CHAPTER II

RURAL LOCAL FINANCE - A THEORETICAL FRAME WORK
AND A GENERAL OVERVIEW

2.1. Introduction

The functions and responsibilities of the local bodies have been increasing with the passage of time especially in respect of rural economic development. Increasing function require increased resources. Unfortunately local bodies face the acute problem of inadequate resources. Even though the services to be provided by the local bodies are quite wide, their power to raise revenues is limited. "In the sense that local government should develop certain characteristics to meet local needs and conditions and make a creative contribution from local wit and enthusiasm, so should there be allowed a measure of independence in order that these particularities may not only be served, but also serve the country as a whole. It is very much a question of finding a balance between expenditure which may seem foolish nationally and yet wise locally".  

In a vast country like India, there are plenty of governmental and collective services, which can best be performed at different levels of government. Efficiency, economy, uniformity of treatment and flexibility are the basic principles in the allocation of function between different levels of government. A close link should be established between the services provided and the collection of own-funds to finance them. "With the development of the
economy and the increasing awareness on the part of the public, the responsibilities of the local bodies are mounting up while their revenue resources are not increasing as rapidly”

It is true that inadequacy of funds in India is not a phenomenon peculiar to local bodies. But the problem is agonising in the case of rural local bodies since it is the grass roots of democracy and the dissatisfaction about the frustrated needs of the people is most keenly felt at this level. “The financial decentralisation is an important aspect of administrative decentralisation. Unless powers and responsibilities are adequately supplied and matched by resources, no model of administrative decentralisation can be expected to be successful”. Hence it is very important to ensure that the Panchayats have adequate funds to discharge the specific functions entrusted to them. U.K. Hicks has also emphasised the need for adequate finance “If the local bodies are to play any significant part in the economic and social development they must clearly have access to adequate finance”.

It is essential to have sufficient finance to undertake any governmental activity. Generally the local bodies have no solid fiscal base for their autonomy. The powers of taxation and other sources of own revenue are limited. However, the role of rural local bodies in the development process has been recognised and attempts have been made to evolve more powers to them and to provide them with sufficient finance.
2.2. Local Finance in the Federal System

Quoting the famous thinker Oates, G. Thimmaiah points out two theoretical arguments advanced by neo-classical theory of fiscal federalism as follows

"(1) The tastes and preferences of citizens for various types of public goods provided by government authorities in vast countries like Australia, Canada, USA, and India differ. An ideal political institutional set up is one which meets the demand for varying types of public goods by combining the advantages of economics of scale and by satisfying the diverse tastes and preferences of the citizens .............

(ii) The second decentralisation hypothesis maintains that when a number of local level self governing institutions are created for providing certain local public goods, it encourages competition and innovation in designing programmes, schemes and efficiency in delivery. Such competition will reduce the cost of public services"

It is not easy to draw a hard and fast line between the spheres of different levels of government and to say that some functions are matters of general importance to be left to the higher levels and others are only of local importance to be left to local bodies. As a matter of fact some functions are clearly national, others are clearly local and capable of more efficient local administration, but some may be regarded as both national and local. Some functions have national
importance yet capable of more efficient local administration. The problem is further complicated by differences in the efficiency of different local governments. V.G. Ramakrishna Aiyar has rightly observed, "Local bodies differ greatly in resources from one another and so to finance a certain standard of service by local resources requires not merely a greater expenditure per head in a poor than in a rich locality but a much more higher rate of tax. Hence local finance requires the combination of a carefully co-ordinated system of local taxes and grants".

Even though the various levels of government in a federal set up are not capable of distinctive demarcation in terms of their functions they have a clear operational range or territorial extension of power. Thus a federation is a system shaped by a complicated pattern of interaction in its spatial and temporal context. Localisation is a process under federalism which results in decentralisation of functions and powers to deal with socio-economic issues. It also results in administrative decentralisation as well as devolution of powers. The process of decentralisation involves the delegation of specified functions to the lower levels of governments. The process of devolution involves legal conferring of powers to discharge the functions assigned. The administration of functions at the local level helps to define the policies for developmental programmes on the basis of specific needs of the local area. Hence there has been deliberate and planned attempt to give more powers and to assign more
functions to local bodies. In this context, it is worthwhile to note the opinion of Henry Maddick, "Over time it would be expected that more services would be locally operated but even then there may have to be variations as national priorities change. Thus a particular function may become so vital that it is questionable whether the local authorities can provide sufficient concentrated effort, sufficient technical effort and sufficient finance to give effect to the priority that the national situation demands".

Another problem in the fiscal federalism is that there may be conflicts in the national interest and local welfare. "While the framework of fiscal federalism is intended to promote national welfare, the decentralisation process is supposed to promote national welfare i.e., the welfare of local citizens. Though the welfare of local citizens and national welfare can be reconciled, sometimes they do conflict with each other. For instance if a national policy is formulated keeping in view the overall national welfare, some local citizens instead of benefiting from such a policy, may have to bear the cost or suffer loss of welfare". However, such conflicts in a federal set up with multi government system can be resolved through proper management of fiscal transfer.

What is generally practised all over the world in a federal set up is not the decentralisation of planning and implementation of developmental activities. As it has been pointed out in the paper 'The Current State of local government finance and further issues' "Local government revenues and expenditures are in
practice controlled by the central government through its disbursement of various subsidies and grant-in-aid and so local governments have extremely little leeway to display their autonomy by adopting original policies”.9

The final report for the first local government conference on fiscal decentralisation held in Palestine made the following observation.

"The conference values the concerns and attention displayed by the ministry of local affairs towards establishing and developing the basis for fiscal decentralisation particularly for local government systems".10

This means that there have been attempts in many countries to have fiscal decentralisation for local governments “One of the most discussed aspects of the dramatic reform taking place in central and eastern Europe has been the decentralisation of the economy......... A second aspect equally critical is the decentralisation of government itself. Indeed a well functioning intergovernmental (decentralised) system is key to the achievement of most of the transition economies' major reform objectives”.11

2.3. Local Finance in the Indian Context

A number of committees and commissions have been constituted by the Government of India as well as the state governments to enquire into the various aspects of devolution of powers to local bodies. Before the passing of th 73rd Constitutional Amendment, different systems of local governments prevailed
in different states. A formal 3 tier system of Panchayati raj was proposed in India in 1959 following the recommendations of Balwantrai Mehta Committee. But the recommendations of the committee were not implemented in all states. Some states opted for 3 tier system, some for 2 tiers and yet others for just one tier. Some states did not introduce the system at all. This is because state governments were given options to choose the models according to their needs and requirements.

