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LOCAL REVENUES

Current State and Recommended Course of Action

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SUMMARY

Local Revenues: Current State and Recommended Course of Action deals with revenues at the local levels of administration and attempts to identify potential sources for funding ongoing recurrent costs, particularly the expenditures associated with operations and maintenance activities. After introducing the Egyptian budgetary system for local administration, particularly the current budget, the document briefly summarizes the various sources of revenues earmarked for that budget. The conclusion is that these resources are far too limited to cover projected current expenditures, which in turn, are insufficient to operate and maintain adequately existing rural infrastructure.

Although fiscal autonomy is almost nonexistent at the local administration levels, localities do control and manage a number of special purpose funds. The most important of these, the Local Services and Development Fund (LSDF), enjoys large balances that can be rolled over from year to year. Unfortunately, the resources of these funds tend to be limited, often meager. Additionally, the management of LSDFs tends to be rigid and centralized, so that many resources do not trickle down to village councils as the local administration law stipulates.

Two notable exceptions to this trend are explored in this study: the Fayoum LSDF, with its decentralized financial management structure and the Daqahliya Water and Wastewater Management Fund, which accumulated substantial balances over the five years since its inception. While both models suffer from certain inefficiencies, our study concludes that an alternative model, combining the positive aspects of these two experiences, offers a potential short-run mechanism for local revenue enhancement and improved spending on O&M activities.

For the medium to longer runs, the study recommends devolution of the revenue collection responsibility to, and the retention of the proceeds by, local administrative units. This could be followed by legislations that would enable local administrations to impose fees and other duties without recourse to the central government.

At the end of this document, sample organizational structures for special purpose funds are outlined. In addition to collecting user charges, these structures would be responsible for surveying and inventorying existing infrastructure; developing plans for operation, maintenance and rehabilitation activities; budgeting for OM&R costs; and managing the cash balances of the funds themselves.

TABLE OF CONTENTS

APPENDICES

LIST OF TABLES

Section 1

INTRODUCTION

This study researches sources of revenues generated at the governorate and lower levels of local administration. It also investigates different local fees and charges that could be mobilized and/or enhanced to generate additional funds. Such funds could be used to cover infrastructure operation and maintenance costs, over and above the annual GOE allocations to Bab II line items on the expenditure side of the national budget.

The study was conducted pursuant to Task LG 6.1 of the 1990-1992 LD II-P Work Plan. Activity LG 6 of this work plan calls for assisting local government units in the service delivery area—particularly O&M management, planning, budgeting and financing. Tasks LG 6.1 and LG 6.2 concentrate on exploring alternative sources of funding for local operation and maintenance needs and developing a model for enhancing local revenues for these purposes. The findings of this study will provide USAID officials with background information, in a summarized fashion, on the workings of the local administration current budgeting system. The final product is a set of recommendations for potential courses of action that could be pursued in the short term. A brief overview of medium-term and long-term options for enhancing local revenue mobilization is also provided.

SCOPE OF THE STUDY

This document concerns itself with the revenues serving to finance the recurrent cost budget. It covers the spectrum of locally-collected current revenues—i.e., Bab I and Bab II revenues. Most of the local revenues listed in the 14 line items of these two budgetary groups are collected either locally or allocated to the governorates by the central government. With the exception of the locally-administered special funds, the revenues are neither retained locally nor are their balances rolled over from one fiscal year to the next.

After a brief discussion of the local administration budgetary system in Section 2 of this document, the line items constituting Bab I and Bab II revenue subcategories are fleshed out in Section 3, Local Revenues. Section 4 provides examples of case studies in provincial governorates, examining how they handle so-called special accounts, particularly the Local Services and Development Fund (LSDF). One case study—Fayoum—describes and analyzes decentralized fiscal management developed by the governorate, while the other—Daqahliya—discusses a scheme for increasing local revenues. The Fayoum experience is of particular importance because, thanks to a governorate ordinance, local administrative units (including village councils), have a great deal of autonomy in their LSDF management and face less red tape in disbursing and procuring goods and services.

Section 5 summarizes the conclusions of the study and recommends a short-term course of action that could be pursued by local administrative units. This model is recommended as a means of satisfying the requirements for a pilot cost recovery scheme outlined in the *LD II-P Fourth-Year Planning Guidelines.* Section 5 also suggests certain medium- to long-term options that could be pursued for the purpose of enhancing local revenues and furthering local fiscal autonomy.

METHODOLOGY

This report is based on research carried out in September and October 1990 by the staff of the Local Government Department of Chemonics/Cairo. Parts of Section 3, which deals with local revenues, were extracted from a draft prepared in June 1990 by two public finance advisors. This earlier draft dealt with the rules, regulations, and laws governing various line items of Bab I (taxes) and Bab II (fees and charges) of the revenue side of the national budget at the local level.

The present study relied on numerous primary sources, including official national budgets and fiscal reports, GOE laws and decrees, local ordinances, end-of-year closing accounts at both the national and the local levels, and numerous interviews with local administration officials. Secondary sources include reports and studies prepared under the auspices of USAID and the World Bank as well as selected articles published in the academic press and the mass media.

Section 2

THE LOCAL CURRENT BUDGET

Our discussion of local revenues and the potential for their enhancement presupposes a basic understanding of how revenues and expenditures are classified in the Egyptian budgetary system. The GOE budget categories are commonly referred to as *Abwab* (plural of *Bab*, or chapter). There are four Abwab on the revenue side of the budget equation and another four on the expenditure side. The following is a brief description of the classification system for revenues and their intended uses.

- *Bab I* relates to *sovereign revenues*, and consists of uniform taxes and other standardized duties assessed against personal and corporate income, wealth, and consumption. These are classified as current revenues since they emanate from periodic activities and transactions of a short-term nature, as opposed to capital investment revenues which consist of one-time irregular transactions and longer-term activities and commitments, as in the case of Bab III.

- *Bab II*, or *current revenues*, consists primarily of miscellaneous fees and charges assessed to defray the cost of services provided by the national government or the local administrative units. This budget category includes licensing fees, fiscal stamps and, where no local public utility company exists, the proceeds from water and electricity consumption charges.

- *Bab III* sources are referred to as *capital investment revenues*. They are fed primarily from subsidies in the form of grants from the GOE and foreign donors, as well as from such self-financing proceeds as the sale of assets.

- *Bab IV* is confined exclusively to *public debt*, such as *loans* and *credit facilities* extended to government agencies, public authorities and local administrative units.

The annual GOE budget consist of three documents: the ***current budget***, the ***capital investment budget***, and the ***capital transfer budget***. The current budget is funded through Bab I and Bab II sources. These are dedicated for the financing of current expenditures, primarily government and public sector payroll and other recurrent costs, such as operations and maintenance of infrastructure and rolling stock. Bab III and Bab IV sources are used to finance long-term commitments such as projected expenditures in the capital investment budget, or to retire portions of the public debt, whose maturity is anticipated in the capital transfer budget.

In this section we will focus on the local administration budgeting system. Because of our interest in recurrent cost funding, particular emphasis will be placed on the current budget.

LOCAL-LEVEL BUDGETS

The Local Current Budget

The ***current budget*** at the local administrative level is the financial statement summarizing local current revenues and national appropriations earmarked for on-going government operations and municipal services. In theory, it is financed with locally-collected current revenues (Bab I sovereign taxes and Bab II fees and charges) supplemented with central government subsidies, and used for the civil service payroll (Bab I expenses) and recurrent costs such as operation and maintenance (Bab II expenses). Table 2.1, below, provides an illustration of a typical governorate current budget.

Table 2.1: CURRENT BUDGET FOR FY 1989/1990
Fayoum Governorate

Current Sources	LE 000	Current Uses	LE 000
BAB I SOVEREIGN REVENUES	9,426	BAB I SALARIES	87,835
BAB II CURRENT REVENUES &		BAB II CURRENT EXPENSES	37,973
TRANSFERS EXCLUDING SUBSIDY	35,591		--------
Current Sovereign Subsidy	80,791		

BAB II Sub-Total	116,382		
	....		
TOTAL	125,808	TOTAL	125,808
	======		======

Source: *GOE 1989/1990 Detailed Budget*

Although considerable preparation takes place within governorates, the ultimate responsibility for current budget allocations for local administration lies with service and line ministries in Cairo. Bab I wages and salaries are the responsibility of the Ministry of Administrative Development, while salary increases and new civil service positions are under the central agency for organization and management. Bab II benefits from the input of service ministries. Budget projections and follow up, including the preparation of fiscal end-of-year statements is the responsibility of the Ministry of Finance.

The Capital Investment and Capital Transfer Budgets

As noted earlier, two other budgets govern local government finances: the ***capital investment budget*** and the ***capital transfer budget***. The capital investment budget relates to investments in infrastructure and other fixed assets, both income and non-income generating, that are financed through a variety of local and central sources, including borrowings from domestic and international institutions. Table 2.2, on the following page, illustrates a typical capital investment budget.

Table 2.2: CAPITAL INVESTMENT BUDGET FOR FY 1989/1990
Fayoum Governorate

Sources	LE 000	Uses	LE 000
BAB III CAPITAL REVENUES		BAB III CAPITAL INVESTMENTS	27,636
III.1 Self financing	160		
III.2 Foreign Grants	16,216		
BAB IV LOANS/CREDIT FACILITY			
National Investment Bank	11,260		
TOTAL	27,636		27,636

Source: *GOE 1989/1990 Detailed Budget*

The capital transfer budget concerns itself with debt and interest payments associated with domestic and foreign loans. These expenditures and outlays are funded through:

- Bab III revenues, such as the sale of surplus supplies, government land, and fixed assets
- Bab IV sources, such as transfers from special funds (for example, the housing fund)
- Debt financing from foreign and domestic sources, such as the National Investment Bank.

Table 2.3 provides an example of a capital transfer budget.

Table 2.3: CAPITAL TRANSFER BUDGET FOR FY 1989/1990
Fayoum Governorate

Sources	LE 000	Uses	LE 000
BAB III CAPITAL REVENUES		BAB IV CAPITAL TRANSFERS	1,146
Excess Inventory Sales	20		
Housing Fund	325		
Capital Subsidy	801		
TOTAL	1,146		1,146

Source: *GOE 1989/1990 Detailed Budget*

The Ministry of Planning (MOP) and the National Investment Bank (NIB) have responsibility for Bab III obligation authority, while the Central Bank, an agency of the Ministry of the Economy, is responsible for the allocation of foreign exchange. The MOP and the NIB monitor capital expenditures at the local levels effected through Bab III.

LOCAL CURRENT REVENUES

In the Egyptian context, *local revenues* are defined in terms of the source of taxes, fees, and charges; the level of responsibility for their collection; and the ends to which they are put. The revenues discussed in this section are of interest as the major source of finance for the operations and maintenance requirements of locally-owned and -managed infrastructure projects. It is important to note, however, that the portion of Bab II funds allocated in the current budget to what are conventionallv thought of as O&M requirements (materials, energy, spare parts, and service contracts) comprises only two of the six expenditure line items of Bab II. In FY 1988/89, these O&M costs amounted to only 38 percent of the total Bab II expense budget of the local administrative units.

Both Bab I, sovereign revenues, and Bab II, local current revenues, consist of seven separate revenue sources. Table 2.4 , on the following page, shows these sources, their nationwide FY 1989/90 projected totals, their percent of the total contribution, and their rank according to relative magnitude in the overall budgetary group.

Revenue Sources

While the bases of assessment of some of these items, such as the agricultural or building taxes, are fairly simple, other items, especially those in Bab II, are composed of diverse sources. For example, the special funds (Bab II.7) are composed of five or more individual funds. One of these, the Local Service and Development Fund (LSDF), is itself composed of five different types of revenue. Of these five, "local fees" is composed of 26 different items, including charges on different types of agricultural products, surcharges on water and electricity bills, loans, and agricultural inputs. (See Section 3 for more information about the individual line item sources and the rules and regulations which govern them.)

