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Transforming Local Finance

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Local fiscal administration has been transformed in the past five years. The gains are, however, minimal and rest on shaky grounds. While the fiscal position of local government units (LGUs) has improved vis-a-vis the national government, the improvement has been quite modest and has shown signs of slowing down. It remains imperative for LGUs to undertake radical tax reforms, exercise their local taxing powers fully, and tap other ways of financing local services in order to address persistent problems and initiate needed improvements.

The Philippines' unitary form of government prescribes, or better yet, enjoins a highly centralized determination of fiscal policies. Local taxes, local budgets and other fiscal decisions formulated at the level of individual local government units (LGUs) are expected to have significance only within the territorial jurisdiction of the local unit which formulated them. In recent years, the national government redefined national-local fiscal relations in favor of devolution.

Under a more liberal policy of decentralization and a constitution that promotes local autonomy, LGUs are expected to take on an increasingly important role in socioeconomic development. LGUs will tend to manage an increasing amount of public resources and are expected to improve their capability for direct provision or production of particular goods and services as the country improves and develops. In the process of enhancing the capability of local governments, the national and local governments alike work in harmony to bring this about.

After almost five years of improved local fiscal autonomy, there is evidence that the content and performance of local fiscal administration has been transformed and undergone some encouraging changes. The fiscal role of local governments has improved with the expansion of local responsibilities and of resources at their disposal. But while this is the case, the gains are minimal, and rest on shaky grounds. This paper examines some general trends and characteristics of Philippine local government finance. It reviews the accomplishments, discusses issues involved in the efficient provision of services, and offers some possibilities to address these.

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Theoretical Framework

With some inspiration from prevailing theses on the causes of increasing public sector activity and expansion of the government sector, I shall begin with the proposition that the government (national and local) sector is expected to periodically examine its fiscal role as the country proceeds from low to high level of development. A result of this examination will be a redefinition of the fiscal role of government and its decentralization from the center to local government units. As the economy reaches higher levels of growth, and as the quality of life of the people improves, local governments tend to play a more significant role in ensuring the delivery of public goods and services. That is, we cannot expect local governments to remain passive participants in the development process. Pressures for change, modernization and globalization will dictate upon the local governments to improve and redefine their scope and quality of service delivery, and for the national government to facilitate the process of strengthening the fiscal capacity of local governments.

Trends and Patterns

Certain broad patterns characterize local government finance in the Philippines in the 1990s:

1. Local revenues and expenditures' share of GNP have increased in recent years.

2. While local revenues in absolute amount and as a percentage of GNP have risen, local revenues from own sources remain inadequate.

3. There is a continuing reliance on a few local taxes particularly the real property tax and the business tax. LGUs have raised the bulk of revenues from these two taxes. While this practice is not necessarily unbefitting, the revenue yield from these two taxes has not been maximized, and tax administration remains inefficient.

4. While no radical measures to raise revenue have been adopted, a few LGUs have shown innovativeness, political will, and a budding shift towards the imposition of benefit-based fees and charges.

5. Given the inadequacy of own-source revenue to finance basic and devolved functions, LGUs have become more dependent on transfers from the national government. Invariably, the internal

revenue allotment (IRA) has occupied a primordial position in local finance.

6. Finances of local governments have unevenly grown resulting in varying level of expenditures, and hence differential access to local public services.

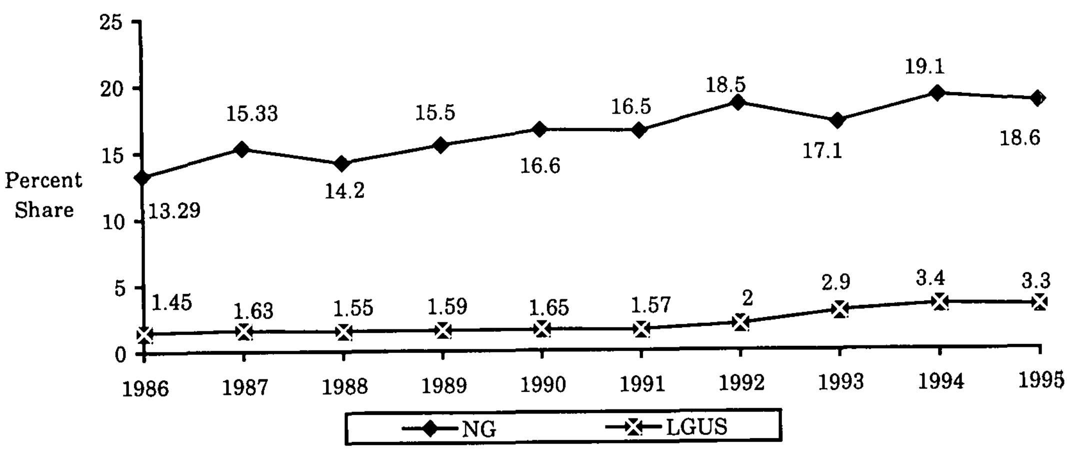
7. At the national level, policy guidelines and technical assistance from the national government have been slow in coming in such areas as local fiscal planning, project feasibility studies preparation, real property tax administration, LGU-private partnership possibilities, and access to credit markets and official grants.

The Importance of Local Finance

The degree or extent of fiscal decentralization may be viewed in terms of the power and functions devolved to local governments, the responsibility that goes with decentralization, the resulting revenue and expenditure shares, and the overall contribution of local governments to the development of the national economy (Cuaresma and Ilago 1997).

National Government Revenues vs. Local Revenues. Figures 1 and 2 and Table 1 provide a comparison of the economic significance of local government finance. The government sector (national and local) in the Philippines is a relatively small component of the mixed- and free enterprise economy. In 1986, the combined revenues of the national and local governments amounted to

Figure 1. National and Local Government Revenue Share to GNP, 1986-1995



₱87.906 billion. This figure was 14.74 percent of the country's Gross National Product (GNP). By 1991, the nominal revenue more than tripled at ₱244.687 billion, with an equivalent tripling of the local revenue-to-GNP share.

Prior to 1991, the national government (NG) dominated the transfer of private resources into the public hands. Its revenue share of total government revenue averaged 90.45 percent, and contributed an average of 15.6 percent to GNP. On the other hand, LGUs contributed eleven percent of total government income in 1986. This was a reduction from the 1981 share of 12.85 percent. In 1991, LGU revenue share of total government income further dipped to 8.74 percent. As a percentage of GNP, local revenue share was very low at 1.45 percent in 1986. By 1992, the LGU revenue-to-GNP share regained significance to 2 percent, just a little more than its 1991 level .

In terms of annual growth rates, national government revenue grew more rapidly than local government revenue within six years prior to the adoption of the code. That is, NG revenues exhibited an annual growth rate of 32.1%, while LGU revenues grew by only 20.3% from 1986 to 1991. Beginning 1992, LGU revenues accelerated at an average of 47.2% annually in the next three years, outpacing NG revenues, which grew by 15.4% per year.

In recent years, the centralized distribution of government financial resources has shifted quite a bit in favor of LGUs. The Code's implementation improved albeit minimally the prevailing distribution of government resources. National government revenue share of total government revenues sharply dropped from 90.2% in 1992 to 85.5% in 1993, and to 84.8% in 1995. Conversely, LGU revenue share gained weight from the 9.78% level in 1992 to 14.52% in 1993, and 15.2% in 1995, as figure 2 shows. Overall, local government revenue share improved from an average of 9.4% during the earlier period to an average of 13.7% during the period 1992 to 1995.

Figure 2. LGU Revenue Shares to Total Government Revenues, 1986 to 1995

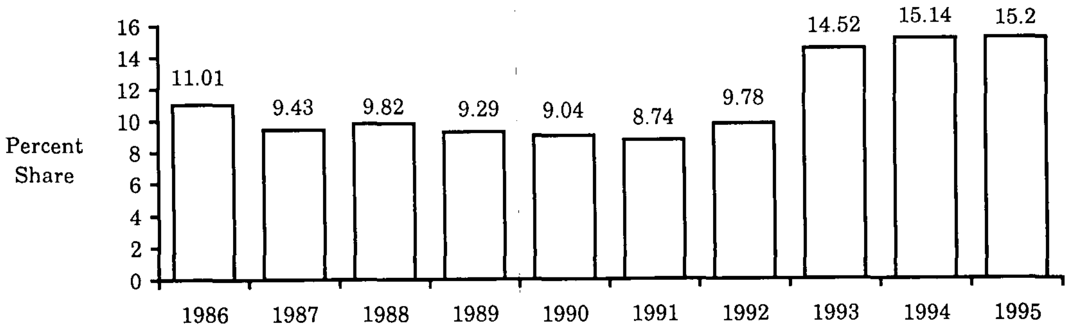


Table 1. Revenue Shares and Averages, NG and LGUs, 1986 to 1995

	Period	*NG*	*LGUs*
Revenue Shares of Total Government Revenue	1986-1991	90.45	9.55
	1992-1995	86.34	13.66
Revenue Share of National Income	1986-1991	15.60	1.6
	1992-1995	18.32	2.9
Revenue Per Capita (Nominal Pesos)	1986-1991	2,457.60	249.4
	1992-1995	4,482.70	724.5

On a per capita basis, national government revenue outpaced that of the local level by four percentage points. NG revenue per capita grew at 20.6% per year while LG revenue per capita increased by 16.2%.

