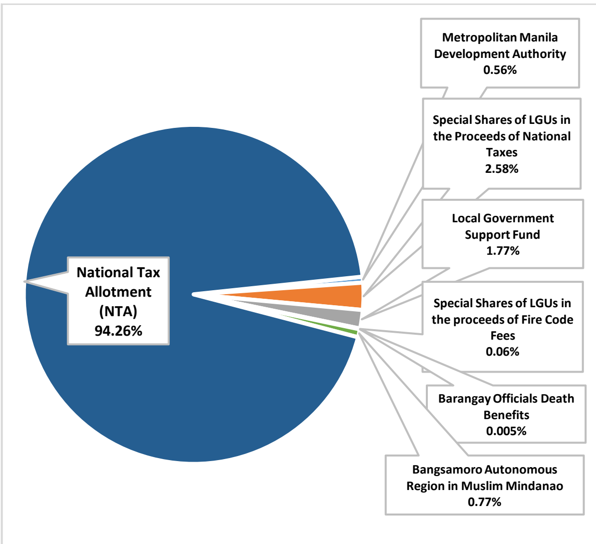
IRA in 2022
At A Glance

February 2022 **AAG-22-02**

The internal revenue allotment (IRA) is the main intergovernmental fiscal transfer in the Philippines. It is the biggest source of operating revenues of local government units (LGUs) to provide basic goods and services and finance other development activities. Like other subnational governments in developing countries (Liu and Waibel 2008), LGUs in the Philippines have been clamoring for more fiscal transfers to address some of the challenges they have been facing. These include the lack of funds to finance the functions devolved to them, the unclear delineation of power and authority, and the large disparities in financial resources among LGUs. The implementation of the Mandanas-Garcia ruling beginning 2022 will result in LGUs having bigger coffers, however, it also poses varying challenges to both national and local governments.

The Supreme Court Ruling. Under Section 284 of Republic Act (RA) No. 7160 or the Local Government Code (LGC) of 1991, LGUs are entitled to a forty percent (40%) share of the national internal revenue taxes, otherwise known as the IRA. The manner by which the IRA was determined was challenged in 2013 by then Representatives Hermilando Mandanas and Enrique Garcia Jr., who argued that the exclusion of certain taxes collected by the Bureau of Customs (BOC) in the IRA computation caused the diminution of the base for determining the just share of LGUs. Known as the Mandanas-Garcia ruling, the Supreme Court (SC) held with finality on 10 April 2019 (G.R. Nos. 199802 and 208488) that all collections of national taxes, except those accruing to special purpose funds and special allotments for the utilization and development of the national wealth, should be included in the computation of the base of the just share of LGUs.

Figure 1. Allocation to LGUs, 2022

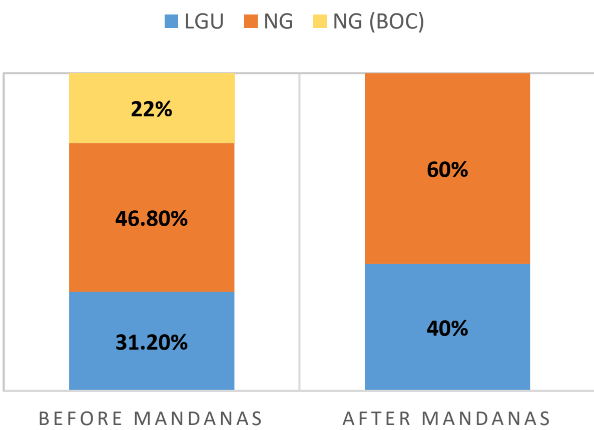


Source of basic data: 2022 General Appropriations Act (GAA)

From IRA to NTA. Following the Mandanas-Garcia ruling, the IRA is renamed as the national tax allocation (NTA). The NTA comprises 91 percent of the PhP1.049 trillion Allocation to LGUs (ALGUS) in the 2022 national budget. The remaining nine percent (PhP90.37 billion) of the ALGUS is distributed among the Local Government Support Fund, the Special Shares of LGUs in the proceeds of National Taxes, the Bangsamoro Autonomous Region in Muslim Mindanao, and the Metropolitan Manila Development Authority, among others (Figure 1).

