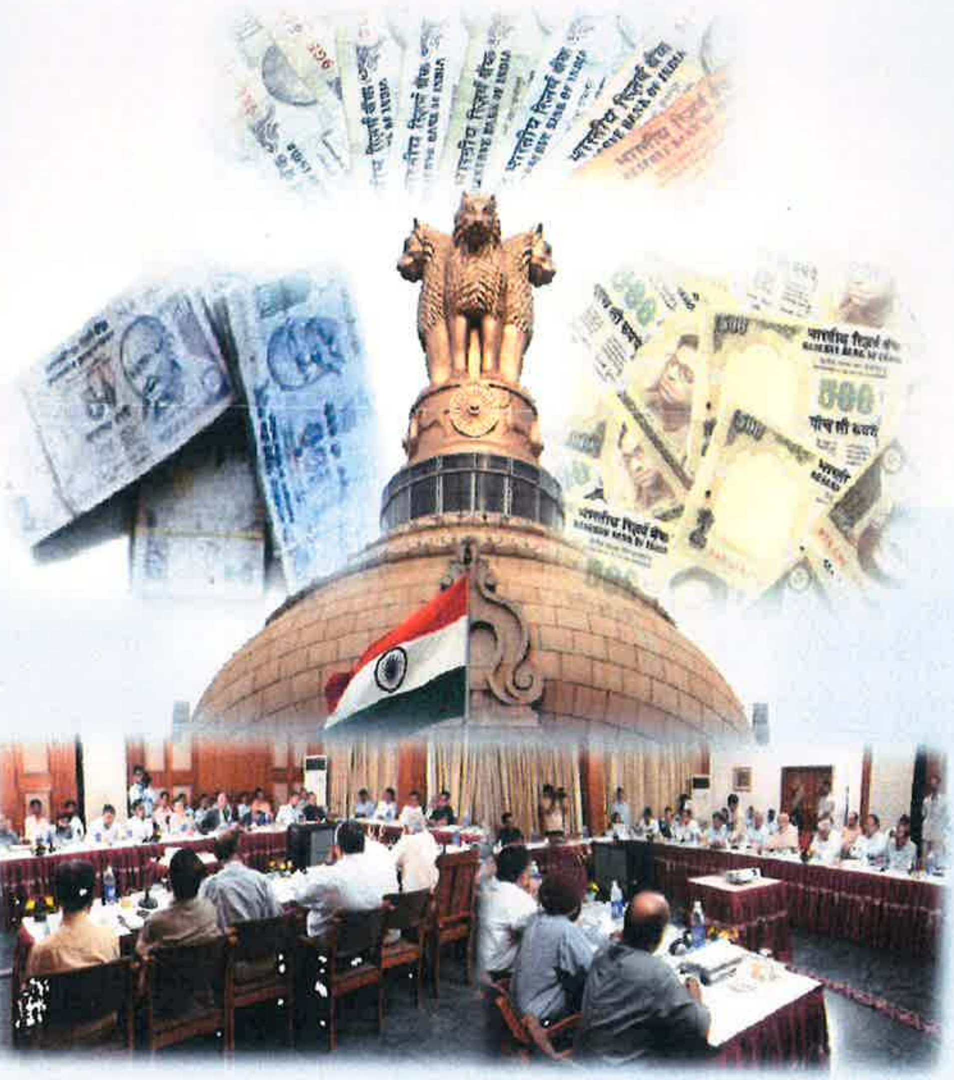
Tracking Central Finance Commissions and State Finance Commissions Grants to Selected States and Urban Local Bodies in India



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National Institute of Urban Affairs

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Preface

The externally provided resources or fiscal transfers from higher tiers of government constitute a significant component of municipal revenues in India. Recently the 13th Central Finance Commission (CFC) has recommended sharing of a divisible pool of central taxes as grant-in-aid to local bodies rather than ad-hoc system of grant-in-aid. In addition to it, the Act has also provided for periodic revision of state-local fiscal relations through the mechanism of State Finance Commissions (SFCs). Every state government is required to constitute once in five years a Finance Commission to review local governments' financial position. However, although the mandate of the SFCs is more or less same but the methodologies and recommendations of SFCs differ a lot.

There are multiple grants/transfers, which are being provided to ULBs in addition to the devolution packages suggested by various SFCs. To know the exact role of state transfers/grant-in-aid will require taking into consideration of all types of transfers/grant-in-aid which are being passed on to ULBs such as amounts as per the devolution packages of SFCs, compensatory grants, assigned revenues, general purpose grants and specific purpose grants etc. Therefore, it is necessary to examine the tracking of system of grant-in-aid to ULBs including devolution packages recommended by the CFCs and the SFCs. In this context, the present study was carried out.

We hope the report will be helpful to urban policy makers and professionals in implementation of transparent and effective system of grant-in-aid to ULBs in the country.

We wish to express our sincere thanks to Mr. A.K Mehta, Joint Secretary (UD), Ministry of Urban Development for giving us the opportunity to work on the study.

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The study has immensely benefited from the guidance, keen interest and patience shown by Professor Om Prakash Mathur at NIPFP. His knowledge and expertise in this area added with the positive comments and suggestions provided by him towards betterment of the report in every stage, has helped in successful completion of the project. I am grateful to Prof. Chetan Vaidya, Director, National Institute of Urban Affairs (NIUA) for entrusting this study to me. At the institute, the team is thankful to Dr. Mukesh P. Mathur, Professor, NIUA, who earlier coordinated the SFC Cell at NIUA for sharing his experiences on municipal finances. I would also like to thank Dr. Debjani Ghosh who gave valuable comments on Report of the study. I would like to acknowledge the hard work put in by Dr. Satpal Singh especially in research support and sharing of his earlier contributions to SFC Cell at NIUA and Mr. Sarveshwar Vyas during the field visits to Madhya Pradesh and Orissa and data compilation. Efforts made by Mr. T.C. Sharma towards the formatting of the Report at the final stages are also appreciated.

I would like to express my gratitude to the state governments and municipal corporations who provided us the requisite data on the finances of municipalities for conducting this study. Without their cooperation and continued assistance, this study could not have been completed.

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List of Abbreviations

ATR	Action Taken Report
BMC	Bhopal Municipal Corporation
CFC	Central Finance Commission
C&AG	Comptroller and Audit General
DA	Dearness Allowance
DMA	Directorate of Municipal Administration
DTP	Directorate of Town Panchayat
GSDP	Gross State Domestic Product
ICDS	Integrated Child Development Scheme
IDSMT	Integrated Development of Small and Medium Towns
JNNUMRM	Jawaharlal Nehru Urban Renewal Mission
LSGI	Local Self Government Institution
PRI	Panchayati Raj Institution
RLB	Rural Local Body
SFC	State Finance Commission
SJSRY	Swarna Jayanti Shahari Rojgar Yojna
ULB	Urban Local Body
UC	Utilization Certificate

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Background:

At present, the Urban Local Bodies (ULBs) in India are getting grants from the Central Government as well as from the State Governments. These central and state grants are mainly based on the recommendations of Central Finance Commissions (CFCs) and State Finance Commissions (SFCs). This study focuses on various devolution packages and system of grant-in-aid suggested by the SFCs and CFCs in the five selected states and ten selected ULBs. These are: Madhya Pradesh (Bhopal and Ujjain); Orissa (Bhubneshwar and Puri); Tamil Nadu (Chennai, Vellore and Alandur); Gujarat (Ahmedabad and Rajkot); and Assam (Guwahati).

Central Finance Commissions:

After the 74th Constitutional Amendment, the 10th, 11th and 12th CFCs provided ad-hoc grants to ULBs. However, the 13th CFC had suggested a devolution package linking the grants to ULBs with central revenues. This is the first time when any CFC has given a serious attempt to the requirements of the ULBs. The 13th CFC has also introduced the concept of performance-based grants to ULBs. The focus of these conditions is for proper budgeting, accounting and audit practices at local body level, a system of better administration at local body level, an electronic transfer system to local bodies at state level, compulsory levy of property tax and constitution of a state-level property tax board and defining of service standards by the state government. The study indicates that State Governments and ULBs of India has a long way to explore these performance-based grants because these are based on certain conditions, which cannot be met without an appropriate guidance.

State Finance Commissions:

The study shows that many states have often delayed the formation of SFCs and setting up of full SFCs, providing support to them, delay in submitting reports by SFCs and delay in submission of Action Taken Reports by the State Governments. SFCs felt handicapped due to non-availability of data/information relating to the financial health and resource gap of ULBs etc. Since there were no agencies at the state level, which collects and maintains comprehensive databases w.r.t ULBs, all the SFCs of the five states conducted their own survey based on detailed questionnaire in the selected municipalities to review their financial position etc. There is no synchronization between SFC Reports and Central Finance Commissions. On the one hand, many of the recommendations of the SFCs were rejected and on the other hand accepted recommendations were implemented with a considerable lapse of time. In two of the five sample states, namely, Madhya Pradesh and Tamil Nadu, SFCs have recommended the approach of global sharing of devolution of funds to local bodies whereas other three states namely Orissa, Gujarat and Assam have continued with an ad-hoc system of grant-in-aid. Both the SFCs of Tamil Nadu have provided a simple and transparent system of state transfers to local bodies, which has resulted in better budgetary planning at ULB level.

State Transfers:

To know the impact of load of state transfers/grant-in-aid to ULBs on state's own revenues, consideration of SFCs' recommended devolution packages was not enough and it required to take into account of all types of state transfers/grant-in-aid which are being passed on to ULBs which are in addition to SFC grants such as assigned revenue, compensatory grants, general purpose and specific purpose grants, etc. The ratio of total non-plan transfers to ULBs as a percentage of state's own revenue was highest for the state of Madhya Pradesh and was close to ten percent and this ratio was between three to four percent for the other three states, namely, Tamil Nadu, Orissa and Gujarat whereas Assam's ratio was found to be lowest with less than one percent.

The study finds the diversity of system of grant-in-aid to ULBs in the selected states in term of types of non-plan transfers. Some of the states have included octroi compensation in SFC's devolution package whereas some of the other states have provided octroi compensation outside the SFC grants. In case of Gujarat, it was found that the share of SFC grants out of total non-plan transfers was low and in addition to, it there were more than thirty types of specific purpose grants which were being released to ULBs to undertake specific activities. The study has highlighted that in case of Tamil Nadu, the gap between actual requirements and own revenues of ULBs was to be funded through fiscal transfers but on the contrary the Government of Tamil Nadu, first deposited the amounts of transfers to ULBs and then asked the ULBs to deposit the remaining amount between the transfers and actual requirements. It is highly doubtful that the ULBs are depositing the amounts based on the difference between the available transfers and actual requirements and the realty could be that the ULBs are only depositing the amounts to their availability of own resources and the concept of depositing of the gap of transfers and actual requirements has been defeated.

Impact at ULB Level:

The study brings forth the fact that in addition to CFC grants and SFC grants there are many other grants, which are being released to ULBs from higher-level governments. Many of the state transfers/grant-in-aid to ULBs, are not possible to be separately accounted as these are absorbed directly into state government expenditure. The state budgets, which give explanation of the grants to ULBs but these, are not clubbed at one place in the state budgets and scattered in several major and minor heads of state budgets.

It was observed that in some of the states the SFC funds were released without obtaining UCs of previous years from ULBs. In Madhya Pradesh, the State Government did not frame any rules for proper and effective implementation of devolution of functions, functionaries and funds. In the absence of rules, there was no system to watch implementation of transfer process. In Orissa, the SFCs had pointed out that releasing of many of the non-plan grants lacked certainty and predictability.

The study further shows that the financial health of most of the selected ULBs was not good and two third of the revenue receipts of ULBs of Madhya Pradesh and Orissa namely Bhopal, Ujjain, Bhubneshwar and Puri were from non-plan transfers and had shown a high dependency on state governments. Whereas, both the ULBs of the state of Gujarat namely Ahmedabad and Rajkot were quite self sufficient and were less dependent on grant-in-aid from higher-level governments. Dependency of Guwahati Municipal Corporation was initially less but had increased over the years. However, the amount of state transfers for the Municipal Corporations of the Gujarat would definitely increase because of recent abolition of octroi in the Municipal Corporations.

Types and Utilization of Grants of ULBs:

Further the study has highlighted that the nature of grants to ULBs is of two types i.e. conditional and unconditional. In case of CFC grants, the amounts released are of conditional nature and are being released after receiving the utilization certificates from individual ULBs. Most of the SFC grants are of unconditional nature and are to be utilized only for revenue expenditure including the expenditure on establishment and salaries, operation and maintenance and interest payments on loans, etc. In case of Orissa, it was observed that the releasing of many of the non-plan grants lacked certainty and predictability and the grants meant to cover the pay and dearness allowance of the ULBs' employees only followed a definite and known formula.

Recommendations:

The Central Government should take necessary steps to amend Article 280(3) (bb) and (c) and to include Article 243 I (2) in the state legislatives as recommended by the 13th CFC. The Central Government guide State Governments and ULBs to explore the performance-based grants as suggested by the 13th CFC. The State Governments and ULBs seriously need guidance on several conditions laid down by the current CFC.

SFCs generally do not have an access to good databases at the ULB level and are no agencies at the state level, which collects and maintains comprehensive databases. State Governments should seriously address the issue of creation and maintenance of databases w.r.t ULBs rather than depending on databases based on sample surveys.

Timely constitution of SFC and timely submission of SFC Reports is very important. To address the issue of complexities of system of grant-in-aid to ULBs, the SFCs should try to introduce the concept of devolution packages after taking into consideration of all types of revenue grants. Further the recommended devolution packages may be linked with State's own resources to capture the concept of elasticity.

SFCs should also consider the idea of performance based or incentive grants based on outcomes such as improved service delivery, improved tax collections and improved financial management etc. SFCs could review and link the grants to performance as suggested by the 13th CFC and reforms under JNNURM. Importantly, the State Governments should give a serious consideration to the recommendations of the SFC Reports and timely issuance of ATRs.

All State Governments should build a system for predictability and transparency of state transfers to ULBs. The State Governments should follow the system of electronic transfers to ULBs rather than the conventional transfers.

1.0 Introduction

1.1 Context

The externally provided resources or fiscal transfers from higher tiers of government constitute a significant component of municipal revenues in India. Fiscal transfers play an extremely important role in meeting the vertical gap of the municipalities i.e. the difference between own revenue receipts and revenue expenditure of municipalities. Shah identifies at least six principles that are supposed to guide designing of a fiscal transfer system (Shah, 2004). These are (a) to bridge a fiscal gap, (ii) to correct fiscal inequities and fiscal inefficiencies arising from differentials in regional/fiscal capacities, (iii) to compensate for benefit spillover, (iv) setting national minimum standards to preserve the internal common market and attain national equity objectives, (v) to influence local priorities in areas of high national but low local priority; and (vi) to create macroeconomic stability in depressed regions. According to Roy Bahl," Those who design transfer system (intergovernmental) and driven by the vertical balance objectives must face up to two major issues. The first is how does one measure vertical imbalance. In order to know how much transfer is necessary, one must estimate the difference between the revenues available to subnational governments, and the expenditure needs of those governments. This is quite a subjective matter, because expenditure needs are almost limitless. Most countries who use the vertical balance approach determine a 'minimum service level', and fill the gap with transfers. In some cases, the amount of transfers is determined by a central budget constraint rather than by a 'minimum requirement' approach. The second issue to be faced by grant designers is that there is a mismatch between the reliance dictated by vertical balance considerations on the one hand, and efficiency considerations on the other. For example, vertical balance considerations might dictate that subnational governments receive $X in transfers. But this amount may result in some services that should be tax-financed being covered by grants. This could lead to overspending by the subnational governments because certain services that should be financed with local taxes and user charges would be financed with external grants" (Bahl, 2000).

India embarked on democratic decentralization through the 73rd and 74th Constitution Amendment Acts (CAA) in the year of 1992. This legislation has not, however, changed the structure of fiscal federalism in the country. Prior to 1994, the Central Government was not involved in any transfer of resources to the Urban Local Bodies (ULBs) in India. This provision was inserted at the time of enactment of 74th CAA. Under the provision of article 280(3) C, the Centre through the Central Finance Commission (CFC) is obliged to make recommendations regarding the measures needed to augment the consolidated fund of the states for supplementation of the resources of the municipalities. After enactment of the CAA, the Centre has constituted four rounds of Finance Commissions i.e. tenth, eleventh, twelfth and thirteenth. All the four CFCs have already submitted their reports. Tenth, eleventh and twelfth CFCs have recommended ad-hoc grants to ULBs and have not considered the idea of sharing central own resources with ULBs. However, 13th CFC has recommended an idea of sharing of a divisible pool of central taxes as grant-in-aid to local bodies during the period of 2009-14. The grant-in-aid to local bodies has been linked to a divisible pool of central taxes rather than ad-hoc grants given by the last three CFCs.

In addition to it, the Act has also provided for periodic revision of state-local fiscal relations through the mechanism of State Finance Commissions (SFCs). Every state government is required to constitute once in five years a finance commission to review local governments' financial position and recommend the principles that should govern – (a) the distribution between the state and local governments of the net proceeds of the taxes, duties, tolls, and fees leviable by the state; (b) the determination of the taxes, duties, tolls, and fees that may be assigned to or appropriated by local governments; and (c) the grants-in-aid to local governments from the consolidated fund of the state. The SFCs are also expected to – (i) review the finances of municipalities; (ii) to estimate their future financial requirements; and (iii) to suggest measures for strengthening their finances. Interestingly, it has been observed that any formula of global sharing by the SFCs does not present a complete scenario of system of grant-in-aid to ULBs. There are several examples where SFCs' grants are not the only grants or transfers, which are being passed on ULBs from the state governments, but there are other types of grant-in-aid which are being provided to ULBs such as compensatory grants (after abolition of Octroi), general and specific purpose grants (on revenue and capital accounts). Merely comparing the devolution packages or system of grant-in-aid by the SFCs cannot give an exact idea about the dependency of ULBs on state transfers. It has been observed that although the mandate of the SFCs is more or less same but the methodologies and recommendations of SFCs differ a lot. Several SFCs have recommended system of ad-hoc grant-in-aid, system of sharing local level taxes such as entertainment tax, profession tax etc. and a system of global sharing of states' own revenue or own tax receipts e.g. Karnataka, Tamil Nadu, Madhya Pradesh etc.

1.2 Relevance of the Study

Literature available on the subject of state transfers/grant-aid to ULBs shows that there are multiple grants/transfers, which are being provided to ULBs in addition to the devolution packages suggested by various SFCs. The multiple grants/transfers are generally found to be in nature of general-purpose grants, specific purpose grants, compensatory grants, assigned revenues and sharing of local level taxes such as entertainment tax. Various audit reports of ULBs have also shown that many grants, which are principally agreed by, state governments are not being released fully or even not being released at all to ULBs. To know the exact role of state transfers/grants-in-aid to ULBs on state finances, consideration of SFCs' recommended devolution packages would not be enough. In other words, to know the exact role of state transfers/grant-in-aid will require taking into consideration of all types of system of grant-in-aid which are being passed on to ULBs such as amounts as per the devolution packages of SFCs, compensatory grants, assigned revenues, general purpose grants and specific purpose grants etc. Therefore, it is necessary to examine the tracking of system of grant-in-aid to ULBs including devolution packages recommended by the SFCs. In this context, the present study was carried out.

1.3 Objectives

The study focuses on various devolution packages suggested by the SFCs of the selected states and also focuses on the purpose of the grants released by the CFCs to the selected ULBs. The objectives of the study are to:

- Examine the nature and purpose of system of grant-in-aid/devolution packages suggested by the SFCs and CFCs in the selected states and ULBs.
- Compare the new system of devolution mechanisms compared to earlier system of grant-in-aid to the ULBs.
- Examine the releasing mechanisms of these SFCs'/CFCs' grants to ULBs.
- Examine the mismatches (if any) at the state level between the devolution packages to the actual released amounts to the ULBs.
- Analyze the trend of grant-in-aid versus own resource generation at the ULB level.

1.4 Methodology and Scope

The information was collected from primary and secondary sources. Primary information was collected through the structured questionnaires to elicit the information from the state and the ULBs. Secondary information was collected from the reports of CFCs and SFCs and their

Action Taken Reports (ATRs). In addition to it, relevant data was extracted from State and Municipal Budgets. Discussions were held with state and municipal officials to find out the exact status of distribution of grants/transfers and exact position of releasing mechanisms.

One state from each of five regions was selected and two ULBs from state were selected for the study. The selected states were Madhya Pradesh, Gujarat, Tamil Nadu, Orissa and Assam. The selected ULBs within states were Bhopal and Ujjain from Madhya Pradesh, Ahmedabad and Rajkot from Gujarat, Chennai, Alandur and Vellore from Tamil Nadu, Bhubneshwar and Puri from Orissa and Guwahati from Assam (Table 1.1). The trend and system of grant-in-aid w.r.t to CFCs and SFCs were studied for the past five years.

Table 1.1: Selected States and ULBs for the Study

Selected States	Selected ULBs
Madhya Pradesh	Bhopal and Ujjain
Gujarat	Ahmedabad and Rajkot
Tamil Nadu	Chennai, Alandur, and Vellore
Orissa	Bhubneshwar and Puri
Assam	Guwahati

2.0 Central Finance Commissions: Approaches and Recommendations

2.1 Background

Creation of CFCs constitutes important mechanism for addressing the vertical fiscal imbalance i.e. dependence on the revenue of higher tiers of government and also addressing for the horizontal imbalance i.e. uneven access to local public resources. All the four CFCs i.e. tenth, eleventh, twelfth and thirteenth, have submitted their Reports. The norms and criteria of the central transfers to ULBs as per these CFCs are discussed below.

2.2 Tenth Finance Commission

The 74th CAA was a watershed in the history of urban decentralization in India. It accorded a Constitutional status to local self-government. The Amendment of clause 3 of Article 280 of the Constitution affected a change in the functional domain of the CFC. It brought into their purview an additional task of suggesting measures to augment the Consolidated Fund of the States to improve the financial viability of PRIs and ULBs. The new mandate of CFC brought about a major change in the fiscal arrangement of local bodies in India and for the first time, issues concerning their finances were portrayed on the national canvass.

Since the amendment of Article 280 came into effect after setting up of the Tenth Finance Commission (10th CFC), its influence on the Terms of Reference of the Commission was not discernible. The 10th CFC was at a loss with respect to a mandate. As 73rd and 74th Constitutional Amendment had become operational, it became obligatory for CFC to make recommendations with respect to local bodies. The Commission decided to make an ad-hoc provision of grants to the tune of Rs.1,000 crores to the ULBs for the award period of 1996 to 2000. In the absence of a clear-cut methodology the criteria for inter se distribution was based on slum population of 1971 census. The inter se distributions were made on the basis of the ratio of slum population of seventies of individual states. These transfers were conditional upon the municipalities making matching contributions and were useable for properly identified projects i.e. maintenance of core civic services. Understandably, this approach allocated more funds to the states that had a high share of slum population. The Commission made it mandatory that these grants should be utilized exclusively for suitably formulated development schemes. It further stipulated that in no case it must be utilized for payment of salaries. Hence earmarking Rs 1000 crores could be conceived as the first step towards augmenting resources of ULBs.

2.3 Eleventh Finance Commission

Unlike its predecessor, the Eleventh Finance Commission (11th CFC) had a clear mandate, its terms of reference made it obligatory to make recommendations on augmentation of funds of states in enhancing resources for local bodies. After considering suggestions given by Ministry of Urban Development, and other states, it was unanimously felt that provision of basic civic services require great attention. The Commission identified certain basic services viz provision of primary education, primary health care, safe drinking water, street light, sanitation, drainage and scavenging facilities, maintenance of cremation and burial grounds, public conveniences and other common property resources. As these services were neglected completely, the Commission envisaged a need to up grade provision of these services and earmarked grants for basic civic services. A total grant amounting to Rs.2000 crores a year was recommended for PRIs and ULBs. The share of ULBs was Rs.400 crores per year. The grants were to be of untied nature to be utilized by ULBs for provision of civic services. The transfer of the 11th CFC amount by respective states to the ULBs was contingent on certain guidelines issued by the Ministry of Finance.

Guidelines for utilization of grants included (i) Timely completion of election process in respect of local bodies; (ii) For states not devolving powers, responsibilities, resources as recommended by State Commissions 25% of grants were to be withheld; (iii) These grants were not to be utilized for any other purpose. Local bodies were to raise matching resources amounting to 50% of grants in case of ULBs (inability of ULBs to provide a matching contribution were to be compensated by the State governments); (iv) Grants were to be transferred within one month or three months if local bodies were not able to raise matching funds; (v) No amount was to be transferred to the intermediate or district level Panchayats that were not directly responsible for the maintenance of civic service; and (vi) Guidelines also contained that CAG of India were to be responsible for the control and supervision over audit and accounts for all three levels of PRIs and ULBs.

The Commission evolved a comprehensive framework for distribution of grants between states. It tried to link devolution of grants to factors like efficiency, equity, and decentralization. The distribution of grants was made on following weighted criteria:

Table 2.1: Inter-se Allocation of Grants among States- 11th CFC

Indicators	Weight (%)
Population	40
Geographical Area	20
Revenue Effort	20
Distance from highest per capita	10
Geographical Area	10

Source: Report of the Eleventh Finance Commission

The Commission wanted to give incentives to the states for effective implementation of decentralization. Hence, it suggested and constructed an Index of Decentralization and assigned weight of 20 percent to it in fiscal transfer to states. This Index included parameters such as (i) Enactment/Amendment of the state/municipal legislation, (ii) Intervention/restriction in the functioning of the ULBs, (iii) Assignment of functions to the ULBs by state legislation, (iv) Actual transfer of functions to the ULBs by way of rules, notification and orders, (v) Assignments of powers of taxation to the ULBs, (vi) Extent of exercise of taxation powers, (vii) Constitution of SFCs and submission of action taken reports, (viii) Action taken by the State Government on SFCs reports, (ix) Election to the ULBs, and (x) Constitution of District Planning Committees as per the provision in Article 243ZD.

It also suggested grants for local bodies for two other key areas namely, up-dating of accounts and creation of database for local bodies. The Commission also made recommendations relating to reformation in local taxes and rates. Recognizing that the financial requirements of ULBs are phenomenal and could not be met by the grant component alone, the Commission had suggested measures for augmentation of the consolidated funds of the states, which could supplement the resources of ULBs. The measures for augmenting the consolidated fund include levying of land taxes by states, property tax reforms, substitution of Octroi by a buoyant tax, introduction of user charges for recovery of operation and maintenance expenses of services, etc.

2.4 Twelfth Finance Commission

The Twelfth Finance Commission (12th CFC) was required to make recommendations on the measures needed to augment the Consolidated Funds of the States to supplement the resources of the Panchayats and Municipalities on the basis of the recommendations of the SFCs. The Commission has given recommendations on this term of reference, which have been accepted by the Union Government. The 12th CFC has recommended grants amounting to Rs.5,000 crores for municipalities payable during the period 2005-10. The inter-se allocation amongst States is based on factors and weights assigned by the CFC is presented in Table 2.2.

