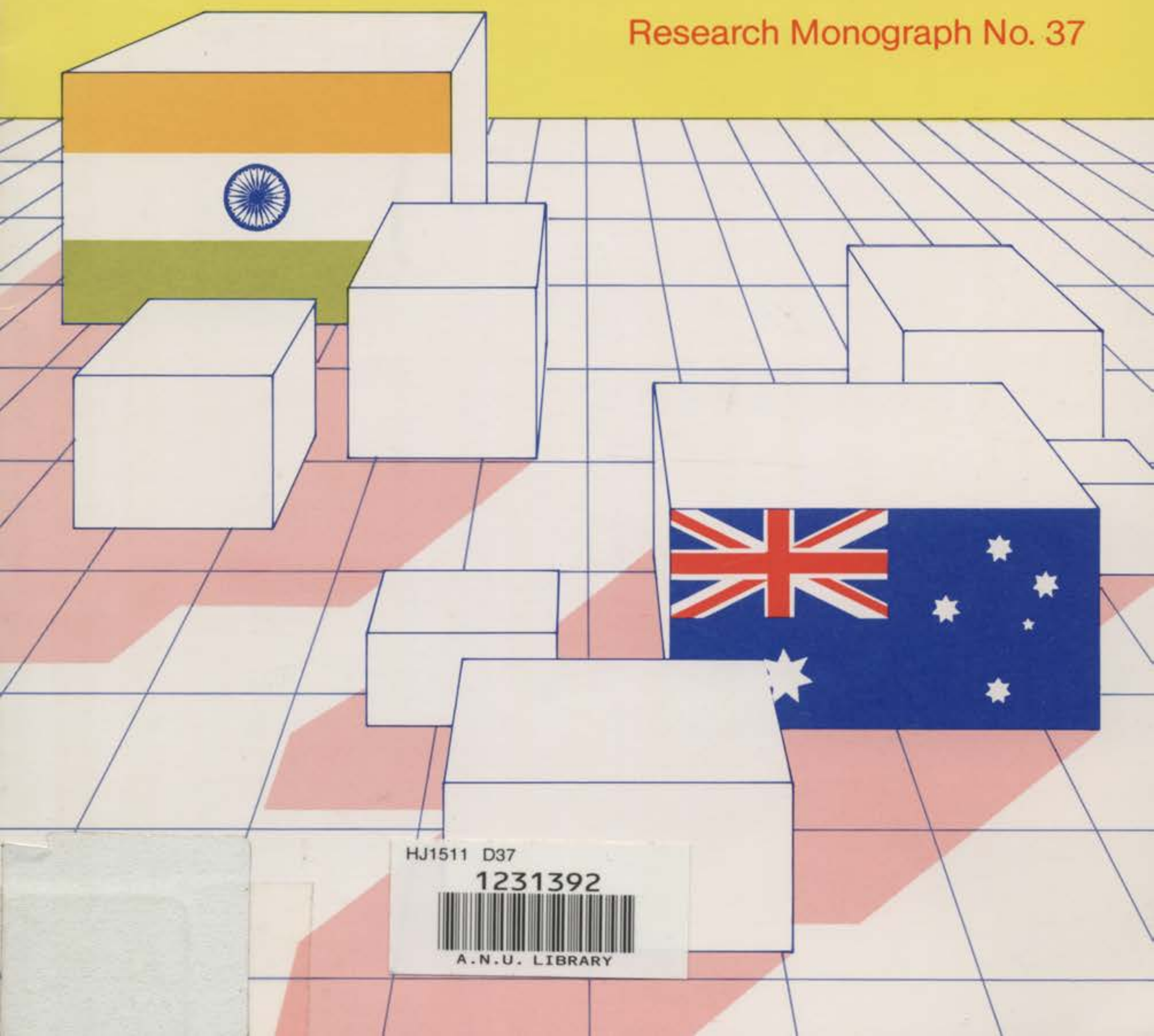
State-Municipal Fiscal Relations: A comparative study of Australia and India

Abhijit Datta

Centre for Research on Federal Financial Relations
The Australian National University, Canberra

Research Monograph No. 37



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This is a comparative study of State–municipal fiscal relations, with particular reference to New South Wales in Australia and West Bengal in India. After outlining the broad structural features of municipal authorities and the framework of State–municipal transfer arrangements, the study concentrates on the operative aspects of intergovernmental fiscal relations in a sub-national context. The results of the study indicate commonalities as well as differences in the transfer arrangements, including the role of federal institutions in financing municipal government.

Professor Abhijit Datta has been Profe[illegible] Urban Administration and Development and Municipal Finance at the Indian Institute of Public Administration, New Delhi, since 1976. During 1980–82, he was a member of the West Bengal Municipal Finance Commission. Professor Datta was educated at the Calcutta and London Universities. His various publications are concerned with issues of urban development and aspects of local government administration and finance in India.

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PREFACE

The study arose out of a short visiting fellowship during April-June 1982, at the Centre for Research on Federal Financial Relations, Australian National University, Canberra. I am particularly grateful to Professor Russell Mathews, Director of the Centre, for constant encouragement and helpful advice during my short stay at Canberra. The Honourable Mr Justice R. Else-Mitchell, Chairman of the Commonwealth Grants Commission, was equally kind in arranging introductions to key officials in New South Wales and providing access to official documents. Grateful thanks are also due to Mr J. Short (Deputy Chairman, New South Wales Local Government Grants Commission), Mr Howard Fox (Director of Local Government, New South Wales) and Mr Graham Miles (Secretary, Local Government and Shires Association, New South Wales). Needless to say any shortcomings of the study should be ascribed to me only. I am also beholden to Mrs Rowena Barker and Ms Joy Baines for transcribing the manuscript into typescript within a short time.

Canberra
June 1982

A. Datta

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November 1982

R.L. Mathews
Director

CONTENTS

CONTENTS (Cont'd)

TABLES

BIOGRAPHICAL NOTE

Professor Abhijit Datta is Professor of Urban Administration and Development and Municipal Finance at the Indian Institute of Public Administration, New Delhi since 1976. He has been a faculty member in the same Institute since 1964. During 1962-64, he was a member of an international research team of the Institute of Public Administration, New York, to study metropolitan planning in Calcutta. He received his M.A. (Commerce) from Calcutta University in 1955 and M.Sc. (Economics) in public finance from London University (London School of Economics and Political Science) in 1961. He is the author of numerous academic publications in books and journals. During 1980-82, Professor Datta was a member of the West Bengal Municipal Finance Commission. He was a Visiting Fellow at the Institute of Local Government Studies, University of Birmingham, during March-May 1980. Recently, he completed a consulting study on municipal finances in India for the World Bank.

I INTRODUCTION

Municipal government in both Australia and India grew out of the original English model, although the colonial environment militated against an exact transplant. The form of urban local government established in the British colonies and the empire was similar to the English municipal corporations and county boroughs, being essentially unitary authorities. Most rural areas were uninhabited in Australia during the earlier days and, therefore, unincorporated; in India the rural areas were administered directly by the central government through a country-wide district administration system. The viability of rural local government in both Australia and India was in doubt and the needed relief to the Imperial exchequer through the imposition of local rates to pay for local sanitation and roads could come only from the urban settlements. Later developments in local government in Australia resulted in the creation of shires for the rural incorporated areas in all States except Tasmania; however, the differences between these and urban local authorities are not significant. In India rural local governments could never free themselves from the apron-strings of the district officer and until today lack the essential characteristics of an autonomous system of local self-government.

A meaningful comparison between Australian and Indian local government is possible only in terms of their municipal institutions. Under the federal division in both Australia and India, local government is a State subject and the differences of State practices make it difficult to attempt meaningful comparison of the working of local governments on a cross-national basis. However, we shall attempt to outline the broad features of the structure of municipal authorities[1] in Australia and India and then concentrate on their workings in terms of two States - New South Wales in Australia and West Bengal in India. The choice of these two States is based on three considerations: (a) in both States experiments with local government have been the earliest in the two countries; (b) both States are urbanised to a comparable extent; and (c) in recent times the State governments have adopted policies that ensure substantial transfer of State funds to finance locally provided services.

Scope of the Study

The study attempts to concentrate on the operational aspects of State-municipal fiscal relations in terms of: (i) the institutional arrangements; (ii) the instrumentalities of fiscal transfer; and (iii) the measures being adopted for strengthening of the municipal fiscal base. Finally, we attempt a synthesis of the comparative experience to speculate on the future directions of municipal finances within the federal governmental context in Australia and India.

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1 The expressions 'urban local' and 'municipal' authorities have been used interchangeably here. In Australia, the shires with significant urban characteristics have been treated as municipal for our study.

Patterns of Municipal Authorities

A straightforward comparison between the purely municipal authorities in Australia and India becomes difficult due to differences in local government classification, population characteristics and nomenclature used by the States. For instance, in Australia the urban local authorities do not include the shires, even though many of them display significant urban features. In India, on the other hand, the urban local authorities are classed in terms of their institutional features, but their conditions of eligibility vary from State to State.

For Australia we have included those shires with at least one urban centre having a population of 1,000; for India all urban local authorities established under State legislation are classed as municipal. These exclude the municipal authorities within the federal territories in both countries and also the cantonments in India created under federal legislation. Municipal authorities here include general purpose urban local authorities created under State legislation, having the power to tax and exercise regulatory control within their jurisdictions. Table 1 gives the total number of municipal authorities in Australia (1971) and India (1980); in spite of a difference of the datum period the overall significance of the comparison is not materially affected, mainly due to slower rate of population growth in Australia compared to India.

The most striking feature in the overall comparison is that in Australia two States - New South Wales and Victoria - claim as many as 57.3 per cent of the total municipal authorities; in India it would take at least four States - Uttar Pradesh, Maharashtra, Karnataka and Madhya Pradesh - to cover a similar proportion - 57.6 per cent - of municipal authorities. The total number of municipal authorities in an Indian State does not indicate the degree of urbanisation as it does in an Australian State, mainly due to the sheer population size of the larger States, high rural population densities and differences in States' policies towards municipalisation. Thus, Bihar has a larger number of municipal authorities than West Bengal, even though the degree of urbanisation is much higher in the latter; this is due to differences in overall State population size. Similarly, the sparsely populated State of Rajasthan has a much larger number of municipalities than Andhra Pradesh due mainly to the liberal municipalisation policy in the former State.

At the other end of the scale, the State having the least number of municipal authorities in Australia is Tasmania, with 4 per cent of the total; in India it would take at least 9 of the smallest States to claim about 5 per cent of the number of municipal authorities in the country. This shows the enormous variation in the distribution of municipal authorities in India compared to Australia. Within Australia, as noted earlier, Tasmania claims 4 per cent of the total municipal authorities, in India the two smallest States have one municipal authority each, i.e. about 0.05 per cent of the total. The largest State in Australia, i.e. New South Wales, has about 30 per cent of the total municipal authorities, whereas in India the largest State of Uttar Pradesh has around 27 per cent of the total municipal authorities in the country. It would seem that the Australian local authorities have larger areas and smaller populations, leading to lesser population densities, than their Indian counterpart, as shown in Table 2.

Table 1

MUNICIPAL AUTHORITIES IN AUSTRALIA AND INDIA

AUSTRALIA (1971)

States	Metropolitan MC	Metropolitan MS	Metropolitan MF	Provincial P	Provincial T	Others UR1	Others UR2	Total
1. New South Wales	28	7	6	25	24	27	47	164
2. Victoria	31	11	13	22	14	22	38	151
3. Queensland	1	2	6	11	12	16	30	78
4. South Australia	20	4	8	4	3	7	24	31
5. Western Australia	11	5	10	5	5	12	16	64
6. Tasmania	–	–	–	7	2	5	8	22
Total:	163			134		252		549

INDIA (1980)

States	Municipal Corporations	Munici-palities	Others	Total
1. Andhra Pradesh	1	8	1	10
2. Assam	1	22	–	23
3. Bihar	1	71	64	136
4. Gujarat	5	50	2	57
5. Haryana	–	28	–	28
6. Himachal Pradesh	1	18	–	19
7. Jammu and Kashmir	–	5	15	20
8. Karnataka	3	12	208	223
9. Kerala	3	29	1	33
10. Madhya Pradesh	6	180	24	210
11. Maharashtra	5	221	–	226
12. Orissa	–	26	64	90
13. Punjab	3	97	7	107
14. Rajasthan	–	144	2	146
15. Tamil Nadu	2	94	7	103
16. Uttar Pradesh	5	174	388	567
17. West Bengal	2	91	7	100
18. Manipur	–	1	21	22
19. Meghalaya	–	1	1	2
20. Nagaland	–	–	3	3
21. Sikkim	1	–	–	1
22. Tripura	–	1	–	1
Total:	39	1273	815	2127

Note: Urban local governments in the Northern Territory of Australia and in the Union Territories of India are excluded. Australian municipal authorities are classed according to their urban characteristics, i.e. Metropolitan City (MC), Metropolitan Suburb (MS), Metropolitan Fringe (MF), Provincial Town: population 10,000–49,999 (P), Other Towns: population 5,000–9,999 (T), local authority having at least one urban centre: population 2,500–4,999 (UR1), local authority having at least one urban centre: population 1,000–2,499 (UR2). Indian municipal authorities are classed according to their organisational types, i.e. Municipal Corporations (population : >500,000), municipalities (population : 5,000–500,000), notified and town area authorities (population : <5,000, having significant urban functions).

Sources: For Australia: Margaret Bowman, *Local Government in Australian States*, Australian Government Publishing Service (AGPS), Canberra, 1976, p.27; for India: All-India Institute of Local Self-Government, Bombay.

Table 2

RANGE OF AREA AND POPULATION OF LOCAL AUTHORITIES IN AUSTRALIA

State	Area (ha)		Population	
	Largest	Smallest	Largest	Smallest
New South Wales	5,141,498	363	163,540	370
Victoria	1,079,500	366	109,588	439
Queensland	9,469,040	1,554	700,620	236
South Australia	635,430	150	77,435	234
Western Australia	33,128,431	104	157,900	121
Tasmania	580,522	2,725	52,426	311

Source: Margaret Bowman, *op. cit.*, p. 10

Municipal Functions

A comparison of municipal expenditure functions relating to the provision of urban services in Australia and India may be made to see to what extent the municipal authorities have either exclusive or concurrent jurisdictions with the States. Table 3 gives details of 60 comparable functions discharged by the municipal authorities in Australia and India, ignoring their service level, intensity and quality. The situation may be summarised:

Function	Australia	India
Exclusively Municipal	40	37
Municipal and State (Jointly)	19	21
Exclusively State	1	2
Total:	60	60

It would appear that the Australian municipal authorities discharge more functions compared to their Indian counterparts and their concurrent functional jurisdiction with the States is also lesser. This means that in India the State intrusion in the provision of urban services is much more compared to Australia and there is a greater need to delineate the purely municipal functional domain in the Indian situation. The exclusive State sphere in Australia is primary education - to some extent this is corrected by the municipal activities in respect of kindergartens. In India the municipal authorities do not handle land acquisition or traffic control; although the municipal authorities have concurrent responsibility for primary education, neither the States nor the municipal authorities provide kindergarten schools.

