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6

Local Government Organization and Finance: ***Rural India***

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As in many other federations, rural local governments in India are supposedly responsible for rendering essential services, including sanitation, drinking water supply, street lighting, and rural roads. They are also empowered to collect certain tax and nontax revenues. In most cases, however, a considerable gap between own resources and requirements can easily be seen. The gap is more noticeable for rural local governments than for their urban counterparts because of their narrower resource base. Hence, rural local governments largely depend on financial support from their state governments.

Evolution of Rural Local Government

The rural local government in India is called the *panchayat*, which literally means an assembly of five persons. These five elderly, nominated persons, over the course of time, were vested with sacred authority and with judicial and executive powers. These village communities were the centers of administration and the custodians of social harmony. Sir Charles Metcalfe, provisional governor general of India from 1835 to 1836, described them as follows:

> The village communities are little republics, having nearly everything they can want within themselves, and almost independent of any foreign relations. They seem to last where nothing else lasts. Dynasty after dynasty tumbles down; revolution succeeds to revolution; . . . but the village community remains the same. . . . This union of the village communities, each one forming a separate little state in itself, has, I conceive, contributed more than any other cause to the preservation of the peoples of India, through all the revolutions and changes which they have suffered, and is in a high degree conducive to their happiness, and to the enjoyment of a great portion of freedom and independence. (Mookerji 1958, p. 2)

Subsequently, Sir George Birdwood echoed that same expression:

> India has undergone more religious and political revolutions than any other country in the world; but the village communities remain in full municipal vigor all over the peninsula. Scythian, Greek, Saracen, Afghan, Mongol, and Maratha have come down from its mountains, and Portuguese, Dutch, English, French, and Dane up out of its seas, and set up their successive dominations in the land; but the religious trades-union villages have remained as little affected by their coming and going as a rock by the rising and falling of the tide. (Mookerji 1958, p. 2)

Evidence suggests that self-governing village communities have always existed in India. Their roots can be traced in the *Rig Veda*[1] as dating back to approximately 1200 BC.

However, the panchayats in ancient India were different in character than the notion advanced in the West:

> In ancient India the king was head of the state, but not of the society. He had a place in the social hierarchy, but it was not the highest place. As a symbol of the state, he appeared to the people like a remote abstraction with no direct touch with their daily life, which was governed by the social organization. (Mookerji 1958, p. 4)

With the advent of British rule, attention shifted from rural to urban local bodies. During the struggle for freedom, Mahatma Gandhi stressed the need for *village swaraj* (independent republic): "My idea of village swaraj is that it is a complete republic, independent of its neighbors for its own vital wants, and yet interdependent for many others in which dependence is a necessity" (Gandhi 1962, p. 31).

Gandhi's vision of village swaraj has had perhaps the most enduring influence on the subsequent debates and discussions on panchayats. In the immediate postindependence period, during the debates on the drafting of India's constitution, sharply discrepant views of panchayats were expressed. In the Constituent Assembly on November 4, 1948, Dr. B. R. Ambedkar, chairman of the Drafting Committee, called village community "a sink of localism, a den of ignorance, narrow-mindedness, and communalism" (Malaviya 1956, p. 97). Panchayats did not find a place in the first draft of India's constitution. At the insistence of Mahatma Gandhi, a compromise was arrived at, and panchayats were included only in the nonjusticiable part of the constitution, under Directive Principles of State Policy, which reads, "The state shall take steps to organize village panchayats and endow them with such powers and authority as may be necessary to enable them to function as units of self-government." Without any reference to panchayats, the term *local government* also crept into item five of the State List in the constitution. These provisions are, at best, only discretionary.

In the early 1950s, Gandhi's village swaraj was kept on the back burner in the overall development plan, which was deeply committed to industrialization, economic growth, and income redistribution (Kohli 1987, p. 62). In the late 1950s, community development projects failed to evoke people's participation. On this issue, a study team headed by Balwantray Mehta recommended that "public participation in community work should be organized through statutory representative bodies" (Government of India, Committee on Plan Projects 1957, p. 23).

A panchayat structure at the district and block levels was also envisioned at this time. On October 2, 1959, India's first prime minister (Pandit Jawaharlal Nehru) inaugurated independent India's first panchayati raj institution (PRI) at Nagaur in Rajasthan. By the mid-1960s, PRIs began to be established in all parts of India. Ironically, with the passage of time, PRIs were marginalized and weakened. The Asoka Mehta Committee was appointed in 1977 to study the weaknesses of PRIs. The committee recognized the district as the administrative unit in the PRI structure. At the same time, it blamed resistant bureaucracy, lack of political will, and elite capture for undermining earlier attempts to establish PRIs. Another major attempt to regenerate PRIs was made with the appointment of the L. M. Singhvi Committee in 1986. The committee recommended that PRIs should be enshrined in the constitution. In 1989, Prime Minister Rajiv Gandhi proposed to assign constitutional status to PRIs and introduced the 64th Constitutional Amendment Bill. This bill was opposed, because it was viewed as an instrument for the union (central) government to deal directly with PRIs and bypass the state governments. The bill was passed in the Lok Sabha (lower house of parliament) but failed in the Rajya Sabha (upper house of parliament) by two votes on October 15, 1989.

Over time, consensus in favor of PRIs grew among all political parties. The National Front government that came into power for a short period introduced a bill for PRIs on September 7, 1990. Finally, the Congress government, which came back to power, introduced a constitutional amendment bill for PRIs in September 1991. After debate and discussion, it became the Constitution (73rd Amendment) Act 1992 (the CAA) on April 24, 1993.

The Legal Framework

With the passage of the CAA, PRIs were recognized in the statute book as institutions of self-government.[2] Under the CAA, it became mandatory for each state to enact conformity acts and make the following provisions:

- The establishment of three-tier PRIs with elected members at village, intermediate, and district levels. The intermediate rung need not be constituted in states with a population under 2 million.
- Direct elections to all seats in PRIs at all levels.
- One-third of seats reserved for women and marginalized communities—scheduled castes (SCs) and scheduled tribes (STs)—in all PRIs, according to the population. This provision also applies to the office of chairperson.
- A uniform five-year term in all PRIs, with elections held within six months in cases of premature dissolution.
- Constitution of a State Election Commission to supervise and organize free and fair elections to PRIs at all levels.
- Setting up of a State Finance Commission at a regular interval of five years to review and revise the financial position of PRIs.
- Establishment of district planning committees.
- Establishment of a *Gram Sabha* (village assembly) in each village, to exercise such powers and perform such functions at the village level as the state may provide by law.

