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**Empowerment of Local Governments,
Stakeholders and Citizens**

A Discussion Paper

for

The Consultation Workshop

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Empowerment of Local Governments, Stakeholders and Citizens

A. Empowerment of Local Governments

The 73rd and 74th amendments of the Constitution were enacted in 1993 with great hope and anticipation. However, while panchayats, nagarapalikas and municipalities have come into existence and elections are being held, this has not translated into effective decentralization of power. The Constitution left the issue of degree of empowerment and devolution to the state legislature. In most states, local governments continue to be weak.

Given this backdrop, we need to examine the possibilities of Union intervention – through constitutional, fiscal and procedural steps – to empower local governments. This issue needs to be linked to the need for improvement of service delivery. The poor and disadvantaged sections of society must have real opportunities for vertical mobility through local empowerment. Such empowerment must conform to four critical principles.

- Principle of subsidiarity: Functions shall be carried out closest to citizens at the smallest unit of governance possible, delegated upwards only when the local unit cannot perform the task. The citizen delegates those functions she cannot perform to the community, functions that the community cannot discharge are passed on to the local governments in the smallest tiers, and so on, from smaller tiers to larger tiers, from local government to the State governments, and from the States to the Union. In this scheme, the citizen and the community are the center of governance. In place of traditional hierarchies, we will have ever-enlarging concentric circles of government, and delegation is outward depending on necessity.
- Greater linkage between citizen's vote and public good
- Effective tracking of resource deployment and of their utilization with productive outcomes
- Fusion of authority with accountability

Apart from possibilities of action at the Union level, we need to identify specific and practical steps required at the state level for effective empowerment and accountability of local governments.

The following are some of the measures listed for discussion in the consultation workshop. A final view will be taken by the NAC on the basis of the feedback and inputs received, and a synthesis of various points of view.

1. Revisiting the Basic Constitutional Scheme

The 73rd and 74th Amendments aim at a fundamental shift in the nature of governance. However, the past experience of over a decade shows that creating structures of elected local governments and ensuring regular elections does not guarantee effective local empowerment. In modern India, the first elected units of self-governance were the municipalities which came into existence in 1890s, and then District Boards, which were created in 1930s. The elected provincial governments came into being in 1937 under the Government of India Act, 1935. Local governments enjoyed considerable power and prestige for five decades before Independence and became cradles of democracy and leadership development. It is a paradox that municipalities under colonial government nurtured the finest leadership, and were far more powerful and effective than those in Independent India.

The tradition of autonomous local governments of course predates colonial rule. From the village republics of the pre-Mauryan era to the breath-taking Uttiramerur inscription of the Chola era, there is substantial and incontrovertible evidence of strong, autonomous, empowered, participative, effective local governments all over India. However, not all of it conforms to modern notions of liberal democracy. Vote was restricted to males and largely upper castes. Often the panchayats were institutional mechanisms to perpetuate caste rigidities and protect the 'purity' of the caste system. But this must be judged against the fact that in the US, despite the adoption of the noble, democratic, republican Constitution in 1789, slavery was legally permissible until the 1863 Emancipation Proclamation of President Lincoln gave concrete shape to the inalienable rights of man. In most modern democracies, women won the right to franchise only in 1920s and later. Therefore, the traditional local governments must be judged by contemporary standards. Modern constitutional values, independent

institutions of state which protect equality and liberty, democratic evolution mandated by universal adult franchise, restructuring of village panchayats forcing realignment of political forces breaking caste orthodoxy, and better models of representation enhancing the legitimacy of the democratic process are some of the means by which the traditional inequities should be confronted, and democracy and self-governance made real and meaningful. Centralization, as the past 58 years amply demonstrate, is not a guarantor of citizens' 'liberty or good governance', it in fact delegitimizes democracy, alienates the citizen, perpetuates hierarchies, and breeds corruption and inefficiency.

A large-sized district in India is larger than about 80 nation-states in the world in terms of population. Most of our larger states would be among the large nations of the world. Uttar Pradesh, Maharashtra, West Bengal and Bihar – each would be the largest nation in Europe. Even a truncated Uttar Pradesh would be the world's sixth largest nation. Centralization in the face of such vast numbers, not to speak of the enormous diversity, has led to poor functioning of public services and marginalization of citizens.

In this backdrop, the 73rd and 74th amendments were intended to be a breath of fresh air, empowering the citizens through local governments, redefining the state, invigorating our democracy, and injecting efficiency and accountability in our public services. But the past 12 years have seen erratic and ineffective empowerment of local governments. Democratic institutions need patience, nurturing and long evolution, and cannot be expected to yield instant results. However, for democracy to work, there should be consistency, predictability, and effective empowerment of institutions combined with accountability. Our experience shows the following:

- Despite the mandatory constitutional injunctions, it took years, and in some cases a decade, to even constitute local governments and hold elections.
- Even when local governments are constituted and elections are held, the states often postponed the subsequent elections on some pretext or other. Each time it is an uphill battle to ensure compliance with the mandatory provisions of the Constitution.
- There has been no linear development or evolution in respect of democratic decentralization. Often, it is one step forward, and two steps backward.
- State governments, legislators and civil servants are in general extremely inimical to effective empowerment of local governments. Only the bare minimum

required to implement the strict letter of the Constitution is allowed in many states. What is implied by the spirit of the Constitution and principles of democracy is often ignored.

- Even the mandatory provisions like constitution of District Planning Boards have been ignored in many states.
- Where the panchayats have been constituted and elections held regularly, they are still left to the mercy of state legislatures. Although local governments have a long tradition of autonomy, the fact that Union and State governments have an established tradition for nearly four decades, means that strong vested interests have developed over time disallowing devolution of power.
- Power in states has been largely reduced to a patronage system mediated through legislators acting as disguised executives. Transfers and postings, contracts and tenders, crime investigation and prosecution – all are often at the mercy of the local legislator. Given the compulsions of survival, the government which depends on the goodwill and support of legislators, is powerless to defy their will except where the Constitution specifically and unambiguously directs it.

The 73rd and 74th Amendments created over-structured and underpowered local governments. The provisions relating to local governments in German Basic Law run to fewer than 50 words, and yet effectively empowered local governments have been mandated. In its original form the US constitution was 4427 words long, and 215 years later, with all amendments, it has 7554 words. In contrast, the 73rd and 74th Amendments have about 7700 words. Excessively rigid structures have been prescribed, and powers and functions under Articles 243-G and 243-W are vague and at the mercy of state legislatures. There is a strong case to revise the constitutional provisions on the following lines.

- Tighten the provisions relating to empowerment of local governments, and make local control of subjects listed in XI and XII Schedules mandatory, giving them the same status as VII Schedule defining the Union-State division of powers.
- Leave the structure of panchayats and municipalities, and the method of composition and election to state legislatures, subject to the over-riding provisions constituting democratic governance. For instance:

– State legislatures could decide the tiers of local governments – two or three.

- The method of election of each tier could be left to States, subject to two provisions, viz: either the council of the head in each tier should be directly elected by the people, and there shall be mandatory reservation for women, scheduled castes and scheduled tribes, and where the legislature desires, for OBCs.

2. Legislative Councils as Councils of Local Governments

Article 171 of the Constitution provides for the formation of Legislative Councils in the states. Such a Council has one-third members elected by local governments, one-third by Legislative Assembly, one-twelfth by graduates, and one-twelfth by teachers and the rest are nominated by the Governor. This was clearly a transitional and anachronistic provision, in keeping with the tradition of constituting quasi-democratic legislatures in colonial era.

With the emergence of local governments as the constitutionally mandated third tier of governance, we need to emulate Rajya Sabha in the composition of Legislative Councils. Just as Rajya Sabha is the Council of States, it is appropriate that Legislative Council becomes Council of Local Governments. The Council can be given veto powers in matters pertaining to rights of local governments. Happily, the composition of the Legislative Council can be changed by a mere law of Parliament, as Art 171 (2) of the Constitution states: “Until Parliament by law or otherwise provides, the composition of the Legislative Council of a State shall be as provided in clause(3).” Clearly, the Constitution-makers envisaged the Council composition being made more democratic in a free India. A provision can be made for any citizen above 30 years of age to be elected to the Council, by the elected members of local governments.

Changing the composition of the Legislative Council, and making it the Council of Local governments on par with the Council of States at the Union level is a simple, politically feasible innovation. The Constitution makers deliberately gave that power to Parliament, and a simple law under Article 171(2) would be sufficient. Now that local governments are constitutionally mandated third tiers of government, the change proposed is both logical and proper. Once such a Council is elected by local government representatives, it will forever protect the interests of local governments, and will keep up the struggle to

expand their powers and functions. As a second chamber, it will have leverage on a continuing basis. Such a reform of the Legislative Council is eminently feasible and long overdue.

Proposal

Article 171 (3) may be amended by a simple law [as provided in Article 171(2)] as follows:

Article 171 (3) reads as:

Article 171. Composition of the Legislative Councils

(3) Of the total number of members of the Legislative Council of a State -

- (a) as nearly as may be, one-third shall be elected by electorates consisting of members of municipalities, district boards and such other local authorities in the State as Parliament may by law specify;
- (b) as nearly as may be, one-twelfth shall be elected by electorates consisting of persons residing in the State who have been for at least three years graduates of any university in the territory of India or have been for at least three years in possession of qualifications prescribed by or under any law made by Parliament as equivalent to that of a graduate of any such university;
- (c) as nearly as may be, one-twelfth shall be elected by electorates consisting of persons who have been for at least three years engaged in teaching in such educational institutions within the State, not lower in standard than that of a secondary school, as may be prescribed by or under any law made by Parliament;
- (d) as nearly as may be, one-third shall be elected by the members of the Legislative Assembly of the State from amongst persons who are not members of the Assembly;
- (e) the remainder shall be nominated by the Governor in accordance with the provisions of clause (5).

Article 171 (3) may be amended as

Article 171. Composition of the Legislative Councils

“(3) Of the total number of members of the Legislative Council of a State –

- a) **As nearly as may be five-sixths shall be elected by electorates consisting of elected members of panchayats and municipalities**
- b) **The remainder shall be nominated by the Governor in accordance with provisions of clause (5)”**

Article 171(4) may be amended as follows:

Article 171 (4) reads as:

Article 171. Composition of the Legislative Councils.-

(4) The members to be elected under sub-clauses (a), (b) and (c) of clause (3) shall be chosen in such territorial constituencies as may be prescribed by or under any law made by Parliament, and the elections under the said sub-clauses and under sub-clause (d) of the said clause shall be held in accordance with the system of proportional representation by means of the single transferable vote.

Article 171 (4) may be amended as

“(4) The members to be elected under clause (a) of clause (3) shall be chosen in such territorial constituencies as may be prescribed by or under any law made by Parliament; and the elections shall be held in accordance with the system of proportional representation by means of the single transferable vote.”

3. District Government

Partly owing to our colonial legacy, there continues to be an artificial divide between urban and rural local governments. As a result, there is no single, undivided government representing all sections at the district level. The people continue to view Zilla Parishad and Municipality as just another body and treat the District Collector as the real symbol of government in the district. The current structure of District Planning Committees is too weak, and in any case they are non-starters in many States. Therefore, there is a need to amend Art 243-C to provide for a single elected district council that will function as a true government for the entire district. Once this is implemented, the District Planning Committee becomes redundant.

If such a constitutional provision comes into effect, there will be one District Council, which represents all people in the district – rural or urban. As people perceive an elected government representing all, the idea of the third tier of the government will become real and meaningful. There will also be much better urban-rural coordination. This however will not affect the village panchayats and intermediate panchayats, or the municipalities. Only the character of the federating body at the district level becomes universal, representing all areas and people in the district.

Proposal

Definition under Article 243 (d) will be amended as:

Article 243(d) reads as:

Article 243. Definitions.- In this Part, unless the context otherwise requires,-
(d) "Panchayat" means an institution (by whatever name called) of self-government constituted under article 243B, for the rural areas;

Definition under Article 243 (d) will be amended as:

(d) **'Panchayat' means an institution (by whatever name called) of self-government constituted under Article 243-B.**

Article 243 – ZD relating to committee for district planning will be repealed.

4. Union Finance Commission and State Finance Commission – Impediments in the Constitutional Amendments

Article 280, which relates to the Union Finance Commission, states: “The President shall, within two years from the commencement of this Constitution, and thereafter at the expiration of every fifth year, or at such earlier time as the President considers necessary, by order, constitute a Finance Commission.” Article 243 - I states: “The Governor of the State, shall, as soon as, may be within one year from the commencement of the Constitution (Seventy-third Amendment) Act, 1992, and thereafter at the expiration of every fifth year, constitute a Finance Commission of panchayats and to make recommendations to the Governor....”

The above article requires the Governors of States to appoint a State Finance Commission within one year from 1993, and thereafter “at the expiry of every fifth year”. This commencement date and the stipulation regarding the period has resulted in the State Finance Commission reports not being relevant to the periods covered by the Union Finance Commission. When a similar situation has arisen with regard to the Five Year Plan periods and the periods covered by the Union Finance Commissions, a synchronization was brought by Union Finance Commission being appointed earlier than five years. This was possible because of the words “or at such earlier time as the President considers necessary” in Article 280. This phrase is missing in Article 243-I. As a result, the Union Finance Commission is not in a position to draw upon the observations, suggestions and the data provided by the State Finance Commissions in devolving funds to local governments in various States. Therefore, it is necessary to amend Article 243-I to introduce the words “or at such earlier times as the Governor considers necessary.”

Proposal

Article 243 (I) may be amended as follows:

“ or at such earlier times as the Governor considers necessary,” will be inserted after “at the expiration of every fifth year.”

5. Ensuring Regular Elections by Removing Causes of Delay at State Government Level

While the Constitution, under Article 243 K, created an independent State Election Commission (SEC), many state governments retained the powers of delimitation of constituencies in local governments, and reservation of constituencies as provided under the Constitution and States Laws. Often, this power is used to effectively postpone elections by the simple expedient of ordering delimitation after elections are due, or not reserving constituencies in time. The SEC is helpless, and is forced to either repeatedly remind the state government to complete these tasks to facilitate elections, or resort to prolonged litigation before courts to force the government to go in for elections. In either case, the state government would have achieved its objective of delaying elections.

