

36277  
Vol. 2

# **Assessment of Non-IRA Transfers and Other Funds for Devolved Services in the Philippines**

## **Final Main Report**

*By*

*Ma. Cecilia G. Soriano*

*Jesper Steffensen*

*Elizabeth P. Makayan*

*Josefina B. Nisperos*

*October 2005*

## List of Contents

<b>LIST OF CONTENTS .....</b>	<b>II</b>
<b>LIST OF TABLES AND DIAGRAMS.....</b>	<b>IV</b>
<b>ABBREVIATIONS .....</b>	<b>V</b>
<b>ACKNOWLEDGEMENTS .....</b>	<b>VII</b>
<b>1. INTRODUCTION .....</b>	<b>1</b>
<b>1.1 Background to the Study .....</b>	<b>1</b>
<b>1.2 Objectives .....</b>	<b>3</b>
<b>1.3 Scope of the Study .....</b>	<b>3</b>
<b>1.4 Study Approach.....</b>	<b>4</b>
<b>2. OVERVIEW OF THE FUNDING FOR DEVOLVED FUNCTIONS.....</b>	<b>5</b>
<b>2.1 Overview of Total Public Sector .....</b>	<b>5</b>
<b>2.2 LGU Revenues and Funds for Devolved Functions.....</b>	<b>6</b>
<b>3. DETAILED COMPOSITION OF LGU REVENUES .....</b>	<b>9</b>
<b>3.1 Overview of the LGU Revenues .....</b>	<b>9</b>
<b>3.2 IRA Transfers .....</b>	<b>9</b>
<b>3.3 Other Mandated Non-IRA Transfers.....</b>	<b>10</b>
<b>3.4 Local Revenue Sources.....</b>	<b>11</b>
<b>3.5 Other LGU Revenues and Borrowings .....</b>	<b>12</b>

<b>4. COMPOSITION OF THE NON-IRA FUNDING.....</b>	<b>13</b>
<b>4.1. Overview of the Non-IRA Funding.....</b>	<b>13</b>
4.1.1 General Overview .....	13
4.1.2 Direct Spending Versus Transfers of funds for Devolved Functions	14
4.1.3 Types of Funds – Economic Categories .....	16
4.1.4 Types of Funds – the Nature of Development Functions .....	17
4.1.5 NGAs and GOCCs .....	17
4.1.6 Types of LGUs.....	17
<b>4.2 Detailed Overview of Non-IRA Funding.....</b>	<b>20</b>
4.2.1 Government Funded Programmes and Projects .....	20
4.2.2 Congressional Allocations .....	20
4.2.3 Loans and Grants Funded Transfers and Spending .....	21
4.2.4 Off-Budget Funding Sourced from Donors.....	23
<b>4.3 Analysis of data by Department/Agency and Corporation.....</b>	<b>23</b>
4.3.1 Overview of Funding by Agency and Corporation.....	23
4.3.2 Allocation Principles.....	27
<b>5. FUTURE OPTIONS AND CONCLUDING COMMENTS .....</b>	<b>31</b>
<b>6. ANNEXES.....</b>	<b>36</b>
<b>Annex 1: TOR</b>	
<b>Annex 2: List of People/Institutions Met</b>	
<b>Annex 3: Tables</b>	
<b>Annex 4: Note on Comparison with Previous Findings</b>	
<b>Annex 5: Bibliography</b>	

## **List of Tables and Diagrams**

### **Tables:**

<b>2.1: Composition of LGU Revenues and Funds for Devolved Functions (2003).....</b>	<b>(p. 7)</b>
<b>4.1: Overview of the Non-IRA Funding (2003).....</b>	<b>(p.13)</b>
<b>4.2: Overview of the Non-IRA Funding – Four Components (2003).....</b>	<b>(p.18)</b>
<b>4.3: Non-IRA Funding for LGU Devolved Functions (2003).....</b>	<b>(p.24)</b>
<b>4.4: Distribution of the Non-IRA Funding on the Main Depts.....</b>	<b>(p.27)</b>

### **Diagrams:**

<b>2.1: Composition of Public Sector Revenues, 2003.....</b>	<b>(p. 6)</b>
<b>2.2: Size of the Total Funding on Devolved Services.....</b>	<b>(p.8)</b>
<b>3.1: Composition of LGU Revenue Source.....</b>	<b>(p.9)</b>
<b>4.1: Distribution of non-IRA Funding Across the Four Components.....</b>	<b>(p.14)</b>
<b>4.2: Direct Spending Versus Transfers including all sources.....</b>	<b>(.14)</b>
<b>4.3: Direct Spending Versus Transfers – excluding CA and OBF.....</b>	<b>(14)</b>
<b>4.4: Composition of the Non-IRA Funding by Object Class.....</b>	<b>(p.16)</b>
<b>4.5: Distribution of Non-IRA Funding Across the Type of LGUs.....</b>	<b>(p. 19)</b>
<b>4.6: Distribution of Non-IRA Funding Across the Type of LGUs, excluding Funding from CAs and Off-Budget Funding.....</b>	<b>(p. 19)</b>
<b>4.7: Distribution of the Total CAs across types of LGUs.....</b>	<b>(p. 21)</b>
<b>4.8: Overview of the Non-IRA Funds by Department.....</b>	<b>(p. 25)</b>
<b>4.9: Overview of the Non-IRA Funds by Department Net of CA&amp;OBF..</b>	<b>(p.26)</b>

## **Abbreviations**

ADB:	Asian Development Bank
ARMM:	Autonomous Region of Muslim Mindanao
AFMA:	Agriculture & Fisheries Modernization Act
ARF:	Agrarian Reform Fund
B:	Billion
Bn:	Billion
BESF:	Budget of Expenditures and Sources of Financing
BFAR:	Bureau of Fisheries and Aquatic Resources
BLGF:	Bureau of Local Government Finance
CA:	Congressional Allocations
CIDA:	Canadian International Development Agency
CO:	Capital Outlays
GOCC:	Government Owned and Controlled Corporations
DA:	Department of Agriculture
DBM:	Department of Budget and Management
DEPED:	Department of Education
DENR:	Department of Environment and National Resources
DICT:	Department of Information and Communications Technology
DILG:	Department of Interior and Local Government
DLR:	Department of Land Reform
DOF:	Department of Finance
DOLE:	Department of Labour and Employment
DOH:	Department of Health
DOT:	Department of Tourism
DOTC:	Department of Transportation and Communications
DPWH:	Department of Public Works and Highways
DSWD:	Department of Social Welfare and Development
DTI:	Department of Trade and Industry
EO:	Executive Order
FAPs:	Foreign Assisted Projects
GAA:	General Appropriations Act
GFI:	Government Financial Institution
GFPP:	Government Funded Programs and Projects
GMA:	Ginintuang Masaganang Ani
GNP:	Gross National Product
GOP:	Government of the Philippines
GTZ:	Gesellschaft für Technische Zusammenarbeit
IBRD:	International Bank for Reconstruction and Development
ICC:	Investments Coordinating Committee
IFAD:	International Fund for Agricultural Development
IFT:	Intergovernmental Fiscal Transfers
IGFT:	Inter-Governmental Fiscal Transfers
IGFTS:	Inter-Governmental Fiscal Transfer System
IRA:	Internal Revenue Administration
JBIC:	Japan Bank for International Cooperation

JICA:	Japan International Cooperation Agency
KR2:	Kennedy Round 2
LA:	Loan Agreement
LGC:	Local Government Code of 1991
LGF:	Loans and Grant Funded Transfers
LGUs:	Local Government Units
IRA:	Internal Revenue Allotment
M:	Million
MC:	Minimum Conditions
MDF:	Municipal Development Fund
MDFO:	Municipal Development Fund Office
MFC:	Municipal Finance Corporation
MOOE:	Maintenance and Other Operating Expenditures
NA:	National Agency
NAFC:	National Agricultural & Fishery Council
NEDA:	National Economic and Development Authority
NG:	National Government
NGA:	National Government Agency
NGO:	Non-Governmental Organization
NIA:	National Irrigation Administration
OBF:	Off-Budget Funding
ODA:	Official Development Assistance
P:	Peso
PAGCOR:	Philippine Amusement and Gaming Corporation
PAP:	Program/Activity/Project
PCSO:	Philippine Charity Sweepstakes Office
PDAF:	Priority Development Assistance Fund
PEPFMR:	Public Expenditure, Procurement and Financial Management Review
PG:	Performance Grants
PM:	Performance Measures
PMO:	Program Management Office
PRRC:	Pasig River Reconstruction Commission
PS:	Personal Services
PTA:	Philippine Tourism Authority
RA:	Republic Act
VAT:	Value Added Tax
WB:	World Bank

**Exchange Rate (2003): 1 US\$ = 54.20 Pesos**

## **Acknowledgements**

As authors of this report, we would like to express our deepest gratitude to the people who have supported the Study Team.

We are indebted to a number of institutions and individuals for support received during the planning and implementation of the Study. First, our gratitude goes to all the Government Departments and Corporations for strong support through all the crucial phases of the exercise, especially to the DOF, DBM, NEDA and DILG for the strong facilitation of the demanding data collection.

We are, furthermore, grateful for the support given by other stakeholders, the representatives of the development partners, representative from LGUs and other institutions, for their invaluable contribution and time set aside for support to the Study.

We would also like to thank the World Bank Team, especially Messrs. Roland White, Chris Hoban and Ming Zhang, who provided valuable support and commented on earlier notes and papers, to Ms. Teresita Angelica Plata and Ms. Zenaida Tejerero of the World Bank for logistical support and to Mr. Rolando Marlon P. Makayan for support to data processing.

Many people, too numerous to mention by name, helped considerably in data collection, analyses and other contributions to this report. Great thanks to all.

This report is based on information collected from March – July 2005. It contains the views of the Study Team, which do not necessarily correspond to the views of the Government of the Philippines or the World Bank<sup>1</sup>. Points of view and errors can be attributed only to the authors.

*Ma. Cecilia G. Soriano  
Jesper Steffensen<sup>2</sup>  
Elizabeth P. Makayan  
Josefina B. Nisperos*

---

<sup>1</sup> The Study was funded by the World Bank.

<sup>2</sup> From the Nordic Consulting Group A/S, Denmark (NCG).

## **1. Introduction**

### **1.1 Background to the Study**

A well-functioning local government financing system in the Philippines is vital for the fulfilment of service delivery and poverty alleviation objectives, and is critical for the overall functioning of the decentralised system of governance as mandated by the Local Government Code (LGC) of 1991.

The present system of LGU finance relies heavily on intergovernmental fiscal transfers (IGFTs) from the central government to the provinces, cities and municipalities. The fiscal transfers<sup>3</sup> from the national government constitute more than 70 % of the total LGU revenues in most of the LGUs and up to nearly 100 % of the total revenues in some of the financially weaker LGUs.

The way in which these transfers are directed and structured is thus critical in determining the efficacy of local service delivery. From the point of view of the national budget, intergovernmental fiscal transfers account for approximately 18 % of total expenditure<sup>4</sup>, the largest item after debt service payments. As the overall fiscal position of government has deteriorated, these expenditures have invited increasing scrutiny, either as a potential source of savings to government and/or to ensure that delivery efficiencies are maximized.

Understandably, most of the attention from both the government and its development partners has dwelt on the Internal Revenue Allotment (the IRA, which accounts for the largest component of these flows), and has tended to focus either on the adequacy of the aggregate resource flow to the sub-national level, or on the equity and efficiency of the horizontal distribution of the grant among LGUs.<sup>5</sup> Thus far, however, it appears that significant reform of the IRA is not likely in the short or medium term.

There is fairly wide agreement on the nature of some of the challenges in the existing transfer system in the Philippines. First, in the context of muted accountability systems at the local level and the disproportionately large share of overall transfers accounted for by the IRA - which functions as an unconditional block grant – the IGFT system currently provides few incentives for improving LGU performance. Second, the non-IRA components of the system are fractured and non-transparent, creating a wide range of difficulties for LGUs that wish to access these grants and support. The national government is faced with the burden of managing a plethora of grant programmes, which have diverse objectives, not always clearly focused on improving delivery of basic services to poor areas.

---

<sup>3</sup> The words intergovernmental fiscal “grants” and “transfers” are used interchangeably in this Report. The same goes for the words “central” and “national” government.

<sup>4</sup> 141 B Pesos out of 804 B Pesos in 2003, cf. “An Analysis of the President’s Budget for Fiscal Year 2003”.

<sup>5</sup> For example, Manasan, R, “Local Public Finance in the Philippines: In Search of Autonomy with Accountability”, December, 2004; Mullins, D, “Assessment of the IRA” (forthcoming); Guevara, M, “The Fiscal Decentralization Process in the Philippines” (2004).

Concerns have been raised from many stakeholders about the extent to which the existing transfer system provides sufficient possibilities and incentives to improve critical areas of LGU performance such as own source revenue mobilisation, planning, budgeting, financial management performance, procurement and good governance and transparency.

However, while there is generally widespread knowledge about the internal revenue allotment (IRA) component of the IGFT system, including the size, the allocation criteria – the vertical and horizontal distribution of the funds- and the trends, the other sources of transfers, like the transfers from the congressional funds and the off-budget funding from the development partners, are less documented and understood.

Furthermore, there are areas, which have been *devolved* to LGUs according to the law<sup>6</sup>, but where central departments are still performing the tasks due to various reasons such as lack of capacity, availability of funds, institutional imperatives, traditions/historical reasons and/or economies of scale in production of services.

To the knowledge of the authors, the last study of some of these issues, carried out in 2001 (data from 1995-99), covered other issues than just the spending on the devolved LGU services and did not include congressional allocations and various donor funds.<sup>7</sup>

In the context of the ongoing development of the IGFT system, and the agreements made at the Philippine Development Forum between the development partners and the Government of the Philippines on the future agenda for the decentralisation reforms<sup>8</sup>, the Government and other stakeholders have expressed a strong wish to gain a better understanding of the non-IRA transfers to the LGUs, and the support from the national departments, agencies and corporations and donors to LGUs, within the devolved areas.

