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The PIPER forum on *20 years of fiscal decentralization*: a synthesis

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The people in the pueblos during the nineteenth century had a saying: "The governor-general is in Manila, far away: the king is in Spain, farther still; and God is in Heaven, farthest of all." The distance between the rural folk and their rulers was not only geographical; it was political distance, and this distance became deeply embedded in the memory of the folk.

– O.D. Corpuz, *The Roots of the Filipino Nation*, vol. 2 (1989, 574)

1. Introduction

Surely, things have changed since the days of our ancestors in the pueblos under the Spanish colonial administration. For one, matters of religion are now delivered in local languages; the president in the Malacañan Palace may now be reached through e-mail, text messages, and social networking sites (www.president.gov.ph); and the directly elected governors and mayors reside in the same jurisdictions as their own constituents. The political distance between the ruled and their rulers during colonial times has since significantly narrowed down, with the developments in transportation and communications that connected the country's 7,100 islands, and with the evolution in our republican institutions that affirmed our sovereignty as a people to establish the government that we want, and which we have asserted in the last three decades when we replaced our top government officials through means both constitutional and otherwise. Whatever the

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Filipino folks may have remembered of the remoteness of the government should have faded away by now, especially in the last 20 years when local governments have supposedly become closer to the people.

The period since the enactment of the Local Government Code (LGC) in 1991 has seen major political, administrative, and fiscal changes that are expected to be associated with, if not the direct causes of, some of the positive developments now observed in many places. Perhaps farther than any previous law, the LGC pushed local fiscal autonomy and accountability to make local government units (LGUs) more responsive to the needs of their constituents.

Marking the progress made in the last 20 years, distilling the lessons from the failures and pitfalls, charting out the needed reforms, and fortifying the consensus and shared vision of local development—these are the underlying objectives of the papers presented and the discussions held during the first Annual PIPER Policy Forum on 16 January 2012 at the Crowne Plaza Manila Galleria Hotel in Mandaluyong City. This paper serves to contextualize and summarize the key findings and main points of the conference papers and proceedings.

2. Devolved functions, finance, and performance

Following Oates [1972] who argued for the advantages of decentralization, the Local Government Code of 1991 can lead to better delivery of frontline public services since local officials, in comparison with national officials, know more about local needs and capacities. Moreover, they are more directly accountable to the service clients. This proposition is based on the condition that the decision makers—local elected and nonelected officials—have the required capabilities and appropriate incentives.

To insure these conditions, the devolved expenditure and revenue functions should be rightly matched to the level of local governments. In this aspect, Llanto [2012] finds the assignment of expenditure functions to conform broadly with the theory that the lowest level of local government assumes the functions and services that include most if not all beneficiaries or users within its jurisdiction. The delegation to LGUs of powers and the responsibility to collect land- and location-based real property taxes and other fees and charges is likewise found efficient. Where local fiscal capacity is deficient or spillovers or externalities exist, the country's intergovernmental fiscal transfers are broadly responsive as well to fix these problems. Llanto [2012] cites cases of inter-LGU cooperation (for example, in coastal resource management) to contain these externalities and exploit possible economies of scale.

However, some transitional problems were encountered. For one thing, LGUs have had to shoulder the costs of devolved functions, which refer to the national government (NG) outlays for them prior to decentralization. Since these outlays largely comprised personnel services and operating expenses for the devolved hospitals, they were not easily scaled down. Moreover, there was no explicit provision in the LGC that tied these additional costs to the incremental internal revenue shares that LGUs also received following the code. As a result, many LGUs faced financial deficits. Aggravating the inequities in the distribution of costs of devolved functions and the incremental internal revenue allotment (IRA), LGUs were also required to shoulder the Magna Carta benefits for health workers and other so-called unfunded mandates. Moreover, instances of interjurisdictional spillovers were inevitable as some health facilities devolved to provinces were located in cities (Brillantes [1997]; Capuno [1997]; Lopez [1998]; Guevara [2000]; Lieberman, Capuno, and Van Minh [2005]).

To be sure, the national government, especially the Department of Health (DOH), adopted measures to alleviate the fiscal burdens of LGUs and secure financing for the devolved health services (including personnel) (Esguerra [1997]; see also comments by Dr. Juan Antonio Perez). These initial measures, however, did not assuage all LGUs. Many local officials demanded to revert the devolved functions to the national government; some were even successful in having the DOH take back some devolved hospitals [Diokno 2012]. The louder LGU clamor, however, was for a bigger IRA, which proves to be the most enduring issue under decentralization.

