



# Decentralization and Changing Scenario of Challenges in Urban Local Bodies Finance: An Experience from Rajasthan Cities

SURBHI GAUR

Centre for the Study of Regional Development (CSRD),  
Jawaharlal Nehru University,  
Delhi (India)

## Abstract:

*Decentralization means basically devolving powers and responsibilities to the local level government from the central or higher authority. The basic objective of decentralization is to empower the local urban government in terms of decision making on administration, functional and financial matter. Some autonomy has been enjoyed by urban local bodies even in pre Independence, but the real decentralization in India; basically started during post independence, but landmarked of urban local governance started from 74<sup>th</sup> Constitutional amendment, 1992 which introduced the system of a three tier local government in the federal structure of India through which the establishment of a local representative government, with granting constitutional status. Henceforth, it also defined the provision for administrative and financial abilities to deliver mandated services to its citizen with effective, accountable and deliverable governance. The amendment constitutionally established the provision for transfer the power and responsibilities for services to urban local bodies. Therefore, way is not so smooth, the Indian federal structure bound the centre to leave issues of their empowerment and operationalisation to the discretion of the state governments. Which leads to spatial disparity in terms of functional, financial reasonability and autonomy in the urban local governance?*

**Keywords:** *Decentralization, Urban Finance, Urban Local Bodies*

## 1. Introduction

Presently India passing through a social transformation by changing from rural or agrarian based economy to urban or service oriented economy. But your cities are not ready in term of infrastructure to absorb a huge amount of immigration. Urban centers are in a crisis situation, in term of quality of service, which they provide. There is an imbalance between the expenditure responsibilities of local urban governments and their revenue raising powers. At the early stages of development, public sector has responsibilities for infrastructure development and the provision of basic living necessities, and the protection of economic stability; this directs the problems of the financial and fiscal centralization (Bahl, 2000). But even after the decentralisation most of the important functions or financial control is still in the hand of centre or state government. In the background of overlapping functions, ambiguous in term of responsibility, lack of accountability and malpractices directly impacts the governance ability of urban local bodies. For managing and maintaining rapid economic growth and urbanization, the public expenditure needs to shift more towards services provided by local governments. Therefore, without proper autonomy the local governments are unable to provide adequate levels of public service. This gap needs to be filled in order to realise the dream of urban local governance in an applied way with proper functioning for them. This could be done in the following two ways: giving local governments more revenue raising powers or by revenue transfers from the central government to the sub-national governments (Bahl 1998). The transfer of funds from the central government to local urban government leads to centralization of financial autonomy in an inefficient way due to federal obstruction or the other hand decentralisation of the responsibility in ambiguous manner. Is this the meaning of decentralization?

The Constitutional amendments as well as most of the state municipal legislation mainly cover electoral reforms and little efforts have been made towards actual devolution of functional and specifically financial powers to urban local bodies (Bagchi, 2000 & Roy Bahl (2000)). Somehow there is gap among the responsibility and delivery among the urban local bodies, which was due to lack of financial autonomy of the urban local bodies. The transfer of responsibility without financial autonomy led them to over impede, which results in term of under deliver or inefficient service delivery. Some favorable cities cope up with the service charge and center aided grant, but those are few only.

## **2. Urbanization and Urban Services in India**

India has witnessed rapid strides in urbanization as can be seen in the explosion of large cities. The urban population has continuously increased from 19.9% in the year 1971 to 31.16% in the year 2011. Increasing concentration of urban population in larger cities is one of the key features of urban India. The number of cities over 1.0 million population, in 2001, was 35 and population share was over 37 percent. According to the 2011 Census, the urban population grew to 377 million showing a growth rate of 2.76% per annum during 2001-2011. The level of urbanisation in the country as a whole increased from 27.7% in 2001 to 31.1% in 2011 – an increase of 3.3 percentage points during 2001-2011 compared to an increase of 2.1 percentage points during 1991-2001 (Bhagat 2012). This process of urbanization has created a huge gap between demand and supply of urban services and infrastructure. However, urban governance and management of the services is far from satisfactory. The research has aim to analyse the trends of urban bodies finances structure in different size cities of Rajasthan. According to the World Development Report (World Bank, 2007), “the adequacy of infrastructure helps determine one country’s success and another’s failure – in diversifying production, expanding trade, coping with population growth, reducing poverty, or improving environmental conditions.” Urban India has grown by nearly five times during the last fifty years, while the population of India has grown two and half times in the same period. As there has been no change in the definition of the urban between the 2001 and 2011 censuses, this has contributed significantly to faster urbanisation in spite of several metropolitan cities showing a huge decline in their growth rates (Kundu 2011), which could be the result of the quality of infrastructure and services, what they are providing to urbanities.

