

Chapter VIII

Local Bodies

8.1 Paragraphs 3(c) and 3(d) of the President's Order require us to make recommendations on the measures needed to augment the Consolidated Funds of the States to supplement the resources of the panchayats and the municipalities on the basis of the recommendations of the State Finance Commissions (SFCs). Further, paragraph 6 of the President's Order states that where the SFCs have not been constituted as yet, or have not submitted their reports giving recommendations, we should make our 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 read with the Eleventh and Twelfth Schedules of the Constitution. This is for the first time that the Presidential Order requires a Finance Commission to make recommendations in this regard.

8.2 The rural and urban local bodies, that is, the panchayats and the municipalities, were in existence even before the seventy-third and the seventy-fourth Constitutional amendments. Every State had enacted suitable legislation for devolution of functions, powers and responsibilities to these bodies, including the power to raise resources. The Constitutional changes – 73rd and 74th amendments – however, envisage the panchayats and municipalities as institutions of self-government. It has been made mandatory, under the Constitution, to hold regular elections to these bodies under the supervision of the State Election Commission. Representation of SCs/STs and women has been made obligatory. The devolution of financial resources to these bodies has been ensured through periodic constitution of the State Finance Commissions that are required to make recommendations on the sharing and assignment of various taxes, duties, tolls, fees etc., and on the grants-in-aid to these bodies from the Consolidated Funds of the States. These provisions are closely related to articles 243G and 243W of the Constitution which require that the State legislature may, by law, entrust these bodies with such powers, functions and responsibility so as to enable them to function as institutions of self-government. In particular, the panchayats and the municipalities may be required to prepare plans for economic development and social justice, and implement the schemes relating thereto including those which are included in the Eleventh and Twelfth Schedules of the Constitution, respectively. The operationalisation of the changes contemplated under the Constitution requires action by both the Centre and the States. The pace of empowerment of these bodies to function as institutions of self-government has, however, generally been slow. We had extensive consultations with the Central and State Governments, representatives of the urban and the rural local bodies and of various other organisations on the present status of these bodies. Their views helped us formulate the principles that we have finally adopted in this regard.

Views of the Ministry of Rural Development

8.3 In the memorandum submitted to us, the Ministry of Rural Development has spelt out views on the approach which may be adopted by this Commission. The Ministry has also drawn our attention to the needs of the panchayats for performance of regulatory, operations and maintenance (O&M) and development functions envisaged under article 243G and the Eleventh Schedule of the Constitution, and the principles which should guide the inter-State distribution of funds meant for panchayats. The memorandum states that though the reports of the SFCs have become available for many States for specified periods, these focus largely on the pre-devolution position of the panchayats and do not adequately recognise their emerging role under the 73rd amendment. It also states that the recommendations made by the SFCs have not been accepted in totality by the State Governments; the States anticipate a very heavy expenditure arising out of the devolution of powers and functions to the panchayats, and unless sufficient funds are devolved to the States under article 280, they will find it extremely difficult to implement the 73rd amendment. The memorandum states that this Commission may also place reliance on the memoranda submitted by the States as these indicate the approach of the States towards panchayati raj institutions (PRIs). It also states that the requirement of funds by the panchayats for performing developmental functions is met under the various Centrally sponsored schemes and the State plan schemes and it is the regulatory and maintenance needs of the panchayats that should receive special dispensation from this Commission. The Ministry has not made any State-wise assessment of such needs and stated that this Commission will have to make its own assessment of the gaps between the needs of the panchayats and the devolution of the resources from the States, and then make recommendations on the relevant terms of reference.

8.4 The Ministry has indicated the requirement of funds for operations and maintenance of the capital assets created under the Centrally sponsored schemes and State plan schemes at Rs.4,500 crore per annum, computed at 7 per cent of the capital costs, in respect of drinking water supply in the rural areas, schools, toilets in the upper primary schools for girls, maintenance of assets created under the watershed development programmes etc. The Ministry has not identified any schemes which have been implemented by the panchayats or any assets created by them under any programme which require financial support for maintenance. It has further stressed the need for a proper system of maintenance of accounts and their audit, under the supervision and control of the Comptroller and Auditor General of India (C&AG). For audit, the cost is estimated as half-a-per cent of the expenditure incurred by the panchayats in a year. It has sought financial support to set up a computerised database system relating to the PRIs, supported by V-SAT facility, to ensure collection and compilation of the data on a uniform pattern and its ready accessibility at the district, State and national levels.

8.5 The Ministry has suggested that the inter-State allocation of Central resources meant for panchayats should be based on certain parameters such as the degree of commitment exhibited by the States towards the PRIs and the degree of resource mobilisation by the PRIs. States should be encouraged to give freedom to the panchayats to raise resources through property, profession, entertainment and advertisement taxes; and by way of levy and collection of market fees, tolls, tariffs and user charges for the amenities provided by these bodies. Staff costs and requirements of certain core services may also be taken into consideration in the devolution formula. Besides, some untied funds may be provided to the panchayats. Every panchayat should get a minimum amount from the devolution recommended by this Commission and additional amounts may be devolved on the basis of additional devolution of functions.

Views of the Ministry of Urban Development and Poverty Alleviation

8.6 The Ministry of Urban Development and Poverty Alleviation has, in its memorandum to us, stated that the urban population that was 26 per cent of the country's total population in 1991, was expected to reach the level of 30 per cent by 2001 and 41 per cent by 2021. The urban centres currently provide over 60 per cent of the GDP, yet they suffer from serious deficiencies in civic services and infrastructure in terms of safe drinking water, sewerage and drainage, solid and liquid waste management, roads, street lighting etc. At the same time, the urban poverty levels too have become significant—about 32 per cent of the urban population is below the poverty line and the urban slum population has grown from the level of 2 crore in 1981 to above 5 crore in 1991 and is estimated to cross 10 crore by the year 2001. In this scenario, the financial position of the urban local bodies (ULBs) is far too inadequate *vis-a-vis* the requirements. The Ministry has cited different sources that have assessed the requirement of resources for the urban local bodies for civic services and infrastructure and has presented its own assessment of the resource gap of the ULBs for their O&M requirements. These are summarised below:

Sl. No.	Source	Services/Infrastructure covered by the report	Period of recommendation	Resource requirement (Rs. in crores)
1	Ninth Plan Document	Urban water supply and sanitation.	1997-2002	50,000
2	India Infrastructure Report, 1996 (Rakesh Mohan Committee)	Various urban infrastructures—capital costs as well as O&M needs.	2000-2005	1,25,000
3	Zakaria Committee Norms (1963) updated to 1997-98	Water supply, sewerage/ sewage disposal, storm water drainage, construction of roads and paths, street lighting and electricity distribution - O&M.	2000-2005	72,099
4	Ministry of Urban Development, GOI	Revenue gap for O&M requirements relating to civic services.	2000-2005	18,500

The Ministry has outlined a charter for municipal reforms and suggested that a part of our award amount relating to the ULBs should be earmarked for allotment by that Ministry for encouraging implementation of such reforms. It has also emphasized that specific attention need be given to the small and medium towns. It has, however, not indicated the break-up of the requirement for discharge of various functions by the ULBs, nor made any suggestion on measures that could be taken for augmenting the Consolidated Funds of the States for supplementing the resources of the municipalities.

