UNIT 2 FISCAL DECENTRALISATION IN INDIA: AN OVERVIEW

Structure:
2.1 Introduction
2.2 Fiscal Decentralisation: Meaning and Importance
2.3 Fiscal Decentralisation in India
2.4 Sources of Local Government Revenue
2.5 Sources of Revenue of Urban Local Bodies in India
2.6 Sources of Revenues of Panchayati Raj Institutions in India
2.7 Criteria for Fiscal Devolution
2.8 Measures for Strengthening Fiscal Decentralisation
2.9 Let Us Sum Up
2.10 References and Selected Readings
2.11 Check Your Progress-Possible Answer

2.1 INTRODUCTION

Decentralisation has become one of the important dimensions of governance of modern democracy. The devolution of functions, functionaries and funds from the Central Government to the provincial and local government is propagated as a step for the effectiveness of decentralisation. Customarily decentralisation is termed as delegation of decision making power to the lower levels of governments. It is studied that decentralisation improves accessibility, promotes responsibility and accountability and effectiveness of the government. Thus decentralisation intends to disperse decision-making governance closer to people. Dispersal of financial responsibility is an important component of decentralisation. Devolution of funds to the local governments closer to the people believed to promote faster development both in rural as well urban areas. After reading this unit you should be able to:

- Explain the meaning and importance of fiscal decentralisation
- Describe the sources of local government revenue
- Discuss the fiscal decentralisation in India
- Analyse the criteria of fiscal decentralisation and measures for strengthening fiscal decentralisation.

2.2 FISCAL DECENTRALISATION: MEANING AND IMPORTANCE

2.2.1 Meaning of Fiscal Decentralisation

The Central Government is increasingly finding difficulty to meet all of the numerous competing needs of their various constituencies at the regional and local levels. Its therefore attempting to build local capacity by delegating responsibilities downwards to their regional governments and local governments.
At the same time, the local governments are also demanding more functional and financial autonomy. As a result two things have happened:

i) Firstly, Central Government is looking towards local and regional government to assist them on devising economic development strategies;

ii) Secondly, regional and local political leaders are demanding more autonomy and want the taxation powers that comensurates with their expenditure responsibility.

According to Kenneth Davey, fiscal decentralisation comprises the financial aspects of devolution to regional and local government and it covers two interrelated issues:

a) First is the division of spending; and

b) The amount of discretion to be given to regional and local governments to determine their expenditures and revenues.

The concept, fiscal decentralisation caught attention of the various countries only after 1990. However, there are evidences that show that countries like Brazil, Peru and Mexico introduced a system of fiscal decentralisation in their economy in the 1990s. Fiscal decentralisation has become worldwide reform agenda supported by the World Bank, USAID, Asian Development Bank and many other bilateral and international agencies. World Bank perceives fiscal decentralisation and the devolution of power as an important engine for shaping governance and development. James Edwin Kee opines that ‘Fiscal decentralisation’ is the devolution by the Central Government to local governments such as states, region and municipalities of specific functions with the administrative authority and fiscal revenues to perform those functions. Chio states that, fiscal decentralisation means that the authority of tax collection or expenditure is transferred from superior to subordinate offices. He advocates that fiscal decentralisation has two aspects that is qualitative and quantitative. The qualitative aspect of fiscal decentralisation analyses finance held by a local government, where as the quantitative aspect estimates the presence of autonomy authority in finance. According to M. A. Oommen, fiscal decentralisation means fiscal empowerment of local governments. More specifically it means devolution of taxing and spending powers to lower levels of government. According to World Bank, fiscal decentralisation accords substantial revenue and expenditure authority to intermediate and local government.

Thus fiscal decentralisation is not only the allocation of resources by the Centre to the regional and local governments but also generation of resources by the regional and local governments. One of the purposes of the fiscal decentralisation in China is to grant the provinces and localities greater flexibility in collecting revenues and making expenditure decisions. The Government of India also made Constitutional provisions for fiscal decentralisation to state and local government.