## **3. Status of Urban Governance in India**

In India, with 31.16% of the urban population, 58% urban households do not have safe sanitation, 20% don't have access to safe potable drinking water and since there is no proper adequate waste management, nearly 40% of garbage generated in urban areas is left uncollected. India's condition in this regard is so pathetic that in South Asia in comparison to neighboring countries. The National Sample Survey also highlights the miserable condition of the India cities. Out of a total population of Rajasthan, 24.89% people live in urban towns, population of which, in the last 10 years has increased by 29.26 %. The rural population growth rate recorded for the decade (2001-2011) was 19.05%. The rate of growth in the urban area (29.3) is far more than the rural area (4<sup>th</sup> SFC, Rajasthan, 2013).

Rapid growth of urban population has raised demands of civic infrastructure and services and to meet with the demand new projects like link roads, mass rapid transport system, parking lots, street lights, water supply, housing, sewerage and waste management schemes become essentials. The role of urban local governments is becoming more important to meet the aforesaid demands because the civic services are the responsibility of local government or municipal bodies. These urban local bodies (ULBs) are traditionally considered as a part of the system of state government and acting on behalf of it. Originally, the constitution of India allotted local self-government to the state list of functions without any specific provision for urban local bodies.

The responsibility of urban services rests with the ULBs with no clear financing avenues. There is a constitutional imbalance between the functions and finances of Urban Local Bodies (ULBs) in India

and most of these are grossly dependent on transfer of funds from the upper tiers of the government. Financial performance of small and medium-sized ULBs is not satisfactory as there is inadequate transfer of funds from the upper tiers of governments and inability on the part of ULBs to put their best efforts for mobilizing existing source of own revenues. In such a situation there should be an effective expenditure management system for better financial performance. Effective expenditure management begins with budgetary control system but budgets in Indian ULBs cannot be effectively used for this purpose.

#### **4. Urban Local Bodies**

In India, after the implementation of the 74<sup>th</sup> Constitutional Amendment Act 1992, ULBs were defined by the Municipal Corporations, Municipal Councils, Town Area Committees and Notified Area Councils/ Committees. Hence, the structure and composition of municipalities varied considerably across regions/states, with wide differences in definition and structure between states prior to reform. The 74<sup>th</sup> Constitutional Amendment Act 1992, brought uniformity in the constitution of the municipal bodies by classifying them as Municipal Corporations for large urban areas, Municipalities for smaller urban areas, followed by Nagar Panchayats and suburban government bodies. According to the Thirteenth Finance Commission (TFC), at present there are 3,842 ULBs in India, of which 139 are Municipal Corporations, 1,595 are Municipalities and 2,108 are Nagar Panchayats. The Municipal Corporations account 4 percent of total urban bodies while Municipalities share 41%; maximum share 55 percent is provided by Nagar Panchayats. (CARE Report).

#### **5. Decentralisation and Urban Local Bodies**

Decentralisation can best be understood as a political process in the sense of the devolution of resources, tasks and decision-making power to democratically elected lower-level authorities, which are largely or wholly independent of central government (World Bank, 2007). Municipal administration has a very long history in India it developed gradually with the time starting from the period of Indus Valley Civilisation. More pervasive initiative was taken during the British period. The root of the modern urban governance rooted and flourish during this time some of noted development are The Charter of James II in 1687 which empowered the establishment of municipal corporations by East India Company. Followed by Mayor's Courts (1726) were established in the Presidency Towns of Madras, Bombay and Calcutta. There act provides the base for the development of the urban structure but the provision devolution of power started from the Royal Commission on Decentralisation (1906).

