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Policy Brief

The Independent Municipal Fund: Reforming the Distributional Criteria

Sami Atallah

Executive Summary

The distribution of the Independent Municipal Fund (IMF) from central to local governments as stated in Decree 1917 of 1979 does not support municipalities' provision of services and local development. The parameters currently in place are increasing inequity among local units, provide no incentives for higher local tax collection, and do not properly allocate resources. They have consequently benefited wealthier municipalities at the poorer ones' expense. The delay in disbursing the funds and the irregularity of the payments are depriving municipalities of the timely and predictable funding needed to deliver services.

There is a need to develop an alternative IMF formula which meets the desired objectives of development and equity. It must be based on the resident population, socio-economic needs, and the efficiency of raising local taxes. The transfers must be issued on time in order to facilitate planning and investment. The new distribution formula must be set by law and should not change frequently as this would reduce the predictability of the transfers.

About the author
Sami Atallah is the Executive Director of LCPS. His policy research work spans the fields of fiscal decentralization and municipal finance, corruption and governance, institutions and development, industrial policy, and competitiveness of firms. Prior to joining LCPS, he led a municipal finance study for the Lebanese Ministry of Interior and Municipalities funded by World Bank and managed by ICMA. Sami is trained in economics, political science, and quantitative methods.

Distribution Rules of the IMF

The Independent Municipal Fund (IMF), an intergovernmental grant system, transfers resources such as taxes and fees from central to local governments. Similar funds exist in many countries worldwide and are based on the rationale that it is more efficient for the central government to collect and distribute taxes to local authorities in order to provide services that would be more effectively delivered by them. Hence, a transfer system is set up in order to complement the taxes and fees being collected locally which, by themselves, are not sufficient enough to finance municipal responsibilities. The Ministry of Finance collects eleven taxes and fees and deposits them into the IMF for distribution to municipalities.

The central government distributes the funds based on a formula outlined in Decree 1917 of 1979.[1] Once the expenditures for salaries, wages, compensation as well as supplies, public works, and services for staff outside the cadre of the Municipal and Village Affairs Department are deducted, the remaining amount is distributed to municipalities and municipal unions. However, the municipal law is not clear regarding the eligibility of unions for IMF transfers. Although the law states that the IMF is a trust fund for municipalities only (Article 87), article 133 of the same law states that municipal unions are partially funded by the IMF. According to Article 7, IMF revenues are distributed in the following way: At least 75% is allocated for municipalities and up to 25% is distributed to municipal unions. The revenues allocated to the municipalities are further divided into several components (Article 11): 70% is assigned to support the budgets of the municipalities and 30% is designated for development project. The fund assigned to support the budget is distributed in the following way: 60% is based on registered population and 40% is based on the actual direct revenues collected during the two years prior.[2]

Although the Municipal Act does not consider municipal unions to be beneficiaries of the IMF, Article 8 of Decree 1917 of 1979 allocates the IMF to municipal unions in the following way: 25% is based on registered population for the purpose of supporting the budget of the union; and 75% is saved for development projects, taking into account the development needs of the unions and giving priority to feasibility studies and projects that already have completed these studies.

According to Article 7, the transfers to municipalities and unions should be made no later than the end of September of every year. The money is disbursed through a decree based on the recommendation of the Minister of Interior and Municipalities.

Shortcomings of the IMF

Despite the objectivity and transparency of the formula set in the Decree, the distributional criteria as well as the disbursement of the funds fail to adequately encourage local development.

1 Other methods of distributing the funds include the following: the origin of the collection of the taxes where regions that have contributed more to the fund get a higher share; partial reimbursement of expenses that are required by the central government; or on ad hoc basis.

