

Tugs of War: Local Governments, National Government

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Abstract

This paper traces the origins of the recurrent functional conflicts among local governments and the financial conflicts between local governments and the national government under decentralization to the formulation and implementation of the Local Government Code of 1991. Though these tugs of war are inherent in a decentralized setup, they are avoidable. They persist, however, because decentralization was pushed too far, leading to fragmentation in service delivery, each piece inefficiently assigned to a different local government. Furthermore, the distribution of the devolved functions was not directly tied to the allocation of the additional fiscal revenue shares to local governments, which did not wean the latter from their financial dependence on the national government. Addressing these issues requires more than simply revising the Code, since increasing urbanization, ICT developments, and climate change over the last 25 years also underscore the need to restructure the local government system and political institutions. The main lesson is to implement the reforms correctly the first time, since rectifying the errors later could prove to be costly, if not impossible.

Keywords: decentralization, local governments, expenditure functions, finance

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Introduction

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

In the last quarter century, the world has changed, and the Philippines with it. There were nearly 40 million more Filipinos in 2015 than when the Code was enacted. Also, there are now more provinces, cities, and barangays. It may be asked, then, if over the same period the people were served well by their local governments. To be sure, there have been successes in local governance and development undertakings since 1991. Indicating greater local government responsiveness, the 20 or so *Galing Pook Award* winners (for innovations in local service delivery) every year attest to the gains. That many LGUs, often in partnership with civil society organizations, are now able to customize health, education, and social welfare services to the needs of their constituents should also count. The improvements in poverty rates, infant mortality rates, or educational outcomes in several places were partly achieved because of decentralization. That some localities lead others in governance, development, or both is inevitable in a decentralized setup, since local leaders vary in terms of competence, courage, or commitment to experiment with new programs or processes. However, such initial differences need not persist, and can be reduced with corrective policies.⁵ Perhaps for this reason, the Eighth Congress deemed it necessary to include a provision for the Code's later appraisal:

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

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

In the rest of the paper, I will argue that some of the conflicts among local governments, and between them and the national government, can be traced to a flaw in the Local Government Code that underlies the country's fiscal decentralization program. Due to this oversight, the inherent but avoidable conflicts in a decentralized setup were aggravated.

While some of these conflicts have been resolved through administrative issuances or court rulings, some persist or reappear in other guises. I illustrate the conflicts and the attempts to resolve them in the case of health services, which comprise the bulk of the devolved functions. The relevant proposed amendments in the Code are also discussed. This paper concludes by identifying some directions for reform.

Function Trailing Finance

Considered a good principle to heed, and one that also works well in practice, is that when decentralizing national government functions, powers, or responsibilities to local governments, the appropriate public services to devolve should *first* be determined, *after which* the requisite revenues or revenue-raising authority to finance the devolved expenditure functions can be decided.⁷ That is, finance should follow function. Decisions about public services can be made first and independent of the initial financial capacity of the local government, because the national government can provide fiscal transfers (i.e., additional resources in cash or kind) to revenue-deficient localities. The public services (or expenditure functions) that are best delegated to local governments are those considered as *local public goods*, i.e., services that can effectively serve the needs of the local population in an area (i.e., any subnational geographic division). Since the service's catchment population is small, the service beneficiaries or users may all be constituents of a single local government unit. It is also possible for the service's catchment area to lie within the local government's physical boundaries. In these cases, the local government will have the administrative responsibility and political incentive to ensure the inclusive and efficient provision of the local public service. When this is not possible due to deficient financial, organizational, or technical capacity, it can be motivated or supported to do so with central fiscal transfers, co-financing arrangements with other local governments, or both.

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

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should always be decided in relation to the devolved functions that must be determined first, and in relation to the welfare of the target population.

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

Of the several provisions in the Code concerning local government finances, the two most important are those about the internal revenue allotment (sections 284–288) and shares in national wealth (sections 289–284). These sections provide the formula for computing the total and individual shares of local governments in the internal tax revenues and earnings from natural resources collected or generated by the national government. Of the two, the internal revenue allotment (IRA) is the bigger in total amount and number of local governments covered. Also, the local government share in internal tax revenues was in place even before the LGC of 1991. In contrast, the 40 percent share in the earnings or proceeds from national wealth is granted only to those localities with the relevant natural resources.

Table 1. Formula for computing the local government shares in internal tax revenues

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

Sources: Presidential Decree 144 c. 1973, Local Government Code of 1991.

