

***MDF4 Workshop:
Empowering Local Government Institutions in the MENA Region Workshop***

*Session: The State of Fiscal Decentralization in the MENA Region:
The Limitation of Local Government*

How well is Lebanon fiscally decentralized?

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The purpose of this paper is to assess the fiscal decentralization framework, and its implementation in Lebanon, in light of economic principles and international experiences. Decentralization, in this paper, is defined as the transfer of authority and responsibility for public functions from central government to local governments. Fiscal decentralization, a core component of decentralization, aims to give local governments the authority to make expenditure decisions and the adequate revenues to carry out the decentralized functions (Litvack and Seddon).

Having earned their political independence through the elections of 1998, municipal governments in Lebanon have yet to secure their fiscal autonomy for the decentralization process to be meaningful. Hence this paper argues that the benefits of political decentralization can be only reaped if only if fiscal decentralization which consists of clear delineation of responsibilities between central and local governments, removal of spending bottlenecks, better tax administration, and a transparent grant system, are put in place.

The chapter has 5 sections. Section I lays out the general benefits of fiscal decentralization and ways to attain them. Section II, III and IV examine the three components of fiscal decentralization: expenditure assignments, revenue assignments, and intergovernmental grant system, respectively. For each component, the paper first examines the economic principles that govern that component with a brief overview of international experiences. This is to be followed by an assessment of fiscal decentralization in Lebanon, which is largely based on a thorough review of the laws and decrees that govern the municipal sector as well as fieldwork on a number of municipalities over the years. Section V concludes the chapter.

Section I – Benefits and reform of fiscal decentralization

Fiscal decentralization, if well designed and implemented, can reap economic, political and social benefits. For one, fiscal decentralization can increase the efficiency and responsiveness of local governments. This is because locally elected leaders tend to know their constituents better than authorities at the national level and hence so should be well positioned to provide the public services local residents want and need. The larger the differences in preferences across jurisdictions, the greater are the benefits of decentralization. A result of this is that local governments can mobilize more revenues since (a) people are more willing to pay for services that respond to their priorities, especially if they have been involved in the decision making process for the delivery of those services; and (b) they are able to identify and access some tax bases more readily than central governments (e.g. certain user charges, real property tax).

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Second, fiscal decentralization plays a primary role in maintaining political stability in the face of pressures for localizations. That is a country that finds itself deeply divided along geographic, sectarian, or ethnic lines, decentralization can provide an institutional mechanism for bringing opposition groups into a formal, rule-bound bargaining process.

Third, it can be a positive force in alleviating poverty. Local officials and community groups are better placed to identify and reach the poor through their access to social networks than central authorities. In fact, central governments must provide the bulk of the funding and local governments must deliver and manage the social services.

Despite these potential benefits, national governments have either postponed or ignored the pressure of fiscal decentralization citing macroeconomic instability as a primary and legitimate excuse. However, experiences show that the potential problems associated with decentralization in developing countries reflect more flaws in the design and implementation than any inherent outcome of decentralization per se (Javed et al, 1999). Thus macroeconomic stability can be ensured as long as two institutional parameters are in place. The first parameter is the hard budget constraint where local governments cannot spend more than they earn. It is often the case when there is a separation between spending and tax decisions that local governments overspend especially if they expect to get more resources from the central governments either through additional discretionary transfers or bailouts. The second parameter is borrowing constraints where creditors will be more conservative in lending to local governments only if they believe that the central government will not bail them out.

Reaping the benefits of fiscal decentralization goes beyond avoiding macroeconomic instability. The most compelling lesson of recent decentralization experience is the need to synchronize the elements of reform (World Development Report 1999/2000). A fiscal decentralization policy must first determine the expenditure assignments – that is the functions and responsibilities - that municipalities must undertake. This must be complemented by the decentralization of management. Expenditure assignment should thus be followed by the assignment of taxes and fees that local governments must levy to finance these responsibilities. And finally, the gap between the expenditure and revenue assignments is covered by the intergovernmental grant system.

Many African countries facing economic collapse devolved a broad range of government services to subnational governments without providing the necessary revenues. Not surprisingly the quality of the decentralized services declined sharply. In much of Latin American, the opposite happened: governments decentralized revenues without offloading corresponding responsibilities. In Columbia, central transfers to municipalities increased by 60% without a matching increase in responsibilities (World Development Report 1999/2000).

Section II – Expenditure assignments

Local governments' primary purpose is to provide services. The first part of the section examines the principles that govern expenditure assignment between central and local government as well as the responsibilities of local governments in other countries. The second part analyzes the gap between what Lebanese municipalities are allowed to do by Law and what they are actually able to do. The section argues that although the responsibilities assigned to Lebanese municipalities by law are in line with economic principles and other countries' experiences, the municipalities, in practice, are unable to assume their responsibilities due to the lack of clear delineation with the central government, excessive control and oversight by ministries and public agencies, and weak fiscal and managerial capabilities.

Economic principles

There are four major principles that govern the assignment of functions between central and local governments. One, the responsibility for the provision of services should be at the lowest level of government compatible with the size of the “benefit area” associated with those services. In other words, the functions should be assigned to that government - central or local - whose jurisdiction most closely approximates the geographical area of benefits. Two, public goods and services should be provided by that government that can best realize the economies of scale in the production of goods or services. Three, the functions should be assigned to jurisdictions that have adequate fiscal capacity to finance the public services as well as can effectively manage them. Fourth, the functions should be assigned to governments that are accessible to and controllable by their residents in performing the function and that provide an opportunity to maximize citizen participation in the delivery of the services (Litvack and Seddon).

An illustrative representative assignment of expenditure responsibilities is depicted in table 1. Following these guidelines, central governments should be responsible for functions that have a national concern such as external trade, defense, foreign affairs, criminal and civil law, and industrial policy, whereas local governments should be in charge of functions that have local benefits such as police, water, sewer, refuse, fire protection, construction and maintenance of local roads and provisions of public transit. In many instances, some functions should be shared between different levels of government, where higher levels of government might exercise a regulatory or policy role, while lower levels of government are responsible for service delivery. Some of these include environment, foreign direct investment, education, parks and recreation.

