

Tugs of War: Local Governments, National Government

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I. Introduction

This year (2016) marks the 25th anniversary of the Local Government Code of 1991; it is the law that underlays the country's fiscal decentralization program. By itself, the LGC is a major legislative achievement. In just under five years the then 8th Congress (1987-1992) fulfilled one of its duties under the 1987 Constitution to enact "...a local government code which shall provide for a more responsive and accountable local government structure instituted through a system of decentralization..." (Article X. Section 3. 1987 Constitution).² Superseding the Marcos-era local government code³ and surpassing it in breadth and depth, the LGC of 1991 triggered the devolution of greater fiscal powers, resources and responsibilities to local government units (LGUs) in the country.⁴

In the last quarter of century the world has changed and the Philippines with it. There were nearly 40 million more Filipinos in 2015 than when the Code was enacted. Also, there are now also more provinces, cities and barangays. It may be asked then if over the same period the people were served well by their local governments. To be sure, there have been successes in local governance and development undertakings since 1991. Indicating greater local government responsiveness, the twenty or so *Galing Pook Award* winners (for innovations in local service delivery) every year attest to the gains. That many LGUs, often in partnership with civil society organizations, are now able to now customize health, education and social welfare services to the needs of their constituents should also count. The improvements in poverty rates, infant mortality rates, or educational outcomes in several places were partly achieved because of decentralization. That some localities lead others in governance, development or both is inevitable in a decentralized setup since local leaders vary in terms of competence, courage or commitment to experiment with new things or processes; but such initial

¹ I am very grateful to Adrian Castro, Xylee Javier and Sylvia Nachura for their research assistance, and Rose San Pascual and Gloria Lambino for logistics support, and the Ayala Foundation for a financial grant to complete this paper.

² Barely three months after the 8th Congress convened in July 1987, there were already "several bills for a local government code introduced in both the House and the Senate." (Hutchcroft, 2004).

³ Batas Pambansa Bilang 337, c. February 1983.

⁴ For the range of devolved functions and powers, see, for example, Diokno (2012) and Llanto (2009, 2012).

differences, however, can be reduced with corrective policies.⁵ Perhaps for this reason, the 8th Congress deemed it necessary to include a provision for the Code's later appraisal:

Sec. 521. *Mandatory Review Every Five Years.* – Congress shall undertake a mandatory review of this Code at least once every five (5) years and as often as it may deem necessary, with the primary objective of providing a more responsive and accountable local government structure.

Since 1992 there have been many reviews and attempts to amend the Code. Several comprehensive and piecemeal amendments have been proposed in Congress, but only piecemeal modifications so far became laws. The latest attempt is an omnibus put together by the League of Cities of the Philippines (CLP) based on consultations with various stakeholders.⁶ While one hopes this latest initiative will buck the trend for so much is at stake, for the same reason however we must be careful what we wish for. If a lesson can be drawn from our inability to modify the Code substantially is that we must get the right provisions the first time since undoing the mistakes later would be difficult and costly.

In the rest of the paper, I will argue that some of the conflicts among local governments and between them and the national government can be traced to a flaw in the Local Government Code of 1991, which underlays the country's fiscal decentralization program. Due to this oversight, the inherent, but avoidable conflicts in a decentralized setup were aggravated. While some of these conflicts have been resolved through administrative issuances or court rulings, some persist or re-appear in other guises. I illustrate the conflicts and the attempts to resolve them in the case of health services, which comprise the bulk of the devolved functions. The relevant proposed amendments in the Code are also discussed. This paper concludes by pointing some directions for reform.

II. Function trailing finance

Considered a good principle to heed and that also works well in practice is that when decentralizing national government functions, powers or responsibilities to local governments *first* determine the appropriate public services to devolve and *then* to transfer the requisite revenues or revenue-raising authority to finance the devolved expenditure functions.⁷ That is, finance should follow function. Decisions about public services can be made first and independent of the initial financial capacity of the local government because the national

⁵ The Philippine experience under the LGC of 1991 has been reviewed many times. The common finding is that the results, at best, are mixed: some places indeed became more responsive to their constituents, many did not. See, for example, Diokno (2012), Llanto (2009, 2019) and World Bank (2011).

⁶ Philippine Development Forum Working Group on Decentralization and Local Government (2014a, 2014b).

⁷ See, for example, Ter-Minassian (1997), Bird and Vaillancourt (1998), or Boadway and Shah (2009).

government can provide fiscal transfers (i.e., additional resources in cash or kind) to revenue-deficient localities. The public services (or expenditures functions) that are best delegated to local governments are those considered as *local public goods*, i.e., services that can effectively serve the needs of the local population in an area (i.e., any sub-national geographic division). Since the service's catchment population is "small", the service beneficiaries or users may all be constituents of a single local government unit. Since the service's catchment area is small, it may lie within the local government's physical boundaries. Hence, the local government will have the administrative responsibility and political incentive to ensure the efficient provision of the local public service. When it cannot due to inadequate financial, organizational or technical capacity, it be motivated or assisted to do so with central fiscal transfers, co-financing arrangement with other local governments or both.