Eventually, the LGUs seem to have accepted that the devolved functions will remain. But have they learned enough to manage them well? Here, the evidence is mixed. Looking at LGU expenditures in the last ten years, Diokno [2012] and Llanto [2012] find a decline in social services but an incline in general public services, which Diokno finds alarming since the country's population continues to grow. Also, provinces are slow to move from low to high Human Development Index (HDI), a composite of average family income, literacy rate, and life expectancy at birth. Perhaps this is unsurprising since HDI indicators are also influenced, if not more so, by national government, private sector, and household decisions. As well, poverty and income inequality are affected by a myriad factors that make them less than ideal measures of local government performance.

Diokno's proposal then for developing and institutionalizing LGU performance indicators, and as seconded by Dr. Roberto de Vera (discussant), is a move in the right direction. It should be noted that more than 30 performance indicator systems and award schemes had been introduced since 1991 [Capuno 2007]. However, none of these seem to have attained sufficient credibility and coverage that Diokno deems necessary. A simple comparison of service delivery outputs also risks missing the point behind decentralization, which is precisely to allow diverse preferences for local public services to prevail (see, for example, World Bank [2011]). For now, only a comparison of LGU compliance with minimum service standards—like, say, 80 percent child immunization rates—perhaps is valid. Other indicators, like the Good Governance Index [Virola et al. 2004] whose component indicators refer to NG functions, are also more appropriate benchmarks for NG performance at the local level. Thus, the Department of the Interior and Local Government (DILG) should learn from the lessons of failed indicator systems, as it implements its new Php 6.5 billion performance-based grant (Seal of Good Housekeeping) to encourage better LGU performance, as discussed by Undersecretary Austere Panadero in his speech (read by DILG Undersecretary Manuel Gotis during the first session).

In reaction to Diokno's claim that the well-managed LGUs are the exception rather than the rule, Dr. Milwida Guevara and Dr. Alex B. Brillantes, both discussants, cited the case of innovative LGUs that were feted nationally and internationally. Mayor Sherwin Gatchalian and ex-Governor Roberto Pagdanganan seconded and cited some reasons why some good local leaders continue to struggle to provide better services. Indeed, more than a hundred LGUs have won the Galing Pook Awards and other honors (Galing Pook Foundation [2006]; Capuno [2011]). However, the greater majority of LGUs have failed to replicate or emulate these exemplary localities [Capuno 2007].

Relative to innovations in service delivery, those in local revenue mobilization arguably are more difficult to accomplish for two reasons. First, not all LGUs have vibrant local economies that yield high tax revenues and the national government has retained for itself the most lucrative tax revenues [Llanto 2012]. Second, it is much easier for the mayor or governor to rely on the IRA than to risk alienating the property owners and other local taxpayers. Since the IRA also nominally grows every year and is automatically released every quarter, it becomes the most readily available income for most LGUs. Exhibiting moral hazard, the LGUs also become less inclined to raise revenues from local sources. Some even claim the same overreliance on the IRA has also adversely affected the development of municipal bonds market and the participation of LGUs in the credit market.

The disincentive effects of IRA on local revenue mobilization have been raised time and again. While plausible, the available evidence, however, is mixed. For example, Manasan and Chatterjee [2003] report that the IRA has negative and statistically significant effect on real property tax revenues of provinces and cities but positive and statistically significant effects on the same type of revenues for municipalities. Indicating that the IRA and real property taxes grow together, the latter result seems possible because both effectively depend on population density. Contrasting results thus warrant further investigation of the issue.

It is further claimed that the inequities in the distribution of the IRA and the devolved expenditure functions have led to 72 new cities since 1991, the creation of which was motivated by the higher average IRA shares of cities than of municipalities [Diokno 2012]. This trend implies that the country's single most important central fiscal transfer has failed to address horizontal fiscal imbalances [Llanto 2012]. Arguably, distributing the IRA on per capita basis rather than as percentage shares can forestall such perverse conversions [Werner 2012].

