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CHANNELING RESOURCES TO LOCAL DEVELOPMENT CONCERNS: ISSUES AND OPTIONS

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The article gives an overview of the benefits and problems that go along with the process of devolution. While local government units (LGUs) appear to be more competent in providing basic services to people, realities like spillover effects and inequalities among LGUs warrant the intervention of the national government (NG). Certain issues arise from such intervention, the most notable of which are financing arrrangements for local projects and differences in development priorities between LGUs and NG. This paper (as well as the other papers in this issue) addresses these concerns by proposing some policy guidelines and options for a more efficient transfer of resources to LGUs.

1. Introduction

The Problem Defined

The passage of the Local Government Code (LGC) in 1991 has been hailed by many as an important step towards a more efficient and equitable allocation of resources for public investment and the provision of basic social services. Through the LGC, central internal revenue allotments (IRAs) are given by the national government to local government units (LGUs) for their use in the delivery and financing of selected government services. Better targeting of government interventions, lower transactions costs, rapid adoption of efficiency-enhancing innovations, and improved matching of resources with needs are expected over the long run with this decentralized approach to governance.

Among the devolved activities are basic social services such as health and social welfare, and environment-related concerns including forest management, solid waste disposal, sanitation, and sewerage. While already devolved, these activities remain on the list of national priorities as the Philippine government is committed to the United Nations 20:20 compact and Agenda 21. Under the 20:20 compact, developing countries must allocate at least 20 percent of their national

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budget for the provision of basic human development needs as donor countries, in turn, direct 20 percent of their aid to these priorities. Agenda 21 is a global action plan to address sustainable development concerns.

In view of the substantial IRA flowing to the LGUs, the national government has been reexamining its role in funding local capital projects since the LGC's passage. Its intervention in local capital projects has been to use its budget support funds as an administrative tool for onlending and grant transfers to LGUs rather than as a programming tool linked to achieving national or sectoral priorities and targets. Thus, a gap exists as to how LGU activities can be influenced towards these national objectives. With the absence of definite policies and implementing mechanisms, this gap is expected to widen and constrain LGU development, as LGU projects addressing national objectives are unable to utilize external sources of finance.

For the 1996 national government budget, an innovation was introduced to help fill in this gap, even if only partially. A special-purpose fund mechanism labeled the Local Government Empowerment Fund (LGEF), was set up to enable the national government to assist poor LGUs in the financing of local services that have been devolved. As stated in its concept paper, the Fund's objectives were (a) to provide a mechanism for channeling grants and concessional loan funds to LGUs; (b) to rationalize the allocation of funds to priority national projects in support of devolved activities of LGUs over and above their mandated IRA shares; and (c) to effect a more transparent presentation of fund allocations to LGUs in the budget. Two specific facilities were contained in the 1996 LGEF: assistance to the 20 priority provinces identified under the Social Reform Agenda (SRA) for industrialization, livelihood, and related poverty alleviation projects; and aid to the SRA priority provinces and fifth and sixth class LGUs for agriculture and water supply, sewerage, and sanitation.

Although the LGEF is certainly a welcome development, a comprehensive study is nevertheless needed to examine ways of addressing this issue systematically, particularly in sectors with significant externalities such as those dealing with health and environmental concerns, and to identify appropriate transfer mechanisms to LGUs for resources available to the national government, including foreign financial assistance.

Unsettled Questions

Earlier studies that have been conducted to review the LGC implementation indicate a need for national government intervention, including financial support, for certain devolved activities other than the simple provision of the IRA.

While the central implementing agencies' focus has shifted to oversight activities like policymaking, local capability building, research, and monitoring, national government intervention may be justified because of the differential impact of devolution across classes of LGUs in terms of available resources and attendant responsibilities, the externalities that are not captured by local decision making which bear on national and sectoral programs and targets, inequalities among LGUs that may have arisen precisely from the nature and types of devolved activities, and transitional difficulties caused by institutional inadequacies.

Differences in development priorities between the national government agencies (NGAs) and the LGUs may also sometimes arise. Especially in the transitional stages of devolution, the three-year administrative cycle may influence LGUs to adopt a short planning horizon with a bias in favor of projects with short gestation periods. Such behavior may particularly disfavor environmental projects like reforestation or coastal management where the payoffs come well into the distant future.

From the financing viewpoint, the tight fiscal situation remains a binding constraint on the capital expenditure programs of both the national government and the LGUs. The implementing rules and regulations of the LGC, particularly the revenue sharing provisions, are also viewed as (unintentionally) biased against many LGUs, especially the poorer provinces and municipalities, for which the increase in responsibilities exceeds the increase in resources at their disposal. In 1993, the cost of devolved health functions alone ate up 29 percent of the IRAs of provinces and 13 percent of the IRAs of municipalities. Cities and barangays, on the other hand, hardly bore any of the devolved health care burden. In addition, localities with the greatest need for basic social services are often those with the least capacity to pay, even if both the transfers from the national government and the local tax bases are taken into account.

The mechanisms available to both the NGAs and the LGUs in addressing the problems associated with financing local development projects are commercial borrowing, foreign assistance through loans and grants, and cost-sharing arrangements for specific projects. The last approach could be particularly expedient in situations where there is a clear lack of resources at the local level, or where a project is considered a high priority by one unit but not by the other. Unfortunately for the LGUs, these mechanisms have not yet been institutionalized. Commercial borrowing from the banking sector or through bond flotation is often tied up with collateral requirements and the project's financial (as against economic) viability, at the expense of projects and programs that address poverty alleviation, public health, natural resource management, and rural development. The flow of foreign assistance to augment local resources is hampered by the absence of clear

and uniform policy guidelines on how such funds are to be channeled, including a constraint imposed by the Foreign Borrowings Act (Republic Act No. 4860) which limits direct borrowers to the NGAs and the government-owned-and-controlled corporations (GOCCs). Cost-sharing arrangements between the NGAs and LGUs are made on a case-to-case, ad hoc basis where the outcome often depends on the negotiating skills of the parties involved.

The absence of any definite policy guidelines addressing these concerns is partly a reflection of the NGAs and LGUs seeking equilibrium in response to the new environment brought about by devolution. But it is also in large part a product of these government units' differences in viewing their respective objectives. In concept, the dilemma of diverging priorities at different levels is resolved as one applies the principle of subsidiarity to the public investment decision. The principle suggests that decisions on where to put the public money should be made at the lowest level possible. Decision-making should move up to the higher level only when an activity has significant spillovers or externalities on the cost side or on the benefit side, whether technological or pecuniary, whether positive or negative.

In the context of project development, this means that investment priorities determined at the lower level should be respected by the higher level for those projects which are local in scope, i.e., where the benefits and costs, both direct and indirect, are internalized within the constituency of the decision-making unit (Alonzo, 1994a). The problem nevertheless arises where a highly beneficial project whose effects and impact are purely local in incidence cannot be fully funded by the meager resources of the community, necessitating national government support. However, if such a project is "low priority" from the NGA's viewpoint, the NGA would sometimes argue that the LGU should bear the full cost, as if the local residents were not part of the nation as a whole.

