



Fiscal Decentralisation to Rural Local Governments in India

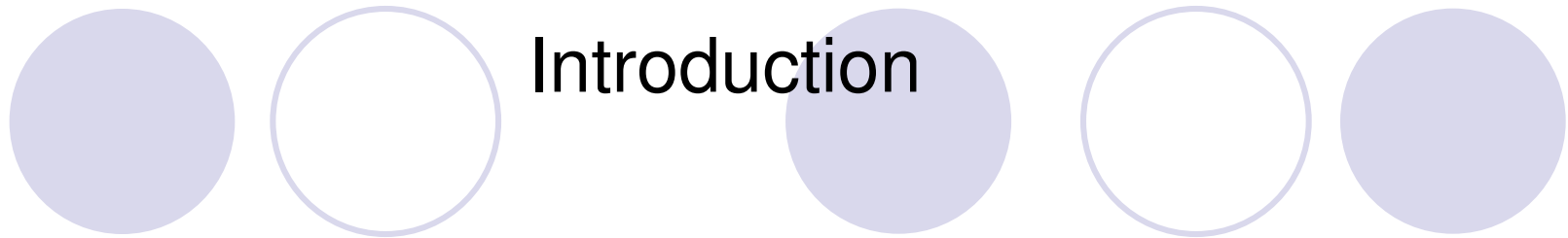
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Scheme of Presentation



- Introduction
- Design of decentralization
- The Assignment System
- Analysis of Revenues
- Analysis of Transfers to Panchayats
- Analysis of Expenditures
- Concluding Remarks



- Worldwide trend towards fiscal decentralization
- Animated discussions about gains and losses
 - Political objective: participatory governance
 - administrative objective: responsive administration
 - economic objective: wider choice through ‘exit’ or ‘voice’ , ‘voting on feet’, decentralization theorem. More effective implementation of development programs.
 - Dangers of decentralization; issues of elite capture, poor implementation capacity and corruption.
- Wanted: A systematic analysis of fiscal decentralization;
- Very few analytical works based on a reasonably good sample size: The analysis here is based on the Karnataka study

Revenue and Expenditure Decentralization in India – 2002-03

Level of Government	Per Cent of GDP			Per Cent of Total		
	Rev Raised	Rev accruals	Expenditures	Per cent of Own Revenues	Per cent of Revenue Accrual	Per cent of Total Expenditure
Centre	11.96	8.14	13.66	62.0	40.6	44.6
States	6.97	10.43	15.45	36.1	52.0	50.4
Local	0.36	0.99	1.55	1.9	7.4	5.1
Urban	0.3	0.51	0.57	1.6	2.5	1.9
Rural	0.07	0.97	0.98	0.3	4.8	3.2
Total	19.66	21.04	30.66	100.00	100.00	100.00

Source: 1. Public Finance Statistics, Ministry of Finance,
2. Report of the Twelfth Finance Commission, Government of India. 2005.

Design of Decentralization

- Devolution of functions – Lack of clear assignment
- Parallel bodies without political accountability.
- Assignment of revenues:
 - Minor revenue handles
 - Poor enforcement capacity
- Assignment of functions
 - Overlapping
 - Functions capsuled in schemes
 - Lack of autonomy
- Transfers:
 - State Finance Commission recommendations: its relevance.
 - Central Finance Commissions;
 - Central schemes.



The Assignment System

- Assignment of functions - States have absolute discretion. All Schedule XI - 29 functions to be devolved.
- Lack of activity mapping: Several state sector programs can be assigned to local governments
- Role of GPs – 5% - TP 55%; DP 40%
- Scheme-wise devolution : 371 plan and 228 non-plan schemes in 2001-02.

Fiscal Decentralization Features

- Concentration of expenditures in a few schemes
 - In TPs 7 plan schemes constituted 71% of outlay. 4 non-plan schemes accounted for 84% non-plan outlay.
 - 16 ZP schemes accounted for 63% of plan outlay. 20 non-plan schemes accounted for 78%.
 - Major schemes implemented by GPs JGSY/SGRY (29%), Central schemes constituted 41 of GP plan outlay.
 - Considerable overlapping in the implementation of schemes;
 - **need for better design: sharing the cost - water supply schemes**
 - **multiplicity of schemes -welfare of SCs and STs- 8 Central and 47 state sector schemes. 22 for backward classes. 36 schemes in medical and public health and another 9 in Indian systems of medicine. Drinking water supply – 3 central and 22 state schemes.**
 - **Multiplication of bureaucracy - thin spread of resources, catering to special interest groups.**

