Issues in local government reform in India.

Nirvikar Singh
Department of Economics
University of California
Santa Cruz

June 1997
revised November 1997

Abstract

This paper reviews the status of rural and urban local governments in India. The focus is on the recent constitutional reforms that strengthen local government, (including subsequent supporting legislation), and the implications for changing local government to achieve more effective delivery of services to constituent populations. Particular attention is paid to finances and revenues, since enhancing local government fiscal resources is crucial for the success of reform in this dimension . An overview of the financial situation and resources of this level of government is provided, plus an economic analysis of the political, managerial and other institutional constraints on effective local government service provision.

This is a substantially revised version of a paper prepared for a World Bank workshop on decentralization. I am indebted to Shanta Devarajan and David Wildasin for encouragement. Gunnar Eskeland provided many suggestions, ideas and conversations that helped clarify my thoughts and guide my analysis. He and M. Govinda Rao both read the June 1997 draft very carefully, and made numerous comments that helped to substantially improve the paper. Pritam Singh Kohli read an earlier draft, and provided me with many useful suggestions. Some of the revision was undertaken while I was a Visiting Fellow at the Australia-South Asia Research Centre at Australian National University: I am most grateful for their hospitality. Of course, I alone am responsible for remaining errors and shortcomings. In particular, neither the World Bank nor any affiliated organization is responsible for the views expressed here.

Issues in local government reform in India.

Nirvikar Singh
Department of Economics
University of California, Santa Cruz
November 1997

I. INTRODUCTION

India has over 250,000 local governments, but their expenditure as a share of GNP is only about 2 %[1]. These figures include a great deal of heterogeneity, from the municipal corporations of the largest metropolitan cities to the smallest village *panchayats*. In the case of rural governments, they include up to three tiers of government below the level of state government. This paper aims to encompass this diversity of local governments, and identify some common features that affect them all, while still recognizing the diversity of situations. In particular, a common analytical framework that examines functional responsibilities, revenue sources, and institutions and incentives is applied to the overall analysis of local government in India.

Recent legislative changes, that is, the 73rd and 74th amendments to the Indian constitution, and following legislation by the states, have the potential to significantly alter the role and relative importance of local governments in India. This paper also seeks to examine the reforms signaled or enabled by this legislation, and to highlight some of the practical difficulties involved in changing local government to achieve more effective delivery of services to constituent populations. Particular attention is paid to finances and revenues, since enhancing local government fiscal resources is crucial for the success of reform in this dimension . However, I also analyze the political, managerial and other institutional constraints on effective local government service provision, as these factors will also be crucial to improving such provision.

The structure of the paper is as follows. In section II, I provide an overview of some features of local government in India, both rural and urban. While comprehensive data are relatively old, and often fragmentary, the resulting picture is up-to-date: great heterogeneity in the nature of the organization, revenues and expenditures of local governments. This section also provides a summary of the constitutional amendments, their rationale, and main features. Sections III - V then proceed to explore the nature of Indian local governments in more detail, along three dimensions: expenditure responsibilities, revenue authority, and organizational features. The first two of these categories correspond to the standard public economics analysis of expenditure and revenue assignment[2]. The third dimension was first stressed by political scientists[3], but

[1] These figures are from Datta (1992), Tables 4.1 and 4.2, p. 180. The corresponding figure for local share of all government expenditures in India is about 6 %.
[2] See, for example, Musgrave and Musgrave (1984).
[3] See, for example, Ostrom, Schroeder and Wynne (1992).

recently has been analyzed by economists as well[4]. In this typology, I am following Dillinger (1994), who provides this lucid expression of the issues:

> The evidence ... suggests that there are three elements to reform in the structure of urban service delivery: (a) the clarification of functional responsibilities between the levels of government; (b) the authorization of revenue sources corresponding to functional responsibilities; and (c) the institution of a system of accountability that encompasses both regulation by central government and incentives for responsiveness to local constituents. (p. 2, paragraph vii)

For this paper, I extend the scope of Dillinger's framework to rural as well as to urban governments, and regulation must include state governments as well as the central government. With these extensions, the above quote succinctly expresses the range of issues faced in the reform of local government in India. Section VI of the paper provides a summary conclusion, relating local government reform to the broader economic changes taking place in India.

Before turning to details in subsequent sections, we can provide a summary of this paper's conclusions within the above framework. The recent constitutional amendments define local government functional responsibilities quite extensively, but do not necessarily delineate them clearly vis-à-vis the responsibilities of the state governments: there is substantial potential overlap, and there may be a period of negotiation between the different sub-central tiers. To the extent that politicians and bureaucrats at higher levels are reluctant to give up authority, and because of the lack of clear accountability due to this overlap, this may be a difficult transition. In practice, therefore, the dimensions of revenue assignment and institutional incentives will be crucial in enabling change in terms of actual expenditure responsibilities.

With respect to revenue authority, the main change in the legislation may be the creation of state level finance commissions, which are intended to bring greater transparency and rule-based criteria to transfers from state to local governments. Whether this will increase local revenues is doubtful, given the states' own fiscal difficulties. However, there is some evidence that local governments in India have not always used their legally assigned revenue potential. Whether they do so now will depend on the changes in institutions and the structure of incentives enabled by the reform legislation, but there is some reason for optimism.

In some sense, therefore, the success of local government reform in India depends on the factor most emphasized by Dillinger: a system of accountability including regulation from above, as well as responsiveness to local constituents. Here, the legislation marks a significant departure, introducing direct elections at each tier of local government, and restricting the ability of state governments to indefinitely supersede elected local government officials. The resulting changes in incentives have the potential to alter both *de facto* functional responsibilities and the raising of revenue by local government. India's legislation for strengthening local government has therefore certainly paid attention to all

[4] See, for example, Cremer, Estache and Seabright (1995).

three elements of reform emphasized by Dillinger, and has set the stage for more effective local government service provision. In this paper I shall expand on the possibilities created, and the potential pitfalls.

II. OVERVIEW

The natural place to start examining local government in India is actually the states, which are significant political units, and together spend almost as much as the central government. The states have traditionally controlled local governments very closely. In many areas, there is a substantial overlap in the functional responsibilities of states and of local governments, and, in practice, states have often ruled local jurisdictions directly, either by ordinary appointment of local officials, or by dismissing elected local officials on various pretexts and replacing them with state government officials as administrators. Examining the data at the state level also allows one to get a sense of the heterogeneity of characteristics across India: state level data is quite complete and relatively reliable, and there has been considerable research on center-state government relations.

Demographics and development levels

Table I presents basic statistics for 16 of India's states, covering 96.5 % of India's population. The excluded states and union territories, with the exception of Delhi, are all small in population, and, except for Goa, fall in the class of "special category" states, being border states, typically with ethnically distinct populations[5]. Several characteristics of the state data in Table I are worth noting. The size range is quite large, as are the populations encompassed: with the exception of Himachal Pradesh, the states have population sizes more typically associated with nations. The largest, Uttar Pradesh, would be in the top ten of countries ordered by population size, but even Haryana, the 15th largest, with 16 million people, has a population larger than many European nations.

Population density, which may be a useful indicator the appropriate locus of government, also varies greatly (a factor of eight from lowest to highest), from lows in the hilly or desert states of Himachal Pradesh, Rajasthan and Madhya Pradesh to the densely populated states of Kerala and West Bengal. Data on urbanization is presented in the third numerical column of Table I: the percentage of rural population in the 16 states ranges roughly between 60 and 90 per cent, with Maharashtra being at one extreme and Himachal Pradesh and Assam at the other. Maharashtra contains the big city of Mumbai (Bombay), which skews the proportion, but other states with high percentages of urban population are Gujarat and Tamil Nadu. There is not a strong correlation between density and the percentage of the population in urban areas, although the relationship is clearly positive.

[5] Assam and Himachal Pradesh, which are also special category states, are included in Table I because of their size. Rao (1997) provides some data on 25 Indian states (see, e.g., his Table 5, p. 19).

TABLE I
Basic State Statistics

	Population in millions 1991	Density per sq. km.	Per cent urban	Per capita income (Rs.) 1989-90	Literacy rate per cent	School enrollment rate per 1000
Andhra Pradesh	66.51	242	26.90	3,986	44.1	134.96
Assam	22.41	286	11.07	3,196	52.9	178.85
Bihar	86.37	497	13.14	2,186	38.5	130.37
Gujarat	41.31	211	34.50	5,368	61.3	184.27
Haryana	16.46	372	24.61	6,026	55.8	153.77
Himachal Pradesh	5.17	93	8.70	4,269	63.9	207.11
Karnataka	44.98	235	30.92	4,305	56.0	175.29
Kerala	29.10	749	26.39	3,451	89.8	206.99
Madhya Pradesh	66.18	149	23.18	2,995	44.2	152.60
Maharashtra	78.94	257	38.69	6,604	64.9	188.72
Orissa	31.66	203	13.39	2,965	49.1	152.49
Punjab	20.28	403	29.54	7,674	58.5	155.44
Rajasthan	44.01	129	22.88	3,219	38.6	137.02
Tamil Nadu	55.86	429	34.16	3,593	62.7	201.95
Uttar Pradesh	139.11	473	19.84	3,092	41.6	127.01
West Bengal	68.08	767	27.48	4,193	57.7	145.98
Total	816.43					
Average	51.03	285	24.94	3,907	51.5	155.87

Source: Compiled from Mathew (1994)

The next column of Table I gives figures on per capita income. The poorest state by this measure is Bihar, and the richest is Punjab, with their ratio being 3.5[6]. Again, this is a substantial degree of heterogeneity. Columns five and six provide alternative measures of development: the literacy rate and the school enrollment rate: these also show substantial variation, though not as much as per capita income. The two measures are highly correlated (0.83), but neither is strongly correlated with per capita income (0.36 for literacy and 0.22 for enrollment).

The lesson of Table I is that one may have to be prepared to examine local government in India on a state-by-state basis, given the great disparities in the characteristics of the different states. This considerably complicates the task of analysis and evaluation. Obviously one could add other statistics, such as on health, roads, access to water supplies, and so on. These would provide a fuller picture of the different Indian states, but are not necessary for our main point[7].

[6] These numbers often vary in quality across states. However, the figures for 1993-94 per capita state domestic product in Rao (1997) give only a marginally lower ratio between Punjab and Bihar of 3.37.
[7] Matthew (1994) provides such state-level data.

Local government demographics

I begin with a state-by-state map of rural local governments in India, in Table II. There are a large number of such governments at the village level, but the count appears to be quite reliable. There are three tiers of such government, with different names in different states, which I shall generically call, in ascending order, village[8], block and district. The traditional council of five of the villages, the *panchayat*, gives the common term "Panchayati Raj" to India's system of rural local government.

TABLE II
Rural local governments

	Village governments *(gram panchayats)*	Block councils *(panchayat samitis)*	District councils *(zilla parishads)*	Electorate in millions	Population per village government	Population per block council.	Population per district council
Andhra Pradesh	19,519	1,092	22	44.67	2,500	45,000	2,210,000
Assam	2,486	196	43	10.15	8,000	102,000	463,000
Bihar	11,653	589	52	NA	6,400	127,000	1,443,000
Gujarat	13,256	182	19	NA	2,000	149,000	1,424,000
Haryana	5,996	109	16	NA	2,100	114,000	776,000
Himachal Pradesh	2,597	69	12	NA	1,800	68,000	393,000
Karnataka	5,641	NA	20	20.64	5,500	NA	1,554,000
Kerala	990	152	14	NA	21,600	141,000	1,530,000
Madhya Pradesh	30,924	459	45	3.08	1,600	111,000	1,130,000
Maharashtra	26,584	296	29	NA	1,800	164,000	1,669,000
Orissa	5,264	314	30	1.81	5,200	87,000	914,000
Punjab	11,596	136	14	9.20	1,200	105,000	1,021,000
Rajasthan	9,189	237	31	NA	3,700	143,000	1,095,000
Tamil Nadu	12,787	387	22	3.67	2,900	95,000	1,672,000
Uttar Pradesh	73,917	897	63	70.20	1,500	124,000	1,770,000
West Bengal	3,325	340	16	30.57	14,800	145,000	3,086,000
Median population per government					2,700	114,000	1,433,500
Total number	235,724	5,455	448				

Notes: Figures in last three columns are based on rural population only.
Population per village government is rounded to the nearest hundred, for the other two levels to the nearest thousand.

Source: Compiled from Mathew (1994)

[8] It is important to note that in doing so, I am simplifying, since the lowest level in many states would involve a group of villages.

The first three columns of Table II report the number of local governments at each level. The last three columns give some idea of the "span of control". It is seen that the population per village government is extremely small, with the median across the state averages being only 2,700. There is considerable variation among the states, but the only two obvious outliers are Kerala and West Bengal. These are also by far the most densely populated states, but the difference is more a reflection of a different institutional arrangement in these states. For most states, the small jurisdictions of these village governments raises questions of economic efficiency and viability. Populations per block council are considerably larger, with a median across these 16 states of 114,000, more of the order of county governments in the United States, for example. The block level is important in approximating the constituencies of the lower houses of the state legislatures, known as Legislative Assemblies. Populations per district council are quite large, with a median across the states of close to 1.5 million. The district is approximately the size of the constituency of the member of the Lok Sabha, the lower house of the national parliament[9]. Both the higher tiers also display considerable variation across states, in the sizes of populations at each government level. Overall, however, some of the variation in the sizes of the states themselves gets removed as one goes down to lower levels of government.

The block and district levels - particularly the latter- have, in fact, been important components of the central administrative apparatus, even prior to independence. Considerable administrative discretion has rested with appointed officials, usually of the Indian Administrative Service (IAS), at the block and district levels. Although IAS members are assigned to states, they are all part of an all-India bureaucratic structure, and can thus be assumed to be responsive to central as well as state-level political imperatives. The block and district levels have also been important in conceptualizing the implementation of India's central plans, and strengthening block-level implementation has been a significant part of attempts to decentralize the planning process. The size of populations as shown in Table II suggests that, since the lowest level is so small in size, the intermediate level may be more important for rural local government reform than has been emphasized in previous discussions, to internalize externalities and to take advantage of economies of scale and scope. These arguments extend to the highest level, the district, but are counterbalanced by its size, in absolute terms (affecting the "span of control") as well as relative to the state level (affecting the ability of state governments to maintain hard budget constraints for the lower level). The highest level of rural local government might not even be characterized as "local" in this respect: basic public services will typically have smaller constituencies. The issue of the interaction between central and state bureaucrats and elected local government officials has been, and will continue to be important, and will be taken up in discussing incentives in section V.

The figures for electorates in Table II are very incomplete, and the reasons for the small electorates reported for Madhya Pradesh, Orissa and Tamil Nadu are not clear. In

[9]Of course these constituencies will include urban populations, excluded from the calculations in Table II.

TABLE III
State legislation and electoral systems, 1992

	Years in which legislation passed	Tiers	Mode of election
Andhra Pradesh	1964 1986	Village	Direct
		Block	Indirect
		District	Indirect
Assam	1972	Village	Direct
		District	Indirect
Bihar	1947	Village	Direct
		Block	Indirect
		District	Indirect
Gujarat	1961	Village	Direct
		Block	Indirect
		District	Indirect
Haryana	1952 1961	Village	Direct
		Block	Indirect
Himachal Pradesh	1968	Village	Direct
		Block	Indirect
		District	Indirect
Karnataka	1983	Village	Direct
		Block	None
		District	Direct
Kerala	1960 1979	Village	Direct
Madhya Pradesh	1990	Village	Direct
		Block	Nominated
		District	Nominated
Maharashtra	1958 1961	Village	Direct
		Block	Indirect
		District	Indirect
Orissa	1959 1964	Village	Direct
		Block	Indirect
Punjab	1952 1961	Village	Direct
		Block	Indirect
		District	Indirect
Rajasthan	1953 1959	Village	Direct
		Block	Indirect
		District	Indirect
Tamil Nadu	1958	Village	Direct
		Block	Direct
		District	Nominated
Uttar Pradesh	1947 1961	Village	Direct
		Block	Nominated
		District	Nominated
West Bengal	1973	Village	Direct
		Block	Indirect
		District	Indirect

Source: adapted from Singh and Misra (1993) the other states, they appear to reflect universal suffrage at the level of local government. However, until the recent legislative changes, the ability to exercise this suffrage was very limited. Dillinger (1994) notes that at any given time since independence, 40-50 per cent of local government bodies in India, have been under state supersession. Furthermore, there was an inherent structural limitation on this exercise, since in most states only the lowest level of rural local government, the village, had directly elected local government officials. The nature of electoral systems for rural local governments before the recent reforms is summarized in Table III. It may be noted that only Karnataka and Tamil Nadu had direct elections above the village level - though Tamil Nadu was a state where rural local elections were not held for a stretch of 15 years. On the other hand, Kerala and West Bengal had larger average populations at the lowest level, and both had political traditions of decentralization. Hence the information in Table III must be supplemented with the different states' experience[10]. However, note that states such as Madhya Pradesh and Uttar Pradesh did not even have indirect elections at the higher two levels of rural local government, those bodies being nominated by state governments. This alone suggests less decentralization or local control compared to states where such elections were possible. Finally, note that several states had only one or two tiers of rural local government, even though both block and district are part of the nationwide administrative structure.

Turning to urban local governments, figures for these are presented in Table IV. This data is less recent, being from 1979-80, and the classifications seem somewhat less reliable[11]. The total number of urban local bodies, about 2600 in the table, has gone well beyond 3000 more recently[12]. The structure of the urban governments in the table is different from that of rural bodies, in that there is no tier system. The first three columns of Table IV are governments of different sizes, from corporations (which do have smaller units such as wards within them) down to municipalities, and then town and notified area committees, but the latter are not components of municipalities or corporations. However, size is not the only criterion for classification, and political, economic and historical factors can also matter. Thus, within each category, as well as across states, there is considerable variation in the nature of urban local bodies.

In general, it is true that corporations have more autonomy and wider responsibilities than municipalities, with town and notified area committees being most restricted. A major difference between notified or town area committees on the one hand and municipalities and corporations on the other is that the former category has not involved any elected governing body: the committees are appointed by state governments.

[10] Each state has its own history of local government legislation, political traditions, land ownership systems, and so on, all of which affect the functioning of local government. It is beyond the scope of this paper to provide even minimal details of each state's experience with local government. Mathew (1994) surveys the states' histories of rural local governments. Some of the variation in the states with respect to urban local governments will come across in the case studies referenced later in the paper. Also see Rao (1986) and Jetha (1992).

[11] This observation is based on inconsistencies in the numbers from the two sources. I have used Rao's numbers, except in separating out corporations , which are missing from his table.

[12] Sachdeva (1993) reports a figure of 3301 in 1989 (p. 23).

