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# The Political Economy of Decentralization: Financing of Health Services in the Philippines

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# THE POLITICAL ECONOMY OF DECENTRALIZATION: FINANCING OF HEALTH SERVICES IN THE PHILIPPINES

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*Abstract*

Like many developing countries, the Philippines has decentralized its public health system. Despite its supposed advantages, however, the decentralization, has not led to widespread improvements in local provision. This is partly because many local government units are found financially inadequate since the current revenue-sharing scheme does not factor in the distribution of the devolved expenditure responsibilities across LGU. Moreover, this particular flaw in the present revenue-sharing scheme has made corrective policy measures more difficult to undertake since it is no longer sufficient to compensate those LGUs originally with financing difficulties. More crucially, it has also become politically necessary to compensate those adversely affected by the corrective policy measure. If only to avoid the added cost of further adjustments, the experience of the Philippines underscores the importance of a well-designed and carefully implemented decentralization program.

Key words: Philippines, political economy, decentralization, health services

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# THE POLITICAL ECONOMY OF DECENTRALIZATION: FINANCING OF HEALTH SERVICES IN THE PHILIPPINES

## 1. INTRODUCTION

Many developing countries, especially those in Asia, Latin America and Africa, have, in various forms, decentralized the generation of public revenues or the provision of public services (see, e.g., Bennett, 1994; Ranis and Stewart, 1994; Rondinelli *et al.*, 1983a; Peterson, 1997). In recent years, many of the formerly socialist countries have also started shifting toward a more decentralized form of government (Bird *et al.*, 1996). Among other reasons, decentralization is adopted in many countries and advocated by donor agencies (World Bank, 1998) because regional government agencies, local governments or private enterprises have institutional advantages over the national government in the provision of certain public services. The supposed advantages include better information about the preferences of the local population, greater knowledge about the fiscal constraints imposed by the local economic condition, and more incentives (and, at the same time, greater pressure) to respond to local needs (Oates, 1972). Furthermore, the heightened competition among jurisdictions can lead to a better matching between revenue-expenditure mixes and preferences of various population groups (Tiebout, 1956).

Two of the public services considered especially suitable for decentralized provision or financing are education and health services, which have the characteristics of local public goods or services. An improved efficiency in the provision or financing of education or health services under decentralization has been reported in a number of developing countries including Chile (Parry, 1997), Papua New Guinea (Campos-Outcalt *et al.* 1995), Botswana and Tunisia (World Bank, 1993b). However, the experiences of these and other countries show that decentralization programs are seldom successful when first implemented because of various technical, economic, political and other institutional constraints. Necessarily, further policy reform measures were needed to

realize the benefits of decentralization (see, e.g., World Bank, 1994; Cheema and Rondinelli, 1983).

Among the constraints to successful decentralization are the insufficient funding for the decentralized public services and the lack of political will to institute the necessary corrective policy measures (Leighton, 1996). The experience of the Philippines under decentralization attests to the possible adverse effects of inadequate resource transfers to local governments. Beginning in 1992, the Philippines has implemented a major devolution program, designed to enhance the role of local government units (LGUs) in the fiscal affairs of the state. Under the program, LGUs absorbed the major expenditure responsibilities including the provision of health services. The devolved health functions comprise hospitals, health personnel and primary care services.

In addition, the LGUs were also granted a higher share in the internal revenues of the national government. While in the aggregate the additional revenue share was more than adequate to finance the devolved functions, the current revenue-sharing scheme failed to take into account the distribution of the devolved expenditure functions across LGUs. As a consequence, many LGUs experienced financing shortfalls for the devolved functions, thus compromising their ability to provide health services.

More seriously, however, the flaw in the present revenue-sharing scheme in the Philippines has made policy reforms more difficult to undertake. The difficulty in achieving policy reform arises because the proposed alternative revenue-sharing formula simply involves a reallocation (of a fixed revenue pie) among LGUs. So, to elicit wider support perhaps, the present *de facto* adjusted revenue-sharing formula does not only allow compensation to LGUs equivalent to the amount of their absorbed expenditure responsibilities. But, more interestingly, the cities, which absorbed the least expenditure functions, also receive additional grants for their own hospital outlays incurred *before* devolution. Arguably, this particular feature of the *de facto* revenue-sharing scheme can be explained in the context of the political economy of redistribution under decentralization in the Philippines.

The experience of the Philippines underscores the importance of insuring sufficient financing for the devolved functions, if only to avoid the additional cost of a corrective policy measure. Since LGUs will evaluate any proposed corrective measure relative to what they already have under the flawed scheme, it is not sufficient to compensate those with inadequate funding under the initial policy change. Almost inevitably, perhaps, it is also necessary to compensate those who might incur losses as a consequence of the corrective measure, even if they are still better off when compared to their situation before decentralization. If the latter group of LGUs have sufficient political clout, as seems to be the case in the Philippines, then more resources are required to neutralize opposition to the reform measures.

The political economy of financing devolved health services in the Philippines is explored more fully in the following sections of the paper. In Section 2, the Philippine decentralization program is briefly described, followed by a more detailed analysis in Section 3 of the distribution of revenues and devolved expenditure functions across LGU levels. Then, the fiscal impact of the devolution on local governments is examined in Section 4. Discussion on the political economy of financing for the devolved health services begins in Section 5 and is further taken up in Section 6 which presents the results of some simulation exercises. Finally, Section 7 ends with some concluding remarks.

## 2. THE 1991 DECENTRALIZATION PROGRAM

### (a) *Major design features*

In the Philippines, the idea of local autonomy and some forms of decentralization have been promulgated through several Acts of Congress and Presidential Decrees. However, it was not until the 1987 Constitution that a decentralized form of government was fully adopted.[1] In 1991, as provided for by the new constitution, the Local Government Code was enacted, paving the way for the heightened participation of the

LGUs in managing the fiscal affairs of the country and reversing the centuries-old tradition of a strong central government.

The Local Government Code (LGC) of 1991 augments the share of the LGUs in the total public revenues. The most significant increase is in the Internal Revenue Allotment (IRA)[2] which is the share of the LGUs in the total internal revenues accumulated by the NG.[3] At the same time, LGUs are assigned greater responsibility over the provision of public services, foremost among which are health services.

In any given year, the size of the IRA and its distribution among LGUs follow a three-step formula. First, the national government's gross internal revenue in the third preceding year is divided up between itself and the local governments. During the first year of LGC implementation (1992), the share of the LGUs was 30 percent.[4] Second, the IRA is then divided by LGU levels: 23 percent to provinces, 23 percent to cities, 34 percent to municipalities and 20 percent to *barangays* (villages). Finally, the individual shares within each LGU level are computed using weight factors: 50 percent to population, 25 percent to land area, and 25 percent as the equal sharing part.

Partly as a result of the LGC implementation, the total IRA share of the LGUs is reported to have increased from about 12 billion pesos in 1991 to 24 billion pesos in 1992 and to about 36 billion pesos in 1993. This is significant since, for many LGUs, the IRA accounts for more than half of their total revenues. Against this seeming dependence on the NG, LGUs, nonetheless, receive their shares largely as block grants, with only 20 percent of it earmarked for *local development projects* (i.e., public works). It should be noted however that the LGC does not categorically state that part of the additional IRA is a grant for the transferred expenditure responsibilities, although it was the intention of the law. Because of this "missing link", many local leaders soon clamored for a separate and additional grant specifically for the devolved functions.

Concomitant with the increased IRA shares, several expenditure functions of the NG were devolved to LGUs as well. Among the transferred functions include health facilities

and personnel, agricultural extension services and local treasury services. In 1992, the total budget appropriation of the national government agencies on the devolved functions, now referred to as the Cost of Devolved Functions (CODEF), was roughly 6.3 billion pesos. About 65 percent of the CODEF is accounted for by the Cost of Devolved Health Functions (CDHF), which was the budget outlay of the Department of Health in 1992 on the more than 2 thousand health facilities and about 46 thousand health personnel devolved to LGUs (Diokno, 1994). It should be noted that, at least in the short run, the devolved functions are fixed recurrent expenditure obligations transferred to LGUs.

Unlike other devolved functions, there is a wide variability in the distribution of the CDHF across LGUs. According to the World Bank (1993a), the bulk of curative care services (i.e., hospitals) went to provinces while most of the preventive services, which include rural health units, and *barangay* health stations were devolved to municipalities. Also, according to DOH estimates, 59.7 percent of the CDHF went to provinces, 37.7 percent went to municipalities and the rest to cities. The disparity between LGUs within each level is also apparent. Many small provinces (e.g., Surigao del Norte) absorbed more hospitals than other bigger provinces (e.g., Pampanga). The disparity can be explained by several factors, namely: the criteria used by the DOH in allocating health resources across LGUs and the impact of political lobbying for hospitals before 1991, and the need to preserve the existing hospital referral system within the hierarchy of LGUs under devolution.