Real development of decentralization was started after the independence. After that a number of Commissions and Committees have been appointed both by the Central Government and various State Governments for examining various issues relating to municipal affairs. The dreams about decentralisation initiative- come in reality through the Constitution Seventy- fourth Constitutional Amendment Act, 1992. It was consider as a watershed development in urban policy initiatives in India. It provides constitutional status to the local urban bodies through devolving powers, functional responsibilities and authorities to them. It provides a third tier of government with functional devolution. Real decentralization governance was started with the Seventy- fourth Constitution Amendment Act 1992 that was come into effect from 1st June 1993 (Bagchi 2001).

The Constitution (Seventy Fourth Amendment) Act, 1992, has made it mandatory for the state governments to constitute Municipalities. A new part, Part IX A, has been enshrined in the Constitution after Part IX of the Constitution. It deals with matters like definition, constitution of Municipalities and ward committees, reservation, disqualifications, powers and responsibilities, powers to impose taxes, all relating to the urban local bodies. Article 243 Y stipulates that the Finance Commission constituted under Article 243 I shall review the financial position of the Municipalities and make recommendations regarding distribution of resources between the State and the Municipalities, determination of taxes, duties etc. grants-in-aid to Municipalities, among other matters.

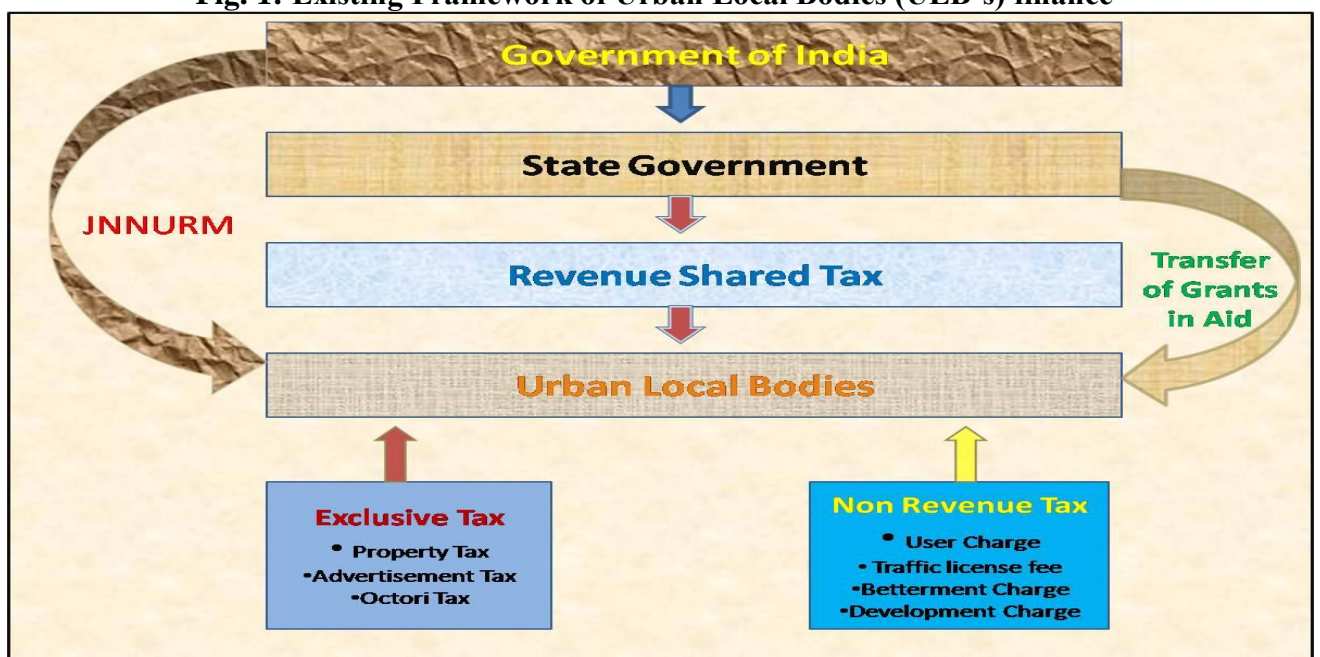
The Government of India (GOI) has developed a Model Municipal Law (MML) in 2003 to guide States to enact municipal legislations. The basic objectives of the MML are to implement the provisions of the 74th CAA in totality for empowerment of the ULBs, and provide the legislative framework for implementation of the Ministry's urban sector reform agenda. This initiative is expected not only to enhance the capacities of ULBs to leverage public funds for development of urban sector but will also help in creating an environment in which ULBs can play their role more effectively and ensure better service delivery. Four states, namely Rajasthan, Bihar, Orissa and Sikkim have prepared their municipal laws on lines of MML and many others are in process of amending their laws. The Rajasthan Municipalities Ordinance 2008 has introduced some very innovative features that should help to empower ULBs in the State.