The state is also expected to transfer 29 functions listed in the 11th Schedule, which was appended to the constitution (box 6.1). The state is also required to devolve concomitant powers and authority to PRIs to carry out the responsibilities conferred on them. The legislature of a state may authorize the PRIs to levy, collect, and appropriate certain duties and fees and may assign to them the revenues of certain state-level taxes, subject to such conditions as are imposed by the state government. Further, grants in aid may also be provided to these bodies. As a result of the CAA, the number of PRIs stands at 248,968, of which 242,328 are village panchayats, 6,097 are intermediate panchayats, and 543 are district panchayats (table 6.1).

BOX 6.1 Classification of Functions Listed in the 11th Schedule

Core functions

- Drinking water
- Roads, culverts, bridges, ferries, waterways, and other means of communication
- Rural electrification, including distribution of electricity
- Health and sanitation, including hospitals, primary health centers, and dispensaries
- Maintenance of community assets

Welfare functions

- Rural housing
- Nonconventional energy sources
- Poverty alleviation program
- Education, including primary and secondary schools
- Technical training and vocational education
- Adult and informal education
- Libraries
- Cultural activities
- Family welfare
- Woman and child development
- Social welfare, including welfare of the handicapped and mentally retarded
- Welfare of the weaker sections, and in particular, of the SCs and STs
- Public distribution system

Agriculture and allied functions

- Agriculture, including agricultural extension
- Land improvement, implementation of land reforms, land consolidation, and soil conservation
- Minor irrigation, water management, and watershed development
- Animal husbandry, dairying, and poultry
- Fisheries
- Social forestry and farm forestry
- Minor forest produce
- Fuel and fodder
- Markets and fairs

Industries

- Small-scale industries, including food processing industries
- Khadi, village, and cottage industries.

Note: The 11th National Finance Commission gave these classifications to the functions enumerated in the 11th Schedule.

TABLE 6.1 Number of Rural Governments by State and Union Territory, April 1, 2005

State or union territory	Panchayats by tier: Village[a]	Intermediate[b]	District[c]	Total	Average rural population per village panchayat
State					
Andhra Pradesh	21,913	1,095	22	23,030	2,663
Arunachal Pradesh	1,747	150	15	1,912	527
Assam	2,489	203	20	2,712	9,911
Bihar	8,471	531	38	9,040	9,654
Chhattisgarh	9,139	146	16	9,301	1,959
Goa	190	0	2	192	3,537
Gujarat	13,819	225	25	14,069	2,447
Haryana	6,034	114	19	6,167	2,687
Himachal Pradesh	3,037	75	12	3,124	1,915
Jammu and Kashmir	2,683	0	0	2,683	8,593
Jharkhand	3,746	211	22	3,979	2,256
Karnataka	5,659	175	27	5,861	6,456
Kerala	991	152	14	1,157	24,714
Madhya Pradesh	22,029	313	45	22,387	2,167
Maharashtra	28,553	349	33	28,935	2,067
Manipur	166	0	4	170	10,284
Meghalaya[d]	5,629	0	3	5,632	366
Mizoram[d]	737	0	3	740	654
Nagaland[d]	1,286	0	0	1,286	1,556
Orissa	6,234	314	30	6,578	5,289
Punjab	12,445	140	17	12,602	1,356
Rajasthan	9,189	237	32	9,458	5,187
Sikkim	159	0	4	163	3,357
Tamil Nadu	12,618	385	29	13,032	2,711
Tripura	537	23	4	564	5,198
Uttar Pradesh	52,028	813	71	52,912	2,757
Uttaranchal	7,227	95	13	7,335	924
West Bengal	3,360	333	18	3,711	18,290
Union territory					
Andaman and Nicobar Islands	67	7	1	75	3,807
Chandigarh	17	1	1	19	6,172
Dadra and Nagar Haveli	11	0	1	12	17,355
Daman and Diu	10	0	1	11	12,848
National Capital Territory of Delhi[e]	0	0	0	0	—

(*continued*)

TABLE 6.1 (*continued*)

State or union territory	Panchayats by tier: Village[a]	Intermediate[b]	District[c]	Total	Average rural population per village panchayat
Lakshadweep	10	0	1	11	3,939
Pondicherry	98	10	0	108	3,477
All India	242,328	6,097	543	248,968	3,278

Source: Figure for number of PRIs from Government of India 2006. Ministry of Panchayati Raj and average rural population for 2005 projected from Census of India 2001.
Note: — = not available.
a. In almost all states, it is known as the *gram panchayat*.
b. The name of the intermediate rung differs from one state to another. It is known as Mandal Parishad in Andhra Pradesh, Anchal Samiti in Arunachal Pradesh, Anchalic Panchayat in Assam, Janpad Panchayat in Chhattisgarh and Madhya Pradesh, Taluka Panchayat in Gujarat, Taluk Panchayat in Karnataka, Panchayat Union in Tamil Nadu, Kshetra Panchayat in Uttar Pradesh and Uttaranchal, and Panchayat Samiti in many states, including Bihar, Haryana, Himachal Pradesh, Jharkhand, Maharashtra, Orissa, Punjab, and Rajasthan.
c. It is also known as Zilla Panchayat/Parishad in many states.
d. Figures from Government of India (2000) for traditional village and district councils that exist in these states; however, figure for Nagaland is from Government of India (2004d).
e. PRI has yet to be revived.

The addition of these democratic institutions has broadened the Indian federal system. The PRIs are seen as the third tier of government. They have also made India the most representative democracy in the world. Today, about 2.2 million representatives stand elected to the three levels of PRIs. More than 40 percent are women, and 27 percent belong to SCs and STs. At the village panchayat level, each elected person's constituency comprises about 340 people or 70 families (Government of India 2006).

