

STATE FINANCE COMMISSIONS IN INDIA: AN ASSESSMENT

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...As far as funds are concerned, the awards of the State Finance Commissions should be fully honoured. There are reports that State Finance Commissions are not constituted, of them not giving awards in time, and of these awards not honoured when given, all of which erode panchayat raj.

- Prime Minister on June 29, 2004

I

FISCAL DECENTRALISATION IN INDIA: THE SETTING

THERE IS a growing realisation around the globe that decentralisation of administrative, political and fiscal responsibilities to the local units of government is one of the best ways of deepening democracy and increasing efficiency. It is also felt that fiscal decentralisation can help mobilise resources by introducing local solutions and promote equitable growth by bringing the poor into mainstream development. The recent past has witnessed many countries, including developing countries, turning to various forms of decentralisation. India is also keeping pace with this trend. New systems of local and intergovernmental finance are being established as part of this evolution. The trend has been noted, particularly since early 90's with the passage of 73rd and 74th Constitutional Amendments that accelerated the process of decentralisation with greater devolution and delegation of powers to local governments and the recognition of Panchayati Raj Institutions (PRIs) and Urban Local Bodies (ULBs) in the book of statute as institutions of self-government.

Consequently, Part IX and IXA have been inserted in the Constitution for rural and urban local bodies respectively and state legislature has been made responsible to transfer functions, listed in the newly created 11th and 12th Schedules. The state is also required to transfer the concomitant powers to enable them to carry out the responsibilities conferred upon them. Under

the Constitution Amendment Act (CAA), the state legislature is supposed to devolve responsibilities, powers and authorities to the local bodies to enable them to function as institutions of self-government. The legislature of a state may both authorise the local bodies to levy, collect and appropriate certain taxes, duties, tolls and fees, etc., and also assign to them the revenues of certain state level taxes subject to such conditions as are imposed by the state government. Further, grants-in-aid may also be provided to these bodies. As a result of the CAA, the ULBs by the end of July 2004 numbered 3723 in all states. This number consists of 109 municipal corporations, 1432 municipalities and 2182 nagar panchayats (Table 1), on the other hand, the number of rural local bodies by the end of July 2004 stood at 243685 of which 236350 are gram panchayats, 6795 are block panchayats and 540 are zilla panchayats (Table 2).

New fiscal arrangement necessitates every State under Article 243 I & 243Y to constitute, at regular interval of five years, a finance commission (SFC), and assign it the task of reviewing the financial position of local bodies and making recommendations on the sharing and assignment of various taxes, duties, tolls, fees etc and grants-in-aid to be given to the local bodies from the consolidated fund of the state. The conformity Acts of the CAA provide for the composition of the commission, the qualifications for its members and the manner of their selection. Every recommendation of the commission is to be laid before the legislature of the state.

In order that this does not act as a disincentive to the state legislatures transferring functions and responsibilities to the local bodies the constitutional amendments provide that the national Finance Commission should consider augmenting states' consolidated funds in the light of the recommendations of the SFCs. So far two national Finance Commissions, *i.e.*, 10th and 11th, have made their recommendations in this regard. The 12th Finance Commission is also set to make its recommendations in this regard by the end of 2004.

It is more than a decade since Part IX and IX A were incorporated into the Constitution. During the last 11 years, one could have found enough reasons to cheer. Conformity Acts have been enacted in all the states. Elections have been conducted in almost all states barring Arunachal Pradesh, Jharkhand and Pondicherry. Women have been elected as mayor for city governance. All states except six have received their first generation Finance Commissions' reports. A number of states have received even their second generation SFC recommendations (Exhibit 1). Notwithstanding, local bodies in almost all states continue to be starved of finances causing major impediment in its growth and effective functioning. The problem is compounded when it is seen with the expanded role and responsibilities of

TABLE 1: NUMBER OF URBAN LOCAL BODIES BY STATE S AS ON JULY 2004

SL. No.	States	Municipal Corporations	Municipal Councils	Nagar Panchyat	Total	Urban Population (in crore)
1	Andhra Pradesh	7	109	1	117	2.08
2	Arunachal Pradesh		ULBs do not exist.			
3	Assam	1	28	54	83	0.34
4	Bihar	5	37	117	159	0.87
5	Chhattisgarh	10	28	71	109	0.42
6	Goa	NA	13	NA	13	0.07
7	Gujarat	7	142	NA	149	1.89
8	Haryana	1	21	46	68	0.61
9	Himachal Pradesh	1	20	28	49	0.06
10	Jammu and Kashmir	2	6	61	69	0.25
11	Jharkhand	1	20	22	43	0.60
12	Karnataka	6	41	175	222	1.80
13	Kerala	5	53	NA	58	0.83
14	Madhya Pradesh	14	86	236	336	1.60
15	Maharashtra	16	228	Na	244	4.11
16	Manipur	9	9	19	28	0.06
17	Meghalaya	NA	6	NA	6	0.05
18	Mizoram		NA	ULBs do not exist		0.04
19	Nagaland	NA	NA	9	9	0.03
20	Orissa	2	33	68	103	0.55
21	Punjab	4	98	32	134	0.83
22	Rajasthan	3	11	169	183	1.32
23	Sikkim		ULBs do not exist.			
24	Tamil Nadu	6	102	611	719	2.75
25	Tripura	NA	1	12	13	0.05
26	Uttar Pradesh	11	195	417	623	3.45
27	Uttaranchal	1	31	31	63	0.22
28	West Bengal	6	114	3	123	2.24
	Total	109	1432	2182	3723	28.61

