Panchayats – Functions, Responsibilities and Resources

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Abstract

The objectives of this paper are to review the current status of functions transferred to PRIs in the wake of 73rd Amendment, to examine whether the resources transferred to them are adequate to perform these functions and fulfill their responsibilities and to suggest ways of improving their financial health.

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1. Introduction

The 73rd Amendment Act (1992) of the Constitution, which created a uniform three-tier system of rural governments at the district, block and village levels, provides for transfer of responsibilities and tax powers from the state government to these rural bodies. The responsibilities include preparation and implementation of plans for economic development and social justice relating to an indicative list of 29 subjects given in Eleventh Schedule of the Constitution.[1] Under Article 243-G, the Constitution has given authority to state governments to endow panchayats with necessary powers to carry out their functions. States are empowered under Article 243-H to authorize panchayats to levy, collect and appropriate taxes, duties, tolls and fees apart from giving them grants-in-aid from the Consolidated Fund of the State. Another provision, that of Article 243-I, provides for the constitution of a State Finance Commission (SFC) every five years to review the financial position of panchayats and to recommend ways of implementing the provisions of Article 243-H so as to improve the financial position of the latter. The Gram Sabha, the general assembly of villagers, has a key role in effective functioning of panchayats through, among other things, discussion of the Annual Financial Statement of gram panchayats.

The main components of fiscal decentralization comprise expenditures, revenues, transfers to local governments and sub-national borrowing (which is not a regular feature of rural governments in India). The objectives of this paper are to review the current status of functions transferred to PRIs in the wake of 73rd Amendment, to examine whether the resources transferred to them are adequate to perform these functions and fulfill their responsibilities and to suggest ways of improving their financial health. The plan of the paper is as follows. In sections 2 and 3 we describe in turn the transfer of functions and the sources of PRIs' income. In section 4, we examine the current status of devolution of funds and the level of financial autonomy enjoyed by PRIs. In the following section we discuss various ways of improving the finances of panchayats and finally, we conclude in section 6.

[1] The 29 subjects in Eleventh Schedule of the Constitution include agriculture, land reforms, housing, rural electrification, education, health centres, provision and maintenance of public goods like local road connectivity, street lighting, sanitation, drainage and water supply and the public distribution system.

2. Transfer of Responsibilities, Functions and Functionaries

The 73rd Amendment merely provides an illustrative or indicative list of functions that are suitable for devolution to panchayats. Unlike the division of subjects and financial relationship between the central and state governments provided by the Constitution, no such definite demarcation of responsibilities and financial relationship exists between the state and local bodies. In order to prevent rigidity and conflict with the interests of the state government, the National Commission on Urbanisation did not approve specification of a "local list" in line with the central, state and concurrent lists. However, despite this lacuna, some states have proceeded with devolution of functions. All States/UTs, except Jammu and Kashmir, Uttaranchal and National Capital Territory of Delhi have passed legislation in accordance with the provisions of the Constitution (Tehelka 2002). According to Indian Express (2002), in villages of Kerala, Karnataka, and parts of Madhya Pradesh, Maharashtra, Chattisgarh and Bengal, "panchayats are running schools, inspecting dispensaries, engaging in group farming, harvesting rain and even setting up power plants". But the pace of the devolution of power in most other states is slow where they are not yet sharing funds, functions and functionaries with rural governments. Only in Karnataka and Kerala have all the 29 subjects been transferred to panchayats. 18 of the funds, functions and functionaries have been transferred in Maharashtra, 12 in Bengal and 10 in both Madhya Pradesh and Chattisgarh. See Table 1 for state-wise details.

Table 1. Status of Devolution to PRIs - Selected Indicators (February 2002)

States/ Union Territories	Status of State Finance Commission Recommendation	Devolution of Funds, Functions, and Functionaries in Respect of 29 Subjects (Art. 243G)
States		
Andhra Pradesh	Accepted 54 recommendations fully, 11 with some modifications & 19 not accepted at all. Second SFC constituted.	Funds - 05, Functions - 17, Functionaries - 02
Arunachal Pradesh	Not constituted.	Not applicable yet.
Assam	Recommendations accepted in part.	No action taken yet.
Bihar	Report awaited.	Funds - , Functions - 20, Functionaries -
Goa	Report under consideration.	No information available.
Gujarat	Received but not yet been placed before Legislature for consideration.	No information available.
Haryana	Accepted major recommendations.	Funds - 0, Functions - 16, Functionaries - 0
Himachal Pradesh	Accepted. Second SFC constituted.	Funds - 2, Functions 23, Funcationaries - 7
Jammu & Kashmir	73rd Constitutional Amendment Act has yet to be extended to State. However, Ministry of Home Affairs has requested the Government of J&K to seek the views of the State Legislature to extend the provisions of the 73rd Consitutional Amendment Act 1992 to the State. *Panchyat* elections in some part were held in January - February, 2001 according to State *Panchayati Raj* Act.	
Karnataka	Accepted major recommendations.	Funds - 29, Functions - 29, Functionaries - 29
Kerala	Accepted and implemented. Second SFC constituted.	Funds - 10, Functions - 23, Functionaries - 15
Madhya Pradesh	Accepted. Second SFC constituted.	Funds - 10, Functions - 23, Functionaries - 9
Maharashtra	Major recommendations accepted.	Funds - 18, Functions - 18, Functionaries - 18
Manipur	Accepted.	Funds - 0, Functions - 22, Functionaries - 4
Meghalaya, Mizoram,	73rd Constitutional Amendment Act does not applicable as the traditional system of local self	