The recommendations of various committees on local government are conflicting. For instance while Balwantrai Mehta Committee recommended a 3 tier system of local government, the Ashok Mehta Committee suggested the abolition of Block as the unit of administration and recommended a 2 tier set up at the district and mandal levels.

However, with the passing of the 73rd Constitutional Amendment, representative democracy has been transformed into participatory democracy. The constitution of Gram Sabhas consisting of all adult members of a village Panchayat, gives 'voice' to the voiceless. This is expected to ensure face to face communication of all adult members forming the Gram Sabha. The national debate on decentralisation gathered momentum with the submission of Ashok Mehta Committee report and Dantwala report on Block level planning. The 73rd and 74th Constitutional Amendments passed by the parliament were the result of
this long national debate. These amendments constitute an important milestone in the history of decentralisation in India by giving constitutional status to Panchayati Raj institutions guaranteeing periodic elections to the local bodies and giving them more powers and functions in the planning process.

But the local bodies have not been given a vital role in the planning process in all the states. T.M. Thomas Issac and K.N. Harilal have rightly observed. “The general experience all over the country since the passage of constitutional amendment as evidenced by the cynical disregard of the constitutional provision for involving local bodies in the planning process does not provide much cause for enthusiasm”.

There is the need for an integrated approach for bringing together all development agencies to look into the problems at local level and for coordinating their activities to address the development problems.

2.4. Panchayat Finance and the 73rd Constitutional Amendment Act.

Article 243 H of the Act contains the provisions regarding the finances of Panchayats. It is as follows:

“The legislature of a state may, by law
a) authorise a Panchayat to levy, collect and appropriate such taxes, duties, tolls and fees in accordance with such procedure and subject to such limits.
b) assign to a Panchayat such taxes, duties, tolls and fees levied and collected
by the state government for such purposes and subject to such conditions and limits

c) provide for making such grants-in-aid to the Panchayats from consolidated fund of the state
d) provide for constitution of such funds for crediting all moneys received respectively, by or on behalf of the Panchayats and also for the withdrawal of such moneys therefrom as may be specified in the law."

Article 243 (I) provides for the constitution of State Finance Commission to review the financial position of Panchayats and to make recommendations to the governor.

For the proper devolution of powers and functions to Panchayats schedule XI has been added to the constitution to give an illustrative list of the subjects. It is given below

2.4.1 "Eleventh Schedule (Article 243 G)

1. Agriculture, including agricultural extension.
2. Land improvement, implementation of land reforms, land consolidation and soil conservation
3. Minor irrigation, water management and watershed development
4. Animal husbandry, dairying and poultry
5. Fisheries
6. Social forestry and farm forestry
7. Minor forest produce
8. Small scale industries, including food processing industries
9. Khadi, village and cottage industries
10. Rural housing
11. Drinking water
12. Fuel and fodder
13. Roads culverts, bridges, ferries waterways and other means of communication
14. Rural electrification including distribution of electricity
15. Non conventional energy sources
16. Poverty alleviation programme
17. Education including primary and secondary schools
18. Technical training and vocational education
19. Adult and non-formal education
20. Libraries
21. Cultural activities
22. Market and fairs
23. Health and sanitation including hospitals, primary health centres and dispensaries
24. Family welfare
25. Women and child development
26. Social welfare including welfare of the handicapped and mentally retarded

27. Welfare of the weaker sections, and in particular of the scheduled castes and scheduled tribes

28. Public distribution system

29. Maintenance of community assets”.

Because of the Amendment Act Panchayat's are vested with a lot of powers and money in the coming years. Panchayats have also a regular existence like any other democratic institution. They will have adequate administrative and financial powers for undertaking development programmes for the people living in rural India.

The Amendment Act has only provided a general guideline for the effective and efficient Panchayati Raj institutions in India. It granted Panchayati Raj institutions a constitutional status, uniformity by making a 3 tier system and elections to these bodies after every five years authorising the state election commission to conduct and supervise the same, more financial autonomy with the provision for setting up the state Finance Commissions. The stipulated deadline for completing the process of enacting fresh legislations by the states was 23rd April 1994. All the states except those which are exempted under the 73rd Amendment Act passed legislations to this effect before the deadline.
2.5 Local Finance in Kerala

Section 66 to Section 81 of the Kerala Panchayat Act 1960 and Section 195 to Section 217 of the Kerala Panchayat Raj Act 1994 contain the provisions relating to the finances of Panchayats.

2.6 Revenue Structure

On a close analysis of these two Acts, it becomes clear that the revenue structure of rural local bodies in Kerala has not undergone any basic change due to 1994 Act. It has the following components

1. Own Taxes
2. Assigned Taxes
3. Shared Taxes
4. Non-Tax Revenue (own-fund)
5. Grant-in-aid from the Government
6. Beneficiary Contributions
7. Loans from Government and financial institutions

2.6.1 Own-Taxes

Own taxes are the taxes assigned by the statute to the local bodies which are levied by the local bodies. Local level resource mobilisation has exceptional significance in the context of development from below. Income from taxes constitutes an important item of revenue of village Panchayat. A good system of Panchayat finance should be based on a sound system of taxation. Local
bodies can be made self-reliant institutions by broadening their tax base. The Royal Commission on decentralisation, however, has expressed an entirely different view “we consider it essential to the popularity and efficiency of the Panchayat system that it should not be associated with any new form of local taxation for the evidence shows that the imposition of taxation of this character has made such bodies as the existing unions and sanitary committees unpopular”.

But this does not mean that Panchayats should not be empowered to levy taxes altogether. Gram Panchayats in all the states are empowered to levy taxes. In Kerala, Gram Panchayats are empowered to levy the following taxes.

