



Central and State Finance Commission Grants to Panchayati Raj Institutions (PRIs): Implications for Financing of Rural WATSAN

Discussion Paper

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LIST OF ABBREVIATIONS

AWCs	<i>Anganwadi</i> Centres	MLA LAD	Member of Legislative Assembly Local Area Development Fund
C&AG	Comptroller and Auditor General of India	MP LAD	Member of Parliament Local Area Development Fund
CAA	Constitutional Amendment Act	ODF	Open Defecation Free
CFCs	Central Finance Commissions	OSR	Own Source Revenue
CSSs	Centrally Sponsored Schemes	PEOs	<i>Panchayat</i> Executive Officers
DRDA	District Rural Development Agency	SBM	<i>Swachh Bharat</i> Mission
GoB	Government of Bihar	SFCs	State Finance Commissions
Gol	Government of India	ToR	Terms of Reference
GP	<i>Gram Panchayat</i>	ULBs	Urban Local Bodies
GPDP	<i>Gram Panchayat</i> Development Plan	WATSAN	Water and Sanitation
JJM	<i>Jal Jeevan</i> Mission	WIMC	Ward Implementation and Monitoring Committee
LBs	Local Bodies		
LFAD	Local Fund Audit Department		

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EXECUTIVE SUMMARY

The rural water and sanitation (WATSAN) sector has received adequate attention from policy makers and Civil Society Organisations (CSOs) for more than two decades. Apart from Union governments, State Government and the private sector, *Panchayat Raj* Institutions (PRIs) have played a vital role in the sector. PRIs have been receiving grants from Central Finance Commission (CFCs) and State Finance Commissions (SFCs) after the 73rd Amendment Act of the Constitution. 14th Finance Commissions (FC) recommended a grant of Rs. 2,00,292 crores to *Gram Panchayats* (GPs) for 2015-20 with the basic grant being Rs. 1,80,262.98 crores and performance grant being Rs. 20,029.22 crores. The amount of grant was transferred directly from State Finance Department/ State *Panchayati Raj* Department into GPs account from the State treasury. Similarly, the Fourth and Fifth SFC of Bihar and Odisha also gave grants to PRIs.

This discussion paper has tried to look into the implementation and key recommendations of the CFC and SFC focusing on Bihar and Odisha. Section I covers the introduction, objectives, scope and methodology with Section II captures highlights including the 14th FC and latest SFCs relevant for financing rural WATSAN. Section III presents the flow of grants to PRIs in recent years. The implications for financing rural WATSAN with regard to the 15th FC's recommendations for financial year (FY) 2020-21 is discussed in Section IV and finally Section V, lays out the concluding observations and policy implications of CFC and SFC Grants to PRIs and its impact on rural WATSAN.

Key Findings:

- In Bihar and Odisha, the CFC grants have mainly been used for supply of drinking water facilities at the household level. In Bihar, the water supply projects were mainly implemented in *Maha Dalit Bastis*. CFC grant has not been used for water and sanitation facilities in social sector institutions like schools and *Anganwadi* Centres (AWCs) despite orders issued by the Government of India. The SFC fund has been used for providing drainage facilities. The 14th FC grants could not be used in Bihar until 2017-18 by the GPs because of *Panchayat* elections and the litigation in court by the *Sarpanches* (Presidents of the GPs) with regard to transfer of the 14th FC fund to Village Implementation and Monitoring Committees (VIMCs) and consequently delays occurred in the fund release from the States to GPs.
- Additionally, shortage of staff in the line departments had affected the planning, implementation, monitoring and accounts preparation work of GPs in Bihar and Odisha. Lack of and poor preparation of *Gram Panchayat* Development Plans (GPDPs), weak monitoring and poor financial management were also some of the reasons for the delay in fund utilisation. There was poor fund absorption capacity in Odisha due the late completion of plans. This was due to the shortage of staff and their capacity as well as delays in receiving instructions from the States. PRIs are largely dependent on the grants from CFC and SFC since the 3Fs (funds, functions and functionaries) have not been effectively devolved to PRIs.
- The 15th FC Recommendations have not given adequate budgetary priority to the local bodies including PRIs given the low level of fund

devolution. In comparison, there was a three-fold jump in the quantum of allocation for the local bodies in the 14th FC from the 13th FC allocation. The total grant of the 15th FC for local bodies has been divided into basic grants and tied grants in the ratio of 50:50. The basic grant is meant for providing general basic services and the tied grants are to be used in critical sectors of sanitation and drinking water. Giving high priority to the water and sanitation (WATSAN) sector has been a welcome step taken by the 15th FC.

- To improve access of WATSAN services, there is a need for effective devolution of the 3Fs to PRIs, strengthening fund absorption capacity, effective decentralised planning, transparency and accountability. The 15th FC should give more budgetary priority to local bodies including PRIs given the low level of fund devolution. There is also a need for a strong coordination mechanism between the Centre, State and Local bodies such as PRIs with regard to implementation of 15th FC Recommendations', activity selection and preparation of GPDP.

I. INTRODUCTION

Local governments, at both rural level - *Panchayati Raj* Institutions (PRIs) and urban level - Urban Local Bodies (ULBs), have been receiving Grants-in-Aid as per the recommendations of the Central Finance Commissions (CFCs)¹ and the State Finance Commissions (SFCs)², after the 73rd and 74th Amendment Act of the Constitution (Box 1.1). Largely, the purpose of these grants is to give untied funds to the local government bodies - PRIs and ULBs, in order to prioritise, plan and provide basic services at the local level. Apart from the CFC and SFC grants, PRIs and ULBs have also been receiving funds from different sources such as Centrally Sponsored Schemes (CSSs), State Sponsored Schemes, State Plan Fund, Own Source Revenue (OSR), Member of Parliament Local Area Development (MP LAD) Fund, Member of Legislative Assembly Local Area Development (MLA LAD) Fund and borrowings (Figure 1.1). The grants from SFC and CFC are untied grants whereas the funds from CSSs are tied in nature which means that the purpose of the funds is predetermined.

