Caught Between Imperial Manila and the Provincial Dynasties: Towards a New Fiscal Federalism

RONALD U. MENDOZA*
JUDE B. OCAMPO

Abstract

"Imperial Manila" is often blamed for influencing public finance in at least three ways: a) by being the beneficiary of a disproportionately larger share of public spending; b) by "controlling" public spending allocations to the LGUs; and c) by passing on unfunded mandates to the LGUs. On the other hand, LGUs—notably those farthest from the capital—have become dominated by political dynasties, in turn linked to deeper poverty and underdevelopment. These two forces often contribute to a center-periphery relationship that perpetuates (or at least fails to correct) bad governance and fiscal dependence. How do we break this impasse? This paper outlines the original rationale behind decentralization and examines efforts towards more effective governance and increased fiscal independence of local government in the Philippines. It then examines some of the historical data and evidence, with a focus on provinces, cities and municipalities. It discusses some of the potential factors behind these patterns; and it concludes with possible reform options towards more effective fiscal federalism.[1]

Keywords: federalism, decentralization, imperial Manila, political dynasties

* Corresponding author. Email: ronmendoza@post.harvard.edu

One of the principal reasons why proponents of federalism have pushed for this change in the Philippines is the perception that "imperial Manila" dominates the economic and political affairs of local governments. This dominance gives rise to complaints that Manila benefits disproportionately from both public and private sector spending and investments, that it controls public spending allocations to local government units (LGUs, and that it also passes on unfunded mandates to LGUs, further shrinking their elbow room to finance and craft their homegrown development strategies.

Furthermore, the political science literature acknowledges how the Philippine presidency is a winner-take-all contest that hands over the keys to imperial Manila and control over the country's still largely centralized public finances to the occupant of Malacañan Palace. In large measure, this concentration of authority over public finance fuels the view of an imperial Manila. Regardless of whether the government is reformist or predatory, federalist proponents contend that this overconcentration of fiscal power breeds bad center–periphery politics and undermines the spirit of decentralized political power in the country.

On the other hand, the Philippines' geographic periphery—supposedly the antithesis of imperial Manila—also faces intense governance challenges. Political dynasties are expanding among the LGUs. When expressed as a share of total local government leadership, the latest calculations on political dynasties suggest that, at an average expansion of about four percentage points per election, they may comprise almost 70 percent of total local government leadership by around 2040 (Banaag and Mendoza 2016). Dynastic expansion, in turn, is associated with weaker political competition, deeper poverty, and much lower human development outcomes. Bad local government managers are often difficult to replace, while potentially good ones are unable to compete in the political system unless they are wealthy or connected. This, largely due to the dominance of political clans. Recent studies also emphasize how dynastic leadership patterns are associated with distortions in public finance—curbing local public finance allocations in favor of family ties rather than economic development and poverty reduction.

> The present system is characterized by a perverse center-periphery relationship.

Thus, the present system is characterized by a perverse center–periphery relationship. The periphery depends heavily on the central government for resources, while showing very mixed results in the implementation of policies and laws. On the other hand, the central government fails to support decentralization and often ends up consolidating power by controlling much of the public resource allocations. In the end, imperial Manila and the dynastic periphery are often found in collusion, and this does not necessarily bring about sustained reforms nor strong development outcomes.

This situation has not produced stronger accountability and fiscal autonomy despite well over 25 years of decentralization. While a variety of factors come into play, there is little doubt that malfunctioning public finance is one of the key reasons behind what ails decentralization in the Philippines. The questions this paper raise are whether and to what extent fiscal federalism can be aligned with greater fiscal independence as well as accountability, both for the central government as well as the LGUs.

It is important to note that the term "fiscal federalism" does not necessarily imply a full-fledged federal system; rather, it covers various forms of central–local fiscal public finance reforms that enable more effective governance.[2] Other reforms will be necessary to enhance fiscal federalism, but those are beyond the scope of this paper and will be briefly acknowledged as part of a possible broad package of reforms.

In what follows, section 1 of this paper briefly reviews the experience behind the Local Government Code. Section 2 then provides a comprehensive review of the fiscal data with a view to analyzing whether and to what extent local governments have managed to improve fiscal autonomy. Section 3 discusses some ideas for reinventing the country's intergovernmental fiscal transfers in order to better align them with stronger independence and accountability over time. A final section synthesizes the main messages.

Review of Evidence on Decentralization Gains

In 1991 the country inaugurated the Local Government Code, reflecting aspirations towards greater decentralization and, in part, as a response to counter centralized power under the Marcos dictatorship and perhaps even the administrations prior to that (Rivera 2002; Tayao 2016). Decentralization, at least in principle, was expected to bring government closer to the people by empowering local government units to respond to the needs of citizens, with policies and interventions that best fit their local conditions. Local authorities could be expected to enhance the efficiency of government response, compared to a centralized structure, given their knowledge of and flexibility to adjust to local conditions. Devolution of public services would continue to the lowest governance unit feasible, while ensuring that there would be few, if any, spillovers from these services across other jurisdictions.[3]

Given spending, taxing, and borrowing powers among other functions devolved to LGUs, the challenge would be to match resources with spending priorities. And many saw this as the key to stronger governance and accountability. Analysts recognized how the ability of local governments to link spending and revenue decisions effectively, represented the key to fiscal responsibility (see Manasan 2005). Yet, functional autonomy continues to be elusive in many LGUs in the Philippines for a variety of reasons.

Mixed Results from Decentralization

Today, almost 25 years after, the Philippines' experience with decentralization has produced mixed results. Some analysts credit decentralization with various reform gains. It has contributed to grassroots empowerment and citizens' participation at the community level, and it has helped to enhance transparency at the local level (in turn feeding into more informed citizens' engagement). They also observe how decentralization spurred greater cooperation and exchange across LGUs, notably the Leagues of Cities and Municipalities as well as other LGUs. Under this environment, the recognition of good local government practices also emerged as a means to support better managed LGUs (e.g., Galing Pook Awards and Most Competitive City under NCC). More localized development plans also emerged from a number of LGUs, along with more women leaders as local officials.[4]

In addition, the beginnings of performance management systems have been introduced at the local level in various degrees and in partnership with different actors (notably donors and civil society groups). In the 1980s the Department of Interior and Local Government introduced the Local Productivity and Performance Measurement System (LPPMS; later revamped and updated in 2000 in partnership with donor agencies) in order to provide the LGUs with an assessment tool for their performance. Data underpinning this performance assessment system is still incomplete and scattered, notwithstanding recent efforts to rationalize these and link them to public finance allocations (see Asian Development Bank 2005 and Panadero 2011).

Nevertheless, a number of malfunctions also characterized the decentralization process. First, there continues to be a significant mismatch between the absorptive capacity of LGUs and their expanded responsibilities. This was further aggravated in many LGUs with the off-loading of unfunded mandates to the LGUs. In addition, many LGUs were caught in a trap whereby their underdeveloped financial capacity contributed to their dependence on intergovernmental transfers (primarily the internal revenue allotment, or IRA). The transfers likely crowded out any capacity building and fiscal autonomy efforts (as will be elaborated in the next section), in turn leading to further dependence of these LGUs.

Under these conditions, central government continued to dominate local public finance—either by design or by default—providing the bulk of support for LGU expenditures. This has, in turn, continued to fuel the size of central government, which has dwarfed the bureaucracy of local government despite decentralization. Finally, and perhaps most importantly, poverty reduction and development in the countryside has remained elusive. Instead, political clans have emerged as powerful political patrons, particularly in the poorest regions farthest from imperial Manila.[5] Anecdotal evidence suggests that the clans are advantaged precisely by their role as patrons-cum-leaders, which grants them access to public finance and other government resources. In many ways, they have little incentives to reduce poverty or introduce dramatic changes to the development landscape.

