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Problems and perspectives of financial decentralization in India

In this article, selection of an appropriate policy for government is taken into consideration to achieve some positive results through its implementation. According to authors, these results can be followed by adjusting to the situation which world brings as a result of progress. Some countries change their socialist economy to capitalization because it is not only beneficial for government and it is also trend of modern world. In this article, the concept of «Public Policy» can be exemplified by the implementation opportunity of financial decentralization in India. The authors analyze financial policy transformation in the country and challenges which faced during this reform. Referring to authors, fiscal decentralization and local governance have positive impact which can lead to development in general especially, for the case of India. This economic growth shows lower violence than before and considerable reduction in poverty. Therefore, political and economic decentralization may boost development because these can provide enough infrastructure and human resources to provide an implementation of public policy in India.

Keywords: finance, public policy, decentralization, financial policy, implementation, policy, economic growth.

1 Introduction

The concept of «Public Policy» is a fairly common one which is implemented by almost all the nations. However due to the diverse circumstances of its application along with the fact that human beings have different perceptions about things, this concept draws various interpretations attached to it. Nonetheless this concept still has a common reference point for its users from various disciplines. It mainly refers to the actions of the government in order to fulfill the aspirations and yearnings of its citizens. This refers to actions undertaken by the government in course of distribution, regulation and redistribution of resources in the society. Although it is not compulsory that all such actions need to be exclusively emanated by the government, these actions can be initiated by the citizens as well. However, such initiatives taken by public require to be acted upon by the government before they can appropriately be called as public policy (Dlakwa, 2009) [1]. Therefore, this concept is central to the government, public and the private organizations. These policies require commitment of lot of time, resources and energy from the government and few such policies might even take years to formulate but once they get enforced, these are regarded as «guiding stick» in the related activity areas. There is much time and energy spent by both public and private organization officers for articulating these policies and explaining how these policies will fit in the existing set up. Rather the common man's perception about the policy is shaped by what such organizations and the government talk, present and do. The concept has become more confusing and ambiguous due to its frequency in public discourse. Every public policy is evaluated from the viewpoint of individuals, government departments, clubs, families, large and small business organizations, communities, cultural groups etc. (Ikelegbe, 1996) [2]. However, the focus always remains on government policies since the government policies give direction to the economy and also induce repositioning of the society in such manner which ensures maintenance of law and order. For a developing economy like India, the public policy is extremely crucial as it works as a spring board to channelize growth. However, in the Indian context it has been observed that the public policies are easily formulated but the proper implementation of these policies remains a great challenge.

2 Conceptualizing public policy

The concept of Public policy does not come with a single meaning to refer. It is looked at from various perspectives based on the demographics, environment and the situation arising from the subject under discussion. Robert and Clark (1982) explained public policy from the view point of power configuration and goal attainment [3]. They explained that the process of public policy making refers to: the steps undertaken by government to resolve problems, decision making, allocation of resources, implementation of policies and overall all those activities which are expected from them by their constituencies. In democracy, the role of

political class in setting the agenda which leads to framing of public policy is very important. Keeping that in mind, the public policy can be considered as series of interrelated decisions by a politician or a political party about the setting of goals and process of achieving them in a specific situation where such decisions should principally be within the span of power of the politician or political party to achieve (Jenkins, 1978) [4]. Whereas, according to Sharkansky (1978), Public policy can be referred to an on- going program or a proposal, the objectives of a program, the key decisions of the refusal for making certain decisions [5]. This definition is highly debatable as it considers the in-action of the government also as a policy. However, our major focus is not the inaction of the government but the government’s actions towards the policy directions as it affects social security, health, education, agriculture, poverty reduction etc. Therefore, the public policy can therefore be described as the decisions of the government affecting the social and socio-economic development of the country.

3 Decentralization in India

Since the late 80’s there have been a strong consensus based upon various objectives and perceptions that there is requirement of decentralization and more power should be given to the city and town governments (Milbert, 2000) [6]. India proves to be a good example of the decentralization reforms initiated during the 1980’s and 90’s. The decentralization policy was taken as a priority by the Indian Government in 1986 and it was implemented and practiced simultaneously with the economic liberalization. The objective of decentralization is transferring all the elements of the democratic system to the local level which also includes political freedom, sovereignty and equality. According to Blair (2000), the local government body is a meaningful authority which is accountable and accessible to the local citizens and it also enjoys full political liberty and rights. The main objective behind decentralization is for ensuring that the political representatives who are locally elected, focus more towards the needs of the local citizens through increased public participation and by increasing accountability of local bodies to the local public. Another objective of decentralization in India was to provide municipal governments with constitutional status in order to initiate decentralized and participative democratic government for the urban areas (Fig. 1).