It is well known that the room for increasing the overall budget envelope for the IGFT system is very limited considering the existing financial situation of the Government of the Philippines. It is therefore of crucial importance that all the existing funds to LGUs and funds for local service delivery are allocated efficiently, in an equitable manner, and that they achieve the intended objectives, even if it concerns a relatively smaller part of the overall resource envelope available for LGUs.

Finally, the study should also be seen in the context of the ongoing dialogue on the linkage between LGU borrowings and grants, the pros and cons for making a clearer distinction between the two funding flows, and in the light of planned reforms in credit institutions and their operations<sup>9</sup>.

---

<sup>6</sup> In this Report this is referred to as “devolved functions” pursuant to the LGC of 1991. It should be noticed that the Code allows NGAs to continue to perform services within the devolved areas.

<sup>7</sup> See Annex 4 for a review of some of the main findings from this Study by Joseph J. Capuno, Thelma C. Manuel and Ma Bella T. Salvador: “*Estimating the IRA, Centrally-Provided Local Public Services and Other Central Transfers to Local Governments*”, 2001.

<sup>8</sup> Report of the Working Group on Decentralisation and Local Government, March 7-8, 2005

<sup>9</sup> Especially the establishment of the Municipal Finance Corporation.

## 1.2 Objectives

The specific objectives of this study are first and foremost to provide a better *overview of the non-IRA components* of the existing intergovernmental fiscal transfer system and *funding of LGU devolved services*, including the national government expenditure on devolved functions, congressional allocations utilised on LGU services and the off budget funding flows to LGUs.

Furthermore, the study should generate some initial concepts and options for the future design of a more performance based grant allocation system and/or a system focusing more on supporting the poorer LGUs. Separate notes provide an outline of the basic concept of performance based grant systems, and of the critical design issues to be considered if a more performance based transfer system is pursued.<sup>10</sup>

## 1.3 Scope of the Study

The Study will provide an overview (data) and analysis of the existing non-IRA transfers and funding of devolved services<sup>11</sup> in the broad sense, including the following components:

- i) Government Funded Programmes & Projects (GFPP): This is the Government Agencies/Corporations' funding of LGU devolved functions from *internally* generated revenues as part of the regular agency/corporation budget, excluding the Priority Development Assistance Fund (PDAF), see below;
- ii) Congressional Allocations (CA): This refers to the Programme & Projects funded by the Priority Development Assistance Fund (PDAF), allocated to devolved functions. While the legislators identify the activities/projects to be funded, the money is released to and implemented by a national government agency /corporation, subject to DBM guidelines;
- iii) Loans and Grant Funded (LGF): This refers to the ODA loans and grants-funded transfers from NGAs/GOCCs to LGUs and NGAs/GOCCs spending on devolved functions. The amounts included here are NGA/COCC expenditures or transfers to LGUs, which were given as “grants” to LGUs, including the GOP counterpart fund with budget cover. These grants may be stand-alone grants or matching grants given in conjunction with loans provided by the NG to LGUs. In the case of the latter, only the grant portion is included, as the Study does not review the LGU borrowing;
- iv) Off-Budget Funding (OBF): This refers to programmes & projects for devolved functions, funded from ODA in the form of grants or donations that are not recorded in the NG budget. In some instances, the donation is

---

<sup>10</sup>See the Paper: “*Overview of Concepts and Directions for Formulation of New Performance Based Grant Types*”, June 2005 and the Paper: “*Key Issues on Performance Based Grant Parameters*”, Final Report, August 2005.

<sup>11</sup> Devolved according to the Local Government Code.

channelled through an NG agency/corporation. In others, donations are given directly to the recipient LGUs and there is no NG record of the transaction.

In the Study, these four components are collectively called: the “non-IRA transfers” or the “**non-IRA funding**”. The study covers both non-IRA *transfers (in cash)* to LGUs for LGU implementation and spending and *centrally spent funds (direct spending)* on devolved LGU mandated functions, i.e. when national agencies/corporations implement the programmes & projects.

The Study does not deal in any detail with the other funds regarding the local share of taxes on wealth, barangay officials’ death and disability benefits, accident insurance funds and indigent health insurance, (in the amount of P 1-2 Billion), and dedicated for special, fixed, legislated and transparent purposes and does not deal with LGU own source revenues and borrowing. These sources are not included in the term “non-IRA funding” applied for this Study.

A second part of the Study has made an initial review of the scope for the reforms of the IGFT system within the area of a more performance oriented system, the range of key issues to be considered if performance oriented grants were to be developed and some initial suggestions for the way forward on some of the key design issues. This part also contains a summary of some of the international experiences in the use of performance based grant allocation systems.<sup>12</sup>

## **1.4 Study Approach**

The work has been conducted through consultations with primary and secondary documentary sources and detailed discussions with government agencies and corporations as well as donor representatives<sup>13</sup>. To support the collection of primary data, a set of detailed structured tables and questionnaires have been elaborated, including explanatory/guiding notes. The team conducted several rounds of consultations and dialogues with each national government agency as well as the GOCCs. In some cases, the primary data required by the study had to be collected by the central office from the regional offices.

The study covers twelve departments/agencies and three GOCCs with actual figures for Fiscal Year 2003. These departments/agencies are DA (including NIA), DepEd, DENR, DOF through the MDFO, DOH, DILG, DLR, DPWH, DSWD, DOT, DOTC and the PRRC. The GOCCs are PCSO, PAGCOR, and PTA.

---

<sup>12</sup> See the following papers: 1) “*Overview, Concepts and Directions for Formulation of New Performance Based-Grant Types*”, June 2005 and 2) “*Key Issues on Performance Based Grant Design Parameters*”, Final Report, August 2005.

<sup>13</sup> The Study was undertaken by a team of national consultants, Dr. Ma. Cecilia G. Soriano, Ms. Elizabeth P. Makayan and Ms. Josefina B. Nisperos and an international consultant Mr. Jesper Steffensen from the Nordic Consulting Group A/S Denmark. The team has been guided by Mr. Roland White, Senior Public Sector Specialist, EASPR, the World Bank, Washington D.C.

As mentioned, funding was classified into four fund sources, namely: 1) GFPP; 2) CA; 3) LGF; and 4) OBF. Each of these groups was broken down into three major sub-divisions<sup>14</sup>:

- 1) *Direct* NGA/GOCC spending on devolved services, i.e. programmes and projects implemented by the NGAs/GOCCs, versus *transfers* of funds to LGUs for LGU implementation and spending;
- 2) Types of LGUs: (i) provinces, (ii) municipalities, and (iii) cities; and
- 3) Types of expenditures: (i) Capital Outlays (CO); (ii) Maintenance and Other Operating Expenditures (MOOE); and (iii) Personal Services (PS).

In cases where a disaggregation was not possible by type of LGU or expenditure components, the amount was recorded under the “unallocated” account.

Questionnaires were also given to the representatives of the main development partners to capture the off-budget funding to LGUs (transfers and funding support in areas where the data was available) and information was collected through interviews with involved key stakeholders.<sup>15</sup>

The bulk of the data was collected from March - July 2005. Based on initial consultations with concerned government agencies, it was decided early on that data would be collected only for the year 2003 to indicate the size of non-IRA funding in a particular year. Attempting to establish data trends over several years would pose a tremendous task and would complicate the study unnecessarily<sup>16</sup>. Initially, both actual and budget figures were to be gathered. But since budget figures were either very different from the actual figures and/or missing for various NGAs, it was decided to apply only actual figures. All figures in this report are therefore actual 2003 figures<sup>17</sup>.

## **2. Overview of the Funding for Devolved Functions**

### **2.1 Overview of Total Public Sector**

The total public sector revenues in the Philippines are comprised of revenues collected by the national government agencies (NGAs), government owned and controlled corporations (GOCCs) and local government units (LGUs).

---

<sup>14</sup> In some cases, a fourth sub-division has been applied - the nature of the government development programmes/functions: i) economic, social and general services, ii) infrastructure and iii) agriculture and natural resources.

<sup>15</sup> Although the main focus has been on capital transfers from the donors to the LGUs, some of the main donors were asked to quantify the amount of “in-kind” /technical assistance they are providing to the LGUs to get a better overview of the entire non-IRA support from the center.

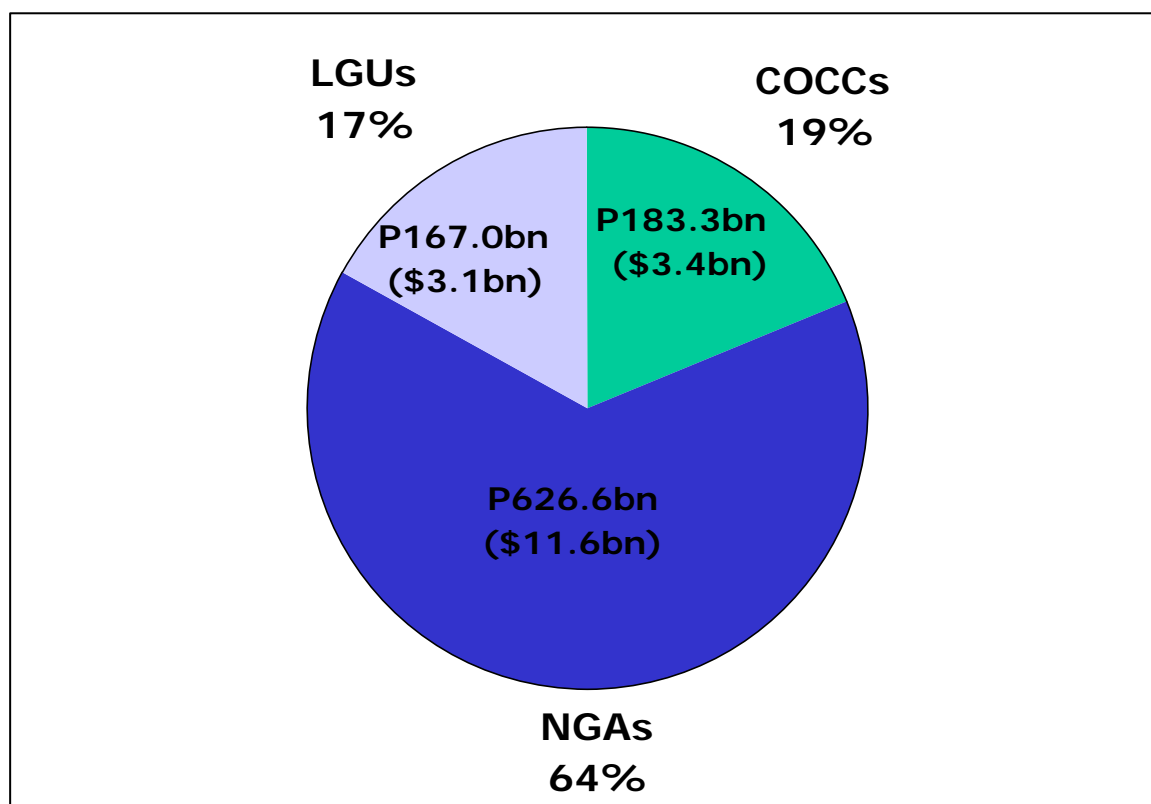
<sup>16</sup> It is important to mention that data on non-IRA support is not readily available in the central offices.

<sup>17</sup> Some figures under DA have been estimated (extrapolated) using information received from three of the regional offices.

In 2003, this amounted to P976.7 Billion (US\$ 18.0 Billion)<sup>18</sup> with NGAs accounting for P626.6 Billion (US\$ 11.6 Billion) or around 64.1%, GOCCs at P183.3 Billion (US\$ 3.4 Billion) or 18.8%, and LGUs at P167.0 Billion (US\$ 3.1 Billion) or 17.1%.

Of the P626.6 Billion (US\$ 11.6 Billion) collected by the NGAs in 2003, P 537.7 Billion (US\$ 9.9 Billion) or 85.8% was tax revenues of which, P 431.2 Billion (US\$8 Billion) or 68.8% were national revenues, see Diagram 2.1 below.

**Diagram 2.1: Composition of Public Sector Resources, 2003**



## 2.2 LGU Revenues and Funds for Devolved Functions

Table 2.1 overleaf shows the LGU revenues<sup>19</sup> and funds spent on LGU devolved services, broken down into main sources. *Group I* – LGU Revenues - are the figures typically provided in various statistics, whereas the *Group II* reflects the results from the present study and is the non-IRA funding (additional funds utilised on devolved service delivery functions).

<sup>18</sup>Actual un-adjusted figures for 2003, as presented in the Budget of Expenditures and Sources of Financing for Fiscal Year 2005, pages 3 and 322, prepared by the Department of Budget and Management.

<sup>19</sup> Also referred to as “income”.

