SELECTED ISSUES IN LOCAL-LEVEL FISCAL DECENTRALISATION : A COMPARATIVE STUDY OF INTERNATIONAL AND INDIAN EXPERIENCE

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I hereby affirm that the research for this dissertation titled, "***Selected Issues in Local-Level Fiscal Decentralisation: A Comparative Study of International and Indian Experience***" being submitted to Jawaharlal Nehru University for the award of the Degree of Master of Philosophy in Applied Economics, was carried out entirely by me at the Centre for Development Studies, Thiruvananthapuram.

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CHAPTER I

INTRODUCTION

Fiscal decentralisation is principally a process of transferring the functional and financial responsibilities to the sub-national government through Constitutional / legal framework. It assumes importance in light of the principle of "subsidiarity" which argues that for the most efficient delivery of public services, government activities should be located at the level of government closest to the people.

The operation of a multi-level fiscal mechanism, however, is not simple any where, it may involve conflicts and trade-offs. Pre-condition for the effective functioning of sub-national government is the functional autonomy supported by the appropriate devolution of financial resources. Otherwise there will be horizontal and vertical imbalances[1] between the expenditure needs and the available resources of the representative layers of government which may hinder the decentralisation of developmental functions.

In the contemporary global economic restructuring, there is a growing recognition that fiscal decentralisation could play a pivotal role in the economy for the efficient delivery of public goods and services, especially in the countries of sharp regional disparities and heterogeneous population. In both developed and developing countries, inter-governmental fiscal relations are

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1 Vertical Imbalance: Imbalances between the fiscal positions of various levels of government.

Horizontal Imbalance: Imbalances between the fiscal positions of different governments at the same level, such as provincial or local governments.

increasingly becoming an important economic and political issue. The previous assignment of fiscal functions and power sharing arrangement of sub-national government are undergoing rapid reform to develop an ideal decentralised system of governance. In the process, each country is trying to reinvigorate a system of decentralisation compatible with the emerging order.

For example, during the 1980s, in Canada, system of governance has been largely decentralised by political consideration, when some provinces demanded more autonomy. The issues in the European Union debate also extensively discussed the pros and cons of fiscal federalism and decentralisation (Tanzi, 1995). Newly emerged States of the former Soviet Union also gave significant responsibilities to sub-national governments. Developing countries like, Argentina, Brazil and Nigeria also introduced large scale reforms in giving more autonomy to the sub-national governments.

In India also, the issue of fiscal decentralisation has become very important in recent years. The 73rd and 74th Constitutional Amendments are a major beginning in this direction, where State legislature is supposed to devolve responsibilities, power and authority to the local bodies to enable them to function as institutions of local self government and also to prepare and implement plans and scheme of economic development and social justice (Gulati, 1994). Along with this, it has become mandatory for the State legislature to devolve finances / financial powers to the local bodies. The 73rd and 74th amendments also made it obligatory on the part of the State governments to appoint State Finance Commission to recommend the transfer of financial resources to the local bodies in the form of tax shares, grants-in-aid, tax assignment and related measures to improve the financial position of the local bodies.

In this context, this study proposes to examine the decentralisation experiences of a few selected countries within the major parameters of inter-governmental relations like, tax assignment and expenditure management; fiscal transfers and the devolution principles; vertical and horizontal fiscal imbalances involved and the institutional parameters, namely, the degree of decentralisation and financial autonomy of the local government. On the background of the experiences of other countries, the study undertakes the state-specific analysis of fiscal decentralisation in India.

Precisely, this study is dichotomised into inter-country and intra-country analysis. Inter-country analysis discusses the fiscal decentralisation experiences of Australia, Canada and UK with that of India. Intra-country analysis focuses on the fiscal decentralisation experience within the federal financial arrangements of India. As we know, fiscal decentralisation is the descending cascade of functions and finances from Centre to State and from State to local bodies, the study confines to the latter.

Local bodies in any State in India comprise of urban local bodies, namely, municipalities and corporations and rural local bodies, namely, Panchayats. The present study confines itself to the analysis of fiscal decentralisation experience of Panchayats. The major hindrance in analysing the Indian local level fiscal decentralisation experience is the non-availability of data from published sources[2]. Due to the paucity of adequate data on local finance, the state-specific analysis is confined to the State of Kerala for which data on Panchayat level finance have been collected from the State Directorate of Panchayats. A comparative analysis of Panchayat finance of Kerala with that of Karnataka and West Bengal has also been attempted, but in a limited way on the basis of the information available from the State Finance Commission (SFC) report of respective States. Since SFC reports of these States also do not contain adequate time series data on local finance, analysis of fiscal decentralisation experience of Karnataka and West Bengal is not quantitative in nature unlike Kerala.

Theoretical Issues Related to Fiscal Decentralisation

The orthodox theory of fiscal economics hardly dedicated five pages to multi-level finance (Musgrave, 1959). For analytical purposes, Musgrave classified fiscal functions into three categories, namely, allocation function, redistribution function and stabilisation function. According to Musgrave, the last two functions are to be performed by the central government whereas the allocative function is essentially a part of the local administration. It is argued that allocation activities can better be performed by the local

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2 The Tenth Finance Commission was able to obtain official figures for no more recent year than 1976-77 to arrive at an across- state average for transfers to Panchayats at 1992-93 prices.

Datta (1992) mentioned that "...(D)ata limitations render the task more difficult: information on the finances of rural local government is almost completely lacking and coverage of financial data on urban local government is inadequate."

government since local governments are better informed regarding customers' preferences. Musgrave further elaborated that fiscal stabilisation policy has to be at the national level because the attempts of the local government to apply its own fiscal stabilisation policy will be restricted by the openness of the local government economy, that is, if a high proportion of public expenditure multiplier leaks away, the local government's fiscal policy would not be very effective (Musgrave and Musgrave,1973). It is further maintained that, the effectiveness of redistributive functions undertaken by sub-central units is limited by the potential inter-jurisdictional mobility of their residents. On the other hand, it is the allocative function by which decentralisation promises greater gains through increased economic efficiency by providing public services corresponding more closely to the varying preferences of groups of consumers.

Tiebout (1956) also discussed these three economic roles of government under a decentralised system using a pseudo market mechanism. Musgrave-Tiebout layer-cake approach can be used as a broad outline in assigning economic roles to the different layers of government, though it is not entirely realistic.

The normative economic argument for fiscal decentralisation can be based on ex-ante and ex-post approaches (Cremer, Estache and Seabright, 1994, cited in Tanzi, 1995). The widely referred "decentralisation theorem " of Oates (1972) states that "each public service should be provided by jurisdiction having control over the minimum geographic area that would internalise benefits and costs of such provision ". Oates' case is based on the recognition that not all public goods have similar spatial characteristics and furthermore, different areas have different preferences for public goods. A centralised government might ignore these spatial characteristics and diversity of preferences and thus might supply a uniform package to all citizens. This "one-size-fits-all" approach does not deliver a basket of public goods that is Pareto optimal for all citizens.

The ex-post case is essentially outlined by Tiebout (1956), who argued that the final outcome of fiscal decentralisation will approach to the outcome of an efficient market mechanism. He further argued that fiscal decentralisation can help in identifying different population group's preferences for public goods, which a local government can meet. Thus, the heterogeneous groups of population can be made to pay a price (tax) based on the benefit they receive from the public goods. At the margin, the benefit from consuming public good or service would be equal to the cost in terms of benefit taxes, thus approaching a Pareto optimal solution. According to Tiebout, individuals "vote with their feet" by moving to the jurisdictions that best reflect their preferences.

Views on decentralisation by Musgarve, Tiebout and Oates converge on a common point that the main economic justification for fiscal decentralisation rests largely on allocative or efficiency ground. These theories of decentralisation could be a useful guideline in federal state-local fiscal mapping. The basic message of decentralisation theory is that centralisation is costly if it leads the government to provide a bundle of public goods different from the preferences of the citizens of particular region or province.

Rondinelli (1981) classified intergovernmental relations into three possible systems, namely, deconcentration, delegation and devolution. Deconcentration implies decentralised administration. Delegation refers to the managerial responsibility for specific functions which is transferred to public organisations that are outside the normal bureaucratic structure of central government. Devolution involves the creation of or strengthening of sub-national units of governments (financially or legally) whose activities are outside the direct control of the central government. In other words, devolution means assignment of power of governance to sub-central units.

The 73rd and 74th Amendments of Indian Constitution may be considered as an important step to move away from deconcentration and delegation towards the concepts of devolution in the intergovernmental relations. It is in this context we examine the issues related to fiscal devolution.

Objectives of the study

Major objectives of the study can be put in the following lines:

(i) An assessment of the significance of the local government expenditure in relation to overall State expenditure, its trend, pattern, growth and diversification.

(ii) Analysis of own resources of the local government, and its relative importance in local level finance.

(iii) Analysis of the relative importance of different instruments of fiscal transfers, viz, tax-sharing and grants-in-aid in local finance.

(iv) A comparative analysis of the different criteria adopted by different States for fiscal transfers.

The above analysis is undertaken (a) in the international comparative context in developed countries, (b) an inter-state comparison within India and (c) a detailed analysis of trends in one particular State, viz, Kerala.

Organisation of the Chapters

The study is organised in the following manner: Chapter I is introductory in nature focusing the research problem. Chapter II analyses the inter-country experience of fiscal decentralisation. Chapter III discusses the state-specific (Kerala) analysis of fiscal decentralisation. Chapter IV critically evaluates the State Finance Commission reports of the States of Kerala, Karnataka and West Bengal. Summary and conclusion of the study are drawn in Chapter V.

Data Source

The study derived data from various secondary sources. The data on local government finance of Australia, Canada and UK are taken from the various issues of Government Finance Statistics Year Book, IMF. Data related to Panchayat finance of Kerala is taken from various Administration Reports of Directorate of Panchayats. Other major sources of data are the State Finance Commission Reports of selected States. Data required for the analysis of State finance is taken from various issues of RBI Bulletin.

CHAPTER II

Fiscal Decentralisation Experience: A Cross Country Analysis

Federal fiscal relations are conditioned by each country's context and it is not possible to replicate one country's system in another. However, cross country analysis of fiscal decentralisation offers important insights in understanding the benefits as well as the intricate problems of multi-level governance.

The present chapter attempts a comparative analysis of the experience of Indian local level fiscal decentralisation with that of Australia, Canada and United Kingdom (here after UK). Australia, Canada and India have federal set up but UK has a unitary system of governance. Our selection would, therefore, facilitate comparison of systems of fiscal decentralisation of federal countries with that of a country of unitary character.

We discuss the fiscal decentralisation experience of the above said countries in terms of i) institutional arrangements, ii) local level expenditure management, iii) instruments of fiscal transfers and iv) the recent changes that have occurred in the local level fiscal arena. The chapter has been divided into five broad sections. Section 1 to Section 4 discuss fiscal decentralisation experience of Australia, Canada, UK and India respectively. Section 5 gives a summary of the findings of the chapter which helps in evaluating India's decentralisation experience in light of the other countries' experiences[1].

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1 This section suffers from major data limitation because aggregate data on Indian local level finance is not readily available from secondary sources. We have mainly depended on government reports and published research

Section 1

Australian Experience

Australia has a highly centralised two-tier federation of six States (New South Wales, Queensland, Western Australia, Victoria, Southern Australia, Tasmania) and two federal territories (Australian Capital Territory and the Northern Territory) with a total of 1994-end population of 17.9 million (Spahn and Shah, 1995). Local governments are the extension of the States[2]. The functional activities of the central government are mainly in areas like defense, trade, immigration, external affairs, social security and employment. States are entrusted with expenditure responsibilities for education, health and social services, transport, railways, electricity and water. Local governments deal with public order and safety, housing and community amenities, fuel and energy, recreation and culture etc. Local governments are given reasonable autonomy in local service delivery. Approximately, there are 900 local bodies like municipalities, cities, towns, shires and district councils (Government Finance Statistics, IMF, 1993). State and local Governments together are responsible for 50 per cent of the total outlay of the public sector but are empowered to raise only less than 20 per cent of revenues (1994-95 Budget paper, Commonwealth of Australia, cited in Spahn and Shah, 1995).

Expenditure Assignment

In Australia, share of local government expenditure in combined budgetary expenditure of all levels of government was around 9 per

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work to analyse Indian local government finance.

2 Since Local Governments in Australia are the extension of the States, it is referred as two-tier system of federation.

cent during the 1980s. The composition of Australian local government expenditure by functions is shown in Table 2.1. It can be seen from the table that between 1980 and 1991, among the different categories of expenditure, transport and communication constituted the major component, ranging between 27 and 30 per cent. The general public services came next in importance with a share of 22 per cent to 24 per cent. The share of expenditure on housing and community amenities and recreation and religious affair was around 15 per cent each during this period. The share of expenditure on education and health in total local government expenditure was very low (around 0.5 per cent and 2 per cent respectively). The share of expenditure on social security and welfare increased from 2.30 per cent in 1980 to 4.19 per cent in 1991.

Table 2.1: Functional Classification of Expenditure of Local Governments in Australia (Per cent)

ITEM	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
1. GPS	22.03	20.61	21.03	22.77	22.01	21.10	21.53	21.40	21.45	23.23	22.73	24.14
3. POS	1.58	1.76	1.60	1.64	1.64	1.46	1.47	1.47	1.54	1.67	1.58	1.03
4. EDU	0.54	0.49	0.49	0.48	0.40	0.41	0.42	0.33	0.40	0.41	0.42	0.33
5. HEALTH	2.20	2.10	2.09	2.02	1.07	1.90	1.96	1.85	1.07	1.90	1.96	1.85
6. SSW	2.30	2.60	2.64	2.34	3.72	3.86	4.03	4.19	3.72	3.86	4.03	4.19
7. HCA	14.22	14.40	14.67	14.75	15.39	14.91	15.15	15.31	15.39	14.91	15.15	15.31
8. RCR	15.95	16.04	15.51	14.40	15.71	15.35	15.12	14.45	15.71	15.35	15.12	14.45
9. F&E	0.04	0.12	0.08	0.02	0.03	0.01	0.02	0.01	0.03	0.01	0.02	0.01
10. AFFH	0.29	0.28	0.33	0.38	0.36	0.34	0.33	0.20	0.36	0.34	0.33	0.20
11. MMC	1.26	1.27	1.25	1.20	1.20	1.28	1.25	1.21	1.20	1.28	1.25	1.21
12. T&C	30.13	29.14	28.66	31.00	28.85	27.80	27.28	28.06	28.85	27.80	27.28	28.06
13. OEAS	2.45	2.66	2.83	2.10	2.11	2.09	2.25	2.23	2.11	2.09	2.25	2.23
14. OE	7.02	8.53	8.03	6.80	7.35	7.09	7.89	7.00	7.35	7.09	7.89	7.00
TE	100	100	100	100	100	100	100	100	100	100	100	100

Note: GPS= General Public services, POS= Public Order and Safety, EDU= Education, SSW= Social Security and Welfare, HCA= Housing and Community Amenities, RCR= Recreation, Cultural and Religious Affairs, F & E= Fuel and energy, AFFFH= Agricultural, Forest, fishing and Husbandry, MMC= Manufacturing, Mining and Construction, T & C= Transport and Communication, OEAS= Other Economic Affair and Services, OE= Other Expenditure, TE= Total Expenditure

Source: IMF, *Government Finance Statistics Yearbook*, IMF Publications, Washington, DC. (Various Issues)

The economic classification of expenditure reported in Table 2.2 reveals that i) between 1980 and 1991, current expenditure has been more than 60 per cent of the total local government expenditure, ii) the share of current expenditure increased steadily from 63.57 per cent in 1980 to 72.28 per cent in 1991, iii) the increase in current expenditure was mainly because of the rise in the expenditure on goods and services, iv) interest payments, subsidies and transfers constituted less than 10 percent of the current expenditure, v) the share of capital expenditure steadily declined from 36.31 per cent in 1980 to 27.77 per cent in 1991 with the result that there was a sharp decline in the expenditure on stocks, land and capital assets, and vi) capital transfers by local government have been negligible.

Table 2.2: Economic Classification of Expenditure by Local Governments in Australia (Per cent)

Item	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Current Expenditure	63.57	65.45	66.23	68.70	69.21	68.78	68.43	69.02	69.62	70.18	71.93	72.23
Exp. on Goods & Serv.	54.79	55.19	55.45	60.22	61.17	60.26	59.94	60.09	61.05	61.81	62.85	64.42
Interest Payments	7.07	8.58	8.95	6.77	6.97	6.90	6.94	7.32	7.46	7.32	8.07	6.94
Subsidies & Transfers	1.69	1.67	1.82	1.73	1.83	1.63	1.57	1.62	1.12	1.06	1.03	0.88
Capital Expenditure	36.31	34.52	33.70	31.35	30.04	31.23	31.65	31.03	30.44	29.86	28.11	27.77
Stocks,land,cap.assets	35.88	34.21	33.37	31.18	29.96	31.16	31.60	30.99	30.36	29.75	27.98	27.70
Capital Transfers	0.43	0.31	0.33	0.17	0.08	0.07	0.05	0.04	0.08	0.11	0.13	0.07
Lending minus Repayments	0.32	0.09	0.16	-0.17	-0.02	-0.05	-0.25	-0.17	-0.17	-0.16	-0.17	-0.05
Total Expenditure	100	100	100	100	100	100	100	100	100	100	100	100

Source: Same as in Table 2.1

Tax Assignment in Australia

Tax assignment in Australia is following the layer-cake approach, where each level of government has its own tax base (Spahn and Shah, 1995). Layer cake approach is supposed to be a proper method of assigning tax jurisdiction to different levels of government to avoid tax competition.

The present tax system in Australia is as follows: i) the important income taxes on individuals, enterprises and non-residents are now completely with the Commonwealth. Furthermore, it collects the sales tax, excise taxes and taxes on international trade. ii) The most important own revenue sources of the States are the pay-roll tax, taxes on financial and capital transactions, and taxes on gambling, on insurance, and on motor vehicles, the States also impose "franchise fees". iii) Local Governments are assigned taxes on immovable property, the property tax.

The composition of local government revenue shown in Table 2.3 reveals that between 1980 and 1991, the share of tax revenue declined from around 50 per cent to 42 per cent. In contrast, the share of non-tax revenue showed sharp increase from around 19 per cent to more than 30 per cent during the same period. This sharp increase in non-tax revenue was mainly due to the improved collections of fees, sales and fines. During this period, in absolute term fees, sales and fines together showed more than 5 fold increase. This may be due to the concurrent rights and flexibility of all levels of government in the assignment of non-tax revenue in Australia. The share of capital receipts, that is, mainly borrowing also has increased from around 5 per cent to around 9 per cent during this period. The grant component of local government revenue was more than 20 per cent during this period.

Table 2.3: Composition of Local Government Revenue of Australia (Per cent)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
I. Current Revenue	69.60	69.10	71.33	70.60	68.53	68.38	69.82	70.95	70.86	71.97	73.24	72.91
a. Tax rev	50.84	49.24	49.60	42.53	41.14	40.15	40.05	40.78	41.04	40.53	41.16	42.11
b. Non Tax rev	18.77	19.94	21.73	28.16	27.39	28.22	29.77	30.17	29.82	31.45	32.08	30.80
I. Capital Revenue	5.47	6.30	4.96	8.67	8.00	8.95	9.44	9.33	9.07	9.41	8.70	9.11
II.Grants	24.92	24.52	23.69	20.65	23.47	22.67	20.73	19.73	20.07	18.62	18.06	17.98
V. Total Revenue	100	100	100	100	100	100	100	100	100	100	100	100

Source: Same as in table 2.1

The present pattern of tax assignment in Australia has led to a significant "vertical fiscal imbalance", a mismatch between own resources available and expenditure needs at the various levels of government. The Commonwealth's own revenues greatly exceeded its expenditures. In 1992-93, Commonwealth revenue was 67 per cent of total public sector revenue, while final demand[3] for Commonwealth services was only 33 percent (Rye and Searl, 1994). In contrast, the States which control most of the major government functions are denied access to the two major sources of revenue, namely, income taxation and taxes on the production and distribution of goods. The Court's ruling that the States can tax goods but not services is the reason why the States imposed 'franchise fees' on liquor, tobacco and petroleum (Spahn and Shah, 1995).

The States met about 60 per cent of public sector final demand, but collected only 28 per cent of all revenue, leaving a significant 'fiscal gap' to be closed. Local government collects also about 5 per cent of revenue but meet 8 per cent of total public sector

3 Public sector final demand is measured by public final consumption expenditure (which includes transfer payments) plus public gross capital expenditure.

demand leaving a fiscal gap of 3 percentage points (1994-95 Budget paper, Commonwealth of Australia, cited in Span and Shah, 1995).

Fiscal Transfers

In Australia, the share of grants in total receipts of the local bodies is much less than in Canada and UK. Variations in the amount of grant devolved to the local bodies are very high due to dissimilar grants policy adopted by the provincial governments. There are three categories of Commonwealth payments for Australian local governments: i) general revenue assistance in the form of local government tax-sharing entitlements; ii) direct specific purpose payments to local government and iii) specific purpose payments for local governments made through States (Russell Mathews, 1985). Under the local government Personal Income Tax Sharing Act (1976), the Commonwealth was required to consult with the States regarding whether any changes be made in tax-sharing arrangements for local bodies.

Although, fiscal equalisation method is adopted in Australia for revenue sharing, considerable difficulties were reported in the application of fiscal equalisation procedures. Difficulties arose due to differences in accounting practices between local governments both within States and between States. Also, there were significant differences in the bases on which property values were assessed affecting the measurement of local taxable capacity.

Relative Importance of Local Governments in Australia

Compared to other federations, the scale of local government in Australia is very small-indeed, judged by the share of local government expenditure in total government expenditure. As can be seen from the Table 2.4, between 1980 and 1991, local government expenditure in Australia hovered only around 9 per cent of the total public expenditure[4]. Local government revenues and total expenditure as a percentage of GDP were below 3 per cent in the last decade. However, local governments' own revenue, as a percentage of local government expenditure is increasing. Local governments' own revenue covered more than 70 per cent of the total local government expenditure in most of the years between 1980 and 1991. This shows increasing financial autonomy of the local government. One point to be noted here is that during the 1980s, local government expenditure as a percentage of GDP and as percentage of combined expenditure of all levels of government did show some increasing trend which at the same time local government expenditure met out of their own revenue (LOR/LGE) also showed a modest increase. This can be considered as a sign of some improvement in the financial autonomy of local governments in Australia.

4 In USA, the same ratio was 23.3 per cent, 23.1 per cent in Switzerland, 20.6 per cent in Canada and 19.8 per cent in West Germany.

Table 2.4: Ratios of Local Government Receipts and Expenditure to the Combined budgetary Receipts of all levels of Government and GDP in Australia

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
LGR/CGR	8.60	8.50	8.30	10.14	10.57	10.06	9.83	9.35	9.06	9.23	9.18	9.37
LGE/CGE	8.53	8.69	8.69	9.41	8.96	8.93	8.99	8.99	9.25	9.71	9.90	9.54
LOR/LGE	69.60	69.10	67.15	69.28	69.75	69.14	70.30	71.17	71.49	73.55	73.91	73.30
CGR/GDP	25.10	26.10	26.44	26.69	25.86	27.40	27.73	28.42	28.23	26.92	26.99	27.11
LGR/GDP	2.16	2.22	2.19	2.71	2.73	2.76	2.73	2.66	2.56	2.49	2.48	2.54
CGE/GDP	26.78	26.85	26.81	29.37	29.96	30.54	30.12	29.44	27.41	25.05	24.79	26.48
LGE/GDP	2.29	2.33	2.33	2.76	2.69	2.73	2.71	2.65	2.53	2.43	2.45	2.53

Note: LGR= Local Government Revenue, LGE= Local Government Expenditure LOR= Local Governments' Own Revenue, CGR= Consolidated Government Revenue[5], CGE= Consolidated Government Expenditure, GDP= Gross Domestic Product

Source: Same as in table 2.1

There are historical reasons for the relatively small scale of Australian local government. Various secondary studies have shown that political dominance of Provincial governments over hinterlands and the reluctance of local citizens to take responsibility of local services are the two main reason for the small size of Australian Local Government. More fundamentally, local government in Australia is constitutionally an exclusive responsibility of the Provinces. It is not unusual in Australia for a local council to be suspended and its function being taken over by the appointed administrator.

Section 2

Canadian Experience

Canada is the second largest country with the lowest population density in the world. It is a federation of ten provinces and two territories. Unlike Australia, it has a highly decentralised two

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5 Consolidated Government Revenue includes the receipts of all levels of government excluding the intergovernmental transfers.

tier system. The ratio of local government expenditure in total government expenditure is around 35 per cent in Canada. The ratio of local expenditure and revenue in GDP is around 10 per cent. It is considered as a model of what is referred to as dual federalism.

There are approximately 8000 units of local bodies like municipal governments, agencies, commissions, special purpose boards and school authorities in Canada (Government Finance Statistics, IMF, 1993). In Canadian fiscal federalism, federal and provincial governments are co-equal partners, whereas local governments do not enjoy independent constitutional status. They are simply hand maidens of the Provinces[6]. They draw all responsibilities and powers from the province in which they are located. In Canada, there is no direct financial relationship between the local bodies and the federal Government.