Table 1: A representative assignment of expenditure responsibilities

Function	Policy & standard oversight	Provision/ administration	Production/ Distribution	Comments
External trade	U	U,N, S	P	Benefits and costs international in scope
Telecommunications	U, N	P	P	National regulations not feasible
Environment	U, N, S, L	U, N, S, L	N, S, L, P	Externalities of global, national, state and local scope
Foreign Direct Investment	N, L	L	P	Local infrastructure is critical
Defense	N	N	N, P	Benefits and costs national in scope
Foreign affairs	N	N	N	Benefits and costs national in scope
Monetary policy, currency, banking	U, ICB	ICB	ICB, P	Independence from all levels essential, some international rule for common discipline
Criminal and civil	N	N	N	Rules of law, a

law				national concern
Industrial policy	N	N	P	To avoid beggary neighbor policy
Regulation	N	N, S, L	N, S, L, P	Internal common market
Fiscal policy	N	N, S, L	N, S, L, P	Coordination is possible
Natural resources	N	N, S, L	N, S, L, P	Promotes regional equity and internal common market
Education, health, and social welfare	N, S, L	S, L	S, L, P	Transfers in kind
Parks and recreation	N, S, L	N, S, L	N, S, L, P	Benefits and costs of various roads vary in scope
Police	S, L	S, L	S, L	Primarily local benefits
Water, sewer, refuse, fire protection	L	L	L, P	Primarily local benefits

U = Supranational responsibility, ICB = Independent Central Bank, N = National government, S = State/provincial government, L = Local government, P = Nongovernmental sectors/civil society

Source: Jennie Litvak and Jessica Seddon, Decentralization Briefing Notes, World Bank

International experiences

Based on countries' experiences, there is a clear trend toward decentralization of expenditure. Subnational governments are responsible for 35% of expenditures in the OECD/industrialized countries. Also expenditure decentralization (measured as the percentage of total government spending executed by subnational governments) for 14 Latin American countries increased from 15.6% in 1985 to 19.3% in 1995 (Stein, ?). Within Latin America, the figure varies from almost 50% in Argentina and 46% in Brazil to 2.9% in the Dominican Republic and 2.3% in Costa Rica (see table 2). It is estimated that around 5% of public spending to total spending is at the local level in Lebanon.

Table 2: Decentralization in Latin America, 1995 (in percent)

Country	Subnational/total government spending
Argentina	49.3%
Brazil	46.0%
Columbia	39.0%
Bolivia	26.7%
Mexico	25.4%
Venezuela	19.6%
Uruguay	14.2%
Chile	13.6%
Honduras	12.3%
Peru	10.5%
Guatemala	10.3%
Ecuador	7.5%
Paraguay	6.2%
Panama	3.2%
Dominican Republic	2.9%
Costa Rica	2.3%
Average Latin American	14.6%
Average OECD	34.9%

Source: Ernesto Stein, Fiscal Decision Making in Decentralized Democracies (chp 3), A LAC experience. Fiscal Stability with Democracy and Decentralization. p 157.

Local governments in Australia, the US and several European countries play a significant role in the provision of certain services. From table 3, it is clear that local governments in these countries play a major role in providing housing and community amenities (66% of total spending is from local governments), recreation and culture (56%), and education (43%). In addition, local governments also play a respectable role in providing health services (28%), public order and safety (27%), and general public services (23%). Center governments solely provide defense (98.72%) and social security and welfare (86%).

Table 3: Expenditure assignments

	Central government	Regional government	Local government
Total government expenditures	70.6%	7.04%	22.35%
General public services	70.58%	5.89%	23.54%
Defense	98.72%	0.36%	0.91%
Public order and safety	62.51%	12.85%	26.64%
Education	43.85%	13.10%	43.05%
Health	62.59%	9.09%	28.32%
Social security and welfare	85.87%	3.79%	10.34%
Housing and community amenities	27.44%	6.48%	66%
Recreation and culture	37.81%	5.99%	56.20%

Note: The countries included are Australia, Belarus, Bulgaria, Canada, Czech Republic, Denmark, Estonia, France, Germany, Hungary, Iceland, Ireland, Latvia, Lithuania, Luxembourg, Netherlands, Norway, Poland, Russia, Switzerland, UK, US.

Source: IMF, government Finance statistics, 1997.

The provision of significant services by local governments is not solely a European or an American experience. In fact, several countries in Latin America have also been transferring expenditure responsibilities from the central to state and local governments. For instance, in Argentina, secondary education and hospitals, holding nutrition programs, highways are the responsibility of local governments. Whereas in Bolivia, local governments are responsible for providing the following services: preschool, primary, and secondary education, public

health, and highways. Local governments in Colombia provide housing, nutrition programs, primary and preschool education, public health, hospitals. Local governments in Mexico, on the other hand, provide preschool, primary, and secondary education and public health, hospitals, nutrition programs, water and sewage, roads and highways. In Bulgaria, Hungary, and Poland, local governments have specific expenditure responsibilities in education (primary and kindergarten) transportation (local or urban streets), environment (garbage collection, disposal, industrial waste), and housing and related services.

The case of Lebanon

In Lebanon, the 1977 law gives a broad delineation of the role of municipalities. It stipulates that any work having a public character or utility within the area of the municipality falls under the jurisdiction of the municipal council. Some of the expenditure assignments listed in the law include the provision of health services, town planning, infrastructure development, etc. which are in line with the “benefit area” argument (see table 4).

Table 4: Expenditure assignments of Lebanese municipalities

In theory	In practice
<ul style="list-style-type: none"> • Street cleaning, garbage collection; • Public health and safety: establishing slaughterhouses, fire-fighting and rescue services, etc.; • Town planning: roads, public parks, etc.; • Infrastructure development: sewage systems, streets and roads, power and street lighting, etc.; • Services: public transportation, infirmaries and hospitals, other social services; • Education: establishing or helping public schools, extra-curricular learning, etc.; • Environmental: developing and using the municipality’s natural resources; and • Establishing museums, theaters, and markets, and providing low-cost housing. 	<ul style="list-style-type: none"> • Street cleaning; • Road asphaltting; • Street lighting; • Setting up road signs; • Rehabilitating and extending the sewage and water drainage systems; • Aid to local cultural, handicapped, and civic associations; • Solid waste land fills; and • Opening secondary roads, public parks, forestation, municipal sport arenas.

But in effect, the services provided by Lebanese municipalities are confined to marginal activities such as street cleaning, road asphaltting, street lighting, setting up road signs, rehabilitating and extending the sewage and water drainage systems, etc. (see table 4). In the case of some of the larger municipalities, there is also spending on solid wasteland fills, opening secondary roads, public parks, forestation, and municipal sport arenas. According to a survey by the Lebanese Center for Policy Studies (LCPS) on 350 municipalities in the year 2001, municipalities’ main task has been confined to the provision of licenses (76.3%), providing lighting and public works (85.9%), and developing water and sewage network (42.3%) (see table 5).

Table 5: Expenditures of Lebanese municipalities

	Average	Small	Medium	Large
Provide licenses for citizens	76.3%	81.4%	70%	100%
Provide lighting & public works	85.9%	85.5%	85.5%	72.2%
Develop water & sewerage network	42.3%	38.6%	44.4%	50%
Provide health services	25.4%	20%	27.3%	50%
Organize & promote tourism	13.1%	5.5%	16%	44.4%
Promote investment & economy	13.1%	11.7%	11%	44.4%

Source: LCPS survey of 350 municipalities

Two major differences between small and medium municipalities on one hand and large municipalities on the other are apparent. Small and medium municipalities provide the same services at lower percentages. This could be due to fiscal and managerial constraints. That is 50% of large municipalities provide health services and develop water and sewerage network versus 27.3% and 44.4%, respectively for medium sized municipalities and 20% and 38.6%, respectively for small sized municipalities. The fact that only 72% of large municipalities provide lighting and public works compare to 85.5% for small and medium municipalities could be due to the fact such services in the large municipalities have been undertaken by development agencies like Council for Development and Reconstruction (CDR).