Views of the States

8.7 States have given various suggestions on the approach that may be adopted by us on the ToR relating to the panchayats and the municipalities. But no State has given any suggestion relating to the 'measures' needed for augmenting the Consolidated Funds of the States. Some States have, however, suggested that powers may be given to the local bodies to levy tax on Central Government properties, about which we have given our recommendation in a later part of this chapter. States have generally taken the view that the words 'measures needed to augment the Consolidated Fund of the State' be interpreted to mean that the Finance Commission have a duty cast on them to recommend devolution of funds to the States for meeting the developmental and other requirements of the panchayats and the municipalities. The financial requirements of the local bodies have been posed on this basis and are not necessarily based on the recommendations made by the SFCs. Most States have sought funds for construction of buildings – residential and non-residential, provision of civic amenities including works of public utilities, maintenance of capital assets, and expenditure on staff and establishment. Some States have identified two other specific areas for our support in relation to the local bodies, namely, development of database and strengthening of the arrangements for maintenance of accounts and audit. Bihar, Karnataka, and Tamil Nadu have further stated that 50 per cent of the funds being given by the State Government to the local bodies should be compensated through the Finance Commission transfers. Gujarat and Haryana have suggested that the condition of providing matching contribution by the local bodies, envisaged by the Tenth Finance Commission, be waived and that the grants recommended for local bodies by the Finance Commission should be untied giving freedom to these bodies to use it for any purpose. Further, deficits of the local bodies, as worked out by the State Government, be provided by the Finance Commission as grants. Madhya Pradesh has suggested that 7 per cent of the

Central taxes be earmarked for devolution to local bodies and from this amount, 80 per cent be distributed to States on the basis of index of infrastructure (weight: 40 per cent), distance from per capita income (40 per cent), unadjusted area (10 per cent) and population of SCs/STs (10 per cent); and the remaining 20 per cent be allocated to those States that have completed the process of elections and transfer of powers to elected representatives of local bodies within the first year of the Constitutional amendments and have also completed the second round of elections by the end of 1999. The total requirement of funds indicated in the memoranda of 18 States comes to Rs.33,115 crore for the panchayats and Rs.39,900 crore for the municipalities. Seven States have not quantified their demand for funds in their memoranda. These are Andhra Pradesh, Karnataka (PRIs), Kerala, Manipur, Nagaland, Sikkim and West Bengal.

8.8 As regards the demand of funds for panchayats and municipalities made by the States, two points need to be highlighted. Firstly, there are a number of schemes that have been taken up by the States as part of the State plans or Centrally sponsored schemes for provision and improvement of civic services in rural and urban areas- such as the drinking water supply, sanitation, rural roads etc. Such schemes should have been transferred to the local bodies for grass root level planning and implementation. Transfer of such schemes to these bodies should be accompanied by transfer of funds and staff too, as is the spirit of the Constitutional amendments, and if need be, suitable legislative amendments may ensure this. Such transfer of schemes to the local bodies should, therefore, not lead to any additional expenditure liability on the States. The construction of panchayat buildings, for instance, should be a part of assistance to the panchayats and to the extent States provide grants for this purpose, these would be covered in the assessment of revenue expenditure of the States. Further requirements have to be built in the State plan. Secondly, if we were to take into account the additional financial burden that falls on a State on account of the acceptance and implementation of the recommendations of the State Finance Commission, such expenditure has to be built into the expenditure stream of the State. Any devolution made by a State for the panchayats and municipalities over and above the recommendations of the State Finance Commission is outside the purview of our consideration, as would be evident from the Constitutional provisions. We, therefore, do not find adequate justification in the demand that a certain percentage of the funds transferred by the States to the panchayats and municipalities be provided by the Finance Commission. However, with a view to highlight that the local bodies are more or less the Third tier of Government, we are sympathetically considering their case.

Tenth Finance Commission award for the local bodies

8.9 The Tenth Finance Commission did not have any mandate, in its terms of reference, to make recommendations for the local bodies. However, the 73rd and 74th Constitutional amendments had become effective before the Commission had finalised its report and, therefore, it took the view that in terms of the sub-clauses (bb) and (c) of article 280(3), it was obliged to make recommendations regarding measures needed to augment the Consolidated Funds of the States for supplementation of the resources of the panchayats and the municipalities. The Commission analysed the scope of such duty cast on it and made the following observations:

- a. The need for augmentation of the Consolidated Funds of the States should first be ascertained and only thereafter the measures for such augmentation be recommended.
- b. Such measures need not necessarily involve transfer of resources from the Centre.
- c. Once the SFCs complete their task, the Finance Commission becomes duty bound to assess and build into the expenditure stream of the States the funding requirements for supplementing the resources of the panchayats and the municipalities. Measures needed for augmentation of the Consolidated Funds of the States may be determined accordingly.
- d. The responsibility for sharing and assigning taxes and providing grants to the local bodies rests with the States and does not stand transferred to the Centre.
- e. The transfer of duties and functions listed in the Eleventh and Twelfth Schedules of the Constitution would also involve concomitant transfer of staff and resources. Transfers of duties and functions to the local bodies should, therefore, not entail any extra financial burden.

8.10 The Tenth Finance Commission had recommended a grant of Rs.100 per capita of rural population, as given in the 1971 census, for the panchayats for its award period. This grant was to be in addition to the amounts transferred to the panchayats as shares of assigned taxes, duties, tolls, fees, grants-in-aid and activity-related budgetary transfers. In the case of municipalities, the Commission recommended an amount of Rs.1,000 crore for its award period, to be distributed among the States on the basis of the inter-State ratio of slum population derived from the urban population figures of the 1971 census. States and areas excluded from the operation of the 73rd and the 74th amendments were also provided grants to supplement the resources of similar local bodies, even if these were not panchayats/municipalities. The local bodies were required to prepare suitable schemes and provide matching contributions. No amount was to be used for expenditure on salaries and wages.

State Finance Commissions

8.11 The determination by us of the measures needed for augmentation of the Consolidated Funds of the States for supplementing the resources of panchayats and municipalities has to be done on the basis of the reports of the SFCs. In

fact, the SFCs' recommendations should have been the basis of our report, but it could not be so in full measure for several reasons. We have indicated such reasons, and the remedial measures, below:

- a. Under the Constitutional provisions, there is no synchronisation of the periods covered by the reports of the SFCs with that of the Finance Commission. The Tenth Finance Commission also had felt the absence of SFC reports as a handicap. However, though the reports of the first generation SFCs of most States were available to us, they were for different periods of time and, except for two (Goa and Orissa), related to only the first or at best the second year of the period to be covered by our report. Article 243I, which provides for constitution of the State Finance Commission 'at the expiration of every fifth year', in effect prohibits the constitution of a new SFC before the completion of the period of five years, leading to this anomaly. The solution lies in amending article 243I to enable a State to set up the SFC 'at the expiration of every fifth year or earlier,' akin to the provision that already exists under article 280 for constituting the Finance Commission. The synchronisation of availability of reports may also be ensured through either a Central legislation or an appropriate provision in the Constitution.
- b. Many SFC reports have not addressed the specific terms listed in articles 243I and 243Y, nor have they provided a clear idea of the powers, authority and responsibilities actually entrusted to the local bodies. Many of these reports also do not clearly indicate the principles formulated for sharing or assignment of State taxes, duties, tolls, fees and the grants-in-aid. It is not our intention to limit the freedom of any State Finance Commission in the manner of preparation of its report but, in order that the report of the SFC could be of use to the Finance Commission at the Centre, it is necessary to get an idea of the specific recommendation on each ToR as indicated in article 243I. We, therefore, suggest that it would be immensely helpful if the SFC reports contain specific chapters narrating the approach adopted by it; an analysis of the resources of the State Government; an analysis of the resources of each tier of the rural local bodies and each level of the urban local bodies; the principles for distribution between the State and the panchayats/municipalities of the net proceeds of the taxes, duties, tolls, and fees leviable by the State; the principles on which these may be distributed among different tiers/levels of rural/urban local bodies; and the grants-in-aid to be given by the State to the panchayats and the municipalities. A separate chapter may also be devoted to specific measures that need to be taken for improving the financial position of these bodies to make them institutions of self-government.
- c. No time limit is prescribed either in the Constitution or in the States' legislation for submission of the explanatory memorandum on the action taken by the State Government (i.e. the action taken report, or the ATR), on the recommendations of the SFC. As the information given in Annexure-VIII.1 would indicate, in some States, the ATRs on SFC recommendations are yet to be submitted to the State legislature, despite the fact that the reports have been available for about two to three years. Even where some recommendations have been accepted, the implementation has been tardy. Several important recommendations of the SFC, relating to sharing/transfer of resources, are often reported to be under consideration for months and even years. It is necessary to ensure that State Governments take their decisions on the recommendations of the SFC, especially in regard to matters relating to resource transfer, and place the ATRs on the floor of the State Legislature within six months from the date of submission of the report by the SFC. Amendments in the laws, if necessary, be made at the earliest.
- d. While articles 280(3)(bb & c) require us to make recommendations in relation to the panchayats and municipalities of a State on the basis of the recommendations made by the SFC, it does not provide for any alternative approach in respect of such States wherein the SFCs have either not been constituted or have not submitted their reports. Apparently, the Presidential Order took note of this situation and accordingly, provided for the alternative in paragraph 6 of our ToR. Indeed, we had to take the help of various sources of information to arrive at our recommendation in relation to the local bodies in respect of States for which the reports of the SFCs were not available. Even in respect of the States wherein such reports were available, we could not form our opinion, in view of their heterogeneity in approach, contents and period covered. The future Finance Commissions too may have to face a similar situation. It may, therefore, be advisable to make suitable amendments to the Constitution so that the Finance Commissions do not get into such a predicament. Accordingly, we recommend that the words 'on the basis of the recommendations made by the Finance Commission of the State' appearing in sub-clauses (bb) and (c) of article 280(3) of the Constitution be deleted.

8.12 We have also looked into the provisions and practices adopted by the States regarding composition of the SFCs. In case of the Finance Commission, article 280 provides that Parliament may, by law, determine the qualification for the members. Accordingly, Parliament enacted the Finance Commission (Miscellaneous Provisions) Act 1951, which prescribed the qualification for a person to be appointed as the Chairman or a member. In case of SFCs, article 243I(2) makes similar requirement for the State Legislature. A few States have enacted exclusive legislation for this purpose, while some have made such provisions in the State Panchayat/Municipal Acts but many have left it to the State Government to prescribe these details by rules. This has led to a wide diversity in this matter, often missing some essential features. For instance, in some States, serving government officers are appointed as chairperson and members of the SFCs and that too in *ex officio* capacities. This puts limitation on the ability of the SFC to act as an autonomous body to make recommendations in a free and independent manner, as has been envisioned in the Constitution. Although the rule of delegation is a permissive provision, but in such cases where SFC has to make recommendation in matters which affect the State

Government, the State Legislature should itself make relevant provisions. Accordingly, we recommend that States should, by legislation, ensure that the chairperson and members of the SFCs may be drawn from amongst experts in specific disciplines such as economics, law, public administration and public finance.

8.13 Para 6 of the Presidential order requires us to make our own assessment about the manner and extent of augmentation of the Consolidated Funds of the States, keeping in view the provisions required to be made for the emoluments and terminal benefits of the local bodies including teachers, the existing powers of the local bodies to raise financial resources, and the powers, authority and responsibility transferred to local bodies. The States' memoranda do not generally indicate the requirement of funds for the emoluments and terminal benefits for the employees including those of teachers. We had sought information on these points specifically through the subsidiary points, but most States have not given this information. States' memoranda to us do not give the position in regard to transfer of powers, authority and responsibility or the financial powers devolved on the local bodies to raise resources. The powers of taxation mentioned in the legislation have been made subject not only to the rules, notification, and orders to be issued by the State government, but also to the procedures and limits to be prescribed; in quite a few States action is yet to be taken.

Study reports on panchayats and municipalities

8.14 We entrusted two studies – one for rural local bodies and the other for urban local bodies – to National Institute of Rural Development (NIRD) and National Institute of Public Finance and Policy (NIPFP) to study the position of devolution of functions to the local bodies, the powers to raise resources and for working out the requirements for the maintenance of core services. The core services were identified as primary education, primary health, rural or municipal roads, drinking water supply, sanitation, and street-lighting. The Study done by the NIRD reveals that the 73rd amendment has not significantly altered the functional domain of the panchayats at various tiers. Few States have been serious in vesting the panchayats with the necessary powers, funds and staff to enable them to perform the functions assigned to them under the statutes. The Centre as well as the States have sponsored schemes for rural people without associating panchayats in planning and implementation. These have further marginalised them. The States' legislation provide for levy and collection of certain taxes, fees and tolls but the rules relating to fixation of rate structure are not periodically done and reviewed. The assessment of the requirement of funds has been stated at Rs. 1,42,128 crore for a period of five years for rural local bodies for operation and maintenance of core services alone. The capital expenditure is assessed at Rs.83,603 crore for the same period. For urban areas, the study done by NIPFP does not indicate the requirement of funds separately for the maintenance of each core service. It has given five options based on level of transfers in 1997-98, revenue gap at 1997-98 level, enhancement of spending by municipalities deficient in revenue expenditure, enhancement of the level of spending of municipalities deficient in operation and maintenance expenditure on core services and enhancement of the level of core services in accordance with Zakaria Committee report. It indicates the requirement of funds ranging from Rs.6,907 crore to Rs.32,598 crore over a period of five years depending on the option chosen. None of these studies has indicated the possible measures that need to be taken at the local and State level to bridge this gap.

Measures to augment the Consolidated Funds of the States

8.15 Our primary task is to identify and recommend measures needed for the augmentation of the Consolidated Funds of the States for supplementing the resources of the local bodies. An assessment of the tax and non-tax revenue of the States has already been done earlier in the chapter on the assessment of States' resources. Additional efforts are needed- both at the local and State level — for raising the resources to meet the growing requirements of the local bodies. In our view, the States may take the measures indicated below for augmenting their Consolidated Funds to supplement the resources of panchayats and municipalities:

- a. **Land taxes:** In many States, land revenue has either been abolished or land holdings up to a certain size have been exempted. However, taxes on land/farm income in some form may be levied to strengthen the resource base of the local bodies. The rate structure should be fixed suitably keeping in view the present economic conditions. The revision should not be linked to or depend on survey and settlement operations. In the urban areas, similar measures should be taken for revision of the lease rents. The amounts so collected may be passed on to the local bodies for improving and strengthening the civic services. Local bodies may also be involved in collection of these taxes.
- b. **Surcharge/Cess on State taxes:** Cess on land based taxes and other State taxes/duties may be levied to mobilise resources for augmenting specific civic services and for improving their quality. For example, a cess or surcharge of 10 per cent on sales tax, State excise, entertainment tax, stamp duties, agricultural income tax, motor vehicles tax, electricity duties etc. may give significant additional revenue which could be devolved to the local bodies for improving the basic civic services and for taking up schemes of social and economic development.
- c. **Profession tax:** Article 276 of the Constitution provides for levy of a tax on professions, trades, callings or employment for the benefit of the State or local bodies at a rate not exceeding Rs.2,500 per tax-payer per year. Many States either do not levy this tax or levy it at very low rates. States should levy this tax with a view to supplement the resources of local bodies or they should empower the local bodies to levy it. The rates should be suitably revised to bring them nearer to the ceiling prescribed under the Constitution. Further, the ceiling that was fixed in 1988 by an amendment to the Constitution, needs to be suitably enhanced. Parliament should be empowered to fix this ceiling without going in for a Constitutional amendment every time.