(b) *Implementation*

Local government units started receiving higher IRA shares in 1992. However, it was not until a year later when they absorbed the devolved functions. The one-year delay was partly intended to give the affected national government agencies (NGAs) enough time to provide estimates of the costs and types of the devolved functions to LGUs so that the latter can factor in the additional expenditures obligations in their respective budget programs for 1993. By 1993, however, when the actual transfer of the central functions occurred, many of the NGAs have not been able to give the needed estimates. Due to

inadequate information, many LGUs failed to adequately plan for the devolved functions despite their one-year financial windfall in 1992.

Aside from the insufficient information, the poor assignment of responsibilities over the devolved health facilities led to other problems. In the devolution of health facilities, it seems that the overriding concern of the DOH was to preserve the hierarchy of the hospital referral system within a province. Primary care facilities (e.g., rural health units, barangay health stations) were devolved to municipalities, while the secondary and tertiary care facilities (e.g., district and provincial hospitals) were transferred to provincial governments. While this worked in many cases since most municipalities and cities are under the administrative control of provincial governments, a number of provincial hospitals, however, are located in independent chartered cities and are thus jointly used by provincial and city residents. By failing to take into account the mismatch between the catchment area of the hospital referral system and political jurisdictions of LGUs, the defective transfer of responsibilities over facilities inadvertently and unduly burdens the provincial government.

Two nationally-mandated adjustments in the salaries and allowances of government employees further complicated the implementation of the decentralization program: one was the Magna Carta for Public Health Workers (Republic Act 7305) passed in March 1992. The law was intended to protect and promote the welfare of all health workers, especially those transferred to LGUs. Among others, the law strengthens the security of tenure of the devolved personnel (who feared the "politicization" of their positions). In addition, it provides for additional remuneration to the devolved personnel, whose pay is now to be drawn from the local treasury, to make their salaries comparable with the higher national pay scale received by the remaining DOH personnel. Each health worker is entitled to the so-called Magna Carta benefits, which include allowances for subsistence and laundry and a salary differential, amounting to about 4,300 pesos per month. In addition, rural physicians are entitled to 2,200 pesos per month as representation and travel allowances.

In 1993, the NG did not provide any additional budgetary support to LGUs for the Magna Carta benefits. Consequently, many LGUs failed to provide for the additional benefits because of financial constraints. However, even the well-off LGUs were reluctant to provide full benefits because they felt that it was the NG's responsibility to take care of the devolved personnel. Although in 1994 the LGUs received 662 million pesos subsidy[5] for the total amount of the Magna Carta benefits, the salary adjustments only sowed further disharmony in the local bureaucracy. With their higher salaries, many devolved rural physicians in the lower-class municipalities ended up receiving more than the local chief executives, i.e., mayors and vice mayors. Furthermore, the distorted relative pay scales between the local government employees and the devolved employees only served to dampen the former's morale.

During the same period, the Salary Standardization Law (SSL) also took effect. The law was intended to improve the government bureaucracy by, among others, attracting and retaining a competent workforce in public service. To realize this, a uniform pay scale for all government employees of comparable levels was designed and implemented, and the basic rate was increased, thus making government salaries comparable with the private sector. Although the LGUs were fully aware of the fiscal implication of the SSL and were thus able to factor this in their budget programs, the deficient information about the devolved personnel, however, made their financing problems more acute.

## 3. DISTRIBUTION OF THE BURDEN OF DEVOLUTION

Early literature on the fiscal risk of devolution forewarned the likelihood that some LGUs will have financing shortfalls or negative net resource transfer under devolution (Manasan, 1992; World Bank , 1993a). These found support in succeeding studies that used more recent data (Diokno, 1994; DOH 1996b). The main reason for the financing deficit is not that the total IRA is inadequate to cover the CODEF. According to Diokno (1994), for example, the total amount of CODEF absorbed by LGUs in 1993 was only

about 6.3 billion pesos (66 percent of which is CDHF), which is just about half of the increase in the IRA share of LGUs between 1992 and 1993.

Instead, the financing shortfall is largely attributed to the inequitable distribution of the burden of the devolution, i.e., the allocation of the IRA share and CODEF across and within different LGU levels.[6] A comparison between provinces and cities provide a clear illustration. The IRA shares of the provinces and the cities are both set equal to 23 percent, as stipulated in the LGC. However, this led to a higher average IRA for cities than for provinces, since there were 76 provinces and only 60 cities as of 1993.[7] Furthermore, the percentage distributions of both the CODEF and the CDHF are highly skewed. According to DOH calculations, the provinces' share either in the CODEF (45.6 percent) or CDHF (59 percent) is at least six times as much as that of the cities. For these reasons, many of the LGUs which experienced difficulty in financing their devolved functions were the provinces.

The relatively detailed estimates presented in Table 1[8] broadly support the findings of earlier studies. Unlike those in earlier studies, however, these figure represent a more consistent estimate of net resource transfer, called the net incremental IRA share, to reflect the real fiscal burden of devolution. The LGU's incremental IRA share for a given year (after 1991) is defined as the difference between its share under the LGC and what its share would have been under the old pre-devolution IRA formula for the same year. Unlike previous estimates of IRA increases, therefore, the incremental IRA share isolates the rise in the IRA due solely to the LGC from other factors that similarly augment it, even without the LGC, such as improved economic conditions and better tax collection procedures. To reflect the endowment value of the incremental IRA share in 1992, it is assumed that LGUs has the option of keeping the amount in interest-bearing assets and used the interest income, which is computed at 10 percent annually, to help defray the CODEF. Deducting the inflation-adjusted CODEF alone or with the Magna Carta benefits from the incremental IRA share for 1993 or from the sum of incremental IRA share for 1993 and the one-year interest income of the incremental IRA share for 1992 then yield various measures of net incremental IRA share.[9] With the recent availability of

more detailed fiscal accounts, LGUs who are directly made worse off by the devolution program are then identified by computing for their net incremental IRA shares.

As Table 1 shows, at the aggregate level, the respective incremental IRA shares of provinces, cities and municipalities are all greater than their shares in the CODEF. In 1993, for example, the incremental IRA shares of provinces, cities and municipalities were about 3.5 billion pesos, 4.6 billion pesos and 5.6 billion pesos, respectively. Their respective shares in the CODEF, on the other hand, were only about 3.3 billion pesos, 0.3 billion pesos and 3.3 billion pesos.

**Table 1. Net Incremental IRA Shares under Devolution: 1992 and 1993***
(in million pesos)

| LGUs | Cost of Devolved Functions (CODEF) (1993) | Incremental IRA (1992) | Incremental IRA (1993) | Net Incremental IRA Share** | | | |
|---|---|---|---|---|---|---|---|
| | | | | Inc. IRA (1993) less CODEF | Inc.IRA (1993) less CODEF and Magna Carta Benefits | Inc.IRA (1993) and Interest Income of Inc. IRA (1992) less CODEF | Inc.IRA (1993) and Interest Income of Inc. IRA (1992) less CODEF and Magna Carta Benefits |
| All | 6889.5 | 10900 | 19218.6 | 6775.4 (95.1) | 6028 (91.8) | 7509.4 (96.1) | 6762 (93.9) |
| Provinces | 3276.3 | 1955 | 3507.5 | 231 (57.9) | 93.6 (52.6) | 426.5 (60.5) | 101.9 (55.2) |
| Cities | 297.2 | 2576 | 4596.6 | 43101.1 (100) | 4292 (100) | 4558.7 (100) | 4549.6 (100) |
| Municipalities | 3316.0 | 2809 | 5560.8 | 2243.3 (96.8) | 1829.5 (93.4) | 2542.2 (97.7) | 2110.4 (95.5) |
| Barangays | 0.0 | 3560 | 5553.7 | 5553.7 (100) | 5553.7 (100) | 5909.7 (100) | 5909.7 (100) |

*Figures in parentheses are the percentage share of LGUs with positive net incremental IRA shares. The estimated IRA shares of LGUs with and without the LGC are taken from Diokno (1994). ** Because of the lack of individual *barangay*-level data, the column totals exclude barangays and may not add up because of rounding off errors. Source of raw data: Department of Budget and Management and Department of Health. Author's own calculations.

In terms of percentage shares in IRA and CODEF, however, the estimated figures are different from those reported in earlier reports. The combined share of the provinces and municipalities in the CODEF is approximately equal to 96 percent, which is roughly divided equally between the two LGU levels. In terms of their share in total incremental IRA, the provinces got only 18 percent in both 1992 and 1993, while the cities' allotment was 24 percent in both years. This shows a marked deviation from the LGC stipulation of an equal IRA share for the provinces and cities (23 percent); the true additional revenues transferred to provinces are lower and the transfers to cities higher than intended. The municipalities also got a lower revenue share than official estimates: 26 percent in 1992 and 29 percent in 1993.[10] Their higher CODEF share strained further their fiscal capabilities. On the other hand, like cities, the *barangays* emerged as "winners" under devolution.

In reality, the gains of the cities under decentralization are far greater than what these figures suggest. Many of the DOH-retained hospitals, which are all big tertiary or specialty hospitals, are located in cities. Since access to these hospitals is relatively cheap, city residents are likely to enjoy more benefits than others within the hospitals' catchment areas. Furthermore, many of the devolved provincial hospitals are also found in cities. Since user fees continue to be low in these facilities, the provincial governments inadvertently subsidize city residents who patronize these facilities at the expense of the relatively poor rural constituents.

