Chapter 4

Local Government Finances: Trends, Issues and Reforms

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An understanding of the effectiveness of local government is incomplete without an insight into its financial arrangements and practices. In India, this is somewhat complicated due to divergent institutional features of rural and urban local government systems. Data limitations render the task more difficult: information on the finances of rural local governments is almost completely lacking, and coverage of financial data on urban local governments is inadequate. Some information is available from periodic official reports; but these are neither up-to-date nor even complete. Paucity of local government financial data results from a lack of effective demand due to (1) confusion on the role of local government; (2) lack of understanding of its institutional status; and (3) limited financing of the necessary statistical work.

GENERAL BACKGROUND

Role and Status

Indian local government has a colonial past; it was introduced toward the end of the last century to provide relief to the Imperial exchequer by financing essential community services out of local taxation, supplemented by limited grants for social services and rural works. Local governments were created as delegated authorities of the central (later provincial) government. Within their delegated sphere the local authorities were to be autonomous and rarely interfered with.

After independence in 1947, following an influencial report chaired by Balwantrai Mehta (India, 1957), rural local government, called *panchayati raj* institutions (PRI), was completely reorganised and modelled on the Soviet pattern. The divergence of the PRI in the rural areas from the generic system of local government in the urban areas, called the municipal authorities (MA), occurred with the implementation of the Mehta report in the 1960s. A marked change in state-local relations also took place through increased centralization, with the adoption of the Soviet system of planning and resource mobilization. Since the MAs remained outside this arrangement, they were left to their own devices to meet their increased fiscal needs.

As a corollary to the general trend of centralization, local governments have been subjected to arbitrary supersessions. About half of the local authorities in the country since independence have been superseded at any point of time. All local authorities have had this fate at one time or another, sometimes lasting for more than a decade. This problem was sought to be controlled by conferring constitutional status to local governments through two bills which, however, failed to secure the required majority in the Parliament (India, 1989b).

Organizational System

During the colonial era, local authorities were of five types: three in the urban areas (municipal corporations, municipal councils, and town or notified area authorities) and two in the rural areas (district boards and union boards). All of these authorities functioned separately and were directly controlled by the state governments. The PRIs are layered on the Soviet pattern, where the lower tier is organically linked with the next higher tier: *gram panchayats* at the village level, *anchal* (or *taluk* or *mandal*) *panchayats* at the area (or block) level, and the *zila parishads* at the district level. The PRIs are attached to the states' field administration, while the MAs continue to be detached from the states, as their English counterparts. (The present numbers of different types of local authorities are shown in Table 4.1).

Administrative, financial, and executive control of local governments by higher levels -- based on a distrust of their elected councillors -- was a feature of colonial local government in India. Further tightening occurred after independence. State government cadres of officials occupy key positions in local government, while the local executive functionary is a state-appointed civil servant. The only exception to this arrangement is the municipal councils in a few states, where the chief executive functionary is the elected chairman (weak-mayor), and the municipal corporations in West Bengal with a cabinet-type executive headed by an elected mayor (strong-mayor).

Operational control over local authorities stems from the states' power of approval and sanction of both administrative and financial decisions, as well as the parallel delivery of local services and usurpation of local tax powers by the states. The concept of autonomy in local government decisionmaking is thus severely limited, both in law and in practice.

LOCAL GOVERNMENT FUNCTIONS AND FINANCES

The relative importance of local government in a country is usually judged by the share of its expenditure in total government expenditure; the accepted norm in the developed countries ranges between 20 per cent and 29 per cent (Marshall, 1969). India is well below the norm, with local government accounting for only 8.6 per cent of total government expenditure in 1976-77 and 6.4 per cent in 1986-87 (Table 4.2), even though during the same period its share in GNP rose from 1.6 per cent to 2.1 per cent. A minimum target of 15 per cent of total expenditure for local government is desirable and achievable if the proposed 1989 bills are passed, allowing for the federal nature of the Indian polity. The desired increase in the ratio of local government expenditure to GNP should be at the expense of the central government rather than that of the states.

Functions

Functional delegation of powers to local governments is made in terms of the English doctrine of *ultra-vires* -- meaning that the local authorities are to operate strictly within the scope of delegated functions. Most municipal legislations, however, contain a general clause to cover local welfare and well-being, and this residual functional delegation could approach the continental doctrine of "general competence". Nevertheless, state governments are not averse to undertaking parallel local functions without amending local government legislations. Another peculiar aspect is a process of division of labor between state and local government functions in terms of development and maintenance, whereby local authorities are supposed to take over state-financed projects for operation and maintenance using their own resources. This is fairly common in metropolitan and district development, creating undue financial strain on the fragile revenue base of local governments and distorting local expenditure priorities.

The narrow range of functional jurisdictions of local authorities, as distinct from their permissible functional domain, is more evident in the PRIs than in the MAs, due to: (1) parallel local service provision by state agencies, (2) the role specification of the local authorities mainly for maintenance tasks, and (3) inadequate arrangements for financing their assigned services. In any scheme of reform, therefore, the function-finance nexus needs to be considered in a wholistic manner.

An analysis of the functional domain of local governments (in Appendix 4.1) shows that the exclusive functions for rural authorities are only five, with another six being concurrent with the states; for the urban authorities the exclusive functions are 14, with another 16 being state-concurrent. All of these are civic services, and some of them are of a regulatory nature, especially the urban services. Although the rural authorities are also supposed to undertake social, welfare and agricultural services, these are largely provided by the states, sometimes through the agency of the rural governments at the area and district levels, despite the long list of functions allotted to the various categories of rural authorities (Table 4.3).

Expenditures

Local functions are usually divided into obligatory and discretionary categories, but such a distinction is only notional in the absence of any quantitative specifications. Urban authorities are reported to be equally dividing their expenditures on these two categories (NIUA, 1989).

Available data on local government expenditures (Table 4.4) show similar functional coverage by urban and rural authorities, despite their differences in functional competence. Such similarities also appear in expenditures on civic and social services, although their relative importance varies. Rural authorities spend relatively more on social services due to the greater availability of function-specific grants for education, health, and welfare. Urban authorities, being financially self-reliant, spend more on community services like public health and sanitation. With increased financial strain resulting from rising staff salaries, urban authorities are cutting down their expenditure on social services and concentrating more on community services and on their core or obligatory services to cope with financial strain. Among rural authorities, the village and area-level authorities are more effective in providing local services than those at the district-level.

The search for economy and efffectiveness in local government expenditures seems to lie in the direction of obtaining "value for money" through : (1) cheaper technology, (2) greater productivity, (3) increased competition, and (4) promotion of joint services. In such efforts, local government manpower issues have a critical significance which sometimes takes on political overtones. Yet there are isolated success stories from various local authorities in this regard, which need to be collected and widely disseminated for replication elsewhere.

Revenues and Taxation

The dissimilar nature of rural and urban governments is apparent from their differing revenue structures: in the former about 89 per cent of revenues are derived from the states, while in the latter about 81 per cent of revenues are internally generated, with local taxation claiming about 55 per cent and nontax revenues about 27 per cent in 1976-77 (Table 4.4). By 1986-87 the dependence of urban local governments on external assistance had increased from 19 per cent to 23 per cent. This was related to the declining share of nontax revenues -- a trend which is likely to continue. On the other hand, a substantial reduction of external dependence in the revenue structure of rural governments must await a radical restructuring of their tax competence, mainly through the assignment of land revenues. Until this happens, rural local government will not develop its own personality, while urban local governments will continue to be marginalised in a generally unified Soviet-type fiscal arrangement.

A state-wise breakdown of local government revenues indicates that three states (Maharashtra, Gujarat, and West Bengal) account for about two-thirds of rural government revenue, while among urban authorities the situation is more variegated, with only one state (Maharashtra) claiming a disproportionate share of 39 per cent (Table 4.5). This is mainly due to the importance of octroi in internal revenue (Maharashtra and Uttar Pradesh) and larger external assistance (Maharashtra, Madhya Pradesh, and West Bengal). In Madhya Pradesh the urban authorities claim more external assistance (43 per cent) due to their share of compensation for the state entry tax. Maharashtra's dominant reliance on internal revenue for both tax and nontax sources (86 per cent both rural and urban) also is striking.

