Part III

Empirical Reviews

CHAPTER 8

PREVIOUS STUDIES AND RECOMMENDATIONS ON THE IMPROVEMENT OF IRA SYSTEM

This chapter consists of two sections. The first section presents a summary of the review of the related literature on IRA issues. The second section intends to reveal the state of development assistance in the area of local government finance.

8.1. Review of Related Literature Concerning IRA

8.1.1. Categorical Framework of Analysis

Literary documents regarding IRA issues have been extensively reviewed and analyzed. For the purpose of analysis, these literary documents are classified into four categories. The first group, or Category 1, compiles the proposals made by LGU leagues, most of which appear as their position papers. Category 2 contains the proposals found in the amendment bills submitted to the Congress. Some amendments bills, such as House Bill 7845 and Senate Bill 1211, are considered as omnibus amendment bills to the LGC, and also include amendments of IRA-related provisions. Category 3 explores the results of the studies which are based on the extensive financial database of the central and local governments. Using panels of financial data of LGUs, a few studies have been investigated to determine how intergovernmental transfers should be addressed in the Philippines. Lastly, found in Category 4 are the stand-alone papers prepared for conferences and meetings by researchers and academes. A brief overview of the above literatures is presented in Annex 19.

1) Category 1: Position Papers or Resolutions by LGU leagues

i) Resolution to recall the cityhood bill for 27 municipalities by League of Cities of the Philippines (LCP)
ii) Resolution to oppose the proposal of Albay Representative Joey Salceda to cut IRA by as much as P20 billion by Union of Local Authority of the Philippines (ULAP)

2) Category 2: Amendment Bills to the LGC

iii) Senate Bill 118 introduced by Sen. Aquilino Q. Pimentel, Jr. during the 14th Congress
iv) Senate Bill 119 introduced by Sen. Aquilino Q. Pimentel, Jr. during the 14th Congress
v) Senate Bill 520 introduced by Sen. Jinggoy Ejercito Estrada during the 14th Congress
vi) Senate Bill 1121 introduced by Sen. Aquilino Q. Pimentel, Jr. during the 13th Congress

vii) House Bill 1020 introduced by Hon. Mauricio G. Domogan during the 14th Congress
viii) House Bill 7845 introduced by Hon. Romeo DC Candazo during the 11th Congress

3) Category 3: Studies based on the Use of Extensive Statistics

ix) "Estimating IRA, Centrally-Provided Local Public Goods and Services, and Other Central Transfers to Local Governments," Joseph J. Capuno, Thelma C. Manuel, Ma. Bella T. Salvador, University of the Philippines School of Economics and National Economic and Development Authority (NEDA)
x) "Local Public Finance in the Philippines: In Search of Autonomy with Accountability" (PIDS Discussion Paper Series No. 2004-42), Dr. Rosario G. Manasan, PIDS

4) Category 4: Papers Presented at Conferences and Meetings

xi) "Reexamining the Internal Revenue Allotment: Issues and Options" (Presented at the National Workshop on Fiscal Equalization and IRA convened by the Union of Local Authorities of the Philippines, DILG and Australian Agency for International Development or AusAID), Romulo E. M. Miral, Jr., Ph.D.
xii) "Revisiting IRA Formula: In Support of Local Autonomy" (presented in the First Quarterly Conference of the Strategic Studies Council held on Feb. 23, 2005), Mr. Erlito R. Pardo
xiii) "Policy Paper on Strengthening Devolution through Meaningful Financial Decentralization: Improving Fiscal Transfers to LGUs," Alex B. Brillantes, Jr. and Jose O. Tiu Sonco II

8.1.2. Criticisms by LGUs

Some of the major criticisms by LGUs or clusters of LGUs are: i) the insufficiency of IRA to finance the responsibilities assigned to them, which comes down to the call for an increase of LGUs' share in the national taxes, ii) the reorganization of the rules and regulations concerning the fragmentation and status-upgrading of LGUs, iii) the vertical and horizontal imbalances in fiscal capacities among and across LGUs, which boils down to the inefficiency of the existing IRA distribution formula to address the fiscal imbalances, and iv) the unpredictability of IRA due to the withholding and deductions of IRA by the central government despite of the provision for the automatic release of IRA under the LGC.

In 2004, budget deficit of the National Government compelled it to explore the possibility of reducing IRA (ULAP Resolution 2004-04). Soon afterwards, the LGUs' strong rejection to this move appeared in the resolution, adopted by the ULAP. This consequence is inevitable because many LGUs feel that the expenditure responsibilities assigned to them by the LGC are far beyond what they receive from the central government, as IRA and other means.

The numbers of units within each level of LGUs naturally affect IRA amount that each LGU receives. Recently, House Bill 24 ("An Act to Exempt from the Income Requirement Capital Towns of the Provinces Subject to Certain Conditions") of the 14th Congress which sought to convert 27 municipalities into cities was denied by the city mayors, resulting in a resolution to recall the said bill.

8.1.3. Proposed Amendments in Perspective

The amendment bills submitted in the current Congress, which refer to IRA issues, are Senate Bill 118 and Senate Bill 520. Senator Jinggoy Ejercito Estrada challenged the existing IRA distribution formula in his Senate Bill 520 and proposed that the shares of provinces, cities and municipalities should be on the basis of the following formula: population 55% (50% in the current formula), land area 20% (25%) and equal sharing 25% (25%). On the other hand, Senate Bill 118 proposed the expansion of the basis of computation of IRA, from internal revenue to national taxes.

Senator Aquilino Q. Pimentel, Jr., author of Senate Bill 118, introduced the idea of applying the national taxes instead of internal revenue as the basis of IRA within Senate Bill 1121, which he filed in the 13th Congress. Senate Bill 1121, an omnibus amendment bill to the LGC, proposed among others, that the shares of LGUs should be based on the collection of national taxes, and that their share should be increased to 50%.

Another omnibus amendment bill to the LGC introduced by Honorable Romeo DC Candazo, House Bill 7845 filed in the 11th Congress, proposed a drastic change in the horizontal distribution formula by offering an alternative formula of (i) tax effort - 50%, and (ii) equalization based on revenue raising capacity and expenditure needs - 50%. House Bill 7845 also touched on the fiscal year for the basis of IRA computation, and proposed that LGUs should receive a 40% share in the gross national internal revenue taxes based on the collection of the second, instead of "third", fiscal year preceding the current fiscal year.

For reference purposes, Senate Bill 119 and House Bill 1020 also dealt with the share of LGUs in national wealth, another formula based block grant transferred from central to sub-national governments.

8.1.4. From Experts' Perspectives

Among the wide range of arguments regarding IRA issues, the most often heard may be about the lack of incentive for local revenue mobilization in the current IRA distribution formula. Pardo argues that the absence of performance indicators in the existing IRA formula has resulted

in undermining LGUs' tax effort and operational efficiency[1]. Manasan also supports the view that regression analysis of per capita local tax revenues on per capita household income (as a proxy for the local tax base) and per capita IRA (as a way to check whether intergovernmental grants stimulates or substitutes for local government revenue effort) provides substantiation for the disincentive effect of IRA on local tax effort after the enactment of LGC[2]. Natural conclusion, led from this argument, is that there is a need to alter IRA distribution formula so as to provide LGUs with incentives for local tax collection effort.

Many experts are also concerned with the imbalances that exist in the distribution of IRA itself in both vertical and horizontal aspects. This appraisement is closely related to the view that the existing IRA distribution formula is counter-equalizing the fiscal capacities of LGUs when expenditure and tax assignments are both taken into account. Some studies, supplemented with statistics, show that wealthy LGUs tend to receive more IRA than the needy LGUs. Interestingly, Manasan throws an insight to this argument that the existing IRA distribution formula has had some success in equalizing the fiscal capacities of cities, but not in the case of provinces and municipalities. She finds that the correlation coefficient between per capita IRA of city governments and per capita household income is consistently negative for the years 1995-2000, but is positive in case of provinces and municipalities in most of the years since 1991[3]. Counter-proposal to this unwanted situation is to include the indicators which would favor the poorer areas, such as poverty incidence, or to reduce the weight given to "population" and/or "equal sharing" indicators.

The fiscal capacity of local government cannot be explained solely by IRA. There is another block grant from central to local government called the share of national wealth. Besides these block grants, there are categorical grants in intergovernmental transfer system in its entirety. Despite its diminishing share, own-sourced revenues still account for a significant portion in the total revenue of local government. It is also pointless to argue about the fiscal capacity of local government regardless of its relativity with the scope of service-delivery responsibility assigned to it by law. For these reasons, a few experts advocate strongly the reassessment of tax power and service responsibilities of local government, and the redesign of intergovernmental transfer system, worked out in a holistic manner.

8.1.5. Summary of Proposals Made in regard to IRA issues

[1] "Revisiting IRA Formula: In Support of Local Autonomy", Mr. Erlito R. Pardo
[2] "Local Public Finance in the Philippines: In Search of Autonomy with Accountability" (PIDS Discussion Paper Series No. 2004-42), Dr. Rosario G. Manasan, PIDS
[3] "Local Public Finance in the Philippines: In Search of Autonomy with Accountability" (PIDS Discussion Paper Series No. 2004-42), Dr. Rosario G. Manasan, PIDS

1) Review of 60%-40% central-local government share

A number of LGUs and experts share the same view that IRA is not sufficient to finance the expenditure assignments granted to local government by the LGC. Many perceive that the LGUs' prevailing share in national taxes is deficient to cover the cost of essential services; much less the cost of so-called unfunded mandates (e.g. the Salary Standardization Law and the additional personnel benefits under the Magna Carta for Health Workers). This compels LGUs to perform in a tight financial frame. The inevitable consequence is that any move by the national government to reduce the aggregate IRA is met with strong denial by the recipients of this grant, which happens to be the largest income source of most LGUs.

In this connection many also argue that the LGUs' share in the national taxes and local government resources and needs should be discussed all together. Deeper thought takes it that central-local transfers (i.e. IRA, the share in national wealth, and centrally-provided local public goods and services) should all be reviewed in tandem with the reassessment of the assignments and taxing powers granted to each level of LGUs.

2) Breaking a counter-equalizing factor in the distribution formula

Researchers refer to the statistics indicating that LGUs which have potentials in raising more income are favored with IRA distribution. Apparently the current distribution is determined regardless of LGUs expenditure needs and potential resources. As a result, there are LGUs with weak tax base that are unable to provide public services in accordance with minimum standards. This leads to a recommendation that IRA should perform more explicitly the role of equalizing the disparities in the resource capacities of LGUs.

Some researchers also point out an adverse effect of priority development assistance fund (PDAF) on the equalization of fiscal capacities of LGUs. They commented that the national government continues to fund some devolved activities through PDAF, which contributes negatively to the equalizing development level of LGUs.

3) Providing incentives for resource mobilization

The current IRA system does not have any fiscal stimulation effect. The LGUs which have not been motivated in their tax collection duties can only rely on grants and subsidies that are shared with them. In fact, there are no provisions in the current public finance system which obliges LGUs to raise their revenue efforts. A recent strategy to solve this concern is to introduce an awarding program for the LGUs and local officials who have achieved outstanding performance levels. However, this alone has limited effect to motivate LGUs in optimizing their tasks in raising revenues. It is for these reasons that some experts suggest the inclusion of a

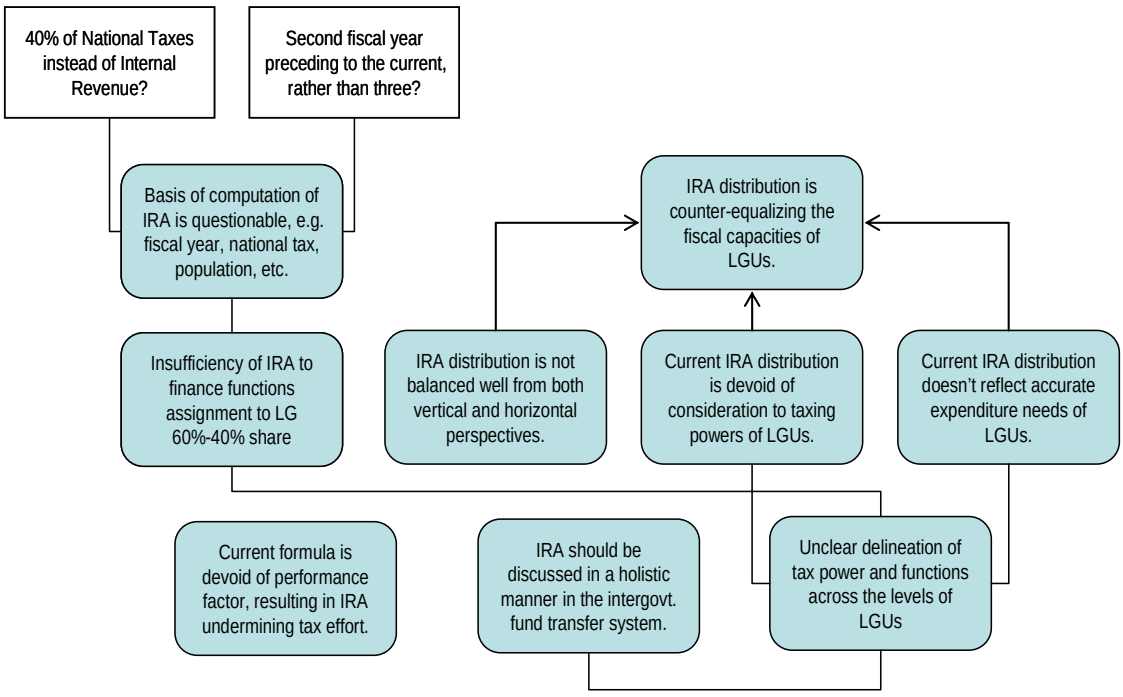
performance-based indicator in IRA distribution formula.

4) Redesigning of inter-governmental fiscal transfer system

Considering all the proposals above, many researchers imply the need to review and redesign the inter-governmental fiscal transfer system in its entirety. It was suggested that greater tax decentralization, paired with a well designed intergovernmental transfer system that includes elements of fiscal equalization, should enhance the gains of the decentralization process.

5) Clarifying the rules of the classification of LGUs

The tendency for the number of LGUs to increase progressively, in order to take advantage of IRA formula, is another critical problem of the local government finance. It is necessary to review the rules for the fragmentation and upgrading of LGUs, and make the granting procedures more transparent and credible.



Source: JICA Study Team

Figure 5-1: Major IRA Issues and Implications

8.2. Development Assistance in Local Government Finance

The LGC not only expanded the scope of functions/responsibilities of LGUs but also enhanced their power to mobilize resources. However, there is still much to be done to promote greater

autonomy and stability of local government finance, so as to maximize the benefits of decentralization. After the enactment of the LGC, the Government of the Philippines (GOP) has implemented some of the key policy reforms, which address the fiscal and financial problems of LGUs. Along with these policy reforms, the donor community has been examining how their development assistance could be rendered more useful. Presently spearheaded by the Philippine Development Forum (PDF)[4] - Working Group on Decentralization and Local Government (WGDLG), the donors coordinate with one another to help build the momentum for the key reforms in local government finance, and promote the principles of good governance.

Inadequate LGU resource mobilization is a critical constraint. Weak LGU expenditure management also limits the effectiveness of local governance. Limited access to private sector financing due to low creditworthiness is another constraint in local finance. There is also a call for the implementation of governance reforms and capacity-building programs for LGUs in order to maximize the gains of their limited resources.

In order to address these issues, the GOP has identified and implemented the following policy measures over the past several years:

i) The GOP issued Executive Order 444 in July 2005, directing DILG to identify activities of NGAs and government corporations that should be devolved.
ii) A new electronic local government accounting system (e-LGAS) was rolled out to the LGUs by the Commission on Audit (COA), while DOF-BLGF improved LGU financial reporting system, the Statement of Income and Expenditure (SIE), to enhance the presentation of LGU budget numbers.
iii) The DOF reaffirmed the GOP's national-local government cost sharing arrangement approved by the NEDA Board in March 2003 and the Investment Coordination Committee (ICC) in May 2006, mandating the granting of a maximum of 50% for LGU projects.
iv) The 1996 LGU Financing Policy Framework, intended to pave way for LGUs to access private sector lending, was formally adopted by the DOF in January 2007[5].
v) The Congress approved the automatic appropriation of IRA on the supplemental appropriation for 2006 (R.A. 9358, Section 4), which resolves the delays in the release of IRA. In addition, a Joint Memorandum Circular was signed by oversight agencies through the initiative of the DBM in the early 2006, which aimed to simplify the requisite documents for the release of LGU shares in the national wealth.
vi) The DBM has included in the 2007 proposed National Expenditure Program, a proposal to

[4] The PDF is formerly the consultative group and was first introduced in 2005 to facilitate more inclusive participation leading to action-oriented activities to support the Philippines development agenda.
[5] The framework recognizes that LGUs have varying financing needs, such that LGUs with greater creditworthiness are encouraged to avail of private commercial financing while LGUs with medium creditworthiness access financing from Government Financial Institutions (GFIs) and those in lower income tiers from the Municipal Development Fund (MDF).

establish a trust fund in the Bureau of Internal Revenue (BIR) to enable the direct remittance of the LGU share in mining taxes.

vii) Four oversight agencies, namely NEDA, DBM, DILG and DOF, signed a Joint Memorandum Circular (JMC) [6] No. 1, Series of 2007, aimed in harmonizing the guidelines for local planning, investment programming, revenue administration and expenditure management in March 2007.

8.2.1. Philippine Development Forum

The PDF provides a platform to identify the priority development issues and coordinate development assistance from donors in the Philippines. The PDF has seven thematic discussion groups and one of these is the "Working Group on Decentralization and Local Government". In its thematic field, the PDF-WGDLG identifies assistance to "Local Government Finance" as one of its main objectives for the 2007-2008 Action Plan. The other three objectives identified by the PDF-WGDLG are "Capacity Building," "Performance Benchmarking," and "Policy Reforms on Devolution."

Within the objective of strengthening "Local Government Finance," the following three overall goals are set:

i) Accelerate revenue mobilization;
ii) Increase access of LGUs to financing; and
iii) Improve the management of expenditures by LGUs.

The details of the three overall goals above are the following.

i) Accelerate revenue mobilization

Some of the action agenda here are upgrading property assessments, improving information sharing systems for revenue generation, and addressing different reporting systems and conflicting guidelines in relation to resource mobilization. Some of the major expected outputs from these actions are roll-out of Assessors' Manual, development of standard valuation for real property tax, improved business tax billing and collection system, and harmonized Statement of Income and Expenditure.

ii) Increase access of LGUs to financing

Some action agenda essential in this theme are introduction of performance-based grants, and setting up of a mechanism for assessing credit worthiness of LGUs and development of

[6] Following their oversight functions, these four agencies agreed to address the long-held clamor of local governments to address the different conflicting guidelines and different reporting systems and timetables required by National Government agencies.

creditworthiness. Major outputs are the design for operation of performance-based grants and development of creditworthiness rating system for BLGF.

iii) Improve the management of expenditures by LGUs
The action agenda here include addressing automatic release of LGU shares in national wealth and other taxes, reviewing the provisions of the Procurement Act, and strengthening expenditure management by LGUs. Major outputs are recommendations to streamline procedures related to the release of LGU shares in national wealth, simplified Procurement Manual for LGUs, and an improved personnel services expenditure policy for LGUs.

The action agenda of PDF for 2007-2008 is found in Annex 20.

8.2.2. Perspective of Development Assistance in Local Government Finance

As presented above, the PDF-WGDLG identifies the critical reform measures to hasten revenue collection and improve expenditure management of the LGUs. Several prominent donors, such as WB, ADB, USAID, and AusAID lead in assisting in these policy targets.

i) ADB has conducted several technical assistance (TA) projects to support the GOP's fiscal consolidation and poverty reduction agenda, by improving resource mobilization, expenditure management, and public service delivery in the LGUs. The noted activities are found in ADB TA4556 and TA4778, related to supporting the GOP's reform efforts.

ii) Planning of a program loan by ADB is on-going (Local Government Financing and Budget Reform Program or LGFBR). The above two TAs are drafted in such a way that they contribute to this program loan[7].

iii) ADB and other donor agencies have provided technical assistance to DILG, DBM, DOF, the Municipal Development Fund Office (MDFO), and NEDA.

iv) The GOP now considers the introduction of a performance-based grant system, as an additional element of the intergovernmental fiscal system in the Philippines. This initiative is funded by WB Japan Fund for Human Resource Development.

v) The bilateral donors, such as LAMP, EPRA, LGSP and others, have implemented some of the noted programs which contributed to the LGUs in improving their service delivery efficiency.

[7] TA4556 contributes to the success of policy outputs being delivered by the BLGF such as the Statement of Receipts and Expenditure (SRE) Financial Reporting System, the Revised Income Classification System, and the Competency Certification for Local Treasurers.

Investment plans that are co-terminus with the political election cycle also inhibit productive investments. The PDF encourages LGUs to work towards investment plans which transcend the three-year terms of elected officials.

8.2.3. Donor-funded Projects in Local Government Finance

Just for reference, the portal site within World Bank homepage contains the details of the programs/projects funded by donors (http://www.lguportal.org/projectslist.asp).

1) ADB TA4556 (Technical Assistance to the Republic of the Philippines for the Local Government Finance and Budget Reform Project)

TA4556, which was implemented from January 2006 to December 2007, had two components, defined as Components A and B. TA4556's scope of work is to provide amendments to the Book II of LGC, which is done through the review of HB7845 and SB1121.

Component A aims to "provide an analytical overview and detailed studies of key issues that would help BLGF design and implement reform of LGU finance and budget processes." The activities under Component A would include studies on: i) legal impediments to LGU revenue mobilization, ii) rationalization of revenue and expenditure assignment between the national government and LGUs, and iii) issues regarding the LGU classification system by income group, etc.

Component B, on the other hand, is intended to enhance the capacity of national government agencies, particularly BLGF, to provide the LGUs with services aimed to improve their finances, and create and maintain LGU financial performance databases that will strengthen their credit markets. The technical assistance to BLGF is expected to result in more efficient delivery of policy advisory, management and administrative assistance to LGUs.

Major proposed amendments are grouped into the following three types:

i) Amendments that seek to broaden local taxing authority like allowing LGUs to impose a franchise tax, allowing LGUs to register vehicles, and increasing the community and professional tax rates;
ii) Amendments that seek to simplify the local tax structure so as to promote tax efficiency like simplifying the present complicated multi-tiered business tax structure to a single maximum rate of just 2% on gross sales/receipts; and
iii) Amendments that seek to enhance LGU tax administration like explicitly and legally requiring the BIR to furnish local treasurers with the information required to conduct local

tax examinations, and allowing the LGUs to contract out to the private sector the collection of local taxes.

2) ADB TA4778 (Technical Assistance to the Republic of the Philippines for Local Governance and Fiscal Management Project)

As a continuation to TA4556, Technical Assistance to the Republic of the Philippines for Local Governance and Fiscal Management Project (TA4778) is under implementation. It aims to support the Philippine government's fiscal consolidation and poverty reduction agenda by improving the local governance framework, resource mobilization, expenditure management, and public service delivery in the LGUs. By developing LGU capacity to operate more efficiently and effectively, these activities will contribute to improved local welfare without requiring additional government transfers.

There are three components in TA4778 (ADB TA 4778 Project Brief).

i) Component A: Improved legal framework for decentralization (with DILG)

This component includes activities like in-depth study of the current status of decentralization, development of proposals for the reform of intergovernmental fiscal relations among different LGU levels, and support for capacity development for DILG, NGA, LGUs and LGU Leagues.

ii) Component B: Transparency and effectiveness in LGU expenditure management and budget processes (with DBM)

This component includes activities, such as;

- development of an improved personnel services expenditure policy for LGUs
- development of a framework for LGU expenditure management
- action plan to implement e-LGAS and Local Government Performance Measurement System
- review of release procedures for the special shares of LGUs: i.e., national wealth, Ecozone, Tabacco Excise, etc.

iii) Component C: LGU capacity to mobilize sufficient resources to finance the necessary services to their constituents (with DOF)

The tasks within this component include preparation of action plans for pilot LGUs on revenue mobilization, implementation of training program in revenue estimation, and study on local asset management.

Expected key outcomes of TA4778 are (as per ADB TA 4778 Project Brief):

- Enhanced LGU access to budget resources, from traditional sources such as taxes and fees, and from other sources including bank credit, bonds, and build-operate-transfer arrangements;
- Improved LGU expenditure and financial management, leading to move effective service delivery and infrastructure development;
- Improvements in the legal framework for decentralization; and
- An in-depth assessment of Philippine decentralization to date, with recommendations for new reform measures, including LGC revisions.

3) World Bank - Local Government Finance and Development Project (LOGOFIND)

The project started in 2000 and was supposed to end by June 2006. In May 2006, however, the Investment Coordinating Committee (ICC) of NEDA, approved a two-year extension of the project, moving the closing schedule to June 2008. LOGOFIND, financed by World Bank through Municipal Development Fund（MDF）office aims to promote and enhance the government's strategic vision of local government autonomy and self-reliance by fulfilling these specific objectives:

i) To assist LGUs in expanding and upgrading basic infrastructure, services and facilities by providing financial assistance in the forms of loans and grants; and
ii) To strengthen the investment and development planning of LGUs, their revenue administration, and their capacity to prepare and implement projects by extending technical assistance and by providing a capacity building program responsive to their needs.

The main target beneficiaries of the LOGOFIND are the low-income LGUs: i.e., the third to sixth income class provinces, cities and municipalities. However, the first and second income class LGUs may also access LOGOFIND assistance, on a case-to-case basis, and specifically for the social and environmental sub-projects that would improve sanitation, environment and quality of life of the urban poor.

To realize the above-enumerated development objectives, the LOGOFIND Project operates with the following four components:

i) Component 1: LGU Subprojects Financing

Through this Component, the project provides loan and grant assistance to LGUs that varies according to type of proposals and income class of the proponents to materialize their

initiatives in the procurement, construction, expansion, rehabilitation and improvement of basic infrastructure, social and environmental services and facilities.

ii) Component 2: LGU-Training and Capacity Building

Apart from investing for local infrastructures and strengthening mobilization of local resources, the project, through Component 2 hones technical competencies involving the knowledge, skills and attitude (KSA) of various officials and key personnel of LGUs, in order to cope with the mounting challenges of decentralization. The project provides capacity building and modules to complement with the development endeavors of client LGUs. The modules are grouped into two, namely: (a) Mandatory Modules, and (b) Demand Driven Modules.

iii) Component 3: LGU-Resource Mobilization and Performance Monitoring

Administered by the Bureau of Local Government Finance (BLGF), this component primarily aims to sharpen LGUs capacity and opportunity, in order to accelerate growth of locally sourced revenues and improve financial monitoring and reporting through four subcomponents, namely: (a) LGU Subprojects Financing; (b) LGU-Training and Capacity Building; (c) LGU-Performance Monitoring and Financial Reporting; and (d) Project Management.

iv) Component 4: MDFO Strengthening

Apart from administering Components 1 and 2 operational requirements and staff, Component 4 also supports MDFO's drive to accelerate its share to the agenda of LGU-led growth and sustainable development. MDFO has to be strengthened to make it more efficient in providing products and services to LGUs of the country which have less resource. MDFO has to be more equipped in performing four major functions that include: (i) administration of the Municipal Development Fund - Second Generation Fund (MDF-SGF); (ii) administration of Foreign Assisted Projects (FAPs) implemented by other national agencies; (iii) implementing projects/programs; and (iv) policy formulation.

4) WB - Installation of a Performance-based Grant System for the Philippines

The basic goal of the performance-based grant system (PBG) is to enhance the performance of recipient LGUs, through linking access to funding on the part of recipient LGUs in order to improve their functions in clearly determined areas. As of December 2008, the Study was completed but the follow-through study is deemed necessary. DOF and the Danish consulting company which conducted the study have not yet agreed on the budget, tasks and team composition for the follow up work which encompasses the technical details in the design and the project implementation plan, etc.

PBG has two elements:

i) A Development Grant which will provide funding for the developmental needs of beneficiary LGUs; and
ii) A Capacity Grant which will provide funding to beneficiary LGUs to support the building of capacity to improve their performance and prepare appropriate development projects.

5) WB/AusAID Land Administration and Management Program II (LAMP II)

In July 1999, Executive Order No. 129 created an Inter-Agency Coordinating Committee (IACC), which is tasked to prepare and coordinate the implementation of a Land Administration and Management Program (LAMP). The Project Design Preparation was financed by AusAID. WB Loan Agreement was signed and the project became effective on January 09, 2001.

LAMP Phase II (LAMP II) involves scaling up of land administration and management initiatives for a potential 15-20 year program to improve land administration in the Philippines. Its goal is to reform the land administration system so that it contributes to the country's socio-economic development objectives. It is a strategic GOP initiative which aims to support an efficient land market and alleviate the present low level of confidence in the system of formal land administration, and the lack of tenure security.

CHAPTER 9

PRINCIPLES AND TYPOLOGIES OF INTERGOVERNMENTAL FINANCIAL ADJUSTMENT SYSTEMS AND OTHER COUNTRIES' EXPERIENCES

The intergovernmental financial adjustment system is one of the main LGU revenue sources for both the developed and still developing countries. As many countries have established their own intergovernmental financial adjustment systems, the Study looks into the existing mechanisms established in other countries as reference. Said systems vary from country to country and the experiences of other countries should be full of suggestions.

