INTERGOVERNMENTAL FISCAL RELATIONS, FISCAL FEDERALISM, AND ECONOMIC DEVELOPMENT IN THE PHILIPPINES

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INTERGOVERNMENTAL FISCAL RELATIONS, FISCAL FEDERALISM, AND ECONOMIC DEVELOPMENT IN THE PHILIPPINES*

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I. ORGANIZATION AND ADMINISTRATION: CONSTITUTIONAL BASIS FOR PROVINCIAL/LOCAL GOVERNMENT RELATIONS

A. *Government Structure*

The Philippine government is a unitary system comprised of the national or central government and the local government units (LGUs). The central government is composed of three independent bodies, namely, executive, legislative and judicial branches. The executive consists of 18 departments headed by a Cabinet Secretary. The President is chief executive, head of state and commander-in-chief of the armed forces. The legislative branch is bicameral with a House of Representatives and a Senate. The judiciary has a Supreme Court and several layers of lower courts.

The local government consists of three levels: province/highly urbanized city, municipality/ component city,and barangays. At present, there are 75 provinces, 15 highly urbanized cities, 45 component cities, 1,536 municipalities and 41,300 barangays.

Composed of a cluster of municipalities and/or component cities, the province is both a political and corporate entity. It serves as a mechanism for promoting the developmental process in, and the effective governance of, the LGUs under its jurisdiction. The provincial governor, its chief executive, is elected. The *sangguniang panlalawigan* or provincial legislature is composed of several elected and a number of *ex-officio* members.

Consisting of more urbanized and developed barangays, the city coordinates and delivers basic, regular and direct services and effectively governs the inhabitants within its jurisdiction. A city may be classified as either component or highly urbanized. Highly urbanized cities have a population of at least 200,000 inhabitants and an annual income of at least P50 million. On the other hand, the municipality which is composed of a group of less urbanized barangays, performs the same role as the city. Each

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municipality and city is headed by an elected mayor who acts as chief executive. The legislative body of the former is the *sangguniang panglunsod* while that of the latter is the *sangguniang bayan*. Each legislature has elected and *ex-officio* members.

The barangay is the basic political unit. It is a cluster of households within a territory. The barangay serves as the primary planning and implementing unit of the government. It also serves as a forum where people express their views and where local disputes may be amicably settled.

B. *Factors Affecting Centralization*

The system of local governments introduced by the Spanish colonizers has been maintained through the various political periods undergone by the country. However, the degree ofcentral government control over the LGUs has been changing. Historically, trends in both political and administrative decentralization have been influenced by the following: (1) threat to national security; (2) personalities of the presidents of the Philippines; (3) national integration; (4) national development; and (5) perception of the central government on the competence of local government (Sosmena 1987).

Commonwealth Period (1935-1941). Local governments were placed under the general supervision of the President as provided for under the 1935 Constitution (Section 10, Article VII). National security, political stability and nation building took precedence over local autonomy (Brillantes 1990). Moreover, President Manuel L. Quezon is generally perceived to be a centralist who took his supervisory power over LGUs to heart.

Third Republic (1946-1972). There was a sharp shift towards greater decentralization.[1] The Government Survey and Reorganization Commission (GSRC) through Plan 53-A of 1956 divided the country into eight regions for administrative purposes.

Republic Act 2262 ("An Act Amending the Laws Governing Local Governments by Increasing their Autonomy and Reorganizing Provincial Governments") was passed in 1959 during President Ramon Magsaysay's term. It provided the city and municipal governments greater fiscal, planning and regulatory functions. The Act broadened the taxing powers of cities and municipalities. It also allowed them to undertake locally-funded public works projects and adopt zoning and planning ordinances (Brillantes 1987).

Republic Act 2370 ("An Act Granting Autonomy to the Barrios of the Philippines") was also enacted in 1959. It gave barrios a quasi-municipal corporate character with legislative and taxing powers. The barrios were to be governed by an elective council. Republic Act 5185 ("Decentralization Act") was legislated in 1967. It increased the financial resources of LGUs and gave local governments greater authority over fiscal, personnel and other substantive matters. Provincial and city governments were allowed to retain amounts that they were previously mandated to contribute to the central (or national) government. Provincial governors were authorized to appoint personnel whose salaries were to be locally-sourced. The Act likewise specified certain "duties and powers of local chief executives not subject to direction or review by any national official."

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1. The leaders of the Second Republic (1941-1946) were too pre-occupied with survival during the war to be interested in decentralization.

However, in the post war years, "rehabilitation was topmost priority. The Huk rebellion was at its height and political factionalism was a negating factor to local autonomy, thereby promoting centralism" (Sosmena 1987).

Martial Law (1972-1981). The decentralist wave described above waned. Brillantes (1987) puts it even more strongly:

> "Decentralization suffered a setback with the concentration of decisionmaking powers in the hands of (President Ferdinand) Marcos. Marcos abolished Congress and then went on to suspend national and local elections, abrogating unto himself the power to appoint local officials. Although elections for a national legislature were later held in 1978, and then for local officials in 1980, these were never considered truly reflective of the people's will because of the prevailing conditions of dictatorship" (Brillantes 1987).

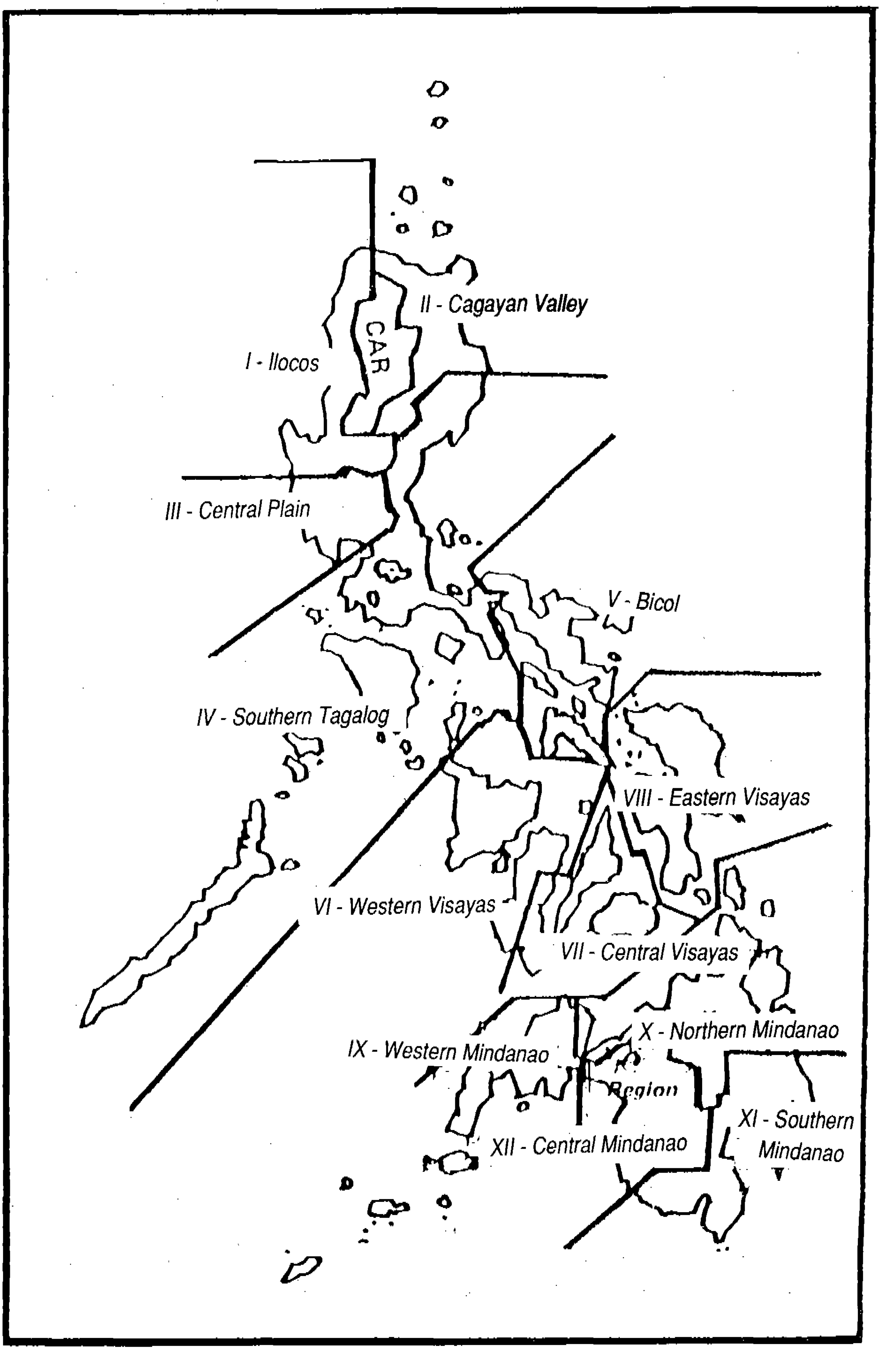
Moreover, the 1976 Amendment to the 1973 Constitution gave the incumbent President and concurrent Prime Minister all the powers and functions that were vested on him by the 1935 and the 1973 Constitutions. The amendment was interpreted to include general supervision over LGUs: "Presidential supervision is defined primarily in terms of his authority to investigate and discipline local officials. Supervision is intended to ensure that local governments comply with national directives and do not exceed their authority" (Ocampo and Panganiban 1985).

However, it cannot be denied that the Marcos government articulated and legislated a number of ostensibly decentralist initiatives. The 1973 Constitution, for instance, contained a more explicit support for political decentralization or devolution. Article XI Section 10 of the 1973 Constitution provided that "The State shall guarantee and promote the autonomy of local units especially barrios (barangays) to ensure their fullest development as self reliant communities." Furthermore, it also provided that "each local government unit shall have the power to create its own sources of revenue and to levy taxes subject to limitations as may be provided by law."