However, to the extent that elected municipalities and corporations have been superseded, the distinction becomes less important. Even in cases where municipalities and corporations have functioning elected governing bodies, state governments have typically

TABLE IV
Urban local bodies

	Corporations	Municipalities	Town Area and Notified Area Committees	Total number	Est. 1976-77 urban popn. in millions	Popn. per urban area
Andhra Pradesh	1	85	0	86	9.75	113,372
Assam	1	23	38	62	2.09	33,710
Bihar	1	71	78	150	7.64	50,933
Gujarat	5	51	1	57	8.64	151,579
Haryana	0	64	0	64	2.30	35,938
Himachal Pradesh	1	18	16	35	0.26	7,429
Karnataka	3	227	6	236	8.68	36,780
Kerala	3	43	0	46	4.07	88,478
Madhya Pradesh	6	200	77	283	7.78	27,491
Maharashtra	5	221	0	226	19.07	84,381
Orissa	0	98	28	126	2.08	16,508
Punjab	3	97	7	107	4.52	42,243
Rajasthan	0	192	0	192	5.30	27,604
Tamil Nadu	2	108	0	110	NA	NA
Uttar Pradesh	5	193	448	646	14.92	23,096
West Bengal	2	93	5	100	14.55	145,500

Source: Number of governments compiled and adapted from Datta (1984), Table 1, p. 2, and Rao (1986), Table 4.4, p. 66. Population figures from Datta (1984), Table 12, p. 21.

retained considerable discretion and bureaucratic control over even the largest urban local governments, for example through municipal commissioners (who would typically be IAS members). Two other indicators of heterogeneity in urban governments across states may be noted. One is the disproportionate use of notified and town area committees by states such as Uttar Pradesh and Bihar. The other is the variation in population per urban government among the states. Some indication of this comes from the last column of Table IV, though these numbers somewhat understate the per-government populations, being based on urban population estimates for 1976-77, rather than 1979-80. Obviously, some of the high figures reflect the inclusion of large cities in the averages, such as Mumbai in Maharashtra, and the smallest figure comes for the hill state of Himachal Pradesh, but the dispersion of these numbers helps to indicate the variation in what constitutes an urban area across the major states.

Local government revenues and expenditures

Tables V and VI provide some data on the totals and patterns of revenues for rural and urban local governments respectively. The data are again somewhat old, there are gaps[13], and some of the figures are estimates, but the numbers are useful in illustrating

TABLE V
Rural government revenues, 1976-77

	Estimated tax revenue (Rs. mill.)	Estimated non-tax revenue (Rs. mill.)	Estimated assigned-share tax revenue (Rs. mill.)	Estimated grant revenue (Rs. mill.)	Total estimated revenue (Rs. mill.)	Approx. revenue per capita rural popn. (Rs.)	Per capita income 1989-90 (Rs.)
Andhra Pradesh	121	35	54	1105	1315	33.2	3986
Assam	12	6	16	30	64	4.4	3196
Bihar	2	0	5	18	25	0.4	2186
Gujarat	127	17	157	1361	1661	75.3	5368
Haryana	NA	NA	12	6	NA	NA	6026
Himachal Pradesh	6	4	1	12	22	6.2	4269
Karnataka	NA	NA	NA	NA	NA	NA	4305
Kerala	35	36	32	12	116	6.6	3451
Madhya Pradesh	14	0	12	48	74	1.8	2995
Maharashtra	145	52	62	1420	1679	42.4	6604
Orissa	1	9	20	285	315	14.7	2965
Punjab	17	6	0	24	47	4.5	7674
Rajasthan	11	22	5	244	281	10.3	3219
Tamil Nadu	NA	NA	NA	NA	NA	NA	3593
Uttar Pradesh	63	23	4	53	144	1.6	3092
West Bengal	37	9	150	1325	1521	42.2	4193

Source: Constructed from Datta (1992), Tables 4.4, 4.5; Datta (1984), Table 12; and Matthew (1994).

some characteristics of these revenues. I have included the per capita income figures from Table I in each of these tables for easy reference. For both rural and urban governments, there is considerable variation in both the per capita totals, and the pattern of revenues. As one would expect, poorer states' local governments raise a smaller proportion of revenue from their own taxes, while getting relatively more from grants and their assigned share of state and central taxes, but this effect is not that strong, and tends to be swamped by the great disparity in amounts. For example, rural local governments in Bihar receive 92 per cent of their revenue from assigned taxes and grants while the corresponding figure for Punjab is about 50 per cent. However, these percentages translate to less than Re.

[13] For Tamil Nadu rural local governments, however, see Tables XI and XII below.

0.40 per capita from these sources in Bihar[14], and more than five times that amount per capita in Punjab. One way to emphasize the wide variation of revenues per capita across the states is to observe the ratios of maximum to minimum for these state averages. These are over six for urban local governments and as much as 100 for rural local governments. In comparison, per capita incomes vary by a factor of only 3.5 across these states[15].

TABLE VI
Urban government revenues, 1976-77

	Estimated tax revenue (Rs. mill.)	Estimated non-tax revenue (Rs. mill.)	Estimated assigned-share tax revenue (Rs. mill.)	Estimated grant revenue (Rs. mill.)	Total estimated revenue (Rs. mill.)	Approx. revenue per capita urban popn. (Rs.)	Per capita income 1989-90 (Rs.)
Andhra Pradesh	148	210	23	95	476	48.9	3986
Assam	23	32	0	4	59	28.2	3196
Bihar	52	0	11	71	134	17.5	2186
Gujarat	355	113	NA	55	523	60.5	5368
Haryana	90	24	1	4	119	51.6	6026
Himachal Pradesh	13	5	0	4	21	81.8	4269
Karnataka	207	116	0	17	340	39.2	4305
Kerala	65	26	9	6	105	25.9	3451
Madhya Pradesh	210	62	70	92	434	55.8	2995
Maharashtra	1262	713	57	281	2313	121.3	6604
Orissa	36	24	7	29	95	45.6	2965
Punjab	116	11	0	11	138	30.6	7674
Rajasthan	155	69	0	27	250	47.2	3219
Tamil Nadu	NA	NA	NA	NA	NA	NA	3593
Uttar Pradesh	291	143	0	108	542	36.3	3092
West Bengal	207	46	39	92	384	26.4	4193

Source: Constructed from Datta (1992), Tables 4.4, 4.5; Datta (1984), Table 12; and Matthew (1994).

It is also useful to calculate the correlations of the different per capita figures. The correlations of per capita local government revenue with per capita income are both similarly positive, being 0.42 for rural and 0.43 for urban governments. The correlation between per capita rural and urban local government revenues is 0.39. These numbers are certainly not small, but neither are they large: clearly other things matter in determining

[14] The figures for Bihar and some other states are remarkably low, but this may truly reflect greater centralization at the level of the state government, as well as poverty.
[15] Excluding the extreme values for each category produces the following ratios between highest and lowest: 2.2 for per capita income, 3.2 for per capita urban government revenue, and about 26 for rural per capita revenue. The variation in revenues per capita across states may also be quantified by calculating coefficients of variation. For urban local governments, the coefficient of variation in per capita revenues is 0.55. For rural local governments, it is as high as 1.22. Again, the coefficient of variation for per capita income is lower, being only 0.36.

the level of revenue raised by local governments besides how well-off their states are. One possibility, given the variation in political emphasis on decentralization in different states, and their different histories and characteristics, is to focus on political and institutional explanations. However, the basic demographic and electoral institutions data in Tables II and III also do not provide any obvious explanation of the differences across states in local government revenue-raising. For example, differences in the sizes of jurisdictions and the legislative structures between states such as Gujarat and Haryana do not by themselves capture the relevant differences in politics and institutions. Some of the variation is explained by differences in legislative assignments, which are quite substantial, even after the recent reforms[16], but even these do not, by themselves, explain the differences across states in local revenue raising.

Returning to the pattern of revenue sources in Tables V and VI, it is evident from Table V that rural governments in many of the states rely on funds collected at a higher level for most of their revenue. The average for the states with available data in this table is 75 % from grants and shared taxes, with only Kerala and Uttar Pradesh below 50 %. This is not in itself a cause for concern: it is reminiscent of the importance of central-state transfers in India. The rationality and transparency of transfers, however, is of concern, as discussed in section IV. Transfers are much lower as a percentage of urban local government revenues (18.7% vs. 89.2%[17]) but the difference is not as large when examined in terms of per capita moneys transferred. For example, grants to rural governments averaged about Rs. 13 per capita in this period, not too much larger than per capita grants to urban governments, which averaged about Rs. 8 per capita[18]. Several observations on patterns of revenue close out this overview. First, Gujarat and Maharashtra, with significant commercial/industrial cities, stand out in terms of urban tax revenue[19]. The low figure for West Bengal, which includes Calcutta, is somewhat of a contrast, though it is balanced to a degree by the high per capita figure for rural government revenue. Finally, the pattern of revenue sources in Kerala seems the most balanced, particularly for rural governments, and this state will be a useful case study in the subsequent analysis. As noted before, West Bengal and Kerala are also two states that have a tradition of decentralization.

I do not have data on expenditures by state for urban governments, but expenditure patterns for a sample of municipal authorities in 1975-76 are presented in Table VII, while aggregate data for rural local governments in 1976-77 and urban local governments in 1976-77 and 1986-87 are given in Table VIII. The data in Table VII

---

[16] Rajaraman *et al* (1996), Tables 1-4, summarize some of the relevant differences across states with respect to rural local governments.

[17] These numbers are taken from a different source (see Table X), and therefore are slightly different from those calculated from the tables here.

[18] Neither of these numbers is large in absolute magnitude, or as a percentage of per capita GNP, but they are significant fractions of local government revenue. This difference, of course, reflects the overall low levels of local government spending.

[19] These states are also able to export taxes to poorer states: this issue is discussed in section IV.

TABLE VII

Expenditure Patterns, Sample Municipal Authorities, 1976-77

	General administration	Collection of revenue	Public health	Public safety	Medical	Water supply	Education	Roads	Loan repayments	Other
Andhra Pradesh	7.9	2.0	22.9	3.7	0.1	16.8	18.7	21.0	0.3	6.7
Assam	16.3	7.8	21.2	9.0	1.5	7.3	0.3	10.2	3.6	22.9
Bihar	13.7	1.1	29.9	6.9	0.9	3.7	7.4	12.3	13.2	10.8
Gujarat	5.1	4.2	8.9	2.3	6.6	2.5	10.3	0.0	10.0	50.3
Haryana	13.5	0.2	27.0	7.7	5.5	16.2	0.9	3.1	1.7	24.4
Himachal Pradesh	14.0	14.1	28.5	4.9	0.3	14.2	0.1	3.6	0.9	19.6
Karnataka	16.7	0.0	17.1	8.3	1.8	8.1	1.1	0.0	6.6	40.3
Kerala	32.7	1.6	12.2	7.7	11.2	6.2	1.0	7.8	7.6	12.2
Madhya Pradesh	17.9	11.1	20.6	7.4	1.5	9.4	4.3	4.5	7.1	16.3
Maharashtra	6.5	5.9	15.9	4.4	13.5	5.1	9.3	12.0	4.0	23.3
Orissa	12.5	11.2	23.8	8.3	0.9	2.7	12.5	0.1	3.3	24.6
Punjab	12.6	17.2	28.4	8.9	1.5	9.1	0.6	4.3	9.9	8.5
Rajasthan	15.2	14.6	48.5	8.5	0.8	1.6	0.7	0.1	2.1	8.0
Tamil Nadu	15.7	0.2	24.8	4.7	5.8	11.3	14.8	4.5	7.5	10.7
Uttar Pradesh	8.1	11.0	41.3	5.0	3.3	6.5	2.2	0.4	6.2	16.0
West Bengal	27.8	2.7	21.9	5.4	2.3	6.8	7.2	2.4	0.6	22.9

Source: Datta (1984), Table 10, p. 18.

indicate substantial variations in the patterns of spending. Administration takes up anywhere from 5.1 per cent (Gujarat) to 32.69 per cent (Kerala) of expenditure, public health from 8.9 per cent (Gujarat again) to 48.5 per cent (Rajasthan), and so on. However, the large size and the variation in the residual category, “Other” makes inferences difficult. Another problem may be that categories are defined differently: Gujarat municipal authorities in this sample spent 6.6 per cent of their outlay in the category “Medical”, versus only 0.8 per cent for Rajasthan. Combining the categories “Public Health” and “Medical” would somewhat reduce the disparity in the spending pattern. Finally, it should also be noted that the differences do not necessarily reflect differences in actual spending, but may simply be the consequence of different expenditure assignments among the states. For example, public health expenditures may be undertaken more at the state level in Gujarat relative to Rajasthan. This kind of possibility can presumably be checked by examining state level data[20].

TABLE VIII
Local Government Expenditures

	Rural 1976-77		Urban 1976-77		Urban 1986-87	
	Amount (Rs. million)	Per cent	Amount (Rs. million)	Per cent	Amount (Rs. million)	Per cent
Administration	582	8.0	584	9.8	547	8.8
Tax collection	23	0.3	268	4.5	249	4.0
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
Education	3,081	42.4	580	9.8	653	10.5
Health	222	3.1	619	10.4	174	2.8
Other services*	1,884	25.9	1,526	25.7	1,443	23.2
Revenue surplus	1,043	14.2	586	9.9	535	8.6
Total	7,265	100	5,933	100	6,219	100

*****Public safety, recreation, welfare, and loan repayment
Source: Datta (1992), Table 4.4, p. 182.

Turning to Table VIII, we see some expected differences in spending patterns between rural and urban local governments. The former spend less of their total on water

[20] For example, for Gujarat, in 1986-87, “health” made up 3.5 per cent of current expenditures of Rs. 25,244 million in the state budget (Jetha, 1992a, Tables 8.1 and 8.4, pp. 413, 415). In Uttar Pradesh, another state with a high percentage allocated to these categories in Table VII, “medical, health and sanitation” constituted 5.9 per cent of current outlays over 1980-90 (Bajaj and Agarwal, 1992, Table 7.21, p. 365). These amounts dwarf the spending at the local level.

supply, public health and sanitation, and roads, all of which are quintessential urban services. Datta (1992) also suggests that rural authorities tended to spend more on education, health and welfare because of the greater availability of categorical grants for these, and because of their heavy reliance on grants. The pattern of expenditure in urban local governments does not show much change over the decade, with the only major shift being from "health" to "public health and sanitation", perhaps reflecting a recategorization of expenditures. Interestingly, the figures for both types of government show revenue surpluses, unusual for government in India. The reason for this nonexpenditure of available funds is discussed in section IV.

Local government legislation: overview

Throughout the period after independence, state and central governments in India appointed a series of committees to examine the functioning of local government, and recommend improvements. In addition, various Finance Commissions made recommendations on this subject. The (aptly named) Central Council of Local Self-Government was created in 1954, under Article 263 of the Constitution, to coordinate urban development issues between the center and states. Rural issues remained separate from urban at the state level, but received even greater attention, and states repeatedly passed legislation dealing with the structures of Panchayati Raj[21]. This legislation was often the result of recommendations made by centrally constituted committees.

In 1988, another central committee recommended that Panchayati Raj bodies should be given constitutional status. After two failed attempts in the next two years, in 1991 two separate amendment bills were introduced, covering *panchayats* and municipalities respectively. These were passed by both houses of parliament towards the end of 1992, ratified by more than half the state assemblies, and brought into force as the 73rd and 74th amendments to the Constitution of India in 1993. These amendments required individual states to pass appropriate legislation, since local government remained a state subject under the constitution, and individual states have proceeded to do so.

What were the key features of the change brought about by the amendments? With regard to rural local governments, the uniformity of the number of tiers, criticized in earlier versions of the bills, was retained, with an exception only for the smallest states, with populations below 2 million. This imposes a three tier structure (village, intermediate block/*taluk*, and district) on the larger states, including those such as Kerala, which had chosen to have two tiers of local government prior to the amendment[22]. However, this seems to be a relatively minor issue, given the flexibility states have in implementation. The crucial change is the reduction of state government discretion concerning elections to local government bodies. Under the new laws, elections to panchayats must be held every

[21] Full texts of such legislations are in Singh and Misra (1993). A collection of historical material pertaining to such efforts is in Venkatarangaiya and Pattabhiram (1969). Mathew (1994) also provides a more detailed history of committees and legislation.

[22] Recall that Table II provides the summary of the tier system in the different major states prior to the constitutional amendment.

five years. Elections to constitute new bodies must be completed before the term expires. If a panchayat is dissolved prematurely, elections must be compulsorily held within six months, the new body to serve out the remainder of the five year term. These provisions will presumably prevent situations such as that in Tamil Nadu, where, as noted before, at one stage *panchayat* elections were not held for 15 years, being repeatedly announced and then postponed by successive state governments. With regard to urban local governments, there is a similar strengthening of the electoral requirements, preventing lengthy supersessions of local powers by the state government, and replacing appointed posts with elected ones.

The 73rd amendment gives considerable attention to the nature of elections for the three tiers of rural local government. Direct elections are specified for seats at all levels, this, too, being a significant change from the situation before the amendments, when indirect elections or nomination were the norm for the higher two rural tiers (see Table II). Seats are reserved for scheduled castes and scheduled tribes in proportion to their population, and offices of chairpersons at all three levels are also reserved in proportion to their population in the state. One third of the seats and of offices of chairpersons are reserved for women. Chairpersons at the intermediate and district levels are to be elected by the *panchayat* membership, while either direct or indirect elections of chairpersons are permitted at the village level. State level election commissions are to be created to supervise and manage the electoral processes. At the intermediate and district levels, chairpersons of bodies one level below can be made members, as can MPs (Members of Parliament), MLAs (Members of Legislative Assemblies) and MLCs (Members of Legislative Councils).

The act provides for one additional potential avenue of representation and accountability of local government. Each village or group of villages will have a *gram sabha*, a body comprising all registered voters in the area. The functions of the *gram sabha* are left up to the states, and are not further specified, but the Karnataka Panchayat Act of 1983 provides some indication of how these may function[23]. This act (now replaced by the new legislation) provided for periodic meetings of *gram sabhas*, to consider the report of the *panchayat*, proposals for new programs for village development, implementation of sanitation and drainage schemes through voluntary labor, programs of adult education, and similar issues. The purpose of these *gram sabhas* is to provide a measure of direct democracy, but their actual role seems likely to remain limited, given their lack of authority or control.

Another vital feature of the reform is its attention to the financial resources of local government. State government legislatures are expected to provide adequate funds for local governments, through grants, the assignment of tax revenues, and the authority to collect taxes, tolls and fees. This will not be entirely at the discretion of the legislatures, since in each state a finance commission must be established (with five year terms, as is the case with the central finance commission) which will determine the principles for providing

---

[23] See Singh and Misra (1993), p. 127.

local governments with adequate resources, including totals of funds and rules for tax sharing. This creation of state level finance commissions is particularly significant: by making local revenues more predictable and less subject to conditions of the state governments, it has the potential to allow local governments to make expenditure decisions more independently of state governments. The envisaged structure parallels that of the central finance commissions[24], as well as being similar to the provisions of the Karnataka Panchayat Act of 1983. States will retain considerable discretion and control, but the experience at the center-state level suggests that state finance commissions, though advisory in nature, will be important. States will also be responsible for making provisions with respect to the maintenance and auditing of lower level government accounts.

