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**FINANCES OF PANCHAYATS  
IN KARNATAKA:  
A POLICY PAPER**

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**INSTITUTE FOR SOCIAL AND ECONOMIC CHANGE  
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# **FINANCES OF PANCHAYATS IN KARNATAKA: A POLICY PAPER**

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## ***Abstract***

*For panchayats to be called self-governing institutions, some degree of fiscal autonomy is needed, among other factors. The analysis of this aspect in the context of Karnataka State, however, reveals certain disturbing trends. Overall, the panchayats in the State have very little fiscal autonomy. The fiscal provisions incorporated in the State Panchayat Raj Act have centralised tendencies. The locally raised revenues are negligible, and thus largely depend on government grants. Of late, the transfers from the State to the panchayats have been declining.*

## **Introduction**

Karnataka, a major state in South India, embarked upon a meaningful decentralisation in the mid 1980s. Further, it was the first state to implement the important provisions of the 73<sup>rd</sup> Constitution Amendment Act brought out in the year 1992. As a first step towards this end, it enacted a new Panchayat Act in the year 1993 namely "The Karnataka Panchayat Raj Act, 1993". Based on this Act, a three-tier panchayat raj system - Grama Panchayat (GP) at the village level, Taluk Panchayat (TP) at the taluk/middle level and Zilla Panchayat (ZP) at the district level, was established during 1994 and 1995. Elections were held for these bodies for the third time in April 2000. In all, there are 5650 GPs, 175 TPs and 27 ZPs in the state. Reservations have been provided for vulnerable sections of the society like Scheduled Castes and Scheduled Tribes (SCs/STs), backward classes and women according to the percentage prescribed in the 73<sup>rd</sup> Amendment Act. Further, reservations have been made not only for membership but also for executive positions. The chairpersons of the panchayats have been accorded the status of 'Executive Head'. In other words, the elected body is placed above the bureaucracy.

To facilitate smooth governance and planning, the state has deputed a large contingency of its personnel to serve in these institutions. The number of personnel working in Panchayat Raj Institutions (PRIs) during 1999-00 stood at 3.43 lakh (Government of Karnataka 1999). With regard to functional decentralisation, the state has transferred nearly 665 plan and non-plan schemes in about 25 development sectors to all

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the three tiers. Considering the importance of resources for the effective functioning of local democratic governments, the State and the Centre have been devolving larger grants since 1987-88. The most striking feature of financial decentralisation in the State was the constitution of a 'State Finance Commission' (SFC) for the purpose of distribution of tax powers and resource between the State and the local governments. Since the initiation of decentralisation in 1980s, three SFCs were constituted and the reports were submitted to the State Government for necessary action (Government of Karnataka 1989, 1996, 2003a).

A fair degree of financial autonomy (in the true spirit of decentralisation of power) is a *sine qua non* for PRIs to function more effectively as self-governing bodies; by financial autonomy we mean that they should have their own taxation and borrowing powers as well as a share in the State's taxes and duties and grants-in-aid. These institutions should not only have the power to raise resources but also the right to use the funds as per their needs and priorities. The resources available from their own sources and those devolved should match the functions and responsibilities entrusted. In the absence of these, PRIs become mere spending agencies, always dependent entirely upon the State Government for the transfer of grants. Bird (2002: 899) is of the view that "if services are to be efficiently provided, transfers must be designed so that those receiving them have a clear mandate, adequate resources, sufficient flexibility to make decisions and are accountable for results". An important related aspect is that the government should have a broad set of criteria for distribution of grants among the panchayats so that the funds are distributed on an equitable basis. Thus, the responsibility of making the PRIs fiscally autonomous and stronger lies with both the State and the Central governments.

### **Objectives and Design of the Study**

Keeping in view the above background, this paper sketches the fiscal status of PRIs in Karnataka. We first describe the legislative provisions provided both at the Central and State levels, coupled with field reality, and then draw comparisons of the experiences of Karnataka with those of neighbouring states (Andhra Pradesh and Tamil Nadu) and suggest policy measures. The analysis has been carried out based on qualitative and quantitative information gathered from various sources, the latter is based on secondary sources of information and the former on observations and discussions held with the functionaries of panchayats. The analysis is based on larger studies undertaken across states and during different periods (Aziz 1994; Aziz et al 1998, 2000; Babu 1999) and is both

descriptive and analytical in nature. In the paper, analysis on the SFC appears in different places and this refers to the 1996 report. Further, the paper largely deals with the revenue aspect of the finances.

## **Legislative Provisions**

The Central and the State Governments have provided for statutory fiscal powers and transfers considering the importance of adequate resources for the effective functioning of PRIs. The provisions relating to these are given below.

### **Central Level Provisions**

At the Central level, articles 243(H) and 243(I) of the 73<sup>rd</sup> Constitution Amendment Act talk about the type and method of bestowing fiscal powers on the PRIs. Article 243(H) states that the legislature of a state may, by law:

- .. Authorise a panchayat to levy, collect and appropriate such taxes, duties, tolls and fees in accordance with such procedure and subject to such limits;
- .. 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;
- .. Provide for making such grants-in-aid to the panchayats from the Consolidated Fund of the state; and
- .. 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 appointment of a 'Finance Commission' by the states once in five years. The responsibilities of the State Finance Commission (SFC) are to:

- .. Distribute the state's resources between the state and the local bodies;
- .. Assign any of the state's taxes, duties and fees to these bodies; and
- .. Recommend grants-in-aid for the purpose of providing services.

