

# DECENTRALIZATION IN MALAWI : AN OVERVIEW<sup>1</sup>

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## I – Introduction

1. Malawi is a relatively small country in population (about 15 million inhabitants) and area (about 120,000 km<sup>2</sup>) – that is the size of Belgium. It still is a poor country (with a GDP/capita of about 300 US\$), although it has been growing rapidly (at about 7% per year) in recent years. Decentralization is a policy concern in Malawi.

2. Because the word “decentralization” often means different things to different persons, some definitions might be useful. The public sector in a country can be organized along different modes. It can be *centralized*, with a central government concentrating political, administrative and fiscal powers and being responsible for the provision of public services to the people. It can be *deconcentrated*, with the central government delegating some of its powers, particularly expenditures powers, to sub-national administrators that remain under the control of the central government, but have a certain degree of discretion in carrying its policies. It can be *decentralized* (devolved as some call it), with independent sub-national governments providing public services to the people.

3. In practice, the public sector of every country is a mix of these three modes of government. Countries differ in the relative importance of centralization, deconcentration and decentralization, and in the details of the relationships between these three modes.

4. Each mode has its benefits and its costs. There is no normative ranking of the three modes. It cannot be said that decentralization is always better than deconcentration, which would be better than centralization. The optimal mix varies over country, and over time. Each country has to find the mix that best serves its citizens. This mix is a function of the characteristics (history, geography, economy, sociology, politics, etc.) of the country, and it has constantly to be adapted to changes of these characteristics. Public sector reform is everywhere an on-going process. Decentralization therefore defines a system in which the share, role, power, discretion, of sub-national governments is relatively large, relative to the central government and to its deconcentrated bodies or agents<sup>1</sup>.

5. Decentralization is expected to achieve two objectives. One is *economic*: to improve the delivery of public services in the country, thereby increasing economic and social welfare. The other is *political*: to further the involvement of citizens in local decision-making, thereby spreading and deepening citizen participation in policies and politics and improving governance. These two objectives are obviously interrelated. Local involvement is seen as contributing to the quality and relevance of service delivery, which in turn encourages political participation.

6. In practice, however, decentralization does not always achieves automatically these worthy objectives. There is no clear correlation between the degree of decentralization and the quality of public service delivery, nor between the degree of decentralization and the quality of political life. To take a simple example, the most centralized country of South America, Chile, happens to be also the most efficient.

7. For decentralization to function effectively and deliver its potential benefits, several conditions or prerequisites are needed. Three can be mentioned<sup>2</sup>. (i) The first is an adequate level of *administrative capacity* of decentralized units. (ii) the second is the existence of *accountability* and accountability mechanisms at the local level. (iii) The third is the availability of an appropriate framework for *intergovernmental relationships*. In the absence of these conditions, decentralization is unlikely to work well, and might even backfire. This is why these conditions are often presented as intermediary outcomes or objectives of a decentralization process. This distinction between final outcomes and intermediary outcomes provides a useful framework to evaluate – and improve – a decentralization process, to be used in this report.

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<sup>1</sup> Language is ambiguous on this matter. The word decentralization is used to describe a state of affairs (a decentralized system), and a process (the move towards a more decentralized system).

<sup>2</sup> And are mentioned in a 2008 report of the World Bank Independent Evaluation Group entitled *Decentralization in Client Countries. An Evaluation of World Bank Support 1990-2007*.

8. During the colonial era, the country was already divided into districts, with appointed district commissioners, some elected councils, and reliance upon traditional chiefs. With independence, in 1964, Malawi became a one-party centralized state for about 30 years. The development of a multi-party system in 1994 was accompanied by a move towards decentralization, leading to the 1998 Local Government Act, that defines the present situation. In 2000, district councils were elected, for a period of 5 years. The elections due for 2005, have been regularly postponed, leaving districts without councils. Elections are planned for April 2011.

9. This note tries to present an overview of the weight and nature of decentralization of the Malawi public sector, as it is presently and as it is planned to develop in the coming years. At the end of a one week mission, we obviously know much less than the World Bank country office and *a fortiori* than the Malawi actors. The hope is that outsiders can perhaps compensate this lack of knowledge by a more synthetic and critical view of matters, and by bringing to bear the experience of a number of other countries.

10. The structure of the paper is as follows. Section II presents the decentralization system, that is the main actors, the financial flows presently involved, and some important planned changes. Section III offers an assessment of this system, of how it fares relative to the three prerequisites of administrative capability, accountability, and intergovernmental relationships. Section IV considers and discusses various options which are offered to the Government of Malawi in several key areas. Section VI concludes, with some options relative to what the World Bank could do to assist this process.

## II – Presentation

11. Let us begin by a description of decentralization in Malawi which is not merely qualitative but as quantitative as possible. It (i) presents briefly the main actors of decentralization in Malawi<sup>1</sup>, (ii) quantifies the financial flows involved, and (iii) discusses several important changes that are currently being introduced.

### *The Actors*

12. Three actors or groups of actors intervene the decentralization game: the central government, the international donors, and above all the sub-national entities.

13. *Government of Malawi* – Malawi benefits from a multi-party system, and a democratically elected Parliament, for 5 years. The 194 MPs are elected in a similar number of jurisdictions in a British first-past-the-post system. There is also a democratically elected President whose powers can be compared to that of an American President. He appoints the cabinet and the top positions in the

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<sup>1</sup> Malawi officials can obviously skip this part of the report

administration, and plays a key role in policy formulation and in the preparation of laws.

14. Malawi benefits from a relatively strong and qualified administration at the national level. Civil servants are, in principle, recruited through a largely independent Civil Service Commission, and cannot be dismissed except for cause. In each ministry, there is a Principal Secretary who runs the ministry - under the supervision of the minister, obviously - as in India. In important areas, such as tax collection, road building, or inter-governmental transfers, specific Agencies have been created (the Malawi Tax Authority, the Malawi Roads Agency, the National Local Government Finance Committee); they are more technical and independent than a ministerial department.

15. *International Donors* - The group of international donors, or development partners, is a key player in Malawi. It spends in Malawi nearly one-fifth of the GDP, and accounts for about half of the public sector. This is said not to be uncommon in Africa (although such high ratios are probably rare), but it is unheard of in the rest of the developing world. International partners are of three types: multilateral (World Bank, African Development Bank, UNICEF, UNDP, UNDCF, European Union), bilateral (German Aid, Japanese Aid, USAID, Irish Aid, etc), and private aid, consisting mostly of NGOs. All of these institutions make efforts (i) to coordinate between themselves in order to avoid duplication, and (ii) to coordinate their actions and expenditures with the authorities of Malawi.

16. *Sub-national Bodies* - Below the central government, there are at least four levels of politico-administrative organization: districts, areas, groups of villages, and villages. None of them is presently a full-fledged local government, and the last two are more informal than formal.

17. Districts, numbering 40, are the basic sub-national units in Malawi. They are presently deconcentrated units of the central government administration. Most ministries, for instance Education or Agriculture, have a representative and an office in each district. In addition, the ministry of Local Government and Regional Policy, in coordination with the Office of the President, appoints in each district a District Commissioner, who has, in principle, authority over the representatives of the various ministries.

18. At the same time, the district is what could be called a decentralized quasi local government. From 2000 to 2005, districts had an elected council. Presently, there is no elected council. A co-opted development committee that represents and specifies the interests of the districts exists. It includes traditional chiefs, the M.Ps elected in the jurisdictions of the district, representatives of the various areas of the district, and respected or/and knowledgeable persons. These members are not paid. There should soon (in April 2011) be elected councils. This dual nature of districts (deconcentrated unit, and local government) is somewhat ambiguous, but not uncommon. The same thing happened in France for nearly two centuries with departments, with a prefect appointed by the central government exercising authority over the representatives of the various ministries and their staff, working together with an elected council and its chairman.

**Table 1 – Urban and Rural Districts, 2008**

	Urban	Rural	(in 1,000 people)	
			Total	Total
4 urban districts (cities)	1,557	-	1,557	12%
of which Lilongwe	674	-		
Blantyre	661	-		
28 rural districts	446	11,063	11,509	88%
Total	2,003	11,063	13,066	100%
Total (%)	15%	85%	100%	

*Sources:* 2008 Census. *Note:* The population of towns is included in the population of rural districts, although towns are a distinct administrative entity; this the reason why the total number of districts is 32, not 40.

19. Districts are diverse, in terms of population, income, poverty, tax bases, etc. Four districts are cities (Lilongwe, Blantyre, Zomba, Mzuzu), eight are towns, and 28 are rural districts. The “capitals” of economic regions are therefore divorced from their immediate rural hinterland. This division is not unheard of, but is not very common. Table 1 shows that the bulk of the population is rural (85%) and that rural districts account for most (88%) of the population. It also shows that there are only two large cities : Lilongwe and Blantyre of about 700,000 people each. The two other cities are about 100,000 people large. The eight “towns” are much smaller, in the 20,000 to 50,000 people range. The population of an average rural district is about 400,000 people, with large variations.

20. At the lowest level, there are about 18,000 *villages*, and about 2,300 groups of villages<sup>1</sup>. The population size of a village would therefore be around 600 people, and that of a group about 5,000 people. They have no formal political nor administrative existence. Yet, they play a significant role. They produce, by cooptation, committees regrouping the most influential, or respected persons of the village (or group of villages), including traditional chiefs. These committees can produce documents expressing the needs of the community, as viewed by them, and can enter into negotiations (with other players external to the community) on behalf of their village or group of village. Members of these committees are not paid.