Sometimes it also happens that even a relatively rich LGU holds back on the local funding of a certain project, although the project is economically viable from the viewpoint of the local community alone, if it senses that the project will have substantial positive spillover effects on other communities. It then argues that the national government should finance the project, citing lack of resources as an excuse. Meanwhile, the NGA claims that as the project's benefits accrue mainly to the LGU, the latter should put out the funds. Negotiations between the NGA and the LGU may take time, leading to delays in the provision of basic services.

Even when the LGU has identified foreign assistance as a funding source, it is often constrained to seek a "sponsor" or partner NGA to provide some form of forward cover. But if the project is not among the NGA's priorities, the NGA is

hesitant to support it, as the local counterpart funding will eat up on the NGA's budgetary appropriations.

These problems stem partly from the lack of a framework for assessing and valuing the costs and benefits of projects relating to social and environmental concerns, and estimating the probable incidence of these costs and benefits between the local residents and the rest of the economy. On the cost side, for example, national taxes on project inputs are viewed as mere transfers from the national viewpoint but not from the local viewpoint. The opportunity cost of capital to the LGU may be higher or lower than the national social discount rate, depending on whether the LGU is a net borrower or a net lender. The use of a shadow exchange rate, which addresses national balance of payments objectives, may not be relevant from the perspective of the LGU.

Beyond the project level, the literature on fiscal federalism and local public finance offers concrete guidelines on the economic, political, institutional, administrative, and legal aspects of intergovernmental fiscal relations. The *World Development Report 1994*, which is devoted to the issue of Infrastructure for Development, discusses different modes of financing local public investments, illustrated with numerous country experiences (World Bank, 1994).

The Study's Objectives and Scope of Work

In justifying national government intervention, therefore, a framework for assessing and valuing the costs and benefits relating to social and environmental concerns and estimating the probable incidence of these costs and benefits on the local residents and the rest of the economy has to be put in place. The evaluation of such projects is also often based mainly on cost-effectiveness analysis (in fact, sometimes, simply on a listing of expected physical output and the corresponding financial cost). There is hardly any attempt at valuation of benefits. A methodology of "social pricing" following a basic needs approach (as used in some Latin American countries) would help quantify how much such projects contribute to national as distinct from local objectives. The set of "social prices" from the national viewpoint may be higher than the imputed local valuation, especially for the poorer LGUs, justifying the necessity for the national government to subsidize or even initiate the otherwise devolved activity.

There is thus the need to come up with clear and definite policy guidelines on the following issues: (1) the definition of the conditions that warrant national government support for devolved functions; (2) the determination of the appropriate form and level of this support; and (3) the identification of mechanisms for intergovernmental transfers (from the national government to the LGUs) for project cost-sharing.

2. Devolution and the 1991 Local Government Code

Benefits from Devolution

The most basic premise underlying any local development effort is the primordial importance of community participation in the decision-making process. People's preferences are better met if the people themselves are involved from the very start in the design of any intervention.

It is widely recognized that LGUs have a comparative advantage over NGAs in the provision of local public goods because they are closer to the intended beneficiaries. This proximity affords LGUs a closer reading of people's needs, and therefore a more focused targeting of interventions. Local chief executives are also more directly accountable to their constituents. While the newspapers are replete with cases of LGU officials being charged with various kinds of wrongdoing, the cases filed against national government officials and their regional subordinates far outweigh those against local officials in the magnitude of the sums involved. The three-year election cycle also puts pressure on local officials to perform.

The beneficial outcomes of increased local autonomy come about by way of increased efficiency in resource use and allocation. The flow of possible benefits from devolution is better seen by taking a closer look at the regular activities of local governments which can broadly be classified into three major areas: (1) administrative and regulatory functions; (2) the provision of general public services; and (3) the construction and maintenance of public infrastructure (Alonzo and Gamboa, 1990).

1. Administrative and Regulatory Functions

Anybody who has had some exposure to the present system of budgeting in the Philippines would decry the highly centralized system of approval for the release of funds. In the name of proper safeguards and financial control, several signatures would be needed to get anything done; in some cases, the approving authority reaches all the way up to the central office in Manila even for matters that pertain to the municipal level. A significant amount of resources is lost in terms of worker time and travel funds spent just to follow up on documents.

The convoluted bureaucratic procedures hamper not only the dealings among the different government agencies but extend as well to transactions between the government and the private sector. In government procurement, the suppliers thus factor in the delays when they submit their bids. Even in the simple matter

of business registration, the need for approval by a national agency may encourage enterprises to go "underground" instead. Decentralization and local autonomy measures help save on these costs.

The devolution of power to the local governments over licensing and regulatory functions also leads to efficiency gains as spillover effects (costs to the local community in particular) are better internalized. Two such broad areas are natural resource exploitation and local public transport operation. In logging, for example, more and more local residents mobilize to prevent the destruction of their forests by timber concessionaires who do not take into account the costs (such as flooding) that their operation imposes on the local community. However, transaction costs for such efforts are often high, as the people have to lobby before NGAs whose offices are difficult to reach. In the regulation of local public transport, LGUs have shown facility with the management of tricycle operations.

General Public Services

As LGUs gain increased control over financial resources, it is expected that they would economize in the use of their funds so that local public goods and services can be provided at lower unit cost. Many local executives pride themselves in being able to construct three classrooms for the Department of Public Works and Highways' (DPWH) price of two. Many also complain that they get only a fraction's worth of the value of the drugs that the Department of Health (DOH) dispenses, as some of the drugs are either expired or of the wrong kind.

With the decision-making unit more closely in touch with the needs of the beneficiaries, there is a better chance that the "correct" amount would be provided. In a highly centralized system, the level provided may be too low to clear the market such that the service gets rationed. Or, in the opposite case where the level provided may be too high, scarce resources are thereby wasted.

Public Infrastructure Spending

There is growing evidence on the developmental effects of rural infrastructure, particularly transportation, electrification, and communication networks, on agricultural production and productivity, nonfarm employment and incomes, and rural welfare in general. While the immediate, measurable effect of the development and improvement of rural road networks is the reduction in transport costs, the efficiency gains that such developments afford are observed to be highly associated with the faster diffusion of agricultural technology, the flourishing of more competitive markets, and the increased mobility of rural labor, which are all supportive of higher productivity and incomes.

With decentralization and increased local autonomy, it is expected that the level and composition of public infrastructure development and maintenance would improve, as decision-making is brought down to the subnational units of government. Similarly, unit costs for construction and maintenance would decline as the LGUs would not be constrained to follow uniform national design standards that may be over-built and would therefore be more responsive to relative input price differences.

Changes in the input mix of local public sector activities are also likely to materialize with decentralization as local decision-making takes better account of relative factor price differences at the local level. The use of cheaper indigenous resources such as labor and materials would thus be favored, and local multiplier effects on employment and incomes would be more pronounced.

