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**RIGHT OF IRAQI LOCAL UNITS IN THE RESORT TO PUBLIC
BORROWING**

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Abstract

The main purpose of this study is to assess the extent of the Iraqi local units right (Governorates) in resorting to public borrowing. This paper discusses the principle of free administration in the financial part that is most important foundations of which the idea of financial independence of the local units of Iraq, represented of Governorates that are not incorporated in a region. Per this principle, the governorates have the right to have sufficient financial resources, and choose the way to spend it, to achieve self-sufficiency in the financial aspect. This makes them Capable of raising the burdens and responsibilities entrusted to the provision of services to citizens in Iraq. Thus, the aim of this paper is to address the position of the Iraqi legislator of the right of the provinces to resort to public borrowing according to the Iraqi Constitution of 2005, Law of Governorates that are not incorporated in a Region No. 21 of 2008 and Financial Management and Public Debt Law No. 94 of 2004. The methodology adopted in this paper is a doctrinal legal research, focusing namely on primary and secondary data. The result indicates the provincial grants asylum to public borrowing to finance conservation through some necessary expenses which aim to satisfy the needs of the people and their needs. As well as, a survey of public borrowing from inside, without the prior approval of the local government to the sum of the loan for investment projects.

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Keywords: Iraqi Constitution of 2005, Law of Governorates Non-Organized in Region of 2008, Financial Management, Public Debt Law of 2004, Public borrowing.



1. Introduction

It is widely recognized that financial independence is one of the necessary elements for the success of decentralized bodies (local units) in carrying out its tasks and projects entrusted to them. Although most of the legislation that adopts administrative decentralization grants local units' multiple financial resources, however, these resources may not accommodate all the projects that decentralized bodies seek to provide for its citizens (Al-Zoghbi, 1988). Therefore, the decentralized bodies may seek to take one of the exceptional funding methods to address the fiscal deficit, and in this regard, the public loan is considered one of the most prominent forms of this funding. Because the Iraqi legislature in the Iraqi constitution of 2005, has adopted administrative decentralization, it is important to highlight the role of the public loans in financing local unit projects. As well as analysing the legal rules governing the use of this method in the financing of governorates projects.

2. Problem Statement

Despite the importance of legal regulation of local government financing, including the public loan approach, the problem of research focuses on the extent of an existence of legal rules that establish and regulate local units' right to public borrowing. There is also ambiguity in the procedures on which local units should base their activity on public borrowing. Finally, the extent to which local units enjoy sufficient independence in the field of public borrowing, especially in a country that adopts the federal state system.

3. Research Questions

Based on the research problems above, the following are the research questions:

This study shows the legal basis for the right of the governorates to resort to general borrowing, in terms of the position of constitutional and legal texts. As well as the extent of local unit's right to enact to the legal regulations that govern public borrowing.

4. Purpose of the Study

This paper will contribute significantly in the following fields:

The importance of this research is reflected from theoretical and practical aspects, by finding an integrated vision of the eligibility of local units (governorates) to resort to the method of public borrowing to finding alternative sources of financing capable of filling the deficit in their traditional resources. Especially, there is a disruption of the legal texts that granted local units some financial revenues, such as imposing the fees and taxes, their share of petrodollar amounts and their share of the revenues of border crossings (Al-Sheikli, 2016). Thus, this vision highlights the legal gaps that greatly hinder the ability of local units to borrow and overcome the difficulties they face.

5. Research Methods

To address the above issues, this research adopts a qualitative approach to discuss and analyse the issues bordering on the related to the extent of the right of local units in public borrowing. This study is a pure legal research, therefore, the analysis of the data collected from the constitutional and legal materials would be analysed based on inductive, interpretive, and analytical method (Creswell, 2012). Additionally, critical and comparative analysis method is adopted to analyse the weaknesses and strengths in the legal mechanisms that governing the idea of public borrowing by local units. With a review the experiences of some countries in this regard, such as France, the United Kingdom and Egypt.

