CHAPTER II

THEORETICAL FRAMEWORK AND REVIEW OF LITERATURE

I

Theoretical Issues

Economic theory holds that decentralised decision-making optimises the outcomes (Pareto) and ensures the well-being of all those who are likely to be affected by such decisions. The rationale of this premise is also derived from the political (democratic) imperative that all of those whose interests are affected by decisions ought to take part in the decision-making process. When everybody takes part in decision-making, self-interest is supposed to guide to arrive at decisions that are consistent with one's own good. This logic provides the theoretical basis for the evolution of decentralised political institutions like Panchayat Raj bodies, which are seen as institutions that promote decentralised decision-making (Aziz, 1995:9).
Many theoretical issues crop up while speaking on decentralisation. The term 'Decentralisation' has many aspects such as political, functional, administrative and financial. This is true even in all the democratic elected institutions like State and Union governments. With regard to financial issues of local governments, they should be treated on par with the State and the Union in the matter of financial powers. The theory of multi-unit fiscal system can be adopted in this case too (Babu, 1996:54).

Thus, the theoretical issues of decentralisation can be grouped into four, based on four schools of thought of different scholars. They are:

1. Fiscal Federalism (Oates, 1972)


4. Political Economy (Rondinelli, McCullough and Jonald, 1989)
Since this study pertains to financial aspects of PRIs, the theoretical issues confine to Fiscal Federalism, Public Finance and Public Administration theories.

According to Fiscal Federal approach, local level planning provides cost efficient public services, because it considers local preferences more carefully than the plan made by Central government (Oates, 1972; Rao, 1996). It determines the system of charging tax revenues and public expenditure commitments between the Central government and Sub-National governments. It allows better matching of public goods supply to local preferences, increases social welfare for general consumer surplus as well as lower organisational costs. Under decentralised fiscal system, the local jurisdiction collects all taxes from various local sources and according to these collections, it undertakes development programmes for the people. The possibilities for welfare gains through decentralisation are further enhanced by the phenomenon of consumer mobility. As Charles Tiebout has argued, in a system of local government, a consumer can to some extent select as his place of residence a community that provides a fiscal package well suited to his
preferences. One can envision a system of local governments where, for example, each community provides a different level of consumption of public goods and in which consumer by "voting on foot" selects the community that provides the level of public output that best satisfies his taste. It also shares tax revenues and public expenditure between highly developed and less developed regions.

Public Finance and Public Administration theorists take a different perspective on decentralisation than neo-classical economists using public choice theories. Public Finance and Administration theories have focused heavily on identifying the sources of local government revenue, assessing the equity and strength of those revenue sources, examining the dependence of local governments on Central government transfers, identifying bottlenecks in the system of revenue generation and financial management and examining mechanisms to stimulate greater local resource mobilisation. Overall, there has been much greater emphasis on revenue generation than on expenditure controls.
From the above, it is clear that the decentralised local governments are democratically elected institutions and should govern like 'self-governments'. For this, besides, others should have some degree of 'fiscal autonomy'. That is to say, they should have own taxation powers, grants-in-aid and other resource raising powers. In other words, they should not depend too much on the higher-level governments for its financial needs. If these institutions have their own revenue raising powers, then they would be in a position to raise resources efficiently and spend the same effectively. This advantage is due to closeness of these institutions to the masses and it is expected that the people would involve themselves in all activities of these institutions, i.e., paying taxes regularly, contributing for the community's development, participation in plan process and implementation of plan programmes/projects.
II

Review of Literature

A plethora of studies on Indian Panchayat Raj bodies are available since local governing system i.e. village administration was there right from ancient days. The studies pertain to evolution/historical aspects of panchayats, the working and participation levels of the elected representatives and people in the panchayat governance, on the extent of powers and functions delegated to these bodies. However, studies relating to fiscal decentralisation, i.e., financial aspects of panchayats are scanty. Only in recent years that the scholars and experts have shown interest in the study of finances of these institutions. Some of the studies made on this subject are available in the form of reports, books and articles. Again, some of these studies may be termed as general as they cover varied aspects such as powers and functions, the democratic nature, participation, resources etc. On the other, some studies focus on one or two specific issues. Further, the literature can be categorised into all India and state specific studies.
In this section, a review has been made on some of the important studies carried out on panchayats. First, it reviews the general studies covering all aspects of panchayats, second, general studies on financial aspects of PRIs, and third, studies pertaining to finances of PRIs of Karnataka state.

a. General Studies

A study made by Venkatarangaiya and Pattabhiram (1969) brings out that local self-government in ancient India was far more widespread, more real and more successful than in the days of British rule or even at present. Further, the study concludes that in those days the conditions were favourable to the panchayats to function freely and effectively and there was no interference from the Central or provincial governments because the control and authority exercised by the government over village affairs were minimal.

