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**FISCAL DECENTRALIZATION IN MYANMAR:
TOWARDS A ROADMAP FOR REFORM
HAMISH NIXON AND CINDY JOELENE**

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FISCAL DECENTRALIZATION IN MYANMAR: TOWARDS A ROADMAP FOR REFORM

HAMISH NIXON AND CINDY JOELENE

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ONE: FISCAL DECENTRALIZATION IN THEORY AND PRACTICE

In theory, decentralization can create important benefits consistent with the policy priorities of the government and the needs of Myanmar’s people. Decentralization is supposed to align public services more closely to the preferences and needs of local people, increasing responsiveness. By enabling stronger accountability and transparency, and reducing administrative bottlenecks, decentralization may improve the technical efficiency and quality of public services. And as a means to achieving greater equity and participation, decentralization may support state legitimacy, and help address some – but not all – kinds of internal conflict. In areas of contested governance, caution should be taken to consider the political implications of decentralization and the sequencing of reforms.

But decentralization is very risky and difficult in practice. There is evidence that, on the whole, more fiscally decentralized countries enjoy higher income and other benefits, but there is little evidence that the process of decentralization systematically produces these benefits. This gap between theory and practice is a result of lack of attention to contextual factors and poor design or implementation of decentralization reforms. Successful decentralization reforms entail aligning decentralization strategy with the political drivers for decentralizing, the institutional starting points, and the capacity of the existing system.

Within such a strategy, *fiscal* decentralization – the adequate and effective resourcing of the responsibilities given to subnational administration – is central to realizing the benefits of decentralization.

1.1: The “textbook” approach to fiscal decentralization, and its limits

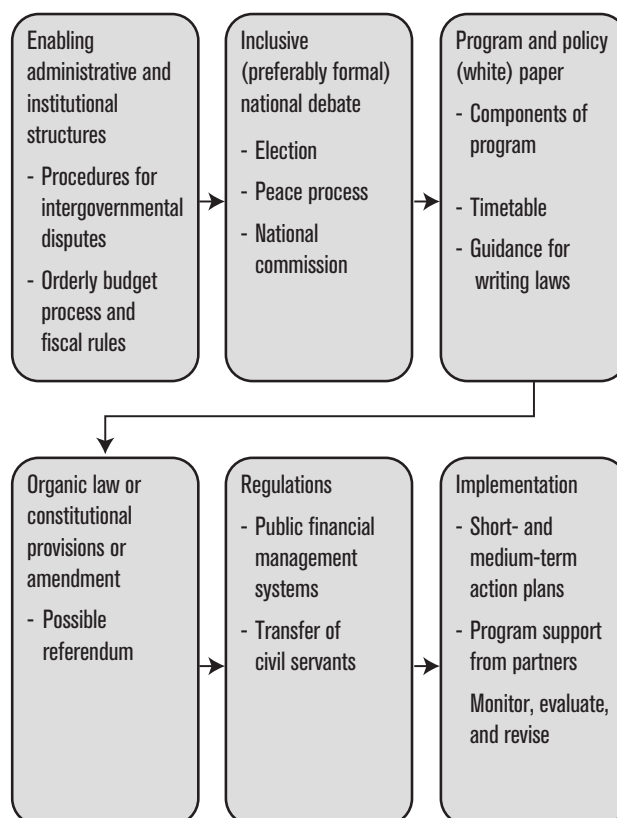
The four pillars of fiscal decentralization

Technical approaches to decentralization processes tend to suggest a common set of “building blocks” and a sequenced process. Among these building blocks are the “four pillars” of fiscal decentralization, each with its own set of best practices:

1. **Assignment of expenditure responsibilities** according to associated principles of public finance such as subsidiarity, economies of scale, externalities, and equity.
2. **Assignment of revenue sources** according to the types of services that are to be funded, avoiding economic distortions, and promoting subnational fiscal autonomy.
3. **Design of intergovernmental transfer systems** to meet any gap between revenue and expenditure for assigned functions, and to promote equity across locations and other policy goals.
4. **Subnational borrowing and fiscal discipline** to ensure long-term investment and prevent fiscal decentralization from creating excess debt.

Since each of these building blocks needs careful technical consideration, there is an ideal or “best practice” sequence for the development of fiscal decentralization strategy (Figure 1).

