
Chapter 8

Local Bodies

8.1 Para 4(iii) of the terms of reference enjoins upon the Commission to make recommendations as to the following matter:

“the measures needed to augment the Consolidated Fund of a State to supplement the resources of the Panchayats and Municipalities in the State on the basis of the recommendations made by the Finance Commission of the State.”

This is a consolidated reproduction of the provisions contained in article 280(3)(bb) and (c) of the Constitution of India, as amended in 1993.

Approach of the Previous Commissions

8.2 For the first time, it was the Eleventh Finance Commission (EFC), which was required to suggest, as per its terms of reference (TOR), the measures to augment the consolidated fund of the states to enable them to supplement the resources of the local bodies. However, earlier, the Tenth Finance Commission had also made recommendations in this regard, as article 280 had been amended before the expiry of its term and the Commission felt that it was obliged to deal with the issue in terms of the amended article 280 even though it was

not included in its TOR. The Commission expressed the view that the measures to augment the consolidated funds of the states for supplementation of the resources of the panchayats and the municipalities need not necessarily involve transfer of resources from the centre to the states. It observed that once the state finance commissions (SFCs) completed their task, the central finance commission was duty bound to assess and build into the expenditure stream of the states, the funding requirements for supplementing resources of the panchayats and the municipalities. Measures needed for augmentation of the consolidated funds of the states could be determined accordingly. The transfer of duties and functions listed in the eleventh and twelfth schedules of the constitution would also involve concomitant transfers of staff and resources. Transfer of duties and functions should, therefore, not entail any extra financial burden. Nevertheless, the Commission recommended a grant of Rs.100 per capita of rural population as per the 1971 census for the panchayats and Rs.1,000 crore for the municipalities to be distributed amongst the states on the basis of the inter-state ratio of slum population derived from 1971 census. The state governments were required to prepare suitable schemes and

prepare detailed guidelines for the utilization of the grants. The local bodies were required to raise 'suitable' matching contributions for the purpose. No amount was to be used for expenditure on salaries and wages.

8.3 The TOR of the EFC clearly required it to make recommendations to augment the consolidated fund of the states to supplement the resources of local bodies on the basis of SFC recommendations. The EFC was, however, asked to make its own assessment, if the recommendations of the SFCs were not available, either because they had not been constituted or they were yet to submit their reports. In making its own assessment of the resources of the local bodies, the EFC was required to keep in view (i) the emoluments and terminal benefits of the employees of the local bodies including teachers; (ii) existing powers of these local bodies to raise financial resources; and (iii) powers, authority and responsibility transferred to the local bodies under articles 243G and 243W of the Constitution.

8.4 The EFC found itself unable to adopt the SFC reports as the basis for its recommendations because of:

- a) non-synchronization of the period of the recommendations of the SFCs and the central finance commission;
- b) lack of clarity in respect of the assignment of powers, authority and responsibilities of the local bodies;
- c) absence of a time frame within which the state governments are required to take action on the recommendations of the SFCs; and
- d) non-availability of the reports of the SFCs.

In view of these constraints, the EFC went so far as to recommend an amendment to the Constitution to delete the words "on the basis of the recommendations made by the Finance Commission of the State".

8.5 The EFC, while dealing with the issue of local body finances recommended a number of measures which could be taken by the state governments and the local bodies for augmenting the consolidated funds of the states to supplement the resources of panchayats and municipalities. These included assignment of land tax, profession tax and surcharge/cess on state taxes for improving the basic civic services and taking up schemes of social and economic development. Reforms had been recommended in respect of property tax/house tax, octroi/entry tax and user charges. The EFC observed that while assessing the revenue and expenditure of the states, it had already taken into account the additional burden falling on their financial resources due to implementation of the SFCs reports and no additional provision, therefore, need be made on this account. But, considering the fact that certain critical areas get overlooked in the normal flow of funds from the states, the EFC recommended *ad hoc* annual grant of Rs.1600 crore for panchayats and Rs.400 crore for municipalities and mandated certain activities such as maintenance of accounts, development of data base and audit to be the first charge on this grant. Amount remaining thereafter was to be utilized by the local bodies for maintenance of core civic services.

Views of the States

8.6 The memoranda received from the states are a mix of demands and suggestions.

Some of the major suggestions made by the states are as follows: (i) a formula based approach, need to be followed for grants from the central finance commission; which may include a minimum level of own revenue generation by the local bodies as one of the conditions; (ii) the *inter se* distribution should take into account the rural capital assets rather than the population; (iii) frequent occurrence of natural calamities should be taken into account; (iv) grants-in-aid should be provided to support an incentive fund for the panchayat samitis and zila parishads; (v) the system of grants should be linked to the level of reforms undertaken by the states; (vi) the central grants should be conditional upon the implementation of the SFC recommendations by the state government; (vii) funds should be made available to meet the revenue account gap, as estimated by the SFC, as also for upgradation of services; (viii) the divisible pool of central taxes should be expanded by 10 per cent for devolution to local bodies; (ix) central support is required to bridge the resource gap of local bodies for upgrading the infrastructure to provide services as per norms; (x) the Twelfth Finance Commission should follow the approach of the EFC and make an independent assessment of the resources required by the local bodies; (xi) an allocation of 5 per cent of the funds may be made for the newly created states; (xii) states, which have truly discharged their constitutional mandate in letter and spirit of the 73rd/74th amendment, should be rewarded; (xiii) 50 per cent of the transfers from the state government to the local bodies should be funded by the centre; (xiv) the transfers recommended by the SFC should be treated as committed expenditure

of the state government while reassessing the expenditure forecasts.

8.7 Some states have sought compensation for the loss of revenue on account of abolition of octroi. Grants have been sought for improving the training infrastructure and for continuing the efforts to streamline the data base and maintenance of accounts. Several states have suggested the withdrawal of the condition, which requires either the state government or the local bodies to provide matching contribution.

8.8 We have taken due note of these suggestions and kept them in view while arriving at the quantum of central grants that could be set apart for the purpose of supplementing the resources of the local bodies.

Views of the Ministry of Rural Development

8.9 The Ministry of Rural Development (MRD) has raised the following issues related to panchayati raj institutions (PRIs) in its memorandum:

- i) poor revenue efforts by the PRIs; their internal revenue mobilization (IRM) of the PRIs constituted only 4.17 per cent of their total revenue as per a study done on behalf of the EFC;
- ii) inefficiencies arising because of reluctance to charge fees, low rates thereof even when imposed and non revision for long periods;
- iii) state governments prescribing minimum and maximum rates of tax thereby encroaching into the financial autonomy of the PRIs;

- iv) lack of administrative machinery for collection of taxes;
- v) limited capacity of the people to pay taxes in the villages, especially in those affected by drought and other disasters;
- vi) inability of the central government to intervene in a substantial manner, local bodies being a state subject;
- vii) lack of synchronization in the award periods of the central finance commission and the SFCs;
- viii) part acceptance/implementation of SFC recommendations by state governments;
- ix) release of funds meant for panchayats to line departments which operate independent of panchayats;
- x) inability of the system to regularly collect, compile and monitor the status of panchayat finances;
- xi) lack of information on the initiatives that were taken by panchayats towards data base building for which funds were earmarked by EFC;
- xii) poor quality of the SFC reports;
- xiii) the casual manner in which SFCs are constituted.