2.2.2 Importance of Fiscal Decentralisation

The fiscal decentralisation hold merits for several reasons and some of the reasons are as follows::
i) Fiscal decentralisation promotes economic value. The fiscal federalism like the political concept of democracy is considered to be an optimal institutional arrangement. It has the provision of public services with cost minimisation and welfare maximisation. It also combines the advantages of decentralisation with the benefits from economies of scale.

ii) Fiscal decentralisation leads to good governance, by ensuring fiscal responsibility to the lower level of government that is local self government. Governance values include responsiveness and accountability, diversity and political participation. Decentralisation places allocation decision making close to the people. As a result, this places greater responsiveness to local officials and greater accountability to citizens.

iii) Fiscal decentralisation would enhance political participation at the local level. This has the potential to enhance democratic value and political stability at the local level. It provides a forum for local debate about local priorities and can be a proving ground for future political leaders. It imparts financial education to the local leaders at the grassroots levels.

iv) The fiscal decentralisation is supposed to reduce poverty through the need-based and demand-driven approach of utilisation of resources through participation of locals at the grassroots. The counties like China and India are very much in the favour of fiscal decentralisation for poverty reduction.

v) With fiscal decentralisation, funds are effectively used as
   a) they are demand-driven and there is high degree of local involvement;
   b) their operations are transparent and accountable;
   c) they are carefully targeted to low income group; and
   d) free from official red tapism.

vi) According to Stigler, fiscal decentralisation brings government closer to the people. However a representative government functions in better manner, when it is close to the people. The theoretical perceptive of this argument goes like this “each public service should be provided by the jurisdiction having control over the minimum geographical area that would internalise benefits and costs of such provision.”

vii) In a fiscally decentralised system where citizens’ participation in decision making is encouraged, locally elected governments have the power to pursue the agenda mandated by voters.

After reading this section, you might have gained idea about the meaning and importance of fiscal decentralisation. Now you would be able to answer the questions given in Check Your Progress-1

Check Your Progress 1

Note: a) Write your answer in about 50 words.
   b) Check your answer with possible answers given at the end of the unit

1) What do you mean by fiscal decentralisation?

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2) Discuss a few merits of fiscal decentralisation

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2.3 FISCAL DECENTRALISATION IN INDIA

In India, fiscal decentralisation assumed importance after 73rd and 74th Constitutional Amendments, which envisaged the devolution of functions, functionaries and funds to the local self government institutions. Before 1992, that is prior to the passing of the 73rd and 74th Constitutional Amendment, several committees and commission recommended for the fiscal decentralisation. Let us discuss in detail the recommendations of various committees and constitutional measures undertaken for fiscal decentralisation in India.

2.3.1 Committees

Various committees and commissions were constituted for suggesting measures for establishing financial autonomy of the Panchayats and municipalities. In the light of these suggestions, the States have made appropriate provisions in their Panchayat Raj Acts. Let us now review the recommendations of various committees appointed from time to time about decentralisation of finances to local self government institutions.

i) Finance enquiry committee

In 1951, the Local Finance Enquiry Committee studied this problem and recommended unconditional assignment of 15% of land revenue to be raised in the panchayat area and the proceeds of surcharge levied on the transfer of immovable property to the Panchayats. Panchayats were also to be empowered to raise their own resources by levying certain taxes in their territories.

ii) Taxation enquiry committee

In 1954, the Taxation Enquiry Committee recommended for reserving certain taxes such as tax on land and building, octroi, tax on non-mechanical transport, tax on property, tax on profession, tax on advertisement other than newspapers, theatre tax, and duty on transfer of property, etc. for Panchayats.

iii) Santhanam Committee

The Santhanam Committee formed in 1963 strongly recommended that it was essential for stability and growth of local institutions to have substantial and growing resources, which were entirely within their power to exploit and to develop.
iv) Ashok Mehta committee

