

Supporting Local Governance Series

## EFFECTIVE DECENTRALISATION

A Research Scoping Study

# WORKING PAPER



Chris Heymans, Andrew Preston, Richard Slater

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**SUPPORTING LOCAL GOVERNANCE SERIES  
EFFECTIVE DECENTRALISATION**

A Research Scoping Study  
Final Report

Prepared for:  
**THE DEPARTMENT FOR INTERNATIONAL DEVELOPMENT**

Chris Heymans  
Andrew Preston  
Richard Slater  
June 2004

***GHK London Office:***  
526 Fulham Road,  
London, SW6 5NR  
United Kingdom

Tel: +44 20 7471 8000 Fax: +44 20 7736 0784  
Website: [www.ghkint.com](http://www.ghkint.com)



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## Acronyms

ADP	Annual Development Plan (Grant)
AE	Assistant Engineer
AP	Andhra Pradesh
BATF	Bangalore Agenda Taskforce
CAA	Constitutional Amendment Act
DBSA	Development Bank of South Africa
DFID	Department for International Development
FFW	Food for Work
FSFC	First State Finance Commission
GoB	Government of Bangladesh
GoI	Government of India
GoWB	Government of West Bengal
GS	Gram Sarkar
IAS	Indian Administrative Service
ISD	Infrastructure and Service Delivery
ISS	Institute of Social Sciences
LGED	Local Government Engineering Department
MP	Madhya Pradesh
NGO	Non-Government Organisation
O&M	Operation and maintenance
PRI	Panchayati Raj Institutions
SALGA	South African Local Government Association
SC	Schedule Caste
SEC	State Election Commission
SFC	State Finance Commission
SLGDP	Sirajganj Local Governance Development Fund Project
SSFC	Second State Finance Commission
ST	Scheduled Tribe
TK	Bangladesh Taka
UN-IAWG	United Nations Inter-Agency Working Group (on decentralisation)
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Program
UZP	Upazilla Parishad
ZP	Zilla Parishad



## Executive summary

The final report of this scoping study sets out a research agenda on the practice and impact of decentralisation. Decentralisation lies at the heart of effective local governance, but local government capacity is often fundamentally constrained by insufficient devolution of finance and human resources or the control of these resources. Lack of a clear understanding of the impact of decentralisation on local service delivery and the poor also hampers effective implementation even if policies are well designed.

The literature review demonstrates the multidimensional nature of decentralisation, and highlights structural, fiscal, administrative, legal and regulatory factors pertinent to decentralisation. It also identifies the paucity of information and excessive aggregation of problems in research. Other methodological issues include unclear definitions, and a series of measurability challenges. It is often not possible to isolate decentralisation as a variable, which makes measuring its specific impact difficult.

There is a need to disaggregate individual components of decentralisation and to consider their impact upon service delivery and poverty reduction. Concerned with practical analysis, and not only conceptual issues, the study looked at South Asian experience in exploring issues within this region foremost, but possibly also elsewhere. Field consultations have been undertaken, focusing on two levels and two dimensions of decentralisation. These are presented as case studies:

- *A macro level analysis of decentralisation and fiscal frameworks in India:* This recognises the centrality of fiscal dimensions to the effective implementation of a decentralisation agenda. The nature and extent of decentralisation within India is delineated, and there is then analysis of the fiscal frameworks governing the operation of local government. The focus is primarily on the state-local government fiscal relations, and there is comparative analysis of the key aspects of frameworks in different states. A more detailed consideration of the experience of Karnataka and West Bengal is included in Annexes 1 and 2. This analysis highlights potentially significant dimensions of fiscal frameworks and shows clear knowledge gaps, in which additional research is required. The Indian findings reinforce those of the literature review. The study suggests that there remains a need for a more systematic mapping of a range of dimensions of fiscal practices and experience across states. Furthermore it highlights the need for the constituent parts of fiscal practice to be unpacked, with further analysis of how specific fiscal instruments impact upon the overall performance of local government and service delivery specifically. Thus, for example, the operational modalities and impacts of instruments such as incentive based funding need to be explored in greater detail.
- *A micro level case study of local governance and service delivery outcomes in Bangladesh:* This explores the impact of decentralised institutional arrangements upon service delivery and the poor, based on a field assessment of a UNCDF supported decentralisation and local governance programme in Bangladesh. The case study describes the innovations introduced under the pilot project and the associated impacts, as contrasted with conventional local government financing, planning and management systems. There is exploration of the conditions necessary for improved local services.

At the micro level, the Bangladesh case study provides useful empirical findings on how a specific set of decentralised institutional arrangements impact upon service delivery. The study directly shows that local government does have the potential to deliver improved local services and better local governance. Moreover it provides some quantification of the extent of these improvements. The study starts to show the associated measures and conditions that are needed for local government to “deliver” efficiently and effectively. This includes dimensions such as capacity building requirements, forms of participatory planning, accountability mechanisms and so on.

The overview highlights a dearth of systematic empirical work and proposes therefore that DFID research could add most value through location-specific studies of fiscal, governance and operational dimensions of decentralisation. It proposes:

- An *applied approach*, focused on local level priorities and information needs;
- A focus on *disaggregating* the most significant dimensions of decentralisation and considering their individual impacts;
- A focus on *comparative and contextualised* research within and across countries and regions;
- A concern with local *practice and outcomes*, especially for the poor.

The South Asia work thus far provided direction for such an approach, and could be replicated in other parts of the world. A DFID research programme should therefore draw on country offices to facilitate case specific research, while the central Policy Division creates an in-house or contracted facility to ensure proper comparative analysis, at least of the following aspects:

- *Fiscal and functional mapping*: This would involve a comparative mapping and tracking of functional autonomy and accompanying resource flows to the local level associated with different devolution frameworks of selected states.
- *Policy and Services Impact Framework*: While several complexities remain, real cases would assist to improve methodology for measuring impact on services. This has to be quantitative and qualitative, linking service outputs to costs, governance and choice. The development of a framework that would assess the level of opportunities and risks associated with different fiscal and administrative devolution mechanisms and arrangements, would help to establish the minimal capacity requirements for supporting and sustaining such arrangements.
- *Fiscal incentives analysis*: Recognising the increasing importance that Incentive based funding instruments are playing in India, this research theme would focus on assessing the impact of different incentive systems in South Asia and elsewhere.

The scoping study detected visible demand in South Asia – and India in particular – for such research. However, GHK experience elsewhere – such as Pakistan, Bangladesh, China, Nigeria and South Africa – suggests there is far wider interest. Hence in parallel with this detailed South Asia research activity, consultations might be held with practitioners and DFID country offices in other regions to further define and detail suitably contextualised research agendas.



# 1 Introduction

This is the final report of a scoping study, the purpose of which is to set out a research agenda on the practice and impact of decentralisation. Decentralisation lies at the heart of effective local governance, but local government capacity is often fundamentally constrained by insufficient devolution of finance and human resources or the control of these resources. Policy frameworks are frequently undermined by weak implementation, and the lack of a clear understanding of the impact of decentralisation on local service delivery and the poor.

This study argues that country and regionally contextualised case studies focused on the practice and impact of decentralisation could add considerable value to the existing literature on decentralisation issues. The scoping study is structured as follows:

- A literature survey of decentralisation issues and experiences focusing on disaggregating the significant dimensions and the factors that are critical for effective decentralisation;
- Case studies of decentralisation policy and practice in South Asia. Field consultations around two case studies consider issues of decentralisation policy, practice and impact in greater detail. The case studies are:
  - Decentralisation and fiscal frameworks in India;
  - Decentralised institutional arrangements, service delivery and poverty reduction in Bangladesh;
- Towards a future research agenda - The main dimensions of a future research agenda are set out.

Detailed investigations of fiscal devolution policy frameworks in Karnataka and West Bengal are included as Annexes 1 and 2.

## 2 Literature review

There is a wide literature on many aspects of decentralisation. This review does not pretend to cover all these dimensions; its primary interest is in the relationship between decentralisation and pro-poor service delivery, and the conditions likely to facilitate a positive relationship between these two variables. It begins by establishing a clear definitional understanding of decentralisation, and of the methodological challenges to comparative analysis of the impacts of decentralisation.

### 2.1 Conceptual and methodological issues

#### 2.1.1 Definitions

The scope for further research on decentralisation depends foremost on what one understands under the concept of “decentralisation”. It is therefore necessary at the outset to delineate the range of generic notions of decentralisation used in the literature and in policy debates. Mostly, “decentralisation” is taken to mean one or a combination of the following:

- **Political decentralisation or devolution:** Motivated by a range of possible factors – democratisation, accommodating regional, ethnic, religious or other diversity – devolution entails a significant shift in power from central to sub-national tiers of government. It is normally constitutionally or legally supported, places significant influence over policy and resource allocation decisions at sub-national tiers, assigns revenue and other resources or the power to mobilise such resources to local levels, and – in democracies – is supported by elected political representation. Advocates of devolution argue that it strengthens accountability at community level, provides citizens greater influence over decisions that affect their lives, including affecting the nature and implementation of local infrastructure and service delivery (ISD). Reforms towards devolution usually incorporate changes in statutory frameworks, the development of local pluralism and democracy in electoral processes and in local government’s interaction with civil society interest groups, and budgetary and fiscal reforms to provide the resource base for such greater autonomy. (Litvack and Seddon undated; UNCDF 2003).
- **Administrative Decentralisation:** Several decentralisation initiatives, or analyses of decentralisation, place less emphasis on shifting political and fiscal power to sub-national levels; focusing instead on enhancing authority and capacity for the management and provision of services at sub-national levels. Such administrative decentralisation could take at least two forms:
  - **Deconcentration:** This is the transfer of functions and finances to sub national levels of administration under the same jurisdictional authority. It is the weakest form of decentralisation as power is primarily retained by the centre. It is commonly found in unitary states. There is however scope for variation in the extent of local discretion – from a mere transfer of central government officials to working in sub national level structures, to the creation of stronger field administrations under the supervision of central government ministries.

- **Delegation:** This represents the transfer of greater authority and autonomy to local government or semi-autonomous organisations which are accountable to central government but are not wholly controlled by it. Often this is through the creation of public enterprises, authorities, special project vehicles or other bodies, or as part of political devolution as depicted above. These local units generally have considerably more discretion in decision-making. They may not be bound by the usual civil service personnel requirements and may also be able to directly levy user charges.
- **Fiscal decentralisation:** Empowered local government requires sufficient fiscal resources to meet ISD obligations (either raised locally or transferred from central government), and discretion in expenditure decision-making. Fiscal decentralisation is normally based upon four building blocks:
  - Assignment of expenditure responsibilities to different levels of government, providing the framework within which those expenditures are funded;
  - Revenue assignments, mainly the assignment of tax and non-tax sources of finance available to local government;
  - Intergovernmental fiscal transfers, i.e. mechanisms for the transfer of additional financial resources necessary to meet expenditure obligations; and
  - Regulatory frameworks for sub-national borrowing. (Boex 2001; Bahl 2001; Shah 1994).

In reality, these are not necessarily distinct categories, and decentralisation often involves a combination of these institutional orientations, moulded to meet particular local conditions and priorities, and sometimes combined with sector reforms or processes of institutional transformation away from centralised control, like unbundling, contracting out or privatisation. Thus, often the forms of decentralisation co-exist and entail pragmatic application of the generic notions or models.

### 2.1.2 Measurability

The literature and experiences in several countries show real methodological difficulties in measuring the outcomes of decentralisation. (UNCDF 2003a, Turner and Hulme 1997; Blair 2000, Crook and Manor 1998, Crook and Sverrisson 2001) This includes:

- **Problems of attribution:** It is often not possible to analytically isolate decentralist variables from other factors that may also influence intended outcomes such as accountable governance, improved service delivery or poverty reduction. This may be complicated by the fact that decentralisation can have conflicting and apparently contradictory impacts, such as increasing levels of participation but reducing levels of efficiency in service delivery;
- **The lack of a comparable alternative:** Decentralisation reforms are often implemented on scale and with the intention to be comprehensive (e.g. country wide). This may leave few or no alternative institutional arrangements with the same volumes of resource transfers that could be compared with decentralised

arrangements and their impacts. This may lead to either an exaggeration of the impacts of decentralisation, or an overly critical assessment as problems caused by other factors could be attributed to decentralisation. This methodological problem could be mitigated by incremental implementation of decentralisation, and this is often done in part to facilitate comparative measuring, or simply because an incremental approach might be more realistic (e.g. in Ethiopia there are four “advanced” regions where selected “reforming municipalities” have been the subject of reforms to pilot new approaches and learn lessons about decentralisation).

- **The public perceptions paradox:** Given that decentralisation can bring qualitative benefits, assessments of citizen perceptions are important. Public attitudes to decentralisation can however be variable – and a public empowered by decentralisation can paradoxically hold more critical attitudes of local government, or simply be more audible than one that does not experience the opportunities decentralised governance offers. It is therefore conceivable that more decentralisation actually negatively distorts the image portrayed of public perceptions about that very process in its own right.
- **Levels of analysis:** It is analytically important to clarify the level at which the impact of decentralisation is being analysed. In some cases, for example, analysis may focus narrowly on how decentralisation affects the efficiency of service; in others, on how it affects accountability, participative governance or the allocative efficiency and equity of resources. Or questions may be directed at particular conditions, such as accommodating ethnic or other diversities. It is clear that the analytical entry point is pivotal to the kind of answers one could expect, and therefore an important issue to clarify when analyses are being designed or assessed.
- **Weak indicators:** The commonly cited indicators of decentralisation impacts are often poorly defined and difficult to measure. For example, enhanced political participation in decision making cannot be easily measured in quantitative terms and may require informed qualitative judgements to be made, whereas it is possible to measure many dimensions of infrastructure and service delivery such as access to health care and educational facilities, feeder roads or basic infrastructure services more precisely (Turner and Hulme 1997). In recent years, there has been considerable progress in developing such indicators, but it remains necessary to be aware of the limitations of many indicators, within specific societies and in comparative analyses<sup>1</sup>.
- **Data shortcomings:** International comparative analysis is also limited by the lack of adequate data, and by factors such as differences in the way in which fiscal information is collected. Moreover even if such data were available, it would be difficult to compare across different forms, structures and functional assignments of government at different levels in different societies (Smoke 2001; Faguet 2004). Nonetheless, some of the more empirical attempts to assess the outcomes of decentralised provision have identified and measured important

<sup>1</sup> The World Bank Institute for example has developed six governance indicators for international comparison measuring: Voice and Accountability, Political Stability, Government Effectiveness, Regulatory Quality, Rule of Law, and Control of Corruption (Kaufman et al (2003).

benefits ranging from increased local accountability to improved service delivery. For example, recent work in India and Pakistan has made it possible to collect data and hence measure changes after decentralisation, such as improved teacher attendance, doctors more often present in health centres, and local health facilities better stocked with medicines and supplies in newly decentralised environments. (Crook and Manor 1998 in Karnataka and Charlton J, et al 2003 in Pakistan.) Smoke (2001) points out three issues of particular pertinence to the data challenges. First, the impact of decentralisation on service delivery is largely a function of country and sector specific factors. Thus, some local impact, low capital intensive services are more suited to decentralised management, and it is therefore necessary to analyse them carefully from the vantage point of variations in available technologies, institutional structures and local capacities. Secondly studies of service delivery undertaken to date tend to focus on *productive efficiency*, and there is little consideration of *allocative efficiencies* (concerned with more qualitative dimensions such as whether people are obtaining the level and quality of service they want). Third there is little attention given to the initial transaction costs of undertaking decentralisation programmes and how these relate to the perceived benefits.