Revenue Collection & Retention

Most of the local revenues listed in the 14 line items of Bab I and Bab II are either collected locally or allocated to the governorates by the central government. However, with the exception of Bab II.7 (special accounts), these revenues are not usually retained locally.[1] The special accounts, in contrast, are never channelled through the central GOE treasury, but are collected, retained, and managed locally. Also unlike other revenues, the special fund balances are normally rolled over from one year to the next. There are several special accounts at local government levels, the most important of which is the LSDF, whose net balance

[1]Most funds are deposited in the general revenue accounts at the central bank. The governorate withdraws monies from a different central bank account for current expenditures.

exceeded, by some estimates, LE 260 million as of 30 June 1990. These funds belong to the local administrative units and are managed by local boards of directors.

Table 2.4: NATION-WIDE LOCAL REVENUES BUDGET
Classification and Size (FY 1989/1990)

Bab/Subgroup	Projected Proceeds (LE 000,000)	% of Total Contrib.	Rank according to size of contribution
BAB I SOVEREIGN REVENUES			
I.1 Agricultural Land Tax	103.2	22%	3
I.2 Building Tax	25.0	5%	5
I.3 Entertainment Tax	16.9	4%	6
I.4 Motor-Vehicle Fees & Taxes	72.4	16%	4
I.5 Share of Common Revenues*	117.2	26%	1
I.6 Share from Joint Fund*	111.2	24%	2
I.7 Share of taxes on Suez Canal Profits	14.9	3%	7
BAB I TOTAL	460.6	100%	
BAB II CURRENT LOCAL REVENUES			
II.1 Locally Operated Utilities	22.1	5%	5
II.2 Collection/Serv. Directorates	21.3	5%	6
II.3 Local Fees and Charges	37.9	8%	3
II.4 Productive Project Profits	115.8	24%	2
II.5 Quarry Revenues	5.3	1%	7
II.6 Misc. Fees and Charges	29.1	6%	4
II.7 Special Funds**	244.6	51	1
BAB II TOTAL	476.0	100%	
Total Current Revenue Budget	936.6	26%	
Current Budget Sovereign Subsidy	2,670.5	74%	
TOTAL CURRENT REVENUES	3,607.1	100%	

* Mainly import/export taxes and surcharges.
** Includes balances carried forward from prior fiscal years.

Note: Differences in totals due to rounding to the nearest 100,000
Source: *GOE 1989/1990 Budget Summary.*

An important distinction about the collection of revenues is that Bab I tax levies are administered directly by agents of the Ministry of Finance, while the Bab II fees, charges and other non-tax proceeds are often collected by local administrative units and service directorates theoretically under the jurisdiction of the governorate headquarters.

Bab I items—those which are the responsibility of the MOF agencies to collect—are easier to collect than Bab II items, which fall to the local financial affairs departments and service directorates. Bab I agricultural, building, and vehicle registration taxes are collected only once a year; other Bab I items such as the governorate share of the import-export taxes, the Suez Canal governorates' share of the tax on the Canal Authority profits, and the entertainment tax are collected by the MOF or its local agencies throughout the year and then posted to the governorate revenue accounts. Few of the Bab II charges have these collection advantages. Utility charges, for example, must be assessed by visual inspection over a large area on a monthly basis, while a large number of extremely diverse types of fees and charges levied under subgroups 3, 6, and 7 of Bab II are probably regularly evaded with impunity.

Revenue Productivity

The productivity of a revenue item depends largely on its rate, its rate structure, and its ease of collection ratio of actual collections to revenue base. At the present time, local governments have little authority to modify rates. Prime Ministerial Decree No. 1251 of 1988 requires the approvals of the Prime Minister, the Ministry of Local Administration, and the Ministerial Committee on Local Government for any increase in rates. Precise measurement of the efficiency of collection for each revenue source is complicated because most items are composed of a variety of sub-items whose collection is sometimes the responsibility of different offices and because the same office often collects revenues for different line items.

GOE Subsidies

While urban governorates enjoy a fairly substantial tax base and a high share of the common revenues and joint fund budgetary subgroups, the remaining governorates depend to a very large extent on central government subsidies for balancing their accounts. For instance, the governorate of Cairo was scheduled to receive LE 168.2 million in subsidies during FY 1989/1990, an amount representing less than 50 percent of its budgeted current expenditures. In contrast, a rural governorate such as Fayoum was allocated LE 80.8 million during the same fiscal year, which amount constituted approximately 64 percent of the projected Bab I and Bab II expenses.

A COMPARATIVE SUMMARY OF THE LOCAL CURRENT BUDGET

What follows is a brief summary of the actual nation-wide local administration budget for fiscal years 1987/1988, 1988/1989, and 1989/1990. Table 2.5 shows the projected current revenue and cost budget for FY 1989/1990, while Table 2.6 presents a comparison of actual current revenues and expenditures incurred during FY 1987/1988 and FY 1988/1989. Table 2.7 compares amended FY 1988/1989 budget figures with actual revenues, expenditures, and central government subsidies to local administrative units.

Table 2.5: CURRENT BUDGET FOR FY 1989/1990
Summary of Projected Revenues & Expenditures of Local Administrative Units

Revenues	Value (LE 000,000)	% Total	Expenditures	Value (LE 000,000)	% Total
Bab I	461	13%	Bab I	2,995	83%
Bab II	476	13%	Bab II	612	17%
Sovereign Subsidy	2,670	74%			
TOTAL	3,607	100%	TOTAL	3,607	100%

Source: GOE 1989/1990 Detailed Budget.

Table 2.6: CURRENT LOCAL REVENUES AND EXPENDITURES
Actual Closing Accounts for FY 1987/1988 and 1988/1989

Revenues	FY 87/88	FY 88/89	% Variance	Expenditures	FY 87/88	FY 88/89	% Variance
Bab I	228	293	+29	Bab I	2,223	2,651	+19
Bab II	373	476	+28	Bab II	520	665	+28
Sovereign Subsidy	2,142	2,547	+19				
TOTAL	2,743	3,316	+21	TOTAL	[illegible]3	3,316	+21

Source: *GOE 1989/1990 Detailed Budget.*

Table 2.7: CURRENT LOCAL REVENUES AND EXPENDITURES
Projected Versus Actual Performance as of 30 June 1989

Revenues	Amended Budget	Actual Budget	% Variance	Expenditures	Amended Budget	Actual Budget	% Variance
Bab I	399	293	-27	Bab I	2,675	2,651	-1
Bab II	483	476	-1	Bab II	705	665	-6
Sovereign Subsidy	2,498	2,547	+2				
TOTAL	3,380	3,316	-2	TOTAL	3,380	3,316	-2

Source: *GOE 1989/1990 Detailed Budget.*

GOE Subsidies

As shown in Table 2.5, the nationwide current budget for local administration relies heavily on central government subsidies. For 1989/1990, these subsidies amounted to LE 2,670 million, or 74 percent of total local revenues. This is LE 123 million, or almost five percent, above the actual GOE contribution in 1988/1989.

Table 2.7 shows that, according to the local administration closing accounts document released by the Ministry of Finance in March 1990, total current expenditures in the governorates were two percent below the amended FY 1988/1989 projections. However, this had very little impact on the GOE subsidy to that budget due to the fact that Bab I revenues fell short by LE 106 million, or 27 percent of the revised projection of local taxes and common revenues. This, combined with savings in Bab I and Bab II expenditures led to an additional LE 49 million (or two percent) central government contribution to the subsidy line item.

Salaries and Wages

On the expenditure side of the equation, Bab I salaries constitute 83 percent of total current expenditures projected for FY 1989/90, a hefty figure which demonstrates the effect of the wages and salaries bill on the local current budget (see Table 2.5). Tables 2.6 and 2.7, which compare FY 1988/1989 actual revenues and expenditures with the previous year's figures and the amended 1988/1989 budget figures, confirm the trend of increasing salary and wages. The trend is the result of the government's full employment policy for university graduates and the continuing expansion of the local administration bureaucracy. Although they have slowed since the mid-eighties, Bab I costs continue to drain the resources of the central government, invariably exceeding the amount of the sovereign subsidy to the local administrative units. In FY 1989/1990, the wages and salaries budget line item (Bab I expenditures) was projected to exceed the GOE subsidy by LE 325 million (see Table 2.5).

Special Accounts

In FY 1989/1990 the Bab II special accounts, including the LSDF were projected to have a total balance of LE 244.6 million. This amounted to approximately 51 percent of the total Bab II budget allocation, 26 percent of local current revenues, and 7 percent of the total current budget.

O&M Expenditures and Allocations

Total O&M expenditures in FY 1988/1989 (excluding payroll) amounted to nearly 40 percent of Bab II expenditures. In Table 2.6, it is noticeable that while the wages and salaries budget category grew at less than the prevailing inflation rate of 25 percent, Bab II expenditures grew almost on par with it. Even so,this is hardly sufficient to cover operation and maintenance costs considering that (1) O&M allocations were insufficient to start with, and (2) increased O&M expenditure requirements caused by additional infrastructure investment over the past two years are not taken into account.

Urban versus Rural Shares

Urban governorates, with roughly 22 percent of the total population, have obtained slightly below their share, or 18 percent of Bab I local administration expenses in FY 1988/1989, and approximately 29 percent of all Bab II expenditure. Administrative Cairo (i.e., the governorate proper excluding the cities of Giza and Shubra), with 12 percent of Egypt's population, received the largest share of both budgetary categories with LE 250 million (or 9.4 percent) of total Bab I expenses on "local civil service" and approximately LE 97 million (or 14.6 percent) of total Bab II expenses incurred by local administrative units.

On the revenue side, urban governorates collected the lion's share of both sovereign taxes and local fees and charges. The cash inflow of Cairo, Alexandria, Port Said, and Suez from Bab I budget categories amounted to LE 124.2 million, or approximately 42 percent of all sovereign local taxes collected throughout Egypt, owing primarily to their larger tax base and shares from the common revenue allocations and the joint fund. As far as Bab II revenues are concerned, the four urban governorates collected approximately LE 140.7 million or roughly 29 percent of all local fees charged by local government units. Conversely, the 22 rural governorates, with 78 percent of the Egyptian population, received LE 2,142 million in central government assistance to cover their current budget deficit. This subsidy constituted 84 percent of the LE 2,547 million in GOE current budget assistance to local administrative units.

Appendices I and II of this document provide a summary of the current budget final accounts for FY 1988/1989. Section 3 presents an overview of the various budgetary categories constituting Bab I and Bab II of the local administration budget. The special accounts, which constitute a potential instrument for furthering local administration fiscal autonomy in the long run, are discussed in Section 4, which is dedicated to case studies in Daqahliya and Fayoum.

SECTION 3

LOCAL REVENUES

This section describes the revenue line items of Bab I and Bab II of the local administration budget that were introduced in Table 2.4 (see page 7). It aims at identifying the enabling legislation and executive decrees governing their rate structures. Occasional reference will be also made to the administrative procedures and management systems associated with the assessment, collection, and reporting of local administration current taxes and fees.

Following an overview of Bab I, or sovereign taxes, and Bab II, or local current revenues, we will argue that the present system could be improved incrementally by devolving many tax collection responsibilities to local institutions and progressively reducing the central government role in the funding arena to a straight subsidy, linked to some economic, demographic, or other type of formula. This recommendation is based on the premise that, by confining the GOE role to this domain, governorates and lower level administrative units will have an incentive to enhance collections, modify existing rate structures, and mobilize additional resources, thus making local revenues "truly" local.

BAB I: LOCALLY-COLLECTED SOVEREIGN REVENUES

This budget category consists of uniform taxes and other standardized sovereign duties. On the national level it includes such items as income and consumption taxes, custom duties, and miscellaneous fiscal charges. Local-level Bab I revenues consist of a combination of the following:

- Property taxes
- Entertainment and amusement taxes
- Central government reallocation of national revenues, including the joint fund, the governorates' share of common revenues, and the share of the Suez Canal Authority profit tax

The largest share of local Bab I revenues comes from the last category.

