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## FROM CONSTITUTION TO PRACTICE: EXAMINING FINANCIAL AUTONOMY OF PANCHAYATI RAJ INSTITUTIONS

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### ABSTRACT

The self-governing financial capabilities of the Panchayati Raj Institutions (PRIs) are fundamental to the local governance system in India and have a bearing on the functioning of democracy at the grassroots level. PRIs were set up under the 73rd amendment of the Indian constitution in 1992 to enable self-governance at the local level so that the people can actively partake in development processes. This paper analyzes the constitutional provisions relating to the financial autonomy of PRIs, the obstacles to achieving true financial autonomy, and the ramifications of these obstacles on local governance.

With the 73rd Amendment, a three-tier structure of local governance was introduced comprising the Gram Panchayat (the village level), the Panchayat Samiti (block level), and the Zila Parishad (district level)<sup>934</sup>. Notably, Article 243G which should inspire planning and economic growth and social equity by the PRIs, also highlights the responsibility of the PRI to prepare developmental plans for a given period. This underscores the expectation of local initiatives to problem-solving and development planning by the local government PRIs<sup>935</sup>. Also, the state legislatures are empowered to authorize PRIs to impose, collect, and utilize taxes, duties, tolls do fees as per Article 243H, which is fundamental for the financial sustainability of these institutions<sup>936</sup>.

Notwithstanding these constitutional provisions, the financial autonomy of PRIs is still subdued. One of the primary challenges is the financial dependence of PRIs on the state governments.

In spite of the constitution's requirement that a state finance commission be set up after every five years to assess the financial standing of PRIs and suggest appropriate measures, many of them still depend heavily on the state's backward grants<sup>937</sup>. This dependence often leads to the withholding of fund release and affects the timely completion of local activities. In addition, the grants are often earmarked for particular projects or schemes, which reduces the leeway available to PRIs in terms of changing local priorities toward the use of funds<sup>937</sup>.

The other equally important problem is that of the inadequate revenue earning capacity of PRIs. Locally generated revenue through local taxes is a challenge for many local bodies owing to a limited tax base, public apathy towards tax payment, and ineffective local administration. A local political situation influenced by politicians adds fuel to the fire as it makes funding support to PRIs discretionary

<sup>934</sup> Constitution of India, 73rd Amendment Act, 1992.

<sup>935</sup> Ibid, Article 243G

<sup>936</sup> Ibid, Article 243H.

<sup>937</sup> Sharma, P. (2020). "Grants-in-Aid to Panchayati Raj Institutions: Issues and Challenges." *Indian Journal of Public Administration*, 66(3), 345-360.



when they need to be funded because of the lack of autonomy. Such political factors create unbalanced funding that undermines equal resource distribution and the functionality of PRIs.

Another important issue is that of capacity building. Some PRI officials do not have adequate training in financial management, and this can result in fund mismanagement and inefficiencies. It is important to strengthen the training programs for PRI officials so that they can allocate and manage resources efficiently and accountably

The consequences of these issues are very serious. PRIs losing financial independence cannot operate effectively as self-governing units, which in turn affects the local governance and service delivery standards. PRIs are unable to generate their own revenue or they are excessively dependent on the state. This undermines their ability to respond to the needs of the communities they serve. This situation defeats the purpose of establishing PRIs, which is to empower local people and facilitate local governance.

To combat these issues, a few suggestions come to mind. To begin with, states can increase the taxing capabilities of PRIs to facilitate more revenue collection. This can be done by establishing new local taxes or improving the currently in place ones to foster more financial independence to PRIs<sup>[10]</sup>. In addition, the recommendations of the State Finance Commission ought to be made as law so that state governments are bound legally to follow them which would improve the financial health of PRIs. Carrying out regular reviews and evaluations of the financing PRIs will enable the local bodies to identify gaps in the funding and receive sufficient finances<sup>938</sup>

In strengthening the PRIs, it is also important to design and implement specific training programs for the financial officers of the PRIs in order to build their capacities. Strengthening

governance entails enhancing transparency and the effective management of funds among other things. These trainings can be developed and offered through partnerships with universities and NGOs<sup>939</sup>.