Functional Domain

Article 243G of the constitution empowers PRIs to function as institutions of self-government for the purposes of preparing plans and implementing schemes for economic development and social justice in their respective areas for various subjects, including the 29 functions listed in the 11th Schedule. However, the list is merely illustrative and indicative. Unlike the division of powers and functions enumerated in the Union List and State List, no clear demarcation exists between the state and PRIs. It is for the state legislature to make laws regarding the devolution of powers and functions to the PRIs.

Almost all states and union territories claim that they have transferred functions in varying degrees to the PRIs, by enacting laws in conformity with the CAA. However, the functional domain of PRIs pertains only to traditional civic functions in several states. Functional domain is without adequate developmental responsibilities in those states where either the intermediate panchayats or the district panchayats were absent for decades. States where PRIs have existed for a long time have repeated the provisions of the old statutes in their new laws with only marginal adjustments. Moreover, many state governments have not framed relevant rules or guidelines as a follow-up measure. A few states realized that the transfer of additional functions requires the transfer of concomitant funds and functionaries to PRIs, enabling them to perform the specified responsibilities. However, PRIs are not very clear about the role they are expected to play in the new federal setup. Almost all of the 29 subjects enumerated in the 11th Schedule are state concurrent, involving duplication and overlapping.

Another challenge before the state government has been the allocation of activities to the appropriate tier of the PRI system. Traditionally, the lowest-level panchayat—the village panchayat—has been the most active in almost all states. Generally, the village panchayats carry out major functions, including core functions, whereas intermediate and district panchayats in most states are "allotted supervisory functions or act mainly as executing agents for the state government" (Jha 2004, p. 3). A task force of the Union Ministry of Rural Development on devolution of powers and functions to PRIs has developed an activity-mapping model on the principle of subsidiarity, which states that any activity that can be undertaken at a lower level must be undertaken at that level in preference to being undertaken at any higher level.[3]

The status of activity mapping can be seen in table 6.2. In most states, the functions devolved to PRIs are subjects rather than activities or subactivities. Only "some states like Andhra Pradesh, Kerala, Gujarat, and Madhya Pradesh have broken the 29 subjects into activities and subactivities" (Oommen 2004, p. 7). In Kerala, complementary legislation has even been issued to change the roles of key line agencies (World Bank 2004).

It is a general perception that PRIs are financially and technically underequipped to perform even the core functions, much less the welfare functions and other economic functions related to agriculture and industries (see box 6.1). Hence, many of the core functions that traditionally belonged to PRIs—drinking water, rural roads, street lighting, sanitation, primary health, and so forth—have not been transferred fully in some states; they are being performed by the line departments of the state government or the parallel parastatals. As a result, the per capita total expenditure of PRIs remains abysmally low in most states (table 6.3).[4]

TABLE 6.2 Current Progress on Activity Mapping

State	Number of subjects transferred through legislation	Number of subjects undertaken for activity mapping	Comments
Andhra Pradesh	17	9	Activity mapping not completed
Assam	29	29	Activity mapping not completed
Bihar	25	0	Consultation process under way
Chhattisgarh	29	7	Activity mapping completed for 7 subjects
Goa	6	18	Activity mapping not completed
Gujarat	15	14	Activity mapping completed for 5 subjects
Haryana	—	—	Draft prepared
Himachal Pradesh	26	—	Consultation process under way
Karnataka	29	29	Activity mapping completed and funds devolved for 26 subjects
Kerala	26	26	Activity mapping completed and funds devolved for 26 subjects
Madhya Pradesh	23	7	Activity mapping not completed
Maharashtra	18	—	Activity mapping not completed
Manipur	22	22	Activity mapping completed for 22 subjects
Orissa	25	7	Activity mapping not completed
Punjab	7	—	Activity mapping not completed
Rajasthan	29	18	Activity mapping not completed
Uttar Pradesh	12	—	Activity mapping not completed
Uttaranchal	14	14	Activity mapping not completed for 9 subjects, executive orders issued for 3
West Bengal	29	—	Activity mapping completed

Source: Government of India 2006.
Note: — = not available in the given source.

Own-Source Taxes

The power of PRIs to impose taxes was considered imperative to enshrine in the constitution under article 243H, to impart certainty, continuity, and strength to PRIs. The union minister of state for rural development, while moving the Constitution (73rd Amendment) Bill in parliament, argued "that unless the panchayats are provided with adequate financial strength, it will be impossible for them to grow in stature" (Oommen 2004, p. 1). Devolution of taxes to PRIs can easily be linked with the activities assigned to them, which

TABLE 6.3 Per Capita Expenditure in PRIs (All Tiers)

State	Per capita (Rs)			Annual growth of total expenditure 1998–2003 (%)
	1990/91	2000/01	2002/03	
Andhra Pradesh	205.7	792.9	898.4	11.9
Assam	1.1	3.2	3.2	2.2
Bihar	18.2	4	37.7	17.3
Chhattisgarh	—	360.8	353.6	11.3
Goa	30.1	198.2	418.9	31
Gujarat	399.4	1,293.5	782.7	–1.6
Haryana	54.7	142.1	241.1	26.7
Himachal Pradesh	8.6	41.2	59.2	12.7
Jammu and Kashmir	0.0	750	851.2	9.6
Karnataka	402.6	1,296.2	1,147.2	5.9
Kerala	46.1	644.9	742.5	0.5
Madhya Pradesh	44.5	113.9	103.5	2
Maharashtra	298.4	685.8	821.2	11.1
Manipur	7.0	25.5	37	21.9
Meghalaya	81.6	51.6	25.5	4.4
Orissa	65.0	37	56.8	25.4
Punjab	70.0	85	108.3	9.7
Rajasthan	218.9	361.6	382.3	5.7
Sikkim	0.0	78.6	74.2	17.7
Tamil Nadu	59.7	164.7	152.8	7.6
Tripura	5.3	186.1	252.9	5.2
Uttar Pradesh	40.9	46.9	43.3	5.1
Uttaranchal	—	49.3	45.9	–2.1
West Bengal	24.5	107.0	29.7	5.5
All (24 states)	148.0	324.0	327.8	6.9

Source: Government of India 2000, 2004d; Census of India 1991, 2001.
Note: — = not available. In the absence of consistent data for the relevant years, the growth rate of Bihar, Kerala, Orissa, and Uttaranchal pertains to a shorter duration than indicated.

vary from state to state. From the long list of the 11th Schedule, certain basic functions could be said to be in the exclusive domain of PRIs. Even these essential services require huge funds. To this end, the devolution of taxes to the three tiers of the PRIs needs to be linked to the activity mapping for the devolution of functions and functionaries (Government of India 2004e).