Presidential Decree 231 (Local Tax Code) was promulgated in 1973 to specify the taxing powers of LGUs and increase the powers of cities and provinces to raise revenues. Presidential Decree 464 (Real Property Tax Code) was issued in 1974 to define the appraisal, assessment, levy and collection of the real property tax by provinces, cities and municipalities. On the other hand, Presidential Decree 144, defining the share of LGUs in national internal revenue taxes, was promulgated in 1973.

At the same time, there were also efforts at administrative decentralization or deconcentration (i.e., the delegation of authority from the central office of national government agencies to their regional and/or sub-regional offices) with the adoption of the Integrated Reorganization Plan (IRP) in 1972. The IRP subdivided the country into 11 regions and mandated national agencies to have regional offices (Figure 1). Furthermore, with the issuance of Letters of Instruction 448 and 895 in 1976 and 1979, respectively, certain administrative (pertaining to appointment, transfer, firing, etc. of personnel, preparation of budget proposals, disbursement of funds, allocation of funds to sub-regional offices, negotiation of contracts for services or supplies not in excess of P200,000, etc.) and substantive (sectoral responsibility of the agency) functions were delegated by the central office to their regional offices. Moreover, the planning function was deconcentrated through the creation of the Regional Development Councils (RDCs). Special regional development authorities were also established to address the specific needs of areas perceived to be lagging in terms of overall development.

Figure 1
MAP OF THE PHILIPPINES



Fourth Republic (1981-1985). From a decentralization perspective, this period is simply an extension of the previous one. The insurgency problem became more pronounced. Moreover, the Marcos government, at this time, suffered low public support. Thus, the central government had to consolidate its position, sometimes at the expense of decentralization. For instance, local police and fire protection services were centralized under the Philippine Constabulary/Integrated National Police. Physical planning and regulatory functions were recentralized under the Ministry of Human Settlements (Brillantes 1987). Agricultural extension services were integrated under the Department of Agriculture.

Nevertheless, *Batas Pambansa* (BP) 337 (Local Government Code) was promulgated in 1983. BP 337 had strong decentralist features. The Code provided that "any power of a barangay, municipality, city or province shall be liberally construed in its favor. Any fair and reasonable doubt as to the existence of the power shall be interpreted in favor of the local government units concerned." In principle, the Code also gave LGUs greater discretion over financial matters. To quote:

> "As a general rule, local governments shall be allowed as much authority and flexibility over the financial aspects of their operations which are consistent with such standards and guidelines as may be prescribed by competent authorities."

However, this was not always followed in spirit. For instance, numerous statutory limitations on the nature and level of LGU expenditures and revenue raising powers were observed. Also, the share of LGUs in national internal revenue taxes were consistently below the maximum allowed by pertinent laws.

Fifth Republic (1986-pressent). The ascent of the Aquino administration into power has been marked by increasing decentralization, albeit with some centralist tendencies at its onset. For instance, the Freedom Constitution allowed the President **control and supervision** over all local governments. Local officials were replaced by so-called officers-in-charge (OICs). Subsequently, however, elections of provincial, city and municipal officials were held in January 1988 and that of barangay officials in March 1989.

With the ratification of the new Constitution in 1987, local autonomy gained some headway. First, it contains more explicit provisions in support for devolution than either the 1935 or the 1973 Constitutions. Specifically, Article X of the 1987 Constitution provides that: (1) the territorial and political subdivisions of the state shall enjoy local autonomy; (2) the enactment of a new Local Government Code by Congress shall decentralize activities with effective mechanisms for recall, initiative and referendum; (3) LGUs shall have the power to create its own sources of revenues and to levy taxes, fees and charges subject to guidelines and limitations of Congress; (4) LGUs shall have a just share in national taxes and in the proceeds of the use of national wealth within their respective areas.

In 1988, the Aquino government issued a number of orders/circulars mandating national government agencies to delegate some of their functions and responsibilities to their regional offices. It also launched the Pilot Decentralization Project (PDP). The purpose of the Project is to develop and adopt a framework for managing decentralization from central offices of line departments to their regional and provincial offices and to LGUs. Initially four, then an additional 15 provinces, were included in the project. The four provinces in the original list received P120 million while the rest received P30 million in block grant from the national government. The block grant or Decentralization Incentive Fund (DIF) was placed at the discretion of the local government officials. In Tarlac and

Laguna, the allocation of the DIF was largely the sole responsibility of the governor. In Davao del Norte, the Provincial Development Council programmed the use of the grant. In Negros Occidental, the *Sangguniang Panlalawigan* (provincial legislature) played a dominant role in identifying and prioritizing projects (Brillantes 1990). The mix of projects funded by the DIF varies from province to province but infrastructure projects comprise the bulk of the outlays made.

Under the PDP, the Memorandum of Agreement (MOA) was the vehicle used to devolve authority from the national government agencies to the LGUs. Following this approach, specific MOAs were supposed to be entered into by the LGUs and the national government agencies (Department of Environment and Natural Resources, Department of Social Welfare and Development, Department of Public Works and Highways, Department of Education Culture and Sports, and the Department of Health) identifying the functions and responsibilities delegated by the latter to the former. However, very few MOAs were consummated.

In the last quarter of 1991, a new Local Government Code was signed into law to take effect in January 1992. It devolves specific powers, functions and responsibilities from the national government agencies to LGUs. It grants LGUs a larger share in national internal revenue taxes. The Code alsogave LGUs broader taxing and revenue raising powers. It also restructured the real property tax. The prospects for decentralization under this new legislation will be discussed in Section 6.

II. GOVERNMENT REVENUES: LEGAL FRAMEWORK

The following discussion will focus on the policy regime that defines the revenue structure of the different levels of government from 1976-1991.

A. *Tax Assignment*

To a large extent, various types of taxes are assigned exclusively to different levels of government. However, there are instances where different levels of government are given the power to impose the same type of tax.

1. Central Government Taxes

The central government collects most of the revenue-productive type of taxes. The authority to impose tariffs on imports, the value added tax (VAT), income tax on individuals and corporations, excise taxes on alcohol, tobacco and petroleum products, taxes on the gross receipts of transportation contractors and common carriers, taxes on estates, inheritance, gifts, etc., and the documentary stamp tax is vested on the central government alone. In addition, the central government also imposes taxes that LGUs may themselves levy like the franchise tax.

2. Local Government Taxes

The bulk of local government taxes comes from the real property tax (RPT) and the local business tax (LBT). However, there are other taxes and fees that local governments are authorized to collect. The tax base of each of these taxes are defined by national legislation which also sets limits (floors and/or ceilings) on the tax rates.

The RPT is reserved solely for local governments. The basis of the RPT is the assessed value of all real properties (lands, buildings and structures, machineries). Assessed value is the product of the fair market value (as determined for tax purposes) and the nationally legislated assessment level for each class and kind of property. The Real Property Tax Code of 1974 mandated that fair market values be revised every three years.[2] However, this was never followed. Thus, during the last 15 years, the schedule of values was only revised twice, in 1979 and 1987. The scheduled revision in 1983 based on 1981/1982 prices, was postponed several times by then President Marcos and was only implemented in mid-1987.

The provinces and their constituent municipalities were each allowed to levy a basic tax, that may range from 1/4 to 1/2 of one percent, on all real properties within their boundaries. Cities and municipalities in Metro Manila were allowed to impose a basic RPT at a rate that may vary from 1/2 of one percent to two percent.

In addition, PD 464 authorized LGUs to collect an additional one percent tax on real property for the Special Education Fund. Proceeds from this tax were shared by the LGUs and the national government and earmarked exclusively for education.

Provinces were allowed to impose a tax on the transfer of ownership of real property, franchises, the practice of profession or occupation, sand and gravel extraction, admissions to amusement places, printing and publication, delivery trucks, vans and peddlers. The transfer tax may not exceed 1/2 of one percent of the total amount involved in the transfer of ownership or the assessed value of the real property, whichever is higher. Professionals may be subjected to an occupation tax equal of P75 or P50, depending on the type of profession or occupation. The printing and publication business as well as franchises may be subjected to a tax not exceeding 1/2 of one percent of the gross receipts in the previous year. The tax on sand and gravel may not be more than P0.75 per cubic meter of material extracted. Amusement tax may not surpass 20-30 percent of the gross receipts from admission, depending on the price charged per ticket. The tax on delivery trucks may not be greater than P50 or P75 per year per truck, depending on the product being transported. Finally, the tax on peddlers may not exceed P2, P5, P10, P15 or P30 per year, depending on the type of peddler.

Municipalities were permitted to levy a local business tax. The local business tax is essentially a graduated fixed tax with different maximum allowable rates for different types of activities like manufacturing, wholesaling, exporting, contracting and peddling.

On the other hand, cities may impose all of the taxes levied by provinces and municipalities. In general, the maximum allowable rates for cities are 50 percent higher than those for provinces and municipalities.

At the same time, the national government imposed a residence tax which was collected by city and municipal treasurers. Ninety-five percent of the proceeds from this tax was divided equally between municipalities/cities and the province. The remaining five percent went to the national government.

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2. Prior to the enactment of the Real Property Tax Code, the schedule of fair market value was revised once every five years.

B. *Non-tax Revenues*

Fees and charges are collected by various government agencies for services rendered. The motor vehicle registration fee is reserved for the central government and is one of its most important non-tax revenue source.