8.10 MRD had initially suggested grants amounting to Rs.22,250 crore for the PRIs at the rate of Rs 300 per capita of the rural population as per 2001 census for 2005-10, as against Rs.8000 crore given by EFC for 2000-05. Subsequently, MRD submitted a supplementary memorandum wherein it recommended a grant of Rs 23468 crore at the rate of Rs.2 lakh per gram panchayat per annum mainly for

operation and maintenance (O&M) activities related to assets like water supply system, canal system, buildings, roads, drains etc. MRD expressed the view that if a decentralization index is to be used, it should comprise parameters which are simple, transparent and objective. It may include (i) constitution and functioning of district planning centres as required under article 243ZD; (ii) assignment of all the 29 functions given in eleventh schedule along with funds and all functionaries (iii) implementation of the SFC recommendations.

8.11 We received a memorandum from the Department of Drinking Water Supply (DDWS), Ministry of Rural Development regarding the requirements of the water supply and sanitation sector. Drinking water and sanitation are among the state subjects that can be entrusted to the panchayats under the eleventh schedule of the constitution. As per 2001 census, while 94.2 per cent of the rural inhabitants have access to potable drinking water with a norm of 40 litres per capita per day, only 22 per cent have basic sanitation facilities. Government of India has been supplementing the efforts of the states in the areas of drinking water supply and sanitation in villages through two centrally sponsored programmes namely, the Accelerated Rural Water Supply Programme (ARWSP) since 1972-73 and the Central Rural Sanitation Programme (CRSP) since 1986.

8.12 Looking at the gaps in the two sectors and the need to encourage PRIs to take over assets created in the past, DDWS suggested a grant of Rs.29,200 crore with the break-up as follows:

- (i) financial assistance to PRIs for major

repairs and replacement of existing water supply schemes – Rs 9000 crore;

- (ii) financial assistance to state government for repair/rejuvenation of existing rural water supply schemes – Rs 5200 crore;
- (iii) one-time incentive contribution to O&M fund of PRIs for new schemes to be transferred to them under Swajaldhara – Rs 1000 crore;
- (iv) creation of water quality monitoring and surveillance infrastructure in states- Rs 440 crore;
- (v) state share in water quality mitigation programme – Rs 1500 crore;
- (vi) completion of ongoing drinking water supply schemes - Rs 6700 crore;
- (vii) O&M cost of sanitation services – Rs 3600 crore;
- (viii) states' share in the Rural Sanitation Programme – Rs 1400 crore;
- (ix) capacity building of PRIs – Rs.350 crore;

Views of the Ministry of Urban Development and Poverty Alleviation

8.13 The Ministry of Urban Development and Poverty Alleviation (MUD&PA) has estimated a resource gap of Rs.76896 crore for all the states during the period 2005-10 in the matter of operation and maintenance of various civic services in urban areas. It has suggested that this gap should be bridged through a grant-in-aid by Twelfth Finance Commission (TFC).

8.14 MUD&PA has suggested the

following to improve the functioning of the urban local bodies:—

- i) it should be made obligatory for the state governments to take a final decision on the recommendations of the finance commission within a specified period preferably within 6 months;
- ii) urban local bodies should be assigned a separate list of taxes and any exemption from levy of property tax should be avoided. They should be adequately compensated if any exemption are given by the state government;
- iii) unproductive and non-viable taxes should be abolished and new sources of revenue should be explored;
- iv) urban local bodies should explore the possibility of issue of municipal bonds;
- v) the accounting procedure should be modernized and use of computer should be facilitated;
- vi) performance budgeting and social auditing should be introduced;
- vii) the cost of public utility services should be recovered by charging appropriate fees from the user of the services;
- viii) municipalities must progressively recover full costs covering operation and maintenance, billing and collection and capital;
- ix) inter-governmental transfers including share in state taxes and grants-in-aid should be formula based and not amenable to negotiation;

- x) borrowings can be one of the primary sources of capital funding for municipalities; and
- xi) grants given for development of infrastructure should be utilized to leverage additional financial resources.

8.15 In another memorandum, MUD&PA drew the Commission's attention to the deficiencies in urban waste management arising out of poor financial health of the urban local bodies and inadequacies in the solid waste management systems in the country. It has been stated that about 42 million tonnes of municipal solid waste is produced annually in urban India with a per capita generation varying between 0.2 to 0.6 kg per day. The waste generation is expected to grow at the rate of 5 per cent per annum. On an average, the urban local bodies spend about 60 to 70 per cent of their budget on this important activity. Following the outbreak of plague in 1994 in Surat and the intervention of the Supreme Court of India, detailed guidelines for municipal solid waste management (MSW) were issued and the Ministry of Environment and Forests notified rules for managing municipal solid waste, laying down deadlines for completion of various activities by the urban local bodies. Since adequate budgetary support has not been made available for this purpose during the Tenth Plan, MUD&PA has suggested devolution of sufficient funds by TFC to assist urban local bodies for solid waste management. According to the scheme prepared by MUD&PA, a total outlay of Rs.3763 crore at an average per capita cost of Rs.220 would be required for implementing it in 400 class I towns. The inter se allocation among the states has been

worked out on the basis of the urban population of the class – I towns, as per 2001 census. The scheme, however, focuses on funding of capital expenditure including the cost of construction of sanitary landfills and compost plants based on wastes. The capital cost of equipment and machinery required for collection, transportation and disposal and their replacement cost for five years are proposed to be provided to the urban local bodies as grants-in-aid.

8.16 The shortcomings of the present solid waste management systems in the urban local bodies extend well beyond the lack of capital infrastructure. Most of the urban local bodies are over-staffed and have to pay for a large, but idle workforce. A lot could be achieved by productively deploying the existing resources and making use of the available infrastructure. However, in view of obvious constraints in this regard, we expect the scheme to emphasize outsourcing of the services connected with the solid waste management in order to achieve efficiency gains. Investing in capital infrastructure without addressing the issue of labour productivity would turn out to be wasteful.

8.17 Composting and waste to energy initiatives would be economically viable in the private sector provided the municipalities can assure regular supply of solid waste (segregated, if necessary). The role of the municipalities should, therefore, be restricted to ensuring proper collection, segregation (if necessary) and transportation. If these activities are outsourced, there would be no need for the capital expenditure on machinery, equipments, etc. It is, therefore, necessary that the scheme for solid waste management provides for grants-in-aid to support the

minimum revenue expenditure (including cost of outsourcing) required to be incurred by the municipalities to ensure its success through public-private partnership.

Studies/Seminars sponsored by the TFC

8.18 The National Institute of Rural Development (NIRD) was commissioned to study the innovative/best practices being adopted by different states to augment the resources of the PRIs with a view to exploring the scope for their replication in others. The detailed study was confined to three major states viz., Kerala, Gujarat and Madhya Pradesh which in the opinion of NIRD exhibit some distinct features in the system of their PRIs. An attempt was also made to cull out important features of panchayati raj in other major states. The study reported that the obligatory/mandatory provisions of the 73rd amendment have largely been complied with by almost all the states.