SOURCES : State Governments and Census of India, 2001

NOTES : NA means not applicable

: As per the CAA there are three types of ULBs. These are (a) Nagar panchayat in areas which are in transition from rural to urban. In many states, nomenclature is different and terms like 'Notified Area Committees', 'Municipal Committees', 'Town Area Committees' 'Urban Station Committees', 'Notified Area Committees' are used, (b) Municipal Councils in smaller urban settlements; it is also called 'Nagar Palika Parishad' and 'Municipality' in some states (c) Municipal Corporations in larger urban areas. In some states, it is called as 'Nagar Nigam', 'City Corporation' and 'Nagar Palikhe'. It is the discretion of the state governments to identify and define the term of "transitional", "smaller" and "larger" urban areas.

the local bodies after CAA became effective and the 11th and 12th Schedules were inserted.

Generally the functional responsibilities are closely linked with the financial powers delegated to the local government, in practice there is a mismatch between these two, leading to a severe fiscal stress at the local level. Own revenues of local bodies are good enough to meet only a part of their O&M requirements, therefore they are dependent on the higher level

TABLE 2 : NUMBER OF RURAL LOCAL BODIES BY STATES AS ON JULY 2004

Sl. No.	States	Gram Panchayat	Block Panchayat	Zilla Panchayat	Total	Rural Population (in crore)
1	Andhra Pradesh	21943	1096	22	23061	5.54
2	Arunachal Pradesh	1747	150	15	1912	0.09
3	Assam	2487	203	20	2710	2.32
4	Bihar	8471	531	38	9040	7.43
5	Chhattisgarh	9139	146	16	9301	1.66
6	Goa	189	NA	2	191	0.07
7	Gujarat	13781	224	25	14030	3.17
8	Haryana	6032	114	19	6165	1.50
9	Himachal Pradesh	3037	75	12	3124	0.55
10	Jammu and Kashmir	2700	134	14	2848	0.76
11	Jharkhand	3765	211	22	3998	2.10
12	Karnataka	5659	175	27	5861	3.49
13	Kerala	991	152	14	1157	2.36
14	Madhya Pradesh	22029	313	45	22387	4.44
15	Maharashtra	28553	349	33	28935	5.58
16	Manipur	166	NA	10	176	0.17
17	Meghalaya	NA	NA	3	3	0.19
18	Mizoram	737	NA	NA	737	0.04
19	Nagaland	1286	NA	NA	1286	0.16
20	Orissa	6234	314	30	6578	3.13
21	Punjab	12449	140	17	12606	1.61
22	Rajasthan	9189	237	32	9458	4.33
23	Sikkim	166	NA	4	170	0.05
24	Tamil Nadu	12618	385	28	13031	3.49
25	Tripura	540	23	4	567	0.27
26	Uttar Pradesh	52029	809	70	52908	13.17
27	Uttaranchal	7055	673	NA	7728	0.63
28	West Bengal	3358	341	18	3717	5.77
Total		236350	6795	540	243685	74.26

SOURCES : State Governments and Census, 2001

In many states, nomenclature is different and terms like Mandal Parishad (Andhra Pradesh), Janpad Panchayat (MP), Kshetra Panchayat (UP), Panchayat Union Council (Tamil Nadu), Block Panchayat (Gujarat), and Panchayat Samiti (Orissa). Under the 73rd Amendment, the middle level panchayat needs not be constituted in states having a population of two million or less.

of governments to finance their activities. The SFCs are responsible to examine not only the revenue-sharing arrangements between the state governments and the local bodies, both rural and urban, but also the entire range of subjects concerning assignment of taxes, transfers of power and such other subjects for improving the financial health of local bodies. In this case, the CAA does not draw any distinction between the plan and non-plan financial requirements of the local bodies. Therefore SFCs are not

confined only to the assessment of non-plan expenditure of the local bodies for recommending the devolution of funds and financial powers to the local bodies at various levels. It is to be noted here that the national Finance Commission constituted under Article 280 has been looking only the non-plan expenditure requirements of the states.