The national government may not bother with activities and projects which are too "small" because of administrative procedures that raise transactions costs but local governments may not have sufficient funds to start them. Piecemeal efforts are thus sometimes resorted to as in the recently passed legislation allotting a concrete road or multi-purpose pavement for every barangay, with the surface area depending on the barangay population. With true decentralization and local autonomy, the need for such well-intentioned but somewhat mechanical transfers would be minimized.

Local control over development funds and the regularity in their flow would also improve the timing of local public sector activities with less delays in implementation and faster response to local needs. Speed of implementation is of course not an end in itself; ill-conceived and ill-prepared projects are obviously better postponed or canceled altogether. But the devolution of project development activities to the subnational levels would reduce the chances of such projects materializing.

Equity goals such as alleviating poverty and meeting basic needs are consistent with economic efficiency. First, the use of more cost-effective methods would mean the availability of more resources to meet these goals directly. Then, too, improvements in efficiency ultimately redound to the benefit of the rural poor as better-placed infrastructure and better-managed support services allow the poor beneficiaries to be themselves more efficient in their undertaking. Improved roads, for example, help reduce transport costs of agricultural output and inputs, raising farm incomes and rural welfare.

Examples of Excellence: The Galing Pook Awards

Positive experiences with what devolution of functions and resources to LGUs can achieve are well-documented, both in the Philippines (e.g., Alonzo and Gamboa, 1990; Abesamis, 1995) and in other countries as well (World Bank, 1994). In the Philippine post-devolution era, the winners of the *Gantimpalang Pang-Lingkod Pook (Galing Pook) Awards* Program offer more recent examples of what LGUs can achieve in enhancing the economic welfare of their constituents.

The *Galing Pook* program was launched in 1994 to give due recognition to LGUs which demonstrate excellence in local development management and innovations. Jointly undertaken by the Asian Institute of Management and the Local Development Academy, the program selects outstanding LGU projects based on the following criteria: effectiveness of service delivery; positive socioeconomic or environmental impact; promotion of people empowerment; and creative use of local powers. Cited below are the programs that may be classified under health and social services, environmental management, and infrastructure (DILG, 1995).

Health and Nutrition

Partnership for Community Health Development in Sulat, Eastern Samar. A joint program of the DOH, the provincial and municipal governments, and a nongovernmental organization (NGO), the project led the people to manage their own preventive and primary health care, realize the interrelatedness of economic and health problems and their solutions, and address these problems through multisectoral partnership.

Social Services

Water System for Every Barangay in Baybay, Leyte. The water system for every barangay solved the problem of water shortage in 60 of the 92 barangays not served by the Baybay Water District. The major strategy involved local government leadership, active participation of the lowest level of local government (barangay), and strong community action within the context of the *bayanihan* spirit.

The Environment

Environmental Protection and Management Program in Zamboanga del Norte. One measure undertaken by the provincial government to control the destruction of its virgin forest was the creation of a multisectoral council which

launched a program involving (a) regular patrolling of forest areas, (b) confis
tion of illegally-cut forest products, (c) surveillance of eight transfer areas in th
province, and (d) an intensive information-education campaign.

4. Local Public Infrastructure

*Municipal Bond Flotation for Low-Cost Housing in Victorias, Negros Oc-
cidental.* The municipal bond flotation for the *Pabahay* Bond Program seeks t
alleviate the problem of housing shortage in Victorias, Negros Occidental. Th
municipality floated bonds worth P8 million to mobilize resources for the co
struction of 170 low-cost dwellings for government employees.

3. Intergovernmental Fiscal Relations: Theory And Practice

Models of Expenditure and Tax Assignment[1]

It is universally recognized that the way taxing and spending authori
are delineated and the manner in which intergovernmental transfers are stru
tured have an important bearing on the efficiency and equity of public servi
provision. The *decentralization theorem* offers broad guidance in defining exp
diture responsibilities, and provides a strong rationale for decentralized deci
making on efficiency, accountability, manageability, and autonomy princip
The theorem states that "each public service should be provided by the jurisdic
having control over the minimum geographic area that would internalize bene
and costs of such provision" (Oates, 1972). A decentralized system ensures con
tency of level and mix of public services with voters' preferences, and provid
incentives for efficient provision of such services.

There are economic considerations, however, that may call for some deg
of centralization or compensatory grants in the provision of services. These fac
include: *geographical differences of preferences with imperfect mobility am
the population,* without which a decentralized mechanism would not ensure mat
ing of public services with local preferences; *spatial externalities*, which ar
when benefits and costs of local public services are realized by nonresidents; *eco
mies of scale*, as some public services (such as transportation, water, and sew
age) require service areas larger than a local jurisdiction for cost-effective pro
sion; and *administrative and compliance costs*, which may be lower under a ce
tralized administration.

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[1] The discussion on models of expenditure assignment and intergovernmental tran
is basically a summary of Anwar Shah's studies on the topics. See Shah (1991, 1994).

There are also certain policy functions which can be performed best by the al government. Among them are stabilization and redistribution policies. lization policies cannot be carried out effectively by a local jurisdiction. Local it of such policies would lead to most of the gains being lost to outside jurisns. Monetary policy, for example, has little scope of being carried out at a level. Effective redistribution is possible only through programs which are nal in scope. A local jurisdiction that attempts to carry out redistributive es is likely to drive out the rich.

overnmental Transfers

Intergovernmental transfers can be broadly classified into two categories: atching and selective matching. *Nonmatching funds* may be either selective neral, conditional or unconditional. *Selective nonmatching transfers* offer a n amount of funds without any local counterpart required provided it is spent particular purpose. They are best suited for subsidizing activities to which igher level government assigns a high priority but which are given low priory local governments. *Unconditional or general nonmatching grants* have no raints as to how they are to be spent. Because no minimum expenditure in area is expected, they are least stimulative of additional local expenditures.

The grant recipient often prefers unconditional nonmatching transfers bee these grants provide him with the maximum flexibility to pursue his own tives without influencing his pattern of spending. On the other hand, the tor may be willing to sacrifice some of the recipient's satisfaction in order to re that the funds are directed towards expenditures on which he places a ity. In this case, conditional, selective nonmatching *block* grants are attrac-

Selective matching grants are those which require that the funds be spent a specific purpose and that the recipient matches the funds to some degree. y are commonly referred to as cost-sharing programs. *Open-ended matching ts* (wherein no limit on available assistance of matching provisions is set) are suited for correcting inefficiencies in public goods provision arising from benspillovers. While matching grants can correct for inefficiencies arising from lovers, they do not cope with problems arising from uneven or inadequate capacities among local governments. Grantors, however, usually prefer closeded matching provisions (wherein funds are provided up to a certain limit only) e they are then better able to control their budgets. The empirical literature ally finds closed-ended grants to be more stimulating.

Why is there extensive use of selective closed-ended matching grants developed countries when they seem ill-designed to solve problems and ineffi cies in public goods provision? It seems that correcting for inefficiencies is not sole or even primary objective sought with their use. Rather, they are employed a means of assisting local governments financially while promoting expendit on activities given priority by grantor. However, while the conditional closed-matching grant may lead to significant transfers of financial assistance, it distort output and cause inefficiencies, as it is often only available for a few acti ties, which results in excessive spending in those areas while others underfinanced.