Expenditure Assignment

Expenditure assignment in Canada is transparent. Money, banking, trade, airlines, railways, foreign affairs, defense and unemployment insurance are federal responsibilities. Pensions, immigration, agriculture and industry are shared by federal and provincial governments. Canadian sub-national governments are not restricted to the provision of collective goods, in fact, their major activities relate to education, health and social welfare (Brown, 1984). As can be seen from the Table 2.5, between 1980 and 1989, the share of education in total local government expenditure

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6 Although many local bodies have populations in excess of small provinces, all provinces have equal sovereign rights. However, the local bodies have no sovereign rights.

constituted the largest component, being around 40 per cent. The expenditure on health was below 6 per cent of the total. Transport and communication and housing amnesties, each constituted around 10 per cent of the total during the same period.

Table 2.5: Functional Classification of Expenditure of Local Governments in Canada (Per cent)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
1. General Public Services	5.13	5.15	5.48	5.36	5.54	5.62	5.05	5.18	5.37	5.35
3. Public Order and safety	7.45	7.64	7.87	7.86	7.88	8.14	8.29	8.29	8.31	8.38
4. Education	40.68	41.29	40.89	41.43	40.86	40.61	40.93	40.77	39.99	39.88
5. Health	4.98	5.25	5.47	5.75	5.81	5.81	5.51	5.64	5.69	5.49
6. Social Security and Welfare	2.97	2.90	3.09	3.41	3.48	3.56	3.73	3.95	4.15	4.19
7. Housing and Comun. Amenities	9.72	9.58	8.95	8.51	8.48	8.61	9.30	8.88	9.41	10.02
8. Rec., Cult. & Religious Affrs.	6.24	6.09	6.06	5.74	5.99	6.25	6.40	6.33	6.35	6.32
12. Transport and Communication	11.57	11.09	10.83	9.40	9.81	10.23	9.97	10.19	10.46	10.64
13. Other Eco. Affairs & Services	1.14	1.08	1.16	1.05	0.99	1.05	1.02	1.02	1.01	1.00
14. Other expenditure	10.12	9.94	10.21	11.50	11.14	10.12	9.80	9.74	9.27	8.73
Total expenditure	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Note: Rec= Recreation, Cult= Culture, Comun= Community
Source: Same as in table 2.1

The composition of expenditure as per economic classification of the budget represented in Table 2.6 shows that during 1980 to 1989, the share of current expenditure of Canadian local government was 86 to 88 per cent of the total expenditure, with the bulk of current expenditure on goods and services. Interest payments accounted for less than 10 per cent of the total expenditure. The expenditure on subsidies and transfers, which was 2.81 percent in 1980 had increased to 4 percent in 1989. The Capital expenditure constituted 10 to 12 percent of total expenditure. The net lending (lending minus repayment) by local government has always been positive but small.

Table 2.6: Economic Classification of Local Government Expenditure in Canada (Per cent)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
I.Current Expenditure	86.88	87.22	86.86	88.34	88.75	87.74	88.52	87.91	87.57	87.03
a.Exp. on goods & services	77.08	77.52	76.90	77.20	77.31	76.23	77.04	76.75	76.80	76.51
b. Interest Payments	6.98	6.90	6.99	7.33	7.40	7.56	7.58	7.18	6.77	6.51
c. Subsidies & Transfers	2.81	2.80	2.97	3.80	3.97	3.95	3.89	3.97	4.01	4.00
II. Capital Exp.	12.68	12.45	12.52	11.16	10.59	12.08	11.45	11.90	12.34	12.89
a. stocks,land,cap. assets	12.68	12.45	12.52	11.16	10.59	12.08	11.45	11.90	12.34	12.89
III.Lending minus Repayments	0.44	0.33	0.62	0.51	0.66	0.18	0.03	0.20	0.09	0.09
IV. Total Expenditure	100	100	100	100	100	100	100	100	100	100

Source: Same as in table 2.1

Tax Assignment in Canada

While in Australia, tax assignment follows layer-cake approach where each government has independent tax base, in Canada, federal, provincial and local governments have considerable overlapping tax jurisdictions. The sources of revenue for the local governments in Canada are taxes on land, property, user charges, business regulation and frontage.

Table 2.7: Canadian Local Government Tax Assignment

Assignment Category	Base	Rate	Adminstration and Collection
Property	P,L	P	P
Land	P,L	P	P
Frontage	L	L	L
User Charges	F,P,L	F,P,L	F,P,L
Business Regulation	P,L	P,L,	P,L

Note: F= Federal Government, P= Provincial Government, L = Local Government
Source: Shah (1995)

As can be seen from the Table 2.7, property tax and land tax as tax bases, are shared by the provincial government and local government, though the fixation of rate, adminstration and collection are exclusively in the hands of provincial government.

The base, rate, adminstration and collection of taxes on business regulation are mutually done by the provincial and local governments. While frontage is exclusively in the hand of local governments, the taxing jurisdictions in regard to user charges not only overlaps with the provincial government but also with federal government. It is interesting to note that even though tax jurisdiction in Canada overlaps considerably, its tax system is highly harmonised. Provinces have the authority to regulate rates of taxes of the local government. The local bodies are not permitted to impose new kinds of taxes. Although the local bodies rely heavily on the property tax for raising local revenues, this traditional tax base (property tax base) is not an exclusive domain of the local bodies due to the overlapping tax jurisdictions.

As can be seen from the Table 2.8, current revenue excluding grants comprises more than 50 per cent of the total revenue of the local government. The composition of grants in total revenue receipts of local government of Canada is comparatively higher than in Australia. It can be seen also that the grant component of local government receipts varied between 45 and 49 per cent and that unlike Australia, local governments do not have any capital receipts even though more than 10 per cent of their total expenditure is in the nature of capital expenditure.

Table 2.8: Composition of Local Government Revenue in Canada (Per cent)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
I. Current Revenue	51.56	52.26	51.13	50.71	51.49	52.16	52.86	53.46	53.64	54.25
a. Tax Revenue	36.48	36.41	35.61	36.06	36.42	36.57	38.04	38.44	38.72	39.39
b.Non tax Revenue	15.09	15.84	15.52	14.65	15.08	15.59	14.82	15.02	14.91	14.86
II. Grants	48.44	47.74	48.87	49.29	48.51	47.84	47.14	46.54	46.36	45.75
III. Capital Revenue	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
IV. Total Revenue	100	100	100	100	100	100	100	100	100	100

Source: Same as in table 2.1

Fiscal Transfers in Canada

The overriding objective of fiscal transfers in Canada is "to secure economic union by maintaining minimum national standards in Provincial-Local public services across the nation" (Shah, 1995). Fiscal transfers to the sub-national governments, are made under three major programmes:

i) Established Programmes Financing (EPF), under which is the conditional block (per-capita) transfers are made for health and education with federal conditions on accessibility and standards of service.

ii) Canadian Assistance Plan (CAP), which is a programme of conditional matching transfers for welfare assistance and

iii) Canadian Fiscal Equalisation Programme(FEP), which is a constitutionally mandated programme of unconditional block transfers to support reasonably comparable levels of taxation.

General grants are given to the local bodies for either current or capital expenditure purposes. They are `unconditional grants´ and their horizontal distribution depend on the per-capita tax capacity or expenditure requirements. `Conditional grants´ to the local bodies are based on the provisions by the municipality of construction plans meeting provincial standards (Marshall, 1969).

The Canadian FEP is of special interest because it is a comprehensive per-capita fiscal capacity equalisation programme, and it takes into account all Provincial-Local revenues. Since the programme uses fiscal capacity as a criterion, it allows the Federal Government to monitor the fiscal positions of sub-national governments on a timely basis. The programme also neglects other transfers in the calculation of equalisation transfers. Finally, it separates taxing and spending decisions.

The federal equalisation grants constitute a major component of fiscal transfer receipts of local governments in Canada. The Federal government gives equalisation grants to local governments to reduce regional disparities in income and thus taxation capacity. These grants are filtered down to local bodies ,on the basis of two indices: population and fiscal capacity of the provincial governments.

The expenditure responsibilities vary significantly between Canada's ten provincial governments as well as the local governments. As a result, federal and provincial governments general grants to local bodies also vary greatly from province to province. For instance, in the province of Nova Scotia, provincially collected railway and branch bank taxes are devolved to the local bodies. One-third of provincially collected oil and natural gas royalties paid to the local bodies of Alberta. In the province of British Columbia, there is a per-capita grant which decreases as the size of the local bodies rises. In Ontario, per-capita grant plus a 'basic shelter exemption' for home ownership which amounts are reimbursed to the local bodies. Redistribution of one-third of the provincially levied - collected sales tax exists in Quebec, while equalisation grants based on fiscal capacity is devolved to the local bodies of New Brunswick province (Marshall, 1969).

Specific purpose grants are also there in the fiscal transfers of Canadian local government. There are several thousands variations in the area of grants related to specific services in provincial-local programmes. In addition to that, federal grants are provided directly to local bodies for grade crossing elimination, sewage treatment plants etc.

Degree of Decentralisation

The fiscal indicators of degree of decentralisation in Canada, as presented in Table 2.9, show that revenue decentralisation is higher than expenditure decentralisation. The ratio of local own revenue to local expenditure, is around 50 per cent. This is also referred to as fiscal autonomy ratio.

Table 2.9: Ratios of Local Government Receipts and Expenditure to the Combined Budgetary Receipts of all levels of Government and GDP in Canada

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
LGR/CGR	47.42	43.44	47.21	47.72	45.57	45.06	43.49	41.44	40.93	39.32
LGE/CGE	42.02	40.30	38.49	37.52	35.05	35.09	37.23	37.48	37.69	36.07
LOR/LGE	49.04	50.46	48.84	48.66	50.02	50.95	51.35	52.52	52.33	52.57
CGR/GDP	17.90	19.92	19.31	18.57	18.83	18.74	19.31	19.73	19.31	20.13
CGE/GDP	21.24	22.25	24.80	24.61	25.20	24.64	23.22	22.21	21.50	22.64
LGR/GDP	8.49	8.66	9.12	8.86	8.58	8.44	8.40	8.18	7.90	7.92
LGE/GDP	8.93	8.96	9.55	9.23	8.83	8.64	8.64	8.32	8.10	8.17

Note: Same as in table 2.4
Source: Same as in table 2.1

Section 3

UK Experience

In UK, the system of governance is unitary. There is direct functional and financial relationship between the Central and local governments. There are approximately 540 local councils/ local governments (IMF, Government Finance Statistics, 1993). During the 1980s, local authorities' current and capital expenditures amounted to 13 to 14 per cent of GDP, which was significantly higher than that of the federal States like Australia and Canada. However, with the shift towards increasing marketisation of UK economy during the 1980s, the influential supply-side school of economic thought in UK called for curbing excessive levels of public expenditure including local governmental expenditure (Bailey and Paddison, 1988). As we shall note later, local government expenditure declined as a proportion of both GDP and Central government expenditure during the 1980s.

Tax Assignment

For the financing of local government expenditure, 'rates' constituted the major source of revenue. 'Rates' is nothing but the local property tax. It was levied on all buildings; domestic (residential) and non-domestic (business). Previously, each local government was free to set its own rate. But during the late 1980s, the Central government initiated rate-capping as a means of controlling public expenditure. Low income households received transfers called rate-rebates to help them to pay these taxes. Altogether, about one-third of all households received rebates. Gross trading profits of trading enterprises and interest receipts were often additional sources of local revenue receipts.

In April 1990, the UK Government implemented the most significant change in local government finance by replacing the existing tax on property or rates with the community charge or "poll tax." This tax was, by its vary nature more regressive than its predecessor, since the base of taxation was shifted from the house to the individual. It was estimated (Bayomi, 1990) that as a consequence of this change and other reforms of 1990s, the long run spending by local governments would have to decline by two and a half percentage.

Apart from the reform in `property tax´, drastic changes were brought in the realm of fiscal transfers as part of the reforms of 1990. Earlier, local councils / governments used to collect the local business tax at differential rates. Reforms led to the centralisation of local business taxes on the ground that differential rates of tax caused economic distortions. Now, the rate of taxation is set by the Central government and is same for all localities and the tax is referred to as Uniform Business Rate (UBR), which is collected initially by Central government and then distributed to the local governments on a per adult basis.

Prior to the reforms, the grant contained a matching element. Because of the matching element in the grant, part of any increase in local expenditure was paid by Central government or the national tax payer. The third part of the reform package eliminated the matching grants-in-aid programme. The amount of grant received by a local government is now independent of its expenditure. Since grant is now lump-sum only and business property tax is set by the

Central government, all marginal or additional expenditures have to be financed out of the community charge or poll tax.

The composition of revenue of the local government shown in Table 2.10 reveals that, between 1980 and 1991, the share of current revenue in total revenue receipts fluctuated within a narrow range of 47 to 50 per cent except last two years when the share of the same declined to 32.54 per cent and 25.48 per cent respectively with a corresponding increase in the grant component. The share of grant in total receipts also fluctuated between 43 to 48 per cent except during the last two years when the share of grant increased to 60.74 per cent and 70.34 per cent respectively. The point to be noted here is that, the UK reforms have enlarged the grants component in local revenue, while aiming to introduce 'accountability' in local finance (Bagchi, 1991). Unlike Canada, total revenue of the UK local government comprises of capital receipts also and its share had always been around 5 per cent except 1990 and 1989 when the share of capital receipts increased to more than 6 and 8 per cent respectively.

Table 2.10: Composition of Local Government Revenue of UK (Per cent)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
I.Current Revenue	49.60	49.94	50.04	46.92	46.53	47.15	48.27	47.86	NA	48.57	32.54	25.48
a. Tax Revenue	29.63	31.04	32.07	30.34	30.34	31.03	32.32	32.39	NA	33.31	17.73	11.63
b. Non tax Revenue	19.97	18.90	17.97	16.58	16.19	16.12	15.96	15.46	NA	15.25	14.82	13.85
II.Grants	46.74	45.78	43.37	47.68	48.79	47.95	47.05	46.66	NA	43.21	60.74	70.34
III. Capital Revenue	3.66	4.28	6.59	5.39	4.68	4.90	4.67	5.48	NA	8.22	6.71	4.18
III. Total Revenue	100	100	100	100	100	100	100	100	NA	100	100	100

Source: Same as in table 2.1

Total grants received by the UK local governments can be divided into two components: specific grants which relate to specific services, such as police and general grants-in-aid or block grant[7]. The block grant was an equalising grant and consisted of general lumpsum and matching grants. Block grant is provided by taking into account the expenditure needs as well as the tax base resources of the local government. Grant related expenditure (GRE) assessment is done by the Central government to provide block grants to meet local expenditure needs. If a local government spent a fixed amount above GRE, otherwise the threshold, the entitlement to grant for further increases in expenditure is reduced. As a result, the local authorities faced, what is referred to as, a kinked budget constraint (Bayomi and Gordon, 1991).

Expenditure Assignment

Composition of expenditure by function shown in Table 2.11 reveals that the thrust of local government expenditure is on education. During the period, 1980 to 1991, more than one-third of the total expenditure was spent on education. The second largest share of the expenditure goes for housing and community amenities. During this period, the share of expenditure on public order and safety increased from around 8 per cent to around 13 per cent. The share of expenditure under social security and welfare also increased very sharply from 8.89 per cent in 1980 to 15.23 per cent in 1986 and then it started declining. Transport and communication also had a share of more than 5 per cent during this period.

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7 Disaggregated data on grant is not readily available. So further analysis on the grant is constrained to that extent.

Table 2.11: Functional Classification of Local Govt. Expenditure in UK (Per cent)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
1. General Public Services	2.91	3.02	3.25	3.01	2.05	3.06	3.36	3.51	NA	4.29	4.55	4.40
2. Defense	0.02	0.03	0.03	0.03	0.03	0.04	0.05	0.05	NA	0.05	0.06	0.05
3. Public Order and safety	8.78	9.69	9.93	9.65	10.23	10.20	10.11	11.39	NA	11.90	12.20	12.76
4. Education	36.44	38.35	36.74	34.65	34.05	33.76	35.52	34.88	NA	33.70	33.19	34.80
6. Social Security and Welf.	8.89	8.87	9.25	13.38	14.20	15.25	15.23	9.03	NA	9.50	9.91	10.57
7. Housing & Comun. Ameni	16.98	14.81	14.94	16.99	16.78	15.62	15.04	21.21	NA	20.46	20.13	18.62
8. Rec. Cult. & Relig. Affa.	4.15	4.29	4.29	4.28	4.38	3.98	4.15	4.13	NA	4.35	4.61	4.48
10. Agri, Fores., Fish, Hunt	0.67	0.62	0.72	0.51	0.40	0.25	0.14	0.42	NA	0.42	0.17	0.15
11. Mining, Manuf.and Const.	0.18	0.19	0.19	0.18	0.18	0.19	0.18	0.19	NA	0.19	0.20	0.22
12. Transport and Communica.	6.79	7.01	7.51	6.96	6.72	6.31	5.99	5.59	NA	5.70	5.90	5.34
13. Other Eco. Affa. & Ser.	1.14	1.05	1.16	1.19	1.30	1.07	1.07	0.93	NA	1.37	1.40	1.24
14. Other expenditure	13.04	12.36	11.99	9.17	8.72	10.20	9.17	8.67	NA	7.90	7.53	7.37
Total expenditure	100	100	100	100	100	100	100	100	NA	100	100	100

Note: Welf= Welfare, Comun. Ameni= Community Amenities, Rec= Recreation, Cult=Culture, Relig. Affa= Religous Affairs, Agri, Fores, Fish, Hunt= Agriculture, Forestry, Fishing and Hunting, Manuf. and Const.= Manufacturing and Construction, Ser= Services

Source: Same as in table 2.1

Composition of expenditure by economic type represented in Table 2.12 shows that, during 1980 to 1991, the share of current expenditure in total expenditure was between 84 to 88 per cent. The major component of the current expenditure is the expenditure on goods and services constituting more than 60 per cent of the total expenditure. Among the other components of current expenditure, the share of interest payment declined from 13.38 per cent in 1980 to 7.40 per cent in 1991. The share of subsidies and transfers in total expenditure increased from 7.55 per cent to 12.87 per cent. Capital expenditure which comprises of stocks, land and capital assets and capital transfers, constituted 12 to 17 per cent of the total expenditure.

Table 2.12: Economic Classification of Local Govt. Expenditure in UK (Per cent)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
I.Current Expenditure	82.64	85.96	84.85	85.06	84.46	86.96	87.34	86.88	NA	83.63	83.64	88.01
a.Exp. on goods & ser	61.71	65.28	65.34	63.19	62.58	64.38	66.27	66.40	NA	62.72	64.91	67.74
b.Interest Payments	13.38	13.06	11.50	9.56	9.03	9.73	8.81	8.76	NA	8.70	7.74	7.40
c.Subsidies&transfers	7.55	7.62	8.01	12.31	12.85	12.84	12.26	11.71	NA	12.21	10.98	12.87
II.Capital Expenditure	15.90	13.21	13.61	15.64	15.91	14.06	13.62	13.83	NA	16.59	16.68	12.36
a.Stocks,land, cap.ast.	15.09	12.29	12.16	12.90	12.89	12.35	12.39	12.51	NA	15.43	15.47	10.86
b.Capital transfers	0.82	0.92	1.45	2.74	3.02	1.71	1.24	1.32	NA	1.17	1.21	1.50
III.Lending minus Repayments	1.46	0.83	1.53	-0.70	-0.37	-1.02	-0.96	-0.71	NA	-0.22	-0.32	-0.37
IV.Total Expenditure	100	100	100	100	100	100	100	100	NA	100	100	100

Source: Same as in table 2.1

Degree of Decentralisation

It can be seen from the Table 2.13, the financial autonomy ratio in the UK (LOR/LGE) fluctuated between 44 per cent and 47 per cent, from 1980 to 1986. After that own revenue mobilisation declined sharply and by the end of 1991, the financial autonomy ratio declined to as low as 25.10 per cent. Yet the degree of decentralisation ratio of UK local government revenue has been greater than the degree of decentralisation of expenditure.

As can be seen from Table 2.13, while combined government expenditure as a percentage of GDP declined sharply from 40.60 per cent in 1980 to 34.30 per cent in 1990, local government expenditure as percentage of GDP decline by one percentage point during the same period, from 13.68 per cent to 12.34 per cent.

Table 2.13: Ratios of Local Government Receipts and Expenditure to the Combined budgetary Receipts of All Levels of Government and GDP in UK

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
LGE/CGE	33.68	31.81	31.94	32.47	33.52	31.22	32.52	33.77	NA	35.60	NA	33.96
LGR/CGR	34.91	36.18	35.32	35.05	34.63	32.84	34.19	34.04	NA	NA	33.42	32.56
LOR/LGE	45.51	50.33	50.84	45.32	44.33	46.00	47.67	32.04	NA	NA	31.66	25.10
CGR/GDP	35.95	36.77	38.66	37.40	37.37	37.66	36.54	35.95	NA	36.09	35.51	36.87
CGE/GDP	40.60	41.50	42.07	41.79	40.53	40.53	38.91	36.63	NA	34.52	34.30	36.33
LGE/GDP	13.68	13.20	13.44	13.57	13.58	12.65	12.65	12.37	NA	12.29	NA	12.34
LGR/GDP	12.55	13.31	13.65	13.11	12.94	12.37	12.50	12.24	NA	NA	11.87	12.00

Note:Same as in table 2.4
Source: Same as in table 2.1

Section 4

Indian Experience

The Royal commission on Decentralisation was set up in India (1907) to study the financial and administrative relations between the government of India and the provincial governments. The Commission noted that functional responsibilities were more than the financial powers of the local bodies. Government of India Act of 1919 for the first time enhanced the financial powers by specifying a number of taxes under the exclusive jurisdiction of local bodies. Assignment of new taxes could not improve the financial position of local bodies due to the mismanagement and administrative lapses in the collection of taxes. The Act of 1935, consequently, repealed the scheduled taxes included in the 1919 Act and provided for three separate lists - the federal, provincial and the concurrent. The distinction between the provincial and local taxation was done away with, and local bodies derived taxation powers from the provincial legislature (NIPFP, 1995) and recommended fiscal transfer to the provinces to fill the vertical gap. Thus the foundation of fiscal federalism in India in a real sense were laid by Government of India Act of 1935.

After independence, the functional and fiscal structure of local bodies underwent a significant change. Article 243 of the Constitution of India enabled the State government to assign appropriate fiscal powers to lower bodies. Thus, devolution to local bodies of taxation powers or funds became discretionary and tendency was to assign minimum possible fiscal powers to lower bodies by State governments.

Revenue Assignment

The structure of federal fiscal arrangement in India is such that comparatively productive and buoyant tax bases are with the higher levels of governments. Generally, taxes assigned to local governments are immobile, inelastic to economic activity and spatially concentrated. Major sources of tax revenues of the Central, State and Local governments in India are shown in Chart 2.1.

Among the central government taxes, income tax and union excise duties are the sharable taxes between Central and State government. A degree of vertical imbalances - that is, the failure of expenditure and own revenue at each level of Government to balance is the built-in feature of the Indian Union (Wallich, 1982). The Central government has been from time to time accused of manipulating taxes to its own benefit, through a variety of means such as raising rates on taxes that it keeps on their entirety and neglecting tax sources that are shared with the States or required to be turned over to them (Bagchi, et al. 1992). This phenomenon has also been observed in the State local fiscal relation. Several taxes that had strong local bases were taken away by State governments. For example, such encroachments are of Entertainment Tax and Motor Vehicle Tax in most States. The local tax bases differ across the States. The most common among them are represented in the Chart 2.1.

Chart 2.1: Major Sources of Tax Revenue of Different Layers of Government in India and their Expenditure Functions

Sources of Tax Revenue	Expenditure Functions
Central Government	Central Government
1. Income tax 2. Corporation tax 3. Customs duty 4. Union Excise duty 5. Wealth tax 6. Other taxes and duties 7. Taxes on Union Territories 8. Service tax	1. Defence, 2. Foreign Affairs, 3. International economic relations, 4. Atomic energy, 5. Aviation, 6.Shipping, 7. post and telecommunication, 8.Highways 9.Banking an insurance, 10. Oil, 11. Petroleum products, 12.Industries within jurisdiction
State Government	State Government
1. Agricultural Income tax 2. Taxes on Profession, Trade and Employment 3. Taxes on Property and Capital Transaction 4. Taxes on Commodity and Services or Sales tax	1. Public order, 2. Police, 3. Prisons, 4. Irrigation, 5. Agriculture and related activities, 6. Land, 7. Public health, 8.Industries within juris diction, 9. Trade and commerce within States,
Local Government	Local Government
1. Land tax 2. House/Building tax 3. Vehicle tax 4. Octroi 5. Taxes on Profession, Trade, etc. 6. Tax on fairs and other Entertainment	1. Local Adminstration, 2. Water supply and sanitation, 3. Street light, 4. Public health, 5. Education, 6. Minor irrigation, 7. public safety, 8. Recreation and welfare,

Sources: 1. Budget Documents of the Central Government (Ministry of Finance), Finances of State Government, RBI Bulletin.
2. Rajaraman, et al (1996) for local taxes and expenditure.

Apart from the tax sources mentioned in the Chart 2.1, local government in India mobilises resources through non-taxes revenues levied and collected by the local bodies, shared revenue and grants-in-aid from the State Government. Another small component of receipts at the local level is the loans from State government and from various financial institutions.