While a variety of factors come into play, there is little doubt that malfunctioning public finance is one of the key reasons behind what ails decentralization. Llanto (2012, 1) argues for a "clearer and more accountable assignment of expenditure by eliminating particular sections of the [Local Government] Code, which serve as a route for national government agencies to be engaged in devolved activities, and for politicians to insert funding for pet projects, which distort local decision making and preferences." In particular, Llanto identified certain departments (e.g., Agriculture and Health) which continued to maintain large bureaucracies despite being devolved. Sections 17c and 17f of the Local Government Code, combined with Executive Order 53, provided "national government agencies the excuse to implement devolved public works and infrastructure projects and other facilities, programs, and services provided these are funded under the General Appropriations Act (GAA), other special laws, pertinent executive orders, and those wholly or partially funded from foreign sources" (Llanto 2012, 9). These loopholes also provided opportunities for corruption as legislators in charge of budget oversight could collude with their local government counterparts in order to place insertions in the budget. Indeed, the political economy of this budgeting environment encouraged continued dependence on spoils

from the budget rather than developing greater fiscal autonomy and efficiency for local area development.[6]

> The political economy of this budgeting environment encouraged continued dependence on spoils from the budget rather than developing greater fiscal autonomy and efficiency for local area development.

Moreover, extensive analyses of fiscal indicators suggest very mixed results as far as efforts to achieve enhanced fiscal autonomy. Manasan (2005), for instance, examined data on fiscal indicators (e.g., own source revenues, fiscal transfers, etc.) spanning the years 1985–2003 and found inconsistent results in this area. First, the resources needed for the devolved functions (including some added on to the LGUs over time) did not match the resources provided to the LGUs, suggesting vertical fiscal imbalance. Provinces, municipalities, cities, and barangays accounted for 37 percent, 39 percent, 6 percent, and 19 percent, respectively, of the total cost of devolved functions. However, the mandated share of the LGUs of the IRA was 23 percent for provinces, 34 percent for municipalities, 23 percent for cities, and 20 percent for barangays, suggesting that only in cities were the figures relatively better matched (Manasan 2005, 77).

In addition, the mismatch between revenue means and expenditure needs across various levels of local government appears to have worsened over the period of Manasan's study, at all levels of local government (e.g., provincial, city, and municipal). The fiscal deficiency for all LGUs grew from around 7 percent in 1985–1991 to almost 17 percent by 1992–2003 (Manasan 2005, 74). Finally, horizontal fiscal balance—the balance achieved across jurisdictions through appropriately calibrated transfers—also failed to improve over time. If all LGUs are aggregated at the provincial level, the per capita IRA was positively correlated with per capital household income in 1995–1999. This implied that the transfers were counter-equalizing from the point of view of the LGUs' fiscal capacities (Manasan 2005, 80).

Hence, on enhancing both vertical and horizontal fiscal balance over time, the evidence suggests deterioration over time. Section 2 of this paper examines these indicators using updated and comprehensive data; it also shows how many LGUs failed to improve their fiscal situation over the decentralization period.

The Promise and Curse of a Rigid Legal Foundation

The legal foundation of the current system of LGU finance rests on three sections in Article X (Local Government) of the 1987 Constitution. Sections 5 to 7 of this Article state:

> SECTION 5. Each local government unit shall have the power to create its own sources of revenues and to levy taxes, fees, and charges subject to such guidelines and limitations as the Congress may provide, consistent with the basic policy of local autonomy. Such taxes, fees, and charges shall accrue exclusively to the local governments.
>
> SECTION 6. Local government units shall have a just share, as determined by law, in the national taxes which shall be automatically released to them.

> SECTION 7. Local governments shall be entitled to an equitable share in the proceeds of the utilization and development of the national wealth within their respective areas, in the manner provided by law, including sharing the same with the inhabitants by way of direct benefits.

The intention of these sections is clear: LGU resources are enhanced through the grant of taxing powers at the local level and the increase of national assistance to local governments, primarily through the internal revenue allotment (IRA).

The President of the Constitutional Commission of 1986, Cecilia Munoz Palma, described Article X of the 1987 Constitution as one which "devolves the powers of imperial Manila to the provinces and cities in the hinterland in a clear reversal of the colonial policy of over centralization." This sentiment against the perceived over centralization of both political and economic powers in Manila (and the rhetoric describing the capital as a colonizer of the periphery) influenced the crafting of the Local Government Code provisions on local taxation and fiscal matters and the decisions of the Supreme Court interpreting Article X and the Local Government Code. In one of the earliest Supreme Court decisions on Article X, the Court echoed a political sentiment to add flourish to legal interpretation. It wrote that while the 1987 Constitution does not "usher in a regime of federalism," it does "break up the monopoly of the national government over the affairs of local governments and as put by political adherents, to 'liberate the local governments from the imperialism of Manila.'"

Section 284 of the Local Government Code, which provides for the LGU share in the national internal revenue taxes,[7] provides a rigid formula for determining the share of LGUs from these taxes: 40 percent of the taxes collected in the third fiscal year preceding a current fiscal year. The national government is only able to reduce such share in the event the national government incurs an unmanageable public sector deficit. Even then, the LGU share cannot be lower than 30 percent of the taxes collected in the third fiscal year preceding a current fiscal year.[8]

Section 286 of the Local Government Code fleshes out the automatic release mandated by Article X, Section 6 of the Constitution by providing that: "(t)he share of each local government unit shall be released, without need of any further action directly to the city, municipality or barangay treasurer, as the case may be, on a quarterly basis within five (5) days after the end of each quarter, and which shall not be subject to any lean or holdback that may be imposed by the national government for whatever purpose."

The sections of the Constitution on local government finance and the provisions of the Local Government Code on IRAs have been put to good use in protecting such allotments from direct assaults by the national government (both by the legislative and the executive) to reduce the LGU share in the IRAs in cases before the Supreme Court. In the leading case of *Pimentel v. Aguirre*,[9] the Court rebuffed the attempt of the President to withhold 10 percent of the allotments and wrote: "A basic feature of local fiscal autonomy is the automatic release of the shares of LGUs in the national internal revenue. This is mandated by no less than the Constitution. The Local Government Code specifies further that the release shall be made directly to the LGU concerned within five (5) days after every quarter of the year and 'shall not be subject to any lien or holdback that may be imposed by the national government for

whatever purpose.' As a rule, the term 'shall' is a word of command that must be given a compulsory meaning. The provision is, therefore, imperative."

In another case interpreting the above same legal text, the Court wrote: "Webster's Third New International Dictionary defines 'automatic' as 'involuntary either wholly or to a major extent so that any activity of the will is largely negligible; of a reflex nature; without volition; mechanical; like or suggestive of an automaton.' Further, the word 'automatically' is defined as 'in an automatic manner: without thought or conscious intention.' Being 'automatic,' thus, connotes something mechanical, spontaneous and perfunctory. As such, the LGUs are not required to perform any act to receive the 'just share' accruing to them from the national coffers. As emphasized by the Local Government Code of 1991, the 'just share' of the LGUs shall be released to them 'without need of further action." This case of *Batangas v. Romulo*[10] is interesting in that the Court here ruled that the national government is not able to modify the 40 percent share and the command for automatic release in the Local Government Code through provisions in the General Appropriations Act – a law validly passed by Congress and signed by the President. The Court explained, that "(i)ncreasing or decreasing the IRA of the LGUs or modifying their percentage sharing therein, which are fixed in the Local Government Code of 1991, are matters of general and substantive law. To permit Congress to undertake these amendments through the GAAs, as the respondents contend, would be to give Congress the unbridled authority to unduly infringe the fiscal autonomy of the LGUs, and thus put the same in jeopardy every year."

