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Abstract of Doctoral Dissertation

Composition, Growth and Prospects of Finances of Local Bodies of Orissa : Case Study of a Municipality in Kalahandi District¹

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I. Introduction

THE THESIS ADDRESSES financial issues that hinder the smooth functioning of local government in Orissa. In view of the fact that more independence has been given to these institutions, there is room for more discussion about their efficient and equitable operations. As the central and state governments have many important functions to perform, delegation of functions to local self-government especially of local needs relieves the central as well as state government. Allocating functions of local needs to local bodies is based on economy, uniformity and efficiency. The justification for a system of local government also starts from the theory of fiscal federalism. Among the local bodies in Orissa, the contribution of urban centers is significant. However with haphazard growth of urban center and continuous migrations of people from rural to urban areas a great mismatch between finances and facilities has emerged. For this there appears in municipal institutions a loss of credibility. The local bodies of Orissa are mostly handicapped due to scarcity of revenue and the political motivations of the state government, which further worsen the problem. Due to inappropriate urban development policies and compulsions of government for rural development led to severe deteriorations of urban basic services. The financial stringency, which affects, urban local government at present is due to laxity in collection of tax and generation of non-tax revenue. Poor collection and low service standards forms a vicious circle, each leading to the other. So far as budgetary provision is concerned, sanctity in the preparation of the budgets is not maintained. Municipal bodies collect surplus amount and spend the same for other purposes in spite of the

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prohibition under the law. Public expenditure is also expanding due to expansion in the functions of the local government. Without finance, like the central government the government at local level has come to a standstill. But strangely enough, it is noticed that local bodies take a lukewarm attitude towards imposing new taxes or revising the existing tax structures for better civic life results the financial bankruptcy of most of the urban local bodies. This happens in each and every municipality of Orissa for which studying about composition, growth, and prospect of finances of local bodies in Orissa is a necessity. Out of 28 states of India, Orissa consists of 30 districts with 36 municipalities having 123 towns in the state. Out of this Kalahandi is a district known to people as poverty stricken and only one municipality is there i.e. Bhawanipatna municipality, which is also the district headquarter of Kalahandi. To analyze the composition, growth and prospects of finances of local bodies in Orissa, the case study of municipality of Bhawanipatna in Kalahandi district is taken in particular.

II. Objectives of the Study

The specific objectives of the study are as follows:

1. To assess whether the tax structure and other structure of receipt of taxes and fees are adequate to yield the maximum receipts for Urban Local Bodies (ULBs).
2. To ascertain whether the method of assessment and collection is effective to raise adequate resources as per provision of tax laws.
3. To find out whether the pattern of expenditure conforms the needs of the urban local bodies.
4. To study whether existing financial (both internal and external) accounting procedure and audit practices are properly exercised to ensure fiscal discipline.
5. To ascertain whether accountability of ULBs to the legislature would lead to curbing the autonomy in decision-making.

III. Methodology, Hypothesis and Data

3.1 Methodology

The Semi-log model of econometrics has been used to calculate the growth rate of various components of expenditure and revenues. It is a non-linear econometric model which is used to obtain the growth of certain economic variables over a period of time. To test the significance of growth rate t-statistic in the context of hypothesis testing has been used.

3.2 Hypotheses to be tested

The followings are the hypotheses proposed to be tested in the study are:

Hypothesis H1 : The growth rate of total revenue expenditure is higher than total revenue receipts.

Hypothesis H2 : The growth rate of expenditure on public works is significant but declining in absolute terms during the period of study.

Hypothesis H3 : The growth rate of total tax revenue is declining.

Hypothesis H4 : The growth rate of government grants is higher than that of other revenue receipts including tax revenue.

Hypothesis H5 : There is a significant share of extraordinary debt in receipt of the municipality.

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Hypothesis H6 : The growth rate of grant-in-aid to Bhawanipatna Municipality is increasing over the period of time.

Hypothesis H7 : The development programmes determined at a macro level on the basis of macro diagnostic studies at state level do not prove effective enough in making the benefits of development available to backward sectors of the municipality.

Hypothesis H8 : The municipal problems of Bhawanipatna have a regional identity and requires a regional approach both for diagnostic purpose and for policy measures.

3.3. Scope of Study

The scope of the study purposefully kept limited in order to develop focus on certain main economic issues relating to composition, growth and prospect of finances of municipality in Orissa. The present study primarily aims at dealings with the problems of finances of Municipality of Bhawanipatna of Kalahandi district and to illuminate an unexplored area of development for all municipalities in Orissa.

