Multilevel Governance: A review of fiscal decentralization policies and practices in the DRC: A Case study*

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Abstract

The DRC's predominantly rural communities, spread across the country, are characterized by socio-economic disparities manifesting in extreme forms of poverty and deprivation. In the present context of underdevelopment and on-going violent inter-regional conflicts can fiscal decentralisation policies be used as an effective instrument to uplift poor communities? This paper investigates the effectiveness and efficiency of the current decentralization policy instruments for multilevel governance and allocation grants in addressing regional disparities in the DRC and the lessons that may be learnt from other countries.

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Introduction

In the transition to democracy, adoption of socioeconomic policies to ensure the decentralization of institutions and decisions is a major government priority. Policy reforms, administrative and economic structural changes are supposed to ensure greater regional autonomy from the central government while at the same time giving expression to the will of the citizens in the effective implementation of such reforms. Thus, in multi-level systems of government, the harmonization of intergovernmental relations between public finances institutions, central government and decentralized institutions remains a compelling responsibility. The implementation of an efficient fiscal policy stance firstly involves the redistribution of national resources and the stabilization of the macroeconomic environment through growth at the national level.Secondly it involves the equitable allocation of resources to maintain a minimum standard of public service and the development of a comprehensive strategy against failures in the local market. In addition, redistribution through an equalization fund reflects government's intention to address poverty and inequality by providing an appropriate means to tackle disparities between and within sub-regions. Equalization financing mechanisms seek to correct the socio-economic disparities between regions with high potentialities and those disadvantaged by the lack of resources. Balancing these diverse priorities is currently the single most important challenge facing the Democratic Republic of the Congo (DRC).

In the public finance literature fiscal decentralization debates centre on whether central government has ultimate responsibility for the redistributive function to eliminate sub-regional disparities related to socio-economic, demographic and geographic considerations (C. M. Tiebout, 1956; J. E. Stiglitz, 1977, R. A. Musgrave and P. B. Musgrave, 1989, J. E. Stiglitz, 2006, I. Kaul and P. Conceião, 2006). Given that the factors of production can be either mobile or immobile, the fundamental question is whether the sharing of responsibilities among different spheres of government can have the same response within economies that are developed and those that are under-developed.

However, notwithstanding this distinction, the stabilization, allocation and redistributive functions remains the responsibility of the central government in the interests of the nation state as a whole. In general the assignment of powers and functions to the different spheres of government for revenue raising and expenditure allocations depends upon many factors. Among others these include: political, constitutional and legal obligations; economic variables; management and administrative capacity; institutional and governance capability: and, geographic and demographic conditions. In addition to macroeconomic management amongst other functions, national or central government's responsibility for maintaining and managing a balanced and prudent fiscal policy stance is a key instrument in mediating tensions and divergent sub-regional interests in multi-level systems of government.

On the revenue side of fiscal policy taxes on labour and consumption are more or less mobile because they are based on the activities of individuals and therefore the taxing assignments vary by country. Given its redistributive functions, the central government is responsible for the collection of taxes on labour (mainly income tax). Likewise the collection of taxes on natural resources is generally the responsibility of the central government.On the expenditure side powers and functions are assigned according to the ‘subsidiarity’ principle that the government closest to the people is best suited to deliver public services in an efficient and cost effective manner. Thus, in general, education, health and certain road networks are assigned to provinces or states, and water, sanitation and basic urban infrastructure is the responsibility of local governments.

The decentralization programme in the DRC began when the new Constitution was endorsed in 2006. The continuing need to effectively implement the programme highlights the requirement for substantial reforms to avoid economic stagnation in a post-conflict and a politically unstable environment following past and recently contested national elections. The implementation of the process of democratization and decentralization of intergovernmental fiscal relations (IGFR) institutions in the DRC is an essential step in setting up fiscal decentralization financing instruments for the equitable sharing of nationally collected revenues. In this regard the ‘Fond de Péréquation’ (equalization fund) was established as a key policy instrument to equitably disburse 10% of nationally collected revenues to provinces.

In this paper we discuss the essential principles and practices for setting up and implementing the equalization fund. After a brief discussion of the data and information used in this evaluation, in the first part we discuss the general determinants of fiscal decentralization and how these may assist in developing an effective IGFR system for the DRC. In the second part we analyse the dynamics of decentralization through the basic tools of the transfer of powers and resources. This will allow us in the third part to examine the implementation of decentralization in the DRC, highlighting the specificities of fiscal policy in the DRC. Finally, we will explore different equalization grant scheme options before making proposals for implementing the equalization fund in the DRC.

Data and Information

Data for the study includes expenditure, tax revenue, demographic and disparity indicator data from provinces in the DRC. These data sets are collected and located in government and state institutions. In addition, academic and financial institutions such as universities and the Central Bank have collected some data sets. In the initial phase, data were collected from three provinces: Kinshasa, Bas-Congo and Katanga. The study also used qualitative information collected during interviews with Congolese authorities and individuals involved in the management of these provinces. The information gathered in this context has been completed by a review of official documents and reports. These included documents from the Central Bank of Congo, the DRC’s 1-2-3 Survey and two important studies entitled “Democratic Republic of Congo: The impact of the “Découpage”, Rapport No 50675, March 2010 (World Bank, EU, BDC, UNDP) and “The Good Governance Program: Provincial and ETD Evaluations” (USAID/DAI, March 2010).