## 6. Finance of Urban Local Bodies

Financing of basic amenities in India has largely remained within the purview of public sector. Though the state governments largely made the required capital investments in projects related to basic amenities, the maintenance of the utilities were the responsibility of the city governments. As a consequence, there was an urgent need for financial strengthening of urban local bodies. The lack of adequate basic urban services and infrastructure is a major challenge in human settlements development. With rapid urbanization, governments are increasingly having difficulties to meet the growing demand for housing and urban development, urban services and infrastructure.

Urban Local Bodies (ULB) in India, like most of the countries all over the world, have own source of revenues in addition to transfer from upper tiers of governments. It is true that revenue generating sources assigned to the ULBs are inadequate in comparison to expenditure functions assigned to them but it is also true that the ULBs do not put their best efforts to mobilize revenue efficiently and effectively from the sources so assigned and therefore the ULBs are not in a position to provide services satisfactorily because of inadequate resources. All these have made the ULBs grossly dependent on the transfer of fund from the upper tiers. There is rapid urbanization in India and expenditure functions and responsibilities of ULBs are increasing. Cost of providing services has become more expensive as compared to income base which is remaining static. In such a situation better financial performance is necessary for financial sustainability of ULBs.

**Fig. 1: Existing Framework of Urban Local Bodies (ULB's) finance**



Source: Adopted from Public Financial Management and Accountability, World Bank Report, 2006 (Only Basis Conceptual Framework)



The role of urban local governments is becoming more important to meet the aforesaid demands because the civic services are the responsibility of local government or municipal bodies. These urban local bodies (ULBs) are traditionally considered as a part of the system of state government and acting on behalf of it. Originally, the constitution of India allotted local self-government to the state list of functions without any specific provision for urban local bodies.

Urban decentralisation- devolving powers and responsibilities to the municipal bodies (the city governments) was a result of the increasing pace of urbanisation, particularly in the larger cities. These cities became the hub of industrial and economic activities and attractive destinations for the foreign direct investments (FDIs) Bagchi (2010). The lack of revenues is one of the biggest problems facing most cities all over the world, which makes them one of the vulnerable layers of government, with increasing responsibilities and small share in the allocation of public resources.

How to tap the private sector resources to provide urban services and infrastructure to the poor and how community-based organizations can participate effectively in urban development and urban services and infrastructure provision and management.

It became inevitable for the city governments- municipal bodies to provide better infrastructure facilities to the citizenry in general and foreign investors in particular. It has now become a major challenge for the civic agencies, particularly in the larger cities to provide internationally competitive infrastructure facilities to attract the FDIs flowing into India. The inter city competitiveness to attract FDIs has made the investors even more demanding regarding the performance of the city governments Bagchi (2010).

