

12498

Report No. 25793-MAG

Madagascar Decentralization

November 5, 2003

PREM I
Southern Africa
Africa Region

COPY:
DESA/DPAD
REFERENCE UNIT
ROOM DC2-2135



Document of the World Bank

EXECUTIVE SUMMARY

1. The democratic transition of the early 1990s provided the context for decentralizing some powers to lower levels of the Malagasy government. Communes became the focal point of Madagascar's decentralization strategy and central ministries increased their local presence through administrative deconcentration. Since then, the decentralization process has been subject to intense political bargaining, leading to several strategic turns in the reform process.
2. Today, there is substantial uncertainty about the future direction of the decentralization process. This uncertainty has created tensions within and between various layers of government. These tensions and uncertainties revolve around two main issues: first, the devolution of authority and responsibility to lower levels of government, although decided, was never fully implemented. At the provincial and commune levels, the central government continued to carry out many of the executive functions of decentralized institutions, even after these institutions had been established. Second, the 2002 political crisis and the subsequent change in government created a strategic vacuum in the country's decentralization policy. The new government *de facto* reversed the radical reform of 1998, which established the autonomous provinces without officially announcing a new strategy.
3. Now that Madagascar has emerged from the crisis, the government needs to take major decisions with respect to the future direction of the decentralization process. Regardless of which approach it will adopt, this will be a long and risky process. Madagascar's new government takes on the legacy of a far-reaching reform centered around the establishment of six autonomous provinces. Given the tensions that arose during the 2002 crisis between the new government and these autonomous provinces, a major reorientation of the decentralization process is expected, and in many respects desirable. The election of local governments – due to take place in November 2003 – will also provide an opportunity to clarify the roles and responsibilities of communes, which are, in practice, the only effective level of sub-national government.
4. Decentralization, in any form, will not be a magic bullet for overcoming Madagascar's development challenges, even though it has often been seen as a panacea for solving Madagascar's governance problems. In many countries, especially in Africa, decentralization results from the failures of a poorly performing centralized state, and in this context, decentralization does not present a recipe for automatic success.
5. As in many other poor developing countries, there are substantial structural constraints to decentralization in Madagascar. These include a large fiscal imbalance between the center and sub-national layers, lack of capacity to carry out decentralized services, and a weak legal system. These constraints *de facto* exclude many of the theoretical options for decentralization typical of developed or transitional economies – in particular with respect to fiscal decentralization (e.g. sub-national borrowing, tax sharing, sophisticated performance-based transfer system).

Madagascar remains a very centralized country

6. Despite having embarked on several waves of decentralization since the early 1990s, Madagascar remains a very centralized country, both administratively and fiscally.

7. **Administrative centralization.** Even after ten years of decentralization policies, very few administrative functions have actually been decentralized. Policy planning, personnel management, and budgeting are still carried out by the central government. Even facility-level management has remained centralized – except in cases where donors work directly with the communities. Commune competencies are limited to some classic functions (administrative services, waste management) and some co-financing of social services through conditional grants. In practice, deconcentrated agents still co-administer local government functions.

8. The deconcentration of services is slightly more advanced. The partial deconcentration of social sector ministries has improved the outreach of health and education services, but the discretion of deconcentrated layers over personnel and budget management remains very limited. Most decisions are still taken at the central level, in the capital Antananarivo.

9. **Fiscal centralization.** The centralization of Madagascar's revenues is higher than in most other low-income countries for which data is available. The central government collects more than 97 percent of total revenues. The only truly decentralized level, the communes, accounts for 2-3 percent of total revenues, out of which almost half is attributable to urban communes. Rural communes collect on average only US\$1 per capita per annum.

10. The high degree of revenue centralization and the minimal volume of sub-national revenues are the result of the twin impact of (i) a very low overall revenue base representing 9.6 percent of GDP (2001), and (ii) a disproportionately high share of revenues items which cannot or should not be decentralized. Trade taxes, corporate income taxes, and VAT accounted for 78 percent of total revenue in 2001.

11. The centralization of revenues is mirrored by a very centralized system of public expenditures, although some steps were taken to deconcentrate the execution of expenditures in the late 1990s. In total, the central government manages and executes 88 percent of total government expenditures. *Deconcentrated expenditures* amount to 10 percent, executed by deconcentrated line agencies of the ministries, mostly in the social sectors. Recurrent expenditures are more deconcentrated than investments, which are almost completely executed from the center. *Decentralized expenditure* amounts to 4-5 percent of the total, out of which central government transfers to sub-national governments cover 3 percent, while only 1-2 percent is attributable to sub-national governments' own revenues.

Challenges and risks

12. Against the background of Madagascar's structural constraints, it is crucial to adopt a prudent and realistic approach: one that seeks to mitigate the risks of the existing decentralization process and does not attempt to go beyond what can reasonably be achieved in the medium term. Currently, the vacuum in Madagascar's decentralization strategy comes from the uncertainty surrounding the status of the autonomous provinces. The autonomous

provinces were introduced (together with the regions) with the 1998 amendments to the constitution. They were made effective with the provincial elections in December 2000 and the provincial executive's nomination in June 2001.