As noted in Section 2, local agencies of the central government are responsible for the assessment and collection of these taxes. The monies collected locally revert subsequently from the Ministry of Finance either directly to the governorates or are channeled to them via the MLA general secretariat. The latter, which administers the joint fund, reallocates monies to the governorates on the basis of a formula that considers per capita and perceived needs.

Line Item I.1—The Agricultural Land Tax

The agricultural land tax is based on Public Laws No. 113 of 1939, No. 50 of 1987 and Presidential Decree No. 1652 of 1963.

Assessment of the tax is based on imputed rental income derived through a system of classification of the land by productivity, extent of irrigation, and location. Originally, this assessment was conducted once every ten years and remained fixed for the following decade. Recently, however, the Minister of Finance issued a decree instructing the assessment to be carried out once every five years. An additional change was that land holdings under three feddans are no longer exempt from taxation when the owner has extra sources of revenue (from employment or otherwise).

The agriculture land tax is administered at the governorate level by the real estate taxation administration, an agency of the Ministry of Finance. The tax rate is 14 percent of the assessed rental value plus a 15 percent surtax. Of the amounts collected, 25 percent is reallocated to the governorate headquarters budget and the remainder goes to the budgets of village councils from which the revenues originated.

During FY 1988/1989, the proceeds from the agricultural land tax jumped from LE 37.3 to LE 49.2 million, a 32 percent increase over the previous year that can be attributed primarily to a recent increase in tax assessments. This trend is expected to continue because of the newly-promulgated decree mentioned earlier and the removal of exemptions to small land owners. However, the growth rate is not expected to be as sharp as the one projected in the following two line items.

Line Item I.2—The Buildings Tax

The buildings tax is based on Public Laws No. 56 of 1954, No. 36 of 1966, No. 46 of 1968, and No. 50 of 1981. It is applicable only to commercial and industrial buildings in *cities*. Residential buildings that are rented are considered commercial properties for purposes of this tax. The tax status (commercial, industrial, residential) is determined every two years. The tax rate is currently set at 20 percent of the actual or impute rental income, less an allowance of 20 percent for expenses. Imputed rentals are based on the location, type of building and use.

The buildings tax is administered by the real estate taxation administration of the MOF. Seventy-five percent of the proceeds of the tax are reallocated to the budgets of the cities from which the taxes were collected and the remainder goes to the budget of the governorate headquarters.

The revenues from the tax on commercial buildings experienced a 21 percent increase during FY 1988/1989, from LE 21.9 in FY 1987/1988 to LE 26.6 million as of 30 June 1989, almost double the growth rate attained the previous year. This trend is consistent with the experience of the eighties decade, during which proceeds jumped from LE 5.9 million in FY 1980/1981 to the 1989 value, a four-fold increase in eight years. Although no change in the tax rate took place since

1981, the jump can be explained by the increased urbanization and higher rents charged on new housing.

Line Item I.3—The Entertainment Tax

The entertainment tax is based on Public Laws No. 22 of 1951 and No. 37 of 1978. It is assessed against the exhibition of cinemas, theater and nightclub shows and other amusements. The taxes are levied from individuals at the point of ticket sale by the service provider and remitted with a daily report to a city-based tax collector.

The proceeds from taxes on entertainment and amusement rose from LE 15.2 in FY 1987/1988 to LE 16.9 million during the following year, a rate of 10 percent, slightly less than half the increase experienced the previous year. Over the past decade, the trend has been upward. Indeed, total collections in FY 1980/1981 did not exceed LE 3.5 million. According to the FY 1989/1990 GOE budget figures for local administration, total collections from that line item were expected to exceed LE 16.8 million. However, most of the revenues were to be generated from urban centers, or urbanized governorates. Administrative Cairo alone, for instance, was scheduled to contribute LE 10.5 million, or 62 percent of total projected proceeds. This was followed by Alexandria with LE 3.1 million (18 percent of total), and Giza governorate with LE 2.1 million (12 percent), most of which to be generated in the city of Giza.

Line Item I.4—Motor Vehicle Tax & Driving License Fees

The taxes on automobile registration and driving license fees are based on Public Laws No. 66 of 1973, No. 78 of 1976 and No. 210 of 1980. The rate structures and fee schedules are approved by the Peoples' Assembly. They are administered at the local levels by the traffic directorate, a line agency of the Ministry of the Interior, and the proceeds revert directly to the GOE treasury.

During FY 1988/1989, net proceeds from this line item experienced a drop of almost one percent, a rather surprising occurrence given the continuous population growth and the increases in numbers of transportation vehicles. The GOE local administration budget for FY 1989/1990 predicted an increase in motor vehicle and driving license collections from LE 67.2 to LE 72.4 million, or almost eight percent; almost 60 percent of anticipated revenues are expected to be generated within the governorate of Cairo.

Line Item I.5—Local Share of Common Revenues/Line Item I.6—Local Share of the Joint Fund

These line items are based on the rules and regulations of Article 35 of Public Law No. 43 of 1979, as amended by Public Law No. 50 of 1981, and regulated by MOF Decrees No. 317 of 1982 and No. 130 of 1987, which provide for two percent of the revenue derived from the following taxes to be reallocated to the governorates as local revenues:

- Import duties and export taxes
- Taxes on investment security holdings
- Taxes on cigarettes and tobacco products
- Profit taxes of commercial and industrial concerns

The proceeds are allocated as follows:

- Line Item I.5—The first half of the amount collected is prorated among the governorates in which the taxes and duties are collected.
- Line Item I.6—The other half is turned over to the MLA administered joint fund, which reallocates it among among all governorates (Cairo and Alexandria being excepted), according to a formula based on demographic data, geographic area,and perceived socioeconomic need. Occasionally, certain balances of this fund are reserved by the MLA for contingencies.

The import/export tax is collected by the MOF customs and duties administration. The other taxes are collected by the ministry's general taxation administration.

Proceeds from the common revenues and the joint fund line items have been almost flat since 1980/1981, and have dropped substantially in real terms. This trend can be partially explained by the fact that, since 1985, import restrictions on luxury items have led to the development of a local light industry (e.g., clothing, cosmetics, canned goods, household electronics, etc.) which has diminished the dependence of Egypt on foreign sources.

The GOE budget for local administration anticipated that each of these line items will exceed LE 110 million during FY 1989/1990, or almost double the amounts actually collected during the preceding fiscal year, a rather surprising claim, since no major rate overhaul took place in the recent past.

Line Item I.7—Share of the Suez Canal Authority Profits

The local share of the tax on Suez Canal Authority profits is based on MOF Decree 17 of 1982. This share corresponds to two percent of the national tax imposed on the Authority's profits, which is fixed at 38 percent of net income. Proceeds of the local share are distributed to the governorates of Port Said, Ismailia, Suez, North Sinai and South Sinai.

The tax is collected by the MOF and the two percent share is forwarded to the MLA for distribution to the beneficiary governorates.

The revenues from this line item are highly elastic and depend on the volume of traffic through the Suez Canal, the rates charged on users, and the expenses of the authority for operations, maintenance, and expansion of the waterway. The share of the five governorates bordering the canal from the tax imposed on the Authority's profits has experienced almost a four-fold increase since FY 1980/1981. For reasons unknown to us, the GOE FY 1989/1990 budget for local administration projected a drop of LE 7.6 million below 1989/1990 actual proceeds, a decrease of 34 percent. With the recent events the Persian Gulf and the subsequent slow down in traffic through the canal, the profits of the Authority, and therefore the beneficiary governorates' share of the tax, are expected to fall during FY 1990/1991.

BAB II: LOCAL CURRENT REVENUES

This budget category applies to fees, charges, and miscellaneous levies collected by local administration institutions. These revenues are destined to partially or completely offset the cost of providing certain municipal services or to be used as a means for regulating and licensing of certain activities. Unlike sovereign revenues collected at the local administrative levels, the local current revenues are collected by agents of the local administrative units or generated from fees assessed by service directorates.

The specific rates for most Bab II revenue items are set nationally. MLA Decree No. 239 of 1971 establishes the rate for the majority of them. This decree was amended recently by a prime ministerial decree (No. 870 of 8 July 1990), which require the tripling of the fees and charges set forth in MLA decree 239/1971.

With the exception of line item II.7, which relates to special accounts maintained by governorates, cities, and sometimes village councils, all revenues generated under Bab II revert to the central treasury where they are earmarked for a particular governorate's budget. In the case of the special accounts, particularly the LSDFs, the monies are managed and controlled by the governorates and the lower levels of local administration.

Line Item II.1—Revenues from Locally-Operated Utilities

Utility revenues include charges for water consumption, wastewater and septage removal, and, when power generating facilities are owned by the local units, for electrical consumption. The water charges are based on national water tariffs as shown in Table 3.1 on the following page, and other schedules.

Water charges are collected by city and village bursars. These rates recognize different types of users and provide for metered and flat rate usage water consumption charges.

Septage collection charges are also established by the national water tariff and are presented as a 10 percent surcharge on the water charges. In areas not served by sewers a septage removal fee is applied. Cities and villages collect these charges in the same way as water charges. Sewer connection fees are similarly established in accordance with the national tariffs: a one-time sewer hookup fee is charged for connecting the buildings to the sewer system.

After experiencing a phenomenal growth between 1980 and 1985, public utility fees slowed somewhat, starding presently at LE 25.4 million. Utility charges, particularly on water consumption, are far too modest, ranging in FY 1989/1990 from 6.5 piasters per cubic meter in the case of small household consumers, to 35 piasters in the case of large commercial concerns and tourist establishments. Estimates of cost of production per cubic meter range from 45 piasters to 65 piasters. It is not clear to us whether or not these last figures include depreciation charges against capital investments.

In accordance with a decision of the GOE's Higher Policy Committee taken on 22 December 1987, water tariffs were to rise annually by up to 10 piasters per cubic meter until FY 1991/1992. As a result, water consumption charges are expected to rise during FY 1990/1991 for the third year in a row, and again in FY 1991/1992.[2]

Table 3.1
NATIONAL WATER CONSUMPTION TARIFF RATES

Consumer Category	Rates (piasters/m³) (1989/1990)	Rates (piasters/m³) (1991/1992)
Residential		
• Domestic < 20 m^3	6.5	8.5
> 20 m^3	8.0	10.0
• Construction	19.0	25.0
Service		
• Mosques, churches, sports clubs	5.5	7.5
• Embassies, public restaurants, youth centers	8.0	10.0
• Coffee shops, gas stations, private schools	13.0	18.0
• Large factories (pipelines > 30 m^3)	19.0	25.0
Productive Use/Investment		
• Tourism/hotels	35.0	45.0
• Investment companies/free zones	35.0	45.0
Raw Water	10.0	12.0
Other Non-Residential		
• Government factories	13.0	18.0
• Local Admin. Units	8.0	10.0
Flat Rates/Unmetered Households		
• 1 Room/month	55.0	75.0
• 2 Rooms/month	65.0	90.0
• 3 Rooms/month	80.0	120.0
• > 3 Rooms/month	110.0	150.0

Based on the GOE's Higher Policy Committee decision of 22 December 1987.

[2]In January 1984, the GOE and USAID signed a memorandum of understanding related to "certain management and administrative actions [that need to be undertaken] to strengthen Egyptian water and wastewater institutions." The MOU covered several issues pertaining to institutional development and management of the sectors and recognized the need for increasing tariffs "to cover the cost of water and wastewater operations, maintenance service, and routine improvements, as well as appropriate increases by the GOE of operations, maintenance, and investment budgets provided to fund the sector." This was followed in 1985 by the issuance by the GOE of guidance for tariff increases to cover the entire costs of operations and maintenance of water service delivery systems and 50 percent of those of wastewater management systems by 1991.