*Net general funds comprise revenues collected net of budgetary funds created by law to facilitate the planning and execution of particular activities by earmarking specific tax and non-tax earnings for their use.

Three things are immediately evident from table 1, which shows how the IRA shares were determined before the LGC was promulgated, and how they are currently computed. The first observation is that the allocation criteria do not consider how expenditure obligations are assigned to local governments. The second observation is that as a group, the LGUs are now getting a bigger IRA than before, both in terms of percentage share and amount (since the IRA pie is bigger). Lastly, the new formula is biased toward barangays, those local governments with land areas, and equity.

A naïve comparison of the percentage shares in the IRA and the cost of devolved functions (CODEF), which is based on the budget appropriation in 1991 of the national government agencies for their devolved services, would suggest that the provinces and municipalities together both incurred losses, receiving only 57 percent of the IRA but 93 percent of the CODEF. In contrast, the cities and barangays together won big time. A proper comparison, however, would be in terms of amounts of CODEF and incremental IRA received (as a consequence of the change in the formula), since only these two can be properly attributed to the Code. Put differently, did LGUs obtain enough incremental funds to cover their additional spending obligations?

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

Published accounts of the political dynamics during the drafting, deliberation, and passage of the local government bill are revealing.⁹ At that time (1987–1991), the key political proponents—Corazon Aquino, Aquilino Pimentel, Jr., Ramon Mitra, Celestino Martinez, Cesar Sarino, Hilario de Pedro, and others—were ostensibly united to promote local autonomy as mandated in 1987 Constitution. Just after 20 years of martial law, the belief that local autonomy can prevent the resurgence of a strong central government was then credible and espoused by many. Since it was also taken to mean financial independence, local autonomy would free local officials from making tedious, if not demeaning, trips to Malacañang, as they did before 1987, to lobby for their local programs or projects.

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

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In contrast, the congresspersons were apparently less animated in their deliberations about what expenditure functions to devolve to which local governments. In this so-called *assignment problem*, the main protagonists were the executive departments and the affected government personnel. Basic education services (including primary schools and teachers) were initially considered and, as local public services, they would have been ideal for devolution. However, the proposal was later dropped, largely for political reasons. Teachers opposed their transfers because their additional poll duties (as canvassers) during elections would inevitably expose them to pressure, influence or intimidation by mayoral or gubernatorial candidates, one of whom would become the winner and ultimately decide on the teacher's tenure, promotion, and even personal safety.

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

If the additional revenues were inadequate, was the expanded LGU revenue-generating authority perhaps capable of providing for their additional spending obligations? Without empirical data, this is hard to ascertain. For the extra authority to yield actual income, taxes or user fees must be collected, and the tax base must be adequate and not impecunious. These factors vary across localities. But as later events suggest, the extra authority did not count for much. Instead, local officials and district representatives to Congress focused their attention more on, to paraphrase Paul Hutchcroft, re-slicing the IRA pie. Through succeeding General Appropriations Acts (GAAs) starting in 1994, the IRA formula was effectively adjusted for the CODEF. The 1994 and 1996 GAAs each stipulate that 50 percent of the actual cost of devolution and the cost of city-funded hospitals existing as of December 31, 1992 must first be deducted from the total IRA share of LGUs before the balance is distributed to individual LGUs following the IRA formula. The amount deducted will be distributed to LGUs according to their shares in the CODEF. In the 1995 and 1997 GAAs, the amount deducted from the total was equivalent to 100 percent of the CODEF and of the cost of city-funded hospitals. Note that these hospitals were operated by cities even before 1991 and were not devolved facilities. As they are not new or additional functions, the city-funded hospitals should therefore not be granted supplementary finances. But since the new GAA provisions cannot be implemented without effectively reducing the cities' IRA share (after 1991), granting them the extra funds for their hospitals can only be considered a political accommodation arising from an error in the decentralization program. These episodes underscore the importance of linking finance directly to function from the beginning, since rectifying the error later could be costly.

Functional Conflicts Among LGUs

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

The two criteria, however, may have inadvertently driven some local governments into conflict. The *functional conflicts* among local governments that are referred to here are those *inherent* in a multilevel government structure. These conflicts could arise when the natural or optimal catchment area of local public services extends over several jurisdictions, thus providing those that enjoy the spillovers with a free ride while discouraging the source LGU to reduce its provision. A conflict may also occur when a local public service achieves its most efficient scale (i.e., lowest average cost) when provided to a large, combined population residing in different jurisdictions. A larger social cost is incurred when each jurisdiction provides the service separately than when they do so jointly. However, disagreements among them about the division of the gains (in terms of cost savings) could forestall cooperation. How these problems played out under decentralization is best illustrated in the case of health services, facilities, and personnel.