Figure 1: A normative approach to sequencing fiscal decentralization¹



Sequencing in practice

However, this idealized approach, where each step happens in the right order, is usually not possible, and in practice there is “no single best approach to sequencing fiscal decentralization.” There are many examples of failed or delayed grand designs for decentralization.² In Nepal, many elements of the Local Self-Governance Act of 1999 remain on paper 15 years later, with intentions to decentralize services unfulfilled, and only a small proportion of the budget given to local governments. Cambodia, after ten years of post-conflict state building, only embarked on a “model” process with a 2005 strategy, a subnational Organic Law in 2008, and the beginning of a ten-year decentralization program in 2010.³

In reality, the “textbook” approach to decentralization confronts the constraints set by the underlying political motivations and conditions for reform. As a result:

“Countries embarking on decentralization often struggle with decisions about the essential components of decentralization, including the order of an introduction of decentralization policies, the number of years necessary to bring a full program on line, and the components of the transition strategy.”⁴

As well as difficulties with clarifying policy aims, the design and implementation of decentralization policy often encounter political and bureaucratic resistance as it proceeds. This can steer countries away from optimal sequencing. Recently, development policy research has focused on the practical challenges of successfully implementing public-sector reforms, including decentralization programs.⁵ To be successful, reforms

should build on contextual and institutional realities, address specific and grounded problems, and proceed incrementally with ongoing learning and adjustment: “[E]ven though a clear vision of longer-term reform is needed, initial steps should be modest and logically phased.”⁶

1.2 Deconcentration vs. devolution

Decentralization takes place in different degrees. In *devolution*, local government has autonomy over decisions about a set of assigned functions, and is usually made accountable for those decisions to local people through elections.⁷ In contrast, *deconcentration* is the assignment of functions and resources to lower administrative levels of a central organization (typically a sectoral ministry), with accountability for these functions still being to the central authority.

There are important differences between devolution and deconcentration. In devolution there is typically much greater accountability to the people, because the local government has more decision-making power and is elected. There is also usually scope for local governments to make decisions about resource allocation across different sectors. For these reasons, devolution is normally considered “more” politically decentralized than deconcentration. In reality, almost all countries have some mixture of these forms of decentralization.

¹ Adapted from Roy W. Bahl and Jorge Martinez-Vazquez, *Sequencing Fiscal Decentralization* (World Bank Publications, 2006), 2-5.

² Ibid., 2.

³ On Cambodia’s painstaking decentralization process see Pak Kimchoeun, *Fiscal Decentralization in Cambodia: A Review of Progress and Challenges*, CDRI Working Paper Series 50 (Phnom Penh: CDRI, 2011).

⁴ Bahl and Martinez-Vazquez, *Sequencing Fiscal Decentralization*, 1.

⁵ See Leni Wild and Marta Foresti, *Working with the Politics* (London: Overseas Development Institute, 2013), <http://www.odi.org.uk/sites/odi.org.uk/files/odi-assets/publications-opinion-files/8587.pdf>; and Matthew Andrews, *The Limits of Institutional Reform in Development – Changing Rules for Realistic Solutions* (Cambridge: Cambridge University Press, 2013).

⁶ Paul Smoke, “Strategic Fiscal Decentralization in Developing Countries: Learning from Recent Innovations,” in World Bank, *Local Dynamics in an Era of Globalization*, ed. Shahid Yusuf, Weiping Wu, and Simon Evenett (New York: Oxford University Press, 2000), 107.

⁷ This is sometimes referred to as “democratic decentralization.”

TWO: MYANMAR'S FISCAL DECENTRALIZATION ENVIRONMENT

Effective decentralization strategies need to build on the existing context. Important contextual factors include the political drivers behind decentralization, the roles and interests of key actors and stakeholders, and the current state of reform.⁸ In Myanmar, ethnic armed groups (EAGs) are key stakeholders among the political drivers behind decentralization, which is set against the backdrop of ongoing discussions on constitutional reform, federalization, and the peace process.

2.1 Political and institutional context for decentralization reform in Myanmar

Historical context

Myanmar's formal process of decentralization began with the adoption of the 2008 Constitution, itself the culmination of the State Peace and Development Council regime's carefully managed "seven-step road map" towards a "modern, developed, and democratic nation." The process of decentralization has accelerated under the Thein Sein government, which emphasized "people-centered development" and aimed at rapid improvement of public services and development with "quick wins." Concrete decentralization reforms since 2011 include the creation of consultative bodies or elected positions at district, township, and village levels; orders for state-and region-level civil servants to coordinate with state/region governments on Union-level responsibilities; and increased budgets for local public functions and development projects.