Concern is also raised about the creeping two-track delivery system for health, social welfare, and agricultural services. Despite being both devolved agencies, the DOH and the Department of Social Work and Development (DSWD) have already exceeded their pre-devolution budgets, which could then duplicate or crowd out LGU initiatives. While the rise in the DSWD budget is due to the Pantawid Pamilyang Pilipino Program (4P), Atty. Roque Tiu pointed out during the lunch conversation that the role of the LGUs in this conditional cash transfer program has to be threshed out. A discussant from the DOH, Dr. Juan Antonio Perez III, clarified that the increase in the department's budget is intended to support and strengthen local health systems.

Ideally, both the direct expenditures of national government agencies and the IRA, and other forms of central fiscal transfers, should be designed as one grant system to ensure horizontal equity and efficiency in the delivery of local public services. Efforts to achieve either or both objectives have focused more on revising the IRA formula or introducing fiscal equalization transfers in the country. Such efforts, however, have not advanced much beyond discussions in both policy and academic circles. The paper by Hutchcroft [2012] and the reaction by Ms. Maria Lourdes Mangahas (discussant) and other participants underscore the political economy of IRA adjustment.

2. Political economy and reforms

Taking a more historical perspective, Hutchcroft [2012] argues that while the new IRA formula may have secured local fiscal autonomy, ironically it also has deepened patronage politics. If the political leaders are not democratically elected, then they are unlikely to be prudent in their use of public funds. They will only use any additional fiscal resources in the same manner and for the same purpose that brought them to power in the first place. Further along this view, any localized revision of the IRA formula (i.e., adjustment affecting only the LGUs) cannot be isolated from the equally important reform in the broader national-local relations.

At the heart of many proposed IRA reforms is a zero-sum game: an increase in the share of one LGU results in an equal reduction in the share of another LGU or of the national government. Inevitably, then, the IRA reallocation pits local leaders against national leaders or against themselves. Several times the national government attempted an IRA embargo purportedly to manage its own finances in times of crises; each time the LGUs strongly opposed such attempts and were favorably supported by Supreme Court decisions. Possibly the only times when the IRA formula was successfully, if temporarily, amended were during the early years of decentralization (1994-97). Through successive General Appropriations Acts, the cost of devolved functions and the budget for city-operated, but not devolved, hospitals were first deducted from the total shares of LGUs in the internal revenues and then the residual was apportioned following the formula for determining the LGU-level and individual-level shares [Capuno 1997]. To avoid similar stalemates in the future, Werner [2012] proposes a sunset clause in the code that would allow an automatic adjustment in the IRA unless the Congress passes a law otherwise. The code only provides for an automatic review, not amendments, for at least once every five years after implementation.

To be sure, the code has governance features intended to ensure the prudent use of public funds and other resources. These features include shorter term limits for elected officials, and greater transparency in local government operations and in the officials' business interests. Relative to those introduced in an earlier code, the LGC mandates wider avenues for people's participation in service planning, budgeting, and monitoring (Table 1).

Table 1. Governance features of the Local Government Codes of 1983 and 1991

Features	LGC of 1983 (Batas Pambansa 337)	LGC of 1991 (Republic Act 7160)
Accountability	• Term of office (six years; unlimited term) • Recall (only once; not within two years after election or one year before regular election) • Suspension and removal of an elective official (unauthorized absence for three consecutive months) • Penal provisions (engaging in business transactions or possession of pecuniary interest)	• Limit of elective officials (three years; three consecutive terms) • Disciplinary actions against an elective official (unauthorized absence for 15 consecutive days) • Recall (only once; not within one year after election or one year before regular election) • Taxpayer's remedies • Local fiscal administration (budgets, expenditures, disbursements, accounting and accountability) • Property and supply management (procurement and disposal) • Penal provisions (more comprehensive) • Submission of annual reports by the local chief executive to the Sanggunian
Transparency	• Filing of statement of assets, liabilities, and property holdings of all officials • Prohibitions on officials to engage in business transactions or possess pecuniary interests	• Local Prequalification, Bids and Awards Committee • Full disclosure of financial and business interests of Sanggunian members • Filing of Statement of Assets, Liabilities and Net Worth of all officials • Effectivity of ordinances and Resolutions (after publications and posting)
Participation	• Local School Boards • Barangay Assembly • Katarungang Pambarangay • Kabataang Barangay • Leagues of Local Government Units and Elective Officials • Municipal Planning and Development Coordinator (promote citizen participation through development planning at the barangay level)	• Relations with people's and nongovernment organizations • Local school board (including Sangguniang Kabataan, non-academic personnel) • Election of sectoral representatives in the Sanggunian • Local Health Board • Local Development Council • Local Peace and Order Council • Local Initiative and Referendum • Barangay Assembly • Katarungang Pambarangay • Sangguniang Kabataan • Leagues of Local Government Units and Elective Officials

Sources: Ministry of Local Government [1983]; Nolledo [1992].