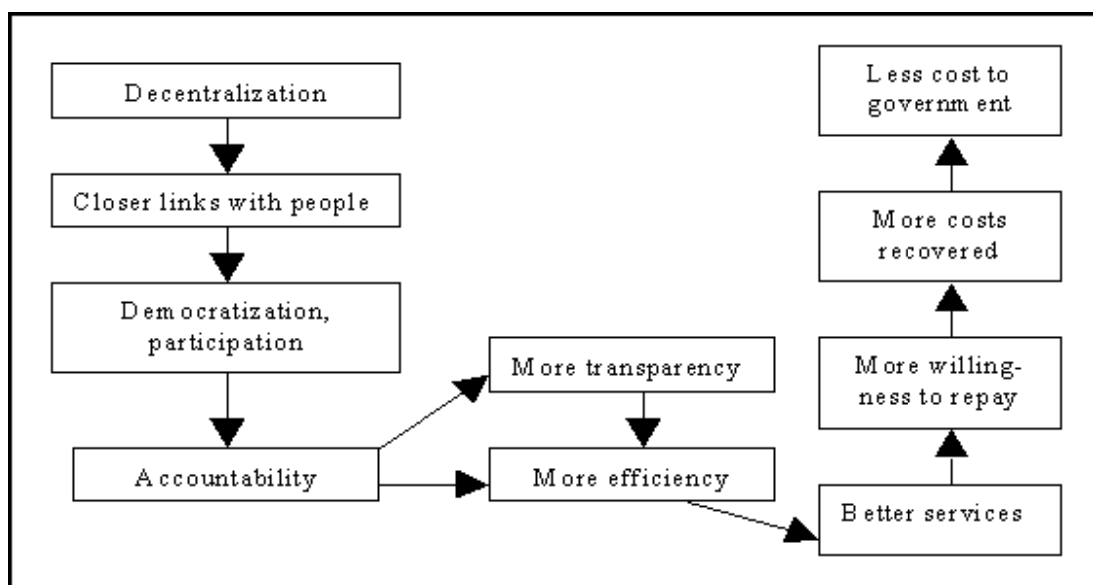


Figure 1. Rationale of Decentralization

In the year 1992, there were two constitutional amendments made regarding the urban and rural decentralization. Considering the federal context, the heavy responsibilities will continue to be borne by the state regarding the legislation and implementation of 74th Constitutional Amendment Act (CAA). Subsequently, all state legislatures cleared confirming legislations for the implementation of CAA although in several cases, this exercise was just obligatory (CRISIL, 2008: 3) [7]. The 74th constitutional amendment denotes financial self-sufficiency of local government. There were massive efforts made to improve the terrible condition of municipal finances during the 1980s when several municipalities received annual budget of approximately just 1 dollar per capita. According to O.P. Mathur(2003), the tax revenues which were locally gener-

ated, amounted for merely 6.9 % to the total central government revenue and about 10.4 % of the state government revenue [8]. While the revenue raised by municipal governments was about 20 % of the central government revenue, the revenue raised by urban municipal areas was equivalent to 50 % of the national GDP (gross domestic product). This indicates that the urban local bodies were not imparted adequate tools for establishing strong connection between the resources and the activities in their local jurisdiction (Mathur 2003). Bercegol (2012) also found that there was lack of political willingness for levying taxes at the city/town level [9] (Fig. 2).