For each and every objective specified by the grantor, there is an associ design of a grant program. Thus, the grant design has to be consistent with objectives for it to be effective in reaching its desired objectives. Some gener principles which further assist in grant design and in ranking various grant de sign options include the following: autonomy, revenue adequacy, equity, pred ability, efficiency, simplicity, incentive, and safeguard of grantor's objectives.

Lessons from Country Experiences

Both the theoretical and the empirical literature on intergovernmental tra fers emphasize certain characteristics of special-purpose grants and cost-shari schemes that enhance the chances of their successful implementation:

1. A grant system should be simple, transparent, and designed to avoid disincentives for the LGU to raise local tax effort or impose user charges or private resources for the provision of the service. To meet these objectives, grant systems feature cost-sharing arrangements between the intended benefi ries, the LGU, and the national government.

2. The community's share may be in cash or in kind (labor or local raw mate als). Some minimum equity from the LGU is desirable, with the balance of contribution possibly coming from a loan. For activities where exclusion is fe sible, the imposition of user charges may be a condition attached to the match grant. In projects like water supply, solid waste management, and commu irrigation, for example, a condition to the grant, aside from the equity contri tions of the beneficiary community and the LGU, may be the imposition of fees that would cover at least the maintenance and operating cost.

3. The grant should be well-targeted. A common form of targeting is by reve class of LGU, with the magnitude of the matching grant depending on the se being supported (Table 1). Under Colombia's *Sistema Nacional de Cofinanci*

for pubic health projects, low-income LGUs get a 90 percent grant, those in the middle-income range receive 80 percent, while those considered high-income are given only 70 percent; for education projects, the corresponding grants by class of LGU are 80, 70, and 60 percent, respectively (Colombia, DNP, 1995; World Bank, 1995). With Mexico's *Programa Nacional de Solidaridad* (PRONASOL), for projects that have little or no cost recovery, rich states get a 50 percent matching transfer from the federal government, while poor states get 75 percent. Meanwhile, for projects with high cost recovery, states are classified into three types: rich states get only 25 percent, poor states 50 percent, in-between states 40 percent (Campbell and Freedheim, 1994).

Table 1 - Comparative Cost-Sharing Schemes (in percent share in project cost)

COLOMBIA	National Government	Local Government	Community
Public Health			
Poor LGUs	90	10	
Middle LGUs	80	20	
Rich LGUs	70	30	
COLOMBIA	**National Government**	**Local Government**	**Community**
Education			
Poor LGUs	90	10	
Middle LGUs	80	20	
Rich LGUs	70	30	
MEXICO	**Federal Government**	**State Government**	**Local/ Community**
With Low Cost Recovery			
Poor States	50	50	
Rich States	75	25	
With High Cost Recovery[a]			
Poor States	50	25	25
Middle States	40	25	35
Rich States	25	25	50

Table 1 (continued)

PHILIPPINES	National Government	State Government	Local/ Commun
School Buildings			
4th-6th Class LGUs	90	10	
1st-3rd Class LGUs	80	20	
Highly Urbanized	70	30	
Water Supply & Sanitation			
3rd Tier LGUs	80	10	10
2nd Tier LGUs	60	30[b]	10

[a] State contribution may be borrowed.
[b] Twenty percent may be a loan extended to community.

In the Philippines, the 1996 national budget contains a matching gr feature using LGU fiscal class indicators: the national government's share in th cost of school buildings is 90 percent for fourth to sixth class LGUs, 80 percent f first to third class LGUs, and only 50 percent for highly urbanized cities, alth the national government used to cover 100 percent across the board before (Phil pines, DBM, 1996). Under the Water Supply and Sanitation Project, for "th tier" LGUs, the community is required to put up 10 percent of subproject cost (i cash or in kind); the LGU puts up another 10 percent, with 80 percent being th national government's matching grant. For "second tier" LGUs, the match grant is 60 percent; the community's counterpart is 10 percent equity and 2 percent loan from the LGU; the LGU's share, therefore, remains at only 10 pe cent equity, but it advances a loan to the community amounting to 20 percent o project cost.

One advantage of targeting by fiscal class of LGU is the ready availabili the information, aside from its obvious function as a measure of the LGU's fina cial capacity to support its local development projects. However, the risk is th fund transfers going to a poor LGU may not be used for the very needy within th LGU; at the same time, a rich LGU may have pockets of poverty within its co stituency which are in dire need of assistance, but without the transfers reaching them.

Other systems of selective grants, therefore, are targeted at specific popu tion groups. Mexico's PRONASOL has a "Special Projects" category aimed at "sp cial groups" such as women, youth, indigenous populations, and rural workers

the Philippines, the Social Reform Agenda identifies ten "basic sectors" as the focus of the program: farmers and landless rural workers; fisherfolk; indigenous peoples; the urban poor; workers in the informal sector; disadvantaged women; disadvantaged youth and students; persons with disabilities; elderly and veterans; and victims of disasters and calamities. The targeting for SRA activities, however, is not for any grant or LGU support system but for national government agencies to focus their programs on these basic sectors.

For rural infrastructure, different types of "needs" indices may be used. Indonesia's INPRES system uses road density, road condition, and unit cost indicators for its road improvement program grant (Shah and Qureshi, 1994). The Philippines' Third Water Supply and Sanitation Project uses seven criteria, ranging from the size of the population to be served (with the lowest weight of 5 percent) to a composite scarcity index incorporating factors like water quantity and quality, reliability of the source, and distance from the households (the index having the highest weight of 25 percent). Community commitment through the formation of Barangay Water Service Associations gets a weight of 20 percent. These criteria, however, are used for subproject selection; the beneficiary provinces are predefined as the 20 priority provinces under the government's Social Reform Agenda.

The Philippines has of course had a long history of identifying criteria for regional and provincial allocations (Alonzo, 1994b). The system being used by the DPWH for the regional allocation of its infrastructure budget dates back to the early 1980s. For the 1994-1998 Medium-Term Public Investment Program (MTPIP), national line agencies were asked to define their respective allocation criteria for their region-based public investment components. Consultative workshops with the regional development councils (RDCs), where local government executives and the private sector are represented, were held in arriving at the criteria (Table 2).

But again, even though many projects in the MTPIP are really local in scope, these regional allocations are not meant for transfers or matching grants to local governments, but are for projects to be implemented by the regional and local offices of the national line agencies. A notable exception is the DOH which, having devolved its field personnel to the local governments, is entering into Comprehensive Health Care Agreements (CHCAs) with provincial governments in the implementation of its programs.

