

# CHAPTER - I

## **CHAPTER – I**

### **THEORY OF LOCAL GOVERNMENT FINANCE**

- 1.1 Introduction
- 1.2 Meaning of Federalism
- 1.3 Federal Structure of India
- 1.4 Meaning of Local Government
- 1.5 Essential Attributes of Local Finance
- 1.6 History of Local Government in India
- 1.7 Structure of Local Government in India
- 1.8 Meaning of Local Finance
- 1.9 Theory of Local Finance
- 1.10 Role of Local Government

## **CHAPTER – I**

# **THEORY OF LOCAL GOVERNMENT FINANCE**

### **1.1 INTRODUCTION**

Forms of Governance are of two types: Unitary form and Federal form. In various countries, we find different governance according to its geographical, social and economic condition. In Unitary system, all powers devolved on single government. In UK, Germany, France and most of Asian countries, there is unitary type of government.

In federal system, there are two or more layers of government functioning simultaneously. The functions and powers of these governments are clearly demarked in the written form in the constitution of nation. In USA, Australia, Canada and India, there is a federal form of government.

### **1.2 MEANING OF FEDERALISM**

Modern concept of federalism was evolved in USA in year 1776 as such federal is often spoke of as an American innovation the founding father of US constitution drew their idea from an ancient Greece.

According to Encyclopedia Britannica, "Federation is a form of government of which the essential principles is that there is union of two or more states under the central body for certain objects."<sup>1</sup>

According to Prof. K. C. Wheare, states that, "Federation is an association of states, which has been formed for certain common purpose but in which the member state retain a large measure of their regional independence."<sup>2</sup>

In short federation provides a thread by which various regions having diverse characteristics can be knitted together into a beautiful and well designed fabric of federal nation.

### **1.3 FEDERAL STRUCTURE OF INDIA**

The constitution of India came into effect from 26<sup>th</sup> January 1956, India was declared to be Union of States. There are 28 states in Indian Union today.

Till 73<sup>rd</sup> and 74<sup>th</sup> amendments the constitution provided for only two level of government at Centre and State with provision for part trust and cantonment area etc.

After 73<sup>rd</sup> and 74<sup>th</sup> constitutional amendment local government play a significant role in Indian federal structure. For each specific

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<sup>1</sup> Encyclopedia Britannica, Vol. 9, p.134.

<sup>2</sup> K. C. Wheare, "Federal Government", p.1.

category of local bodies, the State Legislative is assigned functions and resources out of State list.

Thus, in present federal structure of India, Central government extending its functions over whole length and breadth of the country. State level at middle order and government deal with small issue of local importance.

#### **1.4 MEANING OF LOCAL GOVERNMENT**

The term 'Local Self Government' and 'Local Government' are synonymous. The controversy regarding their use is dead now.

The local government as the term itself suggest is the government of locality as distinguish from the government of country or region their of.

The role of local government is today much important in daily life of citizen. In the real sense, citizens are closely connected with local government. They have been playing a vital role in the over all development of local area. Therefore, it became essential to take into account the meaning of local government.

The term "Local Government" means the government by freely elected local bodies which are endowed with power, discretion and responsibility to be exercised and discharged by them, without control

over their decision by any other higher authority. Their actions are however, subject to supremacy of local government.<sup>3</sup>

Local government has been defined in various ways, but in simplest definition is "A government at local level having authority to undertake the power to perform public activities within its territory."<sup>4</sup>

G. M. Harris in his "Comparative Local Government" has defined local government as 'the government by people themselves through freely elected representative.'<sup>5</sup>

B. K. Gokhale in "The Constitution of India" has defined local government as "the government of specified locality by the local people through the representatives elected by them."<sup>6</sup>

## 1.5 ESSENTIAL ATTRIBUTES OF LOCAL FINANCE

Shriram Maheshwari in 'Local Government of India' has given essential attributes of local government as follows:

- a) Statutory Status;
- b) Power of raise finance by taxation in the area under jurisdiction;
- c) Participation of local community in decision making in specified subjects and their administration;

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<sup>3</sup> Harris, G. M. Comparative Local Government, London, 1948, p.9

<sup>4</sup> Bhogle, S. K. Local Government and Administration in India, 1977

<sup>5</sup> Harris, G. M., Comparative Local Government, 1948, p.12

<sup>6</sup> Gokhale D. K., 'The Constitution of India, pp.1307-1308.