Other aspects of the reform include the creation of a new (eleventh) schedule in the Constitution, of 29 subjects (including agriculture, animal husbandry, land and water management, irrigation, roads, education, electricity, and welfare programs) as *panchayat* responsibilities; specific responsibilities for preparing development plans; the creation of district planning committees to consolidate the plans prepared by *panchayats* and municipalities; and additional provisions concerning eligibility for and composition of rural local governments. All of these provisions have been debated, and often criticized, in some detail[25]. I will try to evaluate some of the salient issues in subsequent sections.

The 74th Amendment, known as the Nagarpalika Act[26], provides a parallel set of reforms for urban and transitional areas. For areas in transition from rural to urban, *nagar panchayats* are to be constituted, and, for most provisions of the Act, are treated equally with municipalities. The composition of municipalities remains under the guidelines of the states, subject to the population categories outlined in the amendment (5,000 to 10,000 for a *nagar panchayat*, 10,000 to 20,000 for a municipal council, etc.). A noteworthy feature is the legislative creation of tiers within larger municipalities, in the form of wards and zones, with their own committees. As is the case for rural local governments, a key feature of the legislation is the strengthening of local election procedures, with members at the ward and municipal level being chosen by direct elections. The zonal committees are more of an intermediate level, their composition being the chairpersons of the ward committees in the zone.

Many of the provisions of the Panchayat Act, including composition, reservations, duration, and the role of state finance commissions, are directly applied to municipalities in

---

[24] The central Finance Commission is constituted every five years with a charge to make recommendations that cover a period concurrent to the period of a five year plan. Its membership includes academics, civil servants and politicians, but the government selects, and hence to some extent controls, who serves on each commission. Its existence and broad functions are mandated in the Indian Constitution. The commission decides on central-state tax revenue sharing, as well as the division among the states. The rationale for such an institution can be seen as providing a way of allowing flexibility in assignment, without making assignment questions politically subservient to the legislature. Transparency and the use of rules are also promoted in this manner. See M.G. Rao (1994, 1995) for further discussion.

[25] See, for example, Mathew (1994) and Singh (1997).

[26] The text of the 1989 version of the act may be found in Sachdeva (1993), pp. 406-416.

the Nagarpalika Act. Paralleling the creation of the eleventh schedule in the Constitution, the legislation also creates a twelfth schedule for municipalities, including public health and sanitation, communications, and various welfare services. Significantly, law and order are not on this list. Finally, the act requires the constitution of planning committees at the level of districts and metropolitan areas.

In the next three sections, I turn to a more detailed examination of the structures of Indian local government, following the framework outlined in the introduction. In doing so, I discuss the structures in place before the amendments, as well examining in more detail the changes sought by the new legislation just summarized.

III. FUNCTIONAL RESPONSIBILITIES

In this section, I will treat rural local governments first, and then urban local governments. In each case, I discuss the situation prior to the recent local government reform package, then the changes being effected. I then assess overall the issue of functional responsibilities in Indian local government. Two categories of problems are identified with respect to the assignment of responsibilities: (1) excessive narrowness, and (2) lack of clarity. The recent reforms provide some improvement with respect to the first, but not clearly with respect to the second.

Rural local governments

Pre-reform

Prior to the passage of the constitutional amendments, the functional responsibilities of rural local governments were in many cases extremely limited. For example, based on national constitutional assignments, Datta (1992)[27] lists only five areas that were the sole jurisdiction of rural local governments: control of noxious vegetation and animals, sanitation and waste disposal, disposal of the dead, animal pounds and the prevention of cattle trespass, and drinking water supply. Another six areas of rural government responsibility were shared with state government: primary education, roads and bridges, ferries and waterways, agriculture including extension, minor irrigation and water development, and markets and fairs. In most of these latter cases, the local government had a minor role relative to that of the state. This reflected both the different revenue capacities, as well as the organizational structures: state governments' command over resources, as well as their authority over the bureaucrats who were often the actual decision-makers, far exceeded that of rural local governments.

Since each state had its own Panchayati Raj legislation, there was substantial variation in the assignment of expenditure responsibilities across states. These assignments were often broader on paper than in practice. For example, the Kerala Panchayat Act of 1960 listed 13 basic responsibilities, the most notable addition to Datta's

[27] This list, as well as other data on functional responsibilities, is in Appendix 4.1 of his paper.

list being the maintenance of the village court[28]. However, there was a supplementary list of 59 specific activities, falling in seven areas, including agriculture, animal husbandry, education and culture, social welfare, public health and sanitation, and public works. Despite the impressive list of functional responsibilities in the state's Panchayat Act there were actually only three main categories of expenditure[29]: public works (maintenance, repairs and extension of rural roads and bridges, and parks and gardens), water supply and drainage (including installation and maintenance), and street lights (provision, maintenance and electricity charges). The combined per capita expenditures for 1981-82 in these three areas were only about Rs. 5. Thus, long legislative assignments did not translate into significant functional responsibilities in practice.

The assignment of responsibility for the three main categories in Kerala illustrates some further issues. With respect to road maintenance, the expenditure typically went for repeated repairs of earthen roads, which were washed away every monsoon, rather than for conversion to metalled roads as desired by constituents. This at least partly seems to be the result of an overly narrow assignment of functional responsibility (and resources) to the rural governments. The assignment of responsibility in the other two categories also reveals oddities. The rural water supply schemes were the responsibility of a state-level special-purpose water authority (or its predecessor, a state government department), with *panchayats* being charged on a formula basis for a share of the capital costs, as well as for maintenance expenses. Both the capital costs and maintenance charges were not apparently based on any well articulated economic grounds of benefits provided. The result was disputes with respect to both. The situation with respect to street lighting seemed to parallel that of water, with problems caused by the lack of accurate (or any) metering of electricity usage for this purpose, and disputes between the *panchayats* and the state electricity board. To some extent, the problem in all these cases was not just with the assignment of responsibilities, but with the level of revenues and the organizational structures throughout the state and local governments.

Another dimension of assignment to rural local governments is the division of responsibilities across tiers (these were absent in Kerala). For example, Shah (1990) provides information on three districts in the Kumaun hills in Uttar Pradesh. The functions of different tiers in the state in the 1980's, in ascending order, were:

> 1. *Gaon Panchayat* [village group]
> Sanitation and health; public works; agriculture; forests; animal husbandry; village industries; welfare activities and promotion of voluntary bodies; education; sports and culture and general administration and security.

---

[28] See Government of Kerala (1986), Appendix IV.

[29] Here I am focusing on expenditure related to service provision: the largest category of expenditure by far was "establishment charges", representing an astonishing 67% to 65% of self-raised income of the *panchayats*, for the years 1980-81 to 1983-84 (Government of Kerala, 1986, p. 103). Aziz (1993), in a sample of *mandal panchayats* (groups of villages) in Karnataka, similarly found that for the years 1987-1992 the two main categories of expenditure were civic amenities and public works, with very little spent on health or education. Pande (1994) reported a similar concentration of expenditures for a *panchayat* in Himachal Pradesh in 1985-90. See also Oomen (1995).

2. *Kshetra Samiti* [block]
Sanitation and health; public works; planning; coordination; supervision and execution of developmental programmes including agency functions.

3. *Zila Parishad* [district]
Public works; planning; coordination; supervision and execution of developmental programmes including agency functions. (Shah, 1990, p. 61).

The two higher tiers thus appear as implementing agencies of the state government, rather than as local government bodies in this set-up. And in practice, even functions such as education, which appear only in the list for the lowest tier, were substantially under the control of state government agencies. This situation was typical for other states also.

Two examples given by Shah, based on interviews, illustrate some of the problems with the functional assignment across the many levels of government. The head of one *panchayat* related that the construction of a proposed road (within the responsibility of the village level) was begun, and the *Zila Parishad* sanctioned the release of *panchayat* funds for this purpose, but this was held up at the intermediate level, causing problems for the village. In another case, a village wished to obtain drinking water whose source was in a government forest, but was unable to get a response from the appropriate state government bureaucrats. In both these cases, functional responsibilities were notionally assigned to the village level, but village level decision makers did not have practical control - the responsibility was actually fragmented.

Post-reform

As noted earlier, the 73rd Amendment created a list of 29 different areas of rural local government functional responsibility. Potentially, therefore, there is a considerable expansion in the expenditure responsibilities of rural local governments. However, two difficulties loom. The first of these has been illustrated above: most of the items in the new schedule are concurrently state government responsibilities[30]. This concurrence requires some alteration in the relative revenue capacities of the levels of government, and in the lines of control throughout the governmental apparatus within the states. This includes the division of functional responsibilities among the different rural tiers (as in the examples from Shah, 1990). The state level legislations based on the amendment do not always clarify this division[31]. Without attention to these issues, situations such as those described above will still occur.

The second potential difficulty is enforcement, and the assignment of law and order in general. Recall that the Kerala act did include the maintenance of village courts as a *panchayat* responsibility. However, the history of decentralization of such functions to the local level in India has been problematic. Before independence the primary role of traditional *panchayats* was as petty courts, with limited functions as providers of public

[30] Datta (1992) , Table 1, identifies only 10, relatively minor responsibilities as exclusive to local governments, with the other 19 involving overlapping responsibility.
[31] See Rajaraman *et al* (1996), p. 1074.

goods. The judicial role of *panchayats* was therefore given some attention after independence. An attempt was made to create separate *nyaya panchayats* (NPs) to handle judicial matters. Despite the informality and flexibility of procedures in the NPs, there were considerable delays and arrears at that level, attributable to the lack of training of personnel, of institution building in general, and ultimately to a lack of adequate funding. Overall, the NP system became effectively moribund[32]. The idea of devolving law and order to the district level was mooted in discussions of the Karnataka reforms of 1983, but was completely absent from the constitutional amendments: law and order remains a state subject[33]. The lesson from the failure of *nyaya panchayats* may not be that decentralization of judicial processes will not work, but that the existing structures of the judicial components of government must be decentralized with adequate resources provided for its success[34]. The point is that this is a functional responsibility that has important complementarities with other local responsibilities[35].

Urban local governments

Pre-reform

As one would expect, the list of functional responsibilities is longer for urban than for rural governments. For the pre-reform phase, based on constitutional assignments, Datta (1992) lists 14 exclusive functions, and 16 that were concurrent with the state governments. Fire services, health centers, libraries, land use, regulation of industry and commerce, and parks and playgrounds were examples of areas of urban government responsibility not included in the rural government list. The pattern of expenditure nationwide in broad categories was shown in Table VIII. In addition, each state has its own legislation governing urban areas in various classes, typically through general Municipal Acts, but sometimes, for large metropolitan cities such as Mumbai, through city-specific legislation. As a result, there was great variation in actual functional responsibilities across cities, even those of similar sizes, with cities such as Mumbai and Ahmedabad having broader responsibilities. For example, the Ahmedabad Corporation plays a major role in education, health, water supply, bus transportation and town planning, while in Chennai (Madras) these are provided by state level institutions (Jetha, 1992). Even in the big cities, while functions such as police protection was organized at

---

[32] Galanter (1989), Chapter 4, examines the judicial role of *panchayats* and *nyaya panchayats* in detail.

[33] As quoted in Mathew (1994), p. 13, social activist Swami Agnivesh asked, "Who will wield the *lathi* [stick used by police]in the villages? Whose orders will the police take to use force?" The answer at that time, from Abdul Nazir Sab, the Panchayati Raj and Rural Development Minister of Karnataka, was, " It is our intention that the police should come under the control of the *zilla parishads*. But we cannot do all these things simultaneously. We will do it step-by-step when the district government is constituted." As it turned out, this never happened in Karnataka. However, Bihar, Himachal Pradesh, and Punjab have given *panchayats* some judicial functions in their state-level legislation (Oomen, 1995, p. 14).

[34] In fact, the problems of delay and arrears are pervasive at all levels of the Indian judicial system. See Mookherjee (1993), for example.

[35] Again, the decentralization of law enforcement may be significant for revenue enhancement also (tax enforcement for example), once again illustrating the tripartite framework of expenditure, revenue and organizational incentives that we are using. On the other hand, economies of scale may work in the opposite direction.

the local level in terms of jurisdiction, effective control was at the state level, with personnel recruited to state or central police services.

Bhagwan (1983) and Jetha (1992) provide some more detailed information on the functioning of the five biggest Indian cities: Ahmedabad Calcutta, Chennai, Delhi, and Mumbai, plus Trivandrum. Table IX summarizes expenditure on the revenue account[36] for these cities, for the major categories of services. Bhagwan discusses the Municipal Corporation of Delhi's (MCD) expenditures, focusing on inefficiencies in provision, but also providing examples of lack of clear, permanent assignments of responsibilities. For example, in 1971, the Slum Department (responsible for providing essential services to slum dwellers) was transferred from the MCD to the Delhi Development Authority (DDA), but transferred back in 1978, and back again to the DDA in 1980! The DDA also has jurisdiction over some gardens and green belt areas, resulting in some confusion of

TABLE IX
Six metropolitan cities, per capita expenditures in current rupees

	Delhi	Mumbai	Calcutta	Chennai		Ahmedabad	Trivandrum
Year	1977-78	1977-78	1977-78	1977-78	1988-89	1988-89	1988-89
Public health	36.23	47.84	18.03	24.73	21.4	66.0	8.9
Education	30.69	32.36	4.90	25.38	43.4	101.6	3.0
Public works	12.39	31.32	20.17	22.57	16.9	78.8	55.9
Public safety and conveniences	7.00	36.68	3.41	22.04			
Miscellaneous*	5.30	25.30	2.86	3.51			
Other					70.5	58.0	5.5
Total	91.61	173.50	49.37	98.23	152.2	304.4	73.3

Sources: 1977-78 figures, Bhagwan (1983), Table 5.2, p. 56; 1988-89 figures, Jetha (1992a), Table 2.7, p. 16. The classification schemes are somewhat different in the two sources.
*Construction and maintenance of swimming pools, stadia, community halls, tourist camps, and night shelters for homeless; promotion of sports and cultural activities; old age pensions for poor; etc.

responsibilities. Other problems have arisen in dealing with Delhi's smaller municipal body, the New Delhi Municipal Committee (NDMC), which obtains services such as fire protection and electricity from the MCD, but is lax in payment for such services. The relationship between the two bodies is complicated by the fact that most central government offices and housing are in the NDMC's geographical area. These issues,

[36] For Delhi, expenditure on the revenue account made up about 83% of the expenditure in these categories, the remainder being on the capital account (Bhagwan, 1983, Table 5.1, pp. 53-54). Also, these figures are for "development expenditure", excluding administration, costs of collection, etc. Development expenditure made up about 93% of the expenditure in Delhi's Municipal Corporation (MCD). Finally, the figures are only for the MCD, by far the largest of Delhi's municipal bodies.

therefore, are again problems of institutional structure rather than functional responsibility alone.

A striking example of lack of clear functional responsibility comes from Ludhiana, the largest city and industrial center (population about 660,000 in 1981) of the relatively wealthy state of Punjab. The state government has, over the years, established several special purpose agencies to perform functions which would normally come under municipal authority. These agencies include the Punjab Housing and Development Board, Punjab Water Supply and Sewerage Board, and various Improvement Trusts. Here is a description of one consequence:

> Labour colony and the adjoining housing areas ... are virtually a hell on earth...The sewerage has collapsed...As many as 264 one bedroom double storey houses built by the Housing Board for the labour and 400 houses for the low income group stand in knee deep water. The sewerage had failed *four years ago* and all pleas for repairing it are said to have gone unheeded. The saddest part is that *no department is willing to own responsibility. The Housing Board authorities say they have handed over the colony to the Municipal Corporation while the Corporation dodges the issue by saying it has not taken over the colony. The Public Health Department which laid the sewerage is also not willing to accept responsibility and repair it.* (Sachdeva, 1991, pp. 95-96, emphases added)

Of course one can also look at this as an example of lack of clear jurisdiction, or of failure of accountability, but one part of the problem again lies with a lack of clear assignment of functional responsibility, particularly due to the existence of multiple government bodies with notional responsibilities for the same function in the same jurisdiction.

Improvement Trusts have been set up by the Punjab government for development tasks such as provision of open space, laying out or altering streets, housing the poor , and land management[37]. They are nominated bodies directly under the control of state government, though with some municipal government representatives. The list of tasks of such agencies reflect a common characteristic of local government in India: capital expenditures for a particular function, say, providing roads, are undertaken by a nonlocal body, while maintenance is left up to the local government. The example from Ludhiana is another illustration of this approach. In such cases, there is a clear assignment of tasks, but not one which provides effective incentives for provision of the service.

Post-reform

The 74th Amendment to the Constitution created a list of 37 areas of responsibility for urban local governments. This did not represent as dramatic a potential expansion of responsibility as did the corresponding reform for rural local governments. Examples of additional responsibilities include secondary and adult education, vital statistics, housing and land use, promotion and development of industrial and commercial estates, and electricity distribution. However, some of these additional assignments were already being

[37] Thus they are quite similar to the DDA in function (Sachdeva, 1993, p. 304). These kinds of bodies have their ancestry in sanitary commissions set up in the 19th century in Bengal, Bombay and Madras. See Sachdeva (1991), Chapter VI. The recent justification for such agencies has been in terms of the lack of local fiscal and managerial capacity, as well as budgetary flexibility and economies from specialization.

carried out by larger urban bodies, such as the Delhi Electric Supply Undertaking under the MCD. Furthermore, there is no change in the state or concurrent lists in the constitution, and therefore the state governments retain considerable authority over functions now notionally in the urban local government sphere. The issue of law and order was discussed at some length in the context of rural local governments, where it still might be argued that decentralization in this dimension is problematical[38]. However, for cities and larger towns, it would seem that the assignment of judicial functions to the local level, with local control, would be feasible. However, this has not been done in the recent constitutional changes.

Assessment

Local governments, both rural and urban, provide examples of a lack of clarity in the division of functional responsibilities. This occurs in several specific ways. First, the same general expenditure or service category is often the statutory responsibility of the state government as well as its subordinate local governments. Second, even where broad areas are explicitly divided, this is not necessarily done in a manner that promotes incentives for efficiency: the division of capital expenditures by the state and operations and maintenance by the local government for the provision of a given service is the main example of this. Third, there has been a tendency for state governments to encroach on what might otherwise be well-defined municipal responsibilities, through the creation of special purpose agencies, or through the intervention of state government departments[39]. Fourth, even when local functional responsibilities have been clear, they have been relatively narrowly defined, leading to inefficiencies such as the repeated repair of earthen (rural) roads rather than construction of more durable alternatives. Finally, the assignment of functional responsibilities has not always been efficient, in terms of allowing local governments control over activities with economies of scope or complementarities: law and order, or judicial services more generally, has been stressed as the most important case of this.