Due to the inequities in the distribution of the CODEF across LGU levels, a number of provinces and municipalities were found to have negative net incremental IRA shares. Depending on the measure of net incremental IRA share used, about 30 to 36 provinces and about 35 to 102 municipalities were found to have financing difficulties in 1993. In contrast, none of the cities and *barangays* was found to be in financial straits in 1993. This is not surprising since the cities' share in the CODEF is small (4 percent) while the *barangays* did not absorb any devolved functions.

A more disaggregated examination also reveals the extent of inequities among provinces. Even without paying for the Magna Carta benefits and other nationally-mandated salary adjustments, most of the provinces listed in Table 2 were not financially capable to shoulder their shares in the CODEF even after imputing for the possible interest earnings from their 1992 IRA shares. In the case of Isabela, Tarlac, Bohol and Zamboanga del Norte, the payment of the required Magna Carta benefits and other salary adjustments put them in the red. However, only Isabela and Bohol can cover the deficit with the possible interest earnings from their 1992 IRA shares. The provinces with the worst financing shortfalls are Pangasinan (51.75 million pesos), Leyte (46.97 million pesos), Iloilo (37.5 million pesos), Bulacan (37.28 million pesos), Laguna (32.22 million pesos), Bataan (32.89 million pesos), Surigao del Norte (31.18 million pesos) and Cebu (30.74 million pesos). Since the devolved functions are recurring expenditures of the LGUs, the shortfalls have long-term implications on the provision of devolved health services. These results show why many provinces are strongly advocating for the revision in the present IRA formula.

The seeming inequity between the municipalities and the *barangays*, however, is less serious. On the one hand, although the municipalities should account for the biggest share in the IRA (34 percent), they also absorbed the biggest share in the CODEF (48 percent). Since the overall increase in the IRA is greater than the CODEF, their average net resource transfer is positive. However, owing to the differences in the allocation formula used in the IRA and the CODEF, many municipalities, especially those in the lower income class, experienced negative net resource transfer. Hence, the inequity in this case is more between the rich and poor municipalities. On the other hand, the average incremental IRA of the nearly 41,000 *barangays* in 1992 and 1993 amounted to only about 87 thousand pesos and 135 thousand pesos, respectively. Therefore, although all *barangays* have positive net resource transfers, their average net gain is significantly less than that of any other LGUs.

**Table 2. Provinces with Negative Net Incremental IRA Shares in 1993**
(in million pesos)

| Province | Net Incremental IRA Share | | | |
|---|---|---|---|---|
| | Incremental IRA (1993) less Cost of Devolved Functions (CODEF) | Incremental IRA (1993) less CODEF and Magna Carta (MC) Benefits | Incremental IRA (1993) and Interest Income of Incremental IRA (1992) less CODEF | Incremental IRA (1993) and Interest Income of Incremental IRA (1992) less CODEF and MC Benefits |
| Mountain Province | -2.61 | -6.40 | -0.69 | -4.48 |
| Ilocos Sur | -18.96 | -24.43 | -16.73 | -22.2 |
| La Union | -5.93 | -10.40 | -3.94 | -8.41 |
| Pangasinan | -43.07 | -55.35 | -39.47 | -51.75 |
| Isabela | 6.02 | -1.29 | 10.39 | 3.08 |
| Nueva Vizcaya | -7.86 | -12.12 | -5.43 | -9.69 |
| Bataan | -30.22 | -34.79 | -28.31 | -32.89 |
| Bulacan | -31.81 | -40.0 | -29.09 | -37.28 |
| Pampanga | -12.34 | -18.88 | -9.84 | -16.38 |
| Tarlac | 0.68 | -3.76 | 3.20 | -1.24 |
| Zambales | -1.48 | -5.57 | 0.91 | -3.18 |
| Batangas | -4.90 | -10.70 | -2.07 | -7.87 |
| Cavite | -17.19 | -22.64 | -14.95 | -20.40 |
| Laguna | -26.62 | -34.67 | -24.17 | -32.22 |
| Quezon | -11.65 | -20.99 | -7.68 | -17.02 |
| Romblon | -6.83 | -10.98 | -5.03 | -9.18 |
| Albay | -18.30 | -24.23 | -15.89 | -21.82 |
| Catanduanes | -22.65 | -27.71 | -20.83 | -25.89 |
| Sorsogon | -9.58 | -14.54 | -7.46 | -12.41 |
| Aklan | -3.56 | -7.75 | -1.57 | -5.77 |
| Antique | -2.72 | -7.16 | -0.56 | -5.0 |
| Capiz | -6.83 | -11.90 | -4.56 | -9.63 |
| Iloilo | -31.11 | -40.61 | -28.00 | -37.5 |
| Negros Occidental | -0.15 | -8.06 | 3.94 | -3.96 |
| Bohol | 1.68 | -2.51 | 4.47 | 0.29 |
| Cebu | -25.01 | -34.13 | -21.62 | -30.74 |
| Negros Oriental | -12.26 | -19.14 | -9.18 | -16.07 |
| Eastern Samar | -5.64 | -11.15 | -3.10 | -8.61 |
| Leyte | -39.20 | -50.16 | -36.01 | -46.97 |
| Northern Samar | -15.93 | -21.15 | -13.56 | -18.78 |
| Southern Leyte | -6.07 | -10.07 | -4.13 | -8.14 |
| Zamboanga del Norte | 0.95 | -5.16 | 4.18 | -1.92 |
| Agusan del Norte | -6.70 | -10.47 | -4.73 | -8.50 |
| Misamis Occidental | -15.50 | -20.35 | -13.46 | -18.32 |
| Surigao del Norte | -26.38 | -33.40 | -24.17 | -31.18 |
| Lanao del Norte | -7.72 | -12.11 | -5.61 | -10.00 |

*Source of raw data: Department of Health and Department of Budget and Management. Author's own calculations.

## 4. IMPACT ON LOCAL PROVISION

One of the supposed advantages of decentralization is the possible improvement in service delivery arising from better information regarding local needs and resources, greater accountability of local leaders to their constituents, and greater competition among LGUs (Oates, 1972; Boadway and Wildasin, 1984; Parry, 1997). Some notable improvements have indeed been realized in many developing countries that have decentralized their health systems (World Bank, 1993b; World Bank, 1994). The experience of the Philippines shows how local leaders and field health personnel adopted various innovative measures in service delivery and financing under decentralization.

According to a DOH study, a number of LGUs have undertaken various initiatives to improve the delivery of health services under decentralization. The provincial government of Negros Oriental introduced the Community Primary Hospital Program, a facility-based primary health care program targeted to people living in remote *barangay*s and other isolated communities in the mountainous parts of the province. The municipal government of Sampaloc (in the province of Quezon) has started to operate a local health insurance program designed to defray the cost of medical services of the members as well as to reduce the financial strain of subsidizing the hospital services borne by the LGU. Some (e.g., Palawan, La Union and Irosin, Sorsogon) have actively teamed up with non-government organizations to upgrade the monitoring of disease outbreaks, execution of health interventions and dissemination of health information. The provincial government of Cebu instituted a new drug procurement and logistics system resulting in significant cost savings. Although these examples offer encouraging prospects, however, more cases need to be documented to assess the overall quality of devolved health services.

Since fiscal data are more readily available, an evaluation can be made regarding the quantity of health service provision under decentralization. When used with other indicators, the changes in the quantity of health service provision, as proxied by local health expenditures for example, yield critical insights into local government behavior, which may be important for policymaking. For example, if the observed reduction in

local health expenditures is primarily due to a financing shortfall, this can be solved through either additional revenue transfers or technical assistance to improve the local managerial capabilities. If the reduction is due to factors other than financial, then this may reveal something about local preference for the devolved health services.

Table 3 shows the changes in local health expenditures between 1991 and 1993 of a sample of LGUs (see appendix for the sources of data). Of the 33 provinces sampled, 22 reduced their spending on local health services and experienced financing shortfalls under devolution. The 22 provinces include both some of the high income (e.g., Cebu, Cavite, Pangasinan) and low income (e.g., Southern Leyte, Quezon, Romblon) provinces. These results indicate that IRA insufficiency is an important explanation for the spending reduction in at least two-thirds of the provinces. Except in the case of two provinces, the financing gap of the rest does not seem to close even under various measures of resource transfers used. Also, it should be noted that 11 of the 22 provinces with financing shortfalls actually cut their health expenditures by more than their IRA shortfalls. This somewhat suggests that a stronger preference for the non-health spending also explains the reduction in health spending.

Twenty three out of the 111 municipalities are also found with reduced health spending due to financing shortfalls under devolution. Of the 23 municipalities, 8 had financing deficits greater than their reductions in health expenditures. The remaining 15 on the other hand had experienced a reduction in their health spending at least as much as the size of their financing deficit. On the average, the municipalities have lower reduction in health spending and financing shortfalls than the provinces. However, the problem is no less acute in the case of municipalities because most of them are dependent on their IRA shares for their revenues. Moreover, they absorbed the primary health care services which are the most accessible to people. As in the case of provinces, the number of municipalities with critical financing problems largely remains the same under various measures of net resource transfer, thus also underscoring the need to evaluate the present IRA allocation formula.