A key constraint for public finance analysis is the lack of reliable official demographic data. According to the United Nations Population Fund (UNPF) the DRC is the only African country that did not carry out a census in the past twenty years (Trefon, 2013) although the UN recommends that population census be carried out every ten years. The last official population census in the DRC was carried out in 1984. All subsequent population data are estimates, based on 10% of all census records and inflated by a 3% growth rate (Marievoet, 2012). The best estimates are from updated sampling of households for national surveys. The last such survey was the United Nations UNICEF endorsed Multiple Indicator Cluster Survey 4 (MICS4) in 2010. UNICEF provided technical guidance for identifying the sample base and defining the survey design.

The analyses for this current study was also supported by interviews with provincial and national government officials and, the USAID/DAI involved in the review of institutions and governance for fiscal decentralization in the DRC. From the 29th October to the 26th November 2012, two surveys were carried out in two provinces: Bas-Congo and Katanga, mainly in the cities of Matadi and Lubumbashi. The fieldwork in Matadi was undertaken from the 29th October to the 11th November 2012. The one in Lubumbashi covered the following period: the 14th to the 26th November 2012. The fieldwork also benefited from initial interviews conducted previously in Kinshasa during 3 days (the 25th to the 27 October 2012). The information collected was based on many sources including a sample of individuals from governmental authorities, and the civil society, mainly the NGOs and the academics. The use of primary information gathered during the interviews provided individual and institutional perspectives and views on decentralisation and the equalisation fund in the DRC.The data and information collected in the DRC was supplemented by data located at the University of Antwerp’s Institute of Development Policy and Management (IOB).

Multi-level governments and the determinants of fiscal decentralization

The challenges for defining the determinants of fiscal decentralization in multi-level systems of government reside in understanding the theory and practice of intergovernmental fiscal relations. There are distinct advantages and disadvantages to adopting fiscal decentralization in multi-level systems of government.The advantages of fiscal decentralization include the fact that programmes can be structured to regional conditions; sub-regional levels of government have more information about regional priorities, prices and other factors; there are greater opportunities for innovation and learning at lower levels; comparative competition among sub-regions could spur efficiency and offers greater citizen participation, diversity and accountability. By the same token fiscal decentralization also comes with some disadvantages. Among others at the national level fiscal decentralization could compromise equity and national norms and standards of services, and undermine macro stability and fiscal discipline. At the sub-regional level, destructive competition could distort distribution of economic activity and encourage injudicious experimentation.

Notwithstanding the advantages and disadvantages of fiscal decentralization multi-level systems of government, they require an intergovernmental fiscal relations system that is appropriate and suited to the historical, political, legal and socio-economic institutions and conditions that prevail in the country. National or central government, provincial or state governments and, local or municipal governments characterize multi-level governments. In this context an intergovernmental fiscal relations system is concerned with the structure of public finance in a state with more than one sphere of government. More specifically it deals with how spending, taxing, borrowing and regulatory functions are distributed among the multi-level spheres. Intergovernmental fiscal relations systems also include regulatory frameworks for public finance transfers of shares and grants among the different levels of government. In addition intergovernmental systems tend to govern the institutional mechanisms for coordination, monitoring, support, supervision and intervention among multi-level governments. Thus an appropriate design of the intergovernmental fiscal relations system will be crucial to managing these multiple interrelationships.

The design of an effective intergovernmental fiscal relations system to efficiently manage fiscal decentralization in multi-level governments must take account of the role of all relevant policy instruments. The main instruments are political decision-making institutions at the legislative and executive levels, key implementing and management agencies, principal budgeting and financing agencies and agencies and institutions responsible for accountability and monitoring of performance.

A disjuncture in any of these roles could undermine the system and compromise the delivery of services to citizens. The intergovernmental powers and functions of the executive, legislative, administrative and financing agencies for fiscal decentralization are determined by the expenditure and revenue assignments of the different levels of government. The powers and functions relate to which level of government is responsible allocating and disbursing expenditures and which level is responsible for revenue raising and sharing of taxes and grants.

The implementation of fiscal decentralization policies is not without conceptual and practical implications. Conceptually, fiscal decentralization may improve efficiency of allocations but, in seeking to do so, it may compromise redistribution policies in the trade-off between equity and efficiency. At the macroeconomic level a disjuncture between public finance allocations and sub-regional funding requirements may undermine stability and macroeconomic management. However, fiscal discipline and a firm regulatory and institutional framework will help to mitigate the worst effects of such impacts.

Practically, the implementation of fiscal decentralization policies will have positive implications for efficiency and effectiveness of service delivery if the intergovernmental system has in place adequate incentives and disincentives to ensure inter-regional and inter-personal equity. Of course, good governance characterized by transparency, public sensitivity and public participation must support such incentives and disincentives. The experience of decentralized states, especially the more established federations, highlights a number of general features that characterize successful intergovernmental systems and set them apart from less successful ones (Shah, 1994).

There is some evidence to suggest that the decentralization of public service provision achieves two objectives: firstly, it gives sub-national governments responsible legislative authority to meet their own constituents' particular needs effectively; secondly, it ensures that citizens are provided with comparable access to basic social services regardless of their residence.

The list of general features that make for good intergovernmental fiscal relations include: the fiscal autonomy of sub-regional governments; revenue sharing for fiscal equity; formula driven rather than discretionary grants; a transparent process for determining grants; unconditional major grants; sub-regional accountability for expenditures; avoidance of bail-outs; the inclusion of norms and costs in grant formula; prudent macro-economic management; sub-regional revenue raising powers; and, effective sub-regional public finance management.

