

COST AND EFFECT: THE IMPACT AND IRONY OF THE INTERNAL REVENUE ALLOTMENT

Dante B. Gatmaytan

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COST AND EFFECT: THE IMPACT AND IRONY OF THE INTERNAL REVENUE ALLOTMENT

Dante B. Gatmaytan*

I. INTRODUCTION

The enactment of the Local Government Code of 1991¹ was a landmark in the history of decentralized government.² The Code was hailed as the “most radical piece of legislation passed in the nation’s history.”³ The principal author of the Code, Senator Aquilino Pimentel Jr., called the law a “revolutionary” solution to the highly centralized character of Philippine government.⁴

The Code’s most prominent feature is the devolution of substantial powers to local government units “to bring development to the countryside.”⁵ The Code attempts to remedy the highly centralized nature of Philippine government, and weans local governments from dependence on the national leadership.⁶ It seeks to abolish this system of patronage between the national and local governments by allowing the latter to develop “at their own pace, with their own resources and at their own discretion.”⁷

* Assistant Professor, University of the Philippines, College of Law. LL.B., University of the Philippines, 1991; M.S.E.L., Vermont Law School, 1995; LL.M., University of California, Los Angeles, 1996. The author would like to thank Ms. Hazel Rose See, L.L.B., 2002 (expected) for her help in preparing this article for publication.

¹ Rep. Act No. 7160 (1991).

² Alma Ocampo-Salvador, *Philippine Local Governments: Toward Local Autonomy and Decentralization*, in *POLITICS & GOVERNANCE: THEORY AND PRACTICE IN THE PHILIPPINE CONTEXT* 117, 147 (1999).

³ Alex B. Brillantes, Jr., *Issues and Trends in Local Governance in the Philippines*, in *THE LOCAL GOVERNMENT CODE: AN ASSESSMENT* 3 (1999).

⁴ AQUILINO Q. PIMENTEL, Jr., *THE LOCAL GOVERNMENT CODE OF 1991: THE KEY TO NATIONAL DEVELOPMENT* 2 (1993).

⁵ *Id.*

⁶ *Id.* at 4.

⁷ *Id.*

Congress attempted to attain this objective by, among others, increasing the financial resources available to local government units. The Code broadens the taxing powers of local governments, provides them with a specific share from the national wealth exploited in their areas, and increases their share from the national taxes – otherwise known as the Internal Revenue Allotment (IRA).⁸

Ten years later, the excitement generated by the Code has waned as analysts are discovering that the Code has yet to fulfill public expectations, particularly on local fiscal autonomy. This shift in perception regarding the potentials of the Code warrants an examination of the state on local government finance.

This study reveals two alarming trends. First, despite the mechanisms for the generation of local revenues, most local government units are heavily dependent on the IRA; some are completely dependent on their share of the national income. The dependence also breeds another unintended effect – local governments are devising ways to gain a larger share of the IRA, usually by upgrading their municipalities to cities. Second, the national government continues to devise ways to control the IRA, either through executive or legislative action. Both trends detract from the goals of local fiscal autonomy.

II. THE LAW ON THE INTERNAL REVENUE ALLOTMENT

Revenue allotments are not new in the Philippines. Legislatures have been transferring funds to local governments for decades.⁹ Former President Ferdinand E. Marcos also made these allocations and gave them a more distinct form under Presidential Decree No. 144.¹⁰

The IRA came with various forms of control. For instance, Marcos created a “development fund” which specified the use for a portion of the IRA.¹¹

⁸ Alex B. Brillantes, Jr., *Local Governments in a Democratizing Polity*, in DEMOCRATIZATION: PHILIPPINE PERSPECTIVES 83, 85 (Felipe B. Miranda ed., 1997).

⁹ See Act No. 3815 (1930), sec. 80, as amended, Com. Act No. 466, sec. 368 (1939), Rep. Act No. 5185 (1967), and Rep. Act No. 6258, sec. 1 (1971).

¹⁰ See Pres. Decree No. 144 (1973).

¹¹ Pres. Decree No. 477 (1974), provided in part that:

SECTION 39. *Disbursement of appropriations for development projects.* — Appropriations for development projects funded from the twenty per cent of the annual internal revenue allotment of the local government and from the barrio development fund shall not be disbursed until after the corresponding work programs shall have been reviewed by the Secretary of Local Government and Community Development or his by duly authorized

Under previous laws, the costs incurred in the care of youthful offenders under the Child and Youth Welfare Code may be taken from the IRA.¹² The failure to provide appropriations for the maintenance and operation of police forces¹³ or to service loans and borrowings and/or other obligations issued by local government units¹⁴ authorized the Secretary of Finance to withhold the IRA of local government units.

President Marcos' control over the IRA was absolute.¹⁵ He rewrote both the amount and the distribution scheme of the IRA many times over.¹⁶ This practice allowed Marcos to develop patronage politics. Local governments who needed support from the national government were compelled to follow the directives of Mr. Marcos.

To end this patronage, the Constitutional Commission of 1986 decided to institute mechanisms in the Constitution that would fix the amount due to local governments and provide for its automatic release. The Constitution now provides that "Local government units shall have a just share, as determined by law, in the national taxes which shall be automatically released to them."¹⁷

The IRA plays an important role in local autonomy. Local governments have the right to receive the IRA as a means to help defray the costs of their new responsibilities under the Code. Section 3 of the Code provides, in part:

SECTION 3. *Operative Principles of Decentralization.* — The formulation and implementation of policies and measures on local autonomy shall be guided by the following operative principles . . .

representative. The Secretary shall issue the guidelines necessary in the proper implementation of this Section.

¹² See Pres. Decree No. 603 (1974), sec. 194.

¹³ See Pres. Decree No. 632 (1975), sec. 1.

¹⁴ See Pres. Decree No. 752 (1975), sec. 3 and 10.

¹⁵ For example, Pres. Decree No. 921 (1976), in part provided that:

SECTION 15. *Allocations of internal revenue allotments and specific tax allotments to the Metropolitan Manila Commission.* — The internal revenue allotments and specific tax allotments accruing to the provinces of Rizal and Bulacan under the provisions of Presidential Decree No. 144, as amended, and Presidential Decree No. 436, as amended, respectively, shall remain as presently allocated up to June 30, 1976. Thereafter, the allotment shares of the aforesaid provinces corresponding to the area, population and ten percent equity of the municipalities integrated within the Metropolitan Manila Area shall be allocated and remitted to the Metropolitan Manila Commission, and the allotments due to the provinces of Rizal and Bulacan shall be determined on the basis of the area, population and ten percent equity corresponding to the municipalities remaining under their respective jurisdictions.

¹⁶ See Pres. Decree No. 144 (1973), as amended by Pres. Decree Nos. 559 (1974), 937 (1976), 1158 (1977), 1231 (1977), and 1741 (1980).

¹⁷ CONST., art. X, sec. 6.

(d) The vesting of duty, responsibility, and accountability in local government units shall be accompanied with provision for reasonably adequate resources to discharge their powers and effectively carry out their functions: hence, they shall have the power to create and broaden their own sources of revenue *and the right to a just share in national taxes* and an equitable share in the proceeds of the utilization and development of the national wealth within their respective areas . . .¹⁸

Congress determined the “just share” through the provisions of the Local Government Code of 1991. Under the Code, local governments are now supposed to receive a yearly share of 40% of the national internal revenue taxes collected three years earlier. The Local Government Code in part provides:

SECTION 284. *Allotment of Internal Revenue Taxes.* — Local government units shall have a share in the national internal revenue taxes based on the collection of the third fiscal year preceding the current fiscal year as follows:

- (a) On the first year of the effectivity of this Code, thirty percent (30%);
- (b) On the second year, thirty-five percent (35%); and
- (c) On the third year and thereafter, forty percent (40%).

Provided, That in the event that the national government incurs an unmanageable public sector deficit, the President of the Philippines is hereby authorized, upon the recommendation of Secretary of Finance, Secretary of Interior and Local Government and Secretary of Budget and Management, and subject to consultation with the presiding officers of both Houses of Congress and the presidents of the liga, to make the necessary adjustments in the internal revenue allotment of local government units but in no case shall the allotment be less than thirty percent (30%) of the

¹⁸ Rep. Act No. 7160, sec. 3(d) (emphasis supplied). Section 18 of the Code also provides:

SECTION 18. *Power to Generate and Apply Resources.* — Local government units shall have the power and authority to establish an organization that shall be responsible for the efficient and effective implementation of their development plans, program objectives and priorities; to create their own sources of revenues and to levy taxes, fees, and charges which shall accrue exclusively for their use and disposition and which shall be retained by them; *to have a just share in national taxes which shall be automatically and directly released to them without need of any further action*; to have an equitable share in the proceeds from the utilization and development of the national wealth and resources within their respective territorial jurisdictions including sharing the same with the inhabitants by way of direct benefits; to acquire, develop, lease, encumber, alienate, or otherwise dispose of real or personal property held by them in their proprietary capacity and to apply their resources and assets for productive, developmental, or welfare purposes, in the exercise or furtherance of their governmental or proprietary powers and functions and thereby ensure their development into self-reliant communities and active participants in the attainment of national goals. (emphasis supplied)

collection of national internal revenue taxes of the third fiscal year preceding the current fiscal year: *Provided, further*, That in the first year of the effectivity of this Code, the local government units shall, in addition to the thirty percent (30%) internal revenue allotment which shall include the cost of devolved functions for essential public services, be entitled to receive the amount equivalent to the cost of devolved personal services.¹⁹

In addition, the Code reiterates the constitutional mandate for the automatic release of the IRA as follows:

SECTION 286. *Automatic Release of Shares.* — (a) The share of each local government unit shall be released, without need of any further action, directly to the provincial, city, municipal or barangay treasurer, as the case may be, on a quarterly basis within five (5) days after the end of each quarter, and which shall not be subject to any lien or holdback that may be imposed by the national government for whatever purpose.

(b) Nothing in this Chapter shall be understood to diminish the share of local government units under existing laws.

¹⁹ The Code further provides:

SECTION 285. *Allocation to Local Government Units.* — The share of local government units in the internal revenue allotment shall be allocated in the following manner:

- (a) Provinces — Twenty-three percent (23%);
- (b) Cities — Twenty-three percent (23%);
- (c) Municipalities — Thirty-four percent (34%); and
- (d) Barangays — Twenty percent (20%)

Provided, however, That the share of each province, city, and municipality shall be determined on the basis of the following formula:

- (a) Population — Fifty percent (50%);
- (b) Land Area — Twenty-five percent (25%); and
- (c) Equal sharing — Twenty-five percent (25%)

Provided, further, That the share of each barangay with a population of not less than one hundred (100) inhabitants shall not be less than Eighty thousand (P80,000.00) per annum chargeable against the twenty percent (20%) share of the barangay from the internal revenue allotment, and the balance to be allocated on the basis of the following formula:

- (a) On the first year of the effectivity of this Code:
 - (1) Population — Forty percent (40%); and
 - (2) Equal sharing — Sixty percent (60%)
- (b) On the second year:
 - (1) Population — Fifty percent (50%); and
 - (2) Equal sharing — Fifty percent (50%)
- (c) On the third year and thereafter:
 - (1) Population — Sixty percent (60%); and
 - (2) Equal sharing — Forty percent (40%).

Provided, finally, That the financial requirements of barangays created by local government units after the effectivity of this Code shall be the responsibility of the local government unit concerned.

The allocation of internal revenue is not a gift of the central government. The IRA is a right that accrues to local governments by virtue of the additional responsibilities that they bear under the Constitution. The Supreme Court in *Alvarez v. Guingona, Jr.*²⁰ explained its importance in the following words:

The practical side to development through a decentralized local government system certainly concerns the matter of financial resources. With its broadened powers and increased responsibilities, a local government unit must now operate on a much wider scale. More extensive operations, in turn, entail more expenses. Understandably, the vesting of duty, responsibility and accountability in every local government unit is accompanied with a provision for reasonably adequate resources to discharge its powers and effectively carry out its functions. Availment of such resources is effectuated through the vesting in every local government unit of (1) the right to create and broaden its own source of revenue; (2) the right to be allocated a just share in national taxes such share being in the form of internal revenue allotments (IRAs); and (3) the right to be given its equitable share in the proceeds of the utilization and development of the national wealth, if any, within its territorial boundaries.

The funds generated from local taxes, IRAs and national wealth utilization proceeds accrue to the general fund of the local government and are used to finance its operations subject to specified modes of spending the same as provided for in the Local Government Code and its implementing rules and regulations. For instance, not less than twenty percent (20%) of the IRAs must be set aside for local development projects. As such, for purposes of budget preparation, which budget should reflect the estimates of the income of the local government unit, among others, the IRAs and the share in the national wealth utilization proceeds are considered items of income. This is as it should be, since income is defined in the Local Government Code to be all revenues and receipts collected or received forming the gross accretions of funds of the local government unit.

The IRAs are items of income because they form part of the gross accretion of the funds of the local government unit. The IRAs regularly and automatically accrue to the local treasury without need of any further action on the part of the local government unit. They thus constitute income which the local government can invariably rely upon as the source of much needed funds.²¹

The IRA, therefore, not only attempts to break national government control over local government units, but is also a right that accrues to local

²⁰ G.R. No. 118303, January 31, 1996, 252 SCRA 695.

²¹ *Id.* at 701-702.

governments because of their additional responsibilities under the Local Government Code.

