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Decentralization in Developing Countries

Global Perspectives on the
Obstacles to Fiscal Devolution

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STUDIES IN FISCAL FEDERALISM AND STATE-LOCAL FINANCE

Edward Elgar

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12. Decentralizing Egypt: Not Just *Another* Economic Reform

Jorge Martinez-Vazquez and Andrey Timofeev

INTRODUCTION

Egypt is a unitary country with one of the longest centralized traditions in the world reaching back several millennia to the times of the pharaohs. Later, local councils (*Diwans*) set up by the French in 1798 were not elected and played a purely consultative/advisory role. In modern Egypt, the regime introduced through the revolution of 1952 by Nasser has remained quite attached to a centralized form of government with several manifestations of territorial deconcentration largely based on the Soviet budgeting model.¹ Although, as discussed below, there has been considerable economic progress and modernization of market institutions in recent times, Egypt's public sector remains bloated and inefficient, and basically unable to improve the quality of basic services such as health and education for its citizens.² This has had adverse impacts on the standard of living of citizens and on the ability to put the country on a sustainable path of economic growth. These failings have also had an impact on the popularity and acceptance of the current political regime. Although formally Egypt is a parliamentary democratic system, de facto, the National Democratic Party (NDP) has ruled the country as a single-party regime under strong presidential rule. The failings of the current system of governance vis-à-vis the delivery of public services has caused the current government to become interested in finding, or at least exploring the possibility of, a solution in some form of decentralization reform. But a successful decentralization effort will require the political empowerment of local communities and this is a step that some in the current regime are unsure can be taken, while at the same time there are others that feel that this is a step that the regime cannot afford not to take. Changing the political landscape and status quo from the bottom up is the most significant obstacle on the horizon for genuine decentralization reform in Egypt.

JUST ANOTHER ECONOMIC REFORM? THE POLITICS OF DECENTRALIZATION

Egypt has a good record on several successful reform programs aiming at resolving significant economic crises in the last couple of decades. After the unraveling of the economic boom of the 1970s, at the start of the 1990s Egypt found itself with a budget deficit over 15 percent of GDP, inflation over 20 percent, and accumulation of arrears on external debt service. The stabilization effort included fiscal adjustment, anchoring exchange rate vis-à-vis US dollar, and liberalization of credit and exchange markets. As indicated in Figure 12.1, the reforms were successful in curbing inflation by 1996, prompting economic growth and planting the seeds for the eventual take-off of the financial market.

The growth spurt that started in 1993 had run out of steam by 2001, prompting another round of reforms. Egypt's economy has undergone a remarkable makeover as result of the ambitious reform agenda pushed through by Prime Minister Nazif within a year after he took office in July 2004. The reforms included lowering the overall tax burden in place of individualized tax breaks, simplifying licensing and tax compliance procedures for both individual and corporate taxpayers, including the creation of one-stop shops for investors in major urban centers.³ Other reform measures included anti-trust legislation and divestiture of government stakes in banks and enterprises. Figure 12.1 shows dramatic improvement in all macroeconomic indicators after 2004, which was particularly explosive for foreign direct investments and financial market capitalization.

However, amidst all those economic successes, the country has been moving much more slowly in the area of public service delivery. For example, while Egypt has achieved a dramatic improvement in literacy rates from under 50 percent in 1986 to more than 70 percent in 2005, it still ranks 125 out of 164 countries (WDI, 2007). The lack of transparency and comprehensive strategy in the provision of healthcare results in local residents seeking private alternatives, which often involve the same doctors as in the public clinics and is often provided on the same public premises. As a result more than half of healthcare financing comes out of patients' pockets (World Bank, 2006a).⁴

One of the most telling indications that local affairs have been mismanaged under the present system is the inefficient urban growth in terms of the use of the scarce arable land. The share of rural population has remained at about 60 percent since the 1960s. However, both rural and urban population more than doubled since the 1960s. Furthermore, both urban and rural populations huddle on a strip of arable land along the river Nile. The national goal of land reclamation, including building new urban

Figure 12.1 Evolution of Macro-economic Indicators

Source: Prepared by authors using data reported in WDI (2007).

Notes: Inflation and GDP growth should be read off the primary vertical axis; FDI and stock market capitalization should be read off the secondary vertical axis.

settlements, has had limited success. Besides concentrating in arable lands, urban growth remains largely uncontrolled, taking out of agricultural use more land than is necessary. It is estimated that by 2025 half of Egypt's arable land will be lost to informal settlements (HDR, 2004). The rate of illegal construction has exceeded that for authorized development. For example, over 1976–1996 the Cairo population in squatter settlements grew at an annual rate of 8 percent compared to 4 percent growth in planned areas of the city (HDR, 2005).

It is within this broad framework of economic modernization reaching out to the subnational government units that decentralization reform has been pitched by reformers within Egypt's political establishment inside the NDP and Government. The statement of the cabinet delivered to the People's Assembly in a session held on December 19, 2004 by Prime Minister Ahmad Nazeef emphasized "deepening decentralization and enhancing community partnership, through expanding in transferring the competences of the departments and ministries to the governorates, and boosting the powers of the governors in administrating the utilities and appointing the senior officials, with giving the governorates more flexibility in deciding its development requirement, and participating in preparing public budget of the state, and delegating them in managing expenses of

certain items of the budgets, which are linked to operation, maintenance and services.”

He called for activating the role of the local popular councils in control functions, to reach some balance between the local executives and local elected councils, giving the latter a bigger part in preparing plans and monitoring their implementation. President Mubarak endorsed the principle of “Decentralization for Democracy” in the Presidential Manifesto of 2005 and reiterated calls for deep decentralization reforms in his recent speeches.⁵ Decentralization was also part of the NDP platform for the parliamentary elections of 2005, and at its 9th annual conference in November 2007, the NDP unveiled in a working paper its decentralization vision.⁶

A critical difficulty with decentralization reform in Egypt is that it is becoming increasingly understood that this will not be just another economic reform that can be implemented by the Government within the existing political institutions. Decentralization reform will require different degrees of democratization and political opening which may facilitate the empowerment of the political opposition to the current regime.

The main political risk of decentralization for the Government and the establishment within the NDP is the fear of providing a platform for the Muslim Brotherhood, an Islamic movement with deep roots in Egypt’s society. While technically outlawed, the Muslim Brotherhood has been the main threat to Egypt’s secularism and to the present political regime for many decades. These fears associated with political decentralization are not unfounded. Since its inception in 1928 the Muslim Brotherhood has been active at the grass-root level and fairly popular with the poor for its social work helping citizens obtain food, jobs, and healthcare and other areas where official government institutions have continued to fail to deliver. In particular, the Muslim Brotherhood has a successful history of taking over defunct public institutions and turning them into well-functioning bodies and later using them as a platform for promoting its cause. Thus in the 1980s, Muslim Brotherhood activists contested elections for many professional syndicates that had been marred by “a lack of transparency, no clear decision-making processes, political infighting, corruption and financial mismanagement.” (Zahid and Medley, 2006 p. 704). Benefiting from the discontent of the syndicates’ membership, Muslim Brotherhood activists were able to win election to the boards of such respected syndicates as engineers, pharmacists, and lawyers. Their past experience of management and administration of resources gained through their grass-root work allowed the Muslim Brotherhood to successfully halt major abuses at the syndicates and turn them into functioning bodies of civic organization.

This prompted the government to issue Law 100 of 1993 effectively nationalizing the syndicates.

Other more recent events point toward the perception of a threat from the Muslim Brotherhood. For example, allegedly an internationally sponsored project for empowering school councils was suspended because of suspected Muslim Brotherhood infiltration (Springborg, 2007). In the 2005 national legislative elections, running as independents, the Muslim Brotherhood won 88 out of 444 seats compared to just 14 seats won by all officially-sanctioned opposition parties together. Politicization of local government increased with the amendments to article 76 of the Constitution, approved in a May 2005 referendum, requiring independent presidential candidates to obtain at least 140 signatures from members of local councils in at least 14 governorates in order to have their name on the ballot. Local council elections were initially scheduled for April 2006, but the government postponed them following the strong showing of Muslim Brotherhood-affiliated candidates in the national legislative elections in late 2005. When the local elections were finally held in April 2008, the Muslim Brotherhood undertook tremendous effort to get on the ballot but they encountered unprecedented difficulties in having their people registered as candidates and ended up boycotting elections resulting in the lowest voter turnout ever (less than 5 percent according to Herzallah and Hamzawy, 2008).

Another political constraint for decentralization is the unwritten policy of zero retrenchment of public employment. In the past, many reform initiatives have failed to overcome this hurdle, including the performance budgeting introduced in the Planning Law (No. 70 of 1973) and Budgeting Law (No. 53 of 1973). The common belief is that the only politically feasible solution to the bloated public sector is to allow natural attrition as the private employment continues growing. However, given the self-selection of those staying in the public sector, the ultimate goal of decentralization to improve local services might be hard to achieve with the available workforce.

