

Fiscal Decentralisation to Urban Local Governments: A Case Study of Kerala & Lessons for Public Policy

A dissertation submitted to the University of Hyderabad in partial fulfillment of the requirements for the degree of

**DOCTOR OF
PHILOSOPHY
IN
ECONOMICS**

BY

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SCHOOL OF ECONOMICS

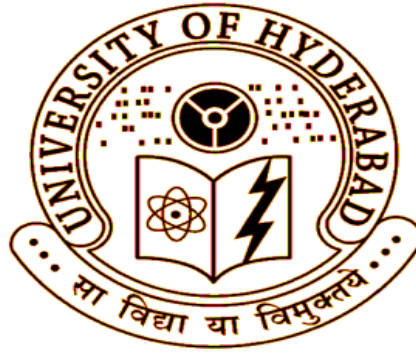
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December, 2022

Dedicated to, our son,
Adam Morocco



DECLARATION

I, Muhammed Riyas M.P, hereby declare that the research embodied in the present dissertation entitled ***“Fiscal Decentralisation to Urban Local Governments: A Case Study of Kerala and Lessons for Public Policy”*** is an original research work carried out by me under the supervision of Dr. Alok Kumar Mishra and Prof. P.K. Mohanty, School of Economics, for the award of Doctor of Philosophy from University of Hyderabad. I also declare to the best of my knowledge that no part of this dissertation is earlier submitted for the award of any research degree or diploma in full or partial fulfillment in any other university or institution.

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CERTIFICATE

This is to certify that the thesis entitled “*Fiscal Decentralisation to Urban Local Governments: A Case Study of Kerala and Lessons for Public Policy*” submitted by **Mr. Muhammed Riyas M.P** bearing registration number 15SEPH09 in partial fulfillment of the requirements for award of **Doctor of Philosophy** in the School of Economics is a bonafide work carried out by him under my supervision and guidance. This thesis is free from plagiarism and has not been submitted previously in part or in full to this or any other university or institution for award of any degree or diploma.

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*I want to make it clear that I am solely responsible for any errors or omissions in this study
and will not blame anyone else.*

*By,
Riyas*

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Abbreviations

AAGR	Annual Average Growth Rate
ADS	Area Development Society
AMRUT	Atal Mission for Urban rejuvenation and transformation
ATR	Action Taken Report
BP	Block Panchayat
CFC.	Central Finance Commission
CSS	Centrally Sponsored Scheme
C&AG	Comptroller and Auditor General
CDS	Community Development Society
DF	Development Fund
DCB	Demand Collection Balance
DP	District Panchayat
DPC	District Planning Committee
FGT	First Generation Theory
GP	Grama Panchayat
GDP	Gross Domestic Product
GIS	Geographic Information System
GST	Goods and Services Tax
GPF	General Purpose Fund
GSDP	Gross state Domestic Product
HFI	Horizontal Fiscal Imbalance
IKM	Information Kerala Mission
ICRIER	Indian Council for Research on InternationalEconomic Relations
IKM	Information Kerala Mission
IMF	International Monetary Fund
KPR Act	Kerala Panchayat Raj Act
KM Act	Kerala Municipal Act
LGs	Local Governments
MF	Maintenance Fund
MLR	Multiple Linear Regression
NHG	Neighborhood Group
NIC	National informatic Centre

OLS	Ordinary Least Square
OECD	Ordinary least square
PRI	Panchayat Raj Institutions
PMAY	Prime Minister's Awas Yojana
RBI	Reserve Bank of India
SC	Schedule Caste
SGT	Second Generation Theory
ST	Schedule Tribe
SFC	State Finance Commission
SOTR	State's own tax revenue
TV	Television
UAs	Urban Agglomeration
UK	United Kingdom
ULB	Urban Local Bodies
ULGs	Urban Local Government
UFC	Union Finance Commission
USA	United States of America
VAT	Value Added Tax
VFI	Vertical Fiscal Imbalance
WG	Working Group

CHAPTER 1

Fiscal Decentralisation to Urban Local Government: An Overview

1.1. Introduction

Centralisation has been on a back foot since the latter part of twentieth century. The advent of globalisation, decline of centrally planned economies, and the emergence of multi-party politics fuelled the quest for decentralisation across the globe. In the last three decades, more than ninety-five countries adopted some degrees of decentralisation. The decentralisation continues to be one of the developmental pursuit of nations regardless of their stages of development. Developed countries pursue fiscal decentralisation for the efficient service delivery and for the enhanced accountability of elected representatives. The developing countries perceive and practice fiscal decentralisation as a panacea to uplift themselves from poverty and other socio-economic impacts historically inflicted on them. Push from international agencies like World Bank and International Monetary Fund (IMF) paced up the spread of fiscal decentralisation and local governance across the world (World Bank 2003).

The fiscal decentralisation is the process of transferring the budgetary authority of taxes and expenses to the elected local governments (Tanzi 1995). Countries around the globe have planned and executed decentralisation with programmes such as: revamping the distribution of responsibilities and revenue-raising powers among the tiers of government, increasing the revenue-sharing and inter-governmental transfers to local authorities, commercialisation, and privatisation of infrastructure, greater co-operation with voluntary organisations, and empowerment of democratic local government institutions (OECD 2016). Regardless of the form and rationale of decentralisation adopted by the countries, the process has relished greater

support from the public (Shah 2005). The support was primarily due to dissatisfaction with the centralised planning and the concern for more dispersed, people-oriented and equitable development. The process of fiscal decentralisation has not been limited to federal countries; unitary countries also pursued the process.

Allocation efficiency, cost economy, good governance and poverty alleviations are the presumed advantages of decentralization over the centralised regimes (Oates 1972). Bringing the governments closer to citizens is the basic feature of decentralization (Bird 1998). Fiscal decentralisation takes into account local taste and preferences (Oates 2006). It ensures better delivery of public services and the enhanced accountability of elected officials (Tiebout 1956). The efficient delivery of the public services increases the willingness to pay of residents, thereby ensuring the accountability in the services. In other words, it enables “development from below”. Fiscal decentralisation encourages revenue mobilisation and promotes innovations in economic activities. It encourages the accountability of elected officials and enlarges the scope of grass-root participation in governance. Fiscal decentralization leads to optimal city size (Shah, 2003). If cities were encouraged to raise their own revenue, the marginal cost of service delivery would increase. The tax disparities among the cities would discourage urban migration and may lead to optimal city size.

Nevertheless, the process of fiscal decentralisation has never been easy-going and free from challenges. Macro-economic management has been a major concern of fiscal decentralisation for public economists (Prud'Homme 1995; Palienko et al., 2017; Melnyk et al., 2018). A fiscally decentralized economy would be more susceptible to external shocks. It would be desirable if the central government undertake effective macroeconomic control over the economy. Investment on social overhead is also a challenge for fiscal decentralization. The centre government will be efficient on investments such as the national power grid, trunk highways, and ports. The trickle down and penetration of corruption is major concern of fiscal

decentralisation. Nevertheless a strategically designed fiscal decentralisation can overcome or minimize those challenges. A better designed fiscal decentralisation system will be the one which minimizes undesirable outcomes of such programme and reaps the maximum advantageous of decentralisation. In this context, Roy Bahl (1999) puts forward twelve implementable rules for the fiscal decentralisation. The design of fiscal decentralisation should coincide with its objectives. The following are the twelve rules of implementation of fiscal decentralisation.

- (i) *Fiscal decentralisation as a comprehensive system:* A comprehensive approach has to be followed in the reforms. Different aspects of the system should be taken care off. A phased approach is desirable; a piecemeal method might be counterproductive.
- (ii) *Finance follows functions:* The functions assigned to the local government must correspond the finance. Adequate and sufficient revenue sources have to be devolved to the local governments to discharge their expenditure duties. Central government should establish expenditure needs of each level of governments. Assignment of expenditure should be on the economic efficiency criteria. On the revenue side, either it comes from own revenues which consist of tax and non-tax base of local governments or the intergovernmental transfers from the higher governments. The decision has to be taken, considering the economic base of the local bodies and incentives at play.
- (iii) *A strong central monitor to evaluate decentralisation:* In the initial phase of the fiscal decentralisation, there must be central government's leadership and monitoring on the matters concerning the financial accounts, audit rules, disclosure requirement for borrowing, determination of the spending mandate, grant formulae and on imposing limits on borrowing. Local government will require technical assistance in the field of

accounting, tax administration, treasury, project management, programme evaluation, data processing and e-governance.

- (iv) *Different local governments should be treated differently*: Local governments in less developed areas depend heavily on grants from the higher government, whereas in developed regions, they get better tax dividend and high credit rating to borrow. Decentralisation strategy should make clear embarkation to classify the local governments based on their endowment and capacity.
- (v) *Fiscal decentralisation calls for significant taxing powers*: Financing the local government predominantly by local taxes, ensures the accountability of the elected representatives towards the residents. The tax must be visible to the voters; it should be large enough to feel the burden, and the tax should not be easily exported to residents outside the jurisdiction. Property tax is the most suitable tax item in the local governments.
- (vi) *Higher governments must keep the rules of fiscal decentralisation that they make*: There should be a non-paternalistic approach in the intergovernmental fiscal relationship. It is often the government at the top that doesn't adhere to the rules that constitute the basis of fiscal decentralisation. It includes the imposition of unfunded functional mandates on local governments, underfunding of transfer programs, the abolition of local taxes etc.
- (vii) *Keep it simple*: A simple fiscal decentralisation is simple to administer and which requires less of constant evaluation. To keep the system simple, it should design as follows:

Avoid complicated allocation formulae which are not supported by existing data; Abstain from enforcing those taxes which are designed other than for revenue raising.

Don't go for conditional grants which need a lot of monitoring, and expenditure mandates which require stringent compliance requirements.

- (viii) *The intergovernmental transfers system should match the objectives of the decentralisation reform:* The designing of intergovernmental transfer has different economic repercussions. The state of local bodies and their revenue position should be considered in designing the transfers. The transfers must prioritise between the vertical and horizontal imbalance in revenues of local governments and higher ones.
- (ix) *Fiscal decentralisation should consider all three levels of governments:* All levels of governments should be considered in the designing of fiscal decentralisation - from central government, to state / provincial government and to local municipal governments.
- (x) *Impose hard budget constraint;* It implies that the autonomous local government should be able to balance its budget without resorting to the assistance from the higher government. Fiscal bail-outing shouldn't be encouraged.
- (xi) *Intergovernmental system is always in transition and prepare for it:* The fiscal decentralisation should adapt itself to the changing economic dynamics. Grant designing and categorisations of the local bodies should reflect the economic development of the respective jurisdiction.
- (xii) *The champion for fiscal decentralisation:* to be successful in decentralisation an internal champion is a must who then understand the cost and benefit running fiscal decentralisation program.

Getting right on the implementation of fiscal decentralisation is as important as the fiscal decentralisation itself. The right implementation will curtail the disadvantages of fiscal decentralisation and maximize the benefits. As literature suggests, if implemented effectively the fiscal decentralisation is bound to achieve the following benefits.

- Effective and expeditious decision making on resource allocation and service delivery
- Easy data collection and use of it for planning

- Greater participation of beneficiaries
- Greater participation of people in financing of the program and in its implementation.
- Improved registering of local preference and matching of local expenditure
- Better use of local finance through ground level knowledge about tax base and its impacts; this enables rationalisation of expenditure at local level.
- Free the fiscal burden of the central government and enabling it to focus on macroeconomic stability and poverty eradication.
- Local official shows stronger commitment in the use of resources
- Streamlining service delivery management through local level targeted capacity building processes.
- Ensuring higher accountability through a cost -benefit linkage of local service – establishing the Wicksellian Connection.
- Fostering grass roots democracy

1.2. The Constitution (74th Amendment) Act and Urban Local Governments in India

The history of local governments in India traces back to pre-colonial periods. British colonialism had a major role in the development of local government in India. Mahatma Gandhi's idea of Grama Swaraj shaped the idea of local self-governance in India (Gandhi 1997). After the independence, various governments both in States and Centre implemented fiscal decentralisation in their own ways. There was no structure or constitutional backing for the local governments. It was Constitutional (73rd and 74th Amendment) Acts 1992 which gave a constitutional existence to local government in India as the third-tier governments. The Constitutional (73rd and Amendment) Act 1992, deals with rural governments, otherwise

known as Panchayat Raj Institutions and Constitutional (74th Amendment) Acts 1992 deals with the Urban Local Governments (ULGs), which is the focus of our study.

74th Constitutional Amendment Act, 1992 conferred the constitutional status to Urban Local Bodies. The Act brought about a uniformity in the structure and mandates of Urban Governments across the nation. It stressed the importance of participation of elected representatives in planning, management and provision of public services. The Act is founded on the premise that all 'power' in democracy rightfully belong to 'the people'. If a state government dissolves a municipality, as per the Act, the election for the same has to be conducted within six months. It mandates the state governments to constitute District Planning Committee (DPC) and Metropolitan Planning Committee (MPC) with a pre-dominant representation of elected members of local governments. There was no specific mentioning of Municipality in the Constitution before the Act. The subject of local governments was assigned to states under Entry 5 of State List.

Prior to the Act, State Governments frequently suspended and superseded elected Municipalities. In case of Chennai, Kanpur and Lucknow the suspension was extended for more than a decade. It was led to erosion of the very basis of local governance and organisation of Municipalities. Traditional functions of local bodies were encroached by parastatal and other agencies of State governments. The Municipalities were weakened, and failed to perform their duties. At this background, the enactment of the Constitutional (74th Amendment) Act was a significant initiative by the Government of India aimed at strengthening Urban Local Governments and according them constitutional status as the third tier. The Act envisaged a comprehensive change in the way in which the local governments conduct. It put forwarded the following institutional framework for the smooth functioning of Municipalities as institutions of local self-government:

Article 243K: State Election Commission,

Article 243Q: Municipalities: Municipal Corporations, Municipal Councils and Nagar Panchayats,

Article 243R: Wards Committee and other Committees,

Article 243I: State Finance Commission,

Article 243I: District Planning Committee,

Article 243ZE: Metropolitan Planning Committee and

Article 243W: Twelfth Schedule - Municipal Functions

Article 280 (New provision): (Central) Finance Commission Devolution for local governments

The Constitution (74th Amendment) Act provides for three types of municipal bodies: Nagar Panchayat for transitional areas; Municipal Council for Smaller urban areas; and Municipal Corporation for larger urban areas. The responsibility of creation and operationalisation of local bodies of different types and instituting other constitutional frameworks is assigned to State Governments.

Ward Committees and Special Committees are aimed at taking the municipal governments physically close to residents and discharging their responsibilities including those in the Twelfth Schedule. State Legislatures may, by law, provide Wards Committees and other Committees "such power and authority as may be necessary to enable them to carry out the responsibilities conferred upon them including those concerning the matters listed in the Twelfth Schedule" (Article 243W).

State Election Commission prepares electoral roll and conducts the elections for both urban and rural local bodies. Ward Committee and other committee take the local governments physically closer to people. State Finance Commission review the finances of local governments and recommends measures to strengthen local finance. District Planning

Committee consolidates the plans prepared by local governments (urban and rural) in the district and prepares a draft development plan for the district. Metropolitan Planning Committee prepares the draft of development plan for a metropolitan area, spreading over one or more districts.

The 74th Amendment prescribes for statutory District Planning Committee and Metropolitan Planning Committee. Article 243ZD of the Constitution makes it mandatory for the setting up of a District Planning Committee in every district "to consolidate the plans prepared by the Panchayats and Municipalities in the district and to prepare a draft development plan for the district as a whole". The District Planning Committee formulates the draft district development plan which includes spatial planning, sharing of water and other physical natural resources, infrastructure development, environment protection, and management of financial and other resources. The Act, mandates that four-fifth of the total member of District Planning Committee is elected from panchayats and municipalities as per the proportion of population in the district.

Article 243ZE of the Constitution mandates a Metropolitan Planning Committee (MPC) to formulate a draft Metropolitan Development Plan for each metropolitan area. The plan aims to integrate rural-urban and physical-financial planning at the metropolitan level. The Metropolitan Development Plan shall address the common interests of Panchayats and Municipalities such as coordinated spatial planning, sharing of physical and natural resources among local bodies, integrated development of infrastructure, environmental conservation and other objectives prioritised by central and state governments. Not less than two-third of an MPC shall be from elected members of Municipalities and chairpersons of Panchayats in proportion to population of Municipalities and Panchayats in the metropolitan area. The chairpersons of DPC and MPC forward the draft development plan for their respective areas to

the state government. The state government is expected to endorse the plan and decide on the resource sharing, including state's support for the plan implementation.

Article 280 of the Constitution was amended to require the (Central) Finance Commission to recommend devolution of central resources for local bodies, basing on the relevant State Finance Commission recommendations.

Expenditure Assignment to Urban Local Governments

Fiscal federalism approach provides a normative framework for the assignment of responsibilities to municipal and higher governments. The assignment to the local governments/ municipalities should be on the considerations of economies of scale, scope, spill over effects, consumer preferences, proximity of beneficiaries and the budgetary decision on composition of spending (Oates 1999; Shah 2003; Bird 1998). In India, the following describe the institutional framework associated with functional assignment to the municipalities of the country.

The 74th Amendment Act envisages that the State Governments may, by law, endow them, “with such powers and authority as may be necessary to enable them to function as institutions of self-government and such law may contain provision for the devolution of powers and responsibilities upon Municipalities, subject to such conditions as may be specified therein, with respect to (i) the preparation of plans for economic development and social justice. (ii) the performance of functions and implementation of schemes as may be entrusted to them including those concerning the matters listed in the Twelfth Schedule....” [Article 243W].

So, the role assigned to ULGs are much broader than that of public service providers. However, the Constitution does not distinguish the functional domains of three categories of Municipalities: Municipal Corporation, Municipal Council and Nagar Panchayat.

The Twelfth Schedule

The Constitution envisages a greater role to urban local governments to perform in the interest of welfare of residents. The 74th Amendment Act adds the Twelfth Schedule to Part IX of the Constitution of India (Article 243W). The Twelfth Schedule provides an illustrative list of functions to be performed by municipalities, which includes:

1. Urban planning including town planning;
2. Regulation of land use and construction of buildings;
3. Planning for economic and social development;
4. Roads and bridges;
5. Supply of water for domestic and commercial requirements;
6. Public health and sanitation;
7. Solid waste management;
8. Fire service;
9. Environmental and ecological protection and urban forestry;
10. Safeguarding the interests of weaker sections of society, including the disabled and the mentally disabled; Protect the interest of weaker sections including disabled;
11. 11. Slum maintenance and up-gradation;
12. Poverty alleviation;
13. Provision of parks, play grounds and gardens;
14. Promotion of cultural and aesthetical aspects;
15. urials and burial grounds, cremations, cremation ground and electric cremation;
16. Vital statistics like birth registration and death registration;
17. Provision of street lighting, bus stops, parking lots and other public amenities;
18. Regulation of slaughterhouses and tanneries. Regularisation of slaughterhouses and tanneries.

Revenue Assignment to Urban Local Governments

Economic efficiency, national equity, administrative feasibility and fiscal adequacy are the major considerations to be taken into account in the fiscal devolution of taxing powers (Bahl, 1999; Shah, 2003; Bahl & Martinez, 2006). The economic trade-off between the cost of increased taxing responsibility and increased accountability can be offset through a fiscal arrangement which overcomes the fragmentation by the joint occupation and the harmonisation of taxes (ibid.). The equalisation transfers can reduce the fiscal inefficiency and the inequity arising out of different fiscal capacities across local government. In India, the following are the institutional arrangement which look after the revenue transfers to the ULGs.

Role of State Government

Article 343X of the Constitution calls for state legislature/government to undertake the following action:

1. It authorises the municipalities to levy, collect an appropriate taxes, fees, duties and tolls subjecting to procedures and limits.
2. It assigns municipalities taxes, fees, duties and tolls levied and collected by the State Government subject to limits and conditions.
3. It provides for transfer of grant-in-aid to the municipalities from the consolidated fund of the state.
4. It provides for the constitution of funds for crediting and withdrawing money. .

Role of State Finance Commission

It is mandatory for the e state governments to constitute State Finance Commissions in every five years. Article 243Y entrusts the SFCs to recommend the following.

1. The principles which should govern;

(a) The distribution of net proceeds of tax, fees, duties and tolls between municipalities and state government levied by the State Government and allocation of the proceeds among municipalities of all levels.

(b) The determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by the Municipalities;

(c) Provide for the grant in aid from consolidated fund of the state to municipalities.

2. Measures to improve financial position of the local bodies and

3. Any other matters referred by the Governor in the interest of the sound finance of the Municipalities.

The State Governor shall cause every recommendation by the SFC, along with an explanatory memorandum on action take on the report, to be laid before the Legislature of the State.

Role of Central Finance Commission

Under Article 280 of the Constitution, Central Finance Commission is appointed to assess the financial needs of the state governments and recommend a financial package as fiscal transfers from the central government in every five years. It is mandatory on CFC to suggest, "the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Municipalities in the State based on the recommendations made by the Finance Commission of the State". This provision in the CFC's mandates is aimed at establishing a fiscal linkage among the local governments, state governments and the central government.

Intergovernmental Transfers

Inter-governmental transfers to municipalities play an important role in the financing of city services and infrastructure in both developed and developing countries (Bahl, 2000 ; Bird &

Smart 2001 ; Shah 2006 ; Farvacque-Vitkovic, et al 2014 ; Shah, 2003). They include the sharing of the tax base, yield and revenues. The inter-governmental transfers aim at reducing vertical and the horizontal fiscal imbalance among the tiers of governments. They compensate municipalities for inter-jurisdictional spillovers of public services, fund the national priorities including adequate provision of merit goods and core infrastructure facilities and enhance the efficiency of tax collection. The vertical imbalance arises when revenue of local governments is inadequate to finance its functional responsibilities and unequal tax bases among the jurisdictions causes the horizontal fiscal imbalance. The "equalisation" transfers are designed to compensate ULGs for fiscal disabilities owing to poor taxable capacity or disproportionately high spending requirements, say, large percentage of residents being poor. It ensures that different local authorities provide similar public services at similar tax rates. Externalities leading to the spillover of costs and benefits between jurisdictions also justify the fiscal transfers. Further, higher level government provide grants to local governments to induce them to achieve national standards of service. The merit goods like education and health and crucial infrastructure for sustainable urbanisation like public transit will be underprovided if consumption decisions are left to citizens or lower levels of government as they do not recognise the true value of such goods. Inter-governmental transfers are also justified when the collection of major taxes is entrusted to central or state government for exploiting scale economies in tax administration.

Many economists make a strong case for fiscal transfers to local governments to discharge redistributive functions (Ferrario 2009, Stossberg 2016). Income taxes are ideal instruments to finance poverty alleviation and social assistance programmes. When municipalities do not have access to buoyant taxes like income tax and sale tax, transfers are necessary to address the problems of poverty, inequality, slums and destitution. The Central and State governments also set policy priorities in the public interest like promoting human

development, providing basic services to citizens, reducing regional disparities, etc. Thus, programmes funded by higher governments are often implemented through the local governments because of the latter's proximity to targeted groups and close access to local knowledge. One example of such programme is Jawaharlal Nehru National Urban Renewal Mission (JnNURM), launched by the Government of India in 2005. JnNURM aimed at reform-linked provision of city-wide infrastructure and basic services to the urban poor, including land tenure, affordable housing, water, sanitation, education, health, and social security. Another example is Rajiv Awas Yojana (RAY), initiated by the Government of India in 2011 to promote slum-free cities. In recent years, the Government of India has launched several new initiatives: Smart City Mission, Atal Mission for Urban Rejuvenation and Transformation (AMRUT) and Housing for All or Prime Minister's Awas Yojana (PMAY).

1.3. Three Decades of Fiscal Decentralisation to Urban Local Governments in India

India is completing its three decades of fiscal decentralisation to Urban Local Governments, initiated by the Constitution (74th Amendment) Act 1992. The experience of fiscal decentralisation to the third tier in India has been far from satisfactory (Mohanty 2014; Oomen 2020). ULGs suffers from pervasive designing issues like Ambiguities and overlapping of activity mapping . Most of the devolving functions are in the form of various schemes of state / central governments where ULGs do not have any decision-making power. The corresponding funds to implement the schemes are also not transferred to ULGs.

ULGs in India have a limited fiscal exchequer. By design local governments are endowed only with a few revenue sources; tax and non-tax. Moreover the urban governments have continuously failed to collect potential revenue (ICRIER 2019; Mohanty 2016). The state and central governments have not been transferring enough to ULGs to discharge their humongous

expenditure tasks which affect the day-to-day life of citizens. The vast arrears of uncollected property tax and obsolete regime of taxation of land and different types of property, professional tax, advertisement tax, entertainment tax, etc. by the urban local governments indicates unwillingness of state governments to go forward with tax reform and raise revenue. The rent seeking behaviour of local politicians and officials exacerbates the problem. There are serious issues regarding the formation SFCs, nature and quality of the recommendations, state governments' approach towards the reports and their implementation. Finance commissions are not constituted regularly in some of the states in India. The chairman and members are expected to be selected from people with expertise in finance but often the members are selected from politicians and retired or serving bureaucrats. Poor quality of analysis and recommendations of the State Finance Commissions are also a challenge. Many Commissions fail to conduct a serious study into fiscal capacity and the financial needs of the municipalities before the making recommendations. Most of the Commissions not even conduct a primary analysis of revenue and the expenditure of respective local bodies. Lack of proper activity mapping in the states acts as a hindrance to fix the expenditure requirements of the municipalities. Consequently, the transfer system between the state government and municipalities is inadequate in terms of volume or not designed scientifically or both. The transfers from the Central Finance Commission to Municipalities are of a tokenism; the size of the transfer is too negligible relative to the expenditure requirements of ULGs and size of central government and state government revenues.

The size of the general-purpose unconditional grant to ULGs is inadequate and is not based on any scientific formula. Instead of correcting this, state governments are resorting to scheme-based and conditional devolution to municipalities which in effect, is robbing the autonomy of the local governments. In addition, there are number of schemes or functions appropriate for central/state government delegated to municipalities for implementation. These

include poverty alleviation, nutrition and health, education, road, women and child development, affordable housing and environmental conservation. The required flexibility is not allowed on these schemes, and sometimes municipalities are simply reduced to an agency of the state/central government. The narrowed fiscal autonomy is an uncontested reality of Indian municipalities, though it differs in magnitude from states to states. The dependency of municipalities on higher levels of government has been getting bigger. Abolition of octroi and introduction of GST further depleted the revenue sources of municipalities. A comprehensive study is required to account for the various changes in the fiscal decentralisation to ULBs in the country over the years.

The urban fiscal decentralisation experience in India is uneven across regions. It is appropriate to study such experience at regional-district-state levels and even at individual local government level. Each experience is valuable and unique which might have something novel to offer for policy and implementation of fiscal decentralisation to urban local governments. The fiscal decentralisation to urban local governments in Kerala is needed to be studied on that backdrop. The state has been a pioneer in fiscal decentralisation in the country. The peoples' planning movement in the state has been widely celebrated. Now Kerala is entering into its third decade of fiscal decentralisation to local governments, including ULGs. It is important to analyse the performance of the state, highlight the achievements and bring out the challenges of fiscal decentralisation in general and urban decentralisation. In particular, this will reflect on the functioning of the state of urban governance and will be useful in the policy-making at state and national levels.

1.4. Fiscal Decentralisation to Urban Local Governments in Kerala

Kerala had initiated the democratic decentralisation process long before the 73rd and 74th Constitutional Amendment. Before the commencement of the Acts, Kerala had two Municipal

Finance Commission and a Taxation Enquiry Committee that reviewed the pattern of distribution of resources between the State and Local Governments. Kerala has been one of the few states in India which took a lead in constituting State Finance Commission (SFC) and perhaps the only state which has accepted the fundamental recommendations SFCs and implemented devolution recommended entirely after the Constitutional enactment (Vijayanand 2009). The massive transfer of funds as an act of political faith is the major feature of Kerala's fiscal decentralisation (Oomen 2020). Kerala carried out decentralisation through a campaigning mode. The celebrated 'People Planning' campaign was a highly successful political-economical experiment which infused trust of people in decentralisation (Heller et al., 2016; Isaac & T.T 2000, 2001).

Ironically, own resource mobilisation by Municipalities in Kerala has not been satisfactory; hence there is heavy municipal fiscal dependence on State and Central governments. The own tax revenue and own non-tax revenue of the ULGs hardly constituted thirty per cent of total municipal receipts. Rapid growth of non-plan expenditure as against plan expenditure and increasing trend of revenue expenditure as against capital expenditure are conspicuous in the spending patterns of municipal governments. The diversion of the Development Fund of ULGs for the State and Central schemes is another serious issue that undermine the very purpose of democratic decentralisation. There are profound challenges at the legal front. Municipalities cannot undertake the revision of tax, fees and charges under the current legal framework. Kerala Municipality Act 1994 doesn't allow the introduction of new taxes and fees. The Municipalities are ill-equipped to carry out revenue recovery measures against the defaulters. They don't have a free hand in acquiring land for the mandatory functions. Municipalities cannot outsource the activities such as waste disposal and cleaning of roads. There is no provision in the present Act that deals with certain pertinent development issues. Service delivery is an area that necessitates separate study. The ULGs lack the staff of

adequate qualification at different levels which impedes the delivery of civic services and the daily administration of Local Governments. There is poor execution of the civic works, shortage of staff and more importantly, many legal impediments for effective functioning of municipalities exist. There is an acute paucity of studies on Urban Local Governments in Kerala. This is a study to discern the different aspects of fiscal decentralisation to urban local governments in Kerala. It aims at looking into the issues of fiscal size, fiscal dependency, fiscal accountability, fiscal efficiency and sustainability of urban local governments in Kerala. The study will be a contribution in understanding the performance and prospects of urban fiscal decentralisation and functioning of urban local governments.

1.5. Statement of the Problem

The key issues of fiscal decentralisation to Urban Local Governments (ULGs) have been neglected in India both at the policy level and in academic persuasion. The fiscal federalism discourse in the country has been confined or dominated by Centre-State relationship. The Local Governments, particularly ULGs hardly received the attention they deserve in the interest of contribution to economic growth, human development and social welfare. The available studies on fiscal decentralisation to Local Governments are largely focused on Panchayats/Rural Local Bodies. Millions of people reside in urban areas. More than 35% of Indians and more than 50% of Keralites are living in urban areas. The functioning of municipal governments has a direct impact on the lives of such huge numbers of people. The municipalities are the closest government of those citizens. They cater to essential services and provide basic amenities to the residents. Further, as the theories of economic geography and urban economics emphasise, growth does not occur everywhere, pointing to the importance of urban space for economic agglomeration and growth. The urban local governments should be able to provide core infrastructure and facilitate growth.

The organisation of local governments is futile if they cannot finance basic expenditure responsibilities. The structure of their finance, the pattern of their expenditure, the revenue-raising capacity and sustainability of municipal finance has much bearing on the efficiency, equity, accountability and sustainability of public service delivery. Kerala has pioneered decentralisation process in the country. It is important to sketch the prospects, performance and challenges of state's urban decentralisation. All aspects of fiscal decentralisation require a revisit in the changing times. This study aims to conduct a comprehensive analysis of fiscal decentralisation to Urban Local Governments in India, focussing on the municipalities in Kerala. There is a significant vacuum of comprehensive studies on Kerala Urban Local Governments. The prevailing studies are narrow in objectives and scope. Most of them are done alongside village Panchayat studies in the state, where the latter has been on the focus. A state in which almost half of its population lives in urban area, deserves an extensive study on Urban Local Governments and its fiscal semantics.

1.6. Objectives of Study

The key research objectives of this study are to:

- Study India's fiscal decentralization and municipal financing, and mark the trends and key highlights.
- Critically analyse the theories of fiscal decentralization, international practices, and theories of local public finance with India's fiscal decentralization experience at the local level.
- Analyse the decentralization experience of Kerala, specifically with Urban Local Governments (ULGs).
- Assess the magnitude and trend of fiscal decentralization. Evaluate the components of municipal finance and their implications for ULGs in the state.

- Conduct an empirical study to explain the variations / determinants of own-source revenue (OSR), grants from the State Government, and expenditure of Urban Local Governments.
- Trace and sketch the impediments in fiscal decentralisation-municipal financing and look for socially, legally, and economically appropriate recommendations and reforms.

1.7. Research Methodology and Data

This thesis is an analytical study. It employs a combination of qualitative and quantitative methods. It uses theoretical predicates and quantitative techniques for data analysis. It uses textual analysis of different State Finance Commissions and Centre Finance Commissions and reviews the relevant secondary sources of studies to evaluate and compare the same with the normative theoretical standards and the best practices in the system. Necessary statistical and econometric tools are employed to analyse the relevant variables. Cross-sectional regression analysis and panel data analysis have been used to explain OSR, Grant, and Expenditure. Kerala Information Mission, Central Finance Commission, State Finance Commission Reports, other major reports, and various budget documents of the State Government/ULBs are the primary data sources for the analysis.

1.8. Organisation of Thesis

This thesis comprises five chapters. The second chapter reviews relevant literature; fiscal decentralization theory, first-generation theory, second-generation theory, implications for decentralization, and municipal financing in India. International experiences of local governments and financing principles are also covered. Local public finance literature is covered to see how those principles are implemented in Indian urban governments. Selected Indian studies are reviewed to understand the state of present scholarship on urban governments and their financing in India. The third chapter critically evaluates the fiscal decentralization

experience of Kerala at the local level as a whole and urban local government, in particular. The fourth chapter is the empirical chapter on fiscal decentralization to ULGs in Kerala. It measures the magnitude and trend of fiscal decentralization to ULGs in the state. It assesses the three components of fiscal decentralization: own source revenue (OSR), grants, and expenditure, their trends, implications for municipal financing., etc. This chapter tries to explain econometrically the variations /determinants of OSR, grant, and expenditure. Chapter 5 provides conclusions, recommendations and a broad direction for reforms of fiscal decentralization to ULGs in the Kerala state and elsewhere.

CHAPTER 2

Fiscal Decentralisation to ULGs

Theories and Experiences: Review of Relevant Literature

2.1. Introduction

Fiscal decentralization is the assignment of expenditure and responsibilities from the central governments to the state and the local governments (Tanzi 1995). Fiscal decentralization is the most crucial component of whole decentralization process, and it is the lifeblood of such process. In the last decade, extensive debates have taken place on the advantages of decentralization and its shortcomings. The early works on fiscal decentralization defend the decentralized fiscal system on its potential economic benefit over the centralized regime (Oates 1972; Musgrave 1959; Tiebout 1956). In general, it has been perceived that decentralization contributes to human welfare and the well-being of the citizen. The developing countries take decentralisation as the remedy to get rid of poverty, mal-governance, and corruption inflicted in their countries. Allocation efficiency, distributional equity, accountability, and better service delivery are the major advantages of fiscal decentralization (Bird 2010). At the same time, the decentralization of fiscal system is blamed for weakening the central government's ability for macroeconomic management, efficiency loss due to weak administration capacity of local governments, and trickling down of corruption (Prud'Homme 1995). The scholarship on fiscal decentralization continues to problematize fiscal decentralization theoretically and empirically accounting the everyday experience and development around the world.

Several developing countries have planned and executed decentralization, with programs such as revamping the distribution of responsibilities and revenue-raising powers between various tiers of government; increased revenue-sharing and inter-governmental transfers to

local authorities; commercialization and privatization of infrastructure; greater cooperation with voluntary agencies and community-based organizations; and empowerment of democratic local self-government institutions. Regardless of the form and rationale of decentralization adopted across countries, the process has enjoyed a good deal of popular support (Shah 2006, 2012; Rao 2011). It is primarily due to the dissatisfaction with centralized planning and the need for more dispersed, people-oriented, balanced and equitable development.

Empirical evidence indicates that the public attaches value to the election of local officials and their proximity to the decision-making process concerning citizens' welfare (Bird 2010; Shah 2012; Mohanty 2014). Decentralized regimes tend to improve the level and quality of community participation, paving the way for increased efficiency in the provision of public services. Local governments are more likely to be centered around problem-solving and remain sensitive to peoples' problems (Bird 2010). Further, as decentralization institutionalizes the participation of the 'affected' persons, it is regarded as intrinsically valuable. "Local people may make 'wrong' decisions from the perspective of the central government or of an outside observer, but if they make them, the decisions must, by definition, be assumed to be 'right' for them" (Bird, 1994). From this point of view, India's Constitution (74th Amendment) Act, 1992, which aims at democratic decentralization to cities and towns and carrying power to the people, is a milestone initiative taken by the country's Parliament since independence.

