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PROJECT FACTS

LOCATION
Four pilot Governorates in southern Iraq: Basra, Maysan, Al Muthanna and Qadissya,

DURATION
August 2016 - April 2018

KEY GOVERNMENT COUNTERPARTS
Ministry of Planning and Governorates, Directorates of Planning and Municipalities of Basra, Maysan, Al Muthanna and Qadissya.

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MUNICIPAL FINANCE & IMPROVED BUDGET EXECUTION IN URBAN RELATED SECTORS

PREAMBLE

Even though the decentralisation of political authority to the Governorates in Iraq is outlined by Law No. 21/2008, the devolution of powers has not been adequately coupled with the necessary administrative and financial decentralisation measures to the sub-national level. Most of the investment budget is allocated to sectors through line ministries and their branches in the provinces, while only a small percentage goes to regional development through the local authorities. Local revenues are negligible compared to citizen needs for services. Municipal Finance, revenue collection and budgeting processes reflect the legacies of a centralist tradition of governance, revealed in the management approaches to policy, planning, budgeting and execution, but are also by a range of systemic inefficiencies and unsustainable subsidies.

This critical LADP component has been working closely with focal points from four pilot municipalities: the city of **Basra** in Basra Governorate; **Al Rumaitha** in Al Muthanna; **Ali Al-Gharbi** in Maysan; and **Al Shamiya** in Qadissiya to assess their capacity to raise municipal revenues, manage expenditures and execute for the improvement of key services in specific urban related sectors with the aim to strengthen the capacities of staff at the provincial level in this regard. The UN-Habitat team, led by a senior economist, guided counterparts through the gathering and analysis of data. Comparative diagrams illustrating the revenues and expenditures and concerted discussions with municipal officials allowed the team to identify discrepancies in revenue collection between governorates, the lack of systematic data, missed opportunities to leverage municipal property values, and a range of legal bottlenecks and policies that hinder the capacity of the local authorities to locally finance improved service delivery.

A **Training Module** to strengthen sub-national and local government capacities in budget management and execution will be delivered in early November 2017 in the Governorate of Basra.

1. GENERAL BACKGROUND

■ **There is then a need to increase the "fiscal space" of the country out of oil prices fluctuations.** The problem of public financing in Iraq is not limited to municipalities only. The average non-extractive tax revenue to

GDP ratio was only of 1% for the 2005-2014 period, rising in 2016 to 4.1%. This is one of the lowest of the world, and in fragile states, as per IMF classification.

■ This is while the IMF has pointed recently the "lack of clear legal framework governing taxation", the "weak tax and customs administration" and the "low tax compliance". This includes the global process of public finance management (PFM), which strongly need to be reformed. **The reform of public finance management (PFM) is however made more difficult as it has to be conducted simultaneously with the implementation of the decentralization.**

■ **The share of wages and salaries in public spending has increased drastically in the last decade**, which makes the necessary review of human resources and the development of capacities at the governorates and municipalities levels more cumbersome.

■ **A territorial/regional development plan, as well as the urban development plans for the different cities, need to be formulated and implemented in order to encourage private productive and service activities, function of the natural advantages of cities and regions.** One of the major problems in Iraq is the weakness of the private sector, in particular in productive and added-value activities outside of the rent seeking sectors (oil, real estate, etc.). In this context, the encouragement of PPP schemes is arguable if they are limited to public services.

2. ANALYSIS OF CURRENT MUNICIPAL FINANCES

A first assessment has been conducted on the municipal finances of four selected Iraqi towns of various sizes located in the south. The analysis of their budgets and intensive consultations have led to the following key observations:

Municipal revenues

■ **There is an issue on how the municipal salaries fit into a unified framework for civil servants**, since the salaries of the civil servants of the municipalities are paid directly by the Ministry of Finance and constitute a major share (typically around 60%) of total revenues.

■ **The apparent decline of municipal revenues from public real estate is making municipalities more vulnerable to uncertainty.** The rents of premises, mostly for commercial activities, along with the sales of land for housing construction, constitute a second major source (around 1/3 of total) of revenues.

■ **There is a major concern in regards to the records of property rights, including those of municipalities**; many had been lost during the war, and the recent efforts to rebuild these records are insufficient.

■ The various fees collected by municipalities (licenses, publicity, etc.) are weak, totaling around 5% of total revenues. **Here and for other items, there is an issue concerning the multiple exemptions**.

■ **Concerning waste management and revenue from the use of pavements, there are issues concerning the legal framework for these "local taxes", their amounts, their indirect collection through "water authorities" and the absence of proper records on cities' inhabitants.** These revenues concern only reach around 3% of total, while waste management constitute the principal public service that the municipalities manage, with real costs exceeding significantly revenues.

Municipal spending

■ **On expenditures as on revenues, there is an issue in the capacity building of municipal councils mastering proper accounting systems and budgeting procedures.** Besides salaries, the main spending items are constituted by oil derivatives (fuel and oil, for around 11% of total), other consumables (13%) and maintenance and public works (6%).