These delays in holding elections, and constituting elected local governments can be prevented by amending Article 243 K by inserting a provision as follows:

- The powers of delimitation of constituencies, and reservation of offices as per the provisions of the Constitution or State Law, shall rest in the State Election Commission, and these powers shall be exercised in consultation with the State Government.

6. Removal of Anomalies in Voter Registration

A citizen over the age of 18 years is eligible to be a voter in elections for Lok Sabha, State Legislative Assembly, and local governments. The qualifications and disqualifications for exercising voting rights are identical. However, there is an anomaly in the Constitution, by which the State Election Commission is separately entrusted the task of preparing electoral rolls for local government elections. This practice is anomalous for the following reasons.

- In all democratic nations, elections to local, provincial and federal governments are seen as a continuum, and in general the same rules and electoral rolls apply for elections at all levels.
- There is a single, common electoral roll for Lok Sabha and State Assembly. In fact, the Lok Sabha constituency is always a combination of contiguous State Assembly constituencies. Therefore, to have separate electoral rolls for local governments defies logic.
- Two different electoral rolls lead to confusion, more errors, and make the process less transparent and difficult to involve citizens to improve voter registration.

Therefore, Article 243 K of the Constitution needs to be amended to provide for common electoral rolls. However, keeping in view the requirements of local government constituency boundaries, the power of reorganization of the Assembly electoral rolls to suit local government requirements should be vested in the State Election Commission. But revision of electoral rolls, and addition and deletion of names and other corrections shall be only at the level of State Legislative Assembly. In other words, the voter needs to be registered in an electoral roll only once, to be eligible to vote in all elections – local, state, and national.

7. Making Financial Devolution to Local Governments Mandatory

The Union Finance Commission recommendations are not mandatory. And yet, the governments of Independent India established a healthy and far-sighted tradition of honouring the devolution packages as proposed by the successive Finance Commissions without any deviation. In effect, the Finance Commission recommendations, in so far as sharing of Union Revenues with states is concerned, are now deemed as mandatory. There is no single instance of deviating from this tradition.

However, the states have not established such a tradition, despite the fact that the provisions of Article 243-I relating to State Finance Commission are identical to those in Article 280 relating to Union Finance Commission. For a variety of reasons discussed earlier, it is unlikely that states will follow the healthy tradition established by Union without a constitutional directive. Such a constitutional directive is particularly necessary because the Union has now included the devolution of resources to local governments

from Union Revenues as an integral part of the Finance Commission recommendations, effective from the Eleventh Finance Commission.

Therefore, Article 243-I should be suitably amended to make the implementation of the recommendations of the State Finance Commission in respect of devolution of resources to local governments and sharing of state revenues with them mandatory. This will ensure effective and progressive devolution to, and empowerment of local governments.

8. Effective and Larger Devolution from Union to Local Governments

In keeping with the spirit of the Constitution after the enactment of 73rd and 74th Amendments, the Union Finance Commission's terms of reference now include the devolution package to local governments. Accordingly, the Eleventh (EFC) and Twelfth Finance Commission (TFC) have recommended devolution of a share of funds to States specifically earmarked for local governments. EFC had recommended Rs 10,000 crores devolution from Union to local governments in this manner over five years, and TFC has recently recommended Rs 25,000 crores over five years. The Union has given effect to these recommendations in keeping with the healthy tradition of accepting Finance Commission recommendations, and in keeping with the spirit of the Constitution (73rd and 74th Amendments).

In effect, given the reluctance of most states to devolve resources, the Union's devolution is the only sure source of funds to local governments. Therefore progressive expansion of devolution from Union to local governments needs to be explored. However, such devolution is possible only in respect of additional resources devolved on States, without affecting the States' finances. This is necessary keeping in mind the fiscal problems most states are facing.

Twelfth Finance Commission recommendations have just been made, and they provide a priceless opportunity to expand and accelerate devolution to local governments, without affecting the finances of States. TFC has recommended an additional package of about Rs 26,000 crores to states per year in the following manner:

- enhanced share of Union taxes and duties, up from 29.5 percent to 30.5 percent – Rs 4000 crore
- consolidation of Union loans to States, and rescheduling – Rs 7000 crore including interest saving and debt write off
- additional grants-in-aid to States – Rs 15,000 crores

It would be appropriate if a precedent is established and these additional allocations to States are devolved on local governments. Thus, with each Finance Commission, there will be progressive and additional devolution to local governments. The States will then be encouraged to transfer personnel and functions to a commensurate extent to local governments, so that funds and functions go together.

The following principles should guide such Union devolution to local governments:

- All additional allocations to states should devolve on local governments.
- The Union will specify broad sectoral allocations in line with the subjects lists in XI and XII Schedules, and the national priorities like education, health care, poverty alleviation, infrastructure, fulfillment of minimum needs and civic amenities.
- Special relief packages like debt relief, interest rate reduction etc will be taken as devolution of finances to States, and additional resources in the same measure should devolve on local governments from States. In other words, such relief shall be conditional, promoting local devolution. Alternatively, the amounts due to the Union should be collected from the States, and then devolved to the local governments in the same measure.
- Measures of local accountability should be insisted upon, in order to ensure proper utilization of resources so devolved. Also State governments shall have all reasonable powers of supervision to ensure effective utilization.
- There should be proper social auditing, and performance monitoring by the Union by way of sample surveys and other measures to measure specific outcomes in each sector.

9. Ward Committees in Urban Areas

The 74th amendment provides an institutional framework to enhance popular participation in urban local governments through the formation of wards committees:

Article 243-S of the Constitution states:

1. There shall be constituted wards committee, constituting of one or more wards, within the territorial area of a municipality, having a population of three lakhs or more.
2. The legislature of a State, may, by law, make provision with respect to:
 - a. The composition and the territorial area of a wards committee
 - b. The manner in which a wards committee shall be filled.
3. A member of the municipality representing a ward, within the territorial area of the wards committee, shall be a member of that committee.
4. Where a wards committee consists of:
 - a. One ward, the member representing that ward in the municipality; or
 - b. Two or more wards, one of the members representing such wards in the municipality elected by the members of the wards committee, shall be the Chairperson of that committee.
5. Nothing in this article shall be deemed to prevent the legislature of the State from making any provision for the constitution of committee, in addition to the wards committee.

The constitution and experience of wards committees varies widely from State to State, as can be seen from the tables below. The constitution envisaged the formation of wards committees, comprising of one or more wards in all municipalities, with population of 3 lakhs or more. As can be seen from the table below, in a majority of the States, 'wards committees' instead of 'ward committees' have been formed, which doesn't facilitate easy interaction of the local citizens with their elected representatives.

Table: Wards Committees (WC) In Municipal Corporations

State	Municipal Corp.	No. of Wards	No. Of WC	No. of Wards Per WC	Composition
Andhra Pradesh	Hyderabad	100	10	Not less than 10 wards	Elected Corporators from the wards and nominated officers with no voting right
Gujarat	Ahmedabad	43	Rules not yet framed	One or more wards	All elected councillors and not more than 5 persons having interest in civic administration nominated by State government
Haryana	Faridabad	25	Rules not yet framed	One or more wards	All elected councillors
Karnataka	Bangalore	100	28	For one or more wards	All elected councillors and not more than 5 experts and 2 from NGOs working within that territorial area nominated by the State government
Kerala	Tiruvananthapuram	81	81	For each ward	Not more than 50 within the territorial area and 3 prominent citizens nominated by the Chairperson
Madhya Pradesh	Bhopal	66	11	One or more wards	Every elected councillor within the territorial area and 2 persons residing in that area nominated by Mayor without voting rights
Maharashtra	Greater Mumbai	221	16	One or more wards	All elected councillors and three nominated members from the NGOs nominated by the State government.
Punjab	Ludhiana	70	Not constituted	Not less than 5 wards	All elected councillors within the territorial area, Municipal Commissioner, and other officers nominated by the Commissioner. No. of nominated members not exceeding half the elected members

State	Municipal Corp.	No. of Wards	No. Of WC	No. of Wards Per WC	Composition
Rajasthan	Jaipur	70	Rules not yet framed	One or more wards	Not specified
Tamil Nadu	Chennai	155	10	One or more wards	All councillors elected within the territorial area, nominated not more than 10 persons without voting rights
Uttar Pradesh	Lucknow	110	11	One or more wards	All sabhasads representing the wards
West Bengal	Kolkata	141	14	For each ward and in addition 14 Borough committees for groups of wards	4 to 14 members elected councillor and such other members nominated by the councillor

Source: DataBase on Municipal Governance in Some Major States, Nagarpalika Network, All India Institute of Local Self-Government, New Delhi, October 2002, pp 83-86

Table-2: Number of Wards Committees and Population in some Municipal Corporations

Municipal Corporation	No. of Wards	No. of Wards Committees	Population* per WC
Greater Mumbai	221	16 Wards Committees	3,97,000
Kolkata	141	01 Wards Committee for each ward	31,000
Delhi	134	12 Wards Committees	6,01,000
Chennai	155	10 Wards Committees	3,84,000
Pune	111	13 Wards Committees	1,21,000
Kanpur	110	11 Wards Committees	1,71,000
Lucknow	110	11 Wards Committees	1,47,000
Varanasi	80	08 Wards Committees	1,16,000

*Based on 1991 Census figures for Municipal Corporation

Kerala has provided by far the most broad-based participatory arrangements. Each ward committee has an elected Councilor as its Chairperson, and not more than 50 persons are to be nominated by the Municipal Chairperson, in consultation with the Councilor. Formal recognition has been given to Neighborhood Groups (NHGs) at the local level. In West Bengal, there is a clear 3-tier structure of local administration. There is a ward

committee at the lowest level and Borough Committee (consisting of minimum 6 wards) at the intermediate level, both linked with the corporation. There are separate rules describing powers and functions of each type of committee and their relationship with municipal administration. A common feature in all the States is that members of the ward committees are not elected. The nominating authorities also vary in different States. In West Bengal, the nominating authorities are the ward Councillor and the Chairperson of the municipality, whereas, in Andhra Pradesh, the Municipal Commissioner nominates the Municipal Officers in such committees. In Delhi, wards committees comprise, exclusively, of councillors of the wards. In Karnataka, members of the committees are to be nominated by the State government. These committees are to consist of the elected Councillors, five expert members, and two from NGOs, nominated by the State government. Maharashtra, Karnataka, Kerala and West Bengal have provided for induction of NGOs, social workers, and gender groups in the wards committees.

Constitution may be amended (Article 243 S) to facilitate Ward Committees for each Municipal Councillor's division, guarantee effective citizen participation and local management and control of civic amenities, and encourage local resource mobilization by linking taxes with local services. The broad principles of such devolution should be as follows.

1. Every ward shall have a ward committee, as opposed to a committee for multiple wards. The committee shall be chaired by the elected Councillor from that ward. The committee shall consist of representatives from the citizens of the ward, and a transparent and equitable mechanism should be adopted to ensure fair representation of women, weaker sections and civil society in these committees.
2. The ward committee shall be empowered to control all such issues, which could be handled at the ward level such as street lighting, sanitation, water supply, drainage, road maintenance, maintenance of school buildings, maintenance of local hospitals/dispensaries, local markets, parks, playgrounds, etc.
3. The employees, in respect of all functions entrusted to the ward committee, shall function under the committee and shall be held accountable by the committee. The salaries to all such employees shall be paid by the committee only after satisfactory performance.
4. The funds allocated to those functions entrusted to the ward committee shall be transferred en-bloc to the ward committee.

5. The budget adopted by the ward committee in respect to the functions allotted to it shall be taken into account in formulating the overall municipal budget. The meetings of the ward committee shall be widely publicized to ensure maximum citizen participation.
6. Ward committee will be given a share of the property taxes collected from the ward, depending on the locality. eg: Poor areas will retain 100% taxes. Middle-income areas will get 2/3rd of all residential property taxes (non-commercial). Affluent areas will get 1/3rd of all residential property taxes (non-commercial).
7. The balance tax amount will go to the central pool for the municipal budget.
8. The ward committee shall also have the power to levy local taxes, but subject to the guidelines set by the municipality. In effect, the ward committee shall function as a de facto Gram Panchayat.
9. The ward committee may raise other resources through donations and other contributions.

10. District Budgets and Financial Devolution

The efficiency and autonomy of the local governments is contingent on the availability of adequate financial resources at their disposal. Article 243 H of the Constitution provides for financial decentralization in the form of tax assignments, revenue sharing, and grants-in-aid. Article 243 H states, the State legislature may, by law:

- Authorize panchayats to levy, collect and appropriate such taxes, duties, tolls and fees in accordance with such procedures and subject to such limits.
- Assign panchayats such taxes, duties, tolls and fees levied and collected by the State government for such purposes and subject to such conditions and limits.
- Provide for making such grants-in-aid to the panchayats from the consolidated fund of the State.
- Provide for constitution of such funds for crediting all money received respectively, by or on behalf of the Panchayats and also withdrawal of such moneys therefrom.

Article 243-I provides for a finance commission at the State level to review the finance of local governments and determine principles that govern the sharing of resources mobilized by the State, between State and panchayats. In spite of the various

constitutional provisions, many State governments continue to neglect the financial requirements of the local governments. The Eleventh Finance Commission, recognizing the growing marginalisation of local governments, suggested that State governments owe greater responsibility to develop local governments, as they are the third tier of the government.

The survey of NIRD in 96 villages, spread over 12 states shows that local governments have significant resource mobilization capability, if adequate powers are given to do so. Paucity of funds that local governments face is a consequence of inadequate devolution, absence of flexibility in managing local finances and schemes, inadequate tax assignments, absence of support staff to collect local taxes, and unviable size of village panchayats.

In order to overcome these impediments, the following measures should be adopted by a Constitutional amendment (Art 243 H).

