A WORLD BANK COUNTRY STUDY

Decentralization in Madagascar





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ABSTRACT

This book takes stock of Madagascar's first 10 years of decentralization. As it happened in many other developing countries, particularly in Africa, Madagascar's decentralization process has seen reversals, uncertainties and lack of clarity all along. This explains why Madagascar, despite the experience with decentralization, remains a highly centralized country with only about 3–4 percent of expenditures spent below the center and with very few prerogatives decentralized to the local level.

Notwithstanding the structural impediments to decentralization in poor countries, many positive lessons can be drawn from the Madagascar case which point to the potentials of the decentralization process. This study provides a detailed analysis of local government finances and develops a methodology for measuring local financing needs (local fiscal gap methodology). Based on this analysis, the study argues that a lot can be gained from simplifying administrative arrangements and fiscal relationships. Instead of a full-blown and ambitious decentralization strategy, this book suggests a number of reforms, which would go a long way by making the current structure work better. These reforms include: (i) a full transfer of the (limited) local competencies to commune, particularly local revenue collection; (ii) increasing transfers to rural communes so that per capita allocations would be the same across communes—rural and urban; and (iii) assigning revenues to one level of government only, except for some very specific types of taxes (such as on natural resources).

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This report presents the results of a close dialogue on decentralization between the World Bank and the Government of Madagascar, in particular the former Ministry of Decentralization, as well as Madagascar's development partners (AfD, Coopération Française, UNDP, EU, GTZ, and Swiss Cooperation). The report builds on extensive research commissioned by the World Bank since 2001.

This report has been prepared by a team consisting of Wolfgang Fengler (Task Team Leader, AFTP1), Emanuela Galasso (DECRG), Aurélien Kruse (AFTP1), and Frank-Borge Wietzke (AFTP1). The team has received strong support and guidance from Jesko Hentschel (Lead Economist until September 2003, AFTP1). Dieudonné Randriamanampisoa (Senior Economist, AFTP1) was instrumental in organizing the studies on local government finance, which were carried out by the consultancy Miara Mita and led by Mamy Ralaivelo. These commune finance studies were funded from the Norwegian Trust Fund (managed by Jacomina de Regt, AFTES). The peer reviewers were: Harold Alderman (AFTHD), James Fitz Ford (TUDUR), Jennie Litvack (MNSED), and Dana Weist (PRMPS).

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The results of the study were presented on September 29, 2003, at a National Conference on Local Development in Antananarivo, which was organized by the Ministry of Decentralization. The outputs of the conference, which will be documented separately, have been included in this study.

ACRONYMS AND ABBREVIATIONS

AfD Agence Française de Développement

AfDB African Development Bank

CATP Centimes additionnels à la Taxe Professionnelle

CCM Commission Centrale des Marchés CDE Contrôle des Dépenses Engagées **CEG** Collège d'Enseignement Général **CES** Conseil Economique et Social **CF** Circonscription Financière

CFAA Country Financial Accountability Assessment

CGI Code Général des Impôts **CHD** Centre Hospitalier du District CIP Conférence Inter-Provinciale **CISCO** Circonscription Scolaire

CLD Comité Local de Développement

CLS Comité Local de Sécurité

CRESSED Crédit pour la Réforme pour le Secteur Education

Centre Sanitaire de Base **CSB**

DAA Délégué Administratif d'Arrondissement **DGG** Délégué Général du Gouvernement **DGI** Direction Générale des Impôts DIRESEB Direction Régionale de l'Education **DIRSAN** Direction Régionale de la Santé Direction Régionale du Budget DRB Direction Régionale des Impôts DRI

EPP Ecole Primaire Publique

 $\mathbf{E}\mathbf{U}$ European Union

FAF Farimbon'Asa iombonana ho Fampandrosoana ny sekoly

FID Fonds d'Intervention pour le Développement

FKL Fokonolona **FKT** Fokontany **FMG** Malagasy Francs

FOFIFA National Institute for Agricultural Research

FOSIS Chilean Social Fund Project

FRAM Fikambanan'ny Ray aman-drenin'ny Mpianatra

GDP Gross Domestic Product **GOM** Government of Madagascar

GTDR Groupe de Travail du Développement Régional **GTZ** Gemeinschaft für Technische Zusammenarbeit

HCC Haute Cours Constitutionnelle **HIPC** Heavily Indebted Poor Countries **IADB** Inter American Development Bank **IBS** Impôt sur les Bénéfices des Sociétés **IFPB** Impôt Foncier sur les Propriétés Bâties

IFT Impôt Foncier sur les Terrains **IGE** Inspecteur Général d'Etat **IMF** International Monetary Fund **INSTAT** Institut National de la Statistique M&E Monitoring and Evaluation

MADIO Madagascar-Dial-Instat-Orstom

MINESEB Ministère de l'Enseignement Secondaire et Education de Base

MINSAN Ministère de la Santé

NGO Non-Governmental Organization

OPCI Organisme Publique de Coopération Intercommunale

PACT Private Agencies Collaborating Together
PAGU Projet d'Appui a la Gestion Urbaine

PAIGEP Public Sector Management and Capacity Building Project

PCD Plan Communal de Développement

PdF Président de Fokontany

PDRAP Projet de Développement Régional d'Ambato-Boeny

PDS Président de la Délégation Spéciale

PER Public Expenditure Review

PETS Public Expenditure Tracking Survey

PP Perception Principale

Ppa Percepteur Principal Assignataire

PREM Poverty Reduction and Economic Management

PRSP Poverty Reduction Strategy Paper

PSDR Programme Sectoriel pour le Développement Rural

ROM Redevance de Collectes et Traitement des Ordures Ménagères

RSA Republic South Africa

SALAMA Centrale d'Achat des Médicaments

SIMA Statistical Information Management and Analysis

SSA Sub-Saharan Africa

SSD Service Sanitaire de District

TAFB Taxe Annexe à l'Impôt Foncier sur la Propriété Bâtie

TP Taxe Professionnelle

TST Taxe Unique sur les Transactions

UNDCF United Nations Capital Development Fund UNDP United Nations Development Program

USAID United States Agency for International Development

US\$ United States Dollar VAT Value Added Tax WBI World Bank Institute

ZAP Zone d'Administration Pédagogique

CURRENCY EQUIVALENTS

Currency Unit = Malagasy Franc (FMG)

US\$1 = FMG 6,012.17 (Exchange Rate Effective March 5, 2004)

FISCAL YEAR

January 1—December 31

EXECUTIVE SUMMARY

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.

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.

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 remain a 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 installation of new local governments, following communal elections in November 2003, also provides an opportunity to clarify the roles and responsibilities of communes, which are, in practice, the only effective level of subnational government.

Decentralization, in any form, will not be a magic bullet for overcoming all of 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.

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 subnational 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 (for example, subnational borrowing, tax sharing, and sophisticated performance-based transfer system).

Madagascar Remains a Very Centralized Country

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

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.

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.

Fiscal centralization. The centralization of Madagascar's revenues is higher than in most other lowincome 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.

The high degree of revenue centralization and the minimal volume of subnational 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.

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 subnational governments cover 3 percent, while only 1-2 percent is attributable to subnational governments' own revenues.

Challenges and Risks

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.

The 1998 constitutional changes were radical because, for the first time, the center had prepared for the transfer of substantial competencies to subnational 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.

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 macroeconomic stability. Almost none of the newly established provinces are financially viable. Underfinancing 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 subnational fiscal deficits and a fragmentation of social services.

The Role of Communes

The most notable achievement of Madagascar's decentralization policies was the establishment of 1,392 communes in 1995 (since 2004: 1,558). 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.

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.

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.

Similar to many other poor developing countries, Madagascar's rural communes systematically underexploit taxes like the property tax. As a consequence, most rural communes must 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 (such as markets, housing, and tourist sites). 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.

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

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 intercommunal 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 1557 communes. Currently, the risks associated with pursuing the installation of autonomous provinces seem to outweigh the potential benefits.

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

Communes are the only operational—and hence the most crucial—subnational 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.

Strengthening subcommune structures, like Fokontany and Fokonolona, is laudable and important because subcommune institutions can play an important role in contributing to communal functions. In particular, strengthening subcommune 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

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

instance, *ex-post* registration for birth certificates are extremely cumbersome to receive and expensive as they entail a court order.

However, the detachment of subcommune 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 subcommune institutions and communes and to limit the role of central government intermediaries (Sous-Prefet and DAA) to control and supervision functions.

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."

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.

Second, communes suffer from the unpredictability with which transfers are executed. The foremost priority is to ensure predictable disbursements within a scheduled rhythm (for example, every six months). Given that, on average, 75 percent of rural communes' financing depends on transfers, predictable disbursements would allow communes to actually plan their expenditures and stop the existing practice of ad hoc budgeting.

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 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 subnational government, this report suggests ways to make the existing setup 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 subnational layer.

A full implementation of the 1998 reforms would put additional stress on an already weak system of control and audit that would find itself 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.

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

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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.

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).

Given that districts represent the core unit for the conception and coordination of 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.

Introduction

adagascar is recovering from a deep economic crisis, which stems from a political crisis in 2002. Immediately after the crisis, the priority was to mitigate the impact on the poor and to jumpstart the economy. Madagascar's post-crisis development objectives are twofold: bring *growth* back—at least—to pre-crisis levels and improve the *distribution* mechanism to increase the poverty impact of growth and public services. This study is an attempt to contribute to the second objective. It focuses on service delivery mechanisms and on options for financing these services.

Madagascar's pre-crisis growth helped raise living standards in the cities. However, most of the country's poor live in the countryside, and the fruits of growth did not reach them. A recent household data survey demonstrates that during Madagascar's recent growth period (from 1997 to 2001), the share of people living in poverty remained broadly unchanged. The share of the population below the poverty line was reduced from 71 percent to 69 percent, while the share of the extreme poor did not change at all.

Poor governance is often considered to be the main reason why the rural poor have not benefited from growth and public services. The administration has been unable to effectively deliver core services in the areas critical for Madagascar's development (in particular infrastructure, social services, and agriculture). Similarly, rules and regulations are not followed or systematically applied, be it with respect to administrative or to legal decisions.

Decentralization has often been thought of as a key instrument for improving governance in Madagascar. The challenge of decentralization—and its complexity—is rooted in its many conflicting objectives and features. It also calls for tough tradeoffs that only a deep understanding of local conditions can inform. On one hand, lower levels of governments tend to have an *information advantage*: they are able to identify cheaper and more appropriate ways of providing public services. On the other hand, decentralization is very difficult to carry out in poor countries like Madagascar, which lack the required financial and administrative foundations, as well as the capacity. Economies of scale, important geographical disparities, and the desire to guarantee national unity all make the case for less rather than more decentralization.

Definition

Decentralization covers a broad range of concepts, but it always deals with the transfer of authority and responsibility from the central government to subordinate or quasi-independent government organizations or the private sector (Rondinelli 1999). Decentralization can have three dimensions: administrative decentralization, political decentralization, or fiscal decentralization. Administrative decentralization can take three major forms: (i) deconcentration, (ii) delegation, and (iii) devolution.

- (i) **Deconcentration** is the transfer of clearly specified decisionmaking, financing, and management functions to local line agencies, which depend directly on central government ministries.
- (ii) **Delegation** is the transfer of decisionmaking authority to semi-autonomous organizations, which are not completely controlled by the central government, but ultimately accountable to it. Examples include public enterprises, as well as housing and transport authorities.
- (iii) **Devolution** is the transfer modality that is probably nearest to the general understanding of decentralization. It includes the transfer of authority and decisionmaking power to legally and politically autonomous subnational governments, in the areas of public finance and management. Devolution and decentralization are used interchangeably in this report.

Objective and Challenges of This Study

The objective of this decentralization study is to provide analysis and policy advice to the new Malagasy government on how to proceed with the decentralization strategy it inherited from the previous government. The end of the post-crisis emergency recovery period creates the opportunity to correct the weaknesses of the previous strategy while building on the exiting achievements. The paper specifically aims to (i) analyze the institutional and fiscal context of decentralization and (ii) present the resulting challenges for service delivery and financing—with a particular focus on local governments. Benefiting from primary data from several hundred local governments, this study aims at proving recommendations of how to improve the functioning of communes in considering the institutional and fiscal parameters.

Madagascar's changing governments and decentralization strategies presented the main challenge in carrying out this work. The study operated in a context of uncertainty about the nature and direction of successive governments' decentralization strategies. Even before the crisis of 2002, the decentralization process had become a moving target, in particular with respect to the status and role of the autonomous provinces.

This study is the result of a longer ranging policy dialogue between the Bank and two consecutive governments. The dialogue started in June 2001 and continued until October 2003. During this time, Madagascar went through a time of severe political crisis which led to a change of government and the suspension of newly created autonomous provinces. The crisis created significant uncertainties, in particular with respect to decentralization laws and the future of intermediate level of governments. The technical analysis and recommendations of this report were part of the Bank's policy advice immediately after the crisis and the subsequent parliamentary and local election. As a result, the government already has implemented some of the recommendations of this study. These reforms include the empowerment of communes in streamlining local administrative relationships and the harmonization of administrative relationships at the center by reintegrating the former Decentralization Ministry into the Ministry of Interior.

Contents and Structure

Decentralization has so many dimensions—political, administrative, sectoral, and fiscal to name only a few—that decentralization studies need necessarily to be selective. At the same time, there is often a danger that sectoral specialists focus on their area of specialization only. This "compart-

mentalization" of decentralization also explains why the assessments of decentralization processes in developing country wary so much: some grass-roots oriented practitioners consider it a blessing to move toward local empowerment, while many macroeconomists often fear the fiscally irresponsible behavior of subnational governments. This is why a broad perspective is needed to gain a balanced understanding of decentralization processes.

This study attempts to take such a broad approach by explaining the political, institutional, and fiscal determinants that have been influencing Madagascar's decentralization process, and which will continue to do so in the future. Based on an institutional and fiscal analysis, the study presents an in-depth analysis of communes—currently the only truly decentralized level of government, in place for three electoral cycles. Thus, the study is structured along three pillars:

(i) Political and institutional determinants

Chapter 2 provides the political and institutional background needed to better understand the decentralization context of today. The chapter analyzes the recent historical and legal context of decentralization. The chapter then takes a closer look at the existing administrative setup to explain functions and responsibilities at different levels of government. To this end, it looks at the regulatory gaps and inconsistencies in the legal framework, the parallelism between decentralized and deconcentrated layers, and the emerging role of intercommunal associations and informal regional planning bodies.

(ii) Fiscal framework

The salient feature of fiscal decentralization in most poor countries is the fiscal gap. Conditions for fiscal decentralization in Madagascar are less conducive than those in average poor or African countries. Based on the concept of the subnational fiscal gap, chapter 3 analyzes structural constraints to fiscal decentralization in Madagascar, and in particular the dominance of revenue items which cannot be decentralized. Given the low degree of fiscal decentralization, the chapter takes a closer look at expenditure deconcentration and provides a more in-depth analysis of deconcentration in the health and education sectors. The last part of the chapter evaluates Madagascar's intergovernmental transfers, which represent the most important source of local government financing.

(iii) Communes

Communes are the lowest and institutionally most advanced level of subnational government in Madagascar. They are also the main focus of this study. The fourth chapter describes the institutional dynamics at the local level to provide the ground for a thorough analysis of local government finance. The chapter provides an estimate of local needs, and analyzes revenue and expenditure patterns based on budget data of a large sample of rural communes.

Given the natural overlaps between the three chapters some repetition and cross-referencing is unavoidable. For instance the section on commune revenues could be covered in the fiscal as well as in the commune chapter. As a general rule, broad trends and aggregate results are presented in the first two chapters. The last chapter then presents the details of the institutional dynamics and fiscal patterns of communes.

This study does not focus on areas which have been or will be addressed in related World Bank studies such as the education and health sector studies, the Country Financial and Accountability Assessment (CFAA), or the Public Expenditure Review (PER). Instead, this study concentrates on Madagascar's service delivery performance from the viewpoint of local governments. Tracking surveys and a deeper analysis of the institutional setup at the health and education district administration level would complement the analysis in this study. These background studies have been commissioned under the upcoming PER and the health sector study.

Today's Decentralization Agenda—Challenges and Institutional Determinants

alagasy territorial administration comprises five main levels: provinces, regions, districts, communes, and villages. The establishment of decentralized governments at the commune level (1995) and at the provincial level (2001) challenged the dominant role of the central administration. The regions, although they were also granted constitutional status in 1998, have not been established yet. Districts, in contrast, are the key level of deconcentrated social service delivery; they represent the most important interface between the central administration and the service facility.

Although these different levels have been defined in broad terms, the exact extent of their competencies and the nature of their interrelations remain uncertain. The 2002 political crisis and the subsequent change in government have created a strategic vacuum in the country's decentralization policy, which causes uncertainties and tensions at many levels. While the new government *de facto* reversed the prevailing policy based on autonomous provinces, it has not yet announced a new decentralization strategy. Now that the country is beginning to recover from the crisis, the government needs to address this strategic vacuum and take decisions with respect to future institutional and administrative relationships in the country. These institutional dimensions include (i) the legal framework, (ii) the relationship between deconcentrated and decentralized administrations, (iii) the control system, and (iv) regional planning bodies.

The Legal Framework

With the 1998 constitution and accompanying by laws in place, Madagascar embarked on a process of asymmetric decentralization, which entailed the progressive transfer of selected competencies to subnational levels of governments. Asymmetric decentralization reforms have been practiced in many industrialized countries (United States, Spain), and they are also believed to be particularly suitable to developing countries, notably because they allow for a gradual adjustment of subnational capacities to newly assigned competencies.

However, this asymmetric approach is also conducive to excessive political bargaining and to attempts by central authorities to block meaningful transfers of competencies and resources. In Madagascar, these dangers were reinforced by an unclear legal framework that left uncertain the status of provinces and subprovincial governments.

The Status of Provinces

The 1998 constitutional framework, with its strong focus on autonomous provinces, places the country at a crossroad from a unitary to a regionalist state.² Even before the recent political crisis broke out into open opposition between central government and autonomous provinces, this new legislation created strong uncertainties about the future of state-province relations.

The 1998 constitution formally grants strong legal and political autonomy to provincial governments, including the right to establish "provincial constitutions" (*lois organiques*) covering the areas of finance and control. It also gives them the right to determine the functions as well as the fiscal, administrative, and control frameworks of lower level governments. In addition provinces were assigned the right to negotiate their competencies directly with central government in a negotiating forum, the *Conférence Inter-Provinciale* (CIP).³

At the same time, the constitution and by laws contain a number of regulatory gaps, which could severely limit the autonomy of provinces. Unlike communes and regions, which enjoy the status of "decentralized territorial entities" (*Collectivités territoriales décentralisées*), provinces are more broadly defined as regular "legal public entities" (Art 126, constitution). In addition to the imprecise definition of their status, provinces have never been attributed financial and administrative competencies:

- Provincial competencies will be negotiated in the CIP between the central and provincial governments resulting in substantial planning uncertainty. The constitution assigns strong discretion to the central government (represented by the presidency) to determine the timing and procedures under which the CIP is to take place. Under the previous government, the CIP's status already generated strong uncertainties about the expected duration and modalities of the negotiation process.⁴
- Resources, such as budgets, equipment, or staff, would be put "at the disposal" (*mis à la disposition*) of provincial governments without further clarification on whether provinces will have the right to determine budget allocations or to hire and fire civil servants.⁵

The Status of Subprovincial Governments

Subprovincial governments are equally affected by regulatory gaps in the current legal framework. If the 1998 constitution had been implemented, communes and regions would have lost most of the administrative and financial autonomy, which they had been granted in 1994. Only the executive and legislative organs as well as the names and demarcation of communes and regions are protected by constitutional law. In contrast, competencies, control mechanisms, revenue assignments,

^{2.} Madagascar has traditionally followed French-Napoleonic principles of unitarian statehood. However, the degree of legal autonomy and political discretion assigned to the six autonomous provinces by the 1998 constitution are more consistent with federalist or regionalist principles of state organization (such as those of Spain or Italy). If implemented, these new regulations could open the door for legal-political arrangements which would be very difficult to absorb in a unitary state framework.

^{3.} According to the constitution, the areas that would remain under central control are: foreign relations, defense, national security, macro-economic and monetary policy, customs, human rights, as well as sectors "of strategic national interest" (Art 135 constitution).

^{4.} cf. Art 139, 150 of the constitution.

^{5.} The constitution does not make provisions for a decentralized civil service code. However, provinces have the right to exercise the civil service code in delegation from the central government (loi organique 2000-16, Art. 17, 18).

and transfer systems to lower level governments are placed directly under the legislation and oversight of the provinces.⁶

Unless complemented by clear by laws, these regulations create strong uncertainties for the future development of subprovincial governments. In the case of communes, these uncertainties put at risk hard earned advances in the areas of local revenue collection, financial management, and local service delivery. Given the inactivity of the provincial legislative bodies after the recent crisis, communes today operate *de facto* under the laws of 1994–95.⁷

Deconcentration and Decentralization

Administrative Parallelism

Since the decentralization reforms of the mid-1990s, Madagascar's administrative setup has been characterized by a strong parallelism between deconcentrated and decentralized functions across many levels (see Table 2.1). While some parallelism is normal and necessary in any country with some degree of decentralization, it has been particularly extreme in Madagascar as a result of the incomplete and often inconsistent implementation of decentralization policies over recent years.

This parallelism between decentralized and deconcentrated command lines affects the implementation of decentralization reforms as well as public service delivery in general. Administrative parallelism exists at the (i) central and (ii) subnational levels:

- (i) At the central level, the Malagasy decentralization policy suffers from unclear assignment of responsibilities among central government institutions with respect to decentralization policy. Currently, the responsibility for monitoring and managing the decentralization process is divided between the Ministry of Interior (control systems), an adjoined State Secretariat for Decentralization (monitoring provinces and communes, allocating transfers),⁸ and the Ministry of Finance and Budget (revenue assignments).
- (ii) At the subnational level, the lack of clear roles and responsibilities has created some confusion and tension between decentralized and deconcentrated levels of government. At the provincial and the commune levels, deconcentrated agents have continued to carry out executive functions of decentralized entities, even after subnational governments were formally put in place.

Deconcentrated Service Delivery

The central government administration and its deconcentrated outposts are still key to Madagascar's service delivery system. Deconcentrated line agencies continue to exist at all levels of government. The ministries of *Interior* and *Finance/Budget* maintain an extended network of deconcentrated agents at all administrative levels. The sector ministries, in particular *Health* and *Education*, have a deconcentrated base in each district (see Table 2.1. and Chart 2.1).

The Ministry of Interior officially represents the central government at all administrative levels through its network of prefects, Under-Prefects, and "districts delegates" (*Délégués Administratifs d'Arrondissement*, DAA). The head of each jurisdiction is responsible for organizing elections, assuming local police and security functions, and ensuring legal control over commune governments. In many cases, representatives of the Ministry of Interior even continue to carry out

^{6.} Art 126, constitution and Loi organique 2000-16, Art 13. Names and demarcations of communes can only be changed through approval by the cabinet (*Conseil des Ministres*). Regarding the institutional arrangements at the commune level, see Loi organique 2000-16, art 15, 38, 50 and Chapter 4.