Line Item II.2—Service Directorate Fees

Public Laws No. 124 of 1960, No. 52 of 1975, and No. 43 of 1979 govern the service directorate fees and charges.

Twelve national service ministries have governorate-level directorates. These directorates provide a variety of services to local residents for which fees or user charges are collected. Registration fees at educational institutions, nominal fees at public health clinics, and charges for veterinary services exemplify the types of services and charges included Fees and rates are determined by the GOE; receipts are collected by the finance unit of the service directorate and channeled to the MOF where they are credited to the governorate revenue accounts.

The majority of the revenues emanate from the governorate directorates of education and public health; however the total proceeds from this line item amount to only 10 percent of the local operational budgets of the service directorates. During the past ten years (FY 1980/81 - FY 1988/1989), these revenues experienced an average increase of less than nine percent per year. The GOE budget for local administration anticipated that these revenues will remain flat during FY 1989/1990.

Line Item II.3—Revenues & Fees of a Local Nature

According to Public Laws No. 50 of 1981 and No. 145 of 1988, and MLA Decree No. 239 of 1971 as recently amended by Prime Ministerial Decree 870 of 1990, local administrative units are authorized to tax, license, and regulate economic activity through fees and charges imposed on local individuals, commercial and industrial enterprises. Allowable rates were defined in decree 239, and recently tripled as a result of the prime ministerial decree.

The principal revenues in this line item are the annual licensing fees for commercial, industrial, and sports establishments. These fees are based on size and economic vitality as assessed by visual inspection of the premises. They range from LE 1 per year in the case of small merchants, to LE 200 per year for commercial establishments such as holding companies and limited partnerships. Other fees and charges derived from MLA decree 239/1971 include levies assessed on agricultural and industrial production, property fees on ownership of industrial materials and machinery, licenses on carriages and draft animals, and charges on use of slaughterhouses.

This budgetary subgroup, which experienced a healthy growth during the second half of the last decade, reached a high in FY 1988/1989 and was expected to remain flat at LE 37.9 million during the following fiscal year according to the 1989/1990 budget. However, all the rates in this line item, except for fees imposed on fishing boats, have been recently tripled and are in process of being implemented. We can therefore expect a marked increase in the revenues of this line item during FY 1990/1991.

Line Item II.4 - Income from Productive Projects

The projects that support this line item are often funded through Bab III, which is administered by the Ministry of Planning, or through grants from foreign donors.[3] Most of the projects tend to be in the food production area (commonly referred to as food security projects). They are locally controlled and managed, as opposed to similar projects which are often managed by public sector companies under the direct supervision of a central ministry.

The source of revenue is governed by Public Laws No. 52 of 1975, No. 43 of 1979 and No. 145 of 1988.

The revenue figures from this line item are misleading. While the closing accounts of the GOE show a consistent increase in revenues, we discovered that a substantial component of this item is in the form of interest-free advances from the central government or straight GOE subsidies meant to help these projects achieve their projected profit margins.

Line Item II.5—Quarry (Mining) Revenues

These revenues emanate from the fees and sale proceeds of sand and gravel extracted from governorate-owned quarries and excavation pits. They are based on MLA Decree No. 239 of 1971 and are collected by the governorate from individuals or entities with concessions or franchises to remove materials from public lands. Total receipts are allocated as follows:

- 40 percent to the governorate LSDF
- 20 percent to marakez LSDFs
- 10 percent to city or village LSDFs
- 10 percent to city or village LSDFs, earmarked for local personnel incentives
- 20 percent to the governorate current budget, as a revenue source for line item II.5.

Line Item II.6—Miscellaneous Revenues

These are various proceeds not specifically mentioned in enabling legislation and/or executive decrees. They include the following sources:

- Various locally-assessed fees and charges
- Interest earnings
- Cancellation of uncashed checks

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[3] There is often some confusion about this source of revenue and that emanating from income-generating projects funded through, and feeding into, the LSDF. See Line Item II.7 for a discussion of the latter.

- Unclaimed deposits by citizens and businesses
- Payments made by citizens for fixing public property they have damaged
- Percentage commissions on the sale of trade union and professional association stamps
- Proceeds of the sale of certain goods granted by foreign donors
- Savings on the wages of governorate personnel drafted by the armed forces
- Penalties assessed on civil servants

The revenues generated through this line item have experienced a healthy growth in the past decade, jumping from LE 9.3 million during FY 1980/1981 to LE 44.6 million at the close of FY 1988/1989. The growth is attributable mainly to the increase in economic activity during the last decade, and is expected to benefit from the prevailing positive climate towards local resources mobilization.

Line Item II.7—Special Funds

This budgetary subgroup is the most important, in our view, from the perspective of local fiscal autonomy and control of revenues and expenditures. Although classified as a current revenue line item, the annual allocation is in reality a cumulative balance of funds rolled over from prior years, to which current year revenues are added and from which expenditures incurred during the same year are subtracted. These expenditures may or not be related to recurrent costs, as in the case of Bab I and Bab II expenses. Indeed, most of the outflow from these funds tends to be for further capital expenditures, such as infrastructure investments and income-generating projects. These revenues and expenses often consist of extra-budget activities.

The most important among these special funds is the Local Services and Development Fund (LSDF), which as noted earlier, consists mainly of revenues raised and controlled locally, and physically located at all levels of local administration.

The Local Services and Development Fund. The LSDF is established in accordance with Public Law No. 52 of 1975, as amended by Public Law No. 145 of 1988. It is also governed by the rules and regulations set forth in MLA Decree No. 8 of 1976, which sets the sources of revenues and rates of fees and charges which can be imposed. These include at the governorate level:

- Special fees approved by the popular council that fall within the limits established by the decree (see Table 3.2, on the following page).
- Profits from income generating projects.
- Voluntary contributions.

Markaz-level LSDFs, which tend to be less prevalent, and city-based funds include similar sources. However, the city funds also draw revenues from rents on housing property financed by the funds and fees assessed against the profits of cooperative associations.

Table 3.2
SPECIAL FEES AND CHARGES LEVIED FOR
THE LOCAL SERVICES AND DEVELOPMENT FUNDS
(In Milliemes: LE 1 = 1000 Milliemes)

Item	Maximum Rate	Unit	Payor
Cotton	100	Qentar	Producer
Rice	100	Dariba	Producer
Onions	10	Qentar	Producer
Sugar cane	1	Qentar	Producer
Peanuts	50	Irdab	Producer
Beans	50	Irdab	Producer
Sesame	100	Irdab	Producer
Vegetables	500	Feddan	Producer
Fruit gardens	1,000	Feddan	Producer
Desert trees	20	Per tree	Producer
Potatoes	100	Ton	Producer
Medical & Perfume plants	1,000	Feddan	Producer
Fertilizers & fodder from cotton seeds	1	Kilogram	Consumer
Poultry and cattle fodder	0.5%/cost	Kilogram	Produce
Agricultural credit	0.5%/cost	Loan amount	Debtor
Beehives	10-20/year	Per beehive	Producer
Pigeon towers	500	Per tower	Producer
Cattle fattening	1,000	Per stable (> 5 heads)	Producer
Fish	10	Kilogram	Producer
Water & electricity	10	Per bill	Consumer
Hotel residence	2 %	Value of bill	Resident
Cinema tickets	10-20	Admission ticket	Spectator

Source: Adapted from the schedule accompanying MLA Decree 8 of 1976.

MLA Decree 8/1976 stipulates that village-specific LSDFs are entitled to 75 percent of all the fees collected, pursuant to rates in Table 3.2, within their jurisdiction. These revenues are to be supplemented with profits from income-generating projects, proceeds of sales and/or rental income of housing units financed through the LSDFs, a share of the profits of local cooperatives, voluntary contributions, and foreign grants.

Purpose of the LSDF. The LSDF aims at giving local administrative units access to resources beyond those centrally allocated for local administration purposes by the national budget, and at providing these units with a flexible mechanism for using locally-generated funds. Since 1975, governorates have managed to generate considerable balances through this fund, which in turn, have financed a large number of development projects. Beginning in the mid-eighties, the LSDF has played an important role in funding local infrastructure projects sponsored by the Local Development II Program, by contributing at least five percent to the capital investment requirements.

Sources of Revenue for the LSDF. The largest component of the LSDF is presently the surplus rolled over from year to year. As of 30 July 1989, total national balances in the special accounts amounted to LE 249.7 million, with the LSDFs accounting for about 80 percent of the total.

The second largest source of LSDF revenues is local fees, followed by profits from income-generating projects. The latter account for approximately 20 percent of total sources and emanate from the profits of income-generating projects managed and staffed by the local administrative units.[4]. In some cases the governorate LSDFs invest in income-generating projects which they do not manage, or in industrial and financial enterprises, by buying shares and assuming an equity position. Daqahliya, for instance, is a major shareholder of the Daqahliya National Bank for Development[5] and is represented on its board of directors.

A recent presidential directive has instructed governorates to divest themselves from income-generating projects. Although some sales did take place, we detected resistance to the directive, particularly among mid-level local officials who supplement their income by incentives they receive for their contribution in the management of such projects. There is also concern that a rush for divestiture, without sufficient planning, combined with limited demand, may lead to a "fire" sale. This would result in a rise in prices of goods and services provided by these projects, and a permanent loss of an important source of discretionary revenues to the local administrative units. Preliminary feedback indicates that the divestiture is proceeding at a slow pace.

In addition to the sources and uses of LSDF revenues outlined in MLA Decree 8/1976, Ministerial Decree No. 578 of 1986 authorizes the establishment of special-purpose LSDF sub-accounts. These sub-accounts were supposed to be of a temporary nature and were to be fed from local popular contributions. It is our understanding that such sub-accounts were indeed opened in conjunction with, and to supplement the allocations to, some LD II-P subprojects. However, the mechanism offers no permanent means of funding and should be replaced by more reliable and consistent income sources.

Further discussion of the LSDF is provided in Section 4, which deals with case studies concerning LSDFs in Daqahliya and Fayoum.

Other Locally-Managed Special Funds. Besides LSDF, there are at least five other funds that are locally managed and controlled. These include the following:

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[4]Unlike the income-generating projects associated with Line Item II.4, these projects are not funded through Bab III.

[5] Not to be confused with the National Bank for Agricultural Development and Credit.

- ***The Housing Fund,*** which aims at providing low-income shelter in the local administrative units. It is sourced from the sale of vacant lands, rental income from locally-owned housing projects and government land, voluntary contributions, and other investments effected by that fund.
- ***The Educational Buildings Fund*** is actually quite centralized. While the revenues are collected and ultimately used locally, the fund is managed in Cairo. It is sourced from 10 percent of the nation-wide LSDF proceeds.
- ***The Hospital Services Improvement Fund*** is funded from fees imposed on patients and visitors. The rates differ from one hospital to another;
- ***The Sanitation Fund*** is destined to clean the streets in the cities and improve their appearance. Its proceeds consist of two percent of housing rental charges.
- ***The Roads Fund,*** which is maintained at the governorate seat, aims at improving and expanding the local roads network. It is funded primarily from the gasoline tax. The Ministry of Petroleum transfers the governorates' share to the MLA which, in turn forwards them to their ultimate beneficiaries. [6]

The importance of the special purpose funds, from a decentralization perspective, lies in the fact that they provide a tested medium of local revenue generation and expenditure funding. Such funds, or similarly designed instruments, can be enhanced and replicated successfully for other purposes with a minimum amount of legislative and administrative complications. Furthermore, the combination of such a revenue generation mechanism with decentralized accounts management and control could provide local government units, particularly village councils, with additional resources to supplement the meager Bab II allowances earmarked by the GOE for the operation and maintenance of village infrastructures (see discussion of the Fayoum model in Section 4). Although the exact budgetary requirements for such an endeavor and for cost recovery schemes have yet to be determined, the expansion of the local revenue base and control over them would definitely have a positive impact on village service delivery systems.