Obviously, the above five problems overlap to a considerable extent. Also, as has been stressed in presenting the examples in this section, the problem of functional assignment is linked very closely with issues of revenue availability and organizational or institutional incentives. This is, of course, the point stressed by Dillinger (1994), and is well illustrated, therefore, by the Indian experience. These issues will be developed further in the following sections. I close this section with some positives. Despite the problems highlighted so far, there are several favorable features or developments in assigning functional responsibilities to local governments, even though the recent reform legislation does not completely addresses the above five issues.. There has always been some attempt at explicitness in the various state legislation, and the constitutional amendments take this a step further, their new schedules providing a floor on local government

[38] For example, Bayley (1969, p. 403) notes issues of competence and parochialism.

[39] It should be noted here that this is not always at the initiative of the state government. The central government, through its Planning Commission, and international lending agencies have also favored or even pushed for the creation of such state-level special purpose agencies.

responsibilities that must, in principle, be respected by the states. This reform also broadens local government responsibilities, reducing to some extent the problem of excessive narrowness. The three tier system imposed on rural local governments also helps to clarify assignments to the extent that the higher two tiers have specific coordination responsibilities, and are meant to be more like components of local government than agencies of the state government. In terms of allowing for geographical distinctions, the Indian experience reflects a well thought out framework and progression, unlike some of the examples mentioned by Dillinger (1994, p. 25) of a "one-size-fits-all" approach. The recent legislation also deals with his stricture that the graduation process in India lags behind the rate of urban growth: there are explicit provisions now made for areas in transition from rural to urban.

IV. REVENUE

Local government responsibilities in India have been broadened and strengthened. How will they be able to carry them out, when even previous narrower responsibilities were often beyond budgetary means of local governments? As numerous commentators have emphasized, raising additional local government revenue will be a key requirement. In this section, I examine the experience with local government revenues in more detail, as well as the implications of legislative changes for revenues. I begin with an overview that includes some example cases; then turn to individual revenue sources - taxes, user charges, transfers and loans; and finally evaluate prospects in the new framework. In each case, I distinguish between the situations of rural and urban governments

Overview

Tables V and VI presented statewise revenue figures for rural and urban local governments respectively. In section II, I stressed the heterogeneity across states[40], and highlighted some of the differences between rural and urban government revenue sources. Datta (1992) provides some additional data on local government revenues, aggregated at the national level, but disaggregated by tiers of rural local government and types of urban local government. These are summarized in Table X. First, note that grants and shared taxes dominated for rural governments, while taxes were more important for urban governments. Second, rural local government revenues were heavily skewed towards the upper tier, which was typically not directly elected, and sometimes just nominated by the

[40] Differences across states reflect institutional variations or special circumstances. For example, in Table V, the high assigned-share tax revenue of urban governments in Madhya Pradesh reflects their share of the state entry tax. In many other states, transit taxes (called octroi) are collected by the urban governments themselves. The figures for Maharashtra are exceptional because of the inclusion of Mumbai, which, in 1977-78 had a revenue of Rs. 1,706 million, of which taxes accounted for Rs. 1,382 million (Bhagwan ,1983). These figures dominate urban government revenues in Maharashtra.

TABLE X
Local government revenue by tier/type 1976-77

	percentages						
	Tax	Non-tax	Shared taxes/grants	Total	Average population ('000)	Revenue per capita (Rs.)	Revenue per authority (Rs. '000)
Rural Tiers							
District councils	6.0	1.2	92.0	100	1500	17.3	25,950
Block councils	14.2	0.2	85.6	100	75	2.2	165
Village governments	34.8	18.2	47.0	100	1.5	2.5	3.75
Total	8.1	2.7	89.2	100			
Urban Types							
Municipal corporations	72.3	14.1	13.6	100	500	125.0	62,500
Municipal councils	58.4	19.2	22.4	100	50	66.0	3,300
Town/notified committees	49.0	18.0	33.0	100	7.5	46.0	345
Total	54.4	26.9	18.7	100			

Source: Datta (1992) Tables 4.6 and 4.7, pp. 185-186.

state government. In many cases, they were just state agencies, control over their expenditure being effectively determined by state government officials. Third, the per capita revenue of the smallest urban governments, town and notified area committees, with an average population of 7,500, was considerably greater than the per capita revenue of the much larger rural district councils and block councils.

Tables XI and XII provide data on revenue patterns of the lowest and intermediate tiers of rural governments by state. These are more recent than the data in Table V, as well as being disaggregated by level. They are also somewhat more detailed in terms of revenue sources[41]. For the lowest level (Table XI), local governments in some states are much better able to mobilize income from taxes and fees or from land revenue. As noted earlier, some of this difference is a consequence of different legislative assignments. In other states, the *panchayats* rely much more on grants from higher level governments. The figures are not completely comparable across states. For example, only the figures for Andhra Pradesh and Uttar Pradesh include central grants under the Jawahar Rozgar Yojana (JRY) scheme of poverty alleviation grants. For the intermediate level (Table XII), there were similar variations across states, with Gujarat standing out in terms of average revenue per block.

[41] However, concerns about data quality and comparability across states apply. For example, Haryana *panchayats* are shown in Table XI as obtaining a significant fraction of revenue from land, while Rajaraman *et al* (1995) state that "Haryana does not levy land revenue at all" (p. 1076).

TABLE XI
Revenue pattern, panchayats, 1989-90

percentages

	Taxes and fees	Land revenue	Revenue sharing	Grants	Other	Total	Per capita revenue (Rs.)
Andhra Pradesh	13.6	0.0	6.6	78.5	1.3	100	40.6
Assam ,	NA	NA	NA	NA	NA	NA	NA
Bihar	NA	NA	NA	NA	NA	NA	NA
Gujarat	31.0	0.8	2.8	41.9	23.5	100	27.6
Haryana	13.2	61.6	0.0	11.2	14.0	100	10.9
Himachal Pradesh	6.9	0.0	1.4	11.3	80.4	100	9.7
Karnataka	NA	NA	NA	NA	NA	NA	NA
Kerala	63.4	0.1	0.0	14.5	22.0	100	31.4
Madhya Pradesh	0.0	92.1	0.0	7.9	0.0	100	0.5
Maharashtra	45.2	0.0	6.5	25.2	23.1	100	12.0
Orissa	5.6	2.7	0.0	85.3	6.4	100	2.4
Punjab	1.0	33.9	1.1	50.9	13.1	100	26.4
Rajasthan	0.0	4.9	0.0	95.1	0.0	100	40.4
Tamil Nadu	33.3	0.0	31.8	34.9	0.0	100	3.1
Uttar Pradesh	1.5	0.0	4.7	91.7	2.1	100	53.2
West Bengal	NA	NA	NA	NA	NA	NA	NA

Source: Oomen (1995), Table 1A, p. 24

Revenue sources and structures

I discuss taxes, fees, transfers and borrowing in turn. Tax sharing is discussed in detail under transfers. Each of these revenue instruments raises different issues. For example, Dillinger (1994, p. 26), notes that “The choice of instruments depends on the objectives, and the objectives vary according to the function that is being financed”. In particular, services where benefits are private and the externality (or merit good) aspect is not strong are better candidates for user charges or local taxes. On the other hand, to the extent that revenue sources are not earmarked, there is not necessarily a simple correspondence between functions and instruments in practice. However, it remains true that the behavioral and distributional impact of each revenue instrument needs to be borne in mind.

Taxes

Examining Table V, we see that the share of rural government revenue that comes from local taxes was quite low in 1976-77, ranging from a high of 29.6 per cent in Kerala down to 0.3 per cent in Orissa. The national average for these figures was only 8.1 per cent in that year. The figures for 1989-90 in Tables XI and XII indicate somewhat higher

TABLE XII
Revenue pattern, block level, 1989-90

percentages

	Taxes and fees	Land revenue	Revenue sharing	Grants	Other	Total	Average per block (Rs. mill.)
Andhra Pradesh	0.0	0.0	2.8	96.6	0.6	100	3.98
Assam ,	NA	NA	NA	NA	NA	NA	NA
Bihar	NA	NA	NA	NA	NA	NA	NA
Gujarat	4.2	3.4	5.4	79.9	7.1	100	10.87
Haryana	29.8	0.0	0.0	70.2	0.0	100	0.08
Himachal Pradesh	96.2	3.8	0.0	0.0	0.0	100	0.08
Karnataka	NA	NA	NA	NA	NA	NA	NA
Kerala	NA	NA	NA	NA	NA	NA	NA
Madhya Pradesh	96.2	3.8	0.0	0.0	0.0	100	NA
Maharashtra	NA	NA	NA	NA	NA	NA	NA
Orissa	0.0	0.0	0.0	100.0	0.0	100	0.11
Punjab	1.3	0.0	7.0	36.8	54.9	100	0.52
Rajasthan	27.7	0.0	4.8	38.7	28.8	100	0.05
Tamil Nadu	4.4	0.0	5.1	90.5	0.0	100	5.56
Uttar Pradesh	46.2	0.0	0.0	47.8	6.0	100	0.27
West Bengal	NA	NA	NA	NA	NA	NA	NA

Source: Oomen (1995), Table 1B, p. 25

percentages for tax revenue, but they are still very low for many states. Yet rural local governments have had 27 different taxes (20 exclusive, 7 concurrent with the state government) available to them[42]. Exclusive taxes included terminal taxes and octroi; property and building taxes; oil engine, food, timber, fishery and produce taxes; and profession and labor taxes. Concurrent taxes included those on commercial crops and on land. For the lowest rural government level in some states, land revenue was a significant proportion of revenue (Table XI). In others states, the state governments dominated in land taxes: collection would be by the state, with an assigned local share, and this would be included in the third column of Table V. The figures for tax sharing are also quite small. Hence, the lack of revenue-raising through taxes by rural local governments is noteworthy.

Comprehensive rural data disaggregated below the state level is scarce, but data at the district level for Kerala (one of the more decentralized states with respect to rural local governments), illustrates several factors in the lack of revenue-raising through taxes by these governments: (1) rates, (2) assessments, (3) coverage. These in turn are related to the institutions and incentives of local government. The data for Kerala also provide

[42] These figures, and the individual lists, are taken from Datta (1992), who compiled them from the relevant constitutional provisions.

further information on the structure of rural government taxes. The discussion of this data is supplemented with information on other states where possible.

Table XIII provides a breakdown of the per capita tax revenue, as well as other major sources of revenue for Kerala districts. There were 1001 panchayats in these 14 districts, with an average population of about 22,000. The data include all major taxes and other major sources of revenue, except grants, for which districtwise data was not available. The variation in the amounts and pattern of revenues across the districts is not too large: this probably reflects the relative economic and social equality of Kerala. The variation in total per capita tax collections across districts appears to be positively correlated with the degree of urbanization[43].

TABLE XIII
Breakdown of rural government revenue per capita, by district, Kerala , 1981-82 (Rupees)

		Main tax sources							
	% Urban 1991	Profession tax (Rs.)	Building tax (Rs.)	Entertain-ment tax (Rs.)	Vehicle, show and service taxes (Rs.)	Tax revenue, main sources (Rs.)	Non-tax revenue (Rs.)	Share of duty on property transfer (Rs.)	Total revenue, main sources (Rs.)
Trivandrum	33.88	0.78	1.14	0.62	0.09	2.63	1.19	3.85	7.68
Quilon	18.53	0.96	1.37	1.40	0.19	3.92	1.15	3.60	8.66
Alleppey	30.46	0.91	1.47	0.69	0.20	3.28	0.95	2.53	6.76
Pathanamthitta	13.05	1.15	1.83	0.52	0.25	3.75	2.12	4.72	10.60
Idukki	4.72	1.56	2.36	0.89	0.07	4.88	1.00	2.43	8.31
Kottayam	17.55	1.29	2.06	0.78	0.26	4.38	0.88	3.36	8.63
Ernakulam	48.74	1.39	2.13	1.05	0.14	4.72	1.55	3.80	10.07
Trichur	26.31	1.06	1.85	1.50	0.15	4.55	0.89	3.35	8.79
Palghat	15.72	1.08	1.42	1.56	0.17	4.23	0.69	2.34	7.27
Malappuram	9.12	0.62	0.99	0.97	0.11	2.69	0.98	2.05	5.73
Kozhikode	38.34	1.05	1.42	1.27	0.10	3.84	0.89	1.83	6.56
Wynad	3.41	1.22	2.57	2.35	0.12	6.26	1.47	2.70	10.43
Cannanore	50.87	0.95	1.82	1.16	0.12	4.04	0.85	2.33	7.23
Kasargode	16.45	0.79	1.39	0.84	0.03	3.06	0.94	2.37	6.37
State Average	26.39	1.03	1.61	1.10	0.15	3.89	1.07	2.95	7.91

Source: Compiled from Government of Kerala (1986), various tables. Percentage urban from Mathew (1994).

[43] This statement is not based directly on the per capita figures reported, which used the population figures in Government of Kerala (1986). Instead, since those figures appear to include urban populations, they were adjusted by the percentage of urban population, in calculating a correlation coefficient of 0.64.

The building tax is the most important of rural taxes in Kerala, followed by profession and entertainment taxes, with others being quite minor. The levy of the building tax is compulsory, with minimum and maximum rates fixed by the state government. This is typically the practice in other states as well: the building tax is the most common of *panchayat* taxes. In states with multiple tiers of rural government, the tax is levied by the lowest tier. The need for minimum rates is illustrated by the experience in Kerala. The minimum rate was raised from 4 to 6 per cent of annual rental value in 1978, leading to a 61 per cent increase in revenue from this source[44] that year. Seventy per cent of *panchayats* taxed at the lowest possible rate in 1983-84: this reluctance on the part of local governments to tax as much as they are allowed is a general theme in descriptions of Indian local governments, and is examined further in section V.

Besides tax rates, a significant dimension in determining the revenue from building taxes is the assessed value. Aside from issues of the details of the system of assessment (often difficult where market transactions are rare or not well recorded), a common problem is simply outdated valuations. This is well illustrated by the Kerala example, where there was a jump of 51 per cent in building tax revenue in 1983-84, the year in which quinquennial assessment revisions were begun. Other states typically still fail to assess values systematically or regularly, making the tax rate itself of limited significance in affecting revenue raised[45].

Finally, the coverage of a tax such as the building tax is important for revenue. Here, the data is not detailed, but some egregious examples of exemption are provided for Kerala (Government of Kerala, 1986, p. 21): twelve *panchayats* exempted 50 per cent or more of buildings from the building tax. Another problem is the exemption of certain types of buildings from the tax: for example, in Haryana, all non-residential structures are exempt (Rajaraman *et al*, 1996).

Other rural property-based local taxes are possible, besides the building tax. Levies on non-agricultural land exist in several states, extending to agricultural land in Bihar, Kerala and Punjab (Rajaraman *et al*, 1996). While there is considerable scope for revenue from taxes on land, actual collections in most states are low (Tables V, XI, XII): in fact, this is true of state-level land taxes as well. Taxes on non-motorized vehicles cannot be a major source of revenue, but there is also scope for sharing motor vehicle tax revenue (collected in urban areas) with rural local governments: currently, Kerala (Table XIII) is an exception in doing this. There are also a few instances of other property-based rural taxes. D.S.K. Rao (1995) documents the success of a levy on agricultural pumpsets in West Bengal, after the management of tubewells was transferred from the state government to the *panchayat* level. Betterment levies or developmental charges, which are common for urban local governments, are rare (Rajaraman *et al*, 1996).

---

[44] Government of Kerala (1986), Table , p. 16. Such figures are typically not corrected for inflation, but that has typically been in single digits in India.

[45] In some cases, the building tax is not even *ad valorem*, but a specific levy: see Rajaraman *et al* (1996).

Other rural data on taxes at a disaggregated level illustrates that taxes are relatively important at the lowest level, but sometimes only as a significant fraction of low amounts. For example, for *panchayats* in the district of Nainital in Uttar Pradesh, in 1979-80, average revenues per block ranged from Rs. 0.2 to Rs. 1.2 per capita, with about 70 % coming from taxes (Shah, 1990). Reasons for such low figures include the poverty of the state, particularly of hill districts such as Nainital, but also the relative centralization of government in Uttar Pradesh (Tables III and V). More recent data (1992-93) on 11 *panchayats* in Saharanpur district of Uttar Pradesh provide own revenue figures (including sharing of land revenue) of Rs. 96,750 per *panchayat*, with 36 % of that being raised through taxes (Oomen, 1995, Appendix B). By this period, *panchayats'* own revenues were supplemented by substantial JRY grants from the center, which were 3.4 times own revenues in this sample. Oomen (1995, pp. 8-9) reports on two other studies, illustrating extremes of revenue-raising through taxes. Bankala *panchayat* in Sirmaur district of Himachal Pradesh raised only 0.5 % of its expenditure on its own over the period 1985-90. In a sample of eight *panchayats* in Karnataka (a relatively decentralized state) for 1991-92, taxes were 44 % of revenue, and over 50 % of revenue excluding JRY grants. The absolute amounts were also relatively large, though again there was great variation across the eight *panchayats*, with the degree of urbanization playing a significant positive role in both the amount of revenue raised and the proportion of revenue from taxes. In these data, the breakdown of revenue from different taxes is not available.

Disaggregated data on urban government tax revenues is more plentiful. Urban governments also had more tax instruments available to them. Datta (1992) notes that 20 different taxes were available to urban governments, nine exclusively to them and 11 concurrent with state governments. Unlike in the case of rural governments, several of these were significant taxes, with two of them, octroi (a levy on goods entering a local area) and property taxes, accounting for 90 per cent of nationwide municipal tax revenue (70 per cent and 20 per cent respectively)[46]. For example, the towns of Ludhiana (described earlier) and Patiala (smaller, with a municipal committee) in Punjab received 72 and 65 per cent, respectively, of their income from octroi in 1985-86, and 18 and 10 per cent respectively from property taxes. Other common taxes included vehicle, profession and terminal taxes. Overall, taxes accounted for a major share of revenue, especially in larger cities or in towns with corporations. This is illustrated in Table XIV for six cities[47]. Note that Chennai and Trivandrum relied on only two taxes for the bulk of revenue from this source, even when octroi was not available. The MCD of Delhi, had 16 taxes available to it[48], but only five of these were important.

---

[46] Datta (1984) gives a somewhat different breakdown in Table I, p. 44: 54 per cent of urban local government tax revenue from property taxes, and 41 per cent from octroi in 1976-77.

[47] Jetha (1992) provides some data on the overall importance of taxes for the states in which Ahmedabad, Trivandrum and Chennai lie: Gujarat, Kerala and Tamil Nadu, respectively. Tax revenue of urban local bodies as a percentage of current expenditure was 67.7 (Gujarat, 1989-90), 77.8 (Tamil Nadu, 1984-85), and 119.1 (Kerala, 1985-86). However, note that urban local expenditures were much smaller percentages of state expenditures in Kerala and Tamil Nadu (Jetha, 1992, Table 2.4). See Table VI also.