**Table 2.1: Composition of LGU Revenues and Funds for Devolved Functions (2003)**

Type of Revenue	Size Billion Pesos	Size Million US\$	Share in Percentage
<b>I) LGU REVENUES</b>			
1.1. IRA	141.0	2,601.5	69.2
1.2. LGU shares in other taxes <sup>20</sup>	1.8	33.4	0.9
1.3. LGU Tax revenues	42.1	775.9	20.6
1.4. LGU Non-Tax revenues	13.1	241.2	6.4
1.5. Extraordinary receipts <sup>21</sup>	1.8	33.2	0.9
1.6. Inter-local transfers	0.8	15.5	0.4
1.7. Borrowing	3.3	60.2	1.6
<b>I) Total LGU Revenues (1.1 – 1.7)<sup>22</sup></b>	<b>203.9</b>	<b>3,761.1</b>	<b>100</b>
<b>II. NON-IRA FUNDING</b>			
2.1. Government Funded Programmes & Projects (GFPP)	4.1	75.7	16.2
2.2. Congressional Allocations to devolved functions (CA)	15.6	288.6	61.7
2.3. ODA Loans and Grants Funded transfers and spending on devolved functions (LGF)	5.4	100.0	21.3
2.4. Off Budget Funding of devolved functions (OBF)	0.2	3.7	0.8
<b>II) Total Non-IRA funding of devolved functions (2.1-2.4)<sup>23</sup></b>	<b>25.4</b>	<b>468.0</b>	<b>100%</b>
<b>III) Total funds used on devolved functions (I + II)</b>	<b>229.3</b>	<b>4,229.1</b>	<b>100%</b>
<b>Part 1: Share of LGU revenues of total funds</b>			<b>89%</b>
<b>Part 2: Share of Non-IRA Funding for devolved functions of total funds</b>			<b>11 %</b>

It should be noted that the total of rounded sub-components does not tally with rounding of total.

<sup>20</sup> Including LGU share in the national wealth tax.

<sup>21</sup> Operating and miscellaneous revenue, capital revenues, smaller grants, calamity funds etc

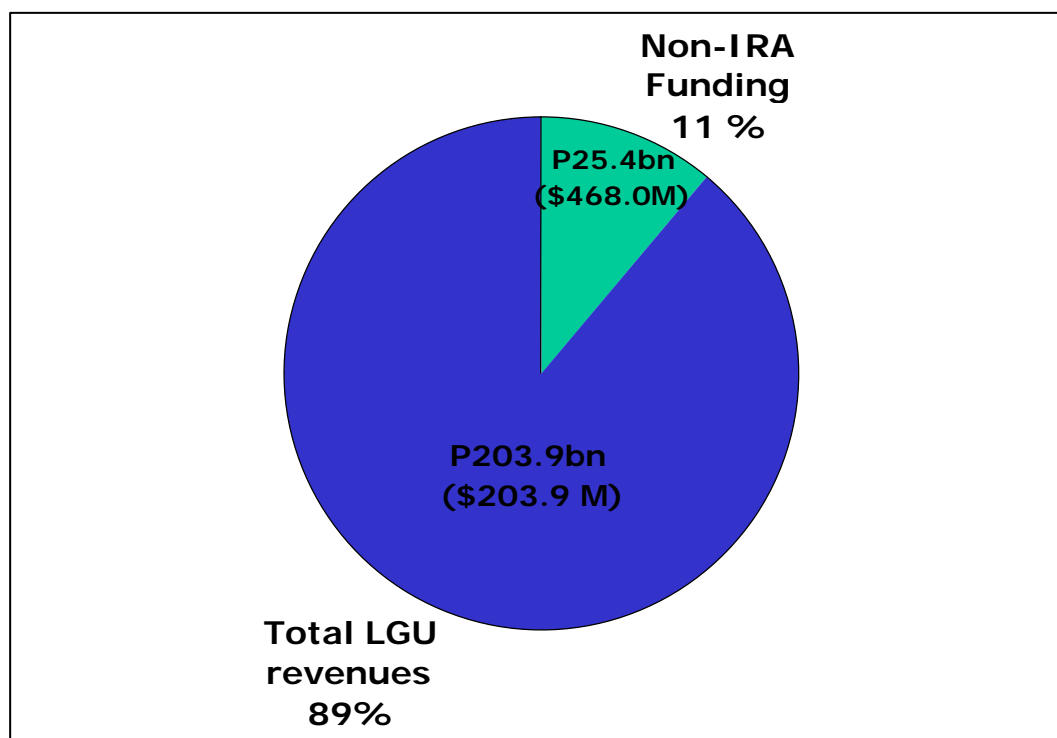
<sup>22</sup> Data on LGU revenues vary from source to source. The most updated figures from the Bureau of Local Government Finance (BLGF) of the DOF, based on reports submitted by the LGUs to BLGF, were used. The IRA includes the transfers to municipalities, provinces, cities and barangays. Data from other sources usually include only figures for provinces, municipalities and cities. In addition to these reported figures, there are smaller revenues collected by the barangays, which are not reflected in the official statistics. Borrowing is included as revenue, as it is contributing to the funding of LGU services. However, it is more rightly seen as a financing instrument.

<sup>23</sup> Data collected from Government agencies and corporations and donor agencies.

As it appears from Table 2.1, the transfers through the IRA are by far the most important LGU revenue source. However, there are significant funds spent on devolved services, not captured in the existing statistics on LGU revenues and expenditures.

The additional (non-IRA) funding for LGU functions is rather significant and constitutes approximately 11% of the total funds used for LGU functions. The diagram below shows a comparison of LGU revenues and the additional funding on LGU functions outside of the IRA transfer scheme.

**Diagram 2.2: Size of the Total Funding of Devolved Functions**

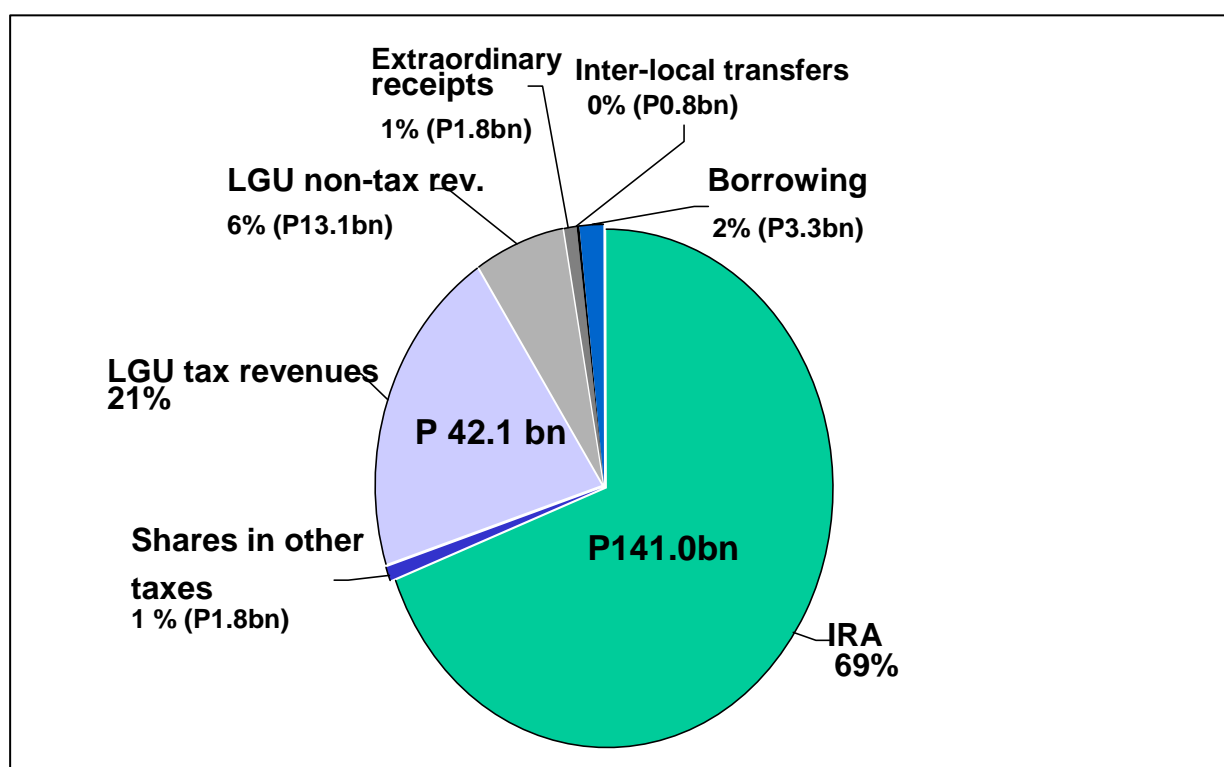


### 3. Detailed Composition of LGU Revenues

#### 3.1 Overview of the LGU Revenues

Diagram 3.1 below provides an overview of the LGU revenue sources as reflected in the LGU budgets and accounts. Brief descriptions of each of the main sources are presented in the following sections.

**Diagram 3.1: Composition of LGU Revenue Sources**



#### 3.2 IRA Transfers

The major funding source for the LGUs is the IRA transfers. The Internal Revenue Allotment accounted for P 141.0 Billion/US\$ 2,601.5 Million in 2003. Data from the Bureau of Local Government Finance show that LGUs (provinces, cities and municipalities) are dependent on the IRA for an average 69% of their total revenues and 73% of their expenditures in 2003<sup>24</sup>. For provinces, IRA accounts for around 83% of revenues and over 90% of their expenditures. For municipalities, IRA accounts for around 77% of revenues and 85% of expenditures. For cities, IRA dependence is much less at around 45% for revenues and just over 50% for

<sup>24</sup> It should be noticed that the total LGU revenues are higher than the total expenditures due to underutilisation of funds.

expenditures. The reliance on the IRA has increased over the years, and the IRA now constitutes more than 95% of the total grants.

About 40% of the national internal revenues collected by the NG are given to LGUs in form of the IRA grant (with a 3 years time-lag in data applied in the calculation). The IRA collections are derived from income taxes, value added tax (VAT), excise taxes, capital gains taxes and other taxes specified under Section 362 of the National Internal Revenue Code.

Computation of IRA share per LGUs follows a definite formula. The current IRA allocation is computed on the basis of internal revenue collections in the third fiscal year preceding the current year. The allocation is distributed among the different levels of LGUs as follows: Provinces (23%), Cities (23%), Municipalities (34%), Barangays (20%). The resulting amount is further divided among the LGUs in each level with the use of the following formula: population (50%), land area (25%), and equal sharing (25%).

For 2005, total IRA is budgeted at P151.6 Billion (US\$ 2,707 Million) or seven percent higher than in 2004, which had the 2003 budget re-enacted. In the meantime, the demand for basic services continues to increase with the growing population and higher level of expectations of the local constituencies. LGUs are also being mandated by various laws and national government agencies to focus on programs and projects to reduce poverty, respond to gender issues, protect the environment, modernize agriculture, and widen access to health insurance, among others.

In addition to the growing strain, the IRA has also become a less certain source of revenues for LGUs in terms of the timeliness of its release and even its absolute level. While the LGC provides for automatic release of the IRA and the Supreme Court has disapproved of various steps that the national government had taken in the past to reduce or delay IRA releases, there is still a provision in the LGC that in the event of an unmanageable public sector deficit, the President, following certain procedures, may adjust the IRA downwards, hence a risk if LGUs remain too reliant on the IRA.

Clearly, LGUs need to explore ways and means to increase and diversify their own source revenues to cover more of their growing expenditures, ensure better ownership and efficiency and improve their future sustainability.

### **3.3 Other Mandated Non-IRA Transfers**

According to BLGF, Table 2.1, the total revenues from shared taxes amounted to P 1.8 billion (US\$ 33.4 Million) in 2003<sup>25</sup>. Some of the major sources were the tobacco, tax share of national wealth and share of VAT.

Aside from the IRA in which all LGUs have a share of internal tax revenues, some LGUs have a share in taxes collected from enterprises or utilities operating in their locality, pursuant to laws other than the LGC. These include the Tobacco Excise Tax

---

<sup>25</sup> It should be noted that these amounts are registered in the official tables as part of the shares from national tax, i.e. under the reporting on the IRA transfers.

per R.A. No. 7171, Value Added Tax per R.A. No. 7643, Gross Income Tax paid by all enterprises within the Economic Zones per R.A. No. 7227, Franchise Tax per R.A. Nos. 8407 and 7963, and Special Privilege Tax for hydroelectric plants per R.A. No. 7156. The LGUs are free to use their shares from these taxes in any manner they see fit. For fiscal year 2003, only P100 million was released as share in the *tobacco excise* tax.

The Premium Subsidy for Indigents under the National Health Insurance Program (NHIP) is another smaller scheme. Pursuant to R.A. No. 7875, LGUs are encouraged to enrol their indigent constituents in the NHIP. It is being administered by the Philippine Health Insurance Corporation (PhilHealth). The National Government covers 50 percent of the premium for each indigent enrolled in the NHIP by the LGU with the LGU shouldering the remaining 50 percent. The NG subsidy is released to PhilHealth upon its submission of the necessary documents to show how many indigents were enrolled or renewed by how many LGUs in each year. In 2003 the *NHIP premium subsidy* was P 216 Million.<sup>26</sup>

In addition to the IRA transfers as mandated, the LGC also provides that LGUs shall have an equitable share in the proceeds from the development and utilization of *natural resources* within their areas. The NGAs and GOCCs are mandated to give a forty percent share from mining taxes, royalties, forestry and fishery charges, earnings from joint ventures or production sharing agreements to the provinces, cities or municipalities, and barangays where the natural resources are located. In the case of the NGA, shares in collections from the preceding fiscal year are to be remitted automatically like the IRA. In the case of GOCCs, remittances shall be made directly to the local treasurers within five days after the end of each quarter.

### **3.4 Local Revenue Sources**

Aside from the IRA and non-IRA transfers from the NG that have been mandated under various laws, LGUs also earn revenues from local sources. In 2003, locally sourced revenues amounted to P 55.1 billion (US\$ 1,017Million) or 27% of total LGU revenues, with tax revenues at P 42.1 Billion (US\$ 775.9 Million) or 21% of total income and non-tax revenues at P 13.1 Billion (US\$ 241.2 Million).<sup>27</sup> These sources were from the property taxes, income from economic enterprises, business taxes, other local taxes and non-tax sources from operating and miscellaneous revenues, user fees and charges. The most important tax revenues were the real property taxes (P22.2Billion/US\$409.3Million) and business taxes (P17.5 Billion/US\$ 322.7 Million).