3.4 Database

For the present study relevant secondary time series and cross-sectional data's are collected. Data relating to Bhawanipatna municipality in particular has been collected from the office of the Bhawanipatna municipality, through a prescribed format. The time period covered is the Ten-year period from 1992-93 to 2001-2002. Trends in revenue and expenditure have been examined in nominal as well as in real terms. Sources of revenue and uses of funds have been classified under common heads so as to facilitate comparison in each year. Appropriate statistical formulas and econometrics tools have been used to facilitate comparison and to test their variability.

3.5 Limitation of Data

The most important limitation is that the data were mostly collected for ten years. However the data relating to income and expenditure may vary from year to year. The data for ten years therefore cannot claim to represent the actual picture of the district with absolute accuracy.

IV. Analysis of Data

The computed values of t-statistic both on revenue heads and expenditure heads showed that growth rate of revenue heads like tax revenues and grant-in-aid are statistically significant. The decrease in the growth rate of tax revenue is found over the period of study. So far as grant-in-aid is concerned it is highly correlated to the revenue generation of Bhawanipatna municipality. The share of grant in aid to total revenue of Bhawanipatna municipality is significant. The total revenue receipts is increasing by 3.4% per annum. The tax revenue is significantly decreasing in Bhawanipatna municipality. Similarly the growth rate of non-tax revenue, extra-ordinary receipts and debts, and receipts except grant-in-aid are negative, but not significant. It shows that during the period of study, non-tax revenue, extraordinary receipts & debts have low relationship with revenue generation of the municipality.

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On the other hand expenditure is increasing with a greater consistency. In comparison to current revenue, the current expenditure of the municipality has experienced a comparatively higher rate of growth. It is evident from table-03 that the growth of expenditure of Bhawanipatna municipality is significant in the period of study. So far as expenditure on public works is concerned it is growing at a rate of 30.2% and found statistically significant. Services rendered through public works department alongwith total current expenditure appear to be highly correlated with the level of economic development. Hence the municipality of Bhawanipatna is allocating a significant share on public works out of its total expenditure.

From the study, it is observed that "failure to contain expenditure and reluctance to raise additional resources on the part of the municipality are the main causes" of the deterioration of the fiscal situation.

Broadly it is implied that, for financial management the mobilization of adequate resources for development activities without causing undue hardship to the people and spending the revenues in a judicious manner is necessary. There has to be a careful balancing between these two and any mismatch between them would cause undue strain on the people.

Finally it can be mentioned that the precarious fiscal situation of municipality is not peculiar to Bhawanipatna alone. In fact, all the municipalities of Orissa are experiencing a high fiscal and increasing revenue deficit and declining revenue effort.

4.1 Economic Dimension

4.1.1 Trend in Tax Revenues

Analysis shows that the growth of each of the major revenue head has shown deceleration in the growth from 1992-93 to 2001-02. Revenue from octroi constitutes two thirds of municipality's own tax revenues and its complete abolition from 1999-2000 on words is the major factor responsible for the slow growth of tax revenues.

From the viewpoint of horizontal equity, revenue productivity & to compensate loss from abolition of octroi, levying holding tax at 10% and proper assessment of annual rental values of property is necessary. For improvement in the collection of property tax, the Rent Control Act needs to be changed. Fixing zonal rates by use/location, nature of occupancy (as practiced in Andhra Pradesh) based on local advantages, could remove the mistakes of assessment. Lastly strict rules are to be implemented to punish defaulters, so that the amount of current receipt be increased and arrears can be decreased.

Another reason for the deceleration in the growth of taxable revenue has to be found in the inability to extend the base of the service sector also. As municipalities are allowed to levy tax on limited services, (restricted to holding, water, light, drainage etc.), the production and consumption of services remain outside the tax net. With this, property tax remittances were also low due to poor quality of services, such as poor water quality, low water quantity, bad sewerages, poor road conditions, pollution etc.

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In total the bases of municipal taxes are rendered narrow also because of large-scale exemption, evasion and avoidance of taxes. Absence of a mechanism to objectively determine the benchmark values by stratifying properties according to the factors influencing the property tax, which has led to continuous reduction in the tax and become an acceptable practice in most of the municipalities.

4.1.2 Declining Non-Tax Revenues

Inability to recover reasonable returns from the investments has been a major reason for the low and declining growth in non-tax revenues. Except the year 1994-95 & 1995-96, whatever amount of money invested by the municipality, they yielded hardly any return. In case of construction of schools & shops the generation of revenue on this head is so low that, do not recover even a fraction of the capital cost. Even more concerning is the fact that the commercial losses as a ratio of net fixed assets have shown steady decline in the municipality through the decade of the 1990's and the policy measures implemented thus far have been ineffective in reversing the trend.