Obviously, this broad summary ignores inter-State variations and indicates the scope for service provision - in reality neither the municipalities nor the States may be covering these areas effectively. This is particularly so in India, where the actual provision of social services is woefully inadequate compared to any other developed country. Many of the services are provided only notionally, or at best regulated. Even then the similarities in both countries are striking - compared to any other developed country, the overall range of municipal functions in both Australia and India is limited - important social services like education, health, housing are basically non-municipal. Many of the important utilities are provided by *ad hoc* authorities although in Australia county councils are joint municipal authorities discharging single-purpose functions. The total range of municipal functions is also much wider in Australia than in India; the significant areas where Indian municipal authorities have not entered are welfare services and trading activities. However, both in Australia and in India the primary emphasis of municipal activities is on property-related rather than people-related functions.

Table 3

PROVISION OF URBAN SERVICES UNDER MUNICIPAL AND STATE GOVERNMENTS IN AUSTRALIA AND INDIA

	Australia	India
1. Water supply and sanitation		
Water supply	Ms	Ms
Drainage and sewerage	Ms	Ms
2. Public health		
Conservancy and public conveniences	M	M
Garbage collection and disposal	M	M
Control of infectious diseases	M	Ms
Mosquito control	M	M
Immunisation	M	M
Street cleaning and watering	M	M
Public baths/washeries	M	M
3. Public works		
Public roads and streets	M	Ms
Footpaths and street furnishings	M	M
Bridges and culverts	M	Ms
4. Town planning		
Building regulations	M	M
Zoning/town planning	Ms	mS
Substandard housing clearance	M	M
Land acquisition	M	S
5. Housing and shelter		
Public housing	mS	mS
Urban renewal	Ms	mS
6. Council properties		
Town hall and offices	M	M
Statues etc.	M	M
Cemeteries, crematoria etc.	M	M
Pounds	M	M
7. Recreational facilities		
Community halls/centres	M	M
Parks, gardens, playgrounds	M	Ms
Public libraries	Ms	mS
Places of amusement/entertainment	M	M

Table 3 (Continued)

	Australia	India
8. Traffic management		
Car parks	M	M
Traffic engineering	Ms	M
Traffic control	mS	S
9. Medical		
Hospitals	mS	mS
Health centres	mS	M
Ambulance services	mS	mS
Maternity homes	-	M
10. Welfare		
Maternity and child welfare	Ms	mS
Night shelters	mS	M
Relief of the disabled	M	mS
11. Education		
Primary	S	Ms
Aid to schools	M	M
12. Public safety		
Fire services	M	mS
Street lighting	M	M
13. Municipal trading		
Abattoirs	M	M
Electricity	M	mS
Ferries	M	M
Markets	M	M
Shops	M	M
Milk supply	M	M
Bus service	Ms	mS
14. Licensing and regulation		
Prevention of food adulteration	M	mS
Weights and measures	mS	mS
Boarding houses	M	M
Dogs and pet animals	M	M
Fairs and amusements	mS	mS
Slaughter houses	mS	M
Restaurants and eating houses	M	M
Cemeteries, crematoria etc.	mS	M
Advertising/hoardings	mS	M
Nuisances	M	M
Noxious trades	M	M
Noxious weeds, pests	M	M
Water holes, tubewells	M	M
Pedlars and hawkers	M	M

Notations: Municipal (M/m); State (S/s). Capital letter indicates major responsibilities, small letter indicates minor participation.

Sources: For Australia: Margaret Bowman, *op. cit.*, pp. 5-8;
For India: Abhijit Datta, *Municipal Finances in India*, The World Bank, *mimeo.*, 1981.

Patterns of Municipal Finance

Expenditure

A comparison of municipal expenditure patterns of Australia and India is attempted in Table 4 below.

Table 4

MUNICIPAL EXPENDITURE PATTERNS IN AUSTRALIA AND INDIA
per cent

	Items	Australia (1973-74)	India (1975-76)
1.	General Administration (including Collection of Revenue)	7.00	16.07
2.	Public Health	4.83	21.25
3.	Water Supply	6.14	6.16
4.	Public Safety	1.05	4.78
5.	Public Works (including Roads)	12.70	7.23
6.	Medical (including Welfare)	0.29	7.30
7.	Education (including Libraries)	1.93	10.03
8.	Loan Repayments	11.80	5.34
9.	Housing	2.49	-
10.	Recreation	7.51	-
11.	Transport	2.57	-
12.	Airport	1.03	-
13.	Electricity and Gas	20.41	-
14.	Abattoirs	1.79	-
15.	Others	18.46	21.84
		100.00	100.00

Total expenditure: Australia $277.6 million; India Rs5977.1 million
Total expenditure per capita: Australia $24; India Rs53

Note: In view of the difficulty in separating municipal expenditure data from local government expenditure, latest official figures could not be used. Indian data are based on a sample of municipal authorities for 17 major States. The June 1982 exchange rate between Australian dollars and Indian rupees was $1 = Rs9.40.

Sources: For Australia: *Joint Study into Local Government Finances: Australia and New Zealand*, AGPS, Canberra, 1976, pp. 29-30; C.P. Harris, *Financing Local Government in Australia*, Reprint Series No. 6, Centre for Research on Federal Financial Relations, Australian National University (ANU), Canberra, 1975, p. 34. For India: Datta, *op. cit.*, pp. 25,29.

Table 4 reveals, not unexpectedly, comparatively less municipal expenditure on public health in Australia than in India, while the emphasis on expenditure on roads is more in Australia than in India. The expenditure on general administration is somewhat higher in India, compared to Australia, although the inclusion of expenditure on tax collection (5.44 per cent) puts it on a much higher level. In Australia, loan repayment seems to be of quite a high order, compared to India; on the other hand, Indian expenditure on education and medical services does not find a parallel in Australia. Indian figures do not report any expenditure on housing, transportation, electricity or abattoirs, as in Australia. By and large, Table 4 reflects the way in which municipal governments function in both countries, and shows the common features of a limited range of activities. The per capita municipal expenditure artificially deflates the Indian figures at the international exchange rate. The domestic purchasing power of the Indian rupee is of a higher order (around Rs3.4 instead of the exchange rate of Rs9.4 for $1).

Revenue Sources

A straightforward comparison of revenue sources between Australian and Indian municipal authorities becomes difficult in view of the fact that the available financial statistics in Australia do not differentiate between local and municipal revenues. However, since our purpose is only to make a broad comparison of the various revenue components in percentage terms, the published data on local government finance have been used, after making a notional separation of the share of taxes from the combined item 'taxes, fees and fines'.

Table 5

LOCAL AND MUNICIPAL REVENUE STRUCTURE
IN AUSTRALIA AND INDIA, 1975-76
per cent

	Items	Australia (Local)	India (Municipal)
1.	Tax revenue	64.8	63.5
2.	Fees and fines	3.8	
3.	Property income	3.3	23.6
4.	Income from enterprises	10.3	
5.	Grants	17.8	12.9
		100.0	100.0

Source: For Australia: Australian Bureau of Statistics, *State and Local Government Finance Australia, 1979-80*, Canberra, 1981, p. 17; for India: Datta, *op. cit.*, p. 20.

The most striking aspect is the almost exact correspondence between tax revenue of local and municipal authorities in Australia and India, the basic difference being that in Australia the local authorities rely on a single local tax, i.e. the rate, while in India apart from property taxes there are *octroi* (local customs-type taxes in respect of traded goods, taxes on trades and professions and non-motorised vehicles, as well as tolls. In spite of the major emphasis on trading and enterprise activities, the revenue derived from these sources by Australian local authorities is not significant, compared to Indian municipal authorities. In Australia, in spite of Commonwealth tax sharing with local authorities, the proportion of State grants is somewhat less than in the case of the Indian municipal authorities. Of course, in India the variation of State grants in the various States is much more pronounced than in Australia, the lowest being 0.15 per cent for Rajasthan and highest 46.70 per cent for Bihar. In Australia, the lowest level of local authority grant was received in Tasmania at 3.46 per cent and the highest level was recorded for New South Wales at 40.74 per cent. In both countries there do seem to be variations due to dissimilar grants policy adopted by the State governments.

Significance of Municipal Finance

The relative significance of municipal finance within the total governmental structure in both Australia and India is strikingly similar; in both countries municipal authorities claim about 2 per cent of the Gross National Product (GNP). The percentage of local government expenditure in total government expenditure is about 7 per cent in both Australia and India (of which 5 per cent could be regarded as purely municipal in both). The situation is strikingly different in other federations, such as Canada, where the percentage of local government expenditure to GNP is around 9 per cent and the percentage of total government expenditure is around 22 per cent. This highlights the comparative neglect of local government, including municipal authorities, in both Australia and India[2].

Any improvement in the current position of municipal government in both countries will require their political revitalisation, coupled with transference of substantive functional areas, widening of the local tax field and improvements in intergovernmental transfers. So far municipal finances in both Australia and India have been treated in isolation, concentrating almost exclusively on their expenditure functions and revenue sources; the basic question that remains is to consider the significance of municipal (and local) governments within the multi-level governmental system and the adequacy of their revenue authority to fulfil the tasks to be performed. We shall revert later to the policy issues that the State and Federal governments need to consider in both Australia and India, after examining in detail State-municipal fiscal relations within the confines of a single State - New South Wales in Australia and West Bengal in India.

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2 For details of these comparisons, see Melville L. McMillan, *Local Intergovernmental Fiscal Relations in Australia and Canada*, Occasional Paper No. 23, Centre for Research on Federal Financial Relations, ANU, Canberra, 1981, p. 10; Datta, *op. cit.*, p. 14.

II ARRANGEMENTS FOR FISCAL RELATIONS: NEW SOUTH WALES AND WEST BENGAL

Municipal Systems

New South Wales

In New South Wales, all local government bodies are divided between municipalities and shires - the former are incorporated towns, while the latter are incorporated rural areas. Some of the municipalities are proclaimed as cities, carrying a certain prestige, where these are either independent urban centres with a population of at least 25,000, or have a distinct character and entity with a population of at least 150,000. There is no distinction between the municipalities and shires in terms of powers and functions, and many of the shires have within their areas one or more urban clusters. The Commonwealth Grants Commission identified four categories of local authorities in Australia and these are also adopted by the New South Wales Local Government Grants Commission, such as:

Category 1 - local governing bodies in metropolitan areas, with or without any formal delineation of such areas;

Category 2 - provincial cities and country municipalities;

Category 3 - local governing bodies with significant urban clusters; and

Category 4 - all other local governing bodies.

For our purposes we shall exclude the last category, which consists of purely rural shires. The institutional distribution under the first three categories in terms of cities, municipalities and urban shires is presented in Table 6 below:

Table 6

MUNICIPAL AUTHORITIES IN NEW SOUTH WALES, 1979-80

	Cities	Municipalities	Urban Shires	Total
Category 1	12	32	9	53
Category 2	13	22	-	35
Category 3	1	-	44	45
Total:	26	54	53	133

Source: New South Wales, Local Government Grants Commission, *Report 1979/80 on Financial Assistance for Local Government*, Government Printer, Sydney, 1979.

West Bengal

In West Bengal, municipal authorities are divided into four classes, namely, municipal corporations, municipalities, notified area committees and town area committees. There are no set standards for constituting a municipal corporation; generally, cities with a population of 500,000 are accorded corporation status in India. In West Bengal, only two cities, Calcutta and Chandannagar, have been accorded this status. Chandannagar does not fulfil the population criterion being followed, but an exception was made in terms of the merger agreement of this city in 1955 between the Indian and the French Governments.

Municipalities in West Bengal must pass the following tests: (i) a minimum population of 10,000; (ii) a minimum population density of 2000 per square mile; (iii) three-quarters of the adult male population must be engaged in non-agricultural occupations; and (iv) an adequate municipal income from domestic sources. The notified area authorities do not meet all the conditions for municipalisation, but are created for those areas where a new town is being developed or where new industries are being established. The town areas are small townships in the former princely-state of Cooch-Bihar which merged with West Bengal after Independence. The municipal corporations and the municipalities are fully elected bodies, whereas the notified area and the town area authorities are nominated local authorities.

The degree of autonomy corresponds to the status of the municipal authorities - the municipal corporation is most autonomous among the local government institutions, followed by a municipality, and the notified or the town area committees are least autonomous. A municipal corporation is also endowed with a somewhat larger tax power and functional responsibility than the other municipal institutions. However, in West Bengal, the Chandannagar Corporation is treated for all practical purposes as a municipality except for the use of the term 'mayor' for the chairman of its council. Calcutta Corporation does have somewhat larger tax powers, compared to the other municipal authorities; but its functional domain has somewhat shrunk compared to the other municipal authorities due to recent legislative changes.

For grant purposes, the municipal authorities in West Bengal are grouped into two broad categories, (1) those within the Calcutta Metropolitan District (CMD) - an area delineated for planning and entry tax (regional *octroi*) purposes, and (2) those falling outside the CMD. We present the municipal authorities in West Bengal under these two categories and classified into corporations, municipalities and other urban authorities in Table 7 below.

Institutional Arrangements

New South Wales

The New South Wales Local Government Grants Commission was established in 1968 to advise the Minister for Local Government on the disbursement of moneys available in the Local Government Assistance Fund. The Fund was established on the recommendation of the 1965 Royal Commission on Local

Table 7

MUNICIPAL AUTHORITIES IN WEST BENGAL, 1979-80

	Corporations	Municipalities	Other Urban Authorities: Notified Areas	Other Urban Authorities: Town Areas	Total
1. CMD Municipal Authorities	2	34	2	-	38
2. Non-CMD Municipal Authorities	-	60	2	4	66
	2	94	4	4	104

Source: West Bengal, *Report of the West Bengal Municipal Finance Commission, mimeo.*, March 1982, Appendix VIII.

Government Valuation, Rating and Finance as a means of financing grants to councils in lieu of rates on Crown lands, transferring a guaranteed amount of $600,000 per annum to the shires as endowments, and making other forms of untied assistance. Unfortunately, the initial grant of $4 million was insufficient to meet the total requirements of the councils.

In 1973, the Commonwealth Grants Commission was given the task of inquiring into and reporting on applications for general purpose revenue assistance from local authorities, and in the years 1974-75 and 1975-76 it recommended (and the Commonwealth paid) grants for local authorities throughout Australia, based on the application of fiscal equalisation principles.

Following amendments by the Commonwealth Government to the Grants Commission Act in 1976, a system of tax sharing grants for local governments replaced the equalisation grants recommended by the Commonwealth Grants Commission and the latter's role was restricted to that of advising on the interest rate distribution. Under the Commonwealth legislation, State governments were required to legislate to establish State Grants Commissions, but pending the passing of the legislation and the setting up of the Commissions the States were allowed to operate under administrative arrangements. Legislation to give effect to the Commonwealth requirements was passed in New South Wales in 1980 through an amendment to the Local Government Act, 1919. The functions of the New South Wales Commission in relation to the distribution of the revenue sharing funds and the general principles to be followed in their distribution correspond with the provisions of the *Local Government (Personal Income Tax Sharing) Act* 1976 of the Commonwealth.

Initially, the New South Wales Local Government Grants Commission consisted of an independent chairman, an officer of the Department of Local

Government and one member each to be nominated by the Local Government Association and Shires Association - in all, four members. The amendment merely provided that at least two members of the Commission should be persons who were associated with local government. It may thus be seen that the Commonwealth requirements were in substantial conformity with the State practice in New South Wales. The Minister for Local Government requested the two Associations to nominate two persons for appointment to the Commission and all members, including the chairman, were reappointed for a further term of five years from 16 January 1981. The representative of the Department of Local Government had been replaced by another member during 1979.