This chapter has been divided into six sections. The first section discusses the theoretical background of fiscal decentralization. An extensive literature review has been conducted ranging from public economics, choice theories and political economy to political science. The theories of fiscal decentralization have been clubbed in the literature into first-generation fiscal decentralization theory and second generational theory. This classification is based on the approaches of fiscal decentralization theories regarding role of government and the market. The second section of the chapter illustrates the international experience of fiscal

decentralization. Developed countries and developing countries have been studied to discern the process of fiscal decentralization around the globe and to understand its relevance in Indian context. The third section covers Indian studies on fiscal decentralization to ULGs. The last section summarizes the entire discussion and provides theoretical and practical insights into fiscal decentralization and municipal financing in India, and their status in the case of ULGs in Kerala.

2.2. First Generation Theory (FGT)

FGT presents a set of normative prescriptions on functional allocation and fiscal transfers among the levels of governments in a federation to correct the vertical and horizontal imbalances. The traditional theories assumed 'benevolent' decision-maker at the federal and local government who engage in optimization of social welfare. The first-generation theory understands that centralized and decentralized governments have distinct advantages and disadvantages; it tried to combine both in a way that maximize social welfare. The works of Tiebout (1956), Musgrave (1959), Oates (1972), Olson (1969) have been the pillars of FGT.

The first-generation theory asserts that the macroeconomic stabilization and distribution of the income is the responsibility of the federal government. The function of public sector is to produce full employment in the economy and the equitable distribution of income while keeping price stability (ibid.). The governments at the bottom will be impotent in economic stabilization since they lack fiscal and monetary instruments to manipulate economic behaviour. The local governments do not have the informational and instrumental capacity to manage macroeconomic stability. The distribution of income in terms of assisting the poor by subnational governments, turns sub-optimal due to the mobility of the people. The poor influx to where redistribution undertakes, and the rich outflux from there because the cost of the program falls on them as additional tax. It would be effective if a national government

undertakes the distribution program since the mobility of the residents within the nation must be lesser when compared to inter-jurisdictional mobility in a local government.

FGT calls for the decentralization of functional allocation. The differentiation in consumption and the internalization of externality are the two major factors in defence of decentralization, as Oats (1972) put it, “each public service should be provided by the jurisdiction having control over the minimum geographical area that would internalize benefits and costs of such provision” (Decentralisation Theorem). Decentralization caters to the public goods and services as per the taste and preferences of residents. In contrast, the federal governments impose uniformity leading to inefficacy and sub-optimal situation. Another defence in favour of decentralisation is the foot vote, “citizens vote with their feet”. i.e., the residents choose jurisdiction which offers him/her the best fiscal package by harnessing ‘consumer mobility’.

The subnational government often serves as the laboratories of experiments (Oates 1999). Innovative ideas are being employed in providing public goods of various sorts. For a federal government, it would be costlier and risky to undertake experiments in delivering public goods. There are many instances where many successful experiments of subnational governments are implemented nationally. It is not to suggest that the experiments are coming only from subnational governments. Inter jurisdictional competition leads to better provisioning of goods and services. The competition among the jurisdictions will lead to better outcomes. If a state government comes with an innovative idea of doing a particular thing, other states also follow the same or go for further better.

Since public goods are being provided through the local taxation, the cost of the goods is weighed against the benefit which in turn, ensure efficient outcome through the decentralized functional allocation. The probability of the community being the watchdog of the public goods is high in a decentralized regime (Bird 2004). The decentralization is strongly supported by the

theoretical and normative consideration of efficiency, equity, autonomy, and accountability. Though FGT was favouring functional decentralisation, it was not been in favour of tax/revenue decentralization. The following sections examine in detail the assignment of expenditure responsibilities and revenue sources among the hierarchal governments.

Expenditure and Revenue Assignments:

Expenditure responsibility and revenue assignment are the critical components of fiscal decentralization. The traditional view has been that the expenditure assignments precede the tax assignment (Musgrave 1959). The revenue can be allocated by looking at the expenditure, and it can't be done in advance. As the theoretical wisdom suggests, the macroeconomic management, the distribution of income, and the provision of public goods whose externalities spread across the jurisdiction should be performed by the federal government. The federal government should provide compensatory grant in case of the benefit of one jurisdiction is spilling over to another. The rest of all the services ideally must be provided by the local governments. If needed, central/federal and state /provincial government may fix the minimum standards of those services. Table 2.1 gives a theoretical guideline on the allocation of the expenditure in the various levels of governments in a federation.

Table 2.1

Expenditure Assignment at Various Governments

Expenditure Category	Service Responsibility	Provision of service	Justifications
Defence	F	F	Benefit and scope national in scope
Foreign affairs	F	F	Benefit and scope national in scope
International trade	F	F	Benefit and cost national in scope

Environment	F	S, L	Benefit and cost national in scope
Currency and banking	F	F	Benefit and cost national in scope
Interstate commerce	F	F	Benefit and cost national in scope
Immigration	F	F	Benefit and cost national in scope
Unemployment insurance	F	F	Benefit and cost national in scope
Airline and railway	F	F	Benefit and cost national in scope
Industry and agriculture	F, S, L	S, L	Significant interstate spill-overs
Education	F, S, L	S, L	Transfers in kind
Health	F, S, L	S, L	Transfers in kind
Social justice	F, S, L	S, L	Transfers in kind
Police	S, L	S, L	Primarily local benefit
Highway	F, S, L	S, L	Some road with significant interstate spill-overs, others primarily local

F- Federal, S- State/Province, L- Local Government/Municipality

Sources: Shah (2012)

The FGT advocates for the centralization of the revenue assignments. The rationale is: the ill-practices due to the competition between sub-national government leads to distortionary practices such as taxing mobile factors, including labor and capital. That may prove to be self-defeating and in turn lead to under-provision of public goods and services. It may hinder an internal common market by blocking the mobility of the resources and result in the ‘beggar thy neighbor’ situation. In this backdrop, FGT favored a centralized tax regime. The benefit-based

taxes like property tax, user charges are transferred to the local governments. Musgrave and Musgrave (1984) brought about a general guideline on taxing of different levels of governments based on the general principles of equity' and 'efficiency'. It is more of an extension of /derivation of the classical understanding of decentralization:

1. Taxes which are useful for economic stabilization must be left to the federal government.
2. Redistributive taxes should be centralized.
3. Taxes on mobile factors of production are better administered by central government.
4. If the tax base is highly unequal among jurisdiction, it must be centralized.
5. Taxes on the immobile factor of production are preferably decentralized to subnational governments.
6. Residence-based taxes are best-suited state governments, such as a tax on consumer goods for customers and exercise, etc.
7. The benefit taxes and user charges might be appropriate for all levels of the government in their respective areas.

Table 2.2 illustrates the assignment of tax at various levels of government advocated by first generation theory. The financial resources are distributed unevenly. The federal government will be having more financial resources and fewer expenditure responsibilities; on the other hand, the subnational governments are having fewer financial resources and greater expenditure responsibilities. This situation gives rise to what is known as vertical fiscal imbalance (VFI). It is the fiscal mismatch of the subnational government to the federal government in correspondence to their expenditure. The mismatch between the fiscal need and the revenue among the same level of government is known as horizontal fiscal imbalance

(HFI). This will necessitate intergovernmental transfers and revenue sharing. We will discuss that in further detail.

Table 2.2

Tax Assignments

Tax	Determination of Tax Base	Determination of Tax Rate	Tax Collection and Administration	Justification
Customs	F	F	F	International Trade
Income Tax	F	F,S	F	Redistributive and mobile
Estate and Gifts	F	F,S	F	Redistributive
Corporate tax	F	F,S	F	Mobile
Resource tax	F	F,S	F	Distributional Disparity
Retail sales	F	S	S	Higher Compliance Cost
Value Added Tax	F	F,S	F,S,C	Boarder tax adjustment
Exercise	S	S	S	Residence-based Tax
Property Tax	s	L	L	Immobility, benefit tax
User Charges	F,S,L	F,S,L	F,S,L	Payment for Services Received

F- Federal, S- State/Province, L- Local Government/ Municipality

Sources: Shah (2012)

Intergovernmental Transfers and Revenue Sharing:

The design of fiscal decentralisation to local governments inevitably invites fiscal imbalance (Oates 1972; Shah 2003; Mohanty 2014). It could be either vertical fiscal imbalance or horizontal fiscal imbalance. The vertical fiscal imbalance occurs when federal government are assigned with more fiscal power and the subnational governments are assigned with more expenditure responsibilities. Generally, a major portion of taxing power is held with the federal government and the sub-national governments are left with meagre tax avenues. This will necessitate compensation to subnational governments for balancing their budget. Moreover, transfers acts as incentive mechanism. Transfers should not be mere 'gap-filling' exercise (Collins 2001). It should not distort the incentives of the sub-national government to raise own revenue or practice the efficient management of expenditure. There has to be specific criteria in the intergovernmental transfers which will help to avoid unhealthy bargaining between the federal government and the sub-national government. The macroeconomic stability is also a concern for federal government while transferring finances to sub-national governments (Tanzi 1995; Iqbal 2010)

HFI arises because of differential fiscal capacities of the subnational governments. The subnational governments are not fiscally equal because historical, cultural and geographical reasons. If a state/ local government is rich in natural resources, its fiscal capacity also will be higher. In the same way, some sub-national governments with chronic fiscal disadvantages such a higher number of old, poor and young people, proneness to natural calamities are likely to be disadvantaged.

Intergovernmental transfers should address the inter-jurisdictional spill-overs (Oates 2005). There are indeed various public goods and services whose externalities spread beyond the providing jurisdiction. Examples include: pollution control, interregional highways, fire safety, crime controlling, ecological conservation, higher education (an educated person may

leave for another region) etc. in which case the public good providing region may not reap the full benefit for the expenditure incurred. There will be disincentives for the region which leads to undersupply of such provisions. i.e., there will be a sort of ‘free riders’ problem. The federal government should take it into notice, and it the duty of the same to provide due incentives to prevent such under investments. The federal government should compensate the subnational governments in case of negative externality.

2.3. Second Generation Theory (SGT)

The second-generation theory emerged in the last decades of twentieth century, drawing its ideas from outside the public finance literature including theory of firm, principal-agent problem, information theories and the contract theories. SGT addresses two main concerns of fiscal decentralisation; political process and behaviour of political participants. As against FGT, second generation theory understands that government officials may not further the interest of common good rather may be having their own self-interests to pursue. And there exist asymmetric information and political agents i.e., some participants have more information on taste, preferences and cost structure than others. The second-generation theory looks at fiscal federalism within an industrial organisational framework. It cautions the dangers of too much of fiscal decentralisation while acknowledging the importance of fiscal decentralisation. The incentives and knowledge are two important aspects of Oates’ (2005) second-generation fiscal decentralisation theory. The local governments have to have an incentive to avoid the out migration of people and firms and the knowledge of local preferences and tastes are important in achieving economic efficiency in the delivery of goods and services by the subnational governments. The crux of second-generation theory is drawn from theories of transaction cost, principal-agent theory and contract theory. Leading studies in the second-

generation fiscal decentralisation theory are: Weingast (1995), Seabright (1996), Lockwood (2002), Petchey and Levchenkova (2002), Baseley and Coate (2003) and Wagner (2007).

The theory of market-preserving federalism, proposed by Weingast in 1995, is a key part of second-generation theory in fiscal decentralization. This theory examines how different jurisdictions can create incentives for credible commitment and lower transaction costs. According to the theory, federalism serves as the foundation for a common market by prohibiting internal trade barriers, which promotes economic activity and competition. In contrast, the concept of "incomplete contract," proposed by Seabright in 1996, suggests that elections can be seen as unverified contracts in which some information is not verifiable. The effectiveness of decentralization and centralization depends on the relative balance of the benefits of internalizing fiscal externalities and the cost of reduced accountability in a centralized system. Some scholars, including Lockwood (2002) and Basely and Coate (2002), argue that if national governments provide different goods and services across regions, a different framework from that of Oates is needed. This model suggests that if it is possible for national governments to deliver goods and services that meet local preferences, it supports the general idea of Oates' fiscal decentralization theorem, which assumes that interjurisdictional externalities are small and regions are diverse. However, conflicts can arise when the central government shares the cost of public goods between people in different jurisdictions in the legislature, which can lead to excessive public spending or uncertainty and misallocation across jurisdictions. The extent of this conflict depends on the spillovers and preferences for public spending. Second-generation literature on fiscal federalism highlights the importance of sub-national governments in revenue generation in order to make them more responsive to citizens, and the importance of establishing "hard-budget constraints" for different levels of government to prevent "soft-budget constraints" and the resulting poor incentives and financial problems. This literature also emphasizes the role of political and institutional factors in creating negative

incentives for sub-national fiscal behavior. While second-generation theory is generally seen as complementary to, rather than contradicting, first-generation theory, both approaches offer valuable insights into the trade-off between centralization and decentralization and its implications for federal systems.

2.5. Municipal Governments Around the World

Municipal local governments around the world vary in the method, organisation and the institution of the process from one country to another. Some countries opted a more flexible structure of fiscal federalism with less specification, whereas others opted a for a rigid structure of fiscal decentralisation. The assignment of buoyant tax is important as far as fiscal autonomy of the municipality is concerned. There are countries which allotted significant buoyant taxes while others heavily relied on the intergovernmental transfers. In this section, both developed and developing countries are taken to study the fiscal decentralization at municipal level. United Kingdom, United States, Canada, Australia, Brazil and China are comprehensively studied. Table 2.3 gives a short and detailed survey of fiscal decentralization in these countries. In United States, fiscal federalism has been loose and flexible without much specification. The delegation of buoyant revenue base to local governments is the feature of fiscal federalism in the States. The local governments in United Kingdom enjoys considerable freedom due to predictable central government transfer. Decentralised Canada devolves significant taxes like property tax, business tax, special taxes meant for the financing of specific purposes and local improvement tax to local governments. Local improvement taxes in Canada are generally in the form of betterment levies linked to benefits accruing to specific local areas due to the provision of infrastructure as a result of the implementation of local improvement plans. The Australian model is quite in contrast to the US model. Australia has a highly unitary model of the polity. China's fiscal system is highly decentralized; nearly 70 per cent of total public

expenditure in China takes place at the sub-national. Brazilian municipalities are granted full autonomy; consumption and production taxes are assigned to all three levels of government. In short, each country has got similarities and differences in the implementation of fiscal decentralisation. Detailed illustration has been given in table 2.3.

Table 2.3

International Experience

Country	Decentralization Experience
United States	▪ Loose and flexible structure of fiscal federalism Free of too many specifications. State governments assign the taxes and fix their maximum rates to local governments. May seek voter referenda on tax rates and additional borrowings Local government revenue accounts 40 to 70 per cent of the expenditure. • Major source of local public finance sources in United States are; Property tax, which accounts for 70 to 75 per cent of the local tax income of United states Local option income tax; states like Alabama, Arkansas, Delaware, Georgia etc. permit levy of local income tax General sales tax, excise taxes, impact taxes Special assessment, user charges and fees, development exactions Debt financing: general obligation bond, revenue bonds, taxable bonds

	Tax increment financing, lease purchase contracts, revolving loan fund, bond banks Impact fees
United Kingdom	Financial regimes in England includes Non-domestic rate: a tax on the commercial and industrial property - collecting into national pool and sharing among local governments. Exchequer grant to local authority Capital finance system: - here local authorities can participate with private sector initiatives Council taxation/ local domestic taxation - later replaced with community charges
Canada	• Main source of municipal finance of Canada includes; Property tax, business tax, special taxes meant for the financing of special purpose schemes and local improvement tax Special service taxes like water works tax, sewer tax, boulevard tax, paving tax, dust treatment tax, tax for road repairment and maintenance, sewer and water facilities tax, ambulance eservice tax etc. in the province of Alberta. Local improvement taxes in Canada generally take the form of betterment levies linked to benefits accruing to specific local area due implementation of infrastructure plans.
Australia	• Significantly in contrast to the US model, highly unitary model of polity

	• 80 per cent of the total tax revenue is from central government • high vertically imbalanced, 50 per cent of the state expenditures are being financed through central grant and local governments are collecting little as their own
Brazil	• Municipalities are granted full autonomy with Constitutional amendment. • Consumption and production taxes are assigned at three levels of governments. • Urban property is taxed by municipalities and rural property tax is central tax. • Tax on services (ISS) is the main municipal tax and a tax called IPTU is charged on urban properties. • Based on constitutionally mandated revenue sharing, municipalities are entitled to (a) 25 per cent of revenue from state value added tax (ICMS), (b) 50 per cent of revenue from motor vehicle registration tax (IPVA), (c) 22.5 per cent from the federal value added tax (IPI) and income Tax (IR), (d) all revenue from all income tax held at source (IRPF) and paid by municipality or by their decentralized agencies, (e) 70 per cent of revenue from the federal financial transaction tax levied on transaction in gold (IOF- Quro) and (f) 50 per cent of revenue from the federal rural-property tax (ITR). • Compensatory transfers and transfers related to health care and investment programs. • Local governments have been poor tax collectors in Brazil.

China	• China's fiscal structure has been highly decentralized. Nearly 70 per centage of public expenditure take place a the sub- national level. • The budget law in China confers substantial autonomy. • Key subnational expenditure includes: Sub-national administration, local capital construction, basic local services, maintenance, repair and operation of urban infrastructure, health and hospital, primary and secondary schooling, support for agricultural production, price subsidies, poverty alleviation, culture and heritage protection, environmental conservation, local and regional and development and physical planning. Major subnational revenue sources include: Business taxes, company income tax, personal income tax, urban land use tax, urban maintenance and development tax, fixed asset capital gain tax, house property tax, stamp taxes, agriculture and related tax, tax on contract, and land use increment taxes. Shared revenue includes VATs (75 per cent central and 25 per cent subnational governments), stamp taxes on security exchange (50:50 sharing) and resource taxes.
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Source: Authors' compilation

2.6. Literature on Indian ULGs

Indian scholars started focusing on urban local governments only after the 74th Constitutional Amendment Act 1992. The public finance literature in India was often found to be reluctant to go beyond central-state fiscal relationship. Among the third tier, urban local bodies were rarely discussed and analysed compared to their rural counterparts. Fiscal decentralization to urban local governments in India has bigger ramifications from the municipal infrastructure financing

point of view to catering to essential amenities required by urban residents and growth-generating firms. The following are some of the relevant literature found to be useful to understand various dimensions of fiscal decentralization to ULBs in India and its different aspects. In these sections, the relevant studies on urban local governments in India have been reviewed. Given the relevance of the present thesis, only the post-Constitutional Amendment studies have been considered. Aspects of the studies are multi-faceted; they don't confine to fiscal decentralisation in its crudest sense, rather all the aspects such as the functioning of the municipalities, financing of the urban local governments and service delivery of the ULGs are covered. The following are some of the relevant studies.

Rao and Chelliah (1991) conducted a study on Indian municipalities and called for institutional arrangement for the fiscal relationship between the state government and the municipalities. It was first of a kind study on the municipalities before the 74th Amendment Act.

NIPFP (1995) studied 293 municipalities across seven states in India. The study found that the vertical imbalance, the fiscal imbalance between the ULBs and the states and the horizontal imbalance, the fiscal imbalance among the ULBs are severe. Inadequate exploitation of the existing resources, exorbitant administrative cost, arbitrary system of fiscal relationship between the states and municipalities are contributing to the situation obtaining in ULBs..

Expert group on commercialisation of infrastructure, GOI, (1996), otherwise known as Rakesh Mohan Committee inter alia urged the ULBs for exploring private participation for urban infrastructure development. The committee stressed upon the exploitation of the capital market for the financing of the urban requirement, including the municipal bond. The committee attempted a projection of investment required for the delivery of goods and services by the municipalities.

Kundu and Bagchi and Kundu (1999) conducted an extensive study of urban local bodies. They observed that the level of inequality in the provision of basic services across local bodies is huge. They suggested that privatization, public-private partnership and community-based projects are the way forward for addressing the fiscal problems of municipalities.

Bagchi (2000) constructed a decentralization index. The index can be used to measure how much decentralisation has taken place in a particular municipality. He assessed the impact through resources generation. He found that the improvement in the decentralization is not alike in the various tiers of urban local bodies. The potential of non-tax revenue as the source of revenue remains unused or underused.

Rao (2001) studied fiscal decentralization entirely in terms of that from centre to municipalities. His major concern of research was how fiscal transfers affect macroeconomic stability. He found that seven per cent of the total fiscal deficit is that of local governments. Though the finding was highly questionable, it opened up a meaningful debate on fiscal transfers and macroeconomic stability.

Bagchi (2001) studied Indian municipalities and called for the following reforms: public-private partnership in the delivery of municipal amenities. He asked for developing buoyant tax base to compensate revenue loss due to abolition of octroi. Structural reforms are necessary, such as institutional and administrative, to strengthen the third-tier institutions.

Vaidya and Johnson (2001) studied the municipal bond issued by the Ahmedabad Municipal Corporation. The corporation issued the municipal bond of 1000 million without the back up of state government. It was a first of its kind in the history municipalities in the country. It was a milestone and best practice to be emulated by the rest of the corporations in the country. The scholars made an extensive study of various aspects of the bonds issued by the corporation.

Pathe and Ghodke (2002) analysed the status of India's infrastructure in general and urban infrastructure, in particular. They found that the infrastructure status of the country in

general and urban area, in particular, is far from satisfactory. The newer financial instruments were suggested to finance urban infrastructure.

Mathur and Rao (2003) developed a framework for assessing creditworthiness and thereby rating the municipalities which might be useful for the issuing of bonds by the local bodies. The legal framework has to be reworked and reforms be undertaken to strengthen the urban local bodies, especially concerning borrowing and issuing of bonds.

Mathur and Thakur (2004) assessed the fiscal performance of municipalities and burden on the state finance consequent upon the implementation of the recommendation of the SFCs. The expenditure incurred by the municipalities was taken in terms of Zakaria committee norms. Bagchi and Chattopadhyay (2004) studied the impact of decentralization on the finances of basic services in the municipalities and found out a mixed experience in the municipalities.

Indian Infrastructure Report (2004) studied the issues of the financial system for infrastructure development. The report recommended a specialized bank for municipal lending, development of municipal bond market and specialised municipal fund etc. for the financing of urban infrastructure.

Ghodke (2004) recommended a 'pooled' method as a promising way to access the capital markets by the ULBs. In this method, the small local bodies are pooled or jointly access the capital market to overcome the resource gap.

Oomen (2005) studied the recommendation of the twelfth finance commission and pointed out how the local finance, especially the urban finance, was neglected in the report.

Mathur (2006), in his study, provided a comparative illustration of various municipal bonds issued by different urban local bodies in the country. Chattopadhyay (2006) documented the problems and prospects of the municipal bond market in India. It concludes that local capacity building, financial empowerment, rationalization of the state-local fiscal relationship

and further legislative changes are critical in developing a viable and vibrant municipal bond system in the country.

Pathe and Lalvani (2006) examined the finance of ULBs in Maharashtra. Pooled financing mechanism was recommended since the finances of local governments was unsatisfactory and uneven.

Lall and Deichmann (2006) suggested that since the implementation of capital value assessment system of property tax reforms assumes huge cost and complications, it has to a long-term goal while implementing other simpler and less costly reforms.

Srinivassan (2006) raised the concern on the equity and accountability in solid waste management (SWM) and other environmental concerns due from public and private bodies in Chennai city. He suggests, it is urgent from the part of authority to safeguard ecological interest of the city and make accountable public and private actors for the actions which are detrimental to the environment.

Mathur (2006) found that spending level of municipalities are 130 per cent less to the fixed norm and standard. Own source revenue is too low to meet the revenue account expenditure. The revenue-expenditure gap is particularly high in the case of states like Madhya Pradesh, Rajasthan, Uttar Pradesh and West Bengal.

Oomen (2006) analysed fiscal decentralisation trend in India focussing on 15 non special category states, using the data provided by 12th Finance Commission. He argued that fiscal transfer mechanism to the sub-state level government through intergovernmental transfer mechanism has been weak and poorly designed.

After the 74th Constitutional Amendment Act 1992 researchers have found interest in the urban local governments. There is a significant scarcity of literature on municipal governments in India. There are little level playing studies in India compared to the international literatures on municipal governments. There has been a tangible change in the

municipal studies in India especially through gaze of economics, public finance and urban economics in the recent years. The existing literature touches across fiscal decentralisation, financing, expenditure assignment, fiscal dependency, transparency and innovative mode of financing the urban needs. More studies are required to understand the nuances of fiscal decentralisation to Indian urban local governments. Hopefully this study will be a smaller contribution in this regard.

2.5. Conclusion

The subject matter of fiscal decentralisation includes the optimal allocation of functional responsibilities among the different tiers of governments (Tanzi 1995). The broad theoretical prescription/ framework to look into functional allocations, efficiency and incentives of the participants in fiscal decentralisation is grouped into first generation and second generation of fiscal decentralisation theory. The main postulates of first-generation theory are ‘fiscal equivalence’ (Osion 1969), ‘decentralisation theorem’ (Oates 1972) and population sorting (Tiebout 1956). The FGT does not see any problem in giving most of the service delivery functions to sub-national governments, assuming that decentralisation of public goods and services brings efficiency (Oates 1972; Bird 2000). It also strongly recommends that the federal government must be provided with more taxing powers than sub-national governments, for the federal government does redistributive, stabilisation and other crucial functions, the scope of which is national.

Second generation theory (SGT) in fiscal decentralization goes beyond traditional public finance and incorporates public choice theorem and political science theories in its analysis. SGT focuses on the trade-off between centralization and decentralization in terms of efficiency outcomes. Key contributions to SGT have been made by scholars such as Weingast (1995), Seabright (1996), Lockwood (2002), Petchy and Levchenkova (2002), Basley and Coate

(2002), and Wagner (2007). While first generation theory (FGT) assumes that governments are benevolent, SGT assumes that governments may engage in "rent-seeking" behaviors if given the opportunity. SGT emphasizes the incentives created by the political process and has examined the incentives for both the federal government to make transfers of funds and for sub-national governments to use these funds. SGT argues that jurisdictions providing services should also have the power to spend and that centralization of taxes can lead to "leviathan" governments that hinder competition. SGT also highlights the importance of sub-national governments in revenue generation and the need for "hard-budget constraints" to prevent "soft-budget constraints" and financial problems. It also emphasizes the role of political and institutional factors in creating negative incentives for sub-national fiscal behavior.

The survey of urban local bodies/municipality around the world provides us insight into working of the local government around the globe. Each country has developed its own kind of municipalities. The functions, functioning and financing of such local governments are distinct across the countries. While certain countries opted a more flexible structure of fiscal federalism with less of specification, some countries opted for a rigid structure. Assignment of buoyant tax is the important aspect as far as fiscal autonomy of the municipality is concerned. There are countries which allotted significant amount of buoyant taxes while certain countries heavily relied on the intergovernmental transfers. Both developed and developing countries are taken into the study, to make sense of the fiscal decentralization to their respective municipalities. The countries like United Kingdom, United States, Canada, Australia, Brazil and China are comprehensively studied to understand the specifics of fiscal decentralization of the municipalities in the respective countries. The fiscal federalism in the United States has been a loose and flexible model without much specification. The delegation of buoyant revenue base to local governments is the common feature of fiscal federalism in the States. United Kingdom has resilient local governments. The local governments in United Kingdom enjoy

considerable grant support from central government. Canada devolves significant taxes like property tax, business tax, special taxes meant for the financing of specific purpose works and local improvement tax to local governments. The Australian model is quite in contrast to US model, which has a highly unitary model of polity. Nevertheless, substantial fiscal powers have been delegated to local governments in Australia. China's fiscal system is highly decentralized, nearly 70 per cent of total public expenditure in China takes place at the sub-national level. Brazilian municipalities are granted full autonomy; consumption and production taxes are assigned to all three levels of government. In short, the countries studied all have resilient local governments compared to India. Many developing countries like Brazil outperform India on fiscal decentralisation to local governments.

Indian studies on municipal governments are limited. The focus of the researchers and policymakers were predominantly on the rural local bodies. Researchers found interested in the urban local governments after the 74th Constitutional Amendment. In recent years, there is a tangible change in the urban government studies in India. Still we lack level playing studies at national and international levels. The literature we studied touches across fiscal decentralisation, financing, expenditure assignment, fiscal dependency, transparency and innovative mode of urban financing. Most of the studies are in terms of measuring the decentralisation and comparing the budgetary capacity of the municipal governments in terms of infrastructure provision and service delivery. New and innovative ways of measuring the decentralisation are still required. The transfers, size and method of transfers, the burden of transfers on state governments are being studied. More studies are required to analyse the dynamics, variations and determinants of grant-in-aid from state governments to local governments. Financing the urban infrastructure requires innovative methods, more studies are required on municipal bonds, public-private partnerships, venture capital and inter-governmental finance based on optimal assignment of functions.

CHAPTER 3

Kerala Model of Decentralization: Performance, Problems, and Prospects

3.1. Introduction

Kerala is the southernmost state in India with a population of 35 million people spread across 38,864 km². The state has been exhibiting a unique trajectory of development. Kerala could embark on higher developmental indicators comparable to developed countries in Asia with a low economic base. Kerala has registered remarkable achievements on several parameters such as lowest population growth, highest literacy rate, highest sex ratio and lowest infant mortality rate which are comparable to high-income countries. The per capita availability of roads, education, health and other services in the state are well above the national average. The phenomenon of exhibiting significantly higher social indicators with relatively lower per capita income has come to be known as Kerala model of development (Dreze & Sen 1997, 2000, 2002; Franke 1992; Rammohan 2000). While the legitimacy and sustainability concerns around the model are still on, the state continues to perform well on the social front and relatively better in economic indicators. Apart from the state initiatives including land reforms, public investment in education and health care, inflows of large-scale remittance, the Kerala democratic decentralization model backed by strong peoples' participation has played a massive role in the development of the state. The democratic decentralization process and the associated 'public actions' have contributed immensely to the outstanding developmental achievements of the state (Sen 1999; Heller 1999; Heller & Harilal 2007). Kerala has started the democratic decentralization process from the inception of the state. The first elected state government itself had appointed Commissions to look into the fiscal decentralization. It had

even appointed exclusive Committee to study municipal governments. The Constitutional Amendments in 1992 streamlined the state's process of decentralization. In the following sections, we delve into the details of decentralization from the state to local governments.

3.2. Structure and Organisation of Local Government

The Gram Sabha (village Panchayat) and ward committee (municipalities) are the basic democratic units in India as per the 73rd and 74th Constitutional amendments. The Panchayat Raj Institutions Act and Nagarpalika Act of 1993 assign the status of constitutional entity for local governments. The Acts provide a uniform structure to local governments, a mechanism for seamless flow of fiscal transfers from higher governments and to hold a regular election. Following the Constitutional Amendment Acts, the state legislature passed the Kerala Panchayat Raj Act, 1994 (KPR Act) and the Kerala Municipality Act, 1994 (KM Act). The state enacted other related Acts to enable the local bodies to function as effective third-tier government. Under the Acts, the local governments will be duty-bound to discharge the matters enumerated in the respective Schedule in their respective jurisdictions and shall have the power to administer those responsibilities. The Act also envisions transferring many state department functions to the local governments.

The LGs in the rural area are called as Panchayat Raj Institution (PRI) and urban local governments (ULGs) are their urban counterparts. PRIs function further in a three-tier fashion, i.e., Gram Panchayat, Block Panchayat and District Panchayat; each tier functions independently of the other. Though LGs are functionally independent of the higher-level governments, the Local Self-Government Department are well within their right to issue the guidelines to LGs as per the policies of national and state government. President/Chairperson/Mayor is the executive head of local government. Every LG has a Secretary, who is the Chief Executive Officer. The elected members of PRIs and Municipalities

elect the President/Vice President, Chairperson/Vice chairperson, Mayor/ Deputy Mayor and Chairperson of the Standing Committee according to the tiers of local governments and legal provisions. The Standing Committee (SC) has the responsibility to analyse the issues and submit the proposals before the concerned Committee and Council. There are four Standing Committees for each Panchayat Raj Institution, six for Municipal Council and eight for Municipal Corporation. KPR and KM Act entrust the local governments with the task of formulation and implementation of development plans at the local level through Gram/Ward Sabha. The Local Governments prepare their plans for every succeeding year following the State Government guidelines. The State Government has transferred schools, health centres, hospitals, veterinary institutions, and other public service delivery institutions as part of functional decentralization. Apart from this, LGs are assigned with implementation of certain Centrally Sponsored Schemes (CSS) and distribution of welfare benefits.

Profile of Local Governments

Kerala has 1200 Local-Self Governments. Out of that 941 are Village Panchayats (VP), 152 Block Panchayats (BP), 14 District Panchayats (DP), 87 Municipal Councils (Municipalities) and 6 Municipal Corporations. The population of a Village Panchayat in Kerala is more than twenty-five thousand with an average area of 37 km². Average population of the Municipality is around fifty thousand and almost five lakhs in a Municipal Corporation. The average geographical size is 23 km² for municipality and 95 km² for Municipal corporation. Unlike other states in India, Kerala has an urban- rural continuum. It is being reflected in the functional distributional and service delivery of respective local governments. Delimitation is a continuous process in the state which take into account the dynamics of demography and service delivery.

Table 3.1*Profile of LGs in the State*

LG	No. of LGs	Avg. Area (Sq.KM)	Avg. Population (2011 census)
DP	14	2651.7	1903357
BP	152	244.24	175309
GP	978	37.16	26674
Municipalities	87	23.65	51664
Municipal Corporations	6	95.6	491240

3.3. Fiscal Decentralization in Kerala: Modus Operandi

Kerala adopted a ‘big push’ approach in the pursuit of decentralization unlike the traditional wisdom which suggests to build the capacity at first and transfer the powers accordingly. The functions and powers were transferred at once on an act of political faith (Oomen 2004, 2014, 20220; Vijayananda 2009). The rationale is that if the decentralisation process was pushed at one-go and high speed, it would have become a fait accompli, before various interest groups and the associated conflict of interest set in. Probably an effective decentralization strategy calls for the big push approach. The assignment of the responsibilities follows capacity building, setting up of procedures and umpire system; the quantum of money transferred to LGs creates a pressure on the State government to ensure that decentralization works at local level and delivers. Kerala adopted a participatory planning model. The campaigning nature of the process made it easy to attract public actions and sentiments in favour of decentralization (Isaac 2000). Table 3.2 lists the milestone initiatives of Kerala’s democratic decentralization process.

Table 3.2*Milestone Initiatives in Kerala's Fiscal Decentralisation*

April/May 1994	Enactment of Kerala Panchayat Raj Act and Kerala Municipality Act.
October 1995	Transferred power and functions to LGs, and institutions, offices and functionaries.
February 1996	Special budget documents for local government allocation.
August 1996	People's Plan Campaign launched; decentralized planning and announcement of earmarking of 35 per cent state resources to LGs.
March 1999	Restructuring of Kerala Panchayat Raj Act and Kerala Municipality Act.
March 2000	Amendments to 35 Acts related to the function of LGs.
July 2000	Transfer of district level officers and staff to District Panchayat.
	Announcement of redeployment of surplus ministerial staff and engineers to LGs.
2002 – 03	Actual deployment of surplus engineers and ministerial staff.
2004	Sharing/devolution of selected taxes converted into fixed shares from total Own Tax revenue of State – 3.5% as General-Purpose Fund and 5.5% as Maintenance Fund.
	System of automatic monthly release of fund introduced.
2005	Institutionalisation efforts began.
2006	Recommendation of Third SFC operationalized with local government-wise predictable grant system
2007	People's Planning relaunched.

2008	Formation of common engineering cadre for all LGs.
	Decision to set up ministerial and executive cadres.
2009	50 % reservation for women in the LGs
2018	Integration of annual plan and local government budgeting

Source : Author's Compilation

3.4. Fiscal Decentralisation: Legal and Institutional Structure

In the light of lessons and experience of 'big bang' decentralization, Kerala Panchayat Raj Act and Kerala Municipality Act were restructured in 1999 to incorporate changing ground realities. This has corrected the shortcomings in the earlier legislations and strived to pave the way for local bodies to transform into local self-governments in the true sense. The following define the significant legal and institutional structures on which local governments are built in Kerala.

