REPUBLIC OF RWANDA

MINISTRY OF LOCAL GOVERNMENT, GOOD GOVERNANCE, COMMUNITY DEVELOPMENT AND SOCIAL AFFAIRS

AND

MINISTRY OF FINANCE AND ECONOMIC PLANNING

FISCAL AND FINANCIAL DECENTRALIZATION POLICY

Revised 2006

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I. Preamble

Fiscal and financial decentralization consists in the devolution of the financial resources and decision-making powers to sub-national governments that will allow them to implement the functions and responsibilities that have been delegated to them. In principle, every new responsibility must be followed with the appropriate level of resources and a precise definition of the sources of revenue for the execution of that new responsibility. In other words, finance must follow function.

The goal of this fiscal and financial decentralization policy is not only to pursue efficiency in the provision of services at the local level, but also sustainable development, economic growth and the reduction of poverty. Indeed, sustainable development implies efficient management of resources and the environment and a dynamic economic growth process, all based upon a partnership between the public sector, the private sector and civil society. Fiscal and financial decentralization can promote efficiency, innovation, human resource development, entrepreneurship, and dynamism at the local level. Indeed, these are the key elements of a poverty reduction policy.

A fiscal and financial decentralization policy must be designed within a legal framework that clearly defines the functions and responsibilities devolved to the local level as well the decentralized sources of revenue. Thus, fiscal decentralization must be linked to institutional and legal reform and its implementation must be continually coordinated, monitored and evaluated. The institutions in charge of carrying out the decentralization being MINALOC and MINECOFIN, the appropriate legal framework must be put in place so that it is better able to implement the fiscal and financial portion of the process.

At the core of a fiscal and financial decentralization policy are some basic principles, including, matching funding to responsibilities, equity, transparency, accountability, incentives and enforcement. The application of the policy is stronger if it is based on a participative approach, which incorporates all the socio-economic sectors of the economy in the decision-making process. A well-conceived fiscal and financial decentralization policy should aim to promote a balanced development process at the local level. This requires that adequate levels of resources be made available to local Administrations to carry out their newly devolved functions and that the distribution of resources be based on equity

There are two main ways local authorities can be empowered to do so

- By empowering local governments to collect their own revenues locally from taxation, user charges and other forms of locally raised revenues
- By transferring funds as grants from centrally collected government resources, including donor funds

In this context, is should be noted that a distinction may be made between the sources of revenue allocated to local government and the responsibility for administration/collection of revenue from a particular source. Fiscal decentralization also implies that local governments are provided with autonomy to deliver services in line with local needs and priorities.

Sustainability requires effective participation and ownership by local communities. This is best achieved if local authorities and policy implementers adopt a code of conduct based on a set of ethics and values that are conducive to building trust between them and the communities. Thus, local financial and fiscal management must be carried out in total transparency. In addition, local authorities must be accountable to the populations they serve. Measures can be put in place to incite excellence, but when necessary, such as in cases of corruption or embezzlement for example, appropriate sanctions must be applied; the credibility of the decentralization process depends on this approach.

There are potential macroeconomic disadvantages if a fiscal decentralization policy is not well conceived and applied. For instance, delegating broad borrowing powers with no limitations or conditions to the local level could negatively impact the central government budget, which could find itself in an obligation to reimburse the debts of sub-national governments in an economic crisis situation. In such cases, the country's macroeconomic stability could be at stake.

II. Political and socio-economic background

During the colonial and post-colonial periods, the Rwandan Government was characterized by a highly centralized state. Decision-making authority and resources were tightly maintained by the central Government allowing it domination over political, social and economic life. Citizens did not participate in decisions affecting them. Accountability of the public sector was upwards toward the center, rather than to citizens and communities. This system of governance caused significant inefficiencies in service delivery and created a passive attitude regarding civic responsibilities among citizens.