Because the New South Wales amendment did not come into force until 1981, during 1979-80 the Commission operated under the 1968 amendment, making proposals for the disbursement of moneys available from the Local Government Assistance Fund and performing the additional functions relating to the Commonwealth revenue sharing without any specific legislative authority. The amounts transferred to the municipal authorities by the Department of Local Government in 1979-80 came from two main sources:

(a) the State's Consolidated Revenue Fund, to provide for (i) general assistance, (ii) assistance for destruction of noxious weeds, and (iii) old age pensioners subsidy; and

(b) a Special Deposit Account, consisting of (i) the Local Government Assistance Fund, (ii) Commonwealth grants, and (iii) a special council employment scheme.

In addition, the municipal authorities received specific conditional assistance for a variety of schemes under various functional categories, distributed through various State departments and agencies. Some of the State grants for roads represented Commonwealth funds passed through the States. The details are given in Table 8.

West Bengal

In West Bengal, the State Government appointed a Municipal Finance Commission in December 1979 to make recommendations on:

(a) the quantum of financial assistance needed to bridge or reduce the revenue gap of the municipal authorities after considering (i) the projected gap between the municipal receipts and expenditure from 1980-81 to 1983-84, and (ii) the measures to be taken by the municipal authorities to bridge or reduce such a revenue gap;

(b) the manner, principles and procedures of extending financial assistance to the municipal bodies including (i) grants-in-aid, (ii) tax sharing, and (iii) the vesting of new revenue sources in the municipal bodies;

(c) measures needed to tackle the debt problems of municipal bodies and ensure the proper administration of their capital account;

(d) the desirable dimensions, patterns, principles and procedures of developmental assistance from the State Government to the municipal bodies during during the period 1980-81 to 1983-84; and

Table 8

STATE ASSISTANCE TO MUNICIPAL AUTHORITIES
IN NEW SOUTH WALES, 1979-80

	$ million		per cent
1. General Assistance		74.8	36.8
(a) Consolidated Revenue Fund		20.5	10.1
(i) Grants to assist minor projects	0.05		(0.0)
(ii) Destruction of noxious weeds	0.12		(0.1)
(iii) Old age pensioners subsidy	20.32		(10.0)
(b) Special Deposit Account		54.3	26.7
(i) Local Government Assistance Fund	5.38		(2.7)
(ii) Commonwealth grants	48.21		(23.7)
(iii) Special Employment Fund	0.67		(0.3)
2. Specific Assistance		128.6	63.2
(i) Roads	73.8		(36.3)
(ii) Public works	1.2		(0.6)
(iii) Water supply	33.0		(16.2)
(iv) Culture	8.9		(4.4)
(v) Recreation	2.9		(1.4)
(vi) Lighting	2.6		(1.3)
(vii) Electricity	3.5		(1.7)
(viii) Transport	1.0		(0.5)
(ix) Others	1.7		(0.8)
Total:		203.4	100.0

Source: New South Wales, Department of Local Government, *Annual Report for the Year ended 30 June 1980*, Government Printer, Sydney, 1981. Allocations under specific assistance to the municipal authorities are notional, as the figures are reported for all local government authorities.

(e) the changes, if any, needed in the relationships between the municipal bodies and the improvement trusts and the development authorities, and the desirable form of these relationships.[3]

The terms of reference of the West Bengal Municipal Finance Commission followed the pattern set for the federal Finance Commission appointed quinquenially to recommend the quantum of revenue assistance from the federal to the State governments. The State Municipal Finance Commission

3 For details see West Bengal (Local Government and Urban Development Department) Resolution No. 1634/C-2/3C-79 dt.6.12.1979.

was established well before the appointment of the eighth federal Finance Commission due by June 1982, so that the State Government could incorporate its revenue commitment for the municipal authorities in its submission to the federal Commission.

The West Bengal Municipal Finance Commission was initially required to submit its recommendations by March 1981; however, its term was extended twice - first to December 1981 and finally to March 1982. The Commission was headed by a distinguished economist and included five other members, of whom three were non-official experts and the other two were official members including the member-secretary. All the members were part-time. It was expected that similar Commissions would be appointed during five-year or lesser intervals with terms of reference similar to the first Commission. The Commission considered the desirability of having a permanent municipal finance commission, as in Australia or in the State of Gujarat in India, but recommended against it as this might 'degenerate into an administrative body or a supplementary advisory body'. However, the Commission thought it desirable that the scheme and guidelines in regard to the State-municipal fiscal relations should be laid down by an independent body which might be accorded a statutory position similar to the federal Finance Commission.[4]

During 1978-79, the year preceding the Commission's appointment, the Department of Local Government and Urban Development transferred substantial funds to the municipal authorities, by way of general subventions towards the cost (inflation compensation) of salaries and wages of municipal employees (about 52 per cent). Another major source of State transfer consisted of tax sharing (about 42 per cent). In addition, a small amount of grant was made available by the various State departments and agencies to the municipal authorities by way of specific functional assistance for revenue purposes (around 6 per cent), of which education claimed the lion's share. The details are given in Table 9 below.

Salient Features

It may thus be seen that the institutional arrangements in New South Wales and West Bengal have marked similarities, as well as differences. In both these States, the general assistance to the municipal authorities is made on the recommendation of an expert advisory body - in New South Wales, this is a statutory permanent Commission, while in West Bengal it is supposed to be a quinquennial *ad hoc* Commission; both consisted of high-level expertise, although in West Bengal the predominance of 'outside' experts probably lent colour to the Commission's composition. Both Commissions were supported by their secretarial staff headed by an executive officer in New South Wales and by the member-secretary in West Bengal. In both States, the Commissions operated in parallel with similar institutions at the federal level.

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4 West Bengal, *Report of the West Bengal Municipal Finance Commission, op. cit.*, paras 14.4.2 to 14.4.4.

Table 9

STATE ASSISTANCE TO MUNICIPAL AUTHORITIES
IN WEST BENGAL, 1978-79

		Rs million		per cent
1.	General Assistance		185.56	94.0
	(a) Subvention		102.65	52.0
	(b) Shared Taxes		82.91	42.0
	(i) Entry Tax	73.04		(37.0)
	(ii) Motor Vehicle Tax	9.87		(5.0)
2.	Specific Assistance		11.84	6.0
	(i) Education	9.87		(5.0)
	(ii) Others	1.97		(1.0)
	Total:		197.40	100.00

Source: West Bengal, *Report..., op. cit.,* Table 6.22.

However, in New South Wales, specific purpose grants to the municipal authorities constituted about 63 per cent of the total State assistance to the municipal authorities - these are outside the purview of the Local Government Grants Commission altogether; in fact, the Commission handled only about 27 per cent of all State assistance to the municipal authorities. If we exclude the share of the Commonwealth grants, the Commission handled through the Local Government Assistance Fund only 3 per cent of the total revenue transfer to the municipal authorities.

By contrast, the West Bengal Municipal Finance Commission had within its purview all State fiscal transfers, revenue and developmental. In this, the West Bengal Commission had responsibilities similar to those of the federal Finance Commission and the Planning Commission put together and had a more comprehensive view of municipal finances than attempted at the State or federal level in either Australia or India. In its recommendations, the West Bengal Commission did not, however, recommend transfers for development purposes independently of the State Government allocation but limited itself to the principles and procedures that should govern the system of such transfers.

Although in both New South Wales and West Bengal the specific functional assistance to the municipal authorities are determined by the various departments, there is a greater possibility of integration of such assistance in West Bengal through the dual mechanism of revenue and development assistance within the framework recommended by the Municipal Finance Commission under revenue allocations awarded by the Commission and the plan (developmental) allocations provided under the federally approved State Plan.

Revenue Transfers

New South Wales

In New South Wales, the Department of Local Government handles all revenue transfers to the municipal authorities. Grants out of the Consolidated Revenue Fund consisted of three items in 1979-80:

(i) grants to assist - an amount of $49,000 was distributed amongst 65 municipal councils to assist them for minor projects including those related to children's activities and needs;

(ii) grants amounting to $121,000 were distributed among 31 municipal councils for noxious plant control (most of these grants are made to the rural shires and certain Pastures Protection Boards);

(iii) subsidies amounting to $20 million were paid to all but 2 municipal councils for writing off pensioners' rates.

Of the three, the first two are in the nature of specific functional assistance, and the third is a compensatory grant in the nature of a rate subsidy. It is not clear why the two functional grants are not channelled through the appropriate State departments.

Grants out of the Special Deposit Account consisted of three types:

(i) Local Government Assistance Fund grants amounting to $5.4 million distributed to all the 79 municipal authorities for scholarships, training, management improvement, special assistance to new areas and the like. It is noted in the 1979-80 Report of the Local Government Grants Commission that there has been no increase in the amount provided for the Fund compared to the past year.

With the introduction of the federal revenue sharing in 1976-77, the Commission considered the total of the grants from the two funds for each council when assessing their *inter se* relativities and thought that it would be desirable to examine the practicability of assessing grants in parallel, so that grants from each fund would reflect the same relativity between the councils as did the present combined total of the grants from the two funds.[5] This meant that grants to some councils would show a variation as to the proportions received from each source, but the total of the grants payable to any council would not be affected. In practice the Commission subsequently took note of the amount of a grant to a council from the Fund before arriving at the grant to be recommended from Commonwealth revenue sharing and the total amount of assistance was what it considered to be justified.[6] The amount provided under the Fund for all

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5 New South Wales, Local Government Grants Commission, *Report 1979/80 on Financial Assistance for Local Government*, Government Printer, Sydney, 1979, p. 27.

6 New South Wales, Local Government Grants Commission, *Report 1980/81 on Financial Assistance for Local Government*, Government Printer, Sydney, 1981, p. 30.

local (including municipal) authorities has remained stable at $9.5 million since 1978-79 and with the increase in the Commonwealth revenue sharing allocations the relative importance of the Local Government Assistance Fund has declined.

Since both sources of general revenue assistance are now considered together it is a moot point whether: (a) the original purposes of creating the Fund are now being diverted and (b) the supplementary element of the State contribution for general assistance is being seriously pursued. If the answer to the first is yes and the second is no then one important reason for the creation of the Fund suggests that contributions towards the rating of Crown land should be made separately as suggested by the 1965 Royal Commission on Local Government Valuation, Rating and Finance. Secondly, the Commonwealth contributions towards general assistance to local government (including municipal) authorities should not be seen as a substitution for State contributions towards local government and the latter should grow at least at the same rate as the increases in Commonwealth funding.

(ii) The most important item under the Special Deposit Account is the Commonwealth revenue sharing grants. An amount of $48 million was distributed among the municipal authorities in 1979-80 out of the Commonwealth funds made available to the State. The total amount available to all the States in 1979-80 was $222 million representing 1.75 per cent of personal income tax collections during the previous year. The percentage has been further increased to 2 per cent effective from 1980-81. The respective shares of the various States are:

States	Percentage
New South Wales	36.50
Victoria	25.45
Queensland	16.86
Western Australia	9.39
South Australia	8.60
Tasmania	3.20
	100.00

The salient features of the Commonwealth revenue sharing are: (a) the total sum provided each year will be expressed as a percentage of personal income tax collections in the previous year; (b) part of the grant to each council - not less than 30 per cent - is to be calculated on a per capita or population basis (Element A); and (c) the balance is to be assessed by the State Grants Commissions using general equalisation principles (Element B). The application of the Element A ensures that every council will receive a grant. In calculating Element A, provision may be made for a weighting of the per capita population figure to take into account factors such as area.

The Commonwealth revenue sharing grants represent about 64 per cent of the State's general assistance and about 25 per cent of its total assistance to the municipal authorities. We shall examine the manner of distribution at a later stage to see to what extent some of its features have relevance in West Bengal.

(iii) The third item of the Special Deposit Account for State assistance to the municipal authorities in New South Wales consists of grants for the relief of unemployment of young people from the Special Employment Fund to the councils on a 1:1 matching basis. An amount of $675,000 was distributed among 42 municipal authorities during 1979-80. As with some of the grants from the Consolidated Revenue Fund, these display functional characteristics and are specific in nature.

The specific assistance grants for various functional categories are administered by State departments directly rather than through the Department of Local Government. They are quite numerous and together constitute about 62 per cent of the total State assistance to municipal authorities. They are all schematic in nature and allocations vary with the amounts voted for each department to administer its programs. We shall revert later to the rationale of their allocation among the various functional heads and their subsequent distribution to the municipal authorities, and compare the arrangements with the situation existing in West Bengal.

West Bengal

In West Bengal, State grants to the municipal authorities to provide inflation compensation for salaries and wages constituted 52 per cent of the total transfer in 1978-79, followed by shared taxes at 42 per cent. Together, these covered 94 per cent of the total transfer. The remaining 6 per cent consisted mainly of the education grant. Except for the share of entry tax, none of the other items of transfer is backed by any discernible principle of allocation. The subvention grant for inflation compensation was not related to any inter-municipal differences in pay scales, but concerned itself only with the cost of living allowance. The population size of the various municipal authorities was also ignored in the distribution of the subvention - a factor which is reflected in the inter-municipal disparity.

The Municipal Finance Commission attempted to change the situation by recommending the abolition of the subvention grant and widening the area of shared taxes, on the basis of detailed projection of the municipal revenue gap for four years, 1982-83 to 1985-86. Even after giving effect to the increased tax sharing proposals of the Commission, there would be need for revenue gap grants for 31 municipal authorities in 1982-83 and 21 municipal authorities in 1985-86, out of a total of 104 authorities. For the rest, there would be modest surpluses which would be transferred to their capital account. The details are shown in Table 10.

The percentage distribution of the proposed revenue transfers for 1982-83 and 1985-86 is shown in Table 11.

It may thus be seen that the percentage of shared taxes in West Bengal is expected to rise over the years, and that of grants is expected to fall. The strategy of the West Bengal fiscal transfer proposal in Table 10 indicates that grants are in the nature of supplementary aid to those municipal authorities that show deficits even after the shared taxes are distributed, so that surplus authorities do not receive the revenue gap grants. Their surpluses are to be transferred to the capital account where development assistance from the State Government will flow. If it was possible to cancel the municipal deficits and surpluses through inter-

Table 10

RECOMMENDED STATE REVENUE TRANSFERS TO MUNICIPAL AUTHORITIES IN WEST BENGAL, 1982-83 AND 1985-86
Rs million

	1982-83			1985-86		
	CMD (38)	Non-CMD (66)	Total (104)	CMD (38)	Non-CMD (66)	Total (104)
1. Revenue Gap	-350.7	-63.0	-413.7	-381.8	- 73.3	-455.1
2. Proposed Transfer of Shared Taxes	305.0	85.0	390.0	405.7	113.1	518.8
3. Revenue Result						
(a) Deficit	- 88.4	-12.7	-101.1	- 53.4	- 12.9	- 66.3
	(11)	(20)	(31)	(7)	(14)	(21)
(b) Surplus	42.7	37.4	77.4	69.1	52.6	121.7
	(27)	(46)	(73)	(31)	(52)	(83)
4. Revenue Gap Grants-in-Aid	88.4	12.7	101.1	53.4	12.9	66.3
	(11)	(20)	(31)	(7)	(14)	(21)
5. Total Transfer	393.4	97.7	491.1	459.1	126.0	585.1

Note: Figures within brackets denote the number of municipal authorities

Source: West Bengal, *Report...*, *op. cit.*, Table 10.6.