The internal revenue mobilization picture of local authorities is diverse: among rural governments the best performers are Kerala and Uttar Pradesh (61 per cent each), followed by Himachal Pradesh (53 per cent), while among urban governments the highest ratings belong to Haryana (99 per cent), Karnataka (95 per cent), and Punjab (92 per cent). The worst states in terms of rural government revenue mobilization are West Bengal and Orissa (3 per cent each), followed by Bihar (8 per cent); in urban government the worst state is again Bihar (less than 40 per cent), while others are way above (Table 4.5).

Per-capita revenues of the various tiers of rural government and types of urban government show their relative fiscal resilience: the village and area authorities are more effective in rural government, while the municipal corporations and councils are effective in urban government. The town and notified authorities are a shade better than the village councils in terms of revenue performance (Table 4.6). On an overall basis, there seems to be a need to enhance minimum revenues of rural authorities substantially (at least five-fold), while the urban authorities need a minimum of half of this level of revenues. This would imply increased tax devolution to the rural authorities and increased assistance for the urban authorities (Table 4.7). A detailed look at the revenue competence of rural authorities shows the need for strengthening their compulsory taxation capabilities through assignment of land revenue and devolution of land cess (Table 4.8).

Local government tax powers include 27 state taxes for rural governments (20 exclusive and 7 concurrent) and 20 state taxes for urban governments (9 exclusive and 11 concurrent), as detailed in Table 4.9. Only minor state taxes have been allocated to rural governments, while urban governments have access to 9 major taxes (including the central terminal tax). Only two taxes, octroi (exclusive) and property taxes (concurrent) account for about 90 per cent of municipal tax revenues -- 70 per cent under octroi and 20% under property taxes (NIUA, 1989).

Apart from limited tax powers, urban local governments are experiencing increasing state intrusions into their tax domains, covering virtually all the important taxes devolved to them. Earlier, under the Government of India Act, 1919, there was a separate "local tax list" for exclusive utilization by local governments; this was abolished with the introduction of provincial autonomy under the Government of India Act, 1935, reaffirmed in the Constitution of 1951. Various commissions and committees have suggested revival of the local tax list through a consensus or under a constitutional amendment. Under the 1989 bills this is left to the judgment of the mandatory state finance commission for each state.

The productivity of local taxes is low. In rural governments, this is partly due to the absence of a compulsory list of taxes and a prescribed minimum rate of levy; in urban governments, there is reluctance to levy high rates of compulsory direct taxes (property and service taxes). The tax collection performance of local governments is also low (around 30 per cent for rural governments and 50 per cent for urban governments). In the non-octroi states in the eastern and north-eastern areas, the tax collection performance of the urban governments is relatively unsatisfactory (NIUA, 1989). The remedy seems to lie in a variety of directions. On the internal side, innovative management and a system of incentives and penalties are important (Delhi Municipal Corporation achieved a 96 per cent improvement in 1986/87); on the external side, local tax performance could be included as a factor in determining the level of general or incentive grants to local government (as in Gujarat).

Considering the small share of local taxes in the total taxes levied in India (5 per cent), it is unlikely that greater utilization of these taxes would materially affect total tax incidence. In any case, the per capita tax incidence of octroi is negligible and the incidence of property tax may be mildly progressive (NCAER, 1980). The buoyancy of local taxes also compares well with similar state and central taxes.

Among possible tax-related reforms, there is a case for imposition of a poll tax to defray the cost of providing a package of local community services that emphasizes local voter-accountability. Such a tax has replaced domestic rating in the UK and is being levied in Nigeria and Papua-New Guinea. In the Indian context, a poll tax would have considerable merit in the PRIs and in the smaller MAs where either the land rate or the property tax is difficult to operate. Its extension to larger MAs would, however, be difficult in the absence of requisite information on assessable adults "resident" in a local area. This is apart from the requirement of large exemptions to unemployables and acceptance of the tax in cash or in labour. Once poll tax succeeds in the smaller MAs, its extension to the larger MAs could be considered to partly relieve the burden of property tax.

The local taxes on professions, trades, callings and employment are being increasingly taken over by the states, and, in spite of the recent increase in their taxable limit to Rs. 2,500 from the earlier Rs. 250, they are rarely utilized to their full potential. There is a need to raise the taxable limit of the professions tax to the full extent of income exempted from income-tax (now Rs.18,000) and utilise this as a lower level income-tax (LLIT), as is done in many countries in southern Africa. Municipal corporations at least should be allowed to use the professions tax as an assigned tax, leaving the rest for sharing with other local authorities on derivative principles. This would widen the local tax base and the own income of the local authorities in a situation when the other two major local taxes (octroi and property tax) are faltering.

The issue of abolition of local octroi came up almost simultaneously with the introduction of local government in the country. During the colonial era the central government pressed for its abolition, while the provincial governments steadily extended its scope (Tinker, 1967). The debate continued after independence, and a few state governments are now actively considering its abolition, mainly due to the pressure of the transport lobby. Octroi was replaced by a state-wide entry tax in Madhya Pradesh (1977) and Karnataka (1979); by a terminal toll in Jammu & Kashmir (1990); and by a surcharge on the state sales tax in Uttar Pradesh (1991). Abolition of octroi has been advocated because of several problems associated with it: (1) hindrance to trade, (2) corruption at the checkposts, (3) high cost of collection, and (4) wastage of time and fuel. The present emphasis is on: (1) the adverse effect of local trade barriers on the national economy and (2) avoidance of the cascading effect of the tax due to its coverage of raw materials and intermediate goods. Despite these shortcomings, octroi continues to be levied in 8 out of the 25 states in the country (Table 4.10). It is interesting to note that while some of the major octroi-states are now thinking of its abolition (Gujarat, Maharashtra and Rajasthan), some other non-octroi states have either opted for it (Manipur, Meghalaya, and Orissa), or imposed trans-local octroi or entry tax to mobilize additional local revenue (West Bengal and Assam).

The experience with the working of the state entry tax in Madhya Pradesh shows several shortcomings, including (1) its limited nature, (2) its coverage of intermediate goods, (3) its partial revenue retention by the state, the compensation being based on a fixed percentage of revenue growth, (4) its adverse effect on the liquidity of local finances, and (5) its erosion of local fiscal autonomy. The other two basic objections against the entry tax are that (1) it is of doubtful constitutional validity, since octroi is a local tax whereas entry tax is not, and (2) the replacement of check-post collection by return-based collection does not remove the adverse economic consequences of internal trade restrictions. Substitution of octroi by terminal toll is a retrograde step since the latter is imposed not only on goods but also on passengers carried by road. A surcharge on sales tax makes the impost too heavy on the existing dutiable goods already subjected to the state sales tax.

Replacement of octroi by a new tax is contingent on the following conditions: (1) the replacement should be return-based, (2) it should be revenue neutral, (3) it should not be more regressive, (4) it should ensure free flow of internal trade, and (5) it should be a local levy. So far the search for a viable local tax substitute for octroi has proved elusive, as all of the possible alternatives -- with the exception of a business property tax -- entail overlapping tax jurisdictions (Nath and Sen, 1989). The business property tax cannot be counted upon due to the lack of evidence of market value for property use or transfer. A local surcharge on sales tax could be allowed to the metropolitan cities, unless terminal taxes are imposed therein; for the other local authorities, a state surcharge seems to be a practical replacement. Both these may eventually entail the transformation of state indirect taxes into a retail value-added tax, shared between the states and local governments under a fixed formula, as in France.

Overall Situation

The surplus syndrome in local government budgets is a familiar phenomenon (Table 4.4), despite the very low physical level of various local services. Partly it is a legal fiction, since local authorities are required to present a surplus budget to meet contingent liabilities and actual shortfalls in revenues. However, there is evidence that these surpluses could be quite large, and there is no discernible cycle of their accumulation and utilization. The reasons could be that (1) local revenue expenditures are pegged at a lower level due to uncertainties in external assistance and (2) there is a desire on the part of urban authorities to finance part of their capital expenditure from revenue surpluses (Datta, 1990a).

Financing of local government services is linked with the issue of a normative level of local expenditures. Attempts have been made to define such norms for urban services in terms of assumed physical standards by a committee of state ministers headed by Rafiq Zakaria (India, 1963b), although local resource availability (both internal and external) and shifts in local expenditure priorities (toward personal rather than property-related services) would make nonsense of such assumed standards. On the basis of Zakaria norms, the MAs would require at least Rs.5,363 million of grants annually during 1990-91 to 1994-95 on the assumptions of constant (1986-87) prices, stable population growth (1971-81 rate), and municipal fiscal stability (at 1986-87 levels). This requirement may increase or decrease depending on the choice of methods adopted to bridge municipal fiscal gaps (NIUA, 1989). No such commitment to underwrite municipal fiscal gaps has been made by the states.

