

**I**n India, 72.2 percent of the total population live in rural areas, out of which, 59 percent of the population are dependent on agriculture and allied activities for their livelihood. Rural India accounts for only 59 per cent of literate persons while the infant mortality is enumerated as 64 per thousand live births. Overall, these data reflect very low development indicators in rural areas. Since the country gained Independence, sustained efforts have been made to improve the living standard of the rural poor by implementing numerous rural development policies and programmes. However, efforts made by both the Central as well as the State governments in this direction, have failed to provide any significant benefits for them. The main obstacles in the promotion of rural development are found to be the lack of adequate infrastructure, highly centralized system of governance, weak

development and social justice for rural areas. More than 15 years have passed since its enactment, yet PRIs are still struggling to get their due share of power and functions mandated by the Constitution, in spite of shouldering many responsibilities related to rural development. In the following section we will delve into the evolution of PRIs as an institution of rural development. Subsequently, we will look into the devolution of powers to the PRIs for rural development, especially focusing on fund devolution.

## PRIS AS AN INSTITUTION OF RURAL DEVELOPMENT

Decentralization is broadly defined as transfer of power to the lower level of government (PRIs). It mainly takes three forms, namely political,

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-Jawed A. Khan

mechanism of public delivery of services and last but not the least, low people's participation.

The B. R. Mehta (1957) committee after reviewing the community development Programme (1952) recommended the three-tier (Zilla, Intermediate and Village level Panchayat) system of local self government or Panchayati Raj Institutions (PRIs). The new system was christened as 'Panchayati Raj' by Jawaharlal Nehru. The PRIs were supposed to improve people's participation and create a decentralized system of governance but did not achieve much success due to lack of desired power devolution by states.

Finally, the 73<sup>rd</sup> Constitutional Amendment of 1992 gave wider functional and adequate financial powers to PRIs to prepare plans for economic

administrative and fiscal. The legitimacy of the centralized system of governance is on a decline because of various factors including lower participation by people, lack of accountability, weak and inefficient delivery mechanism of public services and corruption in many government programmes. Therefore, it is widely believed by the policy makers that decentralization of power would make governance system more responsive and efficient in providing public services at lower level.

It is also expected that decentralisation would improve efficiency in resource mobilization, its appropriation as well as accountability so that benefits of development reaches the poor. The new system can, in many ways, overcome weaknesses and problems of the centralized

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“Decentralized planning of resources is an important pillar of 73rd Constitutional Amendment which is to be prepared at each tier with people’s participation as one of the important features”

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system of governance like lack of information, high transaction cost, and higher cost of contract enforcement. It can also solve the problems of adverse selection, free-riding, rent-seeking behaviour and principal-agent problems as well. The decentralized system can help in building social and other capital resources for overall development that are appropriately matched with local demands.

The decentralization of power at the lower level also figures as a powerful tool for achieving the development goals that respond to the needs of local communities. It is assumed that by assigning power to the people through Panchayats, they can manage local resources and would have information and incentive to make decisions best suited to their needs. Panchayats would bear the economic consequence of their decision making by taking the political responsibilities. Decentralized planning of resources is an important pillar of 73rd Constitutional Amendment which is to be prepared at each tier with people’s participation as one of the important features. The effects of people’s participation on society emphasized in the PRI system can be understood by the sequence given below.

- Participation**
- Representation**
- Empowerment**
- Benefits for All**
- Poverty Reduction**
- Rural Development**

## DECENTRALIZATION OF POWERS AND FUNCTIONS TO PRIs

The autonomy in decision making process, transfer of fiscal power and desired administrative capacity and control is a precondition for smooth functioning of any institution. PRIs as an institution were assigned the responsibilities for preparing plans for economic and social justice. The implementation of plans was entrusted to the PRIs with the objective of developing rural areas. It had also entrusted State governments to devolve all the necessary financial, administrative and functional power to PRIs to carry out development activities in rural areas.

Table I. below enumerates the status of devolution of funds, functions and functionaries

(3 Fs) to PRIs. One can see, that it reflects a very uneven picture regarding power devolution to PRIs across the states. In terms of devolution of the 3 Fs, five states namely Karnataka, Kerala, Sikkim, Rajasthan and Maharashtra have made substantial improvements, while the other states are lagging far behind. Till date, the powers transferred to PRIs in terms of the 3Fs are merely symbolic. There is a lack of demarcation of power and functions at the three tier level. The line department is still stronger than PRIs and elected representatives are unable to exercise their power. Most of the political parties are also not interested to devolve the necessary power to them.

**Table I.**  
**Status of Devolution of Funds, Functions and Functionaries to PRIs (as on 1.4.2004)**

States	No. of Departments /Subjects		
	Transferred to panchayats with		
	Funds	Functions	Functionaries
Karnataka	29	29	29
Kerala	26	26	26
Sikkim	24	24	24
Maharashtra	18	18	18
Andhra Pradesh	05	17	02
Arunachal Pradesh	-	-	-
Assam	-	29	-
Bihar	8	25	Only functional control
Jharkhand	-	-	-
Goa	6	6	-
Gujarat	15	15	15
Haryana	-	16	-
Himachal Pradesh	02	26	11
MP	10	23	9
Chhattisgarh	10	29	09
Manipur	-	22	4
Orissa	9	25	21
Punjab	-	7	-
Rajasthan	18	29	18
Tamil Nadu	-	29	-
Tripura	-	12	-
Uttar Pradesh	04	12	06
Uttaranchal	-	11	11
West Bengal	12	29	12
A&N Island	6	6	6
Chandigarh	-	-	-
D&N Haveli	-	3	3
Daman & Diu	5	3	3
NTC of Delhi Panchayat System	yet to be revived		
Pondicherry	-	-	-
Lakshadweep	-	6	-

Source: MoPanchayati Raj, GoI, 2004

It was also expected that the functionaries of the following type of local institutions would be transferred to the PRIs.

- a) ICDS Centre
- b) Health Sub Centre
- c) Primary Health Centre
- d) Veterinary Centre
- e) Agricultural Centre (Krishi Bhawan)
- f) Schools

However, as of now, PRIs only have the power to supervise and keep attendance record of these transferred staff and in some institutions, disburse salaries to them. In reality, the PRIs have no control on the staff and local institutions except for the task of monitoring and supervision without any disciplinary powers. It has also been found that, at the Panchayat Samiti and Zilla Parishad level, government officials are more powerful than the elected representatives in terms of exercising their powers.

## FISCAL DECENTRALISATION TO PRIS

Fiscal decentralization means devolution of taxing and spending powers to lower level governments. It also emphasises on fiscal autonomy which implies (1) the availability of fund over which Panchayats have full control as distinguished from the schematic fund or specific purpose grants (2) authority to spend funds without obtaining approval from any other agency.

The 73<sup>rd</sup> and 74<sup>th</sup> Amendment Act mandated the State governments to enact conformity laws and constitute the State Finance Commission (SFC) for fiscal decentralisation<sup>1</sup> to the PRIs. In this

regard, the role of the SFC was to make the Panchayat more autonomous in the fiscal matter of implementing 29 subjects<sup>2</sup>. Further, there was a provision for assignment of taxes, duties, levies and tolls to local bodies. PRIs receive funds mainly from four sources:

- (1) The Consolidated Fund of the State as per the recommendations of the SFCs
- (2) Grants-in-aid as per Central Finance Commission award
- (3) Central government via Centrally Sponsored Scheme (CSS)
- (4) Own Source Revenue (OSR).

The recommendations of various SFCs regarding fund devolution can be further divided into three categories:

- (1) Assignment of taxes, duties, levies and tolls to local bodies
- (2) Sharing of tax revenue proceeds and
- (3) Grants-in-aid and other financial assistance. There is a provision for PRIs to have adequate power over untied funds<sup>3</sup> to deliver public good and services assigned to them.

Various research studies have found that revenue mobilization by PRIs is abysmally low and spending power is very weak. The share of untied funds accounts for a very small amount in the total revenue receipts of PRIs. The reasons cited for low fiscal decentralization include mismatch between the functional assignment and financial power, poor tax base, weak administrative and enforcement capacity. A study by Bahl, 1999, identifies the necessary and desirable conditions for a system of fiscal decentralization to function effectively is reproduced in Table II. below.

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**Table II.**  
**The Components in a System of Fiscal Decentralization**

**Necessary conditions**

- Elected local council
- Locally appointed chief officers
- Significant local government discretion to raise revenue
- Significant local government expenditure responsibilities
- Budget autonomy
- A hard budget constraint

**Desirable conditions**

- Transparency and accountability
- Freedom from excessive central expenditure mandates
- Unconditional transfer from higher level governments
- Borrowing powers

Source: Bahl, 1999

<sup>1</sup> Articles 243 (I) and 243 (H) of the Indian Constitution provide financial devolution to Panchayats through constitution of SFCs, implementation of its reports and assignment of taxes

<sup>2</sup> The activities related to socio-economic and infrastructure issues given to PRIs

<sup>3</sup> Untied funds would imply the assigned tax and non-tax revenues raised by PRIs or higher level governments unconditional transfers in terms of share in taxes or in block grants.

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“The revenues raised by Panchayat as a ratio of GDP increased from 0.04 per cent in 1997-98 to 0.07 per cent in 2002-03”

The low transfer of taxing and spending powers to PRIs has caused vertical fiscal imbalances<sup>4</sup>. At the same time, lack of proper demarcation in financial power within each tier of PRIs has created horizontal fiscal imbalances<sup>5</sup> at Panchayat level elucidates that, the capacity to raise resources differs at different tiers of PRIs and therefore are not able to do comparable levy of services at comparable tax rates. The process of decentralization has created a mechanism to reduce both vertical and horizontal fiscal imbalances so that adequacy, equity and efficiency could be maximized in provision of public services.

The study by Rao and Rao (2008) reveal that the revenue mobilization by rural local bodies is dreadfully low. The revenues assigned to the Panchayat do not include any important item. In fact the Panchayats are not even able to exploit the only notable tax base assigned to them; viz. property tax. Table III explains that the revenues raised by Panchayat as a ratio of GDP increased from 0.04 per cent in 1997-98 to 0.07 per cent in 2002-03. At the same time their revenue accruals increased to 1 per cent. These estimates show that the revenue mobilization is quite negligible.

life of rural people towards self-sustenance. In this regard, Central government initiated many Central Sector (CS) and Centrally Sponsored Schemes (CSS) to strengthen the rural development programmes. Subsequently during this process, the role of PRIs came into the limelight as implementing agencies besides line departments.

The CSS mainly operating in rural areas cover various programmes related to poverty alleviation, education, health, water and sanitation, women and child development, rural housing, road and electrification etc. The CSS are designed by the Central Ministries and the outlay and nature of the individual schemes is determined by the provisions and guidelines attached to the respective schemes. The funds for many CSS bypass the State budget and goes through different agencies like District authorities, State/District registered societies and local bodies. Out of the 41 schemes bypassing the State budgets 10 schemes are mainly related to rural development amounting to Rs 21,407.90 crore in the year 2006-07 and have been reaching the PRIs.

Table III.  
Revenues of Different Levels of Governments (% of GDP)

Level of governments	1997-98		2002-03	
	Revenue* collections	Revenue# accrual	Revenue collections	Revenue accrual
Centre	11.4	6.8	11.8	7.74
States	6.3	10.9	6.7	9.63
Local-Urban	0.5	2.1	0.3	0.51
Local-Rural	0.04	0.8	0.07	0.98
Total	18.3	19.8	18.87	18.86

\* Represents own source revenue

# Represents revenue from assigned taxes, share in taxes and grants from higher level of taxes

Sources: (1) Public finance statistics, 2005-06, ministry of finance, GoI, (2) Reports of the Eleventh and Twelfth Finance commission, Ministry of Finance, GoI

## FISCAL DECENTRALIZATION AND RURAL DEVELOPMENT SCHEMES

Rural Development is a process that focuses on developing human and natural resources, utilizing new technologies, infrastructure building, strengthening institutions and organizations to implement government policies and programmes. It also encourages and fastens the economic development in rural areas to improve quality of

These programmes and schemes include Sampoorna Grameen Rozgar Yojna (SGRY), Swarn Jayanti Gram Swarozgar Yojna (SGSY), Indira Awas Yojna (IAY), National Rural Employment Guarantee Scheme (NREGS), Integrated Waste Land Development Programme (IWDP), Drought Prone Area programme (DPAP) Desert Development Programme (DDP), Total Sanitation Campaign (TSC), Member of Parliament/Member of Legislative Assembly Local Area Development

<sup>4</sup> Vertical imbalance implies the fiscal imbalances between centre, states and PRIs

<sup>5</sup> Horizontal imbalances explain the fiscal imbalances between the three tiers of Panchayats

Scheme (MPLAD & MLALAD). There are many CSS in the social sector apart from the rural development programmes like, Sarva Shiksha Abhiyan (SSA), Mid-Day Meal (MDM), TSC, Reproductive and Child Health Programme (RCH), Integrated Child Development Services (ICDS), and National Child Labour Project (NCLP). Among them, funds for MDM and TSC are being transferred directly to Panchayats.

Looking at Table IV, one can observe that PRIs are actively involved in the process of implementation of several Centrally Sponsored Schemes. The role of Panchayat Samiti and Gram Panchayat has been found to be more prominent in the implementation along with monitoring and supervision of the schemes. In a few schemes, the Panchayat Samiti provides all technical and non-technical support to Gram Panchayats, while

the funds they receive under the CSS are backed by rigid guidelines. Most of the CSS have a top-down approach and are implemented as a supply-driven programme. In the implementation of these schemes, PRIs work as agents of Central /State government, doing things on their behalf. They do not have any authority or discretion to spend funds allocated for schemes without obtaining prior approval from a higher level agency. Hence, the definition of 'fiscal decentralization to PRIs' holds true only in the aspect of implementation of the above mentioned CSS, but when it comes to spending matters, their hands are tied.

The grants from the Central and State government are very meager in terms of total expenditure. The Own Source Revenue (OSR) generation of PRIs at all levels is found to be very uneven and negligible. Their internal revenue mobilization

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Table IV.

Schemes Implemented through PRIs

S.No	Category	Schemes implemented through PRIs
1.	Poverty Alleviation	National Rural Employment Guarantee Scheme (NREGA) and Sampoorna Grameen Rozgar Yojna (SGRY) Swarn Jayanti Gram Swarozgar Yojna
2.	Education	Sarva Siksha Abhiyan Mid-day Meal Programme Adult Literacy
3.	Water and Sanitation	Drinking Water Mission /Accelerated Rural Water Supply Programme Total Sanitation Campaign
4.	Health	National Rural Health Mission
5.	Women and Child Development	Integrated Child Development Services (ICDS)
6.	Rural Housing	Indira Awas Yojna
7.	Rural Roads	Pardhan Mantri Grameen Sadak Yojna
8.	Rural Electrification	Rajiv Gandhi Grameen Vidyutikran Yojna. Programmes for non-conventional energy

Source: MOPR, Action Programmes for 11<sup>th</sup> Five year Plan, 2006.

Gram Panchayat is the main authority to implement programs at lower level by selection of beneficiary, activity, work plan and work place. Moreover, Zilla Panchayats also play a supervisory and monitoring role in these schemes.

The role of Panchayat has become critical in the successful completion of these programmes but

constitutes only 4.17 percent of their total revenue as per the study done on the behalf of Eleventh Finance Commission. The inefficiencies arise because of reluctance to charge fees, low rates, non revision of tax rate, encroachment of States in jurisdiction of Panchayats and lack of administrative capacity for tax collection. This reflects that PRIs as an institution of local self

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governance are lacking in devolution of funds which is essential for better delivery of public services with accountability towards local people.

Field experience also reveals that the role of PRIs is varied. They are understaffed and in addition most of the staff has poor training and no capacity building. Planning and project formulation is weak. The elected representatives' lack political will and are unaware of the Guidelines and provisions of schemes which are found to be rigid at the implementation level. Due to lack of people's participation, transparency and accountability of PRIs is far from satisfactory.

The above discussion has revealed that devolution of funds to PRIs is inadequate. Planning process is very weak at various levels of PRIs. The people's participation in the day to day functioning of PRIs was found to be very minimal. As far as the accountability mechanism is concerned, upward accountability is being applied but down ward accountability is still not prevalent. Based on the foregoing discussion,

some measures can be taken to make PRIs into an effective local institution for rural development.

Firstly, there should be a clear cut demarcation of power among all the tiers of Panchayat regarding function, funds and functionaries with proper activity mapping. Secondly, all functions should be devolved to PRIs with funds and functionaries. Thirdly, more untied funds should be provided to Panchayat and regulation and guidelines attached with CSS and grants from Centre and States should be made flexible. Fourthly, a parallel authority like State and Central Board of Taxes must be created for PRIs in case of revenue collection for improving their own source revenue. Fifthly, the Panchayats generating more own source revenue, should be rewarded. Sixthly, special attention should be given for improvement of budgeting, accounting and auditing system. Lastly, for augmenting own source revenue, appropriate training and capacity building programmes should be organized periodically.