1.0 BACKGROUND

Local self-government was central to the ideological framework of India’s national movement. But soon after achieving Independence, the country followed the path of centralization, thereby curtailing the powers and authority of local self-governments. Huge investments made through capital-intensive projects did not percolate down to the masses. It was not difficult to diagnose the malady, not at least for Nehru who said, “To uplift lakhs of villagers is not an ordinary task. This can be done only if people themselves take up the responsibility. They are not merely to be consulted, but the effective power has to be entrusted to the people”.

Converting the vision into reality was a daunting task particularly because India is a vast country with a surging population of multi-ethnic characteristics. Political and economic management of such a big nation from one particular location might be difficult, inefficient and unprofessional. It was under this realisation that, the 73rd and 74th Constitutional Amendments were passed by the Parliament in 1992, which came into effect on April 24, 1993. This was a landmark transition of political power to the grassroots. Subsequently conformity legislation was passed in the States also. It not only provided a Constitutional status to the local bodies but also laid down, without ambiguity, that legislature could by law endow them with such powers and authority that might be necessary to enable them to function as institutions of self-government. Therefore, it was a landmark year in the State-Local relations in India. Even though issue of self governance has been stated clearly by the Directive Principles of State Policy, it was only after these Amendment Acts, the panchayats and the municipalities were provided with wide ranging provisions to transform these local bodies into strong and viable units of ‘self-government’.

An important aspect of these Amendments relate to the finances of panchayats and municipalities. Strengthening the finance is a precursor for the panchayats and municipalities to become viable units of government.
It is enshrined in the Directive Principles of State Policy\(^1\) that the democratically elected local governments compared to other forms of government are in a better position to assess the needs and developmental priorities of the area they represent and provide an outcome that is closest to the preferences of its people. This position has also been the anchor of the earlier attempts\(^2\) that have been made to operationalise the Directive Principles of State Policy and introduce a system of Panchayati Raj in the country. Other important issues concerning to local governments viz. determination of appropriate spending responsibilities for local governments, distribution of fiscal powers between local and higher levels of government, extension of autonomy to local governments in choosing tax rates, laying down their borrowing powers, defining the relations between the executive and the elected councils, or even the more general issue of strengthening local governments, have received a little systematic attention in the past.

1.1 HISTORICAL BACKGROUND: EMERGENCE OF THE LOCAL GOVERNANCE

The system of local self-government, both urban and rural is not alien to India. The inscriptions in *uthiramerur* (Tamil Nadu) exhibit the existence of a similar system during Chola period in 10\(^{th}\) and 11\(^{th}\) centuries A.D, which was controlling the entire community life. The system of election was also in existence even in those days. The British rule eclipsed the system, which was in vogue in India. However the Imperial Government later realised the necessity of local self-government and initiated many measures to create local bodies under various enactments.

Modern history of urban local bodies (hereafter ULB’s) in India can be traced as far back as the year 1687 with the formation of the Municipal Corporation of the port city of Madras. This corporation was set-up to levy certain direct taxes and to provide certain amenities like education, cleaning of roads, etc. However this corporation was substituted by Mayor’s Court in 1726 to collect taxes for provision of local amenities. Similar types of Corporations were also setup in Bombay and Calcutta, which lasted only till 1842. In 1850 a new Act, viz. ‘Improvement of Towns Act’ was passed by the Government of India extending the local self-governments to the whole country and authorising a system of administration by councillors in the matters of construction, repairs, cleanliness, lighting, maintenance, etc. However in 1863, based on the report of
the Royal Army Sanitary Commission, which pinpointed the insanitary state of affairs in Indian towns, a series of Acts were passed, which led to the establishment of city municipalities through Lord Mayors Resolution of 1870.

During the late 19th Century, Lord Ripon undertook an evaluation study on the progress of the local self-government since 1870 that resulted into the Lord Ripon’s Resolution of 1882. The government made attempts to divide the functions between the provincial government and the local bodies in order to raise more income through local sources for themselves. On the recommendations of the Royal Commission on Decentralisation (1907) and the Montague Chelmsford Report (1918) the Government of India Act, 1919 was passed and the system of ‘Dyarchy’ was introduced. The type of organisation, powers and responsibilities of ULBs differed from State to State but they were similar in organizational structure. For the smaller cities and towns, Municipalities were formed, while Municipal Corporations governed big cities. A Corporation was headed by the Mayor and the Municipality by the Chairman.

The ULB’s administration has also been reviewed from time to time by various commissions / enquiry committees, appointed by the Central and State Governments for improving the resource generation and providing local services.