Table 6.4 shows that a variety of taxes have been devolved to different levels of PRIs. The relative importance of these taxes varies from state to state. The intermediate and district panchayats are endowed with powers to collect very few taxes, whereas village panchayats are given substantial taxing powers. In a

TABLE 6.4 Revenue Power of Rural Governments in States at Each Tier

Tax or fee	Andhra Pradesh	Assam	Bihar	Gujarat	Haryana	Himachal Pradesh	Karna-taka	Kerala	Madhya Pradesh	Maha-rashtra	Orissa	Punjab	Rajas-than	Tamil Nadu	Uttar Pradesh	West Bengal
House or property tax	V	V	V	V	V	V	V	V	V	V		V	V	V		V
Surcharge on house or property tax								V		D						
Tax on agriculture land for specific purpose	V															
Cess on land revenue or surcharge	V, I	I		V		V		V	V						V	
Surcharge on additional stamp duty	V	V			I	V	V		I	D				V		V
Tax on professions, trades, calling, etc.		V, I	V,D	D		V	V		V	V		V			D	
Octroi				V						V			V			
Entertainment tax		V	D	V			V	V	I			V			V	V
Pilgrim tax or fees		V		V			V			V			V			
Tax on advertisements	V						V	V								
Education cess				I								I	I			
Tolls	V	I,D	I,D	V										V	D	V,D
Tax on sale of firewood and slaughter houses		V									V					
Tax on goods sold in a market, *haat*, fair, etc.			I,D		I	V					V					
Tax on shops and services		V			V	V										

(*continued*)

TABLE 6.4 Revenue Power of Rural Governments in States at Each Tie (*continued*)

Tax or fee	Andhra Pradesh	Assam	Bihar	Gujarat	Haryana	Himachal Pradesh	Karna-taka	Kerala	Madhya Pradesh	Maha-rashtra	Orissa	Punjab	Rajas-than	Tamil Nadu	Uttar Pradesh	West Bengal
Vehicle tax	V	V		V			V		V	V	V		V		V	
Animal tax				V					V	V	V				V	
Conservancy rate	V	V	V	V				V	V		V	V			V	V
Lighting rate	V	V ,D	V, I,D	V		V		V	V	V	V	V	I		V, I,D	V, I,D
Water rate	V	V, D	V, I,D	V	V, I	V	V	V		V, I,D	V	V, I	V, D		V, I,D	V, I,D
Drainage rate	V			V				V			V				V	V
Special tax for community civic services or works					V	V		V	V			V	V, I			
Surcharge on any tax imposed by village panchayat	I			I, D									I			I

Source: Panchayati raj acts of various states; Oommen 2004; Singh, Mishra, and Pratap 1997.
Note: V = village panchayat, I = intermediate panchayat, D = district panchayat. More than one sign indicates the concurrent power of PRIs for the respective tax.

number of cases, under the tax rental arrangement, the village panchayats collect taxes and pass them on to the higher level of panchayats (Jha 2004). Property tax, cess on land revenue, surcharge on additional stamp duty, tolls, tax on professions, tax on advertisements, nonmotor vehicle tax, octroi, user charges, and the like contribute the maximum to the small kitty of own-source revenue, which contributes only 6 to 7 percent of the total expenditure of PRIs (tables 6.5, 6.6, and 6.7). In most states, the property tax contributes the maximum revenue. However, this tax remains inelastic because of inefficient administration in its collection. Its assessment is based on the annual rental value of taxation and its associated evil: underdeclaration of rentals. However, some progressive states have reformed the tax structure and use the unit area method in determining the tax base.

After own-source revenues, assigned revenues are the most efficient in the dispensation to PRIs. Such revenues are levied and collected by the state

TABLE 6.5 Own-Source Revenue of PRIs, All Tiers

State	Rs million			Annual growth of 1998–2003 (%)
	1990/91	2000/01	2002/03	
Andhra Pradesh	627.0	1,516.5	1,708.5	7.6
Assam	30.1	73.2	76.1	2.0
Bihar	—	77.1	66.7	4.2
Chhattisgarh	—	573.9	578.7	2.0
Goa	10.5	76.5	80.1	2.2
Gujarat	274.5	759.2	698.6	–3.1
Haryana	293.9	701.4	783.6	9.3
Himachal Pradesh	0.2	33.5	53.9	30.2
Karnataka	173.3	668.3	594.6	2.0
Kerala	313.2	2,196.6	2,260.1	3.9
Madhya Pradesh	119.4	1,420.9	1,748.1	8.3
Maharashtra	342.1	3,279.8	4,700.7	18.1
Orissa	59.0	90.6	55.1	–9.6
Punjab	215.6	806.7	987.7	5.7
Rajasthan	242.8	368.9	376.8	3.6
Tamil Nadu	157.2	572.0	654.4	5.2
Tripura	0.1	4.9	6.0	6.8
Uttar Pradesh	227.5	588.3	631.7	7.5
Uttaranchal	—	48.7	61.0	4.9
West Bengal	142.3	325.3	312.7	2.8
All (20 states)	3,228.7	14,182.3	16,435.1	8.0

Source: Government of India 2000, 2004d.
Note: — = data not available in the given source.