Chart 2.2: Major Sources of Tax Revenue of Panchayats in Different States in India

	AP	BH	GJ	HR	KAR	KER	MP	MH	PN	RJ	TN	UP	WB
Local Taxes													
1.H./B. Tax	#	-	#	#	#	#	#	#	#	#	#	-	#
2.Land Tax	#	#	#	-	#	#	#	#	-	-	-	-	#
3.Prof. Tax	-	#	-	-	-	#	#	#	#	-	#	-	#
5.Octroi	-	-	#	-	-	-	-	#	-	#	-	-	*
Shared Revenue.													
1.Land Rev.	#	#	#	#	#	#	#	#	#	#	-	-	#
2.Ad.St.Duty	#	-	-	#	#	#	#	#	#	-	#	#	#
3.Ent. Tax	-	-	-	-	-	-	-	-	-	-	#	-	#
4.Seigniorage Royalties	#	-	-	-	-	-	-	#	-	-	#	-	-

Note:#= Taxes at the Panchayat level
*=Toll on vehicles and animal instead of octroi
H\B Tax = House/ Building tax, Prof. tax = Profession Tax, Land Rev. =Land Revenue, Ad. St. Duty = Additional Stamp Duty,
Ent. Tax = Entertainment tax.
Source: Rajaraman, I (1996)

Different taxes at the Panchayat level is shown in Chart 2.2. Among the different taxes at the Panchayat level, immobile property taxes (which includes taxes on land, house / building) constitute the bulk of local own taxes while the indirect taxes like additional stamp duty and entertainment tax are generally collected by the State government and shared with the local bodies. Royalties collected by State governments on minor minerals and quarried materials like granite and sand are called seigniorage revenue which is shared between States and Panchayats in Andhra Pradesh, Maharastra and Tamil Nadu (Rajaraman, et al, 1996). Income from non-tax revenue includes fees for markets, weekly bazaars, slaughter houses, animals, offensive and dangerous trade etc. and income from the remunerative schemes like market buildings, shopping centres, Panchayat shelters, motels, petrol pumps etc and user charges for public facilities and common resources.

Since data on local level finance in Indian context is very scanty and is not readily available, it acted as a major constraint for us to undertake any time series analysis of the local finance of India as we have done for Australia, Canada and UK. The 7th Finance Commission has provided one time point cross sectional data on revenue and expenditure of both urban and rural local bodies in India, a summary of which is given in Table 2.14. Two points can be readily noted: First is the sharp contrast between the rural and urban local bodies both in terms of income as well as expenditure pattern. Second is the virtual absence of fiscal autonomy as far as rural local bodies are concerned. On an average around 90 per cent of the receipts are in the form of grants (81.8 per cent) and assigned / shared tax (7.4 per cent). Urban local bodies in contrast meet 81 per cent of their total expenditure out of their own resources. Regarding the expenditure pattern, it can be seen from the table that more than 29 per cent of the total expenditure is spent for community services by the urban local bodies. But the highest share of expenditure was on education (42.4 per cent) by the rural local bodies.

Table 2.14: The Composition of Income and Expenditure of Rural and Urban Local Bodies in India in 1976-76

	Rural	Urban
Income Sources		
1. Taxes	8.1	54.4
2. Non-tax Revenues	2.7	26.9
3. Assigned/Shared Tax	7.4	3.6
4. Grants	81.8	15.1
Total	100	100
Expenditure Function		
1. General Services	8.3	14.3
2. Community Services	5.9	29.9
Water Supply	2.0	11.6
Public Health & Sanitation	0.1	7.4
Roads	3.8	10.9
3. Social services	45.5	20.2
Education	42.4	9.8
Health	3.1	10.4
4. Other services	25.9	25.7
5. Revenue Surplus	14.4	9.9
Total	100	100

Source: Datta (1992)

It should however be kept in mind that pattern of local finance widely differs across the States. While the States like Kerala showed a promising picture in the internal mobilisation of revenue potential with a comparatively higher local autonomy index (that is the local revenue as percentage of local government expenditures) was around 50 per cent; the performance of States like West Bengal, Orissa and Bihar was vulnerable. The internal resource mobilisation of tax and non-tax sources in West Bengal and Orissa was only 3 per cent (Datta, 1992).

Grants-in-aid, which constitutes the single major component of receipts of rural local bodies are of two types: general purpose and specific purposes. General purpose grants are unconditional block grant. Specific grants are conditional grants. Major shared and assigned taxes at the local level are Land revenue, entertainment tax, stamp duty, motor vehicle tax and entry tax (Datta 1992, & Rajaraman et al 1996). Regarding the loan component, it is more dominant in urban local bodies, in which borrowing constitute a regular source of receipt. Using State government as guarantee, borrowing are made from L.I.C, HUDCO and such financial institutions for capital expenditure on projects like slum clearance, water supply and sanitation, residential development, hospital, market buildings etc (Gover, 1995).

State governments give interest bearing loans to Grama Panchayats. In Madhya Pradesh loans are given for creating community property, remunerative assets like shopping complex, markets, fishery development, poultry development, etc. so as to increase their income and make them financially viable. In Uttar Pradesh and Bihar, Panchayat Raj Corporations are established to give loans to Panchayats to promote a variety of development works in villages. Kerala experimented with a slightly different institution called Rural Development Board in providing water supply schemes, construction of market complexes etc for the Panchayats through institutional finance (Rao and Srivastava, 1982 cited in Oommen, 1995).

Expenditure Assignment

Having discussed the different sources of receipts of local bodies in India, we turn to the discussion of expenditure functions. With regard to the expenditure responsibilities, constitution of India has made a 3 fold classification of expenditure functions between Centre and States where Central government is solely responsible for 84 categories of expenditure, State governments expenditure responsibilities are over 47 items, another 47 areas are under the concurrent jurisdictions of Centre and States (Bagchi, et al 1992). Expenditure responsibilities of the three levels of government in India is also presented in Chart 2.1. Before 73rd and 74th Constitutional Amendment, local bodies were not given any Constitutional status, and their functional responsibilities were not specified in the Constitution and varied across the States. The most common among varied expenditure functions of local bodies are presented in the chart 2.1. The expenditure functions of the local bodies was concentrated to civic services, while expenditure responsibilities in agricultural and other productive services were usually undertaken on an agency basis.

As can be seen from the Table 2.14 that various types of community and social services alone accounted for more than 50 per cent of the expenditure of both urban and rural local bodies. If other welfare services are included, the share is likely to go up to 65 to 70 per cent. The contrast in expenditure pattern between the urban and rural local bodies are also evident in terms of their share in community services. It is only 5.9 per cent for rural local bodies but 29.9 per cent for urban local bodies.

Datta (1992) has estimated that the share of local expenditure in GDP was around 2 per cent in the late eighties with the rural and urban break up of 0.9 and 1.2 per cent respectively. The share of local expenditure in total government expenditure was also 6.4 per cent with 2.9 per cent and 3.5 per cent for the rural and urban bodies respectively. We know that relative importance of local government among the different levels of government in a particular country is judged by its share in combined budgetary expenditure of the all levels of government. In India, it was only 6.4 per cent which is far below the developed country standard, we have seen in the country specific studies undertaken earlier in this chapter.

Recent Changes

The 73rd and 74th Constitutional Amendments (1992) have changed the status of local bodies in India. First of all, it created a three-tier of governance below the State government covering the rural sector with a network of institutions of self government at the village level, block / taluk and district levels, generally referred to as Panchayati Raj Institutions (PRIs). Taking all States together, this three-tier will consist of about 500 Zilla Parishads, 5000 Panchayat Samitis and 2.5 lakh Gram Panchayats (Oommen, 1995). Secondly, Constitutional Amendments have defined various functions of local bodies. In the 11th schedule of the Constitution, it is mentioned that along with traditional responsibilities mentioned in the chart 2.1, a very large number of developmental functions are listed ranging from agricultural and allied activities, land improvement, social forestry and minor irrigation, rural electrification, public distribution system, rural housing, village level small scale industry, education, literacy and family planning. Article 243 G requires the State legislatures to make laws to endow the PRIs with powers, authority and responsibilities to function as "institutions of self-government". The functions of PRIs include area-based local developmental planning as well. However, the State legislatures are given wide discretionary powers in their choice of functions and responsibilities to be actually devolved. Thirdly, local bodies are given constitutional right to participate in the planning process. Finally, Constitutional Amendments have been made for the financing of local bodies.

The devolution of functions and finance to sub-State level representative institutions has to be done on the basis of the provisions of Constitutional Amendments. Article 243 H envisages tax assignment, revenue sharing and grants-in-aid as the instruments of devolution of resources to the various PRIs. On what principles, in what manner and in what proportions these instruments are to be used is left on the recommendations of an independent statutory body, called the State Finance Commission. Articles 243 H and 243 I show a clear recognition of the need for fiscal transfers consequent on the heavy expenditure responsibilities cast on PRIs (Oommen, 1995). The State Finance Commissions will recommend the scheme of such transfers.

Section 5

Summary

In the descending cascade of decentralisation from the Centre to the States and from States to local bodies, certain similarities and differences can be observed between India and the developed nations like Australia, Canada and UK. This section attempts to sum up the preceding discussion within a comparative frame work.

Table 2.15: Comparison of Fiscal Decentralisation of Selected Developed Countries with India

Countries	Australia	Canada	UK	India
System of Government	Two Tier	Two Tier	Unitary	Three Tier
No. of Local Bodies	900	8000	540	275500
Revenue Sources: A. Tax Rev.	1.Property Tax	1.Property 2.Land tax 3.Frontage	1.Poll Tax 2.Uniform Business Rate	1.Property 2.Service 3.Octroi 4.Terminal 5.Trade & Callings 6.Animal & Vehicle. 7.Toll 8.Miscel-laneous.
B. Non Tax Rev.	1. Fees, 2. Fines, 3. Sales 4. E.P.I.	1. Fees, 2. Fines, 3. Sales 4. E.P.I.	1. Fees, 2. Fines, 3. Sales, 4. E.P.I. 5. C.G.E. P. & W.	1. Fees 2. User charges
C. Fis. Transfer	Grants from Commonwealth and Province	Fiscal Equalis ation Grants	Lumpsum	Grants from Centre & States
Revenue Composition:				
1. Tax	42.15	37.41	27.13	34.62
2. Non Tax	28.85	15.11	16.03	13.58
3. Capital Revenue	8.57	0.00	5.49	0.00
4. Grants	20.43	47.48	51.34	51.80
Exp. Com. by function:				
1. Gen. Pub. Ser.	22.23	5.33	3.63	11.04
2. Community Ser.	0.00	0.00	0.00	16.67
2. Defense	0.00	0.00	0.04	0.00
3. Pub. Ord. and sft.	1.50	8.06	10.94	0.00*

(continued)

4. Education	0.42	40.67	34.84	27.74
5. Health	1.94	5.57	0.00	6.37
6. Soc. Sec.& Welf.	3.36	3.62	11.27	0.00*
7. Hou.& Comm.Ame.	14.91	9.16	17.84	0.00
8. Rec., Cul. & Rel.	15.17	6.20	4.31	0.00*
9. Fuel and Energy	0.03	0.00	0.00	0.00
10.Agri, Fish & Hunt.	0.33	0.00	0.37	0.00
11.Mining, Manf.& Cons.	1.22	0.00	0.19	0.00
12.Tran. & Commu.	29.34	10.37	6.20	0.00
13.Other Eco. Affars.	2.24	1.04	1.20	0.00*
14.Others	7.30	9.98	9.20	25.83
15.Revenue Surplus	0.00	0.00	0.00	12.35
16.Total expenditure	100	100	100	100
Indicators of Decentralisation				
Exp. Decln. Ratio	9.24	37.35	29.89	6.40
Rev. Decln. Ratio	9.38	43.55	30.58	6.27
Fin. Autonomy.	70.98	50.89	42.63	42.52
LGE/GDP	2.54	8.65	12.68	2.10
LGR/GDP	2.54	8.39	11.25	1.57

Note: 1.The share of different components of receipts and expenditure for all the countries except India are an average for the period 1980-81 to 1990-91. For India it is only for the year 1976-77.

* In case of India's expenditure assignment others include Public Order and safety, Recreation, Social Welfare and Other economic Affairs like Loan Repayment.

E.P.I= Entrepreneurial & Property Income, C.G.E.P & W= Contributions to Government Employee Pension & Welfare Fund.

Source:Government Finance Statistics, IMF (1993) and Datta, (1992).

Differences in the institutional arrangements as can be seen from the Table 2.15, Australia and Canada have two-tier system of governance while UK follows unitary system. India too had a virtually two tier system until recently. With the introduction of the 73rd and 74th Amendments to the Constitution, a three-tier system of governance can be said to have been introduced in the country.

As we have seen, the relative significance of local government is possible to judge by the share of local government expenditure in total government expenditure. It can be seen from Table 2.15 that this ratio is currently the highest in Canada (37.35 per cent) followed by UK (29.89 per cent), Australia (9.24 per cent) and India (6.4 per cent).

Also, the system of tax assignment differs across these countries. The experience of Australia shows that the lack of flexible tax bases under State-local control is a severe problem for multi-level governance. India also share the same problem, as India have assigned tax bases to sub-national governments for their exclusive use. Vito Tanzi was of the view that India's macroeconomic difficulties were caused and worsened by the exclusive or rigid method of tax assignment.

Canada has harmonised the system of overlapping tax jurisdiction, but in the UK there is a shift towards increased centralisation. In Australia, local authorities rely on a single local tax, that is rates on property while in Canada apart from rates on property, there are taxes on goods and services. In India, local authority depends mainly on property taxes such as house / building tax and land tax. Other sources are profession taxes, octroi, entertainment tax, service, and non tax revenue like fees, user charges etc.

Inspite of differences, common characteristic of these countries is that local governments depend mainly on immovable property tax base. The proportion of local property tax-GDP ratio of UK, Australia and Canada constituted around 1 to 2 percentage of GDP.

In the functional domain of local governments also, there are both differences and commonalities. In all the countries, local government incur expenditures mainly to provide basic civic services. But, Indian local governments discharge limited functions compared to countries like Australia, Canada and UK. This was due to the fact that in India, the States' intrusion in the provision of local services was much greater compared to those countries. Obviously, this broad summary of expenditure functions ignores inter-state variations.

Before going for a comparative analysis of local government receipts, it should be kept in mind that local government revenue as a percentage of GDP and the composition of local government revenue differs across the countries. The comparative analysis of the revenue composition of local governments showed that the share of tax revenue in total receipts of the local government was the highest in Australia (42.15 per cent), followed by Canada (37.41 per cent), India (34.62 per cent) and UK (27.13 per cent). The share of non-tax revenue in total receipts in Canada, UK and India was around 15 per cent. But its share in Australia was more than 28 per cent. Capital revenue constituted only less than 10 per cent of the total receipts of local government in Australia and UK, while Canada and India do not have any capital revenue.

Regarding grants, local governments of Canada, UK and India received more or less 50 per cent of their revenues from federal and provincial grants. It is only 20 per cent of the total revenue in Australia. This reflects the fact that Australia shows a reducing financial dependency on senior government grants. In fact, in India, grant is the principal source of local revenue (more than 80 per cent) for the rural local bodies.

Among the countries under study, revenue decentralisation ratio and expenditure decentralisation ratio of Canada is much higher than other countries. With regards to the fiscal autonomy ratio, Australia ranks highest (70.98 per cent), while the same ratio is 50.89 per cent and 42.63 per cent respectively in Canada and UK. In India, even though the fiscal autonomy of both urban and rural local bodies together is 42.52 per cent, fiscal autonomy of rural local bodies is only around 10 per cent. On the basis of other indicator of fiscal decentralisation like local government expenditure and revenue as a percentage of GDP, UK ranks first. The desired norm of local expenditure to GDP is 4.0 per cent (Marshall, 1969). The study reveals that India (2.1 per cent) and Australia (2.54 per cent) are much below the accepted norm.

CHAPTER III

An Analysis of Panchayat Finance in Kerala

One of the major difficulties that we faced in the previous chapter, in comparing Indian fiscal decentralisation experience with that of Australia, Canada and UK was the non-availability of the aggregated all India level data on Indian local government finance. Whatever data base that exists for local level finance is on the basis of individual States. Therefore, we have chosen to take up the case study of one specific State, Kerala, which has relatively more comprehensive data base on local finance. A detailed analysis of the system of Panchayat finance of the State of Kerala is undertaken in this chapter.

This chapter is divided into three broad sections: Section 1 analyses the size and pattern of expenditure of Panchayats of Kerala. In this section, we hope to show that total expenditure of the Panchayats is relatively low and has not shown any significant increase in relation to the expenditure of the State government of Kerala. In section 2, we undertake a detailed analysis of the receipts of the Panchayats. Unlike Central and State governments, Panchayats' power of borrowing is severely limited in India. Their resource mobilisation is limited to a few tax and non-tax revenues and the resources made available to them through tax sharing and grants from the State government. A detailed analysis of own revenues of Panchayats and fiscal transfers (section 2.2 and section 2.3 respectively) from the State government is also undertaken. Section 3 discusses the overall budgetary position of the Panchayats and gives a summary of the chapter.

Section 1

Public Expenditure Performance of Panchayats

In Table 3.1, we have presented a time series data on expenditure of Panchayats in Kerala between 1960-61 and 1993-94. The figures for 1960-61 to 1975-76 are deflated in terms of 1952-53 prices while for the rest of the years, the figures are deflated in terms of 1961-62 prices. It is evident that there has been a significant improvement in the real expenditure of Panchayats even on per-capita terms. It is not a surprising trend, given the fact that the overall budgetary expenditure of the State government has dramatically increased during the post independent period.

Perhaps what is more significant is that there has been a deceleration in the growth of expenditure of Panchayats: While, between 1960-61 and 1975-76, their real expenditure increased at a compound growth rate of 8.7 per cent, between 1981-82 and 1993-94, the aggregate expenditure increased only at the rate of 6.6 per cent in real terms.

Column (3) of table 3.1 also shows that as a ratio of expenditure of the State government, there has been an improvement in the performance of Panchayats' during the first period. In 1960-61, the ratio was 1.76 per cent and it reached a peak of 4.7 per cent in 1981-82. Since then, however, the ratio tended to decline and was around 2.9 per cent in early 1990s.

Table 3.1: Per-capita, Real and Local Expenditure as a percentage of State Government's Expenditure

	Per-Capita Local Exp. (Rs.)	Real Local Exp. (Rs. Lakhs)	Local Exp. as a percentage of State Govt. Exp.
1960-61	0.55	77.00	1.76
1961-62	0.57	83.74	1.66
1962-63	0.68	102.15	1.78
1963-64	0.75	119.01	2.06
1964-65	0.76	121.25	2.18
1965-66	0.89	144.94	2.38
1966-67	0.92	155.74	2.35
1967-68	1.08	188.97	2.64
1968-69	1.26	225.39	2.86
1969-70	1.12	208.57	2.50
1970-71	1.34	253.57	3.03
1971-72	1.44	277.34	2.88
1972-73	1.21	241.25	2.45
1973-74	0.94	191.71	2.05
1974-75	1.20	248.25	2.76
1975-76	1.34	281.50	2.40
1976-77	NA	NA	NA
1977-78	NA	NA	NA
1978-79	NA	NA	NA
1979-80	NA	NA	NA
1980-81	2.36	488.69	3.41
1981-82	3.39	702.56	4.74
1982-83	3.29	687.30	4.59
1983-84	3.11	653.16	3.77
1984-85	3.00	631.48	3.40
1985-86	2.82	594.97	2.67
1986-87	3.04	644.37	2.66
1987-88	3.07	653.98	2.70
1988-89	3.90	831.43	3.18
1989-90	4.22	902.95	3.32
1990-91	4.69	1006.88	3.32
1991-92	4.14	893.45	2.93
1992-93	4.25	919.86	2.91
1993-94	4.65	1010.35	2.97

Note: Exp.= Expenditure, NA= Not Available
Source: Administration Reports of Panchayat from Directorate of Panchayats (Various Issues).
For data from 1960-61 to 1975-76 we depend on G.K.Pillai, (1986).

According to the Kerala Panchayat Raj Act of 1960, which determined the functions of Panchayats of the period under review, sixty two functions had been assigned to the Panchayats. However, in actual practice, no productive functions have been devolved to the rural local bodies. Most of their functions are confined to the provision of community and social services. This is reflected in the expenditure pattern of Panchayats (see table 3.2).

The data on Panchayats' expenditure collected from the Directorate of Panchayats have certain limitations. The data are not sufficiently disaggregated for analysing the individual items of expenditure. The existing practice of the official agencies is to show expenditure under several items in one lump. For instance, the expenditure on public health, water supply and sanitation are lumped together. Also under the category "miscellaneous" a major share of total expenditure is lumped together. Disaggregated data on this category of expenditure is not readily available.

It can be seen from the Table 3.2 that administrative expenditure or establishment charges is the single most important claimant on the revenues of Panchayats. Upto the mid 70s, it ranged between 20 and 24 per cent. Since then, it has been characterised by sharp fluctuations reaching the peak of 35 per cent in 1987-88. Since then it has tended to decline somewhat, but was around 27 per cent in the early years of nineties, i.e, between 1991-92 and 1993-94. The administrative-financial burden of Panchayats have risen comparatively faster than other items of their expenditure. It is also evident from Table 3.2 that while the ratio of Panchayats expenditure on education, water supply and public health were never very high. The combined share of these expenditures was around 8 per cent during the 1960s. It had declined to less than 3.3 per cent by 1993-94. This is in contrast to the general situation in the whole country where education alone constitutes the single most important item of expenditure of the Panchayat bodies. In 1976-77, education accounted for 42.4 per cent of the total expenditure of the Panchayats. Historically, the local bodies in Kerala (expect for the District Boards of Malabar during the 1950s) did not play a significant role in education. The educational sector was financed by various communities or organisations aided by the State government or directly by the State government itself. As for the water supply, the public intervention has been significant only during the recent decades and from the latter part of the eighties, it has been centralised under Kerala Water Authority, an agency specially established by the State government.

Public works such as roads and public buildings have been the main developmental activity that Panchayats have been involved in. As can be seen from the table 3.2, the share of public works in the total Panchayat expenditure increased from around 18 per cent in 1960-61 to 33 per cent by the end of the decade. Thereafter there have been sharp year to year fluctuations, with a trend towards decline, reaching an all time low proportion of 11 per cent in 1987-88. During the early 1990s, it improved and averaged around 20 per cent.

The expenses on street lighting is another major item whose share has been around 7 per cent in 1990s. Its share has not tended to rise, despite widely acclaimed near universal electrification of Kerala villages. Partly, it reflects the slow growth of public electric lighting. But its growth is also perhaps constrained by the low user charges even which the local bodies find it hard to raise which also reflects itself in the mounting arrears of the local bodies on this account.

Table 3.2: Composition of Panchayat Expenditure from 1960-61 to 1993-94 (per cent)

	ES	PW	ED	WS	SL	MISC	Total
1960-61	NA	18.18	NA	NA	13.10	NA	100
1961-62	NA	24.17	NA	NA	11.55	NA	100
1962-63	NA	27.03	NA	NA	9.67	NA	100
1963-64	NA	23.30	NA	3.33	8.14	NA	100
1964-65	23.04	27.66	3.08	4.54	8.92	32.75	100
1965-66	24.29	29.54	2.92	3.68	6.53	33.05	100
1966-67	21.46	28.97	3.50	4.90	7.07	34.10	100
1967-68	21.24	29.43	3.21	4.59	6.21	35.30	100
1968-69	20.71	32.13	3.73	4.33	5.63	33.47	100
1969-70	23.25	32.93	3.22	3.40	6.55	30.65	100
1970-71	24.84	31.24	2.87	2.88	7.65	30.52	100
1971-72	23.86	28.50	2.83	4.56	8.48	31.77	100
1972-73	23.06	23.79	2.37	3.37	9.42	37.99	100
1973-74	24.33	20.93	2.52	3.38	10.86	37.98	100
1974-75	31.23	18.34	2.27	3.11	9.59	35.46	100
1975-76	32.32	20.15	2.68	3.04	8.48	33.32	100
1976-77	NA	NA	NA	NA	NA	NA	
1977-78	NA	NA	NA	NA	NA	NA	
1978-79	NA	NA	NA	NA	NA	NA	
1979-80	NA	NA	NA	NA	NA	NA	
1980-81	26.0	26.9	2.6	3.3	6.5	34.7	100
1981-82	19.5	30.3	1.7	2.7	5.0	40.9	100
1982-83	22.2	30.9	1.5	2.5	6.9	36.0	100
1983-84	24.6	27.8	1.1	2.9	9.7	33.9	100
1984-85	26.2	26.9	1.2	2.2	14.5	29.1	100
1985-86	31.6	22.0	1.2	2.2	11.8	31.2	100
1986-87	32.5	16.6	1.6	2.6	10.7	36.0	100
1987-88	35.4	10.8	1.3	1.9	9.7	40.9	100
1988-89	29.1	21.8	1.5	2.2	7.8	37.7	100
1989-90	32.8	18.6	1.7	2.0	6.8	38.1	100
1990-91	25.9	24.8	2.3	3.3	6.1	37.8	100
1991-92	28.2	23.3	1.8	2.1	6.5	38.1	100
1992-93	26.8	25.6	1.7	2.5	6.8	36.6	100
1993-94	27.3	26.9	1.7	1.6	6.9	35.6	100

Note: ES= Establishment Charges, PW= Expenditure on Public Works, ED= expenditure on education , WS= expenditure on water supply and public health, SL= Street lighting, MISC = Miscellenous expenditure. NA= Not Available

Source: Administration Reports of Panchayat from Directorate of Panchayats (Various Issues) and G.K. Pillai, (1986).