The catastrophic social, economic and political impacts of the 1994 genocide and the inappropriate nature of the public governing structures have caused the Rwandan Government to embark on a new direction for managing public affairs. The National Decentralization Policy, officially adopted in May 2000, sets out a new course of citizen participation through elected organs at the local level. Hence, citizens will be able to gain access to decisions that affect them and participate in civic affairs.

Recalling the objectives of the decentralization policy[1]

1. To promote community participation in the decision-making process by devolving powers and resources to the local level.

2. To strengthen responsibility and transparency by requiring that local authorities be directly accountable to the communities they serve by establishing a clear link between taxes paid and service delivery.

3. To enhance the response capacity and sensitivity of public administration to the local environment by placing the planning, financing, and management of service delivery at the delivery point.

4. To enhance and sustain local planning and management capacity as a means to promote economic development and poverty reduction.

5. To strengthen the efficacy and efficiency of service delivery.

[1] *MINALOC, Decentralisation policy, may 2000*

III. Basis for the Fiscal and Financial Decentralization Policy

Various evaluations of local finances carried out since 2001 have indicated the following shortcomings:

1. In general, the levels of resources available to local Administrations are low.

2. The taxable base devolved to the local communities is narrow in that tax revenues are essentially collected from fixed rates and fees imposed on small-scale economic activities.

3. Investments at the District level generally involve social investment, such as vehicle purchases, construction and renovation of offices, schools, health centers, markets, etc… The importance of these social investments must not be underestimated, however, it must be noted that the Districts development budgets fail to incorporate local development strategies that could result in the creation of private sector employment and the broadening of the taxable base at the local level.

4. Whereas the responsibility for service delivery has been devolved to decentralized levels, this has not yet been fully matched with a transfer of funds.

5. The standards of financial management systems at District level remain below those that are internationally accepted and do not conform to their responsibilities. In addition, the internal and external control mechanisms are weak.

6. Public access to information as a monitoring device is almost inexistent.

7. There is a lack of coordination among the sector ministries and the local Administrations limiting therefore the efficiency of service delivery.

8. In the absence of local financial autonomy, Districts tend to resort to borrowing as a means to finance their recurrent expenditures.

9. Central government resources allocated to local Administrations do not reach down to Sectors, which constitutes the points of service delivery.

10. Human resource capacity is weak at all levels.

11. The absorptive capacity at the local level is weak.

These observations explain the necessity for the present revision of the fiscal and financial decentralization policy. Enacting the policy requires, at the outset, a legal and institutional reform.

The Institutional Framework

Since the first Fiscal Decentralization Policy was adopted, Rwanda has begun to implement the National Decentralization Policy in a forthright manner. The administrative reform process lays out the new responsibilities devolved to the local Administrations. Districts have been accorded a greater role for service delivery across all sectors. Boundaries of local governments have been redrawn to consolidate and reduce the former number of districts, thereby strengthening their financial viability. Sectors (and in the future cells) have become the nodes of service delivery. Districts co-ordinate and assist Sectors to deliver better services to the population by determining, co-ordinating and implementing development plans and programmes. To provide a comprehensive picture, Districts must include in their budget, in addition to their own revenues and transfers from central government, all development projects that are implemented on their territory.

This restructuring has led to the integration of Districts' needs into the national budget. It is important to establish a formal mechanism which defines the financial relationships between Districts and the central government. Such formal mechanisms must also apply to the financial relationships between the Districts and lower Administrative levels.

IV. Fiscal and Financial Decentralization Policy

IV.1. General Objective

To provide local Administrations with adequate resources and the necessary resource mobilization powers to implement their decentralized functions.

IV.2. Specific Objectives

The specific objectives of this policy are:

- To develop an efficient and sustainable resource mobilization base for local communities

- To provide the resources for a balanced and equitable local development

- To strengthen planning and management capacity the local level using a participative approach.

V. Implementation Strategies and Mechanisms

In order to reach the objectives delineated above, the following strategies will be applied.

Objective 1.