- d) The freedom to act independently of local control;
- e) Its general purpose in character and not a single purpose in character.

## 1.6 HISTORY OF LOCAL GOVERNMENT IN INDIA

Local government in India has its roots in pre-historic times. Ancient literature reveals that, the conception of local government was not foreign, but originated in India. Sabha or Village assemblies were evolved in the Vedic period also. We find many reference regarding the existing of Gram Sabha in Manusmriti, Jakkas, Shantiparwa of Maharashtra, Arthshastra of Kautaliya also refers to village councils, responsible for village administration.

The beginning of modern system of local government had been made in 1687, when for first time a local government body – A Municipal Corporation was set up for city of Madras. Thus the charter act of 1793 established municipal administration in three presidency town of Madras, Calcutta and Bombay.

Under British Rule in India, the 1870's resolution of Lord Mayo on financial decentralisation is visualised as an effort in development of local government institutions. In 1882, Lord Ripen issued as new resolution on Local Self Government is considered as an important landmark in the evolution of local self government in modern India. According to him, it is an instrument of political and popular education.

After getting independence also, for further development of local government, various different committees have been set up in India.

First time a Local self government minister's conference was held at Simla for discussing all aspect of reconstruction of local self government.

In 1949, Government of India appointed the "Local Enquiry Committee" which made a number of recommendations for improving and stabilising local finance.

After 1950, a universal desire was evidenced to make local institution not only training ground for democracy but also an effective agency to shoulder the added responsibilities envisaged in the Five Year Plan.

A number of Committees and Commissions were set up by the Centre from time to time, to suggest way and means for strengthening the local government structure in the country. These included the recommendation of Taxation Inquiry Commission (1953) on Municipal Taxation, of the rural Relationship Committee (1963) on defining the structure and functions of Urban Local Bodies and their relationship with Panchayat Raj Institution, of the Central Committee for argument on the financial resources of Urban Local Bodies. The Panchayat Raj was indeed recommended by the committee set up by the Central government known as Balwantraji Mehta Committee.



### **Balwantrai Mehta Committee**

One of the well known Committee is the Balwantrai Mehta Committee. It suggests number of measures to bring about effective working of local government in India. The committee also suggests a number of measures for maximum economy and efficiency of implementing various plan projects including community and national extension services. Mehta Committee Report was called as democratic decentralisation. The Committee firmly believed in distribution of ruling machinery, in such manner that power is exercised and executive machinery controlled and directed by popular representative of local place.

The report emphasised the point that this local body is not nominated advisory and ad-hoc in character, but it should be statutory, elective, comprehensive in its duties and function at the same time. The body should be well equipped with necessary executive machinery and possess adequate resources.

Another well known Committee appointed for the same purpose was Ashok Mehta in 1977. According to this Committee it was very essential that these local organisations should be given financial stability and in order to do this change in structure of Panchayat Raj was the need of the hour.

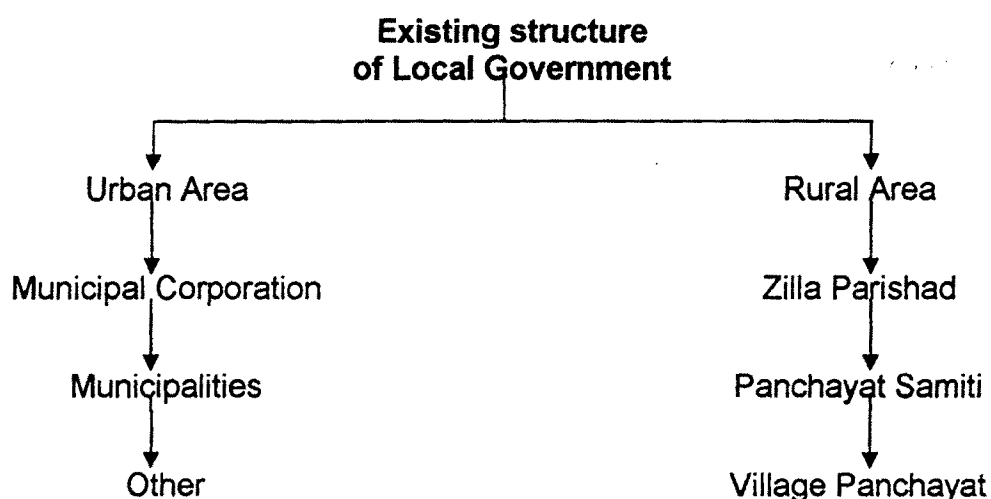
There were other minor Committees appointed from time to time by the concerned government of States. One of such Committee was

appointed under the chairmanship of Shri Vasant Rao Naik in the State of Maharashtra. This Committee suggests that the Panchayat Raj should be allocated more development works and projects to be implemented. The Committee also suggests that there should be district organisation in order to bring unity and coordination among various unit of local governments.

