



PHILIPPINES DEVELOPMENT FORUM

Working Group on Decentralization
and Local Government



PROMOTING DECENTRALIZATION AND LOCAL GOVERNANCE FOR ENHANCED GROWTH AND COMPETITIVENESS: PROGRESS AND CHALLENGES ¹

In the last two years, the Working Group on Decentralization and Local Government (henceforth referred to Decentralization WG) has been pursuing a reform agenda that aims at deepening the decentralization process and promoting the principles of good governance at the LGU level in order to maximize the contribution of the local government sector to the development goals of the country. Through its various activities, the Working Group has built the momentum for LGU reforms, generating optimism that given the right incentives LGUs can and do initiate steps to improve their performance. This note reports the accomplishments of the Decentralization WG for 2006 and proposes an action agenda as part of its work plan for 2007-2008. Extensive consultations with government, the local government units (LGU) through their Leagues, development partners and stakeholders were undertaken throughout the year to validate the various parts of report, culminating in a Consultation Workshop held on February 19, 2007.

This note is divided into three parts: a short background on the objectives of the Working Group for 2006, the accomplishments for the period March 2006-February 2007 and the proposed work plan for 2007-2008.

I. Objectives for 2006

During the 2006 meeting of the Philippine Development Forum (PDF) held in Tagaytay City, the Decentralization WG agreed to pursue the following objectives under four themes of the Working Group:

- **Local Government Finance:** Catalyze efforts to create a more positive environment for financing LGU activities through consistency in policy implementation, improvement in the environment for LGU financing and formulation of new policies that will provide greater flexibility in accessing financing and promote greater accountability & performance;
- **Capacity building:** Build the momentum for harmonizing capacity building efforts through more focused interventions, greater coverage and more cost-effective and innovative delivery mechanisms;
- **Performance benchmarking:** Expand the utilization of performance monitoring systems through vigorous promotion and an incentive system that can also encourage good performance; and improve the integrity and credibility of the performance measures;
- **Policy reforms on devolution:** Support further devolution and rationalization through a thorough assessment of the devolution experience in the country and build the capacity of DILG, DOF and the LGU Leagues to oversee the devolution process.

¹ Prepared for the 2007 Philippine Development Forum held on March 8-9, 2007 at Cebu City.



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The Decentralization WG was also committed to promote the Paris Declaration on Aid Effectiveness as the framework for its activities, focusing in particular to addressing issues on ownership, harmonization and alignment of development assistance during the year.

Given the above objectives, the Working Group approved a more detailed action program on May 2, 2006 together with the a list of priority activities identified by the national government oversight agencies and the Leagues through a series of consultation meetings.

II. Accomplishments for 2006

In general, the Decentralization WG played an important catalytic role in promoting local government reforms and in enhancing the capacity of LGUs to undertake the challenges of decentralization. This was accomplished through the following: (1) support to government in its implementation of policy reforms identified in the Decentralization WG action agenda, including procedural changes that addressed some of the financing issues of LGUs; (2) consensus-building on the reform areas for local government finance, capacity building and performance benchmarking that also strengthened government and LGU commitment to the reform program; (3) alignment and harmonization of LGU assistance from development partners to ensure better use of resources; (4) better identification of LGU needs and performance; (5) providing the venue for exploring issues on the management and coordination of ODA at local level; and (6) promotion of knowledge products and information-sharing on LGU-related matters. The detailed accomplishments of the Working Group are contained in Attachment A.

A. Implemented Key Policy Reforms on Local Government Finance

In the last two years, the Decentralization WG has been identifying critical reform measures to hasten revenue collection and improve expenditure management by LGUs. Among these, the following policy measures in the Work Plan of the Decentralization WG were implemented by government, addressing key issues that had contributed to fiscal and financial problems at the LGU level:

1. The 1996 LGU Financing Policy Framework was formally adopted by the Department of Finance in January 2007. The framework recognizes that LGUs have varying financing needs and levels of creditworthiness that are better served through the following market segmentation: (a) LGUs with greater creditworthiness are encouraged to avail of private commercial financing, except for environmental and social projects; (b) LGUs that have medium creditworthiness will access financing from Government Financial Institutions (GFIs); and (c) LGUs in the lower income tiers access financing (grants and loans) through the Municipal Development Fund (MDF). This policy directive confirms the government's continued commitment to paving the way for LGUs to access private sector lending.



