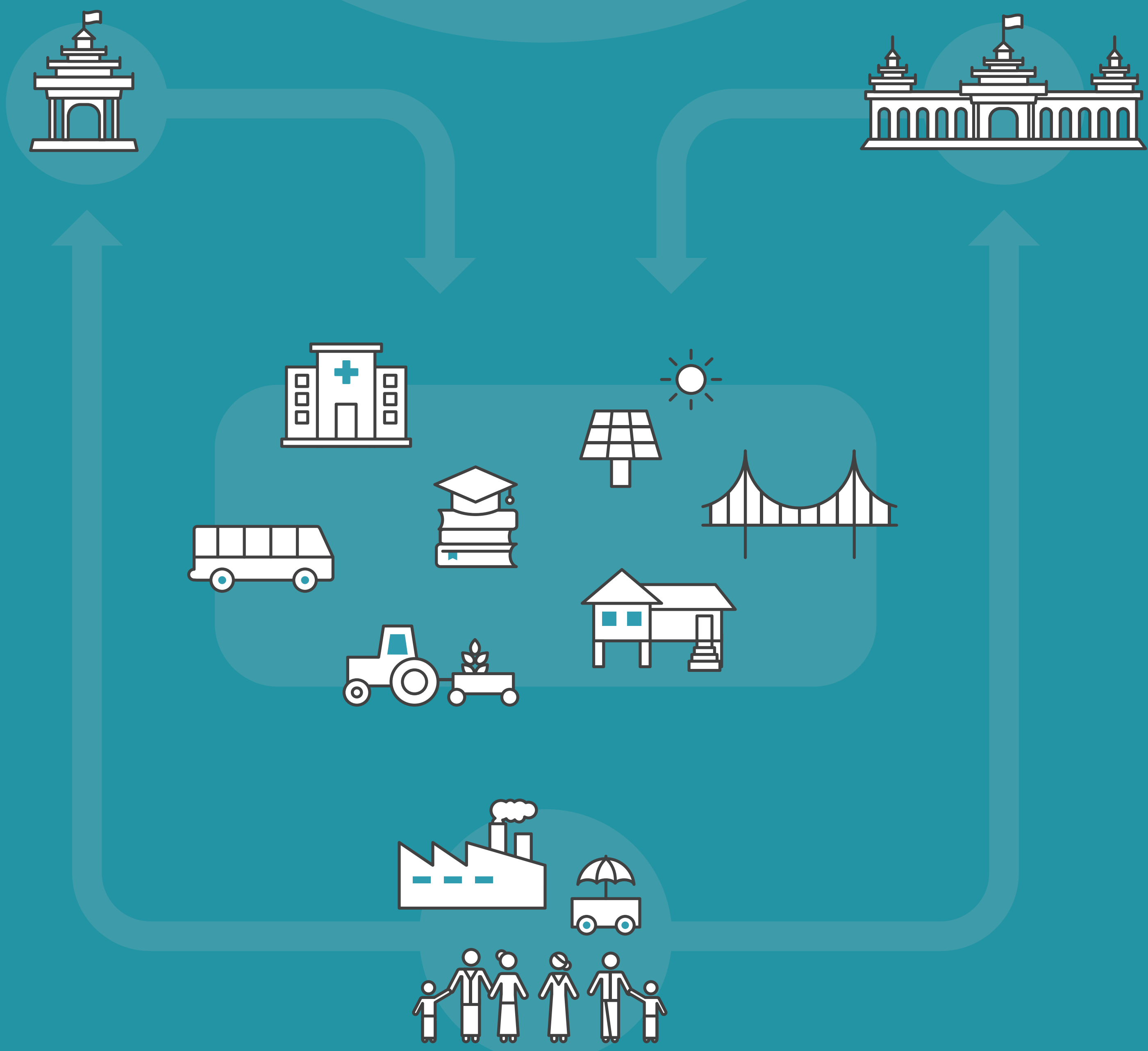
FINANCING LOCAL DEVELOPMENT IN MYANMAR

ARRANGEMENTS, OUTCOMES & OPTIONS FOR IMPROVEMENT

NOVEMBER 2019



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ACKNOWLEDGEMENTS

The author and the research team would like to thank everyone who contributed to this study including respondents from government, civil society, donors, NGOs, and national and international experts, who took time to meet and share their experiences. Special thanks are accorded to the Department of Rural Development for their support, and to many government officials in Kayin, Rakhine and Chin states who generously gave their time. Thanks also to the World Bank staff for their continued support throughout the study.

The author would also like to acknowledge those who reviewed the report for providing invaluable feedback and advice, including the World Bank staff and other reviewers with knowledge of Myanmar's subnational governance system and associated financing arrangements, as well as to Matthew Arnold and Diana Fernandez of The Asia Foundation for their support and guidance throughout the research and writing. Finally, a special note of appreciation to the team of fellow researchers - and especially to Richard Batcheler - for their patient support through the lengthy fieldwork, data analysis and report drafting. Responsibility for any errors of fact, analysis or judgement rests solely with the author.

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PREFACE

How governments finance local development spending for the delivery of local public goods and services is of great importance. This is especially true in Myanmar where it is critically important that actors within and outside government support efficient, equitable and transparent allocation of the government's scare budgetary resources, as the country continues its transition to democracy and greater economic development. We have, however, found a shortage of accessible information on financing arrangements and local budgets, and of decision processes underlying these, in our fieldwork.

In October 2018, The Asia Foundation published a new edition of its *State and Region Government in Myanmar* report. It provided a much-needed update on the structure and functions of subnational governance in Myanmar, identifying the key political, administrative, and fiscal opportunities and challenges presented by decentralization. The report highlighted developments in budgeting and planning processes, including renewed efforts to move towards a "bottom-up" planning process, and recommended the strengthening of public-expenditure management, budgeting, and resource allocation, to ensure greater accountability and responsiveness in decision making.

This report is a companion report, looking in greater detail at how the financing arrangements for local public investment and service delivery in Myanmar occur in practice, and exploring differences among state/regions and between sectors. The research draws from new fieldwork carried out in three states over three months in early 2019, which sought to understand the financing arrangements for sub-national spending, and from analysis of detailed budget data generously provided by state and region authorities. The research also builds on the considerable body of evidence in the reports published by The Asia Foundation and benefits from the experience of the **Accountable and Inclusive States and Regions Program**. This was implemented by The Asia Foundation in partnership with the Renaissance Institute, which provides ongoing technical support to state and region governments, particularly in relation to public financial management and municipal governance. The report aims to make this critical subject accessible to the general reader and, in doing so, pave the way for a better informed, more technically grounded debate on the financing of local development in Myanmar. The report also provides clear, implementable recommendations for all stakeholders in the financing of local plans and budgets, aimed at ensuring more effective, efficient, equitable and transparent local public spending.

The report was generously financed by The World Bank with a grant from the Myanmar Multi-Donor Trust Fund provided by the United Kingdom's Department for International Development (DfID). However, neither The Asia Foundation, nor the World Bank nor DfID necessarily subscribe to the analysis, conclusions or recommendations of this report, which remain those of the author.

We hope that *Financing Local Development in Myanmar* provides a reference source for all stakeholders and stimulates discussion about future directions for local development policies and strategies in Myanmar.

Dr. Matthew B. Arnold
Country Representative

The Asia Foundation, Myanmar
Yangon, November 2019

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ABBREVIATIONS AND ACRONYMS

CDC	City Development Committee
CDD	Community-Driven Development
CDF	Constituency Development Fund
DAO	Development Affairs Organisation
DBE	Department of Basic Education
DDA	Department of Development Affairs
DoB	Department of Budget
DoH	Department of Highways
DoP	Department of Planning
DRD	Department of Rural Development
DRRD	Department of Rural Road Development
ESE	Electricity Supply Enterprise
GAD	General Administration Department
GDP	Gross Domestic Product
IFRD	Intergovernmental Fiscal Relations Division
IRD	Internal Revenue Department
JICA	Japan International Cooperation Agency
MCDC	Mandalay City Development Committee
MDRI-CESD	Myanmar Development Research Institute – Centre for Economic and Social Development
MEB	Myanmar Economic Bank
MIMU	Myanmar Information Management Unit
MMK	Myanmar Kyat (national currency)
MOALI	Ministry of Agriculture, Livestock and Irrigation
MOBA	Ministry of Border Affairs
MOC	Ministry of Construction
MOE	Ministry of Education
MOEE	Ministry of Electricity and Energy
MOH	Ministry of Health and Sports
MOHA	Ministry of Home Affairs
MONREC	Ministry of Natural Resources and Environmental Conservation
MoPF	Ministry of Planning & Finance
MP	Member of Parliament
MSDP	Myanmar Sustainable Development Plan
MTFF	Medium-Term Fiscal Framework
NRGI	Natural Resource Governance Institute
NCDDP	National Community-Driven Development Project
NLD	National League for Democracy
PFM	Public Financial Management
PRF	Poverty Reduction Fund
RDF	Rural Development Fund
RHC	Rural Health Centre
SDC	Swiss Agency for Development Cooperation
SOE	State-Owned Enterprise
TA	Township Administrator
TDI	Township Development Indicators
TDLGP	Township Democratic and Local Governance Project
TEO	Township Education Officer
TPIC	Township Planning and Implementation Committee
UNDP	United Nations Development Programme
USDP	Union Solidarity and Development Party
V	Village
VDP	Village Development Plan
VIP	Very Important Person
VNG	Vereniging van Nederlandse Gemeenten (Association of Netherlands Municipalities)
VT	Village Tract
VTA	Village Tract Administrator
WA	Ward Administrator
WB	World Bank
YCDC	Yangon City Development Committee

EXECUTIVE SUMMARY

WHY ARE LOCAL FINANCING ARRANGEMENTS IN MYANMAR IMPORTANT?

Progress toward achieving many of the goals under the five pillars of the Myanmar Sustainable Development Plan (MSDP) is closely linked to the quality of government spending on local infrastructure and services. In order to achieve these goals, this spending needs to be:

- Effective: both adequate and aligned to the varying needs and priorities of different localities.
- Efficient: making best use of scarce budgetary resources to maximum output and impact.
- Equitable: allocated across both communities and territorial jurisdictions in a manner that is fair, and which responds to varying local needs and resources.
- Sustainable: kept at consistent annual levels, and ensures that assets created are operated and maintained to generate services and benefits over the long term.
- Transparent and accountable: budget allocation decisions should be clear to all and not arbitrary.

Achieving the necessary quality of spending along these dimensions depends on many factors – the quality of general governance and the quality of public financial management, but also critically depends on the nature of the mechanisms in place to finance local spending.

This report therefore: examines the arrangements for this financing, and their practical consequences for government spending at state/region and township levels; identifies any current or potential future problems in these arrangements; and suggests areas where improvements and reforms might be made.

To understand how local development spending is financed, field research was carried out over a period of three months in 10 townships across three states (Chin, Kayin and Rakhine). Additionally, interviews were held in Nay Pyi Taw to understand how financing decisions regarding local development spending are made at the Union level. To understand how financing arrangements vary by type of expenditure, the field research focussed on four sectors: education, electricity, roads, and rural development, and their responsible departments. To complement the field research, quantitative analysis of financing and budget data for both Union and state/region budgets and for a sample of 24 township ‘plans’ was also completed.

BOX A
Local development spending

Reference is made to the term “local development” financing or spending throughout this report – this shorthand refers to *capital budget* spending by those departments most concerned with the provision of *local social and economic infrastructure and services*, but excludes those related to the local administration. Focus on the capital budget is also a reflection of the much greater availability of financing and budget data on the capital budget at local level. This, in no way, seeks to undervalue the importance of current budget spending, for maintaining the local administration and for ensuring local service delivery, especially in the social sectors.

TABLE 1 Union and state/region de facto departmental spending responsibilities for local development

Ministry/Department/Organization	State/Region budget	Union budget
State/Region government bodies		
Cabinet – range of local development spending	✓	
Hluttaw	✓	
Ministries, Departments & Other		
Ministry of Home Affairs		
General Administration Department	✓	
Ministry of Border Affairs		
Department of Development for Border Areas – range of local development spending	✓	✓
Education and Training Department	✓	✓
Ministry of Agriculture, Livestock and Irrigation		
Water Resources Utilization Department	✓	
Department of Industrial Crop Development	✓	
Agricultural Department	✓	✓
Fisheries Department	✓	✓
Livestock Breeding and Veterinary Department	✓	✓
Department of Rural Development		✓
Cooperative Department	✓	
Department of Small Industry	✓	
Ministry of Natural Resources and Environmental Conservation		
Forest Department	✓	
Department of Environmental Conservation	✓	
Ministry of Electricity and Energy		
Electricity Supply Enterprise	✓ (<33 kV)	✓ (>33 kV)
Ministry of Education		
Department of Basic Education		✓
Department of Higher Education		✓
Universities and Technical Colleges		✓
Ministry of Health and Sport		
Department of Public Health		✓
Department of Medical Service		✓
Staff Training Schools		✓
Department of Sports and Physical Education	✓	
Ministry of Construction		
Department of Rural/Urban and Housing Department	✓	
Department of Highways	✓	✓
Department of Bridges	✓ (minor, simpler bridges)	✓ (longer, technically complex bridges)
Department of Rural Road Development	✓ (class A rural roads and culverts)	✓ (classes B & C rural roads and culverts)
Ministry of Social Welfare, Relief and Resettlement		
Department of Social Welfare		✓
Department of Disaster Management		✓
Department of Rehabilitation		✓
Department of Development Affairs		
Development Affairs Organizations (DAOs)	✓	

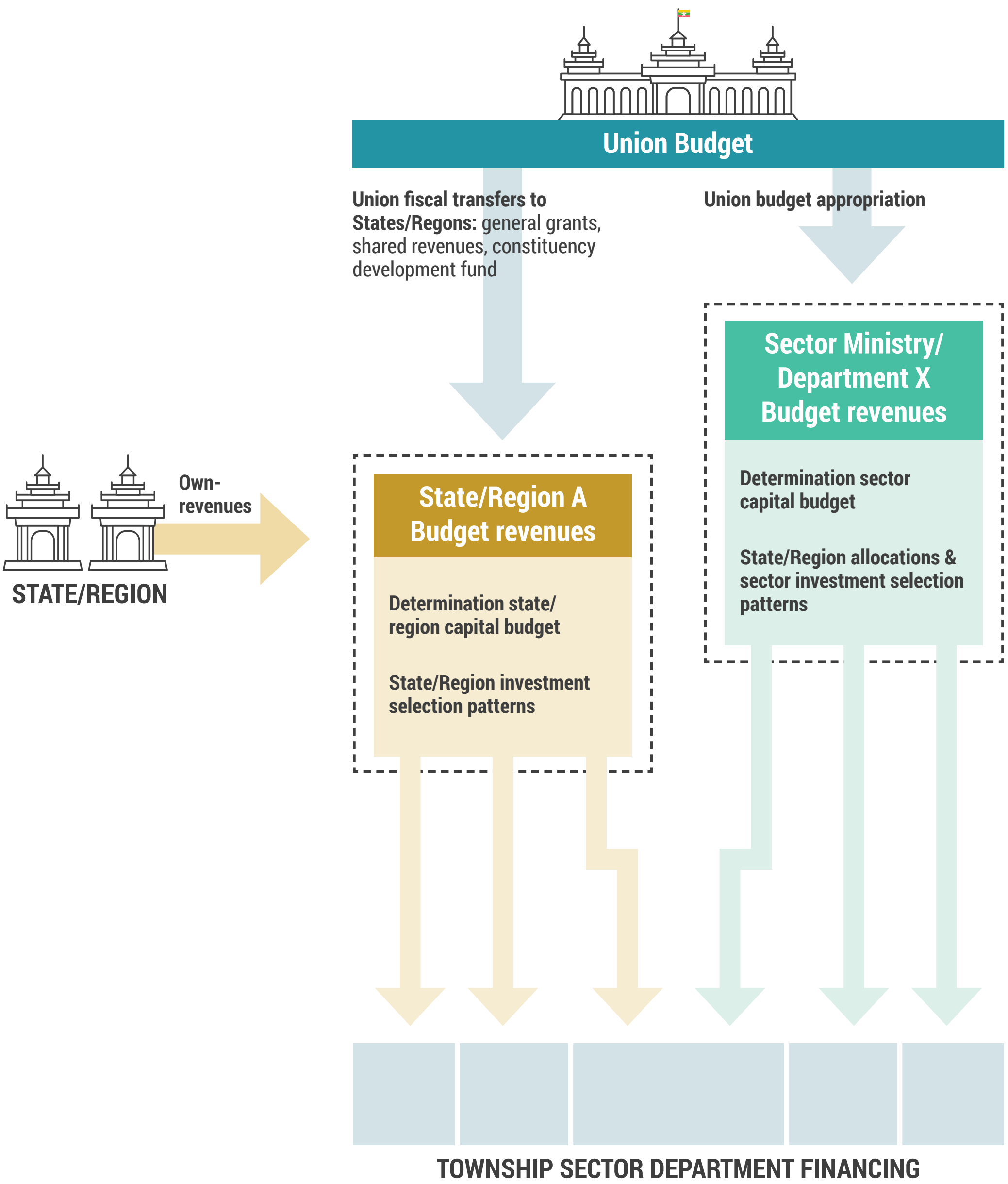
UNDERSTANDING LOCAL DEVELOPMENT FINANCING ARRANGEMENTS

OVERVIEW

Government spending at the local level can only be either through (a) "deconcentrated" funding by Union ministries and departments, financed from the Union budget, or (b) "devolved" funding by state/region government departments, financed from state/region budgets. There is no assigned government budget for townships, village tracts or villages.

Financing arrangements for the Union and state/region budgets reflect the assignment of spending responsibilities. The division of responsibilities between the two types of budget is partly based on Schedules 1 and 2 of the Constitution, partly on sector legislation, and partly on the configuration of departments placed under state/region control. These are not always clear, and some variations are seen across states/regions, but the overall result is a markedly-centralized arrangement – see table 1.

FIGURE 1 Local development financing – flows and determinants



- The Union budget finances all spending on national highways and on the lowest rural road tiers, the main electric grid, health and education, and most rural development, agriculture and environment-related spending.
- State/region budgets finance spending on inter-township highways and bridges, and the higher tier of rural roads, electric transmission connections from the main grid to communities and businesses, and urban infrastructure spending through the Development Affairs Organizations and City Development Committees.

Alternative financing arrangements also exist for the same types of infrastructure. For example, in addition to the usual sector departments, the Ministry of Border Affairs finances spending on rural water, schools, rural roads etc. From the state/region budgets, water, electricity, rural roads, and other investments may also be funded from the Cabinet account under the Chief Minister, while smaller investments in such sectors may be supported by the Constituency Development Fund.

DECONCENTRATED UNION BUDGET FINANCING

Union budget spending is funded from Union revenues, which constitute some 94 percent of all government revenues. Annual appropriations from the Union budget are made for each Union ministry and department from which approved spending is financed. No upfront budget allocations (in the sense of guaranteed entitlements) are made to states/regions in Union-financed sectors, and all final budget approval decisions are made in Nay Pyi Taw.

DEVOLVED STATE/REGION BUDGET FINANCING

State/region budget spending is financed by the following revenue sources:

- State/region own-revenues as laid down under Schedule 5 of the Constitution.
- General grant transfers from the Union budget.
- Shared-revenue transfers, whereby selected Union revenues (commercial, special goods, income taxes, and stamp duties) are allocated on a percentage basis with the originating states/regions.
- The Constituency Development Fund, which provides a flat transfer of MMK 100 million to each township, through the state/region budgets.

DELEGATED BUDGET MANAGEMENT

Within this framework, there are a number of arrangements for delegated budget management from both budgets – for example:

- From the state/region budgets, there is delegation of specific responsibilities for both revenue collection and budget spending in urban areas, to the Development Affairs Organizations, and the Yangon and Mandalay City Development Committees.
- From the Union budget, the Ministry of Education delegates minor spending on school operations and maintenance to school principals through the school grant mechanism, and the Department of Rural Development delegates management of some community development spending under various rural development programs to village committee members.

STATE AND REGION FINANCING IN PRACTICE

COMPOSITION OF REVENUES

State/region own-revenues – outside Yangon – are relatively modest and dominated by revenues accruing to the Development Affairs Organizations and City Development Committees.

Fiscal transfers – and especially the general grant transfers – now dominate state/region revenues, having grown hugely in recent years. There are two main types: (a) shared revenues, which are allocated by area of collection, and hence mainly accrue to Yangon; and (b) the much larger general grant transfers, which are now allocated by formula, although this is only applied to the amount added to the transfer pool each year, and not to the pool as a whole.

In principle, states/regions may borrow, subject to Union approval, but to date, the only such borrowing appears to be by the respective Yangon and Mandalay City Development Committee for donor-supported infrastructure loans. There are, however, instances of Union government on-lending for mainly urban investments funded by donors, which state/region governments have pledged to reimburse.

REVENUE PATTERNS EMERGING

There are marked disparities when state/region revenues are translated into per capita terms. For example, 2018/19 Chin total revenues per capita were MMK 302,000 – more than 11 times those for Ayeyarwaddy (MMK 25,000).

There are understandable disparities in own-revenues and in the shared-revenue transfers, with Yangon enjoying the bulk of these. However, these disparities are outweighed by the allocation of the general grant transfer, which introduces different and much greater disparities. This is due to two factors: (a) the structure of the allocation formula; and (b) especially, the fact that this formula has only been applied to increments in the general grant pool after 2015/2016 – as such, inequities embedded in previous patterns still carry through.

While there are always sound reasons to adjust fiscal allocations between geographic areas to cater for differing needs and fiscal constraints, the very wide disparities between states/regions in per capita resources, and the implications this has for local development spending levels, needs further analysis.

HOW FINANCING TRANSLATES INTO LOCAL DEVELOPMENT SPENDING

DETERMINING FACTORS

Local development spending levels and patterns across townships and departments are determined by several factors, including:[1]

- For state/region government spending, the levels of budgetary resources, resulting from the own-revenue and transfer flows outlined above, vary widely on a per capita basis. For Union ministry spending, the annual budget appropriations for the social sectors are enjoying annual increases, but other sectors such as rural roads are suffering a decline.
- The extent of other “prior claims” on these resources and, most importantly, the priority given to current budget spending claims for the local staff and administration, which appear to take precedence over local development budget spending.
- For state/region budgets, three factors predominate in the planning and budget prioritization processes (see figure 2): state/region strategic priorities (which tend to heavily favor strategic “modernizing” infrastructure, and also urban development); political constituency priorities of members of parliament (MPs), the chief minister and other local VIPs; and underlying this, a default bias to both ensuring that each department receives roughly similar year-to-year allocations, and to spreading resources as evenly as possible across townships (regardless of relative size or needs).
- For the Union budget, the way proposals from townships and states/regions are filtered, appraised and selected or rejected. In this process several factors come into play: the volume and quality of the proposals from the townships and states/regions; the degree of support and lobbying by MPs and other VIPs for individual proposals; the extent to which the Union department wishes to insert its own national spending priorities; and any geographic allocation criteria.

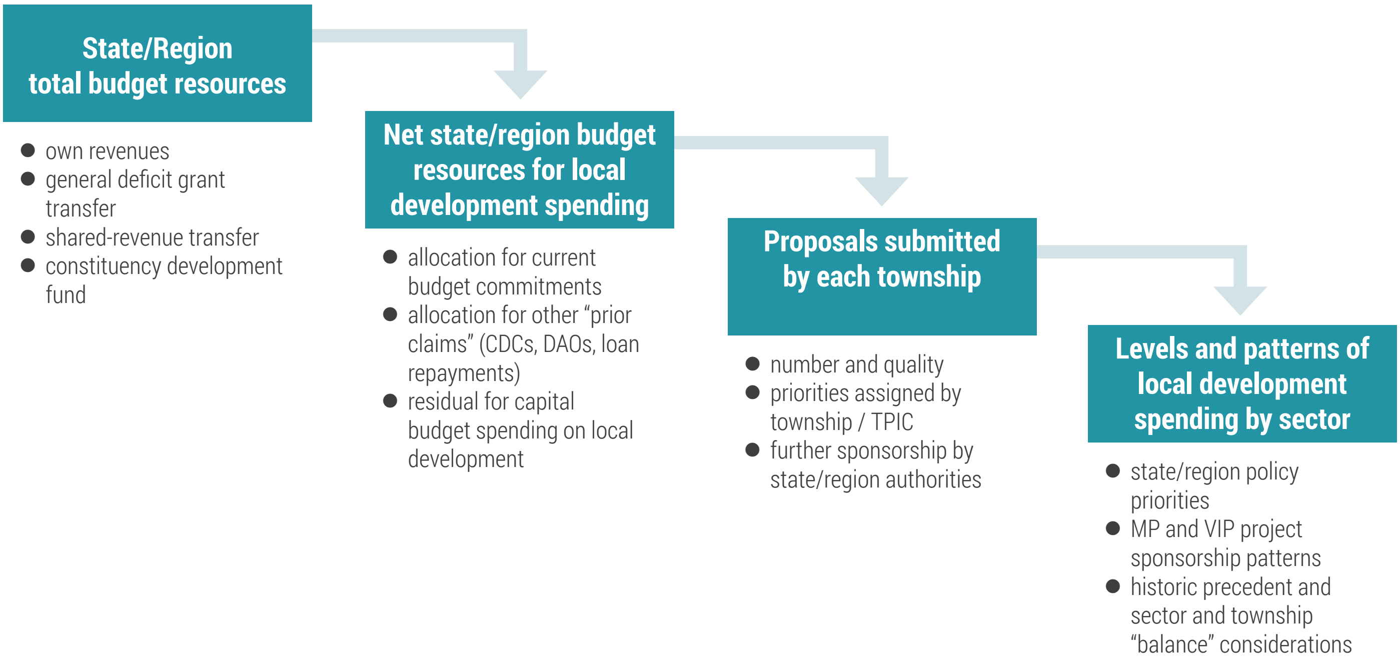
THE SPENDING OUTCOMES[2]

Overall, on average some 56 percent of township local development spending is funded from state/region budgets, and 44 percent from the Union budget. But there is considerable variance across townships as the state/region share ranges from some 30 percent to 90 percent.

Most important are comparisons between per capita spending levels. Table 2 on page 12 below summarizes the statistics by department across the sample of 24 townships. What is most striking is the variance in per capita local development spending by sector departments from both state/region and Union budgets, as seen in the ‘Min:Max’ ratios.

There is substantial variance in average levels of per capita spending by different departments across states/regions. This variance is greater for spending under state/region budgets than spending under the Union budget. There is even greater variance in levels of per capita spending across townships within states/regions. For some departments (i.e. those responsible for larger network infrastructure investments), this variance can be more easily understood, but for other departments such variance is harder to explain. For the Union budget, this suggests that Union departments and ministries make their investment approval decisions on batches of proposals from each state/region, without necessarily

FIGURE 2 Determinants of local development spending patterns from state/region budgets



applying criteria to allocations between townships within these states/regions.

Equal is not equitable: some degree of per capita variance is reasonable, and we should not expect equal per capita spending. Equity requires that spending be adjusted to reflect differing needs, access and deprivation levels, and also varying unit investment costs. However, preliminary correlations against development indices do not suggest that per capita spending patterns can be justified in this way.

ISSUES & RECOMMENDATIONS

ISSUES EMERGING

The efficiency, effectiveness and equity of spending outcomes are negatively affected by:

- The persistence of "wish list" planning and budgeting, whereby the volume of spending proposals from townships may be from 3 to 15 times more than available funding. There is little incentive or capacity to make budget priorities based on real relative needs and considerations. As a result, state/region governments and Union sector departments must screen and appraise an unmanageably large volume of proposals.
- Per capita spending levels across states/regions. This is primarily due to inequity in fiscal transfer allocations to states/regions.
- Greater variance in per capita spending across townships. For some departments (e.g. highways or electricity), such variance is understandable but for others such as the Department of Basic Education, Department of Rural Development, Development Affairs Organizations, Ministry of Livestock, Agriculture and Irrigation, etc., it is much less so.

Underlying causes of issues in the efficiency, effectiveness and equity of spending outcomes:

- Limited subnational spending responsibilities, with

TABLE 2 Variance in MMK per capita local development spending across the township sample 2018/19

	VARIANCE STATISTICS				
	AVERAGE	MEDIAN	MAX	MIN	MAX:MIN
MOALI	14,748	3,064	211,697	56	3,759:1
MONREC	419	4	2,862	0	∞
Department Rural Development	2,175	1,589	8,422	56	150:1
Department Rural Roads Development	10,062	3,790	64,319	0	∞
Department Highways	54,471	10,043	279,268	0	∞
Department Basic Education	11,703	5,479	43,919	3,753	12:1
Electricity Supply Enterprise	16,599	6,490	201,254	0	∞
DAOs	40,734	33,871	149,939	4,859	31:1
All Township Departments	169,718	70,110	712,310	15,301	47:1

decision-making for key areas of local development spending (social sectors, water, agriculture, and rural development), still retained at Union level. This is complicated by multiple spending agencies in some sectors, and several anomalies in budget-decision responsibilities.

- Weak state/region revenue-raising capacities due to multiple collecting departments and historically weak incentives for revenue raising. A further constraint lies in the apparent lack of alignment of all legal and regulatory instruments with some Schedule 5 provisions.
- The full potential of fiscal transfers to states/regions has yet to be realized in either (a) promoting geographic equity between states/regions, or (b) applying advance budget ceilings to strengthen priority-setting by departments or townships within states/regions.
- While Union ministry allocations for subnational spending are also beginning to be made on a more transparent and equitable basis to states/regions, they do not factor in relative township allocations. Allocations are not yet announced in advance to state/region departments.
- Lastly, and crucially, there is no township budget. Township departments can only submit proposals upwards, where approval is decided at the state/region capital or in Nay Pyi Taw, with little or no consultation. This lack of budget certainty undermines incentives for citizens to participate, and for the administration to make serious “budget-constrained” priorities rather than wish-lists.

RECOMMENDATIONS

To address the issues outlined above there are a number of areas where improvement or reform would be important in the near or longer term to improve the efficiency, effectiveness and equity of local development spending.

Phased decentralization of spending decisions

The 2015 amendments to Schedule 2 appear to open the door to further, phased reforms:

- In the shorter term, Union ministries could make clear advance budget allocations for specific types of spending (such as small/medium capital investments with local development impact), to their state/region departments. This would allow the latter to make their own shortlist of budget-ceiling constrained priorities, which would then be reviewed at Union level, but primarily for policy-compliance and adequacy, and consistency of documentation. This would reduce or eliminate the high and unrealistic number of proposals for the limited funding. It would require clear guidelines and capacity support to state/region departments.
- In the medium-longer term, as and when there are additional legal mandates to states/regions, this funding can be converted into sector conditional grants. The purpose of such conditional grants is to ensure that national sector policy spending priorities are being properly met in state/region budgets, which

may not be guaranteed if funding is simply provided through the unconditional general grant mechanism currently used. Over time, as capacities improve, these conditionalities can be relaxed.

Develop tools to better align financing with relative local need

There is a need to develop and refine approaches whereby Union sector departments allocate budgets geographically based on need. The output would be a set of operational tools to guide allocations across states/regions and townships, in a way that properly reflects needs and cost factors. Such tools would help improve deconcentrated financing in the short term and guide the allocation of future sector conditional grants as and when there is greater devolution in these sectors.

Consolidate fiscal transfer reforms on a phased basis

The formula for subnational fiscal transfers and its application should be reviewed. This includes the calculation of formula variables and their weighting to ensure that poverty and fiscal constraint measures are properly "normalized" by relative population, that population itself is given greater weight, and the "fiscal constraint" variables carry less weight. The variables should use the most up-to-date data. The formula should also be applied to the entire allocable pool, and shared revenues could also be factored in. These measures would help to correct the current imbalance which works strongly against the more populous states/regions and strengthen the equity of allocations. To avoid significant changes in allocations between years, which may make changes politically unfeasible, these changes could be gradually introduced on a phased basis.

For the recent revenue-sharing arrangements, in the medium-term, it is recommended that the rationale for the current sharing of selected revenues by origin be reviewed. Merging with the general grant transfer pool to be allocated by formula should be considered.

Strengthen local revenue powers and capacities

- Pre-existing legal and regulatory texts in some of the areas where Schedule 5 grants new revenue powers to states/regions need to be reviewed and harmonized. In making changes, care should be taken to ensure they do not risk major disparities in revenues emerging.
- In the medium-longer term it would be important to rationalize the multiple revenue-collection arrangements at state/region level where appropriate. This would raise efficiencies and greatly facilitate capacity-building in this area.
- Also in the medium-longer term, there is a need to review the current status of the Development Affairs Organizations (DAOs) and their current financing arrangements and prerogatives. There is also the need to address the transparency of some of the major revenues collected. There should be a review of the greatly varying subsidy arrangements funded by states/regions to DAOs and City Development Committees, to chart the implications for equity and efficiency of urban development spending.

Build the township as platform for local/community planning and budgeting

Developing the township as full budget entity and an integral layer of the overall public financial management and budget architecture will take time. In the shorter term, it should be possible to build on some of the current government-development partner initiatives in piloting a township funding model. This would entail:

- Resources to finance annual township budget allocations or grants, distributed through a simple needs-based formula, for an agreed menu of local spending (initially limited to local capital spending).
- Support for the township administrations in general, and the Township Plan Formulation and Implementation Committees (TPICs) in particular, to be able to plan, prepare and implement investment projects, and to manage these resources, and thereby begin to move away from the present wish-list planning. This will require both support to and even institutional development of the TPICs to enable them to play a more pro-active role in technically appraising and prioritizing proposals. It will also require development of institutional arrangements to engage village tracts, villages, and local communities, in these processes in ways which are feasible, cost-effective, and sustainable.
- Consider creating two windows in the township grant: one, to finance "larger, higher-order" investments that will, for example, benefit several Village Tracts (VTs) or the entire township, and a second, to allow communities, villages and VTs to make proposals for more local, "community-scale" investments – of the sort which typically emerge from participatory planning exercises. This requires very clear guidelines and procedures, and attention to transparency, to ensure the legitimacy of the approval process.

Standardizing budget report formats

The current state/region expenditure and revenue report formats need to be reviewed to ensure greater standardization and comprehensiveness of budget information, and greater clarity in the way different revenue and expenditure items are recorded.

CHAPTER 1
INTRODUCTION

1.1 WHY ARE LOCAL FINANCING ARRANGEMENTS IN MYANMAR IMPORTANT?

Progress toward achieving many of the goals under the five pillars of the Myanmar Sustainable Development Plan (MSDP) is closely linked to the quality of government spending on local infrastructure and services. In order to achieve these goals, this spending needs to be:

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- Transparent and accountable: budget allocation decisions should be clear to all and not arbitrary.

Achieving the necessary quality of spending along these dimensions depends on many factors – the quality of general governance and the quality of public financial management, but also critically depends on the nature of the mechanisms in place to finance local spending.