2 This amount excludes retained earnings, revenues from sale of municipal properties, loans, and grants.

Registered population and direct revenues improperly allocate resources

Because of the gap between resident and registered populations, the dependence of the IMF upon the registered population for both municipalities and municipal unions leads to an improper allocation of resources. There are 42 municipalities whose resident population exceeds the registered one by at least a factor of two. These municipalities have a total registered population of only 231,000 people but the resident population is 916,000. This means that there are roughly 685,000 people unaccounted for in the distribution of the IMF. Meanwhile, there are 324 municipalities whose resident population is less than its registered population by at least half. Such municipalities have a registered population of over one million people but the resident population is 336,000. This discrepancy has serious repercussions on municipalities' abilities to provide services because of the fewer resources allocated to them. It ultimately leads to a disconnect between the actual population living under a municipality's jurisdiction and the population based upon how the IMF funds are distributed. This problem applies to the regional level as well. Of the 42 unions, 11 receive half of what they should be earning while 23 receive twice as much. In total, three quarters of the IMF resources are distributed to municipalities and unions based on the distortive registered population measure.

Direct revenue also impacts the allocation of resources. The central government currently uses the average of the last two years of direct revenues collected by the municipality. Since direct revenues predominantly consist of the rental value fee on residential and non-residential units, municipal areas that are urban or touristic get a larger share of the IMF compared to their rural or agricultural counterparts. This criterion is biased against rural and underdeveloped areas as it favors municipalities that have the potential to generate more revenue than those that do not, further exacerbating the inequity among municipalities. Furthermore, since the direct revenue is factored in the formula as the total amount rather than based on the change or improvement in collecting direct fees and taxes, it fails to provide incentives for municipalities to exert more effort to collect their own taxes. Essentially, larger municipalities are rewarded even when they are less efficient in collecting their taxes.

Three quarters of the IMF resources are distributed to municipalities and unions based on the distortive registered population measure

Unpredictability of the IMF disbursements

The second major problem with the IMF is the unpredictability of the amount transferred as well as the delay in the disbursement. Since 1996, the government has changed the criteria and weights of the distributional formula four times. This has increased the uncertainty and the instability in municipal budgeting and planning. For instance, the share of the IMF allocated to municipalities ranged from as low as 65% to as high as 90% of the fund between 1996 and 2009.

In addition to the changes in the municipal share of the IMF, the government has added or dropped new criteria as it sees fit. Although Decree 1917 requires that a portion of the IMF is allocated to development projects, this has rarely been applied in the post war period.[3] Although the government has recently introduced criterion requiring municipalities to undertake development projects, this has two shortcomings: First, the amount which averaged LL36 million ($24,000) in 2008 and 2009 is too small to have any true developmental effect; Second, although only municipalities with a population of less than 4,000 are eligible, the criterion is misguided since population is a poor indicator of developmental needs. Based on a development index, 60% of small municipalities which benefit from these transfers are relatively wealthy.[4] This policy has benefited the small and wealthy municipalities, which presumably is not the intent of the criterion.

The ad hoc changes in the distribution criteria were not confined to municipalities only. In addition to registered population, the government introduced a new criterion for distributing funds to municipal unions, which is the number of members the union has. This has no economic or social justification. In fact, it has increased the share of unions with more members at the expense of those with fewer members. For instance, the municipal unions of Feyhaa' or South Dahieh, each with three members and several times more residents than the unions of Koura or Al-Shakif which have 28 and 29 members, will receive less IMF support. In sum, the changes in the formula made IMF support current spending rather than development projects.

Furthermore, the IMF distribution decrees are being issued beyond the required legal time period which deprives municipalities of the funds needed in order to provide timely services. This means that it is taking the government, on average, 18.7 months, or twice the time, to issue the decrees that authorize IMF transfers. For instance, for the IMF of 1993 and 1994, the government issued Decree 8330 in April of 1996. The closest the government came to meeting the required transfer date was in 2001 and in 2009, when the government distributed the IMF for the previous year (Decree 6512). But this improvement has not been sustained.

The recent allocation of funds for development projects has actually benefited the small and relatively wealthy municipalities

Not only are the decrees issued late, but the transfers from one year to the next are not issued periodically and on a fixed schedule which has made the transfer of the IMF unpredictable. For instance, there was a 20-month period between the 1993/1994 IMF and the 1995 IMF and a 19-month period between the 1998/1999 IMF and the 2000 IMF. The time period between the issuance of the IMF decrees decreased to ten months for the 2005 IMF and the 2006 IMF and nine months for the 2006 IMF and the 2007 IMF. The

3 Although a portion of the IMF was reserved for projects between 1996 and 2000, this money was not actually distributed to municipalities.

