze not only on their MOOE but also on their capital outlays in the post-Code period. Thus, the share of MOOE in total LGU spending contracted from 39.2 percent in 1985-1991 to 31.0 percent in 1993-2003 in the case of municipalities and from 36.9 percent to 35.7 percent in the case of provinces. Similarly, the share of capital outlays in total LGU spending declined from 14.9 percent to 13.0 percent in the case of municipalities and from 18.9 percent to 16.5 percent in the case of provinces.

The salary structure applicable to mandatory LGU positions is set by the Compensation and Position Classification Act (CPCA) of 1989. The CPCA, in tandem with the Codal provisions on mandatory positions, tends to restrict LGUs' ability to re-align their outlays for personal services in consonance with their specific needs and circumstances. In some cases, these restrictions impose a heavy fiscal burden on LGUs (particularly in the case of provinces and municipalities), thus effectively putting a squeeze on the ability of these LGUs' to fund maintenance and capital outlays. In other cases, they make it difficult for low-income class LGUs to retain personnel, particularly in the health sector.

The Local Government Code imposes a ceiling on PS spending of LGUs (45%-55% of the total regular income depending on LGU's income class) but many exemptions are allowed in reckoning compliance to this mandate. Thus, although aggregate LGU spending on personal services was slightly below the ceiling in 1993-2003 (at 53.9% of the total LGU regular income in the previous year), the situation is particularly problematic in the case of municipalities, which posted an aggregate PS ratio of 61.8 percent during the same period (Table 12).

To make matters worse, personal services expenditure, as recorded in the financial statements of LGUs, tends to underestimate the amounts that LGUs actually spend on personnel compensation because of the practice of charging the salaries and wages of contractual employees hired under so-called "job orders" or "service contracts" against MOOE or CO (for development projects). Some LGUs report that this practice is no longer allowed under the new government accounting system (NGAS) while other LGUs claim otherwise. For instance, a number of LGUs report that 15 percent to 20 percent of their MOOE is actually used to pay for contractual personnel. Still other LGUs charge some of their "excess" personal services against the accounts of public enterprises like public markets.

REVENUE ASSIGNMENT AND DISTRIBUTION

Legal framework¹⁵

Table 13 summarizes the various taxes that are assigned to the different levels of local government. Under the Local Government Code, only provinces and cities are authorized to levy the real property tax, the proceeds of which are shared with lower levels of government (i.e., municipalities and barangays in the case of provinces, and barangays in the case of cities). Both provinces and cities are also allowed to impose a tax on the transfer of real property, sand, gravel, and other quarry resources; amusement places; franchises; professionals; delivery vans and trucks; and idle lands.¹⁶ Meanwhile, municipalities and cities (but not provinces) are authorized to levy the community tax and the local business tax (i.e., turnover tax levied on the gross receipts of businesses/traders).

Table 13. Tax assignment in cities, provinces, and municipalities

Subject	Cities	Prov.	Mun.	Brgy.
Real property transfers	✓	✓		
Business of printing and publication	✓	✓		
Franchise	✓	✓		
Sand, gravel, and other quarry resources	✓	✓	<i>a</i>	<i>a</i>
Amusement places	✓	✓	<i>a</i>	
Professionals	✓	✓		
Delivery vans and trucks	✓	✓		
Real property	✓	✓	<i>a</i>	<i>a</i>
Idle lands	✓	✓		
Business	✓		✓	✓
Community tax	✓		✓	<i>a</i>

^aShares in proceeds of levy of province.

Section 133 of the Code lists in some detail the taxes that LGUs are not allowed to touch and that are reserved for the central government. These include the income tax (individual and corporate), customs duties, value-added tax, and excise taxes on alcoholic beverages, tobacco products, and petroleum products. At the same time, the National Internal Revenue Code does not provide for a central government real property tax or for a central government community tax (poll tax).

¹⁵ The discussion that follows refers to the tax assignment under the Local Government Code. Tax assignment in the ARMM is taken up in Box 2.

¹⁶ Lower level local governments likewise have a share in the proceeds of the sand/gravel tax, amusement tax, and community tax.

Box 2. Tax assignment in the ARMM

Under RA 6733, the regional government of the ARMM was authorized to levy all types of taxes with the exception of the income tax and customs duties. In practice, however, the regional government of the ARMM does not touch any of the taxes that the central government levies. Instead, it has chosen to impose a supplementary rate (i.e., a surcharge) on taxes that are typically levied by provincial governments under the Local Government Code like the real property tax, the sand and gravel tax, the amusement tax, the professional tax, and the franchise tax.* In this sense, the amended Organic Act of the ARMM (Republic Act 9054) simply formalizes the symmetrical treatment of the ARMM and the LGUs with regard to the limitations on their taxing powers.

* In practice, the regional government of ARMM imposes tax rates that are 60%-90% lower than those of the LGUs'.

Assessment

The traditional literature on fiscal federalism (e.g., Shah 1994; Ter-Minassian 1997; Bird 1999) provides three general criteria for assessing the appropriateness of tax assignment: economic efficiency, equity, and administrative feasibility. The economic efficiency criterion suggests that each level of government should be assigned taxes that are related to the benefits of its spending responsibility. Thus, user charges for identifiable public services that are provided by subnational governments and taxes that are levied based on the benefit principle (e.g., motor vehicle taxes, which may be used to finance the construction and finance of local infrastructure) are best assigned to LGUs. To the extent that LGUs have to resort to nonbenefit taxation, theory suggests that local governments are assigned tax bases that have low interjurisdictional mobility. Otherwise, nonuniform tax rates levied by different LGUs will distort the geographic allocation of economic resources.

The surveyed literature argues that progressive taxes (i.e., those that are based on one's ability to pay) should finance the redistributive function of government. Since this function is generally ascribed to the central government, progressive taxes are best assigned to the central government. Lastly, the concern for administrative efficiency indicates that the authority to collect particular types of taxes should be given to the level of government that is able to do so with the least collection and enforcement cost.

The new view on tax assignment (e.g., Bird 1999; McLure 1999) emphasizes the need to provide subnational governments with fiscal autonomy. In this sense, what is important is for local governments (1) to have their own source of revenues and (2) to have the power to control the amount of revenues they receive at the margin to be able to fund the level of services they

prefer.¹⁷ As such, “subnational governments would have to face the full marginal tax price of the spending decisions for which they are responsible” (Bird 1999).

Given this background, the Philippine tax assignment appears to be largely consistent with the traditional view. Two of the more important sources of tax revenue for LGUs, the real property tax and the community tax, are taxes on immobile factors. LGUs also enjoy a wide latitude when it comes to the amount of fees and other user charges that they may levy.

However, the current tax assignment scores low in the autonomy criterion. While the Local Government Code authorizes LGUs to levy local taxes on a good number of tax bases (including some which were not allowed under Presidential Decree 231 and Presidential Decree 464 during the pre-Code period like banks and other financial institutions, and printing/publication), the size of the base of taxes outside of the real property tax and the local business tax is not significant. Also, despite these changes, the bulk of the productive tax bases still rests with the central government.

The Local Government Code also seriously limits their power to set local tax rates. One, the Code fixes the tax rate of some of the taxes that are assigned to LGUs (like the SEF real property tax and the community tax). Two, while LGUs do have some discretion in setting tax rates of other local taxes, the Code sets limits (i.e., floors and ceilings) on the tax rates that LGUs may impose. Moreover, the maximum allowable rates appear to be low. For instance, although the Local Government Code raised the ceiling rate for real property taxation at the provincial level from 0.5 percent to 1 percent, it withdrew the power of municipalities¹⁸ to impose such tax (Table 13), thus maintaining the effective real property tax rate in provincial municipalities at the pre-Local Government Code level (Manasan 1992). In terms of real property assessment levels, the Code sets maximum assessment rates for different classes of property. In contrast, the assessment rates were fixed in the pre-Code period. The maximum assessment rates set under the Code are no higher and often significantly lower than the fixed assessment rates in the pre-Code period¹⁹, thus reducing the effective assessment levels of residential land, all types of buildings and machinery, which in turn leads to a potentially substantial reduction in real property tax revenues.

¹⁷ It may be noted that while revenue sharing with the central government (e.g., through block grants) may provide LGUs with adequate own-source revenues, this scheme does not provide fiscal autonomy because subnational governments do not have the power to influence the amount of shared revenues they receive.

¹⁸ Municipalities in Metro Manila are still allowed to impose real property taxes.

¹⁹ The Code also exempts from real property taxation residential buildings with market value below P175,000.

Three, the Code mandates that tax rates can only be adjusted once in five years and by no more than 10 percent. This provision is particularly restrictive for taxes (e.g., the professional tax and the tax on delivery vans and trucks) whose rates are specified in nominal peso terms. Clearly, the resulting adjustments will not allow LGUs to maintain the real value of their revenues.

Thus, future Code amendments should look at giving LGUs greater discretion in setting tax rates by raising the maximum allowable tax rates. Moreover, there is a need to move away from tax rates that are not indexed to inflation as such practice necessitates frequent revisions of local tax ordinances if LGUs want to keep their own-source revenues buoyant.

Also, the tax structure prescribed by the Code for the local business tax is too complex such that different categories of firms are subject to different rate schedules. This situation tends to increase administrative and compliance costs and further strains the capacity of an already weak local tax administration (Taliercio 2003).

It is worth noting that many tax personnel are not well equipped technically for their tasks. Also, very few tax units have certified public accountants, thereby impairing their audit capability. Moreover, not many LGUs have computers that will help them improve their revenue performance.

That local tax administration is severely inadequate in many LGUs is highlighted in Table 14. It shows the declining trend in real property tax collection efficiency of both provinces and cities in the post-Code period.

Finally, many LGU officials tend to underutilize their tax powers. For instance, many provinces and cities have done a general revision of the schedule of market values only once since 1991, resulting in declining collections in real

Table 14. Collection rate of current year for basic real property tax, 1983-1999

	All LGUs	Provinces	Cities
1989	58.0	55.6	61.0
1991	58.9	54.1	65.1
1994	60.7	54.0	66.3
1997	57.4	50.0	62.0
1999	54.1	52.4	54.9
2000	54.6	44.7	57.1
Average			
1989-1991	58.2	54.4	63.1
1992-2000	55.4	49.0	59.7

terms.²⁰ Also, few LGUs have revised their local tax codes since 1992 even if the rates of some of the taxes are not indexed to inflation. This is reportedly due to the resistance of the local chief executive or the local Sanggunian (or both) to increase the tax rates in general for fear of a political backlash. It also appears to be related to the poor incentives resulting from the mismatch between the assignment of taxes and the assignment of expenditure responsibilities to the different levels of local government (More on this point below.) In particular, the share of provinces and municipalities in total LGU own-source revenue has declined in the post-Code period despite their substantial share in the cost of devolved functions.