Nagaland	government exist in these States	
Orissa	Accepted.	Funds - 5, Functions - 25, Functionaries - 3
Punjab	Accepted.	Funds - 0, Functions - 7, Functionaries - 0
Rajasthan	Accepted. Second SFC constituted.	Funds - 0, Functions - 29, Functionaries - 0
Sikkim	Accepted. Second SFC constituted.	Funds - 24, Functions - 24, Functionaries - 24
Tamil Nadu	Accepted. Second SFC constituted.	Funds - 0, Functions - 29, Functionaries - 0
Tripura	Accepted. Second SFC constituted.	Funds - 0, Functions - 12, Functionaries - 0
Uttar Pradesh	Accepted. Second SFC constituted.	Funds - 12, Functions - 13, Functionaries - 9
West Bengal	Accepted.	Funds - 12, Functions - 29, Functionaries - 12
Chattisgarh	Not set up.	Funds - 10, Functions - 23, Functionaries - 09
Jharkhand	Net set up.	No information available.
Uttaranchal	Report awaited.	Funds - 12, Functions - 13, Functionaries - 9
Union Territories		
Andaman & Nicobar Is.	Under consideration.	Funds - 6, Functions - 6, Functionaries - 6
Chandigarh	SFC Report awaited.	No information available.
Daman & Diu	Under consideration.	Funds - 5, Functions - 9, Functionaries - 3
Dadra & Nagar Haveli	Under consideration.	Funds - 0, Functions - 3, Functionaries - 3
Delhi	NCT Delhi had repealed the *Punchayati Raj* Act and sought abolition of the *Panchayati Raj* Institutions (PRIs) System. However, it is now considering adopting the 73rd Amendment Act and reviving the *Panchyats*.	
Lakshadweep	Under consideration.	Funds - , Functions - 6, Functionaries -
Pondicherry	Elections have not been held in the UT, as the matter relating to the validity of provisions pertaining to reservation for backward classes in the Pondicherry *Panchayati Raj* Act was subjudice. The Judgement of the Chennai High Court had become available and the UT Administration filed a clarificatory application in the Chennai High Court. On a similar issue pertaining to Tamil Nadu, the Hon'ble High Court at Chennai had passed Orders making it possible for Tamil Nadu Government to hold elections. The Ministry of Rural Development has advised the UT Administration to take appropriate action to hold *panchayat* elections at the earliest on the same lines.	

Source: Chapter 7, Governance for Human Development, Government of India (GOI 2001)

While many state governments have devolved several subjects to different levels to PRIs, they have not given appropriate functional responsibilities to newly established levels of rural local bodies where they did not exist before or not given appropriate guidelines to the existing ones for delivering their functions. For example, functions are specified as subjects rather than as activities. A Task Force under the Chairmanship of Additional Secretary and Financial Advisor of the Ministry of Rural Development and with secretaries in-charge of the Panchayat Raj of Assam, Chhattisgarh, Kerala, Karnataka, Uttar Pradesh, West Bengal as members, recommended completion of the process of devolution of powers to panchayats by March 2002 [Tehelka (2002)].

The responsibilities and functions carried out by PRIs at different levels show a distinct pattern across states. Gram Panchayats (GPs, the village-level bodies) seem to be the most active in most states. In general, while the GPs carry out major functions (including some obligatory) such as public facilities, health, minor construction, minor irrigation, village roads etc., Panchayat Samitis (PSs at the block-level) and Zilla Parishads (ZPs at the district-level) in most states are allotted supervisory functions or act mainly as executing agents for the state government. While the PSs, in general, are highly dependent on state grants, most of their expenses are on salaries. Thus, not only have the smaller states been allowed to drop this level of government, but the 87th Amendment Bill 1999 was based on lack of substantive functions to be performed by the elected members of PSs and ZPs.

Apart from transfer of functions and powers, states are expected to transfer staff and more revenue raising sources to rural governments for effective fiscal decentralization. Although some states (Gujarat, Karnataka, Kerala, Madhya Pradesh, Rajasthan) have transferred the functionaries, most others have not transferred the required staff to the PRIs to carry out their additional functional responsibilities. Often, senior staff of PRIs are drawn on deputation from various state departments, who are regulated by the state government rules and their sudden transfers severely affect the functioning of the PRIs.