As a percentage of GNP, both national and local government revenue shares took opposite directions after the adoption of the Code. NG revenues share of GNP peaked in 1994 at 19.1% of GNP, and then dipped slightly to 18.6% in 1995. Significantly, the share of GNP of local revenues more than doubled during the period, with the biggest increase realized in 1993. The amount of revenue going to LGUs has increased relative to total government resources and total national income. The revenue share of LGUs increased to 2% in 1992, to 2.9% in 1993, and to 3.4% in 1994. The improved position of LGUs, however, is largely traceable to the mandated increases in internal revenue allotment (IRA), whose percentage share doubled from 20% in 1991 to 40% starting in 1994.

Thus, as far as the aggregate importance of local government finance to the whole economy is concerned, some significant gains have been made. As a whole, the Codal provisions on local finance have been translated into significant increases in revenue and expenditure shares to GNP and to total economic activity.

While the fiscal position of LGUs from 1986 to 1995 has improved vis-à-vis the national government, gains have been quite modest. However, between 1994 and 1995, the growth seems to have slowed down. There is a big probability of an unsustained growth in the revenue position of local governments, and for its performance to move at a turtle pace as it did during the pre-Code years unless LGUs take radical reforms in tax legislation, in actually and fully exercising local taxing powers, and in tapping other ways of financing local services (Cuaresma and Ilago 1997: 4)

National Government Expenditures vs. Local Government Expenditures. The importance of LGUs may be described in terms of their contribution to the aggregate government expenditures. Figure 3 and Table 2 show that LGU share of total government outlays was relatively unchanged during the whole of 1980s, and began to shift upward in 1992. This would imply a growing importance of LGUs as providers of basic services since the Code was implemented.

Figure 3. NG and LGUs Expenditure Shares to GNP, 1986 to 1995

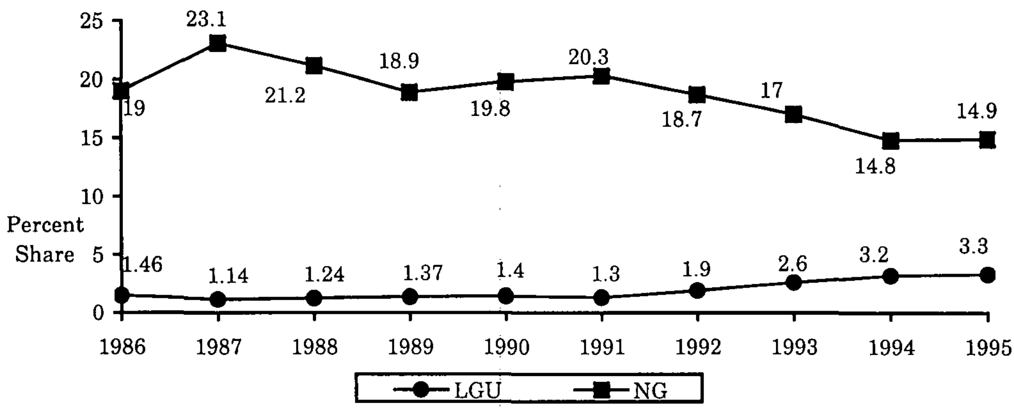


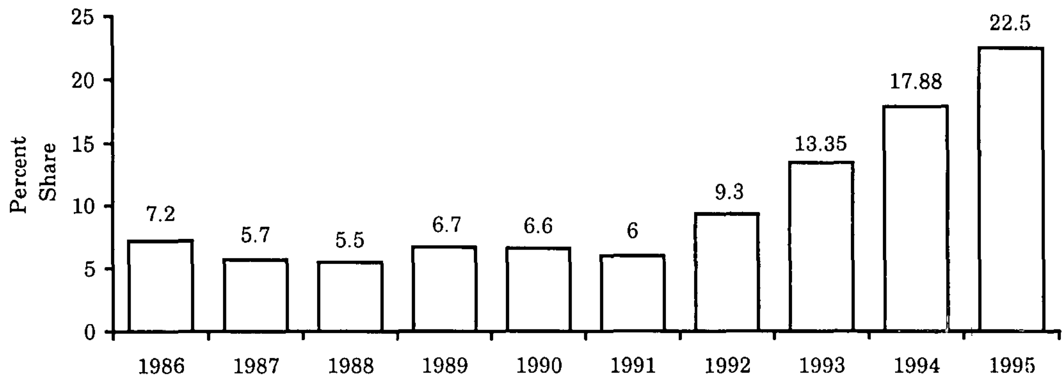
Table 2. Expenditure Shares and Averages, NG and LGUs 1986 to 1995

	Period	*NG*	*LGUs*
Expenditure Shares of Total Government Expenditures	1986-1991	93.7	6.3
	1992-1995	84.2	15.8
Expenditure Share of GNP	1986-1991	20.7	1.3
	1992-1995	16.3	2.8
Expenditure Per Capita (Pesos)	1986-1991	3,241.4	208.8
	1992-1995	3,947.0	691.1

As a proportion of total government expenditures, LGU share averaged 1.5% during the same period. That is to say that national government expenditures remained to dominate government spending before and even after the Code's implementation. The ratios of NG/LGU expenditures to the GNP and to total government outlays shifted a little in favor of LGUs. An average of 15.8% of total government expenditures came from local governments from 1992 to 1995. This is more than double the average during the previous period.

As a proportion of the GNP, LGU expenditures seem to have stabilized at 7.5% from 1986 to 1991 as Figure 4 shows. NG expenditures as a percentage of GNP experienced a 3.6 percentage points decline after the adoption of the Code. On the other hand, LG expenditures' share of GNP gained by 1.42 percentage points, reached 3.3% in 1995, and recorded an average of 1.97% for the period 1992 to 1995. For the first time starting 1992, LGU expenditure share of GNP exceeded 2%. On a per capita basis, LG expenditure per capita amounts to only 11.9% of the average NG expenditure per capita for the whole period.

Figure 4. LGU Expenditure Shares of Total Government Expenditures 1986 to 1995



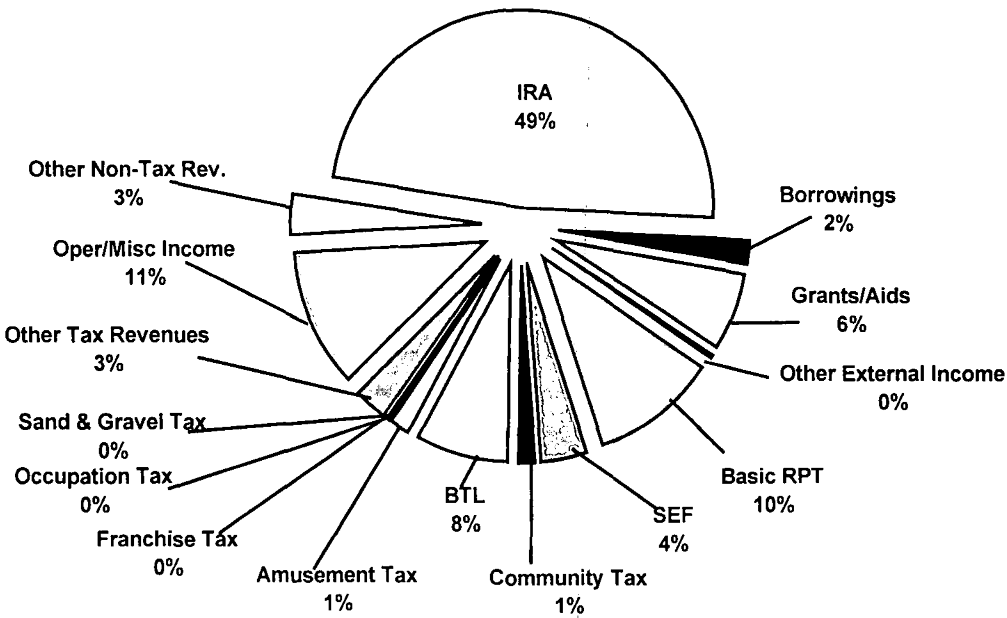
Structure of Local Government Revenues

The percentage distribution of LGU income from 1992 to 1994 is depicted in Figure 5. Certain consistent patterns characterize LGU revenue sources during the past 15 years.

During the period 1986 to 1991, the share of locally generated revenue of total local sources averaged 50.7%, with peak at 59.5% in 1980. Five years since a new order in local finance under RA 7160 was instituted, the local revenue structure has been increasingly dominated by transfers from the national government. In 1991, revenue from own local sources comprised less than half of the total local revenue. By 1994, this ratio was down to a very uncomfortable level of 32.2%.

