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Normative Approach to the Fiscal Assessment of Local Self Governments- a Case Study of ULBs in Kerala, India

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Abstract:
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 ervices 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. Myriads of factors such as poor finances, lack of clear activity mapping, multiplicity of agencies at field level, poor stakeholder participation etc., which adversely affect effective public service delivery. It is argued that if these issues are managed, governance can be emerged from a 'top down model' for the people to a 'bottom top model' by the people.
Under the normative approach, estimation of 'under spending' is used as an indicator of the fiscal performance of the ULBs. The under spending, under the normative approach is influenced by two sets of factors: exogenous and endogenous factors. The exogenous factors include dependency and decentralization whereas the endogenous factors include cost recovery, revenue administration efficiency and establishment and administrative expenditure. The Ahluwalia committee estimated percapita expenditure norms for eight urban public services for twenty year period from 2012 to 2031 at 2011-12 prices. The present study used the same percapita expenditure norms estimated by the report on 'Indian urban infrastructure and services' adjusted to inflation. The analysis on the extent of fiscal decentralization and fiscal performance of TMC under standard and normative approach reveals low level of fiscal decentralization and high under spending on core public services in TMC.

1. Introduction

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 (IVth SFC, Kerala, Prakash, et. al, 2013). Better urban governance systems and sound financial arrangements to public services are critical elements in urban development.

The successive Census results, since independence, reveal a steady growth in urban population from 17.1% in 1951 to 31.16% in 2011. The recent estimates given by the XIIIth Central Finance Commission report show that the aggregate size of municipal expenditure as part of GDP is only 1.5 % in India where barely half of the urban local government expenditure is financed through 'own sources' of revenue. In India the share of Municipal budget in the total budget of Centre, State, and local governments is only 4% as compared to that of 15–25 % in the developing economies (XIII FC, 2010). The documented evidence on public service delivery in India shows a dismal picture (Census 2011 and HPEC 2011). The World Bank (2010) estimated that deficiencies in basic public services lead to 6.4 percent GDP loss in India. The foregoing studies show the poor performance of ULBs in the provision of civic services both financially and physically. Myriads of factors such as poor finances, lack of clear activity mapping, multiplicity of agencies at field level, poor stakeholder participation etc., which adversely affect effective public service delivery. It is argued that if these issues are managed, governance can be emerged from a 'top down model' for the people to a 'bottom top model' by the people.

2. Normative Approach to the Fiscal Performance Assessment

As the standard approach reveals only an assessment of revenue and expenditure of the ULB, an alternative method viz, the normative approach can be employed to understand a more detailed picture of fiscal performance of the ULB. Under the normative approach, estimation of 'underspending' is used as an indicator of the fiscal performance of the ULBs. The underspending, under the normative approach is influenced by two sets of factors: exogenous and endogenous factors. The exogenous factors include dependency and decentralization whereas the endogenous factors include cost recovery, revenue administration efficiency and establishment and administrative expenditure. From among the five Municipal Corporations in Kerala, Thiruvananthapuram Municipal Corporation (TMC) has been selected for the study.

3. Decentralization Ratio: TMC

Decentralization ratio is defined as the ratio of Municipal Corporations' per capita revenue receipts to state per capita revenue expressed as percentage. It is a measure of delegation of autonomy by higher tiers of Government to the Municipal Corporation with respect to the finances. The table shows that on an average during the XI[th] Five year plan period the decentralization ratio was 23.2 %. In other words, the per capita revenue receipt of Trivandrum Municipal Corporation is 23.2% of the Kerala's per capita revenue receipts over the study period. The low decentralization ratio shows weak autonomy of TMC in raising revenues. It implies that the total percapita revenue of TMC which includes own sources of revenue and devolved funds from state government is only less than ¼ of the state percapita revenue. The low decentralization ratio in TMC reveals that the fiscal decentralization efforts has not augmented the fiscal base of ULBs in Kerala. During the XI[th] Five Year Plan period the decentralization ratio shows a decreasing trendrevealing weak autonomy in raising revenues.