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2. The NG-LGU Cost-Sharing Arrangement. In addition the DOF also re-affirmed GOP's NG-LGU cost sharing arrangement approved by the NEDA Board in March 2003 and the Investment Coordination Committee (ICC) in May 2006, mandating the granting of a maximum grant of 50% for LGU projects. This directive will ensure consistency in financing policy for projects targeted to LGUs.
3. Automatic Appropriation of the Internal Revenue Allotment (IRA) and Simplification of Procedures for the Release of LGU Shares. Upon the recommendation of the Department of Budget and Management (DBM), Congress, through R.A. 9358 on the supplemental appropriation for 2006, approved the automatic appropriation of IRA (section 4). In addition, a Joint Memorandum Circular was signed by oversight agencies through the initiative of the DBM in early 2006 that simplified and reduced the requisite documents for the release of LGU shares in national wealth. These measures will resolve the delays in the release of IRA as well as enable LGUs to better program their activities.
4. Establishment of a Trust Fund in the Bureau of Internal Revenue (BIR) for Remittance of LGU Share in Mining Taxes. The Department of Budget and Management has included in the 2007 proposed National Expenditure Program included a proposal to establish a trust fund in the BIR to enable the direct remittance of the LGU share in mining taxes.

In addition to the above policy reforms, the Decentralization WG was also instrumental in responding to the request of the LGUs to study the feasibility of developing a facility that would lend to LGUs without sovereign guarantee. The Decentralization WG initiated discussions on the issue with the World Bank, the International Finance Corporation and the Asian Development Bank. All three agencies have established facilities for sub-national lending. The World Bank and IFC have established a Municipal Fund Department that can offer sub-national loans to LGUs in the Philippines. The ADB is working out arrangements for a similar facility.

The following important policy measures are also expected to be signed soon by the national government: (1) draft issuance providing mechanisms for improving information-sharing between the Bureau of Internal Revenue and the LGUs; (2) DOF Circular clarifying the SITUS of tax rule; (c) Joint Memorandum Circular by the Secretaries of the Interior and Local Government, Socio-Economic Planning and Development, Finance and Budget and Management on the Harmonization of Local Planning, Investment Programming, Budgeting and Expenditure Management and Revenue Administration.



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B. Promoted Consensus-Building on Key Reform Areas on Decentralization and Local Government

The Decentralization WG activities in 2006 also focused on building the consensus of stakeholders on priority reform measures for LGUs. Among the significant outputs in this area include:

1. Policy Reform Agenda for Local Government Finance. Through the initiative of the DOF and the DILG, the government held a retreat in June 2006 to discuss several LGU proposals on local government finance. Agreements reached during this retreat paved the way for the approval of policy reforms in local government finance discussed above.
2. Streamlining of Planning and Budgeting Procedures of LGUs. As a prerequisite for the harmonization of capacity building programs for LGUs, the government addressed conflicts and overlaps in various guidelines on local planning, investment programming, budgeting, expenditure management and revenue administration prepared by the NG agencies like DBM, NEDA, DILG and DOF and disseminated to LGUs. A technical working group was formed to harmonize these guidelines (through preparation of a joint memorandum circular (JMC) by: (a) clarifying conflicting terms used at the local level with respect to planning and budgeting; (b) synchronizing planning and budgeting calendars; (c) delineating the responsibilities of various oversight agencies; and (d) defining the interface between the national government agencies and different LGUs and ensuring complementarity in planning and budgeting activities across different LGU levels.

C. Increased Alignment and Harmonization of Donor Assistance for Decentralization and Local Government

Consistent with the objectives of aid effectiveness, the Working Group initiated activities that encouraged better alignment of development partner assistance with the national government agenda on decentralization and local government.

1. Alignment of Development Assistance with NG and LGU Reform Agenda. Following government efforts to firm up an agenda for decentralization and local government, the Working Group organized thematic discussions on three of its four themes, namely local government finance, capacity building and performance benchmarking. The thematic discussions were venues for information-sharing on the priority reform areas of government provided with ODA funding support and those without assistance. The process led to an agreed program of activities supported by the Working Group that included:

- Study on options for design of performance-based grants (WB)



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- Study on the harmonization of on-lending rates of Government Financial Institutions (GFIs) (WB)
- Review of local government finance framework (WB).
- Support for improvements in planning and budgeting (ADB, CIDA, Gtz))
- Enhancing the corporate powers of LGUs (CIDA)
- Roll-out of manuals on planning, expenditure management, revenue mobilization and financial management developed under various assistance(WB, ADB)
- Development of a concept note for project development support facility (WB)
- Institutional strengthening of the DOF-Bureau of Local Government Finance and the MDFO (WB, AusAID)

2. Harmonizing Development Assistance for LGU-Related Matters

The Decentralization WG focused on the following areas: (a) harmonization of the components of different ODA projects on local government finance; (b) harmonization of capacity building efforts for the local government sector, initially focusing on planning and budgeting but also looking at the inventory of training manuals on revenue mobilization and financial management; (c) improved coordination of development partners activities on LGU-related matters; (d) harmonization of ODA activities at LGU level through case studies of Bohol and Iloilo; and (e) harmonization of LGU-related activities across different PDF Working Groups. These initiatives resulted in better management of ODA, as shown below:

- Starting with issues related to local government finance, the Decentralization WG re-scoped some of the ODA proposals being contemplated by various government agencies and development partners to avoid possible duplication of effort. Specifically, the ODA projects which were studied include the two projects of ADB (TA 4556 and 4778), the AusAID-funded Partnership for Economic Governance Reforms, USAID-funded Economic Policy Reform Advocacy, Gtz's Decentralization Agenda and the IRA studies planned by JICA, ADB and USAID-EPRA. The cooperation and flexibility shown by the development partners in the revision of these projects' scope led to better alignment with government priorities and more effective use of ODA resources. A similar exercise has been initiated with the proposed projects on capacity building for planning, budgeting, fiscal and financial management.
- The harmonization of planning and budgeting activities of the NG agencies is a key step in the process of streamlining operations of LGUs, particularly in improving the vertical and horizontal integration of planning and budgeting at the national and local levels, following synchronized calendars at all levels. The exercise opened up other areas which needed better coordination, e.g. delivery systems for capacity building



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that replicate the composite team approach used to roll out the Procurement Law and harmonized training modules in local revenue mobilization and financial management.

- The process of harmonization also identified the need for assessing the geographical allocation of ODA. The Decentralization WG initiated case studies on LGUs which are recipients of multiple ODA with the objective of identifying success factors and developing capacity building efforts at ensuring that LGUs have capacity to manage and coordinate ODA. The Working Group also developed an LGU poverty index that can be used as a tool for choosing pilot areas for ODA.
- The development partners in the Decentralization WG also undertook joint missions and combined studies and initiated greater information sharing and consultation between them.
- To avoid duplication of effort, the Decentralization WG initiated several meetings with other PDF Working Groups to identify areas of common interest and increase consciousness of LGU issues and identification of possible areas of duplication and complementation/joint work among the LGU-related proposals/activities of other PDF Working Groups.

D. Worked Towards Better Identification of LGU Needs and Performance.

As part of the continuing process of aligning capacity building initiatives, the Working Group has supported the following efforts:

- Facilitated the integration of indicators from the Local Government Fiscal Monitoring System with the Local Government Performance Management System (LGPMS) was operationalized in July 2006 with the data captured in 2005.
- Preparation of the 2004 State of Cities Report by DILG with assistance from the UN agencies; and the printing of 2004 LGU Financing Report by BLGF with assistance from WB-LOGOFIND.
- Initiated preparation of an inventory of awards to LGUs as a basis for enriching the knowledge base on LGU performance and best practices and possibly harmonizing these for use in assessing development performance.

E. Explored Operational Measures to Improve Management and Coordination of ODA at the Local Level

To complement efforts to initiate procedural improvements in ODA allocation for LGUs at the national level, the Decentralization WG discussed aid



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effectiveness at the local level. Using Bohol and Metro Iloilo & Guimaras as case studies, constraints faced by LGUs in coordination & managing ODA were examined & a program of action by development partners, the NG agencies & relevant LGUs to improve coordination and management of projects at the local level was identified. As a result of these efforts, the Working Group will support the development of capacity building modules on ODA management and coordination as a way of accelerating ODA to LGUs and improve ODA allocation to more needy LGUs.

F. Promoted Knowledge Products and Information-Sharing on LGU-Related Matters

Since information sharing is important in promoting harmonization, the Decentralization WG also devoted time to improving access to knowledge products:

- Databases on finance-related matters to assist the DOF-BLGF in its oversight functions: LGU Credit Information Database, Statement of Income and Expenditures, Debt Monitoring System, Financial Services Providers Database, LGU Debt Management Database, Financial and Economic Model, Review of LGFPMS, design of a competency certification system (WB/AusAID)
- Establishing an LGU portal, www.lguph.org, to complement the PDF website; improve access to relevant information on LGUs; and facilitate interaction among development partners, LGUs, the Leagues and the government.
- A Working Group newsletter used to disseminate information on LGU matters.

In summary, the Working Group provided avenues for continuous dialogues among the various stakeholders, promoted transparency in ODA operations, synergized resources for better and effective development results.

III. Proposed 2007-2008 Work Plan

In the last two years, the Decentralization WG has built momentum for LGU oriented reforms. In 2007, the WG will continue its ongoing efforts to support the decentralization and local government agenda. In doing so, it will focus additional effort on promoting effective management and coordination of development assistance in order to enhance LGU contributions to the national objectives of accelerating economic growth and promoting competitiveness.