6. Findings

6.1. The Constitutional and Legal Basis of the Right of the Governorates to Resort to Public Borrowing

The right of local units (i.e. Governorates) to resort to public borrowing should be based on a constitutional basis and legal provisions that are granted this right to local units. As it is also necessary for local units to establish legal regulations governing the mechanism public borrowing. These points are discussed and analysed as follows:

6.1.1. The Constitutional basis of the right of the Governorates in the public borrowing

The Iraqi constitutional legislator in the 2005 constitution of the Republic of Iraq adopted a mechanism for the distribution of powers between the central government, governorates and regions. This mechanism relied on the determined the jurisdictions of the federal authority exclusively. While the other powers remained for the federal provinces and governorates not organized in the province. Hence, the Iraqi constitution expanded the powers of the regions and provinces as opposed to the central authority. The Constitution also mentioned a new type of powers under the name of joint powers, which are exercised in coordination and cooperation between the federal authority and the governments of regions and provinces (Articles 110, 115, Iraqi Constitution of 2005). On the other hand, it made the laws of governments of the regions and provinces prevail over the laws of the federal authority when there is conflict on these powers (Article 114, Iraqi Constitution of 2005).

From the above analysis, it is clear that the Iraqi constitution expanded the powers of regions and governorates in exchange for limited powers of the central authority. It is also noted that the Iraqi constitutional legislator mentioned, on several occasions, the equality of powers between the federal regions on one hand and the provinces on the other. Therefore, it can be said that the provinces in the Iraqi legal system look more than a decentralized administrative body. In other words, it is much closer to the powers of the province in the federal state.

Thus, the question that underlies the study of whether the constitution allows the provinces to resort to public borrowing can be reached by the examination the constitutional texts. The consideration of the provisions of the Iraqi constitution, especially the text of Article (110) that definition of exclusive powers of the central authority shows that borrowing policies should be developed by the central

authority through its various financial institutions, specifically the Ministry of Finance and the Central Bank of Iraq. But what is understood from this text is that the authority of the federal authority is limited to setting a policy of resorting to borrow by state institutions as one of the ways of financing expenditures in the general budget. This does not grant the federal authority the power to deprive the Governorates of resorting to public borrowing to finance domestic revenues. However, this regulation should be through the enactment of a law that sets the rules for public borrowing by the provinces (Constitution of the Republic of Iraq, 2005).

The analysis and discussion of the above-mentioned case can be supported by two points:

- i. Article (122 / II) of the Iraqi Constitution of 2005 provided that the “Governorates that are not incorporated in a federal region shall be granted broad administrative and financial authorities to enable them to manage their affairs in accordance with the principle of decentralized administration”. This text itself allows the Governorates to claim their right to public borrowing because they have the financial power that the constitution has described as having to be broad.
- ii. One of the most important principles that the central authority should respect to achieve the democracy of the administration is the principle of free administration of the local administrative units. This principle would grant Governorates the freedom to manage their administrative and financial affairs in such a way as to facilitate the achievement of their objectives. This means that the legislator's authority can be restricted to regulate the functions of the administrative units, especially their financial freedom, in a manner that enables them to manage their affairs according to the principle of administrative decentralization. In other words, per this principle, the governorates have a constitutional right to access sufficient financial resources and sufficient freedom to choose their own means of spending (Osman Mohammed, 2015).

From analysing the above data, it can be said that the Iraqi constitutional legislator limited the authority to set borrowing policies by the central government, while it not preventing the governorates from this right. However, this requires that the law regulating the borrowing process should give the governorates the right to public borrowing. This is justified by the need of respect the principle of free administration, especially in the financial field. In addition, this view is supported by Iraqi legislator who adopted the right of the governorates to loans in the Financial Management and Public Debt Law No. 94 of 2004, as will be explained.