On the other hand, local governments may collect fees and charge for all sorts of services, licenses and permits. In particular, provinces may charge a fee for the sealing of weights and measures. Municipalities may grant fishery privileges in municipal waters for a fee. All levels of local governments may impose regulatory fees on various activities like business operation, practice of certain occupations, construction of buildings, sanitary inspection and health certification, civil registration, zoning and locational clearance. LGUs may also charge fees for basic services like hospital care, education, roads, bridges, ferries, water supply and for facilities like markets, slaughterhouses, parking, etc. In addition, note that local governments may also operate local business enterprises.[3]

C. *Central-Local Government Transfers*

Presidential Decree 144 (issued in 1973 and amended several times) prescribed that the share of local governments in national internal revenue taxes or the Internal Revenue Allotment (IRA) should be equal to a maximum of 20 percent. Moreover, the IRA share of any particular LGU should not increase by more than 25 percent in any given year.

Ten percent of the LGU share in national internal revenue taxes was set aside for the Barangay Development Fund. Of the remaining 90 percent, 30 percent went to the provinces, 25 percent to the cities and 45 percent to the municipalities.

The IRA was distributed to specific non-barangay LGUs based on a formula that gave population a 70 percent weight, land area, 20 percent, and equal sharing, 10 percent. The share of barangays was distributed on the discretion of national government agencies that manage the Barangay Development Fund.

At the same time, local governments were entitled to a 40 percent share in specific taxes on lubricating oils, 13.8 percent on naphtha, gasoline and the like, 33.3 percent on bunker fuel oil and similar fuel oils, and 4.8 percent on diesel fuel oil. Twenty five percent of the Specific Tax Allotment (STA) went to the Barangay Infrastructure Fund. Of the remaining amount, 20 percent went to the provinces, 50 percent to the cities, and 30 percent to the municipalities. The formula used to distribute the STA to specific LGUs was the same one for IRA.

The national government granted LGUs categorical grants for various types of expenditures. Examples were funds regularly appropriated for: (1) concreting barangay roads; (2) constructing and maintaining local roads; (3) improving rural roads; (4) water supply, sewerage and sanitation project; (5) barangay administration fund for the salaries and allowances of barangay officials; and (6) budgetary

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3. It is important to remember that the treatment of public enterprise in government financial accounts is asymmetrical with regards to "national" public enterprises (oftentimes referred to as government owned and controlled corporations [GOCCs]) and local public enterprises. The financial operations of GOCCs do not enter the books of the national government. In arriving at the consolidated public sector deficit, only its net financial positions are considered. On the other hand, gross receipts of local public enterprises are considered part of the non-tax revenue of LGUs. Their operating expenses are treated analogously.

aid to LGUs. These funds were administered by various national government agencies like the Department of Interior and Local Government (DILG) and the Department of Public Works and Highways (DPWH). The funds were allocatedto various LGUs based on guidelines set by said agencies.

III. REVENUES AND FINANCES: TRENDS AND PATTERNS

General government revenues amounted to P189.9 billion (representing 17.6% of GNP) in 1990 (Table 1). Of this amount, 95.2 percent was collected by the central government. In terms of revenue generation, fiscal decentralization remained at a fairly low level in the last 15 years despite what appears to be significant shifts in legislative provision for greater LGU revenue powers. To illustrate, the share of LGUs to general government revenues remained in the 4.6-6.8 percent range while LGU revenues relative to GNP lingered in the 0.7-1.1 percent range during the period.

A. *National Government Revenues*

National government revenues reached P180.9 billion or 16.8 percent of GNP in 1990. The share of tax and non-tax sources remained fairly stable over time with the latter accounting for 10-15 percent of total national government revenues. Both tax and non-tax revenues exhibited the same trend in the 1980s. The revenues increased slowly from 1980-1985 relative to 1976-1980 and 1985-1990.

The years 1981-1985 represented a bleak period in Philippine public finance. Both tax and non-tax revenues contracted from 12.6 percent and 1.7 percent of GNP in 1980 to 11 percent and 1.4 percent in 1985, respectively. An improvement in tax administration as well as the 1986 Tax Reform Program increased the share of tax revenues to 14.1 percent of GNP in 1990. Similarly, tax buoyancy improved from 0.9 in 1980-1985 to 1.3 in 1985-1990.[4]

At the same time, various items in the tax revenues were also restructured. The share of internal revenues in the national government taxes increased from 56.9 percent in 1976 to 69.7 percent in 1990. On the other hand, the share of import tariffs declined from 40.3 percent in 1976 to 30.2 percent in 1990 (Table 2).

In principle, these developments augur well for local government finance since a substantial portion of LGU revenues comes from tax sharing.

B. *Local Government Receipts/Income*

Relative to GNP, total LGU receipts fluctuated from 1.4 percent in 1976 to 1.8 percent in 1980, then down to 1.5 percent in 1985, and up again to 1.8 percent in 1990 (Table 3).

Locally-generated revenues and intergovernmental transfers had an equal share in the total LGU income except in 1980 when locally-sourced revenues accounted for 59.5 percent of total LGU receipts

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4. Tax elasticity in 1975-1980 was estimated to be one.

Table 1
NATIONAL AND LOCAL GOVERNMENT (NG AND LG) TAX AND NONTAX REVENUES

(In thousand pesos)	1976			1980			1985			1990		
	Total	NG	LG	Total	NG	LG	Total	NG	LG	Total	NG	LG
Revenues	18957223	18089000	868223	37277360	34731000	2546360	73293640	68961000	4332640	189951456	180902000	9049456
Tax revenue	15963368	15327000	636368	32441132	30533000	1908132	64154989	61253000	2901989	157707947	151698000	6009947
Nontax	2993855	2762000	231855	4836228	4198000	638228	9138651	7708000	1430651	32243509	29204000	3039509

(Percent distribution)	1976			1980			1985			1990		
	Total	NG	LG	Total	NG	LG	Total	NG	LG	Total	NG	LG
Revenues	100.00	95.42	4.58	100.00	93.17	6.83	100.00	94.09	5.91	100.00	95.24	4.76
Tax revenue	100.00	96.01	3.99	100.00	94.12	5.88	100.00	95.48	4.52	100.00	96.19	3.81
Nontax	100.00	92.26	7.74	100.00	86.80	13.20	100.00	84.35	15.65	100.00	90.57	9.43

(Share to GNP in percent)	1976			1980			1985			1990		
	Total	NG	LG	Total	NG	LG	Total	NG	LG	Total	NG	LG
Revenues	15.03	14.34	0.69	15.32	14.28	1.05	13.18	12.40	0.78	17.64	16.80	0.84
Tax revenue	12.65	12.15	0.50	13.34	12.55	0.78	11.54	11.02	0.52	14.65	14.09	0.56
Nontax	2.37	2.19	0.18	1.99	1.73	0.26	1.64	1.39	0.26	3.00	2.71	0.28

Table 2
NATIONAL GOVERNMENT TAX REVENUES

	1976	1980	1985	1990
TAX REVENUES (levels in million pesos)	15327	30533	61253	151698
TAX REVENUES (% distribution)	100.00	100.00	100.00	100.00
Bureau of Internal Revenue	56.91	56.89	69.84	69.71
Income & profits	23.80	23.81	30.46	32.54
Excise	16.52	15.84	22.01	19.03
Sales tax and licenses	10.30	15.33	12.48	14.42
Others	6.29	1.90	4.89	3.72
Bureau of Customs	40.26	37.96	27.40	30.29
Other offices	2.83	5.15	2.76	0.00
TAX REVENUES (Share to GNP in %)	12.15	12.55	11.02	14.09
Bureau of Internal Revenue	6.91	7.14	7.69	9.82
Income & profits	2.89	2.99	3.35	4.59
Excise	2.01	1.99	2.42	2.68
Sales tax and licenses	1.25	1.92	1.37	2.03
Others	0.76	0.24	0.54	0.52
Bureau of Customs	4.89	4.76	3.02	4.27
Other offices	0.34	0.65	0.30	0.00