The same interventions could work when the local government underprovides services because the benefits spill over to the constituents of other local governments. Note that the so-called *inter-jurisdictional spillovers* (or spatial externalities) happen when outsiders make use of locally provided services (e.g., to seek treatment in local health clinics) or when the effect of the service itself cross borders (e.g., unclogging local drainage will help reduce flooding even neighboring municipalities). Other possible solutions to spatial externalities are the transfer of responsibility to next higher level of government (that has jurisdiction over all service beneficiaries), combine or merge the smaller local governments into a larger polity, or create a special agency for the purpose. All of these solutions have been tried in many developing countries that decentralized like the Philippines, albeit with varying levels of success. But the important policy lesson is that finance should be decided always in relation to the devolved functions, which must be decided first and in relation to the welfare of the target population.

Instead of finance following function, the underlying design of decentralization program, as reflected in the Code, had it in the wrong order. It is not evident from the Code, its implementing rules and regulations, or from published accounts that indicate that the types, sizes, composition and distribution of the devolved expenditure functions were decided first and then used to formulate the assignment or distribution of fiscal revenues or revenue-generating powers. Apparently, the decision about the allocation of functions was disjoint from that of finance.

Of the several provisions in the Code concerning local government finances, the two most important are those about the internal revenue allotment (Sections 284-288) and shares in national wealth (Sections 289-284). These sections provide the formula for computing the total and individual shares of local governments in the internal tax revenues and earnings from natural resources collected or generated by the national government. Of the two, the Internal

Revenue Allotment (IRA) is the bigger in total amount and number of local governments covered. Also, the local government share in the internal tax revenues has been in place even before the LGC of 1991. In contrast, the 40 percent share in the earnings or proceeds from national wealth is granted only to those localities with the relevant natural resources.

Three things are immediately apparent from Table 1, which shows how the IRA shares are determined before and under the LGC of 1991. The first observation is that the allocation criteria do not consider how expenditure obligations are assigned to local governments. The second observation is that as a group the LGUs are now getting a bigger IRA than before, both in terms of percentage share and amount (since the IRA pie is bigger). Last, the new formula is biased towards barangays, those local governments with land areas, and equity.

Table 1. Formula for computing the local government shares in the internal tax revenues before and under the LGC of 1991

Allocation criteria	Before the LGC of 1991 (under Presidential Decree 144, c. 1973)	Under LGC of 1991 (RA 7160)
A. Total LGU share		
Total internal tax revenues for allocation	Net general funds* collected by the national government in the third year preceding year the allotment is given	Gross national internal revenues based in the collection in the third year preceding the year the allotment is given
Share of the local governments in the total	Maximum of 20%	30% in the first year of the devolution, 35% in second year, 40% in the third year and thereafter
B. Share by LGU level		
Provinces	35% of the total LGU share	23% of the total LGU share
Cities	25% of the total LGU share	23% of the total LGU share
Municipalities	45% of the total LGU share	34% of the total LGU share
Barangays	10% of the total LGU share	20% of the total LGU share
C. Shares of individual LGUs (in the same LGU level)		
Population share	70%	50%
Land area share	20%	25%
Equal sharing	10%	25%

*Net general funds comprise revenues collected net of budgetary funds created by law to facilitate the planning and execution of particular activities by earmarking specific tax and non-tax earnings for their use.
Sources: Presidential Decree 144 c. 1973, Local Government Code of 1991.

A naïve comparison of the percentage shares in the IRA and the cost of devolved functions (CODEF), which is based on the budget appropriation in 1991 of the national government agencies for their devolved services, would suggest that the provinces and municipalities together were “losers”, getting only 57 percent of the IRA but 93 percent of the CODEF. In contrast, the cities and barangays together won big time. A proper comparison though would be in terms of amounts of CODEF and incremental IRA received (as a consequence of the change in

the formula), since only these two can be properly attributed to the Code. Put differently, did LGUs get enough additional money for their additional spending obligations?

Again, only estimates are available. Between 1991 and 1992, the total incremental IRA was about 11 billion pesos. Between 1992 and 1992, it was about 19.2 billion pesos. Thus, the total incremental LGU share in the internal revenues in 1992 or 1993 was enough to cover the total CODEF they got in 1992. But since even the extra IRA was distributed without of the distribution of the CODEF, some LGUs inevitably faced revenue shortfalls. In 1993 around 43 percent of 78 provinces received incremental IRA that were lower than their CODEF.⁸ But if there was enough extra money for the devolved spending obligations to begin with, what then explains the resulting inequities?

Published accounts of the political dynamics during the drafting, deliberation and passage of the local government bill are revealing.⁹ At that time (1987-1991), the key political proponents – Cory Aquino, Nene Pimentel, Ramon Mitra, Celestino Martinez, Cesar Sarino, Hilario de Pedro and others – were ostensibly united to promote local autonomy, as mandated in 1987 Constitution. Just after 20 years of Martial Law, the credo of local autonomy was credible and gained wide currency as an insurance against a strong central government in the future. Local autonomy also had to mean financial independence. With their own funds, local officials need go to Malacañang as they did before 1987 to secure resources for local programs or projects.

