FINANCING THE PANCHAYATI RAJ INSTITUTIONS:
FLAGGING SOME ISSUES FOR THE 13TH CFC

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Some are born to sweet delight
Some are born to endless night
(Auguries of Innocence)
---- William Blake

I. Introduction

India is the flavor of the season. In recent times, the upswing in the secular rate of
growth of the Indian economy, wherein it has managed to significantly break away from
the ‘Hindu rate’ has had positive impact on the way in which India is perceived the world
over. The current growth experience and its impact on the macro-level fiscal and income
variables – in terms of the positive growth dividend – must finally put to rest all the anti-
growth rhetoric. It is amply clear (in the context of growth scenario) that all the good
things – in social sphere, in terms of inclusion – can now be realistically afforded by the
Indian policy maker, perhaps for the first time! It is indeed necessary that we do
something here especially given that many of the ‘poor’ states/regions have remained
‘poor’ through this growth episode. Similarly, there are sections of people as well as
production sectors that have failed to keep pace, both in the urban as well as rural parts of
the economy. This implies an inescapable conclusion that there is certainly an
exclusionary sub-plot to this growth story. This has two implications, one, for purposes of

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Thanks are due to Prof. Govinda Rao, Director, NIPFP, for the opportunity to write and present this
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members at a meeting arranged by MEDC on 27th March 2008 and the other one undertaken on behalf of
IRMA for Ministry of Panchayati Raj (GoI) in preparation of the Status of Panchayati Raj 2007-08. It also
uses an earlier study done for UNDP/UNCHS that I did with Ajit Karnik and Dilip Karmarkar. I would like
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disclaimer applies.
satisfying the very important tenet of inclusion, greater attention needs to be paid to the ‘rural’ sector (farm and non-farm) with focus on core services such as water, education, roads, health and power. This is of particular interest and we shall argue that the first three are particularly germane to the discussion in the context of this paper. Two, it is crucial that the growth (even when somewhat exclusionary in character) has to be sustained, with the further implication that the design of any policy strategy must have incentive compatibility meaningfully as its cornerstone.

The Presidential Order constituting the 13th Central Finance Commission has been issued. A review of the ToRs of the earlier Finance Commissions indicate that the tasks have been cumulatively been increasing. To the extent that these are in response to the changes in macro-environment and/or management paradigm, they are understandable. In this category we would put the influx of the limited concern for incentive compatibility as well as the debt situation of the states in the context of macro-stability and indeed the concern for decentralization. However, when this increase in the mandate is due to contingent and temporary reasons and clearly outside the purview of the core functions of the Finance Commission, it only makes the work more complex – with a multi-objective setting – even at the conceptual level and needs to be avoided. Whilst these are the general considerations confronting the 13th CFC, in this paper we shall be focusing solely on financing of the PRIs within the context of decentralization.

Down from the time of Rig Vedas to Charles Metcalf’s characterization of villages as ‘republics’ to the now famous dictum of ‘power to the people’ by Lord Rippon (a hundred and twenty five years ago), followed by the Bengal initiative in 1885, or indeed the later Gram Swaraj concept of Mahatma Gandhi, Panchayat Raj has been the recurrent theme in our political discourse. In its most potent form the credit of ushering in the Panchayati Raj Institutions must go to the dynamism of the youthful Prime Minister the late Shri Rajiv Gandhi. Despite the faltering attempt of the 64th Constitutional Amendment Rajiv Gandhi pressed on with the 73rd and 74th Constitutional Amendments, convinced that it encapsulated the vision and injunction by our founding fathers. He was acutely conscious that the fruition of the ambitious project of Panchayati Raj would take at least a generation. The peculiar federal set up that India is of course comes in the way of full and immediate implementation.
This paper comprises of seven sections in all, including introduction. In the second section we provide a backdrop and the context to the paper. In the third section which has many subsections, we look at the Finances of the PRIs. In the following section we discuss the role of 13th Finance Commission. In the fifth section – which is brief aside – we look to extract some ‘learnings’ from International experience. In the sixth section we sum-up the way forward and in the last section we wrap up.

II. Prologue: The Backdrop and the Context

The parametric environment of the Indian economy, society and polity have been witness to a rapid change, thanks to the LPG processes set in motion some two decades ago. The macro-management regimen has undergone significant change in the recent past. The present structure of Indian fiscal federalism was formed at a time when its economy was much less market oriented than today. Inter-governmental arrangements are rarely a product of detailed analytical studies by economists or political scientists, but are the result of historical developments, including historical accidents (see Teresa Minassian 1997). It is thus unlikely that the same arrangements would be chosen if today the countries had the freedom to start from scratch. Intergovernmental transfers and reforms therein are taking place today in the context of political decentralization, changing as well as shrinking role of the government and recognition of local autonomy, at least for sometime with Central norms and mandates in place (see, Bird,R and C. Wallich 1993). These provide points of departure and will need to be borne in mind whilst rendering the mandate given to the 13th FC operational.

Although India has a federal structure albeit not in the classical sense (see Roy Ash Narain, 2007), it is essentially a Union with a strong centripetal bias with the constitution ensuring an overwhelming and overriding power to the central government. The days of single party domination are long past and coalitional politics are here to stay. The regional parties with there parochial agendas have been gaining ground for some time now with the strong emergence. This is also important because the most important public goods that need to be serviced – such as health and education – are largely provided by States and below. The autonomy will perforce be required to be
The continued fractured mandate (as far party political strength is concerned) means that the margin of bargain in the non-formula based transfers will be up for grabs and be available on purely party political expediencies (See, Rajaraman Indira, 2007).

The fiscal situation of the states presents a different picture as compared to the one that presented itself at the onset of the 12th FC. The fiscal situation then was indeed very grim. Kelkar (2004) clearly believes that it is much better to concentrate on revenue raising effort with its powerful side effect of strengthening state finances which is not the consequence of expenditure cuts (which any way are politically difficult).

The growth dividend in the form of tax revenue buoyancy that has been witnessed recently has clearly had good effect on the fiscal situation of the states. There are some notable ‘rogue’ exceptions. Also, the debt, (outstanding liabilities, to use the RBI nomenclature) has increased and it will continue to be a cause of concern for the policy maker in times to come and this does not portend well for the future (for greater details see RBI (2007)). In this context, the implications of holding the cap of revenue deficit for expenditures on the crucial (and necessary) sectors of health and education (both essentially state subjects) will require to be watched closely. Much ingenuity – by way of micro-design – in neutralizing the negative impact on the ‘good’ revenue expenditures in this area will have to be exercised by the 13th FC.

Strengthening of decentralization is another feature of the emerging architecture of Indian economy. Whilst the advantages and disadvantages of decentralization as a strategy are well documented (see for example Oates 1972, Tiebout 1961, Tanzi 1996 and Prud’homme 1995) such academic discussion need not detain us here. There are a multitude of individual examples of positive impact of decentralization on governance as well as human development measures. Good governance is recognized as the key to efficient and welfare enhancing key, of which decentralization is one of the constituent best practice. Indeed there is a fair consensus that decentralization whilst a challenging and complex process, promises to be a mechanism for improved democratic governance and sustainable human development. In any case the process of decentralization has been institutionalized through constitutional amendment and is here to stay and is best treated as fait accompli. In today’s global world order the mantra is to think global and act
global. The complimentary synergistic relation between local and global institutions and operations is well recognized (Ministry of Panchayati Raj 2006). This is crucial for the effective adumbration of the ‘glocal’ paradigm. There is no better vehicle – in India – than a meaningfully empowered, extant framework provided by PRIs.

In the current context of PRIs getting effectively empowered, the continued fractured mandate (as far party political strength is concerned) means that the situation is full of potential issues. **However, we believe that such a situation could be turned on its head to bring more progress – rather than less – on the front of empowerment of PRIs.** This belief is supported by a couple of rather hazy propositions about the link between political structure and decentralization. One, that the ceterus paribus, **Central government is far more pro-decentralization (including financial devolution) that the State level government.** Since for the Central Government, the disutility arising out of sharing resources (economic and political) with others is invariant to whether the sharing takes place with one or more sub-national governments. Whereas for the State government it matters how much it actually devolves lower. Second the ‘distance’ and ‘level’ considerations also lead us to believe that decentralization threat is perceived to a much greater extent and immediacy at the State as compared to the Central level. Two, **regional parties would – ceterus paribus – be more inclined to decentralization.** More specifically, **political parties which derive their strength from regional agenda (which are necessarily people-touching and participatory) and generally parties that are cadre based are more positive about decentralization.** This is because the party structure continues to be prominent whether the party is in office or out of it, thus official/elected positions do not grant sufficient powers to provide a threat to higher level functionaries (in office as well as the party). Finally, coalitional government at the central level – especially with one national and others essentially with regional identification – will augur well for an effective big push towards effective decentralization. These then, are the reasons for our seemingly sanguine hope and assertion. Let us now briefly turn to the crucial but brief sub-theme on inclusion.
II.1 Inclusion as a Soul of our Strategy

It is important to understand that our insistence of inclusion as an embedded part of the strategy is not dictated by ethico-moral considerations alone (although these are not bad reasons either). It is a pragmatic position born out of considerations of feasibility and sustainability of the much needed growth phenomenon, within the Indian socio-political milieu. Having taken care that the growth rate regime is not jeopardized, the essential step will be to concentrate on the ‘inclusive’ aspect of growth. Growth is after all only an instrument that strategically will ensure that development takes place. We believe that not only does this make good economic sense but happily makes good political sense too.

