

104

**State Finance Commissions' Recommendations  
and Follow-up Actions Thereon**

Volume I  
**Final Report**

Submitted to the  
Ministry of Urban Development, Government of India



National Institute of Urban Affairs  
New Delhi

July 2005

## PREFACE

The Constitution (Seventy-fourth Amendment) Act (CAA), 1992, relating to Municipalities was enacted by the Government of India to strengthen and improve local governance in the urban areas of the country. This Act outlines a series of measures to strengthen the functioning of urban local bodies (ULBs), such as regular and fair conduct of elections, representation of weaker sections and women in local governments, devolution of powers and functions to local governments, constitution of state finance commissions, constitution of wards committees, metropolitan planning committees and district planning committees. In response to the provisions of the Constitution (74<sup>th</sup> Amendment) Act, most state governments have amended their Municipal Acts and taken significant measures towards implementation of the CAA provisions.

This study focuses on the performance of State Finance Commissions (SFCs) in different states and union territories of India. The SFCs have been constituted in all the states/union territories of the country (except the three north-eastern states of Meghalaya, Mizoram and Nagaland) to monitor and strengthen the financial condition of local governments. In certain parts (scheduled areas and tribal areas) of the three north-eastern states, the CAA provisions have not been applied. The purpose of this study is to compile the key SFC recommendations, review the actions taken by the state governments on the recommendations and also examine the current status of implementation of these recommendations concerning the urban areas.

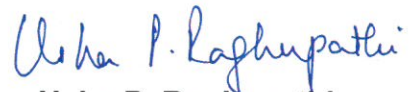
The findings of this study show that the basic objective of improving the finances of ULBs has not been achieved. In this context, it may be stated that although most state governments/union territories have accepted a large number of recommendations, their implementation is weak.

Till date, a detailed study on the functioning of State Finance Commissions has not been conducted at the all-India level. This study is therefore the first effort in this direction. The report has been prepared in two volumes. Volume I is the main report and Volume II consists of appendices.

We would like to thank the Ministry of Urban Development, Government of India, for entrusting this study to us and providing guidance and assistance at all stages of the study.

We would also like to thank all the state government officials who have provided information for the study.

A study of this nature cannot be completed without a team of dedicated individuals. The project team has done a commendable job and deserves special appreciation. NIUA would like to acknowledge their contribution to this important study.



**Usha P. Raghupathi**  
Professor and Office-in-charge

## CONTENTS

Preface	i
Table of Contents	iii
List of Tables	v
Abbreviations	vi
Project Team	vii
Executive Summary	viii

### VOLUME I

<b>Chapter 1</b>	<b>Introduction</b>	<b>1</b>
1.1	The Context and Significance of Study	1
1.1.1	The Constitution (74 <sup>th</sup> Amendment) Act, 1992	2
1.1.2	Status of State Finance Commissions in India	5
1.1.3	Purpose of the Study	8
1.2	Objectives of the Study	8
1.3	Database and Methodology	9
1.3.1	Sources of Data	9
1.3.2	Method of Data Organisation and Analysis	11
1.4	Limitations of the Study	11
1.5	Organisation of the Report	12
<b>Chapter 2</b>	<b>An Overview of State Finance Commissions' Recommendations and Actions Taken</b>	<b>13</b>
2.1	Number of Recommendations	13
2.2	Areas of Recommendations	15
2.3	Status of Actions Taken on SFC Recommendations	16
<b>Chapter 3</b>	<b>Devolution of Funds and Distribution among Municipalities</b>	<b>19</b>
3.1	Revenue Sharing Between State and Local Bodies	20
3.1.1	Actions Taken and Implementation Status	23
3.2	Criteria for Distribution of Funds among Municipalities	24
3.2.1	Actions Taken and Implementation Status	25
<b>Chapter 4</b>	<b>Measures to Improve the Financial Condition of Municipalities</b>	<b>27</b>
4.1	Taxes, Non-taxes, Assigned Revenues and Compensations	27
4.1.1	Property Tax	29
4.1.1.1	Actions Taken and Implementation Status	29
4.1.2	Profession Tax	30
4.1.2.1	Actions Taken and Implementation Status	30

4.1.3	Entertainment Tax	31
4.1.3.1	Actions Taken and Implementation Status	31
4.1.4	User Charges	32
4.1.4.1	Actions Taken and Implementation Status	33
4.2	Grants-in-aid	33
4.2.1	Actions Taken and Implementation Status	35
4.3	Other Financial Measures	37
4.3.1	Actions Taken and Implementation Status	37
<b>Chapter 5</b>	<b>Other Measures to Strengthen Municipal Governance</b>	<b>41</b>
5.1	Devolution of Funds, Functions, Functionaries and Powers	41
5.2	Monitoring and Review of SFC Recommendations	43
5.3	Development and Maintenance of a Database on Municipal Finance	43
5.4	Conduct of Studies on Various Municipal Aspects	43
5.5	Promotion of Participatory Practices	44
5.6	Organisation of Training Programmes	44
<b>Chapter 6</b>	<b>Conclusions</b>	<b>45</b>
6.1	Format of SFC Reports and Action Taken Reports	45
6.2	Differences in the Recommendations made by the First and the Second SFCs	46
6.3	Number of Recommendations: Inter-state and Rural-Urban Differences	46
6.4	Emphasis on Financial and Non-financial Matters	47
6.5	Key Areas of Recommendations	47
6.6	Status of Actions Taken on Key SFC Recommendations	48
6.6.1	Revenue Sharing between State and Municipalities	48
6.6.2	Criteria for Distribution of Funds between Municipalities	49
6.6.3	Taxes, Non-taxes, Assigned Revenues and Compensations	49
6.6.4	Grants-in-aid to Municipalities	51
6.6.5	Other Measures to Improve the Financial Condition of Municipalities	53
6.6.6	Other Recommendations for Strengthening Municipal Governance	56
<b>References</b>		<b>59</b>
<b>VOLUME II</b>		
<b>Appendices</b>		Refer Vol. II of the Report

## LIST OF TABLES

Table 1.1	Status of State Finance Commissions in India	7
Table 1.2	Reports Reviewed in this Study	10
Table 2.1	Number of Key First and Second SFC Recommendations by States and Union Territories	15
Table 2.2	Status of Actions Taken on Key First and Second SFC Recommendations	17
Table 2.3	Proportion of First SFC Recommendations Accepted in Selected States	18
Table 2.4	Proportion of Second SFC Recommendations Accepted in Selected States	18
Table 3.1	SFC Recommendations on Global Sharing of State Revenues and Actions Taken	20
Table 3.2	SFC Recommendations on Revenue Sharing Between State and Local Bodies	22
Table 3.3	SFC Recommendations on Criteria for Inter-se Distribution of Funds	24
Table 4.1	Recommendations on Taxes, Non-taxes, Assigned Revenues and Compensations to Municipalities	28
Table 4.2	Recommendations on Grants-in-aid to Municipalities	34
Table 4.3	Recommendations on Additional Measures to Improve the Financial Condition of Municipalities	38
Table 5.1	Recommendations on Strengthening Municipal Governance	42

## ABBREVIATIONS

ATR	Action Taken Report
A&N Is.	Andaman and Nicobar Islands
BPL	Below Poverty Line
CFC	Central Finance Commission
DNH	Dadra and Nagar Haveli
D&D	Daman and Diu
DLBs	Directorate of Local Bodies
GMFB	Gujarat Municipal Finance Board
GOI	Government of India
IDSMT	Integrated Development of Small and Medium Towns
LIC	Life Insurance Corporation
LSG	Local Self Government
MHA	Ministry of Home Affairs
MUAE	Ministry of Urban Affairs and Employment
MUD	Ministry of Urban Development
MCD	Municipal Corporation of Delhi
NIRD	National Institute of Rural Development
NDMC	New Delhi Municipal Council
PRI	Panchayati Raj Institution
PT	Property Tax
PWSSB	Punjab Water Supply and Sewerage Board
RIPA	Rajasthan Institute of Public Administration
SC	Scheduled Caste
SPV	Special Purpose Vehicle
SFC	State Finance Commission
ST	Scheduled Tribe
ULB	Urban Local Body
UT	Union Territory
UTA	Union Territory Administration

## PROJECT TEAM

Project Coordination	Professor M.P. Mathur
Project Analysis & Report Development	Dr. Rumi Aijaz
Special Assistance	Dr. Rajesh Chandra
Core Research	Dr. Satpal Singh Mr. Ajay Nigam Mr. Naveen Mathur Dr. Barun Kumar Ms. Poonam Kashyap
Computer Assistance	Ms. Aradhana S. Baghel Mr. Mahender Singh Ms. Indu Senan
Photocopying Assistance	Mr. H.P. Pandey Mr. Usman Khan



## **EXECUTIVE SUMMARY**

In India, the Central Government has taken significant steps to address the issues related to the governance of urban areas. Recent government policies allow for greater community participation, private sector participation and decentralisation. Institutions of local governance are being encouraged/assisted to experiment with and introduce new practices. Existing practices are being streamlined by taking into consideration the local issues. An important initiative in this respect is the enactment of the Constitution (74<sup>th</sup> Amendment) Act during the year 1992. Through this measure, an attempt is being made to improve the performance ability of municipalities, so that they are able to discharge their duties efficiently.

The 74<sup>th</sup> Amendment Act provisions allow for strengthening the capability of municipal governments. The main areas to which attention has been given are: constitution of three types of municipalities; regular and fair conduct of municipal elections; representation of weaker sections and women in municipal governments through reservation of seats; devolution of greater powers and functions to municipalities; constitution of state finance commissions; constitution of wards committees, metropolitan planning committees and district planning committees.

The purpose of this study is to review the functioning of state finance commissions (SFCs) in different states and union territories of India. This includes compilation and review of the recommendations for municipalities/urban areas, put forward by the finance commissions of various states and union territories in India and to assess the actions taken by the State Governments/UTAs on the SFC recommendations. Recent studies undertaken to review the progress on this subject point out that in a few States, ad hoc arrangements are being followed, despite the acceptance of SFC recommendations. However, such studies are few and the analysis is limited to either a single state or a few states. Hence, a comparative position on the actions

taken by the state governments/UTAs is not available. Similarly, there is a lack of information on the reasons responsible for non-implementation of the SFC recommendations. This study, therefore, attempts to throw light on some of these aspects.

The finance commissions constituted in various States/UTs of India have attempted a detailed review of the financial position of municipalities. The findings on the local-level issues of governance (including those related to financial aspects) and recommendations to overcome the prevailing constraints confronting municipalities have been documented in the reports prepared by the SFCs of most states/UTs. The actions taken by the State/UT authorities on the SFC recommendations have been documented in the Action Taken Reports (ATRs). These reports indicate whether a recommendation has been accepted or not by the state government, and the steps that have been taken after a recommendation has been accepted.

Information for this study has been obtained through discussions with several state officials and from the available first and second SFC reports and the Action Taken Reports of different States/Union Territories in India. The analysis carried out in this study is based on a review of 24 first SFC reports, 20 first Actions Taken Reports (ATRs), 14 second SFC reports and 7 second ATRs. These reports have been collected through field visits undertaken by the project team to the state/UT headquarters. The main sources identified at the state/UT level for the collection of reports/data and for holding discussions include the Departments of Finance, Urban Development and Municipal Administration Departments, Chairmen/Member Secretary of SFCs, Municipal Commissioners and other agencies/institutions dealing with SFCs.

The following conclusions have been drawn from a review of available information:

## **FORMAT OF SFC REPORTS AND ACTION TAKEN REPORTS**

The format of SFC and ATRs differs from state to state. Although the SFCs were guided by the terms of reference given to them by the state governments, there are differences in the organisation of reports. For instance, in some reports, a clear-cut listing (or summary) of recommendations and a proper classification of recommendations for PRIs/rural areas, ULBs/urban areas, state governments, etc., has not been provided. This has created difficulties in estimating the total number of recommendations (see Table 2.1). Regarding the quality of the ATRs, it may be stated that adequate information on the actions taken and implementation status of recommendations is not provided. It is also observed that in some ATRs, the number of recommendations do not tally with those provided in the SFC reports (see Table 2.1 and 2.2). This implies that some recommendations given in the SFC reports have not been included in the ATRs. Due to these differences, an accurate assessment of the status of SFC recommendations (i.e., proportion of recommendations accepted, not accepted) could not be worked out (see Table 2.2). This is perhaps the main limitation of the study.

## **DIFFERENCES IN THE RECOMMENDATIONS MADE BY THE FIRST AND THE SECOND SFCs**

Differences in the first and second state finance commission recommendations exist in the number of recommendations, their nature, and the approach adopted by the various commissions. From a review of the second SFC reports, it is observed that in some states, the total number of recommendations has gone down as compared to the first SFC reports, whereas in many others, numbers have increased (see Table 2.1). In Tamil Nadu, Uttar Pradesh and Delhi, for example, there has been a drastic change in the number of recommendations. Regarding the approach adopted by the commissions for the devolution of funds to local bodies, the main observation is that global sharing of state revenues is increasingly being accepted as a strategy to strengthen the financial condition of local bodies (see Table 1). It is learnt that a larger number of states/UTs are

adopting this strategy. With respect to the nature of recommendations, it is observed that the general pattern is that the second SFC recommendations are more focused and specific. However, there are still some reports, which contain very general recommendations (see for example the second SFC recommendations of Uttar Pradesh given in Vol. II of this report).

**Table 1: SFC Recommendations on Global Sharing of State Revenues and Actions Taken**

S. No.	State/UT	Recommended Share of Local Bodies (urban and/or rural)	Recommended Share of Local Bodies (urban and/or rural)
		First SFC	Second SFC
1	Andhra Pradesh	<ul style="list-style-type: none"> <li>○ 39.24 % of state revenue from taxes &amp; non-taxes (30 % for urban areas)</li> <li>○ <b>Accepted</b> – however, earmarked funds have been partly devolved</li> </ul>	<ul style="list-style-type: none"> <li>○ 40.92 % of state's tax &amp; non-tax revenue (18.5 % share of ULBs)</li> <li>○ status not specified in ATR</li> </ul>
2	Assam	<ul style="list-style-type: none"> <li>○ 2 % of state taxes</li> <li>○ <b>Accepted</b></li> </ul>	
3	Karnataka	<ul style="list-style-type: none"> <li>○ 36 % of non-loan gross own revenue receipts (NLGRR) of state govt. (5.4 % relative share of ULBs)</li> <li>○ <b>Accepted</b> – a higher % age has been transferred to LBs</li> </ul>	<ul style="list-style-type: none"> <li>○ 40 % of NLGRR of state govt. (8% relative share of ULBs)</li> <li>○ information on status not available</li> </ul>
4	Madhya Pradesh	<ul style="list-style-type: none"> <li>○ 8.67 % of net revenue (taxes &amp; non-taxes) of state govt. for ULBs</li> <li>○ <b>Accepted</b></li> </ul>	<ul style="list-style-type: none"> <li>○ 1.07 % of net own tax revenue of state govt. for ULBs</li> <li>○ <b>Accepted</b></li> </ul>
5	Punjab		<ul style="list-style-type: none"> <li>○ 4 % of net receipts from all state taxes</li> <li>○ <b>Accepted</b></li> </ul>
6	Rajasthan	<ul style="list-style-type: none"> <li>○ 2.18 % of net state tax proceeds</li> <li>○ <b>Accepted</b></li> </ul>	<ul style="list-style-type: none"> <li>○ 2.25 % of state's net own tax revenue, exclu. entertainment tax (23.4 % for ULBs)</li> <li>○ <b>Accepted</b> – amount earmarked for LBs is being distributed</li> </ul>
7	Tamil Nadu	<ul style="list-style-type: none"> <li>○ 8 % of revenue from all state taxes, exclu. entertainment tax (40 % for ULBs)</li> <li>○ <b>Accepted with modification</b> – instead of 40 %, ULBs to be devolved 45 % share</li> </ul>	<ul style="list-style-type: none"> <li>○ 8 % of state's own tax revenue, exclu. entertainment tax (42 % for ULBs)</li> <li>○ <b>Accepted</b></li> </ul>
8	Uttar Pradesh	<ul style="list-style-type: none"> <li>○ 10 % of net own tax revenue receipts of state govt. (7 % for ULBs)</li> <li>○ <b>Accepted</b></li> </ul>	<ul style="list-style-type: none"> <li>○ 12.5 % of net proceeds of taxes, duties, tolls &amp; fees, exclu. entertainment tax &amp; land revenue (7.5 % for ULBs)</li> <li>○ <b>Accepted</b> – regarding share of Nagar Panchayats, it is mentioned in the ATR that the administrative department should reconsider this decision</li> </ul>
9	West Bengal	<ul style="list-style-type: none"> <li>○ 16 % of net proceeds of all state taxes</li> <li>○ <b>Accepted</b> – however, only a small amount of fund was released to LBs</li> </ul>	<ul style="list-style-type: none"> <li>○ 16 % of net proceeds of all state taxes</li> <li>○ information on status not available</li> </ul>
10	Andaman & Nicobar Islands		<ul style="list-style-type: none"> <li>○ 10 % of total net tax proceeds (20 % for ULBs)</li> <li>○ information on status not available</li> </ul>
11	Daman & Diu		<ul style="list-style-type: none"> <li>○ 10 % of total net tax proceeds (20 % for ULBs)</li> <li>○ information on status not available</li> </ul>
12	Delhi	<ul style="list-style-type: none"> <li>○ 9.5 % of Govt. of National Capital Territory of Delhi's tax revenue</li> <li>○ <b>Accepted</b></li> </ul>	<ul style="list-style-type: none"> <li>○ 5.5 % of tax revenue (net proceeds of all taxes &amp; duties)</li> <li>○ <b>Accepted</b></li> </ul>

Source: State Finance Commission Reports and Action Taken Reports.