Tax Trends. To a certain extent, the Code improved the potential taxing powers of local governments, if one considers the increase in the flat tax rates, and the change from flat tax rate to ad valorem rate in certain taxes. The basic real property tax (RPT), business taxes, and license fees remain the most reliable local revenue raisers. Revenue from the amusement tax is rising in absolute amount but its share of total revenue has been fluctuating between 1990 and 1994.

Figure 5. Percentage Distribution of LGU Income (Average Share from 1990 to 1994)



The community tax revenue collection does not reflect the rising income and value of property. From a level of ₱303 million in 1990, revenue from the community tax surged to a realistic level amounting to ₱1.28 billion in 1993; in 1994, collections slid down to ₱350 million. The 344% increase experienced in 1993 may be partly explained by the upward change in the tax rate, but the drop in the 1994 figure is highly irregular.

The revenue from the franchise tax likewise behaved erratically during the same period, beginning at ₱10 million in 1990, peaking in 1992 at ₱1.232 billion, and down again to ₱230 million in 1994.

External Income Trends. The IRA remains a major revenue source as its share of total local income swelled from 50.4% in 1991 to 67.7% in 1994.

The IRA has become a primary source of strength of intergovernmental finance in the 1990s as its contribution to total local revenues surged from 36.69% in 1990 to 62.58% in 1994. In terms of predictability, the Fifth Rapid Appraisal Report indicated that allocations have become more predictable (ARD 1995). Prior to the Code, uncertainty gripped LGUs as to the actual amount of allotment each received per year. Though the mandated share was 20% under

PD 144, LGUs received only an average of 12.7%. Nonetheless, the national government seems to have returned to old habits, because for 1997, the proposed LGU transfers amounting to ₱57.4 billion represent only 80% of the mandated 40% IRA share and the special shares of selected LGUs in the extraction of minerals in their respective locality (RP 1997: 136).

In the past, the allotment was found to replace local revenues, rather than encouraging their enhanced collection. It failed to stimulate greater economic activity, and favored richer LGUs. This problem has not gone away.

As early as 1975, the National Tax Research Center observed that local governments were encouraged to exercise the full extent of their taxing powers, to impose the maximum tax rates allowed by old laws, and to pursue alternative ways of raising financial resources. It was only after the passage of the Code in 1991 that LGUs began adopting innovative measures to raise revenues. These innovative measures were well documented in the *Galing Pook* Awards sponsored by the Department of the Interior and Local Government-Local Government Academy (DILG-LGA), and the Asian Institute of Management (AIM). Some aggressively implemented new local tax ordinances and even resorted to the auction sale of delinquent properties (ARD 1995). Notwithstanding the exemplary performance of some LGUs, the greater majority remain complacent in the area of local taxation.

Overall, own-source local tax revenues rose and ebbed during the period. The biggest gain in own source tax revenues was experienced right after 1992. By 1994, the momentum was dampened by the local governments' inability to pass new tax ordinances and impose higher tax rates, and other factors. In terms of the local revenues' contribution to total local income, i.e., self-sufficiency, the promising local revenue performance was overshadowed by the enlarged IRA as shown in Figure 5.

The IRA should also be analyzed as a percentage of the national government budget. The table below shows an IRA share of 14.4% of the 1997 NG budget.

Local Self-Sufficiency

This brings to light the ability of local governments to finance their own expenditures. Without the IRA, at least one half of total government expenditures will be curtailed. As Table 3 shows, LGUs supported up to 58.8% of their expenditures with revenue from own sources prior to the Code. From 1992 onwards, their self-sufficiency declined to a low of 33.9% in 1994.

Table 3. Total Local Revenues From Own Sources, Total Local Expenditures (In Thousand Pesos) and Self-Sufficiency Ratio, 1991-1996

Year	*Total Own Source Revenue*	*Total Local Expenditures*	*Self-Sufficiency Ratio**
1981	2,965,694	5,092,000	58.24
1982	3,124,133	5,713,000	54.68
1983	3,514,481	6,545,000	53.70
1984	3,876,119	7,616,000	50.89
1985	4,348,057	8,507,900	51.11
1986	4,615,872	8,719,200	52.94
1987	4,887,381	9,587,200	50.98
1988	5,499,197	11,244,600	48.91
1989	7,754,963	13,891,600	55.82
1990	9,268,092	18,021,510	51.43
1991	13,929,771	23,681,880	58.80
1992	11,043,377	26,206,410	42.14
1993	17,686,864	39,814,790	44.42
1994	19,143,069	56,418,770	33.93

* Self-Sufficiency ratio = Own-Source Revenue as a share of Total Local Expenditures

Table 4 indicates that LGUs have increasingly depended on external sources of funds to finance general government expenditures. By level of LGU, cities are the least dependent on transfers, and are able to raise up to an average of 53.91% of needed revenues from local sources. But even that is not a realistic margin. Provinces are worse off considering that they have to depend on external income sources by as much as 73.8% of their revenue requirements.

Table 4. Own-Source and External-Sourced Revenues of Local Governments (Ratio to Total Income; Average)

Level of Local Government		*1981-1991, Average*	*1992-1993, Average*
All LGUs:	Local sources	50.73	37.42*
	External sources	49.27	62.58*
All Provinces:	Local sources	36.02	26.18
	External sources	63.98	73.82
All Cities:	Local sources	62.21	46.09
	External sources	37.79	53.91
All Municipalities:	Local Sources	50.87	43.08
	External sources	49.13	56.92

*Average for 1992 to 1994.

In the final analysis, the extent to which LGUs can become self-sufficient depends on their fiscal capacity as determined by the size of their tax base, the rates that they may impose, and their collection efficiency. Factors such as mandated tax ceilings, limited taxing powers, limited local tax base and inefficient collection will set the pace towards self-sufficiency or improved fiscal capacity. An improvement in local self-sufficiency will depend on the ability of LGUs to surmount these constraints.

Unilaterally, LGUs have little elbow room to expand their taxing powers. However, the Code offers potentially great flexibility in the exercise of regulatory and corporate powers. Local governments could generate substantial amount of income from regulatory fees, and user fees and charges, where individual benefits from local services are direct, and easily quantifiable.

Structure of Local Government Expenditures

The trend in local expenditures was partly dealt with in the previous section in relation to local revenues. In this section, emphasis is placed on the sector and object distribution of local expenditures.

General Expenditure Trends. An examination of the composition of local government expenditures shows that the trend in the sector distribution of expenditures has undergone some vibrant changes from 1990 to 1994. There is a definite increase in the total amount of local expenditures, and a slight change in composition commensurate to the devolution of functions from national government agencies. The bulk of local expenditures is devoted to general public services, which include salaries and wages of employees. Social services' share of expenditures was relatively low in 1990, but has slowly gained significance until it reached 27.06% in 1994. (See Table 5.) By level of local government, almost two-fifths of local expenses are attributed to municipalities. (See Table 6.)

The object distribution of local expenditures remains heavily skewed towards personal services (PS) cornering 44.2% of total local expenditures in 1994. The other 34.1% goes to maintenance and other operating expenses (MOOE). A perceptible change is a four percent decline in PS allocation, which is rechanneled to capital outlay (CO) and MOOE. Capital outlay in 1994 amounted to 21.7% of total local expenditures. (See Table 7.)

Object and Sector Expenditure Trends. The general public services (GPS) sector gets the lion's share of the budget. Its budgetary average share is 40%, while the social and economic services sectors get 26.3% and 27.1%, respectively. In the last five years, the GPS share and the share of the economic services sector have diminished with a corresponding improvement in the

Table 5. Local Government Expenditure Share by Sector, 1990-1994

Items	*1990*	*1991*	*1992*	*1993*	*1994*	*Ave. Share*
Total Local Expenditures (in Million Pesos)	15,995.50	23,681.90	26,206.40	39,814.80	56,418.80	29,334.50
General Public Services	52.54	44.53	49.32	41.77	40.02	45.23
Economic Services	25.36	35.76	25.49	25.48	26.29	28.50
Social Services	17.50	15.44	19.97	26.80	27.06	20.56
Other Services	4.60	4.27	5.22	5.95	6.63	6.60
Total	100.00	100.00	100.00	100.00	100.00	100.00

Table 6. Local Government Expenditure Share by Type of LGU 1990-1994

By LGU Level	*1990*	*1991*	*1992*	*1993*	*1994*	*Ave. Share*
Provinces	31.54	28.96	23.80	24.48	24.74	26.70
Cities	35.97	30.85	34.16	42.92	36.85	36.15
Municipalities	45.16	40.20	42.02	32.60	38.42	39.68
TOTAL	100.00	100.00	100.00	100.00	100.00	100.00

Table 7. Local Government Expenditures by Object as a Percentage of GNP and Share of Total Local Expenditures, 1990 to 1995

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*Average*
Share of GNP	1.67	1.86	1.60	2.44	3.65	3.72	2.49
Current Operating Expenditures*	1.48	1.70	1.21	1.95	2.92	2.98	2.04
Capital Outlay	0.19	0.16	0.39	0.49	0.73	0.74	0.45
Share of Total Local Expenditures	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Personal Services	48.53	44.72	49.95	46.13	44.22	N/A	46.71
Maintenance & Other Operating Expenses	33.94	32.84	31.98	34.52	34.11	N/A	33.48
Capital Outlay	17.53	22.44	18.07	19.35	21.67	N/A	19.81

*Personal Services, and Maintenance and Operating Expenditures allocation for the social services sector. Overall, there are minimal gains and positive trends. More resources are channeled to LGUs. The increases have been allocated to the provision of social services. However, capital outlays remain wanting.