3. Sources of Funds

The Amendments left important matters such as implementation, service delivery (including local capacity building) and transfer of responsibilities and powers to rural local bodies at the discretion of the state legislatures. Consequently, while expenditure responsibilities of local bodies are extensively enhanced, there is no law to ensure a corresponding assignment of funds to match the additional responsibilities. The decisions as to which taxes, duties, tolls and fees should be assigned to local governments and which should be shared by the State with them continue to be with the state legislatures. An appropriately designed transfer system is needed to balance spending needs with local resources.

The SFCs are required to recommend financial support from the state and principles for determination of taxes, tolls and fees that could be assigned to or appropriated by the local bodies. At present, not much fiscal power is vested in the hand of the panchayats. Their finances are drawn largely from tax assignment, tax sharing and grants-in-aid from the state and the centre while the share of own tax and non-tax revenue is very small. The non-tax sources include user charges on public facilities, and on the use of common resources in the form of forests, water bodies, quarried materials and minor minerals; and taxes on private property. In addition funds flow from the central government on the basis of the recommendations of the Central (National) Finance Commission and the Planning Commission.

An evaluation of PRIs’ sources of income including their tax powers and the authority to borrow shows that they differ substantially across states as between the fiscal size and sources of revenue available to different levels of PRIs and their administrative set-up. Most powers to levy various kinds of taxes and duties in rural areas are enjoyed by gram panchayats (GPs) (see Box 1) whereas the first and second tiers, i.e., zilla parishads (ZPs) and panchayat samitis (PSs) are in general not entrusted with taxing powers. When these two tiers do levy these charges, they are often collected at the village level and then passed on to the higher levels of rural bodies. However, PRIs hesitate to levy and collect taxes.

Elected panchayat leaders are reluctant to impose discretionary local taxation for fear of losing future elections as local taxation is often perceived to be regressive. Instead they prefer to rely more on grants from higher level governments.

Box 1. Tax Assignment of Gram Panchayats

Major tax powers

- Land tax (agricultural and non-agricultural)
- House building tax
- Vehicle tax
- Water, drainage and sanitation taxes
- Pilgrim tax
- Tax on profession, trade, and callings
- Tax on fairs and other entertainments
- Tax on advertisement
- Octroi on animals or goods or both brought for sale
- Lump sum levy of factories in lieu of taxes
- Special tax for construction and public works

Fees and charges levied for provision of public facilities

- Water rate
- Lighting fee
- Street cleaning fee
- Conservancy fee
- Drainage fee
- Sanitary fee for public latrines; and pilgrimage fee (sanitation tax/fee)

Fees for use of common resources

- Fee for the use of panchayat shelter
- User charges for hospitals and schools
- Fee for use of common resources like grazing land etc.
- Fee on markets and weekly bazaars
- Fee on animals sold etc.

New powers recommended by SFCs

- House tax
- Tax on pumps and tractors
- Tax on highway services
- Tax on village produce sold in regulated markets
- Tax on telephones and cable T.V.
- (Non-agricultural) profession tax

Source: Bohra (1998, 2002), Rajaraman (2001)

After tax assignment, tax sharing is the major source of PRI finance. Such revenues are of two kinds. First, the law itself authorizes the state government to levy and collect revenue on its own and pass on a portion of it to the local bodies after deducting collection charges. Land revenue on agricultural land and stamp duty on transfers of property are two such important taxes on private property in rural areas which are shared with panchayats (Rajaraman 2003). Seigniorage royalties (royalties on minor minerals and quarried materials like granite and sand) and forest revenue are also shared with PRIs in the same fashion (Bohra 1998). The second category consists of taxes or fees which normally belong to the local bodies but whose collection is taken over by the state for administrative reasons.

Once the revenue sharing arrangement is designed, the SFC is required to recommend the allocation of the sharable revenue among different local bodies, both urban and rural. To provide adequate finance to local governments with weak fiscal capacity but with larger functional responsibilities, a good transfer system should distribute funds on the basis of formulae that take account of needs, capacity, and local effort. On the whole, there is no common approach followed by the SFCs of different states except that most choose to stick to the existing tax powers of local governments and suggest transfer of funds accordingly (Tables 2 and 3).

Table 2. Weights in State Finance Commission Formulae for Devolution to PRIs

Indicator	State				
	Karnataka	Kerala	MP	Rajasthan	UP
Polulation	33.33	75	75	40	80
Area	33.33		25		20
Poverty				50	
Illiteracy rate	11.11				
Population of SC/ST		5			
Population of non-DDP/ non-DPAP/ non-TAD blocks				10	
Persons per bed in govt. hospitals	11.11				
Road length/ sq km	11.12				
Financial need		15			
Tax effort		5			
Total	100	100	100	100	100

Note: The formulae are from the First State Finance Commissions.

