INTRODUCTION

1.1 Decentralization: An Introduction

The term decentralization is the process whereby authority is restructured between institutions of governance at the central, regional and local levels with power and functions transferred to the lowest institutional or social level that is capable of completing them. This is referred to as the principle of subsidiarity. Decentralization relates the role of, and the relationship between central and sub-national institutions, whether they are public, private or civic (Ts‘oele, 2006). It involves devolving political power, defining people’s role in the decision making, transfer of functions, devaluation of funds, making administrative arrangement for planning and implementation, taxing powers and financial autonomy and so on. (Kaushik, 2005).

Decentralization of governance can help mobilize resources, introduces locally and regionally diverse solutions and promote equitable growth by bringing the poor into the mainstream of development (Kumar, 2003). Decentralized governance is increasingly being favoured as the most suitable mode of governance through which poverty reduction interventions can be conceived, planned, implemented, monitored and evaluated. This is because of a greater degree of accountability, responsiveness and participation, it is hoped that effective decentralization can make a big difference by making the provision of local (social and economic) services more efficient, equitable, sustainable and cost-effective. Through community participation in decision making, planning, implementation and monitoring and backed by appropriate institutions and resources, it can go a long way in improving the quality of life, particularly of the poorer and marginalized sections of the society, thereby alleviating poverty (Kanzya, 2004).

The complex phenomenon of decentralization can be classified into three types: deconcentration, delegation and devolution. Deconcentration involves shifting decision-making powers to Central Government officials who are located outside the capital. Decision-makers respond to the central authority, not to local constituencies. Under delegation, locally elected government bodies have new responsibilities but can be regulated strictly by the Central Government. Devolution gives locally elected
governments autonomy in their spheres of responsibility. In a devolved system, local governments have clear and legally recognized geographical boundaries over which they exercise authority and within which they perform public functions (Skira, 2006).

The effectiveness of decentralization requires the calibration of these three interdependent dimensions. Without political decentralization, participatory decision-making is not possible, administrative decentralization is necessary to implement political decisions. Again, this is also an important precondition for fiscal decentralization: efficiency in the delivery of public services depends on administrative efficiency and accountability. The process is classified broadly as political, administrative and fiscal decentralization:

- **Political Decentralization**: Transfers policy and legislative powers from Central Government to autonomous, lower-level assemblies and local councils that have been democratically elected by their constituencies.
- **Administrative Decentralization**: Placing planning and implementation responsibilities with the local bodies and assigning the roles and responsibilities to functionaries and elected members.
- **Fiscal Decentralization**: The transfer of financial resources and assets from the central administration to other levels of governments is called fiscal decentralization. Fiscal decentralization affects the revenue as well as expenditure side of the budget though the impact at local level is generally much stronger on the expenditure side (Sethi, 2004).

Promoters of decentralization argue that decentralized governments are more responsive to the needs of the poor than Central Government, and more likely to conceive and implement pro-poor policies. But decentralization does have potential disadvantage, it is not a panacea for many of the ills afflicting society. Arguments against decentralization have focused on the reduced ability of Central Government to implement macro-economic stabilization programmes; efficiency losses due to the poor capacity of local governments to undertake the functions assigned to them; and the potential for increased corruption. Weak administrative or technical capacity at local levels may result in services being delivered less efficiently and effectively in some areas of the country. Successful decentralization is closely related to observing the design principles of: finance followed functional assignment; informed decision
making; adherence to local priorities and accountability. However, applying these principles in practice have not proven to be simple. Country circumstances differ, often in subtle and complex ways; consequently the policy and institutional instruments that establish decentralization have to be shaped to the specific conditions of individual countries (World Bank, 2011).