Table 2.2: Inter-se Allocation of Grants among States- 12th CFC

Indicators	Weight (%)
Population	40
Geographical Area	10
Distance from highest per capita	20
Geographical Area	10
Revenue Effort	20
(a) with respect to own revenue of states	10
(b) with respect to GSDP	10

Source: Report of the Twelfth Finance Commission

The 12th CFC has stressed the importance of Public Private Partnership (PPP) to enhance service delivery of solid waste management services in the urban areas. The Commission urged that States might require municipalities of towns of over 100,000 population as per 2001 census to prepare comprehensive scheme including composting and waste to energy programmes to be undertaken in the private sector for appropriate funding from the grants recommended by the 12th CFC. The Commission had suggested earmarking of at least 50% of grants for this purpose.

Some of the other important recommendations of the 12th CFC were: (i) 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, (ii) SFC reports should be readily available to CFC for an assessment of the state's need could be made by the CFC on the basis of uniform principles, (iii) convention established at the national level of accepting the principal recommendations of the Finance Commission without modification should be followed at State level in respect of SFC reports, (iv) It is desirable that the SFCs follow the procedure adopted by the CFCs for transfer of resources from the Centre to the States in respect of resources transfers from State Governments to local bodies. It also suggested that SFC Reports should contain an estimation and analysis of the finances of 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 CFC, (v) while estimating the resources of the local bodies, SFCs should follow a normative approach in the assessment of revenues and expenditure rather than made forecasts based on historical trends, (vi) At least 50 per cent of the grants-in-aid provided to each State for ULBs should be earmarked for the scheme of solid waste management through PPP. 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; and (vii) most states do not have credible information on the finances of their local bodies. Local bodies would continue to need funding support for building databases 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.

2.5 Thirteenth Finance Commission

The Thirteenth Finance Commission (13^{th} CFC) was constituted for the period of five years i.e 2009-10 to 2014-15. The Commission required to make recommendations on '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 recommendations made by the Finance Commission of the State'. The report of the 13^{th} CFC has been submitted to the Union Government in February 2010. The CFC has given recommendations on this term of reference, which was accepted by the Union Government.

The 10^{th}, 11^{th} and 12^{th} CFCs had recommended ad-hoc grants to ULBs and had not considered the idea of sharing central own resources with ULBs. However, the 13^{th} CFC did not recognize direct devolution to local bodies and has recommended an idea of sharing of a divisible pool of central taxes as grant-in-aid to local bodies during the period of 2009-14. The grant-in-aid to local bodies has been linked to a divisible pool of central taxes rather than ad-hoc grants given by the last three CFCs and the 13^{th} CFC has recommended of Rs.87,510 crore (based on estimates) grant to all local bodies to improve their financial position. The 13^{th} CFC has quoted, "local bodies (rural and urban local bodies) need to be supported through a predictable and buoyant source of revenue, substantially higher than the present levels, in addition to their own tax revenues and other flows from Central and State Governments. Simultaneously, local bodies should also be made more accountable in the discharge of their functions. Their accounts and audit must be up-to-date. " This CFC has recommended three types of grant-in-aid to rural and urban local bodies namely (i) general basic grant, (ii) general performance grant and (iii) special area basic grant. The general basic grant would amount to 1.5% of the size of the divisible pool in the preceding year and starts from the year of 2010-11 and in addition to it there would be a general performance grant which would be upto 1% of the divisible pool and would be effective from 2011-12 only and will be 0.5% for the year 2011-12 and 1% for the next three years. Whereas, an amount of Rs.20 per capita per year has been allocated as the special area basic grant, which would be accessible by all the eligible states for only four years i.e. 2011-12 to 2014-15.

The total recommended grant for local bodies of an estimate of Rs.87,519 crore for the entire period of 13th CFC would be distributed among rural and urban local bodies in ratio of 73.18 and 26.82 respectively. The inter-se allocation amongst States is based on criteria and weights assigned by the 13th CFC provided in Table 2.3.

Table 2.3: Inter-se Allocation of Grants among States- 13th CFC

Criterion	Weights Allotted (%)	
	PRIs	ULBs
Population	50	50
Area	10	10
Distance from highest per capita sectoral income	10	20
Index of Devolution	15	15
SC/STs proportion in the population	10	-
FC local body grants utilisation index	5	5
Total	100	100

Source: Report of the Thirteenth Finance Commission

The share of ULBs is estimated to be Rs.23,111 crores which is approximately four times of the recommended amount by the 12th CFC. Further, the State Governments would be eligible to draw down its share of 'general performance grant' and 'special area basic grant' only if they comply with the conditions respectively by the CFC. The focus of these conditions is for proper budgeting, accounting and audit practices at local body level, a system of better administration at local body level, an electronic transfer system to local bodies at state level, compulsory levy of property tax and constitution of a state-level property tax board and defining of service standards by the state government. The conditions are-

- Constitution of State Property Tax Board at the State level which would assist all ULBs in the state to put in place and independent and transparent procedure for assessing property tax. Some of the important activities of the Boards could be enumeration of the properties, reviewing of the present system of property tax, suggesting basis for assessment and valuation of properties, and periodic revisions, etc.

- All ULBs should be fully empowered to levy property tax and there should not be any exemptions because the potential of exempted properties is quite high.
- Constitution of Local Body Ombudsman, which would look into complaints of corruption and misadministration of officials and elected representatives.
- State Governments to put in place benchmarks for delivery of essential services, initially for four services namely water supply, sewerage, storm water drainage and solid waste management. These benchmarks should be on the lines of MoUD's Handbook.
- State Governments should put in place Audit System for ULBs.
- State Governments should ensure a system of Electronic Transfer of grants to ULBs for the transparency of system of transfers.

Interestingly, these conditions are in consonance with reforms under the Jawaharlal Nehru Urban Renewal Mission (JNNURM). The 13th CFC has also recommended for an amendment of Article 280(3) (bb) and (c) such that the words 'on the basis of the recommendations made by the Finance Commission of the State' are changed to 'after taking into consideration the recommendations .....'. Further, the Article 243 I (2) of the Constitution enables State Governments to legislate on the requisite qualifications of SFC members. In this regard the Commission has suggested that all states should legislate in this matter.

2.6 A Comparative Analysis of Central Finance Commissions

All the three CFCs prior to the 13th CFC have recommended adhoc grants to ULBs except the amounts and the passing of share of central taxes to ULBs was not recommended. Eleventh, Twelfth and Thirteenth CFCs have recommended a distribution criteria based on five indicators with slight variations whereas the common criteria of all the three CFCs were population, geographical area and distance from per capita income. However, the fourth criteria namely index of decentralization was replaced by index of deprivation and index of devolution by the 12th and 13th CFCs respectively. Moreover the fifth criteria recommended by the 11th and 12th CFCs of revenue effort has been replaced by grant utilization index by the 13th CFC. The conditionality of matching grants was removed by the 11th and 12th CFC unlike the 10th CFC.

Table 2.4: Recommendations of CFCs for ULBs - A Comparative Chart

Items	Tenth CFC (1995-2000)	Eleventh CFC (2000-2005)	Twelfth CFC (2005-2010)	Thirteenth CFC (2010-2015)
Terms of Reference relating local bodies	Not specified. However, since Article 280 had been amended before the expiry of the term, the Commission felt that it was obliged to deal with the issue in terms of the amended Article 280.	The measures needed to augment the Consolidated Fund of the states to supplement the resources of local bodies on the basis of SFC recommendations. The EFC was asked to make its own assessment, if the recommendations of SFCs were not available.	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 Commissions of states.	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 recommendations made by the Finance Commission of the State.
Recommendations for ULBs	Recommended Rs.1000 crore for municipalities to be distributed amongst the states for the five-year period.	Recommended ad hoc annual grant of Rs.400 crore for municipalities. Activities such as maintenance of accounts, development of database and audit to be the first charge on this grant.	Recommended a sum of Rs.5,000 crore for the period 2005-2010 as grants-in-aid to augment the Consolidated Fund of the states to supplement the resources of municipalities.	The grant to local bodies to be from a divisible pool of central taxes and an estimated amount for the ULBs comes to Rs.23,111 crores. The Commission has recommended three types of grants to ULBs namely (i) general basic grant, (ii) performance grant and (iii) special area basic grant.
Criteria for distribution of grant among states	Inter-state ratio of slum population derived from 1971 census.	Based on the following factors and weights: 1. Population 40% 2. Geographical area 10% 3. Distance from Per Capita Income (PCI) 20% 4. Index of decentralization 20% 5. Revenue effort 10%	Based on the following factors and weights: 1. Population 40% 2. Geographical area 10% 3. Distance from highest PCI 20% 4. Index of deprivation 10% 5. Revenue effort 20%	Based on the following factors and weights: 1.Population: 50% 2.Area: 10% 3.Distance from highest per capita sectoral income: 20%. 4. Index of Devolution: 15% 5. FC ULB grants utilization index: 5%
Conditions	Local bodies were required to raise 'suitable' matching contribution for the purpose. No amount was to be used for expenditure on salaries and wages.	Matching contribution was not imposed.	No conditionality. No requirement of matching grant. Suggested that 50% of the grants provided to states should be earmarked for solid waste management. Central Government should not impose any conditions for releasing these grants.	General basic grant would be 1.5% of the divisible pool and general performance grant would be upto 1% of the divisible pool. Whereas, an amount of Rs.20 per capita per year has been allocated as the special area basic grant.

Source: Reports of the Tenth, Eleventh, Twelfth and Thirteenth Central Finance Commissions.

The 13th CFC has adopted a complete shift over in recommending grant-in-aid to local bodies compared to earlier CFCs and has focused on linking of the system of grant-in-aid to a divisible pool of central taxes rather than the system of ad-hoc grant-in-aid recommended by the last three CFCs. Further, the 13th CFC has recommended three types of grant-in-aid to ULBs namely (i) general basic grant, (ii) general performance grant and (iii) special area basic grant. The general performance and special area basic grants are of conditional nature. The State Governments will be eligible to draw down its share of 'general performance grant' and 'special area basic grant' only if they comply with nine and four conditions respectively laid by the 13th CFC. The focus of these conditions is for proper budgeting, accounting and audit practices at local body level, a system of better administration at local body level, an electronic transfer system to local bodies at state level, compulsory levy of property tax and constitution of a state-level property tax board and defining of service standards by the state government. The details are provided in the following Table 2.4.

3.0 State Finance Commissions

3.1 State Transfers

ULBs receive grants mostly from the state governments. Even the union and external grant assistance that are extended are channeled through state administration. Transfers from state government include shared taxes, general and specific purpose grants. There are a few state level taxes, which are shared with Municipal Corporations such as entertainment tax, motor vehicle tax, stamp duty etc. Transfers have several roles, foremost of them being to bridge the gap, since it would be unusual for the revenue raising capacity of municipalities to be perfectly matched with their expenditure needs. General purpose grants are of ad hoc nature and are generally given in lieu of Octroi abolition, DA grant for maintenance of salary level of municipal staff at par with state government employees whereas the specific purpose grants are for assigned functions like health, primary education and for some other functions etc. However, there is an observed drastic change in structure of state transfers among many states in the methods of state transfers after the implementation of SFCs' recommendations of the respective states.

Before 74th CAA, it was not mandatory for the states to devolve any resources or functions to ULBs. Under the provision of 243 Y of the CAA, the states had to constitute state level SFC once in every five-year. SFCs are to recommend the distribution between the state and the municipalities of net proceeds of taxes, duties, tolls and fees leviable by the states. This provision is basic to the emerging fiscal federalism in India more importantly the division of fiscal powers between municipalities and the state and further it can be interpreted to mean that (a) revenue base of municipalities should have some stability and predictability; the recommendations made by the SFCs and accepted by the state governments, it is implied, should remain undisturbed for a period of five years, (b) there should be provision for redrawing the fiscal arrangement between the states and municipalities, or else a quinquinnial review of the finances of municipalities as provided for under Article 243 I and Y may not be justifiable; and (c) revenue base of municipalities should consist of (i) assigned taxes, duties, tolls, and fees; (ii) shared taxes, duties, tolls, and fees; and (iii) grants-in-aid. The details of the Constitution of first, second and third SFCs, report submission and action taken are given in Table 3.1, Table 3.2 and Table 3.3.

Table 3.1: First SFC Reports: Details of Constitution, Report Submission & Action Taken

State	Date of Constitution of SFC	Date of Submission of SFC report	Date of Submission of ATR	Period covered By SFC
Andhra Pradesh	22.6.1994	30.5.1997	29.11.1997	1997-98 to1999-2000
Arunachal Pradesh	21.5.2003	April 2008	Under Consideration	Not Available
Assam	23.6.1995	29.2.1996	18.3.1996	1996-97 to 2000-01
Bihar	23.4.1994	Not submitted	Not submitted	–
Chattisgarh	22.8.2003	15.05.2007	Under Consideration	2005-06 to 2009-10
Goa	1.4.1999	5.6.1999	12.11.2001	2000-01 to 2004-05
Gujarat	15.9.1994	RLBs-13.7.1998,	28.08.2001	1996-97 to 2000-01
		ULBs Oct., 1998		
Haryana	31.5.1994	31.3.1997	5.9.2000	1997-98 to 2000-01
Himachal Pradesh	23.4.1994	30.11.96	5.2.1997	1996-97 to 2000-01
Jammu & Kashmir	15.01.2008	-	Not submitted	2009-2010
Jharkhand	28.1.2004	-	-	Not Available
Karnataka	10.6.1994	RLBs- July 1996,	31.3.1997	1996 -97 to 2000-01
		ULBs 30.1.1996		
Kerala	23.4.1994	29.2.1996	26.02.1997	1996-97 to 2000-01
Madhya Pradesh	25.02.1995	20.7.1996	20.7.1996	1996-97 to 2000-01
Maharashtra	23.4.1994	31.1.1997	5.3.1999	1994-95 to 1996-97#
Manipur	22.4.1994	December, 1996	28.7.1997	1996-97 to 2000-01
Meghalaya	SFC not yet constituted			
Mizoram	SFC not yet constituted			
Nagaland**	01.08.2008	22.10.2009	Under Consideration	2010-2015
Orissa	21.11.1996/ 24.8.1998*	30.12.1998	9.7.1999	1998-99 to 2004-05 $
Punjab	22.04.1994	31.12.1995	17.9.1996	1996-97 to 2000-01
Rajasthan	23.4.1994	31.12.1995	16.3.1996	1995-96 to 1999-2000
Sikkim	23.7.1998*	16.08.1999	June, 2000	2000-01 to 2004-05
Tamil Nadu	23.4.1994	29.11.1996	28.4.1997	1997-98 to 2001-02
Tripura	RLBs- 23.4.1994,	RLBs-12.1.1996,	February 1997	RLBs-Jan.1997 to till date
	ULBs- 19.8.1996	ULBs-17.9.1999	ULBs- 27.11.2000	ULBs-1999-00 to 2003-04
Uttar Pradesh	22.10.1994	26.12.1996	20.1.1998	1997-98 to 2000-01
Uttaranchal	31.3.2001	29.06.2002	3.7.2004	2001-02 to 2005-06
West Bengal	30.5.1994	27.11.1995	22.7.1996	1996-97 to 2000-01

* Date of reconstitution. In case of Gujarat, the SFC report on RLBs was submitted prior to the reconstitution of the SFC.

** Exempt under Article 243 M, SFC constituted under State Act. No specific devolution has been recommended for LB.

As per the ATR, the SFC recommendations shall be effective from 1.4.1999.

$ Though SFC was asked to submit report covering a period of 5 years w.e.f. 1.4.1998, its report covers period from 1998-99 to 2004-05.

Source: Report of the Thirteenth Finance Commission, Government of India, 2010

Table 3.2: Second SFC Reports: Details of Constitution, Report Submission & Action Taken

S. No	State	Date of Constitution of SFC	Date of submission of SFC report	Date of submission of ATR	Period covered by SFC
1.	Andhra Pradesh	8.12.1998	19.08.2002	31.3.2003	2000-01 to 2004-05
2.	Arunachal Pradesh	Not constituted			
3.	Assam	18.4.2001	18.08.2003	07.02.2006	2001-02 to 2005-06
4.	Bihar	20.06.1999	November 2003	Not Available	June'99 to Nov'03
5.	Chattisgarh	Not constituted			
6.	Goa	16.08.2005	31.12.2007	Not Available	2007-08 to 2011-12
7.	Gujarat	19.11.2003	June 2006	Under Consideration	2005-06 to 2009-10
8.	Haryana	6.9.2000	30-09-2004	13.12.2005	2001-02 to 2005-06
9.	Himachal Pradesh	May 1999	24.10.2002	24.06.2003	2002-07
10.	Jammu & Kashmir	Not constituted			
11.	Jharkhand	Not constituted			
12.	Karnataka	25.10.2000	December, 2002	Not submitted	2005-06 to 2009-10
13.	Kerala	23.06.1999	8 January, 2001	07.01.2004	2000-01 to 2005-06
14.	Madhya Pradesh	17.06.1999	July, 2003 (I Report) August 2003 (II Report) December 2003 (III Report)	14.03.2005	2001-02 to 2005-06
15.	Maharashtra	22.06.1999	27.3.2002	29.03.2006	1999-2000 to 2001-02
16.	Manipur	03.01.2003	November 2004	02.12.2005	2001-02 to 2005-06 Award period extended to 31.03.2010
17.	Meghalaya	Exempt under Article 243 M			
18.	Mizoram	Exempt under Article 243 M			
19.	Nagaland	Exempt under Article 243 M			
20.	Orissa	5.6.2003	29.09.2004	11.08.2006	2005-06 to 2009-10
21.	Punjab	21.09. 2000	15.2.2002	08.06.2002	2001-02 to 2005-06
22.	Rajasthan	07.05.1999	29.08.2001	26.03.2002	2000-01 to 2004-05
23.	Sikkim	5 July, 2003	30.09.2004	25.02.2006	2005-06 to 2009-10
24.	Tamil Nadu	03.03.2000	21.5.2001	8.5.2002	2002-03 to 2006-07
25.	Tripura	29.10.1999	10.4.2003	June'08	2003-04 to 2007-08
26.	Uttar Pradesh	25.02 2000	30th June, 2002	30.04.2004	2001-02 to 2005-06
27.	Uttaranchal	30.04.2005	06.06.2006	05.10.2006	2006-07 to 2010-11
28.	West Bengal	14.7.2000	6.2.2002	15-07-2005	2001-02 to 2005-06

Source: Report of the Thirteenth Finance Commission, Government of India, 2010

Table 3.3: Third SFC Reports: Details of Constitution, Report Submission & Action Taken

S. No	State	Date of Constitution of SFC	Date of submission of SFC report	Date of submission of ATR	Period covered by SFC
1.	Andhra Pradesh	29.12.2004	31.01.2009	In Process	2005-06 to 2009-10
2.	Arunachal Pradesh	Not Constituted			
3.	Assam	06.02.2006	27.03.2008	25.09.2009	2006-07 to 2010-11
4.	Bihar	20.07.2004	November 2007	26.03.2007	July 2004 to June 2006
5.	Chattisgarh	Not Constituted			
6.	Goa	Data Not Available			
7.	Gujarat	**Not Constituted**			
8.	Haryana	22.12.2005	31.12.2008	In Process	2006-11
9.	Himachal Pradesh	26.05.2005	2.11.2007	04.06.2008	2007-08 to 2011-12
10.	Jammu & Kashmir	Data Not Available			
11.	Jharkhand	Data Not Available			
12.	Karnataka	20.09.2004	31.12.2008	Not submitted	2010-11 to 2014-15
13.	Kerala	20.09.2004	23.11.2005	16.02.2006	2006-07 to 2010-11
14.	Madhya Pradesh	19.07.2005	01.11.2008	In Process	2006-07 to 2010-11
15.	Maharashtra	15.01.2005	03.06.2006	Under Consideration	2006-07 to 2010-11
16.	Manipur	Not Constituted			
17.	Meghalaya	Exempt under Article 243 M			
18.	Mizoram	Exempt under Article 243 M			
19.	Nagaland	Exempt under Article 243 M			
20.	Orissa	10.09.2008	06.02.2009	**In Process**	2010-11 to 2014-15
21.	Punjab	17.09. 2004	28.12.2006	22.05.2007	2006-07 to 2010-11
22.	Rajasthan	15.09.2005	27.02.2008	17.03.2008	2005-06 to 2009-10
23.	Sikkim	04.03.2009	Due date 30.11.2009	Not Submitted	2010-11 to 2014-15
24.	Tamil Nadu	14.12.2004	30.09.2006	10.05.2007	2007-08 to 2011-12
25.	Tripura	28.03.2008	Awaited	Not Submitted	
26.	Uttar Pradesh	23.12.2004	29.08.2008	Under Consideration	2006-07 to 2010-11
27.	Uttaranchal	Not Constituted			
28.	West Bengal	22.02.2006	31.10.2008	16.07.2009	2008-09 to 2012-13

Source: Report of the Thirteenth Finance Commission, Government of India, 2010

3.2 Recommendations and Devolution Packages of SFCs

The recommendations of the first and second SFCs were not uniform. Further, the SFCs have formulated the fiscal packages without access to a clear directive on the functional jurisdiction of municipalities, particularly with reference to the functions enumerated in Schedule 12 of the Constitution. Absence of clarity in respect of the functional domain of municipalities constitutes a serious gap in the functioning of the SFCs. The recommendations of the first and second SFCs are brought out in Table 3.4.

The Table 3.4 shows a wide variation in the approach to devolution to municipalities. At least three different approaches are noted from the recommendations of the SFCs—

- transfer of specific amounts to municipalities e.g., Himachal Pradesh;
- transfer of parts of those taxes which are appropriated by state governments and shared with municipalities; these comprise of entertainment taxes, taxes on professions, trades, and callings; and electricity duty, and selective transfer of parts of motor vehicle taxes, (Tamil Nadu); and
- sharing of a pool of states revenues, pool consisting of either the (a) net proceeds of tax revenues, or (b) tax and non-tax proceeds, or (c) non-loan gross own revenue receipts (e.g. Karnataka, Madhya Pradesh, Tamil Nadu).

The complexities of the system of grant-in-aid to ULBs has been observed by many SFCs for example first SFC of Uttar Pradesh mentioned that it was an extremely complicated exercise for the Commission to assess the impact of the earlier devolution schemes; neither the budgets or accounts, nor even the internal or external monitoring system had taken specific notice of the reward funds and the way they were spent. In municipal accounts, all finances simply pooled together and spent on the different heads of the expenditure. It has also observed that the actual flow of funds to municipalities from budgetary provision after the SFC Report differed significantly from the recommended devolution and the reasons of these extreme deviations were, (i) the time-lag involved in giving effect to the recommendations (a lag of almost two years) and (ii) no compensation was given to municipalities which received grants during the time-lag period. It has also observed that information provided by the state government and municipalities differs a lot and has quoted, 'Firstly, the municipalities failed to distinguish between entitlements under SFC arrangements and receipts through other sources of finance. Secondly, sub-heads of accounts of municipalities had not been created by the C&AG and thirdly, the very process of transfers was not smooth, with piece by piece release without reference to annual entitlements, carry-over of amounts due from one year to another, time-lags in furnishing utilization certificates which delayed full releases".

Table 3.4: Devolution Package: First and Second State Finance Commission

State	Recommended Share as per the First State Finance Commissions	Recommended Share as per the Second State Finance Commissions
Andhra Pradesh	39.24% of state tax and non-tax revenue to all local bodies.	40.92%of state tax and non-tax revenue to all bodies, both rural and urban bodies, 9.67% is allocated to municipalities.
Assam	2% of state tax for local bodies, both rural and urban. (The share of urban local bodies has not been specified).	
Himachal Pradesh	An amount equals to Rs.12.2 crore as grants in lieu of Octroi for 1996/97, to rise to Rs.17.9 crore in 2000/01 and CSS grants to accrue to municipalities.	An amount equal to Rs.19.66 crore as development grants for the year 2002/03, with a 10 per cent mark-up to neutralize inflation, rising to Rs.28.79 crore by 2006/07, and CSS grants to accrue to ULB
Karnataka	5.4% of the total non-loan gross own revenue receipts for meeting the plan and non-plan requirements.	8% of non-loan gross own revenue receipts for municipalities.
Kerala	1% of state revenues (excluding from certain sources) be transferred to local bodies as non-statutory non-plan grants distributed between the rural and urban local bodies in proportion to their population.	
Madhya Pradesh	8.67% of the tax and non-tax revenues of state government.	1.07% of divisible pool of state own tax revenue.
Maharashtra	25% to 100% of entertainment taxes collected from municipalities of different grades, 25% of vehicle tax and 10% of profession tax are recommended shares for local bodies.	
Orissa	Rs.179.5 crores is the projected transfer (grant) to urban local bodies between 1998/99 and 2004/05. (The deficit of Rs.1,378 crores between the estimated income and expenditure and an additional requirement of Rs.381.48 crore for improvement of core civic services should be met by the Eleventh Finance Commission.	
Punjab	20% of the net proceed for five taxes namely, stamp duty, motor vehicle tax, electricity duty, entertainment tax, and cinematograph shows should be transferred to municipalities, and the projected gap of Rs.322 crore should be met by the CFC.	4 per cent of net tax proceeds of all state taxes to be devolved to all local bodies.
Rajasthan	2.18% the net proceeds of state taxes should be devolved on the local bodies; the division of these proceeds between rural and urban should be in the ratio of 3.4:1.	Total devolution of Rs.794.43 crore consisting of 2.25% share in states net own tax revenue (excluding entertainment tax); 15% share in entertainment tax for ULBs for the award period 2000-05 and 1% share in royalty receipts from minerals to Gram Panchayats.
Tamil Nadu	8% of the state's net tax revenue should be devolved on the local bodies in 1997/98; this percentage should gradually increase in successive years to 9%, 10%, 11% and reaching 12% in 2001/02. The division of this amount between rural and urban should be on the basis of population as in the last Census.	8% of state's own tax revenue, after excluding entertainment tax to local bodies for each year from 2002/03 to 2006/07; shares of PRIs and ULBs in the recommended devolution will be in the ratio 58:42.
Uttar Pradesh	7% of the net proceeds of state's total tax revenue should be transferred to urban local bodies.	
West Bengal	16% of the net proceeds of all taxes collected by the state should be transferred to local bodies. Such funds should be released to the Districts. These proceeds should be divided between urban and rural based on population.	(a) Nearly 72 percent tax proceeds from entertainment tax. (b) 16 percent allocated from states revenue as untied entitlement fund, the proceeds of which are to be distributed between ULB and Panchayats.

Source: NIPFP 2004 and Reports of the State Finance Commissions.