LOCAL LAND AND PROPERTY TAX REFORMS

Rural Land Tax

Rural land tax refers to the local land cess or levies on vacant land in rural habitations (*lal dora*), as distinct from taxes on agricultural land (land revenue or agricultural income tax). The cess is imposed as a surcharge on land revenue, although it is also levied on presumed rental value in West Bengal, Bihar, and Orissa (where this is combined with property taxes). So far the rural land tax has been a minor local tax, as it is generally an assigned or a shared tax. A case could be made that its linkages with land revenue should be severed, along with its devolution to rural government. Ultimately, the tax should be completely merged with property taxes, as in urban government, to resemble its rating characteristics. Earlier thinking of the Santhanam Committee to separate the land rate from a combined property and circumstances tax seems somewhat short-sighted in this context (India, 1963a). However, the suggestion for a change in the method of its valuation from a rental to a capital value base appears to be sound, in view of the difficulties in ascertaining rental evidence in the rural areas.

Property Tax

Property tax, also known as house tax, is a tax on buildings, along with appurtenant land, imposed on owners. The tax is narrower than the UK rate which includes "heriditaments". Property tax, therefore, resembles wealth tax as in the USA and differs from the excise-type UK rate. The concept of ability to pay has limited applicability for this tax due to its *in rem* nature; moreover, the concept of benefit taxation is not quite relevant here (unlike in the case of service taxes) due to the general nature of the tax. These characteristics are important from the angles of its treatment in national accounts, assessment of tax incidence, tax harmonisation arrangements, and tax policy considerations. The major aspects of property tax reform are considered below.

Vacant urban land is generally exempted, except in a few cities (such as Delhi, Calcutta, KAVAL cities in U.P., Ahmedabad, and Visakhapatanam). Where property tax is levied on vacant land, it is at the same rate as the basic tax, but with a poor collection record. There is a case for its wider use in the rapidly growing towns and cities, particularly in the municipal corporations, to combat land speculation and to ensure optimum land use in urban areas. As a measure to mop up increments in urban land values, this is probably not very effective (e.g. the urban land tax in Tamil Nadu). Domestic owner-occupied property is lightly taxed through lower assessment, lower rates, or rebates -- usually as a matter of convention. The extent of revenue leakage on this count is sometimes substantial (e.g. in Gujarat), although there is probably a case for a lower tax rate where valuation is not depressed due to a rent freeze or for limiting the extent of revision during two valuations.

Taxation of government properties also needs a review. Central government properties are exempt under the Constitution (Article 285) until the manner and extent of its imposition is permitted by Parliamentary legislation. No such law has been enacted so far, and the present arrangement is based on a central executive decision exempting these properties from the basic tax but allowing imposition of notional service charges. As for state government properties, practice varies; usually there is a notional contribution on this count as an *in lieu* grant. The Indian practice, therefore, differs from that of the UK of full *in lieu* compensation for tax exemption of Crown properties. There is no reason why the same arrangement should not be adopted in India for taxation of both central and state properties.

The properties of foreign embassies and legations are also exempt, although it is curious to note that exact reciprocity is not insisted upon (for example, the USA does not give any such exemption, while it enjoys this advantage in India). The situation may be easily corrected through central action; but the question remains as to whether this should also be compensated through an *in lieu* grant by the centre.

The basic property tax is usually accompanied by a number of service taxes, for water supply, drainage, conservancy, lighting, fire, education, and so on. These service taxes are to be distinguished from service charges: they are levied where the particular service is made available to residents, irrespective of its actual consumption. Here one has to make a distinction between excludable and non-excludable services, since only in the case of the latter is the concept of service tax relevant. Hence service taxes correspond to benefit taxation. Where there is a consolidated property tax combining basic and service taxes, as in West Bengal, there is scope to withdraw the concession for non-provision of particular services. An alternative method of property taxation would be to impose a variety of taxes on a detailed classification of properties, rather than on a classification of functions, and impose full user charges for consumption of local services, as prevalent in the USA (K.S.R.N. Sarma, in Datta, 1983). This may not, however, be immediatley feasible under Indian conditions.

Valuation of rural property is generally based on capital value; where it is based on rental value, this is largely notional. The rural property market is not bedeviled by black money, so the capital value base is probably realistic. Urban property valuation, however, poses formidable problems without much hope for an immediate solution. It is generally based on the notional rental, or net annual ratable value (ARV). Properties incapable of producing rent are valued by the cost method, but this is mistakenly termed as capital value.

In a few states (Orissa, Assam, and Kerala) a combination of plinth area, structural characteristics and location is used for urban property valuation to produce the legally mandated ARV. In Andhra Pradesh this practice has recently received legal sanction (Andhra Pradesh, 1989), although one could still question the validity of defining ARV in terms of a set of composite criteria rather than the legally mandated rental under rent control legislation. As an informal guideline, however, such composite criteria could be used for operational and training purposes for property valuation and assessment (Rakesh Mohan, in Datta, 1983). In Tamil Nadu, plinth area is a permissible method of valuing rural property. So far these aberrations have gone unchallenged in the courts, but in recent years (since 1961) the Supreme Court has systematically struck down legal provisions based on the floor area or a composite method of property taxation (see, M.K. Balachandran, in Datta, 1983). The reason for attempted substitution of the rental method by the area method, at least in urban areas, is the virtual freezing of the rental market under rent control legislations. The mandated "standard rent" is the upper limit of rental for valuation purposes, irrespective of the actual or prevalent rent. Since rent control is a politically explosive subject, the states are reluctant to substantially liberalize it to allow a relatively free rental market. Some sporadic efforts have been made, however, to introduce a rent control holiday for new constructions or to exempt high rentals from rent control. At the same time, there is an active search for replacing the rental value method by other methods, such as the capital value method and the plinth or area or composite method.

Capital value method. Since the capital value method is based on the comparable sale value of property in a free property market, there are formidable problems hindering its introduction in urban areas, due to a mix of black and white money in urban property transactions, usually in a ratio of 3:2. As the urban property market is even more distorted than the rental market, introduction of the capital value method is not considered to be a feasible proposition for urban property valuation under Indian conditions (West Bengal, 1982; Delhi, 1990).

Area or composite method. The area or composite valuation method implies a tax on quantity rather than on value. As a tax base, it is medieval in nature (like a window tax or a hearth tax) and does not fit into modern monetized economies. Additionally, it offends the constitutional guarantees on equality (Article 14) and holding of property (Article 19). At least two official committees (West Bengal, 1982; Delhi, 1990) have rejected the method after detailed examination of its implications and practicability. Earlier in the UK, the Layfield Committee came to the same conclusion due to the "insurmountable difficulties in deciding the weights to be attached to the less tangible factors" under the composite method (UK, 1976).

The future direction for reform of the property tax base in India seems to lie in liberalizing rent control legislation, so that the rental market can generate realistic data for tax purposes. The method of valuation needs to be easily and widely understood by the taxpayers, tax officials, and the courts.

The rate structure of property taxes is generally flat or proportional, with enabling provisions for progression. In the municipal corporations the rate is usually progressive, with a separate higher schedule for non-domestic properties. There are problems inherent in such a progressive rate structure: (1) high exemption limit resulting in a narrow tax base, (2) crowding of most properties in the lower rate brackets, with higher cost of assessment, (3) a step system of rating resulting in tax evasion and inequality at the margin, and (4) nontransparancy of the average effective rate. There is an attempt to moderate the multiplicity of the step system through the introduction of marginal relief, as in income tax (e.g. in the Delhi municipal corporation) or linking the floor and ceiling rates by a straight line (e.g. in West Bengal).

An examination of the flat rating practices shows a notionally higher rate (e.g. in the Bombay municipal corporation) than could be sustained by normal property rental, leading to derating of properties to counter rent control. Its wider use may lead to extreme inequities in the distribution of property tax burden; the long-term goal needs to be to reduce the effective rate to reasonable levels, say 10-15 per cent for domestic and 15-20 per cent for non-domestic properties (Delhi, 1990).