In addition to the IRA, the Constitution and the Code also provide other sources of revenue for local governments. The Constitution provides a basis for the local governments' power to tax²² and mandates their share in the proceeds of the utilization and development of the national wealth within their territories.²³

The Code empowers local governments to negotiate and secure grants or donations from foreign and local assistance agencies,²⁴ and provides for broader taxing and fee-generating powers for all local government units,²⁵ extensive provisions on real property taxation,²⁶ a share in the exploitation of natural resources within their territories,²⁷ and credit financing.²⁸ All taxes and fees accrue exclusively to the local governments generating them.²⁹

The Tax Reform Act of 1997 also provides for additional allotments in favor of local governments.³⁰

²² CONST., art. X, sec. 5.

²³ CONST., art. X, sec. 7.

²⁴ Rep. Act No. 7160 (1991), sec. 23.

²⁵ See Rep. Act No. 7160 (1991), sec. 134-196.

²⁶ Rep. Act No. 7160 (1991), sec. 197-293.

²⁷ Rep. Act No. 7160 (1991), sec. 289-294.

²⁸ Rep. Act No. 7160 (1991), sec. 295-313.

²⁹ Rep. Act No. 7160 (1991), sec. 129.

³⁰ Pertinent provisions of the Tax Reform Act of 1997 provide:

SEC. 283. *Disposition of National Internal Revenue.* — National internal revenue collected and not applied as herein above provided or otherwise specially disposed of by law shall accrue to the National Treasury and shall be available for the general purposes of the Government, with the exception of the amounts set apart by way of allotment as provided for under Republic Act No. 7160, otherwise known as the Local Government Code of 1991.

In addition to the internal revenue allotment as provided for in the preceding paragraph, fifty percent (50%) of the national taxes collected under Sections 106, 108 and 116 of this Code in excess of the increase in collections for the immediately preceding year shall be distributed as follows:

(a) Twenty percent (20%) shall accrue to the city or municipality where such taxes are collected and shall be allocated in accordance with Section 150 of Republic Act No. 7160, otherwise known as the Local Government Code of 1991; and

(b) Eighty percent (80%) shall accrue to the National Government.

SEC. 284. *Allotment for the Commission on Audit.* — One-half of one percent (1/2 of 1%) of the collections from the national internal revenue taxes not otherwise accruing to special accounts in the general fund of the national government shall accrue to the Commission on Audit as a fee for auditing services rendered to local government units, excluding maintenance, equipment, and other operating expenses as provided for in Section 21 of Presidential Decree No. 898.

III. PROPHECIES AND PROBLEMS

It may seem as though these provisions on fiscal autonomy sufficiently increases the resources available to local governments. The provisions on the IRA were hailed by analysts³¹ and they generated high expectations from local officials and the public since the average IRA of local governments from 1987 to 1990 was around 12.7% of the total income revenues of the national government.³²

Economists, claiming that the Code would remedy fiscal constraints, predicted a windfall for local governments by providing for a measure of certainty in local government finance:

Overall, the lending experience of the financial institutions to LGUs was discouraging and borrowing did not play a significant part in the financing of local government activities in the past. There are three plausible reasons for this low borrowing activity: 1) the conservative attitude of most local officials; 2) the low tax base and therefore low borrowing capability of most LGUs; and 3) the uncertainty of the flow of grants to LGUs from the national government.

An important characteristic of the grant system prior to the 1991 LGC is that provinces, cities and municipalities were never sure of the amount they would receive from the central government. A 1993 World Bank study showed that the actual releases from the IRA were significantly lower

The Secretary of Finance is hereby authorized to deduct from the monthly internal revenue tax collections an amount equivalent to the percentage as herein fixed, and to remit the same directly to the Commission on Audit under such rules and regulations as may be promulgated by the Secretary of Finance and the Chairman of the Commission on Audit.

SEC. 285. *Allotment for the Bureau of Internal Revenue.* — An amount equivalent to five percent (5%) of the excess of actual collections of national internal revenue taxes over the collection goal shall accrue to the special fund of the Bureau of Internal Revenue and shall be treated as receipts automatically appropriated. Said amount shall be utilized as incentive bonus for revenue personnel, purchase of necessary equipment and facilities for the improvement of tax administration, as approved by the Commissioner: Provided, That the President may, upon recommendation of the Commissioner, direct that the excess be credited to a Special Account in the National Treasury to be held in the reserve available for distribution as incentive bonus in the subsequent years.

The Secretary of Finance is hereby authorized to transfer from the Treasury an amount equivalent to the percentage as herein fixed and to remit the same directly to the Bureau of Internal Revenue under such rules and regulations as may be promulgated by the Secretary of Finance.

See Rep. Act No. 8424 (1997), sec. 283-285.

³¹ Alex B. Brillantes, Jr., *Local Governments in a Democratic Polity: Trends and Prospects*, in DEMOCRATIZATION: PHILIPPINE PERSPECTIVES 83, 85 (Felipe B. Miranda ed., 1997).

³² Rosario G. Manasan, *Fiscal Decentralization and the Local Government Code*, in DECENTRALIZATION AND ECONOMIC DEVELOPMENT IN THE PHILIPPINES 83, 84 (Joseph Y. Lim & Katsumi Nozawa, eds. 1992).

than the statutory 20 percent ceiling; the releases differed from year to year, averaging about 10 percent of the internal revenues of the third preceding year since 1986; and during the crisis years of the early mid-1980s, actual releases were considerably lower than appropriations, sometimes by as much as 60 percent.³³

Projections showed that the fiscal positions of all local governments under the Code would “improve significantly as a result of the higher IRA” and that all cities and barangays would become major gainers, as well as “an overwhelming majority of provinces and municipalities.”³⁴ The predictions included the following:

- The number of provinces with fiscal difficulty would decrease to three in 1998.
- Only 7 percent of municipalities will not meet the fiscal requirements under the Code and the number of fiscally threatened municipalities will shrink if moderate measures are undertaken.
- Cities are the biggest winner as a result of the new formula for allocating the IRA. In the aggregate, cities will have a consolidated surplus, ranging from P5.5 billion in 1994 to P10.9 billion in 1998.
- The combined surplus of provinces, cities and municipalities could range from P9.0 billion in 1994 to P23.4 billion in 1998.³⁵

By all indications, the improvements under the Code seemed properly designed to address the fiscal difficulties encountered by local governments before 1991.

After the implementation of the Code, however, certain trends started to surface, suggesting that the aims of the Code were not being met. Often, the IRA formula was identified as the culprit. One study explained and criticized the rationale of the formula:

This formula gives greater weight to land area and equal share and less to population than in the past. This is because the GOP wishes to transfer more resources to the sparsely populated (and presumably poorer) areas and less to more densely populated (and more developed) areas. The GOP also

³³ Benjamin E. Diokno, *Financial Reforms and Credit Finance for Local Governments*, in FINANCIAL SECTOR ISSUES IN THE PHILIPPINES 47, 49 (Raul V. Fabela & Kazuhisa Ito eds., 1996).

³⁴ See *id.* at 51.

³⁵ See *id.* at 53.

hopes that such an allocation rule will, at the margin, slow the rural-urban migration, by improving the quality of life in less populated rural areas. As set forth below, however, the available evidence strongly suggests that, because the services devolved to the cities were considerably less costly than the additional IRA funds transferred to them, the cities, on balance, gained more from devolution than the provinces and the municipalities. The attempt to improve rural relative to urban public services to discourage migration from the former to the latter was thus negated, in whole or in part.

The formula for allocating the IRA among levels of local governments and among individual LGUs was based on no other economic grounds. Therefore, the amounts transferred bear no necessary relationship to the actual cost implications of devolved functions. Nor do they take into account the capacity of local governments to raise their own resources or to carry out devolved functions.³⁶

A World Bank study in 1995³⁷ listed six consequences of the IRA formula that should concern the national government:

- 1) Total transfers to the LGUs greatly exceed the cost of devolved functions, thus providing a large number of LGUs with windfall gains of additional discretionary income and jeopardizing the national budget;³⁸
- 2) The IRA allocations to individual LGUs are not based on their need or capacity, and created winners and losers among LGUs;³⁹

³⁶ WORLD BANK, 1 PHILIPPINES: PUBLIC EXPENDITURES MANAGEMENT FOR SUSTAINED AND EQUITABLE GROWTH 42-43 (1995).

³⁷ See *id.* at 43-44.

³⁸ On the whole, the Code devolved more revenues than the cost of the devolved functions. By 1994, transfers to local governments increased to P 46.7 billion from about P 14-16 billion in 1990-1991, an increase of about P 30 billion. The Department of Budget and Management estimated the savings of the national government from devolving functions to local governments at P 6.3 billion in 1992 prices or about P 7.4 billion in 1994 prices. Net resource transfers in 1994, therefore, were as much as P 22 billion (1.4 percent of GNP). See *id.* at 44.

³⁹ The IRA formula has no direct link to the amount of fiscal resources local governments need to finance devolved functions. Local governments received either less resources than they need to perform the functions assigned to them, or more than they need. In addition, because the cities already provided a high level of services on their own before devolution, the cost of functions additionally devolved to them was only P 500 million as opposed to provinces whose additional responsibilities cost them P 3 billion. The transfer of resources that are not tied to devolved functions is, on average, P 100 million for a city, while an average municipality receives P 4 million, and a province receives P 39 million. There is no net resource loser among cities. However, more than 100 municipalities and 27 provinces need to pay more for devolved functions compared to the IRA allocations they receive. Provinces are disadvantaged because of the narrow tax bases and the high recurrent costs imposed on them as a result of higher than average facilities and personnel devolved. There are no mechanisms that would allow the NG to compensate these

3) Regarding sector spending, LGUs are allocating more resources on social services at the expense of economic services, maybe because the national government has not established a clear role for the LGUs and continues to fund some devolved economic services;⁴⁰

4) Devolution has made it difficult for the NG to provide LGUs with incentive to implement development projects that have high benefit spill-over effects or for the national government to channel donor (loan) resources to devolved activities;⁴¹

local governments who incurred net losses from devolution. In the short run, residents of these local governments may have to suffer less adequate levels of public services. *See id.* at 44.

⁴⁰ The study points out that at local government levels, social sector expenditures increased from 29 percent of GNP in 1991 to 71 percent in 1993. But economic services remain stagnant. *Id.* As expected, health expenditures, which were devolved, increased dramatically with higher local government resources. While the rise in health spending for provinces and municipalities may be viewed as imposed because so much of additional health responsibilities have been devolved to them, at least during the early years of the devolution, cities are voluntarily setting aside more resources for health services. Surprisingly, at all levels of local governments, education expenditures (which have not been devolved) not only increased as a percent of GNP but also as a share of the higher LGU spending. Local governments are spending a substantial amount of additional resources on education whenever they can, above the amount earmarked under the Special Education Fund (SEF). *See id.*, at 45-47. Economic services (including rural roads, water, irrigation and agricultural extension) are taking the brunt of adjustment. Provincial spending declined; when real resource availability goes up by 1 percent, provinces reduce real spending on economic services by 1 percent because so much additional spending is needed for health. For municipalities, the elasticity is very close to zero. Spending on general services seems to be the most stable or inflexible-with elasticity at around 0.7 for all LGU levels. The shrinking share of spending on economic services in local governments can be attributed in part to the willingness of the central government to provide resources to devolved functions. These interventions in devolved activities make it difficult to hold the local authorities accountable for their actions with respect to devolved activities. It may also distort the investment decisions of local officials as they tend to wait for Congress to act on these matters. Interviews with local officials make it clear that they would not provide services that central officials are willing to provide—especially services that substitute local provision—be it irrigation, forestry, or other infrastructure facilities. *See id.*, at 47.

⁴¹ Project implementation became difficult in devolved areas partially because local governments cannot benefit from borrowing from outside sources as the national government cannot guarantee LGUs' external borrowing. This also constrains LGUs' access to the expertise and institutional building such projects often provide. At the same time, due to the unconditional nature of the IRA, the national government has not been able to provide local governments with effective incentives to implement activities of national priorities, such as poverty alleviation or environmental protection. It has also become difficult to channel donors' loan resources to local governments in the devolved sectors. The national government is often willing to be a conduit for these resources to local governments, but local governments consider donor projects, especially in areas where full cost recovery is difficult, as primarily national government responsibilities and demand that the national government grant these resources. The national government, however, is averse to on-granting donor loans to local governments claiming that it already provided them with more than adequate financial resources through the IRA. The gridlock has jeopardized preparation and implementation of many projects financed by loans from donors. *See id.*, at 48.

5) Devolution is likely to have reduced local resource mobilization efforts;⁴² and

6) Devolution is likely to make the fiscal system more inequitable.⁴³

Many of the problems that were detected early continue were validated in the last ten years. In addition, a host of other issues are quickly becoming apparent.

IV. IMPLEMENTING THE CODE

Certain trends in the implementation of the provisions on fiscal autonomy are becoming obvious and are calling attention to the need to amend the Code. Among those that are prominent are local government dependence on the IRA, the fragmentation of local government units and the sufficiency and misuse of the IRA.