^{7.} Laws 1994-01, 1994-06 to 1994-08, 1995-005.

^{8.} The State Secretariat for Decentralization was created as an independent Ministry after the crisis. It was reassigned the status of a State Secretariat after a Government restructuring in January 2004.

^{9.} On the challenges of "co-administration" of deconcentrated and decentralized service delivery structures, see World Bank (1999).

Table 2.1: Administrative Parallelism					
Levels	Decentralized institution	Deconcentrated command lines	Status and competence		
Center	State Secretariat of Decentraliza- tion (now for- merly attached to Min of Interior)	Ministry of Interior Sector ministries	 The Ministry of Interior is in charge of the deconcentrated administration and public security. The State Secretariat of Decentralization is attached to the Ministry of Interior and responsible for the implementation and monitoring of decentralization policy. The line ministries are responsible for the implementation of sector policies and deconcentrated service delivery. 		
6 Provinces	Provincial Council, Governor [suppressed since July 2002]	Président de la Délégation Spéciale (PDS) [previously: Délégué Général du Gouvernement, DGG]	 Provincial councils elected in December 2000, governors elected in June 2001. Responsibilities to be determined by the inter-provincial conference. Since the political crisis of 2002 and the subsequent change of government, the decentralized institutions of the province have been suppressed. The future role of autonomous provinces remains uncertain. 		
Regions	Not yet set up; Planned for under the constitution	Prefect	 The delimitation and number of regions is not yet defined. Main competencies envisaged at this stage: developmental planning and coordination of regional investments and services. 		
III Districts [former cantons]	Suppressed Comité Local de Dévine de la depresse (Député) and by the (Sous-Préfet)	uty of the district	 Electoral district for legislative election. Administrative unit for school districts (CISCO) and health districts (SSD). Under-Prefect carries out legal control. The CLD is bringing together all deconcentrated services of the district and the mayors of the communes. It decides on the allocation of a central government transfer targeted at investments in the communes. 		
1,558 Communes	Commune council; Mayor	Délégué Adminis- tratif d'Arrondisse- ment (DAA)	 Rural and urban communes elected their mayors for the first time in November 1995 and subsequently in a 4-year cycle; some of the larger urban communes are identical to the districts. There are now 45 urban and 1,513 rural communes. Deconcentrated administration is represented by the DAA, who is appointed by the Under-Prefect. He carries out some executive functions of the communes, including collection of certain revenues. 		

TABLE 2.1: ADMINISTRATIVE PARALLELISM (CONTINUED)							
Levels	Decentralized institution	Deconcentrated command lines	Status and competence				
Approx. 16,000 villages (Fokontany)	President de l	Fokontany (PdF)	■ Fokontany (FKT) were decentralized units under the Second Republic (1975–1992). They are further subdivided into approximately 40,000 Fokonolona (FKL). The status of FKT and FKL in relation to decentralized and deconcentrated administration remains unclear; ■ Fokontany/Fokonolona (i) maintain public security and regulated formal and customary law, (ii) support health and education campaigns, and (iii) assist the communes to monitor the village population and manage the Etat Civil.				

administrative functions that should be devolved to communes and other subnational governments, such as the maintenance of cattle registries or the monitoring and coordination of administrative units at the village level.

The Ministry of Finance (and Budget) continues to play a strong role in local revenue collection, including the administration and collection of subnational taxes, through its deconcentrated line agencies. Line agencies are represented at each of the five subnational levels by a hierarchical chain of Treasury agents and by tax collectors (see Chart 2.1). The structure of the Finance Ministry also includes the *Circonscription Financière* (CF). The domain of each CF is slightly larger than the region and it is characterized by the presence of the *Centre Fiscal*, which is the focal point for central revenues' collection. The CF also serves as a base for the National State Inspection (*Contrôle des Dépenses Engagées*, CDE, see Chapter 3). The ministries of Budget and Finance were merged in 2002 and the process of consolidating subnational administrative units is still ongoing.

Among the sector ministries, the Ministries of Education and Health (MINESEB and MINISAN)¹⁰ stand out as they (i) represent the most deconcentrated ministries with a growing network of deconcentrated agents, and (ii) account for about 20 percent of government expenditures:

- The province level administration consists of a light coordination structure. The province head office (*Direction Inter-régionale*) is charged with the execution of statistical monitoring functions, as well as the technical, administrative, and financial (education sector only) oversight over district administrations, but does not hold any significant responsibility for budget management or service delivery.
- The district administrations¹¹ are the core unit of social service delivery. They manage recurrent non-salary budgets for local primary schools and primary health facilities, as well as salary budgets for locally employed service staff (that is, teachers "hors-solde"). They also carry out local procurements and provide technical oversight over service facilities.

^{10.} MINISEB: Ministère de l'Enseignement Secondaire et Éducation de Base; MINISAN: Ministère de la Santé. See Annex B for a more detailed list of the distribution of functions across administrative levels for the education, health, agriculture, and transport ministries.

^{11.} Circonscriptions Scolaires (CISCO) in the education sector and Service Sanitaire de District (SSD) in the health sector.

(former DGG) CES = Conseil Economique et Social ZAP = Zone d'Administration Publique CLD Caniel Local de Dévelopement TP = Trésor Publique (Treasury) PDS = Président de la Délégation Spéciale PP = Perception Principale Ppa = Perception Principal DGG = Délégué Général du Gouvernement PDS S-Préfet of Interior Ministry Prfe t Centre Fiscal **DRB/DRI** of Budget Ministry CHART 2.1: MADAGASCAR'S TERRITORIAL ADMINISTRATION of Finance TP_2 TP_3 Ministry PP if Commune 1st category PROVINCE Financier DISTRICT scription Circon-REGION

DRB = Direction Régionale du Budget DRI = Direction Regionale des Impôs DIRESEB = Direction Régionale de l'Education DIRSAN = Direction Régionale de l'Santé

CISCO = Circonscription Scolaire SSD = Service de la Santátu District DAA = Délégué Administratif d'Arrondissement

of Health Ministry Ministry of

DIRSAN Education DIRESEB

CISCO

ZAP X EPP

CSB

EPP

Chief

DAA

PPa

if commune 2nd category

Commune

Tax collector

Village

CSB

SSD

■ At the local level, the education administration is further supported by local agents of the *Zones Administratives Pédagogiques* (ZAP), who cover almost all primary schools within a commune. Community-based initiatives, often supported by donor projects, complement the deconcentrated administration. In locally financed schools, parent-teacher associations (FRAM and FAF) manage non-salary recurrent expenditures and acquired the right to hire and fire teachers. In the health sector, a cost recovery mechanism for drugs was introduced. Revolving funds are partly managed by district administrations and local NGOs (in the case of larger district hospitals). Horizontal control is exercised by local user committees.

Despite efforts to deconcentrate tasks to local line agencies, most administrative functions of the health and education ministries remain located at the center. Madagascar's degree of administrative centralization can be analyzed in three areas which are potential areas for sectoral decentralization: (i) budget programming, (ii) budget execution, and (iii) civil service management (see Table 2.2).

	Budget planning	Budget execution	Personnel management
Center	Line ministries deter- mine global budget envelopes	Ministries for recurrent administrative expenditures and the whole investment budget	Hiring, firing, and sanctioning of staff
Deconcentrated agencies: ■ Province level: Directions inter-régionales		Payment of salaries for teachers and doctors	Allocation of staff within province
■ District level: CISCOs, SSDs	Allocation of budget across facilities	Execution of recurrent non-salary expenditures (maintenance, materials)	Allocations of staff within districts. Hiring and firing of locally employed teachers (education sector)
Decentralized agencies: Communes		Execution of condi- tional grants on health/ education	
		Co-financing FRAM- managed schools	

- (i) Budget programming: Subnational capacities for technical monitoring and evaluation are relatively well developed because M&E functions were delegated to provincial line agencies in both sectors. However, neither provincial nor district administrations have significant experience with financial planning as most budget allocations are traditionally decided centrally between the Ministry of Finance and the responsible line ministries. In the whole system there is little experience with output or performance oriented budget programming as most budgets are based on past allocations and as budget increases are typically distributed evenly between districts.
- (ii) Budget execution: Line agencies have relatively little experience with deconcentrated budget execution. Where this capacity does exist, it is mostly located at the district, rather than the province level. Investment and most administrative and salary recurrent expenditures are concentrated at the center. Only non-salary recurrent expenditures for primary service facilities are deconcentrated at the district level. The heads of district administrations (CISCO and the SSD) distribute the funds across the schools and health facilities

^{12.} Investment budgets and salaries are almost fully executed at the central level. See Chapter 3 on expenditures for the execution rates.

- within each district. Two thirds of these funds are assigned to the purchase of services (mainly current maintenance), while the rest (purchase of goods) is equally divided between administrative and school supplies. In principle, there is some autonomy in the way districts allocate the funds.
- (iii) Management of the civil service: Madagascar's civil service code remains very centralized. Hiring, firing, and sanctioning rights are controlled centrally by the responsible line ministry. Province administrations (Directions Inter-régionales) and districts have very limited discretion over personnel and budget management, and they have a limited role to (re)allocate staff within their respective geographical levels. However, particularly in the education sector, district administrations have some experience with the management of contractual staff that are employed directly by district administrations, beneficiary groups, and private service providers (see Table 2.2). However, in the health sector, the number of contractual staff has been considerably reduced following a large regularization campaign financed through HIPC funds in 2001.

Control System

In a decentralized environment, control functions can be analyzed along three dimensions:

- (i) The object of control: Control can be exercised over *decentralized governments* or *deconcentrated* line agencies.
- (ii) Control mechanisms: *vertical control* through central inspection agencies or *horizontal control* by the legislature and/or beneficiaries (mostly in the case of decentralized governments).
- (iii) Type of control: *Legal control* over procedures and decrees or *financial control* over the use of public funds.

The following paragraphs focuses on the consequences of the current regulatory vacuum on the control framework for decentralized governments. It also includes a brief description of the existing control system for deconcentrated line agencies. A more thorough overview of the Malagasy control system is provided in a recent CFAA for Madagascar.

Control over Decentralized Government

For decentralized governments, the control framework's effectiveness is particularly affected by the current legal and regulatory uncertainties. With the constitutional changes of 1998, the control framework for subnational governments was (re-)defined in the context of the transfer of competencies to provincial governments. Communes and regions were considered sub-units of the provinces, and accordingly the provinces were charged with defining control functions for subprovincial governments. Now, the *de facto* destitution of the provinces has halted these legal reform initiatives and created a vacuum in the reform of the control framework.

Vertical control. Like in many other countries with ongoing decentralization reforms, vertical control mechanisms have been weakened by the creation of communes and provincial governments. Since the mid-1990s, when decentralization began, the only systematic control of local governments is in the area of legal control (carried out by the Sous-préfet with the assistance of the DAA). Arrangements for financial control differ according to commune types (see Table 2.3.). External financial control only exists for larger communes (exercised through a network of deconcentrated Treasury officials) but not for the majority of smaller rural communes. Financial audits can be carried out through the internal audit body (IGE).

At the current stage, most vertical control mechanisms are ineffective for a number reasons. Legal control is hampered by the inconsistencies and uncertainties in the legal framework governing commune rights and responsibilities. Financial control functions and audits are rarely executed

Table 2.3: The Control Framework						
	Legal control	Financial control (accounting)	Financial control (spending decisions)			
Urban communes	Préfet / Sous-préfet	Public Treasury	Commune Council			
Rural communes (première catégorie)	Sous-Préfet / DAA	Public Treasury (local delegate)	Commune Council			
Rural communes (deuxième catégorie)	Sous-Préfet / DAA	Internal control executed the by commune itself	Commune Council			

due to the lack of capacity at the local level and the generally small levels of expenditure that are managed by local governments. In addition, the absence of deconcentrated administrative and financial courts complicates sanctioning and conflict resolution between local governments and control organs, and renders the control system vulnerable to political interferences.

Horizontal control. Given the weaknesses in the current vertical control system, there is an urgent need to strengthen upward control and horizontal accountability mechanisms. Formal horizontal control on spending decisions and accounting practices (Contrôle d'opportunité et régularité) should theoretically be exercised by the commune council. However, in practice, this control is often limited by insufficient training of council members and/or political conflicts between council members and mayors. The development of more informal horizontal accountability mechanisms, such as through civil society and local populations, is only beginning to take root. However, local governments are now required to engage local populations in the planning and monitoring of local development plans (see Chapter 4). Ongoing training by community driven development projects as well as an evaluation of local accountability mechanisms (currently planned) should help to clarify how these mechanisms can be strengthened in future.

Control over Deconcentrated Line Agencies

Control over deconcentrated line agencies is mostly limited to vertical financial control. This preponderance of vertical control mechanisms is typically present in African countries (see Ndegwa 2003), where central government structures provide most public services. Within this vertical control structure, the *Contrôle des Dépenses Engagées* (CDE) and the *Commission Centrale des Marchés* (CCM) provide internal control, ensuring that spending commitments conform to budget allocations and procurements are carried out correctly. The IGE is the public auditing body and has a very broad mandate that also includes public enterprises.

In practice, most of these control functions are constrained by cumbersome procedures and a general focus on *ex ante* (at the stage of budget commitments) rather than on *ex post* controls. As a consequence, there is persistent evidence of leakage of administrative funds in deconcentrated line agencies; the leakages are primarily caused by procurements at above-market prices and the failure to distribute goods to local service facilities. This is particularly true for the district administrations of the health and education sector, where most deconcentrated funds are managed.¹³

Regional Planning Bodies

In many countries that have decentralized to the local level, there is a tendency to regroup local functions at the regional level. In some cases, regional bodies were formed to lobby for and coordinate the interest of local governments and civil society (Ecuador, Bolivia, Peru). In other countries, regional planning bodies help to improve subnational monitoring and evaluation as well as planning

^{13.} In this respect Madagascar follows the francophone control system. For more details on the process of budget execution see Chapter 3. On the leakage of public funds, see INSTAT / MADIO (2003).

and coordination among local governments and central administrations (that is, Rumania, Bulgaria, Venezuela, and Colombia until end of 2002).14

Several regional and supra-communal initiatives have emerged in Madagascar in recent years: (i) Regional associations were set up in the regions of Ft. Dauphin, Morondava, and Moramanga. These associations identify regional development priorities and coordinate public investment as well as community development initiatives. (ii) Provincial planning committees in Fianarantsoa and Majunga have brought together statistical units of deconcentrated service providers, civil society, and provincial authorities in order to coordinate data collection and information management. (iii) Intercommunal associations (OPCI) were formed by the semi-urban communes around the capital Antananarivo, the communes in the district of Ambato Boeny, and the communes along the railway Fianarantsoa-Manakara (see Box 2.1.). The OPCIs coordinate communal development plans, carry out joint investments and activities, and represent local governments vis-à-vis national government entities and donors.

Box 2.1: The Intercommunal Association Fianarantsoa-Manakara

The OPCI Fianarantsoa-Manakara regroups all communes along the railroad between these two cities. For many communes the railway line represents the only regular form of access, ensuring the export of agricultural products from the communes and the mobility of the population. The main objective of the OPCI is therefore to coordinate the protection of the track. To this end, OPCI organizes communes and communities to carry out maintenance functions and reforestation in erosion endangered areas along the track. In addition, the OPCI has formed a joint institutional capacity-building unit, which helps the participating communes to improve their administrative and financial management. Like all other intercommunal associations in Madagascar, this OPCI was created with external donor support (the US NGO PACT) and still receives support from this side.

Typically, bottom-up processes drive these initiatives. They have no clear legal status and very limited own revenue sources. 15 Yet, particularly in the case of regional M&E and planning units, this "lighter" institutional set up has facilitated the cooperation of actors from the sphere of decentralized and deconcentrated administrations that might not have collaborated under a more established institutional structures (that is, municipal governments, deconcentrated public sector providers, business associations, and so forth).

In the current Malagasy institutional environment of decentralization, OPCIs and regional bodies can be considered as a viable alternative to full-fledged intermediate governments. However, their replicability in other areas is subject to a number of constraints:

- Financing. Given their informal character, most regional planning units do not have their own sources of income. As a consequence, most of the projects in Madagascar have remained dependent on external sources of finance. In some cases this has put at risk the continuity of administrative services and made OPCIs and planning units vulnerable to external factors such as changing donor objectives and stakeholder interests. A solution to this problem has been found by a number of OPCI that have begun to finance administrative overheads through regular contributions of member local governments.
- Diversity across regions. International experience shows that subnational planning and coordination mechanisms cannot be easily replicated or scaled-up through central government decree. 16 Intercommunal associations in Madagascar for instance are often organized

^{14.} For experiences from Latin America, see Frank (2002).

^{15.} Only the status of OPCI is protected by presidential decree (Décret 99-952).

^{16.} Bottom-up driven municipal associations, in Ecuador for example, have been highly successful. This success has even fueled demand for more decentralization of functions to intermediate governments. In contrast, centrally driven regional planning agencies in Colombia were less effective and had to be abandoned (Frank 2002).

- around very specific objectives such as the protection of the southern railway line in the case of the OPCI Fianarantsoa-Manakara, or a joined investments plan in the case of the OPCI Ambato-Boeny.
- Legal uncertainty. Due to their unclear legal status, regional planning units are particularly vulnerable to changes in the existing legal framework. Therefore, the success of these projects in the future will depend strongly on a clarification of their legal status by national law.

Towards a More Service-oriented Administration

Given the constraints of the Malagasy decentralization environment, this report recommends: (i) a series of *short-term reforms* intended to make the existing setup more efficient before decentralizing further, and (ii) legal and institutional reforms that should help to resolve existing inconsistencies in the constitutional and institutional framework in the medium to long term.

Short-term Reforms: Make the Existing Setup More Efficient Before Decentralizing Further In the short term, the Government should consider delaying decentralization to an intermediary level of government, at least until a more reliable legal and institutional framework can be put in place. The immediate focus should be to strengthen the communes and to increase the effectiveness of the existing system of deconcentrated service delivery.

Strengthen the status of communes and encourage intercommunal associations. The government should review the existing legislation on local governments in order to clarify the rights and responsibilities of communes. Particular attention should be paid to the competencies of local governments, financial management and procurement, as well as revenue assignments and local tax collection mechanisms (see Chapter 4). In addition, the status of intercommunal associations should be strengthened and communes encouraged to form new OPCIs where needed.

Strengthen the control and monitoring system for decentralized governments. Control over local governments is virtually non-existent and would have been potentially weakened further by the reforms of the 1998 constitution. In the short term, the government should review the legal control functions of local state representatives (sous-préfets) and strengthen the mandates of local treasury officials and representatives of the State Secretariat for Decentralization who carry out financial control over local governments. At the same time, training and technical support should be provided to horizontal control institutions such as commune councils and community groups.

Improve coordination at the central level. Even after the creation of a State Secretary for Decentralization, the government needs to clarify the competencies and reporting relationships within the central administration with regards to decentralization policy. A possible division of labor could consist of entrusting the State Secretariat for Decentralization with the planning and implementation of legal, fiscal, and administrative decentralization policy, while the Ministry of Interior would carry out reforms of the deconcentrated control framework. Reforms of local tax collection mechanisms should be designed in coordination by the State Secretariat of Decentralization and the Ministry of Finance.

Improve transparency and accountability of deconcentrated line agencies. In the short term, the government should focus on reducing administrative inefficiencies and leakages at the district level. Budget tracking surveys planned for the forthcoming PER and health sector work will provide important insights on the extent to which public funds reach the facility level. In the meantime, it is recommended that budgets allocated to school and health facilities within districts be publicly

posted at the facility and commune levels. At the district level, budget information should also be made available to local beneficiaries through participatory planning and monitoring exercises.¹⁷

Strengthen M&E and planning capacities within line agencies. In order to include local information in budget planning and programming, it is necessary to strengthen subnational monitoring and evaluation capacities. The most important reforms would be to establish clear reporting rights between statistical services at the province and central levels and to harmonize data collection procedures across administrative levels and sectors. In addition, investments are needed to allow for adequate data analysis, treatment and verification at the province and district levels, and to allow for better coordination mechanisms for information sharing with central statistics departments and between sectors.

Medium- to Long-term Reforms: Revise the Constitution and Limit the Number of Subnational Layers

In the medium to long term, the government should engage in broader reforms of the legal and constitutional framework for decentralization. In order to appease and adequately address conflicts that were at the root of the crisis of 2002, these reforms should be embedded in a broad-based and transparent decision making process.

Clarify the principle of subnational autonomy in the constitution. Given the experience of the recent political crisis, a clearer definition of the concept of subnational autonomy should be sought. In particular, the future status of intermediate governments should be revised, as well as the distribution of functions and legislative competencies between national and subnational governments and the organization of intergovernmental relations (central governmentintermediate governments-communes).

Limit the number of intermediate governments to one. Each new layer of decentralization automatically increases overheads and coordination costs of service delivery. Given that the Malagasy government has very scarce resources to distribute, it is advisable to consider the creation of only one intermediate layer of government at either the province or regional level.

Define a homogenous framework for the management and control of subnational governments. While each subnational authority should in principle report to the next higher level of government, there is a strong need to define a homogenous legal framework for the distribution of expenditure, resource assignments, and the control of subnational governments. A coherent national legal framework is particularly needed at the commune level, given the strong legal uncertainties associated with the previous transfer of control and oversight rights to provinces.

^{17.} Reforms of the vertical control mechanisms are discussed in the Country Financial Accountability Assessment (CFAA). An integrated financial management system will be implemented as part of the public sector reform project financed by the World Bank (Institutional Development Technical Assistance Project). In the long term, strengthened control, audit, and budget management systems will constitute an important pillar for decentralizing institutional responsibilities further.

FISCAL FRAMEWORK

The Fiscal Gap

At the beginning of the 21st century, developing and transitional economies are fiscally more centralized than industrial countries were in their early stages of development. In most developing countries, the central government receives more than 90 percent of total revenues and directly accounts for over 70 percent of total government expenditures (Shah 2001). While expenditure responsibilities can be decentralized readily, revenue-raising capacity tends to remain a central prerogative. With regard to subnational levels of government, this translates into a major challenge of decentralization—the *fiscal gap*, or the mismatch between increasing expenditure responsibilities and insufficient generation of own revenues.

In Africa, the challenges of fiscal decentralization are further compounded by (i) an overall low revenue base and (ii) a high degree of centralization of those revenues:

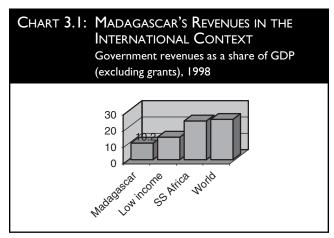
- Low revenue base: On average, government revenues hardly reached 26 percent of GDP for SSA in 2001; in African HIPC-countries the revenue-to-GDP ratio was as low as 18 percent in 2001;¹⁸
- Centralization of revenues: A few revenue sources, such as trade taxes, the VAT, and personal income taxes, typically account for the larger part of total revenues. For macroeconomic, equity, and efficiency reasons, it is widely considered that these revenues should not be decentralized.

