Institutional changes in India since independence have been prompted by two fundamental urges. One is the urge for democratization and the other is the urge for development. These twin urges resulted in the emergence of local self-governments in India both at urban and rural levels which touched the lives and needs of all categories of people at an immense length especially effecting and touching the civic needs.

In India Local Government is widely known as local self-government. It is the integral part of the three-tier system of democratic government. The first being the national government, the second proceeds the state government and the bottom stands local self-governments at urban and rural levels as grass roots for each. The emergence of local self-governments as a distinct governmental units was a result of the interplay of several factors – historical, ideological and administrative. These local self-governments have flourished in India since times immemorial. Both panchayats as village governments as well as towns as urban governments had existed during ancient period. Magastenes gave a description of the administration of towns in the Third Century Before Christ.

Although, local government existed in India in ancient times, in the present structure and style of functioning, it owes its existence to the British Rule in India. In the sense of a representative organization, responsible to a body of electors, enjoying powers of administration
and taxation, and functioning as a school for training in responsibility and as a vital link in the chain of organisms that make up the government of the country, is a British Creation. A beginning of local government may be said to have been made in the year 1687, when for the first time, a local governing body – a Municipal Corporation was set up for the city of Madras (now called as Chennai) which was followed by Bombay (Mumbai) and Calcutta (Kolkata) by 1762. Subsequently, Lord Mayo's Resolution of 1870 called for the introduction of an elected president in the Municipalities. During the period between 1687-1881 Local government was viewed to ease central and provincial finances and thus to sub serve imperial needs. Between 1882-1919 local government began to be viewed as self-government. The period between 1920-1947 Local Government came within the jurisdiction of provinces and further was in a state of repair and reconstruction. After independence, Local Government has been keyed to the requirements of Indian Constitution.

Urbanization is an index of transformation from traditional rural economies to modern industrial one. It is a long term process. At the moment India is among the countries of low level of urbanization. The number of urban agglomeration has grown from 1827 in 1901 to 5161 in 2001 and the number of population residing in urban areas has increased from 2.58 crores in 1901 to 28.53 crores in 2001 and 37.77 crores in 2011. Only 28 percent of population was residing in urban areas as per 2001 census. Over the years there has been continuous concentration of population in Class-I Towns. On the contrary, the
concentration of population in medium and small towns either fluctuated or declined. The graduation of number of urban centres from lower population size categories to Class-I cities has resulted top heavy structure of urban population in India. India's urbanization is often termed as over urbanization or seudo-urbanization. Urbanization is occurring not due to urban pull but due to rural preserve. According to the Census of 2011 urbanization has increased faster than expected. The declining trend in the urban population growth rate observed during the 1980s and 1990s was reversed at the national level, and the level of urbanization increased faster during 2001-2011 and the urban population in India as per roll census was 3771 crores constituting 31.16 percent.

Another significant development in the history of Local Self-Governments in India was the separation of rural local government from urban local governments. The Government of India to this effect left necessary legislation to establish the urban local bodies by the respective states for urban development. Besides a number of central committees and commissions were set up from time to time to suggest ways for streamlining the local government structure in the country.

The period immediately following the Reorganization of States in 1956, was characterized by enactments of Municipal Acts in several States. The State of Andhra Pradesh responded properly to the sequels of the Government of India and enacted the Andhra Pradesh Municipal Act, 1965 which came into force on April 2, 1965. The main objectives of enactment of this Act was to establish Municipalities and
Municipal Corporations in the state. A landmark development in the history of urban local self-governments in India was the enactment of 74th Constitutional Amendment Act, 1992 by Indian Parliament which came into force from June, 1993 and it reconstituted the Municipalities and Municipal Corporations in Andhra Pradesh also along with many other States.

Urban decentralization – devolving powers and responsibilities to the municipal bodies was a result of increasing pace of urbanization, particularly in the larger cities. The basic objective of decentralization is to empower the municipal bodies both administratively as well as financially. Moreover it also aims at analyzing the impact of municipal service delivery.

Urbanization and development are inseparably linked in past because, cities are the leading edge of economic dynamism in our country. Good policies, good local governance systems, and sound arrangements to finance public services, are critical elements in sustainable urban development and shape the nature and quality of public services provided as well as the structure of incentives and accountability. Turning India’s cities into engines of growth is thus a formidable challenge. Not only must adequate finance for the provision of services be found but it is critical to ensure that the money spent results in desired outputs and outcomes. To do this local governance structures also need to be reformed and strengthened.
Until the enactment of the Seventy Fourth Constitutional Amendment Act in 1992, urban local government's were not part of the Indian government's planning and development strategy. A dramatic change in the federal system of India came with the introduction of this Constitutional Amendment Act conferring Constitutional status to the third level of government of local bodies. Part IX-A which included Article 243-P to Article 243 ZG were created in Indian Constitution with Twelfth Schedule which listed the functions of urban local units long with their planning regulation and development powers. The Act also provided for creation of State Finance Commission for each state.