As detailed in the subsequent sections, while the legal provisions on the *mechanical, spontaneous and perfunctory* release of the allotments have been able to protect the share of the LGUs from the national government, they have not been able to protect the LGUs from themselves. Instead of enhancing LGU revenue through efficient use of the local taxing powers, which would lead LGUs towards greater fiscal independence, local politicians have instead sought to increase their share in the IRA.[11]

Political Inequality and Public Finance

As noted earlier, decentralization has not always produced development-oriented local leadership. Indeed, decentralization has ushered the entry of stellar leadership by the likes of Jesse Robredo, but also debilitating impunity such as that exemplified by Andal Ampatuan.

Increasingly, leadership patterns in local government reflect the dominance of a few—notably from political clans that have amassed both name-recall, political capital, and wealth over time—signaling weaker democratic competition and greater political inequality (between the politically powerful and their constituents) in many parts of the country. Analysts trace the emergence and persistence of political dynasties from a variety of factors. Some point to name recall and incumbency advantages that easily translate into self-perpetuation.[12] Stark inequality in socio-economic conditions and the absence of a truly democratic electoral and party system also contribute to a weakness in the supply of non-dynastic leadership options as well as the higher demand for patrons.[13] Regarding the latter, a generally weak institutional environment combined with low human development and high deprivation among a significant swathe of the population further fueled the demand for local patrons, feeding into the political strength of these local elites. And even as

political dynasties won by higher margins of victory and tended to be wealthier on average (Mendoza et al. 2012), they also proliferated in the poorest parts of the country, with some of the lowest per capita incomes, highest infant mortality, and weakest primary education outcomes (Collas-Monsod, Monsod, and Ducanes 2004).[14] And provinces with weak political competition—as signaled by the proliferation of political clans—also demonstrated the weakest income growth and lowest human development outcomes.

The empirical literature suggests that weak political parties and strong political clans tend to produce skewed resource allocations, not necessarily in favor of development goals. Instead, clan ties tend to figure prominently.

Ravanilla (2015), for example, examined data on Philippine Development Assistance Fund (PDAF, or, the pork barrel) allocations among legislators in the 2001, 2004, 2007, and 2010 election years. He found that disbursements were made in favor of mayoral partisan allies and members of the same political clan.

Similarly, Atkinson, Hicken, and Ravanilla (2015) studied Philippine legislators' allocations of post-typhoon reconstruction funds to municipal mayors using data from 2001 to 2010. They found evidence that political ties—notably, belonging to the same political clan as the local officials—tended to increase reconstruction funds channeled by legislators to municipalities. These authors advocated for limits on discretion in order to control against political influence over disaster reconstruction funds.

Political clans have also found ways to expand their public finance footprint through gerrymandering. Since the introduction of the Local Government Code, the number of Philippine cities has more than doubled, from 60 in 1990 to 122 by 2010. Capuno (2013) examined the correlates of the growth in the number of Philippine cities from 2001 to 2010, using a dataset including fiscal, demographic, socioeconomic, and political variables. Based on a model of the decision to convert to cityhood, he found empirical evidence that political payoffs—such as the incumbent mayor's re-election or a political clan member elected to the new city office—are strong predictors of the creation of new cities.

Political clans have also found ways to expand their public finance footprint through gerrymandering.

Furthermore, in a forthcoming report by the World Bank, the authors examined the allocation of Philippine road infrastructure budgets in the aftermath of the PDAF (pork barrel) abolition. They analyzed the factors linked to different road investment portfolios covering over 7,000 individual road projects by regressing these allocations on variables capturing several possible dimensions, notably: a) poverty (e.g., small area poverty estimates at the municipality level), b) productivity (e.g., proportion of barangays with access to transportation with higher capacity; proportion of barangays with access to a highway) and c) political (e.g., affiliation by party and affiliation by clan or family, more commonly known as political dynasty).

The empirical analysis revealed very interesting differences in road budget allocation patterns. Farm-to-market (FMR) roads allocated under the government's bottom up budgeting (BUB) portfolio tended to go to poorer areas (no doubt due to the targeting mechanism integrated in that portfolio); however, the regular FMR allocations in the main

budget seemed to go to municipalities with already better road infrastructure. It was also the road portfolio most affected by political variables. Municipalities in which the mayors shared the same political party as the legislators (the local congresspersons) were 4.3 percentage points more likely to receive road allocations compared to the average municipality; municipalities in which the mayors belonged to the same party as the local legislators and the president were 8.3 percentage points more likely to receive road allocations.

Meanwhile, municipalities where mayors came from the same political clan as any of the relevant province's congresspersons were 14.3 percentage points more likely to receive a farm-to-market road allocation from general appropriations. The authors acknowledged how the effect of political dynasty affiliation seemed much stronger than the effect of political party affiliation, confirming the weakness of political parties in the Philippines and the strength of familial relations in politics and public finance (Clarete et al. 2016).

Under these conditions of skewed public finance allocations and stagnating fiscal autonomy, it is less surprising that stronger progress and development in the countryside have proven elusive, notably where political inequality (read, political clans) has been most entrenched. Mendoza et al. (2016) examined the impact of political clans on poverty across Philippine provinces, utilizing an extensive dataset on political clans spanning the years 2001 to 2013. They found empirical evidence that the expansion of political clans led to deeper poverty incidence at the provincial level, and that this effect is stronger among provinces that are farther from imperial Manila.

Piecing together the empirical literature, the emerging evidence suggests that strong patronage politics at the local level (as signaled by the continued expansion of political dynasties) is matched by a perverse center–periphery relationship that skews national and local public finance in favor of perpetuating political power among dynastic clans. The next section elaborates on evidence, drawing on the latest local public finance data.

Review of Fiscal Independence Data, 1992-2015

Fiscal decentralization can take many forms, but the underlying concept is that it involves devolving revenue generating and spending power from the national to the local government units. As already explained above, the Local Government Code enables LGUs to expand their sources of financial resources. Nevertheless, the attempt to match local resources with the expanded mandate has proven more and more elusive over time. Although local governments possess the legal authority to impose taxes, dependence on central government allocation, instead of the expected fiscal autonomy, appears to have become relatively more ingrained over time.

The IRA dependency ratio—measured by the share of IRA in an LGU's total financial resources—provides a useful benchmark for relative fiscal autonomy over time. Looking at the IRA dependence rates of each local government unit from 1992 to 2015, a majority of the provinces, cities, and municipalities depend on the IRA for more than 50 percent of their budgets. Further, a significant number of these LGUs rely on the IRA for more than 90 percent of their local budgets. Hence, local governments came to depend heavily on fiscal transfers from the central government.

How Independent are the LGUs from the Central Government?

Table 1. IRA Dependency Rates of Provinces

	1992 (of 73)	1995 (of 77)	2000 (of 77)	2005 (of 80)	2010 (of 81)	2015 (of 81)
< 50%	5	2	1	2	2	1
> 50%	68	75	76	78	79	80
> 90%	21	22	27	30	20	20

Source: Authors' calculations based on data from the BLGF.
Note: The groups indicated by >50% and >90% are not mutually exclusive.

Table 2. IRA Dependency Rates of Cities

	1992 (of 60)	1995 (of 65)	2000 (of 81)	2005 (of 117)	2010 (of 121)	2015 (of 144)
< 50%	12	16	21	33	32	41
> 50%	48	49	60	84	89	103
> 90%	2	5	3	11	11	14

Source: Authors' calculations based on data from the BLGF.
Note: The groups indicated by >50% and >90% are not mutually exclusive.