In summary, while there has been considerable analysis of decentralisation and its impacts, several analytical challenges remain relevant, mainly around availability of data, the quality of indicators, and the robustness of analytical links between decentralisation and its presumed impacts, as well across comparative reference points and contexts.

## 2.2 Decentralisation in practice

### 2.2.1 Decentralisation and governance

Decentralisation has been widely advocated as an institutional response to the continuing failure of governance systems to respond effectively to basic infrastructure and service needs in many local communities. Protagonists of decentralisation argue that sub-national governments are better positioned to identify local preferences for infrastructure technology or service quality, and that local decision-making therefore helps to shape services that are appropriate and affordable to local communities<sup>2</sup>.

In this vein, it is notable that many of the services targeted under the global community's Millennium Development Goals are potentially affected by decentralisation: education, aspects of health, basic services like water, and even aspects of poverty programmes. Moreover, decentralisation is one option for the type of system's improvement intended under these MDGs, as well as articulated in the UK's Public Service Agreement (PSA) and DFID's Service Delivery Agreement (SDA) targets. SDA target number 11 commits DFID to support "*better economic and political governance in 50% of PSA countries by 2006 as demonstrated by: (i) an improvement in public financial management and accountability systems (determined by compliance with at least three more benchmarks from the World Bank/IMF standard set) and (ii) a deepening of democracy and improvement in the rights of the socially excluded*"<sup>3</sup>.

<sup>2</sup> These issues have been highlighted by numerous authors in recent years including Rondinelli & Nellis (1986) Shah (1994), Bahl (1994) as well the WDR (1999/2000).

<sup>3</sup> DFID (2003) Public Service Agreement (PSA) and Service Delivery Agreement (SDA) – 2003-06 (Africa), London.

The promotion of local governance through democratic decentralisation potentially address a range of key limitations. Those highlighted by UNCDF (2003) include: the over-centralisation of power, planning and management responsibilities; a weak interface between the government and local communities; limited equity in the allocation of resources between regions and to different communities; poor availability of information.

It should, however, be understood that the promotion of local governance does not represent the transfer of powers from the centre to local areas. Rather it can be seen as a means of connecting local processes to national governance. By association it can be forgotten within the decentralisation literature that good local governance is dependent upon higher level processes shaping practices, and regulating relationships. (UNCDF 2003)

Finally Johnson (2001) emphasises that democratic decentralisation will not necessarily result in greater poverty reduction. It is stressed that the institutions underpinning local governance (such as elections, local planning processes, etc) are less significant than what he terms local processes of “democratic politics.” This is the manner by which different groups within a society compete for power and resources. And it reflects the nature of social relations within that society (levels of inequality, class, religious differences, strength of civil society, the press, etc). This finding parallels Putnam’s seminal work on the effectiveness of regional government in Italy. (Putnam 1993) To simplify his findings, he concludes that government tended to be stronger in those regions with a vibrant civil society. This is largely because civil society provided a stronger basis for political debate and could apply pressure for better governance and performance.

### **2.2.2 Decentralisation and service delivery**

Different levels of government bring varied comparative advantages to the delivery of services. Central government often provides a necessary strategic and holistic perspective, and can ensure consistency across the network. Its role is also often justified on the basis of equity considerations, in that it may facilitate similar levels of delivery and well being for citizens in multiple jurisdictions. Central agencies are also sometimes appropriate where advantages of scale make saving possible, and sometimes different activities within the delivery chain of a service require institutions at different levels. This is why decentralisation discussions are sometimes linked to the debate about unbundling; in a number of countries, for example, generation of electricity is centralised, whereas transmission and distribution is decentralised to regional or local institutions.

The case for greater local control over infrastructure development and service delivery revolves around presumed gains in allocative efficiency, production and delivery, as well as operational and maintenance efficiency gains. Key aspects include: (Turner and Hulme 1997; UNCDF 2003; Litvack et al 1998)

- *Higher levels of local pressure*, resulting from local communities knowing and interfacing more frequently with service providers;
- *Enhanced fiscal sustainability*, because integration of recurrent and capital budgets at local level allows for closer matches between longer term planning of central

line departments with local infrastructure investment programmes; and because local accountability may force decisions to be more careful of the consequences of irresponsible spending;

- *Greater local commitment and investment of local resources and effort*, because local authorities can usually negotiate more effectively with local communities to promote, monitor and backstop community participation in Infrastructure and service delivery operation. They can also be more responsive;
- *Institutional permanence*, as local authorities are perceived to have greater permanence than, for example, NGOs (and may be less dependent upon unreliable donor funding) and so are better placed to plan and provide services over the medium and long term;
- *Better oversight of local service staff* through better information, closer monitoring as well as better management of private contractors through better supervision, local information and the involvement of local communities;
- *Greater co-ordination of service activities* within the framework of local plans and local project and programme processes that set frameworks for co-ordination of horizontal line departments, budgets and activities at a local level.

Whether these benefits are achieved depends on the nature of the service itself, economies of scale in provision, exclusivity, and spatial concentration of beneficiaries as well as the desirability of maintaining uniform standards of service (Slater and Harvey 2003). Moreover, many of these arguments about improved service delivery as a result of decentralisation are premised upon a number of assumptions about institutional arrangements for decentralisation. It assumes that political representatives are responsive to their constituents, that transparency and accountability mechanisms exist, and that local bodies have adequate capacity, financial authority and even some influence over the activities of line departments. In practice some or all of these assumptions may not be true (Watson 2000).

### 2.2.3 Decentralisation outcomes

In a survey of ten countries, focusing on the relationship between decentralisation and poverty outcomes. Crook and Sverrisson (2001) conclude that decentralisation per se does not produce poverty reduction outcomes. This is ultimately dependent upon the commitment and support at a national level for decentralisation. As such decentralisation and poverty issues must be considered with regard to the *regime context* and wider political economy issues.<sup>4</sup> Whilst in the developed world decentralisation reforms are often introduced with a view to issues of administrative and service delivery efficiencies as well as providing improvements in local governance, in the developing world political motivations unrelated to service delivery governance and poverty alleviation can predominate. Thus motivations may include a desire to establish rural political power bases (see for example decentralisation in Bangladesh under Ershad in the 1980s), or

<sup>4</sup> Crook and Sverrisson (2001) proceed to set out a typology of four national scenarios describing the motivations for decentralisation reforms.



to fragment ethnic alliances (as in Uganda and Mozambique). Reforms may also be an attempt to accommodate or deflect pressure from groups which have traditionally been excluded from power. Prud'homme (1993) describes decentralisation in developing countries as *“a political strategy by ruling elites to retain most of their power by relinquishing some of it”*, and Dillinger (1994) provides a description of decentralisation in relation to Africa as a measure by bankrupt central powers to establish new targets for political dissatisfaction.

Moreover it is clear that often decentralisation is introduced by central governments as a series of ad hoc reactive measures rather than as a carefully planned sequence of reforms intended to introduce both incentives and accountabilities for the improvement of service delivery. And badly planned decentralisation can easily worsen regional inequities, cause loss of economies of scale, and result in elite capture at the local level.

The possible positive impacts of decentralisation are shown by Faguet (2004) in a study of the relationship between decentralisation in Bolivia and responsiveness to local needs. This combined rigorous econometric analysis with the depth of analysis associated with a one country study. He provides quite startling evidence of the manner in which decentralisation has changed local government investment patterns, both in terms of the resource allocations made to individual local authorities, and in terms of the sectors in which local government itself is investing. In relation to the former point, decentralisation resulted in more finances flowing to poorer local authorities. And in terms of the sectoral focus, he shows a direct correlation between the nature of sectoral investments and illiteracy rates, water and sewerage connection rates, and malnutrition. The poorest local authorities consistently chose more human capital and social services projects. This suggests that after decentralisation, investment priorities were more directly correlated with local needs. Whilst these findings are unambiguous, Faguet (2002) also stresses that equally important influences on the nature of decentralisation outcomes are the wider political economic context in which decentralisation was occurring, and the existence of civil institutions that allow political competition between interest groups.

Schneider (2003) undertook a wider statistical analysis of the impact of decentralisation (defined in fiscal, administrative and political terms) on taxation levels and the extent of pro-poor expenditures in 108 countries. He used econometric modelling based on six indicators of decentralisation. He found that for each modelled specification political decentralisation was negatively related to pro-poor expenditures. He suggests that this is because the organisational and material resources needed by the poor to advance their claims are less powerful at the local level than nationally. A second of Schneider's findings was that administrative decentralisation had a direct and positive impact upon social policy in democratic countries. His interpretation of this is that local competition, information and innovation associated with decentralisation are likely to result in efficiency benefits that can allow increases in pro-poor spending. These findings directly contradict received wisdom about the benefits of decentralisation, and Schneider proceeds to draw two possible policy conclusions:

- Governments might strengthen the institutions that serve to centralise political functions, especially those which represent the poor. This includes national political



parties, unions and interest groups. Local political competition is bad, but: *“National issues of redistribution and poverty have to be fought and advanced at all levels of government. These issues are not likely to be brought to the table, however, unless there are national level organisations that allow people to organise, articulate their interests and gain representation”*.

- Greater autonomy should be granted to local administrative units (for example through the use of block grants/conditional grants), allowing competition, between sub units of government, innovation and experimentation. This requires and assumes that local information, monitoring and oversight mechanisms are in place to ensure some local accountability.

Schneider therefore proposes a combination of administrative decentralisation and political centralisation in order to promote more progressive public action. Findings from Tendler’s study of government in North East Brazil loosely parallels these conclusions (Tendler 1997). She stresses that improvements in local service delivery did not result directly from the empowerment of local government and civil society or from their supposed comparative advantages of responsiveness and flexibility. Rather she found there was a three way dynamic in which central government played a critical role. This included actively intervening in and controlling certain local “political” decisions, directly engaging with the public through publicity campaigns, actively promoting the development of civil society and finally, monitoring the performance of local government. Tendler talks of the *“paradox of decentralisation”* as identified by a Colombian Minister: *“Decentralization demands more centralization and more sophisticated political skills at the national level”*.

### 2.3 Challenges for effective decentralisation

In practice, decentralised funding and provision of services do not guarantee improvements in service coverage or quality. The potential risks include:

- *Equity may be compromised:* At its best decentralisation provides a powerful way of creating better access to services by people, in a mode that gives them more control over their choices and stronger means to hold their leaders as well as service providers accountable. However, there have been cases where decentralisation was used to protect vested interests and to contain a more equitable redistribution of resources. And in highly unequal situations, decentralisation may hamper the ability of progressive governments to shift resources into areas that have been neglected. For example, in the final years of apartheid South Africa, the then government advanced the cause of stronger local government in part because it seemed like a way of protecting privileged groups against redistribution in post-apartheid South Africa (Heymans and Mmakola 1997). This does not imply that decentralisation always runs counter to equity, but there have to be deliberate policy measures to mitigate this risk.
- *Capture of benefits by local elite groups:* The access given to local groups through decentralisation, does not necessarily mean that the broader community will benefit. Local political institutions often retain biases on the basis of class, gender, religion and other social factors (Johnson C, 2001). There is ongoing contestation

over resources and local elites can manipulate political institutions to take charge, and to exclude historically marginalised groups. Often elites have more and better means to secure control, whereas poor people often lack the means and the organisational support to effectively stake their claims. The experience of Bangladesh in the 1980s illustrates this. The Upazila (sub district) level of government was created under the Ershad regime, but there were serious concerns about corruption and patronage, and there were clear cases of political abuse of the system. In 1991 this tier of government was abolished. (Boex J et al 2002).

- *Revenue minimisation as a result of populist policy:* While decentralisation thrives on more direct links between representatives and their constituents, and service providers and their consumers, this closeness poses risks as well. In particular, their closeness to local constituents may leave local politicians feeling more exposed to the wrath of disenchanted voters, and thus cause unwillingness to levy unpopular local taxes or enforce cost recovery on local services. This has been the case in several contexts, and is often one of the major sources of tension between central treasuries and the local level. In Uganda for example own revenue collection levels actually declined over the period 1999-2003. The reasons attributed to this are the disincentives to revenue collection resulting from increases in central government transfers, political interference and legislative impediments (Onyach-Olaa 2003).
- *Increased corruption:* In the absence of effective monitoring and regulation mechanisms there is a danger that localisation of decision-making may only serve to provide additional local opportunities for corruption.<sup>5</sup> In addition 'local benefits' are often quite overtly material – e.g. access to food aid, or water, or land, or property. Thus, for example, in the former Soviet Union increasing incidence of corruption was reported within local governance institutions over the 1990s, even though there has been greater scope for public scrutiny (World Bank (undated)).
- *Weak administrative and management systems:* Where decentralisation reforms have been rapidly introduced there is a danger that local government will lack the administrative and management systems to manage new responsibilities. For example, South Asia, in contrast to Africa, has traditionally had very weak administrative systems, and has rather been characterised by a deconcentrated bureaucracy either dominating local government (as in the case of the Indian Administrative Service) or working through parallel (line department based) administrative systems (Commonwealth Local Government Handbook 2003).

The extent to which these dangers occur in practice will largely be a function of specific local contextual factors as well as the overall institutional framework governing decentralisation. The next section considers generic conditions which help to provide an enabling environment in which decentralisation can flourish.

<sup>5</sup> Faguet (2002) counters this argument by emphasising that in small local government authorities politicians are often a part of local communities, and their wealth is highly visible. This can serve to reduce the scope for corruption.

## 2.4 Enabling conditions for decentralisation

Based on the above thinking it is clear that the nature and impact of decentralisation cannot be generalised, but rather is dependent upon specific conditions within individual countries. This section considers the conditions which can serve to enable decentralisation. These have been categorised as follows:

- Structural factors;
- Functional autonomy, roles and responsibilities;
- Supportive legislation;
- A clear fiscal framework;
- Accountability, monitoring and regulation mechanisms;
- Capacity Development;
- A process of reform.

These are explained in more detail below. The first category considers structural conditions relating to the nature of the society. The other categories consider more detailed elements which can be considered in supporting decentralisation processes.

### 2.4.1 Structural factors

It should also be recognised that decentralisation is in effect concerned with the redistribution of power and/or access to resources. As such it represents a highly political and contested process that relates directly to the nature of a given society and the power relations that govern it. Indeed Schou and Steffensen (2002) state: *“It is clear...that even the most appropriately designed decentralisation institutions cannot work independently of and certainly not against forces embedded in the social and political structures in which they function.”* Social and political factors within a given society which could influence the nature and impact of decentralisation include:

- The national political environment and traditions (this includes whether there is a tradition of democracy, political parties and competition, etc). Faguet (2002) stresses that decentralisation is likely to be more effective where a sound institutional basis exists for the free interplay of competing political interests (for example between the private sector and civil society)<sup>6</sup>;
- The character of civil society (the existence of strong and vibrant civil society organisations, an independent and vocal press, the degree of social inequality, the influence of local elites, and so on);
- The nature of the civil service (including whether a clear separation exists between political and bureaucratic spheres, the operation of accountability mechanisms and so on);

<sup>6</sup> Faguet proceeds to contrast this negatively with the approach of donors which, he argues, wrongly adopt a technocratic approach, prioritising IT, training and capacity development, and auditing functions.