Table 2 - Regional Investment Allocation Criteria of Line Agencies

AGENCY	CRITERIA/INDICATORS		WEIGHT (in percent)
Public Works and Highways	Equal share among regions		20
	Population		30
Environment and Nat. Resources	Sustainability		20
	Conservation		20
	Environmental enhancement		20
	Economic efficiency		20
	Poverty incidence		20
Agrarian Reform	Extent of agrarian reform coverage		25
	Contribution to rural development		30
	Poverty incidence		20
	Number of project beneficiaries		15
	Land distribution balance		10
Agriculture	Resources in agricultural purposes		20
	Regional contribution to agriculture		40
	Efficiency		20
	Poverty incidence		20
Social Welfare and Development	Magnitude of poverty		30
	Children in difficult circumstances		20
	Youth in difficult circumstances		15
	Disabled and elderly		5
	Women in esp. difficult circ.		15
	Threatened people in disaster areas		15
Labor and Employment	Growth and efficiency		50
	Equity and welfare		50
	Size of unemployed	35	
	Size of visibly underemployed	30	
	Poverty incidence	35	
Health	Infant mortality rate		25
	Poverty incidence		20

ble 2 (continued)

GENCY	CRITERIA/INDICATORS	WEIGHTS (in percent)
alth (continued)	Disaster/epidemic prone-areas	15
	Bed occupancy rate	15
	Prevalence of endemic diseases	10
	Population	20
ucation, Culture, d Sports	Population	15
	Participation rate	15
	Cohort survival rate	15
	Achievement rate	15
	Functional literacy rate	15
	Poverty incidence	25
de and Industry	Cost-benefit considerations	50
	Contribution to regional targets	50

rce: MTPIP, 1994-1998.

4. Options for Channeling Resources to LGUs

rview

The review of the economic literature on intergovernmental fiscal relations d examinations of the nature of activities in the social and environmental sec- s (see the other articles in this issue) point to the continuing need for national ernment support of local government projects, especially those with social and ironmental objectives. This support may be called for even within the context the Local Government Code where responsibility for the provision of basic social vices is devolved to subnational levels of government.

LGUs may underinvest in activities with interjurisdictional spillovers. While peration among neighboring LGUs to internalize such externalities is observed ome cases, transactions costs of such negotiations are usually high, warrant- national government support. The national government may also wish to intain minimum service standards, most important among which are in health d basic education. Similarly, there are social and environmental objectives that

are considered of high national importance but may be of low local priority. In the Philippines, the national government explicitly puts poverty alleviation high in its agenda with the provision of minimum basic needs as a strategy.

Under these terms, the economic literature suggests that the efficient type of support is by way of conditional grants. All too often, however, support is given through a national government agency (or its regional arm) doing the planning and implementation of the intervention, offering only token consultation with the LGUs and the communities affected. Lessons from Philippine and other country experiences show that the application of the principle of subsidiarity leads to more efficient and equitable outcomes.

Even if grant funds are made available, certain local public investment activities may be so lumpy (or the LGU may not have enough resources) as to require financing of the LGU counterpart through loans. Yet, given imperfections in the capital market and the state of local finances, many LGUs are considered as "not bankable," necessitating national government support by way of access to credit. Often, social and environmental projects that warrant conditional matching transfers based on expenditure assignment principles are precisely those that have difficulty getting commercial financing, so that grant and loan programs have to be coordinated.

At the same time, loan programs should ensure that LGUs do not over-borrow. Many countries in Latin America with extensive municipal credit programs are expressing fears that their local governments may not be able to repay their debts. There should thus be a system of monitoring LGUs' present and future fiscal position even as they exercise autonomy in their expenditure and financing functions.

Devolution also implies the "freedom to fail" on the part of local governments, as well as the freedom of the central government from any responsibility to bail out LGUs failing to perform a devolved function (Esguerra, 1996). Without this freedom, there can be no accountability for local executives; it is this freedom which distinguishes a devolution-type decentralization from mere deconcentration or delegation of powers and functions from national to subnational governments.

Recurring Themes and Principles

Before the design of any grant and loan system can be discussed, some recurring themes and principles mentioned in the economic literature on, and country experiences with, decentralization and intergovernmental expenditure assignment should first be noted.

The role of community participation in project development cannot be taken for granted.

Community involvement may be through informal neighborhood associations, formal people's organizations, NGOs, or the households directly. Local preferences are incorporated best when the community intended to benefit from the intervention is consulted from the very start—at the inception stage. This has been documented to lead to lower project cost per beneficiary, lower implementation delays, better maintenance of the facility, and better cost recovery from user charges. It is not uncommon, for example, to find communal irrigation systems constructed by the NGA (the National Irrigation Administration) which, at turnover time, are rejected by the community. Also, interventions to conserve natural resources or to preserve the environment may involve changing livelihood activities which cannot be achieved without the commitment of the communities concerned. Some social forestry schemes entail weaning upland communities away from swidden agriculture into the farming of fruitcrops. In coastal fisheries management, people are discouraged from destructive fishing methods.

LGUs are, in principle, better implementors of local projects than NGAs, because, coming from the area, they have a closer feel of people's needs.

LGUs do better than NGAs in targeting interventions at specific communities and households. They are also more accountable to the people as local chief executives may be voted out of office for poor performance, while regional personnel of NGAs often simply get reassigned to other areas when the project fails. Some studies on decentralization point out that formal or informal participatory institutions, which LGUs have a comparative advantage in tapping, are more important to project success than "technical capacity."

Community equity contributions to project cost should be encouraged.

For poor communities, this contribution may be in kind (land, labor, local raw materials), or it may be in cash for communities which can afford to do so. This policy fosters a sense of project ownership by the community and generates local resource mobilization.

Cost recovery through user charges is desirable.

Revenues from user charges (or frontage fees in the case of roads) enhance the sustainability of a project by way of ensuring the availability of funds for operation and maintenance expenses. Many levels I and II water systems stop operating almost immediately after completion because of maintenance problems stemming from lack of funds.

5. Private sector production should be favored where feasible.

The "private sector" need not be an entrepreneur; it may be a cooperative or some other people's organization or an NGO. Alternative modes of private sector participation include build-operate-transfer schemes, joint ventures, and franchising. LGUs should not be blinded by the prospect of "windfall profits" that the private holder of a local monopoly may reap out of a public service facility. There are ways by which the LGU can share in such gains, as in a public auction of the franchise for such services. If the LGU runs the facility itself, political factors may easily set in: fear of losing votes keeps the local executives from raising tariffs, even if only to keep up with inflation; consumers get to regard the public service as an entitlement and refuse to pay the charges, while the LGU gets afraid to enforce exclusion or cutting off the service to delinquent clients.

6. As much as possible, private financial intermediaries should be tapped for the onlending of credit by the national government to LGUs, and LGUs' relending to, or collecting charges from, communities and households.

A national government agency often finds it difficult to collect from local governments (or local parastatals), even if the latter are able to collect from clients. The case of the Local Waterworks Utilities Administration (LWUA) is a good example: even water districts with good collection rates withhold payment to LWUA because they can get away with it.

Policy Options

The obvious next step then, if the lessons learned from country experiences with decentralization are to be followed, is for the national government to reexamine its expenditure program in order to identify which and how much of their activities are really better undertaken through LGUs. The funds thus identified may serve as contributions to a pool of resources for a unified grant system that shall be pursuing priority national government objectives but at the same time availing of allocative efficiencies that closer community participation brings about without putting a strain on the national budget. This and other options are discussed below.