Although the political risks associated with the third rail of public employment and the partial capture of decentralized governments by the Muslim Brotherhood appear to be quite real, the dilemma for government authorities is whether doing nothing and continuing to go with the status quo is not as politically risky in the medium term. But, before getting into the discussion of what form of decentralization may be both effective and politically feasible, in the next sections we take stock of what the current system of subnational governments is like and what will be needed for change.

A Strongly Hierarchical Vertical Structure of Government

The vertical structure of Egypt's government is composed of 29 governorates (27 before 2008) at the first subnational level, about 300 districts (*markazes* in rural governorates and *kisms* in urban governorates) at the second subnational level, over 200 cities (*medinas*) and 1,100 Villages (*quriyat*) at the third subnational level. In addition there are over four thousand unincorporated settlements without a council. With an average population size of about 200,000, the district level jurisdictions appear to be big enough to provide public services where there exist economies of scale, such as water treatment plants and hospital services. With their average population size over 35,000, cities, and to a lesser extent villages, appear to be also well positioned to provide most other local services in a manner that is most responsive to local needs; however, there are significant deficiencies in administration capacity at this level, at least in villages.

As shown in Table 12.1, there are significant disparities between the four groups of governorates: Urban Governorates, Lower Egypt, Upper Egypt, and Frontier Governorates (see the map in Figure 12.2). Urban governorates are the four largest cities—Alexandria, Cairo, Port Said and Suez—accounting for 20 percent of Egypt's population. They all have socio-economic indicators above the national average. Lower Egypt governorates represent over forty percent of the national population, located in the fertile Nile Delta, in the most Northern part of the country. These are predominantly rural areas with socio-economic indicators around the national average. Upper Egypt governorates cover just over one-third of the national population, located south of Cairo. These are predominantly rural areas with most unfavorable socio-economic indicators. Finally, Frontier Governorates cover only 2 percent of the national population (but 70 percent of land area) located in Sinai and the deserts that lie west and east of the Nile. These are highly urbanized governorates with above average socio-economic indicators and the lowest poverty rate in the country. However, because of their remote location, some areas in the Frontier Governorates lack infrastructure such as access to electricity.

The current hierarchical vertical structure of government is largely based on the 1971 Constitution and Law 43 of 1979. It should be noted that the area of subnational government has experienced a lot of administrative and legislative changes over the last several decades. Thus, since 1960 nine laws have been issued⁷ and the national agency responsible for local government has changed its name and organizational form numerous times. However the substantive changes that have occurred, if anything, resulted in a weaker status for the subnational governments. The most symbolic manifestation of that was the change of the name of Law 43 itself from the initial "On Local Government" to "On Local Administration" as of the 1988 amendment.

Figure 12.2 Groups of Governorates

Source: Prepared by authors.

Once elected, local executive heads—*Omdas* in the sub-village level hamlets—are appointed by the Minister of Interior since 1994. Moreover, in 1988, local councilors lost the power to hold the executives accountable through the so-called interpellation procedure. Furthermore, there is universal opinion that the practice of local administration is far from what is outlined in the current law. As was observed in one study almost two decades ago (Moharram 1992):

Irrespective of what the law provides, most processes involve to a great extent informal, personal interactions. These personal relations are far more important in determining what is achieved, and what is not achieved than the prescribed formal linkages between the different levels of the bureaucracy. This aspect of informality to a greater extent introduces random, subjective, and often arbitrary elements into the decision-making process of the local government.

Some believe that Sadat got ahead of himself declaring a new policy for “democratization and local governance” in the 1970s envisioning elected local governments and appointed governors serving only as representatives of the center (Sawi, 2002). The subsequent backtracking might be explained by the fact that, according to the language of the 1971 Constitution and entrenched political culture, all local administration structures are the arms of the central government. The departure of actual practice from the system of local government outlined in the current law makes it difficult to have a

Table 12.1 Regional Social, Economic and Demographic Conditions

Descriptive Statistics	Urbanization Rate	Pop. Density, persons per 1000 sq km	GDP EGP per capita	Poverty %	Sewerage	Piped water	Electricity
					share of households with services		
URBAN GOVERNORATES							
Average	0.98	10.96	10,950	7.73	0.90	0.98	0.99
Minimum	0.94	0.06	10,156	4.30	0.89	0.94	0.97
Maximum	1.00	40.89	13,419	8.80	0.92	1.00	1.00
LOWER EGYPT							
Average	0.30	1.46	5,598	12.59	0.58	0.97	0.99
Minimum	0.19	0.19	4,638	4.40	0.25	0.92	0.99
Maximum	0.45	3.95	6,933	28.80	0.86	1.00	1.00
UPPER EGYPT							
Average	0.32	2.16	4,417	32.30	0.28	0.85	0.99
Minimum	0.19	1.18	3,337	12.50	0.12	0.00	0.99
Maximum	0.64	5.27	6,825	61.00	0.70	1.00	0.99
FRONTIER GOVERNORATES							
Average	0.65	0.90	8,401	5.40	0.47	0.86	0.91
Minimum	0.48	0.01	6,296	—	0.24	0.76	0.87
Maximum	0.96	4.05	12,819	—	0.69	0.99	0.99

Table 12.1 Regional Social, Economic and Demographic Conditions (continued)

Descriptive Statistics	Urbanization Rate	Pop. Density, persons per 1000 sq km	GDP EGP per capita	Poverty %	Sewerage share of households with services	Piped water	Electricity
<i>ALL GOVERNORATES</i>							
Average	0.47	3.00	6,516	19.77	0.61	0.91	0.97
Minimum	0.19	0.01	3,337	4.30	0.24	0.00	0.87
Maximum	1.00	40.89	13,419	61.00	0.92	1.00	1.00
Correlation Matrix							
Urban. Rate	1.00	0.33	0.81	-0.49	0.58	-0.13	-0.27
Pop. Density	0.33	1.00	0.31	-0.21	0.29	0.01	0.14
GDP per capita	0.81	0.31	1.00	-0.59	0.69	-0.08	-0.37
Poverty	-0.49	-0.21	-0.59	1.00	-0.80	0.00	-0.37
Sewerage	0.58	0.29	0.69	-0.80	1.00	-0.04	0.15
Piped water	-0.13	0.01	-0.08	0.00	-0.04	1.00	0.22
Electricity	-0.27	0.14	-0.37	-0.37	0.15	0.22	1.00

Source: Computed by authors based on the 2006 Census Data.

clear picture of Egypt's local government not only for foreign scholars but for the Government of Egypt itself, which appears many times to be navigating its journey towards decentralization by way of "touch and feel."

Currently, at each subnational level, there is an elected representative organ (Local Popular Council or LPC) and the centrally appointed executive branch. The local executives are made up of the local head's secretariat (*Diwan*) and deconcentrated offices (called 'service directorates') of twelve central government ministries or agencies, sometimes reaching two or more subnational levels. Three central agencies have directorates at the governorate level only: Transportations and Roads, Property Taxation, Organization and Administration. With the exception of property taxation, these functions involve spillover of benefits across district borders and economies of scale. Four agencies have directorates at the governorate level and departments at the district level: Veterinary, Trade, Labor, Youth and Sports. Four agencies are represented at all three levels (governorate, district, and village): Education, Health, Agriculture and Housing. Finally, one agency, Social Affairs, has offices at the governorate and village level but not at the district level.

The service directors form a management group called the Local Executive Council (LEC), which replaced previous Soviet-style "executive committees." The LEC is formally chaired by the appointed executive head: governorate LECs formally chaired by governors appointed by the President, city LECs formally chaired by mayors appointed by the Prime Minister, district LECs formally chaired by district heads appointed by the governors and so on. However, reportedly there is a lack of a legal basis for horizontal coordination within the executive branch and often there is more accountability of service directors along the sectoral hierarchy than to the governor/mayor. Essentially the local executive head (Governor/Mayor) has substantial authority over the finances and personnel only of his own secretariat (*Diwan*), which is similar to the powers of the service directors over the finances and personnel in their respective sectors.

In addition to service directorates, public holding companies for public utilities, such as water supply and wastewater treatment, have operating companies at governorate levels but there is no direct oversight of the operating companies by governors or governorate LPCs.

The local administration system is hierarchical among local units or between local units and the central government. In other words, the LPCs at higher levels have the right to supervise and monitor the lower level LPCs. They also have the right to approve or object to decisions taken at lower levels. Similar hierarchical supervision is exercised by the executive heads in their hierarchical relations with each other and with the central government.

The LPCs have only the right to ask questions or request information from the head and members of LECs, but they do not have the right to interrogate the LECs and thus cannot remove them from office or even recommend that to the central government. By contrast, the heads of local units have the right to object to the decisions of the LPCs if there is violation of the plan, approved budget, laws or regulations.⁸ In this case, the governor or the mayor may return the decision to the council, which issued it, accompanied by his comments and the basis of objection within 15 days from the date the decision was issued. If the governorate LPC insists on its decision, the issue is referred to the Prime Minister. If the decision objected to is issued by the LPC at the sub-governorate level, the issue is referred to the Minister of Local Development after the head of the governorate LPC is informed by the governor. The objected decision must be settled, at least in theory, within 30 days from the date it was presented to the Prime Minister or the Minister of Local Development. Their decision will be final.