6.1.2. The Legal basis of the right of the Governorates in the public borrowing

Under the Iraqi repealed Law of Governorates No. 159 of 1969, there was a provision that the Council of Administrative Unit (Governorate, districts and sub-district) to decide to take a loan for disbursement on the required to carry out its functions that entrusted to them (Article 110, Iraqi Governorates Law, 1969). By contrast, the Law of Governorates that are not incorporated in a Region No. 21 of 2008 (amended) mentioned the financial resources that comprise the governorate's resources, but it

was not including the public loan. Therefore, this text shows at first glance that the governorates do not have the mandate to hold public loans (Article 7, Iraqi Governorates Law, 2008).

However, it can be noted that governorates' revenue which stated by the current Law of Governorates that are not incorporated in a region, were not exclusive. Where there are other laws that pointed to the possibility of diversifying the revenues of the governorate, including the public loans. For example, both the Financial Management and Public Debt Law No. (71) of 2004 and the Public Budget Law of 2013, grant the governorates to conclude the public loan contract with the approval of the Minister of Finance and in accordance with certain conditions.

By shedding light on the position of legislation of some countries, it is possible to note that in France, for example, the public loans are an important source of funding for capital projects carried out by decentralized bodies, in the event of insufficient local resources to meet their activities. For regulation, this task, the French legislator established a committee of loans, which includes representatives of the Council of the province, governorates councils and municipalities in the territory. This committee has the task of determining the terms of granting loans and providing advice in the field of granting loans from local authorities within the region. As is the case for borrowing from external sources, which must be approved by the Minister of Finance (Article 36, French Law, 1982). The French legislator has allowed two types of loans to local bodies, they are: (1) Temporary loans to finance urgent revenues until local revenues are available. (2) Loans to cover the expenses of some capital projects that approval for borrowing has been obtained (Al-Zoghbi, 1988; Brier,1996).

In the United Kingdom (UK), the legislature, under the 1972 law, gave local councils the power to conclude loans with domestic and non-foreign parties. These loans require the approval of the central government through the relevant ministry that needs to finance a specific project requires the loan, as well as the approval of the Minister of Local Government (Al- Tahrawy, 1998).

However, the local councils in the UK can borrow without obtaining the central government's approval of the loan contract in two cases. They are (1) temporary loans that necessary to meet urgent expenses until incomes are obtained, and (2) borrowing for the expenses of a project whose loan contract has been approved (Al-Zoghbi, 1988).

In Egypt, the Egyptian legislator, in the Local Administration Law No. 43 of 1979, gave the local authorities (centre, city, village) the right to borrow, while it did not stipulate on the governorate right to borrow explicitly. However, the law had implicitly referred to this right by allowing the governorate to set up a special account to finance housing projects to be funded from various resources, including loans (Article36).

Finally, it can be noted that the Jordanian legislator in the Municipalities Law No. 41 of 2015 granted local councils the right to resort to public loans for covering the expenses of their projects, especially investment, under the approval of the Minister of Municipal Affairs (Article17).

6.2.Types of Public Borrowing and Its Effects

It can be said that public loans are involving of a variety forms, as well as many implications, which can be explained as follows.

6.2.1. Forms of borrowing

The forms of loans vary depending on the images which the loans come, and which are divided into the following:

1. In terms of the entity granting the loans: The loans are divided into internal and external loans. In internal loans, the borrowing is made from the national or local authorities within the local unit, regardless of whether they are government agencies or private sector. For the ease of this type of borrowing most of the legislations tends to internal loans in financing the expenses of administrative units. While external loans are borrowed from external parties, whether they are countries or other financial institutions such as the World Bank.
2. In terms of the purpose of borrowing; the loans may be for investment or operational. Investment loans mean the allocation of loan amounts to projects that benefit the future that belongs to the administrative unit through spending on investment projects such as roads, bridges, dams, factories, schools, hospitals and so on. Hence, most countries tend to borrow for investment loans rather than loans for current expenses (i.e., operating loans) because it's considered deferred payments that are burdensome for future generations (Badran, 1991). Therefore, it should be limited to investment projects without the operating projects, which may be a burden on future budgets and do not benefit to local units only in emergency circumstances (Awadah, 1983).
3. In terms of duration of loan repayment; Loans can be divided into short-term, medium-term and long-term loans. And each of these types has its reasons and justifications which make the administrative units to resort to it without other forms (Brier,1996).