For provinces, local revenue sources accounted for only 13% of total income of which 8% percent came from tax revenues. For municipalities, local revenues contributed 19% to total income, with tax revenues contributing 12%. Cities had a higher own

---

<sup>26</sup> For 2004, P1.335 billion was programmed to be released as share in the tobacco excise tax, P98 million for share in national wealth, P500 million for the NHIP, and a total of P118 million share in the value added tax, franchise tax, and economic zone gross income tax, for a grand total of just over P2 billion. For 2005, the total amount allocated is P2.657 billion.

<sup>27</sup> Based on data from BLGF.

funding share, 52%, of income coming from local sources, with 43% coming from local taxes.

### **3.5 Other LGU Revenues and Borrowings**

Finally, LGUs have a number of smaller revenue sources from extraordinary receipts in the tune of P 1.8 Billion /US\$ 33.2 Million, including the revenues from the calamity fund, revenues from inter-local transfers: P 0.8 Billion or US\$ 15.5 Million and from borrowing: P 3.3 Billion or US\$ 63 Million, see Table 2.1.

Thirteen LGUs have floated 15 bonds totalling close to P3 Billion with maturity ranging from five to seven years. Bonds are guaranteed by the LGU Guarantee Corporation co-owned by the Development Bank of the Philippines, Bankers Association of the Philippines and Asian Development Bank. Projects financed include the Caticlan-Boracay Jetty Port and Terminal Building, Tagaytay City Convention Center, and various public markets and housing projects

Data from the DOF show that more than 500 LGUs have availed of loans amounting to P60 Billion from government financial institutions such as the Land Bank of the Philippines and Development Bank of the Philippines and from the Municipal Development Fund.

## 4. Composition of the Non-IRA Funding

### 4.1. Overview of the Non-IRA Funding

#### 4.1.1 General Overview

Based on the reviews and consultations with NG, development partners and other agencies, the total non-IRA funding on devolved functions<sup>28</sup> amounted to P25.4 Billion or US\$ 468 Million from all sources within and outside the government's national budget<sup>29</sup>. The summary table 4.1 below, provides an overview of the four funding flows reviewed in this study.

**Table 4.1: Overview of the Non-IRA Funding (2003)**

Source	Size Billion Pesos	Size Million US\$	Percentage
1) Government Funded Programs & Projects (GFPP)	4.1	75.7	16.2
2) Congressional Allocations (CA)	15.6	288.6	61.7
3) (ODA) Loans and Grant Funded Transfers and Spending on Devolved Functions (LGF)	5.4	100.0	21.3
4) Off-Budget Funding (OBF)	0.2	3.7	0.8
<b>Total (1+2+3+4)*</b>	<b>25.4</b>	<b>468.0</b>	<b>100.0</b>

\* Figures are rounded

About 62% (P 15.6 Billion/US\$ 288.6 Million) of the total non-IRA funding for LGUs devolved functions came from the congressional allocations, which were spent on specific programs & projects that were identified by the proponent legislators.

21 % or P 5.4 Billion (US\$ 100 Million) of the funds were sourced from foreign loans and grants from ODA lending institutions. The national government agencies/institutions' spending on devolved functions accounted for 16 % or P 4.1 Billion (US\$ 75.7 Million).

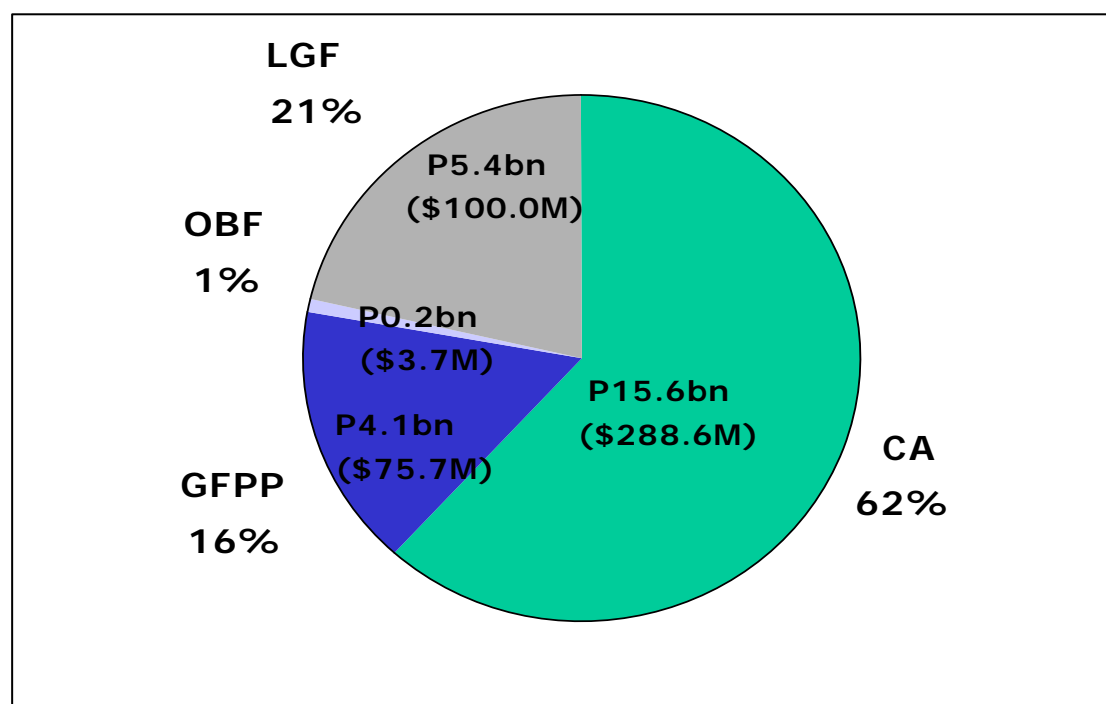
A very small share of the non-IRA funding, 0.8% or P0.2 Billion (US\$3.7 Million), came from off-budget funding which foreign development partners provided directly to LGUs or through a government agency for programs/projects of local concern.

<sup>28</sup> Excluding the smaller statutory transfers and the LGU own revenue sources as defined in sections 1.3 and 2.

<sup>29</sup> While the figures are from 2003, we expect roughly the same amount today (2005), except for the congressional allocations, which have been reduced by 40 % in the 2005 Budget.

These expenditures are not recorded in the books of accounts of the national government. Diagram 4.1 below, provides an overview of the distribution.

**Diagram 4.1: Distribution of non-IRA Funding Across the Four Components**



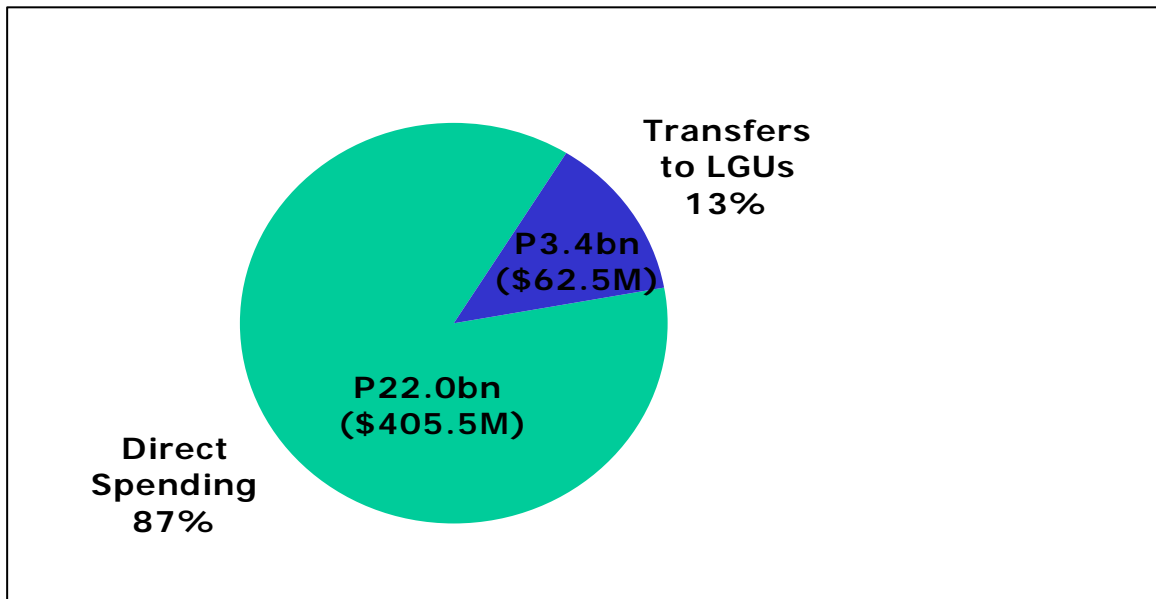
As mentioned under the methodology, the Study reviewed further details of the funding on the devolved functions. The sections below provide an overview of the main findings.

#### 4.1.2 Direct Spending Versus Transfers of funds for Devolved Functions

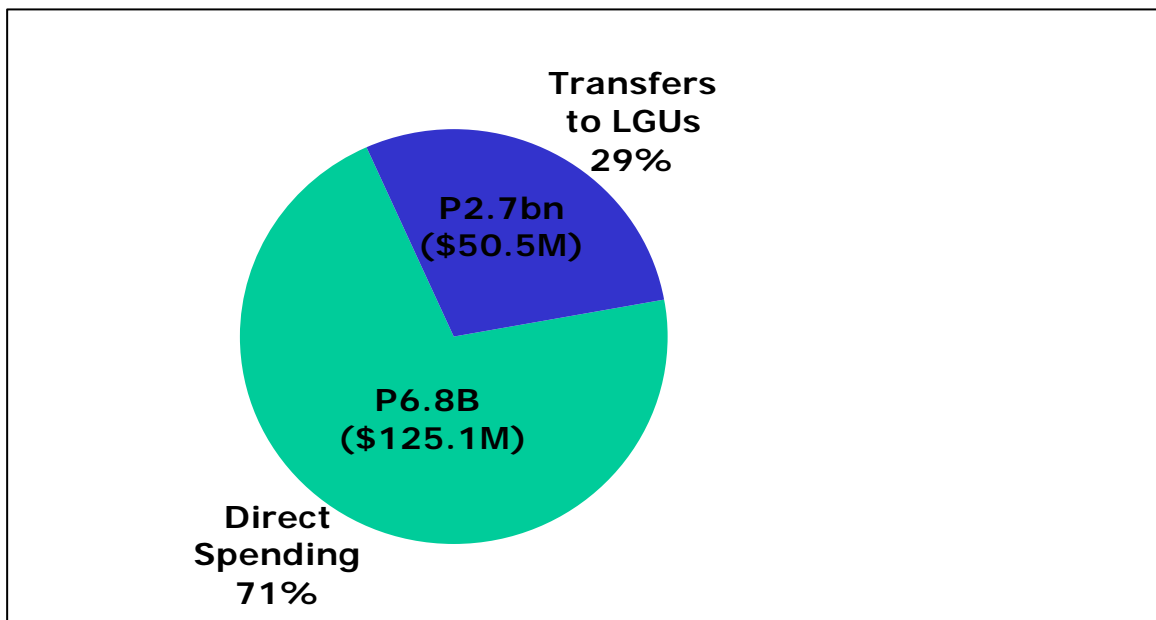
Of the total amount, of P25.4 Billion (US\$468.0 Million), 86.6% or P22.0 Billion (US\$ 405.5 Million) were expended *directly* by NGAs for regular programs/activities on devolved functions. Funds transferred (in cash) to LGUs amounted to P3.4 Billion (US\$ 62.5 Million) or only 13.4%.

The *transferred* funds are covered by a memorandum of agreement based on existing laws, rules, procedures or other legal basis. Excluding the CAs and OBF components, the transferred share increases to 28.8%, see the diagrams 4.2 and 4.3 overleaf, which show the distribution, *including* (all four components) and *excluding* the CA/OBFs.

**Diagram 4.2: Direct Spending Versus Transfers – Including all Sources**



**Diagram 4.3: Direct Spending Versus Transfers – Excluding the CA and the OBF Components**



The transfers included e.g. the Ginintuang Masaganang Ani (GMA) of DA; part of the school building programs of DepEd; construction of local roads and bridges including farm to market roads of DPWH, DLR, and DILG; social welfare services extended by DSWD, DOH, PCSO and PAGCOR.

Of the Government Funded Programmes & Projects (GFPP), P 0.6 Billion (US\$ 11 Million) was transferred to LGUs and P3.5 Billion (US\$ 64 Million) was spent at the NG level directly on devolved services.

Congressional allocations (CA) are regular programs and form part of the authorized NGA functions. However, CA is treated separately from GFPP to distinguish mandatory obligations of the government from discretionary programs. The 61.7% of NGAs expenditures, which came from legislators’ initiatives, was divided into P15.1 Billion (US\$ 278 Million) for *direct spending* and P0.6 Billion (US\$ 11 Million) in actual *cash transfers* to LGUs.