The surest way then to promote local autonomy is to raise the LGUs' stake in the internal tax revenues. While the national government then was warm to the idea, it was in Congress where the bill got stalled because many in the lower house felt that, with the additional IRA, their local rivals (governors and mayors) will unduly gain political advantage over them. Unfortunately for them, then Speaker Ramon Mitra, who was then aspiring to become president, saw in the passage of the bill an opportunity to win local support. Thus motivated, he used his parliamentary skills and prerogative as the Speaker to overcome opposition to the bill. This incident suggests that, from point of view of the congresspersons then, which later events also bear out, the increased IRA share of local governments will unintentionally intensify patronage politics.

The choice about which expenditure functions to devolve to which local government apparently did not animate Congress as much. Rather, the executive departments and the affected personnel were the main protagonists. Basic education services (including primary school and teachers) were initially considered, and, as local public services, they would have been ideal. However, the proposal was later dropped largely for political reason. It was thought

⁸Capuno (2001).

⁹My main source here is Hutchcroft (2002).

that the devolution of education services will jeopardize the tenure, promotion and even personal safety of the teachers, who are also deployed to canvass votes during elections. Because of their election duties, they could be harassed or manipulated by the candidates, some of whom will become mayors and governors who control the devolved school system.

After education services, health services were then considered. Unlike teachers, health workers were assigned poll duties. Like schools, the health facilities were already in place and therefore easily assigned to the LGUs where they were located. Since education and health were then the two biggest nationally-provided and financed social services in terms of budget and personnel, devolving the health functions to local governments would induce them to be more responsive to the health needs of their constituents. The only real, if unsuccessful, opposition came from the health personnel who feared their careers will be “politicized” under devolution since they would then report to elected officials rather to senior health professionals (e.g., Secretary of Health). Apparently, this political argument did not carry as much weight as that of the teachers’. Eventually, health services were chosen, which ended up accounting for the bulk of the devolved functions. Again, it is not clear from published account if the distribution of the cost of devolved health functions was considered in the determination of additional revenues transferred to local governments.

If not the additional revenues, were the expanded revenue-generating authority granted to the LGUs perhaps sufficient for their new spending obligations? Without empirical data, this is hard to ascertain. For the extra authority to yield actual income, taxes or user fees must be collected, and the tax base must be substantial and not impecunious. These factors vary across localities. But as later events suggest, the extra authority did not count for much. Through succeeding General Appropriations Acts (GAAs) starting in 1994, the IRA formula was effectively adjusted for the CODEF. The 1994 and 1996 GAAs each stipulates that 50 percent of the actual cost of devolution and cost of city-funded hospitals existing as of December 31, 1992 must be deducted first from the total IRA share of LGUs before the balance is distributed to individual LGUs following the IRA formula. The amount deducted will be distributed to LGUs according to their shares in the CODEF. In the 1995 and 1997 GAAs, the amount deducted from the total was equivalent to 100 percent of the CODEF and cost of city-funded hospitals. Note that since the city hospitals were not devolved facilities, defraying their costs out of the IRA share could only be considered a political accommodation. These episodes only underscore the importance of linking finance directly to function in the beginning for corrective measures could be costly.

III. Functional conflicts among LGUs

Besides the transfer of the public services, personnel and facilities already on site to the local government that has jurisdiction over the area and the uniform assignment of expenditure functions to all local governments in the same level, whatever other criteria used in devolving expenditure functions in 1992 are less evident. To be sure, the in-situ criterion is simple or convenient to administer since the pertinent facilities (mostly hospitals and health clinics) cannot be relocated without costs or disrupting services. The equal-assignment criterion also seemed fair and even efficient. It made sense then to field social workers everywhere since the poor and the needy were (and still are) everywhere. It also looked prudent then to field agricultural extension workers because most local governments were in rural areas with agriculture-based economies.

The two criteria, however, may have inadvertently led some local governments into conflict. The *functional conflicts* among local governments that are referred here are those *inherent* in a multi-level government structure. These conflicts could arise when the natural or optimal catchment area of the local public services extends several jurisdictions, thus encouraging those that enjoy the spillovers to free-ride and discouraging the source LGU to reduce its provision. A conflict may also arise when a local public service achieves its most efficient scale (i.e., lowest average cost) when provided to a large population, which may reside in different jurisdictions. These jurisdictions are likely to spend more in total when each provides separately than when they do so jointly. However, disagreements among them about the division of the gains (in terms of cost savings) could forestall cooperation. How these problems played out under decentralization is best illustrated in the case of health services, facilities and personnel, which account for bulk of the devolved functions.

Fragmented local health systems

Note that when the devolved public hospitals and other health facilities were first built, equipped and manned, they were not configured to be assigned later to local governments. In fact their transfer became evident only a few months before the Code was passed in October 1991. The facilities were originally configured in each province to constitute a hospital referral system designed to meet the health and medical needs of the local population in an effective and efficient manner. Under this system, the most common illnesses and simple medical needs are attended in primary health facilities located in barangays, *poblaciones* or any other strategic areas in each municipality or city. The low-incidence but more serious illnesses or diseases that require surgery or medical specialists will be treated in secondary hospitals located in districts that encompass two or more municipalities. The most complicated or infrequent medical cases are treated in tertiary hospitals normally located in the most accessible locations in the province

or region. Since these hospitals were constructed without regard for local jurisdictions¹⁰, when devolved many were in fact near the boundaries or far from the central districts of the local governments. Running the local hospitals as one referral system was meant to minimize congestion and long patient queues in high-level facilities and the underutilization of primary facilities.