In 1978, the Ashok Mehta Committee recommended that besides government support, *panchayats* should mobilise enough resources of their own, as no democratic institution can continue to maintain its operational viability by depending upon external resources.

v) Singhvi Committee

In 1966, the Singhvi Committee among others, suggested pattern of compulsory and optional levies. The State Governments shall levy and collect taxes and fees on behalf of PRIs and shall disburse to them based on the recommendation of the Finance Commission in each State. In order to ensure and safeguard the financial autonomy of the PRIs, they should be freed from relying on the “Untied Funds”. But encouraged instead to take to innovative resource mobilisation such as generation of income from entrepreneurial activities, projected loans, public contribution, tax-sharing, tax-assignments and matching grant incentives for tax collection.

2.3.2 Commissions

The 73rd Constitutional Amendment provides for devolution of functions and transfer of functionaries and funds to the three tiers of Panchayati Raj Institutions. The article 243G of the Constitution states, “Subject to the provisions of the Constitution, the legislature of a state, by law, may endow the *panchayats* with such powers and authority as may be necessary to enable them to function as institutions of self-government. Such laws may contain provisions for the devolution of powers and responsibilities upon *panchayats* at the appropriate level, subject to such conditions as may be specified therein, with respect to:

a) The preparation of plans for economic development and social justice; and

b) The implementation of schemes for economic development and social justice as may be entrusted to them including those in relation to matters listed in the Eleventh Schedule.

Article 243A of the Constitution of India embodies the spirit of the democratic decentralisation.

While 280 (3) (bb) of the Constitution enjoins the Central Finance Commission to suggest measures needed to augment the consolidated fund of a state to supplement the resources of the *panchayats* and municipalities on the basis of the recommendations made by the Finance Commission of the State.

Article 243-H of the Constitution, empowers the state legislatures to enact laws:

a) To authorise a *panchayat* to levy, collect and appropriate such taxes, duties, tolls and fees;

b) To assign to a *panchayat*, certain taxes, duties, tolls levied and collected by the state government;

c) To provide for making grants-in-aid to the *panchayats* from the consolidated fund of the state; and

d) To provide for the constitution of such funds for *panchayats* and also the withdrawal of such money there from; as may be specified by law.
Article 243-I of the Constitution envisages for the setting up of the State Finance Commission (SFC) once in every five years to review the financial position of the panchayats and to make recommendations to the Governor as to:

i) The principles which should govern-
   a) The distribution between the state and the panchayats of the net proceeds of the taxes, duties, tolls and fees levied by the state. It may be divided between them under this part and the allocation between the panchayats at all levels of their respective shares of such proceeds;
   b) The determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by the panchayats;
   c) The grants-in-aid to the panchayats from the consolidated fund of the state

i) The measures needed to improve the financial position of the panchayats;

ii) Any other matter referred to the finance commission by the Governor in the interests of sounds finance of the panchayats.

The 74th Constitutional Amendment also states that the State Finance Commission to review the financial position of the urban local bodies, their revenue and capital account requirements. It recommended devolution of taxes, charges, fees, tolls, duties, shared revenues, inter-government transfers and grants from the state to the municipalities. It suggested measures for the mobilisation of municipal resources.

2.3.3 The Central Finance Commission

Direct devolution by CFCs to ULBs began with the Xth CFC after insertion of clause 280(c) in the Constitution and entailed an allocation of Rs.1,000 crore for 1995-2000. It was calculated on the basis of:

i) Slum population;

ii) Matching contribution by municipalities;

iii) Funds to be used for the non-establishment segment of O&M.

CFC has also suggested a reform agenda at the state and municipal level to enable full devolution (2.5% of divisible funds) after the first year (2010-11) of the five-year period of 2010-15. This includes a 1% share of divisible pool on taking up the reform agenda of the XIIIth CFC covering:


- Improved auditing though assignment of technical guidance and supervision (T&GS) to CAG (Comptroller and Auditor General), Government of India, which will induce fiscal discipline.