8.19 In regard to replicating the best practices, the study suggested the following:

- i) levy of certain major taxes and exploitation of non-tax revenue sources be made obligatory for the panchayats. The minimum rates for all such levies be fixed by the state government;
- ii) a minimum revenue collection from the panchayat taxes be insisted;
- iii) incentive grants related to revenue collection beyond a prescribed minimum be introduced by the state government;
- iv) user charges be made obligatory levies;

- v) all common property resources vested in the village panchayats may be identified, listed and made productive of revenue;
- vi) valuation of taxable lands and buildings should be done by a separate cell in the panchayati raj department of the state government and not left to the panchayats;
- vii) powers to levy a tax/surcharge/cess on agricultural holdings should be given to the intermediate or district panchayats;
- viii) revenue transfers from the states to panchayats in the form of revenue sharing/revenue assignment be made statutory in nature;
- ix) state governments should desist from unilaterally taking decisions in regard to revenues whose proceeds are to be transferred either in full or in part to the panchayats;
- x) the quantum of revenue that a panchayat can reasonably expect under the revenue sharing mechanism should be predictable;
- xi) state government should adhere to its commitment in regard to the grants-in-aid; all untied grants to the panchayats should be made statutory in nature;
- xii) SFC should be constituted for a lifespan of 18 months and a time limit of six months be prescribed for a state government to act on the SFC recommendations;
- xiii) the maintenance of accounts by the panchayats be standardized;

panchayat department officials should not be made statutory auditors of the village panchayats; the accounts of the intermediate and district panchayats be subjected to audit by Comptroller and Auditor General (C&AG);

- xiv) a performance audit system be adopted.

We are in broad agreement with these recommendations and commend them for adoption by the state governments.

8.20 The NIRD was also asked to study the recommendations of the SFCs with a view to assessing their impact on state finances so that the required augmentation of the consolidated fund could be known. The findings of the study are summarized below:

- (i) states have not made any progress in mobilizing additional resources exclusively for supplementing the resources of panchayats;
- (ii) together with village panchayats, the intermediate and district panchayats have been granted some revenue powers;
- (iii) the data deficiencies observed four years ago have not been corrected by the states as yet;
- (iv) the size of the own resources of the panchayats are extremely limited in relation to their needs. During 1990-91 to 1997-98, the internal revenue mobilization (IRM) of the panchayats at all levels in 23 states constituted 4.17 per cent of the total revenue. In Bihar, Rajasthan, Manipur and Sikkim there was virtually no IRM. The annual per capita IRM of the panchayats in some states was only around Rs.8;
- (v) there has been a phenomenal dependence of panchayats on revenue transfer from both the Union and the state governments. In 1997-98, the panchayats mobilized 0.04 per cent of the GDP and incurred an expenditure of 1.38 per cent of GDP;
- (vi) assistance to the panchayats from the state government takes the form of revenue sharing, revenue assignments and grants-in-aid. State government grants account for not less than 80 per cent of the total resources of the panchayats, but most of them are tied grants. The system of grants has not been rationalized in many states and the quantum to be made available is often not predictable;
- (vii) in some states, there were delays in constituting the second SFC whereas in others the second SFC was not constituted at all. Only 19 states constituted the second SFC, of which 10 had submitted their reports. Of these, only six have been laid before the state legislature along with action taken report;
- (viii) with regard to implementation of the SFC reports which were accepted, the following issues were highlighted:-
 - a) several states did not take follow up action in terms of legislative/administrative measures;
 - b) recommendations marked

- “under examination” met with “natural death”;
- c) very few states have honoured their commitment for the release of additional resources against these recommendations;
 - d) budgetary provisions regarding these recommendations have “fallen short”.

The study has admitted that it could not succeed in assessing the net additional resource flow from the states to the panchayats consequent to the implementation of the SFC recommendation.

8.21 The National Institute of Public Finance and Policy (NIPFP) was commissioned to undertake similar studies in respect of urban local bodies. The NIPFP conducted the study in respect of 23 states. The study observed that municipal finance statistics were fragile and posed problems in interpreting the data. It noted that the size of municipal sector, measured in terms of what the municipalities raised and spent was 1 per cent of GDP with large inter-state disparities. Performance of municipalities on revenue mobilization and spending levels varied across states. States with high per-capita income were also the ones taking major reform initiatives and were better performing. Transfers constituted an important source of municipal revenue, but were just 3.8 per cent of states’ own resources.

8.22 A study was commissioned on “Management of Solid Waste in Indian Cities”. The report submitted by the Infrastructure Professional Enterprises (IPE) brought out some of the best practices

followed in India as well as around the world. It also listed certain technology options available to convert waste into compost or energy in India and abroad. The IPE worked out the costs for integrated solid waste disposal relating to one sample city, Burdwan (West Bengal). While conducting another study on the costs of provision of sewerage, waste water treatment and drainage, IPE selected five towns of different size classes of population. The case study took into account the urban infrastructure available as well as the coverage of population and worked out the per capita cost in respect of sewerage, waste water treatment and drainage separately. The gaps were estimated separately on each item to arrive at the overall gap. The estimates so provided could at best be a benchmark for a particular class of town. The actual requirement of funds would depend on the availability of infrastructure and population size of each town and need to be estimated independently.

8.23 The task of looking into the qualitative and quantitative measures needed to augment the consolidated funds of the states for supplementing the resources of local bodies based on the recommendations of the SFC reports was assigned to an expert. The focus of the study was the areas that required action on the part of the central government. The report estimated the uncovered gap of the local bodies at Rs.74,000 crores over a five year period. Some of the measures suggested by the SFCs which require action on the part of the central government were listed. These are the following:

- (i) raising the ceiling on the professional tax;

- (ii) enhancement of rates of royalty on mineral resources;
- (iii) constitutional amendment for empowering states/local bodies to levy service taxes;
- (iv) transferring centrally sponsored schemes along with funds and functionaries to the state government/local bodies;
- (v) continuation of fiscal reforms incentive scheme;
- (vi) review of Gadgil formula to enhance the ratio of grants in the plan transfers from the centre to the non-special category states, with a view to reducing their burden of interest payments;
- (vii) writing off old debts of the state governments to the central government, to enable such states to make a clean start while embarking upon fiscal reforms;
- (viii) larger weight to be given by the TFC in its devolution formula to factors like;
 - (a) extent of functional and fiscal decentralization;
 - (b) backwardness of states; and
 - (c) incentive for tax efforts;
- (ix) possibility of setting up of Municipal Finance Corporation and Panchayat Finance Corporation through direct funding by the central government or through merger of existing financial institutions at the central/ state level.

We have commented on these issues at different places in our report and hope that the central government will take due note of our views while formulating or revising various policy measures. In particular, we endorse the suggestion for raising the ceiling on professional tax.