21. In between districts and villages/groups, there are *areas*. The number of areas per district seems to be in the 3-6 range, with therefore something like 120 areas, which would imply an average of about 90,000 people per area, with great size disparities. Like villages, areas have no formal existence, but create committees that represent them. These committees usually include some of the leaders of the groups of villages of the area, the member(s) of Parliament of the area, leading businessmen, representatives of a NGO operating in the area, and of course traditional chiefs. Members are not paid.

22. At all three levels, traditional chiefs are active. They are designated according to their own rules based on inheritance, albeit in different ways (there is a matriachal system in the North, a patriarchal one in the South).

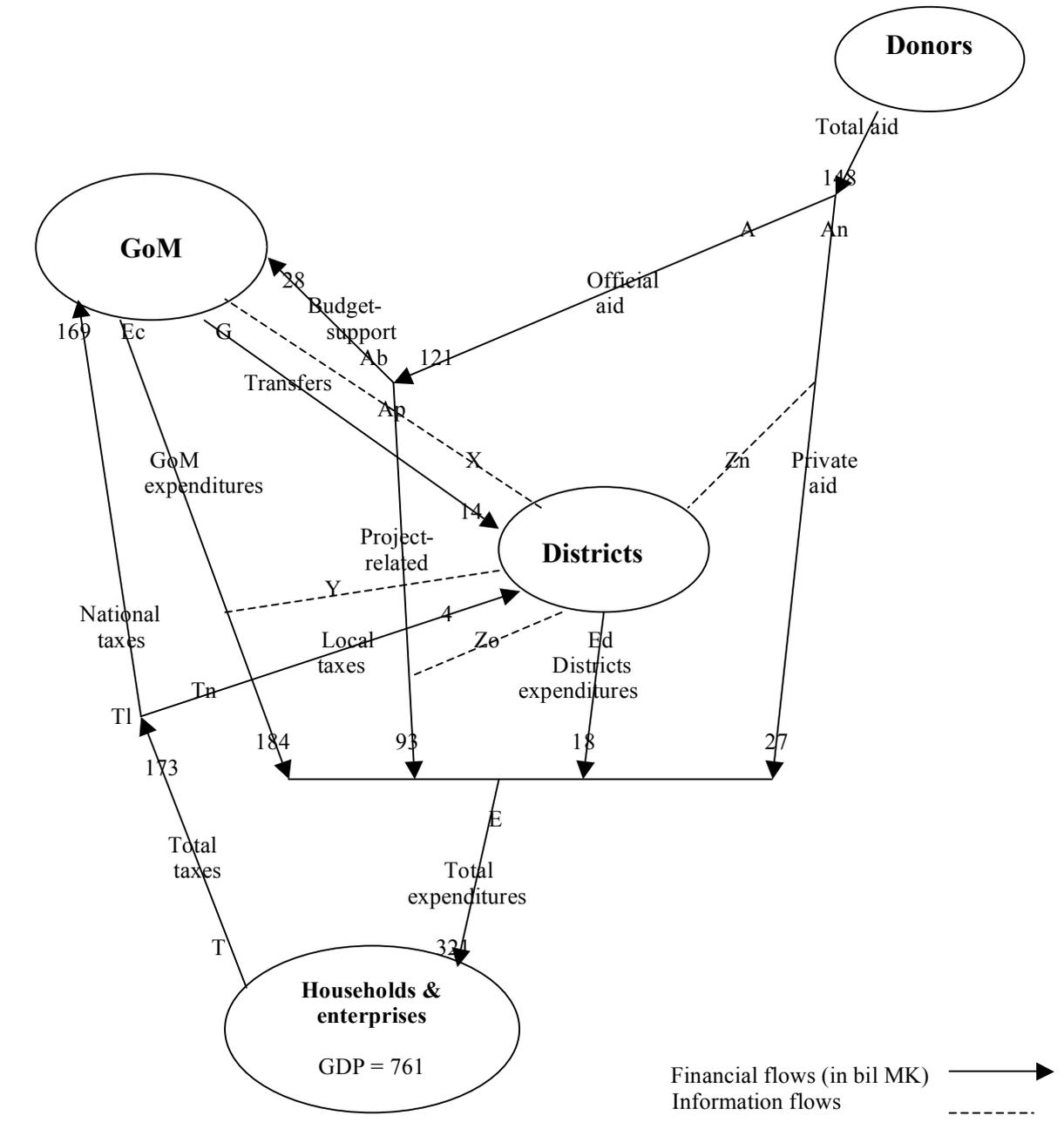
<sup>1</sup> These tentative numbers are based on the number of registered « village headmen » and « group village headmen ».

Most of them are widely respected and listened to. They are registered at, and paid by, the central government, for about 0.8 G MKashas per year.

### *Financial Flows*

23. Decentralization is largely (although not only) a matter of money. Understanding who raises how much and how and who spends how much on what is necessary to understand how centralized, deconcentrated or decentralized the Malawi system is at present. Figure 1 presents the main public sector money flows between the actors mentioned above. The numbers, expressed in billion Malawi kwashas (MK), relate to fiscal year 2009-10. They are imperfect estimates (for instance some were obtained by taking the average of calendar year numbers for 2009 and 2010; some relate to budgets and other relate to forecasts; and these flows can vary significantly from year to year). But they are sufficiently robust to provide meaningful order of magnitudes. The focus is on money flows (in full lines). But it is obvious that money flows are only one part of the story. They are supplemented by information or decision flows (in dotted lines), and by the discussion that follows.

Figure 1 – Malawi Public Sector Finance Flow Chart, 2009-2010



24. *Taxes and fees* raised in Malawi (arrow T) amount to 175 billion MK. This is equal to about 23% of GDP, a relatively high ratio. The bulk of it (arrow Tc), for 169 billions, consists of national taxes (a VAT at 16.5%, a wage tax at a progressive rate, a corporate income tax at 35%, import taxes, etc.), and accrue to the GoM.

25. The balance, for about 2% of total taxes raised, consists of local taxes and levies (arrow Tl), for 4 billion MK, assessed and levied by districts. It is a rare example of taxes levied by a non elected body, and contradicts the famous “no taxation without representation”. The local tax system consists of

three revenues : a property tax, for 70%; market taxes, for 13%; and various fees and licences for 17%.

**Table 2 – Local Taxes and Fees, 2009-10**

	(in billion MK or in %)					
	Rural	Towns	Both	Cities	Total	Total
Property taxes	-	0.09	0.09	2.78	2.87	70%
Market taxes	0.29	0.07	0.36	0.16	0.52	13%
Fees & licences	0.16	0.10	0.26	0.43	0.69	17%
Total	0.44	0.27	0.71	3.38	4.09	100%
Per capita (in MK)			23	2170	31	

*Source* : NLGFC. *Note* : 1 US\$ = 154 MK

26. The most remarkable feature of the Malawi local tax system is that the property tax is only levied in cities and in towns. It follows that the four cities, representing 12% of the population, pocket 83% of local taxes and fees. In per capita terms, the inhabitants of these four cities pay annually about 2,170 MK, when the inhabitants of rural districts (including towns) pay only 23 MK - one hundred times less. The average of 31 MK per capita is therefore not very meaningful.

27. In addition to the 169 billions raised in taxes and fees, the budget of the GoM benefits from an international budget support (Arrow Ab) of 28 billions. Ignoring borrowing and repayment, which are not presently important, this means a budget of about 197 billions. The bulk of it, 184 billions (Arrow Ec), is spent directly on public services provision by the various ministries. A smaller part of it, for 13 billions (Arrow G, as in grants), is spent in the form of transfers to districts.

28. *Inter-governmental transfers* from the GoM to districts (Arrow G) are diverse in nature, and differ also markedly between cities and rural districts, as shown in Table 3. Most of them are ear-marked. The Constituency Development Fund is money equally given to each member of Parliament to undertake projects in his/her constituency. The chiefs honorarium is money that is to be paid to all registered chiefs<sup>1</sup>. The sector fund, which represents 86% of total transfers, is the money given by the various ministries (particularly the Health ministry) for prescribed expenditures in the district. Only the General Resource Fund, representing only 4% of total transfers (and 0.25% of total GoM budget, 20 times less than the 5% of net national budget - a roughly similar concept - decided by Parliament en 2002) and perhaps a “salary subsidy” (on which we failed to gather much information) can be considered as block grants to be used by districts as they think fit.

<sup>1</sup> It could be argued that these two funds are not true intergovernmental transfers ; they are treated as such here because they appear under this label in all official budgetary documents.

**Table 3 – Inter-governmental Transfers, 2009-10**

	Rural districts & towns	Cities	(in billion MK or in %)	
			Total	Total
General Resource Fund	0.48	0.06	0.54	4%
Salary subsidy	0.29	-	0.29	2%
Sector Funds	11.63	0.10	11.73	86%
Infrastructure Devt Fund	-	0.60	0.60	4%
Constituency Devt Fund	0.33	0.03	0.39	3%
Chief honorarium	0.81	-	0.81	6%
Total	12.88	0.78	13.66	100%
Total (%)	94%	6%	100%	
Total per capita (in MK)	1,119	501	1,045	

Source : NLGFC. Note : 1 US\$ = 154 MK

29. *Expenditures of districts and cities* (arrow Ed) amount to 18 billion MK. They are equal to the sum of taxes and fees and of transfers (Ed = Tl + G). Table 4 presents a functional breakdown of these expenditures. The bulk (91%) of these expenditures consist of recurrent expenditures. Many of them (salaries, travel expenditures, office supplies) are primarily overhead expenditures, required to keep the institution going, that only contribute indirectly to the provision of public services. Capital expenditures, by contrast, are small, and those which are controlled directly by districts are even smaller.