Besides this, articles 280(bb) and 280(c) of the Constitution place additional responsibility on the Central Finance Commission (CFC) to look into the resources of the PRIs. As per Article 280(bb) the CFC has to recommend measures needed to augment the Consolidated Fund of a State. The Act further empowers all the three-tiers to mobilise resources from non-tax sources. The non-tax sources comprise rent or income from own buildings and assets, sale proceeds of movable and immovable assets, auction of trees, fruits etc.

- ◆ The Act under sections 214, 220 and 229 empowers the grama panchayats, taluk panchayats and zilla panchayats respectively to raise loans
- ◆ The Act permits the PRIs to receive contributions, gifts and aid from different sources. These are mainly from local people, philanthropists, charitable institutions, and voluntary and non-governmental organisations.

basis of the recommendations made by the Finance Commission of the state.

### **State Level Provisions**

With regard to financial powers of PRIs, the state PR Act has the following provisions:

- ◆ Section 199 of the Act provides for levy of taxes, rate, fee etc., by Grama Panchayats. The important taxes assigned are – tax on buildings and lands, tax on water (drinking water), tax on entertainment other than cinematography shows, tax on vehicles other than motor vehicles, tax on advertisement and hoarding, pilgrim fee, market fee, fee on buses and taxis and auto stands, and fee on grazing lands.
- ◆ Section 202 provides for levy of tax on factory/industry by the Grama Panchayat.
- ◆ Section 204 provides for levy of local cess on the land revenue by the government whose proceeds are to be passed on to the Grama Panchayats.
- ◆ Section 205 provides for the government to levy an additional duty in the form of surcharge (maximum of 3 per cent) on stamp duty, the entire amount collected being passed on to the taluk panchayats in proportion to the population of each taluk.
- ◆ Section 206 states that the government shall make a grant of Rs. 1.00 lakh annually to each grama panchayat on condition that it be utilised for meeting costs of street lights, maintenance of water supply schemes, sanitation and other welfare activities. This statutory grant has been revised to Rs. 2.0 lakhs per annum in the year 1999 through an Order by the government. Again by an Order an additional grant of Rs. 1.5 lakhs (development grant) was given to each GP from the year 2001. This development grant has further been enhanced to Rs. 3.0 lakhs from the financial year 2003 - 04.
- ◆ Section 207 provides for establishment grant by the government to every taluk panchayat and zilla panchayat at such scale as may be determined by it.
- ◆ Section 208 of the Act authorises the government to make discretionary grant to grama panchayats, taluk panchayats and zilla panchayats for such purposes and on such terms and conditions as may be decided by it.

- ◆ The Act further empowers all the three-tiers to mobilise resources from non-tax sources. The non-tax sources comprise rent or income from own buildings and assets, sale proceeds of movable and immovable assets, auction of trees, fruits etc.
- ◆ The Act under sections 214, 220 and 229 empowers the grama panchayats, taluk panchayats and zilla panchayats respectively to raise loans
- ◆ The Act permits the PRIs to receive contributions, gifts and aid from different sources. These are mainly from local people, philanthropists, charitable institutions, and voluntary and non-governmental organisations.

## **Fiscal Powers and Resource Mobilisation**

### **Tax Powers**

As stated earlier, PRIs should have the power to levy tax, a share in State taxes and duties, and grants-in-aid from higher level governments to discharge their duties effectively. In the absence of this, the panchayats would face severe problems of fiscal gap, leading to deficiencies in the provision of services to the people. Keeping this in view, if we take a look at the position in Karnataka, it becomes obvious that there is no clear-cut basis or principle for intergovernmental fiscal transfers while allocating tax powers and grants-in-aid to PRIs. It may be observed that except mandal panchayats (lowest tier of panchayats) in the earlier period (1987–88 to 1991–92) and GPs since 1994–95, no other tier enjoys own taxation powers. Further, no individual tax is shared with PRIs except the surcharge on stamp duty with the TPs. It is obvious that the zilla parishads in the earlier period and zilla panchayats since 1994–95 entirely depend upon state and central grants. Similarly, the present TPs by and large depend upon government grants for their needs since the share of stamp duty (3 per cent surcharge) in their total revenues accounts for just around 6 per cent (Babu 1999: 40).

In contrast to the above, the pictures that we obtain in the neighbouring states of Andhra Pradesh (AP) and Tamil Nadu (TN) are quite different. In these two states, the lowest tier (grama/village panchayat), as in Karnataka, is given certain tax powers. Further, in AP, unlike Karnataka, all the three tiers receive a share in certain taxes, i.e. in the form of cesses and surcharges, per capita grant and, specific purpose grants from the State and the Centre (Babu 2002a: 71-4). The details of fiscal powers of PRIs in AP is given in box 1.

<b>Box 1: Fiscal Powers of PRIs in Andhra Pradesh</b>	
<b>Grama Panchayat:</b>	
(i)	Own taxation powers
(ii)	Shared taxes – land cess, stamp duty, seigniorage fee, mineral cess
(iii)	Per capita grant
(iv)	Development (specific purpose) grants
<b>Mandal Parishad:</b>	
(i)	Shared taxes – land cess, stamp duty, entertainment tax, seigniorage fee, mineral cess
(ii)	Per capita grant
(iii)	Development (specific purpose) grants
<b>Zilla Parishad:</b>	
(i)	Shared taxes – land cess, stamp duty, entertainment tax, seigniorage fee, mineral cess
(ii)	Per capita grant
(iii)	Development (specific purpose) grants

Source: Aziz et al.2002, '**Decentralised Governance and Planning: A Study of Three South Indian States**', Macmillan, New Delhi.

