CHAPTER IV

KARNATAKA STATE FINANCE COMMISSIONS AND THEIR RECOMMENDATIONS

4.1 INTRODUCTION

Devolution is a global paradigm. It is referred to as a process of sharing of powers by the central ruling groups with other groups, each having authority within a specific area or the state. Devolution may involve creation or strengthening of the lower levels and allowing them to function outside the centers control. The devolution of financial resources to the local bodies has been ensured through constitution of State Finance Commission. The State Finance Commission provides a new dimension after 73\textsuperscript{rd} Constitutional Amendment Act in 1992. It is expected to appropriate principles and design flexible method to address the aspects of financial devolution to Local Bodies.

Section 4.2 deals with State Finance Commission and its Devolution recommendations, section 4.3 discuss financial autonomy of local bodies; section 4.4 deals with transfer to rural local bodies in Karnataka, section 4.5 discuss resource mobilization and 4.6 consists conclusion.

4.2 STATE FINANCE COMMISSION DEVOLUTION IN KARNATAKA

The need for State Finance Commission has been felt since a long time. Several committees and commissions that inquired into the local finance recommended constitution of State Finance Commission. State Finance Commission has embarked on the most different task of formulating principles and mechanism for sharing revenue of the state government (Gnaneshvar V:
Governor of state shall, as soon as may be within one year from the commencement of the constitution 73rd Amendment Act, 1992 and there after at the expiration of every 5 years, is empowered to constitute State Finance Commission to review the financial positions of the panchayats and to make recommendations to the Governor. State Finance Commission is appointed every five years. It is required to assess and quantify the fiscal requirements of Local Bodies in Karnataka. The main task of the State Finance Commission is to ensure that, given the distribution of functions and responsibilities by the state government to Local Bodies in accordance with constitutional provisions, adequate matching financial powers and funds are placed at their disposal and that too without such constricting conditions, as would impinge upon their authority. The task faced by State Finance Commission seems to be much more difficult than that of the Central Finance Commission in that, the State Finance Commission is required to clarify panchayat functions and also evaluate their working before making their recommendations on a desired package of panchayat taxes. The tasks of State Finance Commission regarding devolution of finance are mentioned in part IX of the constitution in schedule 11th and 12th is not very helpful in this regard. It is far too narrow in its implications for self-government and far too wide in its functional involvement. Here the 1st responsibility of the State Finance Commission is to see that the existing Local Bodies activities are financed adequately, before exploring the possibility of suggesting devolution of additional functions as per the 11th schedule and then work out their fiscal and staff implications for both the state government and the Local Bodies in this regard.
The main functions of State Finance Commission are:

a) To set principles and distribute taxes between the state government and Local Bodies, and among different government units within each of the Local Body tiers,

b) To consider which additional taxes and non-taxes sources of revenue can be assigned to the Local Bodies to enhance this fiscal empowerment and autonomy,

c) To determine the Grants-in-aid to be given to Local Bodies,

d) To recommend measures needed to improve the financial position of Local Bodies in the state.

The tasks and functions of the State Finance Commission are contained in its terms of reference (ToR) which are by and large guided by the constitutional provisions and the requirements of the state. The systematic approach of the State Finance Commission has been to initially identify the functional responsibilities of different tiers.

Article 243 (I) and 243 (Y) of the Constitution of India mandate the States to constitute State Finance Commission once in five years to review the financial position of the local bodies and to make recommendations to the Governor of the State. The First State Finance Commission, constituted in 1994, gave its report in 1996 for the award period of 1997-2002. The Second State Finance Commission was constituted in 2000 and submitted report in
December 2002, its period is till 2006. Third Karnataka Finance Commission, which was set up in September 2006, it is effective form the period 2006-07 to 2010-11. Karnataka has received its two State Finance Commission reports. The first State Finance Commission was set up in 1994, which submitted its report in 1996. The Second State Finance Commission was set up in October 2000 and submitted its report in December 2002. Prior to 1995-96 PRIs received on an average 35.82 per cent of resources per year and in the entire 12 years period from 1995-96 to 2007-08 the average devolution works out to more or less the same per cent. First State Finance Commission observed that the rural local bodies are deprived of adequate resources and taxing powers, share in taxes, grants-in-aid and power to dispose of the devolved funds to be on more independent and firmer ground and not becoming a mere spending agencies. The First State Finance Commission recommended the transfer of 36% of Non-Loan Gross Own Revenue Receipts (NLGORR) and Second State Finance Commission recorded of the state to local bodies 40% of Non-Loan Gross Own Revenue Receipts. The plan funds are to be distributed to Zilla Panchayat and Taluk Panchayat in the ratio of 65:35. Karnataka is one of the first states in India to extend property tax reforms to all Local Bodies through the introduction of capital value method of property tax assessment and self-assessment procedures for property tax. Another innovation in Karnataka has been the introduction of a new solid waste charge to offset the additional costs.
4.2.1 The Fiscal Devolution Framework:

First and Second State Finance Commission of Karnataka have recommended detailed fiscal devolution framework as indicated in the Table 4.1.

The 1st stage of devolution deals with share of state and local governments in its total revenue. State Finance Commission adopted the concept of Non-Loan Gross Own Revenue Receipts of the state. Under Non-Loan Gross Own Revenue Receipts, entire Gross Own Revenue Receipts of the state government other than loans and the state share of the central revenues form the divisible pool are included. It consists of 3 components - share in tax revenue, assignment of revenue from certain taxes and Grants-in-aid. First State Finance Commission recommended that all local governments should get 36% share of Non-Loan Gross Own Revenue Receipts, which the government accepted. Second State Finance Commission has recommended 4% increase in the share that is 40% share of Non-Loan Gross Own Revenue Receipts for local governments. Only Karnataka has adopted such a broader and most progressive concept of sharing state revenue between state and local governments. The concept of Non-Loan Gross Own Revenue Receipts is comprehensive, simple, highly transparent, and progressive.

The First State Finance Commission sought to use normative approach in place of gap filling approach for the assessment of the total revenue requirements of LBs.
Table 4.1