Local self-government institutions in India being at the cutting edge level of administration, directly influence the well being of the people by providing civic services and socio-economic infrastructure facilities. The 74th Constitutional Amendment Act has mandated grass roots level democracy in urban areas by assigning the task of preparation and implementation of plans for economic development and social justice to elected municipal councils and Ward Committees. It has incorporated the Twelfth Schedule into the Indian Constitution containing a list of 18 functions as the legitimate functional domain of urban local bodies in the country. In view of this position, the demands placed by the public on Municipal bodies for the provision of various civic services have increased considerably. Further, with Globalization, and Liberalization, the rise of the service economy and revolution in information and communication technologies, the urban
population in cities and towns are expecting and demanding more and more civic services and facilities in their day to day life.

Governments in developing countries have resorted to decentralization through various means; de-concentration, delegation and devolution. Devolution means the transfer of authority for decision making, finance and management to autonomous units of local government. It involves transferring responsibilities for services to local bodies that elect their own representatives, raise their own revenues and have independent authority to spend for public services. The 74th Constitutional Amendment Act, 1992 aimed at a decentralized regime through the mechanism of devolution of functions, finances and functionaries to urban local bodies. In the case of urban local bodies, enormous responsibilities have been identified in the Seventy Fourth Constitutional Amendment Act, which included (i) preparation of plans for economic development and social justice, (ii) implementation of such plans and schemes as may be entrusted to them, including those in relation to the matters listed in the Twelfth Schedule to the Constitution (Article 243W). Besides the 18 items of responsibilities envisaged as legitimate functions, the State Legislature, by law, can assign any tasks relating to preparation and implementation of plans for economic development and social justice.

Finance is life blood of administration. An organization needs finances to fulfill the objectives it has chalked out for itself. More
particularly, the urban local bodies which are endowed with the responsibility of providing basic civic and physical facilities and services do require adequate finances. Further all urban poor people will have access to basic level of urban services. In order to perform the above stated responsibilities, urban local bodies have to be financially sound, equipped with powers to raise resources commensurate with the functions mandated. The crux of the financial problems faced by urban local bodies is the mismatch between functions and finances and that this mismatch is seen to be growing with urban growth, population concentration, liberalization and globalization.

Further, the Seventy Fourth Amendment Act listed the expenditure responsibilities of urban local bodies, but it did not specify the legitimate sources of revenue for these authorities. It simply stated that the legislature of the state may, by, law (i) authorize the municipality to levy, collect and appropriate such taxes, duties, tolls and fees, (ii) assign to a municipality such taxes, duties, tolls and fees levied and collected by State Government (iii) provide for making such grants-in-aid to the municipality from the Consolidated Fund of the State and (iv) provide for the constitution of such funds for crediting all moneys received. Thus, while the Municipalities and Municipal Corporations have been assigned the responsibility of preparation of plans for a wide range of matters – from economic development to promotion of cultural, educational and aesthetic aspects, the power to raise resources by identifying taxes and rates to
implement the plans are vested solely with the state legislature. This has created, what is referred to in public finance literature as vertical imbalances, i.e., constitutionally built in mismatches in the division of expenditure liabilities and revenue raising powers of central, states and local bodies. To address this problem two significant provisions were introduced in the Constitution of India through 74th Constitutional Amendment Act, 1992, which are (i) the formation of State Finance Commissions to recommend devaluation of state resources to local bodies and (ii) enabling Central Finance Commission to recommend grants-in-aid for local bodies through augmenting the state consolidated funds.

The Andhra Pradesh State Legislature in consonance with the Seventy Fourth Constitutional Amendment Act, enacted Andhra Pradesh Municipal Corporation Act in 1994. Consequently the earlier Acts governing the Municipal Corporations in the State were amended and the municipal corporations were brought under the governance of the newly enacted Act, i.e., Andhra Pradesh Municipal Corporations Act of 1994. The Municipal Corporations of Warangal, Guntur, Rajahmundry and Kurnool were created newly in the year 1994. The total number of Municipal Corporations in Andhra Pradesh as on today is Eighteen. Except the Greater Hyderabad Municipal Corporation, the organizational structure pattern, the funds flow and financial resources are same and uniform for all municipal corporations in Andhra Pradesh, and these Municipal Corporations
Kurnool is one of the four districts of Rayalaseema region of Andhra Pradesh. The Kurnool Municipal Corporation located at the urban localities of district headquarters area is one of the Eighteen municipal corporations functioning in the state. This corporation was created in August 1994 as an upgradation from Municipality and completed as many as eighteen years of service to the people of Kurnool in its character of being long established one especially in the backward districts of Rayalaseema region in the state. Its history dates back to the year 1866 when it was commenced with a humble beginning as a Municipal Board and in due course of time it has been elevated to the present status of Municipal Corporation. It witnessed various stages of developments, ups and downs in its phenomenal growth and accredited itself with number of positive points besides various lapses. As on now its geographical jurisdiction covers 49.73 sq. km with 4.39 lakh citizens living in 50 Municipal Wards as per 2011 census. As per the revised Budget Estimates for the year 2011-2012 the total receipts of the Corporation was Rs. 109.48 crores which included both Revenue Income and Capital Income, and the total expenditure was Rs.99.94 crores which included Revenue Expenditure and Capital Expenditure.

