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Panchayati Raj and Local Government Finance

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India’s federal system does not stop at the State. It reaches down to the village and the town. The 73rd and 74th Amendments gave local bodies constitutional status in 1992. This lesson explains how villages and towns govern themselves. It also asks the harder question: where does their money come from, and do they have real power?

> **73rd** Villages. In force 24 April 1993.
> **74th** Towns. In force 1 June 1993.
> **29 / 18** Subjects in the 11th / 12th Schedule.
> **1/3** Seats reserved for women.

Gram Sabha: Every adult voter in the village.

SFC: State Finance Commission, Article 243I.

PESA: Panchayats (Extension to Scheduled Areas) Act, 1996.

Social audit: The village checks how scheme money was spent.

1 Chapter 1: The Two Big Amendments of 1992

Must Know

73rd for villages, 74th for towns

- Parliament passed both amendments in 1992 under Prime Minister P.V. Narasimha Rao.

- The 73rd gave constitutional status to rural Panchayati Raj Institutions. It came into force on 24 April 1993.
- The 74th did the same for urban local bodies. It came into force on 1 June 1993.
- The 73rd added the 11th Schedule, with 29 subjects for Panchayats.
- The 74th added the 12th Schedule, with 18 subjects for municipalities.
- Read more: Panchayati Raj Institutions in India and Article 243 of the Constitution.

Why 1992 mattered

- Before 1992, local bodies existed only where a State law created them.
- States could dissolve them at will.
- Elections were often delayed for years.
- The amendments made local government a constitutional entitlement.

Elected, and reserved

- Every Panchayat and municipality must be elected every five years.
- An independent State Election Commission runs the polls under Article 243K.
- Seats and chairperson posts are reserved for women, Scheduled Castes and Scheduled Tribes.
- Reservation for SCs and STs is in proportion to their local population.
- At least one-third of all seats go to women.

Roots and exceptions

- Panchayati Raj began in 1959.

- The Ashok Mehta Committee of 1977–78 proposed reviving it as a two-tier system.
- Meghalaya, Nagaland and Mizoram are exempt. They rely on their own tribal councils.

Remember: 73rd = Panchayats = 11th Schedule. 74th = municipalities = 12th Schedule.

> **Quick check 1.** The 74th Amendment gave constitutional status to Panchayats. *(True or False?)* See answer ↓

2 Chapter 2: Urban Local Bodies and the Schedules

Must Know

Three types of urban bodies

- **Municipal Corporation:** the largest type, for big cities. It has the widest powers.
- **Municipal Council:** for smaller towns, too small for a Corporation.
- **Nagar Panchayat:** for areas moving from village to town. Many fast-growing places pass through this stage.
- The split follows population and how developed the area already is.

Lists of possibilities

- The 11th Schedule lists 29 subjects, from agriculture and land improvement to sanitation and rural housing.
- The 12th Schedule lists 18 subjects, including urban planning, public health and slum improvement.
- Both only list what a State may hand over.

- No State is forced to transfer every subject.

> **Quick check 2.** The 11th Schedule has 29 subjects and the 12th has 18. *(True or False?)* See answer ↓

3 Chapter 3: Where Local Bodies Get Their Money

Good to Know

Three sources together

- **Own revenue:** property tax, local cess, user fees and licence charges.
- **State transfers:** through the State Finance Commission.
- **Central schemes:** funds tied to national programmes. They must usually be spent on that scheme’s purpose.

- Exams ask you to name all three.

The State Finance Commission

- Article 243I requires every State to set up a State Finance Commission every five years.
- It is a State-level mirror of the Union Finance Commission, but for Panchayats and municipalities.
- It recommends how the State's own tax revenue is shared between the State and its local bodies.
- This includes the proceeds of specific State taxes.
- Its advice is not binding.
- The State reads it and decides how much to act on.
- It is the money pipeline that decides whether local government is financially real or only constitutionally real.

Remember: Own taxes + State Finance Commission + central scheme funds = three sources.

> **Quick check 3.** A State Finance Commission's recommendations bind the State government. *(True or False?)* See answer ↓

4 Chapter 4: Gram Sabha and Social Audit

Good to Know

The Gram Sabha

- The Gram Sabha is not an elected body.
- It is every adult registered voter in the village, meeting as a general assembly.

- Article 243A asks States to give it real functions.
- It often approves development plans and beneficiary lists before the Panchayat acts.

Social audit

- In a social audit the village assembly reviews how scheme money was spent.
- It checks government records against what people actually saw.
- This is an extra check on top of the government's own audit.
- It brings accountability from the people the scheme serves.
- Read more: Social Audits: Concept, Legal Basis and Practice.

Capacity decides the result

- An audit works only if the Gram Sabha can read financial records and compare them with what was built.
- Without information, training or outside help, it cannot audit complex spending.
- Legal standing on paper does not guarantee an effective audit.
- Article 40 is the Directive Principle behind village self-government. Read: Article 40 of the Constitution.

> **Quick check 4.** The Gram Sabha is a body of elected village representatives. *(True or False?)* See answer ↓

> **Think it through: Think it through: why audit with villagers?**
>
> Officials can check papers. Only villagers can say whether the road, well or school was really built. A social audit puts those two checks side by side.

5 Chapter 5: Formal Power versus Real Power

Great to Know

The gap

- Passing the amendments was easy.
- Handing over real tax power has been hard.
- Devolving tax power means a State giving up control of money it collects and spends itself.
- Many States have gone no further than the constitutional minimum.
- So how much independence a Panchayat or municipality has depends on its own State, not on the Constitution alone.
- The same 1992 amendments produced very different outcomes across States.