The fiscal status of PRIs in Tamil Nadu is slightly different from the above two states. Its position is shown in box 2.

<b>Box 2: Fiscal Status in Tamil Nadu</b>	
<b>Village Panchayat:</b>	
(i)	Own tax powers
(ii)	Shared taxes (land tax, stamp duty, entertainment tax)
(iii)	Incentive (matching) grant on house tax collection
(iv)	Specific purpose grants
<b>Panchayat Union Council:</b>	
(i)	Own tax powers (land cess, surcharge on land revenue)
(ii)	Incentive (matching) grant on local cess collection
(iii)	Specific purpose grants
<b>District Panchayat:</b>	
(It is largely an advisory body and as such no financial implication is involved)	

## **Non-Tax Revenue**

Non-tax is another important source of revenue for the PRIs. The non-tax sources consist of rents from shops and buildings, sale of assets, auctions of trees and fruits etc. In Karnataka all the three tiers of panchayats are empowered to collect non-tax revenue and utilise the same for their own needs. However, a distinction that needs to be noted in this regard is that the panchayats are allowed to collect and utilise non-tax revenues from their own properties and assets, and all other income, particularly the user charges accruing from various departments, have to be credited to the state's Consolidated Fund. The State has barred PRIs from utilising the latter's revenue on the ground that it shares its entire revenues (own tax and non-tax) with the panchayats.

## **SFC Recommendations**

The first SFC of Karnataka (after the 73rd Constitutional Amendment) submitted its report in the year 1996. The government accepted many of the recommendations of the SFC and follow-up actions were taken (Babu 2002b). The Commission did not recommend any tax powers to zilla and taluk panchayats for various reasons. It had recommended sharing of the State's entire revenues comprising non-loan gross own revenue receipts (NLGARR) with the panchayats. A fixed share of 36 per cent of the State's Consolidated Fund (state's own tax and non-tax revenues) annually was recommended for both urban and rural local bodies. Of the 36 per cent, the share fixed for PRIs was 85 per cent (or 30.6 % of 36 %) and the remaining 15 per cent for Urban Local Bodies (ULBs). The state government, in its action taken report stated that it accepted this recommendation and also implemented accordingly. However, the fact is that it has been devolving more grants to PRIs than prescribed by the Finance Commission except during 1995–96 (Babu, 2002b: 414). The State has accepted this recommendation since it has nothing to lose from the present level of transfers. However, it did not accept the recommendation made with regard to the shares of different tiers of panchayats.

## **Borrowing Powers**

As stated earlier, the Karnataka PR Act empowers the PRIs to raise loans for the execution of any development work or for the purpose of carrying out any of the provisions of the Act. However, so far, there is no evidence of any panchayat making use of this statutory power. Though the Act empowers the panchayats to raise loans from financial and other institutions, the process involved is not that simple. Along with this



provision the State has imposed certain conditions. These are that the panchayats, before going in for loans, should obtain Government's sanction, and that they should form a 'sinking fund' for the repayment of such loans. Owing to these stringent conditions, the panchayats in the State have not made any attempts to raise loans for their developmental needs.

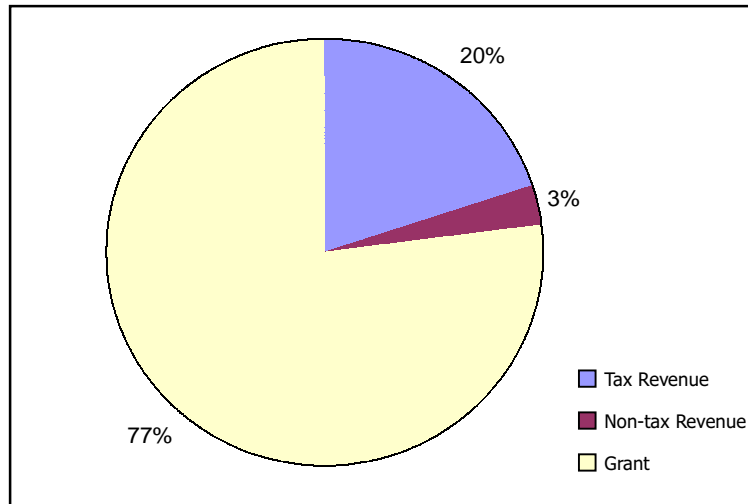
### **Resource Mobilisation by PRIs**

As brought out earlier, the higher two tiers enjoy no tax powers. Only GPs have this privilege. As such, any discussion on the resource mobilisation by the PRIs in the State is confined to GPs only. Though a large number of tax powers have been given to GPs, they could tap only a few of them. By and large, they have tapped house tax, water tax, tax on industry, and shandy (market) fee. The taxes that they have not touched are entertainment tax, vehicle tax, tax on advertisements and hoardings. The reasons for not using these tax sources by the GPs are stated in the concluding section of the paper. The important non-tax sources tapped by GPs are license fees, rents from shops and buildings, and auctions of trees and fruits. It would be pertinent here to present the extent of resources available to the GPs and, in particular, the share of own revenues in their total revenues. This information has been taken from a study undertaken in Karnataka (Babu 1999) and relates to eight sample GPs. The information reveals that the average revenue per GP per year from all sources amounted to Rs. 3.00 lakh in the mid- 1990s. Since the State hiked the grant-in-aid from Rs. 1 lakh to Rs. 2 lakh in the year 1999 and again to Rs. 3.5 lakh (including Rs. 1.5 lakh development grant) during 2001–02, the average revenue per GP/year totals up to Rs. 6.00 lakh. This may further go up to Rs.7.50 lakh as the State Government has announced an additional Rs. 1.5 lakh while presenting the 2003–04 budget (Government of Karnataka 2003b: 9).