The efficiency of any urban local body depends to a greater extent on its financial position. The better the financial resources of
an organization are, the better the amenities and services provided by
the organization. The Kurnool Municipal Corporation gets its revenue
through various sources like Tax resources, Non-tax resources,
Grants-in-aid released by the government for developmental activities
to be taken up by basing upon capital receipts from the grants
released by Government under various schemes and programmes like
SJSRY, MPLADS, ACDP, APUSP, APURMSP, Rajeev Nagara Bata,
UIDSSMT, IH SDP, INDIRAMMA, XII Finance Commission, Rajiv Awas
Yojana, XIII Finance Commission, Pavala Vaddi Scheme and other
developmental programmes and their expenditures are also made as
per the provisions, guidelines, rules and regulations prescribed by the
government orders and Acts from time to time.

RESEARCH CONTEXT

Local Governments are unable to perform well due to various
reasons. Therefore, an important area requiring urgent research is the
“Challenges for Urban Local Governments”. There are a number of
issues concerning local government that have not been highlighted
adequately in the literature.

This research has relevance to the on-going work on Municipal
Finances and Civic Amenities. A review of literature on finances vis-à-
vis services reveals that extensive research is under way to evolve
suitable criteria and methodology for achieving 'good governance' in
municipal bodies. This is due to the realization that a significant
reason for the poor quality of life in urban areas of developing
countries is poor urban governance. In a number of countries, including India, national and regional campaigns on urban governance are being implemented to translate good governance principles into practice especially in financial aspects. However, there is evidence to show that the research and impact of such campaigns is limited and there are still a large number of municipalities in India that have not benefited. The same is observed in respect of the Centre and State Government supported programmes this shows that despite numerous efforts, several municipalities in India continue to remain plagued by a number of financial problems with affect their performance adversely. This research is, therefore, based on the hypothesis that their exist various internal and external financial problems that hinder the quality of life in urban areas.

STATEMENT OF THE PROBLEM

The progress of an area depends to a large extent upon the availability of suitable infrastructure and services. There are many developing countries in the world where service levels in urban areas are much below the standards and the citizens lead a difficult life. It is obvious that such conditions also affect adversely the productivity of urban areas. Much of the blame for the prevailing situation goes to the local government institutions, which are the main actors in the governance process at the local level. This is due to the fact that urban local governments (also known as municipal bodies), on the one
hand, recover costs incurred in service provision by levying a variety of
taxes and non-taxes, and on the other fail to meet the expectations of
the citizens.

With rapid urbanization and pressure on urban areas for service
delivery, the role of urban local governments in general and Kurnool
Municipal Corporation in particular is undoubtedly becoming
important and its financial capacity and adequacy hold the key.
Municipal finances hold the key to the overall status and progress of
service delivery in right direction. Poor finances of municipal
corporation results in poor basic services, low capital investment, low
credibility, poor revenue collection efficiency, corruption and lack of
innovation in resource mobilization. This vicious circle leads to poor
delivery and low quality of services which will hamper the growth
potential of the Municipal Corporation. Understanding the structure /
pattern of finances of Municipal Corporation and its growth holds
greater promise in the move towards improving the municipal
revenue. The Kurnool Municipal Corporation with its eighteen years of
experience, has been witnessing significant pressure on the amenities
and services and yet this city's finances are not inadequate in terms of
meeting the pressure. The quantum of financial resources available to
this municipal corporation had been many times not less than what
was required for the delivery of core urban civic services, which are
defined under the Municipal Corporation Act. However, there was lack
of incapability between the spending requirements for civic services
and amenities and that of the pool of resources available for

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expenditure on various municipal services. The causes for this state of affairs could be traced to both the inefficiency in spending the available resources on one hand and the gross unwillingness in the spending by the Municipal Corporation on the other.

**SCOPE OF THE STUDY**

Hence an attempt is made in this thesis to study the urbanization and urban constitution and governance, administrative and organizational structure of Kurnool Municipal Corporation, municipal management and municipal finances, and analyse the financial resources, the degree of control exercised by the state government in terms of the fixation of tax base, tax rates and tax exemptions, the central and state finance commissions, the expenditure on various municipal civic services, the level of efficiency with which taxes are administered and enforced, delegation of decision making powers in respect fiscal matters, the procedure and status of inter-governmental fiscal transform to reduce the fiscal gap, Revenue and expenditure performance state and local initiatives to assess the correct financial position of this municipal corporation to move forward with the new means to further of fund flow, and to analyze the finances in terms of its financial base and its adequacy vis-à-vis norms and its revenue and expenditure performance in order to suggest ways and means to further strengthen the financial position of Kurnool Municipal Corporation to enable it to spend more judiciously.
and appropriately to render optimum level of services to ensure good and healthy standard of living to its citizen.

OBJECTIVES OF THE STUDY

The objectives of the present study are NINE fold in character. They are:

1. To examine the process and growth of urbanization and urban governance in India.
2. To trace out the origin, growth and role of the urban local bodies in India.
3. To discuss the importance of finances in urban local bodies.
4. Two analyze the Seventy Fourth Constitutional Amendment Act and the sources of finance for Municipal bodies.
5. To explain the composition, powers and functions of Kurnool Municipal Corporation.
6. To describe the fiscal performance of Kurnool Municipal Corporation during the study period from 2002-03 to 2011-12.
7. To identify the problem areas and trouble spots in the management of finances in Kurnool Municipal Corporation during the period from 2002-03 to 2011-12.
8. To assess the impact of financial position of Kurnool Municipal Corporation on the services rendered to its citizens.
To offer remedial measures and suitable suggestions to streamline and strengthen the fiscal management of Kurnool Municipal Corporation.