**Table 4 – Districts Expenditures, by Type, 2009-10**

	Total (in bil. MK)	Total %	per capita (in MK)
Recurrent expenditures :	16.59	91%	1,269
Salaries (incl. chiefs emoluments)	2.47	14%	342
Travel	4.47	25%	342
Office supplies & services	1.57	9%	120
Medical supplies	3.39	19%	259
Miscellaneous	3.51	20%	268
Capital outlays :	1.48	9%	226
Own capital contribution	0.49	3%	38
Constituency Devt Fund	0.39	2%	30
Infrastructure Devt Fund	0.60	3%	45
Total expenditures	17.77	100%	1,360

Source: NLGFC. Note: 1 US\$ = 154 MK

30. *Foreign aid*, amounting to 168 billion MK, is a major component of the picture. It comes in three forms: official aid for direct budget support (arrow Ab) for 28 billions; official aid for projects (Arrow Ap) for 93 billions; and private aid (Arrow An, with n as in NGO) for 27 billions. The total represents 22% of GDP. Both project-related official aid and private aid consist of expenditures on the provision of public services. These expenditures do not appear in central government accounts nor in local government accounts, although they are obviously undertaken in relation with these two levels of governments.

### *Planned Changes*

31. 2011 might well mark a real change in the public sector mix in Malawi, with significant increases in decentralization, or to put it otherwise, an acceleration of the decentralization process. Three factors should or could contribute to this change: (i) district elections are planned to take place in April; (ii) a Local Development Fund (LDF) will begin to operate; and (iii) nation-wide information and reporting systems will soon become fully operational.

32. *Elections* - District councillors were democratically elected in 2000, for five years. This formal transformation of a deconcentrated body into a decentralized one does not seem to have had a marked impact upon Center-districts relationships. The elections that should have taken place in 2005 were postponed, allegedly for costs reasons. New elections have subsequently been planned for various dates, then abandoned. An election which was supposed to take place in the fall 2010 was cancelled and postponed to April 2011.

33. When elections are held, there will be about 400 councillors, an average of 12 per district, elected for 5 years. They will be paid. The basic rule seems to be that there will be two district electoral wards per Parliament constituency, although there will be exceptions. MPs, numbering about 200, will also sit in the councils. Each district council will therefore consist of elected councillors for about two-thirds, and of the MPs elected in the district constituencies for one-third. A number of traditional chiefs will also sit in the councils, without voting powers. The district commissioner, and the representatives of the various ministries in the district will also be present without voting powers. Elected members will elect a council chairman.

34. The cost of councils will be low, although not negligible. A crude estimate puts it at something like 0.5 billion MK, about 3% of total districts expenditures, and 12% of districts own taxes and fees.

35. It is rather likely that this political decentralization will produce political pressure for additional decentralization. Democratically elected councillors will probably demand more fiscal autonomy, in the form of increased block grant transfers and of increased own tax bases. They might increase tax collection efforts. They will also want to control more effectively the activities of the central government and of foreign donors in their district. In short, it will create a decentralization dynamics. The fact that the newly appointed (in August 2010) minister of Local Government and Regional Development was an elected councillor in the 2000-2005 period might reinforce this dynamics.

36. *Local Development Fund* - The GoM and several donors have jointly decided to create a Fund, the LDF (Local Development Fund), that would provide money to sub-national government for deserving development projects. The LDF would essentially do on a larger scale what the World Bank MASAF (Malawi Social Action Fund) project has been doing with what is widely reported to be a fair degree of success. Great hopes are placed

in the contribution that the LDF could make to decentralization. The creation of LDF has taken several years. As of now, it is not yet fully operational. There is an agreement on the notion of having four “windows” in LDF : (i) a Community Window, to “finance demand-driven community socio-economic investment and services directly managed by communities, such as, for instance, the construction of a well; (ii) a Local Authority Window to “finance capital investments, labour-intensive public works programs”; (iii) an Urban Window, “to finance socio- economic infrastructure projects in urban areas which are both labour and capital intensive”<sup>1</sup>, and (iv) a Performance Window, that would “reward good performance”. However, much uncertainty remains, particularly in three important domains.

37. The size of the LDF is not clear. It would seem that, on a yearly basis, the World Bank pledged 1.5 billion MK (for 5 years), the African Development Bank 0.7 billion MK (for 5 years) and the GoM 2.4 billion (for 1 year), and GTZ 0.5 billion<sup>2</sup>. This would amount to 5.1 billions MK per year. How important is this? This is a large amount relative to the financial resources of districts (it is larger than all the taxes and fees they raise), but it represents only about 4% of aid flows and 3% of GoM direct expenditures, and only 1.6% of total public expenditures in the country. LDF is important, but it should not be the tree that hides the forest. It is expected that other donors, such as UNICEF, UNDP, UNCDF, or Irish Aid, would join the LDF and increase this 5 billions MK amount.

38. The allocation criteria of the LDF are not clear. The LDF is reported to be demand-driven. It means that sub-national entities would ask the LDF funding for specific projects. Handbooks have been produced that explain in detail how such projects should be prepared and what their characteristics should be. These projects, it is reported, will be “endorsed” by the LDF. But the demand is likely to be greater than the resources available, and the Fund reply will have to choose from a long list of “endorsed” projects. Will the Fund rank the demands by “quality”, and saturate its budget constraint, thus rejecting the lower quality projects? Or will it establish spatial or sectoral priorities? And, to begin with, how will it allocate its funding between its four “windows”?

39. The targeted sub-national bodies are not very clear either. The handbooks refer to projects managed by “communities” and by “local authorities”. These bodies, as we have seen, play an important role, but they are not true local governments. The only local governments are (or more precisely will be, after the elections) the district councils. It is not even sure that more informal than formal “communities” can open a bank account and receive public money.

40. One can certainly hope that these uncertainties will be progressively reduced in the coming years, as the LDF gets started and evolves as it develops. That more donors will join and increase the size of this basket. That

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<sup>1</sup> This formulation is a bit strange : a project cannot be at the same time labour-intensive and capital-intensive ; a project is said labour-intensive when the production technology utilized puts the emphasis on labour rather than on capital.

<sup>2</sup> Actually 1.6 billion for an unspecified period of time.

meaningful allocation criteria will be developed. And that LDF grants and gentle constraints will make positive, although difficult to forecast, contributions to decentralization.

**Box 1 - the Experience of Bolivia with Development Funds** - In Bolivia in the 1990ies there were elected municipal governments and deconcentrated prefectures. An important (about 30%) share of municipal government resources, and to a lesser extent, of prefecture resources, came from the expenditures made by three Funds: the Fund for social investment (*FIS*), the Fund for regional development (*FNDR*) and the Fund for rural development (*FDC*). In the late 1990ies, such investment expenditures amounted to about 150 M US\$ per year. Most of the money (about 80%) was contributed by the InterAmerican Development Bank and the World Bank, although municipal governments were asked to contribute matching shares, for about 20 m US\$ per year.

Investments were directly undertaken by the Funds *for* municipal governments. Project design originated in principle in municipal governments, but in fact it was revised by the Funds, according to their quality and price norms. Bidding for contractors was done by the Funds, not by municipal governments. So was supervision and payment. Funds expenditures did not appear in municipal accounts that only recorded the matching share (*contraparte*) paid to the Funds. The Funds took this matching share, added their own money, financed the investment, and when it was finished handed it over to the municipal government of the commune where it is located.

The action of the Funds is often heavily criticised, by municipal governments and by ministries. The Funds were accused of being bureaucratic, slow, arbitrary, costly, and even corrupt. Many mayors believed, and said, that if given the amount of money spent by the Funds "for them", they could achieve much more than what they were getting. Some complain that the matching share (*contraparte*) they were asked to deposit with the Funds was often not used for months or years. The Funds claimed that some municipal governments promised matching shares and never paid them, which forced them (the Funds) to require municipal governments to deposit the matching share first.

It is not easy to assess properly the validity of such claims and counter-claims; but there must some truth in most of the criticisms heard. It should be noted, however, in defence of the Funds, that they operate under severe constraints. They had to implement national and donor's policies, in terms of sectoral allocation, spatial allocation, quality and safety, and procurement procedures, and at the same time take municipal governments' wishes into consideration. Three points are clear, however. One is that Funds-aided expenditures favored social, rather than economic, investments. A second is that Funds matching grants did not contribute to strengthen municipal governments : these grants resulted in investments made for them, not by them. A third is that the Funds allocation procedures resulted in relative overinvestment in rural areas and underinvestment in urban areas. In education, for instance, smaller, ie rural, municipalities ended up with a ratio of pupils per classroom three to four times lower than the main cities of la Paz and Santa Cruz.

The three Funds were suppressed in the early 2000.

41. *Information and Reporting Systems* - Over the past years, sophisticated information and reporting systems involving districts have been developed in Malawi. This includes, for instance, highly meritorious and successful efforts by the NLGFC (National Local Government Finance Committee) to monitor the budgets of all districts, and make them available on the net. This includes the development of LAMIS (Local Authority Management Information System) and of IFMIS (Integrated Financial Management System) that

greatly facilitate reporting, monitoring, and dissemination of local financial information. This spatialized information and data infrastructure has paved the ground for a greater and more effective role of districts – that is for decentralization.