Apart from the above, the more important aspect is the share of own revenues in the GPs' total revenues. This information is presented in Figure 1. As can be seen from Figure 1, of the total revenues, own tax revenue constitutes 20 per cent, own non-tax revenue 3 per cent and grants (State and Centre) 77 per cent. A similar study in Karnataka also brings out that the average share of own revenues (tax and non-tax) of GPs account for 18 to 20 per cent of their total revenues (Babu, 2002d: 15). Further, the data (average of three years – 1995–96 to 1997–98) reveals that all the GPs in the State collected just about 41 per cent of the total estimated tax revenue (Babu 1999: 29-30). It is clear from the above that the own effort in the resource mobilisation of GPs is not up to

the mark. They are heavily dependent upon grants from the higher level  
1112 **Figure 2: Percentage Share of PRIs in the State Plan Outlay (State and Centre) from 1987-88 to 2003-04**

Source: 1. Planning Department, 'Economic Survey' (Various years), Government of Karnataka.



2. Reserve Bank of India, 'RBI Bulletins' (Various issues).

Similarly, if we look at the resources devolved to PRIs exclusively from the State's own revenues, a declining trend is visible (Figure 3). The average percent of revenues devolved by the State out of its own revenues in the above respective periods are 37 %, 35 %, 35 % and 33 %. Though the resources devolved to PRIs by the State are much more than that recommended by the SFC (except during 1995-96 and 2003-04), the implication is that the grants devolved to PRIs by the State are not keeping pace with the growing revenues of the State. Due to a general resource crunch, on the one hand, and restrictions in the matters of borrowings and resorting to deficits, on the other, the PRIs have made very nominal allocations to certain important sectors in their annual budgets (Babu 2001: 93). In other words, it implies that there exists a general mismatch between needs and resources at the panchayat level.

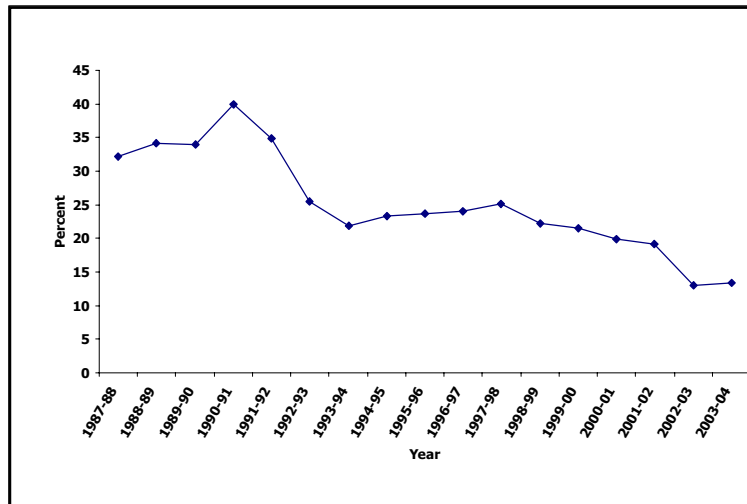
**Nature of Grants Transferred:** Another related issue that needs analysis is tied versus untied grants. This has currently become a vital issue throughout the country. The advocates of decentralisation are for providing untied grants so that the local governments can have discretion in choosing the programmes/projects according to region/local specific needs. In this respect the studies on the nature of grants devolved to PRIs in Karnataka reveal that they are largely tied to various schemes (Aziz 1994; Government of Karnataka 1996; Chandran 2000: 144). Even the Government's own analysis reveals that of the PRIs total plan grants in a year, just 14 per cent was available as free outlay (Government of Karnataka 1988: 45). Comparatively, in Kerala the panchayats receive nearly 35 to 40 per cent of the State Plan Outlay in the form of untied grants (John and Chathukulam 2001: 4). The SFC, after discovering that the PRIs have no free outlay, had recommended provision of at least 10 per cent of their plan grants as free outlay (Government of Karnataka 1996: 293). The elected representatives of PRIs in different forums, particularly in the training programmes, seminars and workshops held at the Institute for Social and Economic Change, Bangalore strongly expressed the need for devolution of untied grants by the governments

Government may provide discretionary grants to the panchayats. This means the devolution of resources from the State to PRIs will depend upon the willingness and ability of the Government and the panchayats have no right or say in this matter. The grants accruing to PRIs are mainly from three sources, namely, the State Government, the Central Government and on the recommendations of the UFC. The State grants consist of plan and non-plan grants, whereas the Central grants constitute only plan grants which are conditional and matching in nature. The grants recommended by UFCs (Tenth and Eleventh) are non-plan and are thus again conditional and matching (Government of India 2000; Babu 2002c).