Prior to the SC decision, the IRA accounts for merely 31.20 percent of total national taxes. With the correction made by the SC, LGUs are set to receive in full their mandated 40 percent NTA share this 2022 (Figure 2).

Figure 2. Change in Revenue Shares of NG & LGUs, as a Percentage of Total National Taxes



Source of basic data: Department of Finance (DOF) Revenue Operations Group

Increase in Local Fiscal Space. The NTA amounts to PhP959.04 billion or about 19.10 percent of the 2022 national budget (Table 1). This is an increase of PhP185.24 billion from the IRA in 2021 or a growth rate of 23.90 percent. The share of LGUs in the NTA will remain as is, and will be allocated as follows: 23 percent for provinces, 23 percent for cities, 34 percent for municipalities, and 20 percent for barangays (Table 2).

With more fiscal space, program allocations of LGUs are estimated to go up by 37.89 percent (Figure 3). However, there are concerns on whether the LGUs can easily absorb a significant increase in revenues (World Bank, 2021 Philippines Economic Update) given their previous spending performance.

LGU Budget Utilization. The IRA is considered an unconditional, formula-based block grant. LGUs basically have the freedom to use it to finance any of their activities, subject to some imperatives. For instance, under Section 17(g) of the LGC, the IRA and other local resources shall first cover the cost of providing basic services and facilities. Section 287 of the LGC also mandates LGUs to appropriate at least 20 percent of its IRA specifically to finance development projects. Commonly known as Local Development Fund (LDF), it is used to finance the priority projects of LGUs as embodied in their duly approved local development plans and Annual Investment Programs (AIP).

Data show that from 2009 to 2018, LGUs mostly spent their IRA and own-source revenues for general public services (46%), social services (21%), and economic services (15%), with capital outlays lagging behind at roughly 12 percent (Sicat et al. 2020a, 12-13). LGU spending was also much lower than the collected revenue. In 2019, the average surplus of provinces was 26 percent while cities and municipalities registered 22 percent and 17 percent, respectively (Figure 4).

Moreover, LGUs have not been fully utilizing their LDFs. Based on Bureau of Local Government Finance (BLGF) data, only one in five LGUs (21.30%) registered 100 percent LDF utilization rate while more than a quarter (25.90%) of the 1,716 LGUs (excluding barangays) in the country have utilization rates of less than 50 percent. In 2019, the national average for LDF utilization rate is 73.84 percent, with Regions IV-B and VII performing the worst, at 55.36 percent and 51.84 percent, respectively (Figure 5).

Table 1. Estimated Increase in the IRA of LGUs, 2022

	IRA in 2022 (NTA)	% Share to National Budget
Before SC decision	PhP773.80 billion	15.40%
After SC decision	PhP959.04 billion	19.09%
Estimated Increase	PhP185.24 billion	3.69%

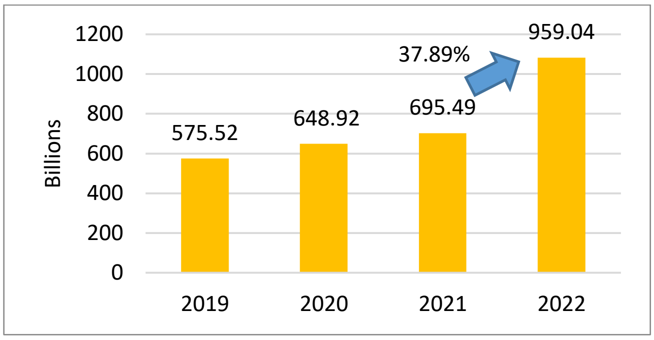
Source of basic data: 2022 GAA

Table 2. Allocation Across Different LGUs

LGU	No. of LGUs (as of 2020)	2021 IRA Share (in billion)	2022 NTA Share (in billion)	% Allocation
Provinces	82	159.96	220.58	23%
Cities	146	159.96	220.58	23%
Municipalities	1,488	236.47	326.07	34%
Barangays	41,933	139.10	191.81	20%
Total	**43,649**	**695.49**	**959.04**	**100%**