Functional Domain and Participatory Fora:

The concerned Acts in the state clearly listed the functional domain of different local governments with great precision. The differentiation is sharp in regard to infrastructure and management of public institutions. The division has not been easy in the productive sector which requires actual experience to identify the natural functional areas of different tiers of local governments. The functional responsibilities of local governments are divided into mandatory functions, general functions and sector-wise functions, the details of which are discussed in the coming sections. Grama Sabha/ Ward Committee are the physical mechanisms that bring the local government to the people. It has wide powers ranging from identification of functionaries, local works and social auditing to advisory powers for the prioritization of developmental needs.

Supremacy of Elected Body

The elected head of the local government is the executive chief of that local body. The senior-most officials of various departments are brought under the control of local governments and have been declared as ex-office secretaries for the concerned subjects. The elected local government has administrative control including the powers of disciplinary action against their staff and the staff transferred to them. The elected council is entrusted to make personnel decisions. The Standing Committee is constituted in a manner that every member will be a member of one committee, which provides an in-depth analysis of issues and proposals to be considered before the full body - for example, finance standing committee, education standing committee, and health standing committee.

There will be a Steering Committee for the coordination of all standing committees consisting of the elected head and chairpersons of all standing committees. Local bodies can also constitute a functional committee for different subjects inclusive of experts, activists, professionals, and other stakeholders. Such committees can advise the local governments in plan formulation. The law has laid down the code of conduct for local government officials and non-officials with certain directive principles, including polite and professional behaviour by the officials and elected members while dealing with local affairs. It facilitates free and fearless expression of civil servants.

Autonomy of Local Governments

The concerned Acts were drastically amended to reduce the control of state government over the elected local bodies. Though the State Government can issue general guidelines, it cannot interfere in the day-to-day affairs of local governments. If state government wanted to cancel a resolution passed by the local government, it has to go through the process in consultation

with the Ombudsman or Appellate Tribunal considering the nature of the resolution. The State Government cannot dissolve a Local Government unless it fails to pass the budget or majority of its members resign. In other cases, a memo of charges has to be issued to the Local Government and the Ombudsman has to be consulted before dissolution. Such procedure does not even exist in centre-state relations. The Local Governments issue administrative sanctions and take actions for schemes from their budget allocation and the Technical Advisory Group of the District Planning Committee can provide technical sanction for the public works. Thus, Local Governments are not required to approach any outside authority to get their legitimate tasks discharged.

Transparency and Accountability

There are two instruments of transparency enshrined in the statutes. (1) *Absolute Right to Information*: it calls for publication of Citizens Charter, containing the entitlements of citizens for various services and their quality vis-a-vis Local Government (2) *Performance Audit System*: provides auxiliary and concurrent audit focussing on procedures, processes and outcomes of spending.

In order to reduce governmental control and to nurture the growth of institutions of local self-government, as envisaged in the Constitution, the State Acts provide for the creation of institutions for the effective functioning of local governments.

- **State Election Commission:** Kerala has a formidable State Election Commission with absolute powers on control over the staff on election duty, preparation of voters list, verification and disqualification of candidates, elections of heads of local bodies, conduct of non-confidence motion, and disqualifications of defectors.
- **Delimitation Commission:** This is an independent body to carry out delimitation of

wards in the local bodies - is headed by the State Election Commission.

- **State Finance Commission:** Five Commissions have been constituted by the state so far. The First State Finance Commission was set up in 1994, followed by one in 1999, 2004, 2009, and the latest being the Fifth Commission in 2014. The constitution of the Sixth Commission is due.
- **District Planning Committee:** Kerala has active District planning Committees with an experience of more than 30 years.
- **Ombudsman for Local Governments:** This high-powered institution, headed by a High Court Judge, has been endowed with vast powers to check the malpractices in local governments.
- **Appellate Tribunal:** This judicial tribunal in the state headquarters, with a District Judge, considers the citizens' appeals against local governments in the exercise of their regulatory functions like the issue of licences and permits.
- **State Development Council:** This institution is headed by the Chief Minister - built on the analogy of National Developmental Council. It consists of the entire Cabinet, Leader of Opposition, Vice Chairman of the State Planning Board, Chief Secretary, Mayors, and Presidents of the District Panchayat. The Council discusses policy and operational issues.

3.5. Functional Responsibilities of Local Governments/Expenditure Assignment

Kerala Panchayat Raj Act and Kerala Municipality Act have laid down functional and developmental responsibilities for local governments. These take into account 11th and 12th Schedules of the Constitution which have presented illustrative functional domain of rural and urban local governments respectively. These schedules include functions ranging from basic

amenities to avenues of value generation for the society, including areas such as environmental conservation and promotion of culture. The Acts envisages the role of local governments as vehicle for socio-economic developments of the citizens. Easing the lives of citizens while providing avenues for productive activities is a key driving factor behind the design of the functional distribution. The functional mandates of local governments are summarised below.

- Infrastructure: Except Highways and major District roads, the Local governments are entrusted with connectivity in the state. In addition to street lighting, the electricity line connectivity is served under the supervision of Local Governments. Promotion of non-conventional energy is the new task of local bodies.
- Sanitisation and solid waste management: Local Governments handle solid and liquid waste management.
- Promotion of small and cottage industries.
- Agriculture: At the agricultural front, Local Governments do agricultural extension, watershed management, minor irrigation, dairy, animal husbandry, and veterinary development and inland fisheries.
- Social welfare: At present, ICDS – Integrated Child Development Scheme - is implemented through Local Governments. The local governments take care of the disabled and elderly citizens. Currently, 50 per cent of the TSP (Tribal Sub Plan) and 2/3rd of the SCP (Special Component Plan) is planned and implemented by Local Governments.
- Poverty alleviation: *Kudumbashree* is a unique poverty alleviation vehicle implemented through Local Governments. Under this mission, each family under BPL (Below Poverty Line) and those just above the poverty line are organised as Neighbourhood Group (NHG) and each family is headed by a woman. NHG in a Ward of the concerned Local Government is grouped into Area Development Society (ADSs) and ADSs in a Local Government

jurisdictions form Community Development Society (CDS). CDSs work along with Local Governments in the matters of poverty alleviation. Local Governments also implement most of the Centrally Sponsored Scheme (CSCs) of the Government of India on poverty alleviation.

- Education: School education up to higher education is a shared responsibility of Local Governments.
- Pensions: The Local Governments have a major role in the discharge of welfare pensions, from the selection of beneficiaries to disbursement of benefits. In general, Local Governments have a significant role to play in the area of social security to citizens with close involvement of their community-based organisations.

Institutions Transferred to Local Governments:

Local Governments undertake nearly three-fourth of the public service delivery responsibilities, ranging from education to health care and other social welfare functions, apart from sanitation and regulatory activities. These responsibilities cover supervision of such functions through various institutions/programmes:

1. Schools up to Higher Secondary.
2. Primary Health Centres, Community Health Centres, Taluk Hospitals under Allopathy, Ayurveda and Homeopathy.
3. Anganwadis/Woman and child welfare centres
4. Mid-day meals
5. Veterinary institutions at District level and below.
6. Pre-matric Hostels for Scheduled Castes/Tribes.

Table 3.3*Institutions transferred to various local governments*

Departments	Sl. No.	Assets	Village Panchayats	Block Panchayats	District Panchayats	Municipalities	Corporations
Agriculture	1.	Krishi Bhavan	#			#	#
	2.	District agricultural farms / coconut palm nursey			#		
	3.	District sales centre			#		
	4.	State seed farms			#		
	5.	Mobile testing laboratory			#		
	6.	Soil testing labs			#		
Animal Husbandry, Dairy development	7.	District Hospitals			#		
	8.	Regional artificial insemination centre			#		
	9.	District Veterinary farms			#		

	10.	Veterinary Hospital	#		#		
	11.	Veterinary Poly Clinic			#	#	#
	12.	Veterinary Dispensary	#			#	#
	13.	Mobile Veterinary Dispensary			#		
	14.	Veterinary Sub Centre	#			#	#
	15.	Mobile Farm Unit			#		
	16.	Clinical Lab			#		
Fisheries	17.	Matsya Bhavan	#			#	#
	18.	Fisheries Dispensary	#				
	19.	Fisheries School			#		
Government hospitals ³	20.	Taluk Hospitals (Allopathy, Ayurveda, Homeo)		#		#	#
	21.	Community Health Centre		#		#	#
	22.	District Hospital of Health-			#		

		Ayurveda, Homeo					
	23.	Government Dispensaries (Allopathy, Ayurveda, Homeo)	#				
	24.	Primary Health Centres	#				
Social Welfare	25.	Day Care centres	#			#	#
	26.	Care Homes		#			
	27.	Old Age Homes		#			
	28.	Anganwadis	#			#	#
	29.	Nursery Schools	#				
	30.	Pre-metric Hostels		#			
	31.	Nursery Schools	#				
	32.	Mid-wifery centres	#				
Schedule Caste Development	33.	Balavadies	#				
	34.	Balavadi-cum- feeding centres	#				
	35.	Seasonal Day Care Centre	#				
	36.	Dormitory	#				

	37.	Pre-matric hostels		#			
Schedule Tribe Development	38.	Balavadies	#				
	39.	Medical Unit	#				
	40.	Nursery School	#				
	41.	Midwifery Centres	#				
	42.	Ayurveda Dispensaries	#				
Education	43.	Government Lower Primary Schools	#			#	#
	44.	Government Upper Primary Schools			#	#	#
	45.	Government High Schools			#	#	#
	46.	Government Higher Secondary School			#	#	#
	47.	Government Vocational Higher Secondary School			#	#	#

Technical Education	48.	Tailoring Trade Centre			#		
	49.	Tailoring & Garment making Training Centres			#		
Public works	50.	Local roads	#				
	51.	Village roads with bridges, culverts, drains..					
	52.	Other district roads			#		

Source: Sixth Finance Commission, Kerala

3.6. Revenue Assignment to Local Governments/Financing of Local Public Goods

Assignment of revenue to the local governments in Kerala has not been clear, unlike the functional devolution. The local governments have often been at the mercy of the state government. No significant buoyant taxes are assigned to local governments. Non-tax sources have also not been significant. Thus, the capacity of local governments to raise internal resource has been on a shaky foundation. The transfers from the state government and the union government are the main revenue sources of local governments in Kerala. The following section looks into the fiscal domain and the trend and composition of various sources of revenue of local governments in Kerala, including transfers.

Fiscal Domain

Avenues for own revenue generation to local governments in Kerala are continuously eroding as elsewhere in the country. Kerala had devolved a reasonable revenue base to local governments even before the 73rd and 74th Constitutional Amendments came into existence. However, a secular deterioration/erosion of the revenue base of local governments is occurring in the state due to several factors, including the introduction of the Centre-State dual GST. The state government has been taking over revenue sources which once were with local governments since the 1919 Government of India Act. The advent of GST, subsuming octroi, entry tax and some local taxes has exacerbated the trend. Table 3.4 provides the fiscal domain of the local governments in Kerala prior to 1994. Notable tax items at the helm of local governments are property tax, professional tax and advertisement tax. GST has subsumed entertainment tax, which was contributing around 20 per cent of local governments' tax revenue, and the state government has not compensated the local governments for the same. Now the advertisement tax also is being taken away from the local governments. Octroi and entry tax, which proved to be buoyant and high-yielding sources, though termed obnoxious by economists, cannot be levied for supporting local governments as they are subsumed under the dual GST and the Constitution of India has been amended accordingly. Some of the local taxes have also become obsolete with the change in time.

Table 3.4

Tax and non-tax revenue of local governments prior to 1994

Tax	Non tax
Property Tax	Fees
Profession Tax	Income from Properties, Markets

Entertainment Tax	Fines
Advertisement Tax	Service Charges
Service Tax for sanitation drainage, street lighting, water supply	Contributions and endowments
Land Conversion Tax	Miscellaneous items
Show Tax	
Surcharge on any tax other than Profession Tax, with sanction of the Government not exceeding 5 per cent of the tax leviable	
Tax on animals and vessels	
Duty on Transfer of Property	
Land conversion cess in respect of paddy lands, marshy land, pod or watershed	

Source: Sixth State Finance Commission – Kerala

State Government Transfers

The revenue instruments in the hand of local governments are utterly inadequate to enable them to discharge their mandated functions. Local infrastructure and services are under stress. Like many states in India, local governments in Kerala are heavily dependent on the state government exchequer for meeting their legitimate financial needs. The table 3.5 gives the size and ratio of fiscal devolution from state government to local governments in India. Table 3.6 provides state wise devolution in India along with per capita devolution in each state. Though, Kerala is one of the highest devolving states, it is not on the top of per capita transfer. States like Karnataka add the salary of local government staff also into the transferred amount to local government, while Kerala does not include salary of local governments employees into such

amount. Kerala would have been the highest devolving state government in the country if it has been adding the salaries of employees to the total transferred amount (State Finance Commission, 2020).

Table 3.5

Devolution from state government to local governments in Kerala: Magnitude and trend

Year	Devolution from State			Plan devolution as share of State plan outlay	Plan and non-plan devolution as share of				Per capita Devolution
	Plan grant /DF to LGs	Non plan grant/ GPF and MF	Total (Rs. Crore)		SOTR	GSDP	State Revenue Receipts	State Budget	
1995-96	30.00	95.09	125.09	1.94	3.70	0.323	2.54	2.02	40.20
1996-97	212.00	328.00	540.00	9.84	13.85	1.215	8.99	7.23	171.25
1997-98	749.00	297.20	1046.20	26.23	23.24	2.114	13.85	11.33	327.36
1998-99	950.00	384.30	1334.30	30.65	28.70	2.374	15.38	12.80	411.96
1999-00	1020.00	405.40	1425.40	31.38	27.45	2.279	15.07	11.85	434.23
2000-01	1045.00	419.90	1464.90	29.56	24.95	2.016	14.40	11.38	440.33
2001-02	890.00	440.90	1330.90	29.52	22.47	1.708	12.52	9.64	398.13
2002-03	1342.00	472.20	1814.20	33.33	24.84	2.088	15.52	11.81	540.11
2003-04	1317.00	505.60	1822.60	30.28	22.53	1.885	14.35	11.06	540.02
2004-05	1350.00	531.11	1881.11	28.13	20.99	1.706	13.19	9.75	554.69
2005-06	1375.00	657.00	2032.00	25.61	20.78	1.485	12.22	9.34	596.31
2006-07	1400.00	650.00	2050.00	20.96	17.17	1.333	11.21	8.17	598.72
2007-08	1540.00	715.00	2255.00	22.16	16.50	1.288	10.51	7.83	655.44
2008-09	1694.00	787.00	2481.00	22.00	15.52	1.223	9.95	8.05	717.67
2009-10	1863.00	865.00	2728.00	20.89	15.48	1.176	9.69	8.06	785.35

2010-11	2050.00	951.00	3001.00	20.45	13.82	1.138	9.62	7.62	859.81
2011-12	2750.00	1410.25	4160.25	22.90	16.18	1.143	10.55	8.34	1186.23
2012-13	3388.00	1846.37	5234.37	24.18	17.40	1.270	10.87	8.84	1485.36
2013-14	3933.00	2314.70	6247.70	23.14	19.53	1.343	10.76	8.86	1764.43
2014-15	4559.00	2707.00	7266.00	22.80	20.62	1.418	11.21	9.13	2042.19
2015-16	5193.00	2873.83	8066.83	25.97	20.69	1.437	10.42	8.46	2256.42
2016-17	5500.00	3170.93	8670.93	22.92	20.56	1.395	10.31	8.32	2413.79
2017-18	6227.50	3547.66	9775.16	23.50	21.04	1.393	10.45	8.21	2708.16
2018-19*	7000.00	4532.95	11532.95	24.01	22.77	1.475	11.22	9.08	3179.86
2019-20	7500.00	4367.20	11867.20	24.50	23.64	1.362	10.29	8.36	3256.36
2020-21	6903.00	4661.06	11564.06	25.00	17.15	1.182	10.09	8.02	3157.99
AAGR Current	44.44	21.66	27.68	23.14					26.74
AAGR Constant 2011-12 prices	36.10	15.41	20.86	7.39					19.97

Source : State Finance Commission, 2020

DF = Development Fund, GPF = General Purpose Fund, MF= Maintenance Fund

SOTR = State's Own Tax Revenue, GSDP = Gross State Domestic Product

Table 3.6

Devolution as per cent of SOTR and Per capita Devolution States-Wise

States	Devolution during 2018-19 as per cent of SOTR	Per capita devolution (Rs.)
Assam	14.42	431.06

Bihar	15.90	356.74
Chhattisgarh	5.02	504.08
Gujarat	NA	NA
Haryana	5.02	737.84
Himachal Pradesh	3.84	367.12
Karnataka	46.65	6090.06
Kerala	20.23	2999.74
MP	7.14	421.59
Odisha	2.31	146.78
Punjab	3.52	456.53
Rajasthan	-	-
Tamil Nadu	10.15	1426.27
Uttar Pradesh	NA	449.53
Uttarakhand	11.80	1361.29
West Bengal	3.71	152.32
All states	7.81	1179.63

Source: Author's Calculations

State Finance Commissions and Fiscal Decentralisation

Kerala is one of the few states in India that has published the reports of six finance commissions and accepted the majority of the recommendations on devolution. These reports have addressed the specific needs and aspirations of local finance and governance in the state. However, the Action Taken Reports (ATRs) show that the government has had mixed success in implementing the recommendations of the

commissions. While the government has generally accepted the recommendations on devolution from the State Finance Commissions (SFCs), it has often chosen to ignore the devolution formulas recommended by the commissions. In this section, we will review the important recommendations of the successive commissions.

First State Finance Commission

The First State Finance Commission (SFC) faced the challenge of starting from scratch. Its key contribution was the collection and compilation of data on local government income and expenditure. The First SFC emphasized the need for formula-based transfers and rationalization of local government tax devolution. It also recommended measures to improve the tax and non-tax base of local governments, including piggy-back taxation and the establishment of benchmarks for service delivery. The First SFC did not make any recommendations on the quantum of planned grants. In 1997-98, the state government devolved 26.23% of the state plan. The First SFC provided the following formula for devolution:

Table 3.7

Devolution weightage provided by first SFC

Items	ULBs	RLBs
Population in 1991 census	75	70
SC/ST Population in 1991	10	10
Total Workers excluding Workers in Manufacturing, Processing, Servicing, and Outside household industry	15	10
Proportion of Agricultural Workers among Workers	Nil	10
Total	100	100

Source: State Finance Commission

Second State Finance Commission

The main contribution of the Second State Finance Commission (SFC) was the classification of devolution into general, maintenance, and development streams. The Commission also recommended indexing tax and non-tax revenue for automatic increases due to inflation. It institutionalized an incentive mechanism by setting aside 10% of the development fund for performance. The Second SFC also attempted to institutionalize local devolution by recommending that at least one-third of the state plan be allocated for this purpose.

Third State Finance Commission

The Third State Finance Commission (SFC) used a completely different approach for devolution. While it retained the three streams of funding, it classified all of them as revenue grants, which allowed the state to request higher deficit grants from the Union Finance Commission (UFC). This approach significantly helped the State Government. The Third SFC also attempted to forecast the revenue and expenditure of local governments and introduced social accountability as a key tool, recommending a system of community-based monitoring, citizen's scorecards, and social audits. Instead of defining devolution as a share of the State Own Tax Revenue (SOTR), the Third SFC set the Maintenance Fund at Rs. 350 crore and the General Purpose Fund at Rs. 300 crore.

Fourth State Finance Commission

The Fourth State Finance Commission submitted a comprehensive report which included the following main contributions:

1. The construction of a Deprivation Index for inclusion in the devolution formula

2. The identification of the most vulnerable local governments (LGs) for gap funding based on rational criteria
3. The suggestion of a Property Tax Board to oversee the zonation and classification process
4. The presentation of a framework for fiscal accountability
5. The promotion of local borrowing and public-private partnership (PPP) projects
6. The collection of best practices and presentation of them as case studies for study and replication
7. The recommendation for the institutionalization of the decentralization process
8. The advocacy for the development of local statistics.

The Fourth State Finance Commission (SFC) conducted a thorough review of the approach taken by the third SFC and recommended avoiding the loss of revenue due to this approach. It proposed that both the General Purpose Fund and the Maintenance Fund be fixed as a share of the State Own Tax Revenue (SOTR) and that the Plan devolution be a share of the state's Plan outlay. The share of the Maintenance Fund was set at 5.5% and the share of the General Purpose Fund at 3.5%. The Plan was fixed at 25% of the state's Plan outlay, with the aim of increasing it to 30% by the final year of the award period. The implementation of the Fourth SFC's recommendations resulted in an improvement in the ratio of Plan and Non-Plan devolution indicators. Table 3.8 in the Fourth SFC report presents the devolution formula that was adopted.

Table 3.8*Devolution formula by Fourth SFC*

Criteria	Village Panchayat	Block Panchayat	District Panchayat	ULGs
Population (excluding SC/ST)	50	50	50	50
Deprivation index	30	30	30	30
Tax effort	10	-	-	10
Area	10	20	20	10
Total	100	100	100	100

Source: State Finance Commission

Fifth State Finance Commission

The Commission assessed the tax shares for the current year's estimates and net proceeds, with a focus on the Own State Revenue (OSR). It emphasized the use of e-governance and software in its operations and called for an effective financial management system in the local government. The fifth State Finance Commission made two significant changes from previous commissions: all grants would be a share of the net State Own Tax Revenue (SOTR) and the base year for SOTR would be the current year instead of the two years prior for centre-to-state devolution. However, the State Government did not accept these recommendations, except for the net proceeds devolution, due to the state's financial difficulties. The Commission divided the Developmental Fund into the General sector, Scheduled Caste Subplan, and Tribal Subplan. The General sectoral fund included the normal share and the share from the Union Finance Commission, which was divided between urban and rural local governments in a 77.21:22.79 ratio based on population. The Scheduled Caste Subplan and Tribal Subplan were distributed based on the 2011 census population of those respective communities. The Scheduled Caste

Subplan was divided between panchayats and urban local governments in a 83.25:16.75 ratio, while the Tribal Subplan was divided between panchayats and urban local governments in a 99.7:0.30 ratio. 5.5% of the OSR was allocated as a maintenance fund for road and non-road assets in a 70:30 ratio, and 3.5% of the OSR was given as a General Purpose Fund which was divided among panchayats, municipalities, and municipal corporations in a 77.2392:13.4254:9.3354 ratio.

Sixth State Finance Commission

To maintain historical continuity, the Commission recommends retaining the t-2 system for the General Purpose Fund and Maintenance Fund. However, the amounts allocated to these funds for a given year should not be lower than the amounts allocated in the previous year, even if the t-2 SOTR (state own tax revenue) decreases, which may happen due to the impact of COVID-19 for one or two years. Therefore, the Commission recommends reverting to the previous practice of sharing gross SOTR, which was in place for 14 years from 2004-05. The Commission also suggests that the cumulative loss incurred since 2017-18, when the government began collecting the goods and services tax (GST), be made up in four instalments paid over the course of six months. The distribution of the General Sector Development Fund among village panchayats, block panchayats, and district panchayats, which had previously been in the ratio of 70:15:15, should be restored. Table 3.9 shows the devolution formula recommended by the Sixth Finance Commission.

Table 3.9*Devolution formula by sixth Finance Commission*

Sl. No	Indicator	Village Panchayat	Block Panchayat	District Panchayat	Municipality	Municipal Corporation
Weightage (%)						
1	Non-SC ST Population (As per 2011 Census)	40	50	50	40	40
2	Area (in sq.KM)	10	10	10	10	10
3	Environmental Vulnerability 1.Flood Plain Area (in Ha), 2.Coastal line Length (km), 3.High Hazard Zone (In Ha)	10	10	10	10	10
4	Deprivation index 1. households without LPG 2.Households without electricity 3.Households without water connection	25	30*	30*	25	25

	4. Antyodaya Anna Yojana and Priority Households 5.Distance from highest Per capita Own Revenue weighted with Population					
5	Incentive For Revenue Mobilisation**	15	--	--	15	15
	Total	100	100	100	100	100

Source: State Finance Commission

SFCs in Kerala state have recommended comprehensive measures for the overall improvement of fiscal decentralisation process at local level. However, many of the recommendations could not be implemented due to various reasons. The following are the major recommendations of different SFCs which are not implemented. The implementation of those recommendations would have led to tangible improvements in the functioning and financing of local governments in the state.

1. Necessary amendments to the Kerala Panchayat Raj Act and the Kerala Municipality Act may be made to specify the minimum shares of LSGIs, of the Plan Grant, Maintenance Grant and General Purpose Grant (Second SFC).
2. A legislative provision may be introduced for indexing non-tax revenue items, and taxes like Property Tax, Advertisement Tax and Service Tax. Two-yearly revisions are recommended for non- tax License items and Advertisement Tax based on Consumer Price Index for non-manual workers for Thiruvananthapuram in the case of Urban

Local Bodies and Consumer Price Index for agricultural labourers for the State in the case of Village Panchayats; four-yearly revision may be done for Profession Tax and Service Tax. (Second SFC).

3. For systemic improvement in financial management, specific steps were listed.
4. Demand register for the biggest three taxes at least should be prepared before the end of current financial year.
5. A register indicating the arrears and the period to which they relate should be prepared.
6. A Demand-Collection-Balance (DCB) statement of all revenue receipts should be prepared and placed before the meetings of the LGs once in a quarter and should be discussed by the Council and appropriate direction given to officials.
7. Review of tax collection and realization of non-tax revenue should be discussed in Grama Sabhas and Ward Meetings once in a quarter
8. A statement of revenue collection and arrear position on LGs should be placed by Government in the State Assembly
 - a. For debt position DCB statement should be prepared and reviewed in Council meetings as well as in Grama Sabhas and Ward Committee meetings.
A list of major defaulters of Property Tax should be put up on the notice boards and websites of LGs (Third SFC):
9. To update the financial profiles of LGs from time to time, make a resources assessment of LGs each year before finalizing the size of the decentralised plan to be implemented by LGs and also to make other studies relevant in this area, a 'Board of Fiscal Research' headed by the Chief Secretary may be constituted (Third SFC)
10. As an exercise of naming and showing of defaulters of tax/non-tax payments, publishing their names on the website of the Local Government concerned may be undertaken and intimated (Fourth SFC).

11. An appropriate software be developed by the NIC to capture on real- time basis the item-wise expenditure data of Local Governments from Development Funds, Maintenance Funds and other categories of funds transacted through the treasury system (Fourth SFC)

Union Finance Commissions and Fiscal Decentralisation

The Union Finance Commission (UFC) has been responsible for overseeing local finance in India since the Tenth Finance Commission, in response to the 73rd and 74th Constitutional Amendment Acts. The terms of reference for the Commission have included the provision of measures to supplement the resources of panchayats and municipalities in each state through the Consolidated Fund of the state, based on recommendations made by the state's Finance Commission. Since then, the UFC has been devolving funds to local governments, with these devolutions constituting the general purpose fund for local governments. The UFC has used different formulas for the distribution of these devolved funds. Each Commission has examined the state of local finances in India and made recommendations accordingly. The following section will discuss the contributions of each Commission from the Tenth to the present.

Tenth Union Finance Commission

The Tenth Finance Commission, established in June 1992 prior to the implementation of Constitutional amendments, recommended a grant of Rs. 100 per capita for rural areas, totalling Rs. 4,380 crore, and Rs. 1,000 crore for urban local governments. The grant for urban areas was to be distributed based on the slum population of each state. These amounts were intended to be additional to the funds already being provided by state governments.

Eleventh Union Finance Commission

The Eleventh Finance Commission made several recommendations to states in order to increase the resources available to local governments by augmenting consolidated fund. These recommendations included using land taxes, surcharges/cesses on state taxes such as sales tax, excise, and motor vehicle tax, and implementing profession tax to augment the Consolidated Fund. The Commission also suggested that local governments should collect property taxes and user charges, and emphasized the importance of proper accounting and audit, including the involvement of the Comptroller and Auditor General in providing technical guidance to the Local Fund Audit Departments of state governments. The Commission further recommended that the report of the Comptroller and Auditor General on the audit of the accounts of panchayats and municipalities should be presented to a committee of the state legislature similar to the Public Accounts Committee. Additionally, the Commission recommended the creation of a database on the finances of local governments, with Rs. 98.6 crore set aside for the maintenance of accounts at the village and intermediate level and Rs. 200 crore provided for the creation of the database. The Commission also stated that all central public sector undertakings, including corporations and companies, should be subject to local government taxes, and that user charges could be collected for services rendered by central government properties. The Commission also provided a flat annual grant of Rs. 1,600 crore for panchayats and Rs. 400 crore for municipalities for each of the five years of the award period, to be used for civic services including primary education and primary healthcare. Table 3.10 shows the devolution formula developed by the Commission.

Table 3.10*Devolution Formula by 11th UFC*

Criteria	Percentage
Population	40
Index of decentralization	20
Distance from highest per capita income	20
Revenue efforts	10
Geographical area	10

Twelfth Finance Commission

The Twelfth Finance Commission recommended that a total of Rs. 25,000 crores (equivalent to 1.24% of sharable tax revenue) be distributed over a period of five years, with 80% going to rural areas and 20% going to urban areas. The Commission also emphasized the importance of improving civic services and maintaining accurate records through the creation of a database. Table 3.11 outlines the formula for this devolution of funds.

Table 3.11*Devolution Formula by 12th UFC*

Criteria	Percentage
Population	40
Geographical area	10
Distance from highest per capita income	20
Index of deprivation	10
Revenue effort	20 of which

(a) With respect to own revenue of States	10
(b) With respect to GSDP	10

Thirteenth Finance Commission

The Thirteenth Finance Commission made a significant change by linking the transfers to local governments to a percentage of the divisible pool of taxes, which was converted into a grant-in-aid under Article 275. This percentage was set at 2.28% of the relevant divisible pool on a t-1 basis, which equated to 1.93% of the divisible pool during the commission's period from 2010-15. The grant was divided into a basic component and a performance-based component, with the basic grant totalling 57,693 crore and the performance grant estimated at 30,385 crore. The Thirteenth Finance Commission also focused on restoring decentralization by considering the amount of money devolved to local governments from the state government. Table 3.12 provides the formula for this devolution.

Table 3.12

Devolution Formula by 13th UFC

Criteria	Weights assigned	
	PRIs	ULBs
Population	50	50
Geographical area	10	10
Distance from highest per capita income	10	20
Index of devolution	15	15
SC/STs proportion in Population	10	
FC local body grant utilisation Index	5	5
Total	100	100

Fourteenth Finance Commission

The Fourteenth Union Finance Commission significantly increased grants to village panchayats and municipalities. For village panchayats, 10% of the grant was tied to performance measures such as proper record-keeping and increased revenue, while for municipalities, 20% of the grant was tied to similar performance measures as well as improvements in service delivery. The Commission also emphasized the importance of sharing revenue from minor minerals with local governments and suggested the use of municipal bonds. It recommended reforms to property taxes and identified advertisement and entertainment taxes as local taxes. It also suggested increasing the profession tax to INR 12,000 per year. The distribution of grants was based on a weighting of 90% population and 10% geographic area, and the funds were to be used for core civic services such as water and sanitation, road maintenance, and waste management.

Fifteenth Finance Commission

The Fifteenth Finance Commission, which released a report covering just one year (2020-21), made the following changes: 1) 50% of grants to local governments were designated as untied grants, while the remaining 50% was designated for sanitation and drinking water; 2) the share of funding for urban areas was increased to 32.5% from the 30% recommended by the Fourteenth Finance Commission. Specifically, Rs. 29,250 crore was allocated for urban areas, with Rs. 9,229 crore earmarked for million-plus cities and urban agglomerations, and the remaining 50% for non-million-plus cities divided equally between untied funds and funding for drinking water and solid waste management. Overall, it seems that each Finance Commission in India has made significant contributions to the reform of local governments, although some state governments, including the government of Kerala, have not fully

implemented the recommended reforms due to a lack of emphasis on decentralization and financial constraints.

It is evident from the analysis that each Finance Commission has considerably contributed for the reforms of local governments in India. Unfortunately, many states governments including Kerala government have not taken all the reform recommendations with due diligence in view of their lack of focus on decentralisation and ways and means problems.

UFC Devolution to Local Governments

Kerala's experience with devolution of funds from the Union Finance Commission (UFC) has been inconsistent. The state has seen a range of impacts from UFC devolution, with the ratio of UFC funding to total plan devolution ranging from 4% to 31%. However, local governments in Kerala have generally benefited from increased funding from central sources since the Thirteenth Finance Commission, as shown in Table 3.13.

Table 3.13

Kerala's Experience with Union Finance Commission Devolution

Year	Devolution from State (Rs.in Crore)		UFC Grants entitled	Share of UFC Grants in plan devolution (%)
	Plan Grant/DF to LGs	Total		
1996-97	212.00	540.00	51.06	24.08
1997-98	749.00	1046.20	51.06	6.82
1998-99	950.00	1334.30	51.06	5.37
1999-00	1020.00	1425.40	51.05	5.00

2000-01	1045.00	1464.90	80.97	7.75
2001-02	1700.00	2140.90	80.97	4.76
2002-03	1342.00	1814.20	80.97	6.03
2003-04	1317.00	1822.60	80.97	6.15
2004-05	1350.00	1881.11	80.97	6.00
2005-06	1375.00	2032.00	226.80	16.49
2006-07	1400.00	2050.00	226.80	16.20
2007-08	1540.00	2255.00	226.80	14.73
2008-09	1694.00	2481.00	226.80	13.39
2009-10	1863.00	2728.00	226.80	12.17
2010-11	2050.00	3001.00	249.20	12.16
2011-12	2750.00	4160.25	387.80	14.10
2012-13	3388.00	5234.37	569.50	14.65
2013-14	3933.00	6247.70	673.40	17.12
2014-15	4559.00	7266.00	796.30	17.47
2015-16	5193.00	8066.83	785.42	15.12
2016-17	5500.00	8670.93	1310.05	23.82
2017-18	6227.50	9775.16	1508.36	24.22
2018-19	7000.00	11532.95	1739.56	24.85
2019-20	7500.00	11867.20	2338.55	31.18
2020-21	6903.00	11564.06	1964.15	28.45

Source: 6th SFC Report

3.7. Fiscal Decentralisation and Participatory Development Experience in Kerala

Kerala's decentralization experiment was in tandem with its overall state developmental strategy (Isaac & T.T 2001). It adopted devolution strategy to tackle the development crisis through empowerment of local governments. The decentralized planning via participatory mode was the main appeal of Kerala's decentralisation process. Kerala did not perceive fiscal decentralisation as downsizing of government through functional delegations and devolution, rather the State has seen the decentralisation as an effective means to strengthen the state and its efficacy (Vijayanand 2009). Decentralization of state apparatus is essential for transforming the existing state institutions to empowered deliberative bodies. As Thomas Isaac (2001), one of the chief architects of Kerala's decentralisation, observes "Democratic decentralization in Kerala was chiefly aimed as a political response to Kerala's development crisis. Kerala's development experience departs significantly from traditional models of economic development. It shows that even at low levels of economic development, basic needs can be met through appropriate redistribution strategies, a paradigm that has come to be called the 'Kerala Model'. Indeed, the serious economic stagnation in the State is a major rationale for the decentralization campaign".

Kerala has followed 'big bang' decentralization model on an act of faith, instead of 'bits and pieces' approach (Oomen 2020; Prakash 2020). The state followed 'learning by doing' in the fiscal decentralisation process. 'Participatory campaigning and planning' was integral part of this exercise. As Chandrasekhar (2001) observes: "Kerala decentralization effort has twin features: First, the effort in Kerala was not to impose (added) decentralization into exercise, but to realize it through a mass movement, which is merely backed by legislation. This not only ensures that decentralization does not just remain in paper or amounts to mere administrative decentralization, but is a genuine participative exercise. Second, the Kerala experiment does

not link financial devolution to the absorptive capacities of lower levels of governance as perceived, correctly or otherwise, by those at the top. To seek to create absorptive capacity prior to devolving resources is predicated on devolution, in as much as the creation of that capacity occurs through the act of doing itself'. Thus, Kerala's fiscal decentralisation was not in the order of functions to be assigned first and financial devolution to follow. Theoretically it was suggested to build the capacity of Local Government first and devolve the functions and powers at the later stage. Contrary to traditional wisdom, the state decided to transfer 30-40 per cent of the State's annual plan outlay to Local Governments. Since 1996, Kerala has initiated a participatory approach in the formulation and implementation of plans of Local Governments. A popular programme was launched named "People Planning Campaign" in the 9th plan which was renamed into "Kerala Development Programme" in the 10th plan and again introduced as "People Planning Campaign" (as a second phase) in the 12th plan. Though the names were changed in tandem with the changing regimes in the state, the broader objectives of the programmes remained almost the same. The effort was on strengthening the new model decentralization and the changes in the popular titles did not affect its core objectives or approach.