Table 11

PERCENTAGE DISTRIBUTION OF RECOMMENDED STATE REVENUE TRANSFERS IN WEST BENGAL, 1982-83 AND 1985-86

	1982-83	1985-86
1. Shared Taxes	79.4	88.7
2. Grants-in-Aid	20.6	11.3
	100.0	100.0

Source: As for Table 10.

municipal transfers - even on a notional basis - then the ultimate deficit could have been wiped-off (items 3(b) - 3(a) in Table 10). But since that is impracticable and as the municipal authorities will also need funds for development purposes, the Municipal Finance Commission suggested that the surpluses be carried over. In making State allocations for development assistance such surpluses will not be attributed to those authorities - this is an incentive device to encourage municipal authorities to reduce their revenue gap through appropriate fiscal measures either on the revenue or on the expenditure side.

III METHODS OF REVENUE SHARING: NEW SOUTH WALES AND WEST BENGAL

Equalisation: New South Wales

The Commonwealth Grants Commission decided to apply the fiscal equalisation procedures which it had developed for State governments to the assessment of local government grants during the first two years of the new financial assistance arrangements for local government, i.e. 1974-75 and 1975-76. Grants were recommended for and made to the councils on the basis of (i) the revenue differential, and (ii) the expenditure differential.

> The revenue differential could be calculated by applying a 'standard' rate of taxation to the difference between a local governing body's own tax base and a 'standard' tax base. The expenditure differential could be calculated by applying a factor to the 'standard' unit cost of carrying out each function,[7] the sum of the individual amounts so derived for each function representing the total expenditure differential. In each case the factor represents the percentage by which a local governing body's cost of carrying out the function exceeds the standard cost for the function because of disabilities. The total grant so calculated should enable each local authority to provide 'standard' services if it maintained a 'standard' taxation or rating effort.[8]

The method adopted was thought to be 'effort neutral' in that councils with a higher rating level than the standard would be able to provide some relief to their ratepayers or to provide a level of services above the standard that could be supplied by the additional funds generated by the above-standard effort. Similarly, the councils with a lower level of rating than the standard could only provide services which would fall short of the standard by the margin which their revenue efforts fell short of the standard effort.

However, considerable difficulties were reported in the application of these procedures, particularly in relation to the expenditure differential. Because of this, the Commonwealth Grants Commission had to use its own judgement on the evidence and the expenditure data supplied by the councils. Difficulties arose due to differences in accounting practices between local governments both within States and between States. Also,

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7 Nine such functions were identified, viz., general public services, health and welfare services, sanitary and garbage, other housing and community services, recreation and culture, roads, other economic services and all other purposes. For 1974-75, education was considered separately from health and welfare, making a total of ten functions.

8 Australian Grants Commission, *Second Report 1975 on Financial Assistance for Local Government,* AGPS, Canberra, 1975, pp. 9-10.

there were significant differences in the bases on which property values were assessed affecting the measurement of local taxable capacity. Furthermore, the reliance on the aggregated actual expenditure experience of the local governments for assessing the expenditure differences affected the assessment of relativities, as these could reflect local priorities, inefficiencies or other factors unrelated to disabilities. However, in the absence of established unit costs of carrying out various functions, these imperfections had to be ignored until empirically validated unit costs were available for each function and the Commission said it would 'have to continue to exercise its judgement on the extent of expenditure disabilities for each function based on the evidence available to it, including the aggregated and individual costs of providing for various functions'.[9]

At the 1976 Premiers Conference, the Commonwealth and the State governments agreed on a new basis of general revenue sharing with local governments. The new scheme involved a major departure from the earlier distribution procedures as well as a significant shift in emphasis in the distribution criteria: the distribution among local governments within each State was to be made on the recommendation of a State Grants Commission to be established for the purpose.

> The Commonwealth *Local Government (Personal Income Tax Sharing) Act* 1976 specifies a number of conditions which must be met by the States and their Local Government Grants Commissions, including establishment by legislation before 30 June 1978, membership, hearings, submissions, reports, and the provision of information to the Commonwealth.
>
> The Act also specifies the distribution criteria which must be followed. At least 30 per cent of a State's total entitlement must be allocated among local governing bodies on a population basis (which may however take into account 'the respective sizes, and the respective population densities, of the areas of those local governing bodies and any other matters agreed upon between the Prime Minister and the Premier of the State as being relevant for the purpose of that allocation'). The remainder is to be allocated on a so-called general equalisation basis, which will help to ensure that each local governing body is able to function, by reasonable effort, at a standard not appreciably below that of other bodies, and which 'takes account of differences in the capacities of those local governing bodies to raise revenue and differences in the amounts required to be expended by those local governing bodies in the performance of their functions'. Payments made by the Commonwealth to the States for this purpose must be passed on by the States unconditionally.[10]

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9 *Ibid.*, p. 11.

10 Centre for Research on Federal Financial Relations, *1976 Report and Review of Fiscal Federalism in Australia*, ANU, Canberra, 1977, p. 77.

It was realised that the new arrangements would entail a shift from horizontal equalisation to vertical adjustments concerned with the supplementation of local government revenues. 'Under the legislation, it will be possible for the whole of a State's entitlement to be distributed among local governing bodies on a straight per capita basis, without regard to equalisation criteria. This is because the requirement of a 30 per cent per capita distribution is only a minimum requirement, and no maximum is specified.'[11]

On the other hand, the original Commonwealth method had one controversial aspect: some councils did not receive any grant under its equalisation exercise. The application of the per capita component (Element A) would ensure that every council would receive a minimum quantum of revenue sharing grants. Furthermore, lack of uniformity in State methods of distribution would ensure flexibility, so that each State could vary it in a way that suited its needs.[12]

Commonwealth Tax Sharing Grants

In New South Wales the Commonwealth's local government revenue sharing grants have two components:

(i) Element A is based on population: 33.33%
- (a) of which 87.5% is distributed to all general-purpose local governments on an overall per capita basis . . . . (29.16%)
- (b) the balance of 12.5% is distributed as an additional grant among all councils with a population density of less than 25 persons per square kilometre . . . . (4.17%)

(ii) Element B is based on equalisation: 66.67%

retaining the factors of revenue equalisation and expenditure differentials as used by the Commonwealth Grants Commission, and including a consideration of need based on the following factors:
- (a) characteristics of population, such as aged, young families, indigents, ethnic groups;
- (b) population scatter and centres of urbanisation;
- (c) geography of area: terrain, rainfall, climate, isolation;
- (d) non-rateable areas requiring council services;
- (e) growth rate high, or area below standard;
- (f) communication, e.g., roads, bridges and ferries;

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11 *Ibid.*, pp. 77-78.

12 New South Wales, Local Government-Grants Commission, *Report 1976/77 on Financial Assistance for Local Government*, Government Printer, Sydney, 1976, p. 6.

(g) service centres: transport, recreational, cultural, social etc.;
(h) trade cycles and natural disasters affecting the revenue potential of a council; and
(i) existing financial state of a council.

Some of these factors are also involved in the assessment of expenditure differentials.

The 1976-77 Report of the New South Wales Local Government Grants Commission outlined the procedure of calculating the two elements of grants as follows.[13]

Element A: Population

1. Councils with a population density of 25 persons and over per square kilometre = Estimated population on 30 June 1975 x \$3.1275 = per capita grant.

2. Councils with a population density of less than 25 persons per square kilometre = Estimated population on 30 June 1975 x \$6.0067 (\$3.1275 + \$2.8792) = per capita grant.

Element B: Equalisation (i) Revenue component

T_c = claimant local body's tax base per capita	1.	The rateable unimproved capital value (u.c.v.) per capita of councils is divided by the population of a council. This gives the rateable u.c.v. per capita of each council (T_c) .
T_s = standard tax base per capita	2.	The total rateable u.c.v. per capita in the top half of each category is divided by the number of councils in the above-standard category (the 50 per cent of councils with the highest per capita revenue bases in each of the four categories of councils adopted by the Commission - metropolitan, provincial cities and country municipalities, other non-metropolitan authorities with urban clusters, and all others) to arrive at the standard u.c.v. per capita of each category (T_s).
t_s = standard tax rate	3.	The rate revenue for ordinary services, pensioners' subsidies and garbage charges, and the per capita grant (Element A) of the councils in the above-standard category are then totalled and divided by the total of

13 *Ibid.*, Chapter 2.

the rateable u.c.v. of these councils to arrive at the standard tax rate for each category (t_s).

4. The difference between the revenue bases of the standard and claimant bodies per head of population is a measure of the difference in their capacities to raise revenue per head of population ($T_s - T_c$); this is then converted to an actual amount by multiplying the figure so derived first by the standard rate (t_s) and secondly by the population of the claimant council (P_c).

P_c = population of the claimant council

R = revenue differential

Therefore, the resultant equation is $R = P_c . t_s (T_s - T_c)$.

Element B: Equalisation (ii) Expenditure Component

The 1977-78 Report of the New South Wales Local Government Grants Commission described the expenditure component of Element B. The general formula for the assessment of expenditure differentials or disabilities is $G_c = E_s . g_c$, where G = grant, c = relevant local body, E = expenditure on a particular function, s = standard, and g = disability factor. The disability factor consists of two parts: the first arises from differences among local bodies in the number or proportion of units served; and the second involves the assessment of additional cost per unit that arises in providing the standard range of local services because of inherent or special circumstances. These are expressed in algebraic terms below.

(1) $$G_c = P_c \left(\frac{N_c}{P_c} - \frac{N_s}{P_s} \right) CP_s$$

where P_c = population of the local body,

$\frac{N_c}{P_c}$ = the number of units of service in the local body's area per capita,

$\frac{N_s}{P_s}$ = the standard number of units per capita, and

CP_s = the standard cost per capita.

This part of the formula enables the calculation, at standard cost, of the differences between local bodies in the number of units to be served (e.g. length of roads, number of children aged under 5 years, number of persons eligible for pension etc.).

(2) $$G_c = P_c \left[\frac{E_c}{P_c} - \frac{E_s}{P_s} \right]$$

where $\frac{E_c}{P_c}$ = local body's cost per capita, and

$\frac{E_s}{P_s}$ = the standard cost per capita.

The main problem with the use of this part of the formula is the difficulty arising in trying to ensure that the differences between E_c/P_c and E_s/P_s reflect inherent or special disabilities and not the priorities or the levels of efficiency of the councils. Separate assessments are made for each function for each local body and the aggregate of the calculations of g_c for all functions is the expenditure disability allowance for each local body.

To summarise, the first element of the formula $(P_c \cdot t_s (T_s - T_c))$ is designed to measure the relative revenue-raising capacity and to calculate the revenue component of the grant of each council; the expenditure component $(E_s \cdot g_c)$ is the second element of the formula which takes into account cost disabilities caused by inherent circumstances as among local bodies in providing local government services.

Local Government Assistance Fund Grants

The formula adopted for the State general assistance grants was based on three factors: (a) 'weighted' population; (b) 'weighted' expenditure from general purpose rates; and (c) relative needs. Of the total grant, 70 per cent was distributed on population and rate factors and 30 per cent on the needs factor. A minimum level of grant was determined at $5,500.

(a) Population: The weightings adopted were:

Central Division			Country Division		
First	10,000	- full value	First	20,000	- full value
Next	10,000	- half value	Next	10,000	- half value
Next	10,000	- quarter value	Next	10,000	- quarter value
Next	270,000	- one-eighth value	Next	260,000	- one-eighth value
Over	300,000	- nil.			

(b) Rates: The weightings adopted were:

Central Division			Country Division		
First	250,000	- full value	First	500,000	- full value
Next	250,000	- half value	Next	250,000	- half value
Next	250,000	- quarter value	Next	250,000	- quarter value
Next	6,750,000	- one-eighth value	Next	6,500,000	- one-eighth value
Over	7,500,000	- nil.			

(c) Relative needs: These were determined by the Commission as the needs of each council relative to the needs of all other councils. The following additional adjustments were made -
  - (i) An amount of $3,000 was determined for each 'urban centre' and an amount of $1,250 for each 'locality'.
  - (ii) Allocations to shire councils were increased where necessary, so that the grants they received represented at least a 50 per cent increase over the previous year paid as shire endowment.
  - (iii) For the Central Division a maximum grant of $1.30 per capita for the population and rate factors was allocated and no maximum was fixed in respect of the needs factor.

It may thus be seen that the weightings fixed for State general assistance were in almost reverse proportions for population and other disability factors compared to the federal revenue sharing grants, so that vertical imbalances were corrected more effectively under the State assistance. However since the amounts involved were much smaller than the federal grants and both the transfers were pooled in awarding the final quantum of grants to each council, the vertical element of the total grant was exceeded by the horizontal element (Element B under the federal grant). One could, therefore, argue that after making separate provision for the compensatory aspects of the State general assistance for Crown land rating and shire endowment, it would be preferable to combine both the State and Commonwealth general assistance under a single distribution formula.

Gap-filling: West Bengal

In West Bengal, the Municipal Finance Commission adopted a revenue gap-filling approach for the municipal authorities, following the practice at the federal level for meeting the revenue gap of the States. This implied a projection of estimated municipal revenues and expenditure for the coming five years. An attempt was made to prepare statistical projections on the basis of municipal data, but the results proved to be unreliable due to the limited period for which the basic data were available, and also the unsatisfactory quality of the data.

The Commission therefore estimated the future municipal revenue and expenditure by applying certain assumed rates of growth. These were: (i) revenue, 10 per cent per annum; (ii) recurrent expenditure (a) salaries and wages, 5 per cent per annum and (b) other recurring expenditure, 10 per cent per annum. The assumed growth rates corresponded with the actual rates in a good number of cases and also with the rates of growth of comparable State expenditure. On the revenue side, the assumed rate was pitched at a somewhat higher level than was being experienced so that the municipal authorities would have to make an effort to realise the assumed target. On the expenditure side, the most important element (about 60 per cent) was for salaries and wages, which change along with changes in State government emoluments. The problem of rewards and penalties was to be tackled in two ways: first, any surplus earned by a municipal body in its revenue budget would be regarded as an 'additional resource' mobilised for its capital (plan) budget and this would not adversely affect their share of plan assistance allocated by the State Government; secondly, since the revenue transfers would be calculated on the assumption of a minimum level of growth of internal revenues, a failure to reach this minimum level would mean that the actual revenue gap would be higher than estimated, and the municipal body concerned would have to make the necessary effort to increase its revenue and/or reduce its expenditure.

> In all such cases, a municipality which fails to reach the standards laid down - based not only on a minimum rate of growth of revenues, but also on a ceiling rate of growth of expenditure - will have to make out a special case and satisfy the [State] Government every year that there are very strong externally imposed factors which make it difficult for the body to keep the gap within the limits prescribed. There is also the fact that

such municipalities will be able to present their case before the subsequent Municipal Finance Commissions that are likely to be appointed.[14]

The revenue gaps were estimated strictly on the basis of the internal revenues of the municipal bodies. Recurrent expenditures (including dearness (cost of living) allowance payments mainly made from special State grants), both existing as well as presumed, were based on (i) the maintenance cost of municipal projects completed by the development authorities such as the Calcutta Metropolitan Development Authority, and (ii) the annual municipal contribution to the improvement trusts in Calcutta and Howrah. The revenue did not include any grants, tax assignments and shared taxes - these were taken into account when considering the manner by which the deficits could be met.