In Madagascar, both indicators are below the—already very low—African average (see Chart 3.1 and 3.2):

■ Low revenue base: Government revenues represented only 9.6 percent of GDP in 2001—a figure which puts Madagascar among the lowest performers in Africa. During the 1990s,

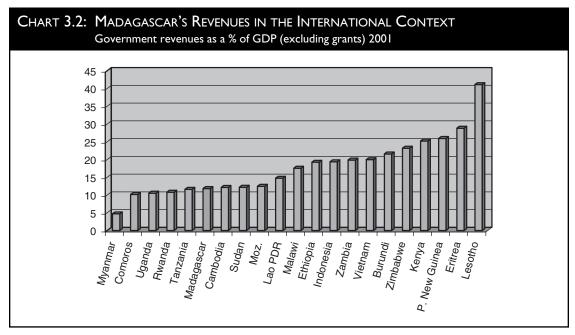
^{18.} If not otherwise stated all data reflects "Government revenues excluding all grants as a share of GDP" and is taken from: SIMA Africa Regional Database.

- revenue-to-GDP ratios remained below 10 percent and only started to pick-up modestly since 2000 (see Chart 3.4);
- Centralization of revenues: A few taxes account for the largest share of total revenues. In 2000, the VAT, the Corporate Income tax and foreign trade taxes accounted for 78 percent of total tax revenues. Foreign trade taxes alone accounted for some 52 percent of tax revenues (even after the elimination of all export duties in 1997). This share, which is among the highest in Africa, results in a large degree of centralization, as trade-tax revenues are typically considered to be indivisible. Consequently, the greater the reliance on trade taxes, the greater the fiscal gap is likely to be between subnational revenue and needs.



Source: World Bank Central WBI Database

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 some 87 percent of the total government expenditures, and 81 percent of the recurrent expenditures. Deconcentrated expenditures amount to 10 percent (recurrent: 16 percent); they are executed by deconcentrated line agencies of the ministries, mostly in the social sectors. Investments are almost exclusively planned and exe-



Source: World Bank Regional Database

cuted at the central level. *Decentralized expenditure* amounts to 4–5 percent of the total, out of which 3 percent represent transfers of the central government to subnational governments and only 1–2 percent are subnational own revenues (see Table 3.2).

The large contribution of transfers to the subnational governments' expenditures, is an indicator of the magnitude of the existing fiscal imbalance—an imbalance which is even more striking when viewed in the light of the very low degree of expenditures decentralization in Madagascar. If the government decides to progressively decentralize larger expenditure items to subnational governments (as was already envisaged for the autonomous provinces in 2001), the country will be facing new and even greater fiscal challenges. In this case, improving the revenue raising capacity of subnational levels and developing an intergovernmental transfer system altogether transparent, predictable, and conducive to enforcing hard-budget constraints would be a high priority.

Expenditures

General Principles of Expenditure Decentralization and Assignment

Information advantage and allocation efficiency. The main argument for the decentralizing expenditures is based on the concept of information advantage and allocative efficiency (Oates 1999; Bird 2000; World Bank 1999). Local agents can often identify more efficient, cheaper, and more appropriate ways of providing public services. Although the central government may reap economies of scale in collecting information, in practice democratically elected local governments still retain the informational advantage because of political accountability—local politicians have a greater incentive to use local information (than national or provincial politicians have) because they are potentially directly answerable to the local electorate.

However, local governments are answerable to the local electorate only insofar as the appropriate checks and balances are in place. As described in Chapter 2, local governments may be better informed about the preferences of the local population, but they may not be sufficiently accountable to their local constituencies. Moreover, they may not have the capacity to handle the transfer of responsibilities without support from higher levels of government. Thus the information asymmetry exists at two different levels—while the central government may not know *what* do to, the local government may not know *how* to do it (Manor 1999; Bardhan and Mookherjee 2000; Bardhan 2002).

The principle of subsidiarity. The "principle of subsidiarity" states that expenditure decisions should occur at the lowest level of government that can fully capture the costs and benefits of providing a public service. According to this principle, local governments should be in charge of managing and providing local public goods. On the contrary, higher levels of governments should provide those services that entail economies of scale, or that internalize externalities across jurisdictions, and carry out those expenditures that involve clear stabilization, distribution, or standard-setting objectives.

It is typically considered that central government should retain control over at least national public services, international affairs, monetary policy, general regulation, transfers to persons and businesses, fiscal policy coordination, regional equity, redistribution, and the preservation of internal common markets. Intermediary levels of government may play an important role in providing some important social services (such as education and health), in intercommunal issues, or in providing oversight of local governments. Finally, lower levels of government should be responsible for all—or most—local services. Within the same field, different functions may be assumed by different levels of government. For instance, in education: central government may retain authority on general policy and oversight issues; intermediary levels may take over personnel-related decision while local governments could be made responsible for infrastructure provision and maintenance.

Whichever the chosen degree of expenditure decentralization, it is vital that respective expenditure responsibilities be defined with great clarity. Failure to do so would likely result in duplications and overlaps as well as in detrimental bargaining between various levels of government. In addition it is important to apply the "finance follows functions" principle, which states that

Table 3.1: Possible Expenditure Assignments by Level of Government					
	Central-level	State-level	Local-level		
Policy	Sovereignty and economic regulation: — Defense, external affairs — Justice, norms, and regulations — Monetary and fiscal policy — Welfare and redistribution	Inter-municipal issues and oversight of local governments	Municipal issues		
	Tertiary health care (control of infectious diseases, research)	Secondary health care (hospitals, curative care)	Primary health care		
	University education	Secondary education	Primary education		
	Natural resources mana	Roads and highways (intra-city)			
Services	Roads and highways, Public transportation (intercity)		Public transportation (intra-city)		
			Solid waste disposal, water, sewerage		
			Land use regulation and zoning, housing		
		Air and wate	r pollution		
		Police pro	tection		

Source: H. Fuhr; World Bank Decentralization homepage, http://www1.worldbank.org/publicsector/decentralization/

expenditure responsibilities need to be defined *before* revenue-raising authority is distributed at each level. Typically though, the reverse is true–revenues are distributed with no, or little, concern for desirable distribution of expenditure responsibilities. The result is a weak budget constraint, a fiscally overburdened government, and widespread misallocation of scarce resources.

Madagascar's Subnational Expenditures

Decentralization of administrative and expenditures responsibilities are closely linked. As a consequence, the analysis of Madagascar's expenditures setup is complicated by the uncertainties surrounding the future of Madagascar's decentralization policies. Currently, very limited decision-making powers have been transferred to local governments and a clear strategy for the transfer of specific functions to subnational governments has not been outlined yet. In this uncertain setting, the purpose of this section is to (i) provide an overview of the current extent of expenditure deconcentration, (ii) evaluate budget execution performance, and (iii) discuss potential expenditure reallocation within the existing framework.

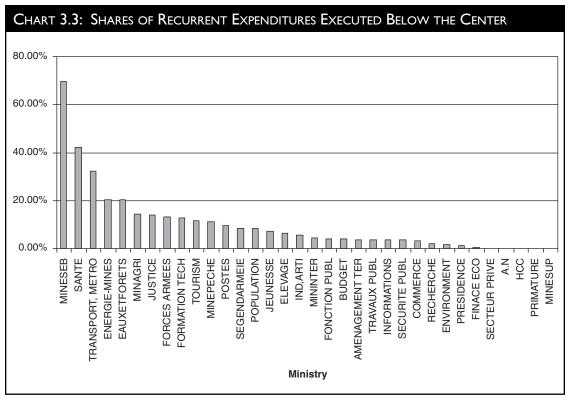
Trends and composition. Madagascar's expenditures are heavily centralized. Given the very weak revenue mobilization of communes, the central government budget accounts for more than 98 percent of total expenditures. These central government expenditures can be broken down into (i) centralized expenditures; (ii) deconcentrated expenditures, and (iii) decentralized expenditures (see Table 3.2):

- (i) Centralized expenditures account for 86.6 percent of total expenditures. Investments are almost completely centralized; the transfer to the districts (representing 1.8 percent) has been suppressed since the beginning of 2003.
- (ii) Deconcentrated expenditures account for 10.0 percent, mostly for recurrent expenditures in health and education. These expenditures will be specifically analyzed in this chapter;
- (iii) Decentralized expenditures account for 3.2 percent of the total and represent the transfers to communes. Decentralized expenditures will be analyzed in Chapter 4.

Table 3.2: Composition of Central Government Expenditures							
	Total Expenditures		Recurrent Expenditures		Investment Expenditures		
Center	6,301,535	86.6%	3,306,200	80.1%	3,000,514	95.1%	
Deconcentration:	724,273	10.0%	642,028	15.6%	82,679	2.6%	
O/w education	387,180		381,707		5,955		
Health	142,290		132,863		9,453		
Transfers to the collectivités	233,610	3.2%	186,540*	<u>4.5%</u>	47,070**	1.5%	
Deconcentration+transfers	957,883	13.2%	828,568	20.1%	129,749	4.1%	
TOTAL	5,658,610	100%	3,351,945	100%	2,306,665	100%	

Note: Data is from the Ministry of Budget's Tableau de Bord for the year 2001. Figures are in millions of FMG. Transfers are administered by the Min. of Budget and defined as central expenditures in the budget nomenclature. In the present table they are considered separately.

Deconcentrated recurrent expenditure has increased since the mid-1990s, when sector ministries increased their outreach. The degree of deconcentration varies across ministries. In 2001, only three ministries had a "deconcentration ratio" of more than 20 percent: The Ministry of Education (70 percent), the Ministry of Health (42 percent), and the Ministry of Transport (32 percent). All other ministries remained highly centralized, most of them with more than 90 percent of centralized expenditures (see Chart 3.3).



Source: Bank staff calculations based on the allocations in the Tableau de Bord for the year 2001.

^{*} Transfers to provinces and communes (health and education) 88,990, transfers to communes (recurrent) 97,550

^{**} Transfers to districts (Fivondronana) 47,070

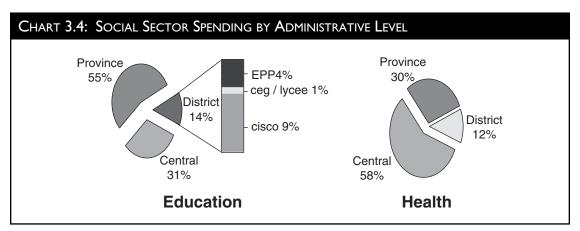
The analysis below focuses on the composition of deconcentrated expenditures in health and education, which account for 78 percent of total deconcentrated spending. The relatively high shares of deconcentrated expenditures in these two ministries are due to the allocation of salary payment authority to the provinces and allocation of non-salary recurrent expenditures to the districts:

Education is the most deconcentrated sector with 70 percent of deconcentrated recurrent expenditures. Most of these recurrent expenditures (80 percent) are salary expenditures, out of which only the administrative salaries (30 percent) are managed by the central ministry. Provinces and districts manage the remainder of recurrent expenditures:

- The province level administration (DIRESEB) administers 70 percent of teacher salaries, which represent 55 percent of total recurrent expenditures;
- The district level administration (CISCO) administers 14 percent of recurrent expenditures. Districts receive more than half of the ministry's non-salary recurrent expenditures. Two thirds of their budget is allocated to the purchase of services (mainly current maintenance), while the purchase of goods is allocated in equal parts to administrative and school supplies respectively. The center sets the share of the budget that should get to the facilities in the district (on average 30 percent to primary schools for school supplies, and the remaining to districts for recurrent maintenance). Therefore, in principle districts have some discretion on how to allocate the funds for a subcomponent of their budget (i.e. from maintenance to local teachers' salaries), but they should be conforming to the central allocations to facilities when distributing school supplies.

Health is the second most deconcentrated ministry with 42 percent of recurrent expenditures deconcentrated. Like in the education sector, administrative salaries are managed at the central level, while the salaries of health personnel are dealt with at the province level. Health districts manage parts of the non-salary recurrent expenditures:

- The province level administration (DIRSAN) is assigned a large share of salary expenditures amounting to 30 percent of total recurrent expenditures;
- The district level administration (SSD) administers 12 percent of total expenditures. SSDs receive 25 percent of the non-salary recurrent expenditures. As in the education sector, most of the districts' budget (two thirds) is earmarked to the purchase of services, mainly for current maintenance. Administrative supplies and expenditures for fuel account for most of the purchase of goods, leaving a small fraction for health supplies.



Source: Bank staff calculations based on the allocations in the Tableau de Bord for the year 2001: recurrent expenditure data.

Geographical Allocation and Budget Execution

The subsequent analysis focuses on two critical measures of service delivery performance: (i) the equity of geographical allocations (in the education sector), and (ii) the efficiency of budget execution to the health and education facilities. Both areas will receive additional attention in the upcoming PER and a Health Sector Study.

Equity of geographical allocations. Existing studies show that there is a strong geographical dimension of poverty in Madagascar, with communes and regions in the same province exhibiting huge variations in standards of livings. ¹⁹ This implies that different jurisdictions will have different needs of public service delivery as well as different abilities to provide services and to raise own revenues to finance their expenditures.

In order to measure the equity dimensions of the distribution of allocations, recurrent deconcentrated expenditures have been matched with indicators of welfare across different geographic administrative units. To this end, a spatial description of the distribution of poverty was carried out in Madagascar by combining the 1993 sample survey data (*Enquête Permanente des Ménages*) and 1993 census unit records. On the expenditure side, given that only recurrent non-salary expenditures are deconcentrated down to the district level for the social sectors, one can rely on complementary administrative data on personnel allocations to obtain an overall picture of the total recurrent budget allocated to different geographical areas.

- (i) The geographic allocation of teachers (and their corresponding wage expenditures) is regressive:
 - At the *primary* school level, Madagascar has an extensive coverage of schools with a disproportionately high share of small schools in isolated rural areas. However, the allocation of teachers does not match this high density of public primary schools, resulting in a strong urban bias in teacher deployment: poor rural areas have fewer teachers per school and more pupils per teacher. These imbalances imply a systematic lower quality of the service provided in rural areas.
 - At the *secondary* school level, public schools are also evenly distributed across the country although private facilities tend to be located in richer areas. As in the case of primary education, there is an evident misallocation of teachers towards districts that are richer and districts with a higher share of urban population. Per capita allocations to nonsalary expenditures in secondary education are reinforcing differences in the allocation of teachers, reaching *both* relatively richer and more urbanized districts.
- (ii) The geographic allocation of nonsalary expenditures is also regressive. Nonsalary expenditures are distributed proportionately to the population across districts. Given the high variability in their poverty incidence across districts a uniform allocation to districts results in regressive expenditures.

These results are in line with existing evidence from the Education Sector Study,²⁰ which highlights the potential for important economies of scale in both primary and secondary education. However, given the sparsely dense population in Madagascar, a large fraction of public primary

^{19.} Mistiaen et al. (2002). The fact that the poverty data dates back to 1993 calls for some caution in the interpretation of the results. However, despite the fact that the census and household are from 1993, the poverty mapping exercise is still meaningful. While the poverty levels might have changed over time, evidence from the 2001 commune census suggests that the relative geographical position of poverty incidence has been stable in Madagascar over the past decade.

^{20.} The Education Sector Study demonstrated that an important determinant of the high drop out rate is supply constraints—the shortage of teachers is such that many schools do not offer a complete cycle of instruction. Accessibility and low quality of service delivery are reflected by an entry rate at grade 1 of 81 percent and a survival rate at grade 5 of 33 percent in 1997. See World Bank (2002).

schools in rural areas are too small to be able to take advantage of their potential economies of scale and have unit costs of service provision that still very high.

In the medium term, ongoing reforms that encourage teacher redeployment in the education sector (multigrade teaching and school consolidation) might allow schools to lower their costs. In the meantime, the geographical disparities call for an improved allocation towards poorer and rural areas that have a larger need of unmet needs, both in terms of teachers' time and availability, as well as in terms of other inputs, such as instructional material.

Efficiency of budget execution. In the current deconcentrated structure, districts receive a small fraction of the budget to provide materials to and basic maintenance of health and education facilities. As examples from other countries have shown, districts may not have the incentives to actually distribute their budget to the facilities and be held accountable for it.²¹ A budget tracking survey which was carried out by the MADIO project, gives some preliminary indications of how the budget flows from districts to the facility level.²²

In the education sector, schools receive deconcentrated funds through the district (CISCO) for maintenance as well as a direct allocation for schools supplies. The MADIO survey found substantial leakages for both categories, and particularly substantial for the CISCO allocation.

In the health sector, the percentage of expenditures reaching the health facilities (*Centre Sanitaire de Base*, CSB) was found to be higher than in the education sector. However, there was a substantial geographical variability: in some areas, the districts distributed supplies to the health facilities only on demand from the facilities themselves. Because of poor communication and transport facilities, the poorer and more remote facilities tended to receive the fewest supplies from their respective district.

In both sectors, geographical isolation is among the main constraints to an effective execution of the budget. In the education sector, schools with a higher pupil-teacher ratio and more remote schools are less likely to receive the allocated budgets. However, the differences are particularly accentuated within rural communes and to a lesser degree between rural and urban areas. The health sector presents the same features—the fraction of the budget received is lower for both rural and for more isolated areas.

Low execution rates in remote facilities are explained by the long distances each budget manager (gestionnaire) needs to travel in order to go to the Circonscriptions Financières (CF)²³ to execute his budget. In theory, the budget manager for those districts that are far from the CF can use a simplified procedure to expedite budget execution (délégation de crédit). Yet in practice, this simplified procedure is seldom used and only for a very small fraction of the total nonsalary credit of the social sectors (3 percent in education and 0.5 percent in health for the 2000 budget).²⁴

Revenues

Challenges in Subnational Revenue Mobilization

Efficiency versus Accountability

In most poor developing countries, two principles of fiscal decentralization collide. While fiscal accountability calls for a close match between revenue means and revenue needs, the predicaments of fiscal federalism revenue assignment amount, in practice, to allocating the collection and admin-

^{21.} Reinnika and Svensson (2001) show that on average during 1991–95 schools received only 13 percent of the central government's allocation for the schools' non-wage expenditures from the districts.

^{22.} The survey was financed by the European Commission and implemented by the national statistical institute INSTAT. The survey was carried out in selected districts in 2000 and 2001 for the budget years 1999 and 2000 respectively (Madio Rapport Méthodologique, July 2001).

^{23.} The contrôleurs des dépenses engagées (for commitment), the sous-ordonnateurs (for ordonnancement) and the trésoreries provinciales (for payment) are all based at the Circonscriptions Financières (CF). There are 13 CF in Madagascar, 11 of which are located in the provinces

^{24.} Figures from Lienert and Paoletti (2001), p. 49. The délégation de credit is mostly used in the Ministère des Forces Armées and by the Ministère des Affaires Etrangères.

istration of most major taxes to the central government and to leaving local governments with only minor tax items:

- Matching revenue means as closely as possible to revenue needs. From a fiscal accountability perspective, financing should occur where the services are being provided. This could either happen (i) directly through cost-recovery, or (ii) indirectly through local taxation.
- Optimal revenue assignment. Central government should raise taxes that (i) are mobile (like capital); (ii) redistribute wealth (like progressive taxes on income and wealth); (iii) are based on unequally distributed deposits of natural resources (like oil, gas, or minerals); and/or (iv) are critical for macroeconomic stabilization. Customs duties are also typically considered to be national-level taxes because of their indivisible nature and because of their strategic importance to foreign trade and national industrial development. Subnational governments, as a consequence, must rely essentially on taxes on immobile factors (land and real estate), user charges, and tolls, most of which yield only small or insignificant amounts (see Table 3.3).

Central-level	State-level	Local-level
Trade taxes	Surcharges on national taxes	User charges
Value added tax	Retail sales taxes	Licenses and fees
Corporate income tax Propert		/ taxes
Natural resources taxes	Vehicle	taxes
Indiv		

Source: Based on Bahl 1994.

In most developing countries, this "optimal" assignment of taxes results directly in the observed over-centralization of revenues. The central government level controls high-yield taxes that account for the most part of total fiscal revenue. Because many expenditure items can be decentralized readily while revenue items cannot, the imbalance is automatic. This gap is compounded in cases where decentralization efforts entail a transfer of services responsibility to local governments in sectors with major expenditure items such as education or health.

The low revenue base of subnational governments and the resulting detachment of means and needs has the potential to jeopardize the accountability purpose of decentralization and carries the risk of structural deficits at the subnational level, potentially leading to macro-disequilibria (especially if subnational units expect to be bailed out). In turn, it threatens to turn on its head the entire rationale for decentralization, the core purpose of which is to allow for better and more efficient service delivery and for more accountability.

Bridging the Gap

Subnational governments need to increase their own revenues to bridge the gap and to overcome the accountability challenge. In order to increase own revenues, subnational governments can adopt a strategy that focuses on (i) increasing the rate of existing taxes, (ii) widening the tax base, and (iii) improving the administration of the existing mix.

Increasing tax rates may be appropriate in cases where taxes are inelastic (such as user charges on water or the property tax). However, as a strategy, it may be the least successful where low revenues are not explained by low tax rates. In Madagascar, low tax revenues are mostly due to tax

evasion and/or exemptions as well as to the important share of the total economic activity that remains unregistered and unmonetized.

A convenient, and often advocated formula is one that consists of subnational surcharges on some major national taxes ("piggybacking"), such as the central personal income tax or the value-added tax. In tapping into these revenue sources, subnational—typically state—governments could balance their budget while retaining an important element of public accountability. However, in poor developing countries like Madagascar, revenue sharing formulas (including "piggybacking") seem unpractical and even risky if they amount to multiplying and diluting responsibilities. The implementation of revenue sharing mechanisms is bound to be hampered by a lack of administrative capacity, efficiency, or oversight mechanisms, leading to leakages and unpredictability.²⁵

Widening the tax base is an option particularly relevant in countries where important revenues and capital are attributable to the informal economy. In Madagascar, this idea spurred the creation of the *Impôt Synthétique*, which targeted individual enterprises in the formal and informal sector with a turnover of less than FMG 12 million (or some US\$2,000). Given that this tax has only been implemented in 2002, the year of the political crisis, it is too early to draw conclusions on its impact; yet preliminary analysis suggests that yields may be too low to justify additional administrative costs. In Madagascar 10 out of more than 25 tax instruments generate 95 percent of fiscal receipts. This means that numerous taxes are used to collect marginal revenues, and it suggests that improvements in revenue administration may be more useful in the short term than the multiplication of tax instruments.

Improving revenue administration is the most promising strategy, but it also encounters many challenges as it often entails a concerted effort of subnational governments to develop or update cadastres as well as the central administration to supervise and validate. For the state level, the most promising sources for subnational revenue mobilization are retail sales taxes and excises; for the local level, user charges, licenses, fees, and property tax offer the largest potentials.

At the state level, retail sales taxes have become a key revenue source in industrial countries. In the United States they represent a third of total state revenues. However, in transition and developing economies, experience has been mixed. In countries with a large informal sector, where most vendors do not have a fixed business location, the tax is extremely difficult to administer.