All other items of expenditure have been lumped together under the category `miscellaneous´. The composition of this category vary from Panchayat to Panchayat and includes a variety of minor development expenditure under heads such as agriculture, animal husbandry, aid to libraries etc; social welfare activities and even repayment of principal and the interest on loans taken. The last two mentioned heads are the most important. The debt repayment is to be made not only with respect to the loans given by the State government, which is relatively less significant, but also more importantly to the financial institutions like Rural Development Board. The latter has been rising over time. However, no trend is visible in the overall share of miscellaneous expenditure that has ranged between 30 to 40 per cent.

Table 3.3 presents inter-district variation in the composition of expenditure of Panchayats. There exists significant differences between districts. Out of 14 districts in Kerala, establishment charges take away more than 30 per cent of the total expenditure in six districts, between 25 per cent and 30 per cent in three districts, between 20 per cent and 25 per cent in four districts and below 20 per cent in one district . Out of 14 districts, 7 districts are having higher share of expenditure on establishment compared to all Panchayat total of the same. Among all the districts, the share of this expenditure was the highest in Idukki (35.62 per cent) and lowest in Wayanad (19.19 per cent). During this period, the share of expenditure on public works was the highest in Kasaragode (35.21 per cent) and the lowest in Pathanamthitta (18.81 per cent). Expenditure under the category 'miscelleneous' was vary high in Kozhikode (49.91 per cent) and Wayanad (48.01 per cent) but it was quite high in other districts also. The share of expenditure on education is around 2 per cent in all the districts except Palakkad where it was 4.90 per cent. The share of expenditure on water supply and public health remained around 3 per cent in all the districts. A significant pattern that emerges is with respect to 'Street Lighting'. It ranged from 2.33 per cent of total expenditure in Wayanad to 14.87 per cent in Pathanamthitta. Northern districts of Kerala in general had a smaller share of expenditure on 'Street Lighting' than the southern districts indicating the regional differences in electrification.

Table 3.3: Composition of Total Expenditure of all Panchayats at the District level Average for 1980-81 to 1993-94 (Per cent)

	ES	PW	ED	WS	SL	MISC	TOTAL
TRIVANDRUM	31.89	20.12	1.92	1.59	12.71	31.77	100
KOLLAM	28.60	22.44	1.86	1.87	11.27	33.97	100
PATT	24.83	18.81	1.19	1.33	14.87	38.98	100
ALLEPEY	32.16	21.81	1.60	1.50	11.03	31.91	100
KOTTAYAM	30.07	21.08	1.60	3.41	9.02	34.82	100
IDUKKI	35.62	23.85	1.95	2.31	4.80	31.48	100
ERNAKULAM	26.99	26.58	1.37	2.67	10.05	32.34	100
THRISSUR	27.67	25.60	1.31	2.87	10.54	32.01	100
PALAKKAD	31.43	20.30	4.90	3.00	7.52	32.84	100
MALAPURAM	32.04	28.43	1.20	2.00	3.14	33.19	100
KOZHIKODE	23.70	19.22	1.95	2.45	3.44	49.23	100
WAYANAD	19.19	26.13	1.41	2.93	2.33	48.01	100
KANNUR	24.24	25.99	2.28	1.57	4.00	41.91	100
KASARAGODE	22.52	35.21	1.60	1.78	2.61	36.28	100
Total Panchayats	27.97	23.71	1.66	2.32	7.75	36.59	100

Note: ES = Establishment Charges PW = expenditure on Public Works, ED = expenditure on education , WS = expenditure on water supply, drainage and public health, SL = Street lighting, MISC = Miscellenous, PATT=Pathanamthitta.
Source: Administration Reports of Panchayat from Directorate of Panchayats (Various Issues).

Village Panchayats in Kerala have been classified into four different categories on the basis of their annual income. Panchayats with annual income of more than Rs. 1.75 lakhs is classified as Special Grade, those with more than Rs. 1 lakh and upto Rs. 1.75 lakhs as Grade 1, those with income of more than Rs. 50,000 and upto Rs.1 lakh as Grade 2 and those with income not exceeding Rs. 50,000 as Grade 3. As can be seen from the Table 3.4, the number of Panchayats having income of more than 1.75 Lakhs of Rs. per annum has increased drastically from 350 in 1980-81 to 979 in 1993-94. Between 1980-81 and 1993-94, the number of Grade 1 and Grade 2 Panchayats was drastically reduced from 435 to 2 and from 206 to 2 respectively. The number of Panchayats in lowest income bracket was always very few and by 1993-94, its number was reduced

Table 3.4: Classification of Village Panchayats in Kerala

Panchayats	1983	1992	1993*
Special Grade	350	334	979
Grade 1	435	433	2
Grade 2	206	206	2
Grade 3	10	10	NIL
Total	1001	983	983

Source: Administration Reports of Panchayats, Directorate of Panchayats. * SFC Report of Kerala, (1996, p.-26)

to zero. Obviously, the classification of Panchayats on income basis has not been changed to take into account the inflationary factors. To say that in 1993 almost all the Panchayat are special grade Panchayat makes a mockery of this particular system of classification. State Finance Commission Report of Kerala has also pointed out that these kind of classification does not have any relevance.

Section 2

Receipts of Panchayats

In this section, we examine the structure, trend, composition and pattern of revenue receipts of Panchayats in Kerala. This section has been divided into three sub-sections. In the first sub-section we provide a brief discussion on different sources of receipts of the Panchayats, their growth and composition. Following two sub-sections provides a disaggregated analysis of the own resources and the transfer of resources from the State government to Panchayats.

Section 2.1

Sources of Receipts

A detailed description of the different sources of income of the village Panchayat is given in Chart 3.1. As can be seen from the Chart, items of receipts can be classified into two broad categories: (i) own revenue of the Panchayats which comprises of own tax and non-tax revenue and (ii) resources devolved from the State government through assigned and shared taxes, loans and grants.

The Panchayats' tax revenues consist principally of own taxes and assigned and shared taxes. Own taxes are directly collected by the local bodies. Assigned tax is collected by the State government and given to local bodies. Shared tax is levied by State government and shared with local bodies.

Non-tax revenues of Panchayats include income from sources like license fees, market fees, contributions and deposits. Grant component is a transfer from the State government which may be either tied or untied. Loans constitute a negligible portion of the total receipts of the Panchayats. A point to be noted here is that, Panchayats borrow from State government as well as from other financial institutions. Since the loans received from an institution like Kerala State Rural Development Board is not included in the State level aggregate data there is an underestimation of the actual loan received by the Panchayat in the estimates presented in this chapter.

Chart 3.1: Sources of Income of Village Panchayats

OWN TAXES
1. Building Tax and Surcharge on Building Tax
2. Service Tax for Sanitation, Water Supply and Street lighting and Drainage
3. Land Cess
4. Profession Tax
5. Entertainment Tax and Additional Tax on Entertainment
6. Show Tax and Surcharge on Show Tax
7. Vehicle tax

ASSIGNED TAX
1. Duty on Transfer of Property
2. Basic Tax or Land Tax

SHARED TAX
1. Motor Vehicle Tax

NON TAX REVENUE
1. License Fee
2. Income from Markets
3. Contributions
4. Deposits
5. Miscellaneous

GRANTS
1. Specific Purpose Grants
2. Untied Grants for Developmental purposes
3. General Purpose Grants

LOANS
1. Loans from Government and Financial Institutions

Source: Administrative Reports of Panchayat from Directorate of Panchayats (Various Issues).

The sources of income of the Panchayats presented in chart 3.1 are substantially the same under the new Act of 1994 as those available to them under the 1960 Act except for the following marginal changes:

I. Under the Kerala Panchayat Act 1960, it was optional on the part of the village Panchayats to levy a service charge not exceeding the rates prescribed by State government which provide services to the community by way of water supply, street lighting, scavenging and drainage. Section 202(2) of Kerala Panchayat Raj Act (KPRA), 1994, has made it obligatory.

II. The provision in 1960 Act which empowered village Panchayats to levy a tax on Vehicles has been deleted in 1994 act.

III. Section 201 of the new Act provides that the village Panchayats by resolution can decide to levy a land cess on all lands except those exempted by the State government. The rate of tax is 1/10th per cent of the capital value of the land. This provision existed in the 1960 Act also but the rate of tax was prescribed as 1/16 per cent of the capital value.

The composition of the total receipts of Kerala Panchayats is shown in Table 3.5. Tax revenue constitutes the most important component of the Panchayat receipts. In most of the years between 1960-61 and 1993-94, the share of tax revenues was more than 50 per cent of the total receipts. Of the Panchayat tax revenues, own taxes have constituted roughly two-third and tax transfer from the State government one-third of the total.

Non-tax revenues have been the second most important source of revenue of Panchayats. In fact, before 1982-83, the share of non-tax revenues in many years exceeded the share of the own tax revenue. The contribution of non-tax revenue in the total Panchayat receipts was relatively higher than the tax transfers of State government in many years. In the late 1960s, the non-tax revenues contributed more than a third of the total receipts of the Panchayats. During the 1970s, the contribution of non-tax revenue tended to fluctuate between 20 to 30 per cent. Since then its importance as a source of revenue has declined and during the early 1990s it constituted only about 23 per cent of the total Panchayat receipts. Both own tax revenue and non-tax revenue together the own resources of the Panchayats constituted more than 65 per cent of the total receipts in most of the years between 1960-61 and 1993-

94. In some the years its share in total receipts fluctuated between 70 to 78 per cent.

As for grants from the State government, their share in Panchayat receipts tended to rise from the late 1960s, reaching all-time high of 27 per cent in 1973-74. Since then the relative importance of grants steadily declined to less than 10 per cent at the end of 1980s. However, with the institutionalisation of untied grant, the share of grants sharply increased from 1991 onwards, once again to above 20 per cent.

As has been noted already, the loan component of the Panchayat receipts has shown a steady decline over the years and by 1993-94 its share had come down to a mere 0.1 per cent. Of course, it has to be borne in mind in this context that the data presented here do not include the institutional loan finance availed of by the Panchayats.

Table 3.5: Composition of Kerala Panchayats' Total Receipts from 1960-61 to 1993-94 (Per cent)

	Tax Rev.	Own Tax	Tax. Transfer	Non Tax	Own Rev.	Grants	Loans	Total Receipts
1960-61	41.41	41.41	NA	34.19	75.60	24.40	NA	100
1961-62	48.08	48.08	NA	46.81	94.89	NA	5.11	100
1962-63	39.24	39.24	NA	28.75	67.09	28.58	3.43	100
1963-64	45.69	45.69	NA	29.12	74.81	22.15	3.05	100
1964-65	55.03	55.03	NA	23.93	78.96	18.43	2.61	100
1965-66	60.58	45.16	15.43	23.68	68.84	13.79	1.95	100
1966-67	55.05	32.48	22.58	32.02	64.50	11.12	1.80	100
1967-68	46.41	24.71	21.71	33.29	58.00	17.88	2.42	100
1968-69	43.57	26.14	17.43	34.72	60.86	19.56	2.15	100
1969-70	44.83	29.47	15.36	29.39	58.86	22.62	3.16	100
1970-71	52.09	38.61	13.48	20.67	59.28	24.42	2.83	100
1971-72	50.99	33.34	17.65	23.91	57.25	22.06	3.04	100
1972-73	44.52	31.27	13.26	30.13	61.40	22.82	2.53	100
1973-74	50.44	33.24	17.20	20.90	54.14	27.07	1.59	100
1974-75	60.17	38.73	21.44	21.98	60.71	17.07	0.78	100
1975-76	66.76	42.69	24.08	17.49	60.18	15.74	0.00	100
1976-77	NA	NA	NA	NA		NA	NA	
1977-78	NA	NA	NA	NA		NA	NA	
1978-79	NA	NA	NA	NA		NA	NA	
1979-80	NA	NA	NA	NA		NA	NA	
1980-81	53.7	31.4	22.4	30.4	61.80	15.5	0.4	100
1981-82	46.3	25.9	20.3	32.7	58.60	20.3	0.8	100
1982-83	58.1	35.1	22.9	30.1	65.20	11.3	0.5	100
1983-84	53.2	34.5	18.7	24.6	59.10	21.8	0.4	100
1984-85	57.7	38.4	19.3	24.3	62.70	17.4	0.5	100
1985-86	62.8	42.6	20.2	24.8	67.40	12.0	0.4	100
1986-87	60.1	39.6	20.5	26.9	66.60	12.5	0.4	100
1987-88	61.2	37.6	23.6	25.4	63.00	12.9	0.4	100
1988-89	60.0	42.7	17.3	29.9	72.00	9.7	0.5	100
1989-90	61.8	44.4	17.3	28.7	73.10	9.3	0.3	100
1990-91	50.5	32.1	18.3	25.7	57.80	23.4	0.3	100
1991-92	51.5	35.7	15.8	24.0	59.70	24.5	0.0	100
1992-93	50.6	31.7	18.9	22.7	54.40	26.2	0.4	100
1993-94	56.9	33.6	23.3	22.4	56.00	20.6	0.1	100

Note: Rev.= Revenue, NA= Not Available
Source: Administration Reports from Directorate of Panchayat (Various Issues) and G.K.Pillai, (1986).

The pattern of growth in revenue receipts is better understood by examining the trend growth rate, with the help of an exponential model of the following type: $\ln Y = A + Bt + e$; where $B = (1+r)$, Y represents revenue receipts and t represents the time period. The growth rate r represents the percentage increase per annum. By applying this model, the values derived as a result are given in Table 3.6.

Table 3.6: Trend Real Rate of Growth of Revenue Receipts during the period 1960-61 to 1975-76 and between 1980-81 to 1993-94

Items	First period Est. log a	Coef. log b	GR	Second Period Est. log a	Coef. log b	GR
Tax Revenue	3.64	0.09	9.8	5.65	0.06	5.8
Non tax revenue	3.47	0.05	4.7	5.05	0.04	3.8
Grants	2.99	0.07	7.0	4.24	0.08	7.9
Loans	1.43	-0.06	-0.7	1.54	-0.10	-9.7
Total Receipts	4.47	0.08	8.2	6.24	0.06	5.6

Note: GR=Growth Rate, Est. Coef.=Estimated Coefficient
Source: Administration Report Panchayat from Directorate of Panchayat (Various Issues), G.K.Pillai,1986

If we compare the period wise growth rate we can see that except grants, the rate of growth of other components of receipts was much lower in the second period compared to the first period. Rate of growth of tax revenue has declined from the first period to second period drastically. This table also shows that during both the periods, growth rate of taxes (9.8 per cent in the first period and 5.8 per cent in the second period) had been higher than the growth rate of total receipts (8.23 per cent in the first period and 5.64 per cent in the second period). In the second period, among the different components of revenue, grant component grew at a higher rate than the tax and non-tax revenue. The growth of non-tax revenue was much lower compared to tax revenue and grants in both the periods.

It can be seen from the Table 3.7 that among the different components of tax revenue, own taxes formed 74.54 per cent of the total tax revenue in 1965-66. Its share remained well above 60 per cent during 1965-66 to 1975-76 except two years in the mid sixties. In 1980-81, its share declined to 58.37 per cent. It has increased to 72 per cent by 1989-90 and since then tended to decline. There

Table 3.7: Composition of Tax Revenue of Kerala Panchayats from 1965-66 to 1993-94 (Per cent)

	OT	AT	ST	TTR
1965-66	74.54	25.46	0.00	100
1966-67	58.99	41.01	0.00	100
1967-68	53.23	46.77	0.00	100
1968-69	60.00	40.00	0.00	100
1969-70	65.74	34.26	0.00	100
1970-71	74.12	25.88	0.00	100
1971-72	65.39	34.61	0.00	100
1972-73	70.23	29.77	0.00	100
1973-74	65.90	34.10	0.00	100
1974-75	64.37	35.63	0.00	100
1975-76	63.93	36.07	0.00	100
1976-77	NA	NA	NA	
1977-78	NA	NA	NA	
1978-79	NA	NA	NA	
1979-80	NA	NA	NA	
1980-81	58.37	41.63	0.00	100
1981-82	56.07	43.93	0.00	100
1982-83	60.50	38.74	0.76	100
1983-84	64.85	34.30	0.85	100
1984-85	66.60	32.69	0.71	100
1985-86	67.86	30.12	2.02	100
1986-87	65.94	33.02	1.03	100
1987-88	61.40	37.82	0.78	100
1988-89	71.22	28.19	0.59	100
1989-90	71.96	28.02	0.03	100
1990-91	63.66	30.83	5.51	100
1991-92	69.34	26.77	3.90	100
1992-93	62.62	29.09	8.29	100
1993-94	59.03	29.20	11.77	100

Note: OT=Own Tax, AT=Assigned Tax, ST= Shared Tax, TTR= Total Tax Revenue. NA= Not Available
Source:Administration Reports of Panchayats, Directorate of Panchayat.(various issues) and G.K.Pillai,1986

is no increasing or decreasing trend in the assigned tax during 1965-66 to 1975-76. It fluctuated within a wide range of 25 per cent to 46 per cent. However, during 1980-81 to 1993-94, its share has declined sharply from 41 per cent to 29 per cent. The earnings of the Panchayat under shared tax has always been negligible (less than one per cent) during the mid 60s to mid 70s. The share of shared tax also were negligible till 1989-90 when it was 0.3 per cent. But a notable change is observed during the early 1990s. This share increased sharply to 6 per cent in 1990-91 and to 12 per cent in 1993-94.

The analysis of trend growth rate of the components of tax revenue presented in Table 3.8 shows that own tax revenue grew at a lower rate than the total tax revenue during 1960-61 to 1975-76. Later, during 1980-81 to 1993-94, own tax revenue grew at a faster rate than the total tax revenue. Revenue from assigned taxes grew at a rate well below own tax and the total tax revenue. Though revenue from shared taxes constituted an insignificant proportion of total revenue, its growth rate has been high (47.7 per cent) during this period and that is mainly because of the increase in its share during the 1990s (refer to table 3.7).

Table 3.8: Real Rate of Growth of Revenue Receipts during the period 1960-61 to 1975-76 and between 1980-81 to 1993-94

Items	First period			Second Period		
	Est. log a	Coef. log b	GR	Est. log a	Coef. log b	GR
Own Tax	3.63	0.06	6.5	5.16	0.06	6.4
Assigned Tax	-	-	-	4.76	0.03	2.7
Shared Tax	-	-	-	-2.24	0.48	47.7
Total Tax	3.64	0.09	9.8	5.65	0.06	5.8

Note: GR=Growth Rate,
Source: Administration Report Panchayat from Directorate of Panchayat (Various Issues).

The composition of district-wise total Panchayat receipts is shown in Table 3.9. Between 1980-81 and 1993-94, own tax revenue constituted around 30 per cent of the total Panchayat receipts in all the districts. Panchayats in Thrissur, Alleppey and Kottayam districts mobilised more than 37 per cent of their total receipts through own taxes. Devolution of taxes from the State government was the highest in Trivandrum (24.99 per cent) and the lowest in Wayanad (11.53 per cent). Districts in the southern part of Kerala are having a greater share of tax transfers compared to Malabar region. The share of non-tax revenue is significantly higher in the district of Kozhikode and Wayanad (above 40 per cent) than other districts. The share of grant component is significantly higher in the lately formed districts, namely Pathanamthitta (33.11 per cent) and Kasaragode (32.65 per cent).

Table 3.9: Composition of Total Receipts of all Panchayats at the District level Average for 1980-81 to 1993-94 (per cent)

	TTR	OTR	T.TRANS	TNR	GRANTS	LOANS	TR
TVM	52.89	27.90	24.99	22.41	24.52	0.18	100
KOLLAM	54.49	31.65	22.84	22.89	22.28	0.34	100
PATT.	40.90	25.40	19.72	22.03	33.11	0.21	100
ALLEPY	58.76	37.61	21.15	20.19	20.97	0.07	100
KOTTAYAM	59.13	37.90	21.23	22.55	18.00	0.32	100
IDUKKI	51.36	32.81	18.56	21.89	26.05	0.70	100
ERNAKULAM	53.64	34.10	19.54	23.92	22.07	0.37	100
THRISSUR	58.07	38.93	19.15	20.43	21.32	0.18	100
PALKKAD	50.08	33.17	16.91	23.65	26.00	0.26	100
MALAPURAM	53.05	32.60	20.45	26.35	20.54	0.06	100
KOZHIKODE	44.48	28.19	16.29	41.33	14.05	0.14	100
WAYANAD	38.89	27.36	11.53	43.71	17.30	0.09	100
KANNUR	49.48	31.92	17.56	30.25	20.21	0.06	100
KASARAGODE	42.37	28.01	15.43	24.95	32.65	0.03	100

Note: TVM=Trivandrum, Patt=Pathanamthitta, TTR=Total Tax Revenue, OTR = Own Tax Revenue, T. TRANS = Tax Transfers, TNR = Total Non-Tax Revenue, = Total Receipts.
Source: Administration Report Panchayat from Directorate of Panchayat (Various Issues).

Table 3.10: Different Components of Panchayat Receipts in Per-capita Term (real) (Rs.)

	TRIVANDRUM		KOLLAM		PATHANAMTHITTA			
	1981	1991	1981	1991	1981	1991		
TAX TRANSFER	2.84	3.09	4.27	3.53	-	3.77		
OWN TAX	2.06	3.82	4.34	5.23	-	5.90		
NONTAX REVENUE	2.79	2.33	4.57	3.38	-	5.77		
TOTAL GRANTS	8.26	4.58	NA	5.73	-	6.78		
TOTAL RECEIPTS	15.95	13.81	13.19	17.87	-	22.22		
	ALLEPPEY		KOTTAYAM		IDUKKI		ERNAKULAM	
	1981	1991	1981	1991	1981	1991	1981	1991
TAX TRANSFER	3.28	2.38	2.96	3.85	3.10	2.03	2.34	2.28
OWN TAX	3.38	4.67	3.91	5.90	5.77	6.66	3.30	4.54
NONTAX REVENUE	3.25	2.80	2.14	4.36	2.96	5.06	3.24	2.56
TOTAL GRANTS	NA	4.59	NA	4.93	NA	9.04	NA	5.38
TOTAL RECEIPTS	9.97	14.43	9.01	19.04	11.95	22.79	9.23	4.76
	THRISSUR		PALAKKAD		MALAPURAM			
	1981	1991	1981	1991	1981	1991		
TAX TRANSFER	2.97	2.70	1.77	2.27	1.46	2.97		
OWN TAX	3.91	7.03	3.83	5.08	2.25	4.22		
NONTAX REVENUE	2.56	4.55	3.77	5.02	4.14	4.58		
TOTAL GRANTS	NA	6.32	NA	6.24	NA	3.75		
TOTAL RECEIPTS	9.59	20.61	9.36	18.62	7.86	15.52		
	KOZIKODE		WAYANAD		KANNUR		KASARAGODE	
	1981	1991	1981	1991	1981	1991	1981	1991
TAX TRANSFER	1.97	2.94	-	2.68	1.26	2.49	-	2.49
OWN TAX	4.43	5.09	-	7.74	3.59	4.65	-	4.02
NONTAX REVENUE	4.95	9.92	-	14.06	2.48	4.32	-	8.38
TOTAL GRANTS	NA	3.12	-	7.08	NA	2.11	-	NA
TOTAL RECEIPTS	11.38	21.08	-	31.57	7.34	13.57	-	19.72

Note: NA= Not Available
Source: Administration Report Panchayat from Directorate of Panchayat (Various Issues).

Inter district differences in the composition of Panchayat receipts is also reflected in differences between districts in per-capita terms. Thus as can be seen from the Table 3.10 that tax transfers from the State government in per-capita real terms have declined for the districts of Kollam, Alleppey, Idukki, Ernakulam and

Thrissur between 1981 and 1991. One significant trend that emerges is that the own tax revenue has increased significantly in real terms in all the districts. Per-capita non-tax revenue has declined in seven districts out of 14 districts of Kerala. The most significant increase in the per-capita non-tax revenue is in the districts of Kozhikode where it increased from Rs. 4.95 to Rs 9.92 in 1991 in real terms. In the district of Trivandrum, per capita grant has declined from Rs.8.26 in 1981 to Rs. 4.58 in the year 1991.

Progressivity of fiscal transfer should be guided by the objective of bringing equality in the fiscal strength of the Panchayats of different levels of income. To achieve that, the mechanism of transfer should be such that Panchayats with lower own income should get higher transfers from the State. In other words, there should be an inverse relationship between per-capita own revenue and per-capita grants across the districts to achieve fiscal equalisation. But data shown in table 3.10, reveals that there is no systematic inverse relationship between per-capita own tax revenue and per-capita grants across the districts except Malapuram, Kozhikode and Kannur. The general trend is that districts with high per-capita own tax revenue have high per-capita grants as well. Districts with low per-capita own tax revenue have low per-capita grants. Exception is the district of Trivandrum, where per-capita grant declined when the per-capita own revenue increased. In 1981, per-capita own tax and non-tax revenue together was Rs. 4.85 in Trivandrum and per-capita grant was Rs. 8.26. But in 1991, per-capita own revenue increased to Rs. 6.15 and per-capita grant declined to Rs. 4.58. We have noted that there is no systematic inverse relationship between per-capita own revenue and per-capita grants. The rank correlation coefficient between per-capita own revenue and per-capita grants of different districts was also only 0.081.