There is, thus, a wide gap between what the municipalities are allowed to do by law, and what they are actually able to do, given their resources. Most projects of a developmental nature are being undertaken not by the municipality, but by ministry of interior (and previously by the ministry of municipal and rural affairs) or CDR using funds from the Independent Municipal Fund or other grants and loans that have been secured by central government agencies or ministries.

In addition, many projects within the jurisdiction of the municipality are managed by other line ministries most notably the health, education, public works, social affairs, energy and water resources, agriculture, environment. In such cases, the ministry generally coordinates with the municipality on specific projects, but remains responsible for their implementation.

When it comes to expenditures, there are a number of bottlenecks, which are provoked by the several layers of financial control and oversight affecting municipalities (see appendix 1). For example, both the chief controller and the muhafiz have oversight over current spending in a given municipality; the chief controller over all spending, the muhafiz over spending of LL 3 million and above. In the case of 55 larger municipalities, spending of above LL75 million must be approved, additionally, by the Bureau of Accounts. In these larger municipalities, the bureau also has the right to conduct post-audits. The decision to place a municipality under the supervision of the Bureau of Accounts is taken in the Council of Ministers and formalized in a decree. There exists a specific revenue criterion for municipalities to be subjected to bureau supervision.

The opening and transferring of credits and loans require the approval of the chief controller. The annual budget of a municipality has to be approved by the chief controller, the *qa'immaqam*, and the *muhafiz*. The ministry of interior can ask the Central Inspection Agency to audit any municipality. The Ministry of Justice is involved in financial control of municipalities through the General Financial Delegation at the Court of Cassation, which is subject to the authority of the Public Prosecutor, as well as through the Committees of Objections that examine complaints filed by taxpayers. In the case of the 55 larger municipalities, the Civil Service Board must approve all decisions relating to salaries and employee compensation.

The chief controller is appointed by the ministry of interior, but received his salary from the municipalities he audits. This creates a clear conflict of interest, which must be resolved. According to articles 105 to 107 of decree 5595 of 1982, the chief controller approved all expenditures requested by the president of a municipal council, monitors any adjustments to municipal funding and taxation, and endorses the municipal budget. This, effectively, eliminates any autonomy the municipality might have in terms of spending.

Moreover, the limited services provided by the 708 municipalities is largely due to the lack of fiscal resources, which in turn is due to the large number of small sized municipalities. The average number of registered population ranges from a low of 2,419 in the Muhafaza of Nabatiyeh to a high of 6,222 in the Muhafaza of the South, excluding Beirut municipality, which has a population of 357,403. On average, each municipality in Lebanon has a population of 3,990.

Table 6: Average number of registered population per municipality

Muhafazat	Avg # of registered population per municipality
South	6,222
North	4,761
Mount Lebanon	3,675
Bika	3,330
Nabatiyeh	2,419
Average	3,714

The emergence of small sized municipalities is largely due to the Law that permits “Every city, town, and village in Lebanon is allowed a municipal authority provided that its population exceeds 300 persons and its annual revenues exceed LL 10,000 (US \$6.67). Neighboring villages and towns not fulfilling these conditions can consolidate their resources to establish one collective municipality.”

However, one way to overcome this is to have municipalities pool their resources together by forming federations. Municipal federations, which enjoy moral personality and financial autonomy have been established among interested municipalities within contiguous areas to consolidate municipal capacities. A federation of municipalities is created or abolished by a decree from the Council of Ministers, upon the suggestion of the Minister of Interior, either through an initiative from the Minister of Interior or upon the request of municipalities. There are currently 13 such federations and they are as follows: Al-Faiha’, Coastal Zugharta, Kisirwan-Fatouh, Coastal and Middle North Metn, Jbeil, Upper Metn, Upper Jard-Bhamdoun, Sidon-Zahrani, Al-Shaqif, Southern Ikleem Al-Kharoub, West Bika, Al-Buhayra, Al-Seewjani. The sources of funds for municipal federations are listed in table 7.

Table 7: Sources of funds for municipal federations

Municipal federation funds are derived from the following sources:

- 10 percent of the actual revenue of the constituent municipalities for the previous year;
- An additional percentage from the budget of the municipalities which benefit from a specific project of common benefit, to be determined by the federation and approved by the Minister of Municipal and Rural Affairs;
- Aids and loans;
- A share from the Independent Municipal Fund for the federation;
- State contribution to the federation budget (Funds are distributed between federations by a decision from the Minister of Municipal and Rural Affairs); and
- Grants and bequests.

Source: Articles 133 and 134 of decree 118.

However, according to the LCPS survey, only 37% of municipalities are part of federations. Moreover, the members of the federations are experiencing several constraints which include fiscal resources (40%), obstacles in the Law (10%), political differences (9%), and the lack of human resources (7%).

Section III – Revenue assignments

In order to assume the responsibilities assigned to local governments, municipalities must have access to an adequate level of fiscal capacity. This section assesses the municipal taxes and fees assigned to Lebanese municipalities in light of economic principles and other countries. The section argues that although an impressive list of taxes and fees is assigned to local governments, their authority is confined to setting the fees within a narrow range and administering the taxes. In addition, the municipal tax administration is impeded by several bottlenecks.

Economic principles

According to Bahl (2000), Tanzi (2000), and Gandhi (1995), the central government should be concerned with the following kinds of taxes: taxes on mobile bases, redistributive taxes, taxes that fall onto taxpayers from other jurisdictions, taxes on bases that are unevenly distributed, taxes that are subject to important economies of scale, taxes that are subject to cyclical fluctuations.

Taxes suitable for local governments are hence limited. According to Bahl (2000), Tanzi (2000) and Gandhi (1995), local taxes must have several characteristics. One, local taxes must be visible to local voters and be large enough to impose a noticeable burden in order for officials be held accountable. Two, local taxes must be immobile in the sense it can not be easily exported to residents of other jurisdictions. Thus the more mobile the tax base the greater the argument for keeping it at the national level. Third, local tax must not have too many objectives (other than raising revenue). The more important these other objectives are in connection with particular tax bases, the less advantageous it is to leave these tax bases to local jurisdictions. For example, the more weight the government assigns to the objective of income redistribution (through progressive taxation or to stabilization (through the use of built in stabilizers), the better it is to leave certain tax bases such as progressive income tax and the corporate income tax to the national government. Fourth, the local tax must not need economies of scale in the tax administration. The more important the economies of scale in

tax administration for a given tax, the stronger the argument for leaving the tax to the national government. Economies of scale may depend on informational requirements (for example, the need for a national taxpayer identification number), on technical requirements (for example, the use of large computers) or on other factors. This consideration would call for the value added tax and for the global income tax to be nationally collected taxes. Fifth, it must be imposed on bases that are evenly distributed to avoid horizontal imbalance among the different municipalities. Some of typical local taxes include the following: Property, vehicle, transfer property, gambling, stamp, industry, trade, pollution, fuel, local turnover, retail sales tax, business taxes.

