The Dynamics of Regional Development: The Philippines in East Asia

Edited by Arsenio M. Balisacan and Hal Hill

Preface and Acknowledgements

This volume may be seen as a sequel to our co-edited book, The Philippine Economy: Development, Policies and Challenges (Oxford University Press and Ateneo de Manila University Press, 2003).

This satisfying venture in transnational scholarship gave us the confidence to tackle a second major study of Philippine economic policy issues and challenges, set against the backdrop of East Asian development.

In exploring options, we quickly settled on the issue of regional development dynamics and decentralization, a topic we had both worked on separately in the past. Given the country's 7,100 islands and 170 spoken languages, the regional dimension has always been prominent in analytical and policy discussions of the Philippines. The country is the world's second-largest archipelagic nation, and it features great economic, social, demographic and ecological diversity. Policy makers have always had to wrestle with a range of daunting regional issues, from the centralizing biases which have concentrated resources in the national capital, Manila, through to deep and protracted insurgencies in the southern region of Mindanao and elsewhere.

Whilst remaining a unitary state, the Philippines was in 1991 one of the first countries in East Asia, and indeed in the developing world, to embark on a program of decentralization. The World Bank (2005) recently classified the country as a 'fast starter' in this respect, and as one with the 'strongest history of democratic decentralization' in East Asia.

As a decade and a half had passed since the introduction of a major program of decentralization, we judged it opportune to undertake a detailed examination of all aspects of the country's regional dynamics and policies.

We therefore hope that this volume will be relevant not only for an audience interested in the Philippines, a large developing nation with a population soon to exceed 100 million people, but also for a readership living in and working on the many other developing countries now embarking on such decentralization programs. To this end, we also commissioned studies of regional development in the two largest East Asian developing nations, China and Indonesia. In addition, we encouraged all our contributors to adopt a broader comparative perspective of the issues wherever appropriate.

We were also attracted to this topic by the growing intellectual interest in the fusion of trade and geography, commonly referred to as the 'new economic geography'. That is, that the notion of 'space' has to be taken seriously in economic, social and institutional analysis. This in turn opens up many interesting questions. For example, why do some regions grow faster than others? How should the problems of by-passed regions be addressed? Is inter-regional inequality a cause for concern and, if so, what are the most effective policy tools?

The Philippines exemplifies another key dimension of regional dynamics and policy. Like many developing countries, it has both liberalized and decentralized. That is, it is now much more open to the global economy, and political authority has to some extent been devolved out of the centre. Moreover, both these policy shifts occurred in the wake of a serious economic crisis, in the mid 1980s. Hence several forces are driving regional development dynamics. In particular, it is increasingly evident that the regions of the Philippines which are the most connected to the global economy are growing faster than the rest of the country. In turn, these regions are as well connected to, for example, neighbouring Hong Kong, as they are to their hinterlands — these global connections may be even better than the domestic ones.

Such trends are reinforced by decisions regarding infrastructure priorities and trade reform, and the quality of local governance. As the Philippine economy has opened up, international trade has become an increasingly important driver of local-level development. In turn, the bridges to the global economy — ports, airports, telecommunications — determine how effectively these regions can connect to the growth engine of the world economy. For example, almost all the growth in Philippine exports since 1990 has originated from free trade zones. In consequence, where these zones and their accompanying infrastructure are located becomes a key arbiter of regional dynamics. Meanwhile, the national government's often parlous fiscal position has contributed to the country's long-running under-investment in physical infrastructure, and hence the ability of much of the country's hinterland to connect to the nation's internationally oriented enclaves.

There are other attractions for studying regional development dynamics and decentralization in the Philippine context. The country's academic community is still arguably the strongest in Southeast Asia, certainly so after Singapore. There is also an open and active debate between academics and practitioners, which we have sought to capture in this volume. The country's regional literature and statistics are both more than adequate for a study of this kind.

In the final section of the introductory chapter, we offer what we consider to be ten major findings from the study. If we were forced to narrow this down to three, we would identify the following. First, while the decentralization program has more or less 'worked', the need is urgent for a clear, predictable, and stable regulatory environment which governs centre-region administrative and financial relations. Second, infrastructure is arguably the most important regional policy tool. Investment priorities shape regional development patterns profoundly, yet decision-makers are rarely able to develop these investments with such a framework in mind. Third, the country's most serious 'regional problem' is undoubtedly Mindanao. The resolution of its deep and protracted conflict is central to the well-being of not only the local population but also the nation as a whole.

As will be obvious, these issues transcend the narrower technicalities of regional policy and centre-region relations. We have organized the contents of this volume with such a framework in mind, and accordingly the authors examined regional development dynamics on a broader canvas than is perhaps customarily the case

Finally, it is a pleasure to acknowledge the support and assistance of many people and institutions.

Our primary debt is to our paper writers, who produced what we believe is a uniformly fine set of essays, and who responded in a timely fashion to our deadlines and queries.

We are most grateful to the Tokyo-based Asian Development Bank Institute for its generous support of the project. The Institute allowed us maximum intellectual freedom in the design of the project, and selection of topics and paper-writers. A particular word of thanks is due to the Dean of the Institute, Peter McCawley, who was unfailingly helpful throughout the project and its sometimes complex operations. The Institute's former Research Director, John Weiss, also contributed much to the project, including a paper for the volume. Both Peter and John kindly attended our preliminary workshop.

We organized the preliminary half-day workshop in February 2004, as well as a two-day workshop at which draft papers were presented and discussed in February 2005. Both these events were held at the Asian Development Bank headquarters in Manila. We are indebted to the Philippine Country Office of the Bank for its support and hospitality, with special thanks to Country Director, Tom Crouch, and Xuelin Liu, a staff member.

In thanking the Bank and the Institute for their support, we should note that we and the contributors are solely responsible for views expressed in the following pages.

We are also very grateful to the discussants at these workshops, who made these lively and highly informative events. We were very fortunate that this included a virtual 'who's who' of the Philippine academic profession. The participants included Alex Brillantes, Jr., Dante Canlas, Benjamin Cariño, Ramon Clarete, Benjamin Diokno, Raul Fabella, Felipe Medalla, Cayetano Paderanga, and Gerardo Sicat from the Universilty from the Philippines, Ponciano Intal from the De La Salle University, Mario Lamberte and Cristina David from the Philippine Institute of Development Studies, Abuzar Asra, Shiloditya Chattergee, Patrick Giraud, Xuelin Liu, Richard Ondrik, and Antero Vahapassi of the Asian Development Bank, and Eduardo Gonzales of the Development Academy of the Philippines. Secretary Romulo Neri of the

National Economic Development Authority shared his views during the finalization workshop. Other dignitaries who participated were Augusto Santos, Marcelina Bacani, Erlinda Capones, and Margarita Songco from NEDA, and Gigette Imperial from the Department of Labor and Employment. We also thank those who came from the AusAID, UNDP, and ADB.

We are most grateful to our publishers, Edward Elgar and Ateneo de Manila University Press (in particular Ma. Corazon Baytion), for their interest in our work, and for the friendly, harmonious working relations.

Finally, we wish to express our deepest thanks to two people who kept us on the road, and without whom this volume would not have seen the light of day. It is testimony to their stamina and our good fortune that they were both with us for the first volume as well.

Sharon Faye Piza managed the project right from the outset, fitting it into all the other commitments in her busy life, never missing a beat or losing her cool. We are delighted that she has co-authored the introductory chapter with us. Beth Thomson as always ran a tight and professional operation, calmly keeping us to our deadlines, and producing the highly polished final version.

AMB and HH
Manila and Canberra
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Chapter 1: The Philippines and Regional Development

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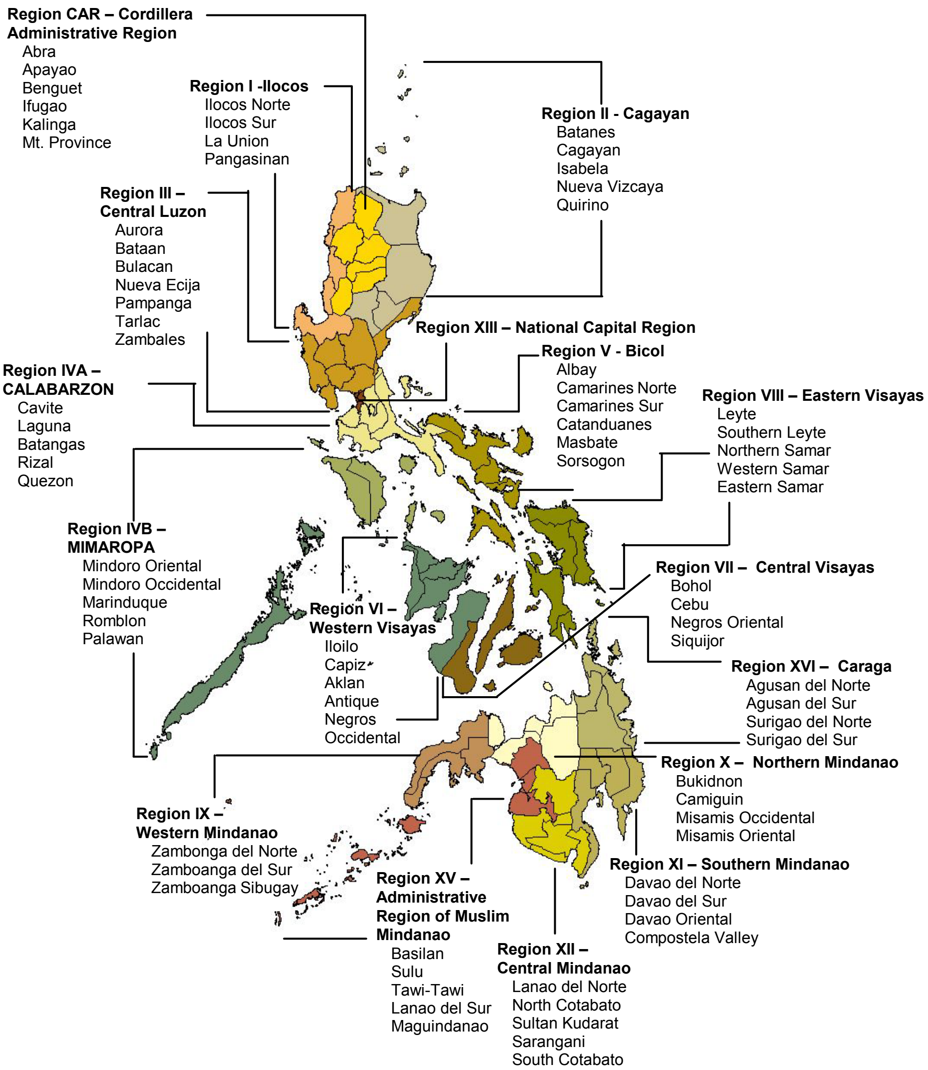
1. Introduction

A glance at the map immediately draws attention to the Philippines' unusual geography. Its 7,100 islands are emphasized in the country's tourist promotion programs, but they also highlight a deeper reality. With a population nearing 90 million people, the country is extraordinarily diverse in terms of geography, ecology, natural resource endowments, economy, ethnicity and culture. It is the second-largest archipelagic state in the world, after Indonesia. There are estimated to be 110 ethnic groups and 170 spoken languages.

Figure 1
The Philippines: Major Administrative Groupings, 2003



Economic activity is highly uneven and is concentrated particularly around the national capital and two adjacent regions, Central Luzon and Southern Luzon. Together, these three regions (out of a total of 16) produce about 55% of total national output.[1] Socio-economic indicators also vary significantly across regions. In the case of poverty incidence, for example, geography certainly matters. In 2003, poverty incidence in the national capital and two adjacent regions was estimated to be 13%, compared to the combined figure of 34% for the other 14 regions (see Balisacan, chapter 13). The head-count poverty estimate for the two poorest regions, Western Mindanao and the Autonomous Region of Muslim Mindanao (ARMM), both in the southwest of the country, was more than 10 times that of the national capital.

Historically, power has been highly diffused in the country. Manila's writ did not extend far beyond Luzon and the major urban settlements in the Visayas and Mindanao. The church was as much a national unifying factor as was the central government. Owing in part to geography, as the Philippines evolved towards a modern nation state, from the Spanish colonial era onwards it has always been regarded as 'difficult to govern' (De Dios, chapter 6). Parts of the southern island of Mindanao have experienced general lawlessness and long-running insurrections against rule from the capital. The islands stretching south-west from Mindanao are often alleged to be breeding grounds for terrorist activity in Southeast Asia and beyond.

Philippine policymakers have long grappled with the issue of how to promote broad-based regional development in such a diverse setting, and what sort of centre-region structures are optimal. The pendulum has swung back and forth between devolution and central authority. During the 20-year presidency of Ferdinand Marcos through to 1986, for example, the power of the centre increased significantly. Next, a major decentralization program commenced in 1992 with the enactment of the Local Government Code. With this background, a volume which examines the analytical and policy issues associated with regional development in the Philippines is timely.

Moreover, examining regional development can provide significant lessons to be applied not only in the Philippines, but internationally; other countries introducing more recent decentralization programs have much to learn from its experience. Thus, the rapidly expanding literature on the theory and practice of regional development in developing countries provides a second foundation for this volume. Central governments practically everywhere are under pressure to devolve administrative authority and financial resources to the regions. In some cases, this process is linked to transitions from a centrally planned to a market economy (e.g., People's Republic of China, Russia, Viet Nam). In others, it occurs in the wake of deep economic and political crises, following the

[1] The regional classification of provinces and cities has changed many times during the past 25 years. Throughout this chapter, unless otherwise specified, we use the 1997 classification, which groups the provinces into 16 regions. Currently (i.e., 2006), the number of regions is 17, following the split of Region 4 (Southern Luzon) into two regions, Mimaropa and Calabarzon.

overthrow of a centralized, authoritarian regime (e.g., Marcos's Philippines, Soeharto's Indonesia). Fear of national integration (Indonesia again, post-Timor Leste) is sometimes a factor. Some experiments are 'big bang' and hasty (e.g., Russia and Indonesia, much of Latin America), while other countries have a long history of federalism and have well-developed institutional structures governing centre-region relations (e.g., India, Malaysia).

Accompanying these reforms, as countries further open up to the global economy, sub-national dynamics alter — sometimes profoundly. The regions best able to connect commercially to the global economy invariably grow more rapidly than the rest of the national economy grows — sometimes (as in coastal China) spectacularly so. Conversely, the problems in so-called bypassed regions may become more serious. Where there is a coincidence of economic, political, and ethnic/religious grievances, as is not uncommon, the challenges have broader international repercussions, in extremis linked to the connections between 'failed states' and incubators of terrorism.