Section 2.2

Own Revenue of Panchayats

Own revenue comprises of own-tax and non-tax revenue. In the last section we have seen that own revenue is the single largest component of total receipts of the Panchayats. In this section we undertake a detailed discussion of different components of own revenue.

Major components of own tax revenue are building tax, profession tax and entertainment tax. Receipts from taxes like service tax, land cess, show tax and surcharge on show tax, vehicle tax[1] etc are included under Miscellaneous taxes; and their contribution to own tax revenues is not significant. As can be seen from the Table 3.11, building tax and its surcharge accounts for the bulk of the own tax revenue. Between 1960-61 and 1993-94, the share of building tax in Panchayats' own tax revenue increased from 51.46 per cent to 59.48 per cent, but for the sharp decline in 1975-76 to 36.22 per cent and the decline in the early eighties to around 40 per cent. The share of profession tax remained stable at around 25 per cent since late sixties. In earlier years, its share was below 20 per cent. The share of entertainment tax fluctuated between 11 to 15 per cent in most of the years between 1960-61 and 1974-75. Its

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1 This Vehicle tax does not include the motor vehicle tax.

contribution was highest (28.05 per cent) in 1980-81. Then onwards, it started declining and by the end of 1993-94, its share in own tax revenue became only 13 per cent. Various components of own tax revenue is discussed later in this section.

Table 3.11: Major Items of Own Tax Revenue of Panchayats in Kerala from 1960-61 to 1993-94 (Per cent)

	BT	PT	ET	MT	TOT
1960-61	51.46	20.54	15.57	12.43	100
1961-62	48.49	19.02	18.33	14.16	100
1962-63	50.45	16.78	24.91	7.86	100
1963-64	56.30	18.73	15.77	9.20	100
1964-65	54.80	17.55	9.82	17.82	100
1965-66	50.90	19.84	10.30	18.96	100
1966-67	51.92	24.36	13.91	9.81	100
1967-68	52.13	23.69	13.89	10.29	100
1968-69	53.88	24.64	12.82	8.66	100
1969-70	54.41	24.94	12.62	8.04	100
1970-71	56.47	25.55	11.12	6.86	100
1971-72	51.54	29.60	11.66	7.20	100
1972-73	60.02	27.58	12.40	NA	100
1973-74	53.61	26.56	11.48	8.36	100
1974-75	51.69	22.39	12.86	13.06	100
1975-76	36.22	23.45	18.81	21.52	100
1976-77	NA	NA	NA	NA	
1977-78	NA	NA	NA	NA	
1978-79	NA	NA	NA	NA	
1979-80	NA	NA	NA	NA	
1980-81	42.88	24.14	28.05	4.93	100
1981-82	41.79	25.93	26.90	5.39	100
1982-83	41.95	27.01	26.79	4.26	100
1983-84	48.23	23.79	24.14	3.84	100
1984-85	52.25	21.50	22.11	4.14	100
1985-86	51.81	24.27	20.30	3.62	100
1986-87	52.71	25.01	19.55	2.73	100
1987-88	50.69	24.88	21.48	2.96	100
1988-89	55.01	23.88	18.38	2.73	100
1989-90	56.53	23.87	16.74	2.86	100
1990-91	56.58	25.29	15.52	2.61	100
1991-92	55.01	28.63	13.98	2.38	100
1992-93	54.39	28.13	15.10	2.38	100
1993-94	59.48	24.47	13.54	2.52	100

Note: BT= Building Tax and Surcharge on Building Tax , PT = Profession Tax, ET = Entertainment Tax , MT= Miscellaneous Taxes include Service Tax, Land Cess, Show tax and Surcharge on Show tax, Vehicle Tax etc. , TOT = Total Own Tax.
Source:Administration Reports of Panchayats, Directorate of Panchayat (various issues) and G.K.Pillai,1986

Dynamism of Local Tax Revenues:

In general it is believed that, the local governments rely on taxes that do not change with the economic activity and prices. In other words, local taxes are neutral or anti-cyclical in relation to the fluctuations in prices and income. In order to test this proposition we use a correlation analysis.

(i). c (ST, Y) > c (LT, Y) > c (LPT, Y).

(II). c (ST, P) > c (LT, P) > c (LPT, P).

where c = linear correlation, ST = State government's own tax revenue, LT = local government tax revenue, LPT = local government property tax, Y = SDP, P = Price Index.

Equation (i) is intended to see whether or to what extent State government taxes are more correlated with the general economic activity (in this case, SDP) than local taxes. Equation (ii) will tell us whether and to what extent the proposition holds when we do the correlation with rate of inflation instead of SDP. A separate test for dynamism of local property tax is undertaken because LPT is the major component of local government's own tax earning.

Table 3.12: Local Taxes and Economic Fluctuations

Tax	Cor.Coef between Tax and SDP	Cor.Coef. between Tax and Price	NIER
ST	0.991	0.982	1.285
LT	0.974	0.985	1.204
LPT	0.990	0.979	1.065

Note: 1.Cor. Coef=Correlation Coefficient, NIER=Nominal Income Elasticity of Revenue Receipts,
2.Nominal Income Elasticity of Revenue receipts is estimated through double log regression.
Source: Data on States own tax Revenue is from RBI finances of State government (various issues), SDP from CSO, CPI from Kerala Economic Review, LT and LPT from Administration Reports of Panchayats, Directorate of Panchayat (various issues).

Table 3.12 presenting the results of the calculations is not in line with our expectations. In Kerala, both the own tax revenue of the State government, local own tax revenue are strongly correlated with SDP and price. Also, revenue from local property tax is strongly correlated to both SDP and price changes. This may be because of the land price increases and construction activities which are sensitive to economic and price fluctuations. The estimated nominal income elasticity of revenue receipts of the States own tax revenue, local tax revenue and local property tax revenue is more than unity. However, while the State's nominal income elasticity of tax revenues is the highest (1.285), that of local tax revenue is slightly lower (1.204) and that of local property tax revenues still lower (1.065).

Building Tax:

Taxes on completely immobile factors are considered to be best suited for the local level on equity and efficiency criteria (Musgrave, 1973). Land and structure (such as buildings) are among the most immobile tax bases. Experience during the past three decades in Kerala also demonstrating that the building tax is the most productive and quite elastic source of local government revenue. At current prices revenue from building tax has increased at a rate (18.62 per cent) faster than the growth of total revenue from own taxes (15.75 per cent) and the total receipts (11.73 per cent). In Kerala context, a large part of increase in revenue from building tax could, in all probability, be the result of a construction boom in Kerala due to the inflow of NRI remittances and their investments in real estates and the increase in the basic building tax rates.

Table 3.13: Building Tax as a percentage of own tax revenue, total tax revenue and total receipts of Panchayats (Per cent)

	BT/OTR	BT/TTR	BT/TOR	BT/TR
1980-81	42.88	25.03	21.79	13.45
1981-82	41.79	23.43	18.50	10.84
1982-83	41.95	25.38	22.58	14.74
1983-84	48.23	31.28	28.13	16.63
1984-85	52.25	34.80	32.00	20.09
1985-86	51.81	35.16	32.75	22.08
1986-87	52.71	34.76	31.39	20.90
1987-88	50.69	31.12	30.23	19.06
1988-89	55.01	39.18	32.38	23.51
1989-90	56.53	40.68	34.35	25.13
1990-91	56.58	36.02	31.42	18.18
1991-92	55.01	38.14	32.88	19.64
1992-93	54.39	34.06	31.68	17.24
1993-94	59.48	35.11	35.66	19.98
1994-95	60.41	46.75	36.80	31.07

Note: BT = Building Tax, OTR= own tax revenue, TTR = total tax revenue, TOR = Total own revenue, TR = total receipts.
Source:Administration Reports of Panchayats, Directorate of Panchayat.(various issues)

The Table 3.13 shows that between 1980-81 to 1994-95, building tax receipts as a percentage of own tax revenue, total tax revenue, total own revenue and total receipts of the Panchayats have increased markedly. During 1994-95, they constituted 60.41 per cent of the own tax revenue of the all the Panchayats of Kerala. As a percentage of total receipts of the Panchayats, building tax receipts increased from 13.45 per cent to 31.07 per cent during this period.

The rate of building tax is decided by the local body within the statutory minimum and maximum limit. The assessments is made every five years by the official machinery available with the local body. The Naha Commission had reported that out of 1001 Panchayats in the State, 703 were levying building tax at the minimum rate of 6 per cent (cited in SFC Report, 1996). Table 3.14, gives the distribution of the Panchayats in Kerala according to the rate of building tax. It can be seen that though in both 1985 and 1995, a majority of Panchayats collected the tax only at the minimum permissible rate (6 per cent) their percentage declined subsequently (70.2 per cent to 56.3 per cent). The percentage of Panchayats having that tax at 8 per cent or above has gone up from 20 per cent to 31 per cent during this period. Consequently, the average rate of building taxes has increased.

Table 3.14: Distribution of Panchayats according to the Rate of Building Tax, 1985 and 1995

Rate at which Building Tax is levied	No and percentage of Panchayats	
	1985	1995*
6%	703 (70.2)	546 (56.3)
7%	94 (9.4)	120 (12.4)
7.5%	4 (0.4)	NIL -
8%	155 (15.5)	217 (22.4)
9%	12 (1.2)	42 (4.3)
10%	33 (3.3)	45 (4.6)
Total	1001 (100.00)	970 (100.00)

Source: Administration Reports of Panchayats, Directorate of Panchayat.(various issues), * State Finance Commission Report, 1996.

The fact that still over half the Panchayats levy building tax at the minimum prescribed rate implies that the potential of raising resource from this tax is quite high. The State Finance Commission (SFC) has pointed out that this tax has not been exploited to a satisfactory extent. At the same time, the entire area of building tax is afflicted by not only underassessment and undervaluation but also by a large number of exemptions and artificial restrictions on the permitted extent of revision etc. The SFC of Kerala has expressed opinion that even without raising the rates of taxation it should be possible for the local bodies to obtain a substantial increase in revenue from this source. One of the major criticisms against the present system of building taxation is that it is often arbitrary and frequently treat equal properties unequally. The SFC has offered the suggestion to adopt the plinth value as the indicator to arrive at the annual rental value.

Profession Tax:

Profession tax, a levy on local incomes, is another source available to the rural local bodies. The Panchayats are levying this tax on individuals and companies by virtue of Section 204 of Kerala Panchayat Raj Act (KPRA, 1994). This tax was leviable under the 1960 Act as well. All companies and individuals transacting business or engaged in a profession for not less than 60 days in a

Table 3.15: Profession Tax as a percentage of Own Tax Revenue, Tax Revenue, Own Revenue and Total Receipts (per cent)

	P/OTR	P/TTR	P/TOR	P/TR
1980-81	24.14	14.09	14.35	7.57
1981-82	25.93	14.54	12.70	6.73
1982-83	27.01	16.34	18.03	9.49
1983-84	23.79	15.42	19.12	8.20
1984-85	21.50	14.32	19.14	8.27
1985-86	24.27	16.47	23.66	10.34
1986-87	25.01	16.49	21.19	9.92
1987-88	24.88	15.27	19.24	9.35
1988-89	23.88	17.01	21.81	10.20
1989-90	23.87	17.17	23.06	10.61
1990-91	25.29	16.10	19.68	8.13
1991-92	28.63	19.85	27.04	10.22
1992-93	28.13	17.61	23.81	8.92
1993-94	24.47	14.44	21.04	8.22
1994-95	24.23	18.75	25.95	12.46

Note: P=Profession Tax, OTR = Own Tax Revenue, TTR = Total Tax Revenue, TOR = Total Own Revenue, TR = Total Receipts.
Source: Administration Reports of Panchayats, Directorate of Panchayat.(various issues)

half-year are liable to pay the tax at such rates as fixed by the Local body subject to the maximum rates prescribed by the State government. The maximum tax is leviable, fixed under Article 276(2) of the Constitution is Rs. 2500 per year.

As a source of revenue for the Panchayats, the revenue from profession tax increased during the period 1980-81 to 1994-95, from Rs. 183.19 lakhs to Rs. 1425.35 lakhs, at a compound rate of growth of 15.78 per cent per annum. But, as can be seen from the Table 3.15, its share in the total receipts of Panchayats has remained more or less static. Profession tax as a percentage of total receipts remained around 10 per cent except 1994-95, when its share increased to 12.46 per cent.

The full potential of this tax is yet to be realised by the rural local bodies. The realisation of the potential of this tax source is dependent however, on the rural local body compiling a complete list of the persons who ought to be paying profession tax at the right rate. Since the database of Panchayats in respect to self employed persons is poor, many escape the tax net or do not pay the right rate. Assessment of income of self-employed persons within the tax net is also a problematic one and prone to disputes. SFC (1996) has suggested a concerted tax mapping to bring more assesses into the tax net. It further recommended that the rates of profession tax can be made uniform in urban and rural local bodies and the number of slabs and the tax structure could be rationalised.

In Kerala, the basis of levying the profession tax is classification of the assesses according to income: different maxima are prescribed for different ranges of income irrespective of the profession. The revenue potential of the tax depends upon the number of assessees, the income bracket to which they belong and the pace at which the lower income bracketed assessees move up to the higher incomes. As modernisation and urbanisation gets accelerated, there would be a favourable change in terms of income and employment generation and this in turn would help the Panchayats in mobilising greater revenue through Profession Tax. This levy is equitable since its incidence can be correlated to income to an extent. The profession tax is more of the nature of local income tax. It is a "personal tax", because it is not only levied on the personal status of the individual but also not transferrable.

It can be seen from the Table 3.16 that between 1980-81 and 1993-94, the share of building tax and profession tax in total Panchayat receipts fluctuated within a range of 11.04 to 20.12 per cent and 5.89 to 11.47 per cent respectively in different districts. Among the different districts, the rate of growth of building tax was the highest in Malapuram (20.64 per cent) and the lowest in Kannur (10.86 per cent). The rate of growth of revenue from profession tax was also the highest in Malapuram (18.15 per cent) followed by Trivandrum (17.86 per cent) and Thrissur (16.23 per cent). In the rest of the districts it fluctuated within a range of 12 to 15 per cent.

Table 3.16: The Share of Building Tax and Profession Tax in total receipts and their growth: A district level average of Panchayats from 1980-81 to 1993-94 (Per cent)

	PBT	GRBT	PPT	GRPT
TRIVANDRUM	13.71	16.32	9.26	17.86
KOLLAM	13.50	13.28	9.65	13.48
PATHANAMTHITTA	15.41	12.88	7.46	12.73
ALLEPPEY	20.12	13.59	11.30	13.31
KOTTAYAM	18.48	13.51	11.47	14.57
IDUKKI	16.52	12.88	11.14	13.99
ERNAKULAM	18.16	14.51	10.86	14.52
THRISSUR	19.57	17.97	10.18	16.23
PALAKKAD	13.36	15.09	9.29	14.16
MALAPURAM	13.90	20.64	7.77	18.15
KOZHIKODE	11.04	14.99	7.73	15.74
WAYANAD	12.65	15.23	5.89	11.86
KANNUR	15.98	10.86	8.93	11.87
KASARAGODE	14.36	18.55	7.06	17.82

Note: PBT = Percentage of Building Tax in total receipts of all the Panchayats at the district level.
GRBT = Compound Growth Rate of Building Tax
PPT = Percentage of Profession tax in total receipts of all Panchayats at the district level.
GRPT=Compound growth rate of profession tax
Source: Administration Reports of Panchayats, Directorate of Panchayat.(various issues)

Inter-district differences in the growth of revenue need to be related to the level of taxation. For this purpose we compare the level of per-capita tax burden in each of the districts. As can be seen from Table 3.17, between 1981 and 1991, there has been a sharp increase in per-capita building and profession tax across the districts. The ordering of the districts in the ascending order of per-capita building and profession tax shows that Idukki ranked the highest in both the time points for profession tax. In 1981 also per-capita building tax was also the highest in Idukki. During 1991, per-capita building tax was the highest in Thrissur (3.87) and the lowest in Kottayam (0.40). At the same time it can be seen that the incidence of profession tax in Malapuram, which showed the highest growth in revenue from this tax is still the lowest.

Trivandrum also has a relatively lower per-capita incidence of profession tax.

Table 3.17: Per-capita Building and Profession tax in 1981 and 1991 in different districts of Kerala (Rs.)

1981		1991		1981		1991	
PROF		PROF		TBT		TBT	
		MALAPURAM	1.03			KOTTAYAM	0.40
		KOZHIKODE	1.31			MALAPURAM	1.80
		KASORGODE	1.31			TVM	1.99
MALAPURAM	0.50	TVM	1.33	TVM	0.43	PALAKKAD	2.09
TVM	0.50	ALLEPPEY	1.38	MALAPURAM	0.45	KOZHIKODE	2.29
KANNUR	0.79	KANNUR	1.40	PALAKKAD	0.67	KOLLAM	2.33
THRISSUR	0.83	ERNAKULAM	1.42	ERNAKULAM	0.77	KANNUR	2.40
ALLEPPEY	0.85	PATT	1.43	ALLEPPEY	0.81	ERNAKULAM	2.59
ERNAKULAM	0.90	PALAKKAD	1.45	KOLLAM	0.82	ALLEPPEY	2.61
PALAKKAD	0.90	KOLLAM	1.63	THRISSUR	0.82	KASORGODE	2.62
KOZHIKODE	0.99	WAYANAD	1.67	KANNUR	0.87	WAYANAD	3.40
KOLLAM	1.02	THRISSUR	1.84	KOZHIKODE	0.93	IDUKKI	3.67
KOTTAYAM	1.06	KOTTAYAM	1.99	KOTTAYAM	0.94	PATT	3.77
IDUKKI	1.29	IDUKKI	2.50	IDUKKI	1.00	THRISSUR	3.87

Note: PROF= Profession Tax, TBT= Total Building Tax, TVM=Trivandrum, PATT= Pathanamthitta
Source: Administration Reports of Panchayats, Directorate of Panchayat (various issues)

Entertainment Tax:

Entertainment tax is a source of revenue of State government in different States in India. The share of entertainment tax in own tax revenue of all State government taken together was 3.54 per cent in 1981-82. But its share has declined over the years and in the early 1990s, it fluctuated between 1 and 2 per cent. In Kerala, entertainment tax is in the hand of local bodies and it is the most important among the indirect taxes of the rural local bodies in Kerala.

Section 200 of KPRA (1994) lists entertainment tax as one of the taxes leviable by the village Panchayats. Entertainment tax and additional entertainment tax are leviable on any fair, performance, amusements, games, race, sports or gambling and cinema (the single largest source). The rate of entertainment tax is to be fixed between the minimum of 15 per cent and maximum of 30 per cent on the price of tickets and the additional entertainment tax is fixed at 60 per cent of the tax. The tax is collected in advance either at the time of stamping or at the retail sale point.

Table 3.18:Entertainment Tax as a percentage of Own tax revenue, Total tax revenue, Total own revenue and Total receipts (Per cent)

	ET/OTR	ET/TTR	ET/TOR	ET/TR
1980-81	28.05	16.37	14.25	8.80
1981-82	26.90	15.08	11.91	6.98
1982-83	26.79	16.21	14.42	9.41
1983-84	24.14	15.66	14.08	8.32
1984-85	22.11	14.72	13.54	8.50
1985-86	20.30	13.78	12.83	8.65
1986-87	19.55	12.89	11.64	7.75
1987-88	21.48	13.19	12.81	8.08
1988-89	18.38	13.09	10.82	7.85
1989-90	16.74	12.05	10.17	7.44
1990-91	15.52	9.88	8.62	4.99
1991-92	13.98	9.69	8.36	4.99
1992-93	15.10	9.46	8.79	4.79
1993-94	13.54	7.99	8.11	4.55
1994-95	12.81	9.91	7.81	6.59

Note: E = Entertainment Tax, TTR = total tax revenue, TOR = total own revenue, TR= total receipts.
Source: Administration Reports of Panchayats, Directorate of Panchayat (various issues)

The revenue from entertainment tax as a percentage of own tax revenue, own revenue and total receipts has sharply declined over the last one decade and a half. It can be seen from the Table 3.18 that, the share of entertainment tax in own tax revenue of the Panchayat has declined from 28.05 per cent in 1980-81 to 12.81 per cent in 1994-95. During, 1994-95, its share in total receipts of the Panchayat was only 6.59 per cent.

The rate of growth of entertainment tax during this period was 9.45 per cent which is much lower than own tax revenue and total tax revenue of the Panchayats. Thus questions can be raised regarding the efficiency of this particular tax collection by the local bodies. The entertainment tax is collected by State government in most parts of India. It is seen that all State annual average rate of growth of entertainment tax was 4.67 per cent during this period which is much lower than the rate of growth of this tax collected by the rural local bodies of Kerala. In States like Karnataka and West Bengal where entertainment tax is under the exclusive jurisdiction of State government, the growth of it was 8.73 and 5.98 per cent respectively during this period. Thus we see that even though the performance of local bodies with regard to entertainment tax collection is not satisfactory in relation to other taxes collected, they have performed better than the States with regard to this tax collection.

Earlier, additional entertainment tax was introduced as source of revenue of the State government. Since 1975, the proceeds from both entertainment tax and additional entertainment tax go to the local bodies, Naha Commission had recommended the merger of entertainment tax and additional entertainment tax and SFC (1996) of Kerala reiterates the above recommendation.

Miscellaneous Taxes

Apart from the major tax source discussed above, Panchayats in Kerala mobilises own tax revenue from other sources like service tax, land cess, show tax and surcharge on show tax and vehicle tax.

All these taxes together constituted below 5 per cent share in the own tax revenue during 1980-81 to 1994-95.

Show tax and surcharge on it constitute only less than one per cent of the total revenue of Kerala Panchayats. Under Section 200 of KPRA (1994), village Panchayats in Kerala are empowered to levy and collect show tax on every 'exhibition' performed in their territory. Rural local bodies are empowered to levy and collect a surcharge on show tax at the rate of 25 per cent of show tax on every show.

Like additional entertainment tax, the proceeds from surcharge on show tax too was originally intended to augment State governments' financial resources. Since August 1975, the entire proceeds go to local bodies along with additional entertainment tax. It is irrelevant to continue the practice of levying, collecting and accounting show tax and surcharge on show tax separately. SFC (1996) recommends the merger of both tax items and replacing the regime of fixed rates by giving freedom to rural local bodies to fix rates at intervals of not less than two years.

For Kerala Panchayats, the revenue from land cess remains an extremely insignificant proportion of their tax receipts. Land is an immovable tax base and would be an ideal tax source for rural local bodies. SFC (1996) notes that this source of revenue by the Panchayats has not been exploited to a greater extent mainly because of the lack of necessary will on the part of the Panchayats to levy and collect the tax.

Non-Tax Revenue:

While own-tax revenue an average constituted more than 35 per cent of the total receipts of Panchayats during 1960-61 to 1993-94, the share of non tax also fluctuated between 22 to 34 per cent in most of the years during this period. This internally mobilised or autonomous non-tax sources include fees, contributions, deposits, income from markets etc. In 1980-81, non-tax revenue formed 30 per cent of the revenue receipts of the rural local bodies. Since mid eighties, it has declined to one-fourth of the total revenue receipts and even less. In 1993-94, it formed 22 per cent of the total revenue receipts of Panchayats.

Table 3.19: Composition of Non-Tax Revenue from 1980-81 to 1993-94

	80-81	81-82	82-83	83-84	84-85	85-86	86-87	87-88	88-89	89-90	90-91	91-92	92-93	93-94
IMKT	62	71	69	83	100	104	115	118	148	149	155	176	182	222
(PC)	8	6	8	9	10	9	8	8	8	7	6	7	7	7
LF	32	46	40	42	49	54	62	67	71	77	77	100	210	172
(PC)	4	4	5	5	5	5	4	4	4	4	3	4	8	5
Con.	41	39	20	19	32	15	46	45	25	75	98	46	72	87
(PC)	6	4	2	2	3	1	3	3	1	4	4	2	3	3
Ds.	143	205	189	193	208	192	184	241	437	406	342	426	479	494
(PC)	20	19	22	21	20	17	12	16	22	20	14	17	17	15
Msc.	457	735	535	572	632	771	1071	1063	1289	1323	1817	1781	1806	2275
(PC)	62	67	63	63	62	68	72	69	65	65	73	70	66	70
TNT	735	1096	853	909	1020	1136	1477	1534	1971	2030	2488	2530	2749	3249
(PC)	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Note: IMKT = Income from the market, LF = license fee, Con. = Contributions, Ds. =Deposits, Msc. = Miscellaneous, TNT = total Nontax revenue. PC= percentage composition.
Source: Administration Reports of Panchayats, Directorate of Panchayat (various issues)

Among the different components of non-tax revenue, the major component is of Miscellaneous receipts whose break up is not readily available. Among the other sources, deposits had the second largest share. As can be seen from the Table 3.19, between 1980-81 to 1994-95, the share of deposits fluctuated between 12 to 20 per cent. Other sources of non-tax revenue such as licence fee, income from market fee and contribution had less than 10 per cent share each in total non-tax revenue.

Section 2:3

Transfer of Resources from the State Government

Resource transfer or the devolution of resources from the State to the local bodies of Kerala takes place through revenue sharing and grants-in-aid[2]. Revenue sharing enables the rural local bodies a predictable flow of revenue, besides some facility to benefit from improved buoyancy of taxes of the higher level of government.