9.1. Principles and Typologies of Intergovernmental Financial Adjustment Systems

9.1.1. Principles of Intergovernmental Financial Adjustment

1) Definition of Terms

The intergovernmental financial adjustment systems have been developed in many countries since World War I for the purpose of adjusting financial disparities among LGUs. An intergovernmental financial adjustment system may be expressed in the following formula:

Intergovernmental Financial Adjustment = Guarantee of Adequate Financial Resources for LGUs + Financial Equalization among (poorer and richer) LGUs

It is desirable to integrate in an intergovernmental financial adjustment system, the roles that (1) guarantee adequate resources for local government, and (2) ensure financial equalization.

2) Principles in European Countries

The European Charter of Local Self-Government (October 1985) could be highly appreciated all over the world as a "Magna Carta" or a "global standard" for local government[1].

Article 9, paragraph 1 of this charter stipulates:

"Local authorities shall be entitled, within national economic policy, to adequate financial

[1] Kenji Yamauchi "The Principle of Adequate Resources in Japan: To Harmonize Local Self-Government with National Economic Policy" ([The Otemon Journal of Australian Studies, Vol.28, 2002])

resources of their own, of which they may dispose freely within the framework of their powers."

And the next paragraph (article 9, paragraph 2) stipulates;

"Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law."

The idea in this paragraph indicates that LGUs shall be entitled to adequate financial resources which are commensurate with their responsibilities. Moreover, it may be assumed that the two paragraphs seek to harmonize financial autonomy of LGUs with the economic policy of central government.

In this connection, article 9, paragraph 5 of the charter states that;

"The protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support."

The idea in this paragraph seems to be highly conceivable with regard to the improvement of intergovernmental financial adjustment systems in development countries.

9.1.2. Typologies of Intergovernmental Financial Adjustment Systems

There are many ways of addressing the disparity in financial capacity among LGUs, and as a consequence, systems differ from country to country. Nevertheless, the basic methods of intergovernmental transfers may be classified into two types: vertical adjustment and/or horizontal adjustment[2]. On the other hand, as far as the specific amounts of funds transferred to individual LGUs are concerned, LGUs' shares are calculated on the basis of "potential revenue", financial needs", or some "financial gaps", which take into account the both adjustments (refer to Table 9-1).

Table 9-2 provides another typology with regard to intergovernmental financial adjustment systems in 11 countries. The IRA system in the Philippines can be classified into "vertical adjustment by rule type".

[2] "Vertical adjustment" here stands for the funds transferred from the upper level governments to lower level governments while "horizontal adjustment" signifies financial adjustment among LGUs within the same level. On the other hand, in this Study, the terms "vertical formula (or distribution)" and "horizontal formula (or distribution)" are used for the explanations of the IRA distribution. Vertical distribution in this Study when referring to the IRA system stands for the distribution of IRA from the central government to all lower LGU levels determined through vertical sharing scheme or vertical formula.

Table 9-1: Intergovernmental Financial Adjustment Systems in Several Countries

	Vertical Adjustment		Combination: Vertical + Horizontal	Horizontal Adjustment
	By "Rule" e.g. Tax Sharing	By "Budgetary Measure"		
Revenue Potential Basis	CANADA			GERMANY
Financial Gaps Basis	AUSTRALIA JAPAN (= + Budget)	ENGLAND CHINA U.S.A.(abolished)	GERMANY SWEDEN FRANCE SWITZERLAND	DENMARK
Financial Needs Basis				

Source: N. Mochida, "Fiscal Equalization in the Drive to Decentralize --- Global Trends in Sweeping Reform" (in Japanese), p.6 Table1-1, (2006, Tokyo University Press)

Table 9-2: Vertical Intergovernmental Adjustment Systems in Several Countries

	Financial (Budgetary) Means	Tax Sharing
Vertical Adjustment	GERMANY (specific grants)	GERMANY (Income Tax, Corp'n Tax, VAT)
Upper level Gov't ↓ LGUs	FRANCE (DGF and DGE)	FRANCE (FNP→ consolidated into DGF)
	ENGLAND (RSG)	ENGLAND (Business Rate)
	ITALY	ITALY (VAT, Insurance Taxes)
	SWEDEN	
	JAPAN (supplementary)	JAPAN (LAT)

Source : J. Blanc " Finances locales comparées " (in French) , p.92 Tab. (2002, LGDJ.), (partly updated by JICA Study Team)

It should also be noted that vertical adjustment as the form of transfer from upper level government to LGUs has two tools: financial (budgetary) means and tax sharing. Furthermore, apart from the Philippines, almost all other countries listed in the table above utilize the two tools. As for horizontal adjustments, a small number of countries have financial transfer mechanisms from richer to poorer, among the same level as federated states and/or LGUs, by tax sharing (refer to Table 9-3).

Table 9-3: Horizontal Intergovernmental Financial Adjustment Systems in Selected Countries

	Financial (Budgetary) Means	Tax Sharing
Horizontal Adjustment Among same level States and/or LGUs (Rich→ Poor)		GERMANY (Länderfinanzausgleich) FRANCE (FSRIF = Ile de France region) SWEDEN (Old system)

Source : J. Blanc, "Finances locales comparées " (in French) , p.92 Tab.,(2002, LGDJ), (partly updated by JICA Study Team)

9.2. Distribution Formulas for Financial Adjustment Systems in the Selected Countries

9.2.1. France

The structure of the intergovernmental financial adjustment system is fairly complicated in France. There are various kinds of fund transfers ("donation" = general source of revenue) from central government to LGUs (regions, departments, and communes). The largest part of "donations" is the General "Donation" for Current Account (DGF: Dotation Globale de Fonctionnement) from central government to LGUs. The total amount of DGF is linked to real GDP growth ratio and CPI (consumer price index). The share of each region, department, and commune is computed by the distribution formula composed of several determinants such as population, fiscal power (potential local tax revenue), tax collection efforts (the actual result of tax collection/expected local tax revenue), road length, number of schoolchildren and so forth. Accordingly, the DGF distribution formula responds not only to financial needs but also to taxing power[3].

9.2.2. Germany

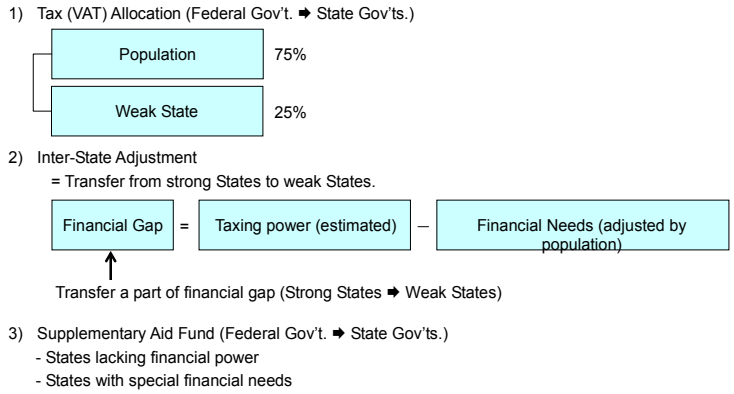
The structure of the intergovernmental financial adjustment system in Germany is more complicated than in France. The system is classified into two levels: federated state level and LGU=city/municipal level[4].

1) Federated State Level

There are three main ruts to adjust financial imbalances among federal states. First, the federal

[3] Masahiro Shinohara "Financial Adjustment in France" (Naohiko Jinno, Takehiko Ikegami "Local Allocation Tax" 2003, toyokeizaishinposya), (in Japanese).
[4] Toshihiko Hanya "Financial Adjustment System in Germany" (N. Jinno , T. Ikegami above 2003) (in Japanese).

government distributes roughly 1/2 of turnover tax (VAT) among the state governments. The share of each state is computed by population (75%), and rest of the amount (25%) is distributed to weaker states. Second, inter-state adjustment as a form of transfer from stronger states to weaker states plays a very important role. This is one of the typical methods on horizontal financial adjustment. Third, the federal government issues a supplementary grant for the states having weak financial conditions, such as lacking financial power or having special administrative needs (see Figure 9-1).

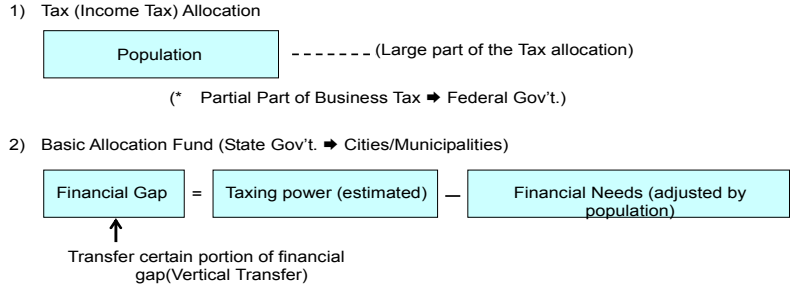


Source: JICA Study Team (based on T. Hanya; footnote 3)

Figure 9-1: Intergovernmental Transfer System in Germany (Federal State Level)

2) LGU (=city and municipal) Level

It must be emphasized that income tax is allocated mainly by population to cities and municipalities. Eventually, the tax allocation system includes financial adjustment functions in it. Furthermore, the state government distributes the basic allocation fund among cities and municipalities for the purpose of supporting their financial gaps. These parallel circuits of vertical intergovernmental financial adjustment funds provided by the federal government and by the state government exist in LGU (=city and municipal) level in Germany (see Figure 9-2).



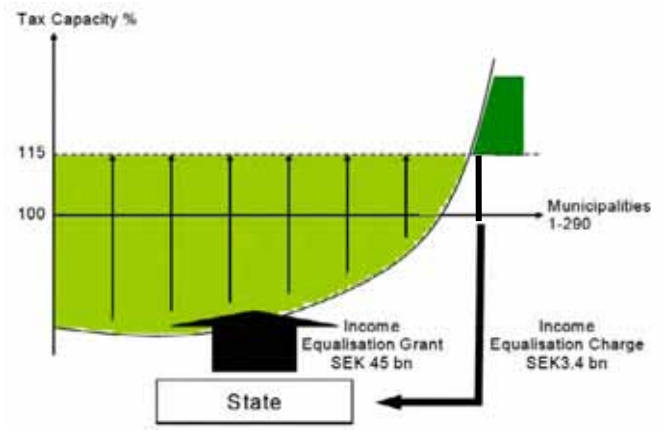
Source: JICA Study Team (based on T. Hanya: footnote 3)

Figure 9-2: Intergovernmental Transfer System in Germany (LGU =City and Municipal Level)

9.2.3. Sweden

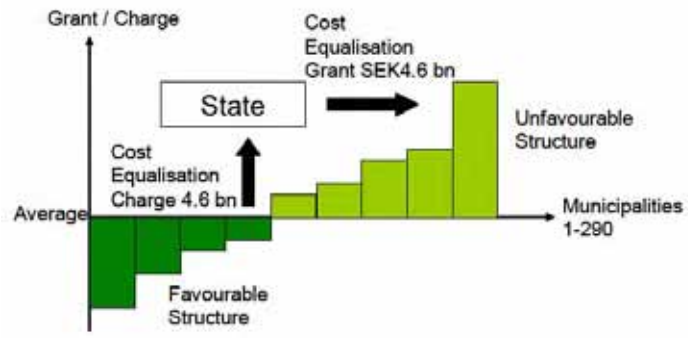
The intergovernmental adjustment system in Sweden can be classified into two types: income side adjustment and cost side adjustment.

In the new system introduced in 2005, as far as income side adjustment is concerned, the central government collects the income equalization charge from municipalities (counties) which is per capita income revenue exceeding "national average × 115%" ("national average × 110%"in case of county). The central government allocates the income equalization grant to municipalities (counties) which is per capita income revenue less than "national average × 115%" ("national average × 110%" in case of county), unifying the income equalization charge with the general fund contributed from national tax (refer to Figure 9-3).



Source: Sweden Association of Local Authorities and Regions (2005), "Local Government Financial Equalisation in Sweden"

Figure 9-3: Income Equalization Grant in Sweden



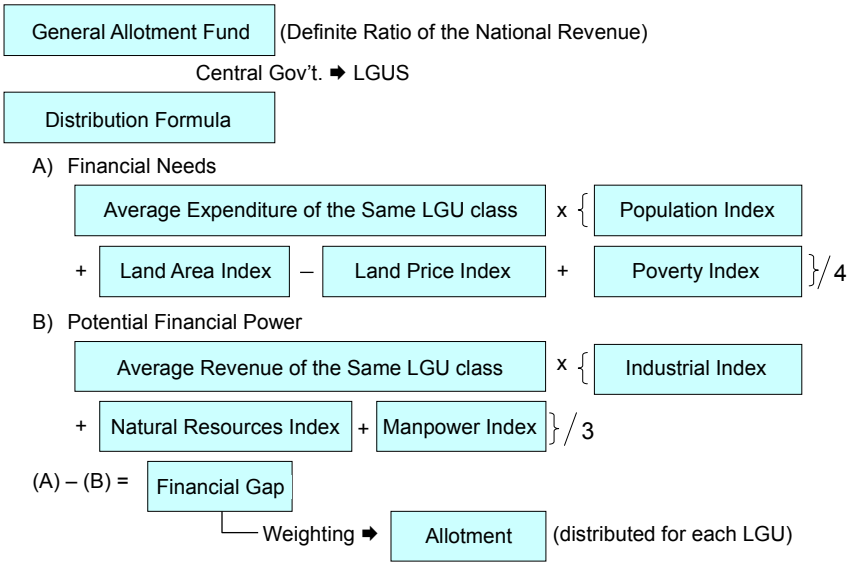
Source: Sweden Association of Local Authorities and Regions (2005) "Local Government Financial Equalisation in Sweden"

Figure 9-4: Cost Equalisation Grant in Sweden

In addition to income side, Sweden has cost side adjustment mechanism among LGUs. The unfavorable structured municipalities (counties) receive cost equalization grant from the favorable structured municipalities (counties) through the central government, based on their cost formations (refer to Figure 9-4).

9.2.4. Indonesia

The Central and Local Financial Equilibrium Law was enacted in 1999 in Indonesia. The intergovernmental adjustment system was reformed by said law, and the General Allotment Fund was transferred from the central government to LGUs, computed using the distribution formula, which was introduced in the country for the first time. As far as the distribution formula is concerned, financial need is computed considering four determinants: population, land area, land price, and poverty index. On the other hand, potential economic power is computed considering three determinants: industrial index, natural resources index, and manpower index. The financial gap is then calculated by subtracting potential financial capacity from financial needs. Lastly, the allotment share is calculated by multiplying financial gap and constant weight, then transferred to LGUs. Taken as a whole, the system in Indonesia is one type of vertical financial adjustment that responds to financial needs, as well as to taxing power to a certain extent[5] (refer to Figure 9-5).



Source: JICA Study Team (based on M. Takahashi: footnote 4)

Figure 9-5: General Allotment System in Indonesia

[5] Masayuki Takahashi "Financial Adjustment Systems in Indonesia and the Philippines"(N. Jinno, T. Ikegami, above 2003),(in Japanese).

However, the Central and Local Financial Equilibrium Law was revised in 2004. The form of calculating General Allotment Fund allocation shifted from the method mentioned above to a new method in 2008 based on this law. Currently, the Fund is allocated to finance a gap in the financial capability of each LGU which is calculated by the new formula.

9.2.5. Distribution Formula and the IRA system

In terms of the intergovernmental financial adjustment, the various systems can be distinguished from one another with three types of methods that address the disparity in financial capacity gap among LGUs. They are:

i) To decide an allocation of intergovernmental financial adjustment fund by counting only financial needs (financial needs focused method);
ii) To decide an allocation of fund by counting only potential revenue (tax collection capability) (potential revenue focused method); and
iii) To decide an allocation of fund by counting both financial needs and potential revenue (financial gap focused method).

JST considered how to appropriately set proxy indicators of financial needs and potential revenue. JST examined and came up with the options for a new IRA distribution formula which can appropriately address the disparity in financial gap among LGUs from the viewpoints of the aforementioned three methodologies.

Furthermore, in regard to the method of computation, the intergovernmental financial adjustment system can be divided into two major categories as follows:

i) To decide intergovernmental financial adjustment fund allocation to reduce the disparity in financial capacity among local governments with a formula which consists of several proxy indicators (formula approach); and
ii) To decide fund allocation to fill the financial gaps of local governments, which could be estimated through the application of build-up method in the computation of financial needs (build-up approach).

Most experiences from other countries belong to the first category, while Japan has established a method belonging to the second category (see section 9.3).

JST decided to continue with the use of the formula approach for making the recommendations on the IRA reform. In the formula approach, a formula consists of several indicators and its weightings. In the meantime, the build-up approach in the computation of financial needs, which is made possible through the detailed calculation of expenditure demand requires a great

deal of investigation as to the service responsibilities of local governments as well as a meticulous summation of the demand cost. Therefore, if the build-up approach is introduced, how to simplify the system becomes a key issue.

From the above viewpoints, the IRA system in the Philippines is characterized as follows:
i) IRA share is computed by the formula-with-indicators-based method.
ii) Taxing power-related determinant is not included in the IRA distribution formula.
iii) The IRA distribution formula responds to financial needs to a certain degree, but still seems to be insufficient.

JST proposed alternatives of the IRA allocation formula to seek suggestions through analysis based on the above points.

9.3. Mechanism and Applicability of the Local Allocation Tax System in Japan

9.3.1. Overview of the Mechanism of the LAT System

The "Local Allocation Tax" (LAT) system in Japan is based on the principle of "adequate financial resources" and "equalization". The Local Government Act §232, para. 2 provides the legal framework for the principle. In any case when LGUs are obliged, by statute or cabinet order, to carry out administrative responsibilities, the central government (CG) should take necessary measures to finance them. The LG Finance Act §13, para. 1. stipulates a similar principle.

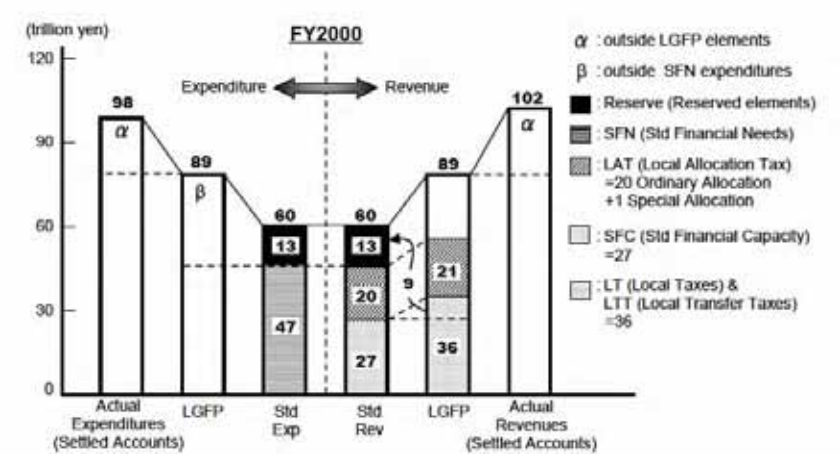
In Japan, there are three-stage processes for ensuring adequate financial resources and equalization.

In the first Stage, LG revenue and expenditure are aggregated by LGFP (LG Finance Programme) at the macro level. It ensures "total" adequate financial resources for aggregate LGUs at the macro level. Every fiscal year, the CG (represented by the Ministry of Internal Affairs and Communications or MIC), together with the Ministry of Finance (or MOF), makes an annual LGFP as part of the process of compiling the CG's annual budget.

In the second Stage, relevant expenditures of LGUs for each service item is aggregated at the macro level. It ensures "aggregate" adequate financial resources for every field of administrative service carried out by LGUs at the macro level.

The MIC makes the framework to calculate the LAT. The MIC also estimates the "total" amount of the "standard financial needs" (Std. FN) of relevant LGUs for every field of administrative service (service item), following the LGFP, and then determines every service item's "unit

cost."



Source: JICA Study Team

Figure 9-6: Relation among Actual Rev/Exp, LGFP Rev/Exp and Standard Rev/Exp

In the third Stage, the LATs are allocated to each LGU at the micro level. It ensures adequate financial resources for each LGU at the micro level. To put it concretely, the MIC determines "modification coefficients", and then calculates "standard financial needs" (Std FN) and "Standard financial capacity" (Std FC) for each LGU. Finally, the MIC fixes each amount of the LAT to be distributed to each LGU (whose Std FN exceeds Std FC). As a result of the calculation, 1,867 (91%) LGUs received LAT ("Ordinary Allocation") in FY2006 (refer to Table 9-4). It also ensures financial equalization among the different localities.

The total amount of the LAT in the law is linked to the following percentages: income tax×32% + liquor tax×32% + corporation tax×34% + national consumption tax×29.5% + national cigarette tax× 25%

Table 9-4: Number of Eligible/ Ineligible LGU for Receiving LAT (FY2006)

	Prefectures	Cities	Towns/Villages	Total
Eligible LGUs for LAT	45	675	980	1,700 (91%)
Ineligible LGUs for LAT	2	104	61	167 (9%)
Total	47	779	1,041	1,867 (100%)

Source: Compiled by JICA Study Team based on MIC

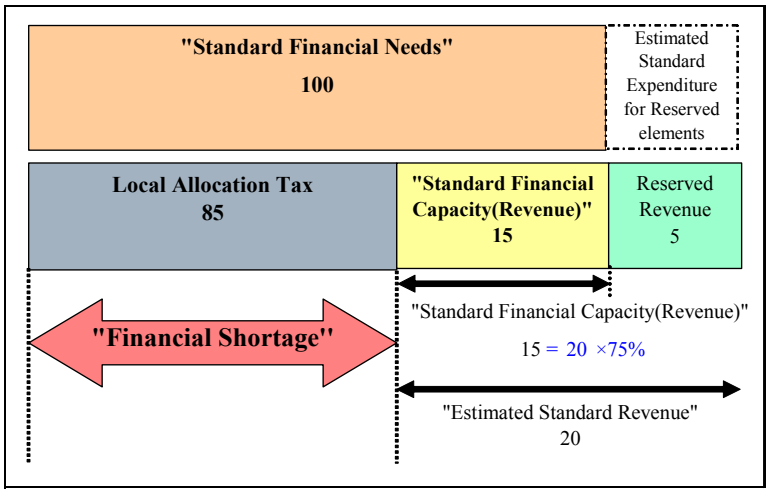
9.3.2. On the Calculation of the LAT in Each LGU

In this section, the method of calculating the amount of the LAT which each LGU receives

annually (third stage above) is explained in detail.

Firstly, there are two types of LAT. One is the “ordinary allocation”, wherein 94% of the total amount of LAT is distributed to level off the differences in the fiscal capacity of each LGU. The other is “special allocation”, wherein the remaining 6% of the total amount of LAT is set aside for extraordinary cases such as natural disasters. Therefore, the LAT which each LGU receives every year consists of both “ordinary allocation” and “special allocation”. The focus of the succeeding explanation is the “ordinary allocation” since it represents a major amount of the LAT.

Secondly, “ordinary allocation” for each LGU is the difference between “Standard Financial Needs” (Std FN) and “Std. Financial Capacity (Revenue)” (Std FC), as determined by a fixed formula. The structure is as follows (refer to Figure 9-7):



Source: JICA Study Team

Figure 9-7: Structure of Calculation of LAT in Each LGU

1) Ordinary allocation for each LGU

“Ordinary allocation” for each LGU (a)
= (“Standard financial needs” (b)－“Standard financial capacity (revenue)”(c))
= Fiscal shortage

2) Standard financial needs

“Standard financial needs”
= Σ“Unit cost” (Cost of “measurement unit”)×“measurement unit” (population, area, etc.)

× "Modification coefficient"[6] (difference between "cold/snow-covered area" and "not cold/snow-covered area", etc.)

3) Standard financial capacity (revenue)

"Standard financial capacity (revenue)"
= Σ "Estimated standard revenue"[7] × 75% (bench mark tax rate)

9.3.3. Calculation of Standard Financial Needs

In this section, the method for calculating "standard financial needs" is shown in an individual case.

As mentioned earlier, "standard financial needs" are "unit cost" times "measurement unit" and "modification coefficient". To calculate "measurement unit", a prefecture with 1.7 million population and a municipality with 100,000 population are set as model LGUs (refer to Table 9-5).

Table 9-5: Model of Prefecture and Municipality

	Prefecture	Municipality (Cities, Towns and Villages)
Population	1.7 million	100,000
Area	6,500 km^2	160 km^2
Number of Households	660,000	39,000
Road Length	3,900 km	500 km

Source: Compiled by JICA Study Team based on MIC

Every year, the MIC sets "unit cost" of a model prefecture and municipality considering essential human resources, projects, maintenance costs, and so on.

For instance, take the "unit cost" of 4,510 yen in public health in welfare (refer to Table 9-6). The calculation of the "unit cost" in public health is based on estimates of the five items. "Cost" of maternal and child health, one of the five items is calculated based on four items such as

[6] "Unit cost" is set as uniform standardized cost. However, natural conditions or social conditions in LGUs differ from one another. Therefore the costs of "financial needs" are different in accordance with conditions in the LGUs. "Modification coefficient" means "coefficient" to incorporate various conditions in the LGUs into "financial needs." "Modification coefficient" in a model LGU is set as 1.0, and it increases or decreases from 1.0 depending on the situation of scale, qualification, depopulation/aging, etc. in the LGUs. The kinds of "modification coefficient" are the so-called "modification by class", "modification by form", "modification by stage", "modification by density", "modification by steep increase or steep decrease in number", "modification by cold area", etc.

[7] When "standard revenue" is estimated, objective indirect materials are used to prevent a tax-collection performance of each LGU from the affecting amount of "standard revenue." However, "standard revenue" of the tax items, of which the amount is scarcely influenced by a tax-collection performance, is based primarily on past annual receipts.

salary (refer to Tables 9-6 and 9-7).

1) “Unit cost” of public health

“Unit cost” of public health (4,510)＝“General revenue” (450,936,000) divided by 100,000 (standard population)

“General revenue requirement” (450,936)＝“Total cost” of all items (808,247)－“Specific revenue sources”(277,854+79,457) (refer to Table 9-6)

2) “Cost” of maternal and child health

“Cost” of maternal and child health (30,894) = Total cost of all items (8,670+1,253+2,433+18,538) (refer to Table 9-7)

Table 9-6: “Measurement Unit” and “Unit Cost” of Municipality in Calculation

Item		“Measurement Unit”	“Unit Cost”
1.Fire Fighting		Population	10,600
2.Infrastructure	1.Road, Bridge	Area of Road	92,800
		Length of Road	299,000
	2.Harbor & Fishing Port	Habor: Length of Habor Facilities	36,600
		Habor: Length of Habor Extra Facilities	6,140
		Fising Port:Length of Fishing Port Facilities	13,300
		Fising Port:Length of Fishing Port Extra	4,810
	3.Urban Planning	Population in Urban Planning Area	1,240
	4.Park	Population	662
		Area of Park in Urbn Planning Area	42,200
	5.Sewarage	Population	100
	6.Others	Population	2,090
3.Education	1.Primary School	Number of Student	41,700
		Number of Class	907,000
		Number of School	7,692,000
	2.Junior High School	Number of Student	38,100
		Number of Class	1,126,000
		Number of School	9,020,000
	3.High School	Number of Teacher	7,529,000
		Number of Syudent	53,800
	4.Others	Population	6,010
		Number of Kindergarten Child	360,000
4.Welfare	1.Livelihood Protection	Population in Urban Area	6,790
	2.Social Welfare	Population	14,500
	3.Public Health	**Population**	**4,510**
	4.Health and Welfare for the Elderly	Number of People 65 years of age and older	80,800
		Number of People 75 years of age and older	71,100
	5.Cleaning	Population	6,260
5.Industry& Economic	1.Agriculture	Number of Farm Family	69,900
	2.Forestry&Fisheries	Number of Persons engaged in Forestry & Fisheries	145,000
	3.Commerce&Industry	Population	1,270
6.General Affairs	1.Tax Collection	Number of Household	7,640
	2.Family Resistration& Basic Resident Resister	Number of Family Registration	1,680
		Number of Household	2,710
7.Debt Service	"Unit Cost" on other sheets		

Source: Compiled by JICA Study Team based on MIC

Table 9-7: Basis of "Cost" of Maternal and Child Health (FY 2006, In Thousand Yen)

Item	Cost	Contents of Accumulation
Salary	8,670	Staff 1
Rewards, Fees	1,253	Antenatal Care and Infant Care (including Fee for Lecturer of Mather's Class)
Office Supplies, Printing and etc.	2,433	Maternal and Child Health Project
Outsourcing Cost	18,538	Infant Health Check etc. (Including Antenatal and Infant Health Check, Diagnosis of Hepatitis B, Home Guidances
Total	**30,894**	

Source: Compiled by JICA Study Team based on MIC

Table 9-8: Basis of "Cost" of Maternal & Child Health (FY 2006, In Thousand Yen)

Item	Cost	Contents of Accumulation
Salary	8,670	Staff 1
Rewards, Fees	1,253	Antenatal Care and Infant Care (including Fee for Lecturer of Mather's Class)
Office Supplies, Printing and etc.	2,433	Maternal and Child Health Project
Outsourcing Cost	18,538	Infant Health Check etc. (Including Antenatal and Infant Health Check, Diagnosis of Hepatitis B, Home Guidances
Total	**30,894**	

Source: Compiled by JICA Study Team based on MIC

9.3.4. Applicability of the LAT system for Local Administration in the Philippines

In this study, JST will show how the LAT system in Japan could apply to conditions of local administration in the Philippines using a trial calculation.