The financing arrangements adopted in Myanmar are not simply about providing budgetary resources to allow for this spending. They have *two further critical consequences*, especially in regard to fiscal transfer arrangements:

- They carry various incentives, very often unintended, which can shape efficiency and effectiveness in local budget priority-setting, as well as the balance between local priorities and national policy objectives, for better or for worse.
- They also can have major impact on the geographic equity of local public spending.

This report examines the arrangements in place and their impact, with special focus on development financing from the capital budget. It concludes by highlighting a series of areas where further review, reform and innovation may help promote better local development spending.

The need to strengthen budgetary decision-making has been recognized by both Union governments in power since 2011. Under President Thein Sein's Union and Solidarity Party (USDP) government and its calls for "people-centered" development, the government pursued a number of reforms such as creating local development committees and local development funds, as well as beginning a number of efforts to reform public financial management throughout government.[3] Under the National League for Democracy (NLD), the government has embraced "bottom-up" planning, whereby an increasing proportion of budget spending is based on planning proposals identified at the local township level.

The creation of elected state and region governments with their own budgets under the 2008 Constitution, which are closer to the electorate than their national counterparts, provides key opportunities for increased budget responsiveness and has created major new opportunities. Since their creation, state/region governments' budgets have tripled in size, and these governments are exercising increasing discretion in how that money is used.[4]

Clearly, the manner on which this financing is provided and allocated has major implications for the effectiveness, efficiency, equity and transparency of public spending for local development and service delivery. This report therefore aims to: examine the arrangements for this financing, and their practical consequences for government spending at state/region and township levels; identify any current or potential future problems in these arrangements; and suggest areas where improvements and reforms might be made.

1.2 WHAT IS THIS REPORT'S APPROACH?

BACKGROUND AND OBJECTIVES

In October 2018, The Asia Foundation published *State and Region Governments in Myanmar*,[5] an up-to-date assessment of subnational governance dynamics in Myanmar, which reflected on important developments since the creation of state/region governments in 2011. The report highlighted the importance of planning and budgeting processes, identified ongoing reforms, and recommended the strengthening of public-expenditure management, budgeting, and resource allocation, to ensure greater accountability and responsiveness in decision-making.

The opportunities and issues identified in the report necessitated new research with the objectives of: understanding better the arrangements for financing local plans and budgets, and any differences among state/regions, and among different sectors; documenting the outcomes of these arrangements; and identifying options for improving these arrangements to ensure better outcomes. The research is a public resource intended to contribute to improving knowledge, dialogue, and policymaking for all actors in Myanmar's transition.

This report serves as a companion report to *Where Top-Down Meets Bottom-Up*[6] from The Asia Foundation, which details the planning and budgeting processes underlying local development spending.

REPORT METHODOLOGY

To understand how local development spending is financed, field research was carried out over a period of three months in 10 townships across three states (Chin, Kayin and Rakhine).[7] These states were selected, in part, because they face some of the starkest development needs in Myanmar, but also to ensure a comparison among areas with differing populations, geography, conflict histories, and governance issues. Additionally, interviews were held in Nay Pyi Taw to understand how financing decisions regarding local development spending are made at the Union level.

To understand how financing arrangements vary by type of expenditure, the field research focused on four sectors: education, electricity, roads, and rural development, and their responsible departments. These sectors were chosen as they are some of the key priorities of the Union and state/region governments and receive a significant proportion of government spending from government budgets, and because the departments reflect varying levels of accountability to the state/region governments. To provide insights into these sectors, the focus of field work was on the following departments: Department of Basic Education (DBE) for the education sector, the Electricity Supply Enterprise (ESE) for the electricity sector, both Department of Highways (DoH) and Department of Rural Roads Development (DRRD)[8] for the roads sector, and the Department of Rural Development (DRD) for the rural development sector. In addition to these sector departments, research included

BOX B
What are the report's key questions?

The research was guided by the following three key questions:

1. What is the constitutional, legal and institutional framework for financing local development spending priorities emerging from planning and budgeting processes, and how do they work out in practice?
2. What are the outcomes of these arrangements in the manner in which local public spending is financed, and how do they vary among states and regions, and among sectors?
3. What challenges and opportunities are there to improve the way local development spending is financed?

Planning and Budget departments, given their centrality in the financing, planning and budgeting processes, as well as less extensive engagement with a range of other sectors, including health and development (municipal) affairs.

The field research comprised semi-structured interviews with a broad range of stakeholders, 192 in total, including state/region ministers, state/region hluttaw[9] members, department officials at township, district, state/region and Union levels, and representatives of civil society organizations and non-governmental organizations. Interviews were guided by questions about the roles, functions, steps, challenges and opportunities that shape the way local development spending is financed. Policy dialogues were held in Chin, Kayin and Rakhine states, which were attended by a range of stakeholders within government, 127 in total, with responsibilities in financing, planning and budgeting across the target sectors. A table detailing the interviews and policy dialogues conducted in support of the research is available in Annex A.

To complement the field research, quantitative analysis of financing and budget data for both Union and state/region budgets and for a sample of 24 township 'plans' was also completed. To that end, all 14 state/region Departments of Budget (DoB) generously provided access to their detailed revenue and expenditure budgets for Budget Estimate (BE)[10] 2018/19, and the Departments of Planning (DoP) in Mandalay, Sagaing, Kayin and Chin provided township 'plans', detailing both Union and state/region capital budget plans for 24 townships, also for BE 2018/19.

This evidence base has been supplemented by reports previously published by The Asia Foundation, in collaboration with the Renaissance Institute and Myanmar Development Resource Institute – Centre for Economic and Social Development (MDRI-CESD), over the past six years.[11] The report also draws on the unique insight and experiences of The Asia Foundation and the Renaissance Institute in delivering technical support to Myanmar's state and region governments, particularly in public financial management.

SCOPE AND LIMITATIONS

The sampling of states, townships, and sectors for the fieldwork and budget analysis reveal a wide variety of financing patterns among different areas and sectors in Myanmar. The sample should therefore not be viewed as necessarily representative of the broader local development financing arena in Myanmar. Rather, the variance documented in this report should serve as a reminder to policymakers and practitioners of the need to understand local context and to appreciate the myriad ways in which policies can be implemented.

STRUCTURE OF THE REPORT

Following this introductory chapter, this report is structured as follows:

Chapter 2 outlines the constitutional, legislative, regulatory, and policy framework in which local development financing occurs in Myanmar.

Chapter 3 details how these arrangements work out in practice for state/region financing and examines emerging issues.

Chapter 4 examines the factors determining how financing is translated into local development budgets by sector from state/region and deconcentrated from Union budgets. It then examines the patterns emerging at township level where these two flows meet and makes a preliminary assessment of the variances documented.

Chapter 5 draws together the main challenges to local development financing which have been documented in earlier chapters, and then outlines a series of areas where further review, reform or innovation is needed, both in the shorter and in the medium-longer term.

CHAPTER 2

WHAT IS THE FRAMEWORK FOR FINANCING LOCAL DEVELOPMENT?

This chapter sets out the legal, institutional and policy framework within which public financing is made available for spending on local development.

BOX C
Local development spending

Reference is made to the term "local development" financing or spending throughout this report – this shorthand refers to *capital budget* spending by those departments most concerned with the provision of l*ocal social and economic infrastructure and services*, but excludes those related to the local administration. Focus on the capital budget is also a reflection of the much greater availability of financing and budget data on the capital budget at local level. This, in no way, seeks to undervalue the importance of current budget spending, for maintaining the local administration and for ensuring local service delivery, especially in the social sectors.

2.1 WHAT IS THE CONSTITUTIONAL, LEGISLATIVE, AND REGULATORY FRAMEWORK FOR FINANCING LOCAL PUBLIC SPENDING?

BUDGETING FRAMEWORK

Pursuant to Myanmar's 2008 Constitution and Financial Rules & Regulations (2017) of the Ministry of Planning and Finance (MOPF), at present public development spending at the local level can only be:

either
Spending by Union ministries and departments, financed from the Union budget – "deconcentrated" spending
or
Spending by state/region government departments, financed from state/region budgets – "devolved" spending.

In consequence, and contrary to a common perception, under current arrangements there is no such thing as a locally-determined territorial District, Township, Ward or Village Tract plan or budget as these administrations are not recognized as budgetary entities.[12]

As we see further below, there is a degree of delegated spending and revenue-raising authority within states/regions, from respective state/region and Union budget holders, notably to the Yangon and Mandalay City Development Committees (CDCs) and the municipal Development Affairs Organisations (DAOs), but these budgets are aggregated within those of their host states/regions. There is also – much more modestly – some delegation of spending to the General Administration Department (GAD) Township Administrator (TA) and to school management authorities.

SPENDING RESPONSIBILITIES FOR

LOCAL DEVELOPMENT

Since "finance follows function", we need to clarify responsibilities for local spending before moving to financing arrangements. Based on Schedule 2 of the Constitution, on sector legislation, and on the configuration of departments placed under state/region authority, there is a fairly clear demarcation of how departmental spending is to be funded from the two budgets. However, there are cases where these appear to be interpreted differently across states/regions (as will be seen in Chapters 3 and 4 below). The 'de facto' demarcation of responsibilities (with occasional 'duplications' that emerge) is depicted above in table 1 on page 7. This table highlights some anomalies – the most obvious being the split in responsibilities for financing the rural road network.[13] It also indicates that certain conventional views of vertical division of responsibility between Union and states/regions are not always borne out in practice, for example:

- Spending by the Ministry of Border Affairs (MOBA) is often said to be funded only from the Union budget, but there are instances where their activities are funded from state/region budgets.
- Some Ministry of Agriculture, Livestock and Irrigation (MoALI) departments receive funding from both Union and state/region budgets.

Not all sector funding, however, is the exclusive domain of one department. Many key local development investments may have more than one possible departmental funding source. For example:

- In many areas MOBA undertakes similar investments in schools, water, and rural roads to those also funded by DBE, DRD or DRRD. For example, spending responsibilities for the national rural road network covering 95,800 km are divided between Ministry of Construction's DRRD - 76,000 km, and MOBA - 19,800 km;
- In all states/regions, the Cabinet appears to finance a multi-sectoral range of investments (water and irrigation, power, rural roads, etc.) of the exact same type as those funded by the responsible departments. This is in at times because the departments concerned may not have their own budget heads within state/region budget, and so they are instead recorded under the Cabinet account – e.g. there is no state/region budget head for DRD, so rural water projects sponsored by state/region authorities or MPs outside of DRD's normal planning process are then financed under the Cabinet budget head. At other times it may simply be the most convenient way to finance investments sponsored by the Chief Minister, or by other state/region ministers or hluttaw representatives.
- Smaller investments in these various sectors may also be funded by the Constituency Development Fund (CDF).[14]

This multiplicity of funding arrangements is depicted in table 3.

It may therefore be telling that a common function of the Township Plan Formulation and Implementation Committees (TPICs) – as highlighted in the companion Asia Foundation report, *Where Top-Down Meets Bottom-Up* - appears to be precisely to detect such duplication, However, this is an inherently hard task given the hundreds of proposals to be reviewed in a few hours[15] – allowing little scope to focus on the more 'positive' planning task of making strategic priorities for the township.

> ***"MANY KEY LOCAL DEVELOPMENT INVESTMENTS MAY HAVE MORE THAN ONE POSSIBLE DEPARTMENTAL FUNDING SOURCE"***

TABLE 3 Multiple departmental financing sources for local development spending

Local development spending on:	STATE/REGION BUDGET								UNION BUDGET						
											MOALI				
	MoC/ DoH & DRRD	MOALI (except DRD)	MONREC	MoBA	MOEE	DAO	CABINET	CDF	MoC/ DRRD	MoE/ DBE	DRD	Other	MONREC	MoH	MoBA
Water				✓ border town-ships		✓ urban water	✓	✓			✓				✓ border townships
Roads, culverts & bridges	✓ Highways Class A rural roads			✓ rural roads in border town-ships		✓ urban roads	✓	✓	✓ classes B & C rural roads		✓ farm ac-cess roads				✓ rural roads in border townships
Schools				✓ border town-ships			✓ ancillary school facil-ities	✓ ancillary school facilities		✓ Build-ings O&M via school grants					✓ border townships
Rural Health Centres				✓ border town-ships			✓ ancillary health facil-ities	✓ ancillary school facilities						✓	✓ border townships
Electricity				✓ solar border town-ships	✓ grid conn.		✓ solar & grid conn.	✓ solar			✓ solar & micro				✓ solar border townships
Agriculture, Livestock & Fisheries		✓									✓ livelihood loans via Evergreen & VDP				
Environment, Forestry & Conservation			✓				✓ drainage & embank-ment works						✓		

STATE/REGION BUDGET

MOC/DOH & DRRD: Ministry of Construction / Dept of Highways & Dept of Rural Road Development
MOALI: Ministry of Agriculture, Livestock & Irrigation
DRD: Dept of Rural Development
MONREC: Ministry of Natural Resources & Environmental Conservation
MOBA: Ministry of Border Affairs
MOEE: Ministry of Electricity and Energy
DAO: Development Affairs Organization
CABINET: Cabinet
CDF: Constituency Development Fund

UNION BUDGET

MOC / DRRD: Ministry of Construction / Dept of Rural Road Development
MOE /DBE: Ministry of Education / Dept of Basic Education
MOALI: Ministry of Agriculture, Livestock & Irrigation
DRD: Dept of Rural Development
MONREC: Ministry of Natural Resources & Environmental Conservation
MOH: Ministry of Health
MoBA: Ministry of Border Affairs
VDP: Village Development Plan

2.2 WHAT ARE THE ARRANGEMENTS FOR FINANCING 'DE-VOLVED' SPENDING FROM STATE/REGION BUDGETS?

State/region budgets are financed from three sources: own-revenues, fiscal transfers and borrowing. We look at the arrangements and the actual practice for each of these in turn.

STATE/REGION OWN-SOURCE REVENUES

State/region own-revenue powers are outlined in Schedule 5 of the Constitution; within states/regions, Development Affairs legislation delegates to DAOs powers to collect a number of tax and other revenues. See boxes E and F overpage.

As will be seen, state/region revenues are overwhelmingly derived from revenues delegated to the municipal DAOs (which retain them for spending in urban centers) – and these, in turn, are overwhelmingly derived from license fees on DAO assets (ferries, slaughterhouses, markets). Tax revenues (property, wheel, land, alcohol, etc.), from all departments, comprise only between 5 percent to 20 percent of all state/region revenues.

The 2015 amendments to the Constitution, referred to above, also included revisions to Schedule 5, and opened the possibility of significant additional new revenue powers to states/regions, **notably** in the extractive sectors: *"states/regions shall be empowered to raise taxes and fees related to the following activities in accord with the law enacted by the Union [....] Investment, Insurance, income, trading, customs, hotels & lodging, tourism, registration of documents, coastal fisheries, petroleum & natural gas, minerals & mines, gemstones, teak and hardwoods, industries, boat construction, air transport, housing, private education establishments, private clinics, literature, films & videos."*

However, it appears that to date no significant legislation has been tabled to enact such powers, other than an initiative[16] by the Ministry of Natural Resources and Environmental Conservation (MONREC) to allow states/regions to retain permit fees paid by artisanal mining companies. If and when more substantial state/region revenue tax powers are granted, great care must be taken to ensure that they do not generate inequities between states/regions – especially for revenues generated from natural-resource (oil, gas, mineral, etc.) extraction.[17]

BOX D
Note on state/region budget formats

State/region revenue budget statements are divided into three parts:

- Part 1 – revenues accruing to the "central group" of institutions of the state/region government itself (Cabinet, hluttaw, courts, etc.), but where shared revenue and CDF grant transfers are also recorded.
- Part 2 - revenues accruing to the various Ministries and their departments which are empowered to collect tax and other revenues.
- Part 3 - revenues accruing to government enterprises and notably to the CDCs and DAOs.

Under State/region revenue budgets, shared tax revenues and CDF transfers are recorded alongside – and often recorded within - other state/region 'current revenues' under Part 1. Similarly, deficit transfers are often recorded as Budget Department revenues, and Funds borrowed by Yangon and Mandalay City Development Committees (YCDC and MCDC) are also simply recorded as 'capital revenues' for the two Regions, under Part 2 of their budgets. As a result, some State/region budget revenue pictures, where CDF and loan receipts are not disaggregated, can be misleading by inflating the depiction of own-revenues.

UNION FISCAL TRANSFERS TO STATES/REGIONS

Most sub-national governments in Asia and elsewhere face a "fiscal gap", in that their spending responsibilities usually far exceed their own revenues, and Myanmar is no exception. However, in Myanmar, aside from Yangon Region, these transfers constitute the bulk of state/region budget financing. The Constitution's Schedule 5 provides for states/regions to receive funds – i.e. fiscal transfers - from the Union Fund Account.

BOX E
Schedule 5 of the 2008 Constitution – Taxes and fees collected by region or state government

1. Land revenue.
2. Excise revenue.
3. Water tax and embankment tax based on dams and reservoirs managed by the region or state and tax on use of electricity generated by such facilities managed by the region or state.
4. Toll fees from using roads and bridges managed by the region or state.
5. Royalty collected on fresh water fisheries and on marine fisheries within the permitted range of territorial water.
6. Taxes collected on vehicles on road transport and vessels on inland waterway transport, in accord with law, in a region or a state.
7. Proceeds, rent fees and other profits from those properties owned by a region or a state.
8. Fees, taxes and other revenues collected on services enterprises by a region or a state.
9. Fines imposed by judicial courts in a region or a state including Region Taya hluttaw or State Taya hluttaw and taxes collected on service provision and other revenues.
10. Interests from loans disbursed by a region or state.
11. Profits returned from investment of a region or state.
12. Taxes collected on extraction of the following items from the forests in a region or a state: on all woods except teak and other restricted hardwoods; on firewood, charcoal, rattan, bamboo, birdnests, cutch, thanetkha, turpentine, eaglewood and honey-based products.
13. Registration fees.
14. Taxes on entertainments.
15. Salt tax.
16. Revenue received from the Union Fund Account.
17. Contributions by Development Affairs Organisations in a region or state concerned.
18. Unclaimed cash and property.
19. Treasure trove.

BOX F
DAOs – local tax and other revenue sources

- Business registration license fees: these revenues derive from the business registration and regulatory functions of township DAOs;
- License auctions: township DAOs auction off the rights to undertake certain economic or administrative activities (e.g. slaughterhouses, ferries, pawnshops, market management, collection of wheel taxes , management of public toilets, etc.). Bid winners of these auctions pay the township DAO for these licenses, either as an upfront payment or in regular instalments;
- Property rates (or “taxes”): DAOs levy an annual property “tax” on households, broken down into a number of separate elements (property tax proper, waste collection, street lighting, water, etc.).
- Wheel tax: these are levied as part of vehicle registration and on out-of-town vehicles;
- Building permits: DAOs collect building permit fees for the construction of buildings of up to two storeys high;
- Property rental and sales: township DAOs collect rent from the users of DAO property and obtain revenues from the sale of any such property;
- Fines and penalties: levied on infractions of various regulations.

BOX G
Fiscal transfers: a simple typology

In all countries central governments provide fiscal resources from central budget revenues to increase subnational government budget resources. These fiscal transfers may be:

- For "unconditional" use by sub-national governments. These transfers are typically made through general, unconditional or 'block' grants, or through untied revenue-sharing arrangements.
- For "conditional" use by sub-national governments, earmarked for specific sectors or services, programs, types of beneficiary, or geographic areas. These transfers are typically in the form of conditional, specific, sector, or program grants, but in some cases also through revenue-sharing arrangements, which are earmarked for certain sectors or types of spending.

BOX H
Advance notice of deficit transfers to states/regions

Under the earlier arrangements, states/regions were only informed by MoPF of their approved transfers after submission of their draft budget proposals, usually in January – i.e. 3 months before the start of the new budget year under the old calendar.

After the move to MTFF formula-based transfers, this notice was then sent earlier, in November, i.e. about 5 months before the start of the new budget year under the old calendar. This has now been further advanced to January, i.e. 9 months before the start of the budget year under the new calendar.

In Myanmar fiscal transfers are of several types.

General grant transfers

These are "unconditional" transfers designed to cover the 'gap' between state/region annual revenue and expenditure budget proposals to the Union government, and - until 2014/15 - the amounts were determined after a process of iterative, bilateral negotiations.[18] However, from 2015/16 these transfers have been determined instead by a 'needs-based' formula, as part of national Public Financial Management (PFM) reforms and MoPF's move towards a Medium-Term Fiscal Framework (this is examined in detail under Chapter 3.).

The move away from the negotiated arrangements and the introduction of a formula has been a major innovation, although there are issues with the allocation criteria and arrangements which will be discussed under Chapter 3 below. It has enabled a more transparent allocation process which largely removes opaque 'behind-the-scenes' agreements.[19] But it has two other perhaps even more important *potential* benefits:

- Announcements of next year's transfer amount can now be made much earlier in the budget calendar to state/region authorities – allowing the states/regions in turn valuable extra time to appraise the merits of multiple competing budget proposal options, and to finalize a much better-considered budget. Indeed, it also allows *potential* for states/regions in the future to allocate indicative budget ceilings, to their departments and to townships, to discipline the budgeting process.
- It *can* be a tool for ensuring greater equity of development spending across states/regions – something which was almost impossible to achieve under the old arrangements. However, as will be seen, fulfilling this potential still requires adjustments to current allocation criteria, which may prove politically difficult.

These transfers, which in total constitute some 66 percent of all state/region revenues, are financed from general Union budget revenues and are recorded as expenses in the Union budget, under Schedule 4.2 in the annex of the annual Union Budget Law. They are not earmarked for any specific type of state/region expenditure but are at the discretion of the state/region governments.[20]

Finally, it is important to note that there are as yet no conditional grant transfer earmarked for specific sectors, allocated to states/regions. But in the future there do appear to be major opportunities to expand fiscal transfers in this direction in a possible future move toward greater decentralization of responsibilities.

Shared tax revenues

Starting from 2016/17, shares of a few selected Union revenues have been returned to the states/regions, on the basis of area of collection. (Until 2017/18, the Income Tax and Stamp Duty revenues were shared right down to the DAOs in the townships where collected, but they now revert to the general state/region account.)

These shared revenues, like general grant transfers, are not earmarked and can be used for general state/region budget spending.[21]

As will be seen, these shared revenues constitute some 20 percent of total state/region revenues, although the bulk naturally accrues to Yangon and Mandalay, which enjoy much larger urban tax bases. The Internal Revenue Department's estimates of next year's shared-revenue transfers are communicated to states/regions along with notice of general grant transfers.

Lastly, as with the granting of own-revenue powers, major caution is also needed regarding any future expansion in revenue-sharing with states/regions. Once such arrangements are in place they can be hard to amend or reverse later.[22]

Constituency Development Fund (CDF)

A third, much more modest, transfer currently provided to states/regions is the Constituency Development Fund (CDF) grant which was instituted in 2013/14[23], as a funding instrument to support township representatives elected to the Union and state/region hluttaws.[24] Annually, the CDF allocates MMK 100 million to each township[25], from the Union hluttaw budget account, equating to a total annual transfer of MMK 33 billion. It appears in the respective state/region budgets as both revenue and expenditure (under the state/region government account in Part 1).

These funds are managed separately from the regular government budgeting process. Projects for CDF funding are proposed by a township committee of selected department heads (usually termed the Township Development Implementation Committee), chaired by one of the members of parliament (MPs) with support of the township administrator (TA) of the General Administration Department (GAD). Proposals are sent up to the Union hluttaw – though reportedly state/region governments may make some input – and, after Union approval, funds are channeled direct from the Union hluttaw to the respective township CDF account through the Myanmar Economic Bank (MEB).

Although a modest transfer, allocation of the CDF nevertheless raises equity issues, when equal grants are given to townships of greatly varying sizes and needs.

Other grant transfers

In previous years there have also been other grant transfers[26] to states/regions but which have been discontinued since 2015/16, notably:

- Poverty Reduction Fund (PRF). The PRF was instituted in 2013/14 to finance the '8 priority areas' for rural development highlighted by President Thein Sein in 2011. Funds were allocated to the Chief Minister of each state/region[27] who approved projects proposed by township authorities and implemented by the GAD TA. Funds allocated under the PRF were MMK 16 billion in 2013/14, and MMK 50 billion in 2014/15, after which the Union government discontinued transfers, although some states/regions apparently continue these arrangements with financing from their own budgets.[28]
- Rural Development Fund (RDF). The RDF was a more modest transfer mechanism (dating back to 1977) also to promote rural development, and managed by GAD, under which annually regions were allocated MMK 15 million and states MMK 20 million from the Union RDF pool of MMK 245 million. Projects were again selected by the Chief Minister from proposals by township authorities. This has also been discontinued as a Union transfer but it appears that some states/region continue to finance similar schemes, managed by GAD, from their own budget resources.

There are other "fund transfer" schemes to local level, but these are delegated by Union ministries (such as under DRD's Village Development Plan (VDP) and Evergreen programs, or DBE's school grants program), funded directly from the Union budget, not on state/region budgets – see Chapter 2.4. below.

TABLE 4 Revenue-sharing sources

Shared tax	Basis for sharing
Commercial Tax (net of tax on imported goods)	15% by state/region of collection
Special Commodity Tax (net of tax on imported goods)	15% by state/region of collection
Individual Income Tax	5% by township of collection
Stamp Duties on 3 instruments	5% by township of collection

2.3 HOW IS 'DECONCENTRATED' LOCAL DEVELOPMENT SPENDING FROM THE UNION BUDGET FINANCED?

The Union budget for "deconcentrated" local development spending (primarily by ministries of Construction, Education, Health, Agriculture and Electricity) is funded from Union government revenues,[29] from which annual appropriations are made for the ministries concerned.

The Union government enjoys the great bulk of overall government revenues, which come primarily from: Commercial and Income taxes, Customs duties, and various taxes and levies on natural resource use. For BE 2018/19 these Union tax revenues are some MMK 7.5 trillion, or 94 per cent of all government revenues when state/region own-revenues (some MMK 0.5 trillion) are also included. Although there may be some scope to increase state/region revenue powers, it is to be expected that a central government assumes powers over the major revenue sources, on the grounds of efficiency and equity. What is critical here is how these are then distributed sectorally and geographically.

Departments do not appear to allocate advance upfront capital budget ceiling amounts to allow their state/region department heads discretionary approval authority; the latter may have an approximate indication of their likely current budget allocation, given the size of their staff establishments, but not for the capital budget. Final budget financing decisions for Union budget spending at local level are in all cases retained at Union level.[30]

2.4 WHAT ARE THE FINANCING FLOWS AND MANAGEMENT ARRANGEMENTS?

CONFLUENCE OF FINANCING FLOWS

Figure 1 on page 8 depicts the two funding flows and their confluence at township level for local development spending; it also indicates the key determining factors at each level (which will be examined in detail in Chapter 4). Some township departments receive funding from only one source, for example, DRD and DBE only from the Union budget, and DAOs only from the state/region budget. But others (e.g. DoH, DRRD, ESE, and some MoALI Depts) may be managing funding from both Union and state/region budget sources.

BUDGET EXECUTION ARRANGEMENTS BY DEPARTMENT

Approved Union and state/region budgets for local development are executed by their budget-holding departments, through their departmental sub-accounts at the MEB, which serves as government treasury. MEB maintains branches at State/region, District and Township levels.

For each department, based on their approved budgets, state/region officers compile quarterly "fund requests" or spending plans – including proposals from their Township and District officers – and submit a Disbursement Letter to MEB, copied to the state/region Department of Budget (DoB). After clearance by DoB, MEB transfers funds to the department sub-accounts from the general Union or state/region Fund accounts at MEB, and provides a corresponding Allotment Letter to each department, specifying the four-digit budget codes against which spending must be made. Payments to contractors, suppliers, etc., are made from these sub-accounts under instruction from the budget-holder. One month before the Allotment Letter expires, departments must submit requests for the next quarter.

While state/region and part of the Union budgets for local development are executed subnationally, there is some variation in practice between departments - and between states/regions – in the degree to which budgets are executed at township level. To illustrate:

- DBE manages budget execution at several levels. Books and school equipment are managed at Union level; school construction and school uniforms at state/region level; and teacher payroll and school grants at township level. At each level DBE officials instruct payments from the DBE sub-account in MEB.[31]
- DRD, DRRD and Department of Highways seem to manage budget execution differently across states/regions. In most cases, payment authorization is retained by state/region department officers, but in some cases, for certain expenditures, this may be delegated to District or even Township department

officers, who authorize payments from the corresponding MEB branches. However, some other deconcentrated local development expenditures from Union ministry budgets are handled centrally, such as solar equipment (DRD) or other goods simply distributed to intended recipients by local department staff.
- CDF budget execution is managed directly by the township CDF committee, with payment to contractors authorized from the CDF sub-account at the township MEB branch by one of the MPs together with the GAD TA. There is also some delegation to communities (see further below).

Reportedly, whenever there are cash shortages due to government revenue shortfalls or delays, MEB treasury management prioritizes current budget spending on staff salaries and allowances – while maintenance and capital spending tends to be deferred until later in the year. Given the delays entailed by capital procurement procedures, this can result in underspending and/or the need for budget rollover to the next budget year.

DELEGATED EXECUTION ARRANGEMENTS

While the state/region tier is the only recognized sub-national budget level, there are some arrangements whereby both state/region governments and Union government have delegated revenue-collection and/or spending authority to local entities.

Delegation of Urban Spending

As noted above, in all townships there are municipal service bodies[32] – the DAOs – which are regulated under the Development Affairs Laws promulgated by the respective state/region hluttaws. Under these laws, DAOs have delegated authority to collect a range of local taxes and other revenues, and to undertake spending - primarily on urban roads, bridges and culverts, with more modest spending on maintenance of urban water supply, solid waste management, markets, parks and playgrounds, etc. DAO budget execution is also managed at township level, through the DAO sub-accounts at the township MEB branch, with payments approved by joint signatories from the DAO and their supervising Department of Development Affairs (DDA).

Similarly, Yangon and Mandalay CDCs enjoy delegated powers[33] to raise various taxes and other revenues, and to spend on urban infrastructure and services.

It should be noted here that while both DAOs and the CDCs retain the revenues they raise, they also receive substantial additional financing from their respective state/region budgets (see Chapter 3).

Delegation of school operations spending

Starting in 2012/13 (with World Bank support), all government schools now receive school capitation grants, for which they have delegated management authority, from Union government, for spending on a prescribed list of minor (non-salary) operating and maintenance expenditures, which previously were managed by the township Education departments.[34] These grants are funded from the DBE Union budget, and allocated on a per student basis (based on school enrolment data), by school level and size band, by the township Education departments.

School grant management is regulated by an Instruction and Operations Manual from the Ministry of Education. School principals are supposed to consult with the specially constituted school improvement committees. This comprises 7 to 13 persons, depending on the school level, including PTA members, other parents, teachers and village elders) to propose a spending plan to the Township Education Officer (TEO). After approval of the plan, the TEO releases funds in two annual cash disbursements (May and October) to the school, which undertakes local procurement directly, according to the procedures in the grant manual. Thereafter, schools can spend according to the approved plan, with no further controls. At present, there appears to be no consolidated reporting upwards from townships on, or analysis by DBE of, these school-level expenditures.

Delegation of minor local spending to village leaders and community bodies

There are in place a number of arrangements allowing 'communities' to manage spending of government funds, and notably:

- Village Development Plan (VDP), Evergreen, NCDDP and ERLIP. These government or donor funds – allocated to village committees under the respective DRD programs – are spent directly in cash on supplies, or through community-contracting in the case of NCDDP, by community members.
- Constituency Development Fund (CDF). For small projects (under MMK 5 million) the township CDF committee usually delegates project execution by transferring cash to the village leader or project committee of the community concerned, who undertakes local purchases of supplies needed.

2.5 LOCAL DEVELOPMENT FINANCING ARRANGEMENTS: EMERGING ISSUES

Some key features of the sub-national financing arrangements outlined above are worth highlighting here:

Centralization of spending responsibilities.
Compared to other countries, spending responsibilities in Myanmar are highly centralized, with the Union government responsible for a range of spending areas (basic education and health facilities, rural roads, rural water, etc.), which in other contexts are often decentralized.[35]

Fragmented spending responsibilities.
The manner in which some responsibilities are divided between Union and states/regions introduces a degree of fragmentation in planning and budgeting decisions and leads to duplication, inefficiency and weakening of accountability over spending responsibilities. For example:

- financing responsibilities for the rural road network are split between class A roads (state/region budget) and classes B and C roads (Union budget), posing the risk that the integrity and connectivity of rural road networks may be compromised. An example would be where investment in a segment of B or C roads is approved at Union level without the class A road investment – linking-up to the highway network – being approved by the state/region.
- community proposals for water supply projects may end up being sponsored by local MPs for the CDF, but also for DRD, for MOBA (in border areas) and/or for Cabinet funding. Lack of coordination between decision-making across these three funding sources can easily lead to duplication, which may only be discovered at time of budget execution.

Limited local revenue powers.
State/region revenue powers under schedule 5 of the constitution are limited, although not excessively so. But one constraint appears to lie in the fact that the regulatory framework for some sectors has not been re-aligned with these powers, causing uncertainty.[36] The existence of multiple revenue collection departments also probably reduces collection efficiencies and complicates any capacity building support.

Fiscal transfers in reform.
States/regions are necessarily reliant on Union transfers and that reliance cannot be expected to change greatly. Myanmar has made important efforts to reform the "negotiated gap-filling" fiscal transfer arrangements,[37] and move toward a more transparent and effective formula-based arrangement with advance notice to states/regions. However, the planning and budgeting system which tends to be associated with the previous 'gap-filling' arrangements – whereby the local administration is encouraged to submit long annual budget wishlists rather than make real budget-constrained priorities, and which also seriously undermines incentives for local participation – proves much slower to reform. This in turn means that state/region authorities and Union sector departments are faced with the very challenging task of reviewing and cutting back many more proposals than they can approve, in a short period of time, in order to select those for inclusion in the budget.[38] Table 21 in Annex B illustrates the 'wishlist' approach to planning with examples from a sample of townships.

Wide local discretion allowed.
It should also be noted that the fiscal transfer arrangements (through both deficit grants and revenue sharing) contain no earmarking, and allow very substantial local discretion to state/region authorities. Such discretion is conventionally viewed as being positive and key to "empowering" local decision making. It stands in contrast to many countries where transfers often comprise an array of sector conditional grants, and often also limit the portion that can be spent on local administration. This gives very considerable freedom to state/region governments in Myanmar to make their own sector budget priorities – within the framework of their spending responsibilities – at their own discretion. There are benefits but also risks to such wide discretion.

No township budget certainty.
A final and crucial feature lies in the fact that the only sub-national budget level is that of the state/region governments, which – with populations from 300,000 to 7 million – are very large jurisdictions and service catchment areas. The sub-national level most concerned with local planning and spending is the township administration, which can be a very large area of jurisdiction as compared to the typical lowest-level local governments elsewhere in Asia. Yet this level presently has no budget allocation of its own, not even a sector department-based allocation. Townships can therefore only submit funding requests upwards. This 'missing piece' in local financing arrangements is understood to be a source of considerable inefficiency, and undermines the quality of local spending. One further important consequence of the lack of any budget certainty is the difficulty it creates to engage communities in consultations around the planning process.[39]

We will return to these challenges in more detail, together with recommendations for addressing them, in Chapter 5.