Though the State possesses discretionary power in providing grants to PRIs, in reality the quantum of grants transferred to them is far greater than is available to panchayats in AP and TN states (Aziz et al 2002; Babu 2002c: 12). But the disturbing trend is that the grants devolved to PRIs over the years have been increasing in absolute terms, but declining in percentage terms. The decline in percentage terms is noticed not only in the plan grants (State and Central share) but also in the resources devolved out of the State's own revenues (plan and non-plan purpose grants). In fact, the plan grants allocated to PRIs have declined in absolute terms also in the present fiscal (2003–04) as well as in the previous fiscal year (2002–03). The share of PRIs, i.e. plan grants in the State plan outlays is depicted in Figure 2.

The average plan grants devolved to PRIs by the state (in percentage terms) in different periods (term of office) - the first period (1987–88 to 1991–92), administrators' period (1992–93 to 1993–94), the second tenure (1994–95 to 1999–00) and in the present period (2001–02 to 2003–04) has been declining. Their respective shares stood at 37 %, 24 %, 23 % and 16 %. The CAGR (Compound Annual Growth Rate) calculated for both State plan outlays and PRIs plan grants also brings out the same results. It may be noted that the CAGR for State plan outlays between 1987–88 and 1991–92 was 13 % whereas in the case of PRIs it was 17 %. In the last period, i.e. from 1997–98 to 2001–02 it was 14 % in the case of the former and in the latter case just 7 %. Thus a drastic decline is witnessed in recent years in the devolution of plan grants to PRIs in the State.

**Figure 2: Percentage Share of PRIs in the State Plan Outlay (State and Centre) from 1987-88 to 2003-04**



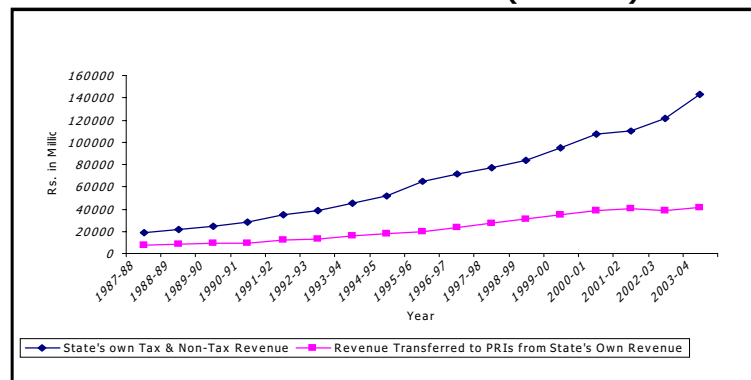
Source: 1. Planning Department, '**Economic Survey**' (Various years), Government of Karnataka.  
 2. Reserve Bank of India, '**RBI Bulletins**' (Various issues).

Similarly, if we look at the resources devolved to PRIs exclusively from the State's own revenues, a declining trend is visible (Figure 3). The average percent of revenues devolved by the State out of its own revenues in the above respective periods are 37 %, 35 %, 35 % and 33 %. Though the resources devolved to PRIs by the State are much more than that recommended by the SFC (except during 1995-96 and 2003-04), the implication is that the grants devolved to PRIs by the State are not keeping pace with the growing revenues of the State. Due to a general resource crunch, on the one hand, and restrictions in the matters of borrowings and resorting to deficits, on the other, the PRIs have made very nominal allocations to certain important sectors in their annual budgets (Babu 2001: 93). In other words, it implies that there exists a general mismatch between needs and resources at the panchayat level.

**Nature of Grants Transferred:** Another related issue that needs analysis is tied versus untied grants. This has currently become a vital issue throughout the country. The advocates of decentralisation are for providing untied grants so that the local governments can have discretion in choosing the programmes/projects according to region/local specific needs. In this respect the studies on the nature of grants devolved to

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**Figure 3: Share of PRIs (Plan and Non-plan Grants) in the State's Own Revenues from 1987-88 to 2003-04 (in Million)**

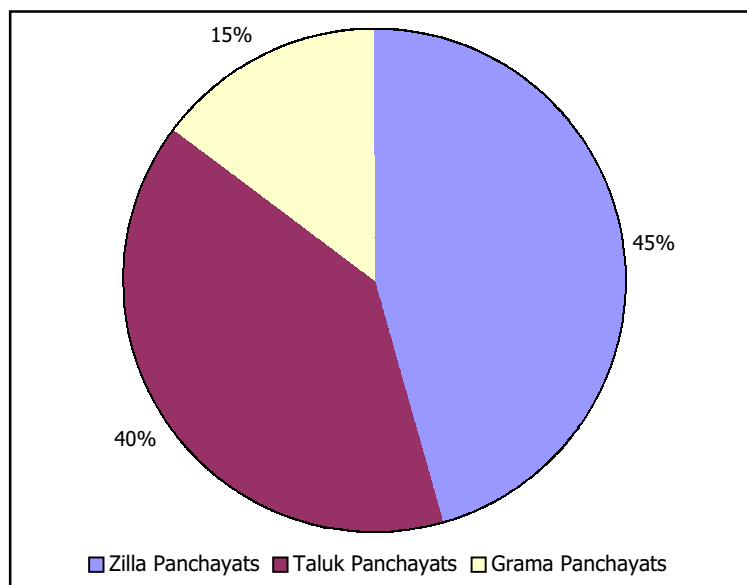


Source: Same as in Figure 2.

