

**BUSINESS GROUPS' POSITION PAPER
ON THE PROPOSED SHIFT TO A FEDERAL SYSTEM**

Financial Executives Institute of the Philippines (FINEX),
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Management Association of the Philippines (MAP),
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Cebu Business Club (CBC)

June 18, 2018 -- We, the undersigned Philippine Business Groups, respectfully submit this position paper on the government's plan to shift to a federal system.

Our economy has achieved robust expansion in recent years, and it is imperative, in the interest of more inclusive growth, that we continue to improve on our competitiveness and our ability to attract job-creating investments through stable policies and reduced uncertainty.

We acknowledge the aspirations of the proponents of a shift to a federal system: the idea that local governments may be more knowledgeable about and responsive to local needs and that increased local authority will allow them to be more successful and even creative in improving governance and standards of living.

We respectfully recommend the following measures:

1. For the Department of Finance, Department of Management and Budget and National Economic Development Authority to conduct comprehensive studies on the budgetary and economic implications of a shift to a federal system and to present their findings to the Consultative Committee, Congress and the public.
2. For the Consultative Committee and Congress to proactively seek feedback from the various sectors and the public, in light of the extremely low level of public awareness, as manifested in a recent survey that showed only 3 percent of those polled rate amending the Constitution as a key concern.¹
3. For the national government to design and implement a program to expand the capabilities of local governments and local government officials, to prepare them for added responsibilities whether or not there will be a shift to a federal system.
4. For the Executive, the Congress and the Consultative Committee to review the objectives of the shift to a federal system, and determine which of these can be addressed immediately and substantially by amending the Local Government Code and other laws, or by enacting new laws and administrative measures, while deliberating on whether to change the Constitution.

¹ Pulse Asia, March 2018 Nationwide Survey on Charter Change:
<http://www.pulseasia.ph/march-2018-nationwide-survey-on-charter-change/>

5. For the national and local governments to strengthen regional economies by developing economic strategies, while deliberating on whether to change the Constitution. The business community stands ready to support the government in developing these strategies.

These recommendations stem from four major concerns:

1. ON THE VITAL NEED TO UPGRADE LOCAL GOVERNMENT CAPABILITY

An eventual shift to federalism implies the significant expansion of the breadth and depth of power and authority that will be transferred from the national government to the proposed federal states and regions. From the current baseline, it is imperative that such a move be preceded by and complemented with a comprehensive build-up of local government capabilities.

This situation needs to be addressed squarely if it is contemplated that the national government shall eventually turn over to the local governments more power and authority over critical processes such as taxation and regulation if a shift to a federal system is implemented.

We, therefore, urge that significant improvements in local government efficiency and service capabilities be instituted and strengthened as a vital precondition prior to a shift to a federal system.

2. ON AN INEFFECTIVE CONSOLIDATION OF PROVINCES INTO FEDERAL REGIONS

We are concerned that well-entrenched political bosses and dynasties will strongly resist any plan to consolidate provinces into federal regions/states. Therefore, either the proposed new federal regions will duplicate many of the provincial agencies and operations, thereby resulting in higher government costs and turf wars, or the new federal regions will be weak and unable to deliver on the promised benefits of a shift to a federal system.

Under one proposal, the provincial governors will form a federal region/state council with a rotating head. While proponents say this has worked well in countries like Switzerland, we believe the likely result may be closer to the already demonstrated weaknesses --- dating back to the martial law era, or for more than four decades --- of the erstwhile Metro Manila Commission and its present-day successor, the Metro Manila Development Authority (MMDA).

In any case, we are concerned that in a shift to a federal system, political dynasties' competition for control and patronage will escalate and intensify, thereby offsetting at least some of the hoped-for benefits of a federal system.

3. ON UNCERTAINTY ABOUT THE DIVISION OF FINANCIAL POWERS

We are concerned that the draft proposals emanating from the House of Representatives and the Consultative Committee to Review the Constitution, an ad hoc body formed by the Office of the President, leave many aspects of the division of financial powers between the national government and the federal regions for future politicians to decide or dispute. This results in

uncertainty in at least three areas:

First, investors are unsure if the proposed states will have the power to increase taxes and, if so, which states would use such power, affecting corporate bottom lines. Investors are unsure if states will have added responsibility for collection and, if so, which states will perform poorly, thereby affecting the delivery of infrastructure and other services.

Second, investors are unsure as to how much new spending power the local governments will exercise and then whether the local governments will use this power wisely or in risky ways. Aside from the program to prepare local governments for added responsibilities we recommended above, we also recommend strict spending and/or budget deficit constraints on the states, similar to but improving on those that new EU states committed to follow.

Third, investors are also concerned about a planned equalization fund, which is meant to transfer undefined amounts of funds during a transition period from more economically strong states to weaker ones.

4. ON GOVERNANCE AND FINANCIAL ISSUES

Aside from a lack of preparation to handle increased responsibilities, some data show that only a handful of prospective federal regions would have the production and trading capacity to support their population with a degree of independence.

One or both of these factors could force big and small businesses to shut down, thereby triggering higher unemployment and making our people's economic burdens even heavier, sparking a downward spiral in the overall quality of life of our people.

This could also compel the national government to bail out several, if not many of the proposed federal regions and states, resulting in a bleak scenario for the national government and economy.

We are concerned that the likelihood that these economically detrimental scenarios could, in fact, materialize thereby triggering a significant decline in investments and a reversal of the strong economic profile achieved painstakingly by the country in the past years.


5. ON THE NEED FOR ACTIVE PARTICIPATION OF KEY ECONOMIC AGENCIES

We are concerned that the Department of Finance, the Department of Budget and Management, and the National Economic Development Authority should be given meaningful opportunity to weigh in on the comprehensive economic implications of a shift to a federal system, let alone its tremendous implications on the size of the national budget, given the possibly huge incremental cost of creating additional bureaucracy for the proposed new federal states and regions. It appears that these agencies have not had sufficient opportunity to focus on its wide-ranging implications. We trust that the country's economic management team will do what is needed to ensure that this does not happen. (END)



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