In this chapter, we introduce the principal analytical and policy issues in regional development and centre-region relations, with special reference to the Philippines. We also synthesize the key findings from the 12 chapters which follow. Section 2 sketches an analytical framework and highlights our major questions. In section 3 we assess this record in comparative context, with special reference to the two largest developing nations in East Asia, the People's Republic of China (PRC) and Indonesia. We then examine in detail the Philippine record in section 4, in light of both its national development objectives and the general lessons from the regional development literature. The last section provides a forward-looking, policy-oriented summary of our arguments.[2]

2. The Issues

Regional science is now at the forefront of development issues. 'New economic geography has come of age', in the words of Neary (2001). Arguably, no author has done more to popularize the intellectual fusion of trade and geography than Paul Krugman in his 1991 volume. As he argued (p. 3):

> '... one of the best ways to understand how the international economy works is to start by looking at what happens inside nations. If we want to understand differences in national growth rates, a good place to start is by examining differences in regional growth; if we want to understand international specialization, a good place to start is with local specialization.'

[2] We eschew here broader issues related to the country's indifferent economic performance since 1980. These were covered in our companion volume (Balisacan and Hill, eds., 2003).

For several reasons — analytics, policy, deeply entrenched spatial inequality, transitions from economic crises or command economies, and the uneven impacts of rapid global integration — spatial disparities and centre-region relations are the focus of much attention in the developing world. As countries have liberalized and decentralized, the analytical prism of the 'new economic geography' aids our understanding of the dynamics of regional development. We draw upon such a framework extensively in this volume. Among the questions we ask, in a Philippine and a comparative East Asian context, are:

- What determines sub-national patterns of development, and are these factors similar to those shaping inter-country differences?
- What determines trends in sub-national inequality, and should high inequality be an issue of concern?
- Are bypassed regions likely to become a serious national (and international) challenge as central governments retreat in authority and place less emphasis on inter-regional equity?
- As national boundaries become more porous and central governments less powerful, will cross-border 'natural economic zones' become increasingly important in the global economy?
- What are the key issues and lessons in decentralization reforms, and why are some programs more successful than others?
- Is regional (sub-national) competition likely to improve local-level (and therefore national) governance quality?

The twin themes of decentralization and globalization are the analytical threads which unite and integrate the following chapters. Both have profoundly altered the character of governance and the location of economic activity in developing countries. Decentralization has resulted in a restructuring of the bureaucracy and a significant shift in public sector resources towards local governments. Globalization has integrated local economies within the global economy. Policy reforms have driven this process, reinforced by rapid technological progress in telecommunications, information flows and logistics.

These developments — global and local, technological and policy-driven — have triggered a reassessment of the importance of location and space in many countries. Moreover, and complicating the process, local-level impacts are invariably uneven. Although decentralization arrangements typically incorporate some safeguards for fiscal equalization, the capacity to seize opportunities from global integration depends crucially on the availability of complimentary local inputs, including transport facilities (ports, airports, and feeder roads), a business-friendly environment, local institutional quality, and entrepreneurial talent. For a variety of reasons, these attributes are distributed unevenly. Thus a collection of internationally connected regional clusters sometimes emerges, while domestic integration may proceed more slowly. The challenge for policymakers at the national level and in bypassed regions is to better connect to the more dynamic clusters and thereby to the international economy.

Of course, the motives for decentralization vary widely. Economic and political crises may trigger major (and sometimes hasty) decentralization programs, especially when authoritarian, centralized regimes crumble. Within the past two decades, for example, Indonesia, the Philippines and Russia have all experienced deep economic crises and far-reaching institutional and political change. Increased regional autonomy featured prominently in the democratic reform agenda of all three countries. Both Indonesia and the former USSR ceded territory in the wake of these crises. Thus, fear of national disintegration introduced an added urgency to these countries' reforms. These and other examples also remind us that the disparities which give rise to sub-national conflict are generally just as much religious, ethnic and political as they are economic.[3]

Especially in large, spatially diverse countries, there is frequently disenchantment with rule from the centre.[4] Local communities often regard capital cities as corrupt, authoritarian, arrogant and remote. Regional development concerns are also motivated by frustration with failed attempts to achieve progress in so-called bypassed regions. While capital cities might tend to ignore these regions, in many cases strategic and political considerations dictate that they should do otherwise. For example, Indonesia's eastern islands, also traditionally the poorest in that country, occupy vast maritime resources and straddle major international shipping lanes.

In some countries, increased regional autonomy may be an incidental consequence of the transition from plan to market. As governments dismantle a command economy and the size of the state enterprise sector shrinks, economic authority inevitably passes from central government planners to private economic agents, so power is decentralized even in the absence of a formal decentralization program. The PRC, Russia, Viet Nam and other formerly centrally planned economies illustrate this proposition. In all cases, specific decentralization initiatives were also in place, but the primary initial driving force was the decision to de-emphasize central planning.

It might be surmised that the so-called 'death of distance', driven by trade liberalization and declining logistics costs (broadly defined to embrace all aspects of transport and communications), would result in a deconcentration of footloose economic activity, and therefore potentially lead to a narrowing of spatial disparities. Yet as Weiss (chapter 2) points out, the trend towards

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[3] That is, in most of the world's localized trouble spots in recent times — Kosovo, Chechnya, Kurdistan, the Tamil Tigers, Kashmir, Tibet, Mindanao, Aceh, Bougainville to name just a few — demands for autonomy or independence typically exhibit a mix of ethnic, religious, political and socio-economic motives, often fanned by inept military intervention from the centre.

[4] While regional issues are of most concern in spatially large economies, they also surface to a surprising degree in small and seemingly homogeneous states. Yoon (2000), for example, notes the importance of regions in the Republic of Korea's political economy structures. East Timor, the world's newest nation, with an economy equivalent to that of a small city in the west, has established no fewer than 13 regional governments in deference to local sentiment.

clustering shows no sign of abating: physical proximity still matters. This suggests that the increasing returns to scale and positive externalities associated with location still matter. In addition, trade liberalization has to be accompanied by expanded domestic infrastructure to avoid the emergence of a set of internationally-oriented enclaves. The entry of foreign investors is another likely unequalizing factor associated with liberalization and limited infrastructure expansion. These firms will attach high priority to international connections. They will also attract the most skilled workers, who are disproportionately located in the major urban centres.

Indeed, as international barriers to commerce decline, sub-national barriers may actually rise. A mixture of local identity, poorly defined centre-region fiscal structures, and inadequate infrastructure explains these patterns. Some coastal economies are better connected to overseas ports than they are to their hinterland regions due to poorly developed national infrastructure and restrictions on the entry of potential providers. For example, it is cheaper to transport goods from Shanghai to Los Angeles than to do so from Shanghai to parts of the PRC's distant west (Carruthers et al., 2004). Geography also shapes regional development patterns and infrastructure provision, so the power of 'one-size-fits-all' infrastructure policy prescriptions is limited.[5]

Moreover, decentralizing the authority to tax may complicate the process of national economic integration, particularly when it gives rise to the phenomenon of 'over-grazing'. Following (and even preceding in some cases) Indonesia's decentralization of 2002, some local governments began imposing taxes on inter-provincial trade; this may have been motivated by the serious need to raise local revenue or simply by corruption. The proliferation of these taxes in regions adjacent to open economies with excellent infrastructure — Sumatra is one example, with its proximity to Singapore — may over time result in those regions becoming more integrated with the global than with the national economy (as some were in the 1950s).[6] As another illustration, Indian states have long imposed restrictions on the movement of essential commodities. In that country, and others, regional labour market barriers (e.g., hiring preferences by local governments, emphasis on local linguistic proficiency) inhibit national integration.

In the absence of a corrective policy regime and free internal mobility of resources, globalization is likely to increase sub-national disparities. The

[5] Infrastructure provision and priorities will differ greatly according to various geographical configurations. Consider the following illustrations: First, countries with long and narrow land mass, poor or limited internal infrastructure but extensive river systems to the coast (e.g., Viet Nam especially, also Chile); second, archipelagic nations such as Indonesia and the Philippines with ease of access to coastal shipping routes but a poorly connected hinterland; and third, countries like the PRC and Russia with a vast interior relatively unconnected to international commerce.

[6] In passing, this example also draws attention to the fact that regions increasingly extend beyond national boundaries, especially where cross-border commercial barriers are minimal and infrastructure is coordinated, as in the Singapore-centred Sijori growth triangle.

uneven distribution of natural resource endowments and locational advantage will likely exacerbate these differences, which are particularly evident in diverse responses to an exogenous shock. During Indonesia's economic crisis of 1997–1998, for example, urban Java was the worst affected region. By contrast, some export-oriented agricultural regions off-Java were little affected by the crisis and benefited from the sharp exchange rate depreciation. Similarly, with regions now entitled to a larger share of natural resource rents, buoyant commodity prices have uneven local impacts.

Although there are diverse and powerful pressures to shift power and resources out of the centre, there is no consensus in the literature on how far and how quickly decentralization ought to proceed. As Bird and Villancourt (1998, p. 1) observe, 'Decentralization [is neither] a plague or a panacea.' The general presumption is that policy competition between regions is desirable and that, beyond the obvious areas of central government responsibility, such as macroeconomic policy, law, foreign policy and defence, decision-making should be as close as possible to stake-holders. For example, the fiscal federalism literature asserts that, with sufficient mobility of voters and capital, decentralization would provide a spur to efficient service delivery, and that local governments are likely to be more responsive to community needs than are those at the centre. Hence the notion that competition for tax and service delivery will act as a discipline on bureaucratic excess and low quality governance among regions; the argument asserts that mobile factors will exit jurisdictions which fail to deliver. Nevertheless, the challenge for hypotheses which are generated by this literature is to explain why, in cross-country comparisons, there appears to be no discernible correlation between the degree of decentralization and economic growth (Martinez-Vazquez and McNab, 2003).

Moreover, to what level of local government should authority be decentralized? In turn, this begs the definitional question as to just what constitutes 'regions'. Official definitions are frequently arbitrary and are often changed. Boundaries may reflect political or ethnic divides rather than constituting natural economic zones. Although analysis has to be dictated by data availability, for some purposes groupings of provinces or states are more appropriate.[7] We address this issue in the Philippine context below.

There is a large literature attempting to explain international differences in growth rates, but much less has been written on inter-regional differences. Can one draw on the former to help explain the latter? In a world of perfect factor mobility and homogeneous nation-wide institutions, the answer is presumably no. Moreover, regions within a country have the same macroeconomic environment and trade regime, and generally operate within the same

[7] In the case of Indonesia, for example, the provincial economic surveys in Hill (ed., 1989) were classified into five categories that do not correspond to the major island groupings: densely populated, resource-rich, isolated, 'settled' off-Java, and sparsely settled.

institutional context (a common legal system, etc.). However, as Hill (chapter 3) points out, the growth literature can be productively used in a modified form. That is, openness can be redefined to mean 'connected' (to the global economy); institutions clearly do differ among regions in many countries; and factor and product markets in developing countries are often poorly integrated.

Similarly, the evidence on long-term trends in inter-regional inequality is mixed. Williamson (1965) hypothesized a Kuznets curve for the relationship between income per capita and regional inequality. That is, inequality rises through to some turning point, and then declines. The intuition underlying this reasoning is that, at early stages of development, rapid growth is an inherently unequalizing force. However, beyond some threshold, equalizing forces come into play; for example, markets begin to work better and governments introduce explicit fiscal equalization mechanisms. In the mid 1960s, there were virtually no regional data for developing countries. The subsequent empirical estimates highlight significant differences among countries with regard to both levels of and trends in spatial inequalities, without any clear correlates (rates of growth, openness, system of government, etc.).[8] Why, for example, among the mostly open and fast-growing East Asian economies has inter-regional inequality increased significantly in the PRC and Thailand since the 1980s, but not in Indonesia or Malaysia?

3. East Asian Comparisons

The volume includes comparative chapters on the lessons from the two major developing East Asian economies: the PRC and Indonesia. Both are decentralizing rapidly, both are considerably larger than the Philippines, and both, especially the PRC, have a higher long-term average growth than the Philippines.

The PRC's regional dynamics have several inter-related features (Song, chapter 4), all of which are set against the backdrop of extraordinarily rapid economic growth: rising inequality, the uneven impacts of global integration, and the transition from plan to market. The growth of the eastern zone has been remarkable, resulting in its share of the fast-growing national economy rising from 48% in 1980 to 61% in 2003. Under certain assumptions, theory predicts that convergence is more likely across regions than countries, owing to fewer intra-national barriers to labour mobility. Yet, after a long period of decline, inter-regional inequality has been rising, particularly since the early 1990s.

Four main factors account for this recent increase in inequality.[9] First, the regions differ dramatically in their international orientation. In the eastern zone,

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[8] See for example Kanbur, Venables and Wan (eds.) 2005.

[9] See also the special issue of Journal of the Asia Pacific Economy, 10 (4), 2005, devoted to 'Growing Inequality in China', together with an extensive literature cited by Song.

the export/GRP ratio was 41% in 2003, some eight times that of the western zone. Similarly, foreign direct investment constitutes about 11% of investment in the east, but only 1% in the still SOE-dominated economy in the west. Second, until recently, restrictions on labour market mobility, in particular the huko (household registration) system, meant that the labour market was unable to play a role as an inter-regional equilibrating mechanism. Moreover, some barriers to inter-regional commerce remain in place. Third, domestic physical infrastructure has not kept pace with the rapid growth, thus reinforcing the policy-induced international commercial orientation of firms in the eastern zone.

Finally, the devolution to the PRC's regions has reinforced the general trend towards the 'retreat from inequality'. Since the 1994 reforms, fiscal authority has become highly decentralized, and sub-national governments now account for 70% of total budgetary expenditure. In turn, this has accentuated inter-regional inequality, as richer regions are better able to provide growth-enhancing public goods and are more adept at exploiting international opportunities.

Perhaps this rapid increase in inequality will plateau. In recent years, the central government has become more concerned with inter-regional equity. There are measures to boost investment in agriculture, infrastructure and public education in the central and western regions. Internal migration has been freed up and the lower cost base in the central and western regions is attracting more investment.

Indonesia shares more similarities with the Philippines. It is an archipelagic nation and it embarked on a decentralization program in the wake of a major economic crisis and a weakened central government. It also has resource-rich frontier zones with a long history of insurrection. The lessons from the Philippine experience, as outlined in this volume, are more relevant to Indonesia than to any other country.

Nevertheless, as Resosudarmo and Vidyattama (chapter 5) point out, there are also significant differences between the two countries. Although Indonesia was a highly centralized regime under Soeharto (arguably more so than was the Philippines under Marcos), regional development was remarkably broad-based. Most regions grew at similar rates, resulting in no significant deterioration in inter-regional inequality. The key to this record was the system of central government disbursements, which were reasonably pro-poor, generous and predictable. A particularly important instrument of regional policy was the massive investments in physical infrastructure over this period in Indonesia, which were more on the scale of Malaysia and Thailand than that of the Philippines.

A second difference has been the concentration of resource-rich enclaves, principally in northern and central Sumatra, East Kalimantan, and Papua (Irian Jaya). These have posed special development challenges: how to distribute the resource revenues between the centre and the regions, and how to ensure reasonably balanced development elsewhere.