[48] Of these, nine were compulsory, including taxes on property, theaters, vehicles, entertainment and property transfers, and a terminal tax (essentially equivalent to octroi). The terminal, entertainment and vehicle taxes were central government levies, shared by the MCD with the NDMC and one other local

TABLE XIV
Six metropolitan cities, per capita revenues in current rupees, and percentage composition of tax revenue

	Delhi	Mumbai	Calcutta	Chennai		Ahmedabad	Trivandrum
Year	1977-78	1977-78	1977-78	1977-78	1988-89	1988-89	1988-89
Current expenditure	91.61	173.50	49.37	98.23	167.0	416.2	90.2
Tax revenue	72.14	185.11	49.62	73.14	115.0	282.4	77.4
Non-tax revenue	12.71	38.32	11.97	31.97	17.8	47.2	15.6
Grants	15.89	5.06	26.07	1.77	18.5	70.7	7.4
Percentage composition of taxes							
Property	39.4	NA	NA	NA	48.9	30.9	36.6
Octroi/Terminal	29.9	NA	NA	NA	-	68.2	-
Vehicle	6.1	NA	NA	NA	-	-	-
Entertainment	9.5	NA	NA	NA	20.3	-	32.2
Electricity	9.6	NA	NA	NA	-	-	-
Other	5.5	NA	NA	NA	30.8	1.0	31.2

Notes: 1970's data from Bhagwan (1983), 1980's data from Jetha (1992). There are some differences in classification in the two sources. Percentage composition for Delhi is for 1978-79.
The main tax in "Other" for Chennai and Trivandrum is a duty on property transfers.
For Mumbai and Calcutta, property taxes were 33.1 % and 33.7 %, respectively, of current receipts in 1989-90 (Jetha, 1992, Table 3.1).

Some data on tax rates and structure of tax revenues at the level of smaller individual urban bodies is available for a sample of 31 Orissa urban bodies (Dash, 1988). All but one of the governments in the sample levied a property tax. Three used the maximum allowable rate of 10 per cent (again, on annual rental value), while two went as low as 2 per cent. Other taxes, for lighting, drainage and sanitation, were variously imposed at different rates. Several cases are cited where these rates were reduced after revisions in assessment had raised valuations and the number of properties valued, negating some of the impact of reassessment. In many cases, revisions of assessment had been conducted in the mid-1970's after decades. Besides property taxes, octroi was the only significant source of tax revenue in this sample. Seventeen governments imposed octroi, and it accounted for 25.6 per cent of revenues. The profession and vehicle taxes were negligible revenue sources. In general, while the revenue from own sources (including non-tax sources) was fairly high - about 68 per cent for the state as a whole - in the sample there were a dozen (typically smaller) governments whose tax revenue was less than 20 per cent of their receipts.

government in Delhi. Five of the seven other available taxes were not levied, the exceptions being an education cess and a tax on electricity

Problems with rates, assessments and coverage, noted in the case of rural governments, are also pervasive in urban local bodies. In addition, there is data for cities on problems with collection, which compound the problems with rates and bases in restricting tax revenues of local governments. Property tax rates were higher in the big cities than in smaller towns or rural areas, with progressive structures, so that the marginal rate was as high as 30% in Ahmedabad. At the same time, these high rates were undercut by problems of failure to include properties in the base and of undervaluation for tax assessment. The problem of valuation in cities and towns is complicated by the existence of rent control laws, combined with the use of annual rental value as the base for taxation. Rates of collection are often below 50 per cent for taxes such as those on property, being as low as 17.8 % for Ahmedabad in 1990-91. Furthermore, these collection rates fell through the 1980's[49]. While one can develop sets of normative criteria for reform of urban local tax structure and administration (Jetha, 1992),implementing these requires considering institutional incentives, and I return to this issue in section V.

The focus above has been on the property tax, because it is the most appropriate local tax in terms of minimizing distortions. On the other hand, octroi, which is so important for urban local governments, is inefficient, subject to corruption, and excessively distortionary[50]. Some states have abolished it, but others have introduced it in recent years. Madhya Pradesh and Karnataka replaced it with a state entry tax, which has some of the same effects[51]. Part of the problem is that simple abolition of such a tax does not immediately provide local governments with a replacement source of revenue. Though in the longer run it may give them incentives to improve the collection of property taxes, this will not be an easy administrative task. In some cities and towns, particularly where octroi is not available, entertainment taxes provide significant revenue. While no single tax can replace octroi revenues, better use of taxes on entertainment, motor vehicles, professions and utilities, which are all reasonable local tax bases, can help collectively. Furthermore, local surcharges on state taxes such as sales taxes are also underutilized. Taxes on utilities such as electricity and water can be quite similar to user fees in practice: this category is discussed below.

To some extent, local tax reform has to be part of the national effort at rationalizing the tax system. Some taxes which are properly local are currently preempted by state governments. Other taxes (for example, a surcharge on property transfer duty) are conveniently or effectively collected by the state government on behalf of localities, but the system of transferring or allocating the proceeds to local governments is inefficient. Considerable work has recently been done on reforming central taxes, with attention to how this will impact state level tax systems. Attention to local governments

[49] See Jetha (1992), Table 3.3. Mumbai did relatively well, with a 72 % collection rate in the same year. Chennai, Calcutta and Trivandrum were in between these two extremes.
[50] The inefficiency and distortionary effects of octroi include high collection costs and the high taxation of intermediate and capital goods. There are also problems of tax exporting in this case. See Jetha (1992, Ch. 6).
[51] An entry tax does economize on collection costs, using dealer returns instead of roadside checkposts. At the same time, the tax is no longer strictly a local tax.

can and should be a part of such ongoing attempts. The constitutional amendments, while expanding and formalizing the assignment of functional responsibilities to local governments, merely instruct the states to provide local governments with adequate revenues or revenue instruments. This requires analysis of rates, bases and collection as well as the nature and number of taxes that local governments are permitted to impose. Tax revenues are low because of incentive constraints as well as statutory ones. Finally, note that issues of local government revenue adequacy also require consideration of other sources as well as taxes.

Fees

The boundary between specific or earmarked taxes and fees or user charges is somewhat arbitrary in the case of some goods provided by local governments. The classification partly depends on the closeness of the connection between usage and payment: a pure public good where exclusion is impossible requires taxes. But in the case of goods like water going to individual houses, users can be charged access fees as well as for use - the latter if it can be monitored. In some states, local authorities use these forms of charges as well as taxes for water added on to property tax assessments. This tax revenue may go into a general fund, however. The classification as tax or charge can therefore also depend on the ownership or earmarking of the revenue[52]. With these conceptual complexities acknowledged, I will proceed to follow the budgetary classifications used in discussing revenue from fees and user charges. I first treat rural and then urban governments.

The state-level data in Table V show non-tax revenue that is considerably smaller than tax revenue, except for Orissa and Kerala, and the numbers for Orissa in both categories combined are minuscule, being about Rs. 0.40 per capita. The most common fees are user charges for water and lighting. These are typically collected at the lowest rural level and, in the absence of monitoring ability, are flat fees. On the other hand, charges for sanitation, or for public events such as fairs and festivals, are not frequently assigned or employed. *Panchayats* are also usually not empowered to levy user charges on health and education[53], even though aspects of these functions are assigned to them. Thus the general ability of panchayats to charge for services has been unduly limited.

Some more detail is available for Kerala. The per capita figure for Kerala from Table V is about Rs. 2, but the number in Table XIII (from a different source) is only half this, and may exclude some revenue sources. The components of the numbers in Table XIII are income from *panchayat* properties, and licenses, fees and fines. The latter included a broad range of charges related to trade and commerce, therefore often similar to taxes in nature. The revenue from licenses, fees and fines was the smaller component for every one of the districts (though not necessarily at the individual *panchayat* level). For the state as a whole, the proportion of non-tax revenue from this source was 23 per

[52] This principle is not necessarily followed in local government budgets: for example, Jetha (1992) treats Chennai's lighting tax as a service charge, though it seems to go into general revenues. Revenue from this tax is therefore not included in Table XIV.

[53] Bihar, Haryana, Rajasthan and Uttar Pradesh are the exceptions. See Rajaraman *et al*, 1996.

cent. Income from *panchayat* properties was mainly derived from enterprises such as market complexes, shopping centers, lodgings and bus stands. Case studies by the state *panchayat* finance commission suggested that these enterprises were indeed almost always profitable, though the rates of return were low.

For the sample of panchayats in Nainital district (Shah, 1990), tax was Rs. 328,000 in 1979-80, dwarfing non-tax revenues of Rs. 23,000 from the land management committee and Rs. 2,000 from the forest *panchayat*. The tiny latter figure is interesting because this is a region where deforestation is a serious problem. Forests are a major rural resource, and were traditionally community property. Somanathan (1991) describes these former types of property structures, and their more recent erosion. This process is therefore partly reflected in the lack of income from what might have otherwise been a significant *panchayat* asset. The lack is particularly significant given the economic structure of the region, with little scope for non-agricultural/forestry activities, and hence of revenue from license fees for trade or similar charges. The generality of this problem of assignment is noted by Rajaraman *et al* (1996). Only Gujarat and Maharashtra share forest revenue with rural governments, in both cases with the highest, district-level tier, and at quite low rates. However, Gujarat allows for additional sharing with *panchayats* in forested areas, as a substitute for land revenue. This is a significant exception from which other states can learn.

Turning to urban local governments, we see from Table VI that non-tax revenue varied considerably across states, as a percentage of total state revenue. Figures in the table imply percentages ranging from 0.5 for Bihar to 44.7 for Andhra Pradesh. The categories included in non-tax revenue were income from municipal property, income from municipal enterprises, and interest on investments. In fact, little of the total was derived from enterprises, except for some larger industrial or commercial cities in Gujarat, Maharashtra, Kerala and Tamil Nadu (Rao, 1986, p. 187). The pattern of municipal enterprises in Kerala was similar to that of rural government enterprises in the state, which were discussed above.

Per capita non-tax revenues for six cities in various years are reported in Table XIV: they are small relative to tax revenues, but not as low as in some other cases. In Ludhiana, for example, various fees provided just about Re. 1 per capita in 1982-83, which was under 4 per cent of the corporation's revenue. For Delhi, income from property and license fees were the main contributors to non-tax revenue, while the MCD's water and electricity supply enterprises ran deficits in 1977-78 and subsequent years (Bhagwan, 1983, Chapter 7). For Ahmedabad, Chennai, and Trivandrum, also, user charges and fees provided only small fractions of the costs of providing water, sewerage, bus transportation and land development (Jetha, 1992, Chapter 4). In some cases, such as water supply, the poor quality of the provision made charging difficult, either for technical or political reasons. In the cases of bus transportation, health and education, distributional considerations presumably play a role, with better-off citizens using and paying for private alternatives. In such cases, the quality of the public service is often very low. The low rates of cost recovery for land development, through charges or betterment levies, can not be explained by concern for distribution: those being subsidized in this way are not relatively poor. Estimates of the subsidies involved in urban land development are as high as 90 % (Jetha, 1992, p. 56).

Similar patterns exist in data for smaller urban areas. For the sample of 31 urban local bodies in Orissa in 1975-76, on average 7.83 per cent of revenue came from income from municipal property (Dash, 1988, p. 100), varying from a low of 2.12 per cent to 34.75 per cent (Dash, p. 139). This variation appears to have been the result of exogenous circumstances: whether the urban body owned valuable land and buildings or not. Income from other municipal enterprises appeared negligible. This sample had considerably lower non-tax revenue per capita than the figures for Orissa in Table VI: given that it included all of the largest of the state's urban areas, this suggests that there may be differences in classification in the two data sets. Again, little revenue was raised from user charges and fees, and the quality of the services provided was often low.

Overall, fees are used more in urban areas than by rural governments, but are often closer to taxes in their application than to charges for services provided. Neither fees nor genuine user charges generate much revenue, as a proportion of the cost of service provision, with one or two exceptions in large cities. Non-tax income in urban areas is often generated from the ownership of property and buildings, but again, this is rarely significant. Municipal enterprises are also not a major source of revenue. The problem of low recovery of costs through user charges and fees is not mitigated by provision through special-purpose bodies. Urban water supply, bus transportation and land development authorities all typically run deficits. There is evidence for urban bus transportation and for solid waste management that private provision can be an effective alternative. In cases of public provision, better regulation and administration are typically required.

Two final points are noteworthy. First, while the use of fees and charges in urban area is limited and in need of improvement, the fact that even smaller urban governments are sometimes able to successfully raise revenue from this source points the way for expanding this method of revenue-raising by rural governments, including through ownership of local assets such as forests. Second, more generally, the problem of raising revenue from user charges and fees is related to the lack of incentives of government decision-makers, as well as the low quality of provision of services. To repeat the point made in the case of taxes, the structure of institutions and incentives has to be addressed if improvements in local government revenue-raising are to occur.

Transfers

Two types of transfers are important in Indian fiscal federalism, whether between center and states (where they are particularly significant) or between state and local governments. These are tax-revenue transfers and grants. Tables V, VI and X illustrated the difference between rural and urban local governments with regard to transfers (typically from states), with grants being particularly important for rural governments[54]. The rationale for transferring tax revenues in whole or in part to a lower level government

[54] See also Tables XI and XII, for rural government tiers.

can be in terms of lower collection costs at the higher level or coordination to avoid undue tax competition, the higher-level government acting as an agent for the lower level. Formula-based tax-sharing transfers also have the advantage over grants of rising with tax revenues, while grants are typically not indexed for inflation. Considerations of fiscal capacity or redistribution do not require that the form of the transfer be through tax sharing: block grants are then appropriate. If the higher-level government wishes to encourage lower-level revenue mobilization, matching grants can be used. And if it wishes to encourage spending in particular categories, specific or categorical grants are appropriate.

A key issue in such transfers is the amount of discretion involved. Dillinger comments, "Perhaps the most important measure developing countries can take is to reduce the unnecessary side effects of existing transfer programs - to reduce the uncertainty and bargaining that now accompanies intergovernmental financial flows and remove incentives for strategic behavior"[55]. Until the recent constitutional amendments, transfers from state to local governments have been largely at the discretion of state governments, though mandated in general form by individual state legislative acts.

Transfers from the central government to rural governments have increased since the time covered in Tables V and VI, due to the increase in poverty alleviation schemes (particularly the JRY), as well as developmental projects coordinated with the planning process. These transfers are to the district level rural governments, and passed down to the lowest level, but are typically controlled by the state governments, since the district level has served as an agency of the state government. The data is also not consistent on these types of transfers: they may or may not show up as rural local government revenue (Table XI).

Of shared taxes at the rural level, the potentially important ones are duty on transfer of property, land revenue, motor vehicle taxes and entertainment taxes. Some of these have been touched on in the discussion of local taxes, and there is no reason why entertainment taxes should not be purely local, based on the nature of the service provided (cinemas). The duty on transfer of property is an important component, on average, of state government revenues, and *panchayats* typically share a surcharge imposed by the state on this duty[56], collected by the state along with the basic duty. Kerala's example illustrates (Table XIII). The duty on transfer of property has been a major contributor to the revenues of that state's *panchayats*: for rural local governments in the state, this revenue source exceeded the contribution of any other single tax. Of the total revenue (pooled at the *taluk*, or intermediate level), 75 per cent was transferred to *panchayats* according to population, while the remainder was according to other criteria such as area, resources and development needs. This kind of well-defined assignment and sharing of a

---

[55] Dillinger (1994), p. 30. This point is also made in Rao (1992) and in other studies of transfers to local governments in India, as well as in the context of central-state transfers in India by Kletzer and Singh (1997).

[56] Gujarat and Rajasthan allow *panchayats* to levy these surcharges, with a state-imposed cap on the rate (Rajaraman *et al*, 1996, p. 1077).

tax is similar in many respects to the approach to central-state transfers by the central finance commission, but has been less common in state-local transfers. At the same time, it has the problem, common in central-state tax-sharing, of weak incentives for collection: distribution by origin would provide local governments with an incentive to aid in collection.

Revenue from agricultural land is, with two or three exceptions, only in the fiscal domain of state governments. State governments give widely varying shares of this levy to rural local governments at one or more of the three tiers. This share is as much as 100% in some states, and is typically divided among local governments by formulae similar to the one described for Kerala's duty on property transfers. Thus, as emphasized by Rajaraman *et al* (1996), incentives for collection are almost completely absent. This, together with political economy factors, has reduced the revenue from this tax to negligible amounts, and there is a strong case for this tax to be made purely local.

Kerala is the only state that shares the state-level motor vehicles tax with rural as well as urban local governments, though the amounts are relatively small (Table XIII), and payments were made irregularly (Government of Kerala, 1986). However, there is an economic case for all state governments to do this: maintenance of rural roads is an important *panchayat* responsibility everywhere, and the current system of funding maintenance, even in Kerala, is inadequate[57]. Similar arguments for sharing with rural governments can also be made for state taxes on liquor and diesel fuel, which are shared with urban local bodies (Rajaraman *et al*, 1996).

Grants are significant for rural local governments, in relative if not absolute terms (Tables V, X, XI, XII). The later years' data in these tables suggests that their importance, particularly at the local level, has been increasing: this is due to schemes such as the JRY. However, even when spending is nominally at the local level, effective control of the grant moneys has often been at the state government level. Thus, some of the differences among states in these tables may simply reflect accounting conventions rather than actual decentralization of funds.

Kerala provides a useful case study on state grants to rural local governments. The data in Table XIII do not include such grants, since this was not available by district. However, they are discussed in the *panchayat* finance commission report (Government of Kerala, 1986). In addition to statutory tax-sharing transfers, there were 26 types of non-statutory grants. Many of these were specific grants, for drainage, water supply, irrigation, road maintenance, and street lighting, for example. Some of these specific grants had matching provisions. Others had distributional motives. At least one had a curious incentive structure: the establishment grant was paid to meet establishment costs in excess of a fixed percentage of "normal income" (recall the discussion in footnote 29). A large grant category was that of developmental activities, which included communication, irrigation, and some facilities construction. Some of these "development" grants also had matching provisions, others did not: all were part of the Indian five-year

[57] Recall the discussion of this issue in section III, on functional responsibilities.

planning exercise, and this led to a very lumpy payment of grants, with Rs. 100 million being disbursed in 1980-81, and less than Rs. 40 million in total over the next four years.

The *panchayats* in the Kumaun hills region of Uttar Pradesh (Shah, 1990), did not receive any tax-revenue share from the state in 1979-80. On the other hand, as in the case of Kerala (and other states), grants were received for development purposes as part of the planning process. These were matching grants for specific projects proposed by *panchayat* officials, with funds coming from the intermediate level (block or area councils) or the state government Development Department. The potential grants at the district level were large, exceeding tax revenues, but less than 20 per cent of the allotment had been utilized, due to uncertainty about the actual level of funds that would be available to an individual *panchayat*. Later data from the same state (Saharanpur district, 1992-93, from Oomen, 1995, Appendix B) shows *panchayats* receiving some share of land revenue, but this and all other *panchayat* revenues being dwarfed by JRY grants.