8.24 In order to understand the precise role of the central finance commission in the light of the constitutional provisions and to gain an insight into the felt needs of the third tier of the government, the TFC sponsored two seminars, one for urban local bodies and the other for the PRIs, organized by the Indian Institute of Public Administration (IIPA) and the NIRD respectively. A list of the speakers and the papers presented by them is placed at annexure 8.1. Some of the views expressed in the seminars were as follows:

- (i) PRIs can realize higher taxes provided they improve administrative capacities by correct evaluation of tax base, cutting out exemptions etc. Financial needs of panchayats far outweigh the resources at their disposal;
- (ii) the transfers from the TFC should be linked to effective fiscal decentralization, meaning thereby transfer of administrative and financial powers to PRIs by states;
- (iii) measures for restructuring of public finances would be complete only if the third tier of the government is also taken into account;
- (iv) the phrase “on the basis of recommendations by SFCs” in the terms of reference of the TFC should be replaced by “after considering the

recommendations of SFCs”;

- (v) there is a crucial need for incentivising local revenue collection. The revenue potential of the panchayats can be assessed using secondary sources such as SDP from non plantation agriculture sector ;
- (vi) the only cost-effective way to incentivise revenue collection is to have a system of norm-based closed-ended grants from the state governments, where allocations for a panchayat are made after deducting baseline calculations of local revenue potential;
- (vii) the initial fixation of the total kitty for distribution to the local bodies should be made on the basis of a decentralization target based on local expenditure as a percent of total government expenditure, instead of an arbitrary per capita allocation for the local bodies. This should be met from central tax sharing; in the global revenue sharing for devolution to the states, the share of the local bodies should be decided simultaneously;
- (viii) there should be a ‘Local List’ in the Constitution covering both local functions and taxes;
- (ix) the centre and state transfers should be transparent and predictable with rewards for better performances;
- (x) resources should flow to the local governments as a matter of right rather than a concession or a consideration.

Data collected by the Commission

8.25 The Commission collected detailed information from each state in respect of local bodies in five schedules which are placed at annexure 8.2 to 8.6. The states were requested to send notes on the following topics with a view to assessing the requirement of each state for augmentation of their consolidated fund in the light of the SFC reports:

- I. status of setting up of SFCs – award periods of SFCs – principles laid down by SFCs for assignment of taxes/devolution/grants-in-aid to PRIs and ULBs – implementation of SFC recommendations – recommendation not accepted-reasons therefor;
- II. details of transfers made to PRIs/ULBs before the setting up of SFCs - growth rate of such transfers – amounts recommended by SFCs under different categories of transfers (such as assignments of taxes, devolution, grants-in-aid) – actual transfers effected –difference between the projected amount for each year based on the average growth rate (in the previous five years) and amounts recommended by SFCs for the same functional responsibilities;
- III. details of additional functional responsibilities assigned to PRIs/ULBs consequent on 73rd/74th amendment-expenditure incurred by state government on the functions before such transfers –growth rate of such expenditure in five years before such transfer-resources transferred to PRIs /ULBs to carry out additional responsibilities – transfer of man

- power from the state to PRIs/ULBs for such functions/ adequacy of transfer of resources compared to responsibilities – approach of SFCs on the issue – recommendations by SFCs – financial implications thereof for the state government;
- IV. the impact on the consolidated fund of the state on account of implementation of SFC recommendations - details of recommendations –annual financial implication of accepting each of the recommendations – efforts made to raise revenues to meet the additional requirement – results thereof;
- V. status of implementation of EFC recommendations – efforts made to raise resources of local bodies for pursuance and results thereof-utilization of grants recommended by EFC-arrangements for maintenance of accounts of village level panchayats and intermediate level panchayats-creation of data base relating to the finances of local bodies-arrangements made for audit of panchayat and urban local bodies and status thereof;
- VI. market borrowing by local bodies-whether permitted – if so, borrowings and outstanding liabilities during the last five years may be furnished.

It was expected that there would be a system of collection and compilation of such information at the state headquarters not only for the purpose of monitoring by the state government but also for the use of the SFCs and, therefore, the information would

be updated and made available within a reasonable time. However, even after considerable persuasion, the response received from different states, barring a few exceptions was found to be rather sketchy. The data furnished by the states did not facilitate quantification of the required augmentation of the consolidated fund on the basis of the SFC recommendations. Information could, however, be compiled regarding (a) the number of rural and urban local bodies at different tiers in each state, and (b) the details of own revenues and transfers from the states to their local bodies. These have been placed at annexures 8.7 to 8.9. These data show that the share of own revenues of the panchayats (all tiers) was 6.40 per cent of their total revenues for the period 1998-99 to 2002-03 which is a definite improvement over 4.17 percent estimated for the period 1990-91 to 1997-98 but is still low.

8.26 The EFC had set apart Rs.200 crore for creation of data base relating to the finances of local bodies and Rs. 98.61 crore per annum for maintenance of accounts of village and intermediate level panchayats. It was recommended that a database on the finances of the panchayats and municipalities should be developed at the district, state and central government levels and be easily accessible by computerising it and linking it through V-SAT. The authority prescribed for conducting the audit of accounts of the local bodies was to be made responsible for this task and the data were to be collected and compiled in standard formats, prescribed by the C&AG. This would have facilitated comparison of performance and state of development of local bodies among the states.

8.27 The progress in respect of implementation of the EFC recommendations relating to accounts, as reported by the C&AG, is as under:

- i. Entrustment of technical guidance and supervision (TGS) over proper maintenance of accounts and audit of all 3 tiers of PRIs and ULBs to C&AG of India** – As of now, 19 states have entrusted the TGS over local bodies to the C&AG. Leaving out the states where the 73rd & 74th amendments are not applicable, five major states viz. Punjab, Haryana, Andhra Pradesh, Gujarat and Arunachal Pradesh have not yet implemented this recommendation;
- ii. Documents prescribed by C&AG for providing TGS** – The C&AG has prescribed auditing standards for PRIs and ULBs, guidelines for certification audit of the account of PRIs, budget and accounts formats for PRIs and ULBs and list of codes for programmes, functions and activities for PRIs;
- iii. Acceptance of Budget and Accounts formats for PRIs and ULBs** – 18 states have agreed to accept the formats prescribed for PRIs and 6 states of Bihar, Tamil Nadu, Himachal Pradesh, Uttar Pradesh, Kerala and Orissa have issued formal orders in this regard. For ULBs, the report of the task force set up by C&AG for devising the budget and accounts formats has been accepted by all states for uniform implementation;

- iv. Arrears in accounts maintenances** – As per the guidelines issued by the Ministry of Finance, the C&AG has to lay down the qualifications and experience for the person/agency to whom the work of maintenance of accounts wherever in arrears, could be awarded. Accordingly, the C&AG has approved the parameters for engaging the outside agencies in the states of Bihar, Tamil Nadu, Kerala and Rajasthan based on the request from the state government. The Accountants General concerned are in touch with the remaining state governments to assess the extent of arrears and send proposals accordingly;
- v. Capacity Building, Training Initiative by C&AG** – Comprehensive training programmes to upgrade the skills of the staff of local fund audit department and PRIs in the states are being conducted by the C&AG through the Institute of Public Auditors of India as nodal agency. This training is to be provided in two phases wherein the first phase would be the training of trainers and in the second phase, these trainers would impart training to the remaining staff. The first phase which is being funded by the C&AG has been completed in 9 states of Bihar, Uttar Pradesh, Orissa, Chhatisgarh, Uttaranchal, Assam, Kerala, Himachal Pradesh and Gujarat. It is being taken up in the remaining states;
- vi. Creation of Central Database on Finances of Local Bodies** – The C&AG has formulated draft standard

formats for creation of a networked database on finances of PRIs at the district and state levels. As of now, 10 states have agreed to adopt of the formats and 7 states have initiated action to set up the infrastructure for collection, transmission and maintenance of the database.