Table 3. IRA Dependency Rates of Municipalities

	1992 (of 1465)	1995 (of 1546)	2000 (of 1441)	2005 (of 1500)	2010 (of 1491)	2015 (of 1485)
< 50%	147	100	60	80	109	65
> 50%	1318	1446	1381	1420	1382	1420
> 90%	281	547	615	640	650	620

Source: Authors' calculations based on data from the BLGF.
Note: The groups indicated by >50% and >90% are not mutually exclusive.

Under the decentralization process, the increased responsibility of local governments to provide local public goods and services implies an increase in their expenditure responsibility. However, the local governments' own revenues were not strengthened to meet the expanded expenditures.

The internal financing ratio, or IFR—defined as the total income from recurring own-source revenues divided by the total operating, or non-investment, expenditures—provides an indicator of the LGU's ability to sustain its expenditure level based on its recurring own-source revenues. A higher value indicates the LGU's greater ability to finance its own spending. Looking at the historical data, only a small number of provinces, cities, and municipalities have an IFR of more than 50 percent. In fact, only 5 of 81 (roughly 0.6 in 10) provinces, 65 of 144 (roughly 4 in 10) cities and 107 of 1,485 (around 0.7 in 10) municipalities in 2015 attained an IFR greater than 50 percent.

Can LGUs Finance Their Own Expenditure?

Table 4. Internal financing ratio of provinces

	1992 (of 73)	1995 (of 77)	2000 (of 77)	2005 (of 80)	2010 (of 81)	2015 (of 81)
> 50%	7	2	3	1	8	5
< 50%	66	75	74	79	73	76
< 10%	18	24	23	34	20	12

Source: Authors' calculations based on data from the Bureau of Local Government Finance.
Note: The groups indicated by <50% and <10% are not mutually exclusive.

Table 5. Internal financing ratio of cities

	1992 (of 60)	1995 (of 65)	2000 (of 81)	2005 (of 117)	2010 (of 121)	2015 (of 144)
> 50%	17	17	23	34	47	65
< 50%	43	48	58	83	74	79
< 10%	2	5	4	12	9	8

Source: Authors' calculations based on data from the Bureau of Local Government Finance.
Note: The groups indicated by <50% and <10% are not mutually exclusive.

Table 6. Internal financing ratio of municipalities

	1992 (of 1465)	1995 (of 1546)	2000 (of 1441)	2005 (of 1500)	2010 (of 1491)	2015 (of 1485)
> 50%	150	92	70	55	70	107
< 50%	1315	1454	1371	1445	1421	1378
< 10%	295	592	623	700	681	559

Source: Authors' calculations based on data from the Bureau of Local Government Finance.
Note: The groups indicated by <50% and <10% are not mutually exclusive.

A core component of fiscal decentralization is financial responsibility. Local governments must have an adequate level of revenues to perform their functions. The ratio of the local income over the total income refers mainly to the percentage of revenues that the LGU collects itself. Local revenues include local taxes on real properties and businesses, service charges, fees and licenses, etc. A low indicator may mean that the LGU has not maximized its taxing powers or collection efficiency. Moreover, by default, it also indicates high reliance on external sources, such as the IRA and other grants. For 2005, 2010, and 2015 not a single province generated more than 50 percent of its own income. Only few local government units generated at least half of their income—26 of 1,485 municipalities and 32 of 144 cities in 2015. The bulk of cities and municipalities have local revenue ratios of less than 50 percent of total income. Meanwhile, a significant number of local government units have local revenues accounting for less than 10 percent of their total income—21 of 81 provinces, 16 of 144 cities, and 757 of 1,485 municipalities.

Can They Generate Their Own Income?

Table 7. Local revenue ratio of provinces

	1992 (of 73)	1995 (of 77)	2000 (of 77)	2005 (of 80)	2010 (of 81)	2015 (of 81)
> 50%	4	1	1	0	0	0
< 50%	69	76	76	80	81	81
< 10%	23	26	23	41	31	21

Source: Authors' calculations based on data from the BLGF.
Note: The groups indicated by <50% and <10% are not mutually exclusive.

Table 8. Local revenue ratio of cities

	1992 (of 60)	1995 (of 65)	2000 (of 81)	2005 (of 117)	2010 (of 121)	2015 (of 144)
> 50%	12	16	21	27	28	32
< 50%	48	49	60	90	93	112
< 10%	2	5	4	14	17	16

Source: Authors' calculations based on data from the BLGF.
Note: The groups indicated by <50% and <10% are not mutually exclusive.

Table 9. Local revenue ratio of municipalities

	1992 (of 1465)	1995 (of 1546)	2000 (of 1441)	2005 (of 1500)	2010 (of 1491	2015 (of 1485)
> 50%	125	76	56	33	28	26
< 50%	1340	1470	1385	1467	1463	1459
< 10%	338	612	660	781	799	757

Source: Authors' calculations based on data from the BLGF.
Note: The groups indicated by <50% and <10% are not mutually exclusive.

Looking at the historical data of each fiscal independence indicator averaged for each local government unit from 2001 to 2015, the IRA dependency of provinces and municipalities fluctuate around 80 percent, while cities have significantly lower dependency rates at around 40 percent. IFR and local revenue ratio of provinces and municipalities remain at low levels of about 20 percent, while a remarkably higher IFR and local revenue ratio are observed only for cities.

Does the IRA Weaken Fiscal Autonomy?

If Philippine decentralization is to be a success there should be clear expenditure and tax revenue assignments between the local and national governments. Given the features of the intergovernmental fiscal relationship, the fiscal capacity of local governments is greatly influenced by that of the central government. The nature of the grant given to the LGUs, which is embedded in the provision of the LGU Code itself, a formula-based and automatically released grant unrelated to the cost of delivering devolved functions, has also faced criticism.

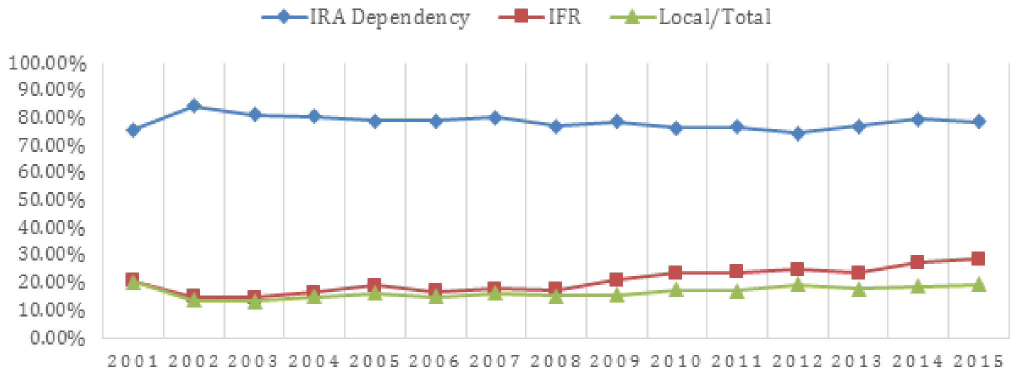

Figure 1. Fiscal indicators for provinces

Source: Authors' calculations based on data from the BLGF.