It is true, however, that several hospitals however were built to accommodate influential local politicians or members of Congress. These, too, however, were not optimally configured for local governments. Since these hospitals were then financed from general taxes and operated by the Department of Health, they were bigger (in terms of bed capacity or range of medical services) than if they had been locally administered and funded in the first place.

Local public health programs for the surveillance and control of communicable diseases (like tuberculosis and malaria), for maternal and child health (pre-natal and post-natal care, child immunization), for disease prevention and for promotion healthy lifestyle, are also best administered as an integrated system within a province. The effective control of epidemics requires the complete and timely information about the afflicted and vulnerable population who may reside in several jurisdictions. Several medical interventions have to done simultaneously in contiguous areas to save on mobilization costs and to effectively contain the spread of disease vectors. Drugs and medical supplies for hospitals for public health programs can also be procured in bulk for the province to avail of volume discounts. Health personnel were also easily assigned or deployed in other places or perform other tasks where they are most needed. Creating further synergy, the public health facilities and public health program within each province were administered as one integrated local health system just before they were devolved.

Rather than preserving the integrated provincial health system in place, the decentralization program fragmented it. The devolved health services were confined within narrow administrative jurisdictions rather than serve their natural catchment areas and as part of a province-wide health system .Rural health units and barangay health stations and their health personnel were transferred to municipalities. The cities got some health centers. The district and provincial hospitals and their health personnel went to the provincial governments. Disease surveillance and health information flows stopped within LGUs. In many places drug supply became erratic and more expensive. Many LGUs remained without doctors, medical technologists and other specialists, many of whom feared the “politicization” of their careers

¹⁰The criteria that the Department of Health used before 1992 in establishing new hospitals were (i) distance of at least 35 kilometers from any existing government hospitals, (ii) accessibility as a referral facility to a minimum three rural health units or main health center facilities within the catchment area, and (iii) a permanent of at least 75,000 to be served within the catchment area.

and their prospects of professional advancement limited in the local bureaucracy. To their dissatisfaction, some LGUs found their devolved hospitals less than ideally located or capacitated. To be sure, attempts were made to consolidate the operations and management of the devolved health services. Some were successful, but most were frustrated by political divisions.

The functional tugs of war among local governments are not only about health services. Conflicts also arise in the management of shared resources like marine, coastal and forestry resources that require the cooperation of two or more affected localities. The proliferation of redundant public infrastructures – like seaports, airports and public roads – is also indicative of the wrong assignment of expenditure functions (and of their financing).¹¹ Perhaps the conflicts arising from the mismatch between the assigned function and the level of local government are nowhere as evident or painful as those experienced daily in Metro Manila. In recent months, traffic in the metropolis has gotten worse, which result in losses estimated at 2.4 billion pesos a day.¹² The losses were higher when Manila City imposed a truck ban for around six months starting in February 2014, purportedly to ease the traffic within its jurisdiction. The city ordinance forced trucks that ferry containers from Manila ports to seek alternate schedules and routes that ultimately worsen road congestions in the rest of the metropolis. Worsening air quality and crime situation, perennial floods and uncollected garbage also indicate the limitations of existing local government structure to deal with metropolitan problems.

IV. Financial conflicts between LGUs and NG

Precisely because finance did not follow functions, which themselves were also not aptly assigned to local governments, soon the latter clamored for additional money from the national government. Since the incremental IRA shares were not linked to the CODEF, local governments considered the first as their entitlement (under local autonomy) and the latter as unfunded mandates. Since 1991, there have been several bills filed in Congress and proposals made by the different local government leagues¹³ to (i) combine other income sources with the internal revenues on which the allocation to local governments is based, (ii) increase the percentage share of the local governments in the total, or (iii) ensure the automatic disbursement of their internal revenue allocations. In these proposals, the local governments were united against the national government. They even took the national government to the Supreme Court when the then Ramos administration withheld 10 percent of their IRA purportedly to manage the public

¹¹ The 2012/2013 Philippine Human Development Report aptly labels this syndrome as “divided-by-N”.

¹² National Economic and Development Authority (undated).

¹³ Dorotan and Carizo (2014) present a summary comparison of the proposals of the respective leagues of provinces, cities, municipalities and barangays.

sector deficit following the 1997 Asian financial crisis. Other proposals that only re-allocate the total share of the local governments among them were not as widely supported. In fact, existing cities opposed the cityhood of some municipalities to protect their IRA. The financial conflicts between local governments and the national government arose time and again, especially when the latter issued corrective measures to make local governments earmark or apportion some of their incomes for the devolved functions. These conflicts are resolved or avoided when local governments get more money.¹⁴

An example of a corrected measure than only heightened the financial conflicts is the so-called Magna Carta benefits for health workers. As provided for Republic Act 7305 of 1992, the devolved health workers are to be given additional allowances and other benefits to make their compensation comparable to those retained by the Department of Health (DOH). In supporting the law, the DOH considered it a good intervention to improve the morale and welfare of the devolved health personnel, and thereby secure the effective delivery of local health services. The problem is that the local governments will have to provide for the Magna Carta benefits from their own budgets. The resulting financial strain and distortions in local pay structures was made worse by the implementation of the Salary Standardization Law that also raised salaries of all government personnel. To allay the protest of local governments, the DOH provided grants to local governments for the extra allowances of health workers. Again, this incident further underscores the importance of linking finance directly and at once to the devolved functions.