1.2 Emerging Concept of Decentralization and Governance

There has been a world-wide trend towards decentralization in recent years. Many countries have experienced devolution of administrative, political and fiscal responsibilities to lower levels of government. Dissatisfaction with the prevailing centralized systems of service delivery, transition from centralized planning to market economy, deepening democratic principles and increasing need to recognize social, economic and political diversities in different regions within the countries are some of the important reasons cited for this phenomenon. This trend towards decentralization is seen in countries with federal systems; it has spanned across countries with varying levels of development; it is seen as much in transitional countries and even military dictatorships as in democratic countries (Ebel and Yilmaz, 2001)

The pursuit of decentralization is wide spread, as both developed and developing countries attempt to challenge Central Government monopoly of decision making power. In the Western World, decentralization is an effective tool for re-organization of the government in order to provide public services cost effectively in the “post welfare state era”. Developing countries are turning to decentralization to escape from the traps of ineffective and inefficient governance, macro economic instability and inadequate economic growth. Throughout post communist Central and Eastern Europe, decentralization of the state is the direct result of the transition from socialist system to market economy and democracy.

Over the past decade and a half, democratic governance and decentralization have occupied a prominent role in the policies of developing and transitional countries in the world. Along with privatization and deregulation, this shift represents a substantial reduction in the authority of national government over economic policy. The first wave of post-world war II thinking on decentralization, in the 1970s and 1980s, focused on decentralizing hierarchical government structure and bureaucracies. During the 1970s and 1980s, globalization forced some governments to recognize the limitations and
constraints of central economic planning and management. A shift during the same period in development theories and strategies in international aid agencies away from central economic planning and trickle-down theories of economic growth towards meeting basic human needs, growth with equity objectives and participatory development also led to increasing calls for decentralization (Ebel and Yilmaz, 2001). The second wave of decentralization beginning in the mid 1980s broadened the concept to include political power sharing, democratization, and market liberalization, expanding the scope for private sector decision making. With the continued weakening of centrally planned economies, the warning of the cold war, and the rapid growth of international trade and investment economies and political forces reshaped conventional concept of not only economic development but governance and decentralization as well by the mid 1980s (Cheema and Rondinelli, 2007). During the 1990s decentralization was seen as a way of opening governance towards public participation through organizations of civil society. Governments were also pressured to decentralize by political, ethnic, cultural and religious groups seeking greater autonomy in decision-making and stronger control over national assets (Jr, 2004).

In Latin America, the origin of decentralization is the political pressure from the public for democratization. The spread of multi-party political system is creating demand for more local voice in decision making in Africa. In some countries such as Ethiopia, decentralization has been a response to pressures from regional or ethnic groups for more control or participation in the political process. Calls for devolution or autonomous rule also came from minority group in Belgium, Quebec, Wales, Scotland, Malaysia, Mexico, Philippines, Yugoslavia, and the former Soviet Union that were dissatisfied with their political representation or allocation of national expenditure. Some governments decentralized under condition of fiscal instability, Argentina in the mid-1980 and Brazil in the late-1980. Countries like, India, Nepal, Bangladesh, Nigeria, China, Sri Lanka, Chile, which have adopted decentralization more vigorously in the last two decades, do not have any similarity of either the cause or the objective or the term. It has emerged due to their socio-economic and political factors that are more country specific than represent any general trend. China has also accepted decentralization to promoting rural development and providing employment to local people. Tanzania’s decentralization is being driven more by dissatisfaction with the quality of local public service, which has been attributed to too little expenditure
discretion at the local government level. Pakistan has adopted decentralization to alleviate some political-market imperfections (Cheema and Rondinelli, 2007).

There may be general perception of failure and resentment towards highly centralized models of governance, such as Russia and other countries that are in transition from planned socialism and absolutist regimes. Finally from Bolivia to Bulgaria, and from West Africa to South Asia, a wide variety of countries are increasing the authority of local governments and working to make them more responsive and effective (Khan and Alam, 2011)

1.3 Principles of Fiscal Decentralization

Fiscal decentralization is a sub-set of decentralization defined as fiscal empowerment of lower tiers of government which involves the devolution of taxing and spending power along with the arrangements for rectifying mismatches in resources and responsibilities. It assumes significance because without its proper functioning decentralization becomes inoperative and meaningless. It has particular significance in the context of a multi-level system of governance with fiscal responsibilities vested in the centre, state and local government. The local governments should have adequate authority and autonomy in regard to the management of the expenditure and revenue side of its budget (Oommen, 2006). There are four pillars of fiscal decentralization:

1.3.1 Assignment of Expenditure Responsibilities

Expenditure assignment is the first step in designing an intergovernmental fiscal system. Designing revenue and transfer components of a decentralized intergovernmental fiscal system in the absence of concrete expenditure responsibilities would weaken decentralization process. The assignment of functional or expenditure responsibilities defines who does what – which functions are assigned to different level in the overall system of government in a given country (Ebel and Yilmaz, 2001). Because there is no single ‘best’ assignment of expenditure responsibilities among different levels and the expenditure assignment choices made in different countries depend, among other factors like historical and political circumstances. However, the key principle in determining which level of government should do what in a fiscally
A decentralized system of government is known as the subsidiarity principle’ and is meant to ensure allocative efficiency and reduce inefficiencies (UNDP, 2005).

1.3.2 Revenue Assignments

The essence of decentralization is that sub-national governments have the authority and responsibility to own revenue from their local services at the margin. Local governments cannot feasibly be assigned revenue sources matching their expenditure assignments. It is important to consider which revenue sources specifically make sound local government revenue sources, since some taxes are better suited for local governments while others are better left to National Governments. For example, local governments should be assigned stable sources of revenue. Local taxes should also be easy to administer and it should be easy to separate the tax base between different local jurisdictions. It is preferable if local taxes broadly correspond to the benefits received by local residents from local government services. But in many countries the problem is that while sub-national governments need to have at least some revenue discretion in order to fully benefit from fiscal decentralization reforms, Central Governments often seems unwilling to provide a significance degree of real revenue autonomy to sub-national governments (UNDP, 2005).

1.3.3 Intergovernmental Fiscal Transfers

The revenue and expenditure assignments give rise to vertical and horizontal imbalances within a nation’s intergovernmental finances. A vertical imbalance occurs when the expenditure responsibilities of sub-national governments do not match with their revenue raising power. A horizontal imbalance occurs when own fiscal capacities to carry out the same functions differ across sub-national governments (Ebel and Yilmaz, 2001). Essentially, an efficient and equitable transfer system means making institutional arrangements for rectifying the vertical and horizontal imbalances arising in intergovernmental fiscal relations. The matching between expenditure responsibilities and its revenue capabilities called the ‘principle of fiscal equivalence’ seldom happens in practice especially in a multi-tiered federation (UNDP, 2005). The task of a good inter-governmental transfer system is (a) to determine normatively the size of the divisible pool which ideally has to be related to the expenditure responsibilities a government has to shoulder and the revenue potential and performance which of course has to be normatively screened to discourage imprudence...
and (b) to equitably distribute the pool among the sub-national governments, keeping the objectives of fiscal decentralization laid out in the Constitution (Oommen, 2008).

### 1.3.4 Sub-national Borrowing

If any local expenditure needs are not properly balanced with the resources available to it, this could result in sub-national deficits and the incurrence of debt or borrowing. There are at least two different channels through which sub-national governments can borrow: through a public intermediary such as infrastructure development bank or direct borrowing from private capital markets (Ebel and Yilmaz, 2001). Local borrowing might be appropriate for certain types of local spending such as responsible borrowing for long-term capital development projects. Local borrowing is also frequently constrained by the lack of local government credit worthiness in many developing countries, especially amongst rural local governments.