6.2.2. The impacts of borrowing by administrative units

The issue of the use of public loans by local units raises a range of effects that involve fears and negative consequences. Among these effects are:

1. It leads to competition between local councils and the central government in seeking to obtain loans. This may increase the demand for capital in a way that raises interest rates.
2. The loans or borrowing generally, if not used correctly may lead to the absorption of the purchasing power of individuals, thereby harming the state's economy (Al-Sheikhli, 2015).
3. Local councils' borrowing leads to an increase in debt servicing in the budgets of the coming years. This may make local governments resort to increasing tax amounts on individuals, which increases the financial burden on them. Especially in the case of failure to repay the loan benefits of it, which undermines confidence in the state in general (Al-Sheikli, 2016).
4. The local authorities when seeking to fill its budget deficit through public borrowing, it would be caused the increase of its expenditures. This may contribute to double inflation and damage the economic policy of the central government.

5. The local authorities may use the amounts of loans to finance certain projects that contrary to the economic development pursued by the central government in the field of investment (Al-Banna, 1973).

According to the above analysis, the present study suggests that clear legal mechanisms should be put in place to reduce the negative effects of public loans by local councils. Achieve these requirements can come from the application of certain conditions for borrowing with the regulation of a clear mechanism for the control of public loans held, as will be clarified in the subsequent points.

6.3. Legal Mechanism to Concluding Local Public Loans

The right of local units in the public borrowing should be surrounded by a set of conditions that must be taken into consideration. As well as, the exercise of this right should be based on the control and supervision by a central authority. Thus, the discussion of the legal mechanism for the holding of public loans by the local units involves the conditions and means of control, as explained as follows.

6.3.1. Conditions for Resorting to Public Borrowing by Local Units

Due to the importance of the public loan to local units on the one hand, and the concerns that may be involved on the other, the legislation of some countries, including Iraq, sets special conditions to be observed by local governments. These conditions can be discussed and clarified in the following points:

- i. The need to use the public loan for investment projects
As explained earlier, the state expenses are divided into two types; the first operational expenses, which include the funds needed by the state for the maintenance of public facilities, like paying employees' salaries, buying the necessary supplies for the work of the state departments and institutions and so on. While there are investment expenditures related to projects which aim to provide services and meet the needs of individuals, as well as can achieve future development goals. Accordingly, most legislations require that the public borrowing by local units should exclusively to finance investment projects (Brier, 1996). The reason for this is that the public loan burdens extend to future generations, which is unfair to be carried it without the benefit of them. Hence, ensuring that these disadvantages and risks are avoided is by requiring that the public loans must allocated to investment projects (e.g., Projects of the hospital, roads, transportation, production factories, etc.), which would continue to benefit and extend for several generations (Awadah, 1983; Al-Banna, 1973).
- ii. The amount of the loan should not exceed a certain percentage of the revenues of the local unit
To ensure that local governments are not overwhelmed by debts and their financial benefits to the extent of their inability to meet these debts, many legislations restricts local units that the loan amount does not exceed a certain percentage of their annual income (Al-Sheikli, 2016). For example, the Egyptian legislator stipulates that the indebtedness of local units should not exceed 40% of their revenues. Otherwise, the Prime Minister's approval is required (Article 15). The German legislator also stipulated that the amount of loans should not exceed in any case the

amount of expenses required and specified in the budget of the local unit (Al-Shakrawi & Al-Budairi, 2013).

In Iraq, the Iraqi legislator followed the same approach but it did not require a certain percentage of the local unit revenue. On another hand, the law stipulated that the amount of the loan should not exceed the allocations of local units authorized by the Council of Ministers (Article 10/2, Financial Management and Public Debt Act, 2004).