Fiscal Devolution Framework for Local Governments in Karnataka

<table>
<thead>
<tr>
<th>Level of devolution</th>
<th>1st SFC Framework</th>
<th>2nd SFC Framework</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st level devolution</td>
<td>36% of NLGORR</td>
<td>40% of NLGORR</td>
</tr>
<tr>
<td>local governments share in state resources</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2nd level of devolution division of resources between urban and rural local governments</td>
<td>Allocation of these indicators resulted into 85% share to PRIs &amp; 15% to ULBs. That is 85% of 36 = 30.60% 15% of 36 = 5.40% Based on 5 indicators Population 33.33% Area 33.33% Backwardness Indicators Illiteracy rate 11.11% Population per hospital bed 11.11% Road length per sq.km 11.12% Total weightage of backwardness index 33.34% Total 100.00</td>
<td>Allocation of these indicators resulted into 80:20 share to PRIs &amp; ULBs. That is 80% of 40 = 32% NLGORR 20% of 40 = 8% NLGORR Based on 5 indicators Population 30% Area 30% Backwardness Indicators Illiteracy rate 15% SC/ST population 15% Population per hospital bed 10% Total weightage of backwardness index 40% Total 100.00</td>
</tr>
<tr>
<td>3rd level devolution/sharing of funds among different tiers of rural &amp; urban local government Part A Panchayats</td>
<td>40% ZP 35% TP 25% GP 100% (30.60% of NLGORR) This formula was not accepted by the state government as there was high ratio of committed expenditure that is salary. As result actual allocation took place on basis of salary expenditure only</td>
<td>-The committed expenditure to be earmarked first out of the amount (32% of NLGORR) available to PRIs -Block grants to the GPs at the rate of Rs 3.50 lakh per GP to be deducted next from the above amount (block grant to increase every yr 25000 per village) -Rs100 million to be deducted next from balance for giving incentive grant. -Remaining amount to be shared by ZP and TP in the ratio of 65:35.</td>
</tr>
<tr>
<td>Part B Municipal bodies</td>
<td>Composite index made up of 5 weightage indicators for inter-re allocation among UL government Population 33.3% Area 33.3% Backwardness Indicators Illiteracy rate 11.11% Population per hospital bed 11.11% Road length per sq/km 11.12% Total 100%</td>
<td>Two weightage indicators for inter-se allocation among local governments Population 67% Illiteracy 33% Total 100%</td>
</tr>
<tr>
<td>4th level devolution/ share funds among different local governments</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: First and Second State Finance Commission of Karnataka
In 2nd stage of devolution, First State Finance Commission recommended that 36% of own non-loan gross own revenue receipts of the state government should be given to local bodies. The distribution between urban and rural local bodies was recommended to be on the basis of population, area and index of backwardness with equal weights assigned to illiteracy rate, number of persons per bed in government hospitals, and road length per sq km area. Based on these criteria, the commission recommended that 15% of the shareable resources should be allocated among urban local bodies, and the remaining 85% should be assigned among Panchayats Raj Institutions. Within Rural Local Bodies, ZPs, TPs and GPs were allocated 40%, 35% and 25% respectively. The local bodies were required to first allocate the resources for the provision of these selected services at normative levels from the resources disbursed to them. The remaining amounts were to be used for general purpose by the LBs.

Second State Finance Commission recommended the devolution of 40% on Non loan gross own revenue receipts. It retained the three factors for the distribution but the index of backwardness was modified to include the schedule caste and schedule tribes' population instead of road length per sq. km area with the last factor assigned 40% weight and each of the remaining two factors assigned 30% weight. 80% (32% of NLRORR) should be assigned to the rural local bodies and the remaining 20% (8% of NLGRR) for urban local bodies.
3rd stage of devolution is for sharing of funds among RLBs and ULBs. According to the recommendations of First State Finance Commission funds are distributed by combining plan and non-plan funds for ZP, TP and GP i.e., 40:35:25 respectively based on 36% of NLGORR. Here actual allocation took place on the basis of salary expenditure only.

The Second State Finance Commission records that the prevailing practice of giving lump sum grants to GPs should be continued. In the first, the allocation should be Rs. 3.5 lakh per GP and the amount should be increased by Rs 25,000 every year for the four subsequent years covered in the commissions’ recommendation. Second State Finance Commission retained the non plan allocation according to the prevailing ratios and applied the indicators and weightage only for the allocation of plan funds. The plan funds are to be distributed to ZPs and TPs in the ratio of 65:35.

4th stage of devolution is for sharing of funds among different local governments. For inter-se allocation among ZP and TP under plan funds weightage is assigned to all five indicators, with the assigned weightage composite index is prepared. Second State Finance Commission had modified the formula for inter-se allocation. Only two indicators are used. They are population with 67% weightage and illiteracy rate with 33% weightage.
It can be seen from the above chart that how the devolution of state's resources to Local Bodies takes place. All the four level of devolution can be seen from the State Resources to all the three tier of Local Bodies at the grassroot level.

From the Table 4.2 it can be seen that the First State Finance Commission gave a tentative devolution to PRIs. The First State Finance Commission, in its devolution scheme had divided the total share of financial transfer going to PRIs in the ratio of 40:35:25 to ZP, TP and GP respectively. The state government has actually affected higher devolution to RPIs.
Table- 4.2

Relative shares as per the devolution scheme indicated by the First SFC (Rs in Cr)

<table>
<thead>
<tr>
<th>A. PRIs : (30.6% of NLGORR)</th>
<th>1996-97</th>
<th>1997-98</th>
<th>1998-99</th>
<th>1999-00</th>
<th>2000-01</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 ZP (40%)</td>
<td>855.22</td>
<td>980.02</td>
<td>1094.96</td>
<td>1223.7</td>
<td>1345.7</td>
</tr>
<tr>
<td>2 TP (35%)</td>
<td>748.32</td>
<td>857.52</td>
<td>958.09</td>
<td>1070.74</td>
<td>1177.49</td>
</tr>
<tr>
<td>3 GP (25%)</td>
<td>543.52</td>
<td>612.52</td>
<td>684.36</td>
<td>764.81</td>
<td>841.07</td>
</tr>
<tr>
<td>Total</td>
<td>2147.06</td>
<td>2450.06</td>
<td>2737.41</td>
<td>3059.25</td>
<td>3364.26</td>
</tr>
<tr>
<td>4 Grants to GPs under section 206 (outside NLGORR)</td>
<td>56.58</td>
<td>56.58</td>
<td>56.58</td>
<td>56.58</td>
<td>56.58</td>
</tr>
</tbody>
</table>

Source: SSFC of Karnataka

Second State Finance Commission has worked out norms for inter-se allocation of the Eleventh Finance Commission grants in Table: 3, as envisaged by the Eleventh Finance Commission. Terms of reference to the Second State Finance Commission do not mention about devolution of Eleventh Finance Commission grants. Eleventh Finance Commission has envisaged in its report that the inter-se distribution of its grants among PRIs and ULBs should be based on the principles recommended by the SFC (para 8.18 of RFC report). Second State Finance Commission recommended that at the rate of Rs.100 lakh per GP, the Eleventh Finance Commission grants should be distributed among GP for the purpose of maintenance of civic services in rural areas. This works out to Rs.56.59 cr.
Table-4.3

Framework for distributing EFC grants to LBs (Rs in crores)

<table>
<thead>
<tr>
<th>Particulars/criteria</th>
<th>Total Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. PRIs</strong></td>
<td></td>
</tr>
<tr>
<td>Amount required for maintenance of assets and audit to be collected at first instance</td>
<td>Rs. 2.34 Cr</td>
</tr>
<tr>
<td>Amount required for development of date base</td>
<td>Rs. 0.94 cr</td>
</tr>
<tr>
<td>Each GP to be given Rs 1.0 lakh for the purpose of maintenance of civic services</td>
<td>Rs. 56.59 cr</td>
</tr>
<tr>
<td>Zilla Panchayat</td>
<td>Rs. 11.37 cr</td>
</tr>
<tr>
<td>Taluk Panchayat</td>
<td>Rs. 7.58 cr</td>
</tr>
<tr>
<td>Total amount</td>
<td>Rs. 78.82 cr</td>
</tr>
<tr>
<td><strong>B. Municipalities</strong></td>
<td>Rs. 24.79 cr</td>
</tr>
</tbody>
</table>

Source: 2\textsuperscript{nd} SFC report of Karnataka.