Though many divergencies can be traced out from the philosophy and practices, the preparation and implementation of plan, which is its quintessential, has been undertaken in participatory mode. As Vijayanand (2009) points out "The State of Kerala has succeeded in providing a concrete methodology for participatory planning for local economic development and social justice. The operational guidelines prepared each time gave very much emphasis for the participatory quality of development planning". The local governments in Kerala have been developed following stages in the preparation of planning for ensures the participation of masses in the development process. This proves that the people participation campaigning was able to provide concrete participatory methodology beyond its rhetoric. The Local

Governments can pursue their unique development plan adhering to general methodology of participatory development. The following are the stages involved in the preparation of participatory planning in the state, involving Gram Sabha (Ward Committee in case of urban areas), Local Government and District Planning Committee:

- *Constitution of Working Group*: it is the first step in the preparation of the plan. The Working Group (WG) consists of experts in the relevant field. As per the Eleventh Plan guideline, minimum twelve WGs have to be constituted by every Local government. A separate WG must be constituted where the fund for tribal development is earmarked. The Chairperson of WG would be an elected member and the senior most official transferred will be the convener.
- *Identification of Needs*: Grama Sabha, identifies the developmental needs of the community. Statistics suggest that initially Grama Sabha had 10-12 per cent of population, the turnout has registered a declining tendency in the successive years due to multiple reasons. The meetings are conducted in a semi -structured fashion where plenary sessions and subgroups are entrusted with specific developmental issues. The decisions in the meeting are recorded and forwarded to the Local Government.
- *Preparation of Development Report and Vision Document*: Local Governments have to prepare the Developmental Report based on the inputs from Gram Sabha and the developmental data. This report will show the status of development in each sector and analyse the problems and envisions the scope of further development in the sector.
- *Strategy Setting*: One day Development seminar will be held taking into board the feedback of Grama Sabha and Development Report wherein experts, elected members, representatives nominated by Grama Sabha and practitioners take part. The development seminar sets broad priorities and general strategies to be followed in achieving those goals.

- *Reorientation by Local Government:* The elected representatives of Local Government and Working Group Members sit together and consider the recommendation of development seminar. The meeting makes modifications and prioritises the developmental needs.
- *Projectisation:* At this stage, the Working Group will prepare a detailed project report which outlines its objectives, describing the benefits, funding, and mode of execution and phasing of the project.
- *Plan Finalisation:* The local government finalises the plan of the year and submits the same to the District Planning Committee after the vetting of experts in the concerned field. Local governments are free to take up any project which is under its subject purview, subject to its resource availability.
- *Plan Approval:* The Local Governments start implementing the plan after the DPC approves the submitted plan. DPC can't change the priority of the local government; instead it can check whether the plan follows the broader objectives laid down in the general guidelines. The Local government issues the administrative approval for the project wise implementation of the plan. The administrative sanctions of the local governments are constrained by nothing but their resource at the disposal.

3.8. Fiscal Decentralisation in Kerala: Achievements and Challenges

Three-decades present an ample time to evaluate a system. Kerala has completed its silver jubilee of fiscal decentralization and it is nearing to thirtieth anniversary. Fiscal decentralisation in the State has been quite successful in providing autonomy to local governments functionally and financially. Though Kerala is doing well compare to other states in India, it needs to improve manifold (Oomen 2020; Prakash 2020). The participation of the people in the decision-making process in the state is unique and exemplary (Bandyopadhyay 1997, Ramanath 2007 Vijayanand 2009). The system has been doing quite well at maintaining

transparency and enforcement of the accountability. Though the fiscal decentralisation in Kerala has been able to achieve certain remarkable leaps in certain front and even ranked one in terms of per capita transfer and massive people participation, there are a couple of shortcomings, including certain structural bottlenecks in the way of successful decentralisation at the local level governments. A decentralisation is learned to be successful when the local governments are being able to provide infrastructure and services to its residents and business on a sustainable financing model. Developing third-tier government involves a lot of challenges. Major achievements and challenges of fiscal decentralisation in the State have been discussed below.

Fiscal Decentralisation: Achievements of the State

- Clear embarkation of autonomy: The fiscal decentralization exercise in the state needs to be duly credited for meticulously carving and preserving the autonomy of the Local Governments in an exemplary manner. The autonomy consists of functional, personnel, administrative and financial autonomy. The principles of subsidiarity and complementarity have been followed in the assignment of functions to local governments. The subsidiarity principle implies that something that can be performed more efficiently at a lower level of government should not be transferred to a higher government. According to this principle, only the residual functions are to be allotted to higher level governments. The complementarity principle implies that there should be harmonious existence in the allotment of different functions; the activities of higher-level governments should complement the activities of lower-level governments. This integration should be based on local needs and developmental priorities of local plan. Sen Committee (2004) has listed out specific factors to be considered in the allotment of functions to local government in the state. In the matter of deciding which level of local bodies to discharge which job,

technical complexity, management complexity, physical size, financial size and nature of the scheme of the projects are considered.

- **People's Participation:** Participation is a deep process which empowers the people to make their own decision after analysing the given situation. It is much beyond involving people, consulting them, and getting their prior concurrence. The local governments in the state have an institutional structure to enable participatory democracy. The reservation for women, SCs, and STs in the various aspects of local government ensures the participation of vulnerable sections in the development process. Peoples' involvement and participation are ensured from the identification of beneficiaries, formulation and implementation to evaluation of projects. The Grama Sabha and the Ward Committee are the ideal vehicles to ensure participation.
- **Sanctity of SFC reports:** So far, the State Finance Commission has submitted six reports. And the state has accepted the whole recommendation regarding the devolution. Each of the SFCs was significant in its own terms. The First Commission integrated numerous specific purpose grants into a broader general-purpose grant. It also streamlined the determination and transfer of state taxes and made the transfers fully formula-based and discrimination-free. It was the Second Commission report which recommended for global sharing of state's own tax revenue instead of sharing of specific state taxes. 3.5 per cent as general-purpose grant and 5.5 per cent as maintenance grant had been fixed. Third SFC moved into a fixed grant system. Second SFC's recommendation being the base year, 10 per cent annual increment was stipulated for five years. This has improved the predictability in the transfer system while considering the possible benefit from buoyancy.
- **Own fiscal domain:** Own source revenue of LGs in the state is not quite bad when compared to rest of the states in India, though it is not good enough in comparison to several developing countries and some states. Own source revenue (OSR) constitutes around 30

per cent of revenue of local governments. Lack of adequate reform in tax and non-tax avenues are responsible for present OSR of LGs in the state.

- On an average, an ULG raises taxes to the tune of about Rs. 489 per capita and non-tax revenue also to the tune of about Rs. 344 per capita. This amount can be raised multi-fold by improving the efficiency of assessment and collection. Own tax base also needs to be augmented to take into account post-GST realities.
- Fiscal transfers: Kerala has a smooth and seamless fiscal transfer system in place which is far superior to other states in India on all the following counts.
- *Quantum of Transfers*: The transfers cater to the expenditure assignments through the three streams of Development Fund, Maintenance Fund and General-Purpose Fund. *Quality of transfers*: the transferred money to the local government is “pure money” in the sense that it is completely untied money; therefore local governments are free to spend where they wish to. In the case of general-purpose fund and maintenance fund, it is practically untied fund, whereas in the case of development fund, 40 per cent of it has been spent on productive sectors, not more than 20 per cent can be spent on infrastructure, and at least 10 per cent should be spent on women, children, aged and disabled. (c) *Transparency*: zero discretion in the transferring of funds is the hallmark of Kerala’s fiscal decentralization. Every rupee is spent on a transparent formula. Every local government will get its due regardless of its political, geographical and other bargaining powers. This is not something that can be attributed to many of the states in India. (d) *Fairness*: in the devolution formula, it takes care of the equity aspects. (e) *Predictability and assuredness*; the government has started local government wise share under the three streams for five years from 2006-07 onwards. A separate document is prepared along with a budget document under three streams for transfers which prevents appropriation and diversion. (f) *Smooth flow*: at the beginning of every month, the share of each LGs is credited in their accounts in the treasury.

Development and maintenance funds are transferred in ten equal instalments and general-purpose funds in twelve equal instalments.

- **Accountability and transparency:** The local governments are accountable to the people in their jurisdiction. Their decisions should be based on norms and rationale and that every choice has to be made public. Procedure and administrative formalities have to be made friendly and easily understood by the common people. In this regard, the state has provided for the mechanism of continuous Social Audit of the local government through the special group. In the context of massive devolution of funds, it is necessary to have proper accountability systems. The following accountability systems are in position:

Right to information: there has been an absolute right to information existing in local government since 1996, wherein all records are subject to scrutiny by the public.

Social audit: in the Gram Sabha all accounts are printed and distributed.

Audit: there are three types of audits in a local government system: Director of Local Fund Audit, Accountant General Audit and Performance Audit. In addition to this, the Finance Inspection Wing does sample checking and a State Level Technical Audit team of senior engineers inspects the quality of execution of public works. There are independent institutions of Ombudsman and Appellate Tribunals.

Fiscal Decentralization: Challenges and Gaps

The important challenges of fiscal decentralisation in Kerala are discussed below.

- **Incorporating professionalism in service delivery of local government** is a struggling task. Weak capacity of local governments with poor capacity at the official level hinder the local government from inducting the cutting-edge professionalism into the system of governance.
- **People's participation:** even though there is quite a good record of people's participation

in general, well-off sections of the society have not shown interest. Grama Sabha and Ward Committee need to go beyond beneficiary identification forum to a venue of serious debates and discussions. While the decentralization process is claimed to be inclusive, and it has brought about inclusive development to a great extent, some of the extremely marginalised sections like tribes and the destitute are still neglected.

- The track record of local governments is not satisfactory in promoting local economic development. In terms of generating income and employment, except in the case of micro enterprises of the poor under *Kudumbashree*, there is not much to cheer about on this front.
- Weak and unreliable local statistical system is a big challenge. There have been improvements in recent years, but it is necessary to make available updated local statistics of each local government in the Internet.
- The institutions like the Ombudsman, Appellate Tribunal, and State Development Council need to get proactive to discharge duties.
- A direct social auditing in the local governments has not been very effective, systematic and widespread. E-governance system needs to be expedited. The Audit Commission has not yet been operationalized.
- Archaic administrative system: poor record keeping system and a non-robust monitoring system at the state level are conspicuous.
- Poor internal resource generation: the state's fiscal decentralisation model has been heavily relied on transfers from the state government to local governments. On an average, state grants from the government accounts seventy per cent of total revenue of local governments. This has led to slackening in own resource mobilisation. Table 3.14 shows state-wise per capita total municipal revenues of Municipal Corporations based on a study of municipal finances conducted at the behest of 15th Finance Commission.

Table 3.14

State-wise Per capita Total Revenues (Rs.) of Municipal Corporations

2012-13 and 2017-18

State	2012-13	2017-18
Andhra Pradesh	2035.9	3385.6
Arunachal Pradesh	NA	NA
Assam	1309.5	553.8
Bihar	458.1	1416.4
Chhattisgarh	1671.4	4306.7
Goa	10930.4	10338.5
Gujarat	4291.1	9404.8
Haryana	2680.7	3019.2
Himachal Pradesh	3066.9	5821.0
Jammu and Kashmir	1266.4	1928.0
Jharkhand	909.7	3157.7
Karnataka	3869.7	5230.7
Kerala	2433.2	4100.2
Madhya Pradesh	3565.2	7160.2
Maharashtra	8641.9	10118.1
Manipur	710.6	701.2
Meghalaya	NA	NA
Mizoram	879.8	1162.3
Nagaland	NA	NA

Odisha	1256.3	2560.8
Punjab	2618.3	3320.6
Rajasthan	1783.3	2752.0
Sikkim	470.1	837.1
Tamil Nadu	2701.9	5381.2
Telangana	2841.7	1760.8
Tripura	5210.8	3610.0
Uttar Pradesh	1958.2	2859.7
Uttarakhand	593.6	2193.8
West Bengal	4832.5	6279.9
India (All States)	4011.4	5782.5

Source: ICRIER (2019)

As can be seen, per capita municipal revenue in the case of Municipal Corporations in Kerala is not amongst the highest in spite of significant fiscal decentralization. The Municipal Corporations are not exploiting own revenue sources, especially property tax in the face of huge transfers from the State Government.

3.9. Conclusion

Kerala has started decentralization process from the formation the state itself. The first elected government had appointed Committees to study the feasibilities of decentralization. 73rd and 74th Constitution amendment gave impetus to the process of decentralization in the state. The subsequent enactment of state legislation consolidated and streamlined the process fiscal decentralisation to local governments in Kerala. The corresponding State legislations specified the functional domain, upheld the supremacy of elected bodies in local public service delivery, and insert the transparency accountability mechanism into focal government system. The

institutional mechanisms like the State Election Commission and Delimitation Commission enabled the process.

The highlight of Kerala's decentralization model is participatory development. The people planning movement hasn't stopped at mere campaigning, it has provided a detailed methodological blueprint for decentralised development planning to the state. The meticulous and scientifically designed steps of plan formulation of the state are a model worth emulating for the rest of the country. Kerala's decentralization has achieved some unique accomplishments; sanctity of SFC reports, formula-based transfer system, clear demarcation of autonomy, tested methods of transparency and innovative ways of peoples' participation are some of them. But then there are, numerous challenges and hurdles in the way of realising the gains of decentralization: low priority of own-source revenue generation, weak staff capacity, archaic administrative procedures, lack of professionalism, and weak database. Real democracy at the grassroots will come when the beneficiaries pay for the services received by them and demand value for money and accountability on the part of local officials and elected representative. This requires reforms in LGs as a continuous process where it should enable a system of feedback, and ensure that the system responds to it. Only a dynamic correction system can address the lacunae in the local government system and attain the goals of good governance and subsidiarity.

CHAPTER 4

Fiscal Decentralization to Urban Local Governments in Kerala: An Empirical Analysis

4.1 Introduction

Kerala is the fastest urbanizing state in India (World Bank 2021). More than 47 percent of the state's population lives in urban areas. The 2011 census registers a decadal growth rate of 82 percent increase in the state's urban population against 36 percent recorded at the national level. The number of towns in Kerala had grown from 159 to 520 between 2001 and 2011. There are 19 urban agglomerations (UAs) in Kerala according to the 2011 census. The main reason for the growth of the state's urban population is not the population's concentration in the existing urban areas, rather the increase in the quantum of urban space and the phenomenon of urbanization of peripheral areas of existing cities. Kerala is experiencing an 'urban sprawl' instead of urban concentration. Even at this rate of urbanization, Kerala does not have a single primate city. Presently the state has six medium-sized urban (tier 2 cities) agglomerations and 87 Municipalities are distributed in terms of population. Assuming that the urban population's percentage would rise significantly, it is presumed that more than half of the state's population would be urbanized in the near future. In this backdrop, financing of urban local governments warrants urgent attention from policymakers and planners. Municipal financing system is extremely important as municipalities are the closest government of the citizens. They significantly impact the quality of life of the people. Infrastructure and civic service delivery have direct impact on the welfare of individuals. Moreover, urbanization acts as engine of productivity enhancement and economic growth. The ways municipalities finance infrastructure and services have a direct implication for the growth and development of the

country. In this chapter we will analyze how municipal finance in Kerala has been structured and cover aspects such as fiscal magnitude, fiscal sustainability, financial accountability and the transparency. ‘How fiscally prudent are the urban local governments in Kerala’ is a key concern we will be dealing with.

Profile of ULGs in Kerala

Kerala has two categories of urban local governments, viz. Municipalities and Municipal Corporations. Presently, there are 87 Municipalities and six Municipal Corporations in the state. Table 4.1 presents the number of Local Governments, number of wards, average geographical area and average population of an urban local government in the state. The number of wards of Municipalities and Municipal Corporations witnessed a substantial increase with the conversion of Gram panchayats to Municipalities in reconstituted Local Governments.

Table 4.1

Profile of Urban Local Government in Kerala

	No. of LGs	No. of Wards	Average Area (Sq.km)	Average Population (2011 Census)
Municipality	87	3122	23.65	51664
Municipal Corporation	6	414	95.6	491240

Source: *Kerala SFC Report*, 2015

4.2. Decentralisation: Magnitude and Trend

Kerala's municipal finance accounts for 0.51 percent of GSDP in 2017-18. It was 1 percent at the national level in the same year. The figure was 1.94 percent in Maharashtra, 1.58 percent in Gujrat, 1.13 percent in Karnataka, and 1.044 percent in Tamil Nadu. These are states in India with more urbanization and bigger cities. The same ratio is reported at 6.0 percent for south Africa, 13.9 percent for the United Kingdom, and 7.4 percent for Brazil (OECD 2012). Table 4.2 shows the ratio of municipal revenue and expenditure with respect to GSDP in Kerala from 2010-11 to 2017-18. Municipal revenue as the ratio of GSDP has increased from 0.48 to 0.51 over the same period. The ratio of municipal expenditure as a percent of GSDP has declined from 0.47 in 2010-11 to 0.20 from 2017-18 (see Figure 4.1). The state's municipal finance size is far from being adequate given the sporadic urbanization happening in the state and patterns observed nationally and internationally. We will assess the Structure, Composition, and Magnitude of Municipal Finance in detail in the following sections.

Table 4.2

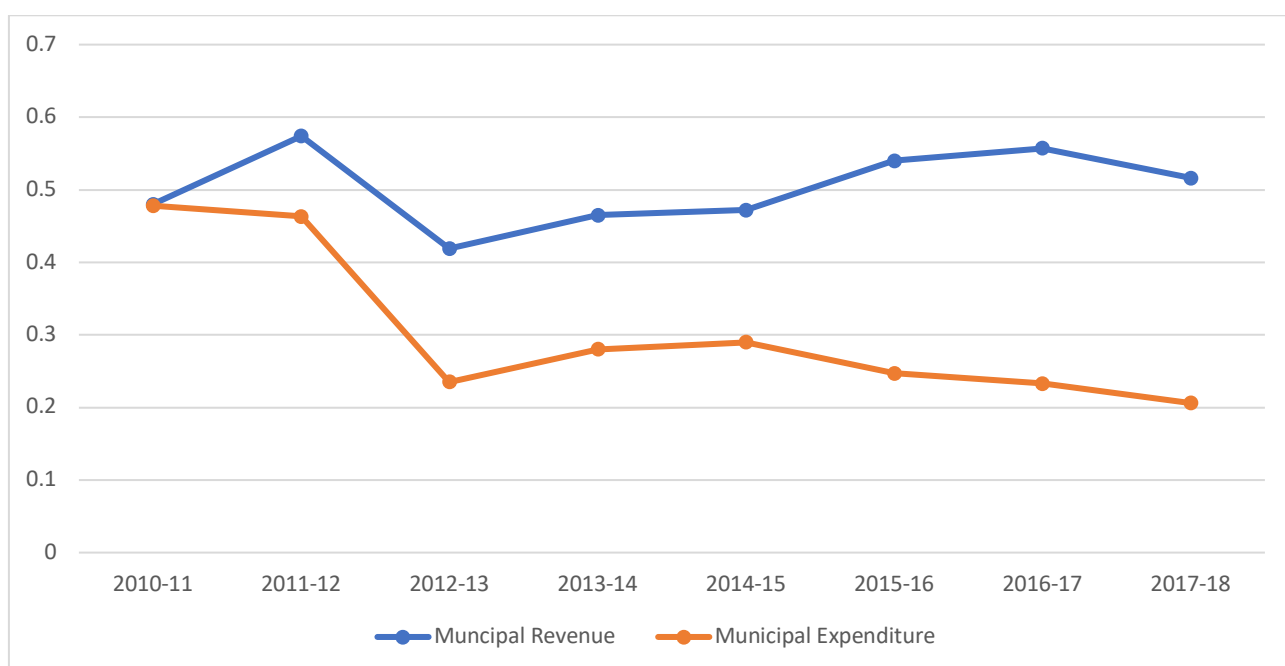
Proportion of Municipal Revenue and Expenditure to GSDP in Kerala

(Percent of GSDP)								
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Municipal Revenue	0.48	0.574	0.419	0.465	0.472	0.54	0.557	0.516
Municipal Expenditure	0.478	0.463	0.235	0.28	0.29	0.247	0.233	0.206

Source: ICRIER, 2019

Figure 4.1

Municipal Revenue and Expenditure in Kerala (Percent of GSDP)



Source: ICRIER, 2019

4.3. Municipal Revenue: Composition and Magnitude

Municipal finance consists of revenue and the expenditure. Municipal revenue sources are tax revenues, non-tax revenues, state government transfers, central government transfers, and borrowing. The revenue generated by Urban Local Governments through taxation and non-taxing avenues is called Own Source Revenue (OSR). In addition to OSR state government predominantly and centre government transfer funds to urban local governments. The state government is the biggest contributor to the local governments' exchequer while central governments transfers occur through Union Finance Commission (UFC) grant and Centrally Sponsored Schemes (CSS). The Central government and state government do distribute pension and welfare scheme funds through local government as agent. In the following sections, we will dive into the structure, composition, and magnitude of each component of fiscal decentralization, along with its implications.

Total Municipal Revenues

Municipal revenue primarily comprises of own-source revenue of Local Governments and intergovernmental transfers from the state and central government. i.e., tax and non-tax revenue of LGs plus the grant from the state government and the devolution from central government. The total municipal revenue of Kerala state is Rs. 3883.8 crore in 2017-18. The total revenue of ULGs has grown by around 20 percent per annum (see Table 4.3 and Figure 4.2). On average, revenue per ULG was Rs. 41.76 crore in 2017-18. As we have seen, the size of revenue in terms of the state's GSDP remains negligible. The lack of big cities, under-exploitation of revenue base and inadequate transfer of resources might be the reason for the relatively smaller municipal revenue size in the state.

Table 4.3

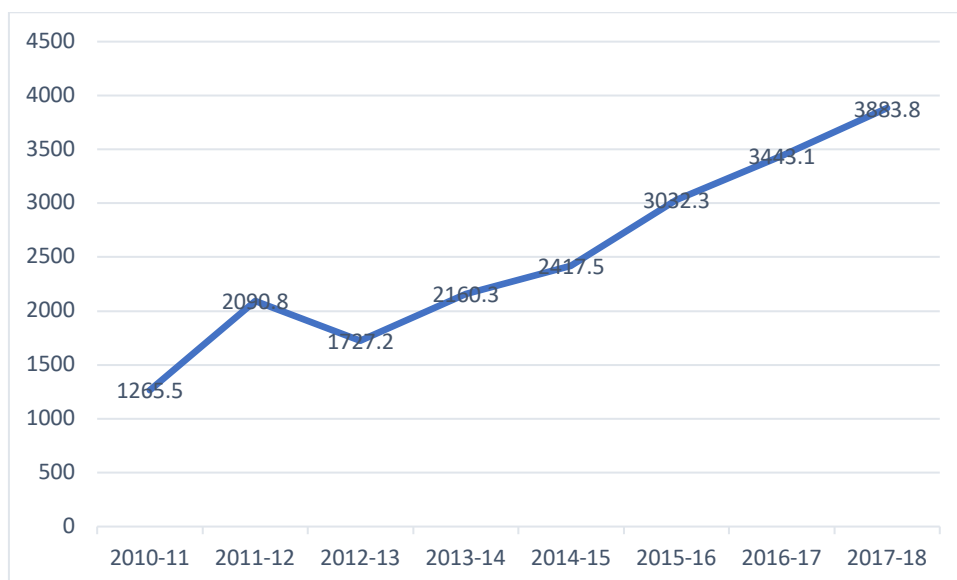
Trends in Total Municipal Revenue: Kerala

Year	Total Revenue (Rs. Crore)	Growth (Percent)	Per ULG (Rs. Crore)
2010-11	1265.5		19.47
2011-12	2090.8	65.22	32.17
2012-13	1727.2	-17.39	26.57
2013-14	2160.3	25.08	33.24
2014-15	2417.5	11.91	37.19
2015-16	3032.3	25.43	32.61
2016-17	3443.1	13.55	37.02
2017-18	3883.8	12.80	41.76

Source: IKM, 2018

Figure 4.2

Total Municipal Revenue in Kerala (Rs. in crore)



Source: IKM, 2018

Municipal Own Source Revenue (OSR)

The revenues generated by urban local governments using the fiscal instruments at their disposal (tax and non-tax) is called OSR. It is the real indicator of fiscal decentralization. It provides financial autonomy and fiscal independence to Local Governments. In an ideal case of fiscal decentralization, every LG would finance their expenditures from their own- revenues. Such a situation is almost impossible due the constitutional and economic framework under which LGs are working. A realistic view approach to evaluate OSR will be the proportion of OSR in total municipal revenue, OSR as the proportion of GSDP or the ratio of OSR to municipal expenditure. Table 4.4 and Figure 4.3 depict the trends on OSR.

Kerala's own-revenue as the percent of GSDP is 0.120 in 2017-18 which very low compared to the national average of 0.429. The figure for the neighbouring states are: Karnataka - 0.30 and Tamil Nadu - 0.31. In the urbanised state of Maharashtra, it is 1.26 per cent; the figure is 0.748 per cent in Gujrat. From 2010-11 to 2017-18 OSR in Kerala has

increased from Rs. 522.2 crore to Rs. 840.7 crores, registering an average of 7.8 growth per annum. On average, ULGs generated 8.7 crores as OSR in 2017-18. The per capita OSR has declined from Rs. 885.7 in 2016-17 to Rs. 785.57 in 2017-18 in the state. Per capita OSR at the national level is Rs.1957. It is Rs. 1393.3 in Karnataka, Rs. 1184.4 in Tamil Nadu. Per capita OSR in Maharashtra is Rs.5730.4, and in Gujrat it is Rs. 3533.1 The statistics indicates an undesirable trend of own-source revenue generation by ULGs in the state. We will discuss it detail in the context of intergovernmental transfers and the ramifications of such low internal resource mobilization of state's ULGs. In the following section we will look into tax revenue and non-tax revenue of urban local governments in Kerala.

Table 4.4

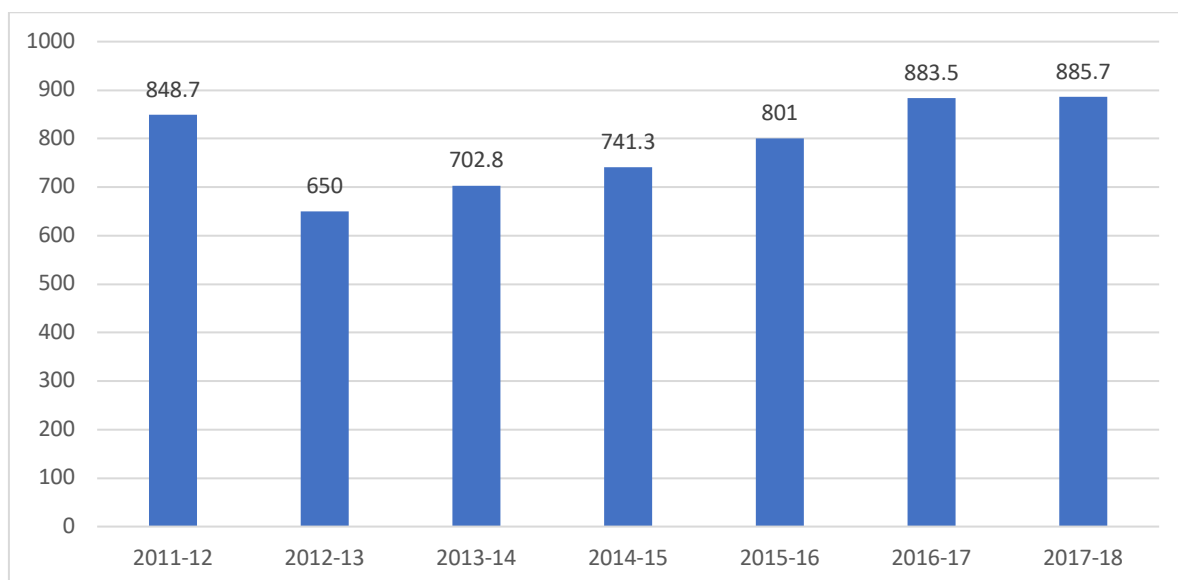
Municipal Own Source Revenue in Kerala

Year	Own Source Revenue (Rs. Crore)	Growth (Percent)	Per ULG OSR (Rs. Crore)	Per Capita OSR (Rs.)
2010-11	522.2		8.03	
2011-12	645.3	23.57	9.93	848.7
2012-13	512.7	-20.55	7.89	650
2013-14	575.2	12.19	8.85	702.8
2014-15	629.6	9.46	9.69	741.3
2015-16	705.8	12.10	7.59	801
2016-17	807.7	14.44	8.68	883.5
2017-18	840.1	4.01	9.03	885.7
Total	5238.6	7.89	8.71	787.6

Source: IKM, 2018

Figure 4.3

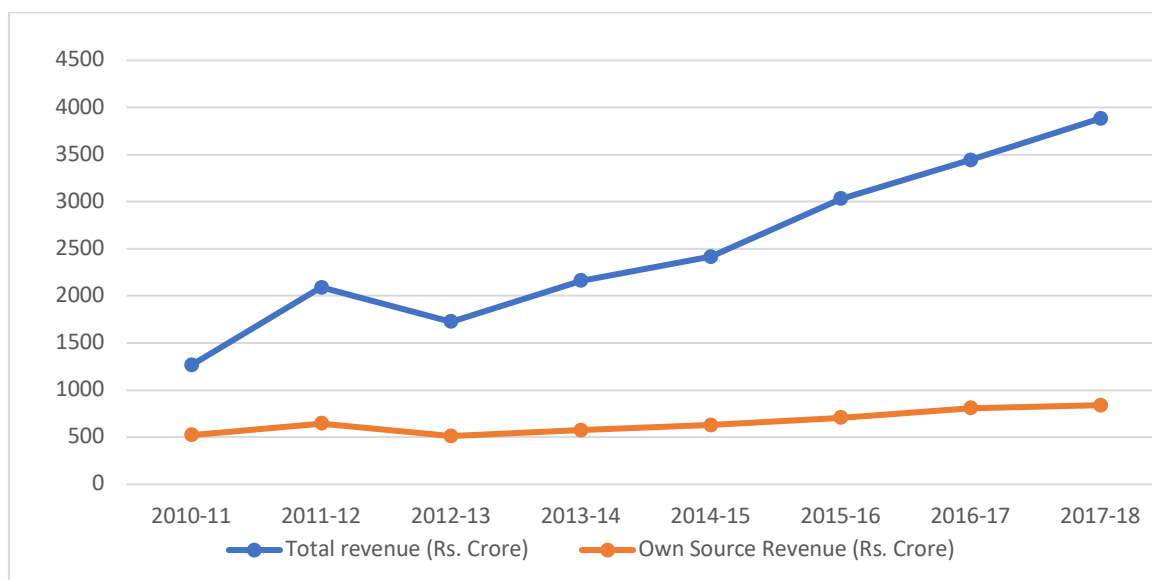
Per Capita Own Source Revenue of ULGs in Kerala



Source: IKM, 2018

Figure 4.4

Trend of Total Revenue and Own Source Revenue of ULGs in Kerala



Source: IKM, 2018

Municipal Tax Revenue

Major taxes collected by ULGs are property tax, profession tax, entertainment tax, and advertisement tax. The total tax collected by ULGs has increased from Rs. 283 crore in 2010-11 to Rs 529.3 crore in 2017-18. Property tax collected from the owners of various buildings accounts for 52% of the total tax revenue for 2017-18. Profession tax is the second major item of tax, accounting for 34% of the total revenue. Entertainment tax is the third major item, accounting for 11% of the total tax receipts. On average, a municipality collected Rs 4.89 crore as taxes during the year 2017-18. The state's municipal tax revenue had declined from 0.10 percent of GSDP in 2010-11 to 0.075 percent in 2017-18. At the national level, municipal revenue declined from 0.30 to GDP 0.25 percent over the same period. Ironically, the combined tax revenues for state and centre as a percent of GDP have increased from 16 to 18 percent over 2017-18 (RBI 2018)

Table 4.5 shows the trends in municipal tax revenues. There is much scope for increasing the tax resources of local Governments through periodical revision of the rate of taxes, increasing tax base, and improving tax collection efficiency. The ceiling of the profession tax (Rs 2500) fixed in 1988 has not been revised since then. The municipalities also failed to collect the tax from the self-employed, certain professionals, and traders. The decline in the number of theatres and the telecast of cinemas through T.V. network and internet has reduced entertainment taxes. Though there is much potential for the collection of advertisement tax, the municipalities are not utilizing the opportunity.

Municipalities around the world have been endowed with a wider basket of taxes such as sales tax, VAT, piggy-backed Income tax, Vehicle tax, registration tax, and construction tax. E.g., Chinese municipalities have access to real estate tax, business tax, urban land use tax,, land appreciation tax, urban maintenance and construction tax, farmland occupation tax, vehicle tax, and deed tax. The tax base of urban local governments in India and Kerala is small

and grossly inadequate.

The local governments in Kerala are not been able to tap their maximum tax potential due to inefficient tax management. The tax rates have not been revised for decades. Inefficiency in the collection, lack of proper database, and reluctance to adopt e-governance tools are responsible for poor tax collection. Though periodical revision of property tax is envisaged in the Kerala Municipality Act, 1994, timely steps have not been taken to revise the property tax rates.

Table 4.5

Total Municipal Tax Revenue in Kerala

Year	Total Tax Revenue (Rs. Crore)	Growth Rate	Per ULB (Rs. Crore)
2010-11	283		3.04
2011-12	349.2	23.39	3.75
2012-13	337.9	-3.24	3.63
2013-14	392	16.01	4.22
2014-15	422.5	7.78	4.54
2015-16	481.7	14.01	5.18
2016-17	538.5	11.79	5.79
2017-18	529.3	-1.71	5.69

Source: IKM

Property Tax

Property tax is the single largest source of income to the Urban Local Governments in Kerala.

In 2017-18, property tax collection accounted for 0.075 percent of GSDP. Property tax

constitutes 23.2 of the total municipal revenues of the state. Property tax increased to Rs.294.9 crore in 2017-18 from Rs.164.1crore in 2010-11. Per capita property tax of ULGs in Kerala stood at Rs. 310.9 in 2017-18. In comparison, per capita property tax in Karnataka was Rs.949.0 and Tamil Nadu collected Rs.487.4 per capita property tax. Whereas the state of Gujarat collects Rs.1911.5 and Maharashtra Rs.1512.2 per capita, the per capita property tax in the state is well below the national per capita figure of Rs.688.2. Table 4.6 depicts the share of property tax in municipal revenues and GSDP. Table 4.7 shows property tax collection over the years. Figure 4.5 presents the trends in per capita property tax collection. Figure 4.6 gives comparative trends of total tax and property tax of ULGs.