It may be mentioned that local governments incurred surpluses from 1986 to 1993. Local revenues expanded at an annual rate of 20.3%, outpacing annual levels of expenditures which grew at a slower rate of 16.5%. Nevertheless, this finding does not necessarily translate into sound fiscal management. While maintaining surpluses is an acceptable financial behavior consistent with the requirement of maintaining a balanced local budget (local governments prepare their budgets on the basis of estimated revenue, unlike the national government which practices expenditure budgeting), there is still a wide gap between the need for, and delivery of, local services. This renders having surpluses questionable, especially when revenue estimates are known to be conservative. Revenue estimates for purposes of budgeting are pegged to last year's level, thus preventing a more realistic planning and programming of local projects.

Real Property Taxation. Among the local taxes, the real property tax and the business taxes are the greatest contributors to local government coffers, and the most productive of all the local taxes. From 1980 to 1991, the RPT contributed an average of 41% of total own-source revenue of local governments. Though the RPT share declined to 38.2% after 1991, it is still the most productive of all local taxes. As a percentage of total local income, the share steadily declined from 17.9% in 1980 to 12.3% in 1994. The ratio of real property tax revenue to GNP in 1992 was lower by 0.02 percentage points than the average during the last 12 years. The ratio improved to 0.42% in 1994, as we see in Table 8.

Total assessed value of real property grew almost three-fold from ₱99.31 billion in 1980 to ₱273.07 billion in 1991, registering an annual growth rate of 15.9%. The amount of collectibles correspondingly increased from ₱2.214 billion in 1980 to ₱6.089 billion in 1991. RPT collections registered significant increases during the period starting from ₱1.18 billion in 1980 to ₱4.29 billion in 1991. Despite the significant gains in the RPT collections, the collection levels were far below the potential revenue. Collection efficiency averaged 54.9% for the period 1980 to 1989. It was only in 1990 and 1991 that collection efficiency improved to 69.3% and 70.5%, respectively (Ilago 1995: 6).

Bahl and Schroeder (1983) and local analysts (Public Ledger 1993:34-48) explained the low collection efficiency of real property taxes in terms of the laxity of local administrators in enforcing collection through legal means, and inadequate management and records keeping. That low collection is also attributed to the low tax ethic of Filipinos could still be true considering the persistently high rate of evasion even of national taxes.

Table 8. Real Property Tax Revenue, As a Percentage of Own-Source Revenue and Total Local Receipts, and Collection Efficiency, 1980 to 1994

Year	*RPT (in billion pesos)*[a]	*RPT as a % of Own-Source Revenue*	*RPT as a % of Total Local Receipts*	*Collection Efficiency*	*Share to GNP*
1980	1.178	46.3	17.9	53.21	0.34
1981	1.295	44.6	18.1	53.77	0.46
1982	1.390	42.9	18.1	57.18	0.44
1983	1.504	41.6	15.3	56.86	0.41
1984	1.637	39.8	15.4	55.45	0.32
1985	1.754	39.5	14.0	52.19	0.32
1986	2.080	43.6	17.2	58.30	0.35
1987	2.123	41.1	15.8	53.89	0.32
1988	2.275	39.7	16.0	50.25	0.29
1989	2.733	33.3	16.1	57.77	0.30
1990	3.728	40.2	15.3	69.27	0.35
1991	4.293	39.1	15.4	70.50	0.34
1992	4.312	39.0	15.7	---	0.31
1993	5.619	37.7	12.7	---	0.37
1994	7.378	38.2	12.3	60.65	0.42
Average					
1980-91	3.726	40.97	16.2	57.39	0.33
1992-94	5.770	38.30	13.57	---	0.37

[a]includes collections for the Special Education Fund

Sources: NCSO (1992); COA (1990-1994); Ilago (1995).

Despite the improved RPT to GNP ratio, and the nominal increases in RPT collection, overall RPT performance can only be rated satisfactory. This is further explained by the notorious understatement of property valuation.

It will be recalled that, under PD 464, the schedule of market values was to be revised every three years. It was not until 1987 that a new schedule was adopted (on a phased basis). But this was also understated since it used the 1981-1982 prices as basis (Manasan 1992: 14). Some local governments tried to adopt new sets of market values for property taxation. In four local governments studied by Tan (1993: 161), she found that the dates of the last general revisions differ — 1980 for Quezon City, 1983 for Laguna Province, and 1985 for Makati. These local governments, and Antipolo in Rizal, held new general revisions in 1990 but have not enforced them. The revised sets of valuation for Makati and Quezon City are now the subject of court cases. In Antipolo, valuation was based on the average sale price for category of property. Since they have done this on an individual basis, the valuation method followed by the assessor of each locality makes a big difference in terms of accuracy. Nevertheless, understatement of the tax base is prevalent considering that property values continue to rise through time.

Under the Code, the local *sanggunian* has to legislate a schedule of fair market values for real property taxation. For now, it would be very difficult for local governments to raise the assessed values from the 1981 to 1996 levels all at once. The current property valuation is much too low compared to actual market values. (See Table 9.) In Quezon City for instance, the assessor's market value has to be raised by about 344% for properties located at Commonwealth Avenue or by 775% for properties in Xavierville Subdivision to approximate the actual market value in 1992 (Tan 1993). The degree of understatement of property values is prevalent and varies by use and location.

Table 9. Assessor's Market Value and Advertised Market Prices of Selected Property, 1992

Selected Property	*Assessor's Market Value (a) per sq.m.*	*Advertised Market Prices (b) per sq.m.*	*(a) as a percentage of (b)*
Commonwealth Avenue	₱ 1,800	₱ 8,000	22.5
Ayala Heights	2,000	6,000	33.3
La Vista Subdivision	800	2,900	27.6
Forbes Park (residential)	3,500	15,000	23.3
Pasay Road (commercial)	8,500	41,000	20.7
Makati Avenue (commercial)	4,000	38,000	10.5

Source: Tan 1993: 164.

As Tan noted, there are no systematic valuation methods used by local governments. The methods used differ by locality. This further adds to the unsystematic valuation of property. The principal method used is case-to-case valuation which is extremely time consuming, highly subjective, with bias against new construction and improvements, and prone to corruption since each property owner is given the opportunity to negotiate with the assessor the valuation of his property. The valuation of construction and other structures could even be more subjective, more inaccurate than land property valuation, since it requires the valuation of individual property units and each unit is assessed separately. In the case of land, market values can be set for blocks of similar characteristics. The same predicament is evident in the disaggregated valuation required for machinery and equipment. The individual units which number in millions have to be identified and their undepreciated market value established.

Judging from the frequency of property valuation in the last 15 years, we can say that the adoption of a new set of property values will spell the success or failure of the real property tax system. This is in turn dependent on the political will of local governments to make the right decisions regarding the following: (1) passage of an ordinance adopting the maximum assessment levels, and (2) adoption of a systematic method of property valuation that reflects and automatically adjusts to current market values of real property.

Development Planning

The Fifth Rapid Field Appraisal (ARD 1995) noted the conduct of more vigorous planning exercises by local governments. There is a movement away from comprehensive sector-based, multi-year plans, all viewed by LGUs as irrelevant to their own needs and to strategic planning, which allows horizontal integration of sectors. Certain LGUs have exerted effort to link all sectors of the community (horizontal), and other LGUs, and national government agencies (NGAs) through their regional offices (vertical) in planning exercises. On the other hand, local planning is still weakly linked to budgeting. Not many LGUs prepare budgets beyond the line-item form, where proposed expenditures bear no relation to the goals and objectives of the local unit.

On the part of national government agencies, a persistent observation is that NGAs still tend to plan without LGU participation. It is not always the case that NGAs consult or inform LGUs and vice versa of what one is doing for the local area.

Redefining Fiscal Relations

Intergovernmental Transfers

National government transfers to LGUs allow the latter to dip into central funds. The IRA, a general purpose grant, has shaped the revenue and expenditure patterns of LGUs. In principle, grants have direct impact on local revenue. Any of three possible fiscal effects could occur (Wright 1988: 258): additive, stimulative and substitutive. A grant by itself adds to the resources of local governments. If matching funds are required, it could be a stimulant to LGUs in raising more revenue. As a sure source of income, a grant could also replace what otherwise could have been locally-sourced income. Local officials tend to rely less on local taxes, which make them unpopular to their constituents. They would rather improve the collection of national taxes, and in return expect a higher allotment share. Local expenditure determination is also affected by grants. Grants could set the tone in budget allocation and spending, particularly when matching funds are required.