Table 3
LOCAL GOVERNMENT ACTUAL INCOME/RECEIPTS

	1976				1980				1985				1990			
	TOTAL	Prov-inces	Munici-palities	Cities	TOTAL	Prov-inces	Munici-palities	Cities	TOTAL	Prov-inces	Munici-palities	Cities	TOTAL	Prov-inces	Munici-palities	Cities
INCOME (levels in P000)	1716074	443144	549594	723336	4293526	1153593	1379014	1760919	8392058	2413060	2799670	3179328	18955586	4680751	7900598	6374237
Share to GNP in %																
INCOME	1.36	0.35	0.44	0.57	1.76	0.47	0.57	0.72	1.51	0.43	0.50	0.57	1.76	0.43	0.73	0.59
TAX REVENUE	0.50	0.08	0.13	0.30	0.78	0.13	0.25	0.40	0.52	0.08	0.19	0.25	0.56	0.08	0.23	0.26
Total property taxes	0.25	0.06	0.07	0.12	0.48	0.11	0.15	0.23	0.32	0.06	0.11	0.14	0.35	0.06	0.14	0.15
Taxes on goods and services	0.20	0.00	0.05	0.15	0.21	0.00	0.09	0.13	0.15	0.00	0.07	0.08	0.16	0.00	0.07	0.08
Business taxes and licenses	0.20	0.00	0.05	0.15	0.20	0.00	0.08	0.12	0.14	0.00	0.06	0.08	0.15	0.00	0.07	0.08
Others	0.00	0.00	0.00	0.00	0.01	0.00	0.00	0.00	0.01	0.00	0.00	0.00	0.01	0.00	0.01	0.00
Total other taxes	0.06	0.02	0.01	0.03	0.09	0.02	0.02	0.05	0.06	0.02	0.01	0.03	0.05	0.01	0.02	0.03
OPERATING & MISCELLANEOUS REVENUE	0.18	0.03	0.07	0.08	0.26	0.07	0.10	0.09	0.26	0.07	0.08	0.11	0.28	0.09	0.10	0.09
Total operating and service income	0.11	0.01	0.05	0.05	0.23	0.05	0.09	0.08	0.23	0.05	0.08	0.10	0.24	0.06	0.09	0.09
Income from public enterprise/investments	0.02	0.01	0.01	0.00	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.01	0.00	0.00
Miscellaneous income	0.05	0.01	0.02	0.03	0.03	0.01	0.01	0.01	0.02	0.02	0.00	0.00	0.03	0.03	0.00	0.00
CAPITAL REVENUE (Sale of assets)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.02	0.00	0.00	0.02
EXTERNAL SOURCES	0.67	0.24	0.23	0.20	0.72	0.27	0.22	0.23	0.73	0.28	0.23	0.22	0.90	0.27	0.41	0.23
Grants & aids	0.26	0.11	0.09	0.06	0.15	0.11	0.02	0.01	0.13	0.10	0.02	0.01	0.25	0.08	0.14	0.03
IRA	0.42	0.14	0.15	0.13	0.56	0.16	0.19	0.21	0.59	0.18	0.21	0.21	0.65	0.18	0.27	0.20
% Distribution by source																
INCOME	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
TAX REVENUE	37.08	22.36	29.98	51.50	44.44	27.44	44.00	55.93	34.58	19.05	37.80	43.53	31.71	17.37	30.83	43.32
Total property taxes	18.67	17.16	16.83	21.00	27.45	22.40	25.72	32.10	20.90	14.94	21.98	24.47	19.67	13.98	18.60	25.17
Taxes on goods and services	14.36	0.13	10.97	25.66	12.13	0.79	15.00	17.32	9.98	0.49	13.24	14.30	8.97	0.41	10.10	13.87
Business taxes and licenses	14.34	0.12	10.95	25.63	11.51	0.05	14.50	16.68	9.41	0.02	12.54	13.77	8.41	0.03	9.35	13.40
Others	0.02	0.01	0.02	0.03	0.62	0.74	0.50	0.64	0.57	0.46	0.70	0.53	0.56	0.38	0.75	0.46
Total other taxes	4.04	5.06	2.18	4.84	4.86	4.25	3.28	6.50	3.70	3.62	2.58	4.76	3.07	2.98	2.13	4.29
OPERATING & MISCELLANEOUS REVENUE	13.51	8.13	16.63	14.44	14.86	14.81	17.58	12.77	17.05	15.68	16.61	18.47	16.03	21.05	13.43	15.58
Total operating and service income	8.11	4.04	10.46	8.81	12.95	10.67	16.51	11.66	15.42	11.75	15.90	17.77	13.69	13.93	12.80	14.63
Income from public enterprise/investments	1.42	2.03	1.89	0.69	0.37	1.00	0.17	0.12	0.17	0.44	0.05	0.07	0.51	1.22	0.06	0.56
Miscellaneous income	3.99	2.06	4.28	4.94	1.54	3.14	0.90	1.00	1.46	3.48	0.66	0.63	1.83	5.90	0.58	0.39
CAPITAL REVENUE (Sale of assets)	0.00	0.00	0.00	0.00	0.16	0.40	0.09	0.05	0.18	0.49	0.06	0.06	1.16	0.41	0.21	2.88
EXTERNAL SOURCES	49.41	69.51	53.39	34.06	40.54	57.35	38.33	31.25	48.19	64.79	45.53	37.94	51.10	61.17	55.53	38.22
Grants & aids	18.84	30.10	20.03	11.04	8.57	23.88	4.31	1.88	8.91	23.80	3.93	2.00	14.20	19.31	18.49	5.13
IRA	30.57	39.41	33.36	23.02	31.97	33.46	34.03	29.37	39.28	40.99	41.60	35.94	36.90	41.86	37.04	33.08

IRA : Internal Revenue Allotment

page 2

	1976				1980				1985				1990			
	TOTAL	Provinces	Municipalities	Cities	TOTAL	Provinces	Municipalities	Cities	TOTAL	Provinces	Municipalities	Cities	TOTAL	Provinces	Municipalities	Cities
% Distribution by level of govt.																
INCOME	100.00	25.82	32.03	42.15	100.00	26.87	32.12	41.01	100.00	28.75	33.36	37.88	100.00	24.69	41.68	33.63
TAX REVENUE	100.00	15.57	25.89	58.54	100.00	16.59	31.80	51.62	100.00	15.84	36.47	47.69	100.00	13.52	40.53	45.95
Total property taxes	100.00	23.73	28.86	47.41	100.00	21.93	30.09	47.98	100.00	20.56	35.08	44.36	100.00	17.55	39.42	43.03
Taxes on goods and services	100.00	0.24	24.46	75.30	100.00	1.74	39.71	58.55	100.00	1.40	44.29	54.31	100.00	1.12	46.91	51.97
Business taxes and licenses	100.00	0.22	24.46	75.33	100.00	0.12	40.46	59.43	100.00	0.08	44.47	55.45	100.00	0.09	46.33	53.58
Others	100.00	14.40	29.33	56.27	100.00	31.89	25.84	42.26	100.00	23.41	41.17	35.42	100.00	16.60	55.61	27.79
Total other taxes	100.00	32.33	17.26	50.41	100.00	23.49	21.65	54.87	100.00	28.10	23.24	48.66	100.00	23.99	28.94	47.06
OPERATING & MISCELLANEOUS REVENUE	100.00	15.53	39.43	45.04	100.00	26.77	37.98	35.24	100.00	26.44	32.51	41.05	100.00	32.41	34.91	32.68
Total operating and service income	100.00	12.88	41.34	45.78	100.00	22.14	40.94	36.92	100.00	21.92	34.41	43.68	100.00	25.12	38.95	35.93
Income from public enterprise/investments	100.00	36.90	42.71	20.39	100.00	72.48	14.67	12.85	100.00	74.42	10.03	15.55	100.00	58.80	4.59	36.61
Miscellaneous income	100.00	13.33	34.38	52.28	100.00	54.75	18.75	26.49	100.00	68.57	15.08	16.35	100.00	79.64	13.18	7.18
CAPITAL REVENUE (Sale of assets)					100.00	68.67	19.35	11.98	100.00	76.93	10.81	12.25	100.00	8.82	7.51	83.67
EXTERNAL SOURCES	100.00	36.33	34.61	29.06	100.00	38.01	30.37	31.62	100.00	38.66	31.52	29.82	100.00	29.56	45.29	25.15
Grants & aids	100.00	41.26	34.04	24.69	100.00	74.86	16.13	9.00	100.00	76.79	14.71	8.49	100.00	33.57	54.27	12.16
IRA	100.00	33.30	34.96	31.75	100.00	28.13	34.19	37.68	100.00	30.01	35.33	34.66	100.00	28.01	41.84	30.15

1. Locally-Sourced Income

Relative to both GNP and total LGU income, locally-sourced LGU revenues exhibited an inverted-U trend in the last 15 years. The share of locally-raised revenues in total LGU income was 50.6 percent in 1976, peaked at 59.5 percent in 1980, declined to 51.8 percent in 1985 and dipped further to 48.9 percent in 1990. Similarly, locally-generated revenues stood at 0.7 percent of GNP in 1976, rose to one percent in 1980, decreased to 0.8 percent in 1985 and improved slightly to 0.9 percent in 1990. The enactment of Local Tax Code in 1973 which broadened the powers of the LGUs to raise more revenues might explain the faster growth (relative to GNP) of local revenues in the earlier period. On the other hand, the sluggish growth of local revenues in the latter period might be attributed to central government restrictions on the local tax structure.

The single major source of indigenously-sourced LGU income was the real property tax (RPT). However, its importance weakened in the 1980s. The RPT contributed 36.6 percent of total LGU locally-sourced receipts in 1976, 46.2 percent in 1980 and 40.3 percent in 1990. From a peak of 0.5 percent of GNP in 1980, RPT revenues declined to 0.3 percent in 1985 and recovered slightly to 0.4 percent in 1990. The peak performance of RPT revenues in 1980 might be explained by the adoption of a revised schedule of fair market values in 1979. The deterioration of RPT in 1985 might be attributed to the politically motivated delay in the updating of the said schedule. On the other hand, the slight improvement in 1990 might be due to the adoption (on a phased basis) of a newschedule based on 1981/1982 prices in 1987.

Meanwhile, LBT revenues declined throughout the period 1976-1990 relative to the total locally-sourced income and to GNP. Revenues from the LBT declined continuously from 28.3 percent of all locally-raised revenues in 1976 to 18.4 percent in 1990 and from 0.2 percent of GNP in 1976 to 0.1 percent in 1990. The inability of LBT revenues to grow at the same pace as GNP might be explained by the unit rates (in contrast to *ad valorem* rates) prescribed by the Tax Code making the tax extremely inelastic.

In contrast, user charges (referred to as operating and service income in the tables) showed an upward trend. The contribution of user charges to locally-sourced revenue grew from 16 percent in 1976 to 28 percent in 1990. The buoyant characteristic of user charges might be due to the fact that while the Tax Code prescribed maximum rates for some fees like slaughterhouse charges, there were no restrictions on the level of imposition of most other user charges. Moreover, in principle, it is politically and administratively easier to increase rates of, and collect user charges relative to taxes because the link between the service provided and the exaction is more direct in the former relative to the latter.

2. Intergovernmental Transfers

Total transfers from the national government to LGUs grew from 0.7 percent of GNP in 1976 to 0.9 percent in 1990. The IRA and the STA, the share of LGUs in national internal revenue taxes and specific taxes, respectively, comprised the bulk from 61.9-81.5 percent of intergovernmental transfers in the last 15 years. The IRA and the STA which are both formula grants, swelled from 0.4 percent of GNP in 1976 to 0.7 percent in 1990 due to the buoyancy of the tax base. However, the relatively low elasticity of national taxes in 1980-1985 is reflected in the slow growth of the IRA/STA in this period.