- Appointment of Independent Local Body Ombudsman to check corruption and malpractices.

- Grants to be transferred electronically to ensure transparency and timely disbursement.
• Laying out qualifications for the members of state finance commission to improve equality and competence of SFC.

• Property tax should be levied on all properties, including central/state government properties.

• States should constitute a Property Tax Board that will lay down norms for the PT system to ensure complete coverage and revenue enhancement.

• States/ULBs should set out service standards (as 31st March) to be accomplished during the next financial year, particularly in relation to core municipal services such as water supply, sewerage, storm water drainage and solid waste management.

All towns with a population above one million should have their own fire fighting service.

2.3.4 The State Finance Commissions

Chapters 243-I and Y of the 73th and 74th Constitutional Amendment Acts, respectively, made it mandatory for state governments to constitute state finance commissions (SFCs) every five years to review the financial position of the panchayats and urban local governments, and to make recommendations for the subsequent five-year period on:

a) the principles to govern the distribution and allocation of the taxes, duties, tolls and fees levied by the state, and the allocation between the panchayats/local governments of such proceeds;

b) the determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by, the panchayats/local governments;

c) the grants-in-aid to the panchayats/local governments from the Consolidated Fund of the state;

d) the measures needed to improve the financial position of the panchayats/municipalities; and

e) any other matter referred to the SFC by the governor in the interests of sound finance of the panchayats/local governments.

2.4 SOURCES OF LOCAL GOVERNMENT REVENUE

The various sources of local government revenue can broadly be categorized into four heads:

i) Local Taxation

ii) User Charges

iii) Inter Governmental Transfers

iv) Capital Finance

i) Local Taxation: The local self government in different countries used to impose local taxes as a source of revenue. However, it varies from state to
state and region to region depending on decision of the concerned state government. Local taxes are generally divided into three categories such as taxes on property, income and sale of goods and services. Generally it is observed that highly progressive and mobile tax bases are assigned to the centre. While, user charges and fee are found to be vested with the local governments. Therefore, decentralized (local) levels of government rely mainly on taxes like property tax, user charges and fees.

ii) User charges: The local governments charges user fee for the services which they provide to the citizen of the municipal areas. Now day local governments are under increasing pressure to increase tariffs to meet the full cost of services which they provide.

iii) Intergovernmental Transfers: The intergovernmental transfer are of two types:

i) Share of national taxes distributed either by formula (i.e. per capital) or by origin (i.e. to the local government where they are located).

ii) The second is the grants/subversions which are either targeted to support specific expenditure (i.e. social benefit, education, etc.) or untargeted and used at discretion of local government (often know as block grants).

Targeted grants are usually intended to stimulate a specific type of expenditure which is favoured or mandated by national government. The untagged or untied grants the other hand can be used by the local governments based on local needs.

iv) Capital Finance: Capital expenditure is normally financed from one or more of the following sources:

i) Grant from the state budget or national funds;

ii) Operating surplus representing excess of current revenue over current expenditure

iii) Sale of assets;

iv) Credit (loans and bonds) grants from the state is a common phenomenon.

**Box: Delegation of financial powers to urban local bodies: 74th Constititional Amendment:**

The State may, by law:

- Authorise a municipality to levy, collect and appropriate such taxes, duties, tolls and fees in accordance with such procedures and subject to such limits;
- Assign to a municipality such taxes, duties and tolls and fees levied and collected by the State Government for such purposes and subject to such conditions and limits;
- Provide or make such grants-in-aid to the municipalities from the consolidated fund of the State; and
- Provide for constitution of such fund for crediting all moneys received, respectively, by or on behalf of the Municipalities and also for the withdrawal of such moneys therefrom.
2.5 SOURCES OF REVENUE OF URBAN LOCAL BODIES IN INDIA