Audit Report of ULBs of Rajasthan for the year ended 31 March 2004 has also pointed that the ground realities differs from the recommendations of SFCs such as there are short-release of grants recommended by the second SFC, non-release of entertainment tax to ULBs and short release of grants in lieu of abolition of Octroi; it has also observed that there are several irregularities in municipal accounting procedures. As per the Audit Report (Urban Local Bodies) of Maharashtra for the year ended 31 March 2006, has also stated, "There were instances of diversion of funds, non-reconciliation of cash book balances with pass books, un-utilized grants, unclaimed deposits, etc., indicating that the internal control mechanisms in the Municipal Corporations was weak". Further, the Audit Report of Andhra Pradesh for the year ended 31 March 2005 has observed that there is incorrect lapsing of 10th and 11th CFCs grants released by Government of India to the extent of Rs. 7.30 crores. Interestingly it has been noticed that as per the recommendation of second SFC of Madhya Pradesh, expenditure against grants received under 11th CFC should be treated under the plan expenditure of their budgets.

Many of the transfers, it should be noted, are not possible to be separately accounted as these are absorbed directly into state government expenditure. The issue of state transfers/grant-in-aid becomes more complex if one tries to have an idea of these system of transfers/grant-in-aid to ULBs from the state budgets and the state finance accounts. There are several departments of state governments, which pass on grants to ULBs and there are several major and minor heads in the state budget and state finance accounts, which give explanation of these grants but these, are not clubbed at one place in the budgets and scattered in several major and minor heads of state budgets. Moreover, municipal budgets also not clearly provide the details of the grants, which are being received from central as well as state governments.

4.0 Madhya Pradesh

4.1 First SFC

4.1.1 Background

The First SFC in the state of Madhya Pradesh was constituted on 25th February 1995 under the State Finance Commission Act, 1994 and it had submitted its report to the State Government for the approval of recommendations on 20th July 1996 with a time period of 1996-97 to 2000-01. The State Government issued the Action Taken Report for the implementation of the accepted recommendations from the year of 1998-99.

4.1.2 Methodology

The First SFC of Madhya Pradesh required a good data base to know the existing system of grant-in-aid to ULBs, financial health and resource gap of ULBs, taxation powers of ULBs, functional domain of ULBs, levels of various basic services, norms and standards of basic services and financial health of the state government of Madhya Pradesh. The first SFC felt handicapped due to non-availability of data/information relating to the finances of the ULBs since there was no agency in the state, which collects and maintains comprehensive databases w.r.t ULBs. In absence of the required information on the finances of ULBs, the SFC conducted its own survey based on detailed questionnaire in the selected municipalities to review their financial position.

4.1.3 Previous System of Grant- in- aid to ULBs

The SFC observed that multiple grants were passed on to ULBs mainly under two broad categories such as (i) general purpose grants and (ii) specific purpose grants. Financial dependency of the ULBs on the State Government had increased by 50% after the demise of Octroi of which the share of compensation in lieu of Octroi duty was 80% and remaining 20% by grants for other purpose. The grants were released from the consolidated fund of the state government. The Commission also observed that the per capita grant in compensation of Octroi was proportionally less for small ULBs whereas per capita specific grants was low in case of bigger ULBs.

The SFC observed that after the abolition of Octroi in the state, the state government decided to impose entry tax from 1st May 1976. The entry tax was introduced, as a measure of compensation but revenue collected through this tax was not equal to the actual amount paid as compensation for Octroi because the formula for compensation and its distribution system had been changed by the state government from time to time with prior consent of the ULBs.

4.1.4 Analysis of State Related Finances w.r.t Grant-in-Aid at ULB level

State budgets and state finance accounts were considered for the analysis of state finances and trends of revenue income and expenditure of the state government. It has been observed that although the SFC has analysed state related finances including growth and trend of income and expenditure for the last ten years but has not calculated the load of grant-in-aid to local bodies of the state. This section could have analysed the impact of total transfers to ULBs on the state finances. The linkage of state finances and system of grant-in-aid in ULBs could have been incorporated in the report.

4.1.5 Recommended System

Global Sharing

The SFC recommended a share of 8.669% of net revenue receipts (tax and non-tax) of the State Government i.e. 8.669% of State's net own revenue (net own tax revenue and net own non-tax revenue) in accordance with the principle of "global sharing" which means the principle of universal partnership of resources. On the basis of this percentage, it was suggested that the funds should be released in coming years also.

Entry Tax

The Commission recommended the additional amount of Rs.203 crores for all ULBs in lieu of entry tax for the year 1996-97. An increase in the tax base and rationalization of rates of entry tax was also suggested to generate minimum of Rs.400 crores from this source by the state government for the year 1996-97.

Passenger Tax and fees, penalties and other receipts

The SFC recommended that the state government should continue to transfer a special grant-in-aid in lieu of abolition of passenger tax, and payments of fees, penalties and other receipts payable to ULBs under different Acts. There should not be any deduction of any kind from the share/grant-in-aid given to the ULBs.

Creation of Urban Development Finance Corporation

The creation of Urban Development Finance Corporation was recommended by the Commission with an authorized share capital of Rs.250 crores for providing adequate financial help to ULBs for capital investment projects. Amount received under 10th CFC should be utilized in form of contribution to the authorized share capital of the above Corporation.

Creation of Urban Infrastructure Development Fund

The creation of Urban Infrastructure Development Fund was recommended by the Commission for investment in infrastructure development of the local bodies. The structure and organization of this fund should be decided by the State Government at its own level.

Inter-District Distribution Formula

The district wise allocation of resources was recommended by the State Government by giving 40% weightage to urban population, 35% to sales tax contribution, 15% to backwardness, scheduled caste/scheduled tribe population (urban) and 10% to the level of infrastructure for development (inverse of per capita electricity consumption in urban areas).

4.1.6 Action Taken Report

Global Sharing

Instead of 8.669%, State Government of Madhya Pradesh accepted to devolve 0.514% of net tax and non-tax revenue of the state government for ULBs from the year of 1998-99 i.e 0.514% of State's net own revenue (net own tax revenue and net own non-tax revenue).

It is to be noted that the SFC had calculated that the combination of all grant-in-aid to ULBs put a load of 4.63 percent of the net proceeds of tax and non-tax revenue of the State Government and recommended 8.669% of the net proceeds of state's own tax and own non-tax revenue. Only 0.514% of net proceeds of state's own tax and own non-tax revenue was accepted for all ULBs of the state. The accepted percentage distribution of state's net proceeds of own tax and own non-tax revenue was comparatively minimal to the existing percentage of distribution. This is because of non-acceptance of the suggestion of merging Octroi compensation and all other grants and linking it with the state's own revenues. The State Government decided to continue with octroi compensation separately.

Entry Tax

The state government decided to continue the existing system of transferring grant-in-aid in lieu of entry tax and also accepted the recommendation. It also indicated that the tax base and tax rate w.r.t entry tax should be rationalized appropriately.

Passenger Tax and fees, penalties and other receipts

The state government accepted recommendation on passenger tax and payments of fees, penalties and other receipts.

Creation of Urban Development Finance Corporation/Urban Infrastructure Development Fund

The state government had not accepted these recommendations.

Incentive grant:

The state government had not indicated its acceptance on this issue and also indicated that the decision would be taken after the consultation with the local government department of the state.

Inter-District Distribution Formula

The state government accepted only urban population as per 1991 as a criterion for the inter-se distribution of state transfers/grant-in-aid among ULBs.

4.2 Second SFC

4.2.1 Background

Second SFC of Madhya Pradesh was constituted on 17th June 1999 and it had submitted its first report on July 2003, second report on August 2003 and third report on December 2003 for the period of five years i.e. 2001-02 to 2005-06. The State Government issued Action Taken Report on 14th March 2005 for implementation for the period of 2004-05 and 2005-06.

4.2.2 Methodology

In absence of the required information on the finances of ULBs, the SFC conducted its own survey based on detailed questionnaire in the selected municipalities to review their financial position for the period of five years i.e. 1995-96 to 1999-2000 and also provided projections for the period of 2001-02 to 2005-06 and interviewed with state and municipal officials. The financial needs of the ULBs were estimated by the SFC w.r.t basic services like lighting and drinking water and sanitation.

4.2.3 System of Grant-in-aid/Transfers to ULBs prior to Second SFC

The Second SFC observed that ULBs in the state were receiving multiple transfers/grants from state government under two broad categories such as (i) Non-plan transfers and (ii) Plan transfers. Non-Plan transfers included the share in own revenue of the state government (recommended by the First SFC), assigned tax revenue comprising of compensation grants in lieu of entry tax, passenger tax and surcharge/cess on state's commercial tax and other grant-in-aid. Whereas plan transfers to ULBs comprised of specific purpose grants, centrally sponsored schemes, CFC grants and grants of tribal sub-plan. The complexities related to state transfers to ULBs remained more or less same even the passage of First SFC. There were no clear-cut mechanisms of transferring of these funds to ULBs except the fiscal package, which was suggested by the First SFC.

4.2.4 Analysis of State Related Finances w.r.t Transfers/Grant-in-Aid at ULB level

The Commission suggested ways and means of augmenting resources of the state government and on revenue account, for meeting the expenditure requirement of the state and also for meeting its constitutional obligation of strengthening local finance in the state and also suggested budgetary reforms. Since the SFC was required to recommend its scheme of devolution of resources from the state government to local bodies against the background of review of state economy and also of finances of the state government, the Commission had made a quick review of the performance of the state economy and also of the constraints on the process of development and change in the state. An attempt to the trend and growth of total transfers to ULBs has not been made and the linkage of state finances and system of transfers/grant-in-aid in ULBs is missing in the report.

4.2.5 Recommended System

Global Sharing

The second SFC unlike the first SFC, which recommended a share of 8.669% of net revenue receipts (tax and non-tax) of the State Government, had recommended a share of 1.07% of net own tax receipts of the State Government for the period of 2001-02 to 2005-06.

Entry Tax, Passenger Tax and Cess/Surcharge on Certain Taxes

The second SFC had recommended that revenue from entry tax, passenger tax and cess/surcharge on certain taxes might be continued to be assigned to municipalities in proportion to collection of revenue from their respective jurisdiction.

Entertainment Tax

The Commission recommended that net revenue from entertainment tax might be assigned to municipalities on the basis of the collection from the respective jurisdiction.

Incentive grant

The Commission had recommended that a sum of Rs.8.5 crores might be provided for the purpose of general-purpose grants to municipalities for 2001-02, to be estimated every year on the basis of performance of collection of property tax.

Inter-District Distribution Formula

The second SFC recommended 1.07% as a share of the divisible pool may be allotted to ULBs. 10% out of the total amount of divisible pool may be pre empted for allocation on to such municipalities, which have slum population higher than 10% of their respective population, as per 2001 census. This amount is to be utilized for providing basic infrastructure at slum areas or the improvement in slum areas. Remaining 90% amount should be allocated to the ULBs of the State on the basis of their respective population including slum population according to 2001 census.

4.2.6 Action Taken Report

Global Sharing

The State Government accepted a recommended share of 1.07% of net tax receipts of the State Government as suggested by the second SFC.

Entry Tax, Passenger Tax and Cess/Surcharge on Certain Taxes

As per the recommendations of the second SFC, the state government had decided to continue the present system of distribution arrangement.

Entertainment Tax

The state government had not accepted the recommendation w.r.t inclusion of entertainment tax under assigned revenues, which were being given to ULBs.

Incentive grant

The State Government had not accepted the recommendation related to general-purpose grants based on performance of collection of property tax.

Inter-District Distribution Formula

The state government accepted the recommendation of second SFC for distribution of amount as per global sharing i.e. 1.07% as a share of the divisible pool allotted to ULBs on the basis of population of ULBs as per Census of 2001. The State Government had also accepted that the share of each municipality in the fiscal package in the form of share in tax revenue, assigned tax revenue and grant-in-aid that should be determined by a designed officer of the Urban Administration Department of the State Government.

4.3 Assessment

First SFC of Madhya Pradesh addressed the complexity of the system of grant-in-aid/transfers to ULBs and tried to make recommendations for a simpler system of grant-in-aid to ULBs by suggesting a new revenue sharing mechanism with ULBs. But the idea of taking into consideration of all grant-in-aid to ULBs and suggesting a fiscal package based on revenue sharing mechanism for the elasticity of grant-in-aid to ULBs was defeated when the state government did not accept this recommendation. The state government decided to continue with all the grants, which were being released to ULBs prior to the first SFC and made only one change by accepting a small portion of grants in the name of SFC grants.

Whereas, the second SFC has given suggestions to share only the net proceeds of tax receipts and ignored the non-tax part. Although it has suggested a higher proportion of share of tax revenue but in principle it has missed out on the message of sharing of net proceeds of tax and non-tax receipts provided by the Constitutional provision for SFCs. The second SFC made recommendation mainly on a new revenue sharing mechanism but the status of all other grant-in-aid to ULBs remained more or less same.

Moreover, both the SFCs have reviewed all sections of the taxation powers mentioned in the Madhya Pradesh Municipal Corporation Act, 1956 but haves not made any recommendations in devolution of new tax powers to ULBs. Similarly, the SFCs have not given any recommendation of devolution of functions as per the 12th Schedule of 74th CAA and nor has given any suggestions on funds and functionaries require to carry out these functions.

4.4 Field Observations: State Level

4.4.1 Background

Data on transfers/grant-in-aid to ULBs has been collected for a period of 2001-02 to 2007-08. Transfers/grant-in-aid to ULBs can be broadly categorized in two heads namely plan grants and non-plan grants/transfers. Plan grants are mainly on capital account and are of the nature of specific purpose grants whereas the non-plan grants/transfers can further be categorized under five heads namely assigned revenue, compensation in lieu of taxes, SFC grants, CFC grants and specific purpose grants. Assigned revenues consist of duty on transfer of properties and mineral royalty whereas compensation in lieu of taxes includes compensation in lieu of abolition of Octroi and passenger tax. The SFC grants are based on first and second SFCs' recommendations i.e. with time periods of 2001-02 to 2004-05 and 2005-06 to 2007-08 for the first and second SFC respectively. Whereas CFC grants are based on eleventh and twelfth finance commissions' recommendations i.e. with time periods of 2001-02 to 2004-05 and 2005-06 to 2007-08 for the eleventh and twelfth CFC respectively.

4.4.2 Transfers to ULBs

Looking at the growth rates of state's own revenues and state transfers to ULBs, it has been found that the total non-plan transfers to all ULBs of the state have risen faster than the own revenue of the state government and the growth rates are 20% and 13.5% respectively for the period of 2001-02 to 2007-08. Within the non-plan transfers, assigned revenues, compensation in lieu of taxes and specific purpose grants have risen with a growth rate of 19.1%, 15.7% and 36.2% respectively during the same period. Whereas, the SFC grants and CFC grants have risen with a growth rate of 30.1% and 28.9% respectively.

Table 4.1: Transfers/Grants-in-aid to ULBs in Madhya Pradesh

Rs. Crore

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	AAGR (%)
Non-Plan Transfers/Grants	415.79	506.21	686.17	762.56	988.91	1163.82	1389.90	20.11
(i) Assigned Revenue	37.82	55.90	61.00	65.85	74.56	93.37	119.03	19.11
(ii) Compensation in lieu of Taxes	315.55	311.32	359.45	435.67	516.95	637.82	808.01	15.67
(iii) SFC Grants	16.59	43.58	27.07	62.32	83.14	87.77	100.86	30.08
(iv) Specific Purpose Grants	33.09	70.00	191.71	173.30	242.06	272.66	289.80	36.17
(v) CFC Grants	12.74	25.41	46.94	25.42	72.20	72.20	72.20	28.91

Source: Directorate of Municipal Administration, Madhya Pradesh.

Since non-plan grants/transfers are the main component of state transfers on disaggregating it further, it was found that the compensation in lieu of taxes has ranged from 76% to 58% of the non-plan grants/transfers during 2001-02 to 2007-08 whereas assigned revenue and specific purpose grants have ranged from 9% to 8.6% and from 8% to 21% respectively.

SFCs and CFCs grants have ranged from 4% to 7.3% and 3% to 5.2% respectively for the same period.

Table 4.2: Composition of Transfers/Grant-in-aid to all ULB's in Madhya Pradesh

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Assigned Revenue as % of State's Non-Plan Grants	9.10	11.04	8.89	8.64	7.54	8.02	8.56
Compensation in lieu of Taxes as % of State Non-Plan Grants	75.89	61.50	52.38	57.13	52.27	54.80	58.13
SFC Grants as % of State's Non-Plan Grants	3.99	8.61	3.95	8.17	8.41	7.54	7.26
Specific Purpose Grants as % of State's Non-Plan Grants	7.96	13.83	27.94	22.73	24.48	23.43	20.85
CFC Grants as % of State's Non-Plan Grants/Transfers	3.06	5.02	6.84	3.33	7.30	6.20	5.19

Source: Directorate of Municipal Administration, Madhya Pradesh.

Looking at the complexities of the system of grant-in-aid/transfers to ULBs in the state of Madhya Pradesh it was interesting to calculate the total load of these non-plan transfers on the state finances. It has been observed that the non-plan transfers to ULBs as a percentage of state own revenues has shown an increasing trend and has ranged from 6% to 9.3% during the period of 2001-02 to 2007-08. This increasing trend is mainly due to high increase in non-plan grants compared to the rise in own revenues of the state.

Table 4.3: Ratio of Transfers/Grant-in-aid to all ULBs in Madhya Pradesh

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Non-Plan Transfers* as a % of State's Own Revenue	6.42	6.16	7.73	6.02	8.10	8.73	9.32
SFC grants as % of State's Own Revenue	**0.26**	**0.56**	**0.33**	**0.51**	0.73	0.70	0.71
SFC grants as % of State's Own Tax Revenue	0.35	0.71	0.40	0.80	**0.91**	**0.86**	**0.86**

Note: * Non-Plan Transfers are excluding CFC grants
Source: Directorate of Municipal Administration, Madhya Pradesh and State Budgets of Madhya Pradesh.

On looking at the actual transfers on SFC account, it has been observed that SFC grants as a percentage of net own revenue of the state government has shown a fluctuating trend and has ranged from 0.26% to 0.51% during 2001-02 to 2004-05 against the recommended share of 0.514% by the first SFC whereas SFC grants as a percentage of net tax revenue of the state government has remained around one percent and has ranged from 0.91% to 0.86% during 2005-06 to 2007-08 against the recommended share of 1.07% by the second SFC.

4.5 Field Observations: ULB Level

4.5.1 Background

Data on municipal finance for the Municipal Corporations of Bhopal and Ujjain has also been collected for a period of 2001-02 to 2007-08. Municipal revenue income can mainly be divided in two categories i.e. income from own receipts and receipts under the head of grants/transfers. Income from own receipts are mainly from tax and non-tax receipts. Receipts under transfers/grants can be broadly categorized in two heads namely plan grants and non-plan grants/transfers. Plan grants are mainly on capital account and are of the nature of specific purpose grants whereas the non-plan grants/transfers can further be categorized under five heads namely assigned revenue, compensation in lieu of taxes, SFC grants, CFC grants and specific purpose grants. Assigned revenues consist of duty on transfer of properties and mineral royalty whereas compensation in lieu of taxes includes compensation in lieu of abolition of Octroi and passenger tax. It is to be noted that in case of Madhya Pradesh, the total property tax demand of Rs. 190.44 crore for 20 ULBs has been raised for duration of 2001-07 but out of which only Rs. 90.21 crore (47 percent) were recovered. A sum of Rs. 100.23 crore (53 percent) is outstanding against the taxpayers. Non-recovery of outstanding taxes by the ULBs under Madhya Pradesh Municipalities Act, 1956, resulted in resource crunch and subsequent hindrance in development works. The SFC grants are based on first and second SFCs' recommendations i.e. with time periods of 2001-02 to 2004-05 and 2005-06 to 2007-08 for the first and second SFC respectively. Whereas CFC grants are based on eleventh and twelfth finance commissions' recommendations i.e. with time periods of 2001-02 to 2004-05 and 2005-06 to 2007-08 for the eleventh and twelfth CFC respectively.

4.5.2 Transfers/Grant-in-Aid to Bhopal and Ujjain Municipal Corporations

Data at the sample Municipal Corporation level namely Bhopal and Ujjain, has shown that own revenue receipts as a percent of total revenue receipts has declined from 52.3% to 39.2% and from 31.3% to 22.6% for Bhopal and Ujjain respectively during the period of 2001-02 to 2007-08, whereas, the transfers/grants as a percent of total revenue receipts has increased from 47.7% to 60.8% and from 68.7% to 77.4% for Bhopal and Ujjain respectively during the period of 2001-02 to 2007-08. In other words, it can be interpreted that the capacity to raise own revenue receipts has gone down and dependency on the transfers has increased for both the ULBs of Madhya Pradesh namely Bhopal and Ujjain.

Table 4.4: Composition of Revenue income of Bhopal and Ujjain (Percentage)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Bhopal M. Corp.							
Own Revenue Receipts as % of Revenue Income	52.31	52.39	52.07	39.57	44.94	48.26	39.22
Non-Plan Transfers as % of Revenue Income	47.69	47.61	47.93	60.43	55.06	51.74	60.78
Total Revenue Receipt	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Ujjain M. Corp.							
Own Revenue Receipts as % of Revenue Income	31.30	27.16	25.28	21.14	24.15	22.56	34.11
Non-Plan Transfers as % of Revenue Income	68.70	72.84	74.72	78.86	75.85	77.44	65.89
Total Revenue Receipt	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Bhopal and Ujjain Municipal Corporations

In per capita terms, Bhopal Municipal Corporation has generated Rs.270.89 from its own revenues in the year of 2001-02, which steadily risen to Rs.346.41 in 2007-08. Whereas, non-plan transfers has increased from Rs.246.97 to Rs.388.53 during 2001-02 to 2006-07 and then risen to Rs.536.87 in 2007-08. Out of non-plan transfers, compensation in lieu of taxes and specific purpose grants has increased from Rs.144.56 to Rs.234.42 and from Rs.81.83 to Rs.164.13 respectively during 2001-02 to 2007-08, whereas assigned revenues and SFC grants has increased from Rs.12.17 to Rs.71.26 and from Rs.8.41 to Rs.41.32 respectively. Per capita CFC grants were merely Rs.25.75 for the year of 2007-08.

Similarly, in per capita terms, Ujjain Municipal Corporation has generated Rs.112.67 from its own revenues in the year of 2001-02, which steadily risen to Rs.3324.49 in 2007-08. Whereas, non-plan transfers has ranged from Rs.247.33 to Rs.500.23 during 2001-02 to 2005-06 and then risen to Rs.626.70 in 2007-08. Out of non-plan transfers, compensation in lieu of taxes and specific purpose grants has increased from Rs.238.20 to Rs.380.83 and from Rs.16.54 to Rs.145.49 respectively during 2001-02 to 2007-08, whereas assigned revenues and SFC grants had increased from Rs.9.13 to Rs.33.72 and from Rs.14.82 to Rs.38.44 respectively. Per capita CFC grants are merely amounted to Rs.28.23 for the year of 2007-08.

In terms of growth rate also, during the period of 2001-02 to 2007-08, own revenue receipts have grown by 7.1% and 10.4% for Bhopal and Ujjain respectively whereas grants/transfers on revenue account have increased by 16% and 19.3%. In case of Bhopal, the capacity of own revenue generation is relatively good during 2001-02, 2002-03 and 2003-04 however it has declined in 2004-05 and dependency on transfers/grants has increased and the same pattern is again observed in 2007-08. In case of Ujjain, the capacity of own revenue generation is throughout poor during the period of 2001-02 to 2007-08 and dependency on transfers/grants kept on rising during this period.

Table 4.5: Transfers/Grant-in-aid for the State of Madhya Pradesh (Average), Bhopal and Ujjain Municipal Corporations

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Per Capita (Average of the State)							
Non-Plan Transfers/Grants	253.64	300.78	397.13	429.88	543.01	622.46	724.08
i) Assigned revenue	23.07	33.22	35.30	37.12	40.94	49.94	62.01
ii) Compensation in lieu of taxes	192.49	184.98	208.04	245.60	283.86	341.13	420.94
iii) SFC Grants	10.12	25.89	15.67	35.13	45.65	46.94	52.54
iv) Specific Purpose Grant	20.19	41.59	110.95	97.70	132.92	145.83	150.97
v) CFC Grants	7.77	15.10	27.17	14.33	39.65	38.62	37.61
Per Capita (Bhopal M. Corp.)							
Non-Plan Transfers/Grants	246.97	265.15	286.45	408.03	393.97	388.53	536.87
i) Assigned revenue	12.17	4.89	19.05	24.32	0.00	32.47	71.26
ii) Compensation in lieu of taxes	144.56	122.65	132.72	201.12	239.56	172.49	234.42
iii) SFC Grants	8.41	6.55	25.22	26.79	23.22	31.47	41.32
iv) Specific Purpose Grant	81.83	131.06	109.46	144.45	103.70	138.77	164.13
v) CFC Grants	0.00	0.00	0.00	11.36	27.49	13.33	25.75
Per Capita (Ujjain M. Corp.)							
Non-Plan Transfers/Grants	247.33	365.14	420.19	491.71	500.23	595.86	626.70
i) Assigned revenue	9.13	2.88	12.04	14.05	36.30	28.78	33.72
(ii) Compensation in lieu of taxes	238.20	312.61	238.59	297.59	334.41	296.53	380.83
(iii) SFC Grants	0.00	14.82	58.85	9.00	65.84	26.05	38.44
(iv) Specific Purpose Grant	0.00	16.54	99.25	171.07	38.70	230.14	145.49
(v) CFC Grants	0.00	18.29	11.46	0.00	24.98	14.36	28.23

Source: Directorate of Municipal Administration, Madhya Pradesh and Bhopal and Ujjain Municipal Corporations.

Further, overall per capita non-plan transfers (average at the state level) to all ULBs have been steadily rising and it has risen from Rs.253.64 to Rs.724.08 during 2001-02 to 2007-08. Comparing state's per capita non-plan transfers with per capita non-plan transfers of Bhopal and Ujjain, it has been found that except for the years 2001-02 and 2002-03, Bhopal has consistently been getting lesser non-plan transfers whereas Ujjain has been receiving more non-plan transfers except for the last three years i.e. 2005-06 to 2007-08 where it has been marginally lesser than the state's average.

