UNIT 8 PARTNERSHIP AMONG DIFFERENT LEVELS OF GOVERNMENT – I: UNION AND STATE GOVERNMENTS

Structure

8.0 LEARNING OUTCOME

After studying this unit you should be able to:

- discuss why we need partnership among different levels of the government;
- highlight the areas of partnership;
- identify the multy-layer decision-making centres; and
- understand the role as an investor in social sectors.

8.1 INTRODUCTION

"To open breaches, stimulate creativity, get out from abandon and solitude, promote intercultural, decentralised and democratic networks" (Jaenson F., 1998) such is the importance of decentralise governance.

In the current era of state reform everybody seems agreed that decentralisation of government is a good thing - governments themselves, aid donors and other international agencies, many of the citizens of various countries, and certainly many academic writers on good governance, public service reform and development. The case for decentralisation is argued on both political grounds - as strengthening democracy, accountability and participation by bringing government 'closer' to its citizens - and economic grounds, those of enhancing the efficiency and effectiveness of public service provision. Decentralisation is also seen by many agencies as being effective in combating poverty.

Since the 1980s, developing countries have increasingly adopted decentralised forms of governance. Decentralisation – the transfer of authority and responsibility from central to intermediate and local governments – now concerns 78 developed and developing countries. It aims to address failures to foster development and reduce poverty, and to consolidate democracy. It may entail transferring certain planning, financing and management tasks to local units of central agencies ('deconcentration'), lower levels of government ('devolution'), or semi-autonomous authorities ('delegation'). It alters the structure and systems of governance (inter-governmental relations, state–society relations). While deconcentration and delegation imply a reorganisation of central government, devolution means relinquishing political power.

There is no standard model of decentralisation: it varies considerably from country to country. Its impact depends greatly on the original objectives and design, as well as institutional arrangements and implementation. Sustained political will is essential. In order to avoid inefficiencies in the institutional arrangements (Haiti, Zambia), decentralisation must be part of an integrated development policy reflecting locally owned models and the country's commitment. A coherent set of rules must regulate the responsibilities, functions, resources and relationships of the different levels of government. Issues include political (constitutional, legal and regulatory frameworks), fiscal (spending, revenue management, inter-governmental transfers, sub-national borrowing), and administrative factors (civil-service reform, bureaucratic capacity, managerial ability). Financial administrative resources have not always been transferred along with the responsibilities.

In this unit we will be discussing the importance of partnership, the rational and limitations. We will also discuss the areas of partnership, the role of the government as enable us, provider of infrastructure and role as a investor in social sector.

8.2 RATIONALE AND LIMITATIONS

The idea of decentralisation is linked to subsidiary (the lowest level of government that can perform functions efficiently and effectively). Economists justify decentralisation on the grounds of 'allocative efficiency', enhancing the responsiveness of policy-making and the effectiveness of poverty reduction. Decisions taken closest to a local constituency are expected to better reflect the preferences of citizens, especially the poor. As a result, local governments are more likely to implement a poverty policy through community participation and social inclusion. The challenge is to maintain a poverty focus at central and local levels, especially given the risks of local governments being captured by local elites and interest-groups, and of problems such as corruption and gender bias being replicated at the local level.

Decentralisation is not a panacea. Clearly, there are limits to what it can achieve. Not all government functions can or should be decentralised. Decentralising weak states may compound the problems, and small island states may not be ideal candidates. An appropriate balance of centralisation and decentralisation is essential, and there needs to be complementary attention to central government. Decentralisation requires a strong central entity to regulate, to provide an overall framework to manage the re-allocation of responsibilities and resources in a predictable and transparent way, and to assist local governments build capacity in the early stages. For instance, there is compelling evidence that some of the best progress against HIV/AIDS is in countries with strong central government (Thailand). The unequal geographic distribution of resources (oil, water), people and poverty, calls for redistribution policies that only the central government can guarantee via transfers, targeted poverty-reduction programmes and social investment funds. Decentralisation, deconcentration and local governance are generally mutually reinforcing.