Some of the important sources of revenues of the urban local bodies in India are as follows:

i) **Tax Revenue**: Urban local bodies levy a few taxes in their area such as *octroi*, property tax, profession tax, entertainment tax, advertisement tax, animal tax, market tax, water tax, pilgrim tax, toll on new bridges, etc. Nowadays most of the states have abolished *octroi* tax, which was a major source of revenue for the urban local bodies. Besides, the urban local bodies also get a percentage of tax revenue from stamp duty, electricity tax and motor vehicle tax imposed by the state government.

ii) **Non-Tax Revenue**: It consists of fees, receipts, fines or income from remunerative activities of urban local bodies. The fees is collected through various forms and processing fees. Besides, fees are collected from park and exhibition ground, halting places, public market, etc.

   a) **Grant-in-Aid**: The State Government gives grants-in-aid to the urban local body. It varies from state to state depending on the recommendations of the concern state finance commission.

   b) **Loans & Bonds**: Under the respective Municipal Acts, the Urban Local bodies are entitled to raise loans from the state governments. The loans are to be paid back within prescribed time limit along with the interest. Besides, the now a days many municipalities and municipal corporations are sailing bonds to enhance their revenue base.

Fig. 2.1: Revenue of ULBs
The progress of implementation of accounting reforms by the ULBs in India is very slow. Only a few states have introduced the measures for raising finance as per the recommendation of the Central Finance Commission.

The Central Finance Commission has suggested several measures to augment the consolidated fund of the state for municipal resource mobilisation. These include land taxes, surcharged cess on state taxes, and property tax. It was also suggested for enhancing of local resources through property tax and fixation of user charges in such a way that the full cost of operation and maintenance is recovered. However, all these suggestions have not been dutifully implemented by various states. Even the state government does not release the funds received on the recommendation of the Central Finance Commission.

The JNNURM (Jawaharlal Nehru National Urban Renewal Mission) has included following mandatory and optional reforms with the objectives to improve pricing and cost recovery of user charges.

i) Mandatory reforms:
   a) Levy of reasonable user charges by ULBs with the objective that full cost of O & M is collected within next five years.
   b) Internal earmarking within local body budget for basic services to the urban poor.
   c) Provision of basic services to urban poor including water supply, sanitation, etc.

ii) Optional reforms:
   a) Revision of by-laws to make rain water harvesting mandatory in all building to come up in future and for adoption of water conservation measures.
   b) By-laws on re-use of reclaimed water.
   c) Encouraging public-private partnership.

In this section, you read about various sources of local government revenue. Now answer the questions given in Check Your Progress-2

Check Your Progress 2

Note: a) Write your answer in about 50 words.
   b) Check your answer with possible answers given at the end of the unit

1) What are the various sources of local revenue?
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   ........................................................................................................................................
   ........................................................................................................................................
   ........................................................................................................................................
   ........................................................................................................................................
2) How local taxation is an important source of revenue?


2.6 SOURCES OF REVENUES OF PANCHAYATI RAJ INSTITUTIONS IN INDIA

_Panchayati Raj_ Institutions (PRIs) receives revenues from various sources. The important sources of revenue of the PRIs in India are as follows:

i) **Revenue from the Central Government:** Every state gets revenue from the Central Government as per the recommendations of the Central Finance Commission. This is based on the criteria fixed by the Central Finance Commission. The PRIs of states also get grant from the National Planning Commission.

ii) **Revenue from the State Government:** The two main sources of revenue from the state government to the PRIs are:
   a) Allocation as per the recommendation of the State Finance Commission;
   b) Scheme specific grant from the State Planning commission.

iii) **Internal resources of Revenue:** The PRIs in different state applies various mechanisms for internal resources mobilisation. The important sources are
   a) Taxable income and fees
   b) Non-taxable income like income from the common property resources, sales of goods and services, borrowings, income from live stocks, etc.