Table 4.6: ULB's Share in Urban Population and ULB's share in Non-Plan Transfers (Percentage)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Bhopal M. Corp.							
ULB's Urban Population as % of State's Urban Population	9.04	9.07	9.11	9.14	9.18	9.21	9.25
ULB's Non-Plan Transfers as % of State's Non-Plan Transfers	8.80	8.00	6.57	8.68	6.66	5.75	6.86
ULB's Assigned revenues as % of State's Assigned Revenues	4.77	1.34	4.91	5.99	0.00	5.99	10.63
ULB's Compensatory Grant as % of State's Compensatory Grants	6.79	6.02	5.81	7.49	7.75	4.66	5.15
ULB's SFC's grants as % of Total SFC's grants	7.51	2.29	14.66	6.97	4.67	6.18	7.27
BMC's Specific Purpose Grants as % of State's Specific Purpose Grants	36.63	28.59	8.98	13.52	7.16	8.77	10.06
ULB's CFC's grants as % of Total CFC's grants	0.00	0.00	0.00	7.25	6.36	3.18	6.33
Ujjain M. Corp.							
ULB's Urban Population as % of State's Urban Population	2.67	2.65	2.62	2.60	2.58	2.55	2.53
ULB's Non-Plan Transfers as % of State's Non-Plan Transfers	2.61	3.21	2.78	2.97	2.37	2.44	2.19
ULB's Assigned revenues as % of State's Assigned Revenues	1.06	0.23	0.89	0.98	2.28	1.47	1.38
ULB's Compensatory Grant as % of State's Compensatory Grants	3.31	4.47	3.01	3.15	3.04	2.22	2.29
ULB's SFC's grants as % of Total SFC's grants	0.00	1.52	9.86	0.67	3.72	1.42	1.85
BMC's Specific Purpose Grants as % of State's Specific Purpose Grants	0.00	1.05	2.35	4.55	0.75	4.03	2.44
ULB's CFC's grants as % of Total CFC's grants	0.00	3.21	1.11	0.00	1.62	0.95	1.90

Source: Bhopal and Ujjain Municipal Corporations.

Most of the transfers to ULBs in the State of Madhya Pradesh are based on population of the ULBs i.e. grants/transfers to ULBs are being principally based in per capita terms. Looking at the various components of non-plan transfers to ULBs it has been found that in case of

Bhopal, it has been consistently lesser percentage share of all the components of transfers compared to its share of urban population except for one or two years when the share of specific grants is higher than its share of population in state's urban population. Similarly, in case of Ujjain also, it has been consistently lesser percentage share of all the components of transfers compared to its share of urban population except for one or two years when the share of compensation grants in the years of 2002-03 is higher than its share of population in state's urban population and the share of SFC grants in the years of 2003-04 is higher than its share of population in state's urban population probably due to release of backlog grants. Please see Table 4.6.

4.5.3 Utilization of Grants

In Madhya Pradesh, grant-in-aid to ULBs can be classified in two broad categories, (i) general purpose grants or block grants and (ii) specific purpose grants. The general-purpose grants are untied in nature but specific purpose grants are being given for particular purposes. The general-purpose grants are intended for meeting revenue expenditure of ULBs, by supplementing the general revenues available for carrying out normal functions, and have no conditionalities attached to them. They are designed to boost up poor ULBs to a minimum level of income, necessary to ensure that all of them are financially able to meet their essential liabilities. Such grants are not conditional and therefore do not impinge upon local government expenditure autonomy.

On the other hand, specific purpose grants are intended for certain identified activities, such as upgradation and improvement of certain services like drinking water supply, primary education, primary health facilities, improvement of slums, street lighting and maintenance of roads etc. These grants are conditioned on particular service being rendered and maintained at a particular level of efficiency. The evaluation of performance of such programs in accordance with the objectives underlying the grant-in-aid, the review of programs and continuous monitoring of such programs and timely submission of audited accounts, accompanied by progress reports, are other requirements of specific grants.

It has been highlighted by the SFC that revenue from tax on vehicles and revenue from entry tax is deposited under "0041-Tax on Vehicles" and "0042-Tax on goods and passengers" respectively. The provision for payment of grants to ULBs, from these receipts is included in the budget under the head – Demand No. 81 – Main head 3604- Compensation to local bodies and Panchayati Raj Institutions. These allocations are intimated to the Director, Urban

Administration every year and payments are made by Directorate to the concerned ULBs. It has been observed that the payments of grant-in-aid are not being passed on to ULBs on timely basis and prescribed amount by the Directorate of Urban Administration. This type of delayed and inadequate flow of funds affects adversely the financial position of the ULBs.

In Madhya Pradesh, the Directorate, Urban Administration and Development Department circular (December 2004) stipulates that grants should not be released before obtaining Utilization Certificates of previous years. Audit scrutiny (April 2008) of records relating to the release of SFC funds by the Directorate UADD Bhopal revealed that funds were released during the year 2004-07 without obtaining UCs of previous years from ULBs.

Centrally Sponsored Schemes such as Conversion of dry latrines, Mid-day meal, Integrated Development of Small and Medium Towns (IDSMT) Swarna Jayanti Shahari Rozgar Yojna (SJSRY) etc. and State Plan Schemes were being implemented through ULB's during 2001-07 Scrutiny of records revealed that grants of Rs. 5.61 crore released to 12 ULB's for the aforesaid specific purposes were lying unspent for a period ranging from one year to eight years. No action was taken to refund the unspent balance of grants to government. The ULB's also did not review the implementation of schemes to ascertain reasons for the non-utilization of grants. This deprived the citizens from intended benefits.

Functions under 12^{th} Schedule of the Constitution were supposed to be transferred to ULBs since its enactments in 1992. However, atleast one Audit Report of ULBs of the state of Madhya Pradesh has pointed out serious flaws in this regard. First of all, the State Government did not frame any rules for proper and effective implementation of devolution of functions, functionaries and funds. In the absence of rules, there was no system to watch implementation of transfer process. Secondly, a decentralization cell was required to be constituted at district level to effectively review the progress of transfer of functions along with functionaries, and funds. The decentralization cell was not constituted at any district level. This shows that the concerned departments were irregularly enjoying the administrative and financial powers of ULBs regarding the implementation of devolved functions.

As per the consolidated information on release and utilization of 12^{th} CFC grant furnished by the State government to the Government of India that 5250 functionaries along with functions were transferred to the ULBs. Audit Reports had revealed that the functionaries attached to devolved functions have not been actually transferred to the ULBs. And lastly, the Government of Madhya Pradesh stated that budget was to be provided to the ULBs for implementation of devolved function under the grant No. 82. The funds provided under this grant were to be drawn and utilized by the ULBs but no specific budget for devolved functions was provided in the above-mentioned grant.

4.5.4 Assessment

State transfers to the ULBs in the State of Madhya Pradesh has shown a higher growth rate compared to its revenue generation which shows the dependence of ULBs on state transfers has increased during the past seven years. The compensatory grant to the ULBs is the main component of state transfers especially after the abolition of Octroi in the state. SFC grants to ULBs as a percentage of State's net tax revenues remained around one percent but the total load of non-plan transfers to all ULBs was observed to be much higher and it had ranged from 6.6% to 9.8% of state's own revenues during 2001-02 to 2007-08.

It has also been observed that the some of the payments of grant-in-aid were not being passed on to ULBs on timely basis and prescribed amount by the Directorate of Urban Administration. This type of delayed and inadequate flow of funds affects adversely the financial position of the ULBs. On the other hand, Audit scrutiny (April 2008) of records relating to the release of SFC funds by the Directorate UADD Bhopal revealed that funds were released during the year 2004-07 without obtaining UCs of previous years from ULBs. Further, the State Government did not frame any rules for proper and effective implementation of devolution of functions, functionaries and funds. In the absence of rules, there was no system to watch implementation of transfer process.

In case of ULBs of Bhopal and Ujjain, the capacity to raise its own resources is found to be poor and dependence on higher-level governmental transfers was very high. Moreover, during the period of past seven years, the growth of transfers is much higher compared to the growth rate of own resources of these two ULBs. Population being the sole criteria for the distribution of grants/transfers to ULBs, Bhopal Municipal Corporation was consistently getting lesser per capita state grants/transfers compared to state's average per capita transfers to ULBs whereas the Ujjain Municipal Corporation was getting grants/transfers from state government quite closer to the state's average per capita transfers.

5.0 Orissa

5.1. First SFC

5.1.1 Background

The First SFC in the State of Orissa was constituted on 21st November 1996 for a period of five years i.e. 1998-99 to 2004-05 as per the ATR for the approval of the recommendations made by the Commission. An Action Taken Report was submitted on 9th July 1999 for the implementation of recommendations to be effective from 1st April 1999.

5.1.2 Methodology

The First SFC attempted to collect primary data through detailed questionnaire from the selected 102 municipalities in the state but the Commission received response only from 48 ULBs. Due to insufficient data/information, the commission had to rely on the secondary data furnished by the Housing and Urban Development Department of the State Government. A financial review of the State Government was also carried out.

5.1.3 Previous System of Grant-in-aid to ULBs

The first SFC observed that transfers to ULBs were made mainly into two accounts (i) assigned revenue and (ii) grant-in-aid. Assigned revenues were merely 5% of the total transfers and the major source of transfer to ULBs was grant-in-aid, which consisted of 95% of the total transfer to ULBs. Surcharge on entertainment tax from the State Government was the only source of assigned revenue.

5.1.4 Analysis of State Related Finances w.r.t. Grant-in-Aid at ULB level

The SFC analysed the non-plan revenue receipt and expenditure including state's own revenue (tax and non tax revenues), statutory transfer from Central Government such as share from income tax, central excise duty, additional excise duty whereas total resources of the state government included revenue resources as well as loan incurred from different sources including loan from employee's provident fund. The Commission observed that there was a huge revenue gap in the non-plan revenue income and expenditure due to substantial addition to the state government employment, hike in salary and wages and pension interest etc. In this context, the Commission also observed that ULBs increased their staff strength without the approval of state government ignoring their own source of income and the future liability on account of such decisions. It has been observed that SFC has not assessed the financial burden of grant-in-aid to local bodies of the state. This section could have analysed the impact of total transfers to ULBs on state finances.

5.1.5. Recommended System

Abolition of Octroi and Introduction of Entry Tax

The SFC recommended for abolition of Octroi and introduction of Entry Tax in its place and in case Octroi was abolished, the state Government should devolve requisite fund to ULBs in the first week of each month and increasing it by 10% each year over 1998-99 level.

Surcharge on Entertainment Tax

The Commission recommended Rs.44.85 lakhs of surcharge on entertainment tax for the Urban Local Bodies in the state except six ULBs namely Cuttack, Bhubaneshwar, Berhampur, Rourkela, Puri and Sambalpur for the period from 1998-99 to 2002-03. For the above six ULBs, the Commission recommended the compounded surcharge on entertainment tax which could be assessed and released the dues to these six ULBs with arrears for the same period.

Motor Vehicle Tax

The Commission suggested that 10% of gross collection should be given to ULBs which should be divisible among Municipalities and NAC in the ratio of 60:40 respectively. It is also suggested that the allocation should be of Rs.1282 lakhs annually based on actual collection of M.V. Tax at 1996-97 level.

Surcharge on Stamp Duty

A uniform rate of 3% is prescribed for Development Authorities, Special Planning Authorities and Improvement Trusts. ULBs are not covered by either Development Authorities or Improvement Trust and Gram Panchayats. Such a scheme is expected to provide a stable elastic source of income to the local bodies that are starving of fund. The Commission recommended that the rate of surcharge on stamp duty be fixed at 2% of the amount collected so as to provide larger revenue to Development Authorities and to the ULBs and RLBs.

Levy of Profession Tax

The Commission had recommended that the State Government may impose profession tax following an example of Andhra Pradesh Profession Tax Act, 1987 and 50% of the gross collection should be assigned to ULBs to improve basic services.

5.1.6 Action Taken Report

The recommendations related to surcharge on entertainment tax, and motor vehicle tax were accepted by the State Government. It had given either suggestions or was silent on the recommendations relating to imposition of entry tax, surcharge on stamp duty and levy of profession tax. After the abolition of Octroi, it was reported by the Administrative Department that the follow up action for sharing of Entry Tax by the ULBs was made with a 10% hike every year from 1999-2000. The state government was silent on the recommendation related to surcharge on stamp duty. Regarding the levy of profession tax, the state government decided that this would be examined in detailed by H&UD department in consultation with finance department and follow up action taken.

5.2 Second SFC

5.2.1 Background

The Second SFC of Orissa was constituted on 5th June 2003 for the period of five years i.e. 2005-06 to 2009-10 and submitted its report on 29th September 2004 for the approval of recommendations. Action Taken Report was submitted on 11th August 2006 for the implementation of the accepted recommendations.

5.2.2. Methodology

The Second SFC of Orissa attempted to collect primary data through detailed questionnaire from state and municipal government. Discussions with the prominent persons, economists, planners, retired government servants, state and municipal officials were held to collect the relevant data and information for the data analysis.

5.2.3 System of Grant-in-Aid/Transfer to ULBs prior to second SFC

The Second SFC observed that ULBs received multiple transfers/grants from the state government, in the form of stamp duty (for 2000-01 to 2003-04), motor vehicle tax, grants to ULBs for staff subsidy and state matching share against EFC grants and entry tax. Regarding

Entry Tax, the Commission observed that there was a huge gap between the collection of entry tax by the state government and the compensation amount released to ULBs of the state. In order to avoid delay in released of compensation amount through processing of the files, the amount was provided in the budget of H&UD department in favour of ULBs with regular intervals without reference to Finance Department. However, the Commission did not provide the resource gap of ULBs in the state.

5.2.4 Analysis of State Related Finances w.r.t. Grant-in-aid at ULB level

State budgets and state finance accounts were considered for the analysis of state finance and trends of revenue income and expenditure of the state government. The Commission attempted to analysis the trend and growth of state finances w.r.t income and expenditure including revenue and capital, statutory transfer from Central Government, ways and means advances, over draft, major crisis factors like salary, pension, capital repayment and interest payment etc. .

5.2.5 Recommended System

The Second SFC estimated the total fund requirements of Rs.1916.50 crore for the rural and urban local bodies. As per the Para 10.8 of the ATR of the 2nd SFC, it was stated, "Be that as it may, any additional burden on the State Exchequer should be supported by the 12th Finance Commission. The Second SFC has recommended Rs.211.83 crore per annum i.e. Rs.1059.15 crore for the five years of award period from 2005-06 to 2009-10. This amount is suggested to be awarded by the 12th Finance Commission for augmenting the Consolidated Fund of the State of Orissa in order to save the State from reeling under further deficit". The Commission therefore suggested that the 12th Finance Commission should devolve the total fund of Rs.1181.08 crores (Rs.1059.15 crore for the state's consolidated fund and grants of Rs.121.93 crore for the rural and urban local bodies). The balance of Rs.735.43 crore should be transferred to the local bodies (Rs.588.34 crore for RLB + Rs.147.09 crore for ULBs) by the state government from its own resources during the period from 2005-06 to 2009-10 with an annual average of Rs.147.09 crore (Rs.117.60 crore for RLB + Rs.29.49 crore for ULBs).

<u>Grant-in-Aid</u>

Apart from the devolution of funds, the Commission recommended the grant-in-aid of Rs. 49.27 crore per annum (Rs.246.37 crores for five years) to the ULBs out of the Consolidated Fund of the state as assistance for discharging various functions and responsibilities entrusted to them under the constitution and the respective laws of the local bodies. Ten per cent of the Gross Own Tax Revenue of the State for the year 2002-03 minus the devolvable amount of Rs.171.47 crores (Rs.383.30 – Rs.211.83) was recommended towards Grant-in-Aid for different specific problems.

Entry Tax

The Commission recommends an annual increase of 20 per cent for the award period in place of the prevailing annual increase of 10 per cent in favour of all ULBs.

5.2.6 Action Taken Report

Instead of Rs.1181.08 crore recommended by the 2nd State Finance Commission to the 12th Finance Commission to provide to the State, the 12th Finance Commission recommended Rs.907 crore which was divided in the ratio of 80:20 (Rs.803 crore for RLBs and Rs.104 crore for ULBs) for the period of 5 years i.e. 2005-06 to 2009-10. Since the devolution by the State Government from its own resources was high (Rs.1256.29 crore), the state government decided to transfer of Rs.1256.29 crore to local bodies in place of Rs.735.43 crore recommended by the 2nd State Finance Commission in the ratio of 80:20 for rural local bodies and urban local bodies respectively. Hence, the amount of Rs.1005.03 crore was for RLBs and Rs.251.26 crore for ULBs for five year period. Per year annual average amount for ULBs was of Rs.50.26 crore. As against the increase in the level of transfer to ULBs was from Rs.23.43 crore in 2002-03 to Rs.27.46 crores in 2003-04 (including arrear Surcharge on Stamp Duty for 4 years for Rs.4.23 crore), the ULBs received Rs.39.17 crore in 2005-06 and Rs.62.73 crore in 2009-10, the annual average transfer of fund was of Rs.50.26 crore for Road Maintenance Grant @ not less than Rs.15 crore per annum; surcharge on Stamp duty for development authorities @ Rs.3 crore per annum, surcharge on Entertainment @ Rs.0.15 crore per annum; pensionary contribution by state government for non-LFS employees of the ULBs

Entry Tax

The State Government should provide 20% increase per annum towards compensation on entry tax to the ULBs but out of this 10% should be passed on to the ULBs as untied resources and the balance 10% should be released by the State Government to the concerned ULBs based on their performance in undertaking various reforms including augmentation of internal non-debt resources.

5.3 Assessment

As far as the first SFC is concerned, it is observed that the period of implementation of the report is not clear as well as from Action Taken Report whereas the period of implementation of second SFC is from 2006-07 onwards for five years. Both the SFCs had not attempted to address the complexity of the system of grants-in-aid to municipalities and did not provide recommendation to resolve the issues related to grants. The First SFC suggested new taxation measures in new areas to strengthen the resource base of ULB to some extent but it is not sufficient to forecast the additional income generated from such sources. Whereas, the Second SFC could not provide the base of its recommendations on "net proceeds" of taxes, duties, tolls, etc. perhaps due to failure to consider the devolution pattern according to the TOR w.r.t to apportionment of net proceeds of taxes, fees and tolls between the state, and local governments. Both the SFCs have analysed state related finances in detailed but have not attempted to look at the total financial burden of state transfers/grant-in-aid to local bodies of the state. Importantly, both SFCs have also not suggested the fiscal devolution package by taking into account of all the existing and new suggested grants.

In this way Orissa had missed to link grants of ULBs with state finances and hence grants to ULBs were not of elastic nature compared to the ULBs of some of the developed states of Tamil Nadu, Andhra Pradesh, Karnataka etc. Further the second SFC has observed that there was a huge gap between the collection of entry tax by the State Government and the compensation amount released to ULBs. It had recommended that the State Government should provide 20% increase per annum towards compensation on entry tax to the ULBs but out of this 10% should be passed on to the ULBs as untied resources and the balance 10% should be released by the State Government to the concerned ULBs based on their performance in undertaking various reforms including augmentation of internal non-debt resources.

5.4 Field Observations: State Level

5.4.1 Background

During the period of First SFC i.e. 2001-02 to 2005-06, non-plan transfers can be categorized under three major heads namely SFC grants, specific purpose grants and CFC grants. The SFC grants during this period are on two accounts (i) compensation in lieu of Octroi and (ii) grants for road maintenance. Whereas, during the period of second SFC i.e. 2006-07 to 2007-08, non-plan transfers can be categorized under three major heads namely SFC grants, specific purpose grants and CFC grants. The SFC grants during this period are on six accounts (i) compensation in lieu of Octroi, (ii) grants for road maintenance, (iii) compensation on entertainment tax, (iv) performance based incentives to ULBs, (v) grants for basic services and (vi) grants towards pension contributions. Whereas, CFC grants are based on 11th and 12th CFCs' recommendations i.e. with time periods of 2001-02 to 2004-05 and 2005-06 to 2007-08 for the 11th and 12th CFC respectively.

5.4.2 Transfers to all ULBs

The First and Second SFCs of Orissa did not link the grants with state related finances i.e. state's own revenues or state's tax revenues. The grants on SFC account has overall risen by 12% during the period of 2001-02 to 2007-08 but there was an observed drastic rise in grants on this account in the first year of second SFC i.e. 2006-07 and it has risen by 36% compared to grants released in 2005-06. Similarly on CFC head also the amounts of 12th CFC has risen substantially during 2005-06 to 2007-08 compared to the amounts of 11th CFC during 2001-02 to 2004-05. On the other hand, the specific purpose grants has overall declined by 20% during 2001-02 to 2007-08, which can be understood from the fact of the nature of this grant, which is of specific purpose and may vary from year to year.

Table 5.1: Transfers/Grant-in-aid to all ULBs in Orissa

Rs. in Lakh

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	AAGR (%)
Non-Plan Transfers/Grants	12228.64	13087.30	14300.16	14540.47	17489.86	24117.83	26968.92	13.18
(i) SFC Grants	10968.64	11998.00	12973.62	13511.81	14420.47	19702.18	22627.62	12.07
a. Compensation in lieu of Octroi	9482.64	10500.00	11482.62	11951.81	12926.47	15439.75	18283.01	10.94
b. Road Maintenance	1486.00	1498.00	1491.00	1560.00	1494.00	2484.48	2500.20	8.67
b. Compensation on Entertainment Tax	.....	.....	.....	.....	.....	189.95	373.00	33.74
c. Performance based Incentives to ULBs	.....	.....	.....	.....	.....	197.00	200.00	0.76
e. Basic Services	.....	.....	.....	.....	.....	828.00	827.41	-0.04
f. Pension Contributions	.....	.....	.....	.....	.....	563.00	444.00	-11.87
(ii) Specific Purpose Grants	460.80	290.10	527.34	229.46	989.39	210.65	136.30	-20.30
(iii) CFC Grants	799.20	799.20	799.20	799.20	2080.00	4205.00	4205.00	27.67

Source: Director Municipal Administration, Housing and Urban Development Department, Orissa.

Looking at the breakups of SFC grants during first and second SFCs, it has been observed that there are major increases on two accounts, one on account of compensation in lieu of Octroi and second on grants on road maintenance. In addition to it, during the second SFC four more grants are included in the SFC grants namely (i) compensation on entertainment tax, (ii) performance based incentives to ULBs, (iii) grants for basic services and (iv) grants towards pension contributions. Compensation in lieu of Octroi remained the major component of the SFC grants and it has ranged from 82% to 90% during 2001-02 to 2007-08. The first SFC has recommended that the compensation in lieu of Octroi should increase by 10% annually but interestingly it has increase by only 7.75% during 2001-02 to 2005-06 thereafter it has shown a jump of 19.4% and 18.4% for the years of 2006-07 and 2007-08.

Table 5.2: Composition of Transfers/Grant-in-aid to all ULBs in Orissa (Percentage)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
SFC Grants as % of State's Non-Plan Grants/Transfers	89.70	91.68	90.72	92.93	82.45	81.69	83.90
Specific Purpose Grants as % of State's Non-Plan Grants/Transfers	3.77	2.22	3.69	1.58	5.66	0.87	0.51
CFC Grants as % of Non-Plan Grants/Transfers	6.54	6.11	5.59	5.50	11.89	17.44	15.59

Source: Director Municipal Administration, Housing and Urban Development Department, Orissa.

In per capita terms, non-plan transfers has ranged from Rs.215.86 to Rs.406.19 annually during 2001-02 to 2007-08, out of which compensation in lieu of Octroi has increased from Rs.167.39 to Rs.275.37 whereas other SFC grants excluding Octroi compensation are merely ranged from Rs.23.72 to Rs. 65.92 and specific purpose grants have ranged from Rs.2.05 to Rs.8.83 annually. On the other hand, the CFC grant has ranged from Rs.13.03 to Rs.63.33 annually.

Looking at the complexities of the system of grant-in-aid/transfers to ULBs in the state of Orissa it is interesting to calculate the total load of these transfers on the state finances. It has been observed that the grants on SFC account as a percentage of state's own revenues as well as grants on SFC account as a percentage of state's tax revenues has shown a declining trend during the period of 2001-02 to 2007-08.

Table 5.3: Ratio of Transfers/Grant-in-aid to all ULBs in Orissa

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Non-Plan Transfers* as % of State's Own Revenue	3.62	3.21	3.07	2.49	2.36	2.62	2.78
SFCs Grants as % of State's Own Revenue	3.47	3.13	2.95	2.45	2.21	2.59	2.76
SFCs Grants as % of State's Tax Revenue	4.45	4.18	3.93	3.24	2.88	3.42	3.42

Note: * Non-Plan Transfers are excluding CFC grants
Source: Director Municipal Administration, Orissa and State Budgets of Orissa.

The grants on SFC account as a percentage of state's own revenues has declined from 3.47% to 2.21% during 2001-02 to 2005-06 and then marginally risen to 2.59% and 2.76% in the years of 2006-07 and 2007-08. Similarly, the grants on SFC account as a percentage of state's tax revenues has declined from 4.45% to 2.88% during 2001-02 to 2005-06 and then marginally risen to 3.42% in the years of 2006-07 and 2007-08. It clearly shows that since the SFC grants to ULBs in the state of Orissa have not been linked with the state related own revenues or state taxes the elasticity of these grants is missing. It can be seen from another fact that the state's own revenues and state's tax revenues has risen by 15.9% and 16.4% respectively during the period of 2001-02 to 2007-08 whereas the SFCs grants have risen by only 12.1% during the same period. On the one hand the second SFC has added four more components in the kitty of SFC grants namely (i) compensation on entertainment tax, (ii) performance based incentives to ULBs, (iii) grants for basic services and (iv) grants towards pension contributions and on the other hand the grants on SFC account as a percentage of state's own revenues as well as grants on SFC account as a percentage of state's tax revenues has shown a declining trend.

5.5 Field Observations: ULB Level

5.5.1 Background

Two ULBs namely Municipal Corporation of Bhubneshwar and Puri municipality from the state of Orissa has been covered for this study. Municipal revenue income can mainly be divided in two categories i.e. income from own receipts and receipts under the head of grants/transfers. Income from own receipts are mainly from tax and non-tax receipts. Receipts under transfers/grants on non-plan head can be broadly categorized in three heads namely SFC grants, CFC grants and specific purpose grants. The SFC grants are based on first and second SFCs' recommendations i.e. with time periods of 2001-02 to 2005-06 and 2006-07 to 2007-08 for the first and second SFC respectively. Whereas CFC grants are based on eleventh and twelfth finance commissions' recommendations i.e. with time periods of 2001-02 to 2004-05 and 2005-06 to 2007-08 respectively.

5.5.2 Transfers/Grant-in-Aid to Bhubneshwar and Puri Municipality

Both the ULBs of the state of Orissa are highly dependent on grant-in-aid and transfers from higher governmental level compared to its own revenue generation capacity. Data at the sample municipality level namely Bhubneshwar and Puri, has shown that own revenue receipts as a percent of total revenue receipts has increased from 11% to 22.7% and from 19.2% to 26.1% for Bhubneshwar and Puri respectively during the period of 2001-02 to 2006-07, whereas the transfers/grants as a percent of total revenue receipts has declined from 86.3% to 68.5% and from 77.2 to 73.9% for Bubneshvar and Puri respectively. In terms of growth rate also, during the period of 2001-02 to 2006-07, own revenue receipts have grown by 27% and 10.3% for Bubneshvar and Puri respectively whereas grants/transfers on revenue account have grown by 7.9% and 3%.