Various case studies from Himachal Pradesh, Karnataka and Maharashtra, summarized in Oomen (1995), bear out the large and increasing role played by grants relative to other rural local revenue sources. While the variety of grant schemes is noted in these studies (similar to the case of Kerala), most grants seem to be specific in nature. The case studies also suggest the perverse incentive effects of these grants on revenue effort by local governments. Exceptions are states such as West Bengal, which has a system of incentive grants tied to the collection of state taxes and mobilization of small savings. However, even in West Bengal, JRY grants appeared as the main source of revenue at the highest rural local level, the district (Oomen, 1995, Appendix C), and are perceived as overwhelming state and local incentives (Oomen, p. 11). These studies suggest that issues of tax effort, tax-sharing and user charges at the rural local level will require attention to the system of grants to local bodies.

Once again, data on transfers to urban governments is more plentiful[58]. On average, for the states in Table VI, 3.7 per cent of revenue came from assigned or shared taxes, and 14.8 per cent from grants. Shared or assigned taxes for urban governments included duty on transfer of property, motor vehicle taxes and entertainment taxes. Grants were mostly specific or categorical. Data on grants for six cities is provided in Table XIV. The tax revenue figures in this table include some shared tax revenues, and these were discussed to some extent with other taxes. Trivandrum and Chennai relied more on shared taxes, while Ahmedabad received more grants: these differences were reflections of differing statewide systems for transfers to urban local bodies. In Delhi, after 1970, the only important transfer was statutory educational grants, which were close to 13 per cent of total revenue for the MCD in 1978-79 (based on the central government providing 50 per cent of recurring education expenditures).

Rao (1992) provides a detailed analysis of transfers to urban governments in five states: Gujarat, Kerala, Maharashtra, Tamil Nadu and West Bengal. Gujarat and Kerala's transfers were relatively systematic, with Gujarat relying more on grants and Kerala on tax

[58] In particular, the study by Rao (1992) is an excellent source.

sharing. Almost all grants in Gujarat were specific, with 19 grant categories in the mid-1980's. For corporations - of which Ahmedabad is the largest - only five categories were used, and the primary education grant constituted almost 74 % of transfers. Corporations also received money from an education cess and from entertainment taxes, the latter earmarked for capital expenditures. Municipalities' main transfers were for primary education (40 %), capital expenditures from entertainment tax revenue (25 %) and dearness allowance[59] (16%), with small percentages from the numerous other specific grants for various health and sanitation expenditures (Jetha, 1992, Table 5.1). Data for Kerala's transfers to urban local bodies reveal a pattern somewhat similar to that of transfers to *panchayats*, but with greater autonomy. The main taxes were on entertainment (cinemas), professions, motor vehicles, and transfers of property. The first two of these were assigned to urban local bodies, while the latter two were shared in different ways. Urban governments were permitted to levy a surcharge on the state duty on property transfers, while the share of vehicle tax revenue was distributed as a specific grant for road maintenance. Tax sharing was also the main transfer vehicle in Tamil Nadu, with entertainment and property transfer taxes being the main sources. Chennai also receives a share of receipts from a sales tax surcharge, based on collections within the city limits. Specific grants were relatively minor since the 1990 assumption of primary education financing by the state government. For Maharashtra, 94 % of transfers in 1990 were specific grants. The three most important categories being for education (29 % of specific grants), dearness allowance (21 %) and development grants to backward regions (15 %). Several grants, such as those to assist in debt servicing, were highly discretionary in nature. The West Bengal transfer system shares some features with the other states: dearness allowance grants are significant (33 % of transfers), followed by education grants (13 %). Shared tax revenue is about equal to that of grants, with the entry tax (similar to octroi) and entertainment tax providing almost all urban revenue from shared taxes.

Individual case studies round out the above picture. In Ludhiana and Patiala, in Punjab, general and specific grants from the state government made up about 10 per cent of municipal income (Sachdeva, 1991). Sachdeva notes their inadequate levels, but also points out several cases of lack of full utilization (p. 168) because of two barriers. First, expenditures had to be sanctioned by the state government's Local Government Department. Second, the work, in many cases, had to be carried out by a state government department. In the sample of 31 urban local bodies in Orissa, grants and shared taxes made up about 30 per cent of revenue in 1975-76 (Dash, 1988, p. 115) or Rs. 7.18 per capita, with most of this coming from grants. The largest category was grants given to meet a part of the dearness allowance of local government employees: this made up 51.8 per cent of transfers. Other grants covered part of the base salaries of local government employees. Dash also describes wide variations in grants across the urban governments in his sample, as well as over time. There was an absence of transparency and certainty in such grants, leading him to state, "Thus the system of grants-in-aid is a political weapon in the hands of the State Government to control the working of urban

[59] "Dearness allowance" is a cost-of-living-based component of income which is adjusted to compensate for inflation, without the necessity of altering the base salary structure.

local bodies and to extend patronage...” (p. 119). Problems of lack of utilization of funds are also described for this sample.

The situation for both rural and urban local governments is one where transfers are often of limited value not just because of their small size, but more significantly because of their discretionary nature, leading to uncertainty and bargaining. This effect is compounded by the incomplete nature of the transfers: strings being attached not only to categories of expenditure, but also to specific details of implementation. One can argue such controls were necessary because of the lack of internal controls and expertise, and this argument will be considered in section V. Furthermore, grants for specific categories such as marginal personnel expenses section have obvious perverse incentive effects on expenditure decisions. Distribution formulas used by states, while trying to achieve some equalization of resources for different local bodies, also tend to adversely affect incentives for collection. Finally, many transfers are discretionary, without clear economic rationales.

A simpler, more transparent system of transfers may be desirable and feasible, with more tax sharing, and the use of fewer types of grants, with block grants to achieve equity. These changes that may be aided by the new legislation that mandates state finance commissions. While these will still be subject to the discretion of state governments, the experience at the center and in states such as Kerala and Karnataka suggests that such commissions do, over time establish rules, conventions and precedents, and achieve degrees of certainty and transparency that might not obtain otherwise[60].

Borrowing

The official literature on Indian government finance often distinguishes between “developmental” and “non-developmental” or between “plan” and “non-plan” activities or expenditures. The former dichotomy is conceptual, and the latter, in principle, reflects the institutional implementation of the former. However, distinctions made in this way can obscure the economically more fundamental distinction between capital and current expenditures. Investment expenditures whose benefits will accrue in the future are natural candidates for financing through borrowing, and, to the extent that many local services require infrastructure (local roads, street lights, parks), borrowing is potentially important for local governments. The efficiency argument for tax collection to be performed by higher levels of government has some force for borrowing as well, but the incentive problems thus created can be severe. These issues will be taken up in the following discussion of Indian local government borrowing. Of course, it should be noted that borrowing is in a different category than the other three revenue sources considered, since it creates future expenditure (repayment) obligations.

[60] This is no guarantee of optimality: grants with perverse incentives persisted in Kerala despite the existence of its Panchayat Finance Commission. A further complication, which has also existed at the center-state level, is that the parallel set of discretionary transfers made for central sector and centrally sponsored schemes will continue. I return to these in considering borrowing.

TABLE XV

Municipal debt, in millions of current Rupees

	1960-61	1976-77
Andhra Pradesh	17.9	66.8
Assam	0.3	6.2
Bihar	0.9	31.4
Gujarat	4.4	109.7
Haryana	NA	22.7
Himachal Pradesh	NA	NA
Karnataka	1.6	34.3
Kerala	NA	NA
Madhya Pradesh	5.9	81.4
Maharashtra	4.8	278.1
Orissa	0.6	2.7
Punjab	1.3	14.0
Rajasthan	1.5	0.4
Tamil Nadu	13.6	NA
Uttar Pradesh	5.4	11.0
West Bengal	1.8	5.5
Total	68.0	667.7

Source: Rao (1986), Table 9.1, p. 231.
Notes: Figures for 1960-61 are state loans only. Figures for 1976-77 include state loans (Rs. 378.1 million) and market borrowing (Rs. 289.6 million).
Figures for Punjab 1960-61 are for undivided Punjab (including Haryana).

Local government borrowing in India has been *ad hoc* and limited in nature. Tables V and VI on revenue sources do not include proceeds from borrowing. Table VIII shows aggregate revenue surpluses for rural and urban local governments. While rural local governments have not been major borrowers, urban governments have increasingly gone into debt: hence Table VIII does not describe well the recent situation[61]. Table XV provides some statewise data on stocks of municipal debt, which does give some idea of the extent of borrowing by urban local governments, and the diversity among the states in this respect. The figures indicate that there have been differences in the growth of such borrowing across states. Rao (1986) notes that close to 90 % of the debt was that of corporations (the urban governments of the larger cities), and of port trusts, the latter

[61] Datta (1992, p. 152) calls these surpluses partly a "legal fiction, since local authorities are required to present a surplus budget to meet contingent liabilities and actual shortfalls in revenues". However, he goes on to suggest that these surpluses may actually be real and large, motivated by two reasons: uncertainties in external aid which depress actual expenditures, and attempts to finance some capital expenditures from revenue surpluses. The first reason may explain why, according to Datta, "there is no discernible cycle of ... accumulation and utilization" of these surpluses. On the other hand, Jetha (1992) and Rao (1992) describe a situation where urban finances are less sound: postponed debt service payments are often not included in budget figures, leading to deficits being understated or hidden (Jetha, p. 13).

having large, specialized infrastructure requirements[62]. According to Rao, in 1976-77 municipal debt was 10.1 % of their total income, comparable to the percentage for the central government, but substantially lower than the corresponding number for the state governments overall (58.4 % in 1975-76). Only 1.5 % of municipal borrowings in 1967 were from the market (Rao, 1986). However, by 1976-77, over 40 per cent of the stock of municipal debt was the result of market borrowing. Hence, at least in some cases, there was a shift in the pattern of borrowing over the years. Yet the shift may be overstated, to the extent that borrowing was from nationalized banks, or from other government-owned financial institutions. Datta (1992) notes the weak distinction between loans made by state governments as part of the planning process, and institutional financing of local projects, also routed through the states. He does put market borrowings of corporations, with repayments ensured by mandated sinking funds, in a different category. These issues will be taken up in looking at specific examples and case studies.

Case studies of rural government borrowing are from Kerala and West Bengal. The Kerala Panchayat Finance Commission report noted the practice of rural local governments incurring loans from the state's Rural Development Board (RDB) for creating remunerative assets. These projects, however, were required to be carried out by the RDB itself. Examples of such projects were Rural Water Supply Schemes, for which, until 1984, 50 % of the capital cost came from the government-owned Life Insurance Corporation of India as loans to the RDB, and 50 % from the state government. *Panchayats* were charged 25 % of the capital cost, in some sense a forced loan. In 1987, ownership of such projects was transferred to a specialized state-level water agency, and the loan liability was also removed. This example indicates the institutional complexities of rural local government "loans". I do not have data on the amounts of such RDB loans, but the report gives a figure of Rs. 2 to 2.5 million for annual loans directly from the state government to *panchayats*. This represented a tiny fraction of the aggregate panchayat income in the early 1980's of Rs. 200 to 300 million, indicating the overall unimportance of rural government borrowing even in Kerala.

West Bengal, like Kerala, has been one of the states most willing to decentralize. The National Rural Employment Programme (NREP) was a central government program designed to employ the rural poor in creating productive community assets which would further benefit the poor, as well as strengthening rural infrastructure in general[63]. Examples included rural roads, water supply schemes, minor irrigation and flood control, forestry projects, schools, houses, and *panchayat* offices. Funding for such projects was to come from loans from the nationalized banks, as well as central government transfers. While this was a national initiative from the central government, implementation in West Bengal was significantly more decentralized, with plans being prepared starting with proposals submitted by the *gram panchayats* to the block level councils, which in turn made consolidated proposals to the district councils. Execution, monitoring and maintenance were also largely *panchayat* responsibilities in West Bengal, much more so

[62] The breakdown given by Rao (1986) for 1967 was: city corporations, 50.8 %; port trusts, 41.1%; municipalities, 8.1 % (p. 232).
[63] Subsequently, this was consolidated along with other similar programs into the JRY.

than the national average[64]. While the familiar problem of lack of certainty in budgets was also present in this case (leading as usual to sporadic or low utilization of funds), local control was more clear cut than in previous examples. Bank borrowing represented 30 % of proposed revenue for the Birbhum District Plan for 1989-90 (Lieten, 1992, Table N7.2, p. 218). Of course this was not market borrowing, being government directed through nationalized banks, and with the state being ultimately responsible for payback, but it did represent borrowed resources over which rural local governments had control. This was in contrast to other states where the lowest level of rural government (typically the only directly elected level) had little role. However, even in West Bengal, rural local governments did not have access to borrowed funds in the same way that large urban governments did. Even district councils, representing populations as large as big cities, did not have the powers or legislative authority available to city corporations.

Other data on rural government borrowing is scarce, partly because it has been very limited. In the Kumaun hills region of Uttar Pradesh (Shah, 1990), borrowing appeared to be absent as a source of finance in 1979-80. This is not surprising, given the poverty of the region: capital expenditures were typically made from state government grants, often channeled through the higher tiers of rural government, and also often initiated at a higher level. Oomen (1995, p.6) notes that Uttar Pradesh and Bihar now have Panchayat Finance Corporations which make investment loans to *panchayats*. Their capital is contributed by rural governments, the state government, and public finance institutions. However, data in Oomen (Tables 1A, 1B) indicate very small percentages (under 1.5 %) of revenue from loans for *panchayats* in Himachal Pradesh, Orissa, and Uttar Pradesh, and 3.5 % of revenue for the middle tier in Gujarat, though in some states loans may be hidden in the “Other” category.

Borrowing is more significant for urban governments. I have noted that city corporations have been the major source of urban local government borrowing (setting aside the special case of port trusts). For Delhi, in 1978-79, the MCD borrowed almost 20 % of its current revenue (i.e., excluding the borrowing)[65]. A large part of this was central government loans for slum improvement schemes, responsibility for which had been passed back and forth between the MCD and the DDA, as discussed in section II. In the early 1970’s borrowing was only 5 to 7 % of revenue. The debt burden - the amount due on borrowings - was 4.4 % of revenue in 1978-79, lower than in previous years. However, the MCD began defaulting on loan payments almost every year from 1966-67. By 1979, 602 loan installments were overdue. These problems are not surprising if one notes that in many years the MCD ran deficits on both its current and its capital account. In the 1980’s, city governments in Ahmedabad, Chennai, and Trivandrum often ran

[64] In a sample conducted by the central Department of Rural Development, *panchayats* in West Bengal were responsible for maintenance in 99 % of cases (India, 35%) and execution in 73 % of cases (India, 42%). Local materials were used more in West Bengal than in other states, and a higher proportion of projects in the sample were deemed successful compared to the rest of the country. See Lieten (1992), p. 221.

[65] The current revenue figure was Rs. 560.4 million. Current and capital expenditure figures for 1978-79 were Rs. 637.7 million and Rs. 121.8 million respectively, indicating a deficit on each account for the year (Bhagwan, 1983, p. 43).

deficits on current and capital accounts, despite postponing debt service (Jetha, 1992, Table 2.5). Sources of capital finance were varied in these three cities. Grants were a minor source for Ahmedabad, which received substantial loans from the state government, the World Bank, and the Housing and Urban Development Corporation (HUDCO), as well as public borrowing. Chennai and Trivandrum relied more on grants, though the Kerala Urban Development Finance Corporation (KUDFC) was an important source of borrowing for Trivandrum. To some extent, these cities were representative of patterns in their respective states, though Tamil Nadu's other municipal bodies relied more on borrowing than Chennai[66].

There is similar evidence on borrowing for smaller towns and cities. Figures for Ludhiana (Sachdeva, 1991, Table 8.6) show its corporation's repayment of loans reaching as high as 11.1 per cent of expenditure in 1983-84, but then falling to 2.2 per cent or less in the subsequent three years. However, this did not give a true picture of the corporation's finances, which are described as in a state of virtual bankruptcy in 1988, with large bills and loans outstanding. At the same time, loans from the state government were made, but not used in a timely manner. Housing, water supply and sewerage projects for even the bigger Punjab cities were being handled by state government-created bodies such as the Housing Development Board and the Water Supply and Sewerage Board. These agencies borrowed from the Life Insurance Corporation (LIC), HUDCO, and the World Bank's International Development Authority, and did implement some significant projects. However, while municipal financial contributions were required, the implementation and the recovery of costs from beneficiaries were subject to inefficiencies associated with a lack of clear assignment of responsibilities.

In Orissa, also, water and housing projects were sometimes funded by state government borrowing from the LIC and HUDCO, respectively. Urban local bodies borrowed for these projects, as well as to finance sanitation projects, commercial infrastructure, street lighting, and even arrears of employee dearness allowance. Their loans came from the state government as well as the LIC. In the mid-1970's, loans to urban local bodies in Orissa averaged about Rs. 2 per capita, quite small relative to the per capita current revenue of Rs. 45 reported in Table VI. Water supply projects were an important case of loan financing, and the state government required two-thirds of their costs to be met by local loans, arranged by the state, with one third in grants. However, execution of the projects was the responsibility of the state Public Health Department. Dash (1988) describes problems of implementation in this situation, with overdue and abandoned projects (p. 137) costing the local government, but not generating benefits or revenue. The state government typically adjusted its grants to localities downward by the amount due on the loans. Local body chairmen in some cases expressed the view that these projects were forced upon them. Another feature in Dash's sample was the failure to utilize borrowed funds in a timely manner, even though interest was being charged. Thus, while urban local borrowing was not large overall, it was not organized in a manner consistent with the efficient allocation of capital.

[66] These statements are based on various tables in the Appendix to Jetha (1992).

These problems with local borrowing are especially noteworthy in light of the fairly stringent statutory restrictions placed on local governments in India. These included restrictions on rates, amounts, aggregate borrowing and length of terms. Individual loans require approval of the state and or the central government, as well as consultation with and approval of the Reserve Bank of India (RBI). Open market borrowings are also subject to higher level government and RBI supervision and approval (Datta, 1984, pp. 77-78). Clearly, no system of monitoring and regulation is perfect, and credit markets are particularly vulnerable, but the evidence suggests a misallocation of effort in some of this regulation in India, resulting in a misallocation (not enough in some cases, in the wrong place in others) of capital for local infrastructure. The constitutional amendments reforming local governments did not address the issue of local borrowing, and this is appropriate, in that the whole issue of financial sector reform needs to be tackled, with changes at this level properly following other innovations. This will also be the time to address plan-related transfers: the central planning exercise has in some cases driven the kinds of schemes typified by the examples above, and these transfers have been the ultimate source of funds for local infrastructure investment.