### 1.7 STRUCTURE OF LOCAL GOVERNMENT IN INDIA

India has not a uniform type of local government like France. But India has adopted a different structure of local government for rural and local areas. India has taken structure of local government from England. In India there are two types of local government, one is at urban level and another is at rural level.

Present structure of local government is as follows:



- 1) Notified Area Committee
- 2) Cantonment Board
- 3) Town Area Committee

The government for rural area in India is called rural local government. Following the recommendations of Balwantrai Mehta team in 1957, Panchayat Raj was introduced in various states in different patterns. In some state rural local government has three bodies there is Village Panchayat at bottom, Zilla Parishad at the top and in between there is Panchayat Samiti. In some states there is two tier.

The latest tally of the three and two tier system is as follow:

Three tier: Andhra Pradesh, Bihar, Gujarat, Himachal Pradesh, Maharashtra, Punjab, Tamil Nadu, Uttar Pradesh and West Bengal (10 states)

Two tier: Assam, Haryana, Karnataka, Madhya Pradesh and Orissa (5 states)

In Jammu and Kashmir and Kerala efforts are being made to introduce higher tier.

The Government for the urban area in India is called urban local government. Presently, five types of municipal authorities exist in different types of cities and town. These are (1) Municipal Corporations, (2) Municipalities, (3) Notified Area Committees, (4) Town Area Committees, (5) Cantonment Boards. But among these five types, only first two bodies are full fledged representatives of urban local government in India. Out of them, large cities have Municipal Corporation, middle and small size towns have municipalities and developing town have notified area committees.

We may now give a brief summary of different levels of local government structure.

### **Gram Panchayat**

The Gram Panchayat is the first tier in Panchayat Raj system. A Gram Panchayat is constituted for one village or a group of villages. It is known by variety of names. It is called 'Panchayat' in Andhra Pradesh, Tamil Nadu, Rajasthan, and Maharashtra. In Bihar, Madhya Pradesh, Orissa, Punjab and West Bengal it is known as Gram Panchayat. While 'Gaon Panchayat' in Assam, Gujarat and Uttar Pradesh. The size of the membership of the Gram Panchayat varies from five to thirty one. By and large, the member of panchas are elected by secret ballot. The Sarpanch (President) of the Gram Panchayat is elected directly in some states like Assam, Bihar, Haryana, Punjab, etc. In some states he is elected by members of Panchayat from among themselves.

The power and functions of Gram Panchayat are more or less similar in all the states. They are made responsible for formulation and implementation of development programmes at the village level. The functions of Gram Panchayat cover a wider range of activities. They can broadly be divided into obligatory and discretionary functions including social, agricultural and development activities.

### **Panchayat Samiti**

The intermediate tier in the Panchayat Raj system is known as the Panchayat Samiti it has different nomenclatures in different state, like Janapad Panchayat in Madhya Pradesh, Taluka Development Board in Karnataka, Panchayat Union Council in Tamil Nadu etc. In majority of States, its jurisdiction is co-extensive with the block, which is generally smaller unit compared with the taluka. In some states the jurisdiction of this intermediate tier is co-extensive with that of the taluka.

The elected head of the Panchayat Samiti is known by different names in different states, such as 'President' in Andhra Pradesh, Assam, Gujarat, Madhya Pradesh, Karnataka and West Bengal, 'Chairman' in Haryana, Himachal Pradesh, Maharashtra, Tamil Nadu, Orissa and Punjab, 'Pradhan' in Rajasthan and 'Pramukh' in Bihar and Uttar Pradesh.

Panchayat Samiti generally comprises the following categories of members:

1. Sarpanch of Panchayats (ex-officio)
2. Local MPs, MLA, MLCs
3. Persons representing women, schedule caste and tribes who are co-opted and whose membership are reserved
4. Person representing Municipalities, co-operatives, etc.

The Panchayat Samiti operate through its statutory committee.