Year	Per capita Revenue of TMC (in Rs.)	Per capita Revenue of Kerala (in Rs.)	Decentralization Ratio
2007 -08	1415.00	5062.00	0.27
2008 – 09	1584.00	6134.00	0.28
2009 – 10	1372.00	6678.00	0.21
2010 – 11	1678.00	7760.00	0.22
2011 -12	1903.00	10007.00	0.19
	6% (CAGR)	15% (CAGR)	-6 % (CAGR)

Table 1: Decentralization Ratio: TMC (2007-12)
Source: Computed from Budget documents of TMC (2007-2012)

The decentralization ratio in TMC decreased from 27 % in 2007-08 to 19% in 2011-12. The autonomy of the TMC in raising revenues or the decentralization ratio is getting deteriorated over the Five Year Plan period with a negative compound average growth rate of 6%. The compound average growth rate of TMC per capita revenue is only 6 % and the per capita revenue of the state shows a compound average growth rate of 15%. It can be inferred from the data that the per capita revenue of the state has shown a 100% increase over the five year plan period. But the per capita revenue of the TMC has increased only by 35% compared to 2007-08 period. It shows that fiscal decentralization efforts did not provide desired results in terms of decision making capacity of the ULBs with respect to its finances. More delegation of autonomy in decision making with respect to financial matters is a necessary condition for effective public service delivery by local governments (Bahl and Wallace 2005). The decreasing trend in the ratio of per capita revenue of TMC to state per capita revenue show more centralization of revenue raising capacity with the state governments. There is a need to provide more autonomy to TMC in raising revenues through internal sources. The internal sources of revenue need more autonomy in terms of fixing and revising the tax rates, user charges, fees etc. The poor decentralization ratio adversely affects the fiscal performance of ULBs and thereby its service delivery effectiveness.

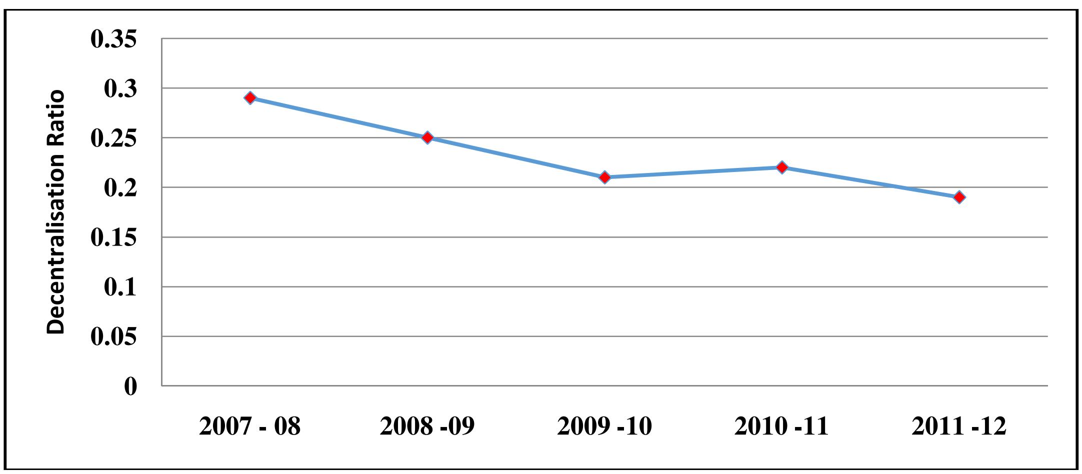

Figure 1: Decentralisation Ratio

4. Cost Recovery Ratio: TMC

Cost recovery is measured as the ratio of non-tax revenues (municipal fees and user charges) to total expenditure of the municipal corporation. Cost recovery of urban public services is an important measure of the municipal finances and it is linked to the self-sustainability of the Urban Local Body in its service delivery obligations. As the service, wise user charges and fees are not available, the study used the broad indicator viz, ratio of municipal fees and user charges to total expenditure as the proxy variable for the cost recovery (Mohanthy et.al, 2007). Hence the study adopted the same for calculating the cost recovery ratio. The non-tax revenue component of the municipal corporation includes rental income from municipal properties, fees and user charges, sale and higher charges etc.

