

Local and Regional Development in the Philippines: An Analysis of the Effects of Decentralization¹

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In 1991, the Local Government Code (LGC) was enacted which provided the policy framework for the decentralization program in the Philippines. The LGC was based on sound principles and consistent with the Decentralization Theorem. It significantly increased the assigned responsibilities and revenue generating powers of subnational governments. The intergovernmental transfers were increased and rationalized. The democratic space for civil society and private sector engagement in governance was broadened.

After 16 years of implementation, a combination of preconceived beliefs, anecdotal accounts, and limited empirical evidence tends to characterize the discussions on the results and outcomes of decentralization. Evaluating the effects of decentralization is not easy as it poses conceptual and methodological issues. There is a dearth of information in the Philippines about how decentralization is and should be measured. Empirical modelling has far-reaching implications on the policy design and implementation of decentralization program. Such exercises are extremely necessary not only in obtaining better appreciation of decentralization in terms of its benefits and drawbacks, but also in making informed decisions about decentralization. If decentralization can be accurately and reliably measured, then it can be better managed.

It is within this context that this study aims to propose an operational model to measure decentralization with the end in view of examining the extent to which decentralization is progressing in the country as well as to assess its impact within the context of promoting local and regional development and supporting the achievement of national priorities. More specifically, the study develops and tests an empirical model to measure decentralization. It uses the said model to analyze the effects of decentralization on governance, economic growth, public sector size, and subnational fiscal balance.

The research model tests four independent variables as measures of fiscal decentralization: (i) local government tax revenues; (ii) local government non-tax

revenues; (iii) intergovernmental transfer in the form of internal revenue allotment; and (iv) other local government income. There are 14 dependent variables in the study. Nine of these are selected from indices used in the International Country Risk Guide: (i) bureaucratic quality; (ii) corruption; (iii) democratic accountability; (iv) government stability; (v) investment profile; (vi) socio-economic conditions; (vii) political risk rating; (viii) economic risk rating; and (ix) financial risk rating. The other five variables are used as growth indicators: (i) Gross National Product (GNP), per capita GNP, and per capita Gross Domestic Product (GDP). Public sector size is measured by the total subnational expenditures as percentage of GDP. The subnational fiscal balance is the total local government expenditures less total local government revenues.

Statistical procedures are carried out to analyze trends and patterns as well as to test the relationships of variables. Descriptive analysis of time series data from 1985 to 2006 show that the country's performance - in terms of the indicators used to represent governance, growth, government size, and fiscal balance – generally improved after the promulgation and implementation of the LGC in 1991. Ratings on some development indices such as corruption, investment profile, political risk, economic risk, government stability, and socio-economic conditions remain mediocre.

Results of the Levene's test for equality of variances and t-test for equality of means indicate that the differences in mean scores of the variables (except for democratic accountability, socioeconomic conditions, subnational government fiscal balance, and other local government income) in the pre-LGC period and post-LGC period are not due to chance. Many of the fiscal decentralization variables are correlated to most of the development outcome variables of the study.

Methodologically, trend analysis, test of means, and test of correlation cannot ascertain causal relationship between variables. In this regard, although the pattern of time-series data may show general improvements from pre-LGC period to post-LGC period, the changes cannot be conclusively attributed to decentralization. Similarly, the statistically significant variances in mean scores on the two samples may not necessarily be due to decentralization. Multiple linear regression models are therefore used by the study to test the relationships.

The regression modelling shows that local tax revenue has significant positive impact on bureaucratic quality (BQ) and democratic accountability (DA). It also reduces financial risk rating (FRR). Tax revenue has no conclusive causal relationship with the other 11 development outcome variables. Non-tax revenue has significant negative impact on investment profile and significant positive

impact on GNP, GNP per capita, and GDP per capita. Non-tax revenue has no conclusive causal relationship with the other 10 dependent variables.

Other local government income has significant negative impact on BQ, FRR, and political risk rating (PRR). It has no conclusive causal relationship with the other 11 outcome variables. The internal revenue allotment (IRA) raises financial risk, GNP, GNP per capita, GDP per capita, and public sector size (PSS). The IRA has no conclusive causal relationship with the other nine dependent variables.

Based on the F-ratios, there is goodness of fit in 12 regression models - BQ, DA, government stability, investment profile, economic risk rating (ERR), FRR, PRR, GNP, GNPpC, GDPpC, subnational government fiscal balance (SGFB), and PSS. Of which five models – DA, ERR, FRR, SGFB, and PSS - have Adjusted R² value less than 0.70. There is no goodness of fit for two regression models – corruption and socioeconomic conditions. The regression test results strengthens the prevailing argument to increase own source revenues (OSR) particularly local taxes and to remedy the overdependence of subnational governments on national transfers.

Decentralization in the Philippines has not fully taken advantage of its potentials. There are some setbacks in the implementation of the country's decentralization program. Intergovernmental coordination as well as unnecessary central government interference on subnational government operations are major concerns. There is also poor tax collection and revenue mobilization effort in many local government units and that there is high dependency on national transfers. Improving tax collection efforts have been resisted by many political elites. Poor governance and weak institutional capacities weigh down the efficiency and effectiveness of subnational governments.

Decentralization has great potentials in achieving a range of development outcomes. It can nonetheless, do more harm than good, if not managed well. There are caveats to decentralization. A decentralized system of government is able to function more effectively when the central government genuinely supports and facilitates local autonomy, fiscal policy and position are sound, economic growth is sustained, and there is an adequate and competent workforce. Spending responsibilities of subnational governments should be matched with taxing powers. Making decentralization work better requires adjustments not only in the design of expenditure and revenue assignment as well as the intergovernmental transfer system, but also in development thinking and management. Under a globalized economy, decentralization must support efforts to make regions and the country competitive.

The design of the decentralization program must take into account strategic actions to expand social, environmental, and economic multipliers. Subnational governments should play a steering role maximizing the multiplier effects in use of capital. Local governments need to enhance its capacities for generating value-adding investment opportunities, sharing resources, and achieving economies of scale in the provision of public goods and services.

Institutional capacities at all levels must be developed for integrated planning, financing, budgeting, project development, revenue collection, and strategic planning. The long-term effectiveness and fiscal sustainability of subnational governments is hinged on building competitive institutions and strategic infrastructure to support and attract investment and development. There is a serious need for financial intermediates and catalysts to work with governments, communities, and private sector to assess, develop, and secure financing for programs and projects towards sustainable growth and improved living conditions.

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