Reforms in local taxes and rates

8.16 In addition to the measures mentioned above, we would like to highlight the need for improving the revenue mobilisation by the local bodies themselves. Many SFCs have, in their reports, given suggestions in this regard, of which some are State specific but some can be considered useful for all the States. We mention two local taxes, besides user charges, for consideration of all the States.

- a. **Property/House tax:** Property tax/house tax is the single most important local tax today, in a majority of the States. Yet it has remained beset with a variety of problems that have prevented the local bodies to exploit its full potential. Such problems are not merely confined to the proximity factor, namely, the local bodies being too close to the people to be effective tax collectors. In most States, the tax rates have not been revised periodically and there is no standard mechanism for determination of property tax rates and their revision. Indeed, West Bengal has experimented with the institution of Central Valuation Authority and some other States have initiated reforms in the system of property taxation with provisions for self-assessment, mandatory periodic revision, dispensing with the demand notice for the tax and putting the onus on property owners for timely tax payment, etc. Such measures have yielded good results and need to be pursued by all States in a rationalised manner. Most States have accorded a variety of tax concessions/exemptions leading to revenue loss to the local bodies. Arrears of taxes are allowed to accumulate either due to sheer inefficiency or due to delay in assessments and in appeals. Yet another major impediment to the growth of revenue from the property/house tax has been the rent control laws. The property/ house tax legislation should be suitably modified to overcome this impediment. Where the property has been let out, the property tax should be made recoverable from the occupier.
- b. **Octroi/Entry tax:** Besides the property/house tax, octroi has been the major source of revenue for the municipalities and, in some States, even for the panchayats. Many States have, however, abolished octroi with a view to remove impediments to the physical movement of goods, though several other new barriers have been created. Some States have introduced a levy in lieu of octroi, usually the entry tax, the net proceeds of which are transferred to the local bodies in the form of grant. During our interaction with the representatives of the local bodies, we were told that though the grant in lieu of octroi given to the local bodies was raised by a certain percentage from year to year, it does not have as much buoyancy as the octroi had. There have also been numerous complaints of delay in release of the compensatory grants. While we do not advocate re-introduction of octroi, we do feel that there is a need for replacing it with a suitable tax that is buoyant and can be collected by the local bodies.
- c. **User charges:** In many States, the operations and maintenance costs of drinking water supply and many other civic services are met by the local bodies. However, the user charges are not revised periodically and a significant percentage of the demand remains in arrears. The rate structure should be revised regularly to keep pace with inflation and to recover at least, as far as possible, the full operations and maintenance cost of providing these services. Local bodies should have the power to fix the rate of taxes and user charges for themselves. That will make for accountability at the margin. People would be willing to pay, if they get better services.

8.17 While assessing the revenue and expenditure of the States, we have already taken into account the additional burden falling on their financial resources due to implementation of the SFCs reports and, therefore, no additional provision needs to be made on this account. The measures recommended by us, if implemented, will generate additional resources and will meet to a good extent the additional requirements of funds for the local bodies, posed by the States. However, we do feel that there are certain critical areas which normally get overlooked in the normal flow of funds from the States. There is, therefore, a need to make suitable provision for them.

Maintenance of civic services

8.18 In our perception, the first such area is the maintenance of civic services in the rural and urban areas, which includes provision of primary education, primary health care, safe drinking water, street lighting, sanitation including drainage and scavenging facilities, maintenance of cremation and burial grounds, public conveniences, and other common property resources. Transfer of these responsibilities to the local bodies should be speeded up, accompanied with transfer of funds and staff. The capital cost of the civic services identified by us would be met under the concerned budgetary heads of the States. The cost of operations and maintenance of these services should be met by raising tax revenues and user charges, and by devolution of funds from the State. However, the maintenance of these services in rural and urban areas has not received adequate attention so far. It is more for the purpose of re-emphasising the attention to this aspect, with concern for the people in focus, that we are recommending grants to the States for immediately passing it on to the panchayats and the urban local bodies that have a primary responsibility in this sphere. No amount from this grant should be given to the intermediate or district level panchayats where these do not have any direct responsibility for maintenance of these services. The distribution of these grants to the panchayats and the urban local bodies should be done on the basis of the principles recommended by the SFCs. These grants would be untied except that they should not be used for payment of salaries and wages. We envisage that the measures recommended by us would encourage enhanced economic activities in the rural and urban areas leading to new sets of employment opportunities rather than direct government employment.

Accounts and audit

8.19 Our second area of concern is the maintenance of accounts and their audit. States have been transferring funds to the local bodies under various heads of account, besides major head 3604. We tried to collect information in this regard from the Finance Accounts, in order to know the extent of decentralization. However, we found that the same minor heads were used, in several cases, for transfers to the panchayats as well as to the municipalities. Further, the break-up of such transfers among different categories of the local bodies was not available. We also looked into the status of maintenance of accounts by these bodies. Articles 243J and 243Z of the Constitution expect the States to make provisions by way of legislation for maintenance of accounts by the panchayats and the municipalities and for the audit of such accounts. Following this, most States' legislation do make general provisions for these purposes, but detailed guidelines or rules have not been laid down, in several cases. In many States, the formats and procedures for maintenance of accounts by these bodies prescribed decades ago, are continued without making any improvements to take into account the manifold increase in their powers, resources and responsibilities. Most village level panchayats do not have any staff except for a full or a part-time Secretary, because of financial constraints. It would, therefore, be rather too much to expect a village panchayat to have a trained person dedicated exclusively to upkeep of accounts. With the passage of time, the flow of funds to the panchayats and the municipalities will increase considerably. Therefore, there is a need to evolve a system of maintenance of accounts by the local bodies that could be adopted by all the States. As regards audit, in many States, the legislation leaves it to the State Government to prescribe the authority. In some States, the Director, Local Fund Audit or a similar authority has been given the responsibility for the audit of accounts of panchayats and municipalities. The C&AG has a role only in a few States and that too for the audit of district level panchayats and for very large urban bodies. In our view, this area – of accounts and audit – needs to be set right under the close supervision of the C&AG and supported by specific earmarking of funds from the grants recommended by us in respect of local bodies. We would like to make the following suggestions in this regard:

- a. States should review the existing accounting heads under which funds are being transferred to the local bodies. For each such major head/sub-major head, six minor heads should be created - three for the PRIs and another three for the ULBs - so that a clear picture of transfers to each category of local bodies is readily available. In addition, specific demand heads should be created in the State Budgets for the rural and the urban local bodies, respectively, wherein transfers to these bodies under various detailed heads of account are enlisted. This may be done in consultation with the C&AG and the Controller General of Accounts, to ensure uniformity among the States.
 - b. The C&AG should be entrusted with the responsibility of exercising control and supervision over the proper maintenance of accounts and their audit for all the tiers/levels of panchayats and urban local bodies.
 - c. The Director, Local Fund Audit or any other agency made responsible for the audit of accounts of the local bodies, should work under the technical and administrative supervision of the C&AG in the same manner as the Chief Electoral Officers of the States operate under the control and supervision of the Central Election Commission. In no case should the Director for Panchayats or for Urban Local Bodies be entrusted with this work. The prescribed authority entrusted with the audit and accounts should not have any functional responsibility in regard to the local bodies, so as to ensure his independence and accountability.
 - d. The C&AG should prescribe the format for the preparation of budgets and for keeping of accounts for the local bodies. Such formats should be amenable to computerisation in a networked environment.
 - e. Local bodies particularly the village level panchayats and in some cases the intermediate level panchayats, that do not have trained accounts staff, may contract out the upkeep of accounts to outside agencies/persons. For this purpose:
 - i. The C&AG may lay down the qualifications and experience for the agency/person who could be contracted out the work of maintenance of accounts. The Director, Local Fund Audit or his equivalent authority may do the registration of such agency/person.
 - ii. A group of local bodies may be entrusted to an agency/person for upkeep of accounts on payment of remuneration as may be fixed by the C&AG in consultation with the State Government.
 - iii. The Director, Local Fund Audit or his equivalent authority, under the direction of the C&AG, may do the supervision over the quality of work of such agency/person.
 - iv. Non-compliance or poor performance should lead to deregistration of the agency/person entrusted with such task.
 - f. Audit of accounts of the local bodies be entrusted to the C&AG who may get it done through his own staff or by engaging outside agencies on payment of remuneration fixed by him. An amount of half-a-per cent of the total expenditure incurred by the local bodies should be placed with the C&AG for this purpose.
 - g. The report of the C&AG relating to audit of accounts of the panchayats and the municipalities should be placed before a Committee of the State Legislature constituted on the same lines as the Public Accounts Committee.
- 8.20 Panchayats at the village level, and sometimes at the intermediate levels too, do not have exclusive staff for

upkeep of accounts. In fact, it may not usually be necessary for them to have regular accounts staff on their pay rolls. They may get the job done on contract basis, as we have indicated before. In our view, an amount of Rs.4,000 per panchayat per annum, on an average, should be adequate to meet the expenditure on maintenance of accounts on contract basis, if the staff/facilities are not available within the panchayat. This amount may be paid from the grants that we are recommending for the rural local bodies. The amount of Rs. 4,000 indicated by us is only suggestive, and may be different for different States and for different panchayats within a State, depending on local conditions. Any additional funds required for this purpose should be met from the grants given to the States for the panchayats. Where a panchayat has got staff available for upkeep of accounts, these funds need not be so earmarked. As for the urban local bodies, they generally do have accounts staff on their pay rolls. However, if any municipality does not have a regular staff for this purpose, the grants provided to it may also be so earmarked. The State-wise expenditure on this account has been worked out and indicated in the Table 8.1.

Table-8.1: Provision for maintenance of accounts of village level panchayats and intermediate level panchayats

(Rs. in lakhs)

Sl. No.	Name of the State	Number of village level panchayats	Amount	Number of intermediate level panchayats	Amount	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1	Andhra Pradesh	21784	871.36	1093	43.72	915.08
2	Arunachal Pradesh	2012	80.48	78	3.12	83.60
3	Assam	2489	99.56	202	8.08	107.64
4	Bihar	12181	487.24	726	29.04	516.28
5	Goa	188	7.52	0	0.00	7.52
6	Gujarat	13547	541.88	184	7.36	549.24
7	Haryana	5958	238.32	111	4.44	242.76
8	Himachal Pradesh	2922	116.88	72	2.88	119.76
9	Jammu & Kashmir	2683	107.32	0	0.00	107.32
10	Karnataka	5673	226.92	175	7.00	233.92
11	Kerala	990	39.60	152	6.08	45.68
12	Madhya Pradesh	31126	1245.04	459	18.36	1263.40
13	Maharashtra	27611	1104.44	319	12.76	1117.20
14	Manipur	2194	87.76	0	0.00	87.76
15	Meghalaya	5629	225.16	0	0.00	225.16
16	Mizoram	723	28.92	0	0.00	28.92
17	Nagaland	1200	48.00	0	0.00	48.00
18	Orissa	5255	210.20	314	12.56	222.76
19	Punjab	11591	463.64	138	5.52	469.16
20	Rajasthan	9184	367.36	237	9.48	376.84
21	Sikkim	159	6.36	0	0.00	6.36
22	Tamil Nadu	12593	503.72	385	15.40	519.12
23	Tripura	962	38.48	41	1.64	40.12
24	Uttar Pradesh	58620	2344.80	904	36.16	2380.96
25	West Bengal	3314	132.56	340	13.60	146.16
Total		240588	9623.52	5930	237.20	9860.72

Database on the finances of the local bodies

8.21 The third area of our concern relates to non-availability of data on the finances of the local bodies. There is no mechanism for collection of data on the revenue and expenditure of the various tiers/levels of the rural/urban local bodies

at a centralised place where it could be compiled, processed and made available for use. In the absence of any reliable financial/budgetary data, no realistic assessment of the needs of the panchayats and municipalities for basic civic and developmental functions can be made nor can any information be generated on the flow of funds to the local bodies for the implementation of various schemes for economic development and social justice. We are, therefore, of the view that a database on the finances of the panchayats and municipalities needs to be developed at the District, State and Central Government levels and be easily accessible by computerising it and linking it through V-SAT. The Director, Local Fund Audit or the authority prescribed for conducting the audit of accounts of the local bodies may be made responsible for this task, as he would be the main agency dealing with the finances, including budgetary position, accounts and audit of the local bodies. The Chief Secretary of the State may do the State-level coordination and monitoring. In order to ensure that this scheme is brought into effect within a defined time schedule and there remains a proper coordination among various agencies at the national and State levels, it would be in the fitness of things that the C&AG is involved at all stages. He may even be requested to undertake this responsibility. The data could be collected and compiled in standard formats, to be prescribed by the C&AG. This will facilitate comparison of performance and state of development of local bodies among the States. We have assessed the cost for this project for all the States to be Rs.200 crore. State-wise details are indicated in Table 8.2.

Table-8.2: Provision for creation of database relating to the finances of local bodies

(Rs. in lakhs)

State		No. of PRIs	No. of ULBs	Total No. of LBs	Allocation for PRIs	Allocation for ULBs	Total allocation
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1	Andhra Pradesh	22899	116	23015	1826.70	9.25	1835.95
2	Arunachal Pradesh	2103	0	2103	167.76	0.00	167.76
3	Assam	2714	79	2793	216.50	6.30	222.80
4	Bihar	12962	170	13132	1034.00	13.56	1047.56
5	Goa	190	14	204	15.16	1.12	16.27
6	Gujarat	13750	149	13899	1096.86	11.89	1108.75
7	Haryana	6085	82	6167	485.41	6.54	491.95
8	Himachal Pradesh	3006	48	3054	239.79	3.83	243.62
9	Jammu & Kashmir	2683	69	2752	214.03	5.50	219.53
10	Karnataka	5875	215	6090	468.66	17.15	485.81
11	Kerala	1156	58	1214	92.22	4.63	96.84
12	Madhya Pradesh	31630	404	32034	2523.18	32.23	2555.41
13	Maharashtra	27959	244	28203	2230.34	19.46	2249.81
14	Manipur	2204	28	2232	175.82	2.23	178.05
15	Meghalaya	5632	6	5638	449.28	0.48	449.75
16	Mizoram	732	6	738	58.39	0.48	58.87
17	Nagaland	1200	9	1209	95.73	0.72	96.44
18	Orissa	5599	102	5701	446.64	8.14	454.78
19	Punjab	11746	137	11883	937.00	10.93	947.93
20	Rajasthan	9453	183	9636	754.08	14.60	768.68
21	Sikkim	163	0	163	13.00	0.00	13.00
22	Tamil Nadu	13006	744	13750	1037.51	59.35	1096.86
23	Tripura	1007	13	1020	80.33	1.04	81.37
24	Uttar Pradesh	59607	684	60291	4754.96	54.56	4809.52
25	West Bengal	3672	122	3794	292.92	9.73	302.65
Total		247033	3682	250715	19706.28	293.72	20000.00

