

# The Macro Framework of Municipalities

*It is a general and undisputed proposition of law that a municipal corporation possesses and can exercise the following powers, and no others: first, those granted in express words; second, those necessarily or fairly implied in or incidental to the powers expressly granted; and third, those essential to the accomplishment of the declared objects and purposes of the corporation - not simply convenient but indispensable.*

—Dillon's Rule

*(John F. Dillon. 1911. Commentaries on the Law of Municipal Corporations. Boston. MA. Little, Brown and Co.)*

The macro framework of municipalities, i.e., the framework within which the municipalities in India function and carry out their activities, has always been diverse and complex, shaped by years of deliberations on state-local distribution of functional assignments, tax bases, criteria for revenue-sharing and grants-in-aid, and responsibilities for service delivery systems. For one thing, municipalities in India which have a long history - the first municipal corporation<sup>1</sup> was formed in Madras in 1687, are characterised by extreme diversity. First, the population size of municipalities differs. Cities with 12-13 million persons and towns with less than 10,000 persons have one or the other form of municipal government. In 1991, there were 18 urban settlements with a population of over one million, and another 304 settlements which had a population ranging between 100,000 and one million. The other end was represented by 1260 settlements which had a population of less than 10,000 persons.

Second, cities and towns have grown at highly variable rates over the

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<sup>1</sup>Notwithstanding the constitution of a municipal corporation in Madras in 1687, municipal administration is said to have begun in the country with the passing of the Regulating Act of 1773 and the Charter Act of 1793. Lord Mayor's resolution of 1870 brought in a measure of self-government at the local level. But it is Lord Ripon's resolution of 1882 that laid the foundation of local and municipal self-government in India.

*Population size, growth rates and civic status of municipalities are an important factor in determining their financial requirements.*

*Expenditure responsibilities of municipalities are large and varied. For the reason that each state government has its own legislation governing the municipalities, municipal government roles, responsibilities, and functions differ in several respects between states.*

decades - some having experienced a growth rate of over 9 per cent annually and others registering an annual growth of less than 1 per cent. During the census decade of 1981-91, 856 settlements acquired the urban status for the first time; however, 93 settlements lost their urban status. Thirdly, urban settlements in India have a complex set of civic status.<sup>2</sup> Thus, it is common for urban settlements to have a status of a corporation, a municipality, nagar panchayat, town committee, and the like. A likely implication of this feature is that the functions and consequently the financial requirements may differ between a local body with the civic status of a nagar panchayat, and another which may be a town committee, a municipality or a corporation.

Fiscal relations between the 28 states and over 4,600 municipalities in India are diverse and complex, with much of it rooted in the Constitution itself, which lays down neither an expenditure jurisdiction nor a fiscal domain for municipalities. These are defined by state governments, and coded in state laws. The state governments, out of the powers and responsibilities enumerated in the seventh schedule assign certain functions and duties to municipalities which historically have consisted of public health and sanitation, communications, i.e., roads, bridges etc. not specified in list I, water subject to the provisions of Entry 56 of list I, markets and fairs, libraries, museums and other similar institutions, and burial and cremation grounds. The main services with which the municipalities are associated and which are generally, though not uniformly, performed by them, are water supply, sewerage and drainage, conservancy and sanitation, street lighting, and municipal roads. In addition, the municipalities are vested with a large number of regulatory functions. The Constitution (seventy-fourth) Amendment Act, 1992, while laying down the procedures for the constitution of municipalities and providing for certain safeguards against their arbitrary suspension or dissolution, has not changed the structure of fiscal federalism in the country. The legislature of a state continues to enjoy absolute powers to endow the municipalities with such authority as it considers necessary 'to enable them to function as institutions of self-government'. This arrangement implies concurrency of functions between states and

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<sup>2</sup>The Census of India, 1991 lists out as many as 38 kinds of civic status for urban local bodies in India. See. Paper 2 of 1991: Provisional Population Totals. pp. 170. A fuller implementation of the Constitution (seventy-fourth) Amendment Act, 1992 will result in three grades of urban local bodies, namely, corporation, municipality, and nagar panchayat.

*Much of the theoretical discussion on state-local relations proceeds on the assumption that clear lines can be drawn between what is or should be local, what is or should be state, and what is or should be federal. In practice, this is not necessarily the case.*

—E. Blaine Liner

*A Decade of Devolution: Perspectives  
of State-local Relations*

municipalities. It implies that the municipalities do not possess what are referred to as general competency powers permitting them to take actions not explicitly prohibited or assigned elsewhere; they possess the legally delegated powers and functions, under the doctrine of *ultra vires* that limit local choice and diversity. They are to take **nothing from the general sovereignty except what is expressly granted**.<sup>3</sup> The functional domain of municipalities has also witnessed periodic shifts and changes, on account of the withdrawal of functions from municipalities or entrusting them with such responsibilities as poverty alleviation. These features have a direct impact on the volume and structure of municipal finances.

The state governments determine the fiscal options of municipal governments. The state laws specify the taxes that the municipalities can levy and collect; like in the case of functional responsibilities, the state governments, out of the tax powers listed in the seventh schedule, devolve certain tax powers to municipalities, which typically have included taxes on lands and buildings, taxes on the entry of goods into a local area for consumption, use or sale therein; taxes on animals and boats; tolls; taxes on professions, trades, callings, and employments; and taxes on entertainment. Significant inter-state variations are witnessed here. Taxes on the entry of goods, which are among the most buoyant and elastic of the local taxes, are currently levied in Gujarat, Maharashtra, Manipur, Orissa, and Punjab. The inclusion or exclusion of this tax has an overwhelmingly large impact on the revenue base of municipalities. Similarly, there are inter-state differences in respect of taxes on entertainment, and taxes on professions, trades, callings, and employment. These tax objects are less mobile, not easily exportable, and thus fit into the model that says that the choice of tax instruments should conform to the rule that each jurisdiction pays for its own benefits.