Cost recovery has to be an integral part of the urban public service provision as and when the service costs can be measured and beneficiaries are identified. Given the proximity of the population and private goods character of many local services, levying user charges is feasible provided the quality of service is ensured (Bhal and Linn, 1992). Thus the low quality of civic services in many ULBs leads to an inability to collect user charges which further leads to the deterioration in existing service levels. During the XIth Five year Plan period under study the ratio of non-tax revenue to total expenditure of TMC is only10.5 % of the total revenue with a fluctuating trend. During the initial periods of the study the cost recovery ratio shows an increasing trend and thereafter it declined to 9.3 % in the terminal year.

Year	Total Expenditure	Non Tax revenue	Cost Recovery Ratio (%)
2007 -08	10467.76	1059.07	10.1
2008 – 09	11441.85	1437.6	12.6
2009 – 10	9567.68	1290.96	13.4
2010 – 11	12489.15	1056.66	8.4
2011 -12	17479.35	1641.63	9.3
	61445.79	6485.92	10.5 %

Table 2: Cost recovery Ratio in TMC: (2007-12)
(Rs in Lakh)
Source: Computed from Budget documents of TMC (2007-2012)

The major sources of non-tax revenue in TMC are rental income from municipal properties, fees and user charges, sale and higher charges. As the non-tax revenues are politically sensitive the municipal authorities are not adequately exploiting it. It is also inferred that the user charges are not applicable as the basic services are provided by multiple agencies. In Thiruvananthapuram municipal area most of the operation and maintenance works on civic services are done by parallel agencies like KWA, PWD, and Minor irrigation Department ,TRIDA , Road fund Board etc. This limits the adoption of user charges as a method of cost recovery by TMC. The user charges can be most effectively implemented only when the service is provided by a single entity. The transfer of water and sewerage services to the Municipal Corporation holds significance from the perspective of cost recovery by a single entity responsible for services within the urban area. One of the reasons for poor state of urban infrastructure services in Imia is the inability of ULBs to adequately price the service that the provide (Ramakrishna,2009). Public private partnership models of public service delivery can also be exploited to levy user charges. By introducing a public private partnership model indirect benefits can be converted into direct benefits and price them easily. The financially viable non-tax revenues such as user charges and fees, which are paid directly to the amount consumed, promote the efficiency in the consumption of the service.

5. Revenue Administration Efficiency: TMC (2007-12)

Revenue administration efficiency remains one of the composite indices used to evaluate the ULB's efficiency in levying and collecting revenues which falls in tis jurisdiction. The ratio of percapita own revenue of Municipal Corporation to State GDP per capita can be taken as a close approximation of efficiency in revenue administration. It measures the performance of the Municipal Corporation with respect to its own revenue. Own revenue of the Municipal corporation is determined by their efforts on (1) updating and maintaining local tax bases,(2) improving local tax administration through establishing collection targets, collection incentives and introducing modern computerized collection methods, (3) removing tax exemptions (4) introducing new local tax revenue sources (5) revising and extending service charges and user charges (6)more flexibility in fixing local tax rates, etc.(James McMaster,1991)With efficient revenue administration, the availability of resources with the municipal corporation improves and the level of underspending is accordingly lower.

