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Fiscal Decentralization - Revenue and Expenditure Analysis of ULBs: A Case Study of Trivandrum Municipal Corporation (TMC), Kerala, India

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Abstract:
Decentralized provision of basic public services whereby local governments is empowered to make all policy decisions on behalf of their residents represents a complex system of political, administrative and fiscal autonomy mechanisms and Service delivery is the most important interfaces between a modern democratic state and its citizens. The 74th Constitutional Amendment provided functional domain to the Urban Local Bodies (ULB) in India and it recognized Urban Local Bodies as the best agencies to deliver basic services such as water, health, education, waste management, sanitation etc. The decentralized urban local governance regime in Kerala aims at providing devolution of functions, finances, functionaries and freedom of planning to Urban Local Bodies enabling them to cater better services to the people at large. However, these efforts have not been transpired into effective service delivery in urban governance. This has been apprehended and debated by different studies and reports.
Even after 20 years of decentralized governance, the quality of public service delivery in urban and rural areas remains a serious concern for the policy makers. Keeping the above perspective, the study has analyzed micro level evidence from the state of Kerala. The study analysed four aspects of fiscal decentralization such as 1. Revenue Performance 2. Efficiency in Mobilization of Tax Revenue 3. Expenditure Performance 4. Fiscal Balance *to analyse the revenue and expenditure details of ULBs in Kerala.*

Keywords: *Urban local bodies, fiscal decentralization*

1. Introduction
Over the last two decades, decentralization of responsibilities from higher tiers of government to lower level locally elected governments have been adopted globally as one of the most common institutional reforms to improve public service delivery. The local Self Governments, being at the cutting edge level of public administration play a significant role in the provision of public services and socio economic infrastructure facilities to the people. Recognizing the importance of Local Governments, the Government of India proposed a functional domain to these third tires of government through the 73rd and 74th Constitutional Amendments. The 12th Schedule of the 74th Constitutional Amendment Act describes the responsibilities of Urban Local Bodies (ULB) in the provision of public services.
At the same time Urbanization is gaining momentum in developing countries and nearly half of the world population today is urban. Basic Public Service delivery in urban areas is always a major challenge among policy makers in the developing countries. Being the fastest urbanizing region in the world, India, also faces a number of challenges in providing adequate basic services to the people in urban areas. The provision of basic public service through local self-governments depends on the autonomy in functions, functionaries and finances of these institutions.
The 74th CAA in India aims at a decentralization regime through devolution of functions, finances and functionaries to Urban Local Bodies. While the 74th Amendment Act listed the expenditure responsibilities of ULBs, it did not specify the sources of revenue for these responsibilities. Hence urban local bodies face the problem of expenditure assignment without a corresponding revenue assignment.
Decentralized provision of basic public services whereby local governments is empowered to make all policy decisions on behalf of their residents represents a complex system of political, administrative and fiscal autonomy mechanisms. The Seventy fourth constitutional Amendment Act listed 18 items of functional responsibilities as legitimate functions of urban local bodies, in addition to the state legislature, by law, can assign any tasks relating to the preparation and implementation of plans for local economic development. Education, health, water supply, sanitation and waste management are the key development priorities for urban local bodies in India but the poor financial health of urban local bodies prevent them to provide better service delivery in urban areas.
A large number of factors influence the performance of decentralized public service delivery. These include the political framework, fiscal aspects of decentralization, transparency of government actions, citizen participation in public service delivery, the capacity of sub national governments to raise resources locally etc. Among these factors the fiscal aspects of decentralization play an important role in effective public services delivery.

The fundamental problem faced by urban local bodies is the vertical imbalance in financial resources. This constitutionally inbuilt mismatch between the functions and finances, widen through the inefficient application of fiscal powers of Urban Local Bodies (RBI 2008). In order to reduce the fiscal imbalance of Urban Local Bodies, the 74th Constitutional Amendment Act allows inter-governmental financial transfer from the higher tiers of government, as per the recommendations of the Central and State Finance Commissions. Transfers from state governments and central government to Urban Local Governments are an important source of revenue for Urban local governments in India

The 2011 census shows that Kerala has undergone the highest level of urbanization (47.71 %) during 2001-11, with a percentage increase of 83.20 over the previous decade. Kerala is one of the leading state in transfer of functions and responsibilities of administration to local governments for better delivery of basic urban services. The decentralization process in Kerala has now moved from the campaign phase to institutionalization phase. The Urban local bodies in Kerala use modern tools of planning, development, project implementation in local government administration to improve the quality of life of urban population. But the urban local bodies are increasingly faced with the problem of meeting rising demand for public services without any increase in the available sources of revenue.