### 1.4 Fiscal Decentralization and Poverty Reduction

Decentralization is linked to poverty reduction in many ways. Poverty reduction means designing, implementing and targeting appropriate methods to ensure that the scarce resources are allocated in such a way to get maximum impact on the poor and decrease their level of deprivation and vulnerability. It has come to be commonly accepted that decentralization can be an effective tool for implementing poverty reduction policies because people at the local level have the information and incentives to design and implement policies that respond to local needs and preferences. It is also important to note that effective implementation of poverty-alleviation policies depends upon the responsiveness and capacity of local government institutions. Governments that are ‘closer to the people’ should in principle, be able to provide services more efficiently and effectively than a remote, centralized authority (Rao, 2002). Decentralization as a means to achieve good governance in terms of greater public participation, accountability of the public sector and reduced corruption can be expected to lead to poverty reduction (Steiner, 2005). The proximity of policy implementers to the target groups reduces information and transaction cost of identifying the poor and help in designing potentially successful ‘capacity improving’ and ‘safety net policies’. These require designing and implementing general purpose and specific purpose transfers to the poorer region. The former are required to offset their general fiscal disabilities so that they are enabled to provide comparable levels of
public services at comparable tax rates and the latter are necessary to ensure that certain very services falling into class of ‘categorical equity’ are provided in these regions at required levels (Rao, 2002).

Decentralized provision of the public services can also help to link revenue-expenditure decisions at the margin. This can improve both efficiency and accountability in the provision of such services (Oommen, 2006). Increased efficiency in service delivery can directly improve access by the poor to services such as education, health, water, roads and electricity. Decentralization promotes good governance, improves the prioritization of budget allocation, and helps to ensure that resources intended for the poor reach their destination (Boex et al. 2006). However, when exploring the relationship between fiscal decentralization and poverty reduction it needs to be remembered that there are certain things that local governments are badly placed to do as about of a poverty alleviation strategy (UNDP, 2005). Macro economic instability is often the result of a poorly executed decentralization process. Governments may misallocate budget by spending on the wrong groups of people. In the absence of expenditure controls and where there is no representative political system, decentralization may lead to the capture of public resources by the elite and local administrations. Such problems could lead to fragmentation of the society and corruption. Risks are minimized when certain institutional conditions are present, such as political freedoms, free flow of information and adequate human and physical capital basis. Unsuccessful decentralization may threaten economic and political stability with negative outcomes for the delivery of public services, but assuming that the correct institutions are in place, there are several potential benefits of fiscal decentralization and decentralized delivery for the poor (Skira, 2006).

1.5 Statement of the Research Problem:

Elimination of poverty has always been on the national policy agenda since the beginning of the planning era and shall continue to do so in future. Strategically the focus of our planning was to improve the economic and social conditions of under-privileged sections of rural society. But less attention has been given to rural local government’s (panchayati raj institutions) fiscal problem and prospects, and their role in rural development. Government efforts to meet the preferences of the people at the local levels demand that more and more responsibility be given to the rural local
governments if the local goods and services are to be provided more efficiently. The entire system of rural local government finance (the assignment of revenue sources, the definition of intergovernmental fiscal transfer) should be considered as an integral part of the policies and strategies for achieving Millennium Development Goals. There is considerable need to rationalize the assignment system to enable the decentralized governments to raise revenues and incur expenditure according to the preference of their citizens. It is necessary to understand the policies and institutions necessary for the success to make the rural local fiscal governance successful. Expenditure functions remain non-transparent and very little expenditure autonomy has been given. It is important to specify expenditure responsibilities to enhance accountability, reduce unproductive overlap, duplication of authority and legal challenges. It is believed that more local control over expenditure decisions can make things better and improve service delivery. As state governments specially the Government of Uttar Pradesh are themselves faced with several resource constraints, the revenue accruals to the rural local bodies are not adequate to enable them to effectively deliver the required standards of public services. The state government out of its own tax powers devolved certain tax powers to rural governments that are less mobile, not easily exportable. The State Finance Commission reports have paid far less attention to issues of autonomy, financial management and auditing procedures. The reports are deficient on linkages between devolution of funds to rural local governments and their responsibilities. The financial needs of rural local bodies far outweigh the resources at their disposal especially with discretionary use. Lack of untied fund is a major cause why rural local bodies have not accepted local planning whole heartedly. Rural local governments treated as “agencies” of government to implement programmes and not as “government” itself, has a lot to do with inadequate functional and fiscal devolution. The agent of implementation of all major programmes has always been the state administration, various parallel bodies that have grossly undermined the importance of the panchayats. An effective institutional mechanism is required for facilitating fiscal decentralization, for enabling the state to monitor the fiscal performance of local governments, identify those in financial difficulties as well as those exerting weak revenue mobilization efforts. It is also important to monitor the success of central government instruments (transfers, subsidies, local taxes) on a periodic basis. Demands for introducing transparency in the functioning of the panchayats holding regular
elections and meetings of the gram sabha and making public details regarding schemes undertaken and funds received and spent by the panchayats are being voiced.