Fiscal Decentralization Features



- Overlapping functions - SGRY
- Need to transfer many state sector schemes to minimize transaction costs and ambiguity and avoid duplication
- Lack of autonomy: 30 largest plan schemes: 58% salary, 11% pass on grants; 10% pass on to individuals; 16% on specified schemes; discretion 3 %.
- Extent of discretion - GP 36% TP 0.29% ZP 1.71%
- Reforms:
 - Need for a Clear Activity Mapping;
 - Subject parallel bodies to panchayat accountability.

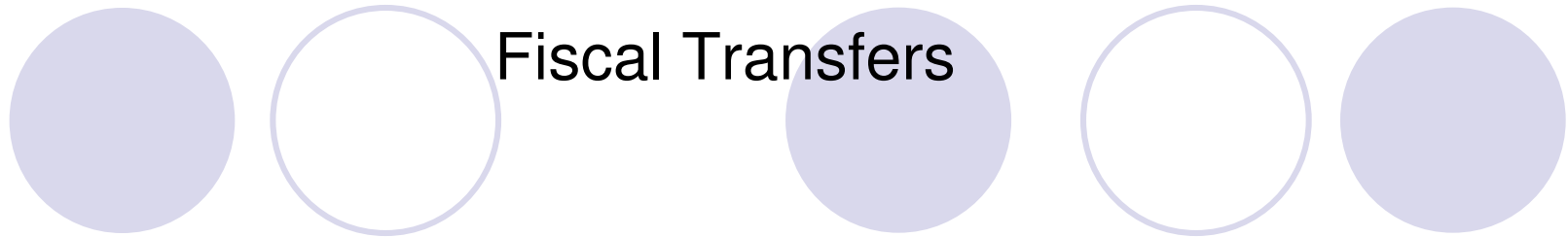


Analysis of Revenues

- Need to have own source of revenues.
- TP and ZP no own source:
- GP Sources:
 - Tax on land and buildings; exemptions and maximum rate specified by State;
 - water rates; entertainment tax other than cinemas; advertisements and hoarding; pilgrim fees; market fee, registration of cattle brought to the market; tax and auto stands; grazing cattle;
 - compounded tax on factories.
 - Land revenue cess, additional stamp duty not exceeding 3% to TPs.

Own Revenues

- Negligible Own Revenues:
 - Average - Rs. 16.22 Highest - Udupi - Rs. 31; Lowest - Bidar Rs. 6.4; 22% of total rev.
- Majority had very low collections - 92% less than Rs. 10
- Wide variations in GP revenues
- Property tax - major source of revenues
 - 49%; License fee 11%; Rent 11%; Other revenue 21%.
- Problems with property tax: ceiling rate stipulation does not make sense; No capacity to enforce: Poor collection efficiency: 69% of demand; 50% of GPs less than 75%, 21% less than 50%.
- Unduly high cost of collection: 72%. 57% in the case of property tax.
- 36% GP had more than 100% cost and in the case of property tax 42% of GPs had more than 100%.
- Determinants: property tax unrelated to income proxy variables (gross cropped area/irrigated area). Accessibility to markets (road length and metalled roads) - important.
- Tax performance is better in more developed districts.



Fiscal Transfers

- State Finance Commissions - Article 243 (i) and 243 (y) of Constitution.
- Lack Of regularity and coordination
- Lack of professionalism
- Working with virtually no information
- No convention of accepting the recommendations
- Central Finance Commission transfers: Negligible
- State transfers: Lack of autonomy.



Concluding Remarks

- Decentralization process can not be done *de novo*. Has to be calibrated keeping the institutional details. Yet reform should keep the implementation rules in the background.
- Clear activity mapping is the first step in decentralization reform
- Revenue powers and capacity building.
- Unbundling the schemes and transfer of untied funds.
- Capacity building in local bodies on fiscal issues. Standardized, simple accounting format; training in fiscal aspects of decentralization;
- Greater flexibility is possible only when the schemes are consolidated and local governments acquire greater command in implementation. Both central and state schemes need to be rationalized.
- Clarity of line agencies; Need to ensure accountability of the employees to local bodies;
- Decentralized planning: Building up from Gram Sabhas.
- Poor information system - need for reliable data for any meaningful policy and analysis.