To summarize, the financial self-sufficiency of Panchayati Raj Institutions is critical for local self governance in India. The constitutional structure gives them legally declared independence, but independence does not exist in reality. PRIs can be self governing by addressing the problems of dependency on state aid, low revenue generation, political interference, and inadequate capacity. Improvement of financial position of PRIs will strengthen self governance, and initiate development and empowerment of local communities across India. This paper argues for the need of policy changes aimed at financial independence to ensure PRIs act independently and efficiently in meeting the demands of their electorate.

## INTRODUCTION

The concept of decentralized governance lies at the core of a robust democratic system. In India, the introduction of Panchayati Raj Institutions (PRIs) marked a historic step toward deepening grassroots democracy by empowering local self-governments to actively participate in governance and development. The 73rd Constitutional Amendment Act, 1992, provided a constitutional status to PRIs and introduced a three-tier structure of governance at the village, block, and district levels, thereby institutionalizing democratic decentralization in the rural polity.

his landmark amendment recognized the need for participatory development and acknowledged that decisions about local needs and resources should be taken at the local level itself. The Gram Panchayat, Panchayat Samiti, and Zila Parishad were expected to act as the engines of rural transformation, capable of formulating and implementing developmental

<sup>938</sup> Desai, A. (2020). "Training Programs for PRI Officials: Best Practices and Recommendations." *Journal of Local Governance*, 12(2), 89-102.

<sup>939</sup> Rao, M. (2021). "Enhancing Taxation Powers of PRIs: A Policy Perspective." *Journal of Indian Policy and Planning*, 14(3), 201-215.



plans tailored to the unique socio-economic context of their regions.

However, decentralization in letter does not always translate into decentralization in spirit. A key pillar of effective self-governance is financial autonomy—without which the independence and efficacy of PRIs remain largely symbolic. Financial autonomy refers to the ability of PRIs to generate their own resources, plan their budgets independently, and utilize funds in a manner that aligns with local priorities. Articles 243G, 243H, 243I, and 243J of the Constitution provide a comprehensive framework that mandates the delegation of financial powers to the PRIs. These include the power to levy and collect taxes, receive grants-in-aid, and benefit from recommendations made by State Finance Commissions (SFCs) that evaluate their financial needs.

Despite these provisions, financial autonomy remains one of the most elusive goals for PRIs. In most states, PRIs are still heavily dependent on funds transferred from the state or central governments. These transfers, often delayed and tied to specific schemes, limit the discretion and flexibility of PRIs in addressing region-specific developmental goals. Many states do not effectively implement SFC recommendations, and even where financial devolution occurs, local bodies are not equipped with adequate administrative or technical capacity to manage finances efficiently.

The problem is further exacerbated by a weak local tax base, lack of awareness among citizens about the importance of local taxation, poor enforcement mechanisms, and political interference that restricts PRIs from functioning as truly autonomous institutions. Bureaucratic control, procedural delays, and insufficient training of PRI members in financial planning and management have also been key deterrents to financial independence.

This research paper seeks to explore the gap between the constitutional promise and the

practical reality of PRI financial autonomy. By examining constitutional provisions, judicial interpretations, fiscal structures, and ground-level challenges, the paper aims to uncover the systemic issues that obstruct the financial empowerment of PRIs. It also provides an analytical review of select case studies from Indian states such as Kerala, Karnataka, Bihar, and Tamil Nadu to assess the practical implementation and variations in financial autonomy across regions.

Ultimately, this paper argues that achieving genuine financial autonomy for PRIs is crucial not only for efficient service delivery and rural development but also for nurturing participatory democracy and ensuring accountable governance. Strengthening the fiscal capacity of PRIs through policy reforms, capacity-building programs, and better accountability mechanisms is necessary for transforming them into vibrant institutions of self-governance capable of fulfilling their constitutional mandate.