DECENTRALIZING LOCAL REVENUE COLLECTION

The existing system for local revenue assessment, collection and subsequent disbursement on expenditure is both quite cumbersome administratively and from a cash management point of view. For one thing, there is no correspondence between current revenues and expenditures. The need for additional revenues to balance the local administration budget is satisfied by a

[6] Although this governorate-based fund will not be explored any further in this study, it is our view that the potential increase of this revenue source should be pursued as an objective for expanding the O&M budget for roads. Section 5 of this study recommends the establishment of markaz-level road funds sourced from fees collected on locally-registered motor vehicles.

GOE infusion of sovereign subsidies which, although limited and barely sufficient to cover essential recurrent costs such as O&M, give no incentives to local officials to control expenses or raise revenues.

As noted, most revenues are either collected directly by local agencies of the GOE, in the case of Bab I, or indirectly, as in the case of line items II.1 through II.6. In both cases, locally-collected funds, after deduction of governorate LSDF share, revert to the central treasury. This lack of control and inability to retain fees and charges, combined with the assurance of a balanced budget thanks to GOE subsidies, further diminishes the governorates' incentive to improve the productivity and efficacy of the collection system.

An intermediate-term solution to this problem, which deserves further investigation, would consist of progressively moving the responsibility of local budget preparation from the Ministry of Finance to the governorate and assigning the latter with the responsibility of collecting locally-generated taxes, fees and charges. This would permit local institutions and service directorates to develop their own operational budgets, determine (within a certain margin) certain tax rates and fees, and retain the funds generated through these media. Such a transfer of responsibility would also permit local administrative units to access the credit markets. In the longer run, if such a system were implemented, governorates, cities, and possibly village councils may be granted the authority to issue short-term debt instruments in anticipation of forthcoming revenues. This will not only pressure the locality to enhance collections, but will also allow them to defray certain costs when expenditures need to be effected or in emergency cases.

The role of the central government in such an environment would be confined to a subsidy consisting of the governorate's share of certain current national revenues (e.g., custom, taxes on wealth, and security holdings) according to a formula for redistribution. This formula may be based on demographics, contributions to national revenues, a matching system to locally generated revenues, and so on, or a combination of the above. This and other options and recommendations will be amplified in Section 5, and will be the subject of further investigation under Task LG 6.2 of the Chemonics' Work Plan. The remainder of this report will concentrate on current and proposed models for enhancing the revenues and management of special purpose funds at the local level.

Section 4

TWO CASE STUDIES IN LOCAL FINANCIAL ADMINISTRATION

Special accounts are managed in a similar fashion among rural governorates. Despite the legislation that authorizes monies to be kept at lower local administration levels, including village councils, LSDF balances are seldom maintained there. In many instances, governorates keep most of the funds in their own LSDF accounts and never reallocate the village councils' share. Many fees and charges normally feeding into the village-based LSDF accounts are retained at the governorate level and never forwarded to the villages. As a result, village LSDF balances are very meager, often not exceeding few hundred pounds. Village councils with relatively large balances owe their fortunes to profitable locally-owned income-generating projects.

Village council access to LSDF accounts tends to be somewhat difficult because of the limited authority of village officials to disburse monies without markaz permission. In most cases, village chiefs must have their checks countersigned by a markaz financial officer before disbursement, a lengthy process which requires travel to the markaz capital, justification, and other clearances. Fayoum Governorate is an exception to this rule; village councils there have been given authority by gubernatorial decree to issue LSDF-related checks without recourse to the markaz financial department.

Another exception is found in Gharbiya, where a number of village-level accounting units accredited by the Ministry of Finance were established in the early eighties, and ten pilot units are presently operational. Repeated attempts to replicate such an experiment since 1984 in other governorates have not been fruitful owing to MOF resistance to expansion. This resistance was largely due to a lack of qualified personnel and funding.

LOCAL RESOURCE MOBILIZATION

Few governorates have gone beyond the revenue sources and rates outlined in MLA Decree No. 8 of 1976 to increase their LSDF or other special accounts. This trend is changing presently, particularly after the issuance of Prime Ministerial Decree No. 870 of 1990. In this decree governorates were instructed to raise Bab II fees and charges, previously outlined in Decree No. 239 of 1971 issued by the then minister of local administration, by up to 200 percent. However, the impact of decree 870/1990 on LSDF revenues is indirect because the rate increase primarily affects Bab II revenues which revert to the central treasury. Nonetheless, some governorates have interpreted this decree as an indication of the central government's willingness to tolerate rate changes for fees and charges collected for the LSDF as well as other Bab II revenues.

Three lower Egypt governorates have adopted non-conforming practices and changed rate structures at the local level. These are reflected in the water and wastewater management fund in Daqahliya; the Sharqiya road fund, which charges predetermined fees on vehicles registered in that governorate; and the cost recovery scheme for sewerage projects instituted by Damietta governorate to help defray the on-going operations and maintenance costs of certain village sewerage systems and treatment plants.

AN EXAMINATION OF TWO MODELS: FAYOUM & DAQAHLIYA

In this section, we will examine the practices of two governorates which have gone beyond the standard (rigid) operating procedures.[7] First, we will describe the experience of Fayoum in their management of the LSDF. In this governorate, thanks to the decentralization of the fund's accounting, village councils are enjoying substantial flexibility in their management of funds, particularly procurement and disbursement. The experience of Fayoum is of particular interest to the objectives of LRM because it offers a mechanism for local asset and liability management that bypasses the rigidity of the practices dictated by MOF rules, without violating the spirit of the regulations. Unfortunately, the resources feeding into the Fayoum village LSDFs are limited, despite the fact that the governorate *does* allocate a share of the LSDF revenues to village council funds.

We will also review the experience of Daqahliya's water and wastewater management fund, an initiative started five years ago. This fund has led to a marked increase of governorate revenues specifically earmarked for the upgrade of water and wastewater management systems. However, while its revenue collection system appears to be quite efficient, the fund's management is extremely rigid. As a result, its disbursement rate is very low, averaging less than 15 percent since its inception in 1985.

The experiences of Daqahliya and Fayoum are of interest to local resource management in the short run because they offer realistic, tested, and accepted solutions for enhancing local revenues and achieving greater fiscal autonomy at the lowest levels of local administration. These experiences could form the basis for a combined model that could be replicated with minimal effort once accepted by other governorates' executives and adopted by their popular councils. The model could also fulfill the requirements of the fourth-year planning guidelines for the establishment of cost recovery schemes for projects funded through the Local Development Program.

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[7]The Damietta experiment is noted briefly only for comparative purposes. Further details can be found in other Chemonics publications prepared by the environmental engineering group. The Sharqiya experiment has not been investigated due to deadline limitations. It is our impression, however, that the working of the fund is very similar to that of Daqahliya, although Chemonics advisors have indicated that Sharqiya has been quite effective in the use of the monies collected through that medium.

From a legal point of view, governorates remain restricted as far as sourcing their LSDF accounts. Article 1 of Decree No. 8 of 1976 stipulates that the revenues of these funds are in part funded by the fees imposed by governorate, city and markaz popular councils "for the purpose of the said account... within the limits mentioned in the schedule appended [to the text of this decree]." The schedule, shown in Table 3.2 (p. 21), shows the allowable sources of revenue. New sources can be added, but are subject to 1) approval of the governorate-wide popular council, and 2) GOE cabinet approval. Until these approvals are obtained, any new charges or increases in existing rates made by a local administrative unit may be legally contested. While such a "confrontation" did occur in the mid-eighties in the governorate of Assyout and led to the elimination of the surtax on land earmarked for road projects and maintenance, the experiments in Daqahliya, Damietta and Sharqiya continue unchallenged.

The Fayoum LSDF Administration

The governorate of Fayoum's interpretation of MLA Decree No. 8 of 1976 is one of the least stringent that we have encountered. Sources of funding are basically the same as those shown in Table 3.2, which govern LSDF accounts pursuant to MLA decree 8/1976. In the administration of the LSDF accounts, however, Fayoum diverged from the practices prevailing among Egyptian village councils. Unlike other governorates, where village council disbursement of LSDF monies requires a second signature by MOF representatives, the Fayoum system is quite decentralized by Egyptian standards.

In 1980, the governor of Fayoum issued decree 421, in which he amended the rules and regulations governing the management and administration of LSDFs at all levels of local administration. The objectives of the LSDF were defined intentionally in very broad terms to give maximum flexibility to local administrative units in using these funds.

According to the gubernatorial decree, the management of the affairs of the village council LSDF accounts is left entirely to a *village-based board of directors* headed by the executive council chairman. The other members include the council's secretary, and one representative from each of departments of social affairs, agriculture, and the local branch of the Bank of Development and Agricultural Credit. The head of the village development accounting unit acts as the rapporteur/secretary of the board of directors. The board is responsible for overseeing the fund and outlining the policy to be followed in the administration of its assets.

In addition to management of the LSDF, the board has the authority to raise revenues beyond those stipulated in the enabling decree, subject to ratification by the village and governorate popular councils. It was not clear during our investigation whether this prerogative has ever been exercised.

The village LSDF accounts in Fayoum are maintained by a *local unit financial affairs department*, headed by a chief accountant who holds a bachelor of commerce degree or some equivalent certification. The chief is assisted by a bursar, a bookkeeper, an auditor, a storekeeper, and a personnel affairs clerk.

In Fayoum Governorate, LSDF monies, as well as those of LD II-P (and BVS prior to that) are disbursed by the village based financial affairs department.[8] The checks normally require two signatures: that of the executive village chief and that of the chief accountant. Signing authority is restricted, however, by Public Law No. 9, which sets the limits at LE 20,000 for directors general (the official rank of the village executive chief). Amounts between LE 20,000 and LE 50,000 require markaz chief approval, while higher amounts need governorate secretary general countersignature. The accounts are audited annually by a markaz-level audit committee and are subject to the auditing procedures of the GOE, including submission of books to the central auditing agency.

Despite these limitations, the Fayoum system has at least four distinct advantages:

- The village councils enjoy a great deal of autonomy when it comes to day to day management of their fiscal affairs.
- Emergency repairs are handled locally, without markaz intervention and lengthy disbursement procedures and other red tape.
- Expenditure patterns are not governed by the rigidity of Bab II expense allocations.
- The village council executive staff feels less patronized and the system implies a greater deal of trust in the intellectual capacity and the integrity of village -evel officials.

We also think the relative decentralization of the LSDF administration in Fayoum makes the village staff more responsive to local needs and reduces the tendency of aiming to please higher officials at the markaz and the governorate levels.

Unfortunately, fiscal management flexibility and decentralized financial responsibility have not been accompanied by an increase in the local resources at the disposal of the various levels of local administration. As shown in Table 4.1 on the following page, LSDF balances have fluctuated within a narrow margin over the past five years after plummeting by 39 percent in FY 1986/1987 due a substantial drop in revenues that year. By the end of FY 1989/1990, balances were actually LE 109 thousand, or nine percent less than those accumulated five years earlier. The net proceeds during the last fiscal year were only LE 561 thousand, about 37 percent lower than those collected in FY 1985/1986.

Table 4.1 also shows that investments in productive projects have decreased noticeably, dropping by more than 75 percent during the period under consideration. Investments in infrastructure and services, on the other hand, experienced an exponential growth, rising from LE 226 thousand in FY 1985/1986 to LE 705 thousand in FY 1989/1990, after peaking at LE 840 thousand the previous year.

[8]This is in contrast to regular GOE accounts related to Bab I, Bab II and Bab III, which continue to be closely managed by the markaz finance department with disbursements countersigned by MOF accredited personnel.