Trend and composition of LGU revenues, 1991-2001

National/subnational revenue distribution. Table 15 and Table 16 confirm that the bulk of the productive sources of local revenue remain with the central government even in the post-Code period. They also show that many LGUs have not fully utilized their revenue-raising powers due to political constraints and to the disincentive effect of the IRA distribution formula on local tax effort. Thus, the contribution of LGUs to total revenues of the general government (central government and LGUs combined) remains low—an average of 6.9 percent in 1992-2003 com-

Table 15. Share of national and subnational governments to general government revenue (in percent)

Levels	National Government			Local Government		
	Total	Tax	Nontax	Total	Tax	Nontax
1985	94.1	95.5	84.2	5.9	4.5	15.8
1987	95.5	96.2	92.2	4.5	3.8	7.8
1989	95.2	96.3	90.6	4.8	3.7	9.4
1991	95.4	96.3	91.6	4.6	3.7	8.4
1993	93.6	94.4	88.2	6.4	5.6	11.8
1995	94.1	94.8	90.0	5.9	5.2	10.0
1997	93.5	94.4	87.4	6.5	5.6	12.6
1999	92.7	93.8	83.8	7.3	6.2	16.2
2001	92.8	93.6	87.4	7.2	6.4	12.6
2003	92.0	92.6	88.6	8.0	7.4	11.4
Average						
1985-1991	95.1	96.1	90.9	4.9	3.9	9.1
1992-2003	93.1	94.0	87.4	6.9	6.0	12.6

²⁰ The Code mandates LGUs to conduct a general revision of market values once every three years with the first one taking effect in 1994.

pared to an average of 4.9 percent in 1985-1991 (Table 15). Moreover, local government revenue effort rose only marginally from an average of 0.8 percent of GNP in the pre-Code period to an average of 1.2 percent of GNP in the post-Code period (Table 16).

Distribution of LGU own-source revenue across levels of local government. The assignment of revenues under the Local Government Code has effectively shifted the distribution of own-source revenue from municipalities and provinces in favor of cities. The Code not only allows cities to impose all the taxes that provinces and municipalities are authorized to levy; it also gives them greater discretion in setting the tax rates. Also, under the Code, the share of provinces in the proceeds of the real property tax (35%) is smaller than that of cities (70%) and municipalities (40%) (Table 17).

Thus, the share of provinces and municipalities in total LGU own-source revenue contracted from an average of 19.9 percent and 37.1 percent, respectively, in 1985-1991, to 12.5 percent and 27.3 percent, respectively, in 1992-2003 (Table 18). In contrast, the share of cities in total LGU own-source revenue expanded from 40.0 percent in the pre-Code period to 60.2 percent in the post-Code period. This kind of movement is evident in tax as well as in nontax sources of own-source revenues.

De jure, the broader powers given cities relative to provinces and municipalities is justified by the fact that cities are expected to carry out all the functions that are assigned to both provinces and municipalities.²¹ *De facto*, however, the cost of devolved functions (specifically those that go with actual personnel transfer) is heavily skewed in favor of provinces and municipalities (Table 10). A comparison of Table 18 with Table 10 highlights the inconsistency between tax assignment and expenditure assignment across local government levels.

Distribution of LGU own-source revenues by type. For all LGUs in the aggregate, tax revenues is the major source of own-source revenue, accounting for 66.3 percent of their total own-source revenue in 1985-1991 and 75.7 percent in 1992-2003 (Table 19). While revenues from the real property tax are more important than those from other taxes for all provinces in the aggregate in the post-Code period, the opposite is true in the case of municipalities and cities. Moreover, the increase in the share of other taxes in total own-source revenue of cities and municipalities is remarkable in the post-Code period.

The bulk of the increase in total own-source revenues of all LGUs in the aggregate came from tax revenues. Real property revenues rose from 0.5 percent of GNP in 1985-1991 to 0.9 percent of GNP in 1992-2003 while revenues from other

²¹ This is true in both the pre-Code and the post-Code periods.

Table 16. General government revenues by level of local government as percent of GNP

Levels	General Government			National Government			Local Government		
	Total	Tax	Non-tax	Total	Tax	Non-tax	Total	Tax	Non-tax
1985	13.3	11.6	1.7	12.5	11.1	1.4	0.8	0.5	0.3
1987	16.2	13.4	2.8	15.5	12.9	2.6	0.7	0.5	0.2
1989	17.7	14.0	3.6	16.8	13.5	3.3	0.9	0.5	0.3
1991	18.4	15.1	3.4	17.6	14.5	3.1	0.8	0.6	0.3
1993	18.5	16.3	2.3	17.4	15.3	2.0	1.2	0.9	0.3
1995	19.6	16.7	2.9	18.4	15.9	2.6	1.2	0.9	0.3
1997	20.0	17.3	2.7	18.7	16.3	2.4	1.3	1.0	0.3
1999	16.5	14.7	1.8	15.3	13.8	1.5	1.2	0.9	0.3
2001	15.7	13.5	2.2	14.5	12.6	1.9	1.1	0.9	0.3
2003	14.8	12.6	2.2	13.6	11.6	1.9	1.2	0.9	0.2
Average									
1985-1991	16.6	13.6	3.0	15.8	13.1	2.7	0.8	0.5	0.3
1992-2003	16.9	14.7	2.3	15.8	13.8	2.0	1.2	0.9	0.3

Table 17. Basic real property tax (RPT) rates and sharing of proceeds

LGU Class	Pre-1991 Code		1991 Code	
	RPT rate (%)	Share (%)	RPT rate (%)	Share (%)
Province	0.25≤RPT≤0.5	Province :	RPT≤1	Province :
		Municipality:		Municipality:
		City:		City:
		Barangay:		Barangay:
Municipality	0.25≤RPT≤0.5	Province :	RPT=0	Province :
		Municipality:		Municipality:
		City:		City:
		Barangay:		Barangay:
City	0.5≤RPT≤2	Province :	RPT≤1	Province :
		Municipality:		Municipality:
		City:		City:
		Barangay:		Barangay:
Barangay	RPT=0		RPT=0	

taxes increased from 0.2 percent to 0.4 percent of GNP (Table 20). In contrast, revenues from user charges and fees rose from 0.2 percent to 0.3 percent of GNP.

The own-source revenue effort for all LGUs in the aggregate showed some stagnation in the second half of the 1990s (Table 20). This trend is true for all sources of revenues but is more pronounced among provinces and municipalities than among cities. However, the positive trend for cities may be attributed more to the conversion of a good number of municipalities into cities than to their good performance *per se*.

When measured relative to GNP, total own-source revenue of provinces registered a slight contraction in the post-Code period, from an average of 0.16 percent of GNP in 1985-1991 to 0.15 percent in 1992-2003 (Table 20). This is primarily traceable to a decline in their nontax revenue (particularly operating and other miscellaneous income). The decline in nontax effort of provinces is surprising given the greater autonomy of LGUs in the setting of fees and user charges.

In contrast, total own-source revenue effort of cities and municipalities rose from an average of 0.35 percent and 0.30 percent of GNP, respectively, in 1985-1991, to 0.71 percent and 0.32 percent of GNP, respectively, in 1992-2003 (Table 20). In cities, all sources of own-source revenues increased in the post-Code period but the improvement in local tax effort (both RPT and other taxes) was more dramatic. On the other hand, the expansion in the own-source revenue effort of municipalities was largely driven by increases in their other taxes and in their operating/miscellaneous revenues.

Table 18. Distribution of LGU own-source revenue across levels of local government by type of revenue (in percent)

	LG total own-source revenue				LG total tax revenue				LG nontax revenue			
	Total	Provinces	Mun.	Cities	Total	Provinces	Mun.	Cities	Total	Provinces	Mun.	Cities
1985	100.0	19.5	35.1	45.4	100.0	15.8	36.5	47.7	100.0	27.0	32.3	40.7
1987	100.0	17.4	37.8	44.8	100.0	16.6	36.1	47.3	100.0	19.5	41.6	38.9
1989	100.0	27.4	33.6	39.0	100.0	17.0	36.2	46.8	100.0	43.3	29.7	27.1
1991	100.0	18.4	38.9	42.7	100.0	13.3	40.7	46.0	100.0	28.4	35.5	36.1
1993	100.0	14.0	48.4	37.6	100.0	11.9	49.4	38.7	100.0	21.0	45.1	33.9
1995	100.0	14.8	31.7	53.5	100.0	13.1	29.5	57.4	100.0	19.7	38.3	42.0
1997	100.0	13.3	29.8	56.9	100.0	10.0	27.3	62.7	100.0	22.6	36.9	40.5
1999	100.0	12.8	25.6	61.6	100.0	11.7	21.9	66.3	100.0	16.1	37.1	46.7
2001	100.0	11.9	23.3	64.8	100.0	10.2	20.2	69.6	100.0	17.5	32.9	49.6
2003	100.0	10.1	22.1	67.9	100.0	8.4	18.8	72.8	100.0	16.3	34.4	49.3
Average												
1985-1991	100.0	19.9	37.1	43.0	100.0	15.2	38.0	46.8	100.0	29.1	35.3	35.6
1992-2003	100.0	12.5	27.3	60.2	100.0	10.7	24.4	64.9	100.0	18.3	36.2	45.5

Table 19. Distribution of LGU revenue by source (in percent)

ALL LGUS	Average		1991	1993	1995	1997	1999	2001	2003
	1985-1991	1992-2003							
TOTAL OWN-SOURCE REVENUE	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
I. Tax Revenues	66.3	75.7	66.3	77.2	75.1	73.9	75.9	75.8	79.0
Real Property Tax	40.4	38.4	40.8	31.8	38.8	38.4	38.6	39.7	39.7
Others	25.8	37.4	25.5	45.4	36.3	35.5	37.3	36.1	39.3
II. Operating & Misc. Revenues	31.2	23.7	31.4	22.7	24.7	24.1	23.8	23.7	21.0
III. Capital	2.5	0.6	2.3	0.2	0.3	1.9	0.3	0.6	0.0

PROVINCES	Average		1991	1993	1995	1997	1999	2001	2003
	1985-1991	1992-2003							
TOTAL OWN-SOURCE REVENUE	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
I. Tax Revenues	50.7	64.6	48.0	65.7	66.7	55.7	69.6	64.5	66.0
Real Property Tax	40.8	48.9	38.3	47.3	44.2	44.9	48.3	51.2	52.3
Others	9.9	15.7	9.7	18.5	22.5	10.8	21.3	13.3	13.7
II. Operating & Misc. Revenues	42.1	32.2	50.4	34.0	32.6	32.8	29.5	31.4	34.0
III. Capital	7.2	3.1	1.7	0.3	0.7	11.5	0.9	4.0	0.0

Table 19 continued

MUNICIPALITIES	Average		1991	1993	1995	1997	1999	2001	2003
	1985-1991	1992-2003							
TOTAL OWN-SOURCE REVENUE	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
I. Tax Revenues	68.0	67.8	69.2	78.7	69.8	67.7	65.1	65.8	67.3
Real Property Tax	39.6	30.5	41.3	25.7	32.1	30.7	29.1	30.8	30.3
Others	28.4	37.3	27.9	53.0	37.7	37.0	36.0	35.0	36.9
II. Operating & Misc. Revenues	31.6	31.8	30.1	21.2	29.6	31.3	34.3	34.0	32.7
III. Capital	0.4	0.4	0.7	0.1	0.5	1.0	0.6	0.2	0.0
CITIES	Average		1991	1993	1995	1997	1999	2001	2003
	1985-1991	1992-2003							
TOTAL OWN-SOURCE REVENUE	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
I. Tax Revenues	72.1	81.7	71.5	79.4	80.4	81.4	81.7	81.5	84.7
Real Property Tax	41.0	39.7	41.3	33.8	41.2	41.0	40.5	40.8	40.9
Others	31.0	41.9	30.1	45.6	39.2	40.4	41.2	40.7	43.8
II. Operating & Misc. Revenues	25.9	18.2	24.5	20.4	19.5	18.4	18.2	18.5	15.3
III. Capital	2.1	0.1	4.1	0.2	0.0	0.2	0.0	0.0	0.0