### III – Assessment

42. To assess the degree, status, strength, weaknesses, and prospects of decentralization in Malawi, we shall use the World Bank analytic framework discussed in the introduction. We shall ignore the contribution of the present and planned decentralization system to the broader objectives of improved public services delivery and improved participation and governance, and focus on the three intermediate inputs of (i) administrative capacity of sub-national governments, (ii) accountability of local governments, and (iii) inter-governmental relationships. As mentioned, progress in clarity in these areas is a contribution and a prerequisite to progress in decentralization.

#### *Administrative capacity*

43. Has the administrative capacity of decentralized units much improved, and is it sufficient to sustain more decentralization? The answer is basically negative, largely because local governments have practically no staff of their own. A district employs directly only a few dozen people on its own resources, most of them sweepers. Most of the civil servants working in the district are in fact central government employees. Even the directors of the various services in the district are seconded by the central government.

44. Whatever administrative capacity there is at the district level hardly “belongs” to the district. Seconded civil servants report to two masters: their district commissioner, and their minister. With an elected district council chairman, they will soon also report to a third master. This cannot but create difficulties and conflicts. In practice, there are reasons to believe that their main loyalty is to their sectoral minister in the capital, because he (or she) is the one who can promote them.

45. Only in the four cities, particularly in Lilongwe and Blantyre, are matters different. Because they are richer, cities can and do afford to hire competent professionals, and to develop an embryo of local government own staff.

46. In addition, one must note that the impact of foreign donors on the administrative capacity of decentralized units is twofold. On the one hand, it is positive, because foreign donors, who are usually rigorously controlled in their home countries, often set good examples in the administrative management of the projects they implement at the local level. On the other hand, this direct management of projects tends to ignore, short-circuit, and eventually weaken Malawi sub-national governments.

47. A major challenge is posed by the magnitude and modalities of foreign aid. Foreign aid, or more precisely project-related official aid plus private aid,

looms large in the public sector of Malawi. It represents about 65% of GoM centralized expenditures, and 15 times the discretionary budget (taxes plus block grant transfers) of districts. It must be realized that the logic of decentralization and the logic of foreign aid are potentially in conflict.

48. The logic of decentralization is that a relatively large share (larger than is presently the case) of power be given to local governments. To achieve two objectives. The first is to allocate public expenditures between projects and sectors. The expectation is that the allocations thus decided will be more in line with the wishes or the needs of the people of each local government. The resulting social benefit will be an improvement in what is called “*allocative efficiency*”. The second is to implement these choices and policies. The expectation here is that local governments will do better, faster, and cheaper than central governments. This is because they are closer to the field and more closely monitored by their electorate. The resulting social benefit will be an improvement in what is called “*productive efficiency*”. Whether this theory always functions in practice is debatable, but it provides the basic reason to promote decentralization. One cannot believe that it does not function and at the same time push for decentralization.

49. The logic of foreign aid is quite different. Citizens of richer countries believe that their fellow citizens of poorer countries do not have the resources and in some cases the managerial capacities to produce by themselves all the basic public services they badly need, and therefore that foreign aid should contribute some of these services. Whether these beliefs are led by a sense of solidarity, or by geo-political considerations, or by economic interests, does not matter here. What matters is that there are people in richer countries ready to put their money on the table (either via their tax systems, or directly to NGOs) to ensure that the public services they believe are needed will be delivered in Malawi. Since most of the richer countries are democratic, these views (whether right or wrong) constrain elected governments and aided NGOs in these richer countries. Aid agencies operating in Malawi therefore have masters (the boards of multilateral institutions, national parliaments for bilateral aid agencies, or the citizens that send money to development NGOs) who have their own views as to what it is that aid should achieve and how it should be conceived. These views of aid must be taken into account by development institutions, if aid flows are to continue to be funded. In practice, fortunately, aid agencies enjoy some discretion to accommodate the directives they receive from their legitimate masters, and can to a certain extent negotiate with these masters. But the logic of their action is to define and implement policies considered desirable in richer countries.

50. These two logics do not necessarily coincide, in terms of sectors priorities, of implementation mechanisms, or of institutional targets. To take a well known example, aid agencies tend to attach a great importance to environmental quality, whereas local people do not: in the District Development Plan we looked at, which considered 12 “development issues”, the environment was ranked 11.

51. In terms of implementation mechanisms, decentralization implies that local governments develop and utilize their own administrations or

bureaucracies, and try to make them as effective as possible. Aid agencies, by contrast, want to control the implementation of their programs – because they have to be able to demonstrate that the money they spent is well spent. They create Project Implementation Units (PIUs). In an effort to be more efficient, transparent and accountable and allow smooth project implementation, they try to isolate themselves from existing public sector institutions (see Box 2).

**Box 2 – Short circuiting government structures** – “MASAF’s governance structure has provided the project with independence and freedom from direct control by any branch of government. Overall policy and fiduciary responsibility was assigned to a Board of Directors comprised of representatives of public and private sector institutions and a national umbrella NGO. This governance structure has sheltered MASAF against ‘political capture’”. - Petros Aklilu & Sanjay Agarwal. 2010. *Good Practice Note: Governance and Anti-Corruption Innovations in the MASAF Project*. Social Development Note n° 31

52. These two equally understandable and even laudable attitudes are potentially in conflict. Aid projects tend to recruit a sizable share of the scarce available professionals (technicians, accountants and engineers), and this eviction out weakens local government bureaucracies. Aid projects are short-term, whereas building local bureaucracies is a long term effort. This has become so obvious in Malawi that the government has decided to forbid PIUs. More generally, direct implementation of foreign aid projects short-circuits and weakens local governments.

#### *Accountability*

53. Has the accountability of local government leaders, and the involvement of citizens in decision-making made much progress? To date, the political mechanism of election has largely been absent. It is a powerful incentive to accountability. The fear of not being re-elected is a strong inducement to provide public service users, who are also electors, with what they want. It has not been completely absent, however, because members of Parliament are at the same time elected locally and usually much involved in local decision-making. It will obviously increase in importance with the coming election of district councillors.

54. It is difficult to predict how councils will function. The electoral system chosen is the first-pass-the-post British system already used for Parliament. It tends to amplify swings in public opinion: a party that increases its voters by 10% usually increases its elected officials by more than 10%. In some districts at least, no party might have a majority, and coalition governments will be necessary. There will be rivalries between councillors and MPs, and it is expected that a number of councillors will use their position to try to oust “their” MP. There might also be personality and political conflicts between the elected council chairman and the appointed district commissioner. There might also be conflicts between the non voting members of the councils, particularly the traditional chiefs, and the elected members. Some people fear that a number of councillors will lack the desirable managerial and technical skills. All of this, however, is not necessarily bad in terms of accountability. It will stimulate political debates, and the issues of “what to do?” and of

“what has been done?” will inevitably come in the discussions, thus contributing to increased accountability.

55. Public participation is a form of accountability. It could be described as *ex ante* accountability, as opposed to the *ex post* accountability involved in reporting and accounting. On that score, Malawi presents a paradox. There has been an important development of public participation in Malawi, but it has not strengthened the accountability of decentralized (or deconcentrated) units. The explanation of this paradox is that participation has taken place mostly at the village, or group of villages level, which are not formal decentralized units.

56. Foreign donors in particular have made significant and often successful efforts to involve local communities in the implementation of their projects. They have been helped by the work of informal “planning committees” at the village or group of village levels, and also in many cases by the traditional leaders. This has been the case of NGOs, whose projects are usually very local. This has also been the case of international institutions such as the World Bank. MASAF, for instance, has systematically tried to create a sense of ownership amongst the potential users of its investments, and is reported to have been rather successful in this effort.

57. But very little of that took place at the district level, and it did not strengthen districts, which are the only decentralized (or quasi decentralized) units in the country. One could even argue that it weakened districts and districts officials, who were largely short-circuited by this (highly desirable in itself) public participation processes.

58. The allocation of sectors funds to a given district has been influenced by participatory processes. Districts have created planning committees that prepare every three years a district development plan. This development plan is itself prepared on the basis of area development plans prepared at the area level by development committees, which themselves take into account group of villages development plans prepared by group development committees. There exists therefore a bottom-up process that conveys to the Center the views, the priorities and the wishes of the people, in a decentralized fashion.

59. How influential is this process is difficult to ascertain. It certainly plays a role, and a useful one, in adjusting national government decisions to sub-national demands. But all these development plans, prepared by entities that have very limited decision powers, tend to be long wish lists, the cost of which is many times beyond the financing possibilities of the Center. We consulted one such district development plan. It began with a very interesting list of 12 development issues ranked by order of priority: 1) inadequate safe water supply, 2) inadequate education infrastructure, 3) food insecurity, etc. It concluded with an investment plan specifying 21 programmes and 87 projects. The cost of this investment plan was estimated to be 955 million MK per year. This is to be compared with the 17 million MK of current taxes and fees of this district, or with the 247 millions of MK of all sector funds received, or with own capital outlays of the district, which amounted to only 1 million MK. The lack of realism of such a constraint-free budget plan

probably does two things. It gives a great latitude to the central government to do what it wants. It breeds frustration at the local level because people are bound to get only a small fraction of what they asked for.

60. Similarly, there are consultations going on between the various ministries and the districts over the substantial and spatial allocation of GoM expenditures. They are illustrated in Figure 1 by the dotted line Y linking sub-national bodies and these massive (184 billions) expenditures. These consultations introduce a dose of deconcentration and decentralization in the Malawi system. They are based on the districts and areas development plans, on the interventions of MPs, on the advocacy of representatives of the ministries in the districts.