Ultimately, decentralizing basic public service provision to provincial or local spheres of government should enhance efficiency and effectiveness of delivery because these basic public services are at the same time among the most important policy instruments for achieving national equity goals. These, explicitly stated or not, include the aim that citizens ought to have equal access to educational opportunities, health care, water and sanitation, housing and socio-economic security, regardless of where they reside.It is the role of the grant structure, and fiscal decentralization policies more generally, to facilitate the decentralization of fiscal responsibilities in a way that leads to efficient and responsible provincial or regional decision-making, while at the same time respecting developmental and macroeconomic policy objectives.

An effective equitable sharing system must be able to effectively balance the competing demands for macroeconomic stability against the need for equity and redistribution in developing nations with high levels of socio-economic and spatial disparities. For the DRC the most important challenge is to design an intergovernmental grant scheme that not only complies with the generally accepted principles of fiscal decentralization but also respects the country's constitutional obligations for the equitable allocation of revenues to sub-regional governments to address socio-economic, demographic and geo-spatial disparities.

Designing a Grant Scheme for the DRC

Almost all decentralized states have some mechanism for the fair sharing of resources among sub-regional governments. Sharing entails affording sub-regional government sufficient resources, such that each can provide comparable levels of public services using similar revenue-raising effort. This is what is referred to as fiscal equity. Grant systems whose amounts are determined by a well-specified formula have a number of advantages over those that are determined on a year-by-year discretionary basis by national government. DRC transfers are not formula-driven as they tend to be allocated according to the density of the population. In this context the provincial population estimates are established every year.

By contrast formula-driven grants are more transparent, reliable and predictable, and are less subject to short-term fiscal constraints and day-to-day political considerations. This aspect of grants cannot be over-emphasised, especially in decentralized systems where provincial governments have relatively limited revenue-raising power, such as in the DRC. Formula driven grants can be designed to be in place for intervals of several years. They can also be designed so that risks of unexpected changes in revenue are borne by national government, which may be especially important, where provincial governments have little or low revenue-raising ability, and where they cannot use debt as a method of insuring themselves against revenue fluctuations.

Major grants, especially those that play an equalizing role, tend to be largely unconditional and non-matching. This ensures that the provinces are able to exercise the utmost discretion. Of course, there may be some requirement to ensure that when provinces use these grants to deliver important social programmes, they adhere to national norms and standards. Political accountability in multi-level government systems is an important element for ensuring that public services are delivered in efficient ways and that they meet the needs of citizens according to prescribed norms and standards. Therefore, explicit and unambiguous delineation of accountability relationships between the different spheres of government is critical.

Thus formula-driven grants can safeguard against the potentially serious problem faced by many intergovernmental systems with large vertical fiscal imbalances – the problem of bailouts of irresponsible (or over-zealous) sub-national governments. This is the so-called "soft budget constraint problem". These requirements notwithstanding, in principle, differences in fiscal requirements ought to be included in equalization grants. This is especially true in systems where provinces have little revenue-raising capacity of their own. Explicit attempts to incorporate such costs in equalization formulas would contribute to the fiscal equity and efficiency of the intergovernmental system.

The inclusion of norms and cost differences in the grant formula can have a perverse incentive for sub-regional governments as they are likely to distort their spending priorities in order to influence the amount of the grant allocation they will receive. For this reason it is important that grants are designed so that norms and costs reflect the objective features of the province and are directly related to the amount of money needed to provide standard levels of public services.

In addition to the above issues other criteria for grant designs include regional autonomy, revenue adequacy, equity, predictability, efficiency, simplicity, incentives for fiscal management and safeguards. However, general international practices suggest that the objective of the grant determine the design, as the grant type must align with the intended objectives. Among other objectives grants target fiscal imbalances, fiscal equalization and intergovernmental spillover effects. Grant types vary and may be unconditional or revenue sharing mechanisms and/or, conditional or specific purpose grants.

The dynamics of decentralization in developing countries

In Sub-Saharan African (SSA) countries decentralization remains a function of central government. Central or national governments define the amount of financial resources allocated to sub-regions or Decentralized Territorial Entities (ETDs) in most of Franco-phone Africa.

It is difficult to determine the potential tax in Africa and the collection of taxes is a costly exercise. This is particularly evident in rural areas. In SSA the determination of tax bases and tax rates is a function of national or central government.

Resource mobilization at the local level is a major problem and funds collected under these conditions remain rudimentary compared to the needs of citizens. In fact, decentralized entities namely “communes” in West Africa do not mobilize more than 1% of GDP for their daily operations. Similarly, the operating grants of the central government in favour of ETDs seem to be narrow. These transfers seem to represent less than 1% of current revenue of the State (La Revue Africaine des Finances Locales, no 3, Special issue, Partenariat pour le Développement Municipal/PDM, 2003).

With respect to expenditures in SSA national or central expenditures are comparatively more important than sub-regional government expenditures. By contrast decentralized entities in developed countries have greater expenditure responsibilities. However, it is difficult to identify the degree of decentralization and practices can vary from one country to another. In most cases, any analysis of indicators of economic and financial performance for local versus central revenues, local versus central expenditures and, transfers provides mixed and ambiguous results (Bird and Vaillancourt, 1997).

Fiscal Decentralization Perspectives in the DRC

The recent evolution of decentralization and fiscal decentralization in the DRC can be traced to the political consensus that was achieved in instituting the Constitution that gave rise to the Third Republic in the 2005/06 period (Kaiser, 2008). Although the Constitution (2006) put in place the broad parameters for decentralization many fiscal decentralization issues were not resolved because there was no political consensus on the necessary legislative policy instruments that would have given effect to the constitutional obligations.