Generally speaking they deal with:

1. Productive programmes
2. Social welfare
3. Co-operative cottage industries etc.
4. Education
5. Rural water supply, health and sanitation
6. Communication and other allied subjects and
7. Finance, taxation and administration.

### **Zilla Parishad**

The Zilla Parishad is an apex of three tier Panchayat Raj structure. It is constituted at the district level in all the states (except Assam and Tamil Nadu). Zilla Parishad is known by different names in different states. It is known as Zilla Parishad in Andhra Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Uttar Pradesh and West Bengal. It is called as the 'District Panchayat in Gujarat', while, 'District Development Council' in Tamil Nadu and Karnataka.

The elected head of this body is termed as 'Chairman' in Andhra Pradesh, Madhya Pradesh and West Bengal. He is called as 'President' in Assam, Gujarat and Maharashtra. He is known as 'Adhyakashya' in Bihar and Uttar Pradesh, 'Pramukh' in Rajasthan. In Tamil Nadu and Karnataka, the collector is head of District Development Council.

This top tier of Panchayat Raj generally comprises the following categories of members.

1. President of Panchayat Samities (ex-officio)
2. Local MPs, MLAs and MLCs
3. Person representing women and schedule caste and tribes who are co-opted and whose membership are reserved
4. Representatives of co-operative societies, municipalities etc.

Beside the Ex-officio member there is also co-opted members.

Zilla Parishad works for the development of Zilla. There are various committees which are appointed for development of district.

Following committees are working under Zilla Parishad Act of Maharashtra.

- a) Standing Committee
- b) Finance Committee
- c) Construction Committee
- d) Agricultural Committee
- e) Education Committee
- f) Health Committee etc.

Presently five types of municipal authorities exist in different types of cities and towns. These are: (1) Municipal Corporation,

(2) Municipalities, (c) Notified Area Committees, (4) Town Area Committees and (5) Cantonment Boards.

### **Municipal Corporation**

Municipal Corporation is generally constituted for a big city or metropolitan area, where city problems acquire a high degree of complexity. In a few states, the criteria for constituting it are laid down in the Act itself. In Karnataka, the urban settlement should have a population of not less than two hundred thousand and the local body of the town or city should have an income of not less than Rs. 10 millions. In Madhya Pradesh the town should have population over one hundred thousands. There is no definite criteria for setting up the Corporation. Municipal Corporation classified into five categories. This classification is based on the criteria of population of city, income and minimum per capita income.

### **Classification for Municipal Corporation**

Grade of Municipal Corporation	Criteria		
	Population	Income	Minimum per capita income in Rs.
1) Special Grade Municipal Corporation	2,50,000	7,50,000	30
2) Selected Grade Municipal Corporation	1,00,000	2,50,000	20
3) First Class	50,000	1,00,000	15
4) Second Class	35,000	50,000	10
5) Third Class	20,000	35,000	5

Source: Recommendation of the Rural Urban Relationship Committee, 1966, Ministry of Health and Family Planning, Govt. of India



## **Municipalities**

This unit of local government is known states by different names, such as, City Municipality, Municipal committee, Municipal Board, Municipality etc. There is no definite and uniform criteria as yet evolved for constitution of municipality. Different states have prescribed different criteria. The population and income criteria for constituting a municipality varies from state to state and time to time. In large number of states the municipal enactments do not suggest any criteria for municipalization. However, minimum of 10,000 population in Karnataka, 25,000 in Andhra Pradesh and 15,000 in Maharashtra has been prescribed. The state of Tamil Nadu, a minimum income of Rs. 3,00,000 must be assured while constituting municipality. Some states have adopted the practice of having the categories/grades of municipalities, depending upon the size of population, financial viability, urban character, state of development as service centres and the specific requirements and needs.

Municipalities' organizational form varies a great deal from state to state. However, in all the states, the municipality consists of an elected Council, 'Executive/Finance Committee' the Chairman, and the Chief Executive Officer.

Recently, some state adopted a more comprehensive system of classification based on population, total income, annual per capita income.

Municipalities with a population exceeding 25,000 (per capita income) a minimum income of Rs. 7,50,000 and minimum PCI of Rs. 30, have been placed in a special grade. Next come the selected grade municipalities with population ranging between 1 lakh and 2.5 lakh, an income of Rs. 7,50,000 or more and per capita income of Rs. 20 or more. Municipalities having population between 50,000 and 1 lakh, an income of Rs. 3,50,000 or more and minimum PCI of Rs. 15 are classified as Grade-I, those with population ranging between 35,000 and 50,000 and income of Rs. 50,000 or more and PCI Rs. 10 as Grade-II. And those with population of less than 35,000 and minimum income of Rs. 1 lakhs are classified as Grade-III. Different states adopted different densification.