1. Building Tax
2. Profession Tax
3. Advertisement Tax
4. Entertainment Tax
5. Service Tax
6. Show Tax
7. Land cess
8. Land conversion cess

2.6.2 Building Tax

Both the Kerala Panchayat Act 1960 and the Kerala Panchayat Raj Act 1994 empower the village Panchayat to levy building tax. Accordingly village
Panchayat can in accordance with the rules prescribed for the purpose levy a tax on all buildings other than huts and buildings exempted by the provisions of the Acts, in the Panchayat area at such a percentage of net annual rental value of the building as may be fixed by the Panchayat by resolution. The maximum and minimum rate of tax has been given in the Act. The Kerala Panchayat Act 1960 fixes the maximum at 10% and minimum at 4% while the corresponding rates as per the Kerala Panchayat Raj Act 1994 are 10% and 6%.

For Government Buildings and buildings not ordinarily let out on rent, the annual rental value is calculated on the basis of present estimated cost of construction after providing for depreciation.

Certain categories of buildings are exempted from building tax. They are

i  Places of worship

ii  Free or charitable choultries.

iii Buildings of recognised educational institutions including hostels

iv  Protected ancient monuments

v  Burial and burning grounds

vi  Government property other than buildings as may be exempted by Government

vii Huts in Panchayats

viii Panchayat and Municipal properties
In addition to the statutory exemptions, government has issued orders from time to time exempting certain categories of houses like those under one lakh housing scheme, buildings for scheduled caste/scheduled tribe constructed by government or under J.R.Y. scheme.

The exemption under the 1960 Act to certain categories of buildings is no longer available under the Kerala Panchayat Raj Act 1994. They are the following categories:

1) Buildings which are attached to places of public worship and are used for residential or other purposes connected there with

2) Charitable hospitals and dispensaries

3) Buildings owned and occupied by unrecognised educational institutions

This change results in an increased amount of Building Tax of Panchayats

2.6.3 Surcharge on Building Tax

Section 208 of the Kerala Panchayat Raj Act 1994 empowers the Panchayats to levy surcharge on Building tax from the whole Panchayat area or any specified portion thereof to cover any unusual expenses incurred by it in respect of any project or plan undertaken. Such surcharge should not exceed 5% of the Building Tax. It is also specified that Panchayat should not levy more than two surcharges on building tax at a time.

There is provision in the Kerala Panchayat Act 1960 also for levying
surcharge on Building Tax. But the maximum rate prescribed is one fourth of the Building Tax.

2.6.4 Profession Tax

Profession Tax is imposed on work, service and other means of earning within the boundary of village Panchayat. Every village Panchayat can levy profession tax by virtue of section 204 of the Kerala Panchayat Raj Act 1994. This tax was leviable under the 1960 Act also. All individuals and companies doing business or engaged in a profession for not less than 60 days in a half year are liable to pay the tax at such rates as are fixed by the local body subject to the maximum rates prescribed by government.

Companies or persons engaged in business are assessed either on the basis of their income on which Income Tax or Agricultural Income Tax or both are assessed or if the profit is not ascertainable, on the basis of turnover.

Based on the report of the First State Finance Commission, the profession tax has been revised in Gram Panchayats. The following table gives the rates of profession tax.
2.6.5 Advertisement Tax

Village Panchayats are empowered to levy advertisement tax under section 209 of the Kerala Panchayat Raj Act 1994. There was no corresponding provision in the Kerala Panchayat Act 1960. Any kind of advertisement in the public or private places within the Panchayat area attracts this tax. However the publicity and advertisement of political parties cannot be taxed. Private institutions not included in the list of social organisations have to pay taxes for the advertisements using microphone at a rate fixed by the village Panchayat. The rate of this tax is subject to the minimum and maximum given in the eighth schedule.

Table 2.1

<table>
<thead>
<tr>
<th>Class</th>
<th>Half Yearly Income (Rs)</th>
<th>Maximum Half yearly Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Between 12,000 - 17,999</td>
<td>Rs. 120.</td>
</tr>
<tr>
<td>II</td>
<td>Between 18,000 - 29,999</td>
<td>Rs. 180</td>
</tr>
<tr>
<td>III</td>
<td>Between 30,000 - 44,999</td>
<td>Rs. 300</td>
</tr>
<tr>
<td>IV</td>
<td>Between 45,000 - 59,999</td>
<td>Rs. 450</td>
</tr>
<tr>
<td>V</td>
<td>Between 60,000 - 74,999</td>
<td>Rs. 600</td>
</tr>
<tr>
<td>VI</td>
<td>Between 75,000 - 99,999</td>
<td>Rs. 750</td>
</tr>
<tr>
<td>VII</td>
<td>Between 1,00,000 - 1,24,999</td>
<td>Rs. 1000</td>
</tr>
<tr>
<td>VIII</td>
<td>Above 1,25,000</td>
<td>Rs. 1250</td>
</tr>
</tbody>
</table>

Source: Economic Review, 2001
2.6.6 Entertainment Tax

The Acts governing the levy of entertainment tax are the Kerala Local Authorities Entertainment Tax Act 1961 and the Kerala Additional Tax on Entertainment and Surcharge on Show Tax (Amendment Act) 1975. According to section 200 of the Kerala Panchayat Raj Act 1994, entertainment tax can be levied by a village Panchayat. The rate can be fixed between the minimum of 15% and the maximum of 30% on the price of tickets. The additional entertainment tax can also be levied by Panchayats which is fixed at 60% of the entertainment tax.

2.6.7 Service Tax

Both the Kerala Panchayat Act 1960 and the Kerala Panchayat Raj Act 1994 contain provisions for levying Service Tax. Service taxes not exceeding such rates as may be prescribed for sanitation, water supply, scavenging, street lighting and drainage may be levied by village Panchayats with the sanction of the Director of Panchayats.

2.6.8 Show Tax

Show Tax is levied on 'exhibition' performed in the territory of Panchayats. 'Exhibition' includes any type of performance like dramatic performance, circus or any other type of show to collect money. Village Panchayats are authorised to levy show tax by the Kerala Panchayat Raj Act 1994 vide Section 4(1) under Section 200. The rates of show tax are prescribed
2.6.9 Surcharge on Show Tax

Village Panchayats are also empowered to levy and collect a surcharge on show tax at a rate of 25% of the Show Tax on every show.