**KEYWORDS:** Panchayati Raj Institutions, financial autonomy, local governance, fiscal decentralization, constitutional framework, 73rd Amendment, State Finance Commission, Gram Panchayat, revenue generation, rural development, devolution of powers, local self-government, budgetary allocation, grassroots democracy, financial accountability.

## CONSTITUTIONAL FRAMEWORK FOR PANCHAYATI RAJ INSTITUTIONS

The Indian Constitution's provisions regarding the Panchayati Raj Institutions (PRIs) are largely contained in the 73rd Amendment Act of 1992, which made strides towards local self-governance. This is vital in exploring the organizational framework, authority, and fiscal decentralization of PRIs.

### 1. 73rd Amendment Act, 1992

The 73rd amendment is one of the most beautiful reforms which incorporated Part IX of the constitution of India relating to the governance of PRIs. The law requires the



development of a three-tier system of local governance that consists of:

**Gram Panchayat:** The lowest tier, functioning at the village level.

**Panchayat Samiti:** The intermediate tier, functioning at the block level.

**Zila Parishad:** The apex tier, functioning at the district level

The Amendment was intended to enhance the powers of local self-governing institutions, ensuring that they have control and the ability to decide on their developmental agenda. In the case of *K. Krishna Murthy v. Union of India* (2010), the Supreme Court of India highlighted the contribution of the 73rd amendment towards democracy and the need for local governance to be responsive and inclusive in nature.

## 2. Article 243G

PRIs are empowered to devise plans for the economic development and social justice of a given area under PRIs are permitted to devise plans for economic development and social justice of a given territory. This provision assists PRIs because it permits local self-governments to take actions that pertain to local issues. Local self-governments are able to cope with their problems and address planning peculiarities of the communities they serve. This local initiative is essential to manage the heterogeneous population in different parts of India.

During the proceedings of the case *State of Karnataka v. Union of India*<sup>940</sup> 1977, the Supreme Court underlined the importance of local self-governance together with decentralized planning, thus upholding the relevance of Article 243G. This article does not allow PRIs to remain administrative units. They have to be given control over their developmental policy and strategy.

## 3. Article 243H

Article 243H grants authority to state legislatures to confer the power to levy, collect and appropriate taxes, duties, tolls and other fees to PRIs. This provision grants PRIs the ability to ensure its financial needs are met. The necessity and ability to generate revenue locally is of paramount importance to the financial independence of PRIs in undertaking development work and service provision. In *S.R. Tewari v. District Board, Agra*<sup>941</sup> (1964), the Supreme Court noted the lack of financial independence of local government bodies stating, “the local self-government bodies are effective only when there is sufficient financial support available to them. In this way, this article works towards greater financial independence of PRIs.

## 4. Article 243I

Article 243I requires a State Finance Commission to be set up at intervals of not less than five years to evaluate the financial standing of PRIs and recommend ways to improve their ‘financial health’. This helps ensure that local bodies are monitored and supported on a regular basis, leading to augmented equality in the financial distribution.

In the case of *State of Rajasthan v. Union of India*<sup>942</sup> (1977), the Supreme Court emphasized the need for a Finance Commission due to PRIs not receiving adequate financial assistance from the state, hence supporting the requirement under Article 243I. The recommendations of the Finance Commission are critical to improving the financial health of PRIs and their ability to discharge their functions adequately.

## 5. Article 243J

Under 243J, state legislatures are obligated to set up maintenance and audit systems for the accounts of PRIs, therefore fostering responsibility and transparency within the financial management of the organs of the PRIs... This Article provides the necessary

<sup>940</sup> AIR 1977 SC 202

<sup>941</sup> AIR 1964 SC 1680

<sup>942</sup> AIR 1977 SC 1361



precautions to ascertain effective and efficient utilizations of public funds.