Decentralization under Myanmar's 2008 Constitution

Myanmar's constitutional provisions relating to the structure of the state set clear limits, including some

crucial constraints on Myanmar's early fiscal decentralization process. First, the Constitution establishes a mixed political system at the state and region level that combines a semi-elected local representative body with an, essentially, centrally appointed chief minister⁹— a common arrangement in decentralizing countries. This combination allows the centrally appointed executive to oversee the activities of newly democratic local governments and exercise control over implementation.

Second, the Constitution mandates important administrative roles in the state and region governments, in the self-administered zones and the Nay Pyi Taw council, and for the General Administration Department (GAD) under the direction of the military-led Home Affairs Ministry.¹⁰ Finally, the Constitution establishes a division of responsibilities between central and subnational levels that retains many developmentally and fiscally important responsibilities, such as health, education, and major economic sectors, as Union-level responsibilities subject to the Union budget process.

Myanmar's institutional context

In addition to the constitutional constraints, Myanmar's public-sector transition is taking place via a civil service that "has long been characterized by a high degree of centralization, a weak degree of administrative and managerial autonomy, and an almost nonexistent consultative process."¹¹ Myanmar's political culture echoes that of some neighbors, with wide acceptance of political patronage, limited experience of accountability, and vertical approaches to managing territory through governors or officers.¹² This organizational culture has led to primarily top-down reform rather than more locally driven processes.

Myanmar's reform is at a balance point. Unlike the "textbook" sequence that suggests broad national

⁸ Kent Eaton, Kai-Alexander Kaiser, and Paul J. Smoke, *The Political Economy of Decentralization Reforms: Implications for Aid Effectiveness* (Washington: World Bank Publications, 2011), 8.

⁹ "Constitution of the Republic of the Union of Myanmar" (Ministry of Information, Government of Myanmar, 2008), Art. 261. As in the National Parliament, 25 percent of state and region representatives are directly appointed by the commander in chief of the armed services.

¹⁰ Ibid., Art. 260, 283, 287. See also Kyi Pyar Chit Saw and Matthew Arnold, *The General Administration Department: An Overview of Myanmar's Administrative Backbone* (Yangon: MDRI-CESD and The Asia Foundation, March 2015).

¹¹ Alex M. Mutebi, "Myanmar's Civil Bureaucracy and the Need for Reform," in *Myanmar: Beyond Politics to Societal Imperatives* (Singapore: Institute of Southeast Asian Studies, 2005).

¹² Tariq H. Niaz, *Deconcentration and Decentralization Reforms in Cambodia* (Philippines: Asian Development Bank, 2011), ix.

consensus should precede reform, there is already considerable political drive for some decentralization. Longer-term political aspects of the decentralization process are still unclear given the discussions around a more federal system, the peace process, and revising and rewriting the Constitution. Importantly, it must be noted that in large territories of contested governance, administration takes place via various hybrid or non-state systems, and decentralizing central government services has political implications that may have a bearing on the peace process.

The end goals of the fiscal decentralization are difficult to see, but there are still opportunities to achieve results while laying the ground for a longer-term decentralization process. To do this means building upon the institutions that are currently functioning and the reforms that have been undertaken, while having the flexibility and space for more than one possible future.

2.2 Myanmar's subnational fiscal structure

These political and institutional factors mean that, so far, Myanmar's fiscal decentralization has been largely driven from the top, focused on service delivery and development spending, and hampered by limited administrative capacity. The defining characteristic of Myanmar's current subnational fiscal structure is its mixture of devolution and deconcentration. In Myanmar, there are devolved subnational governments in the states and regions that have their own sources of revenue and a distinct budget for some functions. Yet a large majority of fiscal resources are retained in the budget of the Union line ministries, and the responsibilities and budget assigned to states and regions remain small. There are three main channels for fiscal resources from the Union budget to the subnational levels.

- **Channel 1:** Line ministries or departments that remain under Union jurisdiction, and which have assigned, to a greater or a lesser degree, some activities and their accompanying budget to their state and region departments through a *deconcentrated channel*.

- **Channel 2:** The Union budget gives aid in the form of grants or loans to the state/region fund to support a range of devolved departments through a *devolution channel*. These state/region budgets are also supported by tax and non-tax revenues and local SEE income.