4.1.3 Intra-Functional Allocation

The study of intra-functional allocation of expenditure of the municipality of Bhawanipatna led to conclude that the management of funds in this institution is not exactly satisfying. Likewise the growth of expenditure on all the heads during the period from 1992-2001 has been quite significant. During this period though the growth has been more on current account, real per capita expenditure has not shown much improvement. Another noticeable feature is that it is income-elastic but prices have had a dampening effect on its movement over the period. Function wise expenditure shows more variation of expenditure throughout the periods of study. In many cases the expenditure that is incurred by the municipality on paying salaries to their employees makes up a large chunk of the total expenditure. Whether these expenditures are backed up by expenditure on supplies for the employees to function efficiently is to be examined. In many a case the study reveals that almost all the expenditure under certain heads is going towards salaries while hardly anything is spent on their equipment or supplies.

4.1.4 Interpretative Comment

Restoring fiscal balance of a municipality is inextricably linked to the improvement in the collection of tax revenue and reversing the trend of non-tax revenue mobilization. Poor financial condition of a municipality should be attributed to poor tax collection and poor cost recovery from public services. Analysis of various social and economic services at Bhawanipatna municipality shows that cost recoveries are not only low but also has shown a decline over the years. The studies show that the malice of poor cost recovery does not lie merely in uneconomic pricing of these services. Often the problem is one of poor efficiency in their provision and increasing the prices will simply pass on the burden of production/distribution inefficiency to the consumer.

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It is also clear indication of the incapability of the municipality to tap the potential revenue sources for resource mobilization. This is mainly due to the non-commercial approach in the provision of urban basic services, which has left its cost recovery at a significantly low level.

So by concluding it can be said that, though the new macro-economic management policy and the process of urbanization enjoin upon the municipality to provide a modicum of basic urban services and infrastructure for enhancing the quality of life, as well as giving needed support to enhance efficiency of the town, the trends in resource generation from own sources of revenue has not been encouraging.

The following conclusions can be derived from the above discussions regarding the financial situation of Bhawanipatna municipality. Firstly significant dependence of the municipality on external sources of revenue is evident and continues to exist even today. Secondly tax sources are the major contributions to the revenues of the municipality and gaps between tax and non-tax sources increased as local revenue sources have widened after the 74th CAA 1992. Thirdly irrespective of the level of development of the state, the post-decentralization impact on resource mobilization capacity of the municipality has remained insignificant. However the above detailed sector wise studies about Bhawanipatna municipality demonstrate considerable scope for raising revenues from the existing taxable sources and targeting various remunerative projects. Lastly whatever the long run sustainable initiative pled by the Bhawanipatna municipality towards improving revenue would be short-lived without a buoyant source of revenue that have the potentiality to grow with town's income. The study specifically focuses on the own sources because at the end of the day it is capacity to generate revenues from own sources that matters. Dependence on external sources of revenues would limit the extent of development.

So from the above discussions it is viewed that the municipality of Bhawanipatna is entitled to differential treatment, having regard to the peculiar need of expenditure on a larger scale on works of public utility befitting its position as the head quarter of a poverty striven district (coming within the red contour line called "KBK" region) and requiring works of a more expensive nature. It will not be right to treat it on the same footing as other towns in which, for instance, first class roads, costly drainage system and public utility services on an efficient scale are not as great as a necessity as in Bhawanipatna with its distinctive population. Bhawanipatna as a cultural and political center with its traditions should maintain a standard with other municipalities in the state could dispense with. On the other hand not being an industrial or commercial center its own source of income do not compare favourably with other towns of the state. Therefore, a case be made out for special treatment in case of the municipality of Bhawanipatna.

4.2 Urban Local Bodies of Orissa: Implications of prospects of finance

Any substantial improvement in the management of urban local bodies in Orissa demand at the first instance far reaching changes in the administrative structure and finance of local government. Much is required

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to be done to enhance the institutional capabilities of municipal governments. Local government in general and municipalities in particular continue to be the seat of financial problems since days of their full fledged establishment in immediate post independence era.

The crucial requirement of financial autonomy for local bodies is yet to be remedied because anything expected is left to the Orissa State Financial Corporation(OSFC) that cannot perform miracles in existing situations. The similarity in pattern of income of local government throughout Orissa has not been investigated anywhere.

Thus strengthening of fiscal capacity has become an imperative for enhancing their institutional capacity. The 74th Constitutional Amendment Act entrusted several new functions to urban local bodies and brought them a chance for resource mobilization. Besides the traditional tax sources, there exist other innovative tax instruments related to income and consumption which are related to growth in urban economies and are buoyant and elastic, i.e. surcharge on electricity, on petroleum products. Local business license tax as in the Philippines is again a promising tax for local resource mobilization. So also the non-tax revenue bases have great potential for giving a substantial boost to the financial autonomy of these grass root organizations in Orissa. At present scenario of privatization, liberalization and globalization the local bodies in Orissa can encourage the private sector to enter into market related activities.