- Socio-economic dimensions (regional inequalities, ethnic difference, prior land reform, literacy rates, etc);
- Rural and urban differences and the extent of urbanisation;
- Political commitment to decentralisation (incentives to decentralise at the central administrative and political tiers).

Concern with such “structural factors” is the focus of the DFID Drivers of Change initiative, (Duncan 2003) which is underpinned by a recognition that donors have traditionally been good at saying *what* needs to be changed (and prescribing technical solutions), but are less effective at articulating *how* it can be achieved given the dynamics and political processes in a given society. Therefore, to impose decentralisation in a context politically unfavourable to it, could be counterproductive, and any such policy directions need to be located such that they build on societal driving forces.

#### ***2.4.2 Functional autonomy, roles and responsibilities***

Ensuring local autonomy is fundamental to effective decentralisation. This is closely linked to definition of roles, responsibilities (as well as the allocation of resources to fulfil such mandates). Such functional autonomy has political, administrative and fiscal dimensions. The last of these is dealt with under item 5.4 below. Key principles include the following:

- *Political Autonomy*: It is important that local government has significant political autonomy. Councillors should be directly elected, and ideally would have geographic representation. Such political autonomy should occur both within legislation and also in practice.
- *Staff accountability*: If local government officers are transferred from central government it is important that they report to the local authorities and are locally accountable.
- *Roles and Responsibilities*: There is a need for a clear definition of the roles and responsibilities for different levels of government and for different sectors. This should operate on the basis of the principle of subsidiarity, namely that responsibilities are decentralised to “*the lowest level of government consistent with allocative efficiency (e.g. the geographic area that internalises the benefits and costs of decision making for a particular service)*”. (World Bank undated) A general principle is that central government should be responsible for ensuring the quality and consistency of infrastructure and service delivery that affects citizens in multiple jurisdictions. (Slater R and Harvey M 2003) Local government should be responsible for the services that can vary between jurisdictions, and should match service provision to local needs without disrupting national development priorities. It is useful to think of the *comparative advantage* of each level of government. Central government has a strategic perspective and can ensure consistency, setting standards and monitoring compliance. Local government has a better understanding of local needs and priorities, and can provide innovative, flexible and responsive solutions.
- *Co-ordination*: Many services will require parallel actions by different tiers of

government at local, regional and national levels. Moreover there is a need to ensure effective co-ordination between sectors. An enabling planning hierarchy can help in this regard.

- *Unbundling*: It is stressed by the World Bank (undated) that whilst a certain level of local government may be responsible for the *provision* of a service it does not necessarily follow that it will undertake *production* of the service. The latter can be undertaken by a range of different public and private sector entities (as “unbundling”). Where the services have been privatised, local government will, however, continue to play an important role in regulating the activities of contractors.

### 2.4.3 Supportive legislation

Constitutional or legal measures are often used to define the degree of local autonomy, rights and responsibilities of local government. This must be premised on a strong national will to decentralise. Such provisions should set out the nature of decentralisation clearly and unambiguously.

A number of countries have legislated to provide a strong enabling environment for decentralisation (see for example, the Indian 73<sup>rd</sup> and 74<sup>th</sup> Constitutional Amendment Act, the South African Constitution (1996), Uganda Constitution (1995) its corollary the Local Government Act (1997). Smoke (2001) states, however, that there is a requirement for further comparative analysis to assess in greater depth the enabling conditions found within such legal provisions that underpin decentralisation reform. Moreover it is also generally accepted that such statute is *necessary but not sufficient* to promote decentralisation. Sometimes too, such as in Uganda, high level units are created to oversee the decentralisation reform processes. These have the benefit of being partially isolated from other ministries which will have some vested interest in the decentralisation process.

Decentralisation can be undermined by the fact that there is often a concern that local government will use its new found discretion badly and misallocate resources. A standard response to this is to tighten central control over local government through ring fencing transfers, controlling the allocation of staffing – but this may serve to curb the longer term development and self sufficiency of local government (Manning N. et al 2003).

### 2.4.4 A clear fiscal framework

A clear fiscal framework underpins and is central to the process of decentralisation. Bahl (2001) however stresses that the nature of the fiscal systems relates to the overall objectives of decentralisation reforms and needs to reflect the nature of wider institutions and systems. With this in mind, core principles for a number of dimensions of fiscal decentralisation are set out below.

#### *Clear expenditure responsibilities*

Important expenditure related principles include:

| G | H | K |

- Benefits and costs of decisions should be borne by the level of government that makes the decisions;
- Local government should have clear expenditure assignments, and this should occur in advance of the assignment of revenues;
- Services that can be priced (such as, for example, public utilities, buses) should primarily be financed through local user charges;
- Services which have a significant local impact (such as public parks), should primarily be financed from local taxation;
- Services, the benefits of which can have an impact beyond the local area can be financed primarily from intergovernmental transfers.

#### *Clear revenue responsibilities*

Core principles include:

- Local government should have some discretion both in terms of revenue raising and in the use/allocation of financial resources. Significant local taxation powers help to ensure that there is a significant degree of government accountability to voters. Such taxation should be visible and should be large enough to impose a noticeable burden on the local area (that cannot be exported to other areas);
- Assigned revenue bases should be relatively immobile and should not have serious spatial efficiency effects;
- Assigned revenues should also have a reasonable degree of buoyancy (rising to an extent that matches economic growth);
- Where tax assignments do not match expenditure assignments (associated with functional responsibilities) a system of predictable transfers should be established. This should have clear and transparent allocation criteria. Provided they are designed on the basis of clear formulas, block grants have the advantages of being transparent and equitable, as well as that they are not prescriptive. This gives local governments greater say over budget decisions at local level. Conditional grants, on the other hand, provide instruments to provide higher level priorities, and offer points of entry to encourage reforms;
- Opportunities to introduce incentive mechanisms which promote greater tax collection should be exploited. This can include the release of additional funds to local authorities which perform effectively;
- Local governments should be encouraged to focus on those revenue sources which can provide substantial yields. Minor taxes can produce minimal yields and can be administratively burdensome to collect.

#### *Grants*

A system of grants to sub national levels of government will generally be necessary.

Such grants should be based on clear allocation criteria. They should address the gap between revenue and expenditure assignments, and should address these ex ante. Ex post grant allocations reduce the scope for sound budgetary practices based on a hard budget constraint and encourage higher expenditures by local government. Central government may wish to retain some discretion in the fiscal transfer system to allow responsiveness to unforeseen circumstances.

### *Borrowing*

Those local governments that cannot balance their expenditure and revenue assignments are likely to incur debt. This can, however, have significant macro-economic effects. As a result central government usually controls the ability of local governments to borrow. (Boex 2001) Where borrowing is permitted this should be on the basis of passing a credit rating review which will allow assessment of the extent to which the local authority can honour its borrowing.

### *Other issues*

A number of other issues emerge within the literature. For example Bahl (2001) stresses the need to “*keep it simple*”. By this he means that intergovernmental fiscal arrangements should not have unduly complicated allocation formulas. This will reduce administration costs and make monitoring easier. Simpler systems are especially important where capacity is more limited. Other relevant principles highlighted by Bahl (2001) include:

- *Ensure central government keeps the rules it makes:* Decentralisation generally entails central government giving up power, and acting in a less clientelistic manner towards sub national tiers of government. The experience of local governments in many countries is that when economic conditions are more pressing local government will not transfer revenues that are due. If central government does not wish to prioritise financial transfers, then it should not make rules in this regard.
- *Impose a hard budget constraint:* If local governments are to be given autonomy it is important that they are also required to balance their budgets, without being able to fall back on central government support. This requires that central government moves away from a more clientelistic approach under which deficit grants are provided to cover year end shortfalls.
- *Incentivise improvement:* Fiscal systems can promote greater resource allocations. For example, transfers of resources to reduce the incentive for local revenue collection, but allocation formulae can incorporate measures which reward revenue collection and wider performance improvement. Such an emphasis on revenue enhancement should only be introduced where local government tax assignments are buoyant (Devas 2002).
- *Use Central Champions:* Ironically decentralisation has often been most effective where there is a strong central champions committed to reform. Donors can play an important supportive role in this regard.



#### **2.4.5 Accountability, monitoring and regulation mechanisms**

It is important that local government is held accountable for its performance. This is usually considered in relation to both requirements of higher levels of government and also to the general public.

##### *Upward accountability*

Local government accountability mechanisms are defined by higher levels of government. The World Bank emphasises that such reporting systems should allow:

- Representative breadth of coverage (across different levels of local government and in different categories of information);
- Consistency (ensuring minimal reporting and classification errors);
- Comparability (same types of activities to be reflected across different levels of govt);
- A practical foundation (for example, reporting actual rather than budgeted activities).

For fiscal decentralisation, Bahl (2001) contends that higher levels of government require:

- A fiscal analysis unit (likely to be part of the Ministry of Finance) with a mandate to monitor local government finance, tracking and monitoring performance;
- An effective data monitoring system. Generally few governments have up to date information.

The development of such reporting systems requires technical assistance, training, time and resources targeted at both local and higher levels of government over an extended period. Devas (2002) stresses that local government reporting of performance is a potentially huge task “*requiring detailed information about multiple indicators collected from dispersed locations*”. He stresses that there is a need for independent verification (as local governments have a natural incentive to overstate their performance). Moreover there is a danger that monitoring can itself become a rent seeking activity for central government inspectors. Whilst the World Bank has introduced Public Expenditure Tracking systems in a number of countries these are costly to undertake. Overall, Devas (2002) writes: “*Central monitoring of resource use is important where institutions of local governance are weak, but this is generally an expensive and cumbersome operation, and is open to abuse. Building local accountability is equally important, by encouraging greater citizen participation, providing local citizens with information about resource allocations to enable them to local elected representatives and officials accountable, and strengthening local democratic processes.*”

##### *Downward Accountability*

The most fundamental method of enforcing downward accountability is through regular elections. In practice, however, other less formal accountability mechanisms are also important. These include participatory budgeting processes; publicising



information on contract tendering and implementation; citizen's charters; and other performance management systems.

These mechanisms are however of marginal significance in comparison to the prevailing nature of social relations in a given society. Downward accountability will be greater where there is a vibrant civil society able to bring pressure to bear on local government, a vocal and free press, and a strong democratic tradition.

Where such conditions are absent, the process of developing local accountability is long and difficult. Significantly, some DFID local government programmes have already incorporated these aspects in their programme activities (DFID Southern Africa 2003).

#### **2.4.6 Capacity development**

Weak capacity and the associated fear that there will be misallocation and inefficient use of resources is a common reason why central government ministries are less willing to decentralise. Uphoff<sup>7</sup> defines capacity as the ability of local government (and associated local stakeholders) to organise themselves to undertake decision making (including planning implementation and monitoring / evaluation); resource mobilisation and management; communication and co-ordination; and conflict resolution.

This definition presents capacity as including both people and wider systems and procedures. It recognises administrative, managerial and political dimensions. This broader definition moves beyond viewing capacity in terms of staffing levels and skills. From the literature a number of generic principles can be gleaned, as follows:

- Whilst there are obvious dangers in devolving responsibilities when there is limited local capacity, it is increasingly recognised that developing capacity does not need to precede decentralisation. Rather local government can become more efficient and effective through an incremental "learning by doing" process of capacity development (Devas 2002, World Bank undated).
- Capacity development is most successful where there is a commitment within local government to improvement. In some countries access to funds for capacity development is based upon local authorities meeting qualification criteria (Watson 2000).
- Performance enhancement is more likely where there are incentives for compliance with required service delivery standards, and penalties for failure to comply.
- Capacity development should be demand driven and there should be some variation according to local needs. In a number of countries such as Uganda, local government has even been able to access additional financial resources to purchase the training it requires as well as to innovate and experiment with new

<sup>7</sup> Quoted in World Bank (undated)

approaches. There is a parallel need to recognise the variations in capacity of different local authorities. Given this, capacity development support should be provided in an incremental, less systematised manner, based on practical, learning by doing (Watson 2000).

- The motivation and commitment of government officials is critical to better performance. Tendler (1997) highlights this as an important component of government performance, and one that is frequently neglected by donors.
- Autonomy in local human resource management improves local government performance. Recruitment and staff management can be either controlled by the local authority itself, or by higher levels of government through a cadre based system. The former allows local authorities greater control and financial flexibility, but they may lack the capacity to manage recruitment processes, and weaker (remoter) authorities may struggle to recruit and retain staff. A cadre based system provides economies of scale in personnel management, and allows technical staff greater career progression opportunities. There may, however, be some loss of local knowledge and local control. Staff may also have divided loyalties between local and central government.
- Development of new systems and procedures involves a process of change. This is likely to result in uncertainty and conflict. This should be recognised and addressed.

#### ***2.4.7 A process of reform***

It is generally recognised that effective decentralisation can only be achieved over a long time period. Given this, careful management of the reform process is often necessary. Smoke (2001) has raised a number of issues in this regard:

- The technical sequencing of reform is important. For example expenditure assignments should be determined before revenue assignments are allocated.
- Political phasing of reforms. Often governments which have made a commitment to decentralisation proceed too quickly. At the outset government should have an overall conception of its ultimate decentralisation aims. It should then focus initially on those functions and services for which success is likely. This includes tasks which do not threaten the central power based, and that do not overwhelm local capacity. This will help to ensure there is support for decentralisation.
- There is not a need for a uniform approach. Often processes work best when committed local authorities are allowed to pioneer change. They provide experience that others can learn from, and are more likely to be successful, helping to build a constituency of support for further change. <sup>8</sup>Bahl (2001) reinforces this message in relation to fiscal decentralisation arguing that larger authorities should commence this and smaller authorities can then “*grow into it*”.

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<sup>8</sup> Tendler (1997) illustrates this in relation to health sector reforms in North East Brazil.

- Capacity development and attitudinal change is needed at a range of levels. It is often not fully recognised that decentralisation not only involves local government taking on new responsibilities. It also entails a change in the nature of the role played by higher levels of government. Tandler (1997) stresses that decentralisation does not entail central government stepping back from a role in service delivery, rather it entails defining a new supportive, enabling and monitoring role for which new skills are required. As such a range of capacity building is required.
- The role of donors in supporting processes of decentralisation can be important. The donors can support the piloting of new approaches and can provide useful insights from wider international experience. Smoke (2001), however, stresses that there can be a danger that donors can paradoxically undermine decentralisation processes as a result of their own organisational imperatives. Pressures of expenditure schedules, the individual sectoral focus taken by many donors, and the associated strong relationships that are formed with individual ministries can all undermine the complex process necessary for decentralisation reform. This is considered in more detail in the section that follows.