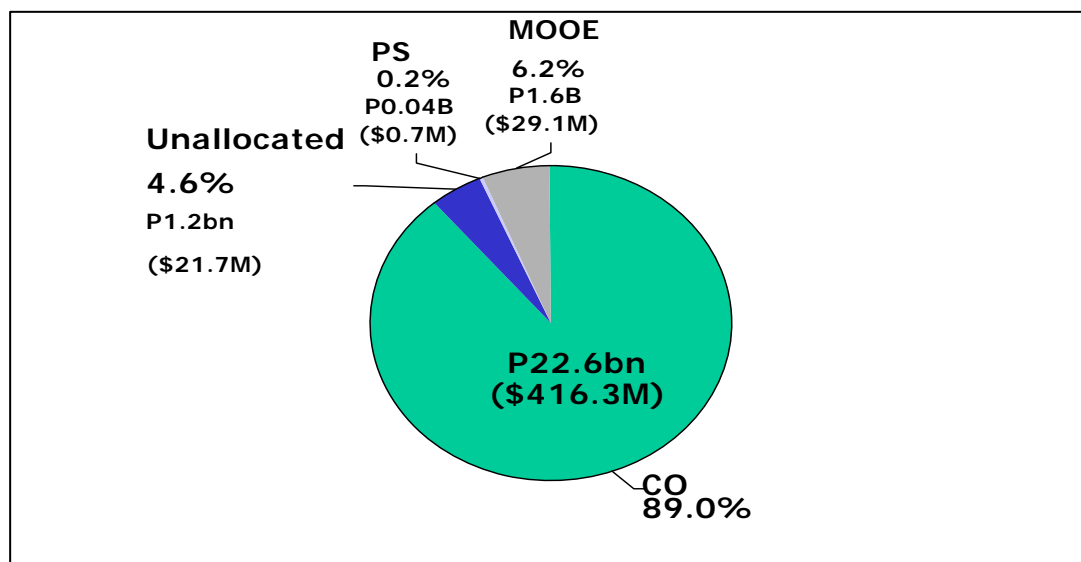
Foreign loans and grants, which amounted to P5.4B (US\$ 100.0 Million) were used fore environmental projects, schoolbuildings, agricultural and agrarian reform programmes, infrastructure, and/or financial assistance to LGUs which were undertaken by DENR, DepEd, DA, DLR, DOT, DOTC, and MDFO. 60.6% or P3.3 Billion (US\$ 60.6 Million) was used at the NGA level (direct spending) and 39.4% or P2.1 Billion (US\$39.4Million) was transferred to LGUs.

In the case of off budget funding, which accounted for only P0.2B (US\$3.7M) only P0.07B (US\$ 1.2 Million) was transferred to LGUs <sup>30</sup>.

#### 4.1.3 Types of Funds – Economic Categories

Diagram 4.4 below shows the composition of the funds, divided on i) Personal Salaries (PS), ii) Maintenance and Other Operating Expenses (MOOE) and iii) Capital Outlays (CO).

**Diagram 4.4: Composition of the Non-IRA Funding by Object Class**



<sup>30</sup> It was generally difficult to track the off- budget funding due to lack of reports from LGUs.

The bulk of the expenditures were used for capital expenditures amounting to P22.6 Billion (US\$ 416.5 Million) or 89% of the total funds. These were used for the construction of school buildings, farm to market roads, irrigation, ports and airports, potable water supply systems, motor vehicles and other equipment.

MOOE accounted for 6.2% at P1.6 Billion (US\$ 29.1 Million). These funds were used for supplies, travel, power and utilities and other administrative cost for devolved activities including incentives given to LGUs for DA extension workers. PS, merely at 0.2% or P0.04 Billion (US\$0.7 Million) represents salaries/allowances and benefits of personnel under the foreign assisted and locally funded projects. Other funds, which could not be broken down were lumped under “unallocated” took up 4.6% or P1.2 Billion (US\$21.7 Million). The unallocated portion represents VAT payments, including mandatory allocations in the budgets of PCSO and PAGCOR.

#### **4.1.4 Types of Funds – the Nature of Development Functions**

The funds were further disaggregated as to the nature of government development programs/functions. The sectors identified are: 1) economic, social and general services, 2) infrastructure and 3) agriculture and natural resources. The economic, social and general services “sector” with DSWD, DOH, DILG, MDFO, PCSO, and PAGCOR accounted for P2.3 Billion (US\$ 42.1 Million). Infrastructure was the most significant group with P19.9Billion (US\$366.8 Million) (DepEd’s schoolbuilding’s programs, DPWH, DOT, DOTC, PRRC and PTA); and agriculture and natural resources took up P3.0 Billion (US\$55.3 Million) for DA including irrigation, DLR, and DENR.<sup>31</sup>

#### **4.1.5 NGAs and GOCCs**

NGAs contributed P24.5 Billion (US\$ 451.2 Million), which is 96.4 % of the total funds, whereas the GOCCs contributed only P0.7B (US\$ 13.1 Million) or 2.8% with the OBF accounting for the remaining P 0.2 Billion (US\$3.7 Million). Please see Section 4.3.1 for further details.

#### **4.1.6 Types of LGUs**

The distribution of the aggregate amount of P25.4 Billion by LGU type reveals that municipal functions received the largest share of the funding, 68.0% or P 17.2 Billion (US\$ 318 Million). Provincial functions received P1.1 Billion (US\$ 20 Million) and cities received P5.4 Billion (US\$ 100 Million) while P1.6Billion (US\$ 29 Million) was classified as “unallocated”. Table 4.2 and the diagrams overleaf provide an overview of the break down of the figures.

---

<sup>31</sup> The remaining P 0.2 Billion or 3.7 Million US\$ was accounted for by the off-budget funding.

**Table 4.2: Overview of the non-IRA Funding- Four Components ( 2003)**

(Account figures in Million Pesos)

LGU Level	1) Government Funded Program/Project (GFPP)		2) Congressional Allocation (CA)		3) Loans and Grants Funded (LGF)		4) Off-budget Funding (OBF)		5) Total	
	Direct	Transfers	Direct	Transfers	Direct	Transfers	Direct	Transfers	Direct	Transfers
(2003)										
Provinces	8.0	70.6	78.3	16.0	536.4	375.7	25.0		647.7	462.4
Cities	423.0	458.2	4,127.0	77.3	73.3	91.9	104.0	67.0	4,727.4	694.5
Municipalities	2,315.9	72.3	10,710.5	318.2	2,483.5	1,340.6	4.0		15,513.9	1,731.1
Unallocated	747.8	4.8	146.8	169.9	193.6	325.5			1,088.1	500.2
<b>Total</b>	<b>3,494.7</b>	<b>605.9</b>	<b>15,062.6</b>	<b>581.4</b>	<b>3,286.8</b>	<b>2,133.7</b>	<b>133.0</b>	<b>67.0</b>	<b>21,977.1</b>	<b>3,388.2</b>

Table 4.2 shows that municipal functions dominated the overall funding flow because most of the congressional allocations were spent on municipal functions under specific congressional districts as specified by the proponent legislators. Also, the school-building programs were lumped under municipalities where the schools are located. Finally, the allocations for barangays were included under the municipality level of government.

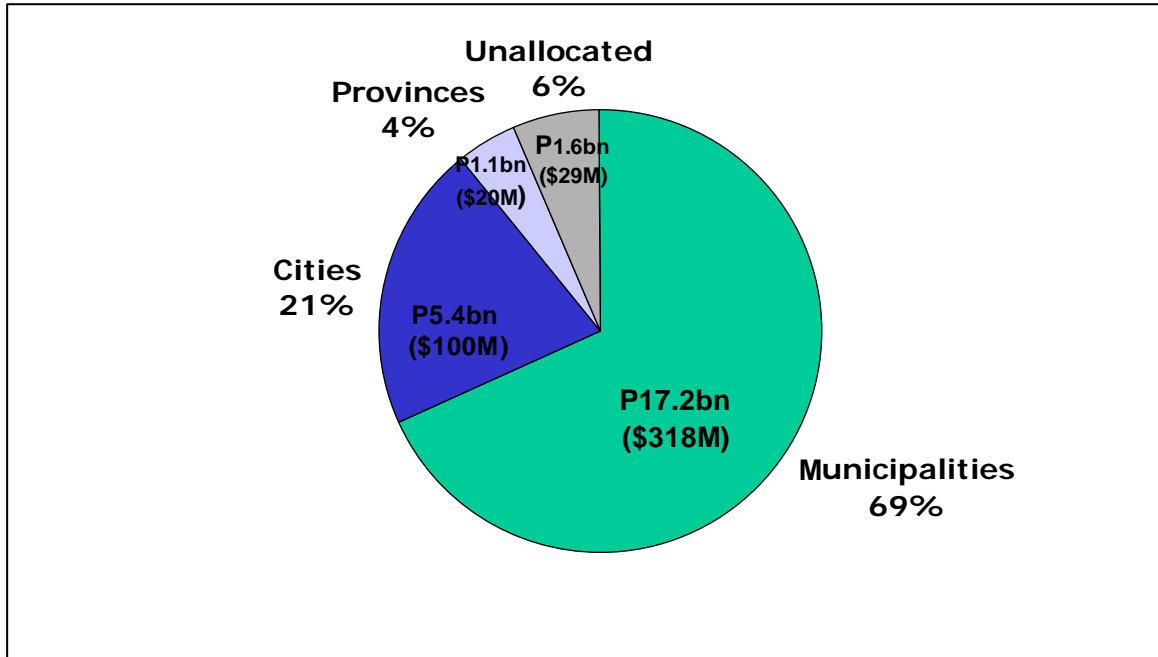
The greatest share of funds for city functions came from congressional allocations, shares from PAGCOR and PCSO and from the off budget sources.

Provinces expenditures came from JICA, which is part of the off-budget funding, and from the programs of DENR and the MDFO.

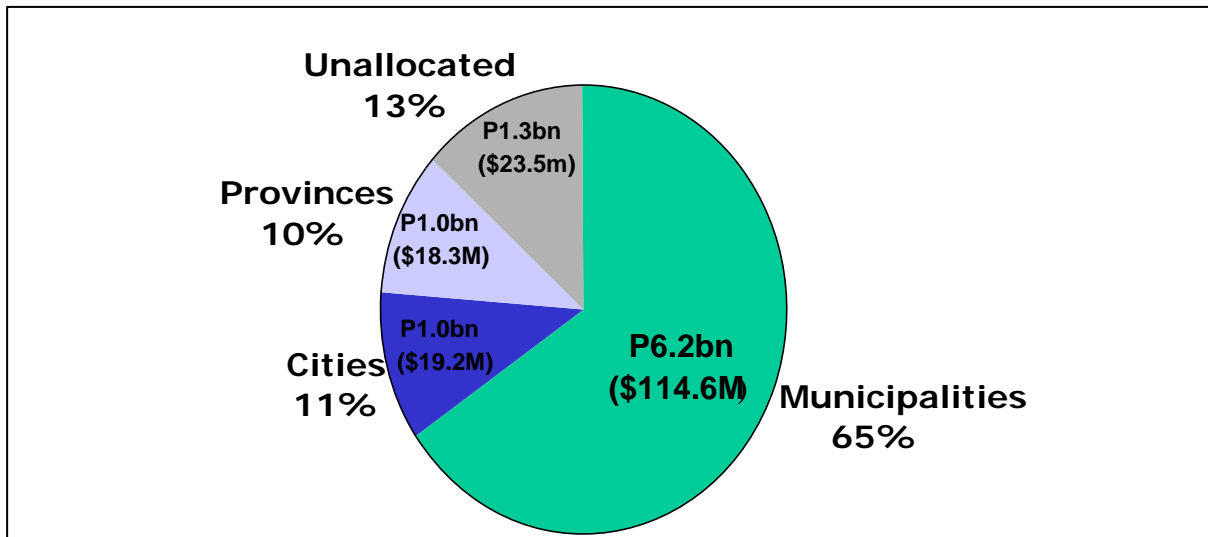
The unallocated portion (P1.6 Billion) is attributed to the unallocated data on GMA programs under DA and other various lump-sum items in the report of actual spending. Data used for GMA programs were based on actual submissions of Regions IV, VI, and XI and the extrapolated figures for the other regions using the average actual obligations of the three actual submissions received. The extrapolated data were estimates and thus lumped under the unallocated portion. Other unallocated items include VAT payments under PRRC, unidentified expansion sites for health development under DOH, some PDAF projects under DILG, foreign assisted projects of DepEd, the Education Facilities Improvement project, and the Forestry Sector Project of DENR, among others.

The diagrams 4.5 and 4.6 overleaf show the distribution on types of LGUs for the non-IRA funding, including and excluding the CA and off-budget funding components.

**Diagram 4.5: Distribution of Non-IRA Funding Across Types of LGUs**



**Diagram 4.6: Distribution of Non-IRA Funding across Types of LGUs, excluding funding from CA and OBF**



## **4.2 Detailed Overview of Non-IRA Funding**

### **4.2.1 Government Funded Programmes and Projects**

The government funded programmes and projects, i.e. functions, which are devolved according to the legal framework, but still performed or funded by the central agencies/corporations, amounted to P4.1 Billion (US\$ 75.7 Million). 85% or P3.5 Billion (US\$ 64.5 Million) was direct spending by NGAs and the actual cash transfers to LGUs amounted to P0.6B (US\$ 11.2 Million).

Expenditures reported under government spending on devolved functions came from programs of the DA, DepEd, DENR, DILG, DOH, DPWH, DOT, DOTC and from the GOCCs: PCSO, PAGCOR and PTA.

Examples of these activities were expenditures of DA amounting to P0.8 Billion (US\$ 16 Million), which focused on food security programs implementing the AFMP law requiring LGUs direct participation through the extension workers and locally funded projects mostly based in Mindanao. The school-building programs (SBP) amounting to P1.7 Billion (US\$ 32 Million) was implemented pursuant to the provisions of RA No.7880, defining the mechanics for constructing classrooms by DPWH, DepEd, LGUs and/or schools. The implementation of the SBP requires coordination with representatives of legislative districts and the concerned LGUs. Although there is no physical transfer of ownership to the LGUs, the SBP was included in this study, since it is part of the activities devolved under the LGC. The maintenance of the school buildings and facilities principally rest with the DepED but LGUs can provide funds out of the Special Education Fund.