The Panchayati Raj Institutions (hereafter PRIs) on the other hand, were in vogue in India from time immemorial. History reveals that there was a well-developed system of village panchayats in ancient India that had almost become defunct during the 17th and 18th Century under the British rule. Gandhiji had remarked long ago, “How long history does not record, the Indian genius worked out the village and local panchayat through which the villager’s life has maintained its tenor even away from the din of battle and the rush of rising and falling empires”. Inspite of its ancient origin the panchayat system was also broken under the British rule, by their ruthless method of revenue collection. Though during the period of Lord Mayo in 1871, the rural bodies were revived, but at the District level and not at the Village level. Under the 1884 Act, a three-tier system of rural local bodies was brought into force, only to collect revenues. After this many Acts were passed for the same reason.
Local self-government was central to the ideological framework of India's National Movement. It was in this context Gandhiji had said, "True democracy cannot function by twenty men sitting at the Centre. It has to be worked from below, by the people of every village."

After India's independence, Gandhiji revived the 'little republic' by his moving words viz. "India’s Independence must begin at the bottom. Thus every village will be a republic or a panchayat having full powers, the greater the powers to the panchayats, the better for the people". As a result, Article 40 (Annexure. A.8) of part C of the Constitution of free India laid down the principle, "The State Government 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".

1.2 NEEDS AND EMERGENCE OF STATE FINANCE COMMISSIONS

The institution of local bodies in India failed to acquire the status and dignity of viable units of local self-government and a responsive people's body. Hence keeping in view the past experiences, the Government of India under the visionary leadership of the late Prime Minister, Mr. Rajiv Gandhi, initiated efforts to provide constitutional status to local self-government to impart 'certainty, continuity and strength'.

Over the years there has been a growing realisation that local bodies have failed to provide adequate services primarily on account of the woefully insufficient resources at their command. Fiscal transfers from the State, which constitute an extremely important part of the municipal revenues, depended more on an ad-hoc system of grants-in-aid rather than being a predetermined share in taxes based on well-defined criteria. No set principles were laid down in matters relating to quantum of grants to the States and the share thereof, which was required to be passed on by them to the local bodies. This gapping omission in the Constitution has been corrected with the adoption of the 73rd and 74th Amendments to the Constitution, which have inserted two parts-IX (Annexure A.1) & IX-A (Annexure A.2) dealing respectively with the panchayats and the municipalities. These historic amendments have accorded constitutional status to the third tiers of government at the local level. They have also provided a constitutional mechanism to take care of the financial inadequacies plaguing the local bodies, which
were not able to perform effectively as vibrant democratic units of self-governments, apart from giving them protection against arbitrary treatment by the State Governments.

One of the salient features of the 73rd and 74th Constitutional Amendment Acts, 1992 was the appointment of a State Finance Commission (SFC) in all the States within one year from the commencement of these Acts, thereafter, for every fifth year. The SFCs would review the finances of local bodies and recommend principles which should govern the distribution / assignment of the net proceeds of the taxes, duties, tolls and fees levied by the States and grants-in-aid from the Consolidated Fund of the State between the State, municipalities and the panchayats at all levels. The basic function of the SFC is to devise a system of distribution of the government revenues to the local bodies; define their power of taxation and responsibilities for improving the local finances and services. The enactment also provides that ‘the legislature of the State may by law provide for the composition of the Commission, the qualifications which shall be requisite for appointment as member thereof and the manner in which they shall be selected’ and further, ‘the Commission shall have such powers in the performance of their functions as the Legislature of the State may, by law confer on them.’

The 1992 amendments are related to two parts-IX and IX-A of the Constitution, wherein Article 243 which had been replaced in 1956, has now been suitably amended and inserted to make provisions in respect of the Panchayats (Article-243 and its sub-parts 243-A to 243-O) (Annexure. A.1) and the Municipalities (Article 243 P to 245 ZG) (Annexure A.2). There are three provisions in the amended Constitution that are directly relating to local bodies, namely,

• to the Constitution and composition of the panchayats and municipalities;
• to the functional and fiscal powers of the panchayats and municipalities; and,
• to the institutional arrangements for planning for economic and social development.

For establishing of the panchayats and municipalities, the Constitution provides that ‘These shall be constituted in every State, panchayats at the village, intermediate and District levels in accordance with the provisions of this part. Panchayats at the
intermediate level may not be constituted in a State having a population not exceeding 20 lakhs' (Article 234 B).

These shall be constituted in every State:

- A Nagar Panchayat for a transitional area, that is to say, an area in transition from rural area to an urban area;
- A Municipal Council for a smaller urban area; and
- A Municipal Corporation for a larger urban area” (Article 243 Q).

An important provision in the amended Constitution is that every panchayat and every municipality shall have tenure of five years; if dissolved sooner, the Constitution requires that elections be held within six months. The Constitution makes a specific provision for the reservation of women and other disadvantaged groups in order to impart greater participation of those sections of local communities, which have been outside the mainstream of development. Thus, the two amendments not only provide for the creation of a third-tier of government, but also confer uniformity in their structure and safety from arbitrary dissolution or suspension. That State Government’s discretion in constituting panchayats or municipalities, determining their structure, or keeping them under dissolution or suspension for long periods, as was the case in the pre-amended era, has been done away with in the new Constitutional framework.