## 2.5 Donor experience of supporting decentralisation

Whilst there have been extensive evaluations of individual donor supported decentralisation projects, few international cross country evaluations of donor support for decentralisation have been undertaken. This is presumably in part because of the considerable variety in the nature and objectives of donor support that has been provided. One notable evaluation was undertaken by the OECD in 2003, considering decentralisation in relation to general support to decentralisation programmes and their implementation; support to fiscal decentralisation; support to local government accountability.

In its findings, it recognised that effective decentralisation only occurs over a period of decades, and as such there is an associated need for long term commitment from donors. Such support is of course premised on a clear central government commitment to reform. The evaluation also emphasises the need for improved co-ordination, both between donors and partner governments, as well as within the donor community itself.

In relation to fiscal decentralisation, experience to date suggests that support for improved financial management has been more successful than improvements in overall system of local government finance and sustainability. Where effective transfer systems have been established they can serve to disincentivise local government own revenue enhancement. There has been some successful experience where transfers are linked to own revenue and incentive mechanisms are built in. Finally the evaluation found that new institutions such as associations of local authorities and independent finance commissions can have an important role in enhancing knowledge and learning.

Regarding local government accountability, important findings suggest that it is important to combine support to local government and efforts to strengthen civil society organisations, focusing especially upon broad based civil society organisations with grass roots linkages.

A final issue highlighted by the evaluation was the need for greater clarity concerning the relationship between decentralisation and new forms of aid instruments being used by the donors. Specifically this referred to Sector Wide Approaches (SWAs) and Poverty Reduction Strategy Papers (PRSPs). These tensions are also summarised by (Watson 2000). In essence these new aid instruments are centralised in nature and there is often little consideration of their interface with local government or parallel decentralization support.

### 3 Decentralisation: policy and practice in South Asia

The previous section provided a broad review of devolution, focusing on those factors that are most important for creating an enabling policy framework. The literature review shows that there are a number of critical factors ranging from structural, fiscal, administrative, legal and regulatory regimes that need to be considered in the devolution process. The review highlights that devolution is both complex and multi-layered, and demonstrates the paucity of information. Several previous attempts to assess such factors have tended to aggregate key factors in such a manner as to make this analysis difficult, and undertook comparisons on an international and even inter-continental basis where the scope for serious comparative analysis is limited.

This suggests that there is a need for detailed analysis of decentralisation practice and impacts. Such analysis needs to be undertaken at a number of levels, incorporating an understanding of macro-level policy dimensions, as well as considering the more detailed local operational modalities of decentralised institutional arrangements. There is a need to disaggregate individual components of decentralisation and to consider their impact upon service delivery and poverty reduction. As a scoping exercise, it is beyond the parameters of this report to conduct such a study in depth, but to demonstrate the potential of such a case-study based approach, two South Asian cases are used. Deliberately different in focus, the two cases are:

- *A macro level analysis of decentralisation and fiscal frameworks in India.* This recognises the centrality of fiscal dimensions to the effective implementation of a decentralisation agenda. The nature and extent of decentralisation within India is delineated, and there is then analysis of the fiscal frameworks governing the operation of local government. The focus is primarily on the state-local government fiscal relations, and there is comparative analysis of the key aspects of frameworks in different states. A more detailed consideration of the experience of Karnataka and West Bengal is included in Annexes 1 and 2. This analysis highlights potentially significant dimensions of fiscal frameworks and shows clear knowledge gaps, in which additional research is required;
- *A micro level case study of local governance and service delivery outcomes in Bangladesh.* This explores the impact of decentralised institutional arrangements upon service delivery and the poor based on a field assessment of a UNCDF supported decentralisation and local governance programme in Bangladesh. The case study describes the innovations introduced under the pilot project and the associated impacts, as contrasted with conventional local government financing, planning and management systems. It explores the conditions necessary for decentralised improved local services.

#### 3.1 Decentralisation and fiscal frameworks in India

India has been chosen because in comparative international terms it has been relatively ambitious and progressive in its attempts to decentralise government. Moreover, given its size, there is interesting scope for comparative analysis of implementation

experience between states. This section starts with a brief outline of the status of decentralisation nationally. There is then a focus on a central component of decentralisation, namely fiscal relations.

### 3.1.1 *The status of decentralisation*

#### *The 73<sup>rd</sup> and 74<sup>th</sup> Constitutional Amendment Acts (CAAs)*

Decentralisation has a long history in India and is probably most prominently associated with the Gandhian notion of village Swaraj (independence). It is, however, the 73<sup>rd</sup> and 74<sup>th</sup> Constitutional Amendment Acts that have underpinned and defined the broad parameters of recent decentralisation reforms in India. Box 1 below summarises the key dimensions of the CAAs (based on UNDP 2000).

#### **Box 1: The 73<sup>rd</sup> and 74<sup>th</sup> Constitutional Amendment Acts (CAAs)**

The 73<sup>rd</sup> and 74<sup>th</sup> Constitutional Amendment Acts, passed in 1992 represent important landmarks of Indian decentralisation. The CAAs mandate a clear role for local bodies as independent institutions of local governance with important service delivery roles. Relating to rural and urban decentralisation respectively, the CAAs define the required structure of local government as well as the broad list of functions to be assigned at different levels. There is a requirement for direct elections on a five yearly basis and minimum seat reservations are made for women as well as for scheduled castes and scheduled tribes.

The institution of the State Election Commission is defined with a mandate to oversee organisation and management of elections. Similarly State Finance Commissions are to be constituted on a five yearly basis to make recommendations on the fiscal relations between state governments and lower levels of government.

The CAAs have introduced a minimal level of decentralisation across the country. Individual state governments have been required to pass enabling legislation for the CAAs, to implement the detailed political, administrative and fiscal structures of decentralisation, making such adaptations to the provisions of the CAAs as are necessary given local contextual factors.

The CAAs were passed by the Government of India, and whilst all states have passed the required enabling legislation, there has been some variation in the commitment of state governments to the principles of decentralisation, and in the implementation of decentralisation reforms. For example, Kerala has shown considerable commitment in devolving both functional and financial responsibilities to lower levels of government. It has increased both the proportion and absolute levels of untied grants and has implemented the internationally recognised People's Planning Campaign. Madhya Pradesh has been active in the promoting village level democracy through the concept of *gram swaraj*, which has given the gram sabha greater powers of planning, consultation and accountability. West Bengal has actively promoted rural reforms from the period prior to the enactment of the CAAs and (like MP) has activated the District Planning Committees, as well as establishing a cabinet style "Mayor in Council" system within

urban local government. The parallel devolution of funding and human resources has, however, been less evident. Further variation in the experience of decentralisation can be related for Gujarat, Karnataka, Maharashtra, Tamil Nadu and other states.

Experience suggests, however, that even more progressive state governments have retained significant control over the operation of local government. This is shown in Table 1 (from World Bank 2000), which illustrates the powers retained by state governments over Panchayati Raj Institutions. This table is especially notable because the states listed have been relatively proactive in the implementation of decentralisation. In addition (as will be considered in more detail at a later stage) the states have retained considerable fiscal powers and resources.

**Table 1 State Government Control over Panchayati Raj Institutions**

State Powers	AP	MP	Kerala	Karnataka	W. Bengal
State reserves powers to make rules and make changes in content of schedule.	X	X	X	X	X
State reserves power of appointment to PRIs	X	X		X	X
Delimitation of constituencies the responsibility of government, not SEC		X	X		
State manages PRIs when delays in elections			X		
State reserves power to dismiss Sarpanch	X	X	X	X	X
State reserves power to cancel resolution or decision of Panchayats	X	X	X		
State reserves power to dissolve Panchayats	X	X	X	X	X
State reserves power to inspect records / works		X	X	X	X
Recommendations of SFC report mandatory		X			

(Source: World Bank 2000)

#### *Political decentralisation*

Political decentralisation has been the most successful of all reforms. New changes have included regular elections at all levels of government, the constitution of State Election Commissions, reservation of seats for women and other marginalized groups, the formation of Gram sabha (village councils), establishment of Mayor in Council systems (in West Bengal), and more. There has been significant progress in promoting

more of a grass roots democratic process. Following the CAAs, the majority of states have held elections more frequently with representation as per constitutional requirements, and levels of participation have been generally high (World Bank 2000). The Institute of Social Sciences (2003), however, in a review of Indian rural decentralisation, stresses that significant challenges remain especially in promoting participation and transparency. Johnson (2003) in turn stresses the dangers of local elite capture. He focuses on the tension that exists between a formal model of democracy and its implementation within a society in which power relations and politics are primarily determined by informal socio-cultural factors which embrace notions of inequality and domination (Johnson 2003).

#### *Functional decentralisation*

The experience of the implementation of functional decentralisation is less positive. The XIth and XIIth schedules of the CAAs define functions to be devolved. Whilst functional responsibilities of different levels of government have been defined within legislation in almost all states, consideration of decentralisation in practice on a state by state basis suggests that, functional responsibilities have generally remained more centralised, often with the same functions being assigned to different tiers of government with no effective co-ordination mechanisms. This is likely to result in duplication. There is also a clear knowledge gap in relation to the determining the appropriate functional assignments to each level of local government (district, block and village) (World Bank 2000). In addition the associated transfer of personnel and resources to lower levels of local government has often been limited, nor have such functionaries generally been brought under the control of local government, reporting instead to line departments.

Another important factor influencing functional decentralisation has been the role of the non elected bureaucracy. Shaped by the colonial legacy, India's administrative machinery is large, and led by the Indian Administrative Service has often worked in a centralised manner on the basis of a "Regulation and command" management style. In many rural areas state government line departments retain considerable implementation powers (in some cases with control over local government resources). The aims of decentralisation often run counter to the incentives and motivations of the non elected bureaucracy, and thus there is resistance to further decentralisation. In relation to devolution of sectoral responsibilities, with the exception of Kerala, no state has made a serious commitment in this regard (ISS 2003).

The third important pillar of decentralisation relates to fiscal issues. Given the centrality of this dimension, it is considered in greater detail in the section which follows.

### ***3.1.2 Fiscal frameworks: moving from policy to implementation***

Fiscal policy lies at the very heart of devolution as the key to ensuring that rural and urban local governments have the financial means to fulfil constitutional and/or legal mandates. Within the Indian context there is also a focus on fiscal policy, because in this regard selected State Finance Commissions have shown a reasonable degree of innovation in the design of fiscal devolution frameworks and transfers. The following sections will thus focus on fiscal policy developments and innovations in general and



more specifically those identified in the two case studies of West Bengal and Karnataka (see Annexes 1 and 2). Prior to this there is a comparative consideration of general fiscal issues within India.

### *The design of Fiscal Devolution Frameworks*

One of the central objectives of fiscal devolution policy relates to the design and implementation of a sound framework that allows local governments adequate financial resources to meet their service provision mandates, and that promote better financial management through the imposition of hard budgetary constraints. Important dimensions of a fiscal framework include *expenditure assignments* (the financial expenditure discretion and responsibilities that is devolved to local government, *revenue assignments* (the taxes and fees that local government is empowered to collect) *the systems of transfers* (from state government). The last requires a transparent and predictable flow of funds to local government and, in turn, depends on the development of a robust formula to guide intergovernmental transfers. These dimensions will facilitate overall budget management and monitoring at both state and local government level, greater budgetary certainty and predictability will also assist local government to develop more effective funding strategies that may lead to greater financial independence through enhanced revenue mobilisation and accessing new sources of capital for investment in local infrastructure and services. A brief analysis of the impact of fiscal devolution reform shows that locally elected members are strongly in favour of new policies that result in greater budgetary certainty and cash flow stability as compared to the former ad hoc system of revenue transfer that often penalised opposition councils. This enables them to plan better, and take responsibility for allocations that affect delivery.

### *Expenditure Assignments*

Expenditure assignments represent the authority that is delegated to local government to make autonomous expenditure decisions. There is some variation in the nature of such assignments between states in India. The cases of Kerala and Karnataka provide interesting contrasts (World Bank 2004). In Karnataka, 29 subjects have “nominally” been assigned to local government, but in practice the state government retains power over key decisions. Moreover, there has been no attempt to unpack the different service provision roles for different levels of government. As such there is a danger of duplicated effort, lack of co-ordination, and weak leadership. By contrast in Kerala (a leading state in this regard), expenditure assignments have been broken down between different levels of government, and further disaggregated into activities and sub-activities. As such it can be expected that local bodies have greater clarity in the definition of their roles, and there should be better co-ordination between different tiers of government.

### *Revenue Assignments*

There is also variation in the extent to which local government are assigned local revenue generation powers. In most parts of South Asia, local governments have a tradition of poor revenue mobilisation and inefficient spending, there is insufficient confidence in such bodies to entrust them with new revenue assignments of any significance. In Karnataka, for example, it was found that levels of local tax collection

are very low, at an average of Rs16 per capita in Gram panchayats, and collection rates for property tax (the primary local tax) were more than 70% less than the demand in 2000/01 (World Bank 2004). ISS (2003) also showed that the share of local revenue from own sources for all tiers in total local expenditures in fourteen states was a mere 3.2%. The reasons suggested for this poor revenue performance include the following:

- An unwillingness on the part of local officials and politicians to levy (unpopular) taxes;
- Poor systems and procedures, including tax rolls and valuations not being up to date;
- Limited tax administration capacity of local government officials;
- A preponderance of small taxes, and too few large and buoyant taxes;
- A poor link between payment of taxes and service provision, resulting in mistrust on the part of tax payers;
- Weak incentives (both rewards and penalties) for local officials to raise additional taxes (World Bank 2004).

Although fiscal commentators such as Rajaraman (2003) argue that new taxes should be assigned to local government, in the reports of the individual State Finance Commissions there is a clear trend favouring revenue sharing and grants-in-aid rather than a focus on revision of tax assignments. Arguably this issue has often been somewhat neglected by the State Finance Commissions, and more could be done to explore options for enhanced local revenue generation.

### *Revenue Sharing*

As a result of competing demands on available resources, state-local government revenue sharing formulae are highly significant. Here, the main policy issue relates to the mechanism for revenue sharing between tiers of government and between governments within defined tiers. The State Finance Commissions in each state have made some quite innovative recommendations in this regard, but the extent of implementation has however been much more limited. These dimensions will be briefly considered.

Whilst a wholly rational and normative approach to revenue sharing is desirable it may not always be feasible, and in reality an ad hoc and subjective approach often prevails. The Karnataka State Finance Commission (SFC)<sup>9</sup> has adopted an innovative 'pragmatic normative approach' in the sense that both administrative feasibility and the norms of services were taken into consideration for estimating the financial requirements of local bodies. The Karnataka SFC maintained that this is different from the traditional gap filling approach often adopted at central government level.