The provision of SFC with wide-ranging task entrusted to them as incorporated in Article 243 I and 243 Y to the Constitution has been a landmark development. After more than a decade of its development an assessment of the provisions and the recommendations of SFCs in improving the fiscal health of the local bodies becomes necessary. The purpose of the assessment is to identify emerging trends, issues and problems. This may offer an insight of emerging state of affairs pertaining to local finances.

II

MAIN RECOMMENDATIONS OF SFCs

The main recommendations of the SFCs can be grouped into the following four major categories:

1. Global sharing of revenue from the state to local bodies;
2. Assignment of taxes to local bodies;
3. Grants-in-aid from the state to local bodies; and
4. Others.

Global Sharing of Revenue from State to Local Bodies

The most critical function of the SFCs is the determination of fiscal transfer from the state to local bodies in the form of revenue sharing and grants-in-aid. Since the recommendations of 10th Finance Commission, a certain percentage of all Union taxes have been devolved to the states. On account of its benefits, the same system has also been advocated to SFCs by many knowledgeable experts. *First*, the system has a self policy feature; the buoyancy of State taxes and levies is automatically shared by the local bodies. *Second*, there is an inbuilt transparency, objectivity and certainty in this system, as local bodies can anticipate, in the beginning of each fiscal year, their share in the divisible pool; and they can prioritise their responsibilities accordingly. *Third*, this system enables local bodies to understand the overall picture of the economy, in other words it induces them for own revenue generation and additional resource mobilisation. *Fourth*, the state government can be neutral in pursuing tax reforms without considering whether a particular tax is sharable with local bodies or not. Many SFCs have adopted the approach in order to discharge their statutory

obligation and recommended a certain percentage from the state divisible pool to the PRIs and ULBs.

Notwithstanding, wide variations can be seen across states in defining the divisible pool and the principle of its sharing among the PRIs and ULBs. While the first SFC of Andhra Pradesh, Assam and Goa have included the share of Union taxes in the state taxes and non taxes to form the divisible pool, the second SFC of Andhra Pradesh, first SFC of Kerala and Madhya Pradesh and SFCs of Uttar Pradesh have not included the share of Union taxes and suggested only the state taxes and non-taxes. The SFCs of Rajasthan, Tamil Nadu, and West Bengal have gone a step further and recommended that only the tax revenues of the state would form the divisible pool. As an exception, the Karnataka SFCs have adopted a different mechanism by using the phrase 'Non loan gross own revenue receipts' in defining the divisible pool. Recommendations of SFCs in this regard are presented in Table 3, which illustrates only those states where SFCs have recommended the concept of 'global sharing' for transfer of state revenues.

The SFCs of other states have recommended sharing of only specific taxes or awarded a fixed amount for PRIs and ULBs. The first SFC of Punjab, for instance, has recommended transferring 20 per cent of net proceeds of the five taxes to the local bodies, *i.e.*, stamp duty, motor vehicle tax, electricity duty, entertainment tax and entertainment tax on cinematography between the PRIs and ULBs. The SFC of Orissa has recommended the transfer of 10 per cent of Motor Vehicle Tax and 50 per cent of Profession Tax to ULBs. The first SFC of Haryana recommended 20 per cent of the motor vehicle tax and 50 per cent of entertainment tax to ULBs in addition to the half of 20 per cent of the royalties on minor minerals. The first SFC of Gujarat recommended 50 per cent of entertainment tax, 35 per cent of land revenue, 75 per cent of education cess and entire local cess on land to ULBs, in addition a share from the income of stamp duty, motor vehicle tax, entertainment tax on cable/dish antenna have also been considered by the Commission. The first SFC of Maharashtra has recommended eight per cent of the profession tax and 25 per cent of vehicle tax to the ULBs. Significant inter-state variations can be noticed in the mechanism of revenue sharing as different SFCs have made different set of recommendations.

Assignment of Taxes to Local Bodies

As per the practice followed in a number of developed and developing countries, the property tax has been assigned to the ULBs in almost all the States and it remains the major source of own tax revenue for most municipalities. Octroi was another tax which was previously assigned to the ULBs only to be abolished in later stage in most states. However, it