PLAN OF ANALYSIS

Though the present study is descriptive in nature, certain tables, charts and diagrams are also presented for analytical purpose.

METHODOLOGY

As is the approach followed in most social science research, this study is based on data collected from both primary and secondary sources. Keeping in view of the above objectives, suitable research tools have been constructed and adopted in the collection as well as evaluation of data. The primary data was collected through field studies, through administration of well structured questionnaires to the officials and non-officials of Kurnool Municipal Corporation and the citizens adopting random sampling methods. The pre-testing was also done at all stages before administering the questionnaires. To gain an insight into the processes and practices of financial management, personal visits were conducted and observed to what extend they followed the fiscal procedures. Personal interviews and group discussions were also conducted with related personnel of finance department as well as civic services extending branches.
The secondary data was collected from publications of Government of India, the State Government, and other publications have been reviewed. Important among these are State Municipal Act that contain information on legal provisions for municipalities, the State Finance Commission reports which describe the municipal finance practices and the financial performance of municipalities at different time periods. Data maintained in the form of the records available in the office of Kurnool Municipal Corporation, its annual administration reports, Budget Estimates for the periods of study, Audited Reports, the Kurnool Municipal Corporation Acts and the 74th Constitutional Amendment Act, the Central and State Finance Commissions Reports, Municipal Corporation's Agenda, Proceedings and resolutions, Andhra Pradesh Gazette and Kurnool District Gazette were thoroughly studied and analyzed. Further various books, journals relating to local governments, urban local bodies, Municipal administration and development, Municipal Corporations and their functioning were consulted. Data was also collected from various libraries and institutions, government departments and directorates and Kurnool Municipal Corporation office. Finally, the national and regional news papers, broachers and other published and un-published literature was also made use of.

**SAMPLING**

For the purpose of conducting field survey through administration of a well-structured questionnaire to collect citizens
perceptions and their reactions, the researcher thought it good to touch every Municipal Ward in Kurnool Municipal Corporation with the questionnaire without applying any theory of sampling in selecting the wards. In fact, it was felt convenient by the researcher to touch each ward as all these wards are located in Kurnool city only. Hence, all the 50 wards were visited and surveyed by the researcher. However in selecting the respondents the researcher had followed a random sampling method. A total of 500 citizens of were selected from all 50 wards. The sampling was arranged in such a way that 10 respondents from each ward were selected at a random sampling method. Out of each 10 respondents equal representation was given to women from each ward and that way 5 women were chosen along with 5 men. Table 7.1 gives details of distribution of sample respondents ward-wise. Thus, out of 500 respondents 250 were male and 250 were female. In these 500 sample respondents all social categories of people like scheduled castes, scheduled tribes, backward classes, Christians, Muslims, and forward castes and others.

Limitations of the Study

Most municipalities in India do not have sufficient resources and technology to collect desegregated town-level data and maintain a database. Hence, data on various municipal aspects and performance parameters is difficult to collect. For example, reliable data on the proportion of population served by water supply; houses connected with underground sewer facility; proportion of solid waste collected
and disposed daily; etc. are generally not maintained. Progress reports containing information on the activities carried out by the different committees/sub-committee constituted by a municipality are prepared from time to time for the higher levels of government. The information contained in these reports is generally not shared with people not affiliated to the municipality. Due to the existence of a highly bureaucratic set up and the non-availability of published information / reports at the local – level, collection of data for this study has proved to be a difficult task for this researcher. Sometimes, the municipal staffs are not willing to share information due to the habit of non-cooperation with others; at other times, they require written orders from the senior most municipal official, which caused unnecessary delays. Although the senior most officials in municipalities are most cooperative, the sub-ordinate staffs, in general, follow an altogether different work style. In this situation, the researcher has relied greatly on the feedback and cooperation received from staff with a positive attitude.

**PLAN OF ANALYSIS**

The proposed thesis has been organized into **EIGHT** chapters

Chapter - I  Introduction Urbanization and Urban Governance in India.

Chapter - II  Emergence of Municipal Government in India and Andhra Pradesh.

Chapter -III  Financial Management in Urban Local Bodies.
Chapter -IV  Seventy Fourth Constitutional Amendment Act and Municipal Finances.

Chapter – V  Kurnool Municipal Corporation Organizational structure, functions and Financial Resources.


Chapter –VII  Kurnool Municipal Corporation – Citizen perceptions.

Chapter -VIII Summary and Conclusions.

The thesis finally ends with overall conclusions, annexures and bibliography.

REVIEW OF LITERATURE

Indian Studies

In the backdrop of a review of the theories of multi-level finance, Rao and Chellaiah (1991) provides a brief survey of literature on fiscal federalism in India and raises several issues pertaining to fiscal decentralization. The study, undertaken prior to the enactment of the 73rd and 74th Constitutional Amendment Acts, highlighted the 'glaring' absence of a reasonably developed independent institutional structure to provide local public services in India.