1.3 OBJECTIVES OF THE STATE FINANCE COMMISSIONS

The main objective of the SFC is to review the existing financial conditions of the local bodies, suggest improvements in the augmentation of resources to match their responsibilities and to improve the delivery system of the public services. The terms-of-references (hereafter TOR) issued by the Government as well as the objectives of the SFC envisaged in the Constitutional Amendments, indicate that the SFC is distinct from the Union Finance Commission. The Union Finance Commission (hereafter FC) has only to suggest distribution of the funds between the Centre and the States, while the SFC has to recommend the taxes of the State which could be assigned to the local bodies and also to indicate the principles of distribution of funds by the State Government to the local bodies and in the distribution of funds among the different tiers of local bodies besides inter-se distribution. The TORs also indicate that the SFC has to
ensure a sound financial management besides suggesting for avoiding unproductive expenditure. It also envisages the measures needed for upkeep of the assets created and maintained by the local bodies to ensure public utility.

Specially, the SFCs have the following objectives to be achieved:
(i) to provide a predictable, unambiguous, simple and detailed mechanism of devolution of funds among the State Government and local bodies;
(ii) to address the terms of references in totality;
(iii) to review the financial position of local bodies;
(iv) to determine the principles of distribution of State resources to the local bodies;
(v) to determine the assignment or appropriation of taxes, duties, fees, etc., to local bodies;
(vi) to provide a mechanism of sharing resources to all tiers of local bodies;
(vii) to determine the principles for grants-in-aid to local bodies from the State;
(viii) to suggest measures needed to improve the financial position of the local bodies;
(ix) to minimise State control over:
   a) fiscal powers of local bodies,
   b) approval of taxes,
   c) approval of taxation rates,
   d) approval of expenditure,
   e) approval of borrowing.

1.4 DIFFERENCE BETWEEN PANCHAYATI RAJ INSTITUTIONS AND THE URBAN LOCAL BODIES

A significant difference between the Panchayati Raj Institutions and the Urban Local bodies is that, the Panchayati Raj Institutions has a linkage of organisations with a three-tier system; whereas the urban local bodies are independent and have no linkage either with the higher bodies or with the administrative machinery at the District levels. In the past they were mostly controlled directly by the State Government and all the aid was rendered direct from the State. However, an inspector, who was also the inspector of other local bodies at the State level, was controlling the municipal bodies. Now a separate Director / Commissioner looks after the Municipal Administration. The
Corporations, however, were under the direct control of the Government until recently while they are placed under the administrative control of the Director General of Municipal Corporation. Further details are given in Chapter 3.

1.5 DIFFERENCE BETWEEN UNION FINANCE COMMISSION (FC) AND STATE FINANCE COMMISSIONS (SFC)

It is necessary to note here that there are two fundamental differences between the Union Finance Commission provided under Article 280 and the State Finance Commissions provided under Article 243-I and 243-Y (Annexure A.1 & A. 2) of the Indian Constitution.

1. The FC was conceived against the background of the realisation by the framers of the Constitution that the Central Government will have more revenues at its disposal, part of which should be transferred to the State Governments so as to reduce vertical as well as horizontal federal fiscal imbalances. But the SFCs are provided mainly to reduce horizontal fiscal imbalances, as there is no possibility of State Governments experiencing surplus revenues. They are expected to transfer some of their functions along with the revenues to the local bodies.

2. The scope of the recommendations of the SFC is much broader than that of the FC. The FC is expected to recommend principles and magnitudes of the revenue from certain taxes levied by the Central Government as also grants-in-aid from the Consolidated Fund of India. The SFCs are expected to recommend sharing of the revenue from tax and non-tax revenue sources, assignment of tax / non-tax sources, grants-in-aid and measures to enable the local bodies to raise revenues. In other words, the FC is not asked to suggest measures for raising more revenue by the State Governments, whereas the SFCs are specifically asked to do so.

1.6 TERMS OF REFERENCES OF SELECTED STATE FINANCE COMMISSIONS

Subsequent to coming into force of 73rd and 74th Constitutional Amendment Acts, the SFCs were constituted in all the States of the country. In the present study reports
submitted by first SFCs of Tamil Nadu, Uttar Pradesh and NCT of Delhi were studied. The States selected represented different size, character and region of the country.