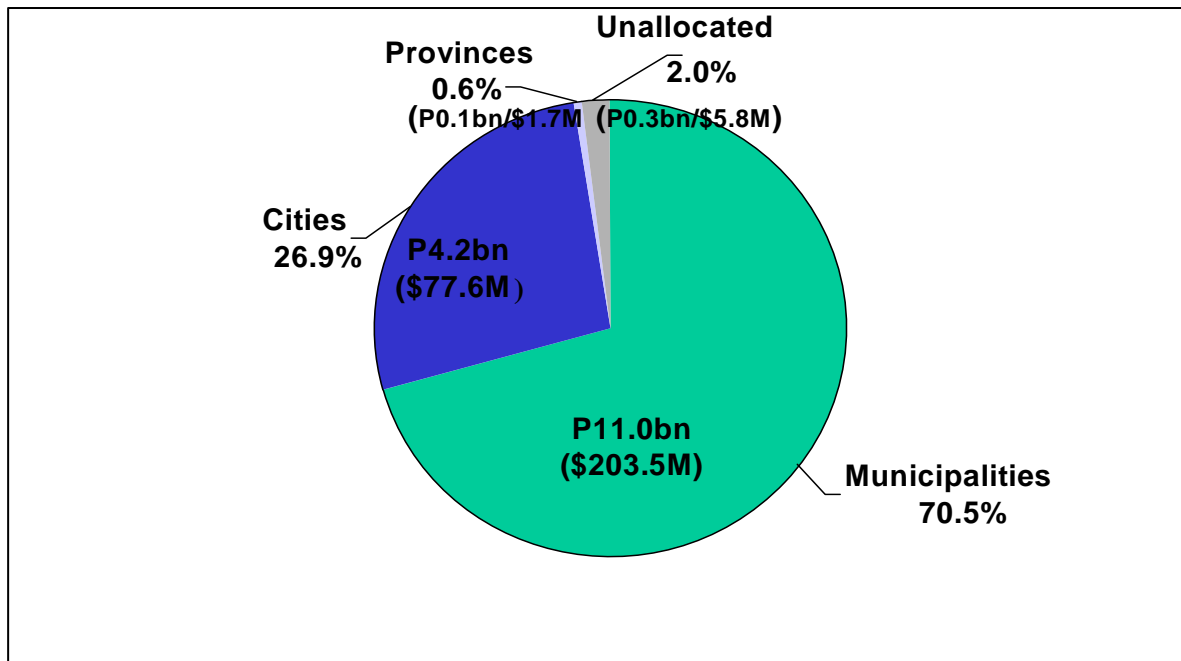
Other sources were the DOH's Center for Health Development reported P0.09 Billion (US\$ 1.7 Million) for the implementation of its hospital health services programs and provision of health care assistance to supplement LGUs requirements and DPWH's allocation of P0.8 Billion (US\$ 15.4 Million) which was intended to address infrastructure deficiencies in LGUs' requirements for farm to market roads and/or local bridges. DOTC transferred P0.03 Billion (US\$ 0.5 Million) to LGUs for ports and airports programs/activities. PTA reported P0.02 Billion (US\$ 0.4 Million) for the construction of various tourism facilities. Finally, financial assistances were extended to LGUs by DOT (P0.01 Billion/US\$ 0.1 Million); PCSO (P0.1 Billion/US\$ 2.1 Million) and PAGCOR (P0.4 Billion/US\$ 8 Million).

### **4.2.2 Congressional Allocations**

A total of P15.6 Billion (US\$ 288.6Million) was given by various legislators for specific projects for LGUs functions in 2003, broken down into direct spending, P15.0 Billion (US\$ 277.9 Million) and P 0.6 Billion (US\$ 10.7 Million) as transferred cash to LGUs.

About 70.5% of the total CA was channelled to municipalities, 26.9% to cities, provinces: 0.6% and unallocated: 2.0% as shown in the Diagram 4.7 overleaf.

**Diagram 4.7: Distribution of the total CAs across types of LGUs:**



More than 95% of the CA was used for capital outlays: P14.9 Billion (US\$ 274.6Million), MOOE accounted for 4.0% or P0.6 Billion (US\$ 11 Million) and the remaining 1% was unallocated. No amount was allocated for personal services.

DPWH incurred the bulk of the expenditures representing infrastructure projects such as local roads, bridges, flood control, water supply systems, multi-purpose building and other devolved projects amounting to P14.5 Billion (US\$ 266.8 Million). DILG spent P0.7 Billion (US\$ 12.6 Million) for the implementation of its Community Based Law Enforcement Public Safety programs (CBLEPSP), purchase of various multi-cab vehicles, other equipment as well as undertook programs and projects addressing terrorism and lawlessness in Mindanao. DA's allocation amounting to P0.2 Billion (US\$ 3.9 Million) was for the conduct of post harvest research and extension services and for the implementation of GMA programs. DLR's share of the CA was used for road concreting and constructed farm to market roads, while, PCSO's share was for the implementation of different health programs, medical assistance and services as well as undertook various charity projects as identified by the proponents.

### 4.2.3 Loans and Grants Funded Transfers and Spending

Loans and Grants funded transfers and spending on devolved functions, sourced from development partners (ODA), accounted for P5.4 Billion or US\$ 100.0Million.<sup>32</sup> ODA funding comes either through multilateral institutions or bilateral programs. It

<sup>32</sup> The study captured only the portion of the foreign loans and grants to the central government that were passed on to LGUs in the form of grants (not loans) and funds spent by the agencies on LGU devolved services.

can take the form of either concessional loan or grant. Approved loans/grant proceeds are included in the annual appropriations to finance specific activities or projects.

Foreign loans and grants funded programmes & projects accounted for 21.4% of the total expenditures of NGAs/GOCCs for devolved projects/activities. More than half of it, 60.6% or P3.3 Billion (\$60.6 Million) was direct spending of the agencies concerned while the difference of 39.4% or P 2.1Billion (US\$39.4 Million) represents fund transferred to LGUs.

Almost 88.6 percent of these expenditures were capital outlays; the rest was thinly distributed to MOOE (8.8%), PS (0.6%), and unallocated funds: (2.0%).

The lion's share of the expenditures went to the municipal functions (70.6%) followed by provinces (16.8%), cities (3.0%) and unallocated: (9.6 %).

More than 50% of the loans/grants funded P&P or P2.7 Billion (US\$ 50.7 Million) were garnered by two biggest departments, namely DepEd (P1.4 Billion/US\$ 26.1 Million) and DPWH (P1.3 Billion/US\$ 24.5 Million). The other half went to DENR and DLR with P0.64 Billion/ US\$ 11.9 Million and P0.65Billion / US\$ 12.1 Million, respectively; followed by MDFO (P 0.46 Billion/US\$ 8.5 Million). DA took up P0.48 Billion /US\$ 8.9 Million; DSWD got P0.2 Billion /US\$ 4 Million; while DILG and PRRC reported P0.14 Billion/US\$ 2.5 Million and P0.08 Billion /US\$ 1.4 Million, respectively.

The loans/grants were extended to finance rural infrastructure such as local access roads, farm to market roads, bridges, water supply systems, communal irrigation systems, public markets, slaughterhouses, school, multi purpose buildings, parks, health centres, solid waste and other equipment or utilization in the form of commodities used to support selected priority social services projects.

42.6% or P2.3Billion (US\$ 42.6 Million) of the loan/grant proceeds came from the WB and IBRD. These were used for the Mindanao Rural Development Project under the DA and DENR (Coastal and Marine Biodiversity Conservation Component - Region XII); school buildings under the TEEP, of the DepEd; the Local Government Finance and Development Project managed by the MDFO to finance various municipal infrastructures; the Agrarian Reform Communities Development Project; and the LGU Urban Water Supply Project of the DILG.

A total of P1.5 Billion (US\$ 27.6 Million), representing 27.6% of the total loans/grants came from ADB and JBIC. These funds supported agrarian reform communities projects and various infrastructure projects, DENR forestry project, school building component of the Secondary Education and Development Improvement project of the DepEd, the DILG projects for the Mindanao basic urban services sector and the rural water supply and sanitation sector, and the Pasig River infrastructure on environmental preservation areas.

The Austrian Government supported the Tulay ng Pangulo project being implemented by the DPWH. This is a loan contracted by the Office of the President for construction of community bridges all over the country.

#### **4.2.4 Off-Budget Funding Sourced from Donors**

The total funds for devolved services sourced from off budget funding was modest P0.2 Billion (US\$ 3.7 Million) and was funded by the World Bank, ADB, JICA and GTZ.

While there is a lot of donor support for LGUs, much of it is for capacity building and most projects are implemented in partnership with a national government agency. Thus, very few donor programs meet the criteria for off-budget funding for activities devolved to LGUs. Those that do are primarily capacity building programs that have an investment or project component. One example is the Cebu Socio Economic Empowerment and Development Project (CEBU-SEED) of the Japan International Cooperation Agency (JICA). The project aims to build local development mechanisms with strengthened local government administration in partnership with communities and NGOs for sustainable and effective use of development resources. It involves the dispatch of Japanese experts, training in Japan, and local activities such as the supply of equipment and implementation of small-scale projects. Disbursements for local activities in 2003 amounted to P25 million. Another example is the Integrated Water Resources Management Program of the GTZ. In addition to the technical advisory, logistical support and training provided to promote partnerships between LGUs and communities and build up capabilities among key stakeholders, water supply demonstration systems and a water laboratory were constructed in three municipalities in Bantayan Island near Cebu with a total cost of P4 million.

Other sources of off budget funding from donors are grants that are made available on a competitive basis to countries within certain regions or participating in certain programs. An example is the Global Environment Facility administered by the World Bank from which Marikina City was able to get funding worth P0.07 Billion to construct bikeways. Another example is the Japan Fund for Poverty Reduction (JFPR) administered by the Asian Development Bank (ADB) to pilot innovative, participatory and direct poverty reduction projects that are linked to existing ADB loans. Four Philippine projects have qualified for funding, two of which directly finance devolved activities with about \$1.9 Million or P0.10 Billion in form of a grant. These are the On-Site Integrated Urban Upgrading for Vulnerable Slum Communities in Payatas, Quezon City and the Off-Site Relocation, Shelter and Urban Services for Vulnerable Slum Communities in Muntinlupa City.

### **4.3 Analysis of data by Department/Agency and Corporation**

#### **4.3.1 Overview of Funding by Agency and Corporation**

Table 4.3 and diagrams 4.8 and 4.9 overleaf provide an overview and distribution of the funding by the various agencies – the total amount is P 25.4 Billion (US\$ 468.0 Million)<sup>33</sup>. NGAs expended 96.4% of the total funds amounting to P24.5 Billion

---

<sup>33</sup> As the CA is significant for the overall figures, the distribution is shown including and excluding the CA component.

(US\$ 451.2 Million); GOCCs expended 2.8% or P0.7 Billion (US\$ 13.1 Million) and the balance of 0.8% or P0.2 Billion (US\$ 3.7 Million) is from the off budget funding.

The DPWH infrastructure projects accounting for 65.5% of the total expenditures. Funding sources for these different programs/projects come from their annual appropriations inclusive of the congressional allocations as well as funds received from other agencies for specific infrastructure projects.

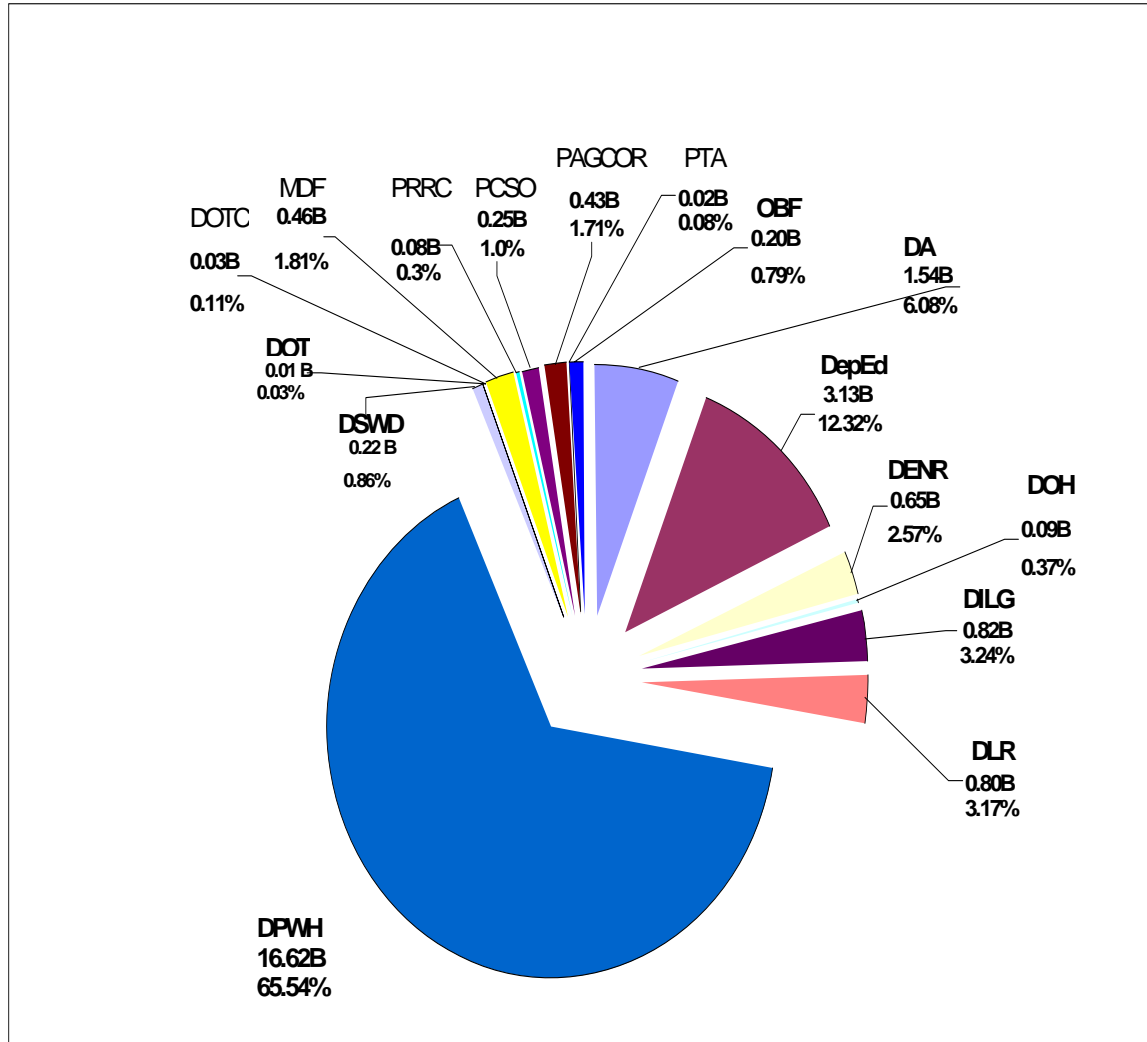
Although the school building program is also being implemented by DPWH, its funding is reported under DepEd. DepEd expenditures accounted for 12.3% of the total non-IRA fund transfers both sourced from the general appropriations and foreign loans/grants, while the Department of Agriculture accounted for 6.1% from all sources. The remaining funds were thinly distributed among the rest of the agencies, see Table 4.3 below.