Besides the internal revenues, the proceeds from “national wealth” also pit the local governments and national government in a financial tug of war under decentralization. The relevant provisions in the Code are:

Section 289. Share in the Proceeds from the Development and Utilization of the National Wealth. – Local government units shall have an equitable share in the proceeds derived from the Utilization and development of the national wealth within their respective areas, including sharing the same with the inhabitants by way of direct benefits.

Section 290. Amounts of Share of Local Government Units. – Local government units shall, in addition to the internal revenue allotment, have a share of forty percent (40%) of the gross collection derived by the national government from the preceding fiscal year from mining taxes, royalties, forestry and fishery

¹⁴ The financial tug of war between the local governments and the national government are not only due to mismatch in the allocation of expenditure functions and finance under decentralization. The IRA, pork barrel funds and other central transfers are also determined by political patronage. See Hutchcroft (2012) and De Dios (2007).

charges, and such other taxes, fees or charges including related surcharges, interests, or fines, and from its share in the utilization and development of the national wealth within their territorial jurisdictions.

As defined, “national wealth” comprises those resources that have in place long before administrative or political boundaries were drawn or whose very nature does not confine them within such unnatural limits. For such type of resources, the level of government that surely encompasses them and therefore with the greatest incentive to use them is the national government. Unfortunately, the inevitable damages to lives, livelihood and environment resulting from their exploitation are largely borne by the local population. Thus Sections 289 and 290 ensures that the proceeds are equitably shared, with the concerned locality getting a hefty share of the proceeds. As a further safeguard, the Code also mandates prior consultation with the local officials, people and other stakeholders to ensure that all concerns are heard and addressed before any irreversible damage is done. This procedural solution is of course prudent when compensation for damages is not easily ascertained ex ante or the ex-post payment of them is not sure. At times these consultations end up in deadlocks that frustrate the parties involved. Sometimes they also become opportunities for rent-seeking by both local and national government officials.

Tugs of war over revenues also happen among governments. However, conflicts over shares in income from sand quarrying are resolved; the contentious issue is above remittance of shares. Another type of conflict is sharing in the payment of use of a local resource, whose harmful byproducts (pollution, damages to environment or health) extends beyond the boundaries of the host locality. An example is the controversy regarding the sanitary landfill opened in Montalban (now Rodriguez) in 2002 purportedly for the garbage collected in Metro Manila. Under the arrangement with the Metro Manila Development Authority, Montalban will be paid for the use of its landfill. A court injunction was subsequently issued to stop the opening of the landfill upon the motion of other stakeholders in the Rizal province that the landfill will cause environmental damages affect other municipalities.

V. Fixing the fragmentation

The problems inherent in a decentralized setup – namely, spatial spillovers and forgone scale economies – are not without solutions. In fact, several of them have been tried since 1992. They can be classified into two. The first set of solution comprises special grants or technical assistance targeted to LGUs to expand provision enough for resident and non-resident beneficiaries. The funds carved out the total IRA in 1994-1997 and then transferred to LGUs for

their CODEFs may be considered as an example of this type of solution. It should be mentioned, however, that such transfers may not be sustainable since they depend on the financial capacity of the grantor (usually the national governments or a development partner). Besides, such transfers may lead to moral hazard, i.e., the receipt of the grant itself now becomes the main motive for underproviding the service.

The second set comprises inter-LGU alliances or coordinated planning, financing and provision. Both types are typically adopted with moral suasion (i.e., with appeal to improve general welfare). To be sure, the formation of inter-LGU alliances is permitted in the Code, to wit:

Sec. 33. Cooperative Undertakings Among Local Government Units. – Local governments may, through appropriate ordinances, group themselves, consolidate, or coordinate their efforts, services, and resources for purposes commonly beneficial to them. In support of such undertakings, the local government units involved may, upon approval by the sanggunian concerned after a public hearing conducted for the purposes, contribute funds, real estate, equipment, and other kinds of property and appoint or assign personnel under such terms and conditions as may be agreed upon by the participating local units through Memoranda of Agreement.