## **7. Issues in Urban Local Bodies Finance**

Urban Local Bodies face so many constraints in which finance is an important. Generally, central governments only provide limited funds to local government for the development and maintenance of basic services in urban area. With the increase in responsibilities as a result of the devolution of eighteen functions through the 12th Schedule of the 74th CAA, empowerment of the ULBs became foreseeable. Moreover, the decline in the budgetary support from the higher tiers of Government (Bagchi, 2000), as a result of the second generation of reforms that aimed at reducing state fiscal deficits, made devolution of powers to ULBs imperative. It is more than a decade that the decentralisation initiative is in place after the second generation of reforms triggered during the early nineties.

Urban Local Bodies (ULBs) has a limited scope for decision making in the absence of appropriate financial control mechanism. They are more depended on the grants provided by the central and state governments. The prior information about expected amount of own fund during a particular period is of great importance for decision making. But large scale dependency on the various level of federal government does not proficient to have prior information about the grant amount and delivery time. An analysis done by Bagchi during (1991-2000) reveals that problems relating to the financing of urban infrastructure in general and urban basic services (UBSs) in particular has aggravated in the recent past. There has been substantial decline in the governments' budgetary support for this purpose.

Decentralisation has its in built negative implications as well. Studies over the World have revealed that devolving fiscal powers to lower tiers of government aggravates regional disparity; uncontrolled borrowing powers to local bodies might lead to increased debt burden on the National Government. It is however, well known that the local governments in India are confronted with poor finances, over-controlled local governance and multiplicity of agencies often with overlapping functional and geographical jurisdictions (Bagchi 2000). At present, user charges are negligible in India, with the proceeds from non-tax revenues from all urban local bodies amounting to a mere 0.13 per cent of GDP. Mohanty et al (2007) show that in 10 large municipal corporations less than 10 per cent of the cost of providing services was recovered through fees; in another six, cost recovery was between 10 to

20 per cent. Only in two of the 25 municipal corporations examined was cost recovery greater than 75 per cent (Rao, 2010). It came into sight that politically impossible to levy user charges when the quality of the services delivered is poor. The result is that a vicious circle is set up, with low quality public services leading to an inability to collect user charges leading to further deterioration in the service levels.

Indian municipal bodies can levy and collect only those taxes that are in the State List in the Constitution and are authorised by the States. Unsurprisingly, the taxing powers assigned are non-uniform across states. However, the most important local taxes are collected by the state government; Municipal governments do have some limited access to consumption taxes. For example in Kerala the power to levy entertainment tax is given to the urban local governments. But In Andhra Pradesh, local governments receive a fixed share of the revenue from entertainment tax. In some states, urban local bodies also collect some revenue from advertisement tax.

Property tax sector is one of important source of urban local bodies but this sector also needs major reform in term of efficiency in collection and expansion of the tax base. The Administrative Reforms Commission (2007) noted that only about 60-70 per cent of the properties in urban areas are actually assessed. A large number of property owners simply do not pay the tax. Application of effective model like Patna and Bangalore model could help the cities of Rajasthan. In most municipal bodies, there is no proper record of ownership of dwellings, leave alone the area of the plots, covered area and the floor space. Nor do they collect information on the alterations made by the owners. In the absence of a good information system on various properties and their improvement, it becomes difficult to enforce the tax even though many of the reformed systems have a self-assessment principle.

The value added tax (VAT) is probably a bad choice for state governments in most LDCs and transition countries. Clossen (1998) points out the widespread use and revenue dependence on the VAT, and its growing importance. But as much as the VAT is an advantage for national government finances, but it is not suitable as a state government tax. Bird and Gedron (1997) have pointed out that sub national governments could carry off an effective value-added tax provided that the local government and the national government used the same base and provided that the central VAT were well administered. In most developing and transition countries, these conditions are not likely to be met (Bahl, 2000). As a final note on local taxes, it is particularly important that states cease the pernicious practice of abolishing local taxes (Octroi) without providing adequate substitute sources of revenue to municipalities. For example, the Gujarat, Rajasthan and Haryana government abolished octroi to without any mechanism to compensate the municipal corporations, although later Gujarat decided to levy a one percentage point additional rate on the sales tax. Rajasthan and Haryana simply abolished the property tax without even consulting the urban local governments.