Second State Finance Commission has recommended setting up incentive fund to encourage Gram Panchayats to maximize their revenue mobilization. An amount of Rs. 100 million has been recommended to be earmarked every year as incentive fund and not to be diverted for any other purpose. All Gram Panchayats whose internal revenue mobilization is 60% and above in each year for 3 conservative preceding financial years are eligible to be considered for according cash incentive under this fund.

First State Finance Commission has recommended following reforms:


- Fixing of minimum and maximum rate of property tax (8% & 12% respectively) in case of Gram Panchayats and regular revision of property estimation is done once in year by the designated authority.
• Assignment of 50% of the share amount of revenue realized by lease/auction of sand beds and stone quarrying.

• In order to facilitate adequate and specify implementation of the supreme court of India’s ordering regarding development of sanitary land fills sites. State Finance Commission has recommended that the cost of acquisition of land should be borne by the state government. This should be outside the Non-Loan Gross Own Revenue Receipts.

• Consolidation of multi-sectoral schemes to accord overlapping timely release of funds.

4.2.2 Week policy Aspects:

State Finance Commission as mentioned above has come out with a simple but comprehensive fiscal devolution framework. But in actual practice the framework has suffered on two broad counts - one- inherent weakness associated with the devolution framework and recommendations of State Finance Commission and two, inadequate implementation by the state government as follows:

Though the First State Finance Commission suggested the use of a normative approach, it was not adopted in actual implementation. Later on taking into account the enormous financial needs and problems associated with estimation of normative needs, Second State Finance Commission dropped it, and has gone a head with devolution based on the composite index.

• The idea of using a composite index for determining 2nd stage devolution between Urban Local Bodies and Rural Local Bodies is quite logical and appropriate. Second State Finance Commission itself felt this way.
At the 3rd stage, Second State Finance Commission has given more reference to Zilla Panchayat and Taluk Panchayat. It is observed that in actual practice Gram Panchayat were getting less than 5% of the amount made available for Rural Local Bodies in spite of recommended share of 25% in First State Finance Commission. In fact, the ultimate aim of fiscal devolution (73rd CAA) is to strengthen lowest level of local governments that is Gram Panchayat. Gram Panchayats are the real local governments while Zilla and Taluk panchayats are intermediary Local Bodies. Thus State Finance Commission has legitimizes present devolution distortions, which is favoring Zilla Panchayat and Taluk Panchayat at the expense of Gram Panchayat.

At the 4th stage that is pertaining to inter-se allocation between municipal bodies, Second State Finance Commission has adopted only two indicators, population, and illiteracy rate against the 5 indicators used by First State Finance Commission again under the pre-tax of non-availability of data.

Second State Finance Commission has recommended uniform Block Grant of Rs.0.035 million with an incremental increase of Rs. 25000 every year to Gram Panchayats, irrespective of their size. The State Finance Commissions have recommended a simple but comprehensive fiscal allocation framework, in practice implementation has been week. The grants provided to Local Bodies do not fully corresponded allocation criteria.
4.2.3 Devolution of State Finance Commission Grant to Local Bodies:

The actual grants provided to Local Bodies do not correspond to the recommended devolution of both the State Finance Commissions. Government of Karnataka has not adopted the formula based percentage share (i.e., 36% of NLGORR) recommended by the First State Finance Commission Report. As a result it has transferred more than 36% of Non-Loan Gross Own Revenue Receipts (Table 4.4).

During the year 1997-98 to 2000-2002, Government of Karnataka transferred on an average 38.98% of share of Non-Loan Gross Own Revenue Receipts to Local Bodies. But transferring of more amount than the share recommended by the First State Finance Commission does not mean that each individual local body received its due or legitimate devolution as per State Finance Commission formula.

The FSFC had recommended devolution of 36% of NLGORR as the total share of PRIs and ULBs. It is evident from the Table 4.4 that the state government has transferred more amount than 36% of Non-Loan Gross Own Revenue Receipts to PRIs and ULBs.

The state government has transferred 38.56% during 97-98, 39.17% during 00-01. The devolution was highest at 39.73% during 98-99. The average transfer of funds to the PRIs and ULBs works out to 38.98% during the said 5 years period. Linking of fiscal transfer of salary commitment instead of prescribed devolution formula is iniquitous distortion and in actual practice is creating inequality among Local Bodies.
### Table 4.4

**Actual devolution of funds to RLBs & ULBs in Karnataka** (Rs in cores)

<table>
<thead>
<tr>
<th>Item</th>
<th>97-98 Actual</th>
<th>98-99 Actual</th>
<th>99-00 Actual</th>
<th>00-01 Actual</th>
<th>01-02 RE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Projected NLGORR of the State by First SFC</td>
<td>7825.55</td>
<td>8764.62</td>
<td>9816.37</td>
<td>10994.33</td>
<td>N.A.</td>
</tr>
<tr>
<td>Actual NLGORR of the state</td>
<td>7676.28</td>
<td>8412.96</td>
<td>9355.65</td>
<td>10702.66</td>
<td>11327.76</td>
</tr>
<tr>
<td>Devolution to PRIs</td>
<td>2685.00 (34.98)</td>
<td>3010.10 (35.78)</td>
<td>3278.00 (35.04)</td>
<td>3661.06 (34.21)</td>
<td>3724.00 (32.87)</td>
</tr>
<tr>
<td>Devolution to ULBs</td>
<td>274.81 (3.58)</td>
<td>332.37 (3.95)</td>
<td>415.66 (4.44)</td>
<td>531.43 (4.97)</td>
<td>575.5 (5.08)</td>
</tr>
<tr>
<td>Total devolution to PRIs &amp; ULBs out of NLGORR</td>
<td>2959.81 (38.56)</td>
<td>3342.37 (39.73)</td>
<td>3693.66 (39.48)</td>
<td>4192.43 (39.17)</td>
<td>299.5 (37.96)</td>
</tr>
</tbody>
</table>

Source: SSFC Report of Karnataka

* Figures in brackets indicate % of NLGORR

Second State Finance Commission has also noted this linking of actual devolution to salary and not to the State Finance Commission formulae but in a very light way. It should have strongly commented on this and should have calculated distortion / inequality caused by this approach of Government of Karnataka.