## Table 3. No. of LGUs with Reduced Spending on Local Health Services and Negative Net Incremental IRA Shares*

| LGUs | Change in Spending on Local Health Services (93-91) | Incremental IRA Share (1993) | | Incremental IRA Share (1993) and the Interest Income of Iincremental IRA Share (1992) | |
|---|---|---|---|---|---|
| | | Less CODEF | Less CODEF and MC Benefits | Less CODEF | Less CODEF and MC Benefits |
| Provinces | 22 | 22 | 22 | 20 | 22 |
| A. With financing deficit greater than the reduction in spending on local health services | 11 (-0.19) | 11 (-0.28) | 11 (-0.34) | 11 (-0.26) | 11 (-0.32) |
| B. With financing deficit less than the reduction in spending on local health services | 11 (-0.29) | 11 (-0.14) | 11 (-0.20) | 9 (-0.11) | 11 (-0.17) |
| Municipalities | 23 | 23 | 23 | 18 | 23 |
| A. With financing deficit greater than the reduction in spending on local health services | 8 (-0.10) | 8 (-0.14) | 8 (-0.18) | 8 (-0.11) | 8 (-0.15) |
| B. With financing deficit less than or equal to the reduction in spending on local health services | 15 (-0.11) | 15 (-0.04) | 15 (-0.08) | 10 (-0.01) | 15 (-0.05) |

*Based on a sample of LGUs included in the UPecon-HPDP LGU Survey. The 22 province account for about 67 percent of the total sample provinces. The 23 municipalities account for about 21 percent of the total sample municipalities. The figures in parentheses are the average real per capital changes in spending on local health services or net incremental IRA shares. Source of table: Capuno (1999).

Given the numerous problems encountered by LGUs during the early years of decentralization, many local leaders have clamored for the "re-nationalization" of the devolved functions, i.e., a return of devolved functions to the NG, while opting to retain the additional revenue shares. Since this would increase further its budget deficit, the NG strongly opposed the move. Eventually, however, many LGUs, led by the provinces, rallied for the amendment of the LGC instead, specifically for the change in the IRA formula to factor in the distribution of the CODEF. Expectedly, the move to amend the IRA found many supporters among LGUs with financing shortfalls.

## 5. THE POLITICAL ECONOMY OF FINANCING HEALTH SERVICES

### (a) *The de facto adjustment in the IRA*

Since 1994, several bills (e.g., HB 5884, HB 5213, SB 1265, Webb Bill) have been filed in Congress and various proposals have argued policy debates to address the problems faced by LGUs under devolution, especially the financing of the devolved functions. So far, however, the LGC remains unmodified. Nonetheless, the IRA formula has been revised since 1994 through the General Appropriations Act (GAA), which is the annual government budget approved by Congress.[11] Under the *de facto* revisions (Table 4), a percentage of the CODEF and the cost of city-funded hospitals are first taken out of the total IRA of the LGUs before the present codal formula is applied on the residual. Then each LGU is compensated for its CODEF out of the amount deducted from the original IRA. Interestingly, each city also gets an additional grant in 1994 for the hospitals it continues to own and operate under devolution, but the grant is based on the city's maintenance and operating expenditures for the same hospitals as of December 31, 1992.

**Table 4. *De facto* Revisions in the IRA Formula through the General Appropriations Act: 1994-1997**

| Year | Amounts deducted from the total IRA shares of LGUs |
|---|---|
| 1994 | 50 percent of the actual CODEF and the cost of city-funded hospitals existing as of December 31, 1992 |
| 1995 | 100 percent of the actual CODEF and the cost of city-funded hospitals existing as of December 31, 1992 |
| 1996 | 50 percent of the actual CODEF and the cost of city-funded hospitals existing as of December 31, 1992 |
| 1997 | 100 percent of the actual CODEF and the cost of city-funded hospitals existing as of December 31, 1992 |

Source: General Appropriations Act, various years.

Unlike an amendment of the LGC, however, the *de facto* revisions in the IRA formula as specified in the GAA only provide a temporary budgetary relief to provinces and municipalities (which absorbed the bulk of devolved functions). As the table suggests, there is a continuing lobby for, and possibly also against, additional funding every budget cycle, perhaps until the present IRA formula is adjusted permanently.

Modifying the present IRA formula, however, is like redistributing a fixed pie. Since the current IRA formula specifies the shares of the LGUs, and therefore also of the NG, in percent rather than in levels (or peso amounts), any adjustment to compensate LGUs for their CODEF is bound to come at the expense of the NG, cities or *barangays*. In such a situation, therefore, LGUs are compelled to continually make and unmake alliances to be on the "winning" side rather than on the "losing" side. As will be shown below, however, the composition of the prospective alliances, and therefore their relative strength, depends on the features of the proposed alternative IRA formula. And the *de facto* IRA revision, among the other alternatives, seems to be the most politically acceptable to a wide range of LGUs.

(b) *Reallocation between the NG and LGUs*

Early on, the NG appeared to be vulnerable to political pressure since it was blamed for most of the problems arising from decentralization. The devolved health personnel were demanding to be taken back unless their concerns regarding changes in their job descriptions, salary standards and career expectations were addressed. In many instances, the media focused on the "politicization" and the seemingly widespread dissatisfaction over the quality and quantity of local health services. Also, LGUs beset with financial or managerial problems were clamoring for additional assistance. Despite the popular demand, however, the NG overcame its perceived indecisiveness and eventually proved to be resolute in protecting its share of the internal revenues.

Acquiescence seemed to have been the NG's worse alternative, given its precarious fiscal position and the external pressure it was facing. Like many developing countries in

the 1980s, the Philippines adopted a series of structural adjustment policies to improve its worsening macroeconomic condition (see Lim and Nozawa, 1992). In this light, the decentralization was adopted partly to relieve the NG of some of its expenditure functions and thereby improve its budget deficit standing, one of the key variables monitored by the country's foreign creditors. With debt servicing taking a huge claim on the national budget, additional grants for the CODEF would have reduced the NG's resources for other public services like education, national defense and (retained) health services. Moreover, the other major source of NG revenues - tariffs and other trade taxes - dwindled because of trade liberalization, another structural adjustment policy pursued by the government (Diokno, 1996).

Under the constitution, the Congress has the sole power to amend the LGC. Moreover, if Congress is determined enough, it can even overturn a presidential veto to reduce the NG's share. Since the members of Congress are elected at large by voting districts comprising several municipalities and, possibly, cities, the representatives of the LGUs with financing deficits could have lobbied for a reallocation of the IRA from the NG to the LGUs. However, the positions of the members of Congress on many issues are influenced by the NG, which controls the pork barrel allocations of the members of Congress. Since the congressional representatives depend on their pork barrel projects for reelection, they are less likely to vote for a proposal inimical to the NG position.

To support the devolved health functions, the NG, especially the DOH, openly advocated instead for the redistribution of (just) the total IRA share of LGUs. The DOH has supported such proposal in the media and in several fora it helped organize. In addition, the DOH has also provided and, in some cases, continues to provide selective financial and technical assistance to distressed LGUs. In addition to the yearly extra-budgetary support for the Magna Carta benefits, the DOH has also singled out LGUs with deficits for additional financial assistance. Since 1994, it has likewise instituted a new grant system, called the Comprehensive Health Care Agreement (CHCA), designed to secure local funding for the devolved health functions and to ensure local support for the national health programs (Eleria *et al*, 1995). However, these programs do not provide a

permanent and equitable solution to the financing problems of many LGUs. Even the CHCA, which is renewed every two years, has its design and implementation shortcomings in its present format that threaten even its own objectives (Medalla, 1996; Esguerra, 1996).

### (c) *Reallocation among LGUs*

Given the rigidity of the NG's position, therefore, the only viable alternative seems to be a reallocation among LGUs – across levels or within each level. However, the number of "winners" and "losers" and the extent of the changes on their IRA shares will depend on the specific features of the proposed alternative. On the one hand, a reallocation across LGU levels would imply that only the cities and *barangays* will bear the burden of adjustment because of their small CODEFs. On the other hand, a reallocation within LGU levels would lead to a reduction in the IRA shares of some provinces and municipalities, given the skewed distribution of the CODEFs within these LGU levels.

