

FISCAL DECENTRALISATION

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It is indeed a matter of great pleasure for me to be in your midst this morning to inaugurate the Seminar on Rural Fiscal Decentralization organized by the NIPFP in collaboration with the World Bank. This seminar has been convened to discuss the findings of the studies sponsored by the World Bank on the subject in the states of Kerala and Kamataka.

Like in many other federations, the Panchayati Raj Institutions (PRIs) which are the grass root level local self governments in India are expected to perform many important functions. These include such essential services as water supply, sanitation, street lighting and roads. That there is a considerable gap in the provision of these services raises several issues concerning the political, administrative and fiscal dimensions of decentralization.

Evolution of Democratic Decentralization in India

The roots of local self-governance in India could, perhaps, be traced to the Vedic times. However, the Village Governments established by tradition were not exactly democratic in character. The institution of Local Self Governments received considerable attention during the British rule, but the focus was essentially on the urban local bodies. It is only after Independence that the debates over Mahatma Gandhi's vision of gram swaraj, led to a consensus and a provision was made in the Constitution under the Directive Principles of State Policy which reads "The state shall take steps to organize village Panchayats and endow them with such powers and authority as may be necessary to enable them to function as units of self-government"

Since the adoption of the Constitution, several high level committees headed by outstanding leaders had gone into the structure, powers and functions to be assigned to the PRIs. Some of these committees are: Balwantrai Mehta Committee in 1957, the Santhanam Committee in 1963, the Ashok Mehta Committee in 1978, the GVK Rao Committee in 1985, and the LM Singhvi Committee in 1986.

The Constitution Seventy -Third Amendment Act, 1992 was a recognition of the fact that the PRIs had not been able to acquire the status of viable and responsive people's bodies. This was attributed to factors such as the absence of regular elections, arbitrary and prolonged supersessions, insufficient representation for weaker sections, inadequate devolution of powers and lack of financial resources. In order to impart certainty, continuity and strength to the Panchayati Raj Institutions, the Act provided for Gram Sabhas and Panchayats at the village

level; direct elections to all seats and to the offices of Chairpersons of Panchayats; reservation of seats for the Scheduled Castes and Scheduled Tribes in proportion to their population and similar reservations in the election of the Chairpersons of Panchayats; reservation of not less than one-third of the seats for women; fixed tenure of 5 years and holding elections within a period of 6 months in the event of supersession of any Panchayat; legislative measures for devolution of powers and responsibilities upon the Panchayats with respect to the preparation and implementation of plans for economic development and social justice, sound finance of the Panchayats through tax assignments and grants and setting up of a State Finance Commission every 5 years to help determine the transfer of resources to local bodies. A new Eleventh Schedule was appended to the Constitution of India listing out 29 functions including agricultural extension, minor irrigation, drinking water, minor forest produce, khadi, village and cottage industries, rural housing, fuel and fodder, education, health, public distribution system etc.

It is now more than a decade since these provisions have come into force and it is time to reflect on the experience gained and redesign the strategy, if necessary. Almost all states have now reported compliance with the mandatory provisions of the Constitution relating to the creation of the PRIs at different levels. However, the discretion allowed to the state governments to transfer the functions listed in the Eleventh Schedule to the PRIs is very large with the result that there is considerable variation in the powers and responsibilities assigned to them in different states. Even among the functions clearly devolved on the Panchayats, very few could be said to be in their exclusive domain. This is particularly true of the developmental functions assigned to them. Often, Panchayats are asked to perform agency functions in respect of implementation of schemes in the formulation of which they are not even consulted. There have been problems in granting the local bodies full administrative control over the state government staff through whom they have to function. Even otherwise, state control over the functional domain of the PRIs is still large. The exercise of the powers devolved on PRIs is subject to several conditions and approvals by the state government. Many states have failed to follow up their Panchayat Acts with necessary rules and orders. These shortcomings have rendered the tasks of normative assessment of the financial requirements of these bodies and a comparison of the level and adequacy of fiscal decentralization Across states extremely difficult.

It is in this context that the studies on Karnataka and Kerala are important and timely, as these two states have been experimenting with decentralization, long before the Constitutional Amendments. The two states have approached the issue of rural decentralization somewhat differently. The Gram Panchayats in Kerala are large in terms of population while they are relatively small in Karnataka. The devolution of functions and resources to the Gram Panchayats is far more in Kerala than in other states including Karnataka. However, there is a lack of clear demarcation of the functions at different levels of the government in both the states. While subjects are transferred to the PRIs, the state governments continue to plan and implement overlapping schemes in respect of the transferred functions. In Karnataka, the state government employees in charge of the transferred functions are not accountable to the District and the Taluk Panchayats. Local governments are not allowed to appoint personnel, prioritize expenditure or design their own schemes. In Kerala, while public health and sanitation have been completely devolved on the Panchayats, considerable expenditure occurs outside the PRI system in respect of other transferred functions. However, in Kerala, in respect of the state and Centrally

Sponsored Schemes, the Panchayats enjoy considerable freedom in the matter of location of projects, selection of beneficiaries' etc. The local governments have been given full managerial control over the transferred staff along with some disciplinary control although the cadres of local government staff continues to be managed and the emoluments of the transferred functionaries continue to be paid by the state government.