A. DEPENDENCE

Over the years, the IRA increased as the revenue-collection efforts of the government improved. The National Statistical Coordination Board estimated that the IRA grew about four times from P19.71 billion in 1992 to P85.22 billion in 1999.⁴⁴

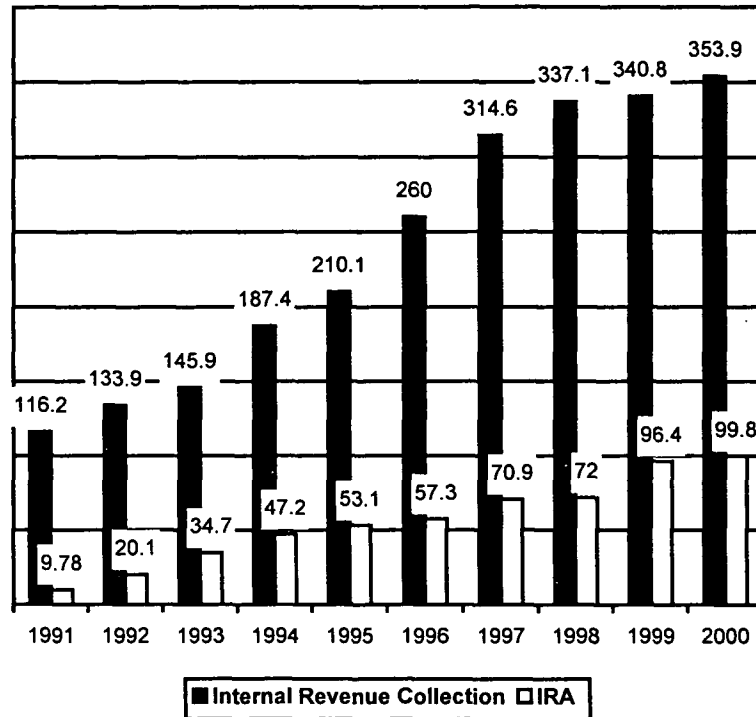
Slightly different figures from the Bureau of Treasury show a similar trend, as can be seen from the figure below.

⁴² Local revenue efforts appear to decline with higher IRA resources. In 1992 the collection rate of the real property taxes fell about 10 percentage points for all LGUs. *See id.*, at 48. When local government income is augmented by transfers from the national government residents want both increased public service provision and increased consumption of private goods-the latter comes from paying lower taxes. *See id.* at 49.

⁴³ The IRA has not contributed to its equity objectives including, provision of more resources to the poor or poorer LGUs; provision of resources according to the fiscal needs; or provision of resources to equalize the level of supply of critical services across the country. IRA resources are being channeled primarily to those LGUs who already have more fiscal resources than others. Efforts to shift the IRA allocation weights away from the population and more towards land area has yet to show significant effects on poverty alleviation. *See id.*, at 50.

⁴⁴ National Statistical Coordination Board, NSCB STATISTICS SERIES, No. 2000-003 (December 2000), at 4.

Figure 1. Internal Revenue Collection and Allotment in Billion Pesos



Source: Bureau of Treasury

It should be stressed, however, that the 40% that local governments receive is based on revenue collections from three years before. As such, the increase may be diluted by inflation and other rising costs.

That local governments derive benefit from the IRA is clear. Because of the IRA, local governments now spend more per capita than prior to the enactment of the Code. The NSCB's study on 1999 figures reveals that there are

in fact greater fiscal resources available to local government units.⁴⁵ Some local governments that clearly benefit from the IRA are listed below:

Table 1: Top Provinces in terms of Financial Resources				
Rank	Provincial Government	Local Resources Per Capita (Pesos)	IRA per Capita (Pesos)	1999 Total Financial Resources per Capita (Pesos)
1	Batanes	5,620.20	5,5562.4	11,182.59
2	Kalinga	4,895.60	1,041.10	5,936.74
3	Quirino	850.60	1,107.00	1,957.62
4	Apayao	22.30	1,627.30	1,649.55
5	Camiguin	38.10	1,323.5	1,361.64

Table 1 emphasizes the impact of the IRA on local government expenditure. From 1985-1991, total receipts of local governments amounted to 1.7 percent of the gross national product (GNP), divided equally between local and external sources of revenue, the latter being almost exclusively from the IRA.⁴⁶ In 1992-1997, after the Local Government Code went into effect, external revenues expanded from 52.0 percent in the earlier period to 64.7 percent after 1992. Local government income from external sources increased from 0.9 percent to 2.2 percent of GNP. Local revenues moved upwards from 0.8 percent to 1.2 percent of GNP.⁴⁷ The ratio of local revenue to the GNP increased during the effectivity of the Code, only in cities.⁴⁸ In every local government unit, the share of externally generated revenue expanded between 1992-1997.⁴⁹

⁴⁵ *Id.*

⁴⁶ William Loehr & Rosario Manasan, *Fiscal Decentralization and Economic Efficiency: Measurement and Evaluation*, CAER II Discussion Paper No. 38 (February 1999), at 24, available at <http://www.hiied.harvard.edu/caer2/htm/content/papers/confpubs/paper38/paper38.htm>.

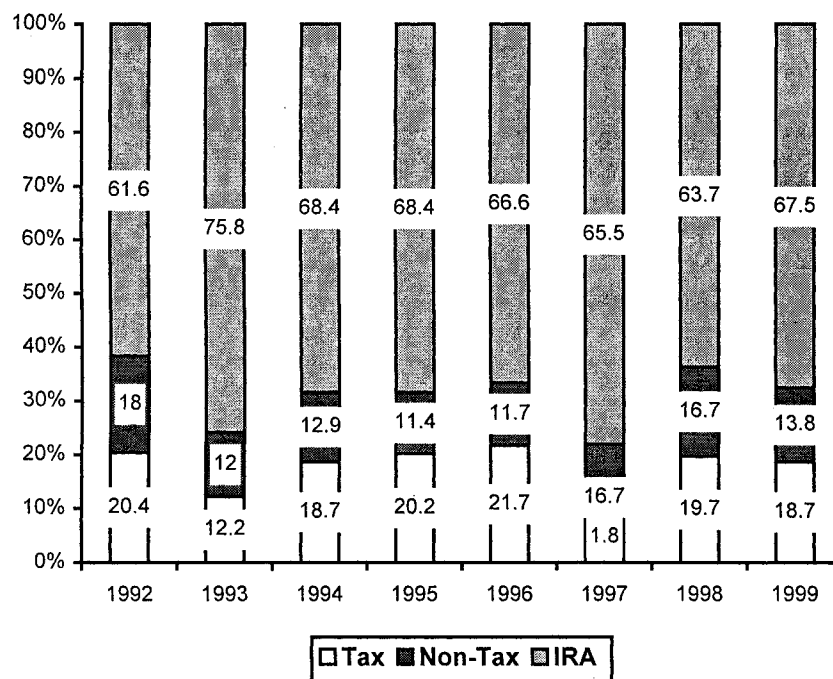
⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.* at 25.

The IRA increased steadily from 19.71 billion pesos in 1992 to 85.2 billion in 1999. On the average, the IRA grows at 23.3% compared to tax at 20.3% and non-tax revenues at 17.1% (See Figure 2).

Figure 2. Percentage of Tax, Non-Tax, and IRA to Total Government Collections (1992-1999)



Source: National Statistical Coordination Board

Figure 2 shows that the IRA made up more than 75% of local government income in 1993. Non-tax revenues never exceeded its 1992 figure of 18%, and has steadily declined. Tax revenues, on the other hand, peaked once in 1996 (to reach 21.7%), only to plummet sharply in 1997 to its lowest level at a mere 1.8%.

These figures do not necessarily mean that local governments are forgoing other avenues for revenue-generation. The fact that the IRA increases every year would naturally reflect higher figures from external sources. However,

as earlier explained, the studies do show that tax collection rates did fall after the Code took effect.

In particular, real property tax is now an unreliable source of local government income because of outdated property assessments, incomplete inventories of or real property, land ownership disputes, antiquated administrative tools, tax amnesties (which encourage non-payment of taxes), high collection costs (due to small property size, low taxes, and difficult topography), and weak collection incentives.⁵⁰

Not surprisingly, recent data provided by the NSCB indicate great reliance on the IRA. In 1999, local governments depended on the IRA for more than 2/3 of their income. In the same year, 70 of the 78 provinces depended on the IRA for up to 50% of their income. Table 2 shows provinces that are dependent on the IRA from around 96 to 100% of their total revenue.⁵¹

Table 2. Local Governments Dependent on the IRA	
Province	1999 % of the IRA to Total Financial Resources
	Percent
Abra	96.8
Apayao	98.6
Camiguin	97.2
Compostela Valley	100.0
Ifugao	95.9
Ilocos Sur	97.9
Lanao del Sur	100.0
Sulu	98.4

Dependence on the IRA is creating other problems. Since cities are clearly at an advantage under the IRA formula, many municipalities are being converted into cities. The following table clearly illustrates the disparity in the allocation of internal revenue to local government units:

⁵⁰ Lochr & Manasan, *supra* note 46, at 39.

⁵¹ National Statistical Coordination Board, NSCB Statistics Series, No. 2000-003, December 2000, Annex "D."

Table 3. 1999 IRA Allocation to Local Government Units					
	Guaranteed Share (in billion pesos)	Local Government Service Equalization Fund (LGSEF)	Share Based on Section 285 of RA 7160		Total IRA Share (billion pesos)
			(billion pesos)	% share	
Provinces	2.935		19.600	23.0	22.535
Cities	0.77		19.600	23.0	20.370
Municipalities	2.856		28.975	34.0	31.831
Sub-total	6.561		68.175		74.736
Barangays			17.044	20.0	17.044
LGSEF		5.000			5.000
Total	6.561	5.000	85.219		96.780

Source: Local Budget Memorandum No. 31, CY 1999 Department of Budget and Management (DBM)

Proponents usually justify the increase in the number of cities as a means of improving the delivery of basic services. However, officials at the Department of the Interior and Local Government Bureau of Local Government Supervision (DILG-BLGS), say that "[t]he IRA is the main reason why LGUs vie for cityhood. There's a lot of monetary benefits involved."⁵²

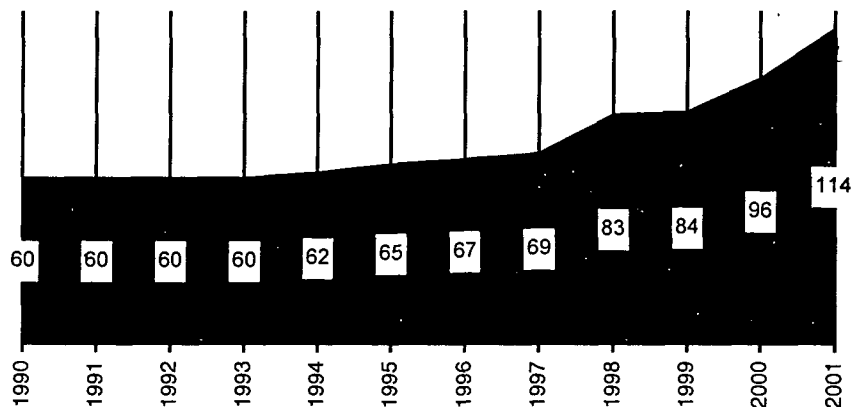
⁵² Cecille E. Yap, *Conversion of Towns Into Cities: The Lure of the City*, BUSINESS WORLD, September 10, 1996, at 1.

B. FRAGMENTATION

The attractiveness and availability of the IRA also fuels the fragmentation of local government units. In 1986, there were 73 provinces, 60 cities, and 1,530 municipalities in the country.⁵³

Of late, there has been an unprecedented rise in the number of local governments that are “upgraded” into cities. The trend continues. On March 5, 2001, less than two months into office, President Arroyo signed 14 bills on the conversion of municipalities into cities,⁵⁴ some of which were already approved by residents. The trend is clearly towards “cityhood.” (See Figure 3).

Figure 3. Number of Cities, 1990-2001



Source: National Statistical Coordinating Board

From 1993 to 2001, 54 cities were created increasing the number of cities by 90%.

The trend is alarming government officials. DILG Assistant Secretary Alexander Padilla criticized Congress for creating new local government units, which are spreading scarce resources thinly among the local government units. He

⁵³ Raul P. de Guzman, Mila A. Reforma & Elena M. Panganiban, *Local Government, in GOVERNMENT AND POLITICS OF THE PHILIPPINES* 207, 208 (Raul P. de Guzman & Mila A. Reforma eds., 1988).

⁵⁴ Marichu Villanueva, *Arroyo Signs 16 Local Measures Into Law*, PHILIPPINE STAR, March 6, 2001, at .

added that the creation of additional local government units should be discouraged because of the pressure it exerts on the country's revenues and the bureaucratic problems it will pose. He also said that the IRA remained almost constant, and in many cases, officials of the newly created government units have reported problems of allocations. He believed that Congress is aware of the impact of the continuous creation of cities but "Congress does not care," he said.⁵⁵ "This is a politicized activity, maybe to win more votes or to accommodate interests."

This trend is costly for both the new local government as well as the affected units. The creation or conversions of local government units entail costs not only for the new local government unit, but the affected units. The following table tabulates these costs:

Table 4. Initial Cost Estimates of Fragmentation ⁵⁶		
Local Government Units	Total Costs	Cost to other Local Government Units
Barangays	8,616,777	357,492
Municipality	63,718,255	8,592,800
Province	225,477,935	85,947,864

Source: Department of Interior and Local Government, Bureau of Local Government Supervision

The BLGS explains that the "costs" in creating local government units are those resulting from a reduction of the IRA and other taxes otherwise available to the "mother" local government.

It should also be emphasized that many of these local government units are not financially stable. DILG records show that 16.6% of provinces and 13.4% of cities belong to the 4th and 5th class income levels. 68% of municipalities fall between 4th and 6th class categories. These local governments are have scarce resources and are dependent on the IRA.⁵⁷

⁵⁵Manuel Cayon, *Congress Hit for New LGUs*, TODAY, available at <http://www.adobo.com/news/to-day/-article.asp?article=10644&source=176&newssec=145>.