Against this background, the various innovations tested under National Community-Driven Development Project (NCDDP) and under the Township Democratic and Local Governance Project (TDLGP)[40] outlined in the Box I are especially important and should help inform opportunities for further reform of local financing arrangements. Although embodying diverse strategies, both (a) effectively decentralize decision-making largely to township level, or below; (b) provide a certain local budget allocation, thereby making participatory planning a meaningful exercise; and (c) through the ceiling inherent in this allocation, encourage serious local prioritization.

BOX I
Two major innovations in financing for local development in Myanmar

There are several major ongoing innovations supported by development partners which are testing out alternative approaches to local development financing.

National Community-Driven Development Project
The National Community-Driven Development Project (NCDDP), implemented by DRD with support from World Bank and other partners, is testing a financing approach in selected townships which differs from the usual government financing arrangements. The key features of the NCDDP approach are:

- Allocation of up-front annual budgets directly to Village Tract (VT) level. These allocations are based on population size (by size bracket) and are provided for a period of four years. Annual allocations range from MMK 12000 to 30,000 per capita.
- Technical support and facilitation – through teams attached to the township DRD offices - to assist Village (V) and Village Tract (VT) committees to help them undertake participatory annual planning, project selection and then implementation, to spend these budgets.
- Fund transfers direct from the project account to local committees to which budget execution and procurement responsibilities are delegated.
- Oversight and monitoring of fund management is done jointly by community-level sub-committees and the project team attached to DRD.

Township Democratic and Local Governance Project
The Township Democratic and Local Governance Project (TDLGP), implemented by Bago, Mon and Rakhine governments, and supported by UNDP and other partners, is testing an alternative financing model, more closely aligned with government arrangements. The key features of the TDLGP are:

- Allocation of up-front annual budgets to the township level, based on a formula comprising population, land area and with a fixed element, and synchronized with the annual budget calendar. Typical annual allocations are some MMK 1,500 per capita.
- Technical support to the township administration to undertake annual participatory planning through the VTAs and civil society organizations, and to support project selection and preparation, and implementation through government procedures.
- Fund transfers from state/region MEB accounts to township MEB sub-accounts, with co-signature by GAD and one or other TPIC member.
- Oversight and monitoring of fund management is undertaken through state/region government procedures, with added project support.

The Bago Region government has itself launched an initiative inspired by TDLGP, whereby it makes an annual formula-based allocation to townships from the region budget.[41]

Three common features
Although the approaches are different, three key factors are common to the financing arrangements being

BOX I (CONTINUED)
Two major innovations in financing for local development in Myanmar

trialed: (a) implicitly, the assignment of a greater degree of spending responsibility to the local level; (b) the provision of a clear budget allocation at the start of the local annual planning process, and (c) the sizing of this allocation based on proxy measures of relative need.

Decentralization of spending responsibility
Both approaches allow much more local authority to make spending decisions on local infrastructure than is normally possible under governmental arrangements – and so should constitute evidence for the feasibility and desirability of a greater degree of decentralization of such responsibilities.

Budget allocation certainty
The budget allocation certainty and the sectoral flexibility of use inherent in the block grants associated with these innovations are important for three different reasons:

- Encouraging participation – budget certainty encourages people to find time to meet and to discuss their needs and project options to address those needs. When there is no such budget certainty (as is the case with the regular township planning process and funding arrangements outlined further above, aside from the CDF) such discussions cannot be more than just preparation of 'wish lists' with little chance of anything being funded. People quickly lose interest in participating in such discussions especially after previous cycles spent agreeing and submitting the same lists of project proposals which went unfunded.
- Encouraging serious prioritization – the other result of budget certainty is that its announced size also constitutes a clear budget constraint, and so provides a discipline forcing discussion of trade-offs between and within different sectoral options and agreement on top priorities. Where there is no budget constraint (as is the case with the normal township funding arrangements), there is an overwhelming incentive to avoid making such priorities, and to simply submit a wish-list satisfying all participants in the discussion, to avoid causing tension and conflict within groups (since making priorities also involves downgrading or discarding proposals made by some stakeholders).
- Sectoral flexibility – lastly, the lack of any sector earmarking provides scope for looking broadly at area-based problems and opportunities, and weighing up options, trade-offs and possible synergies between possible spending options in different sectors. This is key to overcoming silo-based planning by sector.

Allocation based on relative need
Both approaches aim to allocate budgets based on measures of relative spending need. NCDDP allocates VT grants simply based on relative VT population size and population dispersion (as measured by the number of villages in a township), while TDLGP and the Bago Region initiative use a formula comprising population and other factors. No such formula is ever perfect, but it does help ensure that spending patterns – across VTs or townships – remain fairly equitable and aligned with varying local need. However, ensuring such equity with the normal township funding arrangements is very difficult, as will be seen.

CHAPTER 3

WHAT DOES STATE AND REGION FINANCING LOOK LIKE IN PRACTICE?

Chapter 2 set out the formal arrangements for financing local development spending and identified a series of challenges. Chapter 3 now examines how these arrangements play out in practice specifically for state/region budget financing, and identifies a number of patterns and issues.

3.1 OWN-SOURCE REVENUES

OVERVIEW

Table 5 shows both the large number of departments engaged in own-revenue collection and also how much the revenues of the urban entities, the two CDCs and the 400 DAOs, dominate the resource inflow, accounting for 59 percent and 25 percent respectively, of total sub-national own-revenues.

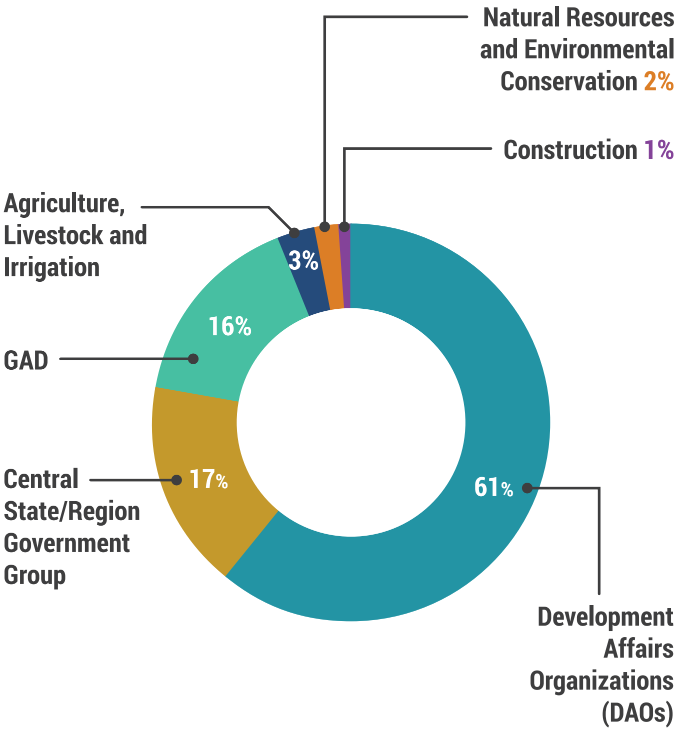
It is useful, however, to remove the distortions of the two CDCs from this picture and examine the composition of the other 12 states/regions, as depicted in figure 3 below. For these 12 other states/regions, over 90 percent of own revenues are comprised of those from the DAOs, from those collected by state/region governments, and by GAD.[42]

"THE TWO CDCS AND THE 400 DAOS DOMINATE STATE/REGION OWN-REVENUES"

TABLE 5 Own-revenues by ministry/departments — all states/regions, 2018/19 (MMK million)

Central State/Region Government Group	**34,511**
Home Affairs	**33,535**
Agriculture, Livestock and Irrigation	**12,620**
Natural Resources and Environmental Conservation	4,031
Health and Sports	537
Planning and Finance	909
Construction	2,887
Information	475
Development Affairs Organizations (DAOs)	137,236
City Development Committees	**325,479**
Electricity and Energy Department	**106**
TOTAL	**552,220**

FIGURE 3 Composition of 12 state/region revenues, 2018/19 (excluding Yangon and Mandalay)



STATE/REGION CABINET AND OTHER "CENTRAL GROUP" GOVERNMENT REVENUES

These revenues derive from water/dam taxes, and various other revenues accruing to state/region cabinets – including those from rental or sale of properties, or - in exceptional cases -from contributions from donors (e.g. funding by UNDP for TDLGP activities[43] in Mon, Bago and Rakhine), or from other third parties. Little detail was available for 2018/19 state/region Cabinet revenue budgets, but revenue data for Shan for 2016/17 listed a range of revenue sources, including revenues related to industrial zones and tourist areas. Aside from Cabinet revenues, state/region governments also collect more minor revenues raised by state/region hluttaws, courts, etc.

GAD REVENUES

These derive mainly from taxes on liquor, mineral extraction, land, dams, etc. collected by GAD, mainly through the VTAs and ward administrators (WAs). What is striking here is how modest land tax revenues are. This is a reflection of the fact that land tax rates are still extremely low in many states/regions, at MMK 3.5 per acre, having remained unchanged through long years of inflation – and (as several VTAs, charged with collecting these taxes, have admitted) cost more to collect than they yield.

TABLE 6 Cabinet revenue breakdown in selected states/regions, 2018/19 (MMK million)

	Kachin	Chin	Bago	Mon
CABINET	39.418	106.648	5,329.943	16,393.666
Tax	29.418			1.213
Water and Dam Tax				1.213
Other Current	10.000	106.648	4,171.690	10,280.019
Capital				5,000.000
External grants			1,158.253	1,112.434
UNDP			1,158.253	1,112.434

TABLE 7 GAD revenue breakdown in selected states/regions, 2018/19 (MMK million)

	Kayah	Sagaing	Mon	Shan
GAD	126.963	3,486.054	2,204.445	1,477.150
Tax	126.963	3,486.054	2,183.045	1,477.150
Excise/alcohol	81.677	3,236.946	889.080	990.613
Land	23.886	151.015	335.417	384.108
Mineral	21.400	0.138	957.923	102.429
Dam		97.955	0.625	–
Other Current	–	–	21.400	–

DAO REVENUES

The bulk of DAO revenues derives not from local taxes, but from what are termed “other current revenues”, which are primarily the proceeds from license auctions, but also include revenue from rentals, permits and fees, etc.

These revenues are recorded as state/region revenues but are generally ‘earmarked’ for DAO spending on urban services. However, DAOs must still submit their annual budget proposals to spend these revenues to their state/region governments for review and approval.

DAOs have been conventionally viewed as fiscally self-sufficient (i.e. spending only the revenues they collect),[44] and in some states/regions this is still the case. However, in recent years, several states/regions allocate substantial additional funding from their own budget resources. In 2018/19 total DAO expenditures (MMK 217.4 billion) are only financed 63 percent by DAO revenues, with the balance covered by such “internal transfers” from state/region budgets. But these patterns vary greatly, as DAOs in Kachin, Mandalay and Rakhine receive no such extra financing.

Similarly, it is worth noting that YCDC and MCDC received additional resources equivalent to 41 percent of their combined spending, from their respective regional government budgets.

The implications of these arrangements will be further reviewed in Chapter 4.

TABLE 8 DAO own-revenue breakdown in selected states/regions, 2018/19 (MMK million)

	Kachin	Kayah	Chin	Bago	Magway	Mon
Property and Wheel tax revenues	802.51	274.98	178.83	936.36	677.51	381.48
Other Current revenues	10,062.70	3,290.21	771.57	13,031.64	10,248.31	9,327.60

BOX J
Support to DAO revenue collection

Property tax revenues per capita in Myanmar are very low by Asia regional standards. The Asia Foundation have been supporting DAOs in some 13 cities of five states and regions to implement reforms to their property tax systems. This has included a transition to a streamlined digital revenue management system, Myankhon, and large-scale property surveys to expand the tax base. In partnership with the Renaissance Institute, reforms to the way that properties are valued are being supported. Communication campaigns have been conducted to build an understanding of the role property tax could play in improving local services and to notify residents of reforms changes. Systems and skills are being improved so that DAO officials are more able to use data to inform policy making, solve problems, and to communicate changes to the public. This work has been underpinned by the first assessment of Myanmar’s property tax system.

PER CAPITA OWN-SOURCE REVENUES[45]

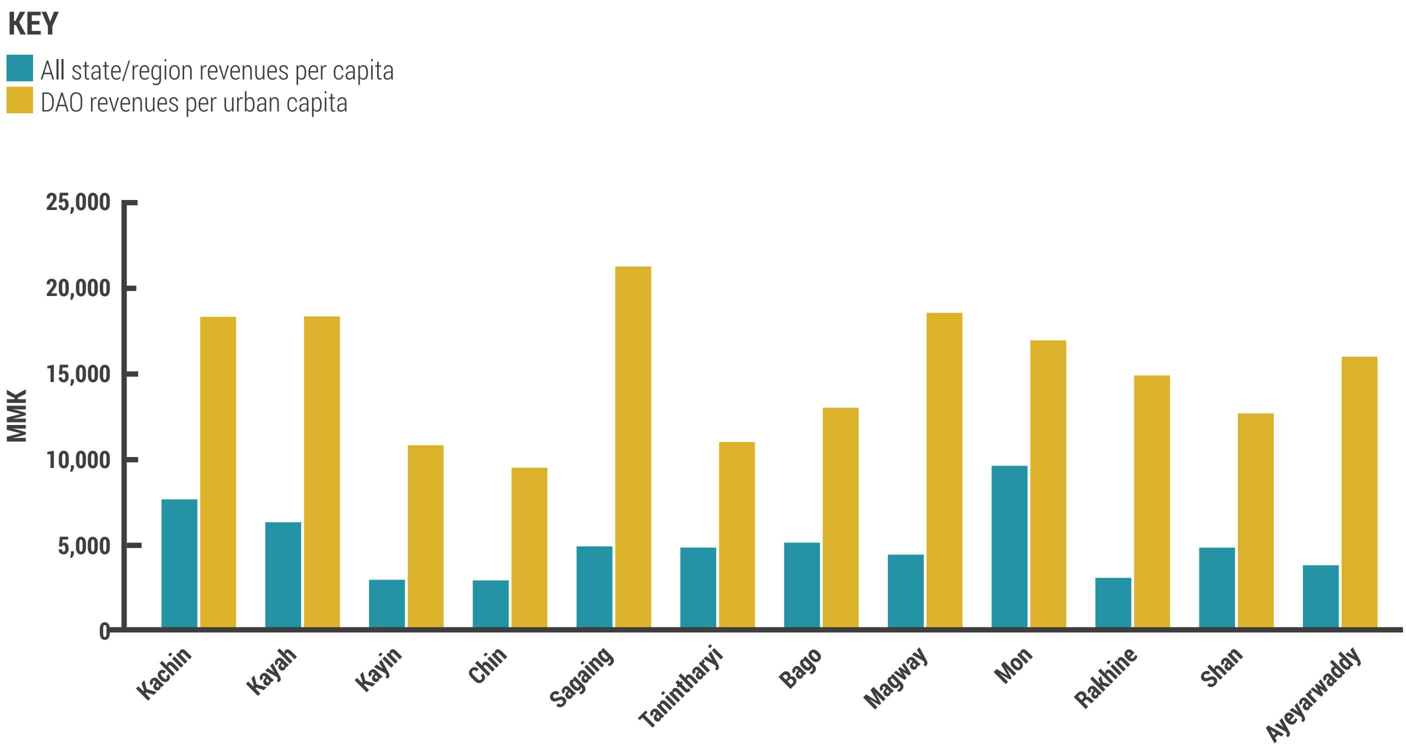
Figure 4 below depicts separately all revenues per capita of the whole population (blue bar) and DAO revenues per capita of only urban population (orange bar) for all states/regions save Mandalay and Yangon (where CDC revenues distort the picture).

Overall levels of revenue effort (at some USD 2 to 5 per capita) are relatively low. This is in part simply because of the very modest revenue powers of states/ regions. But even within these formal powers, states/ regions face difficulties in raising long outdated tax rates on some of these revenue sources. Efficiencies are probably also compromised because revenues are collected by several departments, each with its own staff and procedures. The historical legacy inherent in the fiscal transfer arrangements, only very recently being reformed, has probably also constituted a disincentive to improvements in local revenue-raising performance.

But figure 4 also illustrates quite substantial variance around the low average revenue effort: from MMK 2,959 (Kayin) to MMK 7,665 (Kachin) per capita for all revenues, and from MMK 9,516 (Chin) to MMK 21,291 (Sagaing) per urban capita for DAO revenues. This variance is, no doubt, partly explained by the differing levels of income, urbanization and taxable economic activity of different areas. However, abstracting from these differences, there remain substantial variations in revenue-effort levels which suggest potential to raise revenues in some areas.

> ***"THERE REMAIN SUBSTANTIAL VARIATIONS IN REVENUE-EFFORT LEVELS WHICH SUGGEST POTENTIAL TO RAISE REVENUES IN SOME AREAS"***

FIGURE 4 State/Region and DAO own-revenues per capita, 2018/19 (MMK million)



3.2 FISCAL TRANSFERS

GENERAL GRANT TRANSFERS

The annual pool set aside from the Union budget for these transfers has grown sharply in recent years, as figure 5 below indicates – more than doubling from 2012/13 to 2013/14, and then having plateaued at some MMK 1.7 to 1.8 trillion in recent years. (The "mini-budget" for 2018 was only to allow a phased six month transition between the old and the current budget calendar.) This recent stability of the national transfer pool is part of the MTFF reforms– and constitutes a major innovation insofar as it allows a much greater revenue predictibility for states/regions.

As noted earlier, since 2015/16 grants are nominally allocated based on a formula devised under the PFM support program. The formula adopted aims to reflect both relative spending need and relative fiscal constraints of the states/regions – see box K.

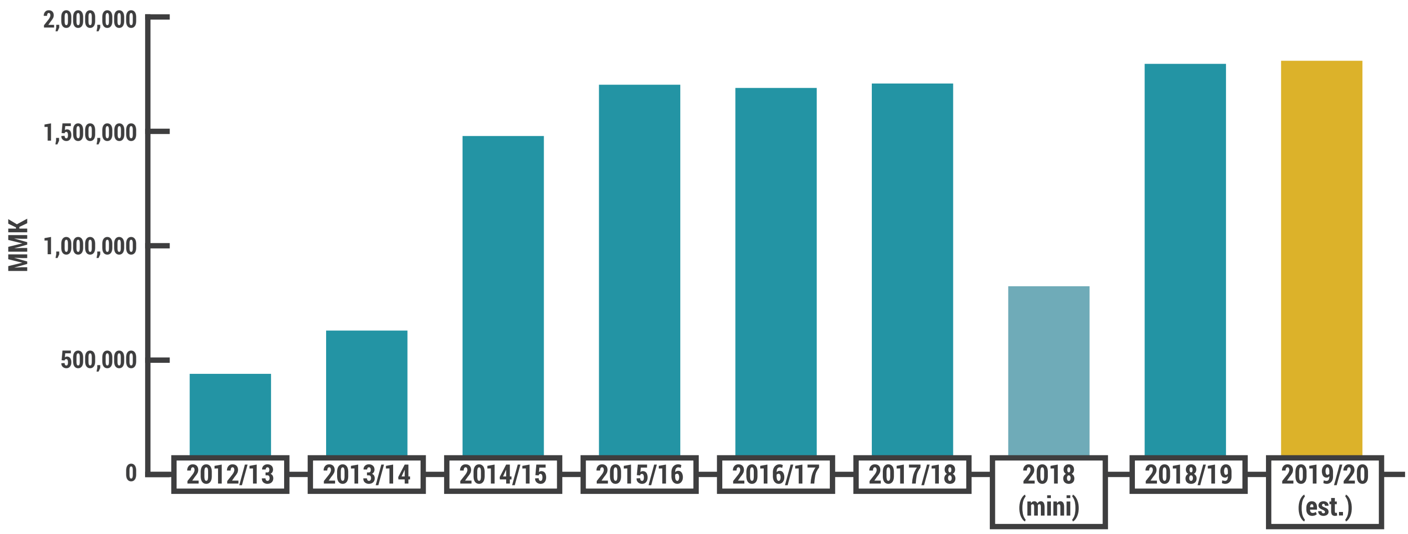
The transfers made to States/Region over the years are depicted in the Chart below and suggest a quite consistent yearly pattern of relative allocations, and hence an important degree of budgeting predictability for state/region authorities (the more insofar as states/regions are now informed some time ahead of their budget finalization).

However, although the introduction of a formula for allocations has been a very positive step and has contributed to greater stability and transparency, the *way it is actually applied, coupled with flaws in the formula itself*, means that the full potential for ensuring equitable financing across the country is not realized.

In practice, it appears that the formula is not used to determine the allocation of the entire annual pool, but rather to allocate the *annual increase* in the pool. As a result, it has therefore enshrined to a large extent the more arbitrary allocation patterns resulting from the previous negotiated deficit approach which prevailed up to 2015/16 and avoids the risk of any state/region receiving less than its historic allocation – hence the consistency in relative allocations seen in figure 6 below. Table 22 and figure 29 in Annex B depict the difference between actual allocations for 2018/19 and the allocations that would have been made if the formula were applied to the entire pool – and table 23 shows the states/regions which would gain or lose, and by how much, if this had been done. These differences are shown in per capita terms in tables 24 and 25 and figure 30 in Annex C.

That aside, it must also be noted that even after application of the formula to the incremental pool, there is some discretionary adjustment made to allocations

FIGURE 5 Annual general grant transfer allocation pool (MMK million)



BOX K

The "MTFF formula" for general grant transfer allocations

Indicators reflecting relative spending needs:

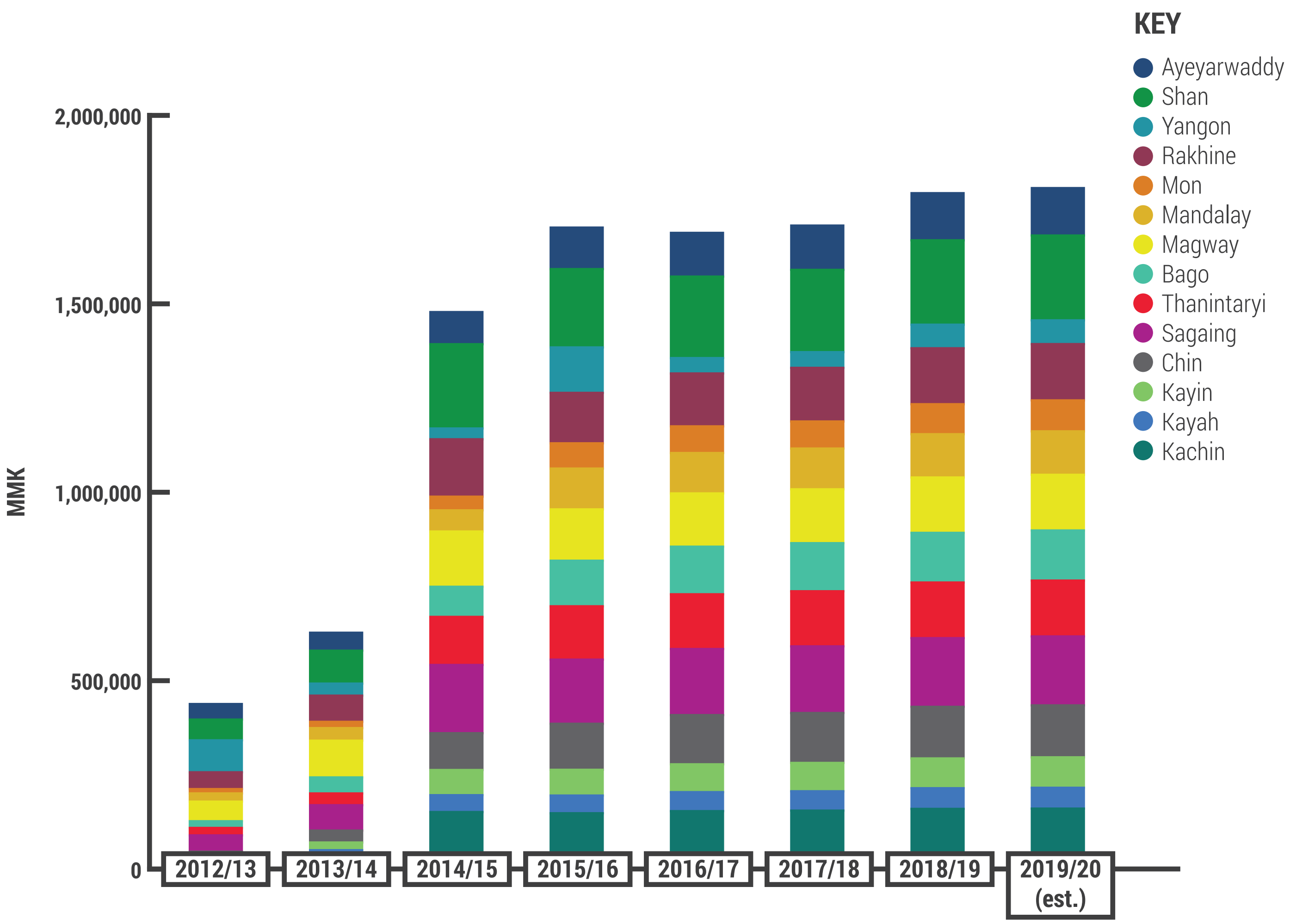
- State/Region Population – based on the national population census, 2014, with annual adjustments.
- State/Region Poverty Index – based on the Integrated Household Living Condition Assessment, 2009/10
- State/Region Land Area – based on the national population census, 2014

Inverse indicators reflecting relative fiscal constraint:

- State/Region per capita GDP – based on Planning Department annual estimates
- State/Region Urban Population as a percentage of the total state population – based on the national population census, 2014, with annual adjustments
- State/Region per capita Tax collection – based on the actual tax revenue collected annually, in the fiscal year N-1

There is no explicit weighting so, by default, each of these six indicators are accorded equal weight – i.e. in principle, each indicator accounts for allocation of one sixth (17 percent) of the pool.

FIGURE 6 General grant transfer allocations to states/regions (MMK million)



by Union government. For BE 2018/19, before the MoPF budget was submitted for Union government and hluttaw approval, the formula-based allocations of the increment of MMK 34.15 billion were then:

- subjected to 'policy adjustment' increases for Yangon, Mon and Kayah but, to stay within the same envelope, this meant decreases for some other states/regions, so that Sagaing, Taninthary, Bago, Magway, Mandalay and Shan saw their increments cut.
- further increased across the board to cover costs of government staff salary increases for all states/regions, with a resultant increment to the pool of MMK 51.37 billion, that is actually more than the original increment to the MTFF transfer pool.
- increased slightly again to allow a small extra grant for Ayeyarwaddy, to cover the costs of emergency bridge reconstruction after flooding.

These adjustments to the "rule-based" allocations are show in table 9 below.

That side, the formula itself is problematic.[46] This is discussed in more detail in Annex C, but the key issues are briefly as follows:

- Four of the six indicators (the Poverty Index and the three "fiscal constraint" indices) need to be "normalized" by relative populations of each state/region. This introduces a mathematical bias against the more populous states/regions.
- The equal weightings of 17 percent given by default to each indicator seem inappropriate. Population is usually given a much greater weight (often 50 percent or more). On the other hand, the combined weight given to the three fiscal constraint indicators seems excessive – given that own-source revenues of all states/regions combined is only some 20

TABLE 9 Computations behind transfer allocations, 2018/19 (MMK billion)

State/Region	Transfer allocations in previous year – 2017/18	Using formula to allocate the increment			Policy adjustments		Further changes		Final transfer allocation for 2018/19
		% to transfer according to 6 indicators	Resulting allocation of increment	Total transfer allocation	Policy adjustment	Provision grant transfer	Extra transfers for salary increases	Extra transfer for emergency bridge reconstruction	
Kachin	153.646	7.3	2.486	156.132		156.132	2.15		158.282
Kayah	51.442	4.8	1.65	53.092	(+) 1.000	54.092	0.842		54.934
Kayin	75.281	7.3	2.508	77.784		77.784	1.331		79.115
Chin	132.528	9.0	3.067	135.595		135.595	1.465		137.06
Sagaing	177.12	8.0	2.739	179.859	(-) 2.739	177.12	5.249		182.369
Tanintharyi	146.384	5.2	1.779	148.163	(-) 1.779	146.384	1.37		147.754
Bago	127.692	6.9	2.36	130.052	(-) 2.360	127.692	4.237		131.929
Magway	142.988	7.5	2.565	145.553	(-) 2.565	142.988	4.092		147.08
Mandalay	108.297	5.5	1.885	110.182	(-) 1.885	108.297	6.617		114.914
Mon	71.887	4.6	1.557	73.444	(+) 4.557	78.001	1.678		79.679
Rakhine	142.393	10.2	3.48	145.873		145.873	2.707		148.58
Yangon	41.695	4.3	1.452	43.147	(+) 9.702	52.849	9.805		62.654
Shan	218.63	11.5	3.931	222.561	(-) 3.931	218.63	5.461		224.091
Ayeyarwaddy	117.597	7.9	2.698	120.295		120.295	4.364	0.545	125.204
Total	**1,707.58**	**100.0**	**34.152**	**1,741.73**		**1,741.73**	**51.368**	**0.545**	**1,793.65**

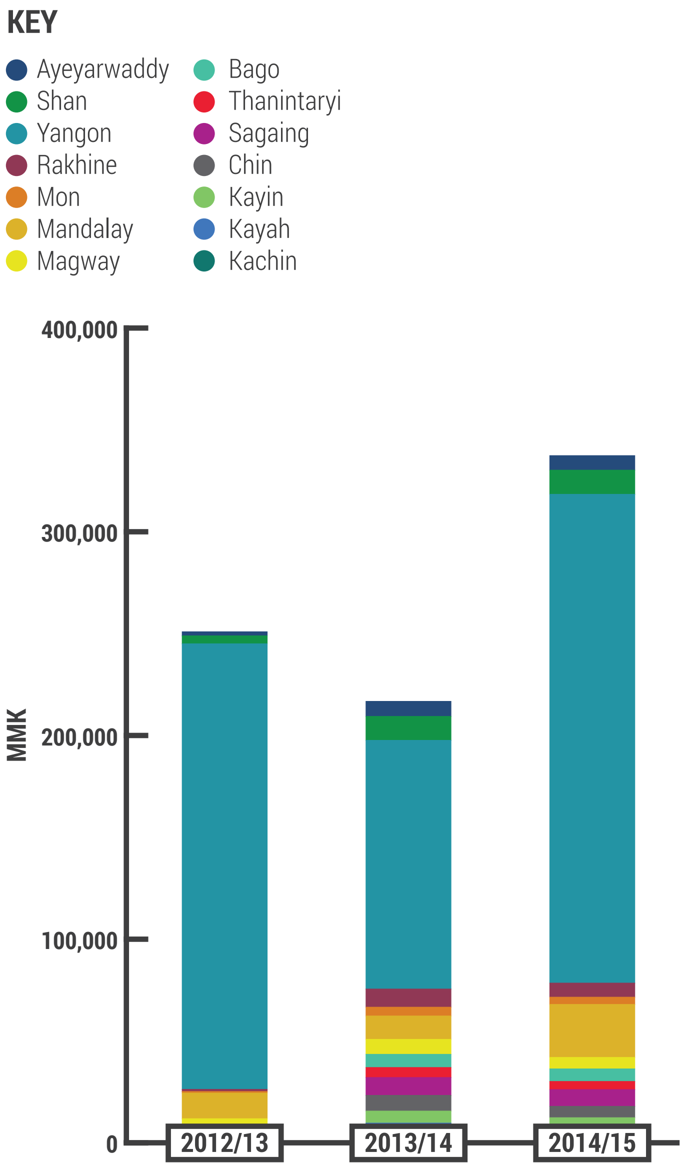
percent of the overall state/region revenue pool.

- Shared-revenue transfers do not seem to be taken into account in the computation.
- Lastly, there appear to be some anomalies and inconsistencies with the data values used for some of the indicators.

The net result is that the general grant transfer allocations display very wide variance across states/regions when computed on a per capita basis. This will be explored more further below.

Tables 22 and 24 , and figures 29 and 30 in Annex C provide simulations where, first, the current formula is applied to the entire allocable pool; then the current formula with variables normalized by relative population is applied to the entire pool; and then an adjusted and differently weighted formula is applied to the entire pool, where the three 'need' factors (especially population) are given higher total weighting, and the three 'fiscal constraint' factors are given a weighting totaling only 20 percent of the pool. The winners and losers of each of these sets of changes, as compared to actual 2018/19 allocations, are highlighted in table 25 in Annex C.

FIGURE 7 Trends in shared revenue transfers (MMK million)



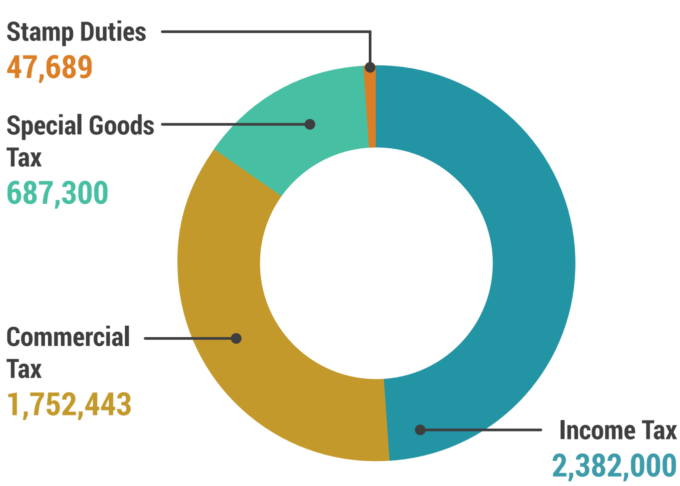
SHARED TAX REVENUE TRANSFERS

Revenue-sharing is the second most important transfer. The figures 7 and 8 below illustrate the trends and allocations of shared revenue transfers, and their composition. They show that commercial and special goods taxes constitute the great bulk, and that some 70 percent of all shared revenues are, unsurprisingly, returned to Yangon region where they were mainly collected. These revenues are recorded under Part 1 (Cabinet) of the state/region budget.

Revenue-sharing was started in 2016/17, and is clearly a positive move toward increasing state/region fiscal resources for local spending. However, the current arrangements do raise a few issues:

- Tax revenues are allocated on a derivation basis (by area of collection), not pooled and allocated by criteria such as the MTTF formula. The latter would both avoid potential horizontal equity problems as well as the much greater unpredictability problems

FIGURE 8 Breakdown total shared revenues, BE 2016/17 (MMK million)



that arise for individual states/regions when such revenues are allocated by collection area and not pooled nationally.

- This allocation by derivation may perhaps reflect some unclarity as to the distinction between Union and state/region revenues and/or a belief that the latter "deserve" a share of those revenues collected locally, despite their being constitutionally designated as Union revenues.
- One issue which complicates this transfer instrument has arisen in the case of large companies which must pay tax to IRD's Large Taxpayer Office, but which only has an office in Yangon – hence the revenues are shared back to Yangon even in cases where the company's operations which generated the revenue are in other states/ regions. This further distorts the revenue-sharing patterns (associated equity issues are discussed further below) and also constitutes further reason to question the "derivation" basis for allocating these revenues.