As stated above, "standard financial needs" are "unit cost" times "measurement unit" and "modification coefficient". To calculate all the "measurement units" and "unit costs" for "financial needs" needs a good deal of time and effort. Hence, the process of calculation for "unit cost" will be shown only in maternal and child's health. The concrete tasks for making a standard "unit cost" involve three steps.

1) Step 1: Investigation on laws and ordinances related with maternal and child health

In the calculation, information and data in the field of maternal and child's health are needed to be gathered as much as possible. If some standards are defined by laws or ordinances in national government, they could be adopted to make "unit cost". For instance, DOH shows the standard ratio to population of experts in health sector (refer to Table 9-9). These standards are not directly useful to apply to "unit cost" in maternal and child health. However, they are helpful as

reference.

Table 9-8: Standard Ratio of Experts in the Health Sector

Name of Experts	Standard Ratio to population
Rural Health Physician	1:20,000
Rural Health Nurse	1:20,000
Rural Health Midwife	1: 5,000
Rural Health Inspector	1:20,000
Rural Health Dentist	1:50,000

Source: Compiled by JICA Study Team based on DOH

2) Step 2: Investigation on actual jobs in municipalities and cities to grasp proper human resources and budget conditions

In case study B, significant data and information were gathered from intended LGUs. The duties and responsibilities of each professional such as public health nurse and midwife could be gathered from documents of some LGUs. At the same time, budgetary data, human resources and activities on maternal and child health were collected (refer to Annex 21 for details).

3) Step3: Preparation of a standard model for financial needs in maternal and child health

Using collected data and information, the "cost" of maternal and child care in a city with 100,000 population is shown in Table 9-10. So "Unit cost" is 60, that is, 5,970,000 divided by 100,000. Needless to say, additional inspection is necessary before using this "unit cost" as a standard in the Philippines. However, the learning the process to make "unit cost" standards is more important than knowing these figures.

Table 9-10: Cost of Maternal and Child Health as a Model

Item	Cost	Contents of Accumulation
Salary	5,720,000	Health Office -Staff 20 Rural Health Unit 2 - Doctor 4 - Nurse 4 - Midwife 12 Health Station -Midwife 15
Equipment, Maintenance, Medicine, etc.	250,000	Pre-natal Care-100,000 Deliveries- 50,000 Under Five Clinic 100,000
Total	5,970,000	

Source: JICA Study Team

Referring to the three steps above, it is possible that all “unit costs” of expenditures in LGUs in the Philippines can be calculated, and that the “measurement unit” can be decided on depending on the availability of statistical data.

Furthermore, it is indispensable that “modification coefficients” should be set in response to conditions of the Philippines. For example, in Japan, “modification coefficients” for cities of 500,000 or more, which are granted special rights by government ordinance, are set higher than those for ordinary cities because they have different mandates and have more responsibilities.

As mentioned before, “standard financial needs” is “unit cost” multiplied by “measurement unit” and “modification coefficient”. In this way, “standard financial needs” could be calculated.

At the same time, it is essential that “standard financial capacity (revenue)” of LGUs should be calculated in a way that is suitable to the actual situation in the Philippines.

“Standard financial needs” minus “standard financial capacity (revenue)” is fiscal shortage. On the basis of fiscal shortage, “IRA” in the Japanese LAT system would be distributed for each LGU. In the disbursement of IRA to LGUs, it is noted that total resources for the allocation are restricted by current total amount of IRA.

Under present circumstances, to introduce “IRA” based on Japanese LAT system into the Philippines immediately does not reflect reality because the national governmental agencies do not have enough standards and data to calculate “unit costs” and the departments in charge and the LGUs would be heavily burdened to calculate such costs by themselves. However, this methodology has the advantage of calculating the IRA accurately in response to the standard fiscal needs of LGUs. Therefore, further investigation and research regarding its possible application to Philippine conditions is expected by referring to the description and the trial calculation in this section.

Part IV

Proposals and Recommendations

CHAPTER 10

PRINCIPLES OF IRA REFORM

IRA is central to the intergovernmental financial adjustment system in the Philippines. Therefore, IRA reform should be determined by its relationship with the entire framework of local administration and finance. With a view to this relationship, this chapter first discusses from medium- to long-term perspective the issues surrounding the local government administration and finance (10.1.). Then, later (10.2.) in this chapter, the basic principles in IRA reform set by JST are introduced. This chapter, so to speak, corresponds to Part IV of the Final Report.

10.1. Issues and Reform concerning Local Government Administration and Finance

This section deals with the issues and reform proposals in regard to local government administration and finance from the perspective of the principles of responsibility sharing between the central and local government and of public finance. The concerns described here may be outside the scope of the Study. However, it is essential to analyze the said issues considering the objective of the Study, which is to address the disparity in financial capacity among LGUs.

10.1.1. Reexamination of IRA sharing

With the enforcement of the LGC, LGUs are tasked to play the central role of providing basic public services to the people. However, most LGUs find themselves in financially weak position, so they encounter difficulties in fulfilling the services prescribed by the LGC.

In spite of the widened tax base under the LGC, few LGUs have managed to raise the level of own-source revenue to meet their budget requirements. The reality is that many LGUs, especially those at the provincial and municipality levels, are heavily dependent on IRA. As described in Chapter 8, most stakeholders point out that the expenditure required for the devolved services is disproportionate to IRA allotment. In other words, many indicate that the current IRA share to the local government, that is, 40% of internal revenue collections does not cover the cost of services it is to perform. So-called unfunded mandates such as the Salary Standardization Law and additional personnel benefits under the Magna Carta for Health Workers may aggravate the financial situation of LGUs.

IRA occupies a considerable portion in the allocation of central government expenditure. The ratio of IRA to total central government expenditure increased from 3.8% in 1991 to 15.8% in

2006. Any increase of IRA would lead to budget cuts for the central government. The shares of national revenue between central and local government are the two sides of the same coin. Therefore, any revision of IRA should be based on the fair scrutiny of role-sharing between central government and local government. Although there is no substantiative evidence, considering LGUs' current situation in general, the Study proposes an increase of IRA for the benefit of LGUs.

10.1.2. Reexamination of tax base of local government

If the local government is to deliver appropriate services, reexamination of the shares of national internal revenue may not be sufficient. In the long term, it may be necessary to readjust the allocation of tax sources between central and local government.

If the local government is expected to perform in line with the spirits of decentralization, LGUs should be provided with sufficient funds. This can be achieved through primarily the collection of local taxes. Readjustment of the allocation of tax sources can be only fair when both the expenditure needs of central government and all different levels of LGUs and the total local source of all LGUs are computed squarely. Ideally speaking, the outcome of the said computation should be the basis of the revision of tax sources of local government and the local tax system in general.

Again, striking the right balance in the allocation of tax sources should be based on the said computation and cautious analysis. However, the local tax raised in 2006 is equivalent of only 6% of the national tax collected. The tax source of local government in the Philippines is extremely limited in comparison with other countries, such as Japan (34%), the United States of America (47%), Germany (48%), France (17%) and England (16%)[1].

10.1.3. Consideration of a fund transfer system among LGUs within a same LGU level

Even though the local tax system is reexamined, there may be still some LGUs which would find it difficult to raise the local revenue as they wish, especially those financially disadvantaged. One of the measures to support these LGUs in their finance is a system of horizontal fund transfers from LGUs with larger own revenue to LGUs with less own revenue.

As pointed out in Chapter 2, the local tax revenue per capita is strikingly high for the first- and second-class cities and relatively high for the first-class municipalities. IRA balances the national internal revenue between central and local government, but it is also expected to balance the financial capacities of LGUs. Although the Study challenges to contribute to the

[1] OECD "Revenue Statistics of OECD Member Countries 1965-2004"

latter, the options for new IRA distribution formula presented in Chapter 11 do not represent the following critical reform approaches. These approaches should be examined carefully in the future.

Firstly, none of the options pursues the zero allocation of IRA for the well-heeled LGUs. This approach signifies that those LGUs which can raise substantial local revenue may be excluded from the IRA recipients. In Japan, for instance, 9% of local government units, in which standard local revenue size exceeds standard expenditure needs size, are unqualified for local allocation tax (more details are presented in Chapter 9, 9.3.). In Indonesia, the local government units, such as Jakarta whose local revenue is substantial became non-recipient of grants from the central government starting in 2008[2].

Secondly, it is an introduction of a fund transfer system among LGUs within the same LGU level. As depicted in Chapter 9, there are countries which adopt a fund transfer system from rich local government units to disadvantaged units without the central government mediation. In the future, this approach may become instrumental to the minimization of the disparity in financial capacity among LGUs if the financial gaps of LGUs are fairly estimated and such system is carefully designed for the context of the Philippines.

10.1.4. Autonomy and efficiency of local government administration

A function of local government finance is to collect and disburse funds which are necessary to implement its policies and relevant public service necessary for promoting economic development and improved standard of living. For that purpose, the local autonomy should be well respected and each LGU should establish an efficient and effective public administration system which will enable it to deliver the services appropriate to the needs of the local communities.

More specifically, local finance must be managed with a strong fiscal discipline. As stipulated in the LGC, each LGU is obliged to formulate a sound financial plan, and its local budget must be based on functions, activities, and projects in terms of expected results. It is noted that a financial plan must be formed based on efficient public administration and optimized utilization of resources.

Moreover, IRA, a block grant from the central government, must be managed with efficiency and discipline as a part of local finance administration. In other words, use of IRA can be also optimized with an efficient and disciplined local finance administration.

[2] JICA "Current Situation of Decentralization in Indonesia" August 2005

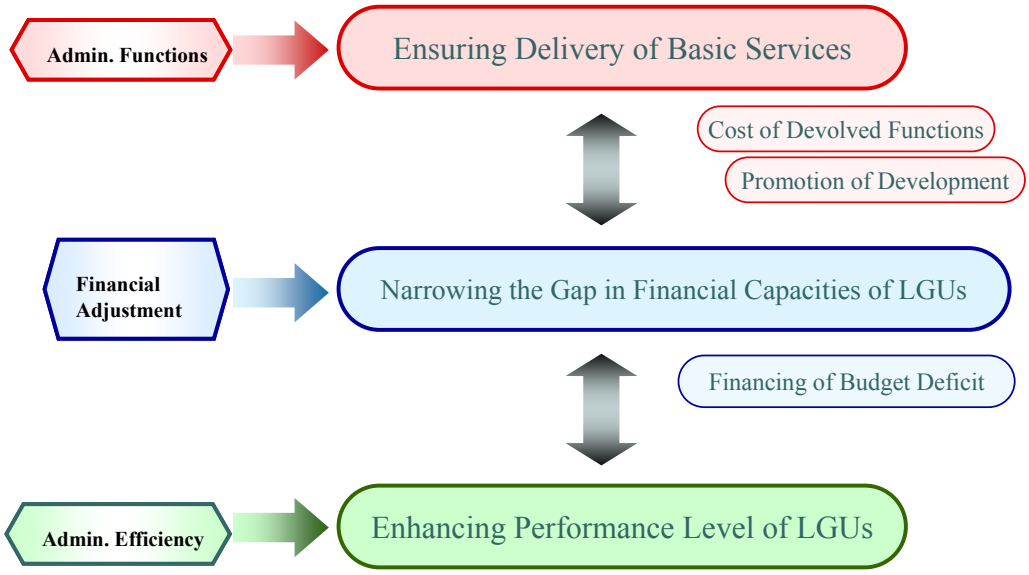
10.2. Basic Policies of Improvements of IRA system

10.2.1. Strategic Objective of Improving IRA System

Objectives and roles of IRA in local finance are not clearly explained in the LGC. Without clear objectives and goals, any IRA distribution formula cannot improve appropriately the problems of local government finance with objectivity. These objectives and goals must be accepted and shared by stakeholders because of the fact that they will lead to better situation of local government finance.

The objective of IRA, which the Study is tasked to pursue, is to narrow the disparity in financial capacity among LGUs. With this objective placed as a banner headline, the Study needed to verify its relevance and specify the strategic targets under the said banner headline.

JST conducted a Survey by Questionnaire and held a series of workshops. Through these activities, it sought to define the strategic objectives of IRA and to help build a consensus among stakeholders in the said definition. The figure below shows the summary of the outputs from these activities (Figure 10-1).



Source: JICA Study Team

Figure 10-1: Perception of Stakeholders on Strategic Objective of IRA

Many respondents of the Survey by Questionnaire and participants of workshops contend that, from the administrative perspective, the role of IRA is to ensure the delivery of basic public services. They also share the same views on the role of IRA from the point of view of the

financial adjustment administrative efficiency. They point out that IRA should serve to equalizing the financial capacities of LGUs and that IRA should promote the enhancement of performance level of LGUs.

What is expressed by the stakeholders here turns out to unite with the principles of intergovernmental financial adjustment mentioned in Chapter 9; that is to say, the desirable financial adjustment system would contain the factors of: i) ensuring financially basic local administration and ii) balancing financial capacities among LGUs. In sum, these two factors should be vested in each other in defining the role of IRA. Therefore, this Study officially defines the role of IRA as equalizing the financial capacities of LGUs with a view to enabling LGUs to perform standard basic public services.

10.2.2. Basic Policies regarding IRA Distribution

One of the missions of the Study is to review IRA distribution formula in order to realize the aforesaid objectives. The next chapter discusses the details of options for new IRA distribution formula JST proposes. But, before getting to the options, JST proposes to set the three basic principles as preconditions for the formulation of the options.

1) Firstly, the Study maintains the current procedure of intergovernmental fund transfer, in which the central government acts as go-between for adjusting the financial capacities of LGUs. There are two major methods of adjusting the local government financial capacities. One is that of the central government providing funds to LGUs from its own resources as a vertical fund transfer system. The other is that of the central government acting as go-between for transferring the resources of rich LGUs to poor LGUs as a horizontal fund transfer system. IRA system in the Philippines belongs to the former. JST considers it practical not to introduce a horizontal fund transfer system in the Philippines (see details in the previous section).

2) Secondly, the Study continues to characterize IRA as a block grant. Currently, there is a regulation that 20% of IRA should be utilized for the purpose of financing the development projects; and the recommendations the Study came up with in this matter are presented in Chapter 13. However, if one chooses to tighten the regulations in terms of the use of IRA, it may lead to bringing damages to local government autonomy and wearing off IRA's essence as a block grant. In sum, the Study considers it inappropriate to shift IRA from a block grant to an earmarked grant.

3) Thirdly, the Study maintains the formula method of determining the distribution of IRA. The distribution can be determined by a formula approach or a build-up computation approach. In the formula method, the share of IRA to each LGU is determined through computation based on the indicators and the weights given to these indicators with a formula. On the other hand, in the

build-up approach, the financial demand of each LGU may be estimated in detail by identifying measurement units and unit costs in different sectors. With this estimate on the financial demand, along with an estimate of standard revenue of LGUs, a build-up method may be able to give a tailor-made estimate of financial gap of individual LGU, thereby making it possible to determine the share of IRA to each LGU based on the financial gap. One disadvantage of the build-up approach is that the estimate of financial demand of LGUs requires a complete data set and detailed computation. It is in this regard that the build-up approach may be an option for the Philippines in the future, provided that the concerned government agencies and institutions join together for the identification of appropriate measurement units (a draft future action flow is presented in Chapter 11, Section 11.6.).

Because of these principles, JST decided to show its proposals in line with the use of formula-approach IRA distribution. It is, however, important to note that formula-approach of IRA distribution has limited capacity in the reduction of financial imbalances among LGUs.

10.2.3. Issues and Challenges of IRA distribution formula

The scope of this Study includes not only providing recommendations on options of new distribution formula, but also giving suggestions on improvements in the use of IRA and other related issues. As for revenue and expenditure of LGUs, there are several regulations and rules which should be reconsidered in conjunction with the reformation of IRA. Major issues related to IRA are as follows:

1) Use of 20% of received IRA for development projects

Each LGU should appropriate in its annual budget no less than twenty percent (20%) of its annual IRA for development projects in accordance with Section 287 of the LGC. The DILG-DBM joint memorandum circular was issued (Nov. 1, 2005) to provide guidelines on the appropriation and utilization of this 20%. However, this rule becomes one of the budgetary constraints of many LGUs because it restricts flexible use of its limited resources. In Chapter 13, JICA Study Team makes proposals in relation to the provisions of Section 287 of the LGC and the DILG-DBM joint memorandum circular.

2) Increase of personnel expenses

Many LGUs are financial strapped to the pressure in the increase of personnel cost under tight financial conditions. Currently, there is a regulation that obligates LGUs to hold down the personnel cost to 45 to 55% of their expenditure. Any IRA reform should encompass a tighter financial discipline in order not to breed thoughtless increase of personnel expenses.

3) Data management and numerical targets

Any increase in IRA should have a direct link with the betterment of standard of living of people. For this to be verified the data relevant to public administration should be well managed and the numerical targets for basic human needs should be established.

4) Allocation of the Cost of Devolved Function (CODEF[3])

Among a total IRA of PhP183.9 billion in FY 2007, PhP6.5 billion was initially allocated to the share equivalent to 1992 cost of devolved functions/city-funded hospitals and, subsequently, the rest was distributed on the basis of formula stipulated in Section 285 of R.A. 7160. The CODEF had become a vested interest of LGUs. However, there is a possibility that the separation of CODEF from total IRA weakens the efficiency of distribution.

5) Calculation of IRA amount based on the national internal revenue of the preceding third fiscal year

LGUs receive a share in national internal revenue taxes, i.e., IRA, based on the collection of the third fiscal year preceding a current fiscal year in accordance with Section 284 of the LGC.

The principle of IRA reform, which addresses all the issues above, is that each LGU performs its functions with the enhanced autonomy in line with decentralization spirits. For this to be achieved, first and foremost, financial discipline is essential. JST recommends reforms in the rules and regulations of IRA system with an emphasis on the improved public finance management and finance discipline (see more details in Chapter 13).

[3] LGC1991 spelled out that the IRA would be increased from 20% to 40% of internal revenue collections in 1994. In 1992 the IRA was increased to 30% but it is not sufficient to cover the cost of functions that have been devolved. Especially, the cost of maintaining the hospitals turned out to be financial pressure to many LGUs. Thus, in 1993 the central government decided to introduce a system called Cost of Devolved Function. 2.8 billion pesos for provinces, 0.9 billion pesos for cities and 2.7 billion pesos for municipalities (a total of 6.5 billion pesos) are deducted first from the total IRA before the IRA amount for each LGU is determined. According to DBM, CODEF is to allocate the funds for the personnel cost of the staff transferred to LGUs and other expenses are to be covered by the increment of IRA after 1991. Unaware of this background, some LGUs claim that CODEF they receive is not sufficient to cover the expenditure of the functions transferred to them from the central government. It is obvious that CODEF adds some confusion to the validity of the IRA distribution. (JICA Preparatory Study on the IRA Improvement (2007))

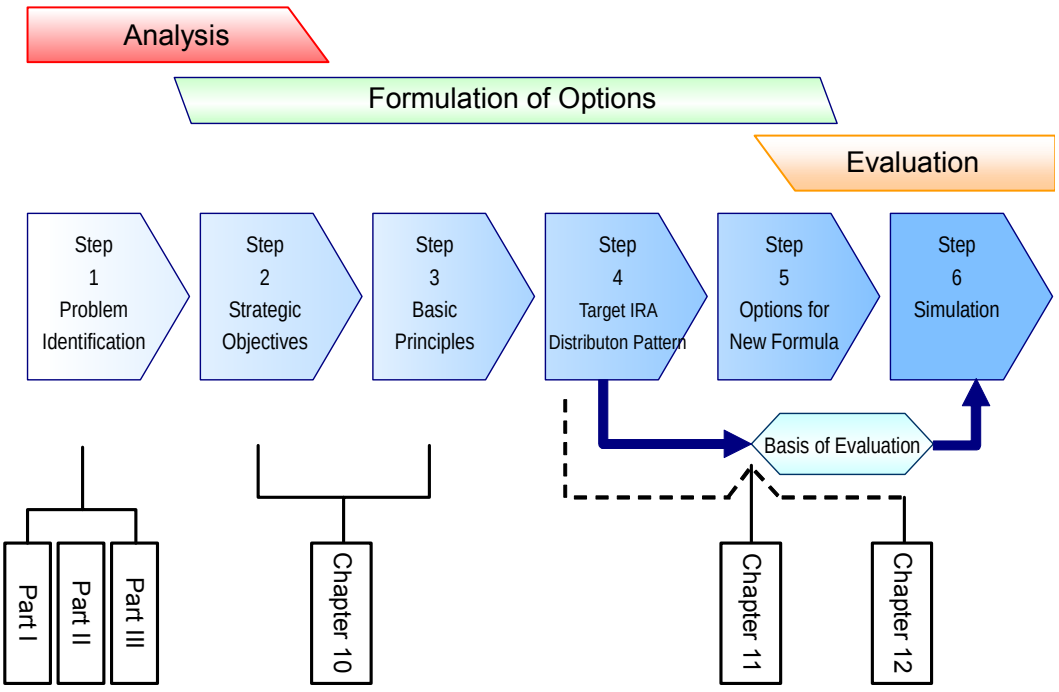
CHAPTER 11

OPTIONS FOR NEW IRA DISTRIBUTION FORMULA

This chapter discusses the options for new IRA distribution formula. The first section exhibits the operation procedure in the formulation of the options (11.1.). The succeeding sections present the preconditions for the formulation of the options (11.2.), the concepts of designing the options (11.3.), the list of options (11.4.) and the proposal for narrowing down the list of options (11.5.). Lastly, the Study drafted an operation procedure for fundamental IRA reform (11.6.).

11.1. Operation Procedure in Formulation of Options

The options for new IRA distribution formula are derived from the findings of the baseline analysis of the current situation of local government administration and finance (Step 1). Part I through Part III of this report corresponds to this. Particularly, the quantitative analysis (Chapter 3 and 4) and the perception analysis (Chapters 5, 6, and 7) are the very basis of the formulation of the options. As described in Chapter 10 and based on the analysis of the current situation, the strategic objectives of IRA and the principles for IRA reform are established (Step 2 and Step 3).



Source: JICA Study Team

Figure 11-1: Operation Procedure in Formulation of Options

Then JST attempted to identify an ideal IRA distribution pattern in accordance with the strategic objectives of IRA established in Step 3 (Step 4). This is due to JST's intention to draw options based on the findings of the analysis of the current situation, as well as the identification of an ideal IRA distribution pattern in line with the strategic objectives of IRA. However, the attempts to set an ideal IRA distribution pattern eventually met a lot of difficulties. In Chapter 12, the procedures undertaken on these attempts and the limitations in setting an ideal IRA distribution pattern are all laid out.

In Step 5, the options for new IRA distribution formula, as well as the details of their formulation, are introduced. In the end, the Study conducts the simulation and impact analysis of these option formulas (Step 6). In Chapter 12, it is shown how each option formula can bring about changes vis-à-vis the current IRA distribution pattern.

11.2. Preconditions for Formulation of Options

In the previous chapter, JST finds it appropriate to apply the formula approach in IRA distribution for the time being considering the present situation of the Philippines. Having said it, JST sets the following preconditions for the formulation of options for new IRA distribution formula.

11.2.1. Prerequisites for new formulas

From the viewpoint of administrative efficiency, JST considers that legitimate formulas should share the following prerequisites: 1) simplicity/clarity, 2) objectivity, and 3) transparency.

1) Simplicity/Clarity

The current vertical and horizontal distribution formulas are simple and clear but they may not be based on clear philosophies. In this light, the proposed new formulas should share the clarity in terms of the philosophies that they arise from, and the simplicity by which it is easy for anyone to comprehend. One of the advantages of the quest for simplicity/clarity is that one can expect to minimize discretionary acts in the determination of IRA shares to LGUs.

2) Objectivity

JST also advocates objectivity as one of the character traits for the determinants of legitimate horizontal formulas as well as for the formulas per se. As for the objectivity of the formulas, they must serve to reduce the imbalances in financial capacity among LGUs. It is also desirable that the formulas per se encompass objectivity in terms of their accountability, as it is

inadequate to bring forth low-income LGUs to a disadvantageous position in receiving IRA shares. In addition, the objectivity stands legitimate for the determinants within formulas. The determinants of horizontal formulas concern all LGUs and, therefore, it is desirable that they are chosen from among the officially disclosed data. Ensuring the objectivity of the determinants of horizontal formulas has the same effect of minimizing room for discretionary acts as the quest for simplicity/clarity.

3) Transparency

Legitimate formulas should also be transparent. It is advisable that any IRA amount extended to any LGU may be verified by a third-party. On the other hand, when the computation of IRA shares becomes complex, it is inevitable that its transparency will be impaired.

Interestingly, ensuring the simplicity/clarity and objectivity in new formulas correlates closely with the search for transparency.

11.2.2. Precedence of vertical formula to horizontal formula

The service responsibilities assigned are the same for all LGUs in each LGU level. The disparities in the fiscal shortages of LGUs among different LGU levels may vary from one region to another. However, it is estimated that the disparities in the fiscal capacities of LGUs in each LGU level are greater than those of LGUs between different LGU levels. Therefore, the study employs the current practice of giving priority to the computation of vertical sharing for the different LGU levels before computing the share of each LGU in each level.

11.2.3. Unchanged shares for barangays

The Study attempted to investigate the service responsibilities of different levels of LGUs including those of barangays. However, the investigation into the administrative and financial situation of barangays has not been sufficiently conducted. There is an opinion that barangays benefit more from the current sharing pattern of IRA than other levels of LGUs, but the Study has little ground to verify this. JST also considers that the following points should also be taken into account:

1) Barangays are the smallest administrative units and the closest units to the people in the Philippines. Their services are deeply intertwined with the activities of their respective communities. This affects negatively the Study's decision to reduce the share of IRA to barangays.

2) Under present circumstances, LGUs at higher levels often take up the service responsibilities

assigned to barangays. In other countries, there is also a tendency that the service requirements of barangays are gradually transferred to local governments at a higher level due to increasing respect to wide-area administration. This, however, affects negatively the Study's decision to increase the share of IRA to barangays.

11.3. Concepts of Designing the Options

The prime role of IRA is to narrow down the gap in financial capacity among LGUs. Therefore, new IRA formula should serve to equalize the financial capacities of LGUs across different LGU levels as well as within each LGU level. JST carefully considered the following aspects on how the financial capacities of LGUs can be equalized.

11.3.1. Design of vertical formulas

1) Frame of reference for designing options

The share of IRA in the expenditure of the national government dropped from 18.5% in 2002 to 14.0% in 2006. Considering the revenue shortage of LGUs, the diminishing share of the internal revenue for LGUs becomes a problem of great concern. This implies the need to review the shares of internal revenue between the national government and LGUs. In this regard, the Study should also tackle the issues of disparity in the fiscal capacity that exists among LGUs. The Study looks into the aggregate financial shortage of LGUs with respect to each LGU level and finds out if there is a better sharing pattern of IRA across different LGU levels.

2) Foundation for designing options

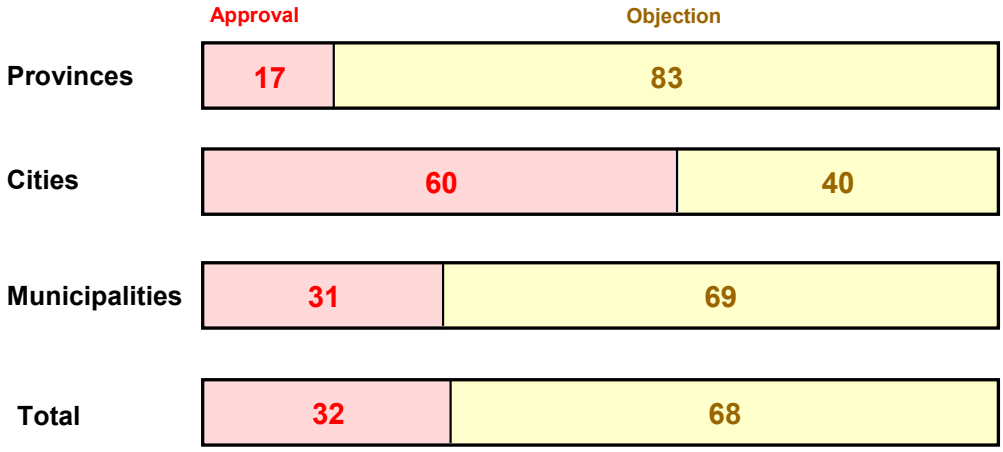
The bases for designing the vertical options are the following three findings of the Study.

i) Results of quantitative analysis

One of the most striking facts on the local government financial structure is that the share of local source revenue to the total income of cities is much larger than that of provinces and municipalities. Moreover, the share of IRA per capita to cities is still bigger than the other two LGU levels. While the share of IRA to the total income for cities remain as low as 41%, at the provincial and municipality levels, the same figure goes up to 78% and 74%, respectively. The existing vertical distribution pattern may have caused the widened disparity across LGUs at different levels.

ii) Results of perception survey (qualitative survey)

The results of the perception survey, presented in Part III, also support the notion that the current IRA distribution formula works more advantageously to cities than the other LGU levels. For instance, 60% of city representatives evaluate the current formula positively as opposed to 17% and 31% for provincial level and municipal level, respectively.