## **NUMBER OF RECOMMENDATIONS: INTER-STATE AND RURAL- URBAN DIFFERENCES**

In respect of the first SFC, it is noted that the two states of Tamil Nadu and Maharashtra show the maximum number of total recommendations. The total number of recommendations is also high for Andhra Pradesh, Punjab, Rajasthan and Uttar Pradesh. States/UTs with a low number of recommendations include Assam, Manipur, Sikkim, Uttaranchal, Delhi and Pondicherry. Further, it is observed that the emphasis on rural and urban areas varies from state to state. For example, emphasis on urban areas vis-à-vis rural areas is higher in the states of Maharashtra, Punjab, Rajasthan, Sikkim, Tamil Nadu and Uttar Pradesh.

The total number of recommendations in the second SFC reports is highest in the state of Uttar Pradesh, followed by Tamil Nadu, Punjab, Madhya Pradesh, and Andhra Pradesh, and low in Karnataka, West Bengal and Daman and Diu. Further, the emphasis on urban areas is higher in Madhya Pradesh, Punjab, Tamil Nadu, Uttar Pradesh, West Bengal and Daman and Diu (see Table 2.1).

## **EMPHASIS ON FINANCIAL AND NON-FINANCIAL MATTERS**

Most of the recommendations put forward by the Finance Commissions of various states pertain to the financial aspects of municipal governance. In addition to the financial recommendations, emphasis has also been given to several non-financial matters, such as: devolution of functions, functionaries, and powers along with a transfer of funds; monitoring and review of SFC recommendations; development and maintenance of a database on municipal finance; conduct of studies on various municipal aspects; promotion of participatory practices; organisation of training programmes; formulation of model plans; development of a Management Information System/computerisation of data; asset management; simplification of municipal Act provisions; etc. (see Table 5.1 and Chapter 5 for more details).

## **KEY AREAS OF RECOMMENDATIONS**

On the basis of a comprehensive review of SFC recommendations, it may be stated that there are six key areas on which the recommendations have been made, namely: (i) Revenue sharing between state and municipalities/urban local bodies; (ii) Criteria for distribution of funds between municipalities; (iii) Taxes, non-taxes, assigned revenues and compensations to municipalities; (iv) Grants-in-aid to municipalities; (v) Other measures to improve the financial condition of municipalities; and (vi) Other measures for strengthening municipal governance.

## **STATUS OF ACTIONS TAKEN ON KEY SFC RECOMMENDATIONS**

The study confirms the fact that actions are being taken in a number of states on the SFC recommendations. The state governments have accepted most of the recommendations fully, partly or in a modified form. There are, however, a few recommendations which have either not been accepted or are under consideration. The decision to accept or reject a recommendation lies with the state government and is based on a number of factors, such as the financial condition of the state/local government, priority areas of concern, etc.

A review of first ATRs reveals that acceptance is 100 per cent in the states of Haryana, Himachal Pradesh and Uttaranchal. The other states/UTs showing high acceptance include Gujarat, Kerala, Madhya Pradesh, Punjab, Tripura, Uttar Pradesh, West Bengal and Delhi. The states/UTs of Assam, Orissa, Andaman and Nicobar Islands and Daman and Diu have shown low acceptance (Table 2). Limited information is available on the acceptance of second SFC recommendations (Table 3). A comparison of first and second SFC recommendations, which have been accepted, shows that this proportion has decreased between the two points of time.

**Table 2: Proportion of First SFC Recommendations Accepted in Selected States**

S. No.	Proportion of Recommendations Accepted	Name of State/Union Territory
1	100 per cent	Haryana, Himachal Pradesh, Uttaranchal
2	80 – 100 per cent	Gujarat, Kerala, Madhya Pradesh, Punjab, Tripura, Uttar Pradesh, West Bengal, Delhi
3	60 – 80 per cent	Andhra Pradesh, Goa, Rajasthan, Tamil Nadu, Pondicherry
4	Less than 60 per cent	Assam, Orissa, Andaman & Nicobar Islands, Daman & Diu

Source: State Finance Commission Reports and Action Taken Reports.

**Table 3: Proportion of Second SFC Recommendations Accepted in Selected States**

S. No.	Proportion of Recommendations Accepted	Name of State/Union Territory
1	100 per cent	Nil
2	80 – 100 per cent	Madhya Pradesh
3	60 – 80 per cent	Uttar Pradesh, Delhi
4	Less than 60 per cent	Andhra Pradesh, Punjab, Rajasthan, Tamil Nadu

Source: State Finance Commission Reports and Action Taken Reports.

An important objective of this study was to examine the current status on the implementation of the SFC recommendations. Chapters 3, 4 and 5 throw light on this aspect. It may, however, be stated that this information is available for a select number of states. Some important conclusions drawn from a review of available information are listed below.

- The recommendation on '**Global Sharing of State Revenues**' has been accepted by most State Governments. However, the recommended share of local bodies from state revenues has been either partly devolved or is yet to be devolved in some states.
- State governments have generally accepted recommendations on **property tax** reforms. In Assam, the quinquennial assessment of ULBs is delayed due to frequent transfer of part-time assessors. In Kerala, necessary revisions have been made in the Municipal Act regarding revision of tax every four years. In Punjab, provisions have been made in Punjab Municipal Bill, 1999 to de-link property tax. However, no decision has been taken by the government to compensate ULBs for loss of revenue due to exemptions granted by the

state government. In Rajasthan, simplification of assessment procedure is in process.

- The recommendations in respect of **profession tax** have been accepted by most states as per the available information. In Kerala, the suggestion on a reduction in the number of slabs and the rationalization of rates has been accepted, however, new slabs have not been notified for ULBs. In Punjab, tax on professions, individuals, traders, commission agents and shopkeepers, has still not been levied. Moreover, the power to fix rates of local taxes continues to remain with the state government.
- Recommendations on **entertainment tax** have been either accepted fully or with minor modifications. For instance, in Haryana, instead of the recommended 50 per cent, only 25 per cent of net proceeds are accepted for transfer to the ULBs, and it is learnt that this share has been transferred. In Kerala, the recommendation on merging entertainment tax and additional entertainment tax has been accepted and implemented. West Bengal government has accepted to hand over this tax (collected by state) to local bodies however, at the time of collection of data from the state, it was learnt that no action had been taken. It is learnt that though almost the entire amount of fund collected on this account is being given to local bodies, this tax has neither been assigned to them, nor they have been given any discretionary powers for fixing the rates. The main reason for this is that the state government already had elaborate machinery for collection of this tax, which would become redundant. Hence, it is suggested that the arrangement of sharing of this tax should be continued.
- Suggestions on **user charges** have been accepted in the states of Assam, Kerala, Madhya Pradesh, Punjab, and Uttar Pradesh. The Madhya Pradesh government has accepted the recommendation that the cost of public utility services should be recovered by charging appropriate fees from the users of services. In Punjab, action is being taken to provide metered water supply and to revise water rates and sewer charges.



- In Assam, the state government has accepted the SFC recommendation on payment of **grants-in-aid** to the local bodies for implementing the development programmes of core subjects within the jurisdiction of each local body. Further, the grants-in-aid under award of the tenth finance commission was released to the ULBs. The Assam ATR, however, shows that of the total allocation, only one-fourth was sanctioned and released. In Gujarat, it is suggested that grants-in-aid given for motor vehicle tax should be discontinued. This recommendation has been accepted and it is mentioned that the powers will be delegated to ULBs for imposing a lifetime tax on vehicles in consultation with the Transport Department. In Kerala, the recommendation on giving rights to local bodies to decide on the application of non-plan grants according to their own priority and needs has been accepted and implemented. However, suggestions on non-statutory non-plan grants and on maintenance grant have not been accepted. In respect of the former, it is mentioned that the state government is already meeting the establishment expenditure regarding the staff transferred to local bodies. In the case of the latter, it is stated that the financial condition of the state government does not allow for this change. The second Madhya Pradesh finance commission that most grants-in-aid may be in the nature of general-purpose grants, has not been accepted by the state government due to the reason that the grant given by the state government is adequately flexible. In Punjab, the recommendation on providing financial assistance (by way of per capita grants-in-aid) to weak ULBs has been accepted, but such grants have not been given to them. In Rajasthan, most recommendations on grants to ULBs have been accepted. Further, information on implementation status shows that the state government has already issued orders and the amount is being distributed.
- The Finance Commissions of Andhra Pradesh, Gujarat, Orissa, Rajasthan, Tamil Nadu, Uttaranchal and Uttar Pradesh have given importance to **devolution of functions, functionaries and powers** along with a transfer of funds. In Andhra Pradesh, the state Government has accepted the

recommendation, but it is pointed out that this cannot be implemented immediately, since the quantum of financial devolution has to be examined carefully in relation to the delegation of functions.

- The SFCs of Andhra Pradesh, Assam, Himachal Pradesh, Kerala, Punjab and Rajasthan have suggested for the **monitoring and review of their recommendations** by the state governments concerned. This recommendation has been accepted by the state governments of Andhra Pradesh, Himachal Pradesh and Punjab. Kerala Government has taken steps to constitute a special cell in the Finance Department for this purpose and it is further recommended that the cell should be revamped and assigned the task of regular monitoring of finances. In Uttar Pradesh, the state government has not accepted the second SFC recommendation on reconstitution and strengthening of the SFC cell.
- In the states of Assam, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Tripura and Uttar Pradesh, the **development and maintenance of a database on municipal finance** is recommended. In addition, emphasis is also given on development of a Management Information System/Computerisation of data in the states of Haryana, Punjab, Rajasthan and Uttaranchal. As per the SFC reports and ATRs, some progress has been achieved, however, much remains to be done. In Delhi, the recommendation on computerisation of public dealing departments has not been accepted, since there already exists a plan scheme for the purpose. In Andaman and Nicobar Islands and in Daman and Diu, emphasis is given on a periodic revision and updating of data in order to determine the size of the tax base.
- Conduct of detailed **studies on the finances of local bodies** (covering areas such as tax potential, sources of additional resource mobilisation, tax structures, user charges, cess, etc), their **organisational structure**, etc., is recommended by the Finance Commissions of Goa, Himachal Pradesh, Kerala, Rajasthan and Uttar Pradesh. The State Governments of Goa and

Rajasthan have accepted the suggestion, however, adequate information is not available on the implementation status.

- **Participation of the community and the private sector**, especially in the delivery of urban services is being emphasised in the states of Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. The information on Rajasthan reveals that in Jaipur and Kota, non-government organisations have been involved in urban services delivery. In Uttar Pradesh, decisions have been taken on providing civic services on contract basis and to promote citizen participation. In Delhi, recommendations on contracting out selected services to the private sector and for downsizing of workforce are being referred for action to both MCD and NDMC.
- In a number of states, it is recommended that **training programmes for municipal officials and non-officials** (i.e., elected representatives) should be organised to improve their efficiency and attitude, and that such training should be imparted by technical, non-profit and autonomous institutions. This suggestion is accepted in the states of Haryana, Karnataka, Maharashtra, Manipur, Orissa, Rajasthan, Tamil Nadu, Uttaranchal and Uttar Pradesh.

# 1 INTRODUCTION

## 1.1 THE CONTEXT AND SIGNIFICANCE OF STUDY

A common phenomenon observed in urban areas of developing countries is a gradual deterioration in the quality of life. Recent data on the quantity and quality of infrastructure available to urban residents are a partial indication of this fact. From a review of literature it is learnt that in most urban centres, there are serious problems of environmental degradation, poor health conditions and deficiencies in basic civic services. On-going research on the subject reveals that the prevailing conditions in urban areas are mainly due to rapid urbanisation, inefficient management and poor urban governance.

In India, the Central Government has taken significant steps to address the issues related to the governance of urban areas. Recent government policies allow for greater community participation, private sector participation and decentralisation. Institutions of local governance are being encouraged/assisted to experiment with and introduce new practices. Existing practices are being streamlined by taking into consideration the local issues. An important initiative in this respect is the enactment of the Constitution (74<sup>th</sup> Amendment) Act during the year 1992. Until the recent amendment, local governments were organised on the basis of the '*ultra vires*' principle [beyond the powers or authority granted by law] and the state governments were free to extend or control the functional sphere through executive decisions without an amendment to the legislative provisions. Through this measure an attempt is being made to improve the performance ability of municipalities, so that they are able to discharge their duties efficiently.

### 1.1.1 The Constitution (74<sup>th</sup> Amendment) Act, 1992

From a review of the 74<sup>th</sup> Amendment Act provisions it is learnt that a series of reforms have been identified to strengthen the capability of municipal governments (Box 1.1). The main areas to which attention has been given are: constitution of three types of municipalities; regular and fair conduct of municipal elections; representation of weaker sections and women in municipal governments through reservation of seats; constitution of wards committees, metropolitan planning committees and district planning committees. Another important provision specified in the Act is related to the devolution of greater functional responsibilities and financial powers to municipalities. In respect of functional devolution, it is noted that Article 243 – W and the 12<sup>th</sup> Schedule of the Indian Constitution provide a basis for the State Legislatures to guide the State Governments in the assignment of various essential functional responsibilities to municipalities (Box 1.2).

#### Box 1.1: Constitution (74<sup>th</sup> Amendment) Act Provisions

- Constitution of **Municipalities** (namely, Municipal Corporation, Municipal Council, Nagar Panchayat) in every Indian State;
- Constitution of **Wards Committees** within the territorial area of a municipality, to ensure people's participation in civic affairs at the grass-roots level;
- Regular and fair conduct of municipal **Elections** by statutorily constituted State Election Commissions; no provision for super session of municipal governments for more than 6 months;
- Adequate representation of weaker sections (Scheduled Caste, Scheduled Tribe, Backward Class) and women in municipal governments through **reservation** of seats;
- Specification by law, through the State Legislatures, of the **powers** (including financial) and **functional responsibilities** to be entrusted to municipalities and wards committees;
- Constitution of **State Finance Commissions**, once in every 5 years, to review the financial position of municipalities and to make recommendations on the measures needed to improve their financial position;
- Constitution of a **District Planning Committee** at the district level and a **Metropolitan Planning Committee** in metropolitan areas of every State, for the preparation and consolidation of development plans.

Source: *Constitutional Provisions*, 1999.

The 12<sup>th</sup> Schedule consists of a total of 18 functions. Besides the traditional core functions of municipalities, some important functions<sup>1</sup>, earlier managed by State agencies or other local-level agencies, have also been included in the list. Similarly, to strengthen the financial condition of municipalities, Articles 243 – I and 243 – Y of the Indian Constitution allow State Governments to constitute a State Finance Commission (SFC) once in five years “to review the financial position of the Municipalities and make recommendations to the Governor as to –

- (a) the principles which should govern -
  - (i) the distribution between the State and the Municipalities of the net proceeds of the taxes, duties, tolls and fees leviable by the State, which may be divided between them under this Part (IX-A) and the allocation between the Municipalities at all levels of their respective shares of such proceeds;
  - (ii) the determination of the taxes, duties, tolls and fees which may be assigned to, or appropriated by, the Municipalities;
  - (iii) the grants-in-aid to the Municipalities from the Consolidated Fund of the State;
- (b) the measures needed to improve the financial position of the Municipalities;
- (c) any other matter referred to the Finance Commission by the Governor in the interests of sound finance of the Municipalities” (*Constitutional Provisions*, 1999: 14-15).

---

<sup>1</sup> Such as planning for economic and social development; urban forestry; protection of the environment and promotion of ecological aspects; safeguarding the interests of weaker sections of society; urban poverty alleviation; promotion of cultural, educational and aesthetic aspects; slum improvement and upgradation.

**Box 1.2: Powers, Authority and Responsibilities of Municipalities (Article 243 – W)**

Subject to the provisions of this Constitution, the Legislature of a State may, by law, endow –

- (a) the Municipalities with such powers and authority as may be necessary to enable them to function as institutions of self-government and such law may contain provisions for the devolution of powers and responsibilities upon Municipalities, subject to such conditions as may be specified therein, with respect to:
  - (i) the preparation of plans for economic development and social justice;
  - (ii) the performance of functions and the implementation of schemes as may be entrusted to them including those in relation to the matters listed in the **Twelfth Schedule**;
- (b) the Committees with such powers and authority as may be necessary to enable them to carry out the responsibilities conferred upon them including those in relation to the matters listed in the Twelfth Schedule.