61. Foreign aid agents have also made efforts to coordinate their programs and projects with both the central government (dotes lines Zo and Zn), and also within themselves. They obviously notify their expenditure intention to the central government and to the districts. In principle at least they engage in discussions and negotiations with these bodies, and let themselves be guided and influence as to what is needed where. It is not sure that this guidance and influence are always decisive. The asymmetry between the GoM that badly needs for its people the money of foreign donors, and the foreign donors that come with their own ideas as to what is needed where, this asymmetry is large and the GoM often finds it difficult to impose its views. This is particularly true at the district level, and for private aid. Foreigners visit the district commissioner in most cases (not all), but often do not care to report back to him. In view of the importance of project-related foreign expenditures (120 billions) relative to districts expenditures (18 billions), this makes it difficult to define and implement policies, be they spatial or sectoral, in each district. An evidence of this difficulty can be found in the fact that nobody compiles the inter-district allocation of foreign aid, be it official project aid (arrow Ap) or private aid (arrow An).

#### *Inter-governmental relation framework*

62. The relationships between central and local governments, particularly the financial relationships, are key determinants of the nature and magnitude of decentralization in any country. Where does Malawi stand in this respect? Two points stand out. One is that the resources and expenditures allocated to decentralized units are relatively unimportant. The other is that what little decentralization there is tends to increase rather than decrease interregional equity.

63. *How important is decentralization ?* - Even if districts are considered as quasi-local governments, their importance in the Malawi public sector appears limited, at least in quantitative terms. On the revenue side, the ratio of local taxes to total taxes (the so-called tax decentralization ratio) at about 2.3% is small by most standards. It can be argued that foreign aid could be considered as a form of central government taxation, and that a more meaningful tax decentralization ratio would be obtained by relating local taxes to the sum of national taxes and foreign aid. This would produce a 1.2% tax decentralization ratio for Malawi. This is low by international standards.

64. On the expenditure side, the ratio of district expenditures over GoM expenditures (Ed/Ec in the language of Figure 1) - the so-called expenditure decentralization ratio – appears to be about 10%, a relatively high number by international standards. But there is little doubt that foreign aid expenditures should be taken into account, and that a more meaningful expenditures ratio is obtained by relating district expenditures to total public expenditures (Ed/E). This reduces our ratio to about 6%, still a relatively high number.

65. This 6%, however, is misleading, because it does not take into account the degree of freedom of districts in the usage of the transfers they receive. As seen above, most of these transfers are ear-marked. Districts, as deconcentrated or decentralized units, take no decisions in relation to such funds. This is obviously the case of the chiefs honorarium transfer, or of the constituency fund transfer: districts must give the money they receive to “their” pre-identified chiefs and to “their” members of parliament. They exercise the discretion of a cashier. More importantly, this is also the case, to a large extent, of the sector funds, which form the bulk of transfers.

66. Sector funds are often presented as evidence of a major move towards decentralization or devolution in Malawi. There is a list of about 70 “functions and services assigned to districts”, and the money necessary to finance them is supposedly jointly transferred. However, the money transferred remains a very small share of the budgets of the various ministries, on the one hand, and is largely predetermined by these ministries, on the other hand.

67. Table 5 presents, for the three most important ministries (in budgetary terms), what is spent directly by ministries and what is given to districts in the form of sector funds. It shows that only one ministry, Health, has deconcentrated a large share (about 40%) of its budgetary resources. Education has deconcentrated 4%, Agriculture less than 2%, and all the other ministries together 0.4%. The total amounts to about 6% of total ministerial expenditures. Table 5 also shows that capital expenditures represent a sizable share of direct ministerial expenditures (about 33%), as opposed to a small share of districts expenditures, which implies that the share of districts in capital expenditures is very small (about 2%).

**Table 5 – Direct and Decentralized Expenditures, by Ministries, 2009-10**

	(in billion MK or in %)				
	Direct recurrent expend.	Direct capital expend.	Direct total expend.	Sector Funds expend.	Sector/ total Expend.
Health	18.1	4.8	22.9	9.1	39.8%
Education	19.4	5.1	24.5	1.0	4.0%
Agriculture	28.5	5.1	33.5	0.5	1.6%
Other	52.2	42.9	95.1	0.4	0.4%
Total	118.2	57.9	176.0	11.0	6.3%

*Sources* : Draft Estimates of Expenditures on Recurrent and Capital Budget for 2009-10 for direct expenditures ; NLGFC for sector funds. *Note* : 1 US\$ = 154 MK

68. Not only are the sector funds limited, they are also constrained. It is not easy to find out how exactly the sector funds are ear-marked. One thing is

sure: they are notified sector by sector, leaving districts with no discretion at all relative to inter-sectoral allocation. Each district receives every month a note indicating what it is allowed to spend ministerial sector by ministerial sector, and it is not allowed to spend less on agriculture in order to spend more on agriculture. It seems that districts have a larger degree of freedom to allocate the money received for a given sector to the various areas of their district. However the fact that the concept of spatial allocation is more relevant for capital expenditures than for recurrent expenditures limits the practical importance of this freedom.

**Table 6 – Key Decentralization Ratios in Malawi, 2008**

	Without foreign aid	(in %) With foreign aid
Tax decentralization ratio	2.3	1.2
Expenditure decentralization ratio	2.9	1.7

*Source* : Figure 1 and text

*Note* : tax decentralization ratio = local taxes/total taxes ; expenditure decentralization ratio = genuine local expenditures / total public expenditures.

69. It can therefore be concluded that the expenditure ratio, that is expenditures effectively controlled by districts relative to total expenditures, are below 3% for GoM expenditures, and below 2% for total public expenditures in the country. These numbers are synthesized in Table 6.

70. To sum up, the present public sector system of Malawi is indeed highly centralized. The financial flows effectively controlled by districts are probably around 5 or 6 billions MK (own taxes and fees, General Resource Fund transfers, etc.). This is less than 2% of all public expenditures in the country. In rural districts, which raise next to nothing in taxes, the ratio is even much lower. And districts as they are now are deconcentrated units rather than decentralized ones. Taking into account non-financial relationship does modify – but only slightly – this picture. Planning mechanisms exist that ensure some dialogue between districts and central ministries. Public participation has also taken place, but only at a sub-district level.

71. *Does decentralization reduce disparities ?* – In Malawi as in most countries, there exist spatial disparities, districts which are poorer than others. How are such disparities affected by decentralization ? Thanks to a very detailed households survey, present inter-district disparities in Malawi are well know. Table 7 presents the distribution of two key indicators : median income per capita, and poverty rates. It also presents the distribution of three local finance related indicators : General Resource Fund (the small block grant transfer) per capita, sector funds per capita, and own revenues per capita. Dispersion coefficients are moderately large for income and poverty rates, somewhat lower for GRF per capita, very large for sector funds, and even larger for own revenues per capita. Maximum/minimum ratios tell the same story. The very high disparity indicators for own revenues per capita reflect the fact that cities have own resources per capita 50 to 100 times larger than rural districts. In other words, decentralization-related indicators (own

revenue per capita, General Resource Fund per capita, Sector Funds per capita) are much more unequal than income-related indicators.

**Table 7 – Interdistrict Disparities, Recent years**

	Median	Average	Dispersion coeff.	Max/min Ratio
Median income/cap (2005)	17,066	18,823	0.29	2.8
Poverty rate (2005)	56%	54%	0.27	3.2
Own revenue/cap (2009-10)	53	297	2.16	2.3
GRF/cap (2009-10)	42	43	0.18	69.3
Sector funds/cap (2009-10)	871	935	0.54	177.3

*Sources* : calculated from the 2005 household survey, the census of population, and NLGFC data. *Notes*: Likoma district, which is too small, has been eliminated. Data for rural districts and for townships have been added together. The dispersion coefficient of a distribution is the standard-error divided by the average. The max/min ratio is the greatest number divided by the smallest.

72. It could happen that this discrepancy is virtuous and that existing disparities are corrected by the present system of transfers. To find out, we ran regressions between transfers per capita and development indicators. The expectation was that poorer districts would receive more, on a per capita basis. The results are presented in Table 8. They show that poverty rates and median income are well correlated, as might be expected. It also appears that Districts own income per capita is well (and positively) correlated with median income. This finding, however, reflects the fact that the four cities have at the same time much higher median incomes, and access to the property tax.

**Table 8 – Regressions Between District Variables, R2**

Explained variable :	Explanatory variable :	Coef	t-stat	R2
Poverty rates	Median income	-0.0084	-14.2	0.88
Own revenue/cap.	Median income	0.100	8.24	0.71
GRF/cap	Median income	4.33	0.0158	0.00009
GRF/cap	Poverty rates	-0.0029	-0.289	0.0029
GRF/cap	Own revenue/cap	0.0058	0.256	0.023
Sector funds/cap	Median income	-0508	-3.44	0.29

73. More interesting perhaps are the relationships between the transfers per capita and income indicators. It appears that the general resource fund transfers per capita are entirely *unrelated* to income per capita, or to poverty. The R2 of the regressions are close to zero. Because of its very small size, this fund could not do much to redress disparities anyway; but one could have expected its allocation to contribute to this objective : it does not. This is surprising, because it is supposed to be calculated with a formula that explicitly includes poverty. The sector funds do better. The amount per capita received by a district is inversely related to the income level of this district. Because sector funds transfers are heavily dominated by ministry of Health transfers, this reflects the behaviour of this ministry : more is given, on a per capita basis to the poorer districts, where health needs are certainly greatest. It also reflects the fact that cities, with a higher income, have next to nothing in the form of sector funds transfers.