Source: Jha (2000)

Grants-in-aid comprise an important element of inter-governmental transfers. One of the objectives of providing grants is to enable the local bodies to manage functions entrusted to them which could not otherwise be undertaken because of their limited taxable capacity. Furthermore, grants are given to them to undertake functions which are funded by the state government. Grants are also given to encourage local bodies to increase their income. Specific purpose, conditional or tied grants come attached with conditions to spend the funds for specified purposes. External funds with no commitment to raise internal funds face the moral hazard problem of making local governments irresponsible and corrupt. The general-purpose, block or untied grants such as per capita grant are meant to be spent by local governments according to their own priorities with no conditions attached.

Table 3. Relative Shares of Local Governments in State Devolution (%)

State	Applicable	Urban	Rural			
			Total	ZP	PS	GP
AP	on SFC recommendation	16	84	57		43
	before SFC (1994-95)	6	94			
Karnataka	on SFC recommendation	15	85	40	35	25
	before SFC (1995-96)	8	92	35	49	13
Kerala	on SFC recommendation	14	86	17	17	66
	before SFC (1996-97)				20	80
MP	on SFC recommendation					
	before SFC					
Rajasthan	on SFC recommendation	23	77	15	25	60
	before SFC					
UP	on SFC recommendation	70	30	20		80
	before SFC					
Maharashtra	on SFC recommendation	NA				
	before SFC					

Note: SFC refers to the First State Finance Commission

Source: Jha (2000)

Rural governments are not empowered to raise loans on their own except loans from the state government while they must keep their expenditure strictly within their income sources so that a situation of deficit budget does not arise. This requirement results in postponement/ avoidance of certain essential expenses, particularly capital, and makes the PRIs even more dependent on the state government.

4. Devolution of Resources and Financial Autonomy of Panchayats

PRIs need additional resources and financial autonomy to fulfill their new functional obligations. But the record on transfer of funds to panchayats for the subjects devolved upon them is not encouraging. Many of the powers given to local bodies are delegated powers and most state governments have retained substantial financial and administrative power which suppresses the autonomy of PRIs (GOI 2001 and Vyasulu 2000). Major areas of rural development expenditure and funds associated with them are kept out of the purview of the locally elected bodies (McCarten and Vyasulu 2003). The earlier “bureaucratic practice” of budgeting for local expenditure has not changed so that even after budget approval, funds are often not made available to rural governments because of cash constraints in a state.

In practice, financial autonomy means release of funds without any technical clearance or conditionalities attached. For example, panchayats in Kerala and Punjab can spend up to Rs 1 lakh and in Madhya Pradesh up to Rs. 3 lakh to take up work without any outside clearance (Tehelka 2002). But in most other states, lower levels of village governments require clearance from the next higher level to spend allocated funds. It is not surprising then to find that the PRIs in most states are restricted in spending their funds. In many cases there is neither a sufficient devolution of resources nor adequate revenue raising power with PRIs, which reinforces their dependence on higher level bodies rather than their empowerment. In Karnataka, e.g., gram panchayats have neither the access to funds from state nor the power to make their own decisions about their requirements while the higher level rural governments fix the priorities and spend the funds. A large fraction of PRI spending is on staff salaries financed from grants from higher level governments implying thereby a low degree of expenditure autonomy (Table 4). In 1999-00 general administration, most of which goes on salaries, and expenditure on (tied) development grants constituted more than 80% of total spending of PRIs in most states. Most of the remaining expenditure was towards obligatory services leaving less than 2% for services at the discretion of the panchayats.

Table 4. Expenditure pattern of largest PRIs in 1999-2000

Total expenditure (Rs. crores)	**AP (ZPs)**	**AP (PSs)**	**Kerala (GPs)**	**MP (GPs)**	**Rajasthan (PSs)**	**UP (GPs)**
General Administration	508.26	1178.74	63.92	95.59	796.64	5.65
Of this, salary of panchayat staff	490.61	1115.50	40.17	79.35	796.64	0.52
Obligatory Services	342.55	36.38	159.63	42.19	17.67	135.97
Discretionary Services	0.00	27.12	0.25	3.97	0.00	0.00
Expenditure on Development Grants	1188.17	18.54	594.28	672.37	58.55	810.39
Repayment of loans	0.00	0.00	0.46	0.00	0.00	0.00
Any other expenditure	0.00	0.00	222.82	0.00	0.00	0.14
Total	2038.98	1260.77	1041.35	814.13	872.86	952.15
Share of expenditure (%)	**AP (ZPs)**	**AP (PSs)**	**Kerala (GPs)**	**MP (GPs)**	**Rajasthan (PSs)**	**UP (GPs)**
General Administration	25	93	6	12	91	1
Of this, salary of panchayat staff	24	88	4	10	91	0.05
Obligatory Services	17	3	15	5	2	14

Discretionary Services	0.00	2.15	0.02	0.49	0.00	0.00
Expenditure on Development Grants	58	1	57	83	7	85
Repayment of loans	0	0	0.04	0	0	0
Any other expenditure	0	0	21	0	0	0.01
Total	100	100	100	100	100	100