**Twelfth Schedule**

1. Urban planning, including town planning;
2. Regulation of land-use and construction of buildings;
3. Planning for economic and social development;
4. Roads and bridges;
5. Water supply for domestic, industrial and commercial purposes;
6. Public health, sanitation, conservancy and solid waste management;
7. Fire services;
8. Urban forestry, protection of the environment and promotion of ecological aspects;
9. Safeguarding the interests of weaker sections of society, including the handicapped & mentally retarded;
10. Slum improvement and upgradation;
11. Urban poverty alleviation;
12. Provision of urban amenities and facilities, such as parks, gardens, playgrounds;
13. Promotion of cultural, educational and aesthetic aspects;
14. Burials and burial grounds; cremations, cremation grounds and electric crematoriums;
15. Cattle pounds; prevention of cruelty to animals;
16. Vital statistics, including registration of births and deaths;
17. Public amenities, including street lighting, parking lots, bus stops and public conveniences; and
18. Regulation of slaughter houses and tanneries.

Source: *Constitutional Provisions*, 1999: 13-14; 18-19.

Available literature indicates that most state governments in India have amended their municipal laws so as to bring these in conformity with the provisions of the 74<sup>th</sup> Amendment Act. Furthermore, information on the impact of the 74<sup>th</sup> Amendment Act points out that several initiatives have been undertaken to improve the functioning of municipalities in different states of India. Those, which are important in the context of this study, include constitution and working of State Finance Commissions (SFCs).

### **1.1.2 Status of State Finance Commissions in India**

The finance commissions constituted in various States/UTs of India have attempted a detailed review of the financial position of municipalities. The findings on the local-level issues of governance (including those related to financial aspects) and recommendations to overcome the prevailing constraints confronting municipalities have been documented in the reports prepared by the SFCs of most states/UTs. It may be stated here that SFCs are constituted for a fixed term (i.e., generally five years) and their recommendations are valid for this period. Upon completion of their term, the next commission is constituted, which reviews the performance of the previous finance commission and gives new recommendations. It is learnt that in most states, the period of first and second SFCs is over or nearing completion and in a few states the third SFC has been constituted.

The status of first and second state finance commissions in different States/UTs of India is presented in Table 1.1. Information given in the table shows that most of the first SFCs were constituted during the period 1994-95. It is further observed that in the states of Jammu and Kashmir and Arunachal Pradesh the first SFCs were constituted in the year 2001 and 2003 respectively. In the newly formed states of Chattisgarh, Jharkhand and Uttaranchal, the first SFCs were constituted during 2003, 2004 and 2001 respectively. Insofar as the submission of first SFC reports is concerned, it is observed that in the states of Punjab, Rajasthan and West Bengal, the report was submitted in the year 1995. However, in most states, the reports were submitted during the period 1996-99. Bihar is an exception, where the report could not be submitted due to various reasons.

Information on the status of second SFCs is also compiled and presented in Table 1.1. It is noted that the state governments of Andhra Pradesh and Himachal Pradesh were the first to constitute the second SFC in the year 1998. In other states/UTs, the second SFCs were constituted during the period 1994-



2004. It is also observed that in the states of Arunachal Pradesh, Chattisgarh, Jammu and Kashmir, Jharkhand and Uttaranchal, the second SFC has not been constituted due to the fact that the period of the first SFC is not yet complete. Regarding the status of second SFC reports, it is learnt that most reports were submitted during the period 2001-2. There are, however, a number of states where the second reports are in the process of being approved by the state government. States falling in this category include Assam, Goa, Gujarat, Haryana, Maharashtra and Orissa.

It may be mentioned here that SFCs have not been constituted in the three north-eastern states of Meghalaya, Mizoram and Nagaland. This is due to the reason that Article 243 – ZC of the 74<sup>th</sup> Amendment Act and Article 243 – M (2) of the 73<sup>rd</sup> Amendment Act do not allow state governments to apply Part IX (The Panchayats) and Part IX – A (The Municipalities) to certain areas in the three states, namely the scheduled areas and the tribal areas. In these states, it is learnt that traditional local institutions of self-government (namely, Municipal Board, Town Area Committee, etc.) continue to function.

The actions taken by the State/UT authorities on the SFC recommendations have been documented in the Action Taken Reports (ATRs). These reports indicate whether a recommendation has been accepted or not by the state government, the steps that have been taken after a recommendation has been accepted, i.e., implementation status. A review of available information on the status of ATRs reveals that in respect of the first SFC reports, the ATRs have been submitted and approved by the State Government/Legislature in almost all States/UTs (Table 1.1). Regarding the status of ATRs with respect to the second SFC reports, it is observed that these reports have been submitted and approved only in a few States/UTs.

**Table 1.1: Status of State Finance Commissions in India**

S. No.	States/ Union Territories	First SFC		Second SFC		Status of Action Taken Reports	
		Date of Constitution	Date of Submission of Report	Date of Constitution	Date of Submission of Report	First	Second
1	Andhra Pradesh	22.6.1994	31.5.1997	8.12.1998	19.8.2002	Submitted	Submitted
2	Arunachal Pradesh #	21.5.2003	I.N.A.	Due in 2008	N.A.	I.N.A.	N.A.
3	Assam	23.6.1995	29.2.1996	Constituted	U.C.	Submitted	N.A.
4	Bihar	23.4.1994	Not submitted @	June 1999	Jan. 2003* (Interim Rep.)	N.A.	I.N.A.
5	Chhatisgarh	22.8.2003	I.N.A.	Due in 2008	N.A.	I.N.A.	N.A.
6	Goa	1.4.1999	5.6.1999	I.N.A.	U.C.	Submitted	N.A.
7	Gujarat	15.9.1994	.10.1998 *	Constituted	U.C.	Submitted	N.A.
8	Haryana	31.5.1994	31.3.1997	6.9.2000	U.C.	Submitted	N.A.
9	Himachal Pradesh	23.4.1994	.11.1996	25.5.1998	24.10.2002*	Submitted	Submitted
10	Jammu & Kashmir	24.4.2001	I.N.A.	Due in 2005	I.N.A.	I.N.A.	I.N.A.
11	Jharkhand	28.1.2004	I.N.A.	Due in 2005	I.N.A.	I.N.A.	I.N.A.
12	Karnataka	10.6.1994	.1.1996 *	25.10.2000	23.12.2002	Submitted	I.N.A.
13	Kerala	23.4.1994	29.2.1996	23.6.1999	8.1.2001	Submitted	I.N.A.
14	Madhya Pradesh	17.6.1994	.6.1996 *	17.6.1999	22.7.2003 *	Submitted	Submitted
15	Maharashtra	23.4.1994	31.1.1997	22.6.1999	U.C.	Submitted	N.A.
16	Manipur	22.4.1994	.12.1996	Constituted	I.N.A.	Submitted	I.N.A.
17	Meghalaya	74 <sup>th</sup> Amendment Act Provisions are not applicable to these States under Article 243-ZC and Article 243-M (2) of the Constitution					
18	Mizoram						
19	Nagaland						
20	Orissa						
21	Punjab	22.4.1994	31.12.1995	21.9.2000	.2.2002	Submitted	Submitted
22	Rajasthan	23.4.1994	31.12.1995	7.5.1999	29.8.2001	Submitted	Submitted
23	Sikkim	22.7.1998	16.8.1999	Constituted	I.N.A.	Submitted	I.N.A.
24	Tamil Nadu	23.4.1994	.11.1996	1.12.1999	.5.2001	Submitted	Submitted
25	Tripura	23.4.1994	17.9.1999 *	29.10.1999	I.N.A.	Submitted	I.N.A.
26	Uttaranchal	31.3.2001	29.6.2002	Due in 2006	N.A.	Submitted	N.A.
27	Uttar Pradesh	22.10.1994	26.12.1996	25.2.2000	.6.2002	Submitted	Submitted
28	West Bengal	30.5.1994	27.11.1995	14.7.2000	6.2.2002	Submitted	U.C.
<b>Union Territories</b>							
1	Andaman & Nicobar Islands \$	20.9.1995	.8.1998	28.8.2001	31.5.2002	Submitted	I.N.A.
2	Chandigarh	.5.1995	I.N.A.	9.1.2001	I.N.A.	I.N.A.	I.N.A.
3	Dadra & Nagar Haveli #, \$	8.9.1995	.8.1998	.12.2001	31.5.2002	Submitted	I.N.A.
4	Daman & Diu \$	8.9.1995	.8.1998	.12.2001	31.5.2002	Submitted	I.N.A.
5	Delhi	3.4.1995	.12.1997	9.1.2001	.4.2002	Submitted	Submitted
6	Lakshadweep #, \$	8.9.1995	.8.1998	.12.2001	31.5.2002	Submitted	I.N.A.
7	Pondicherry ^	12.3.1997	15.9.1997	5.1.2004	I.N.A.	Submitted	I.N.A.

Source: Data collected from the SFC reports of different States/UTs; MUD & CFC database; Field visits.

- Notes:
- (i) # : There are no municipalities in the State/UT.
  - (ii) \$ : One single report contains information on the four UTs of Andaman & Nicobar Islands, Dadra & Nagar Haveli, Daman & Diu and Lakshadweep.
  - (iii) \* : Report relates to municipalities only.
  - (iv) @ : The Interim Report of SFC (Bihar) submitted in January 2003 points out that the first SFC Report could not be submitted due to various reasons.
  - (v) U.C. – Under consideration; I.N.A. – Information Not Available; N.A. – Not Applicable.
  - (vi) ^ : As per Government order, the Commission has submitted 6 six monthly reports containing its recommendations to the Government.

### **1.1.3 Purpose of the Study**

The purpose of this study is to compile and review the recommendations for municipalities/urban areas, put forward by the finance commissions of various States/Union Territories in India and to assess the actions taken by the State Governments/UTAs on the SFC recommendations. Recent studies undertaken to review the progress on this subject point out that in a few States, ad hoc arrangements are being followed, despite the acceptance of SFC recommendations. However, such studies are few and the analysis is limited to either a single state or a few states. Hence, a comparative position on the actions taken by the states/UTs is not available. Similarly, there is a lack of information on the reasons responsible for non-implementation of the SFC recommendations. This study, therefore, attempts to throw light on some of these aspects.

The study assumes significance in view of the prevailing constraints confronting municipal governments in India. The SFCs were constituted in different States/UTs of the country with the objective of monitoring and improving the financial condition of municipalities. Piece-meal studies however reveal that while significant steps have been taken, a lot more remains to be done. Hence, it is essential to understand the extent of progress achieved as a result of this initiative as well as the related shortcomings.

## **1.2 OBJECTIVES OF THE STUDY**

The objectives of the study are as follows:

- (i) To compile the key recommendations of first and second State Finance Commissions keeping in view their terms of reference;
- (ii) To review the actions taken by the State Governments on the recommendations of the first/second SFCs; and
- (iii) To examine the current status on the implementation of the SFC recommendations.

### **1.3 DATA BASE AND METHODOLOGY**

#### **1.3.1 Sources of Data**

In view of the fact that the study deals with the compilation and review of the SFC recommendations as well as the follow-up actions taken by the State Governments, the required information has been obtained through discussions with state officials and from the available first and second SFC reports and the Action Taken Reports of different States/Union Territories in India. These reports have been collected through field visits undertaken by the project team to the state/UT headquarters. The main sources identified at the state/UT level for the collection of reports/data and for holding discussions include the Departments of Finance, Urban Development and Municipal Administration Departments, Chairmen/Member Secretary of SFCs, Municipal Commissioners and other agencies/institutions dealing with SFCs.

In addition, the Census of India, 2001 publications of all States/Union Territories have been referred in order to understand the variations in some urban area characteristics at the state/UT level, such as the proportion of urban population, civic administration status, number of towns, cities and urban agglomerations (see Appendix I given in Vol. II of this report).

The analysis carried out in this study is based on a review of 24 first SFC reports, 20 first Actions Taken Reports (ATRs), 14 second SFC reports and 7 second ATRs. State/UT – wise information on the reports reviewed in this study is given in Table 1.2. Regarding the availability of the SFC reports and the ATRs, it may be stated that an attempt was made to collect reports of all states/UTs. However, during the stage of data collection it was learnt that: (i) first SFC report of Bihar has not been prepared by the SFC; (ii) adequate information regarding the availability of first and second SFC reports of some states is not available; (iii) there are some states/UTs (namely Arunachal Pradesh, Dadra and Nagar Haveli and Lakshadweep) in which municipalities/urban local bodies (ULBs) do not

exist, hence recommendations for rural areas have not been compiled and analysed in this study; (iv) second SFC reports of some states have not been approved by the state governments; (v) in the case of some states (namely, Goa, Sikkim and Uttaranchal), the recommendations of first SFC are valid up to 2005-6, hence the second SFC reports have not been prepared by the SFCs; and (vi) adequate information on the status of second ATRs is not available. It may be stated that the information on the status of SFC recommendations given in this report is updated as per information provided in Table 1.1 as well as the discussions held with a select number of state government officials up to May 2005.

**Table 1.2: Reports Reviewed in this Study**

S. No.	States/ Union Territories	SFC I	ATR I	SFC II	ATR II
1	Andhra Pradesh	✓	✓	✓	✓
2	Arunachal Pradesh	There are no municipalities in this state			
3	Assam	✓	✓		
4	Bihar			✓	
5	Chhatisgarh				
6	Goa	✓	✓		
7	Gujarat	✓	✓		
8	Haryana	✓	✓		
9	Himachal Pradesh	✓	✓	✓	
10	Jammu & Kashmir				
11	Jharkhand				
12	Karnataka	✓		✓	
13	Kerala	✓	✓	✓	
14	Madhya Pradesh	✓	✓	✓	✓
15	Maharashtra	✓			
16	Manipur	✓			
17	Meghalaya	74 <sup>th</sup> Amendment Act Provisions are not applicable to these States under Article 243-ZC and Article 243-M (2) of the Constitution			
18	Mizoram				
19	Nagaland				
20	Orissa	✓	✓		
21	Punjab	✓	✓	✓	✓
22	Rajasthan	✓	✓	✓	✓
23	Sikkim	✓			
24	Tamil Nadu	✓	✓	✓	✓
25	Tripura	✓	✓		
26	Uttaranchal	✓	✓		
27	Uttar Pradesh	✓	✓	✓	✓
28	West Bengal	✓	✓	✓	
<b>Union Territories</b>					
1	Andaman & Nicobar Islands	✓	✓	✓	
2	Chandigarh				
3	Dadra & Nagar Haveli	There are no municipalities in this UT			
4	Daman & Diu	✓	✓	✓	
5	Delhi	✓	✓	✓	✓
6	Lakshadweep	There are no municipalities in this UT			
7	Pondicherry	✓	✓		
<b>Total Number of Reports</b>		<b>24</b>	<b>20</b>	<b>14</b>	<b>7</b>

### **1.3.2 Method of Data Organisation and Analysis**

This report is based on the perceptions of the state officials on the SFC recommendations and on an extensive review of reports prepared and submitted by the SFCs of different states/UTs and approved by the state government. A complete listing of key recommendations of the first and second SFCs and the actions taken against each recommendation/implementation status is provided in Appendix II and III given in Vol. II of this report. It may be mentioned here that the recommendations of the first and second SFCs have been classified under three main headings, namely 'functional', 'financial' and 'other' recommendations. The financial recommendations are further classified under three headings, viz., 'taxes', 'non-taxes' and 'fiscal transfers' (see Appendix II given in Vol. II of this report). Similarly, information on the actions taken on the first and second SFC recommendations has been compiled under four main headings, namely 'accepted', 'not accepted', 'under consideration' and 'remarks/status of implementation'. The accepted category is further classified as 'fully accepted', 'partly accepted' and 'accepted with modifications' (see Appendix III given in Vol. II of this report). The analysis has been carried out by organising the recommendations under broad themes. Each theme has been discussed in separate chapters of this report. Furthermore, state/UT level comparative tables have been prepared to provide an overview on the SFC recommendations.

### **1.4 LIMITATIONS OF THE STUDY**

Two major problems were faced in addressing the objectives of the study. In this regard it may be mentioned that although the first/second SFC recommendations have been listed in most SFC reports, the actions taken and the implementation status in respect of each recommendation has not been clearly described in the Action Taken Reports. In fact, no information has been provided on the actions taken on a large number of recommendations. This problem has been noted in the case of a number of states. Secondly, adequate feedback on the current status of implementation of SFC recommendations and the prevailing reasons for

non-implementation of recommendations has not been received from the identified group of respondents.

## **1.5 ORGANISATION OF THE REPORT**

This report has been prepared in two Volumes: Vol. I and II. Vol. I is the main report, which contains information on the scope of the study, database and methodology, limitations of the study and the status of SFC recommendations. Vol. II consists of three appendices. It contains all-India data on urban population, number of towns and municipalities, and a listing of key first/second SFC recommendations and the actions taken.

There are six chapters in the main report. The introductory chapter contains information on the context and significance of the study, objectives, database, methodology and limitations of the study. In chapter two, an overview of SFC recommendations and actions taken is provided. This chapter has been included in order to familiarise the reader with the overall status on the number and areas of recommendations and the actions taken. Chapters three, four and five contain detailed information on the status of key recommendations in various states/union territories of the country. The key themes covered in these three chapters are: revenue sharing and distribution of funds among municipalities; measures to improve the financial condition of municipalities; and other measures to strengthen municipal governance. In chapter six, the important lessons learned from a review of information on SFC recommendations and the actions taken are mentioned. A complete referencing of all reports and publications used in the preparation of this report is provided at the end of the main report.