It is hoped that these initiatives would make further progress and in future, it would be possible for the state to make the data required by the central finance commission available on a certified basis.

Role of the State Finance Commissions

8.28 In terms of articles 243(I) and 243(Y) of the Constitution, the state finance commissions are to recommend (a) the principles that should govern the distribution between the state on the one hand and the local bodies on the other of the net proceeds of taxes etc. leviable by the state and the inter-se allocation between different panchayats and municipalities; (b) the determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by the local bodies; and (c) grants in aid from the consolidated fund of the state to the local bodies. The SFCs are also required to suggest measures needed to improve the financial position of the panchayats and the municipalities. We have collected information regarding the number of SFCs set up by different states in pursuance of their constitutional obligation, the status of submission of reports by the SFCs and the action taken by the state governments thereon. We are placing the information at annexure 8.10.

8.29 The importance of the SFCs in the scheme of fiscal decentralization is that

besides arbitrating on the claims to resources by the state government and the local bodies, their recommendations would impart greater stability and predictability to the transfer mechanism. The convention established at the national level of accepting the principal recommendations of the finance commission without modification, however, is not being followed in the states. Often, even the accepted recommendations are not fully implemented, citing resource constraints and this defeats the very purpose of constituting the SFCs. This situation needs a change.

8.30 If the SFCs follow the procedure adopted by the central finance commission for transfer of resources from the centre to the states, their reports would contain an estimation and analysis of the finances of the state government as well as the local bodies at the pre and post transfer stages along with a quantification of the revenues that could be generated additionally by the local bodies by adopting the measures recommended therein. The gaps that may still remain would then constitute the basis for the measures to be recommended by the central finance commission.

8.31 While estimating the resource gap, the SFCs should follow a normative approach in the assessment of revenues and expenditure rather than make forecasts based on historical trends. Per capita norms for revenue generation must take into account the data relating to the tax bases and the avenues for raising non tax income by the municipalities and the panchayats, assuming reasonable buoyancies and the scope for additional resource mobilization. Per capita expenditure norms could be evolved on the basis of the average

expenditure incurred by some of the best performing municipalities and panchayats in the provision of core services. The gap between the aggregate revenue and the aggregate expenditure calculated in this manner, after adjusting for the resource transfers recommended by the SFC, will provide the basis for the approach of the central finance commission.

8.32 A careful scrutiny of the SFC reports reveals that few SFCs have followed this approach. This has made it impossible for us to adopt the reports as the basis for our recommendations. We strongly recommend that in future, all SFCs including those which are already set up but are yet to submit their recommendations, follow the above procedure so as to enable the central finance commission to do full justice to its constitutional mandate.

8.33 To make this possible, it is necessary that the states constitute SFCs with people of eminence and competence, instead of viewing the formation of SFCs as a mere constitutional formality. We find that most states are yet to appreciate the importance of this institution in terms of its potential to carry the process of democratic decentralization further and evolve competencies at the cutting edge level by strengthening the PRIs and the municipalities. The delays in the constitution of the SFCs, their constitution in phases, frequent reconstitution, the qualification of the persons chosen, delayed submission of reports and delayed tabling of the action taken report (ATR) in the legislature have in many cases defeated the very purpose of this institution. This cannot, but, be a matter of concern for the central finance commission, which has to adopt their reports

as the basis for its recommendations.

8.34 In the matter of composition of the SFCs, states may be well advised to follow the central legislation and rules which prescribe the qualifications for the chairperson and members and frame similar rules. It is important that experts are drawn from specific disciplines such as economics, public finance, public administration and law. In order that the concerns of both rural and urban local bodies are adequately addressed, it is suggested that at least one member with specialization and/or experience in matters relating to the PRIs and another similarly well versed in municipal affairs must be appointed in the SFC. The number of members including the chairperson may not exceed five excluding a serving officer who may act as the secretary. Since the SFCs are temporary bodies and dedicated efforts are called for to discharge their functions within the time limit, all members and chairman should be full time. Frequent reconstitution of the SFCs should be avoided, as it disturbs the continuity of approach and thought. The main reason for reconstitution appears to be the routine transfers of serving officials. This situation will not arise if the SFC comprises non official experts.

8.35 The compilation of disaggregated data in the formats suggested by C&AG in a time series is the need of the hour for the SFCs to be able to assess the income and expenditure requirements of the local bodies. Both the EFC as well as this Commission were hampered by the absence of credible data. It is with a view to overcome this problem that the EFC had made provision for the creation and maintenance of data as well as for an

improvement in the accounting standards. We are happy to note that the formats prescribed by the C&AG have been accepted by most states and hope that the remaining states will also follow suit. As the collection and collation of data would need to be done constantly and data would need to be made available to the SFC as and when it is constituted, it may be desirable to set up a permanent SFC cell in the finance department of each state. This cell may be headed by a secretary level officer, who will also function as secretary of the SFC, as and when constituted.

8.36 The other issues are the time span to be prescribed for the setting up of a new SFC, the time allowed for submission of its report, the time limits for ATR and synchronization of its award period with that of the central finance commission. The time taken by the SFCs to submit their reports ranges from less than three months to more than three years. There are also instances of a state abandoning the first SFC without receiving a report and setting up the second SFC. The problem with the delayed submission of reports is that quite often the time period for which they are to make recommendations passes out. It is desirable that SFCs are constituted at least two years before the required date of submission of their recommendations, and the deadline should be so decided as to allow the state government at least three months' time for tabling the ATR, preferably along with the budget for the ensuing financial year. Synchronization of the award periods of the SFC with the central finance commission does not mean that they should be co-terminus. What is necessary is that the SFC reports should be readily available to the central finance commission, when the latter

is constituted so that an assessment of the state's need could be made by the central finance commission on the basis of uniform principles. This requires that these reports should not be too dated. As the periodicity of constitution of the central finance commission is predictable, the states should time the constitution of their SFCs suitably. In order to fulfill the overall objective, the procedure and the time limits would need to be built into the relevant legislation.