8.3 DIFFERENT FIELDS OF PARTNERSHIP

8.3.1 Revenue Assignment

Governments rely on a wide variety of tax instruments available for their revenue needs, such as direct, indirect, general, specific, business and individual taxes. The question addressed here is which types of taxes are most suitable for use by each level of government.

Principles of Tax Assignment

The assignment of taxes by jurisdiction depends partly on the mix of various taxes used in the country overall. In public finance theory, the issue of the ideal tax mix even in the unitary state has not been widely developed. Governments almost universally employ balanced tax systems which have the feature that different taxes apply to basically the same bases. For example, general sales taxes, payroll taxes, and income taxes have bases which overlap considerably. From the point of view of standard efficiency and equity, one should be able to make do with a single general tax base, yet no governments behave that way. The usual reason given for this is that administrative considerations play an important role. A mix of taxes keeps the rate on any tax low, thereby reducing the incentive to evade or avoid the tax. Furthermore, by using a mix of taxes, taxpayers who would otherwise be able to avoid taxation of one type are caught in the net of another, making the tax system fairer. The importance of the various taxes in the overall mix remains, however, a matter of judgment rather than something that can be deduced from the principles.

These same general considerations apply in the case of assigning taxes in a federal government system. Efficiency and equity arguments have to be tempered by administrative considerations, and the exact assignment depends upon informed judgment. We can, however, outline the economic principles that come into play in deciding which taxes to assign to lower levels of government. They are as follows:

Efficiency of the Internal Common Market

The internal common market will be functioning efficiently if all resources (labor, capital, goods, and services) are free to move from one region to another without impediments or distortions imposed by policy. Decentralized tax systems can interfere with the efficiency of the economic union in two ways. For one, the uncoordinated setting of taxes is likely to lead to distortions in markets for resources which are mobile across states, especially capital and tradable goods. This problem will be lessened considerably if state governments recognize that resources are mobile. However, if they do recognize that, they may engage in socially wasteful beggar-thy-neighbor policies to attract resources to their own states. If all jurisdictions engage in such policies, the end result will simply be inefficiently low taxes (or high subsidies) on mobile factors.

National Equity

The tax-transfer system in one of the main instruments for achieving redistributive equity. The argument for making equity a federal objective is simply that all persons ought to enter into society is a social welfare functional on an equal basis, and presumably the federal government is the only level that can ensure that residents in different regions are treated equitably. This may be tempered if states have different tastes for redistribution, or if centralized decisionmaking is not guided by normative criteria. To the extent that equity is viewed as being a federal policy objective, decentralized taxes can interfere with the achievement of those objectives. As with the efficiency case, uncoordinated state tax policies may unwittingly induce arbitrary differences in redistributive consequences for residents of different states. Also, given the mobility of labor and capital across the states, the states may engage in perverse redistributive policies using both taxes and transfers to attract high-income persons and repel low-income ones. Beggar-thy-neighbor redistributive policies are likely to be offsetting with respect to resource allocation, but will result in less redistribution than in their absence. (Of course, those who abhor redistribution through government will prefer decentralized policies for precisely the same reason.) This is obviously likely to be more of a problem for those taxes which are redistributive in nature, as well as for transfers.

8.3.2 Industrial Policy Reforms and Investment

The new Industrial Policy of 1991 promoted investment, both domestic and foreign, through de-restriction of domestic production and investment. A number of measures have since been taken to further ease the process of private participation in investment. Of these, the two most critical ones were:

- First, industrial licensing was virtually abolished, except for industries where licensing continues purely on public health, safety and security consideration.
- Second, the number of industries reserved for the public sector was reduced to Just two [(a) atomic energy, and (b) railway transport].

Besides these, procedural delays were eliminated. Industries exempted from licensing are now required to file only the relevant information in the prescribed Industrial Entrepreneurs Memorandum (IEMs) with the Secretariat for Industrial Assistance (SIA) with no requirement of further approvals. At the State level, serious efforts for simplifying the rules and procedures for setting up and operating industrial units have been made. A ‘single window’ system is now in existence in most of the States for granting approval for setting up industrial units.

Investment Incentives

Central Government investment incentives:

- 100 per cent profit deduction for developing, maintaining and operating infrastructure facilities.
- Tax exemption of 100 per cent on export profits for ten years.
- Deduction in respect of certain inter-corporate dividends to the extent of dividend declared.
- Various capital subsidy schemes and fiscal incentives for expansion in the north-eastern region.