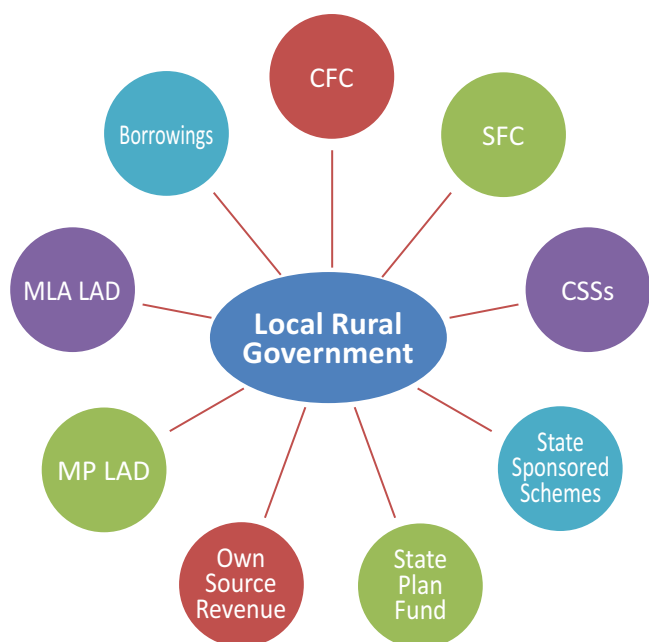
Box 1.1: Salient Features of the 73rd and 74th Amendment Act of the Constitution

- The Acts came into force in the year 1993.
- This added two new parts to the Constitution, namely, Part IX titled “The Panchayats” and Part IXA titled “The Municipalities.”
- The Amendments provided the following for the local governments
 - Creating “Institutions of Local Self-Government”
 - Preparing the local plans and projects related to economic development and social justice
 - Constitution of the SFC, Election Commission, District Planning Committee and holding elections every five years
 - Provision of reservation for SCs/STs and Women
 - Devolution of power (Funds, Functions, Functionaries) to PRIs and ULBs

¹ A **Central Finance Commission (CFC)** was set up in 1951 to define the financial relations between the central government of India and the individual state governments. It is constituted once every five years by the President of India under Article 280 of the Constitution to recommend on sharing of fiscal resources between the Union and the States, a major part of which pertains to sharing of revenue collected in the Central Tax System. The total amount of revenue collected from all Central taxes - excluding the amount collected from Cesses, Surcharges and taxes of Union Territories, and an amount equivalent to the cost of collection of Central Taxes - is considered as the shareable/divisible pool of Central tax revenue. In the recommendation period of the 13th FC (2010-11 to 2014-15), 32 per cent of the divisible pool of Central tax revenue used to be transferred to States every year, which was increased to 42 per cent by the 14th FC (for 2015-16 to 2019-20).

² The **State Finance Commission (SFC)** is an institution created by the 73rd and 74th Constitutional Amendments (CAs) to rationalise and systematise State/sub-State-level fiscal relations in India. Article 243I of the Constitution mandated the State Governor to constitute a Finance Commission every five years. A SFC has functions similar to that of the CFC. It allocates resources of a state to its *Panchayati Raj* Institutions (PRIs) at all three levels (i.e. village level, block level and district level) in terms of taxes, duties and levies to be collected by the state and the local bodies. It reviews the financial position of the *panchayats* in a State and makes recommendations to the Governor about the principles that should govern the distribution of tax proceeds at all three levels amongst many other recommendations.

Figure 1.1: Sources of Funds for WATSAN at the Level of Rural Local Government



Source: Ministry of Panchayati Raj, Government of India

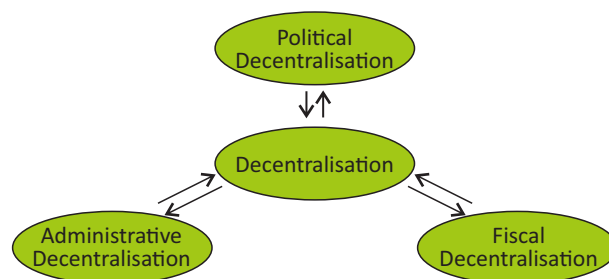
With the purpose of empowering PRIs and making them institutions of local self-governance deciding local level development priorities, the 73rd Constitutional Amendment Act (CAA) was legislated in 1992. The primary objective of CAA was to provide autonomy to PRIs to prioritise needs, prepare local plans and projects related to economic development and social justice in 29 subjects. Basic services of drinking water supply and sanitation are included in the list of subjects amongst a range of other development activities. Further, the devolution of three Fs (Funds, Functions and Functionaries) (Box1.2) is critical to the design of any decentralised system. Moreover, there is need to transfer political responsibility, administration of functionaries and control over fiscal activities (revenue collection and expenditure) to PRIs (Figure 1.2). However, the extent of devolution of power (funds, functions, functionaries) to PRIs has not been specified by the Constitution. Hence, devolution to PRIs has been inconsistent and non-uniform across states in the country.

Box 1.2: The Three Fs: Funds, Functions and Functionaries

Devolution of the three Fs- Funds, Functions and Functionaries, to the PRIs/local bodies, means the devolution of powers should accompany with adequate funds, clear-cut roles and responsibilities and adequate human resources for executing such roles and control over tax collection and spending funds.

Figure 1.2: Decentralisation and Devolution of Funds, Functions and Functionaries

Decentralisation is the transfer of authority and responsibility for public functions from the central government to subordinate or quasi-independent government institutions.