Year	Per capita Own Revenue (TMC) (Rs)	State GDP percapita (Kerala) (Rs)	R A E (%)
2007 -08	610.00	51980	1.10
2008 – 09	749.00	59716	1.30
2009 – 10	844.00	67804	1.20
2010 – 11	821.00	78183	1.10
2011 -12	936.00	90816	1.00

Table 3: Revenue Administration Efficiency (RAE) in TMC- (2007-12)
Source: Computed from Budget documents, TMC, 2007-12

The analysis show that the own revenue of the ULB constitute only one percentage of the state GDP. It is pertinent to note that decentralization ratio and revenue efficiency ratio are the highest during 2008-09 and lowest during 2011-12 period. This in turn shows the positive relationship between decentralization ratio and revenue efficiency ratio (see table 6.10). During 2011-12 period both the ratios are the lowest conforming the positive correlation. Except the year 2007-08, the revenue administration efficiency of TMC is showing a decreasing trend over the study period. The positive correlation between decentralization ratio and revenue administration efficiency indicates that higher autonomy on fiscal matters improves the efficiency in own revenue collection by ULBs. The studies by Mohanthy et al. (2007) and Sudhakar, (2008) also shows the same results. Even though revenue efficiency is both endogenous as well as exogenous matter of the ULB, it is seen that improved autonomy in fiscal matters can fetch more efficiency in revenue and fiscal administration and thereby improve service delivery. The fiscal autonomy and there by revenue efficiency of ULBs can be improved through giving more flexibility in setting local taxes, introducing new local tax revenue source, revising and extending service charges etc.

The dependency ratio, decentralization ratio, cost recovery ratio and revenue administration efficiency ratio have larger bearing upon the provision of effective service delivery in terms of its quality, access, availability and reach. In addition to this, a detailed analysis of functional allocation of public expenditure by TMC becomes significant to explain the overall expenditure performance of the ULB. The relative share assigned to capital, Operation & maintenance and administration & establishment expenditure helps to reveal the expenditure quality of the ULB.

6. Functional Allocation of Expenditure: TMC (2007-12)

The functional allocation or expenditure quality of a Municipal Corporation is defined as how its total expenditure is allocated between various expenditure components such as establishment expenditure, administrative expenditure, operation and maintenance expenditure, development expenditure etc. In this study the quality of expenditure in TMC is measured in terms of three ratios (1) ratio of establishment expenditure and administrative expenditure to total expenditure, (2) ratio of capital expenditure to total expenditure, (3) ratio of Operation and maintenance expenditure to total expenditure (Mohanthy et.al, 2007). The dependency and decentralization ratios are outside the control of the Municipal Corporation and they are exogenous variables. Since the allocation of expenditure for various functional components is an endogenous variable, the municipal corporation have a control over its quality of expenditure. The functional allocation of expenditure needs has direct impact on the delivery of civic services by an ULB. Hence the expenditure quality of TMC is measured in terms of its functional allocation for various expenditure components.

Year	Est. Exp. + Admin. Exp. (in Rs.)	Total Exp. (in Rs.)	E & AE Ratio
2007 -08	3224.00	10467.00	0.31
2008 – 09	3304.00	11442.00	0.30
2009 – 10	3757.00	9567.00	0.39
2010 – 11	4850.00	12489.00	0.39
2011 -12	5975.00	17479.00	0.35
Total	21110.00	61444.00	34.3

Table 4: Establishment and Administration Expenditure Ratio (E & AE Ratio) {Rs in Lakh}
Source: Computed from Budget documents of TMC (2007-2012)

The ratio of establishment and administrative expenditure to total expenditure in TMC is 34.3% on an average during the XIthFive Year Plan period. With the introduction of people's plan campaign and the devolution of functions and functionaries, a major proportion of the salary component of the devolved functionaries of the TMC were met directly by the state government. In this context estimated establishment and administrative expenditure ratio as 34.3% is on the higher side leaving lesser proportion left for developmental expenditure and service delivery in particular. The ratio ranges from 30% to 39%during the five year plan period. Even though there are no specific guidelines/norms towards spending on administrative and establishment expenditure, the TMC should ensure rational allocation of expenditure for various expenditure needs and thereby ensuring expenditure quality.

