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Official Position Paper of the League of Cities of the Philippines on the Amendments to the 1991 Local Government Code (Republic Act No. 7160)

The League respectfully puts forward its position on six (6) out of the fifteen (15) proposals, which were collated from the outcomes of different technical working group meetings co-organized by the Department of Interior and Local Government (DILG), in connection with the review/amendment of the 1991 Local Government Code otherwise known as the Republic Act No. 7160.

1. Support the institutionalization of Inter-LGU Cooperation (ILC).
2. Support the thorough delineation of duties and responsibilities in service delivery across various levels of government.
3. Support with condition the limitation on the use of loan proceeds on 'capital expenditure.'
4. Support the delineation of the debt service ratio.
5. Support the streamlining of the local business tax structure.
6. Support the three-pronged amendment of the income and other requirements for the creation, conversion, and classification of LGUs.

The League is optimistic that these recommendations if acted upon accordingly would prove to be propitious for the interest of its members, especially when initiatives on federalism gain traction in both Houses of Congress.

Background

To achieve convergence on the current efforts of the Senate Committee on Local Government, and to maximize the results of the Local Government Code review conducted in 2015, the League has decided to officially issue its position on six (6) out of the fifteen (15) proposals that were culled from the technical working groups tasked to evaluate the Code. The League has chosen these proposals based on the depth of their potential impact on its members. They fall under three tenets of the local government code to wit: Interlocal cooperation and Basic Services; Local Borrowing and Local Taxation; and, Conversion or Creation of LGUs and Income classification of LGUs.

Discussion

1. Support the institutionalization of the ILC

Delivery of devolved services that imply economies of scale (e.g., solid waste management and water supply) and externalities (e.g., environmental management) will benefit from cooperation among local

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government units. As such, the establishment of legal frameworks for such cooperative endeavors is deemed necessary. These legal frameworks should provide for the establishment of ILCs through registration under the National Registry of Alliances (NRA); their regulation; and, monitoring. The proposal will require amendments particularly on Sections 3 and 33 of the local government code.

Certain types of public goods are delivered more efficiently when city governments work together, rather than independently. Accordingly, the League welcomes the proposal to transform ILCs into a judicial entity. Given the ILC's lack of legal personality and corporate powers under the present version of the Code, they are confronted with legal impediments to the effective consummation of their purpose. For instance, they are not allowed to levy fees or borrow, putting a heavy strain on their financial resources. The composition of the NRA, meanwhile, should include the leagues of local governments, civil society organizations with national networks/members, the DILG, and the Cooperative Development Authority (CDA) among others.

2. Support the thorough delineation of duties and responsibilities in service delivery across various levels of government.

At present, relations between national and local governments are weighed down by the overlapping and, at times, unclear assignment of functions across various levels of government. This results in the waste of resources. At the same time, numerous unfunded mandates result in relevant services either not being delivered at all or not being delivered in sufficient quantities. In either case, the welfare of local communities is adversely affected. To achieve greater clarity in functional assignment, it is proposed that Section 17 (a) of the 1991 LGC be amended by inserting a proviso that will differentiate between 'fully devolved' and 'shared' functions.

By clearly delineating which level of government should provide the services, it would result in a more efficient allocation of resources. The League sees the value in delineating the functions as it has been a strong advocate of performance-based grants. On the other hand, the mechanics of shared functions require further study. Will capacity or need dictate which functions will be shared between national governments and local governments?

3. Support with reservation the limitation on the use of loan proceeds on 'capital expenditure.'

Subnational borrowing is an important source of local development finance if LGUs are to be able to finance lumpy investments in local infrastructure. At present, the overall level of subnational borrowing is low relative to international standards. It is also low relative to the financing

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requirement for local infrastructure for much-needed services. Also, certain provisions of the Local Government Code constrain LGUs access to credit and capital markets. To facilitate LGU borrowing and to mitigate associated fiscal risks in doing such, the limitation on the use of loan proceeds on capital expenditure and the determination of debt service ratio had been proposed. These will involve amendments on Sections 296-297 and 324 respectively.

Loan proceeds should also provide for maintenance and other operating expenses (MOOEs), especially in cases where loans were used in income-generating projects. Furthermore, income from such projects is not guaranteed and cannot be used for financing earlier expenditures. Given such a condition, the League expresses its reservations on restricting the use of loan proceeds on capital expenditures alone. In lieu, the amendment should allow for the utilization of loan proceeds for MOOE but with an identified expiration date.

4. Support the delineation of the 'debt service ratio.'

On the other hand, the League fully supports the proposed amendment to Section 324 defining the debt service ratio in relation to the net operating surplus before interest payments and capital expenditures, rather than in relation to regular income as presently provided. The current way of measuring debt service ratio does not take into account the true capacity of LGUs to service their debt given the preponderance of mandatory expenditures in its budget.