Assigned taxes and shared taxes constitute a significant portion of 'fiscal transfers' to the Kerala Panchayats. In Kerala, stamp duty on transfer of property and basic tax or land tax are the assigned taxes[3]. While under the 1960 Act, the stamp duty on transfer of

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2 While some tax bases are assigned to the exclusive use of particular levels of government, other taxes are shared. Different levels of government may use the same tax base, or one level may collect the tax from a given base and share the revenue with other levels. Sharing of taxes and tax assignments are indicators of fiscal decentralisation. Revenue sharing is an approximate synonym for an unconditional grant (Arson and Hilley, 1986).

3 The Stamp Act, 1959 empowers the State Government to levy stamp duty on transfer of property subjected to specified conditions. Section 206 of KPRA (1994), empowers Village Panchayats to levy a surcharge on Stamp-duty not exceeding 5 per cent of the value of the property transferred. Surcharge on stamp-duty is collected along with the Stamp Duty and 3 per cent is deducted towards collection charges.

property was pooled taluk-wise, under the new legislation (KPRA, 1994) taluk-wise pooling has been done away with and replaced by State level pooling. Now 75 per cent of the State pool is distributed among village Panchayats on population basis, after deducting 3 per cent for collection charges. SFC has pointed out that a more recent phenomenon is the total avoidance of the stamp duty through the device of power of attorney.

Another assigned tax is the basic tax or land tax. The basic tax is collected by the State government and the entire proceeds are statutorily assigned to village Panchayats. Under the Kerala Land Act 1961, basic tax or land tax is levied by the Land Revenue Department on all lands except lands belonging to government and a few other exempted categories. The current rate of basic tax prevalent since April 1993 is 50 paise per acre in Panchayats.

Under Section 202 of the KPRA (1994), government is required to pay annually to each Panchayat in the State a grant, viz, basic-tax grant, equal to the total collection of the basic tax in the preceding year. 75 per cent of tax collected is to be given on the basis of collection and the balance 25 per cent is for distribution among grama Panchayats on the basis of area, population, available financial resources and the requirement of development.

As for shared taxes, motor vehicle tax is the only shared tax and sharing is based on the compensatory principle[4]. The Motor Vehicle Tax Act (India, 1939), deprived the local bodies of the power to

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[4] Compensatory principle recognises the right to compensation for the loss of previously existing source of revenue.

levy taxes on mechanically propelled vehicles. Most of the State governments, however, pay compensation to make up the loss incurred by local bodies as fixed by the State government with due regard to the length of roads maintained by the local bodies and the volume of motor traffic making use of such roads.

The composition of assigned tax and shared tax is shown in Table 3.20. In absolute terms, assigned tax and shared tax together increased from Rs.541 lakhs in 1980-81 to Rs. 3375 lakhs in 1993-94, i.e., more than six times increase in absolute term. The rate of growth of stamp duty on transfer of property (DTP) over the last fifteen years was 8.61 per cent. The collection of shared tax in absolute terms increased from 12 lakhs in 1982-83 to Rs 969 lakhs in 1993-94.

It can be seen from the Table 3.20, assigned tax is the major component of tax transfer having a share of more than 95 per cent of total tax transfer from 1980-81 to 1988-89. During this period, the share of shared tax in total tax transfer was only 2 per cent. Its share in total tax transfer started showing a steady increasing trend from 1989-90 and it constituted 29 per cent of the total tax transfer receipts of the Panchayats.

Table 3.20: Composition of Assigned Tax and Shared Taxes from 1980-81 to 1993-94

	80-81	81-82	82-83	83-84	84-85	85-86	86-87	87-88	88-89	89-90	90-91	91-92	92-93	93-94	94-95
DTP75	NA	NA	493	530	5	4	9	5	7	3	5	3	10	16	19
(PC)			76	77	1	0	1	0	1	0	0	0	0	0	1
DTP25	NA	NA	144	142	673	812	1002	1275	1002	904	1154	1076	1412	2023	1700
(PC)			22	21	83	88	89	89	88	74	65	65	62	60	99
DTP(T)	541	682	637	672	679	816	1010	1280	1009	907	1159	1079	1422	2039	1719
(PC)	100	100	98	98	84	88	90	90	89	74	65	65	62	60	100
BL T	0	0	0	0	112	50	79	116	107	316	346	372	359	367	NA
(PC)	0	0	0	0	14	5	7	8	9	26	20	22	16	11	0
TAT	541	682	637	672	791	866	1089	1396	1116	1224	1505	1451	1781	2406	1719
(PC)	100	100	98	98	98	94	97	98	98	100	85	87	78	71	100
ST	0	0	12	17	17	58	34	29	23	1	269	211	507	969	NA
(PC)	0	0	2	2	2	6	3	2	2	0	15	13	22	29	0
AT+ST	541	682	649	689	808	924	1123	1425	1140	1225	1774	1663	2288	3375	1719
(PC)	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Note: DPT75 = Duty on Transfer of Property (75%) , DTP25 = Duty on Transfer of Property (25%) ,
DTP(T) = Duty on Transfer of Property (total) , B/L T = Basic/Land tax , TAT = Total Assigned Tax , AT =Assigned Tax, ST = Shared tax. PC = Percentage composition.
Source: Administration Reports of Panchayats, Directorate of Panchayat (various issues)

The relative significance of assigned tax and shared tax in total receipts of the Panchayat can be seen from the Table 3.21. It shows that the share of assigned tax in total receipts has declined from 22.37 per cent in 1980-81 to 16.62 per cent in 1993-94 except 1987-88 when the share increased to 23.16 per cent. Relative insignificance of motor vehicle tax as a shared tax is also evident from the Table though it showed a rising trend in early 1990s. As regards the motor vehicle tax, the payment has been highly erratic and the arrears has been mounting.

Table 3.21: Share of Assigned Tax and Shared Tax in Total Receipts of the Panchayat

	Assigned Tax Share	Shared Tax Share
1980-81	22.37	0.00
1981-82	20.33	0.00
1982-83	22.50	0.44
1983-84	18.24	0.45
1984-85	18.87	0.41
1985-86	18.92	1.27
1986-87	19.85	0.62
1987-88	23.16	0.48
1988-89	16.91	0.35
1989-90	17.30	0.02
1990-91	15.57	2.78
1991-92	13.79	2.01
1992-93	14.72	4.19
1993-94	16.62	6.70
1994-95	15.03	NA

Source: Administration Reports of Panchayats, Directorate of Panchayat (various issues)

Grants

Grants-in-aid is a prominent feature of fiscal federalism. Grants-in-aid are fundamentally based on the assumption that the existing resources available with the local bodies are not sufficient to yield the revenue they need. In that case this lacuna necessitates certain fundamental correctives to equip them with the necessary financial powers to meet their genuine requirements.

Grants-in-aid are broadly of two types: Conditional (specific purpose) and Unconditional (general purpose). In the case of the former, the purpose for which the recipient is to use funds is defined by the granter. The amount of a specific grant may be determined in various ways. A certain percentage of locally financed expenditure may be assigned to a given service. Alternatively, a certain amount may be assigned to each unit of need. In contrast, for general purpose grants (unconditional), since no such specifications are laid down, the recipient government can employ the grants according to its own set of priorities. General grants are designed to bring the poorer among the local bodies at a given level of income or to ensure that all local bodies at a given level are financially able to provide certain basic services (Pillai, 1986).

Grants to Panchayats registered an annual average growth of 20.67 per cent over the period 1980-81 to 1993-94. Grants as a proportion of the total receipts of Panchayats declined from 15.50 per cent in 1980-81 to 9 per cent in 1989-90 . From 1990 onwards, because of the starting of untied grant programme, the share of grants in total receipts increased to more than 20 per cent (Refer Table 3.5).

A remarkable trend in grants-in-aid pattern in Kerala Panchayats is that, there has been wide annual fluctuations in the amount of grant received by Panchayats. The nature of the grants-in-aid policy of State governments can also be econometrically analysed using the Ordinary Least Squared (OLS) technique with linear specification of variables. The objective of this econometric analysis is to test whether there are certain systematic variables which may determine the transfer of grants or it is purely discretionary in nature.

The econometric model is as follows:

PCG = A+b1 PEC + b2 PPW + b3 PTT + b4 POR + U.

where PCG = per-capita grants in aid

PEC = per-capita expenditure on establishment charges.

PPW = per-capita expenditure on public works.

PTT= per-capita tax transfers

POR = per-capita own revenue of rural local bodies.

U = surrogate for all the omitted explanatory variables (the disturbance term.)

Selection of independent variables can be justified on the following ground:

I. Since a substantial part of the State grants to rural local bodies is given for meeting expenditure on the categories like establishment charges and public works, we would expect that movements in these variables should explain some of the variation in grants received by Panchayats. The major type of grants given to Panchayats in Kerala are Establishment grants and village Road Maintenance (VRM) grants. Establishment Grant is given to Panchayats to the expenditure incurred in excess of the prescribed percentage of their revenues earmarked for general administration. Village Road Maintenance (VRM) Grant is extended to Panchayats for the maintenance and upkeep of the village roads constructed by them.

II. It is also expected that per-capita own resources of Panchayats influence the movement of grants. It is expected that the relationship between per-capita own resources and per-capita grants would be negative. Because those Panchayats that are able to raise larger per-capita own resources should receive lower per-capita grants.

III. One more independent variable in the model is per-capita tax transfers, comprised of shared and assigned taxes. In case of per-capita tax transfers, the relationship may be open ended. However, we expect a negative a-priori relation between per-capita grants and per-capita tax transfers. That would imply that there is some degree of substitution between grants and tax transfers.

The estimated equation is as follows:

$$\begin{array}{lllll} PCG = -2.39 & - \; 0.463\ PEC & + \; 0.764\ PPW & + \; 0.266\ PTT & + \; 0.262\ POR \\ \quad\quad\;\; (1.62) & \quad (0.458) & \quad (0.566) & \quad (0.399) & \quad (2.368) \end{array}$$

(sample period 1980-81 to 1993-94)

$R^2 = 0.86$ SE = 2.087

$R^2 = 0.80$ DW = 1.750

The figures in the parentheses denotes estimated t values.

One of the interesting results that stem from the analysis is that the `ß´ coefficients of all the explanatory variables turn out to be insignificant at 1 per cent level of significance[5]. This erratic behaviour of the regression results can be explained in several ways. First, the specification of the regression equation may be incorrect. To verify this possibility, a log form of the regression equation had been attempted and no significant improvement in the results is found. Secondly, the movement in grants is explained not by the set of variables included in the regressions. This would however mean that State government is not following any well conceived grants-in-aid policy.

Section 3

Budgetary Position of the Local Bodies

After discussing both expenditure and receipts side of the panchayat, it is necessary to look into the overall budgetary position of the Panchayats. Table 3.22 represents the growth of different components of expenditure and receipts of the Panchayats. It can be seen from the table that aggregate expenditure and receipts of the Panchayat in nominal term grew almost at the same rate, i.e. 14.7 per cent and 14.2 per cent per annum respectively. But the point to be noted here is that, own revenue of the Panchayat grew at a rate of 13.2 per cent which is well below the rate of growth of total expenditure. As a result of that the ratio

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[5] But at 5 per cent level, the per capita own revenue turns out to be significant. But the positive `ß´ coefficient of per capita own revenue reveals the fact that per capita grants are not distributed on the basis of fiscal equalisation method of compensating lower own income panchayats with more per capita grants.

of total expenditure of Panchayat to own revenue also increased from 178.45 per cent in 1980-81 to 225.55 per cent in 1993-94. The increasing ratio of total expenditure to own revenue of the Panchayat shows the increasing short fall in own resources to meet the expenditure responsibilities and accordingly the increasing need of fiscal transfer from the higher level of government. It can be seen from the table, tax transfer from the State government grew only at a rate of 8.6 per cent per annum. Even though the grant increased at a higher rate than the own revenue of the Panchayat, its share in total resources of the Panchayat is relatively small.

Table 3.22: Nominal Rate of Growth of Expenditure and Receipts during 1981-82 to 1993-94

Items of Exp.	GR	Items of Rec.	GR
Establishment	14.6	i.Own Tax	16.3
Public Works	14.2	ii.Non Tax	12.4
Education	10.6	Own Rev.(i+ii)	13.2
WS & PH	7.78	Tax Transfer	8.6
Street Lighting	14.7	Grants	20.7
Miscellaneous	14.4	Loans	-0.8
Total Exp.	14.2	Total Receipts	14.7

Note: GR=Growth Rate, Rev.=Revenue, Rec.=Receipts, Exp.=Expenditure, WS & PH=Water Supply and Public Health
Source: Administration Report Panchayat from Directorate of Panchayat (Various Issues)

Even though expenditure grew at a slightly higher rate than receipts, it is evident from the Table 3.23 that, during 1980-81 to 1993-94, Kerala Panchayats' had surplus in their account except for three years. The surplus syndrome in local government budgets is a familiar phenomenon, despite the low physical level of various local services. It may be a reflection of the lack of autonomy in spending and due to the official stipulation to keep 5 per cent of the revenues as surplus. Thus this kind of surplus situations reflects disguised autonomy rather than genuine decentralisation (Oommen, 1995).

Table 3.23: Receipts-Expenditure Gap of Kerala Panchayats

	REV-EXP GAP (Rs. Lakhs)	GAP/LE (%)	GAP/LR(%)
1980-81	142.85	6.27	5.90
1981-82	-221.88	-6.20	-6.61
1982-83	-764.44	-21.27	-27.02
1983-84	-50.77	-1.36	-1.38
1984-85	323.50	8.36	7.71
1985-86	723.77	18.77	15.81
1986-87	1087.40	24.73	19.83
1987-88	1226.43	25.54	20.35
1988-89	46.89	0.72	0.71
1989-90	-549.27	-7.21	-7.77
1990-91	298.91	3.19	3.09
1991-92	1072.00	11.34	10.18
1992-93	1379.52	12.87	11.40
1993-94	1721.17	13.49	11.89

Note: LR =Local Revenue , LE = Local Expenditure.
Source: Administration Report Panchayat from Directorate of Panchayat (Various Issues)

Furthermore we have noted relatively low ratio of local government expenditure to the total expenditure of the State government during the last three decades. Table 3.24 shows that financial autonomy ratio (FAR) which is the ratio of locally raised revenue in total local expenditure was 56 per cent in 1980-81. It steadily declined to 42 per cent in the early 90s except, three consecutive years in mid 80s when the financial autonomy ratio fluctuated between 58 to 61 per cent.

Table 3.24: Fiscal Autonomy Ratio of Kerala Panchayats

	LOR/LEX
1980-81	56.0
1981-82	49.7
1982-83	41.4
1983-84	42.3
1984-85	46.8
1985-86	51.9
1986-87	58.4
1987-88	61.0
1988-89	47.1
1989-90	42.7
1990-91	42.6
1991-92	42.1
1992-93	42.3
1993-94	44.3

Note: LOR/LEX= Local Own Revenue/Local Expenditure.
Source: RBI bulletin & Administration Reports of Panchayats

Declining financial autonomy reflect the increase in the State transfers to meet the financial need of Panchayats. The point to be noted here is that local government expenditure as a percentage of combined expenditure did not show any increasing trend during this period, rather it stagnated at around 3 per cent. At the same time dependence of the Panchayats on State transfers has increased. If this trend continues, fiscal health of the State will largely determine the function and finance of Panchayat (See Appendix to chapter III for a brief assessment of State resources).

Summary

The substantial issues to be discussed while concluding this chapter relates to the relative growth of various components of the receipts and expenditure of local bodies rather than the gap between the overall expenditure and receipts. In other words, the financial autonomy of local bodies in Kerala even though, is still much better than most of the States, has been declining over time. The fiscal autonomy ratio which was 61 per cent in 1987-88 has declined to 42.3 per cent in 1992-93. It is the resource constraint that is responsible for this phenomena. Certainly, there is a case for the local bodies to exploit their own source of revenue more judiciously. But that alone would not be able to solve the problem of resource constraint of the Panchayats, given few tax and non-tax sources of its own. This underlines the importance of greater fiscal transfers from State government in order to meet the expenditure requirements of local bodies.

An Assessment of the State's Resources

The State of Kerala has been facing a fiscal crisis since eighties. The growing revenue deficit has become a major problem for the State. As can be seen from the Table 3A.1, revenue deficit as a percentage of SDP increased from 0.74 per cent in 1980-81 to 2.90 per cent in 1994-95. Even though, revenue receipts as a percentage of SDP or the tax effort increased from 17.3 percent in 1980-81 to 21.73 percent in 1994-95, it has failed to cover the gap in the revenue account.

Table 3A.1: Major Indicators of State Finance of Kerala (Per cent)

	RR/SDP	RE/SDP	FD/TE	RDF/SDP	FD/SDP
1980-81	17.30	18.03	23.91	-0.74	-5.52
1981-82	21.64	19.20	20.14	+2.44	-5.56
1982-83	17.74	17.15	17.20	+0.59	-3.75
1983-84	17.43	18.52	28.21	-1.09	-6.96
1984-85	19.02	19.25	27.09	-0.23	-7.20
1985-86	21.30	22.46	29.42	-1.15	-9.00
1986-87	20.52	22.60	29.03	-2.08	-8.57
1987-88	19.62	22.02	28.76	-2.41	-8.01
1988-89	21.23	23.07	23.86	-1.84	-6.73
1989-90	20.14	22.61	28.47	-2.46	-8.09
1990-91	19.74	23.21	28.31	-3.47	-7.85
1991-92	19.21	21.36	26.98	-2.15	-7.14
1992-93	18.85	21.43	24.59	-2.58	-6.19
1993-94	20.82	22.79	23.02	-1.97	-6.28
1994-95	21.37	24.27	25.29	-2.90	-7.27

Note: '-' and '+' sign indicates deficit and surplus respectively. RR = Revenue Receipts, RE = Revenue Expenditure, TE = Total Expenditure, FD = Fiscal Deficit, RDF = Revenue Deficit.
Source: RBI Bulletin, Finances of State Government (Various Issues)

Between 1980-81 and 1994-95, State's fiscal deficit or the net borrowing requirement as a percentage of SDP increased from 5.52 per cent to 7.27 per cent. During the same period, gross interest payment as a percentage of revenue receipts also increased sharply from 7.12 per cent to more than 15 per cent. As already the fiscal deficit of the State is so high, in coming years State would have to face an intolerable debt burden unless the revenue mobilisation is increased.

Table 3A.2: Composition of the Devolution of Resources from the Central Government to the State of Kerala (Per cent)

	SSCT	GRC	GLC	TOTAL
1980-81	54.34	18.80	26.85	100.00
1981-82	50.62	21.68	27.70	100.00
1982-83	51.10	19.10	29.81	100.00
1983-84	39.61	22.64	37.75	100.00
1984-85	40.02	23.44	36.54	100.00
1985-86	22.55	31.41	46.04	100.00
1986-87	41.90	22.92	35.18	100.00
1987-88	37.37	23.64	38.99	100.00
1988-89	46.50	22.72	30.78	100.00
1989-90	46.05	18.67	35.28	100.00
1990-91	38.53	29.12	32.36	100.00
1991-92	31.41	27.56	41.03	100.00
1992-93	36.39	31.58	32.03	100.00
1993-94	40.61	27.18	32.21	100.00
1994-95	38.05	28.10	33.86	100.00

Note: SSCT = States Share in Central Taxes, GRC = Grants from the Centre, GLC = Gross Loans from the Centre
Source: RBI Bulletin, Finances of State Government (Various Issues)

Apart from this, another disturbing trend in State finance is the decline in the non-debt creating central transfers. As can be seen from the Table 3A.2, share of central taxes as a percentage of total devolution of resources from the Central government to the State has declined from 54.34 per cent in 1908-81 to 38.35 per cent in 1994-95. Although the share of grants in total devolution increased from 18.80 per cent to 28.10 per cent during this period, it could not offset the decline in the share of central tax which is reflected in the increasing loan transfer from the centre during this period. During this period, the share of central loans as a percentage of gross devolution of resources increased from 26.85 per cent to 33.86 per cent. During the last decade, the interest payment and amortization on central loans together taken away more than 30 per cent of the total resources transferred from the Centre to the State. If this trend of increasing loan transfer in total resources transferred from the centre to the State of Kerala continues, net devolution of resources will further come down which will put further strain on State government finance. The significance of revenue deficit, increasing fiscal deficit, mounting debt burden and declining non-debt creating central transfer to the State is certainly a major constraint for increasing devolution of resources from the State level to the Panchayats.

CHAPTER IV

Future of Financial Devolution To Local Bodies : Indications From A Comparative Analysis of the State Finance Commissions.

The 73rd and 74th Constitutional Amendments mark a new turning point in the history of financial devolution in India, in that it has become mandatory for the State governments to appoint State Finance Commissions (SFC) which would make recommendations regarding the principles of devolution of resources from the State to local bodies. Several States in India, have appointed Finance Commissions and some Finance Commissions have already submitted their report to the State governments. Access to SFC report is a major problem since they are still confidential in nature in most of the States. In this chapter we confine ourselves in the review of SFC report of West Bengal, Karnataka and Kerala.

Major terms of reference of the SFCs of the States mentioned above were the following:

I. Determination of the principles which should govern

(a) the distribution between the state and the local bodies of the net proceeds of the taxes, duties, tolls and fees levied by the state which may be divided between them and allocation in between the local bodies of their respective shares of such proceeds.

(b) the determination of the taxes, duties, tolls and fees which may be assigned to or appropriated by the local bodies.

(c) The grants in aid to local bodies from the Consolidated funds of the state.

II. The measures needed to improve the financial position of the local bodies.

The Government of Karnataka introduced two additional terms of reference for its SFC[1].

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[1] However the data constraints forced the Karnataka SFC to ignore the first additional reference while the second additional terms of reference was considered redundant as

(i) examine and make suggestions on the extent to which and the manner in which the resources available to the local bodies could best be utilised for meeting the expenditure of local bodies.

(ii) make a detailed analysis of the repayment of loans and advances extended by the Government from time to time to the local bodies and make suitable recommendations for repayment of government dues and the possibility of adjusting these dues against future devolution of revenues from Government to these local bodies.

Given their terms of reference, the recommendations of SFCs are certain to place the local finance in India on a firm basis, removing much of the adhocism and arbitrariness that have characterised the local finance before the 73rd and 74th Constitutional Amendments. The comparative analysis of the recommendations of SFCs and the changes that their recommendations are likely to bring about in the States may be considered as broad indicators of likely devolution of local finance in future.

We devote first three sections of the present chapter to the presentation and discussion of the recommendations of SFCs in West Bengal, Karnataka and Kerala. For each State, we shall first discuss the existing State of local finance and then go on to describe the changes that are likely to be brought about by the recommendations of SFCs. In the final section, the discussion is summed up within a comparative framework.

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the local governments do not have outstanding loans.

Section 1

West Bengal

The origin of local self government in West Bengal may be traced to the late 19th century. However, local bodies only enjoyed very limited autonomy and were dominated by rural elites given the property restrictions on franchise. After Independence, as per the recommendation of Belwantra-Mehta Committee (1957), West Bengal Panchayat Act was passed in the same year with the intention to set up a four-tier Panchayati Raj system: Zilla Parishads at the District level, Anchalik Parishads at the block level, Anchal Panchayats at the Union (group of villages) level and the Gram Panchayats at the village level. Subsequently with the enactment of West Bengal Panchayat Raj Act of 1973, a three tier system of Panchayat was introduced with Zilla Parishad at the district level, Panchayat Samiti at the block level and Gram Panchayat at the village level. At present, West Bengal has 16 Zilla Parishads, 340 Panchayat Samities and 3314 Gram Panchayats. In addition to the 16 Zilla Parishads there is Darjeeling Gorkha Hill Council (DGHC)[2].

The functions of the Panchayat Raj Institutions (PRIs) in West Bengal cover a wide spectrum. PRIs in the State have successfully implemented major employment programmes starting from the food for work programme of the late 'seventies to Jawahar Rojgar Yojona (JRY) of the 'nineties. Panchayats also select beneficiaries for IRDP. Panchayats are empowered to undertake minor programmes in

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2 A major amendment was made in 1989 in the West Bengal Panchayat Act (1973), to mark the grant of autonomy to DGHC in the hill areas and the Siliguri Mahakuma Parishad (SMP) replacing the Zilla Parishad for Siliguri sub-division.

irrigation, forestry, fisheries, agriculture and animal husbandry. They supervise integrated child development scheme and a number of social security measures and small scale water supply projects. In the educational sector, Panchayats constructed and maintained school buildings and organise non-formal education. Development of rural infrastructure such as housing, roads and electrification is also undertaken by the Panchayats. Panchayats played a significant role in calamity relief. In fact, it was the devastating flood of 1978 and the vital role that Panchayats played in providing relief that catapulted them into the centre stage. They also played an important role in carrying out land reform and recording of \`bargadars'. Panchayats sponsor eligible cases for credit to Block Level Banker's Committee. PRIs have been involved in the planning process from 1985-86 onwards when block planning committees and the district planning committees were set up[3].