Legislation on local administration requires election of ten councilors from each constituent unit resulting in an unmanageably large size of the elected council. Thus Cairo, divided into 36 districts, has a council of 360 members. Currently LPCs are dominated by government employees. This is likely to create a conflict of interest because supervision of the executive branch by local councilors would essentially mean supervising their own employers (Springborg, 2007).

Several important features of the Egyptian budgeting process bear a close resemblance to the Soviet "matroshka" model in which some subnational budgets are nested into larger ones in a relationship of vertical fiscal dependency allowing for different degrees of fiscal discretion. This discrepancy is due to that fact that the higher-level government only controls budgetary appropriations aggregated for all units at the level immediately below. For example, for each governorate the national government approves appropriations by item for the composite of the governorate government itself and the sum of all districts in that governorate. Similarly, when it comes to budget reporting, the national government receives information on the sum of the governorate and district spending. This clearly allows governorate authorities one important dimension of discretion; for example, if the governor decides not to pass on any part of the petrol appropriations to the district level instead spending it entirely on the governorate headquarters car fleet, the Ministry of Finance would not know it from the reported budget allocations. In addition, the Governor (or governorate service director) has substantial discretion in allocating funds among administrative units at the level immediately below.

The hierarchical/dual subordination takes on different configurations with respect to different government decisions. For example, during budget

planning, budget requests from service directorates are consolidated at the governorate level, and after formal approval by the governorate LPC, sent to or negotiated with the Ministry of Finance. Thus line ministries are at best informed about budget requests from their deconcentrated directorates but are not actively involved in budget negotiations. The only input of the line ministries to budgeting by their deconcentrated units are norms such as teacher–pupil ratios and number of textbooks (World Bank, 2005b).

When it comes to budget execution, disbursements are made directly to the accounts of service directorates and the Governor has no formal authority over sectoral funds but only over the funds of his own secretariat. However, the Governor does have to sign off on the service directors' requests to reallocate their resources within the narrow budget categories before these requests can be submitted to the Ministry of Finance. Even the formal budget holders (i.e. service directors and the executive heads) while enjoying some discretion in allocating funds among lower-level units have little flexibility in shifting funds among budget categories once the budget is approved. Shifting of funds among economic categories, for example from wages to material supplies, requires parliamentary approval. Shifting items among main sub-categories, for example from basic wages to supplemental allowances, requires approval of the Ministry of Finance (or Ministry of Economic Development in the case of capital expenditures). Governors and local heads can authorize moving resources only within narrower sub-categories of expenditures.

The personnel matters of service directorates (appointment, promotion, transfer) are entirely in the purview of line ministries with the final approval by the Central Agency for Organization and Administration (CAOA). At the same time, the wage bill accounts for 93 percent of the directorates' budgets. Importantly, this budget for labor services is essentially predetermined by the number and type of posts and their remuneration set by the CAO. By contrast, in the budgets of executive heads' secretariats (*Diwans*), over which the latter have operational control, personnel costs account for less than one-third and thus allows more flexibility in spending. In fact non-wage budget of the heads' secretariats is almost double of that of the twelve service directorates put together. Furthermore, the non-wage budget of all service directorates is less than the extra-budgetary resources, over which governors have essentially full control. Extra-budgetary funds can be used for: 1) budget shortages (except wages), 2) service improvement (e.g. computerization of service directorates), and 3) capital projects.

Essentially, extra-budgetary accounts are the only available vehicle for exercising meaningful local self-government. For example, villages do not have their own budget or a budgetary account – their expenses are part of

the district budget. However, villages can and do establish extra-budgetary accounts, which they manage independently; they keep a record of all account transactions, which they periodically send to the district finance department, where they are counted as part of the district budget report. Extra-budgetary resources represent on average less than 5 percent of the total local spending but almost a quarter of non-wage expenditures.

DECONCENTRATED EXPENDITURE RESPONSIBILITIES WITH LOW DISCRETION

The assignment of expenditure responsibilities at different levels of governments is, for the most part, unclear. The closest resemblance to a formal assignment of expenditure responsibilities can be found in Law 43 of 1979 on Local Administration. However, the references to specific functions are scattered all over the text of this law. For example, Article 25 establishes responsibility of governors for food security, efficiency of agricultural and industrial production, security, morals, and public values. For districts and towns, other than internal management, the Law only mentions "establishing various services for the benefit of local populations" and regulating public utilities. Village Executive Councils are entrusted with collecting revenues and surveying public demand for services and projects. In a number of occasions, the legislation assigns the same function to several levels of government. Thus, for example, it stipulates that local authorities "take charge of establishing and administering all public services in their territory" (Article 2). However, for example, collecting solid waste in a given neighborhood takes place in the territory of a certain town quarter council, town council, district council, and governorate council. Then, which of the four authorities is in charge? Saying that all the four are responsible may simply imply that nobody is responsible in particular. However, overlapping responsibilities is one of the main features of the "matroshka" model. Given the vagueness of the law, it is impossible to map formal expenditure assignment by level of government. One could establish the actual assignment by looking at the actual expenditures by level of government. However, given the current form of budget reporting, it is impossible to disaggregate subnational expenditures into the governorate and sub-governorate parts due to nesting of budgets. We have to limit our assessment to the division of expenditures into the national and subnational parts.

In practice, the ongoing assignment of expenditure responsibilities gets reflected in a changing picture of public sector expenditures. As shown in Figure 12.3, Egypt's public sector has been declining as percent of GDP—

Figure 12.3 Evolution of Egypt's Budgetary Expenditures, % of GDP

Notes: Prepared by authors based on the IMF's GFS data.

with a short break in 2001—since the stabilization effort of the early 1990s. Thus, relative to GDP, total public expenditures dropped from over 35 percent in 1992 to 30 percent in 2006. The reduction occurred in all sectors except for the cases of public order and healthcare, both of which experienced marginal increases. However, one sector, social protection, has had an explosive growth from less than 1 percent of GDP in 2001 to more than 9 percent in 2006. More than 99 percent of these expenses are subsidies, mostly for fuel and food. Expenditures other than those on social protection dropped from over 26 percent in 2001 to 21 percent in 2006.

Deconcentrated expenditures (those flowing through *Diwans* and service directorates) account for about 5 percent of GDP (Table 12.2). Moreover, the bulk (80 percent) of it is accounted for by just two functions: general public administration and education, and most of these expenditures are for wages and salaries. Note that for the local heads' secretariats (*Diwans*, classified as general public administration), the total budgeted amount is about 25 percent less than the actual expenditures in the previous years (Table 12.2). The reason is that budget plans do not fully account for projects financed through extra-budgetary accounts while the final budget reports do incorporate those expenditures as they occur. This is not observed for other deconcentrated budget holders because most user fees and other project revenues are channeled to the extra-budgetary accounts

Table 12.2 Deconcentrated Budgetary Expenditures, % of GDP

	Actual 2002/03	Actual 2003/04	Actual 2004/05	Budgeted 2005/06	Budgeted 2006/07
General Public Services	1.44	1.62	2.00	1.29	1.26
Defense	0.00	0.00	0.00	0.00	0.00
Public Order And Safety	0.00	0.00	0.00	0.00	0.00
Economic Affairs	0.36	0.33	0.32	0.32	0.32
Environmental Protection	0.00	0.00	0.00	0.00	0.00
Housing and Community Amenities	0.06	0.05	0.05	0.04	0.04
Health	0.64	0.67	0.67	0.49	0.49
Recreation, Culture, and Religion	0.08	0.07	0.07	0.07	0.07
Education	2.64	2.49	2.50	2.34	2.41
Social Protection	0.10	0.09	0.09	0.08	0.08
Total	5.33	5.32	5.71	4.64	4.67

Source: Computed by authors based on National Budget data from FY 06/07.

controlled by the executive heads as opposed to service directors. Notwithstanding the overall reduction of the total public sector expenditures occurring since 2001, the notable trend in actual expenditures at the subnational level is an increase of general public expenditures as a share of GDP, growing almost 40 percent between 2003 and 2005.

For all deconcentrated offices except *Diwans*, housing, and social protection, expenditures on material supplies and capital expenditures have been less decentralized than payroll (Table 12.3). At the same time, personnel establishments and remuneration are tightly controlled by the Central Agency for Organization and Administration (CAOA). Essentially, service directorates act as a post office forwarding paychecks.