## **8. Conditions of Urban Finance in Rajasthan**

In 2010-11 the 82 percent of the urban financial resources are coming from the Grants and non tax revenue in Rajasthan. Tax revenue share only 7.38 percent. Present situation of the financial condition of urban local bodies could be visualised very clearly through Table 1. Most of these grants are bounded in nature or having limited scope for the modification according to local needs. A large amount of funds goes to the human resource management and payment of wages (4<sup>th</sup> SFC Report, Rajasthan, 2013). Huge investment is required in India's urban sector. Since public funds for these services are inadequate, urban local bodies (ULBs) have to look for innovative approaches for financing and management of urban services. However, most critical factors for introducing these innovations are a healthy municipal revenue base and good urban governance (Vaidya, 2009). There is a confrontation between the limited financial resources and the unlimited needs for public services (Tesu, 2011).

**Table 1: Position of Own Income in Total Budget of the ULBs in Rajasthan**

Source of Receipts	2006-06	2007-08	2008-09	2009-10	2010-11
<b>Total Own Revenue</b>	300.53	444.76	467.74	476.69	571
<b>Total non-tax Revenue</b>	328.09	467.63	496.57	641.03	722.43
<b>Total of Grants and Loan</b>	749.61	863.25	1110.29	1284.4	1146.63
<b>Assigned Revenue</b> (Entertainment Tax)	-	-	3	7.12	7.21
<b>Miscellaneous</b>	117.02	159.8	267.81	244.62	175.11

*Source: Directorate Local Bodies Department, 4<sup>th</sup> State Finance Commission, Rajasthan*

As a result there is a constitutional imbalance between the finances and the functions. It may be noted here that the extent of devolution of function to ULBs is at the discretion of the State Government and therefore the extent of devolution structurally and functionally different across the country. Though 74th Constitutional Amendment Act envisages for devolution of additional taxation powers to ULBs so as to make them financially competent for discharging the added functional responsibilities, but unfortunately there is no such devolution of taxation powers and such powers are limited to traditional sphere (Bhattacharyya et. al. 2012).

The 12<sup>th</sup> five year draft plan has highlighted that the Infrastructure of India's present towns is very poor. Sewage, water, sanitation, roads, and housing are woefully inadequate for their inhabitants. The worst affected are the poor in the towns. As more urban conglomerations form and grow without adequate Infrastructure, the problems will only become worse. The 13<sup>th</sup> Finance Commission points out that the aggregate resource requirement of ULBs for fulfilling all their functions is significantly larger. The expenditure of local bodies has significantly increased in the recent past due to three reasons: first, the impact of the Sixth Pay Commission; second, additional operation and maintenance costs due to larger investments in civic infrastructure and third, additional investments necessary for improving the accounting system, computerisation of operations, tax administration, and project monitoring (13<sup>th</sup> Finance Commission, Government of India).

The centre government took several legal and policy based initiative like Model Municipal Code for the implementation of 74<sup>th</sup> CAA and functional devolution while some fiscal empowering policy like Jawaharlal Nehru National Urban Renewal Mission (JNNURM). But these policies are mainly fails to achieve objective except one or two successive stories. These are projects based initiatives and largely based on the political will, imitational functional coverage and regional and sectoral inequalities. Most of them are only for the infrastructure based projects, while urban areas have various social problems also. The fund transfer through these policies only confined to the cities developing agencies instead of the local governing bodies. The Amendment have aim to confer constitutional status of a third-tier government to the urban local bodies. State level agencies, City Improvement Trusts and Urban Development Authorities such as Jaipur Development Authority (JDA/UITs), have been set up in a number of cities. These agencies undertake land acquisition and development works, and take up remunerative projects such as markets and commercial complexes, etc. This leaves the municipal bodies with only the functions of garbage collection/disposal, street lighting, maintenance of inner city roads, registration of births and deaths, etc. The State should provide a higher status to Municipal bodies than to developmental agencies.