- **Channel 3:** Various, separately budgeted funds, mainly for capital expenditure on local infrastructure, also *devolved* to the state/region level, local parliamentarians, or townships according to various distribution and management criteria.

This fiscal structure has important implications for both current and future fiscal decentralization policies. First, each of these three channels has different arrangements for determining both the total pool of available resources and its distribution geographically.

Second, the division of responsibilities that fall under each of the channels is unclear. As a result, different sub-departments of the same ministry may be funded through different channels, meaning that in states and regions, some departments have budgets via both the Union and state/region budget channels. This can lead to poor use of resources and weak accountability.

Importantly, it removes the link between the functions assigned to different levels of government and the availability of resources to carry them out. This kind of policy means that state and region budgets are manipulated and pieced together to meet a policy quota, instead of being an expression of objectives, priorities, and plans. Often this lack of connection between funding sources and the functions they support results in subnational governments being assigned insufficient resources.

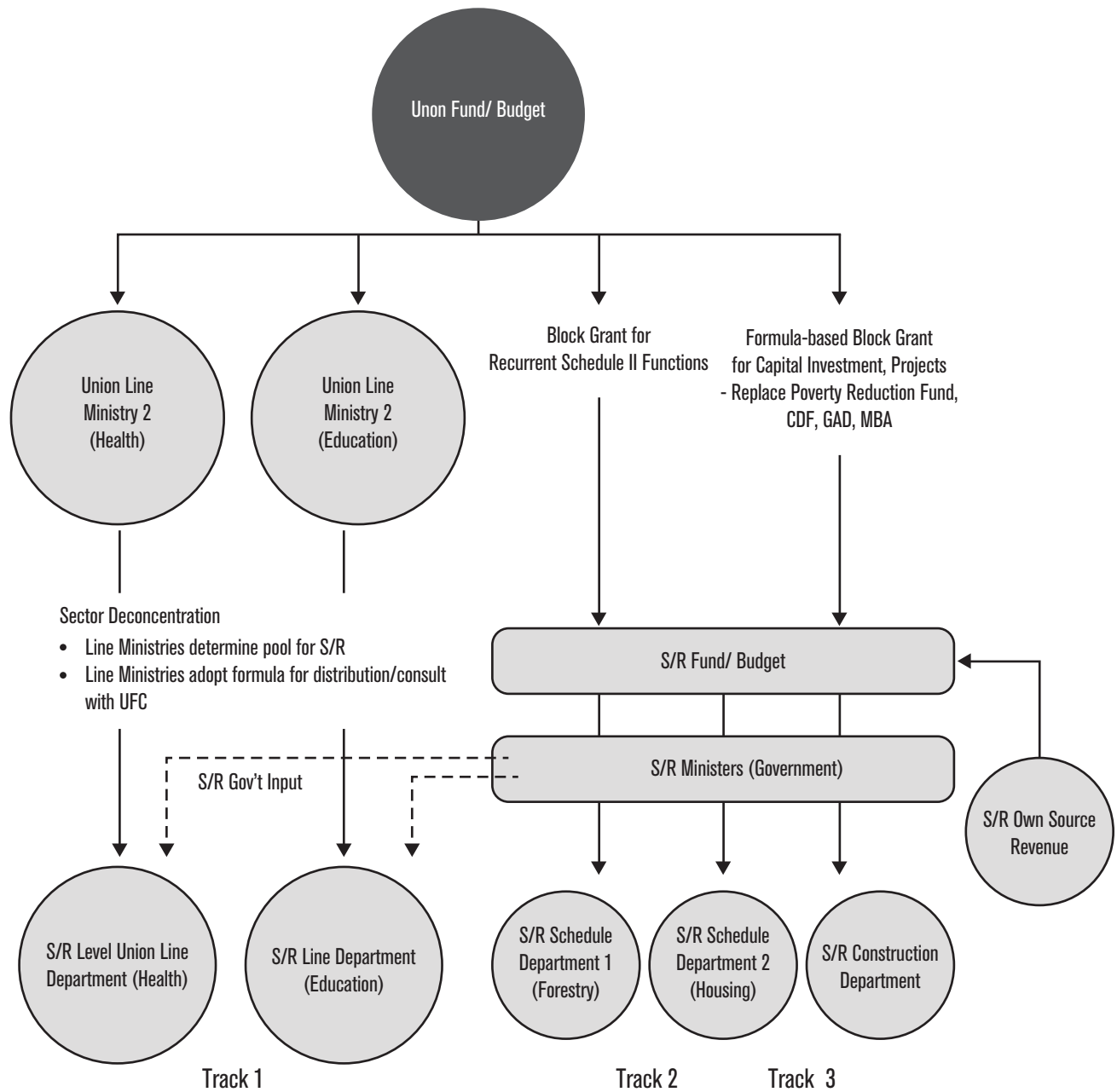
An opposite risk may be emerging in Myanmar: given the limited expenditure responsibilities currently *devolved* to state and region control, further increases in the state and region budgets may take resources away from essential social and economic services that are in the Union budget. Without costing the actual functions under state and region control, it is possible that the budget-share approach to fiscal decentralization currently used will *overfund* a narrow range of local