Role of the Central Finance Commission

8.37 An attempt was made to understand fully the scope of the constitutional provisions requiring the central finance commission to recommend measures for the augmentation of the consolidated fund of the states. Although the dominant view that emerged from the papers presented in the seminars and the meetings held with the state governments, was that these are meant only to be a mechanism for additional resource transfers from the centre to the states, we feel that there may be more to it than this. To us the purport of the relevant provision of the Constitution appears to be two-fold:- (a) there may be a case to augment the consolidated fund of the states through additional grants from the centre keeping in view the special circumstances of the states, which may justify such assistance; and (b) certain recommendations of the SFCs for augmenting the revenues of the state may require decision making by the central government as they may have centre-state and/or inter-state ramifications. The central government may benefit from the expert advice of the central finance commission, while acting on the issues taken up by the

state governments with the centre on the basis of such SFC recommendations. For example, the centre can act in respect of matters such as (a) revision of the rates of taxes/duties wherever the proceeds of such taxes/duties are to be appropriated by or assigned to the state; the stamp duty and duties of excise on medicinal and toilet preparations under article 268 and the central sales tax under article 269 fall in this category; (b) revision of rates for certain categories of non-tax revenues, which are determined by the central government, such as the royalty from minerals wherever a part of such revenues have been recommended to be shared with the local bodies; (c) issues concerning central public sector undertakings, railways etc. including the property and other local taxes payable by them, return of land in their possession in excess of requirement etc.; and (d) upward revision of ceiling on profession tax requiring a constitutional amendment. These are but an illustrative list of issues which do require central intervention and where the decisions of the central government would influence the flows into the consolidated fund of a state. Measures that a central finance commission may choose to recommend on these and other issues of a similar nature after taking into account the views of the SFCs would, therefore, be a substantial fulfillment of its constitutional mandate. In view of this, we recommend that in future, the SFCs must clearly identify the issues which require action on the part of the central government to augment the consolidated fund of the state and list them out in a separate chapter for the consideration of the central finance commission.

Recommendations

8.38 Keeping in view the spirit of the 73rd and 74th amendments and the clear need to provide an impetus to the decentralization process, we have decided to recommend a sum of Rs.25000 crore for the period 2005-10 as grants-in-aid to augment the consolidated fund of the states to supplement the resources of the municipalities and the panchayats. This will be equivalent to 1.24 per cent of the sharable tax revenues and 0.9 per cent of gross revenue receipts of the centre as estimated by us during the period 2005-10.

8.39 The EFC had recommended that the division of the grants in aid should be in the ratio 80:20 for the panchayats and the municipalities respectively. It was reasoned that the urban local bodies had a greater access to tax and non-tax resources of their own and, therefore, it is the PRIs which require substantial support. The urban population of 28 states as per 2001 census is 26.8 per cent. We have separately recommended grants for maintenance of roads and buildings which include the roads maintained by the local bodies. The municipalities will be major beneficiaries of these grants. Looking at the capacity as well as the need to encourage the municipalities to augment their own revenues, a share at 20 per cent, appears to be in order. We accordingly recommend that the amount of Rs.25000 crore may be divided between the panchayats and the municipalities in the ratio of 80:20. The amounts of Rs.20,000 crore for the PRIs and Rs.5,000 crore for the municipalities thus worked out, are a substantial increase over the levels recommended by the previous commissions and will go a long way in improving the standards of civic services

performed by the local governments.

8.40 We would like the grants for the PRIs to be utilized to improve the service delivery by the panchayats in respect of water supply and sanitation. We have been informed that an amount of over Rs.45,000 crore has been invested in the rural water supply schemes over several years. The schemes being taken up under Swajaldhara are provided a grant of 10 per cent of capital costs as incentive for the O&M along with a matching contribution by the state government after it is run successfully for 12 months. There is no provision for O&M for the schemes completed previously. The panchayats need to be encouraged to take over and maintain all such schemes. Some of the existing schemes may require special repairs to make them fully functional. The PRIs may take over the assets and utilize these grants for repairs/rejuvenation and maintenance to make them fully operational. Even after this, the PRIs may not be able to bear the entire cost of O&M of water supply for an initial period of five years. They should, however, recover at least 50 per cent of the recurring costs in the form of user charges.

8.41 The Department of Drinking Water Supply has informed us that panchayats do not get any financial assistance under the total sanitation campaign (TCS) for disposal of solid waste, cleaning of drains etc., until there is basic sanitation coverage. Once they achieve basic sanitation coverage, they qualify for the Nirmal Gram Puraskar ranging from Rs.2 lakh to 4 lakh depending on their population. Till such time as they qualify they could be provided assistance to maintain environmental sanitation for a hand holding period of five years. Against this background we recommend that of the

grants in aid allocated by us for the PRIs in each state, priority should be given to expenditure on the O&M costs of water supply and sanitation. This will facilitate panchayats to take over the schemes and operate them.

8.42 In the case of the urban local bodies, we have already stressed the importance of public-private partnership to enhance the service delivery in respect of solid waste management. The municipalities should concentrate on collection, segregation and transportation of solid waste. State governments may require the municipalities of towns of population over 100,000 by 2001 census to prepare a comprehensive scheme including composting and waste to energy programmes to be undertaken in the private sector for appropriate funding from the grants in aid recommended by us. Grants-in-aid shall, however, be available to support the cost of collection, segregation and transportation only, as the activities to be taken up by the private sector should be commercially viable once the municipality is able to discharge its role effectively. We suggest that at least 50 per cent of the grants provided to each state for the urban local bodies should be earmarked for these schemes. The six mega cities of Delhi, Mumbai, Kolkata, Chennai, Bangalore and Hyderabad may be excluded for the purpose of grants-in-aid, as it should be possible for them to generate their own resources for this important service.

8.43 The EFC allocated Rs.200 crore for creation of database by local bodies, but only Rs.93 crore could be utilized, as per information received from the Ministry of Finance. Out of the allocation of Rs.483 crore for maintenance of accounts, only Rs.113 crore was utilized. The total

utilization has, thus, been hardly 30 per cent of the allocation. While the reasons for such gross under utilization are far from clear, there is no doubt that the data quality at the grass-roots level is poor. Most states do not have accurate information on the finances of their local bodies. A proper accounting system has to be put in place at the grass-roots level to facilitate realistic assessment of the needs of the panchayats and municipalities for basic civic and developmental functions. Resource gap estimation for core services is central to the process of a fiscal transfer that would encourage equalization. The absence of data necessary for a rational determination of the gap between the cost of service delivery and the capacity to raise resources makes the task of recommending measures for achieving equalization of services almost impossible. It is, therefore, imperative that high priority should be accorded to creation of database and maintenance of accounts at the grass-roots level. Some of the modern methods like GIS (Geographic Information Systems) for mapping of properties in urban areas and computerization for switching over to a modern system of financial management would go a long way in creating strong local governments, fulfilling the spirit of the 73rd and 74th constitutional amendments. It is, therefore, recommended that besides expenditure on the O & M costs of water supply and sanitation in rural areas and on the schemes of solid waste management in urban areas, as indicated in paras 8.41 and 8.42 above, PRIs and municipalities should give high priority to expenditure on creation of database and maintenance of accounts through the use of modern technology and management systems, wherever possible. In the absence of credible costing data, we refrain from

making specific allocation for individual items of expenditure and leave it to the states to assess the requirement of each local body on the basis of the principles stated above and earmark funds accordingly out of the total allocation recommended by us.