⁵⁶ See Bureau of Local Government Supervision, *Fragmentation vs. Consolidation: The Case of Philippine Local Governance* (1999).

⁵⁷ Bureau of Local Government Supervision, *Fragmentation vs. Consolidation: The Case of Philippine Local Governance* 2 (1999).

Although a local government will benefit from conversion into a city, this is accomplished only by reducing the allocations of other local governments since the source of the IRA remains the same. Such conversion increases overhead expenses of the new cities and in turn reduces the budget for basic social and economic services.⁵⁸

Fragmentation also reduces a local government's tax base, which necessarily leads to a corresponding reduction in local income. In other words, without a corresponding increase in the number of taxable entities, local governments cannot increase locally generated revenue. This could explain why—as officials of the Department of Finance claim—local government officials are “totally dependent” on their IRA and are neglecting other revenue-generating mechanisms that are available.⁵⁹

C. SUFFICIENCY

The effects of the IRA formula are clear. Its bias towards cities encourages the massive conversion of local government units into cities. Some 110 cities, therefore, receive an inordinate amount of internal revenue collections from the national government. The creation of cities also leads to administrative expenses and the loss of revenue generation among neighboring local government units. While cities enjoy increased financial resources, other local governments suffer losses in their revenue bases.

Local officials are actively lobbying for amendments to the Code ostensibly to provide “genuine local autonomy and decentralization.”⁶⁰ The League of Municipalities of the Philippines (LMP) has been pushing for an increase of their share of the IRA to 50%. The increase, would allegedly “translate to effective delivery of basic services and more development projects to attract investments and generate employment opportunities in the countryside.”⁶¹

⁵⁸ Bureau of Local Government Supervision, *Fragmentation vs. Consolidation: The Case of Philippine Local Governance* 34 (1999).

⁵⁹ Manolo A. Serapio, Jr., *Most Local Government Execs 'Totally Dependent' On IRA*, BUSINESS WORLD, November 1, 1994, at 10.

⁶⁰ Francis Jay M. Bilowan, *Local Officials To Push For Code Amendments, Want Administrative Control of Police Forces*, MANILA TIMES, October 6, 1999, available at <http://www.manila-times.net/1999/oct/6/provincial>.

⁶¹ *Amendments To Local Gov't Code Sought On Its 8th year*, PHILIPPINE DAILY INQUIRER, October 26, 1999, at 5.

The Union of Local Authorities of the Philippines (ULAP)⁶² echoes these demands. Then ULAP President Joey Lina said that local executives are asking for the speedy passage of “badly needed” amendments as well as other measures to enhance the principles of local autonomy and devolution. ULAP’s “Priority Legislative Agenda” puts primacy on fiscal issues. On top of its list are the following:

I. Rationalize the Internal Revenue Allotment (IRA) share of LGUs

1. Broaden the share of LGUs in national taxes;
2. Rationalize the sharing scheme;
3. Provide a more equitable sharing scheme among LGUs.

II. Rationalize the share of LGUs in the National Wealth

1. Broaden the share of LGUs in the proceeds in the utilization and development of national wealth;
2. Ensure transparency in the collection and distribution scheme;
3. Give latitude, consistent with local autonomy, to LGUs in the use of the share.⁶³

⁶² ULAP was formed by officials of the leagues of provinces, cities, municipalities; vice governors league; vice mayors league; provincial board members league; councilors' league; lady local legislatures league; Philippine councilors league; national movement for young legislators; liga ng mga barangay; and the pederasyon ng sangguniang kabataan. ULAP was formed to unite all the Leagues to promote and protect the concerns and general welfare of the local government units, obtain the true essence and goals of decentralization and genuine local autonomy, and ensure the smooth and efficient delivery of basic services to its constituents. Data regarding the Union of Local Officials of the Philippines may be obtained from the ULAP's website at <http://www.ulap.org.ph/ulap.html>.

⁶³ The other items on the ULAP's agenda are as follows:

- III. Localizing the authority over children's rights
 1. General Welfare clause to include children's rights;
 2. Legislative Committee on Women, Children and Family;
 3. Creation of Local Councils for Children;
 4. Expand powers of local Sanggunians to ensure the survival, development, protection and participation rights of children;
 5. Masterlisting of children for child-friendly programs.
- IV. Broaden the devolved powers of LGUs
 1. Expand the concept of general welfare clause to expressly authorize, pursuant to local autonomy, LGUs to exercise those powers not otherwise prohibited by law;
 2. Remove the power of control of DENR over community-based Forestry projects;
 3. Redefine “Devolution” to include powers devolved under RA 7160;

Evidently, financial issues are among the ULAP's concerns. Local officials justify their lobby on the ground that this increase would improve the delivery of basic services to local communities.

This campaign to amend the Code, however, is anchored on certain presumptions that are not adequately supported by studies.⁶⁴ There are research gaps in the quality of services at the local level, and the resource mobilization efforts of local government units. The Philippine experience alone is unable to establish this causal link between decentralization and better services at the local level.⁶⁵ Across provinces in the Philippines, the resources of local governments have a mild impact on family incomes, expenditures per capita, and poverty incidence. The figures are "statistically insignificant."⁶⁶

On the whole, there has been no systematic evaluation of local government performance in service delivery or poverty alleviation. Evidence of

4. Add to the list of corporate powers of LGUs the power to create Private corporations and quasi-municipal corporations in conjunction with the hierarchical relations of LGUs;

5. Expressly delegate the following powers/ basic services to LGUs:

- Public Works funded from national and local funds;
- Low cost Housing for municipalities;
- Regulation of Lotto, casinos and jai-alai;
- Formulation of Labor policies/standards on women/minors;
- Implementation of Comprehensive Agrarian Reform Program;
- Regulation of intra-local operations of jeepneys and buses;
- Provincial Public Utilities.

V. Local Autonomy to include the right and duty of LGUs to define its own Organizational Structure

1. The Salary Standardization Law be not applicable to LGUs;
2. LGUs shall define its own organizational structure and determine and employ its own personnel and set its own wage scales and benefits;
3. Minimize if not eliminate the "mandatory positions" to LGUs;
4. Delete the 45% / 50% cap on personnel administrative costs.

VI. Give more powers to LGUs over local police forces while adhering to the 'one civilian national police' policy

1. Provinces, Cities and Municipalities, at the first instance, be given administrative supervision (i.e. hiring, firing, transfer) over local police personnel, subject to the review and approval by the NAPOLCOM;
2. In addition to the annual quota given, LGUs may employ additional police personnel, if needed;
3. The hierarchical relations between LGUs;
4. In the adoption of public safety plans and peace and order activities, the Province must be accorded coordinative supervisory functions and responsibilities.

⁶⁴ See Steven Rood, *An Assessment of the State of Knowledge Concerning Decentralized Governance under the Philippines' 1991 Local Government Code*, 52 PHIL. J. PUB. ADMIN. 58 (1998).

⁶⁵ *Id.* at 77.

⁶⁶ Ruperto P. Alonzo, *Local Governance and Poverty Alleviation*, in CAUSES OF POVERTY: MYTHS, FACTS & POLICIES 197, 215 (Arsenio M. Balisacan & Shigeaki Fujisaki eds., 1999).

improved performance is largely anecdotal, and worse, questions are being raised about the local governments' capacity to deliver agricultural extension, primary health and road maintenance services.⁶⁷

In the Philippines, where the fiscal system is highly centralized, decentralization understandably becomes attractive. Studies of 1998 figures showed that more than 90% of the Philippines' revenues are generated by taxes. Of this amount, almost 40% are revenue taxes.⁶⁸ Most of the taxes are collected and spent by the national government. Local governments, on the other hand, rely mostly on real property taxes for locally-generated revenue, although "the administration of these taxes is rather weak and is mostly based on outdated property and land values."⁶⁹

It makes sense, therefore, to suggest that local officials who are closer to the realities experienced by their constituencies should be more sensitive to their actual needs and should be better equipped to deal with these concerns. Theoretically, if they had the resources to address these issues, government would become more responsive. Decentralization emerges as the logical solution to the country's problems.

Proximity to the people, however, does not necessarily mean effective local government. The World Bank claims that there is scarcely any evidence to support this contention.⁷⁰ Efficiency in service delivery, according to the study, requires not only the fiscal capability to deliver services, but also "the willingness of subnational governments to improve income distribution within their borders."⁷¹ Worldwide trends in decentralization found difficulty in establishing a causal link between greater decentralization and the improvement in the delivery of basic services.

Clearly, decentralization does not lead to the automatic improvement in the delivery of services. The impact of decentralization on service delivery depends on its design and the prevailing institutional arrangements, as one study argues:

⁶⁷ THE WORLD BANK, PHILIPPINES GROWTH WITH EQUITY: THE REMAINING AGENDA 83 (2000).

⁶⁸ Nanak Kakwani & Hyun Son, On Pro-Poor Government Fiscal Policies: With Application to the Philippines, paper presented at the Asia and Pacific forum on Poverty: Reforming Policies and Institutions for Poverty Reduction, February 5-9 2001, at 9.

⁶⁹ *Id.* at 10.

⁷⁰ THE WORLD BANK, *Decentralization: Rethinking Government*, in WORLD DEVELOPMENT REPORT 1999/2000: ENTERING THE 21ST CENTURY 107, 109-111 (1999).

⁷¹ *Id.* at 110.

[D]ecentralization may work best, in socially and economically homogenous communities; and the devolution of the power to tax can create vertical externalities in terms of tax rates that are too high. The most sensible form of decentralization may therefore be to create local democratic governments, match jurisdictional design to communal lines, and to primarily devolve expenditures rather than taxes.⁷²

There are in fact those who say that the IRA is sufficient for purposes of meeting the costs of devolved functions. As one study points out:

Most of those involved in or closely observing local government say that the IRA has not proven adequate to their needs. Obviously, local officials in particular have an interest in saying this. Moreover, according to one respected public finance expert, this claim is actually wrong: "...the increment in the aggregate IRA of provinces... cities... and municipalities... exceeds the cost of devolved functions and other mandates even if one adjusts said costs for inflation and population growth." The numbers show that the provinces in the aggregate have been net winners from fiscal decentralization, and Mindanao has reaped the largest of these windfalls.⁷³

Perhaps the perceived deficiency of the IRA is a result of less a vertical imbalance—a mismatch between devolved responsibilities and funding—and more of a horizontal imbalance. That is to say, that the problem lies in the distribution of the IRA among the local government units. In fact,

Several authors (e.g., Manasan (1997 and 1999) and Miller (1997)) report mismatches not only in the vertical allocation of resources across levels of government but also in horizontal allocation across jurisdictions within each level.... For example, per capita net resource transfer is the highest for cities and the lowest for provinces. Mindanao (with 17% of GDP and 24% of population) captured 27.2% of IRA, but contributed only 9% of internal revenue collections (Manasan 1999). Per capita IRA varies by a factor of 23 times between the top and bottom recipient provinces (Miller 1997).⁷⁴

⁷² Omar Azfar, *et al.*, *Decentralization, Governance and Public Service: The Impact of Institutional Arrangements*, IRIS Center, University of Maryland, College Park, September 1999, at 28. This is not to suggest that local officials ignore the preferences of their constituents. Local governments "appear to be fairly aware of local preferences but in most cases cannot break out of the procedural, resource, and governance constraints that prevent them from responding." See Omar Azfar, *et al.*, *Conditions for Effective Decentralized Governance: A Synthesis of Research Findings*, IRIS Center, University of Maryland, March 13, 2001, at 75.

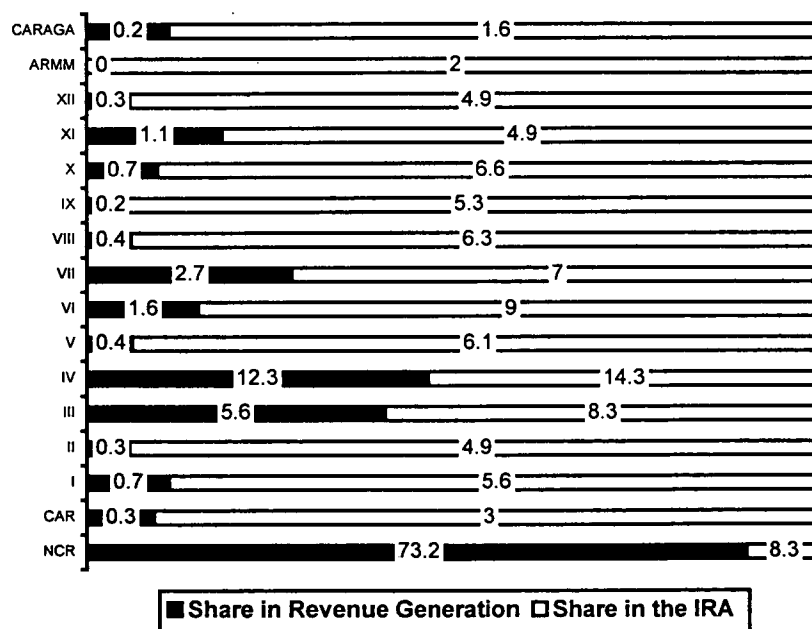
⁷³ Omar Azfar, *et al.*, *Decentralization and Governance: An Empirical Investigation of Public Service Delivery in the Philippines*, IRIS Center, University of Maryland, College Park, December 19, 2000, at 52.

⁷⁴ *Id.* at 53.

