

If you think federalism is the answer,  
first heed the lesson of devolution

Joseph Capuno  
UP School of Economics

## A lesson from 26 years of devolution

*It is important to get the policy reform right in the beginning for correcting the mistakes later may prove costly, if not impossible.*



# Two principles of fiscal federalism that work well in practice (... elsewhere)

## #1. Finance should follow function

- First, decide on what expenditure functions or responsibilities to devolve to LGUs
- Then decide on the financial resources or revenue-raising powers to transfer to LGUs
  - No unfunded mandates
  - No ‘free money’

## What we did ... finance was detached from function

- Central transfers to LGUs: IRA and shares in national wealth
  - While formula driven, not at all linked with the assigned expenditure responsibilities
- Locally-sourced revenues
  - RPT, business taxes – but local economies are not created equal
  - Rates capped by NG

# Two principles of fiscal federalism that work well in practice (...elsewhere)

## **#2. Assign the responsibility over an expenditure function or public service to the LGU that has jurisdiction over the entire service area or beneficiary population**

- To ensure any and all beneficiaries has to contend with only one LGU
- In turn, the LGU must answer to any and all beneficiaries
- Main considerations: economies of scale (cover as many to bring the unit cost to a minimum), local preferences

## **What we did ... devolved health services too much**

- All facilities and personnel in situ are devolved to the LGU, but led to fragmentation of local health system
  - A RHU patient has to deal with the mayor, and then again with the provincial governor if referred to a public hospital
  - Vital health information or disease surveillance data stay in the RHU
  - Deployment of personnel where they are needed elsewhere in the province not possible

# Corrective measures

Mismatch in revenues and expenditures		
	IRA	CODEF
Provinces	23%	47.6%
Cities	23%	4.3%
Municipalities	34%	48.1%
Barangays	20%	0%

- Costly corrective measures
  - 1994-1996 GAA – Adjust IRA formula to account for distribution of CODEF and City-funded hospitals
- Failed corrective measures
  - Magna Carta for Devolved Health Workers
  - CHCA, ILHZ, PIPH
- Unintended consequences
  - Renationalization of some hospitals
  - Conversion of municipalities to cities

# Continuing tugs of war

- Functional conflicts among LGUs
  - Service spillovers, externalities
  - Emergent solutions
    - Inter-LGU cooperation or metropolitan arrangements: All carrots, no sticks
    - Amalgamation: Rare, only IGACOS so far
    - NG takeover
- Financial conflicts between LGUs and NG
  - Higher share in tax revenues and other fiscal resources, as block grants and not related to expenditure responsibilities
  - Performance-based grants, conditional grants

# Relevant provisions in the proposed PDP-Laban Federal Constitution (v1.7)

Article X. Section 12. (1) The regional government shall have a just share, as determined by federal law, in the national federal taxes and revenues which shall be automatically released to them provided that the share of regional governments shall not be less than \_\_\_ percent (\_\_\_%) of all national taxes and revenues

(2) In addition, specific national taxes collected within the territorial jurisdiction of each region shall be retained by and shall accrue exclusively to the regional government

(3) As determined by law, the parliament shall, by law, institute a fair and equitable system of sharing and equalization between the regions, provided that the share of regional governments shall be adjusted in accordance with the needs and capacity of the region.

Section 15. In addition to the equalization grant, regional governments shall be entitled to at least fifty percent (50%) share in the proceeds of the utilization and development of the national wealth.....



# Division of responsibilities

## Federal government

- National defense, police and national security
- Foreign affairs, Currency and monetary policy
- International trade, customs and tariff
- Inter-regional commerce, postal services, national elections
- Quarantine, general auditing
- Citizenship, naturalization, immigration and deportation, maritime, land and air transportation, and communications
- Patents, trademarks, trade names, and copyrights
- Energy, judiciary and administration of justice

## Regional government

- Create own sources of regional revenues...
- Social welfare and development
- Tourism
- Irrigation, water and sewerage
- Waste management, fire protection
- Regional development planning
- Franchises, licenses and permits...
- Regional government transfers to LGUs within the region

# Comments ... looks like function trailing finance again

## Division of responsibilities

- Some are local public goods, rightly assigned to SNGs, not necessarily RGs
- What about other social services: health, education, population and nutrition, housing
- Symmetric or asymmetric assignment
- How to cost these out?
- Pantawid Program
  - If devolved, poor across RGs may get different treatment

## Revenue shares of RGs

- Big chunks unrelated to the types and scales of responsibilities to be assigned to RGs
  - Unequal expenditures responsibilities requires unequal revenue shares
- Do the numbers add up?
  - If large chunks of national revenues and national wealth already go to RGs, how to finance equalization grants?

Again, the lesson ... the devil is in the detail

*If we give the RGS the money now and choose to decide later how we want them to spend it, by then it will be too late...*

*It will be costly and difficult, if not impossible.*