The Expert Group on the Commercialization of Infrastructure (GOI, 1996), also known as Rakesh Mohan Committee, *inter alia*, recommended for private sector participation in urban infrastructure development. It emphasized the need for accessing capital market, including the issuance of municipal bonds. The Committee also made projections of investment requirements in urban infrastructure.

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NIPFP (1995) studied 293 municipalities in India spread over seven States: Andhra Pradesh (54), Assam (21), Gujarat (63), Kerala (57), Maharashtra (33), Punjab (33) and West Bengal (32). The study documents the problems of vertical imbalance, horizontal imbalance, inadequate exploitation of existing resources by local authorities, high cost of administration and collection of local taxes and arbitrary system of fiscal transfers from State Governments to ULBs as the common features of the municipal finance system in the country.

Kundur, Bagchi and Kundu (1999) find that the levels of inequity in the provision of basic services across the States and size categories of urban centers are extremely high. Given the resource crunch in State Governments and urban local bodies, the authors recommend privatization, public-private partnerships and promotion of community-based projects as options for undertaking investments to create civic amenities. However, the aspects of equity are required to be addressed through specific measures. The authors observe that in the case of private sector or joint sector projects, the poor are likely to get priced out due to various reasons. In the case of infrastructure projects taken up with borrowed funds, the finances generated from the common people are likely to get escrowed as a security for projects that are likely to benefit the better-off sections of population or elite colonies.

Bagchi (2000) examines whether the decentralization initiative has succeeded in empowering the city governments, if there has been
any empowerment of such entities and how such empowerment has been reflected in the resource generation capacity of the urban local bodies. The impact of decentralization was studied on the basis of a decentralization index constructed for the purpose. The author finds that though the decentralization initiative has made some headway towards improving the tax generating capacity of city governments, it has, to a large extent, remained confined to the municipal corporations. However, the possibility of improvement in this count, for the lower tiers of urban local bodies, could not be ruled out in the long run, keeping the existing trend in view. The author observes that the decentralization initiative has almost remained ineffective in improving the resource generation out of the non-tax sources for the ULBs.

Bagehi (2001) analyses the nitty-gritty of alternative / unconventional modes of financing urban infrastructure. The author notes that it is due to the inherent characteristics of infrastructure in general and urban basic services in particular – externality, non-excludability, inelastic price demand, huge capital investments with long gestation period – that these are to a large extent provided by the public sector. The study makes the following observations:

(i) An alternate approach to the traditional mode of financing is public – private partnership (PPP). However, presently, the objective of public-private partnership relates much to attracting capital and curtailing public sector employment rather than increasing the efficiency and effectiveness of service delivery. The basic reason for the failure of PPP model is the
lack of customer approach in it and the extensive focus on technical and commercial aspects of infrastructure.

(ii) Just two sources, namely, Octroi and property tax, have been the major sources of revenue. Basically, Octroi is the only tax within the jurisdiction of city governments that has the potential to grow over time with the growth of economic activities. However, Octroi is on the verge of being abolished. Therefore, there is an urgent need for the State Governments to devolve some major tax sources to the municipalities which has their growth potential derived from the economic growth in cities.

(iii) Municipalities have not succeeded in realizing the potential of the property tax, though property values are on rise. A major problem with the property tax system in India lies in the process of tax computation. The linking of the property tax – based on annual rental value (ARV) – with the rent control law has hindered the growth of collection.

(iv) For accessing capital market funds, municipalities need financial, structural, institutional and administrative changes. These include: i) placing certain buoyant revenue sources at their disposal, ii) transforming the urban governance system with limited control by the state, iii) changing the capital market structure and iv) recovering the cost of services to make infrastructure projects commercially viable.

Vaidya and Johnson (2001) gives a vivid account of how the Ahmedabad Municipal Corporation (AMC) issued municipal bonds worth Rs.1,000 million in early 1998, the first such instrument issued in India without a State guarantee and it marked the first step towards a market-based system of local government finance. Before the issue of the bonds, AMC introduced reforms to improve revenue collection so as to make up for the loss it had been incurring. Other
preparatory steps taken by the AMC included preparing a five-year capital investment or corporate plan and credit rating by the CRISIL. For debit servicing, revenues from 10 Octroi collection centres were placed in an escrow account-structured debit obligation (SDO). Other credit enhancing measures adopted by the AMC were fixing minimum average debit service coverage ratio of 1.5 and having a sinking fund for repayment of principal and mortgage equal to 1.2 times the par value of the bonds. The authors suggested that the technical framework developed for the AMC bonds can act as a blueprint for future development initiatives in this area.

Pethe and Ghodke (2002) examine the status of Indian infrastructure, including urban infrastructure, and argue for accessing capital market funds to bridge the resource gap, in view of the changing role of Governments. The paper argued for newer financial instruments like 'Municipal bonds' for financing urban infrastructure. To impart liquidity and create an incentive for individual agents to invest in the bonds, a thick and efficient secondary market for debt instruments is needed.