While for *Diwans*, the allocations on wages and material supplies are roughly equal, for service directorates material supplies are less than one-fifth of their wage bill in FY 2006/07 (Figure 12.4). Mohamed El Shawi (2007) reports that, for the subnational executive heads' secretariats, material costs exceeded payroll by a factor of 3 in 2004/05 (by a factor of 2 in 2003/04), while, for service directorates, material costs amounted to less than 8 percent of the wage bill in 2004/05 and in 2003/04. Thus the bloated staff of service directorates is likely to be quite unproductive without adequate material supply. In addition to lacking material supplies, the deconcentrated public workforce also appears underpaid. Thus, while 58

percent of the public workforce is located at the subnational level, it accounts for only 47 percent of the public wage bill as of 2007 (NDP, 2007).

More than one-third of the budget of local executive heads' secretariats is allocated towards capital expenditures. This is due to capital grants from the Ministry of Economic Development (formerly Ministry of Planning) allocated based on a formula weighing population and HDIs (World Bank, 2005b). Local capital projects are also financed from extra-budgetary funds controlled by the executive heads.

For budgetary accounts, local authorities have no powers to shift funds across budget items or to the next fiscal year. Any surplus at the end of the year has to be returned to the state treasury. By contrast, for extra-budgetary funds, local authorities have discretion over how to use the resources and are also entitled to keep any surplus at the end of the fiscal year.

There are persistent disparities in per capita expenditures among governorates. Thus, in per capita terms frontier governorates spend more than twice the national average expenditures on general government services possibly due to lower population density (Table 12.4). At the same time, governorates in Upper and Lower Egypt spend only two thirds of the national average in per capita terms.

Similarly for education, governorates in Upper and Lower Egypt have less than the average amount of per capita resources while frontier governorates spend almost twice the national average (Table 12.5). At the same time governorates face very different challenges in the area of education. Thus the Upper Egypt governorates have the lowest drop-out rate but the highest share of children never enrolled in school. Lower Egypt has the highest drop-out rate but the share of never-enrolled is below the national average.

In healthcare, frontier governorates have the best health status and at the same time four-fold the per-capita healthcare spending and twice the national average of public hospital capacity per capita (Table 12.6). With only 2 percent of the national population, higher per capita spending does not take away too much from other governorates but demonstrates that adequate funding makes a difference in health outcomes. On the other hand, Upper Egypt had the worst health outcomes and the lowest public hospital capacity.

Table 12.3 Deconcentrated Share of Expenditures by Budget Function, % of Budgeted Amount

Function	Staff	Goods And Services	Interest	Subsidies	Other current	Capital	Total
General Public Services	30	53	0	5	3	50	12
<i>out of which:</i>							
<i>Executive and Legislative organs</i>	92	99	100	99	18	99	95
<i>Financial and fiscal affairs</i>	18	6	0	0	0	0	12
<i>R & D General Public Services</i>	100	100	0	100	100	0	100
Defense	0	0	0	0	0	0	0
Public Order And Safety	0	0	0	0	0	0	0
Economic Affairs	50	4	0	0	1	0	19
<i>out of which:</i>							
<i>General Economic and Commercial Affairs</i>	54	12	0	0	1	0	14
<i>General Labor Affairs</i>	81	58	0	3	83	0	71
<i>Agriculture</i>	78	40	0	4	2	0	71
<i>Veterinary</i>	92	21	0	24	22	0	73
<i>Road Transport</i>	67	4	0	74	2	0	16
Environmental Protection	0	0	0	0	0	0	0

Table 12.3 Deconcentrated Share of Expenditures by Budget Function, % of Budgeted Amount (continued)

Function	Staff	Goods And Services	Interest	Subsidies	Other current	Capital	Total
Housing and Community Amenities	65	31	0	8	7	0	7
<i>out of which:</i>							
<i>Housing Development</i>	97	96	0	96	88	0	85
Health	57	28	0	1	2	0	35
<i>out of which:</i>							
<i>General Hospitals Services</i>	72	42	1	86	4	0	61
Recreation, Culture, and Religion	8	1	0	17	0	0	6
<i>out of which:</i>							
<i>Sporting Services</i>	91	59	0	42	43	0	62
Education	74	18	0	6	0	0	59
<i>out of which:</i>							
<i>Pre - University Education</i>	96	28	0	20	71	0	87
Social Protection	84	47	0	0	3	0	1
Total	47	26	0	0	0	14	15

Source: Computed by authors based on National Budget data from FY 06/07.

Table 12.4 Disparities in per capita Allocations on General Public Services, EGP per Capital

	Actual 02/03	Actual 03/04	Actual 04/05	Budgeted 05/06	Budgeted 06/07
<i>URBAN GOVERNORATES</i>					
Average	141.10	162.52	198.91	169.32	178.93
Minimum	49.39	50.88	115.79	56.92	57.23
Maximum	304.71	344.68	380.77	392.89	401.24
<i>LOWER EGYPT</i>					
Average	84.42	117.24	154.60	118.13	125.87
Minimum	56.71	73.25	99.39	75.17	80.57
Maximum	135.92	205.65	264.57	179.35	189.38
<i>UPPER EGYPT</i>					
Average	88.60	119.66	166.18	119.40	128.96
Minimum	41.04	68.74	109.57	60.95	71.83
Maximum	180.00	238.30	358.79	208.41	231.47
<i>FRONTIER GOVERNORATES</i>					
Average	369.89	475.77	585.59	401.99	439.74
Minimum	211.12	350.55	362.04	301.59	330.86
Maximum	565.39	638.47	766.36	468.03	505.96
<i>ALL GOVERNORATES</i>					
Average	147.08	191.15	244.84	178.71	192.88
Minimum	41.04	50.88	99.39	56.92	57.23
Maximum	565.39	638.47	766.36	468.03	505.96

Source: Computed by authors based on National Budget Data from 06/07

Table 12.5 Regional Variations in Educational Allocations and Educational Inputs

Region	Enrollment	Dropouts	Never enrolled	SAC	Budgeted per capita	Budgeted per SAC	Budgeted per pupil
	% of SAC population			% of population	EGP	EGP	EGP
URBAN GOVERNORATES							
Average	94.8%	2.1%	3.1%	21.6%	274	1,269	1,330
Minimum	93.3%	1.1%	1.8%	20.4%	175	828	886
Maximum	97.1%	2.8%	4.6%	23.7%	451	2,128	2,192
LOWER EGYPT							
Average	93.5%	2.8%	3.7%	23.5%	259	1,101	1,176
Minimum	90.6%	2.0%	2.1%	22.5%	186	786	868
Maximum	95.1%	4.1%	6.5%	24.8%	391	1,706	1,818
UPPER EGYPT							
Average	90.5%	2.0%	7.4%	26.5%	225	855	936
Minimum	85.5%	0.7%	2.9%	23.2%	122	524	568
Maximum	96.4%	3.5%	11.0%	28.1%	350	1,436	1,490
FRONTIER GOVERNORATES							
Average	90.8%	2.7%	6.4%	22.2%	471	2,195	2,381
Minimum	82.7%	0.9%	1.9%	12.8%	240	840	1,015
Maximum	97.2%	5.2%	12.1%	28.6%	876	3,567	3,670

Table 12.5 Regional Variations in Educational Allocations and Educational Inputs (continued)

Region	Enrollment	Dropouts	Never enrolled	SAC	Budgeted per capita	Budgeted per SAC	Budgeted per pupil
	% of SAC population			% of population	EGP	EGP	EGP
ALL GOVERNORATES							
Average	92.2%	2.4%	5.4%	24.0%	289	1,246	1,342
Minimum	82.7%	0.7%	1.8%	12.8%	122	524	568
Maximum	97.2%	5.2%	12.1%	28.6%	876	3,567	3,670

Source: Computed by authors based on data from 2006 Census and 06/07 National Budget.

Note: SAC school-aged child

Table 12.6 Regional Variations in Healthcare Allocations and Outcomes

Region	Infant mortality	<5 mortality	Maternal mortality	Attended births	Immunization	Budgeted per capita	MOH beds	MOH/ Total beds
	per 1000 live births			%	%	EGP	Per 1000 persons	ratio
<i>URBAN GOVERNORATES</i>								
Average	22.58	1.38	73.75	74.58	99.73	39	16	0.49
Minimum	16.90	0.10	60.00	73.50	99.50	7	11	0.30
Maximum	30.60	3.90	90.00	75.50	99.90	90	22	0.69
<i>LOWER EGYPT</i>								
Average	15.84	0.97	65.78	73.21	99.54	34	13	0.67
Minimum	11.50	0.10	46.00	64.70	98.80	8	9	0.54
Maximum	18.70	1.90	80.00	75.50	99.90	82	21	0.91
<i>UPPER EGYPT</i>								
Average	27.12	1.52	73.44	71.36	99.62	64	12	0.76
Minimum	15.60	0.20	54.00	56.50	98.80	7	9	0.51
Maximum	39.70	2.70	94.00	75.10	99.90	152	24	0.98
<i>FRONTIER GOVERNORATES</i>								
Average	16.52	0.06	46.00	70.16	99.18	412	38	0.88
Minimum	9.60	0.00	0.00	63.50	97.20	65	16	0.76
Maximum	21.50	0.10	89.00	75.20	99.90	823	72	0.94

Table 12.6 Regional Variations in Healthcare Allocations and Outcomes (continued)

Region	Infant mortality	< 5 mortality	Maternal mortality	Attended births	Immunization	Budgeted per capita	MOH beds	MOH/ Total beds
	per 1000 live births			%	%	EGP	Per 1000 persons	ratio
<i>ALL GOVERNORATES</i>								
Average	20.73	1.04	65.85	72.23	99.53	115	18	0.71
Minimum	9.60	0.00	0.00	56.50	97.20	7	9	0.30
Maximum	39.70	3.90	94.00	75.50	99.90	823	72	0.98

Source: Computed by authors based on data from 2006 Census and 06/07 National Budget.