An example of such alliance is the Banate Bay Resource Management Council, Inc. (BBRMCIS), which was established in 1996 by the coastal municipalities of Anilao, Barotac Nuevo and Banate in Iloilo province. Its main purpose is to manage the coastal and marine resources of Banate Bay through activities such as the planting of mangroves and the enforcement of ordinances against dynamite fishing.¹⁵ Other similar initiatives in Region VI are Northern Iloilo Alliance for Coastal Development (NIACDEV), Southern Iloilo Coastal Resource Management Council (SICRMC), Southern Negros Coastal Development Management Council (SNCDMC) Central Negros Council for Coastal Resource Development (CENECCORD), and Northern Negros Aquatic Resources Management and Advisory Council (NNARMAC).¹⁶

Other contiguous local governments also formed metropolitan-like arrangements to manage traffic congestion, pollution, illegal squatting and other problems of highly urbanized areas. These arrangements found in the metro-Naga area and metro-Iloilo area, for example. Perhaps the oldest and most advanced among these arrangements is the Metro Manila Development Authority (MMDA). The MMDA has its own charter, a formal governance structure, and separate budget appropriation annually.

¹⁵ Arcenas, Capuno and Ferrer (2011).

¹⁶ Ferrer, Osorio and Chan (2010).

Unlikely but not impossible is a formal amalgamation of several local governments into a bigger unit. This is the case of the Island Garden City of Samal, which was formed in 1998 out of the union of three municipalities (Samal, Babak and Kaputian) in Samal Island, Davao Del Norte. Since then IGACOS has gained prominence among domestic and foreign tourists.

How successful are these attempts to fix the fragmented local services so that they become more effective in containing spatial spillovers or exploiting economies of scale? I am not aware of any comprehensive assessment of all the corrective measures adopted. A short review of various DOH attempts to fix the fragmented local health system could provide some insights. Since 1992, the DOH undertook three initiatives to encourage LGUs to jointly plan, provide and finance their services. These are Comprehensive Health Care Agreement (CHCA), the Inter-Local Health Zones (ILHZs), and the Province-wide Investment Plan for Health (PIPH). Common in all these initiatives, the provincial government and the component municipalities and cities were made to commit their resources for health, and the DOH matching or augmenting the local resources. Whereas the CHCA was formally agreed between the DOH and the provincial government, which was expected to vouch for the participation of the municipalities, the ILHZ and PIPH explicitly sought the agreement of the municipalities. Though simpler, the CHCA was not successful since some municipalities did not have enough funds for their counterpart, while others denied they were party to the agreement. The ILHZs were organized roughly along congressional districts with smaller number of local governments to deal with. Several ILHZs became difficult to organize or became dysfunctional in districts where the local officials (including the Congressperson) and the provincial governor were political rivals. The weak enforcement of fund commitments was also a major reason why the multi-year, integrated health investments included in the PIPH were never carried out as envisioned.

Weak enforcement of commitments, rather than limited expectation of gains is a common reason for why inter-LGU alliances fail to continue after startup years when donor or NGO support was heavy. After garnering national recognition in its early years, BBRMCI began to decline when support to operations from one of the participating municipalities was withdrawn. The BBRMCI Memorandum of Agreement does not stipulate a penalty for defaulting member municipality. The MMDA charter is also strong in carrots but weak in sticks. The last the MMDA chair in numerous occasion expressed the need to amend the charter so that it can enforce traffic regulations in the whole metropolitan area without fear of being contradicted or contravened by separate local ordinances.

Memoranda of Agreements that are all carrots without sticks work only when cooperation is mutually self-enforcing. This is the case, for example, when two LGUs find it mutually beneficial to connect their barangay roads, since neither segment of the road will as

useful without the other. When the alliance is met to contain spatial spillovers, “cheating” trumps cooperation. This is the case, for example, when two LGUs decide to unclog their canals to avoid floods that both affect them when it rains. If only one clears its own drainage system, the other also benefits since the flood water will find an outlet, but saves on the costs. But if each waits for the other to unclog, then both of their canals will remain blocked. While free-riding make sense to each, it will lead to flooding (see Box 1). It is the presence of both carrot and stick provisions in contracts involving the government and private companies that make such agreements work.

Box 1. Coordination Game and Prisoner’s Dilemma Game

Figure 1. Cooperation is self-enforcing

		LGU B	
		Build	Not build
LGU A	Build	10,10	0,0
	Not build	0, 0	2,2

Figure 2. Cooperation is not self-enforcing

		LGU B	
		Unclog	Do not unclog
LGU A	Unclog	10,10	1,12
	Dot not unclog	12, 1	2,2

In a pure coordination game (Figure 1), each of the two players (LGU A and LGU B) stands to get more if they agree, say, to build (10) than when both decide not to build (2) connecting barangay roads, and nothing if one builds and the other does not. Therefore, it to the interest of each to mimic the other’s choice and it will be mutually self-enforcing if they agree to build.

In the Prisoner’s Dilemma game (Figure 2), an initial agreement to unclog canals is not self-enforcing for either player since the other player who deviates from the agreement stands to gain more if he expects the other to stick to the agreement. If both agree not to unclog, neither one can expect more if he decides to do otherwise. Hence, “do not unclog” is the only self-enforcing agreement in the absence any mechanism that will bind them to build.

When disputes or conflicts are not resolved among the local government themselves or between them and the national government, either an administrative or legal remedy is sought. The Department of Interior and Local Government come up with issuance or an opinion, sometime jointly with another department or agency, to clarify on the provisions of the Code and other relevant laws. Some disputes are brought to court, which are sometimes resolved in favor of local governments.¹⁷ These remedies work best in establishing jurisdictions or rights, but apply only to issues brought to court. But if the Code itself is flawed in its technical or economic basis (like function trailing finance), it is better to amend, repeal or replace it with an improved one.