Inclusive growth is a complicated phenomenon involving coordinated role of actors such as PRIs, State and Central Government, and NGOs (SHGs) amongst others on one hand and the vision of a new architecture of rural credit on the other. Supply led and (non-clinical) extension based innovation in credit delivery has to be learnt afresh by the banking community at large. The mistakes in the interest rate policy, leading to disenfranchisement of rural borrowers, under the wrong characterization of it leading to NPAs must not be repeated. In the Indian context a macro view of credit risk needs to be developed that so that the dual role of growth enhancement and risk mitigation are fulfilled in the case of agriculture and allied activities (see, Mujumdar 2007). Changing risk profile as well as risk perception of the bankers must be an explicit and sharply defined policy objective of credit policy, with the capability to translate potential demand into viable risk projects. What we are recommending – to be sure – is not a return to the old ways, but rather a move to a more enlightened – Mark II if you like – market theology. In the newer context this calls for a new/ redefined role of the State which simultaneously lets go and work more intensively on narrowly defined objectives. There are two important strands of argument to be made in the context of decentralization. One, it will be abundantly clear that one of the things we must do is to consolidate schemes that have grown and continue to grow exponentially with the absorption showing perennial decline (the last is also true of many schemes such as RIDF but also of the brilliantly put together PMGSY with the structure of oversight in place.
and technical inputs, including appropriate technology worked upon). In doing so, priorities will need to be set so that the problem is tractable and manageable. We believe that the first such effort has to be concentrated on three areas, Water, Education and Roads. The road connectivity leads to remarkable impact on the lives of the rural folk, as has been amply documented. As Narayan et al have pointed out (See, India Infrastructure Report 2007), the prevailing conditions make it difficult for people to get their goods to the market or for people to get to their place of work or indeed to access health in emergency and generally to access public services. Education as a constituent of development needs no argument, but its delivery through various schemes (notably SSA) as now designed is unsatisfactory. As far as water is concerned it is the life line of civilizations, it is said that the next world war will be fought about water. It is important to combine all the schemes (funds there from) that look at the consumption (drinking/conservation/wells) as well as the investment (minor irrigation schemes/harvesting) aspects as play them through the instrumentality of PRIs. It has been noted that such programs alone will be the saviors of agriculture in rain fed regions. Of course, in case of drought prone areas there would have to be a different approach. 

There is evidence to show that the political empowerment of women have also thrown up such schemes as perceived priorities so that acceptability will not be an issue (for all assertions made above see, India Infrastructure Reports especially 2007 dealing with Rural Infrastructure, also see Annual Report of RDD, GoI 2007, Shubham Chaudhary, 2007 and N.A. Mujumdar 2007)). The externality of such reorganization will be that that the utilization will improve and through impetus to the rural hubs initiative, livelihoods will be created, which alone is the surest way of empowerment. Here one needs to emphasize that there are two elements viz., Health and Power that we have left out that are generally recognized as terribly important. The reason is that whilst some elements (extension) can be incorporated, prioritization requires that things be kept at manageable levels and also that there are indications (from experience elsewhere) that given the skill demands of both these sectors these are not sector that lend themselves to easy and successful decentralization. The second strand of the argument here is that consolidation and transferring the funds to PRIs (along with functionaries) will lead to possibilities of financial market access. This can and should be encouraged using various
possibilities and experiences (see Pethe and Lalvani, 2006). We now turn to the Indian situation with especial reference to PRI finances.

III. Indian Situation: PRI Finances

Considerable work has been done in the different aspects of Panchayati Raj institutions in India. The work by Oommen (2005) and the work by Amba Agarwal, Goel and Rajneesh and of course those by Govinda Rao, Indira Rajaram as well as State of the Panchayati Raj (MoPR, 2006) are particularly noteworthy. The upshot is that clearly the issues are not epistemological or conceptual by a long shot. They are more in the nature of ‘will’ as well as translating the concepts into real processes and actual implementation.

III.1 Fiscal Performance of PRIs: An Inter-State Comparison

In this section we report inter-state comparison of the fiscal performance of PRIs. Data on rural local bodies in the various states are available from the Central Finance Commissions (CFCs) both 11th and 12th and also from the State Finance Commissions (SFCs). The SFC data are somewhat more detailed but since not all SFCs are available on public domain and there is the danger of differing methodologies being used for compiling of the data, it would be inappropriate to use them for inter-state comparison purposes as is being attempted here. For our purpose of state comparison the CFC data (although relatively aggregate) would be most suitable. However, even this data set needs to be used cautiously. Both Govinda Rao (2007) and Oommen (2005) have drawn attention to several examples to explain why they find the data set to be suspect. The paucity of data for some variables for some of the states necessitated that we curtail our analysis to fifteen major states. The changing pattern of some key variables in per capita terms over the period 1993-94 to 2002-03 were used as indicators to signal the fiscal performance of these states.
A comparison of the average per capita own tax revenues shows that own revenues as a whole have tripled in the second phase and own tax revenues have quadrupled. Clearly there has been progress however the small base to begin with has to be kept in mind. A quick calculation shows that a decade after the path breaking Constitutional Amendment Acts own revenues (per capita) still form a mere 9% of the total expenditures (per capita). Thus the key indicators suggest that while there has been some progress in terms of increase in own sources of revenue it has been very slow and PRIs continue to depend heavily on the upper tiers of government for their expenditures. This conclusion is further tested by examining some key ratios that we compute for our fifteen major states.

1. Two versions of Revenue Decentralisation Ratio (RD Ratio 1 and 2).
(a) RD Ratio 1: PRI Own Revenue/ State Own Revenue
(b) RD Ratio 2: PRI Own Revenue/ State Own Revenue+ PRI Own Revenue

(as suggested by Oommen, 2005)
2. FA Ratio: Financial Autonomy Ratio: PRI Own Revenue/ Total Expenditure of PRI
3. DR: Dependency Ratio: (Total Expenditure-Own Revenue)/Total Expenditure
4. DDR: Change in DR (DR\textsubscript{t} – DR\textsubscript{t-1})
5. Two versions of Government Size measure
   (a) GS1: PRI Total Revenue/GSDPP
   (b) GS2: PRI Total Expenditure/GSDPP

Strictly speaking the first four indicators are performance indicators as GS1 and GS2 include transfers from higher levels of government. This exercise may be seen as a fiscal part of the agenda of constructing a devolution index that is being currently undertaken at the behest of MoPR (See, NCAER, 2007). The details of the computations are reported in Pethe and Lalvani (2008). Both Revenue Decentralisation ratios (RD1 and RD2) show that the average PRI own revenues are below 1% of the states’ own revenue for fifteen major states. The Financial Autonomy ratio (FA Ratio) i.e. the extent to which expenditures are being funded out of own revenues shows progress during the two phases from 11% to 25%. This ratio is effectively the flip side of the Dependency ratio (DR) which shows that PRIs depend on upper tiers to the extent of 77%. Thus while fiscal autonomy of PRIs has improved, they are still largely dependent on the higher tiers for their revenue stream. Thus the broad story that emerges is clear – despite the much spoken about decentralization de facto fiscal empowerment of rural local bodies has moved at snails’ pace. Since it is always the case that the macro picture hides both star performers and laggards, it is imperative that to get the complete picture we look at the state-wise performance. For each of these fifteen states we have obtained the per capita key variables for the ten years under consideration and also computed the key ratios and ranked the states based on these key ratios (see again Pethe and Lalvani 2008). It is clear that there are while there are some consistent leaders and laggards, there is much heterogeneity underlining that the statement that ‘PRIs’ fiscal/financial position is pathetic’ needs to be qualified in many ways.

We have gone on in Pethe and Lalvani (2008) to try and explain the picture as well as provide rankings for the states on the basis of each of these ratios across time phases (again the reader may look at the details in the paper cited above). The next table
puts together the change in ranks under each criterion and juxtaposes them against the change in the award to the PRIs in the States by the two recent finance commissions.

Table 2
Improvement/Deterioration in Relative Ranks on Various Key Criteria vis-à-vis relative awards of FCs
(93/94 to 97/98 Phase and 98/99 to 02-03 phase)

<table>
<thead>
<tr>
<th></th>
<th>RD1</th>
<th>RD2</th>
<th>DR</th>
<th>DDR</th>
<th>GS1</th>
<th>GS2</th>
<th>FC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Pradesh</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Status Quo</td>
</tr>
<tr>
<td>Assam</td>
<td>Status Quo</td>
<td>Status Quo</td>
<td>+</td>
<td>-</td>
<td>Status Quo</td>
<td>Status Quo</td>
<td>Unaffected</td>
</tr>
<tr>
<td>Goa</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>-</td>
<td>+</td>
<td>+</td>
<td>Unaffected</td>
</tr>
<tr>
<td>Gujarat</td>
<td>-</td>
<td>Status Quo</td>
<td>+</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td>Status Quo</td>
</tr>
<tr>
<td>Haryana</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>-</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Karnataka</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>Unaffected</td>
</tr>
<tr>
<td>Kerala</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>Unaffected</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>Unaffected</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>Unaffected</td>
</tr>
<tr>
<td>Orissa</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td>Punjab</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>Unaffected</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>Unaffected</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>Status Quo</td>
<td>Loser</td>
</tr>
<tr>
<td>Uttar Pradesh</td>
<td>-</td>
<td>-</td>
<td>Status Quo</td>
<td>-</td>
<td>-</td>
<td>Status Quo</td>
<td>Unaffected</td>
</tr>
<tr>
<td>West Bengal</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>Unaffected</td>
</tr>
</tbody>
</table>

Note: “+” indicates Improvement and “-” a deterioration

We find that for some states such as Kerala which have performed extremely well on all counts have been rewarded as their rankings in the 12th FC position has shown an improvement. However, states such as Rajasthan, West Bengal and Uttar Pradesh, which have shown a deterioration in performance in five out of six criteria have not been penalized (their shares have remained unaffected). Thus there appears to be an element of disjunction between our ranking scheme (with the underlying criterion) and the
considerations that went into the shares proposed by the FCs. This perhaps warrants a relook at the way the FCs are computing the inter se allocations to the Local Bodies.