Table 8: Characteristics of local versus central government taxes

Local government taxes	Central government taxes
<ul style="list-style-type: none"> • Must be visible to local voters and be large enough to impose a noticeable burden; • Tax base must be immobile; • Tax must not have too many objectives (other than raising revenue); • Tax must not need economies of scale in the tax administration; and • Tax must not be imposed on bases that are not evenly distributed 	<ul style="list-style-type: none"> • Taxes on mobile bases; • Redistributive taxes; • Taxes that fall onto taxpayers from other jurisdictions; • Taxes on bases that are unevenly distributed; • Taxes that are subject to important economies of scale; and • Taxes that are subject to cyclical fluctuations.

Source:

International experiences

Based on groups of countries, local taxes as a percent of total government revenues averages around 13%, ranging from 6.36% in South and Central America to 14.80% in the OECD.

Table 9: Own revenues as percent of total government revenues

	Own revenues as percent of total government revenues		
	<i>Percent central</i>	<i>Percent subnational</i>	<i>Percent local</i>
OECD	78.03%	7.16%	14.80%
South and Central America	87.24%	6.40%	6.36%
Eastern Europe	86.95%	0.00%	13.05%
Africa/Asia	84.53%	1.64%	13.83%
Total	82.50%	4.53%	12.97%

Source: Ebel and Vaillancourt in the Challenge of Urban Governments

Effectively, local government has limited tax powers. In fact, few countries permit local government to levy taxes capable of yielding sufficient revenue to meet expanding local needs. In the US for instance, only 65% of local expenditure was financed out of local revenue in 1989. The comparable weighted average figure for 18 developed countries in that year was 62% with a range between a low of 16% in the Netherlands and a high of 87% in Switzerland. Moreover, a study of 18 developing countries found out that own source revenue provided as little as 30% of total local revenue in some countries but over 90% in others. Thus, the gap between expenditure and revenues must be covered by the intergovernmental grant system (discussed in the next section). The rule of thumb is that 2/3 of local spending is

covered by local taxes and the remaining 1/3 is covered by grant transfers (Ebel and Vaillancourt, 2001).

Nevertheless, local governments must have the autonomy to raise their own revenues efficiently and effectively for the sake of accountability and transparency. That is the bottom line underlying this argument is that unless local government have a significant degree of freedom to alter the level and composition of their revenues, neither local autonomy nor local accountability are meaningful concepts. Local government should be able to set tax rates (within limits). Such rate flexibility is essential if a tax is to be adequately responsive to local needs and decisions, while remaining politically accountable to their citizens. Essentially, there are four criteria that determine the autonomy of municipal revenue: (a) which level of government chooses the taxes from which local governments receive revenues; (b) who defines the tax base; (c) who sets the tax rate; and (d) who administers the tax. The most critical aspect of local taxing power is who is politically responsible for setting the tax rate

The case of Lebanon

There are six sources of revenue that finance the municipalities in Lebanon. They are as follows:

1. Municipal tariffs and fees collected directly by the municipality
2. Municipal tariffs and fees collected by the public agencies on behalf of particular municipalities
3. Loans and aids
4. Yields from municipal properties
5. Fines
6. Grants and bequests

The seventh source of revenue, which is surtaxes collected by the central government for all municipalities is treated separately in the following section. Generally, most municipalities rely on these kinds of tariffs and fees collected directly by the central government for all municipalities. According to the LCPS survey, 72% of municipalities rely on these kinds of taxes and fees collected and distributed by central government and only 26% of them rely on the fees and taxes that they directly collect. Moreover, 88% of municipalities stated that an increase in revenue is a priority. This part of the paper examines the first three sources of revenues since the last three are considered to be insignificant.

1. Municipal tariffs and fees collected directly by the municipality

According to Law 60/1988, municipalities are permitted to directly collect 16 different types of tariffs and fees (see appendix 2). These taxes and fees - fees on rental value of built real estate; fees on public places & gambling clubs; fees on advertising; fees on public property; fees on fuel distribution; fees on industrial firms; fees on auctions; fees on mobile vendors; fees on slaughterhouses; fees on tourism sites; fees on registration of contracts; fees on construction permits; fees on building & maintenance of sewage network & pavements; fees on certificates & technical studies; fees on structural improvements; and fees on explosive materials – fit the test mentioned above.

Although this source of revenue is supposed to grant municipalities the most fiscal autonomy, the law does not permit local governments to neither establish any additional local tariffs or fees nor define the tax base. Moreover, the margins of fees and the taxation rates set by law are quite narrow, hence reducing autonomy and accountability of the municipality. Essentially, the municipalities' only prerogatives are to administer the collection of these fees.

Despite the impressive list of fees assigned to the municipalities, only two municipal tariffs and fees are considered important: Fees on rental value of built real estate and fees on construction permits. The absence of a comprehensive commercial and residential mapping makes the increase of the tax base and hence tax collection a hard task.

Moreover, the method of valuation of municipal tariffs and fees, defined by law, is generally primitive or cumbersome. For example, the fees on industrial firms is based on the number of horsepower in a machine used in the factory. Because of the devaluation of the Lebanese pounds in the late 1980s and early 1990s, municipal fees have greatly depreciated in real terms since they were instituted in 1988 and hence some are worthless. For example, the investment fee on industrial firms ranges between LL 10 (\$0.0067) and LL 100 (\$0.067).

Many municipalities maintain their tax schedules on books. The lack of computers prevents them from gathering, processing, and updating information, which would allow them to identify existing and potential sources of revenues. Based on the LCPS survey, 55% think that modernizing tax collection can increase and improve revenues.

In addition, the tax collection process is highly inefficient. For example, tax schedules forwarded to tax collectors are based on property registry number rather than on geographical area, making it more time consuming to collect taxes. Several municipalities like Tripoli and Jounieh do not even have enough tax collectors to collect the potential revenue. Although the municipality has, by law, the right to confiscate personal and non-personal property and auction it off, in reality, it has no mechanism to enforce tax payment. According to the LCPS survey, 56% think that computerizing information can increase and improve revenues

2. Revenue collected on behalf of particular municipalities

A second major source of revenue is collected by public or semi-public or private institutions on behalf of particular municipalities. Local governments have no say in selecting the taxes levied, defining the tax base, or setting surcharge rates, hence are denied fiscal sovereignty.

The types of taxes surtaxes collected by public and semi-public institutions are listed in table 10.

Table 10: Surtaxes collected by public and semi-public institutions

Surtaxes collected by public and semi-public institutions include the following:

- 3% surtax on built real estate tax, of net revenue
- 10% surtax on telephone subscription and phone calls. It is collected by the Telephone Administration
- 10% surtax on electricity consumption fees. It is collected by Electricite du Liban
- 10% surtax on the fees on value of water usage. It is collected by the water authority.

Concerning the revenues collected by the private institutions, these include:

- Fees on insurance premiums, except for life insurance collected by the insurance companies
- 10% municipal tax on cellular telephone use from gross revenue.