Table 4.5 shows trend allocation of funds to the 3 tiers of PRIs during the last 5 years i.e., from 97-98 to 01-02, actual release are less than the allocation made in the budget (link document). The percentage of actual release made to PRIs is more than 30.6% of the NLGORR in each year. In fact percentage has increased to 35.78 during the financial year 1998-99.
### Table- 4.5

**Devolution to PRIs as per FSFC recommendation (Rs in Crore)**

<table>
<thead>
<tr>
<th>Year</th>
<th>97-98</th>
<th>98-99</th>
<th>99-00</th>
<th>00-01</th>
<th>01-02RE</th>
<th>02-03BE</th>
</tr>
</thead>
<tbody>
<tr>
<td>RE</td>
<td>2348.94</td>
<td>2574.37</td>
<td>2862.83</td>
<td>3275.01</td>
<td>3466.29</td>
<td>4148.93</td>
</tr>
<tr>
<td>Allocation should have been made to PRIs as per First SFC (36%) of NLGORR</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Allocation made to PRIs by the government in the budget (link document)</th>
</tr>
</thead>
<tbody>
<tr>
<td>i) Plan</td>
</tr>
<tr>
<td>ii) Non-plan</td>
</tr>
<tr>
<td>Total</td>
</tr>
<tr>
<td>As % of NLGORR</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Actual release made by the government</th>
</tr>
</thead>
<tbody>
<tr>
<td>i) Plan</td>
</tr>
<tr>
<td>ii) Non-plan</td>
</tr>
<tr>
<td>Total</td>
</tr>
<tr>
<td>As % of NLGORR</td>
</tr>
</tbody>
</table>

Source: SSFC of Karnataka

Another significant feature is that a substantial part of the allocation made under non-plan is towards salary expenditure. There is substantial increase in non-plan expenditure on items assigned to ZP and TP. The share of plan allocation has come down to 17% in the year 02-03 from 26.57% in 01-02. It gets reversed when we look at the non-plan allocation where it was 73.43% in 01-02 has gone up to 83% in 02-03.

Thus, though the Karnataka State Finance Commission’s evolved a comprehensive devolution framework for fiscal devolution but in actual practice, it has failed to take and cause any qualitative difference.
4.2.4 Central Finance Commission Grant:

Second State Finance Commission has evolved devolution framework for inter-se allocation of Eleventh Finance Commission Grant, but in actual practice this grant is counted as a part of the State Finance Commission grant by Government of Karnataka. This is against the recommendation of State Finance Commissions. Much of the increase in non plan expenditure is due to incremental benefits given to employees in salaries and allowances. As compared to the pattern of distribution proposed by the First State Finance Commission by combining plan and non plan for ZP, TP and GP, the actual allocation if different which can be seen from the below table 4.6.

Table-4.6

Allocation proposed and allocation actually taken place (Rs in crores)

<table>
<thead>
<tr>
<th></th>
<th>00-01 actual</th>
<th>01-02(RE)</th>
<th>02-03 (BE)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) NLGRR of the State</td>
<td>10702.66</td>
<td>11327.76</td>
<td>13558.59</td>
</tr>
<tr>
<td>2) Allocation should have been made to PRIs as per FSFC recommendation (30.6% of NLGRR)</td>
<td>3275.01</td>
<td>3466.29</td>
<td>4148.59</td>
</tr>
<tr>
<td>i) ZP</td>
<td>1310.01</td>
<td>1386.52</td>
<td>1659.57</td>
</tr>
<tr>
<td>ii) TP</td>
<td>1146.25</td>
<td>1213.2</td>
<td>1452.12</td>
</tr>
<tr>
<td>iii) GP</td>
<td>818.75</td>
<td>866.57</td>
<td>1037.23</td>
</tr>
<tr>
<td>Total</td>
<td>3275.01</td>
<td>3466.29</td>
<td>4148.93</td>
</tr>
<tr>
<td>3) Allocation made to PRIs by the government in the budget (link document)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>i) ZP</td>
<td>1442.55 (37.42)</td>
<td>1514.12 (37.14)</td>
<td>1451.88 (36.37)</td>
</tr>
<tr>
<td>ii) TP</td>
<td>2276.16 (59.05)</td>
<td>2342.96 (57.47)</td>
<td>2309.61 (58.33)</td>
</tr>
<tr>
<td>iii) GP</td>
<td>136.11 (3.53)</td>
<td>220.07 (5.4)</td>
<td>198.06 (0.5)</td>
</tr>
<tr>
<td>Total</td>
<td>3854.82</td>
<td>4077.15</td>
<td>3959.55</td>
</tr>
</tbody>
</table>

Source: SSFC Report of Karnataka

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Over all it can be said that the State Finance Commissions of Karnataka have developed a simple and transparent framework for fiscal transfers. The regular formation of State Finance Commissions and important implementation of their various recommendations by Government of Karnataka has certainly brought in budgetary certainty and degree of predictability.

The State Finance Commissions of Karnataka have certainly addressed the issue of incentive structure, but the amount earmarked for this purpose is far meagre and for singular reforms. Not much of the legal autonomy has been granted by carrying out legal amendments to the Acts and the dependency of local bodies on State transfers still continues to be very high. The real budget autonomy will come through only when their degree of self-reliance will improve through sustained internal system reforms by local bodies.

4.3 FINANCIAL AUTONOMY OF PANCHAYATS

State government should have complete independence and flexibility in setting their own development priorities. Oommen has suggested the following criteria for designing the inter governmental transfers via absorptive capacity. The resource transfer should be in tune with the utilization capacity. The allocation formula should be simple and should have adequate built in arrangement for encouraging resource mobilization and penalizing waste and uneconomic policies (Oommen; 1996). The important thing is transparency, certainty and financial autonomy should always govern the mechanism of resource transfer in a federal setup. An important hallmark of decentralizations is autonomy for local governments to determine the priorities and design of
programs and schemes prior to implementing them. The best way of revenue empowerment is to provide local governments with revenues from local sources, and from transfers that are adequate to match expenditure requirements. PRIs need additional resources and financial autonomy to fulfill their new functional obligations. But the record on transfer of funds to panchayats for the subjects devolved upon them is not encouraging. Many of the powers given to local bodies are delegated powers and most state governments have retained substantial financial and administrative power which suppresses the autonomy of PRIs (GOI 2001 and Vyasulu 2000). Major areas of rural development expenditure and funds associated with them are kept out of the purview of the locally elected bodies (McCarten and Vyasulu 2003). The earlier "bureaucratic practice" of budgeting for local expenditure has not changed so that even after budget approval, funds are often not made available to rural governments because of cash constraints in a state. In practice, financial autonomy means release of funds without any technical clearance or conditionalities attached.

But in most other states, lower levels of village governments require clearance from the next higher level to spend allocated funds. It is not surprising then to find that the PRIs in most states are restricted in spending their funds. In many cases there is neither a sufficient devolution of resources nor adequate revenue raising power with PRIs, which reinforces their dependence on higher level bodies rather than their empowerment. In Karnataka, e.g., gram panchayats have neither the access to funds from state
nor the power to make their own decisions about their requirements while the higher level rural governments fix the priorities and spend the funds. A large fraction of PRI spending is on staff salaries financed from grants from higher level governments implying thereby a low degree of expenditure autonomy.