To obtain a synoptic picture from the rankings on the various criteria we computed a ‘Grand Rank’ by aggregating all the ranks, thereby making the (somewhat simplistic) assumption of according equal weight to each of our criteria. These Grand Ranks are separately obtained for the two different phases and following our previous pattern a change in the rank of each state is obtained. Whilst explicitly admitting to their rather crude nature, we tabulate and present the Grand Ranks in Table 3 below:

**Table 3**

**GRAND RANK**

<table>
<thead>
<tr>
<th></th>
<th>Full Time Period (phase I and II)</th>
<th>Phase I</th>
<th>Phase II</th>
<th>Change in Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Pradesh</td>
<td>1</td>
<td>1</td>
<td>5</td>
<td>-4</td>
</tr>
<tr>
<td>Assam</td>
<td>15</td>
<td>15</td>
<td>14</td>
<td>1</td>
</tr>
<tr>
<td>Goa</td>
<td>5</td>
<td>4</td>
<td>9</td>
<td>-5</td>
</tr>
<tr>
<td>Gujarat</td>
<td>2</td>
<td>2</td>
<td>4</td>
<td>-2</td>
</tr>
<tr>
<td>Haryana</td>
<td>10</td>
<td>8</td>
<td>7</td>
<td>1</td>
</tr>
<tr>
<td>Karnataka</td>
<td>9</td>
<td>9</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td>Kerala</td>
<td>4</td>
<td>13</td>
<td>1</td>
<td>12</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>3</td>
<td>6</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>8</td>
<td>14</td>
<td>3</td>
<td>11</td>
</tr>
<tr>
<td>Orissa</td>
<td>14</td>
<td>12</td>
<td>15</td>
<td>-3</td>
</tr>
<tr>
<td>Punjab</td>
<td>6</td>
<td>3</td>
<td>10</td>
<td>-7</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>7</td>
<td>5</td>
<td>8</td>
<td>-3</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>11</td>
<td>7</td>
<td>11</td>
<td>-4</td>
</tr>
<tr>
<td>Uttar Pradesh</td>
<td>13</td>
<td>11</td>
<td>13</td>
<td>-2</td>
</tr>
<tr>
<td>West Bengal</td>
<td>12</td>
<td>10</td>
<td>12</td>
<td>-2</td>
</tr>
</tbody>
</table>

The broad conclusion that seems to emerge is that the shares allocated to the various states by the 12th FC from the funds set aside for PRIs does not seem to be in consonance with the incremental performance of these states as per the fiscal decentralization criteria that we have used. Further there is a disjunction between the criteria used by the two FCs. If one goes into the political economy aspects (especially partisan politics dealing with who is in power at center and states) it is clear that there is
no pattern here. As an aside, this confirms the commonly held view about CFCs being non-partisan.

The limited purpose of our comments is to question and suggest a re-look at the criteria and the weights that were set out by the 12th FC for *inter se* distribution of the funds set aside for PRIs so as to reward states for any efforts made by the states to empower the rural local bodies. *Clearly the criteria of ‘Revenue Effort’ alone (with a weight of 20%) in the formula for inter se distribution of the 12th FC funds wasn’t adequate to capture the performance of the states on the decentralization front.* Let us now turn to the buoyancy of revenues.

### III.2 Buoyancy of Own Revenues: Tax and Non-Tax

The buoyancies of Own revenues (both tax and non-tax separately) by estimating a double log regression was estimated for all fifteen states put together using panel data estimation procedure (for 15 states and 10 years) and independently for each state too. The time period examined spans the entire ten year period 1993-94 to 2002-03 and also the two sub-periods (or phases) that we have identified previously i.e. Phase I (1993-94 to 1997-98) and Phase II (1998-99 to 2002-03). A familiar qualification though, data availability constraint does not allow us to have results for more recent periods and the same makes us run regression for 5 year period (on which the purist econometrician will undoubtedly frown). The details of the estimation may be seen in Pethe and Lalvani (2008). Here we will only make some pertinent points.

The aggregate buoyancy for fifteen states shows that the buoyancy of own revenue exceeds unity for the ten year period. However, when we look at the two sub-periods or phases we find that the buoyancies have reduced in the second phase as compared to the first one. Keeping in mind the fact that the exercise is with remarkably low degrees of freedom, we would still believe that there is a lesson to be taken from the low levels as well as slippages that call for improvement.

For the aggregate of fifteen states we find that there has been some improvement in buoyancy of Non-Tax revenues in Phase II *vis-à-vis* Phase I. However, there are nine states in phases II which show buoyancy less than unity while there were eight in Phase I.
with less than unity buoyancy. Expectedly we find that the tax buoyancies are less than the non-tax revenues. The case of taxes is easily explained in familiar terms (low base and regulatory constraints) although we may not agree with the position. But non-tax revenues are under researched and could be hiked by rationalization of various charges. Over all, we believe that whilst the arena for operations (of both tax and non-tax sources) can and need to be expanded, even with the given situation there is scope for better exploitation of the potential that exists.

### III.2.1 Some Policy Inferences:

Before turning to end notes on the situation at the India level, we juxtapose state rankings for buoyancies and the Grand Rank for the full ten year time period.

**Table 4**

<table>
<thead>
<tr>
<th>State</th>
<th>Buoyancy rank</th>
<th>Buoyancy</th>
<th>Grand Rank</th>
<th>Grand Rank Buoyancy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra P</td>
<td>12</td>
<td>0.73508</td>
<td>1</td>
<td>1.000000</td>
</tr>
<tr>
<td>Assam</td>
<td>7</td>
<td>1.492585</td>
<td>15</td>
<td>1.000000</td>
</tr>
<tr>
<td>Goa</td>
<td>3</td>
<td>1.981422</td>
<td>5</td>
<td>1.000000</td>
</tr>
<tr>
<td>Gujarat</td>
<td>11</td>
<td>1.043569</td>
<td>2</td>
<td>1.000000</td>
</tr>
<tr>
<td>Haryana</td>
<td>8</td>
<td>1.113253</td>
<td>10</td>
<td>1.000000</td>
</tr>
<tr>
<td>Karnataka</td>
<td>4</td>
<td>1.80265</td>
<td>9</td>
<td>1.000000</td>
</tr>
<tr>
<td>Kerala</td>
<td>1</td>
<td>2.62997</td>
<td>4</td>
<td>1.000000</td>
</tr>
<tr>
<td>M.P.</td>
<td>2</td>
<td>1.985225</td>
<td>3</td>
<td>1.000000</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>6</td>
<td>1.655859</td>
<td>8</td>
<td>1.000000</td>
</tr>
<tr>
<td>Orissa</td>
<td>15</td>
<td>0.0835079</td>
<td>14</td>
<td>1.000000</td>
</tr>
<tr>
<td>Punjab</td>
<td>9</td>
<td>1.067484</td>
<td>6</td>
<td>1.000000</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>14</td>
<td>0.5785745</td>
<td>7</td>
<td>1.000000</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>5</td>
<td>1.785468</td>
<td>11</td>
<td>1.000000</td>
</tr>
<tr>
<td>U.P.</td>
<td>13</td>
<td>0.7246503</td>
<td>13</td>
<td>1.000000</td>
</tr>
<tr>
<td>West Bengal</td>
<td>10</td>
<td>1.064597</td>
<td>12</td>
<td>1.000000</td>
</tr>
</tbody>
</table>

Based on the above rankings we create a matrix (classification) of the states as ‘Good’ and ‘Not Good’ in terms of buoyancies and fiscal decentralization measures. For doing so, we use the above and below average performance in the ranks as well as the values for buoyancies. Although admittedly, a rather crude filter for classification it is simple and intuitive. Earlier in the paper we have discussed the need for redefining the
role of the state. In that vein, we believe that we cannot go for a ‘horses for all courses’ approach but must rather seek refinement in policy measures contingent on specifics. The following matrix categorizes the states which fell into the two categories for buoyancy of own revenue and for fiscal Decentralization as inferred from the matrix below.