Assessment

I began this section by observing that expanded functional responsibilities for local government would require additional revenue. Rural local governments rely heavily on transfers from state governments for revenue. These transfers are often uncertain and restricted in ways that make their effective use difficult. For the lowest rural tier, taxes are a significant fraction of revenue. While even doubling revenue from this source would still imply low per capita levels, assigning better tax instruments (Rajaraman *et al*, 1996) can aid in more efficient resource use at the local level (for example, through benefit taxes such as market fees), and establishing a more effective tax administration can aid in building institutional capacity. In some states, there are sufficient tax instruments assigned by statutes: the problems are in exercising statutory authority[67], administering the tax, and establishing a clear tax assignment. The first problem arises because of inefficiencies in service provision, which may need prior improvement by other means. This will also set the stage for more effective use of fees and user charges. The third problem arises because the more significant sources of tax revenue are typically also assigned to state governments. Hence clearer rules for tax-sharing are essential, including complete assignment of taxes such as land revenue to the local level as a possibility .

The new state level finance commissions, modeled on the central finance commission and previous state-level commissions, will be crucial in achieving clarity,

[67] The following quote from Shah (1990, pp. 137-38), on the nexus of responsibilities, revenues and institutions, is apt: “the Gaon Panchayats ... have been vested with considerable powers to raise their revenues. In addition to ...duties like sanitation, road repairing , street lighting, etc. the panchayats have also the responsibility of developing the socio-economic life of the people...[P]anchayats, though empowered to levy taxes, have been ...slack in collecting them...[A]rrears could be realized as arrears of land revenues. But no panchayat dares to take such repressive steps ... because it is bound to generate bitterness among the people against the panchayat personnel.”

transparency and certainty with respect to tax-sharing and grants to local governments. This will be beneficial in reducing the costs of bargaining and uncertainty, even if the amount of transfers does not increase. A removal of perverse incentives in such transfers will also help: data on administrative expenditures by local governments does not indicate that local governments are always more efficient under current incentives. Since the state finance commissions will take time to become operational and effective, the central finance commission, in its latest report, has allocated funds for local governments in its recommendations on transfers from the center to the states (Finance Commission, 1994). Borrowing for capital expenditures by rural local governments would be the last piece to fall into place, since it is predicated on a development of institutional capacity, as well as other financial reforms. Borrowing is unlikely to ever be significant at the lowest tier, because of its small size, but there is no reason why the upper two tiers of rural government, now given a more independent status, should not eventually follow in the footsteps of municipalities in borrowing. Organizations such as Kerala's RDB or District Rural Development Agencies in other states are a step in the direction of more transparent channeling of capital for rural infrastructure, but are far from market-driven. This matters to the extent that the criteria for making loans and for ensuring repayment are not efficient without some market discipline. The issue of the state government's role as a guarantor of such loans, which creates a moral hazard problem for local borrowing, will have to be addressed.

The issues for urban local government revenue are similar in nature, but the emphasis is different, given the different mix of their revenue sources, as well as their differing responsibilities. For example, urban bodies have greater abilities to tax, and greater scope for charging for services. The importance of taxes for urban bodies' revenue suggests that the payoff from improving the take from this source will be relatively high. To the extent that the property tax is less distortionary than octroi, the other main source of urban tax revenue, improving its enforcement and collection is a priority[68]. As in the case of rural governments, improving efficiency of service provision may be a necessary precondition or adjunct to more effective tax revenue raising and greater reliance on user charges and fees.

Jetha (1992) and other studies emphasize the critical state of India's urban infrastructure, reflecting both a lack and ineffective use of capital funds. For urban local governments, improving access to capital, through borrowing from the private capital market, can perhaps follow more easily on improvements in revenue raising from taxes and fees: this precondition making repayment more feasible. Reliance on allocation of capital through a political process will then be lessened, as stressed by Dillinger (1994). Dillinger also discusses the possibility of municipal credit institutions, which have been tried in many countries, as a transitional approach to greater market reliance, creating an arm's length between the government and the lending process. Such institutions have been suggested in India on several occasions - for example by the Rural Urban Relationship Committee in 1966 - and their working in Kerala, Tamil Nadu and West

[68] Recommendations for this can be found in several sources, including Datta (1984), Rao (1986), Jetha (1992), Sachdeva (1993), and Dillinger (1993).

Bengal is described in Rao (1992). Organizations like the LIC and HUDCO have played somewhat of an intermediary role in India, but to the extent that they also lend to state governments and their agencies (which may then make loans to local governments), they may be less able to maintain the required distance from political considerations. Bodies that lend only to local governments would also avoid crowding out when state governments are also clients. This crowding out is likely when state government departments are providers of infrastructure, as is often currently the case. Finally, state - level municipal finance institutions may be better able to incorporate subsidies for smaller municipalities, or allow cross-subsidization across different types of projects than national institutions with more diverse clients (Rao, 1992)[69].

V. INSTITUTIONS AND INCENTIVES

Indian local government operates within an elaborate and quite well thought out system of legislation. Yet statutes cannot specify the minutiae of organizational detail required for efficient functioning. I shall take all the positives of local government in India somewhat for granted, and focus on current problems and issues. The nature of the institutions that constitute local government is important[70]. Also, a persistent theme in the description of local government functions and revenues in sections III and IV has been the interactions between different levels of government. These interactions have often damaged incentives, or even made them perverse. I therefore turn to this third piece of the puzzle in understanding local government in India.

Responsiveness and electoral accountability

Any democratic government can be thought of as an agent of its constituents. As such, the problem of organizational design for local government can be thought of as one of setting this agent in a context that provides appropriate incentives for action. The practical complications make this a problem without a simple or unique answer, of course: there are multiple constituents with diverse preferences, and the agent itself is an organization and not an individual. This means there are several different aspects to consider. I shall not consider the diversity of preferences very much in the following discussion. Although preference diversity is an important component of theories of why

[69] On the other hand, a national level institution specialized in local level borrowing may be more insulated from state-level pressures for bailouts or rescheduling.

[70] For example, the 31 urban local authorities (municipalities and notified area committees) in Orissa in Dash's (1988) sample show considerable variation in receipts and expenditures per capita. While these are each positively correlated with population size (with correlation coefficients of 0.36 and 0.33 respectively), a regression to explain per capita receipts with a dummy variable for status (1 for a municipality, 0 for a notified are committee), as well as population, makes the latter statistically insignificant. In other words, the organizational form is important for revenue raising, rather than size, in this sample of urban governments. This is also the conclusion in Rao *et al* (1985) for a study of Rajasthan.

decentralization can be welfare-enhancing[71], my focus is to take this as given, and ask what will make local government more effective than it has been in India till now. In answering this question, there are at least two levels of incentives to consider.

First, we can consider the provision of incentives to the government body as a whole. Accountability is the mechanism for providing these incentives, while responsiveness to constituent preferences is the expression of these incentives. Accountability comes from monitoring and auditing performance, and from rewards and punishments based on performance. For democratic governments, the electoral process ("voice") provides the most prominent reward-punishment mechanism, assuming there are attractive rewards associated with elective office, and that the basis for electoral judgment is not too noisy. Of course, a different, more basic level of controls and accountability is provided by the legal system, to prevent malfeasance or fraud.

The second level of incentives is within the government organization: not every government employee can be elected[72]. Non-elected government personnel's incentives are then determined by conventional organizational devices: bonuses, promotions, terminations, and so on. To the extent that elected officials' own incentives are powerful enough, and they have the flexibility to act, they will seek to influence non-elected personnel to act in constituents' interests also. Two fundamental departures from this model in the Indian local government context have been the lack of flexibility in designing incentives within local organizations, and the lack of direct electoral incentives for chief decision-makers at the local government level. Both these departures reflect the intrusion of higher level governments into the details of local action.

This brings me to a key aspect of local government incentives: the existence of a higher level of government. In smaller countries, the national government lies directly above local governments. In India, of course, the state governments are the main influence on local governments. However, as noted in the overview, the dual role played by the central bureaucracy (the IAS, as well as the Indian Police Service), with their state cadres but also a centralized ethos, complicates matters. In general, the lack of regular, direct local government elections in India, either because of the absence of legislative provisions, or because of the overawing of local elective institutions by state governments, has meant that state or central non-elected officials have often been key local government decision-makers. This, does not mean an absence of incentives to be responsive, but instead a less direct mechanism of accountability.

In such a situation, local political accountability might work something like this: constituents, rather than being able to vote out a city government, they are unhappy with, have to register their dissatisfaction about a non-elected agent of the state government

[71] See, for example, Olson (1986) and Oates (1991).
[72] The issue here is presumably the relative efficiency of different incentive mechanisms: it is very costly for voters to assess the performance of each member in a government organization, especially when the organization's performance is a product of joint efforts. Appropriate electoral incentives for key personnel should lead them to provide incentives in turn for their subordinates.

who is running the city. They complain to the lowest-level elected official available, their MLA, who then pressures the bureaucrat as a way of being responsive to constituents. Such a process loses transparency and certainty, as compared to direct, open elections[73]. A further problem is the application of incentives at a higher level of government. The state-level politician represents a local constituency, but not just on local matters: she will also participate in state-level policy making. This means that voters are not permitted to discriminate as finely as they can when they can separately vote for local and for state-level elected officials, possibly weakening the responsiveness of government overall. This effect is compounded if the local government is smaller than the smallest state government constituency[74]. This is certainly true in India, where legislative constituencies in state government (the constituencies of MLAs) correspond very roughly with the block or other intermediate level of rural local government. But this is much larger than the smallest rural or urban local governments, so MLAs' constituencies do not coincide with single local jurisdictions.

The provision for regular elections at the local level in the recent constitutional amendments - so that even if a local government is dismissed, fresh elections must be held within six months - has the potential to increase the responsiveness and accountability of local government in a fairly obvious and direct way. While state governments may continue to try and postpone local elections when it suits them[75], they will no longer have the law on their side. If one accepts that direct electoral accountability is preferable to bureaucratic or indirect electoral accountability, then the above argument applies also to the new requirement for direct elections at the upper two rural government tiers, and for various urban government forms. Replacing indirectly elected or nominated governing bodies with directly elected representatives has the potential to increase responsiveness and accountability by providing decision-makers with more direct incentives to please constituents.

It must be admitted that the empirical evidence for responsiveness is very limited, and in some cases responsiveness does not have positive outcomes. For example, Dash (1988, p. 223) gives examples of the Puri Municipal Council in Orissa providing reductions in or exemptions from octroi taxes to specific commercial products, benefiting local interest groups. Concerns about elite domination of elected rural local bodies have

---

[73] Of course even elected local officials may be vulnerable to higher level interference. An example is related by a former senior civil servant in his memoirs (Sivaraman, 1991). He was serving in the Orissa government administration when a group of villagers petitioned him to overturn their *panchayat's* decision on some matter. Sivaraman refused, but found himself transferred soon after, when the villagers (presumably with some relationship that gave them clout) pressed their case with the state's chief minister. Still, elected local officials with a clear assignment of responsibilities are more likely to be insulated from such pressures than are bureaucrats directly under the state administration: Sivaraman's transfer illustrates bureaucrats' vulnerability.

[74] A nice formalization of related ideas is in Seabright (1996), which also allows for uncertainty in outcomes that affects the ability of voters to discriminate. In that paper, there is a tradeoff, since centralization may provide coordination benefits.

[75] This is what the Karnataka state government did with elections to the upper two rural tiers *after* being the first state to pass new legislation in conformity with the amendment. See Mathew (1994, pp. 102-103).

existed since independence, with examples being commonly observed, in academic studies (Crook and Manor, 1994, for Karnataka) and elsewhere (Naipaul, 1975, for western India). All the case studies discussed in previous sections mention or imply the reluctance of local governments to impose taxes, being responsive to their constituents in this respect (see footnote 67, for example). And Sachdeva (1991, Chapter 10) argues that local politics can simply reflect state level rather than local issues, weakening the incentives for local responsiveness. Finally, Bajaj and Sharma (1995) note problems of information required to assess elected officials:

> When village pradhans were entrusted JRY funds for construction of community assets, the village community at large did not have knowledge about the total funds received and the annual expenditure incurred on various projects. The pradhan and the village panchayat officer, who jointly operated the panchayat account, kept the details a closely guarded secret. (p. M-79)

Thus electoral accountability alone is not enough, and must be supplemented by other measures, so that local governments respond effectively, and to the right signals.

In fact, examples also illustrate that local government in India can overcome problems of elite domination and of monitoring to assess performance. Bajaj and Sharma go on to describe the resolution of the monitoring problem:

> [The higher level] government made it mandatory for information to be posted publicly about the works executed, estimated and actual expenditure and savings if any. The displaying of relevant information on bulletin boards in public places and community halls resulted in community pressure on pradhans to account for public funds, and had the effect of many unfinished projects being rapidly completed.

With respect to elite domination, as long ago as 1965, Béteille observed, in his study of a rural area of Tamil Nadu, “Adult franchise and Panchayati Raj have introduced new processes into village society” (p. 221), and “political and legislative changes have altered the bargaining positions of the old economic classes” (p. 223). Béteille argues that local elections increased the power of those who were worse off but in larger numbers, rather than perpetuating or increasing domination by the traditional rural elite. The final example is urban. While the Shiv Sena is better known for other aspects of its ideology, its success as a political organization has also been built on its attention to ward and municipal constituencies in Mumbai: it has striven for and achieved electoral rewards by being responsive to those near the bottom of the economic ladder (Naipaul, 1975).

Monitoring and regulation

The example above from Bajaj and Sharma illustrates an important complement to electoral accountability: the need to be able to monitor performance. This is a requirement whatever the nature of the incentive system, electoral or bureaucratic. In the case of electoral incentives, there is a broad connection between those who are the beneficiaries, the monitors and the implementers of (electoral) rewards and punishments: these tasks are all done by citizens. There are incentive efficiencies in having these tasks performed by the same individuals, since this avoids the need to provide incentives to delegated monitors with different preferences. However, there are diseconomies associated with large numbers of principals and with lack of specialization. These factors create a role for more specialized monitoring and regulation, through watchdog groups, journalists and other media, and - where poor performance is connected to illegality - the police and the judiciary.

The requirement for disclosure of information is a common and important example of regulation. Conceivably, it could be imposed by constituents themselves, but in the Bajaj-Sharma example, and many other cases, disclosure requirements are imposed and enforced by higher levels of government, for reasons of economies of scale or scope or to ensure commitment. In many cases, monitoring is also performed by another organization, rather than by constituents: essentially, one agent (for example, the financial auditor[76]) monitors another (the local government). There is no conceptual reason why such auditing or monitoring has to be done by the state government. Some functions of this nature can be and are performed by internal auditors or by private companies. Even if monitoring is done by a higher level government, it could conceivably be performed by the next tier up, at least for the two lower rural tiers.

In practice, the state government in India is the main body for monitoring local government performance. This is for two reasons: the state government is where expertise has been, and it is where true ownership or control of resources has been. And yet, the case studies used in this paper (Bhagwan, Dash, Sachdeva, Shah) are replete with examples of misuse of funds, through incompetence, malfeasance, or both. It is possible that focusing on selected examples gives a misleadingly gloomy picture, but one can not excuse failures to follow basic accounting procedures, or outright misappropriation. Two linked explanations are plausible. First, the level of auditing, both quantitatively and qualitatively, is inadequate. This seems to be borne out by the case studies, as well as the surveys by Datta (1984) and Rao (1986), and applies not just to the identification of irregularities, but also to the enforcement of minimum accounting standards. Second, more effort seems to be devoted to other kinds of monitoring rather than to auditing or performance monitoring. Presumably, both these explanations can be traced to the weakness of the accountability of state governments for local government performance.

One simple way to phrase the problem of local government monitoring is to distinguish between input and output monitoring. There is no general case for preferring one over the other in the provision of incentives, but the case of local government in India seems to be marked by excessive control of inputs and process, to the detriment of attention to performance and outcomes[77]. Several examples were given in sections III and IV of detailed approval required from higher level governments for relatively small

[76] The case of the media as monitor is somewhat different, in that they are not agents of citizens, but rather independent entrepreneurs in providing monitoring services.

[77] The choice between input and output monitoring is a complicated one, since certain means may be undesirable in themselves, if they involve corruption or illegality, even though the ends are thus achieved. Mookherjee (1997) analyzes these and other issues in a model of tax administration. See also the references in that piece.

projects or expenditures, sometimes as part of a top-down national and state planning exercise in which local governments had little input. At the same time, performance could often be neglected, with overdue and abandoned projects being commonly cited in the studies referenced in this paper. I think it is useful to characterize this situation as an imbalance in the types of monitoring used. To some extent, this imbalance may be changed by direct electoral accountability of local governments.

The reference to the planning process above is significant, because the nature of regulation of local governments in India has been driven by the overall top-down approach to economic policy, relying on the case-by-case discretion of government decision-makers, in areas such as industrial location and expansion, and the allocation of capital generally. The central government's shift since 1991 from case-by-case regulation to setting general regulatory standards may provide a model for reformulating state regulation of local governments. These issues have not really been addressed in local government reform legislation, and will require some attention.

Control

The discussion of regulation raises the more general issue of control. We can think of this broadly in terms of ownership or property rights. Local governments in India have had a very restricted locus of control or ownership. While the statutory assignment of responsibilities and authority has been ambitious, it has often overlapped substantially with state government functions and revenue authority. Local decisions have often been made by state or central bureaucrats. Requirements for approval of specific expenditures have further circumscribed the authority of local governments. Personnel practices and assignments have also been heavily state-controlled. Control of local land use (such as in the example of forest resources discussed in section IV) is also often in the hands of state governments. A key issue in the development of local government will be whether these loci of control change to any substantial degree, despite the absence of these issues from recent legislation.

Here, the recent legislative provision for regular local elections is potentially very important. One reason for the lack of clear evidence on the positive effects of electoral accountability is the paucity of extended periods of locally elected governments in many places, as well as the lack of complementary powers (even elected governments were severely restricted in their actions). If elected local governments become the norm, this in itself creates the possibility for more positive action, even without further legislative changes. For example, an elected city mayor may have greater incentives to implement infrastructure projects more effectively to please constituents than would a state government bureaucrat. To attract capital for such projects[78], there are incentives to be more efficient in accounting and internal control. At the same time, external agencies may have an easier time dealing with elected governments that will be in office for a predictable

[78] Of course this was something which the elected *panchayat* leaders in the example from Bajaj and Sharma (1995) did not have to do, since they chiefly allocated funds received from higher level governments.

amount of time[79], making specialized state functional departments or specialized state-level agencies (such as housing or water supply boards) relatively less attractive as channels for investment.

On the other hand, there will always be projects where economies of scale or spillover benefits indicate that greater efficiency will be attained by action at the state level. However, for the rural sector, the block and district levels may prove suitable for many larger scale actions, since they will have an independent existence and electoral support hitherto absent in almost every case. While the block and district levels have been the focus for plan implementation in rural areas, they have typically been (*de jure* or *de facto*) state agencies in this role, with effective control remaining at the state government (or even national) level. To the extent that, in the new system, local governments can act independently of state agencies, jurisdictional conflicts such as in some of the examples in sections III and IV can be avoided: such independence goes hand in hand with clear assignments.