Third, while there are parallels between the major islands of Java and Luzon, the differences are just as great. Java has a much greater population concentration.[10] Moreover, the regional dynamics have differed. Historically, the so-called 'Outer Islands' of Indonesia (all except Java and Bali) were richer, owing to their natural resource endowments and favourable land-labour ratios. However, as commodity prices declined in the 1980s and major reforms were introduced, Java became the principal engine of growth with its export-oriented manufacturing economy and more sophisticated services sectors. The two countries' sub-national development dynamics have thus differed significantly over the past quarter-century.

Related to the latter point, Resosudarmo and Vidyattama draw attention to the various exogenous and unintended impacts on Indonesia's regional dynamics. International commodity prices are one such example. Buoyant prices stimulated development in the resource-rich regions, albeit with the mediating mechanism that much of the resources were taxed by the centre and transferred to other regions. Another illustration noted above is that the 1980s liberalizations unleashed rapid, export-oriented industrialization on Java and other regions (Bali, Batam, Medan) well connected to the global economy. The economic crisis of 1997–1998 introduced a further hierarchy of effects, with the natural resource regions off-Java benefiting from the sharp exchange rate depreciation, while the larger share of modern commerce and import-substituting manufactures depressed growth on Java for several years.

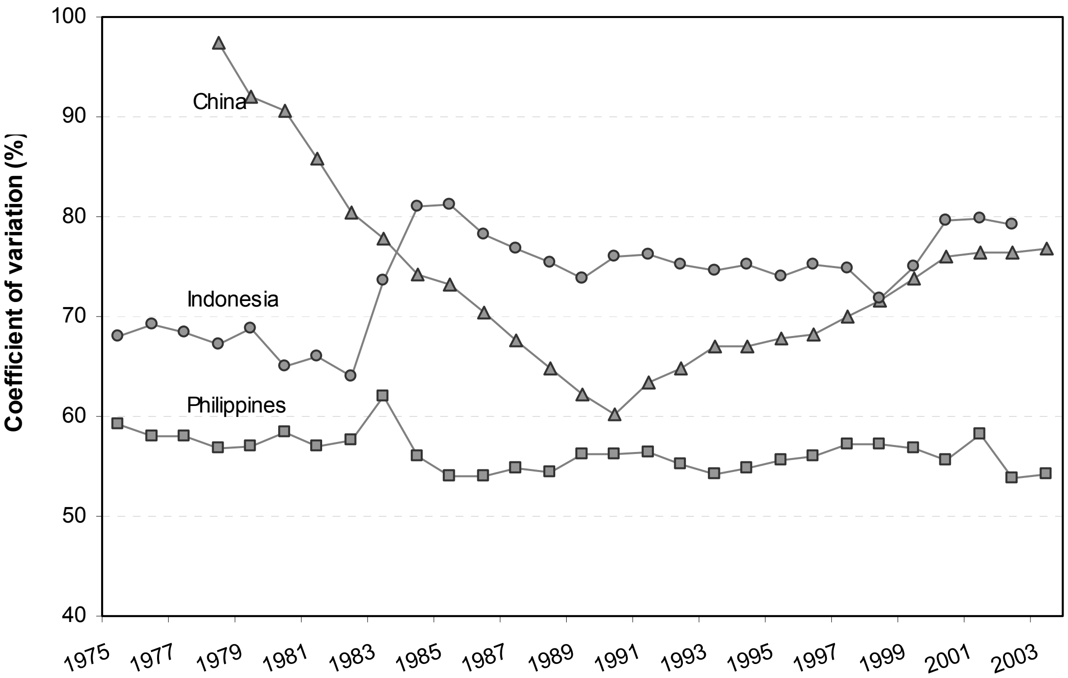
Finally, as in the PRC and the Philippines, successive Indonesian governments have struggled to promote growth in poor and bypassed regions. Much of the efforts have focused on the country's vast, marine-rich eastern islands. These have poorer infrastructure, more limited human capital (with some notable exceptions), and are distant from the commercial (and political) mainstream. Jakarta's management of the huge Papua province remains controversial. Migration has been a key element in the story, with the 'best and brightest' typically moving to Java for education and jobs, although especially in the 1970s and 1980s the government's official transmigration program did sponsor much migration in the opposite direction. It is perhaps noteworthy that, for all these problems, since the 1970s most of Eastern Indonesia has grown at rates not too much slower than those of the national economy and considerably faster than the Philippines.

Figure 2 extends the three-country comparison of trends in sub-national inequality by showing coefficients of variation of provincial/regional per capita incomes. Owing to differences in welfare measures and levels of administrative

[10] Java has 7% of the land area but 60% of Indonesia's population; the respective figures for Luzon are 50% and 56%.

disaggregation, the series cannot be strictly compared across points in time. However, trends are indicative of patterns of inequality. The PRC story displays rising inequality, although current levels remain below those of the late pre-reform era. The Indonesian series, based on per capita non-mining provincial income, shows a modest change over time, particularly since after the upward blip in the early 1980s. Including mining, the series would show a very different story (not shown in Figure 2): levels of inequality are considerably higher in the 1970s, but then decline from around 1980 in the wake of declining oil prices, and remain quite flat thereafter. These trends are generally consistent with the view that regional dynamics, including policy-mediating mechanisms, allowed income growth to be broadly based across regions of Indonesia. In the case of the Philippines, the story is one of generally flat levels of inequality throughout the period (mid-1970s through early 2000s). While seemingly surprising, given the findings reported in this volume that infrastructure investment in support of regional development and integration was paltry in the Philippines compared to both Indonesia and the PRC, the stability of income inequality should be seen in the context of the country's comparatively poor performance in overall economic growth during this period. Moreover, this stability mirrors well the very modest changes in national income inequality in the 1980s through the early 2000s (see Balisacan, 2003). Here, too, the conclusions differ depending on the choice of administrative regions and welfare variable.

Figure 2
Regional Inequality in China, Indonesia and the Philippines



Note: Figures are coefficients of variation of real per capita regional incomes.
In China and Indonesia, the regions referred to are the provinces.
The Indonesia series excludes mining provinces.

Source: China Statistical Yearbook (various issues)
Indonesia Badan Pusat Statistik
Philippine National Income Accounts

4. The Philippine Experience

(a) Evolution of Regional Policy

The Philippines has evolved into a nation state since the highly decentralized Spanish colonial era, in which the Catholic Church was as much a national institution as the Manila government (De Dios, chapter 6). The Spanish period was characterized by a weak central administration and a collection of largely self-sufficient local communities in which a ‘dense set of social relationships’ was more important than were formal administrative structures. Power structures historically were not conducive to national development planning and priorities due to the dominance of local histories and orientation.

Nevertheless, especially from the American colonial period (1898–1946) onwards, national governments have become increasingly important. This process of ‘creeping centralization’ has been driven by many factors: the assumption of national powers to tax and spend, the need for a stronger national government for defence and foreign policy reasons, foreign aid and development assistance, and concerted development strategies which required a more active central government, all reinforced by the patronage politics of national capitals.

‘Regionalization’ as a strategy to attain national development goals began to figure prominently in Philippine development thinking and planning in the 1960s. The various medium-term Development Plans, starting from the presidency of Diosdado Macapagal (1962–1966), recognized the importance of geographically dispersing the benefits of economic development. However, it was only in the 1970s that a full commitment to regional development was evident, as indicated by the efforts of the National Economic and Development Authority (NEDA) ‘to develop a systematic and comprehensive approach to determine investment priorities within and across sectors and regions’ (Alonzo, 1994, p. 203).

Indeed, Pernia et al. (1983, p. 36–37) refer to the 1970s as the ‘regional awareness period’. They maintain that several interrelated factors accounted for the central government’s increased attention to the regions. First, there was a concerted and quite successful program to increase agricultural productivity, partly in response to declining agricultural production and the then historically high rice prices. Although the impact of the benefits was spatially uneven, especially between the favoured, irrigated regions and the rest, the result was at least an increased priority for rural areas. Second, there was growing concern about the costs of urban congestion, particularly about the failure of Manila’s infrastructure to keep pace with population and industrial growth. This led to a number of measures: a ban on new industrial projects within a 50-mile radius of Manila’s centre, fiscal incentives for firms locating outside the capital, and a set of ambitious ‘11 major industrial projects’, mostly heavy industry to be located in the regions. These initiatives were largely ineffective, and were in any case overtaken by the deep economic crisis of the mid 1980s, but at least they were indicative of policy thinking at the time. Third, the post-Independence strategy of extensive import substitution was being increasingly questioned by the late 1970s, and with it by implication the centralizing bias of a complex set of implementing controls and import protection. Finally, there was a growing recognition that the ever-present insurgencies — from the disaffected Muslim community in the south and the communist New People's Army in several regions — had their origins fundamentally in deep-seated socio-economic grievances, which had to be addressed as part of any durable peace settlement.

In the late years of the Marcos regime, serious work began on a reformulation of centre-local relations. In fact, the Local Government Code (LGC) of 1991 is actually similar to a draft prepared in 1983. In the 1980s, of course the national political context changed dramatically with the return of democracy and the advent of a fiscally incapacitated central government, but much of the preparatory administrative work had already been undertaken, and on paper the division of responsibilities between the centre and regions is reasonably clear. Serious research on the intricacies of centre-local relations, especially concerning fiscal arrangements, had also commenced; the major Bahl-Miller (eds., 1983) study was one result of this.

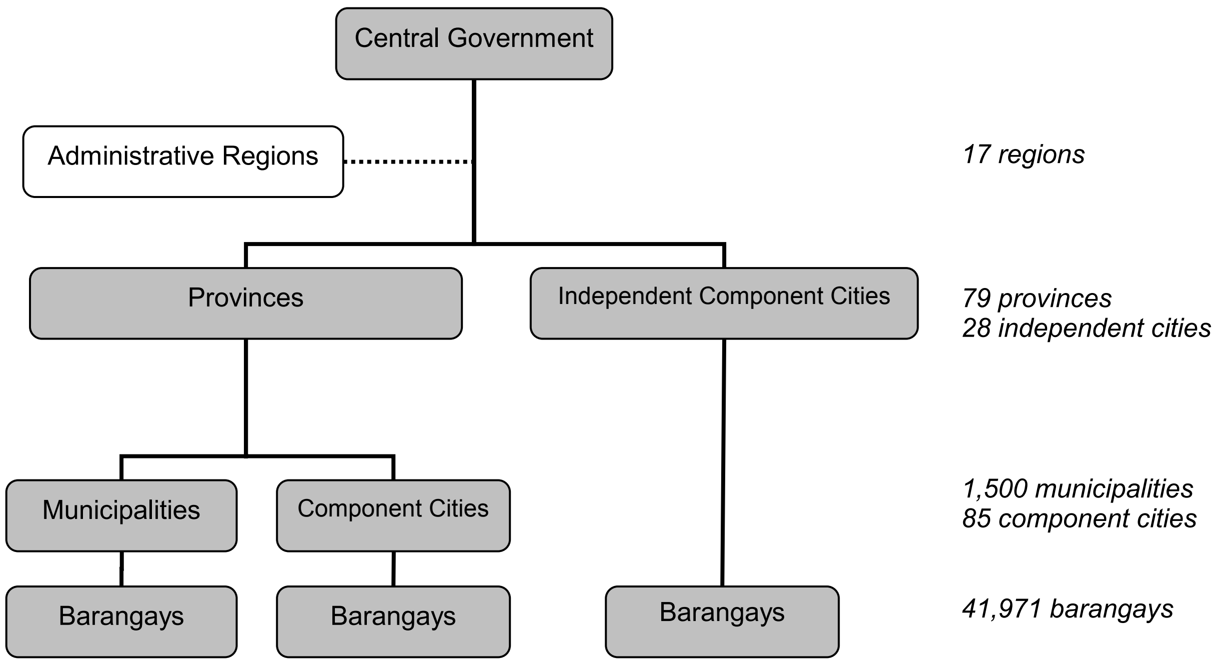
The latter volume (see especially Bahl and Schroeder, 1983a and 1983b) drew attention to the fact that, for all the rhetoric, the Philippines was a highly centralized state during this period, with the central government in effect delegating to the various local government units. In fact, during the 1970s, the share of local governments shrank sharply as the Marcos administration assumed ever more central control. For example, the local government share of total public sector expenditure declined from 20.7% in 1969 to 10.3% in 1979. The relative importance of their own source of revenues also declined. The reach of central government '… extended to day-to-day influence on fiscal decisions and administrative procedures' (Bahl and Schroeder, 1983a, p. 42). This centralization also greatly weakened the local government incentives for resource mobilization and efficiency.

Viewed comparatively, certainly among Asian unitary states, the Philippines moved early and quickly. Within East Asia it was the first country to systematically decentralize, and it has the 'strongest history of democratic decentralization' in the region (World Bank, 2005, p. 26). Furthermore, the Bank report (p. 6–7) classifies East Asian decentralizers as 'fast starters' (Philippines, Indonesia), 'incrementalists' (PRC, Viet Nam), and 'cautious movers' (Cambodia, Thailand). The first two are so classified because their reforms occurred against the backdrop of turbulent national political changes. In some respects the Philippine approach was therefore 'big bang'. However, seeing the approach solely as such would be to simplify greatly. The reform was carefully prepared in advance (unlike in Indonesia and some Latin American cases) and was relatively modest in scale. The Philippines also differed from some of its neighbours in that the arrangements have not been modified subsequently to any significant extent.

(b) Current Regional Structures

Figure 3 shows the current administrative organization of the Philippines. The country is a unitary state, a presidential republic with a bi-cameral legislature. The central government has approximately 20 departments and agencies. The country is divided into 17 regions. However, with the exception of the Autonomous Region of Muslim Mindanao (ARMM), these are essentially administrative regions, in which central government regional offices are located. Article X of the 1987 Constitution provides for the territorial and political subdivision of the Philippines into provinces, cities, municipalities and barangays. The formal second tier of government, comprising local government units (LGUs), together with the ARMM, consists of three layers, all democratically elected. The first of these is the province, headed by an elected governor, and in turn divided into municipalities and 'component cities' (headed by elected mayors). These are further subdivided into the lowest tier of government, the barangay, headed by an elected captain. In addition, there exist so-called 'independent cities', which are at the same level as provinces and which are directly divided into barangays.

Figure 3
Local Government Structure, 2003



Source: Department of Interior and Local Government

All elected officials have a three-year term and are subject to a three-term limit. Each tier of local government is in principle autonomous, but they are subject to some degree of supervision from higher levels. However, this supervision is limited to ensuring that their budgets and ordinances comply with the provisions of the LGC (also known as Republic Act No. 7160) of 1991 and subsequent amendments, which define centre-local governmental relations in the Philippines. The LGC also contains an element of ambiguity: each territorial or political subdivision enjoys local autonomy, but the President has supervisory authority over local governments.