Table 5.4: Composition of Revenue Income of Bhubaneshwar and Puri (Percentage)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Bhubneshwar M.Corp.						
Own Revenue Receipts as % of Revenue Income	10.98	12.04	11.95	16.05	19.79	22.68
Non-Plan Transfers as % of Revenue Income	86.29	82.93	84.05	76.04	72.50	68.54
Other Revenue Receipts as % of Revenue Income	2.73	5.03	4.00	7.91	7.71	8.77
Total Revenue Receipts	100.00	100.00	100.00	100.00	100.00	100.00
Puri Municipality						
Own Revenue Receipts as % of Revenue Income	19.18	19.68	26.97	27.39	23.89	33.13
Non-Plan Transfers as % of Revenue Income	77.16	80.32	73.03	72.61	76.11	66.87
Total Revenue Receipts	100.00	100.00	100.00	100.00	100.00	100.00

Source: Bhubneshwar Municipal Corporation and Puri Municipality

In per capita terms, Bhubneshwar Municipal Corporation has generated merely Rs.46.30 from its own revenues, in the year of 2001-02 which steadily risen to Rs.64.47 in 2004-05 and then risen to Rs.119.90 and Rs.142.10 in the years of 2005-06 and 2006-07, whereas, non-plan transfers have increased from Rs.363.94 to Rs.429.64 during the period of 2001-02 to 2006-07.

Out of non-plan transfers, SFC grants has merely increased from Rs.327.52 to Rs.332.33 during 2001-02 to 2006-07; specific purpose grants has increased from Rs.17.40 to Rs.36.19, and CFC grants has increased from Rs.19.02 to Rs.61.11 annually. Similarly, in per capita terms, Puri municipality has generated merely Rs.62.09 from its own revenues in the year of 2001-02 which steadily risen to Rs.94.78 in the year of 2006-07. Whereas, non-plan transfers have range ranged from Rs.249.77 to Rs.191.32 during the period of 2001-02 to 2006-07. Out of non-plan transfers, SFC grants has merely increased from Rs.126.87 to 150.97 during

2001-02 to 2005-06 and then has declined to Rs.114.84 in 2006-07; specific purpose grants has ranged from Rs.86.61 to Rs.61.94 during the periods of 2001-02 to 2005-06 and then has declined to Rs.15.92 in 2006-07, and CFC grants has increased from Rs.36.02 to Rs.76.55 annually.

Releasing of non-plan grants to ULBs of the state is based on population i.e. grants/transfers to ULBs are being principally based in per capita terms but comparing average per capita grants at the state level with per capita grants of Bhubneshwar and Puri reflects a different scenario. State's average per capita SFC grants has ranged from Rs.193.62 to Rs.304.70 whereas Puri's per capita SFC grants and Bhubneshwar's per capita SFC grants have ranged from Rs.126.87 to Rs.114.84 and from Rs.327.52 to Rs.332.33 respectively during the periods of 2001-02 to 2006-07. It indicates that Puri municipality has been consistently getting lesser grants on SFC account whereas Bhubneshwar Municipal Corporation has been getting more grants on SFC account compared to state's average per capita SFC grants. On the other hand, the per capita CFC grants for Puri and Bhubneshwar are close to State's average per capita CFC grants with minor offshoots.

Table 5.5: Transfers/Grant-in-aid State of Orissa (Average), Bhubneshwar M.Corp. and Puri Municipality

(Rupees)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Per capita (Average of the State)							
Non-Plan Transfers/Grants	215.86	224.99	239.42	237.09	277.73	372.99	406.19
(i) SFC Grants	193.62	206.26	217.21	220.31	228.99	304.70	340.81
(ii) Specific Purpose Grants	8.13	4.99	8.83	3.74	15.71	3.26	2.05
(iii) CFC Grants	14.11	13.74	13.38	13.03	33.03	65.03	63.33
Per capita (Bhubneshwar M.Corp.)							
Non-Plan Transfers/Grants	363.94	355.40	353.36	305.50	439.26	429.64	na
(i) SFC Grants	327.52	323.55	332.48	278.73	352.57	332.33	na
(ii) Specific Purpose Grants	17.40	21.28	20.87	17.12	52.14	36.19	na
(iii) CFC Grants	19.02	10.57	0.00	9.65	34.56	61.11	na
Per capita (Puri Municipality)							
Non-Plan Transfers/Grants	249.77	268.30	221.79	193.58	267.10	191.32	277.18
(i) SFC Grants	126.87	136.39	141.46	124.30	150.97	114.84	170.64
(ii) Specific Purpose Grants	86.61	114.72	58.74	52.06	61.94	15.92	29.99
(iii) CFC Grants	36.29	17.19	21.59	17.22	54.18	60.56	76.55

Source: Director of Municipal Administration, Orissa and Bhubneshwar Municipal Corp. and Puri Municipality

Looking at the ULB's share of urban population from state's urban population and comparing it with ULB's share of SFC grants from state's total SFC grants, it reflects that the percentage of urban population of Bhubneshwar from state's urban population has ranged from 11.97% to 13.16% whereas percentage of SFC grants from state's total SFC grants has ranged from 20.25% to 14.35% during 2001-02 to 2006-07. The percentage of urban population of Puri from state's urban population has ranged from 2.85% to 2.80% whereas percentage of SFC grants from state's total SFC grants has ranged from 1.87% to 1.06%.

Table 5.6: ULB's Share in Urban Population and ULB's Share in Non-Plan Transfers (Percentage)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Bhubneshwar M.Corp						
ULB's Urban Population as % of State's Urban Population	11.97	12.20	12.43	12.67	12.91	13.16
ULB's Non-Plan Transfers as % of State's Non-Plan Transfers	20.18	19.27	18.35	16.33	20.42	15.16
ULB's SFC's grants as % of Total SFC's grants	20.25	19.14	19.03	16.03	19.88	14.35
ULB's CFC's grants as % of State's CFC's grants	16.14	9.38	0.00	9.38	13.51	12.37
Puri Municipality						
ULB's Urban Population as % of State's Urban Population	2.85	2.84	2.83	2.82	2.81	2.80
ULB's Non-Plan Transfers as % of State's Non-Plan Transfers	3.30	3.39	2.62	2.31	2.71	1.44
ULB's SFC's grants as % of Total SFC's grants	1.87	1.88	1.84	1.59	1.86	1.06
ULB's CFC's grants as % of State's CFC's grants	7.33	3.56	4.57	3.73	4.62	2.61

Source: Bhubneshwar Municipal Corporation and Puri Municipality

5.5.3 Utilization of Grants

The grants to ULBs in Orissa can be classified in two broad categories namely general-purpose grants and specific purpose grants. The general-purpose grants were of 'untied' nature and the ULBs who were receiving these grants could use it for a purpose of its own. The specific purpose grants were of 'tied' nature and the amounts of grants were to be utilized for the activity or programme or project in the order of releasing the grant. Further the state government provides grant-in-aid to ULBs both on non-plan and plan heads. Non-plan grants are given for salary of ULBs staff, for road maintenance and restoration of municipal properties and to some ULBs grants were also being provided for specific purpose activities. Grant for the salary of ULBs staff is one of the most important non-plan grants.

This grant is meant to meet a part of the salary costs of the ULB staff. The state government provides 53% of the expenditure on account of pay and salaries etc. for the posts which were created prior to 1974 and remaining 47% of expenditure on pay for such posts are to be borne by the concerned ULBs. In addition to it state government also bear some part of the expenditure on account of dearness allowance. Even the plan grants which are released by the state government to the ULBs of the state of Orissa are provided in three subheads namely (i) salary and remuneration, (ii) maintenance and repair and (iii) other grants. Under salary and remuneration, grants covers a part of salary costs of secondary school teachers working in high schools managed by the ULBs and contribution to Pension Fund of non-local fund service employees of the ULBs. Grants for road development are provided under 'maintenance and repair' and the state government provides 50% of the cost of development in the form of grant-in-aid whereas the balance 50% is provided by the ULBs from their own revenue receipts. Other grants cover a variety of specific purpose and scheme grants.

The SFC of the Orissa had pointed out that releasing of the above-mentioned grants had lacked certainty and predictability. In case of ULBs of Orissa, the grants meant to cover the pay and dearness allowance of the ULBs' employees followed a definite and known formula and the concerned ULBs could be sure of the amount dues on this account and except this grant, no other grant was certain and predictable.

Looking at the breakups of SFC grants during the period of first SFC, these were on two major accounts i.e. one on account of compensation in lieu of Octroi and second on grants on road maintenance. Whereas, during the period of second SFC, four more grants were included in the SFC grants namely (i) compensation on entertainment tax, (ii) performance based incentives to ULBs, (iii) grants for basic services and (iv) grants towards pension contributions. Compensation in lieu of Octroi remained the major component of the SFC grants and it has ranged from 82% to 90% during 2001-02 to 2007-08.

Utilization of SFCs grants was not conditional as can be seen that 82% to 90% of the SFC grants were on account of Octroi compensation and these grants are being used to meet out salary expenses of the ULB staff. Whereas other parts of SFC grants are meant for pension contributions and operation and maintenance of basic services and these grants are not based on utiization certificates.

On the other hand the criteria of sanctioning and releasing of the 12th CFC grants are based on population, area and road length and are released in two installments in each year by way of sanction order based on budgetary provisions. These CFC grants are of conditional nature and are meant for implementation of solid waste management and database and maintenance of accounts, which are being released, to ULBs on the basis of utilization certificates. All ULBs of the state prepares and send their utilization certificates to the Directorate of Municipal Administration (DMA) at the state level and then this DMA prepares a consolidated utilization certificate based on all ULBs and sends it to the Central Government. The Central Government after receiving the utilization certificate from state government on behalf of all ULBs, releases the next installments of these grants.

5.5.4 Assessment

Two third of the revenue receipts of both the ULBs of Orissa namely Bhubneshwar and Puri were from non-plan transfers which had shown a high dependency on state government in terms of grants and transfers. Compensation in lieu of Octroi remained the major component of the SFC grants and it has ranged from 82% to 90% during 2001-02 to 2007-08. The first SFC had recommended that the compensation in lieu of Octroi should increase by 10% annually but interestingly it has increase by only 7.75% during 2001-02 to 2005-06 thereafter it has shown a jump of 19.4% and 18.4% for the years of 2006-07 and 2007-08. On the one hand the second SFC has added four more components in the kitty of SFC grants namely (i) compensation on entertainment tax, (ii) performance based incentives to ULBs, (iii) grants for basic services and (iv) grants towards pension contributions and on the other hand the grants on SFC account as a percentage of state's own revenues as well as a percentage of state's tax revenues had shown a declining trend. In per capita terms, Puri municipality was consistently getting lesser grants on SFC account whereas Bhubneshwar Municipal Corporation was getting more grants on SFC account compared to state's average per capita SFC grants.

The SFCs of Orissa had pointed out that releasing of many of the non-plan grants lacked certainty and predictability. In case of ULBs of Orissa, the grants meant to cover the pay and dearness allowance of the ULBs' employees followed a definite and known formula and the concerned ULBs could be sure of the amount dues on this account and except this grant, no other grant was certain and predictable. Utilization of SFCs grants is not conditional as can be seen that 82% to 90% of the SFC grants are on account of Octroi compensation and these grants are being used to meet out salary expenses of the ULB staff. Whereas other parts of SFC grants are meant for pension contributions and operation and maintenance of basic services and these grants are not based on utiization certificates. On the other hand the criteria of sanctioning and releasing of the 12th CFC grants are based on population, area and road length and this grant is of conditional nature and is meant for implementation of solid waste management and database and maintenance of accounts, which are being released, to ULBs on the basis of utilization certificates.

6.0 Tamil Nadu

6.1 First SFC

6.1.1 Background

The First SFC of Tamil Nadu was constituted on 23rd April 1994 for the period of five years i.e. 1997-98 to 2001-02 and submitted its report on 29th November 1996. An Action Taken Report was submitted to State Government on 28th April 1997 for the implementation of accepted recommendations.

6.1.2 Methodology

The First SFC needed a database of all the ULBs of the state to know the existing system of grants, financial health, resource gap, taxation powers, functional domain, service delivery levels, norms and standards of basic services. Due to non-availability of database on the finances of ULBs etc. the Commission conducted its own survey based on a detailed questionnaire to review the financial position of the selected ULBs.

The Commission projected the perceived fiscal and revenue gap to work out the forecast of revenue generation plan for the period of 1997-98 to 2001-02. Fiscal gap was calculated by taking the difference between the total expenditure (revenue and capital) and total own revenue (excluding assigned and shared taxes and grants) + own non-tax revenue of all municipalities. While, the difference between revenue own income and expenditure of all local governments in the state was considered to calculate the perceived revenue gap.

6.1.3 Previous System of Grant-In-Aid to ULBs

The Commission observed that the ULBs of the state received funds under two heads i.e. (i) assigned revenue and (ii) grant-in-aid. The components of assigned revenues of the ULBs included entertainment tax, surcharge on stamp duty, surcharge on sales tax, income from minor minerals and toll compensation.

6.1.4 Analysis of State Related Finances w.r.t. Grant-In-Aid at the ULB level

State budgets were taken into consideration for the analysis of state finances in terms of state's own revenue (tax and non tax), statutorily transfers from Central Government such as state's share in union excise duties, direct taxes on income, property and capital transactions, land revenue, stamp duty and registration fees, urban land tax and grant-in aid, etc. The sales tax was the single largest revenue earner for the state. The Commission observed that there was wide state resource gap between state revenue income and expenditure.

In the context of grants/transfers to ULBs, the Commission examined the options of sharing tax wise and general sharing out of total tax revenue. Some of the taxes levied by the State were identified and earmarked as taxes for local bodies such as local cess, local cess surcharge, surcharge on stamp duty and entertainment tax in Pool A. The sharing of the state tax revenue was indicated in Pool B, which included all taxes except entertainment tax.

6.1.5 Recommended System

Assigned Revenue (Pool A)

The First SFC recommended to continue with the existing system of assigned taxes to ULBs. The assigned revenues are derived in two parts: part one, from taxes and duties assigned to ULBs for levy but collected by the state government and passed on to the ULBs after the deductions of collection charges and the part two, from taxes and duties levied and collected by the state government and proceeds shared between the ULBs and the state government. The following are the assigned revenues to the ULBs, (i) Surcharge on duties on transfers of property, (ii) Entertainment tax, (iii) Surcharge on stamp duty, (iv) lease of minor minerals and (v) Toll compensation. The ratio for the distribution of funds between RLBs and ULBs would be 60:40.

Fiscal Devolution from the State Government to Local Bodies (Pool B)

The Commission recommended that the quantum of general allocation based on 8,9,10,11, and 12 percentages for the five years i.e. 1997-98 to 2001-02 from the divisible pool B could be distributed after 15% of that was set apart as Reserve to meet the post devolution conditions. The Pool B consists of net tax revenue of the State Government excluding entertainment tax. Out of the total net allocation for general distribution under the divisible pool B, 15% had been earmarked for equalization and incentive fund. The remaining 85% was made available for distribution between RLBs and ULBs. The ratio for the distribution of funds between RLBs and ULBs would be 60:40.

Grant-In-Aid

The Commission recommended that the reimbursement of D.A. increases might be sanctioned to ULBs outside the general devolution.

6.1.6 Action Taken Report

Status of Action Taken on the above recommendations is as given below:

Assigned Revenue (Pool A)

The First SFC recommended to continue with the existing system of assigned taxes to ULBs. The following are the assigned revenues to the ULBs, (i) Surcharge on duties on transfers of property, (ii) Entertainment tax, (iii) Surcharge on stamp duty, (iv) lease of minor minerals and (v) Toll compensation. The State Government had accepted this recommendation.

Fiscal Devolution from the State Government to the Local Bodies (Pool B)

The State Government of Tamil Nadu accepted the recommendations on fiscal devolution and decided that the revenue from all state taxes excluding entertainment tax should be pooled and 8% of it should be shared with the local bodies from 1997-98. The State Government also accepted the recommendation of equalization and incentive fund. Regarding distribution and releasing of funds, the funds should be distributed between RLBs and ULBs in the ratio of 55:45 instead of 60:40.

In addition to this, the Government had also decided to deduct the amount of pension funds, provident funds (with interest) and debt liability from the allocated fund to the ULBs, if the ULBs fail to release the funds on the behalf of their employees or there is a gap in these funds.

Grant-in-Aid

In view of the substantial additional devolution of funds to local bodies, no DA reimbursement grant should be released to local bodies.

6.2 Second SFC

6.2.1 Background

The Second SFC was constituted on 3rd March 2000 for the period of five years i.e. 2002-03 to 2006-07 and submitted its report on 21st May 2001 for the approval of the recommendations made by the Commission. An Action Taken Report (ATR) was submitted on 8th May 2002 for the implementation of the accepted recommendations by the State Government.

6.2.2 Methodology

Data was collected through detailed questionnaires prepared for the elected representatives and the executives. Information and views were elicited from other stakeholders of local bodies through various rounds of discussions. The Commission constituted Task Force Committee for ULBs, Pension sub-committee, urban review committee, etc to strengthen the data/information, data validations and to get more relevant information for the preparation of report. Field visits were also organized.

6.2.3 System of Grant-in-Aid/Transfer to ULBs prior to Second SFC

The Commission observed that ULBs received plan, non-plan and discretionary grants outside the devolution package recommended by the First SFC. It was also observed that the devolution was invariably ordered in the last quarter of the month resulting in resource crunch to the state government. The funds devolved from the state government based on the first SFC recommendations were mostly utilized for the salaries of local body's staff.

6.2.4 Analysis of State Related Finances w.r.t. Grant-in-Aid at ULB level

State budgets were considered for the analysis of state finances including revenue and capital accounts. The state government accrued its income mainly from owned tax revenue that included sales tax, state excise, stamp duty and registration and taxes on vehicles, non-tax revenue, CFC grants, other grants from GoI. The Commission observed that various types of plan, non-plan grants and government loans were transferred from the state government to local bodies outside the SFC devolution. The Commission however did not analyze the financial burden of all types of grant-in-aid to ULBs on state related finances.

6.2.5 Recommended System

Assigned Revenue (Pool A)

The Second SFC recommended to continue with the existing system of assigned taxes to ULBs. The following are the assigned revenues to the ULBs, (i) Surcharge on duties on transfers of property, (ii) Entertainment tax, (iii) Surcharge on stamp duty, (iv) lease of minor minerals and (v) Toll compensation. The State Government had accepted this recommendation. The ratio for the distribution of funds between RLBs and ULBs would be 58:42.

Fiscal Devolution from the State Government to the Local Bodies (Pool B)

The Second SFC recommended that the approach of global sharing for devolution from state to local bodies. The percentage of global sharing from out of the state's own tax revenue after excluding entertainment tax would be 8% in first two years i.e. 2002-03 and 2003-04, 9% in 3rd and 4th year i.e. 2004-05 and 2005-06 and 10% in the 5th year i.e. 2006-07. The ratio for the distribution of funds between RLBs and ULBs would be 58:42. Out of the total net allocation for general distribution under the divisible pool B, 13% had been earmarked for reserve, equalization and incentive fund. The remaining 87% was made available for devolution for general purpose between RLBs and ULBs. The ratio for the distribution of funds between RLBs and ULBs would be 58:42.

6.2.6 Action Taken Report

Status of Action Taken on the above recommendations is as given below:

Assigned Revenue (Pool A)

The Second SFC recommended to continue with the existing system of assigned taxes to ULBs. The following are the assigned revenues to the ULBs, (i) Surcharge on duties on transfers of property, (ii) Entertainment tax, (iii) Surcharge on stamp duty, (iv) lease of minor minerals and (v) Toll compensation. The State Government had accepted this recommendation.

Fiscal Devolution from the State Government to the Local Bodies (Pool B)

The State Government accepted the recommendations on fiscal devolution and decided that the revenue from all state taxes excluding entertainment tax should be pooled and 8% of it should be shared with the local bodies from 2002-03 to 2006-07. The State Government also accepted the recommendation of reserve, equalization and incentive fund. Regarding distribution and releasing of funds, the funds should be distributed between RLBs and ULBs in the ratio of 58:42.

6.3 Third State Finance Commission of Tamil Nadu

6.3.1 Background

The Third SFC was constituted on 14th December 2004 for the period of five years i.e. 2007-08 to 2011-12 and submitted its report on 30th September 2006 for the approval of the recommendations made by the Commission. An Action Taken Report (ATR) was submitted on

10th May 2007 for the implementation of the accepted recommendations by the State Government.

6.3.2 Methodology of Data Collection and Data Analysis

Data was collected through detailed questionnaires prepared for the elected representatives and the executives. Information and views were elicited from other stakeholders of local bodies through various rounds of discussions. The Commission also arranged a brain storming session on 23rd November 2005. It constituted a subcommittee for ULBs, which had given several recommendations regarding ULBs functioning, and financial position. Field visits were also organized to other states.

6.3.3 System of Grant-in-Aid/Transfer to ULBs prior to Third SFC

The Commission observed that ULBs were receiving assigned revenues, SFC grants, specific purpose grants, compensation in lieu of certain taxes and CFC grants. The SFC grants were based on fiscal devolution and 8% of all state taxes excluding entertainment tax were shared with the all-local bodies. Whereas, the assigned revenue were mainly on three accounts (i) entertainment tax, (ii) surcharge on stamp duty and (iii) surcharge on sales tax. These taxes and levies are usually collected by the Government and assigned to local bodies. This assigned revenue is a part of the resource base of the local bodies and needs to be kept intact. But time and again, the resource base has been eroded by the State Government thereby depriving the local bodies their legitimate dues. The following are some of the instances, (i) Reduction in Surcharge on Stamp Duty because of the Memorandum of Understanding signed with Ministry of Urban Development, (ii) Reduction in Entertainment Tax owing to change from compounding pattern to collection on admission basis, and (iii) Non-implementation of increase in Local Cess/Local Cess Surcharge as suggested by Second State Finance Commission and ordered by the Government.

6.3.4 Analysis of State Related Finances w.r.t. Grant-in-Aid at ULB level

As per Para 4 of the Terms of Reference issued to the Third State Finance Commission, the Commission has to take into account the resources of the State Government and its various commitments including the commitment made under the Tamil Nadu Fiscal Responsibility Act, 2003 before making its recommendations. Hence, it looked at the State Finances and their likely growth during the award period of the Commission. The Commission however did not analyze the financial burden of all types of grant-in-aid to ULBs on state related finances.

6.3.5 Recommended System

Assigned Revenue (Pool A)

The Third SFC recommended to continue with the existing system of assigned taxes to ULBs with some minor modifications. The following were the assigned revenues to the ULBs, (i) Entertainment Tax, (ii) Surcharge on Stamp Duty, (iii) Local Cess/Local Cess Surcharge, (iv) Mines and Minerals, (v) Social Forestry Receipts, (vi) Fishery Rental, and (vii) 2 C Patta trees. The ratio for the distribution of funds between RLBs and ULBs would be 58:42.

Fiscal Devolution from the State Government to the Local Bodies (Pool B)

The Third SFC like the Second SFC recommended the approach of global sharing for devolution of funds from state to local bodies. The suggested percentage of global sharing from out of the state's own tax revenue after excluding entertainment tax was 10% during the entire award period i.e. 2007-08 to 2011-2012. The ratio for the distribution of funds between RLBs and ULBs would be 58:42.

Specific Purpose Grant (Pool C)

The Third SFC unlike the Second SFC recommended the approach of global sharing for devolution of funds w.r.t to specific purpose grants also which would be in range of 0.5% to 1% of the State's Own Tax Revenue.

6.3.6 Action Taken Report

Status of Action Taken on the above recommendations is as given below:

Assigned Revenue (Pool A)

The State Government had accepted this recommendation but had not accepted to increase Local Cess and Local Cess Surcharge. Also, arrears w.r.t entertainment tax would be released without any interest thereon.

Fiscal Devolution from the State Government to the Local Bodies (Pool B)

The State Government accepted the recommendation with minor modification and decided that the revenue from all state taxes excluding entertainment tax should be pooled and 9% of it should be shared with the local bodies from 2007-08 to 2008-09, 9.5% for 2009-10 and 10% for 2010-11 to 2011-2012. Regarding distribution and releasing of funds, the funds should be distributed between RLBs and ULBs in the ratio of 58:42.

Specific Purpose Grant (Pool C)

The State Government had not accepted this recommendation of sharing for devolution of funds w.r.t to specific purpose grants.

6.4 Assessment

All the three SFCs of Tamil Nadu recommended the approach of global sharing for devolution of funds from state to local bodies. Contrary to the recommendations of incremental global sharing of state's own taxes after excluding entertainment tax, the State Government accepted only the concept of global sharing of state's own taxes after excluding entertainment tax for the First and Second SFC, whereas for the Third SFC it has accepted the concept of incremental global sharing. In addition to it, in case of First and Second SFCs, the State Government also accepted the concept of general distribution of these funds and earmarking of 13% to 15% of divisible pool for reserve, equalization and incentive fund. There was a minor change in the ratio for the distribution of funds between RLBs and ULBs. Importantly, both the SFCs recommended to continue with the existing system of assigned taxes.

The second SFC observed that ULBs received plan, non-plan and discretionary grants outside the devolution package recommended by the First SFC. It was also observed that the devolution was invariably ordered in the last quarter of the month resulting in resource crunch to the state government. The Second SFC has given suggestions to limit these transfers. It was difficult to bring each and every transfer from state government to local bodies under devolution packages but overall the global sharing of state's revenues with local bodies (RLBs and ULBs) had enabled the concept of elasticity linked with state's economy to be shared with local bodies which resulted in automatic increase in state transfers to local bodies with the increase in state's own tax revenues. All the three SFCs of Tamil Nadu had provided a simple and transparent system of state transfers to local bodies, which has resulted in better budgetary planning at local body level.

6.5 Field Observations: State Level

6.5.1 Background

In case of Tamil Nadu, the period of First SFC ended in the year of 2001-02, whereas the period of second SFC started in the year of 2002-03 and ended in the year of 2007-08. Non-plan transfers for both of these periods i.e. 2001-02 to 2007-08, can be categorized under five major heads namely Assigned revenues, SFC grants, specific purpose grants, compensation in lieu of certain taxes and CFC grants. The assigned revenue are mainly on three accounts (i) entertainment tax, (ii) surcharge on stamp duty and (iii) surcharge on sales tax. The SFC grants are based on fiscal devolution and 8% of all state taxes excluding entertainment tax should be shared with the all-local bodies. Further, the distribution of these grants is in the ratio of 60:40 between rural and urban local bodies. The only difference between the First and Second SFC was that earlier the State Government had decided to deduct the amount of pension funds, provident funds (with interest) and debt liability from the allocated fund to the ULBs, if the ULBs fail to release the funds on the behalf of their employees or there is a gap in these funds however the second SFC has waived off this condition. In other words prior to 2nd SFC, the debt and non-debt liabilities are deducted from the allocated fund to ULBs but 2nd SFC has not accepted any fixing of ceiling for deduction. Whereas CFC grants are based on 11th and 12th CFCs' recommendations i.e. with time periods of 2001-02 to 2004-05 and 2005-06 to 2007-08 for the 11th and 12th CFC respectively.