At the local level, financing is even more challenging. Consequently, most local governments depend on transfers from and/or tax sharing with higher levels of government. User charges and property taxes are typically considered to be the most promising and stable source of revenue for the local level. However, in poor developing countries, property taxation has not yet yielded the anticipated results. In most of Africa, results have been disappointing.²⁶

Experience from other countries shows that substantial increases in property tax revenues only materialize if they are planned in a comprehensive way. Real property tax reform is a process of financing local governments—not a series of unrelated functions. It relies on information and support from many administrative departments and requires political commitment from all levels of government. For instance, the valuation of local property will not have an impact on property tax collection if an oversight institution has not validated the tax registry and/or if collection mechanisms have not been clarified.

There is a need—especially in countries with low local administrative capacity—to drastically simplify the property tax schemes and to apply them uniformly. Instead of applying high-tech methods in valuating property, participatory assessment procedures can significantly improve yields and reduce administration costs. The most promising results can be achieved when property valuation is linked to a process of formalization of property ownership. The latter point seems especially

^{25.} For a more in depth discussion of piggybacking options see Bird (2000) and Brosio (2000). For the challenges of tax sharing in Vietnam see World Bank (1996).

^{26.} On the unfulfilled promises of property tax collection see Bahl (2002). On the potential of user fees see Smoke (2003).

relevant in the Malagasy case where, for instance, only about 10 percent of agricultural land has formal titles.

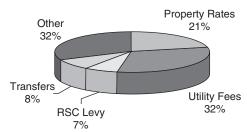
User fees are also underutilized, although they could substantially recover parts of the costs of local service delivery (see Box 3.1 on South Africa). User charges offer the advantages of creating a direct connection between consumption and cost, and of greatly simplifying collection, due to the direct nature of the charge as well as the fact that nonpayers can easily be excluded. In addition, their economic value is increased by resulting efficiency gains—by providing information on demand to public suppliers, the suppliers can evaluate if the services are valued at their marginal cost.

Because of equity concerns, however, it is often argued that user charges are more appropriate for services that have some private components rather than for services that have "public good" qualities. Where demand is price inelastic (demand for water, for instance), the introduction of a fee would not result in significant economic distortions but its effect would be clearly regressive in equity terms. In contrast, a fee is progressive for goods with price-elastic demand (such as electricity). This type of taxes could have an important impact in communes with local markets, on which local governments could levy market rights and service charges.

Box 3.1: Municipal Revenues in South Africa (2001)

South Africa's local governments generated more than 90 percent of their revenues in 1999–2000. The larger urban municipalities (called "metros") mobilized on average more than 95 percent of revenues. Municipalities with budgets larger than R300 million raised over 90 percent of their revenues, while those with smaller budgets were still able to raise 65 percent of revenues.

Sources of revenue: the largest single source of revenue was utility fees accounting for 32 percent of local revenues (electricity fees making up the largest share of total utility fees), followed by property taxes with 21 percent and Regional Service Council levies (7 percent). Other own revenue sources accounted for another 32 percent. Intergovernmental transfers accounted for 8 percent of the total.

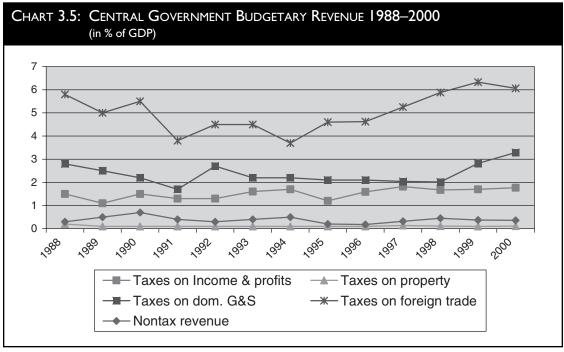


Source: Republic of South Africa (RSA), National Treasury, Intergovernmental Fiscal Review 2001, October 2001.

Madagascar's Revenue Challenge

Trends and Composition

The Malagasy national budget depends on a few main sources of own revenues, all of which are considered to be central revenues by nature. Trade taxes made up almost half (48 percent) of total budgetary revenues in 2001, after having been consistently above 50 percent in the previous years. Therefore, most fluctuations in total revenues since 1988 are explained by a fluctuation in revenues from trade taxes (see Chart 3.5). The VAT alone represented 67 percent of all taxes on goods and services and some 17.5 percent of total budgetary revenue. Finally, taxes on companies' incomes and profits accounted for about 10 percent of total budgetary revenue (IMF 2003).



Source: IMF (2003)

The centralization of Madagascar's revenues is higher than in most other countries in the region for which data is available. In Madagascar, the center collects more than 98 percent of total revenues, leaving communes with 1–2 percent of total revenues. This centralization of revenues results from the structural imbalance in the composition of the revenues, which can only be rebalanced through a gradual, medium-to-long-term process of increasing subnational revenues.

Revenue Assignment

Madagascar's revenue assignment is in line with principle considerations of efficiency and accountability. Revenue items with macroeconomic, equity, and efficiency impacts are assigned to the center. Although the 1998 blueprint included some fiscal decentralization to the provinces (see Annex C), the new government has backtracked. In the 2003 Budget Law, only a few revenue items, such as the *impôt synthétique*, remain candidates for decentralization (see Table 3.4). The 2002 Budget Law introduced a 100 percent allocation principle for each tax, assigning revenues to one level only, excluding piggybacking or tax sharing. The new government still needs to decide if it will uphold this principle.

Furthermore, even for those revenues that accrue to subnational levels, tax policy and collection generally remain centralized. The absence of subnational control over tax rates strongly curtails the decentralization logic, as subnational jurisdictions have no flexibility in adjusting taxation to reflect the expressed preferences of their respective constituencies.

The State of Madagascar's Subnational Revenues

Analysis of subnational revenues in Madagascar is complicated by the strong discrepancy between revenue allocations as they are spelled out in the law and reality as it is observed on the ground. In setting up the autonomous provinces, Malagasy legislators also transferred important revenue items to this new level of government. Although the provinces have not been effectively put in place, the texts have not been significantly amended.

Table 3.4: Revenue Assignments in Madagascar					
Central-level	State-level	Local-level			
Trade taxes	Professional tax	Licenses and fees			
Value added tax		Land tax			
Excise taxes		Tax on buildings			
Personal income taxes	Taxes on gambling*				
Corporate income tax	License for sa	ale of alcohol**			
Redevance fees (alcohol + tobacco)					
Stamp tax					
Registration duties					
Tax on motor vehicles					
Impôt synthétique ***					

^{*} Destined to the Collectivités décentralisées

Province: At the provincial level, the main revenue item is the taxe professionelle (TP). TP yields have shown the largest increase in recent years, but their importance varies greatly according to the provinces—they account for up to 97 percent of provincial revenues in Antananarivo, for 70 percent in Toamasina, but only for 31 percent in Antsiranana (AfDB 2001). While the Loi de Finance 2001 also allocated several other taxes to the province level (including business taxes, the "Vignette," the transaction tax, and licenses for the sale of alcohol), the new government has backtracked on all of them.

Commune Level: Commune level finances will be addressed in depth in the next chapter, and therefore this section will only point out broad trends and findings:

- Total commune revenue is minimal, representing 3–4 percent of total government revenues; rural communes represent 1–2 percent;
- Madagascar is facing a rural-urban divide—while many urban communes have increased their own revenues substantially since 1996, very few rural communes have demonstrated a similar performance. In urban communes, own revenues represent approximately 75 percent of total revenue, in rural communes only 25 percent;
- The poorer the commune, the greater the reliance on economically more counterproductive and volatile revenue sources such as sales taxes on local primary goods.

Transfers

Filling the Subnational Gap

Transfers are the financial lifelines of most subnational governments. This prominence of transfers in the mix of local financing instruments results directly from the structural imbalance between subnational own revenue mobilization capacity and expenditure assignment. Transfers are needed to bridge the subnational fiscal gap and ensure that local and provincial governments can function and deliver an increasing range of public services.

Across sub-Saharan Africa, transfers account for the overwhelming share of subnational revenues—while a few urban governments can contribute significantly to their cities' expenditures, most rural communes and provincial entities are unable to finance even a small fraction of their expenditure needs out of own sources.

In theory, other fiscal tools such as tax sharing and subnational borrowing are available to close the subnational fiscal gap. However, as presented in the previous chapters, tax sharing and borrowing

^{**} Split between the Region and the Commune.

^{***} Collected by the center for decentralized investment projects.

are very limited and often not desirable in most African countries. Thus, in practice the design of the intergovernmental transfer system becomes the single most important tool for allocating resources to the subnational level.

Objectives

Intergovernmental transfers are a necessity in any country with some minimum degree of decentralization. The optimal design and breadth of the transfer system depends on the degree of both revenue and expenditure decentralization—the more fiscally decentralized the country, the higher the demands on the transfer system. In other words, transfers are essentially by-products of the assignment of revenues and expenditures across different levels of government. Yet if transfers are fundamentally *reactive* bridging instruments, the choice of different transfer designs can have a significant impact. Transfers can sometimes provide important incentives for service delivery; at a minimum they should avoid creating disincentives.

The choice of transfer instrument and design can be geared toward several different aims. Four of these objectives are particularly relevant in developing and transitional economies. Well-designed transfer systems can: (i) provide incentives for efficient revenue and expenditure management, (ii) foster greater equity across jurisdictions, (iii) ensure implementation of certain minimum nation-wide standards, and (iv) provide corrective measures to externalities (Shah 1994; Bird 2000; Prud'homme 2003):

- Efficiency: Provide incentives for efficient revenue collection and fiscal discipline. Intergovernmental government transfers should be structured so as to encourage (and at least not discourage): (i) local revenue collection efforts, and (ii) spending discipline. Transfers need to preserve hard-budget constraints at the subnational level. They should not serve to bailout those governments who fail to adequately collect local taxes or to spend revenues efficiently.
- Equity: Reduce regional fiscal disparities. Transfers should redistribute national resources so as to match revenue effort and service delivery outcomes, wherever one lives. This is even more relevant as increasing fiscal decentralization tends to stress disparities across jurisdictions. High degrees of inequality between subnational jurisdictions create a strong demand for progressive transfer systems targeting poorer areas.
- Minimum Standards: Ensure the delivery of minimum standards of key public services. The transfer system should help to ensure that minimum standards for public services will be achieved through subnational financing. This applies in particular to basic services in health, education, water and sanitation, as well as to administrative services.
- Correction of spillovers. Transfer systems may be needed to support subnational expenditure on items with strong spillover effects, for instance infrastructure. Without any incentives (e.g. matching), decentralized institutions are likely to minimize their spending with positive externalities.

Design

The design of a transfer system needs to reflect these broad objectives. At the same time, it also needs to take into account the country's level of development. The poorer the country, the lower the administrative capacity (especially at the subnational level), and the greater the need for simple, straightforward, and predictable transfer systems.

Designing transfer systems involves decision making in three areas. First, one needs to determine *the transferable pool*, or the overall amount to be transferred to subnational levels. Once the overall envelope of transferable resources has been defined, the next issue is the *distribution* of this transferable pool among subnational governments. Finally, a decision needs to be taken regarding the type of transfer instrument and the use of *conditionality*.

The transferable pool can be determined (i) ad hoc, for instance through an annual parliament-approved appropriation, or through a (ii) formula allocation based either on a simple proportion of total revenues or more complex formulas (including, for instance, an evaluation of subnational needs). If the central government wishes to retain the greatest flexibility in its fiscal policy decisions and the ability to match transfers as closely as possible to actual needs, the incentive will be to choose the first option, determining the transferable pool annually and taking into account each year's new budgetary priorities. However, from the point of view of lower tiers of government, "ad-hocism" is detrimental to proper subnational budgeting and to maintaining a hard budget constraint—its discretionary nature leaves too much room for political bargaining and for the exercise of vested-interest pressure.

The distribution of transfers should (i) be based on some clear and transparent formula, and (ii) avoid excessive multiplication of transfer programs addressing multiple objectives. A system of ad hoc allocations should be avoided as it leaves room for favoritism while undermining the predictability of the allocation process.

In poor countries with high degrees of inequality, it is desirable to use the transfer system as a tool to target the poor, while at the same time rewarding performance (in particular the tax effort) of the jurisdiction in question. The fundamental challenge of such a system is that the twin objectives of poverty alleviation and effort stimulation can become contradictory: the poorer jurisdictions, where needs are higher, typically tend to underperform in terms of revenue collection. Conversely, where revenue equalization is pursued with no regard for own-revenue generation effort, both collection efforts and prudent spending are likely to be discouraged, ending up in a situation where those who try the least get the most. One way out of this dilemma is to establish a measure of *fiscal effort* that does not take into account actual tax revenue only, but tax revenues in relation to local revenue generation capacity.

Yet even if it is possible to conceptualize a pro-poor, incentive-based transfer system in theory, several practical challenges may impede implementation. First, sophisticated formulas require abundant and reliable statistical information that is typically not available in poor African countries. Second, the degree of complexity of the formula must take into account the level of administrative capacity of the country. Even in Latin America, where both statistical information and adequate capacity exist, measures of fiscal effort have often proved to be too complex to measure and to be properly exploited. Third, targeting the poor through intergovernmental transfer systems has been difficult because poorer jurisdictions are typically worse at targeting their own poor (Ravallion 1999).

The use of conditionality is widely debated. On one hand, unconditional grants to subnational governments increase their flexibility and discretion to use the grants as part of their total budgetary resources. On the other hand, conditionality is often conceived as an insurance that funds will be spent for activities, that are considered a high national priority, such as the provision of basic social services.

In practice, effective use of conditionality is challenged by the fungibility of resources. Current experience from other African countries suggests that the timing of the earmarking along the decentralization process is crucially important. In Uganda an outright unconditional transfer of responsibility for the delivery of primary health care resulted in a sharp deterioration of spending in health care (Akin et al. 2001). In Tanzania, the initial earmarking of grants has been gradually phased out towards more flexible forms of transfers as local governments proved their management capacity and performance (World Bank 2001).

The choice of instrument depends on the degree of decentralization and on the objectives of the transfer. As a general rule, the more responsibilities have been devolved to lower levels of government, the higher the share of conditional grant. For instance, if a country decides to devolve the management and payment of teachers to lower level of government, the corresponding transfer would be made conditional in order to assure adequate funding of these functions (like salary payments). Table 3.5 provides a summary of grant designs for the four core objectives defined above.

Grant objective	Features of grant design		
Maintaining incentives for efficient revenue	■ General purpose matching grants		
collection and fiscal discipline	Predictable and transparent formula-based		
	■ No bail out		
Reducing regional fiscal disparities	■ General purpose nonmatching grants		
	 Fiscal capacity equalization transfers (if feasible) 		
	 Service delivery equalization (if needed) 		
Achieving national minimum standards	 Specific purpose nonmatching grants with conditions on standards of service and access 		
Compensating for benefit spillovers	Specific purpose matching grants with matching rate consistent with the estimated size of the spillover		

Madagascar's Transfer System

Structure

Madagascar's transfer system was set up when the country embarked on the first phase of its decentralization strategy in 1995. Since then, communes and districts have been receiving transfers. The transfer system was expanded in 2000 to include the newly created autonomous provinces. In 2001, these transfers amounted to FMG 160 billion which represented some 4.7 percent of total budgetary revenue:

- The six provinces each received a subsidy of 4.1 billion in 2001 (up from 1 billion in 2000) for current expenditures during the transition until the full establishment of the autonomous provinces (planned for 2002). A new transfer system, which took into account the transfer of expenditure responsibilities to provinces and also included horizontal equalization among provinces (through a solidarity fund), was also considered by the previous government.
- The 111 Districts each received a yearly transfer of 406 million since 1995 to support local investments. In 2002, this transfer was programmed but not executed. A steering committee, the *Comité Local de Développement* (CLD), led by the deputy and the Under-Prefect, manages this subsidy. This arrangement is fairly atypical, as it does not target a decentralized administration but rather a core level of the central administration. With the 2003 budget this subsidy has been phased out and partially reallocated to communes.
- The 1,558 Communes receive four different transfers per year: one unconditional block grant transfer to cover current expenditures, two smaller conditional grants for maintenance works in local schools and health centers, and one small conditional grant for the *Secrétaire d'Etat Civil*, who carries out administrative functions on behalf of the central state. In 2002, the average transfer amounted to 64 million, which breaks down into FMG 50 million for rural and FMG 445 million for urban communes (Table 3.6).

Table 3.6: Transfers to Administrative Levels (in million FMG) in 2001					
	Grant design	Per unit	TOTAL		
Province	General purpose grant	4,100	24,600		
District	General purpose grant	406	45,066		
Commune	One general purpose grant, three specific purpose non-matching transfer	64 (average)	89,746		
Urban		445 (average)	25,000 (approx.)		
Rural		50 (average)	65,000 (approx.)		
TOTAL			159,412		

The transfers to communes grew on average by 13 percent to account for population growth and inflation between 1998 and 2000, while transfers to the districts (Fivondronana) grew on average by 10.5 percent during the same period. Transfers to communes increased from 77.4 billion to 112.7 between 1998 and 2001. Transfers to the districts increased from 33.6 billion in 1995 to 40.3 billion in 2000 and 45 billion in 2001 (Brunet and Dechen Scheno 2003).

The allocations to communes formula is based and depends on the size and status (rural or urban) of the commune. Every commune receives a minimum allocation of about 34 million for the four transfers combined, irrespective of size and status. All communes above 7,900 inhabitants receive a per capita based allocation of FMG 3,800 per inhabitant in rural communes and FMG 8,800 per inhabitant in urban communes (see Table 3.7).

The unconditional subsidies from the central government (block grant) dominate the overall transfers that communes receive from the center (on average 81 percent of the total transfers). Around 15 percent of all transfers on average is accounted for by conditional transfers that are designated to support two of the communes' basic functions: administrative services and basic maintenance for health and education facilities.

Table 3.7: Transfer to Commune Budgets (2001)					
	Per capita allocation	Total (in millions of FMG)			
Grant for current expenditures	Urban: 8,800; Rural: 3,800	Urban: 19,862; Rural:			
(fonctionnement)	(minimum: 30 million)	54,138			
		74,200			
Grant EPP	402	4,872			
Grant CSB	341	6,215			
Grant Secrétaire de l'Etat Civil	311.78	4,459			
	(minimum: 2.5 million)				
TOTAL		89,746			

Source: State Secretariat of Decentralization.

Achievements

Most African governments are applying ad hoc transfer systems characterized by substantial discretion in allocation decisions by the center and frequent negotiations between the center and subnational governments. In contrast, Madagascar's transfer system is transparent, formula-based and simple, which makes the resulting allocations predictable and less subject to clientelistic bargaining.

The existing practice to calculate the allocation on fixed formula increased predictability even further. Madagascar's communes get an annual per capita allocation, adjusted on a yearly basis for inflation and population growth. Such a system creates maximum predictability for communes with respect to expected revenues. There is no fiscal risk for the state as possible fluctuations in the annual share of the transferable pool would not exceed 1 or 2 percent of total revenues, equivalent to 0.1–0.2 percent of GDP.

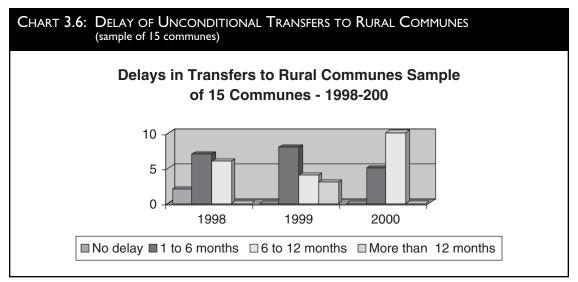
In fiscally centralized countries like Madagascar a formula-based transfer system is clearly more desirable than an ad hoc based system essentially for two reasons: (i) local governments crucially depend on transfers, therefore the predictability of transfers amounts and availability is paramount; (ii) the macroeconomic implication of these transfers is very low, which guarantees sufficient fiscal flexibility for the central government.

Weaknesses and Challenges

The main weakness with Madagascar's transfer system relates to *actual execution* (rather than design) of the transfer system. These delays are often due to inefficient accounting arrangements

between the Ministry of Budget and local treasuries. The transfers typically arrive late in the fiscal year, and sometimes not at all. In a sample of 15 rural communes, none has received the transfers on time in 1999 and 2000; in 1998, only two communes received their transfers as scheduled. Most transfers arrived late by six months or more (see Chart 3.5). The delays for the conditional transfer (for the payment of the *Secrétaire d'Etat Civil*) are even more important—a good third of the communes received their transfers even later than one year (years 1998–1999 only). These delays significantly reduce capacities for strategic planning and management in the majority of rural communes whose revenues depend most strongly on central transfers.

Madagascar's transfer architecture targets too many levels of government, some of which are not even decentralized. Until 2001, intergovernmental transfers were transferred to a decentralized level (commune), a deconcentrated level (district), and a level "in transition" (province). Under the 1998 strategy, a horizontal transfers system between the provinces (establishing a "solidarity fund") would have been set up, complicating the system even further. The transfers to the districts, which are a core unit of central government service delivery, are particularly questionable. This transfer totals FMG 45 billion, which is equivalent to two thirds of the total allocation to rural communes. However, this transfer has been used very inefficiently. Only a small share of the allocated 45 billion arrived at the local level (Miara Mita 2002).



Source: Miara Mita 2002.

The 1998 plan for intergovernmental relations created the risk of actual *re-centralization* of service delivery in Madagascar—the autonomous provinces were given the means and authority to exert extensive control and financial oversight over the communes. Provinces were to decide over the amount and mix of communal revenues, with full discretion on the distribution of subnational revenue items and transfers. This system clearly threatened to deprive the communes of their financial lifeline.

While the allocation formula proved to be predictable, it is not governed by a permanent legal framework but depends on the annual budget law. This reduces the overall predictability of the transfer system because transfer formulas are liable to change every year. In the year of political crisis (2002) for instance, total transfers were reduced to 21 million per commune on an exceptional basis.

A last potential shortcoming relates to the formula of allocating transfers to communes. Everything else being equal, the current per capita allocation formula is regressive as it penalizes rural

communes. Even though rural per capita income is substantially lower than in urban areas, rural per capita transfers are set at FMG 3,800 compared to FMG 8,800 for urban communes (see Table 3.7). With 85 percent of the population, rural communes receive 75 percent of total transfers to communes (FMG 67.5 million) while urban communes, representing 15 percent of the population, receive 25 percent (FMG 22.2 million).

There are several potential—and potentially conflicting—arguments for fixing the rates of rural vis-à-vis urban transfers. Higher allocations for urban communes can be justified by efficiency concerns, while equity principles tend to militate for higher allocations to rural communes. While urban communes arguably face higher *expenditure responsibilities*, they also have access to substantially more *revenues sources*:

- *Revenues:* Urban communes (i) have larger own resources due to a higher number of business activities; (ii) benefit from more efficient tax collection on residential property; and (iii) benefit from local revenue collection of the central government administrative apparatus (see also Chapter 4);
- Expenditures: Urban communes (i) are expected to provide higher levels of services, especially for the provision of economic infrastructure; and (ii) demonstrate greater spending efficiency.

In practice, the separate treatment of rural and urban communes can be questioned. First, the existing separation between "urban" and "rural" communes is artificial. For instance, many communes in the agglomeration of Antananarivo are relatively urbanized, but classified as "rural," while smaller cities in the south are considered as "urban" although they tend to have predominant rural features. Second, the lack of solid and timely empirical data, most notably on the respective unit costs of service provision, impedes better targeting of transfers between and within rural and urban communes.