## **2 AN OVERVIEW OF STATE FINANCE COMMISSIONS' RECOMMENDATIONS AND ACTIONS TAKEN**

As mentioned earlier, this study focuses on three main areas: (a) compilation of key recommendations of first and second State Finance Commissions (SFCs); (b) review of the actions taken by the State Governments on the SFC recommendations; and (c) the current status of their implementation. An overview on the nature and status of SFC recommendations is presented in this chapter. The purpose of this exercise is to develop an understanding on some of the major areas on which recommendations have been made by the Finance Commissions of various states/UTs to strengthen municipal governance.

It is learnt that recommendations have been framed by the SFCs on the basis of a careful assessment of the prevailing conditions at the state and local level. Some common aspects of governance examined by the Finance Commissions include: (a) evolution of local governments; (b) financial condition of the State and Local Governments; (c) functional jurisdiction; (d) resource requirements; (e) debt position; (f) accounts and audit; (g) administrative structures; (h) revenue efforts; etc.

### **2.1. NUMBER OF RECOMMENDATIONS**

Table 2.1 shows the state/UT – wise number of key recommendations of first and second SFCs. This information has been obtained from the SFC reports. It may be stated that the number of recommendations given in the table is an approximation. This is due to the reason that this information has not been properly provided in a number of SFC reports. It is noted that in most SFC reports, the exact number of recommendations has not been clearly specified. Recommendations have been provided in the chapters, and a summary of



recommendations is provided at the end of the SFC reports. In some cases, it is observed that recommendations have not been listed separately. In a number of SFC reports, recommendations for urban and rural areas/local bodies have not been presented under separate sections. There are several recommendations meant for the state government and these too have not been presented separately. This has created problems in arriving at the number of recommendations. Nonetheless, an attempt has been made to count the number of recommendations and to classify them into four categories – total recommendations; recommendations for urban local bodies (ULBs)/urban areas; recommendations for panchayati raj institutions (PRIs)/rural areas; and recommendations which are common for ULBs, PRIs and state governments.

In respect of the first SFC, it is noted that the two states of Tamil Nadu and Maharashtra show the maximum number of total recommendations. The total number of recommendations is also high for Andhra Pradesh, Punjab, Rajasthan and Uttar Pradesh. States/UTs with a low number of recommendations include Assam, Manipur, Sikkim, Uttaranchal, Delhi and Pondicherry. Further, it is observed that the emphasis on rural and urban areas varies from state to state. For example, emphasis on urban areas vis-à-vis rural areas is higher in the states of Maharashtra, Punjab, Rajasthan, Sikkim, Tamil Nadu and Uttar Pradesh.

The total number of recommendations in the second SFC reports is highest in the state of Uttar Pradesh, followed by Tamil Nadu, Punjab, Madhya Pradesh, and Andhra Pradesh, and low in Karnataka, West Bengal and Daman and Diu. Further, the emphasis on urban areas is higher in Madhya Pradesh, Punjab, Tamil Nadu, Uttar Pradesh, West Bengal and Daman and Diu (see Table 2.1).

**Table 2.1: Number of Key First and Second SFC Recommendations by States and UTs**

S. No.	State/UT	First SFC Recommendations				Second SFC Recommendations			
		Total	For ULBs/urban areas	For PRIs/rural areas	Common for ULBs/PRIs/State Govt.	Total	For ULBs/urban areas	For PRIs/rural areas	Common for ULBs/PRIs/State Govt.
1	Andhra Pradesh	84	11	39	34	82	21	40	21
2	Assam	14	1	2	11				
3	Bihar						7		
4	Goa	26	3	9	14				
5	Gujarat		59						
6	Haryana	47	21	21	5				
7	Himachal Pradesh		1		4		6		
8	Karnataka		37		20	27	8	8	11
9	Kerala	69	6	14	49	42		1	41
10	Madhya Pradesh		15			100	48	28	24
11	Maharashtra	112	77	21	14				
12	Manipur	10	1	-	9				
13	Orissa	29	12	13	4				
14	Punjab	97	58	39	-	117	61	40	16
15	Rajasthan	71	49	22	-	45	9	12	24
16	Sikkim	20	9	7	4				
17	Tamil Nadu	413	244	74	95	132	43	22	67
18	Tripura		25						
19	Uttaranchal	4	1	1	2				
20	Uttar Pradesh	97	61	36	-	212	100	92	20
21	West Bengal	46	7	11	28	18	5	4	9
22	Andaman & Nicobar Is.	43	-	1	42	52	5	5	42
23	Daman & Diu	43	-	1	42	24	2	1	21
24	Delhi	9	9	-	-	40	40	-	-
25	Pondicherry	6	-	-	6				

Source: First and Second State Finance Commission Reports.

Note: Blank boxes in the table indicate that either the SFC report has not been approved by the state government or information is not available.

## 2.2 AREAS OF RECOMMENDATIONS

The SFCs have framed recommendations on a number of areas. The 74<sup>th</sup> Amendment Act Provisions as well as Terms of Reference (TOR) notified by the State Governments have provided the basic guidelines and areas on which emphasis is to be laid. This study identifies six major areas on which recommendations have been made, namely:

- (i) Revenue sharing between state and municipalities/local bodies;
- (ii) Criteria for distribution of funds between municipalities;
- (iii) Taxes, non-taxes, assigned revenues and compensations to municipalities;
- (iv) Grants-in-aid to municipalities;
- (v) Other measures to improve the financial condition of municipalities;  
and
- (vi) Other measures for strengthening municipal governance.

It may be stated that although the major thrust is given on strengthening the financial condition of ULBs, there is also an emphasis on improving their overall management capabilities.

### **2.3 STATUS OF ACTIONS TAKEN ON SFC RECOMMENDATIONS<sup>2</sup>**

An attempt has been made in this study to assess the status of actions taken on key SFC recommendations for local bodies (both urban and rural). This analysis is based on a review of 20 first and 7 second ATRs. A classification of recommendations according to the actions taken is presented in Table 2.2. It is observed from a review of both the first and the second ATRs that the proportion of recommendations accepted (either fully, partly or in a modified form) is much higher than those which have not been accepted.

---

<sup>2</sup> It may be stated that this analysis is based on the total number of recommendations, i.e., recommendations for PRIs/rural areas, ULBs/urban areas, state government, etc. This is due to the fact that a proper classification of recommendations is not provided by most SFCs in the SFC or the Action Taken Reports.

**Table 2.2: Status of Actions Taken on Key First and Second SFC Recommendations**

S. No.	State/UT	Status of First SFC Recommendations				Status of Second SFC Recommendations			
		Total No.	Proportion of Recommendations (%)			Total No.	Proportion of Recommendations (%)		
			Accepted	Not Accepted	Under Consideration		Accepted	Not Accepted	Under Consideration
1	Andhra Pradesh	84	76	19	5	98	56	22	22
2	Assam	14	43	-	57				
3	Goa	26	65	35	-				
4	Gujarat	64	85	15	-				
5	Haryana	14	100	-	-				
6	Himachal Pradesh	5	100	-	-				
7	Kerala	69	87	9	4				
8	Madhya Pradesh *	15	87	13	-	100	88	6	6
9	Orissa	34	44	3	53				
10	Punjab	27	85	-	15	7	57	-	43
11	Rajasthan	87	78	16	6	36	50	3	47
12	Tamil Nadu	78	76	24	-	132	48	7	45
13	Tripura *	25	88	4	8				
14	Uttaranchal	30	100	-	-				
15	Uttar Pradesh	97	82	1	17	245	67	19	14
16	West Bengal	44	84	-	16				
17	Andaman & Nicobar Is.	43	26	2	72				
18	Daman & Diu	43	49	9	42				
19	Delhi *	10	80	10	10	22	77	14	9
20	Pondicherry	5	60	40	-				

Source: State Finance Commission Reports and Action Taken Reports.

Note: (i) States with a \* indicate that the first ATR of Madhya Pradesh, first ATR of Tripura and first and second ATR of Delhi relate to municipalities only.

(ii) Blank boxes in the table indicate that either the SFC report has not been approved by the state government or information is not available.

A review of first ATRs reveals that acceptance is 100 per cent in the states of Haryana, Himachal Pradesh and Uttaranchal. The other states/UTs showing high acceptance include Gujarat, Kerala, Madhya Pradesh, Punjab, Tripura, Uttar Pradesh, West Bengal and Delhi. The states/UTs of Assam, Orissa, Andaman and Nicobar Islands and Daman and Diu have shown low acceptance (Table 2.3). Limited information is available on the acceptance of second SFC recommendations (Table 2.4). A comparison of first and second SFC recommendations, which have been accepted, shows that this proportion has decreased between the two points of time.

**Table 2.3: Proportion of First SFC Recommendations Accepted in Selected States**

S. No.	Proportion of Recommendations Accepted	Name of State/UT
1	100 per cent	Haryana, Himachal Pradesh, Uttarakhand
2	80 – 100 per cent	Gujarat, Kerala, Madhya Pradesh, Punjab, Tripura, Uttar Pradesh, West Bengal, Delhi
3	60 – 80 per cent	Andhra Pradesh, Goa, Rajasthan, Tamil Nadu, Pondicherry
4	Less than 60 per cent	Assam, Orissa, Andaman & Nicobar Islands, Daman & Diu

Source: *ibid.*

**Table 2.4: Proportion of Second SFC Recommendations Accepted in Selected States**

S. No.	Proportion of Recommendations Accepted	Name of State/UT
1	100 per cent	Nil
2	80 – 100 per cent	Madhya Pradesh
3	60 – 80 per cent	Uttar Pradesh, Delhi
4	Less than 60 per cent	Andhra Pradesh, Punjab, Rajasthan, Tamil Nadu

Source: *ibid.*

Table 2.2 also provides information on recommendations not accepted and those, which are under consideration. This status is observed in the case of most states/UTs. A high proportion of first SFC recommendations not accepted is noted in the states/UTs of Goa, Tamil Nadu and Pondicherry. In this context it may be stated that decisions on recommendations are generally based on the financial condition of the state/local government/UTA, as well as on the priority areas.

### 3 DEVOLUTION OF FUNDS AND DISTRIBUTION AMONG MUNICIPALITIES

An important recommendation to strengthen the revenue base of ULBs is the sharing of state revenues. It is realised that the financial condition of local bodies continues to remain weak. This is either due to low recovery from own sources of income or due to poor financial management. Hence, a re-emphasis is given on fiscal transfers from the state to the local body by way of revenue sharing. It may be stated that the practice of revenue sharing is not a new phenomenon. The important dimension in this concept is the 'global sharing of revenues' in the total tax/non-tax receipts of the state government (Box 3.1). This implies that a fixed proportion (specific share) of state income generated from its total tax/non-tax receipts (i.e., total divisible pool) is shared with the local bodies. The first SFC report of Uttar Pradesh points out that the earlier practice of sharing revenues from specific taxes, tolls, fees, etc., affected adversely the finances of local bodies. Considering the drawbacks in the earlier system of devolution, the principle of global sharing of state revenues has been suggested by the Finance Commissions of several states, including Uttar Pradesh, Madhya Pradesh, Karnataka, Rajasthan, Tamil Nadu and Assam. However, some states like Punjab and Maharashtra, have continued with the system of sharing of specific taxes.

#### **Box 3.1: The Concept of Global Sharing**

"The system of global sharing has distinct advantages. It allows state governments to tax the more buoyant and elastic tax sources and guarantees a regular, rising and predictable flow of revenues to local bodies...Under global sharing, local bodies automatically share the buoyancy in state's tax revenues. This system also has the advantages of transparency, objectivity, predictability and regularity. It is also helpful in annual budgetary exercises both at the state and the local body levels."

Source: Government of Uttar Pradesh (2002): *Report of the Second SFC*, Vol. I, p. 258.

### 3.1 REVENUE SHARING BETWEEN STATE AND LOCAL BODIES

Local bodies receive funds regularly from the centre and the state government in the form of grants, loans, share in specific taxes, share in state revenues, etc. In this section, information is provided on the share of local bodies in the state revenues, as recommended by the first and the second SFCs of various states (Table 3.1).

**Table 3.1: SFC Recommendations on Global Sharing of State Revenues and Actions Taken**

S. No.	State/UT	Recommended Share of Local Bodies (urban and/or rural)	Recommended Share of Local Bodies (urban and/or rural)
		First SFC	Second SFC
1	Andhra Pradesh	<ul style="list-style-type: none"> <li>○ 39.24 % of state revenue from taxes &amp; non-taxes (30 % for urban areas)</li> <li>○ <b>Accepted</b> – however, earmarked funds have been partly devolved</li> </ul>	<ul style="list-style-type: none"> <li>○ 40.92 % of state's tax &amp; non-tax revenue (18.5 % share of ULBs)</li> <li>○ status not specified in ATR</li> </ul>
2	Assam	<ul style="list-style-type: none"> <li>○ 2 % of state taxes</li> <li>○ <b>Accepted</b></li> </ul>	
3	Karnataka	<ul style="list-style-type: none"> <li>○ 36 % of non-loan gross own revenue receipts (NLGORR) of state govt. (5.4 % relative share of ULBs)</li> <li>○ <b>Accepted</b> – a higher % age has been transferred to LBs</li> </ul>	<ul style="list-style-type: none"> <li>○ 40 % of NLGORR of state govt. (8% relative share of ULBs)</li> <li>○ information on status not available</li> </ul>
4	Madhya Pradesh	<ul style="list-style-type: none"> <li>○ 8.67 % of net revenue (taxes &amp; non-taxes) of state govt. for ULBs</li> <li>○ <b>Accepted</b></li> </ul>	<ul style="list-style-type: none"> <li>○ 1.07 % of net own tax revenue of state govt. for ULBs</li> <li>○ <b>Accepted</b></li> </ul>
5	Punjab		<ul style="list-style-type: none"> <li>○ 4 % of net receipts from all state taxes</li> <li>○ <b>Accepted</b></li> </ul>
6	Rajasthan	<ul style="list-style-type: none"> <li>○ 2.18 % of net state tax proceeds</li> <li>○ <b>Accepted</b></li> </ul>	<ul style="list-style-type: none"> <li>○ 2.25 % of state's net own tax revenue, exclu. entertainment tax (23.4 % for ULBs)</li> <li>○ <b>Accepted</b> – amount earmarked for LBs is being distributed</li> </ul>
7	Tamil Nadu	<ul style="list-style-type: none"> <li>○ 8 % of revenue from all state taxes, exclu. entertainment tax (40 % for ULBs)</li> <li>○ <b>Accepted with modification</b> – instead of 40 %, ULBs to be devolved 45 % share</li> </ul>	<ul style="list-style-type: none"> <li>○ 8 % of state's own tax revenue, exclu. entertainment tax (42 % for ULBs)</li> <li>○ <b>Accepted</b></li> </ul>
8	Uttar Pradesh	<ul style="list-style-type: none"> <li>○ 10 % of net own tax revenue receipts of state govt. (7 % for ULBs)</li> <li>○ <b>Accepted</b></li> </ul>	<ul style="list-style-type: none"> <li>○ 12.5 % of net proceeds of taxes, duties, tolls &amp; fees, exclu. entertainment tax &amp; land revenue (7.5 % for ULBs)</li> <li>○ <b>Accepted</b> – regarding share of Nagar Panchayats, it is mentioned that the administrative department should reconsider this decision</li> </ul>
9	West Bengal	<ul style="list-style-type: none"> <li>○ 16 % of net proceeds of all state taxes</li> <li>○ <b>Accepted</b> – however, only a small amount of fund was released to LBs</li> </ul>	<ul style="list-style-type: none"> <li>○ 16 % of net proceeds of all state taxes</li> <li>○ information on status not available</li> </ul>
10	Andaman & Nicobar Islands		<ul style="list-style-type: none"> <li>○ 10 % of total net tax proceeds (20 % for ULBs)</li> <li>○ information on status not available</li> </ul>
11	Daman & Diu		<ul style="list-style-type: none"> <li>○ 10 % of total net tax proceeds (20 % for ULBs)</li> <li>○ information on status not available</li> </ul>
12	Delhi	<ul style="list-style-type: none"> <li>○ 9.5 % of Govt. of National Capital Territory of Delhi's tax revenue</li> <li>○ <b>Accepted</b></li> </ul>	<ul style="list-style-type: none"> <li>○ 5.5 % of tax revenue (net proceeds of all taxes &amp; duties)</li> <li>○ <b>Accepted</b></li> </ul>

Source: State Finance Commission Reports and Action Taken Reports.

Information provided in Table 3.1 shows that global sharing of revenues is recommended in two ways, namely: (a) as a share in both the tax and non-tax income of the state government; and (b) as a share in only the tax income of the state government.

It is further observed that the recommended share of local bodies (LBs) varies from state to state. It is quite high in the southern states of Andhra Pradesh and Karnataka, followed by West Bengal and Uttar Pradesh. A comparison of the first and second SFC recommendations shows that the recommended share has marginally increased in some states and has declined in some others. This is due to the changes recommended in the principles of devolution by the first and the second SFCs as well as due to the prevailing financial condition of the state government.