5. Support the streamlining of the local business tax structure.

The low 'local tax to GDP' and 'own source revenue to GDP' ratios among LGUs, and their heavy reliance on fiscal transfers, particularly the IRA, are indicative of the low degree of revenue autonomy of the LGUs. Consequently, accountability at the local level may continue to weaken.

Varying categories of firms and tax rates as defined by the Code are partly at fault in the inability of LGUs to fully maximize their taxing powers. Such differentiated local business tax structure tends to incur administrative and compliance costs on the part of LGUs and local businesses. Accordingly, there is a proposal to simplify the present tax structure by implementing a single flat tax rate not exceeding 1.5% of their gross receipts/sales regardless of the type of business. The proposal, if favorably considered, would require amendments particularly under Section 143 of the Code.

The League anticipates some of the potential benefits in streamlining the present local business structure. Firstly, it simplifies local tax administration. The disparities in effective tax rates with respect to the size and type of business may prove to be susceptible to tax

evasion. The present structure also tends to be regressive as it imposes higher tax rates on smaller businesses relative to larger ones, which impedes further business creation and enterprise. Lastly, the revenue impact of this proposal is estimated to be PhP 36 billion for cities.

6. Support the three-pronged amendment on income and other requirements for the creation, conversion, and classification of LGUs.

After the passage of the Local Government Code, conversion of municipalities into cities and the breaking up of existing provinces/municipalities/barangays into two or more new provinces/municipalities/barangays have evidently become a trend. Such a pattern may be explained by pressure on the part of the municipalities to become cities to obtain a larger IRA share and the increasing demand for additional political spaces for local leaders. However, they result in inefficiently sized administrative jurisdictions.

The Code sets income, population, land area as benchmarks for the creation of new provinces, cities, and municipalities. The passage of the Republic Act 9009, meanwhile, increased the income requirement on the conversion of municipalities to cities from PhP 20 million, as originally prescribed by the Code, to PhP 100 million. The conversion requirement for highly urbanized cities (HUCs) and provinces, meanwhile, remained unchanged.

Meanwhile, Executive Order No. 249 mandates the Department of Finance (DOF) to reclassify LGUs according to their annual regular income. The reclassification, however, has been placed on hold since 2012 due to challenges to the Finance Secretary's authority to also revise the income thresholds if it were to be based solely on EO 249. Such an ambiguity and delay have resulted in the inefficacy of the current system of income classification to truly reflect an LGU's financial capability, especially in relation to other LGUs of the same class. Given its phased doubling under the Code, the IRA has also become the biggest component of the annual regular income. Consequently, more LGUs are classified under higher classes while very few are classified in the lower classes. As such, the present classification, particularly for provinces and cities, is skewed in favor of the higher classes.

Against this backdrop, there was a proposal to align with RA 9009 the income requirements not only on conversion of municipalities to cities but also on the creation/conversion of HUC, province, and municipality although RA 9009 only provides for the former. In this regard, it was recommended to increase the income requirement of HUCs from the average annual local income of PhP 50 million (inclusive of IRA) in 1991 prices, to an average local income of Php 250 Million in 2000 prices or PhP 445 million in 2016 prices. There was also a call to definitively confer

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with the DOF not only the mandate to reclassify the LGUs but also to revise the income benchmarks for the reclassification.

The League generally supports the three-pronged proposed adjustment on income and other requirements for the creation/conversion of LGUs.

The League supports the proposal to adopt in the Code the provision in RA 9009 as the new basis for income basis. The Code must be responsive to amending legislations to continually encompass the system of laws pertaining to the local government units. In this case, the Code must adopt the latest applicable provisions to guide the creation and conversion of local government units.

On increasing the income requirement for the creation of HUCs, such a proposal must be carried through an act of Congress. The provisions on HUCs should be reviewed and revised with the goal of setting up stricter guidelines. In addition, benchmarks other than income may be considered. A city's official declaration as a HUC must be grounded to a thorough evaluation of its capability to carry out high-level service delivery on education, health, and agriculture, among others, as applicable to the jurisdiction of interest. These considerations may set apart HUCs from other cities, which, in turn, further the intent and purpose of the LGU classification system.

Finally, the League welcomes the proposal to confer with the DOF the legal power to undertake the regular income reclassification of LGUs, which arguably falls under its mandate to administer policies and supervise LGUs on its revenue matters. Same with the provisions on HUC, this must be institutionalized through an act of Congress. In effect, this will mitigate the ambiguity of Executive Order No. 249 on the administrative authority of the Secretary of Finance.