The lines of authority from the centre changed in 1992. However, contrary to widespread impressions, there has not been a pronounced fragmentation of administrative and political authority. The number of regions has increased by four, hence complicating statistical analysis. As of 2005, there were 80 provinces, 114 cities, 1,496 municipalities and 41,945 barangays. In 1991, immediately prior to decentralization, the relevant numbers were respectively 75, 60, 1,543, and 41,820.[11] The major change has therefore been the near doubling of cities, accompanied by a decline in the number of municipalities. This change reflects in part the country's continuing high population growth and urbanization. But the more generous fiscal treatment of cities, especially chartered cities, has also been a factor, as we discuss below.[12]

Each region is composed of several provinces. The province is the largest local administrative unit; it is headed by an elected governor, who is assisted by a vice governor and council members (known as <u>sangguniang panlalawigan</u>). Other officials are appointed to head offices of finance, tax collection, audit, public works, agriculture, health and education. Although these appointees are technically subordinate to the governor, they also answer to their respective central government departments, hence introducing another potential layer of ambiguity. Lower ranking positions, appointed by the governor, are on the provincial payroll.

As stipulated in the LGC, cities constitute the more urbanized and developed <u>barangays</u>, which are created, divided, merged, abolished or have their boundaries altered by law, as an act of Congress, subject to the approval of a majority of votes cast in a plebiscite conducted by the Commission of Elections. A city may be classified either as a component or an independent component city; the latter are also known as 'highly urbanized' or 'chartered' cities. A city government is headed by a mayor, assisted by a vice-mayor, council members (<u>sangguniang panlunsod</u>), and other appointed officials. Chartered cities are a

[11] The numbers had changed little from the late 1970s, when there were 75 provinces, 60 chartered cities and 1,484 municipalities (Bahl and Schroeder, 1983a, p.1).

[12] In passing, it might be noted that Philippine administrative boundaries have not altered as dramatically as did those in Indonesia during its decentralization experiment. In the latter case, the number of second-level regions (<u>kabupaten</u> and <u>kota</u>), to which power and finances have been devolved, rose by 50% in the five-year period 1998-2003. Local-level activism, a weakened centre, and distortions in centre-region fiscal arrangements that rewarded fragmentation explain this development (Fitriani et al., 2005).

special category in the sense that they are independent and are not part of any province. They do not elect provincial officials and they are not subject to any provincial taxation. They do, however, have the power to levy their own taxes.

Municipalities consist of a group of barangays. They are subordinate to the provincial government. Municipal governments comprise a mayor, vice-mayor, sangguniang members, and other appointed officials. The barangay is the smallest local government unit, and has the least autonomy. It is headed by a locally elected barangay captain.

The LGC provides a comprehensive framework for centre-region relations. It specifies the transfer to LGUs of a wide range of functions and services, and divides responsibility for their provision among the various local tiers. Some 70,000 staff from central government departments were to be transferred to the LGUs, with the largest transfers from the Departments of Health (65% of the total) and Agriculture (25%). However, programs which are considered to be ‘national’ are retained by the central government, including in these portfolios.

The Code also specifies a division of responsibility with regard to revenue assignment. These include the allocation of tax powers, including in some cases specified rates, together with revenue-sharing provisions among LGU tiers where relevant. The major tax reserved for LGUs is on property. The central government retains authority for income tax (both personal and corporate), customs and excise duties, and the value added tax. The Code also specifies an Internal Revenue Allotment (IRA), requiring that 40% of all internal revenue collections (calculated with a three-year lag) be allocated to local governments according to a formula based on land area, population and incomes.

The political economy of regional governance reflects national patterns. In particular, (a) there are frequent turnovers of administrations; (b) the bureaucracy is weak and much of it highly politicized; and (c) major families heavily penetrate both the administrative and political wings of government.[13] As noted below, most regional governments are dominated by a complex web of elite families who are generally also represented in national and local bureaucracies and in national politics.

(c) Overview of Regional Development Patterns

Tables 1–5 describe in detail the Philippine regional geography. We focus mainly on the regions because the number of provinces is too large to handle in a set of descriptive statistics, and because some of the data (e.g., the regional accounts) are available only at the regional level.

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[13] On the latter phenomenon in general, see McCoy’s (1994) analysis of the ‘anarchy of families’.

For analytical purposes, should a typology of Philippine regions be developed based on criteria other than geographic location? As noted above, the literature on regional development has often found it convenient, especially in large and spatially diverse countries, to group regions based on common characteristics or development attributes which do not necessarily correspond to location. The previous major study of regional development in the Philippines (Pernia et al., 1983), identified 4 such regions: Metro Manila, a ‘central industrial region’ (based on the two regions surrounding Manila), a ‘traditional agricultural region’ (Ilocos in the north and Bicol in the south of Luzon, together with the Visayas), plus a ‘frontier region’, comprising Mindanao and the Cagayan Valley in the northeast of Luzon.

A quarter of a century later, such a classification does not sit easily alongside the country’s inexorable population growth and the modest expansion of infrastructure. With the possible exception of the island of Palawan, hardly any regions can now be regarded as ‘frontier’. In principle, alternative schema could be developed, based on detailed provincial classifications. In practice in such an exercise, however, diminishing returns quickly set in and there are insurmountable data constraints for longitudinal comparisons. While recognizing their imperfections, we therefore follow the official administrative divisions. In addition we use the Luzon-Visayas-Mindanao grouping for some time series data, as well as distinguishing Manila and its two immediately adjacent regions as the country’s dominant industrial region.

(i) Patterns of spatial concentration: Manila dominates the Philippine economy, generating a little over one-third of the country’s GDP in recent years (Table 1). Combining the two regions immediately surrounding it (Central Luzon and Southern Luzon), in which the major economic activities are proximate to the national capital, this central region produces about 58% of the country’s GDP. Luzon in aggregate contributes almost two-thirds of the national economy, and is by far the largest of the three major island groupings (Table 2). Its economy has also grown marginally faster than the national economy since the 1970s, resulting in a gradual rise in its national share. The share of the other two regions has changed little, with the Visayas around 16–17%, and Mindanao in the range 17–21%. The latter’s gradually declining share underscores the unfulfilled potential of this resource-rich region, an issue to which we return shortly.

Table 1
Key Economic Indicators, 2003

Region	Per capita RGDP	Composition of RGDP (%)			RGDP Growth rates, 1985-2003
		Agriculture	Industry	Services	
Philippines	*100.0*	*15.0*	*31.8*	*53.2*	*3.1*
NCR	275.8	-	37.1	62.9	3.4
CAR	129.9	11.0	56.5	32.5	6.4
Ilocos Region	53.7	36.0	8.9	55.1	2.5
Cagayan Valley	52.3	45.8	7.5	46.7	2.8
Central Luzon	75.2	20.5	32.7	46.8	3.0
Southern Luzon	85.7	20.2	37.5	42.3	3.5
Bicol Region	43.3	22.7	16.1	61.2	2.2
Western Visayas	83.5	22.6	25.7	51.7	2.9
Central Visayas	93.4	10.4	27.9	61.7	3.7
Eastern Visayas	50.5	29.9	25.7	44.4	2.0
Western Mindanao	62.1	40.2	14.8	45.0	2.4
Northern Mindanao	101.8	28.6	30.2	41.2	2.7
Southern Mindanao	92.4	25.2	25.2	49.6	1.7
Central Mindanao	76.6	40.2	28.0	31.8	3.4
ARMM	23.2	48.6	10.3	41.1	2.5
Caraga	47.8	38.0	18.0	44.0	2.1

Note: Average per capita GDP for the Philippines in 2003 prices is Php 52,470. GRDP shares and growth rates are averages for 3 years centered at the year indicated (i.e. 1985 figure is the average for 1985-1987 while 2003 figure is the average for 2001-2003). Regions are consistently defined across years. Provincial income shares from the household survey data were used.

Source: Authors' estimates based on the National Income Accounts and various rounds of the Family Income and Expenditure Survey

Table 2
Regional Growth and Structure, 1975-2003

	1975-1985	1985-1995	1995-2003	1975-2003
RGDP average growth rate in 1985 prices, %				
Philippines	*2.5*	*2.5*	*3.9*	*3.2*
Luzon	2.6	2.8	4.0	3.4
National Capital Region	2.4	2.8	4.3	3.4
Central and Southern Luzon	2.6	3.1	3.6	3.4
Other Luzon	3.0	2.3	4.3	3.4
Visayas	2.4	2.1	4.0	3.2
Central Visayas	2.7	2.6	4.8	3.7
Other Visayas	2.3	1.7	3.4	2.8
Mindanao	2.2	1.7	3.6	2.6
Share in national GDP, %				
Luzon	62.6	64.8	66.4	64.5
National Capital Region	28.8	31.6	34.4	31.5
Central and Southern Luzon	23.3	23.2	21.9	22.8
Other Luzon	10.5	10.0	10.1	10.2
Visayas	16.7	16.3	15.8	16.2
Central Visayas	6.4	6.5	6.7	6.5
Other Visayas	10.3	9.8	9.1	9.7
Mindanao	20.8	19.0	17.2	19.1
Share in total population, %				
Luzon	54.3	55.1	55.9	55.0
National Capital Region	12.3	13.2	13.1	12.8
Central and Southern Luzon	22.8	23.9	25.7	24.0
Other Luzon	19.2	18.0	17.1	18.2
Visayas	23.2	21.4	20.3	21.7
Central Visayas	7.9	7.5	7.4	7.6
Other Visayas	15.3	13.9	12.9	14.1
Mindanao	22.5	23.5	23.7	23.2

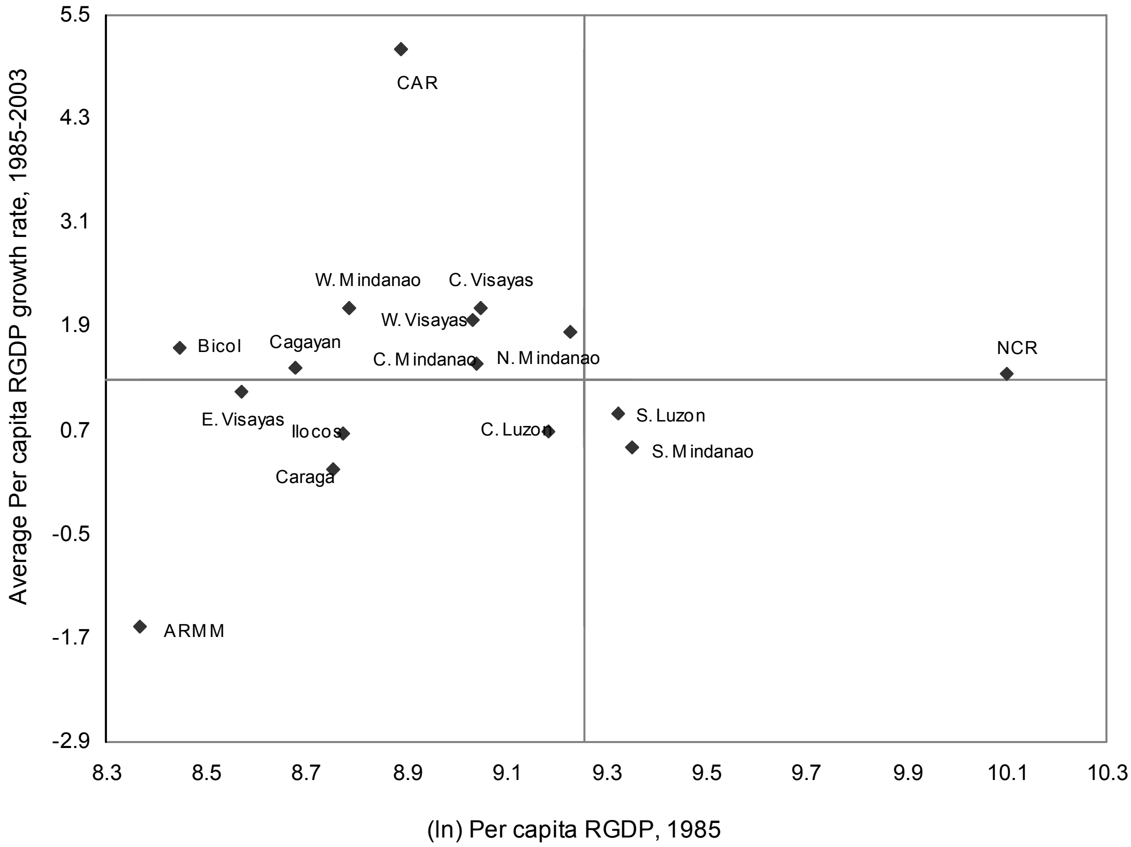
Source: Authors' estimates based on the regional link series 1975-2003, National Income Accounts.

(ii) Income disparities over time: The regional income data draw attention to the country's large economic disparities (Table 1). Manila is by far the wealthiest region. Its per capita income is about 2.75 times that of the national average, more than double that of the next richest region, and twelve times that of the poorest. In fact, only two of the remaining 15 regions also have per capita incomes above the national average. One is the CAR, a small region to the north of Manila, comprising the traditionally prosperous mountain city of Baguio, whose economy has been boosted by tourism and an export manufacturing zone as well as the long-established Benguet mining industry. The second is Northern Mindanao, a region rich in agriculture and mining and somewhat less affected by the insurgency. A third group of regions may be regarded as moderately well off by national standards. This refers to regions whose per capita income is below the national average but is above the ex-Manila national average (of P38,600 in 2003). This includes a diverse group of regions: the two adjacent to Manila, Central and Western Visayas, and Southern and Central Mindanao. A fourth group comprises six poor regions: three in Luzon (Ilocos and Cagayan Valley in the north, Bicol in the south), Eastern Visayas, and two in the western regions of Mindanao (Caraga and Western Mindanao). Finally, the ARMM has to be grouped separately owing to its extremely low income, which is less than half that of the poor grouping and less than one-quarter of the national average.

The last column of Table 1 shows the average annual growth of regional GDP, 1985–2003. All of the poor regions, including ARMM, grew more slowly than the national average of 3.1%. At the other end of the range, the richest region, NCR, grew at about the same pace as the national average. The fastest growing region was CAR, which was also second to Manila in terms of per capita income in 2003.

To illustrate the connection between regional growth rates and (initial) average incomes, Figure 4 presents a 4-quadrant story. The top right quadrant I represents regions with above-average income and growth, and the other quadrants (moving clockwise) represent regions with below average growth and above-average income (II), regions that are below average in both respects (III), and regions that are above-average in growth and below-average in income (IV). The analysis is somewhat complicated by the fact that Manila (NCR) and ARMM are such outliers. In general, however, the more heavily quadrants II and IV are populated, the more likely regional differentials are to be narrowing. In fact, the majority of regions are in the latter quadrants (2 in II and 8 in IV, out of a total of 16). However, the clustering of regions close to the national growth average cautions against drawing too robust a conclusion. Indeed, when we investigate the presence of convergence by estimating a standard regional growth equation, testing for the possibility that incomes are converging over time to the mean, we do not find any evidence of such a convergence. However, as shown by Balisacan (chapter 13), the results are sensitive to the selection of administrative boundaries. In particular, the provincial data show convergence whereas the regional data do not. One plausible explanation for this is that, in a number of cases (e.g., CAR, Southern Luzon, and Southern Mindanao), the composition of provinces in administrative regions is quite a mixed bag (i.e., very diverse economic structures and per capita incomes).