Source: JICA Study Team

Figure 11-2: LGUs' Evaluation of the Current Formula

iii) Estimate of financial needs of LGUs through build-up approach

As described in Chapter 4, the Study attempted to estimate the financial needs of LGUs based on the tabulation of service responsibilities of each level of LGUs. The Study also computed the gaps between the financial needs and the own-source revenues at each LGU level. The calculation of financial needs is based on a simple build-up approach and may not precisely reflect the actual needs; however, it can be credible since it is based on quantitative analysis.

3) Types of vertical formula

i) Type I: Review of vertical sharing of IRA based on the computation of financial needs in the build-up approach

As mentioned before, the build-up method of computing the financial needs of LGUs makes possible the computation of financial shortage of each LGU or aggregate financial shortage at each LGU level. With this, the vertical sharing may be adjusted so as to narrow the gaps in the financial shortages of different LGU levels.

Step 1	Computation of the aggregate total (a) of financial needs of all LGUs at each LGU

	level
Step 2	Computation of the aggregate total (b) of own source income (/total local source) of all LGU at each LGU level
Step 3	Computation of the aggregate total of financial shortages (c) of all LGU at each LGU level by (a)-(b)
Step 4	Review of the vertical sharing of IRA by comparing the financial shortages (c) across different LGU levels

ii) Type II: Review of vertical sharing of IRA in consideration of own-source income

Type II option takes a choice of reducing the sharing of IRA to cities due to the results of local government financial structure and the perception survey described above. The Study proposes also an option combining cities and municipalities into one layer, making it only three layers in all.

11.3.2. Design of horizontal formulas

1) Frame of reference for designing options

The equalization effect of the current horizontal formula on the fiscal capacities of LGUs within each level is not sufficient. For this reason, the options for new IRA horizontal formula should be geared toward the equalization of fiscal capacities of LGUs in each of the different LGU levels.

With this in mind, JST proposes the options which take into account several issues, such as more realistic calculation of financial needs, incorporation of potential own source revenue, financial shortage, and different sharing mechanisms for the increment from the current IRA amount. In addition, it is important to examine the expected effect/s of each option in terms of equalization of the financial capacities of LGUs. This remains as an action assignment in the future.

2) Foundation for designing options

The options for new IRA horizontal formula are derived from the analytical work and the results of the perception survey. As of today, it is difficult to review IRA distribution formula based on the financial shortages of LGUs.

i) Results of quantitative analysis

The quantitative analysis in Chapter 3 highlights that only a small minority of LGUs enjoys bulky own source income while the majority is highly dependent on IRA in their source of income. This means that the appropriation of budget for most LGUs is restricted by the limited size of income. The general trend is that while the appropriation for general public services is increasing, the budget available for social and economic services is diminishing.

In addition, there are several issues in the current IRA horizontal formula which need to be addressed.

- Under the current IRA formula, LGUs with larger population receive more IRA. At the same time, per capita receipt of IRA is higher for more thinly populated LGUs.

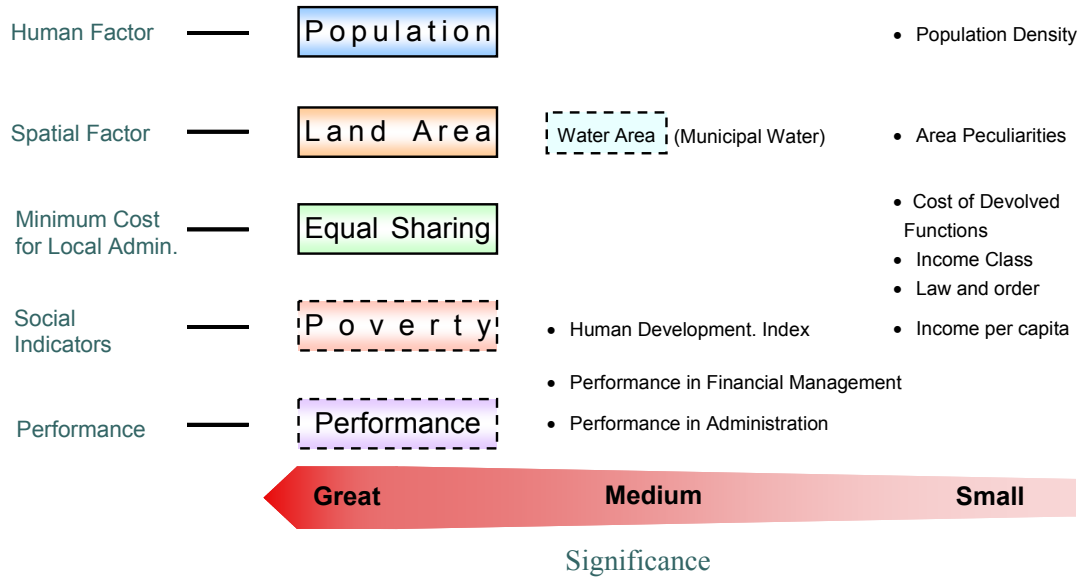
- Tax collection capability is not considered in the distribution of IRA, although IRA corresponds to the expenditure demands of LGUs by including such indicators as land area and population for horizontal distribution.

- The performance of LGUs for efficient budgeting (e.g., proper taxation, tax collection performance, and efficient expenditure) is not measured in the distribution of IRA.

ii) Results of perception survey

JST regards the perception of stakeholders as essential in determining the direction of IRA reform. That is why the LGU Sample Survey, Survey by Questionnaire and workshops were conducted, and in the process consensus-building was promoted in the Study. From this perspective, JST naturally places high value on the results of perception survey in the formulation of options for IRA horizontal distribution formula.

Figure 11-3 shows the perception of stakeholders on the factors (determinants) within formulas. The summary of the perception of stakeholders shows that determinants, such as population and land area remain indispensable in determining the distribution of IRA. Municipal water is regarded by many stakeholders as one of the important determinants for improving the horizontal formula because it gives certain consideration to the financial requirements for the construction of coastal infrastructure. Equal sharing is also supported by a number of stakeholders, since many perceive the necessity of allocating minimum resources for local government administration. Among the factors which are not included in the current formula, poverty and financial management performance, also received high support.



Source: JICA Study Team

Figure 11-3: Perception of Stakeholders on Factors within Formulas

In summary, the results and analysis of the perception survey have given JST an important insight for the formulation of options for new formula.

3) Concepts of options for new IRA horizontal distribution formula and their types

Despite their different nature, all the factors above aim to narrow down the gaps in financial capacity among LGUs. The improved horizontal formula should contribute to further strengthening the fund transfer mechanism from financially advantaged LGUs to those which experience large financial shortages.

Generally, LGUs in the metropolitan areas enjoy a high level of own source income due to agglomeration effects and economic dynamics. On the other hand, LGUs in less populated areas have certain difficulties in raising enough own source income, and as a consequence, they need to work harder to finance their basic services.

i) Type I: Changing only weights and maintaining the current determinants

Type I bundles the options which maintain the determinants within the formula, but by changing the weights given to these determinants aim to provide more resources to the LGUs in less populated areas.

ii) Type II: Options representing different policy concepts

The options under Type II are those which include new determinants, with each new determinant showing a clear vision for IRA reform. The disparity in financial capacity among LGUs can be reduced with the promotion of some critical policies. The question is which policy is more valuable in the search for equalization of LGUs' financial capacities. The newly introduced determinants, each of which points to a certain policy direction, are listed down below.

Meanwhile, it is important to note that some new determinants, such as "poverty" and "potential revenue", should not evoke any malicious intention by LGUs to make a pretense of being in need more than they actually are. If these new determinants are to be added, there is a need to adopt a necessary measure not to let it happen.

Poverty	A formula with poverty incidence is expected to give more resources to poverty stricken areas, thereby, addressing more effectively the nation's goal of poverty reduction.
Geographic peculiarities (coastal area)	A formula with coastal area is expected to address the financial requirements peculiar to the coastal LGUs, which should not be neglected in island countries like the Philippines.
Potential revenue (own source revenue)	A formula factoring in own source income should be able to make IRA distribution pattern more favorable to LGUs with less own source income.
Performance in financial management	A formula with performance factor is expected to promote the enhancement of LGUs' performance in financial management, although JST proposes setting another mechanism outside IRA system for the promotion of LGU performance.

iii) Type III: Special sharing scheme for the increment from the current total IRA

With a view in the end of better balancing the sharing scheme of national revenue between central and local government, the bill which proposes to raise the share of local government from 40% to 50% may pass the Congress. If it passes, the Study proposes to distribute the increment (10%) as priority fund allocation to financially disadvantaged LGUs.

It is also more politically acceptable not to introduce about drastic changes in the current IRA distribution, especially for LGUs whose IRA may be reduced due to the introduction of new IRA formula. Type III, therefore, groups the options which can realize both the strategic goal of IRA within a certain level of political acceptance.

The scheme can be explained as shown below.

Step 1	Identification of the increment from the current sharing in national revenue Step 1a - Distribution of the increase in share of national revenue (10%) by using new formula Step 1b - Distribution of both the increase in share of national revenue (10%) and the increment from the share of the specified fiscal year (whatever the increase from the specified fiscal year) by using new formula
Step 2	Restriction of the distribution of the increment to the LGUs with high own source income level The increment from the current share is allocated only to those LGUs whose per capita own source income level is below an specified level. This means that the LGUs whose per capita own source income is higher than the specified level do not get any share from the increment.
Step 3	Identification of new formula for the distribution of the increment Step 3a - Formula comprised of new determinants, i.e. poverty incidence, own source income, and financial management performance Step 3b - Any formula listed in Type I or Type II

iv) Type IV (Addition): Filling in the financial shortages identified in the computation of financial needs through build-up approach

The Study proposes to establish a mechanism in the allocation IRA in relation to the financial shortage of each LGU described in Chapter 4. This option may not be feasible at this time, but it can be implemented with the assistance of NGAs and other relevant government offices. The operation procedure for this type is drafted by JST and presented in Section 11.6.

11.4. Options for New IRA Distribution Formula

11.4.1. Options for vertical formula

1) Option V1: Current formula

[Province]23%+[City]23%+[Municipality]34%+[Barangay]20%
Characteristics: - Formula already in place and rooted in the system.

Type I

2) Option V2: New sharing based on the computation of financial needs through build-up approach

[Province]23%+[City]22%+[Municipality]35%+[Barangay]20% (a little decrease at the [City] level and a little increase at the [Municipality] level)	
Characteristics:	- The sharing is determined based on the aggregate figures of financial gaps of different LGU levels. - The details of the calculation are presented in Chapter 4 although there are some limitations due to insufficiency of data.

Type II

3) Option V3: Share of IRA to Municipalities increased

[Province]23%+[City]18%+[Municipality]39%+[Barangay]20% (decrease at the [City] level and increase at the [Municipality] level)	
Characteristics:	- With a decrease in the share of cities and increase in the share municipalities, it is expected that the share of lower income municipalities will be increased and, consequently, the overall disparity in financial capability among LGUs will be narrowed. - The impact analysis of this option is presented in Chapter 12, Table 12-1, Simulation #1.

4) Option V4: Shares of IRA to Provinces and Municipalities increased

[Province]26%+[City]17%+[Municipality]37%+[Barangay]20% (increase at the [Province] and [Municipality] levels)	
Characteristics:	- This option represents an increase of shares for provinces and municipalities. - The impact analysis of this option is presented in Chapter 12, Table 12-1, Simulation #2.

5) Option V5: Cities and Municipalities combined into one layer

[Province]23%+([City]+[Municipality])57%+[Barangay]20%	
Characteristics:	- This option aims to minimize chaotic situation which arises due to municipalities' search for cityhood. - The impact analysis of this option is presented in Chapter 12, Table 12-1, Simulation #3.

11.4.2. Options for horizontal formula

1) Option H1: Current formula

[Population]50%+[Land Area]25%+[Equal Sharing]25%	
Characteristics:	- Formula already in place and rooted in the system.

Type I

2) Option H2: Less populated areas favored

a) [Population]45%+[Land Area]30%+[Equal Sharing]25% b) [Population]45%+[Land Area]25%+[Equal Sharing]30%	
Characteristics:	- With the reduction of weight given to [population], the option aims to favor less populated areas and reduce imbalances in financial capacity among LGUs. - The impact analysis of this option is presented in Chapter 12, Table 12-2, Simulation #4 and #5.

Type II

3) Option H3: Areas with high poverty incidence favored

([Population]50%+[Land Area]25%+[Equal Sharing]25%)x(100%-Certain Percentage) (e.g. 90%)+ [Poverty Index]) x Certain Percentage (e.g. 10%)	
Characteristics:	- With the addition of [poverty index] within formula, the option aims to favor poverty-stricken areas and address effectively the poverty reduction. - The issues concerning the data of poverty incidence are explained in Chapter 12, Section 12.2.2.

4) Option H4: Financial needs pertaining to municipal water addressed

[Population]50%+([Land Area]+[Municipal Water])25%+[Equal Sharing]25%	
Characteristics:	- With the introduction of [municipal water], the option aims to

	address the financial needs which arise from coastal resources preservation and development. - The data of municipal water should all be obtained. The issues concerning the data of poverty incidence are explained in Chapter 12, 12.2.2., "Addition of new indicator".

5) Option H5: Level of own-source revenue considered

([Population]50%+[Land Area]25%+[Equal Sharing]25%) x (100%-Certain Percentage) (e.g. 90%) + ([Own source Revenue]) x Certain Percentage (e.g. 10%)	
Characteristics:	- With the use of the inverse of size of own source revenue in the formula, the option aims to reduce IRA allocation of LGUs with more own source revenue and increase IRA of LGUs with less own source revenue. - The impact analysis of this option is presented in Chapter 12, Table 12-3, Simulation #6, #7 and #8 and explained in Section 12.2.2.

6) Option H6: Level of financial management performance considered

([Population]50%+[Land Area]25%+[Equal Sharing]25%) x (100%-Certain Percentage) (e.g. 90%) + ([Performance Index]) x Certain Percentage (e.g. 10%)	
Characteristics:	- With inclusion of performance-related indicators in the formula, it is expected that the option will have a positive effect on revenue generation, expenditure management or financial discipline. - The impact analysis of this option is presented in Chapter 12, Section 12.2.2., and in Figures 12-1 and 12-2.

Type III

7) Option H7: Distribution of the increment from the current 40% of IR to 50% through a new formula

40% of IR is distributed by the current formulas: [Province]23%+[City]23%+[Municipality]34%+[Barangay]20% [Population]50%+[Land Area]25%+[Equal Sharing]25% Percentage increment from 40% to 50% This increment is distributed by a new formula giving priorities to LGUs with larger financial gaps.	
Characteristics:	- This option allows all LGUs to retain the existing IRA allocation computed based on the current distribution formula. - At the same time, the increment can be distributed, based on strong policy decision, to poverty reduction and/or to performance stimulation.

8) Option H8: Distribution of the increment from the specified year through a new formula

Actual IRA in the specified year: This is to maintain the actual IRA amount distributed to LGUs in the specified year. Percentage increment from 40% to 50% and any increment of IRA from the specified year Both increments are distributed by a new formula giving priorities to LGUs with larger financial gaps.	
Characteristics:	- This option allows all LGUs to retain at least the current IRA allocation and no LGUs are subject to reduction of amount. - At the same time, the increment can be distributed based on strong policy decisions.

Type IV (Addition)

9) Option 9: Balancing of financial gaps among LGUs

i) Calculation of fiscal needs Estimates of the fiscal needs of LGUs based on a build-up approach ii) Identification of own-source revenue sizes of LGUs iii) Calculation of fiscal shortage of LGUs through calculating the gap between estimates of i) and ii)	
Characteristics:	- This option may be more effective than the other options in reducing the disparity in financial capacity among LGUs since it addresses the financial gaps of LGUs. - As explained previously, the financial gaps can be estimated through the computation of financial needs and potential revenue. At present, computation of the gap cannot be performed due to insufficient data. - A draft operation procedure is presented in Section 11.6.

11.5. Narrowing down the Options

A bill which proposes new IRA distribution formula should find a suitable combination of vertical formula and horizontal formula. It is expected that the Philippine government will find a most suitable combination by interlocking the vertical and horizontal options proposed in this Study.

The Study takes an approach of separating the vertical formula options from the horizontal ones, and expects to show more clearly the impact analysis of each option. Because of this approach, the Study reveals the character traits of each option and the effects of the weights (parameters) given to each determinant. It is expected that DILG will find the most suitable combination of vertical and horizontal formulas based on the results of the simulation analysis in Chapter 12. It should be worked out by shuffling different combinations of vertical and horizontal formulas.

JST would like to point out some concerns and issues on the procedure of narrowing down the options.

1) Financial Gaps and IRA

The Study managed to give an indication of the macro financial gaps between LGUs at different LGU levels. The aggregate financial gaps, estimated through the computation of financial needs in the build up approach, are about 1.6 times as much as the total IRA (refer to Chapter 4 for details). The computation of financial needs of sample LGUs in Chapter 12 shows that the standard expenditure requires three times as much as the current IRA. Therefore, even if the

computation of financial needs in the build up approach is conducted more accurately in the future, there still remains the problem of IRA not being able to cover the financial gaps of all LGUs. How to cover the financial gaps with IRA remains purely a policy matter, but two options are worth noting; 1) application of IRA distribution proportional to the size of the financial gaps, and 2) application of uniform distribution of IRA with an aim to the attainment of national minimum.

At present, it is not practical to introduce the build up approach in the computation of the financial needs and JST attempted in vain to identify ideal IRA distribution patterns (refer to Chapter 12 for details). It is left to the value judgment and policy priorities of the Government of the Philippines.

2) Suggestions with respect to vertical sharing

JST considers reasonable the combination of Type I (option V2) for vertical formula and any formula from the horizontal options presented in Section 11.4.

In this regard, the disparity in the size of own source revenue across different LGU levels may become a point of controversy, especially between city level and municipality level. Own source revenue of cities (127 units) is 3.2 times larger than that of municipalities (1,501 units) (refer to Chapter 3). On the other hand, the vertical sharing derived from the aggregate financial needs of different LGU levels through the build-up approach has not much difference from the current sharing (refer to Chapter 4).

It is also important to take into account the dynamics in the population and migratory movement with the passage of time. The current calculation of IRA amount for each LGU is based on the population data of year 2000. In the new census conducted lately, the population in the cities should be much larger than it was in 2000. The high population growth rate and the high ratio of youth population are likely to thrust further rapid progress of urbanization in the Philippines. It implicates an increase in the population of cities and decrease in that of municipalities. This indicates that with the passage of time, the disparity that exists between cities and municipalities may be reduced by the demographic dynamics[1].

3) Measures to be taken for financial needs and potential revenue

[1] Some LGUs with small population mark high level of income per capita. This can be attributed to the current IRA distribution pattern favoring excessively those LGUs. It is due to the imbalances in IRA distribution between the urban areas and rural areas. Therefore, there is an argument that the imbalances can be addressed only by improving the vertical formula rather than by changing the horizontal formula. In this light, it is necessary to take into account the delicate outcomes from shuffling the vertical and horizontal formulas by giving due consideration to the effects of IRA reform on the LGUs with small population.

The current horizontal formula does not reflect the aspect of potential revenue of LGUs. Neither does it take into consideration the financial needs of LGUs. In narrowing down the options for new IRA distribution formula, it is necessary to consider the issues of financial needs and potential revenue.

There are two methods of incorporating these issues in the IRA distribution formulas. One is to include both in one IRA distribution formula like the current IRA distribution system. Second is to set two formulas, one for financial needs and one for potential revenue, and then estimate the financial gaps. For the second to be legitimate, the computation of potential revenue should be established. However, the data of proxy indicators, which will be used for the computation of potential revenue, i.e. "per capita income", "the number of population engaged in different industries", etc., are not completely available at all LGU levels. At present, it is difficult to implement the second method.

With these, JST considers it realistic to choose the first method. If the single formula method is to be applied, this should reflect appropriately the values of both financial needs and potential revenue. The determinants, or indicators, of such formula should also be readily available. For financial needs, the indicators such as "population" and "land area" may be still legitimate for the new formula. In addition, "poverty incidence" may be also legitimate although the dataset of poverty incidence is not complete at all LGU levels (Option H3). On the other hand, the Study could only apply to "own source revenue" for the computation of potential revenue (Option H5).

4) Effect of "equal sharing" in the balancing of financial capacities

The Study revealed the critical role of "equal sharing" within the horizontal formula (see Chapters 3 and 12 for details). The impacts of the parameters, or weights given to "equal sharing" proved to be very critical in addressing the imbalances in financial capacity among LGUs. It tends to give lavish IRA distribution on the less populated areas. Consequently, the use of "equal sharing" may have greater impacts on the disparity in financial capacity among LGUs than other determinants[2].

5) Consideration for financial performance

[2] It is an important argument how to relate the IRA reform to the promotion of the balanced development throughout the nation and to the imbalanced financial capacities. The disparity can be explained by: (1) per capita income, (2) standard of living related indicators, such as poverty incidence, infant mortality rate, school enrolment rate, (3) stock related indicators, such as the level of road maintenance and the level of water supply and drainage maintenance, and (4) economic activities related indicators, such as the level of economic accumulation and development level of network economy. It is important to consider wisely the use of "equal sharing" in the IRA distribution formula based on the national policy priorities vis-à-vis the support to urbanization and development of the less populated areas. In this regard, JICA Study Team attempted to address the IRA reform from the aspect of the equalization of the standard of living, but in vain due to the data deficiency (refer to Chapter 3, 3.3. for more details).

Any IRA reform should also deal with the promotion of financial discipline on the side of LGUs. The inclusion of "performance" indicator in the formula may trigger efforts by LGUs to avoid reduction of IRA and improve the overall financial discipline of local governments. However, it may have a significant adverse effect to LGUs with limited local revenue. For this reason, JST recommends that the IRA system should be separated from the promotion of financial performance by LGUs, but rather a separate fund transfer system similar to the performance-based grant system the World Bank advocates.

6) Advantages and disadvantages of the option of applying new formula only to the increment

Among the horizontal options JST presents are two options under Type III, which deal with the application of new formula only to the increment from the current IRA amount. One of them is associated with the increment of IRA from the current level (e.g. 10%) (Option H7) and the other deals with any increment from the IRA amount calculated in the specified year (Option H8).

In Chapter 12, JST designates those LGUs which have more own source revenue than the average "own source income + IRA" as IRA non-recipient. Whether this approach is practical or not cannot be judged since it requires further studies. Nevertheless, considering the fact that IRA cannot cover the financial gaps of all LGUs, the creation of IRA non-recipient LGUs may be a legitimate option.

If any of these two options is chosen, it allows all LGUs to retain at least the current IRA amount and enables the central government to bring in any priority policy in the distribution of the increment. It is also important to keep in mind the upward trend of national internal revenue collections and carefully reexamine the advantages and disadvantages of this option.

11.6. Operation Procedure for Fundamental IRA Reform

In the previous section, the points of argument with respect to the selection of the most suitable options are discussed. It is done on the premise that the current formula approach is maintained. However, as explained previously, the formula approach has its limitations in terms of financial equalization among LGUs.

In this connection, if the Government of the Philippines chooses to adopt a similar system to Japan's LAT system in addressing the financial gaps of LGUs, JST would propose the operation procedure shown in Table 11-1. The operation flow for this procedure along with timeframe is also drafted and presented in Figure 11-4.

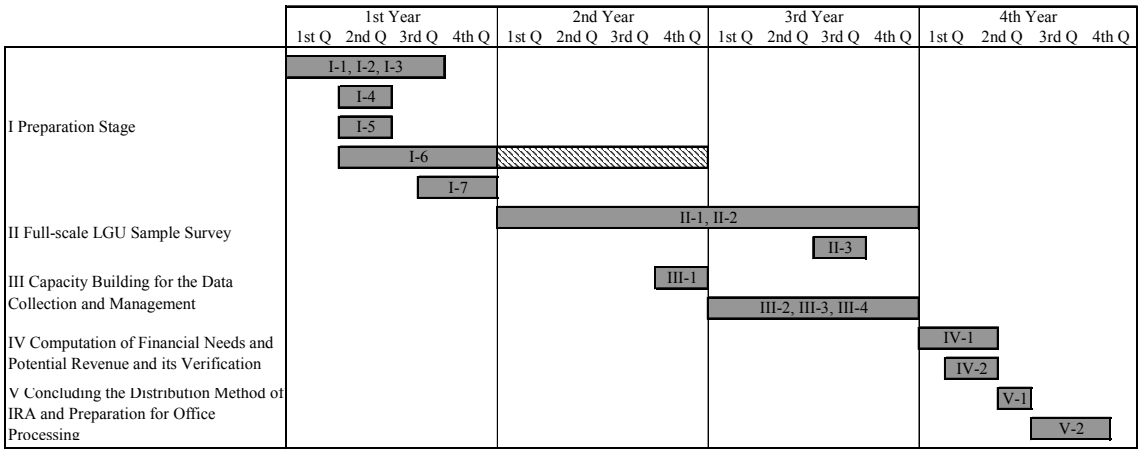
If the computation of the financial needs of LGUs is to be upgraded, there is a need to thoroughly investigate the present state of service delivery of LGUs and to find a transparent way to compute it through the collaboration of concerned NGAs. Therefore, prior to the conduct of LGU sample survey, there should be a solid preparation stage for the operation procedure. It is also important to allot ample time for the verification process on the outcomes of the operation. If all of these are taken into account, the timeframe needed for the entire operation may go between four to five years in total.

Table 11-1: Operation Procedure for Fundamental IRA Reform

I	Preparation Stage	
	I-1	Identification of service responsibilities of each LGU level based on the hearings from the relevant national government agencies (All expense items of service delivery of each LGU level will be laid down through collaboration with relevant national government agencies and institutions.)
	I-2	Conduct of quick LGU sample survey for the analysis of the present state of the LGUs' service delivery (The expense items listed in the I-1 will be verified through quick sample survey and it will be done through collaboration with relevant national government agencies and institutions.)
	I-3	Preparation of the list of candidate measurement units for the computation of financial needs (Candidate measurement units will be for all expense items so that multiple measurement units will be set under each sub-sector.)
	I-4	Establishment of computation methodology of potential revenue (Practical methodology for the computation of potential revenue will be established and the list of data needed will be prepared.)
	I-5	Selection of samples for full-scale LGU sample survey (Sample LGUs will be selected with due consideration to region, income class, and peculiar circumstances (for modification coefficients).)
	I-6	Conduct of the study on the financial adjustment system and other fund transfer systems in the Philippines (Baseline survey will be conducted in order to come up with findings relevant to the establishment of the methodology in IRA distribution.)
	I-7	Establishment of hypothetical methodology for the reduction of disparity in financial capacity (financial gaps) among LGUs (Hypothetical methodology for filling the financial gaps of LGUs by IRA will be set)
II	Full-scale LGU Sample Survey	
	II-1	Verification of the results of I-1 and I-2 through sample survey
	II-2	Identification of measurement units and unit costs through sample survey (Measurement units will be identified and unit costs will be calculated as shown in Chapter 4.)
	II-3	Identification of Modification Coefficients (The present state of service delivery in LGUs with peculiar circumstances and modification coefficients will be identified.)
III	Capacity Building for the Data Collection and Management	
	III-1	Preparation of data capture forms (The data capture forms for the computation of financial needs and potential revenue will be prepared.)
	III-2	Implementation of capacity building for LGUs' data collection (The capacity building targeting the DILG staff positioned in regional offices and local government will be conducted.)
	III-3	Implementation of capacity building for DILG central office's data management
	III-4	Establishment of data management system (The possibility of utilization of LGPMS will be analyzed and the data management system will be conducted.)

IV	Computation of Financial Needs and Potential Revenue and its Verification
	IV-1 Computation of financial needs and potential revenue of all LGUs
	IV-2 Conduct of workshop for the verification of all the work above (The workshop intended for the collection of feedbacks from LGUs and stakeholders in terms of the work above.)
V	Concluding the Distribution Method of IRA and Preparation for Office Processing
	V-1 Concluding of distribution method of IRA (The method of filling the financial gaps of LGUs by IRA will be decided.)
	V-2 Preparation of office processing of the computation of IRA amount for each LGU (Through collaboration with DBM the preparation necessary for the office processing will be made.)