Table 20. Revenue effort of all local governments (Ratio to GNP in percent)

ALL LGUS	Average		1991	1993	1995	1997	1999	2001	2003
	1985-1991	1992-2003							
TOTAL OWN-SOURCE REVENUE	0.81	1.17	0.84	1.18	1.15	1.30	1.20	1.13	1.18
I. Tax Revenues	0.53	0.89	0.56	0.91	0.87	0.96	0.91	0.86	0.93
Real Property Tax	0.33	0.45	0.34	0.37	0.45	0.50	0.46	0.45	0.47
Others	0.21	0.44	0.21	0.53	0.42	0.46	0.45	0.41	0.46
II. Operating & Misc. Revenues	0.25	0.28	0.26	0.27	0.28	0.31	0.29	0.27	0.25
III. Capital	0.02	0.01	0.02	0.00	0.00	0.03	0.00	0.01	0.00
<hr/>									
PROVINCES	Average		1991	1993	1995	1997	1999	2001	2003
	1985-1991	1992-2003							
TOTAL OWN-SOURCE REVENUE	0.16	0.15	0.15	0.16	0.17	0.17	0.15	0.14	0.12
I. Tax Revenues	0.08	0.09	0.07	0.11	0.11	0.10	0.11	0.09	0.08
Real Property Tax	0.07	0.07	0.06	0.08	0.08	0.08	0.07	0.07	0.06
Others	0.02	0.02	0.01	0.03	0.04	0.02	0.03	0.02	0.02
II. Operating & Misc. Revenues	0.07	0.05	0.08	0.06	0.06	0.06	0.05	0.04	0.04
III. Capital	0.01	0.00	0.00	0.00	0.00	0.02	0.00	0.01	0.00

These differences in the revenue performance of provinces, cities, and municipalities may be explained by the differences in their tax bases as well as by the differences in their taxing powers. Thus, since cities are more urbanized and have more market-based economies, their tax base tends to be more buoyant compared to those of municipalities and provinces. However, changes in the own-source revenue effort of cities may also be explained by the reclassification (i.e., the conversion) of a significant number of municipalities into cities in more recent years. A comparison of the revenue effort of the original 60 cities as of the time the Local Government Code was enacted with the revenue effort of all cities (including those that have been converted from municipalities into cities following the implementation of the Code) indicates that almost all of improvement in the revenue effort of all cities in the aggregate in the last half of the 1990s and early 2000s is due to the latter factor.

INTERGOVERNMENTAL TRANSFERS

Legal framework

In the Philippines, central government transfers to subnational governments are of three types: formula-based block grants (i.e., internal revenue allotment or IRA), origin-based share in central government revenues (i.e., share in national wealth), and *ad hoc* categorical grants. In principle, LGUs have almost full discretion in the utilization of their IRA. In contrast, the categorical grants are conditioned on their use for specific purposes.

Internal revenue allotment. While LGUs receive a fixed share of central government tax revenues (IRA) based on a formula fixed by law, the ARMM's share is based on the origin principle. Specifically, said share of subnational governments in the IRA is transferred as a block grant and, as such, both the regional government of the ARMM and the LGUs enjoy considerable discretion in the utilization of the IRA.

The IRA is allocated to the different levels of local government and to specific LGUs within each level according to a predetermined formula that is based on population, land area, and equal sharing. Under the Code, the aggregate IRA of LGUs is set at 40 percent of actual internal revenue tax collections of the central government three years prior to the current year.²²

In addition, the IRA is divided among the different levels of local government as follows: 23 percent to provinces, 23 percent to cities, 34 percent to municipi-

²² The share of LGUs in national taxes was equal to 20 percent of internal revenue taxes *at the maximum* in the pre-Code regime. The amount of IRA appropriated in the pre-Code era was 13 percent of net BIR tax receipts on the average in 1987-1990.

palities, and 20 percent to barangays.²³ In turn, the IRA share of each tier of local government is then apportioned to individual LGUs on the basis of population (50 percent), land area (25 percent), and equal sharing (25 percent).²⁴

Meanwhile, actual collections of internal revenue taxes in the ARMM area are divided as follows: 30 percent to the central government, 35 percent to the regional government, and 35 percent to the local governments in the region (distributed to each according to the derivation principle).²⁵ The collecting agent (in this case the regional office of the Bureau of Internal Revenue) automatically remits to the regional government the latter's share of the regional government together with those of its constituent LGUs. Thus, LGUs in the ARMM are not only entitled to their share of national taxes as defined under the Local Government Code but also to their share as provided for under the Organic Act of the ARMM.

On the other hand, while the Code provides for the *automatic release* of the IRA, the IRA has emerged to be a highly unpredictable source of financing for LGUs since 1998 as the central government, faced with severe fiscal constraints, persistently reduced the amount of intergovernmental transfers to LGUs as mandated by the Code (Table 21). For instance, in 1998, 5 percent of the IRA was not released to LGUs on the basis of a fiscal austerity measure implemented by the DBM.²⁶ A case questioning the legality of the central government's action in this

Table 21. Comparison of IRA appropriations and IRA obligations (in billion pesos)

	1998	1999	2000	2001	2002	2003	2004
(1) Mandated IRA share							
40% of net BIR revenues 3 years back	81.3	100.9	121.8	131.9	134.4	141.0	150.3
(2) Appropriations	81.0	96.8	111.8 ^a	111.8	134.4	141.0	141.0
(3) Obligations	76.9	95.3	114.3 ^b	115.8	134.4	141.0	141.0
(1) Less (3)	4.4	5.6	7.5	16.1	0.0	0.0	9.3

^a P10 billion of the P121.8 billion mandated share was put under "unprogrammed funds" by a member of the Senate.

^b In the course of the budget year, P2.5 billion was transferred from the "unprogrammed fund" to the "programmed" portion of the budget.

²³ Prior to the implementation of the Code, the intertier allocation of the IRA was 27 percent to provinces, 22 percent to cities, 41 percent to municipalities, and 10 percent to barangays.

²⁴ In the pre-Code period, the intratier allocation to individual LGUs was determined as follows: 70 percent based on population, 20 percent based on land area, and 10 percent based on the principle of equal sharing.

²⁵ Prior to the amendment of the Organic Act of the ARMM in 2001, the share of the central government was 40 percent; the regional government, 30 percent; and the provinces or cities, 30 percent.

²⁶ Initially, 10 percent of the IRA was withheld by the DBM. However, toward the end of the year, the DBM announced that it would release half of the remaining portion.

regard was brought to the Supreme Court, which subsequently ruled in favor of LGUs. However, this did not deter the central government from continuing its raid of the LGUs' IRA share.

In 2000, Congress lopped off P10 billion from the mandated IRA share of LGUs and placed it under Unprogrammed Funds (i.e., appropriations that will only be released when revenues in excess of targets are realized). In that year, DBM also required LGUs to submit their Annual Investment Plans prior to releasing 20 percent of the individual LGU's IRA. This was seen as an attempt to delay the release of the IRA and thus reduce the central government's fiscal deficit.

In 2001, the IRA was effectively reduced by P16 billion relative to its mandated share when the government had to operate on the basis of a re-enacted budget (i.e., the previous year's appropriations) because of the failure of Congress to enact a new General Appropriations Act (GAA) on time.²⁷ In 2003, LGUs lost another P9 billion of its mandated IRA share due to the re-enactment of the budget.

Categorical grants. Categorical grants to LGUs come from various sources: (1) lump sum allocations for the same under the GAA of various years; (2) allocations made by central government sector agencies from their own budgets; and (3) lump sum and/or line item appropriations for pork barrel funds of legislators.

In the 1998 and 1999 GAA, for instance, there are three major lump sum funds that finance the implementation of devolved activities supportive of major national government programs. These are the Local Government Service Equalization Fund (LGSEF), the Local Government Empowerment Fund (LGEF), and the Municipal Development Fund (MDF).²⁸

The principal difference among these funding sources stems from (1) the nature of the fund transfers and (2) the agencies that administers them. Both the LGEF and the LGSEF are comprised exclusively of grant funds. In contrast, the MDF includes funds for both loans and grants.

The LGSEF was created by virtue of Executive Order 48 of 1998 and, consequently, the 1999 and the 2000 GAA earmarked P5 billion that was carved out of the aggregate IRA share of LGUs. The LGSEF was originally designed to provide equalization grants to LGUs.²⁹ However, many LGUs officials resent the fact that the money for the LGSEF was taken from the IRA, thus diminishing what they

²⁷ The reduction would have been P20 billion had the DBM not released the P4 billion it withheld in 1998 (per Supreme Court ruling).

²⁸ The LGSEF has been discontinued since 2000 but both the LGEF and MDF are still operational to date. However, the LGSEF is discussed here because it is one of the first attempts to address equalization concerns.

²⁹ The LGSEF was meant to provide grant funds to support affirmative action projects of LGUs belonging to the fifth and sixth income classes.

interpret to be theirs as a matter of entitlement. Because of this, the implementation of LGSEF has been short-lived.

The LGEF provided a budget cover for foreign-assisted projects supportive of major national government programs in the 21 priority provinces and in the fifth- and sixth-class LGUs identified under the Social Reform Agenda (SRA) of the Ramos administration. For instance, the list of projects under the LGEF in the 2002 GAA includes: (1) the Cordillera Highland Agricultural Resource Management Project of the DA and the DENR; (2) the Rural Water Supply, Sewerage and Sanitation Project of the DILG and the DOH; and (3) the Integrated Community Health Services Project of the DOH.

In addition to the LGSEF and the LGEF, many sector agencies implement matching grants programs out of their own budgets under the GAA. These programs are aimed at encouraging LGUs to fund and undertake activities that support national programs and objectives. The Matching Grants Program of the DOH for the promotion of family planning is an example. Generally, LGUs have to apply for the grant and, if they qualify, are required to open a special bank account that will be used to track and implement the grant funds and the LGU counterpart.

Initially, many LGUs had no difficulty providing counterpart funding support to Official Development Assistance (ODA)-assisted and/or NG-assisted projects. This situation appears to be changing as the convergence of a number of these projects in the same LGUs has put a strain on their absorptive capacity. Moreover, the so-called SRA provinces that are targeted by many of these projects are inherently less financially capable to start with.³⁰

The rationale for the continued involvement of central government agencies in devolved activities has to be revisited. While this issue appears to have waned given the current fiscal difficulties faced by the government, it is likely to recur when the fiscal position of the central government improves.³¹ On one hand, there appears to be some justification for matching grants in cases of activities that have significant benefit spillovers across LGU jurisdictions since LGUs tend to underprovide these services in the absence of national government grants. On the other hand, there is a need to evaluate these expenditures given the propensity of national agency bureaucrats to continue to implement devolved activities.

In contrast, the MDF is a facility for channeling the proceeds of various loans that the central government has obtained from foreign governments and

³⁰ Thus, there appears to be some tension between equity and efficiency considerations, or more specifically some tradeoff between the need to focus on the most needy LGUs and the need to encourage LGUs to take fuller responsibility over devolved activities.