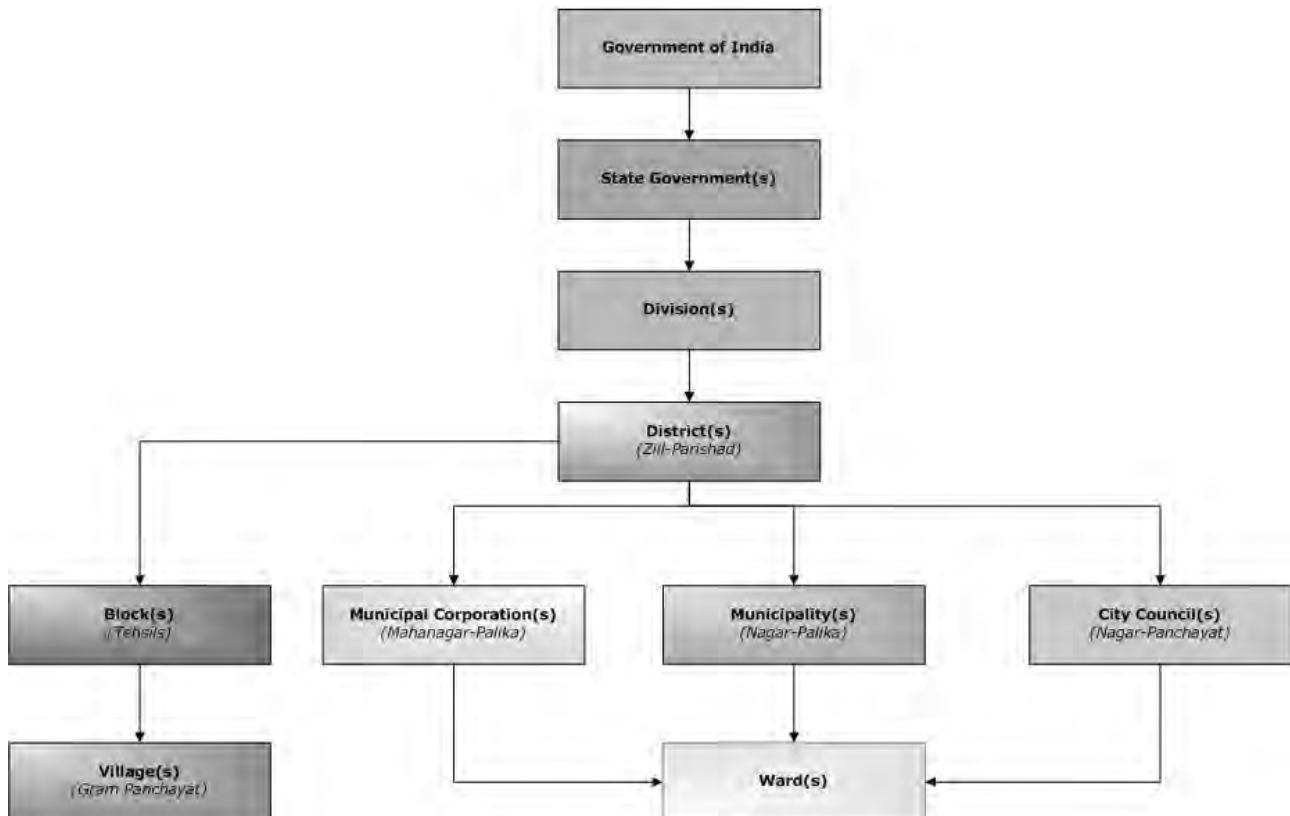


Figure 2. Administrative structure of India

Later various municipal corporations and states made efforts for reforming property taxation such as in Andhra Pradesh and Municipal Corporation issued bonds in Gujarat (Mathur, 2003). However, a more recent study by CRISIL (CRISIL, 2008) still made similar findings as that of Mathur: In the Indian economy, the power of urban bodies to raise revenue has become crucial for boosting growth and there has been substantial shift in the growth pattern which is largely shifted towards the urban bodies in last 20 years. However, even in the last two decades there have been no alterations made in the basic revenue structure of urban bodies. The two-major source of revenue i.e. user charges and property tax are inadequate for funding urban investment and there is requirement of spending approximately spending INR 30000 per capita to improve the infrastructure of cities. The average revenue contribution of top 42 Indian cities amounted to just INR1,700 per capita which clearly indicates that the existing revenues will not suffice to finance the infrastructure investments (CRISIL, 2008).