Source: Ministry of Panchayati Raj, Government of India

³ The Eleventh Schedule of the Constitution provides a list of 29 subjects which are transferred to the local government - <https://www.mea.gov.in/Images/pdf1/S11.pdf>

Most of the State governments have devolved bulk of the functions to PRIs without transferring the matching funds and functionaries. The proportion of untied grants for development work in total receipts is inadequate to meet the functions devolved to the PRIs, and further are not at the discretion of PRIs. PRIs have little control over the revenue and capital/Plan and Non Plan funds⁴ required for creation of new projects and up-scaling and maintenance of existing local level of social and economic services, except in Kerala⁵. Moreover, PRIs have limited power to collect their own resources, the tax base is low and specialised staff for tax collection have not been provided. Currently, in terms of fund availability, PRIs are largely dependent on grants from SFC, CFC and CSSs. However, due to lack of flexibility in terms of fund usage and scheme guidelines, the mechanism of centralised planning and budgeting in CSSs often does not work for PRIs. The SFC and CFC grants give more flexibility to PRIs in terms of planning and budgeting at the local level; however, flexibility in practice differs in each State.

Objectives

In the given context, this Discussion Paper tries to assess the implementation of the 14th FC and SFC (Bihar and Odisha) grants and their priorities for water and sanitation in rural areas. The specific objectives are:

- To document key recommendations pertaining to grants for PRIs made by 14th FC and latest SFCs for Bihar and Odisha;

- To take stock of actual trend of flow and usage of grants to PRIs in Bihar and Odisha in recent years;
- To highlight the major issues and bottlenecks in the financing of rural WATSAN through PRIs in Bihar and Odisha;
- To document and comment on the recommendations of the 15th CFC for PRIs in view of the above.

In terms of data sources and methodology, the paper has relied upon both primary and secondary data. The data and perceptions at the *Gram Panchayat* (GP) level have been collected from Gaya and Samastipur districts in Bihar and Nuapada and Ganjam districts in Odisha.

⁴ Plan expenditure included spending incurred on government programmes and schemes detailed under the prevailing Five Year Plan. It included all kinds of expenditure on schemes, whether on recurring, or revenue or capital heads.

Non-Plan expenditure included outlays on routine functioning of the government. Interest payments, subsidies, salary & pension payments (for regular cadre staff across sectors), police, defence, expenditure on maintenance of assets or infrastructure across sectors constituted Non-Plan expenditure.

⁵ Since the government has moved away from the system of Five-Year Plans, the distinction between plan and non-plan expenditure has been removed since FY 2017-18.

II. KEY RECOMMENDATIONS BY 14TH FC AND LATEST SFCs RELEVANT FOR FINANCING OF RURAL WATSAN

A. Central Finance Commissions (CFCs)

This section discusses in detail the budgetary priorities by CFCs for PRIs at the national level and its role in providing water and sanitation services through PRIs and ULBs. It provides an overview of the CFC grants to States and local bodies since the period of the 10th FC.

For the first time, CFC grants were provided to PRIs from the period of the **10th FC (1995-2000)**, however, it was given to them without any Terms of Reference (ToR). They were given an adhoc grant at the rate of Rs. 100 per capita of rural population based on Census 1971.

Further, the ToR of the **11th FC (2000-2005)** mentions Article 280(3)(bb) and 280(3)(c) of the Constitution of India, *“To recommend measures to supplement the resources of the Panchayats and Municipalities by augmenting the consolidated funds of individual States, taking into account the recommendations of the respective SFCs”*.

The **12th FC's (2005-2010)** mandate was 'to recommend as to the measures needed to augment the Consolidate Fund of a State to supplement the resources of the *Panchayats* and the Municipalities in the State on the basis of the recommendations made by the FC of the State'. It further recommended Grant-in-aid to augment the consolidated fund of the States to supplement the resources of the PRIs and the ULBs. The recommended amount could be divided between the PRIs and the ULBs in the ratio of 80:20.

Box 2.1: Basic Grants and Performance Grants

The 13th and 14th FC had recommended Grants-in-aid to PRIs and ULBs in two parts, namely:

Basic Grant - it is a part of the total grant provided to local governments for delivery of basic services.

Performance Grant - Given for institutional and governance strengthening of GPs. They are designed for the purpose for ensuring reliable audited accounts and improving their own revenue.

The **13th FC (2010-2015)** recommended grants-in-aid to the Local Bodies (LBs) as a percentage of the previous years' pool of taxes over and above the share of the states. Also, it introduced the concept of 'basic grant' for providing basic services and 'performance grants' for strengthening the systems of PRIs (Box 2.1). Under the basic and performance grant, a special area grant was given to the Scheduled V and Scheduled VI areas as well as other areas excluded from the operation of part IX and IX A of the Constitution (Rural Local Self Government added by 73rd Constitutional Amendment Act). These areas largely covered the tribal belts and Autonomous Councils. The 13th FC awarded a percentage of divisible pool to PRIs i.e. basic grant amounting to 1.5 per cent of the divisible pool.⁶ The performance grants (2011-15) were estimated as 0.5 per cent of the divisible pool in 2011-12 and one per cent of same divisible pool in the remaining

⁶ The divisible pool is that portion of gross tax revenue which is distributed between the Centre and the States

years (2012-15). The total estimated grant for PRIs during the 13th FC period was Rs. 63,050 crores comprising Rs. 41,222 crores (approximately 65 per cent) as basic grant for providing basic services and Rs. 21,825 crores (approximately 35 per cent) as performance grant for the period 2010-15. Henceforth, fund availability per capita under 13th FC was Rs. 624 for five years, i.e. Rs. 124 per capita annually. The conditions for availing the performance grant by States during the 13th FC included for the State to provide a Supplementary Budget to the Local Bodies in the State budgets and have a comprehensive audit system as stipulated by the Comptroller and Auditor General (C&AG) of India and maintenance of accounts. Further, they had to appoint independent Local Body Ombudsman, transfer of Grants to Local Body through e-Transfer within five days of receipt from Union Government, prescribing qualification for appointment of SFC members, empowering the Local Body for levying property tax and setting standards for delivery of basic services by PRIs.