Figure 4
Regional Growth vs. Initial Income



Note: Regions are consistently defined across the period.
Source: Authors' estimates based on National Income Accounts and various rounds of the Family Income and Expenditure Survey.

(iii) Economic structures: Regional economic structures vary considerably, reflecting the interplay between levels of development, natural resource endowments, and connections to the global economy. Nationally, the agriculture sector is just 15% of the economy (Table 1), but a number of regions remain heavily dependent on the sector. Using one-third of RGDP as an arbitrary bench-mark, this group comprises the two northern regions of Luzon, together with Western and central Mindanao and ARMM. Consistent with the theory of economic development, these five are also among those with the lowest income regions of the country.

There are also a number of regions which are heavily services-dependent. Of course, the major example is Manila. In four other regions, at least half the

RGDP derives from services. These regions comprise a puzzlingly diverse group: the poor Luzon regions of Ilocos and Bicol and the more dynamic Central Visayas. The latter case is more easy to explain — Cebu is in effect the commercial capital of the central-southern Philippines, and it hosts a diverse array of services from tourism to education. In the poorer regions, the answer is less obvious. Remittances, which end up disproportionately in service sector activities, could be part of the answer. In some cases services function as an activity of 'last resort'. The government sector is also large in some poor regions, notably ARMM, Caraga and Eastern Visayas.

In the case of above-average M shares, the explanations typically relate to high levels of industrialization or mining. The three regions constituting the capital and its surrounds are all more heavily industrial than the rest of the country, particularly in the case of Southern Luzon. The share for Central Visayas is also quite high. The high figures in three of the Mindanao regions, especially Northern Mindanao, reflect the presence of mining, refining and some agro processing. The special case of CAR has been noted above.

(d) Poverty and Social Indicators

How closely do the regional economic and social indicators correlate? This is a central question of Balisacan (chapter 13; see also Balisacan, 2003). Here we summarize his story with reference to the summary indicators (poverty, inequality, HDI life expectancy, and literacy) presented in Table 3. The principal conclusion is that economic and social indicators correlate quite closely, but there are some notable deviations. For instance, while regional mean income is highly correlated with poverty incidence (Spearman correlation coefficient is 0.90), HDI (0.96), and functional literacy (0.84), it is weakly correlated with Gini ratio (0.18) and primary enrollment (0.49). As expected, the correlation between HDI and poverty is also high (0.96), but is not high between HDI and the Gini measure of inequality (0.16).

Table 3
Social Indicators, 2003

Region	Poverty		Income gini ratio	Life expectancy at birth	Adult functional literacy rate	Primary & secondary enrolment rate	Human development index	
	Incidence	Contribution to total					1990	2003
Philippines	*26.0*	*100.0*	*46.8*	*68.3*	*84.2*	*91.5*	*0.713*	*0.721*
NCR	4.9	2.6	43.3	70.0	94.6	92.3	0.944	0.804
CAR	15.3	1.0	43.1	66.2	85.5	95.7	-	0.648
Ilocos Region	16.9	3.4	41.2	69.5	88.4	91.6	0.592	0.649
Cagayan Valley	26.2	3.4	47.1	67.0	84.3	92.6	0.560	0.603
Central Luzon	13.6	5.7	37.6	70.9	86.8	91.0	0.695	0.654
Southern Luzon	20.8	13.0	43.7	68.9	88.7	92.7	0.654	0.646
Bicol Region	45.7	10.7	48.9	68.6	79.8	90.7	0.488	0.538
Western Visayas	26.7	7.8	46.6	68.3	81.5	93.9	0.527	0.601
Central Visayas	36.6	10.4	47.3	70.7	81.6	90.3	0.528	0.592
Eastern Visayas	45.0	8.2	49.2	65.6	76.5	90.1	0.473	0.520
Western Mindanao	49.7	7.6	53.0	66.3	73.0	93.6	0.458	0.524
Northern Mindanao	29.8	4.1	48.1	68.6	82.6	90.1	0.531	0.610
Southern Mindanao	26.8	7.2	50.6	68.8	77.4	90.9	0.571	0.624
Central Mindanao	34.1	4.2	46.2	66.5	80.0	93.1	0.479	0.551
ARMM	63.4	7.2	40.1	54.2	65.9	80.3	-	0.370
Caraga	36.9	3.7	44.5	64.8	80.5	92.9	-	0.531

Note: Enrolment rate estimates are for 2002.
Source: FIES 2003, FLEMMS 2003, APIS 2002, UNDP-HDR and various issues of the Philippine Human Development Report.

The income and inequality data combine to generate the poverty estimates. The Philippines is a high-inequality country compared to most of Asia, and all but one of the regions (Central Luzon) register a Gini ratio of at least 40.[14] Income inequality is particularly high in most of the Visayas as well as in Mindanao — ARMM is a notable exception — owing to the highly inequitable distribution of physical assets, particularly land, and to the mix of economic activities (mining, plantation agriculture, etc.) in these regions.

These high-inequality regions have, for example, land Gini ratios of close to 60%, while the comparable figures for most of Luzon (excluding Bicol) are close to or are below 50%. As Balisacan (2003) has shown, it is the inequality within

[14] The Gini ratio ranges from 100 (perfect inequality) to 0 (perfect equality).

regions, not inequality between regions, that accounts for over 80% of the national variation in household incomes. Balisacan (chapter 13) also shows that high-inequality regions tend to have low steady-state growth rates compared to their lower inequality counterparts. Moreover, his analysis of the data covering the past two decades indicates that changes in poverty incidence (as well as other measures of income poverty) are attributable largely to changes in overall per capita income within regions, rather than to changes in income or asset inequality within or between regions. Unlike in the PRC or Thailand, the Philippine regions did not experience any major changes in asset or income inequality during the past two decades.

Yet the comparatively high level of regional income and asset inequality blunts the effect of the income growth on poverty. Indeed, as Balisacan (chapter 13) shows, the average growth elasticity of poverty is quite low in the Philippines compared to that in most other developing Asian countries. Hence, the country's unenviable record on poverty reduction in recent years is the outcome not only of its comparatively low per capita GDP growth rate but also its weakness in transforming a given rate of income growth into poverty reduction.

(e) The Special Case of Mindanao

No discussion of Philippine regional development issues would be complete without a discussion of both the special development challenges of the southern region of Mindanao and conflict more generally.[15] Over the period 1986–2004, it is estimated that 91% of Philippine provinces were affected by ideology-based armed conflict. The greatest suffering has occurred in Mindanao: of the 21 provinces with the largest number of armed encounters over this period, 15 were in this region.

Mindanao remained staunchly independent during the Spanish colonial rule but gradually came under American control from 1903 onwards, and was included in the Philippine state at the time of Independence in 1946. Its majority Muslim status at that time has been steadily diluted by large-scale migrations from Luzon and the Visayas. The majority of Mindanao's inhabitants are now Christian, and much of the Muslim community has been marginalized economically, socially, politically and geographically.

Local resistance to outside intrusion began to intensify in the 1960s under the Moro National Liberation Front (MNLF), established in 1969 with the aim of securing 'a free and independent state for the Bangsa Moro people'. During the early Martial Law years, armed conflict became more widespread and was only temporarily ameliorated by the 1976 Tripoli peace agreement. This agreement quickly broke down and resulted subsequently in the formation of a splinter group, the Moro Islamic Liberation Front (MILF). Another splinter group has

[15] This volume does not include a special chapter on Mindanao, but one of the authors has been closely associated with a recent major study of the region (PHDR, 2005) on which this section draws heavily.

been the Abu Sayyaf, formed in 1991, with stronger international connections to radical Islam and a willingness to employ extremist terrorist methods to advance its goals. The Muslim community is of course quite diverse, with 13 disparate ethno-linguistic groups spread across the historical homelands of Mindanao, Sulu and Palawan. In practice, therefore the community has rarely spoken with one voice, and its aspirations have alternated between autonomy and independence.

Since 1986, a democratic Philippines has found that resolving the conflict has been just as elusive as it was in authoritarian times. The pattern of sporadic negotiation interspersed with conflict continued under the Aquino administration. In 1996, under the Ramos presidency, the Jakarta Accord between the Philippine government and the MNLF was successfully brokered, with Indonesian cooperation, and the ARMM was established. However, this peace settlement was also relatively short-lived. Hostilities broke out in 1997 and became more serious in 2001. The MNLF split into several factions. In the wake of the 9/11 terrorism attacks, there were joint US-Philippine military operations in early 2002 in an effort to eradicate what had come to be regarded as one of the principal incubators of terrorism in Southeast Asia and beyond. Several major terrorist attacks and high-profile kidnappings occurred.

The protracted conflict in Mindanao has exacted a high price in at least three respects.[16] The first has been the continuing high number of casualties. Documentation is imprecise, but the annual fatality rate since 1986 has been at least 260 combatants, with a further injury toll of at least 85 persons. These figures exclude an unknown number of assassinations and 'disappearances'. They also do not take account of the injuries and indignities suffered by victims of discrimination. Estimates of dislocation caused by the conflict are extremely approximate, but typically number over 100,000 persons in periods of elevated conflict. The magnitude of the dislocation is illustrated by the fact that somewhere between one-third and one-fifth of major Muslim tribes now live in areas outside their ancestral homelands.

Second, it is virtually impossible to obtain an accurate monetary measure for the cost of the Mindanao conflict. Estimates range between P5-10 billion annually over the period 1975–2002, equivalent to about 1% of the GRP of central and southwestern Mindanao. Based on internationally used methodologies, these exercises attempt to calculate the loss of foregone earnings associated with death or injury. These figures of course value human life just in terms of earnings potential, and do not take account of many indirect economic and non-economic costs, nor the general costs of warfare, dislocation and displacement. These estimates are also conservative in the sense that they make no allowance for all manner of other negative externalities. For example,

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[16] As PHDR (2005, chapter 3) points out, armed conflict instigated by the communist-backed new People's Army has also been an ever present feature of the Philippines over this period, and it too has deep historical roots of injustice. However, compared to the Mindanao conflict, it has been more dispersed and has not resulted in the same degree of geographically concentrated socio-economic deprivation.

there is the unknown but likely large amount of foregone investment, both locally and nationally. The conflict also serves as a continuing major distraction for national policymakers, including the diversion of scarce funds and bureaucratic resources to the region.

Third, Mindanao's traditionally poor socio-economic indicators have deteriorated still further relative to the rest of the nation, as highlighted in the above tables and by Balisacan (chapter 13). The country's bottom 10 provinces have usually been dominated by conflict-affected regions. For example, the five provinces with the lowest life expectancy are all in Muslim Mindanao. People in the lower ranked provinces have a life expectancy some 20 years below that of the richest provinces. Muslim Mindanao provinces also dominate the bottom end of the country's human development index (HDI) rankings, with HDI scores comparable to the poor mainland states of Southeast Asia (Laos, Cambodia, Myanmar). Econometric analysis reported in the PHDR (2005) shows that, cet. par., a province in Muslim Mindanao tends on average to have a poverty incidence 32 percentage points higher, an income per person that is P11,000 lower (in 2000 prices), cohort-survival rates in basic education that are 31 percentage points lower, and infant mortality rates that are 15 points higher than in a non-Muslim Mindanao province.

(f) Population, Labour and Migration

Philippine demographics more or less reflect economic patterns. A little over half the nation's population lives in Luzon and its share has been rising gradually since the 1970s (Table 2). The remaining 45% of the population is quite evenly divided between the Visayas and Mindanao, with the latter gradually overtaking the former. Here too, Manila and the two surrounding regions dominate, with 35–40% of the population. The gradually rising share of this central region accounts for all of the increase in Luzon's share. Within the former, Manila's share has been broadly constant at about 13%, indicating that most of the increased population has spilled over the official boundaries.[17]

These patterns reflect the interplay of regional fertility differentials and migration. Through to the 1970s, Pernia et al. (1983) identified two major, long term migration streams. The first was the inflows to the national capital, principally from other parts of Luzon and the Visayas (mainly East and West). A smaller subsidiary flow was into the most lightly settled region of Luzon, the Cagayan Valley. The second major flow was into the country's (then) last remaining frontier region, Mindanao, mostly originating from the Visayas and parts of Luzon.

[17] Taking a longer term view would of course draw attention to Manila's inexorable rise as the nation's dominant centre of commerce, politics, education and much else. Its share of the nation's population rose from 4.9% in 1903 to 12.4% in 1975, while that of industrial employment increased from 6.5% to 47.4% over the same period (Pernia et al., 1983, p. 30). For a fascinating historical analysis of Manila, see Doeppers (1984).

Table 4 provides an updated regional demographic profile of the country. Growth over the period 1980–2000 indicates clearly the socio-economic correlates of these patterns. Southern Luzon has by far the fastest growing population — about 50% above the national average — with Central Luzon also attracting migrants. This principally indicates the attraction of the national capital, even though it has technically become an out-migration region, as a result of its population spilling over its boundaries. Elsewhere in Luzon, growth is below the average, most notably in the island's poorest region, Bicol. Cagayan Valley is no longer the major in-migration region it once was. In the Visayas, the more dynamic central region is growing the fastest, and is the only one of the three central regions to be a net migration recipient. The poor eastern region has the slowest growth of all regions over the period 1980–2000. Population growth is quite high in most of Mindanao, with its southern and central regions above average and with Northern Mindanao a net migration recipient. The figures for the most conflict-affected regions, Caraga and ARMM, need to be treated with caution, owing to the widespread dislocation.

Table 4
Population and Migration, 2000

Region	Total population ('000)	Population density (person/km^2)	Average annual growth rates		Migration rate per '000 population
			1980-1990	1990-2000	
Philippines	*76,504*	*255*	*2.3*	*2.3*	
NCR	9,933	16,091	2.9	2.2	-22
CAR	1,365	70	2.3	1.8	-1
Ilocos Region	4,200	318	2.0	1.7	-1
Cagayan Valley	2,813	90	2.0	1.8	-5
Central Luzon	8,031	437	2.6	2.6	12
Southern Luzon	11,794	239	3.0	3.6	26
Bicol Region	4,687	258	1.2	1.8	-10
Western Visayas	6,211	301	1.8	1.4	-6
Central Visayas	5,707	359	1.9	2.2	2
Eastern Visayas	3,610	155	0.9	1.7	-6
Western Mindanao	3,091	161	2.2	2.3	-9
Northern Mindanao	2,748	170	2.2	2.2	4
Southern Mindanao	5,189	183	3.0	2.6	-1
Central Mindanao	2,598	144	3.3	2.5	-9
ARMM	2,412	95	3.0	2.7	-9
Caraga	2,095	98	2.5	1.7	-6

Note: Calculations are based on intra-country migration.
Source: Authors' estimates based on the Census of Population and Housing for 1990 and 2000, National Statistics Office.

Thus, as would be expected, there is clear movement from poorer to richer regions. We lack detailed data on the characteristics of migrants, the younger and better educated typically display a higher propensity to move. Moreover, families tend to send their children to access the better quality national educational institutions in Manila and other major cities, and they generally remain in those places upon graduation. This 'brain drain' to the major centres is further reinforced by the spatial patterns of employment creation in the wake of trade liberalization, as identified by Tecson (chapter 12).