TABLE 3: SFC RECOMMENDATIONS FOR SHARE IN STATE RESOURCES

<i>State</i>	<i>%</i>	<i>Share of PRIs and ULBs</i>	<i>Basis of distribution</i>
Total Revenue of State:			
Andhra Pradesh (I)	39.24	70% and 30%	Development criteria
Assam(I)	2.0	Not mentioned	Population
Goa (I)	36.0	75% and 25%	Population, geographical area, performance.
Own Revenue of State:			
Andhra Pradesh (II)*	10.39*	65% and 35%	Development criteria
J & K (I)	13.5	67% and 33%	Not mentioned
Kerala (I)	1.0	not mentioned	Population
Madhya Pradesh (I)	11.579	25.13% and 74.87%	Population, area, tax efforts
Sikkim (I)	1	100% and 0%	ULBs do not exist in the state
Uttar Pradesh(I)	10.0	30% and 70%	Population (80%); area (20%)
Uttar Pradesh(II)	12.5	40% and 60%	Population and area
Non-loan gross own revenue:			
Karnataka(I)	36.0	85% and 15%	For panchayats-population area, index of decentralisation and for ULBs
Karnataka(II)	40.0	80% and 20%	population 67% and illiteracy rate 33%
State Own Taxes			
Kerala (II)	5.5	78.5% and 21.5%	Population
Rajasthan(I)	2.18	77.3% and 22.7%	Population
Rajasthan(II)	2.25	76.6% and 23.4%	Population
Tamil Nadu(I)\$	8.0	60% and 40%	Population
Tamil Nadu(II)	8.0	58% and 42%	Population
West Bengal(I)	16.0	Break-up as per population district wise	Population and % of SC/ST, non literates
West Bengal(II)	16.0	Break-up as per population. district-wise	Population 50% and 7% to other variables, population density, SC/ST, non literates, IMR, rural population, per capita income.

SOURCE : Various SFC Reports.

- NOTES : 1* Second SFC of Andhra Pradesh recommended 10.39% share as additional devolution over and above the existing annual devolution.
2. \$ In Tamil Nadu, the divisible pool called pool B consists of sales tax, motor vehicle tax, state excise revenue and other state taxes. The other pool A consists of levies which rightly belong to local bodies, i.e., surcharge on stamp duties, local cess and local cess surcharge and entertainment tax. The entire proceeds of pool A taxes are recommended to be distributed to the local bodies.

continues to be levied even now in Orissa, Punjab, Goa, Maharashtra and Imphal (Manipur) and is considered to be the most buoyant source of revenue. In a number of states either a surcharge on sales tax or an entry tax is levied in lieu of octroi. The States of Rajasthan, Uttar Pradesh,

Karnataka, and Madhya Pradesh fall in this category. Water tax, lighting tax, animal and vehicle tax, trade and callings tax, boat tax, toll tax are the other taxes which have been assigned to the municipalities and panchayats in most States. The profession tax and the entertainment tax stand assigned to the local bodies in Goa, Haryana, Kerala, Madhya Pradesh, Maharashtra and Uttar Pradesh.

Most states have also authorised the municipalities to collect market fee, fee for registration of cattle and vehicles. Municipalities in a number of states including Goa, Gujarat, Haryana, Himachal Pradesh, Maharashtra and Tamil Nadu also collect education cess.

Many SFCs have tried to rationalise the local tax structure by suggesting reforms in assessment and administration of taxes besides assigning powers to local bodies. SFCs of Kerala, Karnataka, Tamil Nadu and Uttar Pradesh for example, have recommended reform in property taxes and have suggested the 'area based' or 'site valuation' system for assessment of property tax. A majority of SFCs has also recommended autonomy to local bodies in fixing tax rates and user charges, e.g. Kerala and Punjab. State-wise recommendations of this kind can be seen in the appendix.

Grants-in-aid from State to Local Bodies

Grants-in-aid are provided to fill the revenue gap of the local bodies so that they can meet the expenditure on basic functions. These can be (a) conditional or specific grants meant for specific purpose, e.g. some schemes or projects, this can be further classified into matching or incentive grants and non-matching grants and (b) general purpose grants or block grants based on some criteria or formula meant for additional resources with no condition attached. Grants can also be either statutory or non-statutory. Statutory grants are compulsory transfers which may also be in lieu of abolition or withdrawal of certain taxes such as octroi.

In the last ten years, both 10th and 11th National Finance Commissions have recommended an *ad hoc* amount of Rs. 5381 crore and Rs 10,000 crore respectively as grants to states for local bodies in order to fulfill the additional responsibility added in Article 280 for the National Finance Commission. This grant is released from the Finance Commission Division in the Department of Expenditure, Government of India to various states as per the recommendation of the National Finance Commission and the explanatory memorandum on the action taken submitted by the Government of India. It is the job of the SFC to work out the formula for the *inter se* distribution among different levels and type of local bodies. Many first and second generation SFCs did make some recommendations on that account. However, these recommendations like others have remained largely unsystematic. Some SFCs recommended its distribution on per capita basis

e.g. first SFC of Assam and Kerala, while others have attached the conditionality as prescribed by the National Finance Commission. Besides, most SFCs recommended the mechanism of grants-in-aid in various forms, block grants, conditional grants and incentive grants; this can be seen in the appendix.