Taxation of nondomestic properties, now being attempted through higher rentals or rates, is not adequate on business properties, which should contribute a larger share in property tax revenues. Following the UK practice, one could suggest a state-wide rate determination of properties used for industry, trade and commerce, entertainment, and professions. Also, it may be easier to remove these from the purview of rent control legislation so that their valuations could be related to market, rather than standard, rent.

COST RECOVERY FOR LOCAL PUBLIC SERVICES

Merit Goods

In theory, direct cost recovery for merit goods is possible where: (1) the minimum needs of merit goods are met through specific grants, (2) the extent of cross-subsidization of users is limited, and (3) the charging method is both feasible and cheap. None of these conditions applies in the local government sphere in India. The case for charging for local services becomes strong only after the basic community and social service needs are met. A few illustrations of specific local services are attempted below.

Water supply. The public health and environmental needs for potable water supply comprise a basic community service need that is still to be met. Since water charges are related to assessed households, the non-assessed household population has to be subsidized either from increased property taxes or from a higher charge level, or a combination of both. It is also not feasible to levy differential charges based on the nature of consumption -- for drinking, household use, gardening, etc. However, it may still be worthwhile to shift a part of the burden to nondomestic consumers in the larger cities, even when water supply charges are tagged to the property tax base. Service charges for disposal of liquid wastes and sewerage suffer the same disabilities of the basic charge, since these are piggy-backed on water charges. Differential charges on domestic consumers for water and related services are inequitable if only the property tax payers are made to pay for consumption by others.

Solid wastes and garbage disposal. Collection and removal of solid wastes and garbage are examples of public goods and are supposed to be met from tax revenues, except where there is an excess generation for special purposes regarded as merit goods (e.g. building construction, land clearing, markets, slaughter houses, hospitals, waste-discharging industries, etc.). Special charges could be and usually are made for these activities by the local authorities, within the constraints of collection cost.

Education and health. So long as the local authorities are concerned with extension of basic social services through universal coverage and access, it is difficult to see how direct cost recovery is a relevant consideration. There is, of course, a possibility of reducing the operational cost if voluntary agencies are involved in service delivery. The experience of charging for these services under the World Bank (IDA)-financed Calcutta slum improvement programme has not been successful. Where local authorities undertake provision of personal social services, like education and health, there are possibilities of charging fees under private auspices, unless means-testing of the beneficiaries is practicable for local public services.

Private goods. Local governments deal with very few private goods. Where city transport and electricity are under municipal ownership, as in Bombay, the gains from electricity make up for the transport losses. There are examples of revenue success of isolated municipal ventures, such as sanitary land-fill (Delhi Municipal Corporation); pay toilets (Tamil Nadu); bus and cart stands (Kerala and Tamil Nadu); markets, shopping centers and slaughter houses (Kerala); and so on. Urban authorities in Kerala have relied the most on income from municipal property (12 per cent of total revenue). Again, the New Delhi Municipal Committee has achieved notable success in raising substantial revenue from real estate development on *nazul* (government) land through joint ventures with the private sector.

During the 1960s, local governments in India were encouraged to rely on revenues from local enterprises, following the practice in the socialist economies, but the results have fallen far short of expectations in the absence of protected markets for their products.

Alternative Private Provision

Deregulation prospects for local government services are not too obvious, as these authorities undertake very few market-related activities. On the other hand, there are opportunities for joint or cooperative ventures with the private sector, especially in real estate development on the urban fringes and in urban renewal. Where municipal undertakings are losing concerns (e.g. city transport in Pune, milk supply in Ahmedabad), their privatization or deregulation could be considered.

Some municipal services may also be contracted out, such as road works, parks maintenance, and garbage disposal -- this is being practised in several cities. Even where a particular local government service is operated through private management, the franchising method could be adopted to retain local government control.

REVENUE TRANSFERS TO LOCAL GOVERNMENTS

Tax-revenue Transfers. Tax-revenue transfers include assigned and shared state tax revenues for local governments. While all the major taxes of the rural authorities are either assigned or shared, it is somewhat paradoxical that revenue grants should dominate their current income. For urban authorities, the assigned taxes are compensatory in nature, except entertainment taxes in two states (Tamil Nadu, Kerala); on the other hand, the shared taxes cover entertainment tax, stamp duty, motor vehicles tax, and now entry tax. Additionally, transfer of tax revenues is discretionary and is regarded as proxy grants, rather than local government entitlements, as in the case of the states. Assigned tax revenues, when compensatory, tap the local tax base and are to be distributed on the derivative principle; shared taxes invariably tap the state tax base, so revenue-sharing assumes the nature of tax-aid. But these principles are not respected while making tax-revenue transfers to local governments.

Three issues are relevant here: (1) tax-revenue transfers to local governments need to be legally prescribed, along with their method of distribution; (2) these are to be the principal means of revenue transfers to local governments; and (3) these are to be regarded as internal local revenues based on entitlements of local governments (West Bengal, 1982).

Revenue Block Grants

From the angle of local fiscal responsibility, there is a need for a block revenue grant to local authorities which should not exceed their internal revenues. International experience suggests a revenue grant component of about one-third of total local government revenue. This is exceeded in the UK due to a single local tax (poll tax) and a single tax assignment (non-domestic property tax), and in the sub-national entities of the Soviet group of countries due to deficit grants. Grants are not relevant for local authorities in Holland where they share a fixed proportion of revenues from a national tax pool. If Indian budgetary practices are to be followed, then both the rural and urban authorities in India should receive about 50 per cent of their total revenue from grants. On the other hand, if the practice of the Western economies is to be emulated, then the reform must start with the gradual abolition of the practice of deficit (or gap-filling) grants to the states. The implications of these approaches are now considered for local government finances.

In most western countries, general grants are supposed to equalize local tax bases (vertical equalization) and tax efforts (horizontal equalization) to meet a desired level of local expenditure in various categories, and also to meet the needs of especially disadvantaged local authorities. A minimum level of local revenue surplus (say, 10 per cent) for capital expenditure might also be specified. These requirements generally result in the adoption of a formula-based block revenue grant to the local authorities.

In the Soviet Union, block grants to local authorities are determined on the basis of a normal level of revenue expenditure for the local authorities on the one hand and an estimation of revenues from transferred taxes and local internal sources on the other. This may also be accompanied by normative expenditure specifications and normative levels of local tax base utilization. The difference between the projected approved expenditure and the desired income would be the permissible local revenue deficit or gap, to be met by a general grant.

The present Indian practice of general grants, as distinct from block grants, to local governments combines both of these methods. The urban authorities follow the Western practice by covering the needs elements through a per-capita grant and emphasizing the tax effort element through an incentive grant (e.g. in Gujarat). The rural authorities receive a part of the general grant as a deficit grant of the Soviet variety, without any entitlement. The pure Soviet variety of grants is also operated for urban authorities in the Calcutta metropolitan area under a deficit grant system -- called the Revised Grants Structure (RGS) -- introduced on the advice of the World Bank (see World Bank, 1984).

Specific Grants

There is a need to consolidate the bewildering variety of specific grants to local government into a basic needs grant covering select items of civic and community services. This grant ought to be conditional in terms of functional standards, coverage criteria, and matching local contributions. Not more than one-third of total grants should be of the specific variety, to enhance local fiscal autonomy. Under the 1989 constitution amendment bills, the provision of direct central fiscal transfers to local governments (Article 282) for both revenue and plan purposes could be activised, despite political resistance by the states. The same result might also be achieved if part of the central fiscal transfers to the states is earmarked for local governments with "pass-through" provisions.

Machinery of Fiscal Transfers

The accepted machinery of fiscal transfers to local governments for both revenue transfers and Plan assistance is the state finance commission (India, 1989b). The state commissions should have permanent secretariats to oversee the implementation of their quinquennial awards made by experts well before the appointment of the federal finance commission (India, 1983). This is to ensure the necessary financial commitment of the states to implement the state finance commissions' recommendations. In view of the observed local tax-displacement effect of deficit grants, federal grants to the states may have to be gradually brought in line with the Western practice, subsequently to be replicated by the state commissions.

The state finance commissions should also have the responsibility for suggesting the distribution of local development assistance and local functional and tax authority adjustments for various categories of local authorities. One associated gain from state finance commissions would be the availability of local financial data and the possibility of inter and intra-state comparisons of such data. Local budgetary and accounting structures could be standardized through the supervision of the Comptroller and Auditor-General, as envisaged under the proposed bills (India, 1989b). Until this happens, there would at least be standardization for all categories of local authorities in a state through the working of its finance commission.