Achieving a degree of financial autonomy is vital to reap the full potential benefits of decentralization. An analysis of fiscal and financial autonomy should be based on an examination of devolution of funds, functions and functionaries. In order to become financially more independent, rural bodies must be encouraged to raise local resources for development before they receive grants from higher governments. “The more dependent a PRI is on the mass of its citizens for financial resources, the more likely it is to use scarce material resources to promote human development and reduce poverty” (GOI 2002).

Government of India (2001) makes several recommendations to improve the financial situation of PRIs. These include: linking devolution of Central Finance Commission funds to states to transfer of administrative and financial powers to PRIs; strengthening revenue raising powers of PRIs to reduce their excessive dependence on state and central governments; improving accountability of local bodies and simplifying rules and procedures to make transactions simple and strengthen financial management and audit procedures.

4.4 THE TRANSFERS TO RURAL LOCAL BODIES IN KARNATAKA

Transfer of resources from the centre to state is common because there always exists a mismatch between the functional responsibilities of the state on
the one hand and their ability to raise matching resources on the other. The recommendations of the Central Finance Commission are generally accepted and implemented by the central government. However, in the case of the State Finance Commission, there is no such tradition. In fact, the state government did not accept the recommendations of the first Finance Commission either in terms of the total amount devolved, distribution between urban and rural local governments, or among the different tiers. In the case of Zilla Panchayats and Taluk Panchayats, transfers continued to be on the basis of various schemes implemented by them. In case of Gram Panchayats block transfers consisted of lump sum transfers paid by the state government and the Central Finance Commission grants. At the Gram Panchayat level, the important lump sum grants consist of statutory grants from the state government and the grants given on the recommendation of the central finance commission.

The transfers from the higher level government to rural local governments come from both the central and the state governments. The central transfers are mainly for central sector and centrally sponsored schemes. Some of these transfers are given to state governments and the latter pass them on to the Zilla Panchayats for implementation. The specific purpose conditional transfers for various plan schemes, the central government gives transfer on the recommendation of the central finance commission as well. The transfers from the state government to rural local government are also given for both plan and non-plan purposes.
4.4.1 Central Finance Commissions:

Tenth Finance Commission (TFC) approach:

The Tenth Finance Commission was constituted by the President on 15th June, 1992 which submitted its recommendations for the period 1995-2000. The Centre-State relations have been developed in India since long. Under the constitutional provisions the Central Finance Commission was constituted to transfer the funds to the states. The Tenth Finance Commission observed that while recommending grants for local bodies, “It is obvious that, however once the State Finance Commissions complete their task, it would be obligatory upon the Finance Commission to assess and build into the expenditure stream of the States the funding requirement for supplementing the resources of the Panchayats/Municipalities. This would be necessary to determine the measures needed for the augmentation of the State Consolidated Fund”. (GOI- Tenth Finance Commission-1995-2000)

Recommendation of Tenth Finance Commission:

1. To identify and recommend measures needed for the augmentation of the consolidated funds of the states for supplementing the resources of the LBs.

2. Taxes on land may be levied in suitable form to strengthen the resource base of the LBs.

3. Cess on land based taxes and other state taxes/duties may be levied and devolved to the LBs for augmenting specific civic services.

4. States should levy professional tax with a view to supplement the resources of LBs. The rates should be suitably revised from time to time.
5. Relevant tax legislation should be suitably modified to delink property tax house tax from the rent control laws.

6. Abolition of octroi should invariably be accompanied with its replacement by a suitable tax that is bought and can be collected by the LBs.

7. The rate structure of user charges levied by the LBs should be revised regularly. LBs should have the power to fix the rates of taxes and user charges.

**Eleventh Finance Commission Approach:**

1. In case of the Eleventh Finance Commission, the Terms of Reference gave a mandate to the Commission as per paragraph 6 of the President's order to make their "own assessment in the matter, keeping in view the provisions required to be made for the emoluments and terminal benefits of the employees of the local bodies including teachers; the existing powers of these bodies to raise financial resources; and the powers, authority and responsibility transferred to them under articles 243G and 243W of the Constitution of India reads with Eleventh and Twelfth Schedules of the Constitution". (Report of EFC, 2000-05)

Based on this mandate, the Eleventh Finance Commission made its own assessment of the needs and did not adequately consider the recommendations of the State Finance Commissions.

The tasks of EFC with reference to the Local bodies were:

(M.Godbole:1993,pp-970-973)
2) To review the recommendation of the SFC with reference to local finance as also that of the state.

3) To evaluate the principles and norms governing their reviews and recommendations.

4) To evolve objective criteria and evaluate the progress made in different states towards establishing institutions of local self government.

5) To promote minimum standards of basic services throughout the country or to promote and other national objective involving local bodies.

6) To review the existing salary and service benefits of employees of the local bodies in order to rationalize the administrative structure in the lowest tier of governance.

7) To suggest measures for augmenting the consolidate fund of the state to supplement the resources of local bodies.

For the first time, the Eleventh finance Commission was required to suggest measures to augment the resources of local bodies it has made a detailed recommendation on devolution of funds to local bodies. These were aimed at strengthening the resource base of the panchayats, improving tax collection, maintenance of accounts and their audit. Some of the recommendations of the Commission are:

1. State Government should take their decision on the recommendations of the State Finance Commission, especially in regard to matters relating to resource transfer. Amendment to the laws, if necessary, should be made to ensure this at the earliest.
2. Taxes on land/farm income may be levied in suitable form to strengthen the resource base of the local bodies. The amounts so collected may be passed on to these bodies for improving and strengthening the civic services. Local bodies may also be involved in collection of these taxes.

3. Cess on land based taxes and other state taxes/duties may be levied and devolved to the local bodies for augmenting specific civic services.

4. State should levy profession tax with a view to supplementing the resources of local bodies, or they should empower the local bodies to levy it. The rates should be suitable revised from time to time.

5. Property tax/house tax has not been exploited to its full potential. The relevant tax legislation should be suitably modified to delink this form the rent control laws where a property has been let out, the property tax should be made recoverable from the occupier.

6. The rate structure of user charges levied by the local bodies should be revised are regularly to keep pace with inflation and to recover at least, as far as possible, the full operations and maintenance cost. Local bodies should have the power to fix the rates of taxes and user charges. (Report of EFC, 2000-05)

The particular Terms of Reference of Eleventh Finance Commission requires it to determine the transfers of resources to the local bodies on the basis of the recommendations of the State Finance Commission. For effective functioning of the local government the process of decentralization needs to be
speeded up. EFC has recommended a number of constitutional legislative and administrative changes for strengthening the PRIs. The 11\textsuperscript{th} schedule places as many as 29 functions within the purview of PRIs ranging from agriculture, minor irrigation, small industries, rural roads, rural electrification, poverty alleviations, education, health and sanitation, welfare, public distributions system and maintenance of community assets. Although devolution of power and responsibilities are listed exhaustively while estimating the devolution to local bodies the TFC and EFC both have given more importance to the equity aspects.