In contrast, the trend of categorical grants was characterized by a U-curve. Grants declined from 0.3 percent of GNP in 1976 to 0.1 percent in 1985, and recovered to 0.3 percent in 1990.

Similarly, the share of categorical grants to aggregate intergovernmental transfers dipped from 38.1 percent in 1976 to 18.5 percent in 1985 and went up again to 27.8 percent in 1990. The Aquino government allocated substantial amounts to grants in 1988-1990. Hence, large increases in grants were registered in those years.

The share of provinces in total intergovernmental transfers was fairly stable from 36-39 percent in 1976-1985. In 1990, however, it dropped to 28.1 percent. Similarly, cities captured 29-31 percent of total transfers in 1976-1985 but only 25.2 percent in 1990. In contrast, the share of municipalities surged from 30-35 percent in 1976-1985 to 45.3 percent in 1990. These trends are likewise reflected in the movement of both formula and categorical grants.

3. Provinces

Among the different levels of LGUs, the provinces were the most dependent on national government transfers. In 1976-1990, for instance, 57-70 percent of total provincial receipts came from said source because of the small tax base assigned to provinces. At the same time, the administrative structure to support the collection of these taxes was weak. The province relied heavily on municipal treasurers to collect taxes. Unfortunately, these treasurers received little incentive to do so. Note that the municipal share in the provincial taxes was small and at times, non-existent.

In 1976-1985, real property taxes were the second most important source of provincial income, contributing 14.9-22.4 percent. User charges contributed 10.5-11.7 percent in the same period. However, in 1990, each of these two sources yielded 14 percent of total provincial income.

4. Municipalities

Municipalities depended on national transfers for 55.5 percent of their total receipts in 1990. RPTs accounted for 18.6 percent of total municipal revenues while user charges and the local business tax contributed 12.8 percent and 9.4 percent, respectively. Note that in earlier years, LBTs ranked third, next to intergovernmental transfers and RPT. User charges ranked fourth in terms of their share in municipal receipts.

5. Cities

As a whole, cities do not depend much on national government transfers as compared to the provinces and municipalities. In 1990, the share of national government transfers in total city income was only 38.2 percent. Being more economically advanced, the cities have a bigger tax base and can generate more revenues than provinces and municipalities. Moreover, both the Local Tax Code and the Real Property Tax Code gave cities greater flexibility on the type of taxes they may impose and rates they may use.

RPT was the second most dominant revenue source for cities representing 25.2 percent of total city receipts. The share of user charges and business taxes were 14.6 percent and 13.4 percent, respectively. Like the municipalities, user charges emerged as an important revenue source only in the latter part of the 1980s.

IV. FISCAL EXPENDITURE RESPONSIBILITIES

A. *Assignment Expenditure Responsibilities*

The functions assigned to LGUs were fairly limited. In general, they included "planning, levying and collecting taxes, budgeting, issuing and enforcing regulations, and administering certain public services" (Ocampo and Panganiban 1985). Provinces had some role in agricultural planning and extension, construction and maintenance of roads and public buildings, operation of high schools, hospitals and health services. In addition to these functions, cities may also operate elementary, vocational and other types of schools. Highly urbanized cities were mandated to exercise zoning and building regulation, environmental sanitation, and transport and traffic regulation. On the other hand, municipalities may operate public markets, slaughterhouses, cemeteries and other facilities. Finally, barangays were tasked to settle minor village disputes (barangay justice) and they also took part in barangay road construction, and health and social services delivery (e.g., operation of health centers and day care centers).

B. *Government Expenditure: Trends and Patterns*

Aggregate general government expenditures reached P265.4 billion or 24.7 percent of GNP in 1990 (Table 4). Debt service was the single most important expenditure item accounting for 40.1 percent of the total government outlays. Economic and social services obtained roughly equal shares of 18.9 percent and 19.3 percent, respectively. General public services received 16.5 percent. Public administration and education were the top two spenders with 14.1 percent and 12.8 percent of the total government budget, respectively. Transportation and communication was a poor third with 8.8 percent of the budget.

In the 1980s, debt service accounted for only 7.5 percent of the general government budget. Both economic and social services received a bigger slice of the budget at 42.3 percent and 23.6 percent, respectively, indicating the government's development thrust. Note also that the infrastructure/utilities received the biggest government allocation at 28.6 percent of the total budget. In contrast, education only got 13 percent.

The national government dominated the expenditure program with 93.3 percent of the total outlays in 1990. This is higher than its 88.8 percent share in 1980 indicating greater concentration at the center. However, if one looks at the budget exclusive of debt service, the degree of fiscal centralization has remained constant at 88 percent in the last 10 years. This percentage declined since 1976 when the share of LGUs in general government expenditures net of debt service was 92 percent.

The degree of fiscal decentralization appears to be low whether one views it relative to revenues or expenditures. However, the share of LGUs in general government expenditures is 2-4 percent higher than the share of LGUs in general government revenues. This is because roughly 50 percent of LGU expenditures are financed by transfers from the national government.

Superimposed on the formal division of functions across different levels of government were statutory requirements preempting the authority of LGUs in allocating their budgets. For instance, LGUs were mandated to appropriate 18 percent of their general fund budget (approximately 65% of their consolidated budget) as aid to Integrated National Police, 3-5 percent as aid to hospitals, 20 percent of

Table 4
GENERAL GOVERNMENT EXPENDITURES
(in thousand pesos)

	1980			1985			1990		
	TOTAL	NG	LG	TOTAL	NG	LG	TOTAL	NG	LG
TOTAL	39783354	35339241	4444113	92938742	84840187	8098555	265411103	247501985	17909118
Share to GNP in percent									
Total economic services	6.91	6.24	0.68	5.76	5.25	0.51	4.67	4.13	0.54
Agrarian reform	0.56	0.11	0.45	0.06	0.06	0.00	0.50	0.50	0.00
Agriculture	0.49	0.49	0.00	0.62	0.61	0.02	0.56	0.53	0.03
Natural resources	0.29	0.29	0.00	1.46	1.46	0.00	0.36	0.36	0.00
Industry	0.41	0.41	0.00	0.14	0.14	0.00	0.09	0.09	0.00
Trade	0.01	0.01	0.00	0.03	0.03	0.00	0.01	0.01	0.00
Tourism	0.03	0.03	0.00	0.02	0.02	0.00	0.02	0.02	0.00
Power & energy	1.10	1.08	0.02	0.21	0.17	0.03	0.17	0.16	0.01
Water resources devt.	0.33	0.32	0.01	0.06	0.05	0.01	0.04	0.04	0.01
Transp. & commun.	3.24	3.17	0.07	0.53	0.51	0.02	2.16	2.13	0.04
Other economic services	0.45	0.33	0.12	2.64	2.21	0.43	0.76	0.30	0.46
Total social services	3.86	3.39	0.47	3.03	2.63	0.40	4.75	4.48	0.27
	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Education	2.12	1.91	0.21	1.90	1.70	0.20	3.16	3.09	0.07
Health	0.70	0.57	0.12	0.56	0.49	0.07	0.79	0.71	0.08
Social services, labor & employn	0.21	0.21	0.01	0.14	0.13	0.01	0.19	0.17	0.01
Housing & community developm	0.76	0.66	0.09	0.37	0.28	0.09	0.45	0.37	0.08
Other social services	0.07	0.04	0.03	0.06	0.03	0.03	0.17	0.14	0.04
Total public services	2.65	1.96	0.68	2.41	1.86	0.55	4.06	3.20	0.86
Public administration	1.74	1.09	0.65	1.56	1.05	0.51	3.48	2.70	0.78
Peace and order	0.68	0.68	0.00	0.52	0.52	0.00	0.08	0.08	0.00
Others	0.22	0.19	0.03	0.33	0.28	0.04	0.50	0.42	0.07
Defense	1.71	1.71	0.00	1.12	1.12	0.00	1.30	1.30	0.00
Debt service	1.23	1.23	0.00	4.40	4.40	0.00	9.88	9.88	0.00
TOTAL	16.35	14.53	1.83	16.71	15.26	1.46	24.65	22.99	1.66

NG : national government
NL : local government

Table 4
page 2

	1980			1985			1990		
	TOTAL	NG	LG	TOTAL	NG	LG	TOTAL	NG	LG
% Distribution by level of government									
Total economic services	100.00	90.20	9.80	100.00	91.14	8.86	100.00	88.43	11.57
Agrarian reform	100.00	19.55	80.45	100.00	100.00	0.00	100.00	100.00	0.00
Agriculture	100.00	100.00	0.00	100.00	97.28	2.72	100.00	95.41	4.59
Natural resources	100.00	100.00	0.00	100.00	100.00	0.00	100.00	100.00	0.00
Industry	100.00	100.00	0.00	100.00	100.00	0.00	100.00	100.00	0.00
Trade	100.00	100.00	0.00	100.00	100.00	0.00	100.00	100.00	0.00
Tourism	100.00	100.00	0.00	100.00	100.00	0.00	100.00	100.00	0.00
Power & energy	100.00	98.23	1.77	100.00	84.16	15.84	100.00	95.57	4.43
Water resources devt.	100.00	95.54	4.46	100.00	76.73	23.27	100.00	81.64	18.36
Transp. & commun.	100.00	97.85	2.15	100.00	96.72	3.28	100.00	98.31	1.69
Other economic services	100.00	72.61	27.39	100.00	83.75	16.25	100.00	39.30	60.70
Total social services	100.00	87.89	12.11	100.00	86.95	13.05	100.00	94.40	5.60
Education	100.00	89.90	10.10	100.00	89.63	10.37	100.00	97.94	2.06
Health	100.00	82.26	17.74	100.00	87.74	12.26	100.00	90.36	9.64
Social services, labor & employn	100.00	96.21	3.79	100.00	94.25	5.75	100.00	93.63	6.37
Housing & community developm	100.00	88.04	11.96	100.00	76.25	23.75	100.00	82.80	17.20
Other social services	100.00	56.52	43.48	100.00	46.31	53.69	100.00	79.07	20.93
Total public services	100.00	74.23	25.77	100.00	77.13	22.87	100.00	78.86	21.14
Public administration	100.00	62.57	37.43	100.00	67.51	32.49	100.00	77.50	22.50
Peace and order	100.00	99.47	0.53	100.00	99.86	0.14	100.00	95.24	4.76
Others	100.00	88.32	11.68	100.00	86.83	13.17	100.00	85.61	14.39
Defense	100.00	100.00	0.00	100.00	100.00	0.00	100.00	100.00	0.00
Debt service	100.00	100.00	0.00	100.00	100.00	0.00	100.00	100.00	0.00
TOTAL	100.00	88.83	11.17	100.00	91.29	8.71	100.00	93.25	6.75

