

IILHR MEMO
LEGAL APPROACH ON 2009 BUDGET LAW ARTICLES
February 14, 2009

The Institute was approached by the Chair of the Committee on Financial Affairs for legal advice on the Draft Budget Law for 2009. We were given two documents: one including Ministry of Finance's amendments to the draft Budget Law for 2009 and the other Comments of Mr. Taleb Ayfan, Advisor to the Iraqi Council of Representative's Committee on Financial Affairs.

***SUBJECT:** To research ways to strengthen the ability of provinces and municipalities to provide basic social and municipal services and to perform their functions in an effective manner by allocating budget items and managerial responsibility directly to provincial government bodies.*

The Ministry of Finance suggests the following amendments to the 2009 Draft Budget Law:

1. Financial and managerial disengagement of all central directorates of the ministries and those who are not connected to ministries except the directorates of ministries and those not connected to ministries, mentioned in the table attached which cannot be distributed or connected to the provinces they are functioning in. Ministries and entities not connected to ministries shall reserve the tasks of planning and technical supervision on the transferred directorates.
2. Minister of finance, with an exception of the existing financial management law and directly upon approval of this budget, shall transfer operational expenses allocated for the central directorates mentioned in paragraph (1) from the budget allocation of the relevant ministries and entities not connected to ministries and shall be attached to the budget of the provinces. Provinces shall be mandated all the administrative and financial powers related to these directorates, including the power to spend operational expenses of these entities under the condition that allocations shall be distributed according to population of each province.
3. Minister of Finance, in coordination with the ministry of planning with an exception of the existing financial management law and directly upon approval of this budget, shall transfer all allocations for the new

investment projects mentioned in paragraph (1) from 2009 budget allocated to ministries and entities not connected to ministries to the relevant provinces. Provinces shall be mandated all administrative and financial powers related to these projects including powers of implementation and spending under the condition of distributing these allocations according to population of each province. Ministries shall reserve the power of implementation and spending over ongoing investment projects until accomplishing them, also joints projects for more than one province unless otherwise agreement is reached among these provinces and the relevant ministry.

4. Ministry of Finance, Ministry of Planning and Development cooperation and the provinces shall commit to prepare budgets of 2010 and on in accordance to what was stated above.

The provisions aim to increase the powers of Provincial Councils by transferring authorities controlled/administered by central government agencies in provinces (as services, local development, investments) to the Provincial Councils.

QUESTIONS which need to be asked are:

- Is this part of a decentralisation strategy or only an attempt to start financial decentralisation?
- Will the jurisdiction over decentralised units (health, education, electricity, water, agriculture and so on) of governmental agencies be transferred to the Provincial authorities with all of their properties? [Law nr. 21/2008 gives limited control/oversight powers to local authorities, employees are still appointed by and planning is made mostly by central government; *Article 7: Sixth: To oversee all activities of local executive bodies, except for courts, military units, colleges and institutions to ensure the quality of their performance, with the exception of offices of federal jurisdiction.*]
- Are the budget items that the Ministry of Finance is referring to a part of the Governorate's Budget or will they be included as separate items in the ministries budget and then administrated by the Ministry of Finance?
- Alternatively, will they be included in a special budgetary fund? Will a special grant be allocated according to Article 44/Fourth of Law nr. 21? In this case what will be the constitutional standards prepared by the Ministry of Finance and approved by Iraqi Council of Representatives

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- Is there a clear definition of how federal and local governments divide local powers on services, assets, operations and personnel?
- There are some projects which should be conducted on a federal basis, but are there any legal provisions dividing expenditures between the federal and governorate authorities?
- What is the future role of the Ministry of Municipalities and Public Works?

SUGGESTIONS:

1. The Government should have a comprehensive strategy for decentralising local administrations which includes financial power distribution between federal, regional and provincial levels of government. In most states, there is a complex set of financial laws that sets forth the allocation process. Decentralisation of government authorities is a long and complex process and needs proper preparation, this process should not be rushed. It would be favourable to study this question more in-depth with the goal to be achieving a process in time for the 2010 budgeting process.
2. A legal framework should be created/clarified/amended in order to clarify the distribution of powers which aim to decentralise.
3. The budget items allocated for diverse local services should be included into the governorate's budgets or as separate items with special destination (as grant of special budget funds).

In fiscal federalism, governments have other ways to divide wealth and allocations. This is done through transfers of:

- a. Unconditional grants (this solves inequity between tasks and available finance)
- b. Conditional grants (depends on degree of achievement in implementing the projects that these grants are allocated for by the national government)
- c. Equal grants (to enable local governments to implement basic services programs, like health and education based on national standards)

For example: In South Africa, the national government has two types of transfers to the Provinces and municipalities in accordance to functions assigned to them:

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- a. Equitable share (block grant to each province based on population, population in poverty and institutional capacity; and to each municipality to subsidy basic services delivery. The equitable share formula is reviewed and updated with new data every year).
 - b. Conditional grants (solely given to provinces and municipalities to address problems of spill-over benefits in connection with national priority programs that are still need to be institutionalized in provincial or municipal budgets (health, education and other vital social and municipal basic services)).
4. It would be advisable for only one governmental agency to be responsible for allocating special budget items or local budgets (as Ministry of Finance or Ministry of Planning or Minister of State for Provinces). In cases where this is not possible, coordination is needed between ministries involved in the process as an inter-ministerial committee of ministries providing basic social and municipal services.
5. Any implementation of a fund allocation formula where funds are to be distributed to a sub-government such as a province requires laws, institutions and mechanisms in place to provide oversight and to punish for fraud, including random and periodic audits. This will prevent cheating and over/under reporting. A trained cadre will be necessary for the implementation, as Mr. Taleb points out.
6. Mr. Taleb is concerned about the conditional transfer of administrative and financial responsibilities for capital investment projects; if the allocation will be distributed according to the population of each province (see Paragraph 3 of his comments) his comments are valid and need to be addressed. One possible way of addressing this is by allocating money for operational/personal items. However, as 70% of budget is salaries, this will create clear problems and could lead to unemployment of a number of civil servants (not advisable before elections). Another concern is the discrepancy between data of the last census done in Iraq and current population of provinces; there is no possibility for accurate/reliable information in the present due to migration of population after 2003.
7. Research should be done on how the distribution of allocations is conducted in other countries. For example, in Romania distribution of allocations for counties (provinces) is based on principal of proportionality, it uses the following formula: 70% according to financial capacity of county based on income of inhabitants and 30% on geographic size of the county.
8. Bob Ward, the current Chief Clerk of Florida Legislature, and former NDI consultant of the Council's Committee on Financial Affairs, sent us a sample presentation (see attachment) that was completed recently for the

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Florida Legislature to understand its own fund allocation formula that it uses to distribute funds to their districts. This may help you in reviewing the complexity of the process and give you some suggestions in the drafting process of the 2009 and following year's budget.

9. On Paragraph 4 (Ministry of Finance's proposal): it is not advisable to commit now to the future budget process before developing a comprehensive strategy on financial decentralisation, and amending/drafting laws on a comprehensive budget process (for example: federal/local financial laws, implementation of article 105/106 of the Constitution could serve a long time fixes for allocating revenues or others).

Please contact IILHR for any further questions, information or comments.

Please find attached the opinion of Bob Ward, Chief Clerk of Florida Legislature.