The policy of 'global revenue sharing' is gaining ground in India, which is evident

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<sup>9</sup> State Finance Commissions are constitutionally mandated. Every state is required to form an independent Commission every five years to make recommendations for improving state fiscal frameworks.

from the reports of the various State Finance Commissions, and involves the creation of a divisible pool of funds at state level. The definition of the divisible pool varies from state to state. Ideally, it should include the net proceeds of all taxes, fees, tolls, etc., levied by respective state governments. But the various state governments have interpreted the concept differently. For instance, the Karnataka SFC included all the 'non-loan gross own revenue receipts' of the state government but excluded the state's share of the Central revenue transferred through the Central Finance Commission, Planning Commission and the loans. In Andhra Pradesh this has been interpreted as a sum of tax and non-tax revenues of the state government.

In Tamil Nadu the divisible pool comprises the net proceeds of all State taxes, excluding entertainment tax, surcharge on stamp duty and local cess plus surcharge levied which are specially earmarked as 'assigned revenues' for local government. Any outstanding amounts for debt servicing or other dues are deducted by the state at source. In Kerala separate Urban and Rural Pools have been established where the former comprises various non-statutory non-plan grants, basic tax (100%) and 25% of the proceeds of the surcharge on stamp duty. Not all state governments, however, have accepted the primary recommendations for pooled sharing of state resources.

Whilst there has been little systematic analysis of the revenue sharing process in India as a whole it is interesting to note that the Government of Madhya Pradesh shared only 0.67% of tax and non-tax revenue as compared with a recommended share of 8.67%. The Government of Tamil Nadu accepted the main recommendation of global sharing at the rate of 8% but failed to increase the local government share annually by the recommended 1%.

The World Bank (2004) has undertaken a review of fiscal decentralisation in Karnataka and Kerala. The findings on the operation of the fiscal transfer systems from these two states highlight fiscal issues of more general concern:

- The Karnataka system of transfer system is complicated, non transparent, and non equalizing. The Government of Karnataka has not fully implemented the SFC recommended allocation criteria, in part because of its own fiscal crisis and also due to a concern with ensuring that the grant received by each urban local authority is sufficient to pay salaries.
- Local government in Karnataka receives a very small proportion of funds as untied grants but it has accessed as many as 428 central and state government conditional grants (some of which require matching funding (Jha 2000)). Local government generally has little expenditure discretion over these grants, which are administratively burdensome, and are likely to result in allocative and other inefficiencies.
- In Kerala, a large proportion of funds (over eighty per cent) are received as untied grants by local government, and for state and central government schemes local government has a degree of discretion in the location and beneficiaries of schemes that is not found in Karnataka.
- In Karnataka untied grants are distributed to local government on an equal share basis. Even for poverty programmes Panchayats with a greater

concentration of poor families do not receive more funding.

- In Kerala whilst the system of transfers has a stronger and more rational basis, the system has been under considerable strain related to the weak finances of the state as a whole. This has limited the scope for the state government to transfer resources.

#### *Incentive based release of funds*

An important trend within Indian fiscal policy has been the increasing adoption of incentive based funding mechanisms. These are being introduced at both the state and central government levels. A number of State Finance Commissions have recommended the establishment of “Incentive Funds” linking the release of untied grant to local government to performance on a number of criteria such as tax collection, expenditure management and improvements in accounting systems. Annexes 1 and 2 provide details of the funds recommended for both Karnataka and West Bengal. To date these schemes have only been limited in scale and have not been widely implemented. Nonetheless they represent a new and important trend within state financing that is seeking to break the dependency culture within local government. At central government level a parallel trend can be seen. Examples of this include:

- The introduction of an Index of Fiscal Discipline for the transfer of funds from the centre to states under the 11th Finance Commission. This rewards better fiscal management through higher funding;
- The City Challenge Fund and Urban Reforms Incentive Fund provide funding for cities undergoing reform of their municipal systems;
- The Rajiv Gandhi Drinking Water Mission is increasingly linking the release of central funding to agreement to sectoral (institutional) reforms;
- The Ministry of Health and Family Welfare has grouped a number of centrally sponsored schemes and is linking funding to agreement performance criteria.

Such approaches represent a significant change in the basis of funding. Nonetheless there is still limited experience of either the operational modalities or the likely impacts of this type of funding.

Annexes 1 and 2 examine in more detail the specific devolution policy frameworks recommended by the State Finance Commissions in Karnataka and West Bengal with a focus on the issues and mechanisms identified above.

#### *Financial Management and Monitoring Issues*

A number of issues affect fiscal and financial management in the states under consideration;

- *A weak information base* A common theme within the analysis of the fiscal decentralisation in India is the lack of effective information systems on local finance. This affects the capacity of local government to plan and budget. It

also affects the capacity of state governments to monitor fiscal performance (World Bank 2004). Jha (2000) has stated that the SFCs are hampered in their analysis and recommendations by the dearth of reliable information on sub-district revenues and actual expenditures. The World Bank (2004) stresses that the information used in the case of Kerala and Karnataka actually exaggerates the level of funding available to gram panchayats.

- *Local government accounting systems* The impact of fiscal decentralisation is also hampered by weak capacity, both in terms of staffing and also systems within local government. Moreover the mechanisms for state government monitoring of local government finances are often weak. For example, systems of auditing in Karnataka and West Bengal are in arrears (World Bank 2000, WSP 2002). This is an important issue, regular auditing makes it possible to identify problems and enforce corrective action.

Within India these issues form part of the agenda of the UN Inter Agency Working Group on Decentralisation. This group's main objective is to act as the resource group for information exchange on decentralisation issues in India.<sup>10</sup>

### 3.1.3 Implications for future research

From the above it can be seen that India presents a very mixed picture of decentralisation. Within a strong enabling framework established by the Constitutional Amendments, there has been considerable devolution of political responsibilities. State governments have, however, generally been more cautious in the implementation of administrative and fiscal decentralisation reforms. Moreover there has been considerable variety between states in the nature of decentralisation initiatives that have been introduced. A combination of factors have been significant in this regard, including the interplay of state and local government interests, the nature of local power relations, the vested interests of the non elected administration, and broader structural factors.

In relation to fiscal decentralisation, there is considerable variation in experience across states. The State Finance Commissions have made a number of interesting and innovative recommendations for the development of improved fiscal frameworks, but the extent of actual implementation has generally been weak. And overall it is clear that the structures governing fiscal relations in India are generally weak. Local government is under-resourced and fiscally dependent, with weak own revenue raising powers, weak incentives for fiscal discipline, to limited monitoring, and to limited information.

Beyond these general conclusions it is, however, difficult to establish a clear understanding of both the precise nature of fiscal relations *in practice*, how they vary between states and their relationship to local service delivery / poverty reduction outcomes. There is an absence of accurate statistical information making comparative analysis of different states difficult.

<sup>10</sup> The IAWG-D is co-chaired by UNDP and UNFPA and membership includes: APCTT (UNESCAP), FAO, ILO, UMPSA (UNCHS), UNAIDS, UNCTAD, UNDP, UNDCP, UNESCO, UNFPA, UNIDO, UNICEF, UNIFEM, WFP, WHO, WSP-SA, and the World Bank. Each member organisation has a Focal Point, who participates in the meetings of IAWGD and is responsible for ensuring the commitment of his/her agency to the activities of IAWGD.

At a more detailed level the operational modalities of specific fiscal instruments and their impact upon service delivery is not well understood. Thus, for example, the proportion of grants to lower levels of government which are untied is not clear, and there is not a good understanding of their actual use at a local level. Similarly the impact of performance based funding mechanisms (which are gaining currency within India) is not clear. There is a need for further consideration of the operational modalities of these innovations and their impact on both service delivery and poverty reduction.

### **3.2 Decentralisation, service delivery and the poor in Bangladesh**

It is widely recognised that Bangladesh does not represent a supportive environment for decentralisation and local governance. This case study presents what is, in effect, a controlled experiment in establishing innovative decentralised institutional arrangements. The experiment is “controlled” insofar as donor support has served to provide additional capacity building, monitoring and regulation that Government of Bangladesh is not currently able to provide. The nature of innovations introduced by the pilot are analysed and directly compared with the conventional service delivery arrangements prevailing at Union Parishad (village council) level. Albeit an artificial model, the case study demonstrates that empowering local government can *potentially* have positive impacts upon service delivery.

#### ***3.2.1 Sirajganj District Local Governance and Development Fund Project<sup>11</sup>***

The UNCDF supported the Sirajganj District Local Governance Development Fund Pilot Project (SLGDP) the *to promote decentralised participatory planning and local governance in Bangladesh*. It demonstrates the potential benefits for service delivery and poverty reduction of decentralising funds to the Union Parishad level, and promoting local infrastructure and service delivery processes that involve participatory planning and capacity building. The project is being implemented in Sirajganj District, and combines the following components:

- The provision of funds directly to the Union Parishad level on an annual block grant basis. These funds are controlled and managed by the Union Parishads;
- The promotion of participatory planning processes at ward level as part of wider improvements in accountability and governance;
- The provision of support and incentives for the Union Parishads to improve their performance and accountability.

#### ***3.2.2 The context of local government***

Only a limited degree of devolution is enshrined within the country’s legislation, and local government in Bangladesh today is correspondingly weak, especially so in rural areas. The lowest tier of government, the Union Parishads, have limited resources, little revenue raising authority, and almost no influence on how the central government

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<sup>11</sup> This is a summary of the findings of an Impact Assessment Study undertaken by GHK for the UNCDF (GHK 2003).

uses its resources in their areas. Union Parishads are dominated by the District and Upazila (sub district) administrations. Education, health, nutrition, family planning, irrigation, agricultural services, and other services are generally managed directly by the central government officers. In addition to this highly centralised administrative control there is very limited directly elected political representation at a local level. Whilst allowed for in the constitution at every administrative level, only Union Parishad members are directly elected. Moreover it is generally recognised that a culture of patronage governs local politics.

### ***3.2.3 A clear fiscal framework***

The pilot project provides funds directly to the Union Parishad level on a block grant basis. These funds are controlled and managed by the Union Parishads. The grant seeks to mirror the standard Annual Development Plan (ADP) Grant in both size and the allocation criteria used.

The key benefits associated with SLGDP fiscal framework include the following:

- *Greater certainty in the allocation levels for the grants:* This allows the Union Parishads to engage in medium term budgeting and planning processes. There have also been transparency improvements and a reduction in the scope for the diversion of funds to other Union Parishads or out of Union Parishads, or for political manipulation.
- *Performance based funding:* Union Parishads that have performed well in the previous year are eligible for additional funding in the next year. This has been shown to incentivise performance improvements.
- *Planning:* The timing of the pilot grant during the year allows the Union Parishads to undertake a better annual budgeting processes. The UPs usually receive notification of their ADP allocations in October, after annual budgets have been prepared in June).
- *Local empowerment:* The flow of funds directly to the UP has helped to move the focus of decision making about scheme selection and implementation to the local level. UPs have greater control over budget allocation and fund management.

### ***3.2.4 Service delivery: autonomy, roles and responsibilities***

The conventional Annual Development Plan (ADP) grant represents a weak form of decentralisation in which the Union Parishads have limited infrastructure and service delivery planning and implementation responsibilities and with financial powers resting at the Upazila (sub district) level. The pilot project introduced considerable autonomy through the mechanism of an untied block grant managed by the Union Parishad.

The pilot project implementation processes mirror those of the ADP. Technical designs and final approvals are obtained from the line department engineer and schemes require approval from a sub district level committee. Union Parishads seek to avoid the use of commercial contractors because their control over implementation of works is



more limited, and because levels of corruption are perceived to be higher and quality levels lower.

Under both the conventional arrangements and the pilot project, committees are formed to manage and monitor implementation of new works. There are, however, significant differences in the manner in which these committees function and in how implementation is undertaken. Under the pilot, levels of community participation and monitoring are higher, and there are stronger institutional arrangements for O&M. These impact positively upon the quality of ISD.

In both ISD arrangements the line department engineer plays an important role in cost estimation, technical assurance and final certification. This is generally problematic both in terms of poor technical quality of works and corruption. The decentralised ISD arrangements on scheme implementation, however, brought substantial improvements in use of materials, labour and other inputs and strict adherence to technical specifications as regards slab thickness, wall footings, plastering, shuttering and finishing. These structures were confirmed to be able to withstand double the load of an ADP structure with a minimum lifespan of 25-30 years or between 3-5 times that found under ADP provision.

Because locals have been involved and recognise the scheme as a priority, they are often more willing to provide additional inputs so as to improve the quality beyond the estimate. Local sources also ascribe these improvements to closer supervision and sufficient funds to produce a quality of structure well above that specified.

Overall, the study found a 37 per cent average differential between the value of the new assets and “book value” or price under ADP contracted arrangements. There was an average 75 per cent reduction in the life of the asset under ADP contracted arrangements and a 35 per cent shortfall in the time required for completion of works to specified standards. Moreover SLGDP schemes were shown to have an average 30 per cent value addition arising from mobilisation of community resources.

### ***3.2.5 Accountability, monitoring and regulation***

There is no culture of participation or accountability within the Union Parishads. The pilot project has sought to introduce greater local accountability in the following ways:

- *Participatory planning processes*, to provide local government with tools and processes by which they can interface with local communities and better understand local needs;
- *A structure of community organisations*, to facilitate, selection, construction and maintenance of new development schemes;
- *Performance Assessment*, through an annual performance review is undertaken in the manner of a Public Report card, to assess the overall performance of the UP and to provide links linked to the release of incentive based funds;
- *Standing committees* (a statutory obligation), developed to focus operational issues and with clearer responsibility;



- *Scheme Notice boards and public information*, to improve communication with local communities;
- *Scheme assessments and participatory planning reviews*, to enhance accountability, monitoring and forward planning with a project specific focus.

Accountability mechanisms under the ADP are weak, restricted to a handful of Union Parishad members on behalf of some 8,000 households. This contrasts with the active involvement of people under the pilot programme, where there are typically around 1,100 people involved in each Union Parishad in different aspects of the planning process. Planning has therefore become more demand led. This has undoubtedly served to ensure that projects are broadly more pro-poor.

It is necessary to briefly elaborate in the *Participatory Performance Assessment* concept. This exercise is conducted in an open public forum where members of the community are invited to comment on and question UP performance. The assessment results in a grading of performance linked to scheme eligibility for the following year, and has been shown to successfully incentivise improvement. Overall a major benefit of this process is the dissemination of information on the linkages between tax compliance, collection and service delivery, and UPs report that one direct benefit of this process is a greater willingness on the part of ordinary citizens to pay their taxes (because they have a better understanding of how their taxes are being used).

### **3.2.6 Capacity Development**

UNCDF has provided a range of capacity development support. This has included the following forms of training:

- Financial management - for local government staff;
- Participatory planning - approaches and tools;
- Awareness development for councillors of their roles and responsibilities;
- Technical engineering aspects of construction for selected community members.

The impacts of this training have been seen in the improved nature of service delivery. It is nonetheless clear that this support has been provided in a weakly institutionalised manner, and a challenge is to develop mechanisms by which higher levels of government can provide capacity development support on an ongoing basis.

### **3.2.7 Implications for future research**

At the micro level, the Bangladesh case study provides useful empirical evidence of how a specific set of decentralised institutional arrangements impact upon service delivery. The case study directly demonstrates that when granted power and autonomy (here in the form of untied block grants) local government has the potential to use this wisely and can improve local service delivery. In Bangladesh these improvements are seen in the nature and quality of infrastructure provision, as well as less concretely in improvements in accountability and local governance.