74. It would be important to know where, to what districts, the main flows of public funds are allocated, and whether this allocation contributes to decrease existing disparities. This data is unfortunately not available. It is not yet collected for the 120 billions of foreign aid. It could probably be obtained for the 184 billions of GoM expenditures, but it is not presently tabulated. This is a pity, because an understanding of the inter-district allocation of these large flows is a prerequisite for the definition of allocation formulae for transfers, which are the most important instrument to counterbalance the disparity increasing forces of decentralization.

75. With respect to the three prerequisites of decentralization discussed (administrative capacity, accountability, intergovernmental framework), Malawi does not fare very well. At the district level, administrative capacity is fragile, accountability is weak. Intergovernmental arrangements leave districts with only marginal tax and expenditure powers; and what little there is does not contribute to reduce inter-districts disparities. In short, the degree of decentralization is presently low. It cannot be expected to impact very significantly on the ultimate objectives of decentralization : improve the efficiency of public service delivery, and improve public governance in general. This finding is not a criticism. It can well be that the centralization-deconcentration-decentralization mix arrived at is optimal for Malawi. But after years of GoM decentralization policy statements, and countless donors “decentralization projects”, this finding is somewhat surprising.

## IV - Options

76. It is not absolutely sure that Malawi should engage in a massive decentralization process in order to improve economic welfare and political balance. Many countries in the world, particularly in Asia, have in recent decades developed rather well under mostly centralized regime (see Box 3).

**Box 3 – Decentralization and Development in Asia** – In India, money and governance are highly centralized at the State level - and the average population of an Indian State is about 50 million people, much greater than that of Malawi. Even in the largest and perhaps most dynamic Indian agglomeration, Mumbai, with a municipality of more than 18 million inhabitants (not counting about 7 million people in adjacent cities which are part of Mumbai agglomeration, nearly all planning and investment decisions are taken by the State of Maharastra (about 100 million inhabitants) or by the Federal government. The same can be said of China, in different ways, because of the highly centralized nature of the ruling Communist Party of China. In Korea, there were local elections in the 1950ies, until 1961, at a time when Korea was not developing well. Then Korea started its impressive growth as a highly centralized country, and waited until 1995 — when it had achieved a rather high level of economic and social development - to hold local elections; until then the mayors of even the largest cities were appointed by the central government.

77. This would have been a conceivable option for Malawi. It seems not the one that has been chosen by the GoM, which has announced its intention to speed up the decentralization process. This, however, can be done in several fashions. In a number of areas, different options can and should be considered. The following discusses five of these.

### *Decentralization Levels*

One such area is the administrativo-geographic level at which to decentralize : should it be the districts, the villages, the group of villages or the area ? In case districts are chosen, should something be done at another level ? And should all districts be treated similarly, or should asymmetric decentralization be preferred ?

78. *Decentralization at the commune level* - An option would be to engage decentralization at the level of groups of villages, numbering about 2,300, or of areas, numbering about 120. This is about the size of communes or municipalities in many countries. In many countries in Europe and Latin America, this is the most ancient and the most important level of decentralization. In some countries, such as the UK or Brazil (at the State level, but Malawi in terms of size and population is more akin to a Brazilian State than to the Brazilian Federation) or Korea, it is the only sub-national layer of government. Communes are usually fairly homogeneous, sufficiently small for citizens to know each other, and facing relatively simple problems. They lend themselves relatively easily to the devolution of resources and responsibilities. In Malawi, this happens to be the level at which public participation has spontaneously developed, and where, informally, planning committees have effectively functioned. In such an option, districts would remain what they have always been: deconcentrated units of the central government. It is probably too late for this option, since the GoM has apparently chosen another course.

79. *Two sub-national levels of government* – A second option would be to have two levels of local governments, existing districts, plus communes or municipalities at the group of villages or the area level. This means local elections would have to be undertaken at that lower level as well. This would combine the advantages of having decentralized governments at this lower level with the benefits of having a government at the already established district level. On the other hand, this option would probably be rather costly. For a country the size of Malawi having three levels of government (the central level plus two sub-national level governments) is probably a luxury : the UK manages with only two (the central government, plus local governments. In Malawi, the resources required to keep formal communes operating would increase the overheads of decentralization, and reduce actual expenditures on direct services to the people. It would also interfere with and jeopardize the present task of building stronger independent districts.

80. *Decentralization at the district level* – A third option, which is apparently the one that seems to prevail, is to decentralize at the district level. The average size of districts in Malawi (4,000 km<sup>2</sup> and 400,000 inhabitants) is sufficiently small to ensure some commonality and homogeneity of the district areas. Also, they have existed in their present boundaries for long enough to create a sense of ownership which is an important ingredient of accountability.

81. The main problem posed by decentralization at the district level is that districts are presently the deconcentrated units of the GoM. In every country,

the central government has responsibilities and activities in the entire country, but it cannot conduct them all from the capital. It decomposes the territory into administrative areas, and each ministry appoints its agent(s) in each of these areas in order to conduct its policies. The degree of freedom given to these agents varies (when it is high, the system is called a very deconcentrated system) but it is never complete, and central government agents always report to their respective ministers, and conduct central government policies. Malawi will continue to have deconcentrated units, and they are most likely to be the districts.

82. At the district level, there will be therefore two politically and administratively distinct entities: a deconcentrated administration reporting to the central government, a decentralized administration reporting to a locally elected council. This creates a risk of confusion and of conflicts. Hence two options (or sub-options): either, there is only one administration, and it will have two masters, a recipe for conflicts and inefficiencies; or there are two distinct administrations, a more effective but more costly solution.

83. Both sub-options exist in practice. In many countries, such as the USA or Brazil or the UK, there are two distinct administrations, that do not have much in common. Their respective responsibilities are defined as clearly as possible, in order to avoid duplications or conflicts. In the USA, for instance, where education is the responsibility of local governments and of States, the federal government is in principle not involved in education : there is practically no minister of Education in Washington, and a fortiori no representative of this ministry in Dallas or Chicago.

84. Some other countries manage to live and operate with one local administration servicing both a locally elected council and at the same time central government ministries. France functioned like that for nearly two centuries. The country was divided at the time of the French Revolution into about 100 *départements*. *Départements* were the basic sub-divisions of the centralized French State, headed by a prefect, who was appointed by the prime minister, and staffed by civil servants appointed by the various ministers. Simultaneously, *departments* were decentralized units, with councils elected by popular vote, choosing a chairman, raising their own taxes and voting their own budget. Often times the chairman of the council and the prefect belonged to different and opposing political parties<sup>1</sup>.

85. The management of this dysfunctional and conflict-prone system required skill, tact, and restraint on the part of the chairman and the prefect. Both knew they had to cohabit, much to lose at open conflicts, and managed to strike workable compromises. For long (until the 1970ies), the dominant influence was that of the prefect. To take an example, the prefect prepared the budget of his *département*, and the council voted it. This gave the prefect some latitude to push his own views (the views of his government). Up to a certain point only, because a budget proposal in sharp contrast with the views of the council would have led to a formal rejection, at a political cost to the prefect.

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<sup>1</sup> This is a short-hand. Prefects were in principle, and largely in practice, a-political, but they were appointed to implement the policies of the political party or parties in office.

On the other hand, a systematic rejection of a reasonable budget would impose a political cost upon council members, or rather upon the voting majority of the council. Both parties had reasons to achieve workable agreements.

86. This system, however, did not quite survive a decentralization movement in recent times. In the 1980ies, the balance of power shifted from the appointed prefect to the elected council. Councils hired political aides and professionals to strengthen their analytic competence and their decision-making capabilities. The French experience tends to show that a hybrid system can function (provided people in charge are ready to compromise), but that it cannot persist.

#### *Asymmetric Decentralization*

87. In most countries, all decentralized units, be they communes or districts as in Malawi, are treated in the same fashion, irrespective of their size, resources, problems, and opportunities. They have the same responsibilities, the same tax bases, and benefit from the same transfer formulae. In France, for instance, the 2 million people municipality of Paris is treated exactly like a 50 people rural municipality. Another option is asymmetric decentralization, a system in which several categories of decentralized units are identified, and given different responsibilities, resources, duties and rights. The best known example of asymmetric decentralization is offered by Spain, at the regional level. There are three types of regions<sup>1</sup>: special regions (Basque region and Navarra), high responsibility regions (5 regions, including Catalonia and Andalusia), low responsibility regions (10 remaining regions). Each type is given different tax bases and different expenditure responsibilities.

88. Malawi could seriously consider this option. The obvious divide in Malawi would be between urban and rural districts. These two types of districts are indeed *very* different, in terms of population size, of wealth, of administrative capabilities, of population growth, of economic activities, etc. It is easy to argue that no single regime can be designed to fit such different creatures.

89. It is often stated that Malawi is a unitary country that cannot even envisage asymmetrical decentralization. Yet, presently, cities and rural districts are treated very differently: cities have taxes denied to rural districts, their own resources are 50 to 100 times greater on a per capita basis, they get practically nothing in the form of sector transfers, and they are beginning to develop an administration of their own. This is *de facto* asymmetrical decentralization. Should this be recognized and formalized, or should Malawi try to eliminate these differences? This is an important policy issue because it is likely than in the coming decades an urbanization process will take place, with urban population increasing more rapidly, perhaps much more rapidly, than rural population. Urban districts will have an important role to play in this process, and might be treated differently in order to cope with it. In terms

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<sup>1</sup> Called *autonomias* (autonomies)

of present and potential capacities and probably also in terms of accountability, Lilongwe and Blantyre are obviously better prepared than most not to say all rural districts to assume decentralization responsibilities.