- The State budget under each head should be divided into:
 - 1) State wide allocation
 - 2) District-wise allocation
 - (i) Here allocations for each district should be shown separately.
 - (ii) By bringing together a district allocations under various heads, a district budget will evolve. This district budget can have amounts under
 - a. control of department at state level, for valid reasons based on established principles
 - b. schemes transferred to Zilla Parishad for execution
 - c. Devolved funds at the disposal of panchayats

In regard to (b), Zilla Parishad will have the powers of the head of the department. The amounts for (c) will be given as lump sum grants-in-aid. Experience in States would show that b+c would be about 40% of total government budget. The State budget shall disclose details of wage and non-wage components in respect of all schemes/items of expenditure included in the State budget under State plan, centrally sponsored schemes and non-plan expenditure

- The State government should release grants-in-aid to the district planning bodies to enable them to utilize the funds even after the close of the financial year. Preparation of link document sector-wise, for each district, in respect of the

schemes transferred to the district planning body, showing the provisions for the year and accounts of the year preceding it, besides scheme-wise budget estimates for State plan, centrally sponsored schemes and non-plan estimates, will help in better utilization of funds. No savings of one district will be diverted to another district.

- All amounts devolved by the State and Union Finance Commission to local governments should be passed on to them subject to only such conditions as the commission may have prescribed.
- The Zilla Parishad should have the powers for re-appropriating amounts from one item to another within the budgetary allocations for the district, subject to the conditions that savings under non-recurring or capital items shall not be diverted by local governments for recurring expenditure
- Savings on recurring expenditure can be diverted to non-recurring expenditure
- Strong auditing norms should be prescribed for all local governments. Local fund audit should be strengthened and the audit function should be independent of the local government.
- Local governments should be given powers to raise loans. Santhanam Committee, in 1963, suggested that PRI's should be given power to borrow or raise loans. The committee suggested that Local Governments Finance Corporation should be established for this purpose. Finance Corporation is usually meant to provide finances for remunerative schemes. In case local government institutions have some projects that are of remunerative nature, it should be possible for them to approach financing agencies directly for funds. In the changed financial scene in the country today, nothing prevents local bodies from going to the market or financing agencies for loans for viable schemes. However, the weaker local governments have to be guaranteed or subsidized by government. The Local Governments Finance Corporation can perform such a function. The Reserve Bank of India (RBI) had suggested a body for borrowing by State governments.
- There is no system of monitoring how much was collected of the taxes in the GP, and whether the complete share of such collections has been given to GP, as for example, entertainment tax. The District Panchayat Officer is expected to monitor the total quantum of collections from GP and to ensure that the total share due is received and is also again duly redistributed to the GP. Similarly, the surcharge on stamp duty and the land revenue cess have to be monitored and distributed similarly. It is, therefore, recommended that there should be monitoring cells,

attached to the DPO and the DDO which will be charged with the responsibility of monitoring and properly distributing the collections to the GP and Intermediate Panchayats and ZPs.

- Proper infrastructure for maintenance of accounts/database at all levels of local governments should be provided. Eleventh Finance Commission made the following observations in this regard:
 1. Articles 243J and 243Z of the Constitution expect the States to make provisions by way of legislation for maintenance of accounts by the panchayats and the municipalities and for the audit of such accounts.
 2. The Comptroller and Auditor General (CAG) should be entrusted with the responsibility of exercising control and supervision over the proper maintenance of accounts and their audit for all the tiers/levels of panchayats and urban local bodies.
 3. The report of the CAG relating to audit of accounts of the panchayats and the municipalities should be placed before a committee of the State Legislature, constituted on the same lines as the Public Accounts Committee.
- Local governments should have discretion to use their general funds

11. Reorganization of Village Panchayats

Unviable size of village panchayats is one of the causes of financial crisis in local governments and poor managerial capacity in providing amenities and services. Kerala state has only 900 village panchayats with an average population about 30,000. In Karnataka and West Bengal also village panchayats have been restructured to ensure a viable size of population. The sizes of village panchayats in some of the major states are as follows.

Sl. No.	State	Rural Population	No. of Gram Panchayats	No. of Villages	Average population of a Gram Panchayat
1.	Rajasthan	43,267,678	9188	41,353	4,709
2.	Bihar	74,199,596	12181	45,113	6,091
3.	Assam	23,248,994	2489	26,247	9,341
4.	West Bengal	57,734,690	3360	40,793	17,183
5.	Orissa	31,210,602	5254	51,349	5,940
6.	Andhra Pradesh	55,223,944	21944	28,123	2,517
7.	Karnataka	38,814,100	5659	29,483	6,859
8.	Kerala	23,571,484	991	1,364	23,786

Small village panchayats increase administrative costs, and make it difficult to find resources to meet the infrastructure and services needs of the community. Therefore, the Union government should provide a special incentive to states to restructure panchayats at village level. A one-time per capita grant of Rs. 50 to 100 could be provided to panchayats conditional upon restructuring of panchayats to ensure an average population of at least 5000 per village panchayats. Scheduled areas may have smaller, but viable, population norms.

Such restructuring and creating unions of small, traditional villages into larger village panchayats serves three other purposes.

- As village units are more equitable in size, it will facilitate better allocation and management of resources.
- Integration of regulatory and other functions with the panchayats will be feasible with adequate staff and managerial capacity which comes with optimal size.
- As the traditional village with its caste hierarchies ceases to be the political unit for representation and local governance, the pace of democratization and modernization will accelerate, giving greater say to the dalits, adivasis, women, and weaker sections of society.

12. Accountability Measures in Local Governments

Democratic theory and Constitutional principles mandate effective empowerment of local governments. While democracy, including local democracy, is by no means a perfect tool to improve governance, the only antidote to imperfections in democracy is more and better democracy. However, the improvement of conditions through local empowerment is necessarily a slow and evolutionary process. The experience over the last decade shows that in many cases local governments are beset by the same evils of corruption, arbitrary exercise of power, and inefficiency which have become the hallmarks of centralized governance.

This local failure is part of a larger process of democratic evolution, and needs to be addressed with patience, perseverance and innovation. In a pervasive culture of corruption which is institutionalized over decades in a centralized democracy, local

governments cannot be islands of probity and competence overnight. The process of power has been distorted, and politics has become a business involving large, unaccounted investments with multiple returns anticipated in a patronage-based, unaccountable, centralized governance structure. Not surprisingly, power at the local level is exercised in a similar manner. The difference is that local corruption and arbitrariness are far more glaring and visible, and touch people's lives more directly as they affect basic amenities and services. In time, as people understand the link between their vote and quality of public goods and services better, things will improve. That is the logic of democracy and universal franchise.

However, all power is prone to corruption and abuse. We need effective instruments of accountability to be able to check abuse of power, and give citizens voice in improving the quality of services.

Therefore a union legislation to enforce accountability in local governments is a desirable initiative. Such a legislation will not be at the cost of state legislation, but will be concurrent, and in addition to it. It will provide a framework of accountability. Such a legislation will also address the legitimate concern of many that decentralization of power should not lead to decentralized corruption. Such a legislation, among other things, could provide for the following mechanisms.

- A district audit unit, as a part of AG's audit under the overall control of CAG.
- Right to information in all local governments.
- Citizens Charters for all basic services at local level, with compensation for every day's delay, and penalties levied on employees responsible for such delays.
- Independent vigilance body reporting to an independent Ombudsman and state legislature.
- An independent Ombudsman for every district, appointed by a collegium comprising of the government, opposition, and judiciary, with the powers and duties of enquiring and taking action against any employee or elected local government. The Ombudsmen's directions must be binding and final, with a provision for appeal to state Ombudsman.
- A district staff committee to address grievances of employees on service matters.

- A staff review commission at the State level to review and determine staffing requirements.
- A mandatory requirement to ensure that no local revenue deficits are permitted, and diversions from capital account to revenue account are prohibited. Any deviations shall be a criminal offence.

13. Empowered Legislative Committees at the State Level to Give Legislators a Meaningful Role

The legislators at the state level often spend enormous sums to get elected. And yet, once elected and a stable government is formed, they have neither any legitimate role in executive functioning, nor any meaningful role in legislation. In a parliamentary executive system as it operates in our country, almost always legislation is fully controlled by the Council of ministers and the civil services. With the anti-defection provisions of the Constitution further tightened, the legislator has no real opportunity to influence the decisions of the Legislature even when there is a legitimate point of view. In other words, a legislator is reduced to a rubber stamp endorsing the government decisions or party directives.

In such a backdrop, the legislator's real power lies only in the nuisance value accompanying the threat of destabilizing the government. In order to appease the legislator, and in the absence of legitimate role in matters of state unless he becomes a minister, the government appeases the elected members of the Assembly by various means. These inducements include discretionary grants at the disposal of the MLA, and connivance in unconstitutional exercise of disguised executive authority in the form of transfers, postings, contracts, tenders, patronage in implementation of various development programmes and schemes, and interference in crime investigation and prosecution. This is the central reason why MLA's are generally opposed to effective devolution of power and resources to local governments, as they fear further marginalization of their own role. Notwithstanding broader political consensus on local government empowerment, these compulsions of real politic preclude the possibility of any serious measures to institutionalize local governments in accordance with the spirit of the constitution.

This fundamental problem needs to be addressed with honesty and sensitivity. Power abhors a vacuum. If positive power is denied to legislators, it will find expression as negative power harming public interest, and undermining local governments and true democracy.

One effective tool to create legitimate role and space to the MLAs, and giving opportunities to exercise positive power for public good is empowered legislative committees.

Some efforts were made to constitute standing committees of parliament in 1993. Rules were framed entrusting certain functions to these standing committees, including considering demands for grants of the concerned ministries and departments, examining bills if referred to the committee by the presiding officers, considering the annual reports of the ministries and considering the policy documents of the ministries if referred to the committee by the presiding officers. While these committees and their functions are a vast improvement over the past, they are still too feeble and ineffective to make a real impact on the functioning of the parliament. In most States there is hardly any committee system.

The US congress has by far the most effective and empowered committee system. A brief review of the congressional committees would be useful to understand how they can play a vital role in making the legislature truly effective. Woodrow Wilson's observation a century ago, "Congress in session is Congress on public exhibition, whilst Congress in its committee-rooms is Congress at work", captures the essence of committee system in the US even today. Although committees have been in existence for over two centuries, the 1946 Legislative Reorganization Act set the foundation of today's committee system. As Carol Hardy Vincent observes, "Decentralization is the most distinctive characteristic of the committee system. Because of the high complexity and volume of its work Congress divides its legislative, oversight, and internal administrative tasks among approximately 250 committees and sub-committees. Within assigned areas of jurisdiction, they gather information, compare and evaluate legislative alternatives; identify policy problems and propose solutions to them; select, determine the text of, and report out measures for the full chambers to consider; monitor the executive branch's performance of its duties (**oversight**); and look into allegations of wrongdoing (**investigation**).

"Standing committees generally have legislative jurisdiction and most operate with subcommittees that handle a committee's work in specific areas. Select and joint committees are chiefly for oversight or housekeeping tasks. Committees receive varying levels of operating funds and employ varying number of aides. Each hires and fires its own staff. Whereas most committee staff and resources are controlled by majority party members, a portion is shared with the minority. Several thousand measures are referred to committees during each Congress. Committees select a small percentage for consideration, and those not addressed often receive no further action. Determining the fate of measures and, in effect, helping to set a chamber's agenda make committees powerful.

"When a committee or subcommittee favours a measure, it usually takes four actions.

First, it asks relevant executive agencies for written comments on the measure.

Second, it holds hearings to gather information and views from non-committee experts. Before the committee, these witnesses summarize submitted statements, then respond to questions from members. (Other types of hearings focus on implementation and administration of programs [oversight] or allegations of wrongdoing [investigative]).

Third, a committee meets to perfect the measure through amendments, and non-committee members sometimes attempt to influence the language.

Fourth, when language is agreed upon, the committee sends the measure back to the chamber, usually along with a written report describing its purposes and provisions and the work of the committee thereon.

"The influence of committees over measures extends to their enactment into law. A committee that considers a measure will manage that full chamber's deliberation on it. Also, its members will be appointed to any conference committee created to reconcile the two chambers' differing versions of a measure".

This elaborate and highly systematized procedure of the committees gives the US Congress tremendous control over the legislative and oversight process, and enables close interaction with the public, experts, and professionals. Obviously our committee

system in parliament and State legislatures is far from adequate. A similar committee system as in the US Congress needs to be adopted in our legislatures both at the Union and State levels. Such a committee system could have the following features and functions:

- approval of demands for grants
- receiving proposals from the government and the public for legislation
- obtaining government's views on measures proposed
- public hearings and expert depositions with the power of summons when necessary
- finalising the proposal
- recommending to the full house a proposal
- making public its meetings, deliberations and records through a variety of means including electronically
- consideration of proposals for appointments of constitutional functionaries and key public offices through public hearings
- monitoring and review of implementation of laws
- monitoring and review of government policies
- review of performance of government ministries and functionaries
- investigation into complaints of wrongdoing

Appropriate constitutional amendments should be considered to make the role of a legislator positive, citizen-centered, self-actualizing and in general promoting democratic values.

14. Decentralization of Police Functioning

Rule of law is the cornerstone of any democracy. The ultimate test of rule of law is the way the criminal justice system enforces law to protect the life and rights of citizens, and the police use the coercive power of the State to ensure compliance of law. Rule of law requires that all individuals are subjected to the same laws in the same measure. The first and most vital function of the State is maintenance of public order and peace in society and ensuring protection of citizens. In the ultimate analysis, the sanction behind State power is the use of force. They are the agency to enforce the will of the State, as

expressed in laws. The way the police function is an index of liberty and rule of law in a democratic society.

The police have two distinct functions, one that relates to society as a whole, and the other that concerns individual citizens. The maintenance of peace and security and protection relates to the first. The prevention of crime and its investigation and punishment, when committed, relates to the second. All these functions are concentrated in a single police force, which has made police functioning increasingly complicated and highly specialized. Each function requires a degree of training, knowledge base, skill, and sophistication, which are not possible to sustain when many functions are concentrated in the same force. In the absence of specialization, more resources and time are wasted to achieve the same results. Thirdly, certain areas of functioning have to be necessarily under political control and monitoring, whereas certain other functions have to be independent of political supervision and are in fact quasi judicial in nature. Since the functions are clubbed in one police force, it is impossible to separate control of one function from another. As a result, politicians have been playing a very prominent and dubious role in influencing crime investigation. This has, on one hand, vitiated the effectiveness of the police and, on the other, vested them with a great deal of extra-legal power.