services, while creating shortages and potentially larger deficits at the national level.

This briefing paper proposes an incremental fiscal decentralization reform strategy with three reform

tracks corresponding with the three channels of resource flows. Figure 2 illustrates this hybrid fiscal structure, using a few sample departments and ministries.

Figure 2: Three reform tracks



2.3 Sketching Myanmar's fiscal decentralization roadmap

The main thrust of Myanmar's fiscal decentralization policy up to this point has been to increase the share of national expenditure included in state and region budgets. This type of top-down, directive policy is quite common around the world, but is inadequate in two ways.

First, it focuses attention mostly on one level of governance, the state and region, but does not yet address the central systems for determining *why* the center should devolve a certain share of the budget, or *how* that share should be divided among different states and regions. Second, it only focuses on one or two of the channels between the center and state/region level – the channel of devolved funds in the state/region budget for their limited functions, and the provision of capital investment through the various local development funds.

This section briefly outlines initial steps for a fiscal decentralization roadmap that builds on the existing channels. At the same time, because of the open-ended nature of the evolving political dimensions of Myanmar's reform environment – notably the peace process – these approaches must not close off too many options for more substantial or dramatic reforms in the future.

Channel 1: Strengthening sectoral decentralization

A vertical deconcentration process for important sectors in Channel 1 has already begun. These steps represent important advances in decentralizing service delivery. However, they do not yet form a systematic and transparent framework for allocating resources across the country. An incremental fiscal decentralization strategy should build upon them through a more systematic approach to the deconcentration of functions, providing the resources to fund them (vertical fiscal balance), and distributing these resources across the

country in line with policy objectives (horizontal fiscal balance). Box 1 provides an example of deconcentration in education.

Box 1: Deconcentration in the education sector

The capital budget for education has been deconcentrated. The procurement and management of school construction is now with the state/region education office, and they work through the state/region government procurement board to select construction contractors, and involve the township education department in supervision.¹³ However, these budget-execution responsibilities do not correspond to decision-making power over the numbers or types of school construction projects, or their locations. Bottom-up input is sought from township offices, and education officers reported that it has some impact on decisions. But they also reported

that poor siting of projects, and the selection of new construction over their recommendations for refurbishment of unsafe or overcrowded schools, were still weaknesses in translating bottom-up input into real planning results.¹⁴

Other sources of capital spending in education include projects supported by local development funds. These projects are difficult to coordinate with the Union ministry's sector spending, since project selection does not take place until well into the year, leaving little opportunity to create a consolidated list of projects prior to submitting the ministry or state/region budgets.

Once ministries have a clear, sequenced plan for deconcentration of functions, and norms for costing, planning, and budgeting those functions, they can rationally allocate resources among their administrative units. At the same time, in line with the notion of

¹³ Interviews, region education officer (January 2014) and township education officer (March 2014).

¹⁴ Interview, township education officer (March 2014).

“people-centered development,” many ministries have tried to gather more planning information and priorities from subnational units. However, to implement decentralization of planning or budgeting, the line ministry needs to provide budget estimates for deconcentrated functions and activities to its state/region departments. This needs to happen early enough in the budget preparation cycle for the local department to plan its activities within those constraints, and to consult and coordinate at the subnational level. This allows for a more meaningful role for state/region governments in planning and implementation, and provides a more effective way to connect the bottom-up information being gathered by ministries with the top-down budgeting process.