Grants could pull local resources toward the grant assisted program. In certain cases, national priorities are given greater consideration in local budgets.

The Internal Revenue Allotment could bring about any of these possible effects in varying degrees depending on the fiscal position of recipient LGUs. In many ways, the following observations seem to pervade the majority of LGUs in so far as the impact of IRA is concerned.

- The IRA remains a major revenue source for all local governments. The criteria for its distribution remain unchanged. Though the weight of population criterion was cut to 50%, still the resulting distribution favors the more urbanized LGUs, which are also more populated.

- To a lesser extent, the IRA has stimulated particular LGUs in expanding their services delivery. Using the IRA as collateral, LGUs have borrowed under the Municipal Development Fund, floated bonds or entered into build-operate-transfer (B-O-T)-type of arrangements to implement local projects.

- To a greater extent, LGUs have responded quite slowly to the need to revise tax ordinances, and raise local tax rates. Many have not done so partly because of an enlarged IRA.

Grants and Inter-Local Loans

By authority of the *sanggunian*, LGUs can directly negotiate and secure financial grants or donations from local and foreign assistance agencies without the need of clearance or approval for such grants by the National Economic and Development Authority (NEDA). While this may be done, the national government or any of its agencies may also enter into bilateral or multilateral grant agreements for and in behalf of LGUs. In this case, LGU proposals need clearance, endorsement or approval by NEDA or an appropriate national government agency, if such is a condition of the funding agency (Tabunda and Galang 1991: 1-45).

Provisions on inter-local loans are rather loose and difficult to implement. The Code in particular states that the majority of all the members of the Sanggunian shall approve the loan, grant or subsidy to other local governments. The only limitation mentioned in the Code is on the amount that an LGU should lend, which is not to exceed its surplus fund in the preceding fiscal year (Sec. 300). The formulation of the terms and conditions under which such loan, grant or subsidy may take place is left to the parties concerned. Under this condition, it is possible that interest rates, terms of repayment, collateral, and other requirements would vary greatly from one LGU to another.

Credit Financing

Borrowing commits future budgets. Debt must be repaid in the future with interest. That being the case, debt instruments must be issued with care. In the Philippines, local borrowing has not been extensively utilized. In a way, the low borrowing activity of LGUs in the 1970s worked in their favor. The LGUs had difficulty of repayment given a relatively small amount of loans incurred. Otherwise, they could have further intensified the debt crisis that the country experienced in the 1980s.

In 1980, the gross outstanding debt of local governments was equivalent to about 2% of their gross revenue (Llanto *et al.* 1996). Bond issue, in particular, is almost unheard of. A local bond market does not exist, and bond flotation is practically an unknown source of financing local development projects.

There are a few successful attempts to float local bonds that can be cited, like the bond flotation of Cebu Province in 1990 to finance infrastructure projects. In Victorias, Negros Occidental; Legazpi City; and Claveria, Misamis Oriental, this was resorted to for a housing project; and in Naga City, this became an alternative to put up a bus terminal. The plan by Vigan, Ilocos Sur to float bonds to finance a housing project may soon be finalized. The biggest local bond issued so far was that of Cebu Province worth ₱300 million, as governed by PD 752. Under RA 7160, Naga City's ₱45 million worth of bonds tops the list of five LGUs, as shown in Table 10.

Many reasons have been given as to why local governments have not utilized borrowing, particularly from private capital markets. The problem can be viewed from two levels: (1) at the level of the national government and (2) at the local government level.

There is no clear-cut policy or overall framework within which borrowing at the local level can be facilitated. As Llanto *et al.* cited (1996: 76), no clear guidelines have been issued stipulating the role and function of government financing institutions (GFIs) such as the Land Bank (LBP) and the Development Bank of the Philippines (DBP). The two GFIs have responded to the financing needs of LGUs depending on their motivation to lend; and have set different requirements on borrowers (LGC-DSE 1995). Much has depended on the feasibility of local proposals, and in the process, low income LGUs were crowded out unable to qualify for bank loans.

It is also highly regulated and centralized. The total amount of credit available, eligible projects, terms of the loan, and the actual distribution among

Table 10. List of LGUs Which Have Issued Local Bonds

LGU	*Purpose*	*Issue Date*	*Amount (Million Pesos)*	*Maturity (No. of Years)*	*Interest Rate Per Annum*
Cebu Province	Infrastructure Development	July 1990	300	3	16
Victorias, Negros Occidental	Housing	Jan. 1994	8	2	1st year = 15.09 2nd year = 14.08
Legazpi City	Housing	Jan. 1995	26	2	15
Claveria, Misamis Oriental	Housing	April 1995	20	2	19
Naga City 1st Series 2nd Series 3rd Series 4th Series 5th Series	Central Bus Terminal	Jan. 1996	45 5.00 6.25 11.25 11.25 11.25	5 2 2 3 4 5	Above 182 day T-bills plus 2.5 plus 2.5 plus 3.0 plus 3.5 plus 4.0
Vigan, Ilocos Sur	Housing	Jan. 1996	10	--	---

Source: Llanto *et al.* (1996: 97).

LGUs are usually established by the central government. The municipal credit market is dominated by a few players from government. Up to the present, private banks have provided but limited loans to LGUs. The national government's Municipal Development Fund (MDF), after the 1980s, became the sole fund source of long-term local credit. GFIs have of late started to re-lend to LGUs after overcoming the disastrous experience with LGU lending in the 1980s (Llanto *et al.* 1996).

LGUs are not familiar with procedural requirements. This is partly due to the absence of a framework and the centralized handling of available credit financing. The Central Bank and the Department of Finance usually set a total credit ceiling for the economy. This amount is allotted among potential borrowers (including the aggregate LGUs) in an ad hoc manner. Borrowing outside this limit is sometimes approved for larger cities, but not great amounts and only with consent from the center. Direct external borrowing by LGUs is not permitted. The loan program of the national government, sourced either from the DBP or the LBP, is done on a project basis. A feature typical in national government project loans is less than full reimbursement of costs. No formal ceiling is placed on local borrowings. In fact, LGUs have not made substantial use of this system (Llanto *et al.* 1996: 76).

On the other hand, the general character of local governments provided some explanations as to why the private sector has shied away from offering them credits and why the LGUs themselves have not extensively availed of such loan possibilities. The first reason borders on the loan repayment capacity of LGUs. This is not surprising considering that—as Department of Finance Order No. 35-93 categorically states—at most only 58 or 3.66% of our LGUs, six (6) provinces out of 73, twelve (12) cities out of 61, and 40 municipalities out of 1,452 are classifiable as first class LGUs. Each of the remaining 1,351 or 85% is either a 4th, 5th or 6th class LGU.

LGUs lack an efficiently managed, up-to-date information structure that would provide decisionmakers readily accessible data to assess their fiscal health. This is coupled by the low quality of project management and executive ability of LGUs, posing great investment risk. Their lack of expertise in the preparation of feasibility studies and project proposals aggravates their inability to identify viable projects. Apart from this, local governments have to show or prove their ability to repay debt, a record of tax collection, borrowing plans, etc.

Moreover, requiring collateral, and subjecting local credit to regulations affecting deposits and bond issuance have heightened the lack of computational, marketing, and monitoring skills of LGUs. LGU personnel lack skills to market, or monitor bond flotation and many are not familiar with procedural requirements on bond flotation (Llanto *et al.* 1996:78).

The use of borrowing as a fiscal tool is further limited by the short (three years) term of office of local chief executives, when project repayment may not even have started.

LGU Borrowing Performance

Prior to 1992, LGUs borrowed for what became traditionally favorite projects like the construction of markets, slaughterhouses, and bus terminals; and purchase of heavy equipment and machinery (Lamberte 1992: 48). Loan size ranged from ₱1 million to ₱5 million, and most LGU borrowers belonged to the first income class category.

Repayment of loans was quite a problem of LGU borrowers. Out of 27 loans extended by the DBP, no payment was received for at least five loans. About 45 loan contracts were in arrears for five years or less, and about 10% of the accounts for more than five years. Only 5% of the loans were fully paid and 21%

were paid on time (cited in Lamberte 1992: 49). Interestingly, wealthier LGUs had higher incidence of default than less wealthy ones. Reasons for the default were:

- low LGU revenue collection;
- poor collection from project users;
- negligence and mismanagement;
- change in LGU officials; and
- fortuitous events and peace and order problem.

Except the fifth reason above, all reasons point to internal inefficiency of the LGUs in debt management. Furthermore, a change in leadership every three years raises the credit risk of private lenders particularly in long-gestating projects.