Thus, among all the states this introduced classification system for grading Municipal Corporation.

Municipal Corporation are distinguished from other types of civic authority because of their enjoying larger degree of autonomy and tax power than other types of urban local bodies. Municipal Corporation directly deal with state government directly.

#### **Other Unit of Urban Government**

Apart from the Municipal Corporation, and Municipality, there exists other units of the urban local government viz. Notified Area Committee, Town Area Committee and Cantonment Board. A brief description of each is given below.

### **Notified Area Committees**

The governing authority of the notified area is known as Notified Area Committee. A Notified Area Committee is created for an area which does not yet fulfill the conditions for the constitution of a Municipality but which otherwise is considered important. It also created for newly developing town or area where industries have been or are being established. Notified Area Committee varied from 3 to 7, Five the most usual member. In most of states, all the members are nominated by the state government, though in few cases election of few members is allowed.

The functions of Notified Area Committee are those of municipalities with few minor exceptions. Notified Area perform only such functions as are notified in the Government Gazette or entrusted to it by the government by special order.

Notified Area Committee can impose any tax in notified area which can be imposed by Municipality under Municipal Act, subject to approval by the government.

### **Town Area Committee**

Town Area Committee is constituted in small town having pronounced rural attributes. Town Area Committee are governed by separate Act of the State Legislative, though in some state they function under the provision of Municipal Act.

The number of members of Town Area Committee varies from 5 to 10 according to the population of the town. The members are elected on adult suffrage, though government reserves the right to nominate members from scheduled castes or other class, if such members are not elected. The chairman is elected by elected members among themselves.

The functions of town area committee are those of municipalities with few minor exceptions sale proceeds, rent and other income.

Control over Town Area Committee is exercised by District Collector.

### **Cantonment Board**

The dictionary meaning of the term Cantonment is a temporary quarters for troops for maneuvers etc. However in India, the cantonment means that they are permanent military stations with sizable areas, housing civilian population brought in there primarily for serving the various needs of military personnel. In short the term cantonment has been applied to permanent military stations in the country.

The Cantonment Board consisting of nominated and elected members in equal number were established, to be presided over by the officer commanding the station. These Boards were charged with the responsibility of running the civic administration.

### **Meaning of Local Finance**

The term local finance refers to finance of local government bodies i. e. Gram Panchayat, Panchayat Samiti, Zilla Parishad, Municipal Council and Municipal Corporation. Local finance is branch of public finance which deals with financial aspect of local government. The word 'Local Finance' is compound word, which is composed 'Local' and 'Finance'. In local finance the branch of public finance, the word 'Local' is denote local government of particular locality and word 'Finance' is used to denote the raising the spending of public funds.

Thus 'Local Finance' means finance of local government. It is the study of how local government raised funds and spends them. In simple word it is the study of income and expenditure of local government. Local finance, the branch of public finance, studies the financial operations therefore, profs canon has very rightly point out that the word local is relative in character, from the point of view of an empire the tax of country is local and from the point of view of a country the tax of a provincial government can be termed as local so the difference between local and national finance is degree only.

### **1.9 THEORY OF LOCAL FINANCE**

There are three layer of government i. e. Central, State and Local government. The finances of local government are called local finance. Local finance is the branch of public finance, which studies financial operations of local government.

From a review of three literature on local bodies, it becomes clear that finance is neglected part of public finance. But, surprising thing is that, its origin is found back to a century. There is also comparative neglect of local government both in practice and academic study.

Therefore, U. K. Hicks in "Development from below" say, one of the primary task in the study local finance is to place the local government finance in the perspective of state and national finance and clearly define their role in national economic development.<sup>7</sup>

An attention towards local government and local finance is not given because local governments are set up as an administrative agency of state government and statutory devolution of functions. Some functions to perform are assigned to them.

There may be two approaches to local finance :

- 1) Correspondence Theory
- 2) Theory of Separation of Local Finance

According to first approach, function and resources of local government must match each other. It means the financial sources of local government should be in proportion to functions which local government has to perform. The revenue should be equal to expenditure required to perform assigned functions to the local government.

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<sup>7</sup> Hicks, U.K., Development from Below, Oxford, 1966, p.8.