The revenue sources of _Panchayati Raj_ Institutions is given in the form of a diagram below

![Fig. 2.2: Revenue of PRIs](image)
The PRIs in Kerala, Karnataka and Gujarat enjoy greater financial autonomy. In Kerala, 40 per cent of plan funds go directly to panchayats. In Karnataka, each panchayat get Rs.3,00,000 annually directly from the state government and in Madhya Pradesh each panchayat gets a grant of rupees Rs.1,00,000 every year from the state government. These are untied funds to be spent according to the need and requirement of each panchayat.

For example, the sources of income of village panchayats in Karnataka include:

i) Statutory grant (Rs 5 lakhs) from the state government

ii) Property tax, water tax, professional tax, fair and exhibition tax and professional tax. These taxes constitute nearly 17 per cent of the total revenue and


In Kerala, a village panchayat levies and collects taxes from the local people. Taxes levied by the village panchayats are property tax, profession tax, entertainment tax, advertisement tax, service tax, show tax including surcharge, cess on conversion of land use and surcharges. The government devolves 40 per cent of plan budget directly to village panchayats in Kerala.

In Madhya Pradesh, in order to make every village self-reliant (gram swaraj) a provision has been made that every village needs to have a gram kosh (village fund). The fund comprises funds collected in the form of taxes, Central and State Government grants and funds given by the district panchayat. Any other income of the village panchayat shall also be deposited in the gram kosh. The gram kosh shall have four components such as:

- Food Kosh
- Commodity Kosh
- Labour Kosh; and
- Cash Kosh.

The sources of income of the village panchayat in Madhya Pradesh are:

- Taxes: house tax, sanitation tax, lighting tax, business tax
- Income from minerals
- Income from fishery
- Grant-in-aids from Central and State government
- Income from common property
- Income from livestock

### 2.7 CRITERIA FOR FISCAL DEVOLUTION

The following criteria may be suggested for the effective transfer of resources to the local self governments by the central government.

i) **Autonomy**: The essence of decentralisation is self-rule and autonomy. The transfer mechanism in no way should result in a dependency syndrome. Fiscal
discipline and own resource mobilisation are the key to autonomy. Therefore, the local self government institutions creativity in mobilisation of resources must be encouraged.

ii) **Equity**: The well-known dictum of equity, namely, ‘from each according to one’s ability and to each according to one’s needs’ is relevant in considering resource mobilisation and intergovernmental resource transfers as well. It should be noted that *Panchayats* at all levels are very unequal in size, resources and development attainments. Given the extreme regional disparities, decentralisation in such conditions can produce the desirable results.

iii) **Predictability**: The PRIs should know the amount and timing of the transfers to make provision for planning, budgeting and implementation of their activities. Irregular payments are not conducive to efficiency. Quite often it happens that allocations may not even be paid, resulting in overdue, which eventually may be permanently lost to them.

iv) **Efficiency**: The resource transfer should be so designed as to facilitate efficient management and discourage inefficient and uneconomic practices. The transfer mechanism should not turn out to be a “gap-filling” approach.

v) **Absorptive Capacity**: The resource transfer should be in the tune with the utilisation ability of the receiving Panchayat or municipal ward. In other words, principle should be each according to its need. The allocation of fund to the panchayat and municipal ward must be free from bias.

vi) **Simplicity**: The formula for transfer the inter-governmetal resources should be simple and transparent. Besides formula formulated by the Central Finance Commission, the state government must device its own formula based on its socio-economic, geographical and population composition for allocation of resources to panchayat and municipalities and also among the different levels of panchayat and urban local bodies.

vii) **Promotion of Incentives**: There should be adequate built-in arrangements for encouraging resource mobilisation and penalising wasteful and uneconomic practices. The panchayat which mobilize and generate their own local resources must be given additional matching grant, which will create competitiveness among the local self government institutions.

viii) **Poverty Reduction**: Removal of poverty should be the main aim the fiscal decentralization. Panchayats and municipalities taking proactive measures in poverty reduction must be given incentives for their initiatives.

ix) **Reduction of Disparities**: Socio-economic disparities are one of the main concerns of the governments. The local self government can play a vital role in narrowing disparities at the grassroots. This must be a basis for the allocation of revenue among various local self government institutions.