NG : national government
LG : local government

Table 4
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	1980			1985			1990		
	TOTAL	NG	LG	TOTAL	NG	LG	TOTAL	NG	LG
% Distribution by sector									
Total economic services	42.28	42.94	37.09	34.47	34.42	35.06	18.93	17.95	32.44
Agrarian reform	3.41	0.75	24.59	0.33	0.36	0.00	2.03	2.17	0.00
Agriculture	2.99	3.36	0.00	3.74	3.98	1.17	2.26	2.31	1.53
Natural resources	1.80	2.03	0.00	8.73	9.57	0.00	1.44	1.55	0.00
Industry	2.49	2.80	0.00	0.82	0.90	0.00	0.36	0.38	0.00
Trade	0.09	0.10	0.00	0.17	0.19	0.00	0.03	0.04	0.00
Tourism	0.17	0.19	0.00	0.09	0.10	0.00	0.08	0.09	0.00
Power & energy	6.72	7.43	1.07	1.24	1.14	2.25	0.69	0.71	0.45
Water resources devt.	2.04	2.20	0.82	0.39	0.32	1.03	0.18	0.15	0.48
Transp. & commun. 1/	19.81	21.82	3.82	3.18	3.37	1.20	8.77	9.25	2.19
Other economic services	2.77	2.27	6.80	15.77	14.47	29.41	3.09	1.30	27.79
Total social services	23.60	23.35	25.60	18.13	17.27	27.15	19.26	19.49	15.99
Education	12.97	13.12	11.72	11.34	11.14	13.50	12.80	13.44	3.91
Health	4.27	3.96	6.78	3.36	3.23	4.73	3.19	3.09	4.55
Social services, labor & employn	1.31	1.42	0.44	0.82	0.84	0.54	0.75	0.76	0.71
Housing & community developm	4.62	4.58	4.95	2.23	1.86	6.08	1.81	1.61	4.61
Other social services	0.44	0.28	1.70	0.37	0.19	2.31	0.71	0.60	2.20
Total public services	16.17	13.52	37.31	14.40	12.16	37.79	16.46	13.92	51.57
Public administration	10.66	7.51	35.71	9.33	6.90	34.79	14.11	11.72	47.04
Peace and order	4.18	4.68	0.20	3.11	3.41	0.05	0.34	0.34	0.24
Others	1.34	1.33	1.40	1.95	1.85	2.94	2.01	1.85	4.29
Defense	10.44	11.75	0.00	6.70	7.33	0.00	5.29	5.67	0.00
Debt service	7.50	8.45	0.00	26.31	28.82	0.00	40.07	42.97	0.00
TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

NG : national government
LG : local government

IRA for development projects that were reviewed by the Department of Local Government, reserve for election expenses, gratuities of optionally retiring employees, and subsistence of national prisoners. Ursal (1989) estimated that approximately 73 percent of the consolidated budget of a typical LGU had been pre-appropriated by law. This implies that LGUs had discretion over a meager 2-3 percent of total general government expenditures in the last 15 years.

1. Central Government Expenditures

In 1990, national government expenditure was equal to 23 percent of GNP, representing a marked increase over the 1980 level (14.5% of GNP). In terms of distribution to various sectors, the expenditure very closely resembled that of the total since it accounted for the bulk of aggregate general government expenditure.

2. Local Government Expenditures

Over the years, local government expenditure ranged only from 1.5-1.8 percent of GNP. LGUs spent 51.6 percent of its total budget on general public services. The next most important item in their budget was economic services which received 32.4 percent of the budget, a big portion (85.6) of which went to business enterprises such as markets, slaughterhouses, etc. Social services was a poor third with a 16 percent share.

Agrarian reform, national defense and natural resource, trade, industry and tourism management and regulation were exclusive functions of the central government. On the other hand, water supply, housing, social welfare and health services were more decentralized than other sectors.

Municipalities contributed the lion's share in total LGU expenditures at 40.1 percent in 1990 while cities accounted for 31.9 percent and provinces 28 percent. While municipalities spent 61.2 percent of their budgets on general public services, provinces and cities spent 41.7 percent and 48.8 percent, respectively. In all levels of government, economic services received approximately 50 percent more than social services.

3. Government Investment

Total capital outlay of the government was equal to 5.7 percent of GNP in 1976 and declined to 3.8 percent of GNP in 1990 (Table 5). Note that since 1983, national government investments suffered huge cutbacks as a result of the 1983-1985 economic crisis and in subsequent years because of the severe budgetary constraint arising from the government's debt overhang. In contrast, while LGU investments dipped from 0.4 percent of GNP in 1980 to 0.2 percent in 1985, they recovered slightly to 0.3 percent in 1990 (Table 5).

LGUs' share in the total general government capital expenditures grew from 4.1 percent in 1976 to 7.7 percent in 1990. LGU investments were equally shared by provinces, cities and municipalities.

The low level of LGU investment expenditures may be traced, in part, to the controls placed by the central government on the mechanics of LGU budget preparation. In particular, the law provides thatthe total amount appropriated in the local budget shall not exceed the estimated income certified collectible by local treasurers. Coupled with the oral tradition that local treasurers are personally liable

Table 5
GENERAL GOVERNMENT CAPITAL OUTLAYS

	1976	1980	1985	1980
General government (P000)	7138818	13612371	27026062	40771234
National	6849639	12658532	25821292	37611435
Local	289179	953839	1204770	3159799
SHARE TO GNP (%)				
General government	5.66	5.60	4.86	3.79
National	5.43	5.20	4.64	3.49
Local	0.23	0.39	0.22	0.29
PERCENT DISTRIBUTION				
General government	100.00	100.00	100.00	100.00
National	95.95	92.99	95.54	92.25
Local	4.05	7.01	4.46	7.75

for year-end fund overdrafts, this requirement led to very conservative income estimates, small LGU regular budgets with very little room for investment expenditures and the practice of preparing up to 12 supplemental budgets a year as additional income is realized. Note that the use of numerous and small supplemental budgets in any given year implies very little long-term planning and programming of investments is actually practised at the LGU level.

At the same time, the regulatory environment was not conducive to LGU debt financing. First, LGUs had to comply with numerous and tedious requirements imposed by central government agencies like the Department of Finance (which endorses all LGU loan applications to banks) and the Commission on Audit (which certifies the LGU's legal and net paying capacity). Second, the Municipal Development Fund (MDF) which provides grants and loans to LGUs at subsidized rates discouraged LGUs from accessing the private capital markets where the interest is almost thrice as that of the MDF. LGU officials reported that they would rather queue for MDF funds even if these are limited. Third, while the provinces and municipalities were permitted to float bonds, the law was sorestrictive that, in a sense, it has pre-designed LGU bonds in terms of interest, maturity, and the like regardless of market forces (Saldana 1992). Thus, to date, only one LGU has been able to issue bonds.

V. ISSUES IN FISCAL FEDERALISM

A. *Revenue Adequacy*

The ability of LGUs to mobilize public resources through both taxes and other means is a major concern in fiscal decentralization.

Can LGUs raise sufficient revenues for their expenditure needs?

The adequacy of LGU revenues may be measured using (1) the ratio of locally-sourced revenues to total LGU expenditures and (2) the ratio of the sum of locally-sourced revenues and LGU share in national taxes to total LGU expenditures. The first, called self-sufficiency ratio, measures the self-sufficiency of LGUs in financing local government expenditures. It depends on fiscal capacity of LGUs and their collection efficiency. In turn, fiscal capacity depends on the size of the base assigned to local units and the rates that local units may levy. However, this measure fails to capture the share of the national government taxes which provide LGUs with **ready** funds even if the local tax base is limited by the prevailing legislative *cum* administrative policies. The second measure, called revenue adequacy ratio, attempts to adjust for the deficiency in the tax base assigned to local units by including shared taxes in the numerator.

Table 6 shows the low self-sufficiency ratio of LGUs in the last 15 years. It improved from 49 percent in 1976 to 57.5 percent in 1980 but deteriorated since then to 51.8 percent in 1990. This poor performance may be attributed to several legislative limitations on the taxing power of LGUs. First, most revenue productive taxes were assigned to the central government. Second, the central government restricted the latitude of LGUs in determining the rates at which they may levy local taxes. Moreover, the prescription of unit rates rather than *ad valorem* rates made the LBT very inelastic. Third, the limited fiscal capacity of LGUs was further constrained by the centrally mandated postponement of the revision of fair market values of real property for tax purposes between 1979 and 1988. Fourth, collection of local taxes had been inefficient. The collection efficiency for the RPT was 46.9 percent in 1985 and 57.7

Table 6
MEASURES OF REVENUE PERFORMANCE

	1976	1980	1985	1990
Self sufficiency ratio	48.97	57.45	53.69	51.75
Revenue adequacy ratio	78.55	88.33	94.39	90.81
Collection rate			46.85	57.74*

*Lanao del Sur excluded due to lack of necessary data.

percent in 1990. While there was no estimate of the efficiency in collecting other types of local taxes, it was likely to be lower than that of RPT because the collection of the former was not as well organized as the latter. Fifth, local officials failed to maximize the use of their revenue raising powers (NTRC 1975 and 1981).