Other Measures

Many SFCs also suggested some changes in the legislative and administrative spheres to strengthen the local government institutions. Some of them require action even on the part of the Union Government. A few of these recommendations are listed below:

- Local body should be allowed to levy taxes and service charges on all government properties (including the properties of public sector undertakings of the Central and state governments, boards, Corporations). The Constitution should be amended for this purpose. – Kerala (I), Maharashtra (I), Rajasthan (I), Tamil Nadu (I), Uttar Pradesh (I) and West Bengal(II)
- The powers, functions and responsibilities of the state governments and the local bodies may be bifurcated similar to the division of subjects that exists between the Centre and the states in the form of the Union and the state lists. A third list for district governments may be inserted in the Constitution. – Rajasthan (I).
- Appointment of State Finance Commission much before the constitution of National Finance Commission. –Andhra Pradesh (II)
- Appointment of Tariff Commission to streamline the existing rates, taxes etc of local bodies - Assam and Gujarat (I)
- Mandatory provision of vigilance committee- Goa
- Public Accounts Committee for municipal finance –Haryana & Punjab(I)
- Finance Commission Cell should function in the Finance Department of the state government after the expiry of the SFC's term to review the implementation of the recommendations of the SFC - Karnataka (I), Kerala(I) and Tamil Nadu(I)
- Fund for data base, computerisation, software etc.–Karnataka (II) Maharashtra (I) and Punjab (I)
- Periodic training for local bodies staff- Andhra Pradesh (I) and (II), Haryana, Karnataka (I), Punjab(I), Maharashtra (I) Tamil Nadu(I) and Kerala (I).
- Establishment of a local development fund for subsidising interest

- rates for non-remunerative but desirable service schemes—Kerala(I)
- Tax valuation committee to listen to the objections of the tax-payer regarding property tax assessment—Punjab(I)
- Creation of municipal service cadre— Manipur
- One common legislation for all local bodies to avoid confusion regarding the regulations and bye-laws—Karnataka(I), Kerala (I), Maharashtra (I), Punjab(I) and Uttar Pradesh(I)
- Audit of municipal corporation accounts by Accountant General of the State— Uttar Pradesh(I)
- Privatisation of activities like maintenance of street lights and roads and other core services—Kerala (I), Punjab (I), Tamil Nadu(I) and Uttar Pradesh(I)
- Privatisation of the maintenance of commercial assets—Tamil Nadu(I)
- Public-private participation for the improvement of essential services – Maharashtra(I) and Uttar Pradesh (I)
- Review of implementation of recommendations of the SFCs may be entrusted to a statutory authority—Andhra Pradesh (I).

III

AN ASSESSMENT

While the SFCs have a major role to ensure that the democratic decentralisation envisaged under the CAA becomes operational and effective, the state governments have the responsibility to enhance the credibility and acceptability of the SFCs. It is the state government which has to enact a conformity Act prescribing the number and qualification of members of the Commission. It has been unfortunate that most states have considered the appointment of SFC as one of the instruments through which they can please or appease the group of favourites whether from bureaucracy or from outside. It is interesting to note that the composition of the SFCs, including the chairperson, varied between two and five that too varied from full time to part time or the mix of both. The qualification, status and background of the members range from anybody to former Chief Minister (Rajasthan) and former Union Minister of State (Andhra Pradesh and Madhya Pradesh). In Madhya Pradesh, the same set of persons constituted the first and the second SFC. In many states, SFC report is submitted to the state government and not to the Governor. In addition, the institution of SFC is further weakened in the absence of firmed database on local bodies and norms for service delivery. Diverse

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AN ASSESSMENT

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views, channels and methods of state-local fiscal transfers make their task even more challenging.

In such surroundings, most SFCs produced second-rate reports without spelling out the principles on which their recommendations are based. Literature, studies and even theoretical models were mentioned without relating to practice. In other words, the chapter on "conceptual framework" or "issues and approach" is not attuned to other chapters including the chapter on recommendations.

It goes without saying that the endowment of financial powers and authority are to be matched by the functions and responsibilities. Most SFCs barely looked at the functional domain of the local bodies as envisaged in the 11th and 12th Schedule and hardly considered the potential resource generation of ULBs while making recommendations for the devolution of funds from the State government to the ULBs.