2.6.10 Land Cess

Under Section 201 of the Kerala Panchayat Raj Act 1994, village Panchayats can levy a cess annually on every land in the Panchayat area other than those exempted by the government at a rate of $\frac{1}{10}$ % of the capital value of the land. There was a corresponding provision in the Kerala Panchayat Act 1960 where the rate leviable was 2 paise per annum for every 5 cents of land or part thereof. This is an optional levy.

2.6.11 Land Conversion Cess

According to Section 200B of the Kerala Panchayat Raj Act 1994, a village Panchayat can levy a cess on conversion of land from the owner of a land for the conversion of the land from one form to another. For example the paddy fields, marshy lands, ponds or watershed lands converted into estate or land for constructing building can attract land conversion cess. The rate of such cess can be fixed and levied by the Panchayat subject to a maximum of Rs. 75 per 'are' of such land converted.

The Kerala Panchayat Act 1960, empowers the village Panchayats to levy
vehicle tax also, in addition to the above taxes. Section 70 of the Act reads "The vehicle tax shall, subject to such rules as may be prescribed including rules relating to exemption and restrictions, be levied every half year on all vehicles kept or used within the Panchayat area at such rates as may be fixed by the Panchayat not exceeding the maximum rates prescribed". An explanation is also given to this section in the Act. Accordingly 'vehicle' does not include a motor vehicle as defined in the Motor Vehicles Act 1939.

2.6.12 Assigned Taxes

Assigned taxes are taxes which are statutorily assigned to local bodies but collected by the state government and made over to local bodies. A major source of local finance is the assigned taxes. Ashok Mehta Committee comments, "The assigned revenues constitute an important element of Panchayati Raj System". Under the system of revenue assignment, the entire net proceeds of certain taxes collected by the State Government is transferred to the local bodies. These are regular fiscal transfers to local bodies required under statutory provisions. Revenue from this source may help local bodies to solve their financial problems to a great extent. It is an assured revenue to the local bodies. Y.R. Naidu remarked "assigning independent and stable revenues is better and surer way of improving the finances of Panchayati Raj Institutions for meeting the changing needs of the local bodies".
In Kerala surcharge on Duty on Transfer of Property and Basic Tax are the two taxes assigned to local bodies.

2.6.13 *Surcharge on Duty on Transfer of Property*

State Government is empowered to levy and collect stamp duty on transfer of property by the Kerala Stamp Act 1959, subject to specified conditions. Section 71 of the Kerala Panchayat Act 1960 and Section 206 of the Kerala Panchayat Raj Act 1994 empower village Panchayats to levy a surcharge on stamp duty. The rates are however fixed by the state government and collection is made by the Registration Department.

**Table 2.2**

Rates of Stamp Duty and Surcharge Under the 1960 and 1994 Acts for Panchayats

<table>
<thead>
<tr>
<th></th>
<th>Stamp Duty</th>
<th>Surcharge</th>
<th>Registration fee*</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 1960 Act</td>
<td>6%</td>
<td>4%</td>
<td>2%</td>
<td>12%</td>
</tr>
<tr>
<td>Under 1994 Act</td>
<td>6%</td>
<td>5% **</td>
<td>2%</td>
<td>13%</td>
</tr>
</tbody>
</table>

*Source: Economic Review, 2001*

* - Registration fee is collected by State Government and is not shared with local bodies.

** - 5% is the maximum rate permitted. But the rate collected remains at 4%.
The surcharge is collected along with the stamp duty and 3% is deducted towards collection charges. Seventy five percent of the net amount collected from all Panchayats in the state is distributed among village Panchayats in proportion to their population and the remaining 25% distributed among village Panchayats in such proportion as may be fixed by government.

There are two basic differences between the Kerala Panchayat Act 1960 and the Kerala Panchayat Raj Act 1994 in this regard. They are:-

(a) The maximum rate of surcharge on duty on transfer of property was 4% under 1960 Act while it is 5% under 1994 Act.

(b) Under the 1960 Act, the collection from Panchayats were pooled on Taluk basis. Seventy five percent of it was distributed among village Panchayats of the Taluk on population basis after deducting 3% for collection charges. Under 1994 Act, state level pooling is done and 75% is distributed from the state pool after deducting 3% for collection charges.

2.6.14 Basic Tax

State Government is empowered to levy and collect basic tax or land tax under the Kerala Land Tax Act 1961. It is levied by the Land Revenue Department on all lands except those belonging to the Government and a few other exempted categories.

Under Section 67 of the Kerala Panchayat Act 1960, the Government was
required to pay annually to each Panchayat in the state a grant equal to three-fourth of the amount of basic tax collected by the Government in the last preceding year from that Panchayat area. The balance of the basic tax was required to be distributed to each Panchayat in such a proportion as may be fixed by the government having regard to the area, population, available resources and the needs of development of the Panchayats and the cost of Panchayat administration.

Under Section 202 of the Kerala Panchayat Raj Act 1994, the Government is required to pay annually to each Panchayat in the state a grant equal to 75% of the amount of basic tax collected by the Government in the preceding year from that Panchayat area. The balance 25% is required to be distributed among village Panchayats on the basis of area, population, available financial resources and the need of development.

Neither the Act of 1960 nor the Act of 1994, provide for deduction of collection charges by the Government. However, the Kerala Panchayat Basic Tax Grant Rules 1978 provides for the deduction of 3% towards collection charges and it continues to be in force. 3/8th of the basic tax is given to the village Panchayats, 3/10th to Block Panchayats and 1/5th to District Panchayats. The remaining 1/8th is credited to the Rural Pool. The distribution is as per the area of the Panchayat concerned, except in the case of Rural Pool.
The Estimates Committee (1982-84) had recommended the entrustment of collection of land revenue to Panchayats. But the Government is not in favour of that. The views of the Government in this regard has been given by the State Finance commission “The Basic Tax can be collected only by an agency which is keeping the basic land records. It is based on the land records that tax is being collected now. Therefore if the tax is to be collected by the Panchayat, the village records will also have to be transferred to the Panchayat. Alternatively, the village office should send the details of the village records to the Panchayat for collection of tax or the Panchayat officials should be allowed to go through the village records maintained in the village office. This is not a practicable proposition as it involves delay and time consuming process.” Hence the State Government is collecting the basic tax and distributing it to the Panchayats.