8.44 As for the *inter se* allocation of the grants in aid among the states, the EFC had adopted the following factors and weights for working out the inter-se allocation of the grants-in-aid among the states:

<u>Criterion</u>	<u>Weight (per cent)</u>
I. Population	40
II. Geographical area	10
III. Distance from highest per capita income	20
IV. Index of decentralization	20
V. Revenue effort	10

We note that the criteria of population and geographical area being neutral meet general acceptance. We have, therefore, decided to retain the weights recommended by the EFC for these two factors. We have used population as per 2001 census for this purpose. We have also decided to retain the criteria of 'distance from the highest per capita income' as evolved by the EFC with a weight of 20 per cent. We have used the average per capita GSDP from primary sector (at comparable prices) derived on the basis of the GSDP figures supplied by the CSO for the years 1999-2000, 2000-01 and 2001-02. The population figures were interpolated/projected for these three years on the basis of census data on rural population for the year 1991 and 2001. The interpolation/projection have been made on the basis of exponential growth in population between 1991 and 2001. Since state wise rural/urban population estimates

were not available based on the census 2001 results, these were first derived for the calendar year and thereafter interpolated for the financial years 1999-00, 2000-01 and 2001-02. The distance of each state was measured from the state with the highest average per capita GSDP, plus half of the standard deviation. The distances were then weighted by the rural population (2001) of the respective state to arrive at its share for the panchayats.

8.45 In the case of the urban local bodies, we have used the average per capita GSDP excluding primary sector (at comparable prices) on the basis of the GSDP data supplied by the CSO and the population figures interpolated/projected for three years; viz. 1999-00, 2000-01 and 2001-02 based on 1991 and 2001 census data on urban population. The distance of each state was measured from the state with the highest average per capita GSDP, plus half of the standard deviation. The distances were then weighted by the urban population (2001) of the respective state to arrive at its share.

8.46 We have in addition attempted to construct an index of deprivation to take into account intra-state disparities on the basis of data relating to certain minimum needs of the population. Drinking water and sanitation are the two core services performed by the local bodies, both rural and urban. State-wise census 2001 data are available with a break up between rural and urban areas regarding the number of households fetching water from a distance (over 100 metres in the case of urban and 500 metres in the case of rural households), households with no latrines within the house premises and households with no drainage facilities for flow of waste water. These have

been used to construct this index. The formula used is $D.I = 0.5x + 0.25(y+z)$ where D.I is the Deprivation Index, x is the percentage of households fetching water from a distance, y is the percentage of households without latrines and z, the percentage of households without drainage. The distance from the minimum deprived state was then weighted by the census 2001 population for rural and urban areas to derive the state-wise share. A standard deviation of 0.5 has been allowed so as to enable the least deprived state also to get a share. We assign a weight of 10 per cent to this criterion.

8.47 The EFC had selected the following 10 parameters for the purpose of arriving at the index of decentralization: -

- (i) enactment/amendment of the state/panchayats/municipal legislation;
- (ii) intervention/restriction in the functioning of the local bodies;
- (iii) assignment of functions to the local bodies by state legislation;
- (iv) actual transfer of functions to these bodies by way of rules, notification and orders;
- (v) assignment of power of taxation to the local bodies;
- (vi) extent of exercise of taxation powers;
- (vii) constitution of the SFCs and the submission of action taken on their reports;
- (viii) action taken on the major recommendations of the SFC;
- (ix) elections to the local bodies; and

- (x) constitution of the district planning committees as per the letter and spirit of article 243ZD.

Considering that almost all states have by now taken effective steps for the implementation of the 73rd and 74th amendments and have enacted legislations, held elections, constituted the state finance commissions and taken action on their reports, most of the factors mentioned above may not be of much relevance in the present context. We have decided to drop this criterion in this form.

8.48 In order to assess the 'revenue effort', the EFC had linked the ratio of own revenues of the local bodies to the state's own revenue and the SDP separately and assigning a 5 per cent weight to each. While in the case of panchayats, the SDP from primary sector excluding mining & quarrying was taken into account, in the case of municipalities the SDP net of primary sector was taken as the basis. These were suitably weighted by the rural and urban population as the case may be. We have decided to modify this criterion by including the mining and quarrying in case of panchayats, with a weight of 10 per cent to each of the elements. The period taken was 2000-01 to 2002-03 in the case of the own revenues of local bodies related to states own revenue and 1999-2000 to 2001-02 in case of own revenues of local bodies related to SDP. Since the newly created states of Jharkhand, Uttaranchal and Chattisgarh were created in November 2000, the fiscal data relating to states own revenue were available from November only. In view of this, the data relating to 2001-02 and 2002-03 only were taken to compute revenue efforts of local bodies vis-à-vis state's own resources in respect of the

states of Bihar, Jharkhand, Chattisgarh, Madhya Pradesh, Uttar Pradesh and Uttaranchal. This approach had to be followed for the residual states of Bihar, Uttar Pradesh and Madhya Pradesh, as the data for 2000-01 were a combination of composite state till November and the divided states after November, 2000. The significance of the ratio of own resources of local bodies to states own revenues is that it also serves as a proxy of revenue decentralization.

8.49 The criteria used for inter-se allocation of grants are summarized below:

<u>Criterion</u>	<u>Weight (per cent)</u>
i) Population	40
ii) Geographical area	10
iii) Distance from highest per capita income	20
iv) Index of deprivation	10
v) Revenue effort	20
<i>of which</i> (a) with respect to own revenue of states	10
(b) with respect to GSDP	10

The shares of the states derived on the basis of the above criteria were rounded off to the nearest whole number in rupees crore. The results of this exercise in terms of state-wise allocation of the grants in aid are given in Table 8.1. The amounts to be released annually to each state for panchayats and municipalities are given in annexures 8.17 and 8.18 respectively.

The data used in respect of each of the factors and the pro rata shares of each state under each of the indicators are shown in annexures 8.11 to 8.18.

8.50 The issue of exclusion of certain areas from the provision of the 73rd and 74th

Table 8.1
Shares of States in Allocation (2005-10)

Sl.No	State	Panchayats		Municipalities	
		Per cent	(Rs Crore)	Per cent	(Rs Crore)
1.	Andhra Pradesh	7.935	1587	7.480	374
2.	Arunachal Pradesh	0.340	68	0.060	3
3.	Assam	2.630	526	1.100	55
4.	Bihar	8.120	1624	2.840	142
5.	Chhattisgarh	3.075	615	1.760	88
6.	Goa	0.090	18	0.240	12
7.	Gujarat	4.655	931	8.280	414
8.	Haryana	1.940	388	1.820	91
9.	Himachal Pradesh	0.735	147	0.160	8
10.	Jammu & Kashmir	1.405	281	0.760	38
11.	Jharkhand	2.410	482	1.960	98
12.	Karnataka	4.440	888	6.460	323
13.	Kerala	4.925	985	2.980	149
14.	Madhya Pradesh	8.315	1663	7.220	361
15.	Maharashtra	9.915	1983	15.820	791
16.	Manipur	0.230	46	0.180	9
17.	Meghalaya	0.250	50	0.160	8
18.	Mizoram	0.100	20	0.200	10
19.	Nagaland	0.200	40	0.120	6
20.	Orissa	4.015	803	2.080	104
21.	Punjab	1.620	324	3.420	171
22.	Rajasthan	6.150	1230	4.400	220
23.	Sikkim	0.065	13	0.020	1
24.	Tamil Nadu	4.350	870	11.440	572
25.	Tripura	0.285	57	0.160	8
26.	Uttar Pradesh	14.640	2928	10.340	517
27.	Uttaranchal	0.810	162	0.680	34
28.	West Bengal	6.355	1271	7.860	393
		100.000	20000	100.000	5000

amendments still remains. The fifth and the sixth schedule areas stood excluded from the operation of the 73rd and 74th amendments. The states of Meghalaya, Mizoram and Nagaland have been specifically excluded from the operation of the 73rd amendment, but the legislatures of these states have been given the power to extend this amendment to their states by law, except in respect of the sixth schedule areas. Autonomous district councils have been constituted under the sixth schedule in the states of Assam, Meghalaya, Mizoram and