Meanwhile, international out-migration is rising rapidly. There are about 8 million Filipinos residing abroad, a number equivalent to almost one-quarter of the domestic labour force (Esguerra and Manning, chapter 8; see also Burgess and Haksar, 2005).[18] Official estimates suggest that remittances in 2004 were about $8.5 billion (the third-largest among developing countries, behind only India and Mexico), equivalent to over 10% of GDP, 20% of imports, and 58% of domestic investment in that year. The official data are known to be significant under-estimates of actual flows, and remittances are probably now equivalent to about 30% of merchandise exports. Data from the 2003 Family Income and Expenditure Survey indicate that remittances tend to rise with household incomes, [19] suggesting that these remittances may have increased inter-household inequality. Official statistics indicate that Overseas Filipino Workers (OFWs) tend to originate disproportionately from the better-off regions (and those which are better connected globally), suggesting that inter-regional inequality is also increased. However, the location immediately prior to overseas departure could be a staging point from more distant origins.

In their examination of the labour story, Esguerra and Manning (chapter 8) address three main questions. How integrated are labour markets spatially? How have sub-national labour markets changed over time? And how have supply side (labour mobility, human capital) and demand side (patterns of economic activity and investment) factors affected outcomes?

They classify the country into the relatively high-income/industrialized regions (the capital and the two adjacent to it, an intermediate group comprising West and Central Visayas, North and South Mindanao; and the rest. Workforce participation rates do not correlate closely with per capita income, but — as expected — human capital does. Unemployment is generally lower in the more agricultural regions, where self-employment is more common, but is higher in the better off areas, presumably because job-seekers can afford to be more choosy, and there is more 'Harris-Todaro' type in-migration in search of employment. Labour market and employment structures reflect levels of development across regions. There is generally, but not always, a correlation

[18] About 40% are temporary workers on official contracts, while 20% are estimated to have irregular work status. The remaining 40% are permanent residents or citizens abroad, including dependents.

[19] The correlation coefficient between household incomes and remittances is about 0.57.

across regions between levels of and rates of growth in wage levels and per capita income.

Labour market regulations have tightened considerably in the post-Marcos era. Minimum wages are close to and in some cases perhaps above market rates. Temporary workers are supposed to have been made permanent if employed for over six months, while labour-only contracting-out is outlawed. These regulations restrict the role that wages can play in allocating labour across industries and regions. However, the regulatory environment is changing. The setting of minimum wages has been decentralized, and some regions, mainly poorer ones, are beginning to compete for employment by offering more flexible labour marker regulations (Sicat, 2003, pp. 102–103).

(g) Infrastructure and Integration

Infrastructure is the glue which unifies the national economy. It enables people and goods to move quickly and efficiently around the country. And often overlooked are the equity implications: poor farmers and consumers invariably benefit from lower logistics costs. A major theme of this book is the key importance of infrastructure for regional development. In many respects, it is the single most important instrument of regional policy. Where the roads, harbours and ports are constructed will be a key factor in the nation’s spatial dynamics. The composition of this infrastructure also matters a lot. For example, efficient connections to the global economy alongside the poorer provision of domestic networks — an increasingly accurate characterization of the Philippines — will result in a series of internationally-oriented enclaves of economic activity weakly integrated to the hinterland.

Effective infrastructure provision requires competent governance in a number of respects. First, many infrastructure projects entail long gestation periods and therefore have particular financing and policy predictability requirements. Second, a number of sectors have ‘natural monopoly’ characteristics (e.g., power generation, land-line telecommunications, major trunk roads, international airports), which in turn prescribe a role for government as regulator, though not necessarily as a provider. Third, as part of the decentralization process, there are now many players in the industry, including several tiers of government, the state-owned providers, and some foreign firms, as well as a number of regulatory agencies. There are therefore major coordination issues.

Philippine infrastructure indicators also generally follow per capita income rankings, with the better off regions also having the capacity (and political influence) to fund better quality physical facilities. We illustrate this proposition with reference to road density, access to water, electricity and irrigation, and telephone density (Table 5).

Table 5
Infrastructure Indicators, 2003

Region	Road density (km/km^2)	Access to potable water (% of HHs)	Access to electricity (% of HHs)	Telephone line density per 100	Irrigation serviced (%)
Philippines	*0.26*	*79.4*	*77.1*	*8.1*	*44.7*
NCR	5.72	84.6	99.1	25.8	-
CAR	0.15	82.2	72.1	6.3	74.1
Ilocos Region	0.54	89.2	84.9	4.5	64.2
Cagayan Valley	0.19	83.3	74.5	1.0	42.4
Central Luzon	0.41	95.5	93.4	5.3	53.6
Southern Luzon	0.21	85.0	85.1	8.7	49.2
Bicol Region	0.23	71.8	65.4	2.5	49.5
Western Visayas	0.34	69.4	69.0	6.2	38.9
Central Visayas	0.38	71.9	70.1	7.8	55.0
Eastern Visayas	0.20	77.9	61.4	3.2	59.0
Western Mindanao	0.22	58.9	52.6	1.0	46.9
Northern Mindanao	0.32	79.6	69.8	4.8	42.4
Southern Mindanao	0.22	77.3	69.7	6.8	36.1
Central Mindanao	0.19	72.0	56.5	2.9	26.9
ARMM	0.25	40.3	31.7	1.3	14.3
Caraga	0.16	78.7	66.7	5.6	24.5

Note: Road density is adjusted for quality (concrete equivalent). Irrigation serviced refers to the total irrigated area over the potential.
Source: Authors' estimates based on data from the Department of Public Works and Highways, Family Income and Expenditure Survey 2003, and the Philippine Statistical Yearbook

Manila and its two surrounding regions clearly register above-average physical infrastructure indicators in most respects.[20] Outside this central region, the picture is more variable. With respect to roads, for example, Ilocos scores well (in part of a legacy of the Marcos regime), as do the two better off regions in the Visayas. In Mindanao some regions, ARMM included, have relatively satisfactory road indicators owing to the disproportionate concentration of development expenditures. More generally, Mindanao does not emerge as a notably 'infrastructure-deficient region' by Philippine standards. In fact, in recent years, as part of the government's peace overtures to the Muslim rebels, infrastructure development on the island has become a high priority for the government and the donor community.

[20] Although to the casual observer stuck in its interminable traffic jams, that may not appear obvious!

Llanto (chapter 10) concludes that the Philippine infrastructure report card is deficient in key respects, and that it holds back the process of efficient regional economic integration.[21] In a recent Global Competitiveness Report, the country's infrastructure performance was ranked 89th out of 102 countries. Most indicators suggest a gradual improvement in availability and quality over the past two decades, although these conclusions are not always supported by anecdotal observations, especially related to the road network.

There are three inter-related problems. First, the country is under-investing in infrastructure; its infrastructure investment to GDP ratio is about half the East Asian average. The immediate cause of this under-investment is the chronic fiscal constraint, in turn the result of past fiscal crises and the continuing poor revenue performance. Fiscal constraints have a particularly adverse effect on infrastructure, since capital works are always the first to be cut in budget-pruning exercises. As a corollary, there is a tendency to rely on donor agencies, in the process resulting in an investment strategy which is short-term in orientation and is poorly integrated. The donor reliance also compounds the politically driven bias to favour new projects over maintenance.

Second, the overall regulatory framework lacks cohesion, coordination between national agencies and between the various tiers of government, and a clear division of responsibilities. About 30 national agencies are involved in infrastructure decision-making, yet in some respects it appears that 'nobody is in charge'. Hence, toll roads are not necessarily consistent with national priorities, and half-built bridges are a frequent sight in the countryside, particularly in the aftermath of elections.

Third, national level decision-makers appear unable or unwilling to deliver the long-term policy predictability and guarantees which major private (and especially foreign) providers require, resulting in potential suppliers factoring in very large risk premia. The corruption and political patronage associated with the award of large infrastructure projects is a feature of many, indeed most, countries. However, perhaps owing to its weak central government and unstable political system, the politicization of large infrastructure investments appears to be unusually severe in the Philippines.[22]

The problems of coordination seem to be most serious in the roads sector. Two dimensions are illustrative of the shortcomings. First, the Department of Public Works and Highways (DPWH) has responsibility for the national road network. But toll roads, of increased importance given the government's fiscal constraints, are the responsibility of the Toll Regulatory Board (TRB), and evidently the two agencies do not coordinate their activities. A second issue relates to the 'missing middle' in the road network. The national government assumes

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[21] See also Carruthers et al. (2004) for some comparative East Asian indicators.

[22] Recent examples include the highly politicized and incomplete Ninoy Aquino International Airport (NAIA) Terminal 3 project, the Manila Light Railway Transit extension project, and the South Luzon Expressway (SLEX) rehabilitation and extension project.

responsibility for the major trunk network, through the DPWH and the TRB, together with donors. While local governments have limited infrastructure budgets,[23] they are responsive to local constituencies demanding farm to market roads. Reflecting the division of political powers, secondary roads, which connect the national and the local, suffer from continued neglect and constitute the major weak link. In principle, the Regional Development Councils are designed to play a coordinating role and identify gaps in service provision. But these agencies have neither budgetary nor administrative authority and are therefore largely irrelevant.

The picture varies considerably by sub-sector. There are some positive achievements. For example, domestic shipping, civil aviation, and cellular telecommunications services were deregulated during the Ramos era, with noticeable benefits for consumers.[24] Although here too, with the greater provision of complementary inputs (e.g., airports and harbours), the dividends could have been greater. Roads are perhaps the weakest link. The power sector has also been plagued by chronic under-investment, dating back to the 1980s when the Aquino administration mothballed the ill-fated, corruption-riddled Bataan nuclear power plant (which cost at least $2.5 billion at then prevailing prices), but failed to invest in alternative facilities.

Is the Philippines becoming a more spatially integrated economy over time? A theme of this volume is that over the past two decades global integration has proceeded more rapidly than has domestic integration, owing to the combination of selective liberalization (in a sectoral and geographical sense) and under-investment in physical infrastructure. The two most common indicators of trends in factor and product markets are population mobility and regional price variations.

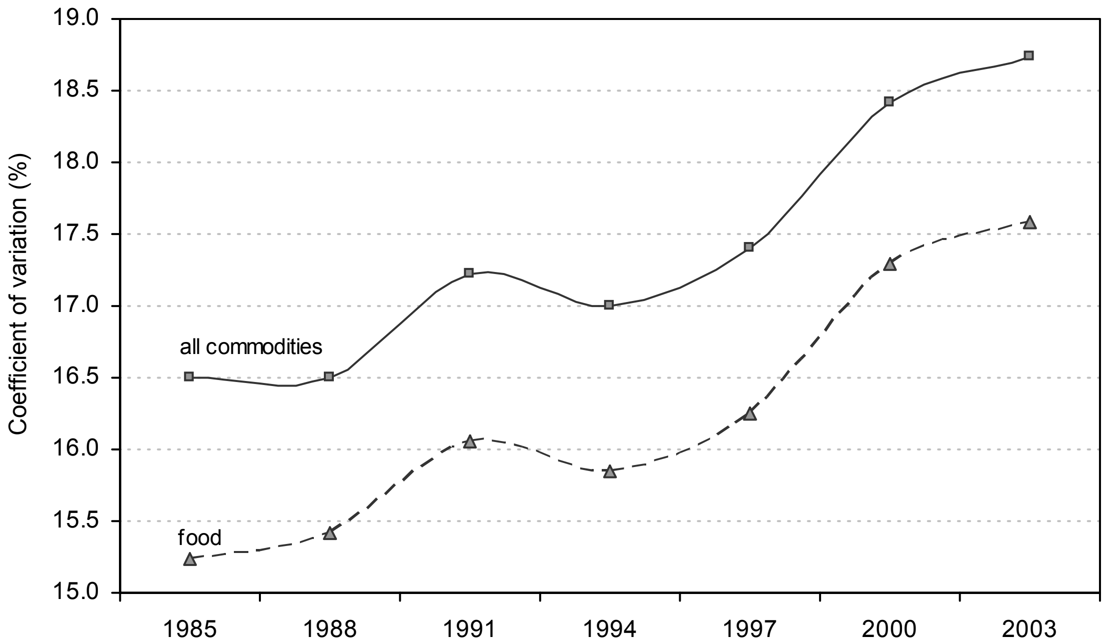
As shown in Esguerra and Manning (chapter 8), there has been considerable inter-regional migration, although the inflows have been mainly to the more industrialized regions adjoining Metro Manila. In general, labour outflows have tended to come from the poorer, agriculturally based regions (see Table 4). Conventional economic theory suggests that if labour is sufficiently mobile, wages are expected to equalize across geographic areas and sectors. Unfortunately, partly because of the paucity of regional wage data, it has not been possible to empirically confirm this expectation. However, in certain agriculturally based regions, Otsuka and David (1993) found that labour mobility was quite common and that real wages tended to equalize between areas

[23] Moreover, as Llanto points out, while LGU expenditure as a percentage of GDP has doubled since decentralization, their infrastructure budgets have not expanded commensurately.
[24] In these areas, the Philippines moved more quickly than several of its neighbours, for example Malaysia in the case of telecommunications (see Salazar (2006) for a comparative study) and Indonesia in domestic transport. The telecommunications reform appears to have worked well in the sense that the Philippines is one of the most intensive users of text/SMS messages in the world. In 2003, for example, subscribers sent an average of 193 messages per month, compared to less than 40 in the UK and just over 10 in the US (The Economist, July 10, 2004).

(favorable vs. unfavorable areas). Related studies on regional integration of commodity prices (see Sombilla et al. 2006) suggest that agricultural commodity prices were regionally integrated, although the transmission of information between regions is far from fully efficient, partly because of poor infrastructure.

In Figure 5, we present estimates of coefficients of variation (CV) of provincial prices for 1985–2003.[25] Two sets of price indices are shown; one consists of a basket of food and non-food items and the other consists only of food items.[26] Ideally, the spatial comparison should involve only tradable goods. Arguably, food is highly tradable, so the latter price index can be regarded as a reasonable measure for regional price comparison of tradable goods. As Figure 5 shows, the two indices exhibit the same pattern: The CVs tend to rise in the second half of the 1980s through the early 2000s, suggesting that impulses for domestic integration have been muted by the widening regional price variations in recent years. This pattern is an outcome of more than one cause, including evolving disparities in infrastructure development and institutional arrangements as well as deregulatory reforms in transport and related services.

Figure 5
Variation in provincial prices, 1985-2003



Note: Figures pertain to coefficients of variation of cost of living indices for a basket of goods and services.
Source: Source Balisacan, 2001. Figures are updated to 2003 using the consumer price indices in the Philippine Statistical Yearbook.

[25] Available regional price indices for the 1980s and beyond are strictly not comparable owing to the marked changes in the composition of regions over time. Moreover, the available data do not capture price variation across regions since each region has a price index value of 100 for the base year.
[26] Details of the construction of the price indices are shown in Balisacan (2001).