The formula recommended by the 11th Central Finance Commission for the inter se share of the states in tax devolution is given in Table-1.
Table 1: Criteria and Relative weights for determining inter se shares of states

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Criterion</th>
<th>Relative weight (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Population</td>
<td>10.0</td>
</tr>
<tr>
<td>2</td>
<td>Income</td>
<td>62.5</td>
</tr>
<tr>
<td>3</td>
<td>Area</td>
<td>7.5</td>
</tr>
<tr>
<td>4</td>
<td>Index &amp; Infrastructure</td>
<td>7.5</td>
</tr>
<tr>
<td>5</td>
<td>Tax effort</td>
<td>5.0</td>
</tr>
<tr>
<td>6</td>
<td>Fiscal discipline</td>
<td>7.5</td>
</tr>
</tbody>
</table>

Source: Report of Eleventh Finance Commission

The percent share of different states according to the formula is given in Table-2

Table 2: Inter se share of states

<table>
<thead>
<tr>
<th>States</th>
<th>Share (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Pradesh</td>
<td>7.701</td>
</tr>
<tr>
<td>Bihar</td>
<td>14.59</td>
</tr>
<tr>
<td>Gujarat</td>
<td>2.82</td>
</tr>
<tr>
<td>Haryana</td>
<td>0.94</td>
</tr>
<tr>
<td>Jammu &amp; Kashmir</td>
<td>1.29</td>
</tr>
<tr>
<td>Karnataka</td>
<td>4.93</td>
</tr>
<tr>
<td>Kerala</td>
<td>3.05</td>
</tr>
<tr>
<td>Madhya Pradesh</td>
<td>8.83</td>
</tr>
<tr>
<td>Maharashtra</td>
<td>4.63</td>
</tr>
<tr>
<td>Orissa</td>
<td>5.05</td>
</tr>
<tr>
<td>Punjab</td>
<td>1.14</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>5.4</td>
</tr>
<tr>
<td>Tamil Nadu</td>
<td>5.38</td>
</tr>
<tr>
<td>Uttar Pradesh</td>
<td>19.79</td>
</tr>
<tr>
<td>West Bengal</td>
<td>8.11</td>
</tr>
</tbody>
</table>

Source: Report of Eleventh Finance Commission

2.8 MEASURES FOR STRENGTHENING FISCAL DECENTRALISATION

Fiscal decentralisation can be strengthened by various ways:

i) Deciding institutional system to strengthen inter-governmental economic relations. The economic relation among the centre, state and local governments must be cordial and healthy. Besides, the basis of financial devolution among the different tiers of local self government must be clearly defined, this will lead to fiscal collaboration rather confrontation.
ii) Planning fiscal transfers to assure regional fiscal equality and to build an effective environment for advanced and competitive service delivery.

iii) Restructure tax responsibility to allow local revenue autonomy, efficiency and accountability. Delegation of responsibility to the local government to collect and spend their taxes according to the local needs will strengthen the fiscal decentralisation.

iv) Determining the functionary funds of different levels of government on the criteria of equality and efficiency.

v) Providing sub-national government an access to responsible credit market. However, with the globalization, the local self government institutions must have access to capital market.

vi) According to Bahl, a measure of fiscal decentralisation should reflect the key characterises of a fiscally decentralised system, such as existence of elected local council, approved budget, local government to collect taxes.

vii) Institutional reforms that minimize adverse incentives and promote transparency, accountability and predictably should be executed to have an effective fiscal decentralization.