³¹ Note that not all of the budgets that sector agencies have for devolved activities are transferred as grants to LGUs. In many instances, the funds are used for the direct provision of devolved services by the central government agency concerned.

multilateral institutions. ODA funds intended for LGUs are first appropriated and allotted to the MDF. The MDF then releases said funds in the form of loans and/or grants to LGUs. The MDF prescribes a loan/equity/grant mix in the financing of varying types of LGU projects depending on the income type of the LGU concerned. For instance, other things being equal, the grant share of lower income LGUs is larger than that of higher income ones (correspondingly, the equity and the loan shares of poorer LGUs are smaller than those of their better off counterparts). On the other hand, other things being equal, the grant share is highest for social projects and blue/green (marine- and forest-related) environmental projects, followed by brown (waste management) environmental projects and revenue-generating ones.

One of the issues relating to the current operation of the MDF is the need to unbundle grants from loans. It is argued that decisions involving the grant system should be isolated from the credit system. An LGU that has access to a grant should not be automatically given access to a loan facility, and vice versa. The reasons for providing grants are distinct from those for giving loans. Grants to LGUs are typically justified on economic efficiency (e.g., existence of externalities) and equity grounds while loans to LGUs depend on their creditworthiness. Unbundling does not mean that an LGU cannot access both sources of financing at the same time. What is critical here is the separate and independent evaluation of the grant and the loan application of LGUs.

The present system (by prescribing a loan-equity-grant mix for various types of projects) effectively results in a subsidized credit program even if the credit component is priced at market rates of interest. Such a situation tends to promote continued LGU dependence on subsidized credit while easing out private capital in the LGU credit market (Llanto et al. 1998). There has been some attempt to move the administration of all central government grant transfers to LGUs to an agency other than the MDFO (e.g., the DBM, the DOF after the latter has shed off the MDFO, or the MDFO itself if it spins off its credit function) but concerns about turf muddled up concerns about grant policy. Thus the proposal was shelved.³²

Size and composition of central government transfers to LGUs

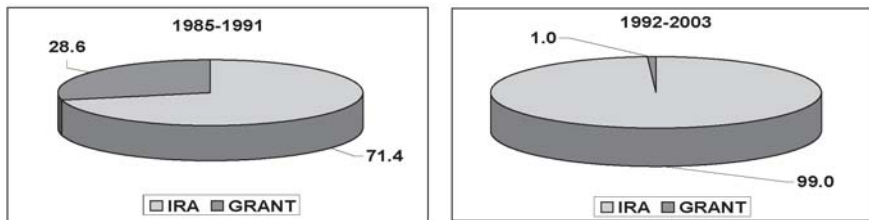
Since the implementation of the Local Government Code, there has been a remarkable increase in the size of central government transfers to LGUs as well as a palpable shift in their composition. For instance, central government transfers to LGUs surged from 5.4 percent of national government revenues (or 4.6% of na-

³² Refer to the ADB Technical Assistance for Strengthening Public Finance and Planning in Local Government Units (TA No. 3145-PHI), which focuses on the continuing provision of decentralized services by national government agencies and the need to increase the quantity of development funding available to LGUs.

tional government expenditures or 0.9% of GNP) in 1985-1991 to 14.5 percent of national government revenues (or 12.3% of national government expenditures or 2.3% of GNP) in 1992-2003 (Table 22). This development has been a source of increasing pressure on national government expenditures in recent years.

On the other hand, there has been a movement away from *ad hoc* grants in favor of formula-based block grants in the post-Code period. In particular, the share of the IRA in total central government transfers to LGUs rose from 71.4 percent in 1985-1991 to 99.0 percent in 1992-2003 while the share of ad hoc grants declined from 28.6 percent to 1.0 percent (Figure 2).

Figure 2. Percent distribution of national government transfers, 1985-2003



Conversely, while the hefty increase in the IRA relative to LGU revenues and LGU expenditures following the implementation of the Code is well known, the total central government transfers did not increase by as much as the IRA in the post-Code period (Table 23). This occurred as *ad hoc* grants declined to less than 1 percent of total LGU revenue in 1992-2003 from 14.7 percent in 1985-1991.

Consistency of revenue and expenditure assignment across levels of local government: adequacy of the IRA

As in other countries, there is a mismatch between revenue means and expenditure needs of various levels of local government in the Philippines. Many types of taxes are either easier to administer at the central level or are deemed to be unsuitable for local subnational government imposition because their tax bases are geographically mobile. The principle of subsidiarity implies that many functions are best assigned to local governments. In this context, intergovernmental transfers are generally viewed as an instrument that may be used to correct the imbalance in the tax and expenditure assignment.

In the case of the Philippines, LGUs have become increasingly dependent on the IRA. Thus, the contribution of the IRA to total LGU income net of borrowings surged from 38.0 percent in 1985-1991 to 65.1 percent in 1992-2003 for all LGUs combined (Table 23). This trend is more dramatic among provinces and municipalities than among cities. In particular, the share of the IRA in total income net of

Table 22. IRA and other grants as a portion of national revenues, national expenditures, and GNP

	NG transfers as percent of NG revenue			NG transfers as percent of NG expenditure			Percent to GNP		
	Total	IRA	Other grants	Total	IRA	Other grants	Total	IRA	Other grants
1985	5.9	4.8	1.1	5.0	4.1	0.9	0.7	0.6	0.1
1987	3.9	3.2	0.6	3.2	2.7	0.5	0.6	0.5	0.1
1989	4.9	3.3	1.6	4.8	3.2	1.6	0.8	0.6	0.3
1991	5.8	4.3	1.5	5.2	3.8	1.4	1.0	0.8	0.3
1993	10.1	9.8	0.2	9.5	9.2	0.2	1.7	1.7	0.0
1995	11.8	11.6	0.2	11.5	11.3	0.2	2.2	2.1	0.0
1997	12.1	12.0	0.1	11.6	11.5	0.1	2.3	2.2	0.0
1999	16.0	15.9	0.1	13.2	13.1	0.1	2.4	2.4	0.0
2001	15.7	15.5	0.1	12.5	12.4	0.1	2.3	2.3	0.0
2003	18.4	18.3	0.1	13.9	13.9	0.1	2.5	2.5	0.0
Average									
1985-1991	5.4	3.9	1.6	4.6	3.3	1.3	0.9	0.6	0.2
1992-2003	14.5	14.3	0.1	12.3	12.2	0.1	2.3	2.3	0.0

Table 23. IRA and other grants as a portion of total LGU income and LGU expenditure (in percent)

All LGUs	NG transfers as % of LGU total income			NG transfers as % of LGU expenditure		
	Total	IRA	Other grants	Total	IRA	Other grants
1985	48.0	39.1	8.9	47.5	38.7	8.8
1987	44.8	37.7	7.1	41.6	35.0	6.6
1989	48.9	32.7	16.1	53.6	35.9	17.7
1991	55.0	40.5	14.5	54.5	40.1	14.3
1993	59.7	58.2	1.5	64.1	62.5	1.6
1995	65.3	64.2	1.1	61.7	60.6	1.1
1997	62.9	62.4	0.6	60.0	59.5	0.5
1999	67.0	66.6	0.4	66.7	66.3	0.4
2001	66.7	66.1	0.6	60.7	60.2	0.5
2003	67.6	67.2	0.4	72.7	72.3	0.4
Average						
1985-1991	51.4	36.7	14.7	53.2	38.0	15.2
1992-2003	66.0	65.3	0.6	65.8	65.1	0.6

borrowings of provinces expanded from 38.8 percent in the pre-Code period to 81.3 percent in the post-Code period. The corresponding figure for municipalities rose from 38.3 percent to 74.1 percent while that for cities increased from 33.2 percent to 47.0 percent.

*Vertical imbalance.*³³ The mismatch between the revenue means and the expenditure needs of various levels of local government may be measured by comparing the subnational government's share in general government revenues with its share in general government expenditures (Shah 1994). Table 24 shows that the vertical fiscal imbalance (before transfers) has worsened at all levels of local government with the implementation of the Local Government Code. Thus, the fiscal deficiency for all LGUs in the aggregate grew from 6.7 percent in 1985-1991 to 16.9 percent in 1992-2003. Furthermore, transfers have not fully closed the vertical fiscal imbalance in both periods.

While the vertical fiscal imbalance after the IRA was trimmed down to less than 4 percent in 1998-2000, it has went up to 6.9 percent in 2001 and more than 4 percent in 2003 because of additional unfunded mandates (Table 24). This resonates with widespread perception that a vertical imbalance exists in the sense that

³³ The following discussion refers to the vertical imbalance in LGUs in general. The vertical balance issue in the case of the ARMM is discussed in Box 3.

Table 24. Indicator of vertical imbalance, with and without IRA

ALL LGUs	Ratio of own-source revenue to general gov't revenue %	Ratio of own-source revenue plus IRA to general gov't revenue %	Ratio of LGU expenditure to general gov't expenditure net of debt service %	Surplus/ (Deficit) - without the IRA %	Surplus/ (Deficit) - with the IRA %
1985	5.62	9.88	12.01	-6.39	-2.13
1987	4.36	7.35	10.55	-6.20	-3.21
1989	4.63	7.61	11.10	-6.47	-3.50
1991	4.31	8.20	12.65	-8.33	-4.44
1993	5.81	14.20	19.99	-14.18	-5.79
1995	5.30	15.14	21.85	-16.54	-6.71
1997	5.86	15.89	21.47	-15.61	-5.57
1999	6.36	19.21	23.05	-16.69	-3.84
2001	6.32	18.89	25.73	-19.41	-6.85
2003	6.85	21.21	25.41	-18.56	-4.20
Average					
1985-1991	4.62	8.13	11.30	-6.67	-3.17
1992-2003	6.09	17.85	22.96	-16.87	-5.12

Box 3. Vertical imbalance in the case of local government units in general

Vertical balance in the ARMM. Under RA 6734, the share of the regional government of the ARMM in national taxes is determined according to the derivation principle. In other words, the regional government of the ARMM and its component LGUs share in the actual collections of internal revenue taxes collected from the region. The sharing is as follows: 30 percent to the central government, 35 percent to the regional government itself, and 35 percent to the local governments in the region (also distributed to each one of them according to the derivation principle). The collecting agent (in this case the regional office of the Bureau of Internal Revenue) *automatically* remits to the regional government the latter's share of the regional government together with those of its constituent LGUs. Like the IRA, these transfers are block grants.

RA 6734 and the Local Government Code, in combination, have resulted in a severe vertical fiscal imbalance in the ARMM as there has been a mismatch between the expenditure responsibilities that were transferred and the revenue means of the subnational government. On the one hand, the regional government's share in internal revenue taxes is not sufficient to cover the expenditure responsibilities assigned to it. In particular, the share of the regional government in internal revenue taxes is equivalent to about 3 percent of the cost of the devolved functions.