Source: JICA Study Team



Source: JICA Study Team

Figure 11-4: Operation Flow for Fundamental IRA Reform

CHAPTER 12

Impact Assessments of Draft Options for New IRA Distribution Formula

This Chapter presents, in tandem with new formula options introduced in the previous chapter, an impact assessment by way of simulation. After an overview of simulation methodology (12.1.), the results of principal simulations are summarized (12.2.), followed by two supplementary studies. One is a sensitivity analysis in terms of changes in formula parameters (12.3.) which will serve as a reference for the selection of the best option, and the other, an examination of the evaluation criterion for equalizing fiscal capacities of LGUs (12.4.).

12.1. Overview of Simulation Methodology

12.1.1. Mechanism of the Simulation System

The IRA values annually received by each LGU are calculated every year by the DBM following the well-known formula described in the Section 284 of the LGC 1991. In order to trace this process, an Excel-based system which automatically calculates the IRA share for all individual LGUs (but for barangays), given an amount of total IRA funds (theoretically 40% of national internal tax revenue). Share weights in both the vertical and horizontal formula are set in the system as variables (to be called “vertical parameters” and “horizontal parameters” respectively here in this chapter). In the case of horizontal distribution, the IRA share for each LGU is calculated, based on population data (2000), land area (2001) and the numbers of LGUs to be coupled with the parameters. The first two are what the DBM has actually used for several years, and the last, a base for “equal share”, correspond to those recorded in the SIE (2005). All these data are treated as fixed values in this system.

The system is designed to display the result of simulation in a given format which includes grouping by income class and region as well as summary statistics such as “coefficient of variation”.

12.1.2. IRA Computation Based on the Present Formula (an examination of the “theoretical value”)

Initially, the system was used to calculate the IRA share for all individual LGUs by applying the distribution formula which is actually in effect at present. Ideally, the computation should have started from the IRA fund total that is derived from the national government budget. But a non-negligible difference was found between this ideal and the sum of IRA actually received by individual LGUs (SIE data, the share for barangays adjusted). Putting aside a thorough

examination of the discrepancy, the latter figure was divided into shares of three layers based on the vertical parameters. The horizontal parameters were then applied to each layer's total to arrive at the share for each LGU.

In comparing the results of the above calculation (might be called "theoretical values") with the SIE actual data, one finds a number of individual LGUs where the error exceeds a non-negligible percentage. Even on the aggregate level, "theoretical values" prove to have an up-bias for cities and a down-bias for provinces. As mentioned in Chapter 3, this seems to reflect two elements: one is the portion of IRA earmarked for the cost of devolution, and the other, recording inconsistencies between the concerned agencies (DOF and DBM). At any rate, in view of the purpose of this simulation, which is to check the difference among alternative formulas, these discrepancies would be taken as being harmless.

12.2. Simulations for Option Formula

12.2.1. General Features of Simulation

Using the system, simulations can be made based on various sets of assumptions, i.e. combination of parameters (factor weights) both vertical and horizontal. It serves as sensitivity tests to check the direction and magnitude of impacts that a change in formula parameters makes on the distribution of IRA. It helps also to evaluate the effectiveness of one alternative formula in comparison with the other.

The system is solely based on equalities, and thus, it is not a sophisticated econometric model; rather, it gives simulated values for all individual LGUs (except for barangays) in a simple and transparent operation thus enabling one to check the results by various category groupings.

The system can be flexibly extended with the addition of new factors in the formulas.

12.2.2. Impacts on IRA Distribution by Each Draft Option Formula

Simulation results are shown here with regard to six main and computational cases out of options proposed earlier in section 11.4.

They are broadly comprised of two classifications namely, one deals with changes in the vertical formula (V3、V4、V5 described in 11.4.1.) and the other, in the horizontal formula (H2-a、H2-b、H5 in 11.4.2.). It is possible to make “mixed" simulations, but these will be tasks to be undertaken in a later stage when stakeholders have been given enough opportunity to discuss and examine the results of this Study.
In all the resulting summary tables, it will be noted that a change in IRA values (total and per

capita) is expressed as a difference between the "theoretical present value" and the value calculated based on a new formula. LGUs are grouped in two ways: a) the conventional P-C-M layers with an income class division[1] for each layer, and b) aggregation into 17 regions. For reference, average income sizes in the year 2005 are shown for the former grouping and indexed regional per capita GDP for the latter[2]. "Coefficient of variation" at the bottom of the tables, serves to show the extent of unevenness in IRA distribution among each LGU layer[3].

1) Options with Changes in the Vertical Formula

i) A reshuffle of vertical parameters

Simulation 1 in Table 12-1 indicates one example of a change in the vertical parameters where the share of municipalities is to be increased by 5% at the expense of cities.

This change leads, as a matter of simple arithmetic, to a 22% reduction in IRA for cities and a 15% increase in IRA for municipalities in terms of total IRA allocated. On per capita PhP basis, municipalities gain PhP151, while cities lose PhP286[4]. Across the regions, NCR suffers most reflecting the existence of big cities in this region.

Simulation 2 shows the case where the share reduced from cities (6%) is to be added equally to provinces and municipalities. Changes in the layer total IRA are plus 13% for provinces, minus 26% for cities and plus 9% for municipalities. In terms of per capita value, provinces and municipalities receive PhP80~90 more, while cities lose substantially by PhP345. Impact by region is not much different from the previous case, except that the reduction for NCR gets greater.

Needless to say, percent changes by income class are constant for each layer. Changes in per capita value do get greater in smaller LGUs, but it is no more a reflection of the initial status shown as Simulation 0.

ii) Cities and municipalities to be treated in a single layer

Simulation 3 in Table 12-1 examines the option where cities and municipalities are treated in a single layer. In this case, the most significant change stems from an operation in which the equal share portions of cities and municipalities are put into the same basket to be divided evenly by

[1] In the database now at JST's disposal, 170 municipalities have no rating and are temporarily classified as "unclassified". Refer to annex table "Income Class Comparison" for additional information of each class.
[2] Regions are in fact placed in the summary tables in descending order of per-capita GDP.
[3] A negative figure implies that the distribution gets more even.
[4] Percent changes on a per -capita basis are the same as the total, as LGU populations remain unchanged.

the total number of these LGUs. (Although both the population and land share are also subject to the same operation, the magnitude of their impact is much smaller compared with that of equal share). As a result, 11% of IRA total funds is shifted from cities to municipalities.

On account of the above operation, percentage changes by income class are different even in the same layer (cities or municipalities). In both the layers, the greater the impact is, the smaller the income size, although the direction of the change is opposite to each other. Regional impacts are greater in magnitude but are of the same pattern as the previous two cases.

This option has been devised to eliminate incentives for relatively big municipalities whose leaders aspire to get qualified as a city, which would then impact negatively on the existing cities. In order for this option to be effective, however, it may be necessary to combine this option with some devices to compensate the cities.

2) Options with Changes in the Horizontal Formula

i) A reshuffle of horizontal parameters

Simulations 4 and 5 (Table 12-2) deal with the cases where a 5% portion in the “population share” is to be shifted to the “land share” or to the “equal share”. As the vertical shares are fixed, the distribution share among these layers does not change. However, the effects by income class seem to be non-negligible. Upper income classes suffer from an IRA reduction in all the three layers, a typical example being the “special class” in the city layer (namely Quezon and Makati).

An important implication is derived from a comparison between Simulations 4 and 5. A reduction in “population share” results only in limited changes with few exceptions when coupled with an augmentation in the “land share”. But when the former is combined with a reduction of the “equal share”, then LGUs in lower income classes enjoy fairly big positive impacts.

Table 12-1: Summary of Results of Optional Simulation (1)

Simulation #		0		1		2		3	
Option Type		Present Formula		A change in vertical parameters		A change in vertical parameters		City and Municipality in a same basket	
Assumptions	Vertical	V1		V3		V4		V5	
	Provinces (P)	23%		0%		3%		0%	
	Cities (C)	23%		−5%		−6%		result: C	→ −11%
	Municipalities (M)	34%		5%		3%		result: M	→ +11%
	Horizontal	H1		H1		H1		H1	
	population (P)	50%		0%		0%		0%	
	land (L)	25%		0%		0%		0%	
	eaqual (E)	25%		0%		0%		0%	
	Others	none		none		none		none	
Variable		IRA total	IRA p.c.	IRA total	IRA p.c.	IRA total	IRA p.c.	IRA total	IRA p.c.
form expressed in (s: simulated value, b: base value)		b,mil.PhP	b,PhP	(s−b)/b	s−b, PhP	(s−b)/b	s−b, PhP	(s−b)/b	s−b, PhP
By LGU	(Average Income size in Million PhP)								
Provinces	576	34,857	580	0.0%	0	13.0%	76	0.0%	0
P−1	778	25,369	519	0.0%	0	13.0%	68	0.0%	0
P−2	401	4,620	701	0.0%	0	13.0%	91	0.0%	0
P−3	314	3,178	922	0.0%	0	13.0%	120	0.0%	0
P−4	233	1,431	1,255	0.0%	0	13.0%	164	0.0%	0
P−5	144	259	2,856	0.0%	0	13.0%	373	0.0%	0
Cities	712	34,857	1,322	−21.6%	−286	−25.9%	−343	−46.9%	−620
C−special	7,248	2,684	715	−21.7%	−155	−26.1%	−186	−19.5%	−140
C−1	1,161	17,368	1,161	−21.7%	−252	−26.1%	−303	−42.2%	−490
C−2	372	3,402	1,596	−21.7%	−347	−26.1%	−416	−52.6%	−839
C−3	281	5,412	1,911	−21.7%	−415	−25.2%	−482	−57.1%	−1,092
C−4	232	4,875	2,238	−21.7%	−487	−26.1%	−584	−60.3%	−1,350
C−5	186	928	2,506	−21.7%	−545	−26.1%	−654	−62.8%	−1,575
Municipalities	46.0	51,528	1,028	14.7%	151	8.8%	91	31.7%	326
M−1	117.7	10,855	806	14.7%	119	8.8%	71	25.5%	206
M−2	60.2	6,538	943	14.7%	139	8.8%	83	29.6%	279
M−3	45.3	9,839	1,000	14.7%	147	8.8%	88	31.1%	311
M−4	32.6	12,113	1,128	14.7%	166	8.8%	100	33.8%	382
M−5	21.2	5,688	1,412	14.7%	208	8.8%	125	38.2%	539
M−6	15.8	143	2,703	14.7%	398	8.8%	239	46.3%	1,251
M−nonclasifiec	24.2	6,309	1,251	14.7%	184	8.8%	110	35.4%	329
By Region (Relative per capita GDP)									
Re. 13 (1.00)	National Capital Region	7719	779	−20.6%	−161	−25.0%	−195	−24.1%	−187
Re. 07 (0.60)	Central Visayas	8774	1498	−1.7%	−26	−1.7%	−26	−5.1%	−76
Re. 11 (0.50)	Davao Region	6199	1672	−3.4%	−57	−3.7%	−62	−8.2%	−138
Re. 14 (0.50)	Cordillera Admin. Region	3794	2779	6.4%	179	8.1%	226	19.6%	544
Re. 10 (0.41)	Northern Mindanao	6881	2010	−2.7%	−55	−3.0%	−60	−8.3%	−166
Re. 04 (0.40)	Calabarzon	11606	1276	1.9%	24	2.3%	29	1.0%	13
Re. 06 (0.38)	Western Visayas	10516	1642	−2.7%	−45	−3.1%	−50	−9.8%	−161
Re. 17 (0.36)	Mimaropa	5778	2642	3.0%	80	4.0%	106	5.7%	150
Re. 03 (0.31)	Central Luzon	11228	1399	1.2%	17	1.7%	24	0.0%	0
Re. 09 (0.22)	Zamboanga Peninsula	5241	1849	−1.3%	−23	−1.7%	−31	−4.3%	−79
Re. 01 (0.22)	Ilocos Region	6657	1553	3.1%	48	3.2%	49	4.1%	64
Re. 02 (0.22)	Cagayan Valley	6328	2244	4.5%	102	5.2%	117	9.9%	222
Re. 16 (0.19)	Caraga	4765	2175	3.0%	65	3.4%	74	7.1%	154
Re. 08 (0.17)	Eastern Visayas	7129	1954	4.0%	78	4.4%	86	8.3%	162
Re. 12 (0.16)	Soccsksargen	5613	1742	1.2%	21	1.7%	30	1.7%	30
Re. 05 (0.14)	Bicol Region	7315	1581	3.9%	61	4.6%	73	5.7%	90
Re. 15 (n.a.)	Auton. Re.in Mus. Mindanao	5698	1984	8.1%	160	9.3%	184	19.5%	386
Coefficient of variation (s−b)	Provinces	−	0.000	−	0.000	−	0.000	−	0.000
	Cities	−	0.000	−	0.000	−	−0.002	−	−0.230
	Municipalities	−	0.000	−	0.000	−	0.000	−	0.211

Note: Figures in parenthesis in the column “By Region” indicate per capita regional GDP in 2006, as expressed in relative value with NCR=1. Regions in this table are placed in the descending order of these figures.

Source: Compiled by the JICA Study Team based on data from the DOF and DBM

Table 12-2: Summary of Results of Optional Simulation (2)

Simulation #		0		4		5	
Option Type		Present Formula		A change in horizontal parameters			
Assumptions	Vertical	V1		V1		V1	
	Provinces (P)	23%		0%		0%	
	Cities (C)	23%		0%		0%	
	Municipalities (M)	34%		0%		0%	
	Horizontal	H1		H2-a		H2-b	
	population (P)	50%		-5%		-5%	
	land (L)	25%		5%		0%	
	eaqual (E)	25%		0%		5%	
	Others	none		none		none	
Variable		IRA total	IRA p.c.	IRA total	IRA p.c.	IRA total	IRA p.c.
form expressed in (s: simulated value, b: base value)		b,mil.PhP	b,PhP	(s-b)/b	s-b, PhP	(s-b)/b	s-b, PhP
By LGU	(Average Income size in Million PhP)						
Provinces	576	34,857	580	0.0%	0	0.0%	0
P-1	778	25,369	519	-0.6%	-3	-1.8%	-9
P-2	401	4,620	701	0.9%	6	2.6%	18
P-3	314	3,178	922	2.2%	21	5.2%	48
P-4	233	1,431	1,255	2.3%	29	8.5%	106
P-5	144	259	2,856	-0.1%	-2	16.0%	457
Cities	712	34,857	1,322	0.0%	0	0.0%	0
C-special	7,248	2,684	715	-8.8%	-63	-8.1%	-58
C-1	1,161	17,368	1,161	-0.7%	-8	-2.1%	-24
C-2	372	3,402	1,596	1.4%	23	2.0%	32
C-3	281	5,412	1,911	2.3%	45	3.9%	74
C-4	232	4,875	2,238	3.5%	78	4.7%	105
C-5	186	928	2,506	2.5%	62	7.0%	175
Municipalities	46.0	51,528	1,028	0.0%	0	0.0%	0
M-1	117.7	10,855	806	-1.8%	-15	-3.7%	-30
M-2	60.2	6,538	943	-0.1%	-1	-1.7%	-16
M-3	45.3	9,839	1,000	0.0%	0	-0.5%	-5
M-4	32.6	12,113	1,128	0.0%	0	1.7%	19
M-5	21.2	5,688	1,412	0.0%	1	5.4%	76
M-6	15.8	143	2,703	1.1%	28	11.3%	306
M-nonclasified	24.2	6,309	1,251	3.0%	38	0.5%	6
By Region (Relative per capita GDP)							
Re. 13 (1.00)	National Capital Region	7719	779	-8.0%	-62	0.8%	13
Re. 07 (0.60)	Central Visayas	8774	1498	-1.6%	-23	1.3%	29
Re. 11 (0.50)	Davao Region	6199	1672	2.2%	37	-1.2%	-16
Re. 14 (0.50)	Cordillera Admin. Region	3794	2779	4.3%	119	-2.3%	-29
Re. 10 (0.41)	Northern Mindanao	6881	2010	2.5%	51	0.4%	6
Re. 04 (0.40)	Calabarzon	11606	1276	-4.0%	-51	0.5%	8
Re. 06 (0.38)	Western Visayas	10516	1642	-0.2%	-4	0.1%	2
Re. 17 (0.36)	Mimaropa	5778	2642	6.0%	158	1.9%	37
Re. 03 (0.31)	Central Luzon	11228	1399	-2.6%	-36	0.6%	12
Re. 09 (0.22)	Zamboanga Peninsula	5241	1849	2.4%	44	1.5%	29
Re. 01 (0.22)	Ilocos Region	6657	1553	-2.1%	-32	-0.8%	-14
Re. 02 (0.22)	Cagayan Valley	6328	2244	4.3%	96	-0.3%	-5
Re. 16 (0.19)	Caraga	4765	2175	3.8%	83	-5.6%	-44
Re. 08 (0.17)	Eastern Visayas	7129	1954	1.5%	29	4.5%	126
Re. 12 (0.16)	Soccsksargen	5613	1742	2.1%	36	1.1%	22
Re. 05 (0.14)	Bicol Region	7315	1581	-1.1%	-17	1.7%	37
Re. 15 (n.a.)	Auton. Re.in Mus. Mindanao	5698	1984	2.5%	50	1.4%	36
Coefficient of variation (s-b)	Provinces	-	0.000	-	0.004	-	0.122
	Cities	-	0.000	-	0.046	-	0.019
	Municipalities	-	0.000	-	0.178	-	0.090

Note: Figures in parenthesis in the column "By Region" indicate per capita regional GDP in 2006, as expressed in relative value with NCR=1. Regions in this table are placed in the descending order of these figures.

Source: Compiled by the JICA Study Team based on data from the DOF and DBM

ii) An addition of the fourth factor

In Chapter 11, some options were proposed with an additional factor which serves different policy concepts such as “imbalance in locally owned sources”, “poverty level”, “municipal water”, “administrative performance” and so on.

If and when any of these “fourth factors” is to be built into the horizontal formula based on well-defined policy implications, it will be indispensable to work out an approach that takes into consideration such practical and concrete issues as following.

a) Use of a relevant converter: The variable range (max-min diversion) of the new indicator has to be optimized using a converter equation.
b) Selection of the “weight”: Should the “fourth factors” be adjusted by any weight or not? If so, through what (for example, population, budget size, etc.)?
c) Choice of “adjustment fund”: Where can one find a resource fund for the “fourth factor adjustment”? Putting aside the case for a net increase in the total IRA, the fund will have to be generated by reducing any one, or all across-the-board of the current three factors (population, land and equal share).
d) Choice of the data time point: Will available data at the latest year be used? Alternatively, should an average of plural time-points be used? In addition, the timing of the updates will have to be planned in advance.

Impact Assessment on the Addition of the “Locally Owned Sources” Factor

As one example of an addition of the fourth factor to the horizontal formula, Simulation 6~8 (Table 12-3) shows the effects of taking into account the present differences in “Total Local Source” (or TLS).

In specific terms, the following steps were taken:
a) Calculate for every LGU a per-capita level of “Total Local Sources”,(TLS=local tax +non-tax local revenue).
b) Find the highest value among each of the three layers,
c) Calculate individual “required adjustment” by multiplying the TLS level in short of the highest standard above and the LGUs population.
d) Calculate the percentage share (X %) of the value above among the total sum of each LGU layer
e) Multiply X % with the total fund for adjustment (10% of IRA, for example) to get the 4th factor allocation to individual LGUs.

Table 12-3: Summary of Results of Optional Simulation (3)

Simulation #		0		6		7		8	
Option Type		Present Formula		A new factor(Total Local Source) addede					
Assumptions	Vertical	V1		V1		V1		V1	
	Provinces (P)	23%		0%		0%		0%	
	Cities (C)	23%		0%		0%		0%	
	Municipalities (M)	34%		0%		0%		0%	
	Horizontal	H1		H5		H5'(reference)		H5''(reference)	
	population (P)	50%		-5.0%		-10.0%		-50.0%	
	land (L)	25%		-2.5%		0%		0%	
	eaqual (E)	25%		-2.5%		0%		0%	
	Others	none		10%(TLS)		10%(TLS)		50%(TLS)	
Variable		IRA total	IRA p.c.	IRA total	IRA p.c.	IRA total	IRA p.c.	IRA total	IRA p.c.
form expressed in (s:simulated value, b:base value)		b,mil.PhP	b,PhP	(s-b)/b	s-b, PhP	(s-b)/b	s-b, PhP	(s-b)/b	s-b, PhP
By LGU	(Average Income size in Million PhP)								
Provinces	576	34,857	580	0.0%	0	0.0%	0	0.0%	0
P-1	778	25,369	519	0.9%	5	-0.2%	-1	-1.2%	-6
P-2	401	4,620	701	-1.2%	-9	0.5%	3	2.4%	17
P-3	314	3,178	922	-2.7%	-25	1.0%	9	5.0%	46
P-4	233	1,431	1,255	-4.9%	-62	0.5%	6	2.3%	29
P-5	144	259	2,856	-8.4%	-239	-0.4%	-12	-2.0%	-58
Cities	712	34,857	1,322	0.0%	0	0.0%	0	0.0%	0
C-special	7,248	2,684	715	9.0%	64	0.5%	3	2.3%	16
C-1	1,161	17,368	1,161	-1.1%	-13	-2.5%	-29	-12.6%	-147
C-2	372	3,402	1,596	2.4%	38	4.1%	66	20.6%	329
C-3	281	5,412	1,911	1.0%	18	4.0%	77	20.2%	385
C-4	232	4,875	2,238	-2.9%	-64	1.2%	28	6.2%	138
C-5	186	928	2,506	-3.6%	-90	1.1%	29	5.7%	144
Municipalities	46.0	51,528	1,028	0.0%	0	0.0%	0	0.0%	0
M-1	117.7	10,855	806	2.1%	17	-0.6%	-5	-3.2%	-26
M-2	60.2	6,538	943	1.0%	10	0.1%	1	0.6%	6
M-3	45.3	9,839	1,000	0.4%	4	0.2%	2	0.9%	9
M-4	32.6	12,113	1,128	-0.7%	-8	0.2%	2	1.0%	12
M-5	21.2	5,688	1,412	-2.5%	-35	0.2%	3	1.1%	16
M-6	15.8	143	2,703	-6.1%	-166	0.0%	1	0.2%	6
M-nonclasified	24.2	6,309	1,251	-1.7%	-101	0.1%	3	0.4%	15
By Region (Relative per capita GDP)									
Re. 13 (1.00)	National Capital Region	7719	779	7.0%	55	0.2%	2	1.1%	8
Re. 07 (0.60)	Central Visayas	8774	1498	0.6%	9	-0.1%	-2	-0.6%	-9
Re. 11 (0.50)	Davao Region	6199	1672	-0.3%	-6	0.3%	6	1.7%	29
Re. 14 (0.50)	Cordillera Admin. Region	3794	2779	-4.5%	-124	-0.1%	-2	-0.4%	-10
Re. 10 (0.41)	Northern Mindanao	6881	2010	-2.3%	-46	-0.3%	-6	-1.4%	-28
Re. 04 (0.40)	Calabarzon	11606	1276	1.6%	21	-1.5%	-19	-7.5%	-96
Re. 06 (0.38)	Western Visayas	10516	1642	-0.3%	-5	0.1%	2	0.5%	9
Re. 17 (0.36)	Mimaropa	5778	2642	-3.2%	-85	0.5%	12	2.3%	60
Re. 03 (0.31)	Central Luzon	11228	1399	1.0%	14	-0.9%	-12	-4.4%	-62
Re. 09 (0.22)	Zamboanga Peninsula	5241	1849	-1.4%	-27	0.1%	1	0.3%	5
Re. 01 (0.22)	Ilocos Region	6657	1553	0.8%	12	0.2%	3	0.9%	14
Re. 02 (0.22)	Cagayan Valley	6328	2244	-2.4%	-50	0.0%	0	0.1%	2
Re. 16 (0.19)	Caraga	4765	2175	-2.5%	-55	0.2%	5	1.2%	26
Re. 08 (0.17)	Eastern Visayas	7129	1954	-1.1%	-21	0.6%	13	3.2%	63
Re. 12 (0.16)	Soccsksargen	5613	1742	-0.5%	-9	0.4%	7	1.9%	34
Re. 05 (0.14)	Bicol Region	7315	1581	1.1%	18	0.8%	13	3.9%	64
Re. 15 (n.a.)	Auton. Re.in Mus. Mindanao	5698	1984	-0.7%	-14	1.1%	22	5.6%	111
Coefficient of variation (s-b)	Provinces	-	0.000	-	-0.076	-	-0.008	-	-0.036
	Cities	-	0.000	-	-0.034	-	0.000	-	0.000
	Municipalities	-	0.000	-	-0.142	-	-0.001	-	-0.005

Note: Figures in parenthesis in the column "By Region" indicate per capita regional GDP in 2006, as expressed in relative value with NCR=1. Regions in this table are placed in the descending order of these figures.

Source: Compiled by the JICA Study Team based on data from the DOF and DBM

In Simulation 6, the "fund for adjustment" is assumed to be generated by reducing each of the

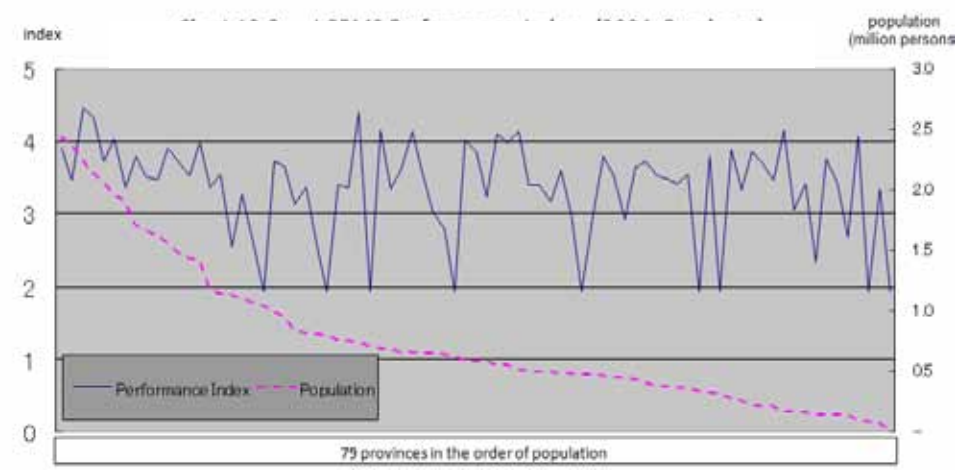
other three shares (population, land area and equal share) by 10%. The simulated results indicated the unexpected, i.e., negative effects for the smaller LGUs. This is borne by the fact that the contribution of "equal share" is much more outstanding for these LGUs.

In view of this mechanism, Simulation 7 assumes the fund for the TLS factor to come entirely from the "population" share. As a result, 1st class municipalities (M-1) turn out to be the single victim with very limited changes elsewhere. Simulation 8 shows, for reference, a case where the entire "population" share is devoted for the "TLS adjustment", the result of which could be seen as a homothetic enlargement of Simulation 7.

Attention should be drawn to another characteristic of this kind of formula. Insofar as a given fund is to be redistributed among numerous LGUs (1500 municipalities, for example), the magnitude of changes tends inevitably to be very small. Thus, in order to assure an effect of certain significance, one may have to prepare extraordinary big funds.

A Consideration on the Addition of the "Performance" Factor

What procedure should be taken when the "LGPMS Performance Indicator" is to be incorporated to reflect the administrative performance of LGU budgets? The LGPMS performance indicator fluctuates within a very narrow range as shown in Chart 12-1. In fact, the performance indicator is an average of a 5-point evaluation in three fields (Revenue Generation, Resource Allocation and Utilization, and Fiscal Assessment), and most observations lie between 2 and 4. Thus, it will be necessary in this case to translate the original value to a relevant index.



Note: Performance Index here is derived as a simple average of three components namely, "Revenue Generation", "Resource Allocation and Utilization" and "Financial Accountability".

Source: Compiled by the JICA Study Team based on the Data Provided by DILG-BLGS

Chart 12-1: LGPMS Performance Index（2004, Provinces）

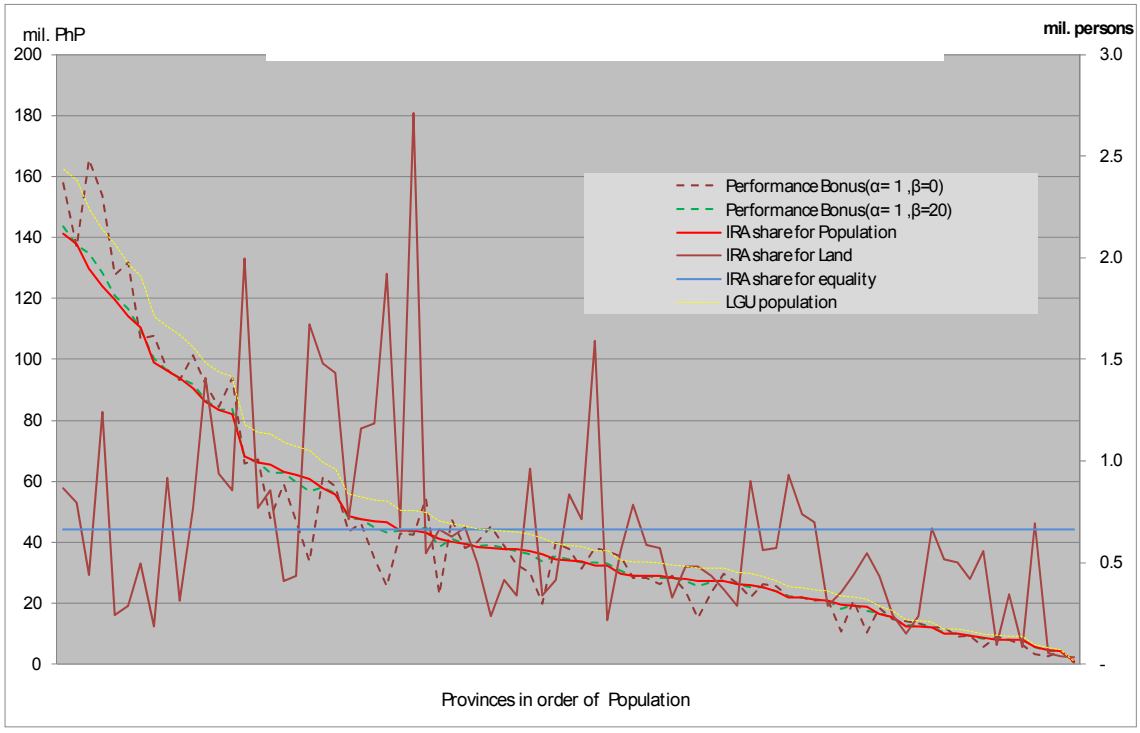
An adjustment equation such as the equation described below may have to be used to give a relevant differentiation:

$$Y=\alpha X+\beta$$

where Y: per-capita bonus point and X: original LGPMS value.