In these sections, you read about fiscal decentralisation in India, criteria of fiscal decentralisation and measures to strengthen fiscal decentralisation. Now answer the questions given in Check Your Progress-3

**Check Your Progress 3**

**Note:** a) Write your answer in about 50 words.

b) Check your answer with possible answers given at the end of the unit

1) What are the various sources of revenue of PRIs in India?

2) Explain three criterions for fiscal decentralisation.
2.9 LET US SUM UP

In this unit you read about the fiscal decentralisation. Fiscal decentralisation is an important component of democratic decentralization. The fiscal decentralization process started since 1990 and in India it was geared up after 1992 with the implementation of 73rd and 74th constitution amendment. In common parlance fiscal decentralization aims at shifting of financial responsibilities from the central to the lower level of governments. As the financial responsibilities become closer to the people, it is believed that it will lead to good governance, transparency and accountability. Besides, meaning and importance of fiscal decentralization, this unit also covers sources of local government revenue in general and of local self government institutions in India in particular. Lastly, this unit also covers criteria for fiscal decentralization and measures to strengthen fiscal decentralization.

2.10 REFERENCES AND SELECTED READINGS


2.11 CHECK YOUR PROGRESS-POSSIBLE ANSWERS

Check Your Progress 1

1) **What do you mean by fiscal decentralisation?**

Fiscal decentralisation means decentralisation of financial power to the lower levels of governments. According to N. Feruglio fiscal decentralisation is a process of shifting decision making power on the composition of expenditure responsibilities and on the composition and level of revenues from the central government to elected sub national governments. M. A. Oommen opined that fiscal decentralisation means fiscal empowerment of local governments. More specifically it means devolution of taxing and spending powers to lower levels of government.

2) **Discuss a few merits of fiscal decentralisation.**

Two important merits of fiscal decentralisation are:

i) Fiscal decentralisation promotes economic value. The fiscal federalism like the political concept of democracy is considered to be an optimal institutional arrangement for the provision of public services with cost minimisation and welfare maximisation;
ii) Secondly, fiscal decentralisation leads to good governance, by ensuring fiscal responsibility to the lower level of government i.e. local self government. Governance values include responsiveness and accountability, diversity and political participation.

Check Your Progress 2

1) **What are the various sources of local government revenue?**

The various sources of local government revenue can broadly be categorized into four heads:

i) Local Taxation

ii) User Charges

iii) Inter governmental Transfers

iv) Capital Finance

2) **How local taxation is an important source of revenue?**

The local taxes are important sources revenue for the local self government. Higher the local taxes imposed by the local self government institutions, lower will be their dependence on the central and state governments for grant. However, it is seen that the local self government are reluctant to impose taxes on the people because their very closer to the people.

Check Your Progress 3

1) **What are the various sources of revenues of PRIs in India?**

The important sources of revenue of the panchayati raj institutions in India are as follows:

i) Revenue from the Central Government: Every state gets revenue from the central government as per the recommendations of the Central Finance commission;

ii) Revenue from the state government: The two main sources of revenue from the state government to the PRIs are:

   a) Allocation as per the recommendation of the State Finance Commission; and

   b) Scheme specific grant from the State Planning commission and

iii) Internal resources of Revenue: The PRIs in different state applies various mechanism for internal resources mobilization. Two important sources are:

   i) Taxable income and fees

   ii) Non-taxable income like income from the common property resources, sales of goods and services, borrowings, income from live stocks, etc.

2) **Explain three criterias for fiscal decentralisation.**

The three important criteria for fiscal decentralization are

i) Autonomy: The essence of decentralisation is self-rule and autonomy;

ii) Equity: The well-known dictum of equity, viz. ‘from each according to one’s ability and to each according to one’s needs’ is relevant;

iii) Predictability: The PRIs should know the amount and timing of the transfers to make provision for planning, budgeting and implementation of their activities.