In its totality, municipalities in India would seem to fall into three groups, with each group presenting a different order of financial requirements—

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<sup>3</sup>The rule known as the Dillon's rule was not accepted by all the judges. However, the Supreme Court of the US upheld it and opined that the relationship between state and local governments was not contractual in nature (thereby implying equality) but was one of a superior (the creator) and the inferior (the created). For further discussion, see Advisory Commission on Intergovernmental Relations. *State and Local Roles in the Federal System*. Washington D.C. 1982.

*Differences in tax jurisdiction, the degree of control exercised by state governments in terms of the fixation of tax base, tax rates, and tax exemptions, and the efficiency with which taxes are administered and enforced, directly impact on the revenue base of municipalities.*

*State control over local bodies is a universal phenomenon. States place conditions on local governments, often imposing requirements on their performance for various reasons. First: the service may be of such importance statewide that its quality and quantity can not be left to the total discretion of local governments. Second: if the provision of the service is considered essential by the legislature or the courts, it must be uniform across the municipalities. Third: state mandates may be necessary in order to achieve a desirable social and economic goal determined by the legislature. Finally, state governments may require municipal governments to perform a function previously performed at the state level in order to increase responsiveness to citizen needs.*

- └ those which have a comparatively large functional and an equally large fiscal domain. Gujarat and Maharashtra are examples of this typology;
- └ those which have a larger fiscal domain but a narrow functional jurisdiction. Rajasthan and Manipur are a typical example of this group; and
- └ those that have a comparatively larger functional jurisdiction, but a narrower fiscal base.

The state-municipal fiscal relations are complex, with state laws limiting the autonomy of municipal government in laying down local tax policies, including policies relating to the choice of tax rates or determining who to include or exclude from payment of taxes. States stipulate the purposes for which funds may be spent, fix salaries, and impose limits on the amount of debt, the purpose for which debt may be incurred, procedures for repayment and the like. Absence of autonomy in matters relating to tax rate fixation, or a low discretion coefficient as it is often referred to, is one of the most serious handicaps of municipal governments in managing their finances and spending responsibilities. In many ways, it has meant increasing dependence of municipalities on the state governments.<sup>4</sup>

Unlike the provisions in the Constitution which specifies the taxes that are to be divided between the Union and the states, e.g., Chapter I of Part XII, and the grants that may be extended to the state under Article 275 of the Constitution, no such provision regarding the division of tax revenues between the state governments and municipalities or about the grants exists in the state laws. Nor do the laws specify as to when and under what circumstances should the states make transfers and what should be the nature of those transfers. On account of the absence of provisions in respect of the taxes, duties, and fees that should be shared between the states and municipalities and the purpose and manner in which grants-in-aid should be extended to them, the role of transfers in the finances of municipalities has remained highly tentative. The

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<sup>4</sup>State limits on local revenue raising authority is neither new nor only a feature of India's federal structure. In the USA, property tax rate limits began in the last century, originating in Rhode Island in 1870.

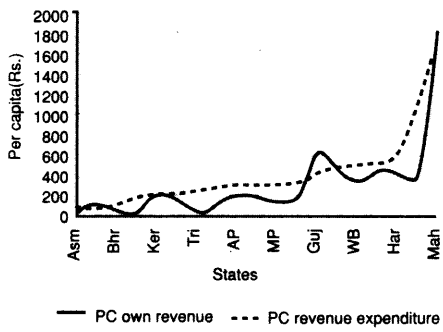
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Constitution (seventy-fourth) Amendment Act, 1992, while recognising the crucial role of transfers, makes no specific provision in this respect, leaving the matter to be considered by the finance commission of states, and eventually determined by the state legislatures.

Yet another complex feature of the state-municipal fiscal relations lies in the provision in the state laws that requires the municipalities to balance their budgets and often even maintain a cash balance at the end of a financial year. The Orissa Municipal Act, for instance, lays down that the state government has powers to prescribe a minimum closing balance to be maintained by a municipality. The West Bengal Municipal Act, 1993 provides that the budget estimate of a municipality for a year shall be presented before the Board at a meeting specially convened for the purpose, provided that no deficit shall be shown in the budget estimate so prepared. The municipal corporations in Punjab are required to maintain a cash balance of not less than Rs.100,000 or such higher sum as may be determined. The Uttar Pradesh Municipalities Act provides for maintaining a minimum closing balance as the state government may prescribe. Such a provision suggests that there may, in fact, be no deficit at the end of a financial year, raising the question as to how, under such circumstances, the revenue gap of municipalities could be assessed or supplementary financial requirements estimated. A surplus or a balanced budget does not automatically suggest the need for resources.

The functioning and finances of municipalities are thus to be understood and analysed in a framework which is characterised by (a) asymmetry in their functional and fiscal jurisdiction, (b) absence of appropriate statutory provisions regarding the transfer of funds from the state governments to municipalities, (c) limited autonomy with municipalities in matters of tax rate fixation, staff salaries, and borrowings, and (d) provisions requiring the municipalities to balance their budgets.



Source: A sample survey. NIPFP. 1999.