The **14th FC (2015- 2020)** recommended grants for local governments in two parts- (i) Basic Grant (ii) Performance Grant for duly constituted GPs and Municipalities during award period of 2015-20. In the case of GPs, 90 per cent of the grant was the basic grant and 10 per cent was the performance grant. The use of these grants during the 14th FC period is given in the Box 2.2. The release of the performance grant was due from the second year of award period i.e. from 2016-17 onwards. The 14th FC recommended a grant of Rs. 2,00,292 crores to GPs for 2015-20 with basic grant being Rs. 1,80,262.98 crores and performance grant being Rs. 20,029.22 crores, hence forth, the fund availability per capita under 14th FC was Rs. 2,404 for five years that is Rs. 480 per capita annually for the rural population. As per the 14th FC recommendations, the grants were to be released in two instalments in June and October every year to the State Treasury which had to transfer to the GPs within 15 days of receipt from the Union

government. The amount of grant was transferred directly from State Finance Department/State *Panchayati Raj* Department into the GPs account from the State treasury.

Box 2.2: Use of Basic Grants and Performance Grants during 14th FC period

- The Basic Grant was given to improve basic civic services like water supply, sanitation, sewage facilities, solid waste management, storm water drainage, maintenance of community assets, roads, footpath, street lighting, and burial and cremation grounds.
- More focus was given on drinking water and sanitation facility at the community level. Also, priority was given for providing drinking water and sanitation facility at institution level such as schools and AWCs.
- The 14th FC fund could also be used for celebrating *Swachhta Pakhwada* in GPs, campaigns on water and sanitation, promoting the use of toilets, improving solid and liquid waste management and installing dustbins in every hamlet.
- As per the 14th FC guidelines, up to 10 per cent grants could be used by GPs for their operation and maintenance, including the purchase of computers, paying wages for contractual staff etc.
- Through the performance grant, the GPs had to take initiatives to prepare proper annual accounts and get them audited regularly without any backlog. GPs were also required to show an increase in their own sources of revenues over the preceding year as reflected in the audited accounts.
- For the purpose of using the 14th FC funds by GPs, a *Gram Panchayat Development Plan* (GPDP) had to be prepared covering all kinds of financial, human and natural resources available in GPs.

Source: Ministry of Panchayati Raj, Government of India

Data on CFC grants presented in Table 2.1 shows that there had been an increase in the amount of transfer of grant to PRIs over the years. There had been a three-fold jump in the amount allotted

to GPs from the 13th FC period to the 14th FC. During the 14th FC period, 88 per cent of total funds had been released by the Union government to the GPs.

Table 2.1: Grants to Local bodies by CFC (in Rs. crore)

Commission	Amount Allocated		Amount Released
	PRIs	ULBs	PRIs
10 th FC (1995-2000)	4,380.9	1,000	3,576.4 (66.5 %)
11 th FC (2000-05)	8,000	2,000	6,601.9 (82.5 %)
12 th FC (2005-10)	18,000	4,500	16,664.8 (92.6%)
13 th FC (2010-15)	63,053	23,111	58,256.6 (92%)
14 th FC (2015-20) #	200,292.2	87,143.8	1,76,336 (88%)
15 th FC (2020-21) **	60,687	29,250	-

Source: Compiled by CBGA from FC Reports, various years and website of Ministry of Panchayati Raj, Govt. of India.

Note: # denotes as on 10.03.2020., ** First report for FC-XIV for 2020-21.

B. Recommended Grants under 14th FC for Bihar and Odisha

Table 2.2 depicts the recommended amount of grants under the 14th FC for Bihar and Odisha. The States of Bihar and Odisha were allotted the basic grants for five years, however, the performance

grants were allotted for four years from 2016-17 based on fulfilling certain parameters of performance. (Table 2.2).

Table 2.2: Recommended Fund Flows under 14th FC for Bihar and Odisha (in Rs. crore)

Year	Bihar			Odisha		
	Basic Grant	Performance Grant	Total	Basic Grant	Performance Grant	Total
2015-16	2,269.18	0	2,269.18	955.52	0	955.52
2016-17	3,142.08	412.15	3,554.23	1,323.09	173.55	1,496.64
2017-18	3,630.39	466.41	4,096.80	1,528.71	196.4	1,725.11
2018-19	4,199.71	529.67	4,729.38	1,768.44	223.04	1,991.48
2019-20	5,674.70	539.55	6,214.25	2,389.54	292.05	2,681.59
2015-20	18,916.05	2,101.78	21,017.83	7,965.28	885.03	8,850.31

Source: Compiled by CBGA from the 14th FC Report, 2015.

C. Recommended grants by SFCs in Bihar and Odisha

As per Article 243-I of the Constitution of India, the SFCs have been constituted to assess the financial status of the State and to determine the principles on the basis of which adequate financial resources would be transferred to the local bodies including PRIs.

i) SFCs in Bihar

The First and Second SFCs of Bihar were constituted in April, 1994 and June, 1999 respectively. Both these SFCs did not submit their reports. The Third SFC, constituted in July 2004, provided for the devolution of three per cent of the State's net own tax revenue to local bodies, grant for salary payment of employees of *Zilla Parishad*, honorarium to elected representatives and lump sum grant for infrastructure which was accepted and implemented by the State government. The Fourth SFC, constituted in June 2007, provided for the devolution of 7.5 per cent of State's own tax revenue, net of collection costs, to local bodies grant for salary of employees of Local Bodies (LBs) by the State government and grant for high priority sectors.

The SFC grants were transferred to GPs directly by the State Finance Department for preparing their local projects. The State has to prioritise the use of SFC funds primarily for drinking water supply, brick laying concrete roads, drainage system, sanitation, street lighting and setting up of library in the GP. The total quantum of fund provided through the SFC was comparatively less than the grant provided by CFC to GPs. As per the recommendations of the SFCs, the amount had been categorised on the basis of functions such as share of net tax revenue of the State for PRIs, grants for water supply, sanitation, smart *Panchayat*, e-governance, *Panchayat Sarkar Bhawan* etc. The amount was to be distributed among GPs, *Panchayat Samitis* (PSs) and *Zila Parishads* (ZPs) in the ratio of 70:10:20 respectively.