A simulation of the fiscal effects several proposed alternative IRA formula would help identity those LGUs who will be on the "winning" side or the "losing" side. Those in the "winning" side will have improved IRA under a particular adjustment, and therefore will likely support the proposed alternative. In contrast, those on the "losing" will have a worse fiscal position under the proposed adjustment, and consequently will also likely coalesce against it. A comparison of the projected incremental IRA shares would indicate how much "improved" or "worse" a particular LGU fares under the adjustments. Moreover, a simple headcount of the "winners" and the "losers" would indicate the relative strength and composition of the LGUs that may ally to support or oppose a particular proposal.[12] The simulation results presented below estimate the changes in the incremental IRA shares in 1993 under different proposed allocation formula[13], following the methodology set out in the previous section.[14]

The present and the various proposed alternative IRA formulas are presented in Table 5. In the table, $I$ refers to total IRA (for a given year), $\theta$ is the percentage share of the

LGUs in the IRA, $\delta_j$ is the share of the *j*th level (of LGU) in the total IRA share of LGUs, $\alpha_{ij}$ is the share of the ith LGU belonging to the *j*th level, $I_{ij}$ is the amount of IRA share of the *i*th LGU belonging to the *j*th level, and *C* is the "total compensation" for the devolved function.[15] The total compensation could refer to the CDHF, or the CDHF plus the Magna Carta benefits. In all the proposed alternatives, the CDHF is fixed to its historical level, i.e., the 1992 amount is adjusted for 10 percent inflation but it excludes all other additional expenditures made by the LGU on the devolved functions. Although the compensation could include the cost of devolved functions other than health functions, the focus here, however, is on the financing of devolved health services. Moreover, the results will not substantially differ since the CDHF account for the bulk of the CODEF.

**Table 5. Present and Proposed Alternative IRA Formula**

| Formula | Definition |
|---|---|
| PRESENT (LGC 1991) | $I_{ij} = \alpha_{ij}\delta_j \theta I$ |
| COLLECTIVE COMPENSATION | $I_{ij}^{C} = \alpha_{ij}\left[\delta_j(\theta I - C) + C_j\right]$ |
| Proposal 1 | C = Cost of Devolved Health Functions |
| Proposal 3 | C = Cost of Devolved Health Functions + Magna Carta Benefits |
| INDIVIDUAL COMPENSATION | $I_{ij}^{L} = \alpha_{ij}\left[\delta_j(\theta I - C)\right] + C_{ij}$ |
| Proposal 2 | C = Cost of Devolved Health Functions |
| House Bill 5884 | C = Cost of Devolved Health Functions; adjustments in $\alpha$ |
| Proposal 4 | C = Cost of Devolved Health Functions + Magna Carta Benefits |
| Modified HB 5884 | C = Cost of Devolved Health Functions + Magna Carta benefits; adjustments in $\alpha$ |

The proposed alternatives can be classified in two broad categories. Under the collective compensation category, the total compensation is first deducted from the total IRA share, before the shares of the different LGU levels are obtained following weights used in the present formula. Then, for each particular LGU level, its share in the total compensation (which is pegged to its actual total CDHF, or CDHF plus Magna Carta benefits) is added to its IRA share. Finally, the individual LGU share is then obtained by

applying the weights specified in the present formula. Collective compensation reduces intra-level inequities because it minimizes the bias for those with bigger CDHFs under devolution who are also the ones favored with greater health service provision before devolution. As will be shown in the next section, collective compensation is also appealing because of the relative homogeneity of its supporters (and, its opponents), besides generating adequate funding for the devolved functions (by LGU level).

Under the individual compensation category, the total required compensation is likewise deducted first from the total IRA share. Unlike in the previous category, however, each LGU receives the exact equivalent amount of its CDHF as compensation. A particular example under this major category is House Bill 5884. Essentially, HB 5884 adjusts the following parameters in the computation of individual IRA share: population from 50 percent to 55 percent, land area from 25 percent to 20 percent, and equal-sharing part remains fixed at 25 percent. Under this category, the LGU is still forced to run the devolved functions more efficiently since the compensation for the CODEF is not adjusted for inflation. The simulation results will show that the likely proponents of this scheme will be heterogeneous, given the inequitable distribution of the CDHF even among LGUs within the same level.

## 6. SIMULATION RESULTS AND ANALYSIS

### (a) *Winners and losers*

The fiscal effects of the adjustment in the IRA formula are simulated using the databases described in the appendix.[16] Four sets of simulations are undertaken. In the first set, the IRA shares of each LGU level obtained under the different alternative formula are compared with their actual shares in 1993. In the second and third sets, LGUs are classified further by income class. Also, the adjustments are assumed not to affect the present IRA shares of the *barangays* which, on average, are already lower than any other LGUs'. This then limits the fiscal effect to the provinces, municipalities and cities which

are the more visible participants in the policy debate. In the second set, however, the compensation is limited to CDHF; while in the third set, the Magna Carta benefits are added. Finally, the net incremental IRA shares are computed in the last set.

The first set of simulation exercises is depicted in Table 6. The results show that provinces and municipalities will gain while cities and *barangay*s will lose under any of the proposed IRA allocation formula. The projected gains and loses, however, will depend on the extent of compensation. On the one hand, if compensation is limited to the CDHF only, the projected 1993 IRA shares of provinces and municipalities are about 1703.5 million pesos and 125.7 million pesos more than their actual 1993 IRA shares, respectively. On the other hand, the projected reductions in the 1993 IRA shares of cities and *barangay*s are about 930.6 million pesos and 898.6 million pesos, respectively.

The gains to provinces and municipalities and the losses to cities and *barangay*s are significantly greater when LGUs are compensated for their shares in the Magna Carta benefits as well. The projected gains for provinces and municipalities are approximately 1860.9 million pesos and 282.5 million pesos, respectively. In contrast, the respective losses of cities and *barangay*s are about 1095.3 million pesos and 1048.1 million pesos.

The number of LGUs that will gain or lose (in terms of changes in their 1993 IRA shares) depends on which IRA formulas are being evaluated. Against the present formula, collective compensation (Proposal 1 or Proposal 3) will benefit all provinces and municipalities. In contrast, all cities and *barangay*s are better off under the present formula than they will be under either Proposal 1 or Proposal 3. Also, a shift from the present formula to one that reimburses individual CDHFs (e.g., Proposal 2, Modified HB 5884) will improve the fiscal position of the majority of provinces and municipalities.

The results highlight the tensions among LGUs and suggest the possible factions that will support or oppose a proposed formula. If the choice is between collective compensation and the status quo, it seems that provinces and municipalities will unanimously support the former. In this, they will be opposed by the cities and

*barangays*. Unanimity is less likely, however, when individual compensation is presented as an alternative. Because of their much improved fiscal positions, 38 provinces, 21 cities and 694 municipalities, for example, will likely reject Proposal 1 in favor of Proposal 2. In a sense, a natural grouping of LGUs can be inferred from the analysis: the LGUs whose percentage shares in the IRA exceed their percentage shares in the CDHF (viz., cities and *barangays*) will prefer the present formula to either Proposal 1 or Proposal 3. They will be "opposed" by those whose percentage shares in the CDHF shares exceed their percentage shares in the IRA (viz., provinces and municipalities).

**Table 6. Changes in the 1993 IRA Shares under Different IRA Formulas***
(in million pesos)

| IRA Formula | Total** | Provinces | Cities | Municipalities | *Barangays* |
|---|---|---|---|---|---|
| 1. Proposal 1 vs. Present | 0.0 (96.4) | 1703.5 (100) | -930.6 (0.0) | 125.7 (100) | -898.6 |
| 2. Proposal 2 vs. Present | 0.0 (54.5) | 1703.5 (90.8) | -930.6 (0.0) | 125.7 (54.9) | -898.6 |
| 3. HB 5884 vs. Present | 0.0 (57.2) | 1703.5 (88.2) | -930.6 (0.0) | 125.7 (57.8) | -898.6 |
| 4. Proposal 2 vs. Proposal 1 | 0.0 (44.9) | 0.0 (50.0) | 0.0 (35.0) | 0.0 (45.0) | 0.0 |
| 5. Proposal 3 vs. Present | 0.0 (96.4) | 1860.9 (100) | -1095.3 (0.0) | 282.5 (100) | -1048.1 |
| 6. Proposal 4 vs. Present | 0.0 (59.5) | 1860.9 (90.8) | -1095.3 (0.0) | 282.5 (60.3) | -1048.1 |
| 7. Modified HB 5884 vs. Present | 0.0 (59.9) | 1860.9 (88.2) | -1095.3 (0.0) | 282.5 (60.8) | -1048.1 |
| 8. Proposal 4 vs. Proposal 3 | 0.0 (41.3) | 0.0 (51.3) | 0.0 (35) | 0.0 (41.1) | 0.0 |

* Figures in parentheses are percentage share of LGUs within each level with increases in their 1993 shares as result of the change in the IRA formula. **The total number of LGUs, which is 1678 (76 provinces, 60 cities and 1542 municipalities),excludes *barangays*.
Source of raw data: DOH-LGAMS.

Since the *barangays* did not absorb any CDHF, they - both individually and collectively - would incur substantial reductions in their IRA shares under any of the proposed alternatives. Given that the individual IRA shares of *barangays* are already relatively small[17], it would also be interesting to see how the revenue shares of other LGUs change when the current *barangays*' share, for equity reasons, is not altered by the IRA adjustments. In the next two exercises, the present IRA share of the *barangay* is first deducted from the total IRA before the proposed formulas are applied on the residual. The residual, which is now just 80 percent of the present IRA share of LGUs, is divided among the rest of the LGUs using the present formula. Note that this alters the effective IRA shares of the provinces (28.75 percent), cities (28.75 percent) and municipalities (42.5 percent).