**Twelfth Finance Commission:**

In the Terms of Reference of Twelfth Commission, there is no such directive by the president. It has been more than a decade after the 73rd and the 74th Constitutional Amendment and in most States decentralization processes have more or less stabilized. The portion of the resources being devolved by the State Government to the Local Bodies is an important parameter for measuring decentralization. It is also a measure of roles and responsibilities transferred by the State Government to the Local Bodies. In such a scenario, it would be worthwhile to base a large portion of support given to the State Governments under this provision, on what they devolve to the local bodies in their States. Government of Karnataka is required to devolve 40\% of its Non-Loan Gross Own Revenue Receipts to its local bodies. It is recommended that the Consolidated Fund of the States should be augmented by the Central Government to an extent of 10\% of financial commitments of this nature. This
would also motivate States to devolve more to their local bodies. (Twelfth finance commission 2005-2010)

Recommendations of the Twelfth Finance Commission:

The Twelfth Finance Commission (TFC) has recommended grants amounting to Rs.25,000 cr payable during the period 2005-10 (Rs.20,000 cr for panchayats)

The summary of the recommendations of the TFC is given below

i) The best practices listed in para 8.19 of the report may be considered for adoption by States to improve the resources of the panchayats. This para deals with few suggestions for state to follow for better functioning such as to insist to levy major taxes, to make few taxes obligatory, regarding transfer of power and decision making power, transfer of funds, revenue raising and valuation of property and for maintenance of accounts and audit system.

ii) The States should avoid delays in the constitution of the SFCs, their constitution in phases, frequent reconstitution, submission of reports and tabling of the Action Taken Report in the legislature. It is desirable that SFCs are constituted at least two years before the required date of submission of their recommendations, and the deadline should be so decided as to allow the state government at least three months’ time for tabling the Action Taken Report, preferably along with the budget for the ensuing financial year.
iii) The SFC reports should be readily available to the Central Finance Commission, when the latter is constituted so that an assessment of the state's need could be made by the Central Finance Commission on the basis of uniform principles. This requires that these reports should not be too dated. As the periodicity of constitution of the Central Finance Commission is predictable, the States should time the constitution of their SFCs suitably.

iv) SFCs must be constituted with people of eminence and competence with qualification and experience in the relevant fields.

v) The convention established at the national level of accepting the principal recommendations of the Finance Commission without modification should be followed at the State level in respect of SFC reports.

vi) The SFCs must clearly identify the issues which require action on the part of the central government to augment the consolidated fund of the State and list them out in a separate chapter for the consideration of the Central Finance Commission.

vii) The suggestions made by SFCs regarding raising the ceiling on professional tax is endorsed for action by Central Government.

viii) It is desirable that the SFCs follow the procedure adopted by the Central Finance Commission for transfer of resources from the Centre to the States in respect of resources transfers from State Governments to local bodies. The SFC reports should contain an estimation and analysis of the finances of the State government as well as the local bodies at the pre and post
transfer stages along with a qualification of the revenues that could be generated additionally by the local bodies by adopting the measures recommended therein. The gaps that may still remain would then constitute the basis for the measures to be recommended by the Central Finance Commission.

ix) While estimating the resources of the local bodies, the SFCs should follow a normative approach in the assessment of revenues and expenditure rather than made forecasts based on historical trends.

x) A permanent SFC cell may be created in the finance department of State governments as the collection and collation of data would need to be done constantly and data would need to be made available to the SFC as and when it is constituted.

xi) A sum of Rs.20,000 crore for the Panchayats and Rs.5000 crore for the Municipalities may be provided as grants-in-aid to augment the consolidated fund of the States for the period 2005-10 to be distributed with inter-se shares as indicated in table 8.1 of the report. (Annex-I).

xii) The PRIs should be encouraged to take over the assets relating to water supply and sanitation and utilize the grants for repairs/rejuvenation as also the O&M costs. The PRIs should, however, recover at least 50 percent of the recurring costs in the form of user charges.

xiii) Of the grants allocated for Panchayats, priority should be given to expenditure on the O&M costs of water supply and sanitation. This will facilitate Panchayats to take over the schemes and operate them.
xiv) At least 50 per cent of the grants-in-aid provided to each State for the urban local bodies should be earmarked for the scheme of solid waste management through public-private partnership. The Municipalities should concentrate on collection, segregation and transportation of solid waste. The cost of these activities whether carried out in house or out sourced could be met from the grants.

xv) Most States do not have credible information on the finances of their local bodies. Local bodies would continue to need funding support for building data base and maintenance of accounts. States may assess the requirement of each local body in this regard and earmark funds accordingly out of the total allocation recommended by us.

xvi) Separate grants-in-aid for the normal and the excluded areas are not proposed. It is for the State concerned to distribute the grants recommended for the State among the local bodies including those in the excluded areas in a fair and just manner.

xvii) No conditionality over and above these recommended by us need be imposed by the Central Government for releasing the grants-in-aid.

An obligation has been imposed by the earlier Finance Commissions on the State Governments to meet a share in the grant given by the Central Government to the Local Bodies. Firstly, the obligation of the Finance Commission is to recommend measures to augment the Consolidated Fund of the States in supporting their local bodies. Thus whatever support is given by the Central Government as per the recommendation should primarily come to
the States and should become a part of the support that they give to their PRIs/ULBs. Secondly, States like Karnataka, which devolve a large portion of their resources to their Local Bodies, should not be compelled to match a part of the share given by the Central Government. This mechanism should change to one where the assistance given by the Central Government should support the State in their devolution to the PRIs/ULBs with the condition that at least the amount recommended by the State Finance Commissions is devolved to the local bodies.

**All State Finance Commission Reports:**

Finance Commission aim to examine how far State Finance Commission has fulfilled the constitutional task expected of it (Oommen, M.A, 1998, p.17) Every State Finance Commission has to formulate clear idea regarding the divisible pool taking into account the functional domain of the state on one hand and that of the local bodies on the other.

**Expenditure Assignment Comparative Picture:**

State Finance Commissions are supposed to review the functional mapping ensured by the concerned state government according to the 73rd Constitutional Amendment Act. Recommendations of First State Finance Commissions Reports of all states are taken.

Finance Commissions of all states, except West Bengal State Finance Commission, have addressed the question of improving the quality of services and increasing the basic services in their expenditure need assessment.
Punjab State Finance Commission made recommendations for devolution of obligatory functions of panchayats. Gujarat State Finance Commission examined the potential of privatization of services and analyzed the trend in government expenditure with a view to recommend steps for reduction in expenditure. Rajasthan State Finance Commission made provision for maintenance of roads and state buildings largely on the basis of ad hoc grants. Similarly Kerala State Finance Commission has assumed 10% of the current capital cost of assets as a normative level of maintenance expenditure for community assets. Andhra Pradesh State Finance Commission made a provision for capital grants of Rs 248 crores per annum for a period of 5 years for water supply. Himachal Pradesh State Finance Commission recommended for developing infrastructure and for its maintenance about Rs 12.8 crores for a period of 5 years. Kerala recommended that maintenance expenditure should be based on the current cost of construction and projected inflation. West Bengal State Finance Commission approach of treating the resources required as an entitlement seems to be relevant in the given context mandates promotes local self government.