TABLE 6.6 Per Capita Own-Source Revenue of PRIs, All Tiers

	Per capita (Rs)		
State	1990/91	2000/01	2002/03
Andhra Pradesh	12.9	27.4	30.0
Assam	1.5	3.2	3.2
Bihar	—	1.0	0.9
Chhattisgarh	—	34.5	33.5
Goa	15.2	113.1	118.8
Gujarat	10.1	23.9	21.3
Haryana	23.7	46.7	50.2
Himachal Pradesh	0.0	6.1	9.5
Karnataka	5.6	19.2	16.7
Kerala	14.6	93.2	94.1
Madhya Pradesh	2.3	32.0	38.0
Maharashtra	7.1	58.8	81.9
Orissa	2.2	2.9	1.7
Punjab	15.1	50.1	59.9
Rajasthan	7.2	8.5	8.3
Tamil Nadu	4.3	16.4	18.9
Tripura	0.1	1.8	2.2
Uttar Pradesh	2.1	4.5	4.6
Uttaranchal	—	7.7	9.4
West Bengal	2.9	5.6	5.2
All (20 states)	5.3	20.1	22.6

Source: Government of India 2000, 2004d; Census of India, 1991, 2001.
Note: — = data not available.

TABLE 6.7 Contribution of Own-Source Revenue in Total Expenditure of PRIs, All Tiers

Revenue	1990/91	2000/01	2001/02	2002/03
Own-source revenue (%)	4.5	5.9	6.0	6.8
Others[a] (%)	87.9	90.7	87.9	92.1

Source: Government of India 2000, 2004d.
a. *Others* includes devolution and grants.

government and are passed on to PRIs for their use. Some states deduct collection charges. The practices in assigning revenue are marked by large interstate variation. However, typical examples of assigned revenue are the surcharge on stamp duty, cess or additional tax on land revenue, tax on professions, and entertainment tax. In many states, these taxes form part of the own-source revenue of PRIs.

Borrowing

No reference is made in the CAA to loans and borrowing by PRIs. Although urban local governments, with the approval of their state governments, have floated bonds in the market, PRIs are not empowered to raise loans from either public or private sources (Jha 2000; Oommen 1995; Rajaraman 2003).

Intergovernmental Fiscal Transfers

Proceeds from internal sources contribute an abysmal share to the panchayat pool. PRIs rely more on fiscal transfers from the state government in the form of shared taxes and grants (tables 6.7 and 6.8). State taxes are shared according to the recommendations of the State Finance Commission (SFC). Constitution of the SFC at a regular interval of five years is a mandatory requirement for states.[5] Besides tax sharing, the SFC is assigned the task of reviewing the financial position of PRIs and making recommendations on the assignment of various taxes, duties, tolls, fees, and grants in aid to be given to PRIs from the consolidated fund of the state.

The most critical function of the SFCs is to determine the fiscal transfer from the state to local bodies in the form of revenue sharing and grants in aid. Since the 80th amendment of the constitution, following the recommendation of the 10th Finance Commission (1995–2000), a certain percentage of all union taxes has been devolved to the states. Many SFCs have also adopted this system for the following reasons: First, the system has a self-policy feature; the local government automatically shares in the buoyancy of state taxes and levies. Second, the system has built-in transparency, objectivity, and certainty; local governments can anticipate, at the beginning of each fiscal year, their share in the divisible pool. Third, the system enables local governments to understand the entire economy and take considered views to exercise their own annual budgets. In other words, it induces local governments to generate their own revenue and to mobilize additional resources. Fourth, the state government can be neutral in pursuing tax reforms without considering whether a particular tax is sharable with local governments.

This leads to the issue related to composition of the divisible pool. Table 6.9 reveals wide variations across states in defining the divisible pool and the principle of sharing it among the PRIs and urban local bodies. The SFCs of Andhra Pradesh, Assam, and Goa have included the share of union

TABLE 6.8 Significance of PRIs' Own-Source Revenue

Year	Share of own-source revenue (%)			Own revenue of PRIs (Rs million)
	Union government	State governments	PRIs	
1990/91	63.42	33.21	0.36	3,251
1995/96	61.03	35.14	0.31	5,680
1998/99	59.65	37.01	0.48	11,610
1999/2000	60.63	36.30	0.47	13,345
2000/01	59.87	37.05	0.45	14,182
2001/02	57.61	39.26	0.44	14,328
2002/03	59.11	38.43	0.45	16,435

Source: Government of India 2000, 2004d, 2005.
Note: Percentages are worked out by adjusting the own-source revenue of local governments in the total tax revenue (all India).

taxes in the state tax and nontax revenues to form the divisible pool. However, the first SFCs of Kerala, Madhya Pradesh, and Sikkim and the second SFCs of Orissa and Uttaranchal have not included the share of union taxes and have suggested including only the state tax and nontax revenues. The SFCs of Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal, as well as the second SFC of Kerala and Punjab, have gone a step further, recommending that only the tax revenues of the state form the divisible pool. The Karnataka SFCs have adopted a different mechanism by using the phrase "nonloan gross own revenue receipts" in defining the divisible pool. Table 6.9 highlights only those states where SFCs have recommended the concept of global sharing for transfer of state revenues.

The SFCs of other states have recommended sharing only specific taxes or have awarded a fixed amount to local governments. The first SFC of Punjab, for instance, recommended transferring 20 percent of the net proceeds of five taxes to the local bodies—namely, stamp duty, motor vehicle tax, electricity duty, entertainment tax, and entertainment tax on cinematography. Significant interstate variations can be noted in the mechanisms of revenue sharing because different SFCs made different sets of recommendations.

National Finance Commission

So that the SFC does not deter the state legislatures in transferring responsibilities and revenue to the local governments, the CAA goes out of the way

TABLE 6.9 SFC Recommendations for Share in State Resources

State	Percentage of divisible pool	Share (%)		Criteria for *inter se* distribution among local bodies
		PRIs	Urban local bodies	
Total state revenue				
Andhra Pradesh (SFC I)	39.24	70.00	30.00	Population, backwardness index, poverty
Andhra Pradesh (SFC II)	10.39[a]	65.00	35.00	Population, area, poverty, revenue mobilization
Assam (SFC I)	2.00	75.00	25.00	Population
Goa (SFC I)	36.00	75.00	25.00	Population, geographic area, performance, backwardness
State own-source revenue				
Jammu and Kashmir (SFC I)	13.50	67.00	33.00	Not mentioned
Kerala (SFC I)	1.00	Not mentioned	Not mentioned	Population
Madhya Pradesh (SFC I)	11.579	25.13	74.87	Population, area, tax efforts
Orissa (SFC II)	10.00	80.00	20.00	Population, density, number of holdings, revenue efforts
Sikkim (SFC I)	1.00	100.00	0	No urban local bodies
Uttaranchal (SFC II)	10.00	60.00	40.00	Population, area, deprivation index, remoteness index, tax efforts
Nonloan gross own-source revenue				
Karnataka (SFC I)	36.00	85.00	15.00	Population, area, illiteracy, road length, persons per hospital bed
Karnataka (SFC II)	40.00	80.00	20.00	Population, area, illiteracy, SCs and STs, persons per hospital bed