1.6 Significance of the Study

With the aforesaid, introduction, it must be clear that panchayati raj institutions assumes an added significance in bringing out the faster socio-economic development at the local level in the rural areas. It is now widely accepted that self government institutions at this local level are essential for national growth and for effective people’s participation and that they are an integral and indispensable part of the democratic process. “Grass-Root of Democracy” based on small unit of government; enable people to feel a sense of responsibility and to inculcate the values of democracy. At the same time it also offers a unique opportunity to participate in public affairs including development work.

From the point of view of functional utility, decentralization is perceived as a means to ensure more effective implementation of national policy by cutting through red tape and complex bureaucratic procedures. Local development units can be effective links between the Central Government and local communities, greater participation in development planning and management may not only promote national integration by giving people in different regions of a country a greater ability to participate in planning and decision-making, but also increase their share in managing the local needs and meeting their aspirations. Panchayati raj institutions have been initiated with large responsibilities which they are entitled to complete and for this they have to perform numerous functions both in general and specific manner. Keeping in view, the present study attempted to analyze the pattern of financing and suggest to measure to mobilize additional resources for panchayats to enable them to effectively provide these services to the rural masses. Also examined the role of participatory planning for poverty alleviation programmes and assessing the gap between needs and resources at rural local level and how peoples are benefited by the decentralization.

1.7 Objectives of the Study

The objectives of the present study are as follows:

- To quantify the present state of expenditure assignment in UP, so as to define the boundaries of functional responsibilities assigned to panchayati raj
institutions and assess this against the functional devolution visualized in the Constitutional Amendments.

- To assess the present state of revenue assignment and composition of revenue receipts by source (centre/state/own) and thereby the present state of intergovernmental transfers.
- To assess the utilization of receipts by PRIs and thereby the state of fiscal monitoring in the study area.
- To examine the implications of fiscal decentralization for targeting rural infrastructure programmes as a rural development measure.
- To define the desirable design of fiscal decentralization from the viewpoint of growth acceleration with poverty reduction.
- To identify the socio-economic profile of the BPL households and changes therein, if any.
- To identify issues and make recommendations to improve the fiscal decentralization system.

1.8 Data base and Methodology

The present study is based on primary as well as secondary sources of data. In the first part broad based study of India as well as Uttar Pradesh were taken up. The administrative division of the state in the form of district such as Aligarh is taken as a basic unit for empirical investigation to gain deeper insights and practical relevance because most of the government data is available at this level. It is one of the developing parts of the Uttar Pradesh where a different type of religious and caste communities resides in its boundaries. The main consideration before us was that Aligarh is situated on the borders of Haryana and is very near to Union Territory of Delhi. It is hoped that being situated at the cross-roads of two states the people of urban district might be very conscious about the functioning of grass-roots institutions. Further it was selected due to its cultural/historical uniqueness and due to the accessibility to the researcher. The researcher himself belongs to Anoopshahar which adjust to Aligarh and knows about the physical and cultural set-up of the district.
1.8.1 Sampling

The study area comprises entire 12 blocks in the district. Thus it was selected 6 gram panchayats (GPs) from each block, which would be representative in character. These gram panchayats were selected on the basis of 2 highly populated, 2 least populated and 2 Ambedkar gram panchayats. Thus 6 gram panchayats from each block- a total of 72 gram panchayats, Block Development Officers of all the 12 blocks and Zila Panchayati Raj Adhikari were selected for the study. 720 BPL household of the 72 selected gram panchayats have been enumerated households on the basis of 10 BPL households from each gram panchayats drawn randomly from the list of BPL census 2002.