1.1. Objective

Municipal finances hold the key to the overall status and progress of service delivery in right direction. Meeting the needs of India's urban population in efficient manner becomes a strategic policy issue in the contemporary society. The urban local bodies in India are statutorily not allowed to have deficit in their budgets and their resource gaps cannot be assessed from the budget documents. In this context, the present study analyzed the Expenditure and Revenue pattern of Trivandrum Municipal corporation under decentralized urban governance. The objective of the study is to analyse the expenditure and Revenue of TMC under standard approach.

A detailed analysis of the finances of sub national governments i.e., revenue and expenditure of TMC would help to explain the fiscal performance of the ULB and its utilization for the delivery of selected civic services. There are two approaches to study the fiscal performance of local governments: The Standard and Normative approaches (Mohanthy et. al, 2007). The Standard approach uses Revenue performance, Expenditure performance and Fiscal balance to measure the overall fiscal performance of the sub national government. Whereas the Normative approach calculates normative under spending on various public services to measure fiscal performance. The study uses standard approach to analyze the fiscal performance of TMC. The important variables used under the standard approach are;

1. Revenue Performance
2. Efficiency in Mobilization of Tax Revenue
3. Expenditure Performance
4. Fiscal Balance

1.2. Case Study

The Trivandrum Municipal Corporation(TMC) is responsible for providing basic services and amenities to its citizens in Trivandrum municipal area. But there is a growing consensus that the TMC has failed to achieve desired standard in their service delivery. The Trivandrum corporation performs its duties through zonal offices and ward members. Over the last few decades the city has been transferred into one of the most polluted and crowed city in India. The Trivandrum Municipal Corporation has seven zonal offices situated in different parts of the city. At Micro level every locality under the 100 Municipal wards are governed by respective ward members. The ward members are elected directly by local residents and they maintain, operate and monitor different corporation activities within their wards. In Trivandrum city area the governance of Urban basic services has become a much debated issue over the last few years because of their poor status

2. Analysis of Revenue and Expenditure in TMC: The Standard Approach

2.1. Revenue Performance of TMC

The total revenue sources of TMC can be broadly divided into internal and external sources. Achieving a good proportion of own revenue to total revenue receipts improves the credit worthiness of the municipal corporation, and a greater share of tax revenue in it is desirable as it is a reliable source of revenue. Growth of tax revenue is an important fiscal indicator which reflects the capability of a Municipal Corporation in the provision of basic public services. A proportion of more than 50 % of own sources of revenue is considered to be favorable and that more than 70% is considered to be favorable from the view point of creditworthiness (Mathur and Ray, 2003 & RBI, 2007). Though there are no provisions, a proportion of tax revenue ranges 30 % - 40% and non-tax revenue between 30 %-20% out of the total revenue, could be considered as a good proportion (Ramakrishna, 2009). As this range of value is used by various relevant studies, the present study also employed the same for estimating revenue performance of TMC.

The growth of total own revenue receipts is also an indication of the soundness on the state of finances of an urban local body and the most appropriate tax at the local level is the tax on real properties. The most important source of tax revenue in TMC is property tax followed by professional tax, advertisement tax and entertainment tax. An analysis of the revenue side of the TMC shows that, on an average, the own sources of revenue contributes less than fifty per cent of the total revenue. The contribution of plan grants in aid to total revenue (53%) of the municipal corporation shows high dependency on external sources of revenue (see table 1). Even though the plan grants in aid is a predictable source of revenue, certain conditionalities are attached to it such as expenditure ceiling on sectors, devolution in installments etc. These conditionalities attached to devolved funds limits the freedom of planning and autonomy of TMC in decision making process and in turn adversely affecting the effectiveness of public service delivery.