Table 4.6

Property Tax as Share of Municipal Revenue and GSDP

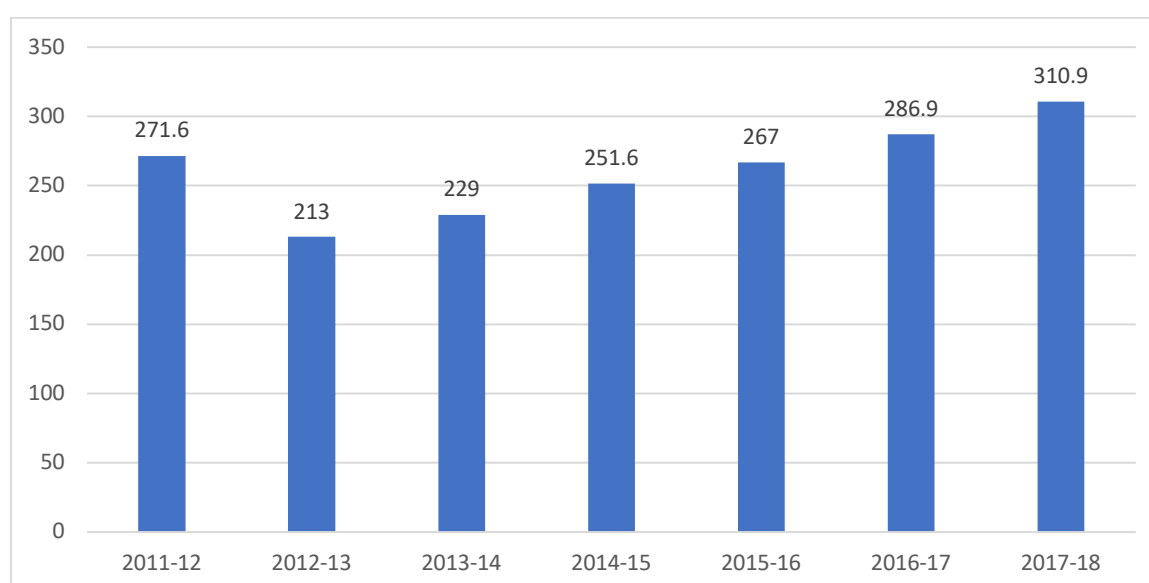
Year	Share of Property Tax in Total Municipal Revenue	Share of Property Tax Revenue in GSDP
2010-11	13	0.262
2011-12	9.9	0.178
2012-13	9.7	0.237
2013-14	8.7	0.2
2014-15	8.8	0.22
2015-16	7.8	0.222
2016-17	7.6	0.227
2017-18	23.2	0.041

Source : ICRIER, 2019

Table 4.7*Trends in Property Tax Collection*

Year	Property Tax (Rs. Crore)	Growth (Percent)	Per ULG Property Tax (Rs. Crore)	Per Capita Property Tax (Rs.)
2010-11	164.1		2.52	
2011-12	206.5	25.84	3.18	271.6
2012-13	168	-18.64	2.58	213
2013-14	187.4	11.55	2.88	229
2014-15	213.6	13.98	3.29	251.6
2015-16	235.2	10.11	2.53	267
2016-17	262.3	11.52	2.82	286.9
2017-18	294.9	12.43	3.17	310.9

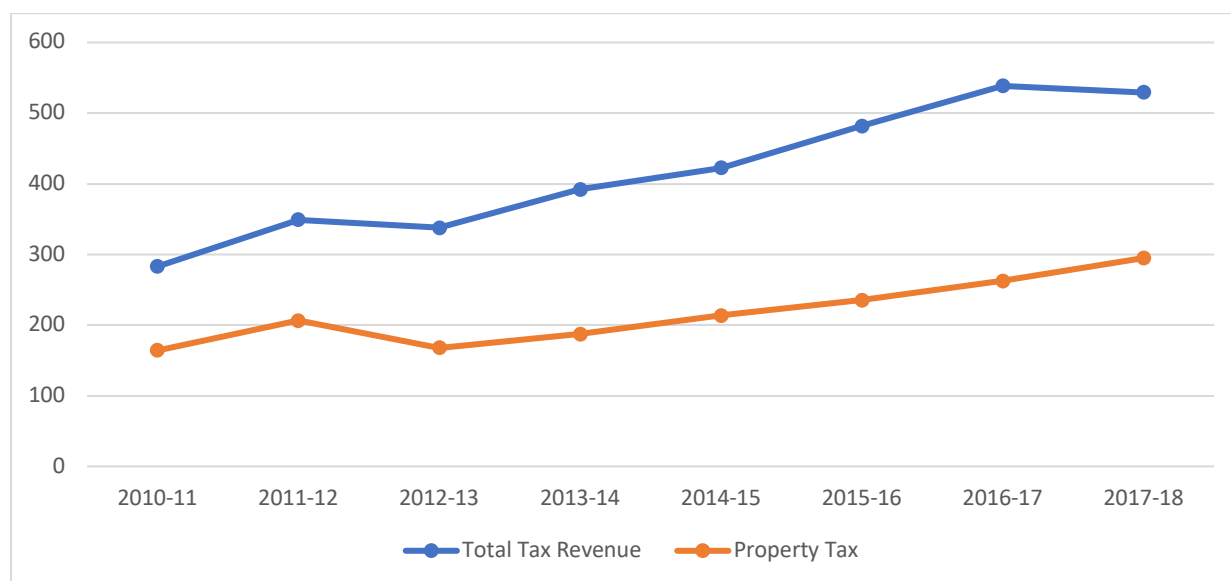
Source: IKM, 2018

Figure 4.5*Per Capita Property Tax*

Source: IKM, 2018

Figure 4.6

Total Tax Revenue and Property Tax Revenue



Source: IKM, 2018

Non-Tax Revenue

Major non-tax revenue sources of local governments are rent of own buildings, building permit fee, fines and penalties, D&O license fee, income from river sand, and other items. The average collection of non-tax revenue per ULG was Rs 3.20 crore in 2017-18 (see Table 4.8). Rent on building is the single most contributing item of urban government non-tax revenue with a share of 24%. Building permits account for 10 %. Besides these, there are other several items like fees and fines, penalties, river sands, slaughterhouses, and D&O Licence (SFC, 2015). The share of non-tax revenue in total revenue declined to 36.9 percent in 2017-18 from 45.8 percent in 2010-11

Presently ULGs in Kerala have a poor record on the recovery of the cost of services.

There is a high potential to raise non-tax revenues of ULGs further by rationalizing rent, charges, and cost of various services. The rate of most of the items remained unchanged for a decade or two. As a result, only a fraction of the potential of rents, fees, and user charges are collected. Lack of periodical revision of the fees, rent, fines, and user charges has also contributed to the poor collection of non-tax sources.

Figure 4.6 compares the movements/trends in municipal tax and non-tax revenues as share of own source revenues (OSR) over the years. As may be inferred, the mobilisation from non-tax revenue has not kept pace with the collection from tax revenues, dominated by property tax.

Table 4.8

Non Tax Revenues

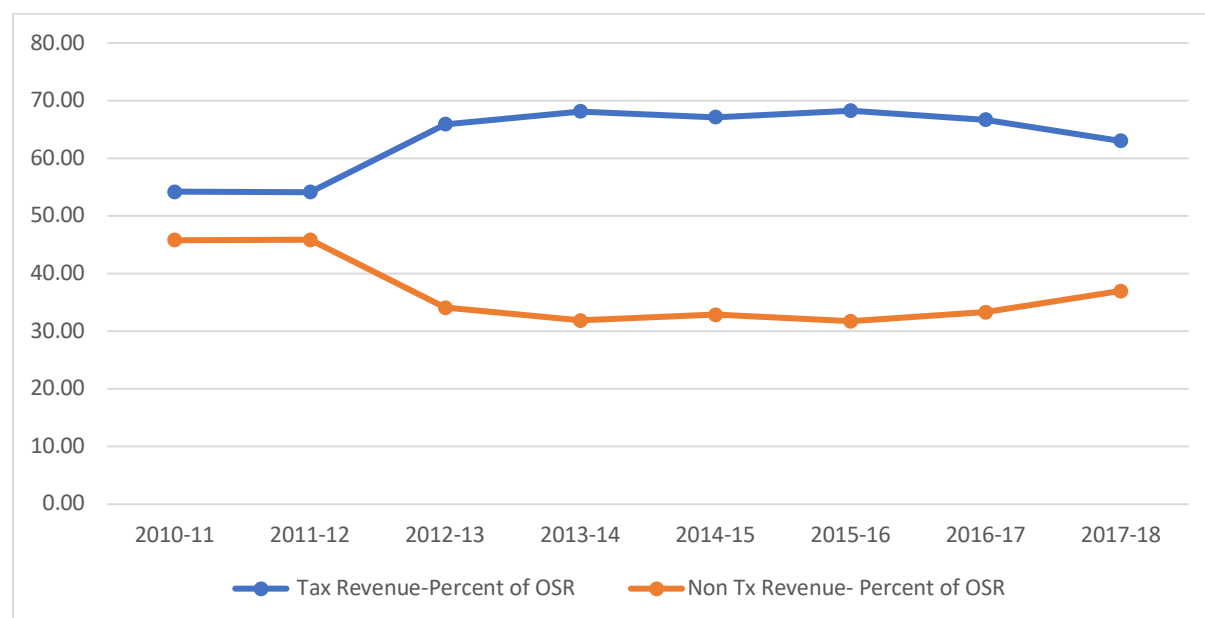
	Total Non-Tax Revenue (Rs. Crore)	Per ULG Non Tax Revenue (Rs. Crore)
2010-11	239.2	3.68
2011-12	296.1	4.56
2012-13	174.8	2.69
2013-14	183.2	2.82
2014-15	207	3.18
2015-16	224.1	2.41
2016-17	269.2	2.89
2017-18	310.8	3.34
Total	1904.4	3.20

Source: IKM, 2018

Figure 4.7

Municipal Tax Revenue and Non Tax Revenue

(Percent of OSR)



Source: IKM, 2018

Intergovernmental Transfers

From the above analysis it is clear that own source fund of urban local governments is inadequate to finance the expenditure requirements of the local governments. This necessitates intergovernmental transfers. The primary role of transfers is to supplement urban local governments' own-source revenue and reduce vertical and horizontal imbalances. State government and Centre governments transfer funds to urban local governments. It is evident from the table 4.9 that transfers have increased both in absolute quantity and as proportion of total municipal revenue. However, it is to be noted that intergovernmental transfers to urban local governments as the percent of GDP is minimal and declining in spite of increasing urbanization; it hardly accounts for 0.45 percent (Mohanty, 2016). Intergovernmental transfers

to local governments are 2.1 percent of GDP in Denmark, 6.0 percent in Norway, 7.8 percent in Italy, and 9.9 percent in the United Kingdom. Ironically, transfers from the central government to state governments in India accounted for 7.23 percent of GDP in 2017-18 (RBI 2018).

An adequate and seamless flow intergovernmental transfer based on the scientific formula is imperative for successful fiscal decentralization. State government transfers funds primarily based on the SFC recommendation and Central government transfers CFC grants and funds for centrally sponsored schemes (CSS). The total transfer of ULGs has increased from 730 crores in 2010-11 to 2785.1 crore in 2017-18 as may be seen from table 4.9. Figure 4.8 presents the composition of transfers to ULGs. We will discuss the State transfers and Central transfers separately in the following sections.

Table 4.9

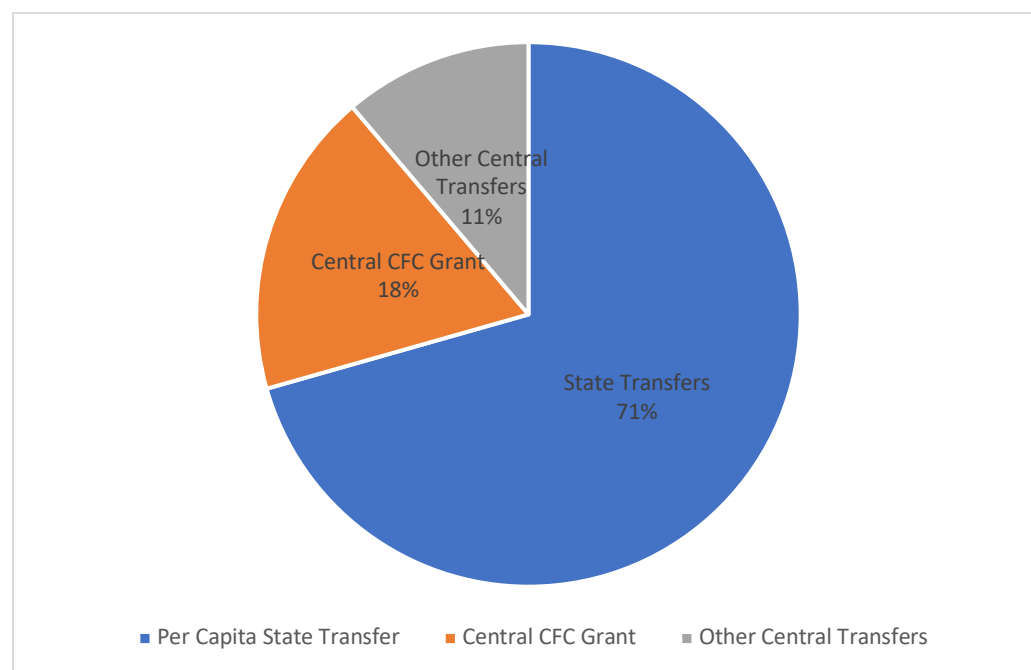
Total Transfers to ULGs in Kerala

Year	Total Central and State Transfers (Rs. Crore)
2010-11	730
2011-12	1387
2012-13	1214.4
2013-14	1585.1
2014-15	1787.9
2015-16	2326.5
2016-17	2654
2017-18	2785.1

Source: IKM, 2018

Figure 4.8

Composition of Intergovernmental Transfers - 2017-18



Source: IKM, 2018

State Government Transfer

State Government accounts for 70 percent of total transfers to Urban local governments in Kerala. The fund transferred from the state government is the primary source of receipts to the Urban Governments. Unlike many other states in India, Kerala has taken clear leadership in transferring a sizable proportion of resources of the state government to local governments. The state government in 1996, decided to transfer 35 % to 40% of state plan outlay to LGs. The state transfers funds through three heads the General-Purpose fund, Maintenance fund (road and non-road), and Development fund as per the State Finance Commission's recommendation.

The transfer from the state government has increased from Rs. 394.8 crore to Rs. 1966.2 crore over the period of 2010-11 to 2017-18 (see Table 4.10). During the same period, per capita state transfers have increased from Rs. 861.2 to Rs. 2073 (see Figure 4.9). On average an ULG could receive Rs. 21.14 crore in 2017-18 based on the general distribution formula. The per capita state transfer to urban local government in Kerala is one of the highest in the country. The national average per capita state transfer is Rs. 1496, while Kerala's per capita state transfer is Rs 2073 in 2017-18. There are only four states who are having per capita state transfers higher than Kerala: Karnataka (Rs.3246.8), Himachal Pradesh (Rs. 2108.1), Gujarat (Rs.2635.7), Madhya Pradesh (Rs.2442.8). Kerala has not been adding salaries of employees of local governments in the transfers to local governments unlike other states in India. If the state added the salaries of the employees to the transfers to the local governments, then it would be the highest transferer to urban government in India.

The state government adopted 'big push' method and the "learning by doing" approach in transferring resources to Urban Local Governments. Even though the state government did not share its tax buoyancy with LGs, the real per capita transfers to local governments did not register negative growth. Given the fact that the state government began with a shallow base, the present trend of transfer to local government is quite commendable.

Table 4.10

State Government Transfers to ULGs

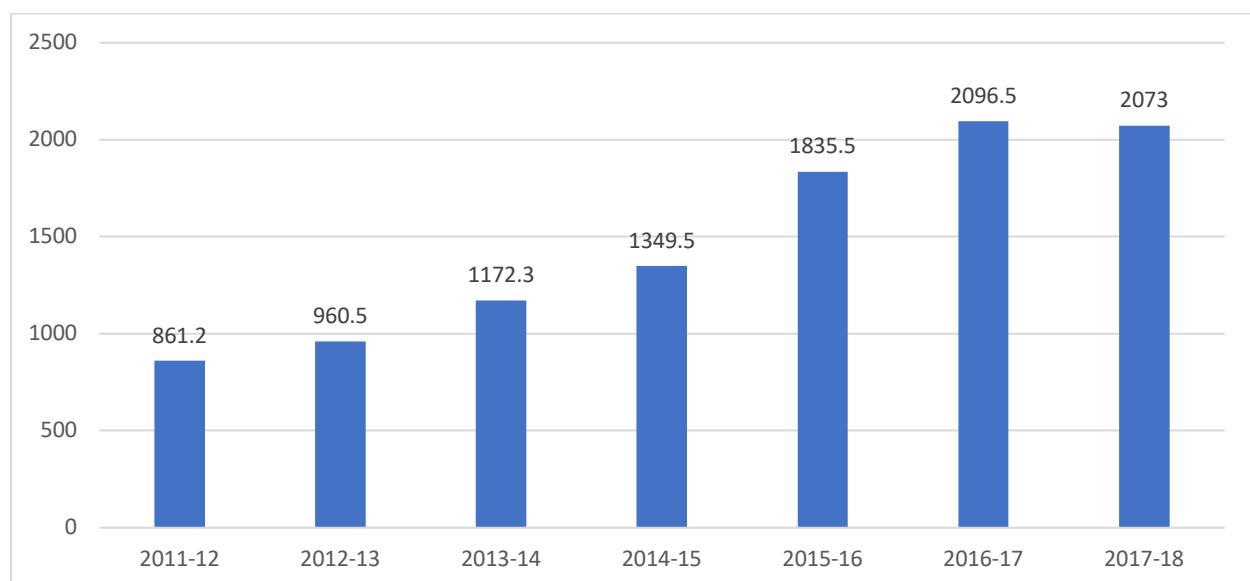
Year	State Transfers (Rs. Crore)	Growth Rate (Percent)	Per ULG State Transfer (Rs. Crore)	Per Capita State Transfer (Rs. Crore)
2010-11	394.8		6.07	

2011-12	654.8	65.86	10.07	861.2
2012-13	757.7	15.71	11.66	960.5
2013-14	959.5	26.63	14.76	1172.3
2014-15	1146	19.44	17.63	1349.5
2015-16	1617.3	41.13	17.39	1835.5
2016-17	1916.6	18.51	20.61	2096.5
2017-18	1966.2	2.59	21.14	2073
Total				

Source: IKM, 2018

Figure 4.9

Per Capita State Transfers



Source: IKM, 2018

Central Finance Commission Transfer

After the 74th Amendment Act, the Central Finance Commission has been required to recommend “the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State”. CFCs are devolving funds to ULGs from 10th Finance Commission onwards. CFC grant to urban local government in 2017-18 was Rs. 506 crores which witnessed an annual hike of around 30 percent from 2010-11 onwards (see Table 4.11). Per capita CFC grant of ULGs was Rs.534.2 in 2017-18, while in 2011-12 it was Rs. 138.4 (see Figure 4.10). On average, an urban local government was to receive Rs.2.64 crore based on the distributional formula. Kerala is the 5th top receiver of CFC grant to ULGs. All India per capita CFC grant was Rs. 331.9. In addition to CFC grant, the ULGs also receive funds under CSS for various schemes and welfare pensions for disbursement. The welfare pensions disbursed through the municipalities are unemployment allowance, National Old Age Pension, pension for unmarried women, destitute pension, disabled pension, and agricultural workers’ pension. The welfare pensions account for about 8.4% of total receipts of ULGs (SFC 2015).

Table 4.12 presents the trend in total central transfers to ULGs in Kerala (CFC + Other).

Figure 4.11 shows central transfers in per capita terms.

Table 4.11

CFC Grant to Urban Local Governments in Kerala

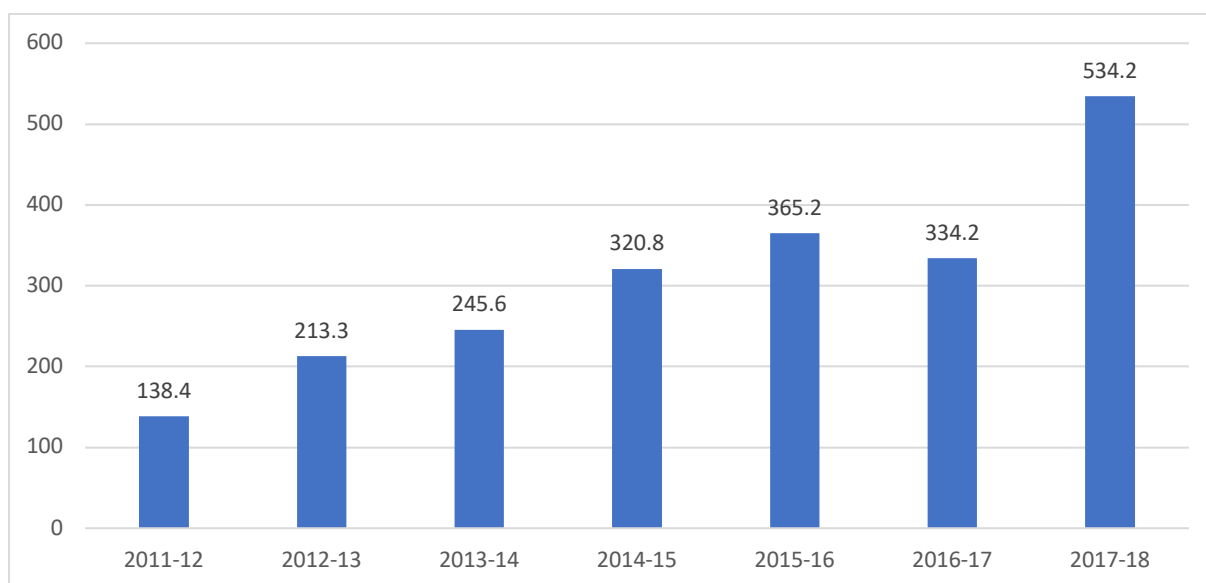
Year	CFC Grant (Rs. Crore)	Growth Rate (Percent)	Per ULG CFC Grant (Rs. Crore)	Per Capita CFC Grant (Rs.)
2010-11	80.9		0.87	
2011-12	105.3	30.16	1.13	138.4
2012-13	168.2	59.73	1.81	213.3

2013-14	201	19.50	2.16	245.6
2014-15	272.4	35.52	2.93	320.8
2015-16	321.7	18.10	3.46	365.2
2016-17	305.5	-5.04	3.28	334.2
2017-18	506.7	65.86	5.45	534.2
Total	1961.7	31.98	2.64	307.39

Source: IKM, 2018

Figure 4.10

Per Capita CFC Grant to ULGs in Kerala



Source: IKM, 2018

Table 4.12

Total Central Transfers to ULGs in Kerala

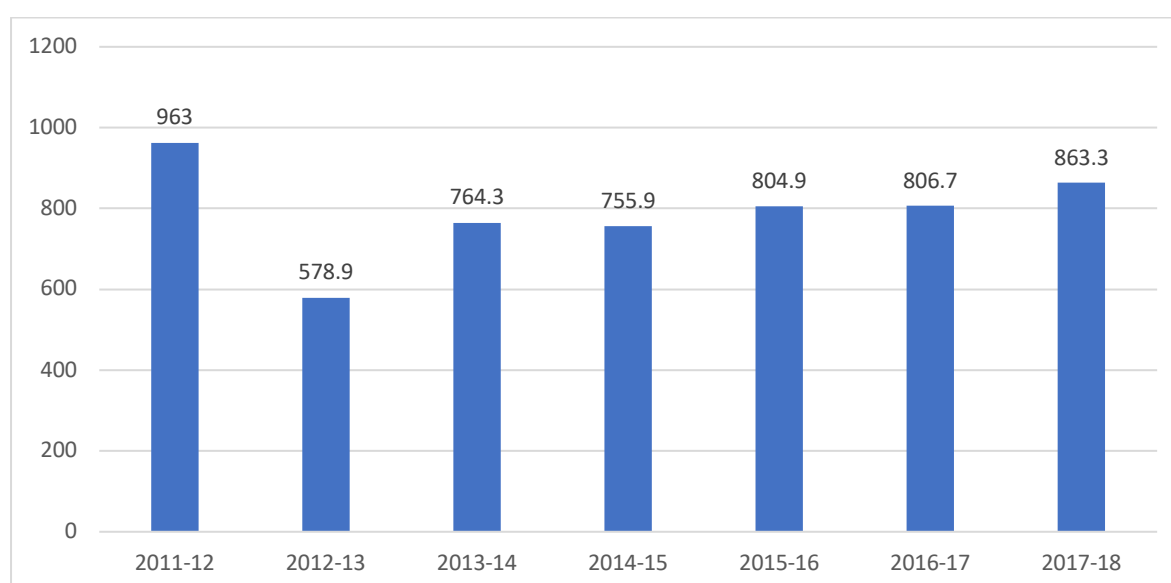
Year	Total Central Transfers (Rs. Crore)	Growth (Percent)	Per ULG Central Transfers (Rs. Crore)	Per Capita Central Transfers (Rs.)
2010-11	335.1		5.16	

2011-12	732.2	118.50	11.26	963
2012-13	456.6	-37.64	7.02	578.9
2013-14	625.5	36.99	9.62	764.3
2014-15	641.9	2.62	9.88	755.9
2015-16	709.2	10.48	7.63	804.9
2016-17	737.4	3.98	7.93	806.7
2017-18	818.9	11.05	8.81	863.3
Total	5056.8	20.86	8.41	791

Source: ICRIER, 2019

Figure 4.11

Per capita Central Transfers to ULGs in Kerala



Source: ICRIER, 2019

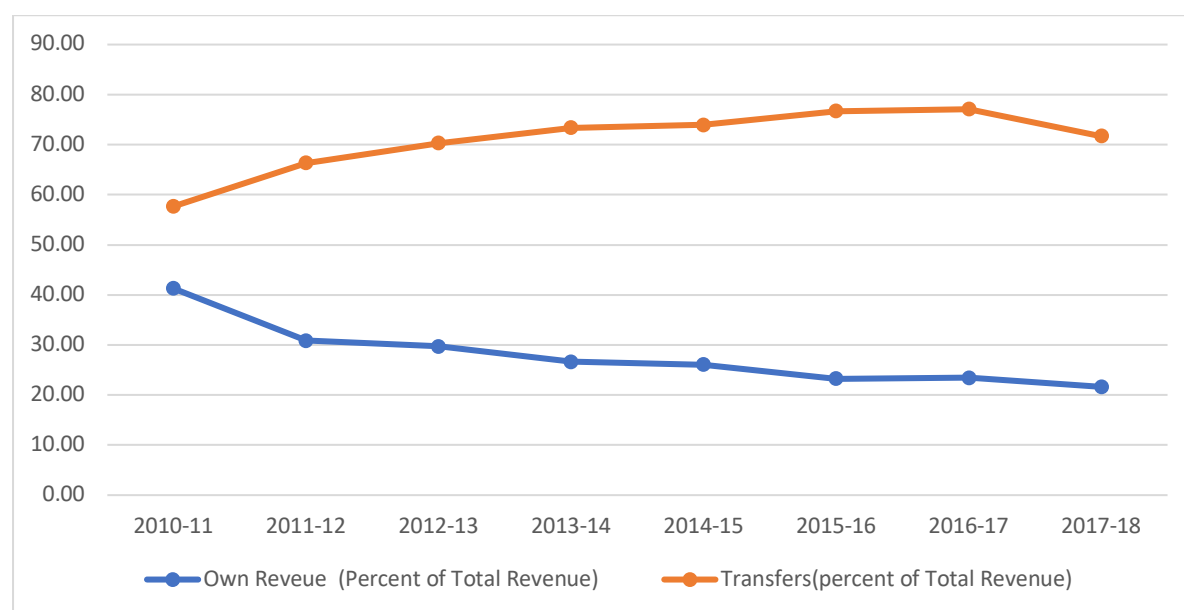
OSR Vs. Intergovernmental Transfers

The trends in OSR and intergovernmental transfers are depicted in Figure 4.12. The OSR as the percent of total revenue is showing a declining trend. On the contrary, the share of intergovernmental transfers in total revenue is increasing. The trend is in tandem with most

states in India except few states having bigger Corporations like Maharashtra and Gujarat. It raises aspersions on the integrity of urban local governments as independent institutions with financial sovereignty. Heavy reliance on intergovernmental transfers dilutes local governments' identity, particularly if the grants are tied with conditionalities. Recently municipalities have been burdened with more and more agency functions from state and central governments. It is counterproductive to the idea of fiscal decentralisation and local government empowerment.

Figure 4.12

OSR Vs. Inter-Governmental Transfers to Urban Loal Governments in Kerala (% of Total Municipal Revenues



Source: ICRIER, 2019

Municipal Borrowing

Borrowing hardly constitutes 1 percent of the total municipal receipt in Kerala. Surprisingly, Municipal Corporations are showing a more flawed track record in using the borrowing as the revenue source as compared to Municipalities. Borrowing has been registering negative growth

rate in successive years (SFC, 2015). At the national level, municipal borrowing accounts for 2 to 3 percent of total revenue (Ahluwalia, 2011). Apart from the traditional borrowing sources, urban local governments have not been utilised the potential of new avenues like capital markets, pooled finance and municipal bonds. Lack of good governance and proper revenue model is failing the urban governments in leveraging borrowing to raise resources to improve infrastructure and services.

Fiscal Decentralisation Indicators: Kerala Vs. Other States

In this section, we have ranked fiscal decentralisation to urban local governments in Kerala vis-à-vis other states in India. The selected indicators are Per Capita Total Municipal Revenue, Per Capita Own Source Revenue, Per Capita Property Tax, Per Capita State Transfer, Per Capita Total Central Transfer, Ratio of Own Revenue to Total Revenue, and Per Capita Expenditure. A comprehensive examination of the Table 4.13 gives us the size and nature of fiscal decentralisation in Kerala with the rest of the Indian states.

At per capita total municipal revenue, Kerala was ranked 8th among the 30 states in India. It shows the size and significance of fiscal decentralisation in the state. Given the state of the economy of Kerala, this is a remarkable achievement. Kerala has been ranked 14th in per capita own-source revenue and 12th in per capita property tax revenue. In terms of the ratio of own-source revenue to total revenue of ULGs, Kerala has been ranked 18th. The trend shows an undesirable state of internal resource mobilization in the Urban Local Governments in the state. In terms of per capita state transfers to urban local government, Kerala is ranked 5th among states. The same rank is also the case of per capita total transfers from the centre to ULGs.

In short, Kerala is one of the leading states in India in terms of transferring funds to urban local governments. It is the only state in India that accepts the SFC Reports and piously

implements the devolution recommendations to local governments. Kerala's fiscal decentralisation to urban local governments is a transfer-based model. The trend of declining on own-source revenue and the heavy dependence on transfers is not in the interest of prudent municipal finance of urban local governments. The transfers from state government and central government are not the substitutes for internal resource mobilization. OSR improves the fiscal autonomy and financial accountability of urban local governments.

Table 4.13

Kerala's Ranking in Fiscal Decentralisation to ULGs among Indian States

Indicators	Ranking of the Kerala in States in India
Per Capita Total Municipal Revenue	8
Per Capita Own Source Revenue	14
Per Capita Property Tax	12
Per Capita State Transfer	5
Per Capita Total Centre Transfer	5
Ratio of Own Revenue to Total Revenue	18
Per Capita Expenditure	11

Source: Authors' compilation

4.4. Municipal Expenditure: Composition, Magnitude and Trend

Expenditure of urban local governments are broadly classified into establishment expenditure, administrative expenditure, and operation and maintained expenditure. Annual plan

expenditure is the actual developmental expenditure incurred by the urban governments. The items coming under establishment expenditures are the salary of the staff and wages, traveling allowance of staff, honorarium, Travelling Allowance of Chairperson and other elected members of the Municipal Council, contribution to the pension fund, and other items. The administrative expenditure comprises rent on buildings, electricity charges of offices, office expenses, TA of Chairperson and elected representatives, expenses relating to transferred institutions, and other items. The operation and maintenance(O&M) expenditure comprises electricity charges for street lights, fuel charges of vehicles, water charges for street taps, repairs and maintenance, sanitation, and other items. The establishment expenditure is the single biggest expenditure component of ULGs. Establishment expenditure accounts for 35 percent of total expenditure. Administrative expenditure and Operation and Maintenance expenditure constitute two percent and five percent respectively. 13 percent goes into maintaining assets. Only 32 percent is left for the decentralised planning expenditure by the ULGs (SFC, 2015).

Municipal expenditure in Kerala has declined as the percent of GSDP from 0.48 in 2010-11 to 0.34 in 2017-18 (see Table 4.14). Kerala is ranked 11th in per capita municipal expenditure, while the state has been ranked 9th in urban population size. There is a significant expenditure deficit in the urban local governments in the state. Kerala's share of municipal expenditure is well below the national average of 0.77. This is a matter of concern. It is indicating a significant underfinancing by the urban local governments, especially in infra sectors. The ULGs are faced with huge backlog, current and growth needs. More than 75 percent of the total expenditure in the state is recorded as revenue expenditure. A realignment of expenditure is imperative to hike the share of capital and O&M expenditure in the state's total expenditure so as to enable cities to contribute as engines of growth.

At the national level, even though per capita municipal expenditure has increased, India spends \$50 per annum on cities; it is far behind China which spent \$362, South Africa which spent \$508, and the United Kingdom which spent \$1772 (Mckinsey, 2010). As Ahluwalia (2011) argued, India would need capital expenditure (excluding the land's cost) to the tune of Rs 31 lakh crore at 2009-10 prices to bridge the urban infrastructure deficit over the period 2012-31. Rs. 18 lakh crore at 2009-10 prices was estimated as the need for O&M expenditure. The per capita expenditure has marginally increased from Rs. 2216 in 2010-11 to Rs.2583 in 2017-18 with significant negative growth in between (see Table 4.15 and Figure 4.13).

Table 4.14

Municipal Expenditure as the Ratio of GSDP in Kerala

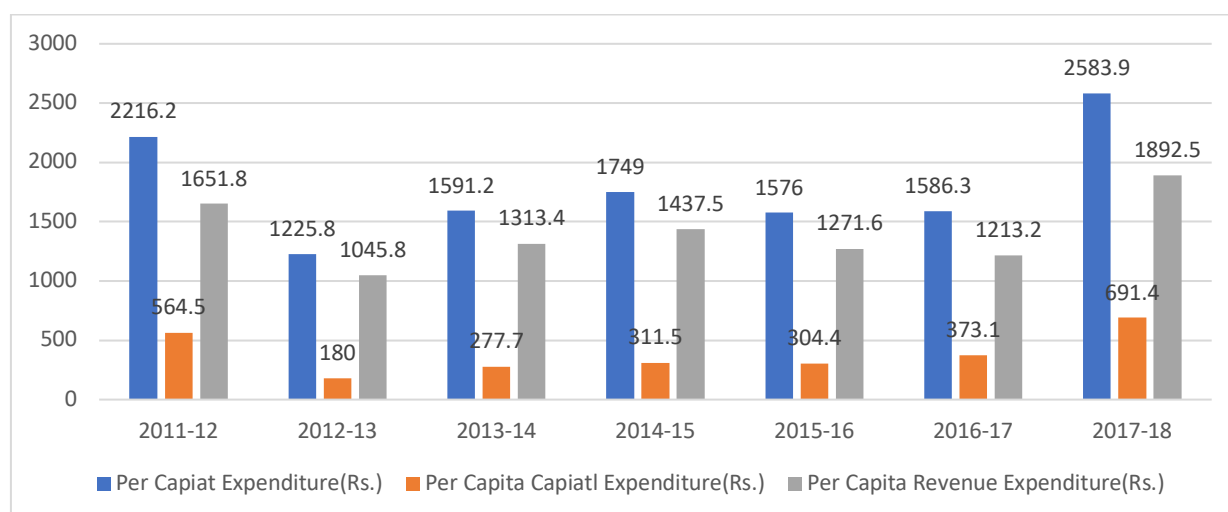
Year	Share of ULGs' Expenditure in GSDP
2010-11	0.478
2011-12	0.463
2012-13	0.235
2013-14	0.28
2014-15	0.29
2015-16	0.247
2016-17	0.233
2017-18	0.344

Source: ICRIER, 2019

Table 4.15*Total Municipal Expenditure, Revenue Expenditure and Capital Expenditure in Kerala*

Year	Total Expenditure (Rs. Crore)	Per Capita Expenditure (Rs.)	Capital Expenditure (Rs. Crore)	Per Capita Capital Expenditure (Rs.)	Revenue Expenditure (Rs. Crore)	Per Capita Revenue Expenditure (Rs.)
2010-11	1260.8		379.8		881	
2011-12	1685.1	2216.2	429.2	564.5	1255.9	1651.8
2012-13	966.9	1225.8	141.9	180	825	1045.8
2013-14	1302.4	1591.2	227.3	277.7	1075	1313.4
2014-15	1485.3	1749	264.5	311.5	1220.7	1437.5
2015-16	1388.6	1576	268.2	304.4	1120.4	1271.6
2016-17	1450.2	1586.3	341	373.1	1109.1	1213.2
2017-18	2450.8	2583.9	655.8	691.4	1795	1892.5

Source: ICRIER, 2019

Figure 4.13*Per Capita Municipal Expenditure, Per Capita Revenue and Per Capita Capital Expenditure in Kerala (Rs.)*

Revenue Gap Analysis – A Measure of Fiscal Health

The revenue gap is a measure of fiscal prudence of Local Governments. It measures to what extent OSR of ULGs are financing their expenditure. If not whole, the OSR is supposed to finance the establishment, maintenance and other related expenditure of urban local governments. The financial performance of ULGs can be measured using 'Revenue gap'. Revenue gap measures the difference or the gap between own-source revenue of LGs and its expenditure (a disaggregated data on the establishment, the administrative expenditure would have better served the analysis). The revenue gap measures how much the OSR of LGs is able to finance the expenditure of local governments. Table 4.17 demonstrates that ULGs are continuously witnessing huge revenue gaps throughout the period. The lack of periodical revision of taxes and non-tax items, laxity, and inefficiency in the collection are the primary reasons for the deficit.