1.8.2 Sample Design

Having discussed the tools employed for selection of the study area, study proceed to sample design. The following categories of respondents were selected for the study.

- Village Panchayat Secretaries of the 72 selected gram panchayats.
- Block Development Officers (BDOs) of the entire 12 blocks.
- District Panchayati Raj Officer (DPRO) of the Aligarh district.
- 720 BPL household of the selected 72 gram panchayats.

1.8.3 Data Collection

For the collection of primary data, three set of well structured questionnaires, one for each of the three tiers in the panchayat structure i.e for the Gram Panchayats, Block Panchayats and Zila Panchayats have been prepared to interview and collect information regarding the composition of revenues receipts by sources of panchayats and defined the channels of intergovernmental fiscal transfers. A separate questionnaire has been used for the interviews of BPL Households to assess their socio-economic condition and their perception on the functioning of rural local governments.

The secondary data has been obtained from published documents of government department mainly by the Ministry of Finance, Ministry of Panchayati Raj and Ministry of Rural Development, Government of India, other departments/offices of the Government of India and RBI. Most of the relevant data have been taken from various sources such as Indian Public Finance Statistics, Central Finance Commission reports,
State Finance Commission reports, Economic survey, NIRD reports, Annual Plan, Government of Uttar Pradesh and Directorate of various departments in Government of Uttar Pradesh, Giri Institute of Development Studies and District Statistical Handbook collected from district Economic and Statistical Division. Apart from this, secondary data and information were collected from monographs, news papers, books and websites.

1.8.4 Tools and Techniques

In order to bring out the clear-cut picture the data of primary and secondary sources were carefully scrutinized and transcribed before the commencement of data tabulation and interpreted through statistical tools. Editing is done to assure that the data are accurate, consistent with other facts gathered and as complete as possible. Sample statistical tools like frequency, percentages, average, compound average growth rate (CAGR), coefficient of variation to measure the relative variability, extrapolation and interpolation to obtain the total projected rural population and base shifting method to convert different series on the same base year for making it comparable, have been used in arriving at the results.

1.8.5 Hypothesis

The present study is based on the following hypothesis: the process of fiscal decentralization and participatory planning in rural areas has been able to reduce poverty to a significant level.

1.9 Limitation of the Study

Keeping in view limited financial resources and time at our command, it was desirable to select Aligarh district that can be studied within the limited resources and time by making frequent visits. BPL Census 2002 was not carried out in several selected gram panchayats in the study area. Further, in some gram panchayats, number of BPL households was not sufficient in the list. So we included the households those who have BPL/Antyodaya ration cards. Overlapping regarding Ambedkar gram Panchayats with that of highly populated and least populated gram panchayats have also been observed.
1.10 Framework of the Study

The study is divided into seven chapters. This chapter covers concepts and issues in fiscal decentralization and poverty reduction, statement of the research problem, significance of the study, objectives, and methodology of the research, hypothesis, limitations, and chapter framework. Chapter two discusses review of literature concerned with research problem. A macro level fiscal scenario of Panchayati Raj Institutions in India and its role in poverty alleviation programmes is analyzed in chapter three. Chapter four assesses the functioning of decentralization in Uttar Pradesh and the initiatives for providing fiscal autonomy and to strengthen the fiscal position of PRIs. Chapter five examines the fiscal behavior of the Aligarh district of the Uttar Pradesh with the detailed description of possible ways to mobilize resources and likely areas where the resources are to be allocated and also discusses the availability of resources and needs at gram panchayats. Section six describes the socio-economic condition of BPL households and their perception towards panchayats and how they are benefited by it. Finally, chapter seven summarizes the main conclusions of the research and recommendations made to improve the panchayati raj system.