On the whole, while provinces and municipalities received 57% of revenue transfers, they bear 92.5% of the costs of devolution. Cities and barangays received 47% of revenue transfers, while shouldering only 7.5% of the costs.⁷⁵

There appears to be some truth to the contention that there is a horizontal imbalance in the distribution of the IRA. The National Capital Region generates an inordinate amount of revenue while receiving a relatively small portion of the IRA.⁷⁶

Figure 4.
Shares in Revenue Collections and IRA
by Region in percent (1999)



⁷⁵ Thomas Bossert, *et al.*, *Decentralization of Health Systems: Preliminary Review of Four Country Case Studies*, Major Applied Research 6, Technical Report 1, January 2000, at 61.

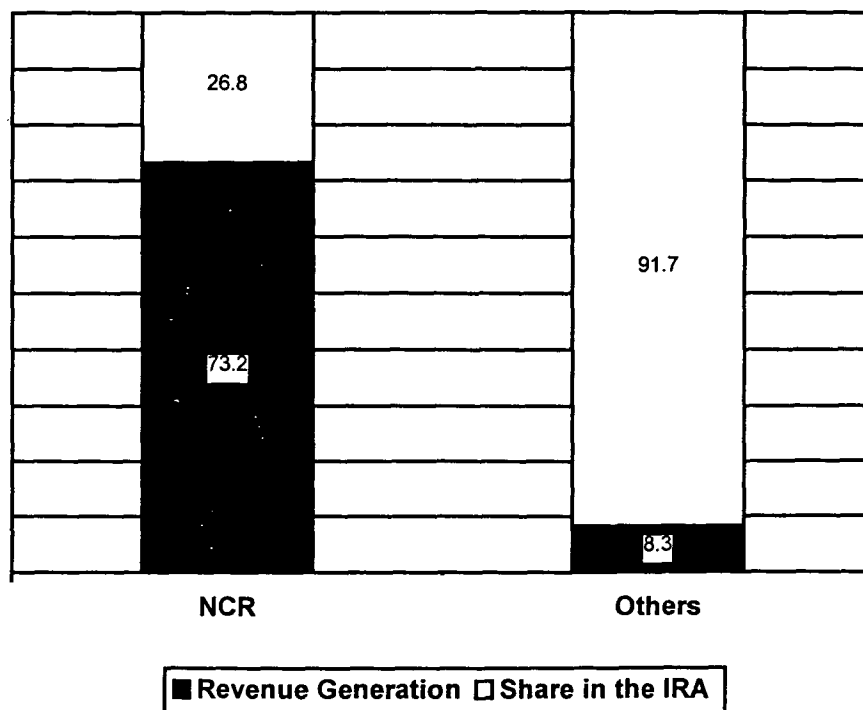
⁷⁶ National Statistical Coordination Board, NSCB Statistics Series No. 2000-003, December 2000, at 13.

As Figure 4 illustrates, the National Capital Region contributed 73.2 % of the national revenues and received only 8.3% of the IRA. On the other hand, Region III produced 5.6% of the revenues and received the same amount as did the NCR. The most extreme example is the case of the Autonomous Region in Muslim Mindanao (ARMM), which contributed nothing to national revenues, yet received 2% of the IRA.

The only thing close to a “balance” pertains to Region IV that generated 12.3 of the country’s total revenues and received 14.3 of the IRA.

In fact, of the 16 Regions in the Philippines, 10 Regions contributed less than one percent of total revenues, and together managed to produced only 3.5% of total revenues in 1999. Indeed, all other Regions outside the National Capital Region contributed 26.8% of the national revenue while they received 91.7 percent of the IRA. (See Figure 5)

Figure 5.
Revenue Generation and IRA Share in Percent (1999)



This is not to criticize the other regions for failing to contribute to the generation of income. It should be emphasized that the IRA is distributed to provinces (23%), cities (23%), municipalities (34%), and barangays (20%). Since the NCR comprises a relatively small collection of local governments, it cannot expect to receive a proportional share of the IRA. It should be added that within the classes of local governments, the IRA is divided based on population (50%), land area (25%), and on "equal sharing (25%). Again, since the NCR is a small portion of the country, most of the IRA would then be disbursed to the other regions.

The figures may also be used to show that the over centralized form of government in the Philippines concentrated revenue-generation to the NCR while the rest of the country remained impoverished. Thus, the concentration of local governments within the NCR can produce most of the country's revenues, while vast areas in Mindanao are incapable of making contributions. This further suggests that most of the population is in economically depressed areas relative to the NCR. If anything, the figures bolster the argument that the IRA formula should be reconsidered if only to ensure that the financial transfers should lead to revenue generation throughout the country. Or else, this pattern will continue and Regions like the ARMM will continue to be dependent on the national government for financial resources.

The view that resources are insufficient can be explained if this is interpreted in the proper context:

First, LGUs want more flexibility than the IRA allows, and they tend to look on it as one of many fiscal sources that can help them meet their particular preferences. Thus, although IRA allotments may exceed the costs of devolved services as budgeted by the center or as spent by local governments, mayors and governors view it as inadequate to their needs, even when they divert IRA funds from devolved functions to their own preferred programs. Raising local taxes or improving local tax enforcement would be a politically painful step that local governments avoid to the extent possible. This leaves them with a fiscal gap in funding their public service priorities.⁷⁷

This could explain why there is a perception regarding the alleged insufficiency of the IRA.

⁷⁷ Azfar, *supra* note 72, at 52.

The second major caveat here is that the large distribution of grants has meant relatively low levels of local fiscal autonomy, which frequently create adverse governance incentives. Overall, externally-sourced LGU revenues grew from 53 % in 1988 to 67% 1995 (NTRC 1997). Fiscal autonomy ratios (the ratio of local own revenues to local expenses) fell in the years following the onset of decentralization, from 52 to 39 percent in the aggregate. During 1992-7, these ratios averaged 50% for cities, 33 % for municipalities, and 22% for provinces. As one would expect, regressions show a negative correlation between local tax effort and IRA per capita. Data on local property and business taxes for 1992-3 and 1996-7 suggest that the IRA has *substituted* for local revenue-raising, thus creating a disincentive to fiscal effort (Loehr and Manasan 1999, Manasan 1999). One reason for concern here is that fiscal autonomy varies widely across the Philippines. Per capita local source revenue varies by a factor of 83 times, and financial autonomy ratios vary by 40 times, between the poorest and richest provinces. The 1994 ratios ranged from 1.2% in Maguindanao to 44.2% in Bataan (Miller 1997). Interestingly, these factors did not prevent an overall rise in LGU tax effort and capital outlays from the pre-decentralization period until the mid-1990s (Manasan 1999).⁷⁸

The local officials' reluctance to exploit the other available, if unpopular sources of revenue fuels the perception that the IRA is insufficient. Since the IRA is automatically released, local officials tend to depend on this amount to finance the local government expenses.

In any case, do these figures show that local officials are correct in asserting that the infusion of income is a step toward improved delivery of services? The evidence is not conclusive either way.⁷⁹ Horizontal imbalances account for the diversity of experiences under the Code. In practice, the IRA seems to be transferred to wealthier local governments. The formula—being unrelated to the actual cost of delivering devolved functions or the prevailing needs in different parts of the country—does little to equalize the satisfaction of needs across local governments.⁸⁰ Some say less attention should be spent on wondering whether the resources that are transferred to local governments are sufficient. Rather, attention should be directed towards ensuring that local governments have the administrative structures that can address the responsibilities devolved to them.⁸¹

⁷⁸ *Id.* at 53.

⁷⁹ THE WORLD BANK, *supra* note 67, at 84.

⁸⁰ *Id.*

⁸¹ *Id.*

D. MISUSE

For all the claims local officials make to secure their internal revenue allotments, local governments allegedly misused their IRA. Recently, the government discovered that local officials used their IRA to finance their vacations to Baguio City.⁸²

A report from the Commission on Audit (COA) showed that there is also a nationwide pattern of local government misuse of the 20% Development Fund mandated by the Local Government Code. The fund is being manipulated as “unsupervised mini-pork barrel” for tourism projects, bands, and to cover the expenses of boy scouts.⁸³

The COA has been reporting on this practice for years. In a report on the utilization of IRAs for 1993 and 1994, the COA said the 20% development fund of several LGUs were “not actually utilized” for development projects as mandated under Section 287 of the Code. Instead, many local governments use their development funds to finance unauthorized expenses of their officials, or those, which can be charged against the local officials’ maintenance and other operating expenses. Worse, some LGUs did not utilize or under-utilized their funds due to lack of development programs.⁸⁴

In response to this report, the DILG issued Memorandum Circular No. 95-216, which provided for guidelines on the utilization of the development fund. In that circular, the DILG allowed the use of the fund on programs, projects, and activities that generate jobs and livelihood opportunities, which must be reflected in their annual investment plans. Unexpended amounts should be appropriated to finance only such projects for the following year.⁸⁵

In fairness to local officials, the COA’s criteria for their reports have been criticized as skewed in favor of infrastructure-related projects. Given this bias, local officials find it difficult to get livelihood and capability-building projects approved by the COA. LMP officials pointed out that the bias for these projects

⁸² *Lakbay Aral Program Junked*, Manila Bulletin, January 17, 2000, at 1 and 6.

⁸³ *COA Documents Show LGU’s Misuse Of Development Funds*, BUSINESS WORLD, December 23, 1999, at 15.

⁸⁴ Esther C. Tanquintic, *LGU’s Using Dev’t Budget For Other Expenses—COA*, BUSINESS WORLD, August 14, 1995, at 12.

⁸⁵ See SOFRONIO B. URSAL, PHILIPPINE LAW ON LOCAL GOVERNMENT TAXATION 409-411 (2000).

prevents local governments from conducting bottom-up planning as mandated by the Code.⁸⁶

While there is some truth to the charges made by local officials,⁸⁷ allegations on the misuse of the IRA and the "development fund" are serious. Local governments have to address these charges before they can earn credibility in their campaign to increase their share in national taxes.

V. THE SIEGE ON THE IRA

A. *Presidents and Precedents*

Whatever the effects of the IRA on local government revenue-generation, the national government seems intent on withholding the funds from local governments. For example, on December 27, 1997, then President Fidel V. Ramos issued Administrative Order No. 372, which required local government units to reduce their expenditures by 25% of their authorized regular appropriations for non-personal services. It also withheld 10% of the IRA of local government units.⁸⁸ President Estrada issued Administrative Order No. 43 reducing the amount withheld from the local governments to 5%.

Senator Aquilino Pimentel filed a petition with the Supreme Court questioning the validity of Administrative Order No. 372 insofar as local governments are concerned. First, Pimentel asked the Supreme Court to annul

⁸⁶ Cecille E. Yap, *COA, Local Chief Executives Clash On Funding Priorities*, BUSINESS WORLD, August 29, 1996, at 12.

⁸⁷ Local governments are often judged based on increased income, leaving out the concept of human development. Studies show that local officials "are validating concerns that in the country's gray cities and municipalities, the most preferred investments are those that produce literally 'concrete' results: buildings, business districts, factories . . . with a basketball court thrown in for good measure." Already saturated, Manila is now turning away migrants and investments that are being absorbed by new cities and industrial centers. The new destinations, however, seem oblivious to the problems that are plaguing Manila, and are replicating the pavement-is-progress approach to local government. Once more, they fail to see human resources development as an investment in itself. See Roby Alampay, *The problem with cities, and the bias for concrete progress*, TODAY, May 14, 1999, at 7.

⁸⁸ The pertinent provisions of the Administrative Order No. 372 are as follows:

SECTION 1. All government departments and agencies, including state universities and colleges, government-owned and controlled corporations and *local governments units* will identify and implement measures in FY 1998 that will reduce total expenditures for the year by at least 25% of authorized regular appropriations for non-personal services items, along the following suggested areas...

SECTION 4. Pending the assessment and evaluation by the Development Budget Coordinating Committee of the emerging fiscal situation, the amount equivalent to 10% of the internal revenue allotment to local government units shall be withheld.

Section 1 of Administrative Order No. 372, insofar as it requires local government units to reduce their expenditures by 25 percent of their authorized regular appropriations for non-personal services. He argued that Section 1 of the Order is in effect a form of "control" over local government officials prohibited by the Constitution. The government defended the Order by asserting that Section 1 was a mere act of "supervision."

Second, Pimentel asked the Court to enjoin the responsible government officials from implementing Section 4 of the Order, which withholds a portion of the internal revenue allotments of local government units. Pimentel claimed that Section 4 violated the Constitution and the Local Government Code because it prevents the automatic release of the IRA. The government, on the other hand, argued that the withholding of the IRA under Section 4 was merely temporary, and, therefore, did not amount to a violation of the laws.

On July 19, 2000, the Supreme Court promulgated its decision in the case of *Aquilino Q. Pimentel Jr., v. Hon. Alexander Aguirre and Emilia Boncodin*,⁸⁹ invalidating the orders of both Presidents. The Court explained that while the President is the head of the economic and planning agency of the government the formulation and the implementation of policies and programs are subject to "consultations with the appropriate public agencies, various private sectors, and local government units."⁹⁰

The Supreme Court saw nothing wrong with Section 1 of the Administrative Order, explaining that the provision is merely "an advisory to prevail upon local executives to recognize the need for fiscal restraint in a period of economic difficulty,"⁹¹ and that no legal sanction may be imposed upon local government units and their officials who do not follow such advice.