13. The 1998 constitutional changes were radical because, for the first time, the center had prepared for the transfer of substantial competencies to sub-national bodies – the autonomous provinces. However, with hindsight, it seems that the establishment of autonomous provinces only resulted in creating even stronger parallelism between deconcentrated and decentralized administrative functions because the respective competencies of the different levels of government were not clearly defined. While some parallelism is normal and necessary in any country with some degree of decentralization, the lack of clear roles and responsibilities has created confusion and tension between “competing” decentralized and deconcentrated levels of government.

14. Arguably, full implementation of the 1998 decentralization strategy would create substantial risks. It is difficult to imagine that such a radical transfer of competencies would be carried out smoothly given Madagascar's high degree of centralization and the weak state of the legal system. There is a particular risk of (i) undermining the autonomy of communes and (ii) weakening service delivery and macro-economic stability:

- ***Undermining the autonomy of communes.*** Under the 1998 strategy of inter-governmental relations, the communes would have fallen under the legislation and financial oversight of the provinces. Provinces would have been able to exercise almost full discretion over communes' finances, including transfers (accounting for 75 percent of rural communes' budgetary revenues) and local revenue assignments. With such a system, there would have been a major risk that competencies formerly decentralized at the commune level would have been “re-centralized” at the province level. Communes would have lost discretion over their finances, and hence their capacity to operate in any real autonomous way.
- ***Weakening services delivery and macro-economic stability.*** Almost none of the newly established provinces are financially viable. Under-financing of the autonomous provinces creates risks for the delivery of government services and for macro-economic stability. To finance even minimal levels of services, all the provinces would have to depend on substantial intergovernmental transfers. While intergovernmental transfers are not harmful *per se*, the magnitude of needed transfers, the imbalance of provincial finances, and the absence of a regulatory framework would mean high risks of structural sub-national fiscal deficits and a fragmentation of social services.

The role of communes

15. The most notable achievement of Madagascar's decentralization policies was the establishment of 1,392 communes in 1995. Currently, communes represent the only effective and viable layer of decentralized government. Yet, communes have been the main victim of political bargaining and uncertainty, which explains why many of their assigned competencies have not yet been effectively transferred to local governments. For instance, deconcentrated agents are continuing to collect the most important sources of local revenue.

16. While many urban communes gained from decentralization – in particular through decentralized and hence improved revenue collection – most rural communes still lack finance, competencies, and capacity. Commune finance is characterized by a great divide between urban and rural revenue mobilization performance. Urban communes have increased their own revenues several fold since the mid-1990s. In contrast, rural communes' own revenues remain marginal both in absolute and in per-capita terms; central government transfers still represent 75 percent of their budgetary resources.

17. This paper argues that communes should be at the core of the government's decentralization strategy, but there should be no illusions as to what communes can reasonably achieve. Commune finance, including transfers, represents between 3 and 4 percent of total government finance and even less in rural communes, where a large majority of Madagascar's poor live. Local services are mainly carried out by the deconcentrated administration (for recurrent expenditures) and donors (for investments). Rural communes' own financing is even inferior to contributions of community groups, which provide a growing share of local service finance. As a result, communes mainly depend on central government transfers, which typically arrive late (by six months or more) and sometimes not at all.

18. Similar to many other poor developing countries, Madagascar's rural communes systematically under-exploit taxes like the property tax. As a consequence, most rural communes have to rely on alternative sources of local revenue. For instance, larger communes receive important shares of revenue through the levy of user fees for local infrastructure (markets, housing, tourist sites, etc.). However, smaller rural communes that do not have comparable infrastructure endowments must rely on economically more counterproductive and volatile revenue sources such as sales taxes on local primary goods.

19. It must be stressed, however, that communes are much more efficient in the collection of local revenues than deconcentrated intermediaries. Although deconcentrated and centralized agents are formally charged with the collection of the majority of local taxes and fees, they only managed to collect 30 percent of local revenues in the communes sampled in this study. In contrast, the few revenues that are directly perceived by the commune (mainly administrative fees and some agricultural taxes) account for almost 70 percent of local governments' own income.

AN AGENDA FOR IMPLEMENTATION

20. Given Madagascar's current institutional and fiscal context, implementing a policy of radical decentralization would be difficult, unnecessary, and probably dangerous. In order to foster institutional stability, the government should consider suppressing or postponing the installation of an intermediary level of government. This report suggests that, for the time being, the establishment of autonomous provinces should not be pursued further. The focus should be on strengthening communes, with inter-communal associations providing a flexible option for regional planning. Eventually, an intermediary level of government could play an important role to bridge the distance between the center and the 1,392 communes. Currently, the risks associated with pursuing the installation of autonomous provinces seem to outweigh the potential benefits.