3.3 STATE/REGION BORROWING

Under MoPF financial regulations, states/regions may seek loans from third parties, but for this they require prior approval from MoPF, and then the Union government and the Pyidaungsu Hluttaw. Currently, only Yangon and Mandalay regions (on behalf of YCDC and MCDC) appear to have availed of this possibility, enjoying loan revenue entries in 2018/19 of MMK 104.2 billion and MMK 39.8 billion, and incurring repayments for previous loans of MMK 3.0 and MMK 6.8 billion, respectively, in the same year.[48]

However, there are also instances whereby State/region authorities – usually on behalf of the DDA/DAOs - appear to have entered into agreement with Union ministries to repay the cost of investments undertaken for specific donor-supported projects which the Union government has borrowed for.

It will, however, be a major challenge for state/region governments to repay such project loans (however subsidized the terms may be), when the user fees[49] generated by these investments barely cover operating costs, let alone the capital costs and when – as will be seen – their general own-revenue base (outside Yangon and Mandalay) is modest in the extreme. The risk then is either loan default by states/regions, or that states/ regions (or indeed the Union government) adopt creative accounting arrangements to simply switch Union transfers toward loan-repayment, to the cost of the wider local development spending agenda.

BOX L
Loan repayment obligations to Union government

In one state/region it was reported that the DDA is liable to repay the following loans to the Union Ministry of Construction:

- MMK 6 billion for water supply and garbage collection investments in selected towns, financed under an ADB project loan. This is pending approval.
- MMK 15 billion for water treatment investments for a selected town , financed under a Japan International Cooperation Agency (JICA) Project supporting a number of secondary towns (loan repayable over 30 years with 8-year grace period). This has been approved.

3.4 THE RESULT: OVERALL STATE/REGION BUDGET FINANCING PATTERNS

Consolidating the financing flows
Figure 9 indicates the total financing flows for devolved state/region spending. Clearly, transfers – and especially general grant transfers - dominate massively in all states/regions other than Yangon and Mandalay. Own-source revenues account for only 20 percent of all state/region financing – but, excluding Yangon and Mandalay, they equate to only 10 percent.

All financing per capita
What is more significant is to examine these total financing flows on a per capita basis, since this provides an insight into the roots of equity issues discussed above. Figure 10 below illustrates very wide variance, both in total resources per capita, and in the component financing flows.

FIGURE 9 Revenues for devolved spending by source, 2018/19 (MMK million)

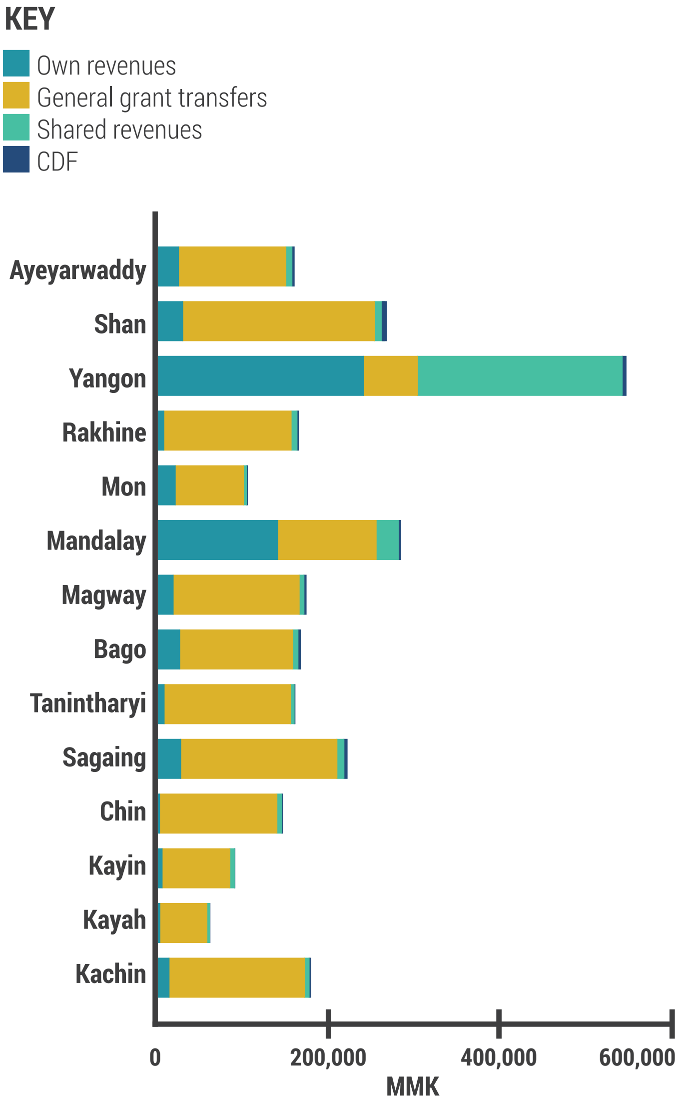
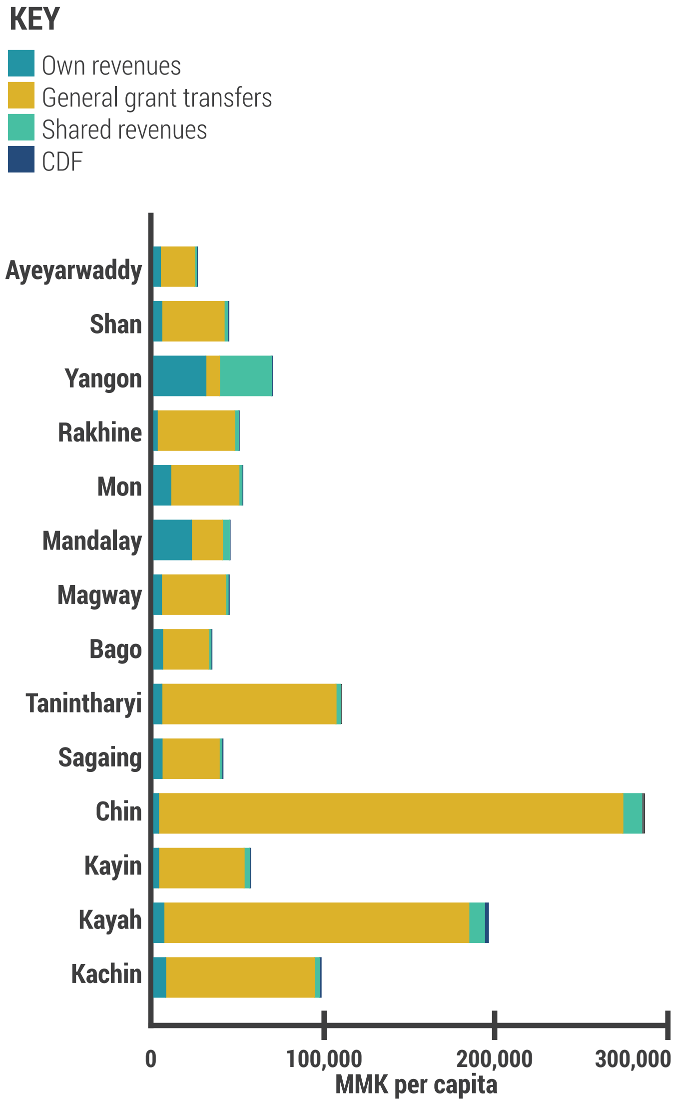


FIGURE 10 State/Region per capita revenues by source, 2018/19 (MMK million)



It is certainly no surprise that there is wide variance in own-source revenues per capita, or in shared revenues per capita (given their allocation by 'derivation'), due to the very different economies and tax bases of the 14 states/regions.

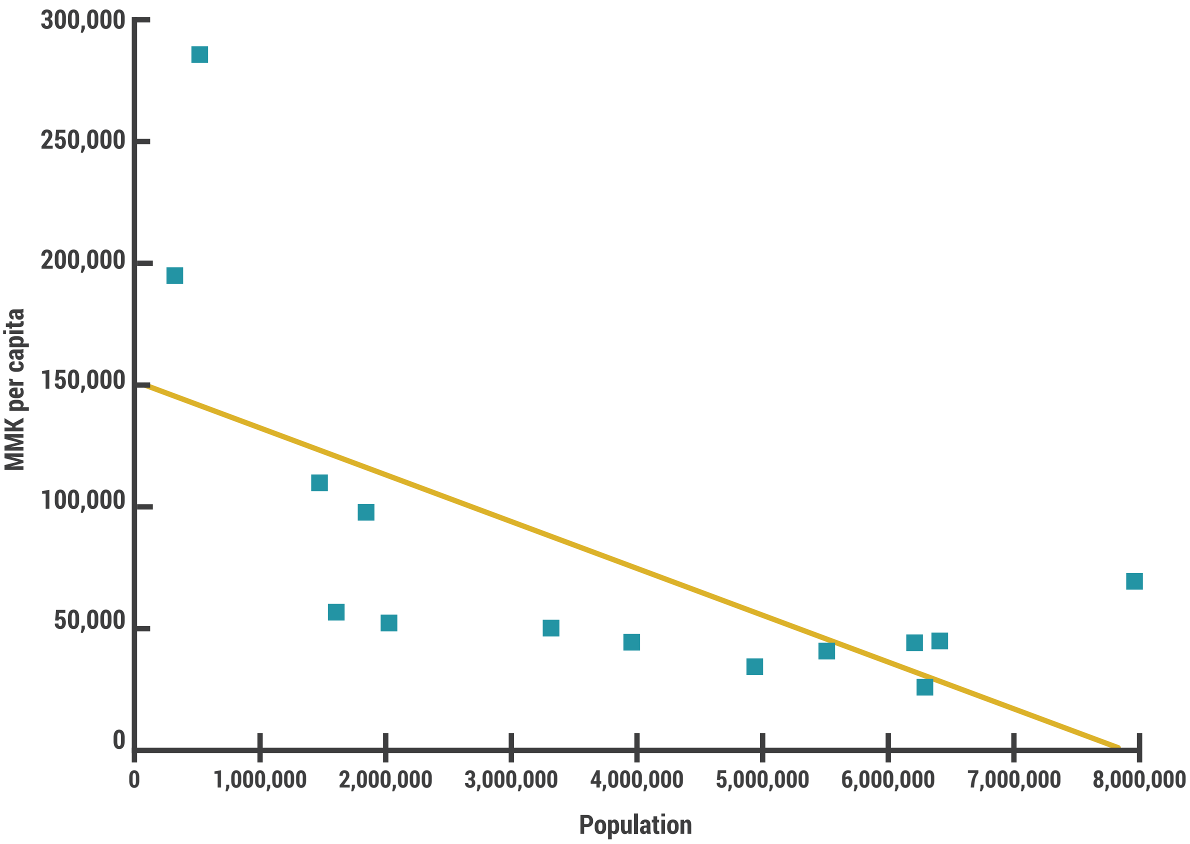
But what is striking is that the general grant transfers do not compensate for these inherent "fiscal constraints" – instead they tend to introduce *much greater inequities* of another sort across states/regions.

The resulting average and median total financing levels per capita are MMK 81,640 and MMK 50,625 respectively. But at one extreme, Chin receives MMK 285,242 per capita, while at the other Ayayerwaddy receives MMK 25,287 – a Max:Min ratio of more than 10:1. This is all very much a result of the issues in the allocation formula noted further above, and detailed in Annex C. Because index values are not normalized by relative population, and population is given such low weighting alongside other factors, the current formula strongly favors states/regions with smaller populations. This is clearly seen in figure 11 below (with a best-fit linear trendline depicting the relationship), and must underlie the findings revealed further below in regard to the variance in average per capita spending levels across Mandalay, Sagaing, Kayin and Chin.

There is certainly no reason for per capita funding to be equal across the country, given varying contexts and needs, but such a very large variance in local public spending capacity is hard to understand. This has inevitable direct knock-on effects on devolved sector spending patterns on local development and underlies part of the substantial variance in per capita spending levels and patterns between states/regions examined in Chapter 4.

"THERE IS CERTAINLY NO REASON FOR PER CAPITA FUNDING TO BE EQUAL ACROSS THE COUNTRY, BUT SUCH A VERY LARGE VARIANCE IN LOCAL PUBLIC SPENDING CAPACITY IS HARD TO UNDERSTAND"

FIGURE 11 Plotting total revenues per capita against state/region populations



3.5 STATE/REGION FINANCING IN PRACTICE: EMERGING ISSUES

Revenue collection. State/region revenue powers are limited but even within these modest powers there are **constraints to revenue-raising**:

- Firstly, state/region authorities are not always able to fully leverage their powers due to **legal and regulatory unclarities** (for example, as to the authority to adjust tax or fee rates);
- Secondly, the **fragmentation of collection responsibilities across different sub-national agencies** (DAOs, GAD, Cabinet, etc.);
- Thirdly, the **legacy of negotiated gap-filling fiscal transfers** to states/regions in Myanmar will very likely have reduced incentives to maximize local revenue potential, as it has in other countries which operate similar transfer arrangements.
- Lastly, the earmarking of the great bulk of state/region revenues for **use solely by DAOs** in the urban areas does impose considerable rigidity in allocating budget resources across the state/region territory.

Despite these various constraints, initiatives such as that of The Asia Foundation to increase property tax collection, noted above, do suggest **opportunities for improving local fiscal effort** from the present very low levels. The reforms to property tax processes, capabilities, policy, and communications being tested also offer lessons for other revenue reforms.

Fiscal transfers. Transfers provide the great bulk of state/region budget resources - about half of budgetary resources in Yangon and Mandalay, and almost the entirety of resources elsewhere. This in itself is not unusual – no sub-national governments in Asia, outside those for large, prosperous metropolitan areas, can expect to be fiscally self-sufficient.

- The financing and allocation of general **grant transfers** has been greatly improved through the MTFF reforms, bringing stability and greater transparency. But, as noted, the full potential is not realized. Allocations between states/regions are markedly inequitable, since the formula is only applied to the annual increment to the pool, and the formula anyway strongly favors states/regions with smaller populations. Further, states/regions have not yet taken full advantage of the advance notice of the fiscal transfers that they now receive, to provide advance budget ceilings to their departments or township administrations. This would inject much-needed priority-setting discipline into the budget process; and this in turn would also provide incentives for much more meaningful community consultations.
- **Shared-revenue transfers** also provide significant budgetary resources – but the rationale for allocating by origin, rather than by formula, is unclear. Since there appears to be no arrangement to compensate for shared revenues in the deficit grant allocation transfer there is also a risk that over time these may lead to further inequities.

Borrowing. Although very limited to date, the instances of Union government on-lending to states/regions for certain donor-supported investment projects (particularly those outside of the major cities) poses future challenges, given their very low revenue-raising capacity.

> ***“DESPITE THE CONSTRAINTS, THERE ARE ALSO OPPORTUNITIES TO RAISE LOCAL FISCAL EFFORT FROM THE PRESENT VERY LOW LEVEL”***

CHAPTER 4

HOW DOES FINANCING TRANSLATE INTO LOCAL DEVELOPMENT SPENDING?

In the foregoing chapters we outlined the arrangements for financing local development spending from Union and state/region budgets, and how financing works out in practice for states/regions. We now turn to examine the factors determining financing allocations for local development budgets by sector, from state/region and Union budgets; and then to examine the patterns emerging at township level where these two flows meet; and finally, to make an initial review of the likely justification for the marked variance patterns that are highlighted.

4.1 STATE/REGION SPENDING LEVELS AND PATTERNS

DETERMINANTS OF LOCAL SPENDING FROM THE STATE/ REGION BUDGET

Local capital budget development spending from state/ region budgets is determined by the following factors:

Net budget resources for local development spending
The most obvious factor of course is the level of available state/region budget resources, resulting from own-revenue and fiscal transfer flows, as detailed in Chapters 2 and 3 above. However, there are obviously also "prior claims" on these budget resources, so that they are not entirely available for local development spending.

Firstly, where states/regions have loan commitments, priority will need to be given to servicing the repayments. As noted in Section 3.3 above, in future years it may be a major issue in those states/regions which have received 'onlent' funding for various DAO investment projects, and repayment must be given priority, cutting into local development spending budget resources. It is also an issue, although a relatively minor one, in Yangon and Mandalay, where project loans incurred by the CDCs have to be paid off.

Secondly, support to the CDCs and the DAOs may present a rather similar "prior claim". Looking at state/ region budgets we see that YCDC and MCDC account for a massive 71 percent and 53 percent of total Yangon and Mandalay regions' budgets, respectively, and which required "internal transfers" (to supplement YCDC and MCDC own revenues) to the two CDCs of 32 percent and 13 percent of the overall Yangon and Mandalay regions' revenue budgets, respectively. See table 10 overpage.

In the case of YCDC this dominance of the Region budget is perhaps not surprising, given that the population of Yangon city is some 61 percent of the Region population. However, for Mandalay, it may raise more questions, given that the city accounts for only less than 20 percent of the Region's population. Interestingly, by contrast, in Mandalay no region budget support is provided to the DAOs in townships outside of Mandalay City.[50]

As seen in Chapter 3, Mandalay already enjoys a relatively low level of budgetary resources per capita. It is likely that this very large allocation of budgetary resources to MCDC further underlies the very low levels of per capita spending in other devolved departments in *other* townships, outside MCDC, in Mandalay Region, that we see further below.[51]

Elsewhere, financing support to the DAOs may also represent a similar "prior claim" in 11 of the states/ regions, where 37 percent of total DAO spending is funded from state/region budget resources.

Deciding the capital share of state/region budgets

Once total revenues are estimated for each state/region (net of "prior claims"), the next step in determining local development spending patterns is the division of total revenues by the state/region government between the current budget (for staff, operations and maintenance, etc.) and the capital budget for investments. In this process, the prior claim seems to be given to current budget commitments for the existing establishment – both staff and facilities of the sector departments as well as the general state/region and GAD administration set up.

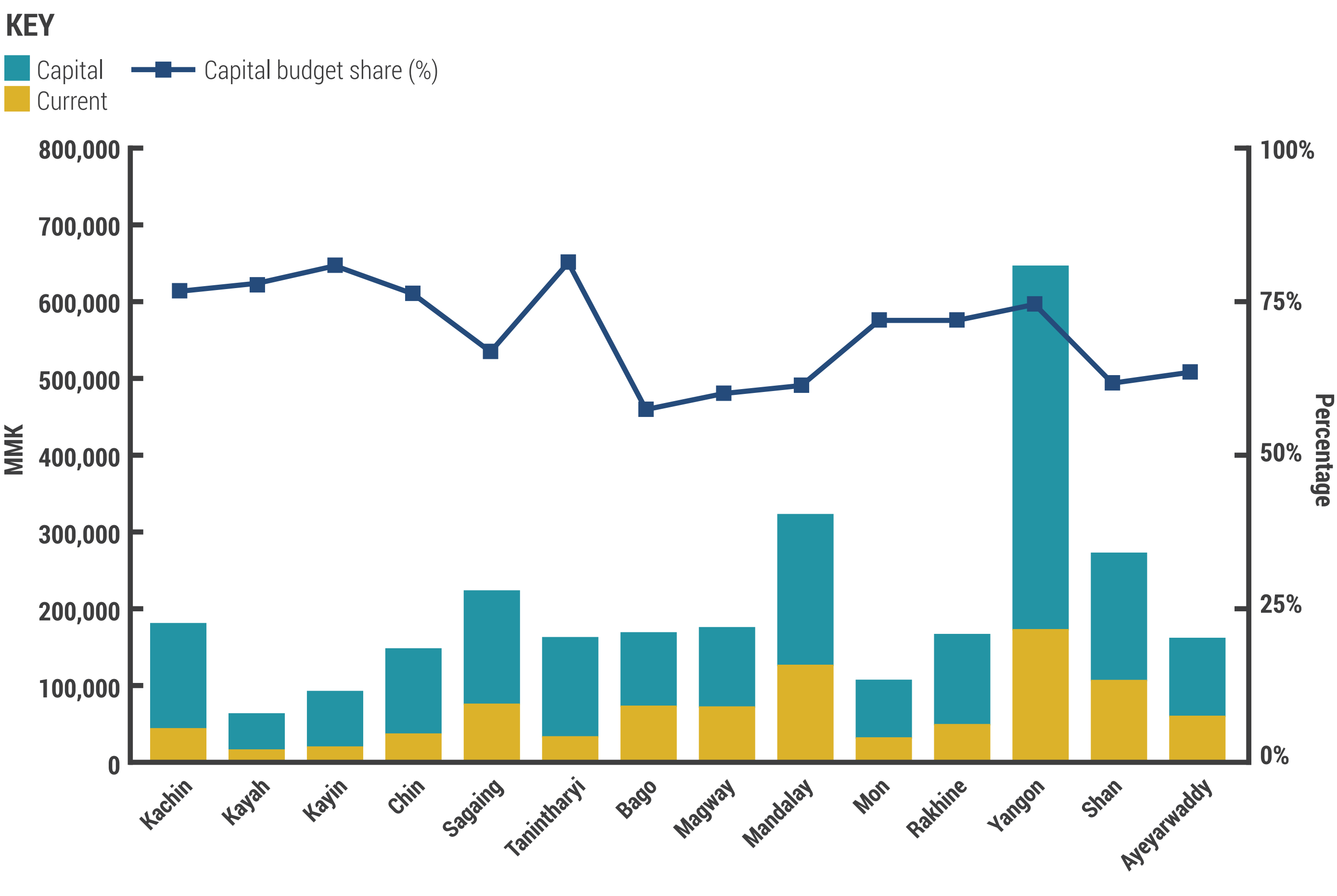
Figure 12 below illustrates the capital budget shares for each state/region.

Overall, this depicts levels of capital spending from sub-national budgets which are high – and seem to have increased compared to earlier years. There is also significant variance in these capital budget shares in total state/region budgets: from highs of 81 percent in Kayin and Tanintharyi, to lows of around 60 percent in Bago, Magway, Mandalay, Shan and Ayayerwaddy. Several reasons are possible for this variance.[52] One is obviously that the relative size of current budget administrative commitments differs between states/regions. But it may also simply relate to the relative

TABLE 10 YCDC and MCDC expenditures and revenues compared to region budgets, 2018/19

	YCDC	MCDC
CDC Expenditures – MMK million	389,562	149,255
CDC revenues – MMK million	213,069	112,409
Internal transfer to CDC from Region budget – MMK million	176,493	36,845
Total Region budget – MMK million	545,979	282,977
Internal transfer as % Region budget	*32%*	*13%*
CDC expenditures as % Region budget	*71%*	*53%*
CDC population as % Region popn.	*61%*	*17%*

FIGURE 12 Capital share of total budgets, 2018/19 (MMK million)



generosity of total budget resources available to each state/region – allowing some states/regions a greater "residual" to allocate to discretionary investments after the current budget commitments are taken care of. Figure 13 below plots percentage capital budget share against total State/region budget revenues per capita and suggests such a correlation.

Deciding state/region local development budgeting priorities

The next step in determining sector spending patterns is the way the state/region government then allocates this capital budget – by sector, by area and by project. This process is examined in detail in the companion Asia Foundation report *Where Top-Down Meets Bottom-Up* but, in brief, the following are the key factors which come into play:

- **State/region government strategic priorities.** Most obviously, local and regional development priorities have major bearing on devolved spending patterns. They typically focus mainly on strategic infrastructure: the primary and secondary highway network (with varying emphasis on the tertiary rural road network), the electric grid, and urban investments through the DAOs and the City Corporations. Investment in other sectors tends to be a residual, greater or lesser depending on the size of the overall capital budget.
- **Political constituency priorities.** The priorities sponsored by MPs – acting for their township constituency interests - and by the Chief Minister are paramount, especially in sectors (water supplies, rural roads, schools, etc.) where there is greater flexibility and where "technical network" considerations are less binding.
- **Bias to "fairness" and historic precedent.** Lastly, there are default biases in allocation decisions, to ensuring some "similarity" both in year-to-year allocations to departments and also in allocations between townships (regardless of the relative sizes or needs of townships). This "even spread" – in time and space – is a natural default bias, seen in many countries, and no doubt serves to appease different political and bureaucratic interests, especially where there are no strong policy and technical criteria to guide budget prioritization and to defend departures from precedent.

FIGURE 13 Plotting capital budget share against total state/region revenues per capita, 2018/19

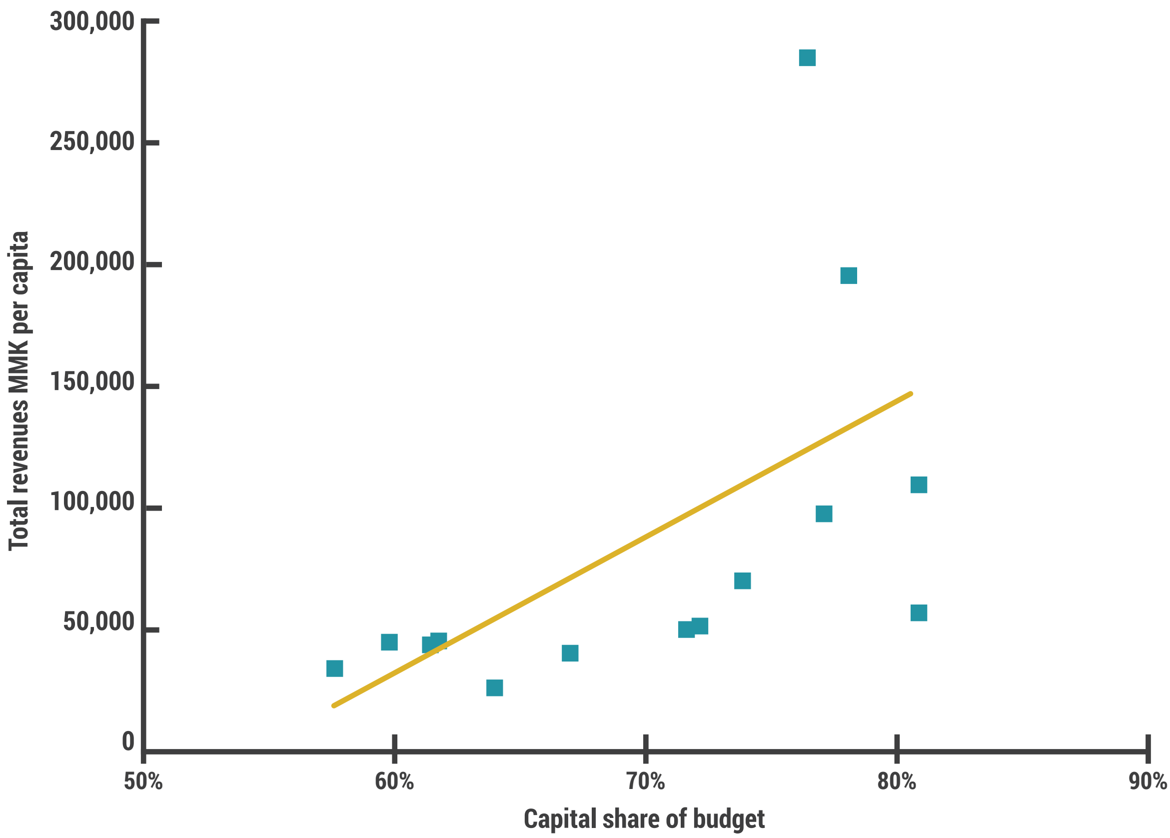
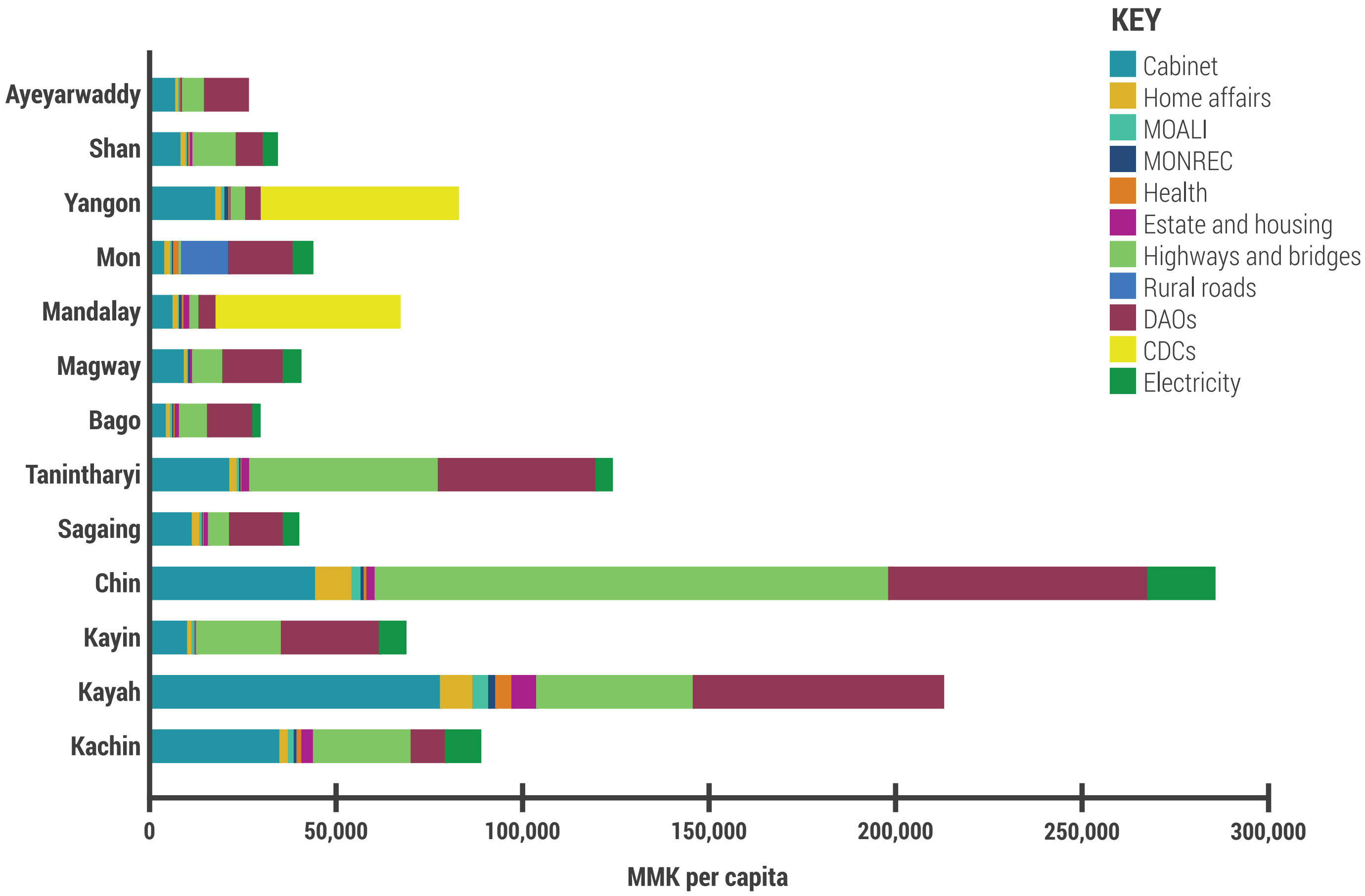


FIGURE 14 Devolved MMK per capita investment spending by state/region and department, 2018/19



STATE/REGION SECTOR SPENDING PATTERNS

Given the considerations just outlined, there is good reason to expect that the departmental capital spending patterns of devolved budgets will be at some variance across states/regions. Figure 14 above depicts capital development spending composition on a per capita basis[53] (figure 23 in Annex B shows total spending patterns by sector).

What emerges is that, other than for Yangon and Mandalay (dominated by CDC spending), capital spending is mostly consumed by highways & bridges, by general Cabinet (multi-sector) spending, by electricity (in some states/regions) and by DAO spending. This appears consistent with the priorities commonly expressed by state/region authorities.

While social sector spending is necessarily absent, being a Union budget responsibility, it is rather surprising to see such low spending levels for those sectors with a specifically rural focus: MOALI and MONREC. Rural road spending through DRRD is even lower (other than for Mon), although this seems inconsistent with levels suggested by the township level budget data (examined further below) – but this discrepancy may be explained by the fact that rural road spending is often recorded under the Cabinet account at state/region level, as discussed in Chapter 2.

Again, and YCDC and MCDC aside, we see that the absolute amounts spent per capita in each sector do vary considerably between states/regions. This is unsurprising given the greatly varying per capita resource pools enjoyed. This variance is captured here in the “heatmap” in table 11 below, showing the three highest and three lowest investment levels per capita for each department.[54]

Table 12 below shows the variance statistics for per capita spending across *all* states/regions. As noted earlier, there are of course reasons to expect wide variance in some sectors where individual investments may be very large (electricity, highways/bridges, etc.). But such large variance in MOALI and MONREC spending is more difficult to understand. There is also substantial variance in urban spending (with DAOs and CDCs combined for Mandalay and Yangon). DAOs in townships outside MCDC enjoy the lowest spending levels, at MMK 9,865 per capita (perhaps because much urban spending there is assumed by MCDC). However, we still see that the next lowest, Ayayerwaddy, spends MMK 11,363 per capita – only one sixth of the high-end per capita spending in Chin and Kayah.

> **THERE ARE REASONS TO EXPECT WIDE GEOGRAPHIC VARIANCE IN PER CAPITA SPENDING IN SOME SECTORS, WITH LARGER STRATEGIC INVESTMENTS, BUT IN OTHER SECTORS THIS IS HARDER TO UNDERSTAND**

TABLE 11 Heat map showing highest and lowest investment per capita levels by sector, 2018/19

	CABINET	HOME AFFAIRS	MOALI	MONREC	HEALTH	ESTATE & HOUSING	HIGHWAYS & BRIDGES	URBAN TOTAL (DAOs + CDCs)	ELECTRICITY
KACHIN	34,996	2,286	1,584	710	1,280	3,110	26,256	9,152	9,127
KAYAH	78,053	8,683	4,320	1,851	4,335	6,633	42,049	66,833	0
KAYIN	10,209	1,184	711	67	176	278	22,731	26,363	6,657
CHIN	44,556	9,725	2,505	789	768	2,217	137,820	69,607	17,609
SAGAING	11,463	2,076	597	241	282	1150	5,633	14,424	3,756
TANINTHARYI	21,502	2,020	621	451	205	2,099	50,598	42,311	4,042
BAGO	4,460	1,147	646	273	307	1,187	7,575	12,107	1,567
MAGWAY	9,347	778	353	472	45	571	8,095	16,177	4,353
MANDALAY	6,269	1,537	191	730	548	1,513	2,467	53,567	0
MON	4,110	1,496	509	383	1,320	21	782	17,305	4,893
YANGON	17,763	1,600	883	1,072	321	243	3,881	56,726	0
SHAN	8,402	1,383	408	323	429	669	11,616	7275	3,390
AYAYERWADDY	7,004	750	405	119	130	464	5,861	11,363	0

Red cells: highest investment, Yellow cells: lowest investment.