Source: Author's calculations based on data from PRI Budgets, Jha (2000)

Notes:

- General administration: staff salaries and terminal benefits, and maintenance of other assets
- Obligatory services: water supply, street lighting, waste disposal, education, health, sanitation, drainage, roads and school buildings
- Discretionary services: parks, play grounds, library and reading rooms, markets, bus stands, SC/ST, women and child welfare
- Development grants: various grants from state and central governments

Achieving a degree of financial autonomy is vital to reap the full potential benefits of decentralization. An analysis of fiscal and financial autonomy should be based on an examination of devolution of funds, functions and functionaries. For example, rural development schemes of the central government are managed by line departments without any discretion of rural local governments in allocating funds between competing activities. In order to become financially more independent, rural bodies must be encouraged to raise local resources for development before they receive grants from higher governments. "The more dependent a PRI is on the mass of its citizens for financial resources, the more likely it is to use scarce material resources to promote human development and reduce poverty" (GOI 2002).

An examination of data from a few selected states shows limited or even a negative impact of the 73rd amendment. For instance, fiscal autonomy, defined as the ratio of own income to total income, is in general lower in the post-amendment period than in the pre-amendment period of 1990s for all the three tiers for all the states considered (Table 5). However, the situation improved at GP level in some states in the 2000s (Table 6). We also define revenue dependency to measure the extent to which local governments rely on the central and state governments and higher level local bodies for their expenditure needs. It gives that component of PRIs' income, which comes in the form of grants. In 1990s, revenue dependency reduced in the major PRI tiers in six states implying thereby that sources of income other than own tax and non-tax revenue and grants from higher level governments have become more important (Table 5). These sources include shared taxes and loans. In the 2000s, revenue dependency continued to decline at block/ district levels in some states (Table 7). But GPs became less dependent for revenues on states.

Table 5. Major Components of Income and Expenditure in 1990s: Pre- and Post-73rd Amendment

Indicator	% Share in Total PRI Income of				% Share of Salary in Total PRI Expenditure	
	Revenue from Own Sources		Grants from Centre & States			
	"Fiscal Autonomy"		"Revenue Dependency"			
State	1990-91 to 1994-95	1995-96 to 1999-2000	1990-91 to 1994-95	1995-96 to 1999-2000	1990-91 to 1994-95	1995-96 to 1999-2000
AP	15	19	80	73	47	44
Kerala				83		8
MP	39	27		72	37	31
Maharashtra	36	28	62	70		
Rajasthan	17	19	83	74	59	66
Uttar Pradesh	32		62	78	39	23

Source: adapted from Jha (2000)

Table 6. Fiscal Autonomy at Different Levels of PRIs (%)

Level of Government	State	Karnataka	Rajasthan		
Revenue from own taxes / (total revenue + capital expenditure)	Year	Village	District	Taluka	Village
	1997-98	23.05	0.09	0.39	.
	1998-99	21.33	0.18	0.28	.
	1999-2000	24.04	0.04	0.41	.
	2000-2001	24.57	.	.	.
	2001-2002	17.76	.	.	.
	2002-2003	19.09	.	.	.
Revenue from own non-tax sources / (total revenue + capital expenditure)	Year	Village	District	Taluka	Village
	1997-98	.	10.75	0.80	6.45
	1998-99	.	4.21	0.58	5.32
	1999-2000	.	2.40	0.53	5.90
	2000-2001	.	.	.	.
	2001-2002	.	.	.	.
	2002-2003	.	.	.	.
Total	Year	Village	District	Taluka	Village
	1997-98	23.05	10.84	1.19	6.45
	1998-99	21.33	4.40	0.86	5.32
	1999-2000	24.04	2.44	0.94	5.90
	2000-2001	24.57	.	.	.
	2001-2002	17.76	.	.	.
	2002-2003	19.09	.	.	.

Source: Author's calculations. Data Source: 12th Finance Commission

Table 7. Revenue Dependency at Different Levels of PRIs (%)

Level of Government	State	Karnataka		Rajasthan		
Grants-in-Aid from states / (total revenue + capital expenditure)	Year	District + Taluka	Village	District	Taluka	Village
	1997-98	.	.	85.99	70.68	20.61
	1998-99	.	.	93.27	74.30	29.32
	1999-2000	.	.	35.87	80.45	36.70
	2000-2001	.	.	.	.	.
	2001-2002	.	.	.	.	.
	2002-2003	.	.	.	.	.
Assignment + Devolution / (total revenue + capital expenditure)	Year	District + Taluka	Village	District	Taluka	Village
	1997-98	116.59	77.21	.	.	.
	1998-99	111.11	63.88	.	.	.
	1999-2000	104.23	90.26	.	.	.
	2000-2001	104.38	78.89	.	.	.
	2001-2002	103.56	93.02	.	.	.
	2002-2003	103.18	108.83	.	.	.
Total	Year	District + Taluka	Village	District	Taluka	Village
	1997-98	116.59	77.21	85.99	70.68	20.61
	1998-99	111.11	63.88	93.27	74.30	29.32
	1999-2000	104.23	90.26	35.87	80.45	36.70
	2000-2001	104.38	78.89	.	.	.
	2001-2002	103.56	93.02	.	.	.
	2002-2003	103.18	108.83	.	.	.