Given this complex political and governance scenario, the horizontal fusion of all functions in a single police force has proved to be very damaging to our governance process. There is almost no single police station that is not subjected to pressure from the political class, on any given day, in its discharge of crime investigation functions. As criminalization of politics, and politicization of crime have both become the order of the day, increasingly, criminals have greater and greater influence in governance. For sheer survival, criminals have entered politics and politicians have become criminals. The Election Commission has gone on record that more than 700 of the 4,072 legislators in all the States of India have a criminal record. Once the electoral process brings such undesirable elements into public office, it is inevitable that the police force is subjected to unwarranted pressure in crime investigation. In fact, most criminals are tempted to enter the electoral fray only in order to be able to influence the police through public office.

The most important reform measure to be undertaken in the police forces is the separation of crime investigation from other branches of policing. By law, the police officials should be independent in discharging this function.

It is, therefore, vital to create an independent wing of police force fully in charge of crime investigation, which should obviously be controlled by, and be accountable to, an independent constitutional machinery. Several mechanisms and models have been suggested by various committees and commissions. Whatever may be the nomenclature, such a crime investigation wing should be under the supervision and control of a collegium at the State level, headed by a Chairperson drawn from the judiciary. Once a High Court judge becomes the head of prosecutions, s/he shall cease to be member of judiciary forever. The other members could be jurists, independent prosecutors, serving police officials at the highest levels, former police and civil officials and eminent citizens from various walks of life. The appointment of this prosecution wing itself should be by a committee comprising of the members of the government, the leaders of the opposition, Speaker of the legislature, and judges of the High Court. Such a body, be it called the State security commission, or the State board of prosecutions, or the State police board, should be fully in control of all matters of appointment, promotions, transfers, postings and disciplinary action relating to crime investigation wing. The crime investigation police should be permanently insulated from other wings of police, with no possibility of transfer from this wing to others or vice versa. Only when such fool-proof institutions are evolved, is it possible to make sure that crime investigation is a truly professional, independent exercise in search of justice rather than making it a partisan tool in the hands of those in power.

There are several police functions which can also be discharged at the local level on a day to day basis, for instance, traffic regulations, patrolling, controlling offences of a minor nature, prosecution of minor offences, public nuisances, etc., can only be handled locally. There can be a local force accountable to the local government at the panchayat or municipal level to discharge these functions. This local police can be organised as small, mobile, effective units under local control. However, there should be effective institutional mechanisms for integrating these local forces with the State police forces. The local police should be attached to a local court, which has jurisdiction over the territory as well as over the petty offences handled by such a police force.

There is still a vast area of police functioning including riot control, security of State properties, protection of important citizens and intelligence gathering. By the very nature of things, all these functions have to be under political supervision and control. Therefore these should be entrusted to a separate police force controlled by, and accountable to, the political executive under overall legislative supervision. There should be no movement, however, between such a police force and the crime investigation wing. The vertical mobility of the local police into the State level police force can be permitted, subject to certain norms and procedures. Such separation of functions will ensure that there will be no undue political interference in areas related to crime investigation, while the legitimate political intervention in areas of public order, riot control and intelligence gathering can be ensured.

A Suggested Model

1. There shall be a police station for every panchayat or group of panchayats comprising a population of about 25,000 and they should be entrusted with functions like traffic regulations, patrolling, controlling offences of a minor nature, prosecution of minor offences, public nuisances, etc., and they shall function under the local government.
2. The local police station shall be co-terminus with the local court.
3. Crime investigation to be separated into a separate independent wing functioning as a quasi-judicial body directly under the control of the judiciary.
4. Crime investigation to be completely and permanently insulated from other branches of policing, with no horizontal transfers from one wing to the other.
5. Riot control, security of State property, security of important citizens and intelligence gathering to still lie with the State level force accountable to the political executive under overall legislative supervision.
6. There should be effective institutional mechanisms to ensure that the local forces are integrated with the State forces.

The Police Act and manuals need to be suitably amended at the Union level to provide for such an effective, decentralized, accountable local police functioning.

15. Local Courts

An independent and impartial judiciary, and a speedy and efficient justice system are the very essence of civilization. However, our judiciary, by its very nature, has become ponderous, excruciatingly slow and inefficient. Imposition of an alien system, with archaic and dilatory procedures, proved to be extremely damaging to our governance and society. In the process, a whole new industry of administering rough and ready justice by using strong-arm tactics to achieve the desired goals has been set up by local hoodlums in almost all of our cities and towns, and increasingly, in recent years, in rural areas. The failure of the justice system has several disastrous implications in society. The only sanction to ensure good conduct and to prevent bad behavior in society is swift punishment. In the absence of the State's capacity to enforce law and to mete out justice, rule of law has all but collapsed. This alarming situation calls for speedy remedial measures. These measures should be practical and effective while they are in consonance with the basic features of the constitution. The judicial reforms, as envisaged, should be capable of providing speedy and efficient justice accessible to the ordinary citizens. At the same time, they should respect and protect the independence of the judiciary.

Because they have taken on themselves too much, the higher courts are not able to render justice speedily and efficiently. The age-old village institutions for justice have been allowed to wither away completely. Local people have neither the access to courts or the means to go through complicated, incomprehensible court procedures. As a result, most citizens avoid courts except in the most extreme circumstances, when they have absolutely no other recourse available.

Essentially, the failure of the civil and criminal justice system is manifesting in abnormal delays in litigation and huge pendency in courts. While accurate statistics are not available, it is estimated that approximately 24 million cases are pending in various law courts all over the country till 2002 - 20 million cases are pending in district and subordinate courts, High Courts account for 3.62 million cases and Supreme Court has around 23,000 pending cases. The disposal of cases in our courts and the conviction rate is abnormally low, with only 6 percent cases resulting in conviction. Even in cases involving extremely grave offences with direct impact on public order and national security, there are abnormal delays.

In a large measure, the failure of justice system means that ordinary citizen cannot rely on law courts to enforce contracts and agreements. The undermining of the sanctity of contracts and agreements has had a very debilitating impact on investment creation and economic growth. The failure of the criminal justice system has led to the near break down of public order in many pockets of the country. This, coupled with the many inadequacies of functioning of the police, has led to a crisis of governability in India.

Perhaps the most important practical reform would be constitution of rural courts for speedy justice. What is needed urgently is a substantial increase in the number of judges at the local level, giving access to the ordinary people. In addition to the number and access, the procedures of these local courts should be simple and uncomplicated, giving room for sufficient flexibility to render justice. These courts should use only the local language and they should be empowered to visit the villages and hear the cases and record evidence locally. Above all, they should be duty bound to deliver the verdict within the specified time frame.

There could be several models like the 'gram nyayalaya,' advocated by the Law Commission in its 114th report. Essentially, there should be such rural courts with special magistrates, with jurisdiction over a town, or a part of a city or a group of villages. These special magistrates should be appointed by District Judge for a term of 3 years. They should have exclusive civil and criminal jurisdiction of, say, all civil disputes up to Rs. 1 lakh in civil cases, and up to an imprisonment of one year in criminal cases. In addition, certain civil disputes arising out of implementation of agrarian reforms and allied statutes, property disputes, family disputes and other disputes, as recommended by the Law Commission, could be entrusted to these rural courts. In civil cases, there should be only a provision for revision by the District Judge on grounds of improper application of law and on no other ground. In criminal cases, where imprisonment is awarded, there could be a provision for appeal to the Sessions Judge. The procedures must be simplified and these courts should be duty bound to deliver a verdict within 90 days from the date of complaint.

A Suggested Model

1. The government shall, for the speedy and accessible administration of civil and criminal justice, establish:

Grama Nyayalayas, one for every panchayat or group of village panchayats comprising a population of about 25,000, with due regard to the density of population and terrain.

Nagara Nyayalayas for a ward or group of wards in a municipality or municipal corporation, comprising a population of about 50,000

2. Nyayalaya will have original jurisdiction in specified issues/offences, generally not exceeding Rs. 1 lakh in civil cases and one year's imprisonment in criminal cases.
3. A person of high repute and legal knowledge will be appointed by the District Judge as Nyayadhikari.
4. The office of the Nyayadhikari shall be an honorary office and he shall be paid such remuneration or honorarium as may be fixed by the government. The Nyayadhikari shall also be paid a fixed monthly traveling allowance and an additional allowance to be utilized for secretarial and other services, as prescribed by government from time to time.
5. The parties have the option to appear in person or be represented through a lawyer.
6. Proceedings of Nyayalaya will be in Telugu
7. Nyayalaya will deal with matters relating to fact, and not involving substantive matters of law.
8. The Nyayalaya will deliver a verdict within 90 days of receiving a petition/complaint.
9. There will be provision for appeal against Nyayalaya's orders.

Such local courts are not part of elected local governments, and shall function as integral parts of independent judiciary. Neither the civil administration, nor elected politicians at any level will have any say in any facet of the functioning of these local courts. However, these independent local courts as part of judiciary, with provision for appeal and accountability to higher judiciary, will promote access to justice and will be part of the larger effort to ensure decentralized, citizen-centered, effective governance and rule of law.

The matter of justice administration is in the concurrent jurisdiction covered by List – III of the VII Schedule. The Union should pass a legislation to provide for such local courts for accessible and speedy justice and upholding of rule of law.

16. Management of Education and Health care at Local Level

There is now an increasing much-needed, and long-overdue emphasis accorded to education and health care in our governance process. Large allocations are certain to be made by the Union in these sectors in future. However, these are largely driven by the states, as school education is essentially the states' responsibility, and health is a state subject. One cardinal principle of improving the quality of these services is local control, ownership and accountability. Therefore, in order to improve access and quality of service in school education and healthcare, local governments should be fully responsible for their delivery.

The Union should facilitate such local involvement, empowerment and accountability by a variety of means. The union has the leverage in promoting local empowerment through fiscal incentives over all state policy, and in designing and coordinating the structure and functioning of the Sarva Siksha Abhiyan and Health Missions. The following mechanisms are to be evolved and implemented through these Missions.

- Union allocations must be on the basis of agreement by states to effectively involve and empower local governments in these sectors.
- A district fund must be created in each sector with Union allocation and state funds devoted to the service.
- The fund should be augmented by local revenues raised by the panchayats and municipalities – as a local tax, or cess, or surcharge linked to property taxes. This should be dedicated to the respective sectors – education or health.
- The control of all schools – primary and secondary – in all respects, including infrastructure, staffing, service conditions, salaries, administrative supervision, disciplinary matters, and overall management must vest with the local government at the appropriate level depending on the specific matter. The funds will be drawn from the District Education Fund. Technical matters, syllabus and examinations will be controlled at the state level.
- The control and management of primary health centers, sub-centers, and other preventive health machinery, as well as all first referral and district hospitals will be vested in the local governments. All funds will be drawn from the District Health fund. Referral hospitals and technical standards and protocols will be the responsibility of state governments.

- In health care, there should be choice to citizens and competition among public service providers. This should be promoted in hospital care as part of the Health Mission through risk pooling, and progressively money following the patient by way of reimbursement on the basis of standard costs and services. This will give voice to citizens, promote competition and accountability among public hospitals, and encourage the public-spirited staff to apply peer pressure on laggards as the failure of one will affect the prospects of all.
- Effective Ombudsmen should be empowered to check abuses and take corrective action.
- Citizen's Charters must be evolved to ensure high quality, predictability, and compensation for non-delivery of services.
- The Union and state will monitor performance and hold the local governments to account by effective performance auditing, and measurement of outcomes through sample surveys.
- Transparency, public participation, people's vigilance and social audit will be institutionalized so that there is pressure to constantly improve quality and give best value for the money utilized.

17. Giving the MLA a Stake in Local Government

This is about making MLAs friends of panchayats. The conventional script on India's rocky road to decentralization is of them being opposed to each other. Promoters of decentralization feel that recalcitrant State governments at the behest of MLAs subvert panchayat raj. State governments on the other hand argue that if the Union is keen on decentralization why not start with the states. In the process the real big opportunity for improving governance is delayed. The debate though not sterile, is yet to come up with implementable solutions acceptable to both.

Such a solution is being suggested here. To break out of the current impasse, there may perhaps be a need to act on the political and administrative levels. Firstly, there may have to be a reimagining of the political space for alterations. Secondly, states need to be incentivised to buy into decentralization in exchange of improved finances and freedom from too many centrally sponsored programmes. Both political and administrative action would need to be conceived together.

Why are State governments (read legislators) against decentralisation? It is not merely a case of each level wanting decentralization only up to its own level. There is a major structural flaw in the current version of panchayat raj. Today we have a three-tier panchayat raj system of the village or Gram Panchayat, the intermediate level of the block panchayat and the district level of the Zilla Panchayat. The intermediate level of the block panchayat – a population of about a lakh people – is almost coterminous with the political constituency of the elected legislator to the state assembly. The MLA and the Block Panchayat system are both competing for political legitimacy at this level. The well-intentioned MLA also has perforce to become an opponent of panchayat raj to retain political space, which is seen as under siege from the panchayat system at the block level. The MLA prefers the line Ministries to execute tasks to keep panchayats at bay. In the process panchayat raj system and effective accountable service delivery get forsaken.

The nature of the 73rd Constitution Amendment is important here to appreciate the predicament. The Act passed by the Parliament as law is substantially different from the one conceived originally by the then Rajiv Gandhi government. Here, though there is an indicative list of functions listed in a Schedule, the actual conferral of powers is left to state governments. Simply put, states can't be pushed to it. They can only be persuaded. Coming to persuasion, people can hardly be persuaded to act against their own interests and legislators are no exception. They are in the business of creating political allegiance and unwilling to sign on the legislations that disempower them. Even when states champion decentralization (few of them have) the real game is as much about giving without really giving.