(h) Regional Dynamics

Rural-urban dimensions: Drawing on extensive comparative research, Estudillo and colleagues in chapter 11 investigate this issue with particular reference to rural off-farm activities. Employment in this sector in the Philippines has been growing rapidly since the 1970s, driven by several factors. Around 1970 the country hit the 'land frontier', thereby limiting the scope for extensive agricultural employment growth. Rapidly rising international employment fed remittances back into the rural economy, much of which appears to have gone into services, especially construction, trade, restaurants and other non-tradables. To avail of the lower labour and land costs in rural areas, well developed subcontracting arrangements have emerged, some with international connections.

The authors point to the declining importance of Manila as an industrial centre, driven by rural-urban cost differentials, accompanied by the development of logistics and information networks. Subcontracting in garments and metal-working has been especially important. The authors also observe that, compared to more dynamic East Asian economies (notably Taiwan), clusters and subcontracting networks are less well developed in the Philippines. Infrastructure bottlenecks and the enclave nature of export orientation in the wake of trade liberalization are presumably among the key differences.

Global and regional interactions: How have the combined effects of trade liberalization and decentralization affected spatial patterns of economic activity, especially in manufacturing? A possible hypothesis is that the dismantling of trade barriers would remove the centralizing regulatory biases embedded in four decades of import substitution, allowing footloose activities to migrate to the most economic locations, perhaps shaping a new economic geography.

Tecson (chapter 12) shows that the results have been mixed. There has been some deconcentration, in the sense of movement out of Manila, apparently on a scale greater than that observed in the rural-urban sub-contracting networks discussed above. However, the overwhelming beneficiaries are just three regions: the two Manila spillovers of Southern Luzon and Central Luzon[27] and the Cebu-centred Central Visayas. Export growth from these regions has been rapid, with Southern Luzon's share of the total rising from 4% to 51% over the decade 1993–2003. Moreover, there has been a re-concentration of exports towards Luzon, with its share rising from 77% to 90% over the same period. Luzon's share of manufacturing output and employment is similarly dominant and is also rising. Thus, on balance trade liberalization has not led to any reduction in industrial concentration. Indeed, depending on how it is measured, this spatial concentration may actually have increased.

[27] The latter region also includes the former US bases of Clark and Subic, which, in addition to newly conferred export zone status, inherited superior-quality infrastructure.

The specific form of the liberalization measures explains these trends. Exports have been the major source of dynamism, and they have emanated overwhelmingly from concessional facilities offered by the government. Particularly important have been the export-oriented foreign investments under the auspices of the Philippine Export Zone Authority, PEZA. As well as offering fiscal and regulatory incentives, the zones have been selected on the basis of international infrastructure connections, principally harbours and ports. Hence, the availability of infrastructure and the location of export zones have become the new drivers of industrial location. As Tecson points out, these are the Philippine equivalents of Mexico's US border zones and the PRC's coastal zones. In both the latter cases, these initially enclave structures have begun to develop broad-based connections to the rest of the economy. The challenge for Philippine policymakers is to replicate these strategies by improving domestic infrastructure, and offering a level fiscal and regulatory playing field to all firms in the country regardless of location. In other words, the challenge is to move to a unified industrial policy strategy.

It is unclear just how quickly the process of linkage formation and clustering is occurring. To the extent that the domestic SME sector is excluded, this process will inevitably be inhibited. It also remains unclear just how much these new export zone clusters have connected to the well known traditional clusters, such as the Marikina shoe industry.

It might also be noted in passing that, while trade liberalization has enabled some regions to grow more quickly, other elements of the 1990s reforms have introduced additional side effects of globalization. For example, in the wake of the decision to float the peso in 1992, its strong appreciation in the mid 1990s boosted the competitiveness of regional economies with an above-average share of non-tradables (e.g., Metro Manila), while its sharp decline in 1998 had the reverse effect.

Finally, Tecson draws attention to emerging patterns of location in some of the new export-oriented service activities. Here too a significant concentration can be observed in and around the capital region. It is likely that different forms of infrastructure matter for these activities; principally they require telecommunications and (since they rely more on person to person contact) international airports. Of crucial importance is the availability of an educated and cosmopolitan workforce, whereas serviced industrial estates and ease of customs movements are less relevant. In all these respects Manila and surrounds have a major competitive advantage as compared to more distant regions.

(i) Centre-Region Relations

Manasan (chapter 9) provides a detailed and authoritative stocktake of centre-region fiscal and administrative relations. She argues that the *assignment of functions* to the various tiers of government has been broadly consistent with public finance notions that power should rest with the jurisdiction best able to internalize the benefits and costs associated with the provision of these services. The principal exception is education, which was retained by the central government for political reasons. As a result of decentralization, LGU expenditure as a share of GDP approximately doubled, but the amounts remain relatively small, rising from 1.6% of GDP 1985–1991 to 3.3% 1992–2003. The Philippines is thus only a moderately decentralized state. For example, the (unweighted) share of subnational expenditures in the total public sector for six East Asian countries was 33% in 2001/2002, whereas the share for the Philippines is 26%.[28]

Similarly, the share of LGUs in total government expenditure (net of debt service) rose from an average of 11% prior to the Code to 21.2% in the latter period. As expected, LGU expenditures generally rose in the sectors for which they assumed responsibility, although in social welfare and infrastructure the increases were minimal.

With regard to *clarity of expenditure assignment*, Manasan concludes that although the arrangements are clear enough in principle, they have been subverted in practice by loopholes which permit arbitrary intervention by central government departments and members of Congress. The central government has also continued to pass on 'unfunded mandates' to the LGUs, thus violating the public finance principle that 'finance follows function'.

The allocation of tax assignment is also broadly consistent with public finance criteria related to efficiency, equity and administrative feasibility, with LGUs in particular having responsibility for tax bases on factors which have low inter-jurisdictional mobility (e.g., property tax and community tax). However, as Manasan argues, the arrangements score less well with regard to the *autonomy criterion*. Apart from property tax, the LGU tax base remains small, the only other revenue sources being business taxes, fees and user charges, and poll taxes. The central government continues to control the major productive tax bases, including personal and corporate income tax, value added and excise tax, and customs duties. Moreover, LGUs have limited authority to change and set the rates: the LGC also sets limits (floors and ceilings) on tax rates imposed by LGUs; they may be adjusted only every five years, and by no more than 10%. Although LGUs are permitted in principle to access the capital market (as governed by the provisions of the 1996 LGU Financing Framework), in practice this is very limited and is confined to government financial agencies such as the Development Bank of the Philippines.

Thus, there are serious misalignments of revenue assignments and expenditure responsibilities between the centre and the regions and also among the regions.

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[28] The shares were (World Bank, 2005, p.10): Cambodia, 17%; PRC, 69%; Indonesia, 32%; Philippines, 26%; Thailand, 10%; Vietnam, 48%.

Many of these problems were identified in the Bahl-Miller (1983) volume, and it is puzzling that they remain unaddressed after decentralization. These misalignments have at least three dimensions.

First, there is a growing imbalance between the revenue and expenditure responsibilities of LGUs. Comparing the pre and post-Code periods identified above, the share of LGUs in total government revenue rose from 4.9% to 6.9%, while their expenditure rose much more quickly, from 11% to 22.9%. As a result, LGUs have become increasingly dependent on central government transfers, with the latter's share of LGU income (net of borrowings) rising from 38% 1985–1991 to 65% 1992–2003. The rising share continues virtually unabated.

Second, little has been done to downsize national agencies and abolish their regional offices as their functions have been transferred to local government units (LGUs). Supposedly some 70,000 personnel have been transferred from the central government to LGUs, with the latter mandated to assume responsibility for their salaries. In any case, this is a small share of the over one million personnel in national government agencies.

Third, there are perverse incentives among the tiers of local government. The formula treats cities more favourably than it does municipalities and provinces. This spurs continuous political pressure from the municipalities to elevate their status to cities.

Returning to centre-region fiscal relations, LGU tax powers are supplemented by central government transfers. These come in two forms: formula-driven block grants, known as Internal Revenue Allotment (IRA), and ad hoc 'categorical grants'. There are also the various and sharply rising Congressional 'pork barrel' schemes. The IRA also includes a formula for the division of funds among the various LGU tiers, based on population, land area, and equity. Manasan notes that although in principle formula-driven and automatic, in practice the IRA has emerged as a 'highly unpredictable' source of funding, owing to frequent changes in magnitudes and composition. This is particularly the case during periods of fiscal crisis, when the central government has used a variety of measures to delay or reduce payments.

With regard to horizontal balance, per capita IRAs were found to be positively related to per capita household income over the period 1995–1999. That is, contrary to the intent (and spirit) of the Code, the issue of horizontal equity is not being addressed. However, and perhaps surprisingly, the smaller categorical grants are occasionally (e.g., for the period 1998–2000) fiscally equalizing.

It would be a mistake to blame all the ills on the centre. LGUs have generally been unwilling to raise their own revenue, particularly through potentially rich sources such as property tax. The share of the IRA in total LGU income net of borrowing rose from 38% in 1985–1991 to 65% in 1992–2003. Thus the IRA has effectively substituted for own-source revenue generation. The widespread perception is that LGUs are invariably controlled by local elites who are unwilling to tax themselves, a point emphasized by Bahl (1983) in the earlier study. In addition, LGUs have generally been unable or unwilling to enact major fiscal reforms. Their financial records are poorly maintained and audited, and they lack transparency.[29] Moreover, local governments continue to employ a significant proportion of 'non-career' staff, an a priori indicator that normal recruitment procedures have been bypassed.[30]

The proliferation of LGU 'nuisance taxes' has become a serious problem, with very little attempt to clean them up since 1992. A large number of taxes, fees and user charges generate less than 0.1% of total LGU revenue. There is also great complexity regarding the type and levels of fees.[31] This complexity directly contributes to widespread under-collection. For example, in the case of property tax, a major problem is that the general revision of assessment (GRA), mandated to be every three years, is not updated by many LGUs.[32]

Inevitably, these generalizations do not capture the full picture. LGU governance quality varies considerably; this will discussed in the next sub-section. Also, the better off provinces have less need to raise taxes, while the poorer ones have limited potential to raise revenue and remain heavily dependent on the centre. Moreover, as noted, incentives to reward good governance are inadequate. The resources of the national government are constrained by low growth and poor revenue collection, while greater tax autonomy is needed to allow progressive and energetic LGUs to raise more revenue.

Inter-LGU coordination is a related issue. One of the concerns at the time of decentralization was how to assess the costs and benefits of projects which involved multiple jurisdictions, especially those involving large externalities (Alonzo, 1997). Yet LGU programs are typically parochial and fragmented. Coordination remains poorly developed in areas such as roads and environmental management, where inter-government cooperation is required and extra-jurisdictional externalities are present. The Regional Development Councils, which are designed to coordinate regional LGUs, are largely ineffective.[33]

[29] In the most recent audit, for the year 2000, only 250 of the 1,689 LGUs were given clean audit reports by the Commission on Audit (WB/ADB, 2005, p. 39).
[30] In 2001, 38.6% of local government staff were non-career, compared to 4.7% for the central government (World Bank, 2005, p. 136).
[31] For example, the WB/ADB (2005, p. 21) report notes that, in the city of Bacolod, ' … there are over 200 different rates for the mayor's business permit fee, as rates vary by the type of establishment. Similarly, there are 24 fees for amusement places …'
[32] In the words of WB/ADB (2005, p. 22): 'Most LGUs [visited] have not undertaken a GRA since 1991'.
[33] In the words of WB/ADB (2005, p. 30): '… the Regional Development Plan formulated by the RDC is seldom, if ever, taken into consideration by LGUs'.

Finally, debate continues over whether the chronic fiscal deficit at the national level and IRA commitments are linked. By way of background, the national budget recorded a modest surplus — unusual for the Philippines — in 1995–1997.[34] As the economic crisis hit, the budget slid into deficit, but the deficit was initially contained (at 1.9% of GDP in 1998). However, a major deterioration occurred in the early 21st century, with deficits of around 5% in 2002–2005. Until mid-2005, Congress rejected the Administration's proposals to address the problem, principally through the automatic indexation of excise taxes on 'sin' products.

Those arguing that the deficits and the IRA commitments are not linked point out that the rising deficit has come mainly from a weaker revenue effort rather than from increased expenditure, so the IRA cannot be blamed. This contrary view refers to the pressure to raise the IRA from 40% to 50%, regardless of the state of the national deficit. According to this argument, the IRA should be linked to national revenues, thus forcing LGUs to become more responsible for their own revenue raising and inducing them to play a constructive role in national efforts to lift revenue.

(j) Local Institutions and Governance Quality

Decentralization in the Philippines has been in place for over a decade, longer than anywhere else in East Asia. Have the reforms delivered better quality governance, and is there a 'reform dividend' for the better governed regions? In principle, one would expect that bringing politics closer to the constituents would make public administration more transparent, more responsive, and (freed of the need to continually refer to Manila) quicker and more cost-effective.[35] However, the evidence is mixed, the quality of governance has varied considerably across regions and over time, and the links between governance quality and development are muted.

Capuno (chapter 7) emphasizes that, measuring local governance quality is no simple matter, and is more complicated than measuring a country's quality of governance. The Human Development Index (HDI) is often used as a proxy, but this is inadequate because it captures outcomes, not variables such as transparency and participation. Moreover, there are cases of provinces with low HDIs but quite good governance, and vice-versa. Research is continuing on a range of other governance measures, notably the 'Governance Quality Index', and this should be a high priority endeavour.

Complicating the evaluation of LGU performance is the absence of obvious correlates. For example, Makati and Naga are widely regarded as among the

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[34] See Sicat and Abdula (2003) for a detailed examination of fiscal policy through to the late 1990s.
[35] For a clear statement of these arguments in the Philippine context of early decentralization, see Alonzo (1997).

best governed, but they are also among the richest and poorest cities, respectively. Nor is the evidence of 'positive neighbourhood effects' compelling. That is, well and poorly governed LGUs are frequently contiguous, even allowing for the possibility of lagged demonstration effects.[36] Using growth empiric techniques, Mapa (2006) shows that there are no discernible neighbourhood effects on provincial income growth.

A range of practical obstacles stand in the way of the effective operation of a framework under which competition across regions delivers improved governance and higher growth. For one thing, standards of governance may be endogenous to the growth process, in the sense that the standards may be poor because the level of development is low. Moreover, local government elections in the Philippines have generally not been an effective instrument for exacting accountability. That is, success in the political arena is only weakly correlated with development achievements, for a number of reasons. There are lags between improved governance leading to faster development. These lags may go beyond the local electoral cycle of three years, rendering investments in development (e.g., health and education) politically unattractive as compared to certain short-term, quick-gestation projects (e.g., basketball courts or waiting sheds) with low social rates of return. LGUs in any case have only limited policy authority as compared to national level impacts. Also, electoral laws and processes provide no guarantee that the electorate's preferences will be reflected in policy. Moreover, analyses of governance in the Philippines, however refined, have to take account of the fact that politics remains highly personalistic, even more so at the local level, and thus formal definitions of governance quality will not necessarily be reflected in electoral performance. As De Dios (chapter 6) points out, in spite of the prohibition of 'political dynasties' in the 1987 Constitution, many families are simultaneously represented at both the national and local political levels.[37]

Furthermore, the central government has not been able to supply some of the key ingredients of an effectively functioning federal framework. These include a competent legal system and police service (the latter was not returned to local governments with decentralization), a stable macroeconomic policy framework, and a predictable, transparent structure of local government grants which rewards local initiative.