2.6.15 Shared Taxes

Taxes which are assigned to the State Government and collected by it, but a share of the proceeds is distributed among local bodies are referred to as shared taxes. Motor Vehicle Tax is the only tax shared by the State Government with village Panchayats in the state.

According to Section 19 of the Motor Vehicle Taxation Act 1976, the State Government should give to each local body from the proceeds of the tax collected under the Act every year, such compensation as may be fixed by Government in accordance with such principles as have been prescribed.
According to Motor Vehicles Tax Rules 1975, the collection charges and administrative costs for the control of motor vehicles shall be deducted from the receipts of Motor Vehicles tax and the net proceeds be divided between Government and local bodies on the basis of the recommendation of a committee appointed by the Government. Panchayats and municipalities get grants from Motor Vehicles Tax known as Vehicle Tax Compensation (VTC) for maintenance of roads. At present 20% of the net collection of Motor Vehicle Tax is distributed among Village Panchayats and Urban Local Bodies as per road length according to the formula based in unit length of roads given in the table 2.3

Table 2.3
Calculation of Road Units for Distribution of VTC
(Basic unit = 1 KM of gravelled road (Unit cost Rs. 3000))

<table>
<thead>
<tr>
<th>Type of Roads</th>
<th>Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cement concrete : Double Lane</td>
<td>1.6</td>
</tr>
<tr>
<td>Cement concrete : Single Lane</td>
<td>0.8</td>
</tr>
<tr>
<td>Black topped : Double Lane</td>
<td>10.6</td>
</tr>
<tr>
<td>Black topped : Single Lane</td>
<td>5.3</td>
</tr>
<tr>
<td>Metalled road : Double Lane</td>
<td>7.5</td>
</tr>
<tr>
<td>Metalled road : Single Lane</td>
<td>3.7</td>
</tr>
</tbody>
</table>

Source: Economic Review, 2001

2.6.16 Non-Tax Revenue (Own-fund)

Non-Tax Revenue consists of license fees registration fees, permits, gate fees, other fees, service charges, donations and income from properties owned
by the Panchayat. The State Finance Commission observes "This is not an insignificant source of Revenue for local bodies and in 1993-94, this contributed to 12% of the income from own sources of the Panchayats and 21% of the income of municipalities".

Licenses are to be obtained for conducting private markets, having private cart stands, private slaughter houses, using of places for dangerous and offensive trades, establishment of factories, workshops or workplace, installing machinery, constructing buildings keeping dogs or pigs in the Panchayat area, for the occupation of 'poromboke' lands vested with Panchayats for the permanent and temporary cinema theatre, for places of public resort and for the manufacture and sale of certain food articles. Panchayats also levy fees from public markets, car stand, slaughter houses etc. run by the Panchayats.

Registration fees can be levied from private hospitals, private paramedical institutions lodging houses and for births and deaths.

The major item of revenue under this head is the income from properties owned by the Panchayat.

2.6.17 Grant-in-aid From Government

A payment by the higher Government to lower government for assisting the latter in performing its activities is termed as grant-in-aid. In this context, it is the grant received by the local bodies from the state government. It is an
outright financial assistance to the local body, though in certain cases, it has strings tied in the form of terms and conditions for its utilisation. In India local bodies have been depending on grants from the State Government. Ashok Mehta has remarked, "Grants from the State Governments are a major source of income to the Gram Panchayats and the bulk of the receipts of Zilla Parishad and Panchayat Samiti are in the form of grants".19

But the system of grant-in-aid is not without disadvantages. To quote Henry Maddick "There are two major difficulties about the giving of grants to local authorities. The first is the temptation to rely all the time on money from the central government ....... The second major difficulty is that to ensure some prudence in expenditure, central ministries may insist on such a very tight control of the grant-in-aided service that independence of action and even thought by the local authority is inhibited if not stifled"20

Grant-in-aid to local bodies can be justified on certain grounds. It can compensate the local governments for the shortage of local resources at their disposal. It also helps local bodies to meet the varying expenditure needs. It facilitates the implementation of specific projects and programmes which needs management at the local level. The structure of grant-in-aid must be constantly reviewed so that they are judiciously allotted to local bodies. For example, if a specific grant has served its purpose, it can be eliminated. There are various types of grant-in-aid. They are the following.
2.6.18 Percentage Grant

It is the most usual grant. When the government finances a certain specified portion of the expenditure of a certain service or project or programme, it is known as percentage grant.

2.6.19 Matching Grant

It is a kind of percentage grant, but it is provided as an incentive to augment the resources of local bodies. For example, a grant equal to a certain percentage of building tax collected by village Panchayat can be given to it.

2.6.20 Unit Grant

This grant is given for each unit of specific service provided by the local body. Grant given for every kilometre of road maintained is an example of this type of grant.

2.6.21 Formula Grant

It is a grant calculated on the basis of a formula based on certain factors like population, poverty etc.

2.6.22 Establishment Grant

For meeting a certain portion of establishment expenses, grants can be given which is termed as establishment grant. For example, grant is given to the Panchayat to meet a certain percentage of salaries of the Panchayat personnel.
2.6.23 *Stimulating Grant*

It is given to encourage a local authority to undertake a new function or provide a service which has been adjudged by the state legislature or parliament as of national importance.

2.6.24 *Compensation Grant*

These are the grants given by one layer of government to another for the loss incurred by the latter on accounts of surrendering the tax rights to the former or on account of the financial burden imposed on the latter by the former.

2.6.25 *Equalisation Grant*

In certain cases grants are specially provided to backward areas to upgrade the area or raise the standard of living of the weaker sections. This is an attempt to equalise the economic status of the people of different Panchayats. Hence it is known as equalisation grant.

2.6.26 *Conditional Grant*

Conditional grant carries certain restrictions attached to its use. The higher authority giving the grant would assess the requirements of local bodies and provide grants for meeting such specific requirement.