- Tax deduction of 100 per cent of profits for 5 years and 50 per cent for next two years for undertakings in Special Economic Zones (Sezs)

State Government investment incentives:

- Single window approval system for setting up industrial units.
- Electricity duty, registration fee and stamp duty exemptions.
- Reservation of plots for NRIs, EOUs and Foreign Investment Projects.
- Rebate on land cost, tax concessions and octroi refunds.
- Interest rate and fixed capital subsidy

8.3.3 Fiscal Need

Maintaining **fiscal responsibility** is critical. Local governments must have adequate revenues – either raised locally through taxes or transferred from the centre – as well as the authority to decide on spending.

To ensure accountability, revenue means should be matched as closely as possible to revenue needs. Thus tax instruments intended to further specific policy objectives should be assigned to the level of government having the responsibility for such a service. Thus progressive redistributive taxes, stabilization instruments, and resource rent taxes would be suitable for assignment to the national government; while tolls on intermunicipal roads are suitably assigned to state governments. In countries with a federal level VAT, it may be too cumbersome to have sub-national sales taxes. In such circumstances, the fiscal need criterion would suggest allowing subnational governments access to taxes which are traditionally regarded as more suitable for national administration, such as personal income taxes.

Expenditure responsibilities of both central and local governments must be made legally explicit to enhance accountability and reduce overlap. As the revenue-raising capacities of local governments often are low, transfers remain the dominant source of revenues. The legal framework ought to clearly establish the formula for calculating transfers, to ensure predictability and avoid protracted, destabilising political bargaining. Indeed, the tax-transfer system is one of the main instruments for achieving redistributive equity at the national level. To avoid financial destabilisation (Argentina, Brazil), sub-national borrowing may be allowed under strict conditions. [2]

Fiscal Incentives - Centre & States

The change in the industrial regime in the post liberalisation period was coupled with a range of fiscal incentives offered by both the Central and State Governments. Both the Centre and the States promote investment through general fiscal incentives for industries. Tax holidays from the Centre in the form of deductions are available for various types of investment, 100 per cent tax exemption is available in special economic zones and for export-oriented units.

Moreover, with a view to attract investors including those from overseas, many states are offering incentive packages in the form of various tax concessions, capital and interest subsidies, reduced power tariffs etc.

8.3.4 Administrative decentralisation

Local governments must have the capacity to carry out their new functions. Controversy exists on the proper timing, pace and sequencing of reforms – should capacity be built first, or should revenue and responsibilities be transferred first? Often, capacity constraints and the vulnerability of local governments to political capture warrant caution. It may be preferable to continue delivering critical social services in a deconcentrated way, awaiting the building of sufficient capacity at the local level. Furthermore, worries about irresponsible spending and corruption as well as the central government's own reluctance to devolve authority caution against premature decentralisation. There is increasing evidence, however, that the capacities of all levels progressively increase as decentralised service systems mature. [3]

Civil service reform is a critical component of administrative decentralisation. Local governance often creates new layers of government, which may overwhelm national budgets, as the increase in local staff may not be matched by a reduction at the central level. Bureaucracies tend to resist reform on political (career perspectives, institutional allegiances, political networks) and efficiency terms (economies of scale and scope, coordination and principal-agent problems, gender inequalities).[5] Appropriate human-resource management is key.

Improving social service delivery New local government responsibilities include social services (education, health care), infrastructure (roads, water and irrigation, sewage), the environment (natural resources), social safety nets and sometimes policing. Decentralisation holds promise for improving the delivery of services, as citizen input (participation) and oversight (accountability) tend to enhance the responsiveness of public policies, especially in the social arena.[6] Decentralised governance may, prima facie, be more likely to adopt pro-poor policies, but this is not automatic, as local elites can be very successful in directing expenditure and taxation policies to their advantage and in gaining unduly from privatisation. Sub-national governments have increasingly taken responsibility for providing and funding 'local public goods' such as roads, water and sewerage systems, transit, power, and telecommunications networks, as well as other public infrastructure (sometimes establishing innovative public–private partnerships).[7]

8.4 MULTI-LAYER DECISION MAKING

Administrative Decentralisation is necessitated by the principle of reconciliation between two divergent tendencies. The widening range of common interests and the need for the local autonomy. Federal political systems have now acquired more popularity. In this system it is easier to maintain a higher relationship between the various diverse elements in terms of language, ethnic origin, culture habits and way of life.