Local Government Plan Financing

Since local governments are not integrated with national planning efforts, the term Plan financing in their contex means implementation of state Plan projects and schemes by local authorities. These are somewhat sporadic and *ad hoc*, depending on the choice of plan implementation machinery by the states and resource availability. The rural authorities hardly have any capital projects of their own, while their urban counterparts incur capital expenditures on water supply, slum improvement, markets, and a variety of civic facilities financed by (1) their own revenue surplus and (2) capital grants and borrowings from central and state Plan funds. The larger urban authorities rely mainly on revenue surpluses, while the smaller urban authorities meet their development needs from Plan grants and loans.

Local Borrowings

Plan loans are of a soft variety, so their repayment is not tied to the financial viability of projects. Such loans, when accumulated, are either rescheduled through injection of further loans or written off. Since institutional financing of local projects is also routed through the states, the distinction between Plan loan (soft) and institutional loan (hard) is somewhat weak. The only exception to this arrangement is market borrowings to finance self-liquidating projects of the larger urban authorities with repayments ensured through the creation of mandated sinking funds. Such local market borrowings are few, due to the need for state guarantee and the increased borrowing needs of the states to finance their own Plans. There is no earmarking of such state borrowings for utilization by local authorities, as is permitted for state undertakings. Effective access of local authorities to market loans would imply either waiving the need for state guarantee by the Reserve Bank of India or earmarking a part of state borrowings for exclusive use by local authorities. Market borrowings by local authorities would necessitate their credit ratings for loan eligibility. At the same time, local authorities may be allowed floating of tax-free bonds, as in the case of state undertakings.

Plan Financing

Under a reformed system of local government finances, local plans could consist of: (1) the local component (for which block Plan assistance is relevant) and (2) the state-sponsored component (for which specific or tied schemes could be made to reflect state priorities). Identification of especially disadvantaged local authorities eligible for various categories of Plan assistance would also be necessary to promote vertical equalization. This might involve separation of the state Plan into state and local sectors. At least 50 per cent of the local sector plan could thus be underwritten from a mix of central and state Plan assistance. Plan assistance for local plans could be financed entirely from capital grants, as soft loans are but a variant of the same. For self-liquidating projects, local authorities could be encouraged to obtain direct institutional loans or permitted to make market borrowings. Only the larger local authorities (municipal corporations and district councils) should be eligible for hard loans.

The Soviet system of Plan financing, as practised in India, has a tendency to increase its size in subsequent periods to cover the mounting burden of maintenance for Plan projects created earlier. The consequent increase in the revenue gap thus arises partly due to separate determination of Plan assistance and the quantum of revenue deficit-grants. Although local authorities are outside this financing arrangement, once they are integrated with national planning it would also mean increasing their dependence on external fiscal assistance and erosion of local accountability. At the same time, it is necessary to end the duality of Plan financing through unification of existing arrangements between the states and local governments, so that subsequent measures to strengthen fiscal responsibility of the states and the local governments could be uniformly applied to both.

Cost-Effectiveness

Initiatives for cost-effectiveness under World Bank - funded urban projects have been attempted through: (1) efficiency in investment programming, (2) review of design standards, and (3) improved project implementation. However, operation and maintenance of large projects tend to impose undue financial strain on the municipal authorities due to increased maintenance costs and, as a consequence, they prefer low-cost and high pay-off projects. Such investments have both hardware (workshops, vehicles, equipment) and software (accounting systems, legal and technical assistance, training) components.

Economy in local government capital expenditures is closely related to manpower issues. The prevailing attitude of the urban authorities of playing Father Christmas to their low-productivity manpower ought to be reviewed and the possibilities of engaging professional consultants explored in the case of the high-skill areas, leaving low-skill activities to be largely contracted out. By far the most widespread experience of contracting out a specific urban development responsibility for the private sector lies in the field of low-cost sanitation (Sulabh International). Similar methods could also be tried out in urban slum improvement and for a miscellany of rural development projects.

FUTURE PROSPECTS AND POLICY OPTIONS

Future Prospects

Future prospects for local fiscal reform are contingent on generic reforms in (1) the pattern of political decentralization and (2) the nature of the economic system, which are intimately linked with subnational fiscal arrangements.

Devolved decentralization. India follows a devolved, rather than an aggregative, nature of decentralization. Since decentralization extends mainly to the states and not to local governments, further decentralization has to be largely directed to the latter. This needs to be pursued as a national agenda for balancing the political power centres in a federal set-up. Ultimately, this would mean a relative reduction of central expenditures and a corresponding increase in local government expenditures (see Table 4.2).

The prospects for strengthening local governments through unification and decentralization are brighter now than ever before. The major national political parties are committed to local-level decentralization, although differing on sequencing its vertical (state-local) and horizontal (rural-urban) application. The desired balancing of multi-level governments might accompany a reduction in the share of total government expenditure to GNP (see Table 4.2). It is also suggested that reform in fiscal federalism in larger countries, like India, might emulate the Canadian system (tax overlapping), rather than that of Australia (tax separation) or that of Brazil (tax sharing). Obviously, this has to be of the piggy-backing variety and would mean enabling local surcharges on state taxes.

Reliance on market mechanism. In a country long used to a directed economy, a move toward reliance on the market mechanism is not a one-shot exercise but has to be achieved in stages. Such a change in the orientation of the economy has far-reaching consequences for the role, structure, and functioning of the government system, including: (1) the role limitations of both national and sub-national governments, (2) a reduction in the size of governments and in the number of parastatals, (3) relating public resource allocation to match market signals, and (4) basing taxation on realized, rather than on presumptive values.

Policy Options

Following the basic policy parameters of decentralization and economic liberalisation, we now consider three sets of options for policy instruments affecting local government finances: (1) local autonomy versus control, (2) private provision versus local public services, and (3) internal versus external financing.

Local autonomy versus control. Traditionally, local governments in India enjoyed limited autonomy due to their colonial origins. Rural authorities are even more circumscribed than their urban counterparts, owing to the parallel functioning of the field administration in districts and lower-level jurisdictions. Of late, urban authorities are being hemmed in due to the creation of the special area and functional authorities, which sometimes cut across local jurisdictions. These tendencies are sought to be reformed under the proposed constitutional amendment bills, through wider local functional domains, new local planning responsibilities, and creation of joint local authorities. There are also opportunities to contract out local responsibilities to state agencies. Local fiscal autonomy will also be promoted through the twin machineries of the state finance commissions and the Comptroller and Auditor-General, as provided for under the 1989 bills. These changes, when effected, would gradually replace the tutelary controls over local governments by measures supportive of local autonomy and accountability (Datta, 1990b).

Private provision versus local public services. In the case of existing local functions, privatization prospects are not self-evident. Future devolution of various functions to local governments -- for distributive-social and supportive-economic services -- will have to consider the alternative of private provision through contracting out, deregulation, and privatization. Local utilities, wherever these are operated, might be the first to involve private participation; later, community and social services also could be provided under cooperative or voluntary auspices. The road to becoming an enabler, rather than a provider, of local services may lead into many blind alleys. However, the associated local-level problems would probably be far more tractable than those facing higher levels of government.

Internal versus external financing. The need for a greater degree of external in relation to internal financing for rural governments would presumably continue for some time, but there are no obvious obstacles to a gradual reduction of undue self-financing of urban governments. Again, through the working of the state finance commissions, it would be possible to bring about a reasonable degree of uniformity in means of financing local services, including a readjustment of local functions and taxes on the one hand and relations vis-a-vis the local and state governments on the other. Success in achieving a desired ratio of internal to external financing of local services is also associated with other non-fiscal measures for achieving local autonomy and accountability. Ultimately, all subnational governments ought to have a similar ratio of internal and external financing of their services.

Conclusion

The scenario for local fiscal reforms outlined above has at least two implications. First, most local fiscal issues are manifestations of problems in the environment of local government; therefore, internal reform attempts are likely to have only a marginal impact on their finances. Second, international experience with local government reforms suggests that a partial attempt at improving certain aspects of local government (organization, finance, personnel, decisionmaking, and external relations) could be counter-productive; hence a comprehensive effort at local government reform would be more fruitful, even if the associated fiscal success is moderate, but durable. in nature.

