

# Decentralization and Intergovernmental Finance in the Palestinian Authority

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## *Summary*

Several specific issues involving local governments and intergovernmental finance need to be addressed in West Bank/Gaza. Growth and development will bring substantial challenges to local government, which in many respects is the level of government closest to peoples' daily lives. It is also the level of government considered most supportive by business. The World Business Environment Survey was administered in Palestine by the World Bank in 2000 before the onset of the current *intifada*. In response to a question as to the relationship between business and the two levels of government, over two-thirds (67.4 percent) of respondents described the relationship with local government as being very or mildly helpful, while just over half (53.9 percent) described the relationship with the central government as being mildly or very helpful. The services provided by local governments in Palestine include the local provision of infrastructure, recreational and cultural services (water, electricity, sewerage, solid waste collection and disposal, local roads, parks and community centers).. These services affect the quality of the daily lives of Palestinians as well as the competitiveness of Palestinian businesses and their adequacy is an important determinant of the credibility of *all* governments in the minds of citizens.

Provision of all of these services is inadequate in different degrees now and some services have very serious problems. These problems are likely to become much more serious, particularly for the poorer municipalities, with growth and development.

As might be expected, financial issues are key to much of the future of local government. The regional consolidation of utilities that has occurred in recent years will lead to better service, but it also leaves many local governments with a problem of replacing revenues that were previously used to cross-subsidize other municipal services. Several proposals to assist local governments to become more self-reliant in their financing will be examined. We shall then look at the need to improve planning and zoning in local government. The section will conclude by considering measures to improve the governance and accountability of local governments.

Transfers to local governments, user fees and property taxes. It is common throughout the world to finance road construction and maintenance by taxing proxies for road use, and the 1997 *Local Authorities Act* of the Palestinian Authority (PA) provides for half of gasoline taxes, vehicle registration fees and traffic fines to be transferred to local governments for these purposes. Unfortunately, the Palestinian Authority has not

carried out these transfers, the reason given being that some local governments are not paying their bills to Israeli utilities, and the Government of Israel then deducted these utility arrears from the revenues (VAT, etc) it collected for and transferred to the Palestinian Authority. In rejoinder, municipalities claim that they have not been paid for utility services they provide to Palestinian Authority ministries and agencies.

The Ministry of Finance is correct in insisting that local governments and their utilities must face a “hard budget constraint,” so that the central government is not forced to pay for local arrears to suppliers. Equally, however, there is no reason why transfers that the PA is obligated to pay by law to local governments should be withheld as a collective punishment affecting all localities, whether they are in arrears to foreign utilities or not. It is important that this issue be resolved in a transparent manner so that the public knows which institutions are paying their bills and that the remedies do not adversely affect jurisdictions and their taxpayers that are carrying out their responsibilities. As a matter of priority, therefore, the Ministry of Finance should establish an alternative procedure for settling debts with individual local governments, including non-payment by central agencies for municipal services.

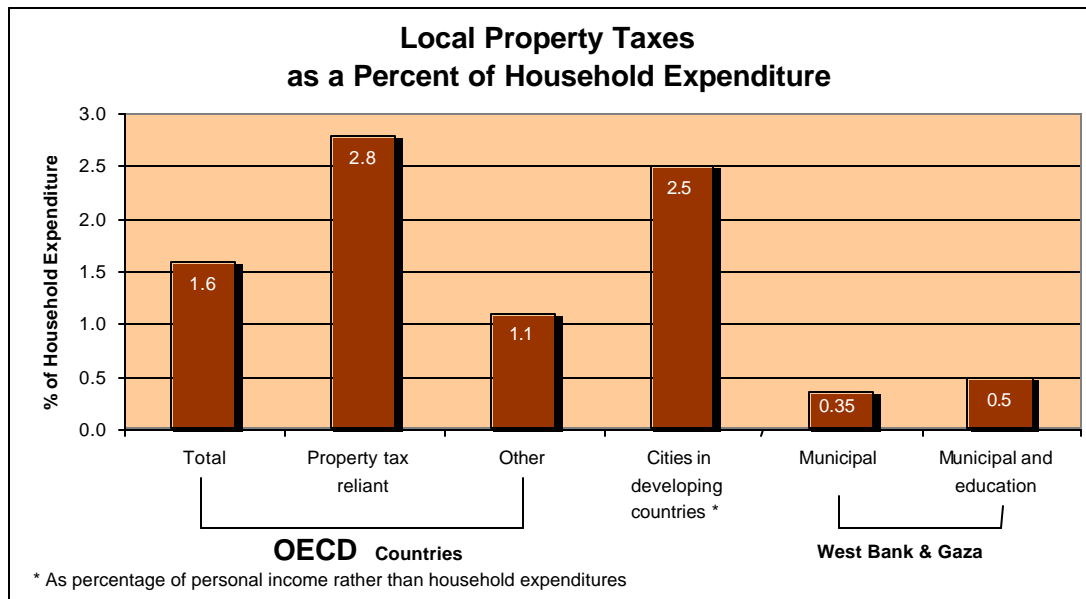
Another issue arises concerning transfers to pay for local road maintenance. As noted, it is appropriate to use government revenues from the sale of automotive fuels for this purpose and excise taxes would be the normal source of government revenue from use of these fuels. In West Bank/Gaza, however, the PA also derives revenues as the monopoly supplier of automotive fuels, so that the actual tax on these fuels may be of lesser significance to the Authority and may not be an adequate source of finance for local road maintenance. The provisions in the *Local Authorities Act* specifying the transfer to local governments for road maintenance might accordingly be changed to constitute one half or some other negotiated share of all government revenues derived from the sale of automotive fuels.