The Fifth SFC in Bihar was constituted in December 2013 for the period 2015-20 and its report was due on 31st March 2015. It was finally submitted on 2nd February 2016 i.e. with a delay of 10 months. Table 2.3 shows the provision of Rs. 18,520 crore as grants recommended by the Fifth SFC.

Table 2.3: Recommended Transfers to PRIs in Bihar under Fifth SFC of Bihar (in Rs. crore)

	2015-16	2016-17	2017-18	2018-19	2019-20	2015-20
Devolution	1,780	1,940	2,390	2,960	3,665	12,735
Grants	555	935	1,085	1,525	1,685	5,785
Total	2,335	2,875	3,475	4,485	5,350	18,520

Source: Compiled by CBGA from the Fifth SFC Report, Govt. of Bihar.

ii) SFC Grants in Odisha

In Odisha, the Second SFC had recommended Rs. 2,143.2 crore to the PRIs towards devolution, compensation and assignment, grant-in-aid and

salary for the period 2005-10, against which only Rs. 984.4 crore (45 per cent) was released by the State government from its own tax revenue. The C&AG Audit Report on Local Bodies, 2018 observed that the Third SFC had made a recommendation of

Rs. 6,787.2 crore for PRIs for the period 2010-15. However, against the recommended transfer, only Rs. 3,120.1 crore (56 per cent) was released by the State government. In the first two years of the Fourth SFC, the State government released Rs. 1,235.5 crore and Rs. 1,395.2 crore towards SFC award during 2015-16 and 2016-17 respectively to the PRIs.

The Fifth SFC aims at strengthening the financial resource base of the local bodies in Odisha. Some of the institutional strengthening measures include strengthening of human resources, strengthening of infrastructure facilities and other financial and accounting measures have been

recommended by the Fifth SFC of Odisha. The estimated total fund requirement for the local bodies during the five-year period 2020-25 is Rs. 50,282.50 crore. Out of this, the SFC has recommended an amount of Rs. 20,771.6 crore thus leaving a gap of Rs. 29,510.9 crore. The Fifth SFC, therefore recommended that the 15th FC could consider augmenting the State's consolidated fund by Rs. 29,510.9 crore, to supplement the resources of the local bodies over and above the fund recommended for transfer from the State's resources. Rs. 13,828.2 crore has been recommended to PRIs out of total fund developed to local bodies during 5th SFC (Table 2.4).

Table 2.4: Recommendations of Fourth and Fifth SFC Grants to PRIs in Odisha (in Rs. crore)

Distribution Mechanism	Fourth SFC	Fifth SFC
	2015-20	2020-25
Devolution of Funds	2,468.9	4,575.5
Assignment of Taxes	3,001.7	4,197.8
Grants-in-aid	2,234.5	5,054.9
Total	7,705	13,828.2

Source: Report of Fifth SFC, Department of Finance, Govt. of Odisha, 2019.

The Fifth SFC recommended an amount of Rs. 750 crore for meeting drinking water requirements with special emphasis on water stressed pockets. It also recommended a provision of Rs. 250 crore for

installing tube well systems based on solar energy. Further, an amount of Rs. 125 crore was recommended for preservation and development of water bodies in GPs.

III. FLOW OF GRANTS TO PRIs IN RECENT YEARS: TAKING STOCK

This section assesses the budgetary priorities for WATSAN at the GP level in Gaya district, Bihar and Nuapada district, Odisha. It also attempts to understand the status of implementation of the 14th FC recommendations and the challenges associated with it.

A. Utilisation of CFC and SFC Grants at GP level in Bihar

During the 14th FC period, Bihar had been deprived from receiving the estimated performance grants⁷ (2016-20) due to eligibility challenges like lack of improvement in OSR and non-submission of audited GP accounts etc. PRIs were unable to collect OSR due to non-notification of rules by the State government. In terms of fund release, Bihar had received the entitled amount of the basic grant i.e. Rs. 2,269.2 crore, for 2015-16. The first instalment for 2016-17 was due in June 2016, the same was released to PRIs in December 2016. However, the second instalment was delayed by six months and was received in March 2017. The C&AG Audit Report on Local Bodies, 2017, found that Bihar received an allotment of Rs. 4,810.7 crore grants under the 13th FC on for 2010-15 out of which PRIs could utilise only Rs. 2,676.4 crore (i.e. 56 per cent) leaving an unspent balance of Rs. 2,134.3 crore (till July 2016).

The Fifth SFC recommended grants of Rs. 18,520 crore. The State had made a budget provision of

Rs. 1,822.9 crore to be released to PRIs during 2015-16 but grants were not released till January 2017. Also, it was found that the full amount of recommended grant was not budgeted in 2015-16. Further, it has been observed that these delays in disbursement often lead to underspending, thereby causing a vicious circle of poor unutilised funds.

In terms of total priority of work under Fourth SFC, adequate focus was not given to the services related to the WATSAN sector. The C&AG Audit Report on Local Bodies, 2017 observed that during the Fourth SFC (2010-15), against the recommendations of Rs. 4,026.6 crore grants, only Rs. 1,580.5 crore (39 per cent) were released. In two years (2011-13) of the Fourth SFC period (2010-15), grants were released in one instalment at the end of the financial year (2013). The following table (Table 3.1) depicts the poor utilisation of grants by PRIs across the years.