The functions that Panchayats have been shouldering in West Bengal are truly impressive. But Panchayat finance in the State represents a very different picture. Panchayats do not seem to enjoy much financial self reliance or autonomy, going by the proportion of own revenue to their total receipts. According to Abhijit Datta (1992), the share of tax and non-tax revenue constituted only 3 per

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3 Budgetary provisions of different departments for schemes those were to be implemented in each of the districts were communicated to the District Planning Committee and similarly for blocks and municipalities. The departments drew up their plan schemes in consultation with block and district planning committees. The District Planning Committee further integrated the sectoral plans and the programmes that have been traditionally implemented through the panchayats into a district plan. A limited amount of \`untied fund' was also made available through District Planning Committees.

cent of the total receipts of Grama Panchayats in West Bengal. There are two reasons for this situation. Firstly, sources of own revenue have been very sparse. Secondly, even these sources have been neglected by the Panchayats, a fact highlighted by the West Bengal SFC.

Own resources of West Bengal Panchayats mainly come from tax on lands and buildings. Panchayats were authorised to levy taxes on profession and employment by West Bengal Panchayat Raj Act of 1973, but in 1992 this authority was withdrawn in line with the decision of State Government to levy 'Single point' Profession Tax. Apart from this, West Bengal Panchayat Raj Act (1973) empowered the Panchayats to levy an additional stamp duty of 2 per cent on all immovable property transfers and an additional stamp duty of 10 per cent on entertainments. Other sources of own income of Panchayats are non-tax revenues like fee for building plans in semi-urban Gram Panchayats, trade licenses, fees on regulation of non-motorised vehicles, charges for sanitary arrangements and tolls on roads, bridges and ferries.

West Bengal SFC notes that Gram Panchayats in general have not exercised their resource mobilisation efforts optimally. It felt that there was scope for greater tax mobilisation through taxes on land and buildings and stamp duty on property transfers. The Commission has strongly recommended the introduction of appropriate rules and legal provisions for better exploitation of these two tax sources. The situation of Panchayat Samities (Block level) in West Bengal has been are no way better. The dependence of Samities upon grants from State Government is total. As the SFC report points out, Samities do not have taxing powers, although they do have the power to levy tolls on roads, bridges and ferries. Water rates, lighting charges, fee for registration of vehicles, license fee for markets are the other sources of income of a Samiti. But they too have failed to mobilise fully whatever source of revenue they had the authority to tap. The situation is almost the same with respect to Zilla Parishads in West Bengal with the difference however that their own sources of revenues are even more scarce.

Has the SFC recommended a major departure from the existing situation? The answer, unfortunately, is in the negative. Direct resource mobilisation possibilities of the local bodies of West Bengal would continue to be low. The SFC has not recommended any major additionalities to the own revenue sources of the Panchayats. The Commissions' recommendations are to transfer (i) entertainment tax from the State to the local bodies, (ii) urban land tax and multi-storied building tax to Calcutta Municipal Corporation and suggested to extend it to all Municipal Corporations and (iii) collection of irrigation rates to the Zilla Parishad. The Commission has emphasised the need for better tapping of the existing revenue potential.

To encourage the own revenue initiatives of all tiers of Panchayats, the Commission has recommended an incentive scheme. The incentive scheme proposed is that any local body raising its own income by 5 per cent or more in a financial year should be entitled to a bonus of 2 / 3 of the incremental revenue. For this purpose, 2 per cent of the entitlement due to a district will be set aside to operate as an incentive fund. The Commission has also drawn attention to the importance of mobilising voluntary contributions in the form of monetary, material and human resources both from the point of view of resource mobilisation and for generating a sense of participation among the people. It is difficult to say whether, as a result, there is going to be a substantial improvement in the own resources of Panchayats. The fear is that their dependence on the financial grants from the State Governments is likely to persist, at least in the near future.

The recommendations of SFC is going to make a qualitative change in the nature of grants to the local bodies. At present, grants received by the Panchayats are of three kinds: (i) non plan grants to cover the committed expenditure, (ii) plan grants which are tied to various schemes drawn up by from above and (iii) untied funds which could be used for locally perceived needs by the Panchayats. The last mentioned grant has been relatively very small. The major recommendation of the SFC is to reverse the existing position by giving untied grant a position of pre-eminence.

For the purpose of devolution, SFC proposed to divide the total district plan fund (which is 53 per cent of total plan expenditure of the State government in 1995-96) into grants and entitlements. It should be kept in mind that entitlement is not an addition to the devolution of funds. It is a method adopted by the SFC for the devolution of a part of plan funds at the district level. In order to ensure a stable flow of fund below the district level, the Commission has recommended that 16 percent of the net proceeds of own tax revenue of the State Government should go as entitlement to the districts and within the district to each unit of the three tiers of the Panchayats. It is untied in nature. SFC also suggested that State should ensure sufficient provisions of funds to meet special needs of some areas of districts. In this case, full freedom is given to the States regarding the devolution of funds for special needs. Regarding the non-pan grants, the amount of funds to be devolved is not specifically mentioned. Commission notes that "....(b)esides plan grants, the district receive larger amounts of non-plan grants to cover committed expenditure."

Entitlement to the districts is to be assessed on the basis of two criteria: (i) population and (ii) the index of backwardness, giving equal weight to both criteria. As can be seen from the Table 4.1, for identifying the degree of backwardness, five indicators have been selected, namely, area of the district, degree of literacy, proportion of backward population, proportion of rural population and inverse ratio of per-capita bank deposit. The additive model (weighted average) of total allocation for each district is represented as:

$$Ii = 0.5\ D1i + 0.1\ (D2i + D3i + D4i + D5i + D6i)$$

for which $i = 1,2,3,\ldots\ldots, n$ (no: of districts). The weight given to each indicators is presented in the table 4.1.

Table 4.1: Criteria for Vertical Sharing of Entitlements in West Bengal

Indicators	Weight
i.Population of the district (D1i)	50 %
ii. Index of backwardness(A+B+C+D+E)	
A.Backward population of the district (D2i)	10 %
B.Area of the district (D3i)	10 %
C.Rural population of the district (D4i)	10 %
D.Illiteracy level of district (D5i)	10 %
E.Inverse ratio of per-capita bank deposit (D6i)	10 %

The devolution of entitlement at the district level to the three tiers of PRIs, namely, Zila Parishad, Panchayat Samiti and Gram Panchayat has been recommended in the ratio of 30:20:50. In addition to the 30 per cent entitlement, Zilla Parishads will also be responsible for utilisation of the District Special Areas Fund. The horizontal sharing of entitlement among Panchayat samities and Gram Panchayats is to be based on the uniform indicators given in Table 4.2.

Table 4.2: Criteria for Horizontal Sharing of Entitlements in West Bengal

Indicators		Weight
(i)	Percentage of population of GP / PS to total population of all the GP/PS of the district.	50
(ii)	Percentage of number of non-literate of GP / PS to total population of all the GP/PS of the district.	25
(iii)	Percentage of SC\ST population of GP / PS to total population of all the GP / PS of the district.	25

The total entitlement on the basis of 1995-96 budget estimates which is 16 per cent of the net proceeds of own tax revenues of the State would be Rs 598 crores, an amount which SFC considered "....(a)dequate to make an impact on decentralised development planning to start with." The point to be noted here is that along with entitlement, entertainment tax and urban land tax and multi-storied building tax are also suggested by the SFC to transfer to the local bodies. The budgetary estimates of these two taxes collected by the State for the year 1995-96 is Rs. 52 crores and Rs. 1.8 crores respectively. If we add the proceeds from these two taxes with entitlement, total tax transfers worked out to be Rs. 651.8 crores. Even if we include the proceeds from these two taxes along with entitlement, effective transfer as a percentage of different components of State revenue do not improve substantially.

Table 4.3: Entitlement to Local Bodies as a percentage of different Components of revenue receipts of State government for the year 1995-96

	Excluding the proceeds from entertainment tax & Urban land tax	Including the proceeds from entertainment tax and Urban land tax
Entitlement as a percentage of total devolution	51.12	53.27
Entitlement as a percentage of own tax receipts	16.00	16.30
Entitlement as a percentage of tax receipts	9.94	10.83
Entitlement as a percentage of non tax revenue	32.50	35.42
Entitlement as a percentage of grants	41.50	45.23
Entitlement as a percentage of total revenue	7.61	8.30

Source: SFC Report of West Bengal, Finances of State Government, RBI Bulletin 1995-96

As can be seen from the Table 4.3, including the proceeds from the taxes recommended to be devolved, tax transfers would increase from 16 per cent to 18.11 per cent of States own tax revenue, 9.94 per cent to 10.83 per cent of the tax revenue, 32.50 per cent to 35.42 per cent of the non-tax revenue, 41.50 per cent to 45.23 per cent of grants received by State government and 7.61 per cent to 8.30 per cent of the total revenue receipts of the State. Entitlement as a percentage of total plan funds to be devolved is 51.12 per cent.

In other words, 51.12 per cent of the plan fund is untied in nature.

The entitlement ratio which is the proportion of the total plan fund assigned to each districts and within it each unit of three tiers of Panchayats will vary from year to year in money terms. But the entitlement ratio will remain fixed till the next SFCs' recommendations. While it is certainly an improvement that West Bengal SFC has refrained from recommending entitlement in absolute terms, however large it may be to start with, the question does arise whether even the fixed entitlement ratio would not operate as a limiting factor as decentralisation of planning proceeds. There could be a shortage of funds in relation to the development needs of the Panchayats as they get involved more and more in local developmental planning. In that case plan funds allotted to the Panchayats on the basis of the fixed entitlement ratio may not be sufficient to cover the needs of plan expenditure. SFC itself speaks of increasing plan decentralisation in future. Instead, the SFC could have perhaps thought of the Panchayats' entitlement ratio increasing every year, with some incentive built-in for increased involvement in local development along with resource mobilisation.

As far the optimistic hope of SFC that there could be increase in the devolution of plan funds with increasing decentralisation, doubt also arises because of the contingency that the resources position of the State government may not improve in real terms at least. For the year 1995-96, 53 per cent of the plan funds earmarked for the district plan sector would be 25 per.cent of the State's own tax revenue. In the Commissions words, "....(O)n the basis of the current estimates of the State Tax Revenue Base (Rs. 3600 crores), a flow of 25 per cent to the district plan sector would protect the current level of decentralisation, while keeping the State liability at the current level." Most importantly, will it meet the resource requirement of the Panchayat plans?

There is no doubt that with the adoption of specific devolution criteria arbitrariness in devolution would be considerably reduced. It guarantees a non-discretionary assured grant for each Panchayat body that could be spent according to the priorities set by themselves, even though the dependence of local bodies on grants would continue.

An important point that West Bengal SFC makes is that any scheme of devolution of resources from the State level to local bodies should be from the pool of State's own taxes instead of individual tax based sharing, since growth of individual taxes vary considerably from year to year. SFC also suggested that till the Centre and the States formulate a system of revenue sharing to local bodies from the national kitty, West Bengal should go ahead in a limited way to share its own resources with local bodies. It also felt that a qualitative change can be effected without imposing additional burden on the State budget.

Apart from this, there will be significant changes in the planning process at the district level. Earlier, the District Plans consisted mostly of departmental schemes drawn up by the departments, may be with the participation of lower tier officials of the departments, but independently of the elected bodies. The role of the three-tiers Panchayats in the District Plan largely consisted of utilisation of funds provided to them for poverty alleviation programmes or as untied funds. The so called integration of planning at the District level was more a formality. The new entitlement scheme recommended by SFC would provide the elected bodies with considerable funds to pursue their own priorities through the plans they can draw up. The flexibility of the local plan is thereby dramatically increased.

Section 2

Karnataka

When the State of Karnataka was formed in 1956, each of its five integrating regions had its own pattern of local self government. Through the Act of 1959, uniform pattern of local self government was introduced throughout the State, with directly elected bodies at the village and taluk level and indirectly elected Panchayats at the district level. Of the three bodies, Taluk Boards were the most important enjoying a variety of regulatory functions. A large number of development responsibilities were assigned to Taluk Board such as construction and maintenance of school buildings, minor irrigation works, drinking water schemes and promotion of agriculture. They were also responsible for the community development programme. The District Development Council was only a coordinating body. The area of the operation of Village Panchayats at the other end of the spectrum was confined to certain civic duties. This system, as in the whole of India, became virtually non-functional by mid-seventies.

Through an enactment of 1983, a new Panchayati Raj system was introduced. This Act was a landmark in the history of local government in the country and made Karnataka a model State for decentralisation. It provided for a two-tier Panchayat structure of Zilla Parishads at the district level and Mandal Panchayats at the village level. The Zilla Parishad was made responsible for planning and implementation of all the development programmes in the district. The Mandal Panchayats in contrast were to be primary implementing agencies. The Zilla Parishad, by virtue of their status and powers, were to be truly district level governments. Their range of functions were spread over almost all the development sectors except power, major and medium irrigation and industry, State highways etc. which involve inter district variations. Mandal Panchayats, on the other hand, were responsible for the provision of local amneties and implementation of anti-poverty programmes. The evaluation studies have shown improvement in the primary education, health care and housing programmes under the new decentralised administration system of Karnataka.

The smooth development of the Panchayat system was disrupted by the change of government in 1990. In 1992, the elected local bodies were superseded. A new legislation was passed in 1993, the new Act providing for a three-tier structure-Grama, Taluk and Zilla Panchayats. The list of functions that entrusted to the Panchayat Raj bodies are fairly impressive. But as compared to the 1983 Act, the new law has strengthened the control of the State government and its bureaucracy over the local bodies. Evidently, the commitment of the State Government to devolve powers and functions seems to have waned when compared to the mid-eighties and paradoxically, that too, inspite of 73rd and 74th Amendment to the Constitution.

An important aspect of the Panchayat Raj system in Karnataka has been the importance attached to decentralised planning from as early as 1968, when the District Plans were prepared. A weakness of the early exercise was that it was more of a departmental bureaucratic exercise. Still, it represented a serious attempt to demarcate between State and District Plans and schemes. District Plans were drawn up, within their financial allocation, with the help of the District Planning Committee and District Development Council. Initially, a lumpsum allocation was made for every district. Soon, however, the detailed sectoral allocation came to be indicated from above so that district level planning responsibility was limited to selection of schemes within sectors. With the implementation of 1983 Act, the planning process became more democratic. The Karnataka SFC, reviewing the situation felt that it was too early to make a realistic assessment of the effectiveness of the decentralised planning process under the new setup introduced in the 1993 Act. However, the grants-in-aid to the Grama Panchayats which is of around Rs one lakh each, is too small to make any significant impact on local level planning. As for the Taluk and Zilla Panchayat, narrow sectoral outlays fixed from above continues to be a serious handicap. They are also burdened with the commitment with respect to spill over projects.

As in most other Indian States, the local bodies in Karnataka have only very limited avenues for raising resources of their own. Even under the 1983 Act, the Zilla Panchayats did not enjoy any power of taxation. The Mandal Panchayats, on the other hand, had certain limited taxation powers with respect to property tax and vehicle tax. To meet the administrative expenses of the local bodies, a per-capita grant of Rs 10 per annum was given by State governments of which three-fourth was the allocation for the Mandal Panchayats. Under the Act of 1993, the higher two tiers do not enjoy taxation powers. Grama Panchayats have been assigned house tax, vacant land tax, animal drawn vehicle tax, tax on shandies, pilgrims etc. Taking the average of 1987-88 to 1991-92, tax revenue of Mandal Panchayats constituted 36.41 per cent and non-tax revenue 14.03 per cent of their total income. During this period, 43.44 per cent of the income came as grants from the State government including JRY grants (Aziz, 1993). In contrast, almost entire income of the Zilla Panchayats was from Government grants. On the expenditure side, nearly 30 per cent of the expenditure of Mandal Panchayats, was on various civic amneties and 32 per cent on public works. Interestingly, while the share of civic amneties steadily declined from 40 per cent to 20 per cent that of public works increased from 18 per cent to 32 per cent between 1987-88 and 1990-91. The total expenditure of Mandal Panchayats increased by 38.79 per cent during the same period (Aziz, 1993).

As for the expenditure of Zilla Panchayats, more than half of their expenditure is on various plan schemes. But as SFC notes, there is lack of consistency over time in the increase in the Plan and Non-plan expenditure of these bodies. According to SFC "the allocation of Plan and Non-plan funds to different Zilla Panchayats / Panchayats in successive years has not been guided by any objective formula or principles but by precedence and divergent political pressures" (SFC, 1996).

In the majority of Zilla Panchayats, primary education was the largest claimant on their expenditure followed by welfare of SC\STs, rural employment and primary health. Nearly 40 per cent of the expenditure of Zilla Panchayats was by Centrally sponsored schemes and as observed by SFC, this share had tended to rise over time.

The most important recommendation of Karnataka SFC has been to allot to PRIs a consolidated share in the total non-loan gross own revenue receipts of the State government. This allotment may be used to meet both Plan and Non-plan expenditure requirements of the local bodies. Currently, total grants received by the local bodies constituted 34.27 per cent of the non-loan gross own revenue receipts of the State government. SFC recommended it to be raised to 36 per cent of which 85 per cent would go to PRIs and 15 per cent to urban local bodies. The share of PRIs is to be distributed among the three tiers of PRIs, namely, Zilla Panchayats, Taluk Panchayats and Grama Panchayats in the ratio of 40:35:25 respectively. As regards intra-tier distribution, five criteria has to be used, with weightage as indicated in the Table 4.4.

Table 4.4: Criteria for Devolution in Karnataka

Indicators	Weight
I. Population	33.33 %
II. Area	33.33 %
III. Index of Backwardness	33.33 %
a.Illiteracy rate	11.11 %
b. Length of roads	11.11 %
c. Hospital bed strength\population	11.11 %

The total devolution to urban and rural local bodies in 1996-97 accordingly be Rs 2675 crores of which PRIs' share would work out to be Rs 2274 crores, excluding Tenth Finance Commission grants. It also recommended that Rs one lakh grant to Grama Panchayat under Section 206 of Karnataka Panchayat Raj Act, 1993 may be continued as an additionality.

The Commission also recommends that the earmarking of around Rs 283 crores per annum from the total fund devolved to local bodies for the upgradation of certain essential public services to the normative levels as prescribed by the Commission. The supply of safe drinking water, street lights, roads, primary education and primary health are essential services for which the funds are to be earmarked (SFC, Karnataka, paragraph 3.31 and 7.1 in page 63 and 197 respectively).

Similarly, grants to local bodies, as per Tenth Finance Commissions' recommendation, is to be earmarked for reconstruction, improvement and repairs of specified assets such as school, health-care centres and veterinary hospital buildings etc. and then for repairing roads and bridges. The Panchayats would have to make a Matching grant towards such non-plan maintenance grants.

To sum up, the first point to be noted is that the SFC recommendations would not result in any step up in the devolution of total funds to the local bodies. The recommended share of non-loan gross own revenue receipts of the State Government is only marginally higher than the present grant receipts of the local bodies. However, the major change the SFC recommendation makes is in terms of its buoyancy and certainty. The recommendation guarantees that the local bodies would continue to share the benefit of aggregate buoyancy of State revenue. Equally important, the arbitrariness in the inter Panchayat allocation has also been put to an end with the transparent norms recommended by the SFC for inter local body distribution of funds. However, a major limitation of the recommendation is that the system of narrow earmarking of Plan funds would continue to persist. The untied allocation for the Panchayats for plan schemes of their choice is only 10 per cent of the total district plan outlay. Further, the recommendation of SFC do not envisage any higher taxation powers to the local bodies. To this extent, their financial self reliance will continue to be limited.

Section 3

Kerala

In the course of a detailed analysis of the State of local finance in Kerala over last three decades (in the previous chapter), it was noted that the share of grants and tax transfers from the State government to the total receipts of the Panchayats fluctuated between 30 to 40 per cent. Though the fiscal autonomy ratio of Panchayats in Kerala marked around 50 per cent, the recent declining trend in this ratio reflects the need for the increase in State transfers. In this context, recommendations of SFC assumes added importance.

The broad approach of the Kerala SFC has been to distinguish between (a) traditional functions and responsibilities of local bodies and (b) additional developmental responsibilities that have been assigned to them under the new enactments that were passed in pursuance of the two Constitutional Amendments. SFC has taken the position that while the traditional functions may continued to be financed by the traditional grants, tax shares and own resources of the local bodies, there is need for further deployment of plan and non-plan funds from the State and Central governments to finance the later. It does recognise that even with respect to the traditional functions and responsibilities, their traditional avenues of finance were hardly adequate. Therefore, the Commission makes a number of suggestions for the improvement of traditional grants-in-aid from the State Government. As for the development functions and responsibilities, it is recognised that most of them relate to development of new assets and maintenance of old assets that will be transferred to the local bodies. The Commission does not go into the issue of either decentralisation of planning or even plan financing. It does however discuss the principles that should govern the horizontal distribution of plan funds between the local bodies while leaving the decision as to the quantum of plan devolution to the planning authorities at the State level. On the other hand, it has undertaken a fairly detailed analysis of the objective financial requirements for maintenance of roads, buildings and other assets that are transferred to the local bodies and requirement for higher per unit maintenance grants.

The plan funds available to the local bodies heretofore came mainly from two sources: (i) Centrally sponsored schemes, (ii) Untied plan Funds from 1990 onwards. Apart from this, local bodies get grants from the departmental plan schemes of State Governments. Centrally sponsored schemes consisted of various poverty alleviation programme which were given to the PRIs for implementation. The SFC, however, preferred not to go into this component because "its quantum and purposes for which it can be used are exogenously determined." Untied plan funds available to the local bodies from 1990 onwards were not large enough to make a significant impact on the planning process. In 1996-97, however, there was a substantial increase in the quantum of untied funds to Rs. 212 crores. SFC suggested that this amount can be distributed in the following manner to the various local bodies:

Village Panchayats	Rs 10 lakh each
Block Panchayats	Rs 10 lakh each
District Panchayats	Rs 2 crores each
Municipalities	Rs 1 crore each
Corporations	Rs 5 crores each

The untied funds scheme was initiated in 1990 as a useful device to impart a measure of freedom to local bodies in the context of centralised planning that then existed. The situation is different now. SFC notes that the new PRI legislation in the State envisages a process of planning from below involving Village, Block and District Panchayat to prepare annual development plans for their respective areas. In addition to the annual plans, three tiers of

Panchayats are also required to prepare a master-plan for a prescribed period which should be submitted to the District Planning Committee (DPC) through the district Panchayat. Urban local bodies are also empowered to formulate development plans which also has to be passed on to the DPC. After receiving the district plans, State Development plan would be formulated which would take into consideration the various aspects of plan financing. Once such a process of planning from below becomes a reality, it will no more be necessary to provide untied funds " to be used for a purpose not contemplated in the PRI legislation", and "the untied funds should taper off and become a part of grants being given for approved plan".

Plan Grants

Regarding the principle of devolution, SFC argues that to develop an appropriate criteria of devolution, one has to consider the composition of functional responsibilities of local bodies. But the transfer of functional responsibilities to the local bodies is far from complete as yet. While as noted above, the Commission has chosen not to make a prior recommendation regarding the portion of State Plan that could, or should, devolve on the local bodies it has suggested the criteria for the distribution of plan funds between the local bodies. The criteria for distribution is based on the indicators given in Table 4.5.

Table 4.5: Criteria for the Distribution of [illegible]-Plan Funds

Indicator	For Urban LB	For Rural LB
1. Population in 1991 Census	75 %	70 %
2. Population of SC\ST in 1991 Census	10 %	10 %
3. Total Workers excluding MPSOH	15 %	10 %
4. Proportion of agricultural workers among workers	nil	10 %

Note:MPSOH= It represents employment in more organised sector of the economy ; i.e, employment in Manufacturing, Processing, Servicing and repairs Outside Household. Therefore, higher the percentage of workers excluding those in MPOH is an indicator of economic backwardness.

SFC has given a high weightage of 70 per cent to population (since it is a neutral index) which is higher than the weightage given to population in the Gadgil formula for plan assistance to States[4]. The ground offered is that inter-panchayat variations in the levels of socio-economic development are less than inter-state differences. SC/ST population, total workers excluding MPSOH and proportion of agricultural workers in working population are taken as the indicators of backwardness. Higher their proportion the greater is the state of economic backwardness. These three indicators are given 10 per cent weightage each in the rural areas.

Non-Plan Grants

Non-plan grants consist of statutory and non-statutory grants. Non-plan statutory grants refers to the tax transfers from the State government to the local bodies which includes the surcharge on stamp duty, basic (land) tax and a share of motor vehicle tax. Non-

[4] Under Gadgil formula, 60 per cent of Central Assistance is on the basis of population, 25 per cent on per capita income, 7.5 per cent on criteria of fiscal management and attainment of national objectives and 7.5 per cent on the basis of special problems.

plan non-statutory grants are given as specific or general purpose grants.

As regards the statutory non-plan grants, SFC makes no significant departure from the past[5]. However, SFC has recommended that non-plan non-statutory grants may be given as a single general purpose grant, in lieu of the current non-plan statutory general purpose and specific grants, at one per cent of the State revenue. This one per cent of the State revenue may be distributed between urban and rural local bodies in proportion to their population. In computing the State revenue, the tax share of local bodies has to be excluded.