1.6.1 TAMIL NADU

In the two notifications issued in G.O.Ms No. 350, Finance, dated 23.4.94 and G.O.Ms No. 971, Finance dated 6.12.94 necessary terms of references were issued to the Tamil Nadu State Finance Commission. Accordingly the Commission was asked to review the financial position of the different tiers of PRIs and the ULBs in the State and make recommendations as to:

(a) The principles which should govern:

i) the distribution between the State and panchayats / urban local bodies of the net proceeds of the taxes, duties, tolls and fees leviable by the Government which may be divided between them, and allocation between the District panchayats, panchayat union councils and village panchayat / urban local bodies of their respective shares of such proceeds;

ii) the determination of the taxes, duties, tolls and fees which may be assigned to or appropriated by the panchayats/urban local bodies;

iii) the grants-in-aid to the panchayats/urban local bodies from the Consolidated Fund of the State.

(b) the measures needed to improve the financial position of the panchayats/ urban local bodies.

In reviewing the financial position of the urban local bodies, the Commission should also

(i) assess the financial position of the panchayat unions/ urban local bodies as on 31st March 1994 with reference to revenue receipts and expenditure and the debt position;

(ii) assess as far as may be practicable the financial position of the village panchayats as on 31st March 1994 with reference to revenue receipts and expenditure.
Further in making its recommendations, the Commission should have due regard to the resources of the State Government, the demand thereon of the resources and the need to generate adequate surplus on revenue account for State’s commitments on capital account. The Commission should also regard to:

(i) the existing level of devolution of resources to the panchayats/ urban local bodies and the adequacy of such devolution.

(ii) the maintenance and upkeep of capital assets owned by or entrusted to panchayats/ urban local bodies.

(iii) the tax efforts of panchayats/urban local bodies and its incentives to increase such tax efforts.

The Commission can suggest changes, if any, in the existing classification of panchayats / municipalities and town panchayats on the basis of their financial position and suggest measures to improve financial management of panchayats/ urban local bodies and to reduce unproductive expenditure in panchayats and urban local bodies. The report of the Commission should however cover the period of five years commencing from 1.4.1997.

1.6.2 UTTAR PRADESH

The terms of reference of the Uttar Pradesh State Finance Commission as contained in the UP Government Finance Department Notification dated 22-10-1994 (as amended) are as follows:

Accordingly, the Commission shall make recommendations relating to the following matters:

a) the distribution between State Gram/ Kshetra/ Zila Panchayats and urban local bodies of the net proceeds of taxes, duties, tolls and fees leviable by the State which may be divided amongst them under Part IX and IX-A of the Constitution and allocation between panchayats at all levels and urban local bodies of their respective shares of such proceeds;
b) the determination of taxes, duties, tolls and fees, which may be assigned to or appropriated by the Gram/ Ksherta/ Zila panchayats as the case may be and by the urban local bodies;

c) the principles which should govern the grant-in-aid to the Gram/ Kshetra/ Zila panchayats as the case may be, and to urban local bodies from the Consolidated Fund of the State;

d) the measures for strengthening the financial position of Gram/ Kshetra/ Zila panchayats and urban local bodies;

e) any other matter which the Government may refer to the commission in the interest of sound finance of Gram/ Kshetra/ Zila panchayats and urban local bodies.

The said Government Notification also stipulated that in making its own recommendation; the Commission shall have regard, among other considerations to:

1) the revenue resources of the State Government and the demands thereon, in particular, on account of expenditure on civil administration, debt serving and other committed expenditure or liabilities;

2) the liabilities of panchayats and urban local bodies in respect of implementation of schemes entrusted to them under Article 243-G and 243-W and works entrusted to them at appropriate levels;

3) the revenue resources of panchayats and urban local bodies at all levels based on the potential for raising resources for the next 5 years and targets fixed for additional resource mobilisation along with tax efforts made in this direction;

4) the scope for better fiscal management consistent with economy in expenditure and efficiency in administration;

5) the maintenance and upkeep of capital assets and maintenance expenditure on those Plan Schemes as are entrusted to these bodies which are completed by March 31, 1997;

6) the Commission may make an assessment of the debt position of the panchayats and urban local bodies at all levels as on March 31, 1994 and suggest such
corrective measures as are deemed necessary keeping in view the financial requirements of the State;

7) if the funds available at the local level do not meet full requirements of expenditure on Plan side after the new arrangements, then the Commission will make specific recommendation regarding the arrangement of funds for expenditure on both Plan and Non-Plan side.

The Commission was enjoined upon to make its report available on each of the aforesaid matters covering a period of 5 years commencing from April 1, 1996. Another term of reference was added through the Government Notification dated January 16, 1996 asking the Commission to give its recommendation regarding the maintenance and auditing of accounts of urban local bodies.