Appendix 4.1

Functional Domain of Local Governments: Exclusive and Concurrent with States

VII Schedule of Constitution			Nature of Functions		Rural		Urban	
	Lists/items	Description			Existing	Additional Proposed[a]	Existing	Additional Proposed[b]
1.	II/1	Public order	1	Street lighting	-	-	M	-
			2	Fire services	-	-	mS	M
			3	Control of unsafe buildings	-	-	M	-
			4	Control of noxious vegetation and animals	p	-	M	-
2.	II/6	Public health and sanitation; hospitals and dispensaries	5	Public health	-	P	Ms	M
			6	Sanitation and wastes disposal	p		M	-
			7	Dispensaries and primary health centres	-	P	Ms	M
			8	Hospitals	-	P	mS	M
3.	III/18	Adulteration of foodstuffs and other goods	9	Prevention of food adulteration and other goods	-	-	mS	M
4.	III/20A	Family welfare	10	Family welfare	-	P	mS	M
5.	II/7	Pilgrimages..	11	Pilgrimages	-	-	-	M

VII Schedule of Constitution					Rural		Urban	
Lists/items		Description	Nature of Functions		Existing	Additional Proposed[a]	Existing	Additional Proposed[b]
6.	II/9	Relief of the disabled and unemployable	12	Social welfare including welfare of handicapped and mentally retarded	-	P	-	M
			13	Women and child development	-	P	-	M
7.	II/10	Burials and burial grounds; cremations and cremation grounds	14	Disposal of the dead	p	-	m	M
8.	III/30	Vital statistics including registration of births and deaths	15	Vital statistics, including registration of births and deaths	-	-	m	M
9.	II/11	Education...	16	Primary education	pS	P	mS	M
			17	Secondary education	-	P	-	M
			18	Adult and non-formal education	-	P	-	M
10.	III/25	Vocational and technical training of labour	19	Vocational and technical training	-	P	-	M
11.	II/12	Libraries,museums and	20	Libraries	-	P	mS	M

VII Schedule of Constitution				Rural		Urban	
Lists/items	Description	Nature of Functions		Existing	Additional Proposed[a]	Existing	Additional Proposed[b]
	other similar institutions..., ancient and historical monuments and records...	21	Museums and monuments	-	-	-	M
12. II/13	Communications, that is to say, roads, bridges, ferries and other means of communication....municipal tramways; ropeways; inland waterways and traffic thereon..., vehicles other than mechanically propelled vehicles	22	Roads, culvets, bridges	pS	-	Ms	-
		23	Ferries, waterways and other means of communication	pS	P	mS	M
		24	Tramcars, city transport	-	-	mS	M
13. II/14	Agriculture including agricultural education and research, protection against pests and prevention of plant diseases	25	Agriculture, including agricultural extension	pS	P	-	-
14. II/15	Preservation, protection	26	Animal husbandry	-	P	-	-

VII Schedule of Constitution			Rural		Urban	
				Additional		Additional
Lists/items	Description	Nature of Functions	Existing	Proposed[a]	Existing	Proposed[b]
	and improvement of stock and prevention of animal diseases; veterinary training and practice	27 Dairying and poultry	-	P	-	-
		28 Veteriary services	-	-	-	M
15. III/17	Prevention of cruelty to animals	29 Prevention of cruelty to animals	-	-	-	M
16. II/16	Pounds and the prevention of cattle tresspass	30 Pounds and the prevention of cattle tresspass	p	P	m	M
17. II/17	Water, that is to say, water supplies, irrigation and canals, drainage and embankmets, water storage and water power...	31 Drinking water supply	p	P	Ms	-
		32 Industrial and commercial use of water	-	-	Ms	-
		33 Minor irrigation, water management and water shed development	pS	P		-
18. II/18	Land, that is to say, rights in/over land, land tenure including the relation of land-	34 Land improvement	-	P	-	-
		35 Colonisation	-	-	mS	-
		36 Town planning, including heritage conservation,	-	-	mS	M

VII Schedule of Constitution				Rural		Urban	
				Additional		Additional	
Lists/items	Description		Nature of Functions	Existing	Proposed[a]	Existing	Proposed[b]
	lord and tenant and the collection of rent; transfer and alienation of agricultural land; land improvement and agricultural loans; colonisation		urban arts and aesthetics				
		37	Slum improvement	-	-	mS	M
		38	Housing	-	P	-	M
		39	Land use and building control	-	-	m	M
		40	Parks, playgrounds and recreational facilities	-	-	m	M
19. II/19	Forests	41	Minor forest produce	-	P	-	-
		42	Local forestry	-	P	-	M
20. III/17A	Social forestry	43	Social forestry	-	P	-	M
		44	Fuel and fodder	-	P	-	-
21. II/21	Fisheries	45	Fisheries	-	P	-	-
22. II/24	Industries...	46	Small scale,including food processing, industries	-	P	-	-
		47	Khadi, village and cottage industries	-	P	-	-
		48	Industrial and commercial estates	-	-	-	M

VII Schedule of Constitution		Nature of Functions		Rural		Urban	
Lists/items	Description			Existing	Additional Proposed[a]	Existing	Additional Proposed[b]
23. II/25	Gas and gas-works	49	Non-conventional energy (bio-gas)	-	P	-	M
24. II/28	Markets and fairs	50	Markets, fairs and slaughter houses	pS	P	M	-
25. I/31	Inns and inn-keepers	51	Inns and inn-keepers	-	-	m	-
26. II/33	Theatres and dramatic performances, entertainments and amusements	52	Licensing of theatres and dramatic performances	-	-	m	M
		53	Cultural activities	-	-	-	M
27. II/35	Works, lands and buildings vested in or in the possession of the State .the municipalities	54	Maintenance of community assets	-	P	-	M
		55	Property vested in or in the possession of	-	-	m	M
28. III/23	Social security and social insurance; employment and	56	Welfare of weaker sections, especially of the scheduled castes and tribes	-	P	-	M

VII Schedule of Constitution				Rural		Urban	
Lists/items	Description	Nature of Functions		Existing	Additional Proposed[a]	Existing	Additional Proposed[b]
	umemployment	57	Poverty alleviation programmes	-	P	-	M
29. III/33	Trade and commerce in, and the production, supply and distribution of..... (essential commodities)	58	Public distribution system	-	P	-	M
30. III/38	Electricity	59	Electrification; including distribution of electricity	-	P	-	M
		60	Non-conventional energy sources	-	P	-	M
31. II & III	...	61	General welfare and well-being	-	-	M	-

[a]11th Schedule, Panchayats Bill (1989).
[b]12th Schedule, Nagarpalika Bill (1989).
Note: Panchayats (P/p); Municipal (M/m); State (S/s).Capital letter indicates major responsibility, while small letter indicates minor involvement.

Source: India (1963 and 1989); Datta (1984).

Appendix 4.2

Tax Powers of Local Governments: Exclusive and Concurrent with States

	List/ items	*Description of Taxes*		*Nature of Tax*	*Rural*	*Urban*
1.	I/89	Terminal taxes on goods on passengers,carried by railway, sea or air; taxes on railway fares and freights.	-	Terminal taxes on goods	p	Ms
2.	II/45	Land revenue,including the assessment and collection of revenue, the maintenance of land records,survey for revenue purposes and records of rights,and alienation of revenues.	-	Tax on agricultural land	pS	-
			-	Land cess	pS	-
			-	Surcharge on land less	ps	-
			-	Surcharge on seigniorage	pS	-
			-	Tax on cultivable fallow land	pS	-
3.	II/46	Taxes on agricultural income	-	Tax on commercial crops	pS	-
4.	II/49	Taxes on lands and buildings	-	Property and circumstances tax	p	-

	List/ items	Description of Taxes	Nature of Tax	Rural	Urban
			- House/property tax	p	Ms
			- Urban land tax	-	Ms
			- Tax on multi-storey buildings	-	m
			- Taxes on water, drainage,sanitation, lighting	p	Ms
			- Education tax	-	m
			- Fire tax	p	m
5.	II/52	Taxes on entry of goods into a local area for consumption,use or sale therein	- Octroi	p	M
6.	II/53	Taxes on consumption or sale of electricity	- Oil engine tax	p	-
			- Electricity tax	-	mS
7.	II/54	Taxes on sale or purchase of goods other than newspapers,	- Pure food tax	p	-
			- Timber tax	p	-
			- Tax on sale of local produce	p	-
			- Tax on fisheries	p	-