There are a number of states, which do not follow the practice of global revenue sharing. The recommendations of first and second SFC for these states are given in Table 3.2. It is noted from the information given in the table that the principles of devolution of funds to local bodies from the state income have not been formulated by the SFCs. In such states, reforms in the existing system – devolving a share from certain taxes and grants-in-aid – are recommended. In this context, the first SFC of Gujarat observes “the Working Group formed for giving guidance to the SFCs has not specified the principles for devolution of funds to the local bodies. Due to this reason, a proper mechanism for global sharing of state revenues could not be worked out.”



**Table 3.2: SFC Recommendations on Revenue Sharing Between State and Local Bodies**

S. No.	State/UT	Recommended Share of Local Bodies (urban and rural)	Recommended Share of Local Bodies (urban and rural)
		First SFC	Second SFC
1	Bihar		<ul style="list-style-type: none"> <li>o Annual central grant of Rs. 1341 lakhs to be devolved to ULBs</li> <li>o Information on status not available</li> </ul>
2	Goa	<ul style="list-style-type: none"> <li>o Devolution of non-plan grants – 36 % of state's own tax revenue &amp; share in central taxes to be devolved to LBs; non-plan devolution to Panchayats &amp; M. Councils works out to 27 % &amp; 9 % respectively</li> <li>o <b>Not accepted</b> – 9 % devolution to ULBs – since the state's own tax revenue is under pressure</li> <li>o Devolution of plan grants – 16 % of average annual plan expenditure to be devolved to LBs; plan devolution to Panchayats &amp; M. Councils works out to 13 % &amp; 3 % respectively</li> <li>o <b>Not accepted</b> – 3 % devolution to ULBs – grants under plan to be released according to approved pattern of assistance on the basis of their performance</li> </ul>	
3	Gujarat	Principles for devolution of funds to LBs from state income have not been formulated by the SFC; system of devolving a share from certain taxes & grants-in-aid exists at present; revisions have been made in the proportion of taxes & grants to be shared with the LBs	
4	Haryana	Principles for devolution of funds to LBs from state income have not been formulated by the SFC; system of devolving a share from certain taxes & grants-in-aid exists at present; revisions have been made in the proportion of taxes & grants to be shared with the LBs	
5	Himachal Pradesh	<ul style="list-style-type: none"> <li>o Per capita provision of Rs. 300 per annum to be provided to ULBs for the effective performance of statutory functions</li> <li>o Status not specified in ATR</li> </ul>	Devolution of resources not considered as a priority area by the second SFC
6	Kerala	<ul style="list-style-type: none"> <li>o Non-statutory non-plan grants given for traditional functions of LBs to be fixed at 1 % of the state revenue</li> <li>o <b>Not accepted</b></li> <li>o Devolution of plan funds – 55.8 % to Village Panchayats, 14.33 % to Block Panchayats, 14.93 % to District Panchayats, 5.64 % to Municipalities, &amp; 2.17 % to Corporations</li> <li>o <b>Accepted</b></li> </ul>	<ul style="list-style-type: none"> <li>o Govt. to devolve to LBs, plan funds not less than 1/3<sup>rd</sup> the annual size of the state plan; 5 ½ % of annual own tax revenue of state govt. to be devolved to LBs as grants-in-aid for maintenance of assets; 3 ½ % of own tax revenue of state govt. to be devolved to LBs as general purpose grant in lieu of assigned taxes, shared taxes &amp; various statutory &amp; non-statutory grants-in-aid, both specific purpose &amp; general purpose</li> <li>o Information on status not available</li> </ul>
7	Maharashtra	Principles for devolution of funds to LBs from state income have not been formulated by the SFC; system of devolving a share from certain taxes & grants-in-aid exists at present; revisions have been made in the proportion of taxes & grants to be shared with the LBs	
8	Manipur	Principles for devolution of funds to LBs from state income have not been formulated by the SFC; system of devolving a share from certain taxes & grants-in-aid exists at present; revisions have been made in the proportion of taxes & grants to be shared with the LBs	
9	Orissa	Principles for devolution of funds to LBs from state income have not been formulated by the SFC; system of devolving a share from certain taxes & grants-in-aid exists at present; revisions have been made in the proportion of taxes & grants to be shared with the LBs	
10	Punjab	<ul style="list-style-type: none"> <li>o 20 % of net proceeds of 5 taxes to be shared with LBs</li> <li>o <b>Accepted</b> – transfers to LBs have been much less than 20 %</li> </ul>	

S. No.	State/UT	Recommended Share of Local Bodies (urban and rural)	Recommended Share of Local Bodies (urban and rural)
		First SFC	Second SFC
11	Sikkim	Grants-in-aid recommended for LBs	
12	Tripura	<ul style="list-style-type: none"> <li>o Rs. 7 crore to be devolved to ULBs as grants-in-aid by the state govt. from the consolidated fund, with 15 % progression per year</li> <li>o <b>Accepted with modification</b> – grants-in-aid for ULBs to be provided @ Rs. 200/- per capita</li> </ul>	
13	Uttaranchal	Devolutions to ULBs to be made in rounded per capita terms in the following manner: <ul style="list-style-type: none"> <li>o M. Corporations – Rs. 250 per capita</li> <li>o M. Councils – Rs. 250-300 per capita</li> <li>o N. Panchayats – Rs. 175-225 per capita</li> <li>o <b>Accepted</b></li> </ul>	
14	Andaman & Nicobar Islands	<ul style="list-style-type: none"> <li>o LBs to be entitled to a fixed grant – Rs. 5 lakh for M. Councils, for effective utilisation bi-annually; no entitlement grant for ULBs; at least 20 % of each annual years plan outlay to be earmarked for LBs</li> <li>o <b>Accepted</b> – subject to final approval by MHA</li> </ul>	
15	Daman & Diu	<ul style="list-style-type: none"> <li>o LBs to be entitled to a fixed grant – Rs. 5 lakh for M. Councils, for effective utilisation bi-annually; no entitlement grant for ULBs; at least 20 % of each annual years plan outlay to be earmarked for LBs</li> <li>o <b>Accepted</b> – subject to final approval by MHA</li> </ul>	
16	Pondicherry	Principles for devolution of funds to LBs from UT income have not been formulated by the SFC; system of devolving a share from certain taxes & grants-in-aid exists at present; revisions have been made in the proportion of taxes & grants to be shared with the LBs	

Source: State Finance Commission Reports and Action Taken Reports.

### 3.1.1 Actions Taken and Implementation Status

The recommendation on 'Global Sharing of State Revenues' has been accepted by most State Governments (see Table 3.1). However, it is learnt that in some states, the recommended share has been either partly devolved or is yet to be devolved. This is true in the case of Andhra Pradesh and West Bengal. In Tamil Nadu, the State Government has frozen the percentage for all the five years owing to resource crunch. In the states of Goa and Kerala, where reforms have been suggested in the traditional practices, the recommendation on devolution of plan/non-plan grants have not been accepted due to the fact that the States' own tax resource base is under pressure. In Punjab, the recommendation on devolution of 20 per cent of the net proceeds of five taxes has been accepted, however, transfers to local bodies have been less than the recommended share. Thus, compliance on revenue sharing by the states is a debatable issue and necessary steps are required to be taken in this regard.

### 3.2 CRITERIA FOR DISTRIBUTION OF FUNDS AMONG MUNICIPALITIES

The SFCs have also determined the criteria/principles for the distribution of funds among local bodies of different sizes. It is recommended that the amount of funds devolved to ULBs from the State revenues is to be distributed among the different types of ULBs on the basis of selected criteria and by assigning weightages (Table 3.3). While population remains a common criterion in respect of all states, the other criteria noted in the case of some states are geographical area, backwardness, performance, discretionary quota, per capita rate, literacy, health, roads, revenue effort, workers in registered factories, consumption of electricity, SC/ST population, per capita tax income, per capita receipts, per capita expenditure on core services, distance from nearest rail head, density of population, length of *kutcha* drains, etc. It is understood that in the selection of criteria, consideration has been given to key urban area characteristics. In some states, such as Tamil Nadu, a vertical and horizontal distribution of funds among local bodies is also recommended.

**Table 3.3: SFC Recommendations on Criteria for Inter-se Distribution of Funds**

S. No.	State/UT	Criteria and Weightages	
		First SFC	Second SFC
1	Andhra Pradesh	Share from state revenue: Population-40 %, area, exclu. slum area-40 %, area of slums in each ULB-20 %	
2	Assam	Motor vehicle tax: Number of vehicles plying within each municipal area	
3	Goa	Plan grants: Population-40 %, geog. area-20 %, backwardness-10%, performance-25%, discretionary quota-5%	
4	Karnataka	Share from state revenue: Population, area, literacy, health, roads	Share from state revenue: Population-67 %, illiteracy rate-33 %
5	Kerala	Plan funds: Population-75 %, SC/ST pop.-10 %, workers-15 %	Plan funds: Population (non SC/ST)-66.82 %, area-5 %, houses without latrines & electricity-20 %, revenue effort-8.18 %
6	Madhya Pradesh	Share from state revenue: Population-50 %, area-12.5 %, no. of workers in registered factories per lakh pop.-12.5 %, per capita consumption of electricity-12.5 %, literacy rate-12.5 %	
7	Punjab		Share from state revenue: Population-70 %, SC pop.-15 %, shortfall of per capita tax income as compared to average per capita tax income of all ULBs-15 %
8	Rajasthan	Share from state revenue: Population size, resource potential of ULBs, marginal capacity	Share from state revenue: Population
9	Tamil Nadu	Share from state revenue: Population, SC/ST pop., per capita receipts under own sources, per capita expenditure on core	Share from state revenue: vertical distribution among LBs – Population-50 %, O&M, capital & debt needs-30 %,

S. No.	State/UT	Criteria and Weightages	
		First SFC	Second SFC
		civic services	resource potential-20 %; horizontal distribution among LBs – Population, SC/ST/Slum pop., per capita own income, asset maintenance, salary & pension expenditure restricted to corp./municipalities with 49 % or less of total revenue income
10	Tripura	Share from state taxes & grants-in-aid: Population-55 %, area-25 %, backwardness (measured in terms of distance from state capital)-20 %	
11	Uttaranchal	Devolution of funds: Population, distance from nearest rail head	
12	Uttar Pradesh	Share from state revenue: Population-80 %, area-20 %	Share from state revenue: to be determined on the basis of a composite multiple indicator based index, which takes into account population, SC/ST pop., illiteracy, pop. with drinking water facility, area & tax efforts of ULBs
13	Andaman & Nicobar Islands		Share from net proceeds: Population-45 %, SC/ST pop.-10 %, inadequacy of civic services-30 %, additional resource mobilisation efforts as compared to previous year-15 %
14	Daman & Diu		Share from net proceeds: Population-45 %, SC/ST pop.-10 %, inadequacy of civic services-30 %, additional resource mobilisation efforts as compared to previous year-15 %
15	Delhi		Share from tax revenue: Population-70 %, area-30 %

Source: State Finance Commission Reports and Action Taken Reports.

### 3.2.1 Actions Taken and Implementation Status

It is noted that the criteria identified and weightages assigned by the first Finance Commission of various states have been accepted either fully or with modifications by the state governments of Andhra Pradesh, Assam, Goa, Tamil Nadu, Tripura, Uttaranchal and Uttar Pradesh. In Andhra Pradesh, these have been accepted with modification, where a marginal change in weightage and parameters has been recommended. In Goa, these have been accepted partly and it is suggested that more weightage should be given to backwardness criterion as compared to population. In Kerala, this is not accepted and a simpler formula is recommended. Information on the status of implementation shows that in Rajasthan, funds are being distributed among ULBs as per the recommended criteria and weightages.

Available information on the actions taken on the recommendations of the second SFC with respect to criteria and weightages shows that this has been accepted in the states of Rajasthan, Uttar Pradesh and Delhi. Tamil Nadu government has not accepted the horizontal distribution among various tiers of ULBs and has instead recommended for new criteria and weightages – Population (40 %), Women Population (40 %), and SC/ST Population including Slum Population (20 %).

## **4 MEASURES TO IMPROVE THE FINANCIAL CONDITION OF MUNICIPALITIES**

The basic objective of constituting a Finance Commission in every State of the country is to ensure that the financial condition of ULBs is reviewed/monitored on a regular basis and measures are suggested for improving their overall financial condition. On the basis of a detailed assessment of the first and second SFC reports of various states, this study identifies the following four areas on which the financial recommendations have been made:

- Revenue sharing
- Taxes, non-taxes, assigned revenues and compensations
- Grants-in-aid
- Other financial measures

Information on revenue sharing between the state government and local bodies is provided in Chapter 3 of this report. In the following sub-sections, the status on the other areas is presented.

### **4.1 TAXES, NON-TAXES, ASSIGNED REVENUES AND COMPENSATIONS**

It is noted that reforms have been recommended by the various SFCs in respect of property tax, profession tax, entertainment tax, user charges, and motor vehicle tax. Suggestions have also been made in respect of octroi, education cess, tax on consumption of electricity, licence fees, advertisement tax, sanitation/scavenging tax, etc. (Table 4.1). Information on recommendations, actions taken and the status of implementation with respect to the above-mentioned areas is given below.

**Table 4.1 Recommendations on Taxes, Non-Taxes, Assigned Revenues and Compensations to Municipalities**

S. No.	State/UT	Profession Tax	Property Tax	Octroi Compensation	Octroi	Motor Vehicle Tax Compensation	Motor Vehicle Tax	Entertainment Tax	Education Cess	Tax on Consumption of Electricity	Licence Fees	Advertisement Tax	User Charges	Sanitation/ Scavenging Tax
1	Andhra Pradesh													
2	Assam													
3	Bihar													
4	Goa													
5	Gujarat													
6	Haryana													
7	Himachal Pradesh													
8	Karnataka													
9	Kerala													
10	Madhya Pradesh													
11	Maharashtra													
12	Manipur													
13	Orissa													
14	Punjab													
15	Rajasthan													
16	Sikkim													
17	Tamil Nadu													
18	Tripura													
19	Uttaranchal													
20	Uttar Pradesh													
21	West Bengal													
22	A & N Is.													
23	Daman & Diu													
24	Delhi													
25	Pondicherry													

Note: Shade in the table denotes that a recommendation has been made by the first/second SFC in respect of a particular item.

#### **4.1.1 Property Tax**

An assessment of recommendations on property tax point out that in most states emphasis is given on the following:

- Reforming the assessment procedure;
- Regular revision of property tax rates/annual rental value (ARV);
- Regular assessment of properties;
- De-linking of property tax from rental value;
- Adoption of area-based method for assessment of ARV;
- Adoption of a simple and transparent procedure for property tax assessment;
- Adoption of the concept of self-assessment of property tax.

##### **4.1.1.1 *Actions Taken and Implementation Status***

It is noted that the state governments have generally accepted recommendations on property tax reforms. In Assam, the recommendation on PT assessment every five years has been accepted. It is learnt that such assessment is done by part-time assessors and there are only three full-time valuation officers. Sometimes the quinquennial assessment of ULBs are delayed due to frequent transfer of part-time assessors. In Kerala, necessary revisions have been made in the Municipal Act regarding revision of tax every four years. In Punjab, provisions have been made in Punjab Municipal Bill, 1999 to de-link property tax. However, no decision has been taken by the government to compensate ULBs for loss of revenue due to exemptions granted by the state government. In Rajasthan, simplification of assessment procedure is in process. In Andhra Pradesh, it is suggested that loss in revenue to ULBs from property tax exempted properties may be compensated by a corresponding increase in grant-in-aid and not by enhancing the amount of compensation by the state government. Further, it is mentioned that a review of exempted properties should be undertaken to limit only non-profitable and charitable institutions. The Uttar Pradesh government has decided to withhold a part of SFC devolution in the case of ULBs failing to revise



PT rates. Other decisions taken by the UP state government on second SFC recommendations include adoption of GIS technology and conduct of periodic surveys for enumeration of properties.

#### **4.1.2 Profession Tax**

Recommendations on profession tax relate to its appropriate sharing with the ULBs and its levy on various professions, such as traders, employees of certain establishments, etc. This is noted in the case of Andhra Pradesh, Gujarat, Madhya Pradesh, Maharashtra, Orissa, Punjab, Sikkim and Delhi. In Kerala, it is suggested that the rate of profession tax is to be made uniform in local bodies and that the rates are to be rationalized. The Finance Commission of Tamil Nadu has specified that immediate steps should be taken by ULBs towards (profession) tax mapping of all categories of assesses. In the case of Pondicherry, it is mentioned that the maximum limit of profession tax should be increased and that the government should make suitable amendments in the Act.

##### **4.1.2.1 *Actions Taken and Implementation Status***

The recommendations in respect of profession tax have been accepted by most states as per the available information. In Kerala, the suggestion on a reduction in the number of slabs and the rationalization of rates has been accepted, however, new slabs have not been notified for ULBs. In Punjab, tax on professions, individuals, traders, commission agents and shopkeepers, has still not been levied. Moreover, the power to fix rates of local taxes continues to remain with the state government. In Pondicherry, action is being taken to amend the local bodies Act with respect to increasing the maximum limit of profession tax. Andhra Pradesh is the only state where the recommendation of transferring a higher share of profession tax from state government to local bodies has not been accepted. This is due to the reason that grant-in-aid is already recommended for carrying out infrastructure development. However, recommendations on criteria for allocation of profession tax to ULBs and the collection of this tax from small traders, employees of certain establishments

(such as TB Sanatorium, etc.) have been accepted by the state government of Andhra Pradesh.