Table 7 shows what happens to the IRA shares when only the CDHF is factored in the proposed revisions. In this case, the total gain to provinces is about 1.65 billion pesos and the losses of cities and municipalities are about 1.27 billion pesos and 0.38 billion pesos, respectively. The gains of provinces are lower than in the previous simulation exercise because the total effective IRA to be allocated among provinces, cities and municipalities is now smaller. Unlike in the previous exercises, the losses of cities are partially shared with municipalities. This is due to the fact that effective percentage share of the municipalities in the IRA is now 42.5 while their percentage share in the CDHF remains at 38. Since their share in the reduction in the total IRA is greater than their share in the total reimbursements for CDHF, they must also incur losses under any of the proposed adjustments in the IRA formula.

If the choice is between Proposal 1 and the present formula, all provinces will support the former while all cities and municipalities will support the latter. Hence, provinces will face stiff resistance from all other LGUs. However, a number of municipalities will support any proposal that compensates LGUs for their individual CDHF. The broadest possible coalition, consisting of 66 provinces and 489 municipalities, will prefer HB 5884 to the present formula. The coalition, however, will comprise only a third of all provinces, cities and municipalities.

**Table 7. Changes in the 1993 IRA Shares under Different IRA Formulas***
(Adjusting for the Cost of Devolved Health Functions)
(in million pesos)

| LGUs (by Income Class) | Proposal 1 vs. Present | | Proposal 2 vs. Present | | HB 5884 vs. Present | | Proposal 2 vs. Proposal 1 | |
|---|---|---|---|---|---|---|---|---|
| | Amt. | No. of Win-ners | Amt. | No. of Win-ners | Amt. | No. of Win-ners | Amt. | No. of Win-ners |
| **Total** | **0.0** | **76** (4.5) | **0.0** | **402** (24.0) | **0.0** | **555** (33.1) | **0.0** | **753** (44.9) |
| **Province** | **1645.7** | **76** (100) | **1645.7** | **69** (90.8) | **1645.7** | **66** (86.6) | **0.0** | **38** (50.0) |
| ARMM | 68.5 | 4 | -45.7 | 0 | -45.9 | 0 | -114.2 | 0 |
| First Class | 905.9 | 27 | 797.5 | 25 | 845.3 | 24 | -108.4 | 10 |
| Second Class | 272.1 | 14 | 317.3 | 14 | 305.1 | 13 | 45.2 | 8 |
| Third Class | 200.4 | 12 | 302.2 | 12 | 283.7 | 12 | 101.8 | 8 |
| Fourth Class | 77.7 | 6 | 123.5 | 6 | 117.3 | 6 | 45.8 | 4 |
| Fifth Class | 109.4 | 11 | 132.0 | 10 | 121.2 | 9 | 22.6 | 6 |
| Sixth Class | 11.8 | 2 | 19.0 | 2 | 19.0 | 2 | 7.2 | 2 |
| **City** | **-1268.5** | **0** (0) | **-1268.5** | **0** (0) | **0.0** | **0** (0) | **0.0** | **21** (35.0) |
| NCR | -240.5 | 0 | -260.9 | 0 | -147.3 | 0 | -20.4 | 0 |
| First Class | -600.5 | 0 | -578.1 | 0 | -656.9 | 0 | 22.4 | 08 |
| Second Class | -271.3 | 0 | -274.6 | 0 | -291.1 | 0 | -3.2 | 6 |
| Third Class | -59.2 | 0 | -58.1 | 0 | -67.3 | 0 | 1.1 | 1 |
| Fourth Class | -73.2 | 0 | -72.6 | 0 | -78.9 | 0 | 0.6 | 5 |
| Fifth Class | -16.9 | 0 | -17.1 | 0 | -19.7 | 0 | -0.2 | 1 |
| Sixth Class | -6.9 | 0 | -7.2 | 0 | -7.3 | 0 | -0.2 | 0 |
| **Municipality** | **-377.2** | **0** (0) | **-377.2** | **333** (21.6) | **-377.2** | **489** (31.7) | **0.0** | **694** (45.0) |
| NCR | -14.9 | 0 | 87.3 | 13 | 125.4 | 13 | 102.2 | 13 |
| ARMM | -16.1 | 0 | -87.6 | 0 | -88.5 | 0 | -71.4 | 0 |
| First Class | -5.1 | 0 | -5.0 | 1 | 3.5 | 6 | 0.0 | 4 |
| Second Class | -4.4 | 0 | -2.6 | 1 | 6.1 | 8 | 1.8 | 5 |
| Third Class | -33.7 | 0 | -21.2 | 19 | 3.4 | 42 | 12.5 | 42 |
| Fourth Class | -64.5 | 0 | -55.2 | 56 | -43.6 | 90 | 9.3 | 104 |
| Fifth Class | -195.3 | 0 | -232.0 | 180 | -297.4 | 26.1 | -36.7 | 389 |
| Sixth Class | -43.2 | 0 | -61.0 | 63 | -86.1 | 69 | -17.7 | 137 |

* Results simulated under the assumption that the present IRA shares of *barangays* are unaffected by the adjustments. "Winners" refers to the number of LGUs (excluding *barangays*) with positive increases in their 1993 IRA shares due to the change in the IRA formula. Figures in parentheses are the percentage shares of "winners" to the total number of LGUs in each level. The LGUs are classified by income class. Column totals may not add up because of rounding errors. Source of raw data: Department of Health, UPEcon-HPDP LGU Survey.

Note also the magnitudes of the gains and loses across income class within each LGU level. In the case of provinces, the gains are bigger for the high-income LGUs than those in the lower income class. This reflects the fact that the high-income provinces have relatively bigger CDHFs which also means that they were receiving relatively greater

health services from the NG before devolution. On the other hand, the lower class municipalities appear to lose more than their well off counterparts. This is not surprising since there are more low-income municipalities than high income ones and the reported figures are cumulative amounts per income class.

Note that the LGUs in the National Capital Region (NCR) are lumped together in a separate category because they are among the richest local economies in the country. Moreover, many of the biggest DOH-retained hospitals are located in the region. As shown in the table, all cities will lose under any of the proposed changes in the IRA while municipalities will gain if LGUs are individually compensated for their CDHF. Hence, there is a possible conflict of interest among LGUs of different levels even if they belong to the same province or region.

Note also that the LGUs in the Autonomous Region of Muslim Mindanao (ARMM) are also classified separately since none of them absorbed any devolved functions. Instead, responsibility over the devolved health functions was transferred to the autonomous regional government. Since the database used here does not have the required data for the regional government, the fiscal, population and land area data of the provinces and municipalities in ARMM are used instead. Hence, the figures are only suggestive of the extent of the fiscal affects of the IRA adjustments to the regional government.

The emerging patterns traced in Table 7 are similar to the ones in Table 8 where the adjustments factor in the effects of the CDHF, the Magna Carta benefits and the other salary increases. Not surprisingly, the gains to provinces (1.76 billion pesos) and losses to cities (1.47 billion pesos) and municipalities (0.28 billion pesos) are greater here. Still, the broadest alliance that may emerge will comprise provinces and municipalities supporting HB 5884 over the present formula. The alliance, however, will remain a minority.

**Table 8. Changes in the 1993 IRA Shares under Different IRA Formulas***
(Adjusting for the Cost of Devolved Health Functions and Magna Carta Benefits)
(in million pesos)