Table 4.1: REVENUE & EXPENDITURE TRENDS
Local Services and Development Account
Condensed Funds Flow Statement (1985-1990)
Fayoum Governorate
(LE 000)

Fiscal Year	1985/ 1986	% Growth	1986/ 1987	% Growth	1987/ 1988	% Growth	1988/ 1989	% Growth	1989/ 1990	% Growth
Sources										
Prior balance	244	-	156	-36.0%	335	114.9%	354	5.5%	459	29.9%
Current balance	886	-	533	-39.8%	975	82.8%	985	1.0%	561	-43.0%
Total Available Resources	1,130	-	689	-39.0%	1,310	90.1%	1,339	2.2%	1,020	-23.8%
Uses										
Income-Gen. Proj.	748	-	60	-91.9%	289	379.1%	39	-86.4%	180	359.4%
Infrastructure & Serv.	226	-	294	30.1%	667	127.2%	840	25.9%	705	-16.1%
Total Uses	974	-	354	-63.6%	956	170.1%	879	-8.1%	885	0.7%
Balance Carried Forward	156	-	335	114.9%	354	5.5%	460	29.9%	135	-70.6%

Source: Governorate Finance Department, data as of end of FY 1989-1990 (30 June 1990).

The Fayoum Governorate finance department expects balances in FY 1990/1991 to exceed LE 1.4 million, about 37 percent above FY 1989/1990 balances.[9] Nevertheless, the long-term trend appears to be downward because of increased pressure by the central government for the sale of locally-owned income-generating projects.

The Daqahliya Water and Wastewater Management Fund

While the expenditures of the governorate of Fayoum averaged almost 74 percent of available annual balances in their LSDF over the past five years, the Daqahliya spending average from LSDF balances was well below half that ratio. Fluctuating between 20 percent in 1987/1988 and 45 percent in the following year, the governorate of Daqahliya spent, on average, not more than 32 percent of its available annual balances since FY 1985/1986. Over the same period, Daqahliya spent almost LE 3.8 million on capital investments (including LD II-P funded subprojects), LE 3.6 million on recurrent costs, and about LE 640 thousand on administrative expenses.

On the sources side of the LSDF funds flow statement, Table 4.2 shows that the current proceeds from fees and income from productive projects has been relatively flat over the five-year period, fluctuating within a narrow range of less

[9] This is the result of anticipated proceeds from quarries of approximately LE 1.1 million compared to LE 318 thousand during the previous fiscal year.

than half a million. This is partially explained by the fact that certain investments (for example the governorate's equity position in the Daqahliya National Development Bank) have performed poorly. A more important reason, however, is that Daqahliya has been diverting some of the potential sources of income to another governorate-managed account, the Water and Wastewater Management Fund (WWF).

Table 4.2: REVENUE & EXPENDITURE TRENDS
Local Services and Development Account
Condensed Funds Flow Statement (1985-1990)
Daqahliya Governorate
(LE 000)

Fiscal Year	1985/ 1986	% Growth	1986/ 1987	% Growth	1987/ 1988	% Growth	1988/ 1989	% Growth	1989/ 1990	% Growth
Sources										
Prior balance	1,048	-	2.144	104.5%	3,611	68.5%	4,188	16.0%	3,377	-19.4%
Current balance	2,008	-	2,356	17.3%	2,323	-1.4%	2,007	-13.6%	2,501	24.6%
Total Available Resources	3,056	-	4,500	47.2%	5,934	31.9%	6,195	4.4%	5,878	-5.1%
Uses										
Project Funding	548	-	432	-21.0%	825	90.6%	1,189	44.1%	774	-34.8%
Current Expenses	243	-	327	34.7%	799	144.0%	1,489	86.4%	831	-44.2%
Admin. Expenses	121	-	128	6.1%	122	-5.0%	140	14.6%	129	-8.2%
Total Uses	912	-	889	-2.6%	1,746	96.5%	2,818	61.4%	1,734	-38.5%
Balance Carried Forward	2,144	-	3,611	68.5%	4,188	16.0%	3,818	-19.4%	4,144	22.7%

Source: Governorate Finance Department, data as of end of FY 1989-1990 (30 June 1990).

The WWF was established in 1975 following the issuance of Gubernatorial Decree No. 289. Since FY 1986/1987, proceeds from collections and loan repayments by indebted localities have consistently exceeded, though by a narrow margin, the revenues collected through the LSDF. At the present time, the WWF has accumulated balances of LE 8.4 million, more than double those sitting in the LSDF account. Unfortunately, such growth is primarily attributable to lack of spending rather than to major increases in collected revenues or to enhancements in the governorate's cost recovery schemes. The important point, though, is that Daqahliya has taken the initiative to set up a fund for enhancing local revenues.

Purpose of the Fund. According to the charter of the fund, the WWF aims to provide the means to finance new water and wastewater works in the governorate and to operate, maintain, and rehabilitate existing facilities (Article 1).

The establishment of such a fund was not meant to reduce Daqahliya's dependence on GOE funding of capital investment and recurrent costs. Instead it was viewed as an additional instrument for revenue generation, which would supplement central government contributions, existing local financial resources, and BVS/LD II-P block grants. These sources of funding were and are insufficient to accommodate the expenses associated with O&M costs, network rehabilitation and expansion, and the initiation of new water and wastewater management projects.[10]

Fund Administration and Finances. In principle, the WWF fund was to be decentralized with the local administrative units acting as subsidiary agencies by supervising, operating, and maintaining the assets and equipment of the funds within their jurisdictions (Article 3). The fund was to be administered by a board of directors including the undersecretary of state heading the governorate's housing directorate, the chairman of the housing committee in the governorate-wide popular council, the markaz executive chiefs, the chairmen of the marakez popular councils, and the governorate secretary general, who would act as chair (Article 4).

Among other tasks, the board was to develop a work plan for the fund, suggest fees that could be levied to finance it, approve its budget, and take appropriate action on the basis of quarterly progress reports (Article 5). The primary sources of funding, which have remained unchanged, were a 50 piaster water fee collected from each existing water connection and a one-time charge of LE 10 to be assessed upon connecting users to the water system or to the sewerage network (Article 8). Annual balances were to revert to the fund itself rather than the central treasury (Article 11).

Five-Year Performance. The performance of the WWF has been a qualified success. While collections have grown at the average rate of 27 percent per year since the fund's establishment (see Table 4.3 on the following page), grants to local administrative units have grown at the modest average rate of 3.7 percent only. On the other hand, low-interest loans to localities have dropped from LE 651 thousand in FY 1985/1986 to a mere 94 thousand as of 30 June 1990, a 69.5 percent decrease in five years. This is despite what appears to be an excellent repayment record by the indebted administrative units. Meanwhile, the present balances stand at almost LE 8.4 million, a substantial amount which could and should be exploited more effectively, at least in the areas of O&M and rehabilitation of existing infrastructure. These idle funds are losing purchasing power by 25 to 30 percent annually, given the GOE restriction regarding the deposit of government monies in interest-bearing accounts.

Table 4.4 on the following page traces the sources and uses of the WWF fund. Since its inception in 1975, annual expenditures averaged only 11 percent of total available balances. Indeed, with the notable exception of FY 1985-1986, when the WWF used 56 percent of its balances, the rate of expenditures ranged between a narrow margin of 6.5 - 16.3 percent of annual balances.

[10] This insufficiency has been noted in the Sogrea master plan study conducted under the auspices of the World Bank.

Table 4.3: REVENUE & EXPENDITURE TRENDS
Water & Wastewater Management Fund
Condensed Funds Flow Statement (1985-1990)
Daqahliya Governorate
(LE 000)

Fiscal Year	1985/ 1986	1986/ 1987	% Growth	1987/ 1988	% Growth	1988/ 1989	% Growth	1989/ 1990	% Growth	5-Year Growth
Sources										
Prior balance	0	532	NA	3,085	480.5%	4,852	57.2%	6,282	29.5%	270.5%
Loan proceeds	0	650	NA	132	-79.9%	270	104.6%	308	14.2%	-13.1%
Collections	1,212	2,119	74.8%	2,520	18.9%	2,386	-5.3%	2,842	19.1%	26.0%
Total Available Resources	1,212	3,301	172.3%	65,737	73.8%	7,508	30.8%	9,433	25.6%	135.6%
Uses										
Assistance to LGUs	0	23	NA	550	2331.4%	847	53.9%	878	3.7%	945.1%
Loans to LGUs	651	132	-79.7%	269	103.9%	308	14.5%	94	-69.5%	-17.1%
Admin. Expenses	30	61	102.4%	67	9.0%	70	5.0%	84	20.2%	35.7%
Total Uses	681	216	-68.3%	886	310.5%	1,225	38.3%	1,056	-13.8%	11.0%
Balance Carried Forward	531	3,085	480.5%	4,851	57.2%	6,283	29.5%%	8,377	33.3%	295.2%

Table 4.4: SOURCES & USES OF FUNDS AS PERCENTAGE OF ANNUAL BALANCE
Water & Wastewater Management Fund
Condensed Funds Flow Statement (1985-1990)
Daqahliya Governorate
(LE 000)

Fiscal Year	1985/ 1988	% Avail.	1986/ 1987	% Avail.	1987/ 1988	% Avail.	1988/ 1989	% Avail.	1989/ 1990	% Avail.
Sources										
Prior balance	0	0.0%	532	16.1%	3,085	53.8%	4,852	64.6%	6,282	66.6%
Loan proceeds	0	0.0%	650	19.7%	132	2.3%	270	3.6%	308	3.3%
Current balance	1,212	100%	2,119	64.2%	2,520	43.9%	2,386	31.8%	2,842	30.1%
Total Available Resources	1,212	100%	3,301	100%	5,737	100%	7,508	100%	9,433	100%
Uses										
Assistance to LGUs	0	0.0%	23	0.7%	550	9.6%	847	11.3%	878	9.3%
Loans to LGUs	651	53.7%	132	4.0%	269	4.7%	308	4.1%	94	1.0%
Admin. Expenses	30	2.5%	61	1.9%	67	1.2%	70	0.9%	84	0.9%
Total Uses	681	56.2%	216	6.5%	886	15.4%	1,225	16.3%	1,056	11.2%
Balance Carried Forward	531	43.8%	3,085	93.5%	4,851	84.6%	6,283	83.7%	8,377	88.8%

Source: Governorate Finance Department, data as of end of FY 1989-1990 (30 June 1990).

Discussions with governorate and other local administration official have revealed that the WWF suffers from two major defects: lack of a permanent management structure and absence of a detailed operational plan outlining the localities and type of projects that need to be targeted as potential grant and/or loan recipients. These deficiencies result from a conservative, overcentralized organization and control structure with minimum delegation of authority to technical personnel and, most importantly, with insufficient feedback from local administrative units. Although no specific examples of individual loans or grants were provided during our field trip to Daqahliya, the disbursement rate and the combined amount of WWF assistance to localities clearly demonstrate the extent of the conservatism of the management of the fund.

This overcentralized management has led to the transformation of the WWF into a patronage medium that relies on a system of petition from, and visits to the governorate seat by delegations of, local communities seeking small grants and bridging loans. Such disbursements are usually effected on the basis of recommendations made by a small circle of high governorate officials and popular council members.

Conclusions about the Daqahliya Model. Despite these concerns, the Daqahliya WWF is a model which should be closely investigated and followed by other governorates in their attempt to recover part of the costs of service provision. Greater efficiencies can definitely be achieved through less stringent governorate controls, but the initiative itself is what should be emulated, especially in response to the cost-recovery concerns outlined in the fourth-year guidelines of LD II-P.

Section 5 discusses a combination model based on the Daqahliya initiative for mobilizing local resources and the Fayoum decentralized system of LSDF management. This model offers a short-run solution that may be "safely" accepted and replicated by other rural governorates. Such a scheme, however, only temporarily alleviates the problem of funding O&M expenditures. Without a local budget that relies on estimates and realistic projections of recurrent costs, it will be hard to determine the structure of the fees to be charged to end users and the optimal level of central subsidy required to preserve capital investments and sustain service delivery systems.

Section 5.