### Table 5: The Good and Not Good Matrix

<table>
<thead>
<tr>
<th>BUOYANCY RANK</th>
<th>FISCAL DECENTRALISATION GRAND RANK</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GOOD</td>
</tr>
<tr>
<td></td>
<td>(I)</td>
</tr>
<tr>
<td></td>
<td>Kerala</td>
</tr>
<tr>
<td></td>
<td>M.P.</td>
</tr>
<tr>
<td></td>
<td>Karnataka</td>
</tr>
<tr>
<td></td>
<td>Goa</td>
</tr>
<tr>
<td></td>
<td>Maharashtra</td>
</tr>
<tr>
<td></td>
<td>NOT GOOD</td>
</tr>
<tr>
<td></td>
<td>(II)</td>
</tr>
<tr>
<td></td>
<td>Assam</td>
</tr>
<tr>
<td></td>
<td>Tamil Nadu</td>
</tr>
<tr>
<td></td>
<td>Punjab</td>
</tr>
<tr>
<td></td>
<td>(III)</td>
</tr>
<tr>
<td></td>
<td>Andhra P.</td>
</tr>
<tr>
<td></td>
<td>Gujarat</td>
</tr>
<tr>
<td></td>
<td>(IV)</td>
</tr>
<tr>
<td></td>
<td>Haryana</td>
</tr>
<tr>
<td></td>
<td>Orissa</td>
</tr>
<tr>
<td></td>
<td>West Bengal</td>
</tr>
<tr>
<td></td>
<td>Rajasthan</td>
</tr>
<tr>
<td></td>
<td>UP</td>
</tr>
</tbody>
</table>

As mentioned earlier, the classification of states into these categories help us to identify the varying roles of the state for each of these categories:

- **The Not Good-Not Good Category** (Group IV i.e. Haryana, Orissa, West Bengal, Rajasthan): This group of states represents a relatively poor performance on all indicators. In the process of delimitation of the role of the state we believe that these states *require direct state intervention or some ‘hand holding/support’ by the State to make headway, even at the cost of some autonomy for the states*. These are also states that are particularly weak state and local economies. Two caveats need to be entered. One, that Haryana is on the cusp, in that it just about finds itself here but the fact that it has shown some progress in recent times it is some distance away from others in this group. Two, West Bengal and Rajasthan (to some extent) represent states that on other than financial counts have a pedigree in matters of decentralization.
• **The Good-Good Category:** (Group I i.e. Kerala, M.P., Karnataka, Goa and Maharashtra): This group of states that relatively speaking are the cherries and would require minimal attention (in the form of enablement). **These are the states that are ready for moving on to better global practices including taking loan exposures and accessing capital markets on their own.** These states are deserving of **bonus awards for their performance to encourage them to carry on the good work.** Here Maharashtra is on the cusp and just about gets into this category.

• **The two in-between categories** (Groups II and III i.e. Andhra Pradesh, Gujarat, Punjab, Assam and Tamil Nadu): These states are what one may term as essentially strong and hence an appropriate policy ‘nudge’ will suffice. For example there are states that need to be either incentivized to financially decentralize or there are those where appropriate enablement (granting flexible handles or assignments) will help raise the buoyancies of their own revenues.

Finally, we now use the categorization to do a small exercise. What we do is look at the best states (by our ranking schema) and pool the relevant data to run regression to extract estimates of buoyancy. The reason for doing this is that, a casual glance at the buoyancy estimates reveal, that for the top five performing states (all from the good-good category) the buoyancies are **about two** and for the rest it is **significantly less than unity** on an average. The regression results indeed show that the value that one gets is 1.45 which is significantly higher than the buoyancy estimates for the other states. **This has a clear implication – with an underlying ‘golden goose’ argument – that the other states will do well (in their own self interest) to emulate the better performing states and reap the benefits of richer revenue rewards, thereby lessening the fiscal stress on their finances.**

### III.3 All India Situation

The diversity in attainment, and flux in performance is quite clear from the foregoing analysis. What it also does is to call into serious question the general (consensual) feeling that the revenues as well as the fiscal base of all the PRIs is uniformly poor leading to the corollary that not much can be done about the increasing
transfer dependency and the inevitable inertia towards attempting anything new, in short encouraging laziness, apathy and cynicism. We wish to strongly suggest two pronged approach in this context. First, we wish to argue that the picture in fact is not altogether discouraging and that much can be done by way of own revenue increases. The obligatory tax handles have to be seriously implemented along with the floor rates prescribed in a mandatory manner. The issues of agricultural levies that are crop specific will (not a very popular subject) as suggested by Indira Rajaraman amongst others will have to be faced (even though agriculture is a state subject). Proper design of incentives for such effort is necessary (with implication for design of transfers) and will help expand the fiscal base of the PRIs so that the trade-off between efficiency and equity is carefully worked out. Apart from granting greater taxation powers to the PRIs, in any case, newer revenue handles will have to be innovatively unearthed, this is especially important because the GST regime might take away some of the existing ones (see Govind Rao, 2008). Many times the argument is advanced that the requirements are so huge that clearly such efforts will not help solve the problem. This is true, however what is not recognized is that such efforts – of transferring funds to PRIs – help create a far healthier balance sheet for the PRIs which then are in a position to present a rating and a borrowing-risk that is viable if not attractive to the Financial Institutions that can then be approached for underwriting or taking exposure, which is the second prong of our suggestion. Already the cooperatives and scheduled commercial banks and NABARD should be looking at bankable viable projects. This needs to be done as a symbiotic effort on all the stake holders (governments at various levels as well as NGOs). The idea can be extended to creation of virtual entities formed by considering different PRIs. The entire set of PRIs will have to be classified into different classes according to economic criteria and strengths and then schemes can be worked out for ‘cross-overs’ that will allow even the weaker PRIs to access credit. Such a scheme has been proposed by us (see Pethe and Lalvani, 2006) in the case of Urban Local Bodies. Indeed, we would suggest the coming together of some PRIs with their urban counter parts too. There is something to be said for a ‘regional’ approach in these matters (see Pethe and Lalvani, 2007), for example consider the case of MMR which is being looked at for Mumbai Transformation Project.
This implies that we should be looking at the entire space as one integrated continuum dotted with local bodies.

III.3.1 Some States

Whilst detailed analysis of panchayati raj finances is not possible currently, for all the states for lack of consistent, updated data, there exist excellent inputs from the work by MoPR, apart from this, excellent studies (Bardhan and Mookherjee (2007), World Bank (2004), Oomen (2004)) which research some of the other states so as to unearth some of the things attempted and document some good practices, especially those which according to us has a bearing on the finances of PRIs. The states that we would point out to are, Kerala, Karnataka, West Bengal, and Uttar Pradesh apart from Maharashtra. This sub-sample happens to have amongst it the most populous state as well as those which are supposedly best performing state w.r.t. PRIs or have a pedigree and experience in PRIs that pre-dates the passage of 73rd CAA.

Maharashtra – which is a early starter (even before the constitutional amendment) has done some things right (especially as captured by our ranking scheme). For example it has delegated the financial powers of considerable magnitude to the PRIs and transferred several schemes to them. Indeed twenty years back (long before the talk of budget window) it started the practice of compilation of a large matrix on financial year basis depicting the fund flows from the line departments to the PRIs. The state has also instituted ‘incentive awards’ under the Yeswantrao Chavan Panchayat Abhiyan.

Inspired by and as a part of the peoples movement, and as recommended by the first administrative reforms committee, the state passed the Kerala Panchayat Bill (1958) and District Council Bill (1959) to get a head start over others. Kerala has devolved most to rural governments and redesigned its planning process by revision of the Panchayat Raj Act in 1999. The state – post 73rd CAA – took a big bang approach to decentralization. The Kerala model is also renowned for the achievements such as high literacy, especially amongst women with a positive impact on local government. Kerala is the only State in which three State Finance Commissions have submitted their reports with practically every recommendation being adopted. Each SFC has been a path breaker.
The most revolutionary aspect of Kerala’s decentralization is the provision of substantial untied funds for local prioritization and local resource allocation to identified priority areas. It is significant to note that this was not recommended by any SFC but was a policy decision taken by the State Government at the beginning of the IXth FYP.

Establishment of ‘local fund’ in 1862 was the beginning by the state with regard to decentralization. In 1954, Local Boards Enquiry Committee recommended setting up of the three tier structure in the state. In 1956 a new act was adopted to standardize the varying structure of governments in the state. In many ways, Karnataka was ahead of the decentralization reforms initiated in 1992 and may have influenced the thinking on empowerment of rural governments. It has also maintained its proactive stance on this matter over time (see, Geeta Sethi, 2004). The State’s devolution of funds to Panchayats has exceeded the proportion recommended by the Finance Commissions.

One of the states that has implemented decentralization more thoroughly and from long time is West Bengal. In the earliest avatar, it took the form of Union Boards through an Act in 1885 followed by the 1919 Bengal Village Self Government Act. Of course, the reasons in this case have more to do with political praxis than economics. The greater emphasis on political decentralization has meant the financial autonomy was rather limited. Apart from responsiveness and accountability, the evidence of seat reservation for women in the chair positions shows a statistically significant shift to road maintenance and drinking water supply projects. West Bengal is one of the few States where all the recommendations of the State Finance Commission have been accepted.