**Table 4.3: NON-IRA FUNDING FOR LGU DEVOLVED FUNCTIONS (2003 Distribution by Department and Corporation)**

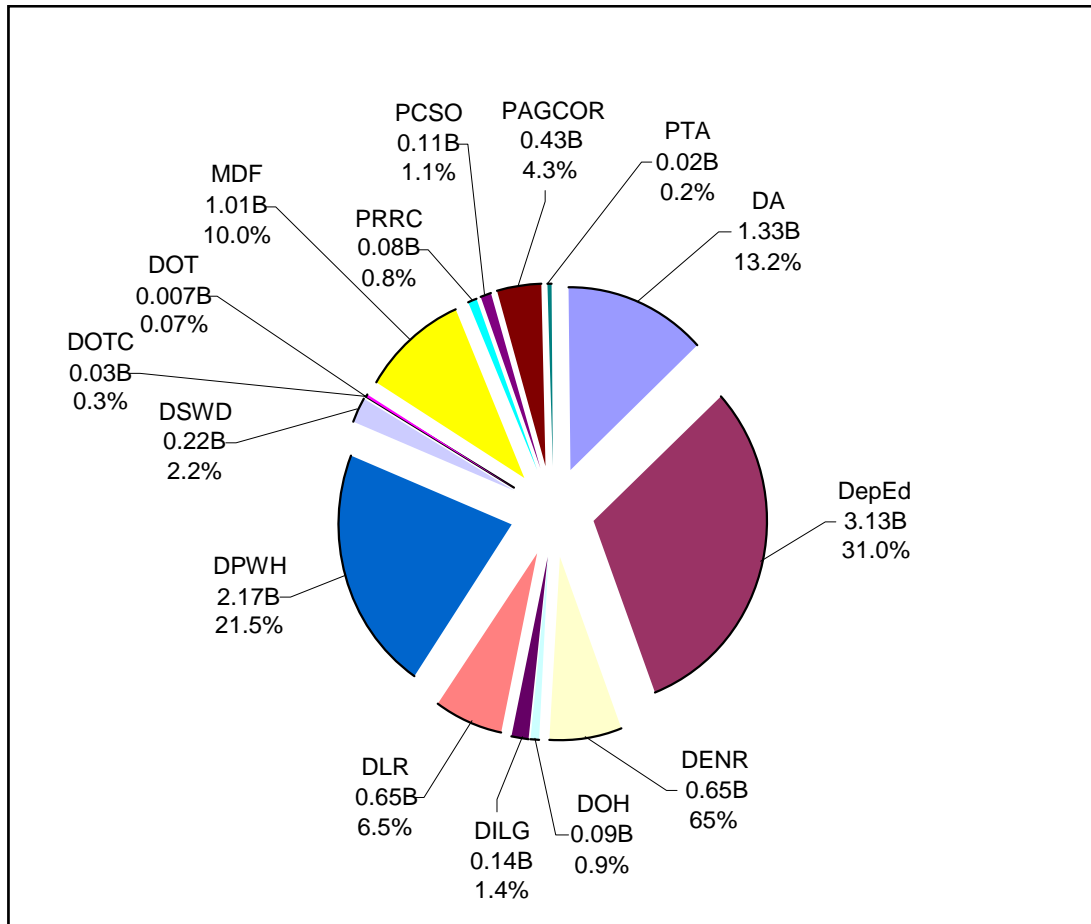
Department/Corporation	Government Funded Programs/Projects	Congressional Allocations	Loans and Grants Funded	Off-Budget Funding	Grand Total
Department of Agriculture	847,224	211,484	484,616		1,543,324
Department of Education	1,710,433		1,415,497		3,125,930
Department of Environment and Natural Resources	8,415		644,063		652,478
Department of Health	94,669				94,669
Department of Interior and Local Government	500	685,602	136,396		822,498
Department of Land Reform (formerly Department of Agrarian Reform)		149,000	654,551		803,551
Department of Public Works and Highways	836,637	14,458,011	1,329,860		16,624,508
Department of Social Welfare and Development			218,887		218,887
Department of Tourism	6,915				6,915
Department of Transportation and Communication	27,961				27,961
Municipal Development Fund Office			460,049		460,049
Pasig River Rehabilitation Commission			76,675		76,675
Philippine Charity and Sweepstakes Office	114,313	139,942			254,254
Philippine Amusement and Gaming Corporation	433,200				433,200
Philippine Tourism Authority	20,378				20,378
Off-budget Funding (OBF)				200,000	200,000
<b>Grand Total</b>	<b>4,100,645</b>	<b>15,644,039</b>	<b>5,420,594</b>	<b>200,000</b>	<b>25,365,278</b>

Diagram 4.8 below provides an overview of the non-IRA funding (all four components) by department/corporation.

**Diagram 4.8: Overview of the Non-IRA Funding by Department**



**Diagram 4.9: Overview of the Non-IRA Funding by Department net of Congressional Allocation and Off-Budget Funding**



Excluding the congressional allocations, the DepEd accounted for the biggest share of 32.8%, followed by DPWH with 22.8%, DA, 14 % and DENR, 6.9%.

The diagrams show that the congressional allocations for the activities under the DPWH took up a large share of the total reported non-IRA funding. However, there were other important sectors.

Table 4.4 overleaf shows the contribution of the major departments and some examples of the largest 20 Programmes & Projects.

**Table 4.4: Distribution of the Non-IRA Funding on the Main Departments**

Dept.	Aggregate (Million Pesos / share of total)	Direct Spending by the NGA	Transfers to LGUs	Main Direct Spending Program (s) (Million Pesos)	Main Transfer Program (s) (Million Pesos)
DepED	3126 Million (33 %)	2692 M	434 M	<input type="checkbox"/> School Building Programme (1,710 M) (GFPP) <input type="checkbox"/> Third Elementary Education Comp. (837M) (LGF) <input type="checkbox"/> Secondary Education Development Improvement Comp. (143M) (LGF)	<input type="checkbox"/> Third Elementary Education Comp. (433M) (LGF)
DPWH	2166 Million (23%)	2,166 M	0 M	<input type="checkbox"/> Tulay Ng Pangulo Project (1,330M) (LGF) <input type="checkbox"/> DA Farm to market roads (546M) (GFPP) Local infrastructure programmes (291M) (GFPP)	
DA	1332 Million (14%)	877 M	455 M	<input type="checkbox"/> GMA incentive allowances to extension workers (347M) (GFPP) <input type="checkbox"/> Balikatan Sagip Patubig Project (378M) (GFPP) <input type="checkbox"/> Integrated food security project (39M) (GFPP) <input type="checkbox"/> Fishery resource (28M) (LGF) <input type="checkbox"/> Irrigation project (14M) (LGF)	<input type="checkbox"/> GMA programs (12M) (GFPP) <input type="checkbox"/> Mindano Rur. Dev. Programme (410M) (LGF) <input type="checkbox"/> Upland Dev. Programme (32M) (LGF)
DLR	655 Million (7%)	0 M	655 M		<input type="checkbox"/> Agriculture Reform Community Project (230M) (LGF) <input type="checkbox"/> Mindanao sust. settlement area devt. (200M) (LGF) <input type="checkbox"/> Agriculture Reform Com. Devt. Project (94M) (LGF)
DENR	652 Million (7 %)	633 M	19 M	<input type="checkbox"/> Forestry- infrastructure: (344 M)(LGF) <input type="checkbox"/> Community Based Forestry (178M)(LGF) <input type="checkbox"/> Ecogovernance technical assistance (83M) (LGF) <input type="checkbox"/> Malalag Waterwork system (13M) (LGF)	<input type="checkbox"/> German Community Forestry Project – (18M) (LGF)

LGF: (ODA) Loans and Grants Funded, GFPP = Government Funded Programme and Projects  
 M= Million, P = Pesos.

### 4.3.2 Allocation Principles

National government agencies (NGAs) usually allocate funds to LGUs based on laws, loan agreements, memorandum of agreements/understanding and other legal and official documents. Based on the mandate of NGAs, they undertake

programs/projects that are beneficial to both NGAs and LGUs. Under the LGC, NGAs are authorized to support functions devolved to LGUs.

The usual instrument used to effect the transfer is a memorandum of agreement signed by the head of the agency and the local chief executive. For project-based allocations, the agency head exercises discretion as to project approval, the amount to be granted and the timing of releases. The project management office (PMO) is responsible for monitoring, control and reportorial requirements. However in cases, where no PMOs are authorized, the respective regional/central offices handle the fund requirements.

Criteria used by agencies were primarily based on existing guidelines/policies and procedures/practices adopted by the office. Mostly agencies adopt allocation criteria, which defines LGUs needs as contained in their letter request and availability of funds subject to approval of the agency head. Criteria like population, number of inhabitants, land area, poverty level, inventory of existing facilities, loan agreements, financial reports/statements, are sometimes used in allocation schemes, but other criteria may be applied as well. The examples, below, provide and indication of the variations in allocation criteria:

- DOT uses several criteria for evaluating the grant of financial assistance. These include the following: tourism appeal, social desirability/community participation, socio-economic and environmental impact, tourism infrastructure, accessibility, security, self-sustaining/level of counterpart funding, benefits and the availability of funds.
- For DA's regular programs, allocation is based on the LGUs' annual targets subject to availability of funds.
- The Congressional allocations through the DA based on the projects as identified by the proponent legislators, many of which were for the implementation of DA's regular GMA programs.
- For foreign-assisted projects, the loan agreements (LA) provide the allocation procedures and beneficiaries. In the case of the Mindanao Rural Development Project (MRDP), cost sharing of the total project cost as defined under LA is (a) DA-14%; (b) LGU-14%, (c) Beneficiaries-(1%), (d) GEF Grant-3% and (e) LGU-68%, grant given to LGUs out of loan proceeds. Implementation of the project is lodged with a PMO located in the project site. The beneficiaries/provinces were pre-identified and the amount of intervention is as stipulated in the LA. Fund releases for MRDP are made to the LGUs through the MDFO.
- For other DA FAPs projects, the PMO is in charge of project implementation. Fund allocation is based on approved work program while availability of funds depends on the national government's fiscal policies. In the case of FAPs of attached agencies like the Water Buffaloes and Beef Cattle Improvement Project, fund releases are made through the central office of the department proper then transferred to the PMO in the sub-agency.

- For regular school building programs (SBP), allocation by congressional district is based on student enrolment, student population, availability of school sites, existing shortages, subject to availability of funds. RA No. 7880 defines the specific allocation as follows: 50% of the fund is pro rata to enrolment based on total national school age population; 40% goes to those districts with shortages of school facilities. The remaining 10% is determined by the Department of Education. Shortages are determined by the excess of approved student per classroom ratio. Funds are released to DPWH or DepEd for the construction of classrooms based on approved DepEd's program of work. In the case of FAPs, the SBP implementation is covered by loan covenants and/or memorandum of understanding under the projects TEEP, SEDIP and EFIP. TEEP is of two kinds, a) principal-led, and b) LGU-led. Funding mix is in accordance with the provisions of LA and beneficiaries were predetermined. A sub-loan agreement is drawn between MDFO and the LGU concerned on funding releases. Priority was given to LGUs who can provide counterpart funds.
- On the Smoke Free EDSA program, the DENR Secretary sets guidelines for the size of the support to be granted to beneficiaries/implementor. Allocation of funds is based on loan agreements. The Materials Recovery Facilities have a fixed allocation of P495,000 per model barangay. Actual needs were based on local situation subject to completeness of the proposals.
- The size of support for agrarian reform projects is based on a demand driven approach. Support is based on actual requirements and the capacity of LGUs to provide counterpart funds. The need is determined through actual consultation with potential beneficiaries. Funds for CA were distributed to selected LGUs for the implementation of capital projects in various ARCs depending on guidelines issued by the legislator concerned. FAPs projects were allocated following the provisions of the LA. Funding for the ARC project is coursed through the MDFO for the implementation of rural infrastructure, water supply and potable water supply.
- The DPWH implemented infrastructure projects for national roads/bridges. Funding for regular programs are sourced from the national budget and allocated based on approved work programs. In coordination with the DA, the department also implements farm to market roads projects. For CAs, project implementation is dependent on the work program submitted by the proponent legislator. The "Tulay ng Pangulo", a FAPs project, is based on the provisions of the LA in coordination with the Office of the President.
- The funding allocations for MDFO administered FAPs were based on the provisions of the LA and the sub-loan agreements among MDFO, NGAs, lending institutions and the LGUs. Evaluation, appraisal and monitoring is done by the PMO which could be based in the lead NGA, project site in MDFO or in the LGU. The PMO is responsible for control and reporting systems for the project while MDFO keeps records of fund releases to LGUs. LGU counterpart funds or cost sharing is a percentage of total project cost. The project LOGOFIND, a multi-sectoral demand driven project, finances municipal infrastructure such as public markets, school buildings, bus

terminals and slaughterhouses. The size of the support is based on the evaluation/appraisal of each LGU subproject proposal. LGU equity ranges from 10% to 20% depending on subproject type and LGU income classification.