4 The development index which was created by CRI (2006) is a composite index of 12 variables which includes the following: resident to registered population ratio, percentage of secondary dwellings, percentage of water connection, percentage of sewage connection, telephone consumption in minutes for residents, telephone consumption in minutes for commercial, percentage of agricultural establishments, percentage of industrial establishments, building height classification, percentage of dwellings after 1991, percentage of medium and large establishments, and percentage of leisure and services establishments.

irregular transfers impede the municipalities' ability to fund projects using IMF resources.

Once the IMF decrees are issued, it is expected that the full amount of the transfers is paid to the municipalities. However, municipalities receive their transfers in installments, which impacts municipal cash flow and consequently prevent them from providing timely services. For instance, the 2005 IMF was paid in four installments. It took the municipality of Tripoli eight months to receive all four installments for the 2004 IMF. It is estimated that it takes, on average, six months to receive all the payments. In the past two years, however, this has improved drastically: the transfers were made in two installments and were paid in full within a two-month period.

Policy Recommendations

For the IMF to serve municipalities' provision of services as well as local development, the formula for distribution must be reformed and the unpredictability in the transfers eliminated. Two major policy reforms are recommended:

Bring in relevant criterion that matches needs, development, and encourages local tax collection

The criterion currently used for distribution must be changed in order to include: resident rather than registered populations which will reflect the actual needs of the municipalities; socio-economic needs of the municipal area in order to close the gap between poor and rich municipalities; and the tax collection rate to reward municipalities that actually exert effort in raising their own local taxes.

In this way, the more populous, poorer, but more efficient municipalities with regard to tax collection will receive more IMF funds than the less populous, richer, and less tax efficient. To ensure that the IMF is not all spent on current expenditures, a share of the money should be allocated for development projects.

Since more than half of the municipalities are considered to be small with few capabilities to undertake development, there is a need to conceive of a stronger role for municipal unions or other forms of regional government that could undertake development. Once this is studied, the IMF formula should be distributed based on a formula that reflects the needs of these regional governments.

The new IMF formula must be based on resident population, socio-economic needs, and efficient tax collection

Adhere to the formula and disburse payments on timely basis

Once the new distributional formula and the weights are agreed upon, they must be respected. Furthermore, the IMF decrees must be issued on time and periodically in order to ensure predictability. There is also a strong need to further reduce the official period of issuing the distribution decrees from nine months to three or four months.

Additionally, the transfers must be made in one payment or at least in periodical payments that are specified by law in advance in order to increase the predictability of the transfers and allow municipalities to plan. To limit central government discretion in distributing the IMF revenues and to ensure predictability and consistency, the new formula should be determined by law rather than by a decree which is amenable to change.

Although the IMF formula should not be regularly altered, it could be revised to reflect the changes on the ground as well as the objective of the transfer. To this end, the government must exert concerted effort to collect data and information needed in order to implement the IMF funding criteria. There is a need to develop a mechanism whereby the needs of the municipalities are examined and develop an institutional setup whereby the data is collected on an on-going basis and municipalities' needs are periodically assessed.

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Policy Brief is a short piece regularly published by LCPS that analyzes key political, economic, and social issues and provides policy recommendations to a wide audience of decision makers and the public at large.

About LCPS
Founded in 1989, the mission of LPS as a nongovernmental, nonprofit think tank, is to produce independent, high quality research relevant to policymaking and to promote policy reform through advocacy and raising public awareness.

Contact Information
Lebanese Center for Policy Studies
Vanlian Center, Eighth Floor
POB 55-215, Mkalles,
Lebanon
T +961 1 48 64 29/30/31
F +961 1 49 03 75
info@lcps-lebanon.org
www.lcps-lebanon.org