1.6.3 NATIONAL CAPITAL TERRITORY OF DELHI

The First Delhi Finance Commission was constituted under Government of NCT of Delhi order dated April 3, 1995 with following terms of references:

The Commission shall:

(a) Determine the manner, principles and procedure which should govern-

(i) the distribution between the National Capital Territory of Delhi and the Municipalities, of the net proceeds of the taxes, duties, tolls and fees leviable by the National Capital Territory of Delhi which may be divided between them;

(ii) the determination of the taxes, duties, tolls and fees which may be assigned to or appropriated by the Municipalities;

(iii) the grants-in-aid to the Municipalities from the Consolidated Fund of the National Capital Territory of Delhi; and

(b) The needed measure to improve the financial position of the Municipalities.

While making its recommendations the Commission shall have regard among other considerations, to-

i) the overall resource position of the Government of the National Capital Territory of Delhi;
ii) the scope for economy in the Municipal Administration;

iii) the scope for improvements in resource mobilisation by the Municipalities; and

iv) the tax efforts made by the Municipalities.

The Commission shall make its report available by 31st March 1996 on each of the matters aforesaid and covering a period of five financial years commencing from the 1st April 1996. It shall also indicate in the report the basis on which it has arrived at its findings and state, as far as possible, the estimates / forecasts for all the Municipalities together, as well as separately for each of such bodies.

1.6.4 COMPARISON OF TORs OF THREE STATES

The three sample States of Delhi, Uttar Pradesh and Tamil Nadu have many similarities in their terms of references of their First State Finance Commissions. It stems from the fact that SFCs have derived their existence and functions from 73rd and 74th Constitution Amendment Acts of 1992.

The TORs of the SFCs of these three States ask for recommendations to determine the measures, principles and procedure for distribution of net proceeds of the taxes, duties, tolls and fees leviable by the government among panchayats and urban local bodies. Since the local bodies had limited resources prior to the said Constitution Amendments, the TORs also call for determination of taxes, duties, tolls and fees that may be appropriated or assigned to them. Third major similarity in the TORs is the recommendations on the principles, which will govern the grants-in-aid to local bodies from the Consolidated Fund of the State. Another major requirement for each of the State Finance Commission is to give recommendations on measures for strengthening the financial position of local bodies while keeping in mind the resources position of the State Government and liabilities of the local bodies. All the TORs also call for scope for economy in expenditure by local bodies and efficiency in administration.

Apart from common points there are some differences in TORs as well. Delhi TOR is concerned only with the financial position of municipality and municipal corporation as no panchayats being left any longer in NCT of Delhi, whereas Uttar Pradesh and Tamil Nadu concern both PRIs and ULBs.
Delhi and Uttar Pradesh TORs enjoin their respective Commission to make its report available on each of the matters covering a period of five years commencing from April 1, 1996 whereas Tamil Nadu specifies a period of five years commencing from April 1, 1997.

A significant TOR, which was later added to the Uttar Pradesh State Finance Commission, was regarding recommendations on maintenance and auditing of accounts of urban local bodies. This finds mention only in TORs of State Finance Commission of Uttar Pradesh.

1.7 REVIEW OF THE LITERATURE

From time to time, Committees / Commissions study teams have been constituted to study the status of local governments in India with a view to improve them. Main focus of some of these committees is as follows:

A study team under the chairmanship of Balwant Rai Mehta (1952) was of the view that all developmental programmes undertaken in a local area should be channelised through elected bodies. The study team also recommended for the creation of an interconnected system of democratic institutions at village, block and District level, which could undertake developmental activities with the people’s participation. The block level institution could be converted as a panchayat union / samiti which should be the unit incharge of all development work since the unit at District level would be unviable and the panchayats at village level should undertake the provision of basic amenities in villages and also involve in the developmental activities formulated by the block level institution. The District level organisation, namely Zila Parishad was more too co-coordinated the activities of various smithies at District level.

Further in 1957 Balwant Rai Mehta Committee felt that development cannot progress unless responsibility and power is given to the community. They recommended an early establishment of statutory elective local bodies and devolution to them of the necessary resources, power and authority. Therefore in order to encourage people’s participation and to overcome defects of the Community Development Programme, Panchayati Raj
Institutions apparatus was stipulated to achieve socio-economic transformation of rural India.

**K. Santhanam Committee** report on Panchayati Raj Finance (1963) was the first committee to deal with the issue involved in strengthening the finances of the panchayats. This committee examined the various aspects of finances of the panchayats and made several recommendations for raising revenues from their own resources and the principles to govern devolution of various grants to the panchayats from the State Governments. One of the most important suggestions of the committee was that attempts should be made to help the panchayats to take remunerative undertakings and thereby increasing the scope for non-tax revenues. The committee was of the view that “loan to the panchayats for these purposes cannot be adequately given by the State Departments and even when it is possible, it is desirable to give loans through special institution which will function purely as a financial concern, free from any kind of political interferences”.