A. Objectives for 2007-2008

For 2007, the WGD LG has set the following goals in line with its four themes:



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- **Local Government Finance:** Accelerate revenue mobilization and access to financing by LGUs; and improve their management of expenditures for better service delivery and to promote growth
- **Capacity building:** Focus on delivery mechanisms for effective capacity building programs for LGUs; and continue capacity building programs for DILG, DOF, NEDA, the LGU Leagues and other concerned agencies which oversee the devolution process
- **Performance benchmarking:** Continue to improve the integrity and credibility of the performance monitoring systems and promote their utilization to encourage good performance
- **Policy reforms on devolution:** Review decentralization experience of the country and develop models of devolution in selected sectors

B. Flagship Projects

The Decentralization WG has identified the following priority projects for 2007-2008:

1. Coordinated Orientation Program for Local Chief Executives and their Staffs

In 2007, the Decentralization WG will continue the harmonization process initiated in 2006 by focusing its efforts on delivery mechanisms for a coordinated capacity building program for LGUs that reduces duplication and eliminates contradictions at local level. The WG will assist in designing a coordinated orientation program for newly elected Local Chief Executives (LCEs) and their core staffs in post-election period, which will include the roll-out of the different manuals harmonized by the NG oversight agencies in 2006 (JMC). The formulation of the orientation program will be coordinated by the DILG in partnership with the LGU Leagues, other oversight agencies, sector agencies, and supported by the development partners and service providers. The objective is to provide the LCEs with a comprehensive orientation program that draws on the strengths of various capacity building initiatives, supports continuing leadership and develops management capability in support of the government's governance, growth and competitiveness objectives.

2. Innovative Financing Schemes to Accelerate the Implementation of the Financing Framework

In 2007, special attention will be given in supporting measures that would attract additional financing to address the development requirements of LGUs such as those programs where local financial resources can be leveraged to attract NG, private sector and ODA financing possibly along the lines of the *Kilos Asenso* framework and related performance-based financing options.



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C. Proposed Action Agenda per Thematic Area

For 2007, the Working Group will continue to focus on the four themes identified in the March 2005 PDF. Since many activities and programs have been started in 2005, it is logical that the WG continue the unfinished activities and build on the gains started. Hence, its action agenda for 2006 will consist of (1) on-going activities with firm-ed-up funding on the areas identified in its 2006 work plan; and (2) new activities consistent with the PDF theme and discussed in various consultation meetings organized by the Decentralization WG. Attachment B contains the details of the 2007-2008 Action Plan of the Working Group.

1. On-Going Activities

Local Government Finance

Revenue Mobilization

- Address the problem of LGUs in updating property assessments
- Improve information sharing between BIR and the LGUs
- Address the different reporting systems and conflicting guidelines on resource mobilization
- Review of the SITUS rule
- Addressing revenues assignment issues across levels of LGUs

Increased Access of LGUs to Financing

- Accreditation of private financial institutions (PFIs) as depository banks
- Introduction of performance-based grants
- Mechanisms for assessing creditworthiness of LGUs
- Recommend measures for better utilization of ODA and GFI funds

Improved Expenditure Management

- Continue to address procedural problems on the release of LGU shares in national wealth and other taxes
- Review of the Procurement Act to make these more relevant to LGU operations
- Strengthen expenditure management of LGUs

Capacity Building

- Undertake capacity building programs in planning, budgeting and overall expenditure management, revenue mobilization and financial management
- Improve the capacity of oversight agencies and LGU leagues to monitor and assist LGUs



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Performance Benchmarking

- Support the use of the performance monitoring systems not only by the LGUs but by other NG agencies, the development partners, LGU Leagues and other stakeholders (e.g. academe) and enhance data analysis and report generation
- Develop incentives for the sustained use of performance monitoring system
- Enhance indicators and improve the integrity and quality of data

Policy Reforms in Devolution

- Support the implementation of agreements and action plans for further devolution in agriculture, natural resources, health and finance and fiscal matters
- Conduct an in-depth study of the current status of decentralization
- Review of the Local Government Code and the IRA formula

2. Possible New Activities of the Working Group for 2007-2008

Local Government Finance

- Conduct of new studies on the implementation of the LGU financing framework (e.g. assessment of the profitability of random sample of markets, slaughterhouses, transport facilities and solid waste facilities and alternative management arrangements, review of the experience of the bond flotations in the Philippines (refer to Attachment B for the details)
- Automation of the financial transactions of LGUs

Capacity Building

- Develop capacity building programs on the management and coordination of ODA by LGUs
- Assist groups of LGUs go beyond their individual needs to develop partnerships designed to strengthen the infrastructure backbone in the countryside
- Develop a career planning system for LGU personnel

Performance Benchmarking

- Develop benchmarks (input and output indicators) for service delivery for LGUs consistent with the outcome indicators in the LGPMS

Policy Reforms in Devolution

- Develop and showcase successful devolution experiences in selected sectors (e.g. agriculture, environment and natural resources)



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