To develop an efficient and sustainable resource mobilization base for local communities

Strategies

Increase local revenue generation and broaden local revenue base through local economic growth.

Greater local autonomy and sustainable and dynamic local resource mobilization requires finding sources of revenue other than government transfers and taxes. Local governments will have to develop growth-enhancing strategies and will work in partnership with the private sector and development partners to implement those strategies.

Diversify local Administrations sources of revenue

Evaluations of local finances have determined that the tax base available to local Administrations is narrow. Local taxing powers are limited and their collection is expensive.

Hence, the government will increase the sources of revenue available to the local level through a legal reform that will aim to allow local Administrations the power to collect their own taxes and fees and to diversify their sources of revenue. This diversification will involve a mix of taxes, fees, licenses, gifts and bequests, central government transfers, direct and indirect funding from national and international development partners, revenues generated from local communities' investments and endowments, and if necessary, and under the prevailing legal constraints, borrowing.

Enhance local revenue collection using a participative approach

For a better collection of local taxes, local Administrations must involve all sectors of the population in the financial decision-making process at the local level. Local Administrations will involve the community in the application and (if need be) the modification of the legal and regulatory framework governing local finances, budgeting and local resource mobilization by creating advisory committees composed of local elected officials and representatives of civil society and the private sector.

Local administration will use the principles of transparency and accountability as instruments of local resource mobilization.

The capacity of local tax collection agents will be enhanced to ensure efficacy in the application of the prevailing laws and regulatory framework. If need be, local Administrations may privatize local tax collection.

While exploring ways of widening the local tax base, the following principles will be taken into consideration:

- The authority to levy taxes by local government will be limited to few tax items to avoid creating distortions in the local economy, red tape and excessive burden on taxpayers. The items must be clearly identifiable and distinguishable from RRA taxes to avoid institutional conflicts and confusions among taxpayers. These taxes will be specified in the Fiscal Decentralization Law.
- While the tax base will vary across taxpayer, the tax rate should be flat to ensure equitable treatment of taxpayers. Progressivity in taxation will rest solely with regular RRA taxation and will not be introduced into local taxes.
- Local tax levies will be as simple and transparent as possible to make tax assessments predictable and understandable by each taxpayer; this is important to ensure accountability to local constituencies.
- Any tax or non-tax levies will be designed without adversely affecting the environment for doing business or increasing red tape.

Local Administrations will develop mechanisms for the identification, census and monitoring of present and potential tax payers.

A distinction may be made between the sources of revenue allocated to local government and the responsibility for administration/collection of revenue from a particular source. The latter will largely depend upon the efficiency of administration/collection and the requisite capacities. The government is committed to allocate to local governments sources of revenue (tax and non-tax) broadly according to their new overall responsibilities. However, in view of limited local authority capacities and other competing priorities at this stage, revenue administration/collection responsibilities may be increased in a phased manner over time, rather than all at once. Moreover, even in the long term, some taxes may be more efficiently collected by RRA, in which case the amounts collected for specific taxes would be transferred to the Districts.

Objective 2.

Provide the resources for equitable development at the local level.

The purpose of making intergovernmental transfers to sub-national Administrations is (1) to provide them with the means to carry out the functions and responsibilities that have been devolved down, and (2) to correct the economic and social distortions that exist between Districts.

Strategies

Establish an efficient system of transfer of Central Government resources to the level of service delivery

While transferring resources, government recognizes the need for a delicate balance between enticing Districts to undertake required actions to achieve the national development objectives and providing resource to address District priorities.

To this end, there are two main ways government will transfer funds for service delivery to the Districts:

1. Block or un-earmarked grants and
2. Earmarked grants

Over the short to medium term, the majority of service delivery will be financed through a series of earmarked grants, whilst block transfers will fund administrative functions at the districts and provide discretionary funds to supplement earmarked allocations to service delivery.

Depending on the District's fiscal capability to mobilize their own resources, the block transfer will be used to enable the Districts to cover their budget obligations.