Table 3.1: Utilisation of CFC and SFC funds by PRIs in Bihar for 2011-16

Year	2011-12	2012-13	2013-14	2014-15	2015-16
Budgetary Allocation (in Rs. crore)	3,549.7	3,526.8	4,074.1	4,809.5	5,467
Expenditure (in Rs. crore)	2,389.5	2,591	3,003.3	2,374.8	2,893
Utilisation Percentage (in per cent)	67.3	73.5	73.7	49.4	52.9

Source: Compiled by CBGA based on the information presented in C&AG Report, 2017

⁷ The grant was supposed to have been given to GPs in 2016-17 on the basis of fulfilling performance criteria of 2014-15 and 2015-16.

Further, there has been poor record of submission of utilisation certificates (UCs) by PRIs in case of 13th FC, 4th SFC and 14th FC due weak financial management of PRIs. This is one of the reasons for the delay in fund flow and subsequently low utilisation of CFC and SFC grants.

Budgetary Priorities for Water and Sanitation at *Gram Panchayat* (GP) level in Bihar

In Bihar, a large chunk of funds received by GPs come from the CFC and SFC grants and it is largely utilised for the local development work and drinking water supply and sanitation. Around 20 per cent as core 14th FC grant has been implemented by the *Mukhiya* (President of the GP) and remaining 80 percent of the fund spent through Chief Minister Seven Resolves Programme (CM's *Saat Nishchaya Yojana*) for drinking water supply (*Har Ghar Nal Ka Jal*) and storm water drainage activities (*Nali Gali Yojana*) in the ratio of

50:50. The projects are executed by the Ward Implementation and Monitoring Committee (WIMC). The budget is transferred to the WIMC account from GPs accounts on the basis of state government order. The WIMC bank account is being operated jointly by Ward Members and a Secretary elected from the ward electorate. The water supply Project is given to those wards which have a predominantly *Maha Dalit* population. The WIMCs have given less focus for water security and water conservation.

The fund utilisation accounted for 76 per cent under the 14th FC, whereas under CM *Nishchaya Yojana*, the percentage of utilisation was 20 per cent. Similarly, only 11 per cent of the SFC could be utilised in 2017-18 (Bhare GP, Gaya). Bhagwanpur GP depicts that the 14th FC and CM *Nishchaya Yojana* have reported a utilisation of 74 per cent and 79 per cent respectively. The 5th SFC accounts for only 18 per cent of the fund utilised out of the total available fund.

Table 3.2: Status of Fund Utilisation in GPs, 2017-18 (in Rs. lakh)

Gram Panchayat	Bhare GP, Gaya (2017-18)			Bhagwanpur GP, Samastipur (2017-18)		
	14th FC	CM Nishchay Yojana	Fifth SFC	14th FC	CM Nishchay Yojana	Fifth SFC
Total Available Fund	18.5	100.9	10.6	13	95.7	9.9
Total Fund utilised (Figures given the parentheses indicates percentage of fund utilisation out of total available fund)	14 (76 %)	19.7 (20%)	1 (9%)	9.6 (74%)	75.4 (79%)	1.8 (18%)

Source: GP Offices of Bhagwanpur Kamla GP, Samastipur and Bhare GP, Gaya, Bihar, February 2019

Issues in Fund Flow and Fund Utilisation

The 14th FC grants could not be used in 2015-16 and 2016-17 by the GPs because of *Panchayat*

election, subsequently the litigation in court by presidents of GPs with regard to transfer of 14th FC fund to WIMCs and consequently delays happened in the fund release from the State. Henceforth, GPs

could spend the fund in 2017-18. Further, water supply projects have gotten delayed due to lack of material availability in the local market related to the projects. State government had made it mandatory to procure materials from the local market only. The presence of hard rock in the soils became a major reason for delay in completion of the water supply projects and hence, low fund utilisation in Gaya. Additionally, shortage of staff in the line departments had affected the planning, implementation, monitoring and accounts preparation work of GPs. Lack of preparation of GPDP, weak monitoring and poor financial management are also some of the reasons for the delay in fund utilisation. Some of the major issues found in fund flow and utilisation includes the following:

- i) **Lack of devolution of Power to PRIs/Staff Shortage:** The functions, functionaries and funds (3Fs) have not been transferred to the PRIs, except those related to rural development and *Panchayati Raj*. It was found that the staff answerable to their respective departments and the PRIs did not have adequate staff to discharge the devolved functions and manage the grants from the CFC and the SFC. The fund available to the PRIs from various sources were grossly inadequate for their assigned functions, they were unable to utilise even that due to capacity constraints. At the GP level, 3,160 posts for *Panchayat Secretaries* (38 per cent of the total 8,397 posts sanctioned) were vacant as of 31st March 2016.
- ii) **Mechanism of audit and accounts maintained at the GP level:** Sample audit of PRIs is done by Examiner of Local Fund Accounts (ELFA) under AG audit and Directorate of Local Fund Audit. Social audit is not being regularly carried out at

the GP level. No independent organisation is constituted for the conduct of social audits formed at the State level.⁸ Currently, audit of account of GPs is done by empanelled private chartered accountants under the supervision of ZP. There are challenges in terms of capacities of financial management at GP level due to inadequate human resources and less focus on conducting capacity building of both elected and non-elected members of the GP for maintaining accounts. Recently, the State government has provided a staff called the GP Executive Officer (GPEO) for each GP. It was further revealed that despite clear guideline and availability of grant to the state, 10 per cent of the administrative costs from 14th FC were not being utilised by GPs.

- iii) **Mechanism for financial monitoring:** The financial progress of GPs was monitored in a weekly meeting at the block level by Block Development Officer and Block *Panchayati Raj* Officer. Monthly or quarterly review meetings are also convened by the Department of *Panchayati Raj* in the district by District *Panchayati Raj* Officer to assess the financial progress. However, officials shared that physical monitoring of assets created from the 14th FC and SFC grants were weak due to inadequate human resources, unavailability of vehicles and the cost for petrol at the block and district level.
- iv) **Information/ Budget Data Transparency:** There is lack of budget data availability and transparency on 14th FC and SFC funds at the district level. Overall, there is reluctance to share financial information/data at the district, block and especially at the GP level.