Grants for the local bodies

8.22. Keeping in view the availability of resources and the overall limits set for the flow of resources from the Centre to the States, we recommend a total grant of Rs.1,600 crore for the panchayats and Rs.400 crore for the municipalities for

each of the five years starting from the financial year 2000-01. In per capita terms, the amounts recommended by us for the rural local bodies are higher than those for the urban local bodies. We have done so because the urban local bodies can generate higher per capita revenue from the same taxes owing to the rural-urban income differentials. This amount will be in addition to what would be generated if the measures recommended by us were fully implemented by the States. These amounts should be over and above the normal flow of funds to the local bodies from the States and the amounts that would flow from the implementation of SFC recommendations. The amounts indicated for maintenance of accounts and audit and for development of database, would be the first charge on the grant recommended by us and would be released by the concerned Ministries of the Government of India, after the arrangements suggested by us have become operational. The remaining amount should be utilised for maintenance of core civic services by the local bodies, on the principles indicated in paragraph 8.18 above.

Principles for *inter se* distribution

8.23 The determination of the *inter se* share of States in the amounts indicated by us for the rural and urban local bodies should be based on the principles which promote the development of local bodies as institutions of self-government and take into account the inter-State differentials in the levels of social and economic development. Population was the sole criterion adopted by the Tenth Finance Commission for allocation of ad hoc grants to the States— rural population for the panchayats and slum population for the municipalities. In our view, population should not be the sole basis for State-wise allocation as it has the effect of perpetuating the *status quo*. Further, it does not take into account the efforts made by the States to let these bodies raise their own resources, the extent of transfer of resources, power, authority and responsibility to the local bodies or the initiative taken by the States in implementing the 73rd and 74th amendments and the income differentials between the States in the rural/urban areas. Nor does it take into account the variation in the cost of providing services in low population-density areas. In our view, such factors need to be recognised and given due weight while devising the principles for inter-State allocation. At the same time, population should continue to be an important factor in determining the needs of the States, as it is ultimately the people who are affected by the quantity and quality of the services. It also ensures devolution to those States that are slow in empowering the local bodies to develop as institutions of self-government. We have allocated 40 per cent of the amount to the States to be given to the panchayats and municipalities on the basis of rural/urban population of the State.

8.24 In view of the 73rd and 74th amendments to the Constitution, States now owe a greater responsibility to develop the local bodies as institutions of local self-government. The burden on the Consolidated Fund of a State on account of transfer of funds to the local bodies has already been taken into account in our assessment of the non-plan revenue expenditure of the States. The additional amount recommended for being given as grant for these bodies is more for the purpose of inducing the States to speed up the process of decentralisation so that these develop as institutions of self-government as envisaged under articles 243(d) and 243P(e) of the Constitution. States that have taken initiative and shown commitment are given some recognition in the principles of devolution adopted by us. We are aware that an objective assessment of the extent of decentralisation often proves difficult because what is indicated on paper does not always match with the ground realities. Decentralisation of power, authority and responsibility is a gradual process and takes time to establish even where intentions are clear and are communicated through appropriate instruments of policy. Keeping all these aspects in view, we have prepared an index of decentralisation based on the steps taken by the States for implementation of the 73rd and the 74th amendments and the speed at which these have been done. We selected ten parameters for the purpose: enactment/amendment of State panchayat/municipal legislation; intervention/restriction in the functioning of the local bodies; assignment of functions to the local bodies by State legislation; actual transfer of functions to these bodies by way of rules, notifications and orders; assignment of powers of taxation to the local bodies and the extent of exercise of such powers; constitution of the SFCs and the extent of action taken on their reports; elections to the local bodies; and constitution of District Planning Committees as per the letter and spirit of article 243ZD. We excluded the constitution of Metropolitan Planning Committees as one of the parameters as no State has yet constituted them. Points were assigned on a graduated scale to the States in respect of each parameter. Following this exercise, an index of decentralisation was prepared. The detailed methodology on the construction of this index is given in Appendix-VIII.1 for the panchayats and Appendix-VIII.2 for the municipalities. We distributed 20 per cent of the grant to the States on the basis of this index of decentralisation. We are aware of the limitation of this analysis and hope that with the availability of more and more information, it should be possible to make refinements.

8.25 Local bodies should be able to raise revenue to meet their current level of revenue expenditure as far as possible. However, the extent to which they can do so, depends on the powers delegated to them under the State legislation and the rules, notifications and orders issued by the respective State Government, besides their own will to do so. We feel that the efforts made in this direction by the States and the local bodies would get reflected in higher revenue mobilisation by these bodies from their own sources and should be accorded some weight in the principles of devolution. We have collected information on the revenue receipts and expenditure of the panchayats and municipalities from the States, which is placed at Annexures-VIII.2A to D and VIII.3A to D, respectively. In view of the wide disparities in the States' Domestic Product (SDP), a uniform criterion will place the low income States at a disadvantage. We have, therefore, linked the efforts made by the local bodies to raise own revenues, with the States' own revenue on the one hand and with the SDP from primary sector (excluding mining and quarrying) for the panchayats and the SDP (net of primary sector) for the municipalities, respectively, on the other hand. The average of the ratio of own revenue collection of the panchayats for the years

1995-96, 1996-97 and 1997-98 with the own revenue of the State for the corresponding years, has been worked out and assigned a weight of 5 per cent. Similarly, the ratio of own revenue of the panchayats for three recent years, viz. 1994-95, 1995-96 and 1996-97, with the SDP for the corresponding years, after making adjustments as indicated above, is given a weight of 5 per cent. For the municipalities too, a similar exercise has been done.

8.26 We are aware that the States with low per capita SDP will continue to have problems in raising revenue at the State level as well as at the level of the local bodies and would, therefore, require additional support. In our scheme of distribution of the grants relating to the rural local bodies, we have provided 20 per cent on the basis of distance from the highest per capita agricultural income. This has been worked out on the basis of average of the ratio of SDP from the primary sector excluding mining and quarrying and the projections for rural population made by the Registrar General of India for the years 1994-95, 1995-96 and 1996-97. Distance of each State has been measured with reference to the State having the highest average per capita SDP, plus half of the standard deviation. The distances have been weighted by the rural population of the respective States for working out the share. In the case of urban local bodies, the same exercise has been done by taking the urban population and the SDP (excluding the primary sector) for the same years. For these calculations, we have adopted the population figures as per 1991 census, in view of the specific indication to that effect in articles 243(f) and 243P(g). Lastly, we recognise the fact that the cost of providing basic services in the sparsely populated areas is relatively high, and would necessitate giving weight to the expanse of the States. Ten per cent of the grant has been distributed on the basis of the geographical area of each State— rural for panchayats and urban for municipalities.