(*continued*)

TABLE 6.9 SFC Recommendations for Share in State Resources (*continued*)

State	Percentage of divisible pool	Share (%)		Criteria for *inter se* distribution among local bodies
		PRIs	Urban local bodies	
State own taxes				
Kerala (SFC II)	3.50[b]	78.50	21.50	Population
Punjab (SFC II)	4.00	67.50	32.50	Population, per capita revenue, SCs
Rajasthan (SFC I)	2.18	77.30	22.70	Population, poverty
Rajasthan (SFC II)	2.25	76.60	23.40	Population, poverty, area, illiteracy
Tamil Nadu (SFC I)[c]	8.00	60.00	40.00	Population, SCs and STs, per capita own-source revenue, core services
Tamil Nadu (SFC II)	8.00	58.00	42.00	Population, SCs and STs, per capita own-source revenue, area, asset maintenance, resource gap
Uttaranchal (SFC I)	11.00	42.23	57.77	Population, distance from rail head
Uttar Pradesh (SFC I)	10.00	30.00	70.00	Population, area
Uttar Pradesh (SFC II)	12.50	40.00	60.00	Population, area
West Bengal (SFC I)	16.00	By district population	By district population	Population, SCs and STs, illiteracy, area, density
West Bengal (SFC II)	16.00	By district population	By district population	Population, density, SCs and STs, illiteracy, infant mortality rate, rural population, per capita income

Source: Alok 2004.

a. The second SFC of Andhra Pradesh recommended a 10.39 percent share as additional devolution over and above the existing annual devolution.

b. In addition, 5.5 percent of the divisible pool was recommended as grant-in-aid for maintenance of assets under the control of local bodies.

c. In Tamil Nadu the divisible pool called *pool B* consists of sales tax, motor vehicle tax, state excise revenue, and other state taxes. *Pool A* consists of levies that rightly belong to local bodies: surcharge on stamp duties, local cess and local cess surcharge, and entertainment tax. The entire proceeds of pool A taxes are recommended to be distributed to the local bodies.

to provide that the National Finance Commission should suggest measures to augment states' consolidated funds in light of the recommendations of SFCs. So far, three National Finance Commissions (the 10th, 11th, and 12th) have made their recommendations.[6] All these commissions were severely constrained for reasons emanating partly from the practice and partly from the design of the new fiscal arrangement: the lack of synchronization of the periods covered by the SFCs with those covered by the National Finance Commission; the absence of a timeframe for action by the state government on the recommendations of the SFC; a lack of clarity in assigning functions, finances, and functionaries to local governments; and heterogeneity in approach, content, and period covered by the various SFCs.

Nevertheless, all the commissions recommended ad hoc grants to PRIs. The 10th National Finance Commission made a provision for Rs 43.8 billion, at Rs 100 per capita, to be passed on to PRIs between 1996 and 2000.[7] In the absence of formal disbursement certificates by the state governments, the national government could release only Rs 35.7 billion. Further, the 11th National Finance Commission recommended a grant of Rs 100 billion for its award period, on the basis of a formula given in table 6.10. Certain institution-building activities such as maintenance of accounts, creation of databases, and audits were made the first charge of the fund. The intention of the grant was to induce the panchayats to act as institutions of self-government. The national government accepted the recommendations, with a caveat compelling PRIs to raise suitable matching resources.

The grant could not be fully utilized. Many state governments and PRIs raised this point during their interactions with the 12th National Finance Commission.[8] The commission had to emphasize the issue in its report: "The central government should not impose any condition other than those prescribed by us, for release or utilization of these grants" (Government of India 2004d, p. 262). In its recommendations, the commission attempted to adopt the equalization principle and allocated Rs 200 billion to improve service delivery by the panchayats primarily for water supply and sanitation. The grants of the National Finance Commission are generally ordained for operation and maintenance and therefore differ from those of the union ministries and the Planning Commission. Through this transfer, the commission intended for the PRIs to take over all of the central schemes related to drinking water, including Swajaldhra, which had not been operational because funds were not available for operation and maintenance.

TABLE 6.10 Criteria Adopted by National Finance Commissions for Distribution among Themselves of Grants to States for PRIs

	Weight assigned by	
Criteria	11th National Finance Commission	12th National Finance Commission
Population	40	40
Area	10	10
Distance	20	20
Decentralization index	20	Not adopted
Revenue efforts	10	20
Deprivation index	Not adopted	10

Source: Government of India 2000, 2004d.

Centrally Sponsored Schemes

The union government, through the state governments, provides a majority of panchayat finances in most states. These grant-based transfers from the Planning Commission or union ministries are made in the form of centrally sponsored schemes (CSSs).[9] These schemes are quite large in number. Many pertain to the 29 subjects being implemented by different ministries and departments of the union government. Table 6.11 reveals that 15 ministries and departments, which primarily deal with functions of the 11th Schedule, have been administering 151 schemes, involving Rs 325.19 billion, which predominantly deal with the functions of PRIs.

The viability of many schemes has been questioned time and again. The Task Force of Officials in Charge of Panchayati Raj in States has given the following summary of the shortcomings of the implementation of CSSs (Government of India 2004c, p. 3):

- Rigid conditionalities
- Inconsistent approach to institutional arrangements—CSSs could be panchayat friendly, panchayat parallel, panchayat ignorant, or panchayat unfriendly
- Obsession with financial presentations
- Inefficient and ineffective monitoring and evaluation of outcomes
- Administrative overload on departments leading to inefficiency in processing requests for funding and delayed financial releases
- Lack of transparency in financial releases.