Democratic decentralisation

- The idea is to push real decision-making power down to elected local bodies.
- They are not meant to be only agents carrying out tasks for the Centre or State.
- This extended democracy down to the village itself.
- Reservations were meant to make it inclusive from the start.

> **Quick check 5.** The amendments give local bodies constitutional status, but not guaranteed tax power. *(True or False?)* See answer ↓

6 Chapter 6: PESA, the Law for Tribal Areas

Great to Know

Why a separate law

- The Panchayats (Extension to Scheduled Areas) Act, 1996 is called PESA.
- It extends the Panchayati Raj system to the Fifth Schedule's tribal areas.
- The 73rd Amendment had originally left these areas out.
- Fifth Schedule areas, spread across ten States, have their own customary systems of self-governance.
- PESA fits the Panchayat structure around those institutions. It does not override them.
- Read more: The Fifth Schedule of the Indian Constitution.

What it gives the Gram Sabha

- Control over minor forest produce.
- A say before land is acquired or transferred.
- A role in preventing moneylending that traps tribal households in debt.
- So PESA shows how the general framework had to be adapted, not simply extended.

> **Quick check 6.** PESA extends Panchayati Raj to the Fifth Schedule areas. *(True or False?)* See answer ↓

7 Chapter 7: National Panchayati Raj Day, 2026

Great to Know

24 April 2026

- The Ministry of Panchayati Raj held National Panchayati Raj Day at Vigyan Bhawan, New Delhi.
- It marked 33 years since the 73rd Amendment came into force in 1993.
- The Ministry released the Panchayat Advancement Index (PAI) 2.0 report.
- It also released three books on rural heritage, in a “Meri Panchayat Meri Dharohar” series.
- Elected Panchayat representatives from across the country took part.
- The date is an exam fact. 24 April marks when the amendment came into force, not when it was passed.
- Source: PIB.

8 Previous Year Questions

Exam angle: real questions on this topic.

Asked before

PYQ 1 · UPSC CDS (I) 2020, Q107

The 11th Schedule of the Constitution of India distributes powers between

(a) the Union and the State Legislatures
(b) the State Legislatures and the Panchayat
(c) the Municipal Corporation and the Panchayat
(d) the Gram Sabha and the Panchayat

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Quick Q&A

- **73rd in force?** 24 April 1993.
- **74th in force?** 1 June 1993.
- **Subjects in 11th Schedule?** 29.
- **SFC under?** Article 243I.
- **PESA year?** 1996.

Practice MCQs

1. What did the 73rd and 74th Amendments (1992) do?

A. Gave constitutional status to rural Panchayati Raj Institutions and urban local bodies respectively

B. Abolished all local government bodies in India

C. Gave constitutional status only to state governments

D. Removed the Finance Commission's role entirely

See answer ↓

2. What does each state's State Finance Commission recommend?

A. Which language should be taught in local schools

B. How resources should be shared between the state and its local bodies

C. How the Governor of the state should be appointed

D. How many Lok Sabha seats each state receives

See answer ↓

3. What does a social audit let a local community do?

A. Elect the state's Chief Minister directly

B. Directly control the state's entire annual budget

C. Overrule decisions made by the national Parliament

D. Directly review how public funds were spent on schemes in their own area

See answer ↓

4. What does the gap between PRIs' constitutional status and their real financial power illustrate?

A. Constitutional amendments automatically guarantee full financial power

B. PRIs have complete financial independence in every Indian state equally

C. There is no gap at all between formal authority and real financial power

D. Granting formal authority is legally straightforward, but genuinely devolving revenue-raising power is politically harder

See answer ↓

5. What does social audits working well depend heavily on, beyond formal legal standing?

A. Nothing beyond the existence of a written law authorizing the audit

B. The size of the state's total annual budget

C. Genuine local capacity, since a Gram Sabha lacking basic information cannot meaningfully audit complex spending

D. Approval from the national government before every single audit

See answer ↓

6. Local self-government can be best explained as an exercise in

A. Federalism

B. Democratic decentralisation

C. Administrative delegation

D. Direct democracy

See answer ↓

Answer Key

1. **A.** The 73rd Amendment gave constitutional status to rural Panchayati Raj Institutions. This happened in 1992. The 74th Amendment did the same for urban local bodies. ↑ Q1
2. **B.** Each state constitutes its own State Finance Commission. This Commission recommends how resources should be shared. This sharing happens between the state and its local bodies. ↑ Q2
3. **D.** A social audit lets a local community directly review spending. This spending covers public funds spent on schemes. The review happens in the community's own area, adding accountability beyond formal auditing. ↑ Q3
4. **D.** The gap between PRIs' constitutional status and real financial power illustrates a common pattern. Granting formal authority is legally straightforward. But devolving revenue-raising power is politically harder, since it means state governments giving up control. ↑ Q4
5. **C.** Social audits work best when paired with genuine local capacity. A Gram Sabha that lacks basic information or organizational support cannot meaningfully audit complex scheme spending. This holds true no matter how strong its formal legal standing is. ↑ Q5
6. **B.** The correct answer is **(b) Democratic decentralisation**. Local self-government pushes real decision-making power down to elected local bodies through Panchayati Raj — that's democratic decentralisation, not simply administrative delegation of tasks or federalism between Union and States. Read more. ↑ Q6

Quick-check answers

1. **False.** ↑ 1
2. **True.** ↑ 2
3. **False.** ↑ 3
4. **False.** ↑ 4
5. **True.** ↑ 5
6. **True.** ↑ 6

Previous year answers

1. **(b) the State Legislatures and the Panchayat** The 11th Schedule lists 29 subjects state legislatures may hand over to Panchayats.

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