Fragmented Local Health Systems

Note that when the devolved public hospitals and other health facilities were first built, equipped, and manned, they were not configured for future transfer to local governments. Managed by the Department of Health, these facilities were originally configured in each province to constitute a hospital referral system designed to meet the health and medical needs of the local population in an effective and efficient manner. Under this system, the most common illnesses and simple medical needs are attended to in primary health facilities located in barangays, *poblaciones*, or any other strategic areas in each municipality or city. The low-incidence but more serious illnesses or diseases that require surgery or medical specialists are treated in secondary hospitals located in districts that encompass two or more municipalities. The most complicated or infrequent medical cases are treated in tertiary hospitals normally located in the most accessible locations in the province or region. Since these hospitals were constructed without regard for local jurisdictions,¹⁰ when devolved, many were in fact near the boundaries or far from the central districts of the local governments. Instead, running the local hospitals as one referral system was originally meant to minimize the congestion and long patient queues in high-level facilities and the underutilization of primary facilities.

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

Rather than keeping the integrated provincial health system in place, the decentralization program fragmented it.

Local public health programs for the surveillance and control of communicable diseases (like tuberculosis and malaria), for maternal and child health (pre-natal and post-natal care, child immunization), for disease prevention, and for promotion of a healthy lifestyle are also best administered as an integrated system within a province. The effective control of epidemics

requires complete and timely information about the afflicted and vulnerable population that may reside in several jurisdictions. A number of medical interventions must be done simultaneously in contiguous areas to save on mobilization costs and to effectively contain the spread of disease vectors. Drugs and medical supplies for hospitals for public health programs can also be procured in bulk to enable the province to avail of volume discounts. Health personnel are also easily assigned or deployed in other places, or to perform other tasks where they are most needed. Before devolution, the public health facilities and public health programs within each province were administered as one integrated local health system, creating synergy.

Rather than keeping the integrated provincial health system in place, the decentralization program fragmented it. The devolved health services were confined to narrow administrative jurisdictions rather than empowered to serve their natural catchment areas and function as part of a province-wide health system. Rural health units and barangay health stations and their health personnel were transferred to municipalities. The cities were assigned some health centers (which were the equivalent of rural health units, and not hospitals). The district and provincial hospitals and their health personnel went to the provincial governments. Disease surveillance and health information flows stopped within LGUs. In many places, drug supply became erratic and more expensive. Many LGUs remained without doctors, medical technologists and other specialists, many of whom feared the politicization of their careers and the limitation of their professional prospects to the local bureaucracy. To their dissatisfaction, some LGUs found their devolved hospitals less than ideally located or capacitated. Add to their woes the fact that the transfer became evident only before the Code was passed in October 1991. Unsurprisingly then, many LGUs in the early years of decentralization clamored for the re-nationalization of the devolved health services. To be sure, attempts were later made to consolidate the operations and management of the devolved health services. Some were successful, but most were frustrated by political discord among local officials.

The functional tugs of war among local governments are not only about health services. Conflicts also arise in the management of shared resources—such as marine, coastal, and forestry resources—that require the cooperation of two or more affected localities. The proliferation of redundant public infrastructures—like seaports, airports, and public

roads—is also indicative of the flawed assignment of expenditure functions (and of their financing).¹¹ Perhaps the conflicts arising from the mismatch between the assigned function and the level of local government are nowhere as evident or painful as those experienced daily in Metro Manila. In recent months, traffic in the metropolis has gotten worse, resulting in losses estimated at PHP 2.4 billion a day.¹² The losses were higher when Manila City imposed a truck ban for around six months starting in February 2014, purportedly to ease the traffic congestion within its jurisdiction. The city ordinance forced trucks that ferry containers from Manila ports to seek alternate schedules and routes that ultimately worsened road congestion in the rest of the metropolis. Worsening air quality and crime, perennial floods, and uncollected garbage also indicate the limitations of existing local government structure to deal with metropolitan problems.