The evidence on the quality of LGU service provision after decentralization is mixed. Like Capuno, the World Bank (2005) comparative report detects no overall deterioration in services provided by local governments. The proportion of LGU budgets devoted to infrastructure has declined, but the LGU share of this sector is small. It also notes that regional differences in infant mortality rates

[36] For example, Makati City, the nation's premier business district, is generally regarded as well-governed. Yet neighbouring Pasay City to its south registers poorly according to the usual indicators.
[37] For example, he cites one study showing that, over the period 1987-2004, two-thirds of Congressional representatives had relatives simultaneously serving in other elective positions, more than half of whom were governors or mayors.

have declined, but it is not clear that decentralization has been the key determining factor. In fact, as Lieberman, Capuno and Minh (2005) observe, some local health facilities in the Philippines have deteriorated to the point where patients resort to services in the private sector, or those offered by higher-level government tiers. International comparisons of local education performance in the Philippines are limited by the fact that, contrary to usual practice, education was not decentralized in the Philippines.

Capuno further observes that local democracy has been quite effective at rewarding good performance and innovation, but less effective at disciplining poor leadership. The traditional dominance of local wealthy families and clans continues, for example.[38] A particular disappointment has been the record in the ARMM. The general security situation has of course complicated the decentralization process there. In addition, elections since 1990 have been marred by fraud and violence, financial mismanagement has been common, and the local bureaucracy has been bloated and ineffective.

If ‘voice’ has had limited impacts, what of ‘exit’? As noted in chapter 8, inter-regional migration in the Philippines is extensive. The principal explanatory factor appears to be relative income levels, that is, migrants select richer regions rather than better governed ones per se (although De Dios, chapter 6, conjectures that there is a little of the latter among professional classes). Indeed, it could be that there is reverse causality in the sense that migration induces better governance.

Although centre-region relations are in need of major reform and the LGU deficiencies are well documented, activist, high-quality LGUs can make a difference. Quezon City, the largest of Metro Manila’s cities, is a case in point.[39] The mayor who took office in 2001 inherited a large deficit. However, a determined revenue collection program increased income by over 50% in one year, and the government was able to record a surplus by the end of 2002. The initiatives embraced a range of carrot-and-stick measures, including prosecution of delinquent tax-payers, inducements for prompt payment, more efficient collection procedures, and an overhaul of staff performance. The WB/ADB report (2005, p. 23) also notes several exceptions to the poor LGU revenue raising efforts.[40]

In sum, although the record has been mixed, some achievements have been made. Transforming institutions, structures, processes, and (especially) mindsets is a slow, long-term process. The mechanics of transferring around

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[38] In fairness, it needs to be noted that these families are not necessarily inimical to development, as cogently pointed out by De Dios (chapter 6) in his discussion of the ‘tale of two cities’ (Cebu and Danao, both in Central Visayas).
[39] This draws on World Bank (2005, Box 6.2, p. 123).
[40] For example, Naga City, Cabanatuan City, and San Fernando municipality all introduced intensified property mapping programs and collection measures. Other LGUs which are commonly regarded as ‘islands of good governance’ include Makati, Marikina, Bohol, Palawan, and Davao.

70,000 personnel from the central government to the regions have commenced but the process remains incomplete. Gradually, competition between the regions is increasing. The annual Galing Pook awards, which recognize local government excellence and innovation, are taken seriously. In the regions, citizens perceive more clearly the sources of poor decision-making in public service delivery, and local level accountability is generally on the rise. In addition, in the more internationally connected regions, some evidence indicates that the imperative of global competition raises standards of governance and thereby weakens the grip of the traditionally dominant families; this phenomenon is not observed in the more isolated regions (see De Dios's discussion of Cavite in chapter 6). Finally, it is important not to forget that the process has been hampered by the slow national growth rate and persistent fiscal crises.

5. Summary and Policy Implications

We conclude this chapter by highlighting a number of key analytical and policy issues. At least ten warrant attention. We group them under two broad headings: regional development dynamics and the decentralization program.

(i) Regional Development Dynamics

First, trends in the global economy have shaped the economic geography of an increasingly open Philippine economy. A central theme of this volume is that the regions which are better connected to the global economy can be expected to grow more rapidly. The international evidence on this is very powerful; examples include the PRC's coastal regions, Mexico's border with the US, and Bali in Indonesia. In the Philippine case, this notion has to be modified in two respects. First, there is no single region which can be identified as the most globally connected. Rather, there are a number of 'enclaves' with better global connections. These include principally Manila and its surrounding corridors and the second city, Cebu. A second tier of regions has good connections; among these regions are the former US naval base of Subic Bay and Cagayan de Oro in Mindanao. The second modification relates to the impact of international migration and remittances. The latter are now so large — almost 50% of merchandise exports — that they need to be incorporated in the analysis of international impacts on sub-national economic geography. It is not possible to trace these impacts with any precision. However, indirect indicators — the region from which overseas workers are recruited and the impact of remittances on household expenditure — suggest these workers are probably drawn disproportionately from better off regions. Hence, these two impacts from the global economy are almost certainly increasing regional inequality in the Philippines.

Second, and as a corollary, investments in key public goods, physical infrastructure, and human capital are major drivers of both the national growth rate and regional development patterns. For example, the Philippines is significantly under-investing in infrastructure by East Asian standards. This lack of investment slows growth and limits the formation of linkages between the internationally-oriented segments of the economy and the rest of the countryside. Unfortunately, the almost continuous fiscal crisis of the past quarter-century has meant that scant public good provision is possible after providing for debt service and civil service salaries. Meanwhile, long-term private investors are deterred by the uncertain and volatile political climate. The deregulation process also needs to be completed in the telecommunications and shipping sectors.

Moreover, the allocation of scarce infrastructure funds has had implications for regional development patterns. The Philippine government (and donors) have been more inclined to invest in internationally-oriented infrastructure (ports, harbours and associated facilities) as compared to domestic transport networks and corridors. The effect has been to reinforce these internationally connected enclaves at the expense of a denser set of domestic connections.

Third, there have been no major changes in Philippine economic geography over the past two decades. In fact, this has probably been the case for longer, though trends prior to the mid 1980s are less precisely measured. The fact is that the ranking of regions by socio-economic indicators has changed relatively little. The regions with above-average indicators continue to be Manila and its surrounds, while the relatively poorer regions remain so. This reflects both the generally slow rate of economic growth nationally — rankings would be more likely to change with faster growth — and the absence of any major change in national policy settings, notwithstanding the decentralization. Nevertheless, two caveats need to be attached to the conclusion that rankings have not changed. First, the rankings exhibit greater fluidity if regions are measured at a more micro level rather than using this fairly aggregated grouping. Second, most of the traditionally poor regions of western Mindanao have slipped further behind owing to the prolonged state of conflict and local mismanagement.

Philippine economic geography has also been shaped by the location decisions related to export zones, and the emergence of clusters. These clusters follow the usual pattern of dense networks of inter-firm linkages, both vertical and horizontal. Government policy is designed to enhance cluster formation. International experience suggests that infrastructure, training, extension and R&D are the most effective policy instruments. In some cases, attracting a ‘leader’ firm has had significant regional catalytic effects. However, the Philippine record on industry policy, and especially firm-specific incentives, has generally been disappointing. Clusters are most likely to flourish when they are market-driven, supported by good infrastructure and a simple and effective regulatory regime — all criteria lacking in the Philippines. Moreover, the regulatory barriers between firms inside and outside the export zones need to be dismantled.

(ii) The Decentralization Program

Fourth, a decade and a half on, decentralization in the Philippines has been neither a notable success nor a disappointing failure. The reform has not delivered what some of its proponents might have expected: a decisive shift of power and resources out of the centre, a vibrant, efficient and responsive system of local government, and a general lift in the quality of governance through the competitive 'voice and exit' accountability mechanisms. Conversely, the reform can hardly be termed a failure. It has broadly 'worked' in the sense that some administrative and political authority has been transferred to the regions, and some local governments have performed well. Moreover, a decentralized system of government is able to function effectively only if the central government plays its part in delivering good quality national governance, sound fiscal policy, and rapid economic development. In all three respects, the contribution of the national government has been deficient over this period.

Fifth, while the Philippine decentralization program was carefully prepared, well-documented, and generally based on sound principles, the record of implementation has been mixed. At a general level on paper, the division of responsibilities between the central and local governments is clear, the assignment of functions across jurisdictions follows public finance principles, and there is reasonable clarity of expenditure assignment.

In practice, the current arrangements do not devolve efficiently and cleanly to local governments. The division of responsibilities remains ambiguous. The central government has displayed a well-developed propensity to intervene arbitrarily in what are considered local government responsibilities, including the transfer of unfunded mandates. Over a decade on, it has yet to transfer all of the staff which were supposed to be relocated to LGUs. IRA allocations have not constituted a predictable revenue stream, owing to frequent and arbitrary central government and congressional interference. As a result of these unstable funding arrangements, LGU revenue-raising efforts have been disappointing, a problem compounded by the reluctance of local elites to tax themselves. In consequence, LGUs have become more dependent — not less — on central government transfers.

Meanwhile, the central government's capacity to deliver on economy-wide macro and microeconomic reforms to accelerate economic growth and regain fiscal prudence is limited. Since 1980, the rate of economic growth in the Philippines has been among the slowest in East Asia, so the political economy struggles — in decentralization as elsewhere — are more likely to be about distribution rather than growth.

Moreover, some ill-considered decisions undertaken at the time of decentralization — notably the decision to devolve health to the regions but not to do so with education — continue to complicate the delivery of basic services.

Sixth, the record has also been mixed with regard to vertical and horizontal balance between and among the central and local governments. The LGUs remain relatively small actors in the Philippine economy; their expenditure amounts to just 3.3% of GDP in the post-decentralization era, much smaller than in most decentralized regimes. The vertical imbalance is growing between LGU revenues and expenditures: the revenues' share of the public sector aggregate is more than three times the expenditures' share of the relevant total. Moreover, the IRA allocations do not appear to be consistent with the objective of horizontal equity, although outcomes vary depending on the composition and magnitude of ad hoc 'categorical grants'.

Seventh, although the decentralization program was initiated over a decade ago, coordination between and among different tiers of government continues to be inadequate. An effectively functioning centre-regional governance partnership requires a clear division of responsibilities, adequate funding and bureaucratic capacity at both levels. The current Philippine arrangements are deficient in all three respects. Numerous illustrations are given above and in the chapters which follow, particularly in those on infrastructure and financial relations. There is a 'missing middle' in the provision of a range of services, including roads. In sectors such as agriculture, where large externalities are present (in R&D, extension, infrastructure, environmental management), either a central government presence or effective coordination mechanisms among local governments (or mostly likely both) are required.

There are also pronounced mismatches among regions. Under the funding arrangements, provincial governors are starved of resources, whereas city mayors enjoy much stronger funding bases, especially in better off regions. In consequence, city hospitals are well resourced while provincial hospitals are poorly equipped. As a result, there is tremendous political pressure for municipalities to circumvent population requirements and to be reclassified as cities.

The process of transferring resources and staff in accord with the responsibilities of a decentralized system of government also remains incomplete. Central government agencies have been reluctant to relinquish staff. Notable examples are the Department of Agriculture, with 20,000 employees attached to its various agencies and corporations, and the Department of Public Works and Highways, which has 30,000 employees building less than 1,000 km of roads per year.

Short-term political horizons, high turnover within the bureaucracy at senior levels, and a weak and poorly remunerated core civil service further compound the problems. Infrastructure spending is done in a flurry immediately prior to elections, leaving half-finished bridges as a legacy. There are large potential gains from lobbying members of Congress, even while Governors and Congressmen engage in familiar and ultimately futile exercises of buck-passing. Budgetary constraints also result in a premium being attached to lobbying for aid project funding, which typically also commits the central government to counterpart support.

Eighth, notwithstanding measurement difficulties, governance quality varies considerably across local governments. In numerous cases, effective local leadership has reformed hitherto poorly governed regions. What remains unclear is whether one can identify structural determinants of these differences, or whether instances of high quality governance are 'accidents of history', driven by the strongly personalistic nature of Philippine politics. Instances exist of emulation and replication, particularly in contiguous regions. Still, one would hesitate to argue that the ideal of 'competitive regionalism' has become a feature of Philippine local government, in the sense that better governed regions are consistently being rewarded with a 'reform dividend' of in-migration of mobile factors, especially investment and skilled labour.

Ninth, has decentralization ameliorated local disaffection with the centre in the country's troubled regions? This was one of the reform's intended objectives, but it should be noted immediately that regional disaffection has many dimensions — national and regional, economic and political — and that a relatively modest decentralization program is unlikely to be the key explanatory variable. By regional standards, the Philippines could be regarded as neither a success nor a failure in this respect. Unlike Indonesia, the country's territorial integrity has been preserved. Moreover, the central government does not have the option available to some nearby states of repressing rebellion in disaffected regions. And even Thailand, long seen as a model for successfully managing disaffection in its Muslim south, has experienced serious problems in recent years. Nevertheless, the deep-rooted conflict in Mindanao continues unabated, and socio-economic indicators in the ARMM have worsened relative to the rest of the nation. Governance in this autonomous region has been very weak, including its record on education.[41] Of course, the primary responsibility for resolving the conflict lies with the central government. But the contribution of the decentralization program has also been minimal.

Tenth, the study has drawn attention to both a common, nation-wide policy agenda as well as a set of region-specific challenges. Among the former are policies to accelerate national growth and significant increases in public and private investment in physical infrastructure and human capital. Also needed is at least a 'minimalist' set of nation-wide social objectives relating to education, health and related sectors. But regional policy also draws attention on diversity, and to the fact that a common policy template cannot be applied to all regions. For example, our discussion of Mindanao drew attention to the fact that the resolution of conflict is the most pressing goal. Infrastructure, by contrast, is relatively good, reflecting the attention the region has received from the central government and donors. Elsewhere, the mix of required policy interventions differs. For regions characterized by long-term poverty, infrastructure

[41] Recall that the ARMM is the only LGU in the Philippines which has responsibility for education.

investment and attention to local economic opportunities will likely be the key, alongside national minimum needs and poverty targeting programs (though these will be focused more on individuals and households than regions). Labour market reform has played a role in enabling poorer regions to attract labour-intensive activities, and using subcontracting networks connecting to major urban centres could be important if infrastructure is improved. Fiscal incentives for bypassed regions are another possible policy option, though they are a blunt instrument and they have been widely abused in the past. Again, out-migration from such regions is often the most effective long-term strategy for alleviating poverty.

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