On the basis of existing arrangements, these gaps were reduced by: (i) shares of entry tax; (ii) shares of motor vehicle tax; and (iii) a wide variety of grants from the State Government. The Commission thought that there were serious objections to the continuation of the existing system because: (a) the municipal bodies were not certain about the receipt of grants and they could not, therefore, make sound financial plans; (b) there might be some municipalities receiving larger grants than others due to lobby pressure; and (c) there was a mixture of capital and revenue elements in the grants that should be avoided, so that the grants to meet the revenue budget deficit should where necessary be made for maintenance assistance. The Commission started from the position disclosed before taking into account existing levels of tax shares and grants. In designing the scheme of transfer, the objectives before the Commission were: (a) to reduce the total dependence of the municipal bodies on the discretionary transfers by the State Government, by making the transfers as firm as possible; (b) to obviate the need for such unsavoury practices as meeting the gaps by drawing on special funds or simply non-payment of dues to semi-government authorities; (c) to minimise the level and also to standardise the methods of grant allocation; and (d) to ensure that as many municipal bodies as possible had a surplus in their capital account as their own contribution.

In its recommendations for gap-filling, the Commission felt that it was necessary to enlarge the field of tax sharing that would provide the required buoyancy to the municipal revenues, especially when the taxes selected would yield rapidly growing amounts. Tax sharing would also create an interest among the sharing units in the increases in the rates of growth of the total proceeds of the taxes shared. The Commission went on to observe:

> There is also the fact that once the State Government adopts clear rules for tax-sharing and for special grants, the expenditure involved will become its <u>committed non-plan expenditure</u> and will, therefore, be eligible for inclusion in the estimates of requirements placed by the State Government before

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14 West Bengal, *Report..., op. cit.*, para 9.3.6.

the Finance Commission appointed under Article 280 of the Constitution. As the federal Finance Commission has to take full account of all expenditure that stands committed on the non-plan side and also allow for an appropriate annual growth rate, the additional burden, if any, on the State Government will be covered by the Finance Commission awards. It is presumed that the State Government will appoint a Municipal Finance Commission at periodic intervals and it will thus be able to present before every federal Finance Commission the financial effects of the accepted recommendations of the preceding Municipal Finance Commission.[15]

Equalisation vs Gap-filling

From the preceding discussion, it is clear that both in New South Wales and in West Bengal the State governments have accepted the responsibility of balancing the revenue requirements of the municipal bodies, although with different methods of allocating the State transfers.

In both States, the respective approaches follow the methods adopted at the federal level for assistance to the State revenue budgets. In this, the approach in Australia has been a method designed to meet the requirements of horizontal transfer, assuming that the needs of vertical transfer are minimal and, in any case, a matter to be determined politically. In India, on the other hand, the approach is to recognise the predominant need for a rational scheme of vertical transfer, while assuming that the requirements for horizontal transfers can be tackled through normal administrative machinery.

The purely technical problems of developing a reasonably satisfactory system of budgetary equalisation are indeed formidable, and in the absence of detailed statistical data for measuring the local tax base or calculating the unit costs of various municipal services under differing conditions, necessary recourse has to be made to informed judgements. One may also raise the question whether this approach is fully satisfactory even at the level of federal transfers to the States. On the other hand, given the fact that the sub-national governments in both federations rely on vertical transfers to a very large extent, the case for a rational scheme of vertical transfer seems all the more compelling.

There is also another aspect of the Australian situation that merits attention. The predominance of specific purpose grants to the local authorities militates against any sensible system of equalisation since these grants have the effect of placing the local authorities on a dissimilar footing at the initial stage. As in the case of the State governments, the local governments in Australia should reasonably expect the major part of their revenue expenditure to be met through domestic revenue <u>and</u> untied transfers; only after this is achieved, will an equalisation method be equitable. Perhaps an increase of the quantum of revenue

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15 West Bengal, *Report..., op. cit.*, para. 10.11.8.

sharing grants and an increase in the per capita element in such sharing will correct the vertical imbalance noticeable in New South Wales local government finance. Alternatively, the possibility of taking the specific purpose grants in the equalisation scheme may be tried through the inclusion method.

In West Bengal, there is an obvious case for introducing an equalisation element in the recommended revenue sharing proposals. This would integrate into the balancing revenue grant an equalisation formula which would take into account both the revenue and the expenditure components of municipal budgets, as in New South Wales.

The most interesting aspect that emerges from the above comparison is that in both Australia and India federal funds are being or are likely to be used for revenue assistance to municipal (local in Australia) governments. In India, of course, this hinges on the expectation that the next (eighth) federal Finance Commission will accept the West Bengal position that its transfer commitments to the municipal authorities are firm and reasonable. Given this situation, one may raise questions about the traditional relations between the State governments and the municipal (or local) governments in both countries.

IV SPECIFIC PURPOSE GRANTS AND DEVELOPMENT ASSISTANCE: NEW SOUTH WALES AND WEST BENGAL

Specific Purpose Grants

New South Wales

As indicated earlier, specific purpose assistance to the municipal authorities constitutes about 63 per cent of total assistance. Total assistance for roads claims about 57 per cent, followed by water supply 26 per cent, culture 7 per cent, recreation 2 per cent, electricity 3 per cent and all others about 5 per cent of the specific grants as shown in Table 12.

Table 12

SPECIFIC PURPOSE GRANTS TO MUNICIPAL AUTHORITIES IN NEW SOUTH WALES, 1979-80

Items	$ million	per cent
1. Roads	73.8	57.4
2. Public works	1.2	0.9
3. Water supply	33.0	25.7
4. Culture	8.9	6.9
5. Recreation	2.9	2.3
6. Lighting	2.6	2.0
7. Electricity	3.5	2.7
8. Transport	1.0	0.8
9. Others	1.7	1.3
	128.6	100.0

Source: Table 8 above.

Direct specific purpose grants from the Commonwealth Government to local government authorities rose in 1975-76 as a result of the Labor Government's policy, but fell in subsequent years mainly because of the termination of the Regional Employment Development Scheme. However, Commonwealth specific purpose grants to local governments via the States were significantly higher in 1977-78 than in 1973-74, although compared to 1975-76, they had also fallen. Of the indirect specific purpose grants from Commonwealth sources, road grants claimed the lion's share in all three years. Specific purpose grants to municipal authorities in New South Wales are for both current maintenance and new capital works.

West Bengal

In West Bengal, as noted earlier, State specific purpose grants to the municipal authorities constitute a minor proportion (6 per cent) of the total State assistance. Of this, education claims the lion's share (about 83 per cent) of all specific purpose grants. Education is not uniformly provided by all the municipal authorities and there are three different

Table 13

COMMONWEALTH SPECIFIC PURPOSE GRANTS TO AUSTRALIAN LOCAL GOVERNMENTS: VARIOUS YEARS
($ million)

	1973-74	1975-76	1977-78
1. Direct to local governments	6.0	106.5	14.2
2. Indirect via States	93.2	157.1	137.5
- Roads	67.5	75.3	116.9
- Others	25.7	81.8	20.6
3. Total Commonwealth Specific Purpose Grants	99.2	263.6	151.7

Source: Melville L. McMillan, *op. cit.*, p. 35.

categories receiving assistance: (i) municipal areas where primary education is free and compulsory; (ii) selected municipal schools receiving grants from the State Education Department towards a dearness (cost of living) allowance for the teachers; and (iii) municipal bodies receiving education grants from the State Local Government and Urban Development Department. In addition there are the two corporations of Calcutta and Chandannagar and the municipalities of the Purulia district (which came to West Bengal from the neighbouring State of Bihar as a result of a States' reorganisation in 1956), where primary education is a compulsory municipal function. Obviously, there is a need for a State-wide uniform grants policy for this activity.

Comparative Analysis

Unlike Australia, there is no direct central (federal) assistance to local governments; however, some of the central assistance to the States outside the State plans, viz. for centrally-sponsored schemes and central sector schemes, does find its way to local governments. It is impossible to make even a rough estimate of the amount, but the total is negligible, perhaps limited only to the central sector scheme for the minimum needs program. The tendency is for the States to assume responsibility for spending all federal assistance through their own departments and *ad hoc* agencies.

In India the general tendency is to rely more on specific purpose than on general purpose grants to municipal authorities; but this tendency is not reflected in the situation in West Bengal, where specific purpose grants represent a very small proportion of the total State assistance. The State Municipal Finance Commission took the view that, with any increase in the coverage and quantum of State development assistance to the municipal authorities, the need for specific purpose grants would be reduced even further, limiting these to compensatory or reimbursement payments, especially for education and health functions.

Development Assistance

The concept of development assistance is current in Indian federal assistance to the States for plan purposes, involving all additions to existing levels of services or the creation of assets for development purposes within the framework of the approved State plans. The allocations are made after reviewing the committed expenditures of the States and their scope for mobilising additional resources for the fulfilling of State plan targets. About two-thirds of the total State plans in the aggregate are financed in this way by the centre, of which 70 per cent represents loans and 30 per cent represents grants in the form of untied (block) development assistance. Market borrowings by the States and institutional finance for State plan schemes are separate from the block transfer. In addition, the centre provides development assistance for centrally-sponsored projects and central sector schemes falling within the ambit of the central plan.[16]

The central assistance for State plans and the central plan schemes to the States constitute what is known as development assistance in India. These forms of assistance are much wider in scope than the traditional specific purpose grants in as much as they are based on (a) inter-sectoral and inter-State targets, (b) a review of the States' committed expenditures for non-development purposes (both revenue and capital), (c) requirements for additional resource mobilisation through taxation, user charges and market borrowing by the States, (d) block assistance for fulfilling the overall State plan targets and separate financial conditions attached to the central plan schemes, and (e) a mixture of loans and grants in an agreed proportion. For the Indian municipal sector a similar method of development assistance system has been suggested.

> Given an integrated system of municipal and state planning, one can visualize a two-tier capital grants system: schemes having overall state priorities might be entitled to patterned grants,* while block grants could be given to the municipal authorities to finance their own plans. Since the state governments are also providers of loan funds for municipal development a block grant-loan package may be offered to the municipal bodies....[17]

In West Bengal, the Municipal Finance Commission suggested that:

> ...it should be made obligatory for every municipality to frame a plan budget every year, which, in its turn, should be an integral element of the State five-year plan. The municipal bodies' plan

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* Patterned grants are specific purpose grants with a loan component.

16 For a detailed discussion on the system of plan finance in India see R.K. Dar, *Recent Developments in Federal Financial Relations in India,* Centre for Research on Federal Financial Relations, Distributed by ANU Press, Canberra, 1981.

17 Abhijit Datta, 'State Grants and Shared Taxes', *Nagarlok,* Vol. III, No.4, October-December, 1971.

budget should be financed partly from their own resources, and partly from special Plan assistance, the Plan assistance should include both grants and loans, the grant element being larger in the case of the small municipalities and in all cases where the plan-projects are not of the revenue yielding type.[18]

It was also envisaged that besides the normal plan assistance there should be special development grants for municipalities showing commendable financial performance and that 'no municipality should be penalised (through an adjustment of Plan grants) for having succeeded in raising more revenue than the expected amounts or for having created a larger surplus (or a smaller deficit) through economy in expenditure'.[19] Furthermore, the plan budget should 'take up primarily the task of levelling up the services to a pre-determined norm, or at least to an all-State median or mean'.[20] The task of determining the norm, however, was left to the State Government itself in its system of plan preparation. The issue of block plan assistance to the municipal bodies was not insisted upon by the Commission as it would take some time to install a system of municipal five-year plans and to provide for their ultimate integration with the State plan on a regular basis. Pending such integration, the existing method of specific schematic development assistance would presumably continue; this consists of State-sponsored schemes for the municipal bodies (corresponding to the centrally-sponsored and central sector schemes for federal plan transfer to the States). During the sixth five-year plan period (1975-76 to 1979-80) the State's development assistance to the municipal bodies amounted to Rs658 million on different schemes, as shown in Table 14.

It will be seen that among the grant-aided schemes there were items, like construction of commercial estates and water supply schemes for large municipalities, which could have been loan-financed; on the other hand, there was an absence of purely loan-financed schemes. Compared to the federal scheme of development assistance, at the State-municipal level the purely grant-aided schemes correspond to the sponsored category, while the mixed schemes have similarities with block assistance. The major difference lies in the fact that at the federal level, the quantum of development assistance is a fixed and an assured part of the total size of the State plan, while at the State-municipal level the total size of the municipal plan is indeterminate, mostly non-existent, and the amount allocated is notional, depending on the exigencies of the budgetary position of the State Government and the *inter se* allocations determined on an *ad hoc* basis.

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18 West Bengal, *Report..., op. cit.*, para 11.1.3.

19 *Ibid.*, para 11.1.5.

20 *Ibid.*, para 11.1.6.

Table 14

WEST BENGAL: DEVELOPMENT ASSISTANCE TO MUNICIPAL BODIES DURING THE SIXTH FIVE YEAR PLAN (1975-76 TO 1979-80)

Schemes	Pattern of Assistance		Amount
	Grant	Loan	
	per cent		Rs million
A. Grant-aided			
(i) Development of selected towns	100	-	191.6
(ii) Commercial estates and community halls	100	-	48.6
(iii) Equipment to scavengers	100	-	4.0
(iv) Conversion of service privies into sanitary latrines	$33\frac{1}{3}$*	-	33.6
(v) Sewerage and drainage schemes	100	-	50.0
(vi) Water supply schemes for small municipalities	100	-	2.0
B. Mixture of grants and loans			
(i) Area development	$33\frac{1}{3}$	$66\frac{2}{3}$	45.0
(ii) Water supply schemes for large municipalities	$33\frac{1}{3}$	$66\frac{2}{3}$	183.5
(iii) Water-supply scheme: Ailiguri municipality	$33\frac{1}{3}$	$66\frac{2}{3}$	100.0
		Total	658.3

* $66\frac{2}{3}$% of cost to be borne by the beneficiaries

Source: West Bengal, *Report...*, *op. cit.*, Table 11.2.

Market Borrowing

Australia

In Australia local government borrowing is conditioned by the Gentlemen's Agreement of 1936 between the Commonwealth and the State governments, which requires a local authority wishing to borrow more than \$1.5 million in any year to seek approval from the Australian Loan Council through the State government. Amounts up to \$1.5 million may be borrowed by a local authority from the market with the approval of the State government. The public sector borrowing program is distributed among the State governments and each State determines the shares of borrowing for the local governments and statutory authorities under its control. It is sometimes suggested that the State governments discriminate against the large local government authorities *vis-à-vis* the statutory utility authorities in the distribution of loan allocations for the larger authorities within their jurisdictions.[21] The interest rates on local authority borrowing are slightly higher than comparable borrowing by the Commonwealth Government, presumably due to the small size of local loans with correspondingly larger servicing costs or variations in the markets from which the loans are raised. One possible way of removing these restraints could be for the Commonwealth or State governments to make capital grants to the local authorities.[22] This raises the issue of the rationale of a possible mixture of capital grants and loans and the criterion for distinguishing between purely grant-aided schemes and loan-financed projects. The allocation of loan limits to the larger local authorities and the sanctioning of borrowing programs of the smaller local government authorities cannot be made effectively in the absence of long-term corporate plans of the local bodies concerned or regional development plans. This problem is not, of course, peculiar to local government borrowing but arises in the case of the entire public sector borrowing arrangements in Australia.