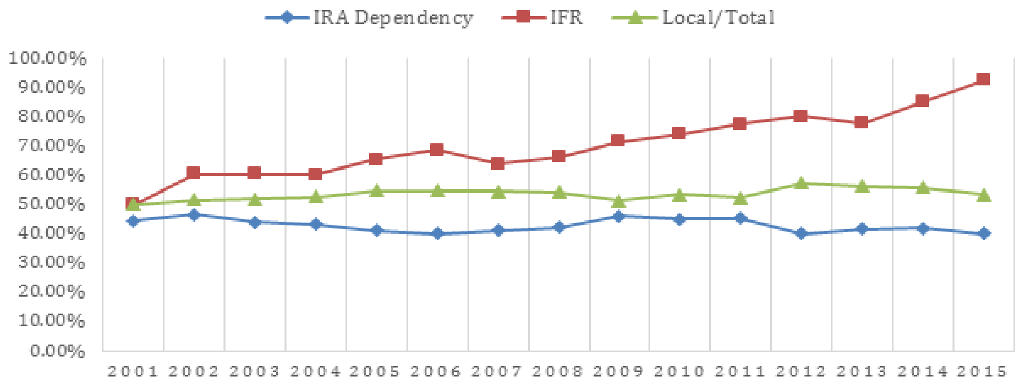

Figure 2. Fiscal indicators for cities

Source: Authors' calculations based on data from the BLGF.

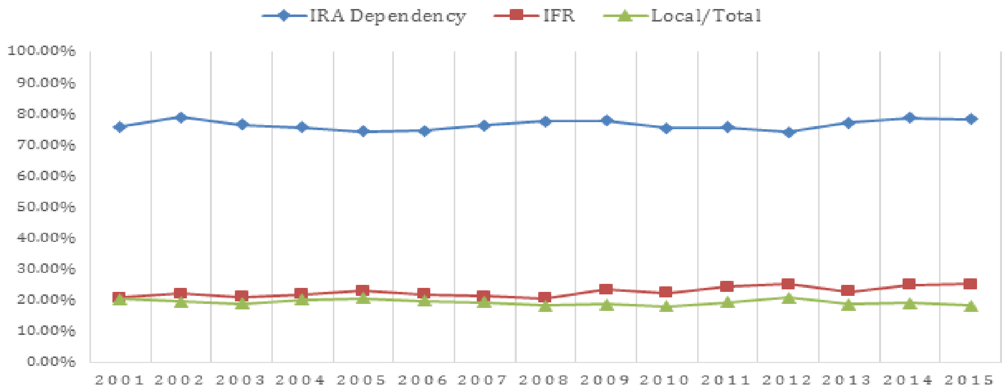

Figure 3. Fiscal Indicators for municipalities

Source: Authors' calculations based on data from the BLGF.

Previous studies—such as by Manasan (2005) and Llanto (2012)—have also highlighted the lack of improvements in fiscal indicators for a vast majority of the country's local government units. Indeed, empirical work by Manasan (2005) reveals how increases in IRA (per capita) is associated with weaker progress in boosting local tax revenues. Manasan considers this part of a possible disincentive effect that the IRA may have on the local governments' efforts to mobilize local resources and wean themselves away from IRA dependence.

We replicate that empirical exercise here, updating the dataset to extend from 2006 to 2012. Manasan's reduced form regression model examines the possible correlates of tax revenues, looking at measures of the local tax base (proxied by average family incomes) and the possible influence of transfers due to the IRA. We add another variable to this—a measure of the prevalence of political dynasties—in order to examine the possible governance backdrop behind fiscal federalism. In previous research, measures of dynastic prevalence were used as proxies for political competition (or the lack thereof) as well as local governance (Balisacan and Fuwa 2004; Mendoza et al. 2012; 2016; Teehankee 2001a; 2001b; 2007).

The hypothesized effect of dynasties on fiscal autonomy could manifest in two different ways. First, many political dynasties are known to build their last names as "brands," associating successful government projects and popular reforms to themselves often with the view to continue this track record through their relatives. In the absence of strong political parties which could more effectively aggregate and continue these reform advocacies, dynastic politicians have filled the void by advancing themselves as a force for continuity and stability (Mendoza et al. 2012; 2016). Hence, dynastic politicians might be expected to continue and build on top of reforms across time—a necessary ingredient in improved fiscal autonomy.

On the other hand, the rise of many political dynasties could also signal a deterioration in democratic checks and balances, as well as an anti-competitive political environment wherein only a few political clans hold most of the political power and have the ability to competitively field political candidates. Here, a high concentration of political power signaled by the rise of political dynasties—notably "fat dynasties," or those clans whose members simultaneously hold many political positions notably at the local government level—could be an indicator of weaker accountability and increasing impunity. Because of these two potentially competing effects, the possible relationship between political dynasties and local fiscal autonomy is an empirical question.

The appendix to this paper presents the main empirical results of the abovementioned regression model. Over all, the results show that a higher IRA (expressed in per capita terms) is associated with weaker tax revenues. Predictably, a growing tax base signaled by higher average family incomes is associated with stronger tax revenues.

Interestingly, the share of political dynasties in total local government leadership at the province level is associated with improvements in total tax revenues. This could be due to the reputation building and reform continuity possibilities that we acknowledged some dynastic clans may be pursuing. Nevertheless, when we turn to a measure of fat dynasties (proxied by the size of the largest political clan in the province), the results show a negative relationship between dynasties and fiscal autonomy. This tends to suggest that, at some

level, political clan size is negatively associated with improved fiscal autonomy, likely due to the weakened accountability and political competition that it entails.

How Might Proposed Federal States Fair?

Today, there is an increasingly popular discussion about shifting from a unitary to a federal government. While advocates see federalism as an avenue to bring economic development to the countryside, critics point to the mixed results of decentralization as a possible signal of continued challenges under full-fledged federalism. Should we adopt federalism? Or just reform the current system? A review of the fiscal performance of selected proposed federal states could help illustrate possible mixed results.

In his proposal for a federal Republic of the Philippines, former Senate President Aquilino Pimentel Jr. eyed the creation of 11 federal states. The proposed federal states are as follows:

- Luzon: four states (Northern Luzon, Central Luzon, Southern Tagalog, Bicol)
- Visayas: four states (Eastern Visayas, Central Visayas, Western Visayas, and Minparom)
- Mindanao: three states (Northern Mindanao, Southern Mindanao, and Bangsamoro)

The Federal State of Bangsamoro arose from the remnants of the ARMM. Looking at the fiscal performance of its cities compared to the national average, all of them are performing below average in terms of the fiscal independence indicators per respective income classification. Thus, this federal state can be expected to depend on central government transfers for some years to come. It is unlikely that federalism per se will change this dramatically.

Table 10. Federal State of Bangsamoro cities' fiscal performance, 2015

Class	Province	IRA Dependency	Local/Total	IFR	Performance
3rd Class	Cotabato City	81.88%	18.12%	22.96%	Below National Average
4th Class	Isabela City	94.38%	5.58%	7.04%	Below National Average
	Marawi City	86.05%	0.48%	0.68%	Below National Average
6th Class	Lamitan City	95.01%	4.76%	6.33%	Below National Average

Table 11. Federal State of Northern Luzon cities' fiscal performance, 2015

Income Class	City	IRA Dependency	Local/Total	IFR	Performance
Unclassified	Iligan City	84.62%	12.09%	16.16%	Below National Average
1st	Baguio City	37.92%	48.67%	83.63%	Below for IFR and Local/ Total; Above for IRA Dependency
	Santiago City	83.74%	16.26%	29.90%	Below National Average
2nd	Dagupan City	51.19%	48.65%	73.53%	Above National Average
	Urdaneta City	46.90%	53.10%	86.37%	Above National Average

Table 11. Federal State of Northern Luzon cities' fiscal performance, 2015 (continued)