Improving Madagascar's Fiscal Framework Expenditures

Strengthen the monitoring and budget planning in social services. The responsiveness to local service delivery is very weak. This suggests that there is substantial room for improving the alignment between salary, nonsalary, and investment expenditures to actual needs across districts. Correcting this mismatch can have substantial benefits for the poorest rural districts, where the mismatch is the greatest. The unit of analysis for planning allocations (both recurrent and investment) should be the school/health facility. Information on local needs should be transferred to the line ministries before the budget is prepared.

Speed-up execution, commit budgets globally for a period of six months, and allow for reallocations between budget lines. Deconcentrated district administrations already enjoy some discretion in the management of non-salary recurrent budgets. To further extend the outreach of central ministries, key services should be further deconcentrated with increased local decision making autonomy in budget management.

Improve the geographical incidence of current social expenditure in poorer areas. Current allocations of deconcentrated expenditures need to be better targeted to poorer districts. This could be done by giving heavier weight to more remote and poor districts. As demonstrated by the poverty mapping exercise, districts are the optimal unit of targeting as (i) they represent the core unit of social sector service delivery and (ii) poverty rate variations are stronger between districts than within districts.

Revenues

The key fiscal reform recommendations for the commune level are presented in the next chapter. Concerning the overall fiscal framework, the most important reform would consist of confirming

and actually implementing the 100 percent allocation principle for each tax (whereby each revenue item is attributed in full to one level of government). Experiences with tax sharing arrangements have not been positive in Madagascar. The expected revenue shares often did not arrive at the local level. In addition, tax sharing also breaks with the accountability principle—which also proved very relevant in Madagascar—that there should be the closest possible match between the collection and spending units.

Transfers

Even though a more sophisticated transfer system, including poverty targeting, would be desirable, the first priority of the government should be to improve the mechanisms of transfer execution. In a first phase, reforms should focus on providing relatively simple and practical solutions to transfer delivery problems. The impact of those improvements on financing local services and on local administrative efficiency would already be substantial.

In this first phase, reforms should also target the (i) simplification of the overall transfer system; (ii) removal of regressive distortions of the current transfer system; and (iii) installation of a monitoring system, including sanctions for noncompliance.

In a second phase (for example, after three years), the transfer formula could be reviewed in order to include some measures of tax effort and poverty targeting into the allocation formula. However, attaining this level of sophistication will remain dependent on the sine qua non condition that recent and reliable data is available for all the 1,392 communes. If an intermediary level of subnational government were to be established, a pro-poor, incentive based system could be envisaged for this level first, as the necessary data would be easier to collect at a more aggregated level.

Priorities for the First Phase

1) Simplification of the overall system

Transfers should go to decentralized levels of government only. Intergovernmental transfers are defined as transfers from the center to decentralized levels of government. As long as provinces and districts remain deconcentrated outposts of the central administration, they should be financed as any other deconcentrated level of government. The suppression of transfers to districts (effective with the financial law 2003) should be made permanent.

The center should keep responsibility and oversight over the transfer systems. The delegation of transfer authority to the provinces (as in the 1998 blueprint) would have created major risks with respect to the overall objectives of the transfer system (gap filling, equity) and it would have endangered the autonomy of the communes.

The mix between conditional and unconditional transfers to communes is appropriate. So far, little expenditure responsibility has been devolved to the local level, so that there is no need to increase the share of conditionality of the existing mix. However, when the 45 billion previously transferred to the districts will be reallocated, this increase should be made a conditional grant for investments. This transfer has already been earmarked for investments and would help communes to meet or exceed the legally required 15 percent investments threshold (see Chapter 4).

2) Improve poverty targeting and transparency of the transfer system

Re-evaluate the transfer formula to rural and urban communes. Depending on the objective of the transfer system (efficiency versus equity) different options for allocating transfers are possible. This paper argues for increasing the allocation to rural communes substantially, at least up to the per capita allocations of urban communes. The per capita transfer to rural communes would thus be increased from 3,800 to FMG 8,800 and the increase of the minimum allocation to FMG 40 million be made permanent. This would also remove the artificial and regressive separation between rural and urban communes and help guarantee that rural communes have the minimum amount of resources to function.

Finance this increase by reallocating the transfers previously assigned to the districts in favor of rural communes. In this way, the strengthening of rural communes would be fiscally neutral while the transfer system would gain in simplicity and focus. Under the scenario of a per capita allocation of FMG 8,800 (and a minimum allocation of FMG 40 million), transfers to communes would increase by 43 billion to 133 billion (including the existing conditional transfers). This increase could be fully financed through the savings from the transfers to the districts.

3) Installation of a monitoring system including sanctions for non-compliance Condition the transfers on effective reporting by the communes of both planned and executed budgets to the State Secretariat of Decentralization. Only a quarter of communes have been regularly reporting their annual budgets and accounts to the center, thus contributing to and deepening the poor quality of the monitoring system.

Use deconcentrated agents as supervisors and controller, not as executers of commune affairs. A more rigorous enforcement of reporting duties would also imply a stronger control function for the deconcentrated agents of the central authorities (in particular of the Under-Prefect and the DAA). To efficiently carry out this function, these agents should be relieved from executing duties for which the communes have responsibility (such as the collection of local taxes).

Medium-term Considerations

In the medium to long term, the general purpose component of the transfer system could be refined to include both poverty and performance indicators. This, however, is a difficult undertaking, which also runs the risk of overburdening the transfer system with objectives that are beyond what the whole decentralization framework can achieve. The minimum condition for introducing such a system are: (i) the availability of reliable data for all jurisdictions (which depends on establishing a monitoring and evaluation system); and (ii) the identification of simple and relevant indicators of *need* and *effort*.

1) Increasing data availability and reliability

Poverty targeting requires that information on poverty levels and on specific needs of the target populations be available at the level of each municipality. This means that municipalities should include, for instance, a social welfare department responsible for collecting and updating relevant data. This has been attempted in Chile with relative success (Bird 2000).

2) Devising a simple transfer formula taking into account both needs and effort
The objective of general purpose grants is to ensure that each local government has the ability to
provide a minimum package of public services (beyond education and health) in accordance to
their constituencies' expressed preferences. In order to target the neediest, while at the same time
maintaining an incentive for fiscal rigor, the transfer design needs to devise an efficient yet accurate
way to measure the recipients' need for additional resources and effort in raising own revenues
(based on capacity).

In the African context, need can often be captured only through very "rough" proxies such as demographic data weighted for specific situations. In Madagascar the weight factor could be, for instance, some measure of "remoteness" or a classification of communes based on socioeconomic characteristics developed in the poverty map. In addition, the observed differentials in the cost of service delivery could be included.

Estimation of fiscal *capacity* (not just *actual* revenue collection) and thus of *effort*, requires a minimum of available objective demographic and economic data. For transfers to communes, the formula should include a proxy that captures the communes' main source of revenue. At minimum, some rough count of taxable property and businesses would be needed. In the Malagasy context, existence of or proximity to a market could also be considered as an important element.

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To ensure maximum efficiency of transfers and to maintain strong performance incentives, mechanisms of sanctions, and rewards can be imagined. The Uganda Local Development Grants provide a straightforward model. The basic idea is that grant allocations to each entity from year to year will be re-evaluated according a set of performance indicators. While good performers see their envelopes increase by 20 percent, poor performers see a similar decrease in their allocations. To harmonize the recipients' capacity to perform efficiently, the relevant authority (in Madagascar the State Secretariat of Decentralization) is expected to play a strong coordination and mentoring role. Transparency can be fostered by allowing for regular inspections and timely publication of all transfers allocations (planned and actual).

COMMUNES

ommunes are Madagascar's local-level governments. They should not be confused with "communities," which are either (i) groups of social and economic community organization (like fishermen, farmers', or parent-teacher associations) or (ii) villages (the *Fokonolona*). Since November 1995, after a first round of municipal elections, communes constitute the lowest level and institutionally most advanced level of subnational government.

Following a recent restructuring, Madagascar has a total of 1,558 communes, out of which 45 are classified as urban and 1,513 as rural:

- Rural communes are subdivided in (i) Primary rural communes (Communes rurales de première catégorie), which typically represent a district headquarter, and (ii) Secondary rural communes (communes rurales de deuxième catégorie), which correspond to the majority of communes in the country;
- Urban communes are subdivided into three categories (i) the capital Antananarivo has a special status; (ii) the provincial capitals (including Antsirabé but excluding Antananarivo); and (iii) the remaining 38 urban communes.

The focus of this study is on rural communes, where 70 percent of Madagascar's population and the large majority of Madagascar's poor live. On average, rural communes have a little under 8,000 inhabitants; the smallest commune has about 2,000 and the largest rural commune has more than 25,000 inhabitants. Many communes cover vast areas, sometimes more than 1,000 km².²⁷

This chapter builds on research and commissioned fieldwork of the World Bank since 2001. After describing the institutional context, it will present the results of in-depth research of local

^{27.} The population data is based on the 1993 census and then adjusted annually with an average population growth. There seems to be a large underreporting of urban communes. A new census was planned for 2003, but may only be carried out in 2004.

government finance, including needs for investments and recurrent expenditures at the commune level and the sources of finance that currently meet parts of these needs. The chapter will then present the revenue and expenditure composition in rural communes and compare this to budget data from selected urban communes.²⁸

Institutional Arrangements at the Commune Level

Commune Institutions and Functions

Local administration has been exposed to several changes in its roles and responsibilities since the beginning of the decentralization process in 1995. The first and most important turn came with the 1998 constitution, which gave the provincial legislature the mandate to redefine the status, competencies, and rights of communes. However, with the inactivity of legislative bodies at the province level after the 2002 crisis, communes remained *de facto* governed by laws and decrees which were issued across the various phases of decentralization policy in the 1990s.²⁹

Competencies of Communes

Commune competencies are defined by a host of different laws and decrees. In summary communes are responsible for (i) maintaining administrative services, (ii) managing the public domain and basic economic infrastructure, (iii) waste management and public hygiene, (iv) providing basic social services, (v) managing local security, and (vi) development planning. In addition to these general functions, communes are responsible for identifying and coordinating all local investments as well as supporting implementation of the Government's PRSP at the local level:

- (i) Administrative services. A core function of communes is to carry out a number of administrative services. These include the (i) management of the civil registry (Etat civil, including the issuing of birth certificates, passport, registering marriages and name change, and so forth), (ii) approval of inhumations, customary exhumations, and transfers of corpses (together with local health staff), (iii) formalization of signatures and official documents, and (iv) assistance to central government agencies in military drafting and the organization of elections.
- (ii) Management of the public domain and economic infrastructure. Communes are the formal owners of local public domains, such as communal roads, parks and places, sport grounds, assembly halls, swimming pools, cemeteries, market places, slaughterhouses, latrines, town halls, and irrigation schemes. Specific responsibilities with respect to the public domain are poorly defined but generally include maintenance, security, and administrative functions. Only in the case of economic infrastructure, public parks, and sport grounds are communes required to carry out small investments (formally 15 percent of their budgets have to be allocated for this purpose).
- (iii) Waste management and public hygiene. Like in many other developing countries, communes are also responsible for waste management and sewage. In addition they have the right to establish a *Bureau Communal d'Hygiène* whose functions are to monitor public hygiene (public space, houses, disinfections, rats, vaccinations, etc).
- (iv) Social services. Following the introduction of conditional transfers for education and health, communes have become formally responsible for carrying out basic investments, maintenance, and procurements for public primary schools and health facilities. Expenditures are planned and executed in cooperation with local service staff. Recurrent salary

^{28.} A more detailed analysis of inequalities and financial management performance among rural communes will be presented in a separate paper on local government finance in Madagascar. See Emanuela Galasso and Frank-Borge Wietzke, "Determinants of local government finance in Madagascar," forthcoming.

^{29.} Laws 1994-01, 1994-06 to 1994-08, 1995-005.

- expenditures such as for teachers or extended service staff (pharmacist, guards) are sometimes paid by the commune as counterpart payments for central government investments in health and educational infrastructure. In addition, communes are required to provide social safety net functions for vulnerable households at the local level.
- (v) Security. Communes are responsible for municipal police functions (public order, regulation of markets and festivities, traffic, migration control). These functions can be carried out by communal staff or, upon request, by regular police forces. The final decision on the use of force remains with the Sous-Préfet and the police command. In more isolated areas local governments can request the installation of gendarmerie posts (Poste avancé). However, this service has to be subsidized by the commune (accommodation and living expenses). In addition, communes can maintain a communal shelter (fourrière) in which they collect unclaimed animals and vehicles. This function often has a strong relevance in areas with high incidence of cattle theft.
- (vi) Development planning. Communes above 10,000 inhabitants are formally required to develop and implement urban development plans. These plans should identify such things as future investments, zoning, plans for infrastructure and equipment. Construction permits are provided by the commune on the basis of its urban development plan. Local development planning was initially not mandatory for smaller rural communes but became a regular function with the introduction of the Plan Communal de Development (PCD), which is inspired by the PRSP and outlines commune development priorities (see Box 4.1).

BOX 4.1: LOCAL DEVELOPMENT PLANNING (PLAN COMMUNAL DE DÉVELOPPEMENT, PCD)

Since 2001 all communes are formally required to produce communal development plans. These plans are supposed to be elaborated, similarly to the PRSP-process at the national level, in participatory processes involving local populations and civil society. The plans should outline local investment and development priorities. Donors have pledged to only support projects that are included in the communal development plans. Despite positive experiences in a number of cases the following drawbacks have been observed:

- In many cases the PCD process has been highly donor-driven and was not always based on bottom-up decision making.
- Particularly smaller communes do not have the capacity to engage in strategic planning or to provide good M&E of their PCD.
- In most cases, communes did not define and reserve funding for own investments, counterpart payments, or to cover maintenance costs.

Institutional Setup

Madagascar's communes are formed by an executive bureau and a commune council. The executive bureau is headed by the mayor who is directly elected by the commune population. There is no formal organization structure for commune administrations. Yet, in general the town hall consists of two deputies and a minimum of three department heads (for finance, general administration, and the *Secrétaire de l'Etat Civil*). Many communes also include departments for cleaning, security, and engineering (technique). The commune council is elected through separate legislative elections. The council's main role is to oversee and control the commune administration. The central administration is represented at the commune level by the DAA who directly reports to the *Sous-Préfet*, who in turn represents the key outpost of the Interior Ministry.

Budget Management

Budget programming and execution are hampered by structural over-programming of revenues and expenditures. Formally each budget prevision should reflect revenues and expenditures of the previous three fiscal years. Yet in order to bypass restrictions on budget reallocations, communes

generally present highly overestimated revenue and expenditure previsions in their annual budget programs.³⁰

The practice of overestimating revenue and expenditure previsions is at odds with basic budgeting procedures. The general lack of funds and the late arrival of transfers and revenue allocations further complicate strategic planning. As a consequence, most communes have ad hoc management styles, where budgets are executed according to the availability of funds rather than on the basis of strategic priorities. Particularly large investments or seasonal increases in recurrent expenditures (that is, related to repairs and maintenance of communal infrastructure before or after the rainy season) are difficult to realize in these incremental budgeting processes.

Subcommune Governments

Because of the large surface area of most rural communes, most villages are quite distant from each other and also far away from the commune headquarters. In many cases, villages are more than 25 km away from the commune headquarters. These distances and the lack of transportation make the sub-structures of communes particularly important. On average there are 10 *Fokontany* (FKT) and 30 *Fokonolona* (FKL) per commune. The role of the FKT was upgraded and partially formalized at the end of the 1970s. The FKL are sub-structures of the FKTs, which represent the traditional unit of Madagascar's social organization (dating back to the pre-colonial period of the Merina kingdom).

The performance of FKT and FKL varies and depends on the local institutional context. Active subcommune governments play a role in carrying out some commune functions. They help to coordinate local affairs in villages that are far from communes, maintain public security (see Box 4.2), regulate formal and customary law, and supervise trade and transport in agricultural products. In addition, they support mayors in health and education campaigns, assist in administrative matters such as monitoring of village population and the *Etat Civil*, prepare elections, and organize village meetings. FKTs and FKLs also manage allowances for security forces, as well as collect some local taxes and user fees (Vonodina).

BOX 4.2: MANAGING LOCAL SECURITY ISSUES IN UNCERTAIN ENVIRONMENTS

An illustrative case for the potentials and constraints of subcommune governments in organizing basic administrative services and security systems can be found in the village of llakaka. Ilakaka—one of the principal places for sapphire mining in Madagascar and known for its chronic problem of insecurity—has an operating FKT and CLS. In the context of election campaigns, the FKT assists in the regularization of miners that have migrated from other areas. The FKT further carries out requests for birth and death certificates in the nearby commune. The FKT and CLS try to battle the problem of insecurity by providing informal conflict resolution and by providing financial support to local police staff. At the same time the FKT's capacities are strongly restricted by the pure dimension of insecurity in llakaka as well as the lack of qualified staff and finance. In order to receive a higher share of central government transfers the FKT has applied for a formal commune status.

Source: Field visits, November 2001.

Despite their important functions for communal service delivery, the roles and institutional relationships of FKT and FKL remain an area of contention. The tension around the status of FKT and FKL, and their relationship to the commune is heavily influenced by the broader disconnect that exists between deconcentrated control agents (Sous-Préfets and DAAs) and decentralized local

^{30.} The budget process is divided into three principal steps, the presentation of the *budget primitif*, (first previsions), the *budget additionnel* (revised previsions), and the *compte administratif*, which presents the executed budget. Reallocations of expenditures are possible between the *budget primitif* and the *budget additionnel*. However, because this option requires lengthy approval procedure by the commune council and deconcentrated control agents it is seldom practiced by many communes.

governments. The lack of clarity relates in particular to the (i) *horizontal* relationship between the commune administration (headed by the mayor) and the deconcentrated administration (represented by the DAA); and the (ii) *vertical* relationship between the commune and subcommune structures.

- Horizontal relationships: Since the local elections of 1995, all communal affairs should have been managed by the decentralized administration, headed by the mayor. Yet, in practice, the DAA and other deconcentrated agents continue to carry out executive functions like the collection of most local revenues;
- *Vertical* relationship: Since their formal establishment by the Second Republic (1975–1992), villages are part of the deconcentrated command chain (with the head of the village appointed by the DAA). Since the constitutional changes of the third Republic, villages became sub-units of the communes. However, the village heads continue to be nominated by and accountable to the DAA and the Under-Prefect.

The lack of coordination between deconcentrated and decentralized reform strategies is also reflected in a November 2002 government decree that seeks to formalize the informal governance structures of the FKTs and FKL (decree 2002-1170). Under this decree, both FKTs and FKL report directly to the *Sous-préfets* and DAAs, acting as their local representative. *Sous-préfets* have the right to nominate and fire village chiefs (equivalent to FKT presidents) as well as to establish administrative demarcations of FKTs and FKL. FKL presidents are elected through community assemblies. However, *Sous-préfets* and DAAs can decide on the suspension of FKL executive organs.

The decree can be seen as a valuable attempt to fill the existing regulatory vacuums at the commune and sub commune level. Moreover it seeks to formalize the use of customary law at the village level (Dina) and strengthens the competencies and discretion of FKTs and FKLs in carrying out local police functions—an attempt of central authorities to address the declining security situation many regions of rural Madagascar. The decree goes as far as to entrust local security groups within the FKL with the discretion to use arms (excluding fire arms), to monitor cattle theft and to pursue alleged criminals.

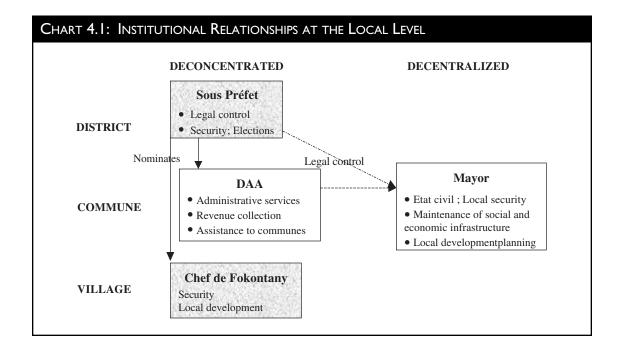
However, with its strong focus on deconcentrated command lines this innovation risks to jeopardize recent gains in decentralization to communes. Communes are threatened to become an empty shell of local government because they now have to establish collaboration with FKT / FKL through the deconcentrated command chains, in particular the *Sous-Préfets* (see Chart 4.1). This is problematic because the decree also assigns FKT and FKL broad functions in areas that traditionally fall under the competencies of communes such as municipal planning, economic and social services, public hygiene, and security.³¹

Measuring Commune Finance: Sample and Methodology

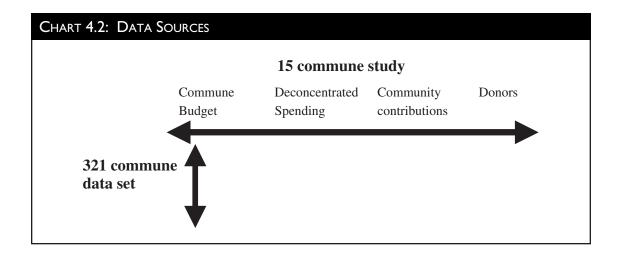
The backbone of the evaluation is two sets of data and analysis: (i) an in-depth analysis in 15 rural communes evaluating all flows of funds and estimating *local financing gaps*, and (ii) a data set of 321 rural commune budgets allowing for a quantitative evaluation of uses, sources and determinants of communes' own finance.

(i) The 15 communes study estimated the local financing gap based on two inputs: (i) assessment of unmet basic service needs in the health, education, and water sectors, and (ii) combination of four sources of service finance: a) commune budget (which includes central government transfers), b) deconcentrated financing, c) community contributions, and d) donors (see Annex E for a detailed description of the methodology). Despite the small size of the

^{31.} In response to the recommendations of this paper, GOM has pledged to return control over FKT and FKL to local governments. A decree that would formalize this reform was about to be published when this paper went to the print shop.



- sample, the results for commune budget data proved to be robust compared to the data set of 321 communes. Financing through central ministries and community groups is likely to vary across communes as much as communes' own resources. The largest deviations can be expected from donors, who provide the largest and least systematic source of financing.
- (ii) *The 321 communes data set*, which was collected at the ministry of budget, provided the basis for a quantitative analysis of communes' revenues and expenditures. Given the large number of non-reported budgets the sample had to be tested for representativeness (see Annex F). This confirmed that the sample was largely representative for rural communes, even though there was an underreporting of the most isolated and smallest communes.



In addition, aggregated budget data was retrieved from six urban communes across the country as well as three sub-urban communes in the area around the capital Antananarivo. This data was used

to establish estimates on revenue and expenditure trends in urban communes. Direct comparisons proved to be difficult to establish due to different budget nomenclatures in the two data sets.

Commune Needs and Overall Flows of Funds

With an annual per capita income of around US\$240 (2002), Madagascar is one of the poorest countries in the world. Given the strong divide between rural and urban poverty rates, needs can be expected to be very high in rural communes. The magnitude of underfinancing of basic local services, as measured by the financing gap analysis, is consistent with Madagascar's poverty rate in rural areas.