A steady growth of tax revenue is an important indicator which reflects the strength of a municipal corporation to undertake service provisioning responsibilities. The rate of growth of total revenue of the TMC is not stable over the XI^{th} Five Year Plan period. It registered negative growth rate of 11% during 2009-10 period and thereafter shows an increasing trend. Even though the rate of growth of total revenue declined at a great extent in 2009, the proportion of tax revenue increased during the same period. During 2011-12 period both the rate of growth of total revenue and tax revenue have shown 43% and 40 % respectively, but during the same period the ratio of tax revenue to total revenue has decreased. The period of 2011-12 is the initial period of implementation of the fourth State Finance Commission and it provided a liberal devolution of plan grants in aid assistance to local self-governments. Over the study period the share of tax revenue as a percentage of total revenue increased in its initial period, and thereafter registered a sustained decrease. The overall share of tax revenue to total revenue of TMC during 2007-12 is only 38% and it needs to increase the share of tax revenue as it is a reliable source of income. The ULBs have complete autonomy in the allocation of own sources of revenue which has a positive impact on local planning process and effective public service delivery.

Year	Total Revenue (Rs.)	Tax Revenue (Rs.)	Non Tax Revenue (Rs.)	Proportion of Tax revenue to Total revenue (%)	Rate of growth of Tax revenue (%)	Rate of growth of Total revenue (%)
2007 – 08	10991.22	3452.61	1059.07	31		
2008 -09	11578.26	4084.16	1437.60	35	15	5
2009 – 10	10292.83	4928.05	1290.96	47	20	-11
2010 - 11	12581.59	5025.59	1056.66	40	2	22
2011 - 12	18082.81	7046.13	1641.63	39	40	43
total	63526.71	24536.54	6485.92	38	15%(CAGR)	10% (CAGR)

Table 1: Growth of Tax Revenue in the TMC (2007 – 12)
Rs. in lakh
Source: Computed from Budget documents of TMC (2007-2012)

Out of the total tax revenue of TMC, more than 52 % is in the form of property tax and other major sources of tax revenues are professional tax (39%), entertainment tax (6.5%) and advertisement tax (1.2%). Advertisement tax contributes only 1.2% of the Total tax revenue even though it has huge potential in TMC because of the consumerist nature of the state. Thus it is clear that the TMC have been assigned with large number of tax sources but major part of its tax revenue is coming from three major sources such as property tax, professional tax and entertainment tax. Moreover, the tax base and rates are fixed by State Government and the ULBs have little autonomy in fixing the rates and introducing new taxes. The poor autonomy in fiscal matters is further revealed that over the last 20 years the property tax rates have not been revised in the state leading to severe potential revenue loss. The TMC can augment the collection of own sources of revenue by improving the 'collection efficiency of property tax' and unlocking the huge potential of advertisement tax and entertainment tax.

2.2. Efficiency in Mobilization of Tax Revenue: TMC

To have a more accurate measure of fiscal performance one could look into the 'collection efficiency of tax revenue' of ULBs. The study assessed the collection efficiency of tax revenue through an analysis of 'demand - collection statement' of property tax. The demand - collection statement shows the actual collection of property tax against its demand. The efficiency of tax collection is measured for property tax as the TMC have data on the total property tax demand. The analysis of demand collection statement of TMC shows that the percentage of collection of property tax against demand is decreasing over the XI^{th} Five Year plan period

Year	2007-08	2008-09	2009-10	2010-11	2011-12
Demand	1773.11	2244.77	2561.36	2813.28	4056.63
Collection	1459.71	1459.71	1706.85	1797.82	2322.55
Percentage of collection against demand	81%	64%	66%	63%	57%

Table 2 (Rs in Lakh)

It shows an average negative compound growth rate of 6%. During 2007-08 period the TMC collected 81% of tax demand and it sharply reduced to 57 % during 2011-12 period. This is a serious concern as the share of property tax revenue to total revenue is 60% (see table 1).

An important rule of sound fiscal decentralization is that 'finances' should follow 'functions' and local governments need access to adequate revenue sources, to finance local public services as they are mandated to provide (Bahl,2002). The data collected from the budget documents of TMC shows that the non-tax revenue component of TMC is only than 10.5% of the total revenue and it shows the poor performance in Cost recovery (see appendix X). The compound average growth rate of TMC on tax revenue is15% and that of non-tax revenue is only 9 %. The poor collection in non-tax revenue component is due to the meagre share of user charges and fees in non-tax revenue. Cost recovery of urban civic service through user charges, fees, rental income from properties etc. play an important role in effective public service delivery. It can be effectively utilized for meeting the operation and maintenance cost of assets created for the delivery of civic services. A detailed analysis of cost recovery is presented in the section where normative revenue analysis is discussed.