TABLE 12 Devolved investment per capita variance statistics across states/regions, 2018/19

	VARIANCE STATISTICS				
	AVERAGE	MEDIAN	MAX	MIN	MAX:MIN RATIO
CABINET	19,856	10,209	78,053	4,110	19:1
HOME AFFAIRS	2,666	1,537	9,725	750	13:1
MOALI	1,056	621	4,320	191	23:1
MONREC	576	451	1,851	67	28:1
HEALTH	780	321	4,335	45	96:1
ESTATE & HOUSING	1,550	1,150	6,633	21	315:1
HIGHWAYS & BRIDGES	25,028	8,095	137,820	782	176:1
URBAN TOTAL (DAOs + CDCs)	31,016	17,305	69,607	7,275	10:1
ELECTRICITY	4,261	3,756	17,609	0	∞

4.2 UNION SPENDING PATTERNS ACROSS STATES/ REGIONS

DETERMINANTS OF LOCAL SPENDING FROM THE UNION BUDGET

Local development spending patterns from the Union budget derive from factors comparable to those outlined just above for state/region budgets.

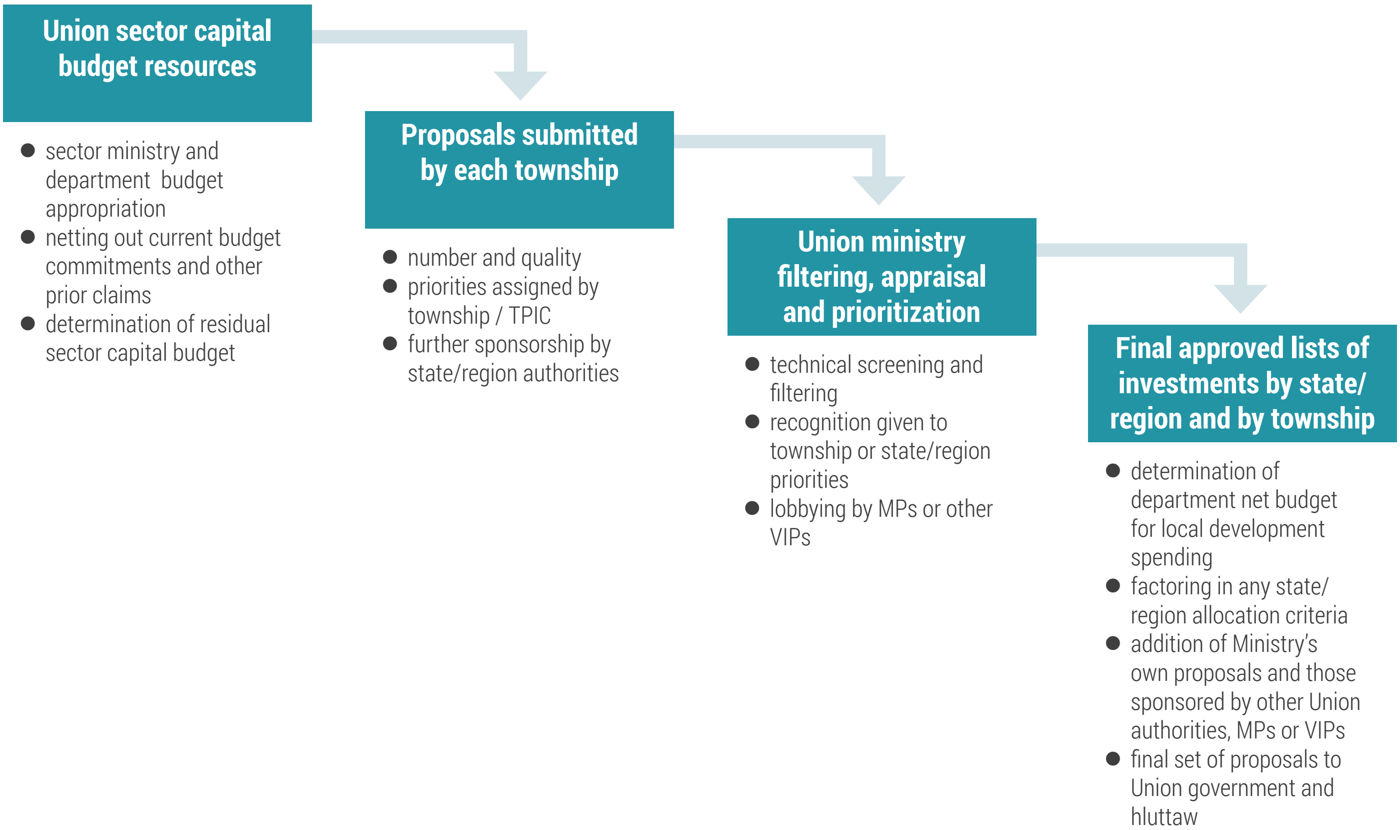
Firstly, the overall annual budget appropriation for the department concerned. The MTFF has brought some stability into these appropriations, although there are variations, with the social sector departments now enjoying considerable yearly increases (after their historically low allocations), but other sectors subject to greater variability, or even budget declines.

Secondly, the division of this allocation between current and capital – and as with state/region budgets, priority is understandably given to the staff component of current budgets (especially in the staff-intensive social sectors). As such, allocations for capital and also current budget maintenance tend often to be a residual.

Thirdly, the way that investment proposals are filtered and selected for approval (or not) together with any criteria applied for allocation across states/regions. In the case of the key Union departments spending on local development, the following factors come into play:

- **Proposals submitted and their sponsorship.** The lists of proposals received from the states/regions and their townships, the relative priorities assigned to these proposals, constitute the bulk of the "pool" from which final investments are selected. To a degree, DBE and other Union authorities do also inject *their own proposals* (DBE, for example, adds-in proposals for school laboratories, libraries, etc., in line with Union NLD policy priorities).
- **The "filtering" and selection process.** Union Departments filter these excessively long lists of proposals, respect - or not - the priorities submitted, cut back on the large numbers of proposals to the limit which can be afforded in their approved budgets. And, although individual ministries and departments apply sector-specific technical criteria when filtering proposals, the degree of support and lobbying by MPs and Chief Ministers for particular

FIGURE 15 Determinants of Union local development spending levels and patterns



proposals and the extent to which departments are subject to further pressures from state/region or Union politicians is always a key factor.

- **Indicative state/region budget allocations.** In parallel with the filtering of individual project proposals, some departments[55] have devised criteria to guide relative state/region budget allocations. Although these are often overridden by other consideration and, critically, there are no such criteria to guide relative allocations from the Union budget to different townships within states/regions.

STATE/REGION ALLOCATIONS OF DECONCENTRATED UNION BUDGET SPENDING

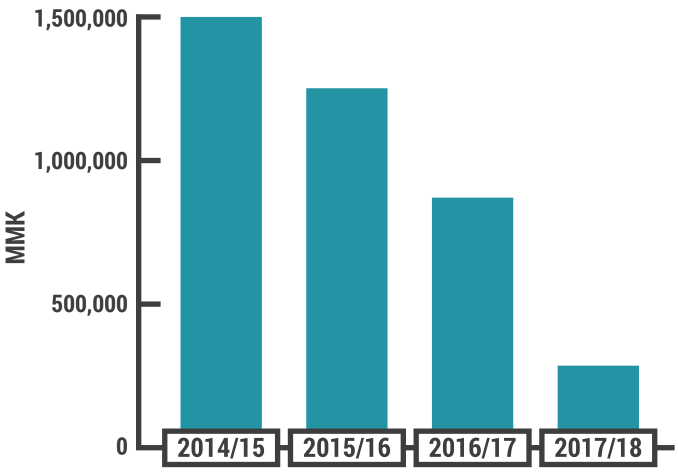
The outcome of these various factors determines the actual allocation of Union Department budget resources across not only states/regions but also across townships. This geographic breakdown is not provided in the Union budget – and can only be found, for the capital budgets, in the "State/Region Plans" and "Township Plans" compiled by state/region Planning Departments, referred to earlier. In this light we examine deconcentrated funding of local development through two departments for which such data was made available: Rural Roads and Basic Education.

DEPARTMENT OF RURAL ROAD DEVELOPMENT

From 2017, the Union Department of Rural Roads Development (Ministry of Construction) took over responsibility from DRD for funding Classes B and C rural roads, with Class A rural roads being devolved to state/region DRRD. This switch and partial devolution of responsibility has also been accompanied by a sharp decrease in Union budget allocations to DRD/DRRD for rural roads – see figure 16[56] (but which excludes MOBA rural road funding).

Historically, rural roads funding translated into per capita terms has been allocated across states/regions

FIGURE 16 Union budget for DRD/ DRRD rural roads (MMK million)



with substantial variance, although this variance has decreased as total funding has decreased more recently. In 2017/18, Kayah received MMK 2,415 per capita, over three times the MMK 703 per capita received by Magway (in earlier years the max:min ratio had been 10:1).

Union DRRD has now devised criteria for budget allocation across states/regions using a combination of three criteria:

A. The relative investment shares of each state/region as proposed in the National Strategy for Rural Roads and Access.[57]
B. The relative rural population sizes of each state/ region.
C. The relative size of the current rural road network.

These three criteria are then averaged, with equal weighting for each. Including both criteria A and B is

TABLE 13 Rural roads budget allocations to state/regions[48]

State/Region	DRRD budget allocation criteria							Actual relative budget allocations under DRRD	
	A. Network development plan		B. Population		C. Current road network		Average of 3 criteria		
	$ million	%	Population	%	Road miles	%	%	2016/17	2017/18
Kachin	106	4.2%	1,050,473	3.0%	1,849	3.4%	3.6%	2.9%	3.9%
Kayah	12	0.5%	214,209	0.6%	446	0.8%	0.6%	0.8%	1.8%
Kayin	85	3.4%	1,175,160	3.4%	1,188	2.2%	3.0%	3.5%	4.1%
Chin	352	13.9%	378,992	1.1%	4,770	8.9%	8.0%	4.7%	1.4%
Sagaing	317	12.6%	4,414,012	12.8%	7,708	14.3%	13.2%	15.4%	13.0%
Tanintharyi	39	1.5%	1,069,982	3.1%	1,969	3.7%	2.8%	2.1%	3.5%
Bago	149	5.9%	3,795,037	11.0%	4,218	7.8%	8.2%	12.2%	13.8%
Magway	268	10.6%	3,329,024	9.6%	6,551	12.2%	10.8%	8.3%	7.9%
Mandalay	77	3.1%	4,022,287	11.6%	5,325	9.9%	8.2%	9.0%	11.6%
Mon	5	0.2%	1,482,204	4.3%	968	1.8%	2.1%	4.9%	3.8%
Rakhine	281	11.1%	1,744,519	5.0%	1,766	3.3%	6.5%	8.4%	7.4%
Yangon	81	3.2%	2,200,191	6.4%	1,949	3.6%	4.4%	5.7%	3.9%
Shan	463	18.3%	4,428,585	12.8%	11,153	20.7%	17.3%	8.4%	10.1%
Ayeyarwaddy	289	11.5%	5,312,229	15.3%	4,009	7.4%	11.4%	13.7%	13.8%
Total	**2,524**	**100%**	**34,616,904**	**100%**	**53,869**	**100%**	**100%**	**100%**	**100%**

a reasonable attempt to reconcile "network expansion efficiency" and equity goals in investment budget allocation, although there is some overlap, since the National Strategy investment allocation plan was itself partly based on relative rural population size of states/ regions. The rationale for criterion C is less clear, insofar as the size of existing networks is likely to be more a factor determining current maintenance budget than investment budget needs. Insofar as this applies to the capital budget allocation, it would be more appropriate to use some *inverse value* of the present rural road infrastructure of each state/region.

No data is available for 2018/19 DRRD allocations. But if DRRD allocation criteria are in fact to be reflected in present and future budget allocations this will result in *some considerable change* to past allocation patterns under DRD: Chin, Magway and Shan getting substantially more than before; Bago, Mandalay, Rakhine and Ayayerwaddy getting rather less. This is illustrated in table 13 on the preceding page.

DEPARTMENT OF BASIC EDUCATION

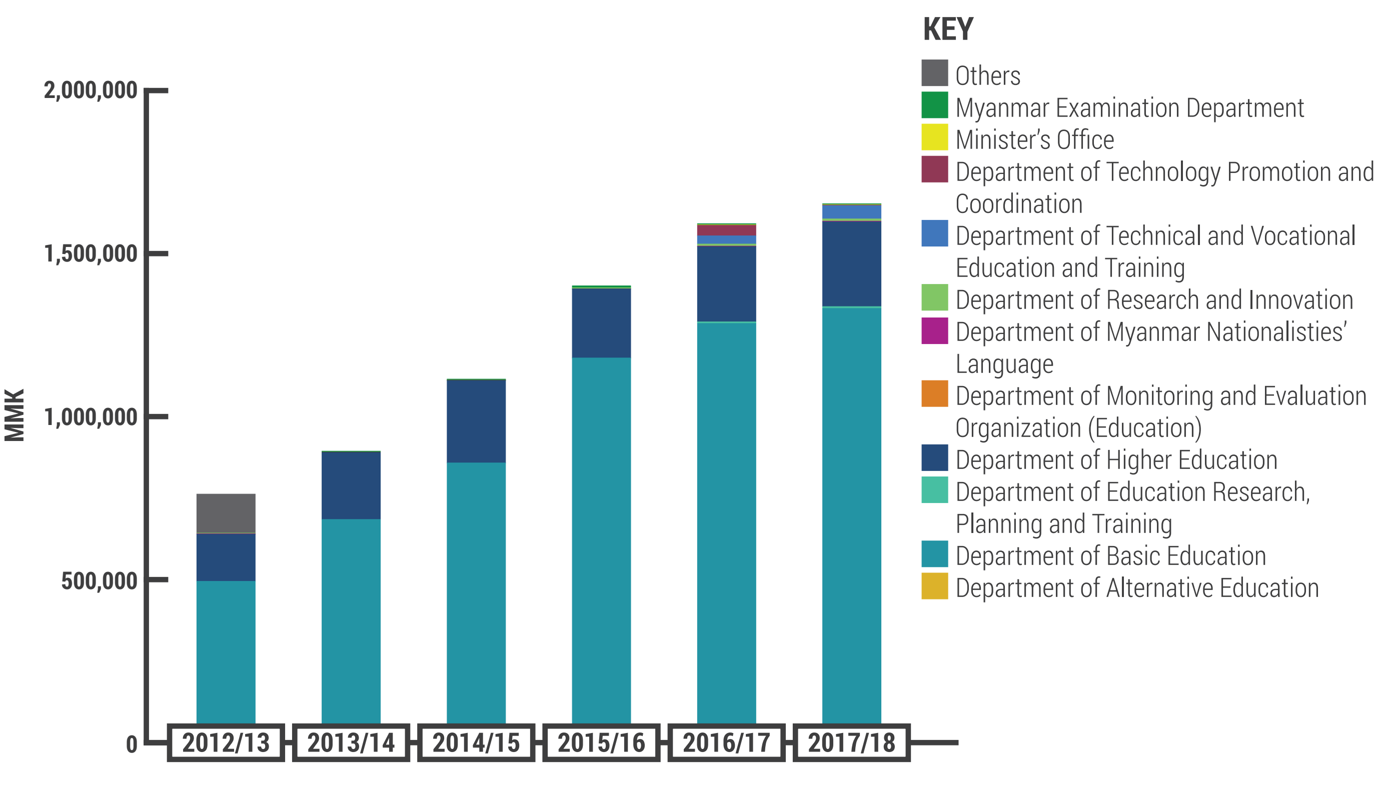
In contrast to the rural road budget, the MoE budget has steadily increased in recent years, as depicted in figure 17 below.[58] This budget is dominated by DBE which accounts for some 80 percent of all MoE spending; of the DBE budget, in turn, 89 percent is on the current budget and 11 percent on the capital budget – primarily for school buildings, although with minor investments in offices and tertiary facilities.

DBE has determined a simple formula for allocating budgets for school investments, where the state/region share of the allocable budget equates to its share of the simple sum of the numbers of enrolled pupils added to the numbers of schools in relation to the total numbers of enrolled pupils and of schools nationwide. Thus for Kachin, the sum of its 345,865 pupils and 1,552 schools ("347,417") is equivalent to 3.8 percent of the sum of the national number of 9,144,469 students and 47,004 schools ("9,191,473") – hence it should receive 3.8 percent of the sector capital budget.

Use of a such a transparent "rule-based" allocation criterion is clearly positive, although it does appear to favor states/regions with relatively higher school capacities – when what is needed would seem to be the opposite, to allow greater investments where there is lower school capacity. But, that said, budget data suggest that this allocation formula is only very loosely followed.

Table 14 shows the actual capital budget allocations for 2018/19 in the left hand column, and compares these to the allocations which would be made according to

FIGURE 17 Ministry of Education budget by department (MMK million)



the formula just described above. We see, for example, that the formula-based allocation for Chin would have been 1.5 percent of the budget, but in fact it received 5.5 percent of the budget – or four times as much. By contrast, Kayin would have received 3.7 percent of the budget according to the formula, but actually only received 3.2 percent - a reduction of 13 percent.

TABLE 14 DBE capital budget allocations: actual vs formula, 2018/19

State/Region	Approved Budget 2018/19		% as per formula	Increase/decrease of actual over formula-based allocation
	MMK million	Actual %		
Kachin	10,156	4.3%	3.8%	16%
Kayah	2,156	0.9%	0.8%	15%
Kayin	7,537	3.2%	3.7%	-13%
Chin	14,071	5.9%	1.5%	308%
Sagaing	24,950	10.5%	11.2%	-4%
Tanintharyi	8,289	3.5%	3.6%	-1%
Bago	21,146	8.9%	10.1%	-10%
Magway	17,757	7.5%	8.0%	-5%
Mandalay	22,884	9.7%	10.7%	-8%
Mon	10,841	4.6%	4.6%	2%
Rakhine	19,246	8.1%	5.7%	46%
Yangon	22,682	9.6%	11.4%	-14%
Shan	22,065	9.3%	9.4%	1%
Ayeyarwaddy	28,065	11.8%	13.0%	-7%

4.3 TOWNSHIP SPENDING PATTERNS: ANALYSIS OF A SAMPLE

Although it was underscored above that there are no township budgets per se, there are township-area breakdowns of approved ministry and department capital investment budgets (both state/region- and Union-funded) which are compiled each year by state/region Departments of Planning. (No such breakdown is available for current budgets.) This chapter is based on analysis of a sample of 24 such “township plans” for 2018/19, from Mandalay, Sagaing, Kayin and Chin. See table 15 overpage.

STATE/REGION & UNION FINANCING SHARES

The sample reveals substantial variance in the overall levels of local spending across the 24 townships. It also shows that on average 56 percent of total local capital development spending is financed from state/region budgets, and 44 percent from the Union budget. The state/region share varied from a low of 32 percent

(Yamethin in Mandalay) to a high of 88 percent (Hpapon in Kayin). State/region shares in Mandalay, Sagaing and Chin are at fairly similar average levels (54 to 57 percent), but rather higher in Kayin (62 percent), though this difference may not be overly significant given the small sample size.

These patterns are themselves a result of varying patterns of local spending by different Union- or state/region-financed departments.

TOTAL TOWNSHIP SECTOR SPENDING PATTERNS

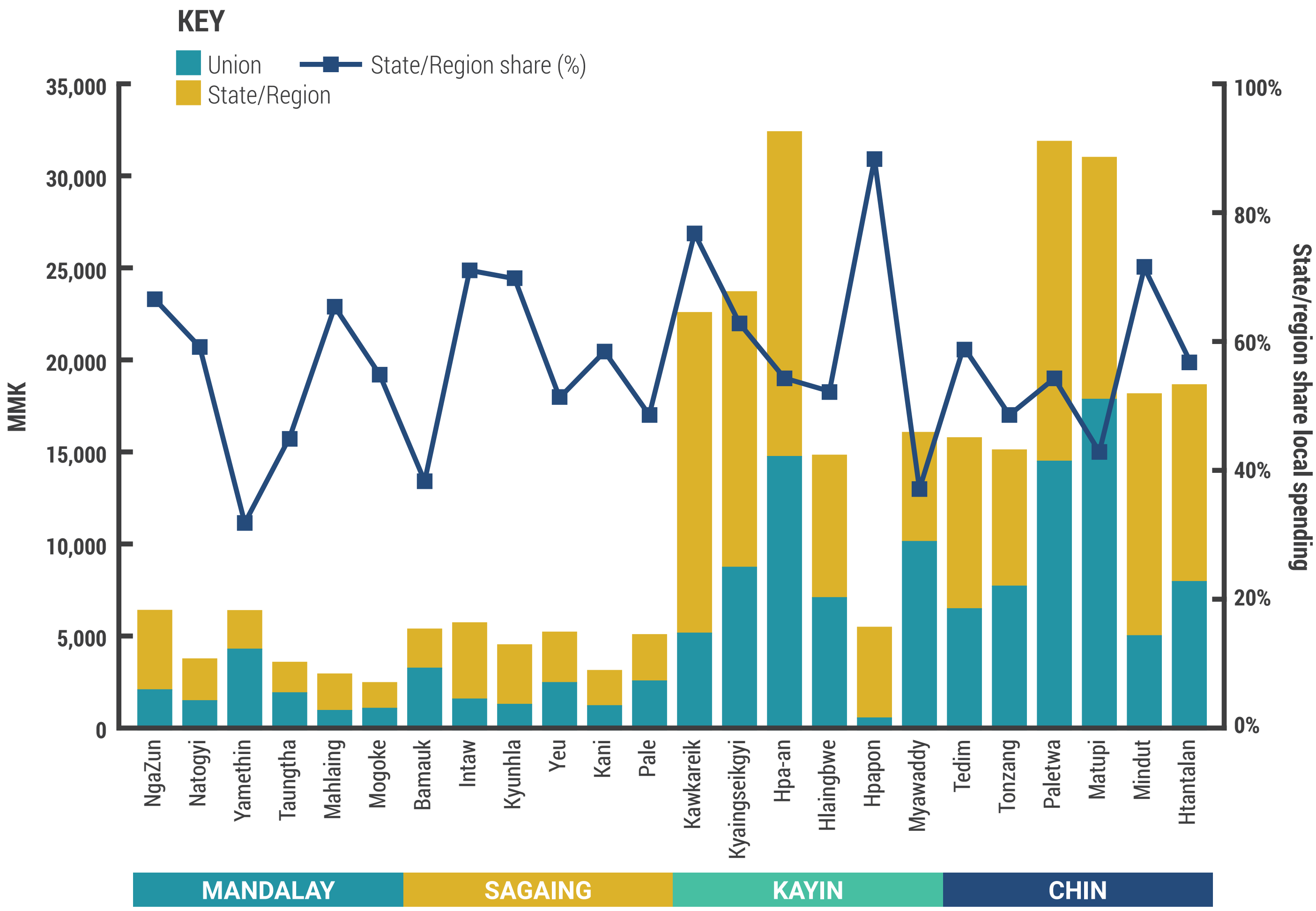
Figure 18 overpage reveals considerable variance in township department investment spending patterns between townships and also between states/regions:

- Total township department spending levels are lowest in Mandalay and Sagaing, and considerably higher in Kayin and, even more so, in Chin.
- Cabinet spending is of variable importance – significant in Mandalay, Sagaing and Chin, but negligible in Kayin. There are no consistent details but the partial data available suggests this spending is largely on highways and rural roads, water, electricity, and irrigation/drainage infrastructure. Mission findings suggest that the Cabinet budget account serves twin purposes: as a residual, discretionary funding pool for the Chief Minister and perhaps other ministers or MPs, and also simply as the only way that states/regions can fund spending in sectors such as irrigation where the corresponding department does not have a state/region budget account.
- Border Affairs is not of course present in Mandalay but features in border townships in the other states/regions in the sample. This spending appears largely on rural roads, off-grid electricity, water, schools and health clinics. Though conventionally Union-financed, in Chin there is some state budget co-funding. To avoid risks of overlap in financing, agreements have been struck in many townships between MOBA and DRRD, DRD and possibly other departments, to demarcate their respective VT 'service areas'.
- MOALI and MONREC capital spending is generally very low, even absent completely in many cases for MONREC. This is rather surprising given the predominantly rural contexts of these townships and of the livelihoods of most of the people living there.[59] Only DRD maintains a consistent, if generally modest, level of spending across all townships. While DRD is always only Union-funded, other MOALI departments enjoy variable degrees of very modest financing from state/region budgets.
- Ministry of Electricity spending is uneven – high in some townships, and absent in others, no doubt due to the mainly technical factors shaping the scope for expansion of the grid.[60] State/region funding is for low voltage "last leg" distribution, while Union funding is for the "lumpier" higher voltage main grid investments, hence the sharper variance in Union Electricity spending across townships.
- Ministry of Education spending is substantial in most townships, and is mainly for DBE's schools and is entirely Union-funded. In larger towns like Hpaan, it includes tertiary institutions too.
- Ministry of Health spending is generally lower than that for education in most townships – and is also entirely Union funded, save for spending by the Sports and Physical Education Department which is on state/region budgets.

TABLE 15 Township 'plan' sample

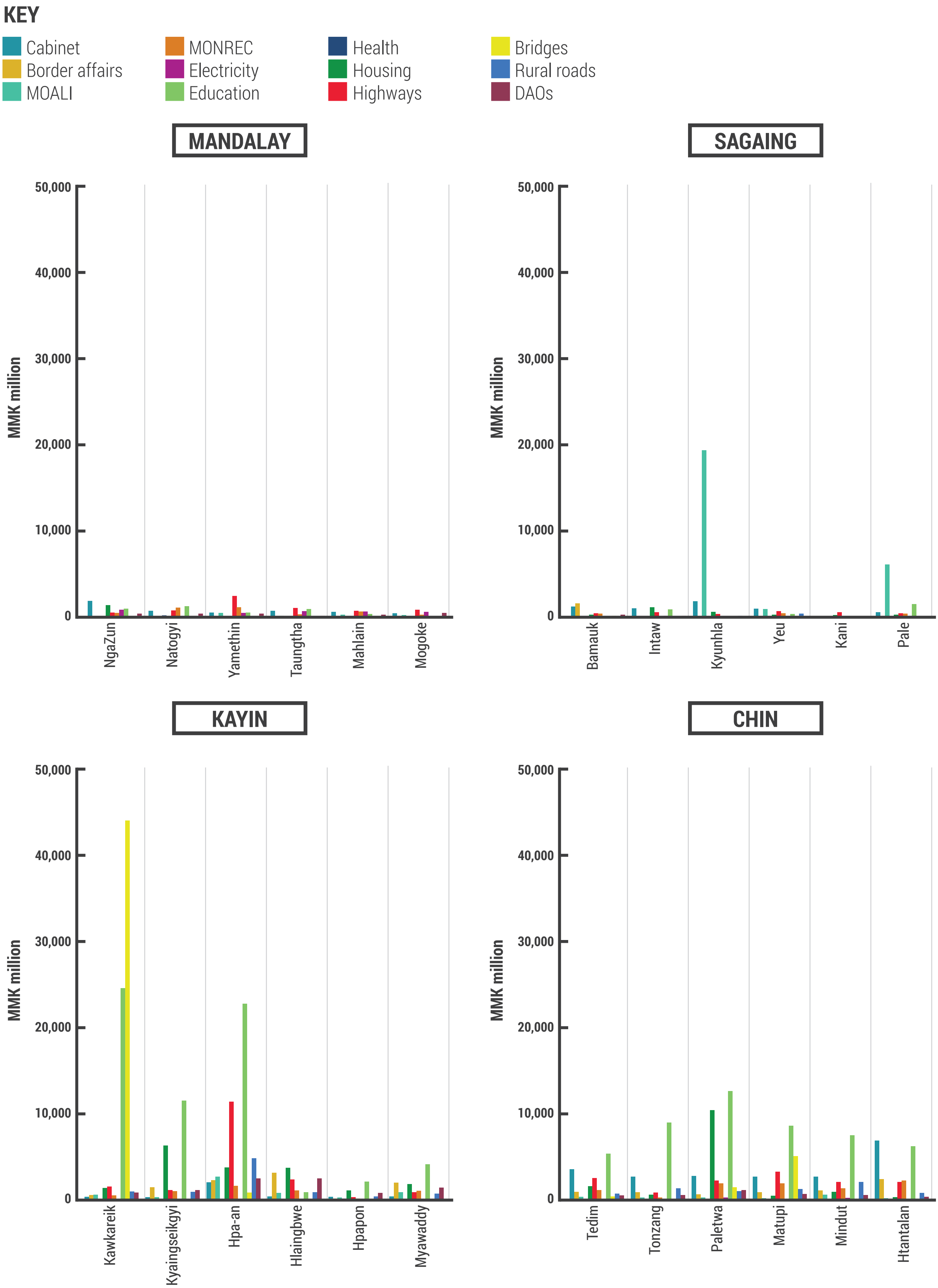
State/Region	Township
Mandalay	NgaZun
	Natogyi
	Yamethin
	Taungtha
	Mahlaing
	Mogoke
Sagaing	Bamauk
	Intaw
	Kyunhla
	Yeu
	Kani
	Pale
Kayin	Kawkareik
	Kyaingseikgyi
	Hpa-an
	Hlaingbwe
	Hpapon
	Myawaddy
Chin	Tedim
	Tonzang
	Paletwa
	Matupi
	Mindut
	Htantalan

FIGURE 18 State/Region and Union shares in total township investment spending (MMK million)



- Ministry of Construction remains the main capital spending entity at township level, although the departmental breakdown varies somewhat across townships:
  - Housing spending is very high in some townships in Mandalay and Sagaing (although it is unclear what exactly this refers to); but is negligible or zero in Kayin and Chin.
  - Highways spending is quite variable, perhaps not surprising given the variable lengths, conditions and importance of different township highway network connections, and variable numbers and types of bridges, which can be very costly in some cases. While these are generally on the state/region budgets, in Chin there is also substantial Union funding – no doubt because of the blurring there of the distinction between national highways (under the Union) and inter-township highways (under states/region), such that many highways there actually meet both definitions.
  - Lastly, spending by DRRD varies. It was newly transferred from DRD, where it was entirely under Union budget, to MoC, where funding responsibilities are shared by road class with state/region budgets. There are very modest spending levels in Chin, Kayin and Sagaing, but none in Mandalay. This difference may partly reflect the varying extent to which the new MoC DRRD institutional and planning arrangements have been put into place at township level, and/or to which DRRD spending is recorded under state/region Cabinet account. Reflecting the rather odd division of responsibilities - whereby Class A rural roads are under the state/region budgets, but Class B & C rural roads under the Union budget - there is a fairly consistent degree of sharing in the funding. The overall modest levels of state/region funding likely also reflect the fact that this represents a recently added state/region mandate for which no additional funding from the Union has been provided, and which may not (yet) constitute a funding priority for state/region governments.

FIGURE 19 Total township spending by sector, 2018/19 (MMK million)



PER CAPITA FINANCING PATTERNS

Township comparisons across states/regions

Table 16 below and figure 20 overpage illustrate the resulting per capita investment spending patterns by township and by spending department, across the four states/regions. Table 16 is a "heat map" tabulation of per capita[61] spending levels by departments and by township in each state/region, where the 3 highest and the 3 lowest values are highlighted in red and yellow respectively. Figure 20 depicts "gradient" charts showing the ranges in per capita financing for highways, rural roads, rural development and basic education across the sample. Figures 24 and 25 in Annex B provide further illustration of these variance patterns.