A historical study of panchayats by Tinker (1976) brings out the fact that new phases of the local institutions actually started with the
coming of Mughals, the period of anarchy following the collapse of the dynasty, establishment and consolidation of British rule in India. The old system gradually started losing its grip with the interference of Central government in its affairs. The Mughals had interfered very little with the ancient customs of village government. During the Mughal period the villages were controlled by strong headmen and it was the rule of one man. The panchayat was not fully representative in character. Most of its members came from the founding families or from the Brahmins and superior cultivators. The menials and landless men had almost no say in the panchayat affairs. Thus, during the Mughal period in India local governments were controlled by the powerful leaders and there was no democratic structure and rule.

A study by Drummond (1937) also supports the above conclusions. According to this study, the panchayats did not have any universality during Mughal period because mostly villages were ruled by landlords or their agents exercising quasi-feudal authority. This was also prevalent in so called ryotwari provinces. The same dismal feature continued with the establishment of British rule in India. Panchayats
were given least importance in the administration, which, in turn, led to the disruption in the village community life. Slowly, these institutions started losing their self-government character which was the feature of the ancient village government system and led to near extinction. The state authority became highly centralised and the villages were dealt directly instead of through its assembly or the panchayat. Special programmes like construction and maintenance of irrigation works, relief works, laying of roads and payment of grants-in-aid to schools were implemented by the state. And then onwards, the villages began to look to the Central/provincial governments for more and more help.

A study by Aziz and others in Karnataka (2000) focuses on planning abilities of the panchayats. The study reveals that the participation levels of both elected representatives and the public in the planning process were very low. The functionaries lacked knowledge on the processes involved in decentralised planning. Again, it brings out that the grama panchayats heavily depended upon the grants from the higher level governments as the share of their own resources in the total revenues was very limited. It strongly suggests the need for capability
building of functionaries before expecting any results from these local democratic governments.

Recently, a comprehensive study on the working of PRIs in three southern states was made by Aziz, *et al* (2002). This is a comparative study of PRIs in Andhra Pradesh, Karnataka and Tamil Nadu. The study brings out the evolution of PRIs in these three states, the present status, i.e., situation after the 73rd Constitutional Amendment Act. It concludes that PRIs in Karnataka are bestowed with larger powers and functions and resources compared to Andhra Pradesh and Tamil Nadu. Further, it states that Tamil Nadu stands last in the above aspects. With regard to finances, it brings out that in all the three states village/grama panchayats have been given some tax powers. Further, in Andhra Pradesh and Tamil Nadu the three-tiers receive a share in certain state taxes. This is not so in the case of Karnataka. The study also reveals that the resource mobilisations by the grama/village panchayats are not up to the desired level.
b. Studies on Finances other than Karnataka State

Rao’s study in Gujarat state has brought out various aspects of revenues and expenditures of PRIs. The major findings of the study are that: there was a transfer of a large number of functions to the district and taluk panchayats; there was also a transfer of the entire land revenue to the PRIs, besides the statutory transfers, and grants for salary and training purposes. Another notable information from the study is that the position of recovery of taxes was not satisfactory. Yet another point to be observed from the study is that Taluk Panchayats in a district together had a major share in the revenue receipts compared to the district panchayat (Rao, 1982a:387-444).

A study of finances of PRIs in Orissa state by Rao between 1958-59 and 1980-81 unfolds various interesting findings. The results show that about 17 per cent of village panchayats enjoyed an annual income of more than Rs. 10,000. Grants-in-aid was the main source of income for Grama Panchayats. With regard to Panchayat Samithi, the average revenue per samithi per annum was about 12.5 lakh in the late 1970s.
Coming to the expenditure, a little more than half was spent on developmental activities. Among these two-fifths of the expenditure was on construction and maintenance of roads. The study has made one important recommendation and that is the collection of taxes needed to be geared up (Rao, 1982b:950-985).