Other legislative instruments (e.g. the Law on Programming the Decentralization process) intended to put in place the fiscal decentralization process, public finance management and the public service institutions were also left in abeyance, delaying the building of the necessary institutional framework for a smooth transition to an effective intergovernmental fiscal relations (IGFR) system. Despite these shortcomings the Constitution is specific on the levels of fiscal transfers to sub-regional governments prescribing that 40% of nationally collected revenue be allocated to provinces and, that 10% be dedicated to an equalization fund (Fond de Péréquation).

The inconclusive transition to decentralization in the DRC fuelled the debates on decentralization and provided a fertile ground for many studies and papers (Marysse, 2005; Sumata, 2008; Liégeois, 2008; Marivoet, 2009). In particular the very comprehensive World Bank and European Commission (EC) technical notes of the problems and challenges related to the implementation of fiscal decentralization in the DRC is reviewed in a working paper by Kai Kaiser (2008). The paper discusses the series of notes produced between April and October 2007. The World Bank and EC notes looked specifically at decentralization with respect to transitory arrangements, fiscal issues and competencies for transfers, human resource requirements, guidance and control systems, the National Equalization Fund and, an impact assessment of the decentralization process on education reform in the DRC.

Notwithstanding interventions by the President and the National Decentralization Forum (NDF) to address the political dissatisfaction consequent on the unilateral central government implementation in 2007 outside of a clear legal framework, the intergovernmental fiscal relations problems persist. More recently, new studies have been undertaken on issues and insights into the immediate challenges facing the implementation of fiscal decentralization. One such study investigated the so-called “guichet unique” established to maximise customs revenue and reduce bribery and corruption in the border town of Kasumbalesa in the copper mining Katanga province. The study analysed the trans-border trade between DRC- and Zambia (Muamba, 2012) and the possible impact diversion of revenues may have on total collected mining revenues. At the institutional level the views of ordinary citizens seem to be ignored by the un-willingnessof the Central government to open up and engage local communities on the decentralization process (Tshipinda, 2012). Thus a combination of economic and institutional challenges characterizes the political economy of fiscal decentralization in the DRC today.

The challenges of the institutional and territorial administration reform

The administrative system and related institutions in the DRC have experienced major upheavals as a result of several reform attempts. The socio-economic context of the DRC and the difficulties faced by the Congolese authorities to put in place sustainable democratic structures is compounded by the lack of financial resources for the management of local public services. The territorial organization Law of 5 (1973) had established a centralized administrative structure controlled by MPR (Popular Movement of the Revolution) party.

The reform law was introduced at the Second Extraordinary MPR Congress held in the 1972. This reform resulted in the removal of the legal status of cities (except for the capital Kinshasa) and the adoption a standardized system of administration for rural and urban areas. The reform also led to the establishment of administrative districts without legal status and the special status of the directorates of the territorial divisions.This was followed by the elimination of the systematic use of traditional political-administrative law. Party decisions in 1974, 1975 and 1976 encouraged the high turnover of administrative officers of the State. In addition, the enactment of the Ordinance-Law n º 73/023 of 4 July 1973 ensured the decentralization of personnel management of the state. Thus the priority and motivation of public officials was to ensure the supremacy of the MPR through a centralized territorial organization.

The Constitution of 18 February 2006 governing the Third Republic explicitly stipulates the adoption of a large-scale decentralization in the DRC and led to the subsequent territorial redistribution of the country into autonomous provinces and smaller decentralized local territorial entities. Under these conditions, the number of provinces is expected to increase from 11 to 26. Moreover, the exercise of power is supposed to revolve around three basic structures represented by the central government, the provinces and decentralized territorial entities (ETDs). As highlighted in Table 1, the sub-regional devolution or “decoupage” of DRC should lead to the establishment of several entities ranging from territories to chiefdoms.

The success of decentralization therefore presupposes the adoption of appropriate incentives to ensure the transfer of powers and responsibilities from the central government to the ETDs. Similarly, the transfer of financial resources in certain areas should be in favour of decentralized bodies to finance sustainable development through local projects. As mentioned in the Constitution, the management of services such as education, health, roads and the environment will be the responsibility of the ETDs and financed through the equitable allocation of nationally collected revenues.

Table 1: Description of the Decentralized Territorial Entities (ETDs)

Province	Territories	Cities	Communes	Sectors	Chiefdoms	Total ETDs
Bandundu	18	2	7	84	10	103
Bas-Congo	10	2	6	55	-	63
Equateur	24	3	7	85	2	97
Western Kasaï	10	2	10	50	3	65
Eastern Kasaï	16	2	8	76	7	93
Katanga	22	3	13	37	55	108
Kinshasa	-	-	24	-	-	24
Maniema	7	1	3	21	13	38
North Kivu	6	3	10	7	10	30
Eastern Province	24	1	6	58	141	206
South Kivu	8	1	3	5	18	27
Total	145	20	97	478	259	854

Source: CTAD/Cellule d’Appui à la Décentralisation (The Technical Unit SupportingDecentralization), February 2011

It should be noted that the provinces have legislative power derived from members being elected to provincial assemblies. From this point of view, the laws may be adopted at the provincial level in the form of edicts. Similarly, the exercise of executive power under these conditions occurs through the channel of a provincial government whose members are invested by the Provincial Assembly. However, power at the ETD level is exercised through elected local governments and autonomous assemblies.