2.3. Expenditure Performance in TMC

The main function of an ULB is to provide local goods and services with in the area of their jurisdiction and the level of spending on various components of expenditure reflects its effectiveness in public service delivery. The segregation of various components of expenditure and its relative share on capital, establishment, administrative, operation and maintenance expenditure reveal the quality of expenditure by the ULB to meet its stated objectives. Expenditure performance is defined as the ratio of revenue expenditure to total expenditure (revenue and capital combined) of the ULB. It reveals that the amount spent for maintaining the current assets and the leftover used for creating new capital assets. The total revenue expenditure, comprising establishment expenditure, administrative expenditure and operation and maintenance expenditure is an important component of municipal expenditure as it relates to the provision of basic public services and their maintenance. It is argued that a very high proportion of revenue expenditure to total expenditure can be detrimental to the expansion of capital assets (Sudhakar, 2009). The analysis based on growth and share of revenue expenditure is calculated for further study.

Year	Total Expenditure (in Rs.)	Revenue Expenditure (in Rs.)	Proportion of Revenue Expenditure to Total Expenditure (%)	Rate of growth of Revenue Expenditure (%)
2007 – 08	10467.76	6314.12	60.32	
2008 -09	11441.85	7716.76	67.44	22%
2009 – 10	9567.68	7713.07	80.61	-0.04 %
2010 - 11	12489.15	8832.77	70.72	14.5 %
2011 - 12	17479.35	10136.75	57.99	14.76 %
Total	61445.79	40713.47	66.26 %	10 % (CAGR)

Table 3: Growth of Revenue Expenditure: TMC (2007 – 12)
(Rs in Lakh)
Source: computed from Budget documents of TMC (2007-2012)

The relative share assigned to each components such as developmental expenditure, establishment expenditure, administrative expenditure etc. in the total public expenditure has a bearing on the financial position and service delivery. While a low proportion of spending on establishment and administrative expenditure is desirable, too low proportion may hamper service delivery as the capital assets need regular maintenance. A reasonable level of expenditure on establishment and administrative matters is necessary for office administration and tax collection. A study by Ramakrishna (2009) among the selected municipal corporations in India found that the revenue expenditure contributes 25% of their total expenditure. During the period of study, the revenue expenditure of the TMC on an average is registered as 66.26%. The high revenue expenditure shows that the actual developmental expenditure/programme expenditure leftover for public service delivery and urban infrastructure becomes very poor in TMC area.

The revenue expenditure in TMC is the highest during 2009-10 period i.e. 80.61% of the total expenditure. Henceforth, the TMC shows a decline in the rate of growth of revenue expenditure with a compound average growth rate of 10%. Even within the declining trend, during the XIth Five Year plan period more than 66% of the total expenditure in TMC is used for meeting revenue expenditure on establishment, administrative and O & M leaving larger implications on service delivery. The higher proportion of revenue expenditure indicates that the TMC is spending lesser amount for the provision of basic services and other infrastructure investments. This comparatively low level of capital expenditure on service delivery will adversely affect the quality and efficiency in the provision of basic public services in the long run especially in the context of large scale urbanization and thereon growing demand for urban amenities.

As the urban public service delivery necessitates large scale investments, decomposition of TMC's total programme expenditure as development expenditure and non-developmental expenditure helps to reveal the magnitude of actual development expenditure incurred by TMC on selected civic services. The total programme expenditure of TMC includes the developmental expenditure on core public services and non-developmental expenditure like welfare pensions etc. The actual development expenditure of TMC is much lower as it includes the provision of various welfare pensions like widow pension, unemployment wage, marriage assistance etc. and the actual developmental expenditure of TMC to total expenditure is only 28.4% during 2007-2012.

