CHAPTER 2

Issues and Approach

2.1 In every federal set-up, devolution of funds takes place from the higher levels of government to the lower ones; but such devolution generally does not meet the fiscal gap of the lower levels to the full extent. In India, the system of fiscal transfers from the Centre to the States, operating for more than 60 years, could not meet all the financial needs of the State Govts. The task of meeting the revenue gap of ULBs and PRIs, is more difficult. Their demands are large and the financial resources of a State are limited as compared to that of the Central Govt. The capacity of local bodies to raise their own financial resources is also very limited. The Constitution envisages the local bodies to be effective third-tier of government, but there is no specific provision in the Constitution for the sources of their finances. There is no third list of subjects in respect of which taxation powers vest in the local bodies. This position is sought to be remedied, to an extent, by the provision of sharing of revenues between the State Govt. and the local bodies through the instrumentality of the SFC. The basic philosophy is that with the devolution of function to the local Govt., devolution of adequate financial resources is necessary to develop their institutional capacity in order to enable them to carry out the functions assigned to them and to provide the services which the citizens are entitled to from them. The basic principle that governs the devolution process is that the local governments should enjoy financial autonomy, which implies both financial adequacy and freedom to spend as considered fit. In other words, the financial resources devolved should be adequate to meet the expenditure on functions devolved on the local governments. Secondly, they should have the freedom to spend that money in a manner consistent with their felt needs and local imperatives. The SFC may, however, recommend such devolution, ensuring a balance between the fiscal position of the State on the one hand and the requirements of the local bodies on the other. The objective is to strengthen the fiscal domain of local bodies, while taking care not to recommended transfer of resources from the State Govt. which would adversely affect its finances and make it difficult for the State Govt. to achieve targets laid down in the Fiscal Responsibility and Budgetary Management (FRBM) Act. The TOR of the Commission specifically requires that, while making its recommendations, the Commission should keep in mind the provisions of the State FRBM Act.

2.2 Chhattisgarh is a predominantly rural State with 77% of the population living in rural areas. The PRIs, particularly the GPs are close to the people and hence need to be the most effective unit of self-government in the rural area. The State Panchayat Act has provided for full functional devolution as per Schedule-XI of the Constitution and in Chhattisgarh all the 29 functions have been entrusted to the GPs. At its present capacity level, however, the GP are unable to carry out all these functions, resulting in a reverse trend of withdrawal of functions from the GPs, as has been observed by the Commission. Apart from funds involved in the discharge of these functions, the agency functions assigned to the GPs and implementation of important State and Central Schemes for rural employment and poverty alleviation, entail management of large expenditure, anything between Rs.30 lakhs to Rs. 1 crore. The GP with its single employee i.e. the Panchayat Secretary, does not have the capacity even for the primary Panchayat functions like delivery of basic services in the village. Maintenance of accounts is poor and statutory audit by the Local Fund Audit Department is practically non-existent. In our approach to devolution, therefore, the emphasis is on development of institutional capacity of the GPs. This should include provision of additional trained staff, adequate training and motivation of both the elected representative and officials. Besides, maintenance of accounts and timely audit are necessary to ensure functional and financial accountability which is lacking presently.

2.3 As we have mentioned in Chaper 1, PESA is in operation in a large part of the State. The capacity of the GPs in these areas is generally very poor. They have little scope for rising own financial resources; the state of physical infrastructure in these predominantly tribal areas is also very poor. The density of population is low at 91 per sq. km., as against 303 in non-PESA areas. As a result, the per capita cost of infrastructure is high. The human development index (value) of PESA area is 0.397 as against 0.517 for non-PESA areas. Left-wing extremism in most of these areas has made matters worse. The Commission feels that it is in these areas, more than elsewhere in the State, the emphasis has to be on eradication of poverty and inclusive growth. Inclusive growth ensures socio-economic justice which requires that people left behind in development are enabled and participate in the planning and implementation of their own development. The Commission's approach is to assign additional financial resources to the PRIs in PESA areas with a view to ensure that they function effectively and are enabled to provide basic services in villages. We have recommended a special allocation for them.

2.4 Urbanization in the State is largely confined to Raipur, Durg, Bhilai and Bilaspur and Korba. The urban population constitutes only about 23% of the total population of the State, but is growing, and is likely to reach 40% in two decades. Many of the municipal areas particularly areas under Nagar Panchayats, are in fact in a transitional phase. Lack of formal criteria for notification of municipal areas has unfortunately impeded planned development of towns in the State. This is best exemplified in the manner in which Nagar Panchayats have been created without much regard to the size and nature of the population and presence of urban infrastructure. Many of the NPs are not 'nagar' while they have discontinued to be Panchayats. The result in many cases has been most unfavorable to the citizens living in the NPs. They are no longer entitled to funds under the various rural development schemes while there is very little scope for raising tax revenue from people, largely rural. The Commission's view is that the process of declaration of ULBs must be rationalized and their capacity strengthened so that they are in a position to deliver a modicum services to the citizens. We have recommended a one-time grant-in-aid of Rs.1 crore for NPs in our interim report.

2.5 There are serious governance problem with the ULBs. They also suffer from severe lack of capacity characterized by lack of staff, poor quality and capacity of existing staff, lack of systems and professionalism in delivery of services, poor resource base in some and poor resource mobilization in most. We feel that unless these problems are seriously addressed transfer of financial resources alone may not make them effective decentralized unit of local self Government. This requires strengthening them functionally, financially and also provision of adequate and well trained staff. The State has to meet the needs not only of the present but also of the future. As already mentioned urbanization is likely to reach 40% in the next two decades.