Source: Author's calculations. Data Source: 12th Finance Commission

5. Expanding the Horizon: Matching Resources with Needs

Major challenges for effective decentralization are to balance responsibilities with resources including own source revenue and intergovernmental transfers along with local participation, accountability and transparency. To cater to significant expenditure responsibility local governments need autonomy for provision of services. A standard practice is to assign expenditures first, then assign revenues that match expenditure needs.

GOI (2001) makes several recommendations to improve the financial situation of PRIs. These include: linking devolution of Central Finance Commission funds to states to transfer of administrative and financial powers to PRIs; strengthening revenue raising powers of PRIs to reduce their excessive dependence on state and central governments; improving accountability of local bodies and simplifying rules and procedures to make transactions simple and strengthen financial management and audit procedures. Moreover, coordination between public and para-statal agencies engaged in development could help reduce overheads and check duplication of effort.

5.1. Enhancing Own Sources of Revenue

Although local revenue mobilization strengthens accountability, local resources are often inadequate to carry out assigned functions. A standard recommendation to enhance PRIs' revenue is to provide them with larger own revenue raising powers and to reduce their excessive dependence on state and central governments (see, e.g., GOI 2002). Apart from a better design of loans and grants from the state, financial autonomy of panchayats can be further strengthened from assigning them powers to levy more of the buoyant and income elastic sources to augment their own resources. The general principles for local taxes include accountability and transparency, linking of benefit to tax-price, stability, buoyancy and ease of administration and compliance. An effective and simple form of tax autonomy is the discretion to set tax rates. While it is best for local governments to set local tax rates, the normal practice followed by states is to allot levies and surcharges on population based formulae.

Though the panchayat raj laws in Bihar, Orissa, Rajasthan, Arunachal Pradesh and Sikkim have provided for collection of some taxes and arrears by panchayats these powers are made optional after some time (Tehelka 2002). In several states, there is a striking contrast between the assigned functional responsibilities and tax powers of PRIs who moreover face several problems in raising local tax revenue such as narrow tax base, lack of administrative machinery and staff trained in tax collection, lack of guidelines to levy new taxes and unpopularity of certain taxes among voters (Jha 2000). As a result some local bodies do not impose and collect taxes that they are authorised to. In states where minimum and maximum rates have been prescribed in the Panchayat Acts, there is a general tendency to impose the minimum rate (Vithal 1997). The problem is compounded by low buoyancy of own taxes (Bohra 2002).

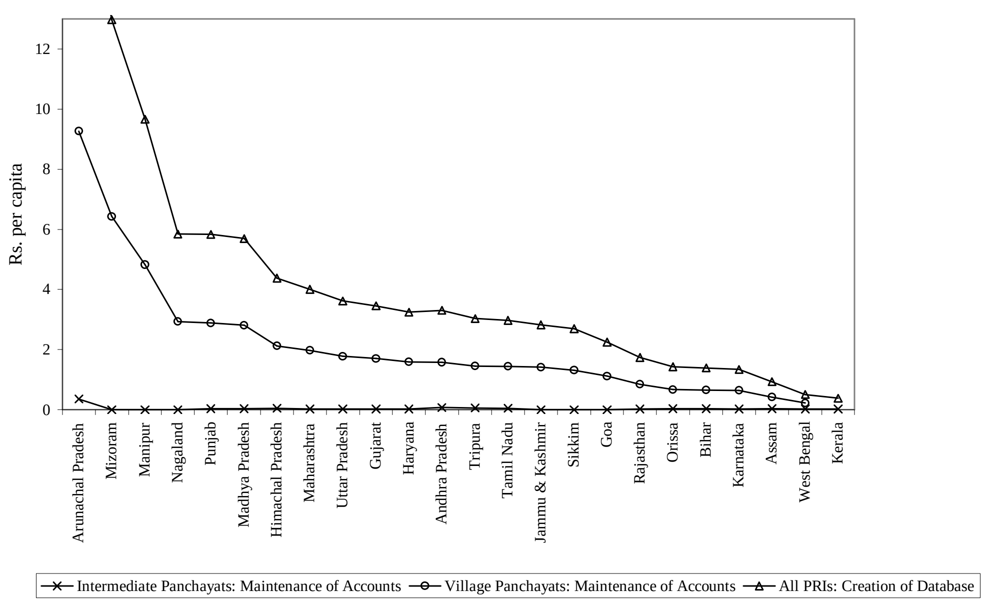
But, even before giving PRIs higher tax authority and the power of more frequent revision of their tax rates, local tax collections can be improved by improving their administrative capacity. Other ways of improving collections from existing sources even without raising rates include correcting the method of valuation of tax base, charging differential rates for commercial and residential property, imposition of taxes on an *ad-valorem* basis and cutting out exemptions.

5.2. Funds from the State and the Centre

Apart from its own revenue generation, additional funds can accrue to a local body from grants, levy of new taxes and assignment/ sharing of specific existing or new state taxes. Intergovernmental transfers should be based on the rationales of correcting vertical and horizontal imbalances, externalities (inter-jurisdictional spillovers), enhancing national objectives at the sub-national level and paying for national programs implemented by sub-national governments. One of the objectives of tax devolution is to equalize the level of public services across regions. Equalization transfers for correcting horizontal imbalances require measures of “need” and “capacity”, explicit equalization mechanisms, sectoral strategies to guide local expenditures, incentives for local budget management and a sound local financial management system. A standard procedure or equalization formula for tax devolution is to calculate the difference between average taxable capacity and actual taxable capacity. For local governments with taxable capacity below the average taxable capacity per capita, this difference is multiplied by population to arrive at the amount to be devolved so as to ‘equalize’ provision of services.

In most cases the need and capacity are likely to vary with the size of the population served. It is a normal practice for the Finance Commissions to equalize the devolution across panchayats. But, it is highly unequal with respect to population. For example, using data from Andhra Pradesh to illustrate, the average size of a GP in terms of total expenditure varies across districts from as low as Rs.21,000 to as high as Rs.3 lakhs (Table 8). Designing a devolution mechanism may thus be more equalizing on a per capita basis. Take another example, that of special purpose grants given to equalize capacities of local governments. Figure 1 presents the provision for financial recordkeeping to PRIs by the 11th Finance Commission. Again, it is not equalized on a per capita basis even though panchayats dealing with larger populations would need to maintain larger records.

Figure 1. Annual EFC Provision for Improving Financial Recordkeeping (2000-05)



Source: Author's calculations. Data Source: Bohra (2002)
Notes: The per capita figures are obtained using rural population as per 2001 Census.

Table 8. Andhra Pradesh - Districtwise Ratios of all Gram Panchayats: 2000-2001

Sl. No.	Districts	% of total current expenditure					Total current expenditure/ GP (Rs. Lakh)
		1. salary	2. interest on public debt	3. tax revenue	4. non-tax revenue	5. grants-in-aid revenue	
1	Srikakulam	20.29	0.00	44.05	87.40	76.53	0.38
2	Vizianagaram	20.97	0.00	47.08	62.61	31.03	0.64
3	Vishakapatnam	41.09	0.00	133.54	41.88	74.69	0.36
4	East Godavari	88.40	0.00	109.45	76.55	0.00	0.85
5	West Godavari	43.18	0.00	19.97	68.65	31.38	2.45
6	Krishna	52.98	0.20	74.35	121.49	68.03	1.68
7	Guntur	32.76	0.00	22.95	89.39	1.40	2.98
8	Prakasham	35.21	7.62	50.85	42.82	50.21	1.71
9	Nellore	100.00	0.00	77.02	95.12	49.62	0.34
	Coastal Andhra	**43.52**	**1.24**	**48.11**	**78.83**	**32.71**	**1.26**
10	Chittoor	33.43	6.06	43.16	45.02	65.17	0.79
11	Cuddapah	42.74	0.21	41.32	62.89	64.36	0.86
12	Ananthapur	49.57	0.50	54.43	49.31	160.90	0.49
13	Kurnool	44.92	1.25	39.89	61.80	45.91	0.89
	Rayalaseema	**41.06**	**2.60**	**43.67**	**54.12**	**75.10**	**0.75**
14	Mahabubnaqar	86.32	0.10	32.13	52.94	46.62	0.34
15	Ranga Reddy	3.05	0.00	98.78	116.98	98.04	0.24
16	Medak	83.84	0.00	158.62	15.70	105.58	0.21
17	Nizamabad	64.15	0.00	66.46	47.29	0.00	1.12
18	Adilabad	49.53	11.97	112.39	17.52	195.38	0.36
19	Karimnagar	55.86	0.00	119.24	34.04	201.27	0.65
20	Warangal	88.23	0.29	208.37	20.30	34.71	0.58
21	Khammam	44.45	0.00	22.80	55.59	23.62	0.34
22	Nalgonda	63.00	0.00	46.58	41.39	85.62	0.82
	Telangana	**64.31**	**0.86**	**92.31**	**40.43**	**85.18**	**0.52**
	Total	**48.15**	**1.37**	**58.08**	**65.47**	**52.39**	**0.86**

Source: Author's calculations
Data Source: 12th Finance Commission (from Directorate of Economics and Statistics, Andhra Pradesh)

It is argued that matching grants can help improve accountability. Another argument is that linking devolution of funds to locally raised matching grants could encourage local tax effort. Although such a requirement may persuade local governments to improve their revenue collection but matching funds can also add to the fiscal burden of local bodies by tightening their financing constraints in the short run. This can result in cutting down of spending in other important areas. The requirement of matching funds is one of the reasons why some panchayats are unable to utilise grants for various rural development schemes.[2] Expenditure reform in such cases requires focusing on quality expenditure

[2] The utilization of funds for most GOI rural development schemes in 2001-02 was less than 50% (Table 5.2, Rajaraman 2001).

including on local capacity building for better review and management of local funds and to spend for enhancing growth thereby enlarging the tax base for higher revenue generation in the long run. In Kerala, the recognition that specific purpose tied grants in some panchayats are diverted to other uses has led to a large fraction of total grants being given as untied grants (40% of plan funds given as consolidated funds).

6. Concluding Comments

We note that the financial needs of panchayats far outweigh the resources at their disposal especially with discretionary use. In order to have more effective rural governments, it is important to have clear and explicit assignment of expenditure and revenue functions. One way to increase local revenues is through higher tax authority and the power to PRIs for more frequent revision of their tax rates. But, even before this is done, local tax collections can be improved by improving their administrative capacity, using the correct method of valuation of tax base, charging differential rates for commercial and residential property, imposition of taxes on an *ad-valorem* basis and cutting out exemptions.

To improve the financial position of PRIs, McCarten and Vyasulu (2003) suggest enlarging the share of untied grants in transfers, adopting an equalization formula for allocation of grants; increasing own and assigned sources of tax revenue and offering matching grants to induce own tax effort. They also suggest transferring a fixed percentage of all state taxes to provide stability to local governments and flexibility to state governments. It is also necessary that transfer allocations are available to local government on a timely basis. GOI (2001) makes several recommendations to improve the financial situation of PRIs. These include: linking devolution of Central Finance Commission funds to states to transfer of administrative and financial powers to PRIs; strengthening revenue raising powers of PRIs to reduce their excessive dependence on state and central governments; improving accountability of local bodies, simplifying rules and procedures and strengthening financial management and audit procedures.

Local bodies do not have accounting systems or balance sheets. An emphasis on prevention of misuse of funds has prevented local accountability (McCarten and Vyasulu 2003). Once panchayat budget procedure is improved and discretionary funds enhanced, auditing of their accounts would become inevitable. At present, this is not a normal practice. However, some efforts are being made in this direction. For example, the Left Front plans to assign the audit of the all the gram panchayat accounts to the Comptroller and Auditor General to ensure transparency (Times News Network 2003). At present, only the zilla parishad accounts are audited by the CAG. There is a wide variation across states and over time in policies followed and the type of information that is available. In particular, there is a systematic lack of uniformity and content in financial data. This can be rectified by setting up of a special cell in the Finance Department to track and monitor annual receipts and expenditure and to compile and computerize a database on basic economic indicators of local bodies.

Some states have set up their second State Finance Commissions (SFCs) but many are still in the stages of implementation of the recommendation of their first SFCs. At the end of the first five-year tenure of PRIs, GOI (2001) carried out a status review of, among other things, recommendations of SFCs; devolution of funds, functions and functionaries for the 29 subjects; and performance of PRIs in mobilization of revenues and undertaking public programmes in the core services of water supply, street lighting, sanitation and roads. They found limited progress in most of the indicators. For example, too many tiers resulted either in ineffectiveness or excessive control. A major lesson drawn up by GOI (2002) based on results of the first round of devolution in the wake of the 73rd /74th Amendment is that the village tier has the highest potential for direct democracy and participation and hence, states should be enabled to abolish either the district or the block level tier of the panchayats. GOI suggests withholding of Finance Commission and other development funds to states unless effective powers are transferred to PRIs.

Successful implementation of rural programmes depends also on an effective delivery system. An important element of expenditure reform therefore relates to effective monitoring of these programmes to assess not only the physical but also the financial progress in implementation to ensure that benefits reach the target groups. To improve public satisfaction, GOI (2002) recommends shifting focus from maximization of the quantity of development funding or increase in the social sector expenditure to maximization of development outcomes and effectiveness of public service delivery through a change in work culture, better policies and sound delivery mechanisms. Inadequacy of staff has seriously affected the functioning of the PRIs whose expenditure needs are rising due to requirement for additional administrative, trained and technical staff for schools, water supply, communications, accounts, tax collection, sweeping, drain cleaning etc. Staff costs can be reduced by attrition, maintaining core professional staff and drawing local expertise (Bird and Rodriguez 1995).

To summarize, steps required to make PRIs financially stronger to meet their needs include a carrots and stick approach. They need better tax collection authority and capacity, more untied grants and help with improving accounting and record keeping. But at the same time they also need to work towards expenditure reform and vitalized service delivery. Linking Central Finance Commission transfers to more effective fiscal decentralization by states would add to the gains.

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