⁸ The Union government of India enacted Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) Audit of Scheme Rules, 2011

B. Budgetary priorities for WATSAN at GP Level in Odisha

Use of 14th FC Grant in Odisha

For the use of the 14th FC Grant, the GPs prepared an Annual Action Plan or *Gram Panchayat* Development Plans which was submitted to and approved by the District *Panchayati Raj* and Drinking Water Department/District Rural Development Agency (DRDA) through the Block Development Office in Nuapada. In 2015-16, the State was able to utilise only 16 per cent of the available fund. In 2016-17, an increase of up to 43

per cent was observed but again it declined to 36 per cent and 30 per cent in 2017-18 and 2018-19, respectively. Again, this was found to be exceedingly low during the four-year award period in Nuapada. In 2015-16, for example, the district was able to utilise only 13 per cent of the available fund. In 2016-17 an increase of up to 70 per cent was observed but once again it declined to 35 per cent and 13 per cent in 2017-18 and 2018-19, respectively (Table 3.3).

Table 3.3: Status of Fund Utilisation of 14th FC Grant in Odisha (in Rs. crore)

State/district	Odisha				Nuapada			
Year	2015-16	2016-17	2017-18	2018-19#	2015-16	2016-17	2017-18	2018-19#
Fund Available	955.7	2,320.5	2,842.3	3,209.1	151	36.4	37.4	40.7
Expenditure	151.6	1,008.8	1,034	971	1.9	25.3	13.2	5.3
% Utilisation	16	43	36	30	13	70	35	13

Note: # January, 2019

Source: *Panchayati Raj* and Drinking Water Deptt. Government of Odisha, available at: www.odishapanchayat.gov.in

Use of Fourth SFC Grants in Odisha

An analysis of the GPDP shows that for five years, the GPs devoted 30 per cent of their total funds for water supply while using the remaining funds on infrastructure gap projects. The rural water supply projects have largely spent money on paying for water tankers and digging tube wells. The infrastructure gap projects have used funds for the construction/repair of CC (Cement Concrete) roads, crematorium and connecting CC roads with schools. The amount of the SFC grant was mainly spent for community level facilities, not for those at the institutional level (schools, AWCs and health centers).

The Fourth SFC recommended Rs. 7,705 crore to be transferred (from State resources) to PRIs for the period 2015-20. Table 3.4 shows the percentage of fund utilisation of the Fourth SFC Grant in Odisha. Again, the level of utilisation was found to be exceedingly low. In 2016-17 and 2017-18, the State was able to utilise only 45 per cent of the available fund; in 2018-19 a decline of up to 30 per cent was observed. The level of fund utilisation was also found to be exceptionally low in Nuapada. In 2016-17, Nuapada was able to utilise only 40 per cent of the available fund; a decline of up to 28 per cent was observed, decreasing further to 13 per cent in 2018-19 (Table 3.4).

Table 3.4: Status of Fund Utilisation of the Fourth SFC in Odisha (in Rs. crore)

State/district	Odisha			Nuapada		
	2016-17	2017-18	2018-19#	2016-17	2017-18	2018-19#
Fund Available	1,421	1,698	1,393.7	34.8	66	55.3
Expenditure	639.4	764	424.9	13.8	18.7	7
Extent of fundutilisation (in %)	45	45	30	40	28	13

Note: # January, 2019

Source: Panchayati Raj and Drinking Water Deptt. Government of Odisha, available at: www.odishapanchayat.gov.in

Reasons for low fund utilisation in Odisha

Some of the major issues found in fund flow and utilisation includes the following:

- There was low utilisation of funds in both the FFC and CFC grants across the year.
- Delay in fund flow happened from the State to the GPs, the late completion of plans was due to shortage of staff and their capacity, as also delays in receiving instructions from the States related to initiating plan processes at the GP level as shared by the GP Sarpanch.
- There was lack of flexibility found in the use of funds while preparing projects and plans in the form of a GPDP as per local felt needs. Decisions with regard to activity selection for the GPDP were taken at the State level.

IV. RECOMMENDATIONS OF THE 15TH FC: IMPLICATIONS ON FINANCING RURAL WATSAN IN GPs

Looking at the 15th FC first interim report,⁹ a significant departure in the recommendations has been observed from the 14th FC. The total size of the grant for local bodies in twenty-eight States has been Rs. 90,000 crore, a little higher from Rs. 87,352 crore for the year 2019-20. The recommended allocation for rural local bodies/PRI in 2020-21 has been Rs. 60,750 crore, which is more or less unchanged from the Rs. 60,687 crore in 2019-20. The total allocation of grants for local bodies in Bihar has declined to Rs. 5,018 crore in 2020-21 from Rs. 6,368.3 crore in 2019-20. Similarly, for Odisha, it has decreased to Rs. 2,258 crore in 2020-21 from Rs. 2,681.6 crore in 2019-20.

This reflects that the 15th FC has not given adequate budgetary priority to the local bodies including PRIs given the low level of fund devolution. There was a three-fold jump in the quantum of allocation for the local bodies in the 14th FC showing an increase in the allocation from the 13th to the 14th FC, however, there has been no such increase from the 14th to the 15th FC. The total 15th FC grant for local bodies has been divided into basic grants and tied grants in the ratio of 50:50. The basic grant is meant for providing general basic services and the tied grants are to be used in the critical sectors of sanitation and drinking water, which include (a) services for sanitation and maintenance of Open Defecation Free (ODF) status of GPs (b) supply of drinking water, rain water harvesting and water recycling. Giving increased priority to water and sanitation is a positive step, nevertheless, the provision of 50 per cent of the

funds as tied grants has been in divergence with the approach of previous CFCs for providing most of the grants as untied. Also, it goes against the spirit of fiscal decentralisation and empowering local governments.