Figure 12.4 Economic Composition of Deconcentrated Expenditures, Budgeted for FY 2006/07

Source: Prepared by authors based on National Budget data from FY 06/07

LOW REVENUE AUTONOMY

Egypt's revenue raising effort of 24.5 percent of GDP is close to the average for low-middle-income countries (26.2 percent) and close to the world average (26.5 percent) according to WDI (2007). However, more than a third of that revenue derives from non-tax sources, mostly remittances from the Egyptian Petroleum Corporation (EGPC) and the Suez Canal Authority (SCA). As of 2006, tax sources generate about 16 percent of GDP out of which 8 percent of GDP was accounted for by direct taxes, 5.6 percent of GDP was accounted for by taxes on goods and services and 1.6 percent of GDP was accounted for by taxes on international trade (Table 12.7). This represents a significant development since 1990 when revenues from indirect taxes outweighed that of direct taxes.

With the exception of a few own taxes authorized for the large cities, all locally-generated revenues come from centrally introduced taxes. Revenue sharing with subnational budgets is done both at the point of collection and through redistribution via the grant pool. Law 43 of 1979 (Art. 35, as amended by Law 50 of 1981) decrees half of shared revenue—structured as a surtax on certain national taxes—be allocated to the governorate budget at the point of collection: the surtax on exports and imports, the surtax on financial assets, and surtax on income derived from trade and manufacturing. The remaining 50 percent of the shared revenues are

Table 12.7 Evolution of Egypt's Budgetary Revenue, % of GDP

	1990	1995	2000	2001	2002	2003	2004	2005	2006
Total revenue	19.14	26.95	21.84	20.73	20.67	21.35	20.99	20.59	24.49
Tax revenue	13.19	17.62	14.59	14.32	13.41	13.35	13.84	14.07	15.83
<i>out of which</i>									
<i>Individual income tax</i>	0.48	0.56	1.26	1.17	1.73	1.61	1.68	1.73	1.52
<i>Corporate income tax</i>	3.10	4.78	4.13	4.16	3.45	3.38	3.94	4.13	6.30
<i>Taxes on property</i>	0.25	0.21	NA	NA	0.20	0.19	0.16	0.19	0.20
<i>Taxes on goods and services</i>	3.12	4.67	5.91	5.80	5.53	5.54	5.47	5.84	5.62
<i>Customs and other import duties</i>	3.16	3.60	2.73	2.56	1.90	1.95	1.88	1.42	1.55
Grants from foreign governments	1.45	0.84	0.52	0.43	0.83	0.56	0.83	0.39	0.28
Non-tax revenue	4.47	8.32	6.73	5.97	6.14	7.21	6.12	5.99	8.27

Source: GFS (2008).

allocated to the common grant pool. According to the law, if activities of a business establishment concentrate in a governorate different from where the business headquarters are located, then the tax revenues from this business is allocated to the former governorate. The rates of these surtaxes have been unstable and have been established in a large body of normative acts over time. This makes it difficult to assess the actual degree of revenue-raising powers of subnational governments in Egypt.

Governorate Popular Councils determine sharing with constituent localities of the following revenue: 25 percent of the land tax and surtax; taxes on motor vehicles and other means of transport licensed by the governorate.

Law 43 of 1979 (Art. 51 and 61) decrees revenue from the gambling and entertainment tax and 75 percent of the land tax to be allocated to the budgets of towns and villages at the point of collection. In addition, town budgets are to receive revenues from the tax and surtaxes on buildings (with the exception of national surtaxes); betterment levies in connection with public works; taxes on motorized vehicles and other means of transport

licensed by the governorate; and revenue from fees out of the list of 11 fees that town councils are authorized to levy. Town council resolutions concerning levies do not take effect until approved by the district popular council and the governor (Art. 53). If the town council refuses to make changes proposed by the governor, the matter is referred to the governorate popular council, and if not resolved then to the Cabinet, whose decision is final. Concession for public utilities/services and extraction of natural resources (except oil and mineral resources) can be given only with the approval of the respective popular council, that is governorate LPC, district LPC, and so on (Art. 129). The Law refers to executive regulations for the assessment of local taxes and the appeal procedure (Art 125). It allows the executive regulations to provide a menu of methods for the local popular council to choose from. The collection of local taxes and tax arrears is subject to the same rules as for national taxes and duties. Local taxes are collected by the Ministry of Finance to the national treasury and then allocated to the local government unit entitled to this revenue.

Law 43 of 1979 (Art. 36–37) allows creation of extra-budgetary funds (also known as Special Development Funds) for land reclamation and affordable housing. In addition, the Law allows Governorates' Popular Councils to establish "Account for Services and Local Development," accumulating user fees, returns on investments of the account funds, donations, and 50 percent of own-sources revenue in excess of the budget estimate. The extra-budgetary accounts are governed by the Governor's decree and managed by a board chaired by the Governor. Similarly each district and village is to establish the "Account for Services and Local Development" to accumulate the following revenue: 75 percent of user fees imposed according to regulations for the governorate "Account for Services and Local Development," profits from agricultural cooperative societies, rents, and other returns to investments (Art. 70). Note that apart from the extra-budgetary funds, districts do not have locally generated revenues. The account is governed by the Governor's decree; Balances in those accounts roll over from one fiscal year to another but are subject to the same financial management rules as the budgetary funds.

In addition to the extra-budgetary funds controlled by the local executive head, service directorates are also authorized to collect revenues for "service improvement" funds (HDR, 2005). For example, in rural clinics, uninsured patients have to pay EGP 3 plus one third of the medicine costs.⁹ Nominal fees are also charged for specialized services such as radiology, dentistry and small surgery.

In practice, the extra-budgetary accounts accumulate revenue from various user fees, administrative charges and license fees. The schedule of fees often includes charges on electricity bills, water meter installation,

industrial licenses, vehicle and motorcycle licenses, and construction permits (HDR, 2005). Besides approval by the LPCs, the schedule of fees has to be authorized by the Prime Minister individually for each governorate. As a result fees on comparable items vary widely across governorates sometimes by a factor of 200 (El Shawi, 2007). One of the reasons is that, once introduced, the fees are not updated frequently. Thus, in Assuit Governorate the schedule of fees for the Services and Local Development Fund has not been updated since it was first introduced in 1983. At the same time, despite the difference in the time of decreeing, in 2000 and 2006 respectively, the governorates of Qena and Beheira have very similar fee schedules possibly due to that fact that same person (Adel Ali Labib, presently governor of Alexandria) served as their governor in those respective times periods.

Local revenues from own sources and shared taxes account for less than a quarter of total local revenue with the rest made up by transfers. It should be noted that property taxes account for less than 10 percent of subnational pre-transfer revenues. In Egypt, property is taxed through three separate tax instruments: Agricultural Land Tax, Building Tax, and Real Estate Transfer Tax. These taxes have rather low yield of 0.2 percent of GDP out of which 0.15 percent of GDP is accounted for by recurrent taxes (Agricultural Land Tax and Building Tax) and the remaining 0.05 percent is accounted for by taxes on property transactions. This is well below the average for low-middle-income countries (0.42 percent) and the world average (0.75 percent) according to Bird and Slack (2004). Just like for other taxes, local authorities are passive recipients of property tax revenue without playing any role in tax-setting or administration. Reportedly in Cairo tax arrears exceed tax collections by a ratio of 6:1 (World Bank, 2006b). However, even if Egypt succeeded in raising the revenue yield to the world average, the property tax could only cover 10 percent of expenditures of the executive head secretariats not including any sectoral expenditure. Motor vehicle fees have a yield comparable to that of the building tax; however, more than two thirds of this revenue is collected in just three urban governorates—Cairo, Alexandria, and Giza (World Bank, 2006b).