Source: Articles 86 to 98, Law 60/88

The transfer of the amount collected by the different public or semi-public bodies takes place directly between the municipality and the relevant bodies. The public agencies are entrusted

to the collection of these surtaxes, which in principle removes the problems of compliance and administration from the responsibilities of the municipalities. In reality, many municipalities face a graver problem, that is ensuring that these public agencies comply in transferring the money collected.

In reality, many municipalities have in the past collected a portion of their revenues from the Ministry of Post and Telecommunication and Electricite du Liban, however, no surtaxes have been collected from the Ministry of Water Resources for water consumption. Moreover, the municipalities have no means of knowing the amount of money they ought to receive from the public agencies mentioned above. Generally, any amount transferred is welcomed as an extra source of revenue. Finally, the municipalities have no means whatsoever to force these public agencies to pay their dues. The unpredictability and discretionary transfer of surcharges prevent local governments from proper planning for their income in the municipal budgets.

3. Loans and aids

Although local government are permitted, according to article 86 of Decree 118. to receive loan, the reality is quite different. In fact, municipalities are entitled to advances from their expected allocated share of the Independent Municipal Fund. These advanced are issued by the Central bank at high interest rates upon the approval of MOI. However, municipalities are not allowed to borrow from commercial banks.

Moreover, municipalities are allowed to receive grants from private institutions such as Issam Fares Foundation and from municipalities of other countries such as the municipality of Marseille in France in the case of Tripoli. Any foreign aid sent to the municipality of Beirut is entrusted to CDR by the COM. In fact the municipality has no say whatsoever in the allocation and use of the funds.

Section IV – Intergovernmental grant system

Since local taxes are not sufficient to meet local needs, the gap is covered by the intergovernmental grant system. The first part of this section covers the justifications of the grant system as well as the factors that influence its impact with reference to other countries. The second part assesses the grant system in Lebanon. The section argues that the grant system in Lebanon, by Law, guarantees local government a specified share of national revenue and carries no condition. However, in practice, the allocation of the grant system is plagued by political interferences.

Economic principles and International experiences

There are three main justifications for the intergovernmental grant system. One, the fiscal capacity in some local governments is low enough that it is not adequate to finance a minimal acceptable level of government services at an average tax effort. Hence the central government may justify a grant system on the ground that some foundation level of services should be provided to all citizens of the country. Second, the existence of externalities from the provision of local public goods may lead to the under-provision of critical public goods such as education. The government may seek to expand the provision of these goods. Third, local government spending and investment priorities may be at odds with national priorities and standards for capital investments. The central government may use a system of transfers towards national concerns.

A quick look at the data show that all local governments rely on transfers for at least 30% of their financing. This dependence ranges from a low of 29.26% in South and Central America to a high of 37.97% in the OECD (see table 11).

Table 11: Grants and own revenues by region

	Grants	Own revenues
OECD	37.97%	62.03%
South and Central America	29.26%	70.74%
Eastern Europe	34.01%	65.99%
Africa/Asia	30.07%	69.93%
Total	34.41%	65.59%

Source: Ebel and Vaillancourt, 2001

The effect of the intergovernmental grant system depends on two factors: the first factor is concerned with how the central government determines the total resource pool. There are three basic approaches which are: the specified share of national tax, ad hoc decisions, and the reimbursement of approved expenditures. The second factor is concerned with how it distributes this pool among local governments. There are four methods to allocate the funds and these include: regional or local origin of collections, formula, total or partial reimbursement of costs, and ad hoc basis. Hence there are 12 potential grant types (see table 12).

Table 12: Forms of Intergovernmental grant programs

Method of allocating the pool	Method of determining the total divisible pool		
	<i>Specified share of national or state tax</i>	<i>Ad hoc decisions</i>	<i>Reimbursement of approved expenditures</i>
<i>Regional or local origin of collections</i>	A	E	Na
<i>Formula</i>	B	F	Na
<i>Total or partial reimbursement of costs</i>	C	G	K
<i>Ad hoc</i>	D	H	Na

Source: Bahl 2000.

Based on Bahl (2000), under a type A grant, the subnational government is allowed to keep a share of national taxes collected within its boundaries. Most transition economies and many developing countries use this approach. Under a type B grant type, a formula governs the distribution of a defined amount of national taxes among local governments. For example, the Philippines distributes 40% of nationally collected revenue among local governments on the basis of population, land area, and an equal share for each recipient. Under type C grant, a fixed percentage of a national tax reimburses local government for the costs of public projects or needs such as teachers' salaries.

The second types of grant are those that are awarded after an ad hoc political decision – such as the yearly budget process. Under type H grant, the central government makes all decisions concerning which entities receive the funds and how much. Under type E, F, and G, the central government distributes grants according to objective criteria. The type G grant is conditional, while the others are not. Under type K grant, a central ministry decides the amount of funding local governments will need to pursue specific projects and whether they meet prescribed eligibility requirements. Examples include grants for infrastructure projects, teachers' salaries, and transfers to individuals to cover income maintenance costs.

These very different types of grants exert very different effects. Type A and B grants are arguably the most decentralizing because they guarantee local governments a specified share

of national revenue and usually carry no conditions. However, even these two transfers have very different impacts. The type A grant favors subnational governments with strong tax bases, whereas the type B grant can redistribute funds to subnational governments according to the local characteristics that central government most wants to reward. The ad hoc transfers are the most centralizing because they allow the national government maximum flexibility in deciding how much to distribute to local public sector each year. The type C, G, and K grants are also centralizing in that they give central government ministries significant control over how money will be spent and allow them to establish standards for construction projects, salary rates, and delivery of services.

Nevertheless, a good intergovernmental transfer program must have the following characteristics (Litvack and Seddon,):

1. Transfers are determined as objectively and openly as possible ideally by some well established formula. They are not subject to hidden political negotiation. The transfer system may be decided by the central government alone, by a quasi independent expert body or by some formal system of central-local committees
2. Transfers are relatively stable from year to year to permit rational subnational budgeting, but at the same they are sufficiently flexible to ensure that national stabilization objective are not thwarted by subnational finances. One system that appears to achieve this dual objective is to set the total level of transfers as a fixed proportion of total central revenues subject to periodic negotiation
3. The formulas are transparent, are based on credible factors and are as simple as possible. Complex formulas are unlikely to prove feasible or credible in developing countries because there often serious disputes on fundamental issues such as regional population size
4. If several objectives are applicable – for example if some degree of equalization is desired and if there are also clear national policy objectives on the provision of minimal standards of education, but perhaps variable degrees of national support for certain local infrastructure activities – having separate transfers targeted to each objective will generally assist with both clarity and effectiveness.

The case of Lebanon

The grant system in Lebanon, in theory, is of type B where the method of determining the total divisible pool is a specified share of national taxes and the method of allocating the pool is formula based. However, in practice, the grant system resembles grant type F where the method of determining the total amount in the fund is subjected to political interference.

The state collects 13 different surtaxes and fees on behalf of all municipalities and municipal federations (see table 13). The revenues go into the Independent Municipal Fund (IMF).