The way out is to act on the structure itself. This could be done by structurally aligning the elected legislator with the panchayat raj system by eliminating the middle tier of Block Panchayat which is actually coterminous, almost, with the MLA's political constituency. Then we would have the gram panchayat, no middle tier but an MLA who would prefer to do business at the village level through panchayats and thereby mentors them and has more congruence than conflict of interest. In a developing society where leaders compete for scarce political and economic resources, this would be a way out. It is pertinent to mention that the level of the intermediate tier of the block was created as unit of

administrative supervision given the difficulty in dealing with hundreds of villages from the district. While the gram panchayat has intrinsic integrity as a grassroots level social and political unit and the District Panchayat can be an effective planning and coordinating unit, the intermediate level of the block has no great merit to exist as a political unit. This will require a Constitution Amendment. The Amendment could be preceded by debate for consensus building. The current flaw can easily be perceived. Political leaders of every persuasion should be willing to support such a change that may offer a way out of the current deadlock over power-sharing. We can visualize the creation of a new political space that integrates MLAs vertically in the structure with no competition for space. This can have huge pay-offs in improving service delivery as state governments ought to have no major objection to devolving powers to panchayats.

The action in the political level needs to be complemented by action at the administrative level where the elements are all in place. There is a shared perception on the need for action to improve state finances. States have made forceful and reasoned pleas to the Government of India, the Planning Commission and Finance Commission. Solutions are being considered. The National Common Minimum Programme argues for winding down centrally sponsored programmes. The possibility here is to trade a financial bail-out package for states in return for a political buy-in into decentralization. The Planning Commission can further incentivise this by scrapping, winding up dysfunctional Centrally Sponsored Schemes (CSS) and offering block funds to states in some cases and in some cases to the panchayat raj system.

NCMP commitments in the social sector especially depend heavily on state-specific situations in delivery. Delivery on the whole can improve if states devolve powers to panchayats. Cash-strapped state governments today see union's desire to push resources to panchayats as cash that would have otherwise gone to them and resist decentralization. A virtuous cycle where state legislators get motivated to work with panchayats and improving delivery of services is possible if the alteration in the structure of panchayats to eliminate the middle-tier and easing of the burden on state finances and CSS comes about together. In the interim, while a Constitution Amendment is being worked on, the middle tier can be rendered superfluous by not devolving funds to that

level as done presently by Ministries like Rural Development. This, rather simple course of action can be adopted by the Government of India.

MLAs and panchayats need not necessarily be antagonistic if we undertake these design corrections. The Union and States working through panchayats can then conceive real improvements in service delivery. This would need climbing down from purist positions of the Constitution Amendment on the three-tier structure as sacrosanct. It would also need an appreciation of the compulsions of political democracy as it is practiced instead of trying to assume it away by invoking a Gandhian vision of village empowerment. First, let there be an alignment of political representatives at all levels for them to deal effectively with the concerns of the people.

18. Measures at the State Level

Much of the action to effectively empower local governments lies at the state level. In addition to local legislations and several fiscal and administrative measures, the Union needs to encourage States to adopt the following measures.

The Constitution permits multi-member constituencies for elections in local governments. Such an election of multiple members will facilitate entry of public-spirited citizens and reduction of money power. In addition, there will be fair representation of all groups and interests and scrupulous adherence to Constitutional provisions of reservation of offices. At the same time, there will be no need for rotation in offices at the council level in each local government, and greater continuity of leadership and participation of competent citizens are promoted. States should be encouraged to adopt such innovative methods of representation.

- Reorganization of village panchayats to ensure economies of scale, effective service delivery, and rapid breakdown of traditional caste hierarchies should be encouraged in states through Union incentives.
- The traditional division of revenue and development functions is now archaic in a democratic India. Local governments should progressively be responsible for both functions, and states should be encouraged to enable that through proper incentives and technical, infrastructural and financial support.

- Reorganization of police forces and creation of local police responsible for simple, local functions and accountable to local governments should be promoted by the Union through appropriate incentives and financial support.
- Constitution and effective functioning of local courts as an integral component of independent judiciary, and with clear separation of judiciary from the executive, with effective internal safeguards and accountability should be encouraged by the Union through fiscal incentives and appropriate support.

B. Empowerment of Stakeholders

In a democracy the citizens are sovereigns. The elected governments derive legitimacy from the willing consent granted by citizens in the form of vote. Vote is merely a transfer of part of the sovereignty to the state for meeting the collective needs of development, security and rule of law. However, representative governments – whether large or small, distant or local – cannot fulfill the aspirations of people to the optimal extent resources permit and citizens need. Some amount of inefficiency and leakages are in-built in any public system. Also even the best vigilance of citizens is not sufficient to enforce accountability and high standards of probity in the public servants who manage the resources and have the authority to regulate conduct of others. Nevertheless, there is no substitute to representative government in meeting most collective needs of citizens.

However, there are certain services which naturally have clearly defined, exclusive stakeholders. In other words, the success or failure of service delivery impacts only on the lives of these defined stakeholders, and does not have a bearing on other. In such select services, it is feasible to redefine state, and create a new form of organization ensuring greater fusion between power and stakes. It is common knowledge that citizens usually care for services which directly affect them, and a public servant who does not need those services is not likely to work to improve them. Therefore, the finest form of effective decentralization would be fusion of stakeholding with power-wielding wherever feasible.

Water users associations in respect of irrigation, School Education Committees constituted with parents and teachers, fair price shop committees formed by ration card holders, marketing committees with producers paying cess and selling their produce, watershed committees with the involvement of potential beneficiaries, and stake-holders groups involved in micro-credit and thrift enterprises with state support and subsidies are some of the groups which can exercise authority directly to maximize the benefits at lowest cost possible. In all such cases, the stakeholders' groups have natural affinity, and are likely to work collectively to improve the quality of delivery of services. If indeed they fail, the loss is theirs, and others are relatively untouched.

Numerous stakeholder groups/community-based initiatives dealing with varied subjects are proliferating all over India. The growth of community-based initiatives signifies the growth of vibrant civil society. Even the Seventh Plan highlighted the importance of peoples' institutions comprised of stakeholder groups, producers or beneficiaries, which are accountable to local community and have the capacity to both draw up and implement need-based local level plans in close cooperation with the local administration. In spite of their growing numbers, the numerical strength and reach of these community organizations is no way near that of local governments. There are many villages where there are no community-based organizations. On the contrary, the 73rd constitutional amendment has ensured that the presence of Gram Panchayat or Gram Sabha is felt in almost all the villages. Agriculture, land improvement and minor forests, and soil and water conservation are part of devolved functions to local governments.

The independent arrangements for planning and organization of work, accounting for finances and the lack of any kind of accountability to the Gram Sabha have meant that the items of devolution to local governments have, in fact, been given to Watershed Committees and Vana Samrakshana Samithis and similar stakeholder groups.

The role of local government, to which social forestry and control of minor forest produce has been devolved, has not been specified clearly. To state it differently, the State government does not see any role for local governments in the management of natural resources that fall under their jurisdiction. While on one hand, the powers of local governments are getting undermined with respect to management of natural resources, on the other, there is absolutely no coordination between the stakeholder groups and local governments, though both perform similar activities in a small geographical space. The reasons for the absence of co-ordination between local governments and stakeholder groups have been summarized below:

Areas of Contest:

- While the representatives of local governments believe that stakeholder groups are undermining their primacy, the stakeholders believe that local governments have no role in the activity in which they are the stakeholders.
- The stakeholder groups consider local governments as “political”, and treat them with contempt.

- The critics of the NGOs point out that the only difference is that while local governments are openly political by an election, stakeholder groups are political by covert infiltration.
- The representatives of local governments generally have low education status and they also lack fiscal powers to implement development initiatives vigorously. On the contrary, stakeholders have an edge over the local governments, as they get support from various NGOs, resulting in greater access to knowledge and latest technological advancements. These NGOs again are not accountable locally. Stakeholder groups and community-based organizations are also permitted to receive up to 50 per cent of the funds of Jawahar Rozgar Yojana (JRY) and Employment Assurance Scheme (EAS).
- While community-based organizations accuse local governments for non-performance, various reports have pointed out that sustainability of initiatives and maintenance of assets created has been a major problem area for the community-based organizations.
- A major criticism against the community-based organizations has been that they represent only a section of community, unlike an elected body.
- The functionaries of local governments accuse stakeholder groups of receiving favorable treatment from State government. For instance, while tanks larger than 100-acre command area have been handed over to WUA for maintenance, the smaller tanks are still under the jurisdiction of Panchayat Raj Engineering Department (PRED). While WUA get a share of irrigation tax, panchayats with smaller tanks neither get resources for maintaining them nor do they have supervisory powers over the works of the PRED.

In spite of the prevalence of discord between the functionaries of local governments and the stakeholder groups, it is vital to institutionalize a mechanism for coordination between these two overlapping interest groups. As they perform similar functions at the grass roots, it becomes imperative to develop functional and institutional linkages between them to facilitate faster development in the rural areas. Some of the areas that are amenable to stakeholder and local government convergence activities are, school education, water users in irrigation, marketing committees, fair price shops, watershed development, joint forest management. Development of functional and institutional linkages should be based on the premise of recognizing the primacy of local governments, as they are the elected bodies, rather than seeing stakeholder groups as

contenders of local governments. The following model can be considered for institutionalizing the linkages between stakeholder groups and local governments.

- State Panchayat Raj Acts provide for functional standing committees at the Gram Panchayat level. The stakeholder groups also perform similar type of functions. Therefore, Gram Sabha shall co-opt one or more members of stakeholder groups to the standing committee of the Gram Panchayat and, wherever necessary, elections will be held by secret ballot. These co-opted members will fully participate in proceedings of the standing committee.
- Members from the stakeholder group will be co-opted to the intermediary level standing committees from amongst the co-opted members of standing committees of the Gram Panchayat for each activity.
- In a similar manner, co-option from members of the stakeholders should be made to the standing committees of Zilla Parishads. Members from the stakeholder groups will be co-opted to the Zilla Parishad level standing committees from amongst the co-opted members of the standing committees of the intermediate panchayat, for each activity group.
- All funds in respect of devolved functions will be spent with the consent of the standing committees of which the co-opted members of the stakeholders are members.
- The functionaries, in respect of that service, shall be accountable to standing committee.
- The stakeholder groups will function under the overall umbrella of the local governments.
- Stakeholder groups will be strengthened by the involvement of independent initiatives and organizations with domain expertise or strong commitment.

Developing linkages between stakeholder groups and local governments, as stated above, will bring about convergence of various rural development programmes. Successful attempts at involving local governments in the activities of the stakeholder groups are readily available. In Uttar Pradesh, joint forest management was brought under the purview of the panchayats through a bill. Similarly, in West Bengal, the Chairman of the ZP, in consultation with site selection committee, distributed tube wells under a World Bank programme. Further, assurances were taken from farmers that they would purchase water supplied by the panchayat. The beneficiary committee looks after day to day working of the tube wells, which is a unique feature of West Bengal

Panchayati Raj. Such convergence in the activities of the local governments and stakeholder groups is necessary for better implementation of programmes in the rural areas.

C. Empowerment of Citizens

In a democracy, the citizens are the sovereigns. All citizens enjoy liberties as inalienable rights, and not as a gift of a ruler. Our Constitution-makers recognized this explicitly, and therefore the preamble declares that we, the people, have given unto ourselves the Constitution in order to secure to all citizens liberty of thought, expression, belief, faith and worship. Fundamental Rights guaranteed in the Constitution protect these liberties against State encroachment. Article 19(1) in particular protects the citizens' right to freedom of speech and expression, and to form associations or unions. These rights can be restricted by the state by law only to the reasonable extent necessary in the interests of security of state, public order, decency or morality etc.

However, because of long tradition of governmental dominance and citizens' subordination, in practice the state's exercise of power has been generally unquestioned in India. Even explicit guarantees in the Constitution are violated with impunity. Often, the laws are restrictive, and citizens' liberties are negated. Even the courts have at times failed to protect these liberties because of absence of clarity about the state's legitimate role. The plight of cooperatives is a good example of this trampling of citizens' liberty at will. Even societies formed to collectively pursue any lawful objective have often been subjected to unreasonable restrictions.

In many liberal democratic societies, citizens' initiatives are not only protected, but are encouraged. In fact, India itself has such a practice of granting tax exemptions, and encouraging donations to such non-profit societies by giving tax deductions to donors. But even in these matters, there are too many hurdles and uncertainty. As a result, civil society initiatives, community-based organizations, and non-profit societies are not flourishing to the extent they should in a free society.

Extensive excerpts of Tocqueville's comments on associations in America are cited here to illustrate the importance and power of free associations of citizens in a society, and the need to facilitate and support them.

“Americans of all ages, all conditions, all minds constantly unite. Not only do they have commercial and industrial associations in which all take part, but they also have a thousand other kinds: religious, moral, grave, futile, very general and very particular, immense and very small; Americans use associations to give fetes, to

found seminaries, to build inns, to raise churches, to distribute books, to send missionaries to the antipodes; in this manner they create hospitals, prisons, schools. Finally if it is a question of bringing to light a truth or developing a sentiment with the support of great example, they associate. Everywhere that, at the head of a new undertaking, you see the government in France and great lord in England, count on it that you will perceive an association in the United States.

“In democratic peoples, associations must take the place of the powerful particular persons whom equality of conditions has made disappear.

“As soon as several of the inhabitants of the United States have conceived a sentiment or an idea that they want to produce in the world, they seek each other out; and when they have found each other, they unite. From then on, they are no longer isolated men, but a power one sees from afar, whose actions serve as an example; a power that speaks, and to which one listens.

“There is nothing, according to me, that deserves more to attract our regard than the intellectual and moral associations of America. We easily perceive the political and industrial associations of the Americans, but the others escape us; and if we discover them, we understand them badly because we have almost never seen anything analogous. One ought however to recognize that they are as necessary as the first to the American people, and perhaps more so.

“In democratic countries the science of association is the mother science; the progress of all the others depends on the progress of that one.