In Table 1 the ETDs are categorized under the headings of cities, towns, chiefdoms and sectors. The ETD assemblies do not have legislative powers. Political decentralization is therefore a process of devolution of administrative powers to the ETD to implement policies that are responsive to the needs of their constituents. Sometimes ETDs find themselves having to implement policies without access to revenues. These unfunded mandates present severe constraints on local governments to meet the basic service needs of citizens in general and disadvantaged communities in particular.

Interviews conducted with provincial officials revealed that demands to implement unfunded mandates are related to an institutional intergovernmental disjuncture in the political, administrative and economic relationships between the different levels of government. In practice, the daily management of the provinces is undermined by shortage of resources and inappropriate means to implement the decentralisation process efficiently and effectively. Such financial constraints hamper the ability of the local administration to deliver financial, social, health and educational services.

Officials interviewed indicated that many civil servants at the provincial level do not trust the Central government because of the delays in implementing the decentralization reforms as prescribed in the Constitution. This is particularly true for the ETDS where autonomy is undermined by delays in organizing local elections. The implication is that they do not have legislative powers to implement policy.

The mechanisms of fiscal decentralization in the DRC

Amongst the main challenges facing fiscal decentralization in DRC is the management of financial resources and the problem of governance. A strategy aimed at public service improvements, transparency and accountability can strengthen the newly created provincial agencies (Strategy Plan for Public Finance Reform (SPPFR), May 2011). The SPPFR has highlighted several measures that should be put in place to improve the public finance and budget management systems at the national and provincial level. At the national level the Strategy Plan advocates for greater budget credibility through widening the scope of the budget; the introduction of medium-term multi-year expenditure framework; realistic forecasts; reliable accounting and effective control. Institutionally the plan suggests promoting the centrality of the budget by reinforcing the role of the departments and line ministries involved in budget preparation, planning and expenditure management.

The SPPFR (2011) further acknowledges that the financial constraints and the transfer of powers and functions to the provincial and ETD level governments is too slow and hinders the full implementation of fiscal decentralization as envisaged in the 2006 Constitution and the three principal laws that give effect to the intergovernmental principles in the constitution. In summary the laws prescribe: (i) the fundamental principles for the free administration of the provinces; (ii) operational arrangements for the conference of provincial governors; and (iii) the composition, organization and operation of decentralized local authorities and their relationships with the central government and with the provinces. (SPPFR, 2011)

The inability of the DRC economy to accommodate the new rules seems to be the main barrier preventing the establishment of effective administrative reform. In the absence of such reforms will the decentralized public administration be able to reinforce the state’s institutional capacity? At least one author (Marievot, 2009) argues that the main problems seem to be the lack of financial resources, competencies and the lack of leadership.

The institutional weaknesses can be addressed and reforms implemented through a commitment to consultation and dialogue between the various institutions involved in the decentralization process. This is possible with consensus on the implementation of structural reforms. For example the assignment of powers and functions between the central government and the provinces could be a key driver for decentralization especially in areas where certain functions remain exclusive, while others require concurrent responsibility for effective management, such as scientific research, conservation and tourism which require a shared responsibility. Similarly, some areas may be horizontal collaboration involving several different provinces or ETDs. However, the legislation for the assignment of powers and function specifically for ETDs still remains to be enacted by an Act of the National Assembly.

Apart from effective institutional reforms fiscal decentralization presupposes effective and efficient intergovernmental fiscal relations (IGFR) that determine the transfer of funds to decentralized institutions to finance sustainable development in favour of disadvantaged communities. In the DRC the daily management of services such as education, health, roads and the environment are entrusted to the ETDs and financed through the equitable allocation of resources. In the DRC shares of nationally collected revenues to central and provincial governments are constitutionally prescribed with 50% for the central government, 40% for the provinces and 10% for a national equalization fund to compensate for fiscal disadvantage. Recently analysts have questioned the 10% share allocated to the equalization grant and argued that this amount would not be enough to ease the disparities among the provinces and to substantially reduce poverty (Liégeois, 2008; Marivoet, 2009).

One can mention that the 10% of government revenue allocated to the equalization fund should be used for investment purposes at local level. However the constitution needs to specify how the money is expected to be divided in order to reduce the gap between resource-rich border provinces and resource-poor ones. Another point is the fact that there are not specific articles specifying the ways to divide the fund between the provincial and lower levels. From the perspective of certain provinces the current formula can lead to considerable inequalities between provinces with resources and those that are most disadvantaged.

It is clear from Table 2 that the provinces of Kinshasa, Bas-Congo and Katanga account for 90.95% of the budget of the Congolese state. Consequently, the immediate application of the rules established by the Constitution may cause significant differences in revenues among the provinces (World Bank; European Commission, *2008*).

Table 2: Projected transfers per province per capita, 2008-2011 (Congolese Franc)

Provinces	**2008**	**2009**	**2010**	**2011**
Bandundu	215	246	285	338
Bas-Congo	4,153	4,822	5,642	6,669
Ecuador	263	304	354	419
Kasai Orientale	1,566	1,784	2,050	2,439
Kasai Occidental	954	1,089	1,252	1,487
Katanga	3,450	4,159	4,905	5,700
Kinshasa	34,896	41,286	50,207	59,163
Maniema	165	198	234	273
North Kivu	810	964	1,138	1,332
Eastern Province	331	396	465	542
South Kivu	1,030	1,199	1,397	1,648

Source: *Democratic Republic of Congo. Decentralization in the Democratic Republic of Congo, Decentralization in the DRC: Note on Fiscal Decentralisation, European Commission / World Bank (2008)*

In addition, most of the revenue comes from two main sources, namely the tariffs on goods and services and exploitation of mineral rights. From this point of view, the wealthier provinces such as Bas Congo and Katanga are the main beneficiaries of trade between the DRC and other countries.