The major part of the establishment expenditure in TMC is contributed by salaries of permanent and contingent employees (80%) followed by contribution to pension fund (17%). The social overhead capital investment for service delivery requires large investment with long gestation period and the estimated higher proportion on establishment and administrative expenditure would give lesser financial support base for effective service delivery. It is also ironical that the cost recovery ratio is only 10.5% of the total revenue of TMC and establishment and administrative expenditure as 34.3% of the total expenditure. Considering the fact that the salary component of employees under transferred institutions are paid by the state government, this high functional allocation for establishment expenditure shows poor financial administration on the part of the TMC.

Year	Establishment Expenditure (EE)	Administrative Expenditure (AE)	Operation & Maintenance Expenditure (O & ME)	Programme Expenditure (PE)	Depreciation
2007 -08	28.3	2.5	24.5	39.7	4.9
2008 – 09	26.8	2.1	32.5	32.6	2.5
2009 – 10	38.1	1.4	39.1	19.4	2.0
2010 – 11	33.0	5.8	27.5	29.3	4.3
2011 -12	31.1	4.3	21.5	40.9	2.3
total	30.90	3.40	28.02	34.30	3.38

Table 5: Functional allocation of Expenditure in TMC (% of Total Expenditure)
(Figures in percentage)
Source: Computed from Budget documents of TMC (2007-2012)

The ratio of operation and maintenance expenditure to total expenditure in TMC is 28.2% on an average during XIth plan period. The decreasing trend over the years on operation and maintenance is a serious concern for TMC considering the large scale demand for urban civic services and the ratio is lowest (21.5%) during the terminal year 2011-12.In addition to the maintenance of own assets, urban local bodies in Kerala have the prime responsibility of maintaining the assets created by various government agencies and line departments. Moreover the users of the services will be willing to pay for the services when the quality of services is maintained and this becomes possible only when the operation and maintenance expenditure is at a reasonable level.

The total programme expenditure of TMC ranges from 19% to 40% over the study period. In addition to the creation of capital assets, the total programme expenditure of TMC include welfare pensions, unemployment wages, mid-day meals program to schools , grant in aid to orphanages, financial assistance to transferred institutions etc. and they are non-developmental expenditure. The total programme expenditure of TMC during the study period is 34.3% and it includes welfare pension, grants and subsidies which is 5.4% (table 6.6). Hence the actual capital and developmental expenditure on urban public services in TMC is only 28.9% of the total expenditure. This comparatively low level of functional allocation for social overhead capital adversely affects the long term urban public service delivery as it require large capital investment with long gestation period. The TMC should rationalize the functional allocation for various expenditure components to improve its expenditure quality**.**

7. Fiscal Balance and under Spending

The analysis of revenue and expenditure performance of the TMC under Standard approach do not reveal its actual under spending on service delivery as there is statutory constraint of surplus budgets. In this context, normative benchmarks and parameters are assuming more importance in this analysis for assessment of the municipal governance and service delivery. The normative benchmarks define the minimum level of expenditure that the ULBs are required to incur ensuring a minimum standard of living of the urban dwellers. A set of expenditure benchmarks, both for creating new assets and for their operation& maintenance were evolved in consonance with the recommendations of the committee appointed by Government of India. The committee under the chairmanship of Ahluwalia estimated the per capita expenditure norms for core urban public services in India in 2011.

8. Per capita expenditure Norms for Selected Services- Ahluwalia Committee

In pursuing with the bench marks stated by the committee, the present study estimated the 'underspending' ratio for selected five basic urban services in Trivandrum Municipal Corporation during the XIth Five-year plan period. Underspending is estimated for the total of capital and maintenance for selected services viz, water supply, urban roads, drainage and sewerage, waste management and street lighting on the basis of actual expenditure and normative expenditure following Ahluwalia committee norms. The analysis of revenue and expenditure performance requires further exploration to understand the ground reality of the investment and expenditure on selected service overheads under normative approach.