¹⁷ See Gatmaytan (2014) for some Supreme Court rulings on cases involving local governments and a national government agency.

VI. Towards a better local government structure

The last 25 years of decentralization has shown both the importance of and the difficulty in consolidating a fragmented local fiscal system, i.e., the gamut of public service delivery and financing functions which from an economic point of view are aptly assigned to local governments. It is important to consolidate or coordinate the provision of some devolved services to manage the spillover effects affecting neighboring jurisdictions. Consolidation can also yield cost savings. But securing the firm commitment of too many local governments, however, is not easy.

To be sure, there are now several initiatives to address promote “consolidation” directly or through amendments in the Code. In particular, the Philippine Development Forum¹⁸ Working Group on Decentralization and Local Government include in their 2013-2016 activities geared towards increasing “inter-local government cooperation for local economic development activities”. Among their targets are “increased number of functioning inter-local cooperation/alliances established” and “adoption of a financing framework for inter-local alliances”. In their review of the LGC of 1991, the same group listed under fiscal policy topics for further analysis “clarifying the service delivery responsibilities by LGUs” and “addressing jurisdictional formation policies and the framework for LGUs alliances.” They see the need to amend the basis for local government creation since the current trend of conversion of municipalities to cities and the splitting up of a local government into two or more smaller jurisdictions is thought to lead inefficiently-sized local governments. To arrest this trend, they propose to essentially raise the income requirements for conversion or creation of new LGUs. Their list of proposed amendments also encompasses expenditure assignments, revenue assignments and taxing powers, intergovernmental fiscal transfers, and fiscal administration; and, they appear to well supported by local governments and other local stakeholders. While these are all important issues in themselves, an equally important issue is that they should also be closely linked and in order – that is, the functions should be determined first before the finance are decided. It is seems, however, that the proponents take the existing local government structure is still suitable after 25 years.

Three developments over the same period underscore not only the need to amend the Code, but the more encompassing decentralization program of the government and the underlying local government structure. These developments are going the decentralization concerns about spatial externalities and economies of scale salient than ever. The first development is continued urbanization. According to World Bank, the proportion of urban-based population

¹⁸ The Philippine Development Forum comprises Philippine government officials and representatives from development partners (e.g., ADB, WB, USAID, EU, AUSAID, JICA).

has increased from 37 percent in 1980 to about 45 percent in 2014. Besides the metropolitan areas of Manila, Cebu and Davao, other areas where population concentrated heavily between 2000 and 2010 are Angeles, Bacolod, Zamboanga, Iloilo, Baguio, General Santos, Cagayan de Oro, Dagupan, Lucen, Iligan, Tagum, Marawi, Batangas, Kabankalan and Butuan (Appendix 1). Of these, seven have their respective land areas within one administrative boundary, which means that their local governments are likely able to manage traffic congestion, floods, garbage collection or other urban problems without having to coordinate with other jurisdictions. In eight of them, however, about half of the total urban area lies outside one administrative boundary, which may necessitate metropolitan arrangements. The urban areas of Manila, Cebu, Angeles and Dagupan extends to several administrative jurisdictions. Since these metro areas are unlike other jurisdictions in the country, they require a different type of “local government” suitable to their needs. While the MMDA is not a local government, it is a special purpose local agency to address metro-wide concerns. Except for its governance structure, it functions like a local government. However, transplanting the MMDA without fixing its governance structure to other metro areas in the country will be inadvisable.

The second development is the rapid growth and adoption of information and communication technology (ICT) by all segments of the population. ICT facilitates not only improved access to information about public services, but also actual access to the service itself. With the appropriate ICT in place, taxes, fees and charges for public services from home and without having to queue up in the municipal cashier’s office. By running online surveys, local officials should be able to determine the needs of their constituents. The public’s access to information about their activities may also make them more responsive and accountable. Since ICT effectively substitutes for some workers, their adoption should lead to leaner local governments. Hence, some of the prescribed plantilla positions in local bureaucracies may become redundant or irrelevant. ICTs should also facilitate coordination among local governments.

Finally, the changing climate worsens rains, floods, and droughts, and distorts weather pattern. These changes affect the livelihoods and local economies, which at once reduce the tax base of local governments and increase the demand for their services. Often, contiguous areas are jointly affected. So contiguous areas must jointly manage the risk, although to recover from disaster they would need outside help, often from the national government. Often, however, the relief and recovery operations are stalled by difficulties in coordinating too many agencies involved. When compared to what has been achieved with massive relief operations of several agencies in Yolanda-affected provinces, the successful “zero-casualty” from recent typhoons achieved in Albay is impressive by far. Unlike in Tacloban, in Albay all the critical disaster

management operations and units were effectively “consolidated” under one command, that of the provincial governor. However, it is far easier to consolidate the relevant units and operations by amending the Code and other relevant than it is to clone Governor Joey Salceda and make his clones run and win other gubernatorial positions. In consolidating disaster relief and recovery operations, their assignment should still be to appropriate level of local government. Identifying the appropriate level of local government, however, may depend on the types and gravity of disasters that can be expected to occur in the area (even allowing for wide margins due to climate change). Consequently, they may be consolidated at the province-level or inter-provincial level.