SFC has recommended for the creation of rural and urban pool of financial resources for the distribution of non-plan grants. As can be seen from the Table 4.6, pool of non-plan grants consist of non statutory general purpose grants (which is one per cent of State revenue); and statutory grants which include 25 percent and 100 percent of basic tax from Panchayats and Urban areas respectively and 25 percent of surcharge on stamp duty from rural and municipal council areas. For the year 1996-97, the estimated quantum of urban

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[5] As per the existing norms, 75 per cent of the surcharge on stamp duty on transfer of property is distributed directly among Panchayats in proportion to their population and 25 per cent is distributed among Panchayats as may be fixed by government. However, for municipal and corporation areas, the distribution would be on the basis of collection. With regard to the basic tax grant (another component of non-plan statutory grants), 75 per cent of the tax collected is given on the basis of collections and balance 25 per cent is for the distribution among gram Panchayat on the basis of area, population, available financial resources and the requirement of development.

and rural pools together is Rs. 3781 lakhs and Rs. 593 lakhs respectively.

Table 4.6: Non-Plan Grants for Distribution among Local Bodies (Rs.in Lakhs)

Rural Pool		Urban Pool	
i) 25 per cent of Basic Tax from Panchayats	303	100 per cent of Basic Tax from Urban Areas	75
ii) 25 per cent of surcharge on stamp duty	1010	25 per cent of surcharge on Stamp duty from MCA	238
iii) Consolidated general grant at 1 per cent of State revenues (Panchayat Share)	2468	Consolidated general grant at 1 per cent of State revenues (MCAs' Share)	280
Total	3781		593

Note:MCA=Municipal Council Area.
Source:SFC Report of Kerala (1996).

The criteria recommended by SFC for the distribution of non-plan grants of rural and urban pools are given in Table 4.7. The first two variables are self explanatory. Third variable, that is. 'financial need of local bodies' is based on the 1993-94 income of local bodies from all sources excluding the motor vehicle tax and loans because of the highly erratic nature of their flow to Panchayats. Tax effort of local bodies is given 5 per cent weightage. SFC suggested that tax effort may be judged by two indicators, viz, (i) percentage of collection to demand (ii) the rate at which property tax is being levied.

Table 4.7: Criteria for the Distribution of Non-Plan Funds

Criteria	Rural	Urban
1. Population in 1991 Census	75 %	80 %
2. Population of SC\STin 1991 census	5 %	5 %
3. Financial needs of Local bodies	15 %	10 %
4. Tax effort of Local bodies	5 %	5 %

The grants from the government to meet the expenses towards the discharge of traditional non-plan responsibilities has always been insufficient in past. However, the SFC notes that "a large step up from the current level will put a severe strain on States' revenues." Therefore it recommended only a moderate increase. Actual disbursement of general and specific non statutory grants worked out to be 0.33 per cent of State revenue during 1993-94 and 1994-95. 0.33 per cent is too low - still SFC has recommended it to one per cent is a major step-up.

SFC has recommended a separate provision of grants for maintenance of institutions and assets which will be transferred to the local bodies under the new Act. The recommendation of SFC is that the maintenance grant should be based on current cost of construction instead of the historical cost. The estimated cost is about Rs. 2750 per sq. metre for a UP/LP school and about Rs. 4200 per sq. metre for a dispensary or Primary Health Centre at 1995 prices. Two per cent of this should be the annual maintenance grant in respect of buildings like schools and three per cent for buildings like hospitals and dispensaries. Regarding roads, SFC recommends that all roads be made eligible for grants from Motor Vehicle Tax at the rate of 25 per cent of the net tax collection and it may be distributed among various local bodies.

SFC also made some recommendations for the improvement of the resource base of the local bodies. Major recommendations in this regard are the assignment of building tax exclusively to the village Panchayats and municipalities, earmarking of the income from the sale of court fee stamps, empowering district Panchayats to levy a tax on the sale price of all immovable properties within the district, and taxing the Cable TV operators thorough annual license fee as well as entertainment tax.

It is doubtful, if the recommendations of the SFC would have any major impact upon the state of local finance in Kerala. The quantum of the major source of new funds for local bodies, viz, the plan funds, have been left out of the purview of recommendation. Therefore a significant increase in funds for local bodies is contingent on the decision of the planning authorities. In fact, given the criteria suggested for the devolution of plan and non-plan funds as too complicated, State government has unified the formula for allocating the plan fund and non-plan funds between local bodies on the basis of population (90 per cent) and area (10 per cent). Besides, the non-plan non-statutory grant of 1 per cent of State revenue has also rejected by the State government.

Section 4

Approach, Recommendations and the Scheme of Devolution: A Critique

The primary task of SFC was to correct the vertical and horizontal imbalances between State and the local bodies. The above survey of the three SFC reports indicates that there are wide inter-state differences in the quantum of funds to be devolved and the criteria recommended for devolution. Thus, the proportion of State revenues that are recommended to be allocated to the local bodies would continue to vary significantly from State to State.

It should be recognised that the task of the SFCs is more difficult than that of the Central Finance Commission because SFCs have to take a view on the functions of local bodies which differ across the States and then recommend such sharing of resources as corresponds to their functions and responsibilities. SFCs' task is also much wider than Central Finance Commissions' because latter confines its recommendations with regard to the revenue sharing and that too to cover non-plan budgets whereas an SFC is expected to deal with the total finances of the local bodies starting from sharing of taxes, grant-in-aid, assignment of new tax and non-tax revenue and measures needed to improve the financial position of local bodies to meet their plan as well as non-plan commitments. The local bodies according to the Constitutional Amendments are charged with responsibilities in development plan also.

While the functions and responsibilities of the local bodies differ from State to State, and there is no uniformity in the pattern of devolution across the States, the recommendations of the SFCs would definitely increase the quantum of devolution and reduce arbitrariness. Table 4.8 gives a comparative picture of the devolution of funds recommended by the SFCs of different States. The point to be borne in mind is that Kerala SFC did not recommend the quantum of plan grants to be devolved to the local bodies. But it is mentioned in the SFC report that for the year 1996-97, amount of plan grants to be devolved from the State's annual plan is 26 per cent of the total plan outlay which is Rs 540 crores. Including non-plan statutory and non-statutory grants as recommended by the SFC, total quantum of devolution worked out to be Rs. 583.74 crores. As we have seen that in West Bengal total plan devolution was 53 per cent of the States' plan expenditure, in absolute terms, for the year 1995-96, it worked out to be Rs. 1169.71 crores of which Rs. 598 crores is entitlement. In Karnataka, 36 per cent of the non-loan gross own revenue, the devolution of funds recommended by the SFC, worked out to be Rs. 2245.85 crores. Thus, in absolute terms, Karataka ranks highest in terms of amount of funds to be devolved, followed by West Bengal and Kerala. As a percentage of different components of State revenue also, the share of devolution is much higher in Karnataka than West Bengal and Kerala. In fact, the share of funds to be devolved in West Bengal is also substantially higher than that of Kerala. It is evident from the comparative analysis of three SFC reports that quantum of devolution differs largely across the States in absolute as well as in relative terms.

Table 4.8: Comparison of Quantum of devolution between West Bengal, Karnataka and Kerala

	West Bengal	Karnataka	Kerala
Year	1995-96	1995-96	1996-97
Share of State funds to be devolved	53 per cent of the total plan plan expenditure of the State	36 per cent of the non loan gross own revenue of the State	1. 26 per cent of the plan outlay 2.*25 and 100 per cent basic tax from Panchayats & Urban areas 3.*25 per cent of stamp duty for Panchayats and Municipal areas 4.#Consolidated generl grants of 1 per cent of State revenue
Entitlement	Rs. 598 Cr.	———	———
Plan Grants	Rs. 571 Cr.	———	Rs. 540 Cr.
Non-Plan Grants	———	———	Rs. 43.74 Cr.
1. Statutory	———	———	Rs. 16.26 Cr.
2. Non Statutory	———	———	Rs. 24.96 Cr.
Total Devolution (entitlement+plan grants+non plan)	Rs.1169.71 Cr.	Rs.2245.85 Cr.	Rs. 583.74 Cr.
Total Devolution as a percentage of own tax revenue	29.26 per cent	43.90 per cent	16.64 per cent
Total Devolution as a percentage of non tax revenue	63.57 per cent	96.62 per cent	194.11 per cent
Total Devolution as a percentage of own revenue	26.60 per cent	36.00 per cent	15.33 per cent
Total Devolution as a percentage of grants	81.17 per cent	186.85 per cent	78.39 per cent
Total Devolution as a percentage of total State revenue	14.89 per cent	25.29 per cent	10.14 per cent

Note:1.'*' indicates non-plan statutory grants, '#' indicates non-plan non-statutory grants.

2.Entitlement is the 16 per cent of the net proceeds of State taxes which worked out to be 598 crores for the year 1995-96 out of the total devolution of plan fund of 1169.71 crores.

Source: SFC Report of West Bengal, Karnataka and Kerala, Finances of State Government (RBI Bulletin) and Tenth Finance Commission Report (1995)

All the three SFCs reviewed by us have taken the position that it is not meaningful to divide plan and non-plan funds in watertight compartments and both have to be considered in totality. However, while Karnataka and West Bengal SFC have recommended, grants which would also contribute a major way to financing the plans of the local bodies, the SFC of Kerala has confined the principles of inter-PRI distribution of plan funds without going into the quantum of plan funds to be devolved.

The SFC of West Bengal and Karnataka are almost similar in approach. Both the SFCs have opted primarily for a pool of total own State revenue to be shared with the local bodies than tax specific transfer of resources like Kerala. West Bengal SFC has also suggested that entertainment tax, which is presently collected by the State government, should be transferred to the local bodies. Also, it has recommended that urban land tax and multi-storied building tax should be handed over to Calcutta Municipal Corporation and later on it should be extended to other Urban local bodies and irrigation rates, presently collected by the State government, should be handed over to the Zilla Parishad. The 16 per cent of the total net proceeds of the taxes collected by the State Government recommended for transfer to the local bodies as entitlement will be in addition to the recommended tax transfers. Karnataka SFC has proposed that 36 per cent of total non-loan gross own revenue receipts of the State government should be shared with the local bodies. As a percentage of the States own tax revenue this would work out to be 43.90 per cent.

The devolution of resources from the gross pool of taxes / revenue has certain advantages. Firstly, in case of specific tax base sharing, the quantum of devolution depends on the buoyancy of the sharable tax. But, if the sharing is from the pool of taxes / revenue, local bodies will have the benefit of the aggregate buoyancy of State taxes / revenue. Secondly, over the years the composition of the State tax /revenue may change. If the system of sharing is tax-specific, then the quantum of devolution will decline if the share of the shareable of tax in the total revenue declines. In case of pooling of taxes / revenues, the changing composition of revenue would not hamper the quantum of devolution.

The devolution of tax revenue from the Centre to the States has so far been precisely tax specific. Shareable taxes were income tax and excise duty. It has been argued that Central tax buoyancy with respect to these two shareable taxes was much lower than that of non-sharable taxes like corporation tax and customs duty. The argument in favour of the existing arrangement is that a government is entitled to the full benefit of its tax-effort. The argument against this arrangement is that it is precisely this arrangement that the Centre concentrates its effort on non-sharable taxes. The pooling arrangement recommended by the Tenth Finance Commission will ensure that since the transfers to the States are made from the gross tax collection, tax effort will not affect adversely the sharable taxes.

Since Kerala SFC has confined itself to financing of only non-plan expenditure, its scope was far more restricted than West Bengal and Karnataka counterparts. However, even Kerala SFC has recognised the merit of pooling of total State revenues for purposes of vertical sharing where it recommends one per cent of the State revenue to be given to local bodies as non-plan non-statutory grants. At the same time it has to be recognised that in Kerala there is already considerably larger financial devolution in the form of either tax-specific sharing or tax-specific assignment or even assignment of taxing powers.

The principles by which the funds for fiscal transfers are distributed between the urban and rural areas, is also likely to vary across States. Karnataka has gone to the extent of appointing a separate SFC for urban local bodies, the report of which we have not been able to examine for the present study. In Kerala, corporations are exempted from pooling any share from their resource allocation. Generally, the urban bodies enjoy higher own resources and the three SFCs do not suggest any measure to bring the rural local bodies at par with the urban local bodies in terms of the resource strength.

Regarding the criteria of horizontal revenue sharing among the local bodies, population is the predominant criteria of devolution with 70 per cent weightage in Kerala, 50 per cent in West Bengal 33.33 per cent in Karnataka. Relatively lower weightage to population is justified by Karnataka SFC on the ground that in a situation of declining decadal growth of population in several districts, higher weightage to it may reduce their share of plan funds. Instead of giving too much weight to population, they have given equal weight to population and area, as large areas impose additional expenditure for providing the same level of public services.

It is true that population criteria has an advantage of providing summary measure of the basic needs free from value judgement and arbitrariness, unlike other indicators. But heavy reliance on too broad a measure of need like population could be inconsistent with promoting fiscal equalisation or balanced development of regions within the State. While commenting on the approach of the Central Finance Commission, Gulati (1987) pointed out that population as a basis of distribution ignores altogether the existence of income disparities among the States. As an alternative to that, he argued that distribution of resources on the basis of per-capita income would be much more even and equalising. This argument holds good at the local level also. But, the major problem in working out the distribution criteria on the basis of per-capita income at the local level is the non-availability of data on per-capita income below the district level. Still it is quite likely that local bodies under the jurisdiction of a particular district with higher per-capita income would be economically better off than the local bodies under the jurisdiction of a district with lower per-capita income. In that case district level per-capita income could be used as a proxy variable of per-capita income at the local level. Significantly higher weightage to population by all the SFCs, instead of per-capita income may increase the inter-Panchayat disparities. Secondly, devolution on the basis of population may be regressive in the sense that it does not necessarily have the desired redistributive effects, since some relatively developed local bodies could be more populous.

Per capita income criteria apart, all three SFCs have considered applying other indices of socio-economic backwardness for the horizontal distribution of resources. In Kerala and West Bengal, the share of SC/ST population is used as an indicator of backwardness. Share of agricultural workers and the share of unorganised workers in total work force are other two indicators of backwardness used by Kerala SFC. Area, rural population, illiteracy and inverse ratio of per-capita bank deposits are indicators of backwardness used by West Bengal SFC. Karnataka SFC used illiteracy rate, length of roads and hospital bed strength per population as the indicators of backwardness.

While selecting the criterion of backwardness, one has to be very careful so that it does not suffer from arbitrariness and excessive value judgement. The index of backwardness should reflect more expenditure need of a backward Panchayat than that of a relatively developed Panchayat. Indices like share of SC/ST population, share of agricultural labourer in total work force and share of unorganised worker in total work force can certainly be considered to reflect the need for funds for social and economic uplift but not necessarily of expenditure priorities of a local body, unless these priorities are built into the financial allocation. The question also arises whether objective indicators of economic and social infrastructure could not also be used for assessing the backwardness of a local body.

Unlike Kerala and West Bengal, Karnataka SFC has taken two social indicators, namely, the primary education and primary health and one economic indicator, namely, road infrastructure as the index of backwardness giving weightage of 11.11 per cent to each. But the major criticism against the use of social indicators as an index of backwardness is that it will be biased against the regions, which despite poor resource base, have achieved relatively high levels of attainment in these sectors.

CHAPTER V

SUMMARY AND CONCLUSIONS

In the mainstream economic literature, the improvement in allocative efficiency of public goods has been the raison d'etre for fiscal decentralisation. The argument in favour of greater allocative efficiency of fiscal decentralisation ranges from Oates' categorisation of public goods by spatial characteristics to Tiebouts' hypothesis that individuals move to those jurisdictions which best reflect their preference leading to Pareto optimal solution.

Allocative efficiency considerations apart, political considerations have also given a powerful impetus for decentralisation in many countries in recent years. In the introductory chapter, we noted that in the large federations, there has been a growing demand for greater autonomy of the provinces, which in turn generated demand for greater local autonomy. Empirical evidence also shows that countries that have given more fiscal powers to the sub-national governments are generally having large population, land area and a more heterogeneous mix of population.

In India, the issues of decentralisation of functional and financial powers from the State to local bodies have come to the force since the 73rd and 74th Constitutional Amendments. Historically, the Indian system of governance has been described to be only quasi-federal in nature, in the sense that, even the States do not enjoy the autonomy, that is normally associated with a federal system. The position of the local bodies vis-a-vis the

State governments was much worse. They enjoyed hardly any autonomy with regard to the very limited powers and functions given to them.

After the 73rd and 74th Amendments have been enacted, it has dramatically restructured State-local relations. Local bodies in India have now been provided constitutional guarantee regarding the tenure, structure, periodical elections, powers and finance. It is in this changed background, that the present study has tried to examine the issues related to fiscal decentralisation in an international and intra-national comparative perspective. For international comparison, we selected Australia and Canada, two of the largest federations; UK, a large unitary State that has a special significance to Indian system and finally, India. Within India, we have examined the fiscal decentralisation experience of three selected States, namely, Kerala, Karnataka and West Bengal with special emphasis on Kerala.

The international experience of fiscal decentralisation of selected countries shows certain commonalities among the developed countries. To begin with, local governments play quite a significant role in providing not only social and community services but also and even for other regulatory functions like law and order. The ratio of local government expenditure to the total government expenditure, which is an index of the significance of local government in the economy shows that this index is relatively higher in UK and Canada at 37 and 30 per cent respectively, while it is only around 10 per cent in Australia and 6 per cent in India. At the same time, the share of current expenditure in total local government expenditure is both high and increasing. The share of current expenditure in total local government expenditure is around 80 per cent in UK; 90 per cent in Canada and 70 per cent in Australia. This situation can be explained by the nature of expenditure responsibilities assigned to the local government. Among the different categories of social service expenditure, the share of expenditure on education is relatively high in Canada and UK. In India also, among the different categories of expenditures of local government, the share of expenditure on education is the highest (28 per cent). The possible explanation for this position in India may be due to the greater availability of function-specific grants for education.

On the revenue side, the local governments have comparatively limited own tax sources in almost all countries and they mainly depend on the immovable tax base, viz, property taxes. The theoretical justification behind the property taxes being universally assigned to the local bodies is on the basis of 'congruence principle', which postulates that " less mobile the tax base, and the stronger the spatial concentration of the tax base and ownership, the lower the level of government to which those taxes should be assigned" (NIPFP, 1995). The limited access of local bodies to own tax sources is based perhaps on the need to avoid multiplicity of taxes at different layers of government coupled with the tendency on the part of higher government to centralise the potential and buoyant sources of revenue in its hands, leaving inelastic and immobile tax bases for the local governments. This pattern of division of taxing powers resulted in significant vertical fiscal imbalances between the different tiers of the government, necessitating large transfer of resources from above to the lower levels of government.

The fiscal autonomy ratio, i.e, the ratio of own revenue to local government expenditure is 71 per cent in Australia and 51 percent in Canada. In UK and India, the ratio is around 42 percent. In India, there are distinct rural urban differences in terms of fiscal autonomy. While the ratio is 11 per cent for the rural local bodies, it is 81 per cent for urban local bodies.

On the basis of a detailed case study of the State-local fiscal relations with respect to PRIs in Kerala, it is observed that during the last three decades even though the real expenditure of the Panchayats of Kerala has increased, its share in total State expenditure stagnated at around 3 per cent. The PRIs in Kerala enjoy a higher fiscal autonomy of around 50 per cent as against the all India average of around 11 per cent. Among their own resources, the building tax has shown the best performance in terms of buoyancy. Though the present system suffers from underassessment and undervaluation, property tax constitutes a highly lucrative source of revenue of rural local bodies. The construction boom in Kerala due to the inflow of NRI deposits and the frequent upward revision of the rental value of buildings may have been the contributory factors.

Entertainment tax as a share of own tax revenue of the Panchayats of Kerala has declined from 28.05 per cent in 1980-81 to 13.54 per cent in 1993-94. Its rate of growth during this period (9.45 per cent) was much lower than that of the own tax revenue growth (16.3

per cent). However, in comparison with the collection of entertainment tax by different State governments, the growth in revenue from entertainment tax in Kerala was better. In Karnataka and West Bengal, the growth rate of entertainment tax revenue was only 8.73 and 5.98 per cent respectively during the same period. The all-state average rate of growth of entertainment tax for the whole country was even lower at 4.67 per cent. This shows that the local bodies in Kerala cannot be faulted for the inadequate exploitation of the full potential of entertainment tax.

Generally, local taxes are insensitive to the economic fluctuations of prices and income. This causes financial strains for local governments since their expenditure is particularly sensitive to inflation. In Kerala, however, local taxes, especially local property taxes have proved to be dynamic. They have shown high response to the variations in economic activity. The double log regression analysis attempted by us shows that local taxes are buoyant and productive. The estimated nominal income elasticity of local taxes in Kerala is more than unity, i.e, 1.204.

The analysis of resource transfers from the State government to the panchayats in Kerala showed that there was no coherent system of grants-in-aid in Kerala. The annual allocations of grants to the rural local bodies was characterised by wide fluctuations . If the objective of the fiscal transfers is to bring about fiscal equalisation through compensating for lower per-capita own revenue of the rural local bodies through grants, there should be an inverse relation between per-capita grants and per-capita own revenue. But our inter-district Panchayat analysis showed that there was no systematic inverse relationship between per-capita own revenue and per-capita grant.

Our analysis of expenditure pattern of PRIs shows that there has been a relatively higher increase in the local government expenditure on establishment charges rather than on education, water supply, health and other social sector heads. Establishment charges as a percentage of own revenue of PRIs increased from 46.43 per cent in 1980-81 to 61.65 per cent in 1993-94. The surplus syndrome in the local government budget was a legal fiction created by the requirement which obliges local authorities to keep 5 per cent of their revenue as surplus to meet their contingent liabilities.

In the post-Constitutional Amendment scenario, local bodies would require larger revenue to carry out the additional responsibilities handed over to them as per 11th schedule of 73rd and 74th Amendments. Despite the greater fiscal autonomy enjoyed by PRIs in Kerala in the past, higher fiscal transfers from the State government would become necessary. In this context, the requirement under the Constitutional Amendments for the appointment of State Finance Commission (SFC) becomes very relevant. The SFC is supposed to review the financial position of the local bodies and make recommendations regarding the devolution of resources to the local bodies in the new context.

A comparative review of SFC reports of the State of West Bengal, Karnataka and Kerala did reveal certain significant pointers as to the future of fiscal devolution in India. At the same time, the differences in the approach adopted and recommendations made, by the three SFCs indicate that the regional diversity in the fiscal decentralisation in India will continue to persist.

To start with, the total quantum of funds recommended for devolution for the year 1995-96, in West Bengal and Karnataka, it worked out to be Rs. 1169.71 crores and Rs. 2245.85 crores respectively. For the year 1996-97, total devolution in Kerala, in absolute terms, worked out to be Rs. 583.74 Crores. Total devolution as a percentage of own tax revenue was 29.26 per cent in West Bengal and 43.90 per cent in Karnataka in 1995-96 and only 16.64 per cent in Kerala in 1996-97.

Out of total devolution recommended by West Bengal SFC, 16 percent of the net proceeds of own tax revenue of the State would go as entitlement transfer to local bodies. Karnataka SFC has recommended total transfer to be 36 per cent of the total own (tax plus non-tax) revenue receipts of the State. In the case of Kerala, the SFC recommendations as regards the non plan funds is unlikely to bring about any significant additionality and therefore much would depend upon the devolution of plan funds, the quantum having been left indeterminate by the SFC.

West Bengal SFC has also assigned some new taxes to the local bodies to improve their own resource position. These taxes are entertainment tax, urban land tax and multi-storied building tax (exclusively for Calcutta Municipal Corporation to start with). In addition, irrigation rates are to be transferred to Zilla Parishads. If we include the proceeds from the entertainment tax and urban land tax of the State government for the year 1995-96, effective transfer of own tax revenue to the local bodies worked out to be more than 18 per cent (inclusive of transfers towards entitlement at the ratio of 16 per cent) in West Bengal.

There is a discernable preference towards the local bodies' sharing from the pool of State revenue rather than from individual tax revenues. This is so in West Bengal and Karnataka. Even in Kerala, which has persisted with the tradition of individual tax sharing, one of the key recommendation of SFC is to create urban and rural pools with regard to the non-plan grants for the distribution to local bodies. Financial devolution from a pool of State resources instead of tax specific share ensures the sharing by the local bodies of the buoyancy of the total own revenues of the State.

All the three SFCs have formulated a criteria for devolution of funds from State to the local bodies, taking variables like population, area and indices of socio-economic backwardness, though the weightage differs across the States. Population has got relatively more weightage in the devolution of both plan and non-plan funds. Weightage recommended for population is 70 per cent in Kerala, 50 per cent in West Bengal 33.33 per cent in Karnataka. Even though population is a neutral index free from arbitrariness and value judgement, dependence on too broad a measure of need like population may fail to promote fiscal equalisation because it ignores altogether the existence of income disparities among the Panchayats. Instead of population, district level per-capita income could have been used as a proxy variable to take care of inter-Panchayat income disparities to a certain extent.

The broad conclusion our study reaches is that local bodies in India have enjoyed very limited functional and financial autonomy compared to other countries like Australia, Canada and UK. Functions of local bodies in India, especially those of PRIs, were restricted to certain civic services without much developmental role. Also, since there were no Constitutional safeguards, local bodies had been under complete uncertainty regarding the devolution of funds from the higher level of governments. Increasing centralisation of tax powers had made the local bodies virtually non-functional. But the 73rd and 74th Constitutional Amendments have given the local bodies the status of local self government. Mandatory appointment of SFC after five years would also help in improving the financial position of local bodies. The principled fiscal devolution recommended by the SFCs would contribute to the elimination of the adhocism and arbitrariness that had, by and large characterised Indian local finance so far. Increasing financial autonomy with appropriate developmental function would enable local self government to play an effective role in local level development according to the local needs.

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