Singh conducted a study on financial aspects of PRIs in the year 1997. The study indicates that some tax powers were given to PRIs particularly to grama panchayats. The important taxation powers vested were house tax, profession tax, vehicle tax, surcharge on agricultural land, pilgrim tax, tax on fairs, festivals and entertainment tax, tax on cattle, sanitary and drainage tax, lighting tax, water tax, tax on fisheries etc. The vehicle tax was been identified as a compulsory tax item by the panchayats. Motorised vehicles were exempted from the panchayat jurisdiction. Further, it states that most of the panchayat Acts provided for a surcharge on stamp duty on immovable property. This is considered to be a potential item for the panchayats to augment its income. This study also states that the taxation powers given to different tiers of panchayats in different states were not uniform. Some state
Acts have bestowed limited taxation powers to PRIs. By and large, tax assignment was not liberal and a majority of taxes assigned was of the traditional type. Notwithstanding the fact that panchayats had to depend upon the devolution from the State or Union government as a democratic institution they had to raise their own resources so as to enjoy some degree of financial autonomy.

Pillai (1986) examines the functions and finances of the panchayats in Kerala and identifies the shortcomings in the then existing set up. He has developed an alternative criteria for fiscal transfer between the state and the panchayats on the basis of their need and fiscal capacity. He also analyses the sources and the structure of revenues and the performance of expenditure of all the panchayats in Kerala using time-series data. The interesting findings of this study are:

- The panchayats in Kerala were leaning more and more on their own resources. Among the resources, tax revenue formed the largest proportion.

- Grants-in-aid formed the most important item in the state's devolution of funds to the PRIs.

- The existing system of grants-in-aid did not help in reducing inter-panchayat inequalities in their revenues.
Bohra's study (1996) points out that for financing the Panchayati Raj Institutions, the three important sources are- tax assignment, sharing of taxes and grants-in-aid. Keeping fiscal autonomy in view, the buoyant and income elastic sources should be assigned to the PRIs. The state taxes having a local base of collection need to be shared with the PRIs. The State Finance Commissions (SFCs) should evolve an appropriate criteria for the distribution of grants between the tiers and between the panchayats within the tier.

Mukherjee (1996) in his study states that there are practical problems concerning the whole issue of finances of PRIs. If the size of funds is minimal in comparison to local requirements, it results in a shortage of funds for a large number of activities. Sustained levels of funds reduce uncertainty and lead to strengthening of community-based action plans. The major way for PRIs in this regard is obviously strengthening of internal resource position. There are perhaps no better substitutes to raising of resources by internal means in a sustainable manner. The merit of such a funding method is yet to be recognised as one big step towards sustainable local development.
Misra's (1996) study brings out that for an effective performance of the functions assigned to the panchayats, adequate resources should be provided to them so that they not only meet the local needs but also improve the economic base of the local areas. There is a vast disparity between the rural and urban areas. Unless this disparity is reduced, there cannot be a viable democratic system in the country. At the same time, one should not forget to mention that the panchayats should properly utilise their funds. The problem of rural reconstruction depends both on availability of adequate amount of funds and efficient system of management of funds.

Pal (1996) highlights that panchayats have been in the quagmire of financial problems ever since their establishment. Several efforts have been made to solve their problems but not much improvement in their economic conditions could be brought about. They have always been begging before the Centre and the state. Because the Centre and state leaderships have not nurtured them as people’s institutions due to the fear of losing their own powers of governance. On the part of the panchayats, though they were empowered to raise their own resources
they could not use the powers for their development due to one or the other reason.

The Constitution 73rd Amendment Act has given a new life to the panchayats. The remedy of the financial malady lies in the clear cut demarcation of functions of the panchayats backed up with adequate resources, compulsory levy of taxes, curtailment of the size of the Centrally sponsored schemes, remodeling of panchayats demographically and inculcation of the federal culture in the Indian polity.

A case study of Kerala (Biju, 1996) points out that the revenues of panchayats can be classified as tax and non-tax revenue. Tax revenue consists of house tax, vehicle tax, profession tax, show tax, surcharge on show tax, duty on transfer of property etc. Non-tax revenue comprises of income from licence fees and panchayat properties. The Kerala Panchayat Act, 1994, empowers panchayats to levy fees at such rates as may be fixed by the panchayats for grant of licences, permissions and renewal of licences. It also brings out the resource problems of grama
panchayats. Dearth of financial resources presents a serious problem to the PRIs. In Kerala state, PRIs are financially far well-off than their counterparts in other states. Also, there are panchayats in Kerala which are larger in size and with gross income more than that of the municipalities, elsewhere. But, if the total income of an average panchayat is considered, in relation to its population strength, it can be clearly seen that the per capita income of a Kerala panchayat is very low.