For the administrative convenience it is a multi-layer decision making centres are organised vertically and horizontally and every layer of government has its specific powers and responsibilities.

8.5 THE ROLE OF THE GOVERNMENT

Over the years, while the role of the Government as a direct investor has diminished with the advent of liberalisation, it remains an active player in the investment domain. Four critical roles of the Government have emerged in the current scenario:

- As an 'enabler' of private investment activity by nurturing an environment that is conducive to private interest.
- As a provider of critical infrastructure that can support production activity and thereby encourage investment.
- As a partner of the private sector in 'public-private' partnerships.
- As an investor in sectors such a health and education where private interest and participation may not be adequate to serve the needs of society.

8.5.1 The Role as "Enabler" and The Importance of Governance

Governance refers to the management of all such processes which in any society define the environment that enables individuals to increase their capability levels and provide opportunities to realise their potential and enlarge the set of available choices. It spans an entire range of issues and activities including the quality of regulation, the delivery of public goods and services, the efficiency. of resource mobilisation, the management of public finances, the empowerment of the public and the quality of judiciary. The three pillars on which the edifice of governance stands are institutions (parliament, judiciary etc), delivery mechanisms (primarily the executive apparatus) and the supportive framework of rules, procedures and laws.

The quality of governance is a critical determinant of the investment climate. Good governance can improve the incentive to invest in the following ways:

- Establishing credibility - Credibility and continuity of policy are critical to investment flows. Investors will agree to invest only if they believe that policies will remain unchanged and independent of the regime in power, particularly for infrastructure projects that have longer gestation periods
- Fostering public trust: Governance has to improve the mutual trust between Government and industry. The absence of trust in Government with respect to industry can lead to excessive regulation which in turn breeds rent-seeking behaviour. On the other hand, mistrust of the Government by investors can lead to an aversion to invest and attempts to circumvent the regulatory or policy environment in taking business decisions.

At a fundamental level, India's superiority in the governance domain lies in the robustness of its institutions. It is a functioning democracy with an established civil service and independent judiciary. However, it is now an accepted fact that in the pre-liberalisation era, excessive intervention or the 'license permit raj' skewed the incentive structure considerably,

The key step in reducing the impact of excessive regulation was to reduce the degree of intervention in the economy. Steps like the abolition of licensing, removing import quotas, as well as reservations are an integral part of improving governance, Current industrial, trade and investment policy aim at 'facilitation' rather than control.

Policy-making in the post-liberalisation phase has focused on a long-term perspective and has signalled a commitment to the process of reform - a process of continuous improvement. Despite changes of Government At both the Centre and States, there has been no reversal of any major reform initiatives that affect investments.

8.5.2 Governance Initiatives in Intellectual Property Rights

The smooth functioning of the Intellectual Property Rights QPR) regime is critical to the growth and development of knowledge intensive sectors such as pharmaceuticals and Information Technology (IT). The government has recently taken a number of initiatives in modernising and revamping the IPR regime in the country.

- India recognises both product and process patents from 2005
- The Intellectual Property Appellate Tribunal was made functional from September 2003.
- Major initiatives are underway for modernising Intellectual Property Administration such as computerisation of intllectual property administration and creation of a digital database of patents, trademarks, liquidation of backlog and design records.

8.5.3 The Role as a Provider of Infrastructure

While the Government has taken a number of measures in the past to improve the availability and the quality of infrastructure, there is tittle doubt that infrastructure facilities are below what could be termed optimal to support India's growth potential. Sunrise sectors like IT have their specific infrastructure needs that have to be met if their growth momentum is to be sustained.

Given these pressures, the Government has to play an active role in improving infrastructural facilities Given the quantum of the need, it is impossible for the Government to attempt to provide everything on its own and a large amount of both domestic private and external funds are necessary to bridge the gap.