### **9. Scope of Alternative Financing**

Alternative financing are the new and innovative method in urban local finance. These methods are alternative ways to augment municipal resources where the traditional resources are not able to fulfill the requirement of present demand. Most of the experiences are taken from the success stories of different India cities. There are Debt financing, public private partnerships (PPP), land as resource, new levies and pooled financing.

Pooled financing is very effective method and have capacity to generate enough amount of resource for urban bodies. But it also has limitations; it could not be well-matched for medium and smaller municipalities, because they are unable to take advantage of resources available in the capital market due to weak financial position and lack of capacity to prepare viable project proposals. Collectively State level pooled financing mechanism for the small and medium town could be best to find solution. A State level Pooled Financing Mechanism is working successfully in Tamil Nadu and Karnataka with the financial assistance from the United States Agency for International Development (USAID). Central Government has set up a Pooled Finance Development Fund (PFDF) to provide credit enhancement to ULBs to access market borrowings based on their credit worthiness through State-Level-Pooled Finance Mechanism. So far two pooled funds were structured in India as pilot projects. A public private partnership (PPP) is frequently accepted method for improvement of the services delivery and resource development. But the funds alone shall not be adequate for meeting investment needs in urban areas. New levies /cess should be used for supplement revenue resources which could be drainage fee, parking fee, Hoarding fees, vacant land tax, development impact fee, etc. But this did not enough potential because of frequently direct inference of political and other social groups.

### References

1. 13<sup>th</sup> Finance Commission Report, Government of India,
2. 4<sup>th</sup> State Finance Commission Report, Rajasthan 2013.
3. Bagchi, S. (2000). "Financial Implications of Decentralisation: Issues Concerning Resource Mobilisation by Urban Local Bodies", *Arth Vijnana* Vol.XLII; No.4.
4. Bagchi, S. (2001). "Financing Capital Investments in Urban Infrastructure: Constraints in Accessing Capital Investments in Urban Basic Services;" *Economic and Political Weekly*, Vol.XXXVI; No.4.
5. Bagchi, S. (2001). "Private Provision of Public Utilities: Some Issues and Evidences from Indian Water and Sanitation Sector", *Nagarlok*; Vol.XXXIII; No.3.
6. Bahl, R. W. and J F Linn (1992). *Urban Public Finance in Developing Countries*, A World Bank Book, OUP Publication, New York.
7. Bahl, Roy W, (1998): "Implementation Rules for Fiscal Decentralisation" Paper presented at the International Seminar on Land Policy and Reform; Taiwan Institute of Land Policy.
8. Bhagat, R. B. (2011). "Emerging Pattern of Urbanisation in India" *Economic and Political Weekly*, August 20, 2011 vol xlvI no 34.
9. Bhattacharyya, S. and Bandyopadhyay G. (2011). "Urban Local Bodies in India- Prudent Financial control Practices", *International Journal of Governmental Financial Management*, Vol XI, No.2, pp.33-49.
10. Bird, R. and P.-P. Gendron (1997) "Dual VATs and Cross-Border Trade: A Review of International Experience," Discussion Paper No. 13, International Centre for Tax Studies, University of Toronto.
11. CARE Report, 2011.
12. Chetan, Vaidya (2008). *Indo-USAID Financial Institutions Reform and Expansion Program (FIRE) report*.
13. Chetan, Vaidya (2009). *Urban Issues, Reforms and Way Forward in India*, Working Paper No.4/2009-DEA, Department of Economic Affairs, Ministry of Finance, Government of India.
14. Govinda, M. Rao & Richard M Bird (2010); "Urban Governance and Finance in India," *Governance Working Papers* 21851, East Asian Bureau of Economic Research.
15. Kundu, Amitabh (2011). "Method in Madness: Urban Data from 2011 Census", *Economic and Political Weekly*; Vol XVI No 40.
16. Tesu, M. D. (2011). "Ways to Finance Investments within the Local Public Administration;" *Economia Seria Management*; Vol-14, Issue 2, pp.492 -499.
17. World Bank (2007). *India Synthesis Study of Public Financial Management and Accountability in Urban local Bodies*, Document of the World Bank, Report No. 41204-IN, Financial Management Unit South Asia Region, 1-51.