“Among the laws that rule human societies there is one that seems more precise and clearer than all the others. In order that men remain civilized or become so, the art of associating must be developed and perfected among them in the same ratio as equality of conditions increases. “

In the light of this, the need to create an enabling climate to promote and nurture vibrant civil society organizations is self evident.

This section addresses some issues related to cooperatives and societies.

1. Autonomy of Cooperatives

The UPA Government has been very farsighted in recognizing the need to preserve the autonomy of peoples' organizations – particularly the Cooperatives, as a part of the right to form associations guaranteed under Article 19(1)(c) of the Constitution. The NCMP made the following commitments vis-à-vis Cooperatives.

- The rural cooperative credit system will be nursed back to health. The UPA Government will ensure that the flow of rural credit is doubled in the next three years and that the coverage of small and marginal farmers by institutional lending is expanded substantially.
- The delivery system for rural credit will be reviewed.
- The UPA Government will bring forward a Constitutional Amendment to ensure the democratic, autonomous and professional functioning of cooperatives.

A Cooperative is a private, autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise. It is normally accepted that any association that is so constituted would be capable of administering itself through its own members.

The cooperative movement has been playing a pivotal role in the development of key sectors such as rural thrift and credit, dairy, sugar, horticulture and other agricultural produce, benefiting crores of Indians. The unique success of Amul and the dairy cooperative movement, making India the world's largest milk producer, is a testimony to the vitality and strength of this sector.

Prior to Independence, the cooperatives were governed by a liberal law modelled after the English Friendly Societies Act and subsequently the subject was transferred to the provinces. In the early 1960s, cooperative legislation all over the country underwent major changes guided by the findings of the All India Rural Credit Survey Committee (Gorwala Committee 1954), which recommended an active role for the state in the spread of the cooperative movement. Based on this committee's recommendations, many states enacted new laws for governing the cooperatives, which gave the state a major role in their functioning.

Since then it has been a steady decline for the bulk of the cooperatives across the country (barring a handful) largely owing to politicisation and mindless tinkering by civil servants. Cooperatives have become captives in the hands of politicians and state functionaries. The members whose share capital is at stake and whose interests are supposed to be served by the cooperative have become irrelevant. They are treated as mendicants, and the officials are the dispensers of patronage.

Wherever the governments intervened, the story is the same. Vibrant, healthy and viable institutions went bankrupt. Public money was squandered, farmers and members were fleeced, bogus voting became rampant, societies were captured, and assets looted. Most cooperatives became moribund, ineffective and dysfunctional.

In 1990, the Brahm Prakash Committee submitted a Model Cooperative Societies Law, to the Planning Commission. This came at a time when the country had chosen to enter a more liberal economic era. The argument was that if other forms of business and other players in the market were to enjoy a more liberal regime, then, so too should cooperative societies. However, states like Andhra Pradesh government found it expedient not to repeal the existing law and replace it with Model Law.

Rural credit system, viability of cooperatives, and the enabling legal climate to establish and run the cooperatives as voluntary, democratic, autonomous, member-owned, member-controlled, collective business enterprises are all integrally linked. The allocations and policies required to nurse the rural cooperative credit system and credit delivery system are being addressed by the respective ministries. But these results will bear fruit only if the NCMP commitment to create a legal framework to ensure democratic, autonomous and professional functioning of cooperatives is implemented.

In order to implement this NCMP commitment, there could be three approaches:

1) Amending Article 19(1)(c)

Article 19(1) (c) reads as:

Article 19. Protection of certain rights regarding freedom of speech, etc.-

(1) All citizens shall have the right-

- (a) to freedom of speech and expression;
- (b) to assemble peaceably and without arms;
- (c) to form associations or unions;
- (d) to move freely throughout the territory of India;
- (e) to reside and settle in any part of the territory of India;

Article 19(1) (c) should be amended to read as:

Article 19. Protection of certain rights regarding freedom of speech, etc.-

(1) All citizens shall have the right-

- (a) to freedom of speech and expression;
- (b) to assemble peaceably and without arms;
- (c) ***to form associations, cooperatives or unions.***
- (d) to move freely throughout the territory of India;
- (e) to reside and settle in any part of the territory of India;

2) an elaborate constitutional amendment which goes into the details of the structure and functioning of the cooperatives.

or

3) the constitution could outline the constitutional rights of a cooperative – including right to elections, member-control, complete autonomy subject to reasonable restrictions outlined in Article 19(4), and right to independent professional audit.

The most appropriate course would be a simple amendment of Article 19(1) (c), incorporating the word “cooperatives”. This guarantees constitutional protection, and any law has to be subject to the limitations of Article 19(4), and would be justiciable. In other words, the implicit fundamental right to form cooperatives and manage them is made explicit.

2. Empowering Citizens

Creating an Enabling Climate for Societies, Charities and Non-Profit Organizations (NPOS)

Sampradaan Indian Center for Philanthropy has studied the Charities Administration in India. The executive summary of the report is enclosed.

Four issues need to be considered:

- In many states, unreasonable fetters are imposed on NPOs, which are clearly violative of the spirit and letter of Article 19. Often, the societies are even forced to pay a hefty fee to their tormentors! Mechanisms need to be evolved to curb these restrictive practices.
- Registration under Foreign Contribution Regulation Act has become a source of harassment and extortion. It is time that the current practice is given up, and registered NPOs are permitted to receive foreign contributions, subject to the condition that there is transparent transaction through banks, all such contributions are reported, and the certified audit report is communicated to regulators.
- There are too many complex and somewhat dilatory provisions and practices in respect of Income Tax exemption. Once the NPO is registered, and the objectives qualify tax-exempt status, it should be automatically granted. In case of abuse of law, there should be swift and strict penalties against the NPO.
- With the enactment of The Election and Other Related Laws Amendment Act, 2003, all contributions from individuals and corporates are fully tax-exempt. Sections 80GGB and 80GGC have been inserted in the Income-Tax Act, 1961, by which the contribution to the registered political parties is deducted from the total income of an assessee – an individual or company – for tax purposes. In case of companies, the ceiling of 5% of average net profit over three years applies. When such deduction is applied to contributions to all registered political parties, it is only proper that the facility is extended to NPOs. Section 501 (C) (3) in the US, providing for full deduction, is applicable to NPOs, provided they pursue any of the listed objectives. Now many NPOs are heavily dependent

on government or foreign funding agencies for their activities. It is time that contributions from Indian citizens and companies become the main source of support of NPOs. Also charity needs to be promoted in India for causes other than caste and religion. Only then can citizens' associations play a meaningful role in society and contribute to spread of ideas, independent voices, and innovative solutions to our collective problems.

Enclosure

Executive Summary of the Report of Sampradaan ICP

REVIEW OF INSTITUTIONAL FRAMEWORKS FOR CHARITY ADMINISTRATION IN OTHER COUNTRIES

The present chapter is based on a review of the institutional framework for charity administration in other countries including Canada, United Kingdom (UK) and United States of America (USA). The main aim of the review was to identify some components of the charity administration framework that have proved to be successful in promoting the non – profit sector / charities and in encouraging good governance of these organisations. The review also aimed at ascertaining the adaptability of such successful components in the Indian charity administration scenario.

4.1 Charity Administration in UK

4.1.1 Charities in UK

There are 188,000 registered charities in England and Wales¹. Their numbers have been growing by approximately 1,800 per year since 1990. Most registered charities are relatively small. In 2001, the 372 large charities whose annual income exceeded £10 million received more than one-third of the £26.71 billion total income of registered charities. There were 42,012 registered charities with an income of £1,000 or below, and 59,699 with an income between £1,001 and £10,000.

There are also a large number of charities that are not registered. For example, very small organizations with income of £1,000 or less, along with certain classes of charity including churches of particular denominations, do not have to register – these are collectively called “*excepted*” charities. Other types of charities, including universities, housing associations and some schools, termed “*exempt*” charities, are not registered on the grounds that they are regulated by other agencies.

¹ “Private Action, Public Benefit” - A report of the Strategy Unit, Government of UK, 2001

The sector also has economic weight. It is an increasingly significant employer: full-time equivalent jobs (FTEs) increased by 6.7 percent between 1998 and 2000, more than in either private or public sectors. General charities now employ over half a million workers, representing the equivalent of 451,000 full time equivalent jobs or 2.2 percent of the total UK workforce.

The charities in UK are registered, monitored, and facilitated through a Charity Commission.

4.1.2 Charity Commission

The Charity Commission has been established by law as the regulator and registrar for charities in England and Wales. It has no direct equivalent in either Scotland or Northern Ireland, though proposals for a similar body in Scotland are under consideration. The Charities Commission aims to provide the best possible regulation of charities, in order to increase their efficiency and effectiveness and public confidence and trust in charities.

The Charity Commission has the following roles:

- To secure compliance with charity law, and deal with abuse and poor practice;
- To enable charities to work better within an effective legal, accounting and governance framework, keeping pace with developments in society, the economy and the law; and
- To promote sound governance and accountability.

The commission's aim is to maintain public confidence in the integrity of charity. It is operationalised by encouraging the development of better methods of administration, giving advice to trustees and correcting abuses of charities. The Charity Commission does not have power to administer charities and does not normally interfere with the trustees' exercise of their discretion. The Commission cannot change decisions properly made by the trustees. However, if an inquiry into the affairs of a charity reveals misconduct or mismanagement, then the Commission may intervene to protect the property of the charity. The commission has no power to make grants to charitable organisations and cannot make donations to charities.

4.1.2.1 Charity Commission – Organisational Structure

Charity Commissioners are appointed by the Home Secretary and derive their authority from the Charities Act of 1993. The act provides for at least three and no more than five Commissioners, two of which must be legally qualified. The Chief Commissioner is both Chair and Chief Executive of the Commission, as well as its Accounting Officer. A second Commissioner has an executive role as head of the Commission's legal division. The other three Commissioners are non-executives. The Commissioners are answerable to the Courts for their legal decisions and their interpretation of charity law, and to the Home Secretary and Parliament for the effective performance of the Commission as the statutory organisation that regulates charities.

Commissioners have the general function of promoting the effective use of charitable resources by:

- Encouraging the development of better methods of administration;
- Giving charity trustees information or advice on any matter affecting the charity; and
- Investigating and checking abuses.

The Commissioners have overall responsibility for the strategic direction and work of the Commission. They have a range of functions including taking decisions on major cases. In practice, assistant commissioners acting under delegated powers exercise most of the powers of the Charity Commission.

4.1.2.2 Charity Commission – Governance

Responsibility for the strategy and future direction of the Commission rests with its Board. The Board comprises all the Commissioners and four Directors responsible for operations, policy, resources and legal services respectively. A small board such as this has the advantage of manageability and ease of decision-making, but is open to the accusation that it is narrowly focused and that the interests of some groups of stakeholders are not fully represented in its discussions.

Corporate decision-making that affects the day-to-day operation of the Commission is delegated to the Executive Group, comprising the Directors and Head of Strategy and

Change and chaired by the Chief Executive. The Directors' duties include implementing the programmes and policies arising from the Board and ensuring effective service delivery.

The Board is supported by an Audit Committee. The Directors are each supported by committees comprising their own senior staff together with representatives of other key parts of the organisation.

The Strategy Unit, Government of UK has undertaken a review of charities and related issues in 2001. Among many other recommendations it has proposed that the Board of the Charity Commission should be expanded by adding four new Commissioners, one of which should be appointed by the Secretary of State for Wales and the remainder by the Home Secretary. It has also proposed that the appointments should achieve wider representation of voluntary sector and other stakeholder interests. With the proposed increase in the number of Commissioners, and the higher public profile that the Commission is to adopt, there is a strong case for introducing separate Chair and Chief Executive posts. The Chair's particular role would be in ensuring good corporate governance and the smooth functioning of the enlarged board, and in representing the Commission in public and at high level within Government and the charitable sector.

4.1.3 Roles / Functions of Charity Commission

The Charity Commission has statutory powers in four principal areas:

- The registration of charities;
- Annual monitoring of the financial and other affairs of larger charities;
- Assistance on legal, governance and administrative issues to help charities run themselves more efficiently (also termed "Charity Support"); and
- The investigation of mismanagement and misconduct within charities.

4.1.3.1 Registration of Charities

All charities in England and Wales, which are not specifically exempt or excepted from registration, are required to register with the Charity Commission. Exempt charities are charities that Parliament has specifically decided do not need to be supervised by the

Charity Commission, typically because other arrangements already exist to supervise and regulate them. Examples include universities, many maintained schools, and many national museums and galleries. An excepted charity is a charity which is exempted from the duty to register either by Regulations made by Ministers or by an Order made by the Commissioners. A charity is also exempted from registration if it has neither:

- any permanent endowment; nor
- the use or occupation of any land (including buildings); nor
- an annual income from all sources of more than £1,000.

Charities that are registered places of worship are also exempt from the need to be registered.

The Charity Commission is required to register any institution which is a charity (unless is excepted or exempt). The procedure for applying for registration as a charity, the "gateway procedure for registration", requires applicants to provide, in addition to their constitutional documents, a range of information about their actual or proposed activities, plans for funding and trading, and trustees. The "gateway" process was developed in response to suggestions from the Public Accounts Committee that greater scrutiny of charities was required at the time of registration. However, this process has been criticized by charities for taking into account the viability of an organisation when deciding whether or not to register it. The critics argue that the Commission is not legally entitled to do this; and applies an "activities test" by looking at an applicant's actual or proposed activities as an aid to interpreting the purposes stated in the applicant's constitution. Some critics are of the view that this process is making it more difficult for charities to register, infact this procedure is onerous for very small organisations.

Registration means that while the organisation remains on the Public Register of Charities it will be legally presumed to be a charity and must be accepted as a charity by other bodies such as the Inland Revenue. Although registration does not necessarily indicate approval of the management of the charity, it does mean that it is subject to supervision by the charity commission and that information about it, including its governing document and accounts, is open to examination by the public. Once a charity is registered, the trustees must inform the charity commission about any change to the charity's registered details. The organizations have to submit their annual accounts to

the charity commission and may be asked periodically to complete a return or supply additional information.