6.5.2 Transfers to ULBs

The total non-plan transfers to all the ULBs has overall risen by 19.42% during the period of 2001-02 to 2007-08 but there has been observed drastic rise in non plan transfers in the first year of second SFC i.e. 2002-03 and it has risen by 112% compared to non plan transfers released in 2001-02. While looking at the break-up of non-plan transfers, the rise in non plan transfers in the first year of second SFC i.e. 2002-03 is mainly due to rise in assigned revenues and SFC grants. The assigned revenue has risen by 106.7% and the SFC grant has risen by 136.2%. During the discussions, it was explained that these increases were mainly due to non-releasing of assigned revenues and SFC grants for the earlier year of 2001-02. During 2002-03 to 2007-08, the assigned revenues are observed to be having a declining trend whereas the SFC grants and specific purpose grants have been rising during the same period.

Similarly on the CFC head also the amounts of 12th CFC has risen substantially during 2005-06 to 2007-08 compared to the amounts of 11th CFC during 2001-02 to 2004-05.

Table 6.1: Transfers/Grant-in-aid to ULBs in Tamil Nadu

Rs. in Lakh

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	AAGR (%)
Non-Plan Transfers/ Grants	54608.03	116017.26	110062.75	94082.95	114045.63	143655.62	175100.64	19.42
(i) Assigned Revenue	23268.37	48093.77	45045.92	29997.27	30669.35	30493.06	35072.00	6.84
(ii) Compensation in lieu of Taxes	19.79	28.26	26.37	49.31	41.17	29.51	2063.41	77.45
(iii) SFC Grants	26163.00	61807.51	59157.16	56555.50	68488.16	88689.82	115035.33	24.68
(iv) Specific Purpose Grants	1258.82	2228.22	1973.80	3578.68	3406.95	13003.23	11489.90	36.85
(v) CFC Grants	3898.05	3859.50	3859.50	3902.19	11440.00	11440.00	11440.00	17.94

Source: Directorate of Municipal Administration, Directorate of Town Panchayats of Tamil Nadu.

Looking at the composition of transfers from state government to ULBs shows that assigned revenues and SFC grants are the two major components besides specific purpose grants and CFC grants. Assigned revenues as a percentage of total non-plan transfers has shown a declining percentage during 2001-02 to 2007-08 and it has declined from 42.61% to 20.03% whereas the SFC grants as a percentage of total non-plan transfers has shown a rising percentage during 2001-02 to 2007-08 and it has risen from 47.91% to 65.70.

In per capita terms, non plan transfers has ranged from Rs.191.19 to Rs.500.91 annually during 2001-02 to 2007-08, out of which assigned revenues has ranged from Rs.82.43 to Rs.100.33 except for two years when it is found to be much higher i.e. Rs.164.41 and Rs.148.60 for 2002-03 and 2003-04. On the other hand SFC grants and a CFC grants have ranged from Rs.92.68 to Rs.329.08 and Rs.11.55 to Rs.32.73 respectively. Specific purpose grants and compensation in lieu of taxes has not shown any significant amounts or any trends.

First and second SFCs recommended sharing 8% of state's tax revenue with all local bodies and the distribution of these grants was in the ratio of 60:40 between rural and urban local bodies. Calculating the share for ULBs it came to 3.2% of state's tax revenue. Looking at the actual SFC released amounts and their ratio from state's tax revenues, it has been observed that the ratio was not constant and it ranged from 1.65% to 2.98%. Releasing of SFC grants to ULBs has shown inconsistencies during 2001-02 to 2007-08.

Table 6.2: Composition of Transfers/Grant-in-aid to ULBs in Tamil Nadu (Percentage)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Assigned Revenue as % of State's Non-Plan Grants/Transfers	42.61	41.45	40.93	31.88	26.89	21.23	20.03
Compensation in lieu of Taxes as % of State Non-Plan Grants/Transfers	0.04	0.02	0.02	0.05	0.04	0.02	1.18
SFC Grants as % of State's Non-Plan Grants/Transfers	47.91	53.27	53.75	60.11	60.05	61.74	65.70
Specific Purpose Grants as % of State's Non-Plan Grants/Transfers	2.31	1.92	1.79	3.80	2.99	9.05	6.56
CFC Grants as % of Non-Plan Grants / Transfers	7.14	3.33	3.51	4.15	10.03	7.96	6.53

Source: Directorate of Municipal Administration, Directorate of Town Panchayats of Tamil Nadu.

Table 6.3: Ratio of Transfers/Grant-in-aid to all ULBs in Tamil Nadu

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Non-Plan Transfers* as % of State's Own Revenue	2.71	5.41	4.49	3.17	3.02	3.27	3.68
(Assigned revenues + SFC Grants) as % of State's Tax revenue	3.11	6.32	5.35	3.67	3.50	3.46	3.89
SFC Grants as % of State's Tax revenue	1.65	3.55	3.04	2.40	2.42	2.58	2.98

Note: * Non-Plan Transfers are excluding CFC grants

Source: Directorate of Municipal Administration and Town Panchayats of Tamil Nadu and State Budgets.

On the other hand, since SFC grants are not the only grants, which are released to ULBs hence the ratio of SFC grants to state's tax revenue would not give an exact load of transfers to ULBs. Taking into the consideration of assigned revenues together with SFC grants would give a closer picture of exact load of transfers on state finances. Assigned revenues together with SFC grants as a percentage of state's tax revenues have ranged from 3.11% to 3.89% during 2001-02 and 2007-08.

6.6 Field Observations: ULB Level

6.6.1 Background

Three ULBs namely Municipal Corporation of Chennai, and Alandur and Vellore municipality from the state of Tamil Nadu are covered for this study. Municipal revenue income can mainly be divided in two categories i.e. income from own receipts and receipts under the head of grants/transfers. Income from own receipts are mainly from tax and non-tax receipts. Receipts under transfers/grants on non-plan head can be broadly categorized in four heads namely assigned revenues, SFC grants, CFC grants and specific purpose grants. The SFC grants are based on first and second SFCs' recommendations i.e. with time periods of 1997-98 to 2001-02 and 2002-03 to 2007-08 for the first and second SFC respectively. Whereas CFC grants are based on 11th and 12th CFCs' recommendations i.e. with time periods of 2001-02 to 2004-05 and 2005-06 to 2007-08 respectively.

6.6.2 Transfers/Grant-in-Aid to Chennai M. Corp., Alandur and Vellore Municipalities

Both the municipalities of the state of Tamil Nadu namely Alandur and Vellore are highly dependent on grant-in-aid/transfers from higher governmental level compared to its own revenue generation capacity whereas the dependency on grants/transfers are comparatively lesser for Chennai Municipal Corporation.

Table 6.4: Composition of Revenue Income of Chennai, Alandur and Vellore (Percentage)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Chennai M. Corp.							
Own Revenue Receipts as % of Revenue Income	61.99	48.95	55.07	62.04	55.32	57.05	57.17
Non-Plan Transfers as % of Revenue Income	38.01	48.62	44.93	37.96	37.41	42.95	42.32
Other Revenue Receipts as % of Revenue Income	0.00	2.44	0.00	0.00	7.27	0.00	0.52
Total Revenue Receipts	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Alandur Municipality							
Own Revenue Receipts as % of Revenue Income	46.46	26.98	34.04	35.50	33.03	36.51	23.62
Non-Plan Transfers as % of Revenue Income	40.72	66.55	62.52	58.22	56.46	55.67	73.07
Other Revenue Receipts as % of Revenue Income	12.82	6.47	3.44	6.28	10.51	7.82	3.31
Total Revenue Receipts	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Vellore Municipality							
Own Revenue Receipts as % of Revenue Income	72.02	55.39	57.97	58.90	36.23	36.96	31.92
Non-Plan Transfers as % of Revenue Income	27.98	44.61	42.03	34.07	57.31	55.43	62.02
Other Revenue Receipts as % of Revenue Income	0.00	0.00	0.00	7.04	6.46	7.61	6.06
Total Revenue Receipts	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Chennai Municipal Corporation and Municipalities of Vellore and Alandur.

Data at the sample municipality level namely Chennai, Alandur and Vellore has shown that own revenue receipts as a percent of total revenue receipts has declined from 62% to 57.2%, from 46.5% to 23.6% and from 72% to 31.9% for Chennai, Alandur and Vellore respectively during the period of 2001-02 to 2007-08. Whereas the non-plan transfers/grants as a percent of total revenue receipts has increased from 38% to 42.3%, from 40.7% to 73.1% and from 28% to 62% for Chennai, Alandur and Vellore respectively. In terms of growth rate also, during the period of 2001-02 to 2007-08, own revenue receipts have grown by 10.20% and 7.25% for Chennai and Alandur respectively but it has declined by 5.7% in case of Vellore. Non-plan transfers/grant-in-aid on revenue account has grown by 13.34%, 28.27% and 21.1% respectively for Chennai, Alandur and Vellore. Out of two major components of non-plan transfers namely assigned revenues and SFC grants, SFC grants has risen with a faster growth rate for all the three ULBs whereas the growth rate of assigned revenues are comparatively lesser for Chennai and Vellore but Alandur has shown a higher growth for assigned revenues. SFC grants has shown a growth rate of 25.6%, 23.04% and 24.8% for Chennai, Alandur and Vellore respectively whereas assigned revenues has shown a growth rate of 5.75%, 36.20% and 12.5%.

In per capita terms, Chennai Municipal Corporation has generated Rs.565.46 from its own revenues, in the year of 2001-02, which has risen to Rs.986.16 in 2007-08, whereas, non-plan transfers have ranged from Rs.346.76 to Rs.730.03 during 2001-02 to 2007-08. Out of non-plan transfers, SFC grants have increased from Rs.380.46 to Rs.353.17 during the period of 2001-02 to 2007-08 and assigned revenues have increased from Rs.230.22 to Rs.307.35 annually. Situation in case of Alandur and Vellore is not so promising especially in generating their own resources, Alandur municipality has generated Rs.200.39 from its own revenues, in the year of 2001-02, which has risen merely to Rs.282.44 in 2007-08 but Vellore municipality had generated Rs.367.76 from its own revenues, in the year of 2001-02, which has declined to Rs.258.77 in 2007-08, whereas, non-plan transfers have ranged from Rs.175.63 to Rs.873.87 and Rs.142.91 to Rs.502.84 during the period of 2001-02 to 2007-08 for Alandur and Vellore respectively. Out of non-plan transfers, SFC grants has increased from Rs.90.27 to Rs.327.84 and from Rs.86.23 to Rs.378.91 and assigned revenues has increased from Rs.61.06 to Rs.489.06 and from Rs.40.67 to Rs.85.43 annually respectively for Alandur and Vellore.

In per capita terms, non-plan transfers to all ULBs has ranged between Rs.191.19 to Rs.425.86 during 2001-02 to 2006-07 whereas non-plan transfers to Chennai Municipal Corporation are consistently higher during this period and has ranged between Rs.346.76 to Rs.606.64. Alandur municipality has also got higher per capita amount on this account but Vellore municipality has got slightly lesser per capita non-plan transfers compared to average non-plan transfers at the state level.

Table 6.5: Transfers/Grants-in-aid for State of Tamil Nadu (Average), Chennai M. Crop., Alandur and Vellore Municipality

(In Rupees)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Per Capita (Average of State)							
Non Plan Transfers/Grants	193.44	396.60	363.07	299.50	350.34	425.86	500.91
(i) Assigned Revenue	82.43	164.41	148.60	95.49	94.21	90.39	100.33
(ii) Compensation in lieu of Taxes	0.07	0.10	0.09	0.16	0.13	0.09	5.90
(iii) SFC Grants	92.68	211.28	195.15	180.04	210.39	262.92	329.08
(iv) Specific Purpose Grants	4.46	7.62	6.51	11.39	10.47	38.55	32.87
(v) CFC Grants	13.81	13.19	12.73	12.42	35.14	33.91	32.73
Per Capita (Chennai M. Crop.)							
Non Plan Transfers/Grants	346.76	563.23	546.23	454.14	524.50	606.64	730.03
(i) Assigned Revenue	230.22	305.88	321.62	217.54	242.31	259.54	307.35
(ii) Compensation in lieu of Taxes	0.47	0.66	0.61	1.13	0.93	0.66	1.41
(iii) SFC Grants	80.46	213.31	184.30	191.45	220.91	273.97	353.17
(iv) Specific Purpose Grants	20.64	28.56	25.02	29.47	17.10	29.62	25.65
(v) CFC Grants	14.96	14.83	14.69	14.55	43.25	42.84	42.45
Per Capita (Alandur Municipality)							
Non Plan Transfers/Grants	175.63	491.41	409.31	304.30	405.55	462.85	873.87
(i) Assigned Revenue	61.06	264.02	208.24	169.63	141.13	197.79	489.06
(ii) Compensation in lieu of Taxes	...	...	...	...	...	...	...
(iii) SFC Grants	90.21	210.14	178.13	130.90	238.88	211.53	327.84
(iv) Specific Purpose Grants	0.00	0.00	0.00	0.00	0.00	0.00	0.00
(v) CFC Grants	24.36	17.25	22.95	3.77	25.53	53.53	56.97
Per Capita (Vellore Municipality)							
Non Plan Transfers/Grants	142.91	316.11	320.01	241.29	431.57	394.23	502.84
(i) Assigned Revenue	40.67	132.95	63.00	55.74	85.88	40.91	85.43
(ii) Compensation in lieu of Taxes	0.00	0.00	0.00	0.00	0.00	0.00	0.00
(iii) SFC Grants	86.23	167.16	230.28	169.60	296.18	291.83	378.91
(iv) Specific Purpose Grants	0.00	0.00	10.75	0.00	10.92	22.95	0.00
(v) CFC Grants	16.02	16.00	15.98	15.96	38.59	38.55	38.50

Source: Directorate of Municipal Administartion and Town Panchayats, Chennai Municipal Corporation and Municipalities of Vellore and Alandur.

Looking at the breakups of non-plan transfers i.e. assigned revenues, SFC grants, CFC grants, specific purpose grants and compensatory grants; it has been observed that SFC grants for Chennai, Alandur and Vellore has not shown any fluctuations compared to state's average per capita SFC grants but the release of assigned revenues has made the much difference.

Assigned revenues to all ULBs in per capita terms, on an average for the state has increased from Rs.82.43 to Rs.90.39 but for Chennai Municipal Corporation, assigned revenues have ranged from Rs.230.22 to Rs.259.54 during 2001-02 to 2006-07 whereas the assigned revenues are also found to be higher for Alandur where it has ranged from Rs.264.02 to Rs.197.79 during 2002-03 to 2006-07. Vellore municipality has received much lesser amounts on account of assigned revenues. As mentioned earlier also, the assigned revenues in the state of Tamil Nadu are on accounts of surcharge on stamp duty, entertainment tax, local cess and local cess surcharge. These amounts are collected by the state government officials from the individual ULBs and returned back to respective ULBs after deducting administrative costs. Hence there is bound to be difference in per capita amounts on account of assigned revenues.

On the other hand, SFC and CFC grants has not shown any fluctuations compared to state's average per capita SFC and CFC grants, which has ranged from Rs.92.68 to Rs.329.08 and Rs.11.55 to Rs.32.73 during 2001-02 to 2007-08.

6.6.3 Utilization of Grants

As per the guidelines issued by the Government of Tamil Nadu for utilization of SFC grants and Assigned revenues indicates that these amounts should be utilized only for revenue expenditure such as-

- Payment of current consumption charges for street lights and water supply maintenance
- Payment of maintenance of charges for water supply schemes by Tamil Nadu Water Supply and Drainage Board and for incurring the expenditure towards water supply maintenance by municipalities including raw materials required for the purpose
- Maintenance of roads and street lights
- Maintenance of conservancy and other public health services including raw materials required for the purpose

- Maintenance of underground drainage and open drainage
- Maintenance of other facilities like compost yard, sewage farm, slaughterhouse, maternity centers, dispensaries, community centers and public toilets, etc.
- Payment of pension and other retirement benefits to retired employees for whom payments are made from the ULBs funds
- Payment of salary of staff including sanitary workers
- Payments of interest on loans obtained from State Government for municipal purposes

It has further instructed to maintain a separate bank account with a separate cashbook, pass book and chequebooks for these funds. Another clause of the Government Order highlights that the corporations, municipalities and town panchayats should work out the total requirements of funds for maintaining infrastructure services under road, water supply, streetlights, conservancy, drainage, underground drainage, interests on loans to be repaid to State Government and items mentioned above such as salary and pension liabilities etc. The difference between actual requirement and allocated devolution package should be credited in this bank account from general funds of concerned ULBs to meet the expenditure.

During discussions with Directorate of Municipal Administration (DMA), Directorate of Town Panchayats (DTP) and Chennai Municipal Corporation it was revealed that only one bank account is maintained at the ULBs level, which is termed as Receipt Account and receipts from devolution package and receipts from own resources such as receipts from tax and non-tax sources are kept under this account. Expenditure on various activities including salary and pension payments as mentioned above is met from this bank account only.

Although the nature of utilization of SFC grants and other grants under assigned revenues is unconditional but these are strictly meant for revenue expenditure only. It is to be noted that during the discussions with DMA and DTP it was pointed out that 80% to 90% of the SFC grants are being spent on salaries and wages of the staff of the ULBs and remaining 10% to 20% is being spent on works related to operation and maintenance.

In case of CFC grants, the amounts released are of conditional nature and are being released after receiving the utilization certificates from individual ULBs by DMA and DTP. The

Commissioner of DMA and DTP send a consolidated utilization certificate to Government of Tamil Nadu and the same is forwarded to Government of India and for getting the release of next installment by Government of India. The CFC grants are meant for the following purposes-

- 50% of the total amount under CFC grant is meant for the schemes of solid waste management through public private partnership. The cost of activities such as collection, segregation and transportation of solid waste whether carried out in house or out sourced could be met from these grants;
- 25% of the CFC grant is allocated for conversion of earthen or metal roads into BT/CC roads and for the formation of storm water drains wherever required; and
- 25% for miscellaneous works such as creation of database and payments of electricity charges.

No component of expenditure on salaries and wages etc. is being disbursed from the CFC grants.

6.6.4 Assessment

Looking at the composition of transfers from state government to ULBs shows that assigned revenues and SFC grants were the two major components besides the specific purpose grants and CFC grants. Assigned revenues had shown a declining trend whereas SFC grants had risen faster during 2001-02 to 2007-08. First and second SFCs recommended sharing 8% of state's tax revenue with all local bodies i.e. rural and urban local bodies but releasing of SFC grants to ULBs has shown inconsistencies during this period. Since the SFC grants were not the only grants, which were being released to ULBs, taking into the consideration of assigned revenues together with SFC grants would give a closer picture of exact load of transfers on state finances, which had risen steadily during 2001-02 and 2007-08. Both the municipalities of the state of Tamil Nadu namely Alandur and Vellore were highly dependent on grant-in-aid/transfers from higher governmental level compared to its own revenue generation capacity whereas the dependency on grants/transfers were comparatively lesser for Chennai Municipal Corporation.

As per the guidelines issued by the Government of Tamil Nadu for utilization of SFC grants and Assigned revenues indicates that these amounts should be utilized only for revenue expenditure including the expenditure on establishment and salaries, operation and maintenance and interest payments on loans etc. In case of CFC grants, the amounts released are of conditional nature and are being released after receiving the utilization certificates from individual ULBs by DMA and DTP. The Commissioner of DMA and DTP send a consolidated utilization certificate to Government of Tamil Nadu and the same is forwarded to Government of India and for getting the release of next installment by Government of India. No component of expenditure on salaries and wages etc. is being disbursed from these CFC grants.

According to theory of fiscal transfers, one of the vertical balance objectives is how does one measures vertical imbalance. In order to know how much transfer is necessary, one must estimate the difference between the own revenues of subnational governments, and the expenditure needs.

Generally the countries that use the vertical balance approach determine a 'minimum service level', and fill the gap with transfers. It has been observed that this idea has been adopted exactly opposite in case of Tamil Nadu. As per the Government Order w.r.t to release of SFC grants, the ULBs should work out the total requirements of funds for maintaining infrastructure services under road, water supply, streetlights, conservancy, drainage, underground drainage, interests on loans to be repaid to State Government and salary and pension liabilities etc. And the difference between actual requirement and allocated devolution package should be credited in one bank account from general funds of concerned ULBs to meet the expenditure. Here two things emerge out, one it is questionable whether the ULBs of Tamil Nadu could calculate their requirements to maintain infrastructural services, etc. especially in absence of any methodologies provided to them by the state government and secondly the gap between actual requirements and own revenues of ULBs was to be funded through fiscal transfers but on the contrary the state government first deposited the amounts of transfers to ULBs and then asked ULBs to deposit the remaining amount between the transfers and actual requirements. It is highly doubtful that the ULBs are depositing the amounts based on the difference between the available transfers and actual requirements and the realty could be that the ULBs are only depositing the amounts to their wish and the concept of depositing of the gap of transfers and actual requirements has been defeated.

Further during discussions with Directorate of Municipal Administration (DMA), Directorate of Town Panchayats (DTP) and Chennai Municipal Corporation, it was revealed that only one bank account is maintained at the ULBs level, which is termed as Receipt Account and receipts from devolution package and receipts from own resources such as receipts from tax and non-tax sources are kept under this account. Expenditure on various activities including salary and pension payments as mentioned above is met from this bank account only and operation and maintenance activities has been undertaken from the remaining balance amounts.

7.0 Gujarat

7.1 First SFC

7.1.1. Background

The First SFC of Gujarat was constituted on 15.9.1994 for the period of five years i.e. 1996-97 to 2000-01 and submitted its reports to State Government for the approval of recommendations in October 1998. The Action Taken Report was submitted on 28th August 2001 for the implementation of accepted recommendations.

7.1.2 Methodology of Data Collection and Data Analysis

The Commission collected data in the prescribed special forms from all ULBs and from all the concerned departments of the state. The information obtained from 6 Municipal Corporations, 86 Municipalities and 60 Borough Municipalities of the state. The Commission also invited suggestions and views of the people through public notice. Discussions with the state and municipal officials were held. A financial review of the state was also carried out.

7.1.3 Previous System of Grant-in-aid to ULBs

The Commission observed that municipalities received multiple grants from the state under three categories i.e. general purpose, special purposes, and statutory grants. General purpose grants consist of per-capita grant for general purpose, grant for non-agricultural assessment, grant for land revenue, grant for education cess, incentive grant, grant against the income of entertainment tax, grant against local cess on local tax and irrigation tax. Whereas the special purposes grants include grant for water supply and sewerage, grants for primary education, maintenance and repairing of roads, pay & allowances, maintenance of dispensaries and hospitals, maintenance of maternity homes and hospital, maintenance of maternity homes and child welfare centres, grants for buildings and equipments, grants for appointment of health officers and scavenging inspectors, leprosy prevention works, mosquito control, purchasing push-cart for the disposal of night soil, for converting dry latrines into flush latrines, for constructing of residential buildings for scavengers, Grant under National Malaria Eradication programme, grant for fileria control, family planning programme, Integrated Child Development Scheme (ICDS) for rooms for primary schools and grant for medical colleges. The State Government also transferred fixed share from the income to the Municipal Corporations and municipalities such as (i) non-agricultural assignment; (ii) land revenue (agriculture); (iii) local cess on land revenue and water rate; (iv) education cess and (v) entertainment tax. ULBs did not get share from the income of respective taxes such as stamp duty, sales tax, electricity duty, motor vehicle tax, traveling tax, entertainment tax on cable/disk antenna.

7.1.4 Analysis of State Related Finances w.r.t. Grant-In-Aid at ULB level

State budgets and data provided by the Gujarat Municipal Finance Board (GMFB) were considered for the analysis of state finances and trends of revenue income and expenditure of the state government. The Commission analysed the revenue income and expenditure, state transfers, and grants-in-aid etc. The Commission estimated the additional income to be accrued on the basis of Commission's recommendations on motor vehicle tax, professional tax, entertainment tax, education cess, non-agricultural land revenue conversion tax, land revenue, local cess, surcharge on stamp duty, entertainment tax on cable T.V./Dish Anteena, grant on established expenditure, per capita basic grant, incentive grant, district planning board etc.

7.1.5 Recommended System

First SFC had only refined earlier system of grant-in-aid and had not suggested any devolution package based on global sharing and at present, non-plan transfers to ULBs at the State level can be categorized under three major heads namely SFC grants, compensation grants and specific purpose grants. The SFC grants were (i) entertainment tax and entertainment tax on cable tv/dish antena, (ii) professional tax, (iii) grants to municipalities for basic per capita and pay allowances and (iv) for creation of municipal finance development fund for ULBs. The compensation grant was mainly compensation in lieu of abolition of Octroi in municipalities. In addition to it there were more than thirty types of specific purpose grants in the state of Gujarat, which were being released to ULBs to undertake specific activities.

Some of the important recommendations on the system of grant-in-aid are discussed below:

<u>Education Cess</u>

The Commission recommended that the ULBs, which undertake the work of primary education, would be entitled to receive 100% of the amount collected by them on account of education cess.

It was also recommended that non-authorized municipalities should be paid 10% of the amount recovered, if the amount recovered is more than 50% of the total demand and if it is less than 50%, no recovery expenses should be paid to the concerned ULB.

Grant for Pay and Allowances

The Commission recommended that this grant should be paid at the rate of Rs.30 per capita on the basis of population and should be linked with Consumer Price Index. Grant-in-aid should not be reduced in case of municipalities, which received grant at the rate of Rs.30 per capita. This should be given till the amount entitled to them equals to the amount commensurate with Consumer Price Index. For this grant Property tax/consolidation tax should not be considered.

Professional Tax

The Commission recommended a share of 50% from the amount reserved from respective area should be disbursed to local bodies like Gram Panchayat, Municipality, or Municipal Corporation against the tax-income received by the State Government.

Entertainment Tax

The Commission recommended to enhance the entertainment tax from 50 percent to 75 percent and should be given to ULBs.

Entertainment Tax on Cable TV/Dish Antenna

The Commission recommended that as this tax is of the nature of local tax, it should be given to ULBs and should be distributed in the ratio of 50:50 between the State Government and ULBs. ULBs should collect this tax under the supervision of Commissioner of Entertainment.

Per capita Basic Grant

The Commission recommended that the rate of per capita basic grants should be doubled and should be paid according to rates prescribed for the different classes of municipalities such as Rs.2\- for Class A; Rs.3\- for Class B; and Rs.5\- for class C.

Grants for maintenance of dispensaries, hospitals, maternity homes and child welfare centre

These institutions should be paid grant at the rate of 40% for A-class, 50% for B-Class, and 60% for C and D- classes municipalities of the total admissible expenditure. Upper ceiling fixed in this regard should be removed.