On the other hand, the revenue adequacy ratio of LGUs was considerably higher than their self-sufficiency ratio. The former registered improvements from 78.6 percent in 1976 to 94.4 percent in 1985, afterwhich it deteriorated to 90.8 percent in 1990. The revenue adequacy ratio would have been considerably higher if the full legislative authorization for shared taxes were actually given to LGUs. Table 7 shows that between 1986-1990, less than 60 percent of the mandated LGU share in national internal revenue taxes was actually released to LGUs. Appropriating less than thelegally-prescribed maximum share (20%) and disbursing less than what is appropriated for IRA has been part of long standing tradition of undue central government control over LGU finances. Note that if LGUs received 20 percent of national internal revenue taxes their revenue adequacy ratios for the period would have been greater than one.

B. *Lessening Regional Disparities*

1. Variations in Regional Development

The variation in regional development may be gleaned from Table 8 which shows the per capita regional GDP index and the index of the region's share to total GDP. The National Capital Region (NCR) has consistently been on top in the last 15 years in terms of per capita regional GDP. Its per capita income was 2.7 times of the national average in 1975.

Southern Tagalog and Southern Minadanao ranked second and third, respectively, with per capita GDP index of 112 for the former and 100 for the latter in 1988. Again, these estimates declined relative to their 1975 levels. In contrast, the Bicol region's and Eastern Visayas region's per capita GDP indices were the lowest at 45 and 42, respectively, in 1988.

In recent years, the relative superiority of the NCR dwindled as its per capita regional GDP dipped to 2.4 times the national average in 1988. Similarly, the per capita GDP indices for Southern Tagalog and Southern Mindanao declined with the drop in the latter more pronounced. On the other hand, the biggest gainers in terms of per capita index in the last 15 years were the regions of Ilocos, Central Visayas, Western, Northern and Central Mindanao.

2. Compensatory Policies

Decentralization Policies. Will decentralization aggravate regional disparities? This issue arises because the distribution of the base of most taxes assigned to local governments is skewed in favor of the more economically- advanced LGUs. In the Philippines, the real property tax base in the different provinces, in nominal or in per capita terms, is positively related with per capita provincial income. Moreover, the correlation coefficients, estimated to be 0.60 and 0.66, respectively, are statistically significant at one percent.

Hence, national government transfers are seen as one way of equalizing fiscal capacities among LGUs. However, prior to 1992, the formula used for distributing the IRA to specific LGUs did not

Table 7
ANNUAL INTERNAL REVENUE ALLOTMENT AS CERTIFIED BY BIR AND AS APPROPRIATED UNDER GAA FROM 1986 TO 1990 AND ACTUALLY RELEASED TO LGUs FROM 1986 TO 1989

	1986	1987	1988	1989	1990	1991
Total share of provinces, cities and municipalities as certified by BIR	4,354,424,782	4,935,861,562	5,589,647,803	8,117,164,752	10,137,891,672	10,829,811,110
Appropriation under GAA	3,918,983,000	2,477,600,000	3,175,262,000	4,232,000,000	6,017,583,000	10,022,324,000
Actual releases (Bureau of Treasury)	2,373,071,785	2,340,087,814	3,055,935,053	3,952,541,636	5,900,000,000	8,354,114,648
% of appropriation to certified share	90.00	50.20	56.81	52.14	59.36	92.54
% of actual releases to certified share	54.50	47.41	54.67	48.69	58.20	77.14
% of actual releases to appropriation	60.55	94.45	96.24	93.40	98.05	83.36

BIR : Bureau of Internal Revenue
GAA : General Appropriations Act
LGUs : Local Government Units

Table 8
INDICES OF PER CAPITA GROSS REGIONAL DOMESTIC PRODUCT
(at constant prices)

REGION/YEAR	1975	1980	1985	1990
PHILIPPINES	100	100	100	100
NCR Metro Manila	267	243	233	244
I Ilocos Region	53	55	62	61
II Cagayan Valley	58	62	56	51
III Central Luzon	83	87	93	96
IV Southern Tagalog	113	112	107	108
V Bicol Region	45	42	45	40
VI Western Visayas	95	80	80	76
VII Central Visayas	84	79	81	87
VIII Eastern Visayas	44	43	50	46
IX Western Mindanao	53	60	63	57
X Northern Mindanao	76	106	97	91
XI Southern Mindanao	104	114	110	101
XII Central Mindanao	70	81	81	74

promote fiscal equalization. The internal revenue allotments for LGUs, in nominal and per capita terms, are found to be positively related to the per capita income of LGUs. The correlation coefficient between nominal IRA and per capita income was 0.54 in 1991 while that of per capita IRA and per capita income was 0.01. The former was significant at one percent while the latter was statistically insignificant.

Direct Central Government Expenditure. In the Philippines, direct central government expenditures has been used to correct the lopsided development in the regions. Table 9 shows that the regional distribution of central government expenditure remained stable between 1983-1988. The distribution may be described as three-tiered with the NCR in the first tier, capturing about 43 percent of total expenditures. Central Luzon (Region III) and Southern Tagalog (Region IV) are in the second tier, each receiving 10-12 percent of total central government expenditures. The rest of the regions are in the third tier, each getting less than five percent. In 1987-1988, some redistribution of government outlays in Region III to the other regions (not including NCR and Region IV) can be observed.

The apparent advantage of the NCR and Regions III and IV is less pronounced if one adjusts for differences in population size. The pattern of per capita government expenditures across regions is also stable over time. The pattern is not as skewed as that of the regions' share in total government expenditures.

While per capita government expenditures in the NCR is highest at more than thrice that of the national average, there are now more regions in the second tier. Per capita government expenditures in Regions II, III, IV and XII are about equal to the national average. The rest of the regions receive per capita government expenditures that are about half the size of the national average (Table 10).

While estimates of the rank correlation coefficient between per capita income and per capita government expenditures (or regions' share in total government expenditures) were always negative in 1983-1988 (indicating that poorer regions were given a bigger share of government expenditures), those that pertain to capital expenditures were significantly different from zero in 1987-1988 (Table 11). However, its impact on the relative development of the regions is still too early to discern.

VI. PROSPECTS

The revenue and expenditure pattern of central and local governments indicate that the perceivedchanging emphasis on decentralization had little impact on ex-post measures of fiscal decentralization. Thus, over time, the share of LGUs in revenues generated and expenditures made have remained low. Moreover, these measures tend to overestimate fiscal decentralization because the central government imposed numerous restrictions on local government budgeting which considerably pre-empted the allocative functions of LGUs.

The Local Government Code (LGC) of 1991 ushers in a new policy environment governing local-central relations. Under the new Code, many of the functions, responsibilities and authorities previously discharged by national government agencies like the Department of Agriculture, Department of Health, Department of Social Welfare and Development, Department of Environment and Natural Resources, Department of Public Works and Highways, Department of Tourism, and Department of Education, Culture and Sports are devolved to LGUs. Thus, the expenditure responsibilities of LGUs have increased considerably.

Table 9
PERCENTAGE DISTRIBUTION OF DIRECT GOVERNMENT EXPENDITURES ACROSS REGIONS, 1983-1988

	1983			1984			1985		
Regions	Total	Current	Capital	Total	Current	Capital	Total	Current	Capital
All	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
NCR	40.26	62.1	12.11	41.11	57.76	14.6	44.98	59.96	14.53
I	3.99	4.29	3.6	3.83	4.11	3.37	3.95	3.82	4.21
II	6.89	2.78	12.18	3.97	2.67	6.04	3.92	2.66	6.47
III	11.37	4.62	20.08	11.84	4.47	23.56	11.58	4.32	26.32
IV	12.15	6.11	19.94	12.05	5.87	21.88	10.94	5.64	21.73
V	4.32	3.1	5.89	3.15	3.08	3.27	2.88	2.98	2.68
VI	3.76	4.45	2.87	3.68	4.44	2.47	3.29	4.05	1.73
VII	2.83	2.17	3.67	3.9	3.34	4.8	3.42	3.11	4.05
VIII	3.31	2.32	4.58	2.93	2.9	2.98	2.66	2.79	2.39
IX	2.15	1.85	2.53	2.45	2.47	2.41	2.16	2.27	1.88
X	2.75	2.06	3.64	3.78	2.88	5.21	3.08	2.76	3.73
XI	2.65	1.96	3.52	2.77	2.86	2.62	2.59	2.76	2.26
XII	3.58	2.19	5.38	4.56	3.15	6.8	4.57	2.86	8.04

	1986			1987			1988		
Regions	Total	Current	Capital	Total	Current	Capital	Total	Current	Capital
All	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
NCR	43.57	55.53	14.47	44.01	54.13	17.00	43.39	52.55	17.13
I	4.07	4.16	3.83	4.45	4.62	4.00	4.41	4.52	4.09
II	3.98	2.91	6.58	3.73	2.85	6.10	3.85	3.05	6.15
III	11.30	4.93	26.80	9.29	4.97	20.80	8.40	4.05	20.86
IV	10.82	6.30	21.80	11.62	6.61	25.00	11.48	6.88	24.68
V	3.01	3.21	2.54	3.38	3.50	3.05	3.94	4.24	3.06
VI	3.77	4.60	1.76	4.12	4.84	2.19	4.12	4.78	2.23
VII	3.64	3.48	4.04	3.62	3.53	3.85	3.83	3.82	3.85
VIII	2.76	2.95	2.29	3.03	3.12	2.80	3.36	3.56	2.81
IX	2.38	2.56	1.94	2.12	2.43	1.29	2.43	2.83	1.30
X	3.30	3.11	3.75	3.40	3.12	4.15	3.45	3.20	4.18
XI	2.92	3.24	2.16	3.14	3.28	2.76	3.08	3.20	2.73
XII	4.49	3.03	8.05	4.09	3.00	7.00	4.25	3.32	6.92