#### **4.1.3 Entertainment Tax**

Entertainment tax is discussed in terms of its sharing with ULBs and the system followed in collection. For example, in Gujarat, Haryana and Uttar Pradesh, it is recommended that 50 per cent of the amount recovered (or the net proceeds) from this tax is to be paid to ULBs. The Finance Commission of Maharashtra suggests a revision in the proportion shared with the ULBs. Rajasthan Finance Commission suggests that the entire net proceeds of entertainment tax are to be transferred to ULBs. In Sikkim, emphasis is given on increase in the proportion to be shared and on modification of the collection system. In respect of Tamil Nadu and West Bengal, it is recommended that benefits from this tax are to be given to local bodies. The Madhya Pradesh second SFC recommends that net revenue from entertainment tax may be included in the list of assigned taxes.

Other recommendations in respect of entertainment tax include: merging of entertainment tax and additional entertainment tax into a single item in Kerala; and assessment of the amount collected on account of compounding the surcharge on entertainment tax in Orissa.

##### **4.1.3.1 *Actions Taken and Implementation Status***

A review of information on actions taken and implementation status reveals that in most states, recommendations on entertainment tax have been either accepted fully or with minor modifications. For instance, in Haryana, instead of the recommended 50 per cent, only 25 per cent of net proceeds are accepted for transfer to the ULBs, and it is reported that this share has been transferred. In Kerala, the recommendation on merging entertainment tax and additional entertainment tax has been accepted and implemented. In Tamil Nadu, the recommendations on transfer of benefits from entertainment tax and assignment of 90 per cent of total realizations of this compounded tax to local bodies have

been accepted. West Bengal government has accepted to hand over this tax (collected by state) to local bodies however, at the time of collection of data from the state, it was learnt that no action had been taken. It is observed that though almost the entire amount of fund collected on this account is being given to local bodies, this tax has neither been assigned to them, nor they have been given any discretionary powers for fixing the rates. The main reason for this is that the state government already had elaborate machinery for collection of this tax, which would become redundant. Hence, it is suggested that the arrangement of sharing of this tax should be continued. In Madhya Pradesh, the recommendation on inclusion of entertainment tax in the list of assigned taxes has not been accepted by the state government.

#### **4.1.4 User Charges**

User charges have emerged as an important component, which can contribute significantly to the finances of ULBs. Emphasis is being given on: the levy of these charges; revision of charges; differential rates and metered supply in respect of water supply; and billing improvements. These suggestions have been noted in the case of Assam, Haryana, Kerala, Maharashtra, Punjab, Uttar Pradesh and West Bengal. The Finance Commission of Maharashtra adds that user charges and fees should be commensurate with the cost of providing the service. The Punjab Finance Commission suggests that ULBs should take necessary steps to improve recovery from user charges. In Uttar Pradesh, metering of domestic water supply and revision of rates is recommended. In West Bengal, it is suggested that: special conservancy charges for commercial and industrial establishments should be introduced; differential rates and fees levied by ULBs should be revised; and user charges and service charges should be levied by all ULBs. The second finance commission of Andaman and Nicobar Islands and Daman and Diu recommends that user charges should be levied on all measurable services of private goods nature.

#### **4.1.4.1 Actions Taken and Implementation Status**

On the basis of a review of available information, it may be mentioned that suggestions on user charges have been accepted in the states of Assam, Kerala, Madhya Pradesh, Punjab, and Uttar Pradesh. The Madhya Pradesh government has accepted the recommendation that the cost of public utility services should be recovered by charging appropriate fees from the users of services. In Punjab, action is being taken to provide metered water supply and to revise water rates and sewer charges. It is also noted that privatization in the operation of water supply has been partially introduced in some ULBs. However, no decision has been taken on linking of water rate with power tariff. In Uttar Pradesh, the urban development department has taken steps to revise water rates.

## **4.2 GRANTS-IN-AID**

Grants are an important source of income of ULBs. It is learnt that the share of grants in the total income of ULBs is as much as 80 per cent in majority of the ULBs in India. In a few states, the system of grants-in-aid has been discontinued due to various problems, and is replaced by a system of global sharing of state revenues. However, grants-in-aid are still the most common practice in most states. This is evident from the fact that recommendations on grants-in-aid have been made by the Finance Commissions of various states (Table 4.2). A review of available information shows that recommendations have been made in respect of the Tenth/Eleventh Finance Commission grants, compensatory grants in lieu of octroi (or any other taxes), per capita grant, salary, pension, roads, maintenance, slum improvement, tourism development, computerization, etc.

Suggestions on grants-in-aid generally relate to: increase in grants; full transfer of grants; linking of grants to performance of ULBs; criteria for full release of grants; discontinuance of some grants; appropriate utilization of grants; and release of grants to weak ULBs.

Table 4.2 Recommendations on Grants-in-aid to Municipalities

S. No.	State/UT	Per Capita Grant	Salary	Pension	10 <sup>th</sup> Finance Commission Grant	11 <sup>th</sup> Finance Commission Grant	Roads	Non-agricultural Land Assessment	Agriculture to Non-agriculture Conversion Tax	Compensatory Grants in lieu of Octroi, any other Taxes	Maintenance Grant	Slum Improvement	Tourism Development	Computerisation /IT
1	Andhra Pradesh													
2	Assam													
3	Bihar													
4	Goa													
5	Gujarat													
6	Haryana													
7	Himachal Pradesh													
8	Karnataka													
9	Kerala													
10	Madhya Pradesh													
11	Maharashtra													
12	Manipur													
13	Orissa													
14	Punjab													
15	Rajasthan													
16	Sikkim													
17	Tamil Nadu													
18	Tripura													
19	Uttaranchal													
20	Uttar Pradesh													
21	West Bengal													
22	A & N Is.													
23	Daman & Diu													
24	Delhi													
25	Pondicherry													

Note: Shade in the table denotes that a recommendation has been made by the first/second SFC in respect of a particular item.

#### **4.2.1 Actions Taken and Implementation Status**

In Andhra Pradesh, the suggestion to increase the per capita grant to ULBs has been accepted in view of the increasing costs of materials required for undertaking development activities. The recommendation to sanction additional grant for newly constituted municipalities has been accepted, however, no action has been taken. In the case of corporations, it is rejected since the same is not considered as an area of priority concern. Release of grants based on performance of ULBs is accepted, however, the matter is under consideration. In Assam, the state government has accepted the SFC recommendation on payment of grants-in-aid to the local bodies for implementing the development programmes of core subjects within the jurisdiction of each local body. Further, the grants-in-aid under award of the tenth finance commission was released to the ULBs. The Assam ATR, however, shows that of the total allocation, only one-fourth was sanctioned and released. In Gujarat, it is suggested that grants-in-aid given for motor vehicle tax should be discontinued. This recommendation has been accepted and it is mentioned that the powers will be delegated to ULBs for imposing a lifetime tax on vehicles in consultation with the Transport Department. Some suggestions which have not been accepted relate to: transfer of a proportion of conversion tax to ULBs; continuance of the existing practice of land revenue recovery from agricultural land; and increase in the rate of local cess and irrigation cess.

In Haryana, the recommendation on transfer of tenth/eleventh finance commission grants has been accepted, but the grant has been partly released. In Himachal Pradesh, the recommendation on transfer of grants in lieu of octroi has been accepted with modification and it is suggested that there should be a source transfer by clubbing octroi grant. In Kerala, the recommendation on giving rights to local bodies to decide on the application of non-plan grants according to their own priority and needs has been accepted and implemented. However, suggestions on non-statutory non-plan grants and on maintenance grant have

not been accepted. In respect of the former, it is mentioned that the state government is already meeting the establishment expenditure regarding the staff transferred to local bodies. In the case of the latter, it is stated that the financial condition of the state government does not allow for this change. The second Madhya Pradesh finance commission that most grants-in-aid may be in the nature of general-purpose grants, has not been accepted by the state government due to the reason that the grant given by the state government is adequately flexible. In Punjab, the recommendation on providing financial assistance (by way of per capita grants-in-aid) to weak ULBs has been accepted, but such grants have not been given to them. In Rajasthan, most recommendations on grants to ULBs have been accepted. Further, information on implementation status shows that the state government has already issued orders and the amount is being distributed. In Tripura, the proposal on devolving Rs. 7 crore to ULBs as grants-in-aid by the state government from the consolidated fund with 15 per cent progression per year in subsequent years has been accepted and it is specified that grants-in-aid may be provided @ Rs. 200/- per capita, to be worked out on the basis of population of ULBs. In Uttar Pradesh, the first SFC recommendation on the criteria for distribution of the tenth finance commission grant has been accepted. The second finance commission of UP has discouraged the use of grants-in-aid as a general means of transfer to local bodies, except in exceptional circumstances. In West Bengal, the state government has accepted the SFC recommendations on grants-in-aid to local bodies. In Andaman and Nicobar Islands and in Daman and Diu, the recommendation on devolving a fixed grant of Rs. 5 lakhs to local bodies has been accepted. In Pondicherry, recommendations on a lump sum compensation grant (due to non-revision of property tax rates) and payment of compensatory grant to local bodies (due to abolition of tolls and vehicle tax on motor vehicles) have not been accepted.

### **4.3 OTHER FINANCIAL MEASURES**

Besides the above-mentioned reforms, a series of measures have been recommended to improve the financial condition of ULBs. Significant among these are: regular revision of service tax rates/user charges; efficient pricing and cost recovery; additional resource mobilization; pooling of resources/creation of an urban development fund; establishment of an urban development finance corporation; revision of budget formats/auditing and maintenance of accounts; etc. (Table 4.3).

#### **4.3.1 Actions Taken and Implementation Status**

Information on actions taken and implementation status is available on a select number of states. In Andhra Pradesh, certain internal and external measures are recommended. An interesting observation is that the suggestion on preventing the government from taking decisions on matters related to taxation has been accepted. In Assam, the state government has accepted the recommendation on maintenance of registers and forms for proper accounts and records. It is learnt that necessary steps are being taken. In Goa, the state government has accepted that local bodies should make an effort towards additional resource mobilization in order to improve the level of basic services and pace of development. In Gujarat, most recommendations falling in this category have been accepted. Some of these are concerned with: depositing a proportion of tax by ULBs for improving basic facilities; transfer of a proportion of funds to local bodies by the District Planning Boards and the criteria for distribution among each type of local body; control over the borrowing powers of ULBs and a periodic review of outstanding dues; rebate on interest to ULBs repaying loan on time; increase in per capita grant (tenth Finance Commission) to local bodies, due to increase in population; and review of tax demand by relevant authorities. In Haryana, the waiver of outstanding amount against ULBs has been accepted and implemented.



**Table 4.3 Recommendations on Additional Measures to Improve the Financial Condition of Municipalities**

S. No	State/UT	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
1	Andhra Pr.																			
2	Assam																			
3	Bihar																			
4	Goa																			
5	Gujarat																			
6	Haryana																			
7	Himachal Pr.																			
8	Karnataka																			
9	Kerala																			
10	Madhya Pr.																			
11	Maharashtra																			
12	Manipur																			
13	Orissa																			
14	Punjab																			
15	Rajasthan																			
16	Sikkim																			
17	Tamil Nadu																			
18	Tripura																			
19	Uttaranchal																			
20	Uttar Pradesh																			
21	West Bengal																			
22	A & N Is.																			
23	Daman & Diu																			
24	Delhi																			
25	Pondicherry																			

Note: Shade in the table denotes that a recommendation has been made by the first/second SFC in respect of a particular item/head.

Heads:

1. No government intervention in tax-related matters.
2. Regular revision of service tax rates, user charges, fees.
3. Reforms in property tax assessment.
4. Vacant land tax.
5. User charges for all services.
6. Additional resource mobilization.
7. Pooling of resources/development of urban (infrastructure) development fund/incentive fund/common purpose fund.
8. State control over borrowing powers of urban local bodies.
9. Outstanding amount to be waived off/paid by state government.
10. Release of grants to be linked to performance.
11. All taxes listed in Statute to be levied.
12. Utilisation of grants by urban local bodies to be properly monitored.
13. No deductions from funds devolved to urban local bodies.
14. Establishment of Urban Development Finance Corporation.
15. Development of internal rating system in respect of loans and guarantees.
16. Revision of budget formats/auditing and maintenance of accounts.
17. Issuance of tax-free municipal bonds.
18. Adoption of accrual based double entry accounting system.
19. Conversion of all loans into grants.

In Himachal Pradesh, the recommendation on raising resources by ULBs, which are exclusively their responsibility, has been accepted, but it is learnt that the local bodies have not shown adequate sincerity towards resource mobilization. Regarding the fixation of rates in respect of taxes and levies, the state government has notified the limits of rates. Further, steps have been taken to decentralize fiscal powers and to give more autonomy to ULBs for collection and levy of taxes, however, it is learnt that some ULBs are still resisting from imposition of house tax. In respect of loans, the state government has given permission to ULBs to negotiate for loans.

In Kerala, the proposal on making central government properties liable for property/building tax has been rejected by the eleventh Finance Commission. Other recommendations related to: replacement of the policy of fixed rates; fixation of minimum rates; distribution of central finance commission grant to ULBs on a per capita basis; creation of an urban pool, etc., have been accepted. Information on the status of implementation shows that in respect of some items mentioned above: rules and byelaws are yet to be issued; and only a rural pool has been created. In Madhya Pradesh, the proposal on creation of an urban infrastructure development fund has been rejected. In Punjab, the recommendation on creation of an incentive fund for local bodies has been accepted. In Rajasthan, recommendations have been made on: development of a system for mid-term appraisal of municipal finance; levy of taxes on those sectors (namely markets, health institutions, restaurants, other commercial and industrial establishments) which strain municipal services; revision of rates of fines; penalties, charges, fees, etc., by state government and ULBs; review of revenue efforts of most ULBs; and maintenance of accounts and audit of ULBs. The state government has accepted these recommendations.

In Tamil Nadu, the suggestion on creation of an equalization fund and an incentive fund has been accepted. In Tripura, the recommendation on a regular auditing of accounts of ULBs has been accepted. Accepted recommendations on

strengthening municipal finances in Uttar Pradesh include: initiation of a special drive by ULBs for recovery of dues and ensuring liquidation of their outstanding liabilities; conversion of loans in respect of certain schemes into grants; common format for budget estimates; assigning responsibility of audit of accounts of ULBs to the Accountant General; release of funds to ULBs on the basis of their performance; and amendments in Municipal Acts in order to enable ULBs to levy various taxes. The recommendation on setting up of a corporation for leveraging funds and subsidizing interest rate on non-remunerative schemes has not been accepted. Regarding the establishment of an urban infrastructure development fund, it is recommended that this fund should be financed by private financial institutions and not by the state government. In West Bengal, recommendations on strengthening the financial condition of local bodies by improving recovery from own sources have been accepted. In Delhi, the government has accepted recommendations on: additional resource mobilization by ULBs (i.e., MCD and NDMC); and consolidation of MCD loan into a single loan of 20-year duration. However, the suggestion to monitor the utilization of fund provided for operation and maintenance expenditure of existing assets of MCD has not been accepted. In respect of the second SFC recommendation, it is noted that the Delhi government has accepted an incentive payment for ULBs, which is equivalent to 2 per cent of the collection from new taxes. Another recommendation accepted pertains to the creation of a municipal reform fund by the government for extending financial support to ULBs.

## **5 OTHER MEASURES TO STRENGTHEN MUNICIPAL GOVERNANCE**

The Finance Commissions of various states have also given attention to several non-financial matters. This is due to the realisation that problems of finance cannot be resolved without reforming the overall system of municipal governance. The prominent recommendations in this respect are: devolution of funds, functions, functionaries and powers; monitoring and review of State Finance Commission recommendations; development and maintenance of a data base on municipal finance; conduct of studies on various municipal aspects; promotion of participatory practices; organisation of training programmes; etc. (Table 5.1). Information on these recommendations, the actions taken and implementation status is given below.

### **5.1 DEVOLUTION OF FUNDS, FUNCTIONS, FUNCTIONARIES AND POWERS**

The Finance Commissions of Andhra Pradesh, Gujarat, Orissa, Rajasthan, Tamil Nadu, Uttaranchal and Uttar Pradesh have given importance to devolution of functions, functionaries and powers along with a transfer of funds. In Andhra Pradesh, the state Government has accepted the recommendation, but it is pointed out that this cannot be implemented immediately, since the quantum of financial devolution has to be examined carefully in relation to the delegation of functions. In the SFC Report of Rajasthan, it is mentioned that the recommendation has been accepted and implemented. In Uttar Pradesh, the recommendation on devolution of powers to ULBs for the purpose of discharging responsibilities marked for them in the twelfth schedule of the constitution has been rejected.