According to Table 12.8, extra-budgetary revenue accounts for 30–50 percent of subnational pre-transfer revenue. Extra-budgetary resources are mostly spent on material supplies (79 percent). Most of these resources are spent by subnational executive heads' secretariat as opposed to service directorates (El Shawi, 2007). The amount and composition of extra-budgetary revenues varies among localities. Thus in relatively affluent Behira governorate, the bulk of extra-budgetary resources comes from revenue-generating projects, such as car parking and vegetable and fruit projects. By contrast in the relatively poor governorate of Assuit, projects

Table 12.8 Pre-transfer Revenue of Subnational Government, million EGP

	2004/2005 Actual	2005/2006 Budgeted	2006/2007 Budgeted
Sovereign Revenues			
Local units share from commercial and industrial profits taxes	-	278.1	-
Local units share from revenue retention	269.4	-	-
Local units share from the revenue pool	252.0	472.9	-
Local units share from Suez Canal revenue	147.0	393.6	-
Agricultural land tax	167.9	178.6	213.0
Building tax	159.2	147.4	188.0
Vehicle fees and tax	137.2	146.4	150.0
Gambling and entertainment tax	44.1	42.8	46.0
Local taxes and fees	70.7	80.7	87.0
Local units share from imports and exports taxes	-	204.8	-
Total sovereign revenues	1247.5	1945.3	684.0
Donations	2.5	208.0	196.0
Extra-budgetary funds	1703.7	1258.4	1338.0
Other current revenues	581.6	690.2	808.0
Total pre-transfer revenue	3535.3	4101.9	3026

Source: Mohamed El Shawi (2007).

Note: Sovereign revenues include local taxes and fees and local retention of some national taxes. The sharp drop in sovereign revenues in 2006/07 budgets compared to the FY 2005/06 figures is due to inability of local budgets to plan for some of the shared revenue. If these omitted revenue sources were added to the budget, the total sovereign revenue would increase to EGP 2.033 million. In FY 2005/06 revenue retention from profit taxes and import and export taxes are reported jointly.

contribute only one third of extra-budgetary revenue with the rest coming from property transfer fee, construction permits, and housing rents.

The potential for mobilizing local resources for projects with tangible local benefits is demonstrated by the national program for integrated rural

development “Shorouk.” This initiative promotes demand-driven projects with popular participation in terms of initiating, planning, financing, implementing and evaluating local development. Even in the relatively poor governorate of Assuit, local communities contributed more than a quarter of the project costs (El Shawi, 2007).

Counter-equalizing Transfers

Technically we can identify transfers only with respect to the secretariat of the local executive heads (*Diwans*). Service directorates have no own revenues and are essentially funded from the national budget pretty much the same way as their sectoral head-offices in Cairo. However, with respect to capital projects, there are reports that the Ministry of Education has experimented with some kind of lump-sum capital grants to education directorates without earmarking for any specific site or type of school. (World Bank, 2005b). However, in the 2006/07 budget, zero capital expenses were planned for education directorates (Table 12.3).

In the case of *Diwans*, we can examine two channels of intergovernmental transfers. First, it is the distribution of funds accumulated from half of shared revenue from special surtaxes on imports/exports, investment security holdings, and income derived from trade or manufacturing. This pool of funds, referred to as the “Joint Revenue Fund” initially operated as an extra-budgetary fund controlled by the Ministry of Local Development (Sawi, 2002). The Ministry of Finance would sign off on the distribution of the “Joint Revenue Fund” as long as funded project proposals submitted by local authorities had been approved by the Ministry of Planning (now the Ministry of Economic Development) and included in the Plan. The distribution of this common pool is governed by a resolution of the Minister for Local Development.

In the early 2000s, the Joint Fund was distributed among governorates excluding Cairo and Alexandria according to a formula weighing in population, land area and need (World Bank, 2006b). Transfers from the “Joint Revenue Fund” account for less than 3 percent of the resources of the executive heads’ secretariats. Reportedly, recently governorates have started receiving capital grants from the Ministry of Economic Development (formerly Ministry of Planning) based on a formula weighing in population and HDIs. It is unclear whether this formula applies to the “Joint Revenue Fund.” Similarly, the revenue from the Suez Canal surtax is used to fund projects approved by the Ministry of Economic Development and distributed among the five governorates surrounding the Canal in the following proportion: 50 percent to Ismailia, 30 percent to Port Said and Suez, and 10 percent each to North and South Sinai. These revenues

account for less than 20 percent of total resources of executive heads' secretariats in those five governorates.

The second channel of transfers for the secretariat of the local executive heads is essentially filling the gap between the budgeted current expenditures and the estimated revenue from own sources and shared taxes. The gap-filling approach also applies to capital grants as reportedly the balance of extra-budgetary funds from the previous year is deducted by the Ministry of Finance before allocating financing for the approved local capital projects.

As can be seen in Table 12.9 the allocation of intergovernmental revenue moderately improves disparities among governorates. Thus, the coefficient of variation in per capita expenditures on general public services by *Diwans* (0.83) is only slightly less than the coefficient of variation in per capita pre-transfer revenue (1.05). The coefficient of variation in per capita expenditures on healthcare services is 50 percent higher than of that for per capita pre-transfer revenue. Only for education is inequality in per capita expenditures significantly lower than for per capita pre-transfer revenue. This is not surprising given that per capita amounts of own-source revenues are positively correlated with per capita amounts of both recurrent and capital transfers, with correlation coefficients of 0.18 and 0.74 respectively.

Borrowing

The existing legislation does not rule out subnational borrowing. Thus, Law 43 of 1979 (Art. 12 as amended by Law 50 of 1981) gives governorate popular councils the power to borrow within the plan limits and authorized budget, provided that total indebtedness does not exceed 40 percent of their own revenue. The Law does not allow local government units to assume debt or any other liabilities leading to future expenses other than those in connection with a project included in the plan or budget approved by the national parliament. The information on the actual level of indebtedness is not available but the amount for subnational interest expenses budgeted in FY 2006/07 was under 3 percent of the budget of the executive heads' secretariats.

Assessment: Ambiguity and Lack of Autonomy as A Way of Conducting Business

Practically every aspect of intergovernmental relations in Egypt seems to suffer from a lack of clarity and from general vagueness. And it is not only foreign observers who have difficulties getting a clear picture of how Egypt's subnational system of finance really works. Often, the Government of Egypt itself appears to navigate its journey towards decentralization by

Table 12.9 Disparity in Subnational Revenue and Expenditures. FY 2003/04. EGP per capita

Governorate	Pre-transfer revenues	Current Transfers	Capital Transfers	Secretariat expenditures	Education expenditures	Healthcare expenditures
Red Sea	319	339	128	596	253	83
South Sinai	326	340	33	638	216	382
Suez	150	310	29	147	212	47
Ismailia	142	323	18	206	201	60
Giza	31	133	7	69	88	9
Port Said	188	554	37	345	354	202
Cairo	59	145	7	51	133	21
Luxor	61	398	11	238	207	133
Matrouh	83	337	46	351	185	746
Behera	63	236	18	124	142	6
Alexandria	46	224	44	107	159	9
Fayoum	34	211	11	126	121	88
Aswan	66	403	12	175	238	158
Menia	33	230	4	90	154	22
Damietta	49	431	11	158	262	71
North Sinai	125	786	20	386	446	422
Kalyoubia	30	216	3	73	136	25
Suhag	32	249	4	84	172	12
Beni Suef	37	254	11	104	143	56
Menoufia	37	332	17	97	195	32

Table 12.9 Disparity in Subnational Revenue and Expenditures. FY 2003/04. EGP per capita (continued)

Governorate	Pre-transfer revenues	Current Transfers	Capital Transfers	Secretariat expenditures	Education expenditures	Healthcare expenditures
El Wadi El Gidid	59	1.095	21	409	641	515
Kafr ElSheikh	29	276	14	95	158	58
Gharbia	33	342	10	105	194	8
Asyout	23	257	6	89	143	33
Qena	25	291	6	100	185	71
Sharkia	20	295	15	86	191	31
Dakahlia	26	360	9	112	225	21
Average	79	347	21	191	213	123
Minimum	20	133	3	51	88	6
Maximum	326	1.095	128	638	641	746
Coef. of Variation	1.05	0.57	1.20	0.83	0.53	1.48

Source: Computed by authors based on data from 06/07 National Budget.and Mohamed El Shawi (2007).

way of "touch and feel." Currently, the information available in Egypt on the behavior of subnational governments would seem to be largely inadequate to inform policy makers about the true situation regarding subnational fiscal accounts and the conditions of service delivery. This overall ambiguity led some scholars to believe that there are, "in reality, no local governments in Egypt, only local outposts of the central government." (Thirsk and Martinez-Vazquez, 2007). The all pervasive ambiguity is likely to be the outcome of an explicit policy design and has several main manifestations. The first source of ambiguity is in the relationships and direction of accountability between a locally elected people's council (LPC) and an appointed local executive council (LEC) operating at every subnational level of government. The LEC prepares and executes the local budget and is responsible for the quantity and quality of local public services that are provided. But their accountability is practically only to the central government hierarchy that employs them, as opposed to the elected councils they are supposed to serve. That is what happens in practice. Formally, the lines of accountability are not very clearly established in the law. Although higher level popular councils have supervisory authority over the lower-level popular councils, they have no authority over the executive branch at the same level (the LECs), especially since the abolishment of the interpellation clause in 1988.