For the budget formulation process to be successful, there are several prerequisites. Crucially, the budget classification system must be adjusted to allow state/region departments to be designated as budget units within the Union budget for these line ministries. In turn, this enables a more transparent allocation of funds by state/region level. Since important public financial management changes, such as budget classification and the timing of the Union budget preparation calendar and procedures, would require joint action by several ministries, there is a pressing need for policy coordination on fiscal decentralization.

Finally, successful deconcentration can help prepare the ground for more democratically decentralized public services in the future, whether through broadened devolution or more federal arrangements. At the Union level, introducing the planning tools to effectively cost and equitably distribute resources is also an important precursor to the kinds of transfers and block grants required to support a system where more services are devolved to state/region and local governments. This kind of preparation for planning and budgeting through deconcentrated delivery is seen as contributing to the success of Indonesia’s decentralization reforms.¹⁵

Channel 2: Rationalizing state and region budgets

Subnational budgets in Myanmar have three broad sources of revenue: aid from the Union government to the various state and region departments, several mechanisms for delivering discretionary funds for local development and infrastructure initiatives, and own-source revenues from a range of taxes and fees collected through several departments.

The size of aid flows to state/region departments from the Union is currently based on the deficit between departments’ revenue and expenditure, or *ad hoc* negotiations with the central level. This method of budget preparation results in inequitable budgets that mirror *current* rates of spending, not what spending *should be* to carry out assigned responsibilities. When the difference between state/region revenues and expenditures are the main determinant of the levels of transfers, states/regions and other local governments do not have an incentive to improve revenue collection. If local departments show more own-source revenue in their budget submission, it is likely that this will result in a lower level of transfer, or at least a lower rate of increase. Analysis of budget expenditure between 2012-13 and 2013-14 shows that states and regions are receiving larger budgets, but are also more dependent on Union transfers.

Channel 3: Allocating subnational development funds

Since 2011, Myanmar has introduced a number of overlapping committees and subnational development funds broadly aimed at poverty alleviation and local development through increased discretionary resources and “bottom-up” planning. Three of the key funds are the Poverty Reduction Fund, which is the principle subnational development fund provided by the Union government; the Constituency Development Fund, which provides budget for local development under the guidance of state/region *hluttaw* representatives; and the

¹⁵ Bahl and Martinez-Vazquez, *Sequencing Fiscal Decentralization*, 5-6.

six-year Myanmar National Community Driven Development Project, funded by the World Bank and supplemented by the government.¹⁶

These funds and their budgeting arrangements operate through various committees at township and village level to support bottom-up planning.

Different fund structures, and the proliferating committees that have grown up to ensure local participation, carry overlapping objectives and mandates, which makes coordination difficult and risks poor targeting of resources. The complex and varied allocation procedures mean that the overall effect of these flows on the horizontal distribution of resources across the country may be difficult to discern. At a time when Myanmar should be aiming for greater budget integration, there is considerable budget fragmentation occurring. There is a need to consider ways to better integrate both the ordinary state/region budgets and the various sources of development funds.

2.4 Managing Myanmar's fiscal decentralization

The three-track strategy

Based on this analysis of Myanmar's current political, institutional, and fiscal realities and international and theoretical lessons, this section suggests an incremental fiscal decentralization reform strategy with three reform tracks, corresponding to the major existing channels of subnational resource flows to states and regions.

The first track consists of a framework for sectoral deconcentration, built on a systematic analysis and adjustment of functional assignments. This is followed by the introduction of sector budgeting formulae to improve subnational budget allocations within major line ministries. The process must run in parallel with changes to budget preparation and presentation, to allow ceilings and final allocations to state/region departments to be transparent within the Union budget, and to allow line ministries to provide budget ceilings

for deconcentrated functions and activities to their state and region departments.

The second and third tracks involve rationalizing preparation of state/region budgets through the development of a more integrated transfer system.

Towards a state/region transfer system

Alongside the process of sectoral deconcentration, Myanmar should move towards a system of transfers that works to meet the objectives of the government for its devolved activities in the second and third channels. The immediate priority is to move from the current system of budgeting for state/region transfers to one that rationalizes (1) the vertical balance of resources between levels, (2) the horizontal balance across the country, and (3) the incentives for own-source revenue collection, while (4) not overwhelming fiscal or implementation capacity in weak or small states and regions. Strengthening revenue capacity is essential for subnational governments to avoid being simply a "spending agent" for the center, and to develop a more permanent balance between revenues and expenditure assignments, with resulting improvements in discretion, autonomy, and accountability.¹⁷ An additional objective of the system may be to enhance the coordination of the ordinary and development/capital sides of the budget.