Table 13: Surtaxes collected by the central government on behalf of municipalities

Surtaxes collected by the central government on behalf of municipalities:

- A progressive surtax on built-up real estate tax;
- A 15% surtax on profits of commercial, industrial, and non-commercial profession;
- A 10% surtax on transfer of property of deceased individuals, and on grants;
- A 5% surtax on real estate registration fees;
- Fees on liquid fuel;
- A 3.5% port fees;
- Fees on insurance premiums, except for life insurance, collected by the insurance companies
- A 25% surtax on registration of cars and motorcycles;
- An average of 1.5% surtax on some imports including beers, wine, other alcoholic beverages, meat, fish, carbonated water, etc.;
- A 10% surtax, collected by the telecommunication ministry, on telephone subscription and calls;
- A 10% surtax on electricity consumption fees, collected by Electricite du Liban;
- A 10% surtax on water usage; and
- A 5% surtax on cigarettes and other tobacco products.

Source: Law 60 of 1988.

A significant portion of the IMF revenue comes from custom duties. With the signing of the partnership agreement with Europe and the conditions related to WTO, tariffs are going to decline gradually towards zero over the next 12 years. This will gradually but seriously undermine the money in the IMF and its ability to assist municipal development.

According to article 2 of decree 1917 of 1979, the IMF is deposited at the Central Bank in an account belonging to the Ministry of Finance. Any withdrawal of money in the account requires the approval of both the finance minister and the interior minister. The following expenditures, determined jointly by the finance minister and the interior minister, are deducted from the IMF account. They include:

- All salaries, compensation, and expenses for public works conducted by individuals from outside the interior ministry;
- Expenditures on equipment and work conducted in municipalities.

For a time, expenditure in both cases followed the following procedures: once the total amount was allocated, it was cleared, first, by a grade three employee at the finance ministry and the Head of Accounting at the ministry of interior. The interior ministry was then free to spend the amount transferred. Since then, the procedure has been streamlined. The interior ministry and the finance ministry decide on total yearly expenditures, which are then transferred to the account of the interior ministry, the ministry can then make individuals withdrawals without finance ministry approval. Once all salaries and expenditures on public works are deducted, the money in the IMF is distributed to the municipalities and municipal federations.

Distribution of funds: the theory

Based on article 4 of the law, the IMF amount is distributed in the way outlined below. As we shall see, however, the reality is somewhat different:

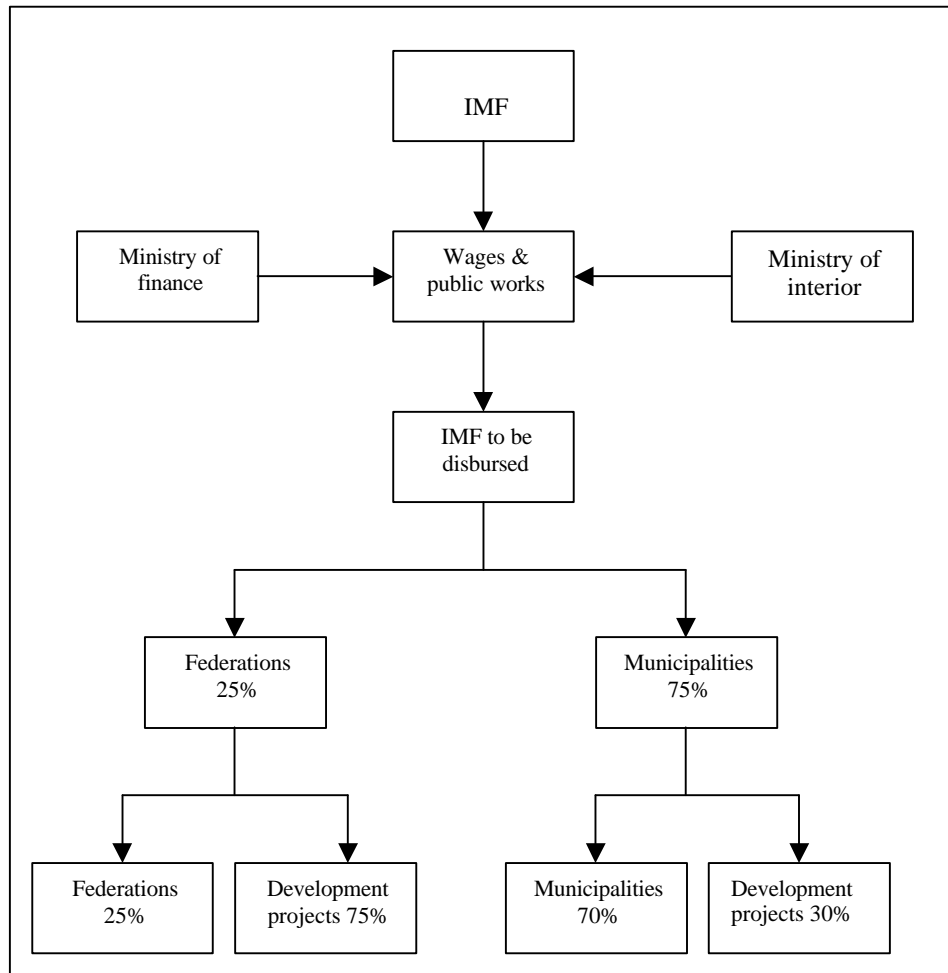
Step one: according to article of decree 1917, 75% is to be distributed to municipalities and 25% to municipal federations.

Step two: according to article 11 and 12, of the money distributed to municipalities, 70% is to go directly to municipal government to bolster their budgets and 30% to development projects approved by the interior ministry.

Stage three: according to article 8, of the 25% which goes to municipal federations, 75% is to go to development projects and 25% to specific municipal federations.

Funds for development projects are disbursed by the interior ministry after a request from a municipality. Municipalities that are members of federations are not allowed to receive their allocated amount unless they have paid their dues to the federation fund.

Chart 1: Distribution of the independent municipal funds (IMF) according to the Law



Source: Decree 1917 of 1979.

Distribution of funds: the reality

While the law is specific when it comes to municipal funding, finance ministry officials underline that money in the IMF is actually distributed according to the following formula. After deducting salaries and money for public works, 75% of the money from the IMF is distributed to development projects, Decree 7425 of 1995 allows the Council of Ministers to entrust the Council for Development and Reconstruction (CDR), the Beirut Council for Large Projects, and other agencies with development projects, financed from the IMF, that benefit all municipalities. The municipal affairs ministry has often financed development projects in municipalities via the CDR or independent contractors. The remaining 25% is distributed to municipalities and municipal federations according to a pre-set formula, which takes into consideration population and revenues.

The total amount disbursed to federations and municipalities between 1993 and 1996 has averaged around LL 49 billion after a deduction of LL 500 million to the ministry of electricity. In effect, 10% of the net amount has been allocated to municipal federations and 90% to the municipalities account, of which 5% is paid to civil defense and roughly 6% to projects and contingencies. Although 10% of the account has been allocated to municipal federations, there is no breakdown of the distribution of the amount as specified by law. Concerning the 90% allocated to the municipalities, 88% is devoted to the municipalities versus the 70% specified in decree 1917, and 6% to projects versus to 30%.