Mathur and Ray (2003) provides a framework for municipalities to assess their creditworthiness for tapping the nascent but expanding capital market for financing urban infrastructure. The paper discusses the changes needed in the legal framework for municipal borrowing based on an analysis of finances of four municipal corporations (Agra, Allahabad, Bangalore and Vadodara).
Mathur and Thankur (2004) examined the fiscal performance of municipalities and assessed the load on state finances on account of the implementation of the State Finance Commission recommendations. The study found that the size of the municipal sector, in terms of revenues, was only 3.07 per cent of publicly raised resources (by municipalities, States and Central Government taken together). The study further found that the expenditure levels on services provided by municipalities across states were low when compared to the norms established by the Zakaria Committee. Another finding of the study was that per capital expenditure-revenue gap declined over the period of 1997-98 to 2001-02. Fiscal transfers to municipalities formed 3.85 per cent of the combined own resources of states.

Bagchi and Chattopadhyay (2004) analyses the impact of decentralization on the mechanism for financing urban basic services in India. The study finds that developed states and larger cities / towns are the major destinations for domestic institutional funds and external assistance. The emphasis made on full cost recovery and imposition of strict financial discipline on state governments by the Reserve Bank of India are likely to result in further concentration of funds in developed states or regions. Chattopadhyay (2004) further examined the impact of decentralization - both revenue and expenditure - on the financial health of urban local bodies through an empirical study of the aggregates of three states in the post-74th Constitutional Amendment Act era. The study observes that
decentralization improved the revenue structure of the municipal corporations and positively affected their tax and non-tax revenue generation. However, the large urban local bodies benefited most from the decentralization initiatives.

India Infrastructure Report 2004, *Inter alia*, discusses the issues relating to creating local financial systems for infrastructure development, accessing capital markets by ULBs and reforming the property tax. In this Report, Jha (2004) lists a range of options and models available to developing countries on how to finance infrastructure projects locally. These options include (i) specialized banks for municipal lending ii) municipal bound markets, and iii) specialized municipal funds. The paper reviews the initiatives for issue of municipal bonds and the experience of Tamil Nadu Urban Development Fund. For strengthening the creditworthiness of local bodies, the paper suggests that they should be given autonomous authority to set realistic tax-rates and user-charges for the basic services provided by them and also for pursuing hiring firing policies. Measures needed for strengthening Municipal Bond issuance, such as bond insurance facility, facilitating the listing of bonds on domestic stock exchanges, etc. are also discussed in the paper.

Ghodke (2004) examines the issues relating to capital market access by ULBs. The study documents that till 2004 the ULBs raised about Rs.700 crores from the domestic capital market by issue of municipal bonds. In view of their increasing resources gap, the paper
makes a strong case for facilitating the access of ULBs to the capital market for debt financing, either through loans or bonds. It suggests 'pooled financing' as a promising method for financing urban infrastructure. Under the 'pooled financing' framework, small local bodies can pool their strength and jointly access the capital market. The paper points out that there are typically two models of municipal credit market followed in countries – the bank lending model used in Western Europe and the municipal bond model used in North America.

Oommen (2005) provides a critique of the approach and recommendations of the Twelfth Finance Commission with reference to the rural and urban local bodies. The author states that during 2002-03, the total tax revenues and expenditures of local bodies as a percentage of the combined taxes and expenditure of Union, States and local bodies was only 1.6 per cent and 4.7 per cent, respectively, indicating marginal presence of local finance in the fiscal structure of India. In advanced countries, local bodies normally account for 20-35 per cent of the total government expenditure (UNDP, 1993). The author reveals that the Tenth Finance Commission (TFC) did not follow the principle of horizontal equity while allocating grants-in-aid. It is noted that the local bodies are yet to be put prominently on the public finance map of India, which is needed to facilitate an inclusive and equitable economic growth and to secure better horizontal equity. The author suggested that the Reserve Bank of India may consider
developing reliable database of the finances of local bodies similar to
the database of the finances of State Governments.

Pethe and Lalvani (2006) examined the finances of ULBs in
Maharashtra and drew attention to the significance of sub-national
governments accessing the financial markets in general, and debt
market in particular. The paper finds that the powers of ULBs in
Maharashtra are highly restricted with respect to both tax and non-
tax sources of revenues, as there has been no sufficient devolution of
taxation powers. The paper noted that the growth of revenue of the
ULBs has been constrained by inherent structural bottlenecks like
limited autonomy regarding taxation, small bandwidth for non-tax
revenues and the unpredictable nature of funds flowing from the
State. For accessing the capital market, the paper extended the
concept of 'pooled funds' and classified the ULBs in the State into
three categories, namely, 'Cherries' (financially better off), 'Salvageable'
(potentially better off) and 'Duds' (financially very poor). While the self-
help group amongst the Cherries and Salvageable will be able to
access the capital markets, infrastructure needs of Duds have to be
taken care of by the State directly. The paper made two other
suggestions. First, the existing infrastructure fund could be used to
facilitate under-writing of the project of the projects to be undertaken
by coalition of ULBs coming together as virtual entities. Second, banks
should look at the coalition formation of ULBs and encourage them by
making more exposure a matter or policy mandate or guided by their
profit motives.
India Infrastructure Report 2006 *inter alia*, discusses the trends and patterns of urbanization and urban public finance in states. It highlights the colossal needs of urban infrastructure investments in keeping with the projected urban trends and suggests measures for municipal reforms needed to access capital markets.