India

In India, with the exception of a few municipal corporations, municipal authorities may borrow only from their respective State governments. The borrowing powers of the corporations are defined in the relevant legislation as a percentage of the total annual rateable value within their jurisdictions, or a percentage of their own domestic revenue or, in some cases, as a definite monetary ceiling. Under central legislation - the Local Authorities Loans Act 1914 - the State governments may sanction local market borrowing below Rs 500,000 within a repayment period of 30 years; beyond these limits central approval is needed. In practice, very few municipal authorities are allowed to tap the capital market directly and independent borrowing is restricted solely to the major municipal corporations. As an illustration, we present the sources and uses of debt position of the Calcutta Corporation as at March 1980 in Table 15.

It may thus be seen that only about 26 per cent of the borrowing of the Calcutta Corporation was obtained from the market; the remaining 74 per cent was from intergovernmental sources. The interesting aspect of these loans are: (a) the Calcutta Metropolitan Development Authority (CMDA) provided loan funds to the Calcutta Corporation for the execution of its various projects - this involved the channelling of State plan assistance through the CMDA; (b) the central government provided direct loan assistance to the Calcutta Corporation - this was somewhat unusual in the system of federal transfers in India, as in Australia; (c) State loans consisted mainly of small loans for a variety of purposes not funded by the CMDA under the major functional headings; and (d) the element of loan repayment in central loans indicated responsibility sharing for local

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21 W.J. Sheehan, 'Issues in Local Government Finance', in Russell Mathews (ed.), *Local Government in Transition: Responsibilities, Finance, Management,* Centre for Research on Federal Financial Relations, Distributed by ANU Press, Canberra, 1978, p. 56.

22 *Ibid.*, p. 54.

Table 15

SOURCES AND USES OF DEBT OF THE CALCUTTA CORPORATION ON 31 MARCH 1980
Rs million

SOURCES	USES						
	Water Supply	Drainage & Sewerage	Conservancy	Housing	Loan Repayment	Others	Total
1. Market Borrowing	12.3	2.2	–	–	–	26.4	40.9 (26.5%)
2. State Government	2.2	–	1.1	–	–	10.9	14.2 (9.2%)
3. CMDA	27.4	13.8	13.1	–	–	0.6	54.9 (35.5%)
4. Central Government	19.9	–	–	0.9	23.7	–	44.5 (28.8%)
	61.8 (40.0%)	16.0 (10.3%)	14.2 (9.2%)	0.9 (0.6%)	23.7 (15.4%)	37.9 (24.5%)	154.5% (100.0%)

Note: Figures within brackets represent percentages

Source: West Bengal, *Report..., op. cit.*, Table 11.4.

borrowing by the central government. It may be mentioned that where intergovernmental borrowings predominate it is not possible to maintain the sharp distinction between a capital grant and a soft loan, because pressures are generated for writing off such outstanding loans where a self-liquidating element of the loan-financed projects is not apparent. Inevitably the market loans impose a degree of financial discipline on the local governments which is absent in the case of intergovernmental loans. From this point of view, one could presume that much of the CMDA loan finance to the Calcutta Corporation would be redeemed.

An Appraisal

It is clear that a system of specific purpose grants coupled with the use of independent borrowing powers by local governments will operate where the activities of the State and the municipal authorities are not integrated through a system of long-term development planning and its financing. On the other hand, such an integration, even when based on rational considerations, may dilute the sense of fiscal responsibility and discipline on the part of the municipal authorities. An effective loan arrangement therefore presumes fiscal separation of the levels of government - both on the capital as well as on the revenue account. Partial independence on the capital account, by way of freedom to raise market loans, also assumes an absence of significant intergovernmental transfers on the revenue side to take care of the loan servicing obligations. In the case of New South Wales, the sizeable transfers in the revenue budgets do take into account the municipal capacity for market borrowing; on the other hand, in West Bengal, in spite of a suggested municipal revenue gap transfer arrangement, the total plan transfers to the municipal authorities are not determined on the basis of the size of the municipal sector plan, but distributed to them on *ad hoc* basis depending on the State's budgetary position and its policy of plan assistance to the municipal authorities. Both the New South Wales and West Bengal municipal systems are therefore likely to become more dependent on fiscal transfers from State governments for both revenue and capital expenditures.

V ADMINISTRATION OF FISCAL TRANSFERS: NEW SOUTH WALES AND WEST BENGAL

Machinery for Transfer

The involvement of the various State departments in distributing revenue grants to the municipal authorities in New South Wales and West Bengal is shown in Table 16.

Table 16

SHARE OF STATE DEPARTMENTS IN GRANTS TO MUNICIPAL AUTHORITIES IN NEW SOUTH WALES AND WEST BENGAL, 1979-80

per cent

	State Departments		Shared	Total
New South Wales	Local Govt.	Functional	Taxation	Grants
General assistance	36.8	-		36.8
Specific assistance	-	63.2		63.2
Total:	36.8	63.2		100.0
West Bengal				
General assistance				
(a) Subvention	52.0	-	-	52.0
(b) Shared taxes	-	-	42.0	42.0
Specific assistance	-	6.0	-	6.0
Total:	52.0	6.0	42.0	100.0

Source: Tables 8 and 9 above.

It will be seen that, compared to New South Wales, West Bengal's Department of Local Government and Urban Development handles a much larger proportion of State grants, while its taxation departments are responsible for allocating shared taxes to the municipal authorities. The role of the functional departments in providing specific assistance is much more pronounced in New South Wales than in West Bengal. In all aspects of the final distribution of grants and shared taxes, the State Treasury or Finance Department is involved in both New South Wales and West Bengal. Earlier we noticed that, in New South Wales, the Local Government Department also handles some assistance of a functional nature, e.g. pest control, children and youth welfare. In West Bengal also the Local Government and Urban Development Department distributes some specific purpose grants for general improvement, water supply and sanitation within the Calcutta metropolitan area; in doing so the department is duplicating the activities of the relevant State functional department in charge of public health. In both New South Wales and West Bengal, the State local government departments are primarily responsible for the role of organisation and supervision of local authorities and their intrusion into functional spheres may be regarded as a distortion of their original purpose. However, the British practice of combining house-keeping and functional activities within a single department of local government is evident in both New South Wales and West Bengal; what is not so clear is the rationale for the retention of functional assistance within their local government departments even when particular functions have been separately organised.

Revenue sharing in both New South Wales and West Bengal is a major responsibility of the local government departments, which also function as the administrative agencies for the local government grants commission or municipal finance commission. The inspectorate or directorate system for local or municipal governments is a responsibility of the State local government department in both New South Wales and West Bengal. The State finance or treasury department keeps in close touch with the local government and other departments and acts as the final authority for decision making in fiscal transfers. However, the relationships between the State local government department on the one hand and the various functional departments on the other are not at all close; in fact there are occasions when differing perceptions of State-municipal relations may emerge due to the particularistic requirements of the functional departments. Again, this is a legacy of the British machinery of government. Proliferation of specific functional grants complicates the situation, especially when these predominate in the total transfer arrangements. Introduction of capital grants similarly tends to acquire functional overtones in the absence of municipal corporate planning; this is evident even in West Bengal, where municipal corporate planning is still not in vogue and the plan assistance to the municipal authorities follows the State's priorities.

Financial Information

New South Wales

The basic sources of financial information available to the Local Government Grants Commission are two: (i) Local Government Statements of Accounts maintained by the Australian Bureau of Statistics; and (ii) the annual Returns of Financial and General Information submitted by the councils to the Local Government Grants Commission. Appropriate items from the Statements of Accounts are stored in the computer file maintained by the Commission, although there are instances of occasional discrepancies in the records of the Commission and the primary data file stored with the Australian Bureau of Statistics.[23] The Commission's own data collected through the annual returns also contained a high degree of inaccuracy and incompleteness, as mentioned in its 1977-78 and 1978-79 reports.

A committee of experts was appointed in 1977 by the New South Wales Government to suggest a new format for the annual Statements of Accounts

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23 New South Wales, Local Government Grants Commission, *Report 1979/80, op. cit.*, p. 18.

of councils and, as a result of the committee's recommendations,[24] a new format was approved by the Minister for Local Government in October 1978. It was hoped that 'if completed correctly it will provide the bulk of the financial data required by the Commission for grant assessment purposes and will eliminate the need for councils to complete the current detailed return'.[25]

In addition to the two basic returns, the Commission obtains supplementary information during its visits to the councils and through council submissions.

West Bengal

West Bengal has still to develop a system of regular collection and publication of municipal financial information. Currently the municipalities (including the notified and town committees, but excluding the Calcutta Corporation) submit an Annual Statistical Return to the State Local Government and Urban Development Department. These returns used to be processed by the State Bureau of Applied Economics for publication as a Handbook, but this is not being published regularly and it is not clear how the aggregated municipal data are being used by the State departments for grant purposes. The Calcutta Corporation submits a copy of its published annual budget to the State Local Government and Urban Development Department, although its accounts are neither finalised nor audited for a number of years.

The Municipal Finance Commission prepared a detailed Questionnaire on municipal finance and services so as to collect basic information on which to base its future estimates, but the response was not encouraging. A number of municipal authorities failed to complete the proforma contained in the Questionnaire and the reported data contained a number of inaccuracies and inconsistencies which did not provide a firm base for the Commission's projections. The Commission therefore suggested that a section should be created within the State Local Government and Urban Development Department to collect basic municipal financial information on a continuing basis and to make it available to subsequent commissions. In view of the absence of aggregative municipal financial information, the Municipal Finance Commission processed the data obtained through its own Questionnaire and appended these in the form of master tables in an Annexure Volume to the Commission's report. These tables will serve as a bench-mark of municipal financial statistics in the State, to be updated in subsequent years by the special section of the Department.

Unlike Australia, in India there is no standardised system of local government accounting and financial reporting. With the involvement of the

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24 New South Wales *Interim Report of the Committee of Inquiry into Local Government Accounting Procedures in New South Wales, mimeo.*, Sydney, September 1978.

25 New South Wales, Local Government Grants Commission, *Report 1979/80, op. cit.*, p. 19

federal Finance Commission in the States' committed and plan expenditure for municipal authorities, it is expected that such a system will emerge eventually.

Performance Indicators

In New South Wales, the revenue-sharing principles adopted prescribe calculation of relative disabilities arising out of local government revenue and expenditure differentials. The revenue differentials reflect differences in local government revenue-raising capacity, including the effects of such factors as: (i) trade cycles and natural disasters; (ii) unemployment; and (iii) non-rateable property. The expenditure differentials reflect expenditure disabilities, the costs of which are quantified by means of indicators in a variety of general and functional areas, namely (i) general disabilities; (ii) general administration; (iii) other public services; (iv) education; (v) health and welfare; (vi) garbage; (vii) other housing and community services; (viii) recreation and culture; (ix) roads; and (x) other economic services. Many, if not most, of these indicators are not capable of being quantified to any reasonable extent, so that the Commission has to fall back on its informed judgement about the disabilities affecting most of the functional areas.

It is possible that State functional departments may have fairly precise disability indicators relating to specific functional areas, which they use to determine unit costs for specific purpose grants. There is thus a possibility of duplication of effort in the assessment of revenue sharing and specific purpose grants. A better course might be to develop indicators for general disability factors on a global basis for revenue sharing purposes, leaving functional disabilities to be corrected through specific grants.

In West Bengal, a simple gap-filling exercise, involving allocations through the dual methods of tax sharing and deficit grants, totally ignores the disability factors and may result in subsidising low revenue effort or waste in expenditure or both. In order to correct these aspects it was thought desirable to introduce an element of incentive grants for development purposes, although the Municipal Finance Commission did not indicate the basis of its *inter se* allocation to the various municipal authorities. In the Indian State of Gujarat there is an incentive grant, calculated at 25 per cent of the State grants allocated in the preceding year to the municipalities. Its eligibility is decided by awarding weights in terms of various indicators of performance. Similar conditions, if applied to West Bengal, would result in a method of calculating an incentive grant as shown in Table 17.

Standardisation of Valuation

New South Wales

In New South Wales, land tax valuations are assessed by an independent State Valuer-General, who is appointed for a term of seven years and may only be removed by the State Governor on the address of both Houses of the Legislature. The Valuer-General prepares the official valuation roll in

Table 17

INDICATORS FOR AN INCENTIVE GRANT TO MUNICIPAL AUTHORITIES IN WEST BENGAL BASED ON GUJARAT SYSTEM

Items	Performance Indicators	Municipal population size	Minimum per capita per annum (Rs)	Weights
1. Income from taxation:	-	Over 100,000	45	35
		50,000-100,000	40	
		Below 50,000	35	
2. Total income:	-	Over 100,000	60	25
		50,000-100,000	55	
		Below 50,000	50	
3. Expenditure on establishment (tax supported functions)	Not more than 25 per cent of own income from tax supported functions			25
4. Recovery of municipal dues	95 per cent			15
5. Expenditure on public health and sanitation	Minimum of 10 per cent of own income			10
			Total	100

Source: Datta, *op. cit.*, pp. 101-2.

terms of the provisions of the valuation legislation. Thus valuations are made by a centralised and independent valuing authority whose principal duty is to investigate the land market, adopt common standards of valuation practice and definition of unimproved value.[26] In the exercise of his professional duties the Valuer-General has a quasi-judicial status. The legislation requires the valuing authorities to not only re-value land at stated intervals, but to keep the record up to date so 'that the valuation roles shall, as nearly as may be, represent correct values'. New South Wales has attempted to reduce the valuation cycle to two years in order to overcome the problem of different valuation dates for different types of authorities and for different purposes. Since 1973, the State has revised

26 M.D. Herps, 'A Study of the Official Land Valuations of the Australian States and of their Capacity to Raise Revenues from Land Transactions', in Commonwealth Grants Commission, *Report on State Tax Sharing Entitlements 1981*, Vol. III - Reports of Consultants, AGPS, Canberra, 1981.

unimproved land valuations in the metropolitan areas of Sydney, Newcastle and Wollongong at two-yearly intervals. The base of valuation is unimproved capital value (u.c.v.) or site value for rating and State land tax purposes, and for the purpose of water rates levied by the water boards.

The standards of academic training and the experience requirements of the valuers are high, mainly due to the activities of the professional institutes. The adoption of a two-yearly cycle of valuations in the State's metropolitan areas led to the adoption of computer technology and mass appraisal techniques to cope with the increased work-load. For instance, urban site values are recorded on large-scale maps on which boundaries of each land parcel are charted and these are used to update the computer-based valuation roll. The computer also records sales of various categories of land as a basis for facilitating valuation. Valuation practice is currently undergoing technological change as a means of promoting consistency and improving the speed of finalisation of valuation. However, these developments have not necessarily promoted consistency between States.[27] It is noted that when large-scale revisions are made within a short cycle, as in the State's metropolitan areas since 1973, there is a tendency towards conservatism. On the other hand, where the revaluation interval is relatively long there is a tendency to base valuations on limited sales evidence close to the base date of valuation.[28] In spite of these problems, the degree of standardisation in valuation within the State is considerable.

West Bengal

As in New South Wales, West Bengal has attempted to standardise municipal valuations. The West Bengal Central Valuation Board Act 1978, thus provides for the establishment of a central valuation board (CVB) and a number of local valuation authorities. These two agencies are practically independent of one another. It is not clear whether the local valuation authorities will function after completion of valuations and the disposing of appeals. The legislation is also silent about the locus of responsibility for annual revisions in the assessment list.[29] So far only the board has been constituted and it is yet to organise itself for the task of undertaking valuation of properties for municipal tax purposes.