4 The challenges

The Constitutional amendment also directed the establishment of state finance commissions but they have not been able to solve the perennial discrepancies between central/state resources and municipal resources and therefore the municipal bodies are not proportionately benefitted with the increasing wealth of cities (UNDP, 2001) [10]. The finance made available to the local bodies in urban areas is not sufficient to meet the fund requirement for performing the major municipal functions and therefore these bodies are dependent upon bureaucratic lobbies and state governments to get funds (UNDP, 2001). There have been several measures suggested to improve the financial weakness of the urban local bodies which include levying

new duties, replacing the octroi tax and revising the property tax assessment method. However, till now the urban local bodies of India are facing great challenges in raising their revenues and levying taxes due to the environment of lack of trust from their constituents (Kalirajan and Otsuka, 2012) [11].

There are also issues related to human resources in the Indian local bodies. India currently has about 3000 elected mayors and 60,000 municipal councillors. Even today, the task to train the local politicians in India is quite challenging as compared to other countries where the candidate's electoral success is dependent on how he fits in the local network and his practical knowledge about the city's issues. However, in India, several municipal councillors lack reasonable educational qualification to analyse the complex documents such as the budget, legal documents, appraisal reports etc. and they also lack experience in urban management. Apart from this, there are very few institutional structures in India which provide quality training to such representatives especially at the state level. Hence, they are generally trained by their political party or by support of the peer group. (UNDP, 2001). Similar training issues are also observed in case of municipal staff who are recruited on local basis and in many cases, they are not able to accomplish the new tasks assigned to their institutions. Therefore, there is immense need to at least basic level of quantitative and qualitative training of the municipal staff (Vaidya, 2007) [12]. Therefore, there are two major challenges faced by urban local bodies: lack of political willingness to share power and the reluctance of state's bureaucrats to share their entitlements with the local institutions who are still facing quality management issues (Mohan, 1997) [13].

5 Decentralization and Privatization in India

Since beginning, decentralization was linked to private local development as it has been mentioned in the United Nations documents (1964) that the governments must decentralize the decision-making powers as soon as possible in order to boost the social and economic development and make sustainable programmes (Thévoz, 1999) [14, 15]. During the early stages of decentralization, the municipalities were not able to handle the ever-growing demand and due to the failure of public bodies there was need of privatization in order to increase the efficiency. In the privatization process, many structural changes were made such as recentralization, public-private partnership etc. During the 1980s, privatization and decentralization process were simultaneously progressing but often privatization process is perceived to be a weakening factor against the basic objective of strengthening the local bodies and making them financially independent.

In the Indian context, there are three ways in which decentralization is closely related to privatization: The most important being outsourcing of urban services such as water garbage collection etc. to the private sector (Baud, Dhanalakshmi, 2007) [16]. However, there are other instances of privatization of cities itself and as well as privatization of urban management staff. However, the new provisions and liberalization policies which were launched for facilitating public-private partnerships could not provide for better infrastructure management and basic urban services (Singh, 2006) [17]. For instance, the development of cities of Faridabad and Gurgaon where the Haryana government tried promotion of modern cities which were industry friendly by redesigning the institutional mechanism in order to fill the gap between the infrastructure investment and the industry needs. Later due to the unexpected pace of urban growth and flow of huge private investments, the state government was not able to meet the demand and there was chaos in providing basic services as transportation, electricity and water supply and therefore the municipal bodies were side-lined in the development process.

The privatization process is also evident in the urban management. There are several tasks such as city development planning for which there is lack of required expertise with the urban local bodies. Such tasks are now outsourced to big engineering companies and highly trained consultants who prepare, monitor and assess the projects and also provide technical expertise for new policy formation and urban research. In few instances, such activities also include municipal staff training (financial management, e-governance etc.). However, these practices may have their own repercussions as they will further side line the inexperienced municipal staff. The process of decentralization is closely linked to privatization in many cases which has created competition amongst the cities and has led to advent city marketing techniques attracting private investments, although the lack of sound leadership has also mitigated these efforts.

There have been several new cities developed in India in absolute compliance with the town- planning norms irrespective of the fact that whether they were developed for political and strategic reasons (for instance, Bhubaneswar, Chandigarh) or if they were developed for economic reasons (mining sites, heavy industries) or for the urban land development (for instance, Navi Mumbai) (Shaw, 2004) [18]. Maximum of such new cities built and planned by the centre government but also there would be authorization of new pri-

vate town on the mining industry sites (Mitra, 2002) [19]. The government's intent of establishment of municipal authorities after the completion of the private new town setup has caused clash of interest with the private builders who wish to retain complete ownership of the township developed by them. The city of Jamshedpur is one such example, this city was developed by Jamshedji Tata in the year 1907. This steel city has population of 1.3 million (as in 2011) and is managed by Tata Industries and has unmatched record of providing excellent services.