2.6.27 *Unconditional Grant*

Unconditional grant does not carry any restriction for its use. The local bodies receiving such grant can use it judiciously for the welfare of the people
of the area under them. This grant is appealing to local authorities as they have the freedom to decide how it is to be spent.

2.6.28 Grant-in-aid and Gram Panchayats in Kerala

The State Finance Commission has schematically expressed the grant-in-aid from State Government to local bodies, which is given below.\textsuperscript{21}
Fig. 2.1 Chart showing Grants from State Government to Local Bodies

Grants from State Government to Local bodies

Plan Grants

- New grants for transferred development responsibilities under KPRA 1994 & KMA 1994

Non-plan Grants

- Old grants being given even prior to KPRA 1994
- New grants for transferred non-plan activities under KPRA 1994 and KMA 1994
- Old grants being given even prior to KPRA 1994 and KMA 1994

Statutory grant

- Specific purpose
- General purpose

Non-statutory
Plan grants and non-plan grants have been given to Panchayats even prior to Kerala Panchayat Raj Act 1994. In addition to such grants still being given to Panchayats, new plan grants for transferred development responsibilities and new non-plan grants for undertaking transferred non-plan activities under the new Act are also being given. The old plan grants are untied plan funds which the State government has been giving to local bodies since 1990. The new plan grants are those required for development projects under schedule 3, 4 and 5 of the Kerala Panchayat Raj Act 1994.

The plan fund given to the Panchayats forms an effective tool imparting freedom to them to initiate development programmes and projects relevant to the local area. Before the initiation of the decentralised planning, the plan funds given to the Panchayats have been significantly lower than those given after the decentralised planning.

A direct role in planning was given to the local bodies for the first time in 1996-97 following the recommendations of Sen Committee. The State Government decided to provide every village Panchayat with an untied plan grant. The Panchayat could utilise this grant according to their own priorities.

2.6.29 Criteria for Distribution of Plan Grant-in-aid

The distribution of the grant-in-aid during 1997-98 was made within the different tiers of local bodies, using population criteria alone. From the next
year a major change was introduced in the criteria for the distribution of plan grant-in-aid. A composite index was evolved taking into consideration, in addition to population the geographical area, area under paddy, own income of village Panchayat, composite index of agricultural labourers, persons engaged in livestock, fisheries and marginal workers and a composite index of backwardness. The details are presented in the following table.

**Table 2.4**

**The Criteria for Intra Tier Distribution of Plan Grant-in-aid**

<table>
<thead>
<tr>
<th>Indicators</th>
<th>Gram Panchayat</th>
<th>Block Panchayat</th>
<th>District Panchayat</th>
<th>Municipality corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Population (Excluding SC/ST)</td>
<td>65</td>
<td>65</td>
<td>55</td>
<td>75</td>
</tr>
<tr>
<td>2. Geographical area (Excluding area under forest)</td>
<td>5</td>
<td>10</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>3. Area under paddy</td>
<td>5</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>4. Own income of Gram Panchayat</td>
<td>10</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>5. Composite index of Agricultural labourers persons engaged in livestock, fisheries etc. and marginal workers</td>
<td>15</td>
<td>25</td>
<td>20</td>
<td>--</td>
</tr>
<tr>
<td>6. Composite index of backwardness/houses without latrine and houses without electricity</td>
<td>--</td>
<td>--</td>
<td>10</td>
<td>20</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

In the distribution of plan grants under SCP/TSP (Special Component Plan and Tribal Sub Plan) greater weightage was assigned to the village Panchayat. The ratio is 40:20:40 for village Panchayats block Panchayats and district Panchayats.

2.6.30 Grants for the Management of Institutions

A number of institutions have been transferred to local bodies with related posts and staff by the government of Kerala. The list of institutions transferred are given by the government. The state government has transferred funds also to the village Panchayat for the management of these institutions.

2.6.31 Funds for Centrally Sponsored Schemes

Jawahar Rozgar Yojana (JRY), a centrally sponsored scheme has been implemented in all the Panchayats in India except those in the union territory of Delhi and Chandigarh. The main objectives of the scheme were to create additional employment and durable community assets.

A committee was set up under the chairmanship of Prof. S.R. Harshim, Member, Planning Commission to review the centrally sponsored scheme for poverty alleviation and employment generation. On the basis of the recommendation of the committee, it was decided to implement the scheme only at the village level to create village infrastructure. So the scheme was renamed as Jawahar Gram Samridhi Yojana (JGSY).
The mode of devolution of JRY funds was explained by the State Finance Commission. "The JRY funds allotted to different states is on the basis of the proportion of rural poor in the state to the total rural poor in the country and from the state level, it is given to districts on the basis of an index of backwardness computed by giving equal weightage to the proportion of rural SC/ST population in the district to the total SC/ST population in the state and the inverse of per capita production of the agricultural workers in the district"\textsuperscript{23}

\textbf{2.6.32 Pension Funds}

From the Financial year 1996-97 onwards, Gram Panchayats have been assigned the function of distributing certain pensions and allowances such as old age pension, widow pension, disability pension, agricultural workers pension and unemployment allowance. The State Government is giving funds to village Panchayats for the distribution of such pensions and allowances. It is not a revenue to the Panchayat in the strict sense because the Panchayat is receiving pension amounts to distribute it to the beneficiaries and the former is acting as an agent of the state government for the distribution of such funds. However, it is a cash receipt to the village Panchayat and the amount distributed as pensions and allowances can be taken as payments, if not an expenditure.

\textbf{2.6.33 Beneficiary Contribution}

Contribution from the beneficiaries of the schemes implemented by the Panchayat contribute a source of income to the Panchayat. This form a part of
non-tax own revenue of Panchayats. The amount of such contribution is substantial during the people's plan campaign.

2.6.34 Loans

Local bodies have the power to borrow as they are corporate bodies with power to sue and be sued. The loan taken by the local body is not an income, but is a capital receipt.

Local authorities should be encouraged to start remunerative enterprises or schemes so as to enhance their non-tax revenue. But the establishment of such enterprises requires huge capital investment. This capital requirement can be met by borrowing funds from higher tiers of Panchayats or from banks and financial institutions.

However, borrowing for non-remunerative purposes should be discouraged as the local authorities will find it difficult to repay the loan and its interest.