Chattopadhyaya (2006) documented the problems and prospects of the municipal bond market in India. The paper finds that several policies and legal frameworks to facilitate the access of ULBs to capital market are already in place. These include: preparation of a Model Municipal Law (MML) to assist ULBs in the areas of accounting reforms, resource mobilization and the entry of private sector partnerships, tax exemptions in the case of bonds issued by ULBs and other local authorities, trading of municipal bonds in the National Stock Exchange, measures taken by RBI to deepen secondary market activities, etc. The paper notes that without the financial empowerment, it is difficult to make the municipalities more market oriented and capable of mobilizing resources from the capital market. The paper concludes that local capacity building, financial empowerment, rationalization of the state-local fiscal relationship and further legislative changes are critical in developing a viable and vibrant municipal bond system in the country.

Lall and Deichmann (2006) report that while reforms in property tax administration have taken off and become quite popular, associated reform efforts focused on assessment and valuation are
less evident. In most ULBs, property rental values are used as the base for assessing property taxes. However, in the face of rent control laws, this approach is limiting the growth of revenues. Based on their study of the assessment systems in Bangalore and Pune, the authors find that structural reforms that link tax assessments to market rental or capital values have the potential to significantly increase aggregate tax revenues. They found that in Pune Municipal Corporation, the use of market values also played a redistributive role by reducing the tax burden in areas with poor services and amenities. In case of Bangalore, a one-time move from the previously used rental value based assessment to an area-based system increased revenues by around 62 per cent. The authors opine that a capital value system which requires the valuation of individual properties is difficult to implement in the present Indian context, especially because property records are in shambles and most local governments do not have a cadre of trained assessors to evaluate property values and update them regularly. Hence, they suggest that while the introduction of true capital value assessment system should be a longer term objective, local governments must implement other simpler and less costly reforms.

Srinivasan (2006) examined the equity, accountability and environmental concerns in Solid Waste Management (SWM) practices of public body, a private body and non-profit organization in Chennai city. The study finds that private sector and civil society participation pose several challenges in terms of equity and accountability. The
study shows that while a crucial role exists for the private sector, the intervention of the state and public policy is imperative to safeguard ecological and equity interests and to enable greater accountability on part of both the public and private actors.

Mathur (2007) finds that the finances of municipalities in India are in a grossly unsatisfactory state. The spending levels of municipalities are about 130 per cent lower compared with norms and standards. Own revenues of municipalities are insufficient to meet even the revenue account expenditure. The revenue expenditure gap is particularly high in states like Madhya Pradesh, Rajasthan, Uttar Pradesh and West Bengal.

Oommen (2008) analyses the trends in fiscal decentralization in India focusing on the 15 non-special category states, based on the data given in the report of the Twelfth Finance Commission. The author finds that total expenditure of local government as a proportion of the combined expenditure of Union, States and Local Governments declined from 6.4 per cent in 1998-99 to 5.1 per cent in 2002-03. Thus, the extent of fiscal decentralization, which was already very low, has shown a pronounced decline in recent years. The author reiterates that in advanced countries, local governments normally account for about 20-35 per cent of total government expenditure. The average rate of growth in the tax revenues of Panchayati Raj Institutions (PRIs) and Urban Local Bodies (ULBs) in most of the States had been negative or declining. Another finding by the author
is that the transfers to local governments as a percentage of State Domestic Product have declined in the country as a whole. Based on empirical analysis, the author concludes that the record of fiscal decentralization to sub-state level governments through the mechanisms of inter-governmental transfers has been very poor.

Pritha Venkatachalam (2009) in his working paper entitled Municipal Finance systems in conflicting cities case studies on Ahmedabad, and Srinagar in India. He highlighted the cities and fragile states component of the crisis states programme. This paper sought to provide a global over view of urban local government finance and then focus on India in terms of revealing a more qualified understanding of the relationship between conflict and municipal structure and finance. The out put of this paper was that Allahabad city had experienced significant communal urban conflict but its municipal structures and finances have remained robust and the state did not collapse on the other hand, Srinagar is combating prolonged insurgency and had a rudimentary municipal system that is being developed under challenging circumstances.

An obvious short coming in the literature of local public finance in India is the inability to locate a suitable alternative to Octroi. Traditionally Octroi has been the most important sources of municipal taxes in the country. Being regarded as an obnoxious tax. Octroi has been on its way out and all but a limited number of States like Maharashtra and Gujarat have already abolished Octroi. However, the
States which abolished Octroi have not been able to find an alternative for their ULBs as buoyant as Octroi. Several States have gone for experiments. Karnataka levied entry tax. Tamil Nadu permitted a surcharge on sales tax for the Chennai Municipal Corporation. States like Uttar Pradesh and Andhra Pradesh have not attempted instituting any major tax in the place of Octroi. The compensations to Municipalities in lieu of Octroi have been kept at abysmally low levels in the States that abolished it. Although in the interest of economic growth and free trade within the country there can be no case for Octroi, the need for assigning a substitute ‘own’ tax to ULBs as buoyant as Octroi continues to be strong.