However, the challenge of filling public services needs often goes beyond the challenge of providing financing. As illustrated in Box 4.3, for the education sector in the districts of Andilamena and Farafangana, the degradation of public schools, and widespread insecurity have caused the closing of schools and the expansion of community-managed schools. The lack of monitoring, evaluation, and beneficiary participation creates dissatisfaction about CISCO management.

BOX 4.3: CASE STUDY OF THE SCHOOLS IN THE SCHOOL DISTRICT OF FARAFANGANA AND ANDILAMENA

In the district of Farafangana, 45 percent of schools have a single teacher. The teacher—pupil ratio is 1/72. Numerous schools are closed, and those schools that have reopened are managed directly by communities. Five schools are closed in the Commune of Etrotroka alone. Among the remaining eight schools that are still opened, five are so-called "daba-schools" (those managed directly by communities) In the Fivondronana of Andilamena, it is not unusual that schools close for reasons linked to security or the lack of teachers. Out of 28 schools that were closed, 17 could be reopened in 2000. The Cisco recruited 21 teachers whose salaries are paid by the catholic mission. The lack of didactic material is widespread and there is typically only one book for every three students. The local agents of the education ministry (les chefs ZAP) complain about CISCO allocations that bear no relation to the proposed utilization program (both in terms of amount and nature). They also complain about the lack of transparency and of teacher involvement in the distribution of these allocations as the distribution of allocations across the different schools is the exclusive competence of a commission at the Cisco level.

Source: Miara Mita, 2002.

Needs: The Local Financing Gap

Existing service finance generally does not suffice to satisfy unmet service needs. This is particularly true in the education sector where a financing gap of US\$16.2 per capita indicates substantial unmet needs. The gap in the water sector appears smaller, but this reflects the large amounts of donor investments in a small number of sampled communes. However, absolute financing needs in the water sector remain substantial with US\$8.8 per capita (see Table 4.1).

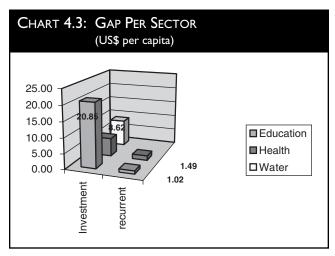
As Table 4.1 shows, service performance is uneven across key social sectors. Access rates for infrastructure are particularly low in education. Even the conservative estimate, based on minimum infrastructure requirements and covering only those children already in school, points to significant investment needs (US\$15.0 per capita). Water needs are also considerable (US\$13.8 per capita). In the health sector, where the service network is better developed, investment needs are comparatively lower at

TABLE 4.1: LOCAL FINANCING GAPS (US\$ per capita and percent of total needs)						
		Needs	Finance	Gap		
	Total	17.5	1.3	16.2		
Education	Capital	15.0	0.9	14.1		
	Recurrent	2.5	0.4	2.1		
	Total	6.9	0.8	6.1		
Health	Capital	4.6	0.6	4.0		
	Recurrent	2.5	0.3	2.1		
Water	Total	13.8	5.0	8.8		

Source: Miara Mita, 2002.

US\$4.6 per capita. Financing needs for recurrent expenditure in both social sectors are comparatively manageable and more evenly distributed (below US\$2.5 per capita).

The combination of all flows still results in very modest per capita spending. In the health and education sectors, (i) average per capita investments were less than US\$1, and (ii) average per capita recurrent expenditures amounted to US\$1.60 (education) and US\$0.65 (health), most of which for salaries (which cannot be reallocated to meet additional needs). Nonsalary recurrent expenditures in the two social sectors are even lower—around US\$0.35 per capita. Financing for water and sanitation is significantly higher with almost US\$5 per capita because of above average donor investments in three of the sampled communes (see Chart 4.3).



Source: Miara Mita, 2002.

If the financing gap results were tentatively extrapolated to the whole country, Madagascar's rural communes would need resource transfers in the magnitude of US\$320 million to cover unmet recurrent and investment needs in the three sectors. In 2001, US\$320 million represented 7 percent of GDP, 43 percent of Madagascar's budgetary resources and forty times the current level of annual block transfers to rural communes. This presents a conservative estimate as (i) it only covers minimum sector norms and does not include important other priorities such as security or transport, and (ii) coverage had been limited in the education sector.

Composition of Available Financing

The relative importance of different financing sources varies significantly between capital and recurrent expenditures, as well as between deconcentrated and local sources of finance (see Table 4.2):

TABLE 4.2 :	SOURCES OF	F FINANCING (a)				
		Central	Donor		Local	Community
		Ministries	projects	Departments	Governments	groups
Education	Recurrent	1.31	0.00	0.00	0.10	0.12
		(1.16 salaries)				
	Investment	0.05	0.68	0.13	0.00	0.06
Health	Recurrent	0.40	0.02	0.00	0.01	0.21
		(0.30 salaries)				
	Investment	0.03	0.47	0.02	0.00	0.11
Water	Recurrent	n.a.	0.00	0.00	0.00	0.03
	Investment	n.a.	4.83	0.00	0.00	0.14
Water						

Source: Miara Mita, 2002.

- Donor investments represent the single most important source of finance for capital expenditure in all three sectors.
- Line ministries (health and education) represent the second biggest source of local service finance with respectively US\$0.40 and US\$1.31 per capita, which is mostly spent on salaries.

■ Districts only play a minor role with the exception of investments in the education sector (US\$0.13 per capita). The value of total spending is much bellow the 406 million investment subsidy, which would represent an average per capita investment of more than US\$0.50.

Community groups' contributions were found to play a stronger-than-expected role for service finance in all three sectors. User fees and cost recovery schemes in the health sector sum up to US\$0.21 per capita, accounting for almost one third of total recurrent expenditures. Likewise, communities also take in charge salary expenditures such as in the education sector, where teachers are often directly employed by local parent-teacher associations.

Local governments provide only a marginal share to overall service finance in the three key sectors. Almost 70 percent of commune expenditures are spent on local administration (see Chart 4.8). Nevertheless, these expenditures translate into some important administrative and organizational services not captured in the sector gap analysis. These administrative functions affect public service delivery and financing. For example, birth certificates delivery is crucial as school children must have formal birth certificates to graduate from primary school (see below).

Commune Revenues

Local Revenue Assignment and Collection

In Madagascar, revenue assignments roughly comply with standard decentralization theory. They have been further simplified since the introduction of the 100 percent allocation principle for each tax, assigning revenues to one level of government only (see Chapter 3). The most important revenue sources of communes include:

- Property taxes on land (IFT) and buildings (IFPB), as well as an additional tax on buildings, which serves as a conditional tax to finance commune counterparts to donor investments (TAFB);
- Excise taxes and licensing rights on gambling machines, festivals, alcoholic beverages;
- Taxes on local natural resources and agricultural products ("ristournes");
- Administrative and user fees like charges for the utilization of communal infrastructure and public territory (see Annex H for a full compilation of all commune revenues).

Despite the assignment of these taxes to the local level, true local revenue mobilization is hampered by (i) the central determination of revenue rates, and (ii) collection of key revenues by deconcentrated intermediaries:

- (i) Determination of revenue rates. In most cases, tax levels and user fees are determined centrally, notably for the mining taxes, and a number of user fees, leaving local governments only with a small margin (in the case of the property tax 2–5 percent) in determining their own desired income levels.
- (ii) Revenue collection. While revenues are appropriately assigned, collection is distributed across several decentralized and deconcentrated institutions: the commune, the DAA, the Treasury, the DGI, and the FKT. Most important local taxes such as the property tax and mining taxes, as well as a number of administrative fees, are collected by central and deconcentrated agents such as the representative of the treasury and the DAA (see Table 4.3 and Annex H).

The Rural-Urban Divide

Commune finance in Madagascar is characterized by a great divide between urban and rural revenue mobilization performance. While urban communes have increased their own revenues several-fold

Table 4.3: Revenue Items and Collection Mechanism				
Revenue source/item Collection mechanism				
Property tax	Treasury (exception: 12 pilot communes under PAIGEP)			
Excise taxes	DAA or "administration fiscale"			
Local natural resources ("ristournes")	FKT, commune and DAA			
Administrative and user fees	Mostly commune			

since the mid-1990s, rural communes' revenues remained marginal both in absolute and in per capita terms. As a result, on average urban communes finance 72 percent of their expenses from own revenues. The only exception is the commune of Fianarantsoa, where transfers represented more than 50 percent of total revenues. In rural communes, the situation is the opposite: own revenues finance one fourth of the budget, while three quarters come from transfers. Semi-urban communes in the surroundings of Antananarivo ("greater Antananarivo") stand in between with 47 percent of own revenues and 53 percent transfers (see Table 4.4).

Table 4.4: Revenue Composition of Urban and Rural Communes (estimated)				
		Rural communes		
I	Urban communes	"Greater Antananarivo"	National average	
Share of own revenues	72%	47%	25%	
of which:				
Tax revenue	34%	17%	12%	
User fees	28%	27%	11%	
Others	10%	3%	2%	
Share of transfers	28%	53%	75%	

Note: Urban communes included in the sample are Antananarivo, Fianarantsoa, Majunga, Tulear, Tamatave, Fenoarivo East, Ambalavao. Averages are based on budget information for the years 1999–2000, except for Majunga (1999–2000) and Fenoarivo East (2000–2001). Communes in the greater Antananarivo area include Ambohidrapeto, Tanjombato Andranonahoatra (year 1999 only). The national average for rural communes calculated based on the data from the sample of 321 communes. Shares of revenue composition are calculated on the basis of recettes de fonctionnement.

The rural-urban divide is also visible in the composition of revenues. Urban communes have now a stable base of tax revenues and user fees, while rural communes—in particularly the poorest—depend to a large degree on fluctuating revenue sources, such as sales taxes on local primary goods. The rural-urban divide is particularly visible in property tax collection, a local tax with potential as demonstrated by Madagascar's urban communes. Starting from a low base, these revenues can grow fast. However, in rural communes, economic, administrative and logistical constraints have inhibited similar performance:

■ Urban communes such as Antananarivo, Tamatave, Majunga, and Ambalavao registered significant increases in the property tax following the intervention of the French Cooperation's technical assistance project PAGU. According to PAGU data, the transfer of responsibilities for property tax collection from DAAs to communes along with updating property cadastres improved property tax recovery rates in 10 urban communes by more than 50 percent in the first year of their introduction.³²

^{32.} Source: Coopération Française, project data for the years 2000 and 2001.

Rural communes, by contrast, saw very little improvement in property tax yields with the exception of some improvements in 12 less isolated communes targeted by the World Bank's project PAIGEP. The main constraints include (i) insecure land rights and outdated valuations, (ii) unclear responsibility on collection (see below); and (iii) higher institutional level constraints, like inadequate enforcement mechanisms (police administrative courts) or delays of approval of tax emissions.

A last dimension of the rural-urban divide is in the transfer system. Although they have a stronger own-revenue base, urban communes paradoxically receive almost twice the amount in per capita transfers than rural communes (US\$1.54 compared to US\$0.86 in rural communes in 2000).³³ As a result, urban communes receive 25 percent of total transfers with only 15 percent of the population. Rural communes are penalized even though their degree of poverty is higher and their revenue raising capacity lower (see Chapter 3 on transfers).

Box 4.4: Social Funds and Decentralization—Moving Progressively Away from the Rural-Urban Divide?

In a country like Madagascar where there are strong differences in the administrative and financial capacity of rural and urban communes, social funds can offer an important alternative to broad based devolution of investment and service delivery functions. Yet, in the past social funds also weakened local capacities, as they tended to bypass local authorities and deconcentrated sector administrations in the planning and implementation of their investments.

To address these shortcomings, social funds across the world have begun to shift their attention from simple investment finance to broader objectives of local institutional reform and capacity building (Barrientos 1999; Parker and Serrano 2000). Madagascar's social fund project FID (Fonds d'Intervention pour le Développement) now coordinates all local investments with local authorities and trains commune governments to take an active role in the coordination of local planning processes (PCD). In addition FID has begun to channel investment funds directly to local governments, involving them closely in financial management, procurement, and supervision of construction works. The fund also provides operational support to ensure better service delivery once an investment is completed (i.e. training of commune staff, user groups and school teachers).

The social fund's approach to engage communal administrations in the management and operation of local infrastructure projects offers a good alternative to full fledged devolution of public services as it allows local governments to gradually build up their administrative and financial capacities. Government and donors alike are therefore exploring ways to improve FID's outreach to local governments, including the scaling up and deepening of training programs to local governments and improving the integration of FID project funds into commune budgets.³⁴

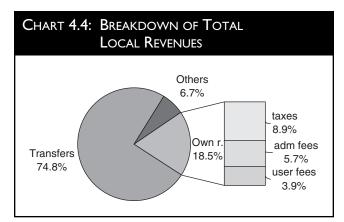
Rural Revenue Performance and Composition

Rural communes' own financial resources are extremely small (equivalent of US\$0.20 per annum) and will continue to play a marginal role. Even when conservative population estimates of the Ministry of Budget were applied, average per capita revenue of rural communes only amounts to US\$1.12, which in turn is dominated by transfers (US\$0.86 per capita). As a proportion to aggregate financing, communes own finance represents less than:

- 2 percent of total government revenue;
- 10 percent of total local finance (which also includes deconcentrated, communities and donors; see also Annex E);
- 5 percent of total local finance in rural communes (Miara Mita 2002).

^{33.} However, real per capita amounts may be lower if we assume that underreporting in Ministry of Budget population data is stronger in the case of urban than rural communes.

^{34.} At this time FID funds are still channeled through special bank accounts in the name of the communes.



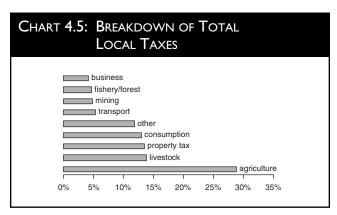
Source: Bank staff calculations based on Miara Mita, 2002.

Rural communes' own revenues are composed of three principle sources: (i) tax revenues, (ii) administrative fees, and (iii) user fees. About 7 percent of commune income are covered through various other sources such as savings, budget overhangs from the previous fiscal exercises, alienation of assets, grants and debts (see Chart 4.4).³⁵

Rural communes revenues are biased towards productive activities (mainly agriculture and livestock) and commerce. Within tax revenues, half of the resources come from agriculture related economic activities. In addition, the sale, registration, and slaugh-

tering of livestock constitutes a substantial component of administrative fees. Most of the revenue from user fees also related to markets and communal infrastructure (see Charts 3.5, 3.6, and 3.7).

In contrast, classic sources of local revenue such as property or business taxes play a rather marginal role in the majority of rural communes. A large share of the sampled communes report income



Source: Bank staff calculations based on: Miara Mita, 2002.

form the property tax, but this tax source still accounts for a small fraction (13 percent of taxes) of the communes' tax revenue. The same goes for business taxes, which only represent 4 percent of local taxes. Rural communes have very few formal businesses and business taxes are thus collected less frequently than in the sample average. Consumption and excise taxes (such as on sales of alcohol, local festivities, or gambling) are comparatively more important and represent an average share of 13 percent of own taxes in the sample total (see Chart 4.5).

Like in many other poor developing countries, Madagascar's rural communes systematically underexploit tax revenues, in particular the property tax. As a consequence, most rural communes rely on alternative sources of local revenue. Larger communes receive important shares of revenue through user fees for communal infrastructure (markets, housing, tourist sites, etc.). Smaller rural communes that do not dispose of comparable infrastructure endowments have to rely on economically more counterproductive and volatile revenue sources such as sales taxes on local primary goods.

One of the most important findings that came out of the analysis of local government finance concerns revenue collection mechanisms. Madagascar's deconcentrated intermediaries are much less effective in revenue collection than local governments themselves. Deconcentrated and agents of the central state, who collect the majority of local taxes and fees, account for less than 30 percent of local

^{35.} Commune debts also form part of this category, typically represented by advance payments from the treasury or arrears on water and electricity bills. However, given that communes are not allowed to run budget deficits, this residual category is reported irregularly and plays only a minor role.

revenues in the sampled communes.³⁶ In contrast, the few revenues that are directly perceived by the commune account for almost 70 percent of local governments' own income (see Table 4.5). User and administrative fees constitute the most important share within the revenue that is collected directly by the commune (about 35 percent). Even more telling, communes collect significantly higher shares of local taxes (26 percent) than their central and deconcentrated counterparts (20 percent). This finding illustrates that, despite all capacity constraints, communes display a certain readiness to take over more complex revenue collection responsibilities than is currently the case.

Commune Expenditures

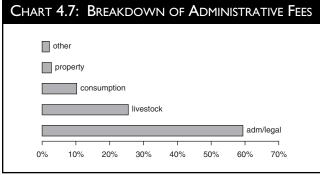
Urban Versus Rural Expenditure Urban and rural spending patterns are more similar than their revenue composition would suggest:

health/hygiene
other
mining
infrastructure
transport
market
0% 10% 20% 30% 40% 50% 60%

Source: Bank staff calculations based on: Miara Mita, 2002.

CHART 4.7: BREAKDOWN OF ADMINISTRATIVE

CHART 4.6: BREAKDOWN OF USER FEES



Source: Bank staff calculations based on Miara Mita, 2002.

■ Recurrent expenditures represent a high share of spending in both urban and rural communes (around 90 percent). However, the largest urban communes tend to finance investments through external loans and donor projects, which artificially increases the share of recurrent expenditures;

TABLE 4.5: OWN REVENUE BY RECOVERY MECHANISM				
	% reporting item	share of total own revenue	Std dev	
Communes	96.9%	69.3%	0.24	
administrative fees	93.5%	14.5%	0.16	
user fees	84.4%	20.1%	0.21	
Taxes	93.8%	26.4%	0.25	
Ristournes	53.3%	12.4%	0.19	
Deconcentrated agents	96.9%	27.9%	0.21	
administrative fees	79.4%	7.9%	0.13	
User fees	_			
Taxes	96.3%	20.0%	0.19	
Ristournes	34.6%	6.7%	0.14	
Others	9.4%	0.4%	0.02	

Source: Bank staff calculations based on: Miara Mita, 2002.

^{36.} The exact shares are difficult to identify because institutional arrangements for revenue collection often differ at the local level.

- Difference remains in the share of *wages*, which still consumes a disproportionate share of rural commune spending (60 percent) compared to 37 percent in urban communes;
- Estimates for functional expenditures, indicate that *spending on administration* is similar (at around 70 percent) but urban communes spend significantly higher shares of their budgets on economic services (32.4 percent), while spending on social services remains much below the trends for rural communes. This trend is possibly explained by the fact that urban communes spend important amounts on economic services such as street cleaning and waste management, while social expenditures—notably in education and health—are made directly to central and private service providers.

An interesting trend can be observed in the case of the three rural communes in the suburban belt around Antananarivo. These communes sometimes spend significant amounts on investments (the average is 37.8 percent, but the range goes up to almost 70 percent in the case of Tanjambato). Most of this investment goes into administrative and economic infrastructure, while social investments only account for a marginal share. Economic expenditures are less important than in larger urban communes, but still significant with an average share of around 23 percent. Social expenditures account in total for 8.4 percent of total expenditures (see Table 4.6).

Table 4.6: Breakdown of Expenditures in Urban Communes and Communes in the Greater Antananarivo Area			
	Urban communes	Greater Antananarivo	Rural communes
share investments	7.4%	37.8%	10.0%
wages as share of total expenditure	36.8%	13.9%	66.1%
wages as share of recurrent	38.1%	20.3%	59.3%
social expenditures / share of total	1.9%	8.4%	15.5%
economic expenditures / share of total	32.4%	23.0%	14.5%
administrative expenditures in % of total	65.7%	68.6%	69.8%

Note: Urban communes included in the sample are Antananarivo, Fianarantsoa, Majunga, Tulear, Tamatave, Fenoarivo East, and Ambalavao. Averages are based on budget information for the years 1999–2000, except for Majunga (1999–2000). Communes in the greater Antananarivo area include Ambohidrapeto, Tanjombato Andranonahoatra (year 1999 only). The national average for rural communes calculated based on the data from the sample of 321 communes.

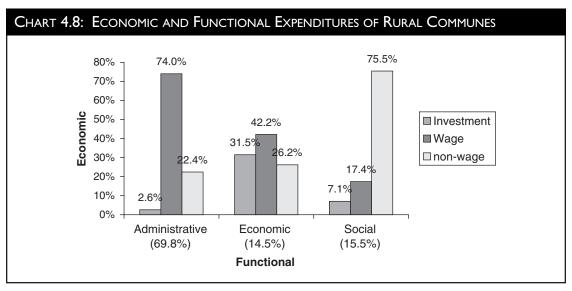
Rural Communes' Spending

Looking at the functional and the economic breakdown of commune expenditures, the following trends stand out (see Chart 4.8):

- Communes' spending is dominated by recurrent expenditures (90.0 percent) while investments only represent a marginal share in commune budgets (10 percent of total). Recurrent expenditures are mostly spent on wages and related expenditures (almost 60 percent of total expenditures).
- Dominance of administrative expenditures (70 percent) over economic (14.5 percent) and social (15.5 percent) spending.

Recurrent Expenditures

Notwithstanding the overall importance of wage-related expenditures by communes in Madagascar, most of the wage expenditure is largely accounted for by the allowances to executive and adminis-



Source: Bank staff calculations based on Miara Mita, 2002.

trative staff and to commune council members (31.8 percent of total expenditures). A smaller fraction of the total budget is used for permanent and non permanent wages, which are more directly related to the provision of public services in the communes.³⁷

The beneficiaries of allowances are difficult to identify on the basis of the budget nomenclature alone (there are many non-specified allowances. This explains the high share of the category "others" in Table 4.7). However, with the limited information available, it is possible to attribute about 5 percent of total allowances to members of the executive of the commune (mayors and deputies) and 26.7 percent to council members. This illustrates that—while generally important—horizontal

Table 4.7: Breakdown of Recurrent Expenditures						
	% communes reporting item	Mean budget share (whole sample)	Std dev			
Total wage	99.1%	59.3%	0.16			
Permanent wages	97.8%	22.3%	0.11			
Non permanent wages	77.6%	5.1%	0.06			
Allowances	99.1%	31.8%	0.13			
Total non-wage	99.1%	30.4%	0.13			
Debt service	21.8%	1.9%	0.05			
Equipment	96.0%	4.4%	0.03			
Subventions to others	81.9%	8.5%	0.08			
Maintenance	79.75%	5.23%	0.07			
Transport	71.34%	1.66%	0.02			
Others	95.95%	8.77%	0.06			

Source: Bank staff calculations based on Miara Mita, 2002.

^{37.} Non-permanent staff is hired for additional requirements such as cleaning drainage systems before the rainy season etc. Other services related to public hygiene, notably the fight against parasites and other natural plagues are generally taken into charge by the communes.

control through the commune council can impose important financial burdens on the budget of the commune (particularly in the case of smaller communes).

Investments

Capital expenditure of communes accounts on average for 10 percent. This is less than the legally required 15 percent of total expenditures that should be allocated to investments. However, there is quite some variability across communes because only 67.9 percent in the sample report investments. Therefore capital expenditures in the communes that do invest represent a much higher share, reaching almost the required 15 percent threshold (14.7 percent on average). Within capital expenditures the biggest share is allocated to construction and rehabilitation works (see Table 4.8).