**Share of Three Tiers:** As noted in the beginning, the state has adopted a three-tier panchayat raj system in conformity with the 73<sup>rd</sup> Amendment Act. The powers, functions and resources devolved vary from tier to tier. The lowest tier i.e. the GP assumes greater importance due to its proximity to the people and enormity of the problems at the village level. The first task of any public institution is to meet the basic necessities of the people. The appropriate unit to deliver these tasks is undoubtedly the GP. Further, decentralised planning envisages that

planning should emanate from the grass-root (village) level and the crucial aspect of such planning is the people's participation in the plan process. Keeping this background in view one should analyse the importance of GPs. One measure that unfolds this is the extent of grants accorded to this tier *vis-à-vis* other tiers. The relative shares of the three tiers in the PRIs total plan grants (average of seven years from 1995-96 to 2003-04) in the State is shown in Figure 4. These shares are 45 %, 40 % and 15 % respectively to the ZPs, TPs and GPs. In the case of GPs, the share had almost remained constant since 1995-96. In contrast to this, the SFC had recommended 40, 35, and 25 per cent respectively, as the shares of ZPs, TPs and GPs in the sharable plan grants (Government of Karnataka 1996: 240). This shows that the SFC wanted the GPs to shoulder more responsibilities especially in the provision of basic services. However, the State Government has not implemented this recommendation. From this it is clear that the GPs in the State are not given their due among the three tiers.

**Figure 4: Share of Three Tiers in the PRIs Plan Grants (Average Percent from 1995-96 to 2003-04)**



Source: 1. For 1995-96 and 1996-97 – Rural Development and Panchayath Raj Department, Government of Karnataka.

2. Government of Karnataka, '**Budget Allotment for Zilla Panchayat – Plan and Non-Plan**', (various years from 1999-2000 to 2003-04).

## Devolution Criteria

One of the objectives of fiscal transfers is to minimise horizontal fiscal imbalances. The same objective holds good at the state and sub-state governmental levels also. To achieve this objective, the concerned grant-giving government should adopt a set of appropriate criteria. The Karnataka Government adopted 12 and 5 criteria (Table 1) for distribution of plan grants across the zilla parishads and mandal panchayats respectively, during the year 1987-88 when the State ushered in a new era of decentralisation. It is claimed that the same 12 criteria are being continued even now for the distribution of grants between the zilla panchayats. For the purpose of distribution of grants across the TPs, the then 5 criteria adopted for mandal panchayats have been replaced with six new criteria in the year 1998 (Table 2). With regard to grama panchayats, the criterion followed is to simply provide a fixed grant uniformly to each of the grama panchayats.

**Table 1: Criteria for Distribution of Plan Grants Across ZPs and MPs**

Criteria	Weightage (per cent)
<b>A. Zilla Parishads</b>	
1. Population	50
2. Backwardness in agriculture as measured by the value of agricultural output per hectare	5
3. Backwardness in irrigation as measured by the proportion of irrigated area to net area sown	7
4. Backwardness as measured by the value of industrial output	5
5. Backwardness in communications as measured by road and Railway mileage per 100 sq. km, and per lakh of population	5
6. Backwardness in financial infrastructure as measured by size of population served by each commercial and co-operative bank	2
7. Backwardness in medical and health facilities as measured by the number of hospitals per 1000 population/bed population ratio	5
8. Backwardness in power supply as measured by the proportion of villages electrified	5

Criteria	Weightage (per cent)
9. Problems of weaker sections: (a) as measured by the proportion of SCs/STs in the total population	2
(b) as measured by the proportion of landless agricultural labourers	2
10. Special problems of Malnad areas and drought-prone areas : (a) as measured by the area under forest	2
(b) as measured by the rural population of drought-prone areas <sup>2</sup>	
11. Literacy percentage	5
12. Performance in family planning programme	3
<b>Total</b>	<b>100</b>
<b>B. Mandal Panchayats</b>	
1. Population	50
2. Area of Mandal panchayat	15
3. Dry land area	15
4. Agricultural labour population	10
5. Per capita resources raised	10
<b>Total</b>	<b>100</b>

Source: Government of Karnataka, (1988), 'District Government and Decentralised Planning', pp.50-51.

**Table 2: Criteria Adopted for Distribution of Plan Grants between the Taluk Panchayats**

Criteria	Weightage (per cent)
1. Population	50
2. Area	10
3. Literacy	10
4. SC/ ST population	10
5. Dry land area	10
6. Number of agricultural labourers	10
<b>TOTAL</b>	<b>100</b>

Source: Rural Development and Panchayat Raj Department, 'GO – RDPR 46, DPD 98, 8-9-1998', Government of Karnataka, 1998.



In contrast to the above, the SFC had recommended a simple formula for *inter se* distribution of the devolution amount all the three tiers of panchayats. The formula and weightages are:

- a) Population (33.33 %)
- b) Area (33.33 %)
- c) Illiteracy rate (11.11 %)
- d) Number of persons per bed in government hospitals (11.11 %),  
and
- e) Road length per sq. km of area (11.12 %).