3. RECOMMENDATIONS ON THE GENERAL FRAMEWORK OF MUNICIPAL FINANCES

■ **A new functionality scheme should be put forward for the municipalities, in line with the process of decentralization and with international standards.** Generally, the framework of municipal functions is outdated and incompatible with sound territorial/regional and urban development schemes. The present municipalities have limited functions, concentrated mainly on solid waste collection and on the management of urban properties. In addition, both functions face significant difficulties: the balance between costs and revenues for the first, and the valuation and property management of non-sustainable resources for the second. This could include the assessment and proposals of revisions of law 165 of 1964 on municipal management, law 130 of 1963 on local taxations (with a draft revision currently in the parliament) and even law 21 of 2013 on decentralization.

■ **The reform of the framework of municipal functions**

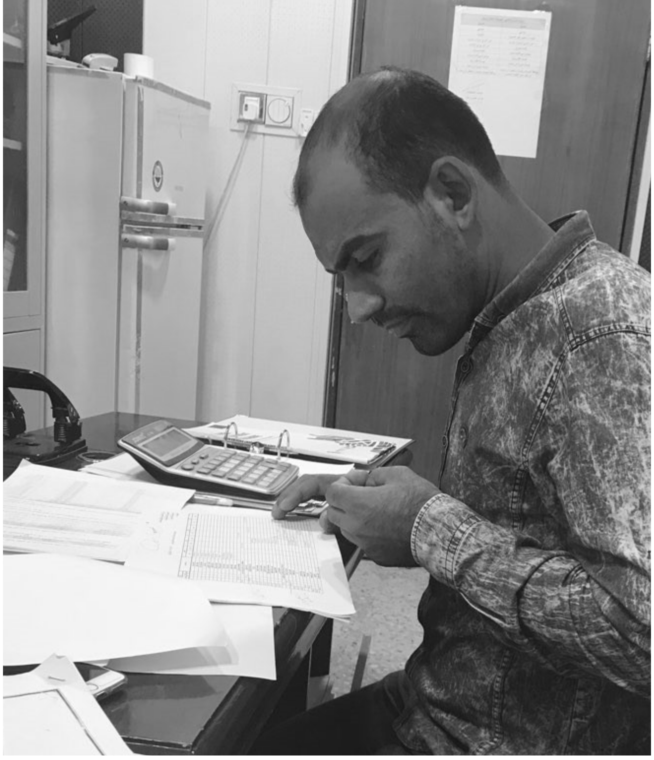
should increase professionalism in financial management and accountability, as well as a strong ownership by municipalities of most of the public services in urban areas and of the urban development management, including the tackling of the issues related to planned urban expansions, informal settlements and poverty.

■ **There is an urgent need to enhance professional accounting management and auditing at the level of municipalities**, as the accounting system of the Iraqi municipalities and its reporting do not comply in most cases with international standards and Iraqi public finance regulations.

■ **Increasing municipal revenues in the present situation appears to be a tremendous task.** The collection of municipal taxes depends on other entities, namely on local water authorities. The municipalities have no proper database of the citizens, households and enterprises. Numerous exemptions are in place. The taxation system is rigid, and local taxation is not differentiated between cities function of their situations and needs (per example for the cities on the Holy shrines' pilgrimage road). In many cases, local taxation revenues rely too strongly on non-sustainable assets (oil, gas, land real estate, etc.).

■ **Citizens perceive public services are generally weak, making difficult any increase in taxation or even a reform of the present public services fees collection system in order to adapt fees to actual consumption (bills of water, of electricity and of waste collection are mostly independent of usage).**
A sound taxation system and a proper management of public services' fees collection and spending, in line with the significant improvement of public services, are essential parts of a sustainable development scheme.

■ **The overall local taxation scheme need to be reformed, in line with the reform of the taxation at the governorates and national levels,** with the implementation of a close collaboration between the municipalities and the other local public institutions providing basic services (electricity, water, etc.) to better serve citizens.



■ **There is a need to develop a base framework of management and coordination between the different public services, in line with international standards and the decentralization acted in the Iraqi constitution.** There are numerous financial difficulties between the municipalities and the governorates and national institutions, including public services utilities. These difficulties concern the coordination and the clarification of responsibilities on investment projects (national level) and on development projects (governorates level). They comprise also issues on the valuation and property transfer of municipal lands and real estates, as well as on the coordination between the different utilities providing public services at the municipal level.

■ **The weakness of the banking sector in Iraq constitutes an impediment for sustainable development in all its aspects.** Most transactions are operated in cash or using paper instruments. This is an essential issue to be tackled with, taking into account the technological innovations (e.g. mobile banking, etc.).

■ **As the number of municipalities is significant, it is important to train "*agents of change*", among young managers, who could accelerate the process of reform.** Most municipalities suffer from the lack of qualified and sufficient human resources. A proper vocational training scheme should be developed increasing qualifications, as well as municipal management curriculum in *administrative high education and training centers*. In particular, such curriculum should be included within the higher education programme planned under LADP in Kufa.

■ **There would be a benefit in promoting the creation of an "*Association of Municipalities*"**, where municipalities could formulate and advocate for common issues with the central authorities. §