3rd	Cauayan City	69.69%	30.31%	40.11%	Below for IRA Dependency and IFR; Above for Local/ Total
	Laoag City	49.16%	38.94%	55.50%	Above National Average
	San Carlos City (PANGASINAN)	81.73%	17.53%	27.64%	Below National Average
	San Fernando City (La Union)	60.42%	37.28%	46.56%	Above for IRA Dependency and Local/Total; Below for IFR
	Tuguegarao City	57.20%	42.56%	79.02%	Above National Average
4th	Alaminos City	77.75%	22.20%	32.50%	Above National Average
	Candon City	59.54%	17.88%	29.41%	Below for IFR and Local/ Total; Above for IRA Dependency
	Vigan City	60.66%	34.98%	54.42%	Above National Average
5th	Batac City	77.52%	22.22%	65.53%	Above National Average
	Tabuk City	93.46%	6.44%	11.22%	Below National Average

Meanwhile, a majority of the cities in the Federal State of Northern Luzon are performing above average on different fiscal independence indicators. If federal groupings are made in such a way that component provinces, cities, and municipalities are performing above average, then the federal state has a fighting chance to be more fiscally autonomous. If, on the other hand, the grouping is made in a such a way that all units are performing below average, then the federal state is likely to face an uphill climb. One of its possible advantages, however, is the expanded taxable jurisdiction which could offer better economies of scale on development programs, compared to the present highly fractionalized setup of LGUs.

Clearly, the current decentralized system has not been successful in making the LGUs more financially responsible. Instead, LGUs became more dependent on the central government in financing their expenditures. But changing the system entirely entails significant costs. If not designed properly, the new proposed system might produce unintended consequences similar to what transpired since the introduction of the Local Government Code.

Towards a New Fiscal Federalism

Addressing some of the failures of decentralization requires a careful recalibration of central-local fiscal relations towards a new fiscal federalism for the country. While the following details are not exhaustive of the economic and political reforms necessary, we outline a few possible areas for focusing reforms in order to set the stage for greater accountability aligned with enhanced access to resources for LGUs.

To begin, the empirical evidence clearly shows how the system of intergovernmental transfers has not succeeded in boosting fiscal autonomy. The number of local government units that have become dependent on central-to-local transfers has increased across the

board. And the empirical patterns indicate that transfers seem to encourage dependence rather than build towards fiscal autonomy over time.

Drawing insights from the foreign aid governance literature, it might be possible to devise alternative fiscal arrangements that would incentivize graduation to higher levels of fiscal autonomy. For instance, Collier (2005) outlined a possible aid disbursement strategy that would begin with providing grants to low income and poor governance countries conditioned on the pursuit of governance reforms. And as these reforms are accomplished and governance improves (as measured by the Country Policy and Institutional Assessment, an indicator developed by the World Bank [15]), the conditions could be relaxed and the country could then graduate to tap concessional loan programs, and, eventually, graduate towards accessing the international financial markets. Throughout this graduated development financing scheme, the country is expected to mobilize ever higher levels of resources from the international community, incentivizing the upward graduation away from conditionalities and towards stronger governance and greater access to resources.

In order to align incentives towards greater accountability to match higher access to resources, we think it would be possible to design a similar graduation mechanism for local governments. In lieu of automatic intergovernmental transfers based on a rigid formula like the IRA, local government units with low income and relatively weak governance track records[16] could be given access to conditional grants. The conditions could then be geared towards addressing governance conditions or improving allocations towards chronic poverty challenges. And as local government units move to a slightly better governance track record and slightly higher income levels, they could be given access to unconditional (or less conditional) grants and matching grants.

Hence, the goal here is to provide more flexibility in managing local public finance decisions as governance track records become more established and as reforms are built continuously over time. Finally, local government units that manage to reach the highest rungs in terms of governance and income level indicators could then begin to develop and access debt instruments, including the development of possible municipal bond markets. In addition to capital grants, the latter are critically important sources of infrastructure finance in many federal systems (Boadway and Shah 2007).

In practice, grant mechanisms in federal systems can be designed with a range of features in order to incentivize better compliance with standards of service delivery, as well as minimize the possible crowding out of local resource mobilization. For instance, output based grants to local jurisdictions are often used to encourage competition and innovation, and improve results-based accountability to citizens at the local level. Conditions are attached to outputs instead of outcomes given that the latter can involve a variety of factors not fully within the control of the local government. In addition, fiscal equalization programs can include these conditional transfers, marrying performance orientation with equity objectives. For instance, central to provincial or local government transfers for primary education and transportation in Indonesia, per pupil grants to schools and grant bonuses for best performing schools and their teachers as well as grants to municipal governments to subsidize water and sewer access for the poor in Chile, per capita transfers for education in Colombia and South Africa, and primary and secondary education per pupil transfers to states in Brazil (Shah 2007).

A better fiscal federalism could offer a way out of the perverse center–periphery relationship that characterizes much of the country's public finance. One can draw on these rich experiences to create a better architecture for the Philippines' fiscal federalism. Such change would entail a revision of the rigid foundations that sought to assure (albeit ineffectively) LGU fiscal independence.

Sections of the Local Government Code on taxation and fiscal matters must be revised as Congress reimagines the concept of an LGU's "just share… in the national taxes" provided in Article X, Section 6 of the Constitution, by embedding effective incentives into the IRA allotment and release mechanisms.[17]

Conclusion

This paper analyzed at least two inter-related governance challenges in the Philippines. The first has to do with a winner-take-all Presidential system that hands to this leader strong control over the bulk of the nation's public finance. This creates strong incentives for Congress and the local governments to quickly align with the winner of this contest every 6 years. It is a recipe for policy volatility and political party turncoatism. There is strong evidence that this central control over finance also breeds dependence of local governments and undermines their fiscal independence.

On the other hand, the provincial periphery is also racked with governance challenges. Studies show that many provinces in the periphery have become dominated by fat dynasties (i.e. political clans whose members simultaneously occupy many positions in the local government, particularly in each province). There is also strong evidence that these dynastic leadership patterns are associated with deeper poverty and underdevelopment. Clearly, issues of weaker checks-and-balances and risks of conflicts of interest abound in this governance environment. Public finance, in this context, becomes subject to abuse and often serves clan interests first, rather than the public good. On top of this, a perverse center-periphery relationship has emerged whereby many local governments become heavily dependent on central government transfers, while politicians in the center have failed to strengthen decentralization, including parts of the public finance system.

There are ways forward towards a more effective fiscal federalism in the Philippines. An appropriately structured intergovernmental transfer system could simultaneously reduce central government control, while increasing the accountability of the local governments. Incentives could be better aligned to increase accountability, not simply through more transfers, but more importantly through the flexibility linked to these transfers. A more coherent fiscal federalism could offer a way out of the perverse center-periphery relationship that characterizes much of the country's public finance.

Notes

1. The authors thank Rodelyn Rodillas and Miann Banaag for providing research assistance and inputs in some sections of this paper. The views expressed herein are the authors' and do not necessarily reflect the views and policies of the Ateneo de Manila University. The authors appreciate the support of the Ayala Corporation and the Ateneo School of Government.