TOWARDS A NEW APPROACH TO LOCAL ADMINISTRATION FINANCE

The conclusions we have drawn from the findings discussed in the preceding sections, and from other observations, can be summarized as follows:

1. Local administration fiscal autonomy is almost non-existent. Although governorate budgets are prepared locally, they remain constrained by rigid central government guidelines and instructions.
2. The link between local revenues and local expenditures, is theoretical at best. Local current budget deficits are covered by a sovereign subsidy that supplies almost 80 percent of projected expenditures on civil service payroll and recurrent costs.
3. All locally-generated revenues, except special accounts, revert to the central treasury. Public Law No. 127 of 1981 stipulates that all Bab I and Bab II revenues collected by the local administrative units and by the service directorates must be deposited in GOE treasury accounts maintained at the Central Bank of Egypt. This includes the fees and charges outlined in MLA Decree 239/1971, but excludes those revenue categories earmarked by MLA Decree 8 /1976, governing LSDF accounts.
4. Local units and agencies draw funds from Central Bank accounts, within the limits outlined in the current budget and within the confines of the spending rules applicable to GOE accounts (e.g., monthly expenditure on any one line item may not exceed one twelfth of the annual allocation).
5. The special funds, particularly the LSDF as currently set up, offer a potentially flexible medium for funding additional activities not provided for in the budget However, the application of rigid GOE account management regulations, which restricts spending authority and disbursement levels, severely limits financial management flexibility. This is particularly true at the village council levels.
6. Local initiatives towards resource mobilization, such as those taken in Daqahliya, Damietta, and Sharqiya, are noteworthy experiments in the cost recovery of basic services. Such endeavors deserve to be refined and furthered; however, they must be linked to specific operational plans and correlated to actual needs. Failure to do this, as in the case of Daqahliya, along with lack of responsiveness to the needs of would be beneficiaries have severely limited the extent of the benefits that could accrue to them.

RECOMMENDED COURSES OF ACTION

On the basis of these conclusions, we have developed three sets of recommendations—short-term, medium-term, and long-term—for courses of action that could be pursued to further local fiscal autonomy and to mobilize additional local resources for sustaining existing service delivery systems. The suggestions are limited to recovery of recurrent costs and do not extend to the establishment of reserves for the capital investment purposes. Rehabilitation work, depending on its extent, can be included in the former category.

In the ***short run,*** a one to two-year time period, we advocate that *rural governorates adopt special purpose funds for cost recovery schemes.* This would be similar to the WWF in Daqahliya, but would be done in conjunction with a flexible, decentralized, management structure.

For the ***intermediate run,*** a two- to five-year timetable, we encourage *an amendment to Public Law 127 of 1981.* The following items would need to be addressed in such an amendment:

- Authorized local retention of locally-collected funds
- Combined enhancements in the revenue collection systems
- "Realistic" budgeting of recurrent costs

These allowances would provide the local administrative units with the necessary tools to improve cost recovery schemes and would lead to definite improvements in the local fiscal management arena. The role of the central government would consist of assuming payroll liability and subsidizing the current budget deficit on the basis of a predetermined formula, which would partially fill in the gap between projected collections of local revenues and anticipated expenditures.

Beyond the five-year time horizon, assuming the scenarios outlined above are implemented, further decentralization can be achieved in the *long term* by *giving local popular councils the mandate to impose fees and other duties without recourse to the central government.* This would require amendment to the present local administration law, which restricts such initiatives and subjects them to cabinet approval.

This document is confined to the development of a short-term model for special purpose funds that are earmarked for rural infrastructure operation, maintenance, and repair. The above-mentioned medium- and longer-term recommendations constitute a starting point for the Work Plan deliverable due on or about 31 March 1991 dealing with a model for enhancing local revenues.

SHORT-TERM ACTION: ESTABLISHMENT OF SPECIAL PURPOSE FUNDS

Over the next one to two years, we recommend that governorates establish one or more special purpose fund earmarked specifically for the operation and maintenance of existing basic services, including municipal equipment and rolling stock. Two such funds could be established on the basis of the model developed by the governorate of Daqahliya: a water and wastewater management fund and a roads fund.

These special funds should be organized on a decentralized basis. In the case of water and wastewater management, a central fund at the governorate seat responsible for the provision of technical, managerial, and other types of assistance to rural cities and village communities is also proposed. Local funds should be responsible for identifying projects in need of monies for operations, maintenance, and repair (OM&R); for preparing annual budgets for OM&R; and for preparing OM&R implementation and contingency plans.

Proposed Model for a Local Water and Wastewater Management Fund

Sources of Revenue. Surcharges on monthly water consumption, bills, and assessments on water and wastewater connections, as in the case of the Daqahliya WWF, would constitute the primary source of revenues. The experience of Daqahliya shows the willingness of end users to make additional payments to their regular bills, on the assumption this will be translated into better service.

Monies will be collected by local units using a standard receipt issued by all units. The surcharges will be segregated from the total proceeds and deposited in a fund-specific account maintained at the village branch of the Bank of Development and Agricultural Credit. Once a quarter, the local unit will send 25 percent of their proceeds from that account to the governorate-based fund.

Initially, the monthly surcharge per household should not exceed 50 piasters per month. Businesses, depending on their water consumption patterns, may be surcharged up to LE 10 per month. The recommended household surcharge would be set intentionally at a low rate in the early stage, given the fact that no demonstrated track record has been achieved. New water and sewerage connections would be charged between LE 20 per household and LE 100 for large businesses, over and above the usual connection charges. *These assessments should be revised once recurrent cost projections are derived from O&M plans and budgets.*

Management. A local board of directors, representing popular and executive council members, would be responsible for the following:

- Administering the fund
- Setting broad policy guidelines and standards of service delivery
- Reviewing and approvingannual operational plans and budgets
- Supervising the local O&M staff
- Interfacing with regional water authorities or companies in the governorate, including the housing directorate, and the central fund.

We recommend that the board be weighted equally among popular and executive council members, with a representative from the village or city branch of the Bank of Development and Agricultural Credit to act as treasurer, and to provide the tipping balance in case of a tie vote.

Staffing. The fund would be staffed by village or city council executive staff, who would assume fund-related functions in addition to their usual tasks. Both clerical staff and technicians presently carrying out O&M work in village workshops or city maintenance facilities would be involved With the exception of the treasury function, all day to day affairs of the fund will be handled by the staff of the local administrative unit.

Planning. A plan for the operation and maintenance of local facilities should be prepared and/or revised once every three years. This plan would rely on a comprehensive survey of all water and wastewater related works within a given jurisdiction. A schedule for major maintenance activities for each facility over the next three years, and an outline of the anticipated manpower and materials requirements and possible need for external assistance from within and without the governorate.would be included. This plan, to be revised once a year on the basis of new information, would serve as a basis for the preparation of an annual OM&R budget.

Budgeting. Budgets for OM&R based on input from the three-year plan and on estimated costs of materials and other supplies, would be prepared once a year by the local unit and submitted to the board for review, approval, and final appropriations. These appropriations would consist of a combination of self-financing through the fund itself, contributions from the Bab II budgets, and when needed, loans from governorate-based funds.

Operations. The board of the fund would be responsible for overseeing all water and wastewater management activities at the local administrative level. This includes new capital investments funded through Bab III or through foreign grants, and on-going operations, maintenance and rehabilitation work financed from Bab II, the fund itself, or other sources.

The fund would also develop a mechanism for recording, investigating, and acting upon consumers complaints. This would involve the development of internal management procedures related to work organization and issuance of procurement orders for services and/or supplies, whether sourced from different governorate and GOE agencies or from the private sector.

Financial administration. The practice followed by the Fayoum governorate in fiscal affairs management is recommended for this model. We have intentionally suggested separating the treasury function from accounting, however, to alleviate fears of potential local mismanagement or abuse. Although training would be required in the areas of accounting, budgeting, planning and cash management, we feel that existing manpower can be safely entrusted with small accounting transactions and banking relationships during the initial stage.

We also believe that small transactions, i.e., those not exceeding LE 20,000, do not require, during the short-term, any change in existing regulations that limit spending authority at the village council level. Intermediate-scale rehabilitation works, which may have to be handled at the village level and may require higher expenditures, could be handled adequately with the current system of approvals by higher levels of local administration. In these instances, higher level involvement is often desirable as the nature of the problems and the required solutions require input and expertise in technical and contractual management that is rarely available at the village levels.

The only divergence from the Fayoum model we recommend is that the local administrative units, at all levels, be granted authority to deposit temporary excess balances in interest-bearing accounts. These balances should correspond to monies exceeding the projected periodical cash requirement, plus an additional amount for such contingencies as emergency breakdowns, rise in the cost of parts and other materials, and other non-planned activities.

While one may argue that balances accumulated by these funds would not justify the implementation of "complicated" cash management techniques, the experience of Daqahliya, with its LE 8.2 million in excess funds five years after the inception of its WWF, clearly proves the contrary. Assuming a modest interest rate of 10 percent, the opportunity loss associated with Daqahliya's cash management practice stands at approximately LE 1.8 million as of the end of FY 1989/1990.

Whether or not the use of interest-bearing accounts would be permitted under current GOE financial regulations is subject to MOF interpretation of the nature of the fund itself. In other words, if the ministry considers the accumulated balances to be public monies, there may be an obstacle. However, the limited success of the LD II-recommended cash management practice in some governorates, and the experience of Fayoum, may serve as a precedent during discussions with the MOF. These aspects of cash management and fiscal decentralization will be further explored under the report on the enhancement of local revenues (Work Plan task LG 6.2) scheduled for delivery on or about 31 March 1991.

External Reporting. Although not an absolute necessity, the practice of publishing annual reports on the activities, budgets, and finances of the special purpose funds may prove an effective public relations medium. An open presentation of public finances and their subjection to public scrutiny would serve as a check on the integrity and performance of public officials. Also, it could convey to the community where and how their fees and charges were used, and show them the extent of the benefit (not always apparent) accruing from public expenditures.

Such a document need not be extensive. A narrative describing the achievements of the fund, together with a brief summary of collected revenues and expenditures would demonstrate to the local community that their monies "are being well spent."

Model for a Governorate-Level Water and Wastewater Management Fund

Sources of Revenue. The governorate-based water and wastewater fund should be sourced from 25 percent of the surcharges collected by local administrative units.

Management. A board of directors, representing popular and executive council members, would be responsible for administering the fund, setting its broad policy guidelines, and determining standards of service delivery to be followed by local administrative units and regional public utilities. The membership would include the following:

- The secretary general, who normally heads the governorate's executive council
- The head of the housing directorate
- A senior engineer from the housing directorate to serve as advisor
- The chairman of the popular council's housing subcommittee
- Three other popular council members
- Governorate finance and planning directors general
- The director of village development department
- An outside treasurer from a bank in the governorate's capital to serve in that capacity.

Staffing. A staff seconded from the housing directorate and from the departments of planning, follow up, financial affairs, and village development would be assigned to the fund *on a full-time basis*. Additional clerical personnel and support staff (e.g., accountants, planners, microcomputer operators, civil and/or mechanical engineers, etc.) would be drawn, as needed, from other governorate departments.

The intent of such an arrangement is to permit the staff of the fund to extend its role beyond that of a simple consulting office. Under this scenario, the fund's staff would be responsible for trouble-shooting, responding to requests from local units, assisting local units in management and technical areas, and coordinating with governorate departments and national agencies. In addition, it would manage financial affairs and assist the governorate in developing or updating master sectorial plans.

Planning. A governorate-wide three-year plan, based on input from plans prepared by the local administrative units and on information gathered by the fund's staff, would be prepared and/or updated once a year.

Budgeting. The budget, based on the three-year plan, would be prepared annually and submitted for approval by the executive and popular councils of the governorate.

Operations. Most of the fund supported public works would be handled by governorate and/or markaz technical personnel, who would seek external expertise as needed. The role of the governorate fund staff should not substitute for that of other departments or of the public utilities. Instead, it should act mainly as a link between utilities and localities, and should follow up on reported problems until they are resolved.