2.6 An analysis of the finances of the local bodies is an important step in the estimation of the revenue gap which the financial package recommended by the SFC is meant to meet. For such analysis we collected data from the P&RD Deptt and Deptt of UA&D. We also made efforts to obtain primary data from all the PRIs and ULBs through detailed questionnaires. In this effort, we have faced the same problems, as was faced by the first SFC and that is, lack of adequate and reliable data. Neither the concerned Deptts nor the Finance Deptt. of the State Govt. compile data in respect of the sources of income, including own sources, and disaggregated expenditure on housekeeping, provision of basic services, etc. of PRIs and

ULBs. In the absence of such data, working out the revenue gap with some degree of accuracy is rendered an impossible task. Not only are there no centralized data available with the respective Departments, the primary data collected from the local bodies directly by this Commission were also not of much help. This is a serious handicap and will continue to be so in future unless detailed data regarding Panchayats including the finances, services provided, accounts and audit are maintained for each district preferably by the ZPs and at the State level by the Director of Panchayats. In our interim report as also in this report, we have recommended that part of the fund allocated to the ZPs should be used for maintenance of district data bank. So far as ULBs are concerned, some centralized data are available with the Director, UAD. But these data do not tally with those obtained from the ULBs directly. Obviously, even with regard to ULBs enough attention has not been paid to compilation of data.

2.7 The financial position which emerged from the data we have collected, in respect of both PRIs and ULBs, is not very encouraging. So far as GPs are concerned, from a sample size of 5427 GPs, which is more than 50% of the total, it emerges that the percentage of GPs which imposed any tax during the last three years (2008-11) is 39.67%. The average own income of a GP is a pittance, at Rs. 24,000 per year, which comes to about Rs.12 per capita. On a sample size of 1945 GPs, which is 20% of the total number in the State, the results are only marginally different. The total annual average receipts and expenditure of GPs is about Rs.11 lakh. The level of the most essential civic services is very poor. For example, in only about 11% of GPs is there piped water supply and only about 10% have drainage. Street lights are provided in 52% of GPs. The position in respect of ULBs is only marginally better. In case of Nagar Panchayats, from a sample size of 78 (out of a total of 127), about 95% collect taxes and the same percentage of NPs have own income. Thus five percent of the NP do not recover any tax. The average own income of a NP is about Rs.15.12 lakh; the average annual receipt is about Rs.82.5 lakh and average annual expenditure about Rs. 70 lakh. So far as Nagar Palikas are concerned from a sample size of 18 out of a total of 32 Nagar Palikas, the position which emerges is that all of them impose taxes and have their own income which is on an average of the order of Rs.103.40 lakh per annum. The average receipts and expenditure are more Rs.463 lakh and Rs.476 lakh respectively. Thus their own income is less than 25% of their total receipts.

2.8 The local bodies, whether PRIs or ULBs, are generally reluctant to impose taxes and raise revenue. The elected representatives do not want to impose any tax- even those taxes which are obligatory under law mainly on political considerations. This is true not only of the PRIs but also of ULBs. The Commission is convinced that unless the local bodies raise adequate financial resources, their autonomy as local self-government units, their sense of responsibility to the citizens and accountability will continue to be low. In view of this position, the Commission's approach is that the State Government has to initiate reforms and encourage the process of raising revenues locally and remove all constraints on PRIs' and ULBs' revenue raising capacity.

2.9 For the State Finance Commission to be effective and meaningful in its recommendations, compilation of financial data relating to PRIs, particularly of Gram Panchayats is very essential. It is also required for any meaningful planning exercise at the district level. We have not made any assessment of revenue gap in respect to the PRIs because of lack of data. An assessment has been made in respect of ULBs, particularly, the Municipal Corporations and Councils, in respect of which service level benchmarks have been specified by the Ministry of Urban Development, GoI and endorsed by the 13th Finance Commission. The Commission had the advantage of the financial norms for service delivery recommended by the High Power Expert Committee on Urban Infrastructure and Services which facilitated an assessment of the financial resources required to meet the infrastructure and service delivery gaps as also the requirement to meet the future needs, including O&M costs. The financial requirement of ULBs has been computed on the basis of the norms indicated by the Committee.

2.10 With the recognition of the criticality of urban areas to national development, the Government of India has launched several development programs like JNNURM, Rajiv Awas Yojana, etc. One of the conditions to access these funds is the introduction of basic reforms in accounts, e.governance, municipal cadres, etc., in ULBs. One of the elements of the approach of this Commission is to look holistically at the working of the ULBs and recommend reforms in areas like staffing, accounts, e-governance, transparency and accountability, etc., so that they are adequately strengthened and equipped both in terms of finances and governance, to be in readiness to access the funds under the above schemes.

2.11 The overall approach of the Commission to devolution of funds on local bodies in the State is that adequate funds should be transferred to them but with less strings attached. Simultaneously, serious steps are required for their capacity development. Presently the ULBs are not in a position to utilize the funds provided to them under various schemes of the Central and the State Government. Thirdly, they should be encouraged to optimize their own internal resource mobilization which alone will make them more responsible and accountable.

2.12 In recent years both the Central and State Finance Commissions have expanded their scope to include governance which is critical to improve the performance of local bodies, both rural and urban. This Commission also believes that financial reforms are possible and effective only when they are accompanied by overall governance improvements. The 11th and 12th Finance Commissions had included governance reforms in their recommendations. The 13th Finance Commission has not only laid down a broad framework of reforms but also has made special grants conditional on the reforms having been carried out. The State Government accepted the reforms recommended in respect of ULBs has carried out all of them and has received the incentive grants. Our's approach is to carry forward the reforms process so as to access the possibly larger funds which the 14th Finance Commission may provide. The Commission viewed the terms of reference with this broad approach and has made its recommendations accordingly.