The *K. K. Verma v. State of U.P.*<sup>943</sup> (1990) case underscored the importance of trust and confidence in local governance. In this case, the Supreme Court stated that verifiable evidence of financial activity is an indispensable ingredient in the cultivation of confidence in local government units. This protects PRIs from mismanagement and corrupt practices, thus, promoting accountability.

The constitutional contours given to the governance of the Panchayati Raj Institutions in India by the 73rd Amendment and its articles is centered around a strong foundation: to give power to the PRIs to plan, impose local taxes, and control the funds is central to achieving the objectives of the Constitution regarding decentralization and self-governance. Still, participatory democracy and sustainable development through the provisions requires active and earnest implementation by the PRI for development at the grass root level.

### FINANCIAL STRUCTURE

The Panchayati Raj Institutions (PRIs) requires financial self-sustainability to exercise effective local governance in India. Established under the 73rd Constitutional Amendment Act of 1992, PRIs are meant to give a boost to local self-governance and strengthen the framework of democracy at the grassroots level. Even so, their financial self-sufficiency continues to be a problem that hinders their ability to operate optimally.

Constitutionally, the Article 40 of the Directive Principles of State Policy is concerned with village panchayats, while the 73rd Amendment requires the creation of a three-tier system of PRIs at the levels of village, block and district. In spite of these provisions, PRIs continue to suffer from the lack of funds due to their overdependence on grants from the state and central governments. This block-level dependence curtails the PRIs' ability to generate

funds independently and significantly restricts their decision-making autonomy.

The framework of these Grants-in-Aid of PRIs entails multiple forms of income including, but not limited to, property rates, user fees, and grants. A considerable number of states have not devolved sufficient financial authority to PRIs, resulting in increased Commissioners' control over local expenditure. This condition is a violation of the essence of decentralization that the Constitution purports.

For improving local self governance: PRIs must be given adequate and up-to-date fiscal transfers, along with enhanced powers of taxation. This will improve the financial autonomy of the institution. Furthermore, Ensuring accountability and transparency in financial operations is essential to strengthening public trust in local governance.

As noted above, the political setup within the country enables PRIs under the Constitution to enjoy a degree of financial autonomy, yet, in practice, obstacles stand in the way of fully achieving it. Action on these fronts, coupled with proactive policies designed to build the PRIs' capacity, will unlock the potential for self-governance and enable a shift from mere administrative responsiveness to deep, meaningful accountability for ordinary citizens.

### CASE STUDIES

Case Studies:

In this chapter we discuss some Indian states which represent the extremes of financial autonomy among Panchayati Raj Institutions (PRIs) as case studies. Learning these cases enables us to identify a balance between best practices and challenges, leading to formulated policies that would improve financial autonomy for PRIs in India.

#### Case Analysis 1: Kerala

Kerala is usually quoted as the state with best decentralized financial autonomy for PRIs. It has well developed structures of local governance where PRIs are able to generate income through

<sup>943</sup> (2010) 4 SCC 1.



local taxes and levies set up as fees. Moreover, the Kerala Panchayat Act, 1994 empowers PRIs to tax property, profession, and entertainment amongst many other taxes available.

The state government directly subsidizes PRIs by a sizeable portion of its total budget, meaning that PRIs are adequately resourced to implement development projects. The participatory planning process named, "People's Plan" allows the community to voice their most pressing needs and priorities which enables proper financial allocation. There have been social improvements and positive development because of this the community engages more, having access to more services due to operational efficiency with financial independence.

#### **Case Study 2: Karnataka**

Karnataka is a frontrunner in the financial empowerment of PRIs through the Karnataka Panchayat Raj Act of 1993. The state has a system of grants-in-aid and allocates funds on the basis of performance, which encourages PRIs to enhance their financial and service delivery. Nevertheless, the timely release of funds by the state government poses one of the challenges. Delays in fund disbursement stall the attainment of certain developmental projects, which can be exasperating for the local leadership and population. Notwithstanding these issues, increased financial autonomy provides greater governance in the southern state of Karnataka.