Under the interpellation procedure, one third or more of council members could submit interpellation concerning the heads of local units, chairmen of executive agencies, and public authorities working in the jurisdiction. The submission proceeded to a permanent commission that had to include representatives of the higher level popular and executive councils. The committee had to report its findings to the council and if two-thirds approved, the governor was informed and had to refer the matter to investigative authorities. However, the 1988 amendment eliminated this clause (Art. 106-BIS) from Law 43.

A second source of ambiguity is found in the relationships between the executive heads appointed by the higher-level executive and heads of the service directorates or departments in the local jurisdiction appointed by respective line ministries. Legally, the heads of the directorates are the budget holders for the respective sectoral funds in the governorates. Thus each of the 12 service directorates within each of the 29 governorates technically has full control over the development and implementation of its budget and priorities within the overall guidelines set by the relevant ministry. But in practice, the governors may exercise considerable influence in the budget process through "discussions" with the heads of directorates although the extent of their involvement differs from governorate to governorate. The involvement of the governor may depend on his political clout in the Prime Minister's Office and the Cabinet. Moreover, the budget

negotiations between the Ministry of Finance and the governorates do not always involve line ministries (although according to the Minister of Finance, tripartite discussions will be held in the future). The information flows and decision lines are quite opaque, to the point that a recent report from the World Bank (2005b) suggests that line ministries may not know what budget requests have been put forward by their directorates.

A third source of ambiguity arises from the unclear delineation of functions between the levels of government. Specific local functions explicitly stated in the current Law of Local Administration of 1979 appear random and are scattered all over the text. The law also assigns the same functions to other levels of government. Saying that several governments are responsible may simply imply that nobody is responsible in particular. Thus, while the previous point suggests unclear delineation of responsibilities between the national and subnational tiers, there is even less clarity in the delineation of responsibilities among the subnational tiers due to the continued use of the "matroshka" model from the old Soviet budgeting system. In this system every subnational budget is nestled into the larger one of the upper-level government creating a relationship of vertical fiscal dependency and the ability to "pass on the buck" upwards. Another distinguishing feature of this "budget within a budget" system is the large degree of fiscal discretion it permits. Political and economic powers vested in upper-level governments give ample opportunities to "reward one's friends and punish one's enemies" and clear-cut, objective rules for determining fiscal allocations are extremely difficult to discern and more fundamentally, they are unwanted. But unlike in the Soviet "matroshka" system, in Egypt, the information passed to the higher level is even more aggregated.

Another source of opaqueness in budget flows, also inherited from the old Soviet-style budgeting system is the lack of an integrated approach between the recurrent and capital budgets. Thus, drafting of the "investments" chapter of local budgets takes place completely outside the sectoral budgetary process and is entirely channeled through the Ministry of Economic Development (former Ministry of Planning) hierarchy and added to other economic items in the budget only at the national level. This disconnect continues during the budget execution; while the sectoral directors are budget holders for sectoral recurrent expenditures, the governor is the budget holder for block grants for spending on investment projects, which are currently allocated by the Ministry of Economic Development to governorates on the basis of a weighted index of population and the Human Development Indicators. The break of the natural linkages between capital and operational costs of local government activities not unexpectedly leads to a whole spate of problems. Thus, in the health sector,

there appears to have been overbuilding of hospitals and a failure to make full use of the existing stock of hospital beds, with the result that in some areas of Egypt there is an excessive number of hospital beds (World Bank, 2005a). In the water sector, investment in new infrastructure appears to be a substitute for adequate preventive maintenance of the existing infrastructure. The disconnect between the capital and recurrent parts of subnational spending is further aggravated by the lack of horizontal coordination among service directorates. This has led, for example, to situations where a newly built school is only partially used by students because the financing of the complementary supporting infrastructure, such as roads, has been pushed back.

Another element of opaqueness in the budget process is the practice of the extra-budgetary accounts ("Special Development Funds"), which represent about 5 percent of subnational resources—comparable to the amount of local revenue from all own and shared taxes put together. Conventionally the use of extra-budgetary funds at the subnational level should be discouraged because they cause fragmentation of budget allocation decisions and reduce the efficient use of resources (end users of these funds typically do not have to compete with other potential users in the budget) and because they reduce transparency and accountability. However, in the case of Egypt, these special accounts provide the only means for local authorities to exercise discretion in the allocation of resources according to local priorities. The lack of access to a broad-based source of revenue results in a plethora of fees earmarked for extra-budgetary funds. In Assuit governorate, an extra-budgetary fund created in 2001 to accumulate revenues for cleaning and beautification activities had a schedule of fees including 52 items (El Shawi, 2007).¹⁰

WHAT DOES THE FUTURE HOLD?

Since 2007 there have been serious discussions within and outside government over what shape and form fiscal decentralization reform should take in Egypt. This impetus has been reinforced by the support of the international community in providing technical assistance for the formulation of the technical aspects of the reform.¹¹ After a series of high level conferences under the leadership of the Ministry of Local Development and the preparation of national decentralization paper for the NDP meeting in late 2007 (see Box 12.1), a lot of work has gone into drafting a national decentralization strategy and implementation plan. It appears that the Egyptian Government understands well the importance of developing a well structured policy vision before moving into concrete

implementation steps. In particular, the idea of jumping on the wagon of amending the Local Administration Law in time for the past April 2008 elections was squarely abandoned.

Despite the NDP working paper guidelines, not surprisingly, for the time being there does not seem to be clarity and agreement among government stakeholders regarding the main features of the new decentralized system. On the one hand, the leadership at the Ministry of Local Development working together with the Ministry of Finance is developing the elements outlined in the NDP working paper in a quite different direction from the one being developed by some line ministries, especially the Ministry of Education.

In a thumbnail, the policy vision being developed by the Ministry of Local Development and the Ministry of Finance is based on four basic points:

- (i) Making the district the basic unit of decentralization at the local level, while the Governorate would become a more clearly defined deconcentrated territorial unit of the central government.
- (ii) Empowering the district Popular Councils to make autonomous budget decisions on their own expenditure responsibilities or functions assigned to them in an exclusive fashion by the law, and for delegated responsibilities assigned to the districts through the selected sectoral decentralization of responsibilities which were, until now, carried out exclusively by the central government.
- (iii) Funding of the lion's share of the expenditure needs of the district governments through block grants from the central government, although districts will be able to raise revenues through service fees and other current revenue sources assigned to them.
- (iv) Establishing Financial Commissions at the national and governorate levels to oversee formula-based distribution of grants among governorates and districts respectively.

The vision for decentralization of the Ministry of Education is quite different. Basically, the funds would flow directly from the Ministry to the school council bypassing entirely the district government and budgets. However, the discussion is limited to appropriations on material supplies, which currently account for less than 5 percent of education directorates' budget. The ongoing discussions include the possibility of adopting similar approaches in other areas such as health.

It is too early to say which view, if any, will be carried forward. A lot will depend on how the Government and the NDP view the political opportunities and perils of decentralization reform. As a sign of anticipation of the growing importance of local governments and the decentralization

Box 12.1 NDP's roadmap for decentralization

- Empowerment of LPCs to activate their monitoring role of the executive councils, and to establish local funds to mobilize local resources through authorized taxes and/or charges;
- Devolution of authorities related to public service delivery to the local level. In that, the Governor would be the prime party responsible for planning and implementation of a package of wide-coverage services (e.g. plant and network services – electricity, sanitation, water supply, roads, etc.). Each governorate will have a budget that includes all allocations to deliver these services. Governorates would have the right to move resources across line items in light of legislated national standards and measures, with the endorsement of the LPCs;
- Markazes, and cities will have their own separate budgets allocated from the respective governorate. Markazes and cities are to use these budgets to plan and implement delivery of public services of local nature (e.g. schools, family health care units, cleansing systems, local networks of public works, etc.). Cities and Markazes will have the right to move resources across line items in light of legislated national standards and measures, with the endorsement of the respective LPCs;
- Governorates are to be the units for socio-economic development. They are to issue a local development program based on programs developed by cities and markazes of the governorate. The national development program is to be based on these governorates' programs. The local program (governorate, city, marakaz) should serve as the basis for budgeting and expenditures for public service;
- Sectoral ministries (e.g. education, health, etc.) are to develop and issue national strategies including sectoral policies and national standards of respective service delivery. The respective quality assurance agency in each sector is to monitor compliance of these standards at the local level. National ministries are to issue annual reports including national averages of indicators of public service delivery, along with information disaggregated at the governorate level. These indicators will be used to direct public resources to governorates with the highest levels of needs to achieve equity;
- The national government will update the budgeting process to reflect new roles of local authorities in the national expenditures. The government is to issue financial standards that are to be applied in localities in budgeting and financial reporting presented to the central level. Formulae to be used to distribute resources among governorates are to be announced;
- Developing the financial and administrative framework that enables establishment of local financial committees at the governorate level comprising the Governor, Chairperson of the LPC, a representative of the Ministry of Finance, a representative of the Ministry of Local Development. The committee will distribute financial allocations of public services of local nature (see above) among marakezes and cities within that governorate to achieve equity among local units;
- The Ministry of Local Development (MoLD) is the governmental body responsible for decentralization. It is responsible for coordination among central entities to activate decentralization. The MoLD is also responsible for the performance of senior executives at local levels. It will publish reports about performance levels of governorates in devolved responsibilities. It will support local units in developing their capacity to undertake new mandates.