MINECOFIN, in collaboration with MINALOC, will develop a formula for allocating the block transfer between districts. This formula will be reviewed regularly.

Government will strive to limit the total number of earmarked grants to a maximum of one grant per sector. However, each earmarked grant may be split into different components. Earmarking of funds and possibly attaching further conditions is justified as a useful mechanism in managing the transition towards strong, autonomous local governments. Earmarking serves to protect services early on in the decentralization process in the light of weak Local Government planning, budgeting, monitoring and accountability systems.

Earmarking should not be seen as restricting the autonomy of Districts. It rather serves to keep explicit ties with the relevant sector ministries at the national level, who have a clear mandate for capacity building and support to the Districts with respect to planning, budgeting, and use of the available funds. In this way, sector ministries help to increase the absorption capacity at local levels and thereby boost the development process.

Finally, earmarking allows the channeling of donors funds to the District in specific sectors through the GOR systems, rather than donors setting up separate projects, which would be likely to stretch limited local capacity. In future years, the degree of detail of the earmarking will be gradually reduced, especially in response to evidence of good planning, budgeting and reporting practices at the District level and good service delivery performance.

Establish a method of equitable and balanced distribution of the resources allocated to local Administrations

The various Districts in Rwanda have different characteristics in terms of population profile, geography, poverty and socio-economic development levels.

Based on the degree of local financial autonomy calculated over five years the amount of the Local Authorities Budget Support Fund

(LABSF – block grant) is set to 5% of previous year's national domestic revenue.
In recognition of this fact, the earmarked funds described above will be distributed among the Districts based on objective formulas taking into consideration expenditure needs. Separate formulae will be developed for each sector/ component, thus allowing them to be kept very simple. The exact formula for the earmarked funds in each sector will be proposed by the relevant line ministry in charge of the specific sector, in consultation with local authorities and MINECOFIN, and approved by ministerial decree.

Moreover, the un-earmarked transfers will take into considerations poverty levels, as well as fiscal potential and fiscal efforts. The un-earmarked funds will thus serve a purpose of equalization, awarding more resources to poorer Districts and those Districts that have low potential for their own revenue mobilisation. Other factors that may enter the equalization formula are population size and District Area. The allocation will be made in a way to encourage and stimulate increased local resource mobilization.

The distribution of transfers based on objective formulae allows Districts to anticipate their allocations and to fully integrate them in the planning and budgeting process.

The formulae governing the distribution of the block grant as well as the earmarked grant transfer framework will be published as part of the annual National Finance Law.

Objective 3.

To strengthen planning and management capacity at the local level using a participative approach.

Local absorptive capacity of allocated resources remains weak; this is due to the technical capacity of the human resources at the local level. The Government will therefore strive to build and strengthen local technical capacity in partnership with the private sector and development partners. Specifically, this will include development of tools to facilitate local implementation – e.g. standard procurement guidelines, cash planning, budgeting templates, etc.

As mentioned above, through the mechanism of earmarked transfers the Districts maintain explicit ties with the national sector ministries, who will be ready to assist in the alleviation of bottlenecks in the implementation of development projects.

Strategies

Develop a clear planning and budgeting cycle for local authorities and appropriate tools

Evaluations of the decentralization program have shown that local financial management capacity is incommensurate with added devolved responsibilities and functions. In addition, the internal and external control systems are weak. Therefore, a modern, efficient and coherent planning, budgeting and financial management system will be put in place at the central as well as the local level.

Strengthen local capacity in planning, financial management, and financial control at all levels

Training will also be provided for local decision-makers and financial managers at the central and local levels.

Internal and external audits will include providing appropriate advice to financial managers. Incentive measures will be designed to promote efficiency and excellence at work.

However, when necessary, sanctions will be applied rigorously, unequivocally, and without regard to the persons involved at all levels.

Integrate the sectoral decentralization policy in the planning and management processes at the local level

Sectoral decentralization, in the education and health sectors for example, is an integral part of the decentralization policy. In the process of planning and budgeting, local Administrations will integrate the need for coordination and implementation of their sectoral responsibilities in order to mobilize adequate resources.