In the case of the performance indicator, the IRA share attributable to the "performance" would be natural to be calculated based on the product of the bonus point (Y above) and the population of each LGU. However, if the fund for this adjustment, say 10 percent of total IRA, is to be shifted from the original "population" share (reduced to 40 %), then the net effects of this adjustment is possibly not very large.

This relationship among choices of "adjustment equation", "weight" and "fund source" is illustrated in Chart 12-2 picking Provinces as an example. It is evident from this chart that if "equal share" or "land" is chosen as the source of the adjustment, LGUs with smaller population will generally suffer from a negative net effect.



Source: Compiled by the JICA Study Team based on data from the DOF and DBM

Chart 12-2: IRA Adjustment by Performance Indicator

A Consideration on the Addition of the "Municipal Water" Factor

"Municipal water" is defined, in the so-called Philippine Fisheries Code of 1998[5], as marine waters within 15 km (a half of the distance between two coastlines when another municipality is situated on opposite shores less than 30 km away) from the coastline of the municipality, in addition to streams, lakes and so on within the municipality. There have been many arguments that administrative needs stemming from the "municipal water" should be taken into account for the distribution of IRA. However, the availability of data on the "municipal water" issue is very limited, as far as the Study team has learned.

As shown in Table 12.4, 812 cities and municipalities are formally designated as "coastal LGUs". But data on "municipal water" is acquired only for 70 cities and municipalities listed in Table 12.5. Thus, a comprehensive analysis being out of question, the relative size of "municipal water" to "land area" given in this table sheds some light.

The former is 2.2 times the latter in average, with a fairly wide dispersion (the maximum and the minimum ratios being 19 and 0.03, respectively).

Table 12-4 Number of Coastal LGUs

REGION	Cities（C)	Municip -alities（M)	C+M
NCR	5	0	5
REGION 1	6	47	53
REGION 2	0	27	27
REGION 3	3	33	36
REGION 4A	4	64	68
REGION 4B	3	69	72
REGION 5	5	84	89
REGION 6	14	69	83
REGION 7	11	98	109
REGION 8	4	117	121
REGION 9	5	43	48
REGION 10	7	49	56
REGION 11	5	25	30
REGION 12	2	9	11
REGION 13	4	0	4
TOTAL	78	734	812

Source: Compiled by the JICA Study Team based on data
from the National Mapping and Resource Information Authority

[5] Formally "An Act Providing for the Development, Management and Conservation of the Fisheries and Aquatic Resources, Integrating All Laws Pertinent Thereto, and for Other Purposes"（Republic Act No.8550）

Table 12-5: A Comparison of "Municipal Water" and "Land Area" of LGUs

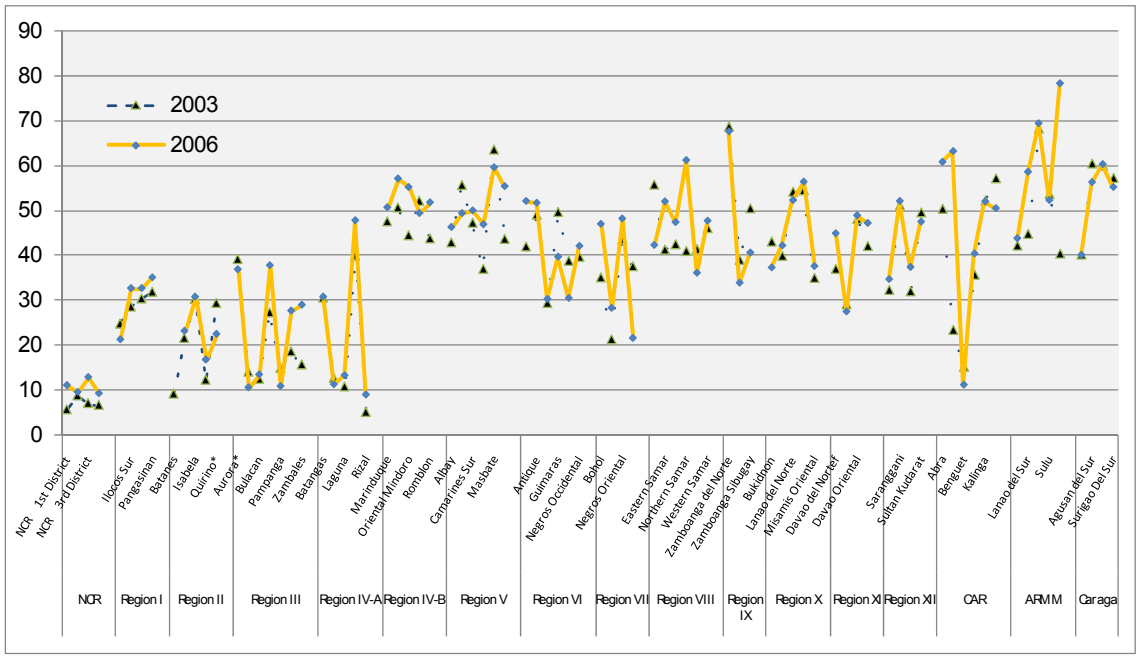
	PROVINCE		Municipalities /Cities	Geo code	Income class	Area of Municipal Waters (w)	Land Area (L)	(w) / (L)
						km²	km²	ratio
1	Agusan del Norte	1	**Butuan City**	160202000	1st Class	43	817	0.1
		2	Carmen	160204000	4th Class	255	214	1.2
		3	Magallanes	160208000	4th Class	41	44	0.9
		4	Nasipit	160209000	3rd Class	131	144	0.9
		5	Tubay	160211000	4th Class	278	138	2.0
2	Antique	6	Pandan	060613000	2nd Class	130	49	2.7
		7	Sebaste	060617000	4th Class	191	177	1.1
3	Basilan	8	**Isabela City**	099701000	5th Class	297	224	1.3
		9	Lamitan	150702000	-	159	254	0.6
		10	Lantawan	150703000	-	2,740	306	9.0
		11	Maluso	150704000	-	499	104	4.8
		12	Sumisip	150705000	-	739	568	1.3
		13	Tipo-tipo	150706000	-	471	217	2.2
		14	Tuburan	150707000	-	1,159	545	2.1
4	Bataan	15	Abucay	030801000	3rd Class	26	80	0.3
		16	**Balanga clty**	030803000	4th Class	12	112	0.1
		17	Orion	030810000	3rd Class	126	65	1.9
		18	Pilar	030811000	4th Class	43	38	1.1
		19	Samal	030812000	4th Class	18	56	0.3
5	Bohol	20	Duero	071221000	5th Class	87	97	0.9
		21	Garcia-Hernandez	071222000	4th Class	185	128	1.4
		22	Guindulman	071224000	3rd Class	140	126	1.1
		23	Maribojoc	071232000	5th Class	58	49	1.2
		24	Panglao	071233000	4th Class	699	48	14.6
		25	Pres. C.P. Garcia	071235000	5th Class	397	55	7.2
6	Camarines Norte	26	Basud	051601000	3rd Class	7	260	0.0
		27	Daet	051603000	1st Class	57	46	1.2
		28	Jose panganiban	051605000	2nd Class	463	214	2.2
		29	Mercedes	051607000	3rd Class	539	174	3.1
7	Camarines Sur	30	Balatan	051702000	4th Class	129	93	1.4
		31	Bato	051703000	3rd Class	73	107	0.7
		32	Bula	051706000	3rd Class	69	151	0.5
		33	Cabusao	051707000	5th Class	48	47	1.0
		34	Calabanga	051708000	2nd Class	177	164	1.1
		35	Libmanan	051718000	1st Class	301	343	0.9
		36	Minalabac	051722000	4th Class	68	126	0.5
		37	Tigaon	051736000	4th Class	20	72	0.3
8	Camiguin	38	Catarman	101801000	5th Class	416	54	7.7
		39	Guinsiliban	101802000	5th Class	102	19	5.5
		40	Mahinog	101803000	5th Class	277	33	8.5
		41	Mambajao	101804000	3rd Class	572	89	6.4
		42	Sagay	101805000	5th Class	74	44	1.7
9	Cebu	43	Alcoy	072202000	5th Class	94	62	1.5
		44	Badian	072207000	4th Class	99	110	0.9
		45	Compostela	072218000	5th Class	63	54	1.2
		46	Dalaguete	072222000	2nd Class	165	155	1.1
		47	Dumanjug	072224000	4th Class	97	86	1.1
		48	Ginatilan	072225000	5th Class	46	70	0.7
		49	Madridejos	072228000	4th Class	100	24	4.2
10	Iloilo	50	San Dionisio	063038000	4th Class	39	127	0.3
11	Leyte	51	Capoocan	083714000	4th Class	154	185	0.8
12	Marinduque	52	Boac	174001000	2nd Class	259	213	1.2
		53	Mogpog	174004000	4th Class	427	108	3.9
13	Misamis Occidental	54	Aloran	104201000	4th Class	151	118	1.3
		55	**Oroquieta City**	104209000	4th Class	108	238	0.5
		56	Panaon	104211000	-	61	47	1.3
		57	Sinacaban	104214000	5th Class	23	99	0.2
		58	**Tangub City**	104215000	4th Class	36	163	0.2
14	Negros Occidental	59	Pulupandan	NA	NA	71	NA	NA
15	Quezon	60	Catanauan	045610000	2nd Class	223	253	0.9
		61	Guinayangan	045618000	3rd Class	114	214	0.5
		62	Jomalig	045621000	5th Class	1,083	57	19.1
		63	Mulanay	045628000	2nd Class	236	420	0.6
		64	San Andres	045640000	4th Class	545	173	3.2
		65	San Narcisco	045644000	3rd Class	394	264	1.5
		66	Tagkawayan	045646000	2nd Class	46	519	0.1
16	Sorsogon	67	Casiguran	056205000	4th Class	26	87	0.3
		68	Magallanes	056211000	4th Class	90	150	0.6
17	Surigao del Norte	69	Socorro	166723000	4th Class	430	114	3.8
18	Zambo Sibugay	70	Siay	098313000	3rd Class	42	314	0.1
	Maximum					2,740	817	19.1
	Minimum					7	19	0.0
	Average					251	161	2.2
	Standard Deviation					380	143	3.3

Source: Compiled the by JICA Study Team based on data from the National Mapping and Resource Information Authority

Even if the data becomes available for all the coastal LGUs, the following issues will have to be addressed before incorporating it into the IRA formula.

- This factor will be most natural to be treated as an amendment to "land share". In this context, however, the role of the adjustment equation will be very important in view of the relative sizes mentioned above.
- Whatever the formality of introduction, around 800 non-coastal LGUs cannot avoid a reduction in the IRA distributed to them, which would inevitably lead to various complaints and controversies.
- In coping with either one of the above points, it will be imperative to clarify the nature and magnitude of an LGUs responsibility with respect to "municipal water", and then to evaluate the related administrative needs in the "build-up" manner.

A Consideration on the Addition of the "Poverty" Factor



Note: Due to the lack of horizontal space, the names of provinces (or districts) are indicated alternately.

Source: Compiled by the JICA Study Team based on data from NSCB

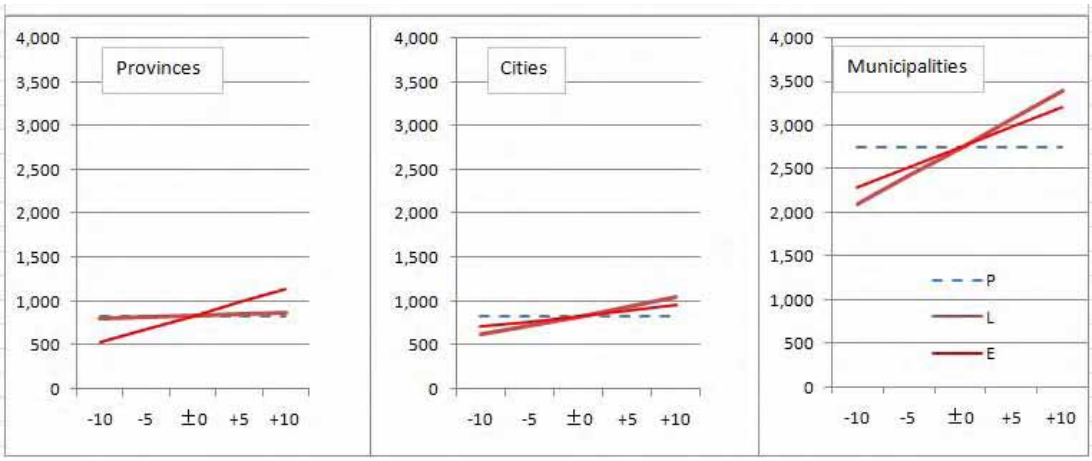
Chart 12-3 Poverty Incidence Among the Provincial Population (%, year 2003 and 2006)

"Poverty" is another candidate for the fourth factor discussed in the previous chapter, representing a view that IRA should be distributed more in favor of LGUs with a high degree of

poverty incidence. In practice however, "Poverty Incidence[6]" as published by the NSCB, the only data available that may be used at present for this purpose are those solely for the entire nation, the regions[7] and the provinces. Chart 12-3 plots the percentage of provincial populations under the "poverty threshold" for the latest two available years. Looking at the 2006 curves, the share of "poverty population" extends widely from around 10% in NCR districts to 70~80% in provinces belonging to ARMM. The differences by province in the same region also seem to be substantial.

At any rate, the accuracy of the household surveys (the base for the poverty threshold computation) is not fully assured because of insufficiency of samples and survey method as admitted by NSCB itself. Therefore, it may require careful examination to judge how far these data reflect the reality of poverty differentials across the provinces. Therefore, in order to introduce this indicator into the formula, a prerequisite will be the higher credibility of the data gathered. In addition, the gathering and publication of poverty incidence data by city and municipality will be necessary to provide a complete picture of this issue in the country.

12.3. A Sensitivity Analysis in Terms of Changes in Parameters (Horizontal Formula)



Source: Compiled by the JICA Study Team based on data from the DOF and DBM

Chart 12-4: A Comparison of the Level of Standard Deviation in Per Capita IRA by Changes in the Formula Parameter of Population (P), Land Area (L) and Equal Share (E)

Irrespective of any particular option, it may be interesting to examine the "sensitivity" of how far a simulated value generally varies with respect to assumed changes in formula parameters. It should be noted, however, that the analysis here is focused on the horizontal formulas, as the

[6] Based on major expenditures made during the past six months by extracted samples of household, a minimum living expense (or "poverty threshold") is calculated for each locality, and the percentages of population or household with an income below it are published every three years.

[7] The NCR is exceptionally divided into four districts.

impacts by changes in the vertical parameters would be almost self-explanatory. Chart 12-4 indicates for each of the three LGU layers, the levels of standard deviation in per capita IRA in cases where one of the three horizontal parameters (i.e. "population", "land" and "equal share") is set to a given percentage (lower or higher) compared with the present values of 50%, 25%, and 25%, respectively. It should be noted that in these simulations, the total IRA value is allowed to change following the increase/decrease in the instrumental variable, as no compensating manipulation is assumed.

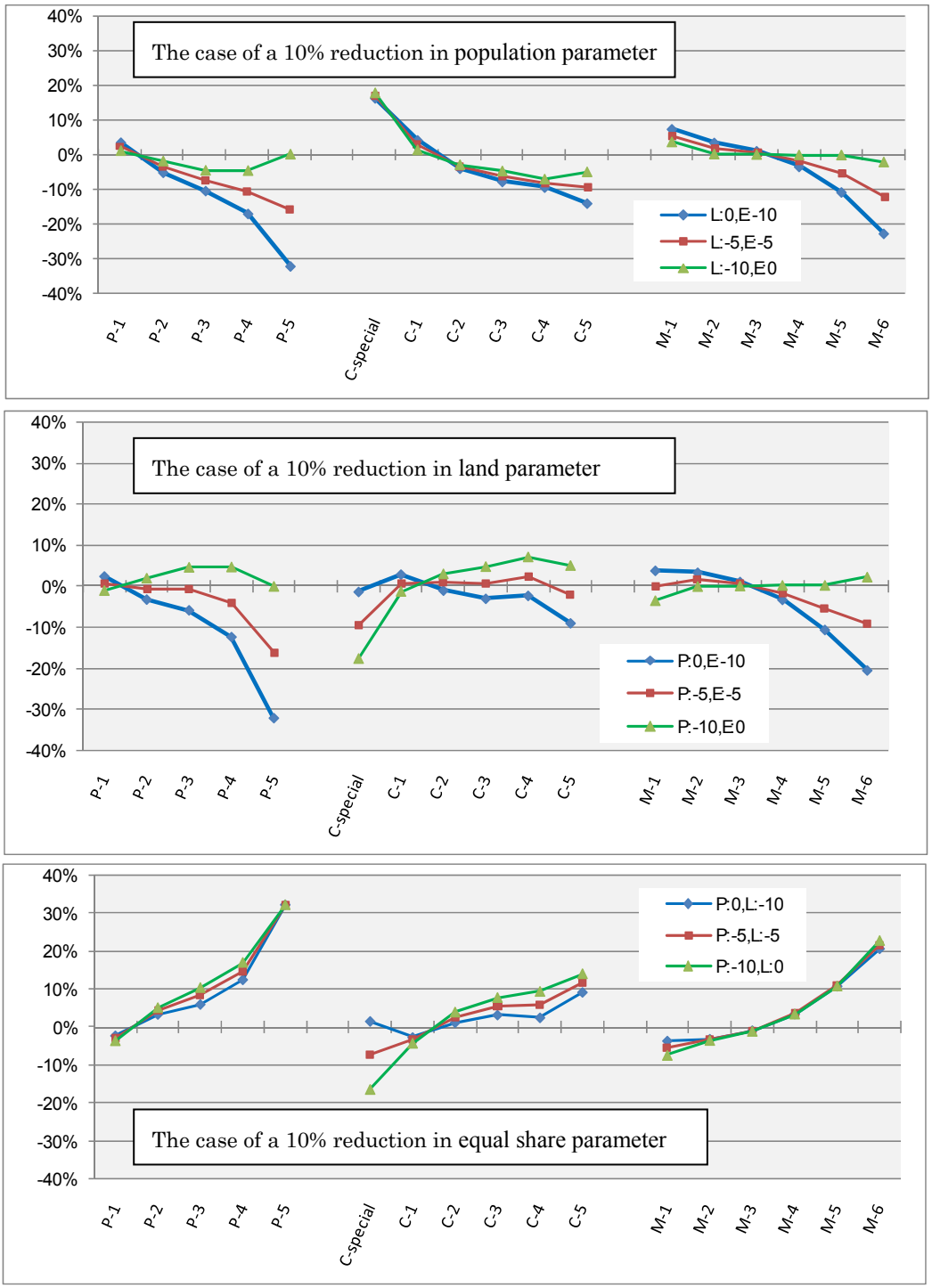
The important observations from this chart are the following:
- Naturally, changes in the "population" parameter have no impact on "per capita" IRA.
- Changes in "equal share" give significant impacts in all the layers, while impacts by "land" are negligible in provinces but exceed those by "equal share" in cities and municipalities.
- Among the three layers, municipalities are characterized by much higher levels of standard deviation and steeper curves for "land" and "equal share."

In Chart 12-5, impacts by parameter changes are compared by LGU income class. This chart, which indicates percent changes[8] (difference from the "theoretical value") in IRA distributed, is a combination of three diagrams ; the case of 10% increase[9] in the "population" parameter (the top), in the "land" parameter (the middle) and in the "equal share" parameter (the bottom) respectively. In each of the diagrams, three lines are drawn according to assumptions on how the augmentation in the given formula parameter is to be compensated by the reduction in the remaining two.

The following tendencies can be observed from Chart 12-5:
- An increase in the "population" parameter negatively affects small LGUs, as suggested by descending curves in the top diagram. This impact is significantly offset in the case of substitution by the reduction in the "land" parameter, while the magnitude of reduction in IRA of small LGUs becomes greater, typically with regard to provinces, in the case of substitution by the "equal share". It is notable with regard to cities, however, that the descending curves are more or less similar regardless of the sources of substitution.
- An increase in the "land" parameter (the middle diagram) tends to produce descending curves when the "equal share" parameter is reduced instead. In the case of substitution by the "population" parameter, impact differentials by income class are mild and obscure, except for cities where a steep ascending curve is drawn.
- Given an increase in the "equal share" parameter (the bottom diagram), impacts are shown as an ascending curve of almost similar shape regardless to the sources of substitution and regardless to the layers. This suggests that an increase in the "equal share" brings about positive

[8] This percent change can be interpreted either as "per layer", "per LGU" or "per inhabitant".
[9] A 10% increase is only hypothetically assumed here. As the system has a perfect proportionality, a 20% assumption produces a result just two times greater.

impacts on smaller LGUs, which are far greater in magnitude than negative effects stemming from the other two parameters.



Source: Compiled by the JICA Study Team based on data from the DOF and DBM

Chart 12-5 A Comparison of Impacts by Changes in Horizontal Parameters (P: Population, L: Land, E: Equal Share) – Percent Change from Theoretical Value of IRA, by Income Class

12.4. Evaluation Criterion for Equalizing Fiscal Capacities

As discussed in Chapter 10, the criteria to evaluate any proposed options should be two-fold namely, a) the magnitude of the changes compared with the present distribution, and b) the distance from a normative "ideal pattern" of distribution.

The simulation method described in earlier sections should serve very effectively for the evaluation based on the first criteria. As to the "ideal pattern" of distribution, several approaches have been tested, and these are described below.

1) An Estimation of a Gap between Fiscal Demands and Locally Owned Revenues

As mentioned in Chapter 3, it seems almost impossible, at least based on the data available from the sample survey conducted by the JST, to formulate any "ideal pattern" by way of "basic fiscal demands minus potential tax revenue".

In Chapter 4, an attempt was made to estimate a fiscal capacity gap of individual provinces where one could collect a minimum set of data for the "build-up" approach. This was expected to serve the formulation of "ideal pattern" of distribution, in addition to demonstrating the methodology itself. It should be remembered, however, that the fiscal capacity gap estimated in Chapter 4 has not yet cleared the deficiency in statistical accuracy. Furthermore, a key issue is how to derive the "ideal pattern" of IRA distribution from the estimated fiscal capacity gap. This is a task best left for political decision by the Philippine government.

2) An Estimation of Fiscal Demands of Model LGUs

As a substitute for the abovementioned approach, a standard level of fiscal demands was estimated based on data of selected LGUs. More specifically, a multiple regression of the following form was tested using the data of LGUs with "best practice" (upper 20% of each layer of LGUs in terms of per capita fiscal expenditure).

LGU Total Expenditure [TE] = F(LGU population [Pop.], LGU land area [Land])

If an estimated function is acceptable in view of general criteria such as suitability and sign conventions, then the estimated parameters can be applied to the remaining LGUs to give the standard level of fiscal expenditure based on their population and land area.

Table 12-6 exhibits the results of this estimation not only the case for the top 20% group but also that for all LGUs.

Table 12-6 Estimation of LGU Total Expenditure Functions

	Const. (t-ratio)	Pop. (t-ratio)	Land (t-ratio)	adj. R2 (number of sample)
Estimation on All LGUs				
Province	494.92 (7.475)	0.02 (0.3024)	0.00 (-0.2257)	-0.02 (79)
City	47.78 (0.7063)	2.56 (15.43)	-0.10 (-0.7679)	0.67 (117)
Municipality	4.48 (3.980)	0.00 (42.9)	0.02 (6.55)	0.57 (1500)
Estimation on the first quintile(upper 20%) LGUs				
Province	398.50 (4.606)	2.23 (4.946)	-0.09 (-2.482)	0.63 (8)
City	-203.56 (-0.5291)	7.00 (5.435)	0.22 (0.6432)	0.71 (12)
Municipality	7.70 (5.00)	0.00 (-0.82)	+0.0044 (1.46)	0.00 (150)

Note: Shaded are figures that suggest statistical dissatisfaction.

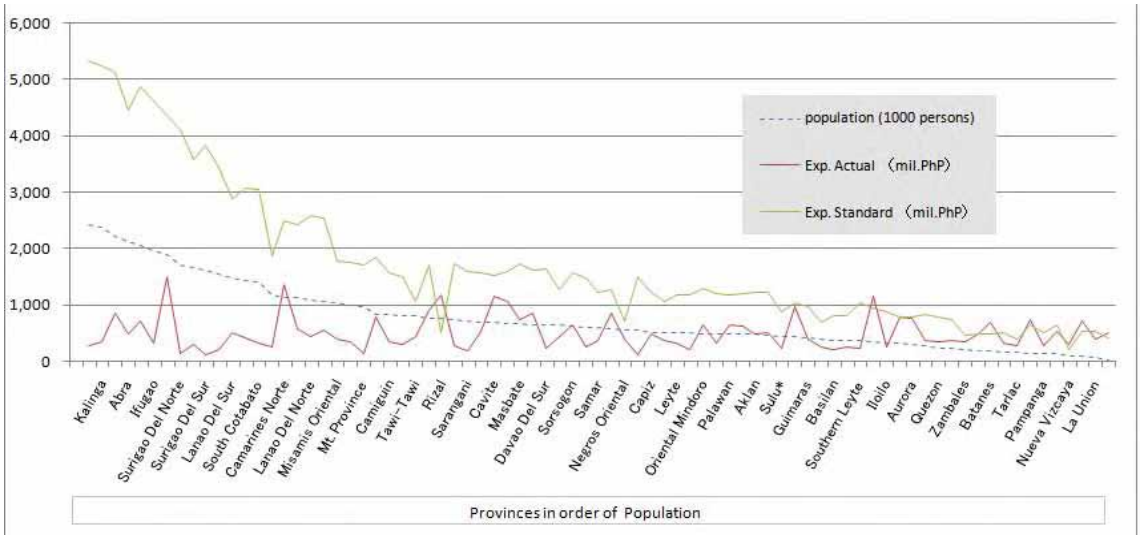
Source: Compiled by the JICA Study Team based on data from the DOF and DBM

Fitness of the estimation is generally very poor and, above all, the minus signs placed on “land” in many cases make a serious hazard for this approach.

Recognizing these statistical limitations, it may be of some interest to use an estimated function to calculate a “standard level of total expenditure” meaning the hypothetical level to be derived by applying population and land area figures of each LGU to the function estimated for the “upper 20%”. Chart 12-4 shows the result of this attempt using the estimated function for the “upper 20%” provinces (TE=398+2.228Pop.-0.0915Land). It should be noted that most of these “upper 20%” provinces are those with relatively small population (located in the right extreme of the chart).

To add for reference's sake, if this “standard level” were to be realized, total required funds (residual between ‘standard’ and ‘actual’) are estimated to amount to PhP96 trillion, which is three times as large as the total IRA in 2005.

Further trials may be necessary to find a better specification of the function because the results make it fairly pessimistic to pursue this approach.



Note: "Exp. Standard" is the level of Total Expenditure estimated from the function TE=398+2.228Pop.-0.0915Land.