The Commission maintains the Public Register of Charities that contains key particulars of all registered charities. During 2001, 5,900 new charities were added to the register taking the total to 188,000 at the year-end. The Public Register of Charities can be accessed via their website or at any one of their three offices. Copies of extracts from the Register, and of governing documents and accounts can be purchased for a small fee. Annual reports of charities are available in the same way.

The Public Register of Charities:

- is the only record of organisations which have been officially accepted as being for the public benefit and which, therefore, receive privileged tax treatment;
- allows charities to give conclusive proof of their status to funders and others;
- gives members of the public up to date information about charities, individually or in groups, and access to the people running them;
- allows the regulator to monitor charities and their affairs on an annual basis;
- allows people running charities, or thinking of starting new ones, to identify others carrying out similar work;
- gives local authorities, umbrella bodies and special interest groups an overall view of the size and scope of charitable provision in their sphere of interest; and
- provides policy-makers and researchers with evidence about the economic weight of the charitable sector and the distribution of wealth within it.

The Charity commission has also prepared guidelines, books and information packs to facilitate the charities in various facets of their work. For example, the guidebook "Registering as a Charity (CC21)" provides all information that the promoters or trustees of an organization need to read before proceeding with the registration. Information packs, like "Application to register a Charity" including guidance about setting up a charity in England and Wales, application forms, etc is also made available. To facilitate the setting up of charities and to simplify the process of registration, the charity commission has also produced a set of draft model governing documents, covering the three main forms taken by charities, namely, Model Memorandum and Articles of Association for a Charitable Company (GD1); Model Declaration of Trust for a Charitable Trust (GD2); and Model Constitution for a Charitable Unincorporated Association (GD3).

4.1.3.2 Annual Monitoring of Charities

Statutory power to monitor charities, through a compulsory annual return, was given to the Charity Commission in 1996, when the relevant Charities Act 1993 provision came into force. The annual monitoring system makes greater demands on charities, and subjects them to greater scrutiny, as their size, and the risk of harm that could result from their failure, increases. Around 50,000 charities – those with an income or expenditure over £10,000 – are monitored annually. The statutory accounting, reporting and auditing requirements are similarly graduated.

A charity, which is not a company must have its accounts for a particular financial year professionally audited (i.e. audited by a person registered as an auditor under the Companies Act 1989) if either:

- its gross income or total expenditure exceeded £250,000 in that financial year; or
- its gross income or total expenditure exceeded £250,000 in either of the two years preceding that financial year.

A charity, which is a company, must have its accounts for a particular financial year professionally audited if its gross income is over £250,000 in that year.

Experts feel that these rules are unnecessarily complicated and impose a professional audit requirement at too low a level. The charity threshold should be raised to £1 million. Below that level (down to an income threshold of £10,000) charities should continue to be required to have their accounts examined by a competent independent person.

4.1.3.3 Assistance on legal, governance and administrative issues

This function, which the Charity Commission calls “Charity Support”, consists of modernizing the purposes, governance and administrative arrangements in charities’ constitutions, advising on legal and regulatory requirements, and authorizing actions and transactions which charities would not otherwise have the legal power to carry out.

The Commission’s primary function is a regulatory one and the bulk of its resources are rightly dedicated to this function. However, it is also part of the Commission’s function to give charity trustees “information and advice on any matter affecting the charity”. This

clearly allows the Commission not only to tell charities what their legal obligations are, but also to adopt a wider advisory role on good practice. The Commission on the Future of the Voluntary Sector, an independent review, examined the tensions that have sometimes arisen out of this “dual role” of regulator and adviser. It concluded that:

- There were good reasons for the Charity Commission to have an advisory as well as a regulatory role; and
- It should do more in its communications with charities to distinguish between matters of law and matters of good practice.

4.1.3.4 Investigation of mismanagement and misconduct within charities

The Commission has statutory power to investigate any registered or excepted charity. It also has powers to:

- protect charity assets at risk; and
- take action against those responsible for misconduct or mismanagement in a charity.

In 2000 – 02, the Commission concluded 212 investigations in which some “cause for concern” was established. There are a number of criminal offences in charity law, designed to ensure compliance with important obligations and to penalize those who fall down on their obligations. In many cases the consent of the Director of Public Prosecutions is needed before proceedings can be taken in many cases.

4.1.4 Mechanisms for Grievance Redressal and Appeals

4.1.4.1 Complaint and Review Systems

The Charity Commission has a complaint system and a review system. The complaint system allows people dissatisfied with the Commission’s conduct or service to lodge a formal complaint. This begins as an internal process but, if the complaint is not resolved that way, it passes to the Independent Complaints Reviewer, whose role is similar to that of an external ombudsman.

The review system allows people dissatisfied with a decision that the Commission has made in exercising its statutory powers to ask for the decision to be reviewed. This is a process with several stages that could go up to Board level within the Commission, but ends there. It can take considerable time to go through the process, which has no external or independent element.

4.1.4.2 Right of Independent Appeal

It is important that the Commission's decisions should be, in both fact and appearance, open to challenge. The right of appeal to an independent authority against a decision of the Charity Commission is to the High Court. However, in practice this right is rarely exercised. There is a widespread perception that appeals necessitate undue expense and delay, and that the Commission is virtually unchallengeable in practice.

The Government believes, therefore, that an independent tribunal should be introduced to hear appeals against Commission decisions. A person or organisation affected by a decision will have an automatic right of appeal and will be able to represent themselves. This will bring the Commission's procedure into line with other departments (the Financial Services Authority, War Pensions Agency, Customs and Excise, and the Inland Revenue) that have an independent review before court action is necessary.

4.1.5 Regulator's funding

The Charity Commission is funded from taxpayers' funds. The Commission does not charge for any of its regulatory services to charities. However, certain discretionary services and products such as training events and publications are charged.

4.1.6 Charity Law Reform in UK

The Government of UK recognizing its role in creating an enabling environment by providing a sound legal and regulatory framework for the non-profit sector; launched a review of the existing legal and institutional framework in July 2001. The details of the review process are available in this report as Annexure 6.

4.2 Charity Administration in USA

4.2.1 Charities in USA

The American Non profit sector has grown from some 50,000 organisations in 1950 to more than a million at present. The charity friendly legal structure is a significant factor for this growth. The laws provide incentives to organisations as well as their financial supporters in the form of tax benefits, and they regulate the non-profit sector to ensure that its assets are used for public good. The American law of charities is not found in a single unified statute or code. Because of the magnitude of tax incentives the tax law is the starting point.

Due to the multiplicity of tax categories, American non-profit organisations fall into two broad groups: charities and other public benefit non-profits and mutual benefit non-profits². The traditional common law definition of charities as derived from English law, speaks of four charitable purposes

- The relief of poverty;
- The advancement of religion;
- The advancement of education; or
- Other purposes beneficial to the public and analogous (or similar) to purposes,

In the modern era however, the traditional definition in the United States has been largely superseded by the tax definition of charity – that is, by the definition of an organisation that pays no tax on its income and whose donors derive tax benefits as a result of their donations.

4.2.2 Tax Exempt Charitable Status

To qualify for a tax exempt charitable status, an organisation must satisfy the requirement of Section 501(C) (3) of the Internal Revenue Code, which provides that an organisation must satisfy the following six requirements:

² Mutual Benefit non-profits are organized to benefit their members. e.g., social clubs, labour unions, professional organisations, rural co-operatives, etc

- It must have an exempt purpose – that is one or more than one of the purposes as defined in 501 (C) (3). The Section lists seven different purposes, namely, religious, charitable, scientific, testing for public safety, literary, education, fostering national or international amateur sports competitions, or the prevention of cruelty to animals.
- It must be organized only for exempt purposes – Section 501 (C) (3) requires a charity to be organized exclusively for one or more exempt purpose. This test, known as the Organisational test, focuses on the charity’s governing documents. For charitable trusts the governing document is the trust agreement. The organisational test is satisfied only if the charity’s governing documents limits its purpose to one or more purposes listed in section 501 (C) (3) and does not “expressly empower the organisation to engage, otherwise than insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.”
- It must be operated primarily for that purpose – Section 501 (C) (3) taken literally, require an organisation to be operated exclusively for the exempt purposes. The Regulations, however, provide some flexibility to what is known as the operational test, when they make it clear that a charity may qualify if it is operated primarily for the exempt purpose and an “insubstantial” part of the charity’s activities are devoted to non-exempt purposes.
- There must be no inurement – that is no improper benefit to anyone in a position to control the charity or exert substantial influence over it. Section 501 (C) (3) requires that “no part of the net earnings of the organisation inures to the benefit of any private shareholder or individual”
- There must be no candidate activity – that is, no support or opposition to any candidate for public office.
- There must be no substantial lobbying activity – that is, no substantial support or opposition to legislation

4.2.3 Formation of a Charity

Forming a charity involves three elements, namely, pre-formation planning, formal incorporation and obtaining the tax-exempt status from Internal Service (IRS).

4.2.3.1 Pre-formation Planning

This early formation stage is the most critical for the success of the charity. The focus at this stage is how the charity hopes to accomplish its purposes and goals and on building the initial group of supporters.

4.2.3.2 Incorporating a non profit

The actual incorporation is quick and easy. The charity's founders select a name for the charity, prepare and sign articles of incorporation that set forth the charity's purpose in general terms and contains language that complies with Section 501 (C) (3)'s organizational test and any other requirements of the state law. They have to submit the signed articles to the Secretary of state in the state selected by the charity; along with the fee that the state charges. The corporation's existence as a legal entity begins when the Secretary of State accepts and files the articles of incorporation. If the articles of incorporation do not contain the required language, the Secretary of State will not accept the articles for filing.

To complete the formation process, the governing body of the new incorporation adopts the bye laws and sets forth its internal governance procedures; elects officers (president, chairman, secretary and treasurer) and makes basic financial management decisions such as where will the corporation open a bank account, who will be authorized to sign checks and withdraw funds; and who is authorized to sign contracts for the corporation, etc.

4.2.3.3 Applying for tax exempt status under section 501 (C) (3)

A charity that seeks recognition that is described in section 501 (C) (3) must complete and file an extensive application form known as Form 1023 with the IRS. The form is available from the IRS office or their website. Some charities complete the form themselves while others seek professional help of lawyers or accountants to assist them. The Form 1023 requires the charity to describe its purposes and proposed activities; to provide a balance sheet and a proposed budget for its first three years of operations; or if the charity has already commenced operations, a statement of actual revenue and expense; and a list of names and addresses of the officers and directors. The charity

must also provide copies of the articles of incorporation and bylaws. Further the charity must respond to the numerous questions designed to elicit information on insider transactions, sources of funds and activities that concern the IRS due to potential abuses of the provisions.

The charity has to submit the exemption application and pay a filing fee. Exempt organisation specialists then review the application. If the application is complete and in order, the IRS issues a determination letter recognizing the Charity as a Section 501 (C) (3) organisation and classifying it as a private foundation or public charity. If more information is required the reviewer contacts the organisation for more information. Unless the organisation fails to provide the required information or reveals an intention not to comply with the provisions of section 501 (C) (3) the IRS generally grants the tax-exempt status. Most applications are processed within 90 days of receipt of the application. However, if an organisation believes that it was improperly denied tax-exempt status then it may appeal the decision within the IRS and if the IRS has exhausted all administrative remedies without success then it can ask the federal court to resolve the matter.

4.2.4 Legal and Institutional Framework for Charity Administration

A charity tax status is a question of the federal law, but its existence as a legal entity and its internal governance are matters of the state law.

4.2.4.1 State Law

In most states, the Attorney General is empowered to supervise and regulate charities. Charities are required to file annual reports regarding their activities and finances to the office of the Attorney General. In most states, the Attorney General has powers to inspect and review a charity's books and records to safeguard the interests in charitable assets. The public also may inspect any of these reports which are easily available on request.

The members of the charity's governing body owe a fiduciary duty to the charity. If a director breaches the duty, the state attorney general has powers to compel the director to repair any damage that the charity suffered as a result.

4.2.4.2 Federal Law

The Internal Revenue Service supervises the operations of charities in three ways:

- Through the information provided in the annual returns;
- Through its power to audit the finances and operations of charities; and
- Through its power to assess penalties and fines and in extreme cases to revoke a charity's exempt status for abuses and violations of the law.

Annual returns: Public charities other than churches, with an annual gross receipts over \$ 25,000 must file an annual information return on IRS Form 990. Private foundations must file Form 990-PF, a longer version of the earlier form. If a charity has unrelated business taxable income it must file Form 990-T and pay tax.

Form 990 and its variations require detailed information about many aspects of a charity's finances and operations, including:

- Revenues and expenses for the year covered by the return, by specific categories;
- Compensation (both current and deferred) and benefits provided to directors, officers, key employees and the five most highly paid employees and independent contractors of the charity. Compensation paid to these people through related organisations (both for profit and not for profit) must also be reported.
- Financial transactions that involve insiders either directly or indirectly, focusing on Section 4841's self dealing rule for private foundations and on section 4958's excess benefit ban for public charities but not limited to transactions that fall within the scope of these statutes.
- A schedule of grants and other charitable distribution, including any relationship between the grantee and an insider in the charity
- Deals of any loans between the charity and its officers, directors, trustees, and key employees.
- Fundraising expenses, accounting fees, legal fees, and similar payments to outside professionals.
- Information on taxable subsidiaries and transactions with related organisations.

- Description of charity's major programme areas.

IRS Audits: Federal tax law gives the IRS the authority to audit the books and records of charities and other non-profit organisations, subject to procedural protections designed to prevent government abuses. An audit may be triggered by information provided in form 990, by information from a disgruntled employee or former supporter, or by the press coverage of the apparent abuses by a charity or its managers. From time to time the IRS decides that it must audit a particular segment of the non-profit sector because of widespread concern about legal compliance. In recent years, the IRS has focused on audit of hospitals and health care systems and on large colleges and universities.

An organisation under audit has an opportunity to confer with the IRS auditor to provide information to support its position and to appeal the auditor's conclusions. If the auditor concludes that the charity has complied with the applicable laws, the IRS confirms the fact in a 'no change' letter. However, if the audit discloses problems the IRS assesses applicable taxes and penalties. If the charity pays a fine it has to be reported on Form 990 of the year in which the fine was paid.