	List/ items	Description of Taxes		Nature of Tax	Rural	Urban
8.	II/55	Taxes on advertisements other than advertisements published in the newspapers	-	Tax on advertisements/hoardings	-	M
9.	II/56	Taxes on goods and passengers carried by road or on inland waterways	-	Terminal toll	-	Ms
			-	Pilgrim tax	p	-
10.	II/57	Taxes on vehicles, whether mechanically propelled or not,suitable for use on roads, including tramcars.....	-	Non-motorised vehicle tax	p	Ms
			-	Wheel tax	-	m[a]
11.	II/58	Taxes on animals and boats tax on animals brought for sale	-	Tax on cattle fairs,	p	-
			-	Cattle tax	p	m
12.	II/59	Tolls	-	Tax on ferries	p	
			-	Road tolls	-	m
			-	Tolls on new bridges	pS	mS
13.	II/60	Taxes on professions,trades, callings and employments (suject to a maximum of Rs.2500 per annum)	-	Profession tax	p	Ms
			-	Labour tax	p	-

	List/ items	Description of Taxes		Nature of Tax	Rural	Urban
14.	II/61	Capitation tax	-	Poll tax	p	-
15.	II/62	Taxes on luxuries,including taxes on entertainments, amusements,betting and gambling or cess thereon	-	Tax on fairs, festivals and entertainments	p	-
			-	Entertainment tax	p	mS
			-	Show tax or cess thereon	-	m
16.	II/63	Rates on stamp duty in respect of documents....	-	Duty on transfer of property	p	-
17.	II	...	-	Any permitted state tax		m[b]

[a]Only in Bombay municipal corporation.
[b]Only in Uttar Pradesh.
Note: Rural (p/P), Urban (m/M), State (s/S) : Capital and small letters indicate major or minor utilisation respectively.

Source: India (1963); Datta (1984).

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Table 4.1

Local Government Authorities by Tiers/Types, 1986

Rural Government: Tiers	*Numbers*
- District Councils	369
- Area Councils	5,199
- Village Committees	2,43,582
Total	2,49,150
Urban Government: Types	
- Municipal Corporations	73
- Municipal Councils	1,767
- Town/Notified Committees	946
Total	2,786

Source: India (1989a and 1989c).

Table 4.2

Government Revenue Expenditure and GNP 1976/77 and 1986/87

(percentages)

	Share of GNP			*Share of Total Expenditure*		
	1976/77	*1986/87*	*Desired*	*1976/77*	*1986/87*	*Desired*
All Governments	18.9	33.2	30.0	100	100	100
1 Central	6.2	16.3	12.0	32.3	49.2	40.0
2 States	11.1	14.8	14.0	59.1	44.4	45.0
3 Local[a]	1.6	2.1	4.0	8.6	6.4	15.0
- Rural	0.7	0.9	1.4	4.0	2.9	5.0
- Urban	0.9	1.2	2.6	4.6	3.5	10.0

[a]Estimated

Source: India(1981) and (1989a).

Table 4.3

Expenditure Items for Rural Local Authorities (Panchayats) in Selected Major States, 1961-62

	Admn.	*Comm. services*	*Social services*	*Public works*	*Agr./Irrg. & allied services*	*Industry, marketing*	*Revenue Enterp.*	*Others*
States	*V A D*	*V A D*	*V A D*	*V A D*	*V A D*	*V A D*	*V A D*	*V A D*
1. Andhra Pradesh	Y Y Y	Y - -	Y Y Y	Y Y Y	- Y Y	- Y -	- - Y	Y Y -
2. Bihar	Y - -	- - -	- - -	Y - -	- - -	- - -	- - -	Y - -
3. Tamil Nadu	Y Y -	- - -	Y Y -	Y Y -	- Y -	- - -	- - -	Y - -
4. Maharashtra	Y - Y	Y - Y	Y - Y	Y - Y	- - Y	- - -	- - -	Y - Y
5. Karnataka	Y Y -	Y - -	Y Y -	Y Y -	- - -	- - -	- - -	Y Y -
6 Orissa	Y Y -	- - -	Y Y -	Y Y -	- Y -	- Y -	- - -	- - -
7. Punjab	Y - -	Y - -	Y - -	Y - -	- - -	- - -	- - -	Y - -
8. Rajasthan	Y Y Y	Y - -	Y Y -	Y Y -	Y - -	- Y -	- - -	Y Y Y
9. Uttar Pradesh	Y Y Y	Y - -	Y Y Y	Y Y Y	- Y Y	- Y Y	- - -	Y - Y

Note: V = Village councils; A = Area councils; D = District councils; - = Nil; Y = Yes.
Source: Maddick (1970).

Table 4.4

Income and Expenditure of Local Governments, 1976-77 and 1986-87

(Rs. Million)

	Rural		Urban			
	1976/77		1976/77		1986/87	
Income	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*
1. Taxes	591	8.1	3,228	54.4	3,377	54.3
2. Nontax revenues	199	2.7	1,594	26.9	1,443	23.2
3. Assigned/shared taxes	533	7.4	216	3.6	361	5.8
4. Grants	5,942	81.8	895	15.1	1,038	16.7
Total	7,265	100	5,933	100	6,219	100
Expenditure						
1. *General services*	605	8.3	852	14.3	796	12.8
- Administration	582	8.0	584	9.8	547	8.8
- Tax collection	23	0.3	268	4.5	249	4.0
2. *Community services*	430	5.9	1,770	29.9	2,618	42.1
- Water Supply	145	2.0	690	11.6	796	12.8
- Public health and sanitation	9	0.1	436	7.4	1,231	19.8
- Roads	276	3.8	644	10.9	591	9.5
3. *Social services*	3,303	45.5	1,199	20.2	827	13.3
- Education	3,081	42.4	580	9.8	653	10.5
- Health	222	3.1	619	10.4	174	2.8
4. *Other services*[a]	1,884	25.9	1,526	25.7	1,443	23.2
5. *Revenue surplus*	1,043	14.4	586	9.9	535	8.6
Total	7,265	100	5,933	100	6,219	100

[a]Public safety, recreation, welfare, and loan repayment.
Source: India (1979); NIUA (1989).

Table 4.5

Structure of Revenue of Local Governments in Larger States, 1976-77

(percentages)

States	Rural					Urban				
	Tax	Non-tax	Assigned/ Shared Taxes	Grants	Total	Tax	Non-tax	Assigned/ Shared Taxes	Grants	Total
1. Andhra Pradesh	9.3	1.2	4.2	85.3	100	31.0	44.7	4.8	19.5	100
	(20.5)	(7.6)	(10.1)	(18.6)	(17.8)	(4.6)	(13.2)	(10.5)	(10.6)	(8.0)
2. Assam	20.1	9.2	27.0	43.7	100	37.0	55.0	..	8.0	100
	(2.1)	(2.8)	(3.0)	(0.5)	(0.8)	(0.7)	(2.0)	(..)	(0.5)	(1.0)
3. Bihar	6.8	0.8	20.4	72.0	100	39.3	0.5	8.4	51.8	100
	(0.3)	(0.1)	(1.0)	(0.3)	(0.3)	(1.6)	(..)	(5.2)	(7.9)	(2.3)
4. Gujarat	7.6	1.0	9.5	81.9	100	67.9	21.9	NA	10.2	100
	(21.5)	(8.3)	(29.6)	(22.9)	(22.9)	(11.0)	(7.1)	(NA)	(6.1)	(8.8)
5. Haryana	NA	NA	66.3	33.7	100	76.0	23.3	0.8	2.9	100
	(NA)	(NA)	(2.3)	(0.1)	(0.3)	(2.8)	(1.5)	(0.4)	(0.4)	(2.0)
6. Himachal Pradesh	30.8	22.0	1.6	45.6	100	64.3	19.0	..	16.7	100
	(1.0)	(2.0)	(0.1)	(0.2)	(0.3)	(0.4)	(0.3)	(..)	(0.4)	(0.4)
7. Karnataka	NA	NA	..	..	..	60.4	34.6	..	5.0	100
	(NA)	(NA)	(..)	(..)	(..)	(6.4)	(7.3)	(..)	(1.9)	(5.7)