The study also suggests other conditions that are important if decentralisation is to “deliver” locally. These include elements such as the nature of capacity building, forms of participatory planning, and strengthened accountability mechanisms. Information of this nature can inform formulation and development of models of decentralisation. Importantly, the study also highlights constraints to effective decentralisation and ongoing risks and challenges such as, the challenge presented by the prevailing structural and institutional context, local power relations. It highlights the value of top-to-bottom as well as bottom-to-top reforms. Given the responsibility, local communities and structures could make considerable progress in improving their local contexts; however, the contextual forums help create a supportive environment.

Studies of this type are also important because they provide direct evidence of the impact of decentralisation that can then be used as an advocacy tool. It is notable that on the basis of exposure to the experience of the Sirajganj project the GoB is now exploring expanding the approach to a further three districts in Bangladesh.

## 4 A future Research Agenda

The scoping study has delineated a number of important strands for a future research agenda:

- The literature review has demonstrated the multidimensional nature of decentralisation, and identified factors most important for the creation of an enabling environment, such as structural, fiscal, administrative, legal and regulatory regimes. In each case the literature review has highlighted the more important aspects of each of these factors showing that the decentralisation process is both complex and multi-layered. It also demonstrated the paucity of information on which aspects of these key factors are most likely to ensure effective service delivery at the local level. Attempts to assess such factors have tended to excessively aggregate issues, and comparisons on an international and even inter-continental basis often miss finer nuances in specific locations.
- The South Asian case studies add the benefit of local nuance to the future research agenda. At the micro level, the Bangladesh study provides useful empirical findings on how a specific set of decentralised institutional arrangements impact upon service delivery. The study directly shows that local government does have the potential to deliver improved local services and better local governance. The study starts to show the associated measures and conditions needed for local government to “deliver” efficiently and effectively. This includes dimensions such as capacity building requirements, forms of participatory planning, and accountability mechanisms.
- The Indian experience in relation to fiscal frameworks reinforces these messages. It suggests that there remains a need for a more systematic mapping of fiscal practices and experience across states. Furthermore it highlights the need for the constituent parts of fiscal practice to be unpacked, with further analysis of how specific fiscal instruments impact upon the overall performance of local government and service delivery specifically. Thus, for example, the operational modalities and impacts of instruments such as incentive based funding need to be explored in greater detail.

On the basis of these lessons from the literature review and provisional case studies, the rest of this section provides a few core elements for future research.

### 4.1 The value of regional and international research

The scoping study has suggested that decentralisation can best be understood when contextualised at national and regional levels. In India and South Asia, there has been a very clear articulation of demand by DFID advisers and other practitioners for further applied research in the South Asian context. It is also understood from GHK’s ongoing decentralisation experience in East and Southern Africa that further research of this nature is also required in the African context (and it might be assumed that this is also true in Latin America). As such a series of parallel region specific research agendas could be taken forward, based on the specific demands for research as articulated

within each region. DFID London would then need to bring these parallel strands together through the establishment of an international facility that promotes learning and dissemination. One means of undertaking this might be through links with the World Bank's Decentralisation Net. Alternatively, DFID could dedicate part-time capacity in London to this task either in-house or on contract.

It is suggested that the best means of taking this research agenda forward would be through support for the South Asia research agenda as defined below, and in parallel through support for field consultations with other regions to further delineate the nature of local demand for research. GHK would be well placed to undertake this work in Eastern and Southern Africa, as a start, and could assist in other regions.

#### 4.2 Principles of the research approach:

The proposed research approach rests on the following principles:

- *Applied research:* The research will build on GHK's previous applied research series on the urban sector, published in the *Building Municipal Capacity* series. Here the focus will be on factors external to local government with a working title of *Supporting Local Governance Series*. Our target audience is national and sub-national politicians and government officials, as well as donors. The research will be directly relevant to programme design and formulation. We will also work closely with local institutions and practitioners.
- *Contextualised research:* This recognises the importance of analysing the decentralisation reforms within an understanding of the wider issues of political economy. This is the terrain of DFID's Drivers of Change approach, and it is important to locate work in the historical evolution, political dynamics and service delivery challenges of particular counties and sub-national institutions.
- *Disaggregating decentralisation:* Research will have to focus on unpacking the different components of decentralisation focusing on those aspects that are likely to have a significant impact, in particular localities. Important as the cross-cutting themes are, they need to be substantiated and nuanced in specific environments. It makes little sense, for example to discuss expenditure or revenue assignments, without systematically disaggregating actual trends in local spending or revenue collection.
- A concern with *practice and outcomes for the poor:* The overall focus is on decentralisation practice, the catalysts for change, innovations, and outcomes of decentralisation for the poor. This means that participation, affordability and access has to be impacted and analysed.

#### 4.3 India and South Asia - Research and Learning Proposal

The scoping study demonstrates that India and South Asia would provide a good laboratory for initiating DFID's decentralisation policy research and learning agenda. The variation of fiscal, administrative and political arrangements within a broadly similar political economy and culture of the region provide useful points of comparison. Research in India especially would allow for a detailed exploration of the impact of a

specific service delivery arrangements in relation to an equivalent counterfactual in each case that would serve to strengthen the comparative analytical content of the study. A more robust analytical framework of this nature would not only benefit policy dialogue and formulation within the DFID India country programme, but could also contribute to wider corporate policy dialogue both in relation to the South Asia region where DFID is already involved in aspects of the Devolution Support Programme in Pakistan, and more widely in Africa (e.g. Uganda and Ethiopia) and elsewhere in Central Asia.

The Delhi workshop of 29th March 2004 presented interim findings and issues that could help guide the overall country strategy. State policy formulation and programme implementation on devolution and service delivery arrangements stand to benefit. There appeared to be a general consensus from participants that a lot more work is required to understand the comparative opportunities, risks and impacts associated with different fiscal and administrative arrangements for devolved service delivery. It was generally agreed that India presents a particularly case for such comparative analysis given the level of variation in specific devolution frameworks within a broadly similar socio-economic and political system.

#### 4.4 Research themes

In the light of the literature review, the case studies, consultation with DFID-India and GHK's experience elsewhere in Asia and Africa, a number of specific learning and research themes should be considered. These are discussed below.

##### 4.4.1 *Fiscal and Functional Mapping*

Comparative mapping and tracking of functional autonomy and accompanying resource flows to the local level would elucidate devolution frameworks of select regions or states. This mapping exercise would provide a valuable inventory of the actual levels of devolved functions and finances implemented in different situations along with an assessment of expectation in relation to what is practical realistic and feasible in different political contexts. This research strand would include the following analysis:

- What levels of expenditure assignment have been devolved? What sectors have been prioritised and does this show in budgets and actual expenditures?
- What are the levels of financial autonomy (what local revenue collection powers, what proportion of tied and untied funds)?
- How are fiscal transfers being implemented in practice, and to what extent to they address issues of equity, efficiency and predictability? What is the balance between conditioned and untied grants and how does this influence the autonomy of local governments?
- What roles and functions have been assigned to different levels of government (sectoral devolution, staff levels, geographic coverage of different levels of government)? How does this compare to international "good" practice? Are they capable to perform these roles?

- What accountability, monitoring and regulation mechanisms are in place and which are practical and robust?
- What are the main political characteristics associated with each of the above factors (party composition, core alliances, party security, manifesto, electoral behaviour, strategies and tactics, role of opposition) How do these influence the technical dimensions of decentralisation?

#### ***4.4.2 Policy Impact Framework***

The development of a framework to assess the level of opportunities and risks associated with different fiscal and administrative devolution mechanisms and arrangements would assist both policy and implementation. Such framework should be based upon empirical data on the impact of different mechanisms and arrangements on service quality, effectiveness and accountability outcomes, and aim to identify the minimum capacity requirements. This framework would be developed in an incremental manner by ‘unpacking’ the respective elements of the devolution package by looking at specific local experiences, and by analysing the risks and impacts of each of the main factors in turn. There is a quantitative and qualitative dimension to this work, and it would have to be linked to costs, governance and choice.

#### ***4.4.3 Fiscal Incentive Analysis***

Fiscal incentive systems are becoming an increasingly important tool in encouraging greater fiscal discipline, accountable governance practice and service delivery within many fiscal devolution frameworks. Yet there is comparatively little data on the impact of such systems generally or the differential impacts of different incentive mechanisms. This proposal would thus develop a focused analysis of the impact of fiscal incentive mechanisms on reform processes in general and service improvement in particular. It would use comparative analysis of the performance of different incentive systems, and relate them to devolved governance arrangements.

There is a slowly evolving body of experience on the formulation and implementation of various fiscal incentive schemes. In India it is in part state inspired as part of a wider fiscal devolution framework (as found in Tamil Nadu for example). Some have been centrally created to encourage enhanced performance (eg city challenge funds) and access to loan finance, it would be useful to take stock of these experiences in general and to undertake a preliminary assessment of those in operation in terms of their impact on revenue enhancement, expenditure management and service delivery.

#### ***4.4.4 State specific analysis***

The selection of states or regions should ensure variety in the nature of decentralisation reforms being introduced, in order to ensure a clear counterfactual for comparison. Consultations in Delhi suggested that West Bengal and Madhya Pradesh would present interesting comparative cases in India. In West Bengal the long standing commitment of the Left Front government to decentralisation, together with its distinctive ideological stance are distinctive. In Madhya Pradesh, since 1994 the state government has legislated a series of reforms which have been intended to strengthen the role of the Gram

Sabha. This resulted in the notion of Gram Swaraj, or village self rule (legislation was passed in 2001). Both states are DFID partner states, in which rural livelihoods and development programmes are being developed. As such the research will be directly and practically relevant to DFID advisers and will inform programme formulation. If the research is widened beyond South Asia - as we would strongly argue – the experiences in this region could assist to develop context for selection. In countries like Ethiopia and Nigeria, for example, donors and governments have selected priority states based on various factors such as size, complexity, and reform, orientation.

#### **4.5 The research contribution to poverty alleviation**

The research findings will promote improved decentralisation practice and will allow a better understanding of how decentralisation processes can be catalysed and supported. Processes of decentralisation, if well managed, have the potential to impact positively upon the operation of local government, through improving accountability of councillors and officials, enhancing management and resource allocation decisions, as well as improving service delivery. These processes will enable accelerated poverty reduction processes and improved livelihoods. The relationship between well managed decentralisation and poverty reduction is confirmed by the literature (Manor 1999, DFID Urban TSP 2001).

There is a notable lack however of quantified and systematic analysis of the relationship between decentralisation and service delivery. It is suggested this should be a specific point on the agenda.

#### **4.6 End-users and target audiences for the research**

Decentralisation research will be especially relevant to organisations involved in local government reform. Thus the end users of the research will be individuals and institutions responsible for decentralisation policy formulation at central and state or regional government level, as well as those implementing or supporting decentralisation processes and capacity builders, such as local government directorates, audit agencies, training institutions and municipalities. The research will also be of relevance to donors (especially organisations such as DFID designing or implementing local government strengthening programmes and municipal reform programmes).

#### **4.7 Evidence of demand for the research**

There would appear to be considerable demand for this research, emerging from a number of major government and donor supported initiatives on devolution across Asia and Africa. This demand, in turn, relates to the lack of information on the impact of different devolution mechanisms in different contexts thus making it difficult to base programme support decisions on sound knowledge and understanding of devolution options. Programmes of interest to DFID in India might include those related to supporting on-going devolution processes in places such as West Bengal to those aimed at promoting a more progressive approach to devolution in Andhra Pradesh, Madhya Pradesh and Orissa. The research could also contribute to further strengthening reform processes in Tamil



Nadu and Kerala as well as helping to build capacity amongst a wider constituency of central and state finance commissions.

Other important constituencies of demand in Asia include the Devolution Support Programme in Pakistan that has a strong interest in applied research in support of programme formulation as well as initiatives to expand devolved finance mechanisms for local government funding in Bangladesh, and Sri Lanka and fiscal policy reform in Nepal, Laos and Vietnam. There would also be good application of findings to support aspects of devolution in Uganda, Kenya, Tanzania, Nigeria and Ghana. Seemingly positive experiences, such as in South Africa, provide a wealth of information and perspective that could have wider application. South Africa still acknowledges major challenges in this regard, and there continues to be a stream of requests for research by the National Treasury and the Department for Provisional and Local Government.

#### **4.8 Local collaboration**

The UK team will establish a learning and research consortium to consolidate existing arrangements with local researchers developed under the scoping study as well as to anchor the research with select institutional linkages in-country. At the outset in India, such linkages might include NIUA/ NIPFP/ NIRD at national level and select linkages at state level that might comprise a mix of policy advisers in government and organisations involved in on-going support to devolution processes. Research institutions, policy institutes and relevant departments or advocacy groups (such as SALGA in South Africa) are potential partners elsewhere.

#### **4.9 Research dissemination**

Dissemination will be coordinated at different levels and based upon the promotion of inter-country and international learning through publications and workshops ,with in-country and in-state dissemination through a series of policy presentations and meetings supported by policy briefing papers and policy notes. Donor dissemination could be jointly coordinated by the DFID strategy and learning team and the research consortium. At the same time, each of the collaborating institutions will build research findings into on-going training activities.

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## **Annex 1: Case Study of fiscal devolution in Karnataka**

Karnataka has been at the forefront of a number of policy reforms over recent decades as the state has seen substantial growth in the development of knowledge based industries and associated infrastructure with a pragmatic stance in relation to governance and decentralization reinforced by innovative policy recommendations on fiscal devolution from two Finance Commissions. Whilst these recommendations have not been yet fully implemented, they nevertheless, represent the basis of a sound fiscal framework for the promotion of further devolution.

Karnataka has been among the forerunners in the implementation of the 73rd & 74th Constitutional Amendments that enshrine decentralization in both the rural and urban areas of the country. In response to these amendments the state government enacted new legislation in a series of Acts covering rural local government institutions and municipalities.

In Karnataka, as in other states, the implementation of the decentralisation agenda has been stronger in rural areas than in urban areas. This is in part because the political return is generally greater in rural areas where there is a more homogeneous polity as opposed to the more highly contested and shifting allegiances of urban politics where there is less confidence about the returns on political investments in decentralisation. Within the rural sector, however, there has been a clear move to utilise decentralization to undermine the progress of the rival Bhartiya Janata Party that has emerged in recent years as a dominant national party while in urban areas, as in some other states (such as Tamil Nadu, Andhra Pradesh, Punjab) reforms have been viewed as a necessary step to achieving economic progress.

Interestingly, the state has long been at the forefront of devolution with an earlier experiment on functional, fiscal and administrative devolution in the late 1980s. This initiative, which was again partly inspired by an interest in undermining Congress Party support amongst the rural electorate, included a short lived attempt to subordinate the powerful district bureaucracy to a locally elected council at district level. In spite of improvements in local services such as health, education and development arising from this initiative, the government was later forced to concede to powerful vested interests that reinstated the dominant role of deconcentrated administration.