2.7 Expenditures

The emergence of a new social and economic order necessitates a rapid increase in the quantum of expenditure of local governments. The decentralised administrative set up for balanced economic development leads to enhanced local government expenditure. A glance through the expenditure pattern of the local bodies in India since 1960, makes the point very clear "So long as we do
not discover or create representative and democratic institutions which supply the local interest, supervision and care necessary to ensure that expenditure of money upon local objects conforms with the needs and wishes of the locality, invest it with adequate powers and assign to it appropriate finances, we will never be able to evoke local interest and excite local initiative in the field of development."\textsuperscript{25}

So local authorities should be assigned additional responsibilities for the social and economic development of the area under their jurisdiction which necessitates additional expenditure. The rural local government should provide the basic amenities in rural areas in the same manner as the urban local governments serve the urban people. "In most of the developing countries in recent years, the rural local authorities have acquired considerable importance as an agency of planning and development at the local level and thus have witnessed a remarkable expansion in the scope and magnitude of their activities".\textsuperscript{26}

In India with the enforcement of the 73\textsuperscript{rd} constitutional (Amendment) Act and the consequent Panchayat Raj legislations in various states the Panchayats have been given more functions for which they have to incur more expenditure. Panchayats have been given more funds to spend for the development of the area under their jurisdiction.
In Kerala, with the initiation of 'Peoples Pan Campaign' in 1996, more powers are assigned to Panchayats. The main items of expenditure of village Panchayats in Kerala are the following.

2.7.1 Management and Collection Expenditure

The Panchayats pay salaries and allowances to their administrative staff and collection staff. They also pay honorarium, sitting fee and travelling allowance to the members of the Panchayat committee. Expenses are also incurred for the day to day administration and for the collection of taxes and fees. All these come under the head 'Management and collection expenditure'.

2.7.2 Public Works and Infrastructure

Public works and infrastructure such as construction and maintenance of roads, bridges, culverts and buildings, capital expenditure on sanitation, drainage, water supply, and street lighting constitute the main development activity of the local bodies. They are the biggest component of expenditure of Panchayats in Kerala in most of the years.

2.7.3 Expenditure on Social Services

Providing Social Service is one of the functions of local bodies. Hence Panchayats have to spend considerable amounts for social services. Many items come under this head. They are the following.

i Expenditure on public health services and safety measures such as
vaccination destruction of dogs, pigs and rats anti mosquito measures
prevention of food adulteration, establishment and maintenance of burial
grounds, disposal of unclaimed dead bodies and fire fighting.

ii  Purchase of land for landless labourers

iii Cost of construction of houses to the landless labourers

iv  Maintenance cost of houses under 'one-lakh housing scheme' and colonies
    of scheduled castes.

v   Subsidies to the Kerala Housing Board and Nirmithi.

vi  Construction of latrines to the villagers and the subsidy for the same.

vii Amount spent for family welfare schemes.

viii Expenditure for thatching the houses of poor families.

ix  Uniform to the poor school children

x   Street lighting.

2.7.4 Expenditure in Productive Sector

Panchayats are empowered to spend for the development of productive
sector, especially for the development of agriculture. Expenditure for the
development of fisheries, animal husbandry and cottage industries also from part
of this item.

2.7.5 Expenditure on Education and Culture

Amounts spent by the village Panchayats for the promotion of education
and culture fall in this category. Establishment charges of educational
institutions, the remuneration to teachers, 'ayas', and wardens given by the Panchayat and any amount spent or grant given by the Panchayat for the repairs and maintenance of such institutions fall under this head. The awards and scholarships given to the students by the Panchayat are also included. Establishment expenses of libraries, community halls and amount spent or grants given by the village Panchayat for the functioning of educational institutions libraries and arts and sports clubs may be taken as expenditure on culture. Total expenditure incurred by the Panchayat for distributing books and newspapers to the libraries and reading rooms of Panchayats or of the voluntary organisations and contributions to memorial and cultural institutions also form part of this item.

2.7.6 Expenditure on Panchayat Properties

Village Panchayats may own certain properties for which it has to spend money. Land, building, shopping complex, vehicles, tourist Bunglow, Rest house etc., are the Panchayat properties usually owned by Panchayats. Panchayat may spend money as capital expenditure on account of capital investment for acquiring such assets or it may spend a revenue expenditure for the repairs and maintenance of such assets.

2.7.7 Debt Heads

Refund of earnest money or security including those on shop rooms or building let out by the Panchayat, library cess and repayment of loan - principal
amount and interest - come under debt heads.

2.7.8 Management of Institutions

Gram Panchayats have to spend money for the management of institutions transferred to it by the state government. The state government provides separate fund to the village Panchayats for meeting the expenditure in this connection.

2.7.9 Pensions

From the financial year 1996-97 onwards, Gram Panchayats are acting as agents to disburse certain types of pensions and allowances. They are receiving the funds from the state government for the same and distributing them to the deserving persons under their jurisdiction. It is a cash outflow to the Gram Panchayat though not a real expenditure.

2.7.10 Annual Budget

The budget is a powerful tool of financial management. It is a detailed plan of operations for some specific future period. It is true in the case of a local body also. If the local body is to function rationally, it must have a budget of receipts and payments. The main characteristic of a local budget is that it fixes the rate of local taxation and the purpose to which the proceeds from taxation shall be applied. It enables the local bodies to review its policies and avoid lopsided development of services.
A good budget should make provision for unforeseen circumstances also. It should provide an efficient yardstick to secure efficient and economic administration. But in the case of a local body, budgets are not always effective. To quote Henry Maddick “There are three factors that stand in the way of proper budgeting. First, grants for plan and other development schemes are decided by the state governments and later known to the local authorities. Since these grants are not often known before the preparation of their budgets, the council makes arbitrary estimates in their budget provisions to strengthen their case for grants. Secondly the interlocking system of the Panchayat raj bodies involve many joint operations ....... Thirdly, estimates of taxes and other dues included in the budget fall short in actual collection which makes the budget provisions unreal and planning a farce”.27

However, it does not in any way reduce the importance of budgeting in local bodies. What is required is to find ways to make budgeting an effective tool to control cost and attain efficiency in the management of funds. “To remedy these confusions and anomalies the imperative need is speedy and timely communication between them and the state government. These problems also highlight the need for competent well trained account staff - a point emphasised by the study group on Budgeting and Accounting Procedures”.28

The provision relating to the preparation of the budget are contained in
Section 78 of the Kerala Panchayat Act 1960 and Section 214 of the Kerala Panchayat Raj Act 1994.