In this regard, it is believed that the position of the Iraqi legislator was successful because the fiscal policy is one of the exclusive powers of the central government. As well as, the borrowing by the local unit should not affect the economic policy of the state. This requires that the public loan must not exceed the rate set by the central authority. However, this must not preclude the requirement that local borrowing should not exceed a certain percentage, such as 30% of the annual revenue of the local unit. The reason for this, the local government is considered ultimately responsible for paying the loan amounts and its benefits. And these loans are one of the exceptional funding sources which must not be expanded of its use. This would ensure that the local unit is not burdened with many of loans that may cause a deficit in its budget for many years.

- iii. Local units must be committed to borrowing from specific financial institutions. The local unit's recourse to public borrowing from financial institutions would affect the interest rate that may rise to the highest levels as a result of the increasing demand for loans. Hence, to avoid these disadvantages, some legislation stipulated that local units should be borrowed from specific financial institutions. In France, for example, local units may borrow only from the National Fund for Estate and Urban Funds, the National Fund for Unions and the Deposit and Insurance Fund. The same situation in the UK, since the legislator obliges local units to borrow only from the loans of Public Works Board and not more than 50% of its needs (Al- Tahrawy, 1998). Otherwise, it is permitted to resort to the capital market to obtaining the necessary funds for its projects. In Egypt, the law did not require from local units to borrow by certain institutions, however, there is a ban on borrowing from foreign parties without the approval of the Prime Minister (Article 15, Egyptian Local Government Act, 1979).

In Iraq, the law did not specify which entities could be borrowed to local governments. This could explain that local units can borrow from both government and non-governmental financial institutions a like. However, it can be noted that the failure of the Iraqi legislator to identify the financial institutions that the governorates can borrow from is considering as a legislative defect that needs to be addressed.

6.4. The Control of Central Government on the Right of Local Units to Public Borrowing

The right of local units to resort to public borrowing should be exercised under the control of the central government. The reason is to ensure that local units do not exceed their financial capacity in such a way that they are unable to pay the debts and their financial benefits. Also, to ensure that the use of the

public loan is for purposes that have been contracted for it, such as allocated for investment projects and not operational. Finally, central oversight is very necessary to harmonize local borrowing policy with the central government's fiscal policy (Badran, 1991).

Accordingly, many legislations have ensured that the central government has the authority to control local governments in public borrowing. In the UK, for example, the law requires from local units obtain the approval of the central government, represented by the local government minister, before concluding the general loan contract. This approval may be direct if the proceeds of the public loan are in the interest of the borrower. While the approval may be indirect if the local unit seeks to borrow in favour of another local unit affiliated to it and obtained the approval of the Minister of Local Government. However, the law exempted local units from the requirement of obtaining the prior approval of the Minister of Local Government in public projects determined by the Minister of Local Government and which made the matter of control by the ministry concerned with the project (Al-Tahrawy, 1998). Moreover, the law, as mentioned earlier, gave local units the right to borrow without the need for central government approval, like the temporary loans to cover urgent domestic expenses and the loans related to covering some project expenses that had already been approved for borrowing (Awadah, 1983).

In France, the French legislator, in accordance with Law No. 213 of 1982, established a loan committee at the level of each region, with the task of determining the general conditions of granting the loans to the local councils within the province. While the municipal councils have absolute power to borrow without the need for supervision by the central government. There are, however, two cases where the law requires the approval of the French State Council of public loans to local units; they are (1) if the loan is by institutions not specified by law. (2) If the public loan was granted to certain conditions or long periods of time (Khudair, 2014).

As for the position of the Egyptian legislator, the law gave local units the possibility of resorting to public borrowing to cover the expenses of production and investment projects without obtaining the approval of the central government if included within the plan and the budget approved. However, if the loan is not within the approved plan and budget, it must be approved by Parliament before it is concluded. It is also required to obtain the approval of the Prime Minister if the indebtedness exceeds 40% of the total annual revenues of the governorate (Article 36, Egyptian Local Government) & (Ismail, p 249).