In the past, the desired amount of private domestic or Foreign Direct Investment did not flow to the infrastructure sector for a number of reasons. User charges in key infrastructure. sectors like power have not been determined by the market. entry norms in these sectors have not been clearly defined. However regulation had potential for large scale improvements and over the last few years. the Government has taken a number of initiatives to rectify these problems and create a healthy environment for investment inflows. Independent regulators for sectors like power and telecom have been set up both at the Central and State levels, who are given the freedom to set tariffs. Entry norms have been simplified with particular emphasis on enabling private sector participation. FDl norms have also been eased considerably. The recently enacted Electricity Act, for instance, introduces a comprehensive framework for reform in virtually every aspect of the sector.

8.5.4 The Role as Investor in Social Sectors

Social sectors like health and education are critical to the development process. However, these: sectors are susceptible to 'market failure' in the sense that the market, on its own, cannot ensure that optimal amounts of these public goods & services are provided. Returns on projects in these sectors are often too low to invite significant participation and charging market rates may mean that the sections of society which need these goods and services the most may not be able to afford them. Besides, the Government needs to focus on programmes specifically targeted at vulnerable groups. Thus, it needs to undertake investments in programmes aimed at poverty alleviation or providing employment in times of crisis such as crop failure.

Therefore, in these sectors, the Government needs to be an active investor. Total investment by the Central Government in community, social & personal services was US$ 7.3 billion in 2001-02 and by the State Governments' (on developmental expenditure on social services) was US$ 29 billion in 2003-04, As the Government steps out of other sectors, it should ideally step up the investment levels in the social sectors. While there is no mechanical yardstick by which the 'optimal quantum' of social sector investments can be determined, the National Common Minimum Programme of the Government targets investments in these sectors at 6 per cent of GDP over the medium term.

The Government has historically been a key participant in investments in social sectors, spanning an entire range of sectors and activities.

However, recent evidence from education and health-care decentralisation suggests that its impact is limited and its results mixed. There is no systematic relationship between decentralisation, economic development and poverty reduction. Decentralisation has the potential to improve services for women, but there is little systematic research on this.

8.6 CONCLUSION

The basic idea behind this form of co-operation or partnership among different levels of Government- I: Union and State Government was to encourage an increased opportunity of development in local communities by means of balanced exchanges in the following sectors: the economy, commerce, culture, health, education, technology, training, social protection and all other fields of integrated human development. In the process, it became increasingly clear that democratic, peaceful development was the only way to solve problems. It strengthened the bonds between peoples and reduced the chance of degeneration into violence, a degeneration that is facilitated by the isolation and fragility of local populations.

Decentralization has the potential to reduce accountability by breaking the links between the levels of taxation and expenditure. Major expenditure responsibilities are being transferred to local governments in an effort to improve service delivery, but there are few high-revenue taxes which can be assigned to local governments without creating national economic distortions. Efficiency in tax administration suggests that local governments should levy taxes on immobile factors (e.g. property taxes) and fiscal need criteria suggest that they should also levy cost recovery user charges such as frontage taxes (tax per linear front foot of property), tolls on local roads and poll taxes. These tax revenues are unlikely to be sufficient in many localities, and thus, intergovernmental transfers are required to mitigate this imbalance. While taxation increases can create constituent pressure for good local performance, some grant designs can create central government pressure for local performance.

8.7 KEY CONCEPTS

Intergovernmental Relations : The complex network of interrelationships among governments; the political, fiscal, programmatic, and administrative processes by which higher units of government hare revenues and other resources with lower units of government, generally accompanied by special conditions that the lower units must satisfy as prerequisites to receiving the assistance.

Fiscal Federalism : The financial relations between and among units of government in a federal system. The theory of fiscal federalism, or multi-unit government finance, is one part of the branch of applied economics known as public finance.

Council of Government (COG) : An organisation of cooperating local governments seeking a regional approach to planning, development, transportation, environment, and other issues.

8.8 REFERENCES AND FURTHER READING

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8.9 ACTIVITIES

1) Discuss why we need partnership among the different levels of government.
2) Explain what do you understand by the multi-layer decision making centres.