There were three official Committees constituted in India for estimating urban infrastructure investments. The first committee commonly known as Zakaria committee (1963) estimated percapita expenditure norms for five infrastructure sectors. The second committee i.e. 'The India Infrastructure Report' (1996) under the chairmanship of Rakesh Mohan used 'inflation adjusted Zakaria committee norms' for calculation of urban infrastructure requirements. Since the pattern and consumption of urban services have changed significantly over the time as a result of increase in income and technological improvements, the Zakaria committee norms have become outdated and present study used the Ahluwalia committee norms for estimation of normative under spending.

The committee under the chairmanship of Ahluwalia (High Powered Expert Committee Report, 2011) made a good attempt to calculate the 'per capita expenditure norms' for urban civic services in India. The Ahluwalia committee estimated per capita expenditure norms for eight urban public services for twenty-year period from 2012 to 2031 at 2011-12 prices. The present study used the same per capita expenditure norms estimated by the report on 'Indian urban infrastructure and services' adjusted to inflation. The study assumes that the per capita expenditure norms suggested by the committee is at 2011-12 constant prices. The per capita expenditure norms for the five selected services has been adjusted suitably for inflation with WPI to get per capita expenditure norms for each year during XIth Five Year Plan period.

	Water supply	Sewerage and drainage	Solid waste management	Urban Roads	Street lights	Total per capita investment
Capital	5924	8586	410	29325	1258	45503
O & M	491	368	135	527	54	1575
Total investment	6415	8954	545	29852	1312	47078

Table 6: Per capita Expenditure Norm for Class I C cities (2011-12 Prices) (Rs.)
Source: HPEC Report (2011), GoI

In preparing the estimates for infrastructure development, the committee used the 'service norms prescribed by the Ministry of Urban development, Government of India. The estimates prepared by the committee indicated that out of the total investment projection of Rs.31 lakh crore, almost 40% is required to address the unmet demand of these services. This shows the large scale underspending on urban civic services in India by ULBs. Based on the stated per capita expenditure norms an attempt is made to calculate the underspending on selected civic services in TMC

Year	Total per capita expenditure	Total Expenditure norm	Under spending	Under spending Ratio
2007-08	505	33967	33462	98%
2008-09	443	36722	36279	99%
2009-10	172	38120	37679	99%
2010-11	389	41782	41339	99%
2011-12	468	45503	45035	98%

Table 7: Under Spending Ratio in TMC
(Rs)
Source: computed from Budget documents of TMC (2007-2012)

The analysis of the revenue and expenditure made in the previous section reveals that it was generating aggregate fiscal surplus over the XIth Five Year Plan period. On the contrary to it ,the assessment of the under spending of the TMC with normative approach shows that it is lower than that of the required for providing a minimum level of services as indicated by the respective total expenditure norms. The major limitation of under spending calculation with the present study is that the expenditure incurred by parallel agencies on the selected services in the TMC area are not included in the estimation of underspending. The study found that the fiscal balance in budget documents and high level of underspending in civic services is due to statutory obligations. The per capita spending on core services by TMC indicates a high level of under spending on capital investment in terms of HPEC report 2011. The per capita under spending ratio in TMC on capital investment through its budget ranges from 98% to 99%. The reasons for under spending can be attributed to exogenous and endogenous factors. The exogenous factors include dependency on higher tiers of government for fiscal matters and inadequate delegation of revenue powers. The endogenous factors include inefficient tax administration, low cost recovery and poor quality of expenditure altogether reveal the lower degree of fiscal decentralization prevails in TMC. The estimated values in terms of fiscal autonomy and fiscal importance unfold the view that there is lesser degree of fiscal decentralization along with high underspending ratio

The analysis on the extent of fiscal decentralization and fiscal performance of TMC under standard and normative approach reveals low level of fiscal decentralization and high under spending on core public services in TMC. It is apparent from the analysis that there is a need for substantial increase in the public spending by local governments. Given the magnitude of the resource gap which is shown by the very high underspending ratio in municipal sector. It becomes imperative to improve the own sources of revenue of the local bodies through more fiscal decentralization efforts.

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