Uttar Pradesh represents the most populous state (16% of the Country) in this massive experiment in democracy. Although it is on of the BIMARU states, the reason for including it here is to acknowledge some initiatives have been taken and in particular an analytical study with a rigorous methodology for sample selection was conducted to gauge awareness and estimated potential revenue sources that could be tapped. Out of the perceived four sources of income (Grazing land, Agricultural land, Orchards and Ponds). But the Gram Panchayats were not raising any appreciable income from these sources. On the basis of sample data the overall value of all available internal resources in U.P. comes to Rs. 44,564 Crores and the total value of encroached resources was Rs.18,216 crore. For greater details see HARAYALI (2007)
While the states noted above represent best practises in the conceptualization (design of transfers) as well as passage of *de jure* enablement through acts, and accomplishment of political devolution, when it comes to – the very crucial – matter of actual finances, the implementation over time leaves scope for improvement.

**III.3.2 SFCs**

The arena of the functioning of SFCs has been widely researched (see e.g., World Bank/ Geeta Sethi (2004), India Infrastructure Report (2003) as also Shubham Chaudhary (2007)). However, the public domain knowledge about these reports continues to be woefully sparse. The State Finance Commissions have been required by the Constitutional mandate as a part of the 73rd CAA. Despite this and the apparent intent on the part of the states to push for decentralization (sometimes beyond the requirement as laid down by either the 73rd CAA or indeed the SFC recommendations) in terms of fiscal-financial decentralization (as captured by us) and ranking emanating there from, they have not done well. This clearly underlines *the pre-eminence of the proposition that an important pre-requisite here is the Finances of the State government itself*. However the fact remains that they have not been successful for a few reasons. First amongst them is that whilst they have mostly been set up rather mechanically, not much thought seems to have gone into the exercise in the composition of the commission. The timing of setting these up have also not been synchronized with the Central Finance Commissions (which work like clockwork) thus depriving Central Finance Commissions of the crucial inputs as envisaged. It can be seen that some of the SFCs have taken their job seriously and come up with useful recommendations, however by and large most of these have been rejected and when they have been accepted (in principle) the States have dragged their feet in the matter of actual implementation. There are only few states that have rigorously kept to a time table of setting up SFCs. Fewer still have actually gone through the process of acceptance and ATR by the respective governments and legislatures. There is varied experience where the newly formed states are only now initiating the process of setting up their first SFC Chattisgarh and Jharkhand). Again, the quality of the reports by the SFC in different states shows heterogeneity. Some of the SFCs have recommended
revenue (tax and non-tax) (Andhra) and sometimes only the tax revenue (Assam), shares to be devolved as well as the sharing between the urban and rural local bodies. The inter se distribution between the different tiers is also recommended based on criteria that vary form simple and straight forward to complicated and detailed/ formula based formats that reflect social concerns (always where there is data to implement such recommendations).

Some have gone to the extent of working out first level demarcation in terms of advanced ordinary and backward PRIs along with weights. Recommendations about assignments of taxes such as advertisement, profession and property tax have routinely been made. In addition some SFCs have suggested newer handles for revenue mobilization or improvement in the efficiency of the existing ones. Some have recommended (and implemented) special grants for weak PRIs as well as incentive grants for well performing ones.

It is difficult to justify the efforts taken by the SFCs when they result in ad-hoc, non-formulaic and paltry grants being handed down to the PRIs. It is surprising to note that even after several years have passed after the submission of reports, states in their response to the query use phrases like ‘accepted in principle’, or ‘under active consideration’, or ‘yet to be ascertained’ (Assam, Tripura and Goa) or indeed the more drastic, ‘details are not available’ (Maharashtra). In most cases even the conditional acceptance means non-acceptance of recommendations that have financial implications. Mercifully there are exceptions wherein not only the recommendations have been accepted but actual implementation and quick releases of funds have happened (Gujarat, Haryana, Sikkim and Punjab). In a rare case, rather than awaiting report of the next FC, a state (Haryana) has gone ahead and released advanced grants. Several new schemes have been initiated with strides in implementation backed by financial releases is another best practice that is reported. This shows the proactive stance of the State and should be considered a good practice especially in contrast to the generally prevalent attitude of finding excuses or shifting blame. Quantum of untied and programmatic schematic funds that reaches each Panchayat is as high as 20 to 30% in some cases (Himachal and Kerala). The practice of supporting weak panchayats and creating incentives is laudable (e;g.; Haryana, Punjab, Maharashtra). The enabling practice in some states of allowing outsourcing especially in technical matters and mandate to raise resources through
borrowings is a good practice that deserves emulation. So is the transfer of rights for extraction of minerals whilst keeping the revenues (Madhya Pradesh).

III.3.3 Governance: Processes and Data

There was a decision some time ago, that the states will provide a window for PRIs within the respective state budgets. The response – in a majority of cases – unfortunately has been one that displays apathy, lethargy and even worse deliberate procrastination. Sometimes there have been reasons advanced for this in a clever bureaucratic fashion that would be amusing except that they are seriously disconcerting. Most of the states continue the practice of transferring the funds through the line departments through routine project /scheme line items to the Rural Development Departments or the parallel bodies such as DRDA s or to the commissioner of Panchayati Raj. Then they are sent onwards to the BDOs or Magistrates or in some cases to the ZPs for onward transmission to the lower tiers. The whole point about the decision for a budget window was two fold, one, to reduce the transaction number and nodes so that the cost of transaction would be reduced and efficiency ensured; two it would be easy to find out the actual transfers to PRIs through the budget in an easy fashion enabling researchers and policy makers to evaluate and monitor the transfer efficiency. State level bureaucracy raises serious questions about and show scant respect to the capacity of lower level functionaries (both officials and elected). To be sure some of the states have started moving towards the goal, by creating newer item-heads that reflect the funds to be transferred to PRIs, this could then be presumably be clubbed to form a budget window operated directly by the finance department. A caveat needs to be entered here, although a good move, this will be really useful if there is uniformity in practices across states. If the grants are not released regularly or in a predictable manner – as reported by some states – then not much is achieved. It has been reported that the many of the above lacunae are present not only where the funds emanating from the state government are concerned but indeed much the same is true for even grants that come under Centrally Sponsored Schemes (CSS). It is not unknown – within government and bureaucracy – that even agency nodes assume power through (wrongly) perceived sense of control.
which leads to such behavior. Even where the CSS funds are transferred quickly, they do not go directly to PRIs but to (parallel) DRDAs, who then assume considerable control over the disbursal. These are clearly important governance issues and needs to be tackled effectively. Some of the states have started to take measures to track the fund movement and have decided to keep the limit for the time from receipt to transfer to two weeks. To be sure, there are some good practices, although not as well distributed across states. For example at least in case of CSS funds there are states that quite directly transfer them to PRI bank accounts (all tiers) automatically through the Fund Transfer Software developed by NIC which is a triumph of IT enablement. There are some good practices where separate fungible funds are created within the Treasury (much like the consolidated fund) and the panchayats are allowed to open bank accounts through which the transfers are made. That these funds are largely non-lapsable (across financial years) is enabling provision at least till the PRIs gain greater capabilities. Also the practice of determining both the time and magnitude of such transfers is an empowering and efficient practice that will enable the PRIs to feel secure and informed in making their expenditure plans. There is a welcome and a palpable reduction in the transfer time from two months to two days! Thus, the picture with regard to transfer of funds although frustrating, is not all bleak. The ‘best practices’ as put in place by some states need to be documented and widely circulated, with a view to emulation by all the states. When all is said and done, the main issue has to do with the actual devolution of finances. With the best of allocations at Central as well at the State levels and even with giving additional revenue handles to the PRIs, not to mention the scrupulously worked out schemas for devolution by the SFCs, ‘the best laid plans will come to a naught’, if these are not backed by actual finances in the hands of the ultimate agents. The ultimate brunt is borne by the vulnerable poor in the rural areas. This has not only adverse implications for the agents but also for the principal in terms of credibility. There are some best practices here being demonstrated by few states that need to be learnt from. The absorptive capacity and involved processes at all levels of governmental functioning entail horrendous waste of time. The irony is that each level of government seems to demean the level of capacity at the lower level with little introspection on the self. The use of this euphemism as an excuse for lack or delay in transfer has gone on too long and would be as funny a la ‘Yes
Minister’, except that it is really hurting. Enough number of reform commissions have mulled over the issues and listed out the simplification, efficiency and transparency mechanisms and the time to act on these is yesterday!

We don’t need to refer to Voltaire’s dictum of ‘text before criticism to recognize the paramount importance of availability of up-to-date data on finances of the PRIs, to meaningfully conduct any exercise. Many researchers including us have commented – almost ad-nauseum – on the data problems in similar arenas. The problem is even more acute when one considers the PRIs. There cannot be greater situational tragedy than to have to study/ evaluate finances where consistent available data at the state levels is available with an almost five years lag. And even then it is not tier level, forget about the level of expenditure-functional classification. It is true that such data must be available somewhere in bits and pieces (and occasional evidence is seen) but non-coordination between different departments and levels precludes the possibility of any automatic compilation in a user-friendly manner. Also one more problem has to do with the fact that there is no uniformity (across states) in the heads under which the data, when available, are recorded. None of this, in this day and age (especially of the much touted IT enablement) should be acceptable in India. A concerted effort is thus called for. Of course the work will have to begin at the source level where data is first recorded. A uniform format for compilation will have to be instituted across states and PRIs. Of course this takes us further back into the entire issue of accounting procedures and capacities. There is something to be said for borrowing the ‘good practice’ of creating manual and corresponding training modules, by the UDD of the GoI. Perhaps the Bureaus/ Directorates of Economics and Statistics at the State government level could be directed to act as the responsible nodal agency. MoPR apart the 13 FC should take some steps to recommend setting up of data warehousing facility in the public domain. There is the quality aspect as well as data on good practices that are equally important. But we believe that those things will have to wait (not for too long, one hopes!) for the moment.