Another example of defiance towards the urban local bodies is the establishment of Special Economic Zones (SEZ). The distinctive features of special economic zones were defined in SEZ Act, 2005 And SEZ Rules, 2006. These zones are basically duty-free destinations given the treatment of foreign territory for duties, tariffs and trade operations. The investors and developers operating in these zones are provided several tax incentives to encourage them to create suitable conditions for export promotion, job creation and private investments. The Indian government has high expectations from SEZ policy and it is projected as the attempt of Indian Government for launching second generation reforms as well as continuing the earlier initiatives for boosting exports. These special economic zones have allowed the government to push radical economic reforms on a localized basis in an adequately big geographical area without facing the difficulties of launching such reforms on the national level. Therefore, there is significant relationship between special economic zones and export promotion. Simultaneously, SEZ are also considered as laboratories for experimenting with spatial management and economic liberalization.

There has been favourable response of big Indian companies towards the SEZs. The establishment of such SEZs have facilitated development of large geographical area and avoiding the issues associated with the cities such as environmental concerns, political issues, slum areas and make a fresh start from zero ground where the investor and planner can work together in a hassle free and internationally competitive environment for exports. An interesting fact about SEZ is that they are not presented as tools for land development or urban settlements policy elements in the official documents. In the past few years, the private sector of India, especially the largest industries such as Tata, Mahindra and Reliance have quickly grabbed the opportunity and made their investments in these zones due to its several financial advantages. So far, there have been 500 special economic zones approved which are spread over thousands of hectares of land and are presently in the stages of planning and implementation. These zones have facilitated the private sector to make their way in the urban investment field and also in the field of land development (airports, road construction, suspension bridges etc.). However, there is contrasting attitude of private sector regarding the SEZ opportunities offered by various states in India. There is deep contrast in the west / south region and north-east region of India. From 2009 onwards, there are plans to establish 50 SEZ in Tamil Nadu, Maharashtra and Gujarat while as in 2013, only one SEZ has been established in Chhattisgarh, Madhya Pradesh, Jharkhand, and Orissa (Ministry of Commerce and Industry, 2013). If this trend continues, such *de facto* privatisation of new town policy and land development would create an outright reversal of the national planning strategies which for the first four decades post-independence had strong perception that the backward regions can attract development by creation of required infrastructure.

6 Conclusion

India has enacted significant measures for political decentralization but so far, the fiscal decentralization has not picked up significant pace. The fiscal liberalization of India has allowed free market to regulate the demand and supply and has helped the country in generating higher GDP numbers which has brought it to international attention. The planning institutions in India still find their roots in the socialist economy which India opted in the beginning and this is proving as a constraint in the development and growth of the economy and is causing poor financial management at the local and state level. After independence, the financial policies of India focused on socialized industrialization and it still has deep rooted socialistic agenda which relents to liberalization only when required. The dependence of state governments on central government for funds and its limited authority on fiscal decision making has further led to creation of various economic barriers in the nation. The tendency of states trying to fully capitalize their limited revenue authority (tax on goods entering the state and tax on trade activities in the state) has further repressed the economic activities at the entrepreneurial level (The Economist, 2006) [20]. Unlike other countries where the migration of workers mitigates the earning differences between various states, the language and cultural differences in India make the workers migration very difficult (Cashin, 1996) [21]. Due to this reason, the per capita income of the poorer states is not able to bridge the gap with the national per capita income which mostly happens in the other developing economies (Cashin, 1996). The central government is facing great challenges in

the implementation of fiscal decentralization as it does not merely have to prepare the infrastructure for the decentralization. Almost seven decades of working in a non-centralized (not entirely centralized) planning system has caused lack of domestic fiscal intelligence which needs to be improved on an urgent basis. The central government will face tough political hurdle to wean off the states from central funding in order to improve the state governments accountability in the long run. However, this can be achieved by spreading education and encouraging public participation for improving the efficiency and quality of service delivery in the country. The report of World Bank (2004) on the economic reforms of India gave many recommendations which highlighted on the significance of fiscal decentralization for boosting economic growth which is in line with the findings of previous research studies on this subject. The recommendations from World Bank included [22]:

- expansion of privatization of public sector such as irrigation and power sector to improve revenue collections and overcome the efficiency and theft losses;
- local bodies should be transferred service responsibilities;
- consumer awareness must be promoted and there should be more transparency to ensure appropriate and timely services;
- the service authority should be granted to states so as to abolish the inter-state tax on trades.