TABLE 16 Heat map of statistical variance in MMK per capita spending by sector, 2018/19

		CABINET	MOBA	MOALI	MONREC	ELEC-TRICITY	EDU-CATION	HEALTH	HOU-SING	HIGH-WAYS	BRID-GES	RURAL ROADS	DAOs
MANDALAY	NgaZun	14,347	0	320	97	10,502	3,753	3,415	6,351	7,148	0	0	2,639
	Natogyi	3,642	0	56	825	0	3,883	5,710	0	6,596	0	0	1,851
	Yamethin	1,837	0	1,813	0	0	9,157	4,174	1,685	1,802	0	0	1,270
	Taungtha	3,057	0	394	113	0	4,542	1,172	2,927	3,896	0	0	393
	Mahlaing	3,790	0	1,516	0	0	4,701	4,016	3,959	2,017	0	0	1,551
	Mogoke	2,303	0	2,030	0	0	4,629	1,251	3,224	0	0	0	2,573
SAGAING	Bamauk	11,314	15,509	727	0	3,762	5,139	4,626	0	0	2,557	0	3,576
	Intaw	10,003	0	692	1,824	11,053	6,099	1,860	2,687	8,791	0	1,236	2,709
	Kyunhla	14,670	0	150,117	1,428	5,431	3,836	1,048	0	1,347	0	2,545	1,217
	Yeu	5,145	0	6,235	211	1,931	3,748	2,656	1,377	2,269	0	3,048	1,135
	Kani	0	0	1,105	287	1,566	2,764	1,001	0	106	0	465	394
	Pale	2,656	321	25,060	852	1,715	2,333	2,063	0	6,196	52	501	665
KAYIN	Kawkareik	1,434	5,639	5,873	0	6,238	7,078	2,263	252	116,155	208,177	9,895	3,801
	Kyaingseikgyi	1,297	7,897	1,438	0	28,260	4,894	4,350	109	51,961	0	4,836	4,997
	Hpa-an	7,840	10,337	12,249	0	14,499	44,373	6,242	48	88,910	3202	22,069	9,482
	Hlaingbwe	803	8,914	2,176	0	8,700	5,472	2,448	29	1,954	0	2,423	5,732
	Hpapon	1,231	474	915	430	3,904	954	462	76	7,787	0	1,336	2,839
	Myawaddy	9,594	110,093	47,269	0	50,586	23,764	28,153	778	116,307	0	38,025	38,628
CHIN	Tedim	16,709	9,477	3,206	0	7,268	11,729	5,084	0	25,192	1710	7,173	2,274
	Tonzang	30,019	11,173	3,129	0	6,193	9,176	2,408	0	101,600	0	17,379	5,847
	Paletwa	82,369	32,126	5,537	0	12,824	101,088	58,262	0	267,942	156848	45,402	19,545
	Matupi	28,193	6,587	2,458	0	106,484	22,588	19,432	2,331	129,311	14343	10,893	11,231
	Mindut	61,934	33,356	17,186	0	20,515	48,122	30,003	4,460	174,369	0	64,319	12,301
	Htantalan	135,616	55,410	3,214	0	4,814	40,652	44,004	0	121,858	0	18,211	6,288

Note: Red cells = highest 3 values for each sector; Yellow cells = lowest 3 values for each sector (though all zero values are counted)

FIGURE 20 Per capita department spending gradients by township, 2018/19 (MMK per capita)

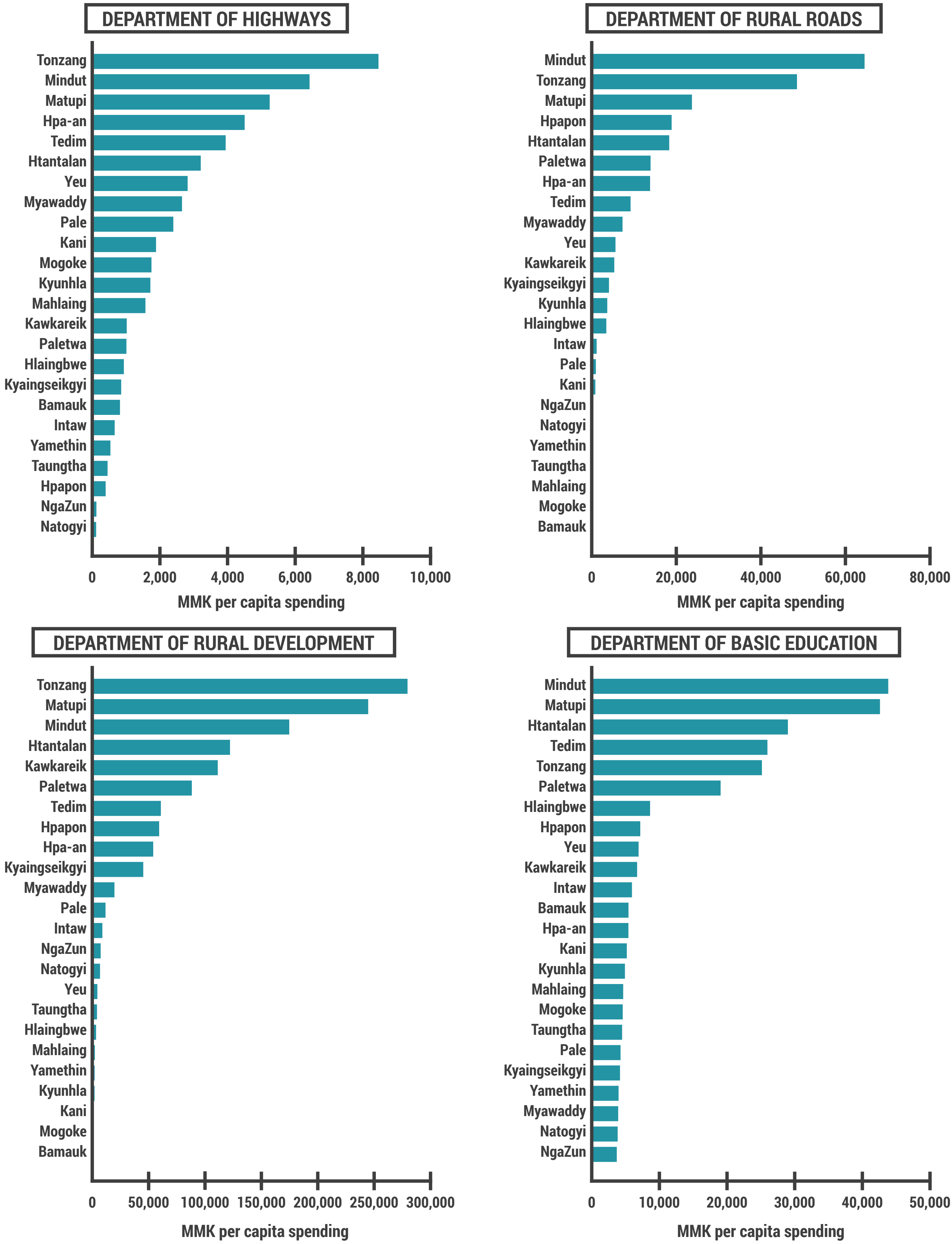
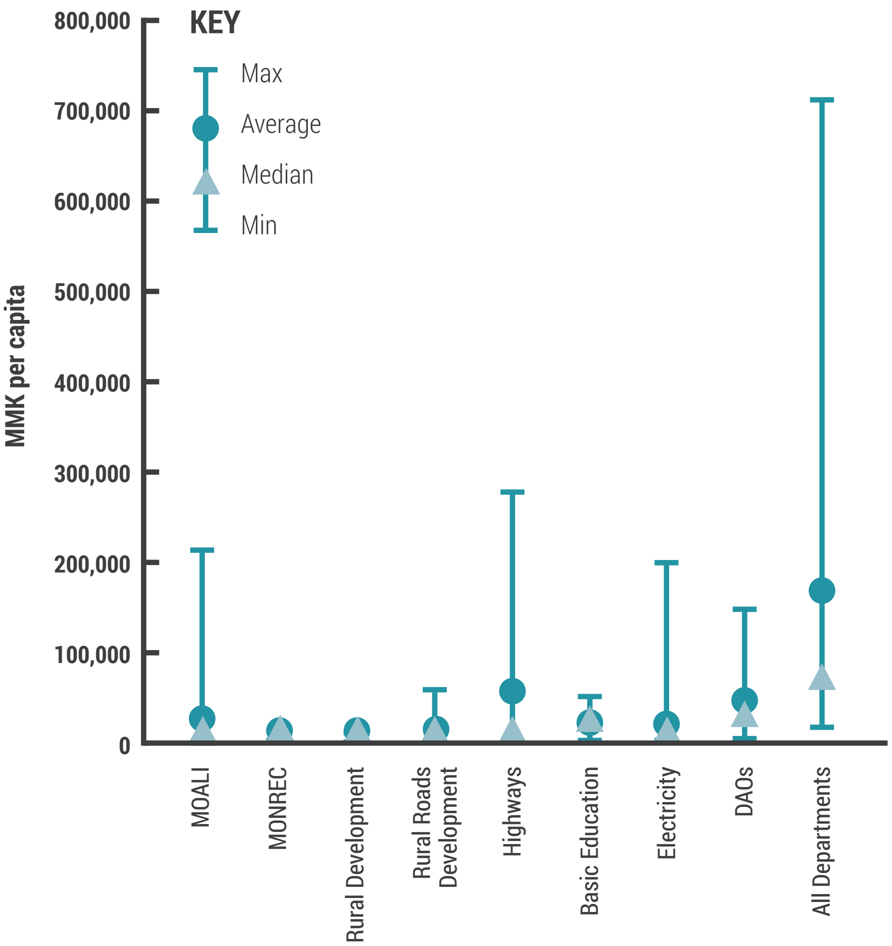


TABLE 17 **Variance in MMK per capita local development spending across the township sample, 2018/19**

	VARIANCE STATISTICS				
	AVERAGE	MEDIAN	MAX	MIN	MAX:MIN
MOALI	14,748	3,064	211,697	56	3,759:1
MONREC	419	4	2,862	0	∞
Department Rural Development	2,175	1,589	8,422	56	150:1
Department Rural Roads Development	10,062	3,790	64,319	0	∞
Department Highways	54,471	10,043	279,268	0	∞
Department Basic Education	11,703	5,479	43,919	3,753	12:1
Electricity Supply Enterprise	16,599	6,490	201,254	0	∞
DAOs	40,734	33,871	149,939	4,859	31:1
All Township Departments	169,718	70,110	712,310	15,301	47:1

FIGURE 21 **Variance in MMK per capita local development spending across the township sample, 2018/19**



A number of patterns emerge:

- In general, lower per capita spending levels in all sectors in Mandalay townships at the top of table 16 above, and *progressively higher levels as we read downwards* to Sagaing, to Kayin and then to Chin townships.
- While there are (as noted above) large variances in spending on Highways, Bridges and Electricity, there is *also* striking variance in per capita spending in other key sectors where such per capita variance is much harder to understand.

Table 17 and figure 21 on the preceding page illustrate variance patterns (as seen in the "maximum to minimum" value ranges around average and median values) in sector per capita spending across the whole sample of 24 townships in the four states/regions. While high variance across townships may be expected in spending on highways or the electric grid, the wide variance in spending by MOALI, Education, Health and DAOs, where per capita spending levels would be expected to be much closer, is much harder to explain.

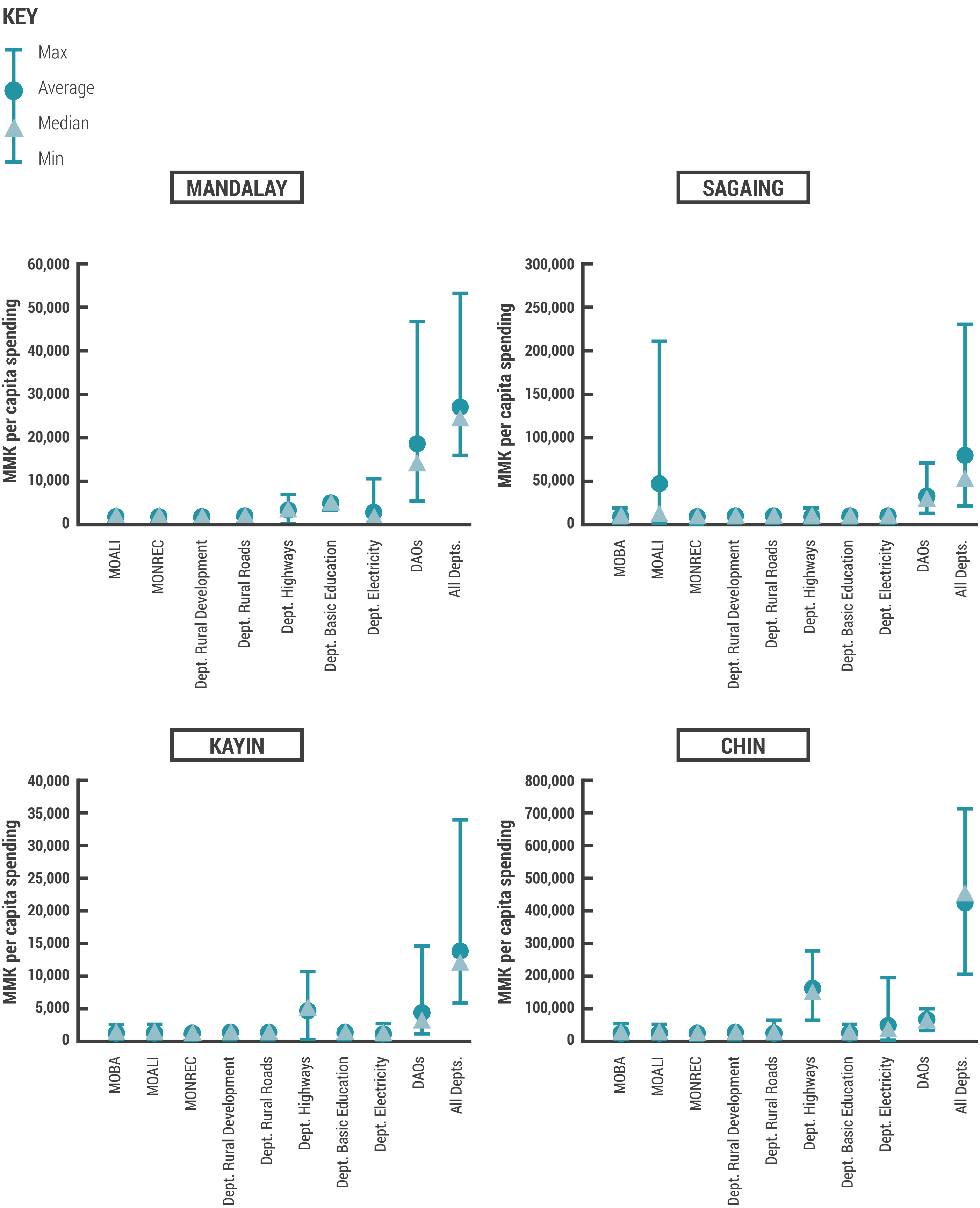
Township comparisons within states/regions

There is also significant variance in per capita spending among the six townships *within* each of the four states/regions, as the statistics in table 18 below and in figure 22 overpage illustrate:

TABLE 18 Variance statistics for MMK per capita spending within states/regions, 2018/19

		MOBA	MOALI	MONREC	Dept. Rural Development	Dept. Rural Roads	Dept. Highways	Dept. Basic Education	Dept. Electricity	DAOs	All
MANDALAY	AVERAGE	NA	1,022	172	701	0	3,576	4,254	1,750	18,288	**26,711**
	MEDIAN	NA	955	49	436	0	2,957	4,279	0	13,726	**23,886**
	MAX	NA	2,030	825	1,695	0	7,148	4,701	10,502	46,302	**53,046**
	MIN	NA	56	0	56	0	0	3,753	0	4,859	**15,301**
	MAX:MIN RATIO	NA	36:1	∞	30:1	∞	∞	1:1	∞	10:1	**3:1**
SAGAING	AVERAGE	2,807	45,157	999	1,662	1,977	4,376	5,494	5,273	32,794	**78,654**
	MEDIAN	0	6,568	999	1,747	989	2,984	5,360	3,806	29,071	**50,302**
	MAX	16,271	211,697	2,014	2,767	5,527	11,440	6,981	10,872	69,753	**230,130**
	MIN	0	605	0	605	0	0	4,307	2,966	12,220	**17,466**
	MAX:MIN RATIO	∞	350:1	∞	5:1	∞	∞	2:1	4:1	6:1	**13:1**
KAYIN	AVERAGE	9,294	6,119	29	1,672	8,709	48,526	6,055	15,161	47,254	**142,052**
	MEDIAN	6,593	5,355	4	920	6,215	49,337	6,118	11,279	29,873	**114,286**
	MAX	20,815	12,863	128	4,456	18,781	110,988	8,677	29,582	149,939	**340,788**
	MIN	2,987	1,187	0	338	3,361	3,098	3,960	5,961	11,625	**59,681**
	MAX:MIN RATIO	7:1	11:1	∞	13:1	6:1	36:1	2:1	5:1	13:1	**6:1**
CHIN	AVERAGE	25,982	6,696	477	4,667	29,560	161,405	31,008	44,214	64,600	**431,455**
	MEDIAN	22,675	4,691	0	4,546	20,892	148,114	27,553	17,243	55,894	**448,471**
	MAX	55,410	17,186	2,862	8,422	64,319	279,268	43,919	201,254	100,452	**712,310**
	MIN	9,769	1,684	0	953	9,087	60,532	19,112	4,212	35,584	**200,679**
	MAX:MIN RATIO	6:1	10:1	∞	9:1	7:1	5:1	2:1	48:1	3:1	**4:1**

FIGURE 22 **Variance in per capita department spending by state/region, 2018/19 (MMK per capita)**



Kayin, especially, and Chin exhibit high variance around the mean/median across townships in per capita investment spending in sectors where such variance is not expected, with max:min ratios for MOALI of 52:1 and 7:1, for Education of 46:1 and 11:1, for Health of 61:1 and 24:1, and for DAOs of 14:1 and 9:1 in Kayin and Chin respectively (and noting that DAO spending variance is also almost as wide in Mandalay and Sagaing).

Again, while variance in other sectors (electricity, highways, etc.) may be explained by the fact that spending includes a few large "lumpy" investments in some townships, which may have to be "rationed" between townships each year, it is hard to understand such variance in the sectors in question.

4.4 HOW FAR IS THE VARIANCE IN PER CAPITA TOWNSHIP SPENDING JUSTIFIED?

As noted, *equitable does not mean equal:* there is no reason for sector spending per capita to be equal in different areas as needs and costs do vary geographically, although probably by not nearly as much as some of the per capita spending variance documented here above.

We therefore turn to see how far the variance in local per capita spending patterns can be understood by correlating them with proxy measures of relative spending need across townships, as derived from The Asia Foundation's Township Development Index (TDI) data base.[62] From these rather approximate correlations of spending against need, depicted in figures 26 and 27 in Annex B, a few tentative conclusions can be drawn:

- In relation to "All Local Development Spending", "Rural Roads spending", and "DRD spending" against the general TDI, one might expect higher levels of per capita spending where the TDI values are lower. Since TDI values tend to be lower in Chin and spending in Chin townships is generally relatively very high, there does appear to be a rough positive correlation. But there are clearly also townships in Kayin, Sagaing and Mandalay with TDI values on a par with those in Chin but which receive much lower spending in these sectors.
- For correlation of "Basic Education" spending against the township education index, similarly one might expect higher spending where the index values are lower. Again the higher Chin DBE spending levels do roughly match generally lower index values – but townships in Kayin, with the very lowest index values, have much lower spending levels.
- Conversely, in figure 27 for health spending, one might expect to see higher levels of spending where "population-to-rural health center or to-bed" ratios are higher, and so where health service access problems may be worse. But looking within each state/region, there are no very obvious "higher spending:higher index value" correlations – with cases of both positive and of negative correlation. Across all four states/regions we see that health access indicators are generally worse in Mandalay, Sagaing and Kayin than in Chin, but that in Chin spending is much higher in most townships.

Figure 28 plots state/region per capita DBE spending against school enrolment rates[63] at different school levels, as proxy measures of education access – here one might expect higher per capita spending where these levels are lower. But in Rakhine, Shan and Kayin, where enrolment rates are lowest, spending levels are relatively low, especially compared to those for Chin.

However, these are only very rough indicators of relative capital spending need – what is needed are measures of sector infrastructure capacity, accessibility and quality, and of unit construction costs, which likely vary significantly, across states/regions. In the case of rural roads there are additional network consolidation criteria which have to also be factored-in.

> **"WHAT IS NEEDED ARE BETTER MEASURES OF EXISTING SECTOR INFRASTRUCTURE CAPACITY, ACCESSIBILITY AND COSTS, TO GUIDE FUTURE BUDGET ALLOCATIONS"**

4.5 FROM FINANCING TO SPENDING: EMERGING ISSUES

A number of issues emerge from the foregoing account of local development spending patterns:

- In keeping with the high degree of centralized control over local spending noted under Chapter 2., only a little more than half of total local investment spending is financed from state/region budgets, the rest being financed from the Union budget. In other words, **the investment decisions on almost half of local spending are made in Nay Pyi Ttaw; the balance is decided in state/region capitals**, excepting decisions for the CDF grants (almost negligible), made at township level.

- For investment spending financed **from the state/ region budgets** we see:
    - **Substantial variance in average levels of per capita spending by different departments *across* states/regions.** This is primarily due to the substantial variance in state/region per capita revenues, stemming from the very inequitable fiscal transfer allocation patterns. But in some cases this may be accentuated by state/region government allocation decisions, as– appears to be the case for Mandalay, where thy substantial resource allocation to MCDC correspondingly reduces funding for other departments operating across other townships, to levels markedly below those of other states/regions.
    - **Even greater variance in levels of per capita spending across townships *within* states/regions.** For some departments, i.e. those responsible for larger network infrastructure investments, this can be understood. But for other departments, responsible for more broad-based infrastructure and service delivery, such variance is harder to justify. This necessarily stems from state/region governments' own allocation decisions. As documented in the companion Asia Foundation report *Where Top down meets Bottom up*, this variance most likely reflects the manner in which budget priorities emerge from the annual process.

- For investment spending financed from the **Union budget** we have seen that:
    - **Some departments do attempt to apply technical, policy-based allocation criteria** (albeit ones which are often overridden by other considerations) to their relative state/region allocations. This is probably the reason for the relatively low degree of variance in per capita funding of Union-funded departments when seen across states/regions.
    - However, the analysis exposed **very substantial variance in per capita Union department spending *across townships* within states/regions.** This is perhaps less surprising in the rural roads sector (where network-investment factors may conflict with per capita equity considerations), but is more surprising in sectors such as basic education or rural development. This suggests that Union departments make their investment approval decisions on batches of proposals from townships from each state/region – within their indicative criteria-based total state/region allocations - without much regard for equity between townships.

- As also underlined, in no sector should we necessarily expect equal per capita spending since equity requires that this be adjusted to reflect varying needs, and also varying unit costs. But **correlating per capita spending patterns with rough proxy measures of such need did not demonstrate in many cases that the per capita spending variances could be justified in this way.**

Above all, this analysis points to the need to develop **operational criteria that can be used by state/region governments and Union departments to guide geographic budget allocations,** in order to better reflect sector policy and equity goals and so ultimately improve the quality of local spending.

> ***“ FOR INVESTMENT SPENDING FROM STATE/REGION BUDGETS WE SEE SUBSTANTIAL PER CAPITA VARIANCE ACROSS STATES/REGIONS... AND EVEN GREATER VARIANCE ACROSS TOWNSHIPS WITHIN STATES/ REGIONS ”***

CHAPTER 5

FINANCING LOCAL DEVELOPMENT: ISSUES AND RECOMMENDATIONS

This chapter draws together the significance of the spending outcomes documented in Chapter 4, and the main challenges to local development financing recounted in earlier chapters. It then outlines a series of areas where reform or innovation is needed, both in the shorter and in the medium-longer term.

5.1 LOCAL DEVELOPMENT FINANCING OUTCOMES AND SIGNIFICANCE FOR SPENDING QUALITY

In Chapter 4 we charted the local spending patterns arising from devolved financing of state/region budgets and deconcentrated financing from the Union budget. In keeping with the high degree of centralized control over local spending, only a little more than half of total local investment spending is financed from state/region budgets, the rest being financed from the Union budget.

State/Region local development spending

For investment spending financed from the state/region budgets we see:

- **Substantial variance in average levels of per capita spending by different departments across states/regions.** This is primarily due to the substantial variance in state/region per capita revenues, stemming from the very inequitable fiscal transfer allocation patterns. In some cases this may also be accentuated by state/region government allocation decisions as appears to be the case for Mandalay, where the very substantial resource allocation to MCDC correspondingly reduces funding for other departments operating across other townships, to levels markedly below those of other states/regions.
- **Even *greater variance* in levels of per capita spending across townships *within* states/regions.** For some departments, i.e. those responsible for larger infrastructure investments, this can be understood. But for other departments, responsible for more broad-based infrastructure and service delivery, such variance is harder to understand – and necessarily stems from state/region governments' own budget allocation decisions, shaped by the "determining factors" identified in Section 4.1.

Union budget local development spending

For investment spending financed from the Union budget we have seen that departments do attempt to apply technical, policy-based allocation criteria (although these are often overridden by other considerations) to their relative state/region allocations. This is probably the reason for the **relatively low degree of variance in per capita funding of Union-funded departments when seen across states/regions.**

But the analysis exposed **very substantial variance in per capita Union department spending across townships within states/regions.** This variance is perhaps less surprising in the rural roads sector (where network-investment factors may conflict with per capita equity considerations) but is more unexpected in sectors such as basic education. This suggests that Union departments make their investment approval decisions on batches of proposals from townships from each state/region – within their indicative criteria-based total state/region allocations - without factoring-in relative investment spending need or equity between townships.

However, as also emphasized, in no sector should we necessarily expect equal per capita spending – equity requires that this be adjusted to reflect varying needs, and varying unit costs. **But correlating per capita spending patterns with rough proxy measures of such need did not in many cases demonstrate that the per capita spending variances could be justified in this way.**

5.2 LOCAL DEVELOPMENT FINANCING ARRANGEMENTS

CHALLENGES

Here we draw together the various challenges in the formal arrangements and the practices which shape the financing of local development spending:

Limited and fragmented sub-national spending responsibilities

Spending responsibilities are still primarily at the central level, with the Union government retaining decision-making responsibility for some 50 percent of local investment spending, in areas such as basic education and health facilities, rural roads, rural water, etc. Where local contexts, needs and priorities vary significantly, local officials are typically better placed to make spending decisions than their Union counterparts. Decision-making responsibilities for the same types of investments are decentralized to lowest-tier local governments in many countries in the Asia region.

The problems stemming from over-centralization are further **compounded by a few anomalies and divided responsibilities** (highlighted in section 2.5), between state/region budgets and departments and funding sources. This fragments budget decision-making hence undermining the quality of spending, and weakening accountabilities.

Weak state/region revenue powers, collection capacities and incentives

Schedule 5 of the Constitution presently grants only modest revenue powers to states/regions. However, even within these limits there are challenges.

Some unclarities or apparent inconsistencies with pre-existing statutes or regulations appear to discourage states/regions from fully taking advantage of some of these powers. There is also **not always the necessary authority to make changes to tax and fee rates which are often long outdated**. Without such authority, states/regions are little more than collection agents, and the benefits of decentralizing revenue powers are not fully realized.

Revenue collection efficiency is further undermined by the **fragmentation of collection across several different departments,** each with own policies and procedures, rather than through a common state/region revenue office. The current fragmented arrangements pose a limit to any wider roll-out the sort of revenue-collection capacity-building activities being implemented by The Asia Foundation with the DAOs.

Most sub-national revenues are collected by DAOs and are earmarked for spending by DAOs in urban areas. Of these revenues, property and other tax revenues and business licenses are currently low in absolute terms, suggesting scope for future increases. The great bulk of DAO revenues derive from license auction revenues, which are partly generated in the wider rural catchment area outside of the urban centre, especially in townships where these urban centres are smaller. On the one hand, this revenue earmarking for the DAOs – rather than for state/region-wide spending – represents a substantial degree of rigidity in state/region allocation of own-revenue resources, and means that spending in the rural areas is almost entirely dependent on Union transfers. On the other hand, under current arrangements, this earmarking may provide an important incentive to encourage revenue collection by DAOs.

The now substantial state/region transfers to DAOs may well be justified to supplement urban spending, but they raise two possible concerns. On the one hand, it is possible they may negatively affect DAO revenue-collection incentives (although they may also carry the potential so as to positively encourage revenue effort, if designed accordingly). On the other hand, there is reason for concern around possible equity issues associated with the way these transfers are allocated between DAOs.

Looking to the future, there is certainly **scope to enact some of the provisions of the 2015 revisions to Schedule 5 of the Constitution**, to expand state/region revenue powers. **But these need careful prior review of trade-offs**, to ensure that any such expansion of powers not undermine overall national efficiencies in revenue collection, nor create economic distortions, nor create excessive disparities between states/region own-revenues which may prove impossible to compensate for through fiscal transfer arrangements.

Fiscal transfers to states/regions in reform

Myanmar has made important efforts to reform the "negotiated gap-filling" fiscal transfer arrangements,[64] and move toward a more transparent and effective formula-based arrangement with advance notice to states/regions. This has been a **very significant reform, bringing transparency and predictability**.

However, the potential of this reform is yet to be fully realized, especially regarding the scope for promoting fiscal equalization, with allocation patterns between states/regions which are still highly inequitable. **Attempts to rectify this may meet opposition** from states/regions which benefit disproportionately from the current arrangements, and reforms will need to be phased in gradually, and to bear in mind the concerns of those states/regions.

It was also noted that present transfers **allow a high degree of state/region discretion in making their budget priorities**. While allowing such discretion is important in principle, it also opens the risk that spending may overly favor maintaining the current administrative staff establishment, which seems to get first claim, at the expense of both operations and maintenance and local capital development spending.

At the same time, the planning and budgeting system associated with the former "negotiated gap-filling" transfer arrangements – whereby the **local administration is encouraged to submit long annual budget wishlists** rather than make real budget-disciplined priorities, and which also seriously undermines incentives for local participation – proves much slower to reform.[65]

Lastly, the rationale for the revenue-sharing transfer arrangements by area of tax origin, rather than simply by formula, is unclear. This can potentially create inequity among states/regions in the future, and also undermine budgeting predictability for individual states/regions – both problems being addressed through pooling of these revenues and allocation by formula.

Ministry allocations for deconcentrated spending

Some Union ministries are attempting to allocate financing for deconcentrated state/region spending on a more transparent basis, and to introduce sector policy criteria. **There is clearly scope for improving these arrangements, but there are also two major problems:**

- Firstly, criteria appear to be concerned with relative state/region allocations, **but do not take account of relative township financing within states/regions.** Evidence suggests that there is considerable disparity between these latter, township, allocations.
- Secondly, there **still remains a considerable degree of "discretionary adjustment"** by political stakeholders at Union level of the "technical" state/region allocations proposed by ministries.

Ultimately, however, **responsibility for many sectoral financing decisions would be more efficiently decentralized** to states/regions – if not to township level.

No township budget

Perhaps most crucially, a key feature in present arrangements lies in the fact that the only sub-national budget level is that of the state/region governments. Given their size – with populations from 500,000 to 7 million – this level represents a jurisdiction or service catchment area that exceeds the normal scale of the types of local services and infrastructure that this report is assessing.

The sub-national level most concerned with the planning for these types of local spending is the township administration. Almost all departments are present at this level; almost all government consultations with communities are organized at this level; almost all local investment spending proposals are formulated at this level; and almost all these investments are implemented under supervision of this level. In economic "planning area" terms, the township (with average population of some 150,000) also constitutes a large infrastructure and service delivery catchment area. Yet the township level enjoys no budget allocation of its own (aside from the CDF), but can only submit funding requests upwards.[66]

The lack of a 'township budget' – whether a multi-sector budget for the township territory or simply by sector department – **has a chain of unintended negative consequences:**

- Lack of budget certainty at township level – makes it **very hard for authorities to engage communities in regular consultative processes**. After one or two rounds of attending meetings where proposals are (often) thrashed out and submitted, but which never received funding or even any later feedback, communities quickly tire of "participating".
- Lack of budget certainty at township level also **leaves departments little choice except to routinely submit upwards long lists of proposals and little incentive to make real priorities within these lists** – in the hope that the more sent up the greater chance of some being approved.
- The lack of a township-wide budget undermines cross-sector flexibility and **incentives for township authorities to look at priorities across sectors**, to explore trade-offs, or the scope for complementarities and synergies.
- In turn this lack of real prioritization means that township departments do **not have adequate time, staff or budgetary resources to ensure that each one of the very many individual annual proposals is properly reviewed, costed, and appraised**; or that – where these proposals come from local communities – **local consultations** have been undertaken in regard to details of project design, siting, land issues, etc., before they are submitted upwards.
- Officials at state/region or Union level are **hard-pressed to properly appraise and make selections from a deluge of proposals which are often inadequately detailed**, and for which they have limited understanding of the township contexts.

The result of this "missing township layer" in the local budget architecture is therefore considerable budgeting inefficiency. It undermines the quality of local spending, and the incentives for effective local community consultation or participation in planning and budgeting processes.

OPPORTUNITIES

Against this background, the various innovations tested under NCDDP and under the TDLGP are especially important, and should help inform opportunities for further reform of local financing arrangements. Although embodying different strategies, both:

- **effectively decentralize decision-making largely to township level**, or below;
- provide a **certain local budget allocation, thereby making participatory planning a meaningful exercise**;
- **encourage serious local prioritization**, through the ceiling inherent in this allocation.

The initiative undertaken by the Bago Region government to replicate the township funding component of the TDLGP approach is also indicative of a more widespread recognition of the need to reform local financing arrangements. It also means that commitments to undertake reforms can be secured, especially when authorities see that innovations proposed are congruent with their policies and procedures.

The work being undertaken by The Asia Foundation to promote property tax revenue collection also offers important lessons for broader support to local revenue mobilization.

5.3 POSSIBLE AVENUES FOR IMPROVEMENT AND REFORM

The issues highlighted above suggest a series of areas where review, improvement or reform could be considered, and which could contribute to better quality of local development spending.

DEVELOPING OPERATIONAL TOOLS TO BETTER ALIGN FINANCING WITH RELATIVE LOCAL NEED

Although progress is being made in the allocation of Union ministry capital budgets across states/regions in a more transparent manner, there is still more to be done to develop operational tools to better align financing with sector priorities and with the goal of equity. For each sector concerned, this would require a major empirical baseline study of size and adequacy of the present infrastructure stock, location, quality, etc., across the states/regions, and between townships, and of the relative construction costs in different contexts, for each sector.

The output would be a **set of operational tools to guide Union ministry officials** now (and, later on with greater decentralization, also state/region officials) **to ensure that relative budget locations across states/regions and townships more fairly reflect the differing investment needs that emerge from sector priorities, and the differing costs.**

These tools will be valuable in improving deconcentrated funding decisions under the present centralized arrangements, but they will also be essential in shaping the design of future conditional grants, in any ensuing move to greater devolution in the sectors concerned.

CONSOLIDATING FISCAL TRANSFER REFORMS

General grant formula

In order to ensure equitable allocations to states/regions a review of the present MTFF-formula arrangements is needed:

- To **normalize the poverty index values by the relative population sizes** of each state/region, to correct the implicit bias against states/regions with larger populations.
- To **re-assess the appropriateness of the very low weighting currently given to relative population**, and to “need” variables overall, and to **simplify the “fiscal constraint” indicators and reduce their weighting**.
- To **assess the continued validity of the data base** used to make the computations – especially as regards both the poverty index and the population data used.
- If the shared revenues cannot themselves be simply merged with the general grant pool for formula-based allocation, to see if there is scope to include a ‘clawback’ arrangement whereby the general grant

allocations are calculated after taking account of different levels of **shared revenues** enjoyed by states/regions.

It is recommended that the formula be applied to the **entire annual general grant transfer pool** (and not just for annual incremental increases).
Lastly, it may be worth assessing the merit of introducing a "partition" in the general grant to cap the portion spent on the local administration.

Recognizing the political economy of these recommendations

It must also be recognized that **any changes to present allocation arrangements are likely to face opposition**, in that some states/regions will gain but other will lose significantly. One option would be to simply enlarge the transfer pool so much that no state/region will lose, in absolute terms, from adjusted allocation arrangements. But it is unlikely that such an increase could be granted given the budgetary constraints faced by Myanmar. It may therefore be necessary to **phase allocation adjustments** over a period of years to render these changes more agreeable. One approach could be to apply the allocation formula to the annual increment and to an increasing portion of the rest of the national pool (e.g. 10 percent), with this portion growing stepwise over a number of years (e.g. over 10 years) until it applies to the whole pool. This would lessen the impact of the reform and should make it more acceptable.

REVIEWING STATE/REGION BORROWING ARRANGEMENTS

It would be useful to conduct a **review of donor-sponsored 'on-lending' arrangements to states/regions** that were noted, especially for investments in DAO infrastructure. It seems very unlikely that DAOs and states/regions would ever be in a position to repay such loans to the union government, however subsidized their terms may be. In consequence, states/regions will either default, or Union transfers will be diverted to repayment, or the Union government will simply assume repayment responsibility – in all cases, undermining the credit-repayment-discipline ethos. In addition to Government regulations regarding such sub-national borrowing, the development community in Myanmar should also consider reviewing its own policies and practices with these types of projects and lending instruments.

STRENGTHENING LOCAL REVENUE POWERS AND CAPACITIES

General

One constraint to states/regions being able to fully use their revenue powers is the fact that some existing legislation in Myanmar has not been realigned to match Schedule 5 of the 2008 Constitution (as subsequently amended). Some legislation remains inconsistent with Schedule 5, and this undermines the ability of states/regions to set their own revenue policies, as well as tax and fee rates. An important step towards strengthening local revenue powers must include reviewing various legal instruments to re-align them to Schedule 5 of the Constitution.

If discussions are revived around Schedule 5 amendments in regard to assigning additional revenue powers to states/regions related to natural resource revenues it is very important that **preliminary studies be undertaken as to the likely medium- and long-term implications and the possible inequities which may result, and whether adequate equalization arrangements through the general grant transfers are feasible**. Caution is needed because once revenue powers are granted it is very difficult to reverse them.

More positively, there may be opportunities for additional revenue powers which are not explicitly outlined in the Schedule 5 amendments but which are worth considering – such as allowing states/regions powers to impose **limited additional "piggyback taxes" or "surcharges" to Union taxes** such as income or commercial tax.