TABLE 6.11 Schemes of the Union Ministries That Primarily Deal with the Functions of PRIs

Name of ministry or department	Number of schemes	Annual allocation (Rs million)
Rural development	6	113,224
Elementary education	9	57,375
Family welfare	49	49,297
Drinking water and rural sanitation	2	33,000
Women and child development	6	21,531
Agriculture	8	12,584
Land resources	4	10,330
Health	14	9,825
Welfare of scheduled castes, other backward castes, and minorities	9	5,816
Animal husbandry	18	3,870
Secondary and higher education	11	3,060
Adult education	4	2,375
Nonconventional energy sources	4	1,260
Tribal affairs	4	1,110
Indian systems of medicine and homeopathy	3	533
Total	**151**	**325,190**

Source: Government of India 2004c, p. 19.

It has been argued that CSSs should be converted to block transfers. The request of the prime minister, in his speech to all chief ministers on June 29, 2004, to "consider if we should adopt a system of providing block grants to districts based on their incidence of poverty to plan and implement strategies that optimize their resource potential" (Government of India 2004b, p. 8) can be seen in that perspective. A government task force (Government of India 2004c) has recommended converging the big schemes into seven block funds: antipoverty, water security, public health, education, family welfare and child development, housing, and rural connectivity.

In a landmark development on September 7, 2005, the government of India enacted the National Rural Employment Guarantee Act, to ensure employment of adult unskilled manual workers for a minimum of 100 days in a financial year. With the union and state governments, PRIs at all levels participate actively in the implementation of the act.

Fiscal Autonomy versus Dependency

Realization is growing that PRIs have an important role to play in deepening democracy by mainstreaming the poor into development. It is also being felt that PRIs can help mobilize resources by introducing local solutions and meeting people's basic requirements. However, the degree of success of panchayat raj as an institution of self-government essentially depends on the extent of administrative and financial devolution, coupled with the autonomy within the constitutional framework.

In many states PRIs are, to some extent, burdened with a historical legacy of subservience. For example, at the state level, under the existing budgetary procedures, significant control and discretion for making financial allocations to PRIs rests with the state government officials. Similar powers are vested in district-level officials. As a result, the funds are parked for a considerable period sequentially in the state treasury and then in the district treasury. This practice prevents PRIs from receiving their share of funds in amounts as well as on time. As a consequence, the quality of expenditure is adversely affected. Over time, a dependency syndrome is created.[10]

This example is consistent with one of the points taken for action in the chief ministers' conference:

> [P]anchayats are starved of finances in virtually all states. This has led to a situation where there has been a constitutionally mandated devolution of powers and responsibilities to the local bodies, but with no real means, financial or statutory, with which to implement the plethora of schemes and programmes devolved. This chicken and egg syndrome has led to panchayati raj and municipality administrations almost everywhere being discredited by mainline developmental administration, leaving elected members disillusioned and frustrated by their very powerlessness and impotence. (Government of India 2004a, p. 3)

In many cases, PRIs must seek permission from the local authorities to spend even the available funds. In some cases, they are not subject to any clearance up to a certain amount. For example, PRIs in Kerala and Madhya Pradesh can undertake a project worth up to Rs 100,000 and Rs 300,000, respectively, without any outside clearance (Jha 2004).

However, issues related to the fiscal autonomy of PRIs are subject to debate. It is argued that fiscal autonomy cannot be built into the regime of grants in aid. Tax assignments with clear taxing powers and tax sharing play a more significant role for self-rule and fiscal autonomy than untied funds, public contributions, and project-tied loans (Oommen 1999). Others assert that own-source revenues are not essential for panchayats in their efficient and effective operations. Fiscal transfers from higher level governments can serve this purpose, "so long as the panchayats have the autonomy to decide how the money gets spent" (Johnson 2003, p. 22).

In practice, devolution of taxation to PRIs poses many difficult political and administrative issues. Manor (1999) has argued, though in an international perspective, that higher-level governments are disinclined to devolve tax-raising powers to local governments, on the one hand, because of perceived apprehensions of power dwindling among central politicians; on the other hand, decentralized authorities are reluctant to impose taxes as it adversely affects their popularity. Lack of administrative capacities at the local level and reluctance on the part of local residents to pay taxes are other impediments to the mobilization of local revenue.

However, the 12th National Finance Commission, in its approach, attempted to strengthen the fiscal domain of local governments and advocated the financing of local public goods by the potential beneficiaries. At the same time, the commission discouraged the reluctance on the part of decentralized authorities to generate revenue: "The principle of equalization extended to the local bodies would mean that while lack of fiscal capacity, at the state level as well as the local level, can be made up, lack of revenue effort should not be made up" (Government of India 2004d, p. 26).

Issues and Lessons

India's experience with decentralization raises many issues of different dimensions. Some could be relevant for other developing countries. A few are listed below:

- *Integrated view and action*. Legislative, political, fiscal, and administrative dimensions of decentralization are interwoven and need to be addressed simultaneously. Reforms in one aspect of decentralization need to be accompanied by necessary changes in others. Legislative changes made 10 years ago were not coupled with suitable administrative and fiscal reforms. The administration has persisted in old habits and has been hesitant to devolve functions along with concomitant finances and functionaries. In a sequence, finance should follow function.
- *Ability to monitor and evaluate the system*. The legislative changes in the form of a central act need to be followed by conformity acts and implementation by various state governments through the creation of an enabling environment for local governments. The union government has to encourage the state governments, through an incentive or reward structure, to create this environment. This action is essential, as the statutory role of the union government is limited to seeing the fulfillment of the mandatory provisions of the constitution.[11]