8.27 Accordingly, we recommend that the amounts of Rs.1,600 crore and Rs.400 crore provided by us for the panchayats and municipalities, respectively, for each of the five years (2000-05) be distributed among the States on the following criteria and weights:

i.	Population	40 per cent
ii.	Index of decentralisation	20 per cent
iii.	Distance from highest per capita income	20 per cent
iv.	Revenue effort	10 per cent
v.	Geographical area	10 per cent

Inter se distribution among the States of the provisions made by us towards panchayats and municipalities are summarised in Tables 8.3 and 8.4 below, in terms of percentage shares. Basic data relating to these two tables are given in the Annexures VIII.4 and VIII.5, respectively. Out of these shares, a component is indicated for the excluded areas in the concerned States, in proportion to the population, for which details are placed at Annexure VIII.6. Such components should be made available to the respective States only after the relevant legislative measures are completed for extension of the provisions of 73rd and 74th amendments to such areas.

Table 8.3 Share of States in allocation for panchayats

Sl.No.	State	Share (in percentage)**			Type of the excluded areas*
		Total for the State	Of which, share for- Normal areas	Excluded areas*	
1	Andhra Pradesh	9.503	8.985	0.518	Fifth Schedule Areas
2	Arunachal Pradesh	0.348	0.348	0.000	
3	Assam	2.918	2.814	0.104	Sixth Schedule Areas
4	Bihar	9.813	8.721	1.092	Fifth Schedule Areas
5	Goa	0.116	0.116	0.000	
6	Gujarat	4.351	3.555	0.796	Fifth Schedule Areas
7	Haryana	1.839	1.839	0.000	
8	Himachal Pradesh	0.821	0.795	0.026	Fifth Schedule Areas
9	Jammu & Kashmir	0.930	0.930	0.000	
10	Karnataka	4.926	4.926	0.000	
11	Kerala	4.120	4.120	0.000	
12	Madhya Pradesh	8.943	6.232	2.711	Fifth Schedule Areas
13	Maharashtra	8.209	7.427	0.782	Fifth Schedule Areas
14	Manipur	0.235	0.128	0.107	Hills Districts Areas
15	Meghalaya #	0.320	0.000	0.320	Sixth Schedule Areas

16	Mizoram #	0.098	0.075	0.023	Sixth Schedule Areas
17	Nagaland #	0.161	0.161	0.000	
18	Orissa	4.320	3.056	1.264	Fifth Schedule Areas
19	Punjab	1.933	1.933	0.000	
20	Rajasthan	6.137	5.558	0.578	Fifth Schedule Areas
21	Sikkim	0.066	0.066	0.000	
22	Tamil Nadu	5.826	5.826	0.000	
23	Tripura	0.356	0.221	0.135	Sixth Schedule Areas
24	Uttar Pradesh	16.489	16.489	0.000	
25	West Bengal ##	7.222	7.222	0.000	
Total		100.000	87.989	12.011	

* Details of population and geographical area of the excluded areas are given in Annexure-VIII.6.

** Annexure-VIII.4 may be seen for further details.

The entire States of Meghalaya, Mizoram and Nagaland are excluded from the provisions of Part-IX, as per article 243M(2).

Provisions of Part-IX relating to the panchayats at district level do not apply to the hill areas of the State of West Bengal for which Darjeeling Gorkha Hill Council exists.

Table 8.4 Share of States in allocation for Municipalities

Sl.No.	State	Share (in percentage)**			Type of the excluded areas*
		Total for the State	Of which, share for- Normal areas	Excluded areas*	
1	Andhra Pradesh	8.233	8.233	0.000	
2	Arunachal Pradesh	0.034	0.034	0.000	
3	Assam	1.077	1.032	0.045	Sixth Schedule Areas
4	Bihar	4.695	3.802	0.892	Fifth Schedule Areas
5	Goa	0.232	0.232	0.000	
6	Gujarat	6.626	6.566	0.060	Fifth Schedule Areas
7	Haryana	1.832	1.832	0.000	
8	Himachal Pradesh	0.195	0.195	0.000	
9	Jammu & Kashmir	0.783	0.783	0.000	
10	Karnataka	6.241	6.241	0.000	
11	Kerala	3.762	3.762	0.000	
12	Madhya Pradesh	7.801	7.247	0.553	Fifth Schedule Areas
13	Maharashtra	15.813	15.677	0.136	Fifth Schedule Areas
14	Manipur	0.220	0.201	0.019	Hills Districts Areas
15	Meghalaya	0.135	0.009	0.126	Sixth Schedule Areas
16	Mizoram	0.192	0.184	0.008	Sixth Schedule Areas
17	Nagaland	0.089	0.089	0.000	
18	Orissa	1.998	1.599	0.399	Fifth Schedule Areas
19	Punjab	2.736	2.736	0.000	
20	Rajasthan	4.971	4.859	0.112	Fifth Schedule Areas
21	Sikkim	0.010	0.010	0.000	
22	Tamil Nadu	9.668	9.668	0.000	

23	Tripura	0.201	0.201	0.000
24	Uttar Pradesh	12.582	12.582	0.000
25	West Bengal	9.874	9.874	0.000
Total		100.000	91.083	8.917

* *Details of population and geographical area of the excluded areas are given in Annexure-VIII.6.*

** *Annexure-VIII.5 may be seen for further details.*

Constitutional, legislative and administrative changes

8.28 While analysing the process of implementation of the 73rd and 74th amendments, we have noticed certain critical problems that would require legislative and administrative changes and, in some cases, further amendments to the Constitution. The areas so identified by us are as follows:

- a. While all the States, barring Arunachal Pradesh, have either enacted a new Panchayat/Municipal Act or have brought the existing legislation in conformity with the 73rd and 74th amendments, it has been noticed that the schemes relating to the subjects included in the Eleventh and Twelfth Schedules have not yet been transferred to these bodies in most of the States. States' legislation merely enumerate the subjects indicated in the two Schedules but do not specify the schemes that have to be implemented by these bodies as contemplated in articles 243G and 243W. Consequently, the funds and the functionaries relating to these schemes continue to remain under the control of the departments of the State Governments. In some cases, the implementation of some programmes has been entrusted to these bodies but only as agency function and they have no role in the planning and formulation of the schemes. Transfer of functions and schemes to the local bodies should be specifically provided by legislation as, in our view, it is mandatory for the States to do so. In some States, even though the legislation empowered the local bodies to levy certain taxes, the necessary rules have yet to be framed, or the notifications laying down the rates have not been issued. We recommend that this may be explored.
- b. A hierarchical structure of the panchayats has been contemplated in the States' legislation with the intermediate level panchayats supervising the village level panchayats and the district level panchayats supervising, advising and coordinating the activities of village level and intermediate level panchayats. However, the role of the three tiers of the panchayats has not been clearly delineated in the State legislation and the matter has usually been left to be decided by way of executive instructions. This has led to a high degree of uncertainty in the matter. There is a need for making legislative arrangements to clearly indicate the role that these bodies have to play in the system of governance in the rural areas of a district.
- c. The Central Government, over the years, have formulated a number of schemes known as Central sector or Centrally sponsored schemes; some of these are implemented for the development of the rural and the urban areas. These schemes are mostly implemented through special agencies created at the district level or through informal and formal organisations established over the years and financed by the Central Ministries directly under these schemes. In some cases, the local bodies have been associated but they are merely performing agency functions with no decisive role clearly assigned to them in the preparation and implementation of the schemes. In particular, mention may be made of the District Rural Development Agencies and District Urban Development Agencies, which are operating as instruments of the Central Government for the planning and implementation of many programmes and schemes related to the subjects included in the two Schedules. These agencies have not been integrated with the new set up. The two Union Ministries- the Ministry of Rural Development and Ministry of Urban Development- are also the nodal Ministries for the implementation of the 73rd and 74th amendments, and, therefore, it is their responsibility to ensure that the local bodies function as institutions of self-government and all impediments to the realisation of this ideal are removed. They have to provide the lead in the movement towards achievement of this goal. Unless these Ministries take the initiative, it may be futile to expect other Ministries in the Central Government to take action for the transfer of more schemes relating to the subjects included in the two Schedules to these bodies.
- d. The Constitution envisages that every State having a population of more than twenty lakhs will have a three-tier panchayati raj system, namely, the village level, the intermediate level and the district level. We feel, on the basis of our own assessment of the working of the local bodies in the States, that it is too rigid an arrangement and there is a need to provide flexibility to the States to decide whether a two-tier system would operate with greater efficiency and economy in a particular situation or a three-tier structure would be essential. Necessary changes need to be made in this regard.
- e. The Fifth and the Sixth Schedule Areas have been specifically excluded from the operation of the 73rd and 74th amendments. Parliament has, however, been given the powers to extend the provisions of these amendments to such areas by legislation. For extension of the provisions of the 73rd amendment to the Fifth Schedule areas, such a legislation was passed by Parliament in 1996 and all the States except Bihar have already made the