Importantly, Punjab State Finance Commission recommended that Rs. 600 per year per house should be available to each Gram Panchayat out of the resources available through sharing of taxes and mobilization of resources.

**Tax Assignment:**

The rationalization of local tax structure and tax assignment is the tasks before all states State Finance Commission reports. The key concepts they have
to keep in mind are; measures to promote fiscal autonomy and building up a cost-effective tax administration and local structure (Bardhan: 1996). Recommendations of First State Finance Commissions Reports of all states are taken.

State Finance Commission of Punjab, Rajasthan, and Kerala have tried to rationalize the local tax structure. Kerala State Finance Commission recommended a revision of the taxes imposed several new taxes. Similarly, Punjab State Finance Commission laid down the principles of tax assignment based on Musgrave's concept of fiscal devolution, and also recommended imposing of several new taxes with rationalization of old ones. Punjab state finance Commission recommended land revenue and cess be assigned to panchayats (GP 50%, PS 30% and ZP 20%) and panchayats should be given freedom to levy taxes and fess and also to fix the rates without state government control and intervention. Rajasthan State Finance Commission recommended broadening the fiscal domain of panchayats through tax assignment. It assumed that the resources earned from primarily education cess will improve the female literacy rate in the states provided that such amount is being spent on improving the educational infrastructure. West Bengal State Finance Commission has recommended a new regime of tax collection, ensuring the cooperation of panchayats. Importantly, Kerala State Finance Commission lamented upon the principles of tax assignment and adopted the criteria for fiscal devolution so that local needs are met with sufficient buoyancy. Andhra Pradesh State Finance Commission recommended
increasing the land cess, local cess, and license fee. It also lamented upon the existing sources of panchayats and recommended that the present levels of rates and prices of users' charges should be revised. Gujarat State Finance Commission has given several recommendations regarding rationalization of tax administration. It suggested revision of taxes, fees and cess. In Uttar Pradesh State Finance Commission suggested additional taxes to panchayats in the assumption that the recovery of such taxes would not be feasible under their jurisdiction.

More autonomy can be ensured by increasing the non-tax revenue raising capabilities of the PRIs. Kerala State Finance Commission and Punjab State Finance Commission made some recommendation to improve upon the resources form non-tax revenue. Kerala State Finance Commission made provision for rationalization of income from properties which are included in non-tax revenue sources. Importantly, in most of the states, State Finance Commission could not recommend the measures to improve the sources of non-tax revenue, although there is great potential to augment such resources.

Loans and advances are given to some specified local bodies. In most of the states, there are no loans outstanding with PRIs. A few State Finance Commissions have recommended that there should be a separate financial corporation to look after the credit and technical needs of PRIs. Punjab State Finance Commission recommended that panchayat should be given freedom to borrow from banks and other financial institutions for the development projects without the state governmental approval and guarantee. Similarly Kerala and
Rajasthan State Finance Commission made provisions for augmenting the resources of local bodies through loans from financial institutions.

Revenue sharing mechanisms are quite common in developing countries. All State Finance Commissions except Kerala have recommended tax sharing. Karnataka, West Bengal and Rajasthan State Finance Commissions have brought the entire tax revenue within the divisible pool while Punjab State Finance Commission has recommended the sharing of 5 taxes viz stamp duty, vehicle tax, electricity duty, entertainment tax etc. Thus, the revenue share for local bodies as recommended by State Finance Commission ranges from 2.18% to total tax revenue of states to 36% of the total Non-Loan Gross Own Revenue Receipts of state government.

The revenue share was reported highest in Kerala as recommended by Kerala State Finance Commission. In case of West Bengal State Finance Commission, 16% of all tax revenue collected by the state was supposed to be channelised to PRI. Importantly, the criteria for fiscal devolution recommended by the Kerala State Finance Commission and West Bengal State Finance Commission have taken into account the principles of territorial equity transparency and predictability. Punjab State Finance Commission has tried to follow the principles of revenue sharing. Uttar Pradesh State Finance Commission recommended that out of 3% of the net proceeds of states taxes, 1/5th there of should be earmarked for Zilla Panchayat and balance 4/5th for the Gram Panchayat.
Grants: There are two types of grants, general grants and specific or conditional grants. The general grant is provided to local authority with additional resources and autonomy to use. On the other hand, conditional or specific grant are being provided to the local authority for improvement in the existing services and creating infrastructure. Grants given to Local Bodies in Karnataka form 1995-2005 is in percentage of total grants. Karnataka got 5.06% in 1995-2000 but it had decreased to 4.92% in 2000-2005. It has gained less in EFC. The existing grants regime in local finance (general purpose and specific) is unsystematic. Rationalization of grants schemes has not been attempted by the State Finance Commissions. (G Pillai 2002).

Kerala State Finance Commission has tried to bring in some rationality into the bewildering variety of statutory and non-statutory grants. Similarly Punjab State Finance Commission has recommended general and specific purpose grants for promoting incentives for better performance of PRIs. Uttar Pradesh State Finance Commission observed that Centrally Sponsored and Central Sector Schemes should be run as usual and the existing system of Grants-in-Aid is needed to be continued. The commission also recommended annual grants of Rs 189.88 from 1996-97 onwards to rural local bodies by the way of state matching contribution.

Dependence of local bodies on state government for devolution of functions and finances:

Local bodies need adequate financial resources in order to discharge their expenditure responsibilities devolved upon them. There was no provision
in the constitution for a list of taxes and duties which could be levied by local bodies. The 73rd Constitutional Amendment also does not make such a provision. The ultimate decision of authorizing and assigning selective taxes of local bodies continues to reside with the state legislature. Constitutional Amendment has kept the financial powers of local bodies within the jurisdiction of the state governments. Similar is the case regarding devolution of functions and responsibilities of local bodies.

Provision of Constitutional Amendment Act 1993, shows that these amendments have succeeded only in providing a long list of functions and responsibilities to be devolved to local bodies, without change in much in empowering local bodies with financial powers of local bodies. Functions of PRIs as indicated in the constitution are discussed in chapter III. In fact, paucity of funds constitutes a major constraint faced by local bodies in the state. The financial conditions of local bodies, therefore depends upon the state government transfers through tax sharing, assignment of revenue and various grants.