90. This is not to say that asymmetric decentralization is a panacea. As suggested by the Spanish example, it might be contentious and unstable. Some of the units in the second category feel unfairly treated and lobby to be upgraded to the first. Similarly, some of the units in the third category want to be promoted to the second. In the case of Malawi, however, the rationale for a regime specific to urban districts would be, and look to be, much less arbitrary than is the case in Spain and therefore more acceptable.

#### *District Taxes*

91. To function effectively, a decentralized system must have reasonably well endowed local governments, with enough discretionary resources at their disposal. This is not the case presently: districts have too few taxes and too many earmarked transfers. Increasing local taxes is a prerequisite to a meaningful decentralization. There is scope for increased local taxation. Three options could be considered, that are not exclusive of each other but could be combined.

92. *Property tax for rural districts* - The first and most obvious option is to extend the property tax to rural districts. Presently, only cities levy a property tax. Rural districts are not allowed to, and consequently raise only market taxes. There is no strong justification for this restriction, which probably dates from the times when there were only very primitive and non taxable properties in rural areas. Admittedly, most of the property tax base is in cities. But in rural districts, there is an increasingly large number of houses and commercial buildings (stores, offices, warehouses, factories) that could well be taxed.

93. *Property tax assessment and collection* – a second option is to improve property tax assessment and collection. Presently, properties are valued by central government valuers (for a fee paid by districts), or by private agencies, for cities and towns. This outsourcing of valuation is fine. But in practice valuations are not frequent (in Lilongwe, some are ten years old), and as a result have little relationship with actual sales values. This undervaluation seems not to be uniform, which makes the tax unfair, which is an obstacle to increased rates or collection.

94. *Additional tax bases for districts* - A third option is to shift some tax bases from central to district governments. It is true that the main taxes (VAT, corporate income tax, personal income tax, import duties) do not lend themselves easily to decentralization. But taxes such as the tourism tax, the wage tax, car taxes, and even some excise taxes (on gasoline, on beer), should be considered. The base of these taxes is local by nature (more local than the base of the main taxes), and they could be turned into local taxes. Indeed they are in many countries.

95. In this respect, there is one tax base which is local, but should remain allocated to the central government: mining royalties. Mining seems about to be developed in Malawi. With it will be associated royalties or other forms of participation in the mining rent. Districts will be tempted to claim the royalties paid on the mine exploitation located in their jurisdiction. Such a claim should be resisted. The spatial allocation of ore deposits between districts is an act of God entirely unrelated to districts efforts or district needs. This allocation is usually very uneven, and using it to allocate taxes would create very large and unjustified disparities. In addition, mining rents tend to fluctuate very much over the course of time and a central government is better equipped than a local government to cope with such large fluctuations. It can be argued that mining brings costs to districts where it takes place. This might justify a tax contribution, but this contribution should be very small (for instance 5% of royalties), not least because mining also brings benefits, particularly in the form of employment.

96. On this matter, Malawi could learn from the experience of Bolivia. In this country, important oil and gas deposits were discovered and exploited in some regions (including the richest region in the country). A large share of the royalties was allocated to “producing” regions, creating major imbalances between producing and non-producing regions. As royalties were increasing rapidly, the central government tried to recuperate the bulk of them. Regions resisted violently, defending “their” royalties, putting the country on the brink of civil war and secession. It would be prudent for Malawi to settle this matter now, at a time when mining royalties are not important and the problem of their allocation is not a burning issue.

#### *Intergovernmental Fiscal Transfers*

97. All systems of decentralization include intergovernmental transfers. In the pure theory of decentralization, sub-national expenditures are financed out of sub-national taxes, and this relationship is seen as a major incentive for the accountability of sub-national governments. In reality, transfers from the central government to sub-national governments – which exist everywhere — are required for two reasons. One (called vertical mismatch) is that many taxes are more appropriate for central government collection than for local government collection, whereas many expenditures are more appropriate for local governments than for the central government. The corporate income tax, for instance, is a good central tax and a bad local tax, because many businesses can easily shift their location from a high tax location to a low tax location. This lack of sufficient local tax bases is one of the two justifications for transfers from the center to local governments.

98. The other (called horizontal mismatch) is that some local governments are richer, often much richer, than other in terms of local tax bases. With a given tax rate, they raise much more tax income than their poorer fellow districts. With more money, they can provide more services, attract more people, businesses, activities, and increase further the gap between rich and poor districts. Uncorrected, tax decentralization can increase, rather than decrease, inter-district disparities. Hence the need to have central government transfers that give more to the poor and less to the rich districts. The necessity of

intergovernmental transfers is not really an option. But the magnitude, types, and allocation criteria of transfers call for options and decisions.

99. *Magnitude of transfers* - When they become too important, transfers unfortunately tend to kill local taxes. Think of a local government the resources of which consist of taxes for 10 and of transfers for 90 considering an increase of taxes of 10 to finance an increase of expenditures of 10. The political cost of increasing local taxes by 100% will be greater than the political benefit of increasing local expenditures by 10%, and no elected politician will take such a measure. A compromise must be arrived at between the need to have subsidies sufficiently high to correct vertical and horizontal mismatches and the need to have subsidies sufficiently low in order not to eliminate local taxes.

100. *Balance between ear-marked and block grants transfers* – A second set of options relate to the types of transfers chosen. Transfers fall into two main categories : (i) ear-marked transfers, that is transfers the use of which is determined by the central government and (ii) block grants that can be used by local governments as they think fit. Block grants are more in keeping with the spirit of decentralization, and the idea that the efficiency of service delivery will be increased if and when local governments, closer to the people than the central government, take the allocation decisions. Ear-marked transfers, on the other hand, make it possible for the central government to conduct its policies through local governments, and limit the dangers of local mismanagement. In practice, both types of transfers are needed, and decisions must be taken about the relative importance of each.

101. Presently, most of the transfers, coming from the so-called sector funds, are ear-marked transfers. District governments cannot use their knowledge of local realities and needs to make sectoral allocations with ear-marked transfers. An important potential benefit of decentralization is therefore missed. Even if one considers that districts do influence somewhat the sectoral allocation they receive from the Center, it seems clear that a greater share of block grants should be considered. A target has been set by a 2002 law: 5% of net central government income. The General Resource Fund (GRF), which is the block grant transfer, presently represents about 0.25% of net central government income. That target might be ambitious, but the present level is most probably too low, and the direction of change seems quite clear.

102. A shift towards a greater share of block grants need not be done overnight. It must be a gradual and prudent process. The example of France might be useful here. In the 1960ies, when France was a highly centralized country, more than 90% intergovernmental transfers were of the ear-marked type: in practice local governments would ask for a particular investment (a water treatment plan, for instance), and the central government by giving or not an ear-marked transfer, would in fact decide whether the investment was undertaken or not. Things began to change in the 1970ies, with ear-marked transfers gradually replaced by block grants. By the end of the 1980ies, the share of ear-marked transfers accounted for less than 10%. It is no

exaggeration to say that this apparently technical shift contributed more than much heralded legal changes to the decentralization of France.

103. *Allocation formulae* - A third set of options concerns allocation formulae. They apply particularly to block grants. Once the total amount of a particular transfer is decided, it must be divided between the 40 districts. Several criteria might be utilized to that effect. The four most important are probably the following: tax bases, needs, performance, fixed costs.

104. (i) tax bases, ie fiscal capacity – Districts that have low tax bases should receive more, all other things equal. Correcting for differences in the capacity to raise their own resources (redressing horizontal fiscal imbalance) is one of the main functions of transfers. This correction cannot and should not be complete, but it should be substantial. Utilizing tax bases as a criteria assumes that tax bases by district are known, and that they can be added (with a proper weighting system).

105. (ii) needs – It is quite straightforward that districts with greater “needs” should receive more, all other things equal. In practice, it is not easy to give a workable content to the concept of “needs”. Median income or poverty ratio can be used as a proxy for needs. It seems evident that districts where income is low or where people are poor do have greater “needs”, although the needs of the people living in a district and the needs of the district as a public entity are not necessarily exactly the same. One can note that median incomes and poverty ratios in Malawi are rather well correlated ( $R^2=0.88$ ). This means that utilizing one of these two indicators is enough. As mentioned in the preceding section, the GRF, the allocation formula of the present block grant, does not fare well in this respect : the per capita amount allocated to a district is entirely uncorrelated to its median income ( $R^2 = 0.0$ ) or to its poverty ratio ( $R^2 = 0.0$ ). Rich districts get as much as poor ones.

106. (iii) performance – It is tempting to decide to give more to districts that “behave well”, ie that perform well in terms of efficiency or accountability. However, it is even more difficult to give a workable content to “performance” than to “needs”. Most indicators of performance will run the risk of being considered as partial, unfair, politicized. The use of performance criteria is not well aligned with the basic idea of decentralization, and of block grants, which is to give local governments the freedom and the chance to spend as they think fit. It is true that the central government must make every effort to ensure that the money it spends in transfers is well utilized, but ear-marked transfers, which are likely to remain the largest part of transfers for some years, offer guarantees in this respect. All things considered, the need for performance criteria in allocation formulae is not very clear.

107. (iv) Fixed costs – The three criteria just mentioned are, or can be made to be, a function of population. But it can be argued that a local government has fixed costs, such as the construction and maintenance of its offices, which are independent of its population, but must be incurred to keep the entity functioning and providing services. This can justify in an allocation formula a fixed amount given to each district.