With respect to the position of the Iraqi legislator, it is noted that the Public Debt Law No. (94) Of 2004 stipulated that the governorates which resort to borrowing take into account a set of conditions. From these conditions, obtaining the approval of the Minister of Finance and the need to adhere to the limits of debt assessed within the public budget. Also, the governorates are required to prepare an annual report at the end of August of each fiscal year that includes estimates of total unfunded loans, loans obtained in the previous fiscal year. This report should be submitted to the Minister of Finance for approval (Article 10/2, Financial Management and Public Debt Act, 2004)

Based on the foregoing analysis of data, it is clear that control of public loans borrowed by local units is considered as a guarantee of the economic policy of the state. However, such this oversight should be regulated in the legislative framework of local units, as is the case for Iraq, which lacks such regulation in the governorates Law.

7. Conclusion

Through the analysis and discussion of the data, the current study reached to the most important legal rules that govern the mechanism of the resort local units to public borrowing. It is therefore possible to clarify the main findings and recommendations of this study as follows:

1. The study revealed that local units have a basic right to have sufficient financial resources that can accommodate the needs of individuals and provide services to them. Therefore, the legislator should not cancel one of the financial resources of local units unless they are compensated by other resources to cover their needs. This is justified by the principle of free management of local units from the financial aspect. Where public borrowing is one of the flexible resources that local units can obtain when other resources are insufficient.
2. The study pointed out that public borrowing is one of the exceptional or reserve methods that can be resorted to by local units only in the case of the inability of the available income to finance one of the investment projects needed by citizens in the administrative unit.
3. The study showed that the Iraqi Law of Governorates that are not incorporated in a region No. 21 of 2008, did not explicitly provide the right of the provinces to resort to public borrowing. This law grants local units, at least formally, a large range of revenues on which local units may rely on the provision of the necessary funds to implement the projects needed by individuals. This is a legislative shortcoming in the regulation of an important financial resource for local units, namely, public loans. Especially, the law of financial management and public debt No. 94 of 2004 and the public budget law of 2013, has explicitly referred to the governorates' right to resort to public borrowing.
4. The study explained that the Iraqi legislator placed restrictions on the right of the provinces to resort to public borrowing, such as the need for approval of the central government represented by the Minister of Finance. Such a restriction would hinder the right of local governments to conclude public loans. On the other hand, the study revealed that the Iraqi legislator did not specify the specific procedures for the exercise of local units the right to public borrowing. Also, it did not refer to the restriction of local units that the general loan be a certain percentage of their annual revenues. Moreover, it did not point out of specific destinations to borrow from, whether foreign, national, government or private sector institutions.

8. Recommendations

For addressing the weaknesses in the legal regulation of public borrowing by local bodies, the study proposes a set of recommendations, as follows.

1. To ensure a clear legal mechanism for public borrowing by local (governorates) units, the Iraqi legislator should explicitly state public borrowing as one of the methods used by local units in circumstances where resources are inadequate. The study also recommends the need to provide

for specific and clear procedures when there is a real need for the administrative unit to obtain the general loan. This shall be through the Governor's proposal and the approval of the Governorate Council by an absolute majority. With the possibility of adjusting the objectives of spending the loan amounts to achieve justice between all the local units in the governorate. Also, the amount of loans received by local units should not be more than half of their annual revenues. Financial institutions that may be borrowed from the governorates should also be identified. These institutions prefer to be national, and in the case of borrowing from the government banks, it should be borrowing rate not less than half of the loan amount.

2. To achieve the requirements of development in the Iraqi governorates, the study recommends that the Iraqi legislator requires of simplifying the previous control procedures by the central government on the governorates when it resorting to public borrowing. The optimal solution would be to narrow the scope of the control and limit it to those loans that exceed a certain percentage, such as 30 percent of the annual revenue of the local unit, or the loans that are long term and may affect future the generations.

The implementation of these recommendations can be done by the legislative authority (the Iraqi Council of Representatives) through the amendment of the law of the unregulated provinces in the region No. 21 of 2008, and the relevant laws.

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