Financial Administration. The central fund would follow the same financial administration procedures as the local funds. In addition, the governorate-based fund, with access to more financial and other resources, would be responsible for extending low-interest loans to local units. The extension of these loans would be based solely on need, technical merits, priorities among requests, and availability of funds. Initially, the fund would keep 25 percent of its total proceeds in contingency accounts. This percentage would be progressively reduced as the fund increased; once the total available annual balance (including rolled-over amounts) exceeds LE 1 million only 10 percent should be retained for contingencies.

The Roads Fund

Unlike the water and wastewater management fund, the road fund would be a ***markaz-based*** fund which will serve the rural cities and the village communities within its jurisdiction. This level of management is recommended because road maintenance and repair requires high investment levels in rolling stock and other equipment, which cannot normally be justified at the village level. Also contractors, who would be responsible for doing work beyond that usually performed by the markaz, tend to favor large-scale work orders that include more than one locality.

The LD II-P experience has revealed that, with the possible exception of so-called national roads, little maintenance is performed along routes connecting villages and rural cities. This has been detrimental to the state of the network and has led to its rapid deterioration. Regular maintenance, on the other hand, can extend the life of a road from the current average of five years up to ten years. This practice has been difficult to implement due to limited Bab II allocations for maintenance and because of the small balances maintained in the governorate road funds sourced by gasoline tax surcharges.

As in the case of the water and wastewater sectors, it is difficult to determine the extent of the resources required for adequate maintenance of the rural roads network until more information about costs is obtained. In the absence of reliable budget figures and plans for road maintenance and repairs, the ***initial*** determining factor for setting rates would be the willingness and the ability of local users to pay.

Sources of Revenues. The markaz-based roads fund would be fed by special fees assessed on motor vehicle owners residing within the markaz boundaries. Unfortunately, since the traffic departments responsible for collecting license fees are not present in all marakez, a redistribution formula must be devised. In the absence of computerization, this process will be necessarily tedious, but not impossible.

A fee structure based on motor vehicle end use and tonnage should be developed. Charges could range from LE 10 per year for privately-owned cars to LE 100 for large lorries. These surcharges,-to be collected by the traffic department at the time of license renewal, would be forwarded once every quarter to the markaz-based roads fund along with registration rosters, which would presumably indicate the addresses of the owners.

Management. A board of directors, representing markaz-wide popular and executive council members, would be responsible for administering the fund. The board would set broad policy guidelines for the fund and determine the road quality standards. Membership would include the markaz chief, the head of the technical department, a senior road engineer, and three representatives from the popular council. An outside treasurer from a bank in the markaz capital could serve as treasurer. The board would work closely with the markaz technical department along with the finance, planning, and village development departments. Requests emanating from the village councils would be channeled to the board through the village development department.

Staffing. A staff seconded from the markaz technical, planning, finance, and village development departments should be dedicated exclusively for the fund's daily administration. This staff would be responsible for surveying the markaz roads, recording complaints from the local administrative units, preparing maintenance plans, and budgets, and reporting their findings to the board. Following board approval, the staff would issue requests for bids, work orders and, with the assistance of the governorate's road directorate, supervise maintenance and repair work.

The staff of the road fund also would be responsible for managing financial affairs and assisting the governorate in developing or updating the road master plan.

Planning. A markaz-wide five-year road maintenance and repair plan would be prepared and/or updated once a year.

Budgeting. An annual budget for the fund, based on the five-year plan, would be prepared annually and submitted for approval by the executive and popular councils of the markaz.

Operations. Most of the fund-supported public works and repairs of road-related rolling stock would be handled by governorate and/or markaz technical personnel, who would seek external expertise as needed. The markaz-based fund would assist the governorate's road directorate in the development of a governorate-wide maintenance and rehabilitation plan. Given the limited financial resources of the directorates, the fund would share the costs associated with the plan on a pro-rata basis.

Financial Administration. The procedures outlined in the case of the local water and wastewater funds would be followed in the administration of the road funds.

Suggested Implementation Steps

The immediate benefit from these models is that they would progressively lead to the development of the following:

- Systematic inventory of existing rural infrastructure
- Better O&M plans and scheduling of activities
- More realistic budgets for parts, materials and outside repair work needed for O&M purposes.

The availability of financial resources and management structure, particularly at the village levels, would ensure that certain maintenance jobs, now more or less neglected because of limited resources, would obtain more attention.

Subject to USAID approval of the model funds and local decentralized fiscal management systems described in this section, we suggest that the agency share the findings and recommendations with the LD II technical *Amana*. The discussions should focus on two themes: (1) the sustainability of the services provided by the rural infrastructure, funded through LD II-P or otherwise, and (2) the need for adequate funding to operate and maintain that infrastructure. The funds should be presented as a potential short-term solution that would have no negative impact on the GOE treasury and would not constitute a big burden on the average user in rural Egypt.

The discussion with the *Amana* may be followed up with a presentation to the Provincial Local Development Committee, during a session specifically devoted to this subject. USAID representatives may present the model funds to the participants, and point to the fact that the options under consideration, if adopted, can fulfill the LD II-P fourth-year requirements pertaining to pilot cost recovery schemes. Governorates willing to commit themselves to such an undertaking would receive, in addition to the necessary technical assistance, such incentives as training in the areas of fiscal administration, and microcomputers for use in financial administration, together with the necessary software and personnel training.

The details of the suggested fund models outlined above remain to be worked out once the concept is accepted among GOE and local administration officials. Experience and feedback received during the latest round of orientation on the LD II-P fourth-year planning cycle indicate that some resistance will be encountered among certain governorates. However, the models are not rigid, and variations on the theme are not only possible, but recommended, according to local circumstances.

What is important is that local administration units, particularly governorates, adopt a mechanism to supplement their meager Bab II resources. Potential resources, such as those noted, must be tapped and used for essential operation, maintenance, and repair works. We believe that the empowerment of village councils with spending authority and the management of cash balances at the lower levels of local administration will give these local units the flexibility required in cases of emergency. Most importantly, it will permit them to program and prioritize their O&M activities on the basis of ampler and more predictable revenues.

ANNEX I

Actual Revenue Collected By Source: All Governorates—FY 1988-89

Bab I—Sovereign Taxes

43

APPENDIX I

ACTUAL REVENUE COLLECTED BY SOURCE :ALL GOVERNORATES - FY 1988-89
(LE 000)

BAB I - SOVEREIGN TAXES

GOVERNORATE	AG. LAND	BUILDINGS	ENTERNMENT	VEHICLE	COMMON	JOINT FUND	SUEZ PROFITS	BAB I TOTAL
ASSWAN	712	174	88	581	103	1,407	0	3,064
ASSYOUT	2,629	374	53	1,110	1	2,817	0	6,984
BEHIERA	6,933	664	26	2,590	0	4,238	0	14,451
BENI SUEF	2,557	162	10	629	3	1,833	0	5,193
DAMIETTA	636	328	116	903	84	1,274	0	3,342
DAQAHLIYA	8,039	776	40	4,740	102	4,872	0	18,569
FAYOUM	1,700	144	51	850	60	2,561	0	5,402
GHARBIYA	2,799	626	124	3,024	325	5,123	0	12,022
GIZA	1,760	2,040	2,870	6,926	1,189	4,000	0	18,784
ISMAILIA	273	194	87	1,322	1	608	9,856	12,343
KAFR EL SHIEKH	2,905	375	23	1,264	0	2,326	0	6,893
MATROUH	0	24	10	239	0	104	0	377
MENUFIYA	2,768	217	2	1,548	299	2,820	0	7,655
MINYA	3,214	162	26	1,471	75	4,545	0	9,492
NEW VALLEY	34	0	1	117	0	207	0	358
NORTH SINAI	0	211	15	669	9	212	2,096	3,211
QALUBIYA	1,496	918	18	2,747	729	3,722	0	9,629
QENA	2,601	299	113	1,060	11	3,722	0	7,806
RED SEA	0	218	41	291	9	104	0	662
SHARQIYA	3,739	42	64	2,183	53	5,886	0	12,348
SOHAG	2,638	225	56	1,190	52	4,236	0	8,396
SOUTH SINAI	0	0	0	268	0	358	1,821	2,448
SUB-TOTAL (RURAL GOVs)	47,433	8,172	3,834	35,724	3,105	56,973	13,774	169,430
CAIRO	30	12,773	9,437	20,159	30,432	0	0	72,831
ALEXANDRIA	1,659	4,182	3,239	9,232	15,381	0	0	33,893
SUEZ	54	452	18	905	1,687	596	2,964	6,676
PORT SAID	0	494	268	1,157	2,467	669	5,758	10,812
SUB-TOTAL (URBAN GOVs)	1,742	17,901	12,961	31,452	49,967	1,266	8,722	124,212
TOTAL	49,175	26,073	16,795	67,176	53,073	58,239	22,496	293,642

* All figures rounded to the nearest thousand.

ANNEX II

Actual Revenue Collected By Source: All Governorates—FY 1988-89

Bab II—Local Current Revenues

45

APPENDIX II

ACTUAL REVENUE COLLECTED BY SOURCE :ALL GOVERNORATES - FY 1988-89
(LE 000)

BAB II - LOCAL CURRENT REVENUES

GOVERNORATE	UTILITIES	DIRECTORATES	ML 239 FEES	PROFITS	QUARRIES	MISC. FEES	SP. FUNDS	BAB II TOTAL
ASSWAN	1,073	522	1,891	275	312	810	7,944	12,827
ASSYOUT	1,793	189	593	2,386	136	1,303	4,333	10,734
BEHIERA	85	2,349	1,144	0	221	1,375	5,863	11,037
BENI SUEF	881	752	605	6,447	41	880	22,457	32,063
DAMIETTA	81	254	851	3,408	8	378	4,459	9,439
DAQAHLIYA	3,391	1,438	1,468	0	22	3,067	7,612	16,998
FAYOUM	1,256	625	632	3,128	116	822	32,059	38,636
GHARBIYA	3,291	1,354	2,008	9,797	5	2,847	12,224	31,525
GIZA	629	1,454	2,484	39	82	5,140	11,167	20,994
ISMAILIA	106	159	291	0	100	1,674	1,475	3,806
KAFR EL SHIEKH	70	702	854	0	0	493	11,541	13,660
MATROUH	178	108	179	1,229	378	1,178	1,422	4,673
MENUFIYA	1,688	1,372	1,385	0	6	1,476	4,223	10,150
MINYA	1,134	913	780	9,416	292	3,144	3,866	19,546
NEW VALLEY	151	63	55	476	20	760	226	1,750
NORTH SINAI	89	249	527	0	50	1,097	2,513	4,525
QALUBIYA	2,000	1,040	2,059	3,709	27	1,100	9,237	19,171
QENA	1,811	736	3,740	6,577	73	1,601	6,429	20,966
RED SEA	2,273	75	73	241	198	2,816	5,909	11,584
SHARQIYA	1,917	1,661	1,300	91	142	2,900	11,946	19,958
SOHAG	1,510	857	692	4,714	108	2,706	5,350	15,938
SOUTH SINAI	3	43	4	0	34	2,401	434	2,917
SUB-TOTAL (RURAL GOVs)	25,409	16,914	23,616	51,933	2,371	39,968	172,688	332,898
CAIRO	0	2,093	8,295	0	1,792	5,532	42,940	60,651
ALEXANDRIA	0	964	3,588	2,439	127	9,086	12,645	28,847
SUEZ	14	1,170	144	0	391	438	3,880	6,037
PORT SAID	0	685	2,078	0	0	1,005	17,580	21,347
SUB-TOTAL (URBAN GOVs)	14	4,911	14,105	2,439	2,309	16,061	77,044	116,882
TOTAL	25,423	21,826	37,720	54,372	4,680	56,029	249,732	449,781

* All figures rounded to the nearest thousand.