Table 10
PER CAPITA DIRECT REAL REGIONAL GOVERNMENT EXPENDITURES, 1983-1988

	1983			1984			1985		
Regions	Total	Current	Capital	Total	Current	Capital	Total	Current	Capital
All	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
NCR	331.83	511.82	99.82	346.41	486.78	123.08	370.75	494.16	119.79
I	55.64	59.83	50.25	53.53	57.55	47.13	55.00	53.20	58.64
II	138.44	55.96	244.76	77.27	51.99	117.49	82.13	55.86	135.56
III	102.80	41.73	181.52	102.44	38.66	203.90	103.30	38.59	234.90
IV	86.69	43.57	142.27	88.24	43.01	160.19	80.08	41.28	158.99
V	61.46	44.10	83.84	45.17	44.14	46.81	40.64	42.04	37.79
VI	42.80	50.66	32.68	42.08	50.76	28.26	37.07	45.70	19.51
VII	38.67	29.72	50.19	52.73	45.11	64.87	46.36	42.18	54.88
VIII	61.92	43.41	85.78	56.27	55.66	57.23	44.28	46.50	39.76
IX	40.63	34.99	47.89	46.37	46.78	45.71	42.56	45.22	37.16
X	46.67	34.93	61.80	62.87	47.93	86.64	52.94	47.39	64.21
XI	37.41	27.78	49.82	36.73	37.99	34.73	35.90	38.19	31.24
XII	81.68	49.86	122.70	99.61	68.77	148.67	101.40	63.49	178.49

	1986			1987			1988		
Regions	Total	Current	Capital	Total	Current	Capital	Total	Current	Capital
All	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
NCR	334.63	426.49	111.11	335.22	412.24	129.48	326.08	394.96	128.74
I	59.38	60.78	55.98	65.78	68.25	59.19	65.35	67.02	60.56
II	94.79	69.32	156.80	85.20	65.01	139.13	86.58	68.60	138.11
III	101.37	44.21	240.47	84.15	45.07	188.52	77.90	37.54	193.55
IV	82.01	47.79	165.28	89.35	50.85	192.21	89.58	53.64	192.56
V	42.94	45.73	36.13	48.92	50.71	44.14	56.95	61.38	44.25
VI	43.29	52.78	20.21	46.87	55.09	24.93	46.83	54.32	25.39
VII	49.30	47.10	54.63	49.73	48.52	52.95	52.59	52.48	52.92
VIII	46.63	49.91	38.65	50.57	52.01	46.75	56.29	59.50	47.06
IX	47.86	51.48	39.07	41.74	47.84	25.45	49.65	57.73	26.49
X	57.62	54.36	65.54	59.23	54.32	72.35	60.02	55.58	72.71
XI	41.98	46.46	31.08	44.95	46.99	39.51	43.13	44.84	38.23
XII	104.42	70.43	187.13	93.82	68.84	160.55	98.06	76.55	159.67

National Average = 100

Table 11
SPEARMAN RANK CORRELATION BETWEEN PER CAPITA INCOME AND GOVERNMENT EXPENDITURES IN REGIONS

	Total	Current	Capital
1983			
Per Capita Income vs Per Capita Goverment Expenditures	-0.15934	-0.02747	-0.06593
Per Capita Income vs % Share in Total Expenditures	-0.14286	-0.21978	-0.12637
1984			
Per Capita Income vs Per Capita Goverment Expenditures	-0.23626	-0.01648	-0.24176
Per Capita Income vs % Share in Total Expenditures	-0.23626	-0.38462	-0.18681
1985			
Per Capita Income vs Per Capita Goverment Expenditures	-0.17033	-0.02198	-0.1978
Per Capita Income vs % Share in Total Expenditures	-0.3022	-0.3989	-0.16484
1986			
Per Capita Income vs Per Capita Goverment Expenditures	-0.17582	-0.02198	-0.2033
Per Capita Income vs % Share in Total Expenditures	-0.19231	-0.24725	-0.30769
1987			
Per Capita Income vs Per Capita Goverment Expenditures	-0.47802 *	-0.25275	-0.47253 *
Per Capita Income vs % Share in Total Expenditures	-0.45055	-0.37689	-0.54396 *
1988			
Per Capita Income vs Per Capita Goverment Expenditures	-0.36264	-0.2747	-0.48901 *
Per Capita Income vs % Share in Total Expenditures	-0.40659	-0.29161	-0.5941 *

*significant at 10% level

The 1991 LGC requires that barangays provide the following services: (1) agricultural support services including the distribution of planting materials and operation of farm produce collection and buying stations; (2) health and social welfare services including the maintenance of health and day care centers; (3) services and facilities related to general hygiene, sanitation, beautification, and solid waste collection; (4) maintenance of barangay justice; (5) maintenance of barangay roads, bridges and water supply systems; (6) infrastructure facilities like multi-purpose center, pavements, sports center, etc.; (7) information and reading center; (8) satellite or public market, where viable.

On the other hand, municipalities are required to provide the following functions: (1) extension and on-site research service facilities related to agriculture and fisheries including dispersal of livestock, poultry and fingerlings; maintenance of seed farms and nurseries; maintenance of interbarangay irrigation systems, etc.; (2) implementation of community-based forestry projects; (3) promotion of primary health, maternal and child care, control of communicable diseases; access to secondary and tertiary health services; (4) social welfare services; (5) information services including those on investment and job placement, tax and marketing, and maintenance of public library; (6) solid waste disposal; (7) municipal buildings, public parks, etc.; (8) infrastructure facilities like municipal roads and bridges, school buildings, clinics and other health facilities; communal irrigation, fish ports, artesian wells, flood control; (9) public markets and slaughterhouses; (10) public cemetery; and (11) tourism facilities.

Meanwhile, provinces are tasked to do the following: 91) agricultural extension and research services including prevention and control of plant and animal pests and diseases; dairy farms, animal breeding stations; assistance in the organization of farmers' and fishermen's cooperatives; (2) industrial research and development services; (3) enforcement of forestry laws in community-based forestry projects, pollution control law, small scale mining law, mini-hydro electric projects; (4) health services including hospitals and other tertiary health services; (5) social welfare services; (6) provincial buildings, parks, etc.; (7) infrastructure facilities like provincial roads and bridges; inter-municipal waterworks, flood control and irrigation systems; (8) low cost housing; (9) investment support services; (10) inter-municipal telecommunication services; (11) tax information system; (12) tourism development.

Finally, cites are authorized to perform all the functions of municipalities and provinces in addition to the provision for communication and transportation facilities; support for education, police and fire services, etc.

Not only are the functions assigned to LGUs far greater than before, the central government control over the local budget in terms of statutory requirements like contributions to hospitals and to Integrated National Police, is minimized. Also, the local budget officer who used to be a central government employee paid out of local funds is now a local government personnel. The necessity to get prior approval from various government agencies like the Department of Interior and Local Government in the implementation of local projects has been abolished.

At the same time, the scope of the revenue powers of local governments is widened. For most local taxes, the maximum allowable rate that LGUs may impose are raised. In some cases, the change is substantial. Moreover, LGUs are now allowed to tax activities that they were not allowed to cover before like banking.

Also, the share of local governments in national internal revenue taxes is increased from 20 percent to 30 percent initially, then eventually to 40 percent. However, if the central government suffers budget deficit, then the law mandates that the LGU share should not be less than 30 percent. Moreover, the new distribution of the IRA tends to equalize fiscal capacities of LGUs more than the previous law. In particular, the correlation coefficient between the nominal level of the IRA and per capita income for 1992 is estimated to be 0.49 and is statistically significant. While this implies that the transfer is still biased in favor of more developed LGUs, it is less so than before. Also, the correlation coefficient between per capita IRA and per capita income in 1992 is -0.21 which implies that poorer LGUs receive higher per capita IRA under the new scheme. However, it is not statistically significant.

At the same time, the Code liberalizes the regulatory framework for LGU credit finance. LGUs may now borrow from the banking system without prior approval from the DOF. Moreover, only the Central Bank and the Securities and Exchange Commission may regulate LGU bond issues.

In addition, greater participation of LGU officials in the Regional Development Councils in recent years allowed them to gain some experience inplanning and programming of projects. They also gained someexperience in project implementation through the management of categorical grants they received from the central government. Thus, local capability is gradually strengthened over time although additional training is still necessary.

Finally, the macroeconomic policy reform that the government undertook in recent years resulted in a more neutral and liberal overall policy environment. This development will tend to reinforce the gains from decentralization that will make the devolution process sustainable. For instance, the bias against agriculture and exports in the highly protectionist trade regime intensified regional disparities. Recent reforms minimizing the biases of the old tariff structure is expected to strengthen regional economies. Also, the liberalization of bank branching should work in favor of rural areas and local governments.

However, some problems still remain. Note that the Code restructured the real property tax making it less revenue productive than before. Also, the ability of local units to raise sufficient revenues to meet their growth is constrained by the use of unit rates in levying most local taxes. Unless the LGUs get the maximum permissible share in national taxes, LGUs will not be able to have adequate funds to finance their new expenditures. This implies that while the opportunity to capture efficiency and redistributional gains from decentralization is engendered by devolution program, said benefits will not be realized unless additional measures are adopted to make LGUs more financially independent.[5]

5. The efficiency and redistributional gains from devolution are expected as LGUs are given greater discretion in deciding the level and mix of public services they provide. This proposition is based on the premise that local units, by virtue of their "nearness" to the people, are in a better position to supply the appropriate quantity and quality of specific services their constituents demand and are also better able to target certain sector as beneficiaries of specific programs.

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