Similarly, Kinshasa benefits from substantial tax revenues given its privileged status and its role in the trade of Congolese natural resources. Many of the richer provinces feel aggrieved that according to the Constitution they have to surrender 40% of their financial resources to the centre but the same Constitution is silent on the practicalities of equitably sharing the nationally collected revenue that includes the 40% from the provinces.

The revenues of the DRC can be grouped into three main categories, namely, revenues from taxes that are easily transferred or deducted, revenues from taxes difficult to locate and, revenues from offshore taxes. These revenues can be reassigned to provinces and retained at source insofar as they are easily identifiable. Secondly, revenues from customs fees and taxes from large companies cannot be so easily collected because their identification remains uncertain as they can pass through several provinces.

Thus their equitable allocation therefore requires a formula defined by a principle of proportionality rewarding all provinces through the taxes flow. Thirdly, the identification of the last category of offshore oil royalties seems uncertain because oil production is erratic and subject to operating agreements with the IMF.

Regional disparities and unequal developments

The DRC’s economic slump resulting from decades of predatory management and post-conflict social instability is a major constraint in the transfer of skills and resources to address the socio-economic disparities. Thus maintaining the intergovernmental responsibilities and functions of the State becomes an ad hoc exercise because of low internally or externally generated financial resources. It could be argued that the overall economic situation is characterized by extreme regional disparities in development.

In fact, there is significant difference between the regions with the largest GDP per capita (The Capital Kinshasa and the provinces of Katanga and Bas-Congo) and the poorest ones (The provinces of Maniema, Bandundu and Equateur, see Figure 1). This dynamic is highlighted in Figure 1.

Unequal regional development has been fuelled by many factors including political instability, democratic transition and war. A new fiscal decentralization dispensation will require a set of new rules and policy instruments targeting disparities and economic development in a post-conflict DRC.

Special attention should focus on less favoured regions and war affected areas as they will need higher levels of finance. Areas most severely affected by war, conflict and socio-economic imbalance include the Eastern Congo, in particular the North and South Kivu provinces.

Table 3: Indicators of Development Index for DRC at province level (2001-2006)

	Human Development Index (HDI)			Gender related Developement Index		
Année	2001	2003	2006	2001	2003	2006
Kinshasa	0.587	0.582	0.583	0.580	o.573	0.574
Bas-Congo	0.467	0.458	0.465	0.455	0.446	0.448
Bandundu	0.348	0.345	0.345	0.327	0.327	0.326
Equateur	0.290	0.290	0.291	0.256	0.258	0.257
Western Kasaï	0.412	0.410	0.409	0.390	0.389	0.387
Eastern Kasaï	0.420	0.420	0.425	0.404	0.406	0.412
Katanga	0.408	0.403	0.407	0.390	0.390	0.400
Orientale Province	0.326	0.330	0.330	0.304	0.308	0.307
North Kivu	0.367	0.363	0.361	0.347	0.350	0.355
South Kivu	0.341	0.343	0.344	0.320	0.329	0.333
Maniema	0.387	0.389	0.389	0.363	0.370	0.378

Source: UNDP (2008)

The Gender-related Development Index constitutes a composite measure of gender equality, provided par United Nations. It helps to analyse the inequalities between men and women by considering the following domains: a long and healthy life, knowledge, and a decent standard of living. The Human Development Index (HDI) evaluates the level of human development of individuals within an economy. It could be argued that larger index numbers are related to higher levels of development. In 2013 the DRC was ranked 186th out of 187 countries in the world and it will not achieve the Millennium Development Goals. Even though it has made some progress over the recent years in terms of education and health (infant mortality and HIV/AIDS), the situation seems to remain disparate at local levels (Table 3). There is some evidence to suggest that the provinces of Bandundu, Equateur and Orientale can be counted among the poorest ones in the country. These regions are facing severe unemployment, malnutrition and poverty.

According to the same PRSP (July 2006), there are disparities between the various provinces as well. In fact, the provinces of Equateur, Bandundu and South Kivu have the highest poverty incidence. For the people of Bas-Congo the lack of basic education and instruction for children seem to be the main sources of poverty, while in the two Kasai provinces (Eastern and Western), the primary causes of poverty are perceived as the lack of electricity, balanced diet, lack of transport, as well as the presence of soil erosion. The population of Equateur views poverty as the inability to access agricultural inputs and technical support, lack of drinking water, its isolation, low agricultural production, difficulties in transporting agricultural products, administrative and police harassment, failure in marriage, polygamy, the time spent by women doing housework, and the lack of roads. In Bandundu, according to the PRSP, the lack of adequate food, low agricultural production, the difficulties in the evacuation of agricultural products and soil erosion are the primary concerns of the people.

In Katanga, the main features of poverty are bankruptcy of Gécamines (Générale des Carrières et des Mines), administrative and police harassment, isolation of villages, poor and inadequate school infrastructure, lack of peace and security, land disputes and community conflicts. Finally, for the people of Kinshasa, unemployment, apathy, poor nutrition and the lack of finance for enterprise development are the major characteristics of poverty.

One of the most significant socio-economic disparities in the DRC is unemployment and income inequality. The distribution of the number of workers reveals unequal distribution among the different provinces of the DRC. According to the report of the Central Bank of Congo published in 2010, the Equateur province has the highest number of employees, followed by the city-province of Kinshasa. Unlike Kinshasa where this number has been rising, in the province of Equateur, the number of jobs remains static. However, data for indicators of unemployment, as well as data related to other socio-economic disparities, has to be interpreted with caution because of the unavailability of consistent data sets for some provinces.