1. NGAs' Realignment of their Expenditure Programs

A significant number of activities covered by NGA regional budgets, while in accordance with the agencies' mandates and sectoral objectives, are really local in benefit incidence. They get labeled as national or regional in scope partly because they are components of an agency program pursuing national or regional

targets, but also partly because of simple administrative convenience. Others may have clear interjurisdictional spillovers. In either case, such activities can obviously benefit from LGU partnership in their planning and implementation, with all the attendant efficiency and equity gains that closer incorporation of local preferences brings about. Not only are sectoral objectives achieved; local resource mobilization is also stimulated as LGUs and communities put up matching counterpart funds.

For purely locally-funded NGA activities, the Development Budget Coordinating Committee (DBCC) can issue similar guidelines, giving preference to agency proposals (on claims against the Priority Programs/Projects Fund) that are designed to encourage LGU partnership in the achievement of their sectoral objectives.

For foreign-assisted projects, the Investment Coordinating Committee (ICC) can issue guidelines to encourage or even require NGA project proposals to include LGU participation, especially in activities that are already supposed to have been devolved. Justification for such projects should of course be based on national and sectoral objectives (such as poverty alleviation), or on clear spillover considerations (such as watershed protection). The approach fits projects which have no LGU loan component, where national government support is in the form of a matching grant. The risk to this option is that the NGAs may claim that the LGU project proposals are not consistent with their own priorities, given their budget constraints; it may also happen that the LGU proposals come after NGA funds have already been committed to other projects. With the Metro Cebu Development Project III, for example, the LGU tried to have the Cebu South Coastal Expressway component included in the DPWH budget, but the DPWH would agree only if the allocation for the project would be supplementary to its agency budget ceiling. The project could not fit in the agency's MTPIP regional distribution; it would displace roads already in their pipeline. LGUs should have some other recourse in such situations; in this particular case, the Cebu government sought Municipal Development Fund (MDF) support.

Another problem that may be encountered is that with foreign-assisted projects, donors usually prescribe international competitive bidding or centralized procurement. This requirement leads to the traditional NGA-led arrangements. Transfers, however, may be in kind, as in the case of the Urban Health and Nutrition Project of the Department of Health. For the Third Rural Water Supply and Sanitation Project, certain procurements are also to be centralized.

This option is suitable for projects with little or no prospect of financial cost recovery addressing poverty alleviation concerns in poor LGUs. For projects with

substantial revenue potential and involving the extension of a loan to the L
the MDF or GFI tracks discussed below offer a more appropriate alternative.

2. An Expanded and Modified Municipal Development Fund

The Municipal Development Fund (MDF) was created in 1984 as a me nism to allow LGUs access to foreign loans and grants, together with trans from the national government and its agencies. The MDF is in the nature revolving fund whereby loan repayments accrue to the Fund for relendin LGUs. First-generation MDF resources are project-based proceeds from O cial Development Assistance and the national government counterpart.

Each project has its own criteria for LGU eligibility. The early proj such as the World Bank-financed Regional Cities Development Program (RC the Program for Essential Municipal Infrastructure Utilities Maintenance Engineering Development (PREMIUMED), and the Metro Manila-based MMIN Project had a clear urban bias, but subsequent projects like the ADB-assi Sorsogon Integrated Area Development Project and the USAID-funded Local source Management Project add a rural perspective to the MDF portfolio.

The MDF in its present form (for MMINUTE II and PREMIUMED I more open to different classes of LGUs, but some bias for bigness neverthe remains. To qualify, a municipality has to have a minimum urban populatio 10,000 with a population growth rate at least equal to the national average o percent. The average revenue for the past years should be at least P3 millio MMINUTE II (thus excluding fifth and sixth class LGUs) and P6 million PREMIUMED II (excluding fourth to sixth class LGUs).

Nevertheless, indicators of need are included among the criteria: the ur population should have a relatively low average per capita income; one-third of population should be below the urban poverty threshold; the municipality sh have major deficiencies in water supply, sanitation and waste water dispo storm drainage and flood prevention, solid waste collection and disposal, and l infrastructure like public markets and bus terminals.

To ensure LGU interest and commitment, for PREMIUMED II, a l council resolution endorsing the project is required even at the prequalifica stage, together with a resolution from project end-users and an ordinance app ing the break-even user charges for the proposed facility. The LGU has t through three public hearings prior to the signing of the agreement. The MDF a high collection efficiency because project agreements call for an intercept of LGU's IRA.

The MDF requires the LGU to put up as equity contribution at least 10 percent of the subproject cost, but only for that portion covered by the loan component. It offers a carrot in the form of national projects to be located in the LGU. For the town of Tanauan in Batangas, for example, out of a total subproject cost of P56 million contained in the agreement, 26 percent or P15 million was a grant for a national road and drainage (presumably adjacent to the public market being financed). The public market itself cost P41 million, of which the town's equity contribution was only P4 million or seven percent of total subproject cost.

The present MDF structure with its operating systems and procedures offers a convenient channeling mechanism by which to effect national government support for LGU projects of high national priority, especially those with social and environmental objectives for which access to private sector financing is difficult if not impossible. Already, it is serving as such. For the 1996 budget, there is a proposed MDF appropriation of P885 million to cover the non-credit component of four foreign-assisted projects (mainly for roads and other infrastructure).

As an immediate, short-term measure, an expanded MDF will help channel funds, particularly ODA resources, to LGUs. Many donor institutions are in fact already familiar with MDF operations as are several line agencies of the national government.

The main disadvantage with the present MDF system, however, is that an LGU with a firm proposal that does not fit into any of the existing project molds will still have to look for a *padrino* from among the national line agencies to sponsor its project. Some LGUs view this as diminishing their autonomy. Recent cases where this problem arose are the Bukidnon Integrated Area Development Project (BIADP) and the Community-Based Resource Management Project (CBRM). In both cases, the LGUs concerned initially refused to play the *padrino* game. But, under the Foreign Borrowings Act, the LGU cannot be given authority to contract foreign loans directly, unlike GOCCs (in an opinion expressed by the Department of Justice in 1994).

For the 1996 national budget, relending of ODA funds to LGUs through the MDF was taken off-budget so that it got reflected not as a national government expense but as an LGU spending. This procedure makes the treatment of relending by the national government to LGUs and GOCCs uniform, and removes constraints imposed by national government expenditure ceilings. With the proper monitoring of the consolidated public sector position, this innovation should not lead to any undue increase in the overall public sector deficit.