The Supreme Court decided, however, that Section 4 of Administrative Order No. 372 violates "a basic feature of local fiscal autonomy"⁹²—which is the automatic release of the shares of local governments in the national internal revenue.

According to the Court, the Local Government Code specifies that the release of the IRA shall be made directly to the LGU concerned within five days

⁸⁹ G.R. No. 132988, July 19, 2000, 336 SCRA 201.

⁹⁰ *Id.* at 220.

⁹¹ *Id.*

⁹² *Id.*

after every quarter of the year. The Code also provides that the IRA "shall not be subject to any lien or holdback that may be imposed by the national government for whatever purpose."⁹³ The Court held that the word "shall" is a word of command that must be given a compulsory meaning. "The provision is, therefore, imperative."⁹⁴

The Court brushed aside the government's defense that the withholding of the IRA was merely temporary:

Although temporary, it is equivalent to a holdback, which means "something held back or withheld, often temporarily." Hence, the "temporary" nature of the retention by the national government does not matter. Any retention is prohibited.

Section 4 thereof has no color of validity at all. The latter provision effectively encroaches on the fiscal autonomy of local governments. Concededly, the President was well-intentioned in issuing his Order to withhold the LGUs' IRA, but the rule of law requires that even the best intentions must be carried out within the parameters of the Constitution and the law.

While *Pimentel* is a clear victory for local autonomy, other Presidential directives continue to control the IRA. Local officials have asked President Arroyo to revoke three executive orders issued by former President Estrada which, they insist, violate *Pimentel v. Aguirre*. They claim that Executive Order No. 189 withholding 20% of the LGUs' IRA as development fund prior to submission of the annual investment plan; Executive Order No. 190 deducting from the IRA share the LGUs' payments to GSIS and other financial institutions; and Executive Order No. 250 mandating LGUs to budget for anti-drugs campaigns, infringe on fiscal autonomy and sets restrictions on the use of LGUs' funds.⁹⁵ President Arroyo repealed all three Executive Orders.⁹⁶

⁹³ *Id.* at 221.

⁹⁴ *Id.*

⁹⁵ Union of Local Authorities of the Philippines League of Provinces, *Local Officials Support GMA And Seek Help On LGU Issues*, March 2, 2001, available at <http://www.leagueofprovinces.org.ph/mar02-2001-news.htm>.

⁹⁶ See Exec. Order No. 9 (2001).

B. Congressional Constraints

The victories in the executive branch notwithstanding, the IRA faces other problems. The national government is further withholding the IRA through the enactment of the General Appropriations Act (GAA).

During the preparation of the GAA in 1999, the Senate Finance Committee contemplated slashing the internal revenue share of local governments by some 30 billion pesos. In response to the proposed cut, ULAP launched a campaign to compel the Senate Finance Committee to abort its plan. In their official statement,⁹⁷ ULAP appealed to Congress to observe and “respect the Constitutional provision and its implementing law on the share of local governments from the national internal revenue taxes and its possible adjustments in case of an unmanageable public sector deficit.”⁹⁸ ULAP warned that the proposed cut would lead to the loss of jobs and derail the delivery of basic social services and programs on food security, mass housing, and health services.⁹⁹ The local officials invoked their role as the front-liners in the delivery of basic services to the people. The cut, they claimed would cripple numerous socio-economic programs of local governments and ultimately affect the Estrada Administration’s programs on food security and mass housing.¹⁰⁰

ULAP emphasized that the cut would disrupt the delivery of basic services throughout the country, especially in the 5th and 6th class LGUs.¹⁰¹ Despite their protests, the IRA suffered a P11.5 billion cut.¹⁰²

⁹⁷ See Union of Local Authorities of the Philippines, *Ours Is A System Of Laws And Not Of Men*, Position Paper on the Senate Finance Committee’s Proposal to Reduce the Internal Revenue Allotment (IRA) Share of Local Government Units, December 9, 1999, available at <http://www.ulap.org.ph/ap-peal.htm>.

⁹⁸ ULAP belied reports that local governments were remiss in collecting real property taxes, claiming that Department of Finance figures show that since 1991, LGUs have a yearly average of 107% collection efficiency rate in RPTA against targets set by DOF. They also stated that they have been delivering the basic services to our people already devolved to LGUs since 1991.

⁹⁹ Cecille Suerte Felipe, *Local Officials Protest Cuts In IRA Allotments*, PHILIPPINE STAR, December 18, 1999, at 1.

¹⁰⁰ Rico C. Navarro *P 30-B Budget Cut Will Set Back Food, Housing Programs, LGUs Warn*, MANILA BULLETIN, December 15, 1999, available at <http://www.mb.com.ph/main/1999%2D12/mn121502.asp>.

¹⁰¹ Union of Local Authorities of the Philippines, *Ours Is A System Of Laws And Not Of Men*, Position Paper on the Senate Finance Committee’s Proposal to Reduce the Internal Revenue Allotment (IRA) Share of Local Government Units, December 9, 1999, available at http://www.balangay.org/-current/ulap%statement_0815.htm.

¹⁰² Rocky Nazareno, *Congress Ratifies Budget*, PHILIPPINE DAILY INQUIRER, February 3, 2000, at 1.

Aside from cutting the budget of local governments, Congress also imposed controls on the use of the IRA. The proposed budget provides that appropriate national government department or agency shall implement local government projects. It allows the agency to forge an agreement with a local government beneficiary "with the concurrence of the concerned members of Congress."¹⁰³ Lina said that the "prior concurrence or consultation" clause specified in about 32 special provisions "clearly shows not only the illegal intrusion of Congress into the authority and functions of the executive branch of government but that the President is virtually being held hostage by the legislative branch in the implementation of programs."¹⁰⁴

Congress placed conditions on the release of the "development fund" of local governments. It mandated that it will be done "only upon submission of the annual investment plan, which must contain specific development programs, projects and activities and must be submitted to the Department of Budget and Management not later than March 31, 2000."¹⁰⁵

Congress ignored the local officials and decided to preserve the reduction of the IRA. On February 16, 2000, President Estrada signed the national budget into law. The President vetoed some items, but did not touch the P 10 Billion cut that Congress imposed. The General Appropriations Act (Republic Act No. 8760) in part provides:

XXXVII. ALLOCATIONS TO LOCAL GOVERNMENT UNITS

INTERNAL REVENUE ALLOTMENT

For apportionment of the shares of local government units in the internal revenue taxes in accordance with the purpose indicated hereunder

P111,778,000,000

¹⁰³ See *Estrada Signs Into Law Budget. Two Other Measures Tomorrow*, BUSINESS WORLD, February 15, 2000, at 1.

¹⁰⁴ Union of Local Authorities of the Philippines, News Release, February 8, 2000, available at <http://www.leagueofprovinces.org.ph/pr/feb082000.htm>.

¹⁰⁵ Yasmin Lee G. Apron & Norman P. Aquino, *Congress Slates P22-B Budget Cuts, More Control On Releases*, BUSINESS WORLD, February 2, 2000, at 1.

The amount withheld by Congress was moved to “unprogrammed funds.” This is not harmless window dressing because it has serious implications on the availability of the said amount. The special provisions of Section 1, LIV, provides:

LIV. UNPROGRAMMED FUND

x x x

x x x

x x x

Special Provisions

1. Release of the Fund. The amounts herein appropriated shall be released *only when the revenue collections exceed the original revenue targets submitted by the President of the Philippines to Congress* pursuant to Section 22, Article VII of the Constitution or when the corresponding funding or receipts for the purpose have been realized except in the special cases covered by specific procedures in Special Provision Nos. 2, 3, 4, 5, 7, 8, 9, 13 and 14 herein: *PROVIDED*, That in cases of foreign-assisted projects, the existence of a perfected loan agreement shall be sufficient compliance for the issuance of a Special Allotment Release Order covering the loan proceeds: *PROVIDED, FURTHER*, That no amount of the Unprogrammed Fund shall be funded out of the savings generated from programmed items in this Act....

x x x

4. Additional Operational Requirements and Projects of Agencies. The appropriations for Purpose 6 – Additional Operational Requirements and Projects of Agencies herein indicated shall be released *only when the original revenue targets submitted by the President of the Philippines to Congress pursuant to Section 22, Article VII of the Constitution can be realized based on a quarterly assessment of the Development Budget Committee, the Committee on Finance of the Senate and the Committee on Appropriations of the House of Representatives and shall be used to fund the following:*

x x x

Internal Revenue Allotments

Maintenance and Other Operating Expenses	<u>P10,000,000,000</u>
---	------------------------

Total, IRA	<u>P10,000,000,000</u>
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President Estrada vetoed the controversial provisions,¹⁰⁶ explaining that the “prior consultation” requirement encroaches on the authorities and functions of the executive branch and blurs the separation of powers between the legislature and the executive. He said that, “Congress, in the exercise of its constitutional powers, has enacted the budget measure. It is now the executive’s responsibility to implement it and report the progress of such implementation to congress.”¹⁰⁷

The prior constraints may have been eliminated (in fact they were only reduced), but the fact is, that the IRA was reduced. The preparation of the GAA raised questions regarding the constitutionality of congressional cut and the President’s veto, both of which remain unresolved.¹⁰⁸

¹⁰⁶ In his veto message, President Estrada stated that:

I hereby veto the following special and general provisions... which will require prior consultation, concurrence, recommendation, or coordination, and at times in writing, from the Members of Congress on matters and activities that concern program/project implementation and therefore, are basically executive decisions. These prior legislative requirements during the execution of the budget are not consistent with the basic doctrine on separation of powers, where the responsibility of the Legislative is the enactment of laws while that of the Executive is the enforcement and implementation of laws.... Hence, these prior requirements will not only manifest encroachment into the authority and functions of the Executive Branch of Government but will also impair the authority of the President under Sections 1 and 17, Article VII of the Constitution in the effective and efficient implementation of vital programs and projects.

See Veto Message of the President, February 16, 2000, at 2 (on file with author).

¹⁰⁷ *Keeping the Country on the Path of Growth*, Speech of His Excellency President Joseph Ejercito Estrada, Signing into Law of the Bills on Public Employment Service Office, National Government Budget for the Year 2000, and VAT Deferral, Ceremonial Hall, Malacañang Palace, February 16, 2000 (on file with author).

¹⁰⁸ The President’s action may have legal basis. In *Philippine Constitution Association v. Enriquez*, G.R. No. 113105, August 19, 1994, 235 SCRA 506, the Supreme Court ruled that:

As the Constitution is explicit that the provision which Congress can include in an appropriations bill must “relate specifically to operation to the appropriation therein” and “be limited in its operation to the appropriation to which it relates,” it follows that any provision which does not relate to any particular item, or is considered “an inappropriate provision” which can be vetoed separately from an item. Also to be included in the category of “inappropriate provisions” are unconstitutional provisions and provisions which are intended to amend other laws, because clearly these kinds of laws have no place in an appropriations bill. These are matters of general legislation more appropriately dealt with in separate enactments. Former Justice Irene Cortes, as *amicus curiae*, commented that Congress cannot by law establish conditions for and regulate the exercise of powers of the President given by the constitution for that would be an unconstitutional intrusion into executive prerogative. (*Id.* at 534.)

It is true that “[i]nherent in the power of appropriation is the power to specify how the money shall be spent.” (*Id.* at 535) However, pertinent to the internal revenue allotment, it can be argued that the conditions set by Congress are “inappropriate provisions” for being in violation of the Constitution because the release of the IRA is no longer automatic. The same case can be used to argue that the restrictions on the use of the “development fund” is a matter that should be addressed through another law specifically directed at amending the Local Government Code. In other words, it has no place in an appropriations bill.

Members of the House of Representatives considered filing a case with the Supreme Court to question the validity of the veto.¹⁰⁹ Local officials, on the other hand, decided not to pursue the reduction of the IRA in court.¹¹⁰ Local officials ultimately decided against it after the President announced that he would release the portion of the IRA that was withheld by Congress. Thereafter, the President also said that the IRA would not be included in the national budget to be submitted to Congress, but will be “released automatically.”¹¹¹

What “released automatically” means is not clear. Former President Estrada included an allocation for the IRA in the 2001 budget placing it under the sub-heading “Automatic Appropriations.” Thus, part of the budget reads as follows:

XXXVII. ALLOCATIONS TO LOCAL GOVERNMENT UNITS
A. INTERNAL REVENUE ALLOTMENT

<u>Appropriations and Obligations</u> (In Thousand Pesos)				
<u>Description</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	
New General Appropriations	<u>96,780,000</u>	<u>111,778,000</u>		
General Fund	96,780,000	111,778,000		
Automatic Appropriations			<u>131,917,470</u>	
Internal Revenue Allotment			131,917,470	
Unreleased Appropriation for MOOE				
R.A. No. 8522	4,028,971			
R.A. No. 8745		905,400		
Unobligated Releases for MOOE				
R.A. No. 8745		<u>689,126</u>		
Total Available Appropriations	100,808,971	113,372,526	131,917,470	
Unused Appropriations/Unobligated Allotments	<u>(5,517,065)</u>	<u>(1,594,526)</u>		
TOTAL OBLIGATIONS	<u>95,291,906</u>	<u>111,778,000</u>	<u>131,917,470</u>	

Senator John Osmeña opposed the automatic appropriation of the IRA, claiming that the Constitution has clearly defined the items that are considered automatically appropriated, and that the IRA is not among them. He said that he

¹⁰⁹ *House Minority To Question Presidential Veto Before SC*, BUSINESS WORLD, February 25, 2000, at 6.

¹¹⁰ *Local Execs Give Up IRA Fight*, PHILIPPINE DAILY INQUIRER, February 25, 2000, at 7.