- The PRRC adopted a fixed formula wherein the size of support depended on the nature of the project/sub-project. For parks, greenbelt and pathway sub-projects under the Environmental Protection Areas (EPA) component, it is based on/commensurate to the cost of constructing said sub-projects in the entire length of the river banks within the jurisdiction of the city. For the community facilities, the size of LGU support is based on the cost of the four basic facilities, namely: elementary/high school building, health/day care center, community market and multi-purpose center projects. The number of facilities provided is based on the standard population facility ratio (number of relocates in each resettlement site). Thus, project ceiling is based on loan allocation but timing of releases is based on a first-come-first-serve basis.
- In the case of PCSO and PAGCOR, the allocation schemes follow the provisions of laws as to how much will be given to the level of the LGUs hosting the authorized games. In the case of PCSO, the size of transfer and decision on allocation are based on Sections 3 and 2, respectively of EO No. 357 series of 1996 as amended by EO No.357-A. Actual allocation is decided by the LGU to where the fund is transferred. Fixed share of revenues is as follows: 7% of the Lotto Charity Fund to municipalities to be shared on a 5:2 ratio between the municipality and its province where lotto tickets are sold. In the case of the city, 5% of the Lotto Charity Fund where lotto tickets are sold.
- In the case of the PAGCOR, the share of cities/provinces is based on a fixed amount monthly as approved by the President for hosting casinos. Utilization of the funds of both PCSO and PAGCOR were not disclosed, hence these were classified under unallocated portion of the object class of expenditures.

In summary, the overall picture of the allocation criteria shows a great variation in terms of applied procedures and practices. Existing guidelines issued by the DBM defined the manner and procedures by which the PMO handles the implementation of the project.

## **5. Future Options and Concluding Comments**

### *Introduction*

Based on the results from the review of the non-IRA funding flow, this Section provides an overview of the fiscal room for future reforms and some initial suggestions for the direction of future grant reform initiatives. It should be seen in conjunction with a paper on the design issues to be addressed in the development of a more performance-based grant system, and a brief note on some of the basic concepts and directions for consideration of the future options, which have been prepared in extension of this report.<sup>34</sup>

### *Fiscal Room for Reforms*

The results of the study were based on actual disbursements reported by the different NGAs and segregated to determine the type of beneficiary LGU as well as the nature of such expenditures for the Fiscal Year 2003. Although the study has shown that there are some gaps in the data available in the national departments'/agencies' offices on the non-IRA transfers and other funds spent on LGU devolved services, caused by various bureaucratic procedures (lack of harmonisation, coordination and streamlining of the various transfer flows and lack of consolidated data at the NGA level), the findings provide a clear picture of the fiscal room for reforms.

The study has shown that there are *significant funds spent* on LGU devolved functions outside of the IRA funded transfer scheme, particularly on capital expenditures and particularly benefiting municipal service provision. There is definitely room for streamlining the existing transfer systems and introducing new initiatives.

Dialogues with various stakeholders have indicated that it is unlikely that a major reform of the IRA transfer allocation system will be implemented in the short term, although all options should be kept open. Considering the fact that there are limited funds available in the public sector budget for new initiatives, it seems likely that the grant systems will basically be funded by the existing funds, identified by this study, and additional donor funds.

Although the overall size of the non-IRA transfers and other funding of LGU functions is modest compared with the IRA funds (less than 20 %), it is quite *significant*<sup>35</sup>, and concerns a large amount of money, which cannot be neglected in an overall reform of the system of intergovernmental fiscal transfers and in future consideration of a more performance based system. This is particularly the case if the capital outlays part of the non-IRA funding, identified in this study, to be at least P22.6 Billion (US\$416.5), is compared to the Capital Outlays funded from the IRA

---

<sup>34</sup> See the following papers: 1) “*Overview, Concepts and Directions for Formulation of New Performance Based-Grant Types*”, June 2005 and 2) Steffensen, Jesper: “*Key Issues on Performance Based Grant Design Parameters*”, Final Report, August 2005.

<sup>35</sup> Even after the reduction of the congressional allocation in 2005. Annex 4 compares the findings with findings from previous related studies.

and own source revenues, estimated at maximum 20 % of the IRA or equal to P28.2 Billion (520.3 US\$).<sup>36</sup> Hence it is estimated that minimum 40-45 % of the total capital outlays on LGU devolved functions in 2003 was funded from these non-IRA funding flows. Although this matter was not the subject of this Study, it is expected that the non-IRA funding components generally concerned larger investment programmes & projects than the ones funded by the IRA funding scheme and LGU own source revenues.

Most funds derived from the congressional allocations, but the Government funded activities within the devolved areas and the loans and grant-funded activities were also significant in certain sectors, particularly education, agriculture and roads. The national government funding of devolved services and the loans and grant funded activities (excluding congressional funds) constituted P9.5 billion (US\$ 175.7 Million) in 2003, whereas the congressional funds used on LGU devolved functions are of a more significant magnitude, with P 15.6 billion (US\$ 288.6 Million) in 2003.<sup>37</sup>

Most of the funding was used for capital investments. This raises serious issues concerning local planning, budgeting and budget execution process, as these funds are not well integrated in the LGU planning and priority-setting processes. The following sections highlight a few details about each funding source.

#### *Congressional Allocations (CA)*

The study found that the congressional allocations accounted for the largest share of national government funds used for devolved activities in 2003, (P15.6 Billion/US\$ 288.6 Million) about 62% of the total funds. It should be noted, that the CA were reduced significantly (by 40 %) in the 2005 budget. While this largely unexpected move has been widely welcomed because of the persistent allegations of lack of transparency and problems in the utilization (such as lack of fit with local plans, high costs of services, etc.), the study has shown that 95% of the congressional allocations were used for capital outlays and that 70.5% went to finance municipal functions. It should also be noted that municipalities have generally been observed to have received less incremental *revenues* than other types of LGUs compared to the amount of responsibilities devolved to them.

The findings suggest a need for further study of the impact of the congressional allocations on the LGU planning and budgeting process. A good case could be made for keeping a significant portion of the cut in congressional allocations for the benefit of LGUs so that countryside development may be accelerated. Less of the funds should be spent by NGAs and more of the funds should be given directly as transfers to the LGUs. The decision on the best method for this transfer scheme requires further

---

<sup>36</sup> Up-dated figures for LGU capital outlays are not easily available and definable, but it is assumed that LGUs spent in the tune of maximum 20 % of the IRA funds on capital outlays (the requirement is that 20 % of the IRA transfers should be allocated on “development”, i.e. P 28.2 Billion in 2003, but part of this is probably not real capital outlays in economic terms). However, there are also other local sources available for capital outlays, hence 20 % of the IRA is the best available estimate.

<sup>37</sup> It is expected that the reduction in the overall congressional allocations in the 2005 Budget will reduce this figure similarly with approx. 40 %, compared to the collected figures.

review, including a review of the possibilities for introducing a form of performance-based grants.

#### *Loans and Grant funded Activities on Devolved Functions (LGF)*

Foreign loans and grants from official sources were the source of around 21.3% of the funds provided by the national government in form of direct spending and transfers for LGU service delivery in 2003 (P 5.4 Billion/US\$100 Million).

The allocations for LGF was also in favour of the direct spending by NGAs (61%) compared to the transfers to LGUs (39%). However these other sources of funds for LGU activities need to be monitored better to determine the development impact of these foreign-assisted projects and more deliberate setting up of mechanisms to assure the sustainability of operations and benefits after the foreign support has left.

Developing the institutional strength and capability of the concerned LGUs would be critical in this respect and putting in the appropriate financial incentives together with capacity building interventions can help achieve this objective. Since the foreign loans and grants themselves may require certain actions on the part of the national government, and loans would require eventual repayment, the national government may ask the beneficiary LGUs to meet certain standards of good governance and financial management or even specific conditionalities tied to the assistance given to the LGUs.

#### *Government Funding of Devolved Programmes & Projects (GFPP)*

Close to 16% of the national government funds used for activities devolved to LGUs were internally generated (P4.1 Billion/US\$ 75.7 Million) and 85% of these were provided through direct spending by the concerned national government agencies. 65.4 % or P2.7 Billion/\$ 49.5 Million was spent on capital outlays.

To speed up the process of devolution, it recommended that the NGAs shift their focus from the direct provision of services to the setting of policies and standards and provision of technical assistance and financial incentives to the LGUs. For example, the construction of school buildings has been devolved under the Local Government Code of 1991 but the national government continues to make a substantial provision for this in its own annual budget. The LGUs should instead be encouraged to use their Special Education Fund (SEF) for this undertaking, which will directly benefit their constituencies. Another example is the area of agriculture, where increased agricultural production and productivity would have certain externalities in terms of assuring national food security, and where LGUs should be given the appropriate incentives to carry out their responsibilities in relation to agricultural extension.

These changes may be accomplished through the setting up of a mechanism for *sectoral performance-based grants* and/or *performance based non-sectoral grants* with incentives to focus on improving performance in key areas of importance for efficient service delivery.

### *Off Budget Funding (OBF)*

With respect to off-budget funding from donors, the study shows that these funds are less significant: P 0.2 Billion/USD 3.7 Million.

Grants, which were obtained on a competitive basis involving different countries may not be the most optimal sources of funds for performance-based grants since it is hard to predict when the country might win them again. On the other hand, the capacity building funds provided by some donors that allow the funding of a small investment project can easily be transformed into support for performance-based grants with the introduction of performance benchmarks and monitoring.

### *Allocation Criteria*

The study reviewed the allocation criteria for the non-IRA funding. Although many of the programmes and projects have their own rational objectives, targets and allocation procedures, the non-IRA funding system appears generally to be fragmented and it is obviously rather difficult for the LGUs to get a clear overall picture of the funding and support possibilities, the allocation criteria, the amounts, access criteria, timing, etc. The allocation criteria for some of the grants are not based on clear, transparent, objective formula-based criteria as recommended by international best practice. This leads to less predictability and lack of prior information for the LGUs about their resource envelope, with implications for the quality of the LGU planning and budgeting processes.

A reform of this system should be pursued in conjunction with the considerations on the development of genuine sector grant systems, see below.

### *Performance Based Grants*

The review of the transfer flows revealed, that there are no genuine performance based grant allocation systems, although there are a few examples of reward giving programmes and projects. Many stakeholders have expressed concerns that there is lack of LGU incentives to improve performance in key generic performance areas, such as e.g. budgeting, revenue mobilisation, procurement, financial and expenditure management and good governance.

There is a need to develop more performance-based and clear, objective criteria for the horizontal allocation of multi-sectoral funds across the LGUs and to continue with a further operationalisation of the performance grant design issues raised in the accompanying papers to this report.<sup>38</sup>

### *Sector Grants*

There are very few sector grants, covering the entire sector and/ all LGUs or a type of LGU (e.g. all provinces), and the support is fragmented in various smaller

---

<sup>38</sup> See “*Key Issues on Performance Based Grant Design Parameters*”, Final Report, August 2005 by Jesper Steffensen, NCG A/S DK.

programmes and projects with their own rationalities and objectives. From the LGU perspective, the resource allocation is non-transparent and difficult to plan and budget for, and from the central perspective it is hard to judge the overall efficiency of the utilised resources. The multiple (80+) programmes & projects provides a very complex and incoherent picture and a system particularly characterized by lack of *incentives* for improved performance, without a clear overall strategy and overview. There is also a lack of monitoring and information on these grants, supervision, follow-up and assessment of the impact.

There is therefore a need to consider the development of genuine sector grants, with consolidated allocation, reporting and monitoring mechanisms, effectively targeting service provision in key areas.

#### *Future Directions and Strategy*

To conclude, the Study has shown, that there is good reason for: (a) rationalizing the existing IGFT system and (b) introducing more of a performance orientation into it, by improving the linkage between the transfers and actual LGU performance to promote good LGU performance in areas of importance for the overall decentralisation objectives.

The Study Team recommends that these challenges be addressed in a sequenced and strategic manner. The findings and the consultations with key stakeholders have shown a strong support for development of a more performance-based grant allocation system and the needs and options have been identified.

Reform towards this end requires a thorough review of a number of design issues, including the major objectives and target (e.g. should the grants be targeted towards sector and/or multi-sectoral utilisation? should the performance areas be generic/process oriented or output oriented?), the design of the allocation criteria, the assessment process, and other important issues.

A related paper – “*Key Issues on Performance Based Grant Design Parameters*”, August 2005, discusses some of the main design issues, which will have to be addressed in case a performance based grant system is pursued. Furthermore a brief note: “*Overview, Concepts and Directions for Formulation of New Performance Based – Grant Types*, June 2005<sup>39</sup> outlines some of the main issues, possibilities and options for the design of a future system of performance-based grants in the Philippines.

Finally, further analytical work will be conducted on the future reform of the transfer schemes with the aim of reviewing the options for a more performance-based system.

---

<sup>39</sup> This note on the future options has benefited greatly from the thoughts in the previous work conducted by Mr. Roland White, the World Bank and Jesper Steffensen, NCG A/S DK and is an expanded version of an earlier note on the same subject.

## **6. Annexes**

**Annex 1: TOR**

**Annex 2: List of People/Institutions Met**

**Annex 3: Tables**

**Annex 4: Note on Comparison with Previous Findings**

**Annex 5: Bibliography**