The State Finance Commissions have examined the financial resources of local bodies for a specific period, classified into tax revenue and also the extent of devolution of resources from a state government. The main sources of revenue are 1) own locally generated revenue, both tax and non-tax; 2) resource transfers from higher level governments, particularly the state government, which included assignment of revenue and grants in aid, both general and specific; 3) borrowings
Fiscal autonomy largely depends upon the extent to which own resources are raised by the local bodies. Self effort to raise resources may be one of the criteria for determining devolution of resources from the state government to local bodies.

4.5 RESOURCE MOBILISATION AND LOCAL BODIES

In practice the recommendations of SFCs governing panchayat finances are often ignored by their respective state governments usually on the grounds of resource constraints. Most state governments in India are experiencing fiscal deficits and are reluctant to devolve greater expenditure autonomy to local government. Political commitment alone cannot ensure well-functioning of PRIs in the absence of transfer of sufficient powers, responsibilities, and resources to the lower tiers of government.

Financial devolution, however, has not been accompanied by greater responsibility for revenue sharing, which leaves panchayats largely dependent on transfer from central and state government. Effective devolution of decision making on expenditure priorities, and to some extent revenue-raising power, is a critical element of successful devolution initiatives, as it provides a legitimate role.

Resource mobilization depends on the size and type of PRIs and on the task to be performed. Some legislative measures to work towards viable panchayats are an essential pre-condition for efficiency and resource mobilization. Resource mobilization by panchayats by way of tax and non-tax revenues has become much important in recent years. An important source of
revenue to the panchayats is the tax on buildings. “Every gram panchayat shall in such a manner and subject to such exemptions as may be prescribed and not exceeding the maximum rate specified in schedule IV levy tax upon buildings and lands which are not subject to agriculture assessment, within the limits of the panchayat area”.

Resource mobilization by the panchayats:

Constitutional Provisions (Internet)

1. According to Art. 243H of the Indian Constitution, the state legislatures are empowered to enact laws authorizing the panchayats to levy, collect and appropriate certain specified taxes, duties, tolls and fees. Such levy, collection and appropriate will be in accordance with such limits as may be specified by the state legislature by law.

2. Similarly under item (ii) of sub-clause (a) of clause (1) of Art.243-I of the Indian constitution, the State Finance Commission is required to make recommendations to the state to Government, the principles which should govern determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by, the panchayats.

3. State Panchayati Raj Acts specify the taxes, duties, tolls and fees which are transferred to panchayats for their exclusive use. In most of the states, revenue raising powers are granted by the state legislatures mostly to the village-level panchayats.
4. At present, under the State Panchayati Raj Acts of AP, Assam, Haryana, HP, TN, Goa, Kar, MP, WB, and Punjab, levy of some taxes and non-taxes by the panchayats has been made compulsory.

Why to mobilize own Resource?

The imperative need to augment the natural resources of the panchayats is due to the following reasons:

- Absence/meager mobilization of local resources will not permit the panchayats to provide at least the minimum basic services to the people.

- In utilizing the resources mobilized through their own efforts, panchayats will be more careful in choosing the items on which funds will be spent.

- Unless panchayats mobilize their own resources they may not be able to make any matching contribution for the Finance Commission grants or other matching grants of state government.

- Greater dependence on government grants will increase the control of the state government over them, and reduce their functional autonomy. They would not be able to enjoy any decision-making power.

- Non-existence of their revenue powers or absence of revenue collections by the panchayats will not create any awareness among the people regarding local governance.

- People’s involvement and participation in panchayat activities of panchayats and development project will be greater if they pay taxes and non-taxes to the panchayats.
• Panchayats may not be able to appoint any staff if they do not have own resources mobilized from their localities.

• The goal of becoming institutions of self-government will not be achieved by the panchayats if they do not raise their own resources.

Present Scenario:

1. Several State Panchayati Raj Acts empower the Panchayats to levy a variety of tax and non-taxes. The taxes which are transferred to the panchayats across the States in the country include powers to levy a tax on professions, trades, employments and callings; a tax on buildings and lands; a tax on vehicles and animals; a tax on entertainments and shows; a tax on advertisements and hoardings; a surcharge on stamp duty; user charges or rates in respect of provision of important civic amenities; pilgrim tax; tax on commercial crops; surcharge on land revenue; etc.

2. Unfortunately, in practice the taxes, which are transferred by the state legislatures to their panchayats, are very few in numbers. Panchayats could not fully utilize their available revenue-raising powers for the following reasons.

   o Absence of suitable guidelines or rules framed by the State governments.

   o Lack of secretarial and other staff.

   o Unwillingness of the elected panchayats to levy and collect taxes and non taxes in their localities.
- Unwillingness of the local people to pay panchayats taxes due to the absence of minimum basic civic services in the villages.

- Inability of several households in the villages to pay taxes due to their poverty.

**Measures to increase own resources:**

- Among the various tax power devolved to the panchayats by the states, the important one is the tax on houses/buildings. This tax is very productive if levied regularly according to the procedures and rules prescribed by the state government. Unfortunately panchayats are not using this tax fully. They will earn significant own revenue if they compulsorily levy this tax, fix the tax rates at a reasonable level, and revise their assessment at least once in every five years, and collect the tax fully each year. In addition, to this tax, panchayats should also make sincere efforts to levy other taxes transferred to them under the state Panchayati Raj Acts.

- Panchayats should also review their tax and non-tax rates each year, and revise them upward where needed. Similarly, they must improve their revenue collection efforts without keeping political consideration in view.

- In the broader interest of local autonomy and democratic decentralization at the grass-root level, the state government may have to strengthen the power and autonomy of the panchayats in mobilizing larger revenue from their localities. This requires enlarging the revenue
base and territorial jurisdiction of the panchayats, offer of revenue-matching grants, and framing appropriate guidelines on financial management offering greater freedom to the panchayats.

- As the panchayats may find it difficult to raise sufficient revenue from their taxes, they must make serious efforts to increase their own resources through other revenue powers granted to them. These powers relate to levy of fees, fines, rents from properties, and tolls. These remunerative enterprises take some of the following forms:

a) Intermediate and District panchayats can construct industrial estates, market sheds, slaughter houses, shopping complexes, community halls, etc., for which they can borrow funds from their state government or Banks. These remunerative enterprises can be leased out by the panchayats to earn additional revenue.

b) In the long run, panchayats can improve their own resources only through non-tax resources and may not depend only on state or central government grants.

4.6 CONCLUSION:

Devolution of financial resources to local bodies has been ensured through constitution of State Finance Commission. So far two State Finance Commissions have been appointed in Karnataka. Four stages of Fiscal devolution framework are recommended by State Finance Commission. Devolution to PRIs as per State Finance Commission Recommendation as per Non Loan Gross Own Revenue Receipts is studied. The criteria used by First
SFC for the distribution are population, area, backwardness indicators, illiteracy rate and population per hospital bed and Second SFC criteria indicators are same as FSFC indicators except SC/ST population. First State Finance Commission recorded the transfer of 36% weightage and Second State Finance Commission recorded 40% weightage of the transfers to local bodies. All the tiers of panchayats have been assigned with large number of functions. But none of them has financial or administrative resources under their control to execute them.