Ministerial decisions 8330 of 1996, 11461 of 1997, and 11462 of 1997, which have allocated the IMF for the years 1993 and 1994, 1995 and 1996, respectively, show an interesting extension. In fact, of the 15% allocated to municipalities and municipal federations, 10% is designated to municipal federation. The remaining 90% have been devoted to municipalities' account, which include 88% for municipalities, 5% for civil defense, and 7% for projects.

The formula used to allocate the IMF to the individual municipalities is based on registered population and revenues with the objective to equalize fiscal capacity and encourage local government to mobilize their resources. However, the population factor is extremely doubtful to meet its intended objectives since many Lebanese have been either displaced or emigrated during the civil war.

For the IMF money to be disbursed to the municipalities, ministry of interior (and previously the ministry of municipal affairs) has added a new condition. The municipality must, in fact, submit a feasibility study for particular projects. Although this may not be a bad thing in itself, however, it goes very much against the spirit of Decree 1917.

Section V - Conclusion

For the benefits of fiscal decentralization - which are economic, political and social – to be realized, the elements of reform must be well synchronized. The government must first decide on what functions municipalities should provide and then assign the appropriate set of taxes and fees to finance these expenditures. The inevitable gap is to be covered through the intergovernmental grant system.

The municipalities in Lebanon, by Law, are entrusted with a wide range of responsibilities. However, in practice, most municipalities are providing only a fraction of these functions due to a lack of clear delineation with central government, expenditure bottlenecks, and weak

fiscal and managerial capabilities. With respect to the revenue assignment, Lebanese municipalities are, by Law, assigned an impressive list of taxes and fees they can collect. In practice, most municipalities rely on only 2 of these taxes and fees. This is mainly due to the weak municipal tax administration. Finally, most municipalities rely on the grant system as a source of revenue. In theory, the method of determining and allocating the total fund is very progressive. In practice, the method of determining the total divisible pool has been tampered with in such a way that has effectively reduced the amount available for distribution.

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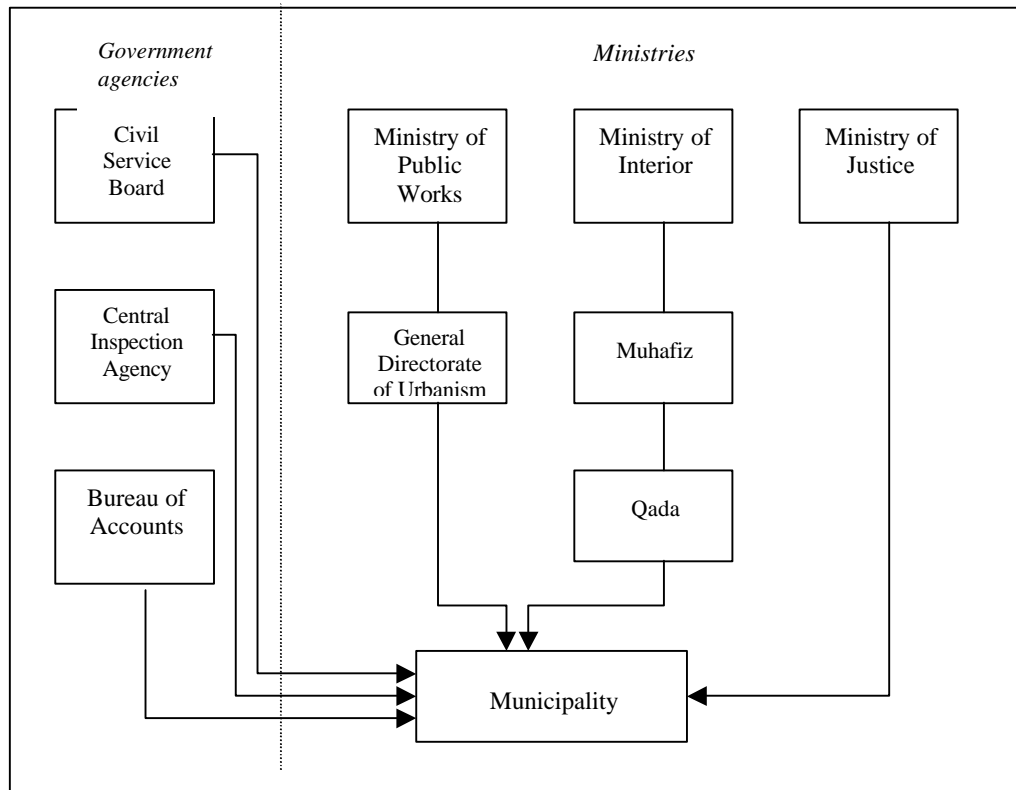
Appendix 1 - Authorities and Control

Despite its moral personality and administrative and financial autonomy, the government exercises both administrative and financial control over the municipalities through various ministries and agencies. (see figure on Administrative and financial control of municipalities)

1. **Ministry of Interior (MOI):** Responsible for planning, budgeting, and spending municipalities' revenues as well as for providing technical and financial support to municipalities when needed. More specifically, MOMRA, through its Chief Controller, exercises its control over the following: Control of the budget and its adjustments; Control of expenditures contracts; Control of revenues; Control of financial operations and transactions; Control of infringement or violation; Participate in inquisitions of a financial character; Control over the settlement of accounts of the budget. Also responsible for organizing and supervising municipal elections, for providing internal security. The *muhafiz* and *qaimmaqam*, who exercise administrative control over the municipalities are supposed to report to MOMRA on matters relating to municipalities, although they are officials of MOI.
2. **Civil Service Board (CSB):** Responsible for overseeing all municipal decisions related to employees, administrative organization, and salaries in large municipalities.
3. **Bureau of Accounts (BOA):** Responsible for financial control over large municipalities, including pre- and post-audits. The central government may appoint a Chief Controller to act as financial controller over municipalities. All large municipalities have a GC. According to article 1 of decree 82 on the Organization of the Bureau of Accounts issued in 1983, the Bureau of Accounts is an administrative court, responsible for the financial jurisdiction, and the supervision of the public funds and the funds deposited in the treasury. With respect to revenues, the Chief Controller who settles the municipal transactions, transfers the transaction to the Bureau of Accounts for administrative pre-auditing. This generally includes either transaction of revenue concession when the value exceeds LL 5 million or transaction of real estate sale when the value exceeds LL 5 million. With respect to expenditures, the Chief Controller transfers the municipal transaction to the Book of Accounts for prior approval. These include:
 - Transactions of equipment and affairs which exceeds LL 75 million.
 - Services transactions which exceed LL 5 million.
 - Consent agreements (incl. rental contracts) which exceed LL 50 million.
 - Transactions of equipment and affairs which exceed LL 75 million.
 - Grant and Aid transactions which exceed LL 15 million.
 - Amicable conciliation of settlement of disputes and allegations which exceed LL 15 million.
4. **General Directorate of Urbanism (GDU):** A unit of the Ministry of Public Works, is responsible for urban planning. Its authorization is required for any real estate or infrastructure development.
5. **Central Inspection Agency (CIA):** Although article 137 of decree 118 excludes the legislative and executive powers in municipalities from the control of the CIA, this does not prevent MOMRA from delegating the CIA to inspect the municipality.
6. **Ministry of Justice:** The control of the Ministry of Justice is restricted to a single issue in financial control that is Conciliation, unlike the financial control exercised by the General Controller or Bureau of Accounts.
 - A. **General Financial Delegation:** This new control system over the fiscality of municipalities was created by the decree 1937 of 1991, stipulating the creation of a *General Financial Delegation* at the *Court of Cassation*, subject to the authority of the *Public Prosecutor*, and responsible for

infringements related to tax laws: governmental, municipal, custom duties, fees on telecommunication, fees related to public institutions and municipalities.