The integration of sectoral decentralization in the management practices at the local level will require establishing mechanisms of coordination and synchronization of sectoral policies at the central and local levels. Therefore, at the central level, an inter-ministerial steering committee, coordinated by MINALOC will be created for the coordination of decentralization aspects at the central level. This committee will serve as the focal point for development partners involved in decentralization. At the local levels, the CDCs will be given the capacity to carry out monitoring and coordination of sectoral decentralization.

The inter-ministerial committee and the CDCs will have to coordinate their activities with each other and with development partners for a more effective and efficient implementation of sectoral decentralization.

Finally, line Ministries will have a crucial role in coordinating and monitoring districts planning, performance, budget preparation and execution.

Create and implement a program of information, education, and communication to achieve a better participation of all stakeholders in local development

The success of fiscal and financial decentralization crucially depends on the degree of participation and ownership by the various sectors of local populations. There is no question that there is strong link between the degree of community participation and the attitude and code of conduct adopted by local authorities and implementers.

For instance, in order to stimulate civic responsibility at the local level and motivate taxpayers to voluntary pay taxes, authorities must inform and sensitize the local populations, and involve them at all levels of the decision-making and budgetary planning and implementation processes. In order to gain the trust of local populations local authorities must adopt a practice of transparent and equitable fiscal and financial management. Decision-makers and implementers must be accountable to the communities they serve. Corruption, embezzlement, and incompetence will be severely punished according to the law.

Awareness campaigns will be designed and implemented continually to inform and educate the populations and the private sector with respect to their roles, rights and responsibilities, in the fiscal and financial decentralization process. These awareness campaigns will use all available means of communication, be it modern or traditional, and will involve the different civil society organizations such as NGO's, trade unions, and women and youth organization, as well as development partners.

VI. Implementation Framework

VI.1. Intergovernmental fiscal relations

The modalities for intergovernmental fiscal relations play a central role in the success of the decentralization process. They shape the relations between central government and districts, and determine the broad framework in which districts must prepare their plans and budgets.

A decentralized system of budgeting requires greater coordination in the budget preparation process as opposed to a centralized system. The roles and responsibilities of each of the line ministries and the district must be extremely clear with respect to how they fit into the process.

After the launch of the 2nd phase of the fiscal decentralization process in Rwanda, it is crucial and most urgent to establish and clarify intergovernmental fiscal relations. Once a clear framework will be in place, it will require close and pro-active monitoring and coordination of the different actors.

1.1 MINECOFIN AND MINALOC'S RESPECTIVE RESPONSIBILITIES

Differentiating the roles and responsibilities of the ministries responsible for finance and local government is an important part of developing a stable and efficient intergovernmental fiscal relations system. This differentiation of roles assists government in ensuring that duplication is reduced, synergies are created and avoids potential confusion.

1.1.1 Responsibilities defined in the Organic Budget Law

The Organic Budget Law specifies the responsibilities of the Minister of Finance in ensuring sound budget and fiscal management practices at local government level.

The Minister of Finance **shall**

1. Determine, subject to Cabinet approval, the fiscal framework for local government. In this regard he/she determines the:
   - Share of nationally-raised revenue (including donor funding) to be allocated to local governments
   - Share of the nationally-raised revenue going to each district and which portion would be conditional (or not)
2. Foster macroeconomic stability which ensures the long-term financial stability of local government through stable intergovernmental transfers to that sphere.
2. Determine the formats to be used by the districts when they prepare their budgets.
3. Determine the formats for monitoring, evaluation and reporting to be used by the districts.
4. Monitor, evaluate and report on the financial performance of each district.
5. Monitor and assess whether districts adhere to:-
   a, Any applicable standards of generally recognised accounting practice.
   b, Uniform expenditure and revenue classification systems;
6. Investigate any system of financial management and internal control in any district (or an entity that reports to it) and recommend improvements.