Thus, there are things that need to be done on an urgent basis (not all of these are within the purview of the 13th FC). The ‘best practices’ in all the spheres need to be documented and other states encouraged (by arm twisting?!) to adopt them. As things stand, by and large, the SFCs seem to have been a singular failure, indeed sans
tokenism they have been given a go by. **There is a serious need for temporal synchronization and uniformity in treatment by the SFCs which can happen only by a uniform template for them across states.** Some good practices with regards to process and quantum of flow of funds are undoubtedly in evidence, but these are largely in states that have already been converted to the dharma of decentralization. The governance issues wherein overlapping jurisdiction of line departments and other entities that are crowding out the legitimate space of PRIs need a redefinition and delimitation. **Perhaps the centripetal bias of our federation needs to be invoked to take concrete steps (including constitutional amendment) to force the issue of empowering properly constituted State Finance Commissions,** who would in their turn become agents of real change. Finally, we would strongly urge two things, one, the things to be done here should not be done sequentially (there would be an argument and urge to do so in the name of convenience and propriety) for, it would only lead to waste of further time. And two, no pilot studies need to undertaken but the whole scheme should be undertaken in a mission mode, here and now in a big bang, here and now, fashion!

**IV. The Role of 13th FC: What Can it Bring to the Table?**

From all that has been said earlier in the paper, a striking fact emerges that the situation – whilst heterogeneous – by and large is characterized by relentless and continuing lack of resources, leading to what we would liken to an endless night. We now turn to what we believe should be done specifically by the 13th Finance Commission so that it can do its own bit. We wish to reiterate that not everything that we believe can be done here should be done by the 13th FC. We also acknowledge – indeed aver the fact – that much needs to be done by ‘others’ so as to change the parametric environment, so as to create a mesh of institutional arrangements and practices that hold together in a self sustaining (reinforcing) fashion and together contribute to attack the malaise. We suggest a strategy to **DEFEAT** the darkness by signaling – in its small way – a dawn for the PRIs.

We suggest that the task is to **Design** a mechanism that is **Efficient**, **Formula-based** with **Effective** processes for **Adequate Transfer** of resources to the PRIs. There are several things involved here by way of themes and sub-themes. In the first instance, the
inter-se distribution between the states must – make all the right noises and give appropriate nudges to the states – be based on the formulae that reflect the concern for decentralization – through assignment of appropriate weights in devolution formula – amongst other things. This means that not only the formulae be importantly informed by incentive compatibility (at least the one sided one) but must also be high on credibility. The weights in the formulae used for devolution must be seen to be fair. Indeed we had suggested such a scheme at the time of 12th Finance Commission and termed it a ‘FAIR PLAN’ approach (for details see, Pethe and Lalvani 2005). At the second level, once the funds are devolved down to the states for augmentation of the consolidated fund of the state for the purposes of further transfer to the local bodies, in particular the PRIs, there is much to be suggested. Again, we had written a paper that proposes a conceptual framework that does precisely such a thing, but for the urban scenario (see Pethe and Karnik, 2006). Here we will provide a very brief outline of both the approaches.

Our conceptual framework is ashtavadhani i.e., comprises eight cardinal principles and is abbreviated as FAIR PLAN. Each of the alphabets in the acronym stands for:

- **Fairness**
- **Adequacy**
- **Incentive Compatibility**
- **Responsiveness**
- **Political Feasibility**
- **Level Playing Field**
- **Accountability**
- **Need Based**

Whilst the elaboration and operational details may be seen from the paper already cited, here we make a few comments very briefly. The criteria are all reflected in the relative weights in the devolution formula. As far as the political feasibility goes, it implies that recommendations are informed by a healthy dose of realism and ‘large’ shift in established policy paradigm should be avoided. Fairness, defined as lack of envy is an over arching criterion and has to do with eventual shares but also with the distributional criteria. Whereas adequacy is well reflected in the established criteria, the trick here is to design the devolution schema in such a way that adequacy and need are normatively
measured and must not encourage laziness. This criterion along with the need for level playing field requires us to look at the flow as well as stock variables. Incentive compatibility is a crucial cornerstone of our recommendations. However, currently the full I/C systems are perhaps not politically feasible and only a one sided I/C system (no penal clause) may be possible. Even this – avoiding disincentives – may be a step forward. Thus, any and every positive effort has to be applauded and responded to rather than being ignored or worse still penalized. In the context of this paper we will strongly argue for weight to be assigned significantly for observable effort towards strengthening of decentralization. Whilst recognizing the importance of incentive compatible systems in terms of encouraging efficiency and discouraging laggards, sight should not be lost of significant differential in the potential. One needs to approach this in a slightly different way than with other criteria. Whereas most of the other criteria are related to flows, the potential (or the lack of it) is dependant crucially on stock endowments (such as those of infrastructure). Thus a rectification of this aspect assumes great import. The rectification requires a different kind of effort in terms of quality and quantum and hence has to be fortified through the instrumentality of external agent (say the Finance Commission). In the context of globalization, the need and accountability is not a matter of ethics or morality but is simply dictated by pragmatism and good economics. This is true for good political economy reasons as well and the truth-value is enhanced many fold when one takes into account the considerations of social harmony. We now turn to the second level devolution i.e., from states to the local bodies, in particular the PRIs that could lead to a creation of a suggested template for the SFCs in general.

IV.1. Devolution of Funds by the States to PRIs

There are several approaches or methods in existence for formulating an approach towards devolution of funds to Local Bodies. Some of these have, at least, a partially theoretical basis, while some others are purely ad-hoc (informed by political and such other exigencies). Our approach, specifically and importantly, will comprise of five cardinal principles or ‘Panchtatva’, abbreviated as PEACE. PEACE stands for (a) Political Feasibility (b) Equity (c) Adequacy (d) Computational Transparency and (e) Efficiency. From what has already been said in the paper there is little reason to elaborate on the meaning or the need for the elements of our approach. We will straightaway get
into operational matters. The total devolution from the CFC to the States and by the States to the LBs, we take as given. Similarly the division of the pool between the ULBs and PRIs we take as given. There are some contentious issues here but they are not particularly germane to the issues at hand (for details see Pethe, Karnik and Karmarkar 2006). Finally, we also keep aside the issue regarding the distribution between the different levels of PRIs, except to note that by all counts and in the nature of things we would expect around 80% of the total allocation here to go to the lowest (GP) level. The total devolution going to PRIs into two components: need-based devolution and efficiency-based devolution (we enter a caveat that we do not discuss the proportional distribution between the two components in this paper).

IV.2 Approach to Need-based Disbursement

A variety of criteria have been used by the various Central Finance Commissions for disbursement of funds to States. Many of these have changed in importance over the years. For example, the weight on population has been going down over the years. However, as far as the Central Finance Commission recommendations are concerned no distinction needs to be drawn between the geographical boundaries of the State and the jurisdictional authority of the State government. The jurisdictional authority of the State government exactly matches the boundaries of the State. This convenient state of affairs breaks down when one is concerned with disbursements below the level of State governments.

The largest geographical entity inside a State is the district. Most of the detailed information, such as Distance from highest income, index of backwardness, etc is available only for the districts. As far as the PRIs are concerned, with some effort, financial data and information on their population and area should be available. Given the difficulty involved in reconciling the characteristics at the district level and those at the local government level we suggest a two-stage strategy for the devolution of need-based funds:

- **Stage 1**: We use some specially selected criteria in combination with estimated shares for each district to arrive at the disbursement to each district.
➢ **Stage 2**: Having obtained the disbursement for each district, we develop a method for distribution of funds to each PRI.

As far as the efficiency based allocations are concerned, we have been able to devise a methodology that directly targets ULBs.

**IV.2.1 Criteria Used for Need-based Disbursement in this Study**

The Criteria that will be used in this study will now be discussed:

1. **Population**: Population of the Rural segment alone is considered here.
2. **Area**: Area of Rural segments of the districts is considered.
3. **Distance from District with Highest Per Capita Income**: The rationale for this is fairly clear. By this criterion the district with the highest income will get the least disbursement (possibly equal to zero). We preferred to use this criterion as compared to measuring distance from the per capita SDP of the State. While the final set of shares of districts emerging from the alternative may be similar, we felt that measuring distance from highest per capita income would be a superior alternative. Measuring distance from per capita SDP would have resulted in a mixture of positive values (where the per capita income of a district is smaller than the per capita SDP) and negative values (where the per capita income of a district is greater than the per capita SDP). This mixture of positive and negative complicates computation of shares of districts. The alternative employed here, while conveying a very similar picture, eases computation considerably.
4. **Inverse Income**: This criterion instead of using per capita income uses the reciprocal of per capita income as a characteristic. Compared to the distance criterion, the inverse income criterion allocates shares, which are relatively higher not only for the poorest states but also the richest states at the cost of middle income states.