Table 4.17

Revenue Gap Analysis

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Owns Source Revenue (A)	522.2	645.3	512.7	575.2	629.6	705.8	807.7	840.1
Total Expenditure (B)	1260.8	1685.1	966.9	1302.4	1485.3	1388.6	1450.2	2450.8
Revenue Gap (A-B)	-738.6	-1039.8	-454.2	-727.2	-855.7	-682.8	-642.5	-1610.7
Per ULG Revenue Gap	-11.36	-16.00	-6.99	-11.19	-13.16	-7.34	-6.91	-17.32

Source: ICRIER, 2019; Author

4.5. Disparities in Municipal Financing: An Econometric Analysis

OSR, grant, and expenditure are the three pillars of municipal finance. These are the three indispensable and mutually connected components of financing of urban local governments. A significant variation in OSR, grant and expenditure among the ULGs has been observed. Identifying the disparity would help to formulate the relevant policy to strengthen fiscal health of urban local governments. The variations cannot be explained by the decisions made at the local level alone, and the State and Central government's decisions are very relevant and critical (Bahl et al., 2010). Explaining the variations in OSR, grants and expenditure is important to formulate relevant policies and strategies on resource mobilization, intergovernmental transfers, and spending by the Urban Local Governments. It is crucial to identify the variable that influences OSR, grant, and expenditure of ULGs. Besides, any change in one variable/component will impact how the revenue responds to the change in expenditure, how expenditure explains revenue, how grants complement and substitute each other. It is important to understand how grant/transfers influence OSR through the crowding in and crowding out of internal resource mobilization and how grants play out in terms of incentivizing/disincentivizing the revenue generation for designing the policies for prudent municipal finance.

Data and Methodology

The database for this analysis is sourced from the Information Kerala Mission (IKM), a computerization initiative under the Local Self Government Department, Government of Kerala, various State Finance Commission Reports, various budget documents of the Government of Kerala, Census Report, Government of India, State Election Commission Websites and other relevant portals.

Multiple linear regression (MLR) was estimated, taking OSR, grant, and expenditure as the dependent variable. Apart from estimating the interactions among these dependent variables, population, literacy rate, SC/ST population percentage, and the proportion of marginal workers are considered independent/ explanatory variables. Data for these variables are collected from the Census of India 2011. BPL household data are collected from State Finance Commission Reports.

Data on own-source revenue and expenditure were collected from Information Kerala Mission (IKM) - the local self-government data in Kerala. Grant amounts are juxtaposed from the budget documents of the concerned period. Data on political affiliation, which party rules each ULB was collected from the State Election Commission website. The analysis is done separately for 2012 and 2016 to distinguish the two years. Furthermore, 2012 and 2016 were taken together to get the combined effects of the studied variables. We could accommodate more meaningful variables in 2016 than the previous year because, unlike previous Finance Commission Reports, the fifth State Finance Commission Report provided much more data on the financial indicators.

A panel data estimation was done for all three dependent variables OSR, grant, and expenditure. In addition to estimating association among them, population, percentage of SC/ST, and BPL households were considered. A political affiliation dummy was used to control the party influences on the dependent variable. A fixed-effect model was estimated with ULB and district dummies. Another panel data regression in the whole sample year was carried out with a fixed-effect model with a year dummy. A comprehensive estimation was made with data obtained from large number of observations.

Variables:

OSR/Revenue

OSR is the dependent variable. To explain the variations in own-source revenue, we estimate ordinary least squares for urban local bodies, where OSR is the dependent variable and the independent variables are explained below.

- *Population size* is expected to have a positive association with the revenue generation of local governments. There would be a greater economic activity, i.e., population agglomeration suggests greater taxable capacity. A ULG receiving inadequate intergovernmental transfers may increase the demand for internal resource mobilization. Alternatively, there could be a case of the complete opposite if there is a proportionate decreasing return or the case of economies of size at the expenditure side and at the margin; it may reduce the demand for OSR.
- *Percent of literacy rate* suggests a higher taxable capacity. It is based on two premises. A literate brings higher productivity and higher wages which increases the tax capacity. Secondly, arguably, a literate person will have more willingness to pay taxes. Thus, it is expected to have a positive relationship with the revenue generation of municipalities.
- *Percentage of scheduled caste and tribe* suggests a concentration of poor households and less taxable capacity. We expect a negative relationship between the SC/ST population with per capita OSR. Another supporting argument is that a higher proportion of the SC/ST population will attract more intergovernmental transfers, which will, in turn, reduce the demand for resource mobilization.
- *The proportion of marginal workers* is a manifestation of a less robust economy. A higher proportion of marginal workers indicates a less taxable capacity of the ULBs.
- *No. of BPL households*, below the poverty line (BPL) is a widely accepted measurement of poverty. It is the household-based measurement of poverty based on the household's threshold income/ calorie intake. We expect that the higher the number of BPL households, the lower the

municipalities' taxable capacity, hence a negative relation between the OSR and the number of BPL households.

- *Political affiliation* has been taken to account as a dummy variable, 1 for the local bodies whose ruling party/ coalition is the same as the states' ruling party and 0 if the ruling party at state government and ULG's were different.
- *ULB and district effect*, fixed effect models are used using the dummy variables for the corporation, district, ULBs, and location. The dummy variables are expected to measure or consider the externalities, economies of scale, agglomeration, administrative efficiency, and infrastructure availability effects.
- *Corporation*, the dummy variable used 1 for the six municipal corporations and 0 for non-municipal corporation ULBs. Location, the dummy variable, accounts for bigger urban local bodies in terms of fiscal size. The municipalities in district headquarters are given 1 and 0 for the others. It is to measure the immeasurable like agglomeration and economies of scale. Besides, in the 2016 OLS estimation, the variable area and average resources are included.
- *Area* is generally expected to affect economic activity levels and agglomeration positively. A more geographical area means more space for greater economic activities. In that case, more geographical area leads to higher taxable capacity. It may not always be true, and it has to do with the area's economies/diseconomies and externalities.
- *Avg. resource* variable gives us the average monetized value of endowments of local governments. It provides a proxy of the assets/wealth of the ULGs. We expect a positive relationship between the per capita OSR and the average resources of Municipalities. Fifth ,SFC has calculated it.

Model: 1.1

$$\ln OSR = \alpha + \beta_0 \ln grant + \beta_1 \ln expenditure + \beta_2 \ln population + \beta_3 scst + \beta_4 literacy + \beta_5 marginalworkers + D_1 corp_i + D_2 political_i + D_3 location_i + \varepsilon_{it}$$

Table 4.18

Model .1: OLS Estimation of Determinants of Variations in Own Source Revenue:2012

VARIABLES	Log OSR	Log OSR
Log grant	0.977*** (0.116)	0.964*** (0.168)
Log population	-0.106 (0.152)	-0.129 (0.145)
Log percent of SC/ST population	-0.0125 (0.0238)	-0.0106 (0.0161)
Log literacy rate	0.00816 (0.0181)	0.0194 (0.0208)
Log percent of marginal workers	0.00101 (0.0162)	-0.00627 (0.0150)
Log number of BPL population	-0.0211 (0.150)	0.0115 (0.0992)
Corporation dummy	1.560*** (0.218)	1.527*** (0.345)
Political dummy	0.235* (0.128)	0.0560 (0.147)
Location dummy	0.227	0.400**

	(0.239)	(0.182)
Constant	8.008*** (2.313)	7.207** (2.826)
District dummy	No	Yes
Observations	62	62
R-squared	0.799	0.888

Note: Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

Model 1.2

$$\ln \text{revenue} = \alpha + \beta_0 \ln \text{grant} + \beta_1 \ln \text{expenditure} + \beta_2 \ln \text{population} + \beta_3 \text{scst} + \beta_4 \text{literacy} + \beta_5 \ln \text{bpl} + \beta_6 \ln \text{area} \ln \text{population} + D_1 \text{corp}_i + D_2 \text{political}_i + D_3 \text{location}_i + \varepsilon_{it}$$

Table 4.19

Model 1.2: OLS Estimation of Determination of variations in OSR of ULGs for the year 2016

VARIABLES	Log OSR	Log OSR
Log grant	-0.896 (0.541)	-0.464 (0.386)
Log population	2.065** (0.814)	1.091 (0.616)
Log percent of SC/ST population	0.0262 (0.0366)	0.0410 (0.0677)
Log number BPL population	-0.0818 (0.232)	-0.0531 (0.242)
Log area	-0.0202**	-0.0153*

	(0.00814)	(0.00855)
Log resources	0.000316** (0.000156)	0.000342* (0.000175)
Corporation dummy	-0.0277 (0.756)	0.444 (0.970)
Political dummy	0.646* (0.372)	0.411 (0.355)
Location dummy	0.652 (0.454)	1.005 (0.619)
Constant	5.218 (4.749)	10.86** (4.653)
District dummy	No	Yes
Observations	93	93
R-squared	0.289	0.401

Note: Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

Model 1.3

$$\ln revenue_{it} = \alpha_0 + \beta_1 \ln expenditure_{it} + \beta_2 grant_{it} + \beta_3 \ln population_{it} + \beta_4 scst_{it} + \beta_5 \ln bpl_{it} +$$

$$D1pol_{it} + \varepsilon_{it}$$

Table 4.20

Model 1.3: OLS Estimation of Determinants of Variations in OSR for the Year 2012 & 2016

VARIABLES	Log OSR	Log OSR	Log OSR	Log OSR
Log grant	0.104	0.124	0.200	0.0904

	(0.267)	(0.261)	(0.200)	(0.0757)
Log population	0.338 (0.244)	0.254 (0.226)	0.143 (0.167)	0.0530 (0.112)
Per cent of SC/ST	0.00531 (0.0233)	0.000278 (0.0229)	0.0144 (0.0304)	-0.0120 (0.0150)
Log BPL	-0.208 (0.202)	-0.170 (0.193)	-0.133 (0.155)	-0.119 (0.130)
Corporation dummy	1.927*** (0.367)	1.974*** (0.382)	1.725*** (0.421)	4.055*** (0.289)
Political dummy	0.241 (0.204)	0.285 (0.212)	0.216 (0.200)	0.0103 (0.0871)
Location dummy	0.504 (0.313)	0.552* (0.305)	0.823** (0.364)	1.589*** (0.503)
Constant	14.51*** (1.927)	15.07*** (2.012)	14.07*** (2.134)	16.02*** (0.941)
Year dummy	No	Yes	Yes	Yes
District dummy	No	No	Yes	Yes
ULB dummy	No	No	No	Yes
Observations	155	155	155	155
R-squared	0.217	0.234	0.382	0.985

Note: Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

The grant received by the ULGs was a significant and positive factor that determined the variations in OSR in the OLS multivariate estimation for 2012. The population showed a negative relationship as against hypothesis; this might be due to diseconomies arising out of

larger population, though it is not statistically significant. The percentage of the SC/ST population and literacy rates showed the expected results, but those were statistically insignificant.

The population is positive and significant in 2016, which coexists with the previous analysis of OSR and the local government population. The location and corporation variables hold significance throughout the period - showing the importance of the two variables. The variable showing the significance and negative sign indicates the diseconomies and highlights that the smaller the ULGs in geographical size better it would be. The variable resources being significant implies the importance of endowments and assets in internal revenue generation. Even though the percentage of SC/ST and marginal workers hold a negative relationship as expected, those were not statistically significant. Literacy wasn't a statically significant factor in explaining variations in OSR.

2016 OLS estimation and 2012 and 2016 estimations dismiss the apprehension of crowding out of resource generation due to the intergovernmental transfers. Rather these two analyses show another way around, i.e., transferring of grants provides incentives to OSR generation.

Grant

Intergovernmental transfers are the lifeblood of local self-governments. The very design of finance of urban local governments is dependent on the higher governments, especially state governments. A well-tailored grant system is an essential component of fiscal decentralization. In the following section, we will run an OLS regression to see the factors that explaining the government transfers to ULBs. The following are the explanatory variable in the regression.

- *Population size*, a negative relationship is expected. While devolving the fund to Municipalities and Municipal Corporations size of the municipalities in terms of population is a significant

factor. The higher the number of residents, the greater the demand for spending, which accentuating government transfers.

- *The literacy rate* shows the overall socio-economic development of the ULBs. It might negatively impact the per capita grant received by the ULGs because higher literacy indicates less concentration of poverty and higher well-being.
- *The Percentage of scheduled caste and tribe* is used to indicate the concentration of poor households. We expect to increase transfers from the government with economic vulnerabilities, i.e., consistent with distributive ideas and equalization motives of the governance. A positive association between intergovernmental transfers and the percentage of SC/ST is expected.
- *The Percentage of marginal workers* is an indication of a weak economy. A higher proportion of marginal workers calls for safety net programs from the government. Hence a positive relationship is expected between the percentage of marginal workers and per capita grant.
- *Political affiliation* has been taken to account as a dummy variable, 1 for the local bodies whose ruling party/ coalition is the same as the state's ruling party and 0 if the ruling party at state government and ULG's were different.
- *Corporation*, the dummy variable used 1 for the six municipal corporations and 0 for non-municipal corporation ULBs. Location, the dummy variable, accounts for bigger urban local bodies in terms of fiscal size. The municipalities in district headquarters are given 1 and 0 for the others. It is to measure the immeasurable like agglomeration and economies of scale.
- *No. of BPL households*, below the poverty line (BPL) is a widely accepted measurement of poverty. It is the household-based measurement of poverty based on the household's threshold income/ calorie intake of the household. We expect that the higher the number of BPL households, the more proactive government measures are required, which demand more

government transfers. Hence a positive relationship between the per capita grant and the number of BPL households is expected.

- *ULB and district effect*, fixed effect models are used using the dummy variables for the corporation, district, ULBs, and location. These dummy variables are expected to measure the externalities like economies of scale, agglomeration, administrative efficiency, and infrastructure availability. In addition, the variables area and average resources (avg resource) were added in the analysis of the year 2016.
- *Area* is generally expected to affect economic activity levels and agglomeration positively. A more geographical area means more space for greater economic activities. In that case, more geographical area leads to higher taxable capacity. It may not always be true with the area's economies/diseconomies and externalities.
- *Avg resource* is the measure of the average monetized value of endowments of concerned local bodies. The fifth state finance commission calculated it for the distribution. We expect a positive relationship between the per capita OSR and the average resources of Municipalities.

Model 2.1

$$\begin{aligned} \ln \text{ grant} = & \alpha + \beta_0 \ln \text{ OSR} + \beta_1 \ln \text{ expenditure} + \beta_2 \ln \text{ population} + \beta_3 \text{ scst} + \beta_4 \text{ literacy} + \beta_5 \ln \text{ bpl} + \\ & + \beta_6 \ln \text{ area} + D_1 \text{ corp}_i + D_2 \text{ political}_i + D_3 \text{ location}_i + \varepsilon_{it} \end{aligned}$$

Table 4.21

Model 2.1: OLS Estimation of Determinants of Variations in Grant Received by ULGs for the Year 2012

VARIABLES	Log grant	Log grant	Log grant	Log grant
Log revenue	0.499*** (0.0773)	0.588*** (0.0727)	0.428*** (0.0831)	0.452*** (0.0660)
Log expenditure			0.160*	0.297***

			(0.0879)	(0.0967)
Log population	0.0361 (0.0969)	0.167 (0.106)	0.0299 (0.0949)	0.210** (0.0956)
Percent of SC/ST population	0.00404 (0.0146)	0.00356 (0.0141)	0.000753 (0.0135)	-0.00117 (0.0124)
Log BPL	0.0478 (0.0784)	0.0115 (0.0602)	0.0435 (0.0760)	-0.0166 (0.0548)
Corporation dummy	-0.284 (0.314)	-0.518 (0.356)	-0.449 (0.315)	-0.758** (0.337)
Political dummy	-0.195* (0.102)	0.000425 (0.136)	-0.137 (0.127)	0.131 (0.132)
Location dummy	0.0314 (0.139)	-0.131 (0.137)	0.0201 (0.139)	-0.222 (0.142)
Literacy rate	-0.000794 (0.0119)	-0.0135 (0.0139)	0.0102 (0.0115)	-0.00811 (0.0132)
Log of marginal workers	-0.00353 (0.0111)	0.0107 (0.0140)	-0.00263 (0.0110)	0.0157 (0.0115)
Constant	0.930 (1.674)	-0.749 (1.770)	0.187 (1.556)	-1.864 (1.927)
District dummy	No	Yes	No	Yes
Observations	62	62	62	62
R-squared	0.695	0.797	0.719	0.841

Note: Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

Model 2.2

$$\ln grant = \alpha + \beta_0 \ln OSR + \beta_1 \ln expenditure + \beta_2 \ln population + \beta_3 scst + \beta_4 literacy + \beta_5 \ln bpl + \beta_6 \ln area + D_1 corp_i + D_2 political_i + D_3 location_i + \varepsilon_{it}$$

Table 4.22

Model 2.2: OLS estimation of determinants of variations in grant received by ULGs for the year 2016

VARIABLES	Log grant	Log grant	Log grant	Log grant
Log revenue	-0.0702*** (0.0217)	-0.0314 (0.0198)	-0.0495** (0.0215)	-0.0234 (0.0182)
Log expenditure			0.360*** (0.112)	0.312** (0.121)
Log population	0.934*** (0.179)	0.996*** (0.155)	0.660*** (0.201)	0.741*** (0.203)
Percent of SC/ST	0.00467 (0.0108)	-0.0226* (0.0134)	-0.00134 (0.00983)	-0.0281** (0.0125)
Log BPL	0.168 (0.117)	0.121 (0.0803)	0.112 (0.105)	0.0612 (0.0757)
Corporation dummy	-0.332 (0.245)	-0.496* (0.264)	-0.229 (0.247)	-0.378 (0.281)
Political dummy	0.127 (0.0968)	0.0192 (0.126)	0.0770 (0.0912)	-0.0210 (0.126)
Location dummy	0.248 (0.241)	0.141 (0.200)	0.196 (0.248)	0.110 (0.211)
Log area	-0.000848 (0.00245)	-0.00149 (0.00215)	-0.000706 (0.00225)	-0.00158 (0.00204)
Log resources	7.65e-05 (4.87e-05)	7.06e-05 (6.71e-05)	5.00e-05 (4.19e-05)	6.65e-05 (6.37e-05)

Constant	-0.207 (1.433)	-0.330 (1.587)	0.210 (1.540)	0.557 (1.785)
District dummy	No	Yes	No	Yes
Observations	93	93	93	93
R-squared	0.780	0.840	0.805	0.855

Note: Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

Model 2.3

$$\ln expenditure = \alpha + \beta_0 \ln grant_{it} + \beta_1 \ln revenue_{it} + \beta_2 \ln population_{it} + \beta_3 \ln scst_{it} + \beta_4 \ln$$

$$bpl_{it} + D_1 corp_i + D_2 political_1 + D_3 location_1 + \varepsilon_{it}$$

Table 4.23

Model 2.3: OLS estimation of determinants variations in Grant received by ULGs in the year

2012 & 2016

VARIABLES	Log grant	Log grant	Log grant	Log grant	Log grant	Log grant	Log grant	Log grant	Log grant
Log OSR	0.0157 (0.0453)	0.0192 (0.0456)		-0.00194 (0.0368)	0.00923 (0.0347)	0.0334 (0.0404)	0.0178 (0.0314)	0.151 (0.192)	0.152 (0.207)
Log expenditure			0.367*** (0.0638)	0.370*** (0.0648)	0.461*** (0.0766)		0.447*** (0.0845)		-0.00259 (0.158)
Log population	0.275** (0.132)	0.286** (0.136)	0.161 (0.112)	0.160 (0.113)	0.183 (0.112)	0.298** (0.118)	0.225** (0.100)	0.0220 (0.0973)	0.0220 (0.0985)
Per cent of SC/ST	-0.00249 (0.00955)	-0.00170 (0.00947)	-0.0101 (0.00876)	-0.0104 (0.00880)	-0.00881 (0.00812)	-0.00500 (0.0114)	-0.00674 (0.0110)	0.0126 (0.0226)	0.0126 (0.0225)
Log BPL	0.153* (0.0805)	0.147* (0.0807)	0.134* (0.0705)	0.135* (0.0709)	0.104 (0.0671)	0.178** (0.0718)	0.110* (0.0652)	0.234 (0.141)	0.234* (0.136)
Corporation	1.068***	1.050***	0.553**	0.554*	0.348	0.860**	0.253	2.343**	3.897

dummy	(0.327)	(0.326)	(0.276)	(0.286)	(0.301)	(0.332)	(0.299)	(1.161)	(2.380)
Political dummy	0.00157 (0.0916)	-0.00620 (0.0892)	0.0792 (0.0880)	0.0770 (0.0863)	0.0602 (0.0826)	0.00629 (0.0932)	0.0731 (0.0887)	0.0453 (0.132)	0.0450 (0.139)
Location dummy	0.160 (0.189)	0.151 (0.193)	0.131 (0.176)	0.133 (0.180)	0.0818 (0.189)	0.215 (0.183)	0.0828 (0.185)	-0.864 (0.949)	-0.868 (1.056)
Constant	5.648*** (1.378)	5.488*** (1.441)	4.647*** (1.005)	4.668*** (1.148)	3.706*** (1.225)	4.266*** (1.305)	2.743** (1.167)	5.872* (3.172)	4.944 (3.317)
Year dummy	No	Yes	No	No	Yes	Yes	Yes	Yes	Yes
ULB dummy	No	No	No	No	No	No	No	Yes	Yes
District dummy	No	No	No	No	No	Yes	Yes	Yes	Yes
Observations	155	155	156	155	155	155	155	155	155
R-squared	0.547	0.549	0.631	0.632	0.660	0.607	0.687	0.905	0.905

Note: Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

The population size holds significance in the 2012 and 2016 OLS estimations. It is going with the conventional wisdom; the population was the most important factor every State Finance Commission factored in a while transferring funds to the local governments. The percentage of SC/ST was significant and negative in 2016, which indicates the equalization nature of grants in terms of the social welfare of the communities. The number of BPL households is a significant factor as far as grant distribution is concerned as per the 2012 and 2016 OLS estimation. The percentage of literacy and percentage of marginal workers were not registered statistical significance. While revenue shows an inconsistent association in 2012, 2016 individually, and combined 2012 and 2016 OLS, the expenditure registered statistical significance and positive signs. That signifies that an increase in expenditure is positively reflected in the distribution of the grant. The corporation dummy is a statistically significant variable in the determinates of variations of the grant received by ULGs. The political factor

has not been registered as significant; it shows that political affiliation was not considered in the state government grants to the ULGs.

Expenditure

The expenditure is the local governments' cost to discharge their mandatory civic functions and other developmental activities. The distribution of transfers and variations in the internal resource generation has led to discrepancies in the spending of ULGs. The size and pattern of the expenditure have direct implications on the welfare of residents. In this section, we have run an OLS regression to explain the local bodies' spending disparities. Expenditure is the dependent variable; independent variables are explained below.

- *Population size* should be negatively associated with per capita spending. It is because the fixed cost effect weighs heavily on the budgets of smaller ULBs.
- *The literacy rate* could indicate a greater willingness to pay for the services, a greater capacity to deliver services and attract more transfers. So, the literacy rate on per capita expenditure will be a positive relationship.
- *The percentage of scheduled caste and tribe:* poor households concentration calls for greater welfare measures, and intergovernmental transfer flows more to where poor households concentrate.
- *No. households below the poverty line (BPL)* is a widely accepted measurement of poverty. It is the household-based measurement of poverty based on the household's threshold income/calorie intake expect that the higher the number of BPL households, the more proactive government measures are required, in turn, demanding more transfers from the government; hence a positive relationship between the per capita grant and the number of BPL households is expected.

- *Percentage of marginal workers* is an indication of a weak economy. Higher the proportion of marginal workers call for safety nets programs from the government. Hence a positive relationship is expected between the percentage of marginal workers and per capita grant.
- *Political affiliation* has been taken to account as a dummy variable, 1 for the local bodies whose ruling party coalition is the same as the states' ruling party and 0 if the ruling party at state government and ULG's were different. This will tell us whether there is any pattern of spending based on the color of the ruling government.
- *Corporation* dummy variable used as 1 for the six municipal corporations and 0 for non-municipal corporation ULBs. Location dummy variable accounts for bigger urban local bodies in terms of fiscal size. The municipalities in district headquarters are given 1 and 0 for the others. It is to measure the immeasurable like agglomeration and economies of scale.
- *ULG and district effect*: fixed effect models are used by using the dummy variables for district and ULG. The dummy variables are expected to measure the externalities, economies of scale, agglomeration, administrative efficiency, and infrastructure availability.

Model 3.1

$$\ln \text{ expenditure} = \alpha + \beta_0 \ln \text{ grant} + \beta_1 \ln \text{ revenue} + \beta_2 \ln \text{ population} + \beta_3 \text{ scst} + \beta_4 \text{ literacy} + \beta_5 \text{ marginal workers} + D_1 \text{ corp}_i + D_2 \text{ political}_i + D_3 \text{ location}_i + \varepsilon_{it}$$

Table 4.24

Model 3.1: OLS estimation of determinants of variations in Expenditure incurred by ULGs in the year 2012

	Log expenditure	Log expenditure
Log grant	0.491**	0.729***

	(0.244)	(0.175)
Log OSR	0.196 (0.159)	0.0298 (0.165)
Log population	0.0208 (0.157)	-0.266* (0.143)
Per cent of SC/ST	0.0185 (0.0195)	0.0133 (0.0146)
Log BPL	0.00320 (0.0806)	0.0860 (0.0850)
Corporation dummy	1.170*** (0.374)	1.186*** (0.413)
Political dummy	-0.268 (0.172)	-0.440*** (0.146)
Location dummy	0.0549 (0.267)	0.402* (0.210)
Literacy rate	-0.0682*** (0.0250)	-0.00827 (0.0245)
Log no of marginal workers	-0.00390 (0.0137)	-0.0247* (0.0133)
Constant	4.172 (3.034)	2.197 (3.468)
District dummy	No	Yes
Observations	62	62
R-squared	0.684	0.857

Note: Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

Model 3.2

$$\begin{aligned} \ln \text{ expenditure} = & \alpha + \beta_0 \ln \text{ grant} + \beta_1 \ln \text{ expenditure} + \beta_2 \ln \text{ population} + \beta_3 \text{ scst} + \beta_4 \\ & \text{literacy} + \beta_5 \ln \text{ bpl} + \beta_6 \ln \text{ area} + D_1 \text{ corp}_i + D_2 \text{ political}_i + D_3 \text{ location}_i + \end{aligned}$$

Table 4.25

Model 3.2: OLS Estimation of Determents Variations in Total Expenditure in the Year 2016

VARIABLES	Log expenditure	Log expenditure
Log revenue	-0.0348 (0.0251)	-0.0158 (0.0231)
Log grant	0.323** (0.157)	0.314* (0.159)
Log population	0.461** (0.181)	0.502** (0.223)
Per cent of SC/ST	0.0152 (0.0109)	0.0248* (0.0133)
Log BPL	0.100** (0.0433)	0.154** (0.0607)
Corporation dummy	-0.178 (0.257)	-0.225 (0.254)
Political dummy	0.0987 (0.0850)	0.123 (0.102)
Location dummy	0.0645 (0.171)	0.0551 (0.179)
Log area	-0.000121	0.000735

	(0.00255)	(0.00322)
Log resources	4.88e-05 (4.90e-05)	-9.01e-06 (6.22e-05)
Constant	-1.090 (1.385)	-2.734 (1.888)
District dummy	No	Yes
Observations	93	93
R-squared	0.767	0.806

Note: Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

Table 4.26

Model 3.2: OLS Estimation of Expenditure: 2012 & 2016

	Log expenditure	Log expenditure	Log expenditure	Log expenditure
Log grant	0.505*** (0.103)	0.534*** (0.116)	0.460*** (0.114)	-0.00182 (0.110)
Log revenue	0.0398 (0.0255)	0.0113 (0.0250)	0.0196 (0.0299)	0.155 (0.169)
Log population	0.171 (0.109)	0.0718 (0.110)	0.0258 (0.100)	-0.00473 (0.0914)
Per cent of SC/ST	0.0227** (0.0108)	0.0163* (0.00893)	0.00618 (0.0116)	-0.00388 (0.0111)
Log BPL	-0.0279 (0.0666)	0.0144 (0.0523)	0.0707 (0.0605)	-0.104 (0.103)

Corporation dummy	0.848*** (0.235)	0.964*** (0.260)	0.962*** (0.254)	4.222** (1.849)
Political dummy	-0.205** (0.0921)	-0.141 (0.0860)	-0.152* (0.0857)	-0.0815 (0.0976)
Location dummy	-0.00730 (0.141)	0.0689 (0.140)	0.197 (0.139)	-1.248 (0.950)
Constant	-0.205 (1.037)	0.938 (0.928)	1.447 (0.927)	5.846** (2.897)
Year dummy	No	Yes	Yes	Yes
District dummy	No	No	Yes	Yes
ULB dummy	No	No	No	Yes
Observations	155	155	155	155
R-squared	0.594	0.681	0.740	0.946

Note: Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

The percentage of SC/ST, the number of BPL households is significant in the 2016 OLS estimation. In 2012, the population was significant and negative, as we have hypothesized. The literacy rate was also significant in the 2012 analysis. Expenditure is responding positively to the grant throughout the analysis.

Panel Data Estimation

Given the kind of data and limitations of OLS estimation, a panel data analysis would give a more nuanced picture of the relationship among dependent variables and respective independent variables. Panel data analysis with the above explanatory variable was done for

the years 2012 and 2016. It is first of a kind in the analysis of ULG financing. The following are the models specified for the panel data estimation.

Model 4.1

$$\ln OSR_{it} = \alpha_0 + \beta_1 \ln expenditure_{it} + \beta_2 grant_{it} + \beta_3 \ln population_{it} + \beta_4 scst_{it} + \beta_5 \ln bpl_{it} + D_{ipol_{it}} + \varepsilon_{it}$$

Model 4.2

$$\ln grant_{it} = \alpha_0 + \beta_1 \ln expenditure_{it} + \beta_2 revenue_{it} + \beta_3 \ln population_{it} + \beta_4 scst_{it} + \beta_5 \ln bpl_{it} + D_{ipol_{it}} + \varepsilon_{it}$$

Model 4.3

$$\ln expenditure_{it} = \alpha_0 + \beta_1 \ln grant_{it} + \beta_2 revenue_{it} + \beta_3 \ln population_{it} + \beta_4 scst_{it} + \beta_5 \ln bpl_{it} + D_{ipol_{it}} + \varepsilon_{it}$$

Table 4.27

Panel data Analysis for the Year 2012 & 2016

VARIABLES	Log Expenditure	Log OSR	Log Grant	Log Grant
Log expenditure				0.166* (0.0848)
Log OSR	0.793** (0.326)		0.367* (0.191)	0.220 (0.213)
Log grant	0.251 (0.201)	0.283*** (0.0553)		
Log population	0.127 (0.108)	0.156* (0.0915)	0.0659 (0.0841)	0.0419 (0.0802)

Per cent of SC/ST	0.0105 (0.0150)	-0.00777 (0.0157)	0.0182 (0.0200)	0.0157 (0.0211)
Log BPL	-0.206* (0.120)	-0.230** (0.114)	0.220* (0.119)	0.246** (0.119)
POL	-0.161 (0.129)	-0.0352 (0.0860)	0.0234 (0.118)	0.0493 (0.122)
Constant	-8.995* (4.669)	15.31*** (0.886)	0.989 (3.654)	2.445 (3.777)
Observations	155	155	155	155
R-squared	0.395	0.157	0.225	0.257
Number of id	93	93	93	93

Note: Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

Panel Data Estimation for Whole Sample Year

A comprehensive panel data analysis has been done, taking the year as a fixed effect variable. This section examines the fiscal interaction between OSR, grants, and expenditure. Political affiliation was incorporated as the dummy variable. The year effect has been included in the model.

Model 5.1

$$\ln grant_{it} = \alpha_0 + \beta_1 \ln expenditure_{it} + \beta_2 revenue_{it} + D_{ipol_{it}} + \lambda_t + \varepsilon_{it}$$

Model 5.2

$$\ln OSR_{it} = \alpha_0 + \beta_1 \ln expenditure_{it} + \beta_2 grant_{it} + D_{ipol_{it}} + \lambda_t + \varepsilon_{it}$$

Model 5.3

$$\ln expenditure_{it} = \alpha_0 + \beta_1 \ln grant_{it} + \beta_2 revenue_{it} D_{ipol_{it}} + \lambda_i + \varepsilon_{it}$$

Table 4.28

Panel Data Estimation of Whole Sample Year

VARIABLES	Log OSR	Log OSR	Log expenditure	Log expenditure	Log grant	Log grant	Log grant	Log grant
Log grant	0.334*** (0.0410)	0.0530 (0.0333)	0.566*** (0.211)	-0.127 (0.137)				
Log OSR			1.423*** (0.346)	0.350 (0.257)	0.611*** (0.0873)	0.0683 (0.0628)	0.0693 (0.0631)	0.573*** (0.0923)
Log expenditure							-0.00276 (0.00322)	0.0218*** (0.00590)
Political dummy	-0.0584 (0.0426)	-0.0167 (0.0342)	-0.204 (0.174)	-0.174 (0.152)	-0.000952 (0.0500)	0.0127 (0.0376)	0.0122 (0.0377)	0.00350 (0.0493)
Constant	14.50*** (0.439)	17.73*** (0.357)	-23.68*** (6.348)	4.445 (4.737)	-0.375 (1.579)	9.703*** (1.144)	9.712*** (1.142)	0.145 (1.635)
Year dummy	No	Yes	No	Yes	No	Yes	Yes	No
Observations	524	524	524	524	524	524	524	524
R-squared	0.213	0.444	0.093	0.190	0.206	0.605	0.605	0.216
Number of id	93	93	93	93	93	93	93	93

Note: Robust standard errors in parentheses *** p<0.01, ** p<0.05, * p<0.1

In the panel data analysis, apart from the mutual relationship among OSR, grant, and expenditure, only a statistically significant variable was BPL households. Political affiliation does not register any significance, which reassures that Kerala has been following a fair decentralization without falling into political bias to a great extent. Panel data estimation of the whole sample year was a more extensive exercise to analyze the data.

4.6. Conclusion

Municipal revenue as a proportion of GSDP accounts for 0.51 percent while it was one percent of GDP at the national level in 2017-18. As a proportion of GSDP, it hardly accounted for 0.20

percent in 2017-18. In this chapter, we have extensively looked into the fiscal structure of urban local governments. The chapter broadly deals with OSR, state and central government transfers and local government expenditures.

OSR is the real account of fiscal decentralisation. It has directly to do with fiscal autonomy and the financial independence of the local governments. Own-source revenue as the percent of total revenue is showing a declining trend. At the same time, the share of intergovernmental transfers in total revenue is widening. The trend shows an undesirable state of internal resource mobilization in the Urban Local Governments in the state. Property tax accounts for more than 50% of tax revenue. It is a buoyant tax too. However, it has been a decade since the property tax rate was revised, and there is a huge revenue loss in terms of arrears, contributing to the deplorable tax collection state. The share of Non-tax revenue in total revenue declined to 36.9 percent in 2017-18 from 45.8 percent in 2010-11. There is a high potential to raise the non-tax revenues of ULGs further by rationalizing rent, charges, and cost of other services. Presently ULGs have a poor record on the recovery of the cost of services. The rate of most of the items remained unchanged for a decade or two. As a result, only a fraction of the potential rents, fees, and user charges are collected. Overall, the OSR generation of urban local governments could be more satisfactory.