- *Free and fair local elections*. Periodic elections to the PRIs by the State Election Commission provide responsiveness and accountability on broad social issues. However, identification of these issues necessitates providing quality information to the voter. The passage of the Right to Information Act helps the voter make informed choices. Forceful media already exist in India.
- *Autonomous institutions*. Elected representatives, autonomous SFCs, and other local institutions are the key to decentralized governance. These institutions need to be central and exogenous to the state government for their technical capacity enhancement and true autonomy.
- *Strong fiscal information system*. The system for designing, implementing, and evaluating decentralization policy, including intergovernmental fiscal policy, must be strong. The World Bank (2004, p. 43) commented on the inferior quality of published fiscal data on revenues and expenditures that were drawn in the reports of the national finance commissions and the SFCs: "This data is badly flawed and inflates the funds actually managed by panchayats considerably."[12]
- *Higher-level government as role model*. The higher-level government, particularly the union government, needs to abide by its own rules. Delaying the transfer of funds for PRIs to state governments, affixing strange and ambiguous conditionalities to the fiscal transfers, and consequently retaining unspent funds at the union level erode the foundation of decentralization.
- *Authority to identify local needs and preferences*. The PRIs must have a say in the design of the scheme or grant program. The CAA recognized the significance of identifying local needs and developing capabilities at the local level in the formulation of the PRI's own plan. The provision for a district planning committee was articulated as mandatory under article 243 ZD. Planning must be undertaken at all levels of PRIs; similarly, all urban bodies prepare their own plans. The consolidation of these sets of plans must be undertaken at the district planning committee. The consolidated district plan is then forwarded to the state government for integration into the state plan. Although district planning committees have been constituted in many states, such detailed grassroots planning is undertaken nowhere.

Of late, the concerted efforts of the Ministry of Panchayati Raj have galvanized people's participation to initiate the process of social and political churning to induce the institution of panchayati raj. Enactment of right to information and of rural employment guarantee in 2005 has further strengthened the PRIs, de jure. Also being contemplated is the enactment of a law assigning judicial power to PRIs and institutionalizing conventional *Nyay* (justice) panchayat. This step may be instrumental to reducing the present discrepancy between the de jure and de facto status of the PRIs to acquire the right blend of the "three Fs": functions, finances, and functionaries.

Notes

1. The *Rig Veda* is the oldest religious scripture in the world and the most revered of the Vedas. It consists of more than 1,000 hymns addressed to gods. It refers to rituals, such as marriage and funeral rites, that differ little from those practiced today in Hinduism. It is the source of much Indian thought, and many consider its study essential to understanding India.
2. Special legal dispensation under the Panchayats (Extension of the Scheduled Area) Act 1996 is given to the panchayats in tribal areas of nine states: Andhra Pradesh, Bihar, Chhattisgarh, Gujarat, Himachal Pradesh, Madhya Pradesh, Maharashtra, Orissa, and Rajasthan. Accordingly, the provisions of the CAA have been extended to those areas, with certain modifications respecting the traditional institutions of the areas and recognizing the rights of tribal populations over natural resources (Singh 2000).
3. The Union Ministry of Panchayati Raj, created on May 27, 2004, and responsible for the monitoring of the implementation of the CAA, provides technical assistance and expertise if sought by state governments to accomplish activity mapping within the timeframe. There was a consensus, during the roundtables, among all states to complete activity mapping by August 31, 2005 (Government of India 2006, p. 12), on the basis of Government of India (2001).
4. However, the data pertaining to local governments in the reports of National Finance Commissions are not consistent. It must be kept in mind that fiscal data for PRIs from any two sources are not comparable.
5. The Conformity Acts of the CAA provide for the composition of the SFC, the qualifications of its members, and the manner of their selection. Every recommendation of the commission is to be laid before the state legislature. However, many states have not taken these provisions seriously. The 12th Finance Commission and the National Commission to Review the Working of the Constitution have advised those states to provide criteria for the membership of the SFC similar to the provisions of the Union Finance Commission (Alok 2004). Poor treatment of the SFC by many states compelled the prime minister to make this statement: "As far as funds are concerned, the awards of the State Finance Commissions should be fully honored. There are reports that State Finance Commissions are not constituted, of them not giving awards in time, and of these awards not honored when given, all of which erode panchayat raj" (Government of India 2004b). However, all but three states (Arunachal Pradesh, Bihar, and Jharkhand) have received their first SFC report, and a few states (Andhra Pradesh, Haryana, Kerala, Punjab, Rajasthan, Uttar Pradesh, and West Bengal) have even constituted their third commissions.
6. The 10th National Finance Commission was not mandated to make recommendations for local governments. Because the CAA became effective before the commission

submitted its report, it made recommendations for the newly inserted subclauses of article 280(3) regarding local governments.

7. Rs 45 = US$1 at the beginning of 2006.
8. State governments also raised this point in the memoranda that they submitted to the 12th National Finance Commission (see http://www.fincomindia.nic.in).
9. The states' contribution to the CSSs was generally 50 percent in the 1980s, which was reduced to one-fourth in the 1990s because of the tight fiscal situations of the states. The share of the states is being reduced further. Some of the schemes are entirely funded by the national government.
10. Recognizing this problem, the 12th National Finance Commission specified a time limit of a maximum of 15 days for the state governments to transfer the grants to local governments. The commission asserted that the union government should take noncompliance seriously.
11. To facilitate informed review and appraisal by the state legislature, the parliament, civil society, and the public, the Fifth Round Table of Ministers in Charge of Panchayati Raj adopted a resolution that all states would present annual reports on the state of the panchayats, along with a devolution index on the basis of a concept paper presented by Alok and Bhandari (2004).
12. However, the 11th National Finance Commission has initiated the process by advocating for scientific accounts, databases, and computerization. Subsequently, the comptroller and auditor general of India prescribed a format of accounts for the PRIs. Most states have accepted the format.

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1 2 3 4 09 08 07 06

ISBN-10: 0-8213-6565-7
ISBN-13: 978-0-8213-6565-6
eISBN-10: 0-8213-6566-5
eISBN-13: 978-0-8213-6566-3
DOI: 10.1596/978-0-8213-6565-6

Library of Congress Cataloging-in-Publication Data

Local governance in developing countries / edited by Anwar Shah.
p. cm. – (Public sector governance and accountability series)
Includes bibliographical references and index.
ISBN-13: 978-0-8213-6565-6
ISBN-10: 0-8213-6565-7
1. Local finance–Developing countries. 2. Local government–Developing countries. 3. Finance, Public–Developing countries. 4. Public administration–Developing countries. I. Shah, Anwar. II. Series.

HJ9695.L63 2006
320.809172'4-dc22

2005057767