¹¹¹ Patricio S. de Quiros, *An IRA Update*, SANGGUNIAN, May 2000, at 10.

would reclassify the IRA and challenged those who disagreed with him to raise the issue in court. He correctly pointed out that “[t]here is nothing in the Supreme Court decision stating that Congress should not appropriate the IRA.”¹¹²

Unfortunately, because of the delays caused by Estrada’s impeachment trial, Congress reenacted the GAA for the year 2001. As a result, the IRA is similarly diminished as part of it was again placed under “unprogrammed funds.”

The fact is that Congress regularly uses appropriation laws to introduce constraints on the IRA. Republic Act. No. 8745, the General Appropriations Act of 1999 contains the following provisions:

1. *Allocation and Release of Funds.* The amount herein appropriated shall be apportioned among the local government units in accordance with the formula prescribed in Section 285 of R.A. No. 7160, the Local Government Code of 1991, after deducting the total actual cost of devolution and the cost of city-funded hospitals as of December 31, 1992, which shall be earmarked directly to fund the devolved programs, projects and activities subject to necessary adjustments as authorized under Section 284 of the Code and to reallocation resulting from land area adjustments which shall be duly certified and submitted by the Land Management Bureau to the Department of Budget and Management not later than 15 December 1999: PROVIDED, That the amount of Five Billion Pesos (P5,000,000,000) shall be earmarked for the Local Government Service Equalization Fund for the funding requirements of projects and activities arising from the full and efficient implementation of devolved functions and services of local government units pursuant to R.A. No. 7160, otherwise known as the Local Government Code of 1991: PROVIDED, FURTHER, That such amount shall be released to the local government units subject to the implementing rules and regulations, including such mechanisms and guidelines for the equitable allocations and distribution of said fund among local government units subject to the guidelines that may be prescribed by the Oversight Committee on Devolution as constituted pursuant to Book IV, Title III, Section 533 (b) of R.A. No. 7160. The Internal Revenue Allotment shall be released directly by the Department of Budget and Management to the Local Government Units concerned.

2. *Use of Funds.* The amount herein appropriated shall, pursuant to Section 17(g) of the Code, provide for the cost of basic services and facilities enumerated under Section 17(b) thereof, particularly those devolved by the Department of Health, Department of Social Welfare and Development, Department of Agriculture, and the Department of

¹¹² Efren Danao, *Automatic Appropriation Of IRA Opposed*, PHILIPPINE STAR, October 4, 2000, at 2.

Environment and Natural Resources as well as other agencies of the National Government, including (1) construction/improvement, repair and maintenance of local roads; (2) concrete barangay roads/multi-purpose pavements, construction and improvement program to be implemented in accordance with R.A. No. 6763; (3) construction, rehabilitation and improvement of communal irrigation projects/systems; and (4) payment of the Magna Carta benefits of devolved health workers pursuant to the provisions of R.A. No. 7305 and other guidelines as may be issued by the Department of Health for the purpose: PROVIDED, That each local government unit shall, in accordance with Section 287 of the Code, appropriate in its budget no less than twenty percent (20%) of its share from Internal Revenue Allotment for development projects: PROVIDED, FURTHER, That an amount equivalent to twenty percent (20%) of the amount appropriated for development projects shall be set aside for programs and activities that address human and ecological security concerns: PROVIDED, FURTHER, That 50% of the increment from IRA for the year shall be devoted to projects that enhance productivity towards the attainment of food security. In the case of highly urbanized cities, said amount shall be used to alleviate the urban poor and for the resettlement of squatters and that no amount of the increment shall be utilized for increases in personnel plantilla positions and upgrading of compensation/allowances consistent with applicable standardized salary rates in the local government units: PROVIDED, FURTHERMORE, That enforcement of the provisions of Sections 325(a) and 331(b) of the Code shall be waived to enable local government units to absorb national government personnel transferred on account of devolution, create the mandatory positions specified in the Code, continue the implementation of the Compensation Standardization authorized under R.A. No. 6758 for provinces, cities and municipalities and as provided for under existing guidelines for the barangays and the payment of the Magna Carta benefits of public health workers as provided above: PROVIDED, FURTHERMORE, That the capitalization of the Partido Development Administration to be subscribed and paid by the member-municipalities pursuant to R.A. No. 7820 may be charged against the respective IRA of the member-municipalities: AND PROVIDED, FINALLY, That no amount of the Internal Revenue Allotment shall be used for trainings, seminars, and study tours of local government officials and employees of local government units.

3. *Authority to Deduct from the Internal Revenue Allotment.* The Department of Budget and Management is hereby authorized to deduct ten percent (10%) from the Internal Revenue Allotment of Local Government Units (LGUs) with unsettled obligation with the national government agencies, rural electric cooperatives and government owned and/or controlled corporations subject to the usual accounting and auditing rules and regulations.

On the other hand, Republic Act No. 8760, the General Appropriations Act for FY 2000 contains the following provisions:

1. *Allocation and Release of Funds.* The amount herein appropriated shall be apportioned among the Local Government Units (LGUs) including new cities whose charters were approved and ratified in CY 1999 in accordance with the formula prescribed in Section 285 of R.A. No. 7160, the Local Government Code of 1991, after deducting the total actual cost of devolution and the cost of city-funded hospitals as of December 31, 1992, which shall be earmarked directly to fund the devolved programs, projects and activities subject to necessary adjustments as authorized under Section 284 of the Code and to the Oversight Committee Resolution No. OCD-99-001 dated May 7, 1999 approved by the President pertaining to reallocation resulting from land area adjustments based on the duly certified master list submitted by the Land Management Bureau to the Department of Budget and Management: PROVIDED, That the amount of Five Billion Pesos (P5,000,000,000) shall be earmarked for the Local Government Service Equalization Fund for the funding requirement of projects and activities arising from the full and efficient implementation of devolved functions and services of local government units pursuant to R.A. No. 7160, otherwise known as the Local Government Code of 1991: PROVIDED, FURTHER, That such amount shall be released to the Local Government Units in accordance with the implementing rules and regulations, including such mechanisms and guidelines for the equitable allocations and distributions of said fund among Local Government Units subject to the guidelines prescribed by the Oversight Committee on Devolution as constituted pursuant to Book IV, Title III, Section 533 (b) of R.A. No. 7160.

The Internal Revenue Allotment shall be released directly by the Department of Budget and Management to the LGUs concerned: PROVIDED, HOWEVER, That the twenty percent (20%) of the Internal Revenue Allotment of each LGU allotted for development projects under Sec. 287 of R.A. No. 7160 shall be released only upon submission by the respective LGUs of their annual investment plan containing specific development programs, projects, and activities to the Department of Budget and Management not later than March 31, 2000, in accordance with Executive Order No. 189 (s. of 1999): PROVIDED, FURTHER, That the amount corresponding to the compulsory contributions and other remittances of LGUs to concerned government agencies, Government Financial Institutions (GFIs) and Government Owned and/or Controlled Corporations (GOCCs) shall be deducted from the IRA of the respective LGUs as prescribed under Executive Order No. 190 (s. of 1999)¹¹³ and remitted to the concerned government agencies, GFIs, and GOCCs through the Department of Budget and Management.

¹¹³ President Arroyo repealed both Executive Order No. 189 and 190. See Exec. Ord. No. 9, (2001).

2. *Use of Funds.* The amount herein appropriated shall, pursuant to Section 17(g) of the Code, provide for the cost of basic Services and facilities enumerated under Section 17(b) thereof, particularly those devolved by the Department of Health, Department of agencies of the National Government, including (1) construction/improvement, repair and maintenance of local roads; (2) concrete barangay roads/multi-purpose pavements, construction and improvement program to be implemented in accordance with R.A. No. 6763; (3) construction, rehabilitation and improvement of communal irrigation projects/systems; and (4) payment of the Magna Carta benefits of devolved health workers pursuant to the provisions of R.A. No. 7305 and other guidelines as may be issued by the Department of Health for the purpose: PROVIDED, That each local government units shall, in accordance with Section 287 of the Code, appropriate in its budget no less than twenty percent (20%) of its share from Internal Revenue Allotment for development projects: PROVIDED, FURTHER, That an amount equivalent to twenty percent (20%) of the amount appropriated for development projects shall be set aside for programs and activities that address human and ecological security concerns: PROVIDED, FURTHERMORE, That enforcement of the provisions of Sections account of devolution, create the mandatory positions specified in the Code, continue the implementation of the Compensation and Standardization Law authorized under R.A. No. 6758 for provinces, cities and municipalities and as provided for under existing guidelines for the barangays and the payment of the Magna Carta benefits of public health workers as provided above: AND PROVIDED, FINALLY, That the capitalization of the Partido Development Administration to be subscribed and paid by the member-municipalities pursuant to R.A. No. 7820 may be charged against the respective IRA of the member-municipalities.

Through the GAA, Congress imposes a string of restrictions on the amount, use, and release of the IRA. While it may be argued that Congress has the power to determine the use of any allocations, this practice may be unconstitutional. What should be evident is that local governments are not even getting the full amount of the IRA. Among others, the Local Government Service Equalization Fund (LGSEF), amounting to 5 billion pesos yearly is deducted from the IRA before it is distributed in accordance with the formula in the Code. Since the GAA of 2000 was reenacted in 2001, the LGSEF accounts for a loss of fifteen billion pesos from local government funds in the last three years.

These impositions explain why local-governments receive less than 40% of internal revenue collections.

C. Confusion and the Court

Although *Pimentel* is a landmark ruling, reactions to the case suggest that few correctly understand the implications of the Supreme Court's decision.

President Estrada welcomed the decision¹¹⁴—a surprising reaction considering that the Supreme Court concluded that he violated the Constitution. Despite the President's statement, other government officials including the Solicitor General were reportedly preparing to ask the Supreme Court to reconsider its decision.¹¹⁵

Worse, then Department of Budget Secretary Benjamin E. Diokno stated that the national government will release 7.5 billion pesos to local governments in response to a Supreme Court ruling that declared a 7.5 billion peso "soft cut" from local government allocations as unconstitutional.¹¹⁶ The report continued by saying that the amount, representing the share of local governments in national taxes, is part of 10 billion pesos slashed from the national budget.

On the other hand, the ULAP hailed the decision by saying, "We have been right all along in our struggle against the illegal and whimsical intrusion by Congress into the rightful share of LGUs." ULAP leaders called the decision a "landmark ruling because the principles enshrined in the Supreme Court's decision cover all cases concerning IRA reduction which is now deemed violative of the Constitution."¹¹⁷

These statements suggest a misunderstanding of the Supreme Court's decision in *Pimentel v. Aguirre*. That case dealt only with the validity of Administrative Order No. 372. The Supreme Court did not scrutinize, much less enjoin any action of Congress.

Pimentel does not cover the transfer of part of the IRA to "unprogrammed funds" or any other form of restraint on the release and the use of the IRA imposed by Congress. It does not affect any other order issued by the President or his subordinates. The President is not under any legal obligation to release any amount beyond the amounts withheld under Administrative Order Nos. 372 and

¹¹⁴ *Estrada Welcomes SC Decision On IRA*, PHILIPPINE STAR, July 21, 2000, at 17.

¹¹⁵ See Cecile S. Visto, *Supreme Court Rules Against Order On IRA Cuts*, BUSINESS WORLD, July 20, 2000, at 1.

¹¹⁶ Dymphna R. Calica, *Gov't To Cut Capital Outlay For Php7.5-B LGU Allocation*, BUSINESS WORLD, August 7, 2000, at 2.

¹¹⁷ *Local Execs Laud SC Ruling On IRA*, MANILA BULLETIN, July 21, 2000, at 1.

43. *Pimentel* does not compel the President to release an amount equivalent to the P10 billion, which Congress placed under “unprogrammed funds” because he is not obligated to restore the “soft cut” engineered by Congress.¹¹⁸

VI. AMENDING THE LAW

The conclusions of this study may be alarming but they are not new. A study by the Economic and Social Commission for Asian and the Pacific as early as 1995¹¹⁹ already detected the increasing dependence of local governments on fiscal autonomy. That study recommended a reconsideration of the IRA formula, which should factor in “certain minimum standards of service delivery” and an incentive feature to encourage local governments to exert greater efforts in tax collection and embark on development projects beyond the basic services they are supposed to deliver.¹²⁰ There are studies already suggesting alternative formulas for the IRA.¹²¹

The NSCB is urging the government to use other criteria for the distribution of the IRA including average family income, number of families with income above the poverty threshold, access to safe drinking water, access to health facilities, and employment rate.¹²² All of which, would allow local governments to target their IRA to address these concerns.

The World Bank suggests that the national government needs to make a number of fundamental decisions:

¹¹⁸ As of this writing, a separate suit has already been filed with the Supreme Court challenging the “soft cut” introduced by Congress. See *ACCORD v. Zamora*, G.R. No. 144256. Petition filed on August 22, 2000.

¹¹⁹ See Economic and Social Commission for Asian and the Pacific, *Local Government in Asia and the Pacific: A Comparative Study* (Country Paper: Philippines), available at <http://www.unescap.org/huset/lgstudy/country/philippines/philippines.htm> (last visited June 30).