Before the constitution of the CVB, municipal valuations were made at five-yearly intervals through empanelled private valuers appointed by the municipal authorities themselves. The Calcutta Corporation had its own assessment department for quinquennial valuation and annual assessment of properties. Valuation proposals were made departmentally and were subject to review by committees of elected councillors in the municipalities (and

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27 *Ibid.*

28 *Ibid.*

29 D.D. Malhotra, 'Organization of Property Tax: Valuation and Assessment', *Nagarlok*, Vol. XII, No. 3, July-September 1980.

judicial officers in the Caluctta Corporation). The use of private valuers has been criticised; there were allegations of malpractices resulting in undervaluation. Further, the review committees would invariably scale down the valuation proposals at the appeal stage. In the case of Calcutta Corporation there were also reports of collusion between the property owners and the assessment staff. In the absence of any professional valuation organisation for property taxes, the content of professionalism in valuation and assessment by municipal staff has been minimal. It is hoped that the CVB will undertake this vital function of developing professionalism in valuation through training, preparation of a valuation code and standardisation of assessment practices for its own staff, as well as for the municipal staff who will presumably be responsible for annual assessments.

The basis of valuation is the annual rental value (a.r.v.) on gross rental with a standard 10 per cent deduction for repair and maintenance. The tax liability is incurred by the owner and he is allowed vacancy remission for a maximum period of 3 months if the property remains unoccupied. Due to the operation of rent control legislation, the determination of rental is subject to the limitations imposed by 'fair rent' defined for rent control purposes resulting in a virtual freezing of a.r.v. in the cities containing old houses. The Municipal Finance Commission examined this problem in some detail and came to the conclusion that ultimately the solution lay in amending the rent control legislation to free municipal valuations from such external restrictions; pending such reform a series of measures was suggested to rationalise valuation methods and assessment practices.[30]

In spite of rent control limitations, the level of valuations in metropolitan Calcutta (CMD) is much higher than elsewhere (non-CMD areas). If valuation standards were to be strictly enforced there would probably be substantial increases in the valuation levels overall. However, differences in the levels of valuation within and outside the CMD indicate substantial inter-municipal disparities requiring standardisation of municipal valuations, so that the differences in tax bases are not accentuated by valuation disparities under a system of gap-filling fiscal transfer.

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30 West Bengal, *Report..., op. cit.*, Ch. VII.

VI ALTERNATIVES TO FISCAL TRANSFER: NEW SOUTH WALES AND WEST BENGAL

New Fields of Local Revenue

New South Wales

The undesirability of relying too heavily on a single local tax base in New South Wales led to an examination of the suitability of assigning new local revenue sources by a Royal Commissioner appointed for the purpose (Mr Justice R. Else-Mitchell). The Commission recommended the following additional sources of local revenue: (a) a poll, residential, or community tax; (b) development and betterment charges; (c) a licensing fee on businesses and clubs on turnover, sales or membership; (d) tourist and entertainments taxes; and (e) sales of land for unpaid taxes.[31] The nature of the suggested sources are discussed below.

(a) Poll tax. The Local Government Association and the Shires Association suggested 'that a poll, residential or community tax might be imposed upon a specific date each year on all residents over the age of eighteen years domiciled in a local government area', except those specifically exempted, such as, ratepayers, persons earning less than a specified amount, pensioners, and wives of ratepayers having no separate income. The Royal Commission thought that the councils should decide the specifications of persons liable to this type of tax, except that the exempted age limit should be under seventeen years.[32] The objections to this tax centred mainly on administrative difficulties, including taxing itinerant and casual workers, non-naturalised migrants, and gainfully employed persons under 21 years. Fearing the high cost of administration and the unpopularity of the tax, many councils suggested that the tax should be collected by a central authority, or through the medium of income tax returns and assessments. On the other hand, the representative of the Local Government Department thought that the concept of fiscal responsibility demanded that such a tax should be levied and collected by the councils.[33]

(b) Development and betterment charges. The Royal Commission endorsed the suggestion of several witnesses 'that councils should be entitled to impose a tax or charge on the capital profit or increment in value which land acquires as a result of community developments or in consequence of the amendment, modification, or suspension of a planning scheme'. It was thought necessary to fix limits to development charges and for this purpose the Commission recommended that 'the amount of charge which a council may fix should not exceed some proportion to be prescribed of the increment in value over a specified period of years immediately preceding the date of

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31 New South Wales, *Report of the Royal Commission of Inquiry into Rating, Valuation and Local Government Finance, op. cit.*, p. 165.

32 *Ibid.*, p. 107.

33 *Loc. cit.*

application for development consent or the date upon which the amendment, modification or suspension of the relevant provision of the town, and country planning scheme takes effect'.[34]

Apart from development charges, the Commission also suggested that a council should have a 'power to require a monetary contribution towards the cost of providing public facilities, such as access and heavy duty roads, from persons for whose benefit those facilities are primarily constructed'.[35]

(c) Licensing charge on businesses and clubs. The Royal Commission also thought that 'a legitimate field for raising of additional revenue might be found in authorizing councils to require the licensing or registration of all or specified businesses within its area and to require payment in respect of each business of an annual charge which would not simply be a fee designed to recoup the council for the cost of administration'.[36] Similarly, 'councils should have the power to require the licensing of clubs and the payment of an annual fee, not merely to recoup administration costs but of a nature which could be related in some manner to the size of the club, the nature of its functions in a community sense, and, perhaps, the number of its members'.[37] Both these charges would be in the nature of taxes without any *quid pro quo* necessary for imposition of a fee.

(d) Tourist and entertainments taxes. As there was no entertainments tax at the Commonwealth and State levels and in view of its revenue potential, the Royal Commission thought it 'proper that councils should be empowered to impose such a tax and to do so either by direct levy or by a system of licensing', in places of entertainments, for television ownership and the like.[38]

(e) Sales of land for unpaid taxes. The Royal Commission suggested that the councils should be empowered to (i) retain the surplus proceeds in excess of rates due when land is sold for tax recovery, and (ii) to retain the land on which rates are unpaid when proceeds of its sale do not cover the unpaid rates.[39] The first suggestion would involve effectively dealing with the possibility of tax evasion, while the second would cover a situation when there was either no purchaser or the price offered was nominal.[40]

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34 *Ibid.*, p. 112.

35 *Loc. cit.*

36 *Ibid.*, pp. 113-14.

37 *Loc. cit.*

38 *Ibid.*, p. 116.

39 *Ibid.*, p. 165.

40 *Ibid.*, p. 117.

Notwithstanding the submissions on the poll tax referred to above, the local government associations in New South Wales opposed the Royal Commission's recommendations on wider revenue powers for the councils and 'signified that they did not want greater revenue-raising powers and that, if they were granted, they would not be prepared to exercise them'.[41] Not surprisingly, the recommendations of the Royal Commission to confer additional revenue powers for local government were not acted upon.

West Bengal

In West Bengal, the Municipal Finance Commission recommended the following additional revenue sources for the municipal authorities: (a) a pay-roll tax for the municipal corporations, (b) terminal tolls for the hill municipalities, (c) surcharges on the consolidated rate for specific services and for specific types of holdings, and (d) revenues for remunerative enterprises. The various considerations for each of these sources are enumerated below.

(a) Pay-roll tax. Presently, the State Government imposes an employment tax with a maximum ceiling of Rs250 per assessment imposed by the Constitution. The Commission thought that 'if separate authorities impose nominally different taxes under the same entry in the Constitution, there would be separate ceilings in respect of each of the taxing authorities'. There is thus a case for permitting the municipal corporations to impose a separate pay-roll tax, although both taxes should be administered with an exchange of information and data with identical coverage, procedures and so on.[42]

(b) Terminal tolls. For the hill municipalites, the Commission preferred a terminal toll, instead of a common State-wide entry tax covering the hill areas as well, to be imposed on all goods and passengers carried by roadways on entry into a local area. This type of tax is already prevalent in some of the municipalities in other States *in lieu* of a terminal tax.[43] Whether the hill municipalities would be exempted from a State-wide entry tax, when imposed, and a separate terminal toll for them be permitted instead, is to be seen.

(c) Surcharges on the consolidated rate. The Commission thought that water metering might not be practicable in the foreseeable future for residential users, especially in the old cities, and suggested that in

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41 R. Else-Mitchell, 'Local Government Finance: Commentary', in Russell Mathews (ed.), *Local Government in Transition..., op. cit.*, p. 78.

42 West Bengal, *Report..., op. cit.*, para 8.1.3.

43 A local impost on goods and passengers carried by rail, sea or air is permissible under central tax powers; this may be differentiated from *octroi* which is a local impost under the State tax powers on goods carried by road for entry into a local area for consumption or sale therein. An entry tax is a variant of *octroi*, imposed by the State government on a regional or state-wide basis.

these cases and also in situations where metering would not be feasible the option for levy of a surcharge on the consolidated rate should be provided.[44] It was left open for the State Government to decide on the permissible surcharge for various services and properties.

(d) Enterprise revenues. The Commission emphasised the need to urge the municipal bodies to accord priority to remunerative and commercial ventures as a means of mobilising additional revenue.[45] It also suggested that the State Directorate of Local Bodies should assist the municipal authorities in undertaking remunerative ventures through identification of suitable schemes, preparation of acceptable financing proposals and sponsoring of these for institutional financing.

Unlike the utilisation of revenue powers, efficient management of commercial and enterprise activities so as to result in surpluses would depend on the availability of skilled manpower and the adoption of a business approach in municipal activities. It is therefore difficult to predict to what extent profits from municipal enterprise activities would lessen the reliance on municipal revenue powers, especially when the municipal authorities operated within a service-oriented ethos.

Functional Reallocation

Functional reallocation as an alternative to State fiscal transfers to municipal authorities has not been considered either in New South Wales or in West Bengal. In New South Wales, the Barnett Committee thought that 'a good system of local government implies elected councils with effective powers of decision-making in a broad field of community activity', although it did not specify which functions cover this broad field.[46] Similarly, the West Bengal Municipal Finance Commission stated as a basic postulate 'that it is desirable to assign to the local authorities all services and other functions which are identifiable as local and then to provide these authorities with adequate powers and assistance - financial, technical and administrative - for the proper performance of these functions'.[47]

In the context of New South Wales, the neglect is somewhat surprising as an examination of local government areas, as undertaken by the Barnett Committee, is meaningless without simultaneously considering the functional domain of the municipal authorities. In West Bengal, in spite of the caveat on municipal functions, the existing mingling of State and municipal functional responsibilities might affect municipal expenditure requirements,

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44 West Bengal, *Report..., op. cit.*, para 8.3.4.

45 *Ibid.*, para 8.3.9.

46 New South Wales, *Report of the Committee of Inquiry into Local Government Areas and Administration in New South Wales, mimeo.*, 1973; quoted in Harris, *op. cit.*, p. 29.

47 West Bengal, *Report..., op. cit.*, para 9.2.2.

as a result of executive decisions by the State to encroach into or vacate from municipal functions.

> In general, there has been no analysis in depth of the functions that local authorities are currently performing and those which they might reasonably be expected to perform in the remainder of this decade. The failure to include a review of functions as an integral component of the reviews of size and finances tends to perpetuate the functional role that local authorities accepted in the early part of this century. It might even be contended that any review of size and finances is both premature and inefficient until a review of functions has been carried out.[48]

The same suggestions could be made for India. Generally one of the three dimensions of municipal reform - functions, areas and finance - is left out of any review process and it is clear that unless all three are examined together the conclusions reached will be sub-optimal. However, from the functional angle, it seems that in New South Wales the major constraint is one of limitation of the range of functions, while in West Bengal the major problem seems to be one of functional overlap. Both these undoubtedly affect the quantum of financial transfers to municipal authorities.

Boundary Adjustments

New South Wales

A Local Government Boundaries Commission was constituted by legislation in 1963 consisting of a chairman nominated by the Minister, a departmental member, and a member nominated by the Local Government and Shires Associations to suggest alterations of boundaries or the creation of new local government areas. The Commission conducts public inquiries, holds discussions with interested parties, conducts surveys and analyses proposals formulated by councils themselves. From time to time the Minister for Local Government refers to the Commission the resolution of boundary problems in particular areas 'to secure, promote and facilitate proper, economical and efficient local government'.[49]

> A number of reports have been issued and during the period since the inception of the Boundaries Commission to July 1980, a total of 57 local government areas have been involved in amalgamations or major boundary changes, resulting in 30 new cities, municipalities or shires, all outside the County of Cumberland. Major changes announced for late 1980 include the amalgamations of 46 country areas to provide 21 new authorities.[50]

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48 C.P. Harris, *op. cit.*

49 New South Wales, Department of Local Government, 'Local Government in New South Wales', *mimeo.*, n.d., p. 9.

50 *Loc. cit.*

The Barnett Committee, appointed in 1973, examined the question of local government areas in some detail and suggested the creation of district councils to replace the existing municipalities and shires, but retaining the cities to cover the whole or a part of a district. The Committee envisaged the creation of 97 districts to replace present 223 units of local government. In the Sydney region, including the County of Cumberland, the City of Blue Mountains and the Shires of Colo and Wollondilly, 20 such units were proposed to replace the existing 40 units.

By and large, the Boundaries Commission's approach has been to reduce the number of existing municipalities and shires through a process of amalgamation. However, the existing differences in rate levels in the rural and urban areas forced the Commission to recommend differential rate levels within a composite district. For the Greater Sydney area, the Commission proposed the strengthening of the basic units of local government before any consideration was given to the desirability of a second-tier local authority; at the same time, the suggestion for a single local authority for the whole of the Greater Sydney area was rejected as being impracticable. Although the merits of a two-tier municipal system for metropolitan Sydney were recognised by the Commission, this was not recommended. This was because the *ad hoc* authorities and State departments concerned with the metropolitan services had been able to develop an expertise in management and technology that the Commission considered could only be matched by local councils in isolated cases. Hence 'it would be dangerous to discard present forms of administration, notwithstanding their fragmented character and lack of effective co-ordination, in favour of a system administered by elected persons untried and inexperienced in the administration of metropolitan-wide services'.[51]

West Bengal

Unlike in New South Wales, there has not been any comprehensive review of municipal areas directed towards their rationalisation, although there have been a few isolated cases of forced amalgamation of municipalities and extension of the boundaries of the Calcutta Corporation. The Municipal Finance Commission was asked to 'review the territorial jurisdiction of municipal bodies, and suggest changes needed, if any therein, to improve the financial viability of the municipal bodies' while making recommendations on the substantive parts of its terms of reference.[52]

The Commission thought that a specific municipal domestic income limit, of Rs100,000 or Rs10 per capita, should be adopted to ensure revenue adequacy; on this basis at least two municipalities would be denotified. In the case of Siliguri, which falls under one district with its urban agglomeration falling into another district, a single municipal corporation was suggested to cover the entire urban area; on the other hand, excision of huge underdeveloped areas within two notified areas and the hill town of

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51 New South Wales, *Report of the Committee of Inquiry...*, *op. cit.*

52 West Bengal, Department of Local Government and Urban Development, Resolution, *op. cit.*, para 4 (b).

Darjeeling was suggested for examination. In future, adjustments to individual municipal boundaries should be made on the advice of a decennial Municipal Boundary Commission, to be constituted after every census to examine the criteria for creating new municipalities and suggest appropriate modifications in municipal boundaries,[53] through (a) denotification, (b) annexation, (c) amalgamation, and (d) division. Regarding metropolitan Calcutta, the Commission's views were as follows:

> Provision of joint services or creation of an area-wide authority in a metropolitan area are alternatives to boundary readjustments of individual units to solve the problems of delivery and co-ordination of environmental, social and utility services, e.g., in metropolitan Calcutta. We have not addressed ourselves to this question as we feel that this involves primarily institutional issues and should be examined separately.[54]

Evaluation

From the foregoing, the similarities in the alternatives to fiscal transfers in New South Wales and West Bengal are evident:

(i) The new fields of local revenue powers identified are few and it would take time for these to be fully delegated. This leaves the local rate as the predominant source of municipal domestic revenue and implies a continuing dependence on State transfers.