One notable feature of SFC's criteria was that for the first time it introduced area as one of the criteria. It reduced the weightage given to the population factor by the State. Both the population and the geographical area get equal weightage of 33.33 per cent. The State Government has not accepted the SFC's criteria on the ground that it has been following its own tested criteria in the distribution of grants across the ZPs and TPs. However, after adopting its own criteria for a few initial years, the State has not been applying its own criteria in the distribution of grants. The practice followed since 1990 as revealed from the discussions with the functionaries was a hike in the grants to each of the ZPs by about five to ten per cent of the previous year's outlay. Similarly, the ZPs are not applying the six criteria suggested by the Rural Development and Panchayat Raj Department for distribution of grants across the TPs in their respective jurisdictions. The ZPs adopt their own parameters in arriving at the development levels/needs of the TPs and accordingly distribute the grants. In the case of GPs no criterion is followed and the system in vogue is to give a fixed grant uniformly across the GPs irrespective of their needs and developmental levels.

Thus, it is clear from the above that the State Government neither follows its own criteria, nor the criteria suggested by SFC. In the absence of any scientific criteria, devolution is bound to be subjective and this results in widening regional disparities within the State. A study of grants devolved to PRIs in the districts of Mysore division of the State shows that the relatively developed districts received larger grants than the poor districts (Babu 2000a). Not only this, of late, there is a practice of releasing additional funds to certain ZPs outside the devolution scheme (Rural Development and Panchayat Raj Department 2002: 93-94). The High Power Committee constituted for the purpose of studying the regional disparities in Karnataka brings out that the districts which are backward

right from the beginning remain backward even now (Government of Karnataka 2002: 83-4). This proves that the State does not apply the criteria it once adopted in the devolution to PRIs. Further, the so-called criteria adopted are only for the distribution of plan grants. The State devolves resources to PRIs in the form of non-plan grants which is more than the plan grants and here also there is no scientific method used in arriving at the needs of various districts.

### **Conclusion and Policy Suggestions**

Apart from powers and functions, the PRIs need to be provided with adequate resources and discretion to utilise the available resources according to their needs and priorities. Seen in this context, the picture emerging in the State is not completely in conformity with the normative approach.

The Constitutional provisions with regard to finances of PRIs, as brought out earlier, have very few things Constitutionally mandatory. A great deal is left to the discretion of the legislature concerned.

As already observed the State has given tax powers only to the GPs. Viewed from the angle of autonomy, local bodies ought to have own resource-raising powers. However, it is feared that some problems such as demarcation of tax base, competition in giving concessions and reduction in tax rates, inefficiency in tax-raising efforts, high cost of fiscal services, externalities etc. may crop up if this power is vested with all the three tiers. On this ground, the SFC neither suggested any tax powers to the TPs and ZPs, nor the sharing of any individual taxes with them.

In contrast to the above, the Eleventh Finance Commission (EFC) of India adopted a set of criteria and the "Index of Decentralisation" (IoD) is one among them for *inter se* distribution of grants to the PRIs. Within this IoD, tax powers vested with the panchayats and the extent of own revenues mobilised were the important indicators included in it (Government of India 2000: 81). In Karnataka, since the two higher level panchayats have no taxation powers and the overall resource mobilisation being very negligible, they get a very small percentage share from the EFC's recommendations (Babu, 2002c: 9). Even at the all India level, except Maharashtra and Gujarat, no other state vested tax powers in the intermediate and the district tier (Girglani, no date: 44). Thus, there exists a controversy about bestowing taxation powers at all the three levels of panchayats, which needs wide discussion and consensus at the national level.

Setting aside the autonomy question, there are many ways of improving the resource base of PRIs within the existing fiscal system. The task of fiscal correction has to be borne both by the State Governments and by the panchayats themselves.

The PR Act has a provision to levy local cess on land revenue to be passed on to the GPs. But, in reality, the State, by not implementing this provision, is depriving the GPs of their legitimate revenue. In order to strengthen the finances of the GPs whose share in the total PRIs grants are very low, the state should collect this cess and pass on the proceeds to the GPs. Alternatively, the GPs should be empowered to levy this cess and appropriate the moneys themselves.

Most of the tax items assigned to the GPs are inelastic and their base is very narrow. Out of many taxes assigned, it seems that except house tax all others are inelastic in nature. Factories tax, though yielding substantial revenue is confined only to a handful of GPs situated near big towns and cities. To tap the bus stand fee, the panchayats should construct bus shelters along with providing other facilities for the passengers. Unless they do this, they cannot levy this fee. Similarly, it is hard to see any entertainment programmes conducted in the villages and as such there is limited scope for collection of entertainment tax. As for vehicle tax, only a few rich farmers possess bicycles and bullock carts. Other than this, we do not find tricycles or horse-pulled carts in the villages. If at all, this tax is mobilised, it will be very negligible.

A disquieting feature noticed is laxity in the resource mobilisation efforts by the GPs even in those sources that are important, like property tax. In certain GPs, the revenue collected from own sources is insufficient even to meet the salaries of their staff. The main factors for this low rate of revenue mobilisation are: small size of GP in terms of area and population, deteriorating standards of governance, non revision of tax rates for years, dependency syndrome and general ignorance of fiscal management.

Experience shows that the functionaries of mandal panchayats, especially the Pradhan (Chairperson), earlier wielded greater powers and clout due to the sheer size of the panchayat and the powers vested with them. If there was some visible development in the village, the people were made to pay the taxes due to the MP. There is evidence which shows that the MPs mobilised larger non-tax revenues by raising nursery, forest and fishery (Aziz 1994). However, the situation at present is quite the opposite. As revealed from discussions, there exists a vicious circle

between the GP and the people. The people blame the GPs for not providing the basic amenities required by them and as such are not bothered to pay taxes regularly. On the other hand, the GPs blame the people for not cooperating with them by paying taxes regularly, and as a result they are not in a position to provide even essential services. However, both the versions are partially true though unacceptable. The GPs should make honest and sincere efforts to maximise revenues from their existing tax and non-tax powers.