States	Rural					Urban				
	Tax	*Non-tax*	*Assigned/ Shared Taxes*	*Grants*	*Total*	*Tax*	*Non-tax*	*Assigned/ Shared Taxes*	*Grants*	*Total*
8. Kerala	29.6	31.4	27.7	11.3	100	61.9	23.9	8.6	5.6	100
	(5.9)	(18.3)	(6.1)	(0.2)	(1.6)	(2.0)	(1.6)	(4.2)	(0.7)	(1.8)
9. Madhya Pradesh	18.5	..	16.1	65.4	100	48.6	14.5	16.1	20.8	100
	(2.4)	(..)	(2.3)	(0.8)	(1.0)	(6.5)	(3.9)	(32.3)	(10.3)	(7.3)
10. Maharashtra	8.6	3.1	3.7	84.6	100	54.6	31.0	2.5	11.9	100
	(24.5)	(26.2)	(11.7)	(23.9)	(23.2)	(39.1)	(44.7)	(26.3)	(31.4)	(39.0)
11. Orissa	0.3	2.8	6.5	90.4	100	36.8	25.9	7.3	30.0	100
	(0.2)	(4.4)	(3.8)	(4.8)	(4.3)	(1.1)	(1.5)	(3.1)	(3.2)	(1.6)
12. Punjab	36.2	13.3	..	50.5	100	84.3	7.9	..	7.8	100
	(2.9)	(3.2)	(..)	(0.4)	(0.7)	(3.6)	(0.7)	(..)	(1.2)	(2.3)
13. Rajasthan	3.7	7.7	1.9	86.7	100	62.2	27.4	..	10.4	100
	(1.8)	(11.0)	(1.0)	(4.1)	(3.9)	(4.8)	(4.3)	(..)	(3.0)	(4.2)
14. Uttar Pradesh	44.5	16.3	3.1	36.1	100	53.6	26.9	..	19.5	100
	(10.7)	(11.5)	(0.8)	(0.9)	(1.9)	(9.0)	(9.0)	(..)	(12.1)	(9.1)
15. West Bengal	2.4	0.6	9.9	87.1	100	54.0	12.1	10.2	23.7	100
	(6.3)	(4.6)	(28.2)	(22.3)	(21.0)	(6.4)	(2.9)	(18.0)	(10.3)	(6.5)
Total	8.1	2.8	7.3	81.8	100	54.4	27.1	3.7	14.8	100
	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)

Note: .. = Negligible; NA = Not Available
Source: India (1979).

Table 4.6

Revenue of Local Governments by Tiers/Types, 1976-77

(percentages)

	Tax	*Non-tax*	*Shared taxes/ Grants*	*Total*
Rural Tiers				
- District Councils	6	1.2	92.0	100
- Area Councils	14.2	0.2	85.6	100
- Village Committees	34.8	18.2	47.0	100
Total	8.1	2.7	89.2	100
Urban Types				
- Municipal Corporations	72.3	14.1	13.6	100
- Municipal Councils	58.4	19.2	22.4	100
- Town/Notified Committees	49.0	18.0	33.0	100
Total	54.4	26.9	18.7	100

Source: India (1978 and 1979).

Table 4.7

Per Capita Revenue Income of Local Governments by Tiers/Types, 1975-76

	Average Population (000)	Actual Income		Minimum Desired (x5) Income	
		Per Capita (Rs.)	Per Authority (Rs.000)	Per Capita (Rs.)	Per Authority (Rs.000)
Rural Tiers					
- District Councils	1500	17.3	25,950	86.5	1,29,950
- Area Councils	15	11.0	165	55.0	825
- Village Councils	1.5	2.5	3.75	18.75	28
Urban Types					
- Municipal Corpns.	500	125.0	62,500	312.5	1,56,250
- Municipal Councils	50	66.0	3,300	165.0	8,250
- Town/Notified Comms.	7.5	46.0	345	115.0	863

Source: India (1978) and (1979).

Table 4.8

Revenue Competence of Rural Local Authorities (Panchayats) by Types in Selected Major States

States	*Taxes*		*Non-tax Revenue*		*Assigned/ Shared taxes*		*Grants*		
	Compulsory	*Optional*	*Fees*	*Property/ Enterprise*	*Stamp duty*	*Land revenue*	*Land cess*	*Other Tiers*	*State*
	V A D	*V A D*	*V A D*	*V A D*	*V A D*	*V A D*	*V A D*	*V A D*	*V A D*
1. Andhra Pradesh	Y - -	Y - -	Y Y Y	Y Y Y	Y Y -	Y Y -	Y Y Y	- Y Y	Y Y Y
2. Assam	- - -	Y Y -	Y Y -	Y Y -	Y - -	Y Y -	Y - -	- - -	Y Y -
3. Bihar	- - -	Y - -	Y Y Y	- Y Y	- - -	- Y Y	- Y Y	- Y Y	Y Y Y
4. Gujarat	- - -	Y - -	Y Y Y	Y Y Y	- Y Y	Y Y Y	- - -	Y Y -	Y Y Y
5. J. & K.	- - -	Y - -	Y - -	Y - -	- - -	- - -	Y - -	- - -	Y - -
6. Kerala	Y - -	Y - -	Y - -	Y - -	Y - -	Y - -	Y - -	- - -	Y - -
7. Madhya Pradesh	Y - -	Y - -	Y Y -	- - -	- Y -	- Y Y	Y - -	- - -	Y Y Y
8. Tamil Nadu	Y - -	Y - -	Y Y -	Y Y -	Y - Y	- Y -	Y Y -	- - -	Y Y -
9. Maharashtra	Y - -	Y - Y	Y - Y	Y - Y	- - -	Y - Y	Y - Y	- Y -	Y - Y
10. Karnataka	Y - -	Y - -	Y Y -	Y Y -	Y Y -	Y Y -	- Y -	Y Y -	Y Y -
11. Orissa	- - -	Y - -	Y - -	Y Y Y	- - -	- Y Y	Y Y Y	- Y -	Y Y Y
12. Punjab	Y - -	Y Y -	Y Y -	Y Y Y	Y - -	Y Y -	- - Y	Y - Y	Y Y Y
13. Rajasthan	- - -	Y Y -	Y Y -	Y Y -	- Y -	Y Y -	- - -	- - Y	Y Y Y
14. Uttar Pradesh	- - -	Y - Y	Y Y -	- Y Y	- - -	Y - -	- - -	- - -	Y Y Y
15. West Bengal	- - -	Y Y Y	- Y -	- Y -	- - -	- - -	- - -	Y - -	Y Y Y

Note: V = Village councils; A = Area councils; D = District councils; - = Nil; Y = Yes

Source: Maddick (1970).

Table 4.9

Tax Powers of Local Governments, 1990

	Rural taxes				Urban taxes			
Powers	*Major*	*Minor*		*Total*	*Major*	*Minor*		*Total*
Exclusive	-	20	=	20	2	7	=	9
Concurrent	-	7	=	7	7	4	=	11
Total	-	27	=	27	9	11	=	20

Source: Detailed information in Appendix 4.2.

Table 4.10

Octroi and Non-octroi States, 1990-91

	Octroi states					Non-octroi states				
		Recently introduced						Substituted by		
								Local	State	
		Regional	Statewide	Thinking of abolition		Recently abolished		terminal toll	Entry tax	Sales tax
1.	Assam	Y[a]	-	-	1.	Andhra Pradesh	Y[b]	-	-	-
2.	Gujarat	-	-	Y	2.	Arunchal Pradesh	-	-	-	-
3.	Haryana	-	-	-	3.	Bihar	-	-	-	-
4.	Maharashtra	-	-	Y	4.	Goa	-	-	-	-
5.	Manipur	-	Y	-	5.	Himachal Pradesh	Y	-	-	-
6.	Meghalaya	-	Y	-	6.	Jammu and Kashmir	Y	Y	-	-
7.	Orissa	-	Y	-	7.	Karnataka	Y	-	Y[c]	-
8.	Punjab	-	-	-	8.	Kerala	-	-	-	-
9.	Rajasthan	-	-	Y	9.	Madhya Pradesh	Y	-	Y	-
10.	West Bengal	Y[d]	-	-	10.	Mizoram	-	-	-	-
					11.	Nagaland	-	-	-	-
					12.	Sikkim	-	-	-	-
					13.	Tamil Nadu	-	-	-	-
					14.	Tripura	-	-	-	-
					15.	Uttar Pradesh	Y	-	-	Y

[a]Only on petroleum produce.
[b]Used to cover the Telengana region.
[c]Only on items subjected to central excise in lieu of sales tax.
[d]Only in the Calcutta metropolitan area.

Note: - = No; Y = Yes