### *Fiscal Policy Instruments*

Whilst the state has undertaken a range of policy reforms over the past two decades that have helped to strengthen local government including tax reforms based on an extension of the self assessment process initiated in Bangalore for property tax, now extended to all municipalities in the state, as well as increasing the scope for local government borrowing, the focus of innovation has been in relation to defining a sound fiscal framework for intergovernmental fiscal transfers and allocations.

### *Revenue assignments*

The main taxes which are assigned to local governments are as follows: property tax;

tax on vacant land; water tax; conservancy tax / scavenging tax. There are a number of taxes that had earlier been within the control of local authorities but have now been appropriated by the state and are then assigned to local bodies. These include: professional tax (tax on professions, trades and callings); entertainment tax; education tax or cess; tax on vehicles; toll tax; library cess.

The State Finance Commissions also have jurisdiction to make recommendations in relation to the arrangements that exist over the specific share that is devolved to local government. In many states, SFCs have now recommended sharing of some of the state taxes within a divisible pool. As a result the following state tax revenues are now commonly shared with local government: surcharge on stamp duty; mines and minerals; local cess and local cess surcharge on land revenue in rural areas. Beside these, local governments are also allowed to levy service charges (such as water charges and a range of licence fees).

Over and above these innovations, Karnataka is one of the first states in India to extend property tax reforms to all urban local governments through the introduction of self-assessment procedures for property tax to enhance tax demand and collection performance. This scheme was piloted in Bangalore and has subsequently been extended to all municipalities. Another innovation in Karnataka has been the introduction of a new solid waste charge to offset the additional costs of compliance with Supreme Court rulings on environmental standards.

The 2nd SFC of Karnataka has also recommended the addition of new sources of revenue for rural local bodies. These include: a 50 percent share out of revenue realised by lease/ auction of sand beds and stone quarrying to gram (village) panchayats. It also recommended a revenue stream from all the minor tanks falling within a gram panchayat to be a fully assigned revenue source. These recommendations have still to be fully accepted implemented.

#### *Intergovernmental fiscal allocations and transfers*

As in India generally, the state's fiscal framework has been defined and revised on the basis of recommendations of the two independent State Finance Commissions (SFCs) of 1996 and 2002. The main recommendations of from these two commissions are summarised in the table below for different categories and tiers of devolved governance. A key innovation of the SFCs in Karnataka has been the development of a multi-level fiscal allocation framework differentiating between:

- 1st level – shares for all tiers of government out of total state revenue
- 2nd level – shares for rural and urban local governments out of the total share of state revenue defined for 1<sup>st</sup> level above
- 3rd level – shares for all three tiers of rural and urban local government
- 4th level – shares between local authorities within each tier of rural and urban local government (eg zilla parishad, taluka panchayats or gram panchayats).

### Fiscal Devolution Frameworks in Karnataka

Level	1 <sup>st</sup> SFC Framework	2 <sup>nd</sup> SFC Framework
<b>1<sup>st</sup> level Allocations</b> Local Governments Share in State's Resources.	36 percent of Non-Loan Gross Own Revenue Receipts (NLGORR)	40 percent of Non Loan Gross Own Revenue Receipts (NLGORR)
<b>2<sup>nd</sup> Level Allocations</b> Division of Resources between Urban & Rural Local Government.	Based on five Indicators (%) Population 33.3 Area 33.3  <i>Backwardness Indicators</i> Illiteracy Rate 11.11 Population per Hospital Beds 11.11 Road Length per Sq. km. 11.12  Application of these indicators resulted into 85% share for PRI & 15 % for urban bodies	Based on Same Indicators Population 30 Area 30  <i>Backwardness Indicators</i> Illiteracy rate 15 SC & ST Population 15 Persons per Hospital Bed 10 Total weightage of Index 40  Application of these weightage indicators resulted into 80: 20 sharing between PRI & urban bodies
<b>3<sup>rd</sup> Level Allocations</b> sharing of funds among different tiers of Rural & Urban Local Governments  <b>Part A - Panchayats</b>	Level of Govt(%) Zilla Panchayat 40 Taluka Panchayat 35 Gram Panchayat 25  This formula was not accepted by State Government as there was a high ratio of committed salary expenditure	- Committed expenditure to be earmarked out of amount available to PRIs (32 % of NLGORR) - Block Grants to the Gram Panchayats (Rs. 350,000 per Gram) to be deducted from the above amount (Block Grant to increase every year by Rs. 25,000 per village - Rs. 100 million to be deducted from the Incentive Grant - Remaining amount to be shared by ZP & TP in a ratio of 65:35
<b>Part B - Municipalities</b>	Five weighted indicators for Inter-re Allocation among Urban Local Governments (%)  Population 33.3 Area 33.3 <i>Backwardness</i> 33.4 - Illiteracy 11.11 - Population per hospital bed 11.11 - Road Length Per sq. km 11.12	Two weighted indicators for inter se allocation amount urban local governments  Population 67 % Area 33 % 2 <sup>nd</sup> SFC omitted other indicators such as area, SC & ST population and population per hospital beds as 2001 data was not available and it felt that 1991 data should not be applied.



The main innovations in this allocation formula are as follows:

- *Non loan gross own revenue receipts:* first level allocations are based on the entire gross own revenue receipts of the state government, other than loans and the state share of the central revenues, which are then aggregated into a divisible revenue pool. The 1st SFC recommended that 36 per cent of this should be allocated to local government while the 2nd SFC recommended a 4 per cent increase in this share. This makes the Karnataka fiscal framework one of the most progressive in India based on a much broader, comprehensive and more transparent system than found elsewhere.
- *Normative approach:* the 1st SFC sought to adopt a zero based budget approach to the assessment of the total revenue requirements of local government rather than a simple “gap filling” approach. This was based on the philosophy that any person living in Karnataka should receive a minimum of essential public/ civic services calculated on the basis of certain normative standards pertaining to each core services along with an estimated amount for priority capital investment. over a 5 year period.
- *Balanced financial allocation approach/ composite index:* the 1<sup>st</sup> SFC suggested a composite index of five indicators (see table above) to address the second level of fiscal devolution (ie that for rural & urban local government) and this has been retained in a modified form by the 2<sup>nd</sup> SFC.
- *Norms for inter-se allocation of 11<sup>th</sup> Central Finance Commission grants:* the 2nd SFC has also calculated norms for the allocation of the Government of India (Central government) 11th Finance Commission (EFC) Grants as envisaged by the Government of India.
- *Incentive grants/ schemes for rural and urban local government:* the 2nd SFC has recommended establishing an incentive fund to encourage local government to improve revenue mobilisation efforts. The SFC recommended an amount of Rs.100 million annually to be earmarked as an incentive fund. All Gram Panchayats whose internal resource mobilisation (recovery against demand, current and past) is 60 percent and above in each year for three consecutive financial years are eligible to be considered for a cash award under this fund. It also recommended that government extend this concept to urban local authorities following a two year period of implementation of the new capital value based property tax system.

### *Borrowing*

There is ample scope to strengthen policy in the area of debt financing drawing from the successful experience of neighbouring Tamil Nadu. In Karnataka, however, whilst municipal corporations have limited powers to borrow, municipalities and rural local authorities are more constrained. Here, the state government still manages loans on their behalf and transfers funds on a notional basis, since capital works tend to be carried out by line departments or parastatals. It is only in the case of municipal corporations, where capital works are usually undertaken in-house, that there is more autonomy in accessing and managing loan capital.

Some state acts provide for debt ceilings on local government based, for example, on levels of property tax demand, but in most cases it is the state government that still undertakes a needs assessments and fiscal capability analysis on a case by case basis should a local government request the authority to raise loan capital. There are several examples where the state, without assessing the debt absorption and repayment capability of a local authority, has allocated disproportionate loans to a local authority as a part of its (and not the local authority's) political agenda. The track record of multi-laterals is very poor in this regard. Once the state has provided a guarantee of repayment they have not looked into the needs and capabilities of the recipient local government and have consequently simply ended up serving the political agenda of the state government itself.

#### *Administrative Instruments*

Karnataka has an interesting past history of innovation in administrative decentralisation. As long ago as the late 1980s the state government sought to devolve greater administrative autonomy to district elected bodies through its Zilla Parishad reform initiative. Here the post of District Collector was made subordinate to the elected Chairperson of the district. In practice, however the strength of bureaucratic resistance led to a gradual re-emergence of administrative centralisation. Today the administrative arrangements governing decentralisation differ little from those found elsewhere in India.

The primary administrative control over local government is through staffing. Recruitment and conditions of service rules are weak. Some grades belong to provincial cadres and so recruitment, transfers etc are controlled by the state. Other middle to lower middle cadre posts can be recruited by the state but are under the control of the local body for conduct and payment of salaries. Staff strength is determined and sanctioned by the state that takes responsibility for payment of salaries through the devolved funding formula or grants-in-aid. Salary costs of any staff recruited beyond the sanctioned staff strength are the responsibility of the local body. Local bodies are usually allowed to recruit lower or sub staff.

#### *Regulatory and support mechanisms*

The 2nd SFC has suggested an interesting innovation for improving the regulation and support to local government in the urban sector based upon a common purpose fund for local government. This fund is aimed at developing software and hardware to help establish a comprehensive computerisation programme including relevant databases covering all the main local government functions. This includes an information system for training, preparation of draft contract documents, agreements, tenders, manuals, studies and surveys. The 2<sup>nd</sup> State Finance Commission recommended that Rs 50 million (US\$ 1.1 million) should be allocated each year out for this purpose of the total share to urban local authorities. Although this has yet to be implemented, it is likely to operate on the basis of equal access for all, rather than on a performance basis.

Whilst the SFCs in Karnataka have recommended a simple but comprehensive fiscal allocation framework, in practice implementation has been weak. The grants provided to local bodies do not fully corresponded to the recommended allocation criteria. In reality the primary objective of the government has still focused on ensuring that the

grants received by each local authority are sufficient to meet their salary requirements. Devolution has been further undermined by the fact that the staffing strength of local authorities continues to be defined by the government and today bears little relation to the size, area, revenue, and functions of the respective local authority. As a result those with higher staffing (for historic reasons) receive higher grants at the cost of other local bodies with equal or greater needs.

There are a number of continuing challenges to the effective implementation of fiscal devolution in particular and accompanying decentralisation in general. In order to overcome these challenges in an effective manner it will be necessary to continue to focus on the design and development of appropriate policy support institutions mechanisms that will facilitate the introduction of new policies, systems and procedures to address such challenges in a successful manner. Here, the specific requirements will include ways and means of addressing the following outstanding policy issues:

- The adoption of a normative approach (as suggested by the 1st SFC) based on an accurate assessment process has, in practice, proven difficult to implement given numerous information gaps and lack of qualified assessment personnel. The second SFC has thus been forced to recommend the adoption of a composite index.
- There is a continuing emphasis to fund higher tiers of rural local government, Zilla Panchayats and Taluka Panchayats, at the expense of the lower tier Gram Panchayats. Gram Panchayats have received less than 5 per cent of the amounts available for rural local government in spite of an SFC recommendation of a 25 percent share. This is largely due to the inability of the system to change the traditional practice of basing (recurrent) allocations on a salary expenditure index (which favours ZP & TP). This change requires greater technical support.
- The 2nd SFC has recommended the use of a uniform block grant for Gram Panchayats of Rs 350,000 with an incremental increase every year irrespective of their size or functions. However, it would be more efficient to linking the size of the grant to key indices such as population and service responsibilities. This would require better information gathering and analysis.
- At the fourth level of allocation (pertaining to the municipalities), the 2nd SFC has confined the main indicators to population and literacy. Again this is due to the lack of data on other indicators. There is still a need to design allocation criteria that better reflect the real needs of a local government on some priority basis.
- Although the 2nd SFC has developed allocation criteria for the 11th Finance Commission grant, in practice, this grant is still counted as a part of the overall FC grant. There is a need to support the introduction of these criteria.
- The Chief Minister's Special Development Grant is included in the total divisible allocation although this amount is distributed at the sole discretion of the Chief Minister on the basis of political imperatives, rather than according to a transparent and equitable allocation formula.

- Deductions from the SFC grant at state level are made from the overall sum available for local government, before dividing it between individual local authorities. Gross-level deductions include: electricity charges; repayment of loans; interest and repayment on securitised dues; and pension contribution dues. This practice of deducting the entire amount of dues is biased in favour of those local governments that have higher amounts payable. As a result those local governments, that have borrowed less (or consumed less), are effectively paying for the local governments, which have higher amounts payable.

Whilst it can be seen from the foregoing that the formation of the SFCs and the implementation of their policy recommendations has helped to strengthen the devolution process in Karnataka, there remains an important need to regulate and support the policy implementation process in a number of critical areas. Without such regulation and support, the innovative fiscal devolution framework is at risk of never being fully implemented, thus jeopardising the entire devolution process.

Undoubtedly, the fiscal policy recommendations to date have helped to introduce greater budgetary certainty and a degree of predictability into the fiscal framework of the state through a simpler and more transparent process for transfers. However, as reported by the 2nd SFC, there are still sizeable fiscal transfers that remain outside the SFC framework and at the same time, the government has not been able to break the link between fiscal transfers and the salary commitments of local government or from various debt related and other water and electricity consumption related deductions and such practices serve to reinforce fiscal distortions and inequalities.

At the same time, whilst the SFCs have sought to introduce incentive funds to help improve own revenue mobilisation, the amount earmarked under the incentive fund has tended to be rather meagre. As a result, the extent of budgetary autonomy that the local bodies enjoy has not improved significantly since much of this depends on generating greater own revenue and self-reliance. No significant legal autonomy has been granted through legal amendments to the acts and the dependency of local bodies on state transfers still continues to be high.

Finally, in a democratic polity it may not be feasible to ensure all inter-governmental transfers are governed by an objective formula, but such transfers should be guided by clarity and limits. Whilst Karnataka has made important strides in this direction more remains to be done both in the field of policy development and implementation support. Bangalore the capital of Karnataka has emerged from a pensioner's paradise to become one of Asia's fastest growing cities. Measured in a recent UNDP survey as the world's 5<sup>th</sup> largest technological hub the city is now viewed as India's answer to 'Silicon Valley'. With the election of the new government in late 1999, Mr S M Krishna took over as the Chief Minister of the state and his belief in innovations in urban governance and desire for positive and rapid change were reflected in his administrative policy.

*Bangalore Agenda Task Force: An Innovative Approach to Policy Support*

The Bangalore Agenda Task Force represents an innovative approach to policy support and policy formulation. The rapid urbanisation of Bangalore in recent years arising from the growth of new sunrise industries in electronics, IT development and global

commercial support activities have placed an enormous strain on the city's infrastructure. The Bangalore Agenda Task Force (BATF) was created specifically to address this issue and represents an interesting approach to policy formulation support. The BATF agenda is represented by the state government's vision for improving infrastructure and citizen centred municipal services to enhance the business environment and help develop a robust and globally competitive urban economy. The task force was constituted through a government order and its mandate is as follows:

- Work with city stakeholders to achieve a vision of a role model city by 2004
- Upgrade and modernise city infrastructure to achieve visible impact
- Modernise systems and processes for citizens convenience
- Ensure best practices / management processes and appropriate use of technology.
- Develop and enhance the internal capacity of stakeholder agencies
- Expand the resource base of the city and help to finance civic infrastructure
- Facilitate effective Private Public Partnerships
- Enable an efficient, effective and pro active administrative framework
- Institutionalise upgraded service delivery mechanisms by amending the legal framework
- Secure greater involvement of citizens, corporate organisations and industry to enhance quality of life.
- Provide intellectual and professional skills to ensure sustainability.