The most appropriate way to accomplish these objectives is to carefully develop a formula-based system for transfers for some, if not all, state- and region-level resources and development funds. In Cambodia, comparison of the horizontal imbalance among communes, which receive a formula-based allocation, and provinces, which undertake a budget process similar to that in Myanmar, confirms that "basic formula-driven approaches that take some account of capacities and needs will lead to more efficient and fairer outcomes than will bargaining between subnational administrations and officials of the central government."¹⁸

¹⁶ These funds and other LDFs are outlined in more detail in Bart Robertson and Cindy Joelene, *Local Development Funds in Myanmar* (Yangon: MDRI-CESD and The Asia Foundation, 2015).

¹⁷ Bahl and Martinez-Vazquez, *Sequencing Fiscal Decentralization*, 22.

¹⁸ Niazi, *Deconcentration and Decentralization Reforms in Cambodia*, 51.

The transparency created by this process can be politically useful as well. In Tanzania, one reason for the introduction of a formula-based transfer system was to clarify to members of parliament the criteria for distribution of revenues among local governments.¹⁹

The first and most important step in developing such a transfer system is to consider carefully the objectives of the system as a whole, and of the individual transfers that make it up. One advantage of introducing formula-based transfers is that their impact on budget outcomes can be *simulated* before any implementation needs to take place. Appropriate measures can then be designed to deal with transitional issues such as the reallocation of existing resources between territories.

In the case of Myanmar's system of transfers to states and regions, some significant decisions are: (1) whether to treat the ordinary state and region budget on a conditional or unconditional basis; (2) how to integrate the various development funds with each other and with the recurrent budget; (3) how to encourage own-source revenue generation; and (4) how to encourage coordination with the separate channel of deconcentrated sectoral services. For Myanmar, a tentative transfer system proposal for state and region transfers might include:

- an unconditional block grant for ordinary functions assigned to that level, possibly with either a matching or mildly performance-based component aimed at improving planning and revenue performance relative to local capacity and conflict sensitivities;
- an additional unconditional grant aggregating the Poverty Reduction Fund and, if politically feasible, the Constituency Development Fund, but with guidelines for coordination with deconcentrated sector services;
- a possible general-purpose grant for equalization, compensation, or derivation based on natural resource revenues.

Policy coordination

Coordinating and eventually integrating these three tracks is a massive policy task, but there is currently no clear policy home for this activity within the Myanmar government. Decentralization can demonstrate benefits quickly – for example, through local development projects and new staff in sector departments – but it is not a “quick win” reform. It requires a consistent and clear effort to establish objectives, coordinate stakeholders, and develop and implement overarching policies. There is an urgent need for a national policy coordination capacity. Additionally, the policy coordination mechanism needs to balance the requirements of political decision-making and support for sound technical analysis and policy development. As decentralization is a crosscutting issue that influences public financial management of all kinds, it needs the participation of all key budgetary institutions.

A high political body such as a national commission or secretariat is likely to suit Myanmar's context, where political decentralization leads administrative and fiscal dimensions, and there are pending, high-level questions about the Constitution, the peace process, and natural resources. This body could oversee and coordinate decentralization, balancing political decision-making with technical analysis and policymaking. Lessons from other countries suggest that these should be permanent bodies with a limited membership, but include the minister of finance, the minister of interior, or equivalent; representatives of local governments; and more independent advisory members from academia, civil society, and the private sector.²⁰

In addition to a higher-level body to guide policy with wider participation, the current constitutionally mandated Financial Commission should be given – through law in accordance with the Constitution – a policy role to design the fiscal frameworks for deconcentration and devolution. The Commission should move from being a forum for inter-governmental

¹⁹ Bahl and Martinez-Vazquez, *Sequencing Fiscal Decentralization*, 9.

²⁰ Jesper Steffensen, *Fiscal Decentralization and Sector Funding Principles and Practices* (Danish International Development Agency, 2010), 33; Roy Kelly, unpublished presentation, Duke University (August 2008).

bargaining to being a policy-setting body for the transfer system. To do so would require substantial investment in a technical secretariat, and legislative requirements for it to consult widely within and beyond government.

Finally, Myanmar can strengthen its decentralization process in an incremental way, while also working towards resolution of a longer-term vision. In this sense, the policy coordination institutions do not need to start by determining everything as in the textbook models, but it will be crucial to form appropriate coordinating institutions and a policy process to manage these evolving fiscal decentralization reforms.