| LGUs (by Income Class) | Proposal 3 vs. Present | | Proposal 4 vs. Present | | Modified HB 5884 vs. Present | | Proposal 4 vs. Proposal 3 | |
|---|---|---|---|---|---|---|---|---|
| | Amt. | No. of Win-ners | Amt. | No. of Win-ners | Amt. | No. of Win-ners | Amt. | No. of Win-ners |
| **Total** | **0.0** | **76** | **0.0** | **445** | **0.0** | **580** | **0.0** | **693** |
| | | (4.5) | | (26.5) | | (34.6) | | (41.3) |
| **Province** | **1755.4** | **76** | **1755.4** | **69** | **1755.4** | **64** | **0.0** | **39** |
| | | (100) | | (90.8) | | (84.2) | | (51.3) |
| ARMM | 73.1 | 4 | -54.8 | 0 | -55.0 | 0 | -127.8 | 0 |
| First Class | 964.5 | 27 | 842.2 | 25 | 888.5 | 22 | -122.3 | 11 |
| Second Class | 290.5 | 14 | 341.1 | 14 | 329.3 | 13 | 50.6 | 8 |
| Third Class | 214.3 | 12 | 329.4 | 12 | 311.5 | 12 | 115.1 | 8 |
| Fourth Class | 83.1 | 6 | 134.3 | 6 | 128.4 | 6 | 51.3 | 4 |
| Fifth Class | 117.2 | 11 | 142.7 | 10 | 132.2 | 9 | 25.5 | 6 |
| Sixth Class | 12.7 | 2 | 20.4 | 2 | 20.4 | 2 | 7.7 | 2 |
| **City** | **-1474.3** | **0** | **-1474.3** | **0** | **-1474.3** | **0** | **0.0** | **21** |
| | | (0) | | (0) | | | | (35.0) |
| NCR | -279.5 | 0 | -301.5 | 0 | -191.4 | 0 | -22.0 | 0 |
| First Class | -698 | 0 | -675.3 | 0 | -751.7 | 0 | 22.7 | 8 |
| Second Class | -315.4 | 0 | -318.3 | 0 | -334.3 | 0 | -2.9 | 6 |
| Third Class | -68.8 | 0 | -67.5 | 0 | -76.4 | 0 | 1.3 | 1 |
| Fourth Class | -85.1 | 0 | -83.8 | 0 | -89.9 | 0 | 1.2 | 5 |
| Fifth Class | -19.6 | 0 | -19.7 | 0 | -22.3 | 0 | -0.1 | 1 |
| Sixth Class | -8.1 | 0 | -8.2 | 0 | -8.4 | 0 | -0.1 | 0 |
| **Municipality** | **-281.0** | **0** | **-281.0** | **376** | **-281.0** | **516** | **0.0** | **633** |
| | | (0) | | (24.4) | | (33.5) | | (41.1) |
| NCR | -11.1 | 0 | 206.3 | 13 | 243.2 | 13 | 217.4 | 13 |
| ARMM | -12.0 | 0 | -101.2 | 0 | -102.1 | 0 | -89.1 | 0 |
| First Class | -3.7 | 0 | -5.8 | 1 | 2.5 | 5 | -2.1 | 5 |
| Second Class | -3.3 | 0 | -3.3 | 1 | 5.1 | 6 | 0 | 3 |
| Third Class | -25.1 | 0 | -24.2 | 20 | -0.2 | 40 | 0.9 | 33 |
| Fourth Class | -48.1 | 0 | -60.3 | 55 | -49.0 | 88 | -12.3 | 89 |
| Fifth Class | -145.5 | 0 | -236.3 | 202 | -299.7 | 273 | -90.8 | 345 |
| Sixth Class | -32.2 | 0 | -56.3 | 84 | -80.7 | 91 | -24.1 | 145 |

* Results simulated under the assumption that the present IRA shares of *barangays* are unaffected by the adjustments. "Winners" refers to the number of LGUs (excluding *barangays*) with positive increases in their 1993 IRA shares due to the change in the IRA formula. Figures in parentheses are the percentage shares of "winners" to the total number of LGUs in each level. The LGUs are classified by income class. Column totals may not add up because of rounding errors. Source of raw data: Department of Health, UPEcon-HPDP LGU Survey.

So far, the simulation exercises accounted only for the CDHF and not for the CODEF. Since the CODEF is greater than CDHF, it is possible that the incremental IRA under the proposed alternative may still be insufficient to cover CODEF. As Table 9

bears out, a number of LGUs will remain unable to meet their expenditure obligations, despite the adjustments in the IRA formula. These LGUs will include a few provinces and many municipalities. The number of provinces and municipalities becomes smaller when LGUs are individually compensated for their CDHF. All cities, however, will still be able to sustain the devolved functions despite the reductions in their IRA shares. Notwithstanding the possible interest income from 1992 IRA shares, estimates presented here seem to indicate that, in addition to the compensation, the proposed alternative should also revise the weight parameters used.

**Table 9. Projected Incremental IRA Net of Cost of Devolved Functions and Magna Carta Benefits: 1993***
(in million pesos)

| Projected Incremental IRA | Total | Provinces | Cities | Municipalities |
|---|---|---|---|---|
| A. Less CODEF | | | | |
| 1. Projected incremental IRA share under Proposal 1 | 6775.4 (94.0) | 1876.7 (92.1) | 3032.6 (100) | 1866.1 (93.8) |
| 2. Projected incremental IRA share under Proposal 2 | 6775.4 (99.0) | 1876.7 (100) | 3032.6 (100) | 1866.1 (98.9) |
| 3. Projected incremental IRA share under HB 5884 | 6775.4 (99.6) | 1876.7 (100) | 3032.6 (100) | 1866.1 (99.5) |
| B. Less CODEF and Magna Carta Benefits | | | | |
| 1. Projected incremental IRA share under Proposal 3 | 6028 (91.1) | 1661.8 (78.9) | 2817.7 (100) | 1548.5 (90.9) |
| 2. Projected incremental IRA share under Proposal 4 | 6028 (97.9) | 1661.8 (100) | 2817.7 (100) | 1548.5 (97.7) |
| 3. Projected incremental IRA share under Modified HB 5884 | 6028 (99.1) | 1661.8 (100) | 2817.7 (100) | 1548.5 (99.0) |

* Results simulated under the assumption that the present IRA shares of *barangays* are unaffected by the adjustments. The CDHF is adjusted for inflation by 10 percent. Figures in parentheses refer to the percentage of LGUs within each level with positive incremental IRA shares net of CDHF or CDHF and Magna Carta Benefits in 1993. Source of raw data: Department of Health, UPEcon-HPDP LGU Survey.

(b) *The de facto IRA revision as political equilibrium*

Based on the insights obtained from the simulation exercises, the *de facto* IRA revisions can be perceived as an emerging political equilibrium in the revenue-redistribution game. In this game, LGUs will want to coalesce to pursue their common interests. The relative strength of the resulting coalitions will depend crucially on their numbers, political clout and how effectively they can resolve intra-group rivalry.

The simulation results suggest a natural alliance among LGUs with high CDHFs. Indeed, the provinces were the most vocal proponents of adjustments in the IRA. In many instances, the League of Provinces has made representations to key national government agencies (namely, Department of Budget and Management, Department of Health and Department of Interior and Local Government) to persuade the latter to secure greater financing. Also, it has expressed support to the different bills in Congress that advance their cause.

In these efforts, the provinces find allies in the municipalities. The municipalities will doubly benefit from the proposed revisions: in the form of higher IRA shares, and potentially improved health services for their constituents. Under the devolution, the municipalities are now dependent on the provinces for the provision of personal health care services. Presumably for these reasons, the leaders of the League of Municipalities have also openly advocated for the adjustments in the IRA.[18]

On the opposing side, LGUs with relatively low CDHFs – principally the cities and *barangays* - will expectedly want to preserve the *status quo*. On the contrary, however, the cities also appear to be supportive of the provinces' cause. Perhaps, the main rationale for this is that many of the cities are under the administrative authority of the provinces. In fact, only the big metropolitan cities such as those in the NCR, Cebu and Davao are truly independent of the provinces. Like the municipalities, therefore, many of the cities rely on the provinces for health service provision. Also, the impact of higher health service budget has tremendous impact on the welfare of city residents since many of the

devolved provincial hospitals are located in cities. Moreover, the cities would be able to sustain a reduction since they are experiencing a windfall under devolution.

However, it seems plausible that the cities would also want to minimize the reduction. It is for this reason, perhaps, that cities are compensated for their own funded hospitals as specified in the GAA. While these hospitals are not part of the devolved functions, the additional compensation could be a political compromise to minimize opposition to, if not to encourage support for, the proposed IRA adjustments.

Similarly, the *barangays* are also dependent on provinces, municipalities and cities for their own health services. Administratively, they are under the jurisdiction of the local mayors. Hence, their constituents will also benefit from the additional compensation given to municipalities and cities. Furthermore, it will be hard to coordinate and monitor the actions of more than 40,000 *barangay* leaders, scattered in more than 7000 islands, for them to be an effective political force. Under these circumstances, therefore, they will likely identify with the causes of the higher level LGUs where they administratively belong than with their own level.

Individual remuneration, which seems to be a bias of political institutions in the Philippines, is another feature of the *de facto* IRA revision. Under the present political setup, most municipalities and a number of cities together belong to the same congressional districts and thus have common representatives in Congress; while the big independent cities are each represented by two or more members of Congress. To ensure reelection, therefore, these representatives would want to promote the interests of the LGUs within their districts. This explains why they would favor providing LGUs additional grants at least as much as their CODEF. This could also explain why cities are compensated for their own hospitals. In contrast, collective compensation will benefit the provinces more. However, the provinces do not really have their own representatives to Congress in the same way that the several congressional districts within their jurisdictions have their own. Worse, many local representatives to Congress are even the political rivals of the provincial governors.

The *de facto* modifications in the IRA seem to reflect a political equilibrium, in that it is a compromise widely supported by various LGU factions. The fact that the IRA has to be adjusted yearly and through the GAA, however, implies that it is an unstable equilibrium. It will probably remain unstable until a clear majority of LGUs emerges. However, as argued above, different majorities emerge as various alternative formulas are proposed. In particular, the size and composition of the factions depend on which pair of proposals are being evaluated, thus possibly leading to a cyclical majority. Hence, stability is less likely until the IRA-reallocation applies to a bigger pie. This entails additional transfers to LGUs on top of their current IRA share. Thus, the NG has to yield a part of its IRA or other sources of revenues have to be exploited.