Ashirvath (1989) in his article indicates that inadequacy of resources assigned and lack of adequate and proper administrative machinery appear to be the root-causes for the ineffective functioning of the panchayats in the states. But, the assertion that the revenue assigned to the panchayats are inadequate to discharge efficiently the functions entrusted to them, becomes valid only when it is shown that the panchayats have fully utilised the sources of revenue allotted to them.

Sharma (1994), in his book, 'Panchayat Raj and Education in India', explains about the panchayats and their finances. He says that various state governments have been giving certain percentage of land
revenue to the panchayats. This amount varies from state to state. Then, in some states the task of revenue collection has been completely assigned to the village panchayats, and in others, only partially. There is much truth in the statement that all panchayats today may not be developed enough to undertake the responsibility. Therefore, conscious attempts should be made to develop them, and as and when they are considered capable for the job, the responsibility should be assigned. This will solve the problem of panchayat finances and will yield valuable returns in the immediate future.

c. Studies on Finances of PRIs in Karnataka

A study of Taluk Development Boards (TDBs) in Karnataka (Sivanna, 1990) put forward the view that the major constraints for better performance of the TDBs were mainly lack of sufficient power and functions, especially in the financial sphere. The study concludes that these institutions have become somewhat unresponsive to fulfilling the tasks and the objectives for which they were established. It is evident
from the study that there is no planning machinery as such at the block/taluk level.

An another study of Finances of Mandal Panchayats in Karnataka (Aziz, Nelson and Babu, 1996) points out that despite its (MPs) popularity and considerable autonomy, it suffers from many problems. Incomes of the Mandals under study is very low and not commensurate with the responsibilities assigned, the share of tax and non-tax revenues though rising is low.

Babu, (1996) examines the patterns of revenue and expenditure of eight selected Mandal Panchayats in Karnataka for the period 1987-88 to 1992-93 and studies their problems in order to suggest remedial measures to such problems which most of the Village/Grama panchayats are expected to face. Many interesting conclusions emerge from his study. These are:

- The selected Mandal Panchayats faced the problem of inadequate finance. Though all the Mandal Panchayats had shown surplus budgets it should not be considered as a sign of their fiscal strength.
The simple reason was that the deficits could not be met by the state or any other agency and hence, the panchayats were compelled to prepare surplus budgets only.

- Though the per capita grant provided by the state was Rs. 10, the Mandal Panchayats got only Rs. 7.5 and the remaining amount was retained by Zilla Parishads themselves for meeting their administrative cost.

- The Mandal Panchayats should have tried to strengthen their finances by tapping certain tax resources which had not been resorted to. In certain cases, political consideration prevented them from mobilisation of revenue through imposition of taxes.

- The Mandal Panchayats could not tap the bus stand fee as they had not constructed any bus shelters. Some Mandal Panchayats were endowed with large scale natural resources like quarries and sand. The private contractors and business people exploited these natural resources without obtaining any licence or paying any royalty. If
these activities had been monitored properly, the Mandal Panchayats could have mobilised a sizable income from themselves.

- The power to tax and collect the land revenue could have been transferred to panchayats. The state government, as far as possible, should avoid any delay in the release of the instalments of grants. Likewise, the stamp duty collected by the state in the jurisdiction of the Mandal Panchayats should have been transferred to the respective panchayats at least every quarter to avoid uncertainty about this item of income during any particular year. Finally, all the Mandal Panchayats depend on their own income to perform their functions. No Mandal Panchayat drew up any plan to mobilise public contributions.

The review of the above studies brings forth that they have either focused on general issues or on finances narrowly. No study brings out comprehensively – the extent of fiscal powers vested in PRIs, extent of grants-in-aid given, tier-wise position, pattern of expenditure etc. Further, no study has brought out the criteria adopted in the devolution
of grants between the tiers and between the panchayats within the tier. Thus, various issues relevant under fiscal decentralisation have not been made. Hence, there is a need for the study of this nature at the present juncture.

References


Babu, M. Devendra (1996), Karnataka Mandal Panchayat Finances: Imbalance in needs and Resources, Indian Journal of Public Administration, XLII(1).