Private banks generally tend not to lend to LGUs for various reasons (Llanto *et al.* 1996: 94):

- dearth of information about the creditworthiness of LGUs;

- private bank's short-term lending does not coincide with LGUs' need for long-gestating projects;

- lack of control over LGU finances, thus increasing their risks (private banks are not officials depository banks of IRA and other LGU funds); and

- banks lack expertise in evaluating local social projects.

Banking services have tended to locate mainly in Metro Manila since the 1980s. According to Llanto *et al.* (1996), 31.2% of banks were located in Metro Manila in 1990. Consequently, there has been a high concentration of bank funds in the Metro Manila region. (See Table 11.)

Concerning the credit market, there have always been restrictive regulations on bond marketing and administration, and the absence of a strategy for directing the LGUs to the private financial markets. As mentioned, there is no local bond rating system that would provide information on the credit worthiness of an LGU.

Official Development Assistance

Official Development Assistance (ODA) refers to foreign aid originating from official (bilateral and multilateral) sources. Bilateral ODA comes from

Table 11. Distribution of Banks, Banks' Resources and their Performance

	Year	*NCR*	*All Other Regions*	*Total*
Number of Banking Services	1990	1,127	2,489	3,616
	1985	1,075	2,522	3,597
	1980	932	22,479	3,411
Total Resources of the Banking System (million pesos)	1990	633,162	157,549	790,711
	1985	403,240	69,860	473,100
	1980	174,223	35,669	209,892
Deposit Mobilization Performance (million pesos)	1990	248,248	117,911	366,159
	1985	121,887	43,689	165,576
	1980	69,847	18,405	88,252

Source: Llanto *et al.* (1996: 94).

governments of other countries like US, Japan, Canada and Australia. Multilateral ODA originates from international institutions like the United Nations agencies, European Economic Community, World Bank, and Asian Development Bank.

ODA has two portions: loans and grants. It is said that ODA carries concessional terms, that is, it has a grant element of at least 25%. What is clear is that ODA is not totally given to recipient countries free of any burden. In both loan and grant portion, there are conditionalities. Grants and loans may be received as:

- Cash donations;
- Expert consultancy services, formally called technical assistance;
- Fellowship or training;
- Equipment; and/or
- Commodity goods.

Certain conditions should be fulfilled before a country can avail itself of ODA. The loans carry with them conditionalities which are in no way concessional, though they are called soft loans. The maturity period of loans is from 3 to 10 years; the interest rates range from 0 to 10 percent. Evidently, a 10-year repayment period may just be too short, and the interest rate of 10 percent is too high. Technical assistance may be tied by source or by end-use.

Local governments can access foreign loans and grants secured by the national government as provided in Section 301 of the Code, but little is known about "sourcing" this at the local level. Local governments have inadequate information on the process of availment of ODA, the requirements set by the national government, and the requirements of lending and grant-giving institutions.

The National Economic and Development Authority (NEDA) and other national government agencies are tasked to provide quarterly information to LGUs on unutilized balances of grant-giving institutions. NEDA in particular is directed to annually provide a directory of all local and foreign grant-giving institutions, and issue guidelines on application for grants as well as other relevant information (Article 51, Implementing Rules and Regulations). Executive Order No. 230, dated 22 July 1987, made NEDA responsible for "...programming of official development assistance as grants and concessional loans from foreign governments and multilateral agencies and organizations...."

At present, the main instrument through which the national government allows LGUs to access ODA is the Municipal Development Fund (MDF). The MDF is a special revolving fund established on 29 March 1984 under Presidential Decree No. 1914. The fund is made available to provinces, cities and municipalities through an appropriate agreement between the Department of Finance and the LGU concerned. The MDF is the national government's mechanism through which various foreign loans or grants availed from international lending institutions such as the World Bank, Asian Development Bank, US Agency for International Development, OECF, among others, are channeled — or relent — to local governments. Using a revolving fund, loan repayments accrue to the fund and are relent to LGUs.

For 1995, the MDF budgetary allocation amounted to ₱427 million. It covered the peso counterpart and loan proceeds of foreign assisted projects (FAPs) directly benefiting LGUs. These FAPs are the Program for Essential Municipal Infrastructure, Utilities, Maintenance and Engineering Development or PREMIUMED II (₱167.4 million), Metro Manila Infrastructure, Utilities and Engineering or MMINUTE II (₱70.8 million), Sorsogon Integrated Area Development or IAD (₱20 million), and Metro Cebu Development Projects (₱169 million).

MDF loans are concessional. They have a maturity period of 15 to 25 years, an interest rate set at 2% above the weighted average interest rate of 61-90 day time deposit, and require no collateral. To secure the credit and provide loan repayment guarantee, the IRA intercept mechanism is used (Llanto *et al.* 1996).

Another feature of MDF loans is the grant-loan package. Under the World Bank-assisted PREMIUMED project, an LGU borrowing for infrastructure is assured a grant portion of up to 50% of the total project cost. This 50% grant is charged to the national government through the Department of Public Works and Highways (DPWH). The other 50% of the project cost is financed in the following manner: 90% of the 50% to be covered by an MDF-subloan, and 10% of the 50% is the LGU's equity (Llanto *et al.* 1996).

LGU performance in accessing ODA through the MDF resembles that in local borrowing. Based on loan records, ODA was mostly utilized for traditional projects like markets, motor pools and maintenance equipment, bus terminals, and similar projects. Most LGU borrowers belonged to the first and second income classes. There was an increase in loan size from the ₱1 million to ₱5 million level to about ₱21 million. However, the amount was apparently beyond the absorptive capacity of lower income LGUs. Llanto *et al.* (1996) noted that high income LGUs tended to meet the project selection criteria, and therefore had greater chances of availing loanable funds. Such requirements as financial capacity to pay, urban population of 10,000 and a population growth rate of at least the national average, an annual income of at least ₱3 million over the last three years, capacity to contribute the required equity, and commitment to establish a project office with full-time staff were more easily met by affluent local governments.

Funding constraints tend to limit the MDF's capacity to fill the need for credit finance of LGUs. On one hand, multilateral institutions in recent years have reduced lending to developing countries whose economies have improved. Second, the MDF is subject to the availability of funds from the National Treasury and competes with priorities of the executive branch of government. The government approved a little more than one-third of the total funds it had originally intended for release into the MDF as Table 12 shows.

Table 12. Comparative MDF Budget: Proposed Versus Approved Amounts (in Million Pesos)

Year	*Proposed Budget*	*Approved Budget*	*Approved Budget as a % of Proposed Budget*
1991	1,139.7	275.6	24.2
1992	2,144.7	1,283.0	59.8
1993	2,856.6	1,137.9	39.8
1994	2,531.8	551.3	21.8
1995	2,463.0	571.3	23.2
Total	11,135.8	3,819.1	34.3

Source: Llanto *et al.* (1996: 91).

Persistent Patterns

Despite some improvements in local fiscal administration, some problems have persisted and improvements are certainly needed in some areas.

- Local revenue remains inadequate. This is borne out of the fact that some LGUs have very little tax base. On the other hand, given their limited taxing powers, some are quite inefficient in revenue collection.

Looking at the experience of local governments in the first four or five years of implementation of the Code, only a few have taken steps to improve their fiscal situation. Some have adopted new revenue ordinances, but have not imposed new taxing powers. Collection efficiency of local taxes remains low and methods used in revenue estimation remain traditional. They have not exerted extra effort in generating more revenues to match revenue from external sources, and thereby be able to undertake more local programs and projects. LGUs' dependence on the internal revenue allotment is deepened by the bigger amount of allotment and its automatic release.

- Collection efficiency in real property tax remains low; and the property valuation used in assessment is outdated.

Real property tax collection efficiency remains low, and 1988 property valuation is still being used. The Quezon City government attempted to raise property valuation for tax purposes, but allegedly failed to follow carefully the mandated process of revising property valuation.

- Local governments continue to rely on one or two local taxes for revenue.

The local tax structure is dominated by two types of taxes: the real property tax and business taxes and license fees. The real property tax and the business tax remain the two major local taxes from which local units generate substantial amount of revenue. This is not surprising considering the absence of tax bases in many LGUs. Even then, the amount of revenue that may be raised from these sources is largely dictated by the presence or absence of business activities. The rural local units cannot expect much from these sources. On the other hand, even the more prosperous LGUs have not exerted extra effort to raise revenue from other taxes, fees and charges. Apart from the fees and charges listed in the Code, LGUs have not come up with unorthodox ways to augment their local income.

- Local governments continue to treat the IRA as a doleout, depend on it as it has become more regular and predictable, and have not exerted greater effort to raise revenues through the exercise of their taxing powers.

On the one hand, it is good to know that the receipt of the IRA is now more regular and predictable. On the other hand, this might cause more complacency on the part of LGUs, which would have less motivation as in the past, to raise more revenue from local taxation.

There is nothing in the IRA or in the Code that mandates LGUs to exercise their taxing powers to the fullest or to raise collection efficiency. Upon receipt, the IRA can be spent as before, that is to finance general government expenditures and development projects. The criteria used for distribution have not been changed, and receipt remains independent of performance. The IRA can be expected to further replace what could have been revenue raised from own sources, not to affect collection efficiency of local taxes, and not to influence local government spending.