108. Once two or three criteria have been selected, there remain the task of devising a formula. A first choice relates to the type of formula. There are two types: (i) open, or bottom up; (ii) closed or top-down. An open formula is such that the total amount of transfers cannot be predicted *a priori*. A closed formula is such that one starts with a pre-determined total amount of transfers and allocates it between districts, so that the sum of money received by all districts is equal to the predetermined amount. Top-down systems are certainly preferable for central government finance management, but local governments prefer bottom-up systems that give them more certainty and predictability.

109. The next choice is to allocate weights to the criteria retained. One can decide that x, the percentage of the transfer allocated according to tax bases, will be 40%; that y, the percentage allocated to needs, will 50%; and that z, the percentage allocated to fixed costs, will be 10%. This is a purely political choice. What matters is that  $x+y+z = 100\%$ .

110. The resulting formula, with

- T = total transfer
- T<sub>i</sub> = transfer to district i
- B<sub>i</sub> = tax base of district i
- B = ΣB<sub>i</sub>
- N<sub>i</sub> = needs of district i
- N = ΣN<sub>i</sub>
- x, y, z = the weighting given to each criteria

would look like that:

$$T_i = T \cdot x \cdot B_i / B + T \cdot y \cdot N_i / N + T \cdot z / 40$$

### *Local Government Staffing*

111. Another issue calling for options and choices relates to local government staff. It is nearly inexistent presently. A district employs directly only a few dozen people on its own resources, most of them sweepers. Most of the civil servants working in the district are in fact central government employees. Even the directors of the various services in the district are seconded by the central government. They therefore report to two masters: their district commissioner, and their minister. With an elected district council chairman, they will soon also report to a third master. This cannot but create difficulties and conflicts. In practice, there are reasons to believe that their main loyalty is to their sectoral minister in the capital, because he (or she) is the one who can promote them. Only in the four cities, particularly in Lilongwe and Blantyre, are matters different. Because they are richer, cities can and do afford to hire competent professionals, and to develop an embryo of local government own staff.

112. The problem is not primarily a problem of training, but a problem of trainees. Great efforts are developed, particularly by foreign aid, to “train” and “improve the skills” of local government employees. But it is difficult to

see who exactly they are targeting, since there are presently hardly any local government employees.

113. To deal with this problem, the GoM has two options. One is to develop autonomous district administrations. The other is to ensure that the same people effectively work for their two masters.

114. The first option is to develop an independent sub-national administration next to the existing deconcentrated central government administration. It would require a framework for local government staff, together with increased functions and resources. This framework should be competitive with the present central government staff framework: recruitment should be on merit, wages should be comparable and perhaps even more generous to compensate for isolated posts, carriers should be equally attractive, and responsibilities sufficiently interesting.

115. This cadre should probably, particularly at the beginning, be articulated with the existing central government civil service cadre. It should be possible for civil servants to shift fairly easily from one cadre to the other, and to shift simultaneously their loyalty. Steps have already been taken, for instance in the pension system. A civil servant moving from the centre to a district will carry his/her pension rights with him/her. Much more would need to be done. This course of action is not impossible. As a matter of fact, it is prefigured by what is presently happening in Lilongwe and Blantyre, which have already developed partly independent city administrations. But it is true it is difficult and very costly.

116. The second option is to ensure that the existing, largely deconcentrated, administration is equally at the service of both the district council and of the central government. This is not an easy task either. Much would rest upon the shoulders of the district commissioner. Perhaps, the district commissioner and the elected council chairman should agree and appoint jointly a sort of principal secretary who would be neutral, and would manage the administration.

## V - Conclusions

117. This note has tried to analyze the present state of decentralization in Malawi, how it might change in the coming years, some of the main challenges that this is creating, and to discuss some of the policy options faced by the GoM.

118. What is at stake is essential. The public sector in Malawi is very large, partly because of the importance of foreign aid, which is a component of it. As shown in Figure 1, public expenditures (including aid expenditures) represent 42% of GDP, a high ratio by world standards, and even by OECD standards. How the public sector is structured and how these 42% of GDP are spent matters immensely for the development of the country and the welfare of its people. Decentralization is an integral dimension of the public sector

system. If decentralization is well conducted, it will improve the efficiency of the public sector; if not, it will lower it.

119. This much needed wise management of decentralization, in terms of speed, focus, people, taxes, transfers, rules, regulations, negotiations, etc., is a very complex and difficult task facing the GoM. A good decentralization law is certainly not enough. The devil is in the details, and a productive decentralization process will require countless decisions in a large number of – often highly technical – areas. It would be presumptuous and even ridiculous for an outside consultant after a brief visit to Malawi to tell the GoM and the World Bank what they should do. We can only conclude by prudently and modestly drawing their attention to some of the key points that have emerged from the analysis.

*For the Government of Malawi*

120. *Help create more autonomous district administrations* – Whatever options are chosen by the GoM, if more power is to be given to elected councils at the district level (which is the definition of decentralization), districts administration must be strengthened. They must become more independent from the central government ministries. How much more, with what modalities, according to what schedule, and with what guidelines or constraints, is for the GoM to decide.

121. *Increase block grants transfers* – The progress of decentralization implies an increase in block grants, that is an increase in transfers that district assemblies can use as they think fit. This does not mean that ear-marked transfers should be eliminated : they certainly have a role to play. It does not mean either that the increase in block grants should be massive and brutal: it should on the contrary be prudent and incremental. The danger that some (hopefully few) districts will have difficulties spending wisely increased amounts of money is real. It must probably be accepted, together with safety nets designed to reduce potential damages, if decentralization is to be introduced and bring benefits. There are no block grant transfers without allocation formulae. Designing simple and disparity reducing formulae will be a key responsibility of the GoM.

122. *Transfer taxes to districts* – Decentralization cannot be : central government raises taxes, and local governments spend it. Decentralized units must also raise at least a share of the money they spend, in particular because this will induce them to spend it more wisely. To that effect they must probably be given access to some of what are presently national taxes. Which ones? for what amounts? over what time frame? with what controls? Is for the GoM to decide.

123. *Consider asymmetric decentralization* – The discrepancies between the four cities, particularly Lilongwe and Blantyre, and rural districts on the other hand are very great. The former are much more ready for decentralization than the latter. The GoM should envisage treating urban districts differently from rural districts, at least in a first phase. This might facilitate greatly the solution of many decentralization problems, and could

perhaps avoid the danger of having just one decentralization regime that would be too generous for rural districts and too stingy for urban districts.

*For the World Bank*

124. Foreign donors, such as the World Bank, have an important responsibility in this matter. First, they are part of the problem, because of the sheer magnitude of foreign aid in the Malawi public sector. Second, they can bring to bear their international experience and their analytic capabilities to engage in a fruitful policy dialogue with the GoM. More precisely, what could an institution like the World Bank do?

125. *Decentralization Reviews* -The first thing the Bank could – and should – do is ensure all its interventions work for, not against, decentralization. That they strengthen districts, the only formal sub-national level unit in Malawi; that they take into account district development plans; that they contribute to create a cadre of local government staff. The Bank should treat decentralization the way it treats environment. The Bank routinely reviews all its projects from the viewpoint of environment, to make sure that they will not damage it, and if necessary the Bank modifies its projects, or take corrective measures, to that effect. Formal or informal internal “decentralization reviews” could be introduced in all Bank activities in Malawi.

126. *Local government finance* - An area in which the World Bank has a comparative advantage is local government finance. This topic has largely been neglected by agencies like the IMF (whose impressive expertise is focussed on national finance and macro-economic issues), or UNICEF (whose domain is children aid), or the African Development Bank, the EU or most bilateral agencies (that tend to be active and knowledgeable on technical or social issues). The exception would be German Aid. Yet, it is an area in which the needs of Malawi are particularly great. Decentralization will simply not function if rural districts continue to levy 23 MK (0.15 US\$) per year per capita. There is some scope for increasing local taxation in the country. This should be prepared by studies examining various options (new tax bases, improved assessment and collection, decrease in national taxation, levy on foreign aid, etc). Once decisions are made, they should be accompanied by technical assistance.

127. Intergovernmental transfers also require stock-taking, analyses, options. The General Resource Fund, the only block grant transfer, cannot remain at 39 MK (0.25 US\$) per year per capita. The transition from earmarked transfers to block grants transfers, must certainly be gradual and prudent. One would want to know better what is the degree of freedom (if any) of districts in the use of the so-called sector funds. Health is the only ministry that has devolved to districts a substantial part of its credits, and account for more than 80% of all “sector funds”. Agriculture or Education have not. A detailed comparative analysis of Health with Agriculture or Education (or both) would reveal whether this form of decentralization or of deconcentration has or not improved service delivery, what lessons can be

drawn from that real life experience, and what could be applied to other sectors.

128. *Spatial distribution of public expenditures* - The allocation of public expenditure by sectors is reasonably well known (well for GoM expenditures, less well for donors expenditures). The allocation of public expenditures by districts is not. It could be obtained relatively easily for GoM expenditures. But specific surveys would be necessary for foreign aid expenditures. Yet this data, and its analysis, will grow in importance with decentralization. More autonomous districts will want to know how much they receive in public expenditures, how much of the 42% of GDP they and their people get. This data will be a prerequisite for the development of formula-driven transfers, and more generally of regional policies. The World Bank could take the lead, perhaps in co-operation with the National Local Government Finance Committee (NLGFC) which has proven its efficiency, in developing these data sets and analyses.