According to the Kerala Panchayat Act 1960, the executive authority shall prepare the budget in the prescribed form showing the probable receipts and expenditure during the following year and forward it to the Deputy Director of Panchayats for scrutiny. If the deputy director is satisfied that adequate provision has not been made in the budget, he can modify it to secure such provision and return it to the executive authority. The Panchayat shall consider these observations and pass the budget.

According to the Kerala Panchayat Raj Act 1994, after considering the estimates and direction of the personnel handling the respective subjects and the secretary, the standing committees concerned must prepare budgets and submit them before January 15 every year to the Finance Standing Committee. Taking into account the provisions of the Act regarding the preparation of budget and the estimates and directions received, the finance standing committee must prepare a budget. The budget so prepared must be placed before the special meeting of the Panchayat committee before the expiry of the first week of March, for approval. The committee may pass the budget with or without amendments. After passing the budget by the Panchayat committee, the copies of the same must be given to the state government, the officers assigned by the government for this purpose and auditors. Copies of the budget passed must
also be given to the district Panchayat and district planning committee. As per the Act a Panchayat cannot spend an amount in excess of what is earmarked in the budget for a certain purpose. If the budget is not passed before 1st April of the financial year the Panchayat cannot spend any amount.

2.7.11 Accounts

The Government of Kerala, by a notification, issued the Kerala Panchayats (Accounts) Rules 1965. Accordingly, “The executive authority shall maintain Account Registers in the forms prescribed for the purpose to show the opening and closing balances as well as the current and the progressive receipts and charges for each month and for the whole year. The transaction for each month shall be posted and the account for each month closed in the concerned register not later than the tenth day of the succeeding month: provided that the account for the month of March and for the whole year may be completed not later than the tenth day of May following”.29

The annual financial statements should be prepared. The annual statement approved by the Panchayat together with the Annual Demand, Collection and Balance Statement and Certificate of Balances and other statements prescribed by the Director of Panchayats shall be forwarded to the Auditors and the District Panchayat Officer not later than 15th day of June following.
The provisions relating to the maintenance of accounts are contained in Section 215 of the Kerala Panchayat Raj Act 1994. As per the section, Panchayat should keep account books and other books related to them and also should prepare an annual statement of account in the prescribed form.

2.7.12 Audit

Huge amounts of public funds are spent by Panchayats. Hence there should be a proper system of auditing the accounts of Panchayats. Sen Committee's opinion regarding audit is to be noted. "In the context of devolution of funds, audit of local bodies assumes much importance. Audit is not to be viewed as an instrument of control by the state government. It is to be seen as an impartial professional support system, working as an antenna of the public keeping track whether the use of public funds is according to accepted laws, procedures and conventions".30

Kerala Panchayat (Audit) Rules 1963 contains the rules related to the audit of accounts of Panchayat. Section 79 of the Kerala Panchayat Act 1960 contains the provisions related to the appointment of auditors. As per this section, the government shall appoint auditors of accounts of receipts and expenditure of Panchayat fund. It is also stated in the Act that no contribution shall be recovered by the government from the Panchayat towards the pay and allowances of such auditors or towards any other expenditure involved in the audit of the accounts of the Panchayat.
The constitution (73rd Amendment) Act 1992 states "The legislature of a state may, by law, make provisions with respect to the maintenance of accounts by the Panchayats and the auditing of such accounts".31

Section 215 of Kerala Panchayat Raj Act 1994 contains the provision regarding the audit of accounts of local bodies. Accordingly, the examiner of local fund accounts and the persons nominated by him shall be the auditors of Panchayat. Auditors should examine the books of accounts every year or a shorter period. They should prepare an audit report after completing an audit and give it to the Panchayat concerned. Copies of the same must also be sent to the authorities appointed by the government for receiving the same. Thus the audit is carried out by the government through one of its department – the Local Fund Audit Department.

Auditing by Accountant General is also done in addition to the above mentioned audit.

2.7.13 Performance Audit

The Sen committee recommended the creation of performance Audit system for carrying out an online corrective audit on a regular basis. This recommendation has been accepted by the government and is operationalised.32

This type of audit is done to monitor and evaluate continuously the implementation of programmes and projects. "Performance auditing, also tuned
as comprehensive or full scope auditing encompasses by efficiency, effectiveness and impact of programmes and projects as well as the traditional post auditing of revenue and expenditure. It is the audit of three 'E's, viz., Economy, Efficiency and Effectiveness of various projects and programmes".33

There is also the social audit to be done by Gram Sabhas. "Social audit is an independent evaluation of the performance of an organisation as it relates to the attainment of its social obligation".34 It is an examination of the administrative system from the point of view of the people in general for whom the administrative system is existing.

2.8 Conclusion

The role of local bodies is the socio-economic development of our nation has been constitutionally recognised. Panchayat are to be strengthened as institutions of self government and not merely an agents of state plan implementation. The State Finance Commission's observations is apt. "The most important sinews of a local body are its financial resources. Government grants both statutory and non-statutory, will play an important role in the financial health of the Local Bodies. It is therefore essential that state government put in position suitable and necessary institutional safeguards to protect the financial resources of local bodies".35 However, no amount of finance is going to be adequate to Panchayat unless financial discipline is
observed by them.

The Kerala State Government resolved to provide higher plan allocation for local bodies for the year 1997-98, the first year of the 9th five year plan. It decided to earmark 35-40% of the state plan outlay for the project and programmes drawn up by the local bodies. It launched a 'people's campaign for ninth plan' to ensure that local bodies prepare their local plans in a participatory time bound manner. Thus from 1997-98 onwards, there has been a wide variation in the revenues and expenditures of Panchayats in Kerala.
Notes and References


24. For a deep analysis, it has been taken separately in the study.
25. Report of the study team on community projects and extension services N.D. vol. 1., p. 70.