A unit in charge of intergovernmental fiscal transfers within MINECOFIN will be responsible for taking forward these issues.

The Minister of Local Government

1. The Minister of Local Government (MINALOC) should takes steps and put mechanisms in place that ensure,
   - A democratic and accountable system of local government
   - The provision of services to communities are delivered in a sustainable manner in districts.
   - Sustainable social and economic development at a local level. In particular, ensure that, within their financial and administrative capacity, districts achieve the developmental objectives of government.
   - The promotion of a safe and health environment and encourage the involvement of communities and community organisations in matters that affect them.
2. MINALOC must ensure that districts structure and manage their administrative and planning processes to give priority to the basic and developmental needs of the community.
3. Central government, through MINALOC, must support and strengthen the capacity of districts to manage their own affairs, exercise their powers and perform their functions.
4. The territorial administration unit in charge of local finance in MINALOC will work continuously with MINECOFIN on coordinating matters related to local government finance.

1.2 RESPECTIVE RESPONSIBILITIES OF LINE MINISTRIES AND DISTRICTS

In general terms, there is a clear separation of responsibilities between line ministries and Districts for decentralized service delivery, as summarized in the table below.

Table1: New Roles under Decentralised Service delivery

Level	Role
Central Government	Establishment of national policies and strategies for local service delivery, the elaboration of systems and guidelines for local governments, the

	provision of fiscal transfers to enable services delivery, and the monitoring of and provision of support to local governments in the delivery of services.
Local Government	Delivery of services, within the context of national policies and guidelines, which are responsive to the needs of the local population, and oriented towards the achievement of national policy objectives

Specifically in the context of financial management, the different responsibilities can be summarized as follows:

1.2.1 Responsibilities of line ministries

Ministries are responsible to negotiate an overall amount with the Ministry of Finance to be transferred to the Districts earmarked for specific sectors. The line ministry will determine the breakdown of this amount into specific components, such as wage, non-wage, or development spending, and may specify specific intervention areas (such as, for example, feeder road construction within the infrastructure development grant). The line ministry will also determine an allocation formula to distribute the transfer amount between the different Districts, and propose a monitoring framework to follow up on the use of transferred resources (financial reporting standards are determined by the Ministry of Finance). In principle, line ministries will strive to limit the number of conditions and degree of earmarking to a minimum, based on a judgment of what allocation is desirable to reach national objectives.

Line ministries follow up District budget execution and performance in the sector they are in charge of, and provide regular updates to MINECOFIN. To promote and strengthen progress in the sector, Districts can call upon the respective line ministries to provide technical support to the districts in respect of elaboration of project proposals, procurement issues, preparation of the annual budget,

1.2.2 Responsibilities of Districts

Once a District receives an indication of the amount to be received from central government (earmarked and unearmarked transfers), they are in charge of preparing a budget that shows how the expected transfers are to be used, while respecting the conditions that are attached to the transfers in terms of earmarking to specific intervention areas. During budget execution, Districts have to respect all financial management procedures as specified by MINECOFIN, and provide regular reporting on budget execution and performance achieved, in line with the monitoring framework specified by the various line ministries in collaboration with MINECOFIN. Where transfers are effected on a quarterly basis, proper reporting may be a pre-condition to receive a next grant installment.

VI.2. Implementation Plan

The implementation plan is laid out over 4 years beginning in 2006.

Activities	Year 1	Year 2	Year 3	Year 4
• Updating FD regulatory framework relative to resource mobilization powers and capacity at local level				
• Provision of training and capacity to elected local leaders to carry out their responsibilities				
• Enhancing technical capacity at the local level				
• Definition of clear guidelines governing intergovernmental financial relations				
• Design and Implementation of Information, Education and Communication strategies				
• Development of a code of conduct for good governance based on ethics, values and best practices				
• Enforcement of code of conduct				
• Monitoring and evaluation based on clear performance indicators				