Since India has a capable central government with efficient institutions, the challenges for fiscal decentralization can be largely mitigated. Those state governments which have strong local governance have positive economic growth face minimum violence and have also achieved significant reduction in poverty. Therefore, it can be concluded that a committed central government can certainly boost development by political and economic decentralization to state and local governments by supplying adequate infrastructure and human resource to handle the authority and responsibilities.

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Үндістандағы қаржылық орталықсыздандырудың мәселелері мен келешектері

Мақалада белгілі бір оң нәтижелерге қолжеткізу үшін елдердің тиісті мемлекеттік саясатты таңдау барысында оны жүзеге асырудың мәселелері қарастырылды. Авторлардың пікірінше, бұл оң нәтиже ағымдық жағдайға бейімделіп, әлемдік үдерістің қолжетімді нәтижесіне әкелуі мүмкін. Кейбір елдер социалистік экономиканы капиталистік экономикаға ауыстыруды дағдыға айналдырған, себебі бұл мемлекет үшін ғана тиімді емес, сонымен бірге қазіргі әлемнің үрдісіне де пайдалы болып келеді. Бұл мақалада Үндістанның қаржылық орталықсыздандыру мысалында мемлекеттік саясатты жүргізу мүмкіндіктері қарастырылды. Авторлар Үндістанның қаржы саясатының трансформациясын және осы реформаларды іске асыру барысында кездескен мәселелерді талдайды. Авторлардың пікірінше, Үндістанда жүргізіліп отырған қаржылық орталықсыздандыру саясаты жергілікті өзін-өзі басқару органдарына оң әсерін тигізеді және тұтастай алғанда елдің одан әрі қарай дамуына тиімді болуы мүмкін. Алынған нәтижелер елдегі экономикалық жағдайдың өсуін зорлық-зомбылық деңгейінің төмендеуімен және кедейшілік ауқымының едәуір қысқаруымен байланысты екенін сипаттайды. Демек, саяси және экономикалық орталықсыздандыру дамуды ынталандыруы мүмкін, себебі ол Үндістандағы мемлекеттік саясатты жүзеге асыру үшін қажетті инфрақұрылымды және адам ресурстарын қамтамасыз ете алады.

Кілт сөздер: қаржы, мемлекеттік саясат, орталықсыздандыру, қаржы саясаты, іске асыру, саясат, экономикалық өсу.

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Проблемы и перспективы финансовой децентрализации в Индии

В статье рассмотрены проблемы выбора соответствующей государственной политики странами для достижения определенных позитивных результатов в ходе ее осуществления. По мнению авторов, за этими позитивными результатами может последовать адаптация к текущим ситуациям, которую мир приносит в результате прогресса. Некоторые страны меняют свою социалистическую экономику на капиталистическую, потому что это не только выгодно для государства, но и является тенденцией современного мира. В данной статье исследованы возможности проведения государственной политики на примере финансовой децентрализации Индии. Авторы анализируют трансформацию финансовой политики Индии и проблемы, с которыми пришлось столкнуться в ходе проведения данной реформы. По мнению авторов, политика финансовой децентрализации, проводимая в Индии, оказывает позитивное воздействие на местное управление и может привести в дальнейшем к развитию страны в целом. Полученные результаты свидетельствуют об экономическом росте страны с более низким уровнем насилия и значительным сокращением масштабов нищеты. Политическая и экономическая децентрализация может стимулировать развитие, поскольку может обеспечить достаточную инфраструктуру и человеческие ресурсы для реализации государственной политики Индии.

Ключевые слова: финансы, государственная политика, децентрализация, финансовая политика, реализация, политика, экономический рост.