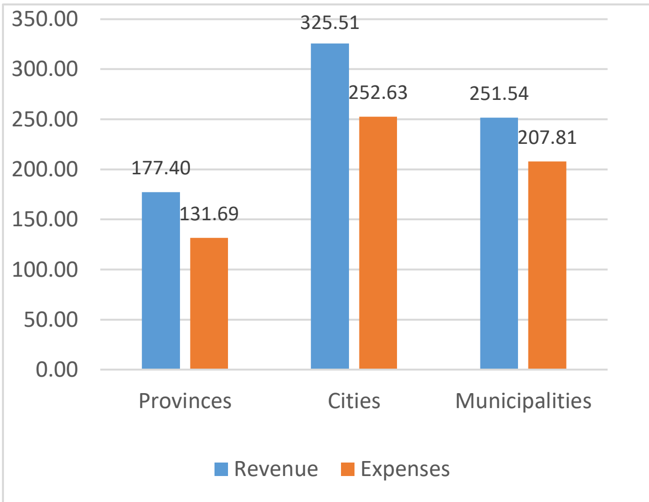
Source: Department of Budget and Management (DBM), 2022 GAA

Figure 3. Program Allocation for IRA/NTA, 2019-2022



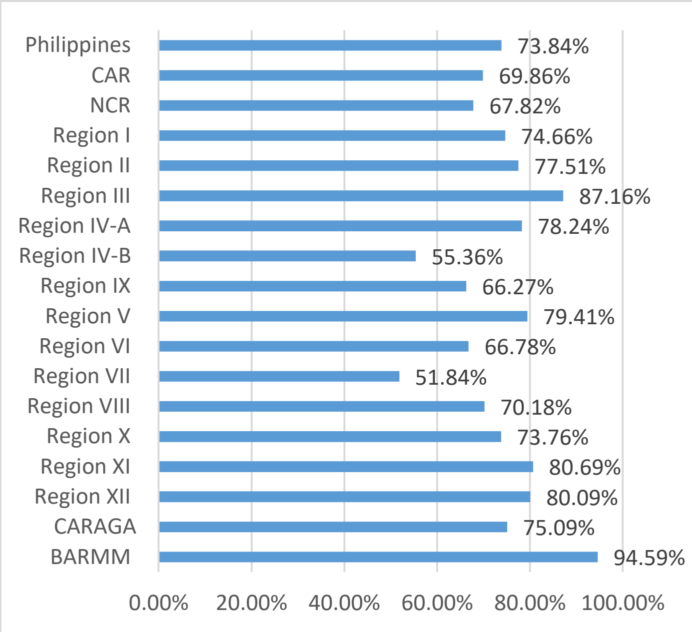
Source: DBM, 2019-2022 GAAs

Figure 4. Revenue and Expenses by LGU Classification, 2019 (in billion pesos)



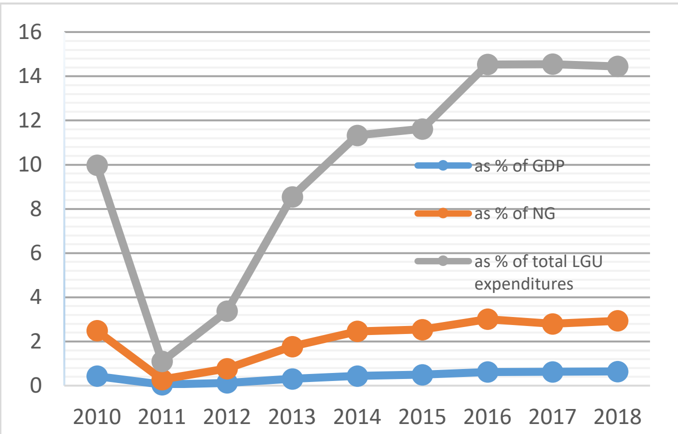
Source: Commission on Audit (COA) Annual Financial Report 2019

Figure 5. Utilization of the 20% Component of the IRA for LDF (2019)



Source of basic data: BLGF-DOF

Figure 6. Summary Percentage of Budget Allocation for National Government LGU Assistance Programs, 2010-2018



Source: Sicat et al. 2020a, 20

Studies have attributed poor budget spending and LDF utilization rates to various reasons such as (1) limited implementation capacity, (2) inadequate planning and program prioritization, (3) weak competencies in public financial management, (4) lack of manpower, and (5) process bottlenecks such as in procurement. There is an apprehension that unless these issues are addressed, a significant increase in the local budget due to the Mandanas-Garcia ruling may result in even worse underspending (World Bank 2021).