An earlier version of this paper was posted as an Ateneo de Manila School of Government Working Paper in SSRN.com

2. Fiscal federalism is a subfield of public economics, focused on the analysis of public sector functions and instruments which can be best centralized or decentralized (see Oates 1999).
3. See Oates (1999) for an elaboration of the efficiency gains from decentralization.
4. Dela Rosa Reyes (2016) and Llanto (2012).
5. See, among others, Asian Development Bank (2005), Dela Rosa Reyes (2016), Llanto (2012), and Mendoza et al. (2016).
6. Llanto (2012) further added that the tax assignment also needs to be reviewed in order to offer more revenue generating options for LGUs.
7. Other laws where the national government shares taxes with the LGUs include Section 283 of Republic Act 8424 (as amended) or the National Internal Revenue Code which requires that in addition to the internal revenue allotment as provided for in the Local Government Code, 50 percent of the national taxes collected under Section 106, 108 and 116 of the Tax Code in excess of the increase in collections for the immediately preceding year shall be shared by the national government and LGUs. The national government gets 80 percent of this amount while the LGUs get 20 percent. Taxes collected under special economic zone legislation such as Republic Act No.7916 or the Special Economic Zone Act of 1995(as amended), and Republic Act No. 7227 or the Bases Conversion and Development Act of 1992 (as amended), are also shared between the national government (which receives 60 percent) and the municipality or city where the taxpayers are located (which receives 40 percent).
8. The Court wrote in *Batangas vs. Romulo*: "Thus, from the above provision, the only possible exception to the mandatory automatic release of the LGUs' IRA is if the national internal revenue collections for the current fiscal year is less than 40 percent of the collections of the preceding third fiscal year, in which case what should be automatically released shall be a proportionate amount of the collections for the current fiscal year."
9. *Aquilino Q. Pimentel, Jr. vs. Alexander Aguirre and Emilia Boncodin*, G.R. No. 132988. (July 19, 2000).
10. *The Province of Batangas vs. Alberto Romulo, Emilia Boncodin and, Jose Lina*. G.R. No. 152774. (May 27, 2004)
11. Gatmaytan (2001) mentions the conversion of municipalities into cities as one way of increasing share in the IRA.
12. Querubin (2016), for instance, examined Philippine leadership data spanning 1946 to 2010, and he found that over 50 percent of legislators in the Philippine Congress and Philippine governors have a relative who was also in Congress or served as a governor in the previous 20 years. His empirical analysis suggests that the ability to self-perpetuate by Filipino legislators elected in the 1990s was three times higher than that of legislators in the United States.
13. And even as political dynasties won by higher margins of victory and tended to be wealthier on average (Mendoza et al. 2012), they also proliferated in the poorest parts of the country, with some of the lowest per capita incomes, highest infant mortality, and weakest primary education outcomes (Collas-Monsod et al 2004).
14. For further readings, the reader may turn to Balisacan and Fuwa (2004), Collas-Monsod, Monsod, and Ducanes (2004), Hutchcroft and Rocamora (2003), Mendoza et al. (2012), Solon, Fabella, and Capuno (2009) and Teehankee (2001a; 2001b; 2007).
15. For more details, see http://data.worldbank.org/data-catalog/CPIA.

16. This could be based on objective and measurable indicators on governance reforms such as transparency practices and favorable audit reports by the Commission on Audit.
17. Pushing these amendments through the legislative mill maybe a challenge should supporters and kin of local politicians in the national legislature resist the rationalization of the allocation formula or the insertion of conditions. Failing this, a quick and more politically expedient measure may be to preserve the current 40 percent IRA share and to supplement LGU support with national government grants based on effective incentives and measured targets.

References

Asian Development Bank. 2005. *Decentralization in the Philippines*. Mandaluyong City, Philippines: Asian Development Bank. http://www.pdf.ph/downloads/decentralization/Study%20on%20Decentralization%20(Strengthening%20LGU%20Financing).pdf.

Atkinson, J., A. Hicken, and N. Ravanilla. 2015. "Pork and Typhoons: The Influence of Political Connections on Disaster Response in the Philippines." *Building Inclusive Democracies in ASEAN*, edited by Ronald U. Mendoza, Edsel L. Beja, Jr., Julio C. Teehankee, Antonio G. M. La Viña, and Maria Fe Villamejor-Mendoza. Mandaluyong City, Philippines: Anvil Publishing, Inc.

Balisacan, A., and N. Fuwa. 2004. "Going Beyond Cross-country Averages: Growth, Inequality and Poverty Reduction in the Philippines." World Development 32:1891-1907.

Banaag, Miann and Ronald U. Mendoza. 2016. "Dynasties Thrive under Decentralization." Working paper, Ateneo School of Government, Quezon City. https://ssrn.com/abstract=2875583.

Boadway, R. and A. Shah, eds. 2007. *Intergovernment Fiscal Transfers: Principles and Practice.* Washington, D.C.: World Bank.

Capuno, Joseph J. 2013. "Fiscal transfers and gerrymandering under decentralization in the Philippines." UP School of Economics Working Paper. Quezon City.

Capuno, Joseph J. and Maria Melody Garcia Schustereder. 2015. "The Correlates of Local Government Responsiveness under Decentralization: Do Performance Ratings Matter in the Philippines?" *International Journal of Public Administration* 38(7):521-32.

Clarete, Ramon et al. Forthcoming. "Local Road Investments in the Philippines." Working paper, World Bank.

Collas-Monsod, S., T. Monsod, and G. Ducanes. 2004. "Philippines' Progress Towards the Millennium Development Goals: Geographical and Political Correlates of Subnational Outcomes." *Journal of Human Development* 5:121-49.

Collier, Paul. 2005. "Loans and Grants: Coherence in Aid Instruments." In P*ublic Finance in a Globalizing World: Innovations in Theory and Practice*, edited by Inge Kaul. Oxford, U.K.: Oxford University Press.

Dela Rosa Reyes, Danilo. 2016. "Issues and Problems in Decentralization and Local Autonomy in the Philippines: A Preliminary Assessment of Impact and Challenges." http://www.copag.msu.ac.th/conference4/files/PDF/10.1%20Danilo%20de%20la%20Rosa%20Reyes%2067-86.pdf.

Encinas-Franco, J. and A.Tablizo. 2006. "Electoral System, Parties and Bureaucracy: The Missing Links in the Charter Change Debate." *Senate Economic Planning Office Policy Insights PI-02-026.*

Gatmaytan, Dante B. 2001. "Cost and Effect: The Impact and Irony of the Internal Revenue Allotment." 75 *Philippine Law Journal* 630.

Hutchcroft, P. and J. Rocamora. 2003. "Strong Demands and Weak Institutions: The Origins and Evolution of the Democratic Deficit in the Philippines." *Journal of East Asian Studies* 3:259-92.

Llanto, Gilberto. 2012. "The Assignment of Functions and Intergovernmental Fiscal Relations in the Philippines Twenty Years after Decentralization." University of the Philippines–School of Economics, Quezon City. http://www.econ.upd.edu.ph/dp/index.php/dp/article/viewFile/688/154.

Manasan, Rosario. 2005. "Local Public Finance in the Philippines: Lessons in Autonomy and Accountability." *Philippine Journal of Development* 32(2):31-102. http://dirp4.pids.gov.ph/ris/pjd/pidspjd05-2publicfinance.pdf.

Mendoza, R., E. Beja, V. Venida, and D. Yap. 2012. "Inequality in Democracy: Insights from an Empirical Analysis of Political Dynasties in the 15th Philippine Congress." *Philippine Political Science Journal* 33:132-45.

———. 2016. "Political Dynasties and Poverty: Measurement and Evidence of Linkages in the Philippines." *Oxford Development Studies* 44(2):189-201.

Oates, W. E. 1999. "An Essay on Fiscal Federalism." *Journal of Economic Literature* 37(3):1120-49.

Panadero, A. 2011. "Performance Challenge Fund: Overview and Update." http://siteresources.worldbank.org/INTPHILIPPINES/Resources/PCFOverview.pdf.

Querubin, P. 2016. "Family and Politics: Dynastic Persistence in the Philippines." *Quarterly Journal of Political Science* 11(2):151-81.