¹²⁰ See *id.* The study also suggested that a portion of the IRA could be transformed into a specific grant tied to tax effort or its variant. Provision of national government grants over and above the IRA, for devolved activities should be strictly justified on the basis of equity, externality and economy of scale and such intervention should be in a form of matching grant and must be specific and time bounded. The LGUs must put up equity to the grant in order to have a sense of ownership of the project and also to ensure goal congruence. See *id.*

¹²¹ See Joseph J. Capuno, *et al.*, *Central Fiscal Transfer and Overall Fiscal Balance: Exploring Alternative Transfer Formulas*, paper presented at The 3rd IRSA International Conference, Borobudur Hotel Jakarta, March 20-21, 2001. See, also, Alicia B. Celestino, *Intergovernmental Transfers in the Philippines: Issues and Practices*, presented at the International Symposium on Intergovernmental Transfers in Asian Countries: Issues and Practices, Hitotsubashi University, Tokyo, Japan (n.d.), at 15-16 (summarizing various proposed amendments to the IRA formula).

¹²² National Statistical Coordination Board, NSCB Statistics Series, No. 2000-003, December 2000, at 15.

First, to make the LGUs accountable and face hard budget constraints, the NG needs to: remove uncertainty on the amount and timing of the LGU transfers; stop funding for devolved activities; and monitor LGU borrowing strictly, without giving LGUs an expectation that the NG would bail them out of any possible debt service difficulties. Second, the NG may consider a reform in the allocation mechanism of resource transfer amount the LGUs to incorporate concerns about equity and local resource mobilization by considering an equalization grant based on the tax base and revenue efforts. Third, another part of the resource transfer should be based on the cost share principle on a selected small number of activities that the National Government consider critical. Finally, many LGUs have insufficient capacity in fiscal planning and implementation especially in view of the need to coordinate with the National Government. The National Government may consider giving technical assistance to LGUs in these areas.¹²³

Senator Pimentel took note of the agitation for the amendment of the Code. However, his proposal insofar as local fiscal autonomy is concerned is to increase the financial resources of the local governments. He explained that the proposed amendments were necessary because “the share in national taxes of the local governments — commonly referred to as their internal revenue allotment — is simply not enough for them to adequately meet the challenges of devolution.”¹²⁴ His proposed amendments would include the following:

- Increase the LGU share in national taxes (currently called “Internal Revenue Allotment”) from 40% of national internal revenue taxes to 50% of all national (not only internal revenue) taxes. (Sec. 284)¹²⁵

¹²³ World Bank, *supra* note 36, at 41.

¹²⁴ Aquilino Q. Pimentel, Jr., *Pursuing Our Collective Struggle for Local Autonomy: Amending the Local Government Code of 1991*, Opening statement of Senator Aquilino Q. Pimentel, Jr., Chair of the Senate Committee on Local Government at the opening ceremonies of the public consultations on the proposed amendments of the Local Government Code of 1991, August 4, 2000, San Fernando City, La Union, available at <http://www.nenepimentel.org/speeches/200008181LGC.html>.

¹²⁵ S. No. 2064, 11th Cong., 2nd Sess. sec. 80 (2000) provides:

SECTION 80. Section 284 of the Code is hereby amended to read as follows:

Section 284. [Allotment] SHARE of [Internal Revenue] NATIONAL Taxes. — UPON APPROVAL OF THIS CODE, AS AMENDED [L]ocal government units [shall have a] ARE ENTITLED TO A FIFTY PERCENT (50%) share [in the] OF national [internal revenue] taxes based on the collection of the third fiscal year preceding the current fiscal year [as follows:].

[(a) On the first year of the effectivity of this Code, thirty percent (30%);

(b) On the second year, thirty-five percent (35%); and

(c) On the third year and thereafter, forty percent (40%);]

[Provided, That in the event that the National Government incurs an unmanageable public sector deficit, the President of the Philippines is hereby authorized, upon the recommendation of the Secretary of Finance, Secretary of Interior and Local Government, and Secretary of Budget and Management, and subject to consultations with the presiding officers of both Houses of the

- Provide for automatic appropriation and obligation of the LGU share in national taxes (Sec. 285);¹²⁶ and for the monthly release of same (Sec. 286).¹²⁷
- Change the formula for allocating the share in national taxes by increasing the share of municipalities from the current 34% to 36%, and reduce the share of cities from 23% to 21%. (Sec. 285)
- Increase the minimum annual appropriation for the local development fund from the current 20% to 30%. (Sec 287)¹²⁸

Congress and the Presidents of the Liga, to make the necessary adjustments in the internal revenue allotment of local government units, but in no case shall the allotment be less than thirty percent (30%) of the collection of the internal revenue taxes the third fiscal year preceding the current fiscal year. *Provided, further*, That in the first year of the effectivity of this Code, the local government units shall, in addition to the thirty percent (30%) internal revenue allotment which shall include the cost of devolved functions for essential public services, be entitled to receive the amount equivalent to the cost of devolved personal services.]

¹²⁶ S. No. 2064, 11th Cong., 2nd Sess. sec. 81(2000) provides:

SECTION 81. Section 285 of the Code is hereby amended to read as follows:

Section 285. *Allocation to Local Government Units.* — The share of local government units in the [internal revenue] NATIONAL TAXES [allotment], WHICH IS AUTOMATICALLY APPROPRIATED AND OBLIGATED, shall be allocated in the following manner:

- (a) Provinces - Twenty-three percent (23%);
- (b) Cities - Twenty - [three] ONE percent [(23%)] (21%);
- (c) Municipalities - Thirty-[four] SIX percent [(34%)] (36%); and
- (d) Barangay[s] - Twenty percent (20%)

Provided, however, That the share of each province, city and municipality shall be determined on the basis of the following formula:

- (a) Population - Fifty percent (50%)
- (b) Land Area - Twenty-five percent (25%)
- (c) Equal sharing - Twenty-five percent (25%)

¹²⁷ S. No. 2064, 11th Cong., 2nd Sess. sec. 82 (2000) provides:

SECTION 82. Section 286 of the Code is hereby amended to read as follows:

Section 286. *Automatic Release of Shares.* — (a) The share of each local government unit shall be released without need of any further action, directly to the provincial, city, municipal or barangay treasurer, as the case may be, on a MONTHLY OR quarterly basis within five (5) days after the end of each MONTH OR quarter [, and which].

(B) SAID SHARE shall not be subject to any lien, or holdback that may be imposed by the [national] CENTRAL government for whatever purpose.

[(b)](C) Nothing in this Chapter shall be understood to diminish the share of local government units under existing laws.

¹²⁸ S. No. 2064, 11th Cong., 2nd Sess. sec. 83 (2000) provides:

SECTION 83. Section 287 of the Code is hereby amended to read as follows:

Section 287. *Local Development Projects.* — Each local government unit shall appropriate in its annual budget no less than [twenty percent (20%)] THIRTY PERCENT (30%) of its annual [internal revenue] NATIONAL TAX [allotment] SHARE for development projects IN ACCORDANCE WITH THE ANNUAL INVESTMENT PROGRAM EMBODIED IN THE LOCAL DEVELOPMENT

- Define "national wealth" (Sec. 289); and increase the LGU share from the use of national wealth from 40% to 60%. (Sec. 290).¹²⁹

Bearing in mind the observations made by other government agencies as well as the trends in local government finance in the last ten years, Senator Pimentel's proposals seem to avoid the issue of local government dependence. The proposals are likely to exacerbate the situation because local governments would now look forward to a sharing 50% of all government tax revenues, which will be automatically appropriated and released monthly. The reduction of the share of cities will have little impact because 100 cities sharing 21% of the IRA would still be at an advantage compared to roughly 1,500 municipalities sharing 36% of the IRA. Besides, with the inclusion of all national government tax revenues in the computation of the IRA, the reduction of the share of cities would be insignificant.

Senator Pimentel also proposed stricter criteria for the creation of new municipalities, cities, and provinces under because of the proliferation of proposals in Congress to form new such local governments.

Under the Bill, Pimentel said the income requirements are increased for the creation of the following LGUs:

- Municipality — from average P2.5 million to P20 million for the last two years.
- City — from average P20 million to P100 million for the last two years.
- High-urbanized city — from latest income of P50 million to P250 million.
- Province — from the latest income of P20 million to P200 million.¹³⁰

Pimentel said a municipality seeking conversion into a city and a city aspiring to be a highly urbanized city should have an average of at least 80 percent real property tax collection efficiency and 70 percent collection of other taxes

PLAN PREPARED BY THE LOCAL DEVELOPMENT COUNCIL AND
APPROVED BY THE SANGUNIAN CONCERNED. [Copies of the development
plans of the local government units shall be furnished the Department of Interior
and Local Government.]

¹²⁹ See Pimentel, *supra* note 124.

¹³⁰ See S. No. 2064, 11th Cong., 2nd Sess. sec. 3 (2000).

every year during the three immediately preceding years. Under the Pimentel proposal, "income" of LGUs is redefined to include only revenues generated locally and, therefore, excludes the IRA.¹³¹

Perhaps because of the urgency of the issue, restrictions regarding the creation of cities were enacted this year. Republic Act No. 9009 (2001) amends section 450 of the Local Government Code of 1991 and now provides that:

Section 450. *Requisites for Creation.* — (a) A municipality or a cluster of barangays may be converted into a component city if it has a locally generated average annual income, as certified by the Department of Finance, of at least One hundred million pesos (P100,000,000.00) for the last two (2) consecutive years based on 2000 constant prices, and if it has either of the following requisites:

(i) a contiguous territory of at least one hundred (100) square kilometers, as certified by the Land Management Bureau; or

(ii) a population of not less than one hundred fifty thousand (150,000) inhabitants, as certified by the National Statistics Office.

The creation thereof shall not reduce the land area, population and income of the original unit or units at the time of said creation to less than the minimum requirements prescribed herein.

(b) The territorial jurisdiction of a newly-created city shall be properly identified by metes and bounds. The requirement on land area shall not apply where the city proposed to be created is composed of one (1) or more islands. The territory need not be contiguous if it comprises two (2) or more islands.

(c) The average annual income shall include the income accruing to the general fund, exclusive of special funds, transfers, and non-recurring income.

Although this law is likely to stem the tide of "cityhood," it does not by itself prevent dependence on the national government.

This is not to suggest that internal revenue allotments should be discontinued. The wisdom of allotting income to cover the costs of devolution cannot be seriously questioned. However, if local governments continue to

¹³¹ *Stricter Criteria for Creation of New Cities/Provinces*, August 11, 2000, available at <http://nenepimentel.org/news/20000816Cities.html>.

become dependent on the IRA, the slightest interruption in its release will affect local government operations. Simply increasing the share of local governments will not solve the issues raised in this paper. If anything, it will probably engender more dependence on the national government.

Ideally, the IRA formula should be amended to correct the obvious bias in favor of cities. The present basis for distribution has not encouraged targeted spending on needed social services and only encouraged the increase in the number of cities.

Other solutions may also be considered. If Congress is confident that local governments may receive up to 50% of all government income, perhaps it should create a separate grant system that is based on the actual needs and revenue-generating capacities of local governments. This second grant system could be used to target the needs of those local governments for poverty alleviation, basic education, or the delivery of basic health services. It should be recalled that the NSCB is urging the government to use average family income, number of families with income above the poverty threshold, access to safe drinking water, access to health facilities, and employment rate as the basis for income distribution. This suggestion makes more sense than the application of a blanket formula that is presently in force under the Code.

In this way, the intergovernmental transfer system can assist in building financially viable local governments instead of pitting them against each other. Hopefully, it will also prevent the national government from tampering with the IRA either through congressional or executive acts.

VII. CONCLUSION

Despite the array of mechanisms available for revenue-generation, local governments continue to depend on the national government for financial resources, primarily through the IRA.

The IRA was conceived as part of a design to free local governments from dependence on the national government. It was intended to end patronage politics between national and local officials. Ten years after the implementation of the Code, however, local governments are becoming dependent on the IRA. Many are upgrading their local governments into cities to take advantage of the formula that is skewed in favor of cities. The national government continues to impose limits on the amount, release and use of the IRA.

Virtually every study conducted on the impact of the IRA recommends the revision of the formula. Unfortunately, the attempts to amend the Code pay little attention to the concerns that are surfacing. If anything, these proposed amendments would lead to even more dependence on the part of local governments. At the same time, they will fail to remedy the seeming inability of the Code to address poverty alleviation and other concerns of the national government.

Ironically, the IRA formula has a bias in favor of cities, which more often than not already has the means to deliver basic services to their constituents. Clearly, the bias should be expunged from the law. This is the better alternative to simply increasing the share of local governments in the income of the national government.

However, Congress may also devise a separate transfer system that addresses the needs and capacities of local governments. This system should give incentives to local governments to raise revenues locally, without neglecting the need of the more impoverished local governments for assistance. Devotion to the current formula cannot help the country in the long run. The present formula proved unable either to develop self-reliant local governments or improve the delivery of basic services in the country. It should be designed to ensure that local governments improve the delivery of basic services. This system may either replace or operate concurrently with the existing formula in the Code.

On the other hand, local governments should exploit the many sources of revenues that are at their disposal, however, politically unpopular they may be. Continued dependence on the national government will leave them vulnerable whenever the national government needs to constrict its own resources. Our experience shows that whenever this happens, the national government tends to exert control over the IRA. Without sufficient local revenues, local governments will find difficulty in performing their functions. This was never the intention of the framers of the Constitution. Ironically, the implementation of the IRA formula continues to breed the evil that the Constitution sought to excise centralization of fiscal resources.

Hopefully, in the next ten years, any assessment of the Code and its impact on local fiscal autonomy will not be so ominous. But unless Congress takes the proper steps today, we will be faced with the same situation in the future and the promise of the Local Government Code will never be realized.

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