THREE: POLICY CONSIDERATIONS

Fiscal decentralization forms the backbone of Myanmar's efforts to strengthen public services, encourage development across the country, and secure peace and stability. This briefing paper has outlined a proposed incremental reform strategy, but crucially, it has emphasized that whatever fiscal decentralization reforms Myanmar pursues, it is vital that these reforms be considered within the political context. Successful decentralization reforms entail aligning decentralization strategy with political drivers for decentralizing, the institutional starting points, and the capacity of the existing system. Whilst Myanmar has a long way to go, its current political and reform environment presents great opportunities due to the strong incentives for reform to succeed. It will be important for stakeholders to capitalize on this political momentum for reform, while applying caution in areas of contested governance. Policymakers involved in Myanmar's fiscal decentralization reforms across the three channels of fiscal resource flows will need to address the following issues.

Decentralization and the peace process: Improving current fiscal institutions will require a clarification of policy goals of the intergovernmental fiscal system as a whole. Progress in the peace process will shape the answers to key questions that have not yet been addressed, such as *why* the center should devolve a

certain share of the budget, or *how* that share should be divided among different states and regions. These questions and answers will need to be considered in the context of the current Constitution – as well as constitutional review, a new government, the peace process, and ongoing political and economic reforms. Many of the issues involved are central to Myanmar's conflict dynamics; therefore, this process must include the national government, military, state and region governments, ethnic and regional parties, and EAGs. For example, the scope of the functions for states and regions as set out in the Constitution's Schedule Two are narrow and likely to require a review involving a wide range of stakeholders.

The urgent need for national policy coordination:

There is an urgent need for a national policy coordination capacity that has so far not been exercised. The challenge for Myanmar is to ensure that political and technical aspects of decentralized governance work together. The most important recommendations of this paper, therefore, are about not just a specific decentralization proposal, but rather the need to form coordinating institutions and a policy process to manage these evolving fiscal reforms. Myanmar has an opportunity to strengthen its decentralization process in an incremental way, while also working toward a longer-term vision.

Capacity building: The gradual decentralization proposed allows time for simultaneous capacity building linked to specific reforms, which together should limit some of the fiduciary and capacity risks. For example, the introduction of a transfer system to states and regions would likely require support at the Union level to introduce the planning and design tools to effectively cost and equitably distribute resources, and technical support for the Financial Commission to carry out its increased responsibilities as proposed. At the state and region level, increased autonomy through the second and third tracks will likely demand additional support in planning, budgeting, and monitoring capacities of local governments and administrations. However, reforms must be undertaken with caution and sensitivity in areas where governance authority over public services is still contested.

Increased fiscal autonomy: The development of more predictable, transparent, and rule-based intergovernmental fiscal institutions can go a long way towards strengthening fiscal autonomy and more clearly defining relations between the center, and states and regions. A key component of increased fiscal autonomy will be strengthening tax policy and administration at the state and region level, as well as wealth-sharing

arrangements.

Foreign financial flows: Private-sector investment, international aid, and loans play a key role in financial flows to states and regions. Policies could be considered that would permit, but regulate, states and regions in directly accessing these funds.

FOUR : KEY QUESTIONS AND FURTHER READING

Discussion Questions

- In designing transfers from the Union to states and regions, what functions should be financed and why? What policy and equity goals are important to consider?
- In a more decentralized system, how could health and education services be financed in areas where governance authority over public services is contested? Where sector budgets are deconcentrated, how can respect for local autonomy and ethno-religious diversity be ensured?
- In designing an appropriate system of transfers to states and regions, what measures can be taken to incentivize revenue mobilization in states and regions, while simultaneously not overwhelming fiscal or implementation capacity? What special considerations would be required in areas where EAGs operate?
- What conditions would encourage, and what mechanisms should be in place, to support greater citizen engagement in local governance and better local governance performance?
- Would a high-level political body be the most suitable option to coordinate and steer decentralization in the context of ongoing reforms and the peace process in Myanmar? If so, what would its role be, and whom would such a body comprise?
- What policies should be in place to manage foreign financial flows, including investment, aid, and potentially loans, in order to permit, but regulate, states and regions directly accessing such funds? What special considerations would be needed in areas where EAGs operate?

Further Reading

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