**Mahavir Tyagi Committee** presented a report on Central Direct Taxes Administration Reforms (1969) and made a number of suggestions regarding the taxes, which could be raised by the panchayats and also indicated different assigned revenues and grants, which could be transferred to them by the State Government.

The **High Level Committee of Gujarat** (1973) was in favor to strengthening the financial position of the local government's and suggested that State Financial Boards should be constituted to go into the matters relating to distribution of State resources between the State and Panchayati Raj bodies.

**Linn (1975)** explained about the problems faced by the urban governments in the developing countries like urban management, slums and squatter settlements, rapid population growth, poverty and laid focus on the urban finance aspects of the difficulties encountered by urban governments in developing countries in trying to cope with rapid urbanization at low levels of income.

The Central Government appointed a High Level Committee in the year 1977 under the chairmanship of eminent legislator **Dr. Ashok Mehta**, to review the Panchayati Raj
system and also to enquire into the causes of decline of the Panchayati Raj Institutions and to recommend appropriate measures to reform and strengthen them. This Committee submitted a number of recommendations for reform and revitalization of Panchayati Raj based upon the ‘central premise of linking institutions of democratic decentralization with socially motivated economic development’ and emphasized the need for District planning and mobilization of funds on their own, for the Plan implementation. The committee drew up three phases of Panchayati Raj in India after Independence. From 1959-64, it was the phase of ascendancy, 1965-69 was the phase of stagnation and from 1969-77 was that of decline and recommended the reorganization of the Panchayati Raj bodies into two main tiers. It felt that the three-tiers in vogue at present may continue for some more time, but in the long run only two-tiers should take the responsibilities of local and regional development. Development necessitates that the first point of decentralisation below the State should be the District Planning. Supervising and coordinating development programmes at District level is necessitated, as administrative and technical competence of the requisite caliber is available only at the District level. The Block should only have an executive committee of the Zila Parishad (e.g. Maharashtra) to implement the development programmes formulated and approved by the Zila Parishad. The existing Village Panchayats are financially as well as leadership-wise weak. Threfore, the committee recommended the Constitution of Mandal Panchayats. Another reason for such recommendation is that people now want better quality of local services, which Village Panchayats with their meager resources cannot provide. The Mandal Panchayats serving a population of 15 to 20 thousands would have adequate resources, menpower, talent and threshold to launch various development projects. The committee has also suggested a tie up between the PRIs and the much needed focal points for spatial development. It further assessed that the inability of the PRIs to come up to the expectation lay in their weak financial resources.

Abhijit Datta (1984) suggests some measures to improve municipal finances, which should lie within the municipal system. Under the Indian conditions significant improvement within the municipal system has to be ushered externally by the States and the Central Government. He indicated specific action areas to improve the boundaries of municipal decision making in the field of municipal functions, taxation, resources transfer and integration of municipal planning with the national planning system. The net result of
all these improvements should enable the municipal authorities to ultimately handle at least 10 per cent of the total governmental revenue over the next decade. Further in 1995 he concluded the discussion of fiscal reforms of the Panchayats in four points:

(i) The panchayats are to be strengthened as institutions of self-government and not merely as agents of State Plan implementation.

(ii) The fiscal strengthening of the panchayats involved simultaneous measures for fiscal and organizational contraction of the State Government.

(iii) The State field staff transfer strategy to the panchayats prevents fiscal decentralization to take root.

(iv) The fiscal accountability of the panchayats is to be outside State bureaucratic control and related mainly to their constituents.

G.V.K. Rao Committee (1985) suggested ways of revamping rural local governments and recommended a bold scheme of democratic decentralization in which the District level body was to be of pivotal importance.

L.M. Singhvi Committee (1986) suggested, “a pattern of compulsory and optional levied taxes and a list of subjects of which powers to levy taxes and fees may be entrusted to PRIs with a provision that for a given period, the State Government shall levy and collect on behalf of Panchayati Raj Institutions and shall disburse to them on the basis of recommendations of the Finance Commission in each State”. This committee tracing the growth and development of democratic decentralization resurrected the nearly forgotten Gram Sabha, comprising all the inhabitants of a village and called it as the embodiment of direct democracy. Besides it wanted to vest Panchayati Raj with Constitutional status, saying that a separate chapter should be added in the Constitution of India, so as to make the identity and integrity of the PRIs ‘reasonably and substantially inviolate’. It wanted the establishment of Nyaya Panchayats for a cluster of villages. As regards the participation of political parties in Panchayati Raj elections, it itself did not volunteer any definite role which is pragmatic, workable and consensual and in consultation with different parties of the land.
Sarkaria Commission on Centre-State Relations (1988) recommended Constitutional provision to secure elections to local bodies. It did not favour the idea of the L.M.Singhvi Committee to confer Constitutional status to the PRIs. The commission advocated that the power of enacting any law on the Panchayats vests under entry 5, list II exclusively with the States. Uniformity in these aspects of the law throughout the territory of India is essential. The uniformity can be secured by adopting in the following order of preference any of the alternatives given below:

1. By law with respect to this matter made by all the State legislatures in accordance with a Model Bill prepared on the basis of consensus at the forum of the Inter-State Council, recommended to be established under Article 263.
2. By a law on this subject made by Parliament under Article 252 (1) with the consent of the legislatures of all the States.
3. By a parliamentary law uniformly applicable throughout India containing provisions analogous to Article 172 and 174 of the Constitution.