**Table 5.1 Recommendations on Strengthening Municipal Governance**

S. No	State/UT	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	
1	Andhra Pr.																				
2	Assam																				
3	Bihar																				
4	Goa																				
5	Gujarat																				
6	Haryana																				
7	Himachal Pr.																				
8	Karnataka																				
9	Kerala																				
10	Madhya Pr.																				
11	Maharashtra																				
12	Manipur																				
13	Orissa																				
14	Punjab																				
15	Rajasthan																				
16	Sikkim																				
17	Tamil Nadu																				
18	Tripura																				
19	Uttaranchal																				
20	Uttar Pradesh																				
21	West Bengal																				
22	A & N Is.																				
23	Daman & Diu																				
24	Delhi																				
25	Pondicherry																				

Note: Shade in the table denotes that a recommendation has been made by the first/second SFC in respect of a particular item/head.

Heads:

1. Formulation of model plans to estimate financial requirements of urban local bodies.
2. Devolution of funds, functionaries and powers.
3. Monitor and review of SFC recommendations.
4. Development and maintenance of database.
5. Constitution of committee to review flow of funds.
6. Constitution of Tariff Commission.
7. Conduct of study on municipal finance/organisational structure of local bodies on a regular basis.
8. Steps to be taken to prevent misuse of powers and to ensure autonomy, accountability and transparency at local level.
9. Promotion of privatisation/community participation.
10. Extension of the term of Mayor/President.
11. Development of a Management Information System/computerization of data.
12. Organisation of training programmes/human resource management/constitution of administrative reforms commission.
13. Asset management.
14. Common legislation for all urban local bodies/amendments to municipal Act.
15. Constitution of a Valuation Authority.
16. Compulsory performance of obligatory duties.
17. Simplification of municipal Act provisions.
18. Separate legislation for urban local bodies.
19. Establishment of a permanent finance commission division/immediate creation of the next SFC cell.

## **5.2 MONITORING AND REVIEW OF SFC RECOMMENDATIONS**

The SFCs of Andhra Pradesh, Assam, Himachal Pradesh, Kerala, Punjab and Rajasthan have suggested for the **monitoring and review of their recommendations** by the state governments concerned. This recommendation has been accepted by the state governments of Andhra Pradesh, Himachal Pradesh and Punjab. Kerala Government has taken steps to constitute a special cell in the Finance Department for this purpose and it is further recommended that the cell should be revamped and assigned the task of regular monitoring of finances. In Uttar Pradesh, the state government has not accepted the second SFC recommendation on reconstitution and strengthening of the SFC cell.

## **5.3 DEVELOPMENT AND MAINTENANCE OF DATABASE ON MUNICIPAL FINANCE**

In the states of Assam, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Tripura and Uttar Pradesh, the development and maintenance of a database on municipal finance is recommended. In addition, emphasis is also given on development of a Management Information System/Computerisation of data in the states of Haryana, Punjab, Rajasthan and Uttaranchal. As per the SFC reports and ATRs, some progress has been achieved, however, much remains to be done. In Delhi, the recommendation on computerisation of public dealing departments has not been accepted, since there already exists a plan scheme for the purpose. In Andaman and Nicobar Islands and in Daman and Diu, emphasis is given on a periodic revision and updating of data in order to determine the size of the tax base.

## **5.4 CONDUCT OF STUDIES ON VARIOUS MUNICIPAL ASPECTS**

Conduct of detailed studies on the finances of local bodies (covering areas such as tax potential, sources of additional resource mobilisation, tax structures, user charges, cess, etc), their organisational structure, etc., is recommended by the Finance Commissions of Goa, Himachal Pradesh, Kerala, Rajasthan and Uttar Pradesh. The State Governments of Goa and Rajasthan have accepted the

suggestion, however, adequate information is not available on the implementation status.

### **5.5 PROMOTION OF PARTICIPATORY PRACTICES**

Participation of the community and the private sector, especially in the delivery of urban services is being emphasised in the states of Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. The information on Rajasthan reveals that in Jaipur and Kota, non-government organisations have been involved in urban services delivery. In Uttar Pradesh, decisions have been taken on providing civic services on contract basis and to promote citizen participation. In Delhi, recommendations on contracting out selected services to the private sector and for downsizing of workforce are being referred for action to both MCD and NDMC.

### **5.6 ORGANISATION OF TRAINING PROGRAMS**

In a number of states, it is recommended that training programmes for municipal officials and non-officials (i.e., elected representatives) should be organised to improve their efficiency and attitude, and that such training should be imparted by technical, non-profit and autonomous institutions. This suggestion is accepted in the states of Haryana, Karnataka, Maharashtra, Manipur, Orissa, Rajasthan, Tamil Nadu, Uttaranchal and Uttar Pradesh.

## **6 CONCLUSION**

In this study an attempt has been made to review the actions taken by the state governments on the recommendations of the first and the second SFCs and to examine the current status on the implementation of SFC recommendations. This exercise has involved classification of key recommendations into three broad categories – accepted, not accepted and under consideration. Information on compilation and classification of key SFC recommendations is provided in Vol. II of this report. Further, the study provides information on the steps taken by the state governments after accepting recommendations and the key reasons for non-acceptance of some recommendations.

The main conclusions drawn from a review of available information are discussed in the following sub-sections:

### **6.1 FORMAT OF SFC REPORTS AND ACTION TAKEN REPORTS**

The format of SFC and ATRs differs from state to state. Although the SFCs were guided by the terms of reference given to them by the state governments, there are differences in the organisation of reports. For instance, in some reports, a clear-cut listing (or summary) of recommendations and a proper classification of recommendations for PRIs/rural areas, ULBs/urban areas, state governments, etc., has not been provided. This has created difficulties in estimating the total number of recommendations (see Table 2.1). Regarding the quality of the ATRs, it may be stated that adequate information on the actions taken and implementation status of recommendations is not provided. It is also observed that in some ATRs, the number of recommendations do not tally with those provided in the SFC reports (see Table 2.1 and 2.2). This implies that some recommendations given in the SFC reports have not been included in the ATRs. Due to these differences, an accurate assessment of the status of SFC



recommendations (i.e., proportion of recommendations accepted, not accepted) could not be worked out (see Table 2.2). This is perhaps the main limitation of the study.

## **6.2 DIFFERENCES IN THE RECOMMENDATIONS MADE BY THE FIRST AND THE SECOND SFCs**

Differences in the first and second state finance commission recommendations exist in the number of recommendations, their nature, and the approach adopted by the various commissions. From a review of the second SFC reports, it is observed that in some states, the total number of recommendations has gone down as compared to the first SFC reports, whereas in many others, numbers have increased (see Table 2.1). In Tamil Nadu, Uttar Pradesh and Delhi, for example, there has been a drastic change in the number of recommendations. Regarding the approach adopted by the commissions for the devolution of funds to local bodies, the main observation is that global sharing of state revenues is increasingly being accepted as a strategy to strengthen the financial condition of local bodies (see Table 3.1). It is learnt that a larger number of states/UTs are adopting this strategy. With respect to the nature of recommendations, it is observed that the general pattern is that the second SFC recommendations are more focused and specific. However, there are still some reports, which contain very general recommendations (see for example the second SFC recommendations of Uttar Pradesh given in Vol. II of this report).

## **6.3 NUMBER OF RECOMMENDATIONS: INTER-STATE AND RURAL-URBAN DIFFERENCES**

In respect of the first SFC, it is noted that the two states of Tamil Nadu and Maharashtra show the maximum number of total recommendations. The total number of recommendations is also high for Andhra Pradesh, Punjab, Rajasthan and Uttar Pradesh. States/UTs with a low number of recommendations include Assam, Manipur, Sikkim, Uttarakhand, Delhi and Pondicherry. Further, it is observed that the emphasis on rural and urban areas varies from state to state.

For example, emphasis on urban areas vis-à-vis rural areas is higher in the states of Maharashtra, Punjab, Rajasthan, Sikkim, Tamil Nadu and Uttar Pradesh.

The total number of recommendations in the second SFC reports is highest in the state of Uttar Pradesh, followed by Tamil Nadu, Punjab, Madhya Pradesh, and Andhra Pradesh, and low in Karnataka, West Bengal and Daman and Diu. Further, the emphasis on urban areas is higher in Madhya Pradesh, Punjab, Tamil Nadu, Uttar Pradesh, West Bengal and Daman and Diu (see Table 2.1).

#### **6.4 EMPHASIS ON FINANCIAL AND NON-FINANCIAL MATTERS**

Most of the recommendations put forward by the Finance Commissions of various states pertain to the financial aspects of municipal governance. In addition to the financial recommendations, emphasis has also been given to several non-financial matters, such as: devolution of functions, functionaries, and powers along with a transfer of funds; monitoring and review of SFC recommendations; development and maintenance of a database on municipal finance; conduct of studies on various municipal aspects; promotion of participatory practices; organisation of training programmes; formulation of model plans; development of a Management Information System/computerisation of data; asset management; simplification of municipal Act provisions; etc. (see Table 5.1 and Chapter 5 for more details).

#### **6.5 KEY AREAS OF RECOMMENDATIONS**

On the basis of a comprehensive review of SFC recommendations, it may be stated that there are six key areas on which the recommendations have been made, namely: (i) Revenue sharing between state and municipalities/local bodies; (ii) Criteria for distribution of funds between municipalities; (iii) Taxes, non-taxes, assigned revenues and compensations to municipalities; (iv) Grants-in-aid to municipalities; (v) Other measures to improve the financial condition of municipalities; and (vi) Other measures for strengthening municipal governance.

## **6.6 STATUS OF ACTIONS TAKEN ON KEY SFC RECOMMENDATIONS**

The study confirms the fact that actions are being taken in a number of states on the SFC recommendations. The state governments have accepted most of the recommendations fully, partly or in a modified form. There are, however, a few recommendations which have either not been accepted or are under consideration. The decision to accept or reject a recommendation lies with the state government and is based on a number of factors, such as the financial condition of the state/local government, priority areas of concern, etc.

An important objective of this study was to examine the current status on the implementation of the SFC recommendations. Chapters 3, 4 and 5 throw light on this aspect. It may, however, be stated that this information is available for a select number of states. Some important conclusions drawn from a review of available information have been summarised below.

### **6.6.1 Revenue Sharing between State and Municipalities**

The recommendation on 'Global Sharing of State Revenues' has been accepted by most State Governments (see Table 3.1). However, it is learnt that in some states, the recommended share has been either partly devolved or is yet to be devolved. This is true in the case of Andhra Pradesh and West Bengal. In Tamil Nadu, the State Government has frozen the percentage for all the five years owing to resource crunch. In the states of Goa and Kerala, where reforms have been suggested in the traditional practices, the recommendation on devolution of plan/non-plan grants have not been accepted due to the fact that the States' own tax resource base is under pressure. In Punjab, the recommendation on devolution of 20 per cent of the net proceeds of five taxes has been accepted, however, transfers to local bodies have been less than the recommended share. Thus, compliance on revenue sharing by the states is a debatable issue and necessary steps are required to be taken in this regard.

### **6.6.2 Criteria for Distribution of Funds between Municipalities**

It is noted that the criteria identified and weightages assigned by the first Finance Commission of various states have been accepted either fully or with modifications by the state governments of Andhra Pradesh, Assam, Goa, Tamil Nadu, Tripura, Uttaranchal and Uttar Pradesh. In Andhra Pradesh, these have been accepted with modification, where a marginal change in weightage and parameters has been recommended. In Goa, these have been accepted partly and it is suggested that more weightage should be given to backwardness criterion as compared to population. In Kerala, this is not accepted and a simpler formula is recommended. Information on the status of implementation shows that in Rajasthan, funds are being distributed among ULBs as per the recommended criteria and weightages.

Available information on the actions taken on the recommendations of the second SFC with respect to criteria and weightages shows that this has been accepted in the states of Rajasthan, Uttar Pradesh and Delhi. Tamil Nadu government has not accepted the horizontal distribution among various tiers of ULBs and has instead recommended for new criteria and weightages – Population (40 %), Women Population (40 %), and SC/ST Population including Slum Population (20 %).

### **6.6.3 Taxes, Non-taxes, Assigned Revenues and Compensations**

State governments have generally accepted recommendations on **property tax** reforms. In Assam, the recommendation on PT assessment every five years has been accepted. It is learnt that such assessment is done by part-time assessors and there are only three full-time valuation officers. Sometimes the quinquennial assessment of ULBs is delayed due to frequent transfer of part-time assessors. In Kerala, necessary revisions have been made in the Municipal Act regarding revision of tax every four years. In Punjab, provisions have been made in Punjab Municipal Bill, 1999 to de-link property tax. However, no decision has been taken by the government to compensate ULBs for loss of revenue due

to exemptions granted by the state government. In Rajasthan, simplification of assessment procedure is in process. In Andhra Pradesh, it is suggested that loss in revenue to ULBs from property tax exempted properties may be compensated by a corresponding increase in grant-in-aid and not by enhancing the amount of compensation by the state government. Further, it is mentioned that a review of exempted properties should be undertaken to limit only non-profitable and charitable institutions. The Uttar Pradesh government has decided to withhold a part of SFC devolution in the case of ULBs failing to revise PT rates. Other decisions taken by the UP state government on second SFC recommendations include adoption of GIS technology and conduct of periodic surveys for enumeration of properties.

The recommendations in respect of **profession tax** have been accepted by most states as per available information. In Kerala, the suggestion on a reduction in the number of slabs and the rationalization of rates has been accepted, however, new slabs have not been notified for ULBs. In Punjab, tax on professions, individuals, traders, commission agents and shopkeepers, has still not been levied. Moreover, the power to fix rates of local taxes continues to remain with the state government. In Pondicherry, action is being taken to amend the local bodies Act with respect to increasing the maximum limit of profession tax. Andhra Pradesh is the only state where the recommendation of transferring a higher share of profession tax from state government to local bodies has not been accepted. This is due to the reason that grant-in-aid is already recommended for carrying out infrastructure development. However, recommendations on criteria for allocation of profession tax to ULBs and the collection of this tax from small traders, employees of certain establishments (such as TB Sanatorium, etc.) have been accepted by the state government of Andhra Pradesh.

Recommendations on **entertainment tax** have been either accepted fully or with minor modifications. For instance, in Haryana, instead of the recommended 50 per cent, only 25 per cent of net proceeds are accepted for transfer to the ULBs,

and it is reported that this share has been transferred. In Kerala, the recommendation on merging entertainment tax and additional entertainment tax has been accepted and implemented. In Tamil Nadu, the recommendations on transfer of benefits from entertainment tax and assignment of 90 per cent of total realizations of this compounded tax to local bodies have been accepted. West Bengal government has accepted to hand over this tax (collected by state) to local bodies however, at the time of collection of data from the state, it was learnt that no action had been taken. It is observed that though almost the entire amount of fund collected on this account is being given to local bodies, this tax has neither been assigned to them, nor they have been given any discretionary powers for fixing the rates. The main reason for this is that the state government already had elaborate machinery for collection of this tax, which would become redundant. Hence, it is suggested that the arrangement of sharing of this tax should be continued. In Madhya Pradesh, the recommendation on inclusion of entertainment tax in the list of assigned taxes has not been accepted by the state government.

Suggestions on **user charges** have been accepted in the states of Assam, Kerala, Madhya Pradesh, Punjab, and Uttar Pradesh. The Madhya Pradesh government has accepted the recommendation that the cost of public utility services should be recovered by charging appropriate fees from the users of services. In Punjab, action is being taken to provide metered water supply and to revise water rates and sewer charges. It is also noted that privatisation in the operation of water supply has been partially introduced in some ULBs. However, no decision has been taken on linking of water rate with power tariff. In Uttar Pradesh, the urban development department has taken steps to revise water rates.

#### **6.6.4 Grants-in-aid to Municipalities**

In Andhra Pradesh, the suggestion to increase the per capita grant to ULBs has been accepted in view of the increasing costs of materials required for

undertaking development activities. The recommendation to sanction additional grant for newly constituted municipalities has been accepted, however, no action has been taken. In the case of corporations, it is rejected since the same is not considered as an area of priority concern. Release of grants based on performance of ULBs is accepted, however, the matter is under consideration. In Assam, the state government has accepted the SFC recommendation on payment of grants-in-aid to the local bodies for implementing the development programmes of core subjects within the jurisdiction of each local body. Further, the grants-in-aid under award of the tenth finance commission was released to the ULBs. The Assam ATR, however, shows that of the total allocation, only one-fourth was sanctioned and released. In Gujarat, it is suggested that grants-in-aid given for motor vehicle tax should be discontinued. This recommendation has been accepted and it is mentioned that the powers will be delegated to ULBs for imposing a lifetime tax on vehicles in consultation with the Transport Department. Some suggestions which have not been accepted relate to: transfer of a proportion of conversion tax to ULBs; continuance of the existing practice of land revenue recovery from agricultural land; and increase in the rate of local cess and irrigation cess.