In the medium-longer term it would be useful to undertake **a review of the disparate state/region revenue collection departments** and their procedures, with a view to exploring options for a unified state/region revenue office, with one set of staff, policies and procedures. Without this it is hard to mount effective support to build state/region revenue-raising capacities.

DAOs

In the short term, it is important to expand the ongoing work – by The Asia Foundation, VNG and other agencies – **for capacity development of the DAOs** in raising property and other revenues. It will also be important to find ways to address transparency issues related to the major DAO revenues derived from auction licenses.

At the same time, in the medium term it would be important to undertake **a review of the general status of DAOs and their current financing arrangements and prerogatives, to assess the merits of earmarking such a significant portion of state/region revenues for solely urban use.** It is also important to **examine more closely**

the growing trend to allocating "transfers" to DAOs from state/region budgets, in order to chart the equity and incentive implications for urban spending that result.

PHASED DECENTRALIZATION OF LOCAL SPENDING DECISIONS

From greater deconcentration to greater devolution

The 2015 amendment to Schedule 2 of the Constitution appears to open the door to assigning greater responsibilities to states/regions, and thereby to allow budget decisions to be made where more information is available in regard to options and trade-offs. There are several, phased options for proceeding in this direction.

- **Greater deconcentration.** In the short term, insofar as the budget calendar allows, the Union ministries concerned may **consider allocating clearer indicative budget ceilings to their state/region departments early enough in the budget year**, to allow them to make their own "first cut" priorities which are then simply reviewed for 'compliance' at ministry level (DRD is already moving in this direction). This would require clear guidelines and capacity development for the state/region departments to ensure they are enabled to make budget priority choices in line with sector policy.
- **Phased devolution.** In the medium term, it should be possible to mandate states/regions with budgeting responsibility (by enacting into law some of the provisions of the Schedule 2 amendments), and at the same time **convert the Union ministry budget allocations into conditional grants for the sectors concerned**. The advantage of conditional grants – rather than simply merging funds into the existing general grant transfers - is that Union government is assured that minimum levels of spending will be maintained in the sectors concerned. This could also be accompanied by limits to the portion of the general grant transfers which can be spent on administration.

Finally, and specifically, there is also scope for a greater degree of decentralization of current budget management in the health sector. This could be through similar delegation to health centers and hospitals as is now practiced in the education sector through the school grant mechanism.

Building the township as platform for local / community planning and budgeting

Developing the township as full budget entity and integral layer of the local budget architecture will probably take time. But **in the shorter term, it should be possible – with development partner support - to expand the piloting initiatives** already begun in Bago and some other states/regions, whereby the township, or the TPIC, is accorded an annual grant allocation for an agreed menu of local capital expenditures, accompanied by capacity support for better local project planning and implementation.

This **township allocation could be based on a simple formula** (e.g. as under TDLGP or NCDDP[67]). It would be, ideally, an upfront grant "entitlement" (as with CDD block grants to VTs or TDLGP grants to townships); or, less ideally, a "ceiling" or a "drawing right" within which townships can submit applications to their state/region government, with final approval reserved for state/region level. The former assures greater certainty for townships and less interference in their decisions, but the latter may be politically more palatable for now for some state/region authorities, since there appears to be widespread reluctance to make upfront budget allocations to townships.[68] The latter may possibly be seen as offering greater protection against risks of abuse and rent seeking by township officials.[69]

While the TPIC is the authority mandated to make inter-sectoral planning decisions at township level, the current arrangements[70] do not fully enable it to play a pro-active planning and decision-making role of the sort required by a township grant mechanism of this sort. **TPICs need to be supplemented by arrangements** (e.g. via a subordinate technical sub-committee, with modest resources) which ensure the 'technical homework' is done to review, vet, cost and appraise the proposals submitted from communities and from departments, and to consult with these proponents on the details of their proposals, to ensure that the selected projects are those with greatest development impact. A greater degree of technical appraisal of the merits of competing proposals would also help to discipline and perhaps contain the role of MPs in the TPIC. There would also be need for facilitation to support community involvement in the planning process, and to implement, monitor and maintain projects. The NCDDP supports such facilitation (for both planning and implementation) but at a level that may be challenging for government to sustain.

In order to support proposals from communities, Villages and VTs, the township grant could be partitioned into two "windows" based on recognition of levels of local investment and of "community self-interest". It is vital to recognise (a) that there is a hierarchy of investments in each sector, and that an exclusively village or community planning approach will only prioritize spending proposals for the lower level of this hierarchy, and (b) that under current arrangements, the township level (where higher order investment proposals also emerge) is hugely constrained by the lack of any budget certainty. To address this, the township allocation could therefore be partitioned (on some percentage basis), to separate financing for proposals from the township and from communities and from village tracts,[71] to ensure the right balance in investment patterns. On the one hand, given that township departments themselves currently enjoy no certain budget allocations, there will be strong pressure to devote an open-ended allocation entirely to "higher-order" township department investments. On the other hand, earmarking the budget only for community proposals risks spending everything on very local village level investments, and hence not be developmentally effective. Maintaining earmarked portions for more strategic township investments and for more local VT or village investments can therefore help ensure there remains incentive for continued community participation while preserving a more developmentally effective balance in overall local investment patterns.

The VT part of the allocation could itself be either broken into individual VT allocations (e.g. by population, as with NCDDP grants), but given that levels of funding will be much lower, this would risk excessive fragmentation of resources. **This study recommends that, instead, VTs should apply and compete for funding from this part of the allocation,** with decisions made at township level. This of course will require clear procedures and criteria, and transparency.

Budget execution would be entrusted to the budget-holder of those investments approved. Thus implementation of sector investments would be by the departments concerned, but smaller "community investments" (to be clearly defined) by community groups or committees (where there is clearly much to build on from CDD and TDLGP experience).

Standardizing and improving state/region budget formats and reports

Finally, it would be important to **review the structure and formats of revenue and expenditure budget reports prepared by states/regions**, with a view to standardizing them so that they are more easily comparable, and to ensure, for example, that revenues are recorded in a manner which does not risk aggregation of shared-revenue transfers or loan receipts with state/region own-source revenues.

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ANNEXES

ANNEX A
INTERVIEWS & POLICY DIALOGUES

TABLE 19 Interviews and policy dialogues conducted in support of the research

INTERVIEWS							
			Number of individuals met				
State/region	Date	Interviews	State/Region Government	State/Region Hluttaw[72]	Officials	W/VTAs[73]	Others[74]
Kayin	January 2019	27	4	5	26	2	3
Rakhine	February 2019	35	3	5	42	11	4
Chin	February – March 2019	28	3	3	33	4	0
Yangon	February – April 2019	6			2		14
Nay Pyi Taw	April 2019	11			28		
Totals		**192 s/holders**	**10**	**13**	**131**	**17**	**21**

POLICY DIALOGUES						
State/ Region	Date	Policy Dialogues	State/Region government participants	State/Region Hluttaw participants	Officials	W/VTAs
Kayin	21st January 2019	1	2	3	24	8
Rakhine	14th February 2019	1	2	0	42	10
Chin	28th February 2019	1	1	2	32	1
Totals		**127 participants**	**5**	**5**	**98**	**19**

ANNEX B
TABLES AND CHARTS

FIGURE 23 **Devolved capital spending by state/region and by department, 2018/19 (MMK million)**

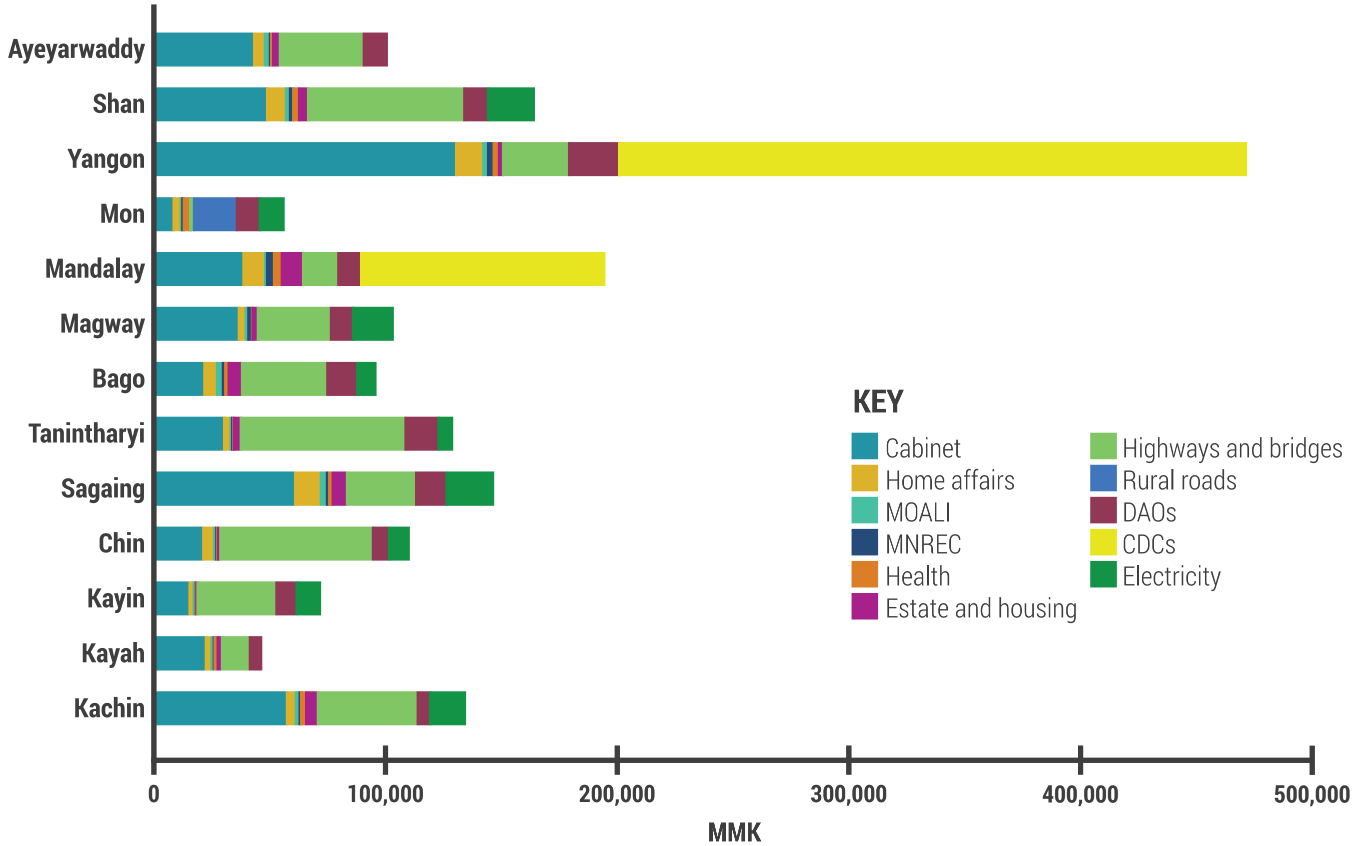

TABLE 20 **Basis for "per capita" spending analysis**

Spending by	Assumed population served
Cabinet	All township population
Border Affairs	Rural township population
MOALI	Rural township population
MONREC	Rural township population
Electricity	All township population
Education	All township population

Spending by	Assumed population served
Health	All township population
Housing	All township population
Highways	All township population
Bridges	All township population
Rural roads	Rural township population
DAOs	Urban township population

FIGURE 24 Per capita spending by sector across townships, 2018/19

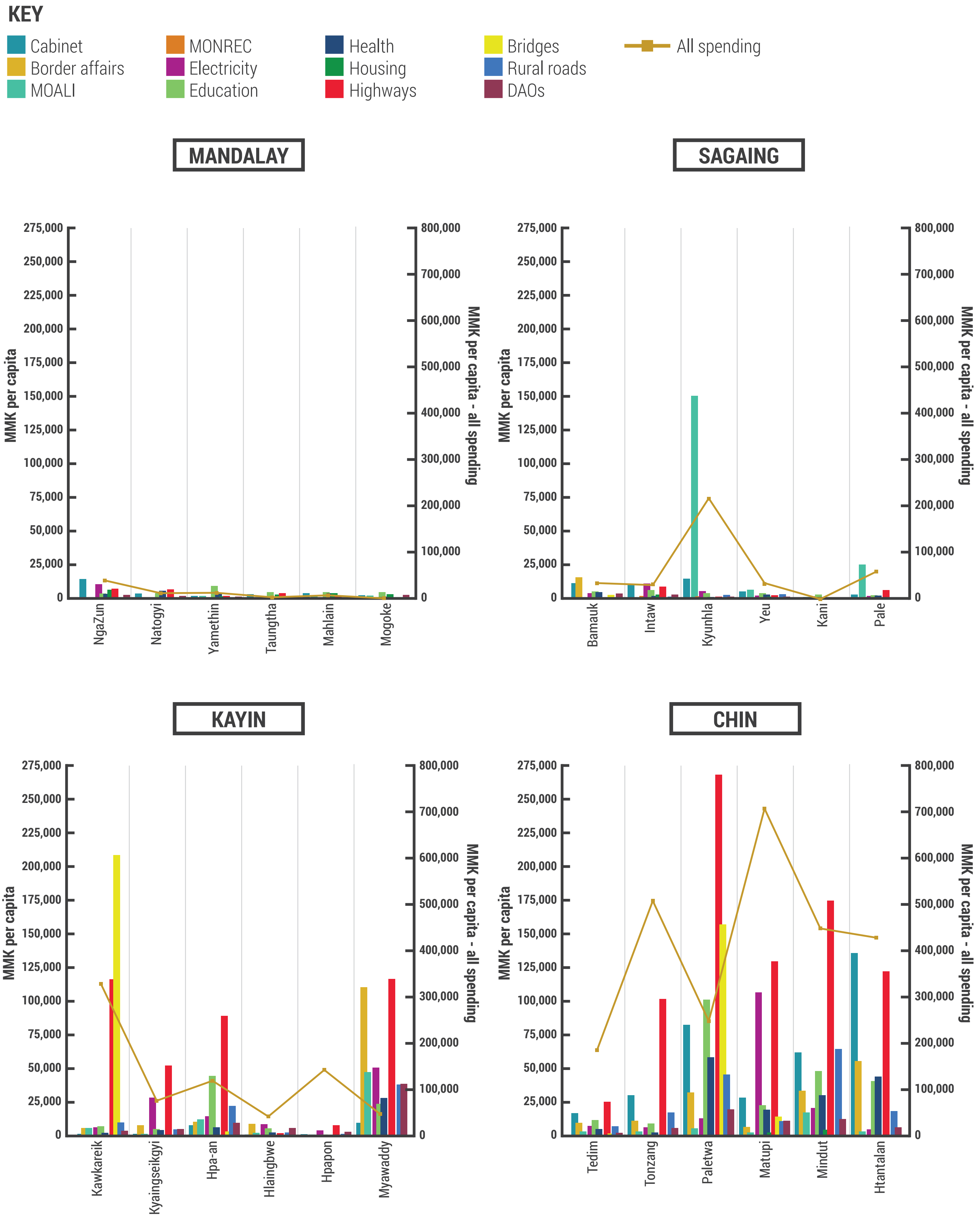

FIGURE 25 Per capita spending by township across sectors, 2018/19 (MMK per capita)

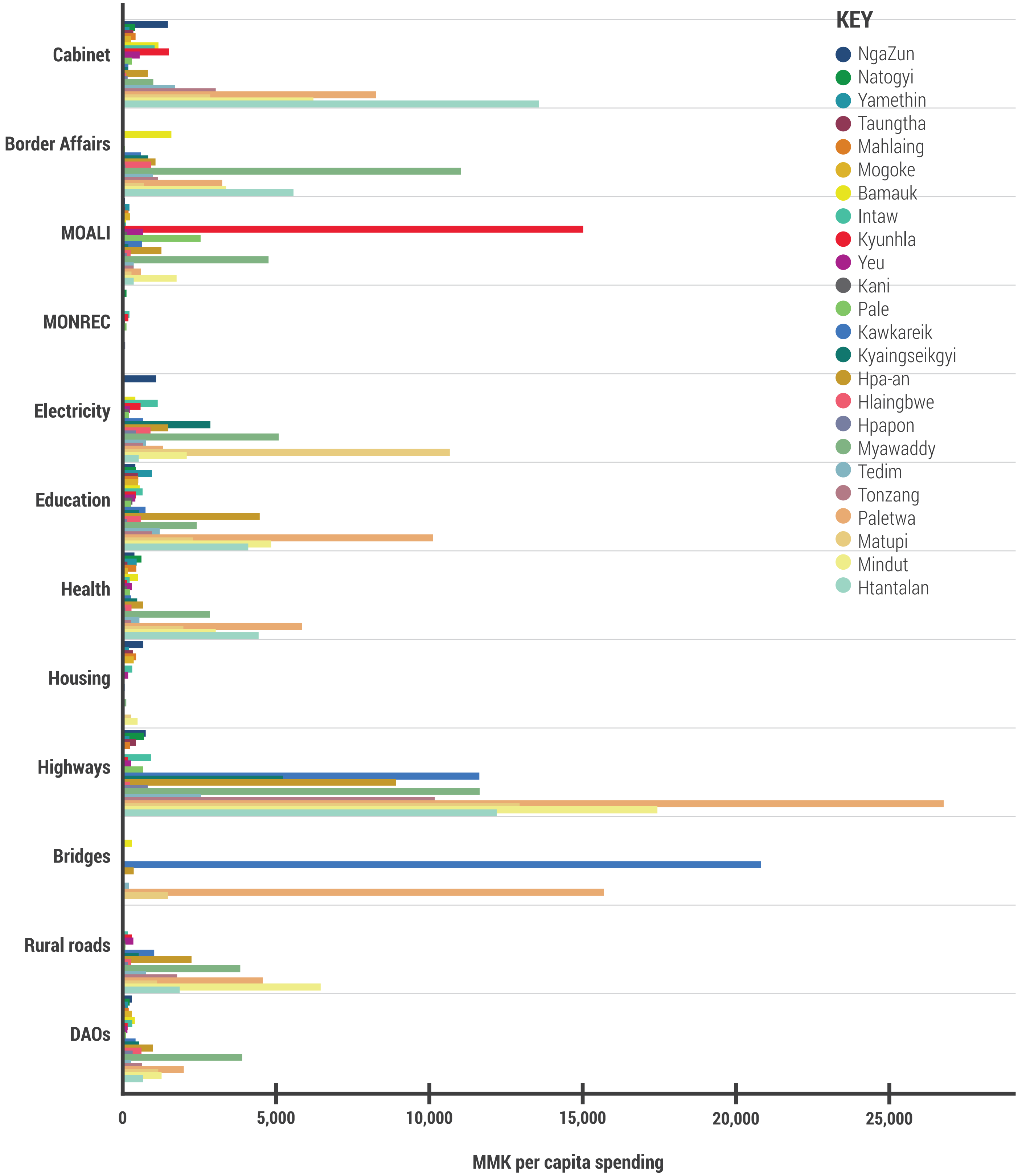

FIGURE 26 Plotting MMK per capita spending against TDI indices

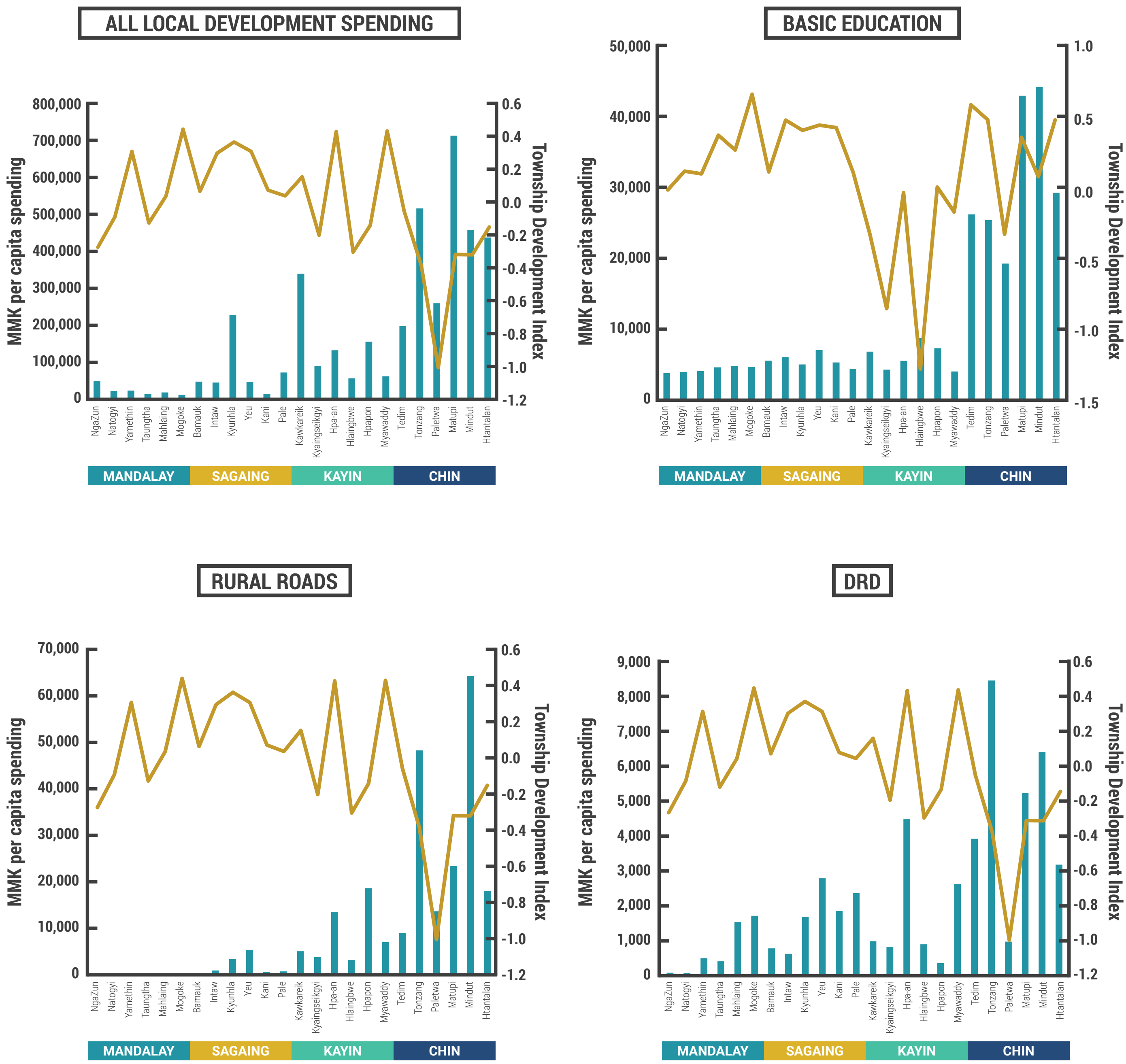

FIGURE 27 Health: plotting MMK per capita investment spend 2018/19, against measures of current health service access

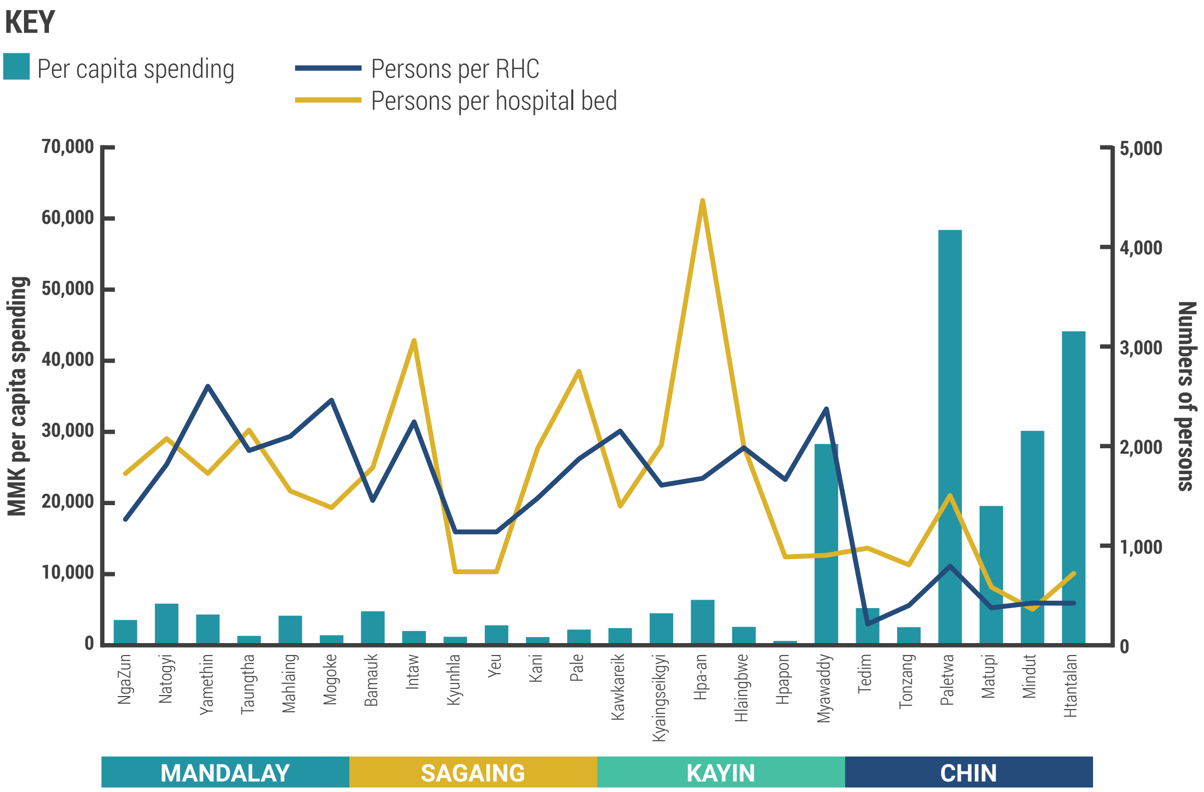

FIGURE 28 Plotting Union DBE MMK per capita allocations against enrollment rates

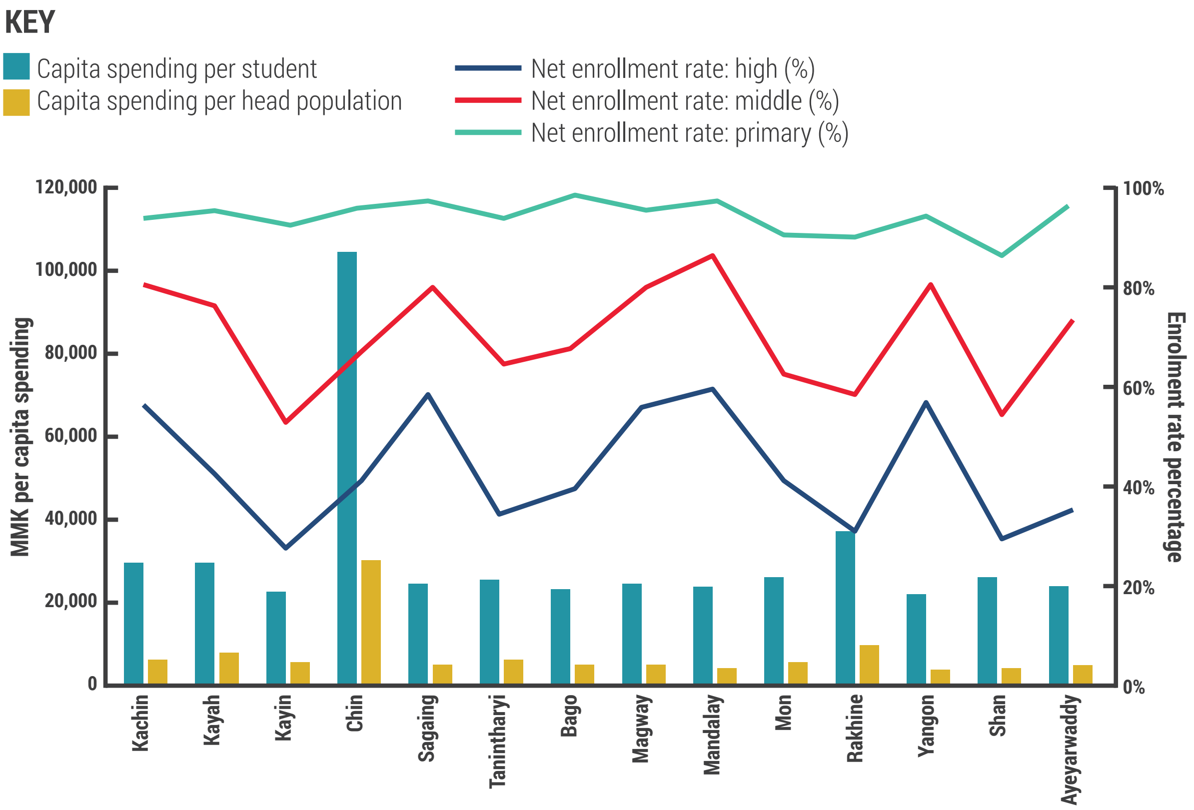

TABLE 21 Township budget proposals compared to approvals: "wish lists"

Township	Department	Approved 2018/19 State & Union budgets combined (MMK millions)	Proposed 2019/20 for State & Union budgets combined (MMK millions)	Ratio of proposal to previous budget approval
A	Highways	578.65	7,765.20	**13**
	Education	*25 schools*	*70 schools*	**3**
B	Education	685.17	7,340.00	**11**
C	Total all departments	10,000.00	70,300.00	**7**
D	DRRD	644.00	3,000.00	**5**
E	Border Affairs	1,939.93	10,430.64	**5**
	Electricity	542.64	2,109.06	**4**
	Education	804.06	3,148.50	**4**
	Health	211.00	2,472.50	**12**
	DRRD	1,289.60	17,243.19	**13**
	All	4,787.23	35,403.89	**7**

ANNEX C
THE GENERAL GRANT ALLOCATION FORMULA: ISSUES AND SIMULATIONS

1. ISSUES

Flaws in the formula itself leading to serious inequities

To the extent the formula is used, there are several technical issues[75] in the indicators themselves, which lead to inequity in the allocations.

- **Utilization of Poverty Index as Need Indicator.** The relative poverty Incidence of states/ regions is an important variable to ensure that per capita allocations in poorer areas are appropriately greater than those allocations in less-poor areas. However, the poverty index value is included as an absolute number in the formula. This means that, for example, Bago and Kayin for which poverty index values are almost the same, receive almost the same amount for this indicator, despite their hugely different populations. Instead, the index value needs to be normalized by weighting for the relative populations of states/regions - otherwise it introduces a serious distortion and, other things being equal, will tend to give larger allocations to states/regions with smaller populations.[76]

The poverty index value for each state/region is normalized as follows:

- Multiply the index value ‘p^i’ for each state/region ‘i’ by the population ‘pop^i’ of that state/region, i.e. $p^i \times pop^i$
- Sum the values of that product for all 14 states/regions, i.e. $\sum (p^i \times pop^i)$
- For each state/region divide the product of ‘p^i’ and ‘pop^i’ by this sum, i.e. $[(p^i \times pop^i) / \sum (p^i \times pop^i)] = v^i\%$
- Use the resultant fraction value / percentage v^i to determine the share of each state/region ‘i’ from the part of the total transfer pool ‘(transfer pool x f%) set aside for the poverty index value, i.e. $v^i\%$ x (transfer pool x f%)

- **Calibrating for local fiscal constraint.** The three variables that have been used to provide a measure of relative ‘fiscal poverty’ for states/regions, tax revenues per capita and urban share of the population each are reasonable proxy measures of fiscal capacity – but they too need to be normalized by relative population, following the same method as outlined above for the poverty index value.

  That aside, by default, the three criteria account for 50 percent of the allocable pool. This seems far too high weighting, considering that, nationally, the volume of own-source revenues is so small, at only about 20 percent of total state/region revenues. In other words, it over-compensates the more “fiscally poor” states/regions at the expense of those with higher spending needs (which two factors may not always co-vary). It would seem simpler to just use the tax per capita indicator (duly normalized by relative population), and accord it a lower weighting, of something like 20 percent.

- **Weighting.**[77] Since no explicit weights seem to have been given to the six ‘MTFF formula’ criteria, then by default each of the six variables is given equally one-sixth (or 17 percent) importance in the allocations. This means that:
  - Population, which is recognized internationally as the most important of all the factors driving relative spending needs and is often given a weighting of 50 percent or more, has only a very low weighting. Mathematically, this therefore means that transfers *per capita* are likely to be very different across states/regions.
  - Combining all three ‘need’ criteria accounts for only three-sixths (50 percent) of the pool. This gives far too little importance to relative expenditure needs (and too much to the relative fiscal constraint).

Data values used
Aside from these problems in the formula indicators, there are also some issues around the data values used for some formula indicators:

- **Population.** The data set used is reportedly the 2014 census, but there appear to be anomalies in population data for Rakhine. The impact is relatively modest given the very low weighting assigned to the population indicator – but if this were to be given its due weight, then the impact of these anomalies would be much more considerable.
- **Poverty Index.** This is reportedly constructed from the 2010 household survey data. One apparent anomaly here is the very high value of 73.3 given for Chin, compared to values for other states/regions which are – with the exception of Rakhine, at 43.5 - half or less this value (e.g. Shan is 33.1, Sagaing 15.1, Kayah 11.4) . No information is available on how this poverty index was constructed (and it remains unchanged since 2015/16), but the results of the more recent Myanmar Living Conditions Survey (2017)[78], suggest rather different relative deprivation levels between states/regions – and that Chin is not obviously more deprived on very many measures than many other states/regions, and that possibly the more overall deprived state is actually Rakhine.

Compensating for shared-revenue allocations
Finally, there is no reflection of the relative amount of revenue-sharing enjoyed by different states/regions, notably Yangon and Mandalay (see further below). It appears that this was factored-in on a one-time basis during the 2016/17 allocations of the deficit transfers, by deducting the shared revenue transfers from the amounts due to each state/region through the formula (a “claw back” arrangement). This deduction appears not to have been repeated in subsequent years for allocation of the annual increment – but it does carry through insofar as it continues to be reflected in the historically reduced “base” allocations of states/regions enjoying such transfers. If patterns or levels of shared revenues change substantially in the future this could, however, create growing inequities between states/ regions.

2. SIMULATIONS
First we look simply at different ways of allocating the 2018/19 general grant transfer pool. Then we bring the shared revenue transfers into the picture, and make compensations in the allocation.

Comparing different formula computations for the 2018/19 general grant transfer pool
Here below are simulations to compare state/region allocations for 2018/19 under different scenarios:

A. Using the MTFF formula as it is now (without normalising index values) only for the 2018/19 increment to the grant transfer pool.
B. Using the MTFF formula as it is now (without normalising index values) for the entire 2018/19 grant transfer pool
C. Using the MTFF formula as it now but normalising the index values and applying to the entire 2018/19 grant transfer pool.
D. Adjusting the formula to change weightings of variables, normalising the index values, and applying to the entire 2018/19 grant transfer pool. The weightings used here are as follows:
    - Population 40%
    - Poverty 20%
    - Land 20%
    - Tax index 10%
    - GDP per capita 5%
    - Urban population share 5%

The tables and charts over page show:

- The consequences of each scenario for total state./region allocation patterns, in table 22 and figure 29.
- The “winners” and “losers”are show in table 23 – ie which states/regions gain and which lose under Scenarios B, C and D as compared to Scenario A.
- Then the state/region allocations are computed in per capita terms for each scenario in table 24 and figure 30.
- Then below “variance statistics” are calculated under each scenario, also in table 24.
- And the winners and losers are shown under each scenario, as compared to scenario A, in table 25.