Tripura. For extension of the provisions of the 73rd amendment to the fifth schedule areas, legislation was passed by Parliament in 1996. In the case of the sixth schedule areas, no action has yet been taken by the Parliament to make these amendments applicable to these areas. The EFC had segregated the grants for normal and excluded areas and hoped that the latter would become 'eligible' through necessary administrative and legislative measures.

8.51 We have been informed that the

Ministry of Home Affairs has been considering proposals for amendment in the sixth schedule to make the autonomous district councils more effective. The proposals envisage enhancement of the powers of these councils and inclusion of certain provisions of the 73rd and 74th amendments in the sixth schedule. In view of this, we do not propose to indicate the grants in aid for the normal and the excluded areas separately. It is for the state concerned to distribute the grants recommended by us for the state among the local bodies including those in the excluded areas in a fair and just manner.

8.52 Our attention has been drawn to the shortfall in the release of grants recommended by the EFC to the states. This is due to (a) non-utilization/under-utilization of the amounts already released and (b) the inability of the state/local bodies to raise matching contributions. The condition regarding matching contribution was not imposed by the EFC. While there is a strong case to motivate the local bodies to raise own resources, we feel that depriving them of the finance commission grants may not be the right approach to the problem. This would only starve them of funds that are due to them. We do not, therefore, recommend any such conditionality. We are also of the view that the central government should not impose any conditions not recommended by the finance commission as these grants are largely in the nature of a correction of vertical imbalance between the centre and the states. The normal practice of insisting on the utilization of amounts already released before further releases are considered, may continue and the grants-in-aid may only be released to a state after it

certifies that the previous releases have been passed on to the local bodies. The amounts due to the states in the first year of our award period viz. 2005-06 may, however, be released without such an insistence.

8.53 It is seen that that the finance commission grants sometimes take a long time to reach the local bodies even after the central government has released the grants to the states. Often, the state governments were found to use them for their ways and means comfort and show no sense of urgency in passing them on to the rightful recipients. This results in withholding of further releases by the centre and the local bodies suffer the consequences for no fault of theirs. We, therefore, strongly urge the state governments to desist from such practices, which defeat the very purpose of providing such grants to local bodies. We also recommend that the central government should take a serious view of any delay beyond 15 days in the passing on of these grants by the state government from the date of release of the grants by the centre.

8.54 Annexures 8.2 to 8.6 contain the formats that had been circulated by the Twelfth Finance Commission to all states for furnishing necessary data regarding local bodies. It is recommended that the SFCs adopt these formats for obtaining the relevant data not only for the purpose of addressing their own TOR but also to enable the central finance commission to draw reliable conclusions on the basis thereof. It is also necessary to stress that states should constantly strive for an improvement in the quality of data.

8.55 Our recommendations may be summarized as below:

- i) The best practices listed in para 8.19

-
- may be considered for adoption by states to improve the resources of the panchayats.
- ii) The states should avoid delays in the constitution of the SFCs, their constitution in phases, frequent reconstitution, submission of reports and tabling of the ATR in the legislature. It is desirable that SFCs are constituted at least two years before the required date of submission of their recommendations, and the deadline should be so decided as to allow the state government at least three months' time for tabling the ATR, preferably along with the budget for the ensuing financial year.
 - iii) The SFC reports should be readily available to the central finance commission, when the latter is constituted so that an assessment of the state's need could be made by the central finance commission on the basis of uniform principles. This requires that these reports should not be too dated. As the periodicity of constitution of the central finance commission is predictable, the states should time the constitution of their SFCs suitably.
 - iv) SFCs must be constituted with people of eminence and competence with qualification and experience in the relevant fields.
 - v) The convention established at the national level of accepting the principal recommendations of the finance commission without modification, should be followed at the state level in respect of SFC reports.
 - vi) The SFCs must clearly identify the issues which require action on the part of the central government to augment the consolidated fund of the state and list them out in a separate chapter for the consideration of the central finance commission.
 - vii) The suggestions made by SFCs regarding raising the ceiling on professional tax is endorsed for action by central government.
 - viii) It is desirable that the SFCs follow the procedure adopted by the central finance commission for transfer of resources from the centre to the states in respect of resource transfers from state governments to local bodies. The SFC reports should contain an estimation and analysis of the finances of the state government as well as the local bodies at the pre and post transfer stages along with a quantification of the revenues that could be generated additionally by the local bodies by adopting the measures recommended therein. The gaps that may still remain would then constitute the basis for the measures to be recommended by the central finance commission.
 - ix) While estimating the resources of the local bodies, the SFCs should follow a normative approach in the assessment of revenues and expenditure rather than make forecasts based on historical trends.
 - x) A permanent SFC cell may be created in the finance department of

state governments as the collection and collation of data would need to be done constantly and data would need to be made available to the SFC as and when it is constituted.

- xi) A sum of Rs.20000 crore for the panchayats and Rs.5000 crore for the municipalities may be provided as grants-in-aid to augment the consolidated fund of the states for the period 2005-10 to be distributed with inter-se shares as indicated in table 8.1.
- xii) The PRIs should be encouraged to take over the assets relating to water supply and sanitation and utilize the grants for repairs/rejuvenation as also the O&M costs. The PRIs should, however, recover at least 50 percent of the recurring costs in the form of user charges.
- xiii) Of the grants allocated for panchayats, priority should be given to expenditure on the O&M costs of water supply and sanitation. This will facilitate panchayats to take over the schemes and operate them.
- xiv) At least 50 per cent of the grants-in-aid provided to each state for the urban local bodies should be

earmarked for the scheme of solid waste management through public-private partnership. The municipalities should concentrate on collection, segregation and transportation of solid waste. The cost of these activities whether carried out in house or out sourced could be met from the grants.

- xv) Most states do not have credible information on the finances of their local bodies. Local bodies would continue to need funding support for building data base and maintenance of accounts. States may assess the requirement of each local body in this regard and earmark funds accordingly out of the total allocation recommended by us.
- xvi) Separate grants-in-aid for the normal and the excluded areas are not proposed. It is for the state concerned to distribute the grants recommended for the state among the local bodies including those in the excluded areas in a fair and just manner.
- xvii) No conditionality over and above those recommended by us need be imposed by the central government for releasing the grants-in-aid.

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