That local governments remain dependent on the IRA is a matter of concern not only for local governments but for the national government as well. The IRA as a portion of total local revenue has become more significant under the Code. IRA contributed an average of 60% to total local resources in the first two years of implementation of the code. There was clamor in the past to include other criteria in the IRA distribution formula, like collection efficiency or tax effort. Such criteria require good performance on the part of local governments before they could receive such grants. In many respects, this is a sound fiscal policy and is likely to address dependency and low revenue generation issues. Nevertheless, such requirement can be viewed as another constraint to IRA receipt or availment, and thus poses another roadblock to local fiscal autonomy. The overall system of giving and receiving allotments and grants should be subjected to a careful review at this point. Local officials should shape up in their revenue generation efforts, lest they be overtaken by events that may transform the IRA into a specific or conditional grant where receipt is not anymore automatic.

- Access to borrowing remains restricted.

Use of borrowing to fund income-generating projects remains limited for a number of reasons. LGUs do not want to borrow where repayment goes beyond the term of office of responsible officials. Private banks have not aggressively lent to LGUs for fear of default. The national government can be said to have restricted LGU access to borrowing also for fear of default and hence increased burden on national funds.

- The absence of a development plan is also a problem that afflicts not a few LGUs.

The importance of having a well-conceived, well-studied development plan need not be stressed. It is very important for LGUs to produce such a plan, to map out their vision of development for the locality, to come up with relevant programs and projects, and to estimate with accuracy the amount of money they need to raise to finance these, and how the money will be raised. In this effort, NG assistance is very crucial.

- On the expenditure side, local governments remain traditional in the kind of development projects funded out of the 20% Development Fund, and those funded through the pork barrel of their District Representative.

An examination of the projects included in the 20% Development Fund would show that these are mostly infrastructure projects with little forward or backward linkages to more pressing needs of the locality. Thus, a basketball court is put up to provide recreation and promote sports among the youth. A waiting shed is constructed because it is needed by commuters. A day care center is also built for children aged below 5 years old. Without discounting the benefits that these projects may generate, they however do not make up a whole plan of development for the locality. The 20% Development Fund supports a host of small projects every year without the benefit of a long term plan. Thus after a while, concrete structures are put up all over the locality, which are not maintained primarily because the local government has not planned for their maintenance and upkeep.

- The composition of expenditures remains focused on general government expenditures.

Expenditures for social and economic services have not improved. The budget is practically devoted to the payment of personal services and general government expenditures with little money left for social services, and economic services or capital outlay.

- There is lack of a framework for credit financing, limited information about ODA and complicated process of availment.

The future of the local credit market will be governed by a market that is much more liberalized. Yet, many local governments cannot be expected to borrow, issue bonds and tap other forms of credit financing unless the following constraints are transcended:

a. The general perception that local governments are inept at financial management is not without basis. Internal control at the local level still has to be improved.

b. The limited tenure of elected local government officials (three years) raises the probability of discontinuity in local programs and projects as had been the case in the past. In the Province of Cebu, the new administration that came to power after the issuance of the bond, attempted to dishonor the said bond. The attempt, according to Laya (1995: 148) was overruled by higher authorities and Ayala restored "... cordial relations ... with the reconveyance of a 4,775 square meter property for a corresponding number of Treasury shares." Though the attempt was thwarted, it did not erase the apprehension of investors. LGUs should recognize the importance of a stable policy environment to the development of the local community.

c. There is lack of knowledge and substantive information on the workings of the securities market. Knowledge of the securities market and available credit instruments at the local level is inadequate. A field survey of 142 local officials conducted by Saldaña (1992) to assess their level of awareness of securities financing as an alternative indicated their lack of reliable or complete information on credit finance. Those who were aware did not know requirements and procedures but entertained such financing instrument. LGU officials also expected the DOF to initiate the bond issue. Thus, LGUs need to increase awareness of bond financing, and to enhance their ability to avail themselves of such approach.

d. There is inadequate appreciation, for lack of exposure, of the importance of these credit facilities and the public responsibility that go with these.

e. There is absence of institutional assistance to explain to local governments and the general public available credit facilities in the early stages of implementation of the Code.

f. There is absence of credit rating of local government issuers, absence of government guarantee, and nonexemption from government taxes. As in other countries, the rating of LGU debt issues would serve as mechanism to guide investors and LGUs alike.

Possibilities

The above discussion provides a handle on local fiscal performance and trends. Local finance stands at the core of intergovernmental relations. Within the present political framework, meaningful participation of local governments in the achievement of fiscal objectives is shaped and directed by national government fiscal policies.

Challenges to LGUs

Local governments should perform their role in the fiscal decentralization process. The Code offers local fiscal authority broad enough for them to have a meaningful local autonomy. It is up to them to make this a reality. The challenge is there for LGUs to prove themselves capable of managing their own affairs, and contribute to the achievement of the goals of their community and those of the nation. Local governments are therefore expected to maximize their taxing powers; impose new taxes that are already provided for in the Code but not in local ordinances; adopt new tax ordinances; adopt the maximum rates provided in the Code; raise collection efficiency; collect fees and charges religiously, use legal remedies in tax collection; encourage all spending units to identify non-taxing ways to raise revenue; involve the nongovernment sector in local services delivery and fund sourcing; encourage the private sector to go into greater production of local services delivery which government would otherwise provide; and adopt other measures to improve their fiscal status.

The undertaking of large infrastructure projects, tax mapping, or cadastral surveys and other projects is often not possible at the local level. LGUs have insufficient revenues and very little access to private capital markets. We have seen that these constraints have led to more dependence on allotments, loans and grants from higher level governments. Ways could be installed in the direction of the following with the NG taking the initiative at this stage to help LGUs improve their capability to access the credit market, national loans and grants for local infrastructure and other services.

- Prepare and adopt a master development plan, an adequate investment plan, and an adequate maintenance plan. The assistance of the national government is very valuable in coming up with these plans.

- Conduct a socioeconomic assessment of the local economy focusing on strengths (or weaknesses) that would favor (or hinder) bond flotation, access to capital markets, or the institution of LGU-private sector service delivery agreement. The output from this exercise should serve as input in the development of a master development plan.

- Conduct a periodic assessment of the state and condition of infrastructure and other social projects. Such assessment reports should be considered in the local maintenance plans.

- LGUs will have to look into build-operate-transfer or build-own-operate arrangements with the private sector and other forms of public-private partnerships in local services delivery. Incentives, consistent local policy, and stable leadership could truly count in attracting the private sector to invest more and more.

- Inter-LGU cooperation will also go a long way in terms of greater delivery of services that will benefit a group of localities.

Challenges to the National Government

The NG has not truly been facilitative of development at the local level. Its expenditures are concentrated in a few regions and it has maintained control over projects and funds of local significance. Overall fiscal policy remains the domain of the NG. As the country moves towards greater and meaningful local autonomy, local governments — whether we like it or not — will play an increasingly significant role and render decisions over an expanding area of local governance. The national government has to give more substance to local fiscal administration if local governments are to take a more active role in national development.

The challenge to the NG is to consider suggestions to provide continued assistance to local governments. Improvements are needed with respect to a more equitable distribution of the internal revenue allotment, nationwide tax mapping of real properties, higher allocation in the national budget for inter-local projects prioritized by the Regional Development Councils, equitable distribution of ODA, and continuous training and retraining of personnel on local fiscal administration, among others. The list is not all-inclusive. A host of other roles can definitely be added here. Necessarily, the NG should consider the following:

- Provide LGUs with adequate technical assistance in areas such as plan development, financial arrangements, construction management, and facility operation and management.

- Make the IRA truly equitable with its distribution being based on need and equity. In principle, the poorer a locality is, the more IRA it should get. However, so as not to further encourage dependence on transfers and complacency in tax collection, the IRA should be distributed such that the high performing LGUs (LGUs with, say, high collection efficiency) are not penalized for doing so, while the low performers (LGUs with low collection efficiency) are not rewarded for being so. Thus, given an average IRA, an LGU gets an additional allocation on top of the average IRA if that LGU is a high performer. The IRA allocation of a low performing LGU, on the other hand, may be lower by a certain percentage than the average IRA.

- Strictly monitor and evaluate the execution and operation of grant-aided work; and require periodic progress reports, field inspection, and formal evaluation of outcomes

- Adopt and issue general framework on credit financing at the local level.

- Directly transfer funds to LGUs with special burdens. A special burden could be nature-induced (lahar or typhoon-related devastation) or man-made (like garbage dump site), which has adversely affected the growth potential of LGUs. For instance, the NG may consider giving special local financial assistance to LGUs affected by the eruption of Mt. Pinatubo to enable them to recover and rebuild the local economy. As it is, funds for the rehabilitation of calamity-stricken areas remain in the hands of the NG through its agencies and through Congressmen.

- In connection with the above, put up a national fund to assist LGUs with special burdens.