Factoring-in shared revenues

In the last section there is a simulation whereby 2018/19 shared-revenues are factored-in. This is done as follows:

- Adding all shared revenues and into the grant transfer pool – giving a total transfer pool of MMK 2,140 billion.
- Applying the formula scenarios C and D to this pool to determine the total transfer that each state/region should receive under each scenario as compared to present Scenario A.
- Then subtracting from this amount the shared-revenues already allocated to each state/region under the current "derivation" method.
- The difference is the amount of general grant transfer to be allocated to each state/region to ensure that each gets the transfer amount dictated by the formula scenario.
- The results are compared – in total and per capita – to the Scenario A allocations, and winners and losers highlighted. See tables 26 and 27, and figure 31.

This analysis and the various simulations below are not intended to be prescriptive – they are simply intended to promote discussion around issues and tradeoffs around future transfer allocation policy options.

TABLE 22 Grant transfer allocation simulations (MMK million)

State/Region	A. MTFF Formula only applied to pool increment	B. MTFF Formula applied to whole pool	C. MTFF Formula with normalized values applied to whole pool	D. Adjusted Formula with normalized values applied to whole pool
Kachin	159,036.56	135,994.83	102,944.64	103,075.39
Kayah	55,371.58	78,999.65	13,035.90	13,426.82
Kayin	79,869.94	136,175.20	73,447.39	66,591.45
Chin	137,923.43	155,834.93	37,742.96	40,284.73
Sagaing	183,184.41	146,997.07	168,055.97	181,619.26
Thanintharyi	148,276.29	94,150.27	54,317.45	62,412.27
Bago	132,615.48	123,910.41	140,372.28	143,429.45
Magway	147,828.15	134,912.65	125,292.57	133,774.43
Mandalay	115,505.82	106,775.78	180,784.06	182,255.37
Mon	80,141.71	83,328.40	53,211.81	54,408.14
Rakhine	149,539.05	172,969.56	159,234.94	148,989.23
Yangon	63,087.60	78,278.19	219,505.24	194,329.96
Shan	225,280.78	214,633.76	302,862.26	288,553.61
Ayeyarwaddy	125,984.31	140,684.00	172,837.63	190,494.99
Total	**1,803,645.11**	**1,803,645.00**	**1,803,645.10**	**1,803,645.10**

FIGURE 29 Grant transfer allocation simulations (MMK million)

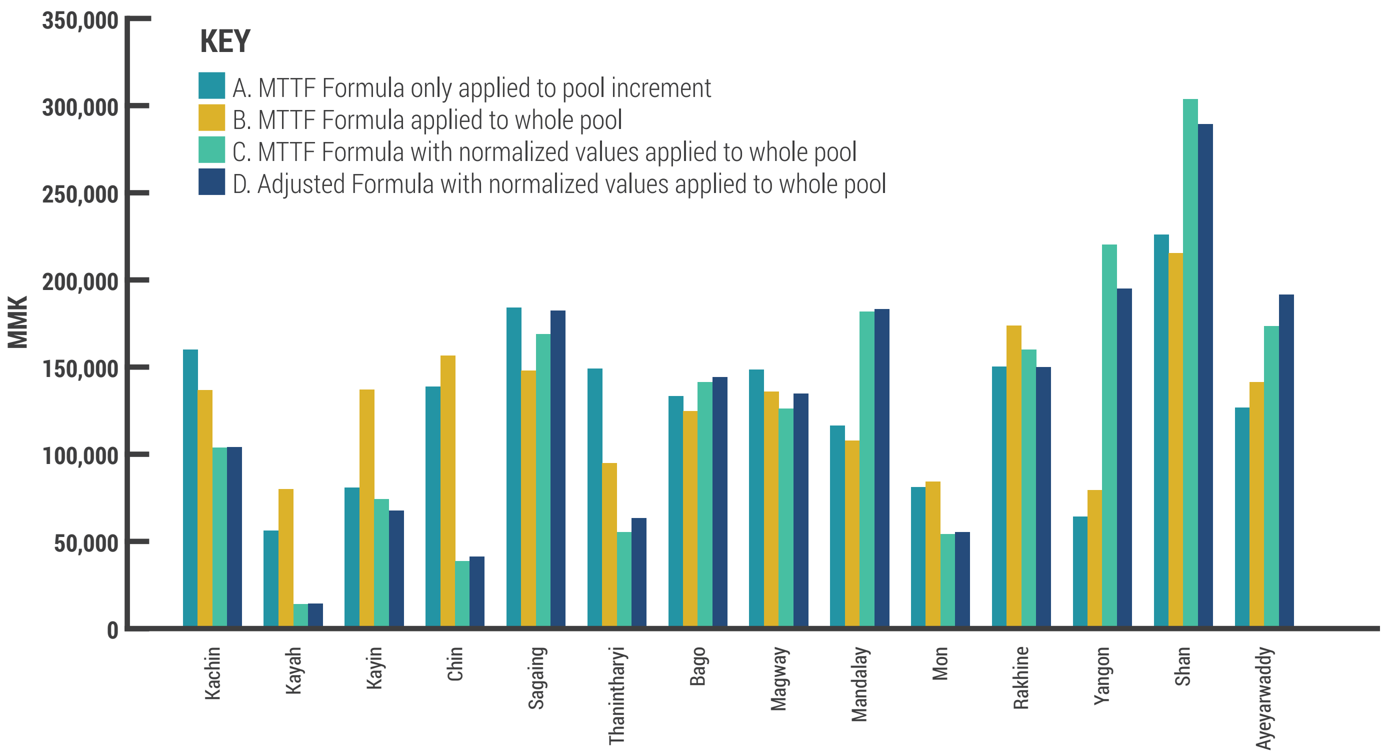

TABLE 23 Grant transfer allocation simulations – winners & losers as compared to scenario A (MMK million)

State/Region	B. MTFF Formula applied to whole pool	C. MTFF Formula with normalized values applied to whole pool	D. Adjusted Formula with normalized values applied to whole pool
Kachin	(23,041.73)	(56,091.92)	(55,961.17)
Kayah	23,628.07	(42,335.68)	(41,944.76)
Kayin	56,305.26	(6,422.55)	(13,278.49)
Chin	17,911.50	(100,180.47)	(97,638.70)
Sagaing	(36,187.34)	(15,128.44)	(1,565.15)
Thanintharyi	(54,126.02)	(93,958.84)	(85,864.02)
Bago	(8,705.07)	7,756.80	10,813.97
Magway	(12,915.50)	(22,535.58)	(14,053.72)
Mandalay	(8,730.04)	65,278.24	66,749.55
Mon	3,186.69	(26,929.90)	(25,733.57)
Rakhine	23,430.51	9,695.89	(549.82)
Yangon	15,190.59	156,417.64	131,242.36
Shan	(10,647.03)	77,581.48	63,272.83
Ayeyarwaddy	14,700.00	46,853.32	64,510.68

TABLE 24 Grant transfer per capita simulations (MMK per capita)

State/Region	A. MTFF Formula only applied to pool increment	B. MTFF Formula applied to whole pool	C. MTFF Formula with normalized values applied to whole pool	D. Adjusted Formula with normalized values applied to whole pool
Kachin	86,905.22	74,314.12	56,253.90	56,325.35
Kayah	178,618.00	254,837.58	42,051.28	43,312.32
Kayin	50,138.07	85,483.49	46,106.33	41,802.54
Chin	271,502.81	306,761.67	74,297.16	79,300.65
Sagaing	33,360.85	26,770.55	30,605.71	33,075.81
Thanintharyi	101,559.10	64,486.49	37,203.73	42,748.13
Bago	26,959.85	25,190.16	28,536.75	29,158.25
Magway	37,510.31	34,233.10	31,792.08	33,944.28
Mandalay	18,078.86	16,712.44	28,296.14	28,526.43
Mon	39,831.86	41,415.71	26,447.22	27,041.82
Rakhine	45,314.86	52,415.02	48,253.01	45,148.25
Yangon	7,948.54	9,862.44	27,655.95	24,484.06
Shan	36,400.19	34,679.88	48,935.57	46,623.62
Ayeyarwaddy	20,089.99	22,434	27,561.41	30,377.13
AVERAGE	68,158	74,971	39,571	40,133
MEDIAN	38,671	38,048	34,498	37,873
MAX	271,503	306,762	74,297	79,301
MIN	7,949	9,862	26,447	24,484
MAX:MIN RATIO	34	31	3	3

FIGURE 30 Grant transfer per capita simulations (MMK per capita)

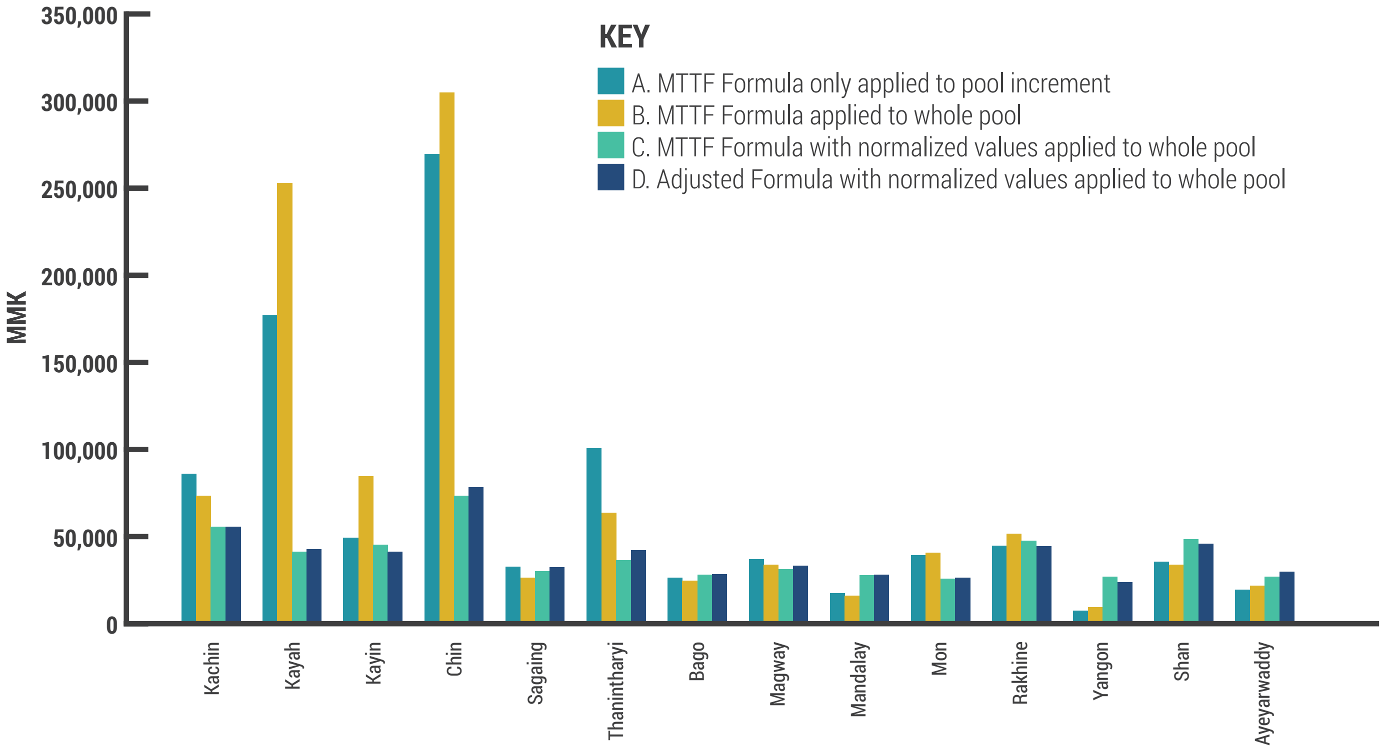

TABLE 25 Grant transfer per capita allocations – winners & losers compared to scenario A (MMK per capita)

State/Region	B. MTFF Formula applied to whole pool	C. MTFF Formula with normalized values applied to whole pool	D. Adjusted Formula with normalized values applied to whole pool
Kachin	(12,591.11)	(30,651.32)	(30,579.87)
Kayah	76,219.58	(136,566.72)	(135,305.68)
Kayin	35,345.42	(4,031.73)	(8,335.53)
Chin	35,258.85	(197,205.66)	(192,202.16)
Sagaing	(6,590.30)	(2,755.13)	(285.04)
Thanintharyi	(37,072.62)	(64,355.37)	(58,810.97)
Bago	(1,769.68)	1,576.91	2,198.41
Magway	(3,277.21)	(5,718.24)	(3,566.03)
Mandalay	(1,366.42)	10,217.29	10,447.57
Mon	1,583.84	(13,384.64)	(12,790.04)
Rakhine	7,100.15	2,938.15	(166.61)
Yangon	1,913.90	19,707.40	16,535.51
Shan	(1,720.31)	12,535.38	10,223.43
Ayeyarwaddy	2,344.12	7,471.43	10,287.14

TABLE 26 Factoring-in shared revenues to states/region allocations & winners & losers (MMK million)

State/Region	FACTORING-IN SHARED REVENUES WITH GENERAL GRANT TRANSFER			GAIN/LOSS COMPARED TO SCENARIO A	
	A. MTFF Formula only applied to pool increment	C. MTFF Formula with normalized values applied to whole pool	D. Adjusted Formula with normalized values applied to whole pool	C. MTFF Formula with normalized values applied to whole pool	D. Adjusted Formula with normalized values applied to whole pool
Kachin	164,222.69	122,173.91	122,329.08	(42,048.78)	(41,893.60)
Kayah	58,207.32	15,470.90	15,934.85	(42,736.42)	(42,272.47)
Kayin	85,013.95	87,166.80	79,030.22	2,152.85	(5,983.73)
Chin	143,486.49	44,793.05	47,809.61	(98,693.44)	(95,676.88)
Sagaing	191,348.21	199,447.53	215,544.34	8,099.32	24,196.13
Thanintharyi	152,269.54	64,463.53	74,070.40	(87,806.01)	(78,199.14)
Bago	138,762.93	166,592.74	170,220.96	27,829.81	31,458.03
Magway	153,432.59	148,696.26	158,762.46	(4,736.33)	5,329.87
Mandalay	141,420.23	214,553.13	216,299.27	73,132.90	74,879.04
Mon	83,688.93	63,151.37	64,571.16	(20,537.56)	(19,117.77)
Rakhine	156,422.92	188,978.80	176,819.27	32,555.88	20,396.35
Yangon	302,095.61	260,507.13	230,629.29	(41,588.48)	(71,466.31)
Shan	237,096.73	359,434.59	342,453.20	122,337.86	105,356.47
Ayeyarwaddy	133,083.98	205,122.36	226,077.98	72,038.38	92,994.00
Total	**2,140,552.11**	**2,140,552.10**	**2,140,552.10**		

FIGURE 31 Factoring-in shared revenues to states/regions (MMK million)

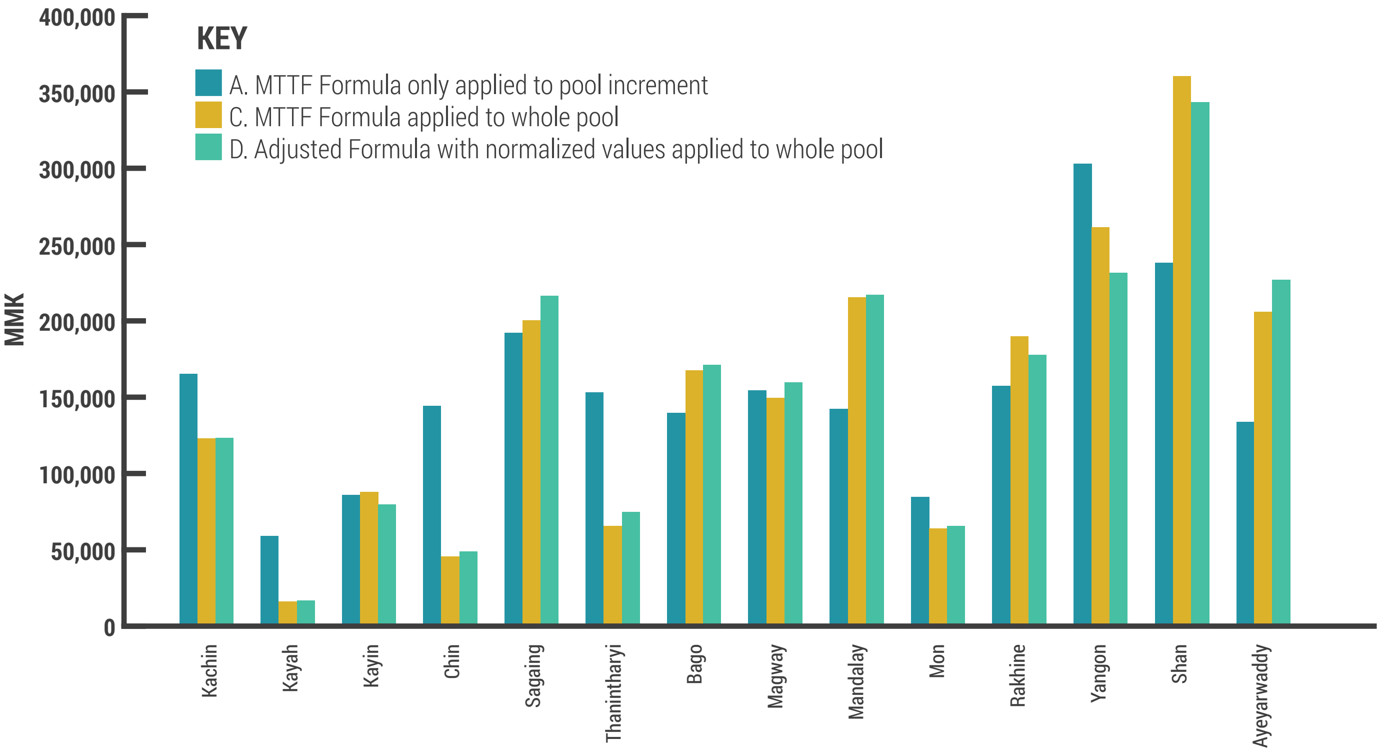

TABLE 27 Factoring-in shared revenues - total transfer per capita implications and winners & losers (MMK per capita)

State/Region	FACTORING-IN SHARED REVENUES WITH GENERAL GRANT TRANSFER			GAIN/LOSS COMPARED TO SCENARIO A	
	A. MTFF Formula only applied to pool increment	C. MTFF Formula with normalized values applied to whole pool	D. Adjusted Formula with normalized values applied to whole pool	C. MTFF Formula with normalized values applied to whole pool	D. Adjusted Formula with normalized values applied to whole pool
Kachin	89,739	66,762	66,846	(22,977.48)	(22,892.68)
Kayah	187,766	49,906	51,403	(137,859.41)	(136,362.82)
Kayin	53,367	54,719	49,611	1,351.45	(3,756.26)
Chin	282,454	88,175	94,113	(194,278.43)	(188,340.32)
Sagaing	34,848	36,323	39,254	1,475.02	4,406.51
Thanintharyi	104,294	44,153	50,733	(60,141.10)	(53,561.05)
Bago	28,210	33,867	34,605	5,657.61	6,395.21
Magway	38,932	37,731	40,285	(1,201.81)	1,352.42
Mandalay	22,135	33,582	33,855	11,446.69	11,719.99
Mon	41,595	31,387	32,093	(10,207.53)	(9,501.87)
Rakhine	47,401	57,266	53,582	9,865.42	6,180.71
Yangon	38,062	32,822	29,057	(5,239.82)	(9,004.20)
Shan	38,309	58,076	55,333	19,766.98	17,023.18
Ayeyarwaddy	21,222	32,710	36,051	11,487.54	14,829.21
AVERAGE	**73,452**	**46,963**	**47,630**		
MEDIAN	**40,264**	**40,942**	**44,948**		
MAX	**282,454**	**88,175**	**94,113**		
MIN	**21,222**	**31,387**	**29,057**		
MAX:MIN RATIO	**13**	**3**	**3**		

ENDNOTES

1. These issues are much more thoroughly examined in the companion Asia Foundation report *Where Top-Down Meets Bottom-Up*. See Batcheler 2019.
2. This is based on an analysis of a sample of 24 "township plans" (capital budgets) in Mandalay, Sagaing, Kayin, and Chin for 2018/19.
3. These efforts include the creation of a new public financial management strategy, and reforms under the Medium-Term Fiscal Framework (MTFF), through which the Union government has been moving towards a "rule-based" financing model, inspired by international best practice.
4. Batcheler 2018. This report built on earlier research undertaken by The Asia Foundation on sub-national governance issues in Myanmar, for which reports are accessible at https://asiafoundation.org/tag/myanmar-governance-discussion-paper-series/
5. Batcheler 2018.
6. Batcheler 2019. This report is accessible at https://asiafoundation.org/publication/where-top-down-meets-bottom-up-planning-and-budgeting-in-myanmar/
7. Research was carried out in Hakha, Matupi, and Tonzang townships in Chin State, in Hlaingbwe, Hpa An, and Kawkareik townships in Kayin State, and Gwa, Ponnagyun, Sittwe, and Thandwe townships in Rakhine State.
8. DRRD was created in 2017, and marked the responsibilities for rural roads transferred from the Department of Rural Development in the Ministry of Agriculture, Livestock and Irrigation, to a newly-created department in the Ministry of Construction.
9. Hluttaw: Council or assembly. Historically, a council of ministers, the term now denotes legislative bodies at the Union and state/region levels. The Pyidaungsu Hluttaw, or Union Legislative Assembly, is a joint session of the upper and lower houses of the Union parliament. The Pyithu Hluttaw, or People's Assembly, is the lower house of the Union parliament. The Amyotha Hluttaw, or Nationalities Assembly, is the upper house of the Union parliament. State/Region hluttaws are the state/region parliaments.
10. Government nomenclature distinguishes between originally approved Budget Estimates (BE), and mid-year adjusted budgets or Revised Estimates (RE).
11. A complete catalogue of The Asia Foundation's reports on subnational governance in Myanmar can be found at https://asiafoundation.org./tag/myanmar-governance-discussion-paper-series/.
12. State/region Plan Departments do prepare 'Township Plans', but these are geographic breakdowns of capital budget approvals made at State/region and Union levels, which are based - to a greater or lesser extent, depending on the Department - on proposals submitted earlier by those Township authorities (there is no similar breakdown available for Township *current* budget spending).
13. Classes B and C rural roads are financed on the Union budget, but Class A roads on state/region budgets.
14. The CDF is described further below under Section 2.2.
15. The research suggested that TPIC meetings typically last from between a half-day and up to three days, in the course of which some 300-600 budget proposals have to be reviewed.
16. This initiative is enacted through the 2015 Amended Mining Law (Section 10).
17. There are important lessons from countries such as Nepal, Indonesia and Mongolia in this regard. Moreover, once such powers are granted, it can be difficult politically to reverse them. See the Natural Resource Governance Institute (NRGI) and UNDP (2016) review of these policy issues, accessible at https://resourcegovernance.org/analysis-tools/publications/natural-resource-revenue-sharing
18. This form of "negotiated gap-filling transfer" being a typical feature of socialist-transition economies - as in Vietnam, Lao PDR, Kazakhstan, Mongolia, etc. The many problems with this form of financing arrangement which result, for example, in the undermining of incentives for both sound budgeting and also for local revenue collection, and horizontal inequities, are well documented. See for example Bird et al 1995; Martinez-Vazquez and Boex 1999; Bahl 2000; and Dabla-Norris et al 2002.
19. In Vietnam, local officials used to refer cynically to the "negotiated gap-filling" transfer arrangements as "begging and receiving".
20. Interpreting state/region budget statements can be confusing insofar as for about half of states/regions these transfers are recorded as current revenues on the Budget Department account where, in cases, they are summed up with the other very minor revenues accruing to that department.
21. Here too, the practice of states/regions recording these shared-revenue transfers as 'other current revenues' under the State/region cabinet account in the budget can lead to some confusion.
22. This issue is seen in Indonesia, where the generous natural resource revenue-related sharing arrangements introduced as part of the big-bang decentralisation reforms 20 years ago have now created very wide spending

power disparities between regions and districts, which are too large to be offset by the normal equalisation grant transfers. Attempts by central government to reform these sharing arrangements have been regularly blocked.

23. Union Parliament Development Funds Law, March 2014; Order No. 82/2013 on 'Procedures for Controlling and Using Development Fund'; and other instructions. CDF transfers are recorded in total as one line under Schedule 4.2 of Annex to Budget Law as grants to Pyidaungsu Hluttaw Development Fund.
24. Similar MP Constituency funds are found in a range of countries around the world, and are object of frequent criticism. See van Zyl 2010.
25. This allocation is made regardless of numbers of township MPs - each township elects 2 MPs to the State/ region hluttaw, and either 1 or 2 MPs to the Union hluttaw.
26. See Robertson et al 2015.
27. In 2013/14 all states/regions received MMK 1 billion, except Chin which received MMK 3 billion. In 2014/15 each state/region received MMK 1 billion, except Chin which received MMK 5 billion, Shan MMK 4 billion, and Kachin and Rakhine MMK 15 billion each.
28. Kayin reportedly set aside MMK 300 million from its 2018/19 budget, with PRF allocations of MMK 5 million each to selected villages, channelled through GAD.
29. Some Union investments – such as major highways, power grids, etc. – are also financed through loans from development partners. Ultimately, these loans are repaid from Union revenues.
30. The approved Union budget does not indicate a geographic breakdown of Union department spending, but each state/region Planning department compiles a breakdown of approved union investment budgets by state/region and by township at the start of the budget year, after approval of Union and state/region budgets.
31. To illustrate, DBE maintains 412 township, district and state/region sub-accounts at MEB.
32. In townships where, aside from the main 'headquarters town', there are also other designated "towns" with secondary "sub-DAOs".
33. These powers are delegated under the Yangon City Development Law (1990) and the City of Mandalay Development Law (2002).
34. There is no similar delegated financing arrangement in the Health sector, and so even minor current spending by Rural Health Centres and local hospitals remains under the responsibility of Township, District or State/region Health Department offices. This seems to be an area where lessons can be learnt from delegated funding initiatives undertaken elsewhere (e.g. Cambodia, Pakistan, Argentina or Brazil), to allow local health facilities greater managerial control over their operating budgets and procurement.
35. It is hard to see how Union officials, without local knowledge or consultations, are better placed to make spending decisions in these areas than local officials whose knowledge of highly variable local contexts and local priorities is critical. Decision-making responsibilities for the same investments are decentralized to lowest-tier local governments in many countries in the region.
36. For example, some state/region officials reported hesitation in collecting certain water-related tax revenues allowed under Schedule 5, citing pre-existing legislation which indicated these as Union revenues. It was unclear whether such cases reflect genuine legal inconsistencies or simply inadequate guidance and understanding of the current revenue powers.
37. These forms of arrangement, typical of many socialist/transition countries, are seen in Lao PDR, Mongolia, and across the Commonwealth of Independent States (CIS), and their inherent problems have been well documented in public finance literature on socialist/transition economies.
38. Field evidence suggests that on average township sector departments submit proposals which may be some 7 times more what is later approved. For Chin state, in 2018/19 the total cost of capital budget proposals submitted was MMK 567 billion, against a capital budget of MMK 110 billion – hence 80% of proposals had to be cut. These issues had been earlier raised in Shotton et al 2016.
39. One VTA in Kayin made this point very clearly to the mission, saying that – to maintain her own local credibility - she no longer bothers to organize community meetings to solicit input for the township planning process – except for the CDF, which *is* associated with budget certainty for her township and hence a greater chance of access for her VT.
40. TDLGP is implemented by the United Nations Development Programme (UNDP) in partnership with Bago, Mon and Rakhine governments. It allocates formula-based grants to selected townships and their TPICs, and supports a participatory planning process managed primarily through the Village Tract Administrators (VTAs) and local civil society.
41. The mission was unable to undertake fieldwork to document this initiative. The formula used is rather different from that applied by TDLGP, and appears designed to ensure township allocations are relatively similar.
42. GAD was previously under the Ministry of Home Affairs, as suggested by the budget heading in the table, but is now under Ministry of the Office of the Union Government.
43. The TDLGP funding model was outlined in the Box at the end of Chapter 2.

44. Here it is worth noting that a substantial part of DAO's revenues derive from auction fees related to economic activity (ferry crossings, livestock abattoirs, etc.) which actually occurs in rural areas, outside of the town limits within which DAOs deliver services. See Winter et al 2016.
45. To compare relative own-revenue collection potential or effort in different states/regions we need to normalize budget data by translating total revenues into per capita revenues.
46. Issues with the allocation formula have been raised earlier in Shotton et al 2016.
47. This arises simply because the inevitable differences between revenue estimates and actual collections are, on average, greatly reduced when revenues are pooled nationally.
48. The mission was unable to confirm this with Yangon or Mandalay authorities. But both region budgets clearly indicate these loan receipts and repayments, and the JICA website suggests that both CDCs have contracted loans from JICA for improvements to urban water supply and other investments.
49. For more detail on DAO fees and revenues see Winter et al 2016.
50. As discussed in Chapter 3, Mandalay, along with Kachin and Rakhine, provided no "transfers" to their DAOs.
51. To further support this hypothesis, we will see that levels of total township spending in Sagaing tend to be higher than those for Mandalay but that, overall, Mandalay revenues per capita (MMK 44,291) are slightly higher than those for Sagaing (MMK 40,132).
52. Some minor variance may also simply be due to inconsistent recording of expenditures between capital and current budget accounts.
53. This analysis uses the same classification assumptions for populations served (regarding general, rural and urban spending) as for the township analysis further below in section 4.3.
54. The reason for the apparent lack of budget spending for Electricity in some states/regions is unclear. In highly urban Yangon Region this may simply be that all such spending is separately recorded under the Electricity SoE account – but this seems unlikely to be the explanation for zero spending across all townships in Mandalay, Kayah and Ayayerwaddy.
55. Thus DBE claims to apply a formula for state/region capital budget allocations based on relative numbers of pupils and schools, but in practice actual budget allocations deviate considerably.
56. Data from Valley et al 2018 accessible at https://rimyanmar.org/en/publication/where-rubber-hits-road-review-decentralisation-myanmar-and-roads-sector
57. Ministry of Agriculture, Irrigation and Livestock and Ministry of Border Affairs 2017.
58. Private communication with Oxford Policy Management, Myanmar.
59. Although it must also be remembered that both ministries are primarily service providers – to the farmers, herders, fishermen in their areas – rather than being themselves producers or investors; further, the main capital investments supporting rural livelihoods are in roads, irrigation, drainage, power, markets, etc., which are responsibilities of other funding ministries or departments.
60. Here it is worth noting that at least in some states/regions, the grid is sometimes expanded into villages which already have received solar investments from DRD, raising questions about appropriateness of grid expansion criteria and efficiency of funds use. In Rakhine, there were reports of villagers having sold off the solar equipment - that they had received in previous years - once the main grid arrived.
61. Spending patterns have been 'normalized' into per capita spending levels by type of population being serviced by that sector. See Table 20 in Annex B.
62. The Township Development Index (TDI) database was developed by The Asia Foundation to meet the demand for township level data, for use in targeted decision-making and planning. The TDI holds over 6,500 indicators organized into 11 different categories including demography, infrastructure and construction, industry and business, and subnational conflict. The TDI includes sex-disaggregated data from over 60 sources (including the Central Statistics Organisation, 2014 census, and GAD) and was collated over a two-year period
63. This data on education enrolment is taken from the Household Living Standards Survey 2017 (Poverty Report) - see Myanmar Central Statistical Organization 2017.
64. These sorts of arrangements, typical of many socialist/transition countries, are seen in Lao PDR, Mongolia, and across the CIS, and their inherent problems have been well documented in public finance literature on socialist/transition economies.
65. The problems in the local planning and budgeting arrangements are more fully examined in the companion Asia Foundation report *Where Top down meets Bottom up*. See Batcheler 2019.
66. By contrast, in many other Asian countries lowest-level local governments, which are much smaller in area and population and far less-well staffed than Myanmar's townships, are budget entities in their own right. This enables them to finance the same sorts of local spending which in Myanmar only takes place on state/region or Union budgets.
67. The TDLGP grant allocation formula comprises the following variables: relative population (2014 census) weighted at 70 percent, relative land area (MIMU data) at 15 percent, and a fixed element of 15 percent of the

allocable pool. The formula adopted by Bago region differs from this, with a large fixed element in the allocation, and very low weighting for relative population. NCDDP allocates funding based on population at a village-tract level and the numbers of village in each village tract.

68. Arguments commonly heard from state/region authorities are that such an upfront township budget allocation "may discourage full identification of local needs" or that "we cannot say in advance how much each township should be allocated, it all depends on expressed need".
69. But any such prior budget approval controls over township budget proposals may not in fact be very effective, given both that state/region officials lack of knowledge of often distant local contexts, and anyway that most corruption problems probably occur more during budget execution rather than preparation. A stronger monitoring and audit mechanism, with sanctions, is likely to be more effective.
70. The problems in current TPIC functioning are more fully documented in Batcheler 2019.
71. To illustrate: a village tract or community window could be used to fund smaller infrastructure with more limited intra-VT impact, such as village water supplies, repairs or improvements to existing infrastructure (schools, culverts, etc.), while a township window could be used to fund infrastructure with wider inter-VT or township impact or externalities, such as inter-village/VT rural roads, schools, etc. This distinction would need to be reflected in the spending menus for each window.
72. State/region hluttaw interviewees and participants comprises hluttaw representatives, and a small number of hluttaw office staff and technical support members of the hluttaw public accounts committees.
73. W/VTAs includes a small number of 100 and 10 household heads, and village and village tract committee members.
74. Other comprises civil society organisations, non-government organisations, and international planning and budgeting experts.
75. These issues were already raised in The Asia Foundation (2017) b.
76. Such neglect of the need to normalise poverty and other indices by relative population in grant allocation formulae is not uncommon. For example, in Nepal and Mongolia it was only after a few years that grant allocation formulas were properly normalized for relative population. It should be stressed that the need for normalization of poverty or other index values is quite separate to the rationale for inclusion of the 'standalone' population number itself in the formula.
77. In all allocation formulae, the various criteria will have, by design or by default, a "weighting". This means that the total pool is split into sub-pools so that the allocations for each of the criteria are made from the corresponding sub-pool. If we give a 10 percent (or 0.1 factor) weighting to a criterion, this means that 10 percent of the total pool will be allocated according to the relative values of each state/region for that particular criterion.
78. Myanmar Living Conditions Survey 2017, Myanmar CSO, World Bank & UNDP (2018).

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