Year	Total expenditure	Total program expenditure	Welfare pensions	Development expenditure	Ratio of actual development expenditure to total expenditure (%)
2007-08	10467.76	4153.64	368.09 (3.4 %)	3785.55	36.0
2008-09	11441.85	3725.09	407.23 (3.6%)	3317.86	32.0
2009-10	9567.68	1854.61	574.69 (5.7%)	1279.92	13.0
2010-11	12489.15	3656.38	740.54 (5.9%)	2915.84	23.0
2011-12	17479.35	7313.60	1203.42 (6.5%)	6160.18	34.0
Total	61445.79	20703.32	3293.97(4.8%)	17459.35	28.40

Table 4: Ratio of Development expenditure to total expenditure
Rs in Lakh
Source: computed from Budget documents of TMC (2007-2012). Figures in the parenthesis show ratio to total expenditure

The total programme expenditure of TMC includes development expenditure on core public services, expenditure of transferred institutions, expenditure on welfare pensions etc. The analysis show that the actual development expenditure of TMC on core public services ranges from 13% to 36 % over the XIth Five Year plan period. On an average the TMC spends only 28.4 %of the total expenditure on developmental activities during the study period. The data also shows that the share of welfare pension as a part of total programme expenditure is increasing in TMC over the years except for the year 2010-11. Even though the provision of welfare pensions is a function of local self-governments, the actual capital investment of the TMC on assets creation is very low. This will adversely affect the delivery of basic services such as waste management, water supply, sanitation, urban roads etc. in the long run. The municipal corporation experiences large scale urbanization and the administrative area of TMC increased to a considerable extent over the years. This necessitates large scale investments in basic infrastructure and asset creation and TMC need to increase the share of developmental expenditure.

2.4. Fiscal Balance: TMC (2007-12)

The analysis of the fiscal performance of the TMC under standard approach would be completed only after an evaluation of the fiscal balance of the ULB. Fiscal balance is defined as the difference between total revenue receipts and total expenditure of the Urban Local Body and it indicates the total resource gap of the Municipal Corporation. The fiscal balance can either be positive or negative, but the ULBs in India are statutorily no allowed to have deficits in their budgets. Hence there is always fiscal balance in the budget documents of ULBs (Mohanthy et al., 2007)

The fiscal balance of the Trivandrum municipal corporation during the XIth Five-year plan period shows that there is a fiscal surplus in the budgets of Thiruvananthapuram Municipal Corporation. There is total fiscal surplus of Rs.2080.48 lakh over the XIth Five-year plan period in TMC (see table 5). The fiscal surplus shown in the budgets of the TMC does not indicate the actual fiscal performance of the Municipal Corporation because it is mandatory on the part of the Municipal Corporation to balance its budget without incurring any budgetary deficit. The fiscal balance of TMC also shows large variations over the study period, it ranges from less than one crore to seven crores.

Year	**Total Revenue Receipts (Rs in Lakh)**	**Total Expenditure (Rs in Lakh)**	**Fiscal Balance (Rs in lakh)**
2007 -08	10991.22	10467.76	523.46
2008 – 09	11578.26	11441.85	136.41
2009 – 10	10292.83	9567.68	725.15
2010 – 11	12581.59	12489.15	92.44
2011 -12	18082.81	17479.35	603.02
total	63526.71	61445.79	2080.48

Table 5: Fiscal Balance: TMC (2007-12)
Source: Computed from Budget documents of TMC (2007-2012)

The fiscal surpluses that are shown in the table are not genuine surpluses of the TMC and it is the result of under spending on Civic services. Studies (Mohanthy et. al 2007, Sudhakar, 2007) also shown that fiscal surpluses in ULBs are always co-existed with poor service delivery and 'under spending' on basic civic services is the major reason cited to this dichotomy. It is clear thatthe fiscal balance is very low during 2010-11 period in TMC i.e. 92.44 lakh. This is revealed by the fact that as the reference period coincided with the local body election in Kerala, the existing elected council maintained only a minimum fiscal balance by allocating a higher amount for welfare pensions and other popular schemes during the same period

3. Conclusion

The above analysis based on standard approach helps to reveal a holistic picture on the fiscal performance in an ULB. The standard fiscal assessment of an organization is normally based on revenue and expenditure aspects. However, this standard approach for making assessment of finances based on the above four variables is not well applicable for Urban Local bodies in India. Because Municipal governments are constrained by statutory mandate of surplus budgets and also they are not granted permission by state governments to incur debt (Mathur and Thakur, 2003, RBI, 2007). But this will help to understand the level of revenue and expenditure of ULBs in India.

4. References

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