Given the heavy non-plan developmental tasks the local bodies have to perform, the assigned taxes and non-tax revenue sources are unlikely to be adequate. Moreover, the revenue generating capacities of local bodies, whatever is their level, differ from state to state and even within the state. Some have high revenue potential while that of others are not so high. Similarly, cost factor in providing services also differs for various reasons including cost disability factor, e.g. area under forest or dessert. One can not deny the fact, that vast differences are also found within the state. A classic example is the case of Uttaranchal, a newly carved out State from Uttar Pradesh, which has been declared a special category State due to its difficult and hilly terrain. Till recently, the State was a part of Uttar Pradesh, a non special category State. No inter-governmental transfer mechanism has ever realised that part of Uttar Pradesh had characteristics akin to a special category state. Intra-state variations postulate the need for an equalisation transfer mechanism through SFCs that assess the needs of the local bodies as well as their efforts to tap their own revenue potential. This kind of normative assessment by the SFCs should have been such that every citizen is entitled to a basic minimum service or a set of public goods. Unfortunately, such an issue has either not addressed or attempted amateurishly in most SFC reports.

It is expected from any finance commission, be it a national or state, to evolve a mechanism so that a fine blend of equity and efficiency objectives can be achieved in fiscal transfers. Only this kind of devolution mechanism can promote autonomy. A system of rewards and punishment has to be developed in the State and the SFCs have to initiate and evolve this mechanism. However, a very few SFCs made its recommendations

in that direction, *e.g.* Tamil Nadu, Maharashtra, Punjab, Rajasthan and Uttar Pradesh.

Most SFCs have recommended the medley of various taxes, cesses, or even surcharge on state taxes. Given the fact that collection of taxes at the local level is difficult, such type of efforts lead only to the escalation of administrative cost as each tax requires tax collection machinery. At times, cost of collection exceeds the actual collection of a particular tax. Moreover, the move is not compatible with the Government of India's efforts in advocating uniform tax rates and simplifying the tax collection procedures by merging additional levies, surcharges, fee, etc. This is a precursor of a comprehensive value added tax regime subsuming Union excise, state sales tax, octroi and the likes. In order to strengthen the revenue base of the local bodies, SFCs could have recommended measures to tighten tax administration for better compliance of existing taxes, rationalisation of taxes and recovery of cost through appropriate user charges.

After the CAA most states made a small change in their existing municipal laws. The move proved to be just the patchwork. Panchayat and municipal laws are fragmented in states. For example, in Maharashtra as many as four municipal laws are governing the ULBs. Very few SFCs addressed the issue—*e.g.* Karnataka, Kerala, Maharashtra, etc.

Like National Finance Commission, SFC's recommendations are recommendatory not mandatory in nature, but unlike National Finance Commission, SFC's recommendations are being given cold shoulders. In fact, many states are making a mockery of the Constitutional provision. On the one hand, they constitute a body with people of little expertise; on the other hand, they do not even consider the report. If the report is considered, very few recommendations are accepted. In the process, the crucial ones are rejected without assigning reasons. In the action taken report, only numbers are mentioned, such as, this many recommendations are accepted with modifications and this many are rejected. In this number game, sometimes the most crucial recommendations are found rejected surreptitiously. At the top of it, more often than not, the accepted recommendations are not implemented, for example, the second SFC of Andhra Pradesh has included a chapter on the status of acceptance or otherwise of the recommendations of the first SFC of Andhra Pradesh. It is interesting to note that in the State, some recommendations which had been accepted were not notified. On some, money was not released even though actions on these recommendations were notified. The story becomes more interesting given the fact that the State Government took two-and a-half years to

only consider the report of the SFC (see exhibit 1).

Since state government do not consider the recommendations of the SFC in time, the major problem regarding the synchronisation of the periods of SFC with that of the National Finance Commission arise. The 10th Finance Commission felt the absence of SFC reports as a handicap. The 11th Finance Commission, though, had the reports of the first generation SFCs of most states but these were of different periods of time and except for two (Goa and Orissa), related to only the first or at best the second year of the period covered by the 11th Finance Commission. For this very reason the 11th Finance Commission even went to the extent and recommended to delete the words "on the basis of the recommendations made by the Finance Commission of the State" appearing in sub-clauses (b) and (c) of Article 280 (3) of the Constitution.

IV

CONCLUSIONS

Following the 73rd and 74th Amendments to the Constitution, new legislation has been enacted in almost all states. Additional functions have been transferred to various levels of local bodies. Since transfer of functions has to be accompanied by funds and functionaries to cover the incremental establishment costs of governance, SFCs made several recommendations in this regard. Considering the feeble own revenue base of the local bodies so far, and its high dependency on higher level of governments, the recommendations of SFC have to be of utmost importance to the local bodies. Since all available SFC reports are different to each other with reference to their approaches and methodologies and even the time period covered by them, some of them have access to data, some have not. In such circumstances, it is extremely difficult, if not impossible, to standardise these recommendations. Since, firmed data on panchayat and municipal finance are still not available from any source, it is extremely difficult to analyse the impact of SFC recommendations on the finances of local bodies. It is clear, from the progress report of the last 11 years, that though the stipulation of SFC is an innovative and significant feature of the CAA, it lacks teeth and substance.