There is a trend all over the State to share the grants available to GPs constituency-wise (electoral ward) and as such the money is distributed to a large number of tiny projects/schemes. These in turn become uneconomic and in certain cases the assets created cannot be used because they are substandard. There is a need to put an end to the practice of sharing grants completely at the earliest. Every effort should be made to convince the elected representatives not to share the limited development grants but to allot and use the resources efficiently, keeping the long-term interest of the peoples and regions in view.

In most of the cases, the elected members of PRIs themselves are the tax defaulters. These members never pay taxes to their GPs unless warranted. It is common to see the members rushing to the GP to pay their tax dues during election time as it is a condition that whoever wants to contest the local election should have cleared the tax due to the local GP. Therefore, these elected members should set a model to the citizens by paying taxes promptly and regularly. Further, they should make it a point to discuss the progress made in tax collection at their regular meetings. Apart from this, they should enlighten the public on the need to pay taxes to the panchayat. If need be, they should make a joint effort along with the panchayat personnel in the tax collection drive. It is also important on the part of GPs to conduct grama sabhas regularly in accordance with the guidelines, which should be used to convince the people of the need to pay taxes regularly.

The PRIs, particularly the GPs, have failed utterly in securing contributions (cash, kind and labour). The general opinion of the functionaries is that contributions are a thing of the past and in these days it is hard to mobilise any. However, the field situation is not that bad. There are instances of people themselves voluntarily maintaining public properties and creation of infrastructure (Ainkai 2003; Kakade 2003; Kumble 2003). In some villages people did express the view that no one from the panchayat asked for contribution and that they were ready to contribute as per their capacity, if such a request had been made (Babu

2000b: 166-7). Thus, the functionaries themselves should first know the importance of contribution and then make sincere efforts to supplement the income of the GPs.

The lumpsum grants provided to PRIs have the effect of inducing complacency on their resource mobilisation efforts, especially at the GP level. In this regard it is worth emulating TN's experiment where it has a system of providing incentive grants to village panchayats based on their tax effort (Sekher and Nelson 2002: 250). But this type of grant will have some problem as it encourages the developed panchayats to collect more revenue and claim equal matching shares. The backward panchayats, however, cannot do this due to lower taxable capacity and to that extent they are deprived of the resources from the government. There is a solution to this type of problem and TN shows the lead. The Tamil Nadu SFC has recommended what is known as 'equalisation grant' for the resource poor panchayats. In Karnataka also similar experiment may be tried at the GP level. The State budget for 2003-04 has announced that GPs which mobilise 100 % tax and other dues including electricity and water charges would be given incentive amounts of Rs. 50,000 (Government of Karnataka 2003b: 9). This is a good beginning in the right direction. But the question is how to make the backward panchayats fiscally better off. What is needed is to provide incentive grants on a slab basis i.e. 100 % matching grant for 100 % collection, 50% for 75 % collection and 25 % for 50 % revenue collection. Coupled with this is to have a 'equalisation fund' to be used exclusively for the backward panchayats.

For ensuring smooth governance in general, and resource mobilisation in particular, both official and non-official members of GPs need training and skill upgradation. The training module should have more of field inputs. Further, training should not end with one course; it should be on a continuous basis.

The expenditure pattern of PRIs reveals a general mismatch between the functions and resources. There is no stability in the flow of funds from the State to the PRIs. Thus there is a case for devolution of larger plan grants to PRIs as in Kerala. Similarly, there is a need to share the State's revenues with the local bodies in proportion to the rising revenues.

The grants provided to PRIs are not free of conditions and guidelines. As a result they have very little leverage over their expenditure decisions. The special development grant provided to them for the past

three years by the State, though untied, is very negligible. The SFC's suggestion to provide 10 per cent of the PRIs plan grants to panchayats to spend on their own, may be worth considering by the state. Further, the state should scrap the unviable schemes/programmes transferred to PRIs.

An unsavory feature noticed at the sub-state level is inconsistency in the allocation of grants between the tiers. ZPs and TPs together share 85 per cent of the PRIs plan grants and the remaining goes to the GPs. Thus, the GPs are the most discriminated among the three-tiers in terms of share in the plan grants. The State has not found it important to rectify this imbalance all these years. The SFC quite rightly recognised the anomalies in the sharing of grants between the three tiers and tried to set it right by recommending 25, 35 and 40 per cent of the PRIs plan grants to the GPs, TPs and ZPs respectively. It is high time that the State rectified this inter-tier fiscal discrepancy by implementing SFC's recommendation along with the reallocation of schemes between them.

Finally, there is a need for applying proper criteria in the distribution of grants across the panchayats. There is no common criteria made applicable in the distribution of grants between the panchayats at all the three levels. The 12 criteria supposed to be adopted by the state at the ZP level involve difficulty in updating the relevant data and computation of shares of each ZP. In contrast to this, the criteria suggested by SFC are compact, easily computable and also take care of equity objective. As such the latter criteria can be adopted for the purpose of distribution of grants across the three tiers and in the course of time some changes can be made in them as the need arises.

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