This occurs largely because the ARMM's share in national taxes is computed on a derivation basis. Precisely because the ARMM is a less developed region, its tax base is lower than the

average tax base of the country in general. However, the problem also partly stems from the fact that all of the responsibilities devolved by the central government are shifted to the regional government, with none being assigned to the LGUs in the area despite the fact that RA 6734 allows the regional government to devolve their functions to the LGUs.^a

As a result, the regional government of ARMM is dependent on yearly allocations from the central government's general appropriations to carry out its mandate. The regional government has very little control over the size and composition of this funding. To wit, the size of this direct funding support is entirely dependent on the central government while the ARMM competes for these resources like any other central government agencies. Also, the allocation of the said transfers to various uses is predetermined by the central government as these are represented by line items in the General Appropriations Act. As such, the regional government is reduced to an administrative arm of the central government by simply implementing the latter's plans and programs.

Since 1992, central government transfers to the regional government has grown at a faster pace than what would have been necessary if one were simply making appropriate adjustments for inflation and population growth. In fact, central government allotment for the ARMM's regular operations is about twice the amount that used to be spent in the region. This may have been the central government's way of making up for its neglect of the region's needs in the past, which detracted from the region's fiscal autonomy.

It should also be emphasized that LGUs in the ARMM are entitled not only to their IRA share as mandated by the Local Government Code but also to their share in internal revenue collections in the ARMM as mandated by RA 6734. Consequently, the aggregate intergovernmental transfer accruing to ARMM LGUs is more than 20 times that of the regional government itself. Moreover, as indicated earlier, the regional government has not devolved any expenditure responsibility to its component LGU. Thus, ARMM LGUs get the resources but not the expenditure responsibilities

^a Note, however, that even if one adds the IRA share of ARMM LGUs to the share of the regional government in internal revenue taxes, the sum would still be substantially lower than the cost of functions devolved to the ARMM.

the LGUs' prevailing share in national taxes is deficient to cover both the cost of devolved functions and the cost of the so-called unfunded mandates despite the significant increase in the IRA share of LGUs under the Code. These unfunded mandates include the salary increases under the Salary Standardization Law, the additional personnel benefits under the Magna Carta for Health Workers, and the additional number of mandatory positions as well as the sectoral representation mandated under the Local Government Code.

A matching of the aggregate IRA levels with LGU expenditure responsibilities (including devolved functions, additional mandatory positions, unfunded mandates, and the budgetary requirement for the 20% development fund) in 1993, 1994, and 1995 shows that while the concern about the vertical balance was not justified in the aggregate in those years, the period 1996-1998 presents a different picture as the salary adjustments under the Salary Stan-

dardization Law were so hefty that the increases in the IRA were not able to keep up with the rising cost of devolved functions and unfunded mandates and the increased pressure for additional expenditures due to population growth (Table 25).³⁴ A parallel analysis for 1999-2003 indicates that the increase in IRA was more than sufficient to fully cover the inflation, population growth, and salary adjustments in the cost of devolved functions for all LGUs combined.³⁵

Moreover, variations in net resource transfer³⁶ across levels of local government are substantial. Table 25 shows that, in the aggregate, the net resource transfer for cities is consistently larger than those for provinces and municipalities. While the net resource transfer has consistently been positive for cities in 1995-2003, those for provinces were negative in 1995-1999 and 2001. In contrast, while the net resource of municipalities was also negative in 1995-1999, they turned positive in 2000-2003. This analysis suggests that provinces and municipalities in the aggregate are relative net losers while cities were relative net winners from fiscal decentralization. It is easy to see why.

Provinces absorbed 37.0 percent of the total cost of devolved functions; municipalities, 38.5 percent; cities, 5.7 percent; and barangays, 18.8 percent.³⁷ When this is contrasted with the mandated share of LGUs in the IRA (provinces, 23%; cities, 23%; municipalities, 34%; and barangays, 20%), it becomes immediately clear that there is a mismatch in the resources transferred and the cost of additional expenditure responsibilities that were devolved to the different levels of local government.

³⁴ The analysis underlying Table 25 is limited by the fact that, in the computation, the cost of devolved functions refers only to the cost of personnel and facilities that were actually transferred to the LGUs as well as the maintenance and operating expenses associated with the said devolved facilities. There are cases, however, where functions were transferred to LGUs without any corresponding devolution of personnel and facilities from the central government. This is true in the case of public works and, to some extent, environmental and natural resource management. In this sense, the estimates of the cost of new LGU expenditure responsibilities used in this analysis would tend to underestimate their true cost and, consequently, overestimate the vertical balance for all LGUs in the aggregate. Moreover, the cost used in the estimation refers to the cost of the devolved functions as budgeted by the central government prior to devolution. As such, they do not necessarily reflect local preferences. These notwithstanding, the analysis is still useful in looking at the vertical balance problem from the perspective of provinces, cities, and municipalities.

³⁵ The mandated increase in salaries of government employees during this period was moderate compared to the earlier period. However, it should be emphasized that the estimates used in the latter period did not include the newer mandate given to LGUs with respect to paying for the health insurance premiums of indigent residents.

³⁶ The net resource transfer for any given year is computed as the difference between the IRA for said year, on the one hand, and the sum of the adjusted cost of devolved functions, cost of other mandates including the provision for the 20 percent Development Fund and sectoral representation, and 1992 IRA, on the other hand. Adjustments on the cost side were made to take into account population growth and inflation.

³⁷ Barangays received P1.5 billion in Barangay Administration Fund under the National Assistance to Local Government Units (NALGU) in 1991. This assistance, which was used to pay for the salaries of barangay officials, was discontinued with the implementation of the Local Government Code. As a result, barangays have to pay those salaries from their own IRAs.

Table 25. Matching of IRA and LGU responsibilities, 1995-2000

	Province	Cities	Municipalities	All LGUs
1995				
Aggregate Net Resource	(0.320)	2.692	(0.114)	2.258
Transfer (in billion pesos) ^a				
Number of LGUs with Negative	48	0	983	
Per Capita Net Resource Transfer				
1997				
Aggregate Net Resource	(1.569)	1.501	(2.231)	(2.299)
Transfer (in billion pesos) ^b				
Number of LGUs with Negative	58	12	1,327	
Per Capita Net Resource Transfer				
1998				
Aggregate Net Resource	(2.743)	0.052	(3.029)	(5.72)
Transfer (in billion pesos) ^c				
Number of LGUs with Negative	65	35	1,336	
Per Capita Net Resource Transfer				
1999				
Aggregate Net Resource	(0.745)	2.746	(0.312)	1.689
Transfer (in billion pesos) ^d				
Number of LGUs with Negative	50	28	893	
Per Capita Net Resource Transfer				
2000				
Aggregate Net Resource	0.115	5.052	1.555	6.722
Transfer (in billion pesos) ^e				
Number of LGUs with Negative	38	11	684	
Per Capita Net Resource Transfer				
2001				
Aggregate Net Resource	(0.139)	4.692	0.284	4.837
Transfer (in billion pesos) ^f				
Number of LGUs with Negative	45	17	772	
Per Capita Net Resource Transfer				
2002				
Aggregate Net Resource	3.548	7.989	8.073	19.610
Transfer (in billion pesos) ^f				
Number of LGUs with Negative	12	18	141	
Per Capita Net Resource Transfer				
2003				
Aggregate Net Resource	4.040	8.830	8.811	21.681
Transfer (in billion pesos) ^f				
Number of LGUs with Negative	12	15	68	
Per Capita Net Resource Transfer				

Source: 1995-1998 results from Manasan (2001); 1999-2000 re-estimated to reflect actual developments in IRA in those years.

Note: See Appendix A for footnotes.

This imbalance may be traced to the fact that the IRA distribution formula was decided much earlier (i.e., during the Congressional debate on the Code) than the actual assignment of functions (including the devolution of personnel) to different levels of local government. Some observers note that this skewed distribution may reflect the perception that governors are a more common threat to congressmen than are mayors since congressmen represent either congressional districts that are coterminous with the boundaries of a single province or one of many districts within a single province. While mayors pose similar threats to some congressmen, there are fewer big city mayors than there are governors and most legislators represent districts without highly urbanized cities in them. Thus, by making provinces responsible for more services than they could pay for with automatic revenue transfers, Congress ensured that governors would remain dependent on legislators, who could subsequently offer their services as brokers of additional revenues from the center in (Eaton 2001).³⁸

In sum. Finance did not follow function. The discussion in Section 3.2 and Section 4.2 shows that this is true when one compares the expenditure responsibilities assigned to LGUs with the own-source revenue authorities that are vested on them under the Code. This is also certainly true for all LGUs in the aggregate in 1995-1999 when one compares the additional revenues from the IRA with the cost of devolved functions. While the vertical imbalance does not appear to be a problem in 2000-2003, the actual picture in those years seems less optimistic than that shown in Table 25 if one takes into account the cost of devolved functions, which did not involve the actual transfer of personnel from the national government agencies to LGUs and the newer expenditure mandate of LGUs with regard to the financing of the health insurance premiums of indigent residents. Clearly, there is a need to improve the IRA distribution formula so that the varying fiscal capacities of the various levels of local government match their expenditure needs more closely.

³⁸ When the Code was being debated in Congress, the attitude of congressmen toward decentralization was ambiguous. Many of them felt threatened, knowing that true local autonomy would reduce their political clout over their respective constituents (who heretofore were largely dependent on projects identified by the congressmen and funded from pork barrel funds) as local government politicians become more powerful with the higher revenue share and expanded expenditure responsibility with fiscal decentralization. On the other hand, many congressmen maintain fraternal relations with local officials as Philippine local politics tends to be dominated by political dynasties. Thus, it is not uncommon to find cities (or provinces) where the mayor (or governor) is the congressman's wife (or brother/sister/father/son). Thus, in agreeing to decentralize revenues and expenditures, the congressmen then tried to protect against what they feared most about decentralization.

Impact of intergovernmental fiscal structure on horizontal fiscal balance

In addition to the vertical imbalance across levels of local government, an imbalance also exists across LGUs within each level. Thus, while the increase in the IRA share of some LGUs is not enough to finance the functions devolved to them, others have received resources beyond their requirements. For instance, in 2001, per capita net resource transfer was negative in 45 (57%) out of 79 provinces, in 772 (52%) out of 1,494 municipalities, and in 17 (15%) out of 113 cities (Table 25).³⁹

When all LGUs are aggregated at the provincial level, per capita IRA is found to be positively related to per capita household income in 1995-1999, suggesting that the IRA distribution formula has been counter-equalizing vis-à-vis the fiscal capacities of LGUs (Table 26). In contrast, the IRA was found to be equalizing in 2000 (as indicated by the negative correlation coefficient between per capita IRA and per capita household income in that year).⁴⁰ Categorical grants are also found to have played an equalizing role in 1998-2000. However, even in 2000, the combined equalizing effect of the IRA and categorical grants was not sufficient to compensate for the inherent disparities in the tax base (as indicated by the positive correlation coefficient between the per capita household income and the sum of the LGUs' per capita own-source revenue and per capita IRA aggregated at the provincial level in Table 26).

Some variation in the equalization character of the IRA distribution formula is evident across levels of local government. Thus, while the correlation coefficient between per capita IRA and per capita household income of city governments is consistently negative throughout the period 1995-2000, it is positive in the case of provinces.⁴¹ This indicates that the existing IRA distribution formula has had some success in equalizing the fiscal capacities of cities but not in the case of provinces and municipalities. Nonetheless, the equalizing effect of the IRA in the case of cities is not enough to counteract the large disparities in their tax base.