Financial Conflicts between Local Government Units and National Government

Precisely because finance did not follow functions that were also not aptly assigned to local governments, local officials soon clamored for additional money from the national government. Since the incremental IRA shares were not linked to the CODEF, local governments considered the first as their entitlement (under local autonomy) and the latter as unfunded mandates. Since 1991, there have been several bills filed in Congress and proposals made by the different local government leagues¹³ to combine other income sources with the internal revenues on which the allocation to local governments is based, increase the percentage share of the local governments in the total, or ensure the automatic disbursement of their internal revenue allocations. In these proposals, the local governments were united against the national government. They even took the national government to the Supreme Court when the then Ramos administration withheld 10 percent of their IRA, purportedly to manage the public sector deficit following the 1997 Asian financial crisis. Other proposals that only reallocate the total share of the local governments among themselves were not as widely supported. In fact, existing cities opposed the conversion of some municipalities to cities in order to protect their IRA. Financial conflicts between local governments and the national government arise time and again, especially when the latter issues corrective measures to make local governments earmark or apportion some of their incomes for the devolved functions. These conflicts are resolved or avoided when local governments get more money.¹⁴

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

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allowances of health workers. Again, this incident further underscores the importance of linking finance directly and straightaway to the devolved functions.

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

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

Section 290. *Amounts of Share of Local Government Units.* — Local government units shall, in addition to the internal revenue allotment, have a share of forty percent (40%) of the gross collection derived by the national government from the preceding fiscal year from mining taxes, royalties, forestry and fishery charges, and such other taxes, fees or charges including related surcharges, interests, or fines, and from its share in the utilization and development of the national wealth within their territorial jurisdictions.

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

Tugs of war over revenues also happen among governments. While the provisions in the Code help avoid conflicts over shares in income from sand quarrying, remittance of the shares remains a contentious issue among concerned local governments. Another type of conflict is sharing in the payment for the use of a local resource whose harmful by-products (pollution, damages to environment, or health) extend beyond the boundaries of the host locality. An example is the controversy regarding the sanitary landfill opened in Montalban (now Rodriguez) in 2002, purportedly for the garbage collected in Metro Manila. Under the arrangement with the Metro Manila Development Authority, Montalban was to be paid for the use of its landfill. A court injunction was subsequently issued to stop the opening of the landfill upon the motion of other stakeholders in Rizal province that the landfill would cause environmental damage to spill over into adjoining municipalities.

Fixing the Fragmentation

The problems inherent in a decentralized setup—namely, spatial spillovers and forgone scale economies—are not without solutions. In fact, several of them have been tried since 1992. They can be classified into two. The first set of solutions comprises special grants or technical assistance targeted to LGUs to expand provisions enough for resident and non-resident beneficiaries. The funds carved out of the total IRA from 1994 to 1997 that were transferred to LGUs for their CODEFs may be considered an example of this type of solution. It should be mentioned, however, that such transfers may not be sustainable since they depend on the financial capacity of the grantor (usually the national governments or a development partner). Besides, such transfers may lead to moral hazards, i.e., the receipt of the grant itself becomes the main motive for under-providing the service.

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

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

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

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

Unlikely but not impossible is a formal amalgamation of several local governments into a bigger unit. This is the case of the Island Garden City of Samal (IGACOS) which was formed

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in 1998 out of the union of three municipalities (Samal, Babak, and Kaputian) on Samal Island, Davao Del Norte. Since then, IGACOS has gained prominence among domestic and foreign tourists.

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

Weak enforcement of commitments, rather than limited expectation of gains, is a common reason for why inter-LGU alliances fail to continue after the startup years when donor or civil society support was heavy. After garnering national recognition in its early years, the BBRMCI began to decline when support to operations from one of the participating municipalities was withdrawn. The defaulting member municipality could not be penalized because there is no penalty provision for such breaches stipulated in the BBRMCI Memorandum of Agreement. The MMDA charter is also strong in carrots but weak in sticks. A previous MMDA chair, on numerous occasions, expressed the need to amend the charter so that the Authority could enforce traffic regulations in the whole metropolitan area without fear of being contradicted or contravened by separate local ordinances.

Memoranda of agreements that are all carrots without sticks work only when cooperation is mutually self-enforcing. This is the case, for example, when two LGUs find it mutually beneficial to connect their barangay roads since neither segment of the road will be as useful without the other. When the alliance is set to contain spatial spillovers, however, cheating trumps cooperation. This is the case, for example, when two LGUs decide to unclog their canals to avoid floods that affect both of them when it rains. If only one clears its own drainage system, the other also benefits since the flood water will find an outlet, but saves on the cost of the cleanup. If each LGU waits for the other to unclog (hoping for a free ride), then both their canals will remain clogged. Come rain, both will be inundated—a worse outcome than if they cooperated in the first place (see Box 1). To ensure cooperation,

both rewards and punishments must be part of the terms of agreement, as is standard in contracts between the government and private companies.