B. Committees of Objections: These committees enjoy a judicial character. The president of each committee is a judge, appointed by a decree, responsible for studying the objections presented by the taxpayers, which represent an indirect control on the rightness of the municipal fees.



Appendix 2 - Municipal Tariffs and Fees, Law 60/88.

List Tariff/Fee	Base of Tariff/fee assessment	Tariff/Fee	Exemptions
<p><i>Fees on the rental value of built real estate *</i></p> <p>Articles 3 - 18</p>	Registered contract assessment by rental value committee	<p>5% for housing units</p> <p>7% for commercial units</p>	<ul style="list-style-type: none"> - Government and public agencies - Property used for religious purposes - Property used by embassies and consulates - Property used by UN - Property used by NGO with an order from CM
<p><i>Fees on public places and gambling clubs</i></p> <p>Articles 19 - 27</p> <p>License fee</p> <p>Investment fee</p>	<p>Hotels - per room</p> <p>Clubs</p> <p>Bars</p> <p>Restaurants</p> <p>Coffee shops</p> <p>Casinos</p> <p>Beaches and health clubs</p> <p>Game rooms - per game machine</p> <p>Cinemas and theaters</p> <p>Gambling clubs</p>	<p>One time fee between 20,000 LL to 200,000 LL on public places</p> <p>One time fee between 60,000 LL to 600,000LL on gambling clubs</p> <p>2,000LL to 20,000LL</p> <p>30,000LL to 300,000LL</p> <p>10,000LL to 100,000LL</p> <p>20,000LL to 200,000LL</p> <p>10,000LL to 100,000LL</p> <p>100,000LL to 1,000,000LL</p> <p>50,000LL to 500,000LL</p> <p>10,000 LL to 100,000 LL</p> <p>500 LL to 5,000 LL</p> <p>5,000 LL to 50,000 LL and 5% on the value of the tickets</p>	<p>Government and Public agencies</p> <p>Educational institutes</p>
<p><i>Fee on advertising</i></p> <p>Articles 28 - 41</p> <p>License fee</p>	<p>Running advertising</p> <p>Temporary advertising on boards mobile or immobile</p>	<p>One time fee between 3,000 LL to 30,000 LL</p> <p>One time fee between 600 LL to 6,000 LL</p>	<p>Government and public agencies</p> <p>Municipality</p> <p>UN</p> <p>Elections advertising</p>

Investment fee	Running advertising (thout lights) Running advertising (thout lights) Temporary advertising on board Cinema advertising TV advertising	Annual fee on 1m2 between 500LL to 5,000 LL Annual fee on 1m2 between 300LL to 3,000 LL Monthly fee on 1m2 between 100LL to 1,000 LL 5% of the contract 5% of the contract	
<i>Fees on public property</i> <i>Articles 42 - 49</i>			
License fee	Work on existing and immobile property Work on mobile	1,000 LL to 10,000 LL 2% of the sales value	
Investment fee	Work on existing and immobile property Work on mobile	1% of the sales value 1,000 LL to 10,000 LL	
<i>Fees on fuel distribution places</i> <i>Articles 50 - 52</i>			
License fee	For every meter	20,000 LL to 100,000 LL	
Investment fee		5,000 LL to 50,000 LL	
<i>Fees on Industrial Institutions</i> <i>Articles 53 - 56</i>			
License fee	Group 1 Group 2 Group 3	10,000 LL to 100,000 LL 5,000 LL to 50,000 LL 2,000 LL to 20,000 LL	
Investment fee	For every horsepower in a machine	10 LL to 100 LL	
<i>Fees on auctions</i>	Sales value of the	2.5% of the value of the	

<i>Articles 57 - 59</i>	good	good	
<i>Fees on mobile vendors</i> <i>Articles 60 - 63</i> License fee		1,000 LL	
<i>Fees on slaughterhouses</i> <i>Articles 64 - 66</i>	Goat or sheep Cow or calf Buffalo, camel or horse Pig Any meat from area outside municipal boundaries	1,000 LL 2,000 LL 3,000 LL 4,000 LL 10 LL per Kilo	
<i>Fees on entry to public touristic areas</i> <i>Article 67</i>	Any touristic site	MC decides the fee	
<i>Fees on registration of contracts</i> <i>Article 68</i>		100 LL fee for registration	
<i>Fees on construction permits +</i> <i>Articles 69 - 80</i>	Sales value of the real estate in m ²	1.5% for 1 m ² =< 25,000 LL 2% for 1 m ² between 25,000 LL to 100,000 LL 1% for 1 m ² > 100,000 LL In addition, 5% for using public property, and 10% to be spent as follows: - If in Beirut, 5% goes to Beirut Museum, and another 5% goes to public restroom and gardens. Anywhere else, 10% goes to schools, public housing, clinics, libraries	
<i>Fees on development and maintenance of sewage system and pavements</i> <i>Articles 78 - 80</i>	Sales value in m ²	1/1000 for new property 1.5% for occupiers	UN
<i>Fees on certificate,</i>		A fee of 1,000 LL	UN

<i>statements and technical studies</i> <i>Articles 81 - 82</i>			
<i>Fees on compensation due to improvement</i> <i>Articles 83 - 84</i>			
<i>Fees on explosive materials</i> <i>Article 85</i>	Rental value of property housing explosives	2%	

Notes:

* *Fees on the rental value of built real estate:* All contracts must be registered in the municipality. A rental value committee is formed to assess the property in four cases: (a) there is no rental contract; (b) the rental value is in question; (c) the property is used by the owner; and (d) the property is used by another party for free or for a low rent. The rental value committee is formed by the MCP. It is usually headed by a member of the MC and includes an official representing the MOF, a local expert on contracts in the area or an engineer from the GDU, a reporter who is a municipality employee. It is the duty of the committee to inspect the property by evaluating it within the context of the neighborhood and with neighboring property which is being rented under similar conditions, and to specify the criteria used for the valuation.

+ *Fees on construction permits:* The sales value of the real estate is determined by a committee formed by the President of the Municipal Council. It is generally headed by a member of the MC, an engineer from the municipality or an engineer from the GDU, and an employee from MOMRA.