Adoption of above alternative (1) or (2) will not require any amendment of the Constitution. However as a condition precedent for adopting alternative (3), those aspects of the matter which are analogous to Article 172 and 174, will have to be carried out of the ambit to entry 5, list II and transposed as a separate item of list II. Recourse to alternative (3) may be had only as a last resort.

On the issue of fiscal crisis of local bodies, Bagchi (1993) is of the view that no single policy instrument like grants can achieve all the objectives. Attempts to serve several objectives simultaneously, like equalisation of fiscal capacity across jurisdiction and stimulating local government tax efforts while minimizing administration costs and promoting local autonomy may end up by achieving a little in any direction as the effect of one may be neutralized by that of the other. Further in 1995, he focuses on the tasks before the SFCs in relation to Panchayat functions and finances and considers the issues relating to the fiscal restructuring of the panchayats in terms of their Plan finance and revenue base.
B.S. Khanna (1994) threw light on the development of rural local self-government during 1947-48 to 1957-58. He made intensive description of Panchayati Raj works in ten States of India and suggests that these States should be classified into three categories:

a) Category I, where Panchayati Raj has been developing satisfactorily as local self-government and development agency.

b) Category II, where Panchayati Raj was radically reorganized and the system made a good headway initially and later solved down and subsequently was dissolved temporarily because of change in the attitude of succeeding party government in the State.

c) Category III, where Panchayati Raj was superseded and dissolved for long periods and elections were delayed considerably or else their structure was truncated thereby resulting in their languid performance.

M.A. Oomen (1995) reviewed the existing structure of the Panchayati Raj finance and conformity legislations passed by the various State legislatures with reference to the functions and finance of PRIs and outlined some of the conceptual and operational issues of intergovernmental transfers with special reference to SFCs and the task facing them. He also suggests some measures to improve panchayat finance, to improve poor tax base and difference in imposing taxes. They are:

- raising non-tax income by assigning more land to panchayats;
- creation of permanent assets like shops, flats, fishing, ponds etc; and
- tax on agriculture.

He further suggests that intergovernmental transfer may be governed by such broad principles as adequacy, autonomy, fiscal prudence, predictability transparency and operationality, tax sharing and tax assignment. Distribution of grants-in-aid interse must be based on criteria which each SFC must evolve, preferably with the help of some composite index of backwardness and measures of resources effort. The goal of building institutions of self-government can be achieved only if the transitional tasks are pursued with clarity of purpose and dedication to the cause of democratic decentralization and finance is made to play the inevitable midwifery role in this task.

Bohra (1996) studied the problems of Centre-State fiscal relations. His study is based on Rajasthan and the analysis is carried out at the level of State and local bodies. He concludes that:

(i) The element of subjectivity in public expenditure is declining over the years.
(ii) The political theory of local finance overrides the Fabricant Hypothesis.
(iii) The expenditure equalisation leases on the models of fiscal choice yield relatively better results.

1.8 OBJECTIVES OF THE STUDY

The ensuing study aims:

1. To examine whether local bodies have been endowed with the powers as enshrined in the Constitution of India according to the 73rd and 74th Amendments.
2. A comparative study of the services provided by the local bodies of Tamil Nadu, Uttar Pradesh and NCT of Delhi.
3. To study performance of local bodies within the State as well as among States.
4. To examine whether intergovernmental fiscal relations are according to the needs of the local bodies.
5. To analyze the scheme/formula or methodology adopted by different State Finance Commissions of Tamil Nadu, Uttar Pradesh and NCT of Delhi for devolution of taxes and transfer of other financial resources to the local bodies.
6. To examine the evolution of intergovernmental fiscal transfers in these States.

1.9 HYPOTHESIS

The hypothesis that there are no major differences in the method of devolution of taxes between the different States and also between PRIs and ULBs within the States is proposed to be examined.
1.10 RESEARCH METHODOLOGY

India is a three-tier polity having Central, State and Local Governments. The focal points of the study are vertical relations as well as horizontal relations of State and local as well as among local governments, which has special features and characteristics. An attempt has been made to compare the attention paid by parent Governments to deal with fiscal issues of its dependent level of Governments.