Motor Vehicle Tax

The Commission recommended that grants for various types of roads to ULBs should be paid for construction of roads as per the recommendations of study group of the 10th Central Finance Commission. It should be paid at the rate of 4% of expenditure incurred according to the new formula. As the amount collected by e municipalities by way of motor vehicle tax was meagre, therefore the collection of this tax should be discontinued.

Surcharge on Stamp Duty

The State Government imposed surcharge on stamp duty on the documents of properties in urban areas at the rate of 25% for giving grant to ULBs from the year 1988-89. The Commission recommended the amount of surcharge as grant to ULBs for their development works.

Octroi

Octroi should be continued until its suitable alternative is available. The report of the Committee on fixing the minimum-maximum rates should be implemented. The Contract for collecting Octroi for the municipalities of 'C' and 'D' categories should be made compulsory.

Non-Agriculture Land Assessment

The Commission recommended increasing the share of 75% to 85% of total recovery effected from their areas. As no share is given to local bodies from the conversion tax, 85% of this income should be paid to the respective ULBs.

7.1.6 Action Taken Report

The recommendations related to professional tax, entertainment tax on cable TV/dish antenna, per capita basic grant, incentive grant, DA grants to newly constituted municipalities, grants related to maintenance of dispensaries, hospitals, maternity homes and child welfare centre, grants for constructing houses for safai karamcharis, and education cess were accepted.

Recommendations related to entertainment tax, grant in respect of transferred schemes of the State Government, motor vehicle tax, grant for pay and allowances, grant in aid for primary education, surcharge on stamp duty and non-agriculture land assessment were accepted with certain modifications such as:

Entertainment Tax

The State Government has accepted recommendation on giving 75% amount of entertainment tax instead of 50%. However, additional amount of 25% should be allotted to municipalities for Bajpai Nagar Vikas Yojana.

Motor Vehicle Tax

Grant for maintenance of roads should be given according to the formula of roads and building department. Recommendation of discontinuing grant under the motor vehicle tax act was accepted. Powers shall be delegated after scrutiny to ULBs for imposing lifetime tax on vehicles in consultation with Home (Transport) Department.

Grant for Pay and Allowances

After taking into consideration the recommendations for grant-in-aid clubbed and decided to give grant of Rs.35/- per capita. This grant would be based on certain conditions.

Grant in aid for primary education

The recommendation was accepted with certain conditions.

Surcharge on Stamp Duty

The recommendation was accepted but its implementation should be made from the year 2000-01. Amount accumulated of earlier years was not allotted. Amount available from stamp duty surcharge should be given to municipalities for Bajpai Nagar Vikas Yojana. This recommendation was accepted with certain conditions.

Non-Agriculture Land Assessment

It has been decided to give 100% amount of non-agricultural assessment through Collector instead of 85% as recommended. Recommendation of giving grant in respect of conversion tax of land was not accepted.

7.2. Second SFC

7.2.1 Background

Second State Finance Commission was constituted on 19th November 2003 by the State Government for the period of five years i.e. 2005-06 to 2009-10 and submitted its report to the State Government for the approval of recommendations in June 2006.

7.2.2 Methodology

An attempt was made to collect data through detailed structured questionnaires, annual reports and municipal budgets. Separate working groups were set up for designing the questionnaires. Other State Finance Commissions were consulted to know the financial relations between the ULBs and state governments. Discussion were also held to elicit the views of the peoples' representatives, MPs, MLAs, Presidents of District Panchayat, Taluka Panchayats and Municipalities, Municipal Corporations and other non-officials.

7.2.3 System of Grant-in-aid to ULBs prior to second SFC and Resource Gap of ULBs

The Second SFC observed that municipalities received multiple grants from the state for the implementation of development schemes formulated by the State Government. These grants were revenue and capital nature grants. Revenue grants were allocated to ULBs to meet their revenue expenses and other expenditures. Whereas capital grants were tied up grants and allocated by atleast five departments of the state government. These grants also include the grants from the Central Government and grants allocated on the basis of recommendations of Central Finance Commission. However, the components of the revenue grants and capital grants were not discussed in the report.

7.2.4 Analysis of State Related Finances w.r.t. Grant-in-aid at ULB level

State Budgets and State finances were considered for the analysis of state finance and trends of revenue income and expenditure of the state government. The Commission examined the state finances, the behavioural pattern of state level income-expenditure and financial deficits over a period. Data pertaining to state level income and expenditure was analysed for the period 1994-95 to 2003-04. The data pertaining to Gross State Domestic Product at current prices was collected from social economic survey of Gujarat for the year 2004-05.

7.2.5 Recommended System

<u>Devolution of Additional Fund to Local Bodies</u>

Regarding devolution of additional fund to local bodies, the Commission proposed to increase 10% of the state revenue should be shared with local bodies of the state. It should be increased from 21.15% to 31.15% from 2005-06 to 2009-10. This additional fund of 10% share in the state revenue should be transferred in the form of non-tied up funds.

Professional Tax

The Commission recommended that the income from professional tax should be shared between ULBs and PRIs on the basis of rural and urban population ratio i.e. 67% to 33%.

Education Cess

The Commission made two recommendations regarding education cess i.e. (a) the Gujarat Municipality Act should be amended in order to collect the education cess on areas based system of property tax which was given on the basis of total collections earlier, and (b) the grant against education cess should be allowed for other development works of the area as earlier it was used for asset creation.

Stamp Duty Cess

The Commission recommended that the ULBs must be authorised to levy cess on stamp duty on the line of Gujarat Panchayat Act.

Road Maintenance Grant

The Commission recommended that the road lengths must be revised and must be given accordingly at the present rate of SORs.

Ad-hoc Grants

The Commission recommended that the Ad-hoc grants should be released on the basis of 2001 census population and should also be revised as per cost escalation during the years since it was pending years before.

Grant for Asset Maintenance

The Commission suggested that the maintenance grant on yearly basis should be given on the line of the grants given for the road maintenance.

Grant for New Areas to be merged with ULBs

Since ULBs require additional finance resources for provision of urban basic amenities to the newly merged areas, the Commission recommended that the respective ULBs should be given ad-hoc grant at the rate of Rs.100/- per capita per year initially for three years.

7.2.6 Action Taken Report

The ATR is still awaited.

7.3 Assessment

The First SFC of Gujarat took four years to submit its report and Government of Gujarat took three years to issue an Action Taken Report for the implementation of accepted recommendations. In the mean time, Government of Gujarat did not constitute Second SFC for the next five years. On the one hand many of the recommendation of First SFC were rejected while on the other hand some recommendations had been accepted and implemented with a considerable lapse of time. First and Second SFCs of Gujarat revealed that the ULBs of the state has been receiving multiple grants from the State Government. Prior to First and Second SFCs of Gujarat, the state of Gujarat had a developed local government system and well-developed grant-in-aid codes. Both the Commissions had not attempted to address the complexity of multiple grants in the state although the transparency of grant-in-aid to ULBs was much better than other states. Moreover, the Commissions had also not attempted to check the financial burden on the state finances of these multiple grants to ULBs. First SFC had only refined earlier system of grant-in-aid and had not suggested any devolution package based on global sharing which had led to the system of fiscal transfers without any formula based framework.

7.4 Field Observations: State Level

7.4.1 Background

During the period of First SFC i.e. 2002-03 to 2007-08, non-plan transfers can be categorized under four major heads namely SFC grants, compensation grants, specific purpose grants and CFC grants. The SFC grants during this period are (i) entertainment tax and entertainment tax on cable tv/dish antena, (ii) professional tax, (iii) grants to municipalities for basic per capita and pay allowances and (iv) for creation of municipal finance development fund for ULBs. The compensation grant is mainly compensation in lieu of abolition of Octroi in municipalities. In addition to it, there are more than thirty types of specific purpose grants in the state of Gujarat, which are being released to ULBs to undertake specific activities. Some of the specific purpose grants are for solid waste management, slum area development, drainage schemes, small and medium towns, health and cleanliness, urban basic service programme and dearness allowance etc. Whereas CFC grants are based on 11th and 12th CFCs' recommendations i.e. with time periods of 2001-02 to 2005-06 and 2006-07 to 2007-08 for the eleventh and twelfth CFC respectively.

7.4.2 Transfers to ULBs

The First and Second SFCs of the state of Gujarat did not link the grants with state related finances i.e. state's own revenues or state's tax revenues. Looking at the composition of non-plan transfers, it can easily be seen that compensation grants and specific purpose grants are the major grants during 2001-02 to 2006-07. In the coming years also the role of compensation grants which is lieu of abolition of Octroi is going to increase tremendously because Octroi has also been abolished in Municipal Corporations of the state of Gujarat in the financial year of 2007-08.

Table 7.1: Composition of Transfers/Grant-in-aid to all ULBs in Gujarat (Percentage)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
SFC Grants as % of State's Non-Plan Grants/Transfers	0.00	11.30	12.52	39.43	23.32	15.79
Compensation Grant as % of State's Non-Plan Grants/Transfers	56.82	46.02	50.60	25.45	32.40	36.02
Specific Purpose Grants as % of State's Non-Plan Grants/Transfers	43.18	34.46	31.85	25.00	33.85	34.77
CFC Grants as % of Non-Plan Grants/Transfers	(-)	8.22	5.03	10.13	10.42	13.43

Source: Directorate of Municipal Administration, Gujarat.

Overall the compensation grant and specific purpose grants has increased by 16.75% and 21.53% during 2001-02 to 2006-07 respectively. Whereas the SFC's grants and CFCs grants has risen by 28% and 32% during the period of 2002-03 to 2006-07 respectively, but the overall share of these grants is very small.

Table 7.2:Transfers/Grant-in-aid to all ULBs in Gujarat

Rs.Lakh

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	AAGR (%)
Non-Plan Transfers/Grants	22011.38	36503.48	39723.02	74944.87	55501.93	80235.90	25.87
(i) SFC Grants	0.00	4125.00	4971.41	29549.97	12942.00	12665.42	28.05
(ii) Compensation in lieu of Octroi	12506.00	16800.00	20100.80	19071.94	17985.03	28900.00	16.75
(iii) Specific Purpose Grants	9505.38	12578.48	12650.81	18733.57	18789.92	27895.46	21.53
(iv) CFC Grants	na	3000.00	2000.00	7589.39	5784.98	10775.02	31.97

Source: Directorate of Municipal Administration, Gujarat.

As mentioned in the earlier section also, SFC grants are (i) entertainment tax and entertainment tax on cable TV/dish antena, (ii) professional tax, (iii) grants to municipalities for basic per capita and pay allowances and (iv) for creation of municipal finance development fund for ULBs. On account of SFC grants, there has been observed drastic rise in absolute amounts in the third year of SFC i.e. 2004-05 where it has risen by five times compared to grants released in 2003-04. This is because of releasing of professional tax grant and its arrears for the last two years. Similarly on CFC head also the amounts of 12th CFC has risen substantially during 2004-05 the years of 2002-03 and 2003-04 but reasons are unknown and during the discussions with state officials, it was told that this rise was due to release of backlog amounts but reasons for backlog amounts were not provided. On the other hand, the specific purpose grants has overall declined by 20% during 2001-02 to 2007-08, which can be understood from the fact of the nature of this grant, which is of specific purpose and may vary from year to year.

In per capita terms, non-plan transfers were only Rs.113 but these have been steadily rising and have increased to Rs.357.38 in the years of 2006-07. Out of which the Octroi compensation grants has ranged between Rs.64.21 to Rs.82.42 during 2001-02 to 2005-06 but suddenly has risen to Rs.128.73 in 2006-07. Similarly specific purpose grants have ranged between Rs.48.81 to Rs.86.11 during 2001-02 to 2005-06 but suddenly have risen to Rs.124.25 in 2006-07. The SFC grants has also steadily risen from Rs.20.59 to Rs.56.41 during 2002-03 to 2006-07 with an exception of year of 2004-05 when arrears on account of professional tax were released and the per capita amount on this account has risen to Rs.139.32. The CFC grants in terms of per capita are minimal upto the year 2003-04 and for the year of 2006-07 it is observed to be only Rs.48 only.

Looking at the complexities of the system of grant-in-aid/transfers to ULBs in Gujarat it is interesting to calculate the load of all state transfers/grant-in-aid on the state finances.

Table 7.3: Ratio of Transfers/Grant-in-aid to all ULBs in Gujarat

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Non-Plan Transfers as % of State's Own Revenue	1.69	2.48	2.61	4.20	2.61	3.09
SFC Grants as % of State's Own Revenue	0.00	0.31	0.34	1.84	0.68	0.56

Note: * Non-Plan Transfers are excluding CFC grants
Source: Directorate of Municipal Administration, Gujarat.

It has been observed that the total state transfers/grant-in-aid to ULBs s as a percentage of state's own revenues come to 3.09% in the year of 2006-07 whereas this ratio is only 1.69% in the year of 2001-02. This ratio has remained around 2.5% during 2002-03 to 2005-06 with an exception in the year of 2004-05 when it was 4.2% due to release of backlog professional tax grant. In the coming years the ratio of total state transfers as a percentage of state's own revenue will definitely go up because the compensation grants which is lieu of abolition of Octroi is going to increase tremendously because of abolition of Octroi in Municipal Corporations also from the financial year of 2007-08.

7.5 Field Observations: ULB Level

7.5.1 Background

Two ULBs namely Municipal Corporations of Ahmedabad and Rajkot from the state of Gujarat have been covered for this study. Municipal revenue income can mainly be divided in two categories i.e. income from own receipts and receipts under the head of grants/transfers. Income from own receipts are mainly from tax and non-tax receipts. Receipts under transfers/grants on non-plan head can be broadly categorized in three heads namely compensatory grants, SFC grants, CFC grants and specific purpose grants. The SFC grants are based on first SFCs' recommendations i.e. with time period of 2002-03 to 2006-07. Whereas CFC grants are based on eleventh and twelfth finance commissions' recommendations i.e. with time periods of 2001-02 to 2004-05 and 2005-06 onwards respectively.

7.5.2 Transfers/Grant-in-Aid to the Municipal Corporations of Ahmedabad and Rajkot

Both the ULBs of the state of Gujarat are quite self sufficient because of generation of high resources from own sources and less dependent on grant-in-aid and transfers from higher governmental level. Data at the sample ULB level namely Ahmedabad and Rajkot, has shown that own revenue receipts as a percent of total revenue receipts has remained around 90% for Ahmedabad during the period of 2001-02 to 2006-07 and it has also remained above 80% for Rajkot during the same period except for the year of 2006-07 when it has declined to 69.4%, whereas the transfers/grants as a percent of total revenue receipts have declined from 8.13% to 5% and has increased from 7% to 26% for Ahmedabad and Rajkot respectively. However the dependency on state transfers in all the Municipal Corporations of the Gujarat is definitely going to increase atleast for the initial coming years due to abolition of Octroi in Municipal Corporations. The impact can clearly be seen in case of Municipal Corporation of Ahmedabad, where the ratio of transfers/grants as a percent of total revenue receipts has increased from 5% in 2006-07 to 26% in 2007-08 and the ratio of own revenue receipts as a percentage of municipal revenue receipts has declined from 90% to 63.4%. The impact of abolition of Octroi is also partial for the financial year of 2007-08 because the Octroi is abolished in the month of November 2007. In the coming years the dependency on state transfers especially on account of compensatory grants is going to increase in case of Municipal Corporations of the state of Gujarat.

Table 7.4: Composition of Revenue Income of Ahmedabad and Rajkot (Percentage)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Ahmedabad M.Corp.						
Own Revenue Receipts as % of Revenue Income	89.43	89.89	89.17	91.43	92.03	89.82
Non-Plan Transfers as % of Revenue Income	8.13	7.58	7.88	5.20	5.37	4.98
Other Revenue Receipts as % of Revenue Income	2.44	2.53	2.95	3.36	2.60	5.20
Total Revenue Receipts	100.00	100.00	100.00	100.00	100.00	100.00
Rajkot M.Corp.						
Own Revenue Receipts as % of Revenue Income	86.26	80.72	85.40	88.86	82.16	69.37
Non-Plan Transfers as % of Revenue Income	6.97	13.58	9.21	7.95	14.20	26.07
Other Revenue Receipts as % of Revenue Income	6.77	5.70	5.39	3.20	3.64	4.56
Total Revenue Receipts	100.00	100.00	100.00	100.00	100.00	100.00

Source: Ahmedabad and Rajkot Municipal Corporations.

In per capita terms, Ahmedabad Municipal Corporation (AMC) has generated Rs.1280.71 from its own revenues, in the year of 2001-02 which has risen to Rs.2518.53 in 2006-07, whereas, non-plan transfers have ranged merely from Rs.116.46 to Rs.139.51 during the period of 2001-02 to 2006-07. There are no compensatory grants, which are released to AMC since the Octroi is not abolished till the end of financial year of 2006-07. Out of non-plan transfers, SFC grants has merely increased from Rs.37.79 to Rs.51.82 during the periods of 2001-02 to 2006-07; specific purpose grants has increased from Rs.27.15 to Rs.80.93, and CFC grants has declined from Rs.51.51 to Rs.6.76 annually because CFC grants on account of solid waste management has not been received by AMC for both the years of 2005-06 and 2006-07.

Similarly, in per capita terms, Rajkot Municipal Corporation (RMC) has generated Rs.782.84 from its own revenues in the year of 2001-02, which has steadily risen to Rs.1087.66 in 2006-07, whereas, non-plan transfers have ranged merely from Rs.63.27 to Rs.178.83 during the periods of 2001-02 to 2005-06 and then has risen to Rs.408.82 in 2006-07. There are no compensatory grants, which are released to RMC since the Octroi has not been abolished till the end of financial year of 2006-07. Out of non-plan transfers, SFC grants have merely increased from Rs.4.57 to Rs.12.95 during 2001-02 to 2006-07; specific purpose grants have increased from Rs.57.57 to Rs.279.84. There is a little amount, which were shown on account of CFC grants for both the eleventh and twelfth CFCs except for the year of 2006-07 when the per capita grant on this account is Rs.116.

Comparing per capita non plan transfers to all the ULBs at the state level with individual Municipal Corporations of Ahmedabad and Rajkot reflected a different story and no clear cut scenario come out. As mentioned above also, there are no compensatory grants on account of abolition of Octroi to these two Municipal Corporations and hence average per capita amounts of non-plan transfers at the state level differed drastically with per capita amounts of non-plan transfers at the two Municipal Corporations' level namely Ahmedabad and Rajkot.

Table 7.5: Transfers/Grant-in-aid for the State of Gujarat (Average), Municipal Corporations of Ahmedabad and Rajkot

(Rupees)

Components	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Per capita (Average of the State)						
Non-Plan Transfers/Grants	113.02	182.17	192.68	353.35	254.34	357.38
(i) SFC Grants	0.00	20.59	24.11	139.32	59.31	56.41
(ii) Compensation Grant	64.21	83.84	97.50	89.92	82.42	128.73
(iii) Specific Purpose Grants	48.81	62.77	61.37	88.32	86.11	124.25
(iv) CFC Grants	na	14.97	9.70	35.78	26.51	47.99
Per capita (Ahmedabad M.Corp.)						
Non-Plan Transfers/Grants	116.46	117.79	139.17	102.99	119.34	139.51
(i) SFC Grants	37.79	25.39	36.27	21.84	68.82	51.82
(ii) Compensation Grant	0.00	0.00	0.00	0.00	0.00	0.00
(iii) Specific Purpose Grants	27.15	40.81	21.42	39.61	24.47	80.93
(iv) CFC Grants	51.51	51.59	81.49	41.54	26.06	6.76
Per capita (Rajkot M.Corp)						
Non-Plan Transfers/Grants	63.27	156.65	92.53	91.00	179.83	63.27
(i) SFC Grants	4.57	7.98	6.88	2.43	0.00	12.95
(ii) Compensation Grant	0.00	0.00	0.00	0.00	0.00	0.00
(iii) Specific Purpose Grants	57.57	144.60	81.76	87.30	178.82	279.84
(iv) CFC Grants	1.13	4.07	3.88	1.26	1.01	116.03

Source: Directorate of Municipal Administration and Municipal Corporations of Ahmedabad and Rajkot.

Per capita SFC grants in case of Ahmedabad are quite close to average per capita SFC grants at the state level except for the year of 2004-05 but in case of Rajkot, SFC grants in per capita terms are no way close to average per capita SFC grants at the state level and these are continuously lesser than state's average per capita amounts. One probable reason could be that the Rajkot Municipal Corporation has accounted these grants as a part of specific purpose grants. Per capita specific purpose grants in case of Ahmedabad is continuously lesser than the average per capita specific purpose grants at the state level but in case of Rajkot, specific purpose grants in per capita terms are continuously higher than state's average per capita amounts especially for the years of 2005-06 and 2006-07. One probable reason could be that the Rajkot Municipal Corporation has accounted SFC grants as a part of specific purpose grants.

7.5.3 Utilization of Grants

There are a number of grants, which are being transferred to the ULBs in the state of Gujarat, and most of them are specific purpose grants and each grant has certain norms and general conditions including utilization certificates, which are to be fulfilled before getting these grants. There are more than twenty such grants which are being released to ULBs and it is very difficult to cover the conditions of utilization of all these grants but conditions and utilization of some of the important grants are as (i) Education Cess: Under Section 5 and Section 7 of the Gujarat Education Cess Act, 1962, education cess has been levied on agricultural and non-agricultural land. The education cess is being levied at the rates prescribed of annual rental values of the lands and buildings, the rates has been varied at 3% to 20% of annual rental value. The ULBs collects this cess and deposits in the exchequer. The recovered amount on account of education cess is credited in the separate fund namely "State Education Cess Fund" after deducting the expenditure of recovery, (ii) Grant for Pay and Allowances: There are a number of conditions, which ULBs has to meet to receive this grant from the state government. Each ULB is expected to furnish details of expenditure of previous year by the month of May of the next year to the Controlling Officer of Grant for getting grant. The grant on this account is being distributed to the ULBs in three installments and (iii) Grant in aid to municipalities from land revenue: A certain portion of land revenue recovered during last year from the respective ULBs is being given back to the ULBs as grant-in-aid from land revenue. This grant is expected to be utilized for the agricultural improvement and for the welfare of the farmers in the municipal area.

7.5.4 Assessment

As mentioned above also that the ULBs of Gujarat were receiving multiple grants from the State Government. There were a number of grants, which are being transferred to the ULBs in the state of Gujarat, and most of them were specific purpose grants and each grant had certain norms and general conditions including utilization certificates, which were to be fulfilled before getting these grants.

Both the SFCs had not attempted to address the complexity of multiple grants in the state and had not suggested the fiscal devolution package for grants to capture the elasticity of state related finances. Looking at the composition of non-plan transfers, it can easily be seen that compensation grants and specific purpose grants are the major grants during 2001-02 to 2006-07. In the coming years also the role of compensation grants which is lieu of abolition of Octroi is going to increase tremendously because Octroi has also been abolished in Municipal Corporations of the state of Gujarat in the financial year of 2007-08. It has been observed that the ratio of state transfers/grant-in-aid to ULBs s as a percentage of state's own revenues has increased over the past six years and in the coming years also this ratio would definitely go up because the compensation grants which is in lieu of abolition of Octroi is going to increase tremendously because of abolition of Octroi in Municipal Corporations.

Both the ULBs of Gujarat were quite self sufficient because of generation of high resources from own sources and less dependent on grant-in-aid and transfers from higher governmental level. However, the dependency on state transfers in all the Municipal Corporations of the Gujarat is definitely going to increase due to abolition of Octroi in Municipal Corporations.

8.0 Assam

8.1 First SFC

8.1.1. Background

The First SFC in the state of Assam was constituted vide Notification No. FEA 58/93/pt/6 dated 23rd June 1995 for the period of five years from 1st April 1996 to 31st March 2001. The Report was submitted to the Governor, Assam Government on 29th February 1996 for the approval of the recommendations made by the commission. The Action Taken Report (ATR) was also submitted on 18th March 1996 for the implementation of accepted recommendations.

8.1.2. Methodology

The First SFC of Assam collected the required data from the State Government and municipalities to analysis the financial position of the state and the local bodies in terms of revenue collection and revenue expenditure including taxes, non-taxes, devolution of taxes and distribution, grant-in-aid, debt position etc. The Commission felt that there was no standard format for data maintenance, which made it difficult to compile the information at the state level.

8.1.3 Previous System of Grant-in-aid to ULBs

The SFC observed that only motor vehicle tax was shared with the municipalities in the state. The inter-se distribution among the municipalities was made on the basis of number of vehicles of each urban body. It was also observed that very limited grants were transferred to ULBs for execution of schemes against the core subjects out of the funds under the award of the 10th CFC and grants for preparation of registers and forms.

8.1.4 Analysis of State Related Finances w.r.t Grants in Aid at ULB level

The SFC attempted to analyze the financial accounts of state government with reference to state transfers to the ULBs, grant-in-aid, debt and loan outstanding of all local bodies in the state. It has been observed that although the SFC has analyzed state related finances but has not attempted to look at the load of grant-in-aid to local bodies of the state. The linkage of state finances and system of grant-in-aid in ULBs could have been incorporated in the report.

8.1.5 Recommended System

Devolution of Taxes

The Commission recommended the devolution of 2 percent of the net proceeds of state taxes for transfer to local bodies from 1996-97 to 2000-2001. In regard to the principles of inter se distribution of the divisible pool between rural and urban local bodies and also among different tiers of local bodies, the Commission adopted the sole criteria of population as per Census 1991 as the basis of inter se distribution.

Grants-in-Aid

The Commission recommended that the grants might be given for implementing the development programmes of core subjects within the jurisdiction of each local body. The fund for this purpose should be provided by the state government out of plan outlay for the period from 1996-97 to 2000-2001. The fund awarded by the 10^{th} CFC should be distributed equally in each year starting from 1996-97 to 1999-2000 as grant-in-aid by the state government to each local body on the basis of population as per 1971 census out of the fund allocated under the State Plan. For the period of 2000-2001, equivalent annual amount of grant to each local body should be sanctioned out of plan fund on the same basis.

8.1.6 Action Taken Report

The recommendations of the first SFC though accepted but have not been implemented.

8.2 Second SFC

8.2.1 Background

The Second SFC of Assam was constituted vide Government notification No. FEA.130/2000/20 dated 18^{th} April 2001 for the period of five years from 1^{st} April 2001 to 31^{st} March 2006. The report was submitted to the Governor, Assam Government on 18^{th} August 2003 for the approval. The ATR was issued on 7^{th} February 2006 by the Assam Government for the implementation of accepted recommendations.

8.2.2 Methodology

The second SFC collected data through detailed questionnaires, which were sent to Guwahati Municipal Corporation (GMC), Municipalities and Town Committees. The relevant data was also obtained from the State and Central Government agencies and autonomous bodies.