  Special burdens are socioeconomic complications that cause negative economic and social externalities, and nature-imposed destruction of a magnitude that are beyond the capacity of the LGU(s) to correct, or to handle. Examples of such burdens are the Mt. Pinatubo destruction, the garbage dump sites hosted by Tondo (Manila), San Mateo (Rizal), and Carmona (Cavite). To the fund should contribute other LGUs, NGAs, NGOs and the private sector which benefit from such hosting of the burden by another LGU. In the case of burdens caused by natural calamities, the NG should take the lead in rehabilitation .

- Make more transparent the determination of LGU shares in the following (and certainty in their receipt):

  a. Share from the development, exploration and utilization of the national wealth

  Section 289 provides that LGUs will receive an equitable share of the proceeds derived from the utilization and development of the national wealth within their respective areas. Specifically, LGUs will get a share of 40% of the gross collection derived by the NG from the preceding fiscal year from mining taxes, royalties, forestry and fishery charges, and such other taxes, fees and charges, including related surcharges, interests and fines, and from its share in any co-production, joint venture or production sharing agreement in the utilization and development of the national wealth within their territorial jurisdiction.

Second, Section 291 provides that LGUs will also have a share based on the preceding year from the proceeds derived by any government agency or government-owned or controlled corporation (GOCC) engaged in the utilization and development of the national wealth based on the following formula, whichever will produce a higher share for the LGU: (1) one percent of the gross sales or receipts of the preceding fiscal year; or (2) forty percent of the mining taxes, royalties, forestry and fishery charges and such other taxes, fees or charges, including related surcharges, interests or fines the government agency or GOCC would have paid if it were not otherwise exempt.

The above shares of LGUs are distributed as follows: 20% to provinces; 45% to component cities and municipalities; and 35% to barangays. In case the natural resources are located in two or more localities, their respective shares will be computed on the basis of two weighted criteria: population, 70%; and land area, 30%. If the natural resources are located in a highly urbanized or independent component city, the sharing will be: 65% to the city and 35% to the barangay.

The prevailing sentiment on the computation of the share is one of distrust and lack of transparency. As pointed out by the Associates in Rural Development (1996), the vast majority of eligible LGUs receive no share and have no reliable means of accessing this income source. National government agencies such as the Department of Environment and Natural Resources, and the Department of Budget and Management, calculate the share and have been reported to withhold information on the mechanics of the computation. LGUs have no way of checking their rightful share (ARD 1996).

In 1995, the allocated share of LGUs from the national wealth was ₱312 million. Not all regions got a slice of this pie. The 1995 allocation shows that the NCR, and Regions I, XII, and ARMM did not get anything from this source. The natural resource endowment of Southern Mindanao worked in its favor: it received the lion's share of the total amount allocated for the purpose. Southern Tagalog and Central Luzon similarly got significant amounts from this source. (See Table 13.)

Table 13. 1995 Share of LGUs from Proceeds in Utilization and Development of the National Wealth (in thousand pesos)

Region	*Amount*	*% Distribution*
Cordillera Administrative Region	12,425	3.98
II Cagayan Valley	19,354	6.20
III Central Luzon	50,542	16.20
IV Southern Tagalog	58,279	18.68
V Bicol	64	0.02
VI Western Visayas	80	0.03
VII Central Visayas	1,273	0.41
VIII Eastern Visayas	410	0.13
IX Western Mindanao	125	0.04
X Northern Mindanao	22,826	7.32
XI Southern Mindanao	146,624	46.99
TOTAL	312,002	100.00

Source: 1996 Program of Expenditures and Sources of Financing, DBM.

b. Share in the tobacco excise tax

This benefits four provinces in Region 1 (Abra, Ilocos Norte, Ilocos Sur and La Union). An allocation of ₱1.4 billion is made in the 1995 General Appropriations Act (GAA) in pursuance of RA 7171 and Memorandum Order No. 61-A, for the 15% of actual excise tax collections on locally manufactured Virginia-type cigarettes in 1993 as certified by the BIR. The amount is divided among the four provinces on the basis of the actual volume of tobacco acceptances for the same year as reported by the National Tobacco Administration. The sharing is: 30% to the provincial government; 40% to the municipalities and cities, of which 50% will be equally divided and the other 50% will be shared in proportion to volume of tobacco; and 30% to the Congressional District. The share of each LGU shall be treated as a special account in the General Fund to be utilized specifically for cooperatives, livelihood, agro-industrial and industrial projects.

c. Additional share from national taxes, other than the internal revenue allotment, as provided under Sections 100, 102, 113 and 114 of the National Internal Revenue Code

In addition to the IRA, 50% of national taxes collected under Sections 100, 102, 113 and 114 of the National Internal

Revenue Code in excess of collection for the immediately preceding year shall be shared with local governments. Sections 100 and 102 pertain to the value-added tax; Section 113, the percentage tax on hotels, motels and the like; and Section 114, the percentage tax on caterers. The distribution of the proceeds is as follows:

20% = to accrue to the city or municipality where such taxes are collected.
80% = to accrue to the national government.

The 20% city and municipal shares are further distributed on the basis of the following as Section 150 of RA 7160 provides:

30% = where principal office is located
70% = where factory, project office, plant or plantation is located.

- Rework the allocation of national government expenditures in favor of LGUs with relatively lower fiscal capacities.

Some LGUs are definitely richer than many others or many others are disparately very poor. The latter is significantly attributed to a very low tax base and therefore low revenue-raising capacity. A more rational allocation of national government expenditures on infrastructures including transportation, telecommunications, and power, and water utilities to low tax base LGUs is urgently and immediately needed to attract business and investments and keep them there. The reallocation could be made easy by having an expanded budget made possible through an improved tax assessment and collection.

- Reconceptualize the pork barrel funds.

For as long as our legislators continue to have at their disposal pork barrel funds such as the Countrywide Development Fund, the Countrywide Industrialization Fund, the Infrastructure Fund and other funds of the same nature, a significant portion of these should find their way into local budgets. LGUs should exert effort to access these funds and should always be ready with their local development plans embodying their programs and projects. The NG should consider for adoption the policy of requiring legislators to course through LGUs at least 50 percent of their CDF. Local Sanggunian should have a role in determining the kind of projects that legislators may undertake in the local community.

In the case of the Countrywide Industrialization Fund (CIF) established pursuant to RA No. 7368, this can be a source of financial assistance to eligible manufacturing and processing projects and related industries including public markets, at amounts not exceeding ₱30 million for each town and ₱40 million for each city. The ₱100 million was allotted in 1995 and released to the Countrywide Industrialization Office (CIO) under the Department of Trade and Industry.

- Finally, tap other sources of local finance.

This includes user fees and charges, donations, private sector financing, and nongovernment sector financing and delivery of public services. Agencies of the national government maintain certain funds for local disbursement and for the benefit of LGUs. LGUs should actively seek to avail of these funds. These are the subsidy to devolved health workers, and pork barrel funds.

Low income class LGUs could demand to receive over a longer time period more than the relatively better off LGUs (and the national government should commit) national government subsidy to devolved public health workers under R.A. No. 7305 or the Magna Carta for health workers.

Fifth and sixth income class LGUs could take advantage of the Local Government Empowerment Fund (LGEF). The LGEF was established in 1996 in response to the need for dedicated subsidized funding for the most depressed areas of the country. The establishment of the fund was triggered by the poverty alleviation thrust of the Social Reform Agenda of the Ramos administration to consolidate anticipated resources from highly concessional sources to be made available for basic needs of the twenty priority provinces as well as LGUs belonging to the 5th and 6th income classes. It was also designed to reconcile the devolution objectives of the national government with the need to focus assistance on LGUs that are financially unable to provide for even the most basic requirements of their constituents (RP 1997: 187).

This year, 1997, ₱526.4 million is appropriated under the LGEF. The amount is earmarked to support the following foreign-assisted projects: ₱160.7 million for the Cordillera Highland Agricultural Resources Management Project of the Department of Agriculture (DA) and Department of Environment and Natural Resources (DENR); ₱115.4 million for the Rural Water Supply Sewerage and Sanitation Project of the Department of the Interior and Local Government (DILG), Department of Health (DOH) and DPWH; and ₱250.3 million for the Integrated Community Health Services Project of DOH. The ₱100 million seed fund created in 1996 under the LGEF for the benefit of the priority provinces and low income LGUs was discontinued in 1997 due to the establishment of the Poverty Alleviation Budget Allocation Scheme (PABAS) and the substantial increase in the IRA.

It may be emphasized that the subsidy to devolved health workers, the pork barrel funds and the LGEF are not permanent fixtures in the national budget. The amounts allotted for these and other national government assistance are legislated yearly by Congress. The LGEF in particular does not come into the hands of LGUs for their disposal, but is disbursed by the national agency or agencies concerned. Its existence represents the national government's continuing reluctance to relinquish some of its power over the purse, if it does not show distrust of the capability of LGUs to manage huge amount of funds.

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