21. Furthermore, there is major room and urgent need for improvement within the existing framework of decentralized and deconcentrated service delivery. The government could focus its service delivery strategy on (i) *strengthening rural communes*, the core unit of decentralized governance, and (ii) *improvements within the existing mechanisms of deconcentrated service delivery*.¹

Strengthening rural communes

22. Communes are the only operational – and hence the most crucial – sub-national layer of government. However, the 1998 reform and recent decrees risk sidelining the communes. The communes should again become the unit of reference at the local level and be governed by a more certain and stable framework. Central government interference should be limited as much as possible. Communes need to receive a real transfer of competencies to raise revenues and most importantly, they need to see an increase of their transfer allocation.

23. Strengthening sub-commune structures, like Fokontany and Fokonolona, is laudable and important because sub-commune institutions can play an important role in contributing to communal functions. In particular, strengthening sub-commune structures could help to better extend administrative services to remote villages. Insufficient procedures to obtain basic registry services (such as birth, death, and marriage certificates) cause major social problems for poor families. For instance, ex-post registration for birth certificates are extremely cumbersome to receive and expensive as they would entail a court order.

24. However, the detachment of sub-commune structures from the commune's authority – as it is currently envisaged – carries the risk of undermining effective provision of communal services. With too strong a focus on deconcentrated command lines, the recent reform threatens to jeopardize the autonomy communes have obtained since the mid-1990s. This paper argues that it would be crucial, instead, to establish clear reporting relationships between sub-commune institutions and communes and to limit the role of central government intermediaries (Sous-Prefet and DAA) to control and supervision functions.

25. While pro-poor targeting of government resources is desirable in a country with very high inequality, administrative efficiency considerations call for simplicity and predictability in the fiscal relations between the center and the periphery. Therefore, in order to improve the financial position of communes, the initial focus should be on basic improvements and good “housekeeping.”

26. First, the responsibility of collecting the communes' own revenues should rest solely on the communes. Until now, three deconcentrated (DAA, Treasury, DGI) and two local (Commune and Fokonatany) institutions are involved in collecting local taxes. As expected from accountability principles and as demonstrated by field studies, communes are more efficient in collecting their own revenues than are deconcentrated intermediaries.

27. Second, communes suffer from the unpredictability with which transfers are executed. The foremost priority is to ensure predictable disbursements within a scheduled rhythm (e.g. every six months). Given that, on average, 75 percent of rural communes' financing depends

¹ See Annex 1 for a compilation of all of this report's short- and medium-term recommendations.

on transfers, predictable disbursements would allow communes to actually plan their expenditures and stop the existing practice of ad-hoc budgeting.

28. Third, transfers to rural communes should be increased to help guarantee that rural communes have the minimum resources to function better. Rural communes should get at least the same *per capita* allocation as urban communes (FMG 8,800), which would also remove the artificial and regressive separation between them. The increase of transfers to rural communes could be fiscally neutral if the transfers to the districts, which have so far not translated in the equivalent local investments, were permanently suppressed.

Improve service delivery within the deconcentrated framework before decentralizing further

29. Madagascar's recent decentralization process has been characterized by several radical turns. This has created uncertainty and tensions at and between different administrative levels. Given that the central administration and its deconcentrated outposts still hold the key to Madagascar's service delivery system, and taking into account the substantial risks associated with rapidly introducing additional layers of sub-national government, this report suggests ways to make the existing set-up more efficient before decentralizing further. This would also foster the stability of the communes. When a more stable institutional framework is in place, Madagascar will be in a position to gradually decentralize further and introduce an additional sub-national layer.

30. With the 1998 reforms, an already weak system of control and audit was further challenged by the magnitude of transfers to the provincial level and by the poorly defined command chains. The gradual transfer of competencies to the deconcentrated level recommended in this study would require an upgrade of control capacity and overall coordination. A possible tool for achieving such control is the *integrated budget management system* discussed under the new institutional reform project. An improved control, audit, and budget management system would also constitute an important pillar for decentralizing institutional responsibilities.

31. In the same context, the government needs to clarify competencies for the monitoring and evaluation of key public services. The most important reforms require the creation of clear reporting rights between statistical services at the province and central levels, as well as an effort to harmonize data collection procedures. In addition, adequate investments are needed to analyze, treat, and verify data at the province and district levels, and to allow for better coordination mechanisms for information sharing with central statistics departments and between sectors.

32. To further strengthen the outreach of central ministries and speed up budget execution, key services should be further deconcentrated, with a transfer of technical operational power to the province level. Under this system, the deconcentrated treasury should also collect the provincial revenues foreseen in the budget (particularly business and automobile taxes).

33. Given that districts represent the core unit for deconcentrated social service delivery and also arguably the optimal unit for poverty targeting, current social expenditure could be better targeted towards poorer areas. Better targeting to poorer districts could be achieved by giving a heavier weight to more remote and poor districts.