Creating new types of metropolitan arrangements, instituting special purpose agencies, asymmetric decentralization (different functions to local governments in the same level) may have to be considered in the review of the government’s decentralization program and of the Code. We may have to reconsider as well the existing local government structure, given developments in the size, distribution and composition of the population. Where the economies of scale are great and the population fairly homogenous (in their preferences for public services), it is more efficient to have big local governments (in terms of size of constituents). Where there no scale economies to be had and the population wide vary in their desired public services, it would sense to split the local government into smaller units. Unlike income and population per se, these criteria (scale economies and heterogeneity of preferences) provide clear economic basis for creation of new LGUs.

Finally, reforming the Code is unlikely to be sufficient. Political reforms concerning elections and political parties are also critical to make the local governments fully responsive and accountable to their constituents. Assigning the responsibility over a public service to the right local governments and then ensuring that that it has the financial resources to carry it out only means that it will do a good job it wants. It will still have to want to do it. Making it do so would require political and administrative reforms concerning elections, and performance audits. Thus, to make the local governments truly responsive and accountable, we need to broaden the scope of reform beyond the Code.

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Appendix 1. Highly populated urban areas in the Philippines, 2000 and 2010

Rank by 2010 urban population	Urban Area Name	Country	Average annual rate of increase				Urban population ^c c2000 (persons)	Urban population ^c c2010 (persons)	Change in urban population 2000 - 2010 (persons)	Average annual rate of change of urban population (%)	Average urban population density c2000 (persons/sq. km.)	Average urban population density c2010 (persons/sq. km.)	Urban expansion per additional inhabitant (sq. m./person)	Administrative boundary arrangement ^d
			Urban land ^a c2000 (sq. km.)	Urban land ^a c2010 (sq. km.)	Increase in urban land 2000 - 2010 (sq. km.)	Average annual rate of increase in urban land (%)								
<i>Urban Areas with populations over 10 million in 2010</i>														
6	Manila urban area	Philippines	1,024	1,275	251	2.2	12,202,314	16,521,948	4,319,634	3.1	11,916	12,958	58	Fragmented
<i>Urban Areas with populations between 1 and 5 million in 2010</i>														
86	Cebu urban area	Philippines	123	161	38	2.8	1,017,447	1,527,407	509,960	4.1	8,268	9,461	75	Fragmented
<i>Urban Areas with populations between 500,000 and 1 million in 2010</i>														
168	Davao urban area	Philippines	65	76	11	1.6	609,127	826,172	217,045	3.1	9,353	10,835	51	Contained
217	Angeles City urban area	Philippines	136	186	50	3.2	425,633	683,176	257,543	4.8	3,135	3,678	194	Fragmented
274	Bacolod urban area	Philippines	48	79	31	5.2	338,784	538,628	199,844	4.7	7,123	6,851	155	Spillover
<i>Urban Areas with populations between 100,000 and 500,000 in 2010</i>														
420	Zamboanga urban area	Philippines	35	39	4	1.1	262,134	350,889	88,755	3.0	7,450	8,968	44	Contained
432	Iloilo urban area	Philippines	33	39	6	1.7	246,951	337,552	90,601	3.2	7,413	8,573	67	Spillover
456	Baguio urban area	Philippines	35	46	12	3.0	222,164	316,654	94,490	3.6	6,428	6,819	126	Spillover
533	General Santos urban area	Philippines	54	68	14	2.3	180,978	269,341	88,363	4.1	3,348	3,976	155	Contained
536	Cagayan de Oro urban area	Philippines	38	47	9	2.1	184,947	268,087	83,140	3.8	4,812	5,674	106	Spillover
575	Cotabato urban area	Philippines	10	12	2	1.6	181,076	242,993	61,917	3.0	17,995	20,571	28	Spillover
629	Dagupan urban area	Philippines	35	37	2	0.5	167,367	213,323	45,956	2.5	4,808	5,825	39	Fragmented
676	Lucena urban area	Philippines	11	16	5	3.7	124,417	185,455	61,038	4.1	11,375	11,775	79	Contained
770	Iligan urban area	Philippines	11	13	2	1.7	101,006	141,727	40,721	3.4	9,130	10,798	51	Contained
772	Tagum urban area	Philippines	15	21	7	3.8	91,253	138,986	47,733	4.3	6,266	6,560	139	Contained
777	Marawi urban area	Philippines	5	6	1	2.2	98,228	136,994	38,766	3.4	20,411	22,832	31	Spillover
842	Batangas urban area	Philippines	22	27	5	2.1	76,078	114,349	38,271	4.2	3,528	4,305	131	Spillover
843	Kabankalan urban area	Philippines	15	26	11	5.5	68,368	114,300	45,932	5.3	4,558	4,471	230	Spillover
858	Butuan urban area	Philippines	10	12	2	1.9	71,756	106,491	34,735	4.0	7,131	8,783	59	Contained

Source of table: The World Bank.