consequential changes in their State legislation. However, for extending the provisions of the 74th amendment to the Fifth Schedule areas, Parliament is yet to enact the enabling legislation. This needs to be speeded up. In the case of the Sixth Schedule Areas, no action has yet been taken by the Parliament to make these amendments applicable to these areas. We understand that the power to extend the provisions of these amendments is already available to the Governor in respect of Assam, and to the President of India in respect of Meghalaya, Mizoram and Tripura. There is a need for clarity of approach on this issue so that the development of the rural and urban local bodies in these areas keeps pace with the developments taking place in the rest of the country.

- f. The States of Meghalaya, Mizoram and Nagaland have been specifically excluded from the operation of the 73rd amendment. However, the legislatures of these States have been given the power to extend this amendment to their States, except in respect of the Sixth Schedule areas, by law. We do hope that suitable action will be taken for extending this amendment in these States so that they can get the benefit of the measures that we are going to recommend for the augmentation of Consolidated Funds of these States. In this connection, we would also like to mention that these States have a system of a village council operating at the local level and performing regulatory and developmental functions on most of the subjects included in the Eleventh Schedule. We suggest that either these village level institutions be recognised as panchayats for the purpose of the 73rd amendment by suitable legislative changes or the State may take action as indicated above.
- g. The hill areas in the State of Manipur, for which district councils have been constituted under a Central Act, are excluded from the operation of the 73rd amendment. Similarly, the provisions relating to district level panchayats have not been made applicable to the hill areas of the district of Darjeeling in West Bengal. There are no enabling provisions in the Constitution for making the 73rd amendment applicable to these areas either now or at a later date. It is necessary to introduce suitable enabling provisions in the Constitution so that these areas too could get the benefit of the 73rd amendment.
- h. Panchayats and municipalities should have adequate administrative infrastructure and should be able to raise financial resources on their own which, together with the devolution from the State Government, should enable them to perform their basic civic, regulatory and developmental functions with efficiency and economy. There are wide variations in the area and population served by different tiers of panchayats in the States, as the details in Annexures-VIII.7 and VIII.8 would indicate. In some States, the population served by a village level panchayat is only in hundreds whereas in some others it is in thousands. It appears that in many cases, panchayats at some tiers have not been conceived as viable units. Administrative reorganisation is necessary to ensure their development as viable institutions of self-government.
- i. The District Planning Committees (DPCs) have not become operational in most States; Metropolitan Planning Committees have not been constituted in any State. On the other hand, in some States, DPCs have been entrusted with executive functions, by which they tend to overshadow the local bodies. Immediate measures are required to ensure that these bodies are constituted soon and they function as per the intention of the Constitution.

Taxation of Central Government properties

8.29 The Ministry of Urban Development (MoUD) has, on the advice of the Ministry of Finance, made a submission to us that the issue relating to levy of service charges/taxation of Central Government properties be taken into consideration while making our recommendations on devolution of resources to the States/Municipalities. The MoUD had drafted a proposal for enacting a Central legislation under article 285(1) of the Constitution for regulating the payment of service charges in respect of Central Government properties. This was based on the report of the working group constituted in November 1994 by that Ministry, to make a study in respect of the various issues relating to the taxation of Government properties. A copy of the reference made by the Ministry is placed at Annexures-VIII.9A & B. Many States have, in their memoranda submitted to us, raised the issue of taxation of Central Government properties by the local bodies. In our interaction with the representatives of the local bodies and the State Governments, this subject had come up again and again for discussion. Their view has been that the local bodies should be permitted to tax the properties of the Central Government, like any other property, for supplementing their resources and that necessary amendments to the Constitution be made for the purpose.

8.30 Article 285(1) of the Constitution prescribes that the property of the Union shall, save in so far as Parliament may by law otherwise provide, be exempt from all taxes imposed by a State or by any authority within a State. Parliament, in its wisdom, has not made any law for imposing any taxation on the properties of the Central Government. However, as per the apex Court's decision, properties vested in the statutory corporations or the companies incorporated under the Companies Act do not enjoy this exemption. Ministry of Finance has, in its memorandum to us, expressed the view against local taxation of Central Government properties following the doctrine that the sovereign cannot be taxed except with his consent. They have, however, expressed no objection to taxation of the properties of Central Public Sector Undertakings (CPSUs) by the local bodies, but have cautioned against the possibilities of these bodies levying unduly high taxes on the CPSU properties. The Ministry has expressed no objection to the proposition of levy of service charges on the properties of the Central Government Departments. They have, however, said that such service charges should be reasonable, i.e. commensurate with the services provided.

8.31 We have given our careful consideration to the arguments advanced both by the Centre and the States. We also note that a similar provision for exempting States' property and income from Union taxation, with some exceptions, has been made in article 289. The principle on which both these exemptions were envisaged by the Constitution was that in a federal set up, the property of one level of government should enjoy immunity from taxation by another. We agree with this principle and suggest no changes in article 285 of the Constitution of India.

8.32 As for levy of user charges, the legal basis, as per the instructions issued by the Central Government from time to time (Annexures VIII.10A to D) is open to question and we learn, as stated by the MoUD, that there have been several disputes on this issue. From the information gathered by us, as also available in the report of the working group constituted by the MoUD in 1994 on the subject, we find that while some local authorities are able to levy and collect user charges on the properties of the Central Government departments/undertakings, many others are unable to do so. It may also be recognised that to the extent the cost of providing services is recovered by user charges, the burden on the Consolidated Funds of the States to supplement the resources of Panchayats and Municipalities would get reduced. While taxation of properties belonging to the Central or State governments would apparently infringe on the sovereign powers of the Union and the States, there is no doubt that all the properties located in rural or urban areas enjoy the benefit of civic services that have a cost. This principle has been recognised in the various instructions issued by the Government of India and, therefore, there is ample justification to formalise and regulate it by law. We are of the view that all Government properties, whether they belong to the Central or the State governments, should be subject to the levy of user charges. We are also of the view that it should be regulated by a suitable legislation.