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1 Professor Ravi Srivastava pointed out at the JNU/UNDP/UN-HABITAT Workshop that the presence of so many characteristics in a devolution scheme could lead them to work at cross-purposes. We believe that by an appropriate weighting scheme – including a weight of zero for some of the criteria – this problem can be overcome. The reason for using so many criteria is to offer as much flexibility to the user of the methodology as possible.
5. **Backlog as a Backwardness Indicator**: The earliest information on backlog of development (with respect to roads, education, electrification, etc.) comes from the GOM (1984). That Report had computed the expenditure that would be involved in clearing the backlog in different sectors, such as roads, irrigation, village electrification, education (general and technical), health services, water supply, land development and veterinary. These expenditures were reported for each of the 26 districts that were in existence at that time. Later reports are available for Maharashtra and we hope that similar information for all the states is also available of recent vintage.

6. **Income from (Primary Sector – Mining) as a proportion of Total Income of the District (Distance Approach)**:

   In deciding weighting pattern past practice as well as informed judgment is crucial. Some of the considerations that were important in the determination of weights are listed below:

   ➢ Too high a weight on Distance discriminates rather strongly against the high-income districts as compared to low-income districts. While efforts must be made to reduce the gap between districts, better performance must not be penalized by too high a weight on this characteristic.

   ➢ The weight given to Backlog: it was felt that this characteristic would be correlated with Distance and too high a weight would discriminate against better off states rather excessively.

   ➢ The Central Finance Commissions have been progressively reducing the weight attached to population. While the weight given to this characteristic by the Tenth Finance Commission was 0.20, this was reduced to 0.10 by the Eleventh Finance Commission.

   ➢ For provision of local public goods, it is *Area of coverage* that is probably more important than the *number of beneficiaries*. Local public goods are more susceptible to congestion than pure public goods and hence area of a jurisdiction combined with
its population would be adequate to estimate the need for funds of a local body within a district.

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**IV.2.2 Determining Shares of Districts for Need-based Disbursement**

Having identified the criteria to be used for disbursement and assumed certain weights for these criteria, the next step is to estimate the shares of districts under each of these criteria. We will now discuss the way in which we estimated the shares of districts. It will be noted that there are certain criteria that are global, in the sense that these are applicable to the district as a whole, both its Rural and Urban segments. We will first discuss the derivation of district shares based on global criteria and then look at shares derived from segment-specific criteria.

**Global Criteria**

1. **Distance from Highest Per Capita Income District (DIST):** Distance is defined as the gap the between the highest per capita income of a geographical area (say, district) and the per capita income of other areas. Thus, defining:

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2 Karnik et al (2002) give the detailed mathematical formulation of this procedure albeit for ULBs in Maharashtra.
Distance = \( Y_n - Y_i \) \( \ldots (1) \)

where,

\( Y_n \) is the highest per capita income among all districts and
\( Y_i \) is per capita income of another district

The share of a district is given by:

\[
S_i = \frac{N_i (Y_n - Y_i)}{\sum_{i=1}^{I} N_i (Y_n - Y_i)} \quad \ldots (2)
\]

where,

\( N_i \) is population of the ith district

The construction of the formula is such that the poorer the district larger its share in revenue sharing arrangement. This will also imply that highest income district would get zero share. Note that we have excluded Mumbai from these computations.

2. Backlog (BACK): Given the total amount of expenditure for eliminating the backlog of all districts in the State we obtain the share for each district as ratio of the backlog expenditure for a district to the total backlog expenditure. Naturally, districts with a higher ratio will command a greater share of disbursement according to this criterion.

**Rural Criteria**

1. Rural Population (RP): Shares of the rural segment of the district under this criterion is computed as under.

\[
Q_i = \frac{N_i}{\sum_{i=1}^{I} N_i} \quad \ldots (3)
\]

where,

\( N_i \) is the rural population of the ith district.

2. Rural Area (RA): Shares of the rural segment of the district under this criterion is computed as given below:
\[ AS_i = \frac{A_i}{\sum_{i=1}^{I} A_i} \] \hspace{1cm} \ldots(4)

where,
\[ A_i \] is the rural area of the \( i \)th district.

3. **Income from (Primary sector - Mining) as a proportion of Total Rural Income of the District (Distance Approach)**: The higher this proportion is for a district, the better off it is and should qualify for a lower share by the need-based approach. The method for generating weights is exactly as given for “Distance from Highest Per Capita Income District” under Global Criteria above. The only difference is that under the usual distance criterion we use distance from highest per capital income to generate shares, here we use distance from highest ratio of income from (Primary Sector – Mining) to Total Income.

4. **Inverse (Primary Sector – Mining) Income**: This is computed as follows:

\[ \text{Share of a district, } B_i = \frac{N_i/Y_i}{\sum_{i=1}^{I} (N_i/Y_i)} \] \hspace{1cm} \ldots(5)

where,
\[ N_i \] is the rural population of \( i \)th district and
\[ Y_i \] is income from (Primary Sector – Mining) sectors of the \( i \)th district.

5. **Weights for PRIs**: Separate weights have been assigned depending on the number of PRIs present in a district. The shares for the district are then computed in terms of the ratio of number of PRIs in the district to the total number of PRIs in the State.

**IV.2.3 Efficiency-based Disbursement to PRIs**

We view efficiency in two broad ways:

1. **Performance**
   (a) Levels (DR)
   (b) Changes (ΔDR)
   (c) Recovery of arrears in taxes (RTAX)

2. **Efficiency**
   (a) Administration (ADMIN)
(b) Public Goods (PG)

The separation between Performance and Efficiency allows a division of the funds reserved for Efficiency-based disbursement.

**Performance: Levels (DR):** This is understood in the sense of overall fiscal balance. We have adapted the measures that have been proposed by the Reserve Bank of India for evaluating the fiscal performance of Indian states. The measure of Performance: Levels that we have used may be called “Own Deficit” of the PRI:

\[
DR = \frac{(\text{Total Expenditure} - \text{Own Income})}{\text{Total Expenditure}} \quad \text{(6)}
\]

This measure gives an indication of the dependence of the ULB on resources (such as grants) from a higher level of government. As defined, DR may be positive (indicating an own deficit) or it may be negative (indicating surplus). It needs to be noted that allocation according to DR will use values of this ratio for the latest year for which data are available. Hence, it is not possible to set out allocations to PRIs according to this criterion for a number of years in the future. *DR will have to be computed afresh every year and then allocations determined.*

**Performance: Changes (ΔDR):** The indicators generated out of Performance (DR) may be termed static indicators i.e., indicators for a particular year. We also need to reward PRIs that show improvement over time. For this we look at the changes in the ratio DR that has been defined above. Given the way in which DR is defined, an improvement over time would be reflected by a decline in the value of the ratio. Hence, if ΔDR is negative for an ULB, it indicates an improvement in performance. Only PRIs with negative ΔDR will qualify and the amount set aside for this indicator will be divided among ULBs in the same manner as DR. As in the case of DR, *ΔDR will have to be computed afresh every year and then allocations determined.*

**Performance: Recovery of Taxes (RTAX):** While some aspect of recovery of taxes is reflected in DR, it was felt that we should also specifically focus on recovery of major taxes. The measure of performance discussed here compares recovery of current and accumulated arrears in property tax in a year with total current demand and arrears in property taxes.
RTAX = (Current Demand And Arrears In Major Taxes Collected)/(Total Current Demand And Arrears In Major Taxes) …(7)

**Efficiency: Administration (ADMIN):** Apart from overall performance, a local body must be efficient in providing services i.e., public goods, to the citizens. The ability to provide such services will be severely compromised if expenditure on administration captures a large part of the resources available to a local body. Consequently we need to devise an indicator that will penalize a PRI for spending excessively on ADMIN to the detriment of public goods provision. The indicator that we use is given by:

\[
\text{ADMIN} = \frac{\text{Exp. on Administration, Salaries, Pensions, Etc.}}{\text{Total Expenditure}} \quad \text{ …(8)}
\]

The higher is this ratio for a PRI the lower will be its share in allocations under this head.

**Efficiency: Public Goods (PG):** We believe that the main objective of decentralization should be to provide local public goods to citizens in a way that reflects their preference structure. Under Public Goods we include Education, Water supply, Roads and such other items from the 11th schedule that are core services:

\[
\text{PG} = \frac{\text{Expenditure On Public Goods}}{\text{Total Expenditure}} \quad \text{ …(9)}
\]

It has also been pointed out, that a broad division between revenue (current) expenditure and capital expenditure will also be indicative of the efficiency of a LB. While we agree that this indeed true, and the dominance of revenue expenditure over capital expenditure is a problem that afflicts all levels of government, at the moment such division of expenditure is not available the level of local bodies. It was pointed out earlier that mere spending on public goods need not result in superior service delivery. It should be clear that we are using expenditure on public goods as a proxy in the absence of data on actual service delivery. However, we would like to make a strong recommendation for collection of data on actual provision of public goods, especially the quality aspect.

It is clear that the methodology suggested here depends critically on the quality of data that are available. There can be no disagreement on this issue. The better the quality
of data, the better will be the results of the exercise. In fact, efforts to strengthen the data base of local bodies should be one of the major recommendations, not just from this paper, but from all efforts at deepening fiscal decentralization. Despite the excessive number of criteria in the need-based devolution scheme, given the diversity of Indian States and the diversity of local bodies within the States, we felt that offering as much flexibility in the form of a plethora of characteristics, to the users of the methodology was desirable. In specific instances, users can emphasize or de-emphasize certain characteristics by increasing or reducing (even setting equal to zero) the weights on the criteria. Our objective here is to suggest a possible step towards creation of a template that could serve as a benchmark for the SFCs to use so that their reports can provide uniform and comparable inputs to the States and more importantly the CFCs.