The Report of the Committee on Octopi (1985), constituted by the then Ministry of Urban Development, Government of India, had made the following recommendations:

(a) Octroi might be retained in Municipal Corporations covering a population of three lakhs or more; the tax could be abolished in the smaller local bodies.

(b) Octroi should be replaced with taxes the incidence of which would be on the transport sector. The alternatives in the case of smaller municipalities include surcharge on sales tax, entry tax, terminal tax, rod tax, tax on motor vehicles, etc. If the revenue realized on account of these taxes was inadequate, augmentation measures through property tax, entertainment tax, professional tax etc. might be considered. If the revenue
still remains inadequate even after the imposition of these taxes, only then special grants-in-aid should be provided. Grants-in-aid should not be considered in isolation without augmentation of the tax base of the local bodies as this would take away their initiative and autonomy.

(c) The procedure for payment of grants to the municipalities should be revised in so far as it related to the loss of Octroi revenue. They should be paid as a direct advance to the municipalities by the Planning Commission at the time of plan allocation and should be adjusted against the revenues due to the State Governments.

(d) The alternative sources of revenue to the local bodies in lieu of Octroi should not only yield revenue equivalent to the amount lost as a result of its abolition, but should be elastic enough to ensure future revenue for the local bodies. Due regard should be paid to the potential of Octroi revenue while deciding the quantum of compensation.

The Eleventh Finance Commission also noted the following:

“Besides the property / house tax, Octroi has been the major source of revenue for the municipalities, and in some states, even for the panchayats. Many states have, however, abolished Octroi with a view to remove impediments to the physical movement of goods, though several other new barriers have been created. Some states have introduced a levy in lieu of Octroi, usually the entry tax, the net
proceeds of which are transferred to the local bodies in the form of grant. During our interaction with representatives of the local bodies, we were told that through the grant in lieu of Octroi given to the local bodies was raised by certain percentage from year to year, it does not have as much buoyancy as the Octroi had. There have also been numerous complaints of delay in release of the compensatory grants. While we do not advocate re-introduction of Octroi, we do feel that there is a need for replacing it with a suitable tax that is buoyant and can be collected by the local bodies. Taxes, such as entertainment tax, which has shown a very good growth, are potential source of increasing the revenue for the local bodies, given that they are linked to the consumption characteristic of good and hence also buoyant.”

**International Literature**

The rationale for fiscal decentralization is well-grounded in theory and it is gaining momentum in many countries. The identified role of local bodies, in the public finance literature, is resource allocation, though they can also contribute to the two other objectives of public finance, namely, macroeconomic stabilization and income distribution. Literature has identified the suitable expenditure responsibilities and revenue sources of local bodies. However, in general, countries assign more expenditure responsibilities than resources to their local bodies, thereby leading to constitutionally, built vertical imbalance in functions and finances. This vertical imbalance, as prominently reflected in the resource gap of local governments, is the basis of inter-governmental fiscal transfers from
national and provincial governments. In the urban context the vertical imbalance, as prominently reflected in the resource gap of local governments, is the basis of inter-governmental fiscal transfers from national and provincial governments. In the urban context the vertical imbalance is getting more pronounced due to population concentration in cities and the inability of city governments to tap economic growth as a source of revenue. Urbanization of Asia in the coming years is likely to put pressure on international resource mobilization and it will in turn get reflected in higher interest rates in the years to come, which is of relevance to central banks. These considerations call for reforms in the structure of local government finance in India.

Indian Literature

Studies in Indian context have traced the progress of fiscal decentralization since the 73rd and 74th Constitutional Amendments. The record of fiscal decentralization to the sub-state level governments through revenue assignment and transfers has been poor. Fiscal decentralization has not made any significant progress in terms of revenues raised and expenditures incurred by a large numbers of local bodies. The dictum that functions, finance and functionaries should be devolved down is observed almost in breach. Decentralization has resulted in improving the tax generating capacity of some urban local bodies, mainly corporations. However, there has not been much impact on non-tax revenues. The size of the municipal fiscal sector is small compared to any conceivable standard, whether in terms of
international comparison or normative considerations. It is evident that the fiscal domain of urban local bodies in India is far narrower than that in most developed countries and several developing countries, mandated to discharge similar responsibilities.

In case of property tax, the introduction of capital value assessment system should be a longer term objective. However, the system is difficult and costly to implement. Area-based property tax system, based on a self assessment scheme, holds promise. A suitable alternative to Octroi has not yet been found out. Given the resource crunch at State and ULB levels, privatization, central state local and public private partnerships and promotion of community based projects are alternate options for creating civic amenities. However, sometimes, the poor are likely to be at a disadvantage in the case of these arrangements. While there is a crucial role for the private sector, the intervention of the state and public policy is imperative to safeguard equity and ecological interests of the society and to enable greater accountability of both public and private actors. The 74th Amendment has envisaged poverty alleviation and slum development as legitimate functions of urban local bodies. This has shifted some redistribution functions of the public sector to the urban local bodies unlike the case in developed countries. Thus, the urban local bodies in India are connected with two major planks of public sector responsibility: allocation and redistribution. However, the revenue assignment required by these institutions woefully falls short of the expenditure assignment.