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

Box 1. Coordination Game and Prisoner's Dilemma Game

Figure 1. Cooperation is self-enforcing

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

Figure 2. Cooperation is not self-enforcing

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

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

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

Toward a Better Local Government Structure

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

To be sure, there are now several initiatives to address and promote consolidation directly or through amendments in the Code. In particular, the Philippine Development Forum¹⁸ Working Group on Decentralization and Local Government includes in its 2013–2016 calendar activities geared toward increasing "inter-local government cooperation for local economic

development activities.” Among their targets are an “increased number of functioning inter-local cooperation/alliances established” and “adoption of a financing framework for inter-local alliances.” In its review of the LGC of 1991, the group listed “clarifying the service delivery responsibilities by LGUs” and “addressing jurisdictional formation policies and the framework for LGUs alliances” under fiscal policy topics for further analysis. It sees the need to amend the basis for local government creation, since the current trend of conversion of municipalities to cities and the splitting up of a local government into two or more smaller jurisdictions is thought to lead to inefficiently-sized local governments. To arrest this trend, the group proposes to essentially raise the income requirements for conversion or creation of new LGUs. The list of proposed amendments also encompasses expenditure assignments, revenue assignments and taxing powers, intergovernmental fiscal transfers, and fiscal administration, and these appear to be well supported by local governments and other local stakeholders. While these are all important issues in themselves, an equally important issue is that they should also be closely linked and in proper sequence—that is, the functions should first be determined before the finances are decided. Seemingly, however, the proponents still take as suitable the existing local government structure after 25 years.

Three developments over the same period underscore not only the need to amend the Code but the more encompassing decentralization program of the government and the underlying local government structure. These developments are making the decentralization concerns about spatial externalities and economies of scale more salient than ever. The first development is continued urbanization. According to the World Bank, the proportion of urban-based population has increased from 37 percent in 1980 to about 45 percent in 2014. Besides the metropolitan areas of Manila, Cebu, and Davao, other areas where population concentrated heavily into urban areas between 2000 and 2010 are Angeles, Bacolod, Zamboanga, Iloilo, Baguio, General Santos, Cagayan de Oro, Cotabato, Dagupan, Lucena, Iligan, Tagum, Marawi, Batangas, Kabankalan, and Butuan (Appendix 1). Of these, seven have their respective land areas within one administrative boundary, which means that their local governments are likely able to manage traffic congestion, floods, garbage collection, or other urban problems without having to coordinate with other jurisdictions. In eight of the areas, however, about half of the total urban area lies outside one administrative boundary, which may necessitate metropolitan arrangements. The urban areas of Manila, Cebu, Angeles, and Dagupan extend to several administrative jurisdictions. Since these metro areas are unlike other jurisdictions in the country, they require a different type of local government suitable to their needs. While the MMDA is not a local government, it is a special purpose

These developments are making the decentralization concerns about spatial externalities and economies of scale more salient than ever.

local agency to address metro-wide concerns. Except for its governance structure, it functions like a local government. However, transplanting the MMDA to other metro areas in the country without fixing its governance structure would be inadvisable.

The second development is the rapid growth and adoption of information and communication technology (ICT) by all segments of the population. ICT facilitates not only improved

access to information about public services but also actual access to the service itself. With the appropriate ICT in place, taxes, fees, and charges for public services can be paid at home without having to queue at the municipal cashier's office. By running online surveys, local officials should be able to determine the needs of their constituents. The public's access to information about their officials' activities may also make those officials more responsive and accountable. Since ICT effectively substitutes for some workers, their adoption should lead to leaner local governments. Hence, some of the prescribed plantilla or regular positions in local bureaucracies may become redundant or irrelevant. ICTs should also facilitate coordination among local governments.

Finally, the changing climate has worsened rains, floods, and droughts, and has distorted weather patterns. These changes negatively affect livelihoods and local economies, which at once reduce the tax base of local governments and increase the demand for services. Since contiguous areas are often jointly affected, they must work together to manage the risks. However, to recover from disasters, they would need help from the outside, including the national government. Often, however, the relief and recovery operations are stalled by snags in coordinating the various agencies involved. When compared to what has been achieved through the massive relief operations of several agencies in Yolanda-affected provinces, the successful zero-casualty result from recent typhoons achieved in Albay is impressive by far. Unlike in Tacloban, all the critical disaster management operations and units in Albay were effectively consolidated under one command—that of the provincial governor. However, it is far easier to consolidate the relevant units and operations by amending the Code and other relevant policies than it is to clone Governor Joey Salceda and make his clones run and win gubernatorial positions. In consolidating disaster relief and recovery operations, the assignment of roles should still be apposite to the local government level. Identifying the pertinent local government level, however, depends on the types and gravity of disasters that can be expected to occur in the area (even allowing for wide margins due to climate change). Consequently, the disaster and risk management functions may be consolidated at the province level or inter-provincial level.