In this regard, the literature on fiscal decentralization suggests that future amendments to the Code should look more closely into the inclusion of equalization grants that are designed to help reduce disparities in revenue capacities (or

³⁹ Per capita net resource transfer in 2000 is defined as per capita 2000 IRA less per capita 1992 IRA less per capita cost of devolved functions adjusted for inflation.

⁴⁰ The difference in the sign of the correlation coefficient between per capita IRA and per capita household income in the years 1995 to 1999, on the one hand, and the year 2000, on the other, suggests that the implementation of the LGSEF scheme in 1999-2000 may have resulted in some equalization. Note that the LGSEF provided additional transfers to lower income class LGUs in 1999-2000. Also, the LGSEF transfers were treated as part of the IRA in the financial statements of LGUs.

⁴¹ In the case of municipalities, the correlation coefficient is found to be negative in 1999-2000 but positive in other years, indicating that the implementation of the LGSEF scheme did have some equalization effect on municipalities.

Table 26. Simple correlation coefficient between the per capita transfer and per capita household income

ALL LGUS AGGREGATED AT PROVINCIAL LEVEL	1991	1995	1996	1997	1998	1999	2000
PC IRA w/ PC Household Income	-0.08	0.10	0.10	0.21	0.25	0.00	-0.02
PC Grants w/ PC Household Income	0.38	-0.05	0.12	0.15	-0.12	-0.01	-0.10
PC OSR + PC IRA w/ PC Household Income	0.31	0.22	0.19	0.35	0.44	0.16	0.14
PC OSR + PC IRA + PCGRANTS w/ PC Household Income	0.40	0.22	0.19	0.35	0.44	0.16	0.14
PC OSR w/ PC Household Income	0.49	0.48	0.44	0.53	0.61	0.59	0.61
PROVINCES	1991	1995	1996	1997	1998	1999	2000
PC IRA w/ PC Household Income	0.12	0.16	0.28	0.33	0.31	0.06	0.05
PC Grants w/ PC Household Income	0.40	-0.11	0.14	0.04	0.02	-0.02	-0.03
PC OSR + PC IRA w/ PC Household Income	0.27	0.21	0.35	0.38	0.39	0.13	0.10
PC OSR + PC IRA + PCGRANTS w/ PC Household Income	0.38	0.21	0.35	0.38	0.39	0.13	0.10
PC OSR w/ PC Household Income	0.34	0.34	0.50	0.51	0.48	0.45	0.52
CITIES	1991	1995	1996	1997	1998	1999	2000
PC IRA w/ PC Household Income	-0.38	-0.41	-0.38	-0.43	-0.46	-0.57	-0.55
PC Grants w/ PC Household Income	0.02	-0.09	0.03	0.20	0.12	0.05	0.02
PC LSR + PC IRA w/ PC Household Income	0.31	0.32	0.49	0.31	0.45	0.30	0.28
PC LSR + PC IRA + PCGRANTS w/ PC Household Income	0.28	0.30	0.48	0.31	0.45	0.30	0.28
PC OSR w/ PC Household Income	0.61	0.81	0.84	0.77	0.80	0.69	0.69
MUNICIPALITIES BY PROVINCIAL LEVEL	1991	1995	1996	1997	1998	1999	2000
PC IRA w/ PC Household Income	-0.10	0.02	-0.02	0.09	0.12	-0.08	-0.11
PC Grants w/ PC Household Income	0.20	-0.11	0.02	0.33	-0.02	0.09	0.01
PC LSR + PC IRA w/ PC Household Income	0.68	0.29	0.09	0.36	0.43	0.21	0.18
PC LSR + PC IRA + PCGRANTS w/ PC Household Income	0.59	0.29	0.09	0.37	0.43	0.21	0.18
PC OSR PC Household Income	0.81	0.71	0.42	0.72	0.75	0.81	0.83

alternatively, the net fiscal capacities, i.e., revenue means less expenditure needs) among individual LGUs.

Impact of intergovernmental fiscal structure on revenue mobilization

Earlier studies shows that while intergovernmental transfers had a neutral effect on local revenue performance in 1985 (prior to the Code), it substituted for local tax

revenues in all levels of local governments in 1992 and 1993 (Manasan 1995).

Using panel data of provinces, cities, and municipalities for 1995-2000, regression analysis of per capita local tax revenues on per capita household income⁴² (as a proxy for the local tax base) and per capita IRA (as a way to check whether intergovernmental grants stimulates or substitutes for local government revenue effort) reconfirms the disincentive effect of the IRA on local tax effort in the post-Code period. The results show that LGUs that were net winners in the fiscal decentralization tended to have lower per capita local tax revenue (as indicated by the negative and statistically significant coefficient of the product of the dummy variable for the sign of the per capita net resource transfer and per capita IRA in both the real property tax and the local business tax equations of provinces and in real property tax equations of cities).⁴³ Similarly, the coefficient of per capita IRA itself is negative and statistically significant in the local business tax equation of cities. These findings suggest that LGUs that received higher IRA (whether in absolute terms or relative to their expenditure responsibilities) tended to be lax in their tax effort. Thus, there appears to be a need to alter the IRA distribution formula to provide incentives for local tax effort.

Consistent with *a priori* expectations, the analysis also shows that per capita local tax revenue is positively and significantly related to per capita household income for both real property tax and local business tax for cities, municipalities, and provinces alike in 1995-2000 (Table 27). This finding confirms that local tax effort is largely determined by the ability to pay. Given the wide disparities in the distribution of the local tax base across regions, this result further highlights the potential for increased regional inequality with greater fiscal decentralization unless part of intergovernmental transfers are designed to have an equalization role.

AGENDA FOR REFORM

Expenditure assignment

Overall, the devolution of expenditure responsibilities to subnational governments is consistent with the decentralization theorem. One important exception to the application of this principle in the Philippines is education. Although the construction and maintenance of school buildings was devolved to LGUs under the Code, the primary responsibility for the provision of education remains with the

⁴² Household income data presented here were obtained from the Family Income and Expenditure Survey of the National Statistics Office.

⁴³ In the regression analysis, a dummy variable that takes on a value of 1 if the LGU has a positive per capita net resource transfer due to the fiscal decentralization (and zero, otherwise) is introduced to check whether net winners behave differently from the net losers. Net resource transfer is defined as the difference between the increment in the IRA and the cost of devolved functions and unfunded mandates.

Table 27. Regression of per capita tax revenue of LGUs ^a

	Province		Cities		Municipalities ^b	
	PCLBT ^b	PCRPT ^b	PCLBT ^c	PCRPT ^b	PCLBT	PCRPT
Constant	-17.246 (-2.91)	-17.980 (-3.82)	-0.886 (-0.25)	-241.829 (-2.25)	-15.072 (-5.38)	-16.392 (-5.26)
Density	-0.360 (-1.48) *	0.204 (1.05)	0.213 (2.19) **	0.005 (1.35) *	0.468 (3.45) **	0.490 (3.24) **
PCFIESY	2.128 (3.67) **	2.155 (4.62) **	0.732 (3.26) **	0.015 (6.68) **	1.289 (4.47) **	1.399 (4.36) **
PCIRA	-0.384 (-1.03)	-0.163 (-0.55)	-0.469 (-1.63) **	0.114 (1.72) **	0.504 (1.74) **	0.538 (1.66) **
D1*PCIRA	-0.102 (-1.70) **	-0.070 (-1.45) *		-0.080 (-1.36) *		
X ² (Chi-square)	4.83	10.66	40.78	22.13	25.77	23.69

^a Numbers in parenthesis refer to t-statistics.

^b Follows double log specification.

^c Follows linear specification.

* Statistically significant at 10%.

** Statistically significant at 5%.

central government. In contrast, the experience in many countries shows that devolving education could possibly improve production efficiency. A review of this specific expenditure assignment may be warranted.

While Section 17(b) of the Local Government Code provides a clear delineation of functions across levels of government, Sections 17(c), which deals with nationally funded devolved activities, and Section 17(f), which focuses on national government augmentation of devolved services, obfuscate what initially appears to be a clear-cut assignment of expenditure responsibilities.

The Code must be revisited to clarify the assignment of expenditure responsibilities across local government levels. In particular, Section 17(c) and 17(f) of the Code has to be re-examined hand in hand with a review of the distribution formula of the IRA. This would require a careful re-assessment of the need for continued funding of devolved activities by national government agencies as well as LGU budgetary support of local offices (and employees) of many national government agencies. Also, the imposition of unfunded mandates that are not associated with compensating funding transfers to LGUs should be avoided in the future. In addition, the devolution of functions from the regional government of the ARMM to the ARMM's LGUs should be encouraged.

Three major trends in LGU expenditure are a major source of concern. First, aggregate LGU spending on the social services sector registered a general upward trend in 1991-2007 when expressed as a percent of GNP and in real per capita terms. However, some stagnation (especially with respect to health expenditures) is evident in 1998-2003 when either of these measures is used. These movements are common across all levels of local government and appear to be related to the fiscal difficulties LGUs faced when their IRA was not released in full in the late 1990s at the same time that they suffered from a decline in their own-source revenue. This development is worrisome considering that LGUs are primarily responsible for the delivery of basic health services. It also highlights the need to design grants that will help ensure that LGUs are able to deliver health and education services that at least meet the minimum service standards.

Second, LGU spending on transportation and communication contracted from 0.5 percent of GNP in 1991 to 0.4 percent of GNP in 2003 despite the devolution of the responsibility for local infrastructure to LGUs. This decline masks even larger reductions in the infrastructure spending of provincial and municipal governments. These developments appear to be linked to the mismatch in the distribution of resources and expenditure responsibilities across levels of local governments. Also, given the robust and strong association between economic growth and infrastructure spending, they may be indicative of a widening of disparities in

economic development across levels of local government. They also underscore the need to strengthen the regulatory framework and arrangements for LGU borrowing and to address the requirement for LGU capital investment financing in the design of intergovernmental transfers .

Third, personal services (PS) is the single biggest expenditure item at all levels of local government. While the share of personal services in total LGU expenditure contracted from 45.8 percent in 1991 to 34.2 percent in 2003 in the case of cities, it expanded from 41.6 percent to 42.1 percent in the case of provinces and from 46.1 percent to 50.8 percent in the case of municipalities. Because of these developments, there has been a squeeze on the capital outlays of provinces and on both the MOOE and capital outlays of municipalities.

In this regard, there is a need to reassess the compensation and position classification system as well as the list of mandatory LGU positions provided for in the Local Government Code in order to give LGUs more leeway in adjusting their PS expenditures. A review of the cap on PS expenditures is also important. Existing practices and procedures that allow LGUs to comply with this requirement do not appear to be helpful in enabling LGUs to effectively control their PS spending.

Tax assignment

The current tax assignment does not fare well in terms of the autonomy criterion. While the Code authorizes LGUs to levy a good number of taxes, the more revenue productive taxes are retained by the central government even as the Code seriously constrains the power of LGUs to set local tax rates. Thus, the link between LGU spending responsibilities and their taxing powers is weak.

Given this background, future Code amendments should focus on promoting greater tax decentralization. In particular, such amendments should give LGUs greater discretion in setting tax rates by (1) raising the maximum allowable tax rates, (2) allowing them to adjust the tax rates more frequently, and (3) relaxing the restrictions on the size of the tax rate adjustments that they are authorized to make. More importantly, LGUs should be allowed to impose a surcharge (i.e., piggyback) on some of the central government taxes (possibly, the individual income tax).