(ii) So far there has not been any comprehensive examination of municipal functions, and the possibility of the 'kerbs and gutter' view of local authorities is likely to continue.

(iii) Boundary adjustments are to be rationalised through quasi-judicial boundary commissions with a view to promoting the viability of individual local authorities.

(iv) For the time being, the existing *ad hoc* functional authorities in metropolitan areas are not likely to be disturbed, since the current task is perceived to be to strengthen the basic units of local government before a two-tier system can be developed.

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53 West Bengal, *Report..., op. cit.*, para 15.5.5.

54 *Ibid.*, para 12.4.2.

VII NATIONAL PERSPECTIVES

The Structure of Local Authorities

Australia

In Australia there is a distinct tendency for committees to propose an increase in the size of local authorities: thus in New South Wales the Barnett Committee recommended that 223 local authorities in the State should be replaced by 97 District Councils; similarly, in South Australia the Royal Commission recommended a reduction of the number of local bodies from 137 to 74 on grounds of administrative difficulties and 'an effective local government voice'.[55] On the other hand, an earlier committee in the same State opposed the view that size by itself could be an indicator of the effectiveness of a local authority or justify abolition of an authority or a change in its boundaries.[56]

> Concern about the structure of local authorities in Australia thus seems to be based on the large number of such bodies, the large number being taken to imply such things as inefficiency due to units being of smaller than optimum size; small units having inadequate fiscal capacity; administrative problems of co-ordination for State Governments; an absence of integrated regional planning resulting in the lack of consideration of interjurisdictional spillovers from local government decisions; and the almost sheer impossibility of the federal government being able to deal effectively with 888 local government bodies.[57]

It has been pointed out that there is no evidence of any relationship between size and efficiency. 'Size must be related to the functions that the local governing body is expected to perform, and the optimum size can not be determined outside of this constraint.'[58] On the other hand, there is no doubt 'that there is a wide dispersion in the sizes of local authorities in Australia in terms of population, areas and population density, and fiscal capacity'.[59] Professor Harris sums up the situation in this regard as follows:

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55 South Australia, *First Report of the Royal Commission into Local Government Areas,* Government Printer, Adelaide, 1974, p. 28.

56 South Australia, *Report by the Local Government Act Revision Committee on Powers, Responsibilities and Organisation of Local Government in South Australia,* Government Printer, Adelaide, 1970, p. 37.

57 C.P. Harris, *op. cit.*, p. 28.

58 *Ibid.*, p. 29.

59 *Ibid.*, p. 33.

> The very large area of Australia, the extreme concentration of population in very small areas defined as metropolitan urban centres, and the extremely low spatial density of the population in rural areas, all make a uniform approach to the determination of the appropriate population sizes of local authority areas inapplicable in the Australian situation. It is clear that Australian local authorities are of various kinds, at one extreme, in metropolitan areas, being very small in area but having a relatively large population, and at the other extreme, in rural areas, being very large in area but having a small population. No process of amalgamation designed merely to increase the average population of local authority areas can be effective unless the different classes of local governing bodies become an integral part of the solution proposed. The socially most desirable role of local authorities, their general structure, and their revenue and expenditure patterns must be related to the kinds of communities that the local authorities serve.[60]

One basic difficulty impeding a satisfactory solution to the problem of local authority structure seems to be the extreme dispersion of population and settlements in the rural areas, a problem partly met by leaving large areas unincorporated and administering these directly by State departments. This being so, the real problem of local authority incorporation in Australia seems to be one of optimum population density, rather than merely one of size as in most other countries having old settlements.

India

In India only the urban areas have autonomous local authorities. The rural areas have dual administration through the States' district administrations and an auxiliary system of local administrations - called the *panchayati raj* - which is heavily dependent on and closely controlled by the district officer. Efforts have been made to devise separate urban councils within the district *panchayat* system (e.g. in Gujarat or Tamil Nadu) but the results have not been very successful. This is because the district *panchayat* councils are dominated by rural interests and only a limited degree of autonomy has been granted to the *panchayat* system of local administrations. The idea of any unification of local government in urban and rural areas therefore lacks the support of urban ratepayers, as this would inevitably bring back the district officer into municipal government - an arrangement abolished under the Montagu-Chelmsford Reforms in 1919 - and result in subsidisation of rural amenities through local taxation in the urban areas.

Characteristically, the structural problems of Indian local government involve a search for a viable urban area population and a minimum level of domestic local revenue. The census definition of an urban area includes: (i) a population of 5,000, (ii) a population density of 1,000 per square mile, and (iii) three-quarters of the adult male population to be engaged

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60 *Ibid.*, pp. 33, 35.

in non-agricultural occupations. We have already indicated that as requirements for the establishment of a local authority in West Bengal the first two census criteria have been doubled. In addition there is a domestic revenue adequacy criterion as a condition for municipalisation. As noted above, the Municipal Finance Commission suggested that the minimum domestic income level should at least be Rs100,000, or Rs10 ($1.06) per capita. A desirable level of municipal services would cost around Rs90 ($9.60) per capita at 1980-81 prices.[61] Even if one assumes that a minimum desirable level of per capita municipal domestic revenue should be Rs50 ($5.30), the per capita grant being pegged at Rs40 ($4.30), that would mean denotification of most of the municipal authorities in the country; in West Bengal only 10 municipal bodies out of 104 would qualify for retention of their local authority status. Therefore, in the short run there is no escape from accepting the low level of municipal services that can be financed from low per capita municipal revenue; in the long run the municipal revenue base has to be strengthened to improve the delivery of local urban services.

Local Revenue Base

Australia

We have seen that local authorities in New South Wales prefer the federal tax-sharing arrangement to any significant change in their own tax efforts or any widening of their fields of taxation. A similar tendency is noticeable in the country as a whole. A reorganisation of local taxation system in Australia proposed by Professor Harris includes:

(a) making a distinction between taxes on land used for business and residential purposes, the residential tax being a fixed zonal rate, reflecting an assessment of inter-zonal variations in physical and social amenities, and the business tax being based on the value of land in use;

(b) an annual business licence fee varying with the type of activity, zonal location, number of employees and the number of separate units provided in the property;

(c) a tax on owners of motor vehicles in the local area; and

(d) appropriate user charges for water, sewerage and other local business undertakings.

Most of these changes would benefit urban local authorities consisting of metropolitan, large city, medium city, small city and large town types, but a 'solution to the financial problems of the other town-type and rural local authorities is unlikely to come to any significant degree from a restructuring of the tax system of local government'.[62]

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61 Abhijit Datta, *Municipal Finances in India, op. cit.*, p. 48.

62 C.P. Harris, *op.cit.*, p. 41.

Professor Harris's suggestion for area-based land taxation under an essentially site value base may be practicable for new urban settlements developed within a town planning zonal system; for already developed urban areas with mixed land uses the practicability of such a system might be questioned.

India

In India, as noted in the case of West Bengal earlier, the major constraint is under-utilisation of the property tax base due to restrictions imposed under rent control legislation freezing the existing rental level, particularly for old structures.

> In order to get away from this *impasse*, various alternative bases have been suggested: (a) capital value; (b) site value; and (c) area-measurement value. It is realized: (a) that as in the case of rental value, capital value base also assumes a free market (for property transfer); (b) that except for the undeveloped areas and new townships it would be difficult to adopt the site value system; and (c) that the area method, being a tax on quantity rather than on value, would introduce a large element of subjectivity and be iniquitous in its impact. In the absence of a suitable alternative valuation base, there are two ways of tackling the problem: (a) to amend the rent control legislations directly and separate the fair rent concept from notional rent for tax purposes; or (b) to allow derating of urban properties, even beyond the ARV itself (this is analogous to the English derating of agricultural and industrial properties after the depression of the thirties).[63]

Relaxation or abolition of rent control to rehabilitate property taxation may not be easy to introduce in the State legislatures; meanwhile, there is evidence that in most States and major municipal corporations the maximum tax rates have exceeded the economic level of 25 per cent.[64] There is thus evidence that derating of property tax is already in operation with consequent inequities involved.

The shortfall in property tax revenue has to be met through widening and/or deepening the existing municipal indirect tax, *octroi*, or its newer variant, the State entry tax. Even these sources will fall far short of achieving a desirable level of municipal domestic income of Rs50 per capita in the foreseeable future. Ultimately, new municipal tax sources or increased levels of State transfers are the only solutions left to strengthen municipal government.

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63 Datta, *op. cit.*, pp. 78-79.

64 Assuming a 10 per cent return and a 20 years life span of urban property, the maximum level of a.r.v. could be fixed at 25 per cent (equivalent to 5 per cent of capital value) in the sense that beyond this level of rate the consequent tax liability cannot be met from the earnings of the property.

Federal Initiatives

Fiscal Measures

In both Australia and India, federal fiscal measures either by way of specific grants or plan assistance to the local authorities via the States are discernible. In the Indian case, the quantum of such assistance filtering into the municipal coffers cannot be determined because of the pass-through arrangement. Even so, there are isolated instances of the central government coming directly to the aid of city corporations, as in Calcutta. The major break-through in federal assistance to the local authorities took place in Australia under the grants and revenue sharing arrangements which commenced in 1974-75. Although similar developments have not taken place in India, it is expected the future federal Finance Commissions will reimburse the States for their committed assistance to the municipal authorities; at least, this is the presumption on which the West Bengal Municipal Finance Commission's recommendations are based. If this happens, the net result will probably be the same, if not better, than the present Australian federal arrangements with the local authorities. Whether similar developments will also take place in Indian plan assistance methods remain to be seen. The Australian Loan Council allocations for local authorities may be inadequate for the large authorities, and may lack a proper rationale in the absence of local authority corporate planning. However, the acceptance of the recent recommendations of the Campbell Committee that borrowings by commercial local authorities should be free from the Loan Council control and that borrowings by non-commercial authorities should continue to enjoy a government guarantee and remain under Loan Council oversight in respect of the overall volume of such borrowing, would go a long way in removing the existing disabilities of the local authorities in gaining access to public borrowing under favourable terms and conditions.[65]

Local authorities in Australia are asking for a 5 per cent share of the federal personal income tax, instead of the present level of 2 per cent. It is contended that recipient 'governments are anxious to enhance their share of tax revenues if they can do so without having to accept direct responsibility' and for this reason revenue sharing is vulnerable in Australia as well.[66] On the other hand, the West Bengal Municipal Finance Commission took the view that tax sharing 'creates an interest among sharing units in the increases in the rates of growth of the total proceeds from the shared taxes'.[67] This could result either through an increase in the sharing proportions or through an increase in the tax rates

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65 Australia, *Final Report of the Committee of Inquiry into the Australian Financial System*, AGPS, Canberra, 1981, p. 200. At the June 1982 Loan Council meeting, significant moves were made in these directions by freeing borrowing by electricity authorities from most Loan Council controls.

66 Melville L. McMillan, *op. cit.*, p. 56.

67 West Bengal, *Report.., op. cit.*, para 10.5.4.

or tax base. One could, therefore, expect that even if an increase in the percentage of distributable income tax proceeds does not take place, an increase in the amount of revenue sharing grants may occur through appropriate federal initiatives in Australia.

Institutional Devices

In Australia attempts have been made by the Commonwealth Government since World War II to create regional organisations to serve a variety of purposes. These have been viewed variously as: (a) a substitute for State governments, (b) a fourth tier of government placed between the States and the local authorities, and (c) an organisation with limited program objectives.[68] Sixty-eight regional organisations of local governing bodies were established in 1973 to facilitate the submission of applications for financial assistance under the new local government grants arrangement. This was supposedly 'a device necessary to overcome the difficulties of dealing with some 900 individual local government authorities'; in practice, the Grants Commission 'dealt with local government authorities on an individual basis' and the regional authorities acted merely 'as a post office or a convenient geographical location for hearings' by the Commission.[69] It is also doubtful whether anything of a durable nature was achieved by the Australian Government's other regional programs.[70]

In India, federal initiatives in promoting new institutional devices include attempts to promote metropolitan and urban development authorities for the major cities, starting with the creation of the Calcutta Metropolitan Development Authority in 1970 under the President's Rule in West Bengal. This was followed in Madras and Bombay and subsequently duplicated in other cities, through conditions attached to central assistance for urban development followed by the necessary enabling State legislation. These authorities are expanded versions of the erstwhile improvement trusts which were created during the colonial era to separate major urban development activities from the municipal arena.

The experience of the working of these development authorities suggests that:

(a) the problems of maintenance of the assets created by these authorities could be solved only through increased assistance to the municipal authorities after the assets were handed over to them;

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68 R. Else-Mitchell, 'Decentralising Government Through Regions and Local Authorities', in Russell Mathews (ed.), *Making Federalism Work: Towards a More Efficient, Equitable and Responsive Federal System,* Centre for Research on Federal Financial Relations, Distributed by ANU Press, Canberra, 1976, p. 190.

69 N.T.G. Miles, 'Local Government and the Federal Initiatives', in Russell Mathews (ed.), *Making Federalism Work..., op. cit.,* p. 180.

70 R. Else-Mitchell, *op. cit.*

(b) the development authorities could not perform the role of co-ordinators of all public authorities operating within their respective jurisdictions;

(c) the development authorities lacked the autonomy needed to take strategic and project decisions; and

(d) the fiscal base of the development authorities was almost non-existent.

Other inadequacies included lack of public participation; and unwieldy areas of operation, including large tracts of non-taxable rural settlements. The municipal authorities regard these development authorities as unnecessary intruders into their own functional spheres and the State *ad hoc* functional authorities devise a variety of ways to by-pass the development authorities in the fields of their operation. At best, the metropolitan and urban development authorities may be regarded as public works agencies, and at worst monitoring and funding agencies for metropolitan and urban development.[71]

An Assessment

From the foregoing it is clear that federal initiatives in relation to fiscal transfers to local authorities in Australia have been of a path-breaking nature. In India they are somewhat modest at present, but are expected to grow in future, first through the revenue transfers to the States in compensation for their own assistance to the municipal authorities and, secondly, through modifications in the central plan assistance for parallel arrangements on the development side.

Regarding institutional devices created to oversee federal transfer arrangements through the creation of regional authorities in Australia and of metropolitan or urban development authorities in India, the result has not been satisfactory. In Australia the regional organisations were never effective decision-making organisations, while in India the expectations that these authorities would act as the prime governmental instrumentalities for metropolitan and urban development have not been fulfilled. In both countries, however, there is a recognition for appropriate regional organisations, but these must be created through the active involvement of the participant local and municipal authorities as joint authorities with multi-functional responsibilities and viable geographical areas.

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71 For a critical examination of the working of the four premier metropolitan authorities in India, see Abhijit Datta and Bappaditya Chakravarty, *Organizing Metropolitan Development*, IIPA, New Delhi, 1981.

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