For a more effective MDF, however, some modifications may be introduced:

a. The MDF's Policy Governing Board should include representation from LGUs. This would help towards the incorporation of LGU concerns in policy decisions.

b. The MDF should assume responsibility in the technical appraisal of projects. In its present form, the Central Project Office that makes project decisions is in the control of the line agency, giving rise to the *padrino* problem. However, assuming responsibility does not mean delinking from and setting up a system parallel to that of the line agencies. A line agency representative may still sit in the Project Steering Committee together with an LGU representative. Project proposals may be passed on to line agencies for review, but with approving authority vested in the MDF itself.

c. The grant components of MDF subprojects have to follow a more uniform and transparent set of guidelines. While there may be some economic ratio-nale to coordinating national with local projects (to exploit synergistic relationships, for example), the use of national projects as a grant to attract LGU participation makes the system supply- rather than demand-driven.

d. The MDF should eventually move towards specializing in projects (and LGUs) that find it difficult getting access to the commercial credit market. Projects with social and environmental objectives fall under this category. The interest rates charged, nevertheless, should be market-based; subsidies to cover spillovers and other objectives should be explicit in the form of matching grants.

e. The MDF should explore ways of involving financial intermediaries (government and private) for onlending. This would help foster LGU-bank client relationships and ease the transition of LGUs into "bankable" borrowers.

These suggestions are, on the main, consistent with the recommendations of the PIDS municipal credit study. Whether the MDF itself or a separate entity should handle the cofinancing grant system is an issue that has to be settled. At present, with MDP III, it is the DPWH that determines the amount of grant (on a negotiated basis), although this is built into the agreement signed by the LGU with the MDF. Colombia's FINDETER, a financial intermediary owned by both the national and local governments, manages (for a service fee) the selective grant funds for urban infrastructure like public markets and bus terminals, while the grant funds for other sectors like health and education are managed by separate bodies controlled by the lead agencies concerned (Alvarado and Gouame, 199[illegible]; Colombia, FINDETER, 1995).

Expanded GFI Credit Programs

Government financial institutions (GFIs) have the authority to contract loans from ODA sources and relend such proceeds to LGUs. There is the perception that the GFIs may be reluctant to play this role; but offered the correct incentives, GFIs have recently been showing interest in participating in such arrangements. The Land Bank of the Philippines, for example, has recently agreed to serve as intermediary for OECF funding of the Cebu South Reclamation Project, a component of the Metro Cebu Development Project III. Another example is the Danish Tied Mixed Credit Facility, where the Development Bank of the Philippines is the conduit. The Facility shall finance projects "within the context of sustaining and improving environmental conditions through clear and safe technologies and equipment." Loans shall be extended to water districts for water supply provision and to firms for acquisition of anti-pollution devices.

Direct ODA Loans to LGUs

Given the present policy environment, the national government does not grant sovereign guarantee to direct LGU foreign borrowing. The disabling legislation cited is the Foreign Borrowings Act, under which "the guarantee of the Philippine government could only be issued to loans granted to GOCCs and GFIs," to quote the 1994 opinion of the Secretary of Justice. ODA sources, however, require this sovereign guarantee. In principle, however, the notion of direct LGU borrowing is economically feasible, provided that debt ceilings are enforced and the IRA intercept mechanism is in place. The LGU should also bear the exchange risk. For this option, therefore, amendments to the Foreign Borrowings Act have to be legislated.

An Expanded and Enhanced Local Government Empowerment Fund

This option, like Option 1, addresses the issue of rationalizing the system of transfers to subnational units of government. It involves the expansion of the LGEF—another innovation in the 1996 proposed national budget—with modifications that incorporate the fundamental principles enumerated in Section B above such as community participation, local autonomy, targeted assistance, and simplicity and transparency in its rules and guidelines.

The 1996 LGEF has two distinct facilities: (a) assistance to the 20 priority SRA provinces for industrialization, livelihood, and related poverty alleviation projects; and (b) assistance to low-income fifth and sixth class LGUs, in addition to the 20 SRA provinces, to undertake devolved activities in agriculture and water supply, sewerage, and sanitation. The ADB-financed Rural Water Supply, Sewerage, and Sanitation Project mentioned earlier is part of the second facility.

The LGEF is a clear expression of the high priority that the national government bestows on poverty alleviation, and its appreciation of the importance of involving communities and LGUs in the achievement of this objective. The 1996 budget for the two facilities under the LGEF, however, was only P228 million. Given the magnitude of the poverty problem, there is thus much scope for the program's expansion. The LGEF, in fact, is but part of the broader Social Reform Agenda which aims to "bring about a sustained program on poverty alleviation through the concept of participatory planning or planning from below" (Philippines, DBM, 1996).

On a consolidated basis, SRA-related programs, projects, and activities involved appropriations of P21 billion for 1995 and P74 billion for 1996. Even if the "Allocation to LGUs" worth P12 billion (consisting mainly of the 20 percent IRA earmarking for LGU spending on local development projects mandated under the LGC) was removed from the 1996 total, the balance would remain substantial. But most of these funds were under the control of the NGAs and other national bodies, even for poverty alleviation activities for which there are no spillover effects. Agencies whose functions were covered by the devolution maintained huge shares in the SRA: P11 billion for the Department of Agriculture, P4 billion for the Department of the Environment and Natural Resources, P2 billion for the Department of Health. Some of these agencies' programs actually contain elements of community and LGU participation, the DOH's Comprehensive Health Care Agreements serving as an example. There are advantages, nevertheless, to "rationalizing" such efforts into a regular special-purpose grant program with a transparent and consistent set of rules announced to the LGUs.

Apportioning part of the SRA commitments to an Expanded LGEF would put more system, substance, and transparency to the concepts of participatory planning and people empowerment and would lead to a more efficient and equitable allocation of resources. In its present form, the LGEF features some of the principles discussed earlier governing the design of an efficient and equitable special-purpose grant system. It is definite on its sectoral coverage (economic and health services) and its target clientele (the 20 SRA provinces and fifth to sixth class municipalities). It requires a matching fund from the beneficiary LGU of no less than 10 percent of project cost. The LGEF serves as an umbrella program fund for national government projects supportive of devolved activities which are funded wholly or partially by grants or highly concessional loans.

This option requires the creation of new institutions and is therefore a medium-term proposal. Its major advantage is that it shall introduce rationality in the management of intergovernmental transfers and provide donors with a framework and mechanism by which to channel funds to local development projects

h social and environmental concerns. The seed money for the Cofinancing Pro-
m may come initially from budget appropriations, starting from allocations
the Priority Programs/Projects Fund and realignments from the SRA projects.
e initial target group may be the 20 priority SRA provinces.

ested Features Common to All Options

The options presented above should all share common features that incorpo-
e the principles enunciated earlier, particularly the importance of bringing in
munity participation early on in the project development process and the infu-
n of a sense of community and LGU ownership of the project through cost-
ring. Several issues, however, remain to be discussed.

he Loan-Grant-Equity Mix

An earlier section has described the selective transfer systems in Colombia
d Mexico, with the actual percentages of cost-sharing that they use. It has been
n that the percentages vary by LGU income class and by type of project. None
the descriptions of the systems appearing in the literature gives any indication
ow the numbers were arrived at. Perhaps it is because it does not matter much
ether it is 50-30-20 or 70-20-10 for the relative cost shares of the national gov-
ment, the LGU, and the community. What matters more is that a consistent
tem is in place where poorer communities and LGUs contribute less than the
er ones, where projects with large benefit spillovers get a higher relative con-
ution from the national government than those with less externalities.