In this context, the suggestions made by the National Commission to review the working of the Constitution deserve due consideration:

- Distinct and separate tax domain for municipalities should be recognised. List of taxes that come under municipal jurisdiction should be prepared and it should form part of the common schedule

of functions and responsibilities for local bodies. In the event it is decided to continue with the 11th and 12th Schedules as separate, the tax domain should figure in the relevant schedule.

- Articles 268 to 274 of the Indian Constitution clearly specify the distribution of tax revenues between the Union and the state governments. Similarly, the concept of a divisible pool of taxes, which can be shared between the Union, the states and the municipalities, should also be recognised. Categories of taxes and levies that form part of the divisible pool, the tax collection responsibility and the share of the three tiers of governments should be categorically specified.
- In case of taxes and levies, the proceeds of which are to be shared with municipalities, prior consultation will be required before any modification is made in the scope of tax or its rates.
- Article 276 on taxes and professions, trade and employment should be amended as suggested by the 11th Finance Commission. The ceiling should be specified by Parliament from time to time rather than requiring amendments to the Constitution.
- State laws should provide for composition of the SFC and the criteria for its membership similar to the provisions in the case of the finance commission set up by the President under Article 280.
- State laws should provide for the establishment of the SFCs in a periodical manner and determine a time schedule for the same so that the work and output of the SFCs are synchronised suitably with the Central Finance Commission.
- Articles 243 I and 243 Y should be amended to ensure that the Action Taken Report by the government is laid before the state legislature within six months of the submission of the SFC recommendations.

In this connection, the following words of Dr. Manmohan Singh, the Prime Minister on June 29, 2004 would be of supreme substance:

... Many studies of effective decentralisation reveal an interesting paradox- that it needs a visionary leadership above to ensure decentralisation. I appeal to the Chief Ministers to play this visionary role to become champions of decentralisation in their respective states. You represent the pinnacle of democratic leadership in your state and elected panchayat leaders are your fellow travellers. They need your support and handholding.

A SELECT READINGS

1. *Census of India, 2001.*
 2. Government of India, *Report of the Task Force on Devolution of Powers and Functions Upon Panchayati Raj Institutions'*, Ministry of Rural Development, August 2001.
 3. Government of India, *The Report of the Working Group on Decentralised Planning and Panchayati Raj Institutions for the Tenth Five Year Plan (2002-07)*', Planning Commission, November 2001.
 4. Government of India, *Report of the Working Group on States' Resources for the Tenth Five-Year Plan (2002-2007)*', Volume II, Planning Commission, January 2002.
 5. Government of India, *Inaugural address by the Prime Minister at the National Conference of Chief Ministers and State Ministers of Rural Development and Panchayati Raj on Poverty Alleviation and Rural Prosperity through Panchayati Raj, June 29-30, 2004 at Vigyan Bhawan, New Delhi*
 6. Lok Sabha Starred question No. 352 on August 19, 2004 regarding World Bank Report on control of panchayats.
 7. National Commission to Review the Working of the Constitution, *A Consultation Paper on Decentralisation and Municipalities, 2001, Vigyan Bhawan Annexe, New Delhi.*
 8. NIUA, *A Compendium of Municipal Legislations in Conformity with Constitution (74th) Amendment Act, 1992, 1998.* National Institute of Urban Affairs, New Delhi
 9. Rajaraman, Indira : *A Fiscal Domain for Panchayats*, Oxford University Press, New Delhi, 2003 .
 10. Report (37th) of the Parliament's Standing Committee on Urban and Rural Development tabled in the Parliament in December 2002.
 11. Report of the Eleventh Finance Commission for 2000 - 2005, 2000, Department of Economic Affairs, Government of India.
 12. Reports of First State Finance Commission of various States.
 13. Reports of Second State Finance Commission of various States.
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**EXHIBIT 1: STATUS OF SFC CONSTITUTIONS AND SUBMISSION OF ITS
REPORTS IN STATES AS ON 30 AUGUST 2004**