#### **Case Study 3: Bihar**

Bihar today is a case where the financial independence of the PRIs is still a work in progress. The Bihar Panchayati Raj Act of 2006 was aimed at enabling greater powers and responsibilities for PRIs, but its execution has been severely lackluster. Financially, PRIs in Bihar are often burdened with a shortage of funds and a greater deficiency when it comes to revenue-generation activities. The state government has faced criticism for not providing sufficient funds to local bodies, which

in turn hampers their ability to undertake development projects. Also, the control exercised by the bureaucracy over finances has hampered the decision-making powers of the PRIs. Still, some recent steps towards better financial management and capacity building at the level of local bodies are welcoming developments.

#### **Case Study 4: Tamil Nadu**

The state of Tamil Nadu decided to take a different stance on financial independence through the promulgation of The Tamil Nadu Urban Local Bodies Act, 1998, which allows urban local bodies, including PRIs, to self-finance through various approaches. The state has adopted a set of reforms on property tax which has no doubt improved the revenue base of local bodies. In addition to all this, the state government significantly funds the local bodies through grants and schemes designed to improve infrastructure and service delivery at the local level. Even with these improvements, other issues like bureaucratic sluggishness and low capacity of local administrative staff remain. The diverse experiences of Kerala, Karnataka, Bihar, and Tamil Nadu case studies showcase the varying levels of financial autonomy of PRIs in India. Kerala and Karnataka serve as successful examples of decentralization and financial empowerment, while Bihar exemplifies the difficulties that can stem from bureaucratic custody and insufficient aid. The Tamil Nadu model shows potential, but also highlights the necessity for further ongoing reforms.

The autonomy of the local governance institutions in these states collectively demonstrate the practicality of finance in the governance system. Policymakers seeking to improve PRI's financial autonomy in India can frame policies after analyzing the aforementioned case studies. This would ultimately lead to enhanced accountability and governance on the ground level.



## CHALLENGES TO FINANCIAL AUTONOMY

**Dependence on State Governments:** Financial dependence on state governments, as mandated constitutionally, keeps many PRIs within a quasi-autonomous level, curtailing further autonomy. This dependence contributes to slow payments and reduced cashflow stifling timeliness on local initiatives being undertaken.<sup>944</sup>

**Inadequate Revenue Generation:** Sufficient revenue generation through local taxes is a challenge afflicting many PRIs. Such as a narrow tax base, public ignorance, and administrative ineptitude contribute to this problem.

**Political Interference:** The budgeting process pertaining to PRIs is usually affected by politics. Even local politics may skew the funding in a certain direction, which may not be fair or just.

**Capacity Building:** Stress is needed for management with advanced financial skills of PRIs in training programs, which enhances the defined PRI functions. The finance management skills of the officials are often insufficient leading to poorly organized systems which results in wastage of resources..

## CONCLUSION

Often the governors ignore the financial PRIs need to achieve IT effective self-governance. However, under the Constitution, sufficient legal groundwork is available for the financial independence of these institutions. Supporting the PRIs by improving their revenue collection capacities, reducing dependence on funds from the government, and providing better training will enable them to operate competently and take meaningful initiatives.

## Recommendations

1. Broaden Taxing Powers: PRIs should be granted wider taxing permissions by the states to improve their revenue. New local taxes may be brought in or existing ones may be increased.

2. Regular Finance Commission Reviews: The Finance Commission should be bound to make regular comments so that PRIs operate sustainably. It needs to be overhauled to make the recommendations mandatory to the governments who have the obligations.
3. Capacity Building Programs: Designate skilled PRI educator trainers to develop and deliver specialized training on financial management and governance skills. This might involve collaboration with universities and NGOs for tailored training courses.

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