Ravanilla, N. 2015. "Motives in Pork Distribution: Partisan Bias or Patronage?" Unpublished manuscript, University of Michigan, Ann Arbor.

Rivera, Temario C. 2002. "Transition Pathways and Democratic Consolidation in Post-Marcos Philippines." *Contemporary Southeast Asia* 24(3):466-83.

Shah, A. 2007. "A Practitioner's Guide to Intergovernmental Fiscal Transfers." In *Intergovernment Fiscal Transfers: Principles and Practice*, edited by R. Boadway, and A. Shah. Washington, D.C.: World Bank.

Solon, O., R. Fabella, and J. Capuno. 2009. "Is Local Development Good Politics? Local Development Expenditures and the Re-Election of Governors in the Philippines in the 1990s." *Asian Journal of Political Science* 17(3):265-84.

Tayao, E. 2016. "Pursuing Federalism in the Philippines: The Context of State and Democratization." In *Federalism and Decentralization: Perceptions of Political and Institutional Reforms*, edited by Wilhelm Hoffmeister and Edmund Tayao, 119-39. Singapore: Konrad Adenauer Stiftung. http://www.kas.de/wf/doc/kas_44612-1522-1-30.pdf?160324032423.

Teehankee, J. 2001a. "Power Bequeathed: Generational Shi and Elite Reproduction in the Eleventh House of Representatives." PhD diss. De La Salle University, Manila.

———. 2001b. "Emerging Dynasties in the Post-Marcos House of Representatives." *Philippine Political Science Journal* 22:55–78.

———. 2007. "And the Clans Play On." Philippine Center for Investigative Journalism. http://pcij.org/stories/and-the-clans-play-on/.

World Bank. Forthcoming. *No Map No Money: Getting Results in Local Road Network Infrastructure Development*. Manila: World Bank.

Annex

Analysis of the Correlates of Local Tax Revenues

We empirically examined the possible factors linked to local tax revenue patterns during part of the decentralization period from 2006–2012. The analysis attempts to update and adapt a similar analysis by Manasan (2005) using earlier data. We turned to a panel data of 79 provinces (i.e., two new provinces, Dinagat Islands and Davao Occidental, were excluded due to unavailability of data) that were observed in three periods: 2006, 2009, and 2012. Owing to our interest in examining the possible link to dynastic leadership patterns, and due to the data availability for this factor, the resulting panel dataset covered only part of the decentralization period.

Six regression models estimated the effects of potential correlates to per capita local tax revenues, per capita real property tax, and per capita business tax. A panel fixed effects model (as opposed to random effects model) was used since this procedure controlled for the inherent unobserved variation among provinces that would potentially impact the dependent variable and predictors. This reduces the risk of endogeneity and potential omitted variable bias to effectively analyze the net effect of the predictors to the dependent variable. The procedure utilized the following models:

$$pctr_{it} = \alpha_i + \beta_1 pcira + \beta_2 aveinc_{it} + \beta_3 dynshare_{it} + U_{it}$$
$$pctr_{it} = \alpha_i + \beta_1 pcira + \beta_2 aveinc_{it} + \beta_3 dynlar + U_{it}$$
$$pcrpt_{it} = \alpha_i + \beta_1 pcira + \beta_2 aveinc_{it} + \beta_3 dynshare_{it} + U_{it}$$
$$pcrpt_{it} = \alpha_i + \beta_1 pcira + \beta_2 aveinc_{it} + \beta_3 dynlar + U_{it}$$
$$pcbt_{it} = \alpha_i + \beta_1 pcira + \beta_2 aveinc_{it} + \beta_3 dynshare_{it} + U_{it}$$
$$pcbt_{it} = \alpha_i + \beta_1 pcira + \beta_2 aveinc_{it} + \beta_3 dynlar + U_{it}$$

where $i = 1,2, \ldots 79;\ t = 1, 2, 3$

$\alpha_i = unknown\ intercept\ for\ each\ province$

$U_{it} = error\ term$

pctr = Per capita provincial local tax revenues

pcrpt=Per capita provincial real property tax revenues

pcbt=Per capita provincial business tax revenues

pcira=Per capita provincial internal revenue allotment

ave_famincome=Average family income

dynshare=Share of political dynasties out of the total local government leaders in the province

dynlar=Size (number of family members in elective office) of the largest political clan in the province

The regression results showed a significant and positive association between average family income and per capita tax revenue at the provincial level. This was confirmation that local tax revenue was linked to constituents' capacity to pay. The dynastic share variable (expressed as a proxy for the measure of political dynasties prevalence in the province) had a positive and statistically significant link to tax revenue. On the other hand, the share of the size of largest political clan displayed a negative association with local tax revenue. This appeared to validate the hypothesis that political dynasties may help develop fiscal independence at lower dynastic prevalence levels (due possibly to their ability to continue policies over time); but at some point when dynastic prevalence becomes very large, these dynastic clans could also impede healthy political competition, weakens checks and balances, and undermine fiscal autonomy in the long run.

Table 1. Regression on per capita tax revenue

	pctr	pctr	pctr	pctr
Pcira	0.008	0.007	-0.007	0.002
	(0.008)	(0.008)	(0.008)	(0.007)
ave_famincome		0.0004***	0.0003**	0.0005***
		(0.00009)	(0.0001)	(0.00009)
dynshare			1.124	
			(0.594)*	
dynlar				-8.177*
				(4.89)
constant	54.747***	-16.56	-21.567	-0.283
	(9.05)	(16.28)	(16.36)	(18.89)
R^2	0.82	0.84	0.85	0.85
N	237	237	237	237

* Statistically significant at α=0.10;
** Statistically significant at α=0.05;
** *Statistically significant at α=0.01; values in parenthesis () are standard errors

Estimated regression models in tables 2 and 3 suggest that an increase in internal revenue allotment had a positive effect on the real property tax but yielded a negative impact on the business tax revenue. This would explain why internal revenue allotment yielded an insignificant effect on the total local tax revenue. Furthermore, the effect of dynastic share and size of largest dynastic political clan was statistically significant for business tax revenues and appeared less relevant for real property tax revenues.

Table 2. Regression on per capita real property tax

	pcrpt	pcrpt	pcrpt	pcrpt
Pcira	0.023**	0.018**	0.014*	0.018**
	(0.007)	(0.007)	(0.008)	(0.007)
ave_famincome		0.0003***	0.0002*	0.0003***
		(0.00009)	(0.0001)	(0.00009)
dynshare			0.581	
			(0.576)	
dynlar				-5.066
				(4.728)
constant	26.365**	-21.116	-23.704	-11.032
	(8.369)	(15.667)	(15.864)	(18.261)
R^2	0.79	0.8	0.8	0.8
N	237	237	237	237

* Statistically significant at α=0.10;
** Statistically significant at α=0.05;
** *Statistically significant at α=0.01; values in parenthesis () are standard errors

Table 3. Regression on per capita business tax

	pcbt	pcbt	pcbt	pcbt
pcira	-0.016***	-0.017***	-0.021***	-0.017***
	(0.002)	(0.002)	(0.002)	(0.002)
ave_famincome		0.0001***	0.0002	0.0001***
		(0.00002)	(0.00004)	(0.00002)
dynshare			0.559**	
			(0.164)	
dynlar				-2.401*
				(1.38)
constant	24.804***	8.167	5.676	12.946
	(2.498)	(4.603)	(4.512)	(5.337)**
R^2	0.59	0.63	0.65	0.63
N	237	237	237	237

* Statistically significant at α=0.10;
** Statistically significant at α=0.05;
** *Statistically significant at α=0.01; values in parenthesis () are standard errors