With this searching of viable investment projects be done, which requires meticulous examination by the local government taking into account the past experience. Market considerations need to be viewed for any project. Cost benefit ratio should be a parameter for selection. Emotionalism should not play a role in selecting a non-profitable item. Thus though the financial aspect of local bodies in Orissa, looks gloomy, still a ray of hope of is there. The gap between expenditure and revenue receipts be minimized, and utilization of funds be taken properly for effective management in local bodies.

V. Major Findings

Keeping in view the analysis of the study,the following are the major findings with regard to the municipalities of Orissa .

Firstly, in India the 73rd and 74th Amendments to the constitutions have no doubt created fiscal federalism but there is a lot of vagueness in this framework. The provisions under these amendments do not specify clearly the expenditure functions and revenue sources of ULBs. Though they are mentioned in the 11th and 12th schedules, the actual assignment is left to the state government legislation.

Secondly, coming to the specific focus of the emerging trends in local government finances, it implies that some new trends have emerged in recent years. But after studying the finances of urban bodies in Orissa, any such new trends are not discernible in the horizon of local government finances. It is felt that State Finance Commission (SFC) has to initiate new trends in

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the local government finances in Orissa. Thirdly suggestions are made for the adoption of Patna model of property tax collection, increasing user charges, substantial financial transfers from the state governments. But with the existing Rent Control legislations and easy accessibility to civil courts, they have become non remunerative.Fourthly, it is possible to raise loan funds for capital works like water supply, sewerage disposal through municipal bonds. But financing through municipal bond requires some preconditions, which are difficult to be fulfilled by any municipalities of Orissa.

An analysis of the expenditure pattern of the ULBs of Orissa reveals a dull uniform pattern. There has not been any uniform budgeting practice with regard to the classification of the expenditure of municipal bodies. Definitional and conceptual problems make it difficult to compare expenditure levels also. One of these is the creation of autonomous local public enterprises like water supply, sewerage etc. These enterprises are set up by state government or operate as separate wing under municipal corporations. Therefore such capital expenditure does not figure as part of the budget of local bodies. Apart from this various systems of cost recovery and accounting procedures relating to maintenance expenditure also making comparison difficult. At last it is shocking to realize that the CAG's budget classifications were not made applicable to municipal bodies.

VI. Suggestions

Against this background the following are the policy options given to support the decision making process of strengthening finances of urban local bodies in Orissa. First, there is a need to evolve a specific practical scheme of property taxation for ULBs in Orissa. Also the collection of tax could be improved through a judicious mix of incentives and penalties.

Second, identification of specific users charges for the ULBs other than water rates is necessary. In other words these ULBs should have an important indirect tax to meet their liquidity requirement as well as to yield buoyant revenue. Third, ULBs should be encouraged to raise loans for creating income-earning assets. Correspondingly the state government should provide legal support by amending the existing laws rent control and to make it difficult for people to approach lower courts for frustrating the efforts of these local bodies from earning revenue from their assets. Fourth, it would be appropriate to encourage the ULBs, to become financially viable and raise funds through municipal bonds. However without appropriate measures towards decentralizing fiscal power to the municipal bodies through innovative mechanisms, accessing market funds by ULBs would remain a distant dream.

Besides greater attention should be paid to the mobilization of non-tax revenue. For this effort should be made to create common community assets such as community halls, market complexes and shops from which additional non-tax revenue could be mobilized. If local governments are to survive under the new horizons of constitutional umbrella they must not forego the revenue. It is further suggested that attempts should be made to

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workout the modalities for the identification of users of the various local government services and the class of people who could be potential contributors of local non-tax revenue. The existing financial stipulations that municipalities should always have surplus budget should be removed. It is enough if they balance their budgets. Finally, it is recommended that a separate financial institution should be created in each state to meet the loan needs of the municipalities for construction of remunerative enterprises.

On the expenditure side, fragmentations of municipal functions should be avoided and all urban development related agencies functioning independently should as far as possible be brought under the executive control of elected municipal bodies.

At last, the thrust has to be on containing the expenditure on non-remunerative schemes, increasing the user charges, prioritization of expenditure, reduction of administrative expenditure, optimum utilization of municipal staff with appropriate redeployment. On the revenue side the municipalities have to take measures for the expansion of the tax base, improving revenue collection by removing bottlenecks, phasing out the non-merit concession on taxation etc. Efforts need to be taken to mobilize additional resources.

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