Despite these safeguards against abuse, the transparency and participation mechanisms seem to have been ineffective. In particular, Azfar, Kahkonen, and Meagher [2001] report that the preferences of local officials are poorly correlated with those of their constituents, which indicate that the local consultative bodies were not constituted or convened regularly [Capuno 2007]. A more recent case study of selected local governments concludes that local health systems are weakly responsive [PIDS and UNICEF 2009].

Hucthcroft [2012] also notes that in some places the IRA has become the "personal slush funds" of local politicians. According to some reports, the Ampatuans of Maguindanao during their reign as regional governors of the Autonomous Region in Muslim Mindanao (ARMM) misused the IRA shares and other finances of the regional government. Whether this case is an isolated one or systemic due to the unique administrative-institutional structure of ARMM, especially since it is among the persistently poorest regions, deserves a separate study.

The lackluster performance of most LGUs is partly explained by the country's weak local bureaucracy and party system that enable political clans, local elites, and interest groups to influence, if not subvert, local decision making. While political clans are found everywhere, their presence in relatively poor areas is taken as proof of their predatory behavior. This conclusion, however, is not fully supported by available evidence. Balisacan and Fuwa [2004] report that political clans have negative impact on annual growth rate of provincial-level mean consumption per capita 1988-1997; however, Balisacan [2007] also found them to have a neutral effect on the annual growth rate of income per capita in 1988-2003; further, both studies report that dynasty has no statistically significant effect on annual growth rate of poverty incidence. Rivera [1999] also found high positive correlation of old, established political clans and Human Development Index across provinces. Also, political clans are mere adaptations of local politicians to missing political parties [de Dios 2007]. Finally, it may not be the presence of a political clan per se that leads to inefficient public provisions, but rather the lack of political competition or of a rival political clan that allows the incumbent clan to reign unchecked [Solon, Fabella, and Capuno 2009].

While the country's political economy renders wholesale IRA reform difficult, a few small but meaningful reforms were suggested. First, the incremental IRA—either the IRA rebates from previous NG embargo that the Supreme Court reversed or the annual increase in IRA—may be used to finance a fiscal equalization grant scheme. However, the earmarked funds have to be substantial for the purpose lest the scheme is perceived inequitable by those who will not benefit from it. In the design of the fiscal equalization transfers, Werner [2012] cautions against "high equalization volume" that can discourage both recipient and donor LGUs to raise additional taxes, and against performance-based grants as they would require detailed local-level data (on revenues and costs) that may not be available, a common frustration of local officials according to Gov. Jose Salceda during the lunch conversation. Further, Werner proposes that the country adopt Canada's Fiscal Arrangement Committee that allows NG-LGU discussions of the features of the equalization grants.

The discussants of Werner's paper zeroed in on the applicability of his proposal to the Philippines. First, Dr. Eduardo Gonzales noted in his review that such schemes have not always led to desired outcomes in other countries. From the Department of Budget and Management, Director Janet Abuel raised the issue of timing—that is, the period required to achieve the desired reforms. Finally, Dr. Gaudioso Sosmena argued that Werner's proposal would require institutional reforms like shifts from mayor-council type to commission type, or possibly a hybrid of both types of local governments.

3. Concluding remarks

On one level, the forum achieved with the four papers its objective of presenting evidence-based, analytical assessments of key decentralization issues. With these as inputs, the ensuing lively floor discussions and reactions from various participants and paper reactors from the government sector, private sector, and academe further attest to the continuing relevance of the topic and the enduring interests of key stakeholders. As reflected in the proceedings, the debates were certainly informed and focused.

While there is wide agreement that reforms are needed, there is less consensus on the directions, forms, and elements of reforms. Arguably, these warrant more and solid evidence, as well as more and timely similar forums.

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