The 15th FC report advocates for provision of tied grants in the critical sectors of sanitation and drinking water in order to ensure additional funds to the local bodies. These are over and above the funds allocated (both Union and State share) for the above critical sectors provided under the CSSs- *Swachh Bharat Mission (SBM)* and *Jal Jeevan Mission (JJM)*. Simultaneously, the guidelines of the SBM and JJM are dependent on the resource allocation from the 15th FC creating confusion and ambiguity on the quantum of resource allocated for water and sanitation.

The guidelines of the 15th FC grants, SBM and JJM¹⁰ focus on water and sanitation services at the household level but does not provide adequate priority to these services in social sector institutions, such as schools, AWCs and health centres. It was expected that the guidelines for the utilisation of the 15th FC grants should have provision and clear targets in terms of delivering water and sanitation services to social sector institutions. Unlike the 14th FC, the 15th FC recommended grants to all tiers of *Panchayats* so as to enable pooling of resources across villages and blocks. This would help in creating durable community assets and improve their functional viability.

⁹ 15th FC was constituted under the chairmanship of Mr. N. K. Singh to provide the recommendations covering the period of FYs 2020-21 to 2024-25. The first report of 15th FC was presented to Union government for FY 2020-21. The term of the commission was originally set to complete by end of October 2019, but was extended by one year to October 30, 2020 to give the recommendation for next five years, i.e. 2020-21 to 2025-26.

¹⁰ The 15th FC has proposed pooling of resources from all three and convergence with CSS.

Grants have been provided to the Fifth and Sixth Schedule areas and cantonment boards which were missing in the 14th FC. For 2020-21, the recommended proportion of grants between the rural and urban local bodies is in the ratio of 67.5:32.5. The share of urban local bodies in the 15th FC grants to local bodies should be gradually increased to 40 per cent over the medium term as suggested by the Report. The distribution of grants between all tiers of PRIs will be on basis of the accepted recommendations of the latest Fifth SFC reports (70-85 per cent for village/GPs, 10-25 per cent for Block and intermediate *Panchayats* and 5-15 per cent for District and *Zilla panchayats*).

The distribution of grants for local bodies among the States is to be based on population and area in the ratio of 90:10. Grants towards local bodies should place special emphasis on areas with higher concentration of Scheduled Caste and Scheduled Tribe population. An assessment of the 15th FC Report also reveals that there are certain areas wherein the Commission has not paid due attention. These are mentioned below.

i) Lack of budgetary provision for maintenance of hygiene and health Care

Keeping in mind the situation of the COVID-19 pandemic, maintenance of hygiene has become a critical area of concern at the household and institutional level. The guidelines of the 15th FC, CSSs such as SBM and

JJM have not given adequate focus and budgetary priority to the maintenance of hygiene. There has been no financial support provided to PRIs for carrying out health services. This is even more critical, since, currently PRIs have been at the frontline in performing several health care activities to combat the pandemic.

ii) Lack of financial support for office and hiring temporary staff

Investment towards recruitment of staff and building capacities of the elected representatives and officials of GPs was found to be inadequate. These are essential for realising the objectives of devolution and the 73rd CAA. The 14th FC had provided a 10 per cent support as administrative support of total grant for hiring staff at the GP level for administrative work, planning and maintaining accounts, which has been discontinued in the 15th FC period.

iii) Discontinuation of Performance Grants for improving audited accounts of OSR

The 15th FC discontinued the performance grants as a criterion for fund distribution. Through the performance grant of the 14th FC, GPs had taken initiatives to prepare proper annual accounts and get them audited regularly. GPs had also shown an increase in their OSR.

V. CONCLUDING OBSERVATIONS AND POLICY IMPLICATIONS

- **Effective Devolution of 3Fs (funds, functions and functionaries) to PRIs**

The 3Fs (funds, functions and functionaries) should be transferred by the State to PRIs for better governance as envisioned by the 73rd CAA. Autonomy should be given to the PRIs by the Government of Bihar so that they can prioritise their needs, prepare local plans and projects related to economic development and social justice in 29 subjects which include public services such as drinking water supply and sanitation. This will also enable GPs to collect OSR by notification of rules by the State government

- **Strengthening capacity of staff for better fund utilisation**

The State governments of Bihar and Odisha should invest more funds in hiring of regular monitoring, engineering, and other technical staff (like accountants) to provide support to PRIs for better planning, implementation, monitoring and utilisation of funds. There is a need to invest more financial resources in capacity building of elected and non-elected of functionaries of GPs including ward members to prepare need-based plans, budgets, regular accounts/audit and to implement the 14th FC and SFC grants. The State government should release CFC and SFC funds timely to GPs along with releasing full entitlement of fund as recommended by CFC and SFC.

- **Effective decentralised planning**

It is important to strengthen the process of GPDP preparation by Government of Bihar and

Odisha to have decentralised plan as per local felt need. Apart from the implementation of water supply projects in the 14th FC, GPs should also focus on water security and water conservation.

- **Ensuring transparency and accountability**

There is a need for transparency in budget and physical outcomes data for projects under the 14th FC and SFC at the district level. Regular audit of accounts by the Local Fund Audit Department (LFAD) and social audit facilitation by the State Government should be done. There is also a need for creation of an independent organisation for conducting social audits at the GP level. CSOs also require regular support to build their capacities on local level planning, budgeting and monitoring in order to engage with the State, district and local governments for transparency and accountability.

- **Need to revisit some of the Recommendations by the 15th FC**

The 15th FC should give more budgetary priority to local bodies including PRIs given the low level of fund devolution. Since the responsibility of development activities lie with the PRIs, the 15th FC should enhance the grants for local bodies. Water and sanitation services at the local level social sector institutions such AWCs, schools and health centres should be strengthened. There should be a specific component for water facilities in these institutions along with a separate budget allocation in JJM and the 15th FC. Hence, it is recommended that the guidelines of JJM and 15th FC should be revised to take into account the WASH requirements of the social

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