V. An Aside: ‘Learnings’ from the International Experience

Although not directly dealing with PRIs, there is a lot to be learnt from the international experience when it comes to general area of decentralization within the context of federalism. Here we briefly mention the learnings derived from experiences of the developing countries, the transition economies as well as the more developed ones. For elaboration on this theme see Pethe and Lalvani (2008). In the main we depend on the excellent work by Work, R (2002), Anwar Shah (2005) and Bardhan and Mookherjee (2007). The dominant motive for move towards decentralization has been the challenge to incumbent at the national level (perceived or real) from competing political/regional forces. The lessons to be learnt from these experiences seem to be that big bang strategy with public participation performs better more often than not. Constellation and distribution of political power plays an important role. Transfer dependencies imply hard rather than soft budget constraints, which may be fine except that too large a gap between Economic and administrative and devolution are more important for better outcomes and generally (except where the party is very dominant and cadre based) financial devolution seems to follow political one.

The lessons here have been drawn from many countries considered by the source material referred to in the text. These include Bolivia, Pakistan, UK, Denmark, Uganda, South Africa, Chile, Brazil, China, France, USA, Italy, Indonesia and some countries from the erstwhile Soviet Union amongst others.
The array of arrangements of a myriad of different aspects leading to success stories as well as unsuccessful ones reminds one of the celebrated ‘Folk Theorem’ where presumably anything goes. However this feature is indeed at once both a strength and weakness. The responsibility of eliciting useful lessons and reading our situation and hence working through the correspondence principle to derive specific ‘learnings’ falls squarely on us. The raison de etre, of decentralization in India is deeply rooted in our history and culture and reflected in the political pronouncements throughout our history. Let us list out a few of the pointers:

- It is obvious that one of things that must be done is that the size of the local government has to be increased uniformly. The local governments will only then come into their own and into reckoning. **The size at the lowest tier in particular needs to be increased so that public participation is assured.**

- At the current stage, some scope for hand holding and even micro-management may be called for. This could be achieved through the transfers – with gatekeeping – by a constitutional authority such as the Central Finance Commission to minimize politicization.

- **Big Bang approach** should be pressed for, otherwise there will be time for the entrenched order to enter caveats and qualify the substantive proposals to render them ineffective. The current constellation of distribution of forces within the political space is such that, this seems possible as never before.

- **Civil services reform** is hugely important. It is essential that the some of the state/scheme officials should be working under panchayats. In this context, it has been noted that the field office is often times treated as punishment transfer. The distance from the seat of power is seen as a hindrance to possible promotions. It is essential that it be made compulsory for all to work at field postings. However, not being votaries of ‘compulsion’ approach, we would rather like this to be achieved through incentive mechanism. Altogether there is the general (nebulous and hence difficult) task of enthusing the civil service agents with positive energy as far as agenda of the PRIs is concerned.

- Transfer dependencies have to be reduced as far as possible because they induce lack of accountability as well as lethargy. The move towards capital market
access and borrowing – which involves – change in the bank behavior at large is also important. This as indicated earlier will be a theme we will return to later.

- Traditional administrative capacity matters but should not be used as an excuse to not decentralize. Indeed for all the problems and challenges, countries like India require decentralization far more than even the industrialized economies.

Having extracted some lessons from the international sphere, we now briefly sum up what needs to be done.

VI. The Way Forward

Apart from International experiences, we need to take in all the lessons and experiences accumulated thus far within India and reflect on it; but even more importantly start afresh in a big ticket mode. As we have argued earlier, the politico-economic conjuncture is opportune. Thus, apart from the data (financial and of best practices as well as protocols with IT enabled ERP solutions) and accounting as well as process matters – which are of a primary importance – we would suggest a few things. Whilst there are quite a number of things that ought to be done by various agencies, here we concentrate only on the role of the 13th Finance Commission.

In a revivalist Keynesian fashion we would like to suggest that we need to put financial resources (as also functionaries) with the PRIs. This alone will lend substance to all the design of transfers and decentralization as well as governance efforts in general. As Thomas Issacs, the architect of People’s Campaign in Kerala, has noted (see, Shubham Chaudhary, 2007) the preconditions for decentralization are to be created in the decentralization process itself. We must not allow the ‘lack of capacity’ argument to detract us even as we continue our efforts on this front. This alone will allow PRIs the facility of learning by doing. After all when ever in history was infrastructure provided in anticipation?! It always happens when a threshold demand is signaled. The fear of decentralization of corruption notwithstanding, we would still strongly hold this view. After all the leakages are of such magnitude that (tongue firmly in cheek) we would venture to hazard that welfare will be better served with more uniformly distributed,
stable term structure of corruption than a monopolized concentrated entitlement at high places. The Central Finance Commissions must be proactive and make devolutions on account of non-plan expenditure so that we move away from the ethos of ribbon cutting activity. In this context – and at a more general level – there needs to be review of the artificial plan/non-plan and even revenue/capital expenditures. The fact that Vijay Kelkar (2004) who heads the 13\textsuperscript{th} FC has views along similar lines gives us reason for hope.

The capital assets created within the jurisdiction of PRIs must be handed over to the PRIs and they must be provided funds for operations, repairs and maintenance. In doing so – for the sake of manageability – we should concentrate on water (drinking as well as small and medium irrigation), education and roads. Here the important task will be to normatively estimate the fund requirements. Not all of these can be (or even should be) provided by CFC, but it will help to get relative proportion of requirements on this count. Perhaps only the non-salary component should be taken into account with the presumed mandate that the states will match up. These are non-plan revenue resources and could be provided by the Central Finance Commission. In order to recognize and strengthen decentralization – in an incentive mode – via weighting pattern in inter se distribution to the states, there is a need to talk directly to the local bodies in general and PRIs in particular. It can be done either through recommending a share of the statutory grants to the states and or directly giving grants for augmentation of states’ consolidated fund for downward transfer or indeed by directly assigning grants to this progeny of the constitution, firmly giving legitimacy to the 2plus character of our federal structure. This is perhaps asking a bit too much nevertheless CFC must do all it can. Further, a large part of what we are suggesting here should have come as inputs from the State level finance commissions and the 12\textsuperscript{th} FC has suggested several steps to make SFCs effective. The 13\textsuperscript{th} FC should now provide at least a template to the SFCs with all the criteria that should appear in the considerations that go into the SFC’s recommendations. Whilst they could have the discretion of changing the weighting pattern this must be logically and transparently justified.

We must call the bluff that the PRIs universally have a poor fiscal base and relentlessly push – in an incentive compatible mode – for greater effort and search of
additional revenue handles. Further, we have to exploit the revenue base that exists (individually and jointly by some PRIs) and use modified pooled funding approach create an access to the capital markets and more simply, loan exposure (see Pethe and Lalvani 2006). To borrow from Wilde, if some of us dare to look up to the stars, it should be encouraged. We ought not to be afraid to be non-homothetic in approach and breaking through the rural-urban divide, treat the whole space as a continuum and forge synergies across the space of local bodies. Here the onus of capacity building and learning firmly lies – to a greater extent – with the financial institutions who will have to create a new risk matrix and reduce the risk profile of the rural sector in general. This will also require us to face the stiff trade off between equity and efficiency.

At the same time, **parametric environ has to change.** In particular we must consolidate schemes (admittedly outside the scope of the CFC). Let go of those that are not functioning and thus cut losses. Prioritize and in the first instance concentrate on those dealing with water, education and roads. We should thus move forward decisively creating an Enabling Mechanism for Panchayats to Operate Water, Education and Road Schemes, and surely we will see that it EMPOWERS!

**VII. Conclusion**

The emerging agenda implied in all that we have written is of mammoth proportions and not for the faint hearted. Much is being done to be sure, and the forces of inertia and continuity in policy space notwithstanding, much more needs to be done. The credit for the fact that there has been some success shown on the front of the State governments taking action on various actions suggested (although at a slow pace) is a singular achievement of the dynamism shown by MoPR and its leadership. The PM has directly intervened to afford centrality to MoPR and its charge (in a sense) the PRIs, in every possible including the flagship programs. This was to be especially true where the CSS hit the ground and impact the local public goods. A whole list of a host of activities has been drawn up which is impressive as it is well thought out, that this is being done by the NDC subcommittee lends it credibility (see GoI, 2008). However, all these functions
are possible only if adequate funding is provided. After all we don’t need Bahl (1999) to tell us that finance must follow function.

The issue is deeper, as has been noted (see Konrad Adenauer (1998)) the PRIs were to be vibrant institutions in the democratic set up on the country and yet the requisite recognition has not been granted in the corridors of power. The recent Central Finance Commissions have been doing their bit – especially the 12 CFC – to situate PRIs within the structure of Indian Federal Public Finance, and one hopes that the tradition is strengthened further (see Pethe, 2008) so that they can be more effective.

Thus, the Polity, Economy and Administration are entwined in a triangular set-up that resembles not a light romantic comedy but rather a rough ménage a trios and it is essential that they find a way through to EMPOWER the PRIs and DEFEAT the darkness, for ensuring smooth attainment of India’s development goals. The concerted effort by the 13th Finance Commission will serve as a harbinger of the dawn that will put an end to the endless night.

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