Source: NDP (2007)

reforms to come, the 2008 local elections saw unusually high competition to enter the electoral races. In the previous elections only 1.2 candidates competed for each seat with 60 percent of seats taken by unopposed candidates from the National Democratic Party. In 2008, the Muslim Brotherhood put forward roughly 5,000 activists to compete for some 52,000 seats at the different levels of local elections of which only 500 were able to register. Meanwhile, opposition parties put forward some 4,000 candidates (1,700 from the liberal al-Wafd, 600 from the leftist Tagammu', and 700 from the liberal al-Ghad), of whom only 1,200 successfully registered (Herzallah and Hamzawy, 2008). There was also fierce competition among NDP members to be nominated as a party candidate with 600 NDP members quitting the party in protest of not getting a nomination. However, there was not as much competition at the ballot as it was during the registration process. At the end the Muslim Brotherhood decided to boycott the elections and voter turnout did not exceed 5 percent. Over 80 percent of the 52,000 local council seats were won by NDP candidates running unopposed and overall 95 percent of seats went to NDP.

CONCLUSIONS AND THE WAY FORWARD

There are reasons to be moderately optimistic about the prospects for fiscal decentralization reform even if the obstacles remain formidable. The 2007 Constitutional amendments gave the national legislature some control over the President-appointed Cabinet (confirmation vote, vote of confidence, etc.). In particular, the national legislature got the right to amend the budget put forward by the government. This is in line with the proposed empowering of LPCs vis-à-vis LECs at the local level (NDP, 2007). Moreover, the 2007 constitutional amendments added the following clause to Article 161: "The law shall guarantee the endorsement of decentralization and regulate the means by which the administrative units can provide and upgrade local facilities and services, improve them and provide good management."

On the other hand, the history of Egypt has already seen local government reform initiatives, including legal and constitutional amendments, which have failed to materialize. Thus, Article 162 of the 1971 Constitution provided for "gradual transfer of authority to the Local Popular Councils." However, 35 years down the road elected local councils are still fairly powerless vis-à-vis the executives and in fact have lost some of the few powers that they used to have, such as the interpellation power. The lines of horizontal accountability are still not established in the law very clearly. Since the abolishment of the interpellation clause in 1988,

popular councils have supervisory authority over lower-level popular councils but no authority over their own executive branch.

The successful implementation of the decentralization reforms this time will depend on fleshing out some of the main elements:

1. Identification of the expenditure responsibilities of the district government, including both own or exclusive responsibilities and delegated responsibilities from the central governments (through sectoral decentralization).
2. Quantification of the expenditure needs that arise from the expenditure assignments to the district governments.
3. Identification of the financial instruments for the transfer of funds to be implemented by the Ministry of Finance: Determining the use of funds in the district government budget (i.e., general funding at the discretion of the local government versus conditional funding where the local government can only use those funds with the conditions attached by the central government.)
4. The process of the distribution of funds through the Grants Commission at the central level and the Local Finance Commission at the governorate level.

In what follows we discuss in more detail how to carry out each of these tasks, pointing out some options when pertinent.

Identification of the expenditure responsibilities of the district government. These responsibilities will need to be identified in the law. At the present time, it is foreseen that the "own" or "exclusive" expenditure responsibilities of district governments will include street lighting, refuse collection, and local/city roads. It may also be advisable to recognize as an "own" expenditure responsibility the administration costs the district government is expected to reasonably incur. For delegated expenditure responsibilities, the prime candidate currently is education services. Given all the political concerns, asymmetrical assignment may be the way to go. The Local Administration law allows a separate statute for "special cities" and Luxor City has such a statute. It appears that newly reclaimed/established urban settlements are governed by a special system with a board of trustees representing the local business community, households, labor and consumers (Sawi, 2002).

Quantification of the expenditure needs that arise from the expenditure assignments to the district governments. This will be the most delicate and important task in the decentralization reforms. The expenditure needs for own responsibilities should be computed separately from the expenditure needs for delegated responsibilities. At some point in the future it may be also desirable to separately estimate the expenditure needs for the various

own responsibilities, but that does not seem to be necessary at the present time (given the anticipated expenditure assignments). It is important that the criteria used to estimate expenditure needs (either own or delegated responsibilities) are reflective of the population needs themselves as opposed to the existing capacity at the district level to provide the services. For example, a funding mechanism for education services based on the number of children of school age is focused on need while a funding mechanism based on the number of classrooms available in the district would be based on existing capacity. Obviously, this second approach would send wrong incentives (build additional classrooms without end) and it would be much less equitable or fair.

The simplest approach to the determination of expenditure needs for own functions or responsibilities is on a "per capita basis" or on a "per capita basis adjusted upwards for the relative number of families living in poverty in the district." In the case of delegated responsibilities a similar approach should be followed. Since the only delegated responsibility in the first phase of decentralization will be basic education, the simplest rule would be to use a transfer formula either based simply on the "number of children of school age in the district" or the "number of children of school age in the district adjusted for cost differentials across districts." Whether or not this second approach is desirable will depend on the existence or not of noticeable differences in costs in different areas of the country in the delivery of a standard package of education services.

Identification of the financial instruments for the transfer of funds to be implemented by the Ministry of Finance. Transfers can take many forms in regards to the use of funds allowed to the recipient subnational government. Given the nature of the assignment of responsibilities for "own functions" and "delegated functions" and also considering the importance of promoting autonomy and accountability at the local level, it would be desirable to organize the transfers for own expenditure responsibilities as unconditional grants and the transfers for education expenditure responsibilities as block grants. (However, a valid case could be made in favor of using conditional specific grants, at least initially, in the case of transfers for education.)

The process of the distribution of funds through the Grants Commission at the central level and the Local Finance Commission at the governorate level. The current strategic vision for decentralization considers the introduction of a National Grants Commission at the central level. It would be the role of the Commission to consider the pluses and minuses of different formulas and approaches, including the ones suggested here. The Commission would need to work with external technical support or rely on the technical expertise of, for example, the newly created Technical Office of the Ministry for Local Development. It is important to be aware that both

the National Grants Commission and the also the proposed Local Finance Commissions at the governorate level must avoid working on a discretionary basis, using hidden criteria, and so on. Instead these two bodies must follow explicit and transparent formulas. But, for example, there may be some decisions local finance commissions may make at the governorate level by selecting values for some of the parameters in the formulas.

NOTES

1. This budgeting system was largely introduced to Egypt during its alignment with the Soviet Union in the 1960s, which continued until Nasser's death in 1970.
2. Thus, the World Bank *Public Expenditure Review* finds that "the poor allocation of resources and the lack of a strategic approach to quality improvement are contributing to the loss of patient satisfaction with the public health services. As a result, most Egyptians, including those living in the poorest regions, are more often seeking health services from the private sector." (World Bank 2006, pp. 17–8)
3. A 2001 study by the General Authority on investment and Free Zone (GAFI) found that a new investment could involve as many as 22 ministries and 78 government agencies.
4. About 30 percent of healthcare is covered directly from the budget, another 10 percent through the social insurance scheme; while the private insurance accounts for less than one percent of total healthcare costs.
5. For example, on April 16, 2008, President Mubarak stated that Egypt's "approach towards decentralization is irreversible" and that "it has become an indivisible part of the Constitution." (Egypt State Information Service website).
6. The contents of the NDP decentralization vision are discussed below in the chapter.
7. The main laws are: law 57 of 1971, law 52 of 1975 and the (current) law 43 of 1979. Furthermore, the last law has been amended several times by law 50 of 1981, law 186 of 1981, law 26 of 1982, law 106 of 1987, law 145 of 1988, law 9 of 1989, and law 84 of 1996.
8. While LPCs formally approve drafts of the budget and final accounts before it is submitted to the Ministry of Finance, it is the latter who conducts negotiations with governors and approves the final versions.
9. USD\$1= 5.7 Egyptian Pounds (EGP).
10. Recently, these resources have been forced into the national Treasury system to generate information and control of the funds. This move, which in theory should not reduce the autonomy of local authorities in deciding the final use of the funds, has been bitterly opposed at the subnational level and it has been interpreted by many as a clear indication of the re-centralization designs of the central authorities.
11. The international support effort has been lead by USAID but also with participation of the UNDP, the World Bank and some other bilateral donors.

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