Source: Compiled by the JICA Study Team based on data from the DOF and DBM

Chart 12-6: Total Expenditure of Provinces: 'Actual' and 'Standard'

3) Setting the Ideal Pattern Based Exclusively on the Income Side

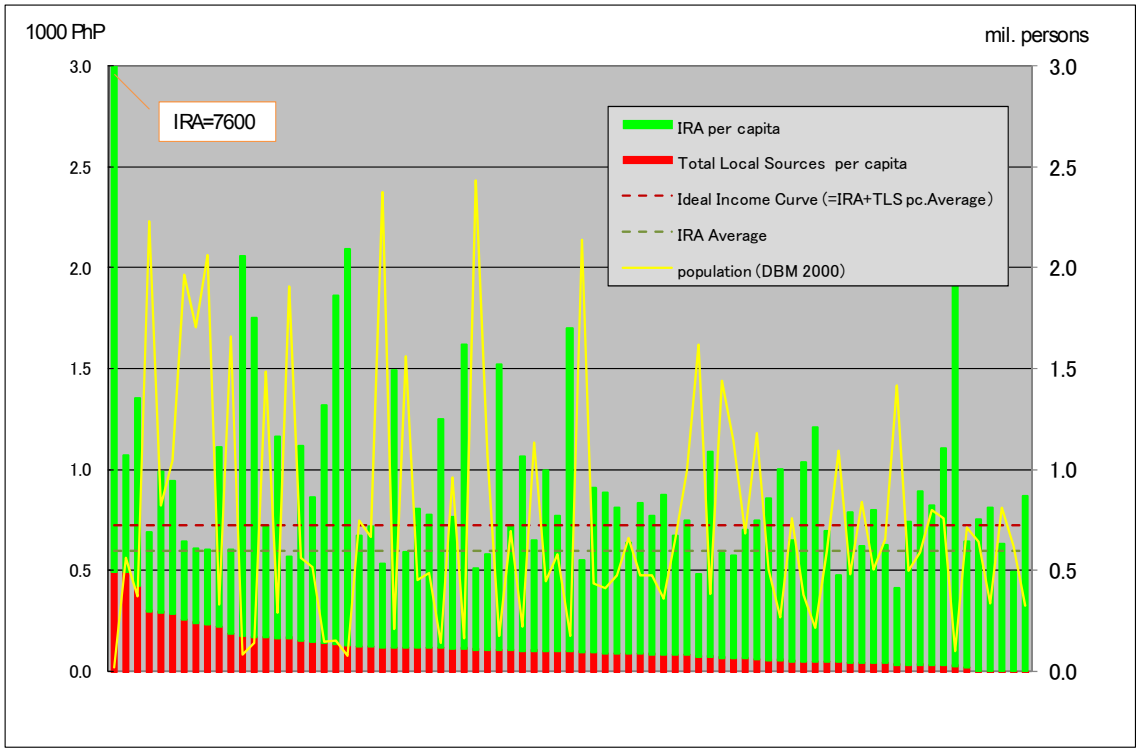
The third approach is to set an ideal pattern of IRA distribution in a way that equalizes the per capita level of LGU income within the same layer. The outcomes of this approach are shown in Charts 12-7, 12-8 and 12-9 for each of three LGU layers respectively. The work process used is as follows.

i) At the start, a per capita level of Total Local Source (TLS) and IRA were calculated for all LGUs using the SIE (2005) data and population (DBM, 2000), and drawn as stacked bar chart for the group of 79 provinces, 117 cities and 1500 municipalities respectively, with LGUs being laid in the order of per capita TLS.

ii) For each layer of LGUs, IRA was assumed to be redistributed so that the present disparity in per capita TLS is minimized. Resultant levels of TLS plus IRA were plotted as an "Ideal Income Curve". Needless to say, this curve should coincide with a horizontal line indicative of the layer's average of TLS plus IRA, as far as the TLS is also allowed to be redistributed. But in reality, the idea of horizontal redistribution (that is a shift of locally owned source from one LGU to another) is out of the scope of this Study (see Chapter 10). Consequently, it was assumed that an LGU with a TLS higher than "layer average TLS+IRA" is designated as a

"non-IRA receiving body", for which no IRA is allocated but its own local source is assured. As a result, for the remaining LGUs, the height of the "Ideal Income Curve" becomes somewhat lower than the "average TLS+IRA" line[10]. .

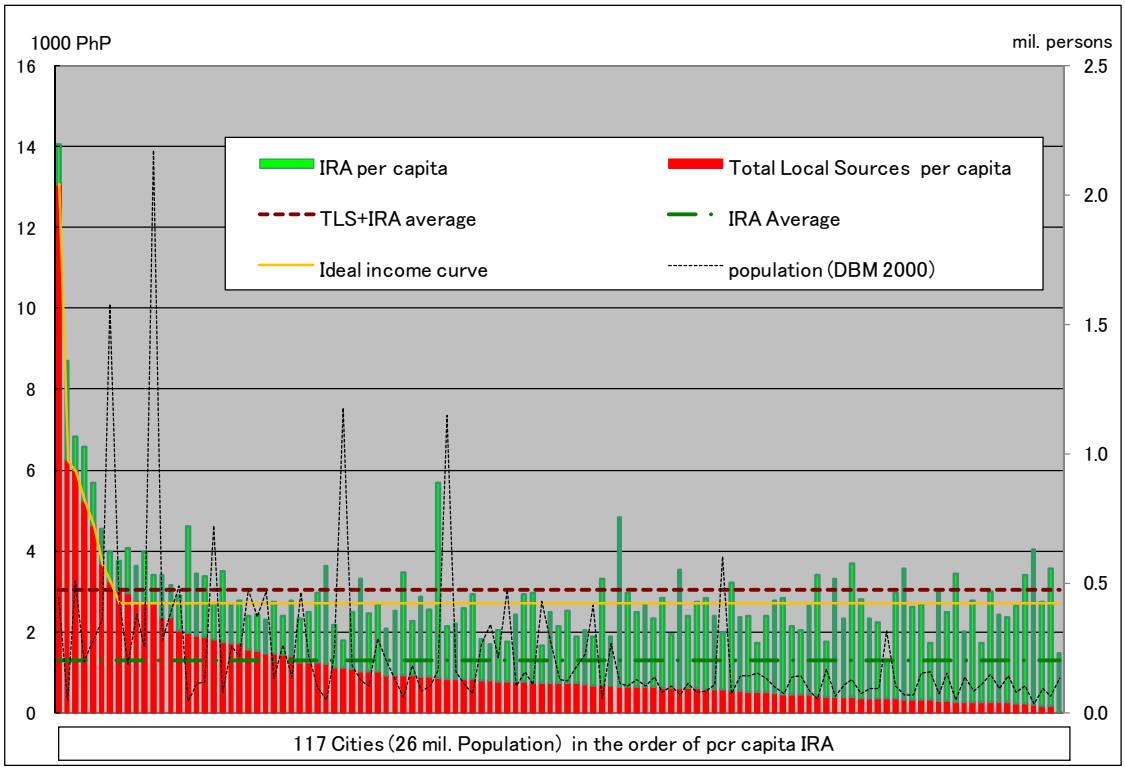
iii) In order to check the characteristics of LGUs with high TLS or IRA in per capita terms, "Top Ten Lists" are shown as Annex Tables 12.1 and 12.2 at the end of this chapter, which identifies these LGUs, the composition of their income and so on.



Source: Compiled by the JICA Study Team based on data from the DOF and DBM

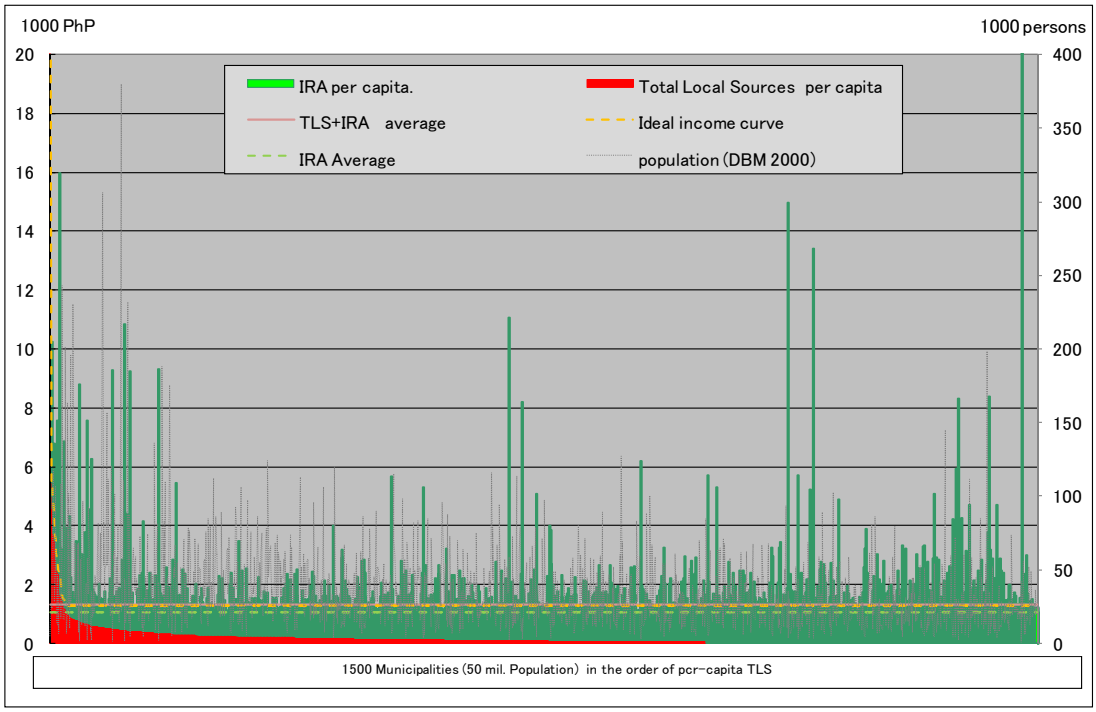
Chart 12-7: TLS and IRA: Provinces, Per Capita PhP

[10] With regard to provinces, the two lines overlap each other, as "non-IRA receiving body" does not exist.



Source: Compiled by the JICA Study Team based on data from the DOF and DBM

Chart 12-8: TLS and IRA: Cities, Per Capita PhP



Source: Compiled by the JICA Study Team based on data from the DOF and DBM

Chart 12-9: TLS and IRA: Municipalities, Per Capita PhP

A careful examination of these charts may cast some doubt on the idea of equalizing per capita income. The reasons are as follows.

i) It seems that LGUs with a high per capita TLS are not necessarily those located in economically advanced urban areas. For example, the province with the highest TLS (per capita) is Batanes (5th class, region II). In the city layer, Makati and other big cities in the National Capital Region do occupy most of the "Top Ten", but the top-ranking municipalities are mostly comprised of small rural towns with populations of 20,000-40,000 only.

ii) With regard to IRA per capita, those in the higher ranks are generally LGUs with relatively small population and are located far from industrial centers. This observation is common to the three LGU layers, and as shown earlier in Chapter 3, it would be logically justified by the structure of the IRA horizontal formula.

iii) All in all, a redistribution of IRA in a way to realize the "Ideal Income Curve" derived above would tend to punish unjustly LGUs with smaller population and larger land. This is probably against the spirit of the IRA improvement whose aim is to narrow down the imbalanced distribution among the LGUs.

4) A Tentative Conclusion on the "Evaluation Criterion"

In view of the discouraging outcomes for the three approaches for a normative "ideal pattern" of distribution, the JST has no means, at present, to objectively select any proposed option as "the best".

Further efforts to estimate the basic (or standard) fiscal needs should be focused on two fields namely, a) a comprehensive data collection and analyses of LGUs' living standards, and b) a development of the "build-up" method introduced in Chapter 4. More particularly, the choice among vertical options can hardly be made without the latter.

These efforts seem promising but will require a certain length of time, say 2-3 years before completion. Thus, as mentioned in Chapter 11, the choice of formula type as well as the magnitude of parameters will have to be left for value judgment or political choice on the part of Filipino stakeholders. It is expected that the result of the diagnosis (Chapter 3) and/or simulation analyses (this chapter) provide useful foundation towards that end.

To summarize, the observations derived from the evaluation in this chapter which may partially duplicate those mentioned in section 11.5, it would be noteworthy to consider the following.

i) The vertical parameters (share among the layers) are difficult to determine without examining further the administrative responsibility assigned to each LGU layer. The balance between layers of LGUs would be better reconsidered comprehensively in view of the great difference in the share of local sources as well as fiscal needs.

ii) With regard to the horizontal formula, the "equal share" factor plays a very important role. On one hand, it benefits relatively small LGUs. On the other, the "equal share" portion of IRA *per LGU* is very much different between LGU layers (roughly in ratio of 10-7-1[11]), reflecting the number of LGUs mentioned just above. This apparently is a factor to understand efforts by some leaders of municipalities to aspire and to be converted into a city.

iii) In pursuing horizontal equality, a per capita concept may sometimes be misleading as IRA and/or TLS in per capita terms tend to be greater for less-populated LGUs.

iv) The skewed distribution of locally owned sources is an aspect not only among the LGU layers but also within the city layer. A limited number of big metropolitan cities have comparatively large local resources, even in per capita terms (Chart 12-8). If the IRA were a sole weapon to rebalance this difference, its size looks very much insufficient.

v) In the wake of introducing new factor/s into the horizontal formula, one must seriously take note that the net effects could be substantially different depending on the choice of adjustment unit (LGU, population or anything else) as well as the source of compensation.

[11] Actual receipt in 2005 is roughly PhP100 million for a province, PhP70 million for a city and PhP10 million for a municipality as mentioned in Chapter 3 (3-2-2).

Annex Table 12-1: Top Ten LGU List: Total Local Source Per Capita

	LGU profile						per capita(PhP)		Composition of Total Income (mil. PhP, CY.2005)								
Rank	Region	Province	CITY/ Municipality	income Class	population CY.2000 (1000 persons)	land area CY.2001 (sqKM)	Total Local Sources per capita	IRA per capita	Total Local Sources	Total Tax Revenue	Real Property Tax	usiness T	ther Taxe	Total Non-Tax Revenue	Regulatory Fees	Service/ User Charges	Receipts from Economic Enterprise
Province, TLSpc. Top 10																	
1	Region II	Batanes		5th	16.5	219	495	6,384	8	3	2	1	0	6	0	0	2
2	Region III	Bataan		1st	557.7	1,373	490	481	273	222	158	4	60	51	0	0	34
3	Region II	Nueva Vizcaya		2nd	367.0	4,379	425	789	156	125	115	7	2	31	2	0	19
4	Region III	Bulacan		1st	2,234.1	2,775	299	324	668	470	367	54	49	198	8	1	164
5	Region IX	Zamb. Del Norte		1st	823.1	7,301	293	573	241	12	9	1	1	230	0	2	175
6	Region X	Bukidnon		1st	1,048.6	10,499	284	575	298	54	45	3	6	244	0	71	172
7	Region IV-A	Laguna		1st	1,965.9	1,824	255	322	502	393	309	62	22	109	0	89	1
8	Region IV-A	Rizal		1st	1,707.2	1,176	240	324	410	366	289	51	27	44	0	11	25
9	Region IV-A	Cavite		1st	2,063.2	1,512	231	315	476	402	291	34	77	74	4	4	64
10	CAR	Benguet		2nd	330.1	2,769	220	736	73	32	24	4	4	40	1	0	38
CITY, TLSpc. Top 10																	
1	NCR	NCR	Makati City	1st	444.9	18	13,061	971	5,810	5,265	2,463	2,514	288	545	188	67	106
2	Region IV-A	Cavite	Tagaytay City	3rd	45.3	65	6,220	2,451	282	222	188	17	17	60	11	3	45
3	NCR	NCR	Pasig City	1st	505.1	48	5,975	842	3,018	2,563	1,126	1,338	99	454	97	153	102
4	Region III	Zambales	Olongapo City	1st	194.3	185	5,229	1,334	1,016	94	47	41	5	922	19	26	874
5	NCR	NCR	Mandaluyong City	1st	278.5	9	4,627	1,035	1,288	1,170	489	642	39	119	54	27	13
6	NCR	NCR	Pasay City	1st	354.9	14	3,657	855	1,298	1,130	762	340	28	168	60	20	46
7	NCR	NCR	Manila City	Special	1,581.1	25	3,228	730	5,104	4,438	1,889	2,351	198	665	270	166	185
8	NCR	NCR	Parañaque City	1st	449.8	47	3,007	725	1,352	1,250	715	478	57	102	42	43	13
9	Region IV-A	Laguna	Sta. Rosa City	1st	185.6	54	2,940	1,106	546	488	223	247	17	58	25	6	26
10	NCR	NCR	Muntinlupa City	1st	379.3	40	2,753	836	1,044	907	469	365	73	138	87	15	13
Municipality, TLSpc. Top 10																	
1	Region II	Nueva Vizcaya	Afonso Castañeda	4th	4.8	375	25,581	5,740	123	123	111	12	0	0	0	0	0
2	Region III	Nueva Ecija	Pantabangan	-	23.9	393	5,832	1,563	139	131	112	18	0	9	0	0	9
3	Region I	Pangasinan	Sual	1st	25.8	130	5,481	1,069	142	131	91	40	0	10	9	0	1
4	Region IV-A	Rizal	Taytay	1st	23.6	39	5,477	4,751	129	94	45	46	3	35	11	3	19
5	Region IV-A	Cavite	Carmona	1st	47.9	40	4,982	733	238	186	44	140	2	53	14	9	25
6	NCR	Metro Manila	San Juan	1st	117.7	6	4,573	642	538	476	184	269	23	62	17	7	24
7	Region IV-A	Batangas	Sto. Tomas	1st	31.2	95	3,730	1,616	116	99	63	34	2	17	3	1	12
8	Region III	Bulacan	Sta. Maria	1st	27.9	91	3,703	3,072	103	76	39	34	2	28	7	1	12
9	Region IV-A	Quezon	Mauban	1st	50.1	416	3,498	932	175	169	104	65	0	6	1	1	1
10	Region IV-A	Laguna	Cabuyao	1st	106.6	43	3,072	595	328	310	123	185	2	18	9	2	6

Note: Numbers in red are for special attention.

Source: Compiled by the JICA Study Team based on data from the DOF and DBM

Annex Table 12-2: Top Ten LGU List: IRA Per Capita

	LGU profile						per capita(PhP)		Composition of IRA (mil. PhP, CY.2005)				
Rank	Region	Province	CITY/ Municipality	income Class	population CY.2000 (1000 persons)	land area CY.2001 (sqKM)	Total Local Sources per capita	IRA per capita	population	land	Equal share	TOTAL IRA theoretical	IRA Official
Province, IRApc. Top 10													
1	Region II	Batanes		5th	16.5	219	495	6,384	4	5	96	105	125
2	CAR	Apayao		4th	97.1	4,351	27	2,274	24	100	96	221	252
3	Region X	Camiguin		5th	74.2	238	132	1,618	19	5	96	120	146
4	Region VII	Siquijor		4th	81.6	337	173	1,523	21	8	96	124	154
5	Region II	Quirino		3rd	148.6	3,486	134	1,440	37	81	96	214	257
6	CAR	Mt. Province		4th	140.4	2,157	170	1,290	35	50	96	181	222
7	CAR	Kalinga		3rd	174.0	3,231	98	1,232	44	75	96	214	279
8	Region III	Aurora		3rd	173.8	3,147	104	1,222	44	73	96	212	247
9	CAR	Ifugao		3rd	161.6	2,628	113	1,221	41	61	96	197	244
10	CAR	Abra		3rd	209.5	4,198	118	1,173	53	97	96	246	289
CITY, IRApc. Top 10													
1	Region IV-B	Palawan	Puerto Princesa City	1st	161.9	2,381	853	4,811	98	591	68	756	779
2	Region VI	Negros Occidenta	Santiago City	4th	110.5	1,222	634	4,187	67	303	68	438	463
3	Region III	Nueva Ecija	Palayan City	5th	31.3	101	188	3,829	19	25	68	112	120
4	Region VI	Negros Occidenta	Sipalay City	4th	62.1	380	138	3,412	37	94	68	200	212
5	Region X	Bukidnon	Malaybalay City	1st	123.7	969	354	3,301	75	240	68	383	408
6	Region IX	Zamb. Del Norte	Dapitan City	3rd	68.2	391	314	3,241	41	97	68	206	221
7	Region VII	Negros Oriental	Bayawan City	3rd	101.4	699	198	3,173	61	173	68	303	322
8	Region VII	Negros Oriental	Canlaon City	4th	46.5	171	258	3,157	28	42	68	139	147
9	Region X	Misamis Occident	Tangub City	4th	49.7	163	391	2,976	30	40	68	138	148
10	Region VII	Negros Oriental	Bais City	3rd	68.1	320	589	2,933	41	79	68	188	200
Municipality, IRApc. Top 10													
1	Region IV-B	Palawan	Kalayaan*	5th	0.2	290	3	61,518	0	13	9	22	14
2	Region II	Isabela	Divilacan	3rd	3.4	889	72	14,878	2	40	9	51	51
3	Region IV-B	Palawan	San Vicente	-	5.8	1,463	2,392	13,562	3	65	9	77	79
4	Region II	Isabela	Dinapigue	-	3.2	874	66	13,302	2	39	9	50	42
5	Region I	Ilocos Norte	Adams	5th	1.5	159	139	10,896	1	7	9	17	16
6	Region I	Ilocos Norte	Carasi*	5th	1.2	83	474	10,356	1	4	9	13	12
7	Region I	Ilocos Norte	Dumalneg	5th	1.5	88	384	8,908	1	4	9	14	13
8	Region II	Isabela	Maconacon	4th	3.7	539	460	8,750	2	24	9	35	33
9	Region II	Batanes	Uyugan	6th	1.3	16	535	8,718	1	1	9	11	11
10	CAR	Abra	Tineg	3rd	5.0	745	13	8,343	3	33	9	45	42

Note: Numbers in red are for special attention.

Source: Compiled by the JICA Study Team based on data from the DOF and DBM

CHAPTER 13

PROPOSALS ON IMPROVEMENTS IN THE EXISTING IRA-RELATED SYSTEMS

The objectives of the study were not only to present options for the new IRA distribution formula but also to recommend reforms in the other IRA-related systems. The JST will provide practical and constructive proposals in this chapter.

13.1. Earmarking of a Component of IRA to a Specific Expenditure Category

13.1.1. Law and Memorandum Circular on 20% of IRA for Development Projects

In accordance with Section 287 of the Local Government Code, each LGU shall appropriate in its annual budget no less than 20% of its annual IRA for development projects. Copies of the development plans of LGUs should be furnished to the DILG. A joint memorandum circular (No. 1s. 2005) was issued by DILG-DBM to provide guidelines on the appropriation and utilization of this 20% of the annual IRA for development projects.

In the perception survey conducted last November 2007 in the course of the study, questions regarding appropriation and utilization of the 20% of the annual IRA for development projects were asked to 166 respondents of the sample LGUs (refer to Chapter 5 4.2.).

Sixty percent of all respondents answered in the affirmative to the current DILG-DBM joint memorandum circular for its full coverage of utilization, but 38% respondents answered in the negative.

In terms of its clarity, 80% of the respondents replied that Sec. 287 of the LGC and the DILG-DBM joint memorandum circular were clear enough to provide guidance on the said utilization. Definitely, the said circular had been playing an important role in defining and explaining “development projects” mentioned in Sec. 287 of the LGC.

Based on the results of the perception survey, the JST believes that Section 287 of the Local Government Code and the said DILG-DBM circular need not be amended.

13.1.2. Utilization of IRA for a Specific Purpose and Operation

The JST supposes that the important thing to consider for the fair and compliant implementation

of an LGU's "development project" is to strengthen DILG's monitoring capacity on LGU expenditures and to establish mechanisms to institute fiscal discipline among LGUs. In other words, external supervision and audits by organizations such as DILG and internal audits by LGUs themselves on their expenditures should be strengthened.

The additional reasons why Sec 287 and the current DILG-DBM Joint Memorandum Circular do not have to be changed were as follows.

1) A great disparity among LGUs exists in terms of fiscal capacity. LGUs with strong revenue capacities can spend more than 20% of their annual IRA for development projects, whereas LGUs with poor revenue capacities cannot easily manage their expenditures for development projects. On the other hand, provinces accord higher priority to infrastructure projects, compared with cities and municipalities. Also, each LGU has different needs and categories in prioritizing and implementing its "development project". "Development project" should, therefore, not be restrictively defined.

2) The argument that the fiscal framework for expenses for health and social welfare services should be established might be brought forward since these services are equally important as the expenses for "development projects". However, IRA is regarded as the intergovernmental transfer of funds from the central government to LGUs, and its utilization should not be restricted only for a specific purpose.

3) The IRA system was originally expected to contribute to the promotion of decentralization. From this point of view, each LGU should try to optimize its allocation of resources by itself, considering its locally owned sources of revenue and fiscal demands.

To strengthen the monitoring capacityof DILG relative to LGU expenditures, it is expected that the DILG officer dispatched to audit an LGU can play a more important monitoring role if he/she realizes the more detailed situation of the LGU where he/she resides. .

Furthermore, if there are some unclear words for LGUs in the joint memorandum circular, the JST recommends that DILG should discuss these with DBM and amend it as needed. In addition, the JST recommends the preparation of a list of frequently asked questions (FAQs) on the utilization of IRA.

13.2. Proposals for the Improvement of the Other IRA-Related Aspects

13.2.1. Enhancement of Fiscal Discipline

The objectives of this study included proposals for the improvement of other IRA-related

aspects. Hence, the JST will point out some suggestions for the improvement regarding institutional problems and operational issues other than those relating to the IRA distribution formula and utilization restriction.

The reason for improving the current formula in this study was to balance locally owned source revenue among LGUs and to adjust to basic fiscal needs of LGUs through the IRA system. Although the amount of IRA given to LGUs with poor revenue capacities increased by changing the formula, it would not be successful when the increase in IRA amount is not linked to the improvement of delivery services. Therefore, it required the LGUs to keep and maintain fiscal discipline so that the increase in IRA amount on the revenue side would be tied to expenditures for service delivery. Thus, the effective and efficient use of the IRA should be closely linked with effective and efficient public administration and finance in all LGUs.

The center of fiscal discipline consists of a balanced budget, proper allocation of resources, and good governance (compliance, accountability, monitoring, etc.). It is important that LGUs can voluntarily manage public finances as self-governed organizations. At the same time, however, budgeting and accounting in LGUs are externally regulated by rules, assembly, and market in order to accomplish sound fiscal administration.

Sec. 305 and other sections of the LGC provide rules about fiscal principles[1]. However, besides rules spelled out in the LGC, fiscal discipline needs to be established by setting a fiscal indicator, realizing full disclosure, monitoring, etc. Enhancement of fiscal discipline will contribute to the allocation of resources properly in order to increase the social welfare of people including the next generation, preventing only specific pressure groups from getting interests and controlling

[1] Sec.305. (g) Local governments shall formulate sound financial plans, and the local budgets shall be based on functions, activities, and projects, in terms of expected results; (h) Local budget plans and goals shall, as far as practicable, be harmonized with national development plans, goals, and strategies in order to optimize the utilization of resources and to avoid duplication in the use of fiscal and physical resources; (j) Local government units shall ensure that their respective budgets incorporate the requirements of their component units and provide the equitable allocation of resources among these component units; and (m) The local government unit shall endeavor to have a balanced budget in each fiscal year of operation.
Sec.319. On or before the end of the current fiscal year, the sanggunian concerned shall enact, through an ordinance, an annual budget of the local government unit for the ensuing fiscal year on the basis of the estimates of income and expenditures submitted by the local chief executive.
Sec.324. (b) Full provision shall be made for all statutory and contractual obligations of the local government unit concerned: Provided, however, that the amount of appropriations for debt servicing shall not exceed twenty percent (20%) of the regular income of the local government unit concerned.
Sec.325. (a) The total appropriations, whether annual or supplemental, for personal services of a local government unit for one (1) fiscal year shall not exceed forty-five percent (45%), in the case of first to third class provinces, cities, and municipalities, and fifty percent (55%) in the case of fourth class or lower, of the total annual income from regular sources realized in the next preceding fiscal year; and (b) No official or employee shall be entitled to a salary rate higher than the maximum fixed for his position or other positions of equivalent rank by applicable laws or rules and regulations issued thereunder.
Sec.348. The books, accounts, papers, and cash of local treasurer, accountant, budget officer, or other accountable officers shall at all times be open for inspection of the COA or its duly authorized representative.
Sec.352. Local treasurers, accountants, budget officers, and other accountable officers shall, within thirty (30) days from the end of each fiscal year, post in at least three (3) publicly accessible and conspicuous places in the local government unit a summary of all revenues collected and funds received including the appropriations and disbursements of such funds during the preceding fiscal year.
Sec.356. Except as otherwise provided herein, acquisition of supplies by local government units shall be through competitive public bidding.

an adequate and reasonable size of human resources in the public sector.

In order to operate financial affairs properly, it is important not only for DILG to fully understand relevant information on the operations of LGUs, but also for residents themselves to be able to access administrative and financial data of LGUs easily. The Local Governance Performance Management System (LGPMS) is a useful tool for DILG since it is expected to be data-based and can be utilized more for monitoring the fiscal discipline of the LGUs.

13.2.2. Five Suggestions Related to Fiscal Discipline

The JST has listed the following suggestions to strengthen fiscal discipline of LGUs.

1) Establishment of Well-Disciplined Public Finance Rules and Mechanisms in Personnel Expenditure

Changes in the IRA distribution formula might provide higher amounts of IRA for LGUs with poor revenue capacities. Moreover, if the total amount of IRA increases from 40% of internal revenue, it might cause most of the LGUs to increase their IRA amount. In this case, it must be avoided that an increase in IRA amount which LGUs receive is simply associated with an unnecessary increase in expense just for human resources. Therefore, a standard model of the suitable number of human resources and their corresponding salary levels for each LGU should be developed, based on the scale of development of LGUs and types of services being rendered. Establishing these rules and mechanisms regarding the costs of human resources are useful for the improvement of fiscal discipline in LGUs.