To operationalize the externalities criterion, a guideline that may be intro-
ed is to grant a larger share of national support to projects involving invest-
nts in human capital (health and education) and less on projects that are land-
d. People are mobile, and returns to investments in health and education may
stay within the community. Land-based improvements, on the other hand,
erate returns, directly through higher incomes and indirectly through higher
l taxes. Such a rule is also compatible with basic needs and poverty alleviation
erns.

ationing Procedures for Excess Demand

If the national grant component is "too high," queuing is likely to result.
w then shall the limited grant funds be rationed? It is tempting to suggest that
NG share be lowered iteratively until the excess demand vanishes. But the
who shall drop out with this procedure may be the ones most needy of assis-
e. Richer LGUs and communities shall have the financial capacity to put up

the higher counterpart. The creation of separate subwindows for different in
classes addresses this problem, but only partially. The common approach
rank project proposals within a given subwindow according to some simple, tr
parent criteria that take levels of community needs and resources into consi
ation, together with benefit and cost-effectiveness indicators. For "small" proj
actual community needs may be generated through rapid appraisal techni
wherein guidelines for their conduct may be disseminated to the proponents. Th
criteria proposed by DPWH for the Rural Water Supply, Sewerage, and Sanita
Project illustrate such a scoring system for project ranking. Here, one would pr
ably want to have community commitment as a prerequisite instead of a criter
and water needs of the community should probably be given more weight.

3. Project Development Guidelines

A common complaint aired against project proposals emanating from
LGUs is that the proposals are badly prepared. Training programs on pro
development for local government personnel do abound, but the trainee someti
ends up getting even more confused than before. Official manuals on project de
opment for each project category will go a long way towards making clear to th
proponents what the evaluators expect of a project study. The Colombian cofina
system has such manuals for every kind of project with simplified forms to fill
The peso value of benefits, for example, need not be estimated if simpler quan
tive measures of these benefits have been shown to be highly correlated with
peso values. Benefit measures can use indicators like expected traffic volume
the proposed road project, or expected number of beneficiaries with the water
ply project. Unit cost guidelines are also important.

A Note on the IRA Formula

National government transfers through the IRA are expected to increa
proportion to GNP as new tax and tariff reform measures augur a shift in reli
from external to internal taxes. This expected trend, however, should not be ta
as an excuse to justify any reduction in the amount of unconditional gran
LGUs. The 40 percent share of LGUs should be maintained as the scope of res
sibilities of local public services is wide. Initial estimates of the so-called "co
devolved functions" showing a substantial surplus for LGUs from the IRA co
ered only personal services and maintenance and other operating expenses. Th
costs, moreover, were based on historical values and not on any deman
needs-based study of how much resources would be needed to perform the dev
functions efficiently.

The 40 percent share is a somewhat misleading symbol—it applies
tional internal revenues of three years ago, not of the current year. For 199

share of this block transfer in the total budget was only 13.6 percent. At the same time, the IRA should not be perceived as if it were a "gift" from the national government. The people paying these taxes are themselves residents of some local government unit. One view is that both the national and the local governments are but the collecting agents of the people (and spending agents as well); it just so happens that, in most cases, the national government is the more efficient collecting unit (due to economies of scale in tax administration and collection, and to avoid tax competition among LGUs), while the local government is the more efficient spending unit. In this view, a fiscal gap is to be expected among LGUs in the absence of any transfer program.

Some observers point out that an increased IRA may lead to "shirking" on the part of LGUs in their local revenue efforts; a huge unconditional transfer may be used by the LGU to provide some relief from local taxes. Indeed, there appears to be some evidence of this substitution. But the benefits gained from a more efficient allocation of public resources may easily outweigh these effects of shifting some resources from local public use to private use. This apparent fall in local tax effort may also just be a transitional adjustment to the sudden increase in the magnitude of the transfers, as LGUs think out ways of using the new resources at hand more efficiently. In the long run, underprovision of public services by locally elected officials is an almost sure way of getting voted out of office.

Fears are also often expressed that LGUs will just "squander" the increased resources in additional spending on personal services and maintenance and operating expenses at the expense of capital outlay. But empirical evidence shows otherwise. For 1993, from a cross-section sample of 28 provinces, the following expenditure elasticities with respect to LGU income are observed: 0.995 for personal services; 0.928 for maintenance and other operating expenses; and 1.054 for capital outlay. The elasticities do not differ much across spending categories, with capital outlay even having a slight edge.

There is nevertheless scope for modifying the present allocation formula across types of LGUs to increase the shares of provinces and municipalities. Barangays which get a 20 percent share have only a few responsibilities devolved to them, and it is often at the barangay level where community involvement through self-help schemes for local resource mobilization are easy to tap. A huge part of barangay work may be done through tapping community volunteers. Cities, on the other hand, get much more per capita than provinces relative to their devolved functions under the present IRA sharing scheme, when they in fact have a much richer local tax base.

Population growth and urbanization, however, offer a natural (but long-term) corrective factor to imbalances in the sharing between provinces, cities, and mu-

nicipalities. As new cities are created with the conversion from municipalities more and more units get to partake of the city pie while less units divide the municipality allocation (for a relatively smaller population).

The 50-25-25 rule (for population, land area, equal sharing) appears at first glance to be rather simplistic. The literature on fiscal federalism suggests the incorporation of local revenue potential among the sharing criteria as an equalization factor. But in the Philippine case, the present formula already appears to capture fiscal imbalance issues within each type of LGU. Based on the 1993 allocation, the poorer the province as defined by its revenue class, the higher the IRA per capita (rising by 20 percent for a one-step movement in class; across cities IRA per capita rises by 25 percent per class).

The Policy Options and Policy Actions

All the options presented in the previous chapter are feasible and are not of an "either-or" nature; with the proper environment, they can be tried simultaneously. However, they may require varying degrees of "preparedness" on the part of both national and local government agencies. Some may need new legislation to be implementable, as any new money for LGUs beyond what is mandated by the LGC will have to pass through the scrutiny of Congress.

Perhaps the easiest to effect is the first option: that of asking the NGAs to realign their expenditure programs and attune them to be more sensitive to local needs and preferences. Already, the ICC has issued a policy framework paper for "National Government Assistance for the Financing of Local Government Projects with Environmental and/or Social Objectives," incorporating the many suggestions offered in this study. On its part, the DOF is initiating an expanded and modified Municipal Development Fund (this study's second option) that shall be more proactive in identifying, financing, and overseeing local development projects. For the 1997 national budget, the DBM has designed a Poverty Alleviation Budget Allocation Scheme (PABAS) which incorporates most of the salient features of a system of matching grants described above. The PABAS, with a 1997 funding of P2 billion, ties in with the SRA in its geographical scope and sectoral coverage. It is hoped that these recent and similar initiatives would continue to increase the flow of resources to the countryside and enhance the efficiency in the use of such resources through the incorporation of the basic themes and principles underlying intergovernmental transfers that this study stresses.

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