Borrowing hardly constitutes one percent of Kerala's total receipt of municipal finance. Lack of good governance and a proper revenue model prevents urban governments from leveraging borrowing to raise municipal finance.

The primary role of transfers is to supplement urban local governments' own-source resources and reduce vertical and horizontal imbalances. Transfer /devolution is the lifeblood of fiscal decentralisation. A sound transfer system will be adequate in size, regular in time, and predictable in nature with the least conditionalities attached. State Government transfers account for 71 percent of total transfers of urban local governments in Kerala. Per capita, state

transfer to urban local government in Kerala is one of the topmost in the country. On average state transfers 25% of its planned expenditure to local self-government. As a percent of OSTR, the state devolves around 16 percent on average. The national average per capita state transfer is Rs. 1496, while Kerala's per capita state transfer was Rs 2073 in 2017-18. Per capita, the CFC grant of urban local governments was Rs.534.2 in 2017-18. Kerala is the 5th top receiver of CFC grants from the central government. All India, the per capita CFC grant is only Rs. 331.9. Moreover, there are transfers from central governments in addition to CFC grants. ULGs receive revenue for agency functions like welfare pension and CSS. ULGs contribute only 35 % of total revenue from own-source revenue. State government contributes roughly 40 % of total revenue; transfers, including UFC, add up to 50%, and the rest are CSS and welfare pensions.

Heavy dependence on intergovernmental transfers dilutes local governments' identity, particularly if they are tied with conditionalities. There is a growing trend of burdening municipalities with more agency functions of state and central governments. On the other hand, the ratio of own-source revenue to total revenue of ULGs of Kerala has been ranked 18th. At the same time, per capita, state transfers to urban local government are ranked 5th all over India. Per capita, total transfers from the centre are also ranked the same. It signifies that Kerala is one of the leading states in India in terms of transferring funds to urban local governments. Kerala is the only state in India that accepts the SFC Reports, and regimentally implements devolution recommendations to local governments. Kerala's fiscal decentralisation to urban local governments is a transfer-based model. The trend of declining own-source revenue and the heavy dependence on transfers is not in the interest of prudent fiscal decentralisation to urban local governments. The transfers from state government and central government are not substitutes for internal resource mobilization, which improves urban local governments' fiscal autonomy and financial accountability.

Municipal expenditure had declined as the percentage of GSDP from 0.47 in 2010-11 to 0.34 in 2017-18. Kerala is ranked 11th in per capita municipal expenditure, while the state has been 9th in urban population size. There is a significant expenditure deficit in the state's urban local governments. Kerala's share of municipal expenditure is well below the national average of 0.77 is a matter of concern. It indicates a significant underfinancing by the urban local governments, especially in the infra sectors. More than 75 percent of the total expenditure in the state is spent on revenue expenditure. A realignment of expenditure is imperative to hike the share of capital and O&M expenditure in its total expenditure. The revenue gap is a novel idea to measure the financial health of a local government. It measures the gap between the own source revenues and the expenditure of ULGs. A widening revenue gap is a disturbing trend in urban local bodies in the state.

An econometrics model was proposed to explain the variations in the OSR, grants, and expenditure of the ULGs. We ran the multivariable regression analysis and the panel data analysis with relevant variables to study the associations.

CHAPTER 5

Summary and Directions for Reforms

5.1 Fiscal Decentralisation: Summary

Fiscal decentralization in general and finances of urban local governments, in particular are gaining attention in academia, and in policy-making around the world. The developed countries have moved ahead in transferring political and fiscal powers to Local Governments. In India, 74th Constitutional Amendment has ushered interest in fiscal decentralization to Urban Local Governments. This thesis is primarily dedicated to the study of fiscal decentralization and municipal financing in the state of Kerala. Kerala has been a pioneering state in India in terms of initiating the decentralization of fiscal powers to local governments. Local governments in the state were given prominent space in public policy and actions. A sustainable fiscal decentralization requires prudent local finance beyond the camping rhetoric. Kerala model of decentralization has been accused of soft budget constraints and over dependence on the state exchequer. On these backdrops, a comprehensive analysis of municipal finance is required. This thesis will add value to the existing literature on municipal finance in India, particularly on Kerala's fiscal decentralization to ULGs.

The thesis has been divided into five chapters. The first chapter presents an overall introduction to the subsequent chapters. It provided a background into the study. It spelled out the rationale and need for the study. The second chapter was a retrospective chapter. It documented and revied the relevant studies, case studies and practices around the world on fiscal decentralization and municipal governance. The third chapter extensively looked into the performance and prospect of fiscal decentralization in the state. The chapter presented a

detailed analysis of origin, organization and structure of local governments in Kerala. The local fiscal structure has been studied. It has been critiqued; achievements and challenges of fiscal decentralization in the state have been examined. In the fourth chapter, an empirical study of fiscal decentralization of Kerala was conducted. Different aspects of the municipal finances are measured including its magnitude and composition. An econometric analysis to analyze fiscal disparity among the urban local governments in the state was conducted. The present chapter contains the summary and policy recommendations.

The second chapter contains the review of relevant literature. It discusses fiscal decentralization theories, international practices, case studies of selected countries and relevant Indian studies. The theories of fiscal decentralization deal with the basic question of what is the optimal allocation of economic responsibilities among the different tiers of governments. Though theories primarily focus on the division of tasks within a federal system of government, the scope of it extends to all forms of intergovernmental relations. Broadly, fiscal decentralization theory can be categorized into first generation fiscal decentralization theory and second-generation fiscal decentralization theory. First generation theory represents those ideas on fiscal decentralization during the period of 1950 to 1980. Tiebout (1956), Musgrave (1959), Oates (1972), Olson (1967), Brennan and Buchanan (1980) are the proponents of first-generation theory. The first-generation theory of fiscal decentralization is concerned with the allocation, distribution and stabilization functions of governments. Musgrave (1959) found stabilization and distribution as the constraints to decentralization and efficiency as the benefit of decentralization. The impure public goods, Tiebout's sorting mechanism by which people move between jurisdiction, taste, tax-benefit metrics are the assumptions or the justification of decentralization. The fiscal equivalence principle is a significant contribution of first-generation theory. It revived the notion of leviathan state. The theory assumes that, service delivery will be efficient if the provisions of those services are left to lowest level of

government. Oates' (1972) decentralization theorem is the foundation of first-generation theory. The first-generation theory of fiscal decentralization drew its ideas from public economics.

The second-generation theory represents those theories evolved from 1990 to till now. Weingast (1995), Seabright (1996), Lockwood (2000), Levtchenkova (2002) and Wagner (2007) are the major proponents of the theory. Second generation theory of fiscal decentralization draws the idea from outside the public finance disciplines such as from the theory of firm, information economics, and the theory of contract and principle-agent problem. The crux of the second-generation fiscal decentralization theory are political process and behavior of political agents and asymmetric information facing such political agents. Market preserving federalism (Weingast 1995) was a seminal contribution in the development of the second-generation theories; it concerned with how the competing jurisdictions create a credible incentives commitment and reduce the transaction cost. The generally accepted view is that second generation theory doesn't contradict the first-generation theory; rather it classifies and compliments the first-generation theory. The models under first generation fundamentally differs in second generational theories; many of them extrapolate a trade between centralization and decentralization in both the first and the second-generation theories of fiscal decentralization.

The second chapter also delved into the international experience on decentralization to urban local governments/ municipalities. We have studied the United Kingdom, the United State of America, Australia, China and Brazil. The United Kingdom has a loose and flexible structure of fiscal federalism. In the United State of America, on the whole, local government revenues finance about of 40 to 70 per cent of their expenditures. The local improvement taxes in Canada are generally in the form of betterment levies linked to benefits accruing to specific local areas due to the provision of infrastructure as a result of implementation of local

improvement plans. In sharp contrast to the US model, Australian municipalities are subject to a highly unitary model of polity. 80 per cent of the total tax revenue is with central government, highly vertically imbalanced, 50 per cent of the state expenditures are being financed through central grant and local governments has been collecting a little as their own. Brazil's municipalities have been granted full autonomy, consumption and production taxes are assigned to all three levels of government. The urban properties are taxed by municipalities, and rural property is a central tax. In contrast to its model of polity, China's fiscal system is highly decentralized; nearly 70 percent of total public expenditure in China takes place at the sub-national level. The Budget Law of China confers substantial autonomy to local governments.

Indian studies on urban local bodies are haphazard in nature. Except the few, there has not been any comprehensive studies on fiscal decentralization of urban governments. Fiscal decentralization as such, the size and magnitude fiscal devolution from state government to urban local bodies were studied. Fiscal relationship between state and ULBs, exclusive relationship between center and ULBs, internal resource mobilization, state and central finance commissions and their effects and implications on finance of ULBs are discussed (Oomen 2005, 2006; Mathur and Thakur 2004; Bagchi 2000; Lall and Deichmann 2006; Mathur 2006; Rao 2001;). Rao (2001) studied the fiscal decentralization entirely from central to municipalities. His major concern of research was how fiscal transfers affect macroeconomic stability. Scholars like Oomen (2006) and Mathur (2006) concerned about the fiscal imbalances: both vertical and horizontal between the local governments and state government and among themselves. Studies like Vaidya and Johnson (2001), Mathur (2006), Chattopdhay (2006) and Mathur and Rao (2003) have explored the prospects and possibilities of municipal bonds and capital market access by municipalities. Kundu and Bagchi (1999) Baghi, and Chattopadhay (2004), Kundu (1999) and Mathur (2006) study the provisions of service

delivery mechanism: government funded, private participation and private public partnerships. Waste management, is a perpetual issue in every municipality especially in the bigger ones. Srinivassan (2006) has studied the problems of waste management in the urban local bodies. Infrastructure development and its financing are studied by a number of government reports (Indian Infrastructure Report 2004; GOI 1996).

Chapter 3 studied the democratic fiscal decentralization model of Kerala. Kerala adopted a 'big bang' approach in pursuit of decentralisation. The state chose the path of participatory local level planning as the entry point. The campaigning strategy succeeded to a considerable extent in harnessing public action/sentiments in favour of decentralisation. The Kerala Panchayat Raj Act and the Kerala Municipality Act, both of which were enacted in 1994 were thoroughly restructured in 1999 incorporating the lessons from experience of the initial years of 'big bang' decentralization. 'Empowered Deliberative Democracy' should produce superior outcomes to traditional 'Representative-Techno-Bureaucratic Democracy' in promoting equity, improving the quality of citizenship and producing better outcomes of State action. Kerala's 'People's Planning Campaign' and 'Kerala Development Programme' institutionalised the participation through annual plan preparation. The following steps are involved in the preparation of plan preparation; Working Group Constitution, Needs Identification, Preparation of Development Report and Vision Document, Strategy Setting, Re-orientation of Local Government Projectisation, Plan Finalization and Plan Approval.

Clear embarkation of Autonomy, People's Participation and Sanctity of SFC Recommendations are the three chief achievements of Kerala model of fiscal decentralization. In addition to embarking on own fiscal domain, the state has designed a systematic transfer system. It also developed an excellent accountability and transparency mechanism. One of the hallmarks of Kerala's administrative decentralisation is the transfer of public service delivery institutions to Local Governments. Primary, Secondary and Higher Secondary Schools.

Dispensaries, Primary Health Canters, Community Health Canters, Taluk Hospitals under the three streams of medicine, namely; Allopathy, Ayurveda and Homeopathy. Anganwadis, District Farms – Agriculture and Animal Husbandry, all veterinary institutions at the district level and below and Pre-Matric Hostels for Scheduled Castes, etc. have been devolved on local government.

Although overall decentralization in the state could achieve some of the most remarkable achievements on certain counts, many substantial aspects have been left behind. The Local Governments have not been very successful in promoting local economic development by increasing incomes and employment opportunities - except in the case of micro-enterprises of the poor under Kudumbashree. The institutions like Ombudsman, Appellate Tribunal, and State Development Council have not been powerful enough to enforce their jurisdictions. Though there has been quite good participation of people, better-off sections of society who control the means of production have not taken a keen interest in intervening the local development processes. It is necessary to transform Gram Sabha's and Ward Sabhas from beneficiary identification venues to fora for development dialogue. Managing professionals, especially those delivering services, has not been very easy for Local Governments. The local statistical system is weak and unreliable.

Chapter 4 empirically evaluates the fiscal decentralisation and municipal financing in the state of Kerala. The size of municipal finance in the state is abysmally low. Kerala's municipal finance accounts only 0.51 percent of GSDP of the state; it was 1 percent at the national level in the same period. The ratio of municipal expenditure as a percent of GSDP has declined from 0.47 to 0.20 from 2010-11 to 2017-18. The state's municipal finance size is far from adequate given the sporadic urbanization happening in the state. The total municipal revenue of the state was Rs. 3883.8 crore in 2017-18. The total revenue of ULGs has grown by around 20 percent per annum. On average, Rs. 41.76 crore was the per ULG municipal revenue in 2017-18.

OSR - Gross State Domestic Product (GSDP) ratio is a good indicator of fiscal decentralisation. These are the revenue generated by local governments either through taxation or through fees and charges. OSR as percent of GSDP stood at 0.120 in Kerala in 2017-18 while it was 1.26 in Maharashtra, 0.748 in Gujrat, 0.30 in Karnataka, and 0.31 in Tamil Nadu. The national average of OSR to GSDP ratio was 0.429 percent. From 2010-11 to 2017-18 OSR has increased from 522.2 crore to 840.7 crores, registering an average of 7.8 percent growth per annum. On average, ULGs generated 8.7 crores as OSR in 2017-18. The per capita OSR has declined from Rs. 885.7 in 2016-17 to Rs. 785.57 in 2017-18 in the state. Per capita OSR at the national level is Rs.1957. The lack of big-size cities and under exploitation of revenue bases can be the reason for the relatively smaller municipal revenue size of the state.

Major taxes collected by ULGs are property tax, profession tax, entertainment tax, and advertisement tax. Property tax collection accounts for 52% of the total tax revenue. Profession accounts for 34%. Property tax is the single most significant tax item at the disposal of Urban Local Governments. it is the most appropriate tax to finance local services since it is the most visible tax in the jurisdiction. in 2017-18, property tax accounts for 0.075 percent of GSDP. Property tax constitutes 23.2 of the total municipal revenues of the state. Property tax increased to Rs.294.9 Cr in 2017-18 from Rs.164.1crore in 2010-11. Per capita property tax of ULGs in Kerala is Rs. 310.9 in 2017-18. Per capita property tax in the state is well below the national per capita Rs.688.2.

The Property taxation in the state could not realise its optimal capacity due to state government's inability to address the administrative challenges of coverage, assessment, valuation, and the political difficulties of enforcement. The property tax can be reformed by a) broadening the tax base, increase the coverage b) rationalize the rate from the current meagre rate,) revalue the properties to reflect on inflation and improve the municipal tax administration. Satellite photography and geocoding of data and technology can help to

improve coverage and efficient property tax administration. Setting up a Property Tax Board recommended by the 13th Finance Commission can fix many issues related to property taxation, including the absence of legal title to properties in the major cities.

Overall, the state's municipal tax revenue had declined from 0.10 percent of GSDP in 2010-11 to 0.075 percent in 2017-18. At the national level, municipal revenue declined from 0.30 to GDP 0.25 percent in the same period. It is when the combined tax revenues for state and centre as a percent of GDP have increased from 16 to 18 in percent 2017-18 (RBI, 2018). Municipalities around the world have been endowed with a wider basket of taxes such as sales tax, VAT, Income tax, Vehicle tax, registration tax, and construction tax. For an E.g., Chinese municipalities have access to real estate tax, business tax, urban land use tax, business tax, land appreciation tax, urban maintenance and construction tax, farmland occupation tax, vehicle tax, and deed tax. The tax base of Urban local governments in India and Kerala is small inadequate.

There is much scope for increasing the tax revenue of Local Governments through periodical revision of the rate of taxes, increasing tax base, and improving tax collection efficiency. The Local Governments are not been able to tap their maximum tax potential due to inefficient tax management. The tax rates have not been revised for the decades. Inefficiency in the collection, lack of proper database, and reluctance in e-governance are responsible for poor tax collection. Though periodical revision of property tax is envisaged in Kerala Municipality Act, 1994, timely steps have not been taken to revise the tax rates.

Major non-tax revenues collected by Local Governments are own buildings rent, building permit fee, fines, and penalties, D&O license, income from river sand, and other items. The average collection of non-tax revenue per ULG was Rs 3.2 crore in 2017-18. Rent on the building is the single most contributing item of Urban Government with 24 %. Building permits account for 10 %. The share of non-tax revenue in total revenue declined to 36. 9 percent in 2017-18 from 45.8 percent in 2010-11. There is a high potential to raise non-tax revenues of

ULGs further by rationalizing rent, charges, and cost of other services. Lack of periodical revision of the fees, rent, fines, and user charges has contributed to the poor collection of non-tax sources. Presently ULGs have a poor record on the recovery of the cost of services.

An adequate and seamless flow of intergovernmental transfer is inevitable for successful fiscal decentralization. The total transfer (state and Centre government) of ULGs has increased from 730 crores in 2010-11 to 2785.1 crore in 2017-18. State Government transfers accounts 70 percent of total transfers of Urban local governments in Kerala. In 1996 state government decided to transfer 35% to 40% of state plan outlay to LGs. The transfers from the state government have increased from Rs. 394.8 crore to Rs. 1966.2 crore in the period of 2010-11 to 2017-18. The per capita, state transfers have increased from Rs. 861.2 to Rs. 2073. On average, a ULG could receive Rs. 21.14 crore in 2017-18 based on the general distributional formula. The Per capita, state transfer to urban local government in Kerala is one of the top in the country.

CFC grant to urban local government in is Rs. 506 crores which had an annual hike of around 30 percent from in 2017-18. Per capita CFC grant of urban local governments was Rs.534.2 in 2017-18. On average, an urban local government will receive Rs.2.64 crore based on the distributional formula. Kerala is the 5th highest receiver of CFC grant from the central government. All India, per capita CFC grant is was Rs. 331.9. In addition to the CFC grant, the urban local governments also receive funds under CSS for various schemes and welfare pensions for disbursement. The welfare pensions disbursed through the municipalities are unemployment allowance, National Old Age Pension, pension for unmarried women, destitute pension, disabled pension, and agricultural workers pension. Though the centre's contribution to ULGs financing is minimal, Kerala has managed to receive the due share. The over burdening of local governments by

Borrowing hardly constitutes 1 percent of the total municipal receipt in Kerala. Surprisingly, Municipal corporation is registering a more flawed track record than the Municipalities in using the borrowing as the revenue base. The negative growth rate is registering in successive years (SFC, 2015). At the national level, municipal borrowing accounts for 2 to 3 percent of total revenue (Ahluwalia 2011).

The state's municipal expenditure had declined as the percent of GSDP from 0.47 in 2010-11 to 0.34 in 2017-18. Kerala is ranked 11th in per capita municipal expenditure while the state is 9th in urban population size. Kerala's share of municipal expenditure is well below the national average of 0.77 is a matter of concern. There is a significant expenditure deficit in the urban local governments in the states. It is indicating a significant underfinancing by the urban local governments, especially in infra sectors. More than 75 percent of the total expenditure in the state is spent on revenue expenditure. A realignment of expenditure is required to increase the share of capital and O&M expenditure in the state's total expenditure.

To place things in context, the chapter has also carried out the ranking of the state with respect to major indices of fiscal decentralisation in India. In terms of per capita total municipal revenue, Kerala was ranked 8th among the 30 states in India. It shows the size and significance of fiscal decentralisation in the state. Given the state of the economy of the state, this is a remarkable achievement. The state has been ranked 14th in per capita own-source revenue and 12th in per capita property tax revenue. On the other hand, the ratio of own-source revenue to total revenue of ULGs of Kerala has been ranked 18th. The trend shows an undesirable state of internal resource mobilization in the Urban Local Governments in the state. At the same time, per capita, state transfers to urban local government are ranked 5th in all over India. Per capita, total transfers from the centre are also ranked the same. It signifies that Kerala is one of the leading states in India in terms of transferring funds to urban local governments. Kerala is the only state in India that accepts the SFC Reports and regimentally implements devolution

recommendations to local governments. Kerala's fiscal decentralisation to urban local governments is a transfer-based model. The trend of declining on own-source revenue and the heavy dependence on transfers is not in the interest of prudent fiscal decentralisations to urban local governments. The transfers from state government and central government are not substitutes for Internal resource mobilization, which improves the fiscal autonomy and financial accountability of urban local governments.

An econometrics analysis was conducted to explain the variations in finances of Urban Local Governments in terms of own source revenue (OSR), grant and expenditure. The OSR, grant and expenditure are the three indispensable and mutually connected components of local finance. It has been observed a significant variation on own source revenue, grant and expenditure among ULGs. The variations cannot explain by the decisions made at local level alone moreover the state and Centre government's decisions are very relevant. Explaining the variations in own source revenue, grants and expenditure is important to formulate relevant policy strategies on resource mobilization, intergovernmental transfers and spending by the urban local governments. Any change in one variable/component will have a bearing on another variable. How revenue OSR respond to a in change expenditure, how expenditure explain with respect to OSR, does grant compliment or substitute OSR. i.e., how grant/transfers influence OSR whether it crowding in or crowding out of resource mobilization and the way in which grant play out in terms of incentivizing/ disincentivizing the revenue generation. The following methods are employed.

Multiple Linear Regression (MLR)

A multiple linear regression was estimated taking OSR, grant and expenditure as dependent variable. In addition to estimate the interactions among these dependent variables, population, literacy rate, per centage of SC/ST population, proportion of marginal workers are taken as

independent/ explanatory variable. Separate analysis was done for the year 2012 and 2016. And 2012 and 2016 were taken together to get combined effects of studied variables. We could able to accommodate more meaningful variable in the year 2016 compared to the previous year, because unlike previous Finance Commission Reports, fifth State Finance Commission Report were providing much more data on the fiscal indicators of the local government.

Panel Data Estimation

The panel data estimation was done for all three dependent variables OSR, grant and expenditure. In addition to estimating association among them, population, per centage of SC/ST and BPL households. Political affiliation dummy was used to control the party influences in the dependent variable. A fixed effect model was estimated with ULB and district dummies. Another panel data regression in whole sample year was carried out with fixed effect model with a year dummy. That's a comprehensive estimation with a data with large observations.

In short, rejuvenating and sustaining the fiscal decentralisation is a continuous process. Improving the OSR structure requires ceaseless effort of rationalisation rates and modernisation of methods. The transfer system has to cop up with increasing demands of LGs and should allow more untied fund to flow into. The expenditure system must rationalise to allow ULGs to more resources for development expenditures including civic functions. The following are some of the policy recommendation.

Contributions of the Thesis

- Provides a critical analysis of fiscal decentralisation, the idea, implementation, advantages, and limitations.
- Reviewed theories of fiscal decentralisation and local public finance. Analysed the

trajectory of theoretical development.

- Analysed international experience of municipal finance and threw light on municipal financing in India and Kerala.
- Studied fiscal decentralisation in the state, structure, strategy, legal and institutional framework, participatory planning, peoples' planning movement, achievements, shortcomings and prospects.
- Empirically studied the fiscal decentralization to urban local governments in the state. Measured the quantum, trend, components of fiscal decentralisation internal resource mobilisation, transfers and expenditure. An econometric model was attempted to explain the variations in OSR, grant and expenditure.

Directions for Reforms

The successful functioning of any local governments is contingent upon the kind and extent of fiscal decentralisation of that local government. Financial reforms are inevitable for urban local governments to realise the visions envisioned in the Constitution. Fiscal adequacy and financial autonomy are essential for fiscal decentralisation to succeed. Kerala has been known for its fiscal decentralisation model. The state has achieved significantly in the spheres of localised planning, peoples' participation, and intergovernmental transfers. Tardy own source mobilisation, archaic legal procedures and abysmal municipal income/staffing remain acute challenges. The local public finance of the state needs thorough restructuring. After a comprehensive study of fiscal decentralisation and municipal financing across nations and performance of other well-to-do states in India, and analysis of empirical data of municipal finance of the state, the following reforms are recommended for the restructuring of urban local finance in Kerala.

(i) Prioritise own source mobilisation

LGs should increase the rate of property tax and hike the ceiling on professional tax. Vacant land tax needs to be imposed. Other taxes like entertainment tax and advertisement tax should be revised with actions to rationalise the rate and amount to be collected. Immediate measures should be taken to size down the tax arrears especially of property tax. The non-tax revenues like fees, fines, charges (user charges, polluters pay charges, congesters pay charges, etc.) should be rationalised and LGs need to adopt innovative avenues of income generations from the new economic activities.

Efforts are needed to remove the legal hindrances in the way of tapping the potential OSR of ULGs. The institutions must have the flexibility to exploit untapped taxing and non-taxing avenues specific to each jurisdiction. The following are the specific recommendations in this regard.

Reform Property Tax

Property tax is the most important tax of urban local governments. It constitutes more than 50 per cent of total tax revenue. Any right step in the direction of improving OSR should start with property tax. The actual property tax collection in the state is far from its potential. Difficulties in coverage, assessment, valuation of properties and the political risk of enforcement prevents the state from tapping full potential of property tax as a buoyant tax base. Factors contributing to low property tax collections are: lack of standardized property count, incomplete property records, unscientific methods of tax calculation, low rate of taxation, and non-revision of property rates in tandem with hike in prices. Vacant land tax variant of property tax is grossly neglected. A Property Tax Board as suggested by CFC is required to look after the tasks to broaden the tax base, rationalise the tax rates, undertake indexing of inflation, make use of GIS

technology for the extended coverages of properties, cut down the administrative, collection cost through self-assessment and simple procedures, use GIS technology for the extended coverage, employ unit area value (UAV) like in Bangalore or capital value method for the better assessment of property values.

Broaden the Revenue Base of ULGs

Given the ever-increasing demand for public amenities and infrastructure pressure from rapid urbanisation and economic growth, existing revenue base is not sufficient and adequate. Taxes which are emanating from urban agglomeration like property registration tax/stamp duty, motor vehicle tax etc should be shared with urban local governments.

Municipal Bond

Though borrowing is a legitimate means of resource mobilisation of ULGs to finance long gestation infrastructure projects, it has not been exploited due to various reasons. Same is plight of innovative financing instruments like municipal bonds/pooled finance bonds. The municipal corporations have not significantly utilised the opportunity. Apart from issues related to credit rating there are legal and institutional hindrances in the way of Corporations raising resource through municipal bonds. Urban local governments should be encouraged to use municipal bonds not only for additional resource mobilisation but also to incentivise them for maintenance of fiscal prudence.

Sharing of GST

Though the recommendation for the sharing of GST pool to local governments sounds radical, it seems to be the only reasonable way out to go forward to tackle the perpetual of tax base depletion municipalities, especially after abolition of octroi and entry tax.

More and more taxes are brought under GST ambit (e.g: entertainment tax and advertisement tax) which have led to a negative impact on the exchequer of urban local governments. As Kelkar (2019) suggested, a single rate of 12 percent where 10 per centage be equally divided between the state and centre and remaining 2 per cent be shared with local government. That would ensure a solid fiscal base to urban local governments.

- (ii) Enhance the corresponding share of LGs in the total plan outlay of the state. The transfer from the state should address the increasing fiscal pressure on LGs due rapid urbanisation and pressure for increased infrastructure needed by growth. It should also consider the inflationary effects and equalisation goal in the transferring of grants. The specific fiscal disadvantages of individual local governments should be taken care of.
- (iii) Decentralised/ planned expenditure must be hiked. The increasing share non-planned expenditure is worrisome. Lethargic attitudes of LGs in execution of annual plan must end. The diversion of development fund of LGs for centre and state governments' schemes should be checked.
- (iv) Increase the investment in civic amenities. Ensure proper provisioning of public amenities.
- (v) Introduce innovative measures the improve people's participation in the Ward Committee and other development planning avenues. The state has been witnessing a deterioration in the people's participation in the planning and developmental process of local governments. The Ward Committee is often reduced to beneficiary identification/distribution forum. The well-off sections of the society did not participate in the developmental planning of the local government. Proactive efforts are needed to bring back people participation into the Ward Committee.
- (vi) Streamline and expedite the accountability mechanism and institutions. Improve the

working of appellate institutions of local governments. Strengthen the institutions of tribunal and ombudsman and deliver on the grievances of public against the local governments on a time-bound manner. Professionalise these bodies, and empower them with necessary legal teeth, and support them with adequate financial-human resource instruments.

- (vii) Complete the e- governance measures adopted and widen them to newer areas. Even after three decades of local governance, many areas in local governments remain in archaic paper file system. There are definite improvements particularly in the issuance of relevant certificates from the local governments; still much need to be go in this direction. Expediting the computerisation on administrative and service delivery is important.
- (viii) Improve the statistics and data collection at ULGs. Incomplete and inaccurate data is a serious challenge facing local governments in the state. There is quite an improvement after commencement of Information Kerala mission (IKM); still large chunk of data of ULGs remains unrecorded or under recorded. Individual ULGs are not publishing their data, especially financial data in their website as suggested by various Finance Commissions. It is urgent and imperative to employ scientific data collection along with recording of data with systematic accounting system. ULGs should broaden the database and make it available to the general public.

Directions for Future Research

Fiscal decentralisation to local governments has been a thought-out developmental policy across the world. The disenchantment of people to centralisation and expansion of globalisation fuelled the trend of decentralisation around the globe. Efficient service delivery, accountability from the local officials, and provision for the local taste and

preferences have been the major supporting arguments for fiscal decentralisation. The economists were sceptical about fiscal decentralisation in the beginning. Macroeconomic instability, provision of merit goods and spill-over effects of service delivery have been the major concerns of economists regarding fiscal decentralisation. Enormous theoretical works have been carried out on the feasibility, assignments, advantages and the shortcoming of the process. The first generation and second generation theories of fiscal decentralisation engage with such questions. While developed countries embraced the fiscal decentralisation for efficiency considerations, the developing countries like ours looked upon fiscal decentralisation as transformative mechanism to pull the people out poverty and miseries. Even though decentralisation and democratisation have been the building ethos of Indian republic, the constitutional imperative for fiscal decentralisation came into existence after the 73rd and 74th Constitution Amendment Acts. In this thesis we are focused on the fiscal decentralisation to urban local government in Kerala. The 74th Constitutional Amendment deals with urban local governments. This thesis is a study on fiscal decentralisation to urban local governments in Kerala in the larger context of Indian fiscal decentralisation to urban governments. Why Kerala? Kerala has been acknowledged for its model of fiscal decentralisation. It has been a pioneer in many aspects of fiscal decentralization. Each fiscal decentralisation model is unique. There will be something to learn and unlearn from each model.

Fiscal decentralisation or size of municipal revenue in India has been the one of the lowest compared to its neighbours and other developing nations. An adequate and sustainable municipal financing is essential for growth of cities/ towns to provide

adequate infrastructure and civic amenities to the residents of the jurisdiction. A study of urban local governments is relevant not only from the perspective of traditional sense of decentralised governance but also to facilitate the mechanism of economic growth. The review of international experience presents grim picture of fiscal decentralisation and municipal financing in India. Kerala's fiscal decentralisation was a popular exercise. The organic participation of the people and subsequent public actions shaped the fiscal decentralisation exercise in the state. The 74th constitutional Act and the subsequent amendments to laws by the state government have given body and soul to fiscal decentralisation process in the state. In this study we have measured the fiscal decentralisation; its various indicators, composition, trend and magnitude. We have used total municipal revenue as percentage of GSDP, total tax revenue as percentage of GSDP, own source as percentage total revenue and property tax as percent of GSDP. Such indicators of Kerala have been abysmally low. But the national average is not quite different.

Another major thrust given in the analysis was OSR. Internal resource mobilisation of the ULGs in Kerala has been awfully low. The tax and non-tax collection of local governments are dreadful. At most only 30 per cent of the total revenue was contributed through own-sources. The study has particularly keen on property tax collection. We have seen that Kerala's fiscal decentralisation has been a state government funded model. The soft budget constraint at local level has been entertained. We have measured the proportion of state government transfers on total revenue of the urban local government. In addition to evaluating the components of fiscal decentralisation, the thesis tried to understand the variations in OSR, grant and

per capita expenditure among the local governments. Multiple linear regression was employed. Data is a huge limitation on any study on local governments. Kerala Government did not have an open database regarding local governments finance. IKM which is the data arm of the local governments in Kerala have data only from 2012 which is also not complete, with data on some relevant variables not being compiled. The paucity of data makes the study less amenable for various econometrical and statistical analysis.

Municipal financing requires a comprehensive study. It requires to analyse the multiple variables affecting the fiscal decentralisation, internal resource mobilisation, utilisation of the grants, effects of grants on resource mobilisation, crowding out and crowding in. The nature of expenditure and types of financing, spending efficiency and utilisation of transfer funds, soft budget constraint and its implications on other expenditure, accountability, and corruption are needed to be studied. How the pattern of financing affects the accountability, service delivery efficiency, peoples' satisfaction, peoples' willingness to pay for the local governments services, application of innovative financing mechanisms such as municipal bond and PPP are required to be analysed. The feasibility of cost reimbursing mechanisms, polluter-pay and congesters-pay principles, user charges for availing exclusive services, extent of externalities to be penalised and their use as a revenue source for the local governments are some areas for major research. Rigorous studies utilising large and longer data are needed to get into the complexities of municipal finances. There is wider scope on studies of urban local governments, fiscal decentralisation and municipal finance in India and Kerala. This study is a modest contribution towards that end.

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Chapter 7

Fiscal Decentralization—A Case Study of Kerala State

Naseer Ahmed Khan and M.P. Muhammed Riyas

Abstract This work studies fiscal decentralisation at local level governments. It gives a critical narration to the empirical analysis in the fiscal decentralisation. The key components of fiscal decentralisation, fiscal autonomy has been given significant role while looking at the intergovernmental transactions between local governments with state and Centre. The aspects of fiscal responsibility also analysed.

Keywords Fiscal decentralisation • Fiscal autonomy • Fiscal responsibilities

Centralization is no more a catching slogan in the international polity. The age of concentration is fading fast. There is a distinct reception for the democratic decentralization. Liberal democracy, beyond its rhetoric, has failed to reach out into the poor and weak and failed to provide voice and choice in the decision-making process. In federal polity like India, where complex diversities exist, multi lingual and multi culture, democratic decentralization commands a natural appeal. Apart from the fact that it has the vehement potential to lower both transaction and coordination cost, it reduces inequality and it enhances equity. Fiscal decentralization is the subset of democratic decentralization is highly significant, because without which the idea becomes inoperative and meaningless. It calls for special attention when the fiscal responsibilities entrusted in the central, state and local self-government (LSG). In the public finance literature, it is broadly called as fiscal federalism or decentralized fiscal system.

India land marked its journey of ‘fiscal federalism’ through 73rd/74th amendment to its constitution in the year 1992 which inserted third tier of local government to its federal structure. The soul of the 73rd amendment was to reform and reconstruct rural India via Panchayat. It will be interesting to requite what the then Minister of State for Rural Development, Venal Swami said when forwarding the 73rd amendment to the constitution on 1 December 1992: ‘the constitution (73rd) amendment bill cast a duty on the union as well as the states to establish and

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nourish the village Panchayat so as to make them effective self-governing institutions, we feel that unless the Panchayat is provided with adequate financial strength, it will be impossible for them to grow stature'. It was a vintage point from there the theory and praxis of the fiscal decentralization in India undergone a tremendous change.

Democratic decentralization is appreciated not only for its intrinsic value but also for the instrumental benefits it carries, i.e. efficient and equitable delivery of public services at the bottom level of people's participation. There are scholars who oppose decentralization the reason suggested is that fiscal decentralization will ruin the macroeconomic management and it make unviable to attain the macroeconomic objective. This is a purely an empirical query. A study conducted by Anwar Shah through the econometric analysis of the 24 countries stand strongly in defense of the decentralization with respect to macroeconomic management and what is required in the proper greater clarity in the role and functions of the various different layers transparency as well as immense care in the designing of the institutions. Shah critiques the decentralization and macro management of Chinese economy, which is the biggest unitary economy in the world, and argues otherwise.