The studies have revealed several shortcomings in the matter of transfer of resources. The non-plan expenditures at the Zilla and Taluk levels are very high in Karnataka amounting to over two thirds of the total expenditure. Transfers to the Gram Panchayats are low at 4 per cent of the total state transfers to the PRIs. The Zilla Panchayats and the Taluk Panchayats are provided with 52 per cent and 44 per cent, respectively, of the total resources. These bodies receive large non-plan assistance towards the salaries of teachers and health workers. However, fiscal transfers are based more on the cost of schemes transferred to the PRIs than an assessment of their fiscal disabilities. With little untied grants, the transfers are not exactly equalizing. Kerala, however, is reported to have managed to consolidate a large number of small and adhoc non-plan grants to make the transfers more predictable.

Development spending by the PRIs in almost all states is entirely out of state government transfers of the funds allocated for the State Plan and the Centrally Sponsored Schemes. In Karnataka, the Plan allocations are predominantly in favour of the Zilla and Taluk Panchayats while in Kerala, the Plan schemes are implemented largely through the Village Panchayats. In Karnataka, the share of the Gram, Taluk and Zilla Panchayats in the Plan outlay in the year 2002-03 was in the ratio of 20:33:47. Shortfalls in the funding of transferred schemes have also been reported. The shared cost schemes suffer in particular whenever there is a resource crunch and expenditure compression. Consequently, the share of the rural local bodies in the Plan outlay in Karnataka is reported to have come down to about 18% in 2002-03 compared to about 28% in 2001-02. Kerala, on the other hand, devolves Plan assistance to the extent of 35-40% for budgeted schemes as well as in the form of untied grants. The Village, Block and District Panchayats share the General Sector grants in the ratio of 70:15:15. This has led to far higher levels of per capita expenditure at the lowest level of governance in Kerala and reflects the rapid strides made by the state compared to certain others with a longer history of democratic decentralization.

In both states, the resources transferred to the PRIs have been shown to be inflated as the receipts by the local governments are based on allocations from the budget and not actual expenditures. This has happened in other states as well.

Status of PRI Finances

Post-73rd Amendment. Panchayats have been established at three levels, the district, block and cluster of villages in all states. The village Panchayats number over 2,30,000, the intermediate Panchayats over 5,900 and the district Panchayats about 500. These numbers make the task of data collection in respect of the resources and expenditure of Panchayats formidable. The Eleventh Finance Commission had earmarked funds for data building but no reliable information is available on the initiatives taken in this regard. Even though the responsibilities assigned to the Panchayats vary from state to state, certain essential services such as provision of safe drinking

water, rural sanitation, lighting of public places, preventive health care and primary education have come to be accepted as the legitimate and core functions of the local government. The funding requirements of these services are staggering. Given the paucity of resources, it is not difficult to imagine the quality of services that may be available from these bodies.

The need to empower and encourage the Panchayats to raise their own resources cannot, therefore, be over emphasized. The resources of the Panchayats broadly comprise internal revenue mobilized by themselves through the exercise of tax and non-tax powers, and resources received from the state in the form of devolution and grants from both the state and the Union Government. There are essentially three types of taxes which devolve on the Panchayats: Own taxes - the levy, collection and use of which vests in the Panchayat by statute; Assigned taxes - the levy and collection of which vests in state but its use vests in the Panchayat and Shared taxes, - the levy and collection of which vests in the state government but shared with local bodies. The non-tax sources for PRIs consists of revenues from license fees, fines and penalties, rents/leases from Governmental properties.

Different states have devolved different types of taxes on PRIs with the relative importance of these taxes varying across states. Most states have empowered the Gram Panchayats alone to levy taxes and fees leaving the District and intermediate level Panchayats to depend on the state funding.

In practice, internal revenue mobilization (IRM) has been observed to play a very limited role in the finances of the Panchayats. The data on Panchayat Finances supplied to the Eleventh Finance Commission showed that the IRM constituted only 4.17% of the total revenue of Panchayats at all levels in 23 states during 1990-91 to 1997-98. In a few states like Bihar, Rajasthan, Manipur, and Sikkim, IRM by the Panchayats during the period was totally absent. While the situation is much better in Karnataka, the declining trend of own revenues out of the total revenues of the Panchayats from 27% in 1999-2000 to 21% in 2000-01 should be a matter of concern. Kerala, on the other hand, has posted a steady growth in own revenues due to the construction boom resulting in higher non-tax revenues. Own source revenues of Gram Panchayats which was around Rs.60 crores in 1993-94 had increased to Rs.150 crore in 1998-99, nearly 150% increase in six years. In 1998-99, the per capita own revenues of Gram Panchayats worked out to Rs.57. It was as low as Rs.8.44 in Andhra Pradesh and Rs.5.31 in Rajasthan.

Amongst the reasons given for the general reluctance on the part of Panchayats to raise own revenues are fear of erosion in the vote base; lack of necessary administrative machinery to collect taxes and limited capacity to pay tax in the villages, especially in drought hit and other disaster hit villages. Even the states considered to be advanced in the matter of rural decentralization do not seem to be an exception in this regard.

Central Finance Commission

The Constitution requires the Finance Commission to recommend measures to augment the Consolidated Fund of the states to supplement the resources of the Local Body on the basis of the recommendations of the SFCs. For both historical and economic reasons, the extent of devolution of functions to the local bodies, their fiscal capacity and expenditure needs vary widely across states. The lack of uniformity in the approach of the SFCs in terms of the

principles laid down for devolution of resources from the state government to the local bodies and the absence of reliable estimates of the gap between normative costs of service delivery and the normative capacity to raise resources from all sources in different states makes the task of the Finance Commission at the national level.

Conclusion

It is well recognized that local bodies have an important role to play in the democratic process and in meeting the basic requirements of people. The old adage "for every citizen, most government is local government" still holds good. It is also recognized that the financial resources available to the PRIs fall far short of what is needed by these institutions to fulfill their responsibilities. The role of the Central Finance Commission in this context is one step removed. The primary responsibility rests with the local bodies and the state Governments. The local bodies need to do their best to raise as much resources as possible through the various avenues available to them. At present there is no strong evidence that the Panchayats are exercising in full the powers given to them to raise revenues. The expectation that benefit taxes where there is a direct quid-pro-quo between the taxpayer and the tax authority can be levied more easily has not been realised.

The Terms of Reference to the Twelfth Finance Commission require the Commission to suggest measures needed to augment the Consolidated Fund of the states to supplement the resources of the Panchayats and municipalities. "Measures" could be interpreted to include not only financial but also legislative and administrative. In relation to allocation of financial resources by Central Finance Commission to the Panchayats, several approaches are possible. One is a radical departure under which a proportion of tax devolution from the central pool is set aside for local bodies. The other is to follow the route of the Tenth and Eleventh Finance Commission and provide for an ad hoc grant which will go in some way to augment the resources of the local bodies while at the same time building in incentives for decentralization. A third approach can be to supplement the ad hoc grants with additional resources to fulfill some basic services such as, say, supply of drinking water in rural areas. This would be an application of the equalization principle that a citizen should be entitled to certain minimum standard of civic services irrespective of where he or she resides. Each local government must be able to provide a comparable level of services at comparable charges and if there are gaps due to the factors beyond the control of the local bodies, the higher levels of government should come to its aid. Even here one must recognize that the role of the Central Finance Commission must be treated as supplementary rather than primary. Nevertheless, an application of the equalization principle to one or two select services based on normative projections of revenue and expenditure is worth experimenting with. The Finance Commission is keen to play its role to improve the standards of services of the Panchayats.

Decentralization has administrative, political and fiscal dimensions. The three dimensions are interdependent and the effectiveness of decentralization requires calibration of the three dimensions together. Although it is possible to deal with each of the dimensions independently, reforms in one aspect of decentralization cannot be carried out beyond a point unless there are accommodating changes in others.

Decentralization implies the transfer to the local bodies of functions, functionaries and finances. This has not happened to the necessary extent. Functions have not always been fully transferred. Even where the functions have been transferred, functionaries and finances have remained under the control of higher levels of government. Decentralization always raises issues of efficiency. It is quite true that, at present, problems have become so complex that some of them cannot be handled at the local level exclusively. For example, improving the drinking water supply in many villages and towns is no longer possible by the actions of the local bodies alone. However, even here, there is no doubt that the maintenance of assets created and the day-to-day management of the supply system can be done by local bodies better. The design of decentralization may require a re-look to take care of some of these problems. The service delivery system should not rob the local governments of autonomy and flexibility.

As things stand, fiscal decentralization, in terms of resource mobilization and strengthening the revenue-expenditure link remains weak and the success of the future of decentralization depends to a large extent on strengthening the revenue base of Panchayats. In these areas, there are some interesting ongoing experiments, as reported in the studies in Karnataka and Kerala. These two studies offer valuable lessons of what to do and what not to do in furthering the process of decentralization. I am happy that we have the Hon'ble Minister of Rural Development and Panchayati Raj in West Bengal here to attend the seminar. West Bengal has been a forerunner in galvanizing local governments to hasten rural development. I am sure that the discussions here will help in calibrating the decentralization reform in the future. I wish to congratulate the two authors on their excellent study.