The Task Force was visualised as a partnership between the cities development agencies and its citizens. A Government Order constituted the fifteen task force members, who included prominent citizens from various professional fields and representatives from government. Private sector members included representatives from: management consultancy; architecture; financial management; IT; education and marketing and communications. The government representation on the other hand was drawn from the Urban Development Department and the Commissioner of the Bangalore was elected as the task force's ex officio secretary. The main focal areas of activity included:

#### *The Voice of Citizens – The Citizens Poll*

With the broad vision and mandate of the task force outlined it now had to formulate its agenda, plans and strategies. With no previous examples or guidelines to work with as it was the first initiative of its kind in the country the task force decided to ask city citizens to set the agenda. Using the framework and parameters of the cities vision and mandate, the first in a series of citizens polls was undertaken to ask citizens to prioritise what they thought were the variety of issues that Bangalore needed to tackle. The citizens' poll was designed to be carried out every six months to gauge the success of implemented projects and formulate new projects based on feedback from citizens.

### *The Framing of the Bangalore Agenda*

The top 10 issues facing the citizens of Bangalore were taken as indicators of areas in which the task force needed to focus on. Among these were garbage, road safety and traffic. In addition, other stakeholders also identified areas such as innovative financing, redefining systems and procedures and revenue augmentation, which were all incorporated into the Bangalore Agenda. The BATF and other stakeholders studied the results of the poll to identify long and short-term programmes and how these could work in parallel with current programmes.

### *The Bangalore Summit*

These projects were then incorporated into a public agenda, and announced in the first ever Bangalore Forward Summit. The Chief Minister, various dignitaries and representatives from the government attended this along with representatives from the private sector, media and citizens. To promote transparency and accountability the agenda was unveiled in a series of public forum presentations.

Having defined the areas in which the BATF would work, members of the task force defined the strategy through which projects would be achieved. They chose a combination of short and long-term strategic initiatives using different methods depending on the specific nature of each project. The forum has subsequently implemented actions in a variety of areas leading to a new policy oriented public private partnership based on a common forum for action and greater citizen involvement, transparency and accountability in policy formulation.

## Annex 2: Case Study of fiscal devolution in West Bengal

West Bengal illustrates a continuing strong commitment to devolution based upon a high degree of political certainty resulting from over twenty five years of control by the CPI(M) party with a well embedded political structure at the local level accompanied by little effective opposition in local government. Consequently the state government has enacted a range of innovative legislation designed to strengthen local political power bases. This includes the Chairperson in Council (Cabinet style) system, co-ordinated local planning mechanisms, and the basis of a systematic fiscal framework.

The Government of West Bengal has consistently supported the empowerment of local government. The state's urban and rural local government system has been successfully functioning with regular elections and devolution of powers for almost three decades. West Bengal has led other states in India in developing a legislative framework for decentralised local government, with separate Municipal Corporation Acts for large urban local authorities, a progressive West Bengal Municipal Act, (1993) governing municipalities and the West Bengal Panchayats Act for the various levels of rural local bodies in the state. This strong commitment to empowering local government is closely linked to the nature of politics within the state. Since 1977 West Bengal has been ruled by a Left Front coalition led by the Communist Party of India (Marxist). This has demonstrated a strong ideological commitment to promoting decentralisation and rural reform especially. Decentralisation has also arguably also served to strengthen local party power bases, and the CPI-M has evolved a well organised party cadre machinery.

In the light of the 73rd and 74th CAA, the West Bengal government was quick to amend laws relating to local government providing them with functional authority to take on the range of new responsibilities listed in the CAA. The government has also been pro-active in setting up State Finance Commissions, as well as a Municipal Administrative Reforms Committee in 2001. The state continues to show a clear political commitment to the promotion of all forms of decentralization. Examples of this include:

- Promoting the effective operation of the District Planning Committees. Such committees are central to the annual development planning hierarchy, and whilst operational in other states in India have been more actively implemented within West Bengal;
- The establishment of the Kolkata Metropolitan Planning Committee. Although legally mandated within the 74th CAA, this is the first such metropolitan planning body in India allowing municipal representation in this level of planning (Municipal councillors comprise two thirds of the committee).
- At a local level the GoWB has supported the establishment of ward committees in all urban local authorities and an associated ward level planning process. This is serving to promote a localised expression of need.



### *Fiscal Devolution Framework*

Local government finances need to be considered in the context of the serious fiscal crisis affecting the state government, with a broadening revenue-expenditure gap. This context has undoubtedly reduced the scope for more radical changes in the nature of the fiscal framework.

### *Revenue assignments*

Urban local authorities derive revenue from government grants, property tax and other assigned taxes such as entertainment tax, motor vehicle tax etc. Despite having the delegated power to raise revenues, urban local authorities in the state are largely dependent on government grants to meet their establishment costs. The entire salary payments and 80% of the dearness subvention is provided by the state government together with a significant portion of pension dues. These have led to a situation in which urban local authorities have become complacent about their own resource mobilization and consequently, civic services are often poor. In relation to expenditure, the single largest expenditure head is salary and wages, which generally accounts for more than 70% of expenditure.

Urban local authorities thus rely heavily on government grants, plan funds and development schemes to fund the necessary infrastructure works. Studies have repeatedly shown that urban local authorities are capable of significantly increasing their own revenues and easing the pressure on the state for funds.

Rural local authorities have three major sources of revenue: schematic funds, untied funds from the centre and funds from the state. Although PRIs are empowered to collect certain local taxes and levy user charges, they are essentially grant-dependent and experience poor local revenue collection.

In this context, the degree of fiscal autonomy enjoyed by local government is limited. Central schemes such as the Jawahar Rozgar Yojana are routed through the panchayat system and are heavily specified in terms of details with perhaps the only freedom being in terms of location or detailed choice of beneficiary. This highlights the fact that rural local authorities are almost fully dependent on centre / state funding and hence the fiscal devolution policy is very important for these urban local authorities. It is clear that there is a significant dependence upon vertical transfers. The State Finance Commissions have thus been important in defining the nature of such transfers.

### *First State Finance Commission*

The First State Finance Commission (FSFC) reported in 1995. The FSFC established, for the first time, clear and transparent 'entitlements' for local authorities based on a range of indicators. Major recommendations included:

- Streamlining of certain shared taxes for local authorities and levying of a surcharge to compensate for earlier entry tax;
- Staff costs including full dearness allowance to be met by the state government;

- Greater allocation of untied funds as ‘entitlements’ to local authorities. For this the commission decided to earmark 16 percent of the net proceeds of all tax collected by the state in a year for transfer to local bodies. These will be untied funds at the disposal of the local bodies and to be released to the districts in suitable instalments.
- Local authorities should be encouraged to step up their internal resource mobilization especially from property tax
- An Incentive scheme has been suggested to encourage Panchayats and Municipalities to raise their income. 2 percent of the entitlement due to a district will be set aside to act as an incentive fund.
- Suitable adjustments in district organization should be made for ensuring effective use of the entitlement funds at local level
- Improved financial systems such as audit, accounts and budgeting systems should be established in local governments.

The FSFC brought out clear percentage ‘entitlements’ at each level of local government and emphasized the importance of untied funds as a vital tool for establishing the autonomy and responsiveness of local governments.

Although the Government accepted the FSFC recommendations in principle, these have yet to be fully implemented. Instead of the entitlement fund, the state government is now allotting a part of the plan fund as lump sum ‘Grants in aid to Local authorities, mainly to the Zilla Parishads. The department requests the ZPs to utilize these grants for schemes and programmes already identified with some flexibility to prioritise them at the local level. Although funds thus released approximated 16 percent of the tax revenues, this system hardly reflects the spirit behind the FSFC recommendation.

#### *West Bengal Second State Finance Commission*

The Second State Finance Commission (SSFC) submitted its recommendations in 2002. The SSFC built upon the framework of the FSFC and made the following significant recommendations:

- The level of entitlement grant should be maintained at 16 percent of tax revenues. However, since the exact amount of revenues cannot be determined until the audit by the Comptroller and Auditor General of India (CAG), a minimum amount of Rs.7.0 billion should be provided for untied entitlement during the year, balance being issued after the revenue is confirmed in next year.
- 2 percent of the entitlement should be retained as incentive at the state level instead of the district level.
- Legislation should be passed for local government to collect taxes on urban areas and multi-storied buildings
- User charges, service charges and level of fees should be enhanced

- Better capacity should be built locally for planning, implementation & monitoring.
- The administrative and institutional arrangements should be established in local government for participatory democratic process and co-ordination with District Planning Committees.

The detailed structure of fund devolution worked out by the two finance commissions is presented below.

#### *Principles for allocation of funds*

Principles were set out in the FSFC report, and although criteria and indicators were modified by the SSFC, the basic principles remained the same. The FSFC recommended 16 per cent devolution as an 'untied entitlement'. It rejected a needs based approach for determining the untied entitlement allocation for local government since it felt there was insufficient reliable data to fulfil this purpose.

The FSFC felt that local government should be allowed to devise their own approaches for managing their budgets based on their estimation of the feasibility of rendering services within budgetary constraints. The state's contribution (entitlement) should be based more on broad principles of equity rather than on any assumed cost of services to be rendered.

#### *Criteria for Inter-district Fund Entitlements*

The SFC used a number of basic criteria to calculate the entitlement for each local authority. These are shown in the table below. The first and most important criterion is population with a weightage of 50 percent. This is based on the obvious principle of equity, clearly recognizing that the level of population, to a large extent, determines the need for funds in the district. A range of other socio-economic indicators are also used which allow for the varying levels of development in the districts. It can be seen that additional criteria were introduced in the SSFC.

#### **State Finance Commission Criteria for district wise fund allocations**

<b>Criteria</b>	<b>FSFC % weight</b>	<b>Criteria</b>	<b>SSFC % weight</b>
Population of the district	50%	Population	50%
Illiteracy level of the district	10%	Non Literate Population	7%
Backward population of the district	10%	ST Population	8 %
		SC and minority population	7%
Area of the district	10%	Density of Population	7%
Rural population	10%	Rural population	7%
Inverse ratio of per capita Bank Deposit (including PAC working capital)	10%	Infant Mortality Rate	7%
		Per capita Net District Domestic Product (NDDP) at constant price	7%
TOTAL	100%	TOTAL	100%

*Intra-District Allocations*

After completing the above procedure, and allowing for the 2 per cent incentive fund, the FSFC recommended that the funds be split into three parts, namely i) District Municipal Fund, ii) District Panchayat Fund and iii) District Special Area Fund.

The allocation to these three components is to be made in line with the population under each of the divisions. The special area fund is expected to cover specific areas that do not fall under either Panchayats or Municipalities. The SSFC marginally revised the procedure, suggesting instead that the 2 percent retention is made at the state level rather than the district level. It also suggested a further 0.4 percent separate fund for hilly areas. The SSFC also suggested that the district fund should be split into only two components namely a District Municipal Fund and District Panchayat Fund on the basis of the rural and urban population of the district.

The balance amount available for intra-district allocation in the urban sector is divided on the basis of a further set of weighted population and socio-economic measures (population, literacy, scheduled caste/ tribe, population density, length of kutchra drains etc). For rural bodies the SFCs specified a percentage allocation for the vertical allocation formula as shown below:

<b>Vertical Level</b>	<b>FSFC</b>	<b>SSFC</b>
Zila Parishad	30%	20%
All Panchayat Samitis together	20%	20%
All Gram Panchayats together	50%	60%

The distribution of entitlement funds amongst Panchayat Samitis is based on weighted criteria (population, SC/ST population, non literates, villages without power, and villages without pucca approach roads). In Gram Panchayats the criteria used is based on population, SC/ST population, and non literates alone.

*Incentive funds*

As described above both the First and Second SFCs recommended the establishment of an Incentive Fund to encourage the mobilization of own resources by local government. Both SFCs recommended an initial 2 per cent allocation to be devolved as untied incentive funds. The government has yet to develop the criteria for the release of these funds but the concept of ‘incentive based’ release of funds has now been accepted at the state level. The Directorate of Local Bodies (DLB) has developed a monitoring mechanism and funds are sanctioned to progressive local authorities that have demonstrated significant improvements in revenue collection, expenditure management and accounting improvements. This parallels other central government schemes such as the Urban Reforms Initiative Fund and City Challenge Fund (described elsewhere in this report). Similarly, donor interventions in the West Bengal local government sector are also promoting incentive based financial reform and fiscal independence.

*Administrative Mechanisms*

An interesting administrative decentralization mechanism that reflects the extent to which urban decentralization is politically underpinned in West Bengal is the cabinet style Mayor/

Chairman in Council structure. Under this arrangement, a number of local councillors form a cabinet, each with executive responsibilities for separate service delivery functions. This is in marked contrast to local government in other states in which councillors are generally subordinate to Municipal Commissioners (often state appointed Indian Administrative Service officers). In West Bengal the top official is generally a superannuated state government officer appointed on a two year contract. As a result his/ her knowledge of municipal governance is more limited and these officials are generally considerably less powerful than the councillors. Within rural local government there are standing committees at various levels that are the interaction points with district officials, opposition members and line ministries.

In relation the staffing, state government has significant control. It determines and controls the levels of staffing, recruitment and transfers. As a result individual local authorities can be unaware of their approved staffing patterns and these are also not generally revised in line with changing needs.

#### *Regulation and Support Mechanisms*

In relation to regulation and support, the primary innovations of the GoWB relate to the “institutional architecture” established to support urban local government. For its urban administration, GoWB has established a number of state level enabling institutions under the Municipal Affairs Department that are not found elsewhere in India. These include the following:

- The Directorate of Local Bodies (DLB), which is charged with monitoring urban local government operations and legislative compliance. Created in 1980 the DLB serves to oversee the performance of the local bodies and to coordinate their activities. This includes both an auditing role and final sanction of staffing levels. Under a new government programme, with bilateral support, the roll of the DLB will be enhanced to guide and support local governments in the implementation of financial, managerial and technical reforms.
- The Municipal Engineering Directorate (MED), which provides engineering support. MED was created in 1981 to function as the engineering cell of the DLB for planning and implementation of water supply, drainage, sewerage and other engineering works for urban local government.
- The Institute of Local Government and Urban Studies provides training. Established in 1982, its primary purpose was to undertake research, training and consultancy services for urban local government. The institute will be strengthened through a new capacity development programme that aims to introduce the concept of decentralised support to training and local government.
- The West Bengal Valuation Board was set up in 1979 for centralised assessment and valuation of properties for tax purposes. Such a body is unusual within Indian public administration, and represents an attempt to ensure economies of scale, and objective standardised professional assessment.
- The State Urban Development Agency (SUDA) was set up in 1991 as a registered society to work as the state level body for monitoring implementation of poverty-alleviation programmes in the urban areas in the state.

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