Income distribution in different provinces

Income inequality features prominently as a major contributor to poverty across all provinces in the DRC. At the national level the inequality index as represented by the Gini Coefficient is relatively high at 42% (PRSP 1, July 2006) and is indicative of endemic levels of distributive injustice, discrimination and exclusion. At the provincial level the provinces of Kasai and Katanga account for the highest inequality rates with Gini coefficients of more than 40% compared to relatively low rates in the provinces of Bas-Congo and South Kivu. The city-province of Kinshasa, it is also characterized by high inequality with a Gini index equal to 39%.

Income inequality is also pronounced when poverty distribution within poor communities themselves is measured using the Foster-Greer-Thorbecke index (FGT) calculated for each province. This indicator represents a generalized measure of poverty considering a variety of factors for a given population and helps to evaluate how income can be optimally distributed below the poverty line. It is used to assess the degree of poverty aversion and measures the inequality among the poor in the provinces (Table 4).

Table 4: The aversion of the province for poverty

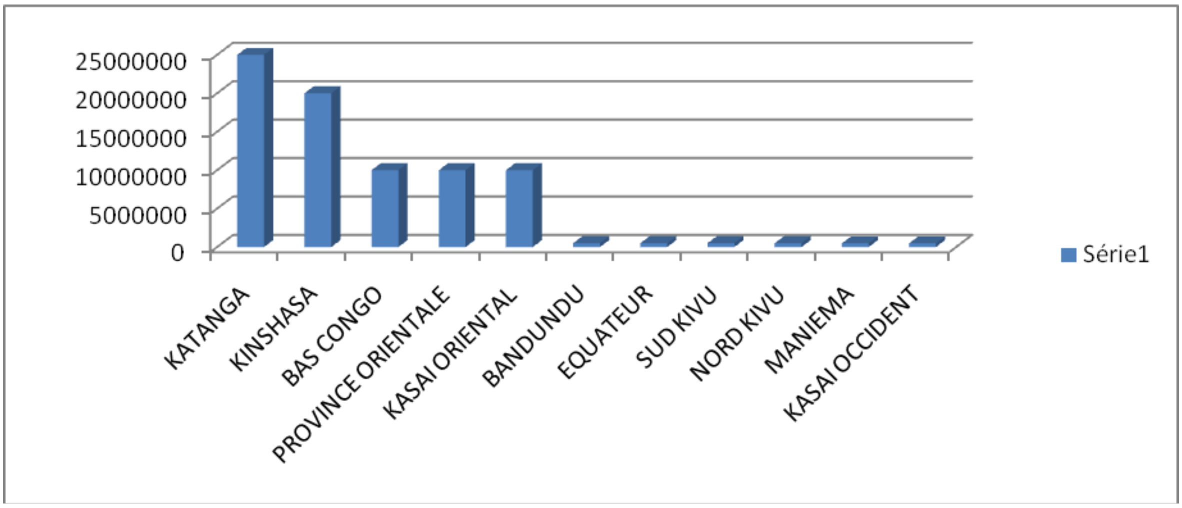
Provinces	Aversion for poverty
Kinshasa	5.8
Bas-Congo	10.56
Bandundu	26.26
Equateur	31.38
Orientale Province	18.99
North Kivu	18.37
Maniema	9.83
South Kivu	20.92
Katanga	18.42
Western Kasai	14.84
Eastern Kasai	10.73

Source: PRSP1 (Poverty Reduction Strategy Paper1), July 2006

In taking account of sub-regional disparities in a fiscal decentralization grant scheme for the DRC the level of provincial contributions to the GDP is important because the Constitution prescribes that a portion of all provincial revenues should be proportionately and equitably allocated to provinces for the provision of services to citizens.

The extent to which a province is able to contribute to the GDP will be significant not only in the equitable sharing process but also in the determination of equalization grant allocations intended to compensate for disadvantages emanating from inherited, structural and institutional disparities. As highlighted in Figure 1, the provincial contribution to GDP in the DRC is unequal. In fact, the province of Katanga has the highest value, followed by the city-province of Kinshasa, the province of Bas-Congo, the Orientale Province, Eastern Kasai, Bandundu, Equateur, South Kivu, North Kivu, Maniema and Western Kasai.

Figure 1: Value added of sectors at the provincial level



Source: Own compilation, using data from PRSP2.

According to the PRSP 2, the mining sector has contributed significantly to the value added of the Katanga province, whereas the capital, Kinshasa, has mostly benefited from the service sector. The agricultural sector has been at the forefront of contribution for the other provinces.

Towards Fiscal Equalization in the DRC

Transfers of financial resources from the central government to decentralized entities in the case of fiscal decentralization must take into account several dimensions by setting a strategy of optimal and efficient allocation of funds. In general, the resolution of this complex and multifaceted equation involves taking into account the political, economic and geographic considerations.

Implementation equalization also involves determining the exact amount to be transferred to the provinces. It is certainly not easy to estimate the expenditure needs and to choose appropriate variables to allocate budgetary resources. In fact, the central government may decide the amount of resources to be allocated by formula or by sharing (derivation-based). It could be argued that the choice of a formula seems to be more appropriate for the case of DRC. This system is expected to meet the needs of poor territories and make them better off to some extent. In fact, sharing on derivation method remains generally counter equalizing as it channels resources to higher-income regions.