## 7. CONCLUDING REMARKS

The experience of the Philippines indicates that a poorly designed devolution program, especially when it leads to inequitable distribution of revenue shares and expenditure responsibilities, creates two major problems. First, it cripples the local health service delivery system and, consequently, may endanger local health status. Second, it makes policy reform initiatives more difficult to implement than the initial program. The political economy of reform initiatives in the Philippines suggests that: first, it is not only necessary to offset the loses of the LGUs with inadequate funding under the initial policy change; second, it may also become inevitable to compensate those who would lose as a consequence of the corrective measure, even if they are still better off when compared to their situation before any policy adjustment was made. Since LGUs will evaluate the policy reform against what they already have, and not against what they had before, more resources may be needed to minimize resistance to or to achieve a wider consensus for the new program.

Hence, the importance of a well-designed and carefully implemented devolution program cannot be overemphasized. The desired features of a devolution program ensure

that the recipient LGUs will have the necessary financial and technical capabilities to assume the transferred functions. In order to ensure financial capability, the net resource transfer should be meticulously measured. The general rule should be: the (adequate) money and devolved responsibilities should go together (Shah, 1991a, 199b). Many of the problems encountered under devolution in the Philippines could have been avoided if the distribution, and not just the total amount, of the cost of devolved functions were factored in the revenue-sharing scheme. Moreover, it seems proper to give additional grants to cover expenses incidental to the program (such as salary increases of devolved personnel), especially if these are beyond the control of the LGUs. Caution should be made, however, when compensating for the devolved expenditure responsibilities to avoid perpetuating any existing inefficiencies or inequities in the spatial distribution of the devolved functions.

## NOTES

1. Tapales (1993) and Manasan (1992b) give a short account of the various laws and programs with decentralization features promulgated in the Philippines. Brillantes (1987) gives a detailed analysis of decentralization in the Philippines before 1991. Sosmena (1987) reviews the historical forces that shaped the centralist tendencies of the Philippine government before the 1987 Constitution.
2. The total internal revenues basically comprise the tax revenues collected by the national government, excluding tariffs and other taxes on international trade.
3. LGUs were also receiving IRA shares and other forms of central transfers before 1991. For a more detailed discussion on the intergovernmental transfers before 1991, see Lamberte *et al.* (1993) and Bahl and Schroeder (1983). The LGC of 1991 also stipulates that LGUs should have a share in the proceeds from the development of national wealth within their jurisdictions. However, the IRA constitutes the bulk of central transfers to LGUs before and after the LGC of 1991.
4. For the first year (1992) of the implementation of the LGC, 30 percent of the gross internal revenues is transferred to LGUs as IRA share. The IRA share is then increased to 35 percent in the second year before it is finally fixed to 40 percent in the third and succeeding years.
5. The budgetary support to LGUs, however, proved to be temporary since it was cut to 50 percent in 1995, and then further to 25 percent in 1996 before it was completely withdrawn in 1997.
6. The are other reasons, including: lack of technical and administrative capabilities of LGUs to assume their devolved functions and to take advantage of their new revenue opportunities, and the possible dampening effect of additional IRA on revenue collections.
7. Since 1994, the numbers have started to change dramatically since many highly developed municipalities were converted to cities.
8. The data used in this paper are described in the appendix.
9. The assumed 10 percent inflation and interest rates are not too far off: in 1992, the actual national-level inflation rate and 91-day Treasury Bill rate were 8.9 and 16.02, respectively.
10. The main reason for the disparity between the intended and actual IRA shares is the differences in the shares of the LGU levels under the pre-devolution IRA formula: the share of the provinces is higher than the cities, and the share of the municipalities is higher than the *barangays*. See Lamberte et al., 1992 for a comparison between the allocation formula used before and after the LGC.
11. Under the present budget procedures, the IRA, being an integral part of the NG's revenue and expenditure program, must also be approved as part of the GAA.
12. Coalition formation is not modeled here, although LGUs in the same level have formal alliances in the Philippines. Provinces have their League of Provinces; cities their League of Cities, municipalities their League of Municipalities; and *barangays* their League of *Barangays*. Although not all LGUs are members or active in these political organizations, the current members nonetheless constitute the majority. In varying degree, these political organizations are active in promoting and protecting the welfare of their members.

13. The latest year with complete and detailed data available in the database used here is 1993. Although the results would appear quite dated because of this limitation, they somehow reflect the tensions that happened during the early years of decentralization.
14. In this case, the incremental IRA share is defined as the difference between the simulated IRA under the proposed alternative formula and what the IRA would have been under the pre-devolution formula.
15. The parameter values under the present formula are: $\theta$ is 35 percent in 1993; $\delta$ is 23 percent for provinces, 23 percent for cities, 34 percent for municipalities, and 20 percent for *barangays*; and $\alpha$ is function of land area, population and an equal-sharing part.
16. To check the reliability of the database, the 1993 IRA shares of LGUs were simulated and compared with their actual 1993 IRA shares. The cumulative difference between the simulated and actual 1993 IRA shares is about 0.2 million pesos for provinces, -1.7 million pesos for cities, 1.5 million pesos for municipalities and zero for *barangays*. However, it has the following limitations: first, it has no *barangay*-level information on population and land area. Hence, only the changes in the total IRA share of *barangays* can be estimated. Second, the figures for the Magna Carta benefits include the salary adjustments as specified in the Salary Standardization Law. Third, the available data on population and land area available is only up to 1993. Hence, it is less reliable for projections beyond 1993. Lastly, it does not have an estimate of the hospital budget of the cities in 1992.
17. Since there is no available *barangay*-level information on population and land area, a rough estimate would be to divide the 20 percent IRA share of the *barangays* by their total number. The amount is about 176 thousand pesos per barangay in 1993.
18. Although they have their own League, the municipalities are likely to be less able to police their ranks because of their sheer number. Hence, even its leadership might find it difficult to ensure full support to the provinces. Even without the League's backing, however, provinces can still muster support from the municipalities under their administrative control.

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## APPENDIX

The fiscal, socioeconomic and health data used are taken from both secondary and primary sources. Secondary data are sourced from existing studies (e.g., Diokno, 1996; Manasan 1992a, 1992b, 1995), research monographs (e.g., World Bank, 1993a) and published government reports (e.g., *Philippine Health Statistics*).

The primary data are collected from the national government agencies (Department of Health, Department of the Budget and Management, Nationals Statistics Office, National Economic and Development Authority, and the Commission on Audit) and also from the LGUs themselves (Hospital Records, Rural Health Units, Treasury, Office of the Mayor, Accounting, Local Development Office, etc.). The primary data are stored in two databases. The first database is the LGU Information Retrieval System developed by the Local Government Assistance and Monitoring System (LGAMS) of the Department of Health (DOH). This database was developed primarily to identify the LGUs that need supplemental funds to support the devolved health functions. Here, it is used extensively in simulating the fiscal effects of the different proposed formula for computing the IRA share of the LGUs to finance the devolved services. It contains the following information for all provinces, cities and municipalities in 1991: population, land area, cost of devolved functions (1992), and the cost of devolved health functions (1992). In 1993, there were 76 provinces, 60 cities and 1542 municipalities and 40,904 barangays.

The second database contains the survey data collected under the LGU Project of the UPecon-Health Policy Development Program (UPecon-HPDP) from August to November 1994. The survey was designed to examine the changes in the delivery of health services under devolution. In particular, it aimed to document cases of LGUs that have successfully adopted innovative measures, and to investigate the effects of health, managerial, fiscal and socioeconomic factors on the provision of health services before and after devolution. A total of 180 LGUs was included in the sample. The period coverage is 1991 (pre-devolution) and 1993 (post-devolution). Since some LGUs have missing data on some variables, a subsample of 157 LGUs comprising 33 provinces, 13 cities and 111 municipalities is used in this paper.

The sample selection proceeded following this scheme: the sample provinces were selected on the basis of their geographical location (i.e., from the three main island groups of Luzon , Visayas and Mindanao), socioeconomic profile (i.e., by income class) and the presence of DOH-retained health facilities in the province. Within each sample province, the sample cities and municipalities are chose in two stages. In the first stage, either the richest city (if the province has a city or cities) or one of the municipalities belonging to the highest income class is chosen. The classification used here adopts the system used by the Department of Budget and Management (DBM) which rates LGUs according to their average annual income for four consecutive years. The income classes range from the first to the sixth class, with the first class indicating the highest class. In

the second stage, one for each of the lower class municipalities present is selected on the basis of its proximity to the city or municipality chose in the first stage.

The data collected in this project include the following: fiscal variables (e.g., revenues and expenditures), financial profiles (e.g., assets and liabilities), socioeconomic indicators (e.g., income class, population), health status indicators (e.g., death rates, mortality rates), organizational and administrative details (e.g., background of personnel, tax resolutions, development plans), and information on intergovernmental interactions (e.g., fiscal competition, joint use of devolved facilities, cost-sharing arrangements). These data are supplemented by field reports containing some anecdotal evidence and other narrative information (HPDP-LGU Project Field Reports).