Local governments in less well-off areas cannot afford to offer the services supplied by better off localities with their richer revenue bases. Needs are particularly pressing in the rural villages, where public opinion surveys indicate residents view changes in local conditions since the Oslo Agreements much less positively than those living in municipalities or refugee camps, and even report significant deterioration in some services such as the supply of drinking water. “Equalization” transfers to poorer local governments, which have the objective of enabling all local governments to supply essential services with the same local tax effort, are a feature of intergovernmental finance throughout the world and have sound equity and efficiency rationales. Despite the extreme fiscal pressures that will bear on the central government (i.e., the Palestinian Authority), introduction of such transfers to assist less well-off local governments to supply essential services deserves priority consideration.

The fiscal pressures on the Palestinian Authority imply a need for local governments to finance their activities largely from their own resources. This is also appropriate considering the functions assigned to local governments. Since most benefits of these services are captured by their local users in proportion to use, user fees should

finance provision of most of the services. Local governments can and should increase their revenues by improved management of user fees. A recent World Bank study for West Bank/Gaza by Fitz Ford finds that “poor collection efficiency is emerging as the single most important source of cash shortages for municipal services and functions.”

Where such direct user fees are inappropriate, local governments should have access to a suitable tax base. Throughout the world, property taxes are thought to be appropriate for this purpose and are usually assigned exclusively to local governments. The property tax is an appropriate and equitable local revenue source in Palestine because it pays for the infrastructure services provided by local governments that directly benefit local property and because property ownership is reasonably related to ability to pay the tax. The figure below, which is taken from the World Bank’s 1999 publication *Strengthening Public Sector Management in West Bank/Gaza*, suggests both that the property tax is underutilized in Palestine compared to its use by local governments elsewhere in the developed and developing worlds and that there is no question that local residents can afford to bear a higher property tax load in Palestine.



The Palestinian Authority has agreed to hand over the administration of the property tax to local governments, but could still retain a role in setting national guidelines for implementation of this tax and other local fees and tariffs. Further, the property tax, while being the mainstay of local government’s “own” revenues elsewhere in the world, is difficult to administer and the experience of donors should be tapped in building capacity in local governments to administer it in Palestine.

Joint services councils. The creation of regional electricity and water companies indicates that the boundaries for efficient provision of local services need not coincide with existing local government boundaries and this may also be true also for other local services. But attaining efficient scale in producing these services may not require the

creation of new regional undertakings. Experience in France and the United States indicates that cooperative arrangements and well-functioning markets mean that efficient sizes of local governments can be quite small. The average population of French communes, 1300, is much smaller than the average size of local government districts in other European states (e.g., 20,000 in Germany, 30,000 in Sweden, and 120,000 in the United Kingdom). The communes make extensive use of cooperative arrangements (*syndicats intercommunaux*) to provide services. The US Association of Contract Cities, whose members are mostly located in California, provides an example of reliance on market solutions to provide municipal services. The local governments in the Association themselves perform few of the functions for which they are responsible. They buy and sell services between themselves, and private firms offering to provide services compete for contracts in a highly competitive environment.

The savings from contracting out or cooperative provision obviously have to be balanced against the costs of coordinating these alternative actions, but the alternatives allow considerable organizational flexibility in provision of local services. The Palestinian Authority's *Local Authorities Act of 1997* provides for Joint Services Councils to obtain services collectively for local governments and these provisions are being used. An example is the formation of a Joint Services Council to manage solid waste in the Jenin region.

Planning and zoning. An important set of problems facing local governments consists of their legal powers and capacities in the area of planning and zoning. These services are almost totally deficient now but the need for them will rise enormously with growth in the population and economy. Building local government capacity in this management and planning role is inherently more difficult than adding to physical infrastructure, such as building inter-urban roads or wastewater facilities, but will be a critical need. West Bank/Gaza will have to decide what guidance local governments need to get to allocate land and land use as returnees appear, as the population grows and as the private sector demands clear rules for access to infrastructure and local licensing and planning.

Local government elections. Finally, there is a more fundamental local priority than any discussed so far: the need in West Bank/Gaza to give legitimacy to local governments by holding early local elections. The old principle linking taxation with representation indicates the fundamental point at issue: the power to raise local taxes carries with it the reciprocal responsibility in a democracy of being accountable to local taxpayers. The principle linking taxation with representation also indicates precisely what is wrong with proposals such as those in 1999 to give the unelected, centrally appointed governorates powers to raise local taxes. These proposals were debated (but shelved) in the Palestinian Legislative Council. Early local elections would also reinforce donor support for local investment, whose purpose has been frequently and clearly stated as being to encourage the growth of local self-governing institutions.

Transparency in local government. Other steps should also be taken to increase the accountability of local government, by increasing transparency of its actions. The annual budgets and audited annual accounts of local governments have traditionally been public

documents in other democracies and should similarly be available by right to the public in West Bank/Gaza. As has happened in the United Kingdom, the central government could also emphasize the responsibilities that have been assigned to local governments by regular publication of performance reports for local governments.