With regard to investment programming, LGUs tend to prioritize the implementation of programs funded by the National Government than their own local development programs. As shown in a paper by the Philippine Institute for Development Studies (PIDS), Sicat et al. (2020a, 18 and 45), National Government LGU financial assistance and support programs averaged about 12 percent of local government expenditures (Figure 6), which is roughly the average share that LGUs spent on capital outlays. Figure 6 also shows that these local government support programs averaged about 0.5 percent of gross domestic product (GDP) and 2 percent of National Government expenditures.

Among the general recommendations of Sicat et al. (2020a, 45) is the need for the National Government to ensure that LGUs fully utilize the LDF for increased infrastructure investment, particularly with the increase in funding brought by the Mandanas-Garcia ruling.

Table 3. Local Infrastructure and Fiscal Gaps (2017)

Infrastructure Area	Current Situation/ Estimated Infrastructure Gap	Total, Estimated Fiscal Gap
(a) Local roads	47.42% unpaved roads	133.30 trillion
(b) Potable water systems	516 barangays with only Level 1 water system	-
(c) Evacuation centers	69.20% of LGUs without primary evacuation centers	1.95 billion for the least costly building
(d) Rural health units (RHUs)	1,638 LGUs without RHUs	17.86 billion at the least

Source: Sicat et al. 2020b, 20

A related PIDS baseline study shows the estimated infrastructure and fiscal gaps on some key infrastructure areas in the country where the windfall income from the Mandanas-Garcia ruling could be used (Table 3). For instance, the fiscal gap to pave existing local roads for 1,190 municipalities (79.97% of the total municipalities) is pegged at PhP133.30 trillion. Data from the LGUs also showed that there are 516 barangays (found in 34 municipalities in 21 provinces) that access water only from Level 1 water system sources (Sicat et al. 2020b, 20). The other findings of the study are as follows: (1) only 30.80 percent of LGUs in disaster-prone areas (i.e., Geographically-Isolated and

Disadvantaged Areas or GIDAs, as identified by the Department of Health) have evacuation centers; and (2) with a total of 1,186 RHUs reported as of June 2019, the gap based on the 2015 Census data is 1,638 RHUs with a cost ranging from PhP17.86 billion to PhP21.40 billion to meet the ideal number of one RHU per 20,000 population (Philippine Health Facilities Development Plan 2017-2022 in Sicat et al. 2020b, 15, 20-23).

Full Devolution. To ensure the sustainability of its fiscal position after the Mandanas-Garcia ruling, the National Government issued Executive Order No. 138 on 01 June 2021. It mandated a funding cut for functions that have been devolved to LGUs under the LGC which some National Government agencies continue to perform, arguably for the purpose of "meeting national objectives." This could be a primary step towards improving decentralization and enhancing local service delivery. A heightened collaboration between the National Government and the LGUs, and an improved strategic planning and funding at the local level could address the issues on lack of resources, overlapping mandates, and disparities in financial resources.

Resolving the structural issues of decentralization necessitates a long-term commitment to creating successful institutional structures. In the short term, there is a need to clearly identify, discuss, and coordinate the "re-devolution" of functions, as well as to focus on implementation-ready initiatives and projects to reduce unnecessary LGU budget allocation. Over the medium term, it is recommended that government: (1) support LGU capacity-building; (2) eliminate inequality by gradually "re-devolving" and targeting National Government subsidies toward disadvantaged LGUs; and (3) strengthen monitoring and evaluation (M&E) mechanisms (World Bank 2021, 46-48; Manasan 2020, 16-17).

Over the long term, there is a need to establish a well-functioning local government financing system in the Philippines, which is vital for the fulfilment of service delivery and poverty alleviation objectives and is critical for the overall functioning of the decentralized system of governance as mandated by the LGC. This could be achieved by (1) amending the restrictive provisions of the LGC on increasing local government own-source revenues (i.e., Senate Bill Nos. 444, 494, 839, 842, 843, 881 and 1202); (2) reformulating the NTA, e.g., using a more appropriate baseline to accurately determine proposed variables such as LGU expenditure needs (i.e., Senate Bill Nos. 97, 223, 269, 326, 426, 447, 607, 758, 819, 1030 and 1138; and (c) rationalizing LGU credit financing (i.e., Senate Bill Nos. 841, 844, 846, 1011, 1211 and 1634), among others.

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