What is fiscal decentralization? Before that it imperative to have an idea of what is decentralization all about. It is concept variously defined and differently understood by different people. That's why it has been abused by its usage many times. Sometimes it is used in limited sense of delegation or just de-concentration, i.e. unbundling of responsibilities or burden of the superior government officer to the bottom one. Democratic decentralization is a far reaching concept especially when it says strengthening the local levels of governance. We define the decentralization as the process of empowering the people through empowering the local self-government, in the rural context of India, empowering the Panchayat. So the fiscal decentralization means empowerment of Panchayat fiscally. It means devolution of fiscal powers such as taxing and spending powers to lower levels of governments. It is nothing less than local government should have adequate command over in term of its autonomy regarding the expenditure and revenue of its budget.

There is no single and universal pattern and objective of decentralization. The historical context or the temporal specification and the objective to be attained by the decentralization vary from country to country. In order to ensure more rational public finance in terms of efficiency and equity, a multi-level federal polity which aims to boost democratic decentralization has to address four basic questions. Those are being asked in the context of India as below (Oommen 2004).

Functional mapping: basically, it is a question of who should what? In a multi layered federal polity by considering the allocative efficiency which level of government should be done what is being decided. This is what is called principle of subsidiarity. India has been characterized as a quasi-federal system, it was the 73rd and 74th amendment was instrumental to reverse this to greater extend. Adding schedule XI for Panchayats and Schedule XII for the urban local bodies (ULBs) into the existing concurrence of centre and state will attract more confusion the role

and responsibilities of different tiers. So the clear cut mapping of role assignment must take place.

Revenue assignment: the issue of financing the expenditure raises the equally important question of who should tax and what? Constitution envisaged a two tier system where more productive and elastic sources of taxes such as income tax, custom duties corporation tax, etc., were assigned to union list and land revenue, sales tax, stamp duties, etc., placed in state list.

Developing an efficient and an equitable transfer system: It basically means having an institutional arrangement to look after the both vertical and horizontal imbalances arising out of the intergovernmental fiscal relationship. Ideally, the expenditure requirement and revenue acquirement must match. The vertical imbalances have to be addressed through proper arrangement.

Accountability mechanism: decentralized governance has been legitimized through proper mechanism of accountability. Their management of expenditure is critical, as the institution of Grama Sabha (Article 243A), the assembly of voters at village level having power to review the budget, hear audit report, and so on. The Panchayat raj amendment has taken the accountability institution into the door step people.

7.1 Objectives and Methodology

7.1.1 Introduction

Decentralization of governance has been widely acclaimed by the scholars and policy-makers as a way out from the melancholies of centralization. Democratic decentralization has been projected as the substitute to the centralized liberal democracy which utterly failed to give voice and choice to poor and other down-trodden sections of the society. Fiscal decentralization is having not only the intrinsic value but also numerous instrumental benefits too. Fiscal decentralization is important in order to operationalize the democratic decentralization. Fiscal decentralization is crucial not only in term of fiscal autonomy but also it ensures the financial health of the exchequer.

7.1.2 Research Problem

This is a case study of the state of Kerala. The broader intention is to understand the anatomy of the exchequer of the local self-government with emphasis on the Grama Panchayat in the state of Kerala. The spirit of decentralization is attained only when the local government having adequate financial or fiscal autonomy. The study is mainly interested in the structure and composition of the revenue as well as the expenditure.

7.1.3 Objectives

The following are the specific objectives of this study.

- To understand the structure and composition of receipt of Panchayat with respect fiscal autonomy.
- To critically evaluate pattern of expenditure with respect to financial health of the Grama Panchayat.
- To analyze the functioning of state finance commission.

7.1.4 Methodology

The study is analytical in nature and descriptive in form. The purpose of the study is to critically understand financing of the local governments especially Grama Panchayat. The aim of the study is to examine how far fiscal decentralization has been taking place. Report of the finance commission was the source in which study was depended more apart from the other government institutions like Information Kerala mission, website of the ministry of the Panchayat, etc., expert views and interactions with official in charge were harnessed for more information.

7.1.5 Source of Data

Mainly secondary data were used for the analysis. The report of the finance commissioner was the important reference for the data. In addition to other published sources like government publications especially ministry of the Panchayat, economic review, websites of the department of finance and Panchayat, the views and observations of the experts were taken into account as well as the practical experience of officers in charge.

7.2 Reviews of Related Literature

Various studies have been carried out by a large number of scholars with respect to different aspects of fiscal decentralization including the philosophical foundation of the idea called decentralization. A few among them are:

Fritz Breuss (2004) analyzed the question of fiscal decentralization and its relationship with that of economic growth. It was an enquiry to link between two. Even though theory indicates vehemently a positive impact of fiscal decentralization on economic growth due to efficiency gain, but there is no strong empirical work to completely endorse this argument, but support partially.

Akai et al. (2004) have presented new empirical evidence on this important issue. Having provided evidence that fiscal decentralization contributes to economic growth; this paper suggests that recent moves towards fiscal decentralization by developed countries may stimulate their economic growth.

Daniel Treisman's (2000) writings are interesting, which tries to answer why are some countries more fiscally decentralized than others? Scholars have attributed such differences to geographical, cultural, institutional and economic factors. Using a dataset of 66 countries, I test various hypotheses. The results suggest territorially larger—but not necessarily more populous—countries are more fiscally decentralized, etc.

7.3 Data Analysis and Interpretation on State Level

Table 7.1 depicts the structure and composition of receipts and gives the various components of revenue receipts of GPs. Own source revenue (own tax revenue + non-tax revenue) constitute only 12% of the total revenue. Lion share of the revenue comes through state transfer, i.e. 76% and central transfer along with made 85% of the revenue. We find a definite increase in the central transfers from the low of 8.3 in the year 2009–10 to 16.5% in 2013–14, an annual increment of 26%, is indeed high. The various flagship programmes of the central government in the

Table 7.1 Various components of revenue receipts of GPs

	2009–10	2010–11	2011–12	2012–13	2013–14	CAGR
Own tax revenue	118.4	123.8	152.0	160.4	160.1	7.8
	[6.9]	[6.4]	[7.9]	[7.2]	[6.4]	
Non-tax revenue	85.8	93.6	104.6	135.3	155.2	16
	[5]	[4.8]	[5.5]	[6]	[6.2]	
Own source revenue	204.2	217.3	256.7	295.7	315.4	11.5
	[12]	[11.2]	[13.4]	[13.2]	[12.6]	
State transfer	130.0	152.7	147.1	161.7	173.8	7.5
	[76.1]	[78.4]	[76.6]	[72.3]	[69.3]	
Central transfer	162.2	164.9	159.3	287.5	414.1	26.4
	[9.5]	[8.5]	[8.3]	[12.8]	[16.5]	
Borrowing	8.3	5.4	3.5	4.3	12.7	11.2
	[2]	[0.3]	[0.2]	[0.2]	[0.5]	
Other receipts	32.1	34.2	29.1	33.3	29.3	-2.3
	[1.1]	[1.8]	[1.5]	[1.5]	[1.2]	
Total receipts	1706.67	1948.60	1919.35	2237.99	2509.47	10.1

Rupees in Crore

Source Kerala State Finance Commission Report (2014)

recent years, which are implemented directly through LSG can explain this spur in central share to a large extent.

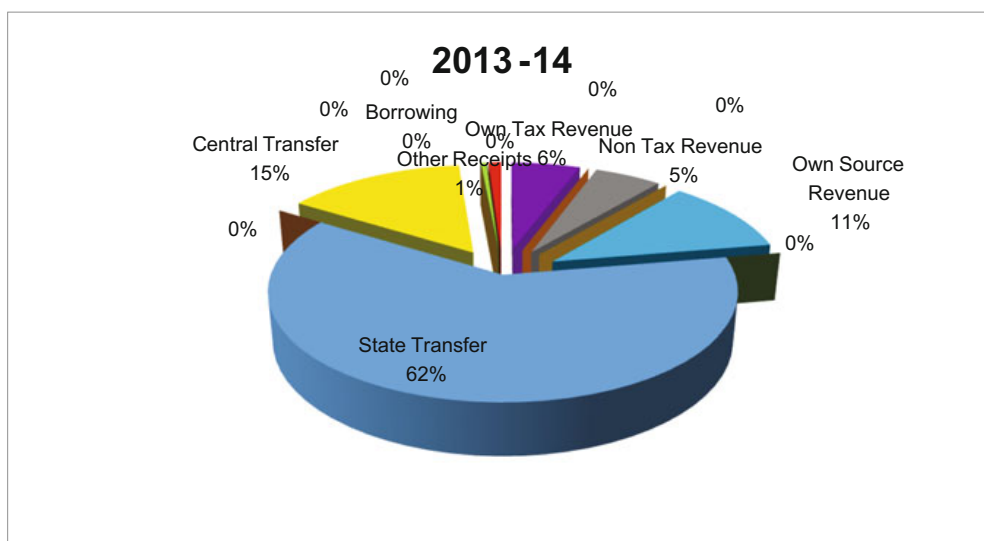
Table 7.1 gives the various components of revenue receipts of GPs. Own source revenue (own tax revenue + non-tax revenue) constitute only 12% of the total revenue. Lion share of the revenue comes through state transfer, i.e. 76% and central transfer along with made 85% of the revenue. We find a definite increase in the central transfers from the low of 8.3% in the year 2009–10 to 16.5% in 2013–14, an annual increment of 26%, is indeed high. The various flagship programmes of the central government in the recent years, which are implemented directly through LSG can explain this spur in central share to a large extent.

Table 7.2 gives us more precise analysis of the receipt by presenting it into per capita values. Per GP receipt increased from Rs. 1.85 crore to 2.72 crore during the period. Per capita receipt increased to Rs. 1023 from Rs. 696 with a 10.1 annual hike.

Table 7.2 Precise analysis of the receipt per capita values

	2009–10	2010–11	2011–12	2012–13	2013–14	CAGR
Per GP OTR	1,285,991	1,343,968	1,650,831	1,741,227	1,738,672	7.8
Per capita OTR	48	50	62	65	65	
Per GP NTR	931,251	1,015,801	1,135,907	1,469,198	1,685,571	15.6
Per capita NTR	35	38	43	55	63	
Per GP OSR	2,217,242	2,359,769	2,786,738	3,210,426	3,424,243	11.3
Per capita OSR	83	89	105	121	129	
Per GP state transfer	14,113,576	16,577,534	15,968,880	1,759,260	18,871,428	7.5
Per capita state transfer	530	623	600	660	709	
Per GP CSS	1,760,874	1,790,556	1,729,924	3,121,548	4,495,785	26.4
Per capita CSS	66	67	65	117	169	
Per GP borrowing	89,980	58,145	38,049	46,545	137,382	11.2
Per capita borrowing	3	2	1	2	5	
Per GP other receipt	348,962	371,449	316,230	361,810	318,401	–2.3
Per capita other receipt	13	14	12	14	12	
Per GP total receipt	18,530,633	21,157,453	20,839,822	24,299,589	27,247,239	10.1
Per capita total receipt	696	795	783	913	1023	

Source Kerala State Finance Commission Report (2014)



The expenditure

Expenditure is the integral part of the financing of local governance. For a sound public financing it is desirable to have rate of growth of OSR higher than that of public expenditure. Table 7.3 and gives the broad pattern of expenditure vis-a-vis OSR. Broadly, expenditure is for administration and for the core function which is consisting of revenue and capital expenditure. The total expenditure per GP has increased from Rs. 1.45 crore in 2009–10 to Rs. 2.58 crore in 2013–14, i.e. grew at

Table 7.3 Broad pattern of expenditure

	2009–10	2010–11	2011–12	2012–13	2013–14	CAGR 2009–10 to 2013– 14
Onw source revenue	2,217,242	2,359,769	2,786,738	3,210,426	3,424,243	11.5
Expenditure on direction and administration	2,348,807	2,536,165	2,791,203	3,294,192	3,610,341	11.3
Expenditure on core functions (a + b)	1,457,345	1,797,338	1,992,026	1,998,567	2,170,206	10.5
a. Revenue	1,025,849	1,235,578	1,422,669	1,501,924	1,652,262	12.7
b. Capital	431,495	561,760	569,356	496,643	517,944	4.7
Total expenditure	14,529,691	16,445,771	18,651,997	21,518,818	25,771,047	15.4

Source Kerala State Finance Commission Report (2014)

15.4% per annum. Whereas OSR of the GPs grew at a rate of 11.5% only and total tax revenue growth was at lower rate of 7.8% per annum. In the year 2009–10, the proportion of the OSR to total expenditure was 14.35%, it came down to 13.29% in year 2013–14. It can infer that OSR is stuck around 14%. It is a matter of concern that in the core functions revenue expenditure exceeds the capital expenditure. Revenue expenditure grew at the rate of 12.7 per annum whereas capital expenditure grew only at 4.7 per annum. This raises serious questions regarding the fiscal health and the sustainability of local finance.

Following are the major criticism levelled against the functioning of the state finance commissions in general and Kerala State Finance Commission in particular. Firstly, the recommendation of the commission is some time obsolete and not up to date to cope with fast changing nature of economic activities. The complexities of the grass root weren't reflected in the recommendation. Secondly, there is intrinsic favoring of state over the local government unreasonable sometimes to the extent of questioning very spirit of democratic decentralization. Problem of lack of enforcement mechanism to get done the recommendation of the commission. Incompetent appointment of chairpersons and Lack of complete database containing the data related to every subject pertaining to economic activities in the Panchayat level, etc.

7.4 Finding of the Study

Local governments especially GPs overwhelmingly depended on the transfers from the higher government in order to finance their expenditure. Share of both centre and state will account for about the 85% of the total revenue of the GPs.

Own source revenue consists of two things. They are called as own tax revenue and non-tax revenue. Own tax revenues are those revenues collected by the GPs from the various items of taxes assigned by the state to local bodies. Non-tax revenues are those revenues earned by the local self-government through the sources other than taxation. In 2009–10, OSR was just 12% of the total revenue. Out of that OTR consist of 6.9% and NTR contributed 5.0% to the revenue.

Property tax, professional tax, entertainment tax, advertisement tax, etc., are the main sources of taxing revenues of the Panchayat. Property tax is the highest contributor to the total tax revenue of the Panchayat. In 2009–10, property tax contributed 53.8% of the tax revenue where as its share in 2013–14 even though declined to 47.4%, it continues to be the largest contributor into tax revenue of the Panchayat. During this period property tax registered only marginal annual growth rate of 4.5. And in 2009–10 per GP property tax was Rs. 637,549,417 whereas in 2013–14 it rose to Rs. 759,024,214. As per capita value, it was Rs. 26 in 2009–10 and Rs. 31 in 2013–14.

Expenditure on the core function is revenue and capital expenditure. As far as the financial/fiscal health is concerned the proportion of capital expenditure is important. But while revenue expenditure it has a growth rate of 12.7 per annum

whereas capital expenditure has grown only at 4.7% per annum not only in the relative term in the absolute term also revenue expenditure has a leap compared to capital expenditure of the GPs in the state. Expenditure on core function together has a growth rate of 10.5 per annum during this period.

Per GP expenditure in 2009–10 was Rs. 14,529,691 and which gone up to Rs. 25,771,047 in 2013–14. And per capita expenditure in this period was 546 and 968 in the respective year.

In 2009–10, the percentage of expenditure for the welfare activities to the total expenditure was 37.2% and in 2013–14 it gone up to 47.5% in 2013–14, i.e. welfare expenditure is a significant component of expenditure of the Panchayat in the state. As far as equity aspects are concerned it is a desirable thing.

It is not a desirable trend with respect to developmental expenditure which comes down from 36.6 to 30% in the respective period. It poses uncomfortable signs of sustainability and fiscal health of the Panchayat. Expenditure on core functions of the Panchayat which includes both revenue as well as capital expenditure registered a declining trend from 10 to 8.4% from 2009–10 to 2013–14. Analysis by disintegrating will tell us, it was capital expenditure which declined drastically.

The expenditure for other activities too comes down from 16.1 to 13.9% during this period.

The structure and pattern of expenditure of Grama Panchayat is not desirable in some respect.

7.5 Conclusion

There is much greater appeal for democratic decentralization all over world regardless of their level of economic development. In order to operationalize democratic decentralization, fiscal decentralization is inevitable. Fiscal decentralization is important it leads to fiscal autonomy and ensures fiscal responsibility by the officials.

Kerala as a state is one who took pioneering steps of decentralized governance even before the Panchayat raj amendment. Kerala could manage quite good track record with respect to political and administrative devolution. In order to implement and sustain the decentralization, fiscal decentralization is crucial. Unfortunately in that respect, record of the state is not comfortable, especially regarding fiscal autonomy. Still, own source revenue of the GPs constitutes only 12% of the total revenue. The GPs could not grow to the expectation in making revenue finance its expenditure.

Own source revenue consists of own tax revenue as well as non-tax revenue. Property tax, professional tax, entertainment tax, and advertisement tax, etc., non-tax revenue consisting of fees, license charges, fines, rent, etc. The base and rate of the tax items and other revenue sources are not dynamic enough to cope up

with spatial and temporal changes and ever changing economic relations. Expenditure on administration continues to be a major component of GPs expenditure. It must be brought down immediately for its sustainability. Out of the total expenditure, revenue expenditure out pass capital expenditure to the extent that formers growth rate is thrice that of latter. There are differences and exceptions to the average trend. There are exceptionally performing GPs too. Having power to borrow is imperative as far as fiscal autonomy is concerned, but GPs having negligible power for borrowing. The functioning of the state finance commission which is supposed to be the watch dog of the local bodies is not been satisfactory. Commission has always not been able to catch up to the required dynamism in dealing with decentralized exchequer.

In short, compared to the last report there is improvement in the fiscal position of the GPs in the state. But it is not at adequate pace. Kept aside the complete fiscal autonomy, finding half of that is a distant dream. There should be imaginative measures broaden the revenue base of the Panchayat through taxation and the sources other than taxation. Local bodies should rationalize their expenditure by focusing on the financial health and sustainability.

7.6 Recommendations

The following are the suggestions put forwarded in the light of analysis of the fiscal position of GPs in Kerala.

- Improve the revenue base of the Grama Panchayat both tax and non-tax base.
- Allow the GPs to fix their rate of the tax or else state government fix a reasonable range of rate with negotiation of the local government.
- Empower the state by devolving more taxing item through legislation.
- Stop the unilateral encroachment of state government into the existing tax base of the local government.
- Enlarge the non-taxing revenue of the local governments.
- Revise the rate, fees, fine, etc., periodically to meet cost of services.
- Rationalize and priorities the expenditure of the GPs.
- Bring down share of expenditure for the administration.
- Rationalize the revenue expenditure.
- Tally the rate of growth of total expenditure and rate of growth of own source revenue (OSR).
- Bestow the GPs with reasonable amount power to borrow from the market.
- Professionalize the accounting system of GPs.
- Professionalize the appointment of the members of the finance commission and improve the quality of the recommendation to cope with changes occurring on the ground.
- Put in place a mechanism to police or a structure of incentives to ensure the recommendation of the commission is being taken seriously.

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URBAN LOCAL BODIES AND STATE OF SERVICE DELIVERY IN INDIA CHALLENGES OF INCLUSIVE URBANIZATION

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University of Hyderabad

I. INTRODUCTION

Indian urbanization is the weak phenomenon in its size and the pace. According to United Nations, the share of world's urban population in 2011 was 52.1 percent. The figure for Asia for the same year was 45.0 percent, while that for Africa, Europe, Northern America, Latin America and the Caribbean was 39.6, 72.9, 82.2, 79.1 percent respectively. Thirty one percent of the population living in urban areas in 2011, India is less urbanized compared to many developing countries. UN data on percentage urban population are as follows for 2010 – Indonesia (49.9), China (49.2), Philippines (48.6), Thailand (33.7), South Africa (61.2), Ghana (51.2), Nigeria (49.0), Egypt (43.4) and Zimbabwe (38.1). While the level of urbanization increased by about 23 percentage points globally during 1950-2011, from 29.4 percent in 1950 to 52.1 percent in 2011, the figure for India went up by only 14 points – from 17 percent in 1950 to about 31 percent in 2011. China, which had a lower level of urbanization of 11.8 percent in 1950, has overtaken India with the percentage urban reaching 49.2 percent in 2010.

In addition to low level, the pace of urbanization in India has also been slow. The simple average increase in the level of urbanization in India over the 60-year period 1951-2011 is about

2 percent per decade. The country's urban population increased from 62 million in 1951 to 377 million in 2011. India's share in world urban population has gone up from 8.7 percent in 1950 to about 10.5 percent in 2011. However, in spite of its growing importance in a global urban hierarchy, India will lag behind many developing countries in reaching the 50 percent urban threshold. According to UN projections, India is expected to achieve the 50 percent urbanization mark between 2040 and 2050.

India's 377 million urban population in 2011 constitutes 31.16 percent of the total population. The number of ULBs, i.e., statutory towns increased by 242 - from 3,799 in 2001 to 4041 in 2011, and the number of census towns increased significantly from 5,161 in 2001 to 7935 in 2011.¹ The urban population is projected to grow faster.

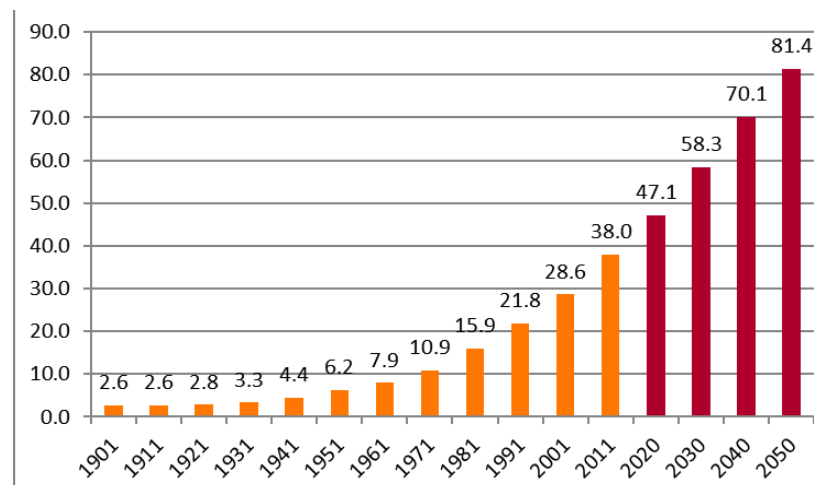
Census projections indicate that the urban population is likely to be 534 million by 2026 constituting over 38.2 percent of the total population. But the urban population reached 31.16 percent as against Census projection of 30% in 2011. The other estimates put the figures differently. For example, McKinsey Global Institute projected that the urban population would be 590 million constituting 40 percent of the total population by 2030.³ The twelfth five-year plan estimated that by 2031 India's urban population

would be about 600 million, an increase of over 200 million in the next two decades.⁴ The United Nations projected that the urban population would reach 40 percent by 2030 and cross 50 percent by

2050.5 In absolute terms the urban population would cross 583 and 814 million in 2030 and 2050 respectively.

India's urbanization trend-present and projected

Fig.1.1



Source: Census of India, 2011 Reports: United Nation, World Urbanization

Prospects: The 2014 Revision.

Table1.1

Size-class	Population size No. Towns	No. of Towns	Population	% of Urban Population
Class I	100000 and more	485	223,901,559	59
Class II	50000 to 99000	551	37,843,118	10
Class III	20000 to 49000	1,313	40,938,091	11
Class IV	10000 to 19999	1,087	16,012,784	4
Class V	5000 to 9999	473	3,736,710	1
Class VI	Less than 5000	132	389,275	0
Census Towns		3,892	54,278,626	14
Total		7,933	377,100,163	100

Source: census of India, 2011

Urban Local Bodies and Service Delivery

Urban local bodies viz., municipal corporation, municipality, and Nagar panchayat are the autonomous constitutional bodies entrusted with the provision of urban deliveries along with state and central government. Urbanization, despite its contributions to economy and development, brings in its train many a challenge that relates to demography, governance, infrastructure and service delivery, poverty and slums, environment, housing, traffic, and transportation, etc. service delivery is the crucial paramount factor among them. Service delivery is important in two ways.

Firstly, to harnessing the potential of the cities through the efficient functioning of the space, an ill-serviced urban can no longer deliver productive output in term of economic growth. Second is the equity concern; an under-delivery of the service mainly affects the urban poor which intern is contributing to “urbanization of the poor.”

It is the primary responsibility of ULBs to provide services to the local communities. The concept of levy and collection of municipal taxes like property or conservancy tax began to meet the costs of these local services. Over the years the list of functions to be undertaken and the services to be

provided by the local bodies expanded considerably and the Municipal Acts listed out them clearly and was reinforced by the 74 CAA, as seen in the previous chapter. The functions contained in the 12th Schedule functions relating to services include water supply, public health, sanitation, conservancy and solid waste management, roads and bridges, provision of urban

amenities such as parks, gardens and playgrounds and public facilities including street lighting, and general conveniences.

The slum improvement inter-alia also includes the provision of these services. Delivery of these services is critical to urban living, and they are being provided by most ULBs but with different levels of efficiency.

Table 1.2

#	Period	Municipal Corporation	Municipality	Nagar Panchayat	Total
1	11 FC	96	1494	2092	3682
2	12 FC	109	1432	2182	3723
3	13 FC	139	1595	2108	3842
4	Census 2011	151	1608	2282	4041
5	14 FC	162	1482	2349	4143

Source: ASCH Report, 2014

Bench Marking of Municipal Services

It is an initiative undertaken by the MoUD in 2008 to monitor the service delivery of the urban local bodies (ULBs). Service level benchmark (SLB) is the as a minimum set of performance standard parameters that are commonly by the stakeholders for evaluation. It has been recognized as an instrument of measuring and auditing service delivery by the ULBs. SLB initiative covering water supply, sewerage, SWM, and storm water drainage in 2008 and ministry published Handbook on Service Level Benchmarking. It is a reliable source for understanding the status of service delivery in the ULBs. Accordingly, 13th finance Commission taken the SLB norms as the criteria to assess the service delivery in the ULBs and

incorporated the same for the allocation of performance grant for the provision of the service delivery.

Under the ambit of service delivery six basic services as far as the urban living are concerned are examined. Water supply, safe latrine, open defecation, piped sewerage system, closed drainage and road networks.

Water supply

From the table it evident that 37.83 % of urban residents don't have a reasonable access for the water supply. There is significant variation among state, while Himachal Pradesh which is having 91.2 % of water supply while Maharashtra provides to its 86.19 residents.

Table 1.3. Access to services

S.No	State	Town	HHs	% of HHs having access to			
				Water Supply	Safe Latrine Facility	Piped Sewer System	Closed Drainage
1	Andhra Pradesh	28	3871982	60.49	91.87	26.51	56.76
2	Assam	14	363997	25.79	87.51	19.74	22.25
3	Bihar	33	1021257	24.31	52.53	9.8	43.64
4	Chhattisgarh	17	741454	23.89	74.1	4.6	22.29
5	Goa	3	54281	85.41	91.57	34.9	71.27
6	Gujrat	19	3325728	88.21	85	79.67	32.82
7	Haryana	17	797675	59.58	89.12	63.67	58.23
8	Himachal Pradesh	6	52174	91.12	88.99	66.55	23.76
9	Jammu & Kashmir	8	290476	79.45	74.52	31.36	42.22
10	Jharkhand	11	648844	31.98	74.17	18.06	30.97
11	Karnataka	36	3345955	56.38	90.2	42.19	24.4
12	Kerala	11	719484	54.27	89.91	8.99	7.51
13	Madhya Pradesh	54	1912752	42.58	78.65	25.24	45.32
14	Maharashtra	35	7375743	86.19	86.12	57.86	61.8
15	Manipur	13	105962	34.3	70.81	7.76	7.15
16	Odisha	22	539415	40.63	73.3	13.36	8.72
17	Punjab	21	1110863	69.74	94.07	76.77	71.2
18	Rajasthan	26	1425780	69.01	76.28	43.66	56.05
19	Sikkim	7	33389	66.86	94.48	36.74	38.74
20	Tamil Nadu	51	2904948	59.76	91.2	56.31	69.77
21	Tripura	7	127182	30.8	67.41	1.22	3.09
22	Uttar Pradesh	73	35111675	44.14	73.44	28.31	50.62
23	Uttarakhand	12	226349	80.97	95.14	47.31	52.3
24	West Bengal	26	2284399	47.2	71.5	5.23	12.86
Total		550	36791764	62.17	83.2	41.6	46.19

Source: Census of India, 2011

Table 1.4. Present Level of Services and Projection

#	State	Access to water supply (%)		Per capita water supply		Access to sanitation (%)	
		2012-13	2019-20	2012-13	2019-20	2012-13	2019-20
1	Andhra Pradesh	74.79	95.09	100.97	128.37	69.26	97.46
2	Arunachal Pradesh	NA	NA	NA	NA	NANA	NA
3	Assam	NA	NA	NA	Na	DOES NOT ARISE	DOES NOT ARISE
4	Bihar	NIL	NIL	NIL	Nil	NIL	NIL
5	Chhattisgarh	34.12	NA	71.24	NA	84	NA
6	Goa	NIL	NIL	NIL	NIL	NA	NIL
7	Gujrat	89	99	108	127	88.67	96
8	Haryana	88	93.00	110-125	110-125	69.2	NA
9	Himachal Pradesh						100
10	Jammu & Kashmir	NA	NA	NA	NA	75	100
11	Jharkhand	DATA NOT RECEIVED					
12	Karnataka	79	95	92	110	98	82
13	Kerala	65	100	70	70	78.18	100
14	Madhya Pradesh	100	NA	135	NA		NA
15	Maharashtra						
16	Manipur	100	100	100	100	NA	NA
17	Meghalaya	NA	NA	NA	NA	100	NA
18	Mizoram	NA	NA	NA	NA	NA	NA
19	Nagaland	17.11	NA	16.3	NA	8	12
20	Odisha	81	100	255	225	81.5	100
21	Punjab	88	98	200-240	240-300	NA	85
22	Rajasthan	NA	NA	NA	150	63.89	100
23	Sikkim	NA	NA	NA	NA	NA	NA
24	Tamil Nadu	100	100	97	130	84	90
25	Tripura	98	100	135	135	93	100
26	Uttar Pradesh	47	76	90	128	90	100
27	Uttarakhand	77.91	NA	135	135	94.5	95
28	West Bengal	53.88	79.35	75.66	102.71	90.23	100

Source: ASCI Reports, 2014

Table 1.5 Absence of sewerage system

S.No	State	Municipal corporation	Municipality	Nagar panchayat	Total
1	Andhra Pradesh	8	13		21
2	Bihar	9	10		19
3	Chhattisgarh	5	5		10
4	Gujrat		2		2
5	Himachal Pradesh			1	1
6	Karnataka		5		5
7	Kerala	3	6		9
8	Madhya Pradesh	6	11	2	19
9	Maharashtra	6	7		13
10	Odisha	1	6	13	20
11	Rajasthan		17	4	21
12	Tripura		1		1
13	Uttar Pradesh	1	16		17
14	West Bengal	4	7	1	12
	total	43	106	21	170

Source: ASCI Reports, 2014

Inclusive cities and challenges before the Indian ULBs

A city is said to be inclusive if it includes all sections of the society be it rich, poor, different ethnicities, children, and olds, etc. in the developmental process. In other words, make everybody part of the process of urbanization. The following are the suggestions that can ensure better service delivery and thereby reduce the increasing exclusion in the urbanization process.

Priorities basic services such as water, sanitation in the delivery of the municipalities. The higher level governments like state and union must help the municipalities to discharge these functions. Cross-subsidization can be implemented to provide water to the weaker sections of the society. It will ensure the well-off will be disincentive from the wastage of water. Service charges can be imposed to reimburse the cost of delivery, in turn, sustain the delivery. Urban slums are worse in term of the availability of water. Area-specific plans should be introduced to cater to the differential demands. Central and state government can incentivize the municipalities to do these by altering performance grants. Since water is not an urban issue, a holistic and integrated blueprint has to be prepared for equitable conservation distribution of water. Conservations include protection of the existing water resources, rationalizing the usage, recycling and reusing the water along with ensuring just availability of the water especially for the poor sections of the society.

Sanitation is the crucial factor the efficient functioning of the cities. It adversely affects health citizens and gives rise to different epidemics. It carries the substantial economic cost in term of exorbitant medical expenditure along with the reduction of labour productivity as a factor of production. The social cost is manifesting in term of uncomfortable living in the city. Sanitation is

paramount from the individual well as the social point of view. Urban local governments should invest its fund and interest to get the sanitation right in the jurisdiction. Along with government investment, private investment can be harnessed by accommodating it under the corporate social responsibility. The public-private partnership is also an effective method to finance these ventures.

Open defecation is never being a rural alone problem; there have been significant incidents of open defecation in the urban jurisdiction. It is a spurious and alarming phenomenon which causes hazardous health infections moreover it is a blow to the human dignity. Lack of physical toilet with complete equipment including water is the primary reason for the open defecation. A substantial quantum of investment is required to remove this menace along with broader campaigning to create awareness among the masses. The later is not substitute for the former, and the flagship program like 'Swach Bharat' should go in such way that respecting this priority. Involvement of non-governmental organizations is critical in these spheres. Safe and hygienic latrine must be the right based priority for ULBs in the country.

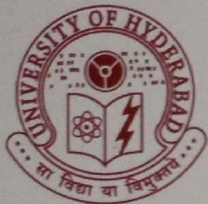
Piped sewerage system and closed drainage systems are imperatives as far as the waste management of the cities are concerned. Half of the Indian cities are without piped sewerage system is a matter of concern. Cities are the producers of the large quantity of contaminated and polluted water in addition to it dumping various sorts of wastage both human and other. it grabs the huge socio-economical and health menace in the cities. Not only has the fact that it spread epidemic rather it ruined comfortable living in the jurisdiction. The wastage of all sorts must be adequately piped and dispose of scientifically with technology best available I the market. If it doesn't

address timely and adequately it would further imageries urban development.

Connectivity is another significant factor as far the basic services are concerned. Availability of road and the type of roads and their maintenance etc. have a critical bearing on the people's movement the jurisdiction and easing their everyday life along with contributing to urban development. Some of the urban domains having very poor road connectivity and some of them having only earthen and other non-modern roads. Roads connectivity need to be revamped urgently to smoothen the urbanization process in the countries.

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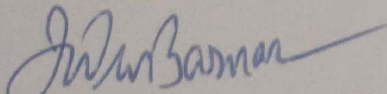
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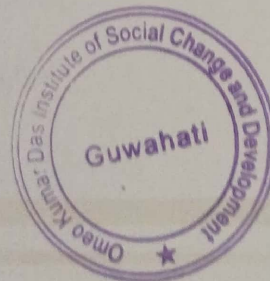
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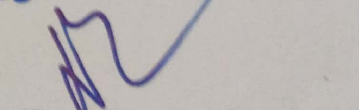
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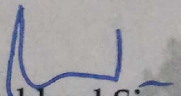
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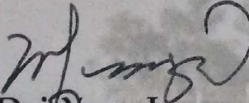
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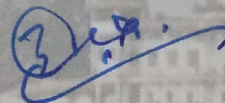
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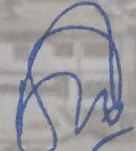
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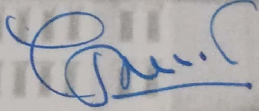
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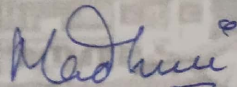

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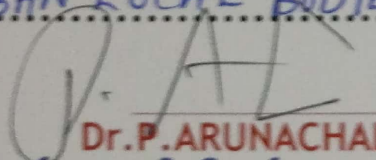
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and URBAN LOCAL BODIES: A SUSTAINABLE FORMULAE FOR INCLUSIVE GROWTH"


Dr. P. ARUNACHALAM
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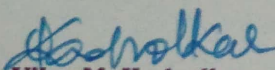
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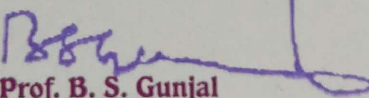
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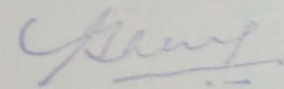
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Prof./Dr./Mr./Ms. Muhammed Riyaz M. P., Research scholar
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Organised / Participated / ☒ Chaired / ~~Moderated~~ a session in the **National Conference on 'Changing Contours of
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by Muhammed Riyas M.p

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