State government control in the past has often been implemented by functional departments at the state level. Even in states where local government legislation has given municipal governments somewhat more nominal autonomy, this freedom has been limited in practice by functional department control of municipal authorities. Bhattacharya (1972), in four case studies[80], traces the reasons for this control partly to the role of functional departments as providers of technical assistance. This supposed technical role has been motivated by concerns for efficiency - in turn driven by a perceived lack of expertise at the local government level. In practice, this has often translated into direct control of decision-making, rather than technical assistance coupled with performance monitoring. The lack of well-designed systems of state-local transfers, discussed in section IV, has reinforced this tendency, since, in the absence of appropriate incentive grants, direct control becomes relatively more appealing. While Bhattacharya discusses only urban cases, the problems are similar for rural local governments. The solution, since local governments will continue to require outside expertise, is to make sure that their new status gives them control in contracting for technical help, including going to the private sector, the national government, or even other state and local governments as alternatives to their own state government.

Efficiency

The different aspects of institutions discussed so far, accountability, monitoring and control, ultimately matter to the extent that they improve efficiency in the provision of public services. I close this discussion with a more explicit look at the connection between

---

[79] The new legislation will presumably support this by curtailing incentives for state government supersession of elected local bodies. Of course this is not a guarantee that dealing with local government bodies will become easy for outside funding agencies.

[80] The cases are water supply in Gujarat, primary education in Maharashtra, roads in Tamil Nadu, and health services in West Bengal. Bhattacharya characterizes Tamil Nadu's municipalities as the least autonomous, followed by Maharashtra, West Bengal and Gujarat.

accountability and efficiency. In the appendix, I analyze a simple model of government-citizen decision-making, adapted from Inman (1985). This model was originally developed to analyze tax limitations imposed by voters in some states in the U.S. The relevance here is the repeated observation for Indian local governments that their decision-makers are reluctant to impose higher taxes, or to collect existing taxes because they fear voters' displeasure. At the same time, the level of local public services is often perceived as too low. The model displays this type of equilibrium. It also shows that increasing efficiency, perhaps even slightly, may lead to a very different equilibrium, with higher levels of provision and higher welfare. The relevance to the above discussion is that if local government reforms provide an environment where the efficiency of provision increases through better regulatory structures[81], there may be perceptible improvement in the performance of local government in India.

The model also allows a comparison of full and partial accountability in a simple way. In the model, partial accountability, which allows local government decision-makers to choose service levels given citizen demand, may be better for citizens than no accountability at all, but it is also possible that partial accountability is no better for citizens than the case of no accountability. Citizens are likely to be best off with full accountability, where citizens can choose service levels and rewards, given an acceptance constraint for competitive government decision-makers. Even with full accountability, the equilibrium may not be very desirable for citizens, and small increases in efficiency may substantially improve outcomes because of discontinuities in behavior.

The main lesson of the model in the appendix is thus to tie together in a simple way the discussion of accountability and monitoring. Both electoral accountability and improvements in regulatory mechanisms will be required for more efficient provision of public services. The legislative reforms have reshaped the mechanisms of accountability for local government, but the details of the new relationship between local and state governments will need to be worked out.

VI. CONCLUSION

This paper has focused exclusively on local governments, including their interactions with state-level governments and government agencies. The interplay of assignments of functional responsibility, revenue authority, and organizational structures has been stressed in examining past and possible future reforms of local government. It is useful to conclude by relating these reforms to the country's broader set of economic policy changes.

Reform of local government in India has had a different impetus and history than the changes put in motion by the 1991 balance of payments crisis. However, they are closely connected by the issue of reducing fiscal deficits, and the management of

[81] The model does not endogenize this link between regulation and efficiency, but this can presumably be done along the lines of the approach taken in Mookherjee (1997) and the references therein.

government finances in general. It is now well recognized that the structure of fiscal federalism in India has contributed to the overall problem of government deficits. The states, used to operating with soft budget constraints, have seen their finances deteriorate, and the post-reform squeeze has tended to reduce their spending on social and economic services such as education and health. In this climate, there are real concerns about the fiscal impact of local government reform. For example, the recent World Bank country study, in discussing tax reform, tax sharing and the disincentives for lower level resource mobilization, offers the following caution:

> The 73rd Amendment...is an important and welcome change, aimed at increasing the autonomy of local governments. However, it may accentuate fiscal indiscipline by establishing between states and local governments a system of transfers similar to the one in place between the central and state governments.

Related concerns, that the center will ultimately have to channel resources to local governments, directly and through the states, are expressed in the Tenth Finance Commission report (Finance Commission, 1994, Chapters 10 and 15).

However, I think the Indian case offers some positive prospects, for the following reasons. First, the decentralization is down to the local level, where smaller constituencies make it easier to impose hard budget constraints. Second, the quote from the World Bank study seems to neglect the fact that the central finance commissions have done a relatively good job, within its constraints: greater problems have arisen with more discretionary transfers, including categorical grants and loans. This has been the only system operating between the state and local levels. The creation of state finance commissions has the potential to reduce such discretionary transfers from the states to local governments, and to increase the transparency, certainty and, ultimately, efficiency of such transfers. The state commissions can also learn from the past, and avoid grant schemes with perverse incentives, such as those which pay for marginal personnel costs.

While making intergovernment transfers more efficient will help, raising resources more effectively is crucial. Here also, the broader set of reforms may turn out to be complementary to the reform of local government. One may think of the underlying goal of economic reforms in India as the achievement of a more efficient use of resources (and capital in particular), to support higher growth. Reforms of trade, industry and financial markets are all, in some way, driven by this basic objective. Relying on smoothly functioning (and well-regulated) financial markets to allocate capital, in this view, is crucial for government as well as for the private sector. Historically, state and local governments have not been able to engage in market borrowing. Instead, they have relied on top-down funding through the central planning process, which has often not been responsive to the wants of local residents. Since many municipal service projects involve long-lasting capital and equipment, the building up of local capital has been hindered. The creation of urban local governments with independent status, legal authority and regularly elected officials, raises the possibility that local governments may eventually be able to borrow money in the financial markets for local sanitation, roads and schools. Again, for this to work, hard budget constraints must exist: municipalities should not be allowed to expect a bail-out if they overspend. Clearly, this development will take time, but it should be noted that the central government has taken the first steps towards market borrowing itself, representing a major break with past practice.

Improving the effectiveness of the tax system is another avenue for revenue enhancement, and is necessary for local government borrowing as well, since borrowing for non-remunerative public projects requires future tax revenues to fund loan repayment. True representative government at the local level is more likely to be able to raise revenue through taxes, if the citizens thereby are able to more closely connect benefits received with taxes paid. The discussion in section IV highlighted several respects in which the assignment and administration of local taxes might be improved. A third route for increasing local governments' revenues to meet their new functional responsibilities is user charges. For many local government goods, user charges and fees can be quite close to taxes in practice, and both these sources of revenue have been constrained partly by the inefficient delivery of public services. Local governments with limited accountability, and typically little freedom of action with respect to expenditures, have tended not to risk upsetting constituents by raising resources through these means, preferring to rely on whatever funding they could obtain from higher-level governments. Constituents have been unwilling to pay more for an inefficient provision of services.

Ultimately, therefore, the primary issue to be considered is whether decentralization will permit the more efficient use of government funds. Greater responsiveness to constituents as a result of local democracy and decentralization should certainly help. However, this paper has stressed that complementary reforms in organizational structures, to improve incentives for government decision-makers, are necessary to reap the full benefits of greater electoral accountability at the local level. Some possible changes are quite drastic, such as the transfer of existing staff from central and state government to local government, and the reorganization of administration at all levels. However, changing the incentives within existing institutional structures can also have a strong payoff. Together with some reallocation of personnel, this can mitigate concerns that increasing local government responsibilities will require large increases in "establishment costs" (Rajaraman *et al*, 1996). Increasing efficiency of provision can be the basis for more effective use of taxes and fees.

Whether increases in efficiency in local government are possible or likely remains to be seen, but the outcome of even partial economic reforms at the national level has been to suggest that the idea of a low "Hindu rate of growth" may be a myth, and further gains may be feasible at subnational levels. India's legislation for strengthening local government did not (and could not) explicitly deal with all the details of incentives and institutional structures discussed in this paper, but it has paid attention to all three elements of reform emphasized in the introduction: functional responsibilities, revenue sources, and structures of accountability, and may therefore have at least set the stage for more effective local government service provision.

REFERENCES

Aziz, A. (1993), *Decentralised Planning: The Karnataka Experience*, New Delhi: Sage Publications.

Bajaj, J.L., and O.P. Agarwal (1992), "State Finances in Uttar Pradesh: 1965-90", in *State Finances in India*, ed., Amaresh Bagchi, J.L. Bajaj, and William A. Byrd, New Delhi: Vikas Publishing House.

Bajaj, J.L., and Rita Sharma (1995), "Improving Government Delivery Systems: Some Issues and Prospects", *Economic and Political Weekly*, May 27, M73-M80.

Bayley, David H. (1969), *The Police and Political Development in India*, Princeton, NJ: Princeton University Press.

Béteille, André (1965), *Caste, Class, and Power: Changing Patterns of Stratification in a Tanjore Village*, Berkeley: University of California Press.

Bhattacharya, Mohit (1972), *State Municipal Relations*, New Delhi: Indian Institute of Public Administration.

Crémer, Jacques, Antonio Estache and Paul Seabright (1995), "The Decentralization of Public Services: Lessons From the Theory of the Firm", in *Decentralizing Infrastructure: Advantages and Limitations*, ed., Antonio Estache, World Bank Discussion Paper 290.

Crook, R., and J. Manor (1994), *Enhancing Participation and Institutional Performance: Democratic Decentralization in South Asia and West Africa*, Report to Overseas Development Administration, U.K.

Dash, Gokulananda (1988), *Municipal Finance in India: Based on Orissa*, New Delhi: Concept Publishing.

Datta, Abhijit (1992), "Local Government Finances: Trends, Issues and Reforms", in *State Finances in India*, ed., Amaresh Bagchi, J.L. Bajaj, and William A. Byrd, New Delhi: Vikas Publishing House.

Datta, Abhijit (1984), *Municipal Finances in India*, New Delhi: Indian Institute of Public Administration.

Dillinger, William (1994), *Decentralization and Its Implications for Urban Service Delivery*, UNDP/UNCHS/World Bank Urban Management Programme Discussion Paper, UMP 16.

Dillinger, William (1993), *Property Tax Reform: Guidelines and Recommendations*, UNDP/UNCHS/World Bank Urban Management Programme Discussion Paper, UMP 1.

Finance Commission (1994), *Report for 1995-2000*, Government of India: New Delhi.

Galanter, Marc (1989), *Law and Society in Modern India*, Delhi: Oxford University Press.

Government of Karnataka (1989), *Report of the Finance Commission for Zilla Parishads and Mandal Panchayats*, Bangalore: Govt. of Karnataka.

Government of Kerala (1986), *Report of the Panchayat Finance Commission,* Trivandrum: Govt. of Kerala .

Inman, Robert P. (1985), “The ‘New’ Political Economy”, in *Handbook of Public Economics, Volume 2*, ed., Alan Auerbach and Martin Feldstein, Amsterdam: North Holland.

Jetha, Nizar (1992), “Financing of Municipal Services in India: Selected Issues”, World Bank Report No. 10452-IN.

Jetha, Nizar (1992a), “Gujarat State Finances”, in *State Finances in India*, ed., Amaresh Bagchi, J.L. Bajaj, and William A. Byrd, New Delhi: Vikas Publishing House.

Kletzer, Kenneth and Nirvikar Singh (1997), "The Political Economy of Indian Fiscal Federalism", forthcoming, *Fiscal Policy in India*, ed., Sudipto Mundle, New Delhi: Oxford University Press.

Lieten, Georges K. (1992), *Continuity and Change in Rural West Bengal*, New Delhi: Sage Publications.

Mathew George (1994), ed., *Status of Panchayati Raj in the States of India*, 1994, Institute of Social Sciences, New Delhi: Concept Publishing Company.

Mookherjee, Dilip (1997), “Incentive Reforms in Developing Country Bureaucracies: Lessons from Tax Administration”, paper presented at Annual World Bank Conference on Development Economics, Washington, D.C., April 30 and May 1.

Mookherjee, Dilip (1993), "Redefining the Economic Role of the State: The Role of 'Positive' and 'Negative' Institutional Reforms in India", paper presented at conference on Economic Liberalization in South Asia, University of California, Berkeley, April.

Musgrave, Peggy, and Richard Musgrave (1984), *Public Finance in Theory and Practice*, New York: McGraw Hill.

Naipaul, V.S. (1975), *India: A Wounded Civilization*, New York: Alfred Knopf.

Oates, W. (1991), "Principles of Fiscal Federalism: A Survey of Recent Theoretical and Empirical Research", IRIS Working Paper No. 21, University of Maryland, College Park.

Olson, M. (1986), "Toward a More General Theory of Governmental Structure", *American Economic Review*, May.

Oomen, M.A. (1995), “Panchayats and their Finances”, Institute of Social Sciences Paper, New Delhi.

Ostrom, Elinor, L. Schroeder, and S. Wynne (1992), *Institutional Incentives and Sustainable Development*, Boulder, CO: Westview Press.

Pande, A.K. (1994), “Flow of Funds in Panchayat Benkala During the Seventh Five Year Plan”, *Journal of Rural Development*, v. 13(2).

Rajaraman, Indira, O.P. Bohra, and V.S. Renganathan (1996), “Augmentation of Panchayat Resources”, *Economic and Political Weekly*, May 4, 1071-1083.

Rao, D.S.K. (1995), “Farmer Management of Public Tubewells in West Bengal”, *Economic and Political Weekly*, September 30, A117-A122.

Rao, M. Govinda (1997), “Intergovernmental Fiscal Relations in a Planned Economy: The Indian Case”, processed, Australia South Asia Research Centre, Research School of Pacific and Asian Studies, Australian National University.

Rao, M. Govinda (1995), "Fiscal Federalism in India: Problems and Prospects", forthcoming, Sudipto Mundle (ed.), *Fiscal Policy in India*, New Delhi: Oxford University Press.

Rao, M. Govinda (1994), "Intergovernment Transfers in India", processed, paper presented at Conference on Fiscal Transfer Systems, Qingdao, China, July 25-29.

Rao, M. Govinda (1992), “State Government Transfers to Urban Local Bodies”, processed, National Institute of Public Finance and Policy, New Delhi.

Rao, M. Govinda, G. Pradhan and O. P. Bohra (1985), " Alternatives to Octroi in Rajasthan" , processed, National Institute of Public Finance and Policy, New Delhi.

Rao, N. Rajagopala (1986), *Municipal Finances in India (Theory and Practice),* New Delhi: Inter-India Publications.

Sachdeva, Pardeep (1991), *Dynamics of Municipal Government and Politics in India*, Allahabad: Kitab Mahal.

Sachdeva, Pardeep (1993), *Urban Local Government and Administration in India*, Allahabad: Kitab Mahal.

Seabright, Paul (1996), "Accountability and Decentralization in Government: An Incomplete Contracts Model", *European Economic Review*, 40, 61-89.

Shah, B.L. (1990), *The Role of Panchayats in Integrated Rural Development*, New Delhi: Cosmo Publications.

Singh, Nirvikar (1997), "Governance and Reform in India", *Journal of International Trade and Economic Development*, June.

Singh, S.S. and Suresh Misra (1993), *Legislative Framework of Panchayati Raj in India*, New Delhi: Intellectual Publishing House.

Sivaraman B. (1991), *Bitter Sweet: Governance of India in Transition*, New Delhi: Ashish Publishing House.

Somanathan, E. (1991), "Deforestation, Property Rights and Incentives in Central Himalaya", *Economic and Political Weekly*, January 26, PE37-PE46.

Venkatarangaiya, M., and M. Pattabhiram (1969), *Local Government in India: Select Readings*, Calcutta: Allied Publishers.

World Bank (1995), *India: Recent Economic Developments and Prospects*, Washington, D.C.: The World Bank.

APPENDIX

The model is of a single politician-bureaucrat and a single citizen-voter. The choice variables are the level of public service provision (quality adjusted), denoted x, and the per unit wage of the politician, denoted w. The politician's income is y = wx. The effort required to produce x is e=rx, where r is an efficiency parameter. The utility functions of the two individuals are:

Politician: $U(y, e) = u(y) - c(e) = u(wx) - c(rx)$

Voter: $V(x, y) = v(x) - k(y) = v(x) - k(wx)$

u, v are strictly concave; c, k are strictly convex. All functions are twice differentiable.

Competitive provision

Suppose that both sides take w as given, and choose their optimal x as a function of w. The first order conditions are $U_x = 0$ and $V_x = 0$. Given the concavity of the functions, these are sufficient for local maxima, and can be solved respectively to give $x^s(w, r)$, the supply function, and $x^d(w)$, the demand function.

The supply function is upward sloping if $yu''/u' < 1$, while the demand curve is always downward sloping.

Furthermore, each side has a reservation utility, U_0 and V_0 respectively. The latter can be equal to $V(0, 0)$, i.e., the absence of public services. If the solution to the first order condition is below the reservation utility, the global maximum is zero. Figure 1 shows the individual optima and an interior competitive equilibrium.

FIGURE 1

Politician **Voter** **Equilibrium**

No accountability

Several alternative situations of control are possible. If the politician is monopolistic, and chooses x and w subject only to the constraint that $V \geq V_0$, a possible equilibrium is shown in Figure 2.

FIGURE 2

Partial accountability

Possibly somewhat better for citizens is the case where the politician also faces the constraint that $x = x^d(w)$. Figure 3 shows two cases. On the left, only the demand constraint is binding. The voters are better off than in Figure 2, but with a lower level of public services than in the full monopolistic case. On the right, however, both constraints are binding, and voters are not only no better off, but they have a lower level of public services. In fact, the outcome is not on the Pareto frontier. This case, perhaps, loosely approximates the state of Indian local government, with partial accountability only.

FIGURE 3

Yet another possibility is that citizens can choose their optimal combination of x and w, given a competitive supply of politicians. Two cases are shown in Figure 4. Again, provision of public services is suboptimal, but citizens are actually better off than in the full competitive case of Figure 1.

FIGURE 4

Efficiency

Increases in efficiency of public good provision in this model are reductions in the input requirement parameter r. It is easy to check that $x^s_r(w, r) < 0$, so that increasing efficiency shifts the supply curve to the right. A case where a relatively small increase in efficiency leads to a substantial increase in the level of service is shown in Figure 5.

FIGURE 5

In this model, equilibria with a low level of provision of public services may not be worse for citizens, since they pay less also. However, if there are many citizens enjoying a nonrival good, the low-service equilibrium may be worse for them, due to the inability to coordinate.