In Haryana, the recommendation on transfer of tenth/eleventh finance commission grants has been accepted, but the grant has been partly released. In Himachal Pradesh, the recommendation on transfer of grants in lieu of octroi has been accepted with modification and it is suggested that there should be a source transfer by clubbing octroi grant. In Kerala, the recommendation on giving rights to local bodies to decide on the application of non-plan grants according to their own priority and needs has been accepted and implemented. However, suggestions on non-statutory non-plan grants and on maintenance grant have not been accepted. In respect of the former, it is mentioned that the state government is already meeting the establishment expenditure regarding the staff transferred to local bodies. In the case of the latter, it is stated that the financial condition of the state government does not allow for this change. The second

Madhya Pradesh finance commission that most grants-in-aid may be in the nature of general-purpose grants, has not been accepted by the state government due to the reason that the grant given by the state government is adequately flexible. In Punjab, the recommendation on providing financial assistance (by way of per capita grants-in-aid) to weak ULBs has been accepted, but such grants have not been given to them. In Rajasthan, most recommendations on grants to ULBs have been accepted. Further, information on implementation status shows that the state government has already issued orders and the amount is being distributed. In Tripura, the proposal on devolving Rs. 7 crore to ULBs as grants-in-aid by the state government from the consolidated fund with 15 per cent progression per year in subsequent years has been accepted and it is specified that grants-in-aid may be provided @ Rs. 200/- per capita, to be worked out on the basis of population of ULBs. In Uttar Pradesh, the first SFC recommendation on the criteria for distribution of the tenth finance commission grant has been accepted. The second finance commission of UP has discouraged the use of grants-in-aid as a general means of transfer to local bodies, except in exceptional circumstances. In West Bengal, the state government has accepted the SFC recommendations on grants-in-aid to local bodies. In Andaman and Nicobar Islands and in Daman and Diu, the recommendation on devolving a fixed grant of Rs. 5 lakhs to local bodies has been accepted. In Pondicherry, recommendations on a lump sum compensation grant (due to non-revision of property tax rates) and payment of compensatory grant to local bodies (due to abolition of tolls and vehicle tax on motor vehicles) have not been accepted.

#### **6.6.5 Other Measures to Improve the Financial Condition of Municipalities**

In Andhra Pradesh, certain internal and external measures are recommended. An interesting observation is that the suggestion on preventing the government from taking decisions on matters related to taxation has been accepted. In Assam, the state government has accepted the recommendation on maintenance of registers and forms for proper accounts and records. It is learnt



that necessary steps are being taken. In Goa, the state government has accepted that local bodies should make an effort towards additional resource mobilization in order to improve the level of basic services and pace of development. In Gujarat, most recommendations falling in this category have been accepted. Some of these are concerned with: depositing a proportion of tax by ULBs for improving basic facilities; transfer of a proportion of funds to local bodies by the District Planning Boards and the criteria for distribution among each type of local body; control over the borrowing powers of ULBs and a periodic review of outstanding dues; rebate on interest to ULBs repaying loan on time; increase in per capita grant (tenth Finance Commission) to local bodies, due to increase in population; and review of tax demand by relevant authorities. In Haryana, the waiver of outstanding amount against ULBs has been accepted and implemented. In Himachal Pradesh, the recommendation on raising resources by ULBs, which are exclusively their responsibility, has been accepted, but it is learnt that the local bodies have not shown adequate sincerity towards resource mobilization. Regarding the fixation of rates in respect of taxes and levies, the state government has notified the limits of rates. Further, steps have been taken to decentralize fiscal powers and to give more autonomy to ULBs for collection and levy of taxes, however, it is learnt that some ULBs are still resisting from imposition of house tax. In respect of loans, the state government has given permission to ULBs to negotiate for loans.

In Kerala, the proposal on making central government properties liable for property/building tax has been rejected by the eleventh Finance Commission. Other recommendations related to: replacement of the policy of fixed rates; fixation of minimum rates; distribution of central finance commission grant to ULBs on a per capita basis; creation of an urban pool, etc., have been accepted. Information on the status of implementation shows that in respect of some items mentioned above: rules and byelaws are yet to be issued; and only a rural pool has been created. In Madhya Pradesh, the proposal on creation of an urban infrastructure development fund has been rejected. In Punjab, the

recommendation on creation of an incentive fund for local bodies has been accepted. In Rajasthan, recommendations have been made on: development of a system for mid-term appraisal of municipal finance; levy of taxes on those sectors (namely markets, health institutions, restaurants, other commercial and industrial establishments) which strain municipal services; revision of rates of fines; penalties, charges, fees, etc., by state government and ULBs; review of revenue efforts of most ULBs; and maintenance of accounts and audit of ULBs. The state government has accepted these recommendations.

In Tamil Nadu, the suggestion on creation of an equalization fund and an incentive fund has been accepted. In Tripura, the recommendation on a regular auditing of accounts of ULBs has been accepted. Accepted recommendations on strengthening municipal finances in Uttar Pradesh include: initiation of a special drive by ULBs for recovery of dues and ensuring liquidation of their outstanding liabilities; conversion of loans in respect of certain schemes into grants; common format for budget estimates; assigning responsibility of audit of accounts of ULBs to the Accountant General; release of funds to ULBs on the basis of their performance; and amendments in Municipal Acts in order to enable ULBs to levy various taxes. The recommendation on setting up of a corporation for leveraging funds and subsidizing interest rate on non-remunerative schemes has not been accepted. Regarding the establishment of an urban infrastructure development fund, it is recommended that this fund should be financed by private financial institutions and not by the state government. In West Bengal, recommendations on strengthening the financial condition of local bodies by improving recovery from own sources have been accepted. In Delhi, the government has accepted recommendations on: additional resource mobilization by ULBs (i.e., MCD and NDMC); and consolidation of MCD loan into a single loan of 20-year duration. However, the suggestion to monitor the utilization of fund provided for operation and maintenance expenditure of existing assets of MCD has not been accepted. In respect of the second SFC recommendation, it is noted that the Delhi government has accepted an incentive payment for ULBs, which is equivalent to

2 per cent of the collection from new taxes. Another recommendation accepted pertains to the creation of a municipal reform fund by the government for extending financial support to ULBs.

#### **6.6.6 Other Recommendations for Strengthening Municipal Governance**

The Finance Commissions of Andhra Pradesh, Gujarat, Orissa, Rajasthan, Tamil Nadu, Uttaranchal and Uttar Pradesh have given importance to **devolution of functions, functionaries and powers** along with a transfer of funds. In Andhra Pradesh, the state Government has accepted the recommendation, but it is pointed out that this cannot be implemented immediately, since the quantum of financial devolution has to be examined carefully in relation to the delegation of functions. In the SFC Report of Rajasthan, it is mentioned that the recommendation has been accepted and implemented. In Uttar Pradesh, the recommendation on devolution of powers to ULBs for the purpose of discharging responsibilities marked for them in the twelfth schedule of the constitution has been rejected.

The SFCs of Andhra Pradesh, Assam, Himachal Pradesh, Kerala, Punjab and Rajasthan have suggested for the **monitoring and review of their recommendations** by the state governments concerned. This recommendation has been accepted by the state governments of Andhra Pradesh, Himachal Pradesh and Punjab. Kerala Government has taken steps to constitute a special cell in the Finance Department for this purpose and it is further recommended that the cell should be revamped and assigned the task of regular monitoring of finances. In Uttar Pradesh, the state government has not accepted the second SFC recommendation on reconstitution and strengthening of the SFC cell.

In the states of Assam, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Tripura and Uttar Pradesh, the **development and maintenance of a database on municipal finance** is recommended. In addition, emphasis is also given on development of a Management Information

System/Computerisation of data in the states of Haryana, Punjab, Rajasthan and Uttaranchal. As per the SFC reports and ATRs, some progress has been achieved, however, much remains to be done. In Delhi, the recommendation on computerisation of public dealing departments has not been accepted, since there already exists a plan scheme for the purpose. In Andaman and Nicobar Islands and in Daman and Diu, emphasis is given on a periodic revision and updating of data in order to determine the size of the tax base.

Conduct of detailed **studies on the finances of local bodies** (covering areas such as tax potential, sources of additional resource mobilisation, tax structures, user charges, cess, etc), their **organisational structure**, etc., is recommended by the Finance Commissions of Goa, Himachal Pradesh, Kerala, Rajasthan and Uttar Pradesh. The State Governments of Goa and Rajasthan have accepted the suggestion, however, adequate information is not available on the implementation status.

**Participation of the community and the private sector**, especially in the delivery of urban services is being emphasised in the states of Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. The information on Rajasthan reveals that in Jaipur and Kota, non-government organisations have been involved in urban services delivery. In Uttar Pradesh, decisions have been taken on providing civic services on contract basis and to promote citizen participation. In Delhi, recommendations on contracting out selected services to the private sector and for downsizing of workforce are being referred for action to both MCD and NDMC.

In a number of states, it is recommended that **training programmes for municipal officials and non-officials** (i.e., elected representatives) should be organised to improve their efficiency and attitude, and that such training should be imparted by technical, non-profit and autonomous institutions. This

suggestion is accepted in the states of Haryana, Karnataka, Maharashtra, Manipur, Orissa, Rajasthan, Tamil Nadu, Uttaranchal and Uttar Pradesh.

## REFERENCES

- A. Reports of First State Finance Commissions
- B. Reports of Second State Finance Commissions
- C. Action Taken Reports on the Recommendations of the First State Finance Commissions
- D. Action Taken Reports on the Recommendations of the Second State Finance Commissions
- E. Other References

## REFERENCES

### A. Reports of First State Finance Commissions

Government of Andhra Pradesh, Report of the First State Finance Commission, Report for 1997-2000, May 1997, Hyderabad.

Government of Assam, Report of the Assam Finance Commission, Report for 1996-2001, 29 February 1996.

Government of Goa, Report of the State Finance Commission, Report for 2000-2005, June 1999, Panaji, Goa.

Government of Gujarat, Report on Urban Local Bodies in Gujarat State, Third (Final) Report of Gujarat Finance Commission, October 1998.

Government of Haryana, Report of the Finance Commission, Report for 1997-98 to 2000-01, Haryana, March 1997, Chandigarh.

Government of Himachal Pradesh, Report of the Himachal Pradesh State Finance Commission, November 1996, Shimla.

Government of Karnataka, Report of the State Finance Commission Relating to Urban Local Bodies, January 1996.

Government of Kerala, State Finance Commission, Final Report, February 1996.

Government of Madhya Pradesh, Report for Urban Local Bodies (April 1996 to March 2001), June 1996, Madhya Pradesh State Finance Commission.

Government of Maharashtra, Report of the First Maharashtra Finance Commission, January 1997, State Finance Commission, Mumbai.

Government of Manipur, Report of the Manipur State Finance Commission, December 1996.

Government of Orissa, Report of the State Finance Commission, 1998-2002, Bhubaneswar, December 1998.

Government of Punjab, Report of the First Punjab Finance Commission, December 1995, State Finance Commission, Chandigarh.

Government of Rajasthan, Report of the First State Finance Commission, Rajasthan, 1995-2000, December 1995, Jaipur.

Government of Sikkim, Recommendations of State Finance Commission, Sikkim, 1999, Gangtok, Sikkim.

Government of Tamil Nadu, Summary of Recommendations of the State Finance Commission for Local Bodies, Volume I; The Report, Vol. II.

Government of Tripura, State Finance Commission Report, September 1999.

Government of Uttar Pradesh, State Finance Commission (Panchayati Raj and Urban Local Bodies), Uttar Pradesh, Final Report, Volume I, December 1996.

Government of Uttaranchal, Report of the First State Finance Commission of Uttaranchal, 2001-2006, Volume I, II and III, June 2002, Dehradun.

Government of West Bengal, Recommendations of the State Finance Commission, West Bengal, 1995, Calcutta.

Government of National Capital Territory of Delhi, Report of the First Delhi Finance Commission on Municipalities in National Capital Territory of Delhi (1996-2001), Volume I and II, December 1997.

Government of Pondicherry, First Six Monthly Report of Pondicherry Finance Commission, September 1997, Pondicherry.

## **B. Reports of Second State Finance Commissions**

Government of Andhra Pradesh, Second State Finance Commission, Report for 2000-01 to 2004-05, Hyderabad.

Government of Bihar, Interim Report on Devolution of Funds to Urban Local Bodies, January 2003, Department of Rural Development.

Government of Himachal Pradesh, Report of the Himachal Pradesh Second State Finance Commission in respect of Urban Local Bodies, Part I, Shimla.

Government of Karnataka, Report of the Second State Finance Commission, December 2002.

Government of Kerala, Second State Finance Commission, Report, Part I, January 2001.

Government of Madhya Pradesh, Report of the Second State Finance Commission for Urban Local Bodies (April 2001 to March 2006), July 2003.

Government of Punjab, Report of the Second Punjab Finance Commission, Main Report, Second Punjab Finance Commission, Chandigarh.



Government of Rajasthan, Report of the Second State Finance Commission, Rajasthan (for 2000-2005), August 2001, Jaipur.

Government of Tamil Nadu, Report and Recommendations of the Second State Finance Commission (2002-2007), Tamil Nadu, Volume I, May 2001.

Government of Uttar Pradesh, Report of the Second State Finance Commission (PRIs and ULBs), Vol. 1, June 2002.

Government of West Bengal, Report of the Second State Finance Commission, West Bengal 2002, 6<sup>th</sup> February 2002, Kolkata.

Ministry of Home Affairs, Government of India, Report of the Second Finance Commission for Union Territories of Andaman and Nicobar Islands, Daman and Diu, Dadra and Nagar Haveli and Lakshdweep, Vol. One (A), May 31, 2002

National Capital Territory of Delhi, Report of the Second Delhi Finance Commission, Vol. 1, April 2002.

**C. Action Taken Reports on the Recommendations of the First State Finance Commissions**

Government of Andhra Pradesh, Recommendations of the Cabinet Subcommittee on the Report of State Finance Commission, November 1997.

Government of Assam, Detailed Note on Implementation of Recommendations of First Finance Commission, 1996-2001.

Government of Goa, Statement showing the Recommendations of the First State Finance Commission and the Explanatory Memorandum as to the action taken thereon, Goa.

Government of Gujarat, Action Taken Report on the Recommendations of the Third (Final) Report of Gujarat Finance Commission, Urban Development and Urban Housing Department, Gujarat.

Government of Haryana, Explanatory memorandum as to the Action Taken on the Recommendations made by the First State Finance Commission for rural and urban local bodies submitted to the Governor, Haryana in March 1997, Finance Department.

Government of Himachal Pradesh, Implementation Report on the Recommendations of the First State Finance Commission, Himachal Pradesh.

Government of Kerala, Recommendations of the Cabinet Sub-Committee as approved by the government on the State Finance Commission Report, 1996.

Government of Madhya Pradesh, Actions Taken on Recommendations of the First State Finance Commission.

Government of Orissa, Action Taken Report on the Recommendation of Orissa Finance Commission, Finance Department, 1999.

Government of Rajasthan, Action Taken Report on the other suggestions and Recommendations of ULBs by First State Finance Commission, 2003, Rajasthan.

Government of Tamil Nadu, Explanatory memorandum on the action taken on the Recommendations made by the State Finance Commission in its Report submitted to the Governor on November 29, 1996, Finance Department, Government of Tamil Nadu.

Government of Tripura, Decisions on the Recommendations of State Finance Commission, Urban Development Department, November 2000.

Government of Uttaranchal, Actions Taken by State Government on Recommendations of First State Finance Commission.

Government of Uttar Pradesh, Action Taken Report on the interim and final report as recommended by the State Finance Commission.

Government of West Bengal, Explanatory Memorandum as to the Action Taken on the Recommendations made by the West Bengal Finance Commission in its Report Submitted to the Government on November 27, 1995, Finance Department.

Government of National Capital Territory of Delhi, Action Taken Report on the Recommendations of the First Delhi Finance Commission, December 1997.

Government of Pondicherry, Recommendations of State Finance Commission and Actions Taken by the State, Pondicherry.

#### **D. Action Taken Reports on the Recommendations of the Second State Finance Commissions**

Government of Andhra Pradesh, Recommendations of the Cabinet Sub-committee on the Report of Second State Finance Commission, March 2003.

Government of Madhya Pradesh, Action Taken Report on the Recommendations made by the Second State Finance Commission in its Report submitted to the Governor in July, August and December 2003, Finance Department.

Government of Punjab, Explanatory Memorandum as to the Action Taken on the Recommendations made by the Second Punjab Finance Commission for Panchayats and Municipalities Submitted on 15 February 2002.

Government of Rajasthan, Action Taken Report on the other suggestions and Recommendations of ULBs by Second State Finance Commission, 2003, Rajasthan.

Government of Tamil Nadu, Explanatory memorandum on the action taken on the recommendations of the Second State Finance Commission, Finance Department, Chennai, May 2002.

Government of Uttar Pradesh, Actions Taken by the State Government on the Recommendations made by the Second State Finance Commission for 2001-6.

Government of National Capital Territory of Delhi, Explanatory Memorandum as to the Action Taken on the Recommendations made by the Second Delhi Finance Commission.

#### **E. Other References**

COI - Census of India, 2001: Provisional Population Totals, Paper-2: Rural-Urban Distribution (All States and Union Territories).

Constitutional Provisions Relating to Village Panchayats and Municipalities in India, Sixth Edition, 1999, Eastern Book Company, Lucknow.