2) Setting of Numeric Targets on BHN

By setting the numeric standards on basic human needs (BHN), e.g. the number of elementary schools and teachers, as a guideline in accordance with capacity and area characteristics, the expenditure goals of each LGU can be clearly spelled out. This would easily ensure that any increase in IRA in each LGU is linked with the expenses for basic human needs.

3) Sharing of Basic Data Set of LGUs

The sample survey of LGUs conducted in November 2007 in the course of this study had made it clear that essential statistical data in LGUs that could lead to a better understanding of the conditions of their public administration were not enough both in quality and in quantity. As self-governed organizations, LGUs by themselves should be equipped with basic statistical data sets in order to monitor and evaluate its output and outcome for its input. Sharing of such basic

statistical data sets between LGUs and DILG was extremely useful. From this standpoint, the function of LGPMS should be enhanced more particularly in the systematic collection of the basic statistical data sets of LGUs.

4) Transparency and Objectivity in IRA Calculation

For transparency in IRA calculation, it is important for each LGU to verify the amount of IRA by itself. Of course, although the current IRA distribution formula is simple and clear, it is difficult for LGUs to predict the amount of IRA due them partially because of the Cost of Devolved Function (CODEF), which are deducted from the total amount of IRA before disbursement of IRA to LGUs, and partially because of the fact that the statistical area data of LGUs which DBM is using in the calculation of IRA is sometimes different from those that LGUs have. Easy computation by LGUs would make the IRA system more transparent, objective and predictable.

5) Capacity Development in Public Finance in LGUs

Capacity development in public finance in LGUs should be promoted to realize the effective and efficient use of their IRA, including expenditures for their “development project/s”. One of the means to develop financial capacity in LGUs is by preparing and making widely available a public finance manual (guidelines). This manual shall cover every stage of public finance: budgeting, implementation of internal and external audit. The preparation of a mid-term (3-5 years) financial plan is also recommended.

CHAPTER 14

COMMUNICATIONS STRATEGY

This chapter presents the Communications Strategy (hereinafter referred to the "Strategy"), which is considered essential for DILG to effectively spread an improvement policy of the IRA system to concerned stakeholders and thus, achieve an improvement in IRA system, after completion of the Study. The Communication Strategy Paper, which is the basis of strategies provided in this chapter, is presented in Annex 22.

14.1. Effect of the Strategy

The Strategy sets out a communication framework proposed to DILG in communicating a key message and its associated information on key issues and strategic directions of an improvement policy of IRA system, and in facilitating awareness, understanding and the support of stakeholders to gain from them a certain level of consensus on such improvement policy. In this regard, the Strategy is expected to ensure that all stakeholders are provided with accurate and consistent information and provided as well with opportunities to participate in communication activities and feedback opinions, views, and suggestions on an improvement policy of the IRA system through a two-way communication of the Strategy. The framework of the Strategy is set out according to basic strategies to ensure that wider awareness, understanding and support of stakeholders are facilitated and according to guiding principles to ensure that the intended results of the Strategy are appropriately guided based on government commitment, consultation and feedback, transparency and accountability, consistency and evaluation.

14.2. Points of the Strategy to Note

The target audiences of the Strategy are grouped into the four groups as explained in the subsequent sections, such as the national government, local governments, academic and research institutes, and international donors. Among these groups, the target audiences considered important towards an improvement in the IRA system are: (1) the Local Government Committees of the Senate and the Congress as the national legislative body in terms of its given roles to discuss a bill proposing to amend the LGC as it relates to an improvement policy of the IRA system, and (2) the LGUs such as province, city, municipality, and barangay, which come under the direct influence of an improvement policy of the IRA system, and LGU-related associations representing LGUs to the national government.

In regard to the Local Government Committees of the Senate and the Congress, the Strategy shall consider to provide concise and clear information of the Strategy in order to facilitate

discussion about key issues on an improvement policy of the IRA system, and obtain constructive opinions, views, and suggestions from the members of the Senate and the Congress on strategic directions on an improvement in the IRA system. Furthermore, it is recommended that DILG shall assign its staff as a Liaison Officers for the Local Government Committees of the Senate and the Congress to provide updated information and materials related to IRA and maintain close contact and cooperation towards the process of transforming a bill proposing to amend certain provisions of the LGC into law.

In the case of the LGUs, which are the concerned parties on an improvement policy of the IRA system, a certain level of consensus-building shall be achieved on strategic directions on such a policy by facilitating understanding among the Local Chief Executives and the Local Councilors once they are provided with accurate and consistent information through active communication activities. Furthermore, it is expected that LGU-related associations shall be concerned with coordinating with all LGUs about the strategic directions on this improvement policy in the IRA system through discussions in local chapters and during the annual general assembly so that constructive opinions, views, and suggestions can be obtained as feedbacks from LGUs.

14.3. Strategic Objectives of Communication

In order for the Strategy to be able to demonstrate the effect on an improvement in the IRA system, the following specific communication objectives are established.

- Deepen awareness and understanding on key issues on an improvement policy of the IRA system among stakeholders;
- Build consensus on strategic directions on an improvement policy of the IRA system among stakeholders;
- Provide necessary information to all stakeholders;
- Facilitate encouragement of stakeholders to provide feedback based on their opinions, views, and suggestions, and thereafter, assess such feedback; and
- Monitor and evaluate the activities and the results of the Strategy for its subsequent improvement, if deemed necessary..

14.4. Targets of the Strategy

The target audiences of the Strategy are the stakeholders of the improvement policy of the IRA system. These include the national government, local governments, academic and research institutes, and international donors.

14.4.1. National Government

This audience group is an influential group that includes administrative and legislative bodies at the national level, which are concerned with the formulation and implementation of a national policy on local government administration and finance. More specific audiences in this group are identified and explained below.

- *National Administrative Body* is divided into two groups: internal and external groups. The internal group is DILG which is the proponent agency for this improvement policy of the IRA system and is responsible for supervising LGUs. The DILG is composed of the national head office and local offices located nationwide at the regional, provincial, city, and municipal levels. On the other hand, the external group includes coordinating government agencies of DILG as these relate to the IRA: the DOF, which is in charge of fiscal and financial affairs of LGUs with specific concerns on the management of revenues and expenditures; the DBM, which is in charge of monitoring and assessing the physical and financial operations of LGUs with specific concerns on the calculation and remittance of IRA.
- *National Legislative Body* is represented by the Senate and the Congress whose functions include, among others, drafting, discussing and enacting proposed bills. These bodies are considered important institutions for the Strategy to work. More specifically, the Senate and the Congress, particularly their respective Local Government Committees, are the ones that will discuss on proposed amendments to the LGC related to an improvement policy of the IRA system. In the Congress of the Philippines, a member of the Congress himself or herself, or its Bill Drafting Division of the Reference and Research Bureau could prepare a draft of the bill upon the request of on of its members. It should be noted, however, that most of the needed legislation of the country today that is considered by the Congress originates from the executive departments and agencies. These departments or agencies prepare a draft and transmit a proposed legislation to the Congress. In like manner, such procedures are also observed when introducing legislation for the consideration of the Senate.

14.4.2. Local Governments

The local governments are a primary group that comes under the most influence of an improvement policy of the IRA system and include administrative and legislative bodies at the local level as well as the respective nationwide associations of LGUs.

- *Local Administrative Body* is composed of province, city, municipality and barangay called as LGUs as a whole, headed by the Local Chief Executive such as provincial governor, city mayor, municipal mayor and punong barangay, respectively. The LGUs are responsible for

the provision of basic services and facilities as well as the implementation of development programs and projectss within their respective administrative jurisdictions.

- *Local Legislative Body* is represented by the Local Councils such as Sangguniang Panlalawigan (Provincial Council), Sangguniang Panlungsod (City Council), Sangguniang Bayan (Municipal Council) and Sangguniang Barangay (Barangay Council). These councils enact ordinances and adopt resolutions that are consistent with the law and are made within each LGU's respective administrative jurisdiction.
- *LGU-Related Association* is a nationwide organization of LGUs stipulated in the LGC and established at its respective administrative level, such as the League of Provinces of the Philippines, the League of Cities of the Philippines, the League of Municipalities of the Philippines, and the Liga ng mga Barangay, which are represented by respective Local Chief Executives as its members. These associations ventilate, articulate and crystallize issues affecting provincial, city, municipal, or barangay government administration and security through proper and legal means and solutions. Furthermore, there are several leagues organized for Local Legislators, such as the Provincial Board Members League of the Philippines, the Lady Local Legislators League of the Philippines, the Philippine Councilors League and the National Movement of Young Legislators. In addition, there is an umbrella organization for all leagues of LGUs called the Union of Local Authorities of the Philippines that serves to unite all member-leagues and enhance its partnership with all stakeholders to ensure local and fiscal autonomy for all LGUs.

14.4.3. Academic and Research Institutes

The academic and research institutes include public and private universities and research institutes in the country that could play an important role in influencing an improvement policy of the IRA system through a scholarly public policy research undertaken on IRA and in the field of a local government administration and finance. In this regard, there have been many similar studies and researches conducted in this field over the years.

- *Academic Institute* is an educational and research institute and contributes to the public through the conduct of studies and researches in its respective domain of expertise. In regard to the IRA, one of the active academic institutes in local government administration and finance in the country is the Center for Local and Regional Governance at the National College of Public Administration and Governance in the University of the Philippines at its Diliman campus. This center provides research, consulting services, and training on local government administration and finance and collaborates with local and international institutions in promoting decentralization and publishing materials for the benefit of local government and regional units.
- *Research Institute* assists government planners and policy makers of administrative and legislative bodies in planning and policy formulation through the conduct of studies and

researches. One of the active research institutes in local government administration and finance in the country is the Philippine Institute for Development Studies, which is a non-profit government institute established by law and one of the attached agencies of NEDA.

14.4.4. International Donors

The international donors include those institutions which provide funding support for development programs and projects, including those for local government administration and finance in the country. In this field, international organizations are interested in an improvement policy of the IRA system, have been active and may have directly and indirectly influenced thrusts and directions for such an improvement policy.

- *International Donors* include ADB, WB, CIDA, AusAID and JICA and are active in providing funding support for programs and projects in the field of local government administration and finance (refer to Chapter 8).
- *Consultative and Coordinating Platform* is established between the Philippine government and international donors to facilitate substantive policy dialogue on development agenda and also serves as a process for developing consensus and generating commitments among different stakeholders toward critical actionable items of reform agenda in the country. As already mentioned in Chapter 8, this platform is called the Philippine Development Forum and organized with a couple of working groups by sector, of which one is related to a local government administration and finance called the Working Group on Decentralization and Local Governance.

14.5. Approaches of the Strategy

14.5.1. Key Message

The Strategy is designed to communicate with target audiences through a key message to achieve its communications objectives as mentioned in Section 14.3. It is, therefore, necessary that a key message shall be discussed and defined by DILG. Furthermore, it would be necessary to add more specific objective-driven sub-messages based on this key message.

In this regard, the strategic objective of an improvement policy of the IRA system presented in this Final Report shall be stated as a key message.

- *Strategic Objective of Improvement Policy of the IRA System* is considered as a principal message to share and seek strategic directions of improving the IRA system with target audiences and is stated as "*the role of IRA as equalizing financial capacities of LGUs with*

a view to enabling LGUs to perform standard basic public services (refer to Chapter 10) ".

14.5.2. Communication Channels

It is important to choose appropriate channels for reaching and collecting feedback from target audiences. Given the condition that the majority of target audiences are LGUs located nationwide, it is also important that all target audiences are provided with the necessary and consistent information through a multi-channel approach and given opportunities as well to participate and provide feedback through appropriate communication channels. In this regard, it is recommended that the communication channels of the Strategy make efficient use of existing institutions.

Internal Channels

The internal channels are communication channels that refer to existing communication flows within the structure of DILG and also between DILG and its coordinating government agencies as these relate to IRA.

- *Organizational System of DILG* is a nationwide organizational system of DILG from the national head office to local offices such as regional, provincial, city, and municipal offices. Of the local offices, provincial, city, and municipal offices are stationed at the respective LGUs, and city and municipal offices provide general supervision over their respective component barangays. In this regard, the national organizational system of DILG shall be utilized as an internal channel of the Strategy in communicating among all offices of DILG nationwide.
- *Intergovernmental Network of DILG* is an internal channel of DILG that functions as a coordinating platform with coordinating government agencies related to IRA such as DOF and DBM as previously mentioned in Section 14.4.1 and utilized as an internal channel of the Strategy for an intergovernmental communication channel of DILG. In this regard, the Steering Committee established for the Study is recommended to be retained after completion of the Study and utilized to function as an intergovernmental network of DILG under the Strategy. It is noted that this intergovernmental network of DILG shall be also extended to function in communicating with the Senate, the Congress, and public academic and research institutes as well.

External Channels

The external channels are existing communication channels outside of the structure of DILG.

- *Network of LGU Leagues* is a nationwide network of leagues of LGUs as previously

mentioned in Section 14.4.2. The leagues are headquartered in Metro Manila with its respective national offices and secretariats. Representation of LGUs in the leagues is such that each league is basically represented by its local chapters. For example, the League of Cities of the Philippines has local chapters at the provincial level and highly urbanized cities; similarly, the League of Municipalities of the Philippines has local chapters at the provincial level; and the Liga ng mga Barangay has local chapters at the municipal, city, and provincial levels. In this regard, a nationwide network of leagues of LGUs shall be utilized as an external channel of the Strategy to communicate with all Local Chief Executives and its respective LGUs through these local chapters.

- *Philippine Development Forum* is a consultative and coordinating platform established between the Philippine government and international donors as previously mentioned in Section 14.4.4. This forum, particularly the Working Group on Decentralization and Local Governance, is a platform that can be utilized to function as an external channel of the Strategy to communicate with all international donors that are concerned with local government administration and finance.
- *Website of DILG/BLGS* is an existing official communication channel of DILG/BLGS, which shall be utilized as an effective external channel of the Strategy for target audiences. In this regard, the website of DILG/BLGS shall be considered as an essential communication channel to provide up-to-date and consistent information for target audiences. Among others, such information could include documents and publications prepared as part of the Strategy, links to related information, an online forum for discussion and feedback, event information and contact information, and so on. It is noted that the website of DILG/BLGS shall be also utilized as an internal communication channel within the structure of DILG, as long as local offices are connected to the internet.
- *Mass Media* is generally defined and understood to be newspapers, and television and radio stations, which have a broad reach to the public. They are effective in increasing awareness of relevant issue and in providing an easy and accessible means of communicating information to audiences. In this regard, the Strategy implemented by DILG shall establish and maintain good working relations with these mass media outlets to generate accurate and consistent reporting of information of the Strategy. Therefore, a Media Relations Scheme is recommended to be implemented under the Strategy, which is described in more detail in Section 14.7.

14.5.3. Communication Materials and Methods

The communication materials and methods used by the Strategy are composed of printed and visual materials as well as learning and consultation methods that help promote effective communication for target audiences provided through communication channels. More specific communication materials and methods are explained in the following subsections.

Printed and Visual Materials

The printed and visual materials of the Strategy are composed of a newsletter, a brochure, a fact sheet, and a presentation material, which are distributed through communication channels of the Strategy. In particular, it is noted that these materials are often electronically channeled through emails and websites in the form of the Portable Document Format (PDF) that has gained acceptance and popularity over printed correspondence.

- *Newsletter* is one or more printed sheets and periodically distributed to communicate information on a specific topic. This material shall be used to provide an updated topic, an issue or development of communication activities on an improvement policy of the IRA system undertaken by the Strategy and issued regularly, preferably on a quarterly basis. It is noted that DILG has a regularly published newsletter called "DILG News Digest", so it shall be utilized as a newsletter of the Strategy for both internal and external purposes.
- *Brochure* is a folded and printed double-sided booklet with multiple text panels that contains concise texts, graphics or tables. This material shall be used to provide highlights of key issues on an improvement policy of the IRA system and a key message of the Strategy, with selected supporting graphs and tables.
- *Fact Sheet* is a short printed document with texts, graphs or tables and provided in the least amount of space that contains a specific topic in a format emphasizing key points of interest and concern. This material shall be used to provide a summary of an updated key point on an improvement policy of the IRA system with its associated information supported by graphs and tables.
- *Presentation Material* is a promotion material composed of a set of an audio-visual presentation to visually present the content of a topic to target audiences with audio explanations. This material shall be used to provide an outline of key issues on an improvement policy of the IRA system and a key message of the Strategy with its associated information utilizing clear and concise statements, graphs and tables. It is noted that this presentation material shall be stored in the form of a CD-ROM and duplicated for distribution purposes.

Learning and Consultation Methods

The Strategy applies meeting and seminar methods to a learning and consultation process of target audiences, which shall bring participants together to work toward learning, consensus building or discussion on key issues on an improvement policy of the IRA system and a key message of the Strategy. Each of these defined learning and consultation method is explained as follows.

- *Policy Meeting* is an internal meeting of DILG and participated in by senior officials

concerned with the Strategy such as Undersecretary for Local Government, Directors and Division Chiefs at the national head office and Regional Directors. This meeting is held to (1) create and share a common policy foundation about key issues on an improvement policy of the IRA system and a key message of the Strategy and (2) discuss about strategic directions of an improvement policy of the IRA system among senior officials by reviewing feedbacks obtained from target audiences through communication activities of the Strategy.

- *Learning Seminar* is a one-day seminar for DILG local office staff and held at the regional level for its respective provincial, city and municipal office staff to provide an opportunity for deepening knowledge and enhancing understanding about key issues on an improvement policy of the IRA system and a key message of the Strategy. With this opportunity given, DILG local office staff shall be able to provide accurate and consistent information, explanations and consultations to local target audiences through communication activities of the Strategy.
- *Consultation Seminar* is a one-day seminar for local administrative and legislative bodies and conducted at the provincial level by DILG for the Local Chief Executives and the Local Councilors including key administrative staff of their respective LGUs concerned with IRA, in cooperation with provincial chapters of LGU-related associations. This seminar is to provide an opportunity for understanding on key issues on an improvement policy of the IRA system and a key message of the Strategy and establishing a common foundation among participants toward consensus building.
- *Consultation Meeting* is a half-day meeting for each of national administrative and legislative bodies, LGU related associations, academic and research institutes and international donors located in Metro Manila. This meeting shall be designed to provide an opportunity for discussing and exchanging opinions, views, and suggestions on highlighted key issues on an improvement policy of IRA system and a key message of the Strategy and to get a certain level of support and consensus among these target audiences.

14.6. Recommended Operations Framework of the Strategy

The Study proposes the recommended operations framework of the Strategy, as summarized in the table below.

Table 14-1: Summary of Recommended Operations Framework of the Strategy (1/2)

Target Audiences	Key Strategies	Communication Channels	Communication Materials and Methods
National Government (DILG)	• Create and share a common policy foundation among DILG senior officials on an improvement policy of the IRA system and a key message, and discuss on its strategic directions through feedbacks of the Strategy. • Provide training for DILG local office staff to enable them to understand very well the key issues and the key message of the Strategy on an improvement policy of the IRA system so they can provide accurate and consistent information for local target audiences.	• Organizational system of DILG • Website - DILG / BLGS • Mass media	• Policy meeting (senior officials) • Learning seminar (local office staff) • Presentation material • Newsletter • Fact sheet • Brochure

Source: JICA Study Team

Table 14-1: Summary of Recommended Operations Framework of the Strategy (2/2)

Target Audiences	Key Strategies	Communication Channels	Communication Materials and Methods
National Government (Coordinating Agencies of DILG related to IRA)	• Discuss and share on feedbacks obtained from target audiences. • Coordinate and consult on strategic directions of an improvement policy of the IRA system through feedbacks of the Strategy.	• Intergovernmental network of DILG • Website - DILG / BLGS • Mass media	• Consultation meeting • Presentation material • Newsletter • Fact sheet • Brochure
National Government (National Legislative Body)	• Provide concise and clear information to facilitate discussion about key issues on an improvement policy of the IRA system and obtain constructive opinions, views, and suggestions. • Maintain close contacts and relationships with the Local Government Committees of the Senate and the Congress, particularly by assigning DILG staff as a Liaison Officers for the Senate and the Congress who will provide Senators and Congressmen updated and the latest information and materials of the Strategy.	• Intergovernmental network of DILG • Website – DILG / BLGS • Mass media	• Consultation meeting • Presentation material • Newsletter • Fact sheet • Brochure
Local Governments (Local Administrative and Legislative Body)	• Facilitate awareness and understanding on an improvement policy of the IRA system by providing accurate and consistent message and information of the Strategy. • Build consensus toward an improvement policy of the IRA system through communication activities of the Strategy.	• Organizational system of DILG • Network - LGU leagues • Website - DILG / BLGS • Mass media	• Consultation seminar • Presentation material • Newsletter • Fact sheet • Brochure

Local Governments (LGU-Related Associations)	• Provide and keep updating the latest information on an improvement policy of the IRA system. • Maintain close contacts to see strategic directions of an improvement policy of IRA system, discuss on constructive opinions, views, and suggestions about feedbacks of LGUs obtained from communication activities of the Strategy and coordinate with the Local Chief Executives and the Local Councilors on strategic directions of an improvement policy of the IRA system.	• Network - LGU leagues • Website - DILG / BLGS • Mass media	• Consultation meeting • Presentation material • Newsletter • Fact sheet • Brochure
Academic and Research Institutes	• Develop and maintain relationships by providing updated information of the Strategy. • Obtain and review advices and suggestions through opportunities provided for discussions.	• Intergovernmental network of DILG • Website – DILG / BLGS • Mass media	• Consultation meeting • Presentation material • Newsletter • Fact sheet • Brochure
International Donors	• Maintain relationships by providing updated information and materials of the Strategy. • Discuss and exchange opinions and views on results of the Strategy for an improvement policy of the IRA system.	• Philippine Development Forum • Website – DILG / BLGS • Mass media	• Consultation meeting • Presentation material • Newsletter • Fact sheet • Brochure

Source: JICA Study Team

14.7. Recommended Arrangements for Implementation of the Strategy

This section presents the recommended arrangements for the implementation of the Strategy, which is summarized in the table below.

Table 14-2: Recommended Arrangements for Implementation

Arrangements	Summarized Contents
Communication Unit	• National level - establish in the Office of Public Affairs (OPA) at the national head office of DILG, whose member staff shall be composed of Communication Officers from OPA responsible for overall communication planning, supervision and monitoring of the Strategy, and Policy Officers from BLGS responsible for overall technical assistance on an improvement policy of IRA system and coordination of the Strategy, and • Local level - DILG Regional Office Staff shall be assigned as Regional Supervision Officers responsible for overall supervision of all communication activities of the Strategy within its regional jurisdiction, and Provincial, City and Municipal Office Staff shall be assigned as Provincial, City or Municipal Operations Officers responsible for undertaking operations of the Strategy within their respective jurisdictions.
Local Information Center	• Utilize DILG local offices at provincial, city, and municipal levels located at respective LGUs as Local Information Center to increase its capacity of providing all basic information on an improvement policy of the IRA system to be made available for local target audiences, which shall ensure that accurate and consistent information is provided to target audiences nationwide.

Media Relations Scheme	• Establish and maintain good working relations with media such as newspapers, and television and radio stations to generate accurate and consistent reporting by media on information of the Strategy by determining the interests and needs of media, such as (1) monitoring of media reports in newspapers, and television and radio stations and (2) collection and analysis of press clippings, and • Help media identify newsworthy topics, obtain access to sources and prepare interesting articles, benefiting both DILG and media by generating more accurate reporting of information of the Strategy by preparing newsworthy information for media, such as (1) news releases, (2) fact sheets, (3) feature stories, (4) opinion pieces, (5) newsletters, and (6) a list of resource persons and experts on IRA and its related field in local government administration and finance.
Monitoring and Evaluation Framework	• Gathering of feedback - feedbacks gathered through all communication channels of the Strategy shall be analyzed and summarized into responsiveness summaries with explanations and comments prepared by DILG. The responsiveness summaries shall be provided to target audiences through communication channels of the Strategy, and • Importance of feedback - feedbacks gathered shall be utilized by DILG to improve effectiveness, consistency and accuracy of communication activities of the Strategy as well as to analyze and evaluate awareness and understanding of target audiences on an improvement policy of the IRA system by generalizing the opinions and views of target audiences.

Source: JICA Study Team

14.8. Issues

It is expected that, after completion of the Study, DILG shall review a proposal of the Study on options for an IRA distribution formula and an improvement policy of the IRA system. Thereafter, DILG could finalize its proposal and decide on a bill that would amend the LGC to be submitted to the Local Government Committee of the Senate and the Congress.

In this regard, the Strategy presented here shall be utilized by DILG to obtain wider understanding of and build a consensus of stakeholders on the necessity of an improvement policy of the IRA system as part of the process of preparing a bill amending the LGC. It is, therefore, necessary that the time frame required to implement the Strategy shall be examined and prepared by DILG, according to the schedule to be made for the abovementioned promotion activities.

CHAPTER 15

CONCLUSION

Seventeen years have passed since the enactment to the LGC, and there has been a wealth of argument about IRA. It would appear that the momentum of the IRA reform is rising at present. The implementation of the Study is especially pertinent under these circumstances. The JST only hopes that the Study has contributed to a solid basis for the preparation and evenual realization of the IRA reform. Finally, a brief note on the accomplishments and constraints of the Study is presented in this concluding chapter.

15.1. Accomplishments and Characteristics of the Study

A number of studies and researches have focused on the IRA issue and its reform. This JICA Study may differ from the rest of the studies of the past in the following aspects.

Firstly, the Study draws its proposals from the extensive baseline survey and analysis. As mentioned in Chapter 1, the proposals in this Study are based on the analysis of the current conditions from institutional and quantitative perspectives (Part I), the results of an extensive perception survey (Part II), and the review of the existing theories and studies about IRA (Part III).

Secondly, based on the available data, the Study reveals statistically the details of the financial structure of the local government, excluding barangays, as well as the current IRA distribution pattern, and clarifies the whole picture. Such analytical work and the data obtained in this Study should be useful for any attempts in the future to contemplate a reform in the local government administration and finance.

Thirdly, the Study provides a system by which simulation of any new IRA distribution formulas can be made. As the skills for running this simulation system are transferred to DILG, it should help DILG narrow down the options in search for the most suitable formula.

Fourthly, the Study examines in detail how the financial needs of the local government are computed in a build-up approach. In addition, the Study shows how Japan’s LAT system can be applied in the context of the Philippines by demonstrating an example in the health sector. These efforts should be help future attempts to use IRA in filling in the financial gaps of LGUs as the financial needs may be more accurately revealed through a build-up method.

15.2. Constraints of the Study

Despite the accomplishments, some constraints are inevitable in the Study. Listed below are some of them.

First and foremost, the dearth and defectiveness of data should be mentioned. The baseline statistics of central and local government finance and socioeconomic situation is not made available satisfactorily. The data collection from the LGU Sample Survey did not produce the expected results, and some of the data collected was of doubtful value. Admittedly, such circumstances inhibit the performance of the Study to some extent.

Another major constraint of the Study is that it has not been able to calculate as meticulously as it desired the financial needs and potential revenue-raising capacities of the target LGUs under the sample survey. Consequently, the Study is inadequate in terms of estimating the financial shortages of LGUs.

The unavailability of the barangay data gives another restraint to the Study. The JST attempted to collect the necessary data in Case Study B, but the data were not available. This leaves the Study no other option but to exclude barangay level when reviewing the IRA distribution formula.

Lastly, the Study finds it difficult to depict a target IRA distribution pattern. Following the JICA Advisory Committee's suggestion, the JST tried many different methods to search a target IRA distribution pattern, but to no avail.

15.3. Action Assignments for the Future

The JST would like to point out the following action assignments for the future.

First, it is the task of selecting the best formulas from vertical options and horizontal options. In the months ahead, DILG is expected to find the best combination of new formulas for the preparation of the amendment bill. In doing so, DILG may utilize the communication strategy introduced in Chapter 14 in order to gain popular understanding for the selected formulas among stakeholders.

Secondly, it is the active utilization of the simulation system introduced by this Study. It should help the people concerned a great deal in not only pinpointing the best option within the vertical and horizontal option groups but also promoting consensus building among stakeholders.

Thirdly, it is expected that the build-up method in the computation of the financial needs of

local governments introduced by the Study should be further developed and may be put into practical use in the future. With reference to Japan's LAT system, the Government of the Philippines needs to upgrade the work conducted in this Study in regard to the computation of the financial needs of LGUs and to the management of the data required for it. In this light, the concerned government offices must coordinate to tackle the challenges of computing the financial needs and the potential revenues of LGUs as proposed by the JST in Chapter 11, 11.6.

Finally, somewhat related to the above issue, it is the development of data collection and management system. It is hoped that data are gathered sufficiently and properly at the local level and managed systematically at the national level. As barangays are basic units of local governments, collecting the barangay data systematically should be an idea worth considering.

JST would like to extend warmest thanks to the people concerned on both Philippine side and Japan side for their cooperation.