Sl. No.	State	Month of SFC Constitution	Month of report submission	Month of ATR	Period Covered by SFC
1	Andhra Pradesh (I)	Jun' 94	May' 97	Nov' 97	1997-98 to 1999-00
2	Andhra Pradesh (II)	Dec' 98	Aug' 02	Mar'03	2000-01 to 2004-05
3	Arunachal Pradesh	May'03	Jun'03	Jul'03	
4	Assam (I)	Jun' 95	Feb' 96(Interim)	Mar' 96	1996-97 to 2000-01
5	Assam (II)	Apr' 01	Aug'03		2001-02 to 2005-06
6	Bihar	Apr' 94/Jun' 99	Not submitted		
7	Chhattisgarh	Not constituted			
8	Goa	Apr' 94/Sep' 99	Jun' 99	Nov' 01	2000-01 to 2004-05
9	Gujarat	Sep' 94/ Aug' 98	Oct' 98	Submitted	1996-97 to 2000-01
10	Haryana (I)	May' 94	Mar' 97	Oct' 99	1997-98 to 2001-02
11	Haryana (II)	Sep' 00	Not yet submitted		2001-02 to 2005-06
12	Himachal Pradesh(I)	Apr' 94	Nov' 96	Feb' 97	1996-97 to 2000-01
13	Himachal Pradesh(II)	May' 98	Oct' 02	Jun'03	2002-03 to 2006-07
14	Jammu & Kashmir	constituted	Submitted (interim)		2003-04 to 2004-05
15	Jharkhand	Not constituted			
16	Karnataka (I)	Jun' 94	Aug' 96	Mar' 99	1997-98 to 2001-02
17	Karnataka (II)	Oct' 00	Dec' 02		2003-04 to 2007-08
18	Kerala (I)	Apr' 94	Feb' 96	Mar' 97	1996-97 to 2000-01
19	Kerala (II)	Jun' 99	Jan' 01 (part I)		2000-01 to 2005-06
20	Madhya Pradesh (I)	Jun' 94/Feb'95	Jul' 96	Mar' 97	1996-97 to 2000-01
21	Madhya Pradesh (II)	Jun' 99			2001-02 to 2005-06
22	Maharashtra (I)	Apr' 94	Jan' 97	Mar' 99	1996-97 to 2000-01
23	Maharashtra (II)	Jun' 99	submitted		2001-02 to 2005-06
24	Manipur (I)	Apr' 94/may'96	Dec' 96	Jul' 97	1996-97 to 2000-01
25	Manipur (II)	Jan' 03	submitted		2001-02 to 2005-06
26	Orissa (I)	Nov' 96/Aug' 98	Dec' 98	Jul' 99	1998-99 to 2004-05
27	Orissa (II)	Jun'03	Oct'03		2005-06 to 2009-10
28	Punjab (I)	Apr' 94	Dec' 95	Sep' 96	1996-97 to 2000-01
29	Punjab (II)	Sep' 00	Feb' 02	Jun' 02	2002-03 to 2005-06
30	Rajasthan (I)	Apr' 94	Dec' 95	Mar' 96	1995-96 to 1999-00
31	Rajasthan (II)	May' 99	Aug' 01	Mar' 02	2000-01 to 2004-05
32	Sikkim	Apr' 97/Jul' 98	Aug' 99	Submitted	2000-01 to 2004-05
33	Tamil Nadu (I)	Apr' 94	Nov' 96	Apr' 97	1997-98 to 2001-02
34	Tamil Nadu (II)	Dec' 99	May' 01		2002-03 to 2006-07
35	Tripura (I)	Aug' 96	Sep' 99	Nov' 00	2000-01 to 2004-05
36	Tripura (II)	Oct' 99	Apr'03		2003-04 to 2007-08
37	Uttar Pradesh (I)	Oct' 94	Dec' 96	Jan' 98	1996-97 to 2000-01
38	Uttar Pradesh (II)	May' 00	Jun' 02		2001-02 to 2005-06
39	Uttaranchal	Constituted	Jun' 02		2001-02 to 2005-06
40	West Bengal (I)	May' 94	Nov' 95	Jul' 96	1996-97 to 2000-01
41	West Bengal (II)	Jul' 00	Feb' 02		2001-02 to 2006-07

SOURCE : SFC Reports and action taken reports by State Governments

NOTES : SFC has been reconstituted wherever two separate months are mentioned in same cell.

: Information is not available with respect to the blank cells.

: Wherever II SFC has been constituted it has been marked as (I) and (II).

243Y. Finance Commission -

(1) The Finance Commission constituted under article 243-I shall also 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 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 appropriate by, the Municipalities;

(iii) the measures needed to improve the financial position of the Municipalities;

(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 interest of sound finance of the Municipalities.

(2) The Governor shall cause every recommendation made by the Commission under this article together with an explanatory memorandum as to the action taken thereon to be laid before the Legislature of the State.

2 The 73rd and 74th Constitutional Amendment Acts are the Union Acts to establish the third tier of governments and the conformity Acts are state legislations.

3 Many States have had a second round of elections since the Constitution was amended.

4 The entire States of Meghalaya, Mizoram and Nagaland have been excluded from the operation as per article 243 M(2). The First SFC of Bihar has not submitted its report. In the newly formed States of Chhattisgarh, and Jharkhand either the report has not been submitted or it has not been considered so far.