The success of the equalizing scenario depends in most cases on cooperation between the central government and decentralized entities. In addition, the use of a formula to calculate the actual value of the allowance should be based on dependent variables of population structure (density, age, education, nutrition, housing, etc.) and/or the real needs of decentralized entities in terms of services expected by economic agents.

It is wise to note that the equalization formulas are designed to maintain a social safety net in the provinces and decentralized entities by allocating adequate resources on health and education. In general, the equalization formulas tend to be based on variables reflecting the fiscal capacity or expenditure structure (i.e. the real needs of decentralized entities) of the provinces. Other formulas are established under certain conditions and seem to take on board urgent needs of specific areas. Transfers of funds carried out in this context can be deployed concurrently with the search for local funding from decentralized entities.

The adoption of equalization in the DRC remains a perilous exercise given the disproportions and unequal development of provinces and decentralized entities. In fact, a proper assessment of revenue capacity at local levels is needed as well as the setting of specific rules to channel transfers to development projects. One can mention that the financial resources transferred are expected to fill the gap between the spending needs and revenue capacity. The aim is insure the implementation of bankable projects for the benefit of a large number of the population. Similarly, the problem of handover of provincial tax revenues to other decentralized entities also arises with particular acuity. The crucial question remains the establishment of the legal framework distributing the powers between the provinces and the decentralized entities.

In fact, the different views expressed on legal texts can lead to political instability and sustainable conflicts. Another point is the fact that the joint management of various sources of tax collections may accelerate tensions. The equalizing fund formula should allow the resources to be directed first to the poorest provinces and decentralized entities. This strategy requires the wise selection of the regions facing higher levels of needs and/or lower fiscal capacity.

In order to proceed with the assessment of real potential of each province and/or decentralized entity, it is wise to examine the approach to be taken to choose reliable indicators to obtain relevant results. The variables such as the GDP per capita, the unemployment rate and the degree of urbanization are major assets. In the case of DRC, the main problem remains the lack of appropriate official demographic data as highlighted before. In fact, statistical tools and methods of data collection tend to be not reliable.

Consequently, one of the main challenges is to devise a strategy for improving statistical capacity especially at the levels of provinces and decentralized entities.

Conclusions

The success of fiscal decentralization and the equalization fund depends on several factors. In fact, an assessment of the potential tax and indicators of development of each province is definitely needed to accurately identify the real needs of each decentralized entity. The decentralization process in the DRC may cause slippage in the institutions given the delays associated with rebalancing the public administration system to the new standards. From this point of view, there is a potential risk due to the consequent increase in transaction costs related to the process of learning new rules. Immediate Fiscal Decentralization as guaranteed by the Congolese Constitution is a perilous exercise given the weaknesses of the institutions and the limited financial resources mobilised in this context. The immediate transfer of responsibilities, especially in the areas of primary and secondary education, health and public service may cause catastrophic setbacks. In fact, the new decentralized authorities may be unable to fulfil commitments relating to urgent spending priorities.

On the other hand, the paucity of accurate statistics seems to be a major challenge that can hamper the implementation of the equalization fund as the DRC is experiencing the lack of basic data and the rudimentary methods used to collect statistics. The situation is even worse for the provinces and the rural areas that generally do not have adequate services to collect data and conduct investigations. The success of decentralization also implies the establishment of collaborative non-confrontational relationships between the central and local governments to maintain an endogenous and sustainable development agenda. Training is therefore the backbone of priority action programs to develop in this context. In fact, learning new techniques of financial management and collection of statistical data is likely to improve the quality of public service.

The setting of strict budgetary and financial control at all levels of power is likely to increase the level of state financial resources. From this point of view, the central government can possibly play the role of advisor to decentralized entities to help them to improve the management of resources at the local level. The adjustment of the legal system to the new standards is also needed to ensure the success of this strategy.

Financing public investment through the National Equalization Fund can alleviate poverty if the fiscal decentralization process is wisely implemented. It should take into account the unequal development of provinces and the state of decay in which most local entities remain. Similarly, the scarcity of the financial and material resources available to the government authorities may drastically disrupt the setting of reforms and the achievement of development priorities.

Moreover, a special attention should be given to the education sector and allocating more resources to this sector may be a destabilizing factor in the balance of public finances. In fact, education seems to absorb 45% of the payroll and also tends to employ half-staff of the Public. Therefore, the reforms to be undertaken in the context of decentralization should take into account organizational and institutional capacity of local governments to effectively discharge their responsibilities for these new tasks.

Decentralization remains therefore a gradual process requiring the implementation of an effective partnership between the central government and decentralized entities. In fact, this process requires a significant cooperation between these institutions within a legal framework.

The economic slump of the DRC from decades of predatory management and post-conflict social instability are major burdens hampering the transfer of skills and resources to provinces and/or decentralized entities. Maintaining the sovereign functions of the State then becomes random due to the low financial resources internally or externally mobilised. It is worth mentioning for example that the financing of the budget of the Congolese state is about 50% contributed by external financial resources. The economy therefore remains extroverted since the budget is relying heavily on these external financial resources.

The system of decentralization in the DRC can bring positive results in laying the foundations for a sustainable and endogenous development if certain preconditions are met. However, the institutions and actors involved in the process should fully play their role. In this context, it is essential to establish adequate rules for channelling resources equitably to decentralized entities (provinces) taking into account the basic needs of local populations. From this point of view, it is wise to explicitly define a legal framework and to set up adequate rules. This dynamic may help to avoid the perpetuation of a hostile environment impacting adversely on economic growth and social progress.

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