Table 4.8: Breakdown of I	nvestments		
	% communes reporting	average budget share (whole sample)	Std dev
total investments	67.9%	10.0%	0.14
Investment (if reported)		15.7%	0.15
formal investment allocation (15%)	10.0%	1.3%	0.07
Breakdown by type:			
Purchase of assets	20.6%	1.0%	0.03
Construction/rehabilitation	63.2%	9.0%	0.13

Source: Bank staff calculations based on Miara Mita, 2002.

Spending for Administrative, Economic, and Social Services

The functional classification of commune expenditures (administrative, economic and social) permits to assess the degree to which communes carryout their legally defined functions in the areas of administrative, economic, and social services. However, the current budget nomenclature for local governments does not contain a clear functional classification. As a consequence the following analysis is based on a reclassification of commune expenditures which was developed for the purpose of this analysis.³⁸

Commune expenditures are dominated by administrative services (69.7 percent of total) while social and economic expenditures each account for roughly 15 percent of total expenditures (see Chart 4.8 and Table 4.9):

- *Administrative expenditures* are dominated by the operating costs of the town hall (22 percent) as well as a large portion of diverse administrative overheads that are difficult to attribute to specific functions (35 percent);
- Economic expenditures are more irregular. The most regularly-registered item is security, which is reported by more than two thirds of the communes. Security spending includes subsidies to accommodation and living expenses of local police forces or salaries to local security forces (quartiers mobiles). However, in aggregate terms, spending on security is low with an average share of 2.7 percent of total expenditures in the sample total and 4 percent in the communes which report this item. Expenditures on waste management and public hygiene are reported by a good half of the communes, yet overall spending is even lower with only 0.8 percent of the total budget.

^{38.} Classification errors may have occurred, particularly in the case of cross-cutting expenditures (i.e. technical staff, equipment, and transport that may be used to support administrative, social, or economic services of the commune). In cases of doubt, we attributed all administrative overheads to administrative expenditures and technical expenditures to economic services. Therefore there may be an over-reporting in administrative and economic services.

	% communes	budget share	
	reporting	(whole sample)	Std dev
Administrative total	99.1%	69.8%	0.16
General administrative	99.1%	35.6%	0.15
Commune administration	99.7%	22.2%	0.11
Commune council	98.8%	8.1%	0.04
Executive office	86.3%	2.5%	0.04
Revenue collection	77.0%	1.4%	0.02
Economic total	94.1%	14.5%	0.13
Others	72.0%	6.0%	0.11
Security	69.2%	2.7%	0.04
Transport	40.5%	2.2%	0.07
Markets	32.4%	1.5%	0.04
Water	29.0%	1.0%	0.03
Waste management/Hygiene	49.2%	0.8%	0.02
Agriculture	13.7%	0.4%	0.02
Social total	96.3%	15.5%	0.10
Health	82.9%	5.5%	0.05
Education	80.1%	5.0%	0.05
Others	91.0%	4.6%	0.05
Social assistance	14.0%	0.4%	0.03

Source: Bank staff calculations based on Miara Mita, 2002.

Social expenditures account for 15.5 percent of the total. Within social expenditures spending on social assistance—one of the formal responsibility of local governments—is insignificant with only 14 percent of communes reporting this item. In contrast spending on education and health is reported much more regularly (80 percent and almost 83 percent of the communes respectively). Spending on these services is very low with around 5 percent of total expenditures spent on each of the two services.

If we compare social expenditures to conditional transfers for education and health we find that parts of these services are financed through the commune's own funds. In 65 percent of the sampled communes we observe that conditional transfer payments are lower than non-salary social expenditures. If we include salary related expenditures in the social sectors this ratio increases to 85 percent of the communes. This illustrates that the majority of rural communes utilize conditional transfers reasonably well.

Improving Service Delivery at the Commune Level

Communes should be the core of the government's decentralization strategy, but there should be no illusions as to what communes can reasonably achieve. So far, decentralization to the commune level has not brought about the desired effects on the financial capacity of local governments to support local service delivery. Although communes have been in place for almost seven years, they remain a marginal player in terms of finance and local service finance and delivery. Commune finance represents less than four percent of total government finance and even less in rural communes, where the large majority of Madagascar's poor lives. Local services are mainly carried out by the deconcentrated administration (for recurrent expenditures) and donors (for investments). Rural commune financing is even inferior to contributions of informal community groups, which provide a growing share of local service finance.

In order to improve the service delivery performance of communes, local governments should be empowered to carryout communes' functions, while central government agents should play a supervisory, supporting and controlling role. Co-administration at the local level proved to be inefficient, created tensions and contributed to a lower level of revenue mobilization. It is thus important to implement (i) *institutional reforms* to streamline the institutional relationships; and (ii) *fiscal reforms* to put the communes fully in charge of local revenue collection while improving the execution of transfers.

Institutional Reforms

Institutional Relationships: The Commune Should Be in Charge

Strengthening subcommune structures (Fokontany and Fokonolona) is laudable and important. Fokontany and Fokonolona committees (as well as other local institutions) can play important roles, both in strengthening downward accountability of local governments and in carrying out commune functions. In particular, strengthening subcommune structures could help to better provide administrative services in remote villages. For instance, insufficient procedures to obtain basic registry services (like birth, death, and marriage certificates) causes major social problems for poor families as ex-post registration is estimated at a prohibitive US\$45 (FMG 300,000).

However, the detachment of subcommune structures from the communes carries the risk of undermining effective provision of communal services. GOM has already declared its wish to establish clear reporting relationships between subcommune institutions and communes and to limit the role of central government intermediaries (Sous-Préfet and DAA) to control and supervision functions. Forthcoming analytical work on local horizontal accountability networks and institutional capacity building needs at the subcommune level will help to formulate Bank support in this direction.³⁹

The deconcentrated agents of the central administration, in particular the DAAs, should focus on their control and supervisory roles and where necessary provide technical assistance to local governments. This would simplify the roles of deconcentrated agents at the commune level, strengthen the financial and legal control framework, and relieve the local governments from co-administration and central government intervention.

Classification and Organization of Communes

The classifications of communes in rural, urban, and first/second category are outdated because they do not capture differences in commune functions and recent changes in the population size. The following changes are suggested:

- The second category of rural communes should be divided into sub-categories in order to account for differences in population size, economic potential, and degree of isolation.
- The classification of second category urban communes and first category rural communes should be reviewed in order to make sure that the two categories correctly reflect differences in population size and degree of urbanization.

In addition, the potential of intercommunal associations should be revitalized. Lessons from the well functioning intercommunal associations along the railroad Finanarantsu-Manakara and the Antananarivo suburbs demonstrate the utility of such functional associations. Given the difficulty to systematically set up intercommunal associations, donors should continue to support them in the medium-term.

Fiscal Reforms

For decentralization to work, communes need to increase their revenues. Otherwise the financing gap will continue to be substantial and incentives for efficient local service delivery hampered. There is no magic recipe which would increase commune revenues to a level which would substan-

^{39.} See forthcoming decree on commune-FKT relationship.

tially close the gap. However, given the low level of revenues in absolute terms, rural communes resources—own revenues and transfers—could be substantially increased in relative terms. The following reforms would contribute to such an increase.

Revenue Collection

Communes should be in charge of raising all of their own revenues. Until now, three deconcentrated (DAA, Treasury, DGI) and two local institutions (Communes and Fokonatany) are involved in collecting local taxes. As demonstrated and as expected from accountability principles, communes are more efficient in collecting their own revenues than deconcentrated intermediaries. Even though communes collect only a few taxes and some administrative fees directly, these revenues account for almost 70 percent of local governments' own income. Deconcentrated agents are still in charge of collecting the majority of local taxes and fees, but they only collected 30 percent of local revenues in the communes sampled in this study.

Revenue Mobilization: The Property Tax

To increase the potential of property tax collection, which could represent one of the most important revenue sources of communes, technical assistance needs to be combined with participatory local census methods. Experience from a Bank-funded technical assistance project, PAIGEP, indicates that the constraints of property tax collection are typically not overcome through sophisticated evaluation methods such as satellite or aerial photographs. Instead, participatory assessment procedures can significantly improve yields and reduce costs. Most promising results can be achieved when property valuation is linked to a process of formalization of property ownership.

In addition, a higher level of institutional support needs to accompany the property tax reforms. In the case of PAIGEP, formal approval of tax emissions was delayed due to insufficient involvement of central and deconcentrated revenue administrations in the process. In addition, clarification of legal regress procedures and strengthening of provincial or regional courts would have been required to facilitate the enforcement of property tax emissions.

Transfers

The foremost priority is to ensure predictable disbursements within a scheduled framework. Rural communes suffer most from the existing delays because transfers compose 75 percent of their budgets on average. There needs to be a system for ensuring that the predefined amounts arrive in a timely fashion. For instance, the transfers could be split in two equal tranches to be disbursed every March and September, respectively. Predictable disbursements would allow communes to actually plan their expenditures and stop the existing practice of ad hoc budgeting. In addition, existing bottlenecks between the State Secretariat of Decentralization and the Public Treasury would have to be removed.

The 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 would be fiscally neutral if the transfers to the districts (Fivondruna) were permanently suppressed. Transfers to districts have not translated in the equivalent local investments for which they were foreseen.

Communes and communities should be encouraged to gradually take over more far reaching competencies for service delivery in the medium term. While this paper recommends that local service delivery in the key social and economic sectors should remain in the hands of deconcentrated administrations for the time being, there is a strong potential to empower communes and communities to gradually take over the financing, planning, and supervision of local services. At this stage, communes are already starting to coordinate public investments at the local level (*Plans communaux de développement*). In a addition, a number of projects, such as the social fund, have begun to execute local investments through commune governments. As these programs evolve, government and agencies should consider more systemic support to commune-executed investments.

ANNEXES

ANNEX A

MATRIX OF POLICY RECOMMENDATIONS

MATRIX OF POLICY	Matrix of Policy Recommendations ⁴⁰		
	Institutional and	Sharp to the same of the same	
	administrative reforms	riscal tramework	Communes
Main recommendations	 Strengthen rural communes Improve service delivery with Post-pone the setup of an int 	Strengthen rural communes Improve service delivery within the deconcentrated framework Post-pone the setup of an intermediary level of government	
Short term	■ Strengthen the control and	■ Improve efficiency and accountability in	Institutional reforms
	monitoring system: upgrade control capacities and improve	revenue collection: confirm and implement the 100 percent allocation principle for each tax.	Reinforce communes' executive
	vertical co-ordination; clarify	Speed-up budget execution: allow global	ing relationships with subcommune
	competencies within the central administration with respect	engagement of budgets over six months and	institutions and re-center deconcen-
	to decentralization.	within limits; increase revenue base and spending	control missions.
		powers of deconcentrated units of line ministries.	■ Review the classification and
	accountability at the dis-	Simplify the overall transfer system: limit	organization of communes to bet-
	closure of facility budgets	chaisteis to deceild alized levels of government	ter account for population size, eco-
	allocations: establish clear	the transfer exetems at the central level: make	nomic potential, degree of isolation or
	reporting rights between	additional transfers to communes conditional.	urbanization.
	statistical services and harmo-	Remove the regressive components of the	Fiscal reforms
	nization of data collection	current transfer system: allocate the same per	Strengthen communes' revenue
	procedures at different admin-	capita amounts to rural and urban communes;	of deconcentrated agents to control
	istrative levels.	finance this increase by reallocating the transfers	missions.
		Inprove the monitoring system: condition	■ Increase the potential of property
		the transfers on accurate and timely budget	tax collection through participatory
		reporting by communes; use deconcentrated	approaches.
		agents as supervisors and controllers.	ensure regular and timely delivery and
			increase transfer amounts to rural
Medium to long	Consider introducing an	Communes.	communes.
Term	intermediary level of gov-	■ Devise a simple transfer formula with some measure of needs and effort: find adequate	easure of needs and effort: find adequate
	ernment only gradually:	proxies and incentives mechanisms.	
	provide a clear and transpar-		
	ent framework for the division		
	Decentralize to the level of supervision.	to the level of services providers (school or health clinic) with the commune providing administrative services and	nmune providing administrative services and

40. At the conference on local development September 29 and 30, 2003 Madagascar's development partners (European Union, French Cooperation, GTZ, PACT, Swiss Cooperation, UNDP, USAID, and World Bank) presented an extended version of this matrix of recommendations to the government.

ANNEX B

DISTRIBUTION OF MINISTERIAL FUNCTIONS

DISTRIBUTIO	Distribution of Ministerial Functions			
	Health	Education	Agriculture	Transport
Central	MINISAN	MINISEB	Ministry of Agriculture	Ministry of Public Works
government	Develops health policy	Policy making: (Plan d'éducation)	Policy making	Transport policy
	Budget Programming	Budget programming (Cisco and	Technical and financial	Hiring and firing of central staff
	Technical financial oversight	school level)	monitoring	Technical oversight
	Hires and fires staff	Technical and financial oversight	Hiring and firing of staff.	Planning and monitoring of construc-
	SALAMA	Hire and fire staff		tion and rehabilitation of National
	Procurement of medicines.	l eacher training		contractors
	Replenishment of district and hospital pharmacies.			
	(Distribution by private contractors)			
	DIRSAN	DIRESEB		Provincial Roads Districts
rrovince	Technical and financial	Technical and financial oversight		Planning and monitoring of provin-
	oversight-province level.	Province-level planning		cial roads (using Transport Fund)
	Province level health planning.	Staff allocation within province		Hiring and firing of local administra-
	Allocation of staff within province			LIVE SCAII.
				Technical planning for third parties
				(contractual service)
				Provincial Procurement departments
				Procurement and technical supervi-
				sion of road works for PRDPs and
				בווו כ המינים:
				Procurement units manage their
				own budgets
Region			Direction Régional de l'Agriculture	
			Monitoring of agricultural extension services	
			Training of extension staff	
			Groupes de Travail du Développement Rural Régional.	
			GTDR	

District Allocation of staff within Technical and Financial o Non-salary recurrent he budgets DISTRICT PHARI Manages revolving funds Distributes medical supp pharmacies Distributes medical supp pharmacies CHD (I/II) Manages own non-salary budget Commune No own budget, except i	SSD Allocation of staff within district Technical and Financial oversight		Regional investment planning	
	SSD f staff within district d Financial oversight		Identification and monitoring of local sub-projects (PSDR)	
	d Financial oversight	CISCO Non calary requiremt school	GTDR sub-regional antenas	
	310000000000000000000000000000000000000	budgets	always to district demarcations)	
	Non-salary recurrent health post budgets	Hiring and firing of teachers "hors solde"	Monitoring of regional and local	
	DISTRICT PHARMACY	Staff allocation within district	Regional investment planning	
	olving funds	Distribution of goods Technical oversight school level	Identification and monitoring of local sub-projects (PSDR)	
	Distributes medical supplies to local pharmacies)		
	CHD (I/II)			
	Manages own non-salary recurrent budget			
	CSB (I/II)	ZAP		Communes
FOCA	No own budget, except user fees.	Technical oversight		Management of local roads
LOCA		Distribution of goods		Rehabilitation and maintenance through local revenue
-	LOCAL PHARMACY	COMMUNE	GTDR local antenas	
Sells medical s	Sells medical supplies against user fees	Conditional grants for school	(optional) Outreach and project monitor-	
Manages revolv	Manages revolving pharmacy budget (cost recovery)	recurrent expenditure	ing (mostly temporary, dependent on project activities)	
Requests replenis	Requests replenishment through district pharmacy			
ŏ	COMMUNE			
Conditional transfe recurrent expendition	Conditional transfer: nonsalary recurrent expenditures except			
Commission Comité de dection	to city	Parout Touchor Arrogistions:		
	Connecting of local pharmacies	rarent - reacher Associations: Management of school budgets (CRESSED)		
		Hiring / firing of locally employed teachers		

ANNEX C

REVENUE ASSIGNMENT IN THE 2000 AND 2001 BUDGET

Revenue Assignment in the 2000 and 200	I BUDGET
Loi de Finance 2000	Loi de Finance 2001
General budget	General budget
Taxes on capital income (IRCM)	Taxes on capital income (IRCM)
Capitalization tax / taxe d'incorporation	Capitalization tax / taxe d'incorporation
Tax on transfers abroad (TFT)	Tax on transfers abroad (TFT)
Real Estate capital gains tax (IPVI)	Real Estate capital gains tax (IPVI)
Personal wage income Taxes (IRSA)	Personal wage income Taxes (IRSA)
Non wage personal income tax (IRNS)	Non wage personal income tax (IRNS)
Impôt sur les bénéfices des sociétés (IBS)	Impôt sur les bénéfices des sociétés (IBS)
Tax on company cars (TAVS)	Tax on company cars (TAVS)
Registration duties (DE)	Registration duties (DE)
Tax on real estate advertising (TPF)	Tax on real estate advertising (TPF)
Tax on insurance policies	Tax on insurance policies
Turnover tax (TCA) / VAT, TST	Turnover tax (TCA) / VAT, TST
Excise tax (DA)	Excise tax (DA)
Special tax (FNPDJSL)	Special tax (FNPDJSL)
Redevance fees	Redevance fees
Stamp tax	Stamp tax
Tax on gambling and gambling establishments	Tax on gambling and gambling establishments
Customs duty (DD)	Customs duty (DD)
Import tax (TI)	Import tax (TI)
Statistical tax (TSI)	Statistical tax (TSI)
Stamp duty on imports	Stamp duty on imports
VAT	VAT
Excise tax	Excise tax
Import tax on petroleum products (TUPP)	Import tax on petroleum products (TUPP)
Stamp tax	Stamp tax
Tax on motor vehicles (vignette)	
Impôt synthétique (IS)	
Taxes to be split between subnational governments	
Tax on gambling products	Budget of the Autonomous Provinces
Transaction tax (TST)	Professional taxes (TP)
Budget of the Autonomous Provinces	Centimes additionnels (30 percent of principal of PT)*
Professional taxes (TP)	Business license tax
Business license tax	Impôt synthétique (IS)
Centimes additionnels (15 percent of principal of PT)	Tax on motor vehicles (vignette)
Licenses for sale of alcohol products (20 percent of total)	Transaction tax (TST)
Annual tax on televisions	Tax on gambling products
Budget of the Communes	Licenses for sale of alcohol products
Land Tax (IFT)	Annual tax on televisions
Tax on buildings (IFPB)	Budget of the Communes
Local government tax on buildings (IFPB-TAFB)	Land Tax (IFT)
Additional tax on registration duties (2% of principal)	Tax on buildings (IFPB)
Centimes additionnels (15% of principal of PT)	Local government tax on buildings (IFPB-TAFB)
Licenses for sale of alcohol products (80% of total)	Additional tax on registration duties (2% of principal)
Annual tax on slot machines	Annual tax on slot machines

ANNEX D

DECONCENTRATION OF EXPENDITURES

TABLE DI: LEVEL	. OF DEC	ONCENTRA	tion by I	MINISTRY,	RECURRENT EXPENDITURES
	Center	Provinces	Regions	Districts	Others
MINESEB	31.14%	55.93%	0.03%	12.90%	
SANTE	45.83%	39.66%	0.34%	14.16%	
PECHES	73.34%	19.63%	7.03%		
AFF. ETRANG.	78.63%				21.37% (ambassades, consulats)
JUSTICE	83.90%	12.62%	2.50%		0.97% (President Tribunal 1,2)
TOURISM	83.95%	11.49%	4.56%		
FORMATION TECH.	85.49%	14.51%			
MINAGRI	87.95%	4.77%	2.96%		4.32% (Centre d'appui formation, EASTA)
EAUX ET FORETS	88.00%	8.64%			3.36%
POPULATION	88.57%	6.20%	5.23%		
FORCES ARMEES	88.92%	9.62%	1.46%		
ENERGIE, MINES	88.97%	7.47%	3.56%		
JEUNESSES	90.23%	9.77%			
ELEVAGE	90.51%	6.81%	2.67%		
TRANSPORT, METEO	91.34%		6.77%		I.88% (not specified)
SE GENDARMERIE	91.96%		1.14%		6.89% (Groupement gendarmerie)
BUDGET DEV. PA	93.27%	6.00%	0.72%		
FONCT. PUBL.	93.36%	1.92%	0.11%		4.61% (not specified)
IND. ARTIS.	93.48%	5.42%	1.10%		
TRAVAUX PUBL.	94.92%	5.08%			
COMMERCE	95.26%	2.59%	2.15%		
MININTER	95.50%	0.39%			4.11%
AMENAGEMENT V.	96.22%		1.89%		I.89% (SRD, SRPTF)
INFORMATIONS	96.63%	3.37%			
SE SEC. PUB.	96.69%		3.31%		
ENVIRONNEMENT	98.09%	1.91%			
RECHERCHE	98.58%	1.42%			
PRESIDENCE	99.20%	0.67%	0.13%		
FINANCE EC.	99.76%	0.07%	0.03%		0.14% (Trésorerie Principale)
SEC. PRIVE	99.92%	0.08%			
PRIMATURE	100%				
POSTES	100%				
HCC	100%				
EINSEGN SUP.	100%				
A.N.	100%				
Total	84.47%	10.65%	0.41%		4.46%

Ministries are ranked according to the share of expenditures assigned below the center, from the highest to the lowest. The level below the region is ministry-specific and does not necessarily match a geographical level: for example, for the Min Affaires Etrangères, it identifies the embassies and consulates abroad, for the Min Finance it identifies the Trésorerie Principale, etc.

Transfers to deconcentrated agencies are here recorded as recurrent expenditures at the central level.

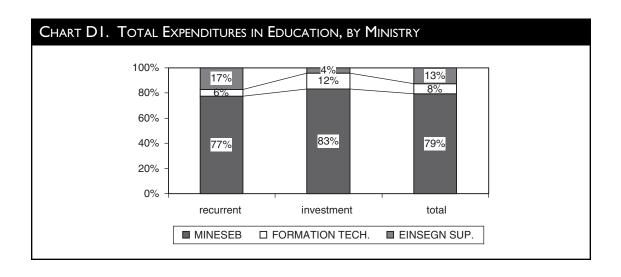


TABLE D2:	RECURRENT EXPEN	NDITURES BY	ADMINIST	RATIVE LEV	el: E duc <i>i</i>	ATION	
				Non-	salary exp:	disaggreg	gated
				Purchase	Purchase		
		Salary	Non-salary	of	of	Permanent	Transfers/
	Total	ехр	ехр	goods	services	charges	subventions
Central	129,159,000	101,701,700	27,457,300	7,322,816	12,650,838	1,067,590	6,416,042
	31.14%	31.02%	31.57%	23.67%	28.11%	37.35%	78.52%
Province	232,000,000	224,649,300	7,350,700	1,559,160	3,959,260	580,180	1,252,180
	55.93%	68.53%	8.45%	5.04%	8.80%	20.30%	15.32%
Region	118,875	0	118,875	44,288	61,505	13,082	
	0.03%		0.14%	0.14%	0.14%	0.46%	
ENI	1,871,550	120,000	1,751,550	677,650	397,990	173,100	502,810
	0.45%	0.04%	2.01%	2.19%	0.88%	6.06%	6.15%
District Level:							
CISCO	30,959,828	1,259,440	29,700,388	7,930,893	21,328,313	441,182	
	7.46%	0.38%	34.15%	25.63%	47.39%	15.43%	
EPP	16,113,747	0	16,113,747	11,692,807	4,289,614	131,326	
	3.88%		18.53%	37.79%	9.53%	4.59%	
Lycée	1,589,760	77,030	1,512,730	646,223	631,250	235,257	
	0.38%	0.02%	1.74%	2.09%	1.40%	8.23%	
CEG	2,975,040	2,000	2,973,040	1,067,142	1,689,065	216,833	
	0.72%	0.00%	3.42%	3.45%	3.75%	7.59%	
Total	414,787,800	327,809,400	86,978,400	30,940,979	45,007,835	2,858,550	8,171,032
	100%	100%	100%	100%	100%	100%	100%

Amounts are expressed in thousands of FMG. The percentages represent the percent of the total column. The majority (60 percent) of the transfers/subventions are transfers to the private sector, the rest is given by bourses (to ENI) and transfers to organisms public. ENI stands for Ecole National d'Informatique.