Creating new types of metropolitan arrangements, instituting special purpose agencies, and decentralizing asymmetrically (different functions to local governments of the same level) need to be considered in the review of the government's decentralization program and of the Code.

Creating new types of metropolitan arrangements, instituting special purpose agencies, and decentralizing asymmetrically (different functions to local governments of the same level) need to be considered in the review of the government's decentralization program and of the Code. Furthermore, the existing local government structure must be re-examined, given developments in the size, distribution, and composition of the population. Where the economies of scale are great and the population fairly homogenous (in their preferences for public services), it is more efficient to have big local governments (in terms of size of

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constituents). Where there are no scale economies to be had and the people vary widely in their desired public services, it would make sense to split the local government into smaller units. Unlike income and population per se, these criteria (scale economies and heterogeneity of preferences) provide a clear economic basis for the creation of new LGUs.

Finally, reforming the Code is unlikely to be sufficient. Political reforms concerning elections and political parties are also critical in making the local governments fully responsive and accountable to their constituents. Assigning the responsibility over a public service to the right local government and then ensuring that it has the financial resources does not mean that it will automatically do a good job—it will still have to want to deliver that public service. Making it do so would require political and administrative reforms concerning elections, and the conduct of performance audits. Thus, to make the local governments truly responsive and accountable, we need to broaden the scope of reform beyond the Code.

Postscript

Three months after this paper was presented in a public forum, a new president was elected with the campaign promise to turn the Philippines into a federal state. While a federal setup would change the current local government structure, the aforementioned factors—urbanization, ICT developments, climate change and political institutions—recommend more than simply empowering the existing regions and giving more resources to local governments, contrary to what the federalism advocates believe. The lesson of 25 years of devolution harks again: Set the reforms right as much as possible in the beginning, for rectifying the errors later could be difficult, if not impossible.

Notes

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2. Barely three months after the Eighth Congress convened in July 1987, there were already “several bills for a local government code introduced in both the House and the Senate” (Hutchcroft 2004).
3. *Batas Pambansa Bilang 337*, c. February 1983.
4. For the range of devolved functions and powers, see, for example, Diokno (2012) and Llanto (2009; 2012).
5. The Philippine experience under the LGC of 1991 has been reviewed many times. The common finding is that the results, at best, are mixed: Some places indeed became more responsive to their constituents; many did not. See, for example, Diokno (2012), Llanto (2009; 2019), and World Bank (2011).

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6. Philippine Development Forum (2014a; 2014b).
7. See, for example, Ter-Minassian (1997), Bird and Vaillancourt (1998), or Boadway and Shah (2009).
8. Capuno (2001).
9. My main source here is Hutchcroft (2004).
10. The criteria that the Department of Health used before 1992 in establishing new hospitals were (i) distance of at least 35 kilometers from any existing government hospitals, (ii) accessibility as a referral facility to a minimum three rural health units or main health center facilities within the catchment area, and (iii) a permanent population of at least 75,000 to be served within the catchment area.
11. The 2012/2013 Philippine Human Development Report aptly labels this syndrome as “divided-by-N.”
12. National Economic and Development Authority (undated).
13. Dorotan and Carizo (2014) present a summary comparison of the proposals of the respective leagues of provinces, cities, municipalities and barangays.
14. The financial tug of war between the local governments and the national government is not only due to the mismatch in the allocation of expenditure functions and finance under decentralization. The IRA, pork barrel funds, and other central transfers are also determined by political patronage. See Hutchcroft (2012) and De Dios (2007).
15. Arcenas, Capuno, and Ferrer (2011).
16. Ferrer, Osorio, and Chan (2010).
17. See Gatmaytan (2014) for some Supreme Court rulings on cases involving local governments and a national government agency.
18. The Philippine Development Forum comprises Philippine government officials and representatives from development partners (e.g., ADB, WB, USAID, EU, AUSAID, JICA).

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Annex 1. Urban Areas with Populations Greater Than 100,000 People

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

Source: Table reproduced from World Bank (2014)