Fines and Penalties: The ultimate penalty is the revocation of an organisations' tax exempt status. However, this sanction is rarely applied. More often the charity agrees to correct the problem and pay a fine. Section 4958's ban on excess benefit transaction of public charities, which is enforced by penalties imposed on the wrongdoer rather than the charity itself, gives the IRS an effective weapon against abuses.

4.2.5 Mechanisms for Appeal

In the United States, all applications to the Internal Revenue Service for tax-exempt status are handled centrally, in Cincinnati. An organization that receives an initial adverse determination of tax-exemption (or a letter proposing to revoke an existing exemption) may seek recourse from a separate branch of the Internal Revenue Service (the Appeals Office), by filing a protest within 30 days. The protest letter must include details such as the aspects of the original decision the organization disagrees with, the facts supporting its position, and the law or authority on which it is relying. If requested, a conference can be held, but otherwise the procedure can be conducted by correspondence or telephone. Appeals Office staff can only determine cases according

to established precedents and policy. Where there are no established precedents and policy, the matter is referred to head office in Washington. The organization also has the option of having the file referred directly to Washington.

In addition, organizations can go directly to court, rather than using the Appeals Office, or they can go to court if they disagree with the decision of either the Appeals Office or head office. If the court finds the organization to be the “prevailing party,” it can recover its administrative and litigation costs.

4.2.6 Mechanisms for Public Accountability

A charity is obliged by law to provide a copy of its tax exempt application and its three most recent tax returns, together with all attachments except the donor list to anyone requesting them, immediately if the request is made in person and within 30 days if the request is made in writing.

The organisational test of Section 501 (C) (3) requires a charity to state, in its governing document, that its assets are irrevocably dedicated to charitable purposes and that if the charity ceases to exist, its remaining assets (after payment of its debts) will be distributed for charitable purposes. In practice, the responsibility for ensuring that the charitable assets remain devoted to charitable purposes when a charity ceases to exist rests with the states, specifically with the office of the Attorney General.

4.3 Charity Administration in Canada

4.3.1 Registration

An organization that wants to become a registered charity must apply to the Charities Directorate of the Canada Customs and Revenue Agency (CCRA). The application needs to include the purposes for which the charity wishes to be registered. It should also contain information about how the charity will achieve these purposes. The application is reviewed by a Charities Directorate examiner. There is no legislated definition of charity, so the examiner has to compare the application against court cases that have helped explain what is considered to be charitable. Collectively, these cases form what is sometimes known as the common law of charity.

The courts have said there are four types or “heads” of charities. Charities can be created for:

- The relief of poverty;
- The advancement of religion;
- The advancement of education; or
- Other purposes beneficial to the public and analogous (or similar) to purposes, which the courts have found to be charitable.

The examiner who reviews an application may do one of several things. The examiner may:

- Approve the application, sending a letter telling an organization that it has been registered;
- Write or telephone the applicant, asking for more information; or
- Send a letter, called an “Administrative Fairness Letter,” explaining why it appears the application cannot be approved. In cases where an Administrative Fairness Letter is sent, the organization can submit additional information or arguments. If the examiner is persuaded, then the organization will be registered. If not, the applicant will receive a final letter saying that the application has been denied.

About 4,000 organizations apply for charitable registration each year. Approximately 3,000 applications are approved, another 200 receive final letters denying registration and the remaining 800 fail to respond to either a request for more information or to the Administrative Fairness Letter. They are considered to have withdrawn their applications.

If an organization is registered as a charity, its name appears on the list of charities that is maintained on the CCRA website (www.ccra-adrc.gc.ca). Any member of the public has the right to ask the Charities Directorate for a copy of a registered charity’s application for registration. However, if an organization is denied registration, or if it drops out of the process, no information about the application is made available to the public.

4.3.2 Monitoring

The Charities Directorate is responsible for ensuring that charities comply with the *Income Tax Act* and with the rules that have been established for charities.

All charities must file an annual information return with the Charities Directorate. This form contains information about what the charity has done in the previous year as well as financial information. A copy of this return can be made available to any member of the public on request. The charity must also include a copy of its full financial statements with its return, but those statements are only made available to the public if the charity agrees.

The Charities Directorate conducts between 500 and 600 audits each year. An auditor visits the charity and reviews its books and records to ensure that the organization still complies

with the laws and procedures. Some organizations are selected at random for an audit; others are selected because of information the Charities Directorate has received or because it has decided to pay particular attention to a certain type of charity.

Some of these audits end with the Charities Directorate saying that no problems were uncovered. Most result in an education letter, telling the charity about problems that were found and identifying what should be done to correct them. In some cases, the Directorate will ask for an undertaking – a promise that the charity will correct the problems. In a very few cases, the Directorate looks to revoke a charity's registration for failing to comply with the law. In these cases, the Directorate writes the charity to give the reasons why it is proposing a revocation and invites the charity to address the concerns raised.

Under the law, the Charities Directorate cannot tell anyone other than the charity involved about an audit. It cannot even confirm whether an audit has taken place. However, if a charity's registration is revoked, the Directorate's letter setting out the reasons for the revocation is publicly available.

4.3.3 Sanctions

If a charity does not comply with the law, the Charities Directorate has only one penalty readily available to it – deregistration, removing the organization’s status as a registered charity. About 2,500 charities are deregistered each year. About 66% of those deregistrations are because the charity has not filed its annual return with the Charities Directorate. Another 30% are made at the charity’s request because it has decided to stop operating. In the last five years, very few have been deregistered “for cause” – for some serious violation of the rules governing charities.

4.3.4 Appeals

If an organization feels it has been unfairly denied charitable registration, or had its charitable registration revoked, it may ask the courts to overturn the decision. In that case, the organization takes an appeal to the Federal Court of Appeal. A panel of three judges hears arguments and considers the documents and information that the Charities Directorate used in coming to its decision. Some of this material comes from the application for registration, or from documents obtained during an audit. Other material is gathered by the Charities Directorate as a result of its own research. This is called an appeal “on the record.” There is no testimony by witnesses at the appeal.

A further appeal can be taken to the Supreme Court of Canada, if that court grants permission. These appeals help clarify the law about what is charitable in Canada. Since there is no legislated definition of charity, it is these court decisions that must be used by the Charities Directorate in considering future applications. Over the last 25 years, there has been an average of only one court decision on charity law each year. Decisions from provincial courts and courts in other countries can sometimes be helpful, but are not binding on the Charities Directorate.

4.4 Conclusions

In our review of institutional arrangements, we examined the situation in other countries (UK - England and Wales, the United States, and Canada). The following are the main findings:

- In a majority of the countries that we examined, revenue officials initially make the decision as to whether an organization is charitable. This approach is based on the assertion that revenue officials are non-partisan in their determinations of charity registrations and that the tax authority is in the best position to administer the system of tax deductibility, including determining which organizations are eligible for tax exemption. At this time, the only jurisdiction that has delegated authority to determine registration and deregistration issues to a separate agency, is England and Wales.
- The Charity Commission for England and Wales administers the *Charities Act*, which is not the functional equivalent of the *Income Tax Act*. The Act gives the Charity Commission for England and Wales jurisdiction over all matters concerning charities including regulatory powers that in Canada and USA fall under provincial jurisdiction, such as providing support and advice to ensure charities have good administrative practices and are effectively organized.
- In all countries studied, registration is a state responsibility but regulation is through the Income tax, which is a federal one. The main difference between the UK and USA / Canada institutional arrangement is that while in UK registration is done by the Charity Commission which concerns itself not only with the financial aspects but also the administrative aspects, modernizing the process of charity to keep abreast of the new developments, in the USA / Canada model, it is the Income tax department which has the main regulatory responsibility. It also has a narrower perspective.
- In all cases there is easy public access to data about charities, both through a Public Register, of charities and making it mandatory on a charity to supply information on demand.
- There are well-recognized and functioning systems for having grievances, for appeals against decisions, and graded sanctions for violation of laws.

Annexure 6

Charity Law Reform Process in UK

The Government of UK recognizing its role in creating an enabling environment by providing a sound legal and regulatory framework for the non-profit sector, launched a review of the existing legal and institutional framework in July 2001.

The Government of UK has already promoted support for the sector through the Compact on relations between government and voluntary organisations; tax changes to encourage charitable giving; initiatives on volunteering; and closer partnerships between central, local government and the sector on initiatives such as the National Strategy for Neighbourhood Renewal. Building on these reforms, the Government of UK has also undertaken three complementary reviews to help the sector achieve its full potential. These cover:

- The legal and regulatory framework for charities and the wider not-for-profit sector (led by the Strategy Unit, Government of UK);
- The role of the voluntary sector in public service delivery (led by HM Treasury as part of the 2002 Spending Review); and
- Improving access to public regeneration funding (led by the Regional Co-ordination Unit).

The Government published a report on the other reviews in September 2002 – ‘The Role of the Voluntary and Community Sector in Service Delivery’.

Objectives of the Review on Legal and Regulatory Framework

The review process considers how to improve the legal and regulatory framework to enable existing organisations to thrive, to encourage new types of organisations to develop, and to ensure public confidence.

The review sets out a package of proposals for reform which aim to:

- *Modernise charity law and status to provide greater clarity and a stronger emphasis on the delivery of public benefit;*

- Improve the range of available legal forms enabling organisations to be more effective and entrepreneurial;
- Develop greater accountability and transparency to build public trust and confidence; and
- Ensure independent, fair and proportionate regulation.

Main Recommendations:

The main recommendations are as stated below:

1. Modernising charity law

The law on charitable status is outdated and unclear. It excludes some types of organisation that clearly provide public benefit. This review proposes a number of legal reforms.

i) Updating and expanding the list of charitable purposes

A charity should be redefined as an organisation providing public benefit which has one or more of the following ten purposes:

1. The prevention and relief of poverty.
2. The advancement of education.
3. The advancement of religion.
4. The advancement of health.
5. Social and community advancement.
6. The advancement of culture, arts and heritage.
7. The advancement of amateur sport.
8. The promotion of human rights, conflict resolution and reconciliation.
9. The advancement of environmental protection and improvement.
10. Other purposes beneficial to the community.

ii) Requiring a clearer focus on public benefit

There should be a clearer focus on public benefit. In particular charities which charge large fees for their services, thereby excluding a substantial part of the population, will need to demonstrate how their activities have a public character.

It is recommended that the Charity Commission should have an on-going programme to review the public character of charities.

iii) Encouraging entrepreneurialism

Charities increasingly seek entrepreneurial ways to secure a sustainable income. This review proposes to provide greater freedoms by removing the requirement for trading charities to establish separate trading subsidiaries.

iv) Enabling charities to campaign

Charities perform a valuable role in campaigning for social change. The guidelines on campaigning should be revised to encourage charities to play this role to the fullest extent.

v) Cutting red tape.

Some legal obstacles inhibit charities from modernising their constitutions, merging with others, or using their endowments in different ways. A package of deregulatory measures have been proposed to give charities greater flexibilities.

2. Improving the range of legal forms available to charities and social enterprises

There are no corporate legal forms designed specifically for charities. Those available to social enterprises are often not well suited to their needs, because they neither protect assets nor offer a strong identity in which the public and funders can have confidence.

i) By creating Community Interest Companies

This review proposes a new legal form for social enterprise - the Community Interest Company. This would improve access to finance, create a strong new brand, be legally protected from demutualisation, and preserve assets and profits solely for social purposes.

ii) Modernising the law on Industrial and Provident Societies

The Industrial and Provident Society is an under-used form. It is recommended that this be strengthened and up-dated by enabling Societies

to opt for protection from demutualisation, and by renaming them as either Co-operatives or Community Benefit Societies.

iii) Introducing the Charitable Incorporated Organisation.

Many charities choose to incorporate as Companies Limited by Guarantee, but this legal form was not designed for charities and does not differentiate clearly the requirements of company law and charity law. Introducing the Charitable Incorporated Organisation, a new form specifically for charities, would remove these difficulties.

3. Developing greater accountability and transparency

Public trust and confidence enable charities and the wider sector to thrive and prosper. But for some there are few external pressures to improve performance. And accountabilities to beneficiaries and donors are unclear.

i) By improving information available to the public

In general the sector does not produce sufficiently accessible and relevant information to meet the public's needs. The review proposes higher standards of information provision, including a Standard Information Return in which larger charities will focus on their objectives and measure outcomes against these. It encourages benchmarking, social audit and other quality tools through sector-led initiatives with Government support.

ii) Regulating fundraising more effectively.

Fundraising is the public face of the sector and can strongly influence public attitudes. A simplified licensing system for public collections should be introduced. A new self-regulatory initiative, overseen by a new independent body, should be developed to promote good practice in fundraising.

4. Ensuring independent, open and proportionate regulation

The regulation of charities should aim to:

- Increase public trust and confidence;
- Ensure compliance with charity law;
- Enable and encourage charities to maximize their social and economic potential; and
- Enhance accountability to donors and beneficiaries.

i) By updating the rules on registration

Accountability for the smallest organisations is best ensured at the local level, but standard regulation can be excessive for the smallest organisations. There should be higher thresholds for registration with the Charity Commission, and a new status of “Small Charity” for those which are too small to register. Some large charities are currently not required to register with the Charity Commission. To achieve greater accountability for voluntary funds, these charities should be monitored for compliance with charity law by their existing sector regulator – or, where necessary, by the charity regulator.

ii) Giving the Charity Commission clearer goals and greater accountability

The Charity Commission regulates charities in England and Wales. The review proposes consolidating recent improvements in its performance and ensuring greater accountability through establishing:

Clear statutory objectives against which it regularly reports;

- Open public Board meetings and an Annual General Meeting;
- An enlarged Board to include a wider range of stakeholders;
- A new status as a statutory corporation called the Charity Regulation Authority;
- A new independent tribunal to enable trustees to challenge its decisions at reasonable cost; and
- Reports, carried out with sector participation, of performance in particular areas of charitable provision.

* * *