Besides, the discussions were also held with departmental officers of the State Government. However, the Commission hardly received any response from individuals, institutions, political parties and Organizations etc. But the Commission received data from 32 ULBs only and from Urban Development Department.

8.2.3 System of Grant-in-aid/Transfer to ULBs prior to Second SFC

The Second SFC observed that the ULBs in the state received a number of Grants under the heads of (a) general purpose grant, (b) cash allowance to sweepers, (c) special ad hoc general purpose grant, (d) grants for maintenance of PWD road side drains (e) communication grant and (f) flood damage grant. Some of the grants were on paper only e.g. cash allowance to sweepers. The SFC also found that the ULBs shared a number of taxes with the state government namely motor vehicle tax, entertainment tax, land revenue and local rates based on the principle of sharing of taxes by origin. In case of GMC, a substantial amount of transfers on account of entertainment tax was given to the Corporation but the amounts actually released to GMC were fluctuated from year to year depending upon the budgetary and cash flow position of the State Government. Apart from GMC, no other ULBs were entitled to get a share in entertainment tax as per the existing statutes. The Commission observed that the ULBs including GMC received Motor Vehicles tax (MV tax) on the basis of 30% of the actual total collection of the MV tax.

8.2.4 Analysis of State Related Finances w.r.t Grants in Aid at ULB level

The SFC attempted to analyze the financial accounts of the state government in terms of state transfers to the ULBs, grant-in-aid, debt and contingent liabilities. The Commission provided ways and means and financial reforms to overcome the financial problem of the state. Fiscal capacity was estimated by using proxies like per capita tax collections and per capita income in the primary sector net of mining and quarrying. Cost disadvantages were taken into account by considering differential expenditure requirements rose from factors such as area, number of services recipients and O & M obligations. The Commission observed that the devolution of resources from the state government to local body could play only a limited role in facilitating the provision of public services to citizens.

8.2.5 Recommended System

Devolution of Tax Revenue to Local Bodies

The Commission recommended the discontinuation of the system of derivation based tax sharing and its replacement by global sharing. The divisible pool should be 3.5% of the aggregate collection of State taxes and duties and this should be devolved annually to local bodies. The urban divisible pool was to be allocated among GMC, Municipal Boards and Town Committees on the basis of composite index of (i) population (1991) 50%, (ii) urban geographical area 25%, (iii) infrastructural index 12.5% and (iv) per capita tax collection. The infrastructure index was constructed using three parameters viz, (i) length of surface roads, (ii) length of pucca drains and (iii) number of street lights. Equal weightage was to be given to all.

Grant-In Aid

The Commission recommended a grant of Rs.10 crore annually to ULBs out of which GMC should receive Rs.5 crores and the remaining Rs.5 crore should be allocated to the other ULBs annually on the basis of 1991 population.

The Commission recommended the transfer of funds for the meant of supplement and not substitute the existing sources of revenue of the local bodies. These local bodies had to make determined and sustained efforts to raise their own tax and non-tax revenues from all sources.

8.2.6 Action Taken Report

Devolution of Tax Revenue to Local Bodies

Implementation the recommendation of devolution of 3.5% of the aggregate collection of State taxes to the urban local bodies was not budgeted for 2005-06. It may continue the arrangement of sharing motor vehicle tax, entertainment tax, land revenue and the local rates with rural local bodies and urban local bodies after the year 2006-07 under various statutory provision and executive decisions. The State Finance Department should sanction and release the funds to the local bodies and consider the feasibility of opening local body wise personal ledger accounts for this purpose.

8.3 Third Assam State Finance Commission

8.3.1 Background

The Third SFC was constituted vide Notification No. EFA 182/2005/375 dated 6th February 2006 covering the period of five years from 1st April 2006 to 31st March 2011. The report was submitted to the Governor of Assam on 27th March 2008 for the approval of the recommendations made by the Commission. The report of Action Taken on the recommendations of the commission was issued by the State Government on 25th September 2009.

8.3.2 Methodology

The Third SFC collected data from the State Government and municipalities to analysis the financial position of the State Government and local bodies. However, the Commission had not received substantial data and a database as perceived by Eleventh Finance Commission is practically non-existent. The Commission had to satisfy with whatever data could be provided by the concerned Departments. There is no mechanism in the Department of Urban Development for monitoring, coordination and integration of whatever limited data/information is available.

8.3.3 Previous System of Grant-in-Aid to ULBs

The SFC observed that Motor Vehicle Tax and Entertainment Tax are shared with the ULBs of the State. As per the decision of the State cabinet, 30 per cent of the net proceeds of Motor Vehicle Tax collected on the basis of its registered vehicle by the State are made sharable with the ULBs including GMC. Apart from this, no other state tax or duty is shared with the ULBs. With regard to Grants-in-aid, the Commission observed that the ULBs receive general and specific purpose grants like maintenance of PWD road side drains, communication grants, flood damage restoration grant and cash allowance to sweepers. However, the mechanism of transfer through grants-in-aid has gradually been discarded and the current level of grants to ULBs is almost negligible.

8.3.4 Analysis of State Related Finances w.r.t Grants-in-aid at ULB Level

The State Government attempted to analyse the financial accounts of the State Government in terms of Centre share tax and non-plan grants. With regard to Grants-in-aid, the state government receive non-plan grants under the award of CFC's. Apart from this, the State

Government receive other non-plan grants for other purposes such as modernization of police force, re-imbursement of security related expenditure, home guards, civil defense, Indo-Bangladesh border check posts, calamity relief, national highways and the like.

8.3.5 Recommended System

Divisible Pool (DP)

The Commission recommends that 25 percent of the Non-Loan Gross Own Tax Revenue Receipt (NLGOTRR) minus collection expenditure of GoA should form the DP out of which allocations should be made to PRIs and ULBs during the three financial Years 2008-11.

The Commission recommends the urban divisible pool (the second part of DP) will be allocated horizontally among GMC and the other ULBs on the basis of the weighted composite index of population (50 percent), area (25 percent), index of infrastructure (12.5% percent) and per capita tax collection (12.5%).

Quantum of Devolution

The Commission recommends that the same criteria as recommended in the Ad Interim Report should be adopted during the three financial years 2008-11 except that the quantum will be 25 per cent of NLGOTRR during 2008-11 and the actual expenditure on collection charges will be deducted. For 2007-08 the quantum will remain at 10 percent of NLGOTRR as already recommended in the Ad Interim Report.

8.3.6. Action Taken Report (ATR)

The State Government accepted the recommendations made on Divisible Pool and Quantum of Devolution.

8.4 Assessment

The principles laid down by the first, the second and the third SFC did not favour assignment of taxes to local bodies. They recommended devolution in the shape of sharing the net proceeds of taxes duties collected by the State Government to be supplemented by grant-in-aid on a selective basis. The first SFC recommended 2 percent of the net proceeds of state taxes, the second SFC stepped it up to 3.5 percent, the interim Report of the third SFC recommended 10 percent while the final Report of the third SFC raised it to 25 percent.

The SFCs have made an estimation and analysis of the finances of the state government and the third SFC has made an estimation of state finances of the pre and post transfer stages.

Such estimation and analysis made in respect of the finances of local bodies cannot be said to be accurate in view of acute data constraint. SFCs in general have made host of suggestions for generating additional resources by the local bodies but they could not quantify the amounts from such measures. Only the third SFC, recently has quantified certain amounts to be raised additionally by the local bodies.

The status of implementation of recommendations of the SFCs has been rather tardy. The recommendations of the first SFC though accepted but have not been implemented. The recommendations of the second SFC were partially accepted and did not accept the recommendation of sharing net proceeds of state taxes etc. However, implementation of recommendations of the third SFC is under active consideration of the State Government

8.5 Field Observations: State Level

8.5.1 Background

In case of Assam, non plan transfers to ULBs can be categorized in three major head namely assigned revenues and devolutions, specific purpose grants and CFC grants. Assigned revenues and devolutions mainly consist of motor vehicle tax, surcharge on stamp duty, entertainment tax and grant-in-aid. Although the periods of first, second and third SFCs were 1996-97 to 2000-01, 2001-02 to 2005-06 and 2006-07 to 2010 respectively but the recommendations of first and second SFCs were not be implemented in the state of Assam, whereas, the recommendations of the third SFC are still to be implemented. The CFC grants are based on eleventh and twelfth finance commissions' recommendations i.e. with time periods of 2000-2005 and 2006 to 2010 for the eleventh and twelfth CFC respectively.

8.5.2 Transfers to ULBs

Looking at the trends and pattern of state transfers to ULBs, it has been found that there is no pattern at all. The rise in non-plan transfers to all ULBs in the years of 2003-04 and 2004-05 is mainly due to release of assigned revenues mainly entertainment tax and then onwards there is a decline during 2005-06 to 2007-08. Since the recommendations of first and second SFCs were not implemented the state government released the funds of their own convenience and the link between state's own revenues and grant-in-aid to ULBs could not be established. It has also been found that the grants w.r.t to 11th and 12th CFCs are not systematic.

Table 8.1: Transfers/Grants-in-aid to ULBs in Assam

Rs. Lakh

Components	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Non-Plan Transfers/Grants	437.00	1586.00	2727.00	1892.00	2054.00	4248.00
(i) Assigned Revenue and Devolutions	369.00	1206.00	1287.00	802.00	636.00	550.00
(ii) Specific Purpose Grants	20.00	46.00	821.00	1009.00	898.00	3648.00
(iii) CFC Grants	48.00	334.00	619.00	81.00	520.00	50.00

Source: Finance Department (SFC Cell), Government of Assam.

Since non-plan grants/transfers are the main component of state transfers and disaggregating it further, it has been found that assigned revenue and devolutions is the main component during 2002-03 and 2003-04 and the role of specific purpose grants is minimal. Assigned revenue and devolutions as percent of total non-plan transfers are around 95 percent for the years of 2002-03 and 2003-04. However, this trend is reversed during 2004-05 to 2007-08 when the importance of specific purpose grants increased, assigned revenue and devolutions as percent of total non-plan transfers are declined to 61 percent, 44 percent, 41 percent and finally to 13 percent during 2004-05, 2005-06, 2006-07 and 2007-08.

Table 8.2: Composition of Transfers/Grant-in-aid to all ULB's in Assam

Components	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Assigned Revenue and Devolutions as % of State's Non-Plan Grants	94.86	96.33	61.05	44.28	41.46	13.10
Specific Purpose Grants as % of State's Non-Plan Grants	5.14	3.67	38.95	55.72	58.54	86.90

Source: Finance Department (SFC Cell), Government of Assam.

The principles laid down by the first, the second and the third SFC did not favour assignment of taxes to local bodies. They recommended devolution in the shape of sharing the net proceeds of taxes duties collected by the State Government to be supplemented by grant-in-aid on a selective basis.

Although, the first SFC recommended 2 percent of the net proceeds of state taxes, the second SFC stepped it up to 3.5 percent, the interim Report of the third SFC recommended 10 percent while the final Report of the third SFC raised it to 25 percent.

Table 8.3: Ratio of Transfers/Grant-in-aid to all ULBs in Assam

Components	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Non-Plan Transfers* as a % of State's Own Revenue	0.15	0.42	0.56	0.39	0.30	0.73

Note: * Non-Plan Transfers are excluding CFC grants
Source: Finance Department (SFC Cell), Government of Assam and State Budgets of Assam.

However, the recommendations of the first SFC though accepted but have not been implemented. The recommendations of the second SFC were partially accepted and did not accept the recommendation of sharing net proceeds of state taxes etc. Further, calculating the total load of non-plan transfers on the state finances, it has been found that the non-plan transfers to ULBs as a percentage of state own revenues had ranged from merely 0.15% to 0.73% during 2002-03 to 2007-08. This increasing trend is not sufficient enough to meet the requirements of the ULBs in the state of Assam. Linking of state own revenues with transfers to ULBs as suggested by all the three SFCs is an important aspect and need to be addressed by the state government.

The Audit Report of ULBs has pointed out that an amount of Rs.10.77 crores was received from GoI as 11th CFC grant during 2002-05 and withdrawal were also made by the DMA but no records relating to utilization of 11th CFC grants was made available to audit. Therefore, proper utilization as envisaged in the guidelines could not be ascertained by audit in absence of UC and expenditure vouchers. Further, w.r.t 12th CFC grants, according the GOI guidelines, States have to mandatory transfer the grants released by the Central Government to the ULBs within fifteen days of the date of its credit to the state government account. It was found that there has been a delay of range of 418 to 457 days in crediting the funds to ULBs account and interest amounting to Rs.103.44 lakh had not been reimbursed by the state government for delay transfer of 12th CFC grant.

Further, an amount of Rs.31.50 lakh was earmarked under 11th CFC during 2003-06 for creation of database on municipal finance but as per GMA, no database so far has been created and the purpose for which funds were utilized was also not stated.

8.6 Field Observations: ULB Level

8.6.1 Background

Data on municipal finance for the Municipal Corporation of Guwahati has also been collected for a period of 2002-03 to 2007-08. Municipal revenue income can mainly be divided in two compulsory levy of property tax and constitution of a state-level property tax board and defining of service standards by the state government.

State Finance Commissions:

According to the Constitution, SFCs are to be constituted once in every five years. Many states have often delayed the formation of SFCs. The delay in the formation of SFCs, their partial constitution, delay in submitting Reports and delay in submission of Action Taken Reports have been carried over to the third SFCs. The 12th CFC reported that out of 26 states, 19 states constituted their second SFCs, of which 10 had submitted reports at the time of examination. There was a considerable delay in submission of SFC Reports in case Madhya Pradesh, Orissa and Gujarat. In fact, the first SFC of Gujarat took four years to submit its report and Government of Gujarat took three years to issue an Action Taken Report for the implementation of accepted recommendations. In the mean time, Government of Gujarat did not constitute second SFC for the next five years.

First and Second SFCs of the five states namely Madhya Pradesh, Orissa, Tamil Nadu, Gujarat and Assam did not have an access to a good database at the ULB level and felt handicapped due to non-availability of data/information relating to the financial health and resource gap of ULBs, taxation powers of ULBs, functional domain of ULBs, expenditure assignments of ULBs, levels of various basic services, norms and standards of basic services. Since there were no agencies at the state level, which collects and maintains comprehensive databases w.r.t ULBs, all the SFCs of the five states conducted their own survey based on detailed questionnaire in the selected municipalities to review their financial position etc. Further, the methodologies adopted by the SFCs differ a lot and in the absence of good databases, there were inconsistencies in calculating the resource gap of the ULBs. In addition to it, none of the SFCs could address the complexities of the system of grant-in-aid to ULBs prior to the SFCs and had not addressed to suggest any change in fiscal powers of the ULBs.

Out of the five states, three states namely Madhya Pradesh, Tamil Nadu and Assam recommended the approach of global sharing for devolution of funds from state to local bodies and other two states namely Orissa and Gujarat followed an ad-hoc system of grant-in-aid to ULBs. The first and second SFCs of Madhya Pradesh, Tamil Nadu and Assam have linked the state resources with devolution package of the ULBs. However, the recommendations of first and second SFCs of Assam were not implemented and ad-hoc system of grant-in-aid was followed. Whereas, other two states namely Orissa and Gujarat followed a system of ad-hoc grant-in-aid to ULBs and has missed linking of grants of ULBs with state finances and hence grants to ULBs was not of elastic nature compared to the ULBs of some of the developed states of Tamil Nadu, Andhra Pradesh, Karnataka etc.

The First SFC of Madhya Pradesh had recommended a revenue sharing mechanism with ULBs, which had suggested a fiscal package after taken into account of all types of grant-in-aid to ULBs, based on revenue sharing mechanism for the buoyancy of grant-in-aid to ULBs. However, this suggestion was not accepted and implemented by the State Government of Madhya Pradesh. Further, both the SFCs of Madhya Pradesh had not made any recommendations in devolution of new tax powers to ULBs and devolution of functions as per the 12th Schedule of 74th CAA.

On the other hand, both the SFCs of the state of Tamil Nadu recommended the concept of global sharing of state's own taxes after excluding entertainment tax. The second SFC had pointed out that it was difficult to bring each and every transfer from state government to local bodies under devolution package but overall the global sharing of state's revenues with local bodies had enabled the concept of elasticity linked with state's economy. Both the SFCs recommended continuing with the existing system of assigned taxes to ULBs in addition to SFC grants. A simple and transparent system of transfers to local bodies has resulted in better budgetary planning at local body level.

Field Observations: Diversity of System of Transfers at the State Level:

Many of the state transfers/grant-in-aid to ULBs, are not possible to be separately accounted as these are absorbed directly into state government expenditure. The issue of state transfers/grant-in-aid becomes more complex if one tries to have an idea of these system of transfers/grant-in-aid to ULBs from the state budgets and the state finance accounts. There are several departments of state governments, which pass on grants to ULBs and there are several major and minor heads in the state budget and state finance accounts, which give explanation of these grants but these are not clubbed at one place in the budgets and scattered in several major and minor heads of state budgets.

The study finds the diversity of system of grant-in-aid to ULBs in the selected states in term of types of non-plan transfers. Non-plan transfers among the states of Madhya Pradesh and Tamil Nadu were on five major heads assigned revenue, compensation in lieu of taxes, SFC grants, CFC grants and specific purpose grants. Whereas, the assigned revenues and compensation in lieu of taxes were made on duty on transfer of properties and mineral royalty and compensation in lieu of abolition of Octroi and passenger tax respectively. However, in case of Tamil Nadu, the assigned revenue was on three accounts (i) entertainment tax, (ii) surcharge on stamp duty and (iii) surcharge on sales tax and compensation in lieu of taxes did not include the compensation in lieu of abolition of Octroi because it has already been taken care of under the devolution package of SFC grant.

On the other hand, in case of Orissa and Assam, these transfers were made on three heads namely SFC grants, specific purpose grants and CFC grants. Whereas in case of Orissa, the SFC grants were made on six accounts (i) compensation in lieu of Octroi, (ii) grants for road maintenance, (iii) compensation on entertainment tax, (iv) performance based incentives to ULBs, (v) grants for basic services and (vi) grants towards pension contributions. However, in Assam, assigned revenues and devolutions consist of (i) motor vehicle tax, (ii) surcharge on stamp duty, (iii) entertainment tax and (iv) grant-in-aid.

In Gujarat, non-plan transfers were made on four major accounts namely SFC grants, compensation grants, specific purpose grants and CFC grants. The SFC grants were (i) entertainment tax and entertainment tax on cable tv/dish antena, (ii) professional tax, (iii) grants to municipalities for basic per capita and pay allowances and (iv) for creation of municipal finance development fund for ULBs. The compensation grant is mainly compensation in lieu of abolition of Octroi in municipalities. In addition to, it there are more than thirty types of specific purpose grants in the state of Gujarat, which are being released to ULBs to undertake specific activities.

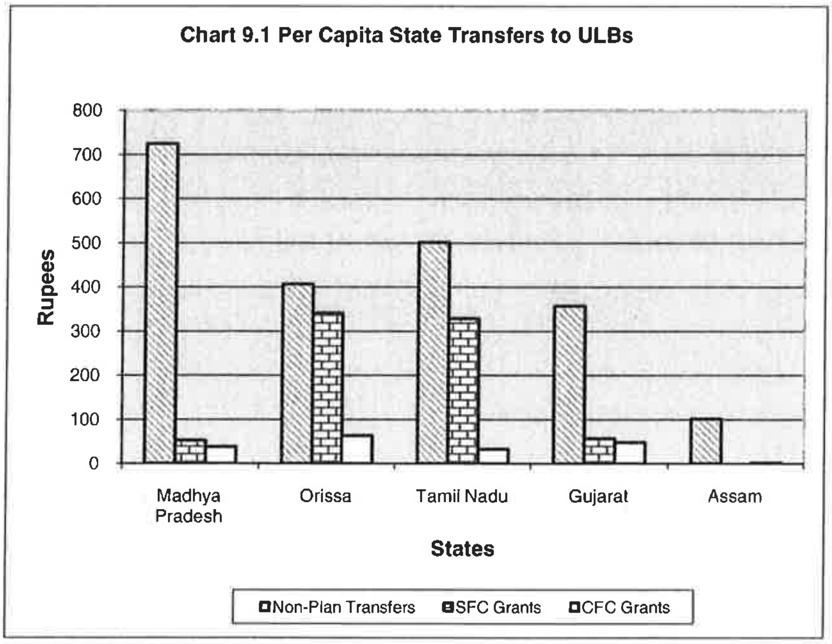
In case of Tamil Nadu, one of the Government Orders w.r.t to release of SFC grants states that the ULBs should work out the total requirements of funds for maintaining infrastructure services under road, water supply, streetlights, conservancy, drainage, underground drainage, interests on loans to be repaid to State Government and salary and pension liabilities etc. And the difference between actual requirement and allocated devolution package should be credited in one bank account from general funds of concerned ULBs to meet the expenditure. Here two things emerge out, one it is questionable whether the ULBs of Tamil Nadu could calculate their requirements to maintain infrastructural services, etc. especially in absence of any uniform methodology provided to them by the state government. Secondly the gap between actual requirements and own revenues of ULBs was to be funded through fiscal transfers but on the contrary the state government first deposited the amounts of transfers to ULBs and then asked ULBs to deposit the remaining amount between the transfers and actual requirements. It is highly doubtful that the ULBs are depositing the amounts based on the difference between the available transfers and actual requirements and the realty could be that the ULBs are only depositing the amounts to their availability of own resources and the concept of depositing of the gap of transfers and actual requirements has been defeated.

Comparing of total non-plan transfers and SFC grants to all the ULBs at the five states level indicated that per capita non-plan transfers were highest for the state of Madhya Pradesh for the year of 2007-08 followed by Tamil Nadu, Orissa, Gujarat and Assam. Compensation in lieu of taxes was highest in Madhya Pradesh followed by Gujarat because these compensatory grants have not been included in the domain of SFC grants like Orissa and Tamil Nadu.

Table 9.1: Per Capita Transfers/Grant-in-aid to all the ULBs (average)

Components	Madhya Pradesh 2007-08	Orissa 2007-08	Tamil Nadu 2007-08	Gujarat 2006-07	Assam 2007-08
Per Capita Amount (Rupees)					
Non-Plan Transfers/Grants	724.08	406.19	500.91	357.38	100.94
(i) Assigned revenue	62.01	(-)	100.33	(-)	13.07
(ii) Compensation in lieu of taxes	420.94	(-)	5.90	128.73	(-)
(iii) SFC Grants	52.54	340.81	329.08	56.41	(-)
(iv) Specific Purpose Grant	150.97	2.05	32.87	124.25	86.68
(v) CFC Grants	37.61	63.33	32.73	47.99	1.19

Source: Table 4.5, 5.5, 6.5, 7.5 and 8.5.



Whereas both the ULBs of the state of Gujarat namely Ahmedabad and Rajkot were quite self sufficient because of generation of high resources from own sources and less dependent on grant-in-aid and transfers from higher governmental level. However the dependency on state transfers in all the Municipal Corporations of the Gujarat is definitely going to increase due to abolition of Octroi in Municipal Corporations.

Utilization of Grants:

In case of CFC grants, the amounts released are of conditional nature and are being released after receiving the utilization certificates from individual ULBs by DMAs and DTPs of the concerned states. The Commissioners of DMAs and DTPs send a consolidated utilization certificate to the concerned states and the same is forwarded to Government of India and for getting the release of next installment by Government of India. No component of expenditure on salaries and wages etc. is being disbursed from these CFC grants.

In case of the ULBs of Madhya Pradesh, it was observed that the SFC funds were released during the year 2004-07 without obtaining UCs of previous years from ULBs. Further, the State Government did not frame any rules for proper and effective implementation of devolution of functions, functionaries and funds. In the absence of rules, there was no system to watch implementation of transfer process. A decentralization cell was also required to be constituted at district level to effectively review the progress of transfer of functions along with functionaries, and funds. The decentralization cell was not constituted at any district level. This shows that the concerned departments at the state level were irregularly enjoying the administrative and financial powers of ULBs regarding the implementation of devolved functions.

In case of Orissa, the SFCs had pointed out that releasing of many of the non-plan grants lacked certainty and predictability. In case of ULBs of Orissa, the grants meant to cover the pay and dearness allowance of the ULBs' employees followed a definite and known formula and except this grant, no other grant was certain and predictable. Utilization of SFCs grants is not conditional as can be seen that 82% to 90% of the SFC grants are on account of Octroi compensation and these grants are being used to meet out salary expenses of the ULB staff. Whereas other parts of SFC grants are meant for pension contributions and operation and maintenance of basic services and these grants are not based on utiization certificates.

In case of Tamil Nadu, the guidelines for utilization of SFC grants and Assigned revenues indicates that these amounts are to be utilized only for revenue expenditure including the expenditure on establishment and salaries, operation and maintenance and interest payments on loans etc. Whereas, in case of Gujarat, the ULBs has been receiving multiple grants and each grant has certain norms and general conditions including utilization certificates, which are to be fulfilled before getting these grants.

9.2 Recommendations

- The Central Government should guide State Governments and ULBs to explore the performance-based grants as suggested by the 13th CFC. State Governments and ULBs seriously need guidance on several conditions laid down by the CFC.
- Timely constitution of SFC and submission of SFC Reports is very important. The State Governments should give a serious consideration to the recommendations of the SFC Reports and timely issuance of ATRs. Status of financial health of ULBs and their resource gap together with the implementation of SFC reports should be available to CFCs at an appropriate time.
- SFCs generally do not have an access to good databases at the ULB level and are no agencies at the state level, which collects and maintains comprehensive databases. State Governments should seriously address the issue of creation and maintenance of databases w.r.t ULBs rather than depending on databases based on sample surveys.
- The methodology of the SFCs should seriously address the resource gap of the local bodies after linking it with the devolved functions of ULBs. Untapped potential of tax powers and untapped cost recovery mechanisms are also important considerations for the SFCs. The recommendations on state transfers should be made only after knowing the exact shortfalls of the ULBs. Exploring new tax assignments to ULBs is also one of the most important challenges for the SFCs because no SFC in the past has given any attempt on this issue especially after the abolition of Octroi.
- To address the issue of complexities of system of grant-in-aid to ULBs, the SFCs should try to introduce the concept of devolution packages after taking into consideration of all types of revenue grants. Further the recommended devolution packages may be linked with State's own resources to capture the concept of elasticity.

- SFCs should also consider the idea of performance based or incentive grants based on outcomes such as improved service delivery, improved tax collections and improved financial management etc. SFCs could review and link the grants to performance as suggested by the 13^{th} CFC and reforms under JNNURM.
- Non-predictability and non-transparent system of grant-in-aid can seriously hamper the financial management of ULBs and day to day functioning of the ULBs. All State Governments should build a system for predictability and transparency of state transfers to ULBs. The State Governments should follow the system of electronic transfers to ULBs rather than the conventional transfers.
- State Governments should clearly provide a distinction between tied and untied grants and ULBs should be asked for timely submission of utilization certificates for tied grants whereas freedom should be given to ULBs to utilize untied grants.

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