Source: Tableau de Bord 2000..

Table D3: Recurrent Expenditures by Administrative Level: Health							
				Non-salary: disaggregated			ed
				Purchase	Purchase	Utilities	
	Total			of	of	(þerm.	Transfers/
	recurrent	Salary	Non-salary	goods	services	charges)	Subventions
Center	101,779,900 <i>45</i> .83%	43,437,864 35.79%	58,342,036 <i>57.94</i> %	44,111,766 74.70%	9,791,934 <i>30.75</i> %	2,407,098 32.56%	2,031,216 <i>84.4</i> 2%
Province	88,064,940 39.66 %	76,408,072 62.96 %	11,656,868 11.58%	4,599,649 7.79%	5,151,174 <i>16.17</i> %	1,531,145 20.71%	374,900 15.58%
Region	761,994 0.34%	17,843 0.01%	744,151 0.74%	302,007 <i>0.51</i> %	344,244 1.08%	97,900 1.32%	
Primary health care:							
Health district (SSD)	20,719,860 9.33 %	904,603 <i>0.75</i> %	19,815,257 <i>19.68</i> %	5,241,261 8.88%	13,221,612 41.51%	1,352,384 18.30%	
Centres Hosp.	5,499,760	407,233	5,092,527	2,666,138	1,617,235	809,154	
District (CHD)	2.48%	0.34%	5.06%	4.51%	5.08%	10.95%	
Secondary health care: Centre Hosp. Regional	4,057 1.83%	135,300 <i>0.11%</i>	3,921,708 3.89%	1,574,300 2.67%	1,386,721 4.35%	960,687 13%	
Hôpitaux	1,177,069	48.473	1,128,596	559,869	335,163	233,564	
Spécialisés	0.53%	0.04%	1.12%	0.95%	1.05%	3.16%	
Total	222,060,500 100%	121,359,400 100%	100,701,100 100%	59,054,990 100%	31,848,083 100%	7,391,932 100%	2,406,116 100%

Amounts are expressed in thousands of FMG. The majority (86 percent) of transfers/subventions are transfers to the private sector.

Source: Tableau de Bord 2000.

THE LOCAL FINANCING GAP METHODOLOGY⁴¹

The Approach

Local financing gap analysis offers a rapid assessment of service needs and available financing at the local level. It compares estimates of local financing needs with available resource flows to facilities for a particular year. This tool is not designed to measure the degree of leakage in resource flows, which will be analyzed through separate expenditure tracking surveys (PETS) for the health and education sectors. The approach has three steps:

- (i) Estimate unmet needs for basic, local services, defined as the difference between a predefined benchmark for service delivery and existing local service capacities;
- (ii) Identify financial resources available to support local service delivery, which include financing from local governments, centralized and deconcentrated service providers, donors, NGOs and communities.
- (iii) Estimate the *financing gap* by deducting flows of available financing from estimated needs.

BOX E1: CALCULATING THE LOCAL FINANCING GAP

Service needs,
relative to existing — existing flows of stocks of services existing flows of service finance

In Madagascar, health, education,

and water sectors were analyzed because of their significant share of commune financing, their low degree of externalities beyond commune boundaries, and their importance as PRSP priorities. Because local financing gap analysis requires intensive empirical field work it is usually only applied to a limited sample. This analysis was based on a national sample of

15 communes, which were distributed evenly across six provinces and geographical regions, but differ in size and socioeconomic characteristics. Questionnaires on budget data, available service infrastructure and administrative capacities were submitted to commune and community representatives as well as to service and project staff at the local, district, and central level.

^{41.} Fengler and Wietzke (2003).

Advantages of Local Fiscal Gap Analysis

Local fiscal gap analysis requires intensive empirical field work and can therefore only be applied in a limited study sample. Yet, through its strong local research focus it provides important complementary information for other research tools that address service delivery from higher aggregate levels. Specifically it can be applied across sectors and covers all relevant sources of finance from centralized and deconcentrated expenditures to local counterpart payments by commune governments and communities.

- adds a local demand-side perspective to more supply-oriented public expenditure reviews and tracking surveys.
- provides important empirical data on local service finance in countries that lack sufficiently disaggregated expenditure data at the central level.
- produces relevant information in a decentralization context such as for policy advice on fiscal transfer mechanisms, expenditure and investment planning, and local service delivery instruments.

Estimating Local Service Needs

Local needs are estimated based on the difference between a predefined level of local services and existing service levels, as measured by infrastructure, staff and equipment levels. This approach poses methodological challenges because estimated needs depend directly on how service delivery benchmarks are defined. In this study, estimated needs were based on *service standards* and *target populations*. Access-based standards were defined, which reflect the quantity and capacity of local service facilities as well as the range of services provided. Technical standards were provided by the responsible line ministries or, if unavailable, technical guidelines from donor projects and international organizations were used (see Table E1). Needs were defined for those population groups that have access to basic, local services. Local populations without access or specially targeted groups were excluded due to lack of reliable demographic and household data. Water needs were aggregated at the village level.

TABLE E1: SERVICE STANDARDS ⁴²						
	Education	Health	Water			
Infrastructure	I room / 50 students I kitchen / school	12 rooms + shower and WC / health post	l water source per village			
Equipment	18 tables / class room I blackboard I text book / student and subject administrative equipment	12 beds and tables 14 chairs and footrests 5 desks and cupboards 1 stretcher, 5 suspenders medical kits for diagnosis, first aid, small surgery, injection, post and pre- natal diagnosis, child delivery	Technical specifications: flow capacity: 0.7 m³/h Diameter drilling: 13 inches Diameter well: >13 inches Depth of drilling: 50–60 m Depth of well: 15 m Maximum time to collect water: 15 minutes			
Staff	I teacher / 50 students	I medical doctor I midwife 2 nurses I sanitary assistant I guardian				

^{42.} Standards in the education sector refer to the minimum needs estimate. In the health sector, all standards refer to Rural Health Centers. Norms for smaller Health posts may vary.

Local needs are estimated based on the difference between a hypothetical benchmark of local service delivery and existing service capacities, as measured by infrastructure, staff and equipment levels. In the case study a conservative service benchmark was adopted, in order to avoid unrealistically high estimates of the financing gap. This measure was built around technical standards for physical infrastructure, equipment and staff coverage which were obtained from the responsible line ministries or alternatively donor projects (see Box E2 for alternative approaches to estimate service needs). In the education sector these standards were applied to the number of children that were already enrolled in primary schools.⁴³ In the health and water sector the standards were used to calculate the costs of a functioning health facility at the commune level and a collective potable water system at the village level (excluding individual household connections).

Box E2: Determining Local Need

Depending on policy objectives, various measures of need can be applied

- Relative needs: This approach tries to identify regional variations in service supply relative to the national average. This measure is useful for designing fiscal equalization grants, and other fiscal transfer mechanisms, yet, it tells little about actual needs at the local level.
- Absolute needs This approach measures absolute needs for service delivery, based on predefined service benchmarks or policy objectives (i.e. poverty reduction and social policy perspectives). It is helpful to redirect policy priorities and expenditure assignments, such as under HIPC and PRSP strategies. The following benchmark indicators can be used to measure absolute needs:
 - Access based indicators such as Basic Needs Assessments or standard-based indicators that focus on distance to nearest infrastructure facility, capacity or the range of services provided.
 - Qualitative and outcome-based indicators, such as school repetition and drop-out rates in the education sector, data on nutrition and epidemiological patterns in the health sector, or user surveys and social assessments that identify specific service needs of local populations.
- Coverage: needs estimates can vary considerably, depending on the size of the target population that is considered eligible for a specific service. Service coverage could be (i) broadened to include the totality of the local population, (ii) deepened to improve services for those parts of the population that already have access to service facilities, or (iii) target specific beneficiary groups, such as vulnerable households.

Analyzing Available Resources

All commune resources from the center, intermediate service providers, and local sources should be analyzed. In Madagascar, most of the field work was spent reviewing expenditure data from centralized, deconcentrated or alternative local service providers. Four sources of local financing were reviewed: (i) commune budgets; (ii) central government and deconcentrated service providers; (iii) private contributions by beneficiaries and community groups; (iv) projects, investments and other contributions by donors and NGOs.

In the case study, fixed salary expenditures were excluded from the available resources as these already contributed to existing level of service delivery. In the case of investment and recurrent non-salary expenditures we assumed that these represented fungible allocations that could be used to address unmet service needs.

Calculating the Financing Gap

The local financing gap compares unmet local service financing needs to available flows of service finance. It is calculated by subtracting available resources for service finance from estimated service needs. In the case study we excluded fixed salary expenditures as these already contributed to existing level of service delivery. In the case of investment and recurrent non-salary expenditures we assumed that these represented fungible allocations that could be used to address unmet service needs.

^{43.} A calculation for total populations in the schooling age would have been desirable but could not be carried out due to lack of reliable demographic information.

THE REPRESENTATIVENESS OF THE 232 COMMUNE SAMPLE

o account for these constraints a second data set was used, consisting of a country wide commune census, that was conducted in 2001 by the Agricultural Research Institute (FOFIFA) and Cornell University. The commune census has a small section on aggregated expenditures and revenues of the commune that can be used to verify the representativeness of the ministry of Budget sample. In addition, the survey contains a broad range of indicators on socioeconomic characteristics, infrastructure endowments and accessibility of communes.

Representativeness of the Sample

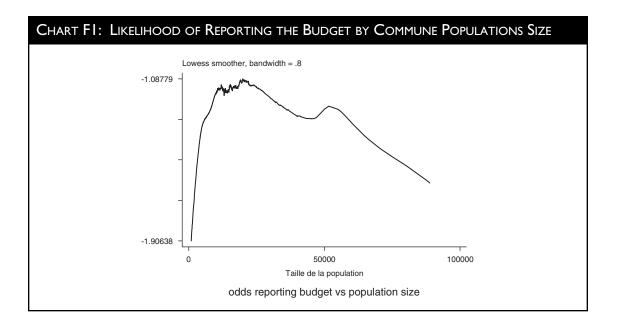
We assessed the representativeness of the sample in two steps. First, we use data from the total budget figures of the commune census to verify whether there are significant differences in the absolute size of the budget among those communes who report in the census and those who reported their budgets to the central authorities. Second, we looked at whether the likelihood of reporting the budget is systematically related to some structural characteristics of the commune, such as the population and the degree of isolation of a commune.

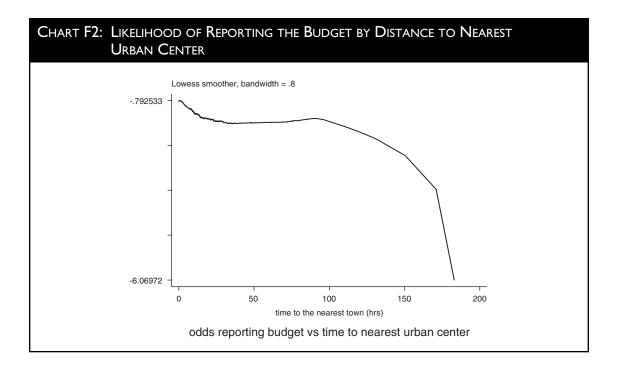
Using data from the Commune Census, on average, we find no significant differences in the budget size of those communes who report the budget to the ministry of budget and those who do not do so. Communes who are reporting their budget are also on average smaller, even if the difference is not significant. Table F2 below suggests that our sample is not skewed towards communes with larger budgets. However, while the variability in reporting is not related to

TABLE F1: OVERLAPS BETWEEN THE TWO SAMPLES						
	Reported to the ministry					
	No Yes					
Reported in the	no	105	18	123		
commune census		7.6%	1.3%	8.9%		
	yes	959	303	1262		
		69.2%	21.9%	91.1%		
		1064	321	1385		
		76.8%	23.2%	100%		

Table F2: Overlap between Reported Budgets with Budgets in the COMMUNE CENSUS **COMMUNE CENSUS MINISTRY of BUDGET** difference Non difference Census-Whole Reporting Non-rep/rep Min Bldg. reporting Reporting budget budget (p value) budget (p value) census Tot. revenue 96,192.8 98,076.7 90.205.5 0.60 n.s. 86,410.9 0.52 n.s. (232,400)(262,300)(84, 261)(60,502)Share transfers/ 0.71 0.72 0.68 0.31 n.s. 0.76 0.00** (0.53)tot revenue (0.48)(0.24)(0.16)0.41 n.s. Tot. expenditures 81,310.8 83,260.2 75,122.6 74,272.6 0.85 n.s. (150,200)(168, 100)(66,230)(47,099)0.55 n.s. 0.02** 19,876.2 20,245.1 18,689.5 12,183.4 Investment (15,897)expenditures (37,677)(36,765)(40,524)0.07* Recurrent 63,838.7 65,643.8 58,126.5 0.38 n.s. 66,620.5 expenditures (132,600)(150,600)(38,262)(40,436)**Population** 15026.4 15454.7 13609.3 0.36 (850.9)(1096.7)(519.9)0.00** Time to nearest 19.00 20.05 15.52 urban center (hrs) (0.62)(0.73)(1.15)

Note: figures are in 1000 FMG. Standard errors are in parentheses. (n.s. means statistically not significant at 5 percent confidence level).





the size of the budget, it seems to be related to structural constraints. Communes that are more remote and less accessible⁴⁴ are less likely to report the budget. Moreover, neither the smaller nor the biggest communes, in terms of population size are likely to send their budget to the center.⁴⁵ This leads us to conclude that the sample of 321 communes is more representative for less isolated as well as for medium rural communes.⁴⁶

^{44.} In particular, we find that communes that are more distance to urban centers, or that do not have a bush taxi connection, are less likely to report the budget.

^{45.} The fact that the likelihood of reporting the budget decreases with population size indicates that there are few urban communes in our sample. Our discussion of the case of urban communes will therefore be limited to the analysis of aggregate budget data.

^{46.} Future work will check how this selectivity affects the main correlations we find between revenue/expenditure composition and the socioeconomic characteristics of the communes.

ANNEX G

LOCAL GOVERNMENT ORGANIGRAM

LOCAL GOVERNMENT ORGANIGRAM **PROVINCE** : TOAMASINA DISTRICT : Brickaville COMMUNE : Andovoranto (2nd Category) CONSEIL COMMUNAL 1 Président 1 Vice-Président 14 2 Rapporteurs 10 Membres **BUREAU EXECUTIF** 1 Maire 1 Adjoint ADMINISTRATION GENERALE **FINANCES** ETAT-CIVIL 1 Secrétaire - Trésorier 1 Secrétaire EC 1 Gardien 14 Conseillers communaux 5 membres du personnel, dont : Superficie : 325 km^2 1 Maire 1 Adjoint Population : 11 291 Hab. 1 Secrétaire - Trésorier Densité: 35 Hab./km² 1 Secrétaire Etat-Civil 1 Gardien 1 Dispensateur et 1 Gardien CSB.

ANNEX H

LOCAL GOVERNMENT REVENUE ASSIGNMENTS

TABLE HI: TAX ASSIGNMENTS					
NATURE	Legal Reference	Tax level	Assignment	Recovery mechanism	
I. Land Tax (Impôts Fonciers sur les Terrains IFT)	Art. 10.02.01 to 10.02.10	Determined by Commune council	100% Commune	Treasury	
2. Property Tax (Impôts Fonciers sur la Propriété Bâtie, IFPB)	Art. 10.03.01 to 10.03.14	Determined by Commune council	100% Commune	Treasury	
3. Annex to the Property Tax (Taxe Annexe à l'Impôt Foncier sur la Propriété Bâtie TAFB)	Art. 10.04.01 to 10.04.07	Determined by Commune council	100% Commune	Treasury	
6. Annex to the Professional Tax (Centimes additionnels à la Taxe Professionnelle C.A.T.P)	Art. 01.06.40 of CGI 1999	15% of principal	I5% Region I5% Commune	Treasury	
7. Annex to tax on registration duties (Taxe Additionnelle à l'Enregistrement des actes et mutations des biens)	Art. 10.05.01 to 10.05.03	2% of principal	100% Commune	Revenue Administration	
8. Taxes on Licenses for sale of alcoholic beverages	Art. 03.02.11 03.02.14 03.02.22 03.02.26 du	Variable according to licences and population (5.000/2.000 FMG per	100% Commune	DAA	
	CGI 1999 Art. 10.06.12 to 10.06.91	License of 12 hours)			
9. Tax on slot machines	Art. 03.03.12 du CGI 1999	2.000.000 FMG slot machines 500.000 FMG others	100% Commune	DAA	
10. Tax on gambling	Art. 03.02.12 Art. 10.07.01 to 10.07.07	Cf. Art. 03.02.12 of CGI	Determined by Ministry of Budget	Revenue Administration	
II. Tax on transactions (Taxe Unique sur les transactions, TST)	Art. 06.02.01 ff	5% of transaction value	Determined by Ministry of Budget	Revenue Administration	
13. User fee for waste management Redevance de collecte et traitement des Ordures Ménagères, ROM)	Art. 01.09.05 du CGI 1999	Determined by commune council	100% Commune		
14. Various Mining taxes	Law n° 95-016 (Code Minier)				

TABLE H2: ADMINISTRATIVE FEES	
Fee	Collection
Fee for cattle registration	Deconcentrated
Fee on for passports	Commune
Licencing fee for slaugthering	Commune
Fishery tax	Deconcentrated
Fee for regularization of passports	Commune
Exhumation permit	Commune
Construction permit / Frais de constitution des dossiers domaniaux	Commune
Prestation de service et autres	Deconcentrated
Arbitrage and conflict resolution	Commune
Drawing right	Commune
Plainte	Commune
Fee on share cropping	Commune
Fines on tax arrears (10%)	Commune
Fines / confiscation	Commune
Execution of charts (chartres)	Commune
Fee for Secrétaires d'état civil	Commune

TABLE H3: USER FEES	
Fee	Collection
Desinsectification tax	Commune
Fee for waste management and street cleaning	Commune
Collection fee (mining, natural resources)	Fokontany
Fee on rice mills	Commune
Taxe de mouillage	Commune
Rent from communal housing / infrastructure	Commune
Arrears on Rent from communal housing / infrastructure	Commune
Location d'objets mobiliers et matériels	Commune
Rent from communal housing / infrastructure	Commune
Rent from communal housing / infrastructure	Commune
Transport rights (droit de voirie)	Commune
Market fees	Commune
Fees burial grounds	Commune
Road fees	Commune
Camping fees	Commune
Fees for public toilets	Commune
Fee Garage / shelter fourrière	Commune
Parking fees	Commune
Fees on pirogue	Commune
Fee on pasture	Commune
Produits des péages, mesurage, jaugeage	Commune
Sewage fees	Commune
Library fees	Commune
Retenue d'hôpital	Commune
Cotisation au fonctionnement de l'hôpital	Commune

GLOSSARY OF FRENCH AND MALAGASY TERMINOLOGY

Canton: Administrative unit regrouping several communes during the colonial period

Circonscription Financière (CF): Administrative unit of Financial organization

Centre Fiscal: Fiscal Center

Centre Sanitaire de Base (CSB): Communal level Health Center

Comité Local de Développement (CLD): Local Development Committee

Commission Centrale des Marchés (CCM): Public Procurement Committee

Comptes Administratifs: Budget Accounts

Contrôle des Dépenses Engagées (CDE): Internal State Control Organ, in charge of ex-ante controls of expenditure procedures in line ministries and public administrations

Délégué Administratif d'Arrondissement (DAA): Local Administrative Delegate-at the Commune and/or Neighborhood level (in urban communes)

Délégué Général du Gouvernement (DGG): State Representative at the Province level (not functional at this stage)

Département: State level administrative division headed by a sous-préfet

Député: Member of Parliament (National Assembly)

Etat Civil: Civil Registry

Fartany: Former state level administrative unit (equivalent of provinces)

Firaisana: Former local level administrative unit (equivalent of communes)

Fivondrona: District

Fokonolona: traditional unit of the Malagasy community

Fokontany: semi-formal administrative unit at village and / or neighborhood level

Gestionnaire: Civil servant or elected representative in charge of managing public funds

Inspecteur Général de l'Etat (IGE): Central auditing body—Administrative Inspection

Ordonnateur: Higher level civil servant who orders commitment and payment of public funds

Plan Communal de Développement (PCD): Municipal Development Plan

Préfecture: Deconcentrated administrative unit (about equivalent of the regional level)

Préfet: Deconcentrated state representative representing all ministers individually and collectively at the "regional" level. The *préfet* is appointed by a Presidential decree and reports directly to the Ministry of Interior. He is also in charge of safety and security issues.

Président de la Délégation Spéciale (PDS): State representative nominated centrally to manage provincial affairs

Secrétaire d'Etat Civil: Communal agent in charge of maintaining the Civil registry

Sous-préfecture: Deconcentrated administrative unit, equivalent to the department level

Sous-préfet: Deconcentrated state representative, head of the sous-préfecture

Tutelle: Authority for control and oversight (delegated to the Préfet in each Department)

Zone Administrative Pédagogique: Communal level Administrative unit for Education

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This book takes stock of Madagascar's first 10 years of decentralization. As it happened in many other developing countries, particularly in Africa, Madagascar's decentralization process has seen reversals, uncertainties and lack of clarity all along. This explains why Madagascar, despite the experience with decentralization, remains a highly centralized country with only about 3-4 percent of expenditures spent below the center and with very few prerogatives decentralized to the local level.

Notwithstanding the structural impediments to decentralization in poor countries, many positive lessons can be drawn from the Madagascar case which point to the potentials of the decentralization process. This study provides a detailed analysis of local government finances and develops a methodology for measuring local financing needs (local fiscal gap methodology). Based on this analysis, the study argues that a lot can be gained from simplifying administrative arrangements and fiscal relationships. Instead of a full-blown and ambitious decentralization strategy, this book suggests a number of reforms, which would go a long way by making the current structure work better. These reforms include: (i) a full transfer of the (limited) local competencies to commune, particularly local revenue collection; (ii) increasing transfers to rural communes so that per capita allocations would be the same across communes—rural and urban; and (iii) assigning revenues to one level of government only, except for some very specific types of taxes (such as on natural resources).

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