According to second approach there should be separation of sources and functions to be performed. The discriminatory treatment should be given to resources and functions to be performed.

Local government performs various functions as to achieve the determined objectives. Local government can not perform function in absence of adequate revenue. Local government can perform functions and render services with adequate revenue only. Venkatraman has aptly remarked, "The building up social overhead so necessary can not take place first enough unless the local bodies are entrusted with responsibly of mopping up resource for the purpose."<sup>8</sup>

Local governments have no independent and adequate source of finance, but the state government assigns them some sources of finance. A local government collect its revenue with the help of tax and non tax revenue. Revenue assigned to a local government is not adequate. Therefore, there is need of assigning revenue resources especially in local area to required extent. The activities of local government are increasing extensively and intensively, but to that extent revenue is not increasing.

Traditionally, there was a tendency to treat separately the principal of taxation between local and central government. Seligman held a view that, revenue raising based on ability principles much

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<sup>8</sup> Venkataraman, K., *Local Finance in Perspective*, 1965, Asia, p.3.

relevant to central government and benefit principle to local government. Because the wider the tax base and wider the geographical operational area, ability principle is more beneficial. On the contrary the smaller the tax base and narrow the government jurisdiction then benefit principle is more relevant. At the same time, local government is community service unit over a specified area. Hence cost benefit considerations are more proper in local finance. The ability taxes though useful have only limited role in the local finance system, because it is mainly the beneficial service which forms the major portion of municipal local activities and beneficiaries are located in that particular local area. Therefore the benefit principle must be guiding rule of local finance.

The benefit principle is very suitable for local unit for number of reasons.<sup>9</sup>

1. They are based on property value which is easily derivable;
2. They are strictly confined to local base;
3. The accounting is simple;
4. The management costs are low.

However, the benefit principle has some deficiencies. Benefit taxation is relatively rigid and inelastic and after a point it tends to be regressive on small property owners. The tax burden may increase along with increase in benefit. It results in falling revenue from taxation.

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<sup>9</sup> Sinha, K. K., *Local Taxation in Developing Economy*, 1968, p.4.



It is at this point that grants and subsidies from State government assume significance.

From the foregoing discussion, following principles or maximum of local finance should be considered.

- 1) Canon of Locality: The tax base should be tangible and localised. Immovable property in the form of land and building are more suitable for local taxation.
- 2) Canon of Simplicity: Both tax compliance and collection should be low. Also the administrative proceeding must be simple and direct.
- 3) Canon of Least Effect: The local taxation must have practically no price or any other economic effects.
- 4) Canon of quid-pro-que: Local taxation should have a large element of net return of benefits to the citizens.

In short, a local tax system that cover the beneficiaries of the area and has a simple administration and assessment code may be considered as good.

#### **1.10 ROLE OF LOCAL GOVERNMENT**

Local government is important form of federal structure of India, which concerned with local affairs, related to particular area like central and state government, local government has increased activities to do. It play vital role in achieving social economic objectives. Today, local

government is much more important in the daily life of citizen than that of the state or central government, Local government tries to solve the problem created in locality due to communal living. For this, it provides civic amenities like water supply removal of rubbish drainage, street lighting, preventing of epidemic health and medical facilities, education, road construction and repairing. It has become the responsibility of local government to make living better physically, economically, socially and also culturally for people. Local government can take care of all affairs of each locality in an efficient and speedy manner.

Beside Local government is found to be economical to manage local affairs at that level only. This because of the fact that local people can find suitable and realistic solution to their problems.

Local government has an educative value also. It not only creates consciousness of the principle of management of the administrative affairs and sense of responsibilities among the people but also serves as a training ground for politician. Local governments are important unit to help to achieve decentralisation of political power and promotion of democratic values.

The Planning Commission in the first Five Year Plan stated that many in administration realise that official machinery by itself can not carry out these development programmes which call for a great deal of initiative and participation on the part of people themselves. Representatives elected to the Panchayats, Local Boards, and Municipal

Committees are certainly in a position to express local needs to suggest programmes of work, for their respective areas. At the stage of development which local self government have reached programmes for local development may be best conceived of as joint enterprise to be carried out in close co-operation by agencies of State government and representative of people elected to local self governing institutions.

Local self governing bodies have a vital part to play in the field of development; we consider that general direction of policy should be to encourage them and assist them in assuming responsibility for as long a portion of administrative and social service within their areas as may be possible.