Also, the tax structure prescribed by the Code for the local business tax should be simplified to ease up tax administration and improve taxpayer compliance. At the same time, support for greater computerization and capacity building for the staff of the tax division is critical.

Finally, the conduct of the general revision of the schedule of market values of real property may be depoliticized by assigning this activity to the central government. Such a move will not reduce the autonomy of LGUs, provided they retain, if not increase, their control over local tax rates and assessment levels.

Intergovernmental transfers

As in other countries, LGUs in the aggregate in the Philippines suffer a vertical fiscal gap. Many types of taxes are either easier to administer at the central level or are deemed unsuitable for local subnational government imposition because their tax bases are geographically mobile. The principle of subsidiarity implies that many functions are best assigned to local governments. To a large extent, this gap is addressed by intergovernmental transfers (specifically the IRA) and LGUs have been clamoring to increase the size of the IRA pool.

Also, as indicated above, there is a mismatch between the assignment of revenues (local taxes plus IRA) and the assignment of expenditure responsibilities to the different levels of local government. The share of provinces and municipalities in total LGU own-source revenue declined in the post-Code period despite their large share in the cost of devolved functions.

In this context, there is a need to re-assess the tax and expenditure assignment across different levels of local government. At the same time, the vertical imbalance should be primarily addressed through greater tax decentralization—the assignment of more tax bases to LGUs. Consequently, intergovernmental transfers would then be re-designed to help close the disparities in the fiscal capacities of LGUs and ensure that LGUs get the appropriate financing for them to meet the minimum service standards for key basic social services.

Annex Table 1 continued

B. ALL PROVINCES	1991	1995	1999	2001	2002	2003
Trade	0.00	0.00	0.00	0.00	0.00	0.00
Tourism	0.00	0.00	0.00	0.00	0.00	0.00
Power and Energy	0.00	0.01	0.00	0.00	0.00	0.00
Water Resources Dev't. and Flood Control	0.00	0.00	0.00	0.00	0.00	0.00
Transportation and Communication	0.21	0.13	0.13	0.13	0.10	0.11
Other Economic Services	0.01	0.06	0.07	0.09	0.07	0.07
Total Social Services	0.10	0.32	0.28	0.28	0.22	0.23
Education	0.01	0.05	0.04	0.05	0.03	0.04
Health	0.02	0.19	0.20	0.18	0.16	0.16
Social Services, Labor and Employment	0.01	0.01	0.02	0.02	0.01	0.01
Housing and Community Development	0.06	0.07	0.02	0.03	0.01	0.02
General Public Service	0.19	0.26	0.27	0.30	0.28	0.28
Public Administration	0.19	0.26	0.27	0.30	0.28	0.28
Peace and Order	0.00	0.00	0.00	0.00	0.00	0.00
Others	0.02	0.05	0.04	0.06	0.08	0.06
Defense	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service	0.00	0.01	0.02	0.02	0.01	0.02
C. ALL MUNICIPALITIES	1991	1995	1999	2001	2002	2003
GRAND TOTAL	0.76	1.33	1.32	1.30	1.25	1.18
Total Economic Services	0.23	0.32	0.28	0.28	0.25	0.24
Agrarian Reform	0.00	0.00	0.00	0.00	0.00	0.00
Agriculture	0.00	0.06	0.06	0.05	0.05	0.04
Natural Resources	0.00	0.00	0.00	0.00	0.00	0.00
Industry	0.00	0.00	0.00	0.00	0.00	0.00
Trade	0.00	0.00	0.00	0.00	0.00	0.00
Tourism	0.00	0.00	0.00	0.00	0.00	0.00
Power and Energy	0.00	0.00	0.00	0.00	0.00	0.00
Water Resources Dev't. and Flood Control	0.00	0.00	0.01	0.01	0.01	0.01
Transportation and Communication	0.16	0.14	0.11	0.11	0.09	0.08
Other Economic Services	0.05	0.11	0.11	0.11	0.10	0.11
Total Social Services	0.07	0.27	0.28	0.27	0.23	0.22

Annex Table 1 continued

C. ALL MUNICIPALITIES	1991	1995	1999	2001	2002	2003
Education	0.03	0.07	0.05	0.05	0.04	0.05
Health	0.01	0.12	0.134	0.123	0.120	0.104
Social Services, Labor and Employment	0.02	0.04	0.04	0.04	0.04	0.04
Housing and Community Development	0.01	0.04	0.05	0.05	0.03	0.04
General Public Service	0.43	0.66	0.69	0.68	0.68	0.61
Public Administration	0.43	0.66	0.69	0.68	0.68	0.60
Peace and Order	0.00	0.00	0.00	0.00	0.00	0.00
Others	0.03	0.06	0.05	0.06	0.08	0.10
Defense	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service	0.00	0.01	0.02	0.02	0.01	0.01
D. ALL CITIES	1991	1995	1999	2001	2002	2003
GRAND TOTAL	0.58	1.34	1.50	1.54	1.37	1.44
Total Economic Services	0.21	0.42	0.40	0.39	0.30	0.31
Agrarian Reform	0.00	0.00	0.00	0.00	0.00	0.00
Agriculture	0.01	0.02	0.02	0.02	0.02	0.02
Natural Resources	0.00	0.01	0.02	0.02	0.03	0.02
Industry	0.00	0.00	0.00	0.00	0.00	0.00
Trade	0.00	0.00	0.00	0.00	0.00	0.00
Tourism	0.00	0.00	0.00	0.00	0.00	0.00
Power and Energy	0.02	0.01	0.01	0.01	0.00	0.00
Water Resources Dev't. and Flood Control	0.00	0.00	0.00	0.00	0.00	0.00
Transportation and Communication	0.15	0.30	0.27	0.25	0.18	0.18
Other Economic Services	0.03	0.08	0.07	0.09	0.08	0.08
Total Social Services	0.12	0.35	0.41	0.45	0.33	0.38
Education	0.03	0.13	0.17	0.18	0.11	0.13
Health	0.05	0.10	0.12	0.12	0.09	0.11
Social Services, Labor and Employment	0.03	0.03	0.03	0.03	0.02	0.03
Housing and Community Development	0.02	0.09	0.09	0.12	0.10	0.11
General Public Service	0.22	0.44	0.50	0.54	0.57	0.53
Public Administration	0.22	0.43	0.49	0.53	0.56	0.51

Annex Table 1 continued

D. ALL CITIES	1991	1995	1999	2001	2002	2003
Peace and Order	0.01	0.01	0.01	0.01	0.01	0.01
Others	0.02	0.07	0.15	0.11	0.10	0.16
Defense	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service	0.01	0.06	0.05	0.05	0.06	0.06

*Adjusted for DOH and DA advances.

Annex Table 2. Sectoral distribution of local government expenditures (in percent)

A. ALL LGUs	Average		1991	1995	1999	2001	2002	2003
	1985-1991	1993-2003						
GRAND TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Total Economic Services	32.85	24.59	35.76	27.62	25.19	24.58	22.17	22.36
Agrarian Reform	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Agriculture	1.27	3.01	1.08	3.03	3.08	2.90	2.89	2.71
Natural Resources	0.00	0.59	0.00	0.41	0.62	0.61	0.92	0.76
Industry	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Trade	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Tourism	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Power and Energy	1.08	0.47	1.18	0.58	0.55	0.51	0.16	0.15
Water Resources Dev't. and Flood Control	0.59	0.26	0.53	0.26	0.29	0.28	0.23	0.22
Transportation and Communication	24.59	13.16	27.85	16.07	13.89	12.83	10.74	11.08
Other Economic Services	5.32	7.10	5.12	7.27	6.75	7.44	7.23	7.44
Total Social Services	20.47	25.87	15.44	26.50	26.28	26.63	22.76	24.37
Education	7.48	7.15	3.58	7.16	7.45	7.58	5.39	6.30
Health	4.92	11.72	4.19	11.41	12.22	11.48	11.06	10.99
Social Services, Labor and Employment	2.74	2.28	2.83	2.14	2.22	2.47	2.17	2.30
Housing and Community Development	5.32	4.72	4.83	5.78	4.39	5.10	4.14	4.79
General Public Service	42.83	40.71	44.53	38.36	39.93	40.61	44.72	41.25
Public Administration	40.29	40.29	43.98	37.82	39.61	40.23	44.30	40.85

Annex Table 2 continued

A. ALL LGUs	Average		1991	1995	1999	2001	2002	2003
	1985-1991	1993-2003						
Peace and Order	2.54	0.41	0.55	0.54	0.32	0.38	0.42	0.41
Others	2.97	6.56	3.51	5.13	6.48	5.94	7.66	9.24
Defense	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service	0.88	2.27	0.76	2.39	2.12	2.24	2.69	2.77
B. ALL PROVINCES	Average		1991	1995	1999	2001	2002	2003
	1985-1991	1993-2003						
GRAND TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Total Economic Services	40.86	27.90	43.76	27.50	29.25	28.41	25.20	26.34
Agrarian Reform	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Agriculture	2.66	4.27	1.76	4.07	4.64	4.06	3.98	3.91
Natural Resources	0.00	0.53	0.00	0.53	0.52	0.55	0.55	0.52
Industry	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Trade	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Tourism	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Power and Energy	0.57	0.42	0.66	0.73	0.57	0.09	0.01	0.06
Water Resources Dev't. and Flood Control	0.63	0.13	0.67	0.19	0.17	0.08	0.08	0.04
Transportation and Communication	32.09	14.61	38.10	14.77	15.15	14.10	12.17	13.66
Other Economic Services	4.90	7.94	2.57	7.21	8.20	9.53	8.41	8.15

Annex Table 2 continued

B. ALL PROVINCES	Average		1991	1995	1999	2001	2002	2003
	1985-1991	1993-2003						
Total Social Services	21.13	31.96	17.93	36.29	32.57	30.87	27.43	28.73
Education	2.79	5.45	1.63	5.45	5.17	5.63	4.11	5.52
Health	3.78	21.56	2.91	21.58	23.05	20.23	20.42	19.57
Social Services, Labor and Employment	1.69	1.82	1.89	1.51	1.78	2.21	1.56	1.69
Housing and Community Development	12.88	3.14	11.50	7.75	2.57	2.80	1.34	1.95
General Public Service	33.71	32.17	34.35	29.67	31.28	32.61	35.09	34.73
Public Administration	33.63	32.08	34.33	29.34	31.24	32.58	35.02	34.67
Peace and Order	0.08	0.09	0.02	0.33	0.03	0.03	0.07	0.06
Others	3.11	6.13	3.70	5.19	5.02	6.05	10.45	7.83
Defense	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service	1.19	1.84	0.26	1.35	1.87	2.07	1.83	2.36
C. ALL MUNICIPALITIES	Average		1991	1995	1999	2001	2002	2003
	1985-1991	1993-2003						
GRAND TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Total Economic Services	27.24	21.44	29.96	24.16	21.22	21.30	20.28	20.66

Annex Table 2 continued

C. ALL MUNICIPALITIES	Average		1991	1995	1999	2001	2002	2003
	1985-1991	1993-2003						
Agrarian Reform	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Agriculture	0.27	4.05	0.22	4.27	4.23	4.05	3.97	3.63
Natural Resources	0.00	0.08	0.00	0.03	0.05	0.08	0.11	0.10
Industry	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Trade	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Tourism	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Power and Energy	0.52	0.29	0.48	0.24	0.28	0.27	0.37	0.32
Water Resources Dev't. and Flood Control	0.75	0.44	0.64	0.34	0.39	0.52	0.44	0.47
Transportation and Communication	19.29	8.40	21.59	10.85	8.14	8.19	7.43	7.14
Other Economic Services	6.40	8.18	7.03	8.44	8.14	8.18	7.97	9.01
Total Social Services	14.68	20.58	9.26	20.67	20.98	20.47	18.22	18.70
Education	8.04	4.52	3.71	5.55	4.15	4.01	3.12	3.84
Health	2.34	9.67	1.75	9.08	10.16	9.45	9.56	8.82
Social Services, Labor and Employment	2.61	2.92	2.27	2.67	2.91	3.14	2.97	2.99
Housing and Community Development	1.69	3.47	1.54	3.37	3.76	3.87	2.57	3.06
General Public Service	54.77	51.94	56.60	49.70	52.76	52.65	54.46	51.37
Public Administration	51.63	51.67	56.01	49.41	52.57	52.44	54.15	51.14
Peace and Order	3.13	0.27	0.58	0.28	0.19	0.21	0.31	0.23
Others	2.94	4.96	3.88	4.76	3.78	4.39	6.05	8.05

Annex Table 2 continued

C. ALL MUNICIPALITIES	Average		1991	1995	1999	2001	2002	2003
	1985-1991	1993-2003						
Defense	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service	0.38	1.09	0.29	0.72	1.25	1.19	0.99	1.22
D. ALL CITIES	Average		1991	1995	1999	2001	2002	2003
	1985-1991	1993-2003						
GRAND TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Total Economic Services	32.34	25.46	35.81	31.13	26.36	25.07	22.12	21.52
Agrarian Reform	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Agriculture	1.21	1.32	1.58	1.12	1.20	1.25	1.27	1.28
Natural Resources	0.00	1.08	0.00	0.71	1.17	1.09	1.88	1.43
Industry	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Trade	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Tourism	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Power and Energy	2.18	0.66	2.58	0.82	0.78	0.97	0.04	0.06
Water Resources Dev't. and Flood Control	0.37	0.18	0.23	0.22	0.27	0.20	0.13	0.11
Transportation and Communication	24.17	16.60	26.39	22.10	18.22	15.97	12.95	12.88
Other Economic Services	4.41	5.61	5.03	6.16	4.72	5.59	5.85	5.76
Total Social Services	26.73	27.02	21.15	25.91	27.38	29.30	24.17	26.59
Education	11.03	10.55	5.23	9.89	11.62	11.73	8.22	8.76

Annex Table 2 continued

D. ALL CITIES	Average		1991	1995	1999	2001	2002	2003
	1985-1991	1993-2003						
Health	9.01	7.68	8.59	7.12	7.91	8.03	6.93	7.95
Social Services, Labor and Employment	3.84	1.99	4.46	2.01	1.87	2.05	1.79	2.07
Housing and Community Development	2.85	6.81	2.87	6.89	5.98	7.49	7.23	7.81
General Public Service	36.86	35.65	38.35	32.76	33.57	35.21	41.45	36.60
Public Administration	32.82	34.91	37.34	31.81	32.97	34.48	40.73	35.85
Peace and Order	4.03	0.74	1.01	0.95	0.60	0.73	0.72	0.75
Others	2.87	8.28	2.85	5.47	9.67	7.19	7.51	11.00
Defense	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service	1.20	3.59	1.84	4.73	3.02	3.23	4.75	4.29

*Adjusted for DOH & DA advances

Annex Table 3. Per capita local government expenditures, in 1985 prices (including transfers to NG)

A. ALL LGUs	1991	1995	1999	2001	2002	2003
GRAND TOTAL	218.04	426.13	473.53	506.44	470.71	486.25
Total Economic Services	77.97	117.70	119.27	124.47	104.36	108.74
Agrarian Reform	0.00	0.00	0.00	0.00	0.00	0.00
Agriculture	2.36	12.91	14.61	14.70	13.61	13.18
Natural Resources	0.00	1.75	2.93	3.08	4.33	3.67
Industry	0.00	0.00	0.00	0.00	0.00	0.00
Trade	0.00	0.00	0.00	0.00	0.00	0.00
Tourism	0.00	0.00	0.00	0.00	0.00	0.00
Power and Energy	2.57	2.47	2.62	2.60	0.73	0.72
Water Resources Dev't. and Flood Control	1.15	1.10	1.37	1.43	1.10	1.07
Transportation and Communication	60.73	68.47	65.76	64.97	50.57	53.89
Other Economic Services	11.16	31.00	31.98	37.69	34.02	36.20
Total Social Services	33.66	112.91	124.47	134.85	107.12	118.51
Education	7.80	30.53	35.27	38.38	25.37	30.62
Health	9.14	48.64	57.88	58.16	52.05	53.44
Social Services, Labor and Employment	6.18	9.11	10.51	12.49	10.20	11.18
Housing and Community Development	10.53	24.64	20.81	25.83	19.51	23.28
General Public Service	97.09	163.46	189.07	205.66	210.49	200.60
Public Administration	95.88	161.14	187.54	203.74	208.52	198.61
Peace and Order	1.21	2.32	1.53	1.92	1.97	1.99
Others	7.65	21.87	30.69	30.11	36.08	44.91
Defense	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service	1.66	10.18	10.03	11.35	12.65	13.49
B. ALL PROVINCES	1991	1995	1999	2001	2002	2003
GRAND TOTAL	79.99	134.93	142.99	156.72	140.54	149.52
Total Economic Services	35.00	37.10	41.83	44.52	35.42	39.38
Agrarian Reform	0.00	0.00	0.00	0.00	0.00	0.00
Agriculture	1.40	5.49	6.63	6.37	5.59	5.84
Natural Resources	0.00	0.71	0.75	0.86	0.77	0.77

Annex Table 3 continued

B. ALL PROVINCES	1991	1995	1999	2001	2002	2003
Industry	0.00	0.00	0.00	0.00	0.00	0.00
Trade	0.00	0.00	0.00	0.00	0.00	0.00
Tourism	0.00	0.00	0.00	0.00	0.00	0.00
Power and Energy	0.53	0.99	0.82	0.14	0.02	0.08
Water Resources Dev't. and Flood Control	0.54	0.26	0.24	0.13	0.12	0.07
Transportation and Communication	30.48	19.93	21.66	22.10	17.10	20.43
Other Economic Services	2.05	9.73	11.73	14.93	11.82	12.19
Total Social Services	14.34	48.97	46.57	48.37	38.55	42.96
Education	1.31	7.35	7.39	8.82	5.77	8.25
Health	2.33	29.12	32.96	31.70	28.70	29.26
Social Services, Labor and Employment	1.51	2.04	2.54	3.46	2.19	2.53
Housing and Community Development	9.20	10.46	3.68	4.39	1.88	2.92
General Public Service	27.48	40.03	44.72	51.11	49.32	51.93
Public Administration	27.46	39.59	44.67	51.06	49.22	51.84
Peace and Order	0.02	0.44	0.05	0.04	0.10	0.08
Others	2.96	7.01	7.18	9.48	14.68	11.71
Defense	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service	0.21	1.82	2.68	3.24	2.57	3.53
	31.54	21.17	22.72	22.36	17.24	20.58
C. ALL MUNICIPALITIES	1991	1995	1999	2001	2002	2003
GRAND TOTAL	111.05	209.42	241.44	248.92	258.51	257.69
Total Economic Services	33.27	50.60	51.24	53.01	52.44	53.25
Agrarian Reform	0.00	0.00	0.00	0.00	0.00	0.00
Agriculture	0.24	8.94	10.21	10.08	10.26	9.36
Natural Resources	0.00	0.06	0.12	0.20	0.28	0.25
Industry	0.00	0.00	0.00	0.00	0.00	0.00
Trade	0.00	0.00	0.00	0.00	0.00	0.00
Tourism	0.00	0.00	0.00	0.00	0.00	0.00
Power and Energy	0.53	0.50	0.68	0.68	0.95	0.82
Water Resources Dev't. and Flood Control	0.72	0.72	0.94	1.30	1.14	1.21
Transportation and Communication	23.97	22.71	19.64	20.39	19.20	18.40
Other Economic Services	7.81	17.67	19.64	20.37	20.61	23.21

Annex Table 3 continued

C. ALL MUNICIPALITIES	1991	1995	1999	2001	2002	2003
Total Social Services	10.29	43.29	50.66	50.96	47.11	48.18
Education	4.12	11.62	10.02	9.98	8.08	9.89
Health	1.94	19.02	24.54	23.52	24.71	22.72
Social Services, Labor and Employment	2.52	5.59	7.01	7.82	7.67	7.71
Housing and Community Development	1.71	7.06	9.09	9.64	6.65	7.88
General Public Service	62.85	104.07	127.39	131.05	140.78	132.37
Public Administration	62.20	103.48	126.92	130.53	139.99	131.77
Peace and Order	0.65	0.59	0.47	0.53	0.80	0.60
Others	4.31	9.96	9.13	10.92	15.63	20.74
Defense	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service	0.32	1.50	3.02	2.96	2.55	3.14
D. ALL CITIES	1991	1995	1999	2001	2002	2003
GRAND TOTAL	319.17	684.15	654.89	702.35	563.32	624.75
Total Economic Services	114.30	213.00	172.66	176.09	124.61	134.45
Agrarian Reform	0.00	0.00	0.00	0.00	0.00	0.00
Agriculture	5.03	7.69	7.88	8.80	7.13	7.98
Natural Resources	0.00	4.88	7.67	7.66	10.60	8.94
Industry	0.00	0.00	0.00	0.00	0.00	0.00
Trade	0.00	0.00	0.00	0.00	0.00	0.00
Tourism	0.00	0.00	0.00	0.00	0.00	0.00
Power and Energy	8.25	5.61	5.11	6.79	0.25	0.39
Water Resources Dev't. and Flood Control	0.75	1.48	1.77	1.40	0.73	0.71
Transportation and Communication	84.24	151.19	119.29	112.19	72.93	80.45
Other Economic Services	16.04	42.15	30.94	39.25	32.97	35.97
Total Social Services	67.49	177.28	179.29	205.76	136.14	166.11
Education	16.69	67.65	76.13	82.37	46.29	54.73
Health	27.41	48.70	51.77	56.40	39.03	49.64
Social Services, Labor and Employment	14.24	13.78	12.25	14.38	10.08	12.95
Housing and Community Development	9.16	47.15	39.14	52.61	40.73	48.79
General Public Service	122.42	224.11	219.87	247.32	233.49	228.69

Annex Table 3 continued

D. ALL CITIES	1991	1995	1999	2001	2002	2003
Public Administration	119.18	217.63	215.94	242.20	229.42	223.97
Peace and Order	3.24	6.48	3.93	5.12	4.07	4.71
Others	9.09	37.39	63.33	50.50	42.31	68.74
Defense	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service	5.87	32.37	19.75	22.68	26.78	26.77

*Adjusted for DOH & DA advances

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