The study is a review of the recommendations made by the First State Finance Commissions. The sample is limited to three States, namely, Uttar Pradesh, Tamil Nadu and National Capital Territory of Delhi (NCT of Delhi), because it is not possible to study all the States. Though desirable, but it is very difficult for an individual researcher due to time, space and other constraints. The study is purely based on secondary data collected from various reports of State Finance Commissions and other Government publications. The problem under study on the basis of comparative economic methods has also been examined.

Uttar Pradesh (UP) has been selected because it is the parent State of the researcher and it also represents northern part of the country. Lately, the erstwhile State has been bifurcated into Uttaranchal and the present Uttar Pradesh, but this study has taken into analysis the combined State for which first SFC submitted its report. This State also represents the poorer and backward States of the country.

Tamil Nadu (TN) represents a Southern State and is also considered to be one of the developed States where local governments, both urban and rural, do play an important role in their economy.

Delhi, though basically is a Union Territory and the capital city of India, represents a unique system of governance. It was accorded the quasi-statehood, because all the State powers have not been granted to it whether in terms of resource raising or functional domain. Many of the State functions are under various Ministries of the Union Government. Its local body like Municipal Corporation of Delhi is under control of Ministry of Home Affairs and Delhi Cantonment Board is regulated by the Ministry of
Defence. The State Government has a little regulatory and administrative control over them.

1.11 DATA AVAILABILITY

The proposed study is basically of the nature of the survey of measure TOR, methodology adopted, scope and recommendations of the SFC reports of selected States. It has been noted that although the TOR has been derived from the Constitution of India under Article 243-I and 243-Y, yet there is no uniformity in the approach and scope adopted by these States.

Statistical and analytical data have also been given in these reports with varied coverage for example the coverage by Tamil Nadu and NCT of Delhi is adequate but in Uttar Pradesh it desired to be covers by more information.

1.12 LIMITATIONS OF THE STUDY

1. For this study only three States have been taken because of the limitation of time and other constrains; and it is purely based on secondary data, particularly the information gathered from the reports of State Finance Commissions.
2. These three States have been selected because Tamil Nadu represents from Southern part of India, Uttar Pradesh is from north and Delhi is not purely a State but a mixture of both State and Union Territory.
3. The simple and advanced econometric method for empirical study could not be applied, as the research scholar is not familiar with these tools.
4. The Delhi Cantonment Board (DCB), which is under the control of Ministry of Defence, did not fall within the purview of the State Finance Commission of NCT of Delhi, hence has not been included in the present study.

1.13 SUMMARY

The concept of local self-government is not new to India, the similar system may be traced back during Chola period. The British rule eclipsed the system, however, the Imperial Government latter on realised the necessity of local self-government and
initiated many measures to create local bodies under various enactments. Though several committees and commissions were appointed earlier to examine the financial requirements of ULB's and PRI's, yet they were adhoc in character and they did not enjoy any Constitutional status. It has been strongly suggested by many, that the chronic problem of local finance can be solved only through having any scientific method of devolution of power and resources. These SFCs should make recommendations so as to ensure a stride and adequate flow of resources to the local bodies through grants and loans in addition to the assigned heads of revenue and shared taxes. The 1992 Acts suggest for an appointment of Finance Commission in all the States within one year from the commencement of the Constitution Amendment Act initially and thereafter for every five years, to review the finances of the local bodies and to recommend the principles on the basis of which the taxes are to be appropriated by or assigned to the local bodies, as also grants-in-aid to the local bodies from the Consolidated Funds of the States. The basic function of the SFC is to look into the finances of the local bodies, both rural and urban and to devise a system of distribution of the government revenues to the local bodies, its powers of taxation and the responsibilities for improving its local finances and services.

In the chapter to follow, several theories related to fiscal federalism propounded by eminent economists would be discussed which have direct bearing on State-Local fiscal relations.

Footnotes:
2. The Balwantarai Mehta Committee (1952), recommended setting up of a three-tier structure of PRI's for effective decentralization and Ashok Mehta Committee on Panchayati Raj Institution (1977) emphasized that the psychic dividends of the association of rural people with the planning and development process are crux of the matter. A committee set up by the Planning Commission to review the progress in the sphere of decentralization identified absence of financial autonomy and the primacy of government officials as against people's representatives as major weakness.
4. Until its repealment in 1956, Article 243 related to the territories in Part D of the first schedule and any other comprised within the territory of India but not specified in that schedule.
5. The gradation of an area into transitional, small or large, is to be determined by the Governor of a State, on the basis of such factors as population, area, density, revenue generated for local
administration, employment in non-agricultural activities and other factors that point to the economic importance of the area (243 Q